

DATE:

November 16, 1983

TO:

Rosalind Paaswell, First Deputy Commissioner

FROM:

Sam Venturella, City Planner

SUBJECT:

Opposition and Support for Land Value Taxation

This memorandum discusses the nature and reasons for opposition to the taxation of land values.

There are no valid economic arguments against land value taxation. Arguments by economists are based on a purported difficulty in distinguishing between rent for land and rent for improvements; and on a confusion arising from the present day practice of applying the term economic rent not only to the value of the land but also to capital, and in some cases even to specialized labor such as entertainers and professional athletes who earn fabulous sums enviously considered to be in excess of normal wages.

A typical treatment is found in a textbook written by Richard S. Eckaus, Professor of Economics, Massachusetts Institute of Technology. He presents a demonstration graph of increases in (land) rents due to demand and makes a statement agreed upon by all economists: "A tax on economic rent would only take away 'unearned increments' and would not distort the use of resources in fixed supply." (His

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DEPARTMENT OF

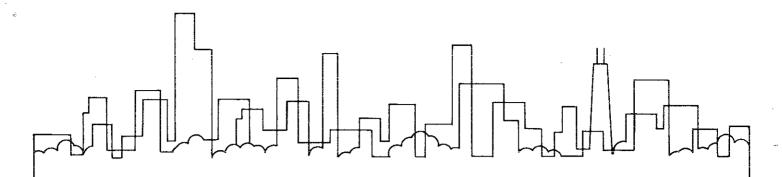
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City of Chicago Harold Washington Mayor

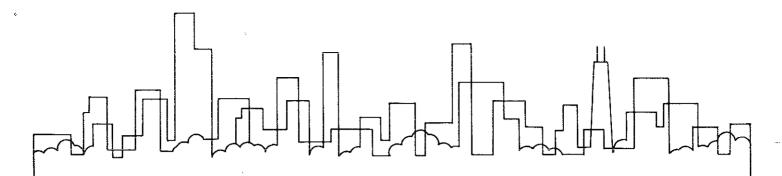


italics for entire sentence, and quote marks on <u>unearned</u> increments).

Professor Eckaus then raised what I consider to be spurious arguments. First he imagines a difficulty in identifying "the economic rent portion of the rentals paid"; although he admits it is common practice in Australia to value sites independently of improvements. Either he is unaware or chose not to mention that it is also common practice in New Zealand and South Africa, is practiced in many jurisdictions in the U.S. and Canada, and real estate appraisers value sites independently of improvements when a client is interested in purchasing an improved site to be cleared for redevelopment.

The second argument is "a tax on economic rent on land may not take the unearned increment from the owner who benefited from it." I may add here that Henry J. Aaron did a monograph, Who Pays the Property Tax? A New View, for the Brookings Institution, dealing with this proposition. He remarks, "The case against an abrupt replacement of the property tax is overwhelming, for it would entail massive redistribution of tax burdens, as well as major shifts in property values." A redistribution of the tax burden is precisely the effect desired and achieved whenever the property tax has been shifted from capital improvements to land values. The owners of skyscrapers pay less; the owners of vacant lots pay more.

The third argument by Professor Eckaus is, "the landowner

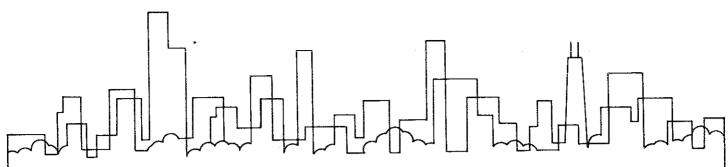


may also say, "Why? I'm not the only one receiving economic rents (which you should not confuse with ordinary land rents)." Here and in the summary when he says, "A tax on rents on land also ignores the economic rent elements in other factor earnings and is, therefore, subject to criticism on grounds of equity.", he confuses as do so many of today's economists the economic rent of land with the earnings of the other factors of production.

Thirty years ago, the most popular textbook in economics was written by Paul A. Samuelson, also of M.I.T. It was the usual practice before Samuelson to ignore Henry George, or, at best, to dismiss him with a snide remark. Professor Samuelson rendered an exposition of the theory of rent as first expounded by David Ricardo. Then he gave a proper exposition of Henry George's proposal to tax the value, or economic rent, of land. With more candor than shown by Eckaus, Samuelson observes that the proposal is a political question and says, "such a political question has no place in the present discussion."

When economists discuss the property tax there is no disagreement that removing the tax from improvements would encourage development, and that increasing the tax on land would discourage holding land idle and only reduces the return to landowners who hold land in speculation or lease land to developers.

