TRANSITION TO LAND VALUE TAXATION: SOME MAJOR PROBLEMS

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Other participants ~~to varying extent~~ have touched upon aspects of transition. Without ~~attempting detailed~~ cross-referencing, and hoping to keep duplication at a minimum, I shall ~~try to~~ draw upon their contributions.

Some Framework Assumptions

~~In one important respect~~ the terms of reference which seemed to me most useful for my particular paper will differ from those of some others in this volume. For studying transition, ~~my subject,~~ the concept of "land value taxation" does not necessarily mean reliance upon land (or site) value alone as the property tax base. During transition, is not some tax on structures inevitable~~, or nearly so~~? Probably "yes," at least for a few years. But from the start the rate of tax on improvements would be significantly lower than that on land and then would decline further, perhaps to zero. The decisions about the width of the initial difference and the amount and speed of later changes might depend in part upon questions of constitutionality (a big increase in land tax perhaps being attacked ~~prohibited in some states~~ as confiscatory), the requirements of due process, tax and debt limits, covenants affecting outstanding local debt obligations, the level of professional competence of assessors, voter understanding, and ~~perhaps~~ other elements.

A possibility referred to only briefly in this paper, and in our discussions, deserves careful study. Instead of basing the tax which is associated with land on value alone, a portion might well rest upon ~~be based on~~ charges or rates related to differential costs of supplying water, street, sewer, fire, and other services which are most closely tied to space or distance. The rationale of such an approach is persuasive indeed. One result would be greater charges on outlying areas (relative to those closer in) because of cost differences. Less reliance upon value as a base and greater use of more objective measures--area and distance--would among other things both

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How long would the transition itself be? Something would depend upon the amount of prior discussion to establish public understanding as well as the other points noted in the last paragraph. Presumably several years would be required. But conditions would vary according to many factors. As the change became increasingly probable, the terms of more and more real estate transactions would have made some allowance for the eventuality. Therefore, the transition disturbances due to the change would be fewer and smaller than might have been predicted from simple theory alone. The formal shift-over ~~, I should think,~~ would hardly be less than five years; however, ten ~~would probably~~ might be more than needed. Nevertheless, some ~~special~~ provisions should be made to take account of unusual features of long-term leases, property titles, trustee restrictions and responsibilities, escalator clauses, and other aspects of real property ownership which cannot be handled all at once. Their practical significance ~~of such elements~~ calls for special study with, of course, care to prevent biased and unbalanced conclusions.

element except value

For the most part, the tax revisions will not themselves lead to changes in local government expenditures, more specifically to changes in the quantity and quality of local government services. Moreover, we assume that ~~Except as noted,~~ the transition to land value taxation, it is assumed, will no alter the Federal or state income tax treatment of real estate. Any charge which is based on ~~related to~~ distance or other ... should be a tax and thus unlike a price or special assessment deductible in computing taxable income ~~rather than a price~~

I do not intend to deal with problems of changing the taxation of personal property (including business inventory), public utilities, franchises, banks, and other types of property now receiving special treatment. The concern here will concentrate on urban conditions with little explicit attention to the special problems of agriculture except in the urban fringe. Little will be said about ~~the problems of~~ exemptions or the ~~and~~ probable likely new pressures to qualify land for exemption.

Generally, but by no means exclusively, state government participation will be required for success. A considerable amount of state leadership can contribute, not only in the necessary revision of laws but also in carrying out parts of the program.

Difference in Tax Rates as a Source of Problems: Distinguishing Land from Improvements

From the beginning of the transition, the tax rate on land would be higher than just before and the rate on improvements lower, even if not zero. The divergence could soon become very large, two or three hundred percent. Then we should expect most of the difficulties which arise from both (1) high tax rates and (2) large differences in rates.

Owners would have incentives, not only as at present to keep the total assessment low. They would also have inducements to keep the assessment on land low by trying to alter the proportions of the total. One could expect taxpayers to search for evidence that the land value portion of the whole is "low" rather than "high." A new bias would plague the assessment process. Owners' interests would lie in interpreting the eveidence of sales or other transactions to show more for the improvements, and less for the land, portion of the total. The seller, of course, would have less reason than the buyer to try to influence the division but might be willing to help keep tax low. Therefore, the problems of the assessor would not be simplified quite so much as might appear at first sight. Ingenious methods of devising and rearranging real estate contracts might present new legal challenges with results differing from state to state.

Use of a base other than value, such as taxes based resting on area or distance to cover costs of certain facilities, as ~~we~~ suggested earlier, would reduce the need for large differences in rates on land and building~~s~~ values. The assessment problem being discussed here would be simplified, perhaps materially.

The difference in tax rates (one rate perhaps eventually being zero) enhances the importance of issues discussed by Professor Vickrey. The law instituting land value taxation should certainly try to make as explicit as possible just what tangible and intangible elements are to be included in the land tax base. Let us assume that the general goal is to tax on values created by nature and the community, not on the individual's own expenditure of capital and effort. Zoning permissions, the treatment of air rights, easements, and other intangibles demand attention. Plans should explicitly include provisions for dealing with the somewhat more tangible elements embodied in land, such as clearing, grading, fill, drainage, landscaping, sewers, and other preparations for use. Past investments of this type must be included. In principle, however, such improvements embodied in land -- capital investment no less than structures rising above -- should be treated as are buildings. Certainly as regards the future, if tax laws discourage one kind of investment (improvements in land) as against others (buildings), flows of new capital will not lead to the most productive allocation of resources. Incentives will be distorted. The most creative and efficient use of land cannot result if the outlays making land more usable are to be taxed on the same basis as the "original and indestructible" qualities. What about streets and other investments of a group or "corporate" nature for which the owner makes some contribution--projects of local governments (including special districts) for which owners have paid in special assessments? The most rational and practical solution ~~is~~ is open to some debate. A tax based on distance or area, as for water, sewer, and other such facilities, would ~~certainly~~ not be appropriately added to the owner's base.

The attempt is made in parts of Australia and New Zealand to base the tax on unimproved value of land, the worth today of land as it existed in its natural state. Results of estimating today's value of something which does not exist, and has not traded for decades, must sometimes be wide of the mark in percentage terms; the absolute amounts of tax resulting from any error are impossible to estimate but will not be large in many cases.[2] Use of pure value in the original state would not now be feasible in the United States. The data we have for land values include elements of past investments in the plot. For the future, however, owners could be permitted to record outlays on the land and have them treated as are buildings.[3]

The change-over itself would alter relations among values and thus introduce disturbances which would complicate matters for a time. Some shifts of relative prices which where in the transition can be predicted as to nature but not amount. The tax change would tend to reduce the prices of land while raising the worth of structures.

For the first ——————————

communities the inward flow of new capital would expand and in doing so would offset some of the initial effects of the tax changes. This rise in supply, financing a higher rate of new construction, would tend to keep the values of structures from going up as much might be expected.

What about land? The outlook is not so clear. Initially, a doubling or tripling of the rate of tax on land would reduce market prices. But where the flow of capital for new building grows larger, the demand for land will rise, offsetting some (or all) of the initial, depressing, effects of the higher tax.

Established methods of valuation include those for distinguishing between land and improvements. Would these methods continue to serve, and serve adequately, for the new needs? The specialists participating in this conference are optimistic. The transitional problems, however, might for a time strain the best of organizations by injecting a host of essentially short-term deviations from the recent past and tax-reduced fluctuations among property values. Since owners would often be critical of the results of the assessor's work and would have incentives to bias the allocation of the total value between land and improvements, extra provisions for skilled and expeditious assessment and review ought to be provided -- temporary expansion of staff, use of outside appraisers, and special appeals bodies (including quick access to the judicial authorities who will certainly have something to say about the general guiding principles).[4] The cycle of assessment ought to be shorter during the transition than will be tolerable after settling down. Conceivably, land values could be reexamined and adjusted much more frequently than in the past. Use of computers could be planned to assist in shortening the assessment cycle.

(Minor) Possible Transition Aids

Some communities could act now. Bringing assessments into line with the spirit and the letter of today's law could be an important first move in some localities. Where land is now undervalued relative to structures, there exists an opportunity ~~of~~ to moving in the direction of land value taxation by doing what current law calls for.[5] Getting land valuations fully in line with market values (adjusted for "normal" underassessment) would do more than raise the portion of present tax based on land. The action would force careful study of relative values and thus provide a better basis for more extensive change later. Carrying cases through the appeals and the judicial process would also improve the basis for more sweeping change. The case for implementing this proposal is highly persuasive. State government initiative might make an important contribution.

Another transition possibility would be to confine resort for all increases in revenue to land tax, while assigning reductions wherever they can be enjoyed to the rates of tax on improvements. Thus, the tax rate on structures would be frozen or move downward, while that on land would go up as the needs for revenue required.

My reactions to this latter proposal are mixed. Such a rule might seem to invite an increase in expenditures and thereby revenues by emphasizing the use of a "good" tax -- the argument that the tax on land would be somewhat burdensomeless (using that term loosely); perhaps my misgivings are unfounded and restraints on the unwise growth of spending may be adequate. But in communities where expenditure increases do call for higher tax rates, concentrating on the land portion has merit in itself and ought to help as a starter toward site value taxation. Generally, however, the effectiveness of this change as an aid in achieving the broader objectives would probably be slight because the magnitudes involved, i.e., the differences in the two rates, would not be large. And the absolute tax rate on building could remain high.

