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GETTING DOWN TO BUSINESS
Economic Development and the Financing of Urban Growth Policy

This chapter brings together the Realty Regime’s economic development policy and the initial stages of its expansive urban growth policy. Economic development policy was based on misreadings of such elements of economic development as transportation, economic trends, and the business organization. The regime failed to understand that a key element in Cleveland’s economic development was its ability to adapt to changing transportation technologies. The regime also failed to perceive the changing themes of the post World War I economy and the new vertically integrated business organization. The most critical misreading came when the regime substituted urban growth policy for economic development policy, a mistake which obliged the regime to use tax reform and municipal budgets to raise the large sums necessary to finance its urban growth policy.

ECONOMIC DEVELOPMENT: THE LOST POLICY

Any economic activity that did not put money directly in the pockets of realtors failed to kindle the interest of the Realty Regime. Urban growth did generate pecuniary rewards, and the self-interested thinking of the Realty Regime deflected its attention from economic development policy to urban growth policy. But the shortsighted substitution of urban growth policy for economic development policy stemmed also from other factors.

Cleveland’s economic development in the 1920s was shaped by three forces, one misunderstood by the regime and the other two not comprehended at all. First, the Realty Regime failed to understand that Cleveland’s
economic development was tied more to the city’s ability to keep pace with technological innovations in long-distance transportation than to long-distance transportation per se. Second, Cleveland’s economic development during the course of the Realty Regime was affected by the swings of long-wave cycles, national, perhaps international, economic phenomena not well understood by anyone. These undulations crested in 1920 and fell thereafter, with devastating results for Cleveland’s economy. Third, the Realty Regime did not appreciate the consequences of the organizational and managerial changes taking place in multilocational businesses. These changes shifted economic development policy making from the Realty Regime to corporate managers who, like the realtors, were unaware that their decisions shaped Cleveland’s economic future. The managers focused narrowly on the economic health of the companies and ignored the local impact of their business decisions.

**Long-Distance Transportation: The Past as Present and Future**

Cleveland’s economic development paralleled advances in long-distance transportation technology, the surfaced road, the canal, and the railroad. By the 1920s the link between transportation and industry was a litany tirelessly repeated in noon hour oratory, Fourth of July celebrations, and election campaigns. The point obscured by the orators was that earlier economic development policy tied the city to innovations in long-distance transportation technology. The Realty Regime missed the point. They saw Cleveland’s future economic development tethered to the older technology of water and rails. They were oblivious to the new technological innovations in long-distance transportation, the truck and the airplane. Not linking Cleveland to the new transportation technologies contributed to the listless pace of economic development.

The rail transportation element in the Realty Regime’s economic development policy was set by the Van Sweringen brothers, Cleveland real estate operators but also the builders of a Cleveland-headquartered railroad empire. The Vans invested heavily in traditional modes of long-distance transportation, and after their purchase of the Nickel Plate Railroad in 1916, they devoted the next decade to consolidating their ownership of other railroads serving Cleveland. Ultimately, these acquisitions gave the brothers, who confided to a local reporter that their favorite authors were Rand and McNally, a near monopoly on rail transport throughout the northeastern quadrant of the country and a commanding presence in the Trans-Mississippi West. The Van Sweringen rail empire was financed
through an elaborate pyramid of holding companies originating in Nickel Plate Securities, extending to the notorious Allegheny Corporation, and culminating in an apex formed by the Vaness and General Securities corporations. Initially, the heavily mortgaged Van Sweringen railroads were profitable, transshipping thousands of tons of freight and depositing 2 million passengers annually in Cleveland.

With the city’s long-distance transportation connections locally owned and headquartered, Realty Regime policy makers assumed that the economic development of the city was assured. But just as the Van Sweringens were assembling their debt-burdened railroad empire, the industry itself was proving overbuilt. Warning signs were ignored. As the use of trucks, cars, and planes increased, railroad traffic steeply declined in the late 1920s and profits with it.

