

Reflections on the Single Tax: In Light of the California Plan of 1938

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IN NOVEMBER, 1938 the citizens of California rejected for the seventh time a proposal to revise the tax system of the State in the direction of the single tax.¹ Even including sales tax repeal in the initiative measure did not suffice to overcome the well-financed opposition. Newspapers, billboards, pamphlets, and radio portrayed the single tax monster seeking to destroy the school system, dispossess home owners, raise rents, and generally bankrupt the entire State. Proponents were handicapped as usual by lack of funds and publicity outlets. Perhaps they suffered even more from the competition of a less shop-worn panacea which promised direct and immediate benefits to hundreds of thousands of oldsters.

Higher taxes upon land values have long been favored by many economists, particularly for regions like California with rapidly increasing population. In this centenary of Henry George's birth the proposals of his followers in his ideological birthplace afford a good occasion for comment on certain important problems of applying his principles, with special attention to the incidence of the burden during the transition.

The California plan of 1938 had certain novel features. The personal income tax, inheritance tax, corporation taxes, gasoline tax, and various license taxes and fees were specifically retained as

sources of revenue. Taxes on realty improvements and tangible personality² were to be removed by gradual reductions in their *tax rate* rather than their assessed value.³ In the first fiscal year this tax would have been 9/10 the current rate on land; in the second, 8/10; and so on with reductions of 1/10 per year until in the 10th year and thereafter the rate would have been zero. During this time, however, the tax rate on land values would necessarily be rising and therefore the tax reductions would not have been as rapid nor as uniform as the law made them appear.⁴ The change would have applied to all political subdivisions of the State now using the general property tax.

Background of the 1938 Proposal

In order to understand the concurrent proposal to repeal the retail sales tax it is necessary to review the circumstances attending its introduction. The depression brought a great decline in property income in 1931 and 1932, with a resulting rise in foreclosures and tax delinquencies. Many individuals lost their property and local government budgets became increasingly unbalanced. To alleviate this situation an amendment to the State Constitution was proposed and adopted in 1933. Under its provisions the burden of property taxation was to

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¹ On the tax history of California see reports of various state tax commissions in 1906, 1912, 1917, 1929, 1931, and 1933; Earl C. Campbell, "Separation of Sources of State and Local Tax Revenues in California," 26 *American Economic Review* 41-52 (March, 1936); and the rather popular, H. Dewey Anderson, *Our California State Taxes* (Stanford: Stanford University Press, 1937).

² Since it is treated like improvements and is of minor importance, tangible personality will not hereafter be mentioned separately.

³ The first \$1,000 assessed value of improvements on homesteads is exempted from the outset.

⁴ Taxes repealed in the first year would have added ¼ to the property tax load. Therefore, the tax rate on improvements would have gone up for a year or two before the 1/10 annual reductions brought it below original levels.

be lightened in two ways: (1) by shifting county school costs to the state general fund beginning with the fiscal year 1933-4; and (2) by transferring the operative property of public utilities from their existing use as state revenue sources through a gross income tax to the assessment rolls of local subdivisions in fiscal 1935-6 and thereafter.⁵ Each of these changes was expected to reduce local tax rates 10 to 15%, or about 25% in toto. Actual reductions were less than this because additional expenditures were budgeted.

When the Legislature met in 1933 to consider the State's financial problems caused by the assumption of school costs and the decline in state revenues, it was faced with the task of raising \$40,000,000 new revenue each year. Under the new amendment a general property tax for school costs was illegal and to use it for other purposes would merely have put the tax burden back on the shoulders of those who had tried to shake it off. Hence the legislators adopted a 2½% retail sales tax, together with a small income tax subsequently vetoed by the governor.

At the end of the next two years the transfer of public utility operative property to the counties for taxation again raised the question of additional state revenue. The new administration proposed to raise the sales tax rate to 3% but was strenuously opposed by the EPIC (End Poverty in California) bloc of legislators who demanded a reduction of 2%. A compromise was finally effected at the higher rate, but foodstuffs were exempted. A small income tax with rates about ¼ those of the federal tax was also

introduced, and higher rates were imposed on bank and corporation incomes (called a franchise tax), insurance premiums, and inheritances.

