

RICE UNIVERSITY

THE PROPERTY TAX AND URBAN PROBLEMS

by

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Thesis Director's signature:

A handwritten signature in dark ink, appearing to read "W. W. Kipp", written over a horizontal line.

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# Abstract

## THE PROPERTY TAX AND URBAN PROBLEMS

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The intent of this study is to show that the American property tax, the chief urban tax revenue producing institution, contributes significantly to a number of contemporary urban problems. Further, that this is the case despite the existence of viable alternatives and reforms to the present property tax system, which if enacted could actually encourage solutions to these urban problems.

The negative effects of the property tax are found to be concentrated in three main areas of the tax and its operation: taxing jurisdictions, the tax on improvements, and property tax assessment. Fragmented urban taxing jurisdictions adversely effect both central city fiscal problems, as well as urban area land use decisions. The heavy taxation of improvements negatively effects urban housing and renewal in our metropolitan areas. The lack of uniformity in property tax assessment which deprives communities of additional services, is in direct conflict with most state constitutions, and effects the stability of land, especially at the urban fringe.

The first section of this paper describes the American property tax and establishes a background for the above mentioned tri-part analysis of the effects of the tax on urban problems.

The concluding section summarizes the negative effects of the American property tax in the urban situation and, in addition, shows the existence of a number of

workable alternatives and basic reforms to the present tax system, which could convert the property tax into a fiscal institution that would promoted solutions to urban problems instead of being part of their cause.

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# I. The American Property Tax

The first section of this paper will briefly trace the origins of the American property tax, describe its present status and level of operation, and finally establish the importance of the tax in urban finance. This information will provide the background necessary for examining the role of the tax in current urban problems.

## Historical Origins

The origins of the property tax in the United States can be traced back to colonial times, when government expenditures in this essentially agrarian period were extremely modest, allowing the development of local tax systems. Generally, the first tax to appear in the colonies was the poll tax. Wealth at this time was rather evenly distributed, so that this sort of levy had some degree of logic. By the late eighteenth century in northern areas, taxes on property, mostly land, as well as taxes on income or faculty, were levied to supplement the poll taxes, first as needs arose, then on an annual basis.

Arthur D. Lynn, Jr. states concerning this period:

In effect, the combination of poll, property and faculty taxes sought to use ability, as it was then conceived, as a tax base. This overlapping tax triad constituted a colonial equivalent of the nineteenth century general property tax and is the fiscal institution out of which that levy evolved.<sup>1</sup>

As time progressed, income came to supply only very small amounts of revenue while the property tax grew in significance. This development pattern was typical for most of the northern states, whereas the situation in the south was somewhat different. There, the poll tax was generally supplemented by customs

and tonnage taxes until after the revolution, when import duties were transferred to the federal government. This necessitated implementation of property taxes in the southern states. By the beginning of the nineteenth century, the property tax, levied chiefly on land, had become the dominant revenue source for state and local governments in the United States.<sup>2</sup>

As the nineteenth century progressed, the states shifted from area-measurement to market value assessment standards and began adopting, most often by constitutional provision, concepts of universality and uniformity. Thus, by the Civil War, generally all property, unless specifically exempted, was subject to tax at a single rate, within each jurisdiction. Under this kind of all-inclusive tax, a sharp distinction is usually made between two major categories of taxable property, real and personal. Real property consists of both land as well as structures or other improvements on the land. Personal property, on the other hand, consists of both tangible items, such as commodities, furnishings, vehicles, and machinery; as well as intangible items that have exchange value rather than value for direct use such as, money, bank deposits, stocks, bonds, and mortgages. The concept of universality strove to better reflect ability to pay by attempting to tax the growing amounts of wealth in the forms of personal tangible and intangible property.

State and local budgets in the latter half of the nineteenth and early twentieth centuries rapidly expanded, mostly due to urbanization and growing expenditures for public education.<sup>3</sup> Growing budgets, coupled with the heavy reliance of these governments on the property tax as a source of revenue, resulted in sharply rising tax rates. Rising tax rates drew ever-increasing attention to gross inequities in assessment and equalization, and generated interest in new sources of

government revenue. During this period, E. R. A. Seligman, in an often quoted passage, states of the property tax:

Practically, the general property tax as actually administered is beyond all doubt one of the worst taxes known in the civilized world. Because its attempt to tax intangible as well as tangible things, it sins against the cardinal rules of uniformity, of equality and of universality of taxation. It puts a premium on dishonesty and debauches the public conscience; it presses hardest on those least able to pay; it imposes double taxation on one man and grants entire immunity to the next. In short, the general property tax is so flagrantly inequitable, that its retention can be explained only through ignorance or inertia. It is the cause of such crying injustice that its alteration or its abolition must become the battle cry of every statesman and reformer.<sup>4</sup>

In the 1920's, then, the movement began to exempt most classes of intangible, as well as some classes of tangible personal property from the property tax because of the great difficulties involved in locating and accurately assessing them. In some cases special taxes on such property were substituted. In this period, too, state and local governments began seeking more equitable alternative sources of revenue, including income and sales taxes and increased federal and state aid. This quest gained strong impetus during the depression of the 1930's, eventually resulting in the virtual end of state government reliance on the property tax. Today the tax is almost exclusively a source of local government revenue.

In summary, as the American economy developed, property taxation moved from taxation of land to tax coverage of all or most property. Then other taxes were substituted for some categories of property as property became more heterogeneous and ownership distributed less equally. Thus, the property tax today has returned to a levy essentially on realty. As Lynn points out:

Property taxation has developed out of an essentially agrarian background and, despite the efforts of many over a rather extended period, is not yet well adjusted to an essentially urban society.<sup>5</sup>



## Status and Level of Operation

Although the American property tax, which raises some \$25 billion annually, has certain common characteristics throughout the country, it is not one tax but rather a group of taxes with wide variations. This is the case mainly because the tax "has evolved under individual state sponsorship within a federal system of government".<sup>6</sup> In addition, local governments who are primarily responsible for administering the tax exhibit variations in policy and practice. Thus, the property tax not only varies from state to state but from jurisdiction to jurisdiction within the various states as well.

### TAXING JURISDICTIONS

Tables I-1 and I-2 show the breakdown of over 80,000 local governmental units most of which are authorized to levy the property tax, a quarter of which are located within the 227 standard metropolitan statistical areas (SMSA's). Table I-3 shows further breakdown of one of the largest group of these jurisdictions, special districts.

### ASSESSED VALUATIONS

All legally taxable property within any jurisdiction must be assessed to determine its value as a basis for levying the property tax. This assessed value is usually some fraction of full or market value which is often statutorily set. For personal property the ratio of assessed value to market value varies widely among the states and between the different types of property involved. For the country as a whole these ratios average around 20 percent for business equipment and inventories, 6 percent for household durables, and over 40 percent for motor vehicles.<sup>7</sup> Real property in 1966, according to the most recent Census of Gov-

TABLE I-1 - Numbers of Local Governments by Type, Within and Outside SMSA's: 1966

Type of local government	United States	Within SMSA's	Outside SMSA's	Percent in SMSA's
Total.....	81,248	20,703	60,545	25.5
School districts.....	21,782	5,018	16,764	23.0
Other.....	59,466	15,685	43,781	26.4
Counties.....	3,049	404	2,645	13.3
Municipalities.....	18,048	4,977	13,071	27.6
Townships.....	17,105	3,255	13,850	19.0
Special districts...	21,264	7,049	14,215	33.1
Dependent school systems <sup>1</sup> .....	1,608	511	1,097	31.8

<sup>1</sup>Not included in count of governments.

TABLE I-2 - Distribution of SMSA's, Their Population, and Local Governments by Population Size Groups: 1966

SMSA size group (1960 population)	Number of SMSA's	1960 population (thousands)	Local governments, 1967
All SMSA's.....	227	118,108	20,703
1,000,000 or more.....	24	61,598	7,367
500,000 to 999,999.....	32	22,012	3,878
300,000 to 499,999.....	30	11,359	2,734
200,000 to 299,999.....	40	10,083	2,919
100,000 to 199,999.....	74	10,848	3,123
50,000 to 99,999.....	27	2,209	682

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE 1-3 - Breakdown of Special Districts: 1966

Type of special district	United States	Within SMSA's	Outside SMSA's	Percent in SMSA's
Total.....	21,264	7,049	14,215	33.1
Natural resources....	6,539	1,275	5,264	19.5
Other than natural resources.....	14,725	5,774	8,951	39.2
Cemeteries.....	1,397	142	1,255	10.2
Fire protection....	3,665	1,383	2,282	37.7
Highways.....	774	195	579	25.2
Hospitals.....	537	105	432	19.6
Housing and urban renewal.....	1,565	522	1,043	33.4
Libraries.....	410	131	279	32.0
Parks and recreation.....	613	305	308	49.8
School buildings...	956	588	368	61.5
Sewerage.....	1,233	778	455	63.1
Urban water supply.	2,140	964	1,176	45.0
Other single-function districts	982	380	602	38.7
Multiple-function districts.....	453	281	172	62.0

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE I-4 - State Distribution of Average Assessment Ratios, by Property Type: 1966

Average assessment ratio of property involved in measurable sales	Nonfarm residential property	Acreage and farms	Vacant lots	Commercial and industrial property
Total.....	51	51	51	51
Less than 15 percent	5	24	17	8
15 to 19.9 percent..	8	7	8	11
20 to 24.9 percent..	7	7	3	5
25 to 29.9 percent..	6	5	10	5
30 to 34.9 percent..	4	4	6	1
35 to 39.9 percent..	5	1	2	4
40 to 49.9 percent..	3	1	3	4
50 percent or more..	13	2	2	13

TABLE I-5 - Breakdown of Nation-wide State and Local Assessments: 1966

Item	Amount (billion dollars)	Percent
Total.....	484.1	100.0
State-assessed property.....	41.6	8.6
Railroads.....	5.1	1.1
Other utilities.....	25.0	5.2
Other.....	11.5	2.4
Locally assessed property.....	442.5	91.4
Real property.....	378.9	78.3
Personal property.....	63.6	13.1

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Government Printing Office, 1968).

ernments: 1967, was assessed at a nation-wide average ratio of about 33 percent of market value, although here, too, wide variations can be found.<sup>8</sup> The state distribution of average assessment ratios for 1966 is shown in table 1-4.

The responsibility for assessment of most taxable property rests with local governments, but some types of property, notably railroads and utilities because of their complex and regional character, are assessed by the states for local tax purposes. Table 1-5 shows this nation-wide state and local assessment breakdown for 1966. It should be noted that usually no distinction is made between real and personal property in state assessments. Of the total gross assessed valuations in 1966 for all taxable property in the United States, over \$15 billion or almost 3 percent, mostly real property, was subject to special exemption by the various states. Of this amount, 60 percent were partial homestead exemptions granted by six states.<sup>9</sup> Table 1-6 shows the nation-wide state and local assessment breakdown, inside and outside the SMSA's, both before and after deduction of these exemptions.

#### COMPOSITION OF THE TAX BASE

The sum of the assessed values for all legally taxable property constitutes the total tax base. Of the total 1966 assessed values for the nation as a whole, \$499 billion, personal property accounted for only slightly more than 13 percent, while real property constituted almost four-fifths, or \$393 billion, with state assessed property making up the remainder.<sup>10</sup> Real property, then, is by far the largest segment within the property tax base.

Table 1-7 shows the nation-wide breakdown of the gross assessed real property values for 1966. Here it can be seen that of the total, over 60 percent is made up of nonfarm residential realty, fully half is single family residences, while

TABLE 1-6 - Assessed Valuations Set in 1966 for Local General Property Taxation, Within and Outside SMSA's  
(Amounts in Millions of Dollars)

Item	United States	Within SMSA's	Outside SMSA's	Percent within SMSA's
Gross assessed valuations.....	498,962	352,415	146,541	70.6
State-assessed.....	4,594	24,836	16,755	59.7
Locally assessed.....	457,368	327,579	129,786	71.6
Real property.....	393,193	287,502	105,691	73.1
Personal property.....	64,175	40,077	24,095	62.4
Assessed value subject to tax (after deduction of exemptions).....	484,057	342,192	141,865	70.7
State assessed.....	41,581	24,837	16,745	59.7
Locally assessed.....	442,475	317,356	125,119	71.7
Real property.....	378,920	277,627	101,294	73.3
Personal property.....	63,554	39,730	23,825	62.5
Percent of assessed value subject to tax.....	100.0	100.0	100.0	-
State-assessed property.....	8.6	7.3	11.8	-
Locally assessed real property.....	78.3	81.1	71.4	-
Locally assessed personal property.....	13.1	11.6	16.8	-

Note: Because of rounding, detail may not add to totals.  
- Represents zero.

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE 1-7 - Breakdown of Nation-wide Locally Assessed Real Property: 1966

Type of real property	Gross assessed value		Properties	
	Amount (billion dollars)	Percent	Number (thou- sands)	Percent
Total.....	393.2	100.0	74,832	100.0
Residential (nonfarm)..	236.3	60.1	42,329	56.6
Single-family houses.	196.7	50.0	40,436	54.0
Acreage and farms.....	43.4	11.0	14,085	18.8
Vacant lots.....	10.2	2.6	14,250	19.0
Commercial and indus- trial properties.....	97.2	24.7	2,487	3.3
Commercial.....	60.0	15.3	2,112	2.8
Industrial.....	37.1	9.4	376	0.5
Other and unallocable..	6.0	1.5	1,679	2.2

Note: Because of rounding, detail may not add to totals.

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE 1-8 - Locally Assessed Taxable Real Property in SMSA's, by Type of Property: 1966

Type of property	Locally assessed real properties in SMSA's		Gross assessed value of locally assessed real properties in SMSA's		SMSA percentage of national totals of--	
	Number	Percent	Amount (millions of dollars)	Percent	Locally assessed real properties	Gross assessed value of locally assessed real property
All types.....	38,249,000	100.0	287,502	100.0	51.1	73.1
Nonfarm residential.....	26,738,000	69.9	186,034	64.7	63.2	78.7
Single-family houses only.....	25,031,000	65.4	148,158	51.5	61.9	75.3
Commercial and industrial.....	1,454,000	3.8	78,806	27.4	58.5	81.1
Commercial.....	1,227,000	3.2	49,261	17.1	58.1	82.0
Industrial.....	228,000	0.6	29,545	10.3	60.6	79.5
Vacant lots.....	7,089,000	18.5	7,315	2.5	49.7	71.4
Acreage and farms.....	2,655,000	6.9	12,668	4.4	18.8	29.2

Note: Except for the total assessed value for all types of property, these data are estimates subject to sampling variation; see source report cited in text. Because of rounding, detail may not add to totals.