At the same time, Cleveland’s tradition of relying heavily on water transportation continued. Because the Cuyahoga River was historically linked to the harbor complex, the Chamber of Commerce, as in the past, supported projects coupling river straightening and harbor improvements; but the Cleveland Real Estate Board only paid lip service to harbor improvements and adamantly refused to endorse tax increases and bond issues to straighten the river.

The Realty Regime was not opposed to water transportation connections. Instead, CREB supported the grandiose St. Lawrence Waterway Project, which would be paid for by federal rather than local taxes. The Realty Regime felt that river and harbor infrastructure were already built and that rail infrastructure was safely contained in the Van Sweringen rail empire. The St. Lawrence Waterway Project was Realty Regime economic development policy at its most visionary.

Closer to home, the Realty Regime shunned other new long-distance transportation technology—flight facilities. In 1926, the Cleveland Realtor reported that other cities had left Cleveland behind in the development of air transportation. Cleveland, the paper concluded, needed an airport. The city lagged in the development of air service because the city’s banks refused to loan money to finance the routes. When William B. Stout, a pioneer in the air passenger business and airplane manufacturing, came to Cleveland to raise money to finance his routes, he was turned down by Cleveland banks. Stout went next to Detroit, where he received the financial backing of Henry Ford, a man in the flight-related finished metals products industry, an entrepreneurial type in short supply in Cleveland.

Cleveland banks no longer supplied investment capital to industry because their assets were committed to the Van Sweringens and other real estate developments. The pool of potential venture capital held by the
entrepreneurs was now invested either as passive capital or was channeled into the University Circle institutions.

Long-Wave Rhythms and Short-Term Cycles

Quite apart from Realty Regime reliance on railroads and water connections, Cleveland’s economic development was adversely affected by long-wave up and down rhythms in the international economic system. A long-range up rhythm of approximately fifty years ended abruptly in 1920. It was during this long-range rhythm that Cleveland experienced its industrial revolution. The economic factors that paced this long-wave rhythm—railroad construction, iron and coal extraction, and metals making—formed the core of Cleveland’s economy. As the long-range rhythm ended, railroad construction, iron and coal extraction, and metals making entered a steep downward slide beginning in 1920, bottoming out in 1930. The effects of the long-range rhythm limited the city’s economic development policy options throughout the decade.8

Simultaneously, a cyclical stagflation crisis hit the nation’s economy in 1918–1919, bringing with it more immediate local repercussions. Policy makers could measure the stagflation crisis in the sharp increases in prices paid for goods and services, soaring municipal operating budgets, spiraling debt, higher interest rates, strident employee demands for increased wages, and a drop in housing starts. But Realty Regime growth policy led by infrastructure spending helped pull Cleveland out of the stagflation crisis. Bridge building, streetcar line extensions, street and highway construction, and utilities installations created the jobs and profits fueling what became a decade-long city building boom encouraged after 1921 when the Federal Reserve lowered interest rates. Throughout the decade, the long-range economic rhythm had a negative impact on the city’s economic development, but the correction of the shorter term economic cycle created a building boom in Cleveland and a false sense of prosperity.9

The Impact of Vertical Integration

The Realty Regime could have improved the relative competitive position of Cleveland’s export sector by heeding the new technologies in transportation (trucks and planes) which were responsible for the decline of the railroad industry. However, the fate of the export sector was also swayed by a newly evolving business organization, the institutional offspring of
America’s second great corporate merger wave, surfacing shortly before World War I and cresting in the late 1920s. Many of Cleveland’s entrepreneurs, as noted earlier, sold off their businesses during the initial merger wave. The consolidation process in durable goods industries continued and was largely completed during the second merger wave in the 1920s, in which large companies integrated their operations from raw materials sourcing to finished products distribution. Independent Cleveland companies in minerals, shipping, metals making, and metals fabrication stood as signposts along the road toward vertical integration and were easily absorbed into giant vertically integrated combines.

