

WHY TAX THE LAND AND NOT THE BUILDINGS

A brief explanation of The Graded Tax Law for Cities of the Third Class in Pennsylvania

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The Importance of Real Estate Taxes

A new law*, perhaps the most significant property tax law ever to be passed in America, is now a part of the tax policy of Pennsylvania. Very few people realize its potential. Only a few, familiar with the basic principle of land value taxation, realize how its adoption and use might affect the economy of a city. It will take time, but sooner or later some town is going to discover that by applying this principle it can make of itself an economic oasis in the midst of a desert of depression.

Most people find it hard to believe that by a simple adjustment of the local real estate tax policy a whole new pattern of economic life might begin to unfold. It is the purpose of this paper to explain how this can be.

Traditionally real estate taxes in the United States have been levied against *land and buildings alike*. The underlying assumption of such a policy is that land and buildings are alike. Nothing could be further from the truth. Despite the fact that we lump them both together and refer to them as real estate, thus paving the way for all kinds of confusion, land and buildings are entirely dissimilar and taxes affect each in diametrically opposite ways.

FIRST, buildings are products of human labor. Land is not. We need not elaborate. SECOND, buildings may be produced or destroyed at will. Land is a fixed quantity, except in rare or isolated instances. There is no way for man to create mines, to manufacture farms or to fabricate a new world. THIRD, buildings are worth no more than the cost of reproducing them. For this reason their value, no matter where they may be located is largely determined by the cost of renewal at any particular time. Land will vary greatly in value, sometimes increasing 1000% in worth in a short space of time. This never happens to a building because socially created values tend to attach themselves to land and *not* to buildings. These values, created by the presence and activity of many people working and playing together, do attach themselves to land and are reflected in the rental or selling price of land.

These are the essential differences. We shall see presently why taxes affect each in opposite ways. As we proceed it will become apparent that of all the taxes levied by all

levels of government the most important are the ones levied against real estate. Nothing affects the character of a free economy so much as the manner in which these taxes are determined.

The New Law

What then is the law? Simply stated in non-legal terms it is this: Cities of the Third Class in Pennsylvania, of which there are forty-eight, and so called because they all share a common form of city government, may voluntarily and by vote of the city council (no referendum required) transfer all or part of the city real estate taxes from buildings and improvements to land value. That is all.

To most people this means absolutely nothing. Upon announcing that such a shift in the tax base is possible, the reaction is either a vacant, questioning stare or an audible, "So what?" Ignorance of the principle of land value taxation is so nearly total, that one is baffled by the incredulity of well educated people, who suspect there must be something wrong with the idea because they never even heard of it before.

Since what we propose to do involves the simple process of taking taxes off buildings and raising an equivalent amount from land value instead, we might begin by asking ourselves what would happen if we put all the taxes on buildings and improvements and untaxed land entirely.

This is actually the tax policy in many countries. For many years, members of The House of Lords in England, landowners all, have refused to levy any tax at all upon vacant land. The Maharajahs of India could never have held their vast estates together had they been obliged to pay taxes upon their land. Indeed, you can make inquiries around the world, and wherever you find people divided into classes or castes, and wherever poverty is so intense that you cannot even classify peasants as consumers, you will find that those who hold title deeds to land, will have resisted all efforts to levy taxes against land value.

Effects of Taxing Buildings

Let us assume that all real estate taxes are levied against buildings alone. Remembering that buildings are products of human labor let us state a universally recognized economic law. Whenever a product of human labor is taxed, both the quantity and quality of that item is reduced. By this very obvious law buildings would be sparingly built. Not

only would they be less in number but they would be smaller in size and cheaper in their construction. People would be loath to build new or make improvements on old buildings. The building business, our basic industry, would be discouraged and the demand for materials would be lessened. Fewer jobs would result. Less money would be spent in stores and the economy as a whole would be slowed.

Homes would be affected. Owners would consider carefully before building a garage or adding a new wing. With taxes all levied against buildings such additions would call for increased assessments. Those who owned houses *for rent* would be particularly slow in adding refinements. Even though a house might be in the final stage of obsolescence the desire to tear it down and erect a new one would be met with a high wall of taxation. If the rented house or building happened to be located on a valuable piece of land the incentive to rebuild would be even less pronounced. Old houses, strategically located, can be cheaply reconditioned to serve commercial purposes, and old commercial buildings in the high land value districts, despite their poor condition, will draw substantial rents. A new building, in keeping with the activities of a busy neighborhood, would command such a high tax that in most cases the owners would elect to make cheap repairs and collect the rent as long as anyone would use the building. Should the building become too old the owner might tear it down in order to avoid paying any tax at all.