A more extensive possibility, and one with both attractions and problems, would be to exempt new buildings (or major repairs and additions) -- entirely, partially, permanently, or temporarily. Or a new building (additions or quality improvement) could be taxed on the value of whatever it replaced. Provisions largely exempting new buildings of certain types have been made for various purposes. The obvious general goal is to encourage new construction. As a compromise measure this has some appeal. It would, of course, moderate and delay the rise in the rate of tax on land. Except in very new communities, many years would be required to come close to the full result of exempting improvements. Owners of older buildings might properly complain about discrimination. The pressures to limit exemption to certain types of properties, such as low income housing, might well distort the actual results. And the effects on relative land values would complicate valuation as land suitable for new buildings would gain somewhat in relative worth.

Homestead, Veteran, and Other Exemptions

Transition to site value taxation might include as part of the change the abolition of homestead, veteran, aged, and other special exemptions, including those for industrial location. Nevertheless, much as some of us who criticize such exemptions may wish to see them eliminated, or very substantially modified and rationalized, they ~~present~~ issues which they present ought to examined separately from site value taxation. As a practical matter we should recognize that the forces which brought them about are likely to continue; ~~and~~ they must be taken into account, not "wished away," in establishing land value taxation.

An inescapable question must be answered: Is ~~The problem is~~ the exemption ~~is~~ to attach to land or to improvements (or conceivably be divided between ~~some division~~)? The difference would be great. If assigned to the house or other structure, the exemption would lose value as the tax rate went down and would disappear if improvements were untaxed completely. However, as long as some tax on buildings remained, the tax-saving advantage could be maintained by enlarging the dollar size of the exemption. In principle, no serious difficulties would seem to arise; but clerical work would be required (perhaps easily done with computers), and frictions might occasionally be troublesome, e.g., the timing of sale, getting taxpayer understanding.

If the exemption were assigned to the land, the dollar value would rise with the increase in tax rate. Benefits greater than originally intended would then result. To stabilize the dollar value of the tax saving, a reduction in the dollar amount of exemption would be needed. Thus, an exemption of $2,000 when the rate of tax was 2 percent would be cut to $667 if the tax rate rose to 6 percent. The clerical work, as in the other case, ought not to be a determining consideration. Somewhat more difficult might be getting the taxpayers to accept such a change; my concern on this point is not that homeowners could not see the logic of scaling down the exemption but that they would try to prevent the ~~change and thus~~ adjustment in order to gain more for themselves. There is no need to get hung up on this matter. There is need to make provision in the plans.

Industrial exemptions are of many types and governed by a variety of contracts and agreements. The ~~parties~~ direct beneficiaries are responsible businesses with which one can assume that negotiations on a rational basis will usually be possible. The goal should depend upon the longer-run objectives. To the extent that a dollar amount of tax advantage is the immediate goal, there may seem to be no great difference in terms of allocation (assuming that enough tax would otherwise remain on buildings to permit the result). The incentive effects, however, could differ.

Would a veteran, industrial, or homestead exemption attaching to the land be capitalized in land price? If so, would not present (or original) holders get all the benefit so that over time future owners would receive no benefit from an exemption because they would have to pay a price higher by the worth of the exemption? I think not. The ~~typical~~ exemption of this group, which is typical, is personal, being an incident to the condition or status of the owner. Exemption does not go with the land upon sale.

Federal Government Leadership: Inducement or Compulsion from Washington

Federal action could have a big impact in getting the changes started. Congress could exert powerful influence, not only in speeding acceptance of the principle in general but also on details.

One or more grant-in-aid programs (now totalling over $21 billion a year) might be tied to the response of state-local governments in moving to land taxation. The dollar acount of aids made contingent could be so large that in fact no choice remained to reject the offer. Or as with the establishing of unemployment insurance in the 1930's, a tax credit could be made so attractive as to compel state compliance; 20 or some other percent of land tax might be allowed as credit against income tax if there were no tax on buildings. If some kind of Federal revenue sharing comes into effect, it might be made contingent on adoption of land value taxation. Or property tax deductability in computing taxable income might be restricted to the portion on land alone. Other possibilities could certainly be suggested for analysing. In fact, anything that would be worth serious consideration would need to be much more developed than the sketching indications here.

Federal influence offers the prospect of quick results on a large scale. Does not this method seem tempting? Despite the attractions, we can all think of difficulties in implementing any such suggestion, and suprises would add to the list. The practical feasibility of using Federal pressures to alter a major, established feature of state-local government -- the property tax -- will be vastly different from either the "inducement" force of most grant programs or establishing an entirely new system, such as unemployment insurance in the 1930's. The property tax has a long history. It is governed by provisions of state constitutions; they differ in many ways, including the difficulty of change.

For these and other reasons "a" nationwide plan to be implemented with forceful impulse from the center would require careful, detailed planning of a nature and scope vastly different from anything in past experience. Some of us do not enthuse over the prospect of Federal near-compulsion on states and localities. The notion, in principle, seems to deny the range and depth of the diversity, the creativiy of freedom, and the fallibility of man (even when legitimately holding power on the Potomac). In land taxation, however, the possibility may deserve more sympathetic attention than in some others. Such would be the case if Federally raised funds are to be used for local purposes which are closely tied to land use. In fact, without some precautions not yet in evidence, too much of special aid for housing or urban revewal or other such programs can be "lost" as a contributor toward achieving the general objectives because it will be capitalized into higher land prices, for example on neighboring properties. Later projects become more costly when one or more have made an area less bad.

If Federal (national government) concern and involvement are great enough to lead to expenditures for urban revewal, or for other programs whose identification and results are sufficiently local to influence land prices, then by the same token the Federal interest is direct enough to warrant action on land values.[6] Greater reliance upon distance- or area-related ~~charges or~~ taxes in partial replacement of value-based levies as well as site value taxation well offer enough of a possibility to warrant serious concern; revenue effects of direct or indirect Federal aids (benefits mostly) would not necessarily go to local government (or local taxpayers), but they might. If improvement in the stock of housing is to approximate the goal articulated in Federal legislation -- 26 million new units in 10 years -- untaxing new building may seem important enough to override many objections. Perhaps some sweetener for states would be desirable -- but Uncle Sam does not have unlimited resources. Note that what would be involved is Federal pressure to get states and localities to raise revenue in different ways, not to give them more. The implications of trying to use Federal compulsion on states to modify property taxation are so complex and go so deeply into fundamentals of our institutuions that much more exploration is required.

Less sweeping accommodations could give assistance. Helpful adaptations of the income tax and possibly the estate tax could undoubtedly be devised, some perhaps generally strengthening the Federal tax structure. But conflicts would arise. One possibility to assist in bringing underutilized land on the market would be a "roll over" for purposes of taxing capital gains (as granted homeowners under certain conditions), weakening the "lock in" effect. What is apparently the present practice of often using property tax assessments as a starting point in computing depreciation for income tax purposes creates something of an incentive for assessors to bend toward a division of the whole with higher improvement and lower land value than otherwise. Alternation of this practice could be made by administrative action without need for action by Congress. The income tax treatment of demolition expense might be revised to help achieve the objectives of shift to land value taxation. The allowance of special assessments as a tax deduction would enourage their use. Other technical tax provisions bear upon the real estate related use but in ways which I cannot attempt to integrate here.

Education: Preparing Opinion

Site value taxation can become a reality only after a tremendous amount of public education. Voters and property owners, real estate brokers and operators, legislators and aldermen, professors and teachers, taxpayer organizations and builders, all these and other groups will play a role. Two more are of special importance -- (1) assessors and others who are close to real estate operations and (2) judges and others in the review process.

The goal in efforts directed toward assessors would not be to infuse them with missionary zeal or to attempt to make them in any sense originators of policy rather than administrators. Nevertheless, the assessor works within margins for the use of discretion and judgment. He will carry out policies best if he understands well the rationale for them. Moreover, assessors will sometimes have an important role in dealing with owners, of explaining and interpreting. The more fully that assessors know the principles which underlie what is being attempted, the greater the successes to be realized.

Informal appeals and formal litigation must be expected to arise from the shift. They can have crucial effect in setting prededents whose effects extend far beyond the particular cases adjudicated. And decades of accumulated cases will need to be somewhat super~~vised~~ seded. Therefore, the education of judges calls for special attention. But how? Sensitive matters of propriety will require delicate and careful preparation.[7] (Perhaps drafts of possible amicus curiae briefs could be commissioned.) No single kind of effort can meet all needs.

Mortgage lenders and officers of financial institutions in general will have a direct interest. The security of some outstanding loans may seem to be affected. The future will certainly be different. Their counsel should ~~probably~~ be sought and their understanding made as clear as possible.

Preparing public opinion will involve two distinguishable stages.[8] The first will be that which leads to change in the law, the second, getting operations under way. My own experience in trying to explain land value taxation to the "non-converted" leaves no doubt that the obstacles can be discouraging. How, for example, can one convey the idea that the higher the tax on land the lower the price and therefore interest costs if one borrows to buy? How can the public get a true appreciation of the significance of the difference between land and other types of property?

