

Introduction to Property Tax Policy

(4 hours long)

Module 1 of International Association of Assessing Officers' Property Tax Policy Course

By

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(1) Learning Objectives

After completing this module, the participant should possess:

- ✓ A basic understanding of what a market-based economy is and the benefits that it can produce for society.
- ✓ A realization that the benefits of a market-based economy arise only under restrictive conditions. When these conditions are not met, there may be a role for government intervention. This provides a theoretical justification for government and the need for publicly raised dollars – including property taxation – to support it.
- ✓ A comprehension of how state and local governments in the United States raise own-source revenue and how this revenue reliance changed for local governments in the last 40 years.
- ✓ A working knowledge of current academic thinking on policy debates surrounding the taxation of property; specifically, who ultimately pays property taxes, economic distortions generated by property taxation, and the administration of property taxes.
- ✓ An appreciation for the various roles that property tax assessors can play in the making of property tax policy (providers and interpreters of property tax data, and acting as advocates on property tax related policies).
- ✓ Knowledge regarding the difference between property tax policy advocacy that involves value judgments and ones that does not.

(2) Outline of Material Covered

Also included in separate PowerPoint file.

Introduction to Property Tax Policy

Overview

- ✓ Policy oriented
- ✓ Geared for property tax assessors and legislators
- ✓ Covers
 - Public and private sector roles in a market-based economy
 - Current policy debates in property taxation
 - Role of assessing personnel

Public and Private Sector Roles in a Market-Based Economy

- ✓ Definition of a market-based economy
- ✓ Benefits of an idealized market-based economy
- ✓ Necessary conditions for idealized market-based benefits
- ✓ How market-based economy can fail to generate idealized benefits
- ✓ Functional roles for government in a market-based economy
- ✓ Financing the operation of government
- ✓ Case study: Michigan's property tax reform

Current Policy Debates in Property Taxation

- ✓ Who ultimately pays property taxes?
- ✓ Economic distortions generated by property taxation
- ✓ Case study: Property tax abatement in Metropolitan Detroit
- ✓ Property tax administration
- ✓ Case Study: California property tax equity after 20 years of acquisition value assessment

Role of Assessing Personnel

- ✓ Provider of property tax data
- ✓ Interpreter of property tax data
- ✓ Policy advocate

(3) Narrative

Terms in italics are included in the glossary that follows.

Overview

This is the first module of the International Association of Assessing Officers' (IAAO) Property Tax Policy Course. The overall objective of this module is to provide the motivation and background to complete the remaining seven modules in this total 30-hour course. This is accomplished through an initial presentation on the optimal roles that the private and public sector play in a market-based economy, a discussion of current policy debates in property taxation, and finally a description of the role that assessors can play in implementing and crafting property tax policy.

The first section of this introductory module seeks to develop a simple understanding of what a market-based economy is and the benefits it can produce for society. At the same time, the important point is made that these benefits only arise under restrictive conditions. Examples of how these conditions may not be met are given. But to not imply that government can easily solve the market failures that can arise in a capitalistic system, examples of government failures that can result because of attempts to correct market failures are also given. The purpose of these examples is to demonstrate that there are functional roles for government in a capitalistic economy and the need for publicly raised dollars – including property taxation – to support them. In addition, the first section offers information on how state and local governments in the United States raise own-source revenue and how this revenue reliance has changed in the last 40 years.

The second section in this introductory module describes current policy debates surrounding the taxation of property. These debates are organized under the broad categories of who ultimately pays property taxes, economic distortions generated by property taxation, and issues arising from the administration of property taxes. Though most taking this course are familiar with all of these issues, the objective here is to refresh memories, offer current academic thinking on these issues, and to provide these debates as a reason to take the entire course.

The final section of this introductory module describes the various roles that property tax assessors can play in making and implementing property tax policy. The learning objective is to understand what these basic roles entail and to encourage the community of U.S. property tax assessors to embrace them. Assessor's policy roles are summarized as providers and interpreters of property tax data, and acting as advocates on property tax related public policies. When acting as policy advocates, an important learning objective is the difference between advocacy that involves value judgments and advocacy that does not. Legislators and other policymakers will also learn the potential policy resource that assessors can be.

Public and Private Sector Roles in a Market-Based Economy

Definition, benefits, and necessary conditions

A market-based economy is one in which decisions about the use of resources (labor, land and natural resources, and buildings and machines), and decisions on what goods to produce and consume are primarily based on signals derived from prices generated in markets. These markets consist of voluntary exchanges between the suppliers and demanders of specific inputs and outputs.

There are many private and social benefits that can arise from an economic system based primarily on market transactions. These include: (1) the generation of economic outcomes in which no change in production or consumption could occur without making

someone worse off, (2) a reduced need to coerce individuals to do what is best for all, (3) prices charged for goods that are equal to lowest *average total cost* to produce these goods, and (4) decentralized economic power that is less likely to produce centralized political influences.

Certain basic conditions are necessary to guarantee that a market-based economic system yields the four virtues just described. These conditions include the requirements that a market exists for each good or service generated or desired in the economy, that each market have a large number of potential producers and consumers, and the availability of low-cost information concerning the quality of goods and services produced in each market.

Furthermore, to fully guarantee the four benefits of markets described above, the following must also occur: (1) an individual may only be allowed to consume a good if they pay for it, (2) if one consumes a good then another cannot, and (3) all the costs (benefits) generated by a good must be borne by only the producer (consumer) of the good.

Discussion: Summarize and offer examples some of the private and social benefits that arise in an economic system that is based primarily on market transactions.

Market failure

Understanding the necessary conditions for a market economy to produce only ideal results is easy to see how a purely market-based economy can fail in this regard. For instance, there are many incomplete or non-existent markets for goods. One example is the difficulty many would experience in getting loans for college attendance if state and/or federal governments did not guarantee their payback. In addition, *economies of scale* in production can lead to only one firm (or a monopoly) producing a given good and charging a price for it that exceeds the cost to produce it. A case in point would be the provision of local cable television if

local government did not regulate it. Furthermore, if it were not for government regulatory agencies like the U.S. Food and Drug Administration, it would be extremely costly for individuals to get accurate information on the efficacy and side-effects of medical goods.

Economists also point out that many goods are best considered *public goods* because more than one person can consume them at a time and once they are produced, it is difficult to keep a non-payer from consuming them. If goods of this type are left to only private provision, the private market is likely to fail in achieving a socially optimal amount of production. An example of such a public good, which would be underprovided in a pure market-based economic system, is a local mosquito abatement program. Economists also recognize that in some instances, more than just the supplier and demander of a specific good experience the benefits and costs of producing and consuming that good. A negative *externality* occurs when a portion of the costs of production (consumption) are not paid by the producer (consumer) of the good; for instance, automobile use imposes a social cost in the form of air pollution. A positive externality occurs when the benefits of consumption (production) are enjoyed by individuals other than the consumer (producer) generating them; for example; the completion of primary and secondary education by an individual generates social benefits. In the generation of both negative and positive externalities, there is a possible role for government to intervene and get the producers and consumers of externalities to better account for them in their economic decisions. Should this government intervention not occur, from the perspective of all in society, there will be too much produced of goods generating negative externalities and too little produced of goods generating positive externalities.

Beyond these concerns for the results sometimes generated in markets where government plays no role, it is also reasonable to be concerned about the overall outcomes generated in a purely free-market based economy. These include distributional concerns about the number of low-income people and cyclical concerns like inflation and unemployment.

Discussion: Problems arise in market-based economic systems when there are incomplete or non-existent markets for a good. Besides federal/state guaranteed loans for college, describe another market that would not exist were it not for government activity. What are the benefits created from government intervention to create this market? Are there any costs?

Discussion: Describe the difference between a public good and a private good. What are the problems that arise if a public good is provided by private suppliers and not the government?

