

THE MERITS OF SITE VALUE TAXATION
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Using the Instruments of Government Effectively

Three arguments for the application of site value taxation are normally offered in contemporary political discussion. It addresses the problems of 1) the burdensome structure of current taxes, whether on homeowners or on business and industrial organizations; 2) the destruction and expense of current land development patterns, typically known as sprawl; and 3) the deterioration of infrastructure, particularly transportation and school facilities, which policy makers widely acknowledge cannot be allowed to proceed. All of these concerns been addressed by public policy measures of varying and imaginative quality over the course of the past half century, but success is at best mixed. It is difficult, however, to talk about the implementation of site value taxation without also taking into account how such a policy would fit with application of other instruments.

One must begin a discussion by recognizing that governments, constitutionally speaking, have two means by which to effectuate public policy, conventionally known as tax powers and police powers.¹ The primary purpose of taxing power historically has been to raise the necessary revenue to support government functions as defined by the electorate through its chosen representatives. Many students of government argue that this should be its only purpose. President Reagan, for example, reflected this view of taxation when he stated in 1981 that the taxing power of the government must be used to provide for legitimate government purposes. It must not be used to regulate the economy or bring about social change.² This view has within it the implicit view that there is a way to tax that is totally neutral in its influence on economic behavior, something which has not always been understood or agreed to. Taxes have always been used to facilitate socioeconomic policies, and in recent years have become a conscious tool of policy makers even more. One recent study notes that in the state of Washington, for example, 222 of the 378 identifiable tax breaks for special purposes have been enacted since 1970; the state of Oregon, similarly, has witnessed 288.³ But whether using taxing powers to facilitate other purposes is a wise and efficient approach needs to be more carefully considered, and there has been too little discussion of this issue in contemporary scholarship or political life. Furthermore, only recently has it been possible to understand the possibility of tax neutrality.

¹The national government could effect measures to alter socio-economic behavior under the provisions of its war powers, an instrument which has been insufficiently studied in public policy discourse. This is because enacting such measures would likely take a formal declaration of war, something that has happened only five times in U.S. history, the last in response to Pearl Harbor. There is therefore little use of the war powers provision.

²Quoted in William J. Baumol and Alan S. Blinder, *Economics: Principles and Policy*, Fifth Edition. New York: Harcourt Brace Jovanovich, 1991, p. 693.

³Cited by Alan Durning and Yoram Bauman, *Tax Shift: How to Help the Economy, Improve the Environment, and Get the Tax Man Off Our Backs*. Seattle: Northwest Environment Watch, April, 1998, p. 26.

Debate about the influence of various tax designs on social and economic behavior is nowhere clearer than in attempts to describe and define the concept of tax expenditures.⁴ Tax expenditures are special provisions in the tax code, any tax code, that forgo the collection of certain revenues with the intent that their retention by taxpayers will foster public purposes better than through programs financed directly through the budgetary process. Implicit in this notion is the idea that there is some absolute and pure tax base and revenue system which is compromised by various deductions, exemptions, credits, and other allowances that alter its otherwise ideal design. Whether that tax structure can ever be identified, let alone realized in practice, is worth pondering. Yet to abandon all attempts at adherence to the principles of tax theory that have evolved over the course of centuries is equally foolish. Taxes have generally come to be regarded as a necessary evil, but not all taxes are equally evil.⁵ Some taxes are more evil than others, and Milton Friedman once said that a tax on land value is the least worst tax.⁶

To the extent that taxing powers of government are used to implement social policies beyond the collection of revenue, they take on a complexity and a political tenor that involve a number of counterproductive elements. The acceptance of tax expenditures as a means of effectuating public policy in the tax code has led increasingly legislators= vulnerability to the crude blandishments of a host of special pleaders. Such considerations deserve attention and should be kept in mind when the designs of tax structures are discussed. Most often they are ignored. If, on the other hand, tax policy is confined solely to the function of raising of revenue, in the most neutral and efficient manner possible, then other functions of government can be employed to implement what programs policy makers choose to undertake. This encourages greater accountability in the performance of government functions by ensuring that policy makers themselves are in charge of the budgetary process and the performance of public functions. Most functions of government are constitutionally authorized under what are regarded as the police powers of government. Using the tax powers solely for taxation and the police powers for regulation and ensuring public welfare is a matter worthy of further discussion than it receives.

Not all revenue collection on the part of government is grounded in the constitutional authority of its tax powers. Taxes in the strictest sense of the term are revenues involuntarily paid to general funds for the general purposes of government. But there are many other revenues paid

⁴The term "tax expenditure" was coined by the late Professor Stanley S. Surrey during the nineteen sixties. For further detail, see Stanley S. Su Paul R. McDaniel, *Tax Expenditures*, Cambridge, Harvard University Press, 1985.

⁵Discussion of taxation as a necessary evil is presented at length in Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization*, New York: Madison Books, 1993.

⁶In my opinion, the least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago. @ *Human Events*, November 18, 1978, p. 14; see also the *Fortune Encyclopedia of Economics*, New York: Warner Books, 1993.

to government that would never be construed as taxes: lottery revenues, fines, interest payments, environmental (green) fees, payment for information, and user fees being the most common examples. Fines, green fees, and user fees are instruments of police power precisely because their primary purpose is to correct behavior, and only secondarily to raise revenue. User fees, along with environmental fees particularly, are employed to recover the costs of use, wear or damage to environmental or government-provided services. (Only in recent years has it been fashionable to regard use or degradation of the natural environment as a service, necessitating correction, as was originally explicated by Pigou earlier this century.⁷)

Fiscal measures such as those noted above can be employed under police powers to correct, or at least compensate for, otherwise egregious social behavior, and public policy makers must concern themselves with the question whether such measures are more or less appropriate or effective. These provide an attractive alternative to what have come to be known as command and control approaches. Just as are so many fiscal measures, command-and-control approaches to regulating and controlling social and economic behavior is also grounded in the police powers of government. Administrative theory has grown in appreciation for fiscal approaches and away from command-and-control approaches in recent years.⁸ This is because they are often far less expensive and more efficient to implement, easier to understand, have a greater degree of compliance, and has the added virtue, lastly, of raising revenue for the support of governmental responsibilities. This interest in tax shifting has inspired the slogan, *Tax Bads, Not Goods*.⁹

Many so-called command-and-control approaches have been instituted to restore the damage that has come about because of the distortion wrought by the tax structure itself. To take a particularly clear example, the policy of zoning, now almost ubiquitous in our urban areas, has been a consequence of the choices people have made in the wake of a property tax system that encourages development with little rational basis and is economically and socially inefficient. To take a still more poignant instance, the restriction upon development in certain areas in order to retain and restore green space is also a direct consequence of property tax policies that have engendered centrifugal pressures for their development, pressures that would not exist with the right tax structure. And to take a final example, compliance with legal provisions imposed on industries that pollute the natural environment is difficult and expensive to enforce for government, and often confusing, economically inefficient, and expensive to perpetrators as well can more easily be brought about through fiscal instruments that serve as carrots rather than sticks.

⁷ Arthur Cecil Pigou, *The Economics of Welfare* (several editions) London: MacMillan, orig. 1920.

⁸ For a discussion of regulatory versus pricing approaches, the following are some of the major works: Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis and Alfred E. Kahn*, Cambridge: Harvard University Press, 1986; and ed Kahn, *The Economics of Regulation: Principles and Institutions*, Cambridge: MIT Press, 1988; Oliver E. Williamson, *The Mechanisms of Enforcement*, New York: Oxford University Press, 1996; and W. Kip Viscusi, et al., *Economics of Regulation and Antitrust*, Cambridge: MIT Press, 1995.

⁹ Durning and Bauman, op.cit.

At the national level, deregulation has been accomplished in a number of realms of the economy; at the state and local levels, except in the area of electric power, it is essentially unaddressed. Discussion of means by which fiscal measures can replace command-and-control measures continues to be a prime focus of policy discussion in the current government milieu, even though they appear both administratively and politically difficult challenges.

