What’s the matter with Michigan? Rise and collapse of an economic wonder

Mason Gaffney, December 27, 2008

Introduction.

In 1995, through an accident of scheduling, two separate meetings were merged at the Levy Institute, Annandale-on-Hudson, NY. It was an odd coupling: one group was of Georgists; the other was of economic advisers to Governor John Engler of Michigan, intent on cutting the property tax. Possibly some hurried planner, we speculated, had confused Michigan’s “Single Business Tax” with George’s “Single Tax”. Still for three days we talked to, or at least past each other.

We warned Michigan what had happened to California after Prop. 13. In Lansing, however, the die had been cast. Engler’s advisors tuned out our words and went home to help him take public schools off the property tax and put them on a sales tax. Michigan’s fatal downslide accelerated. Let us trace her path from adolescence and vigor through long dominance down to senility, where famous firms are dying, industrial cities rotting, great universities shedding, public services declining, public schools starving, unemployment soaring, and youth fleeing. Michigan’s number of apportioned U.S. Representatives has dropped from 19 in 1960 to 15 in 2000. The great University of Michigan now charges the highest tuition of any public university in the nation. Michigan’s “Big 3” auto firms have crashed loudly and publicly, going to Washington to beg.

I. Hazen Pingree, mass transit, high wages, and the birth of the auto industry.

From 1890-1900 Detroit’s population grew, in spite of the depression, by 40%. That was faster than almost all other cities except Cleveland. By 1910 it had boomed another 60%, leading the nation, and by 1920 another 113%. The auto industry did it, but why in Detroit? It helped that Michigan had produced horse-drawn carriages from its hardwood lumber, but so had other places. It was not low wages, for Detroit paid better than most, which of course is why so many people moved there so fast. It was not business-dominated politics, for Michigan was a Progressive state, a Teddy Roosevelt state that went with his “Bull Moose” splinter party in 1912, the first eastern state to adopt the Initiative and Referendum, an early Home-Rule-for-cities state, an early adopter of direct election of U.S. Senators, a high tax state (in an era when most state and local taxes were property taxes). Governor Hazen Pingree’s 1897 message to the State Legislature is a strikingly radical document, even for its times, and moreso for today.

Mayor Hazen Pingree, soon to be Governor, was an early Georgist Progressive. He found city taxes biased for the rich; he changed that, and pushed the single-tax principle. He was a mentor to and model for the Georgist soon-to-be Mayors Tom Johnson and Newton Baker of Cleveland, and Samuel Jones and Brand Whitlock of Toledo. Pingree reformed assessments and raised property taxes in order to provide vital services for working men and their families. Mass transit, then called "traction", was a central issue.

The Progressive single-tax movement then went hand-in-hand with "traction" in all the growing cities of that, their Golden Age. Property taxes were to cover fixed costs, so as to keep fares low. Pingree could not sway enough allies to municipalize traction, so instead he subsidized a competing firm, forcing the older one to lower fares and extend service. It is one of history's ironies: trolley cars nursed the auto industry that was later to rise up and slay them.

Pingree plugged for public ownership of city monopolies and for low fares, an attitude later to be rationalized by many academics as "marginal-cost pricing". Property taxes also paid for public education, public health, public parks, water, sanitation, welfare, etc., all the public services that make a big city livable, and its small industries viable. Property tax rates of 2.5% were normal; there were no sales taxes, business taxes, or income taxes. Detroit's private sector was a big collection of small machine shops, little businesses and services providing a matrix for the famous innovators who were to spawn the auto industry. Jane Jacobs would have venerated it, as she did Tokyo and Birmingham (1969, *The Economy of Cities,* and later works).

Land speculation and monopoly were problems, so in 1891 Pingree campaigned for "higher taxes on the vast landed estates of the city", and won. In 1893 a big industry threatened to leave town if its taxes rose. Pingree was losing this battle when he called on his Georgism and raised just the land assessments. This won the support of businesses he had alienated by campaigning to soak the rich (Holli, Reform in Detroit, p.59).

