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What happens when a state radically slashes
its property tax?

California can show you 17 years of experience. Here is what has happened since California passed Proposition 13 in
1978.

The obvious direct results have been to cut public services, raise other taxes, and lose credit rating.

Our school support fell from #5, nationally, to #40 in 1985 when last seen, still falling. County road maintenance is down
to where my county (Riverside) is repaving its roads at an annual rate of once every 130 years. Once in 20 years is
recommended here, and up north you generally need higher frequency. You can't just build infrastructure and then stop
paying for it, it's a perpetual commitment. Thanks to urban scatter, a high fraction of our population now depends on these
county roads.

In 1978 we had a surplus in Sacramento. Since then we have raised business taxes, income taxes, sales taxes and gas
taxes, but go broke every June, even as other states are in the black again. Now our State bond rating is last among the
states. One of our richest counties (Orange) has gone bankrupt; Los Angeles is on the brink of it, saving itself by closing
emergency rooms and hospitals that serve as a last resort for the uninsured poor. We are ill-prepared for Congress'
current move (right or wrong) to shift more functions back to the states.

The private sector fares no better. Raising income taxes, business taxes, and sales taxes is no way to stimulate an
economy; each is a drag on work and enterprise. Our income per capita was down from #7 to #12 among the states by
1992, then fell more: from 1992-94, California was one of three states where median household income fell. Our
unemployment rate is 9%, 50% higher than the national mean of 6%. Our poverty rate is 18%, compared to 14.5%

nationally. That helps explain why the only government function that grows now is building and operating prisons. One of
our few rebounding industries is cinema. Another thriving trade is auctioning off used machinery for export to the east.

In 1993 there was net outmigration (including international migration) from this state that has symbolized American growth
since time immemorial. It is unheard of: 426,000 people were lost, nearly 2% of the population. This is a watershed
change: imagine, of all states California, America's trend-setter, our El Dorado, The Golden State, our Horn of Plenty,
the safety-valve for job-seekers and retirees and entrepreneurs from everywhere, the end of the rainbow, losing
population! It's enough to make a person ask "What are we doing wrong?".

The fall of our income per capita is greater than appears from the purely monetary measure. Real pay (in constant $) has
fallen more, because of the drastic rise of shelter prices. In San Francisco, shelter takes 50% of the median income, with
many other cities, especially coastal ones, not far behind. It is unusual to find livable quarters for less than $600/month.
The median home price rose 163% during the 1980s, to $258,000 (that is just the median - the mean is higher). These
rises are part of the C.O.L. of all renters and new buyers, a part not fully incorporated in standard CPI measures (for
various foolish reasons too technical to open up now).

Some cities are in desperate straits. San Bernardino in 1976 was chosen an "All-America City, a City on the Go." Go it
did: today, 40% of its people are on welfare.

California has always been earthquake country, but has always renewed itself, routinely. It was different after the
Northridge quake in the San Fernando Valley, January, 1994. This is the upper-middle neighborhood of Los Angeles, but
now large pockets of ruined buildings remain, unreconstructed, inhabited only by vagrants and criminals: an instant Bronx
West. These blighted sections, ominous portents, spread more blight around them.

It should give one pause. It is, however, if you think about it, the expectable result of what the voters did. They turned
property from a functional concept into a sacred one; from a commission to be enterprising, hire people, produce goods,

and pay taxes into a welfare entitlement. They rejected the concept of taxing inert wealth in favor of the alternative: taxing
liquidity, cash flow, work, production, and commerce. The predictable result is to inhibit economic activity, and encourage
holding wealth inert and stagnant.

We had a construction boom in the 1980s, but it was not healthy. It was marked by extreme scatter, and extreme
instability. Downtown L.A. was to become a great new financial capital, but now has nearly the highest office vacancy
rate in the U.S., with of course a high rate of builder bankruptcies. Speculative builders were led on to overbuild, in part,
by anticipated higher land rents and prices. This Lorelei effect was magnified by national income-tax provisions, luring on
speculative builders, but we have to ask why California fell harder than other states, even with the object-lessons of the oil
states in clear view.