Vertically integrated corporations in steel, electricity, autos, and communications inaugurated a new phase of managerial capitalism. Operating decisions rested in the hands of salaried managers who were also the designers of these giant oligopolistic combines, enterprises which competed with one another for market share and profits by means of functional and strategic effectiveness. “Functional” competition meant improving the product, streamlining the processes of production, sophisticated marketing, timely and cost conscious purchasing, and stable labor relations. “Strategic” competition compelled professional managers to make quick decisions about when to enter and leave markets. Corporate functional and strategic decision making brought local geographical repercussions which, almost unnoticed, substituted for the economic development policy in most cities, including Cleveland. Vertically integrated businesses hired many white collar managers and functionaries who more than offset the loss of blue collar jobs in the 1920s. The bountiful market in upper middle class suburban residential real estate that enriched Cleveland’s real estate operators during the decade was the local effect of the organizational and managerial employment in export sector industries. The corporate managers residing in these suburban dwellings made economic development policy for urban America from their offices in the central business district.

Functional strategic decision making in a vertically integrated organization became a key element in the urban economy. Corporate decisions about where to locate the production, distribution, back office, and headquarters functions of the modern industrial enterprise replaced local economic development policy. These decisions affected countless other decisions by managers in ancillary industries and services. For example, the decision by the Ford Motor Company (and later GM) to build an assembly plant in Cleveland influenced the locational decisions of parts makers and paint and tire manufacturers.

In the 1920s Cleveland was the beneficiary of management decisions made in other cities. The cloud on the horizon was the sensitivity of managers
to growing and declining markets. As long as Cleveland was perceived as a growing market and an advantageous point of distribution, it would benefit from managerial decision making. Even in the 1920s, however, production and distribution facility decisions were predicated on market size, availability of land for single-story production facilities, and integration into the emerging auto and air transportation network. Doubts had already been expressed about Cleveland because of the inability of the industrial real estate market to generate sites for single-story production facilities and the apparent local indifference to the new transportation technologies.15

Reliance on traditional forms of long-distance transportation to achieve development failed the Realty Regime and failed Cleveland. The realtors were working with an industrial era understanding of the metals making corporation that required rail and water transportation. Both of these the Realty Regime believed to be in good shape, a belief that jaundiced its view of air transport. The emergence of the modern vertically integrated industrial enterprise doomed local control over economic development policy. As a result of these factors, Realty Regime economic development policy came more and more to be linked to urban growth. Most of the issues the regime supported in the name of economic development were in fact infrastructure schemes designed to achieve urban growth.

FINANCING THE REALTY REGIME I: REVENUES

Analysis of the urban growth policy of the Realty Regime begins with a journey through the jungle of tax avoidance and tax burden shifting. Indeed, no policy-related issue claimed more of the Cleveland Real Estate Board’s energy than taxation. Taxation had a dual importance: it was crucial to the real estate industry’s matrix of profit and loss calculations, and it also was central to public policy making because taxation redistributes wealth from one group to another, determining, in effect, which groups will pay for the urban policy preferences of the regime in power.

It was an article of faith with Realty Regime members that the local tax structure inherited from the Corporate Regime redistributed wealth from themselves to wealthier individuals, multilocational corporations, utilities, and the service-consuming public more generally. The Realty Regime’s attempts to shift the tax burden involved it in a hard fought tax reform war waged in four successive fronts: (1) a losing battle against wealthier individuals and corporations—the core of the Corporate Regime—to shift the burden of local taxation from real to personal property; (2) a fight to
achieve an objective, scientific method of property tax valuations and from these valuations a determination of the taxable percentage of the market value; (3) the struggle to achieve a fair ratio between site and improvement taxes, and (4), during the darkest hour when the tax war seemed lost, a successful last ditch campaign to shift the burden of the real estate tax from large to small holders of realty.

Real vs. Personal Property

One of the unsung accomplishments of the Corporate Regime was its success in shifting the burden of local tax incidence (who pays) from themselves in the form of personal property to others in the form of real property. The tax dollars that supported Corporate Regime public policies came mainly from the real estate tax, a classically suave example of the regime in power shifting the tax burden from themselves to those at the margins of power.