Pingree saw, and ordinary voters could see, that Detroit could raise revenues from industry without driving it away, simply by focusing assessments more on land, less on capital. Since then a century of rococo decadence in economic analysis lets a leading

Michigan tax authority write that "Michigan … is reluctant to impose taxes at high rates on economic activity that might thereby be reduced or encouraged to relocate. In this, Michigan faces the same dilemma that all taxing jurisdictions face" (James R. Hines, Jr., 2003, Michigan's Flirtation with The Single Business Tax.) To solve the dilemma, Hines touts Michigan's "Single Business Tax" (SBT), a form of Value-added Tax in which businesses can deduct purchases of real estate, but not labor payrolls, from the tax base. Deducting real estate purchases as though they were current expenses is supposed to help Michigan by untaxing capital formation, as though real estate were all capital, and buying old capital is the same as creating new. Professor Hines is Director of Research at a leading professional think-tank, The Office of Tax Policy Research (OTPR), University of Michigan. He is actually savvy and fair-minded in most respects, likable, credentialed, modern, and well-connected - too modern and well-connected to be free of Neo-classical bias that conflates land with capital.

The crash of 1893 hit Detroit soon after Pingree became Mayor. The City was riddled with holes held by land speculators. Pingree prevailed on them to let the unemployed plant vegetables there, and "Pingree's Potato Patches" won national renown, and inspired other cities to do likewise (Catlin, pp. 609, 616). To Pingree the publicist and politician this was a graphic way to demonstrate to his voters, fresh from following the plow, what people can do when given access to land, a goal he had for all industries. He used tax money on welfare for the unemployed, a move that did not spoil labor so much as it kept it on hand to man the next industrial boom. His majorities increased with each election.

Another irony is that the traction monopoly that Pingree fought was owned by none other than Tom Johnson. The relationship was complex, but this is part of the process that converted Johnson to become the most prominent Georgist politician of his decade – think Epiphany on the road to Damascus.

Pingree also supported academic freedom, a fragile seedling in that era. He did not quail at taking and probably paying for advice from economist Edward Bemis, whom Rockefeller's new University of Chicago had just fired for the solecism of supporting the Pullman strikers in 1894. Polite academicians just don't do things like that.

In 1897 Pingree became Governor. He centralized the assessment of property taxes, and had the State Board of Tax Commissioners revalue all property. They found so much untaxed land, especially railroad holdings, to put on the rolls that they actually lowered tax rates even as they raised more taxes (Lovett, p.37) – a feat that inspired Robert LaFollette across the lake later to emulate in Wisconsin. Arthur Laffer failed to duplicate the success later in Washington because Laffer and his boss, Ronald Reagan, never got the point that was so obvious to Pingree: lower bad taxes by raising the good one.

In the midst of reforms, Pingree died in 1901. He had not worked alone, however, and in 1904 new Governor Fred Warner resumed Pingree's work and in 1908 won his 3rd term. In 1909 Michigan adopted a new constitution with many basic progressive reforms. The State continued its extraordinary growth and prosperity. Detroit grew from 205,000 souls in 1890 to 1,850,000 in 1950, a faster percentage growth rate than any other city, rising to be America's 4th biggest city. This was an extreme case of a national pattern for cities with pro-labor Georgist leadership to outgrow cities run by the opposition (Gaffney, 2006, New Growth in Old Cities, pp.34-36). As for urban sprawl, Pingree favored growth without annexation – a formula that later growthmen were to forget, to their sorrow.

II. The stagnant Upper Peninsula (The U.P.)

Meantime the U.P. was stagnant. Longfellow in The Song of Hiawatha had romanticized it as "Gitche Gumi" (Ojibway for Lake Superior). Ben Smith, a retired engineer from Grand Rapids, saw it more realistically as a land of barons and peasants, and not many of either (1975, *Latifundia in Gitche Gumi*). Its owners managed to escape from Pingree's reforms, so the U.P. remained an economic desert, even while the L.P. was making homes and jobs for millions. These owners were and are few, and tightly organized to resist taxes. They are timber firms and mining firms, or at least the owners of mineral land that someone might mine some day.

The U.P. is not barren of resources. It has hundreds of miles of shoreline on the Great Lakes hard by what was the industrial heartland of the U.S. Inland it has vast forestlands and reserves of copper, iron, and who knows what other minerals. Its problem is more like the economists' "Dutch disease" of excessive easy riches.

