Solution to School Finance Equity Dilemma in NY State
A Response to the Court of Appeals Decision to provide
$4 – 6 Billion to the New York City School System

H. William Batt, Ph.D., Albany, NY 12204; hwbatt@yahoo.com.

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The Court of Appeals has spoken.[1] The State Legislature is challenged in response to find an additional $4 to 6 Billion to support the New York City School System, as described by the continuing Campaign for Fiscal Equity, an organization expressly designed to press for this resolution.

Where will the money come from? It can come from only three possible sources: taxes on *land, labor*,[2] or *capital*.[3] Land in economics refers to all natural resources—air, water, the radio spectrum—plus land in the more common sense of acreage and urban sites. Unfortunately some neoclassical economists have effectively hidden and defined land out of existence, classifying it as capital, a grave mistake.[4] This blinds many otherwise proficient students of economics and public finance to an obvious solution to this school finance crisis.

Negative consequences of taxing labor and capital are profound. Taxing labor makes people work harder for less, that is for fewer of the things needed to support their families.[5] Taxing capital, whether in the form of sales, savings, investments or equipment, incurs what is called "deadweight loss,"[6] which puts an enterprise or region at an economic disadvantage.

In contrast, if land is the tax base, there is no such loss. Clearly the same amount of land remains after land is taxed, as advocates of taxing the economic rent from land point out.

The beneficial effects of taxing land have been noted by at least eight Nobel Prize-winning economists.[7] Moreover, taxing land value–or location value–comports with all the textbook principles of sound tax theory.[8] Indeed the more the economic rent of land is collected as a public revenue source, the greater the positive effects:

- Taxing land fosters its more intensive and efficient use.
- It engenders greater economic vitality by exerting downward pressure on the market price of sites so that their acquisition becomes more feasible to potential users.
- Potential developers are able to secure their first choice of locations rather than being driven to second-best sub-optimal sites.
- Taxing prime locations discourages their being held off the market by speculators, making the full array of locational choices available for appropriate use.
- Taxing land reverses the centrifugal forces of sprawl development by making sites in core areas competitive with sites at the periphery. Cities thereby become more livable.

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[1] Campaign for Fiscal Equity, Inc.,v.The State of New York November 20, 2006. See www.cfequity.org.
[2] Efforts of human hands or minds.
[3] Products created out of land and labor used to create more wealth.
[4] Mason Gaffney, *The Corruption of Economics*, Shepheard Walwyn, 1995, fully online at http://homepage.ntlworld.com/janusg/coe/!index.htm; and Herman Daly and Joshua Farley, *Ecological Economics*, Island Press, 2003. Batt, "How the Railroads Got us on the Wrong Economic Track," at www.wealthandwant.com/docs/Batt_HTRGUOTWET.html
[5] This truism was popularized by the famous Laffer Curve. http://en.wikipedia.org/wiki/Laffer_curve.
[6] http://en.wikipedia.org/wiki/Deadweight_loss
[7] See, among others, www.taxreform.com.au/economists.php
[8] www.progress.org/cg/battprincip02.htm

More than simply fostering better land use patterns, taxing land positively affects the economic vitality of a region, as shown in economic models,[9] and in many actual examples.[10]

In 1982, Harrisburg, Pennsylvania was adjudged the second most depressed city in the nation under Federal distress criteria. Since that city's phase-in of ever greater tax rates on land than on improvements, Mayor Stephen Reed notes[11] that "Harrisburg has registered in excess of $3.1 billion in new investment. The number of businesses on the City's tax rolls has increased from 1,908 to more than 5,900. Taxable real estate values have increased from an aggregate of $212 million to over $1.6 billion. The number of vacant properties has been cut by 85%." The crime rate has been reduced 54% and the fire rate has dropped over 76%. Mayor Reed, re-elected continually since 1982, was just named one of the world's most outstanding mayors.[12] The City's tax rate on land values is six times the rate on improvements. Twenty other Pennsylvania cities are now following suit.

A tax on land values is eminently fair. It correlates highly with ability to pay. At the same time it serves as a benefit fee or user charge.