Because command-and-control approaches entail greater scope, weight and domain for government than comparable alternative fiscal approaches, these latter have become highly attractive in a political environment where the public sector, and the taxes to support it, have come to be resented by a large element of the electorate. The more deft and nuanced manner by which fiscal instruments can foster policy goals has led to their greater attraction and more considered use. Command and control approaches, requiring as they do the persistent and assiduous hand of bureaucracy and political oversight, are therefore vulnerable to not just mutation and neglect but even corruption. Well-conceived fiscal measures have the advantages of fostering voluntary compliance and with much less continuous scrutiny. Although many industries have seized upon the anti-regulation sentiment to press for the elimination of any strictures upon their behavior at all, however irresponsible and socially harmful, there is growing appreciation of the power which well-crafted measures hold. While more attention may be required initially to ensure that their design is correct, they ensure, long term, that the economic burden which society bears is far lower.

Performance Evaluation of Government Policies

Just as there are two constitutional approaches which governments can use to implement the public will, there are essentially two approaches to their performance evaluation. They can for convenience be regarded as the inductive and the deductive approaches. They have their counterparts in the historical development of other disciplines, particularly in the natural sciences. Biology and geology were characterized in their earlier years by the collection and taxonomic classification of information of all sorts. More recently they have developed bodies of theory to aid in their evolving facility at generalization and further explanation. The policy sciences have experienced some of the same growth and evolution. Today evolving theories allow students of administration to consider the efficacy and utility of certain patterns of social organization with a view to their comparison and improvement. It becomes less necessary to carry out detailed, labor intensive, and expensive empirical studies to ascertain the merits of various programs and designs.

In the history of taxation, extending as it does to the beginning of civilization, several lessons have been learned that offer instructive guidelines to their heirs.¹⁰ In ancient Israel, taxing trees resulted in barren landscapes. In early England taxing the windows of houses resulted in windowless buildings. So also with experiments taxing frontages, roof lines, and chimneys. For the most part, taxing an item results in a drop in the level of its use, and in its evasion. Taxing

¹⁰Two particularly good general discussions of taxation practices have been written in recent years: Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World*, New York: Simon and Schuster, 1986; and Charles Adams, *For Good and Evil*, op cit

wages discourages work and leads to an underground labor force; taxing sales leads to black markets; and taxing savings leads to offshore banking. Any reader is likely to be able to offer comparable examples. These anecdotal and sometimes even apocryphal stories have over the course of centuries led nonetheless to a body of wisdom about what constitutes sound tax policy and what is not. Students of tax design and administration are an identifiable profession inasmuch as they accept and rely upon a recognized body of knowledge about taxation. This body of theory offers opportunities to evaluate various policy practices in ways that transcend particularistic and anecdotal information. The evolution of policy discourse now allows various practices to be evaluated against a set of principles, enumerated in standard graduate texts and are typically set forth in the beginning of official reports.¹¹

Particularistic empirical studies are still required for many purposes, however. Many of the recent studies of the effectiveness of fiscal measures, those employed with the intention of bringing about precise goals, have been of this nature. Studies of business locational decisions, for example, have been few, precisely because any collection of experiences is necessarily so expensive. When actual empirical studies have been impossible to perform, the next best has been to secure the collective opinion of experts, those at least not vested with particular interests in the success of certain approaches. At the more localized level, where decision strategies have been adopted to revitalize identified areas for development and/or renewal, the studies are again limited by their expense and varied purposes. They are more likely to be inductive, based on limited aggregate data or experience or grounded in general consensus opinion, more than they are evaluated against the more abstract principles and theory that has come to characterize fiscal policy discourse.

With respect to the efficacy of various schemes and programs devised to carry out economic development and urban revitalization, those limited studies available show that their impact is decidedly mixed. Studies of various government programs intended to foster job creation or to engender the critical mass of economic vitality to sustain an area on an upward course show that they are generally not effective.¹² What tends to happen instead is the development of bidding wars

¹¹Most recently the Kemp Commission has invoked these measures in its proposals for reform. See *Unleashing America's Potential: a Pro-growth, Pro-family Tax System for the 21st Century*, Washington: Report of the National Commission on Economic Growth and Tax Reform, 1996. See also Parthasarathi Shome (ed.), *Tax Policy Handbook*, Washington: Fiscal Affairs Department, International Monetary Fund, 1995.

¹²Roger Wilson, Policy Analyst, *Economic Development in the States: State Business Incentives and Economic Growth: Are they Effective? A Review of the Literature*, Lexington, KY: Council of State Governments, 1989 and *Do State and Local Tax Incentives Work?* by Robert G. Lynch, Lexington: Economic Policy Institute, 1996.

between the several states and localities, driven by the felt pressures of political leaders to produce results even when more resources are spent in attracting the enterprise than are likely to be returned in subsequent benefit. These zero-sum games between competitive political jurisdictions benefit the industries that are being wooed with little net gain to the general public. At the micro level, incentive programs offered to depressed localities and to revitalize demarcated areas show equally mixed results, a matter to be discussed further below.

Principles of Sound Tax Theory

There is greater advantage in assessing the merit of various tax strategies against principles that have their beginnings with the writing of Adam Smith more than two centuries ago. These principles, typically noted as four, five, six, or seven, form the guideposts for assessment of what is a sound tax and what is not. It is worth describing in brief form what constitutes the core of tax experience, offering as it does a shorthand for further assessment of fiscal practices. Then, it will be possible, having looked at the measures of tax design and administration as lessons have been learned, to investigate the effectiveness and congruity of those policies which have been employed in Minnesota. It will also be evident how certain tax practices have in fact engendered the very problems the State of Minnesota faces with respect to resentment of taxes, inefficient land use, urban inactivity, transportation dislocation, and environmental despoliation.

The place to start is taking advantage of what economists and tax theorists have learned over the course of the past three hundred years about a government's role in the economy. Far from assuming that the economy works best by a total hands-off policy as Adam Smith was falsely believed to have advocated by his invocation of an invisible hand, policy leaders need to recognize that certain values we hold dear are outside the economy, and are threatened by our failure to price them properly. That we treat certain goods and services in nature as free means that we overuse them and our environment is degraded. Clean water and air, for example, aren't given any value in our economic system, and when they are degraded by agricultural runoff, industrial pollutants, or auto-emissions, those who are using up these resources go untaxed. The notion that the economy is a self-regulating system, operating according to defined laws and in ongoing equilibrium, is no longer entertained by serious students of economic and fiscal policy. The debate rather is over which government interventions are constructive and which ones are dysfunctional. The best place to start correcting property tax inequities and environmental degradation is by the right kind of taxes.

Tax theorists evaluate revenue structures according to the criteria of ***economic neutrality***,

*efficiency, equity, administrability, simplicity, stability, and sufficiency.*¹³

Tax neutrality refers to the influence (or absence of such) that any particular design has on economic behavior. Typically taxes are perceived as a damp on economic activity. Taxing income reduces the incentive to work, taxing sales discourages retail transactions, and taxing savings reduces the propensity to save. The more neutral the tax, the less identifiable the distortions it imposes on the economy. The common assumption of most tax theorists is that all taxes impose distortions; it's simply a matter of which ones are least burdensome to economic health. A tax which imposes no distortions is theoretically best.

Tax efficiency is much like tax neutrality, and measures how much shifting of behavior it imposes, resulting in what is called "excess burden," or "deadweight loss" on the economy. Tax economists usually hold that the best taxes are those that are shifted little if at all. Because the elasticities (a technical word for the slope of supply and demand curves) of each differ, a tax on items that have little or zero elasticity is the best way of assuring that taxes are not shifted. Zero elasticity is another way of saying fixed supply, such as, for example, land.¹⁴

The principle of equity is central to any discussion of tax design. Tax design must consider both what is fair in the context of the other principal considerations. Fairness can be evaluated according to what is termed "horizontal equity" (the extent to which those in similar circumstances will pay similar tax burdens, and "vertical equity" (how well those in different classes bear different burdens in the tax structure in terms of what is called Ability to pay.¹⁵ It is this latter perspective that leads to the use of terms like "proportional," "progressive," and "regressive" in referring to tax structures. A tax is progressive with respect to income if the ratio of tax revenue to income rises when moving up the income scale, proportional if the ratio is constant, and regressive if the ratio declines. There is an ancillary question of whether taxing to reach greater equity should employ measures of income or of wealth, difficult as this is to measure.