Effect of the Sales Tax

The status of property owners did improve after 1933, but it is difficult to separate the various factors involved. Probably the improvement in business conditions did more for them and for local budgets than the temporary decrease in property tax rates. By 1937 local tax collectors were demanding as much money from property owners as they had in fiscal 1933, the year before \$35,000,000 annual school costs were shifted from the counties to the State.

Certain individuals have clearly gained from the change. Those whose income is derived solely from property gained more from lower property taxes than they lost through added sales taxes. The 70 million dollars derived from the latter source in 1936 amounted to about 1% of the total assessed value of property in the State. Thus an individual receiving a net income of approximately 10% per year on the value of his property would lose about 1/10 of this income if the sales tax were changed into a general property tax. At the present this individual pays 3% on his retail purchases of things other than food. If these amount to 1/3 of his annual income, 3% on 1/3 of 10% would mean an annual sales tax payment equal to 1/10 of 1% of the value of his property.⁶ In other words, the property owner in this illustration is 10 times better off under the

⁵ This meant virtual abandonment of the principle of separation of sources of state and local tax revenues in effect since 1910. (Cf. Campbell, *op. cit.*)

⁶ Cf. Leven, et al., *America's Capacity to Consume* (Washington: Brookings Institution, 1934), p. 257. In this computation the amount spent for attire and

"other living" amounts to from 29% of total expenditures in the lower income groups to 38% at higher levels. (Food, home, and savings are the other three items.) Allowance should also be made in this State for restaurant meals, now taxed. This would help to offset the untaxed expenditures probably included in "other living."

sales tax than he would be under an equivalent general property tax.

At the other extreme is a large group of people who own no real estate at all. They lose by the sales tax, for their rents are not appreciably lower because of the saving made by property owners. Nor would a return to the old property tax in place of the sales tax raise rents very much, although a long-run shift of that portion of the tax which fell upon improvements would ultimately occur.

Between these two extremes is another large group whose only real property is their homes. They depend upon wages or salaries for most of their income. Assuming again that the average individual spends about $\frac{1}{3}$ of his income upon taxable retail purchases, the home owner neither gains nor loses if his annual income is equal to the assessed value of his taxable property. That is, 1% on his property is equal to 3% on $\frac{1}{3}$ of his income. If he has an annual income greater than the assessed value of his property, he loses by the sales tax, and vice versa. Or if he spends more than $\frac{1}{3}$ of his annual income for taxable commodities, he loses, and so on.

We have no figures on the number of persons deriving their income chiefly from real property, but the number must be small, even if stockholders of corporations are included. The number in the other two groups may be roughly estimated from census data as being about 60% tenants and 40% home owners.

The Tax Rate under the Proposed Law

Since the sales tax repeal under the proposed measure would have burdened

⁷ State taxes which would be retained brought in \$135,000,000 in 1937. Chief among them were the 3-cent gasoline sales tax, \$44,000,000; personal income, \$17,000,000; bank and corporation income, \$17,000,000; liquor, \$16,000,000; and motor vehicle licenses, \$12,000,000. If all taxes are considered, the burden upon the people of the State was about half a billion dollars, or \$80 per capita.

landowners only, some estimate must now be made of the probable future tax rate on land in 1949. The existing ad valorem property taxes of various local units (the State has no such tax) raised about \$260,000,000 in fiscal 1937. Taxes to be repealed brought another \$100,000,000 (retail sales, \$85,000,000; motor vehicles as property, \$12,000,000; railroad cars, \$400,000), making a total of \$360,000,000 to be raised by land-value taxes.⁷ Given the 1937 land value of \$3,300,000,000, to raise this revenue would require an average tax rate of about 11% if there were no delinquencies.

