

The Taxable Capacity of Land

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The question I am assigned is whether the taxable capacity of land without buildings is up to the job of financing cities, counties, and schools. Will the revenue be enough? The answer is "yes."

The universal state and local revenue problem today is whether we must cap tax rates to avoid driving business away. It is exemplified by Governor Pete Wilson of the suffering State of California. He keeps repeating we must make a hard choice: cut taxes and public services, or drive out business and jobs. (When a public figure gives you two choices, you know they're both bad, and he wants one of them.)

The unique, remarkable quality of a property tax based on land ex⁽¹⁾ buildings is that you may raise the rate with no fear of driving away business, construction, people, jobs, or capital! You certainly will not drive away the land. However high the tax rate, not one square foot of it will put on track shoes and run out of town. The only bad thing to say about this tax's incentive effects is that it stimulates revitalization, and makes jobs. If some people think that is bad, maybe this attitude is the problem.

That is the answer to Governor Wilson. I hope that here in The Empire State you will supply a practical demonstration of the answer, one that we may then use to inspire The Golden State. California now, following Proposition 13, has become a morality play, a gruesome object lesson in what happens when the property tax is pushed down toward zero. It forces higher taxes on production and exchange. Non-property taxes, you know, mostly have the character that they "shoot anything that moves," penalizing and discouraging economic activity. New buildings gain by having a lower property tax burden, it is true; but they bear the brunt of these new taxes and impost fees up front, at

(1) exempting

the time they are built. These offset the benefits of their lower property tax rate.

Most California land, on the other hand, is now taxed at well below the allowable max of 1%. Speculators may sit on it at little tax cost, however many highways and water and sewer lines run to and past it, however many policemen are guarding it from trespass. Little wonder that California enterprise, once so dynamic, flexible, and vital, is giving way to stasis and decay. We used to lead the nation in making jobs; now in losing them. We used to lead in schooling; now in jail population. When you tax land, the market moves its owners to join it with labor and capital as a vehicle for enterprise or shelter. When you untax it, the market moves its owners to hold it more passively and obstructively as a "store of value." The market not only moves the sitting owners, it moves ownership itself to new owners whose needs are compatible with the tax system you impose.

The property tax, rather than "shoot anything that moves," is a charge on inactivity. It taxes both lands and buildings on their market value, regardless of how they are used. "Hold on," you might say, "how about the very activity of constructing those buildings?" Yes, touché, the property tax does shoot at that, and shoot hard. However, that is why we are here today, to consider modifying the tax to exempt buildings. The proposal is to make it a tax mainly, or even purely, on "land ex buildings," a tax on inactivity, a tax just for sitting on a piece carved from the nation's fixed, limited land supply.

"Hold on again," I have heard, "how much revenue can land yield by itself?" It is my job to address that. I assure you it can yield more than local governments need. I have already pointed out you can raise the rate to any level without fear of driving away jobs, capital, people, or building. That is a remarkable quality in a tax, especially one as progressive as the land tax. I will also support the point in several other ways.

The taxable capacity of land is camouflaged by a consistent tendency to underassess it, relative to buildings. There are several reasons this happens, but today we just need to know the fact: it happens. There are several studies in point. The most general one is the quinquennial Report of the U.S. Census of Governments. It actually understates the tendency a lot, by

omitting the class of land most underassessed, that is, raw acreage in and near cities.

There is great latitude in the assessment process. This latitude is now used to lower the fraction of the property tax base that is listed as land value, and raise the fraction that is listed as building value. It could just as well be used the other way, and used to be in many cities, whenever assessors were getting that message through the election returns. This would have roughly the same effect as going to a two-rate system on a more formal basis - except, obviously, that the formal basis is more permanent, reliable, and generally respectable.

I have here data I worked up in Milwaukee in 1965 indicating that, if land were assessed correctly, the land fraction of the real estate tax base would be over twice what the City Assessor reported. His fraction was 31%; it should have been 70%.

How does one come to so startling a finding? Wisconsin is not a backward state. It prides itself on the high quality of its public administration. What I did was study sites on the eve of demolition. When you buy an old junker to tear down and replace with a new building, you (the market) are obviously recognizing that the building has no residual value.¹ All the value is then in the land. However, in Milwaukee in 1965 the Assessor was saying the building was worth about three times as much as the land, just before tear-down. That is a good way to measure to what extent land is underassessed.