Administrability refers to the ease with which a tax can be administered and collected. Taxes which distort the economy are inefficient as are taxes that cost lots to administer. This is measured not only in the direct costs of tax avoidance and accounting expenses, but in the level of

¹³Adam Smith's *Wealth of Nations* (1776) remains even today a starting point for students of tax design, for he captured, even at that early time, the sum of learning to that date but his own acute insights. See, for example, "Principles of Taxation, in Light of Modern Developments," *Federal Tax Policy Memo*, The Tax Foundation, Washington, DC. For further discussion of what students of tax policy regard as the principles which should guide their design, see, for example, Richard and Peggy Musgrave, *Public Finance: Theory and Practice*, Fifth Edition. New York: Praeger, 1989, Part Four: Principles of Taxation, pp. 210-314; George Break, "Taxation," *Encarta Encyclopedia* by Microsoft, 1993; "Principles of a High Quality Revenue System," *Tax Notes*, March 21, 1988; David G. Davies, *United States Taxes and Tax Policy*. New York: Cambridge University Press, 1986, pp. 17-19; and *Unleashing America's Potential: a Pro-Growth, Pro-Family Tax System for the 21st Century*. Washington: Report of the National Commission on Economic Growth and Tax Reform (Kemp Commission), 1996.

¹⁴Hence Will Rogers advised people to **Buy land, because they ain't makin' any more of it.**

¹⁵User fees, however, employ another notion of fairness: **benefit received, costs incurred or wear imposed.**

*evasion and cheating, and by the cost of government auditing and policing.*¹⁶ When the taxpaying public perceives that a tax is easily evaded, cumbersome, and unfair, it loses its legitimacy and calls government itself into question.

This is why the principle of simplicity is important: the more complex the tax design, the more lawyers and accountants will find loopholes, encourage the appearance of unfairness, and drive up the cost of its administration. With simple taxes other parties cannot avoid paying their fair share, thereby enhancing the legitimacy and hence the compliance of the tax system.

Stability refers to the ability of a tax to produce revenue in the face of changing economic circumstances. Income and sales taxes, for example, vary according to phases in the economic cycle; the property tax, in contrast, is highly stable regardless of the state of the economy.

In assessing the value of a tax it is also important, of course, to understand its potential to bring in revenue for the purposes of government, usually deemed revenue sufficiency. Income, sales and property taxes, along with corporation taxes to a lesser extent, have come to be regarded as the workhorses of the American revenue structure. But, as anti-tax politicians are quick to note, the higher these taxes are, the more they impose a drag on the economy. One recent study calculates that the deadweight loss due to taxes in the American economy is equal to \$1 trillion every year, about a sixth of the total GDP.¹⁷ This is why one should ponder whether to consider raising taxes which have demonstrable distorting effects.

Much of the environmental damage we have witnessed in the 20th century can be laid directly at the doorstep of faulty government policy, particularly fiscal policy. Suburban sprawl, to take the instance of greatest concern to us all now, results from two misapplications of fiscal policy applied under police powers. The first is the pricing motor vehicle transportation service at only about a tenth of what it really costs to drive. The second is the design of our conventional property tax which encourages the destructive practice of land speculation and the centrifugal forces of sprawl. The argument needs to be developed in two parts. Pricing transportation services properly are equally as important as location pricing, as the two are, to a large extent, reciprocals. In this report only the matter of property taxation is addressed.

¹⁶ Alan Durning notes in his book *Tax Shift* (1998, p. 17), that "Complying [with the personal income tax alone] takes Americans 5 billion hours each year. For every dollar raised, U.S. taxpayers spend nine cents obeying the law. Cheating is widespread; roughly one-fifth of the tax goes unreported."

¹⁷ Fred Harrison (Ed.), *The Losses of Nations: Deadweight Politics versus Public Rent Dividends*. London: Othila, 1998. See also Dale Johnson and Kun-Young Yun, "The Excess Burden of Taxation in the United States," *Journal of Accounting, Auditing, and Finance*, fall 1998.

Land Tax is the Perfect Tax

It may therefore come as a surprise to many that the perfect tax to students of tax theory is one imposed on land value alone. Unlike the conventional property tax which uses both land value and improvement value as its base, a tax on landsites satisfies all the criteria of sound tax theory. It is highly stable, regardless of the state of the economy. It can always be set to raise sufficient revenue, without undue burden. Because land supply is inelastic, it cannot impose any economic distortions and it is therefore totally neutral with respect to all economic choices. Whatever tax is borne is capitalized in the value of the site parcel, without in any way affecting its sale price, which of course is determined by the market. Most importantly of all, studies have now recognized that a tax levied on land according to its value is quite progressive, contrary to much conventional wisdom.¹⁸

To a land economist, the land value and any building value must be regarded separately: each has its own economic dynamic. As to the land component, one must understand that the value of that site is due not to how the owner uses it but rather due to the activity of the whole neighborhood or even the region. Any value which a land parcel accrues above the cost of its creation is due to the accretion of what economists call economic rent. The word rent has a very different meaning than that used in everyday discourse. Since the community is responsible for the rise or fall in the value of a land site, or rather of all those in the neighborhood, any increase in the value of that location can be reclaimed by that community more than by the titleholder alone. Were it not for the accretion of land rent on a parcel, all land would have the same market value.

When one looks at the value of land in any broad way, its value will be highest at the center and falls as one looks out to the frontier. The highest value land, that with the greatest accrued rent, is at the very center of the city—usually where the commercial parcels are located. In the spring of 1998, one land parcel (the building was to be razed) of less than an acre and split in two pieces in New York City's Times Square was sold by Prudential Life to Disney for an estimated \$240 million,¹⁹ more than the value of all the land and buildings together in the lands north of the

¹⁸ See, for example, the discussion in the current leading graduate text in graduate public finance courses: Harvey S. Rosen, *Public Finance*, 4th Edition. Homewood, IL: Irwin Press, 1988, pp. 483-489. See also Mason Gaffney, "The Property Tax is a Progressive Tax," *Proceedings, National Tax Association, 64th Annual Conference, Kansas City, 1971*, pp. 408-426. [Republished in *The Congressional Record*, March 16, 1972, pp. 5-79. (Cong. Les Aspin.) Resources for the Future, Inc., *The Property Tax is a Progressive Tax*, Reprint No. 104, October, 1972]; James Brun, "Who Bears the Burden of the Property Tax?" in C. Lowell Harriss (ed.), *The Property Tax and Local Finance*. Proceedings of the American Academy of Political Science, Vol. 35, No. 1 New York, 1983, pp. 56-71; Henry J. Aaron, *Who Pays the Property Tax: A New View*. Washington: Brookings Institution, 1975; and Charles C. Geisler, "Land and Poverty in the United States: Insights and Oversights," *Land Economics* Vol. 71 (February, 1995), pp. 16-34; and Andrew Reschovsky, "The Progressivity of State Tax Systems," *The Future of State Taxation*, David Forster, Editor, Washington: Urban Institute Press, 1998, pp. 161-189; Edward N. Wolff, "Distributional Consequences of a National Land Value Tax on Real Property," in Dick Netzer (ed.) *Land Value Taxation: Can it Work Today?*, Cambridge: Lincoln Institute of Land Policy, 1998.

¹⁹ *New York Times*, March 7, 1998.