Functional roles for government

Given that the conditions necessary for the generation of only desirable results from non-regulated markets do not always exist, there are situations where it is justified for federal, state, and/or local governments to play a functional role in a primarily market-based economy. Economists label these roles as the allocation, redistribution, and stabilization functions of government.

The allocation function involves government actions designed to produce a change to the economy in which some in the economy are made worse off (in terms of dollars lost) in order to make others better off (in terms of dollars gained). In doing so, social welfare is maximized provided the gains to the “winners” exceed the losses to the “losers.” Examples include government-guaranteed student loans, regulation of a *natural monopoly* like cable television, the creation of a government run information clearing house like the U.S. Food and Drug Administration, government production of a public good like mosquito abatement, government set automobile emission standards, and government provision of free and compulsory K-12 public education.

The redistribution function involves government actions to change the purely market-based allocation of wealth, income, and goods into one that society deems more equitable. Examples include cash transfers from the rich to poor, TANF, rent subsidies, farm price supports, public transportation, etc. Finally, the stabilization function involves government actions that smooth out economic cycles and attempt to put the economy on a more stable path of growth. These can include unemployment compensation, deficit spending by government, tax policy, and interest rate manipulation by the Federal Reserve Bank.

In the United States, which has a *federalist system of government*, these functional roles are divided between the local, state, and federal levels of government. Economists generally believe that the allocation function is best handled at the local or state level because of the amount of location specific information that is necessary to implement it. While, the redistribution function is best handled at the state or federal level because mobility between local jurisdictions make it difficult to pursue income redistribution within only a locality because such a policy will drive the rich out of the locality attempting it and attract the poor. While the stabilization function is usually relegated to the federal government due its ability to print money, manipulate national interest rates, and undertake massive tax or government spending changes.

Discussion: The correction of a negative externality in a market, such as the water pollution generated by a private producer that chooses to dump its waste into a river, offers an example of the allocation role that government can play in a market economy. Describe how government intervention in this area could make society as a whole better off.

Government failure

Understanding that market economies can sometimes fail to produce socially optimal results, and that there are possible roles for government to intervene in a market economy and

conceivably produce results that make society better off, it also important to recognize that government can also fail in its attempts at socially optimal interventions. Just as the above-described problems are referred to as market failures, economists also recognize the possibility of government failures in their attempt to correct market failures.

Government failure, in an attempt to correct market failures, are usually related to: (1) lack of information, (2) the influence of special interest groups, (3) bureaucratic costs, and/or (4) and the disincentives generated from taxation. A lack of information can generate a government failure when it intervenes in a market because a good understanding of the social and private benefits, and social and private costs of the failing economic activity are necessary to make the appropriate intervention. In addition, even if a government possesses the information necessary to make an appropriate intervention in the market economy, politics and the undue influence of special interest groups may steer this intervention on the wrong course. Also, since the organization and management of government entities are often large and bureaucratic, the actual cost of intervention may be quite high even if information and politics due not cause problems. Finally, the raising of taxes, which are usually necessary to finance a government intervention in the market economy, impose additional collection and disincentive effects that must be considered when deciding upon the degree of intervention to undertake in a market economy.

The bottom line is that the extent that government gets involved with the allocation, redistribution, and stabilization functions in a market economy should depend upon both an evaluation of the market failures that are occurring and the potential government failures that may occur if the government decides to intervene.

Financing the operation of government

Even though there are theoretical justifications for a limited government role in a market-based economy, the unanswered difficult questions are: How large should the government's role be? Whether the intervention should be handled at the federal, state, or local government

level? And, most importantly for the purposes of this course, how to pay for this government role? Assuming that constitutional, judicial, and political processes handle the issues of how large government intervention should be and what level of government in a federalist system that intervention should occur at, there still remains the question of how to pay for the operation of government in the United States. The use of property taxes for this purpose is summarized next.

The most recent available distribution of *own-source funding* and total funding for all state or local governments in the United States are listed below in Tables 1 and 2.

Table 1

1999 Percentage of Own-Source or Total **State** Revenue From

	Own-Source	Total
Property Taxes	1.5%	0.9%
Sales/Gross Receipts Taxes	35.5%	20.0%
Individual Income Taxes	27.4%	15.4%
Corporate Income taxes	4.6%	2.6%
Current Charges	12.2%	6.9%

Source: U.S, Census Bureau, *1997 Census of Governments*, available at <http://www.census.gov/govs/estimate/00sl00us.html> .

Table 2

1999 Percentage of Own-Source or Total **Local** Revenue From

	Own-Source	Total
Property Taxes	44.2%	23.5%
Sales/Gross Receipts Taxes	10.6%	5.6%
Individual Income Taxes	3.1%	1.6%
Corporate Income taxes	0.6%	0.3%
Current Charges	25.4%	13.5%

Source: U.S, Census Bureau, *1997 Census of Governments*, available at <http://www.census.gov/govs/estimate/00sl00us.html> .

As shown in Table 1, property taxes are an insignificant source of revenue for most state governments in the United States. However, Table 2 shows that property taxes remain the most important source of own-source and total revenue for local governments in the United States. But as indicated in Table 3, own-source local government reliance on property taxation has dropped since 1957.

Table 3

1957 to 1999 Percentage of Own-Source **Local** Revenue From Property Taxation

1999	44.2%
1997	45.3%
1987	45.9%
1977	59.0%
1967	66.2%
1957	69.3%

Source: U.S. Census Bureau, various issues of *Census of Governments*, available at <http://www.census.gov>.

Analysts have attributed the rather drastic drop in property taxation as an own-source of local revenue to various reasons that will be discussed in more detail throughout this course. These include: (1) a growing dislike of property taxation among the economic development community, (2) a growing dislike of property taxation among believers in per-pupil spending equality in public school education, (3) a continued populist belief that property taxes are *regressive*, (4) homeowner's dislike of the property tax because it is levied on an estimated (and often viewed as flawed) base value and levied on wealth (and not income); (5) the fact that property taxes are highly visible and paid in large lump-sums, and (6) even though all taxes are disliked, the property tax is one that people and business feel they can do something about to reduce.

Discussion: Offer two reasons why own-source reliance on property taxation by local governments in the United States has declined over the last 40 years. Give specific real-world examples of these motivators from your own professional experience.

Case study: Michigan's property tax reform

The information for this case taken primarily from Wassmer and Fisher (1996).

In the 1993-94 fiscal year, local property taxes in Michigan provided two-thirds of the revenue needed in the state for the provision of K-12 public education. Just one year later, local property taxes provided only one fourth of the state's public school revenue, while statewide property taxes provided about seven percent. How did such a radical reduction in property taxation come about in such a short time? A quick examination of the Michigan case offers an excellent example of the economic and political forces that have, and continue to drive, property tax reform (reductions) in the United States.

The roots of property tax reform in the United States extend back over the past 30 years. Since the early 1970s, concerns have been raised over the fact that inequalities in per-student property tax bases across local school districts result in inter-district inequalities in per-student spending. This is of special concern because most state constitutions guarantee their residents an "equal" public education. U.S. courts have responded to this concern with the forced implementation of solutions that have effectively moved states away from their reliance on local property taxes for the provision of local public education. In addition, citing the need to offer a competitive business climate, economic development officials have become increasingly concerned about the degree of local property taxation imposed upon mobile business. Furthermore, as demonstrated by the now defunct Advisory Commission on Intergovernmental Relations (A.C.I.R.) polls dating back to the 1970s, only about 10% of Americans believe that a

local property tax increase is the preferred way to raise a small amount of additional local revenue.

Thus, state policymakers have looked to reduce property tax reliance to equalize local public school spending, to win voter support, and to further the cause of state and local economic development. This melding of the drive to equalize local per-pupil spending in public schools, along with increasing pressure from individuals and economic development officials for property tax cuts, goes a long way toward explaining property tax cuts in the United States and Michigan. Though, at least in the case of Michigan, its radical reduction in property tax reliance to fund public school expenditures would not have occurred without the political environment that existed in that state in 1993.

