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AN AGENDA FOR STRENGTHENING THE PROPERTY TAX

by Mason Gaffney

I have four points: we do not need property tax relief; we *do* need assessment reform; we *do* need to shift the property tax in part to the state level; and we *do* need to convert the general property tax into a tax on site value.

WE DO NOT NEED PROPERTY TAX RELIEF

To speak of property tax "relief" is tendentious. Property tax relief is sales tax aggravation, or income tax or payroll tax aggravation. True tax relief may be secured by making cities more compact, economical, and efficient; by cutting out boondoggling in public works and highways; by increasing employment and cutting the welfare rolls; by reducing military outlays; and so on. Insofar as tax policy may contribute to these ends it will indeed bring true tax relief, and one reason for favoring the site value approach to property taxation is to make cities more efficient and cut per capita social overhead costs. That is genuine tax relief.

The Property Tax in the Total Tax System

We need to view the property tax in the context of a total tax system. The personal income tax, which is larger than the property tax, shelters property income from the full impact of its rates, so that payrolls must bear the main brunt. The other payroll tax, the one once connected with social security, is also larger than the property tax—and not deductible, as property taxes are, from taxable income. The sum of all excise taxes is certainly larger. Only a small share of the total tax burden is comprised by the \$45 billion paid in property taxes.

The other taxes are all activity-based—that is, they are based on some act, usually constructive, of enterprise, management, trade, turn-

MASON GAFFNEY, Senior Research Staff, Resources For The Future. (Since July 1973, Director, British Columbia Institute for Economic Policy Analysis, Victoria, British Columbia.)

over, consumption, and above all labor. The property tax is the only one based on passively owning, as opposed to doing. I submit that enterprise and labor are worth more to a nation than inert wealth. The property tax activates wealth. That is especially true of the part of the tax that falls on land—another reason, of course, for favoring the site value approach. In lesser measure, and in the short run, it is also true of the part that falls on capital, most notably in cartelized industries which are characterized by excess capacity.

In one sense the property tax cannot be progressive because it is simply proportional to value, without regard to size of ownership. However, a common tax rate applied to all property, regardless of the owner's total wealth, tends to be progressive for the basic reason that the use of property is generally regressive. That is, larger holdings are combined with less labor, and produce less volume per dollar of capital and more profit per dollar of volume than smaller properties do. This follows as a result of the tendency of interest rates to be regressive—the poor and the small must pay more to hire capital.

To illustrate I have calculated profits per dollar of sales for *Fortune's* 500 largest industrial corporations, ranked by net worth. For the top ten it is 9.6 percent; for all 500, 6.1 percent; and for the smallest ten, .8 percent.¹ The last figure should not be taken too literally because the top 500 were originally chosen by sales; then I reranked them by net worth, so the bottom ten are biased to include firms of high sales relative to net worth. Still, the contrast of 9.6 percent for the top and .8 percent for the bottom ten is hard to dismiss.

Wage rates on the other hand tend to be progressive—the rich pay more. So larger firms are more capital-intensive and land and resource-intensive; smaller firms are more labor-intensive. Larger capitals turn over more slowly; smaller ones more rapidly, thus generating more activity and volume per dollar of taxable property. Illustrating this, I calculated the profits per employee for *Fortune's* 500. For the top ten this was \$3,291; for the whole group, \$1,489; and for the smallest ten \$297. Again, the last figure is biased downwards by the selection process, as described before. But the contrast of the top ten with the whole group is not materially biased, and the contrasts are hard to dismiss.

The meaning for tax policy is that a property tax tends to be progressive (among corporations) when compared with taxes on activity, such as sales, personal income, or payroll taxes.

There is an *a priori* reason to assume that the stock of the better cushioned corporations is held by wealthier individuals, on the whole,

1. The *Fortune* Directory, August 1964.

than the stock of the marginal corporations with low profit margins. The reason is that rentable assets everywhere gravitate to strong hands, while financially weaker individuals move into marginal situations with high turnover. Strong hands also enjoy a comparative advantage in holding appreciating assets for future liquidation, and the six oil companies in the top ten obviously represent that kind of situation, compared with firms in the bottom ten like Iowa Beef Packers, Olivetti-Underwood, and Jonathan Logan.

If this *a priori* reasoning is correct, then wealthier individuals are attracted to the stock of corporations whose income comes more from wealth than from activity, regardless of size. It follows that the property tax may zero in on wealth more accurately than even a corporate income tax; even a progressive one. Corporate size is correlated with high profit margins and low employment/wealth ratios but is not identical with them. It is incidental here rather than essential. However when we move from interpersonal equity to another question, the viability of a free market economy, then corporate size becomes more central. The property tax must earn good marks as a tax that hits bigger businesses harder than small. It also hits cartels harder because their hallmark is excess capacity.