The temptation to exaggerate, to oversell and oversimplify, will probably be well-nigh irresistible. The enthusiast for anything can be expected to emphasize the prospective merits and to go light in describing defects and limitations. The history of the Single Tax has had more than a healthy share of over-enthusiasm. Yet even the highly optimistic hopes held out by zealots failed to convince enough voters to swing the balance of opinion. What will be most effective now?

Competing for attention in the world around will tempt -- or force? -- one to strain the bonds of scholarly accuracy. Presentations limited to what can be proved without reasonable question will in many respects be unexciting and not dramatically appealing. In other respects more depth of analysis will be required than all but a few of the public are prepared to pursue. (The logic of shifting a portion of the burden from a value-based levy to one related to differential cost of providing certain public capital facilities would seem to me potentially less difficult to explain than, say, shifting much weight from buildings to land.) "Salesmanship" must be confident and sustained--and full of bright, attractive prospects. Raising expectations above heights that are realizable can seem to help in getting support, but exaggeration can damage the likelihood of success over the years. The program can be discredited by failing to yield the results which people were led to expect. Yet vigorous efforts utilizing optimistic hopes may be needed to get the support required for a change so major as this.

Apparently extravagant "promises" can sometimes be justified. A slight change can tip a balance. Results are occasionally far, far greater than the size of the new force relative to the whole which has moved. Marginal influences, as economists emphasize, can work great things in some sets of circumstances but therefore, have imperceptible effects in others. Advance judgments have a large element of uncertainty. Such doubts are especially troubling when the issues embody very complex forces of widely disparate nature - as is so manifestly true for real estate, cities, and government finance.

The shift to land value taxation would <u>not</u> be a minor change, even though to some observers it might seem so. As a marginal force it <u>could</u> be large enough to set in process various movements of still greater size than its own magnitude would suggest. The enthusiast's wild and apparently irresponsible predictions may become reality. One cannot be certain, one way or another, but as noted later, real resources can set limits whose sobering implications deserve explicit recognition.

The proponents of land value taxation whose views

I know, including the professional economists, emphasize somewhat different weightings in the package of desirable results. No one can speak for all of the others about the relative importance of these effects. And we are all hampered by doubts about magnitudes. Will a change whose nature and direction seem clear be 2 X or 14 X? Over what period of time?

My qualifications do not extend into the realms of public relations and advertising. I do wish to record a conviction that the many aspects of the task are worthy of expert attention, that lasting success requires a solid basis of fact and analysis, not merely the rhetoric of enthusiastic supporters. The job must be a continuing one if only because of the hold of tradition.

Presumably some localities will move ahead of others. Perhaps unmistakable successes will be recorded. ~~Perhaps unmistakable successes will be recorded.~~ Perhaps there will be results so clearly progressive, so demonstrably desirable, that they will ease immensely the job of further persuasion and education. But we cannot count upon such early assistance, especially if we respect canons of professional responsibility. For one thing, the total results from the shift we are considering will hardly appear in the short run of two or three years, and some of the most important will by their very nature require many years to develop. The consequences which do occur will be mixed with others, both as cause and effect, and in ways which even the most advanced of statistical techniques cannot always disentangle.[9] The scholar's standards of proof may not permit simple and clearcut conclusions about causal responsibilities. Preparing a "salable" program under such conditions may not be easy. Hopefully, of course, positive responses which are striking enough to be convincing will appear early. But some of the best may take years to work out fully.

In a country with as many owneroccupants as ours, an influential group of voters will be sensitive to prospective changes in tax burdens. For most homeowners the initial differences in tax would probably not be large. But even unjustified fears can spark responses which will not be helpful. Forethought about the educational aspects deserves much attention. The case is strong - but not self-evident.

Not an Income Tax

One obstacle to be overcome in a program of public education will be a feeling -- often latent and of unknown influence -- that this tax (or any big tax) should be structured and judged and administered according to criteria applicable to an income tax, that ideally any tax should impose graduated (instead of proportional) burdens. Many persons do seem to feel that any tax (of appreciable size) should be related to income or determined in some way by it, and by "income" they mean more or less the actual cash income as distinguished from income viewed as the accrual of economic power (which can include unrealized increment in value).

Vacant land or land that is grossly underutilized will bring little cash income relative to its potential.

Assessors will be subject to pressure, perhaps subtle, to try to relate the property tax to current money income as contrasted with what would be the value if the best use of the land were made. Some popular support for this view can be expected. Yet the tax on land value finds its justification in reasons rather different and removed from those of income taxation as ordinarily understood.

The term "ability to pay" will be used with only a vague notion of the meaning attached--or its relation to other terms important in our thinking and feeling about taxation, notably "justice" and "fairness" and "equity." The property tax presents exceptional difficulties of evaluation on this score. How much of what we pay was capitalized in the price of land when we or the landlord bought it? How is the tax on business property really distributed over the public? The benefit aspects bear directly on some issues--variations in service levels from one community or type of property to another--and differently from income taxation, but in ways sometimes overlooked.

One advantage of greater use of a basis other than value, ~~and~~ one related to costs of providing facilities, is that benefit and cost both have a logic, which ought to be generally understood and accepted. If there are greater costs per acre or per housing unity to supply public capital facilities in some areas than in others, then the arguments to base tax on such differences would probably get favorable reception.

The Urban Fringe: The Aged and Other Special Cases

Another somewhat related educational challenge, one source of difficulty in getting acceptance, will arise from land in transitional areas. Taxes based on current market value can be quite out of line with (higher than) the worth in existing use. Yet the owner may be reluctant to convert to other use. Perhaps he wants to hold for possible rise in price or to avoid income tax on capital gain or for sentimental reasons or because of inertia.

One purpose of the shift to the land value basis of taxation is to speed the transformation of land use into closer conformity with market developments. Owners should not, it is argued, find easy the withholding of a resource created by nature, much of whose value results from community cheap- investments. Cheap

Relief and special consideration for owners who wish to resist change would run counter to the broad purposes of getting land into the uses most consistent with human preferences as reflected in current market prices.

Yet some compromise may be desirable as a matter of expediency. One problem may be lack of liquidity; an owner's net worth may rise, and very considerably, without yielding the cash needed for convenient payment. of tax Postponement of payment and ease of borrowing ~~to pay tax~~ come to mind. But a program for dealing with liquidity needs can easily become one for escaping the forces which the tax should be reenforcing. And government needs cash year by year.

Some older people are already having difficulty meeting rising property tax bills out of stable money incomes. The move to land value taxation would help in some such cases and hurt in others. For the latter, help in financing ~~help~~ may be both humane and expedient -- within limits that are not so large as to defeat the incentive effects of the plan.

<u>Acceleration of the Upgrading of Assessing</u>

Of absolutely prime importance will be the quality of assessing -- not only "in general" but also as bearing upon land values in particular.[5] The need to educate assessors about the reasons for the change has been mentioned. Other papers in this volume deal with aspects of valuation. Speeding the professionalization of assessment deserves public support in any case. The directions of desirable change are generally known even though they differ somewhat from place to place.

So far as concerns the training and integrity of personnel, the completeness of records, and all of the other requirements for first-class assessment, some communities make a good showing. Of course, the men in change of even the best staffs will point to opportunities to do better but which, for lack of funds, personnel, and other things they have not been able to exploit ~~because of~~. Good results show what possible.

For most of the country, however, assessment facilities leave much to be desired. Getting top-notch assessing does not seem to me a prerequisite for "success" in shifting to site value taxation. Improving on the present system of property taxation does not require achieving the quality of administration to which we aspire. In fact, easier administration is one benefit expected. Yet in the transition, moving from one set of valuations to another will be upsetting. Foresight and special effort can help to anticipate and prepare for meeting difficulties. New mistakes can create new tensions. Perhaps they will sometimes be harder to tolerate than the results of present defects which are every bit, as bad but to which adjustments have been made.

Accurate and complete data on the terms of sales, leases, and other market events are requisites for efficient assessing. Some states are far in the lead, and others are serious laggards, in obtaining such information. Procedures for assemblying and analyzing ~~such~~ data differ tremendously. One line of action to facilitate transition, as well as to obtain good performance permanently, is to identify the best methods and to speed the spreading of their adoption. Of direct importance are the principles, formulae, and other factors more or less specially bearing on land values such as depth tables, allowances for irregular shapes, corner influence, and so on. Adoption of any new basis other than value, such as distance or area, would require new procedures.

Transfer of experience from the "early mover" communities to those making the shift later could undoubtedly be of valuable help in the transition. Advance planning can help to facilitate the transmittal of the fruits of the learning process. Professional and commercial organizations can both play a valuable role in supplementing the work of assessors.

<u>The First to Change</u>

What will be the transition conditions in the communities which move first, those ahead of the great majority? The changes observed will, of course, come from a mixture ~~XXX~~ of causes and in an environment which has both similarities and differences as compared with others at the same time or in a later period.[10] They will not necessarily be duplicated in relative amount (or even in nature) in the communities which change later. One great difficulty in forecasting the results must come from doubt about how much of the shift will have been discounted in advance., e.g., in the flows of new investment funds. Speedy action in moving to site value taxation may have allowed little time to anticipate the change and to begin adjustment. But in other cases there will be time. As the prospect of a major new departure grows more real, investment and land use decisions will take it into account.