By 1993, Michigan voters had faced 12 different initiatives that had asked them to approve various forms of school finance and property tax reform. The motivation for these initiatives, at least in part, was the failure of the state's system of *power-equalized aid to local school districts* to alleviate larger per-pupil spending differences in the 20 years that it had been in place. But all of the initiatives, which substituted some form of statewide tax for a reduction in local property taxes for schools, had been rejected. As an example, in June of 1993 Michigan voters rejected Proposal A – by a 54% margin – that would have cut local school property taxes by 30% and raised the flat rate of the state's personal income tax from 4% to 6% to replace the lost revenue.

In response to the rejection of Proposal A, in the summer of 1993, Republicans in the state's legislature proposed property tax cuts that received strong support from Michigan's Republican Governor Engler, but only lukewarm support from Democrats in the legislature. To the surprise of many, and likely motivated by a growing dislike for the inherent inequity they generate in per-pupil spending, in September of 1993 a Democratic state representative proposed the elimination of all local property taxes for public schools beginning in fiscal year 1994-95. Even though no form of replacement revenue was mentioned, the truly radical bill

passed and work immediately began in the Michigan Legislature on a way to replace the lost revenue of \$6.5 billion (or 20% of total state expenditure). A final agreement on possible forms of revenue replacement was not reached until Christmas Eve 1993.

The legislative agreement called for a March 1995 referendum to raise the state's sales tax rate from 4 to 6%, a slightly lower flat rate of state income taxation, a higher rate of cigarette taxation, an *acquisition value system of property tax assessment* on primary residential property that limited yearly non-sale assessment increases to the lesser of inflation or 5%, and a system of lower statewide property taxes. If this referendum failed, legislation would automatically go into effect to raise the state's personal income and business tax rates. Perhaps not surprising given the choice, the referendum was adopted by Michigan voters with a 65% majority.

Discussion: Offer the reasons why both politically conservative and politically liberal politicians can support a reduction in local property tax reliance. Was this the case in Michigan in 1993?

Current Policy Debates in Property Taxation

This section of the first module on property tax policy offers an introduction to some of the current policy debates in property taxation. These debates are divided into four broad categories: (1) who ultimately pays property taxes, (2) countering a populist argument that is often made (3) economic distortions generated by property taxation, and (4) property tax administration.

Who ultimately pays property taxes

The issue of who ultimately pays property taxes is usually broken down into a comparison of whether high-income people devote a larger, smaller, or equal percentage of their income to this expenditure than low-income people. This determination of *income*

incidence is an important factor in regard to society's evaluation of the fairness and ultimate desirability of using property taxation as a revenue instrument for the provision of government services.

The academic debate on this issue has been divided into three camps. These camps have come to be referred to as the Traditional View, New View, and Benefit View. The Traditional and New Views separate the forms of property that are taxed into land (immobile factors) and structures (mobile factors), and rely on separate market (supply and demand) models of land and structures to predict the final income incidence of property taxation. For the purpose of these analyses, land and structures are assumed to have both an owner (supplier) and a renter (demander). If someone owns a piece of property and uses it herself, they take on the role of both owner and renter. The Traditional and New Views reach different conclusions on income incidence based upon the models' different underlying assumptions. Though one important assumption made in both the Traditional and New Views is that the local provisions of goods and services are not affected by local changes in the property tax rate. Local governments rely on alternative revenue sources to provide the same level of services when the rate of property taxation is cut.

The Traditional View of who pays property taxes assumes that the supply of land in a jurisdiction levying a property tax is fixed. Thus, if a tax on land is put in place, the after-tax return of the land falls by the full amount of the tax and the owner of land bears the full burden of tax. The Traditional View also presumes that the supply of structures to a jurisdiction is infinite at a market rate of return to them that is determined throughout the economy. This means that a city can continue to get builders to put up additional structures in their jurisdiction, as long as the return on these structures equals the market rate of return generated everywhere. In this case, if a property tax is levied on structures in a jurisdiction, the rate of return from a structure (determined by the rental income stream) in that jurisdiction must rise by the full amount of the tax. If it does not rise, then existing structures will leave the jurisdiction

and no new structures will be built there. This reduction in the supply of structures drives up rental rates in the jurisdiction. As a result, demanders of these structures, or renters, pay the full property tax.

Under the Traditional View, the land portion of property taxes is borne by landowners in proportion to the fraction of income that they receive from land rents. Since the wealthy receive a larger portion of their income from land rents than the poor, this portion of the property tax is considered *progressive* (the rich devote a greater percentage of their income to it than the poor). Following the model used in the Traditional View, the structure portion of the property tax is borne by people in proportion to the fraction of their income devoted to housing. Since in any given year the poor devote a greater portion of their income to housing expenses than the rich, the structure portion of the tax is viewed as regressive; though there is some evidence that the structure portion of this finding changes if examined over a lifetime of housing consumption (in which low and high income people are more likely to devote equal percentages of lifetime income to housing). Most ignore this life-cycle finding and conclude that the structure portion of the property tax under the Traditional View is regressive. Since a larger percentage of property tax revenue is collected from structures than land, the conclusion reached using the Traditional View is that the property tax is regressive in its income incidence.

Alternatively, the New View considers property taxation to be a general tax on capital (which includes both land and structures) throughout the United States; with some jurisdictions taxing above the average rate observed in the country and some taxing below it. Under the New View, property tax effects are divided into two separate effects, the general tax effect and the excise tax effect. The general tax effect indicates – to the extent that the supply of land and structures in the United States is fixed – that the average rate of property taxation in the country depresses the return on these assets by the full amount of the tax. The excise tax effect recognizes that jurisdictions tax property at a rate above and below the average rate in the country. If possible, owners of structures will thus move them out of high property tax rate

jurisdictions and into low property tax jurisdictions. This is expected to continue to occur until the after-tax return on structures is equal across jurisdictions. The result is a complicated adjustment process that can lower (raise) structural values and wages in the short term in high (low) property tax jurisdictions, and lower (raise) land values and employment in high (low) property tax jurisdictions in the long term.

Under the New View, the general tax effect of property taxation in the United States is borne by people in proportion to the fraction of income received from property rents. As in the land portion of the Traditional View analysis, this makes it a progressive tax. Since most conclude that the general tax effect is larger than the excise tax effects, the conclusion from the New View is that the rich devote a larger percentage of their income to paying property taxes than the poor. This overall progressive determination of the income incidence of property taxation is the opposite of the overall regressive finding derived under the Traditional View.

Both the Traditional and New Views of property taxation ignore the fact that if you pay higher property taxes to a jurisdiction you may get a greater level of local services from that jurisdiction. If people and businesses are mobile across property taxing jurisdictions, they will seek jurisdictions that offer the mix of local government services that they desire at the lowest local expense (including local property taxes). This will raise demand for land in local jurisdictions that provide desired local services at a low local charge and raise land prices in such jurisdictions. In turn, this mobility will lower demand for land in local jurisdictions where desired local services are only obtained at a high expense and lower land prices in such jurisdictions. Under certain conditions, mobility and the *capitalization* of the local fiscal package into local land values can make the property tax more like a local fee for local government services. If this is the case, of paying for a given set of local services with low property tax rates and high land prices, or paying for the same given local services in another jurisdiction with high property tax rates and low land prices; the property tax can become a benefit tax. Since you get

what you pay for, this Benefit View of property taxation concludes that there is no need to consider the income incidence of the property tax.