The use of property tends to be regressive. Carrying this a step farther, larger ownerships tend to make more expansive use of land relative to capital. The top ten firms include six oil companies, heavily committed to gas stations, key refinery sites, tank farms, docks, yards for truck fleets, pipeline rights of way, and above all minerals in the ground. More systematically the *U.S. Census of Agriculture* from 1900-40 reported separately on land and building values. I calculated the ratio of building value to land value by size class for 1940, the latest year reported.² Three figures tell the story. For all farms this building/land ratio is .45; for farms of 20-49 acres, .68; for farms 1,000 acres and over, .14. The ratio declines without a break from the smallest to the largest class.

More recently, John Riew has found the same pattern in Wisconsin farming, using assessed values.³ Other studies of this pattern are by Morton Paglin⁴ and Albert Berry.⁵ This pattern is of course another reason for favoring the site value approach to property tax-

2. 1940 Census of Agriculture, Vol. 3, Washington, D.C., p. 80.

3. John Riew, "Assigning Collections of a Statewide Uniform Rate Land Tax," to be published in Richard Lindholm, *Property Taxation and the Finance of Education*, Madison, University of Wisconsin Press, 1973.

4. Morton Paglin, "Surplus Agricultural Labor and Development: Facts and Theories," *American Economic Review*, September 1965, pp. 815-33.

5. Albert Berry, "Presumptive Income Tax on Agricultural Land: The Case of Colombia," *National Tax Journal*, June 1972, pp. 169-81.

tion. If factor proportions are skewed towards a greater relative use of land among wealthier producers, a tax on land value would be more progressive than a tax on all property value.

Property Income Differs from Labor Income

Welfare argument.

Yet another reason for favoring property taxation is that on welfare grounds, property income should be taxed at a higher rate than labor income.

Wealth itself is part of "ability to pay," regardless of current income. Wealth implies the ability to liquidate and, to avoid that, the ability to borrow, for wealth is the basis of credit ratings. With respect to the elderly, wealth is a reasonable basis for expecting one's heirs to cover his or her real estate taxes. The maudlin approach that is used in discussing the retired elderly seems to be premised on the idea that children do not care for their aged parents. It is an unusual condition, the more so when the parents are holding property for these same children. I invite your attention to the fact that many elderly property owners avoid selling homes and farms which are much too large for them, specifically to avoid payment of capital gains taxes. We know that when property changes hands at death, the entire capital gain up to that date escapes income tax, 100 percent. The heir begins with a new stepped-up basis, the value at death.

The principle that wealth is part of ability to pay is quite general, but in respect to the elderly specifically, some liquidation of wealth during retirement years is a normal part of the life cycle. It is unreasonable and misleading to judge the relative burden on the aged in terms of current income alone. The aged, in anticipation of death, have a greater ability to liquidate their wealth than others, and a much greater security in terms of support from middle-aged children. Most of us can supply illustrations from our own families.

An exaggerated concern to give special privileges to the elderly and the retired is part of the put-them-on-the-shelf syndrome toward the aged which should go the way of white racism and male chauvinism. The aged, like the rest of us, do not need to be patronized. They need the opportunity to be useful. Those that become welfare cases should be treated by the welfare system on an impartial basis, without special favor to property owners. To use property tax relief as a substitute for welfare is to distribute welfare in proportion to wealth, surely an odd notion. To shape the entire property tax for the benefit of one special age and class of people would not, on its face, be well-balanced policy making.

Worse, the preoccupation with the special short-run situation of a few aged property owners serves as a diversion to distract us

from larger issues of property tax reform. It sounds suspiciously like the widows-and-orphans melodrama in new greasepaint. It lets senators on the Intergovernmental Relations Subcommittee sponsor bills called "property tax reform" when all they are doing is making a little loophole for one special group defined by age and adjusted gross income, avoiding the large and tough issues.

There is a maudlin appeal to aiding the helpless widow that should put us on guard by reflex: who is playing our emotions, and to what end? If there is a good case to be made it can be made soberly and without seeking to shame us into holding back sharp questions. The young have problems too. And in terms of maximizing everyone's welfare by allocating wealth efficiently, the major problem between youth and age is increasingly to pry loose the control of inert property from the old for the young before the young have become the old.

Property income puts one on a higher plane of well-being or welfare than labor income of the same amount, because one needn't work for it. Fifteen thousand dollars a year earned by working long shifts in a coal mine with black lung disease is not the same as \$15,000 a year from property with a life of ease (plus the option of living off the wealth, or banking or parlaying it). The industrial accident and disease toll each year is frightful. So is the highway accident toll, most of which occurs during commutation. Income is not income, in terms of welfare: it depends on what you have to do to get it. Before 1942, there was an earned-income credit in the personal income tax in recognition of this. Today, income from labor is taxed much higher than income from property, because tax shelters and loopholes mainly involve property ownership. The main counterpoise to this is the property tax.