Under Michigan's Forest Tax Law the State exempts all "certified commercial forests" from the ad valorem property tax. 14% of the U.P. is thus exempted. Instead, the owners pay 15¢ per acre - and the State pays the county 25¢ per acre with money drawn from L.P. taxpayers (Smith, p.115). This break for timber is not unique to Michigan: California is just as bad, so its northern forest counties are also economic deserts, and parasites on the State fisc. Both States have outstanding Schools of Forestry whose personnel, advising legislators and owners, are complicit in these arrangements. Alabama is even worse, as Law School Professor and Christian activist Susan Pace Hamill and her ally, Governor Bob Riley, have recently brought out as they bumped heads with the timberland owners – and lost. In New Hampshire, forest landowners have led in squelching bills submitted by Assemblyman Richard Noyes for a statewide land tax. Forest landowners are a problem for Georgists everywhere – a big topic for another day.

Under Michigan's mineral tax law, newly discovered ore is exempt for 10 years. In practice the effect of that and other laws is that "Virtually all iron ore land is exempt from taxation." Before 1963 it was done illegally; a 1963 Act made it legal (Smith pp. 115-17). There is a nominal severance tax, but Smith illustrates how owners of iron ore in the Marquette Range dodge it.

Smith's monograph is full of vignettes, such as that in Keweenaw County (in 1975), 80% of the private surface land is owned by one copper company, Calumet & Hecla Corporation, a subsidiary of Universal Oil Products.

We omit the U.P., therefore, from the following history: it is a stagnant world, living on the L.P., unrelieved by the cycles of at least occasional prosperity that make the L.P. more livable.

III. Urban sprawl around Detroit in the 1920's; its awful collapse

By 1930 Detroit had 68% more people than in 1920, again leading the nation. 1920's leaders, however, were not like the Progressive Republicans of yore, they were New Era Republicans of what Michigan's Professor Kenneth Boulding was to call "The Cowboy Economy". They twisted Pingree's ideas by growing in area even more than in people. Detroit's best-known product, marketed to millions, let builders sprawl over outskirts and suburbs to a degree hitherto unthinkable. Detroit's rich tax base, misspent, helped them do it.

Michigan Business Professor Ernest M. Fisher, normally a tame and timid soul given to understatement, documented the damages in monographs and articles that became minor classics of boom and bust in urban expansion. Most American cities underwent the same process, but Detroit, like Florida, sprawled well beyond the average. Hard-luck Flint became a poster-child victim of sprawl and land speculation, singled out for attention by leading planner Edmund Bacon (1940, “A Diagnosis”). Harold S. Buttenheim, Georgist Editor of the then-influential *American City* Magazine, focused on Detroit. Today, as GM closes down Flint’s life-support, publicist Michael Moore is republicizing Flint as poster-child. Neither glare of publicity has cured Flint’s problems, however; that would require stronger measures.

IV. Michigan in the Great Depression

Detroit, like most big industrial cities, slowed down in the “Dirty Thirties”. Many cities shrunk; Detroit did better, growing by 3.5%. Still, its people knew hard times, and searched for new ideas and leaders. It produced at least three prominent new men from outside the establishment, who led it in the New Deal direction. These were Charles Coughlin, Frank Murphy, and Walter Reuther. Coughlin and Murphy flashed across history’s stage and faded. Reuther, working in the grubby trenches and staying home, was to have the more lasting impact. In modern terms you could call him a “community organizer”.

Fr. Charles Coughlin was pastor of a small church in Royal Oak, a northern inner suburb of Detroit. He mastered early on the new medium of radio, even before FDR, and amassed a huge following in the early depression years. He saw social salvation in the 1931 Encyclical of Pope Pius XI, *Quadragesimo Anno* (40 Years Later), an update of Pope Leo XIII’s *Rerum Novarum*, 1891. He popularized those messages as never before. They bear an uncanny likeness to FDR’s New Deal, much of it framed by Irish and other Catholics whom they touched through Coughlin. The story of Coughlin’s sensational rise and tragic fall is told at length in Gaffney, 2000, *Henry George, Fr. Edward McGlynn, and Pope Leo XIII*. Suffice it here that Coughlin’s Michigan springboard rocketed him so fast to national and international fame and influence and controversy that he had little role in Michigan.

