Property Tax Reform in the Big Picture

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Paper Delivered at the Conference on Land, Wealth, and Poverty

The Jerome Levy Institute, November 3, 1995

INTRODUCTION

"Make no small plans: they have no magic to stir men's blood," quoth Daniel Burnham.[1] As a successful architect and planner, he knew how to stir his clients' blood. However, his ringing phrase is negative and preemptive, hence overstated. Leo Tolstoy noted in *War and Peace* that wars are won and lost by the sum of individual confrontations on chaotic battlefields, where generals lose control. Folk wisdom says "The devil is in the details." We do need small plans, lots of them, to implement big visions. My hat is off to the trench warriors who are advancing graded tax plans in Pennsylvania and New York, one small city at a time.

Let's rephrase Burnham in the affirmative: Make big plans; they have magic to stir people's blood. Big Plans imply Grand Visions. Henry George had few peers at stirring his hearers' blood, and agreed.

> "If you would move men to action, to what shall you appeal? Not to their pockets, but to their patriotism; not to selfishness, but to sympathy. Self-interest is, as it were, a mechanical force … But in loyalty to higher impulses men will give even life."

Big Plans and Grand Visions inspire small ones. They also help orient and coordinate them. They help us divide the major from the minor, to direct our work most efficiently. This is what I will attempt here.

Big Plans can also scare people, it is true. We see this right now, when drastic changes and new philosophies are moving in Congress. That does not mean they won't prevail, however. They scare some because they move many others. Abstract philosophies, living only in intellectual undergrounds, build up slowly until suddenly they take command. This is how change occurs. Superficially it seems "sudden," but intellectually the way has been paved by years of Grand Visions and Big Plans.

The upshot is, we need Big Plans with Details Ready. My time slot leaves no time for details, so I speak here of Big Plans with magic to stir the blood of those who see the benefits of supporting government from land and resource rents. I'll sketch the big picture, where details fit in, and how they all fit together.

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[1] I am told now it was really a Burnham draftsman who inscribed this gratuitously around the edges of a blueprint.

Priority #1: Safeguarding the Property Tax

We need to uphold and safeguard the property tax as the mainstay of state and local finance. Remember, it is partly a tax on land value. It is the institutional basis for much of the Georgist goal. We speak of reforming the property tax, but first there must *be* a property tax. Because it exists, we can modify it to tap land rent for public uses in a non-catastrophic way, using traditional laws, administrative agencies, and land tenures. Capping the property tax rate, as in California, ties the hands of reformers.

There has been much ado about Hawaii's phased-in shift to a graded property tax plan. However, Hawaii raises only 16% of its state and local revenues from the property tax, so the rate is very low. You can focus the Hawaiian property tax on land values 100%, and still have an 84%-messed-up tax system. Studies would then show little visible result from the reform. Critics would say, "Ho-hum, we told you so."

New Hampshire is another story. It raises 64% of its state and local revenues from the property tax, double the U.S. mean of 32%. New Hampshire is called a "low-tax" state, but its property tax is highest in the nation, per capita, at $1,344. The U.S. mean is $699 per capita, and it goes down to $174 per capita in Alabama. Politicians whose priority is raising sales taxes for property tax relief might study Alabama's economy overall, and ask if that is the model they aspire to. Its per capita income ranks forty-first in the United States. May Georgists please stop looking for miracles from Fairhope, Alabama? At Alabama rates, the Fairhope plan is tokenism. Meantime, New Hampshire's marshy peneplains, barren granites, icy winters, and impassable mountains are producing the seventh-highest per capita income in the nation.

In New Hampshire, fortunately, Assemblyman Richard Noyes is hard at work upgrading the property tax. He is chair of the legislative committee overseeing assessment quality; his priority is bringing land assessments up to market, and building assessments down. He does this by pushing for more frequent reassessment. Whatever he thus achieves in the Granite State is magnified by its high dependence on the property tax.

How about New York? It ranks near the middle in the ratio of property taxes to all state and local taxes, at 33% (the U.S. mean is 32%). That is not because New York property taxes are low, but its other taxes are high. So New York is an OK place to sow the seed of two-rate tax plan, but the harvest of any success will be sparser than it would be in New Hampshire.

How about Pennsylvania? This state stands out for its efforts to reform local property taxation but, sad to relate, it ranks below the middle in the ratio of property taxes to all state and local taxes, at 29%. It is low in property taxes per capita, at $609, less than half the New Hampshire level. Property tax reform in Pennsylvania is, therefore, heavily diluted. Add to that the problem of overlapping tax jurisdictions: when a city reforms its property tax, its county and school district carry on as before. What changes, then, is just one-third of 28%, or about 9% of the complex of state and local taxes. Federal taxes are totally untouched. Trench warfare in Pennsylvania cities is therefore inchmeal, and the results hard to measure.

What happens when a state radically slashes its property tax? Michiganders are saying they must wait and see, but there is no need for that: California can show you seventeen years of experience. To read your future, just study our past. Here is what has happened since California passed Proposition 13 in 1978.

The obvious direct results have been to cut public services, raise other taxes, and lose credit rating. Our school support fell from No. 5, nationally, to No. 40 in 1985 when last seen, and still falling. County road maintenance is down to where my county (Riverside) is repaving its roads at an annual rate of once every 130 years. Once in twenty years is recommended here, and up north you generally need higher frequency. You can't just build infrastructure and then stop paying for it; it's a perpetual commitment. Thanks to urban sprawl, a high fraction of our population now depends on these county roads.