The Public Equity in Land

The property tax asserts a general public equity in land under private tenure. This is a counterpart to a system in which much of our land is committed to private tenure. Most of the United States was public domain not long ago—not long in the perspective of history. Everyone had an equal claim. Land was turned to private tenure in order that the land be put to a higher use than is possible or likely under direct public administration. It is not practical to give everyone an equal share. To compensate those who are left out, land in private tenure has been made subject to the property tax. The tax asserts the equity of nonholders.

This was all darkened over when the states relinquished the property tax to localities, which are not much interested in protecting the equity of the landless, especially as the latter become increas-

and/or federal. This can be done without sacrificing local or individual control of schools by following the pattern of the G.I. Bill and employing a voucher system, or any other system where state funds are proportional to attendance, or any other formula based on numbers of people. Conceivably such formulae might be modified for differential local costs and "needs," as some school finance people wish, but that is an option. The point here is that support should vary as a function of population, thus giving the distribution the character of a social dividend.

Regressivity

The property tax is not regressive. I have written an article to this effect, which I cite here rather than recite.⁶ I would underscore certain central points that have been omitted or overlooked in later discussion.

I have already mentioned here that income, and especially current cash or realized income, is no index to well-being or ability to pay, either. On top of that, the Adjusted Gross Income (AGI) calculated on Form 1040 is no index to income. AGI is what is left over after most of the loopholes. Most of the loopholes are related to owning property—a blue collar job has never been called a tax shelter.

Wendell Willkie once said that a good catchword can obscure analysis for fifty years. The catchword of the generation now pushing fifty has certainly been "income." The economics profession has practiced idolatry on it, and made the income tax a panacea. This comes to the surface when economists judge the property tax by comparing it with AGI.

Yet tax economists have long been up in arms against loopholes, and the public is, if anything, ahead of them. It is a popular campaign issue, near the top rating. AGI is neither intellectually respectable nor popularly credible. It is bad enough to stack the cards by judging the property tax on the basis of how closely it resembles an income tax. It is worse to judge it on the basis of how closely it resembles a tax based on AGI. AGI has gotten so bad, any public policy based on AGI is a fraud.

Consider the effect that a few wealthy persons with low AGI have on the data which we see on the property taxes of "low-income" people. Suppose one person has a million dollars in taxable property and, at 2 percent, pays \$20,000 a year in property taxes but has managed to reach near zero AGI through a skillful use of loopholes.

6. Mason Gaffney, "The Property Tax Is a Progressive Tax," Proceedings of 64th Annual Conference on Taxation, National Tax Association, 1971, pp. 408-26.

It would take 100 genuine paupers in \$10,000 dwelling units to have a million dollars of taxable property and pay \$20,000 in property taxes. That one ringer in the crowd doubles the mean property tax burden.

Then the statistician takes the mean value and says poor people with income below \$2,000 pay 10 percent of their income in property taxes, and it is a groaning burden. Talleyrand said "The masses want to believe in something; for their benefit, nothing is so easy to arrange as the facts." We had better massage the data some more and get rid of that enormity.

The ownership of property is incomparably more concentrated in a few hands than is the receipt of taxable income. The data are cited in my article mentioned above. In the lower brackets of income, most income comes from labor; in the higher brackets most comes from property, and much property income isn't even counted. I see no way to get away from these overpowering facts.

Even if the residential property tax were 100 percent shifted forward, that would not make it regressive. Almost everyone has overlooked the point that the poor live, by and large, in dwelling units whose capital value is low relative to the rent. Slums have a low price/earnings ratio, and besides that the earnings are a small share of the gross rent because of high operating and collection costs. The property tax is based on capital value, not on rent. Data cited on how rent relates to income are therefore not relevant. Even if all property taxes were shifted to tenants and included in rent, the property taxes levied on the dwellings of the poor are a small share of the rent.⁷ It is true that some slums are located on land of high speculative value on the growing edges of business districts, but here it is only the land that is valuable. The buildings have little value remaining. And if any part of the property tax is shifted to tenants it is of course only the part on buildings.

In addition, the rich go in for second homes, summer homes, lakeside cottages, ski chalets, hobby farms, and the like. The rich travel more, and spend more on hotels and motels—all taxable property.

Homeowner Exemptions

There have been recurrent proposals in the wind to exempt homeowners. This group is now nominated to enjoy the mindless adulation and bottomless subsidy previously heaped on such fallen angels as farmers, motherhood, growth, and maybe even the Pentagon.

7. George Peterson, "The 'Regressivity' of the Residential Property Tax," Working Paper 1207-10, Washington, D.C., The Urban Institute, November 1972.

Americans need to spoil something, it seems, and home folks are good folks.