Frank Murphy, Detroit’s Mayor 1930-33, was “a New Dealer before there was a New Deal” (Sidney Fine, biographer, 1984), and helped elect FDR. By all accounts he was of high character and ability and ambition. FDR bundled him off to the Philippines as Governor-General (possibly to exile a potential rival?). Murphy returned to become one of Michigan’s few Democratic Governors. During his tenure (1936-38) Walter Reuther’s fledgling UAW pioneered the sit-down strike at GM’s plant in Flint. Governor Murphy called out the national guard, but refused to authorize violence. Instead he negotiated a settlement that legitimized the UAW, using the new national Wagner Act. It was “The strike heard round the world”. UAW membership exploded from 30,000 to 500,000. “Industrial unionism” had arrived to rival and later join the old AFL. Organized labor, for better or worse, has been a major political player ever since. Murphy went on to become A.G. in 1939, and then a Justice of the U.S. Supreme Court, but thus ended his role in Michigan.

Walter Reuther was a socialist from a socialist family, and a beaver who came up the hard way, organizing unions in a time of violence when employers controlled the police and the FBI. He survived beatings by strikebreakers, and two assassination attempts before finally falling to a third one in 1970. He couldn’t get elected even to the Detroit City Council, yet TIME Magazine included him with the 100 most influential people of the 20th Century. He turned Republican Michigan into a union state, and his union into a major national political force. From 1939 he became a Democrat, increasingly on intimate terms with Party leaders. He never stopped supporting liberal causes (Martin Luther King, Jr., César Chavez) until he was slain. Even today, it is said, Senate Republicans oppose bailing out Detroit auto-makers to avoid helping out Reuther’s creation, the UAW.

All this time, with all this excitement, with boom and bust in the land market, Michigan fiscs depended mainly on the property tax. From 1932, other states were turning to sales taxes for “property tax relief”, but not Michigan, not yet. Doughty Ben Smith of Grand Rapids, he who wrote about the U.P., churned out reams of essays and tables of data demonstrating that states progressed economically in the measure that they used the property tax to finance government. It is tragic he didn’t live long enough to polish and package his works better; they were diamonds in the rough.

V. Detroit in the arsenal of democracy, 1940-50

After 1940, and especially after Pearl Harbor, FDR naturally turned to Detroit to convert its assembly lines and supply sources to war production. The whole nation revived, but Detroit grew by 14% while most cities grew by much less, and many shrank. This was the age of Rosie the Riveter, but Rosie favored Detroit over most other venues. Walter Reuther the anti-fascist converted to a Democrat; Reuther the German-American squelched wildcat strikes against the war effort; Reuther the born Marxist purged communists from his unions, joined the cold war, and rated high in Washington. He was a man for his times. It would appear that Detroit and Michigan were back on the fast track.

VI. Famous Governors and meager results, 1950-70

From 1950-60, Detroit shrank by 10%, the first break in its sensational upward trajectory. What could the matter be? “Explainers” could blame an exogenous force, the end of the war, but demand for autos and trucks was booming: America was pouring billions into the Interstate Highway System. The St. Lawrence Seaway was on track to open in 1959. The world was buying American cars. The causes must have been endogenous.

1952 brought on Governor G. Mennen “Soapy” Williams, scion of an old Detroit family (Mennen toiletries), handsome, personable, an academic “prodigy”, eastern prep, Princeton, Michigan Law School, ambitious, cover of TIME, and presidential timber. Like Murphy, he won as a Democrat in a Republican state. In Michigan, party lines are fuzzier and politicians more temperate than in Wisconsin and Minnesota. (Ethnically, one might guess it reflects the Dutch temperament vs. the central European, but that is speculative.)

In 1952 the new Governor Williams allied with old warrior Reuther, and represented some of his views. He saw a need for more state services. Michigan had no state income tax at that time – only half the states did, and Michigan’s neighbors and competitors Indiana, Ohio, and Illinois did not (Hines, p.11). Taxing “business” may have sounded good to Reuther, the intellectual steeped in Marxist economics.

Williams’ 1953 tax was called the Business Activities Tax (BAT). Technically it was an odd duck, a kind of modified VAT that “the business community” (as Professor Hines calls it) preferred to a tax on corporate income. If it and Williams’ new welfare programs helped Michigan grow one could not prove it from Detroit’s falling population. Michigan overall still grew, as Detroit was hollowing out; but Michigan grew slower than the national average, losing another Congressional seat. It stood still compared with, say, California. As for Williams he was shuffled off, like Murphy before him, to minor foreign posts. He came home and ended his career as Chief Justice of the Michigan Supreme Court. His lasting memorial is the long expensive Mackinac bridge, a 1950s version of a “bridge to nowhere”, for it links the L.P. only with the barren U.P., which remains barren since it needs another kind of therapy.