Perhaps the most significant aspect of the policy of taxing buildings is that it tends to penalize the initiative of those who build. Under such a system those who would allow their buildings to deteriorate would be rewarded with a lower tax. Those who would invest in new buildings would be punished by the imposition of a higher tax.

In pointing up the disadvantages of taxing buildings, perhaps the reader sensed that something like this was going on in all American cities. How does it happen that our towns are so slow to renew themselves and that Main Street U. S. A. is so famous for its red brick mausoleums and dingy walk-ups? Why is it that so many ambitious people are frustrated and held back? Why is there so much vacant land being held out of use in thickly populated areas? Why do we have need for slum clearance programs for which the Federal Government unblushingly announces that it intends to spend eight billion dollars, your dollars and mine, in the next few years?

*Act No. 299, August 1951. Amended as per Senate Bill 535, April 1959.

To answer these questions we need to explain what we mean when we use the expression, "we tax land and buildings alike." To say this is apt to create a false impression. Since Pennsylvania cities show total building assessments as being from three to seven times as high as the total assessments on land, this means that, on the average, for every dollar we pay on land we pay from three to seven dollars on buildings. Where the ratio between building value and land value is higher than the average, as is the case with most of the homes, the individual taxpayer may be paying ten or fifteen times as much on his building as on his land. Many manufacturing concerns will pay from twenty to forty times as much on buildings as on land. This being so, when we pay taxes on land and buildings alike we are paying high taxes on buildings and low taxes on land.

As we present this new approach to tax policy we often hear the expression, "There must be a catch somewhere." We can assure any reader that the catch lies in the conventional system which implies that it is right to tax buildings. When the proposition is thought through it becomes abundantly clear that it is *ridiculous* to tax buildings. To do so is destructive of the basic principle of free enterprise. The assumption of such a policy is that to build is an unsocial act.

A Subversive Policy

Because almost every suggestion to improve on our economy is suspect these days we occasionally find people wondering if there may not be something "subversive" about this approach, the word subversive having become a sort of catch-all for any notion that is not conventional. If you will look the word subversive up in the dictionary you will find that it means "to destroy." Our economic philosophers have come to use the term to brand certain kinds of principles which tend to destroy the basic rights and liberties of our people, or that tend to cripple initiative or diminish incentive. Self styled conservatives are insisting that many of the policies that have been adopted by our government in the past thirty years are destructive of basic rights and liberties, and so, subversive. Such criticisms may be just but it is our conviction that such laws would never have been demanded in the first place if our so-called free enterprise system had not operated for years on a tax policy that is a violation of the whole idea of free enterprise. This deeply rooted custom of taxing buildings is and always has been destructive of those factors in our lives that make for freedom of action or which tend to energize an economy. Our policy of taxing land and buildings alike is sickeningly subversive. What we need and want are more and better buildings but because we persist in taxing a vitally needed labor product we

destroy the power to produce that product freely and without restraint. To tax labor products is subversive because it tends to cripple the power to produce at all. If this is so the American people had better come to their senses, for most of the vast accumulation of federal taxes are levied against production.

So much for the proposition of taxing buildings. Now, what about the companion to this idea, the untaxing of land?

Effects of Taxing Land

When the owner of a piece of vacant land is obliged to pay no tax at all, on the assumption that unused land brings in no returns from which taxes might be paid, the state immediately confers upon such a person a tremendous privilege. He is in a position to hold his land out of use until he is able to sell it to someone whose need is great enough to make him willing to mortgage his future earnings on the land for as much as ten or twenty years. Since there is no pressure being applied in the form of a tax, the owner can refuse to sell at even a fabulous price, for the simple reason that the land is appreciating in value so fast that by just doing nothing and playing "dog in the manger" he can watch his land increase in value. In other words he can "get rich in his sleep." He contributes nothing to society but in due time he can collect a price that will make him independently wealthy.

