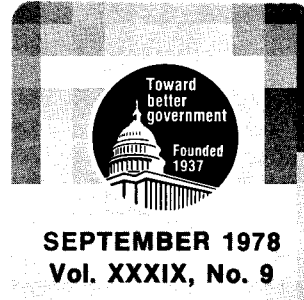


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Proposition 13: A Prostitution of Conservative Principles

By Donald G. Hagman

A survey of California's Proposition 13 vote shows that a large majority of conservatives voted "yes," including those who were renters and who worked for government. Conservative renters and government employees were not likely voting their pocketbook. They were voting an ideology that the public interest would be served by enactment of Proposition 13. They were led to that belief by respected conservative political economists. For example, William Buckley columnized in 13's favor, Dr. Milton Friedman appeared in pro-13 TV ads and Dr. Neal Jacoby's name appeared in the pro-13 ballot pamphlet argument.

Buckley, Friedman, Jacoby and their conservative followers were wrong. Lowering local property taxes, especially to homeowners, is the worst of alternative mediums for the conservative message. As the movement to limit the public sector spreads, and Proposition 13 is not the "only game in town," it is to be hoped that conservatives will get their priorities right.

Conservatives believe that the public sector is wasteful, inefficient. It is inefficient in two major respects, there is waste *from* government and there is waste *in* government. Waste *from* government results because of attempts to produce private goods (e.g. better hospital care) and public goods (e.g. clean air) by regulation of the private sector. Conservatives would agree that regulatory waste involves more dollars than does the waste *in* government which results from taxing-spending.

Proposition 13 does nothing to limit regulatory waste, and the private sector is impacted by a

cacophony of edicts from a vast number of specialized bureaus in Federal, state, regional and sometimes in local governments. The more specialized the bureau, the more dedicated tend to be its workers (at least until captured by the regulatees) to produce the maximum amount of that aspect of the good for which it has been put in charge. Rather

This Issue in Brief

Proposition 13 is not a true conservative response to government fiscal problems, maintains Professor Donald G. Hagman, in this issue of *Tax Review*. Conservatives believe that waste and inefficiency in government must be controlled. Proposition 13, however, does not do this. In fact, it could shift the emphasis toward greater government regulatory activity and cost taxpayers even more.

Even if one argues that cutting taxes could force government to reduce regulatory activity, the property tax is the wrong place to start. This tax is the mainstay of local government, but it is not used at all by Federal government and scarcely by the states, where most regulations originate.

The property tax is efficient. It is visible and hard to pay. Consequently, it keeps the public aware of the tax burden it is bearing, a sound conservative goal.

A much surer answer to the huge cost of government is to impose limits on regulations and on Federal and state spending. This is in accord with conservative economic principles. Surprisingly, it is also backed by correct thinking liberals.

than spend \$1 of tax funds to buy \$1 or more of goods, a bureau could allocate \$1 to implementing a regulatory scheme which imposes say \$4 of costs on the private sector. The bureau scarcely cares whether the scheme produces \$2 or \$3 or \$4 or \$5 or more worth of goods. Even if the bang is only \$2, it still exceeds the buck that shows up in the *bureau's* budget.

Specialized bureaus are not charged to be concerned with the overall public weal. They are concerned only with their aspect of it. Their regulations inefficiently force the production of undesired goods, alternatives being considered. Their priorities get in each other's way. They spend enormous sums in largely futile attempts to respond to directives to coordinate their activities. Indeed, extensive uncoordinated regulation may have been Proposition 13's trigger. The rapidly increasing property tax assessments on residential real estate reflected prices made high in part because land development is probably more severely and fragmentedly regulated in California than anywhere in the world.

If the appetite of government for producing goods stays the same, interference with taxing-spending could merely shift government action to more regulation. The post-13 result would then be higher prices for less goods, a change in a wasteful, inefficient direction.

