

## Taxing Land More Than Buildings: The Record in Pennsylvania

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For decades, land-value advocates have urged that all taxes be shifted off wages and productive capital and onto land values, but they had no test cases to support their advocacy, at least not in this country. They could only appeal to logic. To be sure, the logic was impressive: by untaxing wages, take-home pay would be increased; by untaxing buildings, operating costs would be lower and new construction would be encouraged. If, on the other hand, land were to be taxed more, then inefficient land use would be discouraged because it would become too expensive—too much tax outgo, too little income or use. Landowners would be encouraged to put their sites to their most appropriate use, yet they would not be taxed for doing so.

A tax on labor or the products of labor would result in fewer of those desirable things. But a high tax on land values could not possibly reduce the supply of land; in fact, it would increase the available supply, since such a tax would discourage land speculation and underuse. A tax on land would key land use to land demand; a failure to tax it would result in sprawl, blight, and unemployment. There is also an ethical dimension to the logical argument: the locational value of land is produced by society. Hence society should collect through land-value taxation what it has produced rather than tax individually produced labor and capital.

### *Successful Applications Abroad*

Australia, New Zealand, the Republic of South Africa, and Denmark are the countries most extensively applying land-value taxation. Most of their cities apply it for local-tax purposes. The application in New Zealand and Denmark is so widespread and so long-standing that it becomes difficult to know whether an alternative taxing system would produce any different economic results.

This problem does not exist in Australia or the Republic of South Africa,

however, where localities taxing land values exist alongside neighboring and comparable localities that tax either the capital value of land and buildings (as in the United States) or real-estate income.

For example, in Victoria, Australia (the southeastern state, which includes Melbourne), twenty-four cities switched from taxing land and buildings to taxing land only between 1954 and 1975. Not only did all of these localities experience a spurt in construction within three years following their switch to taxing only land values, but in each case they showed more construction growth than neighboring and comparable cities.

A recent study (soon to be published) of over 300 municipalities showed similar results in the Republic of South Africa.<sup>1</sup> Municipalities taxing only land values experienced more construction than those that taxed land primarily but also buildings, while the latter municipalities taxing land more than buildings experienced more construction than municipalities that taxed land and buildings at the same flat rate. It is not surprising that there has been a decided shift to the heavier taxation of land values over the years.

### *The Pittsburgh Experience*

These nations are so far away that their statistics seem somewhat unreal to Americans. But now the United States, particularly Pennsylvania, has some similar statistics to offer. In 1913, the Pennsylvania Legislature passed a law requiring Pittsburgh and Scranton to increase their property-tax rates on land and decrease their rates on buildings in five steps so that, by 1925 and thereafter, their tax rates on land would be double their tax rates on buildings. In 1977 both of these cities happened to get home rule charters, which among other things meant they could set their own property-tax rates as they saw fit to do. Thereupon Pittsburgh raised its property-tax rates as shown in table 1. Scranton went from 5.1 percent land and 2.55 percent buildings in 1979 to 9.6 percent land and 2.55 percent buildings for 1980-82.

TABLE 1  
*Pittsburgh Property-Tax Rates, 1978-82*

	1978	1979	1980	1981	1982
Land tax rate	4.95%	9.75%	12.55%	12.55%	13.3%
Building tax rate	2.475	2.475	2.475	2.475	3.2

<sup>1</sup> Godfrey Dunkley, "Rating in South Africa: A Quest for Stability Through Land Tenure and Taxation" (Paper delivered at the 15th Conference of the International Union for Land Value Taxation and Free Trade, Utrecht, The Netherlands, July 21, 1982).

In addition, in 1980, both cities granted liberal property-tax exemptions to all new construction (but not to the site). In the case of Pittsburgh, the property-tax exemption is 100 percent for three years on all new construction (exclusive of the value of the land). In Scranton, commercial and industrial construction is property-tax exempt for ten years, and new residential construction is completely exempt the first year, and for each year afterward the exemption is reduced 10 percent until the exemption disappears altogether after the tenth year. These liberal new-construction exemptions further differentiate the land and building tax rates from each other.