Land prices will tend to go down as the tax increase gets capitalized. The amount of the drop will depend upon several factors--the size of tax relative to income from the property, interest rates, the various anticipations. Land, as it becomes the ~~now~~ predominant (or exclusive) portion of the tax base will drop in value. The drop may create need for a higher tax rate eventually.

Or will it? In many areas under assessment is so great that very big increases in tax may not depress land values below the assessment level. Relative prices may change quite a bit but without bringing much (or any) land prices to less than assessed values.

May not owners of land insist on higher rents and selling prices when the tax goes up? There will undoubtedly be some cases in which the tax increase will lead an owner to bargain more firmly and get better terms than he would have obtained otherwise. Results of this type, however, will be exceptional -- unless more landowners are more easygoing and less anxious to obtain good results than I believe generally to be the case. Escalator clauses may permit some shifting of higher land tax to tenants for a time. But again such results will be exceptional.

Where the tax rates on (new) buildings go down, the communities will attract more capital than otherwise. After-tax yields from investment in structures in these areas will have become more attractive. A bigger fraction of the country's total flow of funds for new investment will go to localities where the tax on new investment has dropped. The land bears heavier tax but cannot move to areas where tax is less. But some of the owners of land will be more aggressive in trying to develop it. They will thus add to the demand for funds for construction. They will pull in capital more decisively than if the impetus from higher land tax had not been injected into the situation.

As more capital seeks to be used here, rather in communities which have not untaxed improvements, one result will be a relatively larger demand for land (as well as an increase in the amount being offered for new uses). The demand may rise enough to keep land prices from falling (or even to raise the prices of some parcels) despite the increase in the annual tax burden. The land tax base, therefore, will not drop so much as would generally be predicted. Such favorable movements of the tax base will ease transition. If structures remain in the base (to be taxed at a lower rate), the high level of construction will make things easier for all.

The physical characteristics of the locality will improve. How much? One cannot say with confidence, but within a few years the net betterment might be large. (Limits on the availability of skilled labor and other resources for construction will affect results even when money seems rather plentiful.) Southland, Michigan, offers instructive indication of what can happen, but calls for caution because the conditions of time and place there have been to some extent unique. Recognizing the limitation, ~~XXXXX XXX~~ I see no reason to doubt the predictions of theory. More junk would be replaced faster and with better structures. Sprawl would be counteracted. More intensive use of land would be expected. However, to generalize for the economy as a whole (or even a state) from the results which are reasonably to be expected in the first cases can lead to error, as will be discussed later. Overoptimism is a danger. We must guard against exaggerating the ease of transition problems, e.g., a larger increase in building and drop in the tax rate on improvements than may be feasible in the first two or three years.

Another result -- the diversion of new capital from areas which do not alter their property tax -- will be widely diffused over the whole economy. The people who are hurt only a little and very indirectly may not realize that anything much has happened. The adverse effects on those who fail to change will not be identifiable, certainly not until quite a large fraction of the country has made a shift, and perhaps not even then.

Probable Results Through the Economy as Many Communities Change

When a large fraction of the whole country has made the shift, conditions call for rather different analysis. Different states and localities will, of course, follow different schedules. Talking about the United States as a whole, therefore, cannot be so truly general as the speaking of it implies. One reasonable assumption to begin with is that the total demand for the use of real property, though rising somewhat, will not change much.[11] And short-run supply is relatively inelastic, but not, of course, completely so. Then the total of real estate values, it seems to me, should not initially change much. But through the capitalization process the value of land will decline as higher tax reduces net yield. The prices of existing structures, however, will tend to go up, for the tax cut will raise their net yield. Consequently, the first round of assessments after the new tax rates had become effective would find different relations of prices of land and buildings. Would this "post-reform" reshuffling of the prices of properties in the tax base then make it necessary to put still higher tax rates on land to get the same dollar revenue yield from the land? Probably not in most localities, for the reason indicated earlier -- initial underassessment will have been so deep that market prices will not drop to their level. But many uncertainties hamper generalization. Lower rates on buildings, however, might suffice to yield the proportion of total revenue. Obviously, the starting conditions and the sizes of the initial steps would have substantial effect on the sequence of results.

What are realistic magnitudes? The relative importance of true land values will differ from one community to another. Ours is an endlessly varied economy. Land (including past private and governmental investment in clearing, drainage, grading, other preparation for use, streets, sewers, and so on) in most communities may be from one fourth to one half of the total; in predominantly farm areas, of course, land will constitute a larger fraction. The estimated average figure of 40 percent of "ordinary real estate" in the report of the National Commission on Urban Affairs applies to "what ought to be." Actual assessments appear to average nearer 30 percent of the total. Professor Gaffney's paper in this volume indicates that we ought to think in terms of a higher figure than the "around one third" used in my draft for the conference if -- and "if" is important -- determined efforts are made before the changeover to bring land-to-building assessment ratios more nearly into line with market reality. He finds underassessment of land to be greater than my curbstone guesses.

Where land makes up one third of total assessments (and ignoring the possibility of using a form of tax related to land but not its value), a tripling of the tax rate might seem enough to implement a pure land value tax and get as much revenue as at present. Such a rise would sharply reduce land values. In some cases it could wipe out, or even exceed, the gross income from certain parcels. Depending on the amount of original underassessment, therefore, the tax base for the next period might decline, requiring, then, perhaps a rate on land of four or five times that under the earlier system. Clearly, precision of prediction cannot be expected.

Where some reliance on taxing buildings remains, the tax rate on them can drop appreciably -- easily by half or two thirds. This part of the total potential base will grow somewhat because of capitalization of the worth of tax reduction. Will actual assessments really reflect the change? Conditions will differ. In most areas underassessment originally will have been so great that value changes due to lower taxes will not necessarily raise assessments to levels which have become appropriate. The opportunity will be there. If assessors keep relative assessments as before, the building portion will go up.

The <u>real</u> base will rise (certainly in the areas first to change) because of the stimulus to new construction. The tax rate on buildings can go down again. If land rents (income, yields, or products) are being capitalized at 6 percent of net income (after tax) and the current tax is 3 percent of full market value, then a tripling of the land tax (the magnitude suggested earlier) would raise the amount payable by 6 percent of property value (from 3 to 9 percent). Then no net yield would remain. The salable value of the property would be very slight indeed. (This is the type of situation in which owners let property "go for taxes.") This case seems to me to be extreme. Reduction of assessment in response to such a big drop in market price would presumably lower the tax due, leave some net yield, and restore positive value.

Let us look at another set of hypothetical figures. Assume that the tax rate before change is 2 percent of full market value and the rate of capitalization is 8 percent; a tripling of tax to 6 percent, adding 4 percent, would cut the capital value in half; that is, 4 percent of full value is half of the yield when the market price has been at a level to net 8 percent. Assume that assessments had been at 40 percent of market price and the tax rate imposed had been 5 percent. Then tripling the tax rate to 15 percent would result in a burden of 6 percent on the original full value. The latter would drop by half, under the assumptions here -- not enough to go below the assessment figure.[12]

For New York City, however, the situation would be rather different. Excluding the property of utilities, land accounted for $9.6 billion (of the 1968-69 tax base and improvements for $18.9 billion.) (The one third fraction used earlier for the country as a whole turns out to be rather close for New York City.) Assessments in New York City, especially in Manhattan with 43 percent of total (nonutility) real estate and 52 percent of land value, are much nearer full value than the figures used in my illustration above. If the average is 72 percent (the 1968 rate as determined by N.Y. State Board of Equalization and Assessment), the tax was nearly 3.8 percent of full value. (The 1969-70 rate will be over 4 percent.) Tripling this to get the full yield of the property fax from land alone would <u>add</u> about 7.5 percent of full vlaue -- a very large amount indeed, over $1 billion, to go on land and to come off of structures.

Let us assume the full value of land to be $14 billion; applying the 72 percent assessment ratio to $9.6 billion gives a value of $13.3 billion, but to be conservative for present purposes I use a somewhat lower assessment average of around 68 percent. To put all of the $1 billion more of tax on land values alone would reduce land prices by about $10 billion if a 10 percent capitalization rate applied -- assuming no partially offsetting rise in the demand for land as a result of the vastly improved tax treatment of structrues. But this latter assumption must be abandoned as utterly unrealistic. If the better tax treatment of buildings were to offset half of the depressing effect of the higher burden on land, \$5 billion would still remain, enough to drag market values of land below assessments. They would certainly go down unless New York courts drastically altered their interpretations of the law; the revenue from the rate of tax assumed (over 11 percent of full value) would then not be adequate. At a capitalization rate of 5 percent, but ignoring the favorable effects of untaxing buildings, the value of land (for private owners) would be less than zero in the absence of assessment reduction, which in turn would make impossible the raising of the total revenue of the present tax. Clearly, one vital element is unknown -- the amount by which the reduction of tax on structures would add to the demand for land.[13]

All through the analysis some uncertainty about a point of importance will force reservations about the conclusions. The tax relief on improvements will tend to have some favorable effects on land prices. The "ripeness" of older areas of cities for demolition and renewal would be of significance, especially in the short run.

Such simple illustrations of magnitudes are exceedingly crude. More relevant variables ought to be taken into account in even preparatory exploration, for market forces would certainly reflect them as one or another actual or potential buyer or seller considered them.[14] The new equilibria yielding the revenue totals which the earlier tax would have produced will consist of different

XXX relations of tax rates (old to new and land to structures) from one place to another. As a guess, however, I suggest that rates three to four times as high on land as on structures might be worked out more or less effectively over a few years to approximate new equilibria.