In 1978 we had a surplus in Sacramento. Since then we have raised business taxes, income taxes, sales taxes, and gas taxes, but go broke every June. Now our state bond rating is last among the states. One of our richest counties (Orange) has gone bankrupt; Los Angeles is on the brink of it, saving itself by closing emergency rooms and hospitals that serve as a last resort for the uninsured poor.

The private sector is doing badly, too. Raising income taxes, business taxes, and sales taxes is no way to stimulate an economy; they are all a drag on work and enterprise. Our income per capita was down from No. 7 to No. 12 among the states by 1992, then fell some more. From 1992 to 1994, California was one of three states where median household income fell. Our unemployment rate is 9%, 50% higher than the national mean of 6%. Our poverty rate is 18%, compared to 14.5% nationally. Not surprisingly, therefore, the only government function that grows now is building and operating prisons. One of our few rebounding industries is cinema, the art of escaping from reality: we excel at that. Another thriving activity is that of auctioning off used machinery for export to the east.

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

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

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

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

It should give one pause. It is, however, if you think about it, the expectable result of what the voters did. They turned property from a functional concept into a sacred one; from a commission to be enterprising, hire people, produce goods, and pay taxes into a welfare entitlement. They rejected the concept of a tax on inert wealth in favor of the rival concept of taxing liquidity and cash flow. The predictable result is to inhibit economic activity, and encourage holding wealth inert and stagnant.

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

David Shulman tersely summarized the distributive effects of Proposition 13 as he left us for Salomon Brothers in Manhattan: "it breached the social compact." Alienation is the result, and the Rodney King riots, arson, and looting are the results of alienation. True, the Watts riots preceded Proposition 13, but they were part of a national epidemic. By 1967 there were riots with arson and looting in seventy or more American cities. The Rodney King riots were endemic to California, and spread over a much wider area of Los Angeles than the Watts riots did. The looters and arsonists were not all black, and the targets were not all white, but mainly Korean-Americans who just happened to be there minding their stores.

Conventional wisdom blames our bust on the end of the Cold War. Surely that is a factor, but as a causal explanation it is too pat, too easy, and ahistorical. Compare today with 1945. Los Angeles' economy depended much more on the Hot War, 1940-1945, than it ever did on the Cold War. Los Angeles' wartime boom had swelled its population as no other great city, 1940-1945. After 1945 the United States pulled the plug on defense spending, more than today. Jane Jacobs, in *The Economy of Cities*, tells us what happened to military spending in Los Angeles after 1945. It lost three-fourths of its aircraft workers, and 80% of its shipbuilders. It lost its military and naval overseas supply and replacement businesses. Troops stopped funneling through. It got worse: petroleum and cinema and citrus, its traditional exports, all declined.

Pundits then forecast a regional collapse. Yet, regardless, Los Angeles never collapsed, nor missed a beat. The wartime immigrants stayed put here. They formed creative, innovative small businesses in large numbers, giving L.A. its deserved reputation for having the most dynamic, flexible, adaptable industrial base in the nation. Besides exporting goods, L.A. also became more self-contained, providing itself with more of the goods it previously imported. How could this be?

One-eighth of all new businesses started in the United States were in L.A., 1945-1950. These were small, creative, flexible, and too varied to classify. No Linnaeus could sort them in conventional categories: the new Angelenos simply stayed here and started producing everything for themselves, some things previously imported, and others never seen before. Eastern firms established branch plants here. Top eastern students came to California's great university system, and stayed behind to make careers and jobs here. There was a kind of regional "El Dorado Effect," as demand and supply grew together, and growing local demand allowed for economies of scale serving local markets. Food and shelter were cheap and abundant. Land for business was accessible, providing a basis for the whole self-contained phenomenon. A "continental tilt" developed in both interest rates and wage rates, drawing in eastern capital and labor.

Why is that not happening today, 1995? An invisible, pervasive change is Proposition 13, which makes it possible to hold land at negligible tax cost. In 1945 land was taxed at 3% every year, building a fire under holdouts to turn their land to use. Today that same tax cost is well below 1%. Using Gwartney's Rule of Thumb (see below under Priority #2, A, "Reassessing Land Frequently"), it is about one-eighth of 1%: a rate of 1% applied to one-eighth of the true value.

Landowners are only taxed now if they use their land to hire people and produce something useful. When they do so, they meet the drag of our high business and employment and sales taxes, necessitated by the fall of property taxes. A handful of oligopolistic landowners control most of the market; small businesses are squeezed out. This helps us segue from being at the cutting edge of industrial progress to a third-world economy—from the New Hampshire model to the Alabama model—with little relief in sight.

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

Several states had "single-tax" movements and initiatives, 1910-1914, but most of them petered out. In California they continued through 1924, and then popped up again in 1934-1938, when Jackson Ralston led an initiative movement to replace the unpopular new sales tax with a land tax. In 1934 the "EPIC" platform of Upton Sinclair included a significant Georgist element—it proposed a surtax on "large land-holdings held out of productive use," for taxing "natural resources," and for setting up new factories on idle land (Sinclair, 1934, p. 123). Meantime, Jackson Ralston was pushing a purer land tax initiative, 1934-1938.

