USA

Understanding the Property Tax

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ALMOST nobody seems to understand the property tax—not one business man in a hundred and not one taxpayer in a thousand.

Even the assessors charged with its administration are apt to confuse it with an income tax. So too often they grossly underassess and undertax land that is kept so underused or misused that it is earning little income. And then they overassess and overtax land whose owners are making the most of it.

What most taxpayers know about property taxation seems to stop with just knowing that the tax bills on their own homes have been getting quite a bit bigger. This lack of understanding may explain but certainly does not justify their being more belligerent about rising property taxes than about any other levy. For the truth is that property taxes have gone up much less than any other major source of government revenue.

What the lack of taxpayer understanding does explain is why the big landowners have found it easy to sell the voters on so-called property tax reforms that would be a lot better for land speculators than for anyone else. Among these questionable reforms are:

1. present use assessment
2. farm value assessment
3. temporary open space reserves
4. saleable development rights
5. legalized underassessment of land
6. farm buy-up and lease-back
7. the British system of rates
8. just cutting the property tax in half.

Says Dr. Arthur Solomon, director of the Joint Harvard-MIT Centre for Urban Studies:

"In state after state the principal leaders of the property tax 'revolt' prove to be substantial property owners and realtors rather than the proverbial 'little men' . . . . We believe that it is these relatively well-to-do people who would be the true beneficiaries of the currently popular proposals for effecting massive property tax reductions."

What too few tax officials and too few taxpayers understand is that the property tax is not just one tax. On the contrary, said the urban experts and tax authorities at a round table conference co-sponsored by the National League of Cities and the Council of State Governments:

"The property tax combines and confuses on one tax bill two completely different and conflicting taxes, and it would be hard to imagine two taxes whose consequences would be more different."

One of the two conflicting taxes fused and confused in the property tax is the tax on the improvement—the tax on what past, present, and future owners of the property have spent or will spend of their own money to improve it.

And, said the round table consensus:

"It should be obvious to anyone that heavy taxes on improvements are bound to discourage, inhibit, and often prevent private investment in improvements.
The other levy confused in the property tax is the land tax—the tax on the unimproved location value of the site, the tax on what land in that location would be worth if its past and present owners had never spent anything or done anything to improve it. And it should be obvious to anyone that heavy taxes on the location cannot discourage or inhibit improvements; on the contrary, heavy taxes on locations could put effective pressure on the owners to put their sites to better use so as to bring in enough income to earn a good profit after paying the heavier tax."

So, concluded the round table:

"All this is so obvious that you would think every city would try to tax land heavily and tax improvements lightly if at all; but just the opposite is the case. Almost every city collects two or three times as much money from taxes on improvements as from taxes on land. In fact, many cities tax improvements more heavily than the combined local, state, and federal taxes on any other product of American industry except hard liquor, cigarettes, and perhaps gasoline.
Conversely, millions of idle urban and suburban acres are so underassessed and undertaxed that owners have been able to hold their land off the market for a net yearly tax cost seldom exceeding one per cent waiting for inflation and an enormous investment of other people's money to double or triple its price [*i.e.,* to increase its price one or two hundred times as much as the net yearly tax cost].
Wisely applied, the property tax could be one of the wisest and fairest of all taxes; but as most cities apply it today it may well be the very worst—a weird combination of overtaxation and undertaxation, an incentive tax for what we don't want and a disincentive tax for what we do want. It harnesses the profit motive backward instead of forward to both urban renewal and urban development. Too often it makes it more profitable to let buildings decay than to improve them or replace them."

If improvements were taxed more lightly or (better still) untaxed, our cities would have to find another tax source to make up the loss.

The cities can't very well raise the new revenue by multiplying the city income tax. That would give everyone with an income one more reason to move out of the city. And anyhow no good can come of piling a heavy city income tax on top of a state income tax on top of the federal individual income tax schedules. The income tax has already passed the point of diminishing returns. Since 1939 it has been multiplied seventy-one times over at the federal level and fifty-two times over at the state level.

Likewise, most cities dare not try to get the new revenue by multiplying the city sales tax. That would make it too much cheaper to shop outside the city line. And anyhow the sales tax is a bad tax whose only advantage is that it is collected in so many small pieces that the taxpayer is less likely to notice its cost. It comes down hardest on the poor, and its end result is fewer jobs and less production of real wealth, for each one per cent it adds to the cost of living translates into much less consumer purchasing power and therefore less sales, less production, less jobs, and less Gross National Product.