Try that in Manhattan. When the visitor first ogles its skyline from afar, it looks like one big modern high-rise. If you poke around on foot much, though, you soon realize those are the exception. Most of the lots are covered with obsolete junk, commanding rents mainly for their location value. Check the Empire State Building. Old as it is, it is still nearly the tallest building in the world. As to its site, it is in a so-so reach of 5th Avenue (34th Street), many blocks from the 100% location (57th Street, I would guess). Even so, when the site and the building sold in separate transactions a few years ago,

¹Sometimes the junker remains physically sound, but suffers from obsolescence, especially from locational obsolescence. Economically it is the same, a loss of value.

the site represented 1/3 of the total value. What does that say about the land fraction on neighboring parcels, covered only with the remains of ordinary old structures? What does that say about the land fraction nearer the 100% location?

Besides that, exempting buildings from the property tax will raise the value of the land that goes with them. When you exempt buildings and uptax land, you are still taxing the same parcel of real estate, you are just taxing it in a different way. What you don't get from the building you can now get from the land, whose taxable capacity is enhanced by your exempting the building, and all potential future buildings, on the parcel. The process of arbitrage, the higgling of the land market, should make the land value rise by about the amount of the discounted present value of the building taxes abated.

How much is that? Take a property tax rate at 2% of the market value of a new building. Over fifty years, tax payments add up to 100% of the original value. That's a lot. To be sure, we must correct for the "time value of money," and discount those future payments to the present. We must adjust for the anticipated drop in the building assessment after 20 years or so. Doing so brings that 100% down to about 30%, more or less, depending on your discount rate. Thus, the impact of a 2% property tax on a new structure is about the same as a 30% building permit fee levied once, at the time of building. Ouch! Now, remove that tax threat, and buyers will be willing, if they must, to bid that much more for the land underneath. If they must? They must: competition and arbitrage see to that. Land is fixed, but Capital flows like liquid or gas. It abhors a vacuum, and moves quickly into new chances. To seize this one, the investor must bid for land in the subject jurisdiction. Collectively they bid land up, fortifying your land tax base.

"What, then, has changed?", you might ask. It's a fair question. What's changed is that your property tax is no longer biased against renewal, against replacement of old by new. Neither is it biased against full development of the economic capacity of each site. All the ground rents that are now aborted by deferral of renewal, and by underdevelopment, will be generated by new, full development. Land prices, your new tax base, will be pushed up just by the expectation of new buildings' being tax free. The mere expectation will immediately boost the

value of land, your new city tax base, even before the new buildings go up.

For example, Pittsburgh in 1980 downtaxed its buildings and uptaxed its land, and is fiscally very sound, much moreso than bleeding California. It is raising revenue and also attracting capital: a nice combination. At the very same time the Mayor of desperate Philadelphia, clueless and unavailing, is telling the world he cannot raise taxes because everyone would leave the city! You can peer south across the line better than he, apparently, can look west in his own state. You, by observing and thinking, can benefit from Pittsburgh's example, and Philadelphia's folly.

"How about corporate stock?", I hear. "Should we exempt corporate wealth from the property tax?" Actually, almost all jurisdictions already do, along with other "intangible" property. Not to worry, however, you tax corporate assets: corporations are the major landowners in most jurisdictions. When you rank property owners by value of holdings, the top ten on most tax rolls are all corporations. None of their fancy multi-national profit-shifting through layered ownership of foreign subs, and phony transfer pricing, can camouflage or hide their taxable property on your assessor's maps. This makes sense anyway. Why should you think you can tax a corporation for its business in Malaysia? What concerns you is its property in your home town.

"Wait another minute," I hear. "Some corporations build auto plants in cow pastures, with a high fraction of building value. If you exempt buildings, you let them off easy." There are cases in point, I concede, like the blue-collar industrial suburbs of Cudahy and South Milwaukee, Wisconsin. Probably you could have said that in Amsterdam, N.Y., when the rug industry was thriving there. Amsterdam's fate, however, draws a moral about that. An industry that depends on your land, your location, is likely to stay put; but an industry that brings in most of its own assets, in the form of capital, is mobile. What it brought in it can take out.

"Take out buildings? Be serious!" you may say. Buildings look rooted to the spot, but that is illusory: those roots are temporary. Buildings depreciate. They may be milked through undermaintenance, and the capital consumption allowances (CCAs)

reinvested elsewhere. After a few years the plant is an empty shell. They close it, flat-bed the equipment, and silently steal away. If they really need nothing but a cow pasture, they can find ten thousand others, anywhere, and reinvest their CCAs there. You are wise not to tax such plants out of town. You need them, but they can take their capital to greener pastures. Capital is mobile, both coming and going. Only land stays put.