Proposition 13 not only cuts property taxes, it inhibits enactment of increased and new state and local taxes. If conservatives voted for 13 because of the inhibitions, they defeated another of their goals. Conservative economists believe that taxes or charges by the public sector are more efficient than regulations. For example, pollution taxes and charges, rather than regulation of pollution, is an emerging reality. In the face of 13's inhibitions, new taxes and charges may remain an impossible dream.

A conservative might indulge in the probably fallacious assumption that cutting taxes lowers the

capacity of government to regulate. Regulatory waste could then be cut by lowering taxes. Even if the validity of the assumption is granted, where should the conservative priority be? Surely the higher the level of government, the more specialized its bureaus. One would start with the Federal government and next with the state if one wanted to cut taxes to restrain regulatory zeal. The regulatory waste emanating from local general purpose governments is minimal either because they are not specialized enough to get their regulatory act together or because the regulatee can relatively easily move to a locality having lesser regulation or having regulation most in accord with the individual's preference. Any attack on taxes so as to lower regulatory capability, therefore, should be mounted against Federal and state taxes, not, for heaven's sake, against the property tax as in Proposition 13. That tax is the mainstay of local government in America, is used not at all by the Federal government and is scarcely used by any state.

Waste in Government

There is, of course, waste *in* government. Small potatoes when compared with regulatory waste, a conservative nevertheless makes waste in government a next priority target. Waste *in* government is of two basic sorts, inefficiency in raising revenues and inefficiency in spending.

Consider waste in raising revenues first. Compare the Federal income tax and the local property tax. A conservative realizes that the total cost of raising revenues at the Federal level is far more than raising them at the local level through the property tax. That is not because the costs to the IRS of administering income taxes are high relative to collections. Indeed, even though the cost to government of administering the property tax is very low, IRS does better. But the total cost of collecting taxes includes the costs imposed on the taxpayer of dealing with the tax system. Nineteen of 20 tax lawyers and accountants would likely starve to death on the fees the private sector pays them to deal with local property taxes.

Moreover, counting both governmental and taxpayer costs, the property tax probably costs less as a proportion of revenues raised to administer than most other local taxes. If any alternative taxes can be and are enacted to raise revenues for property taxes lost under 13, a conservative should realize that many may cost almost as much to administer as they yield in revenues.



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Proposition 13 (1) limits real property taxes to one percent of market value, thus cutting yearly revenues from property taxes in California from \$12 billion to about \$5 billion; (2) determines that market value as of 1975-76 property tax assessments or the value at the time of later construction or change in ownership of property; (3) provides that the assessed value of real estate for property tax purposes cannot be increased by more than two percent per year; (4) precludes other taxes from being increased except by two-thirds vote of all members of the legislature at the state level or a two-thirds vote of those eligible to vote at the local level.

The Spending Side

Consider waste in the spending side of government. It is difficult to know whether there are more featherbedding, incompetency, large pensions, perquisites, etc. on the Federal, state or large local government level. Indeed, it is difficult to think of a New York City or a Los Angeles County or a Los Angeles City as local government when their populations each exceed those of most states. Conservatives believe that the most efficient governments are small, local ones. Names such as Tiebout and Ostrom cause conservative political economists to salivate with pleasure.

Ostrom has done studies of police in metropolitan areas and has found that better police services are rendered at lower costs in "Lilliputian" governments. Since local property taxes are generally a higher percentage of the revenues of small local governments than of large local governments, why would a conservative attack the property tax, the mainstay of smaller local governments?

The Tiebout thesis is that small local governments are like commercial firms. A resident chooses a community and thereby purchases the amount and the mix of public services desired. If one does not like the amount or the mix, one can move. At least in any metropolitan area, there is a wide choice of communities to buy. Getting what one wants with one's dollar is what efficiency is all about.