Ralston and Sinclair lost, but the mere existence of such political action in California, when the movement was torpid elsewhere, tells us a lot. It reveals a large matrix of supportive voters and workers to whom politicians (including elected county assessors) would naturally respond by focusing on land assessments. Politicians survive by accommodating and absorbing dissident movements. Even while "losing," such campaigns raised consciousness of the issue to such a degree that assessors were focusing more attention on land. Thus, in California, 1917, tax valuers focused on land value so much that it constituted 72% of the assessment roll for property taxation—a much higher fraction than today.

This remained the California tendency for years. As late as the late 1960s, Sacramento County elected an avowed single-tax assessor, Dr. Irene Hickman, while San Diego County harbored an active movement, the California Homeowners' League, that focused its efforts on raising land assessments. There were four California cities that supported active branches of the Henry

George School—San Diego, Los Angeles, San Francisco, and Sacramento—while most states had none. These schools were small, but a surprising number of leading elected officials had studied at them and showed the influence. These included state Senators Alan Mills and Albert Rodda (chair of the Senate Finance Committee), Congressman Lionel van Deerlin, Senator Alan Cranston, and Assemblyman William Filante.

California displayed amazing growth up to 1978, and the resilience to shrug off the loss of war industries after 1945 and still grow "explosively" (as Jane Jacobs put it). After 1978 we have a string of reverses. The timing, along with a priori causative analysis, plus various direct observations too numerous for this time slot, support a hypothesis that the reverses were aggravated by Proposition 13. Michigan, be warned: "This Could Happen to You."

Priority #2: Enforcing Good Laws We Already Have

A. Reassessing Land Frequently

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

New Hampshire Assemblyman Richard Noyes has published data on the effect of reassessment in New Hampshire. The land fraction of assessed value rises each time there is a reassessment. Keene, New Hampshire, is in the lead, with frequent reassessments, a high fraction of land in the mix, and a particularly strong track record attracting enterprise and jobs.

In California, where we used to have good assessment, we now have bad assessment legally mandated by Proposition 13. So long as land is unsold, and/or not newly improved, its assessment rise is capped at 2% a year, while market prices soar. Here is one example of the results. This year (1995) the Metro Water District of Southern California (MWD) condemned 410 acres for a new reservoir to expand the system (to accommodate land speculators in the desert boonies). A local jury hit them for $43 million, which works out to about $1.95 a square foot.

How does that square with the assessed value for property taxation? I asked Ted Gwartney, a professional appraiser then with the Bank of America, to check the assessed value. It is about $0.07 a square foot. The condemnation price, supposedly based on market value, is about twenty-eight times the assessed value.

This is not the result of fractional assessment. In California we assess property at 100% when land changes ownership, or there is new building. Rather, this is the result of Proposition 13 and its prohibition of market reassessment until land sells.

I thought that was startling, but appraiser Gwartney's reaction was "Ho-hum." He, who works with such data every day, has a rule of thumb that market land value in California today is about eight times assessed value. That is important enough to repeat: *our assessed land values are routinely at one-eighth of true land value*. I wouldn't dare say that on my own authority, but Mr.

Gwartney is right here to confirm it. He is a veteran appraiser; for many years he was director of assessments for the entire province of British Columbia.

Does this help you understand why California landowners are now so slow to adapt to new demands, and respond so slowly to the withdrawal of old military demands? In 1945 the assessors were building fires under them, so they sought new uses to meet new needs. Today there is only a weak such incentive: tax collectors mainly only shoot them if they move. Sit still, lie low, hire no one, hang on, produce nothing, and your holding costs are negligible.

A little of the old magic lingers. In October 1995, a 225-acre parcel in Corona, the Chase Ranch, was sold to a builder, Coscan Davidson Homes, for building 967 units. The previous owners, GGS, including a Japanese insurance firm, were "seeking a way out. They were behind in tax payments, and GGS was *losing its staying power*," quoth Stephen Doyle, spokesman for the buyer, Coscan Davidson Homes. Think about that expression, "staying power." Is that a productive use of economic power? It is that "staying power" that stifles land use and production. Coscan wants to build immediately. Even so, though, it will take five years to build out the project.

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

B. Using the Building-residual Method

It is equally important to use the "building-residual method" of allocating value between land and buildings. This means you value the land first, as though it were vacant, based on highest and best use. You subtract this land value from the total value of land-cum-building as currently improved: the residual, if any, is building value.

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

Using this method, I valued Milwaukee land in 1963 and 1967. The building-residual method nearly tripled the land values reported by the city assessor, who was using the assessor's usual inconsistent mix of various other methods. By his methods, buildings on the eve of demolition were carrying values higher than their sites; by the building-residual method they had no value at all, which of course is why they were being torn down. Besides depreciation and technological obsolescence, many buildings suffered severe "locational obsolescence," owing to shifting demand patterns. The land was reusable, and had as much or more value without the extant buildings.

Using the building-residual method requires no change in present laws. It is within the latitude of assessing officials. These worthies, in turn, respond to public opinion. The conscientious citizens' move is to raise consciousness and bring pressure.

C. Federal Income Taxes

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

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

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

Thus far, any tax preference goes to A, the builder, and may be seen as a well-considered stimulus to building. Watch, however, what happens next. "A" sells to B, and B depreciates the building all over again, from his purchase price. To do so, B must allocate the new "basis"—i.e., his purchase price—between non-depreciable land and depreciable building.