As Youngman (2002) points out in her clear interpretation of the Benefit View:

The concept of regressivity itself must be reexamined when the tax is analyzed as a payment for services. For example, it could readily be established that food, shelter, and other basic necessities require a diminishing proportion of income as household income rises. Increased discretionary income means that a lower proportion of income is devoted to nondiscretionary necessities. But that does not imply that food or shelter prices are best analyzed as regressive taxes, or that society would be better served by substituting a different price system for these commodities. If the tax is viewed as part of consumer activity, the focus of the inquiry has shifted from a one-way payment -- the government's collection of a specific amount from each taxpayer -- to a market exchange of money for goods and services.

A major assumption of the Benefit View is that residents choose a residence in a particular city in a metropolitan area in part based upon the local services they get for property taxes paid. If the poor are mobile (which is an important assumption that is often not the case) they cannot live in a community that has high property taxes and high services unless they really sacrifice and give up a lot of their other consumption. This is the same as the poor cannot have expensive clothes, restaurant meals, cars, etc. For these privately provided goods they purchase what they can afford and there is no discussion of purchases in these markets being regressive, just as under the Benefit View there is no discussion of regressivity of local property taxes because it is a fee for service. The concern is over the poor having enough resources to purchase the necessities of life, not the property tax itself. The Benefit View is only relevant if people have many communities to choose to live in, as in a large metro area, and they are mobile between location choices. Since this is often not the case, this is not the best overall way to think about property tax incidence and hence the general conclusion that it is appropriate to think about it as progressive in its income incidence.

Given these three alternative views of how to think about the incidence of property taxation, it is not surprising that a populist debate still exists around the question of whether high or low-income people devote a greater percentage of their income to paying property taxes.

Since most existing policymakers were taught the Traditional View, property taxation is often described as regressive in political discussions. On the other hand, the consensus among public economists, who favor the more complex New View, is that the property tax is best considered progressive. Then again, there are public economists who believe in the capacity of mobility and capitalization to turn the property tax into a benefit tax. For a more complete description of this debate see Youngman (2002).

Beyond the important concern of whether property taxation in general is best considered a regressive or progressive tax, or whether one should ignore the income incidence of property taxation; the New and Benefit views of property taxation described above offer valuable theoretical approaches to think about the impact of various real world property tax changes. These are summarized in Table 4 below.

Table 4
Models to Best Analyze a Hypothetical Change in Property Taxation

Property Tax Policy Change	Model To Use	Expected Results
(1) The average rate of property taxation in the United States declines with no change in the level of state and local government services (revenues to continue to provide these services are made up in other ways).	New View – general tax effect	<p>This results in an increase in the return from owning property in the United States and benefits owners of property if supply of property in United States is fixed (definitely the case for land).</p> <p>The rich benefit from this change more than the poor because a greater percentage of their income is earned from property ownership. But if this reduction in property taxation brings in more mobile property to the U.S. (machines, buildings, etc.), benefits in the form of higher wages or greater employment extends to workers that use the additional property.</p>
(2) A state cuts its rate of property taxation to half the national average rate of property taxation and at the same time does not cut back on its provision of government services	New View – excise tax effect	Buildings, machinery, and inventories are usually moved to a state that lowers its rate of property taxation because the rate of return on this property rises if the rate of property

<p>(revenues to continue to provide these services are made up in other ways).</p>		<p>taxation on it is cut. While workers and homeowners are less likely to move between states just due to property tax changes.</p> <p>The buildings, machinery, and inventory that move into the lower property tax state require land to locate upon and land values are driven up in the state. This benefits the rich more than the poor because they derive a greater fraction of their overall income from land rents. At the same time there is now a greater housing stock in the state that has cut its rate of property taxation and prices and rental rates on housing should fall along with an increase in wages paid the fixed labor force in the state.</p>
<p>(3) A city, which was previously taxing property within its boundaries at a rate similar to other cities in its metropolitan area, cuts its property tax rate in half and finances the cut with an increase in local sales taxes and fees. It provides no more or no less local government services after this change.</p>	<p>New View – excise tax effect</p>	<p>It is likely that buildings, machinery, and inventory can be moved between cities in a metropolitan area. If the rate of return offered this mobile property rises in one city, due to a property tax cut, mobile property will migrate to that city. It also likely that workers and homeowners will seek employment and residence in this lower property tax city.</p> <p>All of these occurrences will increase the price of land in the lower tax city as mobile property owners, employees, and homebuyers seek it out. This will benefit the rich more than the poor since they are more likely to have owned this land before the tax cut. There will be more residents and workers in the now low property tax city. Though, wages paid in the city will eventually be the same as elsewhere in the metropolitan area because employee mobility between cities in the metropolitan causes them to equalize.</p>
<p>(4) Voters in a bedroom community in a metropolitan area that is completely built up with homes vote to raise their rate of property taxation to fund an increase in local library services that a vast majority</p>	<p>Benefit View</p>	<p>Homeowners in the community view this local property tax increase as a fee for a service that they desire. (No different than if the went to the local bookstore to buy desired books.) This policy change does not cause owners</p>

<p>of residents in the community support.</p>		<p>of property to leave or enter the community. Land values in the city remain the same.</p> <p>There is no reason to think about how this change affects the rich or poor differently because most in community desired it. For the few that perhaps did not wish to pay more property taxes for more local library services, they have the option of leaving the community for another one in the metropolitan area with lower property taxes and less local library services.</p>
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Countering a populist argument that is often made

Populists, including many legislators (from either political party) often anecdotally point to the fact that some people of limited income end up owning land or property that has a high market value and thus end up paying high property taxes. Often times the anecdotes that are relied upon are based on farm land or resort property (such as a home on a lake) which has become more valuable as a result of recent phenomena, such as development or recreational desirability of adjacent parcels.

The situation just described is not the general case, but the special case where an area becomes "gentrified" or in greater demand than it was previously. This increase in demand will raise land and fixed property values in that area. If a market based system of assessment is used, this will raise the property tax payments of people owning property in that area. In most cases, the people who own such property are higher income folk. But the case could be made of a rural lake in which low to middle income residents lived on it and it became popular as a place to put up a "trophy" home; or the case of low income folk living in an established central city neighborhood where higher income people are moving in, tearing down existing homes, and putting up larger more valuable homes. This would raise land values for these low and moderate income people and they would pay higher property taxes if their property is assessed

in relation to market value. The important point is that this is more the exception than the rule and it does not change the overall finding that property taxes as a whole are progressive.

Though policymakers are correctly concerned about this exception because it does cause a low income person to devote a higher percentage of their low fixed income to these taxes and the circuit breaker programs discussed later are the appropriate solution to dealing with cases like this. Though a counter argument, that does not usually fly politically, this is that formerly low income people are no longer so after this increase in land values. Their "potential" income from their increased wealth of higher land values has risen. They can tap into this potential income to pay these higher property taxes.

This situation does exist that there are some poor people who devote a greater percentage of their income to property taxes than some rich people, but the point that economists make is that it does not exist often enough to counter the New View conclusion that high property tax rates, for a given level of local services provided, reduce the value of land (as measured by selling price or rental rate) in the community that exhibits them. Since the wealthy receive a greater portion of their overall income from land holdings than the poor, high property taxes, or the depressed land values they generate, fall upon the rich to a greater extent than the poor. This makes the overall system of state and local property taxation in the United States a progressive tax (i.e., the rich pay a greater percentage of their income in property taxes than the poor).

Beyond the important concern of whether property taxation in general is best considered a regressive or progressive tax, or whether one should ignore the income incidence of property taxation; the New and Benefit views of property taxation described above offer valuable theoretical bases to think about the impact of various real world property changes. These are summarized in Table 4 below.

Discussion: Explain why in the Traditional View of the income incidence of property taxation, that the portion of the tax that is levied on structures is considered regressive. Is there a life-cycle occurrence that could mitigate this conclusion?