A state-wide change of this type would have had uneven effects upon different regions and different classes of property, a point which single-tax proponents should not overlook. Future county tax rates would have depended largely upon the ratios of exempted property value to land value.⁸ A rough calculation (city costs excluded) indicates probable tax rates varying from 5 to 14% with the most populous county, Los Angeles (it has $\frac{1}{3}$ the State's land value), at about 11%. The owners of unimproved and relatively unproductive land would obviously have been under the greatest pressure where the tax rates were highest, i.e., chiefly in urban counties already highly improved and where city taxes would add to the load. Delinquencies would vary according to this pressure and the opportunity for relief through increasing the productivity of the land.⁹

Opponents of the measure estimated probable delinquencies at from 25 to 50%. These figures seem too high when

⁸ For simplicity, state and county levies are here combined into a single county figure.

⁹ Tripled land taxes, even where the total rate would be low, as in the northern forested counties, would accelerate exploitative lumbering and mining operations, a disadvantage which single taxers should take into consideration.

one considers the relatively low assessed value of the undeveloped land which might go delinquent and the alternative possibility of making land productive by improving it. There is also the probability that, if delinquencies were seen to be mounting dangerously toward the end of the 10-year transition period, the income and inheritance taxes permitted by the proposed amendment would have been called upon to bear a larger share of the load. Ten percent delinquency seems a more reasonable estimate. This would raise the necessary average tax rate on the remaining property to 12%, or approximately three times the present average of about 4%.

Consider next the position of land now being utilized in such a way as to make it yield its full economic rent. What tax rate would be required to appropriate all that economic rent and reduce the value of the land to zero? The answer is a function of the present tax rate, the ratio between assessed and market value, and the capitalization rate for the particular land in question. By State law the assessed value is supposed to equal half the market value. Assume also a present average tax rate of 4%. Then a confiscatory tax would be imposed when the rate exceeded 4% by twice the capitalization rate. That is, to take all the economic rent the tax must take both the net income previously appropriated and the net income remaining which gave the land its value. At a capitalization rate of 5%, a tax rate of 14% or more would be confiscatory; at 6% the tax rate would have to equal or exceed 16%.

For the State as a whole the present economic rent of land available for taxation may be estimated at about \$455,000,000, or 13.5% of present assessed

value. This includes existing land taxes of \$125,000,000 plus \$330,000,000 which is 5% of today's land value estimated conservatively at twice the assessed value in 1937. If the 1949 tax burden upon land were only \$360,000,000 as calculated above, there would have been a safety margin of nearly \$100,000,000 in economic rent remaining in private hands.¹⁰ But the burden of taxation in some cities and on some pieces of income-yielding land would undoubtedly have exceeded the economic rent, unless relief had been granted through reassessment or the State made greater use of alternative taxes. Taxes in excess of economic rent could be paid only by using part of the income from improvements, thus indirectly reimposing upon the latter some of the taxation the amendment intended to remove. From an administrative point of view there is much to be said for using supplementary income to keep the land-value tax from exceeding 90% of the economic rent. Land would then retain some market value, remain largely in private hands, and assessment would be facilitated.

Before proceeding further we should digress for a moment to point out that every increase in the tax rate on land decreases the net income and the market value. The assessed value should then be correspondingly reduced, but this would necessitate a further increase in the tax rate. This is one of the most difficult administrative problems involved in the proposed change. The greater the proportion of the net economic rent which the taxing body wanted to take, the lower would go the value of the land and the higher would be the rate which would have to be imposed to yield the expected revenue if assessments were revised downward. As the net revenue

¹⁰ Government expenses will, of course, increase, but so will economic rent. Since conditions 10 years hence

are quite problematical, it has seemed wise to refer all calculations to 1937 as a type year.

remaining to the landowner approached zero, the theoretical tax rate required would therefore have to approach infinity. This mathematical difficulty might be avoided by abandoning the usual method of assessing land at some ratio of its market value. Instead, land could be appraised by capitalizing the *total* economic rent, instead of the remainder accruing to the owner after taxes are deducted. A better method would be to tax directly a certain portion of the economic rent, but this would have the disadvantage of being unfamiliar to the general public.