Likewise, the cities can hardly hope to raise the offsetting billions by new or increased taxes on corporate income. For the state and federal governments are already taxing away much more than half the profits of corporate business.

Cities would be foolish to hope they could get the federal government to offset any part of the tax loss from untaxing improvements by increased revenue sharing. For sooner or later the federal government will have to face up to the fact that it is in much worse money trouble than the cities. For years the federal deficit has been running bigger than the total of all the deficits of all our local governments combined!

Land, The Ideal Revenue Source

Land is the only taxable that can't leave town to escape taxation. So the only revenue source a city could tap to make up for the revenue loss by untaxing improvements would be to increase the tax on the unimproved location value of land in the city.

And very fortunately, the result of doubling or tripling the tax on unimproved location values should be at least as good as the results you could expect from untaxing improvements. Low taxes on land get capitalized into high land prices, so some cities like St. Louis where the property tax is too low are in even worse trouble than cities like Buffalo and Boston where the property tax is too high.

Untaxing improvements would provide the carrot; uptaxing location values would provide the stick needed to prod the owners of underused and misused land to put it to better use in order to bring in enough additional income to pay the higher tax.

The unimproved value of nonfarm land means what land in any given urban or suburban location would be worth if its past and present owners had never done anything or spent anything to improve it. In other words, it means the value that land in that location derives almost entirely from an often enormous investment of other people's money and most notably other taxpayers' money to develop the community around it, thus making land in that location accessible, livable and richly saleable. For the life of me I can't think of a fairer tax than a tax on the unearned increment from other people's investment.

A Persistent Controversy

NORMAN AYCLIFFE

THE theoretical differences between the Keynesian economists and the monetarists have narrowed considerably. Keynesians and monetarists agree that a sharp or persistent increase in the stock of money will be associated with a broadly proportionate increase in prices. Non-inflationary monetary expansion can take place only if there is a background of unemployment of both labour and capital. Persistently rising prices cannot take place without associated monetary expansion. Given this much agreement the layman might be forgiven for wondering what there is left to argue about. To most of us, the question of causation, strictly defined, is of little importance so long as the matter of prevention and cure have both been settled. Yet the controversy continues. In a recent paperback* an attempt at a balanced position is put in the following terms:

> "To argue that monetary expansion is the sole cause of inflation is to ignore the social and political factors which cause governments to permit that monetary expansion to take place. But to believe that inflation can be cured without control of the money supply is to ignore what is probably the best-documented and most-researched relationship in economics—the relationship between the level of income and the demand for money."

To most of us it is a relief that the continuation of the controversy depends upon so fine an interpretation of the notion of causation—especially if we find the statistical debate too difficult to follow. But those of us who always did believe in a strong connection between monetary expansion and inflation, should still be grateful for simply stated explanations of some of the mechanisms, and of some of the remaining problems.

How, under a fractional reserve system, do the banks influence the money supply? Most textbooks supply an answer which is heavily dependent upon assumptions about the behaviour of the banks and their customers. Are these assumptions universally valid? And what happens if they are varied? Using simple arithmetical examples and with the minimum of (strictly optional) algebra, Professor Bain makes this mechanism understandable to anyone with the persistence and curiosity to examine it.

Why, in spite of avowals of intention to control monetary expansion has inflation proved so persistent a disease? Were the avowals lacking in sincerity, or was there a real problem in learning how to reduce monetary growth once it had gathered momentum? A valuable insight into these questions is provided by this latest revision of Professor Bain's book. "That a lower rate of monetary growth is a *sine qua non* for price stability is not seriously in dispute. Argument centres on how to bring this about without exposing countries to intolerable economic costs and political strains." This may appear to shift the centre of interest from common-sense economics to financial technicalities, and thus again to move the argument to areas beyond the scope of the layman. But the clarity of Professor Bain's explanations are such that one feels that, without having to understand every detail, the essence of the problem is made clear.

* *The Control of the Money Supply*, A. D. Bain. Second edition 1976. Penguin Modern Economics Texts, £1.25.