

# Debt Death and Deadweight

## CHAPTER 6

# Citizens as champions of tax Reform, Pennsylvania-style

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**T**HE DIFFICULTY in valuing land separate from the value of buildings is considered to be fatal to the one tax policy that does not damage people's personal or social interests. Even advocates who recognize the wisdom of drawing government revenue from rent retreat from the policy on such grounds. One of them, Malcolm Torry, appealed to the authority of the Bible in support of treating rent as public revenue. And yet, he withdraws his support because

**'Determining the value that accrues to those who occupy land is no easy matter, so it would not be easy to calculate the amount of tax that each occupant of land should pay.'**<sup>1</sup>

And yet, the practice of valuing land has a professional history that ought to have long ago silenced the ideologues who wish to retain the taxes that redistribute wealth from producers to rentier (i.e., landowning) interests. The empirical evidence from the United States goes back to the beginning of the twentieth century, when states began to require separate assessment of land and improvements.

The theoretical strengths and implementation challenges associated with what is now generally referred to as *land value taxation* offers insights to guide tax reform in Britain.

The debate in the United States over how revenue ought to be raised to pay for public goods and services began even before the establishment of the states and the federal government. The taxation of real estate was assigned to local tax jurisdictions to pay for public schools and services provided by cities, towns, boroughs, townships and counties. The quality of implementation has not always followed best practice, leading to charges by taxpayers of inequity and corruption.

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1. Malcolm Torry (2016), *Citizen's Basic Income: A Christian Social Policy*, London: Darton, Longman and Todd.

The need for fundamental reform erupted late in the 19th century when journalist turned political economist Henry George published a forensic critique of the way governments around the world funded public services. In *Progress and Poverty* (1879) he argued on grounds of moral principle and economic efficiency that only the potential annual rental value of a location was the appropriate source of public revenue. Buildings, as legitimate private goods, should be exempted from taxation. Support for George's views mutated into the first global reform movement. But his supporters in America were faced with a difficult legal obstacle: the constitutions of twenty-five states called for uniform rates of taxation on both land and buildings.

As a consequence, proponents of George's reform sought to convince officials to lobby for the local option to implement this radical change in public policy. Commissions were created in many states to hear testimony on the issue, but changes in law were effectively opposed by those who benefited most by maintaining the *status quo*. The breakthrough came in 1913. The state of Pennsylvania enacted legislation that gave two cities – Pittsburgh and Scranton – the local option to impose a higher tax rate on the assessed value of land than on buildings.

## The Pittsburgh model

Pittsburgh taxed locations at double the rate imposed on the value of buildings. William N. McNair, who was elected mayor in 1934, recorded the outcome.

**'After 20 years of taxing houses less than land, I think the people of Pittsburgh are heartily in favour of the system and no one of consequence in Pittsburgh seriously proposes a return to the old system which prevailed prior to the Act of 1913...Much greater benefits will be realized if Pittsburgh's present tax policy is so extended in scope as to materially reduce all taxes on improvements and eventually to eliminate all taxes on improvements.'**<sup>2</sup>

The Graded Tax was a triumph! Its effectiveness, however, depended on the accurate assessment of property values – recognizing that buildings depreciate in value over time, while land values are pulled upward. Pittsburgh was fortunate in having able land appraisers as heads of its City Board of Assessors.<sup>3</sup>

Following the end of the Second World War, civic leaders in Pittsburgh began to focus on modernization of the city's central district. An area of 59 acres of 'commercial blight' was cleared in 1950, replaced by a state park, new high-rise office towers and a new hotel. Pittsburgh's unique property tax structure played an important role:

2. From an address by The Hon. William N. McNair, Mayor of Pittsburgh, Pennsylvania, delivered at the Fifth International Conference to promote Land Value Taxation and Free Trade, Caxton hall, Westminster, London, September, 1936.

3. Percy R. Williams (1963), "The Pittsburgh Grade Tax Plan", New York: Schalkenbach Foundation.

**‘The graded tax offers the incentive of substantially lower taxes for these great private improvement projects...The graded tax also assists in making land more readily available because the higher land tax has checked land speculation by making it unprofitable to hold valuable land out of use and thus tends either to reduce or to stabilize prices.’<sup>4</sup>**

The Graded Tax, however, was insufficiently powerful to compensate for the nationwide stagflation of the late 1970, as well as the lack of permissive statutes for the Pittsburgh School District to enact land value taxation. As a consequence, the base rate to fund the schools exceeded the city rate by the late 1960s. Facing a budgetary crisis in 1979, Pittsburgh increased the rate of taxation on assessed land values, from 4.95% to 9.85%. As a result, the value of building permits issued ‘rose 14% as compared with the 1977-78 average.’<sup>5</sup> The rate was increased again in 1980, along with a three-year tax exemption on the value of all new buildings. Even so, Pittsburgh was plagued by the same economic and financial challenges shared by other northern rust belt cities. The city was losing population to the ring of suburban communities and to the rapidly growing parts of the U.S.