Mohawk River/Erie Canal in New York State. The highest value land is typically surrounded by a belt of residential areas, and with farmlands starting at the fringe. The more valuable parcels are taxed, the more their titleholders will find ways to recover their carrying costs. And it cannot affect the behavior of tenants as any change in burden is not passed through. In this sense, land value taxation fosters clustered development and reverses the egregious patterns of sprawl. **Jessica Matthews, now with the Council on Foreign Relations, recently wrote a syndicated piece observing that,**

In a now familiar sequence, developers reach for the cheapest land, out in the cow pastures. Government is left to fill in behind with brand-new infrastructure—roads, sewerage systems and schools—paid for in part by those whose existing roads and schools are left to decline. Property values rise in a ring that marches steadily outward from the city and fall in older suburbs inside the moving edge.

Because residential development can't meet the public bills, local governments compete for commercial investment with tax discounts that deplete their revenues still further. Property taxes then rise, providing an incentive for new development.

Years of such leapfrogging construction devours land at an astonishing pace.²⁰

Taxing high value land parcels encourages their efficient use. The highest value parcels will then be settled at sufficient density that public transportation services become economically viable—experts recognize that it typically takes at least 10-12 households per acre for this to happen.²¹ ***This both relieves dependency upon motor vehicle transportation and enhances the livability of communities. Taxing land alone also removes the penalty for titleholders who want to improve their properties. Under current property tax structures, one is penalized if one adds a garage, an extra wing of rooms, or in any way makes an upgrade. This is perverse: when people maintain and improve their homes and other buildings it is a social and economic benefit.***

Taxing land by its value has many economic advantages. The first is that it is equitable: those who have title to the most land value will pay the most taxes; those who have no land pay no taxes. Because a tax on land alone cannot be passed on to tenants, this means that all those households that do not own their own home will pay no taxes. Nationally only 65 percent of households are homeowners; in New York State, it's only 52 percent.²²

²⁰ "Are Automobiles the Blessing that's Turning into a Curse?" by Jessica Matthews, Albany Times Union, Friday, October 4, 1996.

²¹ *Transit and Urban Form*, Report 16, Portland: Parsons Brinkerhoff, National Academy Press (sponsored by the National Research Council's Transportation Research Board), 1996.

²² <http://www.census.gov/hhes/www/housing/homeown/tab1.html>

And since we know that it is typically the wealthier element of the society that owns there is a certain fairness in this. Of those parcels that currently pay taxes on their real property, about half are homeowners, and the remainders are commercial, industrial, and agricultural titleholders. Agricultural parcels typically have very little market value because their location is so remote; they would have little if any tax burden. Commercial parcels, in contrast, are usually sited in very high value locations, and therefore would pay the most. A shift of taxes away from buildings and onto land alone typically relieves homeowners, and adds to the burden of high value parcels (usually in commercial cores) that are underused relative to their value—fully depreciated structures, parking lots, drive-in banks, gas stations, fast food services, and so on.

*Equity for people whose incomes have suddenly changed is easily maintained with site value taxation, such as the elderly.*²³ Building, like cars or any other manufactured items, typically depreciate over time, but land, conversely, usually appreciates. More than twenty states have instituted a system where people facing difficulty paying their property tax can defer it. Such policies allow people to live in their homes after they retire or if their incomes have fallen, and it opens up housing markets for young families who might otherwise not yet have means to purchase their first home. Then when they finally Acash out@ to move or go to retirement homes, the sale of their asset can be used to pay the tax liability in full. This works much like a reverse mortgage. It removes any special privilege for any given class of taxpayers.

*In addition, a land tax provides few loopholes and is hard to evade. There is increasing evidence that many people are able to hide their wealth and income from the tax collector by moving it offshore to places like Monaco or the Cayman Islands. One can=t move one=s land to another place. It is no accident that eight Nobel prizewinning economists have endorse the idea of taxing site value.*²⁴

Until recently there was concern that it was impossible to accurately evaluate the market value of land parcels in the absence of sufficient comparable sales data or when the site had improvements. This is no longer a concern, largely due to the advances in computer databases used for comparison and to the availability of computer programs such as GIS (geographical information systems). In fact it is now easier to assess the

²³ See further discussion of this below.

²⁴ Led by future Nobel laureate William Vickrey and others, a letter was circulated in 1991 signed by thirty leading economists, eight of the winners, urging that Mikhail Gorbachev implement a tax solely on land value. That letter is reprinted, with signatories, in Richard Noy, *Now the Synthesis: Capitalism, Socialism & the New Social Contract*, London: Shephard-Walwyn Press (New York: Holmes & Meier), pp. 225-230.

value of land than it is the value of buildings.²⁵

Conventional Instruments of Fiscal Policy: An Assessment

Apart from strategies which rely upon police powers of government to foster land use patterns consistent with the public good, three instruments have been relied upon in recent years that are fiscal in nature. The first is public purchase of land parcels so that they will be held off the open market for development or else exempting them from taxation so long as they are retained as farmland or open space. A second is tax increment financing, and the third is impact fees. One needs to ask in each case whether these measures are complementary or antithetical to site value taxation's effects. Examination of the administrative and economic dynamics of each, taken in conjunction with the earlier discussion of site value taxation, will make clearer just how compatible they are.

Open Space Preservation

These programs usually involve either direct purchase through public money or provide for preferential and deferred assessment of qualifying agricultural, forest or other open lands. When the land no longer qualifies for the deferment or is sold, a tax is often due equal to the amount by which the preferential valuation has reduced the property tax for the previous several years. Farmland is eligible if it is primarily devoted to agricultural use and meets certain farm income, production and ownership requirements. Owners must file an application for the deferment with the local assessor to receive the benefit. The intention of the program is to relieve the pressure on titleholders to sell their lands to developers for reason that the tax burdens are too heavy for them to maintain.

How it happens that land value has increased so much that its tax burden is onerous to its owners is a frequently asked question. The answer of course lies in the fact that site values are a function largely of their geographic location, and when locations are such that their value has greater potential use for use other than as agricultural or open space, there is imminent pressure to develop them. This is usually the consequence of development elsewhere, either private or public, and of the fact that parcels in a new region generally reflect increased value as well. The greatest single factor in altering the locational value of a particular land site is the provision of improved access. The development of a new highway, an added interchange, a new shopping center, or other public facility will immediately raise the value of all the sites in close proximity. Farmland or open space exposed to the economic impact of these larger forces will be subject to the pressures of development, even when the gain is short term, the land use configurations wasteful and irrational, and the added externalities argue against such use. Policies can be instituted to discourage such pressures beforehand, and taking such action is far more sound than trying to recover open space later when it is later threatened with loss.

²⁵At the moment this writer is seeking to demonstrate the advantages of assessments of this kind using GIS computer algorithms coupled with databases.

Measures that have been adopted throughout the nation to address the concern about wasteful and haphazard land development have been expensive and questionably effective. The most expensive method of all is for the public to buy up such parcels, typically at market price, and protect them against development by ownership of title. Most often the market price identified reflects the development in adjacent areas and gain in value which titleholders have counted on as a speculative investment. Buying open land seems to be the approach being taken in New Jersey at the present time,²⁶ and is reflected in the Smart growth@ program recently announced by Vice President Al Gore.²⁷ A further variation on this is to place such parcels in a land trust, such that their use is thereafter limited. This device is usually by people who are looking to shelter otherwise taxable income gains. But, whenever the parcels are purchased by either the public or various conservation organizations, the practice is likely to reward the very practices they are intended to resolve: they reward the titleholders who in many instances have purchased the land years earlier and have seen their values escalate. Now, at a time when concern has built over the consequences of speculative land development, these very same people are rewarded for their apparent foresight. This ignores the underlying problem that prompted the behavior in the first place.

