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Pennsylvania's Success with Local Property Tax Reform:

The Split Rate Tax

By ALANNA HARTZOK*

ABSTRACT. Fifteen cities in Pennsylvania are pioneering an innovative approach to local *tax reform* that harnesses market incentives for *urban renewal.*

Opting for the so-called "two-rate" or "split-rate" *property tax,* these cities are lowering taxes on buildings, thereby encouraging improvements and *renovations,* while raising the tax on land values, thus discouraging land *speculation.* The resulting infill development as indicated by increased *building permits* means downtown *jobs,* efficient use of urban infrastructure, an improved *housing* stock, and less *urban sprawl.*

Cities in other states are poised to follow Pennsylvania's example.

I

Pennsylvania's Initiative

PENNSYLVANIA has been experimenting with a new approach to property tax reform which has already begun to attract attention in New York, Maryland, and other states. This policy offers an entirely different angle to the current mainstream dialogue on property tax "reform" which consists mainly of efforts to reduce and curtail the use of property taxes while increasing sales or income taxes.

The property tax is actually two types of taxes, one upon building values, and the other upon land values. This distinction is an important one, as these two types of taxes have significantly different impacts on incentive motives and development results.

Pennsylvania's pioneering approach to property tax reform recognizes this im-

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This invited article evolved out of her talk at the November 2–4, 1995 conference on "Land, Wealth, and Poverty" held at the Jerome Levy Economics Institute of Bard College, Annandale-on-Hudson, NY. The kindness of the Director of the Institute, Dimitri B. Papadimitriou in allowing this reproduction and of Professor Kris Feder for helping to organize the Conference is acknowledged.

A subsequent version of this paper since it contains a brief elaboration of the earth trusteeship concepts of John McConnell, Earth Day Founder, credits him as a co-author.

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portant distinction between land and building values through what is now known as the split-rate or two-tier property tax. The tax is decreased on buildings, thereby giving property owners the incentive to build and to maintain and improve their properties, and the levy on land values is increased, thus discouraging land speculation and encouraging infill development. This shifting of the tax burden promotes a more efficient use of urban infrastructure (such as roads and sewers), decreases the pressure towards urban sprawl, and assures a broader spread of the benefits of development to the community as a whole.

Taxing land values, while decreasing taxes on buildings, is sometimes proclaimed as a way to increase development. In today's world the word "development" is likely to be a red flag to many ears. However, it is important to keep in mind that the purpose of this policy is not first and foremost to encourage development, but rather to assure that the benefits of development be broadly shared while impacting as lightly as possible on existing ecosystems.

Current mainstream development models and methods in most cases contribute to the maldistribution of wealth. Statistics show that the richest 1% of Americans possess greater wealth than the bottom 90%.[1] The land value tax, in essence a type of user fee for access to limited natural resources, is a policy that both harnesses market incentives and individual initiative and furthers social cohesion and well-being by narrowing the rich/poor gap. There is even greater need to make this point now, when the direction is towards cutbacks in many social services, the removal of the bandages placed to hold back the hemorrhage of the body politic. Better tax policy could reduce the need for social services provided via government spending.

Land value taxation was a key policy recommendation made by the Committee on Banking, Finance and Urban Affairs of the House of Representatives, 96th Congress whose groundbreaking report was entitled "Compact Cities: Energy Saving Strategies for the Eighties."

Land value based public finance policies encourage home improvements and affordable housing. In Pennsylvania 85% of homeowners pay less with this policy than they do with the traditional flatrate approach. For those who do pay more, it is not significantly more and they tend to be wealthier homeowners who can better afford to pay a little more. Some, indeed, whose business efforts are encouraged by this policy, come out ahead.