In other cases, industries occupy land of high value that is wrongly assessed low simply because industry occupies it, and it has not been subdivided. What has subdivision to do with it? The bias of assessors is to value industrial "acreage" low, relative to improved "lots," even though they lie cheek by jowl. It is a kind of wholesale discount for owners of "raw" (undivided) tracts.

For example, in West Allis, Wisconsin, the southwest corner of the Allis-Chalmers plant occupies the northeast corner of the 100% location, the most valuable commercial site in town. That land, with the same retail potential as the other three corners, is assessed as raw industrial acreage, as though it were in the boonies, with no recognition of its high location value for retail/office use. To make a land tax work, the assessor must be instructed to value that land at its highest and best use rather than as ordinary raw acreage. Exempting buildings would create the necessary pressure, thus solving the very problem that otherwise might be taken as a point against it. As noted earlier, the U.S. Census of Governments gives us no data on this point. You, however, can find it easily enough: tax assessments are public records, and you know your own town.

"Corporate" is not coterminous with "industrial," anyway. Many corporations are in retailing. They own chain stores, malls, gasoline stations, auto dealerships, major real estate "developments," drive-ins, office space, department stores, banks, "power centers," etc. As to these, shifting to the land basis will shift more of the tax burden to them, because retailing has a higher land fraction than any other major land use (except vacant, golf courses, cemeteries, parking lots, etc.). That is because location is more critical to retailers than other businesses. You can tell this by their high rate of tear-downs and remodeling.

Among its other effects, site-value taxation will induce some land to shift from retail to industrial use. Recall that exempting the building, or prospective building, lets buyers bid more for land. The higher the building fraction, the stronger is that force. Thus the present system, which is biased against buildings generally, is biased against industrial compared with retail uses. Removing that bias will help industry outbid retail for land - not all land, of course, but land on the tipping point between the uses. Most towns today seem oversupplied with retailers, compared with their shortage of basic industries. Shifting to the site-value basis of property taxation helps redress that balance.

"Let the market decide," some say. "No good can come from forcing land into use, against the owner's private judgment." Actually, the proposal to exempt buildings and focus property taxes on site values is premised on the market concept of consumer sovereignty, unlike the present property tax. The case may be summed up like this: if the tax on a parcel varies with the use of the parcel, then the tax biases choices against the use more taxed. Economists call the land tax "neutral," for that very reason: it does not vary with use. It does not bias the choice of uses; the consumer sovereign prevails. "No other tax can make that statement."

I do not view that as saying we should throw away other social controls over land use. I have written a short piece, "Land Planning and the Property Tax,"² showing how land taxation strengthens the hand of planners and helps them and the market work together. There are a few libertarians who would terminate city planning altogether, but that is pretty extreme, and not the proposal we should be considering here today. Rather, let us consider a measured proposal, an incremental change within the framework of present legislation and custom.

"Hold on once more," I hear, "not so fast, how about the mansions of rich people?" Another fair question: how, indeed, can you justify exempting them from taxation? Here are some data from British Columbia that speak to the point. They are from the

²J. of the American Institute of Planners, 35(3):178-83 (May 1969). Also available from the writer. I attach a copy, in the hope it may be included with these proceedings.

area around Vancouver (The "Lower Mainland") and the southern part of Vancouver Island, around Victoria, where over half the people in the province live. B.C. practices high quality professional assessment; data from its rolls are quite reliable, as such things go.

Cities and districts around Vancouver and Victoria are ranked, in Table 1, according to the land value per property (single-family residences). These range from nearly \$700,000 @ in the "University Endowment Lands" district (very posh), to around \$40,000 @ in the "Victoria Rural" district (more modest). The last column, LSREV (Land Share of Real Estate Value), shows the land value (L) as a share of the total value (B+L).

These shares range from a high of 80% on the University Endowment Lands down to 38% in Colwood, the lowest, and 39% in Victoria Rural. In between, the numbers follow the trend closely. The dearer the land parcels, the higher is the "land fraction" (the fraction of total real estate value that is land value). From such data, one might formulate a rule along the lines that "the lot value increases with the square of the house value." It is hard to be so precise, and not necessary.³ The relevant rule we need here is just that people's houses are more alike than the value of their lots. It is lot value, more than house value, that divides the rich from the poor.

