OutLANDish TAXes?

by Pam Neary

published in the Summer, 1999 issue of the ***New Rules Journal***

Outraged voters, tight city budgets and intractable urban problems have all combined to encourage public and policymakers to explore alternative forms of taxation, especially a tax that could replace the vilified property tax. One of the "new" taxes under increasingly widespread examination is the land value tax--first proposed over 100 years ago by political economist Henry George. Can a land tax reduce sprawl and strengthen urban economies? The evidence is persuasive, but not conclusive, and many things have changed since 1879, when George published his famous book, ***Progress and Poverty***. Henry George lived in San Francisco during one of California's many land booms in the 1860s. During that time he observed that increasing poverty usually accompanied rapid economic growth, and a correlation existed between the increased wealth of landowners and the decreased wages of workers. He believed it was because land speculators withheld their holdings from productive activity in anticipation of greater returns in subsequent years, forcing the costs of production up and the level of wages down.

George's solution to this dilemma was simple yet revolutionary -- abolish all taxes except for a tax on land. This single tax would eliminate land speculation and thus make more land available for production. And by removing all other taxes, higher wages and lower prices would result, raising the standard of living for all. Because land is immobile and fixed in supply, owners cannot manipulate or hide their assets to avoid a tax. In contrast, a property tax on buildings offers abundant opportunities for manipulation. Tax theory predicts that people will alter their economic behaviors in response to taxation and history bears that out. Witness the unusual placement of houses in old Charleston, where city lots were taxed according to the length of their road frontage. Not surprisingly, it didn't take long to realize you could build a very nice mansion on a long, narrow lot and forego the road frontage. You can see the interesting effects of that tax policy today when you gaze at the lovely antebellum homes that line the streets of old Charleston. Nearly every home is situated so that the narrow end of the house faces the street and the long, porch-lined front extends along the side yard gardens of the typical deep and narrow Charleston city lot.

As James Howard Kunstler expressively describes some of the impacts of our current property tax system in Geography of Nowhere,

Our system of property taxes punishes anyone who puts up a decent building made of durable materials. It rewards those who let existing buildings go to hell. It favors speculators who sit on vacant or underutilized land in the hearts of our cities and towns. In doing so it creates an artificial scarcity of land on the free market, which drives up the price of land in general, and encourages ever more scattered development, i.e., suburban sprawl...

Is Georgist tax a remedy? The evidence is convincing that it should be an element in any comprehensive strategy. But a land tax in and of itself will not revitalize our central cities nor end urban sprawl.

How a Land Value Tax Works

Current property taxes are based on the value of property, reflecting both the land and structure value, as determined by local property assessors. Assessments are based on the sales of comparable property or, if commercial property, on revenue streams. Decisions to reinvest or remodel currently result in higher assessment valuations and thus higher taxes. Conversely, there is no penalty to undermaintain your property. In fact, if your property value goes down because you refuse to paint, maintain or upgrade your building, you are "rewarded" with reduced property taxes.

A Georgist land tax would not include the value of the structure and so the tax would not be applied to the individual efforts to improve the property. If entire neighborhoods were improved, over time land values would also rise, reflecting higher community amenities, and the tax would capture the collective efforts of the community at improving their properties. In this way, reinvestment would not be discouraged and property owners would be encouraged to maximize the use of their properties.

There is widespread disagreement as to what portion of property value is attributable to land. Current assessments capture both the public value (neighborhood amenities, public infrastructure, quality of schools, etc.) and the private value (quality and design of the building). Taxes are levied on the whole and there is no incentive to try and attach a true value to the land portion only. Because of this, the value of land as a percentage of overall property values varies widely between cities.

- In Minneapolis about 28 percent of value is land and 72 percent is structure.
- In Quebec municipalities, the land is worth about 47 percent, the structure 53 percent.
- In Pittsburgh, where they use a split rate tax on land and structures (see below), residential land is valued at only 20 percent of the total property value. These

wide differentials are not due to real value differences, but to different assessment practices.