The core problem is that economic forces have been put in place that drive development to the periphery of developed areas, fostering further peripheral development. Whether attempts to address it by urban growth boundaries, conservation trusts, public purchases, tax deferrals and exemptions, or other devices, all purport to answer the problem in the face of its continuing, and even growing, pressure. Changing the economic dynamics which bring about such behavior are what needs exploration. The study of land economics shows that the answer lies in the recovery of land rent in areas of greatest appreciating gain, thereby making urban high-value parcels more economically competitive with the outlying areas, and reversing the centrifugal forces that are currently at work. This entails a greater understanding by the public of how land values influence land use configurations, as well as how cross subsidies due to tax policy designs, transportation services and externalized public costs engender sprawl development and threaten open space. Graphical maps are able to show how differential land values make development more feasible in outlying areas, particularly when the public foots the bill for the infrastructure services.

Tax Increment Financing

Tax Increment Financing (TIF) is a typically a state-enacted

²⁶<http://www.state.nj.us/sos99/tree.html>

²⁷http://smartgrowth.sustainable.org/library/gore_intro.html

statutory procedure available to cities and counties to encourage the redevelopment of blighted, conservation or economic development areas. The TIF statute authorizes the governing body of a city or county to adopt a redevelopment plan providing for the redevelopment of a designated area and to use tax increment financing to fund the costs of redevelopment projects in the same designated area. The method of financing involves the issuance of bonds or other obligations which are secured by a pledge of all or part of funds deposited in a special allocation, or earmarked, fund. The special allocation fund is funded with payments, in lieu of taxes, attributable to the increase in assessed valuation of taxable real property within a designated area resulting from redevelopment improvements.²⁸

The theory of TIF is that by encouraging redevelopment projects the assessed valuation of real property in a redevelopment area will increase. When a TIF plan is adopted, the assessed valuation of real property in the redevelopment area is frozen for tax purposes at the current base level prior to construction of improvements. The owner of the property continues to pay property taxes at this base level. As the property is improved, the assessed value of real property in the demarcated redevelopment area increases above the base level. By applying the tax rate of all taxing districts having power within the redevelopment area to the increase in assessed valuation of the improved property over the base level, a "tax increment" is produced. The tax increments, often referred to as "payments in lieu of taxes" (or pilots), are transferred by the collecting agency to the treasurer of the city or county and deposited in a special allocation fund. Revenues in the fund are used to directly pay for project costs or to retire bonds or other obligations issued to pay project costs.

Few states, it appears, have made greater use of tax increment financing than Minnesota.²⁹ But after more than twenty years of experience, there is little demonstrable evidence that such programs have been effective in bringing about their professed purposes. A considerable amount of study has been undertaken with the expectation of refining established practices. Concern is frequently expressed that the provisions are employed in areas where development would not otherwise have taken place, or where it might have evolved in any case. There is frequent mention of the fact that such projects are undertaken in response to special interest pressures, favoring well-situated

²⁸ Eric Kassoﬀ, "Tax Increment Financing Development Districts," *Land Use Law and Zoning Digest*, January, 1991, reprinted in Patricia E. in (ed.), *Financing Local Transportation Infrastructure*, Government Law Center, Albany Law School, January 14, 1992; and Sam Casella, *Tax Increment Financing Report #389*, Chicago: Planners Press, American Planning Association, 1985.

²⁹ *Tax Increment Financing*, Program Evaluation Division, Office of the Legislative Auditor, State of Minnesota, Monograph 96-06, March 1996. The State Auditor also issues an annual report on Tax Increment Financing, the most recent of which was released on April 12, 1995.

parties that would be equipped to undertake enterprises anyway. The programs that exist, now established in 44 states, take rational initiative out of the hands of economic players and place it in the hands of political leaders who may or may not be responsive to general public interest concerns. To be sure, a large number of consulting firms have established themselves to profit by guiding the various players through the intricacies of various TIF programs. But there is little evidence to show, apart from the professions of parties intimately tied to the success of such ventures, that they would be successful were they left to their own initiative.

Without getting into the details of the programs in Minnesota per se, two more general discussions are suggestive of the current views of disinterested students of tax increment financing. Penelope Lemov, the highly regarded public finance reporter for *Governing Magazine*, knows the sentiments of local and state officials throughout the nation. In her last review of the subject in 1994, she concluded that these were *A tough times for TIFs,*³⁰ and that credit agencies were increasingly looking askance at their value. Particular attention was paid in this article to the difficulties that Minnesota has experienced. The view was expressed, reflective of many of her contacts throughout the nation, that TIFs were not typically able to recover the costs of their investment, particularly inasmuch as revenue that would have been allotted to other taxing authorities was diverted to the earmarked TIFs, and in consequence depressing the economic activity of the neighboring areas. A more recent study released by the Public Policy Institute of California casts strong doubt on TIF successes.³¹ The conclusion stated that

Redevelopment projects do not increase property values by enough to account for the tax increment revenues they receive. Overall, the agencies stimulated enough growth to cover just about half of those tax revenues. The rest resulted from local trends and would have gone to other jurisdictions in the absence of redevelopment.

Another study done on the efficacy of TIFs in Pittsburgh was undertaken by a team of reporters for the *Pittsburgh Tribune Review* in 1998.³² In a series of three long articles, the conclusion was drawn that projects there had a mixed success at best and were so fraught with political intrigue that it was

³⁰Lemov, Penelope, "Tough Times for TIF," *Governing Magazine*, February, 1994, pp. 18-19.

³¹Michael Dardia, *Subsidizing Redevelopment in California*, Monograph of the Public Policy Institute of California, January, 1998, p. 2.

³²By Rich Lord, *September 20-24, 1998*.

impossible to ascertain whether they would have been compelling in the absence of such interventions. Much of the uncertainty about the security of TIF approaches depends upon leveraging land sites as an asset in securing greater financing. But land values are very much subject to fluctuations and forces beyond the immediate environment. They are, rather, a consequence of the vitality of local and regional economics, and may take unpredictable turns after initial arrangements have been made.

One could certainly argue that, if a TIF is likely to be effective in redeveloping one area of a locality, why should it not be employed in other areas as well, or universally. Picking favored enterprises through administrative or political intervention, and without the general input of elements of the public that stand to pay the costs, removes decisions from the hand of the free market, precisely in whose name such projects are often undertaken. If the proverbial Alevel playing field@ is to be the framework in which enterprises are to be judged, every effort needs first to be made to foster that leveling. TIFs work in exactly the opposite manner, with mixed results.

Impact Fees

Impact fees are fees assessed by municipalities to developers for costs associated with off-site improvements necessitated as a result of the proposed development.³³ Typically the improvements are transportation infrastructure, but they can be used for the recovery of benefits associated with investments in water and sewer, telecommunications utilities, or other cost recovery which can be delineated by a specific area and administered by a levy on property. Unlike TIFs, however, impact fees involve guarantees of income return and can be added on rather than substituted for other revenue sources. Furthermore, they mostly apply to recovering costs associated with capital improvements only, and allow recovery of administrative and related expenses, but not maintenance expenses. They are seldom, if ever, used to correct existing deficiencies or fiscal problems in infrastructure development. Rather, they apply only to new and enhanced development. ***Impact fees are usually collected from users of infrastructure improvements according to their estimated proportional use at the time the facilities are authorized for construction or occupancy.***

In this way, the increased burden on parcel titleholders in the defined benefit area is reflective of the added value that stems from the infrastructure service. The greater the infrastructure investment, the greater also is the benefit in the area serviced. Although the administration of an impact fee structure typically involves forecasts of both investment costs and

³³James C. Nicholas, et al., *A Practitioner=s Guide to Development Impact Fees*. Chicago: Planners Press, American Planning Association; Patricia E. Salkin (ed.), *Impact Fees for New York Municipalities: Time for Legislative Action?*. Government Law Center, Albany Law School, April, 1991.

revenue requirements, it is a foregone conclusion that they will be in rough balance or else the project will not be undertaken. Although the design of an impact fee is frequently related to an existing tax on real property, imposed in the same way a surtax would be, this is not necessarily so. For example, the recovery of benefit for a project may also be secured through data on trip generation of commercial facilities.³⁴ It may be based on a proxy indicator such as the consumption of water. Impact fees may even be linked to special benefit districts programs such as police patrols or fire prevention services. On the other hand, when services are each earmarked to specifically defined funds, the efficiency of their administration is typically reduced. The relationship between costs incurred and benefits received is necessarily approximate, and, as the revenue principles noted above suggest, whatever may be gained in attempts to achieve equity is likely to be lost in the administration of greater complexity.