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).



commercial and industrial properties together amount to less than a quarter. In table I-8, the breakdown of assessed real property values in SMSA's, shows that the nonfarm residential segment of the tax base in urban areas is even more significant than for the nation as a whole. Also of significance is that while vacant lots in these urban areas account for over 18 percent of the number of properties, they constitute only 2.5 percent of the assessed values. Thus, perhaps results the often lucrative endeavor of speculatively holding vacant real estate in and around urban areas.

### TAX RATES

All taxable assessed property is most often statutorily subject to the same nominal tax rate within a single jurisdiction. According to the 1967 Census of Governments this nominal rate nationally averaged just under 6 percent in 1966.<sup>11</sup>

Distribution of nominal tax rates for 122 of the 130 largest U.S. cities in 1966 is shown in table I-9. These nominal tax rates do not take into account differences in the level of assessed valuations and thus exhibit extremes that might be misleading. Table I-10 shows for the same 122 cities the tendency for low assessment ratios to be associated with high nominal tax rates. The result is some what of an equalization seen in the distribution of effective tax rates shown in table I-11. Significant variations still can be seen, with the highest effective rates found in the Northeast and the lowest, generally, in the South and West.

### Importance of the Tax in Urban Finance

While state government reliance on the property tax has dwindled over the years to insignificant levels, local government reliance on this source of tax revenue remains heavy. If intergovernmental and other nontax revenue is disregarded, the

TABLE I-9 - Distribution of 122 Large SMSA's by Median Nominal Tax Rates: 1966

Median nominal tax rate	Number of cities	Percent	Cumulative percent
15 percent or more.....	3	2.5	2.5
12.5 to 14.99 percent.....	7	5.7	8.2
10.0 to 12.49 percent.....	12	9.8	18.0
7.5 to 9.99 percent.....	35	28.7	46.7
5.0 to 7.49 percent.....	22	18.0	64.7
2.5 to 4.99 percent.....	39	32.0	96.7
Less than 2.5 percent.....	4	3.3	100.0

TABLE I-10 - Distribution of 122 Large SMSA's by Median Assessment Ratio With Average Nominal Tax Rates: 1966

Median assessment ratio	Number of cities	Average nominal tax rates (percent)
Less than 15 percent.....	7	18.80
15 to 19.9 percent.....	20	9.33
20 to 24.9 percent.....	17	8.85
25 to 29.9 percent.....	16	7.86
30 to 34.9 percent.....	12	6.23
35 to 39.9 percent.....	11	5.37
40 to 49.9 percent.....	17	5.24
50 to 59.9 percent.....	8	5.23
60 percent or more.....	14	3.64

TABLE I-11 - Distribution of 122 Large SMSA's by Area and Median Effective Tax Rates: 1966

Median effective tax rate	Number of cities				
	Total	North-east	North Central	South	West
Total.....	122	25	34	39	24
4.0 percent or more..	2	2	-	-	-
3.5 to 3.99 percent..	2	2	-	-	-
3.0 to 3.49 percent..	9	6	2	1	-
2.5 to 2.99 percent..	13	8	5	-	-
2.0 to 2.49 percent..	27	3	8	7	9
1.5 to 1.99 percent..	39	2	16	11	10
1.0 to 1.49 percent..	21	2	3	12	4
Less than 1.0 percent	9	-	-	8	1

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Printing Office, 1968).

portion of state tax revenue derived from the property tax, from 1922 to 1966, has dropped from over half to less than 3 percent.<sup>12</sup> During the same period, local government property tax reliance has decreased from 97 percent to 87 percent of total tax revenue.<sup>13</sup> However, these figures tend to overstate the importance of the tax at the local level mainly because federal and state aid payments to local governments for education, highways, and public assistance (in some states), coupled with local government nontax revenue now provide about half of all local funds. The result is that the property tax has declined to about 45 percent of all local revenue.<sup>14</sup> But this relative decline only reflects the more rapid increases in other forms of local revenue. Table I-12 shows that in the 9 years from 1957 to 1965-66, local property tax revenue in the United States increased by over 90 percent or \$11.5 billion. Population during the same period increased by only 14 percent.<sup>15</sup>

The property tax is highly urban in nature. Of the total property tax collections in 1966, 96.6 percent were raised by local governments and three quarters of this were raised by governments in the 227 SMSA's. Table I-13 gives the breakdown of government revenue by source for the 227 SMSA's according to size and shows property taxes average nationally 45.5 percent of revenue from all sources. This is 85.5 percent of all tax revenue raised by these SMSA's. Table I-14 shows the dependence of local governments in the 38 largest SMSA's in 1965-66, by type of government. Because state aid is a larger portion of local revenue in the less urbanized areas, dependence on the property tax in these larger SMSA's is even greater than for all SMSA's. Both cases illustrate that the American property tax is by far the largest single source of governmental revenue for financing urban expenditure.

TABLE 1-12 - Property Tax Revenue by State and Local Governments: 1957 to 1965-66

Fiscal year	Amount (million dollars)		Percent of all tax revenue	
	State and local governments	Local governments only	State and local governments	Local governments only
1965-66 <sup>1</sup> .	<sup>1</sup> 24,670	23,836	43.5	87.1
1964-65 <sup>1</sup> .	<sup>1</sup> 22,583	21,817	44.1	86.9
1963-64 <sup>1</sup> .	<sup>1</sup> 21,241	20,519	44.5	87.2
1963.....	20,089	19,401	45.4	87.5
1962.....	19,054	18,414	45.9	87.7
1961.....	18,002	17,370	46.3	87.7
1960.....	16,405	15,798	45.4	87.4
1959.....	14,983	14,417	46.3	87.2
1958.....	14,047	13,514	46.2	87.4
1957.....	12,864	12,385	44.6	86.7

<sup>1</sup>Data are for governmental fiscal years ended during the period July through June; for prior years, data are for governmental fiscal years ended during the calendar year.

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE 1-13 - Percent Distribution of General Revenue by Source and by Function for All Local Governments in SMSA's by Population Size of Area: 1966-67

Item	Size groups of SMSA's (1966 population)						
	All SMSA's	1,000,000 or more	500,000 to 999,999	300,000 to 499,999	200,000 to 299,999	100,000 to 199,999	50,000 to 99,999
All general revenue.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Intergovernmental revenue from States.....	29.1	28.4	29.1	30.8	33.3	30.1	25.7
Intergovernmental revenue from Federal Government.....	3.3	3.2	3.5	3.1	3.6	3.3	3.1
Property taxes.....	44.6	45.1	43.7	43.5	39.6	47.6	50.4
Other taxes.....	7.9	9.1	6.9	5.7	6.2	3.4	3.4
Current charges.....	10.3	9.6	11.2	11.8	12.5	10.8	13.3
Miscellaneous.....	4.8	4.5	5.6	5.1	4.8	4.7	4.1

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).

TABLE I-14 - Dependence on the Property Tax by Local Governments in the 38 Largest SMSA's by Type of Government: 1965-66

Type of government	Property tax revenue as percent of—	
	Total local government general revenue	Locally raised general revenue <sup>2</sup>
All local governments in 38 largest SMSA's.....	47	66
Counties.....	46	75
Municipalities.....	39	53
(34 central cities with 1960 populations of 300,000 or more).....	(37)	(51)
(Other municipalities).....	(47)	(58)
Townships.....	65	80
School districts.....	55	88
Special districts.....	27	32

<sup>1</sup> Based on U.S. Bureau of the Census, *Local Government Finances in Selected Metropolitan Areas in 1965-66* (1967) and *City Government Finances in 1965-66* (1967).

<sup>2</sup> Total general revenue less revenue from other governments.

SOURCE: Dick Netzer, *Impact of the Property Tax: Its Economic Implications for Urban Problems* (Washington, D.C.: U.S. Government Printing Office, 1968).

## Notes

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10. See tables I-5 and I-6.
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12. U.S. Census Bureau, Census of Governments: 1967, Vol. VI, Historical Statistics on Governmental Finances and Employment (Washington, D.C.: U.S. Government Printing Office, 1968), pages 42, 44.
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## II. The Effects of Fragmented Urban Taxing Jurisdictions



As we have seen, there are over 20 thousand local governmental units in the 227 standard metropolitan statistical areas, most of which have the authority to levy the property tax. Thirteen SMSA's contain over 250 such local units each and are shown in table II-1. This multiplicity of taxing jurisdictions contributes significantly to urban fiscal problems and promotes land use decisions that are not in the best interest of the overall urban area.

## Effects on the Urban Fiscal Crisis

Many of our central cities are threatened by a fiscal downspin related to the fragmentation of urban taxing jurisdictions. Buildings, as they become older, develop into fiscal-deficits.<sup>1</sup> That is, they require more in the way of public services than they return by the declining amount of property tax revenue they provide. Thus, as core city areas age, the number of fiscal-deficit generators, within their borders, becomes ever greater. These growing central city areas attract concentrations of urban poor who are associated with increased expenditure for welfare and related human services. A continually declining tax base coupled with increasing poverty-related expenditure necessitates constantly rising central city tax rates. Significant amounts of new investment locates in outlying newer low tax areas, partially in order to avoid becoming a fiscal surplus generator for the high tax central cities. As the central cities go around in this vicious circle, they are losing high tax industry as well as high paying jobs and are gaining old physical structure including dwelling units whose lower rents attract the poor.

TABLE II-1 - SMSA's Containing Over 250 Local Governmental Units Each:  
1966

Standard metropolitan statistical area	Local governments, 1967			1960 popula- tion (thou- sands)
	Total	Central portion	Outlying portions	
Chicago, Ill.....	1,113	466	647	6,221
Philadelphia, Pa.-N.J.	876	5	871	4,343
Pittsburgh, Pa.....	704	318	386	2,405
New York, N.Y.....	551	3	548	10,695
St. Louis, Mo.-Ill....	474	6	468	2,105
Portland, Oreg.-Wash..	385	134	251	812
San Francisco-Oakland, Calif.....	312	69	243	2,649
Indianapolis, Ind.....	282	60	222	944
Kansas City, Mo.-Kans.	272	42	230	1,093
Denver, Colo.....	269	6	263	929
Seattle-Everett, Wash.	268	268	-	1,107
Cincinnati, Ohio-Ky.- Ind.....	266	79	187	1,268
Peoria, Ill.....	261	106	155	313

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. V, Local Governments in Metropolitan Areas (Washington, D.C.: U.S. Government Printing Office, 1968).

The relationship between this fiscal downspin and the fragmented urban taxing jurisdictions, which result in urban-suburban tax differentials, can be shown in two ways: first, by illustrating the erosion of tax resources in the central city, and second, by showing the variations in property tax financed expenditure among these urban areas.

### EROSION OF THE CENTRAL CITY TAX BASE

The existence of many different taxing jurisdictions within a single metropolitan area has generally allowed new investment in taxable property to slip over tax boundry lines out of the central city into the newer suburban areas. This coupled with the large amounts of worn and deteriorating physical stock in the central cities causes a continual erosion of the tax base and contributes to higher tax rates for these core areas.

The most rapid growth of the suburban areas began shortly after the end of the Second World War. Previously, practically all high value commercial and industrial property was subject to central city taxes. Even as late as the early fifties, it could be argued that the costs imposed on the cities by those who lived in the growing suburban communities, and worked and shopped in the central cities were made up by taxes on their places of employment and on shops where they purchased. But as the move to the suburbs continued through the fifties, large segments of new investment, not only in residential building, but in manufacturing and commercial construction as well, followed suit.<sup>2</sup> By 1960, the per capita business property values were significantly higher in the suburbs, although business property, largely service oriented, remained a greater segment of the central city tax base.<sup>3</sup> Business properties are the main fiscal surplus generators, since about half of all property tax revenue in urban areas goes to

finance public education, and shops and factories contribute no pupils to the school systems. In addition to this shift in per capita business property, residential per capita property values are higher in the suburbs - reflecting the higher average incomes of their predominantly middle and upper income populations. The generally lower per capita housing values in the central cities reflect the deteriorating and obsolete nature of significant sections of older core areas where property values are low and continually falling. Thus, even ignoring industrial enclaves, jurisdictions often set up specifically to protect concentrations of high value industry from property taxes, per capita property value differentials of order of 15:1 are not uncommon in large urban areas.<sup>4</sup> Table II-2 shows property tax differentials between central cities and suburbs in 32 large metropolitan areas. The first column shows estimated per capita taxable property values for the suburbs expressed as a percentage of central city values. As might be expected, the suburban values are generally higher, especially in the older metropolitan areas of the Midwest and Northeast.

#### VARIATIONS IN EXPENDITURE

There is little doubt that differences in tax base contribute significantly to tax differentials in urban areas, but this is only half of the story. Concentrations of urban poor in the central cores impose fiscal burdens on these areas that are not shared due to the fragmentation of metropolitan jurisdictions. The large areas of aging and dilapidated housing in the central cities are the homes of almost all of the urban poor due, in part, to lower rents. These urban poor are associated with higher expenditures for welfare, health, education, police, fire, and correctional services in these core areas. These poverty linked expenditure differentials are given in the second column of table II-3 for the 22 largest SMSA's. These figures show suburban expenditures average only 56

TABLE II-2 - Property Tax Differentials, Central Cities vs. Suburbs, Selected Large Metropolitan Areas, Selected Years Between 1957 and 1961  
(Values shown = outlying portions of area as percentage of central city)

Region and Metropolitan Area	Estimated Per Capita Taxable Property Values	Estimated Per Capita Property Tax Revenue	Approximate Effective Tax Rate Relationship <sup>b</sup>
<b>Northeast:</b>			
New York City and rest of SMSA	131	134	102 (100)
Philadelphia and rest of SMSA	146	94	64
Buffalo and rest of Erie County	112	96	86 (92)
Newark and rest of Essex County	158	91	58 (51)
Rochester and rest of Monroe County	100	58	58 (75)
<b>North Central:</b>			
Chicago and rest of Cook County	123	93	76
Detroit and rest of Wayne County	102	87	85
Cleveland and rest of Cuyahoga County	106	88	83 (97)
St. Louis and rest of SMSA	96	105	109
Milwaukee and rest of Milwaukee County	138	91	66 (81)
Cincinnati and rest of Hamilton County	122	66	54
Kansas City and rest of Jackson County	52	62	119
Columbus and rest of Franklin County	117	137	117
Toledo and rest of Lucas County	122	107	88
Omaha and rest of Douglas County	148	65	44
<b>West:</b>			
Los Angeles and rest of Los Angeles County	102	68	67
San Francisco and rest of SMSA	85	89	105
San Diego and rest of San Diego County	100	90	90
Seattle and rest of King County	91	66	73
Denver and rest of SMSA	90	58	64
Phoenix and rest of Maricopa County	116	163	141
Portland and rest of Multnomah County	77	47	61
Oakland and rest of Alameda County	90	78	87
<b>South:</b>			
Baltimore and rest of SMSA	110	58	53 (55)
Washington, D.C., and rest of SMSA	95	96	101
San Antonio and rest of Bexar County	203	17	8
Memphis and rest of Shelby County	108	4	4
Atlanta and rest of Fulton County	82	71	87
Louisville and rest of Jefferson County	145	98	68
Fort Worth and rest of Tarrant County	88	32	36
Birmingham and rest of Jefferson County	87	102	117
Oklahoma City and rest of Oklahoma County	97	48	49

SMSA—Standard Metropolitan Statistical Area.