II

The Current Situation in Pennsylvania

FIFTEEN PENNSYLVANIA CITIES (Table 1) now use the two-rate approach. Pittsburgh and Scranton implemented this policy as far back as 1913. Since then enabling

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Table 1

TWO-RATE PENNSYLVANIA CITIES AS OF 1995

Two-Rate since date	Land tax rate %	Bldg tax rate %	One -rate %[a]	% of tax on land	Removed from Bldgs in $000's	Population
Aliquippa schools '93	16.3	1.1	4.4	85.5	2,115	13,374
Aliquippa '88	7.9	0.7	2.3	75.9	1,001	13,374
Clairton '89	10.0	2.1	3.7	53.7	300	9,656
Coatesville '91	5.2	2.5	3.0	33.9	70	11,038
Connellsville '92	11.3	1.7	3.0	50.1	384	9,229
DuBois '91	5.1	1.3	1.9	43.9	31	8,286
Duquesne '85	8.0	3.8	4.6	34.0	134	8,845
Harrisburg '75	3.2	1.1	1.4	36.0	2,533	52,376
Lock Haven '91	3.1	1.	1.7	61.8	117	9,230
McKeesport '80	10.0	1.9	3.6	59.0	865	26,016
New Castle '82	8.7	2.2	3.4	46.6	1,192	28,334
Oil City '89	8.5	2.7	3.8	42.5	478	11,949
Pittsburgh '13[b]	18.4	3.2	6.1	57.4	73,739	369,379
Scranton '13[b]	6.6	1.2	2.6	65.9	3,997	81,805
Titusville '90	61.3	1.5	2.0	32.9	308	6,434
Washington '85	17.7	1.8	4.8	70.4	1,495	15,791

Total amount of taxes removed from buildings: $88,767,010

[a]One-Rate refers to the tax rate if there were no rate differentiation between land and buildings with the tax yield unchanged.
[b]Scranton and Pittsburgh had a land tax to building tax ratio of 2 to 1 from 1913 until 1979 when both cities expanded land tax rates beyond that ratio.
Please note: PA property tax rates are expressed in mills, e.g. Aliquippa: 16.3% = 163 mills
Source: Center for the Study of Economics, 2000 Century Plaza, Suite 238, Columbia, MD, 21044

legislation was passed which gave this option to third class cities as well. Land value tax policy in Pennsylvania really took off in the 1980's through the "Johnny Appleseed" work of Steven Cord, formerly a professor at Indiana University in Pennsylvania, now director of the Center for the Study of Economics in Columbia, Maryland.

In 1993, legislation sponsored by state representative Sue Laughlin extended the two-rate option to school districts of the third class that had coterminous boundaries with third class cities. Although only eight school districts met this qualification, it was a beginning. Currently, HB 2093, sponsored by Representative Ronald Buxton, would extend the two-rate tax option to all school districts.

In addition to this school district bill there are six other bills in the Pennsylvania State Legislature which would further extend the two-rate tax option. Twin bills in both the House and Senate would give the two-rate tax policy choice to the nearly 1000 boroughs of the state. Their total population is two-and-a-half million.

Bills, which are part of Representative Joseph Gladeck's enterprise package, extend the option to first and second class townships and cities of the first class (which applies only to Philadelphia). His "Tax Free Development Zone Act" (HB 1256) recommends that municipalities wishing to designate an area as a tax free zone use the split-rate tax as well.

Among the cities that have gone to the two-rate system there is a considerable spread between the taxes on the value of land and those on the value of buildings.

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Table 2

LAND TO BUILDING TAX RATIOS IN PENNSYLVANIA CITIES USING THE TWO-RATE TAX

Cities	Tax Ratio in 1996
Pittsburgh	5.61 to 1
Scranton	3.90 to 1
Harrisburg	4.00 to 1
McKeesport	4.00 to 1
New Castle	1.75 to 1
Washington	4.35 to 1
Duquesne	5.61 to 1
Aliquippa	16.20 to 1
Clairton	4.76 to 1
Oil City	1.23 to 1
Titusville	8.68 to 1

For instance, the small city of Aliquippa, which led the way towards the two-rate option for school districts, taxes land 16 times more heavily than buildings. Titusville's tax rate on land is nearly 9 to 1, while Harrisburg's ratio which has been 3 to 1, will soon change to 4 to 1.