Of course, if one can have more public sector goods for free, one will choose more goods. When local governments are financed by state government, which is a result of Proposition 13, a citizen has virtually no sense that one's taxes are paying for local

goods and services. Therefore, the appetite for public sector goods from one's local community results in more goods or the wrong mix of goods being produced by that sector than is desired when alternatives to paying taxes are considered. That is inefficient.

And what best allows one to perceive that one is paying for a public service? A conservative economist prefers a charge for a service.

A per capita tax is next best. Members of a small community might decide they want a community which provides \$1,000 of a particular mix of public goods and services and each resident would be charged \$1,000. As a voter, a resident could vote a higher or lower or different mix for appropriate changes in the per capita tax. In case of disagreement with others in the community, one could move.

Per capita taxes are not popular, perhaps because they are too direct or too easily evaded. The next most efficient tax is probably that part of the property tax which falls on residential occupancy, be the occupant an owner-occupier or a tenant. Such a tax is probably less shiftable to someone else than any other. The property tax paid by industrial or commercial firms, for example, is largely passed backwards to suppliers, labor or investors or forward to consumers in the form of higher prices. Allowing local residents to tax industrial and commercial property is no more efficient than having the state support local government. A conservative does not support a split-role scheme of property taxes where industrial-commercial property bears a heavier tax than home ownership or occupancy.

Conservative View of Property Tax

We have come full circle. The property tax on the homeowner-resident-voter in a community is the best tax from a conservative-efficiency perspective. Yet it was that tax which the conservatives voted down by 13. Down went a tax which is visible and hard to pay. The result is use of the state surplus which is accumulated through income and sales taxes that are relatively invisible, easy to pay.

Efficiency would have been promoted by keeping the property tax and making the other taxes harder to pay. The efficiency of the property tax also could be improved if the tax was imposed on the occupant's interest in real estate, whether owner or tenant. That tenants are paying for desired services then would be made clearer. Conservatives would also support the

change to taxes on tenancy because the result would be to cut Federal income taxes by permitting tenants a deduction. Contrary to conservative principles, Proposition 13 raised Federal taxes to Californians while lowering local ones.

Equity and the Property Tax

Finally, consider equity. Conservative economists do not worry much about equity, partly because the lot of the poor can be made better by expanding the pie as well as by redistributing it. So conservatives dislike taxes which discourage productivity. An income tax discourages enterprise and therefore productivity; a sales tax discourages consumption and therefore the production of the consumables; inheritance and capital gains taxes discourage savings to be invested in the machines of production. How about the property tax? Much of the property tax is incident on land. Is less land produced when taxes on it are high? Hardly, God made the land, and God doesn't pay taxes. Conservatives should reread Adam Smith or Henry George if they've forgotten about land taxes. Proposition 13 lowers the property tax on land and those taxes are being replaced by revenues generated primarily by sales and income taxes.

Conservatives support more equal wealth distribution through private generosity rather than through governmental compulsion. In a small local government supported by local taxes, governmental redistribution of wealth is as privatized as

possible—almost like passing the hat among neighbors. No one feels like a voluntary giver when paying the state sales or the Federal income tax.

To the extent that conservatives worry about equity, they know that Proposition 13 lowered tax equity. That is so not only because of 13's quirky provision that sold or newly constructed property pays more than identical old, nonsold property. It is also because equity in taxation is generally considered on two criteria, ability to pay and benefit received. A homeowner who occupies a house worth twice as much as his neighbor has double the ability to pay based on wealth, everything else being equal. Such a person probably also receives a double benefit. Everything else being equal, isn't it true that one with twice as much house probably receives twice as much benefit from say police and fire services rendered to property?

When conservatives apply their principles right, they will give priority to limits on regulation and on Federal and state spending, not to limits on local spending or local property taxes. It may come as some surprise that correct thinking liberals have the same priorities. Even they are coming to the view that much if not most government regulation and government taxation-spending by higher level governments is making the poor poorer. How correct thinking liberals should think about these matters, however, is not here documented. Such a discussion would require an essay addressed to them rather than to conservatives.