Assessments in the City of Pittsburgh were seriously affected by a change in law. After 1942, responsibility for property assessment was transferred to the County, which employed a methodology that countered the effects of the Graded Tax in Pittsburgh.

**‘[T]he County used a property’s assessed value from the prior year when assessing value in the current year, sometimes with a slight increase in neighborhoods where property values were increasing, and a slight decrease in neighborhoods where values were perceived as declining. Periodically, an entire area was reassessed, though the area may only have comprised a portion of a school district.’<sup>6</sup>**

In 2000, the courts ordered the county to perform annual reassessments on all properties. Some 90,000 taxpayers filed appeals contesting their 2001 valuations, many within the City of Pittsburgh. Several corrective reassessments followed, and, in response to public outrage, Pittsburgh’s elected officials returned to a uniform tax rate on real estate. Construction in Pittsburgh came to a standstill for several years. The city’s population has since 2000 fallen by 30,000 inhabitants. A form of land value taxation does remain in Pittsburgh, however. The Pittsburgh Improvement District continues to employ a surcharge on assessed land values.

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4. *Ibid.*, 59.

5. Gurney Breckenfeld (1983), “Higher Taxes That Promote Development,” *Fortune Magazine*, 8 August. [http://www.cooperative-individualism.org/breckenfeld-gurney\\_higher-taxes-that-promote-development-1983.htm](http://www.cooperative-individualism.org/breckenfeld-gurney_higher-taxes-that-promote-development-1983.htm)

6. *Clifton vs. Allegheny County*, 29 April, 2009.

## The Harrisburg test

The organization whose mission is to work with local government officials to advocate land-value taxation is the Philadelphia-based Center for the Study of Economics (CSE), which appointed Steven Cord, Professor of History at Indiana University of Pennsylvania, as its head in the 1970s.

Prof Cord toured cities large and small across Pennsylvania to promote land value taxation. His efforts, supported at times by local proponents, resulted in a small, and slowly growing list of cities and towns whose elected officials voted to incrementally adopt fiscal reform. Dr. Cord reported in 2000 that each of the 23 Pennsylvania localities that adopted the Graded Tax experienced an increase in the issue of building permits. Similarly-sized nearby communities experienced declines in construction. Since then, a few cities (for reasons different from Pittsburgh's) returned to the traditional uniform rate structure. However, two school districts, one borough and a few new cities have implemented land value taxation. The most significant city was the state capital, Harrisburg.

Beginning in the late 1960s, Harrisburg had fallen into serious decay. In 1981, it was listed as the second-most distressed city in the United States according to metrics employed by the federal government. The city had lost 800 businesses and a third of its population during the previous two decades. The ultimate test for land value taxation began in 1975, when the city initiated a gradual adoption of the measure. The policy was fully embraced by a new mayor, Stephen Reed, who was elected in 1981. During the next two decades, the city periodically increased the tax rate on land, reaching a six-to-one ratio by 2003. When the Philadelphia City Controller asked for information on the results, Mayor Reed reported:

**'Harrisburg...launched aggressive initiatives related to economic development, the creation of non-tax revenue sources, and a constant effort to refine and improve the operations of city government...As part of our economic development incentives, the land-value tax policy is key, and without it, a significant amount of new investment would not have occurred here during recent years.'**<sup>7</sup>

The Mayor celebrated Harrisburg's track record by declaring:

**'In the current era, we have registered in excess of \$3.1 billion in new investment. The number of businesses on the City's tax rolls has increased from 1,908 to more than 5,900. Taxable real estate values have increased from an aggregate of \$212 million to over \$1.6 billion. The number of vacant properties has been cut by 85%.'**

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7. The city made numerous other moves to attract businesses and residents, including attraction (and eventual purchase) of a minor league baseball team and measures to reduce the city's exposure to flooding of the Susquehanna River.

**The crime rate has been reduced 54% and the fire rate has dropped over 76%. Unemployment, which generally ran in the double digits, even in times of a good national economy, is normally less than half those previous rates today.'**

Reed's successors, Linda Thompson (2010-2014) and Eric Papenfuse (2014-) had to deal with financial problems created by the national recession and a general decline in property values after 2008. Harrisburg has the additional problem of having to fund services to tax-exempt state-owned properties, which occupy 42% of the city's land. Whether the current mayor and city council will move further in the direction of land-value taxation or in the reverse direction is a matter that now concerns Joshua Vincent, the current President of the Center for the Study of Economics.