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

Assessors don't care as much as they should: local revenues are not immediately nor obviously affected. Local assessors have little reason not to accommodate their constituents, local landowners, to help them depreciate land for federal and state income tax purposes. Thus, they have little reason to use the correct building-residual method of allocating value, and a compelling reason to use the incorrect alternative, the land-residual method. This latter method understates land value, thus converting non-depreciable land value into depreciable building value. It is the modern version of "competitive underassessment." In the process, however, it also converts the local property tax from a land tax into a building tax.

After a while B sells to C, who in turn sells to D, so each building is depreciated many times. So is a large part of the land under it, time after time, although it should not be depreciated at all.

This is carried so far that real estate pays no federal or state income taxes at all, a matter developed by Michael Hudson in another paper for this conference.

The solution to this lies with the U.S. Congress. The need is to limit depreciation to one cycle only. It is a most urgent problem for both federal and local treasuries. We all have congressmen. Write them and raise their consciousness. They are just brokers: they respond to public opinion, as they should. It is we who are derelict: get on their cases.

Priority #3: De-Balkanizing Tax Enclaves

A. Rich and Poor

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

In California, you might think that rural counties like Tulare have a lot more taxable real estate value per capita than suburban ones like Marin. Such is the conventional wisdom, but it is not so. Tulare County reports assessed values per capita of $38,100. The whole state averages $60,000 per capita. Suburban Marin County weighs in with $95,400; urban Los Angeles County has $59,000; Orange County has $74,000.

You might also think that Tulare, being rural, has a lot higher fraction of land value in its mix, but again, not so. The land share of real estate value (LSREV) in Tulare County is 28%, compared to a statewide mean of 40%, and 47% in Orange County.[2] Grazing and mining counties like Inyo have high values of LSREV, but they are a small share of the farm economy.[3] Counties with intensive working farms, like those of the San Joaquin Valley, have low values of LSREV.

Within counties, disparities among cities and school districts are even greater, much greater. One desperate little farm town in Fresno County, Parlier, has just $10,000 of assessed value per capita. Here are some assessed values per capita from different California cities in the county of Los Angeles: Lynwood, $21,500; Beverly Hills, $294,000 (thirteen times Lynwood); City of Industry, $5,533,000 (257 times Lynwood, and 553 times Parlier).

This is why some critics have called the property tax "regressive." Balkanization of the property tax gives some plausibility to the otherwise bizarre claim that switching to a sales tax is less regressive than sticking with a property tax. Within each city the property tax is progressive, but when your data meld cities like poor little Parlier and Lynwood with Beverly Hills you sometimes find poor people paying more of their income in property taxes than rich people, and

[2]This datum, and others of like kind, refute the conventional belief that farm counties are heavy on land in the mix. On this last point, I must respectfully take issue with my good old friend Gene Wunderlich, whose paper at this conference suggests that farm counties have higher land fractions. I wonder if he has perhaps conflated building values with pure land values? My data, from the California State Board of Equalization, show lower land fractions in real estate in the purely rural counties of the San Joaquin Valley.

[3]Inyo County, lightly peopled but heavily cattled, has $136,000 per capita, with very few human capita (and its cattle are exempt from the California property tax).

getting less for it. Switching just the *local* property tax to land exempting buildings will do little to correct such disparities. It will therefore make little progress toward overall distributive justice, and the wide support that would evoke. There is, in fact, a natural cap on local property tax rates imposed by local particularism. The City Council of Beverly Hills will not raise taxes in Beverly Hills for the benefit of voters in Parlier.

To avoid such regressivity we must work out some formula for power equalization. The most straightforward formula is simply a statewide land tax. On this I must again applaud Dick Noyes in New Hampshire—not for what he says, but what he does. What he *says* is that the genius of New Hampshire is its local control of revenues; what he *does* is initiate bills for a statewide land tax.

There are many other tax enclaves and exemptions by which much property stays off the tax rolls. I have a long list, with about thirty-five items. Here I'll just focus on two: timber and oil.

B. Timber and Timberland

Standing timber is generally now exempt from property taxes, by law or custom. Land remains on the property tax rolls. This sounds like a Georgist idea; advocate Ellis Williams, a forest economist, has made the point. It is, however, just partial and discriminatory Georgism. Standing timber is exempt, but as soon as it is cut, milled, and hammered into buildings, it goes on the property tax rolls. The bias is apparent between capital in different forms. The kind with higher labor content—buildings—is taxed higher so the kind with less labor-content—timber—may be exempt.

Timber still yields some revenue when it is cut. The idea has been to substitute a yield tax for the property tax. In practice, though, yield tax rates are much too low to be revenue-neutral. In California, for example, the yield tax rate is 2.9%. Two-point-nine percent, levied just once at the *end* of each sixty years is obviously less than 1% levied every year, starting from year one. Values are very low in the sapling years, it is true, but well above zero; and, in the last few years before harvest, the stumpage is worth nearly as much as its final harvest value. I have calculated that a yield tax of 38% or so (varying with the tree life and the interest rate) is needed to have a present value equal to that of a 1% property tax (Gaffney, 1996). The present system works as though you exempted half the buildings in a city from a tax and raised the rate on the others.

Here is the revenue result in one major California timber county, Mendocino. Its major property value is timber, but the county government and its subdivisions hardly get dried beans from the yield tax on it: $3.9 million in 1993, compared to $45 million from all property.