Discussion: Under the New View of the income incidence of property taxation, the excise effects of property taxation result in the short term in lower wages for a jurisdiction with high property taxes, and in the long term in lower employment in the jurisdiction. Explain the mechanisms that cause this to occur.

Discussion: Why does the Benefit View of property taxation conclude that it is unimportant to consider the income incidence of the tax?

Economic distortions generated by property taxation

Related to the debate over whether property taxes are best viewed as benefit taxes, is the policy issue of how much the taxation of property distorts investment and consumption decisions. If property taxes always act as benefit taxes, then no distortion can occur. But most public economists agree that the Benefit View only fully applies where mobility among alternate jurisdictions is possible and state and local fiscal packages are perfectly capitalized into local land values.

The taxation of property is expected to generate greater economic distortions the greater the differential in property tax rates among jurisdictions and the shorter the time period under consideration. In a short time period, economic distortions can arise because land values are less likely to have fully adjusted to differences in fiscal packages. In these situations, given that jurisdiction A has a higher rate of property taxation than jurisdiction B, and that jurisdictions A and B both offer the same package of local government services and charge residents the same

fees and other taxes; jurisdiction A is likely to have fewer business buildings and machines, and exhibit a lower upkeep of existing residential structures. This also causes businesses in jurisdiction A to pay lower wages and employ fewer people.

These economic distortions send shivers down the spines of economic development officials within a jurisdiction, and politicians who run on the voter-desired platform of jobs, jobs, and more jobs for a jurisdiction. Thus, it is no surprise that the reaction by state and local policymakers in the United States has been the movement to reduce overall reliance on property taxation, grant targeted property tax abatements, and allow *Tax Increment Financing* (TIFs). A TIF, or the allowance that a zone within a jurisdiction gets to keep the increment in property tax revenue growth occurring within the zone for the funding of capital projects within the zone, makes the property tax more like a benefit tax for businesses residing in the zone.

Besides property tax abatements (which are discussed further in the case below) and TIFs, there are other alternatives to reducing economic distortions generated from property taxation. One possibility is property tax revenue sharing among jurisdictions in a metropolitan area. As practiced in the Minneapolis-St. Paul Metropolitan Area of Minnesota, 40% of the growth in a city's locally generated property tax revenue is placed in a regional fund that is then distributed back to all cities based on their percentage of property tax base relative to the entire region. This reduces the economic distortions generated through local property tax differentials in a metropolitan area by discouraging business and residential mobility for only the reason of high property tax rates/low local government service levels. Since the fiscally more attractive communities are usually likely to be at the periphery of an urban area, such a plan could also reduce "urban sprawl".

Another alternative to reducing the economic distortions likely generated through property taxation is the adoption of a property tax roll that splits the taxation of land values from other forms of property. Such an idea - first proposed in 1879 by Henry George and currently used in the City of Pittsburgh - taxes the land component of property at a higher rate than the

structure/machine/inventory components. Since land is immobile, while structures, machines, and inventories can be very mobile, such a split role can discourage property mobility away from high property tax/low government service jurisdictions. Oates and Schwab (1998) have found evidence in support of this assertion for Pittsburgh. The alternative of taxing land at a lower rate, as practiced in programs intended to preserve land used for agriculture, is discussed later.

Case study: Property tax abatement in Metropolitan Detroit

The information for this case taken primarily from Anderson and Wassmer (2000).

Under the Plant Rehabilitation and Industrial Development Districts Act (Public Act 198) of 1974, the State of Michigan has granted municipalities, townships, or villages the authority to grant property tax abatements to companies that invested in new facilities or rehabilitated existing but obsolete facilities. To accomplish this, the jurisdiction has to first designate a redevelopment district. These districts can be established with the permission of the owners of three-quarters of the property value in the district. After the district is established, the firm within such a district applies for an exemption certificate that entitles it to property tax abatements for up to twelve years. At the end of twelve years a renewal of the property tax exemption is available by request and the reality is that most requests have been granted. For a new facility, the certificate provides for the abatement of half of the taxes on the property (both real and personal). After the granting of this abatement the property tax rates for all government units are reduced to one-half their normal level. For a rehabilitated facility the assessed valuation of the property is frozen at its pre-rehabilitation level and all accretion to value due to the investment project is tax exempt.

Local governments in Michigan are given wide latitude in establishing districts and granting manufacturing property tax abatements. If the amount of property involved with the establishment of an abatement district exceeds five percent of the total manufacturing property in the jurisdiction, the district is required to prepare a report indicating that the abatement would not impair the fiscal health of the jurisdiction. Michigan jurisdictions are also required to assure

state officials that there is a “reasonable likelihood” that employment is created or retained through the granting of the abatement. Since the Act contains no specific definitions of reasonable or likely, this requirement offers little hindrance to the formation of districts and granting abatements.

Under Public Act 198 the local governmental unit approves the application for an exemption and the State Tax Commission at the Michigan Department of Treasury reviews the application and grants the certificate. Though the Commission does possess the ultimate ability to veto a local abatement, this capability is rarely (if ever) used. To try and avoid the escalation of job wars between jurisdictions, PA 198 also includes a provision that if the abatement were to cause employment to be transferred between two Michigan communities, the exemption certificate will not be granted unless the community losing employment approves. To squelch what could be considered unnecessary abatements, in 1988 PA 198 was amended to require that once a district was formed, property tax abatements had to be granted within six months of the beginning of construction.

The local ability to grant manufacturing property tax abatements in metropolitan Detroit has been used to widely varying degrees over time. Table 4 provides descriptive information on the average percentage of manufacturing property granted abatement in 12 metro Detroit area municipalities for the first 20 years of the program’s existence. For the first four years of the incentive’s availability (1974 to 1977), only 14 percent of the communities in the metropolitan area granted any manufacturing property tax abatements. The greatest frequency value of new abatements offered by a community during this period fell between one and five million real 1990 dollars. The City of Detroit offered abatements that totaled \$180 million to manufacturing property between 1974 and 1977.

The five-year period between 1978 and 1982 was marked by a great expansion in the number of communities granting manufacturing property tax abatements. During this period,

Table 5

1977 to 1992 Average Percentage of Manufacturing Property Granted Property Tax Abatement for 112 Metropolitan Detroit Area Municipalities

1977	1982	1987	1992
0.02	0.14	0.27	0.35

Source: Anderson and Wassmer (2000).

the number of jurisdictions granting new manufacturing abatements grew from 16 to 49 of the 112 communities in metropolitan Detroit. In 1982 only a little more than half of the jurisdictions in metropolitan Detroit communities refrained from offering any manufacturing property tax abatements. In 1990 dollars, 29 of the 49 communities offering new abatements granted fewer than \$20 million in total community abatements. Another ten communities granted new abatements that totaled for each city between \$20 million and \$60 million. Two communities granted new abatements in excess of \$80 million, but less than \$100 million. While eight communities granted new abatements in excess of \$200 million.

As shown by Table 4, the offering of new manufacturing abatements grew during the 1983 -1987 period. In the previous five-year period 49 communities chose to offer manufacturing abatements. By this period, the number had grown to 69. The greatest frequency of abatements occurred in the one to five million real dollar range. This finding is the same for the previous two periods observed. In the 1983 to 1987 period, the number of communities choosing to offer greater than \$200 million in new manufacturing abatements fell to six. The period 1988 through 1992 saw a reduced reliance on local manufacturing property tax abatements, though the cumulative percentage distribution looked similar to earlier periods. Of the 112 communities in metropolitan Detroit, 60 offered no new manufacturing abatements during this last time period. Of the remaining 52 communities offering new abatements, 34 offered abatements of less than \$40 million. Another 9 communities offered between \$40

million and \$100 million in abatements. At the top of the abatement distribution were seven communities offering more than \$100 million in new manufacturing property tax abatement. During this last period, the cities of Detroit and Livonia each made abatement offers of around \$660 million.