In the closing decades of the nineteenth century, the “property tax” was the largest single source of municipal revenues, amounting to some 60 percent in Cleveland and most other cities. The term “property tax,” however, is a misnomer because it embraces two antagonistic elements: real property and personal property. The real property tax was a measure of the tax burden of real estate holders, while personal property tax was a measure of the tax burden of individuals and corporations. Therefore, the assertion that the “property tax” contributed some 60 percent of all municipal revenues between 1870 and 1930 needs to be separated between shares paid by real estate taxes and those paid by personal property taxes.

The many varieties of personal property included individually owned household items, bank accounts, stocks, and bonds; in addition, such corporate holdings as machinery, inventories, bank accounts, stocks, and bonds were also classified as personal property. This was the wealth (earlier identified as active capital) which the Corporate Regime heralded as good capital and which as such should be shielded from the grasp of the local tax collector. The Corporate Regime regarded real property, in contrast, as passive (bad) capital which richly deserved the attention of local officials. Three classes of real property were taxed: income-producing property; property bought for resale; and owner-occupied residential property. In Cleveland, uniquely, the ninety-nine-year leasehold constituted a fourth form of taxable real estate.

As early as 1895, at the very dawning of the Corporate Regime, the ratio within the property tax between real estate taxes and personal property
taxes was shifting to the detriment of real property holders. During the
decade of the 1890s alone, the share paid by personal property tax slumped
to 39 percent of the whole. Two decades later, Amos Burt Thompson, in
testimony before the state’s Special Joint Committee on Taxation in 1917,
charged that the value of personal property on the county tax duplicate was
less than the deposits in Cleveland banks, the deposits themselves repre-
senting only a fraction of the total of personal property owned by Clevel-
landers. Thompson offered the joint committee data showing that county
real estate tax now amounted to 75 percent of local taxes, while the portion
paid by personalty had eroded to a negligible share. The difference
between Thompson’s 75 percent figure and 100 percent was made up by
various local user taxes. These statistics testify to the ability of the Cor-
porate Regime, during its heyday dating from 1895 to 1917, to shift tax
incidence from themselves to the then less powerful holders of realty. Cor-
porate interests justified this on the grounds that personal property was
active capital and an asset to the export sector of the economy while real
property was passive capital held in the main by greedy land speculators
and franchise-holding monopolists who fittingly deserved punitive taxes.

This shift explains why Ohio Grange orators were popular speakers at
Cleveland Real Estate Board (CREB) luncheons in the 1920s. Grangers and
the farm interests they represented had more experience than any other
political interest group in matters of land taxation. For half a century,
Grangers opposed real property taxes because they made real property
owners pay the cost of government services which benefited corporate
interests more than farmers. Granger rhetoric argued for a “fairer” system
of taxation in an attempt to shift the weight of tax incidence from land
holders to individuals and corporations. This goal could be achieved in
three ways: through a fairer, more scientific system of real estate appraisal;
by collecting the widely evaded personal property tax; and by taxing other
forms of wealth. Initially, at least, the second and third parts of the Granger
testament had more appeal to the Cleveland Real Estate Board than the
first.

Fired by Granger rhetoric, CREB and its allies in the city attacked the
tax evasion artifices of Cuyahoga County’s wealthy individuals and corpo-
rations. In doing so, they locked horns with John A. Zangerle, the formi-
dable Cuyahoga County auditor. Zangerle was a man of many talents, a
local legend in the newly emerging field of real estate appraisal, a lawyer, a
land economics expert, and, like his critics, a part-time real estate opera-
tor. Zangerle was not out of sympathy with the claims of the realtors, but
he was far more realistic about the possibilities of tax burden shifting than
his critics in the real estate industry.
CREB repeatedly pushed for greater reliance on the personal property tax, a stratagem Zangerle scorned. Zangerle’s calculations showed that a rigorously enforced personal property tax would yield little more money than the tax was already generating. The personalty held by individuals was difficult to assess and was in any case too easily hidden from the tax collector. The truth was that individuals held only a small fraction of the total value of personalty, a portion estimated by Zangerle in 1924 to be only 11 percent.

