

Appreciating the Property Tax

The property tax has been subject to much popular criticism and political pressure in recent decades. Several states have implemented, or are considering, a variety of caps and limits on property assessments, property tax rates, or total revenue raised from the property tax. Perhaps the best-known example is California's Proposition 13, which ties property assessments to the purchase price of a dwelling (rather than its current market value) and limits the tax rate that can be levied on homes.

It is worth taking another look at the property tax and considering its strengths and weaknesses as a source of funding for local government services.

One of its major strengths is that local public services generally benefit local taxpayers. Police and fire protection, trash removal, and street cleaning directly affect real property and real property values in the taxing jurisdiction. Moreover, because land and buildings are immobile, it is difficult for local property owners to escape a tax on their real estate holdings. By contrast, a local sales tax can encourage purchases in a low-tax locality, and a local income tax can encourage relocation by high-income earners.

Many observers believe that taxpayers are particularly sensitive to the property tax because it is highly visible and is levied at regular intervals. This visibility undoubtedly invites more scrutiny from taxpayers, which sometimes leads to new proposals for property tax limits. However, this scrutiny also leads taxpayers to engage with their local governments to review how tax revenues are being spent on services, thus promoting both civic engagement and fiscal discipline in local governments. These outcomes are strengths of the property tax, not weaknesses.

Local governments typically cannot incur deficits in their operating budgets, so they must be able to accurately predict both their revenues and expenses during each fiscal year. Property tax revenues are more predictable and stable within a fiscal year than revenues from virtually any other tax. The property tax base changes little during the year, and nonpayment rates of property taxes are low because the consequences of nonpayment are severe. By comparison, revenues from income and sales taxes can and do vary



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dramatically within a fiscal year because they closely track variations in overall economic activity. In addition, data indicate that property tax revenues are more stable across fiscal years than either revenues from other taxes or state aid payments to local governments because property tax revenues are less correlated with business cycles.

Although many observers believe that property taxes as a share of income are high-

er for low-income households than for high-income households, terming them "regressive," this view is problematic for several reasons. First, most simple analyses of property tax incidence ignore renter households (who typically have below-average incomes), and are based only on the principal residence, whereas many high-income households have more than one home.

Second, because local property taxes are used mainly to provide local services to households who choose to live in the service-providing community, property taxes are essentially payments for those services. To the extent that property taxes are payments for benefits received by property owners, it makes no more sense to characterize them as regressive than it would to consider household payments for other goods such as food or clothing as regressive. Third, empirical studies show that the value of local services received by households is often capitalized in their property values. Finally, sales taxes—often proposed as an alternative to property taxes—are clearly regressive.

Special challenges arise when local property taxes are used to fund local public services that spill over municipal boundaries or that raise issues of equity. For example, many states have altered the use of local property taxes to fund local schools by reducing the variation in per-pupil expenditures among local jurisdictions in order to improve the equity of school funding. These changes essentially reflect the view that the local provision of education is appropriate, but the level of funding for education should not be completely determined or borne by local governments.

In short, property taxes are extremely well suited as a source of funding for local services, and they are widely used in both industrial and developing countries. **I**