The definition problems are formidable. How much of a hobby farm is a "home," how much a speculative investment? You can imagine how much expensive fun the lawyers will make of that, and how counterproductive it all will be. But that is only a nit, next to the main fault.

I deplore the use of slanted catchphrases like "relief for the homeowners." There are other life-support systems besides owner-occupied homes, and it is single-minded to judge a policy on the basis of what it does for the homeowner or any other special class. The world is full of various kinds of fundamentalists. You name it, and I can find ten people who think the taxpayers should subsidize it: hunting and fishing, caribou in Alaska, fine arts, performing arts, highway transportation, the merchant marine, interplanetary exploration, education, religion, medicine, birth, birth control, burial, war, peace . . . it goes on and on. The world has invented the market to help arbitrate these competing claims, or some of them. Anyone who wants to substitute his judgment for the market's needs to face up to a certain burden of proof. For the market, with all its failings, does have a rationale.

Residential relief is not especially called for if it means more payroll taxes, for example. The imputed income from the capital value of the owner-occupied home is already exempt from the income tax, while payrolls are taxed both as payrolls and again as income, and again on retail purchases.

Homeowner relief is certainly uncalled for if it means sloughing the burden onto tenants. If regressivity is one's concern then he would certainly begin with tenant relief, not homeowner relief.

On the other hand, there is a place for residential relief—for example, by deBalkanizing the property tax base and bringing industrial and mineral tax enclaves into school districts with many poor children. We need to tax cars much more heavily than homes, for the homes now provide streets for the cars and suffer enormously from auto noise and fumes. But "relief for the homeowner" is not an end in itself. Fairness, overall balanced equity, and maximum social efficiency and well-being are more adequate statements of ultimate goals. They do not point to lowering the property tax.

Voters Overrule the Polls

Poll results are alleged to show that the property tax is the least popular tax. How are we to reconcile this with the direct messages we have from the voters? Proposals to cut down the property tax

were defeated in California, Oregon, Michigan, Colorado, and New Jersey in 1972, by direct popular vote. It was not a partisan issue. Nixon and McGovern alike campaigned to lower property taxes. But faced with the issue itself, the voters saved the property tax. There is no tax over which the average voter has so much control as over the local property tax. The rapid rise of this tax testifies to its popularity, not the reverse. It is conventional rhetoric to grumble about property taxes, perhaps because large owners of property set fashions. When I was a graduate student twenty years ago in California, and ever since, it has been the style to condemn the property tax—and go right on raising it.

If indeed the property tax is so unpopular, it is fair to ask why many legislatures have made it harder for the voters to raise the property tax than other taxes: to set debt limits and tax limits for localities; to require two-thirds approval on bond issues; to require improvement districts to prove benefits received by property which they tax? There are no such handcuffs on other taxes. Ever since Alexander Hamilton, it has been a pattern of legislators protecting property against the irresponsible popular will.

I ask you to ponder the inconsistency in the deliberations following *Serrano v. Priest*, of postulating the unpopularity of the property tax while on the other hand raising the specter that localities, relieved from school finance, will move right in and raise property taxes for other purposes. This is more consistent with a hypothesis that the property tax is unpopular with a minority who would block the majority from making use of it. If it were really so unpopular it would go away by popular vote.

WE DO NEED ASSESSMENT REFORM

The U.S. Census of Governments' quinquennial report on assessment ratios is persuasive and general evidence that we need assessment reform, but it understates how much we need reform. In respect to industrial property, it omits ownerships whose value is judged to surpass a quarter of a million dollars; that is, most industrial property. It is unfortunate that this is pointed out in a part of the Census most users don't get around to reading, even though perhaps they should, so that it took Nader's Raiders to ferret this out.

So many economists are mistaken, I believe, to cite the Census to show that industrial property is not underassessed. The Census is simply not in on the action here, and Nader's data, non-random though they may be, have more to tell us than the Census.

Much of Nader's data are consistent with and supplement and

reaffirm the general principle that land is underassessed. He has focused on industrial landholdings: oil in Texas, coal in the Appalachians, copper in Montana, timber in Georgia and Maine. I know of no reason to doubt the generality of these findings, and many reasons to believe it.

Census Study Omission

The Census study omits the class of land most underassessed, that is unsubdivided acreage inside SMSAs. Much of that is speculative; much is in estates held by the very (and the very very) rich; and much is industrial.

