

• INSITE investigates

claims that a tax on rent

is a positive incentive to

the creators of wealth.

PENNSYLVANIA'S TWO-RATE PROPERTY TAX CITIES: %

	Land Tax Rate	Building Tax Rate
Scranton	4.37	0.80
Harrisburg	5.52	2.19
McKeesport	9.00	2.00
New Castle	6.96	2.20
Duquesne	6.36	2.70
Washington	6.056	1.68
Pittsburgh	15.15	2.70

## IRREFUTABLE EVIDENCE

ALL TAXES are bad. That is the axiomatic claim by today's free market economists, who define "reform" in terms of reducing - or abolishing - taxes.

This sweeping assertion is confusing, because the textbooks still insist that there is one tax which provides benefits: a tax on the rent of land. The evidence to test the claim that a land value tax is a good tax is supplied by Pittsburgh, the Pennsylvanian city which has progressively shifted the property tax from the income generated by buildings and on to the rental value of land.

*A good tax should be neutral.* In other words, it should not damage the efforts of people to earn income. The injurious effects of taxation result mainly from the fact that they are passed on to final consumers in the form of higher prices.

So the demand for the article or service declines, and the satisfaction of consumers is lower than what it would otherwise be.

A tax on the rent of land is not passed on; it therefore does not reduce the demand for land, or distort the pattern of land use. As Professor Samuelson explains in his widely-studied textbook: "... the tax is 'shifted' completely to the supplier, who absorbs it all out of economic rent. The consumer buys exactly as much

of the good or service as before and at no higher price."<sup>1</sup>

Under current conditions, in fact, a reform of the property tax - which entails an *increase* in the tax burden on land! - would actually reduce the price of land.

This is because many sites that now stand idle within the city boundaries, held by speculators who expect to make a large capital gain in the future, would come onto the market. The adjustment in the land market would increase the supply and moderate rental levels.

BUT IS it true that a reformed property tax would encourage new investment?

Steven Bourassa, an assistant professor of city and regional planning at Memphis State University, studied the economic effects of Pittsburgh's dual-rate property tax, and discovered that a 1% decrease in the tax on buildings resulted in a 2.36% increase in the amount of new housing construction.<sup>2</sup>

Concludes the professor: "The need for fundamental changes in the property tax stems from the fact that local tax policies are at odds with economic development goals.

"It is an economic truism that increases in taxes result in decreases in supply. This applies to buildings and other improvements to land. The higher the

real estate tax rate, the lower the construction rate.

"The fact is recognized, at least implicitly, in Memphis and in numerous other cities with tax freeze or abatement programs. By holding taxes constant as improvements are made, municipalities hope to encourage development that would not otherwise take place. In Memphis, tax freezes are granted by the Center City Revenue Finance Corporation as a means for spurring downtown development.

"If taxes on buildings discourage development, then why not abolish such taxes altogether? The obvious answer to this question is that local governments lack a suitable alternative source of revenue.

"In fact, there is a good alternative to taxing buildings. The real estate tax itself can be modified to yield the same amount of revenue and encourage development.

"The evidence from Pittsburgh strongly supports the idea that cities concerned with economic development should shift their real estate taxes from buildings to land, to maintain revenues while encouraging development."

#### REFERENCES

1. P. Samuelson and W. Nordhaus, *Economics*, NY: McGraw-Hill, 12 edn., 1985, p.402.
2. "Land Value Taxation and New Housing Development in Pittsburgh," in *Growth and Change*, Vol.18, No.4 (Fall, 1987), pp. 44-56.