The average house (ex land) in the posh University Endowment Lands jurisdiction is worth 2.8 times the average in the Victoria Rural jurisdiction (\$173.1/\$61.9). The average land parcel in the University Endowment Lands (ex building) is worth 17.5 times the average in the Victoria Rural jurisdiction (\$692.5/\$39.6).

Now do us both a favor, please. Pause and savor that comparison, like a slow sip of Fredonia's best. Let it linger, roll it on your tongue, mull sensually over its aroma and bouquet and cerebrally over its full import. The house that shelters the very rich family is worth 2.8 times the house of the modest family; but the land under the house of the very rich is worth 17.5 times the land of the modest. Seventeen and one half times as much! Again, it is lot value, more than building value, that

³Technically, it will not be a nice clean integer like the square, but you get the idea.

divides the rich from the poor. Seldom will you find an economic rule more strongly supported by data.

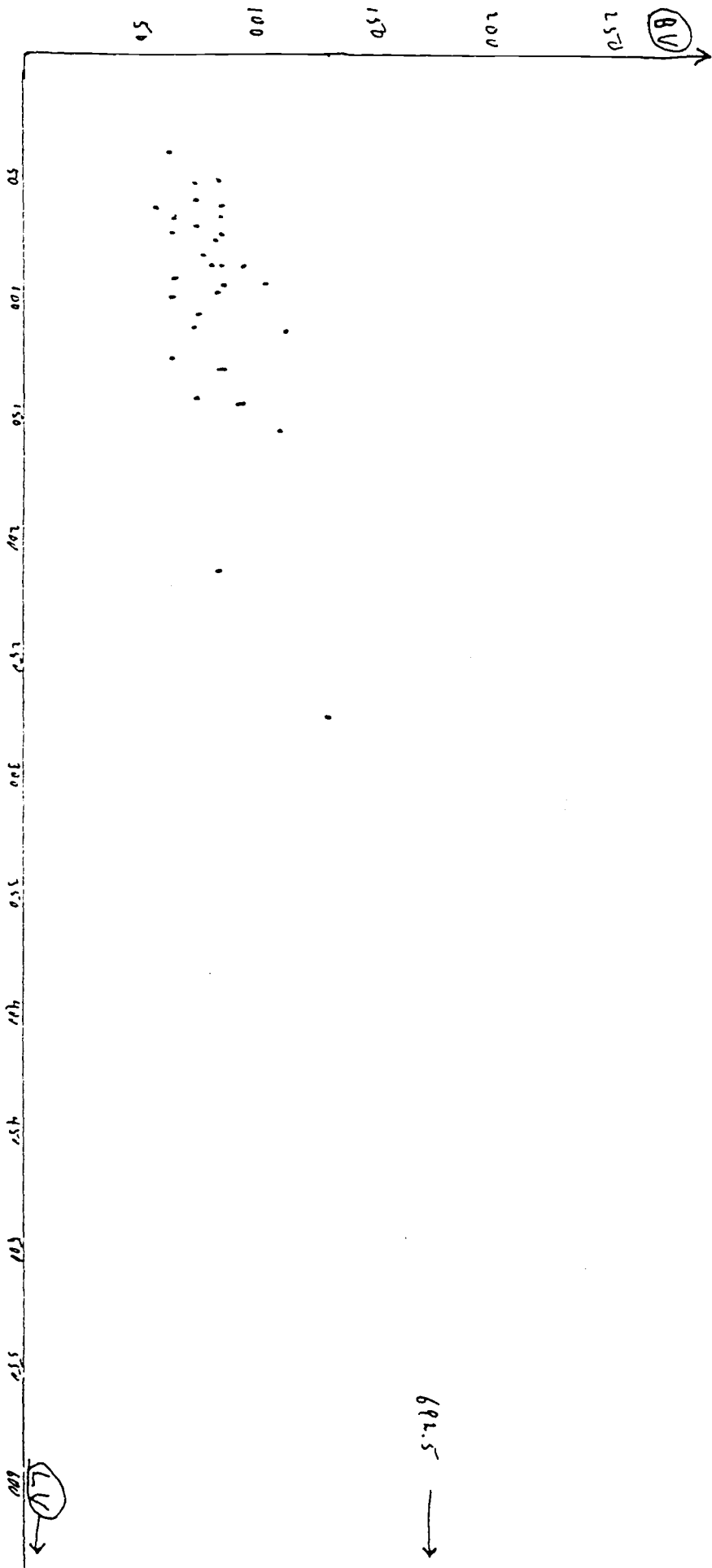
TABLE 1
 Land Values (LV) per Residential Property, Building Values per Residential Property, and Land as Share of Total Real Estate Value (LSREV)
 Data from British Columbia, Lower Mainland and Victoria regions, 1992⁴

