

DIRECTORS' PERSPECTIVES (CONT.)

CALIFORNIA VOTERS MAY OPT FOR VALUE CAPTURE TO SAVE TRANSIT FROM PANDEMIC

BY: MARK MOLLINEAUX

Addressing a conference on urban issues held in San Francisco, the British author and economist Barbara Ward (famous for several best-selling books on international equity and developmental economics) explained a key challenge afoot in the Bay Area. The year was 1967, and the locals were anticipating the launch of its ambitious regional subway, BART (Bay Area Rapid Transit).

"I have seen estimates that the windfall gain to property owners around the Bay Area Rapid Transit Scheme's thirty stations will be nearly a billion dollars," said Ward. Warning that, at a time in which America's urban areas were paying more in taxes than they were receiving in federal receipts, the region absolutely could not afford to see public investment seep out to private hands. Ward noted that the Erie Canal recouped much of its costs through taxes on the lands it enhanced, and said that the Bay Area could do much the same sort of value capture today. "Has the city the courage of the old builders of the Erie Canal?"

As it turned out, the city, and in fact the entire state of California, did not have this courage. Financing for BART fell mainly upon regressive sales taxes. (BART enacted a three-county sales tax regime that is now its second-largest source of revenue after fares. Other regional transit agencies, featuring more modest buses and light rail, got funded in a similar way: the Transportation Development Act of 1971 shared sales taxes on a statewide basis and became a pillar of transit revenues that lasts to this day.)

Meanwhile, as the 1970s stretched on, amidst worsening stagflation a homeowner-driven tax revolt resulted in enactment of Proposition 13 in 1978. By amending the California State Constitution to impose strict restrictions on ad valorem taxation, homeowners got what they wanted: reduced property tax obligations. Property tax is capped at

1% of the assessed value, which is frozen for each landowner; assessments cannot increase more than 2% each year. (Note that this isn't simply true for residential homeowners; all landowners received this subsidy.)

The impact was dramatic; by severing the direct means of recouping land value uplift, California kicked off cycles of ever-more expensive real estate with increasing austerity. School funding in California dropped from 7th-highest in the nation before Prop 13 to 41st by the mid-2010s. Transit agencies had to re-up on sales tax measures in order merely to preserve declining service frequencies.

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A TAX THAT BOOSTS THE ECONOMY

BY: VICTOR RAMIREZ



Like the iconic scene of Clint Eastwood in the Wild West facing two gunmen in a three-way duel and whoever shoots first is at a disadvantage, such is the nature of real estate construction. It is in each property owner's interest that some neighbor faces the risk of being the first to build, in order to then follow in his footsteps and reap greater benefits. However, if everyone waits for their neighbor, no one builds and everyone loses as the entire neighborhood stagnates and begins to deteriorate.

Speculative disuse is like a party where no one wants to be the first to dance and consequently the dance floor stays empty all night. The next day, guests comment, without realizing the irony, that the party was rather boring. (Cont. Page 6)



DIRECTORS' PERSPECTIVES (CONT.)

DEMOCRACY FAILS (CONT.)

Attempts to limit the role of the moneyed and landed interests have been unsuccessful. First, there is the clash between free speech and restrictions on campaign contributions. Second, since governmental representatives need campaign money, they will allow ways to overcome limitations, such as the use of political action committees, to indirectly support candidates. It is like building a dam to hold back a flood: gushing water will go over and around the dam.

Some propose that government would and should pay for political campaigns. But the prohibition of a candidate using one's own money for the campaign again clashes with free speech. Freedom of expression requires the freedom to use media to spread the message. Moreover, many taxpayers would object to being forced to finance negative and false advertising.

There is really no effective way to reform an inherently dysfunctional system. The remedy is small-group democracy, in which voting takes place only in a small group. But, how can millions of people be represented in small-group voting? By the method of multi-level, bottom-up voting.

Small-group voting is implemented by dividing the political body into tiny neighborhood cells, like the human body and biological cells. Hence, small-group voting has also been referred to as "cellular democracy." The cell is a geographical neighborhood of about 1000 persons. The residents elect a neighborhood council and an alternate. Suppose the neighborhoods are in a city of 100,000 persons. The 100 neighborhood councils each send a representative to the city council. A large city would be divided into districts of 100,000, whose councils then elect the city council. The city councils then elect a county council, which elects the state or provincial legislature, which then elects the national or federal congress or parliament. The national and state legislatures elect a president or governor.

An advantage of cellular democracy – small group, bottom-up, multi-level voting – is that it would be much easier to remove a representative or chief executive who performs poorly. The demand for campaign funds would disappear. And, the desires of the people would be much better represented.

Small-group voting would have a profound effect on government policy. For example, taxation would become decentralized. Income taxes, for example, enable the federal government to impose policies on the states in order for them to obtain federal funds. But, as political power would flow bottom-up, so too would revenues. Tax power would shift from the federal and state governments down to the counties that elect the higher-level governments.

The federal and state income taxes would likely be replaced by county-level property taxes, ideally tapping only the land value and not the value of buildings and other improvements. As they send representatives to the states, so too would counties send some of their tax funds to the state governments, and the states would send funds to the federal governments. Taxing power would follow the voting power.

This year, when so many Americans are worried about the integrity of the election, let's make this an opportunity to rethink our system of democracy. Back in 1789, when the Constitution was adopted, the population was much smaller, and most people were not allowed to vote. Now, with our much greater population and voting, mass democracy is ever more vulnerable to voter suppression, fraud, and postal manipulations.