Certain other possible changes in the tax-base should be noted. Some single taxers estimate that, if farm lands were reappraised to eliminate the value of all man-made improvements, their valuation would drop 50%.¹¹ Others suggest the justice of higher valuations on much city land, also mineral and petroleum land, and would assess public utility franchises. They expect an increased demand for land to occur and raise its value after taxes on improvements are removed. Some of these changes would increase the tax-base while others would lower it, but the net change would probably not be large enough in either direction to warrant revising the tax rate previously estimated.

Effect of the Proposal on Different Classes of Improved Property

The status of present owners of various classes of improved land has not been adequately examined in most single-tax literature. In the California tax picture the tripling of the tax on land values would mean injury to all whose improvements were assessed at less than twice the value of their land. That is, if

¹¹ A provision in the proposed measure specifically included in the improvements which were gradually to be made tax free: "pipes, ditches, wells, tunnels, roads,

the taxes on one's improvements were removed, he would benefit only if the taxes on his land were not increased by a larger amount. This raises the important question: "What kind of property has improvements worth less than twice as much as the land value?" Owners in this class would suffer from the change.

Farm Lands. An examination of assessment rolls in Los Angeles County reveals that those with the lowest ratio of improvement value to land value are the farmers. The ratio tends to be lowest on the larger farms and those given to annual crops. It is highest for walnut and citrus orchards and for places more residential than commercial. But in practically no instance does the ratio exceed two to one. Present owners of these properties should therefore be staunch opponents of the proposed change.

Residences. Urban residential property is of many types. The lowest ratios occur in the older portions of the city where the infiltration of apartments and business has raised land values. Dwellings are old and by rule-of-thumb assessments have been depreciated to a small fraction of their original cost. Many home owners in this area would have to pay twice as heavy taxes under the new system.

New homes have ratios of four or five to one and owners would consequently gain. A rough estimate would be that houses built more than 12 years ago have adverse ratios and those of more recent construction have favorable ratios. Even though the growth of population has been rapid in recent years, more home owners, numerically, would be harmed than helped.

The above analysis for Los Angeles County where land values are relatively

clearing and leveling; also vineyards, orchards, alfalfa, growing crops, planted timber and applied fertility or other alterations or additions to nature made by man."

high would have to be modified for the less urbanized parts of the State. Building costs would there be much the same, but land values lower. Hence ratios would generally be more favorable under the single-tax change for home owners in small towns than in large cities.

Another observation should be made regarding the size of homes among those more recently built. In general, the more the builder spends, the higher the improvement ratio, though exceptions are not infrequent. Older structures do not show a similar trend, for the general depreciation of buildings and the uneven appreciation of sites obscure the original relationships.

"Downtown" Real Estate. Single taxers seem to feel that much of the tax burden would be shifted to "downtown" real estate. An examination of the assessment rolls reveals that most stores and office buildings are now more than 10 years old and in nearly every case have an improvement ratio of less than two to one. A representative sample of 75 downtown business properties in Los Angeles showed an average ratio of 0.4 to 1.0. Samples from Pasadena and Long Beach, where land values are lower and structures perhaps newer, showed ratios of 0.65 to 1.00 and 0.8 to 1.0 respectively, still far below the 2.0 to 1.0 dividing line. Taxes on such property would indeed be increased. But where would be the incidence? Owners of stores rented on long leases would have to bear the brunt of the change except where, as is not uncommon, the lessee is under contract to pay the taxes. In that case the additional cost, since it would be uneven in its effect upon merchants, would mean bankruptcy for some firms. The stimulated construction of new stores on vacant lots would increase competition and make matters worse, assuming a less

than proportionate increase in population and volume of business.

Office buildings present similar problems except that here the owner of the land more often pays the taxes. Wealthy landowners would indeed be hurt by the change and would find no way to shift the burden to others. Ratios for industrial property vary considerably, but are usually within the danger zone. An exception of importance is the public utilities whose property has been assessed throughout the State by the State Board of Equalization at figures which show improvements and personal property (vehicles, transmission lines, etc.) totaling \$849,000,000 in 1937 against a land value of \$100,000,000. This ratio in excess of eight to one would make the public utilities, owners of 1/7 of the taxable property of the State, important beneficiaries of the single tax, though somehow it is hard to conceive their championing the measure.