David Shulman tersely summarized the distributive effects of Prop. 13 as he left us to become Chief Equity Strategist for
Salamon Brothers in Manhattan: "it breached the social compact." Alienation is the result, and the results of alienation
are the Rodney King riots, arson and looting. The Watts riots, you may object, preceded Prop. 13, and you are right.

However, the Watts riots were part of a national epidemic. By 1967 there were riots with arson and looting in 70 or more
American cities. The Rodney King riots were endemic to California, and they spread over a much wider area of Los
Angeles than the Watts riots did. The looters and arsonists were not all black, and the targets were not all white, but
mainly Korean-Americans who just happened to be there minding their stores.

Conventional wisdom now blames our California bust on the end of the Cold War. Surely that is a factor, but as a causal
explanation it is too pat, too easy, and too convenient. It shifts the load off ourselves onto impersonal historical forces -
the Marxist worldview. Let us see if it can survive analysis.

Compare today with 1945.

Los Angeles' economy depended much more on The Hot War, 1940-1945, than it ever did on The Cold War. Los

Angeles' wartime boom had swelled its population as no other great city, 1940-45. After 1945 the U.S. pulled the plug
on defense spending, more than today. Jane Jacobs, in The Economy of Cities, tells us what happened to military
spending in Los Angeles after 1945. It lost 3/4 of its aircraft workers, and 80% of its shipbuilders. It lost its military and
naval overseas supply and replacement businesses. Troops stopped funneling through. It got worse: petroleum and cinema
and citrus, its traditional exports, all declined.

Pundits then forecast a regional collapse, but Los Angeles boomed, instead. The wartime immigrants stayed. They formed
creative, innovative small businesses in large numbers, giving L.A. its deserved reputation for having the most dynamic,
flexible, adaptable industrial base in the nation. Besides exporting goods, L.A. also became more self-contained,
providing itself with more of the goods it previously imported. How could this be? Angelenos had access to land, the basis
of all supply and demand in any economy.

1/8 of all new businesses started in the U.S. were in L.A., 1945-50. These were small, creative, flexible, miscellaneous,
and too varied and dynamic to classify. No Linnaeus could sort them in static conventional boxes; they were the despair
of traditional economic geographers and base theorists, who were at a loss to explain the region's thriving economy. The
new Angelenos stayed and startedproducing everything for themselves, some things previously imported, and others never
seen before.

Eastern firms established branch plants here. Top eastern students came to California's great university system, and stayed
behind to make careers and jobs here, and send their children through California's excellent public schools. California
became famous for supporting outstanding higher education at three tiers, K-12 education, adult education, highways,
water supplies, public health, public safety, and other public services, all without repelling business by taxation. There was
a kind of regional "El Dorado Effect," as demand and supply grew together, and growing local demand allowed for
economies of scale serving local markets. Food and shelter were cheap and abundant. Land for business was accessible,
providing a basis for the whole self-contained phenomenon. A "continental tilt" developed in both interest rates and wage
rates, drawing in eastern capital and labor.

Why is that not happening today, 1995? An invisible, pervasive change is Proposition 13, which makes it possible to hold
land at negligible tax cost.

In 1945 land was taxed at 3% every year, building a fire under holdouts to turn their land to use. Today that same tax cost
is well below 1%. Using Gwartney's Rule of Thumb (see below under #2,A, "Reassessing Land Frequently") it is about
1/8 of 1%: a rate of 1% applied to 1/8 of the true value.

Landowners are only taxed now if they use their land to hire people and produce something useful. Then they meet the
drag of our high business and employment and sales taxes, necessitated by the fall of property taxes. A handful of
oligopolistic landowners control most of the market; small businesses are squeezed out.

This helps us segue from being at the cutting edge of industrial progress to a third-world economy - with little relief in
sight.