Fees of this nature are evaluated somewhat differently than are taxes more generically defined. Tax equity is typically measured according to ability-to-pay criteria; user and benefit fee equity, on the other hand, has no relationship to one's ability to pay, and may even conflict with it. User fees, in contrast, are usually evaluated according to the criteria of costs or damage incurred or benefits received.³⁵ As will be clear shortly, the peculiar nature of a tax levied on land value is its effective function either as a tax based on one's ability to pay and as a fee based on benefits received.³⁶ It satisfies both criteria of tax equity.

Coupling Conventional Instruments with Site Value Taxation

Land values in any given area tend to rise and fall together, and tend also to form a contour somewhat comparable to a topographical survey map. In the city's center are the highest value locations, analogous to a mountain peak. As one departs from that center, land values fall in direct proportion to the value of their use, made more or less attractive by whatever social attributes have been provided in the proximate areas.³⁷ Thus, staying with the topographical comparison, a typical metropolitan area would show hills at neighborhood centers, with land sloping away to areas of lower value, with ridges and ripples of various elevations extending away from cities marking the transportation corridors where contiguous land areas are more attractive to use. Continuing out, a topographical model shows less and less height,

³⁴H. William Batt, "A Transportation Development District Fee Using a Land-Value Component," Presented at the Annual Conference of Geogist Organizations, Los Angeles, July, 1993; and H. William Batt, "A Framework for Designing A Transportation Development District," Presented at the Northeast Regional Conference of the American Society for Public Administration, October, 1993.

³⁵H. William Batt, "User Fees: The Nontax Revenue Alternative," *State Tax Notes*, Vol. 4, No. 14 (April 5, 1993), pp. 787-794.

³⁶Walter Rybeck, "The Property Tax as a Super User Charge," in C. Lowell Harriss (ed.), *The Property Tax and Local Finance*, Proceedings of the Academy of Political Science, Vol. 35, No. 1 (1983) pp. 133-147.

³⁷This is discussed in detail in Joseph K. Eckert, et.al (eds.), *Property Appraisal and Assessment Administration* (The International Association of Assessing Officers, 1991, pp. 182-183.

symbolizing lower and lower value, ultimately to reach the hypothetical point where no potential buyers exist at all.

Of course many public policies have distorted the market values of land areas, and maps can show patterns reflecting divergences from what logic and economic theory would suggest. The influence of land speculation, choosing consciously to hold certain attractive and valuable parcels off the market with the hope of securing high sale prices, has had a profound effect on the configuration of our urban areas and accounting for the now ubiquitous problem of sprawl.³⁸ This makes more complex any portrayal of land values in a region, even though it remains true that locations tend to rise or fall relationally. The combined effect of not adequately recovering land rent in taxes, a tax which penalizes improvements, and underpricing motor vehicle transportation has changed the gradient in land values in urban areas profoundly. The result is that there typically exists in most regions a patchwork of differential land values that sprawl over the landscape in ways that defy both efficient performance and use configurations as well as logic.

In a land use configuration with no property taxes to distort uses, no subsidies to transportation services, and no constraints on use of certain parcels or areas, one would likely find that the slope of land values from core to peripheral regions would be both gradual and uninterrupted. Remote areas typically used for agriculture or forest will have the lowest values, but closer to the central areas site values would rise sharply. Today instead one more often finds parcels used ostensibly for agriculture but which are really being held for speculative gain. Whether the visions for their use are residential suburbs or commercial shopping facilities, this patchwork is likely to be determined by the existence of other developments, the presence of transportation, communication, and water and sewer infrastructure, as well as more indeterminate factors such as zoning.

The result is that there is no simple way *a priori* by which to determine whether or not (or where) there will be disjunctures in the land value and/or tax burdens between current levy systems and site value taxation. Current configurations are random even if the latter have a logic. The only answer is a piecemeal test of each prospective application, even where other refinements have been proposed and tried. The greatest disparities are likely to be in what parcels are identified as open space *Agreen acres,* because their current tax burden is determined largely by their use, whereas under a site

³⁸ *Mason Gaffney and Fred Harrison, The Corruption of Economics* (London: Shephard-Walwyn), 1994; and H. William Batt, *How 1 roads Got Us on the Wrong Economic Track,* *Torch Magazine*, Winter, 1998, and [://www.geocities.com/Athens/Acropolis/5148/batt_railroad_1.html](http://www.geocities.com/Athens/Acropolis/5148/batt_railroad_1.html).

value system their market value (and hence assessed value) is determined far more by their location. Centrally and strategically located parcels identified as green acres in densely developed areas would likely be taxed more heavily under a site value regime. Absent measures to insure their remaining open, they are likely to be improved. On the other hand, holding those sites vacant frequently enhances the market value of adjacent parcels so much that there is no necessary loss of revenue to the public where the former are preserved as natural. The enhanced value of developed areas overlooking untaxed parkland often more than makes up for whatever loss of revenue those vacant sites might have provided.³⁹

With respect to the existence of TIFs in certain demarcated localities, it is not just that their tax revenue is often sequestered and earmarked to honor the retirement of bonding. What also happens is that the revenue base, and hence the parcel values, is distorted as well. The combination of economic and legal factors interfering with the natural market pricing of parcels means that there is again no *a priori* way to ascertain how revenue structures will be affected. The legal contracts governing such revenue streams are binding, and are likely to prevail over any attempts to apply site value taxation in an equitable fashion.

This should not be taken, however, as an argument against the implementation of site value taxation, far from it. The distortions in tax equity and in land use configuration wrought by the current policies are likely to continue and further exacerbate the imbalances evident at the present time. There is no consolation or advantage to continuing policies that are misguided if indeed those policies are likely to create increased and more insurmountable difficulties at a later time. Speaking conceptually, democracy finds it hard to direct a society to specific goals because it is engaged in "process" politics as opposed to "systems" politics:

As the name implies, process politics emphasizes the adequacy and fairness of the rules governing the process of politics. If the process is fair, then, as in a trial conducted according to due process, the outcome is assumed to be just or at least the best the system can achieve. By contrast, systems politics is concerned primarily with desired outcomes; means are subordinated to predetermined ends.⁴⁰

If the criteria of fairness changes, as happens with the

³⁹*An illustration of this has just unfolded in New York City in the spring of 1999, where Mayor Giuliani proposed that the publicly owned vacant parcels being used by neighborhoods as community gardens be sold and developed as private properties to add to the tax roll. The neighborhoods arose in vehement resistance, and won to retain their gardens. They were able to show that those vacant parcels more than tributed to the added tax base of the city as well as fostering neighborhood solidarity and safety by their existence.*

⁴⁰*William Ophuls, Ecology and the Politics of Scarcity Revisited: The Unraveling of the American Dream, New York: W. H. Freeman, 1981, p. 11.*

application of site value taxation, the challenge is even more formidable, and leadership, education, and luck are needed more than ever.

It is likely that impact fees are the easiest provision to align with site value taxation of the three instruments just discussed. One could argue that impact fees are simply a variant of site value taxation for a delimited spatial area. Because site values are a function of their proximity to other features that have a mutually reinforcing value, they reflect the presence of infrastructure attributes just as they do other attractions. Indeed the replacement of impact fees with site value taxation is likely to more accurately reflect actual benefits received, as frequently the boundaries of an impact fee benefit district either are arbitrarily drawn or have changed over time. Hence it is that those people who reap the benefit of a service facility may not always be those who bear their proper share of its burden. Eliminating the boundary of an impact fee district rectifies this potential disparity and restores the equity implicit in an impact fee=s design.