Now let us see what happened to the issuance of building permits in these two cities. In Pittsburgh, immediately after its first land-tax increase in 1979, new construction increased 14 percent as compared to the 1977-78 annual average, and then 312 percent for 1980 (the year the land tax rate was further increased and the new-construction exemption went into effect). New construction in 1981 exceeded the 1977-78 annual average by an astounding 590 percent. The nationwide figures for new office building starts increased only 37 percent, 41 percent, and 84 percent for the respective years.<sup>2</sup>

The figures in table 2 represent both taxable and nontaxable new construction, but the taxable far exceeded the other. The nontaxable construction was distributed fairly evenly throughout the years, except that the start of a city-owned convention center in 1977 augmented considerably the dollar value of the building permits issued in that year.

The question, of course, remains: Would this burst of new construction have happened anyway, even if the uptaxing of land and the untaxing of new improvements had not occurred? It is hard to know what other factors were responsible; if they existed, they are not clearly visible. Perhaps the time was ripe for an office building boom; such construction often occurs in sporadic spurts. The mayor has claimed that his close relations with the business com-

TABLE 2  
*Pittsburgh's Record of Total Building Permits Issued*

Year	Number	Dollar Value
1976	3,179	\$55,794,694
1977	3,819	101,458,569
1978	3,622	89,264,159
1979	4,420	108,398,188
1980	4,804	297,484,884
1981	4,335	563,072,735

Source: *Reports of Building Permits Issued*, Pittsburgh Bureau of Building Inspection; 1976-78 annual reports and December 1980 and December 1981 reports.

<sup>2</sup> George A. Christie, personal letter, April 27, 1982.

munity brought on this new renaissance. Perhaps that is true. In fact, however, not much attention has been given to why the renaissance occurred. Most disturbing for the "uptax land, untax new construction" explanation is that it has received so little attention, even though many of the big new downtown office buildings have received tax reductions in excess of \$1 million a year because of the property-tax reforms.

### *Scranton*

It is proper to compare Pittsburgh to national statistics, since it is a large city very much involved in the national economy, but a smaller city like Scranton (population, 87,378) should more properly be compared to similar and neighboring Wilkes-Barre (population, 51,117). The two cities are twelve miles apart and have similar ethnic and economic characteristics. Their property-tax revenue per capita is almost exactly the same. But Scranton in 1980 nearly doubled its land-tax rate and untaxed new construction, while Wilkes-Barre has offered no such inducements to new construction.

As shown in table 3, after its tax changes in 1980, Scranton increased its number of building permits issued by 22 percent, whereas Wilkes-Barre's building permits declined by 44 percent. Could factors other than the tax change account for this? Perhaps, but none is apparent.

TABLE 3  
*Taxable Building Permits  
Issued in Scranton and Wilkes-Barre, 1977-81*

City	1977-79		1980-81		% Change 1977-79/1980-81	
	Number	Value	Number	Value	Number	Value
Scranton	1,145	\$8,658,747	1,307	\$10,594,093	+ 14%	+ 22%
Wilkes-Barre	2,520	14,542,318	1,763	8,105,006	- 30%	- 44%

Note: These figures represent annual averages for the years indicated. For example, 1,145 building permits were issued annually, on the average, during 1977-79.

Source: Building permit records in the city halls of Scranton and Wilkes-Barre.

It is also helpful to look at this matter from the viewpoint of the investor. Let us assume that he is considering two sites, both worth \$100,000; one is in Scranton and the other in Wilkes-Barre. He wishes to erect a \$900,000 office building (a 9:1 ratio is typical for a new office building, and if it errs it is on the conservative side). Here are his comparable tax liabilities in both cities:

*Scranton:*  $\$100,000 \times .35$  (assessment-to-market ratio)  $\times .096$  (land-tax rate) = \$3,360/year.