This is not because they are cutting timber slowly; actually, they are depleting the inventory. Neither is it because other values are high. This county has no large cities. Most of its people live outside cities, and its annual timber harvest is twice as high as the sum of all its other "agricultural" gross output (including fishing). The *net* cash flow from timber harvests is much more than twice as high as the *net* cash flow from other property, because stumpage value is added mainly by property (land and growing stock), while other farm products like grapes, fruits, and milk are more labor-using.

How about land under the timber? It is separately valued, and kept on the property tax rolls. However, it yields revenue of only $1.2 million—one-third of what the yield tax renders.

Why so little? They could raise the valuation of timberland to compensate for exempting the trees. In addition, "timberland" in some areas is sold for vacation homes and resorts. Assessors once began using those sales to justify higher valuations. They also observed smaller timberland owners paying higher unit prices than giant corporate owners, and up-valued parts of the vast spreads accordingly.

Timber owners had other ideas, however. Major owners led by SP (520,000 acres of timber in California) took alarm and went to Sacramento for relief. They got their lands put in a "Timber Preserve Zone" (TPZ), wherein land is assessed only on its putative value for raising timber, regardless of market value, regardless of alternative uses, and regardless of non-timber income from land growing timber. These "compatible" (untaxed) uses include grazing, resorts, vacation homes, campsites, fishing, hunting, watershed protection, tourism, rifle ranges, rights-of-way, mining, log storage, landings, roads, logging camps, etc. There is also hemp for the drug trade: possibly the state's most valuable crop, but unrecorded.

TPZ is hardly known outside the timber counties, but it covers vastly more acres than the better-known "Williamson Act," which provides for preferential low assessment of farmland. In Mendocino County, TPZ land of medium grade ("Site III") is now tax assessed at $136/acre. This is about 10% of its value for growing timber (disregarding the increment to value from "compatible" uses that occur in the space among trunks), and a lesser fraction of its value for higher-valued "incompatible" uses like retirement homes that require formal "conversion" (obtainable on demand) out of TPZ. This is how they keep the tax payments on TPZ land down to only $1.2 million.

Mendocino County, lying on the north coast, is redwood country. Redwood's value on the stump ("stumpage") this year is $0.53 per board foot (pbf) when mature. In Shasta County, timber stumpage is worth about half that, $0.28 pbf, and is heavily logged at that value—Shasta is our biggest producer. Since it is worth logging great volumes of Shasta timber to get $0.28 pbf, then there is a lot of surplus in Mendocino timber at $0.53 pbf. This surplus is what makes this land so valuable for timber culture. This surplus, unvexed by taxation, is what makes these lands so attractive to, and the playthings of, corporate raiders, merger specialists, speculators, arbitrageurs, lawyers, and junk-bond salesmen living thousands of miles away.

Redwood, in spite of its legendary longevity, is a faster-growing species, when young, than most Western timber (although much slower than yellow pine in the southeastern states). An acre of good (Site II) Mendocino land will yield a crop of 40,000 bf after sixty years of growth, worth about $20,000 on the stump at the 1995 price. Discounting that to the present, using a real interest rate of 5%, means dividing it by about sixteen. Add 10% for the present value of all harvests after sixty years, and you have very roughly $1,400 per acre for the land value based purely on timber culture, considering no other values. Yet, under TPZ its assessed value for taxation is only $156, about 11% of its true value just for timber culture. This is accomplished by legislating the assessed values in Sacramento (*California Revenue and Tax Code*, §434.5). The legislated formula mandates that "income-based" assessments be found using *past* prices, projected in the far future with no adjustments for inflation, but discounted at a high interest rate (i.e., a rate *not* adjusted for inflation). It is clear for whose benefit this law was framed.

Meantime, urban demand is probing up north into southern Mendocino County from the Bay Area and Sonoma County, its southern neighbor.[4] Mendocino has a long, scenic coastline with premium amenity values. A significant fraction of the TPZ land has a speculative value for resort, retirement, and vacation uses, well above its timber value. None of this is reflected in tax assessments: TPZ protects against that, even though owners may convert out of TPZ at will. Land may be classed as TPZ regardless of past, present, or intended use.

The private area of Mendocino County is 1.9 million acres. Half of that is timberland, with 863,000 acres in TPZ. At an estimated $1.36/acre in taxes, this contributes $1.2 million to the county budget. The county gets $45 million from all property, of which the timberland fraction is 2.7%.

Add to that the yield tax of $3.9 million and you have timber and timberland together providing about $5 million of county taxes. However, the county and its subdivisions, especially school districts, get over $100 million in subventions from Sacramento, paid by taxes on income, sales, and businesses. By comparison, the $5 million is a paltry share indeed to raise from the most valuable resource in the county.

Timberland owners around the country have sold this bill of goods to legislators. In many states, less than half the private land is fully taxable, because of such laws. These are not all Southern and Western states, either, as one might surmise. In New Hampshire, for example, only 45% of the private land (and none of the federal land) is fully taxable. The rest is sheltered by the state's "current use" tax law, their version of our TPZ law.