Phasing In Site Value Taxation

In most instances, the technical implementation of site value taxation involves little more than a ten-minute computer adjustment such that a tax rate is applied solely to the land value component of a parcel's assessment rather than to the total (land and improvement) value taken as a whole. This assumes, of course that assessments are tolerably accurate and reliable, but, if they are not, the same objection would obtain with reference to the conventional property tax design. Indeed if an assessment is performed well, the land value component is more likely to be accurate than the improvement component.⁴¹ Addressing issues of politics and equity involved in the transition are more difficult.

Because the conventional property tax would be gradually replaced by a tax on site value alone, it is important to recognize how various elements of the population typically fare under such a change. The shift toward site value taxation involves gradually raising the proportion of revenue yield from the land value base while lowering the revenue yield from improvements in revenue neutral fashion. Several generalizations can be drawn from experiences and simulations performed elsewhere. When aggregate improvement values are calculated as a ratio to aggregate land values, one derives a figure (a ratio typically between 2:1 and 3:1 improvements to land) which can serve as a quick index determining which parcel holders will pay higher taxes and which will pay less. Those parcels with a higher-than-average ratio of improvement values to land values will find themselves with lower taxes; conversely, those with a lower-than-average ratio will pay more in taxes.

⁴¹*The value of land parcels are separately determined, but this is not always so. If assessment of property are properly done, land should be treated as the residual value remaining after whatever calculation is arrived at on the improvement. This is often regarded as a critical mistake made by assessors, and accounts for the often undervaluing land in conventional practice. Knowledgeable assessors realize full well, however, that land values must be arrived at separately.*

Generally speaking residential parcel owners end up receiving a lower tax bill, sometimes substantially lower. This is because residential parcels are typically situated not in the highest value locations but rather midway between the center and the rural sections of a municipality. Moreover, residential parcels have a relatively small footprint: they are essentially a house, a curtilage, and perhaps a small garden. The highest value parcels are typically business locations, chosen precisely for their strategic access. It is this which makes them valuable. Under site value taxation these business parcels typically pay higher taxes. But, as will be shown in the more elaborate explanation below, this constitutes no penalty to their success.

Households that do not own their own homes, apartment tenants, will have no property tax burden shifted to them at all. This is because, as earlier explained, the inelastic character of land means that any increased tax burdens placed upon it is simply capitalized in the market value of the parcel. Agricultural and woodland parcels in the more remote locations typically see negligible tax burdens, because the land value gradient falls so far from central business districts, to residential neighborhoods, to rural areas that the effect frequently is to unburden these parcel titleholders almost entirely.

Alleviating Special-Case Hardships

Because any transition to site value taxation necessarily catches some titleholders in the position of having to abide by a changed set of rules, ones which they would not have bought into had they been in place when their original locational choice was made, there is justice in phasing in any tax on site values in incremental steps. If, for example, 35 percent of all the property tax base in a municipality represented the land component under the existing property tax, this could be shifted gradually so that initially 50 percent of the revenue was drawn from land and improvements each. This would entail two rates: one rate imposed on the land value component and one on the improvement value component. A year or two thereafter, the percentage yield from the land might be increased once more, to 65 percent, and gradually higher until such time that improvements were exempt from the burden of taxation entirely.

In the overwhelming number of instances, parcel holders' tax burdens shift only a few points or dollars. The tails of the distribution see great changes in their tax bills. Those that have a very high ratio of building to land value will experience large reductions in their tax burden. Those, on the other hand that have a low ratio of building to land, or alternatively have title to vacant parcels with high site value, will experience large increases in their tax burdens.

Even though only a small proportion of the sites will experience changes, there is merit, perhaps also justice, in adding special provisions to address cases of undue hardship. One does not want, for example, to have so sudden and grave a shift in the tax burden that certain titleholders are unable to pay their bills. Furthermore, it is counterproductive to a municipality to shift its rate so quickly that real estate markets are disrupted. To address special circumstances, it has often been proposed that any parcel experiencing an increase in burden over 3 percent in a given year will be held to that limit. That guarantee would affect only a miniscule number of parcels and can serve to relieve any resentment and anxiety that otherwise might eventuate.

Another difficulty is often expressed with respect to elderly or indigent homeowners that are threatened with eviction from their homes for lack of ability to pay. While this circumstance in no way relates only to situations for site value taxation, it can arise even under the current conventional property tax structure. The fairest and economically most efficient solution is what is known as tax deferral. Property tax deferral programs offer a far more equitable alternative than provisions such as the more commonly known homestead exemption, especially if it is agreed that senior citizens should be relieved of a portion of their tax burden while they continue to live in their homes. These operate much as reverse mortgages and relieve homeowners of the burden of heavy taxation when their incomes can ill afford it. Such programs are designed for elderly homeowners who are equity-rich but cash-poor. Taxes are owed to a locality until the equity in the property is liquidated, and then paid off in full, usually with interest. Deferral programs are available to elderly homeowners in twenty-one states.⁴²

Because senior homeowners typically capitalize their lifetime incomes into their property during their working years, most in retirement are house rich but income poor. Although as yet there has been little discussion in this vein, analogies might be made to retirement pensions, wherein assets are accumulated during one's most productive years, exempt from taxation, to be "spent down" during one's retirement years and taxed. If concern is only to avoid forcing retirees to relinquish their homes, many more equitable ways of doing so are possible. Retirement homeownership can be thought of as the same kind of "spend down" when employed with reverse mortgages and property tax deferral programs.

⁴²*In five of these states the programs are offered at the option of local governments. Fifteen of these states require qualifying homeowner income eligibility guidelines, and six make the programs available to elderly homeowners of all income levels. State Tax Policy & Senior Citizens, Second Edition. Washington: National Conference of State Legislatures, December, 1994, pp. 52 ff.*

If one examines the financial resources of households relative to their age, one is likely to find that senior citizens are the wealthiest segment of the population, even if their income as such is less. Households with growing families usually have comparatively less wealth, even if they have greater income. Yet as a matter of policy, legislatures have typically elected not to tax wealth except in the form of estate taxes. And much of a home's value, reflected in the appreciation of the land value, is the consequence of the public not recovering the economic rent. The increased value that typically accrues to homeowners is solely in the land component (the building depreciates in value), likely making it their greatest asset. But, following the theory upon which the concept of economic rent is grounded, it is an asset which is a result of community enterprise, not something earned by the individual parcel holder. Taxing that rent means both that there would be less appreciation and that tax burdens reflecting the property value would not inflate over time.

Senior citizens have shown a marked reluctance to relinquish these windfall nest eggs they accumulate over the course of a lifetime—preferring to hold them either as private safety nets or to pass onto heirs. In fact they often come to regard this as their rightful due. Yet whenever certain elements of the population are favored as to housing privileges, others necessarily are not. In view of the large number of households that cannot afford home ownership at all, fostering this level of overhousing for favored groups is economically inefficient and arguably unfair. Public policy issues are implicit in such decisions that warrant discussion, and programs should be implemented that encourage rational behavior, even if certain people may sometimes choose to behave irrationally. Deferral programs deal with all these problems effectively by diffusing the issue of intergenerational equity. Offering deferral programs to senior homeowners alleviates any appearance of injustice about property tax burdens, and makes any discontent less credible.