Look first at matters of ability to pay or what may be called vertical equity. Households that own no land pay no land taxes even indirectly. Land, being "inelastic" or fixed in supply, means land owners cannot pass taxes forward to tenants. Taxes on structures can be shifted, but not the taxes on land.[13] Thus the roughly one third of all households who are tenants, largely poor people, pay no property taxes. Of those that do own real estate -- homeowners, businesses, industries, and farmers – roughly half the aggregate burden in normal circumstances is paid by non-residential titleholders. Valuable parcels are typically located in the urban centers, and homeowners are at the urban peripheries. Remote farmland usually is inconsequential for tax revenue – if it isn't protected in any case by other save-harmless clauses.[14] Maps of land value

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[9] One study calculated that "on average, a one percentage point increase in the tax differential will yield an increase in the total value of construction of 17.8 percent." Tideman, Nicolaus and Florenz Plassman, "A Markov Chain Monte Carlo Analysis of the Effect of Two-Rate Property Taxes on Construction," *Journal of Urban Economics* 47(2)216-247. This researcher found that a $128 million highway investment of eleven miles generated additional land value of $3.734 billion within a limit of two miles on either side. "Value Capture as a Policy Tool in Transportation Economics: An Exploration in Public Finance in the Tradition of Henry George," *The American Journal of Economics and Sociology,* 60(1)195-228 (Jan. 2001); reprinted in Laurence S. Moss (ed.), City and Country. Malden MA: Blackwell Publishers, 2001. www.urbantools.net/pdf/ValueCaptureAsAPublicFinanceTool-BillBatt.pdf . Still a third study compares state tax burdens and their economic plights, and New Hampshire, which has a tax bearing most heavily on land values (albeit in the form of the conventional tax on real property) fares favorably with states that rely more generally on a balance of income, sales, and property taxes. See "The Income-Stimulating Incentives of the Property Tax," by Mason Gaffney and Richard Noyes, in *The Losses of Nations: Deadweight Politics versus Public Rent Dividends*, Fred Harrison, Editor. London: Othila Press, 1998, also at www.cooperativeindividualism.org/gaffney_noyes_lossesofnations1.html

[10] See especially the record of the impact of Land Value Taxation's use in the city of Harrisburg, PA, at www.urbantools.org, and Alanna Hartzok, "Pennsylvania's Success with Local Property Tax Reform: The Split-rate Tax," *American Journal of Economics and Sociology*, 56(2)205-214 (April, 1997), and www.earthrights.net/docs/success.html .

[11] Letter to municipal colleagues, in this case, to Philadelphia Controller, May 1, 2003.

[12] www.worldmayor.com/results06/profile_harrisburg.html.

[13] See Harvey S. Rosen, *Public Finance, 2nd Edition* (Homewood, IL: Irwin Press, 1988), pp. 483-489

[14] Such regimes compare favorably to current property tax designs where farmers are sometimes taxed on their homes, barns and other structures. In urban areas, buildings on a small footprint (i.e., with little if any curtilage) pay less than under current property taxes, and properties that have small structures relative to their land sites – drive-in eateries, service stations, and parking lots – pay far more.

typically look like those showing elevation above sea level, downtowns constituting the peaks.[15] Empirical studies on the incidence of the property tax also show that it is progressive.[16] At the same time it fares well by the other criterion of fairness, payment according to use.[17]

It is timely to note the effect of a land tax on the market price of real estate. It is well understood that buildings depreciate over time. Just as cars, computers, and factory equipment get old and obsolete even with maintenance, so do buildings. The rise in the market price of real estate comes from the appreciation of land, not from the homes or commercial buildings on the land.

What creates this land value? In part it reflects the overall entrepreneurial activity in a location, rather than what any given titleholder does to the site. It also reflects the general vitality of a neighborhood or region. And it very much results from the totality of public facilities and services serving a locality. In sum, the value of land is community created.

Land speculation may be understood as the attempt by owners, who apparently have little interest in tapping the productive potential of their sites, to ride the upward market trends and to reap these socially created land values. Often the owners reap these gains by waiting to be bought out by public ventures after suitable time passes. John Stuart Mill noted[18] that *landlords grow richer in their sleep without working, risking or economizing. The increase in the value of land, arising as it does from the efforts of an entire community, should belong to the community and not to the individual who might hold title.* This does not prevent opportunistic speculators from pirating the public birthright when the opportunity arises.[19] A century ago commentator William Riordan aptly portrayed New York ex-Senator George Washington Plunkitt's saying.[20]

There's an honest graft, and I'm an example of how it works. I might sum up the whole thing by sayin': "I seen my opportunities and I took 'em."