The next famous Governor was George Romney, 1962-68, a hero because he had rescued American Motors by promoting the Rambler (although it was made in Wisconsin). Romney was a “liberal Republican” (as the term was then understood), loosely allied with Nelson Rockefeller who loaned him economic adviser George Gilder, co-author with Jude Wanniski of early “supply-side” works. He viewed Reuther as “the most dangerous man in America” because Reuther had a visionary and idealistic side, when Romney might better have sided with Reuther against primitive Jimmy Hoffa, Reuther’s arch-enemy. Romney introduced an income tax to help support public schools and provide “property tax relief”, a PR catchword that caught on in the times.

Meantime the property tax itself was degenerating, nationwide, into more of a tax on buildings, less on land, through confusion and corruption in the assessment process. One can trace this openly in professional and scholarly books and articles on appraisal and assessment – material for another article. Manuals from the International Association of Assessing Officers (IAAO) grew increasing muddled. The John C. Lincoln Foundation, supposedly dedicated to advancing the ideas found in *Progress and Poverty* by Henry George, was devoting major funding to promote “Computer-Assisted Mass Appraisal” (CAMA)of <u>buildings</u>, but not of land values.

Detroit was assessing land values at next to nil, using assessments dating from the Great Depression (Andelson, 2000, p.163, citing James Clarkson, Mayor of Southfield), and no one was doing anything about it. Economists weren’t even writing about it, not even talking about it. So Ben Smith’s faith in the invigorating powers of property taxation had less basis than before, even as the property tax itself was being diluted with other revenues. One Michigan city, Southfield, made itself an outstanding exception with outstanding results, treated below.

Note in passing that the part of the property tax that falls on capital, bad as it is, is not as bad as taxes on income, sales, value-added, or business activity. The key word is <u>activity</u>. The property tax penalizes capital for standing still; the activity taxes penalize it for moving

The late 1960s saw riots related to race and civil rights in many cities, but Detroit’s in 1967 were so bad that President LBJ sent in U.S. troops. Candidate Romney had courted blacks more than previous Republicans had, but he was a prominent leader in his Mormon Church. At that time (before 1978) this Church denied blacks full membership its (“priesthood”), and had a long if ambiguous and arguable record of discrimination in its sacred texts (blacks were “Lamanites”). That did not sit well in the new era of civil rights, although many other churches discriminated too, de facto.

Governor Romney had also been preoccupied during this, his last term, seeking the Republican nomination for U.S. President. The

12th Street Detroit Riots in 1967 damaged both him and LBJ, both of whom dropped out of the race. Romney was also condemned for opposing the war, and LBJ for waging it, but as that does not make sense it seems likely that their poor handling of the riots played a role. They never recovered, and neither has Detroit.

In 1967, more quietly, Michigan dropped its “BAT” and replaced it with a regular corporate income tax. This tax lacks some of the worst features of the BAT, but they were soon to return in the “Single Business Tax” (SBT), discussed below.

VII. Southfield booms while Detroit busts

While Detroit hollowed out, its suburb Southfield boomed. From 1950-70 it more than tripled from 19,000 to 69,000 people. It had a Georgist Mayor, James Clarkson, who made a point of raising land assessments and lowering building assessments. How can a mayor do that? Clarkson observed there is wide latitude in the assessment process, which most assessors were using to underassess land. Southfield’s Assessor had been valuing land at 10% or less of market value. In 1960 Clarkson, like Pingree in 1890, campaigned for Mayor to correct that. Meeting resistance, he hired a Georgist assessor, Ted Gwartney, and had him upvalue land and downvalue buildings. Gwartney had honed this skill earlier working for Dr. Irene Hickman, elected Assessor of Sacramento County, California, who was also an activist Georgist. Clarkson served four terms before the Michigan powers lured him away with a judgeship (Andelson 2000, pp. 162 ff.). Gwartney left to pursue a distinguished career elsewhere. Southfield immediately leveled off at 76,000 people and has not grown since.