Would it be economically possible to put all of the proerty tax on (pure) land values? Prof. Gaffney's paper concludes that there would be enough land value. On the bsis of crude aggregate figures given in the footnote below, I incline to agree but with the caution that in some high tax areas the base would perhaps be inadequate even if society were willing to vote such extremes of, in effect, a capital levy.

A study of Bethlehem, Pennsylvania, assessments for 1957 included, among other things, comparisons of assessments with sales and with an appraisal of a sample of 50 properties. The authors found land to be underassessed by considerably more than improvements.[16] Land was assessed at about 12 percent of appraised values and improvements 30 percent. Divergences of inequalities among properties were large. A shift to land value taxation would have affected properties far from uniformly. The existing tax averaged 1.1 percent of value as appraised for the study. A land tax of 4.1 percent on values at the time, as appraised, would have brought the same yield, with very big increases in tax on a shopping center, a golf course, and a plot of vacant land then being developed; conforming to expectations would have been large declines on a new apartment house deveopment, a plot with a large office building, one with a bottling plant, and a few others. If the tax were half on land and half on improvements, a rate of somewhat over 1.7 percent would have been required. These estimates do not attempt to judge what would result in the form of market price changes following the revision of tax relations, but land prices would hardly have fallen to as low a level as assessed values.

A recent study of a selected sample of properties in San Bernardino, California, was made by an economist who is also a qualified appraiser. He had available the regular valuations made for taxation and also some made by the California Department of Highways and some made by the Division of Savings and Loan of the State of California.[17]

Land turned out to be nearly half of the real property base of this sample. Land in general was found to be more underassessed than buildings. The exising system imposed an effective rate on land of 1.7 percent, whereas for all improved property the rate was from 2.2 to 2.3 percent. Exempting improvements entirely and doubling the tax rate would have made the effective rate about 5% of full market value of land at the time (but without any allowance for the depressing effect

In order for an owner to break even, the land had to account for 45% of the total value and the improvement for 55%. The effects on different properties would have been far from uniform. For example, 14 of the commercial and industrial properties would have paid higher taxes, and 11 would have paid less under the land value system. Properties in transitional regions would have paid more. One fourth of the single family residences, 47 out of 182, would have paid an average a tax increase of $64 a year, while 135 would have enjoyed an average reduction of $169. Obviously, howmeowners as a group would have benefitted. Fifty-nine vacant properties or those improved with structures of insignificant value would have been required to pay an average increase of $429. Vacant land accounted for the major increase in burden.

The author concludes, among other things, that most of the results usually ~~XXXX~~ predicted would come about. He concludes that common beliefs concerning the replacement of real property taxation would be capitalized into higher land values in the neighborhoods with higher ratios of improvements to the value of sites. There would be some substitution of improvements for land, that is, land would be used more intensively.

For the country as a whole the best prospects would be in the communities moving first and getting new capital on a scale that boosts the demand for land substantially. As already indicated, however, there would be cases in which, quite possibly, the gross yield would be exhausted. Anything in this order of magnitude would have implications for land-ownership and management ~~calling for land-ownership and management~~ calling for a kind of analysis which

I have not seen.[18]

The propriety of seeking a complete shift to site value taxation within a transition period of less than five years seems to me questionable. (The "justifiable" length of the transition would depend in part upon the advance discussion and anticipation.) Most property owners would gain about as much from ending the tax on structures as would be lost in land prices. The number and seriousness of true hardship cases would be hard to estimate. How much allowance ought to be made in fairness (and for other considerations) for advance notice, the "announcement effects" and owner use, or lack of use, of land?

In this connection is there not something to be said for thinking of the property tax on structures as to some extent a charge for government services based upon the use of buildings? Benefit criteria related to buildings may well have an appropriate and constructive role to play. Capital, however, is not always the most logical basis for a benefit tax. Some cost of schooling, for example, might be related to number of square feet (or other measure of space) in a house or apartment, cost of fire protection to type of structure, garbage collection to some other measure based on the building but in ways other than by value.[19] For the moment, at least, I am inclined to doubt that shifting entirely the use of property as a tax base to site value would be the optimum move in most U.S. cities.

The property with a fine building which uses land intensively will probably end with a lower tax. The very best office buildings and luxury apartments will often come off with less tax. A few extreme cases can get publicity that can discredit a plan which by and large produces quite different results. In the short run, at least in most cases, competition cannot be expected to pass the benefit on to consumers. Even if long-term lease provisions ~~did~~ do not prevent change quickly, other factors exert influence. For the years ahead it seems most unlikely that excess capacity in the fine properties will be great enough to force owners to bargain downward as aggressively as would be needed to get the tax savings reflected fully in rents. Time would be required to adjust supply. In the total scheme of things, cases requiring several years for reasonably full adjustment downwardly occupancy cost might not account for much of the total. But a few could stand as symbols of unfairness.[20]

Unfortunately, what ~~appears~~ appearing more or less promptly and publicly ~~at~~ will not be the whole truth. Changes in property tax liability tend to be converted into changes ~~in~~ in capital value, and ~~there are~~ they are not always easy to spot accurately. Owners will shoulder differences ~~in tax (as well as other results)~~ in tax which ~~are~~ amount to much more than the change (for the particular year; the owner "gets" the capitalized value of these changes, good and bad.

So far as land is concerned, the period of capitalization will be perpetuity; if the interest rate for capitalization is 8 percent, a permanent \$1 annual change is now worth a capital sum of \$12.50 For structures the periods of capitalization will vary tremendously but will be shorter than perpetuity.[21] At 8 percent the present worth of a \$1 annual change for 5 years -- and a significant adjustment of supply can sometimes occur in this length of time -- is not \$5 but \$4; for 10 years it is \$6.7. The capital loss on land will be greater per dollar of tax increase than the capitalized gain for a dollar of tax reduction on structures. More years are involved for la[illegible]

The owner of land an[illegible] structures whose tax changes just offset each other will li[illegible] end with some net loss of capital value unless the demand for his property rises as a result of changes in the flows of new capital. The capital losses on land through this process may not be evident except to experts and persons close to real estate; when there is no sale under conditions which sharply reveal the "before and after," the effects of the tax rise on capital value will hardly make the news. In contrast, the increase in after-tax income for the owners of structures may be more out in the open. Adequate comparison of the two changes can be difficult. Inequities will appear to be greater than they really are -- and perhaps in different directions.[22]

Positive and negative windfalls on the same property will be equal only by accident. In some cases land and building are under the same ownership; but sometimes the two will be in different hands, and any offset will be nonexistent. The ratios of building value to land value will differ greatly. Owners of relatively new and highly valued structures on land owned by someone else would benefit most; such benefits may be difficult to justify. The length of the prior period of discussion of the possibility of shift to land value taxation will have affected the prior adjustment. Uncertainty, however, will have hampered somewhat the ability of men making investment decisions to take the actual change into account. Incentive will have been influenced, but the net results will be impossibly difficult to judge if only because each case will differ from others. Provisions of law to require "pass through" of tax changes to users other than owners, even if constitutionally valid, would at best deal with only a portion of the issues of equity and incentives.

Will windfall capital gains and losses be absorbed or offset by Federal income tax? To some extent, but not very extensively. The realitites of income taxation are such that one must be very caustious in attributing appreciable weight to this possibility of neutralizing much of the effect of porperty tax changes on capital values. For one thing, only a small minority of owners of property will realize gains or losses promptly for income tax purposes. Tax on capital gains can be postponed by delaying realization so that fortunate owners can keep from paying for many years (or forever by holding till death because heirs take over the property at the stepped up value used for estate purposes). Realization of losses also lies at the option of the owner; he has reason to realize them to offset against gains and also to the limited amount allowed against other income.

windfall-gains? As one looks at new structures of high value, fully occupied at peak rentals, the possibilities of unmerited benefits can arouse concern. (Yet the owners, in contrast to the group who were content to hold on to old buildings, have provided new facilities for the use of the community; the people being hurt more than a little by the exchange would be those who have kept land away from its best use.) Life, of course, has more interrelations than most of us appreciate intuitively. For example, the hope for such windfalls can serve as an incentive device of considerable effectiveness.

Beginning when adoption of the plan seems to be a realistic possibility, the prospect of a juicy tax cut for the owners of buildings would make risk-takers more willing to commit funds to construction. Persons considering new investment in buildings would have hope of a ~~lower~~ tax cut later and would tend to be more willing to go ahead. Whether society, applying some criteria of ethics, "ought" to utilize such methods, may be debated; but here is one device which would do something to stimulate construction ~~investment~~. (Land prices would probably take some advance account of the prospect of higher taxes, dropping and thus making acquisition of land somewhat easier.) Effects could be felt before any ~~the~~ shift to site value taxation became an actuality. More capital would tend to move into communities where the prospect of lower tax on buildings seemed real.

Conditions would differ greatly from one community to another, depending upon the degree of confidence in prospects, good and bad. For this reason, among many, no generalization about the country as a whole can be of much help, except to say that desire to benefit from possible cuts in tax on buildings would ~~will~~ influence behavior in ways which could ~~can~~ benefit the community.