What was different then? One obvious difference was the lower burdens of sales tax, business tax, and income tax. We
had high property tax rates, but they were more focused on land than now, less on new buildings. California was more
hospitable to Georgist thinking than perhaps any other state then, shown by its long run of Georgist political action in the
prior thirty years. Most people today are totally numb on this subject, which has been blanked out of our history books.

A Brief Historical Review

Several states had "single-tax" movements and initiatives, 1910-14, but most of them petered out. In California they
continued through 1924, and then popped up again in 1934-38. In 1934 the "EPIC" campaign of Upton Sinclair included
a strong Georgist element - he proposed to set up new factories and farms on idle land. Meantime, Jackson Ralston was
pushing a pure land tax initiative, 1934-38.

Sinclair and Ralston lost, but the mere existence of such political action in California, when the movement was torpid
elsewhere, tells us a lot. It reveals a large matrix of supportive voters and workers, with effective leaders, to whom
politicians (including elected County Assessors) would naturally respond by focusing on land assessments. Politicians

survive by accommodating and absorbing dissident movements. Even while "losing," such campaigns raise consciousness
of the issue. Thus, in California, 1917, land value constituted 72% of the assessment roll for property taxation.

This remained the California tendency for years.

California was different. Even into the 1960s, Sacramento County elected an avowed single-tax Assessor, Irene
Hickman; San Diego County harbored an active movement for raising land assessments. The Henry George Schools of
San Francisco, San Diego, Los Angeles, and Sacramento were the most active such schools in the country: four in one
state, when most had none. State Senator Al Rodda, Chair of the Senate Finance Committee, held hearings and tried to
push landtax legislation through his Committee in the 1960s and early 1970s. He assigned a staffer, Jack Massen, to
spend a year working out the detailed effects on intergovernmental relations. Assemblyman Dr. William Filante, from a
base of Georgist support in Marin County, picked up the torch, too.

California displayed amazing prosperity and growth up to 1978. It had the resilience to shrug off the loss of war industries
after 1945 and still grow "explosively" (as Jane Jacobs put it). After 1978 we have had, instead, a string of reverses. The
timing, along with a priori causative analysis, plus various direct observations too numerous for this time-slot, support an
hypothesis that the reverses were aggravated by Prop. 13.

Enforcing good laws we already have

A. Reassessing land frequently

It is important to assess land for tax purposes early and often, especially on a rising market. (Landowners will see to it you
do so on a falling market.) Over time, land appreciates more years than not, while buildings depreciate physically every
year. Lagging assessments therefore automatically overtax buildings relative to land.

New Hampshire Assemblyman Richard Noyes has circulated data on the effect of reassessment in NH.

The land fraction of assessed value rises each time there is a reassessment. Keene, NH, is in the lead, with frequent

reassessments, a high fraction of land in the mix, and a strong track record attracting enterprise and jobs.

In California, where we used to have good assessment, we now have bad assessment legally mandated by Prop. 13. So
long as land is unsold, and/or not newly improved, its assessment rise is capped at 2% a year, while market prices soar.
Here is one example of the results. This year the Metro Water District of Southern California (MWD) condemned 410
acres for its new Domenigoni Reservoir to expand the system (to accommodate land speculators in the desert boonies).
The jury hit them for $43 millions, which works out to about $1.95 a square foot.

The question occurred to me, how does that square with the assessed value for property taxation? I asked Ted
Gwartney, a professional appraiser with the Bank of America, to check the assessed value. It is about 7=9B a square
foot. The condemnation price, supposedly based on market value, is about 28 times the assessed value.

This is not the result of fractional assessment.

In California we assess property at 100% when land changes ownership, or there is new building. Rather, this is the result
of Prop. 13 and its prohibition of market reassessment until land sells.

I thought that was startling, but Mr. Gwartney's reaction was "Ho-hum, what else is new?" He, who works with such data
every day, has a rule of thumb that market land value in California today is about 8 times assessed value. That is important
enough to repeat: our assessed land values are routinely at 1/8 of true land value. I wouldn't dare say that on my own
authority, but Mr. Gwartney is here to confirm it. He is a veteran appraiser; for many years he was Director of
Assessments for the entire Province of British Columbia.