Corporate personalty was the key element in the personal property tax. The seven wealthiest individuals in Cleveland held personalty amounting to only $14.2 million; but the share value of the seven largest corporations headquartered in Cleveland totaled $71.7 million. Even this latter figure was an underrepresentation. According to Zangerle, corporate personalty was assessed by a flawed formula. Corporations were assessed only in terms of their local plant, capital equipment, and inventories. These assets did not reflect the real worth of the company. In a speech before his critics at CREB, Zangerle explained that the true worth of the corporation was not the value of its personal property in Cleveland, or even its stock, but rather the value of its stock plus its debentures (bonded debt). The personal property of the Standard Oil Company, to cite one of Zangerle’s examples, was valued at $6.4 million, but the value of the company’s shares was $19.25 million, meaning that in shares alone there was an untaxed “corporate excess” of $12.845 million. Zangerle was also keenly aware of the local tax implications of the multilocal corporation. Those seven Cleveland companies cited above whose Ohio shares were worth $71.7 million had out-of-state operations totaling $60.9 million in share value. In 1919, even before the merger wave of the 1920s was felt, Ohio assets were just 54 percent of the corporate total. The problem was, Zangerle told his listeners, that existing state tax law was not in synch with the multilocal corporation.

Zangerle proposed a comprehensive set of tax reforms, including graduated personal and corporate income taxes and taxes on inheritances and decedent estates. He advocated registration fees and property taxes on automobiles. Zangerle also saw that public utilities, franchises, building and loans, commercial banks, and corporations used sleight of hand accounting techniques to avoid paying their share of local taxes. To cut through the dubious accounting, Zangerle told the state legislature’s Joint Tax Committee that these businesses should be assessed at their market value, that is, share plus debenture value. Corporate book value, another option presented to the legislators, Zangerle opposed because book value was based more on the sorcery of company accountants than on business reality.
These reforms never materialized during the course of the Realty Regime. CREB and its Cleveland and Granger allies lobbied hard with the state legislature for passage of a tax reform package similar to that proposed by Zangerle, but it was blocked by corporate interests in every legislative session. With the battle to shift taxes from real property to personal property apparently lost, the Realty Regime turned to the first point in the Granger testament: fair, objective, and scientific real estate appraisal.

**Appraisals**

The real property tax was levied against four forms of real estate: (1) income-producing property; (2) property bought for resale, including vacant land; (3) residential property; and (4) the ninety-nine-year leasehold.\(^30\)

John A. Zangerle had a simple, yet fair, solution to the problem of valuing all four forms of real property for tax purposes. Appraisals of value should be based on the most recent sale of the property.\(^31\) That way the value of real estate was set by impartial market forces based on bargaining between buyer and seller that seemed fair and objective and could be used to set valuations for all four forms of real property.\(^32\) The Realty Regime, unsympathetic to Zangerle’s procedure, charged that the auditor’s method was simplistic because it treated all four forms of real property as one when in fact they were significantly different. The real estate industry argued for a real estate tax appraisal system sophisticated enough to recognize the differences between the four forms of real property.\(^33\)

**INCOME-PRODUCING PROPERTY**

In Cuyahoga County, income-producing property, like all other forms of real property, was taxed on total value of the property based on its most recent sale. The consequences of property re-evaluation after a sale were that businessmen either sustained lower after-tax profits or, more commonly, they retaliated by passing these costs on to consumers in the form of higher prices. The real problem, however, was that the real estate tax was calculated on the value of the entire asset, rather than the income generated by the real property asset.\(^34\) The real estate industry claimed owners and consumers could both benefit if the American system of taxing income-producing properties followed the English example. In England, only the income derived from the property was taxed, not the total capital value of the property, the American practice.\(^35\) CREB lobbied hard but in
the end failed to change the tax laws on income-generating property.