The possibility of gains for owners of buildings might help to mobilize support for the proposal. Publicity to alert real estate owners would help to make proponents out of some who would otherwise be opposed or lukewarm.

Assessment Figures as a Basis for Compensation in Government or Private Acquisition.

Two related, but by no means identical, points noted in this and the next section, deserve more attention than I can give them on this occasion.

One suggested means of improving the assessment process has found less than a little favor in this country. Assessments could be geared to someone's opportunity to acquire, and the owner's compulsion to sell -- land on terms other than a freely made decision of both parties. Despite our instinctive dislike, almost repulsion, the possibility warrants more than instant rejection. May there not be potential usefulness in some form of owner participation in assessment with a tie to ~~some form of~~ a requirement for offer of sale at a price related to the value for tax purposes? Government right to purchase at assessed value has been proposed many times as a device to help improve assessing.

Owners might be given the right, or assigned the obligation, to set, or more probably to approve, the figures of value to be used for purposes of property taxation. The degree of owner participation could be limited to implicit endorsement of an assessment or more active involvement when he wishes. Government reservation of the right to buy land at the valuation set by the owner could provide a powerful saction -- acquisition for a "land bank" or in condemnation cases.

The lower the value for property tax purposes, the greater the danger to the owner of being required to sell to government at an uncomfortably low price. Much more extreme influence would exist if third parties were allowed to buy at, say, 120 percent of the assessment. Another conceivable rule might give any owner the right to demand government purchase of the property at the assessment or acceptance in meeting tax or ~~any~~ other obligations. The obstacles to any such scheme are formidable. For example, when improvements on land are important, and such is true in most cases, the complexities are far more serious than for land alone. Two neighboring plots ~~alone~~ will rarely differ by much in value per square foot, but with their structures the totals can be very far apart. The practical problems of valuation would be much beyond the competence of most owners.

No near-term use of such possiblities can be conceived. For the transition this range of proposals would be singularly inappropriate because relative values would be changing and owners would be at a serious practical disadvantage. The long practice of large underassessment has created traditions and experience which cannot be replaced soon. Ordinarily the property owner is illequipped to judge the value of his property. And rarely will local governments have funds available for much acquisition of land. Nevertheless, further study and discussion seem to me well worth undertaking.

Governmental Acquisition

A governmental "land bank" resting on the acquisition of land in advance of need, perhaps by many years, would make sense in some cases (as explained in a 1968 ~~(Refer to IPA~~ study (by the Institute of Public Administration). Two aspects or goals of the proposals need to be distinguished. One is to get prospective unearned increments. Another is to facilitate planning and execution of land use.

For the latter, I should think, zoning can do much of the job. The relative costs and advantages of zoning and advance acquisition require careful study beyond anything possible or appropriate here. But preparing for a transition to land value taxation should take account of any potential for advance acquisition. For example, might owners subject to large increases in land tax be given opportunity to turn over land in payment (perhaps receiving some cash)? Does not the hope for governmental capturing of unearned increments rest, among other things, upon belief in ability to outguess the market? To some extent it seems so to me. But another basis could be favorable financing (borrowing) opportunities.

Land Taxes and the Security of Debt

The transition to land value taxation would include changes in land prices which in some cases would be substantial--downward. For purposes of the tax base, as I have indicated, the decline might not get market prices below assessments; for tax purposes, therefore, serious troubles might well be infrequent. But land values serve other purposes, one of which deserves explicit attention in advance.

Land is security for debt. What counts in such cases is not the physical nature of the land (which for present purposes we can consider as being unchanged during the transition) but the price on the market. A price decline reduces the security protecting the lender.

The great majority of cases would be essentially unaffected. The value of land and structure would not change much during the transition. In some cases, however, land prices might go down enough to impair significantly the security of the loan. Where debt and ownership are highly leveraged, a rather modest drop in the worth of land can materially affect a very large total financial arrangement. Others may then feel effects. The total of disruptions can be distressingly greater than the size of the initial impulse itself might lead one to expect.

Serious inquiry into the possibilities and the probabilities will require specialized knowledge and should, of course, be part of the preparations for a move to land value taxation. Here once again, the significance would be affected by the length of time spent in advance discussion and the degree of certainty about the prospects. Lenders would not all agree, of course, but would scarcely ignore any change so important if its adoption seemed likely.

Local Monopoly: Resource Immobility

One troubling prospect arises from the existence in some communities of groups with monopoly power. Unions in the building trades come to mind. Will they not use the power growing out of their organization to absorb more than a little of the benefits of lower tax on new construction? The demand for building labor will rise in localities where the tax rate on structures goes down. The normal forces of the market will operate to raise wage rates and other prices associated with construction. Additionally, "artificial" restrictions on entry to the craft and on output make supply in some areas abnormally inelastic. Will not costs rise, thus leading to higher prices than otherwise? The answer, "Yes", seems clear -- but not the magnitudes.

Some monopolistic suppliers may be able to do very well for themselves by taking advantage of the increase in demand, of course, more in the short, than in the long, run. (Note a contrast: The owners of another resources whose supply is inelastic--land--are under new pressure to put it to use.) For intermediate and longer-run periods the supply conditions for materials, except possibly bricks and other products with high transport costs, probably have enough elasticity to keep prices from rising a great deal as a result of the tax change. Similarly, as regards finance and interest rates; though market imperfections are not always negligible, competition will generally keep interest rates in various parts of the country in line with the underlying forces of demand and supply so that changes in demand among localities will be met more by changes in the flows of funds than by lasting ~~variances~~ differences in price (the rate of interest).

For skilled labor, however, conditions are often quite different. Mobility is hampered, not only by the many costs of moving but also by controls on entry to the trade and its union. Who knows how high labor costs may go where the union is strong and demand seems likely to rise? Perhaps there is a ceiling, more or less, to the height of wage rates in the building trades. In some cities it may seem, wage rates are already so near the possible limit that room for further rise is too small to be of great consequence. But I have doubts, serious doubts. Unless I am wrong, one characteristic of the transition will be larger increases in some wage costs than would otherwise come about.[23]

How much of the beneficial effect of a shift to site value taxation might in this way go for results other than more and better construction? I am not qualified even to suggest the orders of magnitude. On-the-spot labor constitutes ~~from -- to -- percent~~ a significant but not dominating portion of the total cost of new building. If projections of the results of untaxing buildings are to be realistic, conditions of the supply of skilled labor must certainly be taken into account. What happens--good and bad--in one place or under one set of circumstances can differ greatly from the average economy, but more so in the short-run than permanently. Results which in the transition may amply justify the term "distortions" will be vulnerable to the equalizing influences of market forces which link together, loosely but not ineffectively, elements that sometimes seem insulated from each other.

Yet the process of surmounting the barriers, natural and artifical, encounters obstacles. Most important, wage rates in construction seem to have no downward flexibility. At least there now appears no hope for downward adjustment of wage costs (allowance being made for productivity improvements) in those localities where the failure to shift to land value taxation weakens the ability to compete for new capital and therefore where the demand for new construction sags. Unemployment would be expected. Some labor might move rather promptly to areas of rising demand. The softening of demand would tend to depress land prices but not, it seems to me, by enough to offset the effects of wage rate increases in excess of productivity advance.

Capital Availability

The greatly desired rebuilding of cities on a massive scale, a huge extension and improvement of housing in communities large and small, these require vast amounts of capital. They call for higher levels than recently of new investments of such types. Would shift to site value taxation make reality out of visions of rapid improvement in the quality of American cities and towns? Success would require capital flows much bigger than anything in our experience. Yet for years this country has not let large amounts of (potential) capital remain "undeveloped" -- idle and uninvested -- that is, savings wasted or frustrated in "noninvestment."[24]

For the economy as a whole during a transition period, would the shift to land value taxation change by much the supply of savings for new investment? A rise in the demand for funds to finance building might lead to some increase in saving, but there is no obvious reason why it should be more than slight. Recent (1969) experience does not indicate that personal saving rises merely because the demand for loans goes up sharply and stays high. Are there other possible sources of more funds for building?

Untaxing buildings would make investment conditions in the United States more favorable relative to the rest of the world. Therefore, less U.S. capital would go abroad, and more foreign capital would come here. The magnitude as a percentage of the whole would probably be very small -- hardly 10 or even 5 percent as much as the $30 billion or so spent per year on new housing. But there just might ~~well~~ be enough to cumulate over the years to an appreciable improvement in the country's stock of housing and other structures -- a possible even though by no means certain, result.

A third means by which untaxing buildings might improve the availability of capital for real estate would be improvement in the competitive position of investment in building relative to machinery, inventory, and consumer goods. Lowering the tax on structures would raise yields, thus increasing the relative attractiveness of such investment. Moreover, the increase in tax on land by lowering price reduces the amount of capital needed for acquisition of building space. (More of the annual cost will go to government in taxes and less in interest and amortization to compensate the former owner.) What would be the magnitudes? Diversion of even a small percentage of the nearly $70 billion annually (1969 rate) of gross investment in producers' durable equipment would certainly make a difference. Since even more is spent on consumer durables, the potentialities here ~~are~~ may in fact be greater; removing or reducing the property tax discrimination against housing as a form of consumption would alter spending patterns somewhat. I have no basis for estimating the total amounts but feel reasonably sure that they would be ~~significant~~ positive but not huge.