Champions of these laws argue that land taxes, accumulating with interest over long growth periods, would eat up all the profit from growing timber. Let us see. Taxes of $1.56 per acre per year, accumulating over sixty years at a real interest rate of 5%, come to $552 per acre in constant 1995 dollars. At that time the timber stumpage will be worth about $20,000 in 1995 dollars, or thirty-six times the accumulated future value of the land taxes. In addition, the timber will have shielded the owners from the eroding effects of inflation, a very real benefit that is assumed away by the "simplifying" technique of using constant dollars and "real" interest rates. On top of that, it is a good bet the real value of timber will have risen after sixty years of population growth.

Thus, land taxes would have to be thirty-six times what they are now to consume the whole value of timber harvests. The fact is, present taxes are a negligible token. Timberland is effectively sheltered from the full weight (light as it is) of the 1% property tax imposed on ordinary land. It contributes, as we have seen, only about $1.2 million a year to help support public services in Mendocino County.

The acre value of timberland is low compared with downtown values in San Francisco, where one little square *foot* in the hottest spot may fetch $2,000. That is $87 million per acre! However,

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[4]There is plenty of empty land in Sonoma County, and even south of that in Marin County, but each of those has anti-growth land policies that force demand to leapfrog farther from the center of the metropolis, San Francisco.

there are very few such golden acres, compared to a million acres of timberland in Mendocino County, 35 million acres in California, and 737 million acres in the United States. That is 32% of the area of the fifty states. (The fraction of public and private land in forests is, by coincidence, the same: 32%.[5])

Owing to the success of timber people in spreading their peculiar gospel, almost all of their land is under-assessed. Almost all state yield taxes, imposed in lieu of property taxes on standing timber, are too low to be revenue-neutral. Add to that, Congress since 1943 has made timber a "capital asset" for federal (and therefore state) income tax. Many costs of managing and carrying this capital asset are expensable—certainly interest and property taxes are. The net result is that timberland contributes very little to public revenues at any level.

Residents of timber counties would like to get more local revenues from timber, but they are typically scattered, and poorly organized. Timber companies are huge, rich, few, and tightly organized. In Mendocino County, Georgia-Pacific and Louisiana-Pacific, absentee owners, together own 500,000 acres—58% of the county's timberland—and Georgia-Pacific owns Louisiana-Pacific. Timber firms influence state forestry schools, hiring professors as consultants. They patronize research in forest economics at think tanks like Resources for the Future in Washington, D.C., which has never criticized their tax preferences, but trained its big guns on public agencies: the Forest Service and Bureau of Land Management (BLM). "The industry" controls tax laws in fifty states, and sloughs tax burdens onto others. It will continue to do so until voters in the timber counties wake up and organize to control state timber tax laws.

C. Offshore Oil

In 1946, Harry Truman increased the area of the United States by 50% with the stroke of a pen, when he unilaterally extended our traditional three-mile limit out to two hundred miles. The first three miles was given to the coastal states; California and Alaska both raise large lease and tax revenues from their lands under these coastal waters. The next 197 miles, however, is unorganized territory, outside the sovereignty and tax reach of any state, or subdivision thereof.

Most of our domestic oil and gas is now produced from this water wilderness. The property is public domain under federal BLM administration, but firms bid for leaseholds there under a system that the majors seem to manipulate to their advantage. Even so, there are some federal revenues from both lease payments and corporate taxes. State and local revenues, however, are nil.

Counties may, and often do, assess and tax "possessory interests" in leaseholds on federal uplands that lie within state boundaries. They are helpless, however, to tax such property held offshore. The property values are huge, and so are the firms that own the leaseholds. Many firms own tens of millions of acres apiece, areas larger than whole states. Offshore oil is our largest enclave protecting rent-bearing lands from property taxation, and any other form of state or local taxation.

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[5] Arthur Daugherty, 1995. *Major Land Uses in the U.S.*, Ag. Ec. Rpt. #723, ERS, USDA, September.

Perhaps some form of national property tax is called for; or higher lease payments in lieu of taxes. Perhaps some income tax surcharge is the best way, or special federal tax on net proceeds. This short paper cannot enter the thicket of what jurisdiction should have sovereignty to tax offshore leaseholds, nor how best to levy the tax. The point here is that no system of resource-based taxation is complete, philosophically or practically, that leaves this enclave untouched.

D. The Many Varieties of Natural Resources and Tenures

Advances in the arts and sciences keep disclosing new values in old resources. Owing to institutional lag, these values can grow huge without finding their way onto the tax rolls. A common reaction to that is, "Those /*!!\@#^! bureaucrats want to tax everything!" The common reaction is thoughtless and perverse, because the idea is to lower taxes on incomes, payrolls, sales, and productive business. Land taxation will not win wide support, nor will it deserve to, if it focuses on median workers, homeowners, farmers, and merchants, while exempting oilmen, media tycoons, and timber barons.

In addition to newly awakened resources, many other resources long known (like water) are held in odd tenures that have not been recognized as taxable property, although they should be. Any comprehensive move toward using resource rents for public revenue must include these varied resources and tenures. I have a list of thirty or so. It includes pollution easements over air and water; aircraft landing time slots and gates; aquifers; benefits from covenants; access easements; power drops; concessions; fisheries; franchises; the gene pool; grazing licenses; minerals; orbits; soils; radio spectrum; rights-of-way; shipping lanes; standing to sue; strata titles; use of the streets; wildlife; wind; and zoning.

In tackling these many varieties of resources and tenures, citizens and their representatives may have to set priorities. Two practical criteria rise to the top: go first for the big values, and go for the soft targets.