UNIMPROVED PROPERTY

The taxation of unimproved land was an inflammatory issue in both corporate and realty eras. The great disparities of wealth characteristic of the industrial era were attributed by many reformers to the unearned increment in rents and land sales reaped by the holders of unimproved land. Reformers prescribed very high taxes on unearned increments, the proceeds from which would be used to solve social problems. Some of the more imaginative critics blamed profits in undeveloped land for suburbanization, and suburbanization in turn for the maladies visited upon inner cities.36

The Realty Regime saw things differently. Viewing these matters as both taxpayers and profit seekers, the Realty Regime claimed that real estate taxes on unimproved land were counterproductive. The real estate operator who bought unimproved land was celebrated by his fellows as a fearless, risk-taking entrepreneur, a long-odds gambler who put his capital on the line when he invested in unimproved real estate. Because unimproved land generates no income, the real estate tax is felt keenly. From an accounting standpoint, taxes are temporary losses and are added to the cost of the property. If, for example, the property taxes amount to 3 percent annually, nearly 17 percent would be added to the cost of the land over a period of fifteen years. Realtors therefore opposed paying taxes on non-income-generating land. Real estate taxes forced land into the market too soon and into expedient rather than higher and better uses as claimed by tax reformers. The Realty Regime argued for not taxing vacant land until the time of sale and then, at the time of sale, imposing a fair capital gains tax. Here again the Realty Regime failed. The public and the county auditor were too finely attuned to the twin evils of speculation and unearned increments to allow changes in the practice of taxing unimproved land.37

SITE VS. IMPROVEMENT TAXATION

The 1911 Tax Commission raised real estate taxes on sites and lowered them on improvements. This was a strategy calculated to reward improvements and punish speculators tempted to hold sites vacant or in low-order uses until market conditions ripened. CREB reacted to the punitive effects of site vs. improvement taxation, but it failed to devise a sound alternative solution to the problem. While the Realty Regime thought sites were too heavily taxed, the real estate industry was unwilling to shift the burden to improvements. High real estate taxes on sites impeded land parcel assembly,
and high taxes on improvements worked against the principle of highest and best use. Because the Realty Regime lost the battle to shift the tax burden from all forms of real property to personal property, site vs. improvement taxation was a crucial issue, but it stymied CREB. The organization was unable to develop a position on the issue that would satisfy land owners and site developers. This dilemma caused the Realty Regime to fight for personal property tax reform long after it was obvious that the Regime would not be able to shift the burden of taxation to personal property.  

THE NINETY-NINE-YEAR LEASEHOLD

Appraisal techniques and site vs. improvement taxation loomed large in ninety-nine-year leaseholds. The first problem involved assessing the value of the site. Since no sale actually occurred, the actual market value of the land was murky. The county auditor’s position was that the market value of the land was the same as the value of the lease. For example, under a standard ninety-nine-year lease, a $100,000 property would pay $777,000 in rents over the term of the lease. Accordingly, the property was assessed at $777,000. Lawyers Amos Burt Thompson and Robert Bingham complained bitterly that since in a fee simple sale the market value of the land would be $100,000, that sum should be the assessed value, not the $777,000 tabulated by the auditor.

Lessees fought in vain for assessments calculated from current marketplace value. The ninety-nine-year leasehold, of course, was in some measure designed as a tax avoidance scheme: leaseholds commonly transferred the tax obligation from the owner of the site to the owner of the improvement because the owner of the improvement received better tax treatment than the owner of the land. Nonetheless, the lessees fought to reduce their tax obligations. Unable to sway the county auditor, Thompson and Bingham altered the standard leasehold contract so that the tax burden was shared, the lessor paying taxes on the site and the lessee paying on the improvement. This was not an ideal solution, but it allowed ninety-nine-year leasehold arrangements to continue. In the 1920s, however, federal tax advantages for both parties outweighed the local tax liabilities Thompson and Bingham fought against.