In busy downtown areas it is the landowner who can sit back and levy a claim on a portion of what everyone who works on his land produces. It is by virtue of a no-tax policy or a low tax policy that this is possible. All businessmen know how fabulous are the returns to those who own extremely valuable land. What they do not know is that this happens because the government does not collect in the name of the people the values which are there.

There is a basic formula at work here. Tax land light or not at all and the price of land becomes very high. Tax land heavy, so that the economic rent for the land is appropriated by the government rather than by the individual landowner, and the price of land is brought down. Thus is land made accessible to those who need it. Thus can a man get possession of land without having to mortgage his future earnings on the land and without standing helplessly by and watching the erstwhile owner appropriate as his own that which he, the buyer, produces.

Where land is not taxed at all and population is heavy, there you may depend upon it, the price of land will be exceedingly high. In every society there are those who are ambitious and willing to venture out on their own, but such persons are artificially restricted and held back. If the country is old and all the land has been taken up the

ambitious people are frustrated at every turn. Talk about subversive policies! Nothing Marx ever dreamed up could be as completely subversive as this combination, a tax policy that taxes buildings and lets land go scot-free.

We said above that taxes affect land and buildings in diametrically opposite ways. Because buildings are products of human labor high taxes on buildings make them scarce and expensive to maintain. However a high tax on land tends to bring the price of land down and makes it more readily available to those who need to use it. High taxes on land act as a solvent might act in a chemical compound. Pour high taxes on and the high walls of price that act as hardened barriers against initiative are dissolved as if by magic.

Most people think of taxes as money they might have spent themselves but which is demanded by the government instead. This is actually how it is when taxes are levied against production. But when taxes are levied against land value the price of land is immediately lowered and whether people realize it or not the accessibility or inaccessibility to land is the key to the successful operation of any economy. If land is made available to those who need it or if pressure is put upon the owner of land so that he is obliged to put it to work, then things begin to happen in a community.

Land Value Taxes Can Off-set Effects of Federal Taxes

A local government, by taxing land value and untaxing buildings, can literally overcome the repressive effects of the federal income tax, which may take out of its community ten times as much money as is paid in real estate taxes. The billions of dollars collected by the federal government will have less detrimental effects upon the economy than the shifting of the relatively low tax on land value would have if it were put over into the tax-on-production column. The tax now paid on land value is very small compared to the taxes being paid on production *a la* the federal system. But if this small tax were removed and all taxes put on production, the effect would be immediate and disastrous. Land would soar in price, rents would be confiscatory, wages would be depressed and the whole economy would bog down. We must think in terms of going the other way. We must open things up by making opportunity available to those who do not mind working for what they get. There is nothing like a land value tax to cut down on the power of some to live off the labor of others.

Motivation For Progress

We come now to the most important aspect of the whole idea,—the energizing of

the economy of a community. We have pointed out how taxes on buildings hinder the whole-building process and how low taxes on land make the price of land high. These are the prongs of a gigantic pincer movement that is holding progress back all over America. You find a town that needs a good hotel. There is a site beautifully located for such a venture. You inquire about the price of the land. It is headachingly high. Already you are discouraged but you go to the assessor and ask, "What would my taxes be on a building worth a million dollars?" The answer finds you holding your aching head in your hands and leaving town. It happens everywhere. We are imprisoned by the high price of land and the high cost of taxes on buildings.

Correct this condition. Knock the price of land down. Take the taxes off buildings and General Electric's slogan, "Progress is our most important product" will become the slogan of an entire nation.

If such a tax policy were invoked there would be such a stir in the economy of a city as to focus the attention of a nation on the amazing results. A building boom would ensue, old run down properties would be razed and good buildings put in their place. Improvements would be made on properties all over town. The conditions now prevailing would attract new industries and many businesses that need new buildings would find they could buy land and erect buildings cheaper here than elsewhere. A flood of new enterprises would be drawn to the community as by a magnet. Building materials and builders of all kinds would be in demand. Hundreds would come running. News that new buildings can be erected in Yourtown without involving the payment of taxes on the building, and that land, long vacant, can now be bought at reasonable figures will spread like wildfire. Firms looking for places to build office buildings, warehouses or small factories will hear the news and a flood of inquiries will come into the office of the Chamber of Commerce and scouts will appear to explore the possibilities.

We Should Have Known!