JURISDICTION	LV PER PROP- ERTY (\$K)	BV PER PROP. (\$K)	LSREV ⁵ L/(L+B)
UNIVERSITY ENDOWMENT LAND	692.5	173.1	.80
WEST VANCOUVER	276.7	130.2	.68
VANCOUVER CITY	216.3	84.1	.72
LIONS BAY	152.7	110.6	.58
OAK BAY	145.9	93.3	.61
BURNABY	144.6	96.4	.60
N. VANCOUVER DISTRICT	140.7	75.8	.65
BELCARRA	130.5	87.0	.60
RICHMOND	127.9	65.9	.66
NORTH SAANICH	116.8	112.2	.51
NEW WESTMINSTER RURAL	111.6	74.4	.60
N. VANCOUVER CITY	108.0	78.2	.58
WHITE ROCK	100.1	64.0	.61
DELTA	99.8	81.7	.55
SAANICH SD 63	96.3	104.3	.48
NEW WESTMINSTER CITY	95.8	88.4	.52
ANMORE	91.1	66.0	.58
COQUITLAM	88.2	84.7	.51
PORT COQUITLAM	88.2	95.5	.48
PORT MOODY	87.2	80.5	.52
SAANICH SD 61	81.8	78.6	.51
SURREY	78.5	81.7	.49
VICTORIA	76.5	86.3	.47
ESQUIMALT	71.3	65.8	.52
VIEW ROYAL	69.8	72.6	.49
SIDNEY	67.0	64.4	.51
CENTRAL SAANICH	66.7	84.9	.44
METCHOSIN	61.2	84.5	.42
LANGLEY (C)	60.2	73.6	.45
GULF ISLANDS	57.5	59.8	.49
LANGLEY (T)	53.7	74.2	.42
COLWOOD	51.1	83.4	.38
VICTORIA RURAL	39.6	61.9	.39

⁴Basic Data from B.C. Assessment Authority, thanks to Alistair Crerar.

⁵LSREV = Land Share of Real Estate Value

Figure 1: Land Values (LV) and Building Values (BV)
Residential Property, B.C., 1942
Data from Table 1



An American counterpart of Vancouver's "University Endowment Lands" is Beverly Hills, California, where land value composes some 80% of residential values, and the mean parcel is worth something like a million dollars. Beverly Hills, with its great wealth and mansions, is known as "Tear-down City," because many a grand old palace is torn down every year to salvage its site for the next, grander mansion. In a land boom, such as crested in 1989, half the city goes to the brink of demolition and replacement.

What do those data tell us? The rich as a rule do not live next to the poor. Rather, they cluster in neighborhoods with much higher lot values. The poor seek shelter first, and go where it is affordable. The rich put a high premium on location, neighborhood, views, and grounds, resulting in higher land fractions in their real estate. Mansions are visible evidences of wealth, impressing viewers powerfully; land values are invisible. The perceptual bias is to underrate them, if you are not regularly in the real estate market. In the numbers, however, land and buildings are equally visible, and their message is clear. It is land value more than house value that divides the rich from the poor. Ergo, a tax shift from buildings to land is a shift from the poor to the rich, even though the houses of the rich are exempted. It makes the property tax more progressive.⁶

To be sure, those data are grouped by separate municipalities, not neighborhoods within municipalities. The poor of Colwood cannot tax the rich in the University Endowment Lands, except through a higher level of government. However, what is true among municipalities is also true among neighborhoods within municipalities. Indeed, if we divided Vancouver into neighborhoods, the contrasts might be sharper than those shown. The "University Endowment Lands," for example, are really just a neighborhood in Vancouver that, for historical

⁶We are speaking of statistical aggregates. There are always exceptions. For example, if we just compared North Saanich with New Westminster Rural, we would reverse our conclusion. That is why selected data can be marshaled to support any point. To overcome that, I have presented all the data, in which the major trend is unmistakably as I have stated it.

reasons, happens to be reported on separately. Harold Brodsky has done neighborhood comparisons in Washington, D.C.; Margaret Reid in Chicago; Richard Muth in various cities. They tell the same story.

Making the property tax more progressive is not just equitable, it raises its revenue capacity. That is because visible damage to the poor and marginal puts a cap on any tax. You can't squeeze blood out of a turnip, and if you try you'll look like the Sheriff of Nottingham. A land tax won't drive the poor from their humble huts, because it exempts the huts, and the sites have low tax valuations. It may tax a few off valuable land, if their poor huts are there and they own the the land. However, if they own such land, are they really poor?