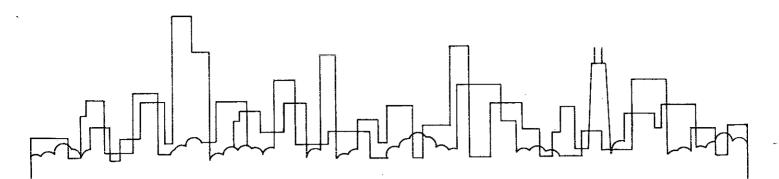
For a long time there was general agreement among economists and tax specialists that the real property tax is a regressive tax. Today there is controversey as to whether it is



regressive or progressive. The leader of the progressive view is Professor M. Mason Gaffney, now at University of California - Riverside. He found it implausible that serious scholars could consider the property tax to be regressive, saying, "To own property is to be rich, in the measure that one owns, and to tax the quality of richness should not be presumed to burden the poor more than the rich." He found the regressive view to be based on the "selection of data sources, assumptions, concepts and methods, not in the subject."

Professor Gaffney presents a rationale for the property tax:

- "1. "Ability-to-pay" derives from wealth as well as current income. James Tobin, Arnold Zellner, Taylor and Houthakker, Harold Somers and others have stressed this lately. The old cliche that "taxes are paid out of income" is as empty as the one that we consume "out of income." We spend money, and it is not labelled.
- "2. The property tax asserts the public equity in land which was won and is defended by joint efforts, and whose value derives from public works and spillovers, not from the owner's efforts. It exempts human effort, thus rewarding service to the community and denying the state any equity in the bodies of its citizens whose freedom and dignity is thus enhanced in their capacity as human beings, as distinct from owners of wealth.
- "3. Property taxes reduce the differential effect of inherited wealth on the current generation. They strike directly at concentration of economic and other power based on wealth, promoting competition and equal opportunity. Property as collateral is a source of invisible income (credit rating). Taxing property reduces the differential advantage of the rich in credit rationing.
- "4. Property income of a given dollar value places



"the receiver on a higher welfare plane than labor income, because he needn't work for it. \$10,000 a year received by dint of working long hours in a coal mine with black lung disease is not the same as \$10,000 plus a life of ease.

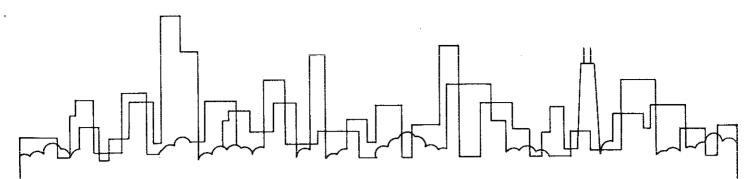
"5. The property tax is needed to plug loopholes in the income tax, which is inexorably devolving into a payroll tax."

Is Gaffney's rationale economic or political? The decision to impose any tax is political. Revenue is necessary to provide for the safety of the persons and possessions of a community's citizens; to maintain public rights-of-way; to provide educational and recreational facilities. There are some people, for example, Ludwig von Mises and his followers, who maintain that these services and facilities should be paid for by users as used.

The general concurrence among economists of the effects of a tax on land values would seem to indicate that the political decision to impose such a tax would be based on sound economic principles.

Gurney Breckenfeld's "Higher Taxes That Promote Development" in the August 8, 1983 issue of FORTUNE presents only the experience of the five Pennsylvania cities that levy higher tax rates on land/lower tax rates on buildings. (Clairton City, Pennsylvania has since voted to adopt heavier land/lighter improvements taxes). So it is natural to ask if other jurisdictions have adopted such a tax program.

Senator Edmund S. Muskie's Subcommittee on Intergovernmental



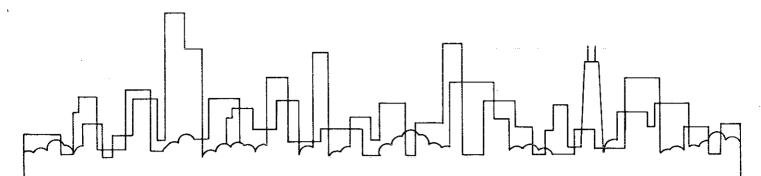
Relations published a study on <u>Property Taxation</u>: <u>Effects</u>
on <u>Land Use and Local Government Revenues</u>, in which land
value taxation is discussed. In addition to the Pennsylvania
graded tax plan, the report also presents the experiences
of the Modesto (California) Irrigation District, single (land)
tax enclaves in Alabama, Delaware and New Jersey in the U.S.,
and the Australian experience.