In a thorough statistical analysis of this data, Anderson and Wassmer (2000) show that the efficacy of these abatement offers – defined as directing manufacturing activity to jurisdictions it would not have gone to without abatement – declined over time. The reasons given for this is that the initial jurisdictions that offered abatements in the Detroit metropolitan area were ones that were at a competitive disadvantage and used the incentive as a way to overcome it. Over time, other jurisdictions offered abatements to retain the competitive location advantage they would have had without the ability of any communities to grant abatement. When communities are left to their own devices, property tax abatements are increasingly offered by communities that do not fit the “high unemployment and fiscally blighted” characterization of communities that abatements were originally intended to assist. Anderson and Wassmer recommend that since a strong argument can be made for the social benefits of only these type of communities being able to offer incentives, and since the state possesses the constitutional power to regulate the offering of all local incentives within its boundaries, states should restrict the use of abatements to communities that are at a location disadvantage due to high local property taxes and/or low local government services provided to businesses.

Discussion: Would you describe the use of manufacturing property tax abatements in the Metropolitan Detroit area as a success? Would you be in favor of eliminating the use of property tax abatements altogether, or reforming the mechanism by which they are offered. Offer some specific suggestions.

Property tax system design

The final set of policy debates relating to property taxation in the United States is centered on the administration and collection of these taxes. Since property taxes are levied on a base whose value is not easily determined, the first administrative debate surrounds the determination of market value. Since the base for property taxation is often the market value of property in a given year (or a set percentage of it), and only a small fraction of properties sell in a given year, assessors are faced with the difficult task of estimating market value. The issue of which is the best method to estimate the market value of a property – either the comparative sales, cost to replace, income generated, or some combination of all three – have left the realm of discussions among professional assessors and spilled over to the courts with property owners appealing what they view as an inaccurate representation of the market value of their property.

Besides a split property tax roll that would tax the land component of property more heavily than improvements, debate continues as to whether or not to tax business property at a higher or lower rate than residential property. As a way to raise additional revenue, California is currently considering the taxation of business property at a higher rate than residential property through the reinstatement of market value property assessment for business and the retention of acquisition value assessment for homeowners. Proponents argue for the additional revenue this would raise without necessarily upsetting voters while opponents point to the real and perceived negative business climate this creates for the jurisdictions adopting it.

On the residential side of property tax administration, policy debates persist on the desirability and appropriate way to grant relief to those considered to be paying too much of their annual income in property taxes. One form of property tax relief is a homestead exemption that allows the exemption of a specific amount of a person's residential property value from taxation. In many states these exemptions are restricted to low income, senior, veteran, and/or disabled heads of households. A second, and more targeted option currently used to grant

residential property tax relief has come to be termed a circuit breaker because it only applies to property taxes that exceed some specific percentage of a person's income or is based upon a sliding scale that is phased out as one's income rises. Qualifying individuals are allowed to deduct excess property taxes from state income tax obligations.

Policy discussions continue on the desirability of limiting property taxes on agricultural land. The goal of these programs is usually given as farmland preservation. The need for such a program is that farmland on the edge of urban areas may exhibit a market value that is greater than what a farmer would pay for the land if it was only intended for agricultural production. If such land is valued for tax purposes based upon its best use, and not its current agricultural use, then farmers are more likely to sell the property to a nonagricultural user. The controversy that arises is whether farmers should be allowed to pay property taxes based upon current use-value assessment, as most states currently allow, or should the market be allowed to function in its guidance of the property towards its "highest and best" economic use. Recent concerns over urban sprawl and open-space preservation have brought such agricultural exemptions back to the forefront of urban tax and land use debates.

The final policy issue regarding property tax administration is the use of acquisition value assessment as compared to market value assessment. Acquisition value assessment is a form of property tax relief that usually requires that a property only be assessed at its market value in the years that it sells. In the years that a sale does not occur, assessed value increases are limited to a fixed rate and/or a rate that does not exceed the rate of increase in the consumer price index. This method of property assessment was first adopted in 1978 under California's Proposition 13.

The beneficial aspects of acquisition value are that it results in people and business paying less property tax over time, is much easier to administer than market value assessment, allows income constrained people to keep their house, and discourages residential mobility. Some may ask why less residential mobility is necessarily a plus. Well as determined by the

U.S. Supreme Court in their overturning of a case that challenged the federal constitutionality of acquisition value based upon equal protection under the federal constitution, less mobility encourages the formation of neighborhoods that are “better” due to the fact that people have lived in them for a long time. In the Supreme Court’s view this “benefit” is enough to override the concern that a neighbor who has lived in their home longer than you, receiving the same local services as you, can pay less local property taxes for the same services. Besides this fairness concern, the negative aspects of acquisition value include a reduction in the local government revenue stream and the discouragement of new business activity because start up business pay more in property taxes than existing ones. Further background on the effects of acquisition value assessment in California is offered in the next case study.

Discussion: Describe the advantages and disadvantages of using a split property tax role in the forms of: (1) taxing the land component of property different than the remaining components, and (2) taxing residential property at a different rate than non-residential property.

Discussion: Offer an economic-based argument of why it may not be a good idea for a state to allow a farmland preservation based break on property taxes. What effect do such programs have on the generation of urban sprawl?

Case study: Property tax equity in California after 20 years of acquisition value

Reprinted with permission from Sheffrin and Sexton (1998).

Note to IAAO: Need to get PPIC permission to use this.

Under Proposition 13, [in California] the assessed value of property cannot increase by more than two percent per year until the property is sold, at which time it is reassessed at its full market value, usually the selling price. Until the early 1990s, inflation in real estate generally

exceeded 2 percent per year, creating a widening gap in property taxes between homes bought more recently and those owned for many years. However, from 1991 through 1995, California experienced a severe recession. Property values fell throughout the state, dropping as much as 30 percent in many places. Although the decline in property values helped to eliminate some of the inequities in the property tax system, reducing the gap between market value and assessed value, it also placed a tremendous strain on California's under staffed and under funded county assessors' offices. As property values fell, residents and businesses throughout the state inundated county assessors with appeals for reassessment.

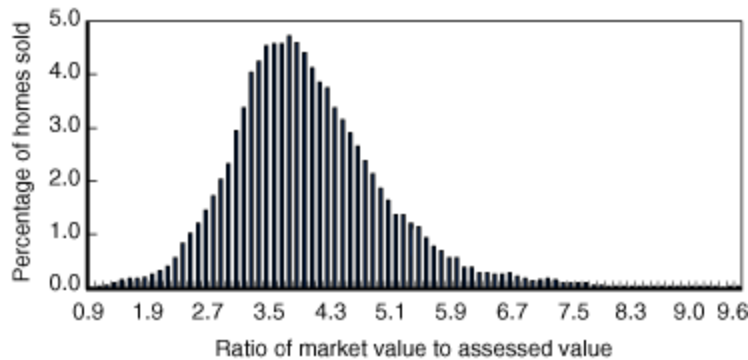
When the voters passed Proposition 13 in 1978, assessments were rolled back to the property values that prevailed in 1975. This was the initial "base year" for all existing properties in the state. When property is sold, it is reassessed and assigned a new base year. As long as housing price inflation exceeds 2 percent per year, properties with more recent base years will be assessed closer to market value than properties with older base years. The base year is the key piece of information needed to estimate the disparity between market value and assessed value, which the authors [Sheffrin and Sexton, (1998)] define as the disparity ratio. Once they have identified the base year of a property, they can calculate the disparity ratio by dividing the market value of the property by its assessed value in the preceding year. They did this for properties sold in Los Angeles and San Mateo Counties in 1990-1991 and in 1995-1996, the years bracketing the recession. The analysis involved about 8 million property records for Los Angeles County and 1.4 million for San Mateo County, with base years running from 1975 to 1996.