III

Some Data on Consequences

LET US NOW CONSIDER how this has worked in Pittsburgh and Harrisburg in particular. Pittsburgh has the longest history of use of this approach which dates back to 1913. This city has extended its land value tax since that time so that now land values are taxed six times more heavily than are building values.

Pittsburgh has a more compact development pattern than many cities, with the big buildings concentrated in the downtown area, not sprawled across the land as is the case in so many cities where land speculation forces "leapfrog" development. Pittsburgh was highlighted in a *Fortune* magazine story (8/8/83) entitled "Higher Taxes that Promote Development." Research conducted by *Fortune's* real estate editor on the first four cities to go to the two-rate system independently verified that this approach does, indeed, encourage economic regeneration in the urban centers.

A recent study (Table 3) by University of Maryland economists, Wallace Oates and Robert Schwab, compared average annual building permit values in Pittsburgh and 14 other eastern cities during the decade before, and the decade after, Pittsburgh greatly expanded its two-rate tax. Pittsburgh had a 70.4% increase in the value of building permits while the 15 city average decreased by 14.4%. These findings about Pittsburgh's far superior showing are especially remarkable when it is recalled that this city's traditional basic industry—steel—was undergoing a severe crisis throughout the latter decade.

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Table 3

AVERAGE ANNUAL VALUE OF BUILDING PERMITS
(THOUSANDS OF CONSTANT 1982 DOLLARS)

City	1960-79	1980-89	% Change
Pittsburgh	181,734	309,727	+70.4
Akron	134,026	87,907	-34.4
Allentown	48,124	28,801	-40.2
Buffalo	93,749	82,930	-11.5
Canton	40,235	24,251	-39.7
Cincinnati	318,248	231,561	-27.2
Cleveland	329,511	224,587	-31.8
Columbus	456,580	527,026	+15.4
Dayton	107,798	92,249	-14.4
Detroit	368,894	277,783	-24.7
Erie	48,353	22,761	-52.9
Rochester	118,726	82,411	-30.6
Syracuse	94,503	53,673	-43.2
Toledo	138,384	93,495	-32.4
Youngstown	33,688	11,120	-67.0
Average of the 15 cities	167,503	143,352	-14.4

Source: "The Impact of Urban Land Taxation: The Pittsburgh Experience," by Wallace E. Oates and Robert M. Schwab, forthcoming (March 1997) *The National Tax Journal*

Research based on building permits issued in the three-year period before and after the implementation of the two-rate tax policy in Pennsylvania cities consistently shows significant increases in building permits issued after the policy was put in place.

Pennsylvania is a pioneer leading the way and this is being increasingly acknowledged. A *Wall Street Journal* article (3/12/85) was entitled "It's the Land Tax, by George, That Sets Pennsylvania Apart." (The reference is to Henry George who drew great public attention to these possibilities a long time ago.)

Recently the headline of an article in *The Washington Post* (9/24/95) simply stated "D.C. Should Learn From Pittsburgh." Stories in the *Philadelphia Inquirer* (6/5/95) and the *Philadelphia Weekly* (7/19/95) urged the adoption of land value tax policy. The *Herald Mail* announced (10/8/95) "Hagerstown Council to Consider Split Tax Rate." This is a just a small sampling of the rapid increase in media attention to this policy.

To turn now to Harrisburg which was once considered one of the most distressed cities in the nation. Harrisburg since 1982 has sustained an economic resurgence that has garnered national acclaim. It twice won the top United States community honor as All-American City, along with the top state recognition from the state Chamber of Business and Industry as Outstanding Community in Pennsylvania, all because of Harrisburg's development initiatives and progress.

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Harrisburg taxes land values three times more than building values. This city's glossy promotional magazine points to its 2/3 lower property tax millage on improvements than on land as one reason why businesses should locate there.

