Non-Glamorous Gains: The Pennsylvania Land Tax Experiment

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Cover photo: 1930s postcard of Harrisburg, from Wikimedia Commons

For over a century, Pennsylvania has undertaken a quiet experiment. It is one of the only U.S. states where cities are allowed to tax land at a higher rate than the buildings on it. Pittsburgh and Scranton adopted this tax system in 1913, and roughly a dozen other cities have followed suit since the 1950s. This Pennsylvania Experiment has a lot to teach us about how taxes shape the behavior of property owners.

Most people think of the Keystone State as "East" just like New York or Massachusetts. Part of it is, but west of the Tuscarora Tunnel the traveler finds small towns and cities surrounded by miles of Appalachian Mountains and a few farms in the open lowlands.

These cities powered the US from the beginning of the Civil War until the end of World War II. When the steel industry finally collapsed in the mid to late seventies, these towns lost people, businesses and tax base. As in much of the country, people and commerce pulled out, and built anew, sometimes only a couple of miles away.

Image: Bob Jagendorf via Flickr

The situation was dire. Many cities fell into state control. During this period, Clairton, Aliquippa, and New Castle adopted a land value tax (LVT) at the recommendation of the State. By 1982, the state capital, Harrisburg, was facing bankruptcy. The Mayor looked at the papers to sign and said "No!" Instead, Harrisburg took LVT and expanded it.

These moves were a bet that changing the property tax system could stem the tide of blight and vacancy in Pennsylvania cities: specifically, that taxing land at a higher rate than buildings would incentivize redevelopment and discourage owners from sitting on unused land, as Charles Marohn outlines in "You Get What You Tax For."

Did LVT help prevent blight in deindustrializing Pennsylvania cities? Let's take a look.

The Case for Harrisburg

In 1982, Harrisburg instituted a tax rate on land that was four times the rate on buildings. By 1994, the mayor, Stephen Reed, wrote the following in a letter to Allentown, PA civic activists:

With over 90% of the property owners in the City of Harrisburg, the two-tiered tax rate system actually saves money over what would otherwise be a single tax system that is currently in use nearly all municipalities in Pennsylvania.

We therefore continue to regard the two-tiered tax rate system as an important ingredient in our overall economic development activities.

I should note that the City of Harrisburg was considered the second most distressed in the United States twelve years ago under the Federal distress criteria. Since then, over $1.2 billion new investment has occurred here, reversing nearly three decades of very serious previous decline. None of this happened by accident and a variety of economic development initiatives and policies were created and utilized. The two-rate system has been and continues to be one of the key local policies that has been factored into this initial economic success here.

The number of vacant structures in Harrisburg declined from over 4200 in 1982 to under 500 by 2001. The downtown—previously a ghost town—is alive, even at night. The number of businesses on the tax roll has grown from 1,908 to 8,864.

The Case for Allentown

The city of Allentown adopted LVT in 1996, establishing dual tax rates of 5.038% on land value and 1.072% on building value. The land tax rate is nearly five times greater than the building rate. Under a traditional single-rate property tax, Allentown would levy a tax of 1.752% to produce the same amount of revenue.

Pennsylvania US Senator Pat Toomey was an early private-sector proponent of LVT in Allentown. He encourages other cities to adopt LVT in order to stabilize the tax base and induce investment:

When the people of Allentown voted for the land value tax in 1994, nearly 3 out of every 4 properties saw at least some sort of tax cut. Today, many of the properties that did pay more have new or better buildings on them, stabilizing the tax base to the point where we haven't had a tax increase in five years. In that time, the number of building permits in Allentown has increased by 32% from before we had a land tax.

Allentown row houses (Image: anaxila via Flickr)

Allentown's outcomes are notable by many measures.

After LVT was adopted by voters in 1996, 70% of residential parcels saw a tax decrease; importantly, in the most at-risk neighborhoods (older pre-war housing and factory blocks) upwards of 90% of homes had their tax liability reduced. Local business taxes were frozen by law at 1996 levels. Construction returned to the city: the number of taxable building permits surged past neighboring Bethlehem, market investment returned, and capital improvement reappeared in city budgets. Tax burdens on productive work and business declined. The losers in this trade were absentee owners of vacant lots, who had to shoulder much more of the burden.

LVT in Small Cities Helps Forgotten Citizens

Among the smaller cities that use LVT, their goal was to help citizens no one would help: the retired and the jobless. Said Mayor Sonny Spossey of Washington, PA:

> LVT still helps reduce taxes for our most vulnerable citizens. We have an aging demographic, like the county, region and the state. Taxpayers everywhere are less able to keep up with taxes, and that hurts revenue. LVT helps us mitigate the impact both to them and the city. It's a win/win.

The Key: Taxing What Can't Move

The land value tax (LVT) signals a halt to the policy of taxing whatever moves.