Does this help you understand why California landowners are now so slow to adapt to new demands, and respond so
slowly to the withdrawal of old military demands? In 1945 the assessors were building fires under them, so they sought
new uses to meet new needs.

Today there is only a weak such incentive: tax collectors mainly only burn them if they move. Sit still, lie low, hire no one,
hang on, produce nothing, and your holding costs are negligible.

A little of the old magic lingers. In October, 1995, a 225 acre parcel in Corona, the Chase Ranch, was sold to a builder,
Coscan Davidson Homes, for building 967 units. The previous owners, "GGS," including a Japanese insurance firm, were
"seeking a way out. They were behind in tax payments, and GGS was losing its staying power ..." quoth Stephen
Doyle, spokesman for the buyer. It is that "staying power" that stifles land use and production. Coscan wants to build
immediately. Even so, though, they plan to take 5 years to build out the project - if everything goes well. This is the new,
post-Prop.13 meaning of "immediately."

In spite of extreme under-assessment, the assessed value of taxable land in California is 40% of the total real estate value.
Imagine what it would be if assessed values were real values, "marked-to-market," as the law used to stipulate. It would
be over 70%, as in 1917. "Staying power" would go down; land use, jobs and production would rise.

B. Using the building-residual method

It is equally important to use the "Building-Residual Method" of allocating value between land and buildings. This means
you value the land first, as though it were vacant, based on highest and best use.

You subtract this land value from the total value of land-cum-building as currently improved: the residual, if any, is building
value.

Valuing one lot or parcel this way, you have information needed for valuing neighboring and other comparable parcels.
Using a map with value contours, you can value a whole city this way with surprising ease and speed.

Using this method, I valued Milwaukee land in 1963 and 1967. The building-residual method nearly tripled the land values
reported by the City Assessor, who was using the assessor's usual inconsistent mix of various other methods. How's that
again? Did I say tripled?

Yes, I really said "tripled." By his methods, buildings on the eve of demolition were carrying values higher than their sites;
by the building-residual method these old buildings had no value at all, which of course is why they were being torn down.
Besides depreciation and technological obsolescence, many buildings suffered severe "locational obsolescence," owing to

shifting demand patterns. The land was re-usable, and had as much or more value without the extant buildings.

Using the building-residual method requires no change in present laws. It is within the latitude of assessing officials. These
worthies, in turn, respond to public opinion. The conscientious citizens' move is to raise consciousness and bring pressure,
just as the old single-tax campaigners like Jackson Ralston did.

In the process of "losing" they won over half of what they sought, just by taking a stand and making the effort.

C. Federal income taxes

Assessors' problem today is that the strongest pressures they feel are from owners wanting to allocate as much value as
possible to buildings that they may depreciate for federal income tax purposes. Here is where we must study how the
parts fit together to form the big picture in the Big Plan we are limning; here is where federal and local tax policies
intersect. Some traditional Georgists have neglected or misunderstood the income-tax treatment of land income, to their
great oblivion, myopia, insularity, and weakness. Let us see how this works.

Congress and the IRS let one depreciate buildings, but not land, for income tax. This important distinction harks back to
when the income tax was new, and Georgist Congressmen like Warren Worth Bailey, from Johnstown, PA, and Henry
George Jr., from Brooklyn, were instrumental in shaping it.

When a building is new, the depreciable value is limited to the cost of construction. The non-depreciable land is the bare
land value before construction. So far, so good. Over time, however, building owners have converted this into a tax
shelter scheme. Owner A, the builder, writes off the building in a few years, much less than its economic life, and sells it to
B. "A" pays a tax on the excess of sales price over "basis." The basis is reduced by all depreciation taken, so any excess
depreciation is "recaptured" upon sale. It is defined by Congress as a "capital gain," and given the corresponding package
of tax preferences: deferral of tax, lower rate, step-up of basis at time of death, tax-free exchanges, etc.