Shifting the Tax Burden

Historians as well as contemporary observers have documented a shift in the burden of the real estate tax from large to small real property holders
in the 1920s. The simplistic system of real property tax assessments that became the bane of the Realty Regime most significantly made no distinction between income-generating commercial property and non–income-generating residential property. All forms of real estate were taxed at the same flat rate. Factories worth in excess of $100,000 were taxed at the same $19.30 rate that owner-occupied houses valued at under $10,000 were charged. Throughout the 1920s, however, the Realty Regime was able to hold down increases in commercial property assessments by filing an avalanche of appeals and bargaining outcomes with civil servants in the auditor’s office. The Cleveland Association of Building Owners and Managers (CABOM) also took aim at the evasive tax accounting techniques of the utilities companies, who dodged personal property taxes and paid little in real estate taxes. Obviously CABOM, as the representative of large realty holders, participated in shifting the burden of real estate taxation to smaller taxpayers and found scapegoats to blame for the result. What could not be won from the holders of personal property was won from the small holders of real estate. This was a less than ideal solution to the problem of regressive local taxation, but it did succeed in easing the burden on large realty holders.

THE CONSEQUENCES OF SHIFTING THE TAX BURDEN

A price was paid for the victory. Richard T. Ely, a University of Wisconsin economist, told a CREB lunch hour audience that the local low-income housing shortage was caused by inequitable real estate taxation. “Better housing,” Ely said, “means reconstruction of taxation. Our American system of taxation nearly everywhere, and I think I may say, especially in Cleveland and Chicago, is antiquated, resulting in unjust distribution of the public burden.”

Ely calculated that the burden of real estate taxation had shifted to home owners in the course of the decade that the Realty Regime had been in power and calculated that Cleveland, like many other cities, was also undergoing a crisis in the supply of low-income housing. The real estate tax structure, he said, contributed to the low-income housing crisis. For low-income owners of low-income housing, the tax was an additional expense that could not easily be borne by financially strapped families. For those who invested in low-income rental properties, the tax cut into profits that were already razor thin and unattractive compared to alternative investments in middle-income rental housing. The real estate tax also contributed to the crisis in the construction of new low-income housing because the high cost of inner city land, inflationary construction costs,
interest, and taxation narrowed profit margins to unappealing levels. There were far more profitable investments to be made in other forms of real estate where the tax burden could be more easily absorbed or passed on to more affluent buyers or tenants. These were far more profitable investments to be made in other forms of real estate where the tax burden could be more easily absorbed or passed on to more affluent buyers or tenants.44

The decade-long war to shift the tax burden from real property to others ended inconclusively. The campaign to tax personal property failed. So too did the battle to achieve more sophisticated formulas for property valuation, formulas which would make fine-grained distinctions between the four forms of real property. Because the Realty Regime’s tax reform agenda was conflicted, the outcome of the struggle to achieve some form of parity between site and improvement taxation was muddled. In the end, the real estate tax burden was shifted to the owners of residential real estate, a hollow victory because home owners became highly sensitive to policies which would raise their property taxes. Because the Realty Regime advocated urban growth and service distribution policies that were highly dependent on infrastructure spending financed from the real estate tax, alternative means were sought to camouflage the cost of urban growth policy making.

FINANCING THE REALTY REGIME II: MUNICIPAL BUDGET EXPENDITURES

The narrow purpose of tax reform was to improve real estate industry profits, but the broader goal was to increase the flow of revenue needed to finance urban growth policy. The failure of tax reform led the Realty Regime to resort to schemes which would exploit fiscal opportunities on the expenditure rather than revenue side of urban finance. Rebuffed in its attempt to tax and spend to finance its policies, the Realty Regime, not unhappily, resorted to the practice of borrowing and spending, municipality by municipality.