SOURCE: Dick Netzer, Economics of the Property Tax (Washington, D.C.: The Brookings Institution, 1965).

TABLE II-3 - Per Capita Expenditures Financed by Local Governments in Core Cities and Suburbs, 22 Largest Metropolitan Areas: 1962

SMSAs	Education <sup>b</sup>		Poverty-Linked <sup>c</sup>		Non-Aided Common <sup>d</sup>	
	Cities	Suburbs	Cities	Suburbs	Cities	Suburbs
New York .....	\$ 51.11	\$127.93	\$51.69	\$20.30	\$73.75	\$61.13
Chicago .....	67.27	95.76	27.89	14.61	84.04	31.83
Los Angeles .....	120.15	76.03	41.79	34.29	78.11	49.18
Philadelphia .....	37.75	81.42	26.28	12.36	56.50	34.90
Detroit .....	68.08	88.51	41.20	25.42	68.75	40.58
Baltimore .....	61.25	81.22	31.47	9.15	69.76	42.38
Houston .....	53.56	116.81	25.15	14.09	46.33	21.88
Cleveland .....	59.46	101.00	39.23	26.09	67.87	48.83
St. Louis .....	38.94	77.96	44.75	14.13	65.33	23.42
Milwaukee .....	54.45	104.26	43.03	31.21	101.63	52.60
San Francisco .....	55.01	109.00	46.42	40.59	77.36	51.17
Boston .....	53.37	93.19	56.94	21.49	77.40	44.91
Dallas .....	56.43	50.94	21.11	20.54	54.60	30.75
Pittsburgh .....	48.92	61.57	17.74	8.56	63.06	33.48
San Diego .....	76.03	108.96	35.03	37.20	73.11	39.22
Seattle .....	51.89	58.84	19.72	15.42	90.61	40.61
Buffalo .....	43.44	76.21	35.51	23.68	66.77	41.54
Cincinnati .....	68.32	88.44	50.36	15.09	67.45	28.02
Atlanta .....	43.33	51.51	35.15	24.44	53.24	30.46
Minneapolis .....	55.02	87.84	48.45	25.17	55.02	42.33
Kansas City, Mo. ...	62.85	84.57	31.27	16.27	50.37	31.65
Newark .....	80.71	94.13	67.72	23.00	88.27	49.19
Mean .....	59.42	87.10	38.09	21.50	69.52	39.55

<sup>a</sup> "Suburbs" refer to the entire SMSAs outside of central cities.

<sup>b</sup> Total education expenditure minus state-aid for education.

<sup>c</sup> Includes amounts financed by local governments for public welfare, health and hospital services, and those spent for the education of children in families with incomes under \$3,000.

<sup>d</sup> Includes police, fire, sanitation, recreation, and general control.

Note: Education expenditures estimated for children in poor families by the city-suburban ratio of families with incomes under \$3,000 are probably under estimates for the following reasons: (1) the "poverty level" for education purposes is probably above \$3,000; (2) the general education cost per student in central cities is likely to be higher than the average for the SMSAs; and (3) the proportion of low-income students in city schools is undoubtedly higher than the proportion of low-income families in the cities.

SOURCE: Woo Sik Kee, "City-Suburban Differentials in Local Government Fiscal Effort," National Tax Journal, Vol. XXI, No. 2 (June 1968).

percent of those in the central cities, and in some cases, such as Newark, they are only a third of those in the core area.

These discrepancies in poverty linked expenditure are further illustrated by the differences in suburban - central city tax efforts computed for the 22 largest SMSA's given in table II-4. It should be noted that these computations use total tax revenue. Since central city reliance on nonproperty taxes is greater than the suburbs', the differentials shown would be even greater for property tax financed expenditure only. The second column in this table shows total tax efforts, found by dividing total tax revenue by income, to be higher in all cases, save one, for the central cities. The third column shows the tax efforts after the locally financed portion of public welfare, health and hospital expenditure is deducted. Here, the difference in the mean values has dropped from 1.9 to 1.2, and in four of the 22 cases the suburban effort is actually equal to or greater than that of the corresponding central city. The last column in table II-4 shows tax efforts after the additional deduction of the locally financed portion of educational expenditures for the poor. Here, for six of the SMSA's the suburban effort is equal to or greater than that of the core city.

The remaining 1.0 difference in mean values in the last column of table II-4 can be attributed, in large part, to the differentials in non-aided common expenditures for police, fire, sanitation, recreation and general control given in the last column of table II-3. These figures show that the central cities not only foot the bill for increased police, fire, and sanitation services in their high density, high crime urban poverty areas, but are providing much of the metropolitan areas recreational facilities including parks, zoos, museums, etc. It should be pointed out that these recreational facilities, in addition to requiring

TABLE II-4 - General Fiscal and Tax Effort by Core Cities and Suburbs in 22 Largest Metropolitan Areas: 1962

SMSAs	General Fiscal Effort <sup>a</sup>		Tax Effort I <sup>b</sup>		Tax Effort II <sup>c</sup>		Tax Effort III <sup>d</sup>	
	Cities	Suburbs	Cities	Suburbs	Cities	Suburbs	Cities	Suburbs
New York .....	12.3	8.4	9.5	7.5	7.8	7.0	7.3	6.8
Chicago .....	8.8	7.0	7.4	6.1	6.6	5.8	6.2	5.6
Los Angeles .....	10.1	8.4	8.4	7.0	7.3	6.0	6.8	5.6
Philadelphia .....	9.3	6.4	7.4	4.9	6.6	4.6	6.1	4.4
Detroit .....	9.1	7.3	7.5	5.7	6.2	4.9	5.5	4.6
Baltimore .....	8.8	5.5	6.9	4.4	6.0	4.3	5.3	3.9
Houston .....	8.3	6.8	5.9	5.6	5.4	5.4	4.7	4.9
Cleveland .....	9.5	6.7	7.4	5.2	6.1	4.4	5.5	4.2
St. Louis .....	9.7	6.1	7.6	5.1	5.9	4.8	5.2	4.4
Milwaukee .....	10.3	7.8	8.4	6.5	6.8	5.4	6.3	5.2
San Francisco ....	9.4	9.1	7.4	7.2	6.1	6.0	5.6	5.6
Boston .....	13.1	8.2	11.2	7.4	8.9	6.8	8.3	6.4
Dallas .....	7.3	5.4	5.7	3.7	5.2	3.1	4.8	2.7
Pittsburgh .....	8.8	6.2	7.2	4.9	6.8	4.7	6.3	4.5
San Diego .....	8.4	8.9	6.3	6.7	5.3	5.6	4.7	4.9
Seattle .....	7.7	6.1	5.0	3.6	4.5	3.2	4.2	2.9
Buffalo .....	8.7	8.3	7.5	7.0	6.2	6.2	5.7	5.9
Cincinnati .....	12.7	5.5	8.2	4.5	6.5	4.2	5.7	3.8
Atlanta .....	8.6	5.8	6.3	3.7	5.1	2.8	4.5	2.4
Minneapolis .....	8.8	8.4	7.0	6.5	5.3	5.6	4.8	5.3
Kansas City, Mo. ..	7.9	6.7	6.0	5.4	5.1	5.0	4.5	4.6
Newark .....	14.2	7.7	12.3	7.0	9.5	6.5	8.9	6.2
Mean .....	9.6	7.1	7.6	5.7	6.3	5.1	5.8	4.8

<sup>a</sup> Total general revenue minus intergovernmental receipts divided by income.

<sup>b</sup> Total tax revenue divided by income.

<sup>c</sup> Total tax minus the locally financed portion of public welfare, health and hospital expenditures divided by income.

<sup>d</sup> Total tax minus the locally financed portion of public welfare, education expenditures for the poor, health and hospital expenditures divided by income.

SOURCE: Woo Sik Kee, "City-Suburban Differentials in Local Government Fiscal Effort," National Tax Journal, Vol. XXI, No. 2 (June 1968).



tax funds to operate, are for the most part property tax exempt, placing a double burden on the finances of the central city jurisdictions. Per capita school expenditure, though, is markedly higher in the suburbs as shown in the first column of table II-3, indicating an income-elastic demand for education. But this is not enough to make up for the aforementioned differences in the opposite direction.

The combination of a lower tax base and higher expenditure in the central cities, then, in most cases results in the higher effective tax rates for the core areas relative to their corresponding suburbs shown in the last column of table II-2 (suburban rates are expressed as a percentage of central city values). In many cases, these ever-increasing central city tax rates are pushing the property tax, the backbone of urban finance, to the limits of its revenue productivity. Several cities, mostly in the high tax areas of the Northeast, are now on the verge of bankruptcy, mainly because fragmented urban taxing jurisdictions make it impossible to share the tax base or the tax burdens equitably throughout a single metropolitan area.

It is highly interesting to note that the Southern states in general, and Texas in particular, allow the core cities of metropolitan areas the greatest freedom to annex substantial amounts of nearby territory. The 1960 populations of areas annexed between 1950 and 1960 were: 251,193 for Houston, 192,707 for Dallas, and 171,467 for Atlanta.<sup>5</sup> These extensive annexations provide a far healthier central city tax base resulting in smaller necessary increases in per capita general expenditure and even decreases in many noneducation expenditures.<sup>6</sup>

## Effects on Land Use Decisions

A second and strongly related problem of fragmented urban taxing jurisdictions is land use decisions made chiefly on the basis of what might be called fiscal expediency. Jurisdictions zone and compete for fiscal-surplus generating commercial and industrial property, while at the same time deterring such fiscal-deficit generators as low income housing. Such decisions work against solutions to the overall metropolitan area problems.

### FISCAL ZONING

Rapidly developing suburban jurisdictions, in order to stay on top of high educational costs are turning more and more to fiscal zoning. As mentioned before, most classes of business property are looked upon as being fiscal-surplus generators; that is, they provide a large amount of taxable property without adding pupils to heavily property tax financed school systems. Community decisionmakers, in order to keep taxes as low as possible, are deciding land uses mainly on the basis of a fiscal balance sheet. As the Urban Land Institute points out:

...as new schools fill up almost as soon as their doors open, the policies of the new suburban community may be pushed toward fiscal zoning. A sudden hunger develops for large and expensive houses, shopping centers, and new industrial plants. The community attempts to "put the fiscal brakes on" by the device of zoning its remaining uncommitted land for higher uses.<sup>7</sup>

An analysis of the impacts of industry on school finances in the St. Louis area indicates that, in general, the introduction of most industries into a school district will improve the district's overall financial situation. The exceptions involve industries that employ large numbers of low wage laborers, such as the textile industries. Evidently, low wage industries have many employees with

school age children and yet their plants and the homes of their employees have relatively low property values. On the other hand, the opposite seems to hold for high wage capital intensive industries, such as chemical and petroleum.<sup>8</sup> Therefore, suburban communities zone for industrial parks full of high wage capital intensive industries in preference to much needed urban housing.

In addition, these communities minimize the "problem" by zoning extremely large residential lot sizes. This limits newcomers to the wealthy, who are likely to be older and have fewer school age children. For this reason, nearly half of all vacant land in the 22 county New York City area, as of 1960, was zoned to require single family houses on minimum lot sizes of one acre or more.<sup>9</sup>

It is obvious, too, that these same kind of considerations work to sustain outmoded and inefficient central city land uses. For example, the fiscal balance sheet weighs heavily against attempts to convert our urban waterfront areas to highly desired recreational uses.

Land use decisions, based mainly on these kinds of fiscal expediency do not deal with long-range solutions to urban problems. Although fiscal zoning may make sense to individual communities, it most often does so at the expense of any coordinated overall metropolitan plan.

## SUBURBAN INTEGRATION

The fragmentation of urban taxing jurisdictions works directly against attempts to integrate suburban areas with lower income groups. Such an integration would tend to help the urban poverty problem in two ways. First, it would locate some of the poor, who are largely black, closer to the expanding suburban

manufacturing and service job markets, and second, it would remove at least a few of the poor from the stifling atmosphere of the urban ghetto. Recently, federal attempts to accomplish these goals have met with strong resistance from the affected communities in the form of prohibitive zoning ordinances. This has been the case for federal projects in both Blackjack, Missouri, just outside of St. Louis,<sup>10</sup> and Waren, Michigan, a suburb of Detroit.<sup>11</sup> Resistance, though often termed racial in character, may be to a large degree economic. Such federal projects are fiscal-deficit generators since they contribute relatively large numbers of pupils to the schools with usually only very limited payments in lieu of any property taxes. The federal government recognizes the essentially economic character of this type of problem. President Nixon announced that he has decided not to force integration of the suburbs as long as the problem remains economic in nature.<sup>12</sup> This will be the case as long as the fragmented urban taxing situation encourages fiscal merchantilism.

