CAN A CITY RAISE NEEDED PUBLIC REVENUE AND STIMULATE ITS ECONOMY AT THE SAME TIME?

by Edward Dodson, Cherry Hill, NJ

One of the most consistent issues civic leaders have faced over the last half century is how to provide the kind of public goods and services required to compete with suburban communities and with other regions in the United States (or locations in other countries). Large sections of many cities in the United States have emptied or have become home to households who do not have the incomes to be self-supporting or the diversity of skills to make for thriving communities. An ongoing challenge is how to raise the revenue to pay for needed social welfare services while trying to rebuild an aging infrastructure. Cities need to foster a positive business climate and also create a safe and healthy environment for residents and visitors.

Assistance from the Federal and State governments has never been fully adequate to meet the rapidly increasing costs of city government. With each budget cycle, the revenue side of the equation has been addressed by a combination of increased taxation and debt financing, the latter a measure that only postpones the day of reckoning. With every constituency and interest group looking for "tax relief," the chosen course of action has been to impose taxes on almost every form of asset and every type of transaction that occurs in the city. While this approach tends to spread the impact broadly across the business community and residents, the longer-term impact is to contribute to the overall decline of the city's economic base. For decades, some analysts, urban economists and activists have been arguing that this could have been avoided and that there are effective measures that will put cities on a firm financial footing and a path of sustained economic expansion. At the center of the recovery plan is the issue of how the city raises its revenue -- its tax policies.

What is not well-recognized is that not all taxes have the same impact on an economy -- on individual and business investment and location decisions, for example. For businesses, taxes are costs they attempt to pass on to customers in order to achieve targeted profit margins. In a global economy this is not easily achieved, and businesses subjected to intense price competition are constantly looking for places to operate where they can save on costs. A high wage tax indirectly affects businesses as well because they must offer higher salaries to management and technical workers to compensate for the high wage taxes charged to work in the city. Ideally, the interests of the city are the same as its business owners -- to reduce to a minimum the taxation of income and assets that otherwise raise costs.

Arguably even more significant to business profitability and location decisions is the impact of how a city taxes real estate. Taxes on real estate have long been an important source of public revenue, although the percentage of needed revenue collected from real estate has fallen over the decades, in part because of the reasons mentioned above but also because administration of the real estate tax has been highly politicized and inefficient. Assessments in most cities are adjusted infrequently, so that properties may be assessed anywhere from 30% to more than 100% of market value. The other serious problem is that the tax on improvements (i.e., on buildings) equates to a sales tax imposed each and every year. Property maintenance, renovation and even new construction are discouraged by high improvement taxes. Recognizing this is so, cities frequently offer some owners periods of abatement on new buildings or on the value of renovations.

There is an argument that says the strongest pro-housing, pro-development and economically-sustaining measure a city could adopt is to gradually exempt all property improvements from taxation and rely on the value of land parcels alone -- a shift to what economists call "land value taxation." In order to meet revenue objectives, the rate of taxation applied to land values would be significantly higher than is now applied, so owners of land parcels that are vacant and under-improved would experience an increased tax obligation. Most homeowners and most business owners would experience a reduced property tax. Holding land idle (either for speculative gain or simply because the costs of doing so have been so low) would begin to cost owners considerably more. Many would take action by developing the land to its highest and best use or sell it to someone who would. The effect would be felt most quickly in the central business district and in other neighborhoods where land values are high. Although land in neighborhoods where there is widespread abandonment is generally low in value, here, at least homeownership would be supported by reductions in the property tax; and, if the tax rate on improvements is eventually eliminated there would no financial penalty for making extensive renovations.

If your city suffers from an ongoing loss in population, a deteriorating housing stock and continued abandonment of older, previously-industrialized areas, urge your elected officials to examine the city's tax policies in light of the consequences described above. If your city suffers from a declining supply of decent, affordable housing and is experiencing rapidly rising land prices that drive out businesses and moderate-income residents, the same solutions are applicable.

(editor's note: In Philadelphia the City Controller is coming out strongly in favor of adopting LVT, and Josh Vincent of the Center for Study of Economics has managed to get a member of City Council to draft enabling legislation. Ed Dodson has been working to pull together a public forum on LVT, working with a civic group called the Greater Philadelphia Urban Affairs Coalition. In preparation for a meeting of the GPUAC Committee on Economic Development, Dodson prepared this statement of the case for LVT. Dodson may be emailed at ejdodson@home.com.) □