A fourth source of additional capital for new construction in a meaningful sense would consist of more efficient use funds.25 ~~It~~ This gain would appear because more new

investment would be made closer in to areas already developed. Compactness reduces the need for capital to expand utility facilities--both governmentally and privately supplied. Less outlay on street, water, gas, telephone, and other such capacity is needed to provide a given amount of service per family. As less new investment is devoted to expanding coverage into new areas, more funds become available for better and more intensive development of the areas nearer in. A higher level of quality would be obtained. Once again guessing about magnitudes must rest on data which are all too sketchy for one to have much confidence in estimates: Public utitlity plus state-local government spending on structures totalled nearly $60 billion in 1968 (not including utility outlays on equipment). Rechanneling only a small percentage would finance significant amounts of community improvement.

To recapitulate, capital availability for enlarging and improving the physical facilities of American communities would increase as a result of shifting to land value taxation. The amount from all sources combined could be large enough to make dreams partially self-fulfilling — not mammoth but far from insignificant relative to the other magnitudes.

Nonmarket Guidance and Control

The tax changes which we are considering would alter the relative weights of market forces and in some cases their direction. People in their real estate dealings would act differently. For the most part the changes in actions would rest upon an improvement in the mix of criteria taken into account. Considerations which in a real sense are irrelevant to the outcome of a decision would carry less weight in making it. Today, for example, the decision about when, how, and how much to improve a building will also influence the amount which one must pay for government (taxes) even when the costs of government will not be changed one iota by the decision. After the change In fact, true relevance would exert greater influence, For example, the relative governmental costs of intensive and extensive land use would ~~carry~~ have greater positive ~~weight~~ influence in the making of private decisions.

The forces of the market with their vast, pervasive, flexible, yet also oten obscured, implementation of human wishes would have greater scope to work more efficiently. The indirect (and largely unintended) influence which government exerts through the coercion of taxation would conflict less with the desires of the members of the community, ~~that is,~~ taxes would have less depressive effect on new investment in buildings, and the higher burden on land supply would not ~~change~~ alter the amount in existence but would increase availability as some owners sought to put land to better use.

The preferences of the persons concerned, and the alternatives truly open for choice, would more clearly and completely determine land use and the flow of the new capital. Or would they? Land use requires some nonmarket guidance, e.g., zoning and planning, to serve man best. Such supplements to the market have very great potentials for both good and bad. During a transition the basic conditions and alternatives would change. And anything which alters appreciably the conditions of the market which ~~affecting~~ affects land use will call for reexamination of preexisting governmental controls--and promptly. New conditions of property taxation can alter profoundly the balance of forces which had been prevailing. Owners of many parcels will ~~have~~ face a significantly different mix of factors affecting the choice to be made about the use of particular plots. Some responses to new conditions will be both quick and large.

In the very nature of things the prior zoning could not have taken the new conditions into account, or not so fully as with the appearance of the added pressure to bring underutilized land into more intensive development. The change may lead to haste which does not require, or even permit, full recognition of the new conditions. Fears about bad results can be justified. Important framework changes --

taxation of real estate -- can be made before the potentials of their full effects have been analyzed and communicated to those who act.

Community development can be "premature and immature." Both the space and the time aspects of real estate linkage extend the significance of ~~each~~ individual decisions, especially those involving large investments in office, commercial, transport, industrial, utility, governmental, and nonprofit (college, church, hospital, artistic, etc.,) buildings. Actions exert influence over a long lifetime. Some wrong decisions may in practice seem almost irreversible for many years; they commit capital of such large totals as to rule out as a near-term possibility demolition for replacement. A mistake in one place will affect the nieghborhood, perhaps very unfortunately. The cost and ill effects of one man's error do not always rest on him alone. Good decisions, on the other hand, can bring benefits stretching long into the future and extending much beyond one man's property line.

The new pressure from a shift to site value taxation will speed the reallocation of land, presumably to what economists call "higher and better use." When will such shifts made to benefit the owner of land lead to changes which on balance for the community as a whole are undesirable? How may it come about that society will suffer from a misdirection of resources which results from the operation of forces to which one looks for constructive help in bringing land to better uses?

Inadequate information about the full range of alternative lies at the base of much error. In this respect land does not differ from other objects of human choice. But land use has more complex elements, such as the cost of correcting an error made in deciding on new building. Moreover, lack of pressure to take account of the interests of neighbors will lead to what from the point of view of the community as a whole are mistakes. Incomplete integration of new private facilities with those provided publicly, now and in the future, can result in waste. In short, both ignorance of, and indifference to, the full scope of varied interests can bring about bad results.

There can be over-building -- in an area or of particular types of properties -- because developers fail to take adequate account of each others' plans. Decisions which seem wise to individual owners may reduce amenities, such as green and open space, which have worth for others, The sacrifice of desirable, and the creation of undesirable, "neighborhood" characteristics can result from decisions by persons who have no need to allow for the interests and desires of anyone who is not a direct party to the agreement. The fact that such possibilities will exist during a transition to land value taxation does not mean that conditions were satisfactory before, or even any better. The proper concern is to make the new choices as good as possible.

Plots of "green and beauty" may be covered with brick and mortar sooner or more completely than without the tax change. Heights may intrude on light and air for neighbors. Congestion and pollution can get worse as individual decisions ignore the effects on others.

Without full accounting for results whose values are not priced and which are not appropriately balanced in the decisions, the best for the owner (privately) can diverge sadly from the best for the community. Any such tendency would properly cause concern. Most of our activities of consumption and investing are carried on with rules which do not bring "third party" interest into particular decisions. But the amount of effects on others are typically much less significant than in the case of real estate. There, where the effects on others will be good, encouragement is worth some effort. Bad ones we ought to try to forestall, if possible. Government investment in streets, schools, parks, and other public facilities needs reexamination in the light of changed conditions.

A point made earlier bears repeating here: The effects at the margin of a substantial increase in land tax (and untaxing of buildings) can be considerable, tipping the balance. The total result, therefore, can exceed by a multiple what the size of the new element itself might lead one to expect. This magnification can appear, in the transition and later on, even though the total capital investment changes only a little-- reallocation of even one third of total outlays could bring changes of great significance. Society needs to prepare in advance for incentives directing investment in new ways. And, I suggest, preparation should envisage many surprises and changes on a scale which may be larger than seems probable.

The need for good zoning and planning would be very real. Would the need be greater than at present? An answer of "No" seems to follow from one set of reasons: The forces of the market, so far as affected by property taxes, ~~wuld~~ would conform more closely to the real conditions of life -- "harnessing to go forward, not backward." An answer of "Yes," more need for good zoning, gets support from the fact that the tax change itself would accelerate action on land use. New pressures having come into the market, ~~one~~ and the speed of change being greater, new provisions to take care of them are called for.

Though trite, it is still right to say, "Neighborhood effects, good and bad, need to be taken into account as wisely as possible." How, then, can society's decisions reflect more fully the varied "external" benefits and costs of changes in land use, those beyond or outside of the owners and users alone? ~~Present~~ Today's practice must be ~~far~~ better in some cases than in others. (Let us look to see) What is giving best results? What clues do we get for improving results? New conditions would create new opportunities. Better zoning and planning are not prerequisities for benefitting from shift to land value taxation. But the results will depend upon the quality of zoning and other nonmarket direction.

We need to try earnestly to bring the best of information to bear on decisions affecting land use. The broad public interest is inevitably difficult to identify and measure. The speeding of change in land use would enlarge the importance of prompt review of plans and zoning. New approaches to governmental investment would be required.

Appendix

In undertaking this assignment a year ago, I had hopes of being able to draw upon materials to be gathered on a trip then being planned. The trip did reveal a great deal about property taxation and city finances. It touched down at many places, including several in Australia and New Zealand, with a wide variety of practices of property taxation -- or lack thereof. Although I have not yet had time to review all of the material gathered, most of the conclusions as regards <u>transition</u> in the United States, the subject here, have probably been woven into this paper. Conditions differ greatly from those in American cities. They also differ among themselves in many ways -- from city to city and country to country.

One example affecting Australian-U.S. comparisons bears upon construction: Australia allows no income tax deductions for the depreciation of buildings, despite the absence of what has been a factor of no small importance in the United States (accelerated depreciation as a contributor to income tax sheltering). Australia has had a building boom, one which might well have been less vigorous if improvements were taxed as heavily by the annual property tax as in this country. Australia and New Zealand do not subject capital gains and losses to income tax. Such contrasts between income tax treatments here and there vastly complicate analysis (of a macroeconomic nature) of investment flows for construction in the two economies ~~to try~~ in an effort to judge the effects of (largely) exempting improvements from property taxation.

My conclusions about Australia and New Zealand as regards the more "micro effects" conform to those in the report of Woodruff and

Ecker-Racz. As far as I can judge, it needs no appreciable revision. They examined localities with different methods of "rating," taxing land, and charging for water and related services. They found, subject to various qualifications, that as regards the "quality" of communities, the observable and identifiable differences from one place to another do not, in general, show up with enough clarity to support strong and definite conclusions relevant here. Yet as these American scholars emphasized, the levels of property tax rates lie considerably below those in most of the United States; they are very much below tax loads (on owners and users of property) in some parts of our country, especially eastern cities. Therefore, differences in tax burdens among Australian communities are rarely large by U.S. standards. Differences of such magnitudes would not be expected to exert influences of the size which might come from those we are considering, whether for (1) some localities using land value taxation only while others follow the present system or (2) on a broader basis a general <u>shift</u> to land value taxation to raise revenue on the total scale of today.