Mayor Stephen Reed of Harrisburg sent the following letter to Patrick Toomey, businessman, civic activist, and member of the Home Rule Commission of Allentown (10/5/94):

> The City of Harrisburg continues in the view that a land value taxation system, which places a much higher tax rate on land than on improvements, is an important incentive for the highest and best use of land in already developed communities, such as cities.
>
> In our central business district, for example, our two-tiered tax rate policy has specifically encouraged vertical development, meaning highrise construction, as opposed to lowrise or horizontal development that seems to permeate suburban communities and which utilizes much more land than is necessary.
>
> With over 90% of the property owners in the City of Harrisburg, the two-tiered tax rate system actually saves money over what would otherwise be a single tax sytem that is currently in use in nearly all municipalities in Pennsylvania.
>
> We therefore continue to regard the two-tiered tax rate system as an important ingredient in our overall economic development activities.
>
> I should note that the City of Harrisburg was considered the second most distressed in the United States twelve years ago under the Federal distress criteria. Since then, over $1.2 billion in new investment has occurred here, reversing nearly three decades of very serious previous decline. None of this happened by accident and a variety of economic development initiatives and policies were created and utilized. The two-rate system has been and continues to be one of the key local policies that has been factored into this initial economic success here.

Here are a few of the improvements mentioned in the Harrisburg promotional literature[2]:

- The number of vacant structures, over 4200 in 1982, is today less than 500.
- With a resident population of 53,000, today there are 4,700 more city residents employed than in 1982.
- The crime rate has dropped 22.5% since 1981.
- The fire rate has dropped 51% since 1982.

These results are especially noteworthy when one considers the fact that 41% of the land and buildings of Harrisburg cannot be taxed by the city because it is owned by the state or non-profit bodies.

IV

Maryland and Beyond

Recent developments in the state of Maryland are very interesting. Enabling legislation for the two-rate policy was vetoed by the Governor in April 1994. Immediately following the veto the Henry George Foundation of America, based in Columbia,

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began to research the history of the property tax in Maryland. The HGFA suspected the existence of an earlier law permitting municipalities the two-rate tax option. After weeks of law library research HGFA found in the 1994 Annotated Code of Maryland a 1916 law that had gone through several permutations. This research indicated that Maryland municipalities could go to the two-rate system.

The Attorney General of the state of Maryland was asked for an opinion and on January 25, 1995 issued Opinion #95-002 which confirmed the authority of municipalities (with the exception of Baltimore) to set differential property tax rates.

The small town of North Beach will probably go to the two-rate system next April, and Hyattsville may soon follow. Mayor Steven Sager of Hagerstown, which has only 35% home ownership, is urging his city council to move in this direction.

Joshua Vincent of the HGFA reports that the buildings to land ratios in Maryland are "more professional, less politicized. There is no distortion of residential assessments such as that existing in Pennsylvania. As a result, upper and upper-middle class homeowners pay their fair share but the poor and the working class get a real break."

No doubt Pennsylvania could be learning more about accurate assessment practices from Maryland while Maryland is learning how best to implement the two-rate tax system based on Pennsylvania's successful experiences so far. But interest is being shown in other states and cities as well.

Last February assessments expert Ted Gwartney, Walter Rybeck of the Center for Public Dialog, and this paper's author were asked by West Virginia Delegate, Bruce Petersen, to speak to the State House of Delegates about Pennsylvania's land value tax. Delegate Petersen is writing enabling legislation for land value taxation for West Virginia.

The mayors of Wheeling and Cincinnatti have stated that they would like to move their local public finance in this direction. The City of Amsterdam in New York has recently received permission to implement the two-rate tax policy and will serve as a pilot project for that state.

Detailed studies on the effects of the two-rate policy have been conducted for Washington, DC, St. Louis, Missouri, and the state of Washington. There are groups actively supporting this policy in these places as well as in nearly every state in the United States and numerous other countries as well.

V

The Art of Tax Improvement

WHILE MUCH HAS BEEN LEARNED about the succesful use of land value based local public finance in Pennsylvania, mistakes have been made. For instance, the City of Uniontown reverted back to the flat rate system after an initial experience with the

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two-rate approach. What happened in Uniontown? Here the two-rate shift was combined with an overall tax increase the same year. A handful of irate community residents equated the two-rate policy with the tax increase and had it rescinded.