Harvard Law Professor Oliver Oldman, a leading tax authority, scoffed at the evidence, at a meeting we both attended. Southfield was merely taking advantage of Detroit’s problems, in his view, and exploiting white flight. Southfield was engaging in competitive undertaxation, a “race to the bottom. Such, unfortunately, has been the academic PC mindset, screening out examples like Southfield’s.

Southfield’s tax base actually rose by 20% per year under Clarkson/Gwartney, and it provided good utilities and public services. Even the landowners whose assessments Gwartney raised made out well because the benefit of the relief of potential buildings from overtaxation was shifted to landowners in higher market values. It was rather Detroit that was “racing to the bottom”.

VIII. The “Single Business Tax” (SBT), 1975

In 1975 Michigan adopted its distinctive "Single Business Tax" (SBT), replacing the corporate income tax. This is a variety of VAT, a tax on gross receipts less certain deductions. First, as with any VAT, one deducts purchases from other firms, reasoning they have been taxed already on the value they added. One does NOT deduct labor costs.

Michigan's SBT has two especially bad features. One is that unincorporated businesses, mostly small, are as subject to the tax as corporations, some gigantic. The other is that buying real estate, including land, is deductible as a current expense (Hines, p.16). Logically buying land should not even be depreciable, since land does not wear out, and *a fortiori* should not be expensible in the year purchased. Imagine owners A and B selling a parcel of land to each other in alternate years, each buyer expensing it each time! It amounts to a great subsidy for holding land. At any rate, by 1980 Detroit had dropped another 20% of its people from 1970. No other state has adopted this kind of tax.

IX. Governor John Engler scuppers the property tax, 1995

In 1995 Governor John Engler decided to heal Michigan by taking its public schools off the property tax. This is when we Georgists met with his staff at the Levy Institute. Playing Cassandra, here is the advice I offered in 1995.

"What happens when a state radically slashes its property tax? Michiganders are saying they must wait and see, but there is no need for that: California can show you 17 years of experience. To read your future, just study our past. Here is what has happened since California passed Proposition 13 in 1978.

The obvious direct results have been to cut public services, raise other taxes, and lose credit rating. Our school support fell from #5, nationally, to #40 in 1985 when last seen, still falling. County road maintenance is down to where my county (Riverside) is repaving its roads at an annual rate of once every 130 years. Once in 20 years is recommended here, and up north you generally need higher frequency. You can't just build infrastructure and then stop paying for it, it's a perpetual commitment. Thanks to urban sprawl, a high fraction of our population now depends on these county roads.

In 1978 we had a surplus in Sacramento. Since then we have raised business taxes, income taxes, sales taxes and gas taxes, but go broke every June. Now our State bond rating is last among the states. One of our richest counties (Orange) has gone bankrupt; Los Angeles is on the brink of it, saving itself by closing emergency rooms and hospitals that serve as a last resort for the uninsured poor.

The private sector is doing badly, too. Raising income taxes, business taxes, and sales taxes is no way to stimulate an economy; they are all a drag on work and enterprise. Our income pc was down from #7 to #12 among the states by 1992, then fell some more. From 1992-94, California was one of three *states where median household income fell. Our unemployment rate is 9%, 50% higher than the national mean of 6%. Our poverty rate is 18%, compared to 14.5% nationally. Not surprisingly, therefore, the only government function that grows now is building and operating prisons. One of our few rebounding industries is cinema, the art of escaping from reality: we excel at that. Another thriving activity is that of auctioning off used machinery for export to the east.*

In 1993 there was net outmigration (including international migration) from this state that has symbolized American growth since time immemorial. It is unheard of. 426,000 people were lost, nearly 2% of the population. This is a watershed change: imagine of all states California, America's trend-setter, our El Dorado, The Golden State, our Horn of Plenty, the safety-valve for job-seekers and retirees and entrepreneurs from everywhere, the end of the rainbow, losing population! It's almost enough to make a person click off the tube and think.

The fall of our income pc is greater than appears from the purely monetary measure. Real pay has fallen more, because of the drastic rise of shelter prices. In San Francisco, shelter takes 50% of the median income, with many other cities, especially coastal ones, not far behind. It is unusual to find livable quarters for less than $600/mo. The median home price rose 163% during the 1980s, to $258,000 (remember that is just the <u>median</u> - the mean is higher). These rises are part of the C.O.L. of all renters and new buyers, a part not fully incorporated in standard CPI measures (for various unworthy reasons too technical to open up now).