They may be "land-poor": a few folks always are. They have non-cash assets, but are illiquid. "Illiquid" may be just a euphemism for "holding out for more" - there is always a market at a price. Even so their plight, genuine or affected, traditionally evokes sympathy and support. We must address it.

California, although backward in many ways, has addressed it effectively. In our special improvement districts (SIDs), State law allows the SID to contract with the landowner as follows. You don't have to pay your annual charge in cash. If you choose not to, we take an equity in your property, charging a modest rate of interest. Our equity accumulates over time. When you die, we sell the property and take our share; your estate gets the rest. Should our equity reach 100% during your lifetime, you stay there for the duration, tax free.

Objectively, it looks like a good deal for the taxpayer. They can't come out behind, even if they die soon; if they live long, they come out ahead. The instructive result is that very few people take this apparently advantageous option. UCLA's Donald Shoup has published several works on the program. One way or another, they manage to pay on time. Perhaps it attracts the attention of potential heirs, in a compelling way, but somehow the cash comes forth. While intending only to relieve distress, the program seems to have called a great bluff. The lachrymose plea of the cash-poor widow is unanswerable in debate, without appearing callous, doctrinaire, and jackbooted. Meantime wealthy

interests, thoroughly undistressed, hide behind the widow's skirt and get their way.

We also hear, sometimes, that "it's never been done," or it's only been done by our drab neighbor Pennsylvania, for whom familiarity may have bred contempt? Only "far kine have long horns." Or, whatever progress ensued there was happening anyway. Fate rules; we are destiny's tots. Nothing much can come from conscious action by a city council. We are in the grip of cosmic forces, we rise and fall with the waves and the tide, relax and accept what the gods dish out. Fatalism: it's a sure recipe for milling around ineffectually while life passes us by.

Let's raise our sights far afield to where "it" has also been done. I was in Johannesburg not long ago, a city that thrives in the face of daunting handicaps. I am struck by the miracle of the place; it is Bootstrap City. It should have died when its gold mines played out, like a normal mining boomtown. Instead it remains as the economic capital of its nation and half a continent.

Johannesburg defies most laws of urban economics, e.g. that "mines create no great cities." Its once-fabled gold mines are just tailings now, so it should be a ghost town. It has no harbor, no water transportation, not even any gravity water supply. It is, in fact, on a ridge-top, the Rand or "reef," at an elevation over 5,000'. Water supply is pumped uphill.

It has no sunburst of rail lines, like Chicago or Boston, "The Hub," except perhaps what it has attracted itself. It is on the main rail line, but so are a thousand miles of other sites. The natural site lacks outstanding amenities, and can't hold a candle to Cape Town. Jo-burg has no governmental economic base. Surrounding farmland is poor, the climate droughty. Why Johannesburg? Why is it the largest city, the center of finance, industry, commerce, and international air travel?

As a public finance economist I may overvalue incentive taxation, but Jo-burg has it. The property tax is on site value alone, and at a high rate: they tell me it is 4%. This is what makes Jo-burg distinctive. Challenge and response: Jo-burg had to do something right in order to survive, and that is what it did. It not only survived, it became and remains Number One.

Give me a better explanation and I'll back off. I haven't heard one yet.

Jo-burg is not heaven, far from it. It is surrounded by and transfused with social problems we can hardly imagine, much more expensive to handle and solve than what we know. That is part of the present point. Jo-burg obstinately prospers in the face of these, added to its natural geographic disadvantages.

Cape Town, by contrast, is Sleeping Beauty. Nature has been generous there. It is gifted with one of the world's great harbors and sites, ideal climate and scenery. It has the national legislative Capitol. It enjoys the business potential of New York, the climate of La Jolla, the scenery of Vancouver, and the political base of Washington (or at least Albany). Tourists flock there, and would do so even if the place were misgoverned by Mayor Idi Amin with Police Chief Saddam Hussein. Meantime Jo-burg, the ugly duckling, walks off with most of the nation's business. What is Cape Town's problem? It taxes buildings, the way we do.