Land is something that can't be shipped to the Caymans or Texas. This makes it a unique revenue-raising system for government, in comparison to other programs that require not much more than faith and excitable supplicants. Subsidies, abatements, TIFs, and "opportunity zones" are inexplicably popular, and results are vague and scattershot.

Cities that institute LVT can reduce or remove not just most or all of the tax on buildings, but a whole menu of local taxes that discourage use (and reuse) of land that already has extensive and still useful infrastructure. LVT is not temporary, does not confer favor for a few, and doesn't disrespect those longtime businesses and citizens that always kept the faith (and their capital) in their hometown.

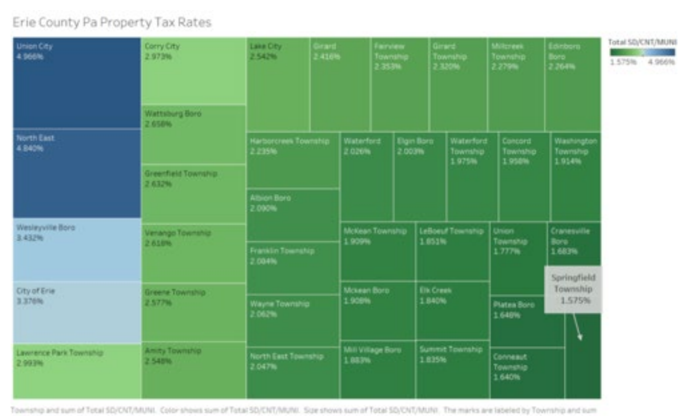

Figure 1: Total property tax rates in Erie, Pennsylvania and its suburbs.

Why is LVT different? LVT extracts its revenue from the ground, as opposed to the structures sitting on it. Land in cities is made more valuable by already existing physical infrastructure, and services such as police, parks, and schools. Indeed, competition between city and suburb for market investment has always placed communities with extensive infrastructure at a tax disadvantage. Suburbs can skate by with low tax rates because of the newness of their infrastructure. Figure 1 illustrates the range of tax rates in Erie County, PA, revealing that urban tax rates (blue) are several times those of outlying suburban townships (green).

By not taxing structures and improvements, the city does not discourage property owners from using their land productively. It opens itself to re-growth and reinvestment, which leads to lower long-term costs to property owners; by the same token a good house or office put up 20 years ago has its tax liabilities reduced as well. This breaks the vicious cycle in which an economically stagnating city must raise tax rates to maintain services and aging infrastructure.

Because LVT is a local policy, a room full of citizens often figures out what LVT means in a few minutes. They know how things work, after all, under a conventional property tax:

- **Q:** What happens when you fix your house up?
- **A:** My taxes go up.
- **Q:** What happens when the shabby absentee-owned rental property across the street finally falls over or burns down?
- **A:** Its tax bill is reduced dramatically.
- **Q:** So why does the city overtax work and investment, and reward blight?
- **A:** Because that's the way it's always been.

Many cities already make a regular practice of offering tax subsidies and abatements to prospective investors and builders. LVT simply extends this across the board to universally cover all buildings and improvements, new or old. With a simple change in the annual property tax ordinance, taxation of structures is permanently decreased, and moreover, it applies to everyone. No applications, no forms to fill out, and no golf games at the country club to get the tax break.

Long-Term, Non-Glamorous Gains

As Harrisburg Mayor Stephen Reed has said:

> "What I would like to argue here is that a single tax rate system generates… sprawl. A land value tax policy instead serves to invite and reward vertical development in our cities and older communities that save, land, utilizes existing infrastructure and creates a sense of community and place that commuter oriented areas of a sprawl simply do not have."

LVT is not a panacea for all of the problems of Pennsylvania's cities. Yet almost all LVT cities have found that long-term non-glamorous gains exist: breathing space and time to figure out what's next. Tax revenues have stayed stable or even increased. Harrisburg's effective municipal tax rate dropped throughout 10 years from 1990 to 2000.

Buildings use infrastructure; vacant lots do not. LVT ramps up the use of existing infrastructure, a century-old asset that literally creates value from the ground up.

Under LVT, vacant or underused land ceases to be a great place to park your money. In most LVT cities the percentage of tax revenue derived from buildings drops from 75% or 80% to 20%. In towns like Millbourne, Clairton, and Aliquippa, tax revenue from the community-generated value of land has gone from 10% or 20% to 80% or 90%. The message to private land bankers is that while land ownership is a right in the United States, somebody will have to start paying for that privilege.

LVT is indeed no silver bullet, but towns that use it and stick with it become fiscally healthier. Their citizens grab the chance to create their own success with an environment that encourages free market activity. It's both an effective tax policy and an ethical way to treat citizens.