Some cities are in desperate straits. San Bernardino in 1976 was chosen an "All-America City, a City on the Go." It went, all right: today, 40% of its people are on welfare.

California has always been earthquake country, but has always renewed itself, routinely. It was different after the Northridge quake in the San Fernando Valley, January, 1994. This is the upper-middle neighborhood of Los Angeles, but now large pockets of ruined buildings remain, unreconstructed, inhabited only by vagrants and criminals: an instant Bronx West. These blighted sections, ominous portents, spread more blight around them.

It should give one pause. It is, however, if you think about it, the expectable result of what the voters did. They turned property from a functional concept into a sacred one; from a commission to be enterprising, hire people, produce goods, and pay taxes into a welfare entitlement. They rejected the concept of a tax on inert wealth in favor of the rival concept of taxing liquidity and cash flow. The predictable result is to inhibit economic activity, and encourage holding wealth inert and stagnant.

We had a construction boom in the 1980s, but it was not healthy. It was marked by extreme sprawl, and extreme instability. Downtown L.A. was to become a great new financial capital, but now has nearly the highest office vacancy rate in the U.S., with of course a high rate of builder bankruptcies. Speculative builders were led on to overbuild, in part, by anticipated higher land rents and prices. This Lorelei effect was magnified by national income-tax provisions luring on speculative builders, but we have to ask why California fell harder than other states, even with the object-lessons of the oil states in clear view.

David Shulman tersely summarized the distributive effects of Prop. 13 as he left us for Salamon Brothers in Manhattan: "it breached the social compact." Alienation is the result, and the Rodney King riots, arson and looting are the results of alienation. True, the Watts riots preceded Prop. 13, but they were part of a national epidemic. By 1967 there were riots with arson and looting in 70 or more American cities. The Rodney King riots were endemic to California, and spread over a much wider area of Los Angeles than the Watts riots did. The looters and arsonists were not all black, and the targets were not all white, but mainly Korean-Americans who just happened to be there minding their stores.

Conventional wisdom blames our bust on the end of the Cold War. Surely that is a factor, but as a causal explanation it is too pat, too easy, and a-historical. Compare today with 1945. Los Angeles' economy depended much more on The Hot War, 1940-1945, than it ever did on The Cold War. Los Angeles' wartime boom had swelled its population as no other great city, 1940-45. After 1945 the U.S. pulled the plug on defense spending, more than today. Jane Jacobs, in The Economy of Cities, tells us what happened to military spending in Los Angeles after 1945. It lost 3/4 of its aircraft workers, and 80% of its shipbuilders. It lost its military and naval overseas supply and replacement businesses. Troops stopped funneling through. It got worse: petroleum and cinema and citrus, its traditional exports, all declined.

Pundits then forecast a regional collapse. Yet, regardless, Los Angeles never collapsed, nor missed a beat. The wartime immigrants stayed put here. They formed creative, innovative small businesses in large numbers, giving L.A. its deserved reputation for having the most dynamic, flexible, adaptable industrial base in the nation. Besides exporting goods, L.A. also became more self-contained, providing itself with more of the goods it previously imported. How could this be?

1/8 of all new businesses started in the U.S. were in L.A., 1945-50. These were small, creative, flexible, and too varied to classify. No Linnaeus could sort them in conventional categories: the new Angelenos simply stayed here and started producing everything for themselves, some things previously imported, and others never seen before. Eastern firms established branch plants here. Top eastern students came to California's great university system, and stayed behind to make careers and jobs here. There was a kind of regional "El Dorado Effect," as demand and supply grew together, and growing local demand allowed for economies of scale serving local markets. Food and shelter were cheap and abundant. Land for business was accessible, providing a basis for the whole self-contained phenomenon. A "continental tilt" developed in both interest rates and wage rates, drawing in eastern capital and labor.

Why is that not happening today, 1995? An invisible, pervasive change is Proposition 13, which makes it possible to hold land at negligible tax cost. In 1945 land was taxed at 3% every year, building a fire under holdouts to turn their land to use. Today that same tax cost is well below 1%. Using Gwartney's Rule of Thumb (see below under B,1), it is about 1/8 of 1%: a rate of 1% applied to 1/8 of the true value.