Taiwan is another place that "did it," in part. Its present government is what remains of the Kuomintang, founded by Dr. Sun Yat-sen on the mainland around 1920. Sun's ideas were abandoned to corruption until the Kuomintang's remnants, discredited and beaten, fled to Taiwan in 1948. Then finally, backs to the wall, they purified themselves. They put Sun's visage on their currency and buildings, and beatified him. They created an efficient, honest government and applied the policies Dr. Sun had prescribed long ago for all China. Sun's basic economic program was simple. He was a convert to the ideas of Henry George, which were stirring the world in Sun's formative years. Tax the land; exempt the buildings, said Dr. Sun. That is what Taiwan finally did; the Taiwanese economic miracle ensued. It is there to see and study. Them as has eyes t'see, let'm see.

It's not that simple, of course, and certainly not that pure: nothing ever is. That is the gist of it, however. As to adequacy of revenues, they have combined their local land tax with a national tax on land gains, levied at time of sale. These two taxes between them raise a full 20% of all Taiwanese revenues: local, regional, and national. Remember we are talking about a government under siege, with a heavy military budget. We

are talking about land prices that keep rising in spite of taxes levied on the land value base. Again, it is there to observe. It is not in America, true: it is even better. It is an American export that took root and flourishes in an alien culture because it answers universal needs. Among the Chinese it also evoked memories of revered statesmen and philosophers, like Wang An-shih, who had implemented land taxation to abet China's ancient glories.

Singapore, Sydney, Brisbane, and Nairobi are other cities that collect substantial land revenues. From 1900-20, roughly, many American and Canadian cities uptaxed land and downtaxed buildings. It was a part of the Progressive syndrome. There is a world of experience to instruct us, if we will but study it. Pittsburgh and those other smart Pennsylvania cities are near and now and noteworthy, but they are not the whole story. If you want more, your world of observation is as big, and time as long, as you want to make them.

The adequacy of a tax base must be judged over the cycle of boom and bust, a cycle we are now learning is still much alive. How stable is the base? Capital comes and goes; land is fixed. When they finally close that plant and move the work to Mexico, at present we reward them by lowering their taxable valuation -- reward them and punish ourselves, as city revenues fall. On the other hand, if we taxed just their land, the valuation would remain about the same. They will squeal, cajole, and threaten, but no way can they move their land to Mexico. They will just have to find a new use for it. Meantime, you will have made it more likely there are profitable new uses by removing the tax threat against whatever new capital they might invest in your town to employ your people.

Land prices boom and bust too, jeopardizing revenue stability. That can be a problem, but land taxation contains a built-in contra-cyclical factor. When a land boom reaches its manic phase, as it did in California before 1989, growth expectations rise so high that they offset interest costs: people think they are holding land with no net carrying cost. Your home is expected not just to shelter you, but pay off its own mortgage, upkeep, and maintenance by appreciating. Call it irrational, but it happens. In this phase, the fast-moving tax assessor is an equilibrating force. The quicker he follows such a market, the

quicker he showers it with cold water, by imposing a sobering cash drain on the participants. This is an excellent time for local governments, if they have the wit, to pay their debts, fix their potholes, and fill the reservoir against the next drought.

Those getting the cold shower, meantime, may resist it. In California, the land of extremes, we got Howard Jarvis and Prop. 13. This Constitutional Amendment capped the property tax rate at 1%, and virtually froze assessed values until land sold. Then the boom really went wild. I myself, after campaigning hard against Jarvis, unexpectedly made \$200,000 in a few months after it passed. Buyers were chasing me around the block, just to buy a scrap of land I happened to have in the right place at the right time. It was blind luck, but the money was as good as though I had earned it honestly: better, in fact, because 60% of the gain was not even reportable as taxable income. It was a once-in-a-lifetime experience, but buyers and sellers quickly adapted. They came to regard it as normal, and only fair. Regular annual increments were a divine right of property. For a few mad years, they were.

It was the lack of a tax stabilizer that took the cap off land prices. When my lot rose to \$240,000, it was still assessed at \$10,000, and capped there by constitutional law! Taxes were 1% of \$10,000 - that's right, \$100/year, 1/24 of 1% of the market value. Was I in a strong bargaining position? You bet, and I loved it, just as you might. Now we are paying the price, or just beginning to, as our public services collapse and our criminals outgun our police. This year they are cutting faculty salaries (that's me) 5%, and raising college tuition (that's my three children) 100%. I'll pay all right. All tax rates other than property are headed north; land prices south. Our once-vibrant economy is dead; our unemployment rate leads the nation. Our largest city was torched last year by the frustrated unemployed. Our once-leading schools trail the nation; our murder rate leads it. Those are the economic consequences of Howard Jarvis. Like Tokyo and London and Faust, we signed with Mephistopheles, and he has returned to take his due. To paraphrase Kipling, "Be warned of our lot, which I dread you may not, and learn about Jarvis from me."