Thus far, any tax preference goes to A, the builder, and may be seen as a well-considered building-incentive. Watch,

however, what happens next. "A" sells to B, and B depreciates the building all over again, from his purchase price. To do
so, B must allocate the new "basis" - i.e. his purchase price - between depreciable building and non-depreciable land.

How shall B allocate the new basis? Enter the local tax assessor. Here is where local assessment intersects with Federal
income tax policy. The IRS does not try to assess land and buildings. Instead, IRS instructions tell taxpayers they may use
locally assessed values to allocate basis between depreciable buildings and non-depreciable land. The IRS accepts this
allocation as conclusive. As a result, local owners of income property press their assessors to allocate as much value as
possible to buildings, and as little as possible to land. This does not affect their local taxes, but lowers their federal taxes.
It lets them depreciate land.

Assessors don't care as much as they should: local revenues are not immediately affected. Local assessors have little
reason not to accommodate their constituents, local landowners, to help them depreciate land for federal and state income
tax purposes. They have little reason to use the correct "building-residual" method of allocating value, and a compelling
reason to use the wrong method that understates land value. Thus they convert non-depreciable land value into
depreciable building value. It is modern version of "competitive underassessment." In the process, they also convert the
local property tax from a land tax into a building tax.

After a while B sells to C, who in turn sells to D, so each building is depreciated many times. So is a large part of the land
under it, time after time, although it should not be depreciated at all. This is carried so far that real estate pays no federal
or state income taxes at all, a matter developed by Michael Hudson in his paper for this conference.

The solution to this lies with the U.S. Congress.

The need is to limit depreciation to one cycle only.

It is a most urgent problem for both federal and local treasuries. We all have Congressmen. Write them and raise their
consciousness. They are brokers who respond to public opinion, as they should. It is we who are derelict: get on their
cases.

Rich and poor

There are rich jurisdictions, and poor. Professor Tideman's paper in this conference alludes to this matter in passing. Let
us support his point with some numbers.

In California, you might think that farm counties like Tulare have a lot more taxable value per capita than cities, but au
contraire. Tulare County reports assessed values per capita of $38,100; the whole State averages $60,000 per capita.
Suburban Marin County weighs in with $95,400; urban Los Angeles County has $59,000; Orange County has $74,000.

You might also think that Tulare, being rural, has a lot higher fraction of land value in its mix, but again, not so. The Land
Share of Real Estate Value (LSREV) in Tulare County is 28%, compared to a statewide mean of 40%, and 47% in
Orange County.

Grazing and mining counties like Inyo have high values of LSREV, but they are a small share of the farm economy. Major
farm counties with intensive farms, like those of the San Joaquin Valley, have low values of LSREV.

Within counties, disparities among cities and school districts are much greater. In Tulare County, one pathetic little
povertyville, the City of Parlier, has just $10,000 of assessed value per capita. Here are some assessed values per capita
from different California cities in The County of Los Angeles: Lynwood, $21,500; Beverly Hills, $294,000 (14 times
Lynwood); City of Industry, $5,533,000 (257 times Lynwood).

This is why some critics call the property tax "regressive." It has given some plausibility to the otherwise bizarre claim that
switching to a sales tax is less regressive than sticking with the property tax.

Within each city a property tax is progressive, but when your data meld cities like poor little Parlier and Lynwood with
Beverly Hills you sometimes find poor people paying more of their income in property taxes than rich people, and getting
less for it. Switching just the local property tax to land ex buildings will do little or nothing to correct such disparities, and
therefore make little progress toward overall social justice, and the wide support that will evoke. There is, in fact, a natural
cap on local property tax rates imposed by local particularism: the City Council of Beverly Hills will not raise taxes in

Beverly Hills for the benefit of voters in Parlier.

To avoid such regressivity we must work out some formula for power equalization. The most straightforward formula is
simply a statewide land tax.

The above was part of a paper:
Big Plans to Stir the Blood and Steer the Course
delivered by Professor Gaffney at a conference on Land, Wealth and Poverty
at the Jerome Levy Institute on 3 November 1995.