Testimony Submitted To the Connecticut Senate and General Assembly on
2009 Bills SB 392 and SB 379
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I am submitting this brief on the two proposals authorizing localities to levy separate tax rates on land values than on improvement values. This measure is sound and defensible from the standpoint of both tax policy and environmental policy. I will speak to these concerns in turn.

Since the writing of Adam Smith, students of economics and tax policy have been in general agreement that "Ground rents and the ordinary rent of land . . . are the species of revenue that can best bear to have a peculiar tax imposed upon them." Although he expressed it in the language of classical economics, he was talking essentially about land value tax. John Stuart Mill further ratified this a century later by observing that "Landlords grow richer in their sleep without working, risking or economizing. The increase in the value of land, arising as it does from the efforts of an entire community, should belong to the community and not to the individual who might hold title."

What students of economic theory have long accepted is that there are general principles of taxation that should guide the design and implementation of revenue collection. To be sure, political deliberations don't always follow the wisdom of scholarship, but they are there for those who wish to be advised of them. They are listed as few as three or as many as eight such principles but little disagreement exists as to their substance, regardless of ideology or government. Most commonly enumerated are neutrality, efficiency, equity, administrability, simplicity, stability, sufficiency. Tax theorists typically measure revenue structures according to any or all of these criteria:

* Tax neutrality refers to the influence (or absence of such) that any particular design has on economic behavior. Typically taxes are perceived as a damp on economic activity — taxing income reduces the incentive to work, taxing sales discourages retail transactions, and taxing savings reduces the propensity to save. The more a tax is perceived to be neutral the less the identifiable distortions it imposes on the economy. The common assumption of most tax theorists is that all taxes impose

distortions; it's simply a matter of which ones are least burdensome to economic health. A tax which imposes no distortions is ideally best.

* Tax efficiency is much like tax neutrality, and is the measure of how much shifting of behavior it imposes, resulting in what is called "excess burden," or "deadweight loss" on the economy. Tax economists usually hold that the best taxes are those that are shifted little if at all. Because the elasticities (a technical word for the slope of supply and demand curves) of each are very different, a tax on land values and a tax on improvement values have very contrastive effects on economic choices. Using a tax base that has little or zero elasticity is the best way of assuring that taxes are not shifted. Zero elasticity is another way of saying fixed supply.

* The principle of equity is central to any discussion of tax design. Tax design requires concern with both what is fair and the extent to which it must sometimes be compromised to satisfy the other principal criteria. Fairness can be evaluated according to what is termed "horizontal equity" -- the extent to which those in similar circumstances will pay similar tax burdens, and "vertical equity" -- how well those in different classes bear different burdens in the tax structure. It is this latter perspective that leads to the use of terms like "proportional," "progressive," and "regressive" in referring to tax structures. A tax is progressive with respect to income if the ratio of tax revenue to income rises when moving up the income scale, proportional if the ratio is constant, and regressive if the ratio declines. There is an ancillary question of whether taxing to reach greater equity should employ measures of income or of wealth, difficult as this is to measure. Such questions of equity are a matter particularly central when discussing the property tax.

* Administrability refers to the ease with which a tax can be administered and collected. Taxes which distort the economy are inefficient but so are taxes that cost lots to administer. This is measured not only in the direct costs of tax avoidance and accounting expenses, but in the level of evasion and cheating, and by the cost of government auditing and policing. When the taxpaying public perceives that a tax is easily evaded, cumbersome, and unfair, it loses its legitimacy and calls government itself into question.

* This is why the principle of simplicity is important: the more complex the tax design, the more lawyers and accountants will find loopholes, encourage the appearance of unfairness, and drive up the cost of its administration. People know that with simple taxes other parties are also paying their fair share, and all this enhances the legitimacy and therefore the compliance of the tax system.

* Stability refers to the ability of a tax to produce revenue in the face of changing economic circumstances. Income and sales taxes, for example, vary greatly according to phases in the economic cycle; the property tax, in contrast, is highly stable regardless of the state of the economy. This is one reason why school administrators have typically been supportive of using the property tax base rather than some other tax to support school services.

* The certainty of a tax's collection ensures that the number and types of tax changes be kept to a minimum. Frequent changes in tax rates and bases interfere with business decisions and the ability to make long-term financial plans. This concept reinforces the need for stability because an unstable revenue system is more likely to require continual adjustments.

* In assessing the value of a tax it is also important, of course, to understand its potential to bring in revenue for the purposes of government, usually deemed revenue sufficiency. Income, sales and property taxes, along with corporation taxes to a lesser extent, have come to be regarded as the workhorses of the American revenue structure. But, as anti-tax politicians are quick to note, the higher these taxes are, the more they impose a drag on the economy. This is why one should ponder whether to consider raising taxes which have demonstrable distorting effects.

Only one tax comports totally with these principles: that is a tax on the inelastic supply of land according to its market value, commonly known as land value taxation (LVT). To amplify further only one of these points, one needs to recognize that a tax on an inelastic base cannot be shifted -- either forward to tenants or backwards to suppliers. This means that only those who hold title to parcels pay any burden at all. Among those who do hold title, the split is typically evenly on residential parcels and non-residential parcels. Parcels owned by households usually comprise far greater spatial area, but are typically in more remote locations than commercial and office sites, which occupy more valuable locations. There is a rough equity in the application of LVT that is not otherwise easily accomplished.

A second important feature of LVT is its leverage in fostering sound land use configurations. The far higher value of locations in urban cores induces investment for a return on carrying costs, thereby reversing the centrifugal forces of sprawl development that obtain with a conventional property tax. The greater the tax burden on sites, the more such sites become market available rather than being land-banked for speculative

gain. LVT thereby discourages the recourse for development of second-best, suboptimal parcels because the most ideal sites are unavailable. LVT works to foster sound and efficient land use in a natural and organic pattern as the values of such sites invite.

For decades, LVT was regarded as technically and administratively difficult to administer, even though it has been widely implemented. Today, computer power and available data make it easily and quickly feasible, the most attractive choice of any tax alternative.