Apartment houses, particularly the newer ones, are also in the particularly favored group with ratios as high as eight and ten to one. Is the single tax, proverbial friend of home owners, going to prove a whip to drive people to live in apartments where one's fractional land cost is reduced to a minimum?

Effect of the Repeal of the Sales Tax

These conclusions regarding the effect of the proposed tax change upon different classes of property owners must, however, be modified to take account of the gains to be derived from the repeal of the sales tax. For instance, assume an owner of a small home whose assessments are \$600 for improvements and \$500 for land, a ratio of 1.2 to 1.0. At 4% his taxes would be \$24 per year on his house and \$20 on the lot, or a total of \$44. If the tax rate on land were to rise in 10 years to 12% and fall to noth-

ing on the improvements, his tax bill, assessments remaining the same, would be \$60, or \$16 more than before. This increase would be offset if the home owner had an annual income of \$1,600 and spent $\frac{1}{3}$ of it (\$533) on articles formerly taxed at 3% under the retail sales tax. With a smaller income or an older house he would have come out in the red. It seems a fair assumption that few home owners among the low income groups (under \$1,500) own new homes. Their improvement ratio is likely to be low and their saving from sales-tax-repeal small. Hence they are likely to be numbered among those most adversely affected unless roundabout gains through greater employment or lower prices should eventually occur.

Tenants, who comprise some 60% of the population, would benefit from the change. The decreased tax on improvements would stimulate building and reduce rents, while the increased tax on land cannot be shifted to the lessee. There would also be an obvious gain to this group through the repeal of the sales tax.

Effect on Future Land Values

One should not forget that the separation of income from land and income from improvements is merely a device for logical analysis and does not often exist in fact. Improved property usually yields a joint income of rent from land and quasi-rent from improvements. To the present owner of improved property it would be immaterial whether his taxes were levied against his land value or against his improvements or against both jointly, if they were the same total amount in each case. For the future owner, however, it would make a difference, since a property tax exclusively on land values would reduce the initial cost of acquiring land, and for a time

after the change in the tax-base the net income from improvement would probably exceed interest on the investment by that portion of the tax saving not yet passed on to the lessee. The ultimate cost of holding land should not be greatly changed, for taxes which equal economic rent should also be equivalent to interest on the former purchase price, i.e., capitalized economic rent.

Many real estate purchases are not based upon careful audits to determine present and probable net incomes. Capitalization rates are not always thoughtfully calculated and certainly they are not uniform throughout an area as large as California with its varying regional rates of population growth. Buyers and sellers alike "play their hunches" in dealing in investment property. They buy that which they think will appreciate most and sell what to them seems likely to depreciate or have an inferior rate of appreciation. But they follow no set formula and present income may be a minor consideration.¹² Speculative buyers who have paid more than 20 times the current economic rent of their land would suffer severely by the proposed change as, of course, single taxers predict. Once the impact of the tax change had worn off, then new owners of old property would have been as well off as new owners of newly improved property.

Conclusion

The above analysis leads one to conclude that however much the 1938 single-tax measure might have brought social justice and economic gain to future generations of Californians, the burden of the transition would certainly not have been distributed according to the canon of ability to pay. More farm-

¹² Cf. H. D. Simpson, "Incidence of Real Estate Taxes," 22 *American Economic Review* 219-30 (June, 1932).

ers and small home owners of today would have suffered, while the wealthy would have escaped, unless they happened to be owners of unimproved or old, improved real estate. The effect on business firms would have been very uneven. Some would have received an undeserved subsidy, such as the public utilities; others would have suffered an unmerited penalty. Gains would not need to have been passed on to customers or employees, but losses which brought bankruptcy might well hurt workers in addition to owners and credi-

tors. Not until a new "generation" of landowners had taken possession of all property on which the taxes had been increased would the adverse effects have been removed. The probable gains from more extensive land-value taxation make it desirable, but legislation to bring it about must be very carefully drafted to minimize economic injustice and prevent political back-fire. Specific provisions for reassessment of certain classes of land should be included and allowances made for regional economic differences.