Another attractive feature of land taxation is its tendency to hit absentee owners harder than resident owners. The land

fraction in real estate is generally highest in the CBD of any city, so that is a favorite place for absentees to buy and hold. They like the steady income, and the "trophy" quality. The surplus in real estate is what attracts outside buyers, and land is what yields the surplus. About 2/3 of downtown Los Angeles is owned by non-resident aliens, for example. In a more workaday city, Milwaukee, the absentee owners consist of former residents, or their heirs, who grew too rich to abide the harsh winters.

Consider the effect on your balance of payments. When you get more tax money from absentees, money that used to flow to Tehran, Zurich, or Palm Beach now flows into your local treasury to pay your local teachers and city workers, and relieve your builders and building managers. In this way taxing land actually acts to undergird the value of its own base.

To stimulate building is also to uphold and fortify the tax base, even though you do not tax the new buildings directly. Some people fault the "depressing" canyons of Manhattan, between the skyscrapers. In my observation, it is not the canyons that depress Manhattan. When the GM building went up, Fortune Magazine reported it doubled the rents of stores across the deep canyon so formed. Its spillover effects were highly positive. What really depresses Manhattan are rather the centenarian firetraps and the activities they attract. They tend to downvalue other lands nearby, eroding the tax base.

Consider the effect of floorspace rentals on ground rents and land values. Doubling floorspace rentals will more than double land values, through a kind of leverage effect. That is because all cash flows above a constant amount required for the building will inure as ground rents. The higgling and arbitrage of the market will see to that. Once that constant is met, everything above it goes to landownership as such, raising land prices which are the land tax base.

When you observe cities much, the positive neighborhood effects of replacing old buildings with new are irresistible and contagious, raising land prices all around. The converse is also true: the negative neighborhood effects of letting old junkers stand without replacement are depressive. Thus, when you take the tax off new buildings, and put it on the land under old buildings, you kick off a general process of revitalization that

turns gloom into hope into optimism: optimism that boosts land prices and the land tax base.

There are three kinds of slums. Type I slums develop on land in the van of downtown expansion, on land held for a future higher use. The speculators are milking the old structures for any residual value, and don't much mind when the tenants leave.

Type III slums (listed here out of numerical order) develop on land that is no good, and never will be, like floodplains and earthquake faults. In the short run they also develop around abattoirs, dumps, stockyards, etc. People are driven there by the inadequate development of good land.

Type II slums, our focus here, are the most extensive. They occur on good or superior residential land originally developed over fifty or a hundred years ago. It may once have housed the upper crust, but as the buildings aged without replacement they "filtered down," and down, and down, until their occupants began radiating negative neighborhood effects. There comes a tipping point where the neighborhood self-destructs cumulatively, because no one wants to build new in a decayed, menacing neighborhood. The renewal value of land is lost, the tax base is lost, nothing remains but social and public costs: a municipal disaster area. The city that fails to renew itself on time is steering itself to this fate, like Camden, the Bronx, East St. Louis, Benton Harbor, MI, and Detroit.

That's the bad news. How do you turn it around? When you exempt buildings from the property tax base, you change the arithmetic of incentives, as we have discussed. Parachuting into the middle of a slum is still hopeless, as before. Change will come first to the fringes of the Type II slum, where it merges into healthy neighborhoods. New development likes to anchor onto healthy neighborhoods. Richard Hurd, father of urban studies in America, taught us in 1902 that land values are marked by continuity in space. It's still so. Fashions and technology change, but principles last. Hope survives at the edge of the slum; land there retains some renewal value. There is where you'll first see change, because there is where the forces are evenly balanced. Tip the forces for renewal, and there is where it begins.

Once it begins, it proceeds incrementally through the Type II slum. When it's through, your oldest neighborhood has become your newest, the cutting edge of progress, the showplace of the town. That is how it has got to work; that is how it will work when you exempt buildings and tax only land. When it is through, you have a high tax base where now you have nothing but fire and police calls.

I once wrote a long chapter on this subject, "The Adequacy of Land as a Tax Base." It came out of two years of research, and is too long even to summarize now. I am delivering it to Pat Salkin, however, and hope she may add it to the record of this conference. I also attach a short bibliography of articles that expand on topics covered above, for whoever is moved to study more on this fascinating subject. I hope you think it as important as I do. Please pick up this ball and run with it. Your fans will love you for a touchdown. They really need a lift; they've waited so long!

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