When voting for your neighborhood council, there would only be paper ballots, and the counting would be done in public. It is now time for the movements for social justice to include decentralized voting as a major element of reform.

CALIFORNIA TRANSIT (CONT.)

Now, this election year of 2020 brings for the first time the opportunity to peel back these restrictions in the state Constitution. Prop 15 (the Schools and Communities First Initiative) is on the ballot this November, and if enacted will strip away a large amount of Prop 13's impact: assessments will be restored to current fair-market value for all commercial landowners. The initiative, pushed by a coalition of public employee and teacher unions, would create dedicated pipelines to restore this revenue (overall on the scale of \$10 billion/year) to school districts, transit agencies, and other sources of public infrastructure.

And it couldn't have come at a more necessary time: the pandemic of 2020 has been devastating to transit. Declines in ridership of 90% or more have been seen on the commuter-heavy lines. For agencies such as BART, funded 65% by fares, the shortfalls have been enormous: a projection of \$78 million decrease in revenues in 2020, \$177 million decrease in 2021. And the picture is even more alarming for transit that serves a lower-income clientele: Alameda County's AC Transit, serving Oakland and other disadvantaged communities, is experiencing budget shortfalls that are, in the absence of new revenue sources, going to force the agency to close 30% of its current service capacity, hurting those who can least afford it. This goes hand-in-hand with a struggle to pay for critical supplies to make each trip safer: masks and sanitizer.

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DIRECTORS' PERSPECTIVES (CONT.)

CALIFORNIA TRANSIT (CONT.)

California's transit woes are a reflection of how different tax policies result in different levels of robustness in this pandemic. Sales tax revenue is expected to decline statewide by 30%, whereas property tax is expected to be robust even in the face of a pandemic.

Interestingly, clawing back value capture from Prop 13 via constitutional amendment isn't the only way that California has to restore value capture. Even though ad valorem taxes are restricted and gummed-up, there are certain workarounds that allow some more imperfect methods of recapture. Parcel taxes are common: a flat rate imposed on all parcels, this smooths things out unduly, but in a situation where every parcel in a city has benefited from public investment (generally the case in the Bay Area, where median home prices north of \$1 million are the norm), it can be a reasonable approximation. Special districts, Mello-Roos, can be set up with special property tax provisions for additional community facilities, but they don't scale. A more interesting opportunity, however, is being explored with Land Value Increment Taxation districts.

Such a district would impose a progressive capital gains tax on real estate sales within a Transit Value Capture District, which could be defined as a radius from a fixed-rail station or high-frequency bus stop, of 0.25 to 1 mile.

TAX BOOST ECONOMY (CONT.)

Property owners are not the only ones that lose from this disuse. In Puerto Rico, there is a chronic housing problem. According to the Census, houses cost twice what they cost in the United States when you consider family income level. At the same time, one in five homes is vacant, a larger share than any state, except Maine.

Meanwhile our traditional urban centers, stewards of our historical heritage, are dying even with tax incentives. Families are increasingly forced to live in distant suburbs, burdened by congestion, often devoid of public services and infrastructure, or susceptible to landslides or floods.

There is a type of tax that breaks the vicious circle of speculative disuse – the real estate tax on the value of the land. It is very similar to the CRIM property tax, but buildings or other improvements are exempt. When an owner builds a house, they are not penalized in their tax bill. Similarly, whoever demolishes a building is not rewarded with a reduced bill. Applying a tax on buildings makes the same sense as if a condominium increased the maintenance due to the owner who remodeled his kitchen.

It should be noted that the tax rate would apply not to the acreage of land, but rather to its market value. A square foot of beachfront in Condado is worth more than an acre of

The imperfection would be that imputed rents would be left alone, and value recaptured only upon each sale, but in the long run, this offers some interesting potential. The regional transit planning organization for the Bay Area, MTC, listed LVIT (which they dubbed a "windfall tax") as a potential source for future revenue, as part of its recent housing study.

Even if it's decades removed from Barbara Ward's original warnings, it's reassuring to see transit officials now exploring the potential of value capture. As BART director Rebecca Saltzman recently noted on Twitter, "During BART Board discussion on a second Transbay Crossing I raised the issue of huge economic activity and wealth that would be generated by this investment. I asked staff to study how BART and the public could recapture some of this for operations and maintenance, and they will. If BART had captured a small portion of the massive amount of wealth generated by the first Transbay Tube, that could have funded BART operations ongoing. Fares could be much cheaper. We would not be playing catch up on infrastructure investment. We can't let this opportunity pass again."

rugged terrain in Maricao. Additionally, for the vast majority of property owners, buildings and improvements are worth more than their land, which means that they would have to pay less than what is paid with a tax on the entire property.

In basketball rules, there is a countdown to prevent the team in advantage from running the clock. Similarly, a tax on land value makes disuse a costly liability and thus serves as a countdown to bite the bullet and make a real investment in a property. Owners would be obliged to use their properties to cover the tax liability or sell it to someone else who is will. In order to use properties, investment, construction, repairs, and therefore more jobs are needed.

In the late 1970s, the city of Pittsburgh, mired in a process of deindustrialization not unlike Puerto Rico, opted for this type of tax. The effect was a construction boom, evidenced by a 3-fold increase in construction permits. Even today, Pittsburgh can boast about having some the most affordable housing in the United States.

Beyond a possible construction boom, homeowners benefit from this type of tax because it serves as an insurance policy against the risk that a neighbor's property will be disused and perhaps end up as an illegal dump.

A question to ponder: If there are taxes that drive the economy, why do we have taxes that depress it?