## Summary

The fragmentation of urban taxing jurisdictions makes it impossible to share equitably either the tax base or the tax burdens throughout an urban area. This contributes significantly to the fiscal crisis in many of our major central cities, as an eroding core area tax base is burdened by concentrations of urban poor and the provision of regional services. In addition, this situation encourages land use decisions based strongly on immediate local fiscal considerations, while ignoring longer ranged coordination attempts at metropolitan area planning, and working directly against integration of suburban areas.

## Notes

1. See M. M. Gaffney, "Tax Tool for Meeting Urban Fiscal Crisis," American Journal of Economics and Sociology, Vol. 27 (July 1968), page 253.
2. For a more detailed explanation of this movement and its causes, see John F. Kain, "The Distribution and Movement of Jobs and Industry," The Metropolitan Enigma, James Q. Wilson, ed. (Garden City, N.Y.: Doubleday and Company, Inc., 1970), pages 1 - 43.
3. Dick Netzer, Economics of the Property Tax (Washington, D.C.: The Brookings Institution, 1966), page 120.
4. Ibid., page 124.
5. Woo Sik Kee, "Suburban Population Growth and its Implications for Core City Finance," Land Economics, Vol. 43, No. 2 (May 1967), page 205.
6. Ibid., pages 204, 205.
7. Jerome P. Pickard, Taxation and Land Use in Metropolitan and Urban America (Washington, D.C.: Urban Land Institute, 1966), page 26.
8. Werner Z. Hirsch, "Fiscal Impact of Industrialization on Local Schools," Review of Economics and Statistics, Vol. 46, No. 2 (May 1964), pages 191 - 199.
9. Netzer, Economics of the Property Tax, page 132.
10. "Open Communities: Frozen Federal Lever," City (January/February 1971), page 76.
11. "Waren Keeps Most of its Castle Intact," City (January/February 1971), page 77.
12. Richard M. Nixon, President of the United States, in a television interview conducted by ABC news correspondent Howard K. Smith, March 22, 1971.

### III. The Effects of the Tax on Improvements

The tax on real property can be broken down into the tax on land, and the tax on buildings and other improvements on the land. The tax on improvements, which constitutes over 90 percent of the tax on real property,<sup>1</sup> is passed on to the occupant, while the tax on land is said to be capitalized into the value of the land.

The value of fixed-supply capital, such as land, is determined by the demand for what it produces. For land, this demand is measured by economic rent. Thus, a piece of property that yields \$1,000 per year gross rent with no taxes or expenses is capitalized at the current rate, say 10 percent, for a total value of \$10,000. If a \$250 annual tax is levied on this property the net rent would be reduced to \$750, which capitalized at 10 percent would result in a total value of \$7,500. A buyer purchasing this land for \$7,500 would be buying it free of tax burden for the taxes would be absorbed by the original owner in the form of a lower selling price. The new owner would be burdened only by incremental tax increases which would again be capitalized into the land value.<sup>2</sup>

The burden of the improvements tax on the occupant is obvious in the case of owner-occupied properties. In the case of rental properties this shift takes place as new taxes lower the profitability of investments in rental structures. For example, the lower profitability of new investment in rental housing caused by a property tax increase that is not shifted results in less new investment in this form of property. As the supply declines relative to the demand for such units, the tax increase can be passed on to the renter in the form of higher

rents. Once the shift is accomplished, new investment in rental housing returns again to its former level of profitability.

Thus, the current owners of land are not burdened by past taxes which have been capitalized into lower land prices while in the case of rental properties, they are able to shift most of the tax on improvements to the occupants. This situation coupled with high tax rates results in reducing the amount and quality of housing available in urban areas, and works against both private and public renewal of deteriorating areas of central cities.

## Effects on Urban Housing

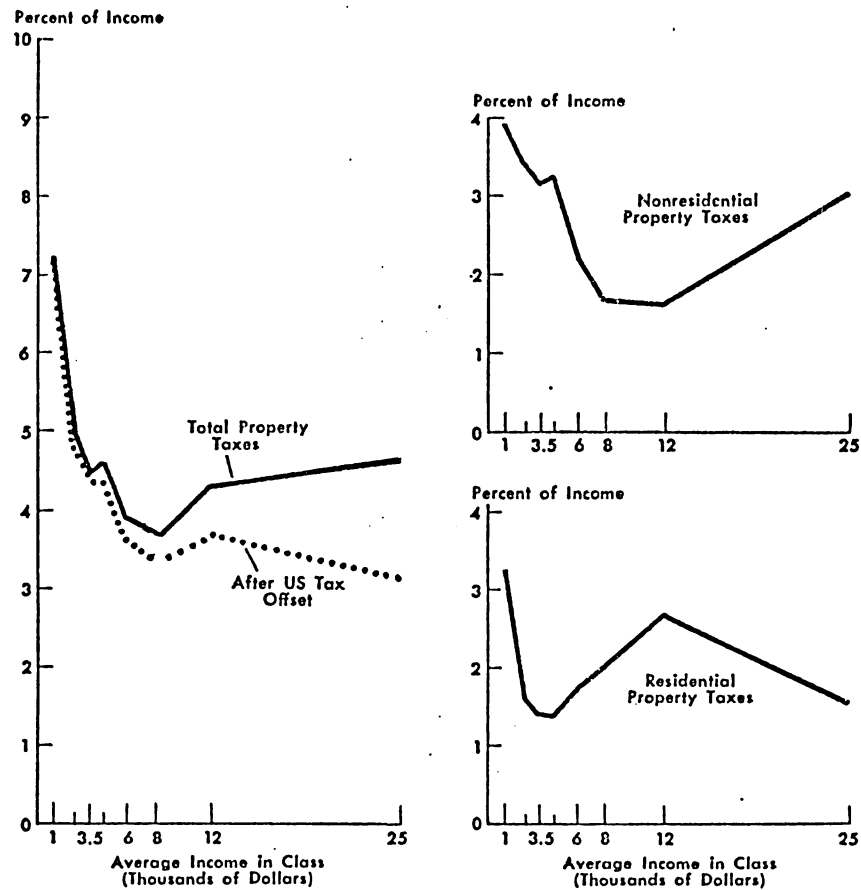
The high levels of improvements taxation on housing act against attempts to improve the quantity and quality of housing in urban areas at a time when both national and metropolitan efforts are trying to solve a housing crisis. In 1968 the United States Congress declared a need for 26 million new housing units by 1978 and implemented the most far-reaching housing programs in this country's history to help in the attainment of this goal. Yet within the first year it was obvious that goals were not being met and that the crisis in housing would continue:

Last year (1968) only 1,548,000 new housing units of all types, were built in the U.S., yet new families, and the demolition of existing housing, had generated a need for 2,100,000 new units. More over, of the total units built, fewer than 50,000 were for low-income families, yet 20 million Americans are living in sub-standard housing.

Add to these already glum statistics the fact that fewer than a quarter of last year's new housing units were built in central cities, where the housing shortage is most acute, and you begin to realize why housing is a key factor in our urban crisis.<sup>3</sup>



FIGURE III-1 - Property Taxes as Percentages of Money Income: 1957



SOURCE: Dick Netzer, Economics of the Property Tax (Washington, D.C.: The Brookings Institution, 1966).

High property taxes effect adversely the supply and quality of housing in several ways: by reducing levels of housing consumption, by reducing investment in rental housing, and by deterring improvements in existing housing. In addition, since the property tax is markedly regressive, these effects operate disproportionately on the poor.

Figure III-1 plots tax payments as a percentage of income against income class. The graph on the left of this figure shows the regressive nature of the tax considered alone, as well as its even greater regressiveness after taking into account the federal tax offsets; that is, the deductability of property tax payments on federal income taxes. The basic regressiveness of the property tax is due mainly to the larger portions of income spent for housing by the lower income groups. Since, for the most part, lower income groups rent their housing, and because there are no tax offsets for renters, the regressiveness of the tax after this offset is even greater. Table III-1 gives estimated property taxes paid on renter-occupied nonfarm housing by income of renter in 1960. This table shows, in the last column, an increased regressiveness for renters relative to the figures for all housing shown in the last column of table III-2. Thus, the average renting family making under \$2,000 pays 8.5 percent of its income in property taxes on its living unit. It should be remembered that this is a nation-wide average and is a much higher figure for the high tax central city areas of the Northeast and Midwest. For example, table III-3 gives estimated residential property taxes as percentages of income in eight northeastern New Jersey counties.<sup>4</sup>

#### HOUSING CONSUMPTION

High residential property taxes deter housing consumption by taxing away a

TABLE III-1 - Estimated Property Taxes Paid on Renter-occupied Nonfarm Housing by Income of Renter: 1960 (Dollar Amounts in Millions)

Income Class	Number of Renter-Occupied Units (In thousands)	Estimated Gross Annual Rent <sup>b</sup>	Estimated Real Estate Tax <sup>c</sup>	Mean Income in Class <sup>d</sup>	Estimated Total Income in Class <sup>e</sup>	Estimated Effective Rate of Real Estate Tax <sup>f</sup>
Less than \$2,000	4,523	\$ 2,658	\$ 375	\$ 977	\$ 4,419	8.49%
\$ 2,000-\$3,000	2,202	1,534	216	2,503	5,512	3.92
3,000- 4,000	2,412	1,878	249	3,495	8,430	2.95
4,000- 5,000	2,460	2,080	273	4,497	11,063	2.47
5,000- 7,000	3,869	3,621	472	5,935	22,963	2.06
7,000-10,000	2,493	2,640	359	8,242	20,547	1.75
10,000-15,000	1,003	1,210	191	11,753	11,788	1.62
Over \$15,000	331	467	125	27,999	9,268	1.35
All classes <sup>g</sup>	19,294	16,088	2,258	4,871	93,990	2.40

<sup>a</sup> Based largely on data in U. S. Bureau of the Census, *Census of Housing: 1960, "Metropolitan Housing,"* Final Report HC(2)-1 (1963), Table A-2.

<sup>b</sup> Number of units in each gross rent class times midpoint of gross rent class interval, times twelve.

<sup>c</sup> Total is estimated that \$406 million represented the land tax component, distributed on the basis of rental income in adjusted gross income. The remainder equals 10.6 percent of aggregate gross annual rent; this percentage is applied to each gross rent figure.

<sup>d</sup> Adjusted gross income on U. S. individual income tax returns in class, divided by number of taxable and nontaxable returns, from U. S. Treasury Department, *Statistics of Income, Individual Income Tax Returns, 1960*. Figures are to nearest dollar.

<sup>e</sup> Mean income times total number of renter-occupied housing units.

<sup>f</sup> Real estate tax divided by aggregate income in class.

<sup>g</sup> Detail may not add to totals because of rounding.

SOURCE: Dick Netzer, *Economics of the Property Tax* (Washington, D.C.: The Brookings Institution, 1966).

TABLE III-2 - Estimated Distribution of Residential Property Taxes by Income Class: 1957

(Dollar amounts in millions)

Income Class	Percentage Distribution of Tax Payments <sup>a</sup>	1957 Tax Amounts <sup>b</sup>		Tax as Percentage of Income <sup>d</sup>	
		Before U.S. Tax Offset	After U.S. Tax Offset <sup>c</sup>	Before U.S. Tax Offset	After U.S. Tax Offset
Less than \$2,000	9.0	\$ 468	\$ 468	3.27	3.27
\$ 2,000-\$3,000	5.9	307	300	1.61	1.57
3,000- 4,000	7.4	385	372	1.41	1.37
4,000- 5,000	9.5	494	470	1.40	1.33
5,000- 7,000	22.2	1,154	1,062	1.74	1.60
7,000-10,000	21.3	1,108	986	2.04	1.82
10,000-15,000	13.4	697	608	2.68	2.34
Over \$15,000	11.3	587	433	1.57	1.15
All classes	100.0	5,200	4,700	1.86	1.68

Notes: Because of rounding, detail may not add to totals.

TABLE III-3 - Estimated Rental Property Taxes as Percentages of Income in Eight Northeastern New Jersey Counties: 1960

County	Income Class						
	Under \$3,000	\$3,000- \$5,000	\$5,000- \$7,000	\$7,000- \$10,000	\$10,000- \$15,000	\$15,000- \$25,000	Over \$25,000
Bergen	17.6%	6.2%	4.7%	3.7%	2.9%	2.3%	1.1%
Essex	15.6	6.0	4.5	3.8	3.3	2.8	1.3
Hudson	10.5	4.4	3.1	2.5	1.9	1.3	0.6
Middlesex	12.3	4.8	3.6	2.9	2.2	1.6	0.7
Morris	17.2	6.5	4.8	3.8	3.4	2.6	1.3
Passaic	13.4	5.1	3.9	3.3	2.6	2.1	1.0
Somerset	13.5	5.4	3.8	3.1	2.3	1.8	0.9
Union	15.4	5.8	4.3	3.6	3.0	2.4	1.2

<sup>a</sup> Based on unpublished tabulations from the 1960 Census of Population and Housing, and New Jersey Division of Local Governments data on assessment ratios.

SOURCE: Dick Netzer, Economics of the Property Tax (Washington, D.C.: The Brookings Institution, 1966).

significant portion of the income that can be allotted for housing expenditure.

It should be noted that any tax reduces the amount of available income for expenditure and thus reduces the demand for housing as well as for all other consumer goods. But the price-increasing effect of a tax specifically on housing, such as the property tax, will depress the demand for housing far more than would the income-reducing effect of a more general tax such as that on income.

The last column in table III-4 gives property taxes as a percentage of housing expenditure (annual cash housing outlays) for owner-occupied single-family houses in 1960. For the country as a whole, property taxes were 17.4 percent of housing expenditure, while in New York and Boston they are over 28 percent. Table III-5 shows that these figures are growing. Property taxes as a percentage of the annual rental value of nonfarm housing increased from 18.5 percent to 19.1 percent in the 5 years from 1960 to 1965. This 19.1 percent figure is equivalent to an excise tax of almost 24 percent on housing (the tax as a percentage of housing expenditure before property tax is added).