These facts should have been known and clearly understood by the time this country was being settled. However no one had as yet appeared to explain these relationships. The terrible conditions in Europe from which the early settlers of this country fled were caused primarily by failure of men and governments to understand and control the law of rent. No one knew why life was so intolerable. When they came to America they thought the vexations of European life could all be voted away by giving the ballot to the common man. They did not know that it was the refusal to tax land value and the consequent clotting of economic power that was at the bottom of all

the deviltry in Europe. This fact has remained obscure to most Americans even to this day. This lack of understanding has nurtured a multibillion dollar, non-productive business all over America, the business of buying and selling vacant land.

No one can blame anyone for taking advantage of a tax policy that made this business so lucrative. No one knew that it came into being because the land was not taxed according to its value, setting into motion processes which made the fabulous increases in land value capable of being cornered by individuals. Everyone thought this was just a natural condition. They do, even yet.

Had a land value tax policy prevailed from the beginning our cities would have been built out solidly. The thirteen million vacant lots that are scattered through American cities would nearly all be in use. There would have been none of the "suburban sprawl" brought about by the leap frogging out into the rural areas to build suburban houses, leaving vast areas lying idle between the town and the far out suburban development. Thus would our cities have avoided the waste involved in running roads, sewers, telephone, gas and electric systems past endless miles of undeveloped areas. Endless hours of time would have been saved by millions who are now obliged to commute daily past wide expanses of vacant land.

What is even more intriguing the obsolescence and decay that has settled down upon our cities could have been avoided. Instead of dingy rows of old worn out buildings decorating our downtown areas they might have been resplendent with new and attractive structures of all kinds.

But all this is water over the dam. What can be done about it? Let us take a close look at the new law.

The Mechanics Involved

It is relatively simple to understand the mechanics of the land value tax system. In each Pennsylvania city real estate taxes are levied by three taxing authorities,—the City, the School Board and the County. In a city having a population of from ten to fifty thousand the City will require about 30%, the School Board about 60% and the County about 10% of the total real estate tax.

A Mythical City

Let us now set down a few figures to show how a land value tax plan would work in a mythical city. Let us suppose the town has a population of 10,000. The buildings are assessed at \$25,000,000, land at \$5,000,000. The City must raise for budgetary purposes \$300,000. Under the present system a 10 mill levy against \$30,000,000 will suffice. Should the City Council vote to adopt the land value tax plan it would be neces-

sary to levy 60 mills against the \$5,000,000 of land value. This would provide the same amount of money, \$300,000.

How would this effect the individual taxpayers? In the mythical city above, the owner of a vacant lot now paying \$20.00 will be obliged to pay \$120.00. This may seem a bit rough at first but the owner can now put a valuable building on the lot, how valuable nobody really cares, and his taxes will still be \$120.00. What could be sweeter?

Where the building values are exactly five times as much as the land values the tax will remain the same as under the present system. However improvements can now be made without incurring any additional assessment so any property owner who would seem to come out even is actually ahead of the game.

Where the present building values are more than five times as great as the land values the tax will be reduced. Four-fifths of the people in any city will find themselves in this category or the one above. Practically all dwellings, whether large, average or small, will enjoy reduced taxes. New homes will be particularly benefitted. Manufacturing concerns usually fall into this class. Indeed, since most manufacturers require extensive plant equipment and are located on relatively cheap land, they are heavy winners here. This is as it should be. They are "doers," and doers always win out under a land value tax system. Funeral parlors, banks, apartment hotels and most businesses that require heavy investments in buildings find taxes lower. This is also as it should be. These people have improved the city by their "doings."

In our mythical city, where the building values are less than five times as much as the land values, the tax will be increased. There is a great deal of "virtually vacant land" in all Pennsylvania cities. By this we mean land upon which old, unpainted, worn-out buildings sit and sit and sit. One might think the owners cannot afford to fix them up. Closer study will reveal that many landowners have discovered that they can make more money by investing in slum-type properties than by erecting good buildings and paying the high taxes involved. If a tax policy makes bad citizens out of some landowners we should not blame the landowners too much. We should try to change the tax policy so that it will no longer be profitable to keep old buildings on relatively valuable land. At first many landowners will think a land value tax is aimed at their ruin. They will soon discover that it is tailored for their special need.

Where Taxes Go Up

When it becomes clear that most of the owners of old commercial buildings in the high land value districts will have to pay heavier taxes, the first reaction of those who

study the plan is "How can we expect business to pay heavier taxes when every one on the street is complaining how hard it is to keep ahead of the Sheriff?"