The biggest values are probably in energy, communications, water, rights-of-way, zoning, and street use. Let's just look at what we are learning about communications. Knowledge and entertainment appear both at top and bottom on man's hierarchy of needs. People without even adequate shelter may be seen huddled around TV sets; people in war, or under totalitarian governments, risk their lives to hear smuggled broadcasts. People with higher incomes and security equip themselves with mobile telephones, and call around the world; they rush to get on the information highway. AT&T was the biggest non-financial corporation in the world before splitting up. Newspapers depend on their wire services: the first great monopolies were Western Union and its appendage, AP.

Recent FCC auctions have fetched billions of dollars for spectrum licenses, but this is like selling the badlands after giving away the beachfronts. The values involved are very high. AT&T recently paid $12.5 billion for the McCaw Company spectrum licenses, which are a smattering of all that is out there. These licenses should be on the property tax rolls in the jurisdictions that they cover. The revenue possibilities are staggering.

How about soft targets? A soft target is any tenure recently created, in a field that is easy to understand. Fisheries come to mind. In the last few years governments in Canada and the United

States have limited allowable fish hauls by excluding new fishing boats and imposing quotas on the owners of old ones. This "imposition" amounts to a gift. Some quotas swiftly rose in value to over $1 million each, suddenly creating a class society where before there was equal opportunity. There is now a class of *nouveaux*, instant millionaires and parlor fishermen who rent out their quotas to working fishermen.

Very likely it is wise to limit fish catches and avoid the "tragedy of the commons." It is also necessary to police the waters and keep out alien interlopers, a dicey business calling for the full power of a strong national government. It is not necessary, however, to give away the quotas so dearly policed. It is obvious to any objective observer that the quotas should be sold or (better) leased to the highest bidder. If the feds insist on giving them away, states and localities should class them as taxable property subject to a high rate. The best time to levy appropriate charges is now, when quotas are new, and the injustice of the present dispensation is apparent to all.

Another soft target is the Manhattan taxi license, or "medallion." For some reason this has long been a favorite object lesson among economists, even as they shut their eyes to grosser sources of rent. It may be because cabbies are rude and visible and lower class, but whatever the reasons these writers have shown their consciousness of the rent aspect of medallions, and raised the consciousness of others.

The idea of going for soft targets is not so much for the money they can yield, but for the illustration of principles. Once the principle is understood and established, wider applications should follow more easily. In economic principle, fishing quotas and taxi medallions are just like conventional land titles: privileged control over limited natural resources. If it makes sense to socialize the rent from quotas and medallions, why not from land titles, too?

Priority #4: What Tax to Fight First?

We also need to set priorities on what tax to lower or kill. The Georgist objective is dual: to raise taxes on land, and to untax production, exchange, and capital formation. Some Georgists have gotten locked into minding just the local property tax in a vacuum, but this was never George's main point. It certainly should not be ours today, when there are other new or augmented taxes more damaging and noxious even than the part of the property tax that falls on reproducible buildings and movable capital. These other taxes include state taxes on retail sales, payroll taxes, personal income taxes falling on wages and salaries, excise taxes, etc.

Some Georgists have supported untaxing "personal" (movable) capital, and rejoiced when it occurred. If political success be the test, this movement has won massively (although silently) in state after state, and in all Canadian provinces. The result, though, is as baleful as benign, for the exemption of capital here is only partial, and therefore discriminatory. "Real" (immovable) capital remains taxable, which biases the way investors allocate their capital. Indeed, some "real" capital is transmuted into "personal" capital merely by unbolting it from the floor, putting it on casters instead.

This result is also regressive, because "personal" capital in most industries is more concentrated in ownership than "real" (immovable) capital. In farming, for example, "personal" capital includes breeding cattle and race horses, whose ownership is highly concentrated among the very wealthy, while the working farmer's dwelling is "real" capital. Stored grain and farm machinery are also concentrated in ownership.

Other Georgists (like Larry Rathbun and George Duncan in New Hampshire, ca. 1935-1950) have diverted their efforts into deleting the property tax on standing timber, replacing it with a "yield" tax (at rates much too low to be revenue-neutral). Again, the result is partial and discriminatory, biasing investors to allocate more capital in the form of timber, and correspondingly less in other forms. As noted earlier, the present system works as though you exempted wood-frame buildings from the property tax, and raised the rate on brick buildings.

This timber bias is highly regressive, too, because the ownership of timber is much more concentrated than the ownership of the dwellings of loggers, mill workers, and retirees in timber counties. It would not be so bad if the reformers had seen that land taxes on timber-growing sites were raised enough to compensate for exempting the growing stock, but they failed in this: we have shown above how these land taxes are also held down to token levels. The net result has been to turn timber and timberland owners into a gigantic public welfare case, a case supported by a sophisticated brainwashing machinery paid by the discretionary income and wealth of timberland owners.

Most Georgist activists today devote their main efforts to lowering the property tax rate applied to urban buildings. As we have seen, this effort is only effective in those few remaining states, notably New Hampshire, that still rely heavily on the property tax. Even in such states, all the gains won laboriously, trench by trench, can be lost overnight should the state legislature or the electorate be gulled into capping property tax rates, shifting taxes to sales, incomes, and productive business. This occurred in California (1978), in Michigan (1995), and has been threatened in several other states, including Pennsylvania, where Georgist activists make so much of the "two-rate" property tax that some localities have adopted.