Landowners are only taxed now if they use their land to hire people and produce something useful. Then they meet the drag of our high business and employment and sales taxes, necessitated by the fall of property taxes. A handful of oligopolistic landowners control most of the market; small *businesses are squeezed out. This helps us segue from being at the cutting edge of industrial progress to a third-world economy - from the New Hampshire model to the Alabama model - with little relief in sight.*

What was different then? One obvious difference was the high property tax dependence in 1945, and the lower burdens of sales tax, business tax, and income tax. We not only had high property tax rates, they were more focused on land then than now. California was more hospitable to Georgist thinking than perhaps any other state then, shown by its long run of Georgist political action in the prior thirty years. Several states had "single-tax" movements and initiatives, 1910-14, but most of them petered out. In California they continued through 1924, and then popped up again in 1934-38. Even while "losing," such campaigns raised consciousness of the issue to such a degree that assessors were focusing more attention on land. Thus, in California, 1917, tax valuers focused on land value so much that it constituted 72% of the assessment roll for property taxation - a much higher fraction than today. This became the California tradition.

In 1934 the "EPIC" campaign of Upton Sinclair included a strong Georgist element - he proposed to set up new factories on idle land. Meantime, Jackson Ralston was pushing a purer land tax initiative, 1934-38. Ralston lost, but the mere existence of such political action in California, when the movement was torpid elsewhere, tells us a lot. It reveals a large matrix of supportive voters and workers to whom politicians (including tax assessors) would naturally respond by focusing on land assessments.

California displayed amazing growth up to 1978, and the resilience to shrug off the loss of war industries after 1945 and still grow "explosively" (as Jane Jacobs put it). After 1978 we have a string of reverses. The timing, along with a priori causative analysis, plus various direct observations too numerous for this time-slot, support an hypothesis that the reverses were aggravated by Prop. 13. Michigan, be warned of our lot, and learn about taxes from us: "This Could Happen to You."

End of quote.

The Lansing staff went home unmoved, and in 1995 Michigan, led by Governor John Engler, took its schools off the property tax, putting them on a State sales tax. The national media commented favorably, crediting California's pioneering Prop. 13. Soon, however, Michigan got sicker. The press of March 11, 2007 reported the following:

- Michigan's unemployment rate is at 7% and has been for 4 years. Only Mississippi is higher; the national average is 4.6%. Some Michigan counties are at 10%. As old industries leave they are not being replaced.
- Since June, 2000, Michigan has lost 300,000 jobs
- Personal income per capita dropped below the national average in 2000 and has stayed below.
- 22,500 people aged 18-24 have left since 2000. Michigan's rate of outmigration ranks among the U.S.'s highest.

- As everywhere, home foreclosures are up, sales and prices are down, (Riverside, The Press-Enterprise, 3-11-07, page G-6)
- It may be coincidental, but most symbolic, that the Detroit Lions of the NFL are just completing the worst season of any pro football franchise anywhere, ever.

Note again that first point, “As old industries leave they are not being replaced.” What is left behind then but idle land? Once again, Detroit is riddled with holes, and in another of history’s ironies people today are growing food in them to subsist – “Pingree’s Potato Patches” again, 105 years later.

Those are not the results you would expect from a good tax system. Michigan leaders are behaving foolishly. To protect homeowners, they shift taxes to business gross sales, and the result is loss of jobs, with homes dumped on the market for a big loss. Displaced workers emigrate with little cash, to start new lives at the bottom of the job ladder, and thank you, Governor Engler!

None of Michigan’s postwar efforts at stimulative tax reform, save one, have done the job. That one is Southfield 1960-1970, which scholars and politicians have studiously ignored. Bellwether Detroit has lost 50% of its people, 1950-2000. Flint has lost 40%. Benton Harbor on Lake Michigan is a basket case. Now, to top it off, today in 2008 Michigan has moved on from mere decline to a Crash heard round the world. All the Big 3 face bankruptcy and are begging Washington for bailouts just to keep Michigan’s once-proud auto industry going at all.

Should Washington refuse to bail Michigan, perhaps Michigan leaders will finally look in the mirror, foreswear their foolish ways, and begin a new round of prosperity. Let us hope and pray, yes, but also furnish our minds with the facts and analyses needed to do our job of pointing the way. What could be more timely, and of more permanent value?