I studied some of this industrial land in Milwaukee. It was not only underassessed, but regressively assessed. The large tracts were given a wholesale rate, allegedly because large tracts sell for less per unit. At the same time, the city was assembling and/or holding large tracts in an industrial land bank, allegedly because the market put a premium on large tracts. It makes an interesting contrast. I have published some of my findings on this question elsewhere.⁸ Similar findings by Armin Jocz in Beloit, Wisconsin and by Alene Ammond in Cherry Hill, New Jersey, were published recently as testimony presented to the Senate Subcommittee on Intergovernmental Relations.⁹

Professor Samuel Loescher of Indiana University has written me that his students' study "confirms the substantial underassessment of industrial land relative to adjacent residential land, measured on a per-acre basis, in the area of every major industrial property in Monroe County, Indiana."¹⁰

Beyond Revenue Productivity

The value of assessment reform is much greater than the gain of revenue, however great or small that may be. Increased taxpayer confidence and acceptance are equally important. I do not think that people who countenance corruption and maladministration have any inkling of how destructive these are to the morale of citizens who are outraged first by the facts, and then outraged again by the complaisance and laxity of responsible officials who have the power and duty to act.

8. "What Is Property Tax Reform?" *American Journal of Economics and Sociology*, April 1972, and "Adequacy of Land as a Tax Base," in Daniel Holland, Ed., *The Assessment of Land Value*, Madison, University of Wisconsin Press, 1970.

9. *Hearings before the Subcommittee on Intergovernmental Relations, The Impact and Administration of the Property Tax*, Washington, D.C., Government Printing Office, 1973.

10. John Goss and Dave Hill, "An Examination of Property Tax Assessments in Monroe County," MS.

The revenue productivity of a tax is limited by the suffering of those most impacted, i.e. those overassessed and paying the highest effective rates. These become the widows and orphans trotted out to damn the entire system.

Easy Half Step

We can move halfway from here to the site value tax without changing any law, simply by obeying the laws we already have and assessing land at market the way we do buildings. I do not exaggerate. Listen to what people say when an assessor moves toward bringing assessed valuation up to market value. "The assessor has gone hog-wild." "He's trying to tell people how to use their land." "The assessor is taking over the planning function." "This vicious radical theory of market value." "Our community is unique." Sound familiar? It gives a notion how time has withered and custom staled the notion that all property should be assessed on the same basis according to law.

I invite your close attention to what has happened in a few jurisdictions whose assessors have brought land up to market: Rosslyn, Va.; Southfield, Michigan; Sacramento, California. I further invite your attention to the cities of Canada, especially western Canada, where assessors traditionally value land more heavily than they do here. These cities compare favorably in most respects with the remains of many of ours.

The underassessment of land is worse than the Census shows, at least in my experience. *Building the American City*, the final report of the Douglas Commission (National Commission on Urban Problems), cites Allen D. Marvel to the effect that 40 percent of urban real estate value is land value, and I believe the true figure is at least that high. But in most city assessment rolls it is down nearer 20 percent or 25 percent.

In sylvan areas, every forest owner likes to overstate the value of stumpage for federal tax purposes (to transfer profit to timber culture, which gets capital gains) and to understate it for state and local excise and property tax purposes. All that is needed here is for state and federal tax officers to exchange information and demand the same valuations be used, although of course immature timber must be discounted from its maturity value.

The most underassessed of all properties are mineral reserves: Producing properties are underassessed; reserve properties are not assessed as mineral-bearing land at all. This has something to do with the problem of measuring reserves, but not very much. It has more to do with differential political power and constitutes, in my

opinion, one of the worst breakdowns of the democratic process that we suffer. If one *really* means to help those poor widows, here is a place to start. If the Watergate catharsis is used merely to review the way we play cops-and-robbers, the newsprint lavished on the affair will have been largely wasted. The point is rather how dependence on campaign contributions biases and subverts politicians of both parties at all levels in favor of large contributors. Federal income tax loopholes for mineral owners are matched by local assessors and courts who underassess mineral reserves to the point of exemption.

In West Virginia, for example, the United States Geological Survey maps of coal reserves have been available for a long time, but not used. Recently the State Department of Assessment has begun staff work to help local assessors use these maps, and to win the court cases that inevitably follow. They need help.

Congress should instruct the U.S.G.S., Bureau of Mines, and other federal agencies to cooperate actively with state and perhaps local agencies in the process of valuing mineral reserves. This entails not just ascertaining the physical volume and grade of the reserves; it entails valuation, an economic art.

If it be anticipated that states might not cooperate, I suggest that no state—until it shall have done so—be allowed to plead poverty in Washington. I predict few of them would have reason to plead poverty afterwards.

If it be anticipated that the agencies might not cooperate, or would represent the assessed parties instead of the public, then a new agency may be called for. Whether in a new or old agency, new personnel are needed with new skills and a sense of the new mission.

How Underassessing Land Bleeds U.S. Treasury

The Internal Revenue Service accepts the assessment of land by local assessors as prima facie evidence of land value in disputes over income taxes. Land is not depreciable for income tax; buildings are. Understating the share of land lets the taxpayer overstate the depreciable share of real estate. It lets the owner of income property depreciate land to write off against cash flow.

There is little useful incentive effect of this tax break. On the contrary, it is a reason for urban nonrenewal and decay. Ecologists will not smile on the wildlife it shelters, the *Rattus norvegicus*, *Rattus rattus*, and friends. The main shelter goes to owners of land with older buildings.

