

Warren Buffett the Proposition 13 Slayer

By Fred E. Foldvary

Warren Buffett, financier and adviser to gubernatorial candidate Arnold Schwarzenegger, roused some political huffing and puffing with his suggestion that California scrap Proposition 13, which limits the real-estate property tax. Passed in 1978, Proposition 13 limits the real estate tax to one percent of market value when purchased, and limits increases to 2 percent annually. Predictably, some of the other candidates disparaged this suggestion. But Buffett knows what he is talking about, and he is correct. Proposition 13 should be repealed.

The "tax revolt" that voted in Proposition 13 into the California constitution did not reduce government or taxes, but restructured the state's taxes in a bad way. Californians now have higher sales, income, and car taxes. Fees have been increased, including charges that real estate developers have to pay, which are then passed on to home buyers. Some of the increases have masqueraded as penalties, such as hugely increased fines for traffic violations, which amount to randomly applied added taxes on cars and driving.

This fiscal crisis is a good opportunity to fix California's punitive and irrational tax system. Proposition 13 needs to be replaced by a real estate tax that exempts buildings and other improvements entirely, and taxes only land value, according to assessments of market value that are updated annually. Everybody should be taxed at the same rate no matter who owns the property or when it was bought.

The state sales tax should be repealed entirely. Sales taxes fall hard on the poor and also hurt the rich. In the USA, state income taxes and real estate taxes can be deducted from federally taxable income, but not sales taxes. If California terminates sales taxes and shifts the taxation to real estate and income, wealthier taxpayers who itemize deductions will save on federal taxes. By having a state sales tax, California gives away money to the federal government!

Warren Buffett is called the "Oracle of Omaha" because he is the head of a successful conglomerate company, Berkshire Hathaway, which invests in various companies, like a mutual fund. Buffett's comments on investing and markets are well respected and heeded. The negative reaction to Buffett's advice on Prop. 13 just shows the ignorance and political bias of the critics.

A newspaper article stated that Buffett's comments in a Wall Street Journal interview, raised questions about Schwarzenegger's solutions for California's fiscal crisis. But the relevant question is why the other candidates are not also confronting Prop. 13. Many Californians support Prop. 13, so it is not politically advantageous to propose repealing it. Arnold Schwarzenegger himself has not accepted Buffett's advice on Prop. 13, having previously spoken in favor of it.

Over time, the property taxes paid by Californians become more and more unequal. Those who have lived in their houses for a long time pay much less than those who recently bought their

homes. Also, commercial real estate pays ever less taxes per value than residences, since residential real estate turns over more frequently.

One reason why real estate taxes are not popular is that they are direct and visible. Owners get a big bill, usually twice a year. A sensible real-estate tax should be paid monthly, preferably as an automatic deduction from a salary, like income taxes today. If buildings are exempt from the tax, then once in place, even real estate owners have no real tax burden. That is because the value of the land will fall to make up for having to pay the tax. What one pays as a tax on the land value is offset by not having to pay mortgage interest on it.

So the only real problem is that of the transition. This can be made smoother with aid to those who have net losses. The future benefits way more than make up for the temporary costs. Taxes on land rent or land value do not penalize enterprise, labor, and investment, unlike taxes on sales and income. Taxing land value even helps the economy by preventing land-speculation sprawl that moves enterprise and housing to less productive marginal areas.

But the typical Californian is utterly ignorant about land economics. Proposition 13 has become a religion, a cult that has captured the minds of the public. Fellow Republican-party candidates are calling for Schwarzenegger to fire Buffett. That would be a great mistake.

By wrecking the property tax, Prop. 13 has centralized taxation and power to the state government in Sacramento. Real estate taxes, especially on land value, are well suited to local government and promote decentralization. It is amusing to see Republicans support income taxes that centralize state power. Democrats are no better; the governor said he was proud that property taxes are lower in California than in other states. So should we be proud about California's high income and sales taxes? Should we be proud that California landowners get subsidized from public works that add to their property value, without having to pay for it?

It looks like Californians will need an even bigger fiscal crisis before they realize that Buffett is right on. Go head on Warren Buffett, keep slaying that Proposition 13 fiscal vampire!

-- Fred Foldvary

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