The figure below shows the distribution of disparity ratios for single family, owner-occupied homes in Los Angeles County that had a base year of 1975 and that were sold in 1995-1996. The median disparity ratio for all these homes is 3.84. This means that an average new homebuyer in Los Angeles today will pay almost four times the basic property tax as a household that has been in its home since 1975. The disparity between market and assessed

value was much greater in 1991, when the median disparity ratio for 1975 base year property was 5.19 or 26 percent higher than in 1996. The decline in the disparity ratio was a direct consequence of the recession and falling real estate prices.

Figure 1

Disparity Ratios for Properties in Los Angeles County: 1975 Base Year



SOURCE: Authors' analysis of data obtained from the Los Angeles County Assessor.

The fraction of 1975 base year property also decreased substantially during this period. In 1991, 43 percent of all properties in Los Angeles County had 1975 base years. By 1996, the number had fallen to 33 percent. Two primary factors contributed to this decline. First, some of the 1975 base year properties were sold and thus assumed later base years. Second, new construction increased the total number of properties and thereby reduced the 1975 base year percentage. The 1975 base year percentages are key statistics because they are the most important source of property tax disparities. The median disparity ratio in all base years after 1980 currently falls below 1.3, and a 30 percent difference between assessed and market values is not unusual in states using a market-value-based rather than an acquisition-value-based property tax system. In other words, the inequity of the post-Proposition-13 tax system is not that serious in the case of properties with base years after 1980. Whether inequities in the

property tax system will continue to be reduced through turnover and new construction depends largely on two factors. The first is property appreciation. If housing inflation again begins to exceed 2 percent per year on a sustained basis, inequities will increase. The second factor is the stock of 1975 base year housing. Whether the owners of these properties sell or pass the properties on to their children or grandchildren (and thereby maintain the base year) will largely determine whether the number of such properties - those with the greatest disparities - will decrease over time.

Before 1991, the assessor's job was relatively easy. For the majority of properties, it was simply a matter of adjusting the previous year's assessed value upward by 2 percent or the rate of inflation, whichever was smaller. However, between 1991 and 1996, hundreds of thousands of property owners who believed that the market value of their property had fallen below the base year value filed appeals for reassessment. Under Proposition 8, a constitutional amendment passed by California voters in 1978, such properties must be reviewed and reassessed each year until the market value again exceeds the factored base year value (base year value plus 2 percent for each subsequent year). If an appeal is not resolved within two years, the assessor is obligated to enroll the property at the value claimed by the owner of the appeal (which may be artificially low).

At the same time that hundreds of thousands of appeals were being filed, assessors' budgets were being cut. In 1992 and 1993, at the peak of the recession, the Governor reduced the state's financial obligations to schools by shifting \$3.4 billion in property tax revenues from local agencies to schools through the Educational Revenue Augmentation Fund. This led to a significant reduction in counties' share of property tax revenues, which continues to this day. For example, Alameda County saw its revenue share decline from 40 percent to 16 percent, and Orange County keeps only about one nickel of every property tax dollar collected in the county. Although the state enacted certain measures to help counties enhance their property tax administration, including a temporary loan program that enabled assessors' offices to hire

additional staff, many counties were still working through a backlog of appeals cases several years later. Although property values have more than fully recovered, property tax administration problems remain. Because counties' share of property tax revenues is so small, they have little incentive to spend their scarce budgetary dollars on staffing and modernizing assessors' offices, at the expense of other county services. One solution to the budgetary problems would be to ensure that all recipients of property tax revenue pay a portion of the administrative costs, in proportion to what they receive. This was the essence of a bill passed in 1990, SB 2557. However, in 1991, schools were exempted. According to the allocation of property tax revenues in 1995-1996, schools received over 53 percent of all property tax revenues. Thus, under this proposal, the state would pay 53 percent of property tax administration costs on behalf of schools. However, relieving counties of some of the administrative costs does not provide them with the type of incentives for thorough and accurate assessments that come with having a larger stake in the outcome, namely, property tax revenues. A better (but politically difficult) solution would be to shift property tax revenues back to counties as their primary source of revenue.

Discussion: The acquisition value method of property tax assessment has become popular in the United States. Describe its political and economic advantages and disadvantages relative to the more traditional form of market-based property tax assessment. What has California's experience been with 25 years of using acquisition value assessment?

Role of Assessing Personnel in Property Tax Policy

A property tax assessor in the United States can serve at least three roles in the crafting of property tax policy. The possible policy roles for an assessor include being a provider of the data necessary to craft such policy, acting as a the expert interpreter of the derivation and

meaning of property tax data, and a policy advocate for widely accepted property tax principles and practices. Each of these roles is discussed next.

Provider of property tax data

Analysts, citizens, and business people will seek information on property tax institutions, assessment methods, and taxable property values from assessors. To the extent possible, the crafting of good property tax policy necessarily requires that the assessor respond to these inquiries. The creation of a handout or web posting that contains answers to frequently asked questions regarding a jurisdiction's property tax institutions and assessment practices would make responding to these questions easier. Furthermore, it would be advisable to keep data on a jurisdiction's property tax values – in as much individual property detail as legally allowed and possible – in a spreadsheet that is up to date and error free. The policy analyst or practitioner wishing to use this data would also benefit from a description of information contained in the spreadsheet and a glossary of terms used. If privacy concerns allow, it would be easier for all concerned if such information were posted at a web site.

Interpreter of property tax data

There is no doubt that once an assessor's office has provided property tax information to analysts, citizens, and business people, they will be back to ask follow up questions concerning the data; hence, the recommendations above to provide the information in as easy an interpretable form as possible. Even so, to the extent possible, the assessor should be prepared to help and take a lesson that good teachers learn early on: "there is no such thing as a stupid question."

Policy advocate

Perhaps the most difficult, controversial, and potentially rewarding role that a property tax assessor may be asked to play is that of a policy advocate. The requirements of this role are both a knowledgeable and policy-connected assessor. The intention of this course is to fulfill both of these objectives for those that take it.

If one is to act as a policy advocate, they need to be aware of the difference between a *positive or normative statement*. A positive statement is based purely on facts and includes no value judgments. An example of a positive statement is: "If homeowners move in and out of a neighborhood with the same exact homes, and acquisition value is used for assessment, different homeowners will pay different property taxes for the same local services." A normative statement relies on some form of value judgment. A clear example of a statement that does require an assessor's value judgment is: "Acquisition value assessment is preferred (or not preferred) to market value assessment."

My most basic suggestion to assessors who drift into the realm of property tax policy is to try to keep their advocacy within the positive realm. If making normative statements when offering policy advice, let it be known that this is your opinion and cannot necessarily be supported by the facts alone. Beyond knowing this distinction between positive and normative statements, make sure that the normative statements you do make are accurate. This requires

that an assessor know the specifics of the law and policymaking practices in their jurisdiction and state that relate to property taxation.

Finally, an effective policy advocate needs to learn to think like a policy analyst. Without having to get a Master's degree in public policy, I would summarize this thinking in the form of learning to define a policy problem without including a specific solution in the statement of the problem. An example of how to appropriately define a policy problem would be: "Local governments in the United States have less revenue than what it costs to provide the goods demanded from them." One inappropriate way to define this policy problem is: "Local governments should raise local property tax rates to cover the shortfall in revenue they experience." This second statement clearly includes a value judgment and assumes the answer to the policy problem within the statement that defines it.

Once a policy analyst has defined a policy problem in an appropriate manner, they look to suggest specific alternatives/solutions to it. For instance, for the above problem of a shortfall in local government revenue, solutions could include higher local property taxes, sales taxes, fees, etc.; or even making citizen's more aware of the true cost of local government services, in the hope that their demand for them will decrease, and so will the shortfall. Once the reasonable alternatives are suggested, they are evaluated by the policy analyst based upon a decided upon set of criteria that are equally applied to each. This alternatives/criteria technique is widely recognized as a policy tool (see Bardach, 2000; and Munger, 2001) and an example is provided below in Table 6. The purpose of this somewhat scientific procedure is that it allows the analyst to be transparent in their ranking of policy options. If raising local property taxes is identified as the preferred solution to a revenue shortfall, you will be better able to justify your choice in a more normative manner.