There is a lesson here in the "art of tax improvement." It is necessary to move to the two-rate system while maintaining a revenue neutral tax base, at least initially. Another key is to move gradually. One generally accepted guildeline is to shift no more than 20% of the taxes off buildings and onto land each year for a period of five years, or 10% each year for a period of ten years, in order to fully shift all taxes off buildings and onto land values.

Such a gradual transition, combined with community education, allows the citizenry to make the adjustments required, particularly to orient away from expectations of speculative gain in real estate land price escalation and towards investment in the development of affordable housing and business activities. Obviously, as buildings are taxed less their value might rise, while the value of the more heavily taxed land should fall. While more research of these types of effects is needed it would appear from the long continuation of this tax policy in areas that have tried it that it meets with voter approval.

VI

The Need For The Public To Be Informed

WITH THE MANY POSITIVE RESULTS of this policy in Pennsylvania, why have only 15 cities implemented it, when 50 cities could do so? Why is the main thrust and public discussion focused there as elsewhere on reducing reliance on property taxes and giving local municipalities options to levy sales and income taxes?

The truth is that the word has just simply not gotten out. The success so far has come from the persistent efforts of just a handful of devoted activists who have educated city council members and urged them to adopt this policy.

But the majority of state legislators, public officials, community leaders, and the public at large remain, for the most part, in the dark. This does appear to be gradually changing in the legislature though because of the several current land value tax bills already mentioned. Both the Pennsylvania League of Cities and Municipalities and the State Association of Boroughs have professional lobbyists following these bills.

Unfortunately at this time, few professors in economics or government at the university level introduce their students to this policy. Indeed this macroeconomics approach has been taught not by mainstream academic institutions but for the most part by the devoted teachers who volunteer their time at the Henry George School of Social Science, headquartered in New York with branches in Philadelphia, Chi-

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cago, San Francisco, Los Angeles, and Santo Domingo, and by the important work of the Robert Schalkenbach Foundation, also in New York city.

There is a great need for institutions like the Jerome Levy Economics Institute to come to the fore of enlightened economic education and to teach their students about public finance policies that further freemarket incentives while at the same time narrowing the gap between the rich and the poor.

I feel a great deal of appreciation for the Jerome Levy Economics Institute for sponsoring this "Land, Wealth, and Poverty" conference.

Notes

1. David Kotz, "How Many Billionaires Are Enough?" *New York Times,* 19 October, 1986
2. "Harrisburg—An Economic Profile" available at the City Government Center, 10 N. Second Street, Harrisburg, PA 17101-1678, Tel. 717-255-3040

Worth Comes to Land

NEW YORK CITY based *Worth* magazine in its commendable February 1997, issue enlisted the aid of three talented writers to discover the latest facts, figures, and anecdotal memories about land ownership in America. Author William P. Barrett reports that "taken as a group, with number one owning 1.3 million acres and number 100 owning 95,000, [the top 100 landowners] hold more than 1 percent of the country, a landmass the size of Kentucky" (p. 78). Most of the mega-estates are in the western states. For the record book, R. E. "Ted" Turner of Roswell, Georgia holds the record for America with 1.15 million acres in New Mexico. Also named is the Koch family with 220,000 acres spread over Texas, Kansas, and Montana. Their $20 billion Koch Industries—one of the largest privately owned businesses in the United States—has helped Mr. Charles Koch actively support academic research including work on the philosophical foundations of a free society.

A well defined personal philosophy about land ownership seems to motivate many modern-day land barons as well as scores of mini-imitators who own a place in the forest and another by the shore. That philosophy is explained by writer Richard Todd in an article appropiately entitled "The Guardian" (pp. 90–95). Todd explained how those nascent landowners who crave to be guardians-over-the-land typically agree with Henry George who argued in *Progress and Poverty* that "land is the source of all wealth." Interestingly, guardians read George selectively because, as Todd admitted, "we tend not to agree with his corollary, that government should therefore raise its revenues from a tax on landholdings alone" (p. 92). Guardians need to have dominion over their surroundings and frequently will veer toward

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