Since the property tax is regressive and since core city tax rates are higher, consumption of housing is limited more in the lower income groups of the central cities. For example, a family with an income of \$4,000 per year might afford to spend a maximum of \$100 per month or 30 percent of their yearly income for housing (the FHA sets this figure at 20 percent for their low income assistance programs). If there is a tax of equal to 25 percent of gross rents in the core city in which they live, then they are spending only \$75 per month on actual rents. Stated differently, if the tax were eliminated, the same family could

TABLE III-4 - Regional Differences in Real Estate Taxes on Owner-occupied Single-family Houses: 1960

Area	Median Annual Real Estate Taxes		
	Per \$1,000 of Property Value	As Percentage of Median Family Income of Owners <sup>b</sup>	As Percentage of Median Annual Housing Costs <sup>b</sup>
<i>United States</i>	<u>\$13</u>	<u>2.5</u>	<u>17.4</u>
Inside SMSA's	15	3.0	18.8
Outside SMSA's	11	n.a.	n.a.
<i>Northeast<sup>a</sup></i>	<u>19</u>	<u>3.8</u>	<u>23.6</u>
Boston SMSA	24	5.3	28.6
Buffalo SMSA	19	4.3	27.2
New York SCA	22	5.1	28.2
Philadelphia SMSA	18	3.0	22.6
Pittsburgh SMSA	15	2.8	23.6
<i>North Central<sup>a</sup></i>	<u>14</u>	<u>2.7</u>	<u>19.8</u>
Chicago SCA	15	3.3	20.2
Cleveland SMSA	14	3.3	20.3
Detroit SMSA	16	3.1	20.0
Minneapolis SMSA	17	3.7	21.0
St. Louis SMSA	14	2.7	18.7
<i>South<sup>a</sup></i>	<u>8</u>	<u>1.4</u>	<u>10.3</u>
Atlanta SMSA	10	1.9	12.8
Baltimore SMSA	20	3.4	21.3
Dallas SMSA	12	1.9	13.6
Washington, D.C., SMSA	13	2.6	16.4
<i>West<sup>a</sup></i>	<u>13</u>	<u>2.8</u>	<u>17.5</u>
Los Angeles SMSA	15	3.3	20.7
San Francisco SMSA	15	3.2	21.5

SMSA = Standard Metropolitan Statistical Area.

SCA = Standard Consolidated Area.

n.a. = Not available.

<sup>a</sup> Data from U. S. Bureau of the Census, *Census of Housing: 1960*, Vol. V, "Residential Finances," Part 1, "Home-owner Properties." Data apply to both mortgaged and nonmortgaged properties. Separate data are shown in the Census volume for the two classes, but, although the levels differ considerably, the interregional comparisons are substantially similar. The data on real estate taxes and housing costs apply only to properties acquired before 1959 (approximately 90 percent of the number of properties nationwide).

<sup>b</sup> These figures are median values divided by median values rather than true medians of the percentages for individual properties.

<sup>c</sup> Data for regions include the SMSA's indicated plus all other single-family owner-occupied houses within the region.

SOURCE: Dick Netzer, *Economics of the Property Tax* (Washington, D.C.: The Brookings Institution, 1966).

TABLE III-5 - Property Tax on Housing as Percent of Housing Expenditure

	1960	1965
I. In relation to rental value of nonfarm housing (national income data): <sup>1</sup>		
Owner-occupied housing.....	18.1	18.9
Rental housing.....	19.3	19.4
All nonfarm housing.....	18.5	19.1
II. In relation to actual housing expenditure or rents (census data): <sup>2</sup>		
Owner-occupied single-family houses—		
All United States.....	17	-----
In standard metropolitan statistical areas.....	19	-----
Northeast region.....	24	-----
North central.....	20	-----
South.....	10	-----
West.....	18	-----
Rental properties—		
1-4 unit properties.....	17	-----
5-49 unit properties.....	17	-----
New York City.....	23	-----
Elsewhere.....	16	-----
50-or-more unit properties.....	20	-----
New York City.....	23	-----
Elsewhere.....	15	-----

SOURCE: Dick Netzer, Impact of the Property Tax: Its Economic Implications for Urban Problems (Washington, D.C.: U.S. Government Printing Office, 1968).

afford to rent a unit that is currently renting for \$133 per month and still keep within 30 percent of their income.

The federal income tax advantages of homeownership are substantial for the relatively well off taxpayers. For example, consider the person in the 40 percent income tax bracket, making \$45,000 per year, who bought a \$40,000 home 5 years ago, financing \$32,000 of the purchase price at 5 3/4 percent over a 25 year period. Currently, this person is enjoying a \$960 per year "tax subsidy", gained by the deduction from his federal taxable income of the present year's interest and property tax payments totaling \$2,400 ( $\$2,400 \times .40 = \$960$ ).<sup>5</sup> While the benefits of the federal income tax subsidy are practically nonexistent for the lower income groups, due to their low tax brackets, they overwhelm property tax disincentives to housing consumption in the upper income groups, and to some degree in the middle income groups as well. But still, a reduction in improvements taxes would reduce housing costs for all income groups, and it would seem that most consumers will buy more and better housing if the price is lower, just as they do for most other consumables. Strong evidence from the fifties suggests that the housing conditions of the lower income groups improve most in areas where the total housing supply experienced the greatest growth.<sup>6</sup> The lowering of housing costs and rents through a reduction in the property tax on improvements would ultimately increase the total housing supply, as those who now could suddenly afford more of the existing housing expanded the housing market.

## HOUSING INVESTMENT

High differentials in property taxes within urban areas hinder the shifting process and tend to deter investment in rental residential properties in the high tax



central cities.

The conventional theory of property tax incidence is the simple dichotomy of land taxes, for the most part, being capitalized into land prices and improvement taxes being shifted to the occupant. An alternative theory, recently articulated, suggests that the large tax differentials commonly found in most cities modify the shifting process so that only a portion of the taxes on improvements can be shifted to the renter.<sup>7</sup> Table III-6 shows property tax rates and revenues for taxing jurisdictions in the Boston area. Rates in this area range from a low of 2.1 percent of market value in a suburban jurisdiction, to a high of 6.6 percent in the Boston central city. A landlord renting housing units in the low tax suburban jurisdiction will be able to shift the whole amount of the improvements tax onto his renter under the traditional shifting theory explained previously. However, a landlord renting in the high central city jurisdiction will be able to shift only the portion of the improvements tax equal to that which is shifted in the low tax areas; for, if he should shift more than this, his rents would become differentially higher and thus uncompetitive with those of the low tax areas. Although locational advantages come to play here, the advantages of central city locations over those in the suburbs are fast dwindling as our cities continue to decentralize.<sup>8</sup> The result is that the landlord in the high tax Boston central city can shift only about one third of the property tax on improvements, and must pay the other two thirds himself. Although this would generally lower the assumed tax burden (not rents) for central city low income renters, it would also mean investment in housing, in the high tax central cities where the greatest need exists, would be less profitable relative to opportunities in the lower tax suburbs (to the extent that this theory operates, anyway). Thus, the property tax might be somewhat less

TABLE III-6 - Property Tax Rates and Revenues in the Boston Area: 1959

Community	Equalized Tax Rate (Single- family homes) (Per Cent)	Total Property Tax Revenue (\$1,000's)
Andover .....	2.4	1,127
Belmont .....	2.1	3,673
Boston .....	6.6	148,395
Braintree .....	2.9	3,884
Brookline .....	3.5	10,107
Cambridge .....	3.6	15,478
Chelsea .....	5.4	4,363
Dedham .....	2.5	2,824
Everett .....	3.0	6,413
Hingham .....	3.9	2,700
Holbrook .....	3.0	1,012
Lynnfield .....	2.2	1,101
Malden .....	3.7	7,165
Marblehead .....	2.4	2,343
Medford .....	3.1	6,755
Melrose .....	2.8	3,446
Newton .....	2.9	15,012
Norfolk .....	3.2	286
Peabody .....	2.6	3,000
Quincy .....	3.4	13,079
Randolph .....	3.1	1,891
Rockland .....	2.9	1,317
Saugus .....	3.0	2,195
Somerville .....	5.0	11,173
Swampscott .....	2.8	2,312
Wakefield .....	2.8	2,658
Watertown .....	3.4	5,073
Wellesley .....	2.3	4,139
Westwood .....	2.5	1,546
Winthrop .....	3.3	1,945
Woburn .....	3.0	2,814

SOURCE: Larry L. Orr, "The Incidence of Differential Property Taxes on Urban Housing," National Tax Journal, Vol. XXI, No. 3 (September 1968).

regressive than normally assumed, but this non-shifting of tax differentials would tend to provide additional barriers to investment in both new housing as well as improvements of older housing in the central cities where property taxes are as much as three times higher than in nearby suburban areas.

## IMPROVEMENTS

High urban property taxes deter housing improvements for two main reasons: first, because it appears that the demand for housing space is far greater than the demand for housing quality especially at the lower income ranges, and second, because there exists a fear (whether warranted or not) that any improvements will cause greater tax liability.

Evidence shows that the demand for housing space is highly unresponsive to price while the demand for housing quality is directly related to it.<sup>9</sup> Thus the low income family (often renters) with only a limited amount to spend on housing tends to use space requirements, based on family size, as the primary criteria of selection of a housing unit. Housing quality, for these consumers, is only a secondary consideration. As income increases the demand grows rapidly for increased maintenance, newer layouts, more and better fixtures and appliances, swimming pools, garages, and even doormen, while the unit size itself may expand only modestly. Thus, the demand for space increases as income rises, but only slightly, relative to increased demands for quality in housing. Central city landlords of low income slum properties realize this principle as evidenced in figure III-2. In this figure Newark slum landlords by size of holdings have ranked inhibitors to improvements and increased maintenance. Here, in the three groups of landlords with the largest holdings, the feeling that their tenants would not or could not pay for the improvements and maintenance through increased

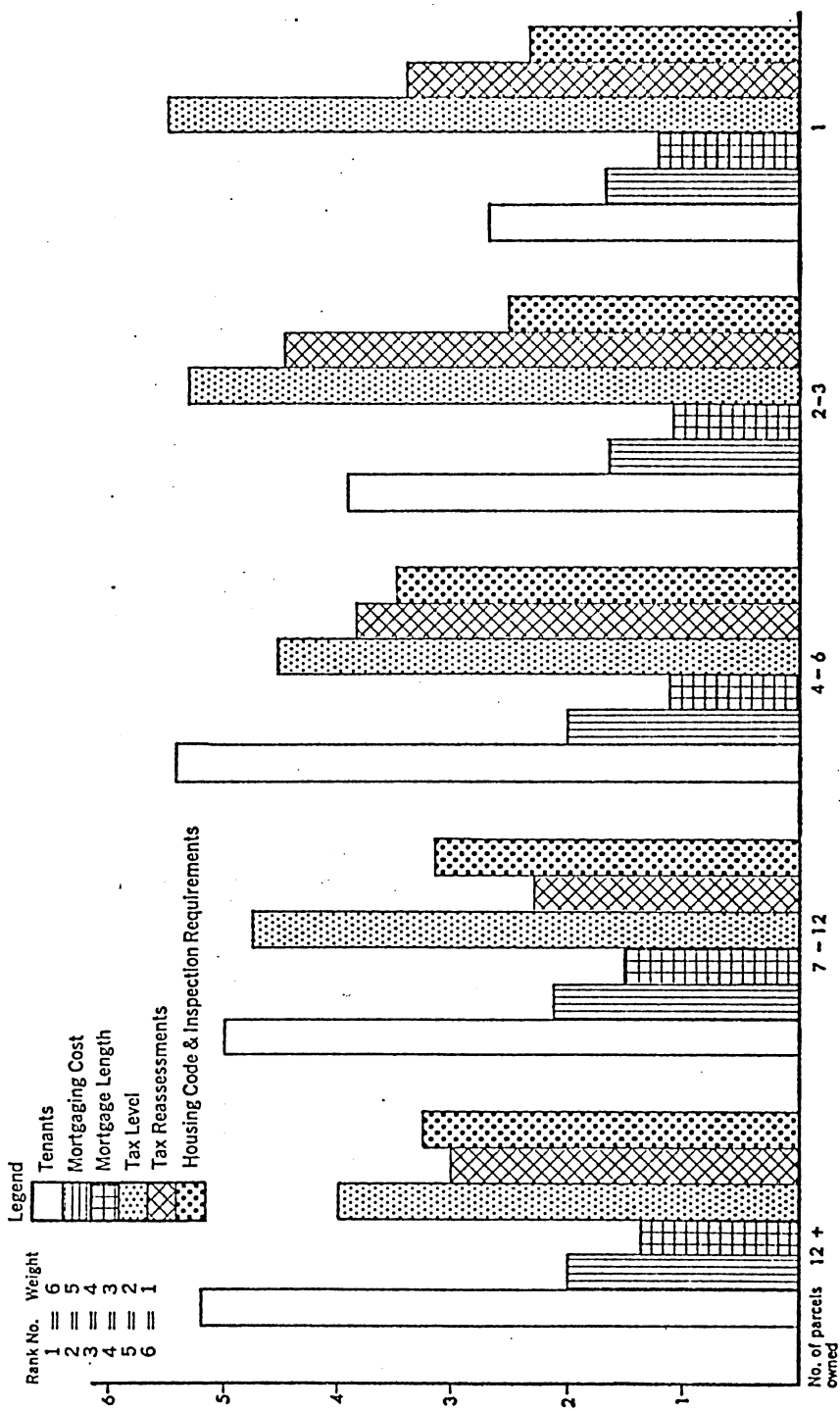
rents was the largest of the inhibitors. It seems, then, not totally unreasonable to assume that any reduction in heavy property tax burdens would be directly reflected in increased maintenance of housing properties, especially in low income urban slums.

Another strong deterrent to improvements is the fear that improvements will cause a substantial increase in taxes. In some cases, where the old housing is assessed at levels which are low for that city, any substantial improvements might trigger an inordinately large increase in assessment and thus tax liability. In other areas assessors heavily discount improvements. But whether warranted or not, the fear of increased tax liability has a definite deterrent effect as seen in figure III-2. For these Newark landlords fear of increased tax liability was ranked either one or two as an inhibitor to improvements and maintenance in all groups, but those landlords with smaller housings seemed definitely more affected. This is most likely the case because the larger landlords, as commercial operators, take present and future property tax problems more into consideration when purchasing their properties.

As an editorial in a Newark newspaper stated:

The property that requires the least service, the well-maintained residential property with modern facilities, is assessed the highest tax bill. The worst property of the slums that are a drain on police, fire, and health resources of the city, is encouraged with the lowest tax bills. The slums, in effect, are subsidized by the tax system, and the decent housing properties penalized. As long as the tax system helps to make slums big money earners for their owners and, by contrast, severely limits the profits to be made on good housing, the government does much more to spread slums than any housing court can do to combat them...<sup>10</sup>

FIGURE III-2 - Landlords' Rank Ordering of Improvement and Maintenance Inhibitors by Size of Holdings



SOURCE: George Sternlieb, The Tenement Landlord (Rutgers, New Jersey: Urban Studies Center, The State University, 1966).