- Land values should be determined by the value someone would be willing to pay for vacant land that could be used for similar purposes as those surrounding properties. In its simplest form, this would mean that cities could be mapped as gradients of land value, similar to a topographical map. The highest gradients would be where there are high public amenities or investments, such as transportation systems, parks and well-designed neighborhoods. These gradients would reflect the land values due to public investments and communal investments. Lots situated next to each other would have the same values regardless of whether used for office building or parking lot, apartment or single family home.
- Using any of the ratios from the examples given above, a land tax could significantly reduce the taxes on structures since the value of structures is relatively high when compared to the value of land. A land tax should be high enough to totally replace the revenues of the tax it replaces. The beneficial aspects of the land tax originate both from the characteristics inherent in the tax--neutral and nondistorting--and from the elimination of the negative characteristics of the tax that is replaced. Therefore if the land tax replaces the current property tax, one could expect to see more reinvestment and higher densities.
- **The Evidence**
- Only a handful of places in the United States tax land much more heavily than buildings. None has instituted a tax only on land, as advocated by Henry George.
- Pittsburgh, Pennsylvania, has used a 2-tiered tax since 1913, when the land portion of property value was taxed at a twice the rate of buildings. Largely because of the vested political interests at the time--steel company executives with large land holdings--the differential remained at this relatively low spread until 1979. By the 1970s steel had lost its clout and Pittsburgh was reeling from the economic fallout. In 1979, Pittsburgh decided to increase its land tax to nearly 5 times the rate on structures in order to induce reinvestment in the city. Today, Pittsburgh taxes land at $18.45 per $100 of the assessed valuation of land, and $3.20 per $100 of the assessed valuation of all buildings. On the other hand, neither Pittsburgh's school district nor Allegheny County uses the split rate tax on property, so the overall tax rate on land remains at about twice that of structures. Properties outside the city are subject to the usual property tax system in which land and structures are taxed at the same rate.
- Several researchers have tried to analyze the effects of the Pittsburgh policies. The results are somewhat inconclusive. Construction in Pittsburgh did make dramatic gains in the years following the 1979 tax change. During the decade

of the '80s, the value of Pittsburgh's building permits rose by over 70 percent relative to the two decades that preceded the tax reform. Other Rust Belt cities showed either static or declining construction activity in the same period.

- But it is hard to conclude that the land tax was a key cause of Pittsburgh's revived economy. Several major corporations decided to expand their headquarters in Pittsburgh and were offered public assistance to construct a series of major office complexes. Virtually all of the increased construction activity was in commercial and industrial buildings. Pittsburgh's residential construction barely moved in the '80s.
- Perhaps the differential between suburban property taxes and Pittsburgh land taxes induced at least some of the construction activity. Since land taxes have not been enacted on a regionwide or statewide basis, structures in Pittsburgh clearly receive beneficial treatment when compared to the surrounding communities. Some researchers believe that it is this differential that most influenced Pittsburgh's construction since 1979. Given that more expensive structures benefit the most from a land tax, it is perhaps not so surprising that commercial construction activity increased most noticeably.
- Many other cities in Pennsylvania have experimented with the split rate tax system, including Aliquippa, Carbondale, Clarion, Coatsville, Du Bois, Duquesne, Harrisburg, Hazleton, Lock Haven, McKeesport, New Castle, Oil City, Pittsburgh, Scranton, Titusville, Uniontown, and Washington. In 1998, Pennsylvania enacted Act 108, which permits the state's nearly 1,000 boroughs with a population of 2.5 million to implement split-rate property taxation.
- Studies of other Pennsylvania cities have been more supportive of the benefits of land value taxation:
- Stephen Cord compared Scranton and neighboring Wilkes-Barre, cities with nearly equal revenue per capita, as well as similar ethnic characteristics. In 1979, Scranton nearly doubled the tax rate on land and removed the property tax from new construction while Wilkes-Barre kept the standard flat-rate property tax. In the two years following the tax change, average annual building permits increased 22 percent in Scranton and decreased 44 percent in Wilkes-Barre from the three previous years.
- In 1980, McKeesport increased the tax rate on land, decreased the tax rate on buildings, and offered three-year tax abatements for new construction. Cord found that construction in McKeesport rose in 1980-81 relative to the preceding three years but fell in two neighboring cities that maintained the standard property tax.
- In an analysis by the Center for the Study of Economics, Washington, which adopted a graded tax in 1985 and expanded it throughout the next decade, compared favorably with the similar, neighboring Uniontown, which also adopted a graded tax but quickly rescinded the tax after one year. Average

annual construction per person over the 1987-1995 period was 23 percent higher in Washington.