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[15] New computer technology allows ease of computer mapping, even of assessments, although few governments have availed themselves of such tools. For one illustration of landvaluescapes that shows how variable locational sites can be, see, the author's "The Nexus of Transportation, Economic Rent, and Land Use," at www.taxpolicy.com/batt/

[16] Only two empirical studies have ever been done on the subject, but both concluded that the real property tax is mildly progressive. When land and improvements, the two elements of the property tax, are taken separately, it becomes even clearer why this is so. See Peter Mieszkowski, "The Property Tax: An Excise or a Profits Tax," *Journal of Public Economics* 1 (April 1972): 73-96, cited and discussed extensively by James Heilbrun, "Who Bears the Burden of the Property Tax?" in Lowell Harriss (ed.), *The Property Tax and Local Finance*, Proceedings of the Academy of Political Science, Vol 35, #1 (1983), pp. 56-71; and Henry J. Aaron, *Who Pays the Property Tax: A New View*, Washington: the Brookings Institution, 1975. These are reprinted and further discussed in Dick Netzer and Matthew P. Drennan (eds.), *Readings in State and Local Public Finance*. Oxford: Blackwell Publishers, 1997, Chapters 7 -- 10. See also Harvey S. Rosen, *Public Finance, 2nd Edition* (Homewood, IL: Irwin Press, 1988), pp. 483-489; Mason Gaffney, "The Property Tax is a Progressive Tax," *Proceedings*, National Tax Association, 64th Annual Conference, Kansas City, 1971, pp. 408-426. [Republished in The Congressional Record, March 16, 1972: E 2675-79. (Cong. Les Aspin.) Resources for the Future, Inc., *The Property Tax is a Progressive Tax*, Reprint No. 104, October, 1972], online at www.schalkenbach.org/library/progressivet.pdf .

[17] Walter Rybeck, "The Property Tax as a Super User Charge," in Lowell Harriss (ed.), *The Property Tax and Local Finance.* New York: Academy of Political Science, 35(1)133-147, 1983.

[18] John Stuart Mill, *Principles of Political Economy*, bk. 5, chap. 2, sec. 5.

[19] One of Henry George's most notable speeches was titled, "Thou Shalt Not Steal," see www.wealthandwant.com/HG/George_TSNS.html

[20] William Riordan, *Plunkitt of Tammany Hall*. New York: Dutton Paperback, 1963 (orig.1905); online at http://www.marxists.org/reference/archive/plunkett-george/tammany-hall/index.htm .

Just let me explain by examples. My party's in power in the city, and its goin' to undertake a lot of public improvements. Well, I'm tipped off, say, that they're going to lay out a new park in a certain place.

I see my opportunity and I take it. I go to that place and I buy up all the land I can in the neighborhood. Then the board of this or that makes its plan public, and there is a rush to get my land, which nobody cared particularly for before.

Ain't it perfectly honest to charge a good price and make a profit on my investment and foresight? Of course, it is. Well, that's honest graft.

But when a land tax is in place, the economic rent is recovered by the community so that land doesn't rise in market price. It is stabilized. And there is no opportunity for such trickery. Real estate, especially residential property, thereby becomes more affordable. The greater the tax on land parcels, the greater the downward pressure on market prices. A land tax is the only tax that actually works to foster economic growth. The higher the tax on land value, the greater the incentive to economic vitality. This was recognized in a notable article in *Fortune Magazine* over two decades ago.[21]

It is this logic, taken in total, that invites consideration of a land value tax, administered statewide at a single rate, as a solution to New York State's need to come up with $5 billion. Keeping in mind once more that the higher the tax on land the more it drives down the market price of real estate, and the higher the tax the more it removes the deadweight loss hampering economic development, it should become clear that instituting such a measure would solve the problem of securing the necessary revenue. With sound land assessment statewide, a rate can be calculated that will bring in the required total. Down the road, the sales prices of such parcels may well be lower while titleholders pay more "up front." But even this prospect needs to be qualified, as increased activity may work in the opposite direction.[22]

The most likely question is how the burden will be borne. Much of the obligation will fall on parcels that are underused relative to their value – often locations not as productive as they potentially could be. This will provide an incentive to their improvement, so that their contribution to neighborhood and regional economic health will further enhance overall site values. If at the same time local taxes on improvements are phased out, as is occurring in Harrisburg and other Pennsylvania cities, the overall burden on parcels which contribute most to economic vitality will begin to decline relative to others.