J. P. Pethrick, Valuer-General (assessor) for the State of South Australia, tells us "Land tax in Australia is imposed on all privately owned land by the use of a progressive tax on the aggregate unimproved-value of all land in the same ownership." Further on he says "Overall, to change from annual or improved-value property taxation to land-value taxation is to reduce the tax payable by property owners whose property values include a high improvement value content and to increase the tax payable by property owners whose property values include a high vacant or unimproved land content."

One of the most common objections to a land value tax is raised by Mr. Petherick in the following passage:

"The value of land usually reflects the wealth or financial capacity of the property owner, so that a tax on land should generally bear a relationship to the owner's ability to pay the tax. That it does not always do so is evidenced by the hardship caused some retired property owners with fixed or pensionable incomes who are residents in areas that have become subject to very high values."

A variation of this one is the elderly widow. It never



seems to occur to these often truly sympathetic objectors that the retired couple or elderly widow could sell the property, buy shares in the luxury high-rise that most likely will be built on the site, and enjoy life in a high-rise apartment with a view.

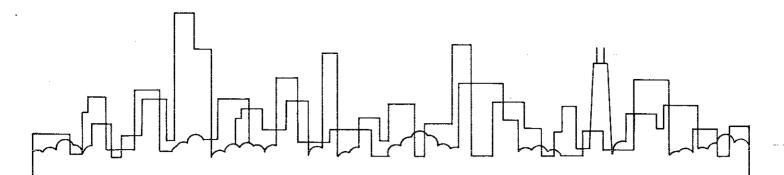
At any rate, Mason Gaffney, in a meeting at the Center for the Study of Democratic Institutions, met the objection this way:

"We can ask that a single standard be applied to owners troubled by higher taxes and tenants troubled by higher rents. When a widow A is in tax trouble it is time to turn on Hearts and Flowers, forebode darkly, curse oppressive government, demand tax relief. When widow B has trouble with escalating rents, that touches a different button. You have to be realistic about welfare bums who play on your sympathy so they can tie up valuable property. You have to pay the bank, after all. A man will grit his teeth and do what he must: garnishee her welfare check. If it's too little, give notice. Finally, you could call the Sheriff. Go to the beach until it's over—that's what we pay taxes for. Welfare is their problem.

"Anyway, widow B is not being forced out of her own house, like widow A and so many like her. Jarvis said taxes are forcing three million Californians from their homes this year. But in truth, evictions are frequent; Sheriff's sales are rare. Those who do sell "because of taxes" (they say) and all their other circumstances usually cash out handsomely which is, after all, why their taxes had gone up."

"A tax on land values", says Professor Gaffney, "is the only tax known to man which is both progressive and favorable to incentives."

To say that opposition to land value taxation is political



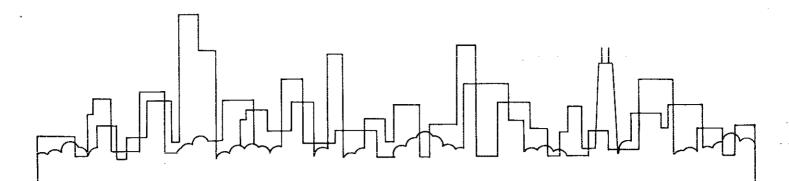
is one thing; but to identify the categories or groups of people aligned in favor or in opposition is quite another. A seminar on "Property Taxation, Housing and Urban Growth" was held at The Urban Institute in 1970. One of the sessions was on political aspects of changing the property tax. Mr. L. Laszlo Ecker-Racz, Senior Fellow, Washington Center for Metropolitan Studies, Washington, D. C. was called upon to initiate the discussion of the politics of either improving or changing the property tax.

Mr. Ecker-Racz introduced the subject of the politics of either improving or changing the property tax with two assumptions:

- "Most people's reaction will be motivated by pocketbook interests."
- 2. "Those who are politically responsible are concerned, not by what happens fifty years from now, but what will happen by the time they have to run for re-election."

Six groups opposed and two groups for a land value tax were identified by Mr. Ecker-Racz. The important groups opposed are:

- 1. "The governing boards that depend upon property tax revenue." They want someone else to try it first.
- 2. "State legislators who fear it might not produce the required revenue."
- 3. "People with very large investments in land, either through inheritance, acquisition or through speculative activities."

