Statement of William G. Hamm
to the Commission on the 21st Century Economy
Davis, California – April 9, 2009

Mr. Chairman and Members of the Commission

Good afternoon, and thank you for inviting me to appear before you today.

Introduction

I currently serve as the Global Head of Economics Practices at LECG [SLIDE #3] – a California-based consulting firm with offices throughout the US, as well as in Canada, Mexico, South America, Europe, China, Australia, and New Zealand. While most of my work today involves testifying as an economics expert in damages trials for the US Department of Justice and other clients, I have an extensive public policy background that I acquired during 17 years' service in government.

I have been asked to present to you the findings and conclusions in a study [SLIDE #4] that Dr. Jose Alberro and I prepared last August on the likely economic consequences if California were to adopt a so-called split property tax roll. Before I do so, let me acknowledge for the record that a decision to adopt or reject a split roll will be shaped my many considerations besides economics. [SLIDE #5] Neither Dr. Alberro nor I presume to tell you, the Governor, or the Legislature whether a split roll should or should not be adopted. I believe, however, that we can inform a decision on a split roll by providing an objective analysis of the economic consequences that adoption of a split roll would produce.

Let me also acknowledge for the record that our study [SLIDE #6] was commissioned by two groups that are opposed to the split roll, and we were paid for our work. As I always do in circumstances such as these, I insisted on complete substantive and editorial control of the project, and Dr. Alberro and I did not let the source of funding influence in any way our findings and conclusions.

Our study [SLIDE #7] addresses five important questions regarding the likely effects of a split roll:

1. How would a split-roll affect jobs and income in California?
2. How would a split-roll affect
   - Workers?
   - Consumers?
   - Renters?
3. How would a split-roll affect small businesses?
4. Would a split-roll have a disproportionate impact on racial minorities?
5. How would a split-roll affect public retirement funds?

The Economics of Property Taxes [SLIDE #8]

Before I go any further, let me explain what we mean by the term "split roll". [SLIDE #9] In California today, property taxation laws make no distinction between property where Californians live and property where Californians work. The same rules apply to the valuation both types of property (with a few exceptions, such as oil- and gas-producing property), and the same tax rate applies to both. Were a split property tax roll adopted for California, this would change. Commercial and industrial property – where Californians work – would be taxed at a higher effective tax rate than owner-occupied residential property, either because it would be assessed differently, or because a higher tax rate would apply to this class of property.

In analyzing the likely economic effects of raising taxes on commercial and industrial property, we have applied four widely accepted economics principles [SLIDE #10]:

1. Land is fixed; capital is highly ***mobile***
2. Business behavior is shaped by ***expectations*** about the future
3. Investment decisions are based on expected ***after-tax*** returns
4. A change in taxes will lead to ***changes in behavior***

From these principles, and from decades of empirical research, we can confidently make certain predictions about how a business will react to an increase in its taxes [SLIDE #11]. First, wherever possible, the business will attempt to pass the increased taxes along to one of three groups:

- ***Consumers***, in the form of higher prices for goods and services.
- ***Renters***, in the form of higher rents.
- ***Workers***, via reduced wages and/or benefits.

It is not always possible to pass-along the entire cost of higher taxes, in which case the firm will seek to reduce its tax exposure, such as by reducing its use of inputs subject to the tax. When labor become more expensive due to payroll taxes, the demand for labor drops. Similarly, when capital equipment becomes more expensive, a business may use less equipment.

Businesses may also attempt to escape the tax by locating or relocating operations to other taxing jurisdictions. I say "may" because there are important factors that influence business location decisions besides taxes. But as we will see, taxes are still important, and can be decisive in certain circumstances.

Where a firm is unable to escape the tax, and must absorb it, one of two things will happen. If the firm operates in a market that temporarily is not competitive, it may just have to forego a portion of the excess profits that it is earnings – and we need shed no tears for such firms. But in competitive markets, where prices provide only the revenues needed to cover the business's costs, including the cost of capital invested in the business, the inability to pass-along or escape the tax will force the business to close.

Looking Backward [SLIDE #12]

Before I share with you our findings regarding the economic effects of adopting a split roll, I'd like to address an argument that is often advanced in support of taxing commercial and industrial properties more heavily: the claim that Proposition 13 has shifted the property tax burden in California away from business and toward homeowners.