## UNDERTAXATION OF LAND (A DIGRESSION)

High property taxes on improvements do tend to have certain significant negative effects on the supply and quality of housing in urban areas, as seen above. In addition, the corresponding low tax on the land increment of real property adversely affects the urban housing situation. Builders have maintained that the escalating cost of land is a major reason for the sharply increasing costs of urban housing. According to the executive director of the Urban Land Institute, Max Wehrly, during the 15 years from 1951 to 1966 the cost of the land around our urban areas, suitable for residential development, has increased by 234 percent, while, during the same period, building costs have increased by 89 percent.<sup>11</sup> Since the average housing unit has enlarged slightly in size during this period, the increase in actual square foot costs of housing construction would even be under this 89 percent figure. The dramatic increase in the price of land, which constitutes about one quarter of the cost of a single-family home, is the result of land speculation which is encouraged by undertaxation. Such preferential tax treatment sets speculative land apart from the market action of supply and demand. P. I. Prentice, former publisher of House & Home, and current building advisor to Time, Inc., states:

In an economy where pretty much everything else is taxed almost beyond the point of diminishing returns, land is so lightly taxed that landowners are under no pressure to sell their underused land. So they have created an artificial shortage, or perhaps it would be more correct to say they have created an illusion of shortage in the midst of plenty, by holding millions of acres of suburban land off today's market, waiting for 1990 prices now.<sup>12</sup>

The undertaxation of land is due in large part to underassessment. In many cases urban fringe land is assessed at only 10 percent of speculative market value, or even less. For example, a farmer owning land on the edge of the San Francisco

urban area took a \$500-an-acre assessment to court, but dropped the case when he sold his property for \$6,000 an acre.<sup>13</sup>

Underassessment coupled with the deductability of property taxes from federal taxable income results in extremely low land holding costs. For instance, the net property tax related holding costs on a \$100,000 piece of land, owned by an individual in the 40 percent income tax bracket, assessed at 10 percent, and taxed at a 4 percent rate (60% of 10% of 4% of \$100,000), would be only \$240 per year.

Low holding costs such as this, resulting from undertaxation of land, encourage land speculation. Such speculation drastically inflates land prices by creating an artificial shortage. These higher land prices are in turn translated into higher housing costs, which effectively reduce demand for housing by pricing it out of range of significant portions of the housing market.

## Effects on Urban Renewal

The high property tax on the improvements portion of real property hinders both private incentives and public attempts to renew and rebuild the dilapidating sections of urban core areas.

### PRIVATE RENEWAL

The improvements tax that hinders improvements to residential properties inhibits improvements to all properties, and thus retards private urban renewal. It is not difficult to understand why, when you realize that improvements are taxed at a greater rate, in this country, than any other product of industry, except

hard liquor, cigarettes and possibly gasoline. Generally, this fact is not very obvious because the improvements tax is paid on the installment plan. New York City's 3 percent of true value property tax, paid annually during the 60 year life of an improvement, would be equivalent to a 52 percent sales tax financed at 5 percent for the life of the improvement.<sup>14</sup> Likewise, Boston's 6.1 percent tax would be equivalent to an initially paid sales tax of over 100 percent, and San Francisco's modest 2.2 percent tax on improvements over the years becomes equivalent to a sales tax of over 40 percent.<sup>15</sup> Such high levels of improvements taxation can only result in deterring private decisions to rebuild or improve aging central city structures.

The inhibitive effect of high levels of improvements taxation is evidenced by the growing use of tax abatement devices to induce redevelopment. In New York City, over 700,000 housing units have been constructed under such devices.<sup>16</sup> Milwaukee, to encourage redevelopment, makes use of an "assessment freeze", which holds assessments at pre-redevelopment levels for seven years after the new structure is built.<sup>17</sup> But methods like these can only make the overall problem worse by increasing the improvement tax burden everywhere else, thus further discouraging all other improvements.

#### PUBLIC RENEWAL (A DIGRESSION)

Attempts at public urban renewal are seriously handicapped by property taxes that burden improvements heavily while at the same time undertaxing land. The property tax theoretically taxes both land and improvements at the same rate. But the fact that the value of improvements is typically many times the value of the land under them, coupled with the deductability of the depreciation of improvements on federal income taxes (which encourage the write-up of improvement



values relative to land values) results in a large proportion of property tax burdens falling on improvements. This lop-sided situation when added to poor reassessment practices allows the capitalization of public improvements into nearby private land values. Thus public urban renewal funds spent in one area are capitalized into the land value of adjacent areas to be subsequently redeveloped, increasing the amount of public funds necessary to purchase them. For example, Philadelphia, the city that has obtained more federal urban renewal funds than any other city except New Haven and possibly Boston, needed a subsidy of \$225 million to carry out the same program that was budgeted at \$135 million just one year before. The reason, according to the local federal renewal director, was that urban renewal was so "successful" in Philadelphia that much higher prices had to be paid for subsequent renewal sites.<sup>18</sup> Previous urban renewal expenditures have been capitalized into future renewal areas in at least one other renewal project as well. In San Francisco, the land cost for Western Addition No. 2 was tripled by the success of Western Addition No. 1.<sup>19</sup> Because of the undertaxation of land, then, private land holders are reaping huge windfall gains at public expense, raising the costs of urban renewal projects several times over in the process.

## Summary

It seems almost backward to tax heavily the efforts of a property owner who invests in and maintains his property to a high level, while at the same time grossly undertaxing large gains in land value made at public expense. But the present system of property taxation does just this, and in the process, significantly deters housing consumption, especially in the lower income groups, and inhibits both public and private efforts and incentives to renew and put to

better use the deteriorating, underused sections of our central cities.

## Notes

1. Dick Netzer, Impact of the Property Tax: Its Economic Implications for Urban Problems (Washington, D.C.: U.S. Government Printing Office, 1968), page 16.
2. For a fuller explanation of capitalization and limitations of the capitalization process, as applied to the property tax, see Walter A. Morton, Housing Taxation (Madison, Wisconsin: University of Wisconsin Press, 1955), pages 103 - 109.
3. "Housing: The Continuing Crisis," Forum (July/August 1969), page 44.
4. These figures are based on a weighted combination of renters and owner-occupiers.
5. John Mixon, "A Description of Housing Subsidies," Institute of Urban Studies, University of Houston, 1971, pages 1 - 3. (Mimeographed.)
6. Frank S. Kristof, "Housing Policy Goals and the Turnover of Housing," Journal of the American Institute of Planners, Vol. 31, No. 3 (August 1965), pages 232 - 245.
7. Larry L. Orr, "The Incidence of Differential Property Taxes on Urban Housing," National Tax Journal, Vol. XXI, No. 3 (September 1968), pages 253 - 265.
8. For a highly abstract view of the existence of urban tax differentials as the reflection of market choice between levels of services see Charles M. Tiebout, "A Pure Theory of Local Expenditure," Journal of Political Economy, Vol. 64 (October 1956), pages 416 - 424.
9. Margaret Reid, Housing and Income (Chicago, Illinois: University of Chicago Press, 1962), page 381.
10. George Sternlieb, The Tenement Landlord (Rutgers, New Jersey: Urban Studies Center, The State University, 1966), page 203, quoting from the Newark Star Ledger (August 30, 1954), page 14.
11. Lee Syracuse, ed., "Open Space Planning," Land Use Report (Washington, D.C.: National Association of Home Builders, 1968), page 54.
12. P. I. Prentice, "What's Good for the Landowner Is Bad for the Builder," Practical Builder (June 1967), page 118.
13. Ibid.
14. P.I. Prentice, "The Case for Taxing Location Values," American Journal of Economics and Sociology, Vol. 28, No. 2 (April 1969), page 149.
15. Ibid.

16. Kristof, "Housing Policy Goals," page 238.
17. Jerome P. Pickard, Taxation and Land Use in Metropolitan and Urban America (Washington, D.C.: Urban Land Institute, 1966), page 24.
18. Prentice, "The Case for Taxing Location Values," page 156.
19. Ibid., page 155.

## IV. The Effects of Assessment Discrimination

Though figures show improvement over recent years, the typical level of uniformity in property tax assessment within single taxing jurisdictions remains low. In addition, there exists significant variations in assessment levels between different classes of property as well as evidence of racial discrimination in assessment of single-family homes.

## Intra-Area Uniformity

Large differences in assessment ratios within a single class of property in the same taxing jurisdiction indicate extremely poor uniformity in assessment administration. The main measurement standard of intra-area assessment uniformity is the coefficient of dispersion used in assessment studies by the Bureau of the Census. This coefficient, which is computed on the basis of a sample of measureable sales of nonfarm single-family houses taking place during a 6 month period, is the percentage by which the various individual sales items differ, on the average, from the median assessment ratio in that area. The method of computation is as follows: the median ratio of the individual assessments of sold properties in the sample is determined. The deviation is then divided by the median assessment ratio to give the desired coefficient. This process can be illustrated by the following example using a sample of 9 houses for which the coefficient of dispersion is found to be 20 (in this example, it is assumed that the sale price of each of the 9 houses was \$20,000).<sup>1</sup> (See example at top of next page.)

The late Dr. John H. Russell, former director of research for the Virginia

<i>House</i>	<i>Assessed Value</i>	<i>Assessment Ratio</i>	<i>Deviations from Median</i>
A	\$ 6,400	32.0	—18.0
B	7,400	37.0	—13.0
C	8,000	40.0	—10.0
D	8,800	44.0	— 6.0
E	10,000	50.0	— 0.0
F	11,000	55.0	5.0
G	11,600	58.0	8.0
H	12,800	64.0	14.0
I	13,200	66.0	16.0
Total deviations.....			90.0
Average deviation.....			10.0
Coefficient of dispersion (10, the average deviation, divided by 50, the median ratio) = 20 per cent			

Department of Taxation, is reported to have established that:

... 'an index as low as 20 should be considered a goal desirable of achievement and reasonably attainable,' and that anything below this is to be considered as an excellent degree of equalization for uniformity, and that 'an index as high as 45 should be judged cause for gravest concern.'<sup>2</sup>

But an index of 20 hardly seems a good standard of uniformity. In the example given above, the coefficient was found to be 20, yet on the 9 houses, all of which were assumed to be worth \$20,000, where the median assessment level was 50 percent or \$10,000, the range of assessments was from \$6,400 to \$13,200. Thus, with the "goal" of 20 attained, the final tax bill of one property might still be more than double the amount of the tax on another property of equal market value. This in no way seems uniform.

The last column of table IV-1 shows the intra-area coefficients of dispersion state by state for 1966. These levels show a marked improvement over those of 10 years previous (table IV-2 compares the distribution of states by coefficient of dispersion for both 1956 and 1966). But over half of the states have not yet

TABLE IV-1 - Distribution of Selected Local Areas According to the Coefficient of Dispersion of Assessment Ratios for Nonfarm Houses Within Each Area, by States: 1966

State	Total number of selected areas <sup>1</sup>	Percent of areas having a coefficient of intra-area dispersion (in percent) of--			Coefficient of intra-area dispersion (in percent) of median area
		Less than 20.0	20.0 to 39.9	40.0 or more	
UNITED STATES . . . . .	1 401	53	37	10	19.2
ALABAMA . . . . .	23	30	48	22	27.4
ALASKA . . . . .	7	57	29	14	17.3
ARIZONA . . . . .	9	22	78	-	26.0
ARKANSAS . . . . .	18	50	44	6	19.8
CALIFORNIA . . . . .	37	86	14	-	15.1
COLORADO . . . . .	18	56	44	-	19.0
CONNECTICUT . . . . .	59	85	14	2	12.3
DELAWARE . . . . .	3	67	33	-	19.8
DISTRICT OF COLUMBIA . . . . .	1	(X)	(X)	(X)	(X)
FLORIDA . . . . .	31	77	23	-	14.2
GEORGIA . . . . .	26	69	23	8	16.9
HAWAII . . . . .	4	25	75	-	25.7
IDAHO . . . . .	11	36	36	27	25.7
ILLINOIS . . . . .	41	46	51	2	20.3
INDIANA . . . . .	44	41	48	11	22.7
IOWA . . . . .	27	63	37	-	18.9
KANSAS . . . . .	23	26	61	13	20.5
KENTUCKY . . . . .	28	79	21	-	15.8
LOUISIANA . . . . .	24	42	50	3	22.5
MAINE . . . . .	44	73	25	2	15.6
MARYLAND . . . . .	17	71	29	-	16.9
MASSACHUSETTS . . . . .	67	78	19	3	14.6
MICHIGAN . . . . .	102	48	28	24	20.7
MINNESOTA . . . . .	19	21	74	5	22.8
MISSISSIPPI . . . . .	19	16	79	5	27.8
MISSOURI . . . . .	26	31	62	8	25.3
MONTANA . . . . .	10	40	50	10	22.5
NEBRASKA . . . . .	17	35	53	12	23.7
NEVADA . . . . .	5	60	20	20	19.4
NEW HAMPSHIRE . . . . .	29	83	14	3	14.8
NEW JERSEY . . . . .	21	76	24	-	18.1
NEW MEXICO . . . . .	14	43	43	14	22.7
NEW YORK . . . . .	43	16	47	37	34.3
NORTH CAROLINA . . . . .	44	57	36	7	17.7
NORTH DAKOTA . . . . .	11	36	55	9	26.8
OHIO . . . . .	56	70	30	-	16.2
OKLAHOMA . . . . .	20	45	40	15	23.2
OREGON . . . . .	18	56	44	-	18.9
PENNSYLVANIA . . . . .	49	31	49	20	25.5
RHODE ISLAND . . . . .	30	80	20	-	14.2
SOUTH CAROLINA . . . . .	21	14	48	38	33.7
SOUTH DAKOTA . . . . .	16	38	56	6	22.0
TENNESSEE . . . . .	23	57	30	13	19.5
TEXAS . . . . .	57	28	46	26	29.0
UTAH . . . . .	9	44	44	11	21.0
VERMONT . . . . .	24	58	38	4	18.8
VIRGINIA . . . . .	37	65	24	11	15.8
WASHINGTON . . . . .	20	25	75	-	21.7
WEST VIRGINIA . . . . .	24	33	63	4	22.9
WISCONSIN . . . . .	67	64	24	12	16.2
WYOMING . . . . .	8	50	50	-	23.0

SOURCE: U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Government Printing Office, 1968).