There is also the question of how to treat the case of the proverbial "poor widow" who may otherwise be driven out of her home. Such situations exist under current tax regimes, so that the application of a land tax constitutes a situation no different. What many states have done is to institute a practice of tax deferral, reserving the option for such titleholders to pay in full, with interest, when their homes are finally sold. This may come at time of transfer to other living arrangements or at death. Even with the recapture of deferred obligations, the increase in market prices is typically far greater than what taxes are due. One recent study notes that some 24 states employ property tax deferral provisions of one sort or another.[23] This relief

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[21] "Higher Taxes that Promote Development," *Fortune*, August 8, 1983, available at http://localtax.com/fortune/hightax.html .

[22] This argument is effectively made by Professor Nicolaus Tideman, in, among others, his "Taxing Land is Better than Neutral: Land Taxes, Land Speculation, and the Timing of Development," in Kenneth C. Wenzer (ed.), *Land Value Taxation: The Equitable and Efficient Source of Public Finance*. Armonk, NY: M.E. Sharpe, 1999.

[23] *State Tax Policy & Senior Citizens: Second Edition*, Washington: National Conference of State Legislatures, 1994; David Baer, *State Programs and Practices for Reducing Residential Property Taxes*,

mechanism is far more just than others such as the oft-mentioned circuit-breaker or various tax credits or exemptions. The reason is that there is no net loss of tax revenue, and better use of residential infrastructure is likely to eventuate. There is no reason for young households to be locked out of housing opportunities for lack of ability to afford them, or for inheritors of elderly titleholders to reap the windfall gains from what is essentially the accretion of economic rent to the value of property sites.

A statewide tax on land values would foster efficient economic policies to serve both upstate and downstate regions. Real estate values are far greater downstate than upstate, to the point that they make housing oft-times unaffordable. A statewide land value tax raises the necessary revenue by driving down market prices of real estate. Any parcel with a building to land ratio greater than the average would pay proportionately less with a tax shift off improvements. Any parcel with a below average ratio would pay more. Vacant lots in high value areas would bear the greatest increase, fostering their development. By recovering the economic rent that otherwise accretes, the economies are relieved of the deadweight loss, or excess burden, that exerts a dampening influence on market transactions. Again, the greater the tax, the greater the impetus to economic stimulation.

In upstate regions, where the economic conditions are often moribund, the same factors apply to a lesser degree. The excess burden of economic rent is removed from land markets, and the impact on land use configurations is likely to be positive in as much as vacant and underused parcels will be most affected. Because the market prices of real estate, largely reflected in land values, are so much lower upstate than they are downstate, a single statewide tax rate on land values is likely to raise the greatest proportion of revenue from downstate regions, even while it is viewed as "fair" by its being a single statewide levy. This is important as a political consideration, because any other revenue stream from hard-pressed upstate regions will be catastrophic. Only a tax on land values can have a positive impact on economic circumstances.

It remains to be explored how such a design will work – how accurate assessments of land value can be made to be,[24] how easy it can be to educate the citizenry about a new paradigm of economics and taxation so that such a regime can be politically acceptable, and what proportion of the revenue stream will derive from various regions of the state. But these are empirical questions, and they can be quickly and easily determined. Computer-assisted assessment of land by itself is far easier to carry out than is assessment of land and building values together.[25] Simulating the feasibility and the results would likely be achieved in a matter of hours.

Apart from the technical feasibility and economic soundness of a statewide land value tax, there is a matter of its attractiveness as an environmental policy, and as a matter of economic and political justice. As an environmental policy, numerous organizations have come to see the

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Washington: AARP, 2003; www.aarp.org.ppi; and "Research Memo," by Don C. Richards, Senior Research Analyst, Wyoming Legislative Service Office, July 14, 2006.