*Wilkes-Barre:*  $(\$900,000 + \$100,000) \times .5$  (assessment-to-market ratio)  $\times .04266$  (property-tax rate) = \$21,330/year.

If the investor locates in Scranton, he will save \$17,970 a year as compared to locating in Wilkes-Barre. This difference would be a major factor in any investor's choice of a location.

To be sure, this savings applies only to the first ten years, but even after that, an investor would save tax money by locating in Scranton rather than in Wilkes-Barre:

*Scranton:*  $\$100,000 \times .35 \times .096 + \$900,000 \times .35 \times .0255$  (building-tax rate) = \$11,393/year.

*Wilkes-Barre:*  $(\$900,000 + \$100,000 \times .5) \times .04266 = \$21,330/\text{year}.$

After the first ten years, assuming no changes in assessments, an investor would save \$9,937 a year by locating in Scranton as compared to Wilkes-Barre.

### *Harrisburg and New Castle*

Three other cities in Pennsylvania are taxing land more than buildings. Harrisburg (population, 53,113) started to do so in 1974 and has since spread its rates to 5.825 percent on land and 2.188 percent on buildings. During this period, it experienced a spurt in new construction, but there is a strong obvious cause for this other than its two-rate tax: the state of Pennsylvania has invested millions of dollars into new buildings to revitalize the city and has made other grants as well. So Harrisburg is not a clear-cut test case for a two-rate property tax.

The city of New Castle (population, 33,426), situated sixty miles north of Pittsburgh on the state border with Ohio, adopted a two-rate tax for the year 1982. It is taxing land at 4 percent and buildings at 2.28 percent (the assessment-to-market ratio is 100 percent). In late 1981, New Castle also adopted a property-tax exemption for new construction. New residential construction is exempted (but not the land value) for three years at 100 percent. New commercial and industrial construction is exempted for ten years but on a sliding basis—100 percent the first year, 90 percent the second year, 80 percent the third year, and so on until the exemption disappears at the end of ten years.

At this early date, not much can be concluded from an examination of New Castle's building permits. At least a full year is needed, preferably two years. But is is reassuring to note that New Castle's new construction is exceeding that of its two most comparable neighbors, Sharon (population, 19,036) and Butler (population, 16,964)—this for the first seven months of 1982 as compared to the same months in 1981.

All three cities are rather close to each other. Their economies all rely on heavy manufacturing, particularly steel, and all three have experienced above-average unemployment. No other comparable cities are nearby.

The number of new building permits issued in New Castle rose by 12.9 per-

cent for January through July 1982, as compared to the year-earlier period, and its dollar value of building permits issued increased by 3.4 percent, despite the horrendous economic conditions. The similar statistics for Sharon were -13.4 percent and -37.3 percent, and for Butler they were -21 percent and -77.4 percent (the latter figure would have been -28.5 percent if it had not been for two large construction jobs started in the January through July 1981 period).<sup>3</sup> More time is needed to see whether these trends continue.

### *McKeesport*

In 1980, McKeesport (population, 31,017) took two major steps toward uptaxing land and downtaxing buildings. Its tax rate in 1979 had been 2.45 percent on both land and buildings. In 1980, it raised its tax rate to 9 percent on land and lowered its tax rate on buildings to 2 percent. The new rates (which still prevail at this writing) represented an increase of more than 50 percent in property-tax revenue for the city and raised the same revenue as would a flat-rate tax of 3.75 percent on both land and buildings. Such a precipitous property-tax increase was required, because the city could no longer continue its long-standing policy of deficit financing.

McKeesport has a history of turbulent politics and the property-tax increase occasioned a heated protest meeting in the city council chambers attended by about thirty irate homeowners. The new mayor, Louis Washowich, was able to mollify the protesters by making clear how parlous was the state of the city government's financial affairs.