If deferral programs are to be available for senior citizens 65 and over, there is no reason in principle why they should not be available to others as well—people who are temporarily unemployed, for example. There are many instances where the circumstances of homeowners change precipitously, and simple equity calls for the application of such programs without discrimination as to age. But other programs intended to relieve hardship often incur just as many inequities as they are intended to resolve. The widely known circuit breaker offers a case in point. The circuit breaker is intended to relieve the tax burden for people whose payment exceeds a specified percentage of household income.⁴³ Because residential sites, and the costs of living, vary so much from place to place,⁴⁴ the parameters are frequently set so widely that, as described earlier, those eligible can be house rich even if they are income poor. Just as deferral offers a suitable solution for other instances where the burdens are disproportionate, they are an efficient alternative to homestead or circuit breaker programs.⁴⁵

⁴³ *Household income is defined in a variety of ways from state to state, sometimes including social security payments and sometimes not.*

⁴⁴ *In many states the difference in median residential home values varies as much as six or seven times from metropolitan to rural areas, accounted for not by the cost of the building but rather by that of the land. State statutes addressing concerns over equity usually establish thresholds so high that they provide windfalls to residents in low land-value areas as they concern themselves with the burdens of others in more expensive*

Still other ways of alleviating the burden of land taxes, just as for the conventional property tax, involve the timing of tax payments. Discounts can be offered for early payment, for example, the opposite of surcharge penalties added for late payment. Payments can be spaced monthly or quarterly rather than paid on an annual basis. This is especially attractive where bankers hold no mortgage and do not maintain escrow accounts for all maintenance payments such as insurance, utilities, etc. If zoning changes are instituted that in any way alter the use or value of a site, revaluation might be guaranteed and paid for by the taxing authority. Partial exemptions may be provided for uses of sites consistent with expressly public purposes. Lastly, partial rebates can be provided for those whose circumstances change, or where structures have been damaged or demolished.

The Equity of Site Value Taxation

It is important to address the matter forthrightly of who wins and who loses with site value taxation. The greatest proportion of winners are those who own no real property at all: tenant households. In the conventional property tax system, the tax component that rests on the improvement portion of a property parcel is passed on to the tenant in increased rent. Tenants, one should note, are in most instances financially the least well off elements of the society, and for them the added rent reflected in the tax passed forward can be considerable. The tax on the land component, reflecting the inelasticity of land supply, cannot be passed forward, and its incidence is borne solely by the owner of the land. Relieving this component of the population of any property tax burden makes this tax substantially more progressive than it is for the conventional property tax. Nationally, approximately 65 percent of all households own their own home.

areas.

⁴⁵However, the circuitbreaker provision does nothing to remove the distortion in land use wrought by the tax structure.

As to the burden added to business parcels that occupy high value locations and which typically would receive an increase in their payment, capitalization of their taxes in the value of their parcels exerts a downward pressure on market values. However, there is a countervailing pressure that also operates: the incentive to all parcels in a neighborhood to improve to the full extent that the added carrying costs warrant (particularly the least efficiently used parcels relative to their value) tends to make the aggregate value of all the land in a neighborhood increase in collective fashion. Site value taxation often tends in fact to exert an upward market pressure on land value that is higher than the downward pressures explained by the tax burden. The total tax effect then tends to be neutralized, with a result that all the parcels in a neighborhood tend to be better used and maintained. Studies show the power of land value taxation to induce economic development. One by Oates and Schwab shows by comparative counts of building permits issued in Pennsylvania cities that do and do not employ site value taxation. Those cities with SVT had profoundly higher number of building permits issued in comparable periods of time.⁴⁶

A final point to note is that most businesses in commercial districts do not own their own buildings; they rent. This means that the actual tenants, whether they are commercial, light industrial, office service or even residential, will typically see little if any change in their tax burdens on account of the shift to SVT. With respect to the owners of those sites, the rates for the rental of floor space that they set is determined not by the amount of the tax burden but rather by the rental price per square foot over a wider region. All that can possibly eventuate is that the differential between the income received from the payment of tenants and the carrying costs of building maintenance and debt service may be reduced. Should that happen it will be at most a gradual adjustment over a lengthy period. The destructive inclination to speculate in land, however, is strongly reduced, consequently improving urban ambience by attention to vacant land parcels of high value.

Conclusion

Americans all appear to be losers to the property tax in at least one sense of the term. There is an incalculable dead weight loss associated with the appeal system, the burdensome administration, the resentment and alienation alone that naturally accompanies such a design. This needs to be pointed out, in addition to the further distortions in land use configurations wrought by such a design.

⁴⁶ See Wallace Oates and Robert Schwab, "The Impact of Urban Land Taxation: The Pittsburgh Experience." Cambridge, MA: Lincoln Institute of Land Policy, WP92W01, 1995. A second and very recent study by Florenz Plassmann found that on average, a one percentage increase in the tax differential will yield an increase in the total value of construction of 17.8 percent. Florenz Plassmann, "The Impact of Rate Taxes on Construction in Pennsylvania." Doctoral Dissertation, Virginia Polytechnic Institute, 1997, p. 122. This study can be found at <http://scholar.lib.vt.edu/theses/public/etd-61097-13834/etd-title.html>.

Typically residential parcels represent somewhere in the vicinity of half of all real property taxes paid. And homeowners, being particularly sensitive to and aware of their property tax burdens, understandably are aroused. Data is only now being assembled to show this distribution on a state and national basis, but it is quite clear that, although the proportions vary widely, that represented by Olmsted County would rest at the highest end of the spectrum. The result of such a profile is not only to burden the households with taxes they both feel the weight of, it also feeds resentment of government, encourages ANimbyism@ (Anot in my back yard@), and fosters land use configurations that force people to spend more of their after-tax income in ways to accommodate the dislocations which the tax structure has created.

Secondly, those households that do not own their own homes are burdened with taxes that are passed to them as tenants, and these are people typically the least able to sustain such tax burdens of any in the locality. They suffer not only the weight of the tax burden but also the fact that government resources are constrained to serve them through adequate public services. Urban cores, far from having the highest tax bases from which to draw revenue are instead hamstrung in their development by the Alphonse/Gaston games played between governments and urban land holders.

Non-residential titleholders also face uncertain fortunes that discourage their willingness to make commitments to their holdings, fearful that the level of risk involved is so high that they are better rewarded to follow trends in the making elsewhere. And those other trends are likely at the periphery of urban areas where ever expanding rings of growth away from the center offer a more assured level of financial return. Lastly farmers, caught between the pressures to sell their holdings lucrative gain and the uncertainties imposed on them by international agricultural markets, are tempted to sell while they can, not knowing whether the future will be better or worse. Quality of life takes a back seat to immediate returns and the promises of financial security. There are few real Awinners@ in a poorly designed property tax system. The costs imposed on society by the ill considered but once-established templates scratched into the land are permanent, and in many cases irreversible.

The feasibility of site value taxation in the current context, however, is hardly better than the choice of considering the patterns that are now in place. Urban areas that developed their configurations prior to the advent of the automobile have shown an ability to employ SVT effectively and with skill. And in circumstances where patterns of land use are not yet established, site value taxation is demonstrably effective, defining a sense of place that quickly establish their identities. In regions that have developed premised first of all on motor vehicle transportation, the challenge is far more difficult. The metaphor of changing horses in mid-stream is very apt. Going back is impossible, but going forward is equally daunting. Leadership and planning are premium qualities facing societies with such challenges.

More than any time during the past century, tax policy has come to dominate the political agenda in American society, and the public seems particularly unaware, even more than for other realms of public policy, of the framework by which to think about it. One student of tax policy, Michael J. Graetz, has written a book entitled *The Decline (and Fall?) of the Income Tax*,⁴⁷ and will issue a second shortly entitled [the] *U.S. Income Tax: What it is, How it Got that Way, and Where we Go from Here*.⁴⁸ But although the income tax and its various forms dominate the national agenda, it is the property tax that has become the focus of the state and local government discourse. It is not simply a matter of what mode of taxation should be considered, just as important is the level of government that should be responsible for services to be provided. This necessarily entails a discussion of the finance of such services. For the first time perhaps in half a century, Americans are being forced to consider their framework of government, and the role that government should play. With it, of course, is an examination of the scope, weight and domain of government, something which is as much a matter of economic discussion as it is one of politics.

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⁴⁷Michael J. Graetz, *The Decline (and Fall?) of the Income Tax*, New York: W.W. Norton, 1997.

⁴⁸Michael J. Graetz, *[The] U.S. Income Tax: What it is, How it Got that Way, and Where we Go from Here*, forthcoming, New York: W.W. Norton, 1999.