TABLE IV-2 - Distribution of States by Coefficient of Dispersion: 1956 & 1966

<u>Median Area Coefficient of Dispersion</u>	<u>Number of States</u>	
	1956.	1966.
Less than 15	1	5
15.0-19.9	2	19
20.0-24.9	5	14
25.0-29.9	10	10
30.0-34.9	11	2
35.0-39.9	11	-
40 or over	5	-

SOURCE: Fredrick L. Bird, The General Property Tax: Findings of the 1957 Census of Governments (Chicago, Illinois: Public Administration Service, 1960), and table IV-1.

attained even the modest "goal" of 20. In addition, the following major cities have coefficients over 20:<sup>3</sup>

Baltimore	24.3
Boston	28.9
Buffalo (entire county)	57.0
Chicago	24.5
Dallas	72.6
Detroit	20.4
Kansas City (Jackson County portion)	24.5
New York	23.1
Philadelphia	26.3
Pittsburg	20.4
St. Louis	26.4
St. Paul	24.7
San Francisco	28.9

It should be remembered that these are average values and that a significant number of areas still exist where the index is over 40, as seen in the middle columns of table IV-1.

Since these coefficients are for single-family nonfarm houses, for which there is a large amount of good market information on which to base assessments, one might expect the coefficients to be even higher on larger commercial and industrial properties, where market sales on which to base assessments are fewer and farther between.

## Property Class Discrimination

There seems to be a conscious effort on the part of the assessors to assess different classes of property at differing percentages of full value. Such a practice not only distributes the tax burden unequally but also deprives communities of services that would otherwise be provided with the additional revenue. In addition, this practice tends to effect the stability of urban land, most notably at the fringes of metropolitan areas.

The average nation-wide percentage ratios of assessed values to sales price for 1966, in standard metropolitan statistical areas, were as follows:<sup>4</sup>

All types of property	33.7 %
Residential	35.9
Acreage in farms	20.0
Vacant lots	23.9
Commercial and industrial	31.9

With an average assessment ratio of 33.7 percent for all types of property, a 3 percent difference in assessment means a 10 percent relative difference in tax liability. In the case of acreage in farms in SMSA's, the almost 14 point lower assessment ratio means an over 40 percent lower tax liability for this classification of property, relative to all property. Since farmers are abnormally affected by property taxes (the property tax as a percentage of national income originating for farming averages more than three times the corresponding figure for manufacturing<sup>5</sup>), assessors in urban areas consciously underassess farm lands at the edges of metropolitan areas. In addition, too many local assessors tend to think of the property tax as an income tax rather than a tax on income potential and thus assess idle land at low values, as evidenced by the relatively low assessment ratio for vacant lots. But these practices produce instability in land use and lead to land speculation as explained previously in section III.

The favored treatment (over and above legal exemptions) given by urban tax assessors to encourage location of industry in their various jurisdictions results in the average 10 percent lower tax liabilities of commercial and industrial properties. Again, it should be noted that these are average figures and that in many cases differences are much more extreme. For example, in Houston, a recent study showed that while residential properties are valued at about 32 percent of market value for tax purposes, commercial and industrial properties are assessed at only 13 percent.<sup>6</sup>

It could be argued that the practice of assessing business properties at lower levels than residential properties has some merit. This is the case for two reasons. First, since commercial and industrial properties do not directly burden property tax financed schools, it might seem more equitable if they did not have to pay for them. And second, since nonresidential property taxes are more regressive than residential property taxes for incomes under \$12,000,<sup>7</sup> lower assessment (therefore, lower taxation) of business properties would seem more equitable for these income groups. On the other hand, commercial and industrial properties definitely benefit indirectly from an educated society, and therefore should perhaps make some contribution in this area. Any shift from nonresidential to residential property taxation would mean a more regressive property tax for incomes over \$12,000.<sup>8</sup> And, too, property class discrimination is in direct conflict with tax equity provisions of most state constitutions.

## Evidence of Racial Discrimination

Recent evidence indicates that racial discrimination in property tax assessment does exist. Such practices further obstruct attempts by minority groups to better house themselves. William S. Hendon, of Texas Technological College, in a sample of homes sold in the Fort Worth area, found that local assessors valued Negro owned single-family homes consistently higher than comparably priced white owned homes.<sup>9</sup>

Table IV-3 gives comparable assessment ratios by sales price and shows that in the lowest price group, Negro owned homes were assessed at levels more than twice those of white owned homes. This discrimination in the assessment was

TABLE IV-3 - Ratio of Assessed Value to Sale Price of Negro Owned Residential Properties, Fort Worth, Texas

1958-1963	
Sale Price	Ratio
\$5,001- 6,000	1.03
6,001- 7,000	.85
7,001- 8,000	.89
8,001- 9,000	.89
9,001-10,000	.93

Ratio of Assessed Value to Sale Price of White Owned Residential Properties, Fort Worth, Texas

1958-1963	
Sale Price	Ratio
\$5,001- 6,000	.49
6,001- 7,000	.56
7,001- 8,000	.57
8,001- 9,000	.59
9,001-10,000	.74

SOURCE: William S. Hendon, "Discrimination Against Negro Homeowners in Property Tax Assessment," American Journal of Economics and Sociology, Vol. 27, No. 2 (April 1968).

in addition to the higher prices and greater finance charges Negroes normally pay for homeownership. To the extent that racial discrimination of this type exists, minority groups are being burdened by property taxes far beyond their fair share, which can only result in poorer housing for these groups than would otherwise be obtainable.

## Legal Aspects of Assessment Discrimination

For many years, the taxpayer whose property was assessed at a higher proportion of its value than other property could not obtain effective judicial relief in most state courts if his property assessment was not in excess of the statutory standard. The only resort he had was to seek political action to have all property assessed according to the statutory standards.

In 1923 the United States Supreme Court held in the *Sioux City Bridge* case<sup>10</sup> that the taxpayer who was assessed on a discriminatory basis was entitled to have his assessment reduced to a common level. But the effect of this decision was weakened, first, by the advent of the Depression with its detrimental impact on property values and property tax administration,<sup>11</sup> and second, by the Supreme Court's subsequent decision in the *Browning* case,<sup>12</sup> where it held that the long-continued practice of classification assumed an aura of legality sufficient to exempt it from attack under the equal protection clause. In 1946 the Court reversed this stand in the *Cromwell* case<sup>13</sup> and reaffirmed its *Sioux City Bridge* holding and also said that equal protection is denied unless the state itself removes the discrimination.

The need for a judicial remedy in assessment discrimination cases has since been

well recognized. Two New Jersey Supreme Court decisions took the lead in this area. In the Baldwin case<sup>14</sup> the taxpayer's right to discrimination relief was recognized, and in the landmark Switz case<sup>15</sup> the Court ordered assessing officials to equalize assessments while it retained jurisdiction to insure that the mandate was carried out.

Since the New Jersey cases in the mid-fifties, most state courts have indicated that the taxpayer is entitled to relief, where discrimination in property tax assessment can be shown. The following cases are characteristic:<sup>16</sup>

ARIZONA: *Southern Pacific Co. v. Cochise County*, 92 Ariz. 395, 377 P.2d 770 (1963)—assessment ratio of state-assessed property compared to locally assessed property.

ILLINOIS: *People ex rel. Hillison v. Chicago, B. & Q. R.R.*, 22 Ill. 2d 88, 174 N.E.2d 175; *People ex rel. Kohorst v. Gulf, M. & O. R.R.*, 22 Ill. 2d 104, 174 N.E.2d 182 (1961) among others—assessment ratio of state-assessed property compared to locally assessed property. Cf. *People ex rel. Callahan v. Gulf, M. & O. R.R.*, 8 Ill. 2d 66, 132 N.E.2d 544 (1956).

MARYLAND: *Sears, Roebuck and Co. v. State Tax Commission*, 214 Md. 550, 136 A.2d 567 (1957)—assessment ratio of stock in trade compared to real estate. The statute was subsequently amended (L. 1958, Ch. 73) to provide for the separate classification of real and personal property and the subclassification of personal property. A classified assessment under the amended law was sustained in *National Can Corp. v. State Tax Commission*, 220 Md. 418, 153 A.2d 287 (1959), *appeal dismissed for want of a substantial federal question*, 361 U.S. 534 (1960).

MASSACHUSETTS: *Shoppers' World, Inc. v. Board of Assessors of Framingham*, 348 Mass. 366, 203 N.E.2d 811 (1965)—assessment ratio of complainant's land compared to other property—*overruling* *City of Lowell v. County Commissioners of Middlesex*, 152 Mass. 372, 25 N.E. 469 (1890).

MINNESOTA: *Hamm v. State*, 255 Minn. 64, 95 N.W.2d 649 (1959)—ratio of complainant's commercial property compared to other commercial property—*overruling* *State v. Cudahy Packing Co.*, 103 Minn. 419, 115 N.W. 645, 1039 (1908); *Dulton Realty, Inc. v. Minnesota*, 270 Minn. 1, 132 N.W.2d 394 (1964)—assessment ratio of downtown commercial property compared to other property.

NEBRASKA: *Chicago, B. & Q. R.R. v. State Board of Equalization and Assessment*, 170 Nebr. 77, 101 N.W.2d 856 (1960)—assessment ratio of state-assessed property compared to locally assessed property.

OHIO: *State ex rel. The Park Investment Co. v. Board of Tax Appeals*, 175 Ohio St. 410, 195 N.E.2d 908, *cert. denied*, 379 U.S. 818 (1964)—assessment ratio of commercial property compared to other real property; *Koblenz v. Board of Revision*, 5 Ohio St. 2d 214, 215 N.E.2d 384—assessment ratio of complainant's residence compared to other residences.

In the Switz case, the majority of the Court felt that equalization of assessment was sufficient, even if under statutory levels. But the minority held that the best method of achieving equalization was adherence to statutory standards. The courts of several states, notably Kentucky<sup>17</sup> and Florida,<sup>18</sup> have favored the views of the minority in the Switz case, demanding strict adherence to the stat-

utory standards (full value assessment in both Kentucky and Florida).

An indirect aspect of this judicial interest in property tax administration is that it has prompted legislative and administrative action designed to eliminate property tax problems. Recently California and New Jersey have made substantial revisions in their property tax laws, and important changes are being proposed in a number of other states including Alabama, Georgia, Iowa, Minnesota, Mississippi, Rhode Island, South Carolina, Tennessee, and Vermont. Judicially prompted administrative action includes more effective supervision of the assessment process, reduction in property class discrimination, furnishing of technical assistance to assessors, and encouragement of reappraisal programs.<sup>19</sup>

It would seem that the judicial process has had, and will continue to have, a significant influence both directly and indirectly on the improvement of property tax assessment and administration.

## Summary

Despite judicially spurred improvement, there still exists substantial intra-area and property class discrimination. Aside from the obvious conflicts with state constitutional property tax equity provisions, such discrimination deprives communities of services the additional revenue could provide. In addition, assessing different classes of property at differing rates of full value produces instability in land use and leads, as in the case of farm land on the urban fringe, to land speculation. Racial discrimination in property tax assessment, wherever it exists, creates additional barriers in an already difficult minority urban housing market.



## Notes

1. Fredrick L. Bird, The Property Tax: Findings of the 1957 Census of Governments (Chicago, Illinois: Public Administration Service, 1960), page 54.
2. Ibid., citing J. Edward Rountry, "Equalization at Market Value," Appraisal Journal, Vol. XXIV, No. 2 (April 1956), page 222.
3. U.S. Census Bureau, Census of Governments: 1967, Vol. II, Taxable Property Values (Washington, D.C.: U.S. Government Printing Office, 1968), pages 125 - 145.
4. Ibid., page 42.
5. Dick Netzer, Economics of the Property Tax (Washington, D.C.: The Brookings Institution, 1966), page 28.
6. Kim Quaile Hill, "Ad Valorem Tax Assessment Levels of Commercial Property in Houston and Harris County, Texas," The Center for Responsive Law, Washington, D.C., 1970. (Mimeographed.)
7. See figure III-1.
8. Ibid.
9. William S. Hendon, "Discrimination Against Negro Homeowners in Property Tax Assessment," American Journal of Economics and Sociology, Vol. 27, No. 2 (April 1968), pages 125 - 132.
10. Sioux City Bridge Co. v. Dakota County, 260 U.S. 441 (1923).
11. Nashville, C. & St. L. Ry. v. Browning, 310 U.S. 362 (1940).
12. Charles F. Conlon, "Impact of Recent Judicial Decisions," The Property Tax: Problems and Potentials, ed., (Princeton: Tax Institute of America, 1967), page 43.
13. Hillsborough v. Cromwell, 326 U.S. 620 (1946).
14. Baldwin Construction Co. v. Essex County Board of Taxation, 16 N.J. 329, 108 A.2d 598 (1954).
15. Switz v. Township of Middletown, 23 N.J. 580, 130 A.2d 15 (1957).
16. Charles F. Conlon, "Impact of Recent Judicial Decisions," page 45.
17. Russman v. Lockett, 391 S.W.2d 694 (Ky. 1965).
18. Walter v. Schuler, 176 So. 2d 81 (Fla. 1965).
19. See Advisory Commission on Intergovernmental Relations, The Role of the States in Strengthening the Property Tax (Washington, D.C.: U.S. Government Printing Office), page 165.

## V. Conclusions and Proposals

## Conclusions

As we have seen, the American property tax contributes significantly to a great many of our urban problems. This is the case mainly because the tax, which is now the backbone of urban finance, has developed out of an essentially agrarian background and has not been well adjusted to the urban society which now exists.

The negative effects of the property tax in an urban context were found to be grouped in three main areas of the tax and its operation.

### TAXING JURISDICTIONS

The multiplicity of urban taxing jurisdictions makes it impossible to share equitably either the tax base or the tax burdens throughout an urban area. This situation contributes to the fiscal crisis in many of our major cities as an eroding core area tax base is burdened by concentrations of urban poor and the provision of regional services. In addition, this situation encourages land use decisions based strongly on immediate local fiscal considerations, while ignoring longer ranged coordinated attempts at metropolitan area planning, and working directly against the goal of suburban integration.