The protestors were concerned about the sudden increase in their taxes, and the shift to a two-rate tax did not much concern them. But after the meeting, the mayor remarked that the tax change had lessened the impact of the property-tax increase for most homeowners; if the shift had not occurred, he said, it would have been necessary to hold the protest meeting in the high school gymnasium instead, it would have been so well attended. In fact, studies show that almost without exception, most homeowners pay less with a building-to-land tax shift.<sup>4</sup>

McKeesport also introduced another tax reform in 1980: it granted a three-year tax exemption to all new construction. In short, in 1980 it uptaxed land (from 2.45 to 9 percent) and downtaxed existing buildings (from 2.45 to 2 percent) and untaxed new construction (for three years). Did all this produce a jump in new construction, as the economic theory would imply?

To answer this question, we should compare McKeesport's post-January 1980 record of building permits issued with its pre-1980 record. But in addition, we should compare McKeesport's record with that of the two most obviously com-

<sup>3</sup> All figures come from the building permit offices in the city halls of New Castle, Sharon, and Butler.

<sup>4</sup> See *Incentive Taxation*, May-June-July 1976 and October 1978; also a forthcoming issue.

parable cities, Clairton (population, 12,073) and Duquesne (population, 10,099). All three cities practically abut each other. The steel industry is their economic mainstay, and each has one large U.S. Steel mill. They share the same chamber of commerce and have much higher-than-average rates of unemployment. In the last twenty years, all have experienced the same rather large percentage drop in population. Their governments are faced with huge deficits and are verging on bankruptcy. There are no other nearby cities, either comparable or non-comparable.

Since these three cities are truly triplets, the only visible relevant difference being that McKeesport uptaxed land in 1980 and dountaxed new construction, while the other two cities did not. Table 4 indicates the taxable building permit statistics for each of these cities. Before concluding anything from the figures, however, we should know that in 1980, the Duquesne Business Advisory Corporation obtained a federal grant for subsidizing storefront alterations in the central business district. This grant accounts at least in part for Duquesne's increase in the number of building permits issued.

TABLE 4  
*Taxable Building Permit Statistics for Three Pennsylvania Cities*

	Annual Average 1977-79	Annual Average 1980-81	% Change
<i>McKeesport</i>			
Number	429	457	+ 6.5
Amount	\$1,716,010	\$2,333,014	+ 36.0
<i>Clairton</i>			
Number	235	204	- 13.0
Amount	746,710	526,073	- 30.0
<i>Duquesne</i>			
Number	95	134	+ 41.0
Amount	1,053,305	900,722	- 14.0

Source: Records of building permits issued in the respective city halls.

The figures for these three cities show that, despite horrendous economic conditions, McKeesport's new construction actually increased, whereas new construction in its two comparable neighbors declined. Certainly, that is true when construction is measured in dollar value; it is also true for the less important number of building permits issued once we take into account Duquesne's federal grant.

### *Conclusion*

The figures are compelling, almost as compelling as the logic. But we must be careful not to conclude too much or too strongly. In order to assert with confidence that there is adequate empirical proof for the contention that in the

United States a building-to-land tax shift spurs new construction, we would need at least a dozen cases similar to those presented here.

It is difficult to isolate cause and effect in the social laboratory, because too many things are going on at once. Nevertheless, it is reassuring to note that the experiences of Pittsburgh, Scranton, and McKeesport (perhaps even New Castle) are fully corroborated by over 1,000 localities in Victoria, Australia, and over 300 cities in the Republic of South Africa. Surely no politician need be considered rash if he proceeded to replace the property tax on buildings with one on land values. He could base his actions on the existing logic of the case and the relevant facts.

Unemployment pervades United States cities. Perhaps it is because less-than-fully-employed land leads to less-than-fully-employed people. Perhaps if city governments were to tax the land values—created by their roads, schools, hospitals, and the like—they would not have to tax the private initiative that produces wages and buildings. Quite possibly the economy would be much better off for doing so.

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Ster Print 0703 - 400

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