Additional features of the Australian property tax bear upon our problem. 1) Hardship exemptions for some homeowners and 2) agricultural exemptions in urban fringe areas combine to reduce significantly the potential of tax pressures to alter land use. (Studies now being made under the direction of university staffs in Australia will reveal more about the influences of various forces affecting land use there.) However, on one point of great concern for our conference -- the administrative feasibility of land value taxation -- there is no question. The job is done there. The difficult valuation problems are not insuperable. A. M. Woodruff and L. L. Ecker-Racz, "Property Taxes and Land Use Patterns in Australia and New Zealand," The Tax Executive, Oct. 1965, pp. 16-63. My own conclusions about the probabilities of administrative success in the United States are more sober. Taking account of the requirements here and the comparative extent of professionalism in assessment valuation in the two countries, we must not expect, soon or easily, to achieve the results which are so generally realized in Australia.

Limitations on time have not permitted me in preparing this paper to restudy the Report of the Royal Commission of Inquiry (New South Wales) into Rating, Valuation and Local Government Finance (Sydney; Government Printer, New South Wales, 1967). Its 167 large pages, closely printed, plus appendixes reveal a great deal about the many aspects of taxation in the most populous state of Australia. For the period Jan. 1, 1957, to Jan. 1, 1966, the unimproved capital value of ratable lands rose from nearly $1.1 to $2.7 billion. The total tax paid was $431 million, probably a little over 2¼ percent on the average of assessed value which, though lagging behind market prices, was generally very much closer than in this country. The net increase in value was almost 4 times as large as the tax and almost 3 times in excess of tax. In all but 14 out of ___ councils (localities) capital values rose, but in ____ the tax paid exceeded the value increase. From one community to another the availability of land increments as a potential source of revenue differed very greatly. Recommendations of the Commission include the following, from pages 162-166, numbering omitted: "A rate (tax) on land is the most appropriate method of financing the services which councils are authorized to provide under the Local Government Act. The claim that 'rates have reached saturation point' is not established. ...The council of each local government area should have power to levy general, special, local, or loan rates -- (a) upon the unimproved (or site) value, the improved value, or the assessed annual value, or (b) (some combination of the three) ...(and a development or betterment charge based on the increment in value of land over a specified period upon -- (i) the granting of approval for development under a planning scheme, and (ii) any amendment...in a planning scheme..." The reference to "betterment levy" does not apply to a tax on all increments of land value but to a more narrowly limited group -- those increments which result from the two sources indicated. This restricted treatment, which has not been attempted in Australia, resembles closely those of the United Kingdom and the Union of South Africa.

A most enlightening study of its subject, prepared by J. Bruce Brown, Valuer-General, Valuation Department, New Zealand, is A Critical Study of the Unimproved Value of Land, Its Basis, Determination and Uses, Research Paper, 68-1, File 55/9 (Wellington, 1968). A valuable survey of practices in several countries appears in G. E. Lent, "The Taxation of Land Value," from International Monetary Fund Staff Papers, March 1967, pp. 89-123. In a later paper I hope to discuss more fully what seem to me to be conclusions from practices in other countries as I have observed them.

1. The appendix presents observations based upon recent experiences abroad.

2. Occasionally, significant differences can result from accurate application of the principle. See the study by J. Bruce Brown noted in the Appendix. He strongly recommends shift to the use of present condition of land as the basis.

3. Plans for taking account of the effects of changes in zoning and other government action should be included in formulating details of the revision of property taxation. Ought we to add a "betterment levy" to absorb some of the worth of results of zoning and other governmental actions? The issues raised by this question call for analysis on their own which would go beyond the scope of this paper.

4. A new and specialized element of the judicial system might well be introduced. The "lands tribunal" of the United Kingdom and the somewhat similar courts elsewhere in the British Commonwealth can provide models. The general objective would be to assume a higher level of competence, a larger role for expertise as contrasted with the capacity of the relative amateur (a judge) to extract truth from an adversary proceeding.

5. Land assessments appear to have lagged appreciably behind the rise in market prices in many areas. Other papers in this volume have more to say about such discrepancies.

6. One may question, as I have, the propriety of using taxes collected from all over the country to pay for benefits to selected local areas and their residents. Whatever one's conclusions -- the right answer will not be found by trying to match in cities the spending on farm programs -- society seems likely to move in this direction. We need to be prepared for the consequences of the decisions which are made.

7. During conference discussion assessors cited examples of difficulties in getting judges to understand and accept principles of valuation which are needed to make land value taxation a reality in some circumstances.

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8. Congress is now considering tax restrictions on the use of funds of foundations where legislation and matters of public policy are involved. Although many results cannot now be foreseen, reenforcement of the status quo would be one consequence because fewer resources would be available to induce change.

9. Interest rate changes, zoning and building costs, governmental investments, (streets, sewers, prisons, etc.), technological advance, rate of population growth and family formation, are among the elements bearing upon the total situation. For more about the place of property taxation in our economy see W.J. Shultz and C. Lowell Harriss, American Public Finance, Eigth Edition (Englewood Cliffs: Prentice-Hall, Inc.). Ch. XVIII and XIX.

10. A full shift in a high property tax state, such as Massachusetts, or New York, would be of different significance from a shift in Alabama, Louisiana, or New Mexico, where property tax rates are much lower absolutely and relative to personal income.

11. The decline in the cost-of-government element (tax) included in the use of buildings will tend to make housing and other uses of real estate relatively more attractive than before. Some shift of preferences from other consumer and producer goods to buildings would occur. How much? How fast? I have no basis for estimating. How much shift from land to structural elements of housing demand would result over, say, a decade? Some, I should think.

12. Property brings $10,000 before taxes; assessed at 40 percent of market price of $100,000; tax rate 5 percent. Tax, therefore, is $2,000. The $8,000 left is 8 percent of $100,000, confirming the starting point and the capitalization assumption. Tax rate then triples to 15 percent of assessment of $40,000; tax goes to $6,000, leaving $4,000, which is 8 percent of $50,000, a new market price for the land. It is still more than the assessment.

13. Estimates based on data from City of New York, Annual Report of the Tax Commission for 1968-69..., and State of New York, Office of Local Government.

14. At times, and such has been the case in recent years, some of the worth of land will consist of value attributed to land as a hedge against inflation and land as a means of sharing in the benefits of economic growth. Substantial increases in tax on land values might be interpreted as an inroad on the prospects of future increments for the owner. If so, the drop in land prices would be greater than the amount due to capitalization of higher tax alone. Some of the speculative value would have disappeared.

15. Piecing together two sets of data in Statistical Abstract for 1968, p. 336 -- one showing total wealth in January 1967 as $2.8 trillion and another which puts nonpublic land at 13.8 percent of the total, the worth of land then was about $386 billion. A 1969 figure would be considerably higher. As Professor Gaffney points out, such estimates are likely to be very far from correct, being too low. Subject to the same criticism is a figure for land of $311 billion in 1958, shown in the "Staff Report" of Wealth Inventory Planning Study...Measuring the Nation's Wealth, (Washington: Joint Economic Committee, 1964), p. 54.

16. Eli Schwartz and others, An Analysis of the Potential Effects of a Movement Toward a Land Value Based Property Tax...(in) Bethelehem, Pennsylvania (Albany, New York; Economic Education League, 1958).

17. Theodore Reynolds, Smith, A Comparative Analysis of Real Property and Land Value Taxation (Claremont: 1969).

18. In Sydney, Australia's biggest city, the property tax does fall on land only. Despite the tax, land values are substantial and have been rising. But ~~despite~~ the total tax (relative to value or other measure) is much less than generally the case in this country. Local governments in Australia do not have to finance functions, including education and welfare, which in total account for a considerable portion of the outlays to which we look to the property tax in this country. A study of Wellinton, New Zealand, concluded that under site value taxation residential properties would pay less, and commercial properties more, than under capital value. Industrial and other properties would pay slightly less on the site value basis. Valuation Department, New Zealand, A Comparison of Rating Systems, The City of Wellington, Research Paper 661, 1966, p. 6.

19. See C. Lowell Harriss, "Alternative Bases for Real Estate Taxation" in Tax Policy League, Property Taxes (1940; now available through Tax Institute of America, Princeton, N.J.), pp. 218-29; also Carl S. Shoup, Public Finance (Chicago: Aldine, 1969), pp. 401-2. For a recent statement of my reasons for reducing greatly the reliance on value of structures as a tax base see C. Lowell Harriss, "Economic Evaluation of Real Property Taxes," in Academy of Political Science, Columbia University, Municipal Income Taxes, Vol. XXVIII, No. 4, Jan. 1968, pp. 489-504.

A forthcoming study by H. J. G. Bab will develop at length the case for what he calls "land service" taxes, by which he means essentially what I have referred to as taxes or charges on land related to distance, area, or some other non-value basis. See also William Vickrey, "General and Specific Financing of Urban Services," in Public Expenditure Decisions in the Urban Community, H. G. Schaller, ed. (Baltimore: The Johns Hopkins Press, 1963).