### THE TAX ON IMPROVEMENTS

Undertaxation of land allows land owners to profit from large gains in land values resulting from the expenditure of community dollars, and thus encourages land speculation which drastically inflates land prices. On the other hand, the heavy taxation of improvements burdens most the owner who spends his own dollars to

invest and maintain his property, and in the process significantly deters housing consumption, especially in the lower income groups, and inhibits public efforts as well as private incentives to renew and rebuild aging, underused portions of our central cities.

## TAX ASSESSMENT

Lack of intra-area uniformity and property class discrimination in assessment, deprive communities of additional revenue and services, distribute urban tax loads unevenly, and are in direct conflict with tax equity provisions of most state constitutions. In addition, assessing different classes of property at differing rates of full value results in a degree of instability in land use, and leads, as in the case of farm land on the urban fringe, to land speculation. Racial discrimination in property tax assessment is grossly unfair wherever it exists, and makes an already difficult urban minority housing situation even worse.

## Proposals

Obviously the negative side effects of the American property tax in urban areas can be reduced by a decreased reliance on the tax as a source of local revenue. But since a case can be made for some form of property taxation, the negative effects inherent in the present system can, for the most part, be eliminated through basic reforms in the property tax and its operation. Some of these reforms would actually exert some positive influences that could help solve some of our urban problems.

## REDUCED RELIANCE

The most obvious way to reduce the undesirable effects of the property tax in

the urban situation would be a reduction in the relative role of the tax as a source of local revenue. This might be done in several ways: through increased aid from state and federal governments, which do not rely on the property tax; increased use of other local taxes, especially the income tax; and through increased use of local user-charges.

*The process question*

Increased State and Federal Aid - The increased mobility of our society argues strongly for increased aid for many local expenditures from higher governmental sources. For example, the benefits derived from public education are not likely to be felt directly within the local taxing jurisdiction or even the area or state, due to this increased mobility. This factor coupled with the realization that high quality public education will benefit the society as a whole, seems to argue for increased state and especially federal aid. This move and similar ones based on arguments to be made for relieving the local property tax of the job of financing highway construction, as well as the public services linked to a seemingly national poverty problem, would only reinforce existing trends towards decreased property tax reliance in these areas. As seen below, the property tax financed portions of these services have declined substantially between 1927 and 1965-66, due mostly to increased state and federal aid:<sup>1</sup>

	1927	1965-66
Education	73 %	37 %
Highways	56	13
Public welfare	61	8
Health and hospitals	32	15

Since local education expenditure alone now amounts to about half of property revenue, further moves in the direction of increased state and federal aid in these areas would do much to reduce reliance on the property tax.

Local Income Taxes - Another way in which local governments can decrease their reliance on the property tax, and thus decrease its negative effects, is through the use of alternative local taxes, especially the income tax. The income tax is not regressive as is the property tax; in addition, it does not have the property tax's especially negative effects on housing. The local income tax, if widely used, could become a needed supplement to increase grants from state and federal sources. For state-aid formulas permit the reflection of differing community needs, while local supplemental taxes allow far more local government choice as to the use of the funds.

User-Charges - Although local governments currently employ user-charges for some services (hospital and airport services, public housing, and school lunch programs) as well as in the form of special assessments, increased use of these utility-type charges would further reduce local reliance on the property tax while more efficiently allocating local resources. As Netzer states:

If the purposes of providing the public service is to offer different customers the services they want, and place some value on, then they ought to pay for such services in proportion to the costs. Otherwise, governments will be called upon to provide a great deal more of the service than people would be willing to consume if they did not have to pay for it - a wasteful use of resources; or the service will be in such short supply that a form of non-price rationing will be employed to allocate the service among customers. The outstanding example is street congestion in cities: users pay for highways in the aggregate but not for specific individual uses of the streets and therefore, not surprisingly, treat highways as a free good. The only deterrent to use of the streets at the most crowded times and in the most crowded places is the value one places on time; the rationing in effect then results in those who place a low value on time preempting the street space from those who place a high value on time. Ordinarily, in our society, rationing is on the basis of price. Somebody who values a service highly bids it away from someone who places a lower value on that service and would rather use his income for alternative kinds of consumption.<sup>2</sup>

The greatest opportunities for the increased utilization of user-charges, as Netzer

suggests, would be in connection with urban highways and parking facilities, waste collection and disposal, and recreational activities; although the regressiveness of these charges on the lower income groups would have to be considered.

## LAND VALUE TAXATION

Most of the value of land is not a result of actions by individual property owners, but rather the result of collective investment, community development, and population growth. Individual land owners can therefore realize large "unearned increments" in land value over time. It seems highly appropriate for the community to gain back these unearned land value increments through taxation and use them to community benefit. This could be accomplished by changing the present property tax on both land and improvements to exclusive taxation of land values, or for substantially heavier taxation of land than of buildings. Land value taxation, first championed in this country by Henry George in the late nineteenth century, is rather widely practiced in varying degrees - in Australia, New Zealand, Western Canada, South Africa, and most recently in Hawaii. This system would not only eliminate the negative effects of the heavy taxation of improvements in our urban areas, but would provide some positive side effects on the urban situation.

Aside from the above argument, that heavier taxation of land would reduce the unearned land value increment due to external factors (including such public expenditures as urban development, freeway construction, and implementation of mass transit), land value taxation would have the following points in its favor:

1. Encourage Building and Rehabilitation - As seen previously, present property

taxes discourage building and improvements, especially in housing, while encouraging poor maintenance and underimprovement. If the tax burden were transferred to the land increment of real property the situation would be reversed. For improvements, no matter how costly, would not be effected by the tax, whereas land which is not fully developed will pay its full share of taxes. This would tend to strongly encourage development of urban land to its highest and best use. As land taxation advocate Mary Rawson states:

To exempt improvements and at the same time to tax land more heavily would provide a double incentive to owners of derelict buildings to demolish them and to use the land more intensively. Here surely is a golden key to urban renewal, to the automatic regeneration of the city - and not at the public expense.<sup>3</sup>

2. Discourage Land Speculation - While the present property tax favors land speculators, allowing them to hold land at very low costs, placing higher taxes on land would discourage this practice by increasing holding costs substantially.

3. Reduce Urban Sprawl - The land speculators' ability to hold land off the market in anticipation of higher prices has been a contributing factor in the leap-frog development of our urban fringes which leaves vacant tracts in otherwise built up areas. Higher land taxes would encourage more compact and efficient urban development by decreasing the number of hold-out property owners, and by encouraging fuller use of existing urban sites.

It could be argued that this particular aspect of land value taxation might be a liability of the tax rather than a benefit, as implied here, mainly because of the growing case in favor of the existence of scattered urban development. This case centers on two main points. First, discontinuous urban development allows an age mix of relatively small developments within one area, so that



older areas are mixed with new ones. This would tend, it is argued, to make redevelopment, when needed, a more favorable proposition, and would also eventually disperse the urban poor by distributing the older areas, which tend to attract them, throughout the urban fringe.<sup>4</sup> And second, scattered urban development allows more option for growth and change as our urban areas evolve.

Land speculation induced by undertaxation of land is only one factor contributing to scatteration. Federal income tax policies, property tax assessment practices, and methods of finance all favor the staging of large developments in smaller units over time and thus promote discontinuous urban growth.<sup>5</sup> It would seem that more research is needed to determine the actual costs and benefits of scattered urban development before a fair appraisal can be made. The elimination of urban sprawl is mentioned here only because a more compact form of development would allow lower costs for the provision of urban services, and the elimination of land speculation would return urban fringe land to the control of market operation.

4. Reduce the Cost Of Land - A higher tax on land values would have an eventual result of lower land values since the net economic rent of land would be reduced by the amount of the tax. This therefore, would mean a lower capital value. The effect would be like a permanent loan to the land buyer. Since land costs have risen faster over recent years than any construction component, reduced land cost would mean both homeowners and businesses could afford to build better with the same investment.

5. Redistribute the Tax Load Among Land Uses - A move to tax land values more heavily would shift the tax load away from the generally lower land values

of residential properties onto the higher land values of commercial and industrial properties.

6. Decreased Regressiveness - The redistribution of the tax load more towards commercial and industrial properties coupled with the decreased degree of shifting possible with the land tax would result in a markedly less regressive tax than the present property tax. For commercial and industrial property owners are most likely of a higher income class than homeowners, and property owners in general are better off than renters.

As with most reforms, land value taxation is not without its critics. The following are the factors mentioned most often in argument against land value taxation:

1. It Would Foster Premature Development - Critics suggest that higher taxes on land would force premature development that would preclude more permanent and efficient land use patterns that would otherwise have evolved. It is also suggested that open spaces would disappear as increased land taxes increased pressure for higher density development. But both of these drawbacks could be avoided, it would seem, by greater use of planning and zoning to better control development and insure not only enough open space, but open space efficiently located.

2. Problems of Land Valuation - Critics of land value taxation seriously doubt the administrative possibility of accurately assessing the land increment of real property especially when it is improved. These critics hasten to point out the difficulties and lack of accuracy that result whenever this is done even for single isolated properties. This criticism would indeed be a serious one if, in fact, it were proved the case. But as A. M. Woodruff and L. L. Ecker-Racz

point out, based on their extensive first hand studies of land value taxation in Australia and New Zealand:

The argument commonly heard in America that site value rating is administratively impossible because of the difficulty of assessing land apart from the buildings on it, is not heard at all in Australia and New Zealand. Many decades of experience have convinced even the most hardened skeptics that while it may be considerably more difficult to appraise the land component of a single improved parcel apart from the building on it, the reverse is true when great numbers of properties have to be evaluated for tax purposes.<sup>6</sup>

Because of the lack of large discrepancies in the land values of adjacent properties, land seems to lend itself well to simple extrapolation methods of valuation as is the case in Australia and New Zealand. Thus, experienced tax officials from these countries, including the few who are opposed to land value taxation, "are agreed on its administrative simplicity."<sup>7</sup>

3. Shifting Incidence - With any major tax reform of this type, there are bound to be certain land uses or social groups that will suffer in the change over. For example, increased land value taxation might fall heaviest on elderly homeowners living in older, underimproved structures, since the land increment of such property would tend to be a greater than average percentage of total property value. Hawaii, which in 1965 began a change over to heavier taxation of land, solved these problems in two ways. First, the change over, which will ultimately tax improvements at 40 percent of the rate on land, will be accomplished gradually over a period of ten or more years, thus softening its immediate impact. Second, amendments to the new tax law grant hardship exemptions to those individuals most severely affected.<sup>8</sup> The necessity for such exemptions, which indicates the pressure of land value taxation on underused land, should only temporarily impede the desired effects of increased land taxation; fewer hardship exemptions

should be required as the amount of underused land diminishes.

4. Inadequacy - One of the more potentially serious criticisms of a complete shift to land value taxation is the possibility that land values would not provide an adequate base for necessary levels of taxation. Estimates, notably the Goldsmith Data, indicate that the economic rent of land alone could not, even if taxed at 100 percent, provide the equivalent amount of revenue raised by the current property tax.<sup>9</sup> If this be the case, either the reliance on the property tax as a source of local revenue could be reduced, as suggested previously, or the shift to land value taxation could take the form of a graded or differential tax - the application of a higher tax rate to the land portion than to the improvements portion of property value, as in Hawaii.

#### LAND VALUE INCREMENT TAXATION

A more direct method of gaining back for public use the unearned land value increments - increases in land value that occur not through the efforts of the landowner but through government expenditure for new highways, mass transit lines, zoning changes, etc., and through community investment and population growth, would be to tax directly increases in land values. There are several variations to this approach to taxation which are used in a number of countries. In some Latin American countries, notably Columbia, specific public improvements are financed from taxes on the estimated land value increases in adjacent properties. This is similar in rationale to the way special assessments are used in this country to finance street and sewer projects. In several European countries land value increment taxation shows up in the less favorable income tax treatment of capital gains on land relative to the tax treatment of other capital gains.

It has been suggested that taxation of land value increments might be accomplished easiest in this country through state income taxation, by a special supplemental rate on the capital gains from land, or by including a larger portion of the gain as ordinary income. Such a method would seem easiest because the gains are already reported and legal definitions exist and are already being applied.<sup>10</sup>

Although its impact and revenue potential would be far less than that of land value taxation, this form of taxation, like land value taxation, would be essentially neutral with respect to land use decisions, and would not discourage new construction.

In addition, while decreasing the amount of the property tax, or shifting to heavier land value taxation would involve substantial shifts in capital as the reduced tax, or new taxes, are capitalized into land values, land value increment taxation would only burden those who showed actual gains in land value.

#### PROPERTY TAX FEDERATION

The problems associated with fragmented urban taxing jurisdictions could be eliminated, for the most part, through property tax federation. Such a federation could go far towards improving the quality of assessment as well.

Under this scheme local taxing jurisdictions within a single metropolitan area would delegate tax assessment and collection powers to a single area-wide authority. This federation authority would then levy the property tax over the entire area at a single effective rate and distribute tax moneys, as well as state aid funds, on a per capita and per pupil basis back to the individual

jurisdictions. If it is felt desirable, these individual jurisdictions would have the option of levying an additional tax increment on themselves to provide additional or higher quality services.

Property tax federation would help to end central city fiscal problems by allowing the tax burdens as well as the tax base to be shared equitably throughout a single metropolitan area. In addition, the federation of taxing jurisdictions would eliminate incentives for fiscal zoning, by ending inter-jurisdictional competition for tax base, and provide a far better climate for the implementation of area-wide planning.

Evidence from the 1967 Census of Governments suggests that the level of assessment uniformity improves as the size of the assessment operation increases.<sup>11</sup> It would seem, then, that property tax federation would likely result in the additional benefit of improved assessment quality due to the larger assessment operation possible under such a scheme.

## Summary

The American property tax has been shown to contribute significantly to urban problems. With the existence of viable alternatives and basic reforms to the present property tax system, and with a willingness to accept change, it would seem that urban governments could alter their main fiscal institution from one which promotes urban problems to one which contributes to their solution.

## Notes

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5. Jack Lessinger, "The Case for Scatteration: Some Reflections on the National Capital Region - Plan for the Year 2000," Journal of the American Institute of Planners, Vol. XXVIII, No. 3 (August 1962), pages 159 - 169.
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