## The power of accurate assessment

The degree to which the beneficial effects of land value taxation are realized depends in part on the quality of assessments. Under conditions of economic expansion and population growth, the value of land will increase. This effect is offset by the depreciation of buildings. Recessions also accelerate the depreciated value of buildings and can erode the value of land. Under such conditions, owners who believe their properties are overvalued will appeal for a downward reassessment.

As the campaign initiated by Henry George gained traction, support came from those who were trained to assess real estate. One of these professionals, in New York City, was Lawson Purdy. In 1906 he revealed how assessment practices had been corrupted.

**'It is notorious that assessments are not generally made as the law directs, at full value, but are made at some arbitrary proportion. The adoption of any standard of value other than that required by law really takes away all standards. Each assessor is a law unto himself, and each assessment becomes a matter of his own arbitrary and secret judgment.'**<sup>8</sup>

Purdy was appointed President of the New York City Tax Department in 1911. He helped to promote legislation, enacted in 1921, to exempt from taxation the value of new construction in the City of New York for 10 years. The result was an impressive \$7 billion building boom, impressive even for the roaring twenties. However, not even this economic stimulus could soften the impact of the Great Depression. The Empire State Building, which opened in 1931, found few tenants, relying on fees from visitors taking an elevator to

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8. Lawson Purdy (1906), "The Influence of Taxation on the Prosperity of Cities." A paper read before the League of American Municipalities, in session at Chicago, 26 September. Reprinted in *The Public*, 6 October, 1906.

the observation deck. Not until 1950 was the building profitable.<sup>9</sup>

In the mid-1960s a young property appraiser named Ted Gwartney became interested in Henry George's philosophy. In 1967, he was recruited by James Clarkson, the Mayor of Southfield, Michigan, to implement the partial exemption of improvements from the tax base. Land assessments were to be brought up to market value. As Ted Gwartney later reported:

**'To accomplish the first reappraisal, the J.M. Cleminshaw Company... was hired. The Cleminshaw Company did a complete reappraisal of land values throughout the city which resulted in an increase in valuation of land parcels amounting to \$45 million. The Council balked, and a compromise was reached by depreciating all buildings in the city by \$22.5 million.'**<sup>10</sup>

Ted Gwartney went on to become one of the nation's leading assessment practitioners. In 1974 he was appointed Assessment Commissioner in British Columbia. Under his supervision, the Canadian state produced the first province-wide assessment of 879,126 properties, whose valued totaled \$42.2 billion.<sup>11</sup>

Drawing on his extensive experience, Ted Gwartney explained to public officials that at some point after the adoption of land-value taxation, assessments needed to be converted from market (capital) values to rental values. In 1992, he authored a paper on the technical process:

**'In 1981, a simple model was used for computer calculation of land values for 1,200,000 residential land sites. The model, which included the size of the plot, the number of building lots into which the original plot can legally be divided, and the location of the plot, was based on analysis of the sales prices for 6,000 residential lots. In this model, the land rental value could be estimated by multiplying the land value by the appropriate capitalization rate. A country adopting a system of land rentals would have actual data for every site in use and could estimate rental value for the unused sites.'**<sup>12</sup>

The ease with which property professionals can assess the market rents of land is beyond question. But despite the important initial successes in Pennsylvania, factors having nothing to do with the positive effects of land-value taxation resulted in decisions to abandon the reform in Pittsburgh, and four smaller cities (Coatesville, Connellsville, Oil City, Altoona). Only by maintaining ongoing contact with current officials, by monitoring changes

9. The underlying land is owned separately, by Empire State Building Associates, comprised of nearly 2,800 investors. The building itself is owned by a partnership between the Malkin family, the Qatar Investment Authority and other foreign investors.

10. Ted Gwartney. "The Southfield Story: A Lesson in Creative Taxation." A paper presented at the Twelfth International Conference on Land-Value Taxation and Free Trade, Caswell Bay, Wales, September 1968.

11. Ted Gwartney (2016), "The Potential of Public Value: Assessing the Dynamics of Real Estate", in Fred Harrison (ed.), *Rent Unmasked*, London: Shephard-Walwyn.

12. Ted Gwartney (1992), "A Simple, Practical Protocol for Assigning Rental Value to Land." An unpublished paper.

in building permits and other economic measures, and testimony at public hearings has CSE been able to maintain existing gains in land-value taxation and convince officials in other cities (in Pennsylvania and, more recently, in Connecticut, Maryland and Virginia) to consider switching to the two-rate property tax structure.

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