Every time an old building is sold the buyer may depreciate it

again. For the new basis he uses the new purchase price, never mind how many times previous owners have written off the building, and part of the land value, too. It is bad enough to let an owner depreciate land once only. If you figure it out it is tantamount to exemption in perpetuity: all the Treasury gets thereafter is a return on its own investment.¹¹ But our tax system lets land be depreciated as many times as it is sold, or inherited. The income is not only exempt, it is supplemented by the Treasury, for each additional false depreciation is a gift.

This practice bleeds the Treasury. It affects most income property, nonresidential and residential both, and thus affects more than half of all the property there is. I have not tried to estimate how many billions of tax money hemorrhage from this ruptured artery, but it can hardly be inconsiderable. Two otherwise impressive quantitative studies of depreciation, one by Slitor for the Douglas Commission¹² and one by Aaron,¹³ shed no light on this particular matter. Both were limited to housing. Both studies downplayed the quantity of tax subsidy in fast write-off (Aaron) and multiple write-off (Slitor). They did not come to grips with false write-off of land. I know of no study that has. It is past time that the Office of Tax Analysis and a hundred independent researchers jump into this issue with both feet. The ACIR recently suggested that such a study be made.¹⁴ Would that it will soon follow through and devote some of its own resources to such a study.

I recommend that there be established in the Internal Revenue Service something like a Federal Board of Equalization, whose function would be to prevent local assessors from helping their constituents lower their income tax liability in this manner. Otherwise we never will get true assessment of land, for you need little imagination to see what pressure this inevitably brings on the local assessor, a

11. Suppose in 1973 I write off \$100 of land value, and my tax rate is 40 percent. I reduce my taxes by \$40 in 1973. Thereafter the Treasury has a \$40 or 40 percent investment in the land. It takes 40 percent of the ordinary income in perpetuity (maybe), thus getting only a return on its investment. The owner has a 60 percent investment in the land, and clears 60 percent of the ordinary income after taxes. Effective tax rate: zero. This is modified by liability for capital gains tax on excess of sales price over book value. But there are a dozen ways to cut that down, often to zero, and in every case it comes later than the write-off, and only half of it is taxable.

12. Richard E. Slitor, *The Federal Income Tax in Relation to Housing*, Research Report 5, National Commission on Urban Problems, Washington, D.C., Government Printing Office, 1968.

13. Henry Aaron, "Income Taxes and Housing," *American Economic Review*, Vol. 60, December 1970, pp. 789-806.

14. *Advisory Commission on Intergovernmental Relations, Financing Schools and Property Tax Relief: a State Responsibility*, Washington, ACIR, January 1973, p. 6.

pressure that is all one-sided. What we have now is a modern variation of the old problem of competitive underassessment. States solve that problem at low cost by the use of boards of equalization. The federal government can and should do the same.

We keep hearing of public land purchases at prices far above equalized assessed value. Each such case is evidence of malfeasance on someone's part and should alert us to the need for full review, disclosure, and perhaps criminal charges. Is such systematic violation of the law less harmful than breaking and entering?

WE DO NEED TO SHIFT THE PROPERTY TAX TO THE STATE LEVEL

Half the reasons one hears cited for damning the property tax are not arguments against the property tax as such, but against tax enclaves, against Balkanization, against fiscal zoning and havens of high per capita tax base. These are arguments in favor of shifting the financing of some public services, especially schools, to the state level. The property tax is only incidental, because for the last few decades it has been mainly local. It used to be a state level tax, and could be again.

Serrano v. Priest and like decisions in other states have not outlawed the property tax for school finance. Rather they have outlawed gross inequalities in the local tax base used for school finance. In *Rodriguez* the U.S. Supreme Court did not say "forget it." It said each state legislature should respond to its own courts and voters. One way or another, the courts are saying tax bases must be equalized at the state level.

It is not necessary, therefore, to relinquish the property tax, but only to move it to the state level. Thus every local tax haven will automatically be tapped for the benefit of every school child—and without the need for families to move to invade the tax havens, either, and I submit that when people start locating without being influenced by this factor we will achieve a much more compact and rational pattern of metropolitan settlement.

It is not just industrial tax enclaves like Emeryville, California, West Milwaukee, Wisconsin, and Clearing, Illinois that will be tapped. Butte, Montana, Hibbing, Minnesota, and Kern County, California look like good candidates, too, with their mineral wealth. (Mineral wealth is concentrated in a few places, usually remote from populous school districts.) So do the undertaxed forest lands of Maine, Oregon, and Florida, and the coal reserves of Appalachia.