There is a relationship here which is not generally understood. When a tax is levied on any labor product the tax is passed on and reflected in the price to the ultimate consumer. A tax on land value cannot be passed on. It must be borne by the landowner. It is impossible for the owner to increase the rent for he is already getting all the market will bear. He can no more increase the rent to pay higher taxes than he could increase the rent to pay interest on a mortgage which he has been obliged to place on the property.

Whether a landowner or a renter is conducting a business, so much of the proceeds of the business must be considered as "land rent." The renter pays it out. The owner absorbs it and adds it to what he would call his profit. When a merchant owns his own land and building and he is operating in a favorable location, he seldom has any trouble keeping ahead of the game. It is the tenant, who must pay a stiff rent before he can call anything his own, who keeps wondering how he is going to make the grade. He is the man who is always giving the impression that it is touch and go along Main Street. In this he is perfectly justified. For his kind it is touch and go, and it takes a sharp operator to come out very far on top.

There is a wide-spread impression that any act which might force the price of land down is apt to produce some detrimental effects. This is not so. The reverse is true. You have heard it said, "Our town is booming. Land values are going up everywhere," as if the fact that land values were going up was a great social blessing. The opposite is actually the truth. When land values are going up in a community where taxes on land are nil or low (that's us), it is a community calamity, not a blessing. It is wonderful for the relatively few people who own the valuable land; but it is a sentence to long hours of hard work to those who will have to be using the land. The fact that land

is going up is good. That reflects the fact of progress. But under the present system the values being produced are automatically confiscated by the rent process, and far too much of the money corralled on Main Street by the hard working managers and clerks is siphoned into the bank accounts of the owners of the most valuable land.

One thing is certain. The only people who are really interested in keeping the price of land up are *not* the ones who want to use the land, but rather the ones who want that easy money that can be had by renting it or selling it to those who do.

Legal Limitations

We come now to a very sad part of our story. This new law can be applied only by city governments. It is necessary for schools and counties to operate in the same old way. This means that a partial application can only bring partial results. However, if we were to suddenly change to land value taxation on *all* real estate taxes, about one-tenth of the people would be caught holding too much vacant land, or too much badly improved land for comfort. Despite the fact that everyone else would be in clover, and we do mean very fragrant clover, the sudden shift would be met with sharp cries of pain from the few who have really been using the low tax on land policy to feather their economic nests by exercising a minimum of community responsibility. Someday, when the method of taxing land more heavily proves to be a good thing, pressures can be applied to have the Legislature extend this law to cover School and County taxes. When that day comes you can kiss all your urban redevelopment programs good-bye. Cities will automatically renew themselves.

Let us not disparage the good that a land value tax on City taxes might do. Some people say, "Oh, well, if we cannot go all the way why go to the bother of changing at all?" In answer we would simply say that there is a right way and a wrong way

to tax real estate. If we can switch from a bad way to a good way on 30% of the total tax collection, let us do so and demonstrate why we should eventually levy all real estate taxes on land.

Granted, a 30% switch will not supply sufficient economic motivation to bring about a complete renewal of old, run-down buildings. But it will set any town that adopts even that much land value taxation apart, and many a firm will see the advantage of putting their new buildings or plant there. It will inspire enough new construction to greatly increase the School and County take and if the officials are true to their trust, they could reduce the millage on their "land and building alike" system and still have as much money as before.

More Information Available

We wish that space would permit us to discuss in greater detail many aspects of this idea. Courses of study will be offered in those towns that show a reasonable interest. If you want to know more than this short presentation affords and are willing to really concentrate, Dr. Harry Gunnison Brown has written a small book entitled "The Effective Answer To Communism and Why You Don't Get It In College." Then, there is "The Self-Supporting City" by Gilbert Tucker. Should you want a complete bibliography of books in this field, send to The Schalkenbach Foundation, 50 East 69th Street, New York City.

Yes, there are many places where land value taxation is at work. The evidence is piling up and there is ample proof that this method of taxation has been as effectively demonstrated in the laboratories of political science as the Salk vaccine has been demonstrated in the laboratories of modern medicine.

NOTE: Both books mentioned are available at The Schalkenbach Foundation.

Dr. Brown's Book.....35 cents
Gilbert Tucker's Book.....\$1.00

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