- New Castle experienced a 70 percent increase in the number of building permits issued within a three-year period following its change to a graded tax. Neighboring towns retaining their flat rate experienced a 66 and 90 percent decrease.

Challenges for the land tax

Despite these fledgling successes, there are obstacles to implementing an effective land value tax. One is zoning, an urban planning tool introduced after Henry George's time. Zoning is important for thinking about property tax policy because zoning plays a major role in determining the value of land and buildings. Zoning is also subject to political manipulation, which means that speculative opportunities are difficult to eradicate from this process.

George advocated a universally applied land tax based on the value of land in its best economic use--as determined only by market forces. But market forces do not necessarily create the best communities. In Henry George's era, cities were organized around a central core with most of the public investment concentrated in a relatively small area. Land values were determined by locational benefits with land near the core being more valuable. But the value of the core has changed as the economy has changed and as public investments have become less centralized.

Freeways now roam through rural areas and skim by the edges of cities and towns. Without the restraint of zoning policies, there are many enhanced commercial opportunities and higher corresponding land values along freeways. But do we really want the seemingly unending commercial strips that would then result? Many cities are trying to battle wasteful urban sprawl by creating new town centers and neighborhood commercial zones, requiring businesses to locate where pedestrians and transit can easily access their services. The elimination of zoning would undermine these fledgling efforts and create less than desirable communities.

But zoning also creates the opportunity for speculative activity. A major reason for implementing a land value tax is to eliminate land speculation. It's a tension that land value tax proponents must attempt to resolve.

For example, at the fringes of most American cities, you will find farmers fighting to retain their agricultural zoning É until it's time to retire. At that point, many farmers determine that their land has "lost its agricultural productivity" and they petition for a

rezoning to residential or commercial uses, which will bring a higher selling price for the retiree. This process is a form of speculation that will be difficult to deter, even with a land tax, unless our local land use practices are also reformed.

Communities may choose to apply only parts of Henry George's theory, but that leaves one wondering whether the difficulty of enacting the change is worth the more limited benefits it would bring.

With a changing economy and unsolved public policy challenges, the time seems ripe for redefining our tax and revenue structures. The land tax, a concept new to some but with a dignified history, is worthy of revisiting. It clearly contributes to better equity than does the current property tax system. A land tax captures the value of public investments, but leaves the benefits of private activity in private hands. And in an ever more mobile economy, a fair but immobile tax with which to sustain our cities and towns will be an important factor in improving and maintaining the viability of our communities into the 21st century.

International Experience With Land Value Taxes

- In Denmark, as early as 1844, the national property tax was assessed on the value of the land but not the improvements on the land. The site-value property tax was abolished in 1903 and replaced with a flat rate on the total value of land and improvements. However, this tax change hurt the many small farmers in Denmark who had invested heavily in improvements but had limited holdings of land. These farmers joined together to lobby for a return to the site-value tax. Today, all cities in Denmark use a graded property tax. The effects of a graded tax on development have not been studied extensively in Denmark despite the widespread use of the graded tax because the proportion of overall revenues raised by the property tax has decreased with time.
- Prior to 1976, all of the states in Australia taxed property based on the value of the unimproved land. Today, all but the state of Tasmania continue with the land tax, although the revenue raised by the states is relatively small. Many local governments in Australia also use variants of the graded tax. Sydney, for example, began levying a tax on the unimproved value of land in 1916. Valuation of land is based on fair market value, which implies that it is based on the property's value in the highest potential use and not current use. This is in contrast to methods employed in the United States, where typically site value is assessed as the "land value proportion of the current market value of an improved property."
- From 1903 to 1913, Canada introduced site-value taxation in the western provinces in an effort to encourage the breakup of large areas of land held by absentee owners, to prevent land speculation, and to spur construction.

Assessments reflected the highest and best use of the land in question. Provinces have since turned over the property tax to the municipalities. Today, cities in the four western provinces either exempt improvements from the property tax base, or record the improvements on the assessment roll at a percentage of their full value.

RESOURCES:

Land Value Taxation: Can it and will it work today? Edited by Dick Netzer. Published by the Lincoln Institute of Land Policy, 1998