LEADING ECONOMISTS ON ECONOMIC IMPACTS OF PROPOSITION 15

Voters in California will be considering Proposition 15 on the November ballot. If passed, it will raise up to $12 billion in new revenues for education and local governments by requiring that many commercial and industrial properties be assessed at fair market value. The measure does not apply to residential property or agricultural land and provides an exemption for small property owners. Under the current system, commercial and industrial property taxes in California have more to do with the date of purchase than the fair market value of what is owned. As a result, under current law competing firms may own properties with equivalent actual market values and yet pay radically different effective property tax rates.

This system is highly distortionary. Older companies charge market prices for their products while paying millions of dollars less in taxes each year than do their newer competitors. Landlords who bought property 30 or 40 years ago lease their land at market rates while enjoying extremely low property tax assessments that are based on the original purchase price. On top of this, the system causes additional distortions and tax-avoidance tactics because it encourages firms to structure real estate transactions so as to avoid reassessment.

The opponents of Proposition 15 claim its tax increases will be passed through entirely to consumers and small businesses. This is unfounded for several reasons.

First, it is the forces of supply and demand that shape market pricing. Businesses compete based on price, quality, service, and their ability to innovate. Firms attempting to raise prices above market rates must consider the risk of losing customers to their competitors. Firms do not reduce prices out of the goodness of their hearts; instead, they set prices at what the market will bear. Large firms that enjoy cost savings over their rivals due to out-of-date tax valuations tend to take the savings as windfall profits rather than pass them on to their customers.

Bringing large business properties up to the same effective rate as paid by their competitors would largely eliminate the distortions in the system. By eliminating assessment disparities, the cost of Proposition 15 would mainly result in reduced windfall profits at the corporate level. These profits disproportionately accrue to large, older firms and are a competitive barrier to new and innovative small businesses.

Second, Proposition 15's increases will vary from firm to firm. The limitations on property tax rates set by Proposition 13 will be unchanged; and thus, the impact of Proposition 15 on any individual business will depend on the disparity between that business's property's current assessed value and its fair market value. Standard economic theory says that these kinds of impacts reduce windfall profits; they do not lead to price increases.

Third, many businesses will not be affected. Sixty-five percent of all business properties will be exempt because of Proposition 15's exclusion of owners of commercial and industrial property with $3 million or less in value. Home-based businesses, accounting for over half of all small businesses according to the California Department of Industrial Relations, also will be exempt.

Fourth, all affected businesses will not be reassessed at the same time. Proposition 15 provides for a phase-in of reassessments over a minimum of three years.

Finally, some businesses will experience a net property tax reduction. Proposition 15 eliminates the property tax on equipment and fixtures for small businesses and provides a $500,000 a year exemption for all other businesses. For exempt businesses or businesses currently assessed at or near market value, the measure's net effect could result in a tax cut.

Proposition 15 will improve California's economy over the long term. It eliminates economic distortions that hurt competition and growth. By broadening the property tax base, it will help level the playing field and provide additional funds for education and local communities.

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