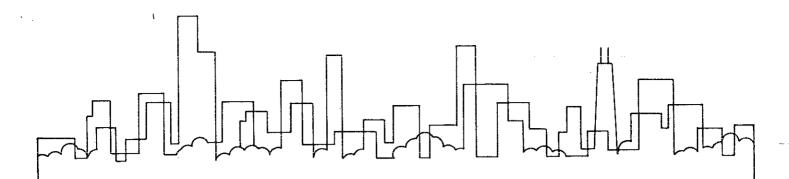


- 4. "Every property owner with a little bit or piece of land who hopes to leave an estate in land value to his children and grand-children."
- 5. "Property owners in all categories who happen to be so located that they have a relatively high value in land relative to value of improvement."
- 6. "The professional assessors...don't want to have the responsibility for valuing land as distinguished from total value. Every professional likes to be allowed to continue to operate with his present know-how. He doesn't like to assume the burden of acquiring a new know-how. It's significant that our assessors' opposite numbers in countries that do value land separately—the New Zealanders and Australians—feel precisely the opposite. They are equally as convinced that it's easier to value land alone than to value the two things together."

The important groups for a land value tax are:

- 1. The growing number of "people who like to be governed by theory"...and "all those people interested in urban land use."
- 2. "The owners of modern, intensively developed urban property. Those who own high-rise buildings drool at the mouth at the prospect of the tax being taken off their improvement values."

Frederick B. Stocker, Professor of Business Research, Ohio State University, Columbus, Ohio, - another participant - said "it appears that concern over tax equity has almost always outweighed consideration of economic effects,...it has seemed <u>fair</u> to generations of state legislators and policy makers that the man who has invested in structures should be taxed the same as the man whose investment is in land."



It has seemed <u>fair</u> to make no distinction between land and the improvements thereon. But in the hundreds of years since William the Conqueror ordered an inventory of the royal (spelled <u>real</u> in Norman French) estate we've made some distinctions. After William whomped Harold at the battle of Hastings in 1066, he claimed England, all of it - the land and everything in and on it: buildings, animals, people and tools they worked with.

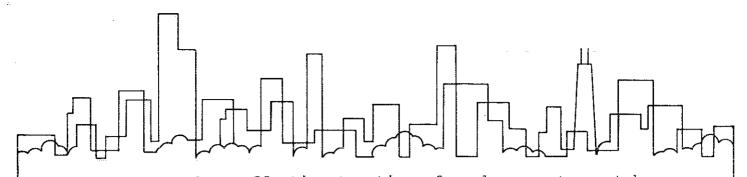
Our perception of real estate has changed. We no longer consider people, animals and tools as part of real property. Our perception of the real property tax is based in part on our treatment of the two components - land and building - as one. Real estate which consists of land and improvements generally has a higher improvement value to land value. A tax rate levied on the combined value of building and land actually falls heavier on buildings.

The National Commission on Urban Problems computed the following typical land-value to building percentages:

One-family nonfarm houses	26
Other nonfarm residential property	1.7
Commercial property	34
Industrial property	19
Acreage and farms	85
Vacant lots	100

(These figures are based on reported assessments of 13 major assessing jurisdictions containing cities of 100,000 or more population.)

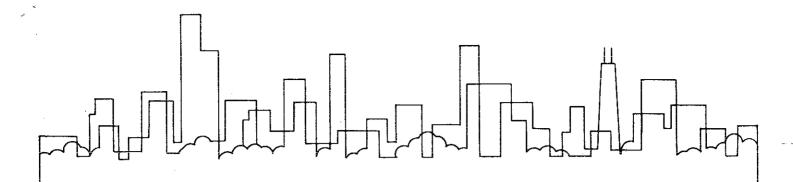
Residential, commercial and industrial property would experience lower tax burdens if the tax were shifted entirely to land values.



Present laws affecting taxation of real property must be amended to permit Chicago to meet its revenue needs by imposing a heavier tax on land values. Taking into account political reality - the need for any change in the way property is now assessed and taxed to be politically palatable - three options are available: an amendment to the Illinois Revenue Article; or either of two amendments to the Cook County Property Assessment Classification Ordinance; one possible amendment to the assessment ordinance is to reduce the present seven classes to two, I. Land; II. Improvements. The other possible amendment is to remove vacant land from the present Class I, which is assessed at 16% of market value; and add vacant land to Class V, which is assessed at 40% of market value.

The first and second options would require intensive campaigns to overcome the natural reluctance to change on the one hand, and, on the other, the heavily financed intensely emotional campaign which will be mounted by owners of vacant land and lessors of high value improved land. A constitutional amendment would require a statewide campaign until the eve of the election day when the amendment is to be voted on by the entire electorate of the state.

Favorable consideration by the County Commissioners to an amendment to the Cook County ordinance requires favorable comment by a significant number of the civic organizations, business and trade associations which will present their views at the requisite hearings. It should be an easier task to educate the opinion makers in these organizations, than to educate the public at large.



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