Table 6

Alternative/Criteria Matrix for Shortfall in Local government Revenue

Alternative	Criteria		
	Fairness	Low Cost to Administrate	Political Acceptability
Higher Local Property Tax Rate	Medium	High	Low
Higher Local Sales Tax Rate	Low	High	Medium
Higher Local Fees	High	Low	Medium
Make Citizens more aware of true cost of local government services	High	Low	High

Alternatives are given a high, medium, or low based upon author's opinion on how well they satisfy the given criteria.

Discussion: What are the three roles that a property tax assessor can play in the shaping of local and state property tax policy? If an assessor, offer real-world examples of how you have played these roles. If not an assessor, comments on how you feel the assessors in your jurisdiction are equipped to play these roles.

Discussion: Apply the alternatives/criteria method discussed in the text to a specific property tax policy issue that you are familiar with. That is create a matrix that has three alternatives to a property tax policy problem listed in the first column and four criteria by which to evaluate these alternatives listed in the first row. Fill in the resulting squares that correspond to an alternative and how you expect it to satisfy a specific criterion. Make a recommendation, based upon matrix results, of what is the preferred alternative.

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(5) Glossary of Terms

Acquisition value system of property tax assessment – a system of property value assessment that only sets the market value as the property value to be taxed in the year that a property is sold. When no sale of a property occurs in a year, assessment increases are limited to the lesser of inflation or a fixed percentage value.

Average total cost – the total cost to produce something divided by the number of units produced.

Capitalization – used in terms of the value of land being lower in a jurisdiction with a high tax/low public service fiscal structure; or alternatively in terms of the value of land being higher in a jurisdiction with a low tax/high public service fiscal structure.

Economies of scale in production – the average total cost to produce something continually falls as more of it is produced and it can be beneficial to have only one producer (a natural monopoly). This is usually due to a large fixed cost of production.

Externality – produced when the costs (benefits) faced by a producer (consumer) of a good/service do not represent all of the costs (benefits) generated from production (consumption).

Federalist system of government – a system of government in which the distribution of power is shared between a central authority (federal government) and the constituent units; each of the constituent units (state and local governments) is more or less self-governing units

Income incidence – the determination of the percentage of a person's income that is devoted to paying a tax. For a given tax, if this percentage rises (falls) as income rises, the tax is considered progressive (regressive).

Natural monopoly – is a monopoly, or a single producer of a good, that arises due to economies of scale throughout the relevant range of production of the good. This results in a continually declining average total cost to produce and the least expensive way to produce the good being a single producer.

Normative statement – a statement that involves the use of value judgments and whose merits cannot be evaluated on facts alone.

Own-source funding – is government funding that only comes from within the jurisdiction under consideration. For local governments this means that it excludes revenue received from federal and state intergovernmental grants.

Positive statement – a statement that involves the use of no value judgments and whose merits can be evaluated on facts alone.

Power-equalized aid to local school districts – a system of state revenue sharing to local schools based upon guaranteeing that each school district has the same property tax base per student upon which to level local property taxes to fund per-student expenditure on public education.

Progressive – indicates that a low (high) income individual devotes a smaller (greater) percentage of their income to paying a tax.

Public good – a good/service that once produced can be jointly consumed and it is difficult to keep a nonpayer from consuming. This is the opposite of a private good (such as an apple) that as a whole cannot be jointly consumed and another can easily be stopped from consuming.

Regressive – indicates that a low (high) income individual devotes a greater (smaller) percentage of their income to paying a tax.

TANF - Temporary Aid to Needy Families is commonly referred to as welfare and has replaced AFDC (Aid to Families with Dependent Children) in 1996. TANF is administered through a federal block grant to states that requires state welfare programs where most recipients must work within two years of receiving assistance, limits most assistance to five years total, and let states establish "family caps" to deny additional benefits to mothers for children born while the mothers are already on public assistance.

Tax increment financing – the allowance that a zone within a jurisdiction gets to keep the increment in property tax revenue growth occurring within the zone for the funding of capital projects within the zone,

(6) Section Multiple Choice Quiz

Correct Answers are underlined

1. Certain basic conditions are necessary to guarantee that the results produced in a market-based economy area always desirable. From the list below, pick the one that is not necessary:
 - a. A large number of producers and consumers
 - b. Availability of low-cost information on the quality of goods and service produced
 - c. A market exists for each good or service desired or produced
 - d. A government official who deems that prices in some markets are too high

2. Examples of negative externalities include all but one of the following. Pick the one description that does not fit:
 - a. The water pollution generated from a silicon chip firm that dumps water used in production into a stream
 - b. The increased property value that I experience after all my neighbors fix up their homes
 - c. The slowdown in traffic that occurs when I enter a crowded freeway at rush hour
 - d. The increase in crime that occurs after a transit stop is located in my front yard

3. The primary reason that economists believe that local governments should not be heavily involved in the redistribution function of government is that:
 - a. Taxing the rich, to redistribute to the poor in a city can be self-defeating because the rich will leave the city and the poor will come to it
 - b. Local governments are primarily composed of Republicans
 - c. It is hard to get agreement in a city upon the level of income redistribution that is desired
 - d. Cities do not have the fiscal mechanisms at their disposal to attempt such a redistribution

4. From 1957 to 1999, the percentage of own-source local revenue from property taxes:
 - a. Increased
 - b. Stayed about the same
 - c. Decreased
 - d. There is no way of knowing because such data is not collected

5. Politically conservative and liberal politicians have supported property tax reductions across the United States for all but one of the following reasons, which one is it:
 - a. A belief that a heavy reliance on local property taxation reduces local economic development
 - b. A reliance in local property taxation to fund local schools generates differences in per-pupil spending
 - c. Homeowners dislike the property tax because they pay it in small amounts that are distributed equally throughout a year
 - d. Activists feel that the property tax is something that grassroots politics can change

6. According to most economists, the income incidence of the property tax is
 - i. _____.
 According to many public policy people, the income incidence of the property tax is
 - ii. _____.
 - a. i. Regressive or unimportant if it taxes are used to provide a desired local service / ii. progressive
 - b. i. Progressive or unimportant if it taxes are used to provide a desired local service / ii. regressive
 - c. i. Proportional / ii. proportional
 - d. i. Unable to be calculated / ii. regressive

7. If a state decides to raise its rate of state/local property taxation and at the same time make no changes in the quantity and quality of state and local government services offered in the states. The primary affect of this in the state will be:
 - a. Lower land values in the state and higher unemployment
 - b. Higher land values and no affect on employment.
 - c. No change in land values or employment
 - d. Lower land values and an increase in wages

8. All but one of the following statements applies to describing the possible benefits of acquisition value assessment for property taxation. Pick the one that does not apply:
 - a. It makes the determination of value use for property tax purposes easier than market assessment
 - b. People and business pay less property taxes over times
 - c. A neighbor living in the same house as I can pay more or less property taxes for the same local government services received
 - d. It allows income constrained people to be more likely to keep their house

9. Which of the following is not an example of a normative statement:
 - a. Cake is better than ice cream
 - b. In 1999, states derived less than 1% of their total revenue from property taxation
 - c. States should increase their reliance on property taxation
 - d. The instructor did a great job at teaching this course

10. In the following list, find the one role that a property tax assessor should not play in the property tax policy process:
 - a. Provider of property tax data
 - b. Interpreter of property tax data
 - c. Always taking the same position on property tax issues as their city council person
 - d. Relying on alternative/criteria analysis to sort out difficult policy issues