The quality of property tax administration would probably im-

prove at the state level. The optimal scale of assessors' work is larger than most jurisdictions presently going, although the optimal size would fall if we could spread the overhead over more frequent and careful assessments. The ideal arrangement involves a compromise between the advantages of scale and those of local intimacy, with staff work and research and training conducted at the state level, and nuts-and-bolts assessment at the county level, with equalization and review again at the state level.

However, this is only a mote next to the basic gain from state assumption of the property tax for schools. The quantum advance in the quality of American government that would result is the change of local incentives toward immigration. Now, every tax jurisdiction in the country, be it rural, *sylvan*, suburb or central city, is fighting to dump its fiscal deficit generators over its borders. Mayor Henry Maier of Milwaukee, President of the National Conference of Mayors, said in his presidential address in New Orleans that we must remove "whole square miles of people" from the cities, and this sums up the prevailing attitudes nicely. So everyone adopts exclusionary low density zoning and a host of allied policies to repel the poor and avoiding diluting the local tax base. But given state support of schools, local governments would be faced with a different set of incentives and become much more hospitable to the poor.

We had better move in that direction soon, or we will create a class of gypsies who have no place to park their trailers but on the Interstate Highway System. Anyone who thinks that is a good idea had better review the data on rising rates of crime and welfare dependency. For a democratic society to work, we need local governments that compete to attract people, not to exclude them.

WE DO NEED TO CONVERT THE PROPERTY TAX TO A SITE VALUE TAX

Dick Netzer, Lowell Harriss, Arthur Becker, I, and others have written a good deal about the advantages of the site value approach, and I will merely summarize here some major points, stressing a few which have been neglected.

The proposal is to exempt reproducible capital from the property tax base, and focus it on land value. There would be little or no loss of tax base. Untaxing buildings adds to site value an amount as great as the capitalized value of the building taxes, and this new value becomes part of the site value base.¹⁵ Thus, we would be taxing the same real estate; we would just be taxing it in a different way.

15. "Adequacy of Land as a Tax Base," *op. cit.* (note 8), pp. 187-92.

For the same reason, there would be, in general, no invasion of the present owners' equity in land. There would be some re-shuffling, and over a transition period there would be a recentralization of values because the redevelopment of inner lands would satisfy and pull in the demand now proliferating over peripheral areas. Judging by what one hears, most owners in peripheral areas would prefer it that way.

The market would become the judge of what is the best use of land, unswayed by tax bias, as now. When buildings are taxed, the tax biases the owner in favor of the use more lightly taxed.

Nowadays some people decry "highest and best use" as though it were a kind of morbidity. There may be a tendency for social critics to overstate the external effects of a land use and understate the basic internal purpose. Highest and best use simply means that use offering society the greatest net service flow, insofar as the market is able to judge it. Those not accepting the market's judgment need to show that their objection is based on something more substantial than, for example, a subjective esthetic reaction. It would only be a form of tyranny to let taste dictators judge the external effects of a building on the sort of emotive basis that is fashionable among architectural journalists.

A more objective method, I believe, would be to note the effect on land values across the street. In my studies of land values, I have almost always found that highrise buildings, even something like the Allen-Bradley building in Milwaukee, an eight-story factory that uses its land to the sidewalk, raise values around them. I cannot say the same for gas stations, junk yards, auto dealerships, and vacant lots—no, not even cemeteries—and I wish that those who are concerned with external effects of land uses would get more exercised about those that can be objectively demonstrated to harm their neighborhoods and communities.

Effects of Taxing Buildings

Taxing buildings slows down renewal and replacement of decayed and obsolete buildings by new. Taxing land does just the opposite. It drains cash from the holdout and the sleeping owner of underdeveloped land and presses him to improve, or sell.

We hear a lot about how the site value tax is economically "neutral," and lets the market alone to do its work. In an important sense that is true. But tax theorists have long noted that taxes have two kinds of effects. There is the marginal effect, and the wealth effect. Land taxes have no marginal effect, that is, the marginal increment of capital applied to land is not taxed, and that is a great virtue. But land

taxes do have a wealth effect. They drain wealth from holdouts and reduce their holdout power. It is not a small matter.

In some European colonies in Africa, the European governments once forced natives to work in the mines by levying a head tax. The natives, living happily in the bush, had to work in the mines to raise the money to pay the head tax—or else go to jail. That is a wealth effect. The land tax uses the same principle in favor of labor. It forces landowners to put land to use to pay the tax. But there is no jail in view. It is a carrot and stick thing. The carrot is the option of building on land free of building taxes. The carrot and stick together get results. The carrot balances the stick in terms of equity. And everyone gains.

That might seem too obvious to spell out were it not that the large Chicago-Virginia-UCLA axis has built an influential, highly reasoned philosophy that pretty well dismisses wealth effects. To this school of thought it doesn't matter who originally owns property or who begins the game with all the chips. Create good tenure rights, minimize transaction and information costs, and the market will lead to the same ideal results. For example, charging polluters an effluent tax leads to the same results as "bribing" them not to pollute so much. It is this kind of thinking that makes a tax on site value merely "neutral." There is far more in taxing the earth, Horatio, than is comprehended in this poor philosophy. In my opinion the wealth effects are at least as important as the marginal or trade-off effects.