[24] By far the largest component of land value is in cities, typically upwards of 90 percent, and the ability to accurately assess such parcels is very much dependent upon data on adjacent sites. The official handbook of The International Association of Assessing Officers states (p.547) that "the chief measure of uniformity [in aggregate analysis] is the coefficient of dispersion (COD), which, depending on the nature of the properties involved, should not exceed 10.0-15.0 for residential properties, 15.0-20.0 for commercial properties, and 20.0 for vacant [i.e., rural] land." Joseph K. Eckert, et al, *Property Appraisal and Assessment Administration*, Chicago: IAAO, 1990. The revolution in computerized assessment is fast making such tolerances far too generous, and will soon in fact at least be halved.

[25] Ted Gwartney, "Estimating Land Values," www.geocities.com/bororissa/land.html and www.henrygeorge.org/ted.htm

virtues of a tax on land value; an extensive list can be found on the website of the Center for the Study of Economics.[26] As a matter of political and economic justice, no name is more closely associated with these principles than the greatest advocate of this philosophy and approach: Henry George.[27] At the time of his death in 1897, he was, along with Thomas Edison and Mark Twain, the most famous man in America. Today, a Google search on the words "economic justice" calls up among the top listings the Georgist websites, www.progress.org and www.earthrights.net. Two recent articles by this writer further explain how land value taxation can facilitate solutions to contemporary problems of a wide-ranging sort.[28]

In the final analysis, a statewide land tax is neither difficult nor alien to New York State. Almost a decade ago, the City of Amsterdam sought to institute it, and in fact did so for one year. Prior to so doing a legal ruling was necessary to deem it constitutional in New York, and the already available assessment roll separation of land values from totals made the shift a matter of a small computer adjustment. Unfortunately, however, the assessments were of poor quality, and titleholders blamed the land value tax regime for the disparities they noticed perhaps for the first time. The policy was rescinded, but not before many lessons were gained about its future implementation.[29]

Nor is a statewide property tax something without precedent in New York. As early as 1799, one mill was levied on real estate and personal property, and this was continued intermittently until 1842. After that time an effort was begin in earnest and the tax continued throughout the 19th century.[30] Roughly three quarters of the property tax was on real property. In the early period, sale of public lands constituted a significant proportion of the state's revenue, but records show that over $90,000 in property taxes were netted in the year 1800. Although the total vacillated greatly from year to year, the amount reached $1.25 million by 1854, and $7.8 million by 1890. Sowers' *Financial History of New York State* shows that by 1912 state property taxes totaled $6,325,823, constituting 10.5 percent of total state revenues.[31]

What are the alternatives? There are none. Every other tax choice has strong downside consequences. Every other revenue stream penalizes real estate development, depresses investment and savings, discourages work, drives out economic expansion, and/or stifles commerce. If New York intends to address the challenge handed it by the Court, it will examine, and adopt, a statewide land value tax. It will lead the way to a revitalized New York State.

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[26] www.urbantools.org/land-value-tax-in-policy

[27] Henry George's classic book, *Progress and Poverty: An Inquiry into the cause of Industrial Depressions and of Increase of Want with Increase of Wealth. . . The Remedy*. (orig. 1879). New York: Robert Schalkenbach Foundation. See www.schalkenbach.org. for more exposition, and for access to contemporary works and abridgements of this classic work.

[28] "Who Says Cities are Poor? They Just don't know how to Tax their Wealth!" and "Painless Taxation," at www.wealthandwant.com/docs/Batt_WSCP.htm and www.wealthandwant.com/docs/Batt_Painless.htm

[29] See Donald Reeb, "The Adoption and Repeal of the Two-Rate Property Tax in Amsterdam, New York," Lincoln Institute of Land Policy, 1998. www.lincolninst.edu/subcenters/valuation_taxation/dl/reeb.pdf

[30] John Christopher Schwab, *History of the New York Property Tax: An Introduction to the History of State and Local Finance in New York*, American Economic Association, V(5), September, 1890; and Don Sowers, *The Financial History of New York State From 1789 to 1912*, New York: Columbia University Studies in History, Economics and Public Law, LVII(2), Whole Number 140, and Longmans, Green & Co., 1914.

[31] Sowers, Appendix II.