The local "two-rate" approach is potentially productive, even in states with low rates, because it sets the stage for raising property tax rates. Once buildings are exempted, a polity may raise property tax rates as high as you please without driving away any industry, capital, or talented people. Today, politicians like California Governor Pete Wilson make their careers out of starving schools and libraries and police in order to attract and retain employers by offering them lower tax rates. Given a property tax on land-ex-buildings, we could support all public services without penalizing industry, or thrift, or homebuilding at all.

However, to achieve that end we must stifle sales and payroll and income taxes. These are the chief alternatives to property taxes. All are inherently counterproductive because all hang on some "taxable event," meaning some constructive act of production or exchange. Henry George put it like this. A packhorse can bear a heavy load on its back, but hardly any bound to its shins. Theorists write of the "excess burden" of excise taxes, and of the "Laffer Curve Effect." Lawyers write of "taxable events." Both are describing the same thing in their respective slangs. Sales and payroll and income taxes are like the load strapped to the horse's shins, dragging on every pace. Indeed, they are more like a load bonded under each hoof, for they are burdenless when the horse refuses to move at all.

What, then, makes these bad taxes so attractive to landowners? Why this constant clamor to raise them to provide "relief" from property taxes? It is because they *appear* to shift taxes off landowners, who are well organized and vocal, and onto workers who are not. They shift back onto landowners by repelling labor and capital, but seeing that calls for an act of insight and analysis beyond the ambition of many lazy thinkers.

Priority #5: Closing Landowners' Escape Routes

The solution is to *make the bad taxes pinch landowners* in ways they cannot fail to perceive. The income tax, when new, was designed to do exactly that. First, the corporate income tax (from 1909) preceded the personal income tax (from 1913 constitutionally, and 1916 de facto). Then, Georgist congressmen like Henry George, Jr. (Brooklyn) and Warren Worth Bailey (Johnstown, PA) took the lead in shaping it to focus the personal income tax on property income primarily. Over time, though, Congress has converted it, inch by inch, into the present payroll tax. State income taxes, riding piggyback on the federal model, followed suit. As the income tax changed it became increasingly popular with landowners, with their constant clamor for "property tax relief."

In 1942, for example, Congress excluded 50% of "capital" gains (read: unearned increments) and broadened the definition of "capital" assets. As top-bracket rates on "ordinary" income rose above 50%, Congress froze the cap on capital gains at 25% (i.e., at 50% of half the gain). Meantime, wage-tax-withholding was sold as a wartime measure—we must all do our duty, you know. College professors were mindlessly indoctrinating their students that the income tax is the perfect tax: fair, progressive, and allocationally neutral, all at once.

Then, with landowners so well protected, income tax rates on "ordinary" income went wild, rising as high as 92%. Federal and state personal income taxes became the mainstay of public finance. Owners of income property learned to avoid most income taxes by claiming short tax lives. This device lets an owner offset all taxable cash flow with overstated depreciation.

Once Owner A has thus exhausted her depreciation "basis," she sells to Owner B, who depreciates the property all over again, and so on through several rounds of depreciating the same capital. The treasury nominally "recaptures" this fictional depreciation when A sells to B and has to report the excess of sales price over un-depreciated basis as a capital gain. In effect, thus, the rent of income property shows up as a capital gain. This tax burden is capped, however, by capping rates on capital gains. This helps explain the constant drumbeat in Congress to lower tax rates on capital gains.

Many who think of themselves as "Georgists" have donned blinders on this central matter. Some simply declare a pox on all forms of income tax, as though all sources of income were the same. Others even join the hue and cry for preferentially exempting "capital" gains from taxation. These positions are, I submit, worse than foolish. So long as we have an income tax that treats land income kindlier and gentler than wage and salary and interest income, so long will we have perpetual crying for "property tax relief" via income-tax exacerbation. Landowners will shift the burden until no burden remains to shift—a condition we are approaching in half the states. Nor will they stop there. The freer they are from taxation, the greater is their motive to demand more subsidies, of which they already get many, to raise land rents and values.

However, landowners and their advocacy groups are already ahead of potential income tax reformers, and will remain so until we wake up and smell the coffee. They are already lobbying to replace or supplement income taxes with what they miscall "consumer" taxes, a generic euphemism that covers most taxes on exchange. The euphemism includes various excise taxes, retail sales taxes, revised income taxes that allow expensing of all capital outlays and land purchases (e.g., the mislabeled "flat" tax), the proposed "cash flow tax," VAT, *et hoc genus omne*.

These taxes are mislabeled because they all exempt land consumption from the base. Land consumption is holding land without using it to earn any cash. A true, comprehensive consumer tax would include such land consumption. At the same time it would exclude retail purchases of necessities used to form and maintain human capital. It would, thus, look less like the present retail sales tax and more like a land tax. It is only by bending the meaning of words to a class-biased goal that the apologists of private rent-taking and land-hoarding have sold sales taxes and VATs as taxes on "consumption."

Again, to turn back the ongoing drive for more consumer taxation, we need only insist that the base include land consumption. Then either the drive would achieve a Georgist goal or, more likely, turn tail and stampede back whence it came.

We cannot accomplish those ends if we glue our eyes only on the next fifty feet of no-man's-land and fight only for local tax reform, trench by trench. We have to survey the whole battlefield and marshal forces where they will do the most good. Please review this paper with that thought uppermost.