Taxing Land Economizes on Public Capital

When public works are extended, land assessments rise, bringing in private buildings to match the public, nicely synchronized with it and with each other. Planning needs such a tool. And here at last is a way to tax relief—true tax relief achieved in the only possible way by economy in public spending, not by the childish dodge of substituting another tax and calling it relief.

Compact settlement reduces almost all public costs per capita since most of these, and many private costs as well, vary with the length of streets and lines. This important principle has been obscured in many comparative studies because they have lumped school costs with land-service costs.¹⁶ High density does not reduce school costs, except in small ways. It does reduce street improvement costs, capital budgets, linkage and distribution costs, and all other costs that vary with area, like the costs of flood control and radio coverage, for example.

16. Many studies comparing suburbs and central cities have also compared new suburbs and old cities, thus biasing the findings against high density.

The share of wealth that is land tends to increase with total wealth, making the land tax very progressive. As discussed above, the use of land is regressive, making a land tax progressive relative to activity-based taxes. The land tax may be as heavy as the community likes without driving away capital, but only attracting it the more. No other tax can make that statement.

Stimulating Employment

By stimulating rebuilding and new building and putting land to full use, the site value tax stimulates employment. This in turn cuts down on welfare costs, affording true tax relief.

This has to be viewed in the national perspective. Many of us are hung up on viewing the property tax in provincial and particularistic terms, and think of employment as a pestilence, inviting problems and especially school taxes into our enclave. But here we are discussing the property tax as a national institution. The national effects of a national change in the character of the tax would be to increase the demand for labor nationwide, and abate the problem of unemployment and its derivative evils. It would not involve flooding any one particular jurisdiction with the rejects of all the others.

Looking at it this way, you can see why some have thought that the site value tax might tend to accomplish the goal that we once hoped Keynesian policies would achieve, to wit full employment. Society has now allowed this utopian dream to be entertained, and even legislated it as a national goal in the Full Employment Act of 1946. The Keynesian approaches seem to have been pushed past their load limit, but perhaps at least it is permissible to dream some more. It was unrealistic of the old Georgists to expect local jurisdictions to solve the national unemployment problem with local tools. But now that we have a national Full Employment Act, and an Advisory Commission on Intergovernmental Relations that is concerned with the property tax, could we not begin to think of the property tax in part as a tool to help achieve full employment?

EIGHT RECOMMENDATIONS

I have eight specific recommendations as my own agenda for property tax reform:

1. That the Bureau of Mines, the United States Geological Survey, and other appropriate federal agencies be instructed and funded to work actively with state and local assessors to help assess mineral reserves.

2. That the Internal Revenue Service be instructed to share in-

formation with local assessors in order to help improve the assessment product.

3. That federal acquisition of real estate at prices above its equalized assessed valuation be declared contrary to public policy. Either condemnation shall be at the equalized assessed value; or else the entire jurisdictional assessment shall be challengeable by any other affected party.

4. That timber valuations for income tax be made identical with assessed valuations for state and local taxation; and the same for mineral valuations at the time of severance. In each case, the value of immature reserves needs a discount, but I warn against a propensity to exaggerate the discount, especially for larger owners with slower schedules of harvest and extraction of reserves.

5. That there be established, presumably in the Internal Revenue Service and with the aid of the Census of Governments, a national Board of Equalization, whose function is to protect the federal revenues by preventing the underassessment of land and resulting depreciation of land.

6. That the federal influence be exerted to encourage shifting the property tax to the state level.

7. That the federal influence be exerted to encourage converting the property tax to a site value tax.

8. Finally, that the federal power to tax property be reviewed. The Constitution allows federal property taxation, and the federal government has used this power five times. The power was weakened by the requirement that the tax be apportioned among the states according to their respective populations as determined by the Census, just like Congressmen. Now, however, two changes have occurred.

One is the Sixteenth Amendment, allowing taxation of income from whatever source derived and without apportionment. It is reasonably certain that imputed income from property might be included, as Joseph Pechman and other advocates of a "comprehensive tax base" preach it should be. Imputed income and unrealized capital gains both tend to be in proportion to capital value, so a tax on these incomes could be levied just as the property tax is now on the base of capital value.

The second change is revenue sharing. A federal property tax could be apportioned by population, and the revenue then shared in the same way, or any way Congress decides. The Constitution tells us how taxes must be apportioned, but with spending, anything goes. So, as Professor Don Hagman of the U.C.L.A. law school has pointed out, apportionment is really no constitutional barrier to an effective use of the property tax by the federal government. There isn't any.