Manipulating municipal expenditures was an easier task than changing tax laws, but legal obstacles nonetheless existed. These were state-mandated municipal expenditure limitations. Such expenditure limitations dated from the 1911 Smith Act, which limited local tax increases for operating budgets to one percent but allowed an additional one half of one percent for sinking fund charges and interest on debt.45

State-mandated municipal tax ceilings brought a renewed sensitivity to the distinctions between operating and capital budgets. Neighboring states learned early that tax limitation laws such as the Smith Act did not limit overall municipal spending. While the tax ceilings held operating budgets
in check, municipalities resorted to various forms of capital budget borrowing to circumvent caps on operating budgets. “Public finance,” a New York legislative committee found, “is made within budget but public overseers have adopted a more relaxed attitude toward capital budgets and municipal debt.”

Post–World War I inflation placed heavy upward pressure on municipal budgets. Relief came at last from the Gardner Act (1920), which released cities from tax ceilings on debt. In the aftermath, Cleveland’s debt soared (although it was brought under control late in the decade). Operating budgets were subject to Smith Act ceilings, but the Gardner Act liberated capital budgets. The Realty Regime became the vocal public champion of fiscal restraint in operating budgets, while with less ceremony it liberated capital budgets in municipalities everywhere in Cuyahoga County. At a time when Cleveland’s bonded indebtedness rose to $137 per capita, suburbs such as East Cleveland reached $153, Lakewood, $175, West Park, $217, and Cleveland Heights a pace-setting $470. Suburban capital debt was the handiwork of the Gardner Act, and the Realty Regime made fiscal policy regional in scope, for the Realty Regime viewed city and suburban budgets as a single fiscal pot. The Realty Regime postured as operating budget slashers in both Cleveland and the suburban municipalities because operating budget increases made an immediate, highly visible impact on vote-casting taxpayers, and were in truth restrained by the Smith Act. Capital budgets were another matter.

Suburban capital budgets were the Realty Regime’s piggy bank. Home rule municipal charters, the Gardner Act, and the tax-free municipal bond gave the Realty Regime virtually a free hand in developing the suburbs and in creating the balkanized urban regions we know today. Municipal charters opportunely separated municipalities from school districts, giving municipalities and school districts separate taxing authority. Although the Smith Act restrained municipal operating budgets, it did not affect school district operating budgets, which soared through the 1920s. The Gardner Act, however, was the key to municipal finance because it permitted almost unrestrained capital-expenditure borrowing for both municipalities and school districts. Suburban mayors, councilmen, and school boards were largely members of the Realty Regime, and they used suburban capital budgets and school operating and capital budgets to develop a place-specific regional urban policy.

Because they were highly visible to the taxpayers, suburban municipalities had tight operating budgets, and most suburban municipal operating budgets were only a fraction of the school district’s operating budget. Suburban municipal operating budgets were held up to Cleveland’s political
leadership as models of fiscal restraint. Capital budgets painted a far different picture. Suburban municipalities borrowed heavily for growth-related schemes designed to lure home buyers to the suburbs. Infrastructure spending for the delivery of services was also a major suburban expense, and it was purchased though the capital budget and financed with tax-free municipal bonds. School districts borrowed heavily for buildings and equipment. Municipal bonds, in addition to the appealing tax advantages, were sold as safe investments because of the affluence of the resident population and the community’s potential for growth.51

Municipal bonds created a booming business for a local underwriting community composed of bankers, lawyers, and brokers.52 The most attractive aspect of capital-budget bonded debt was that the real costs of government could be hidden from suburban taxpayers for decades, perhaps until another regime was on watch.

CONCLUSION

The Realty Regime’s dubious economic development policy and an urban growth policy grounded in the maze of municipal finance had long-term effects on Cleveland, possibly even greater than the more conspicuous achievements of the Corporate Regime. Realty Regime economic development policy, perhaps, should not even by dignified by the word “policy” because the regime had so little understanding of what economic development was and the institutions responsible for shaping it. The realtors were, for the most part, small businessmen in the local rather than export side of the urban economy. They did not understand the great changes taking place in the modern business enterprise during the 1920s. Nothing about these giant combines resembled Realty Regime businesses. Most of all, the Realty Regime did not understand that corporate decisions about where to locate the parts of the business enterprise governed local economic development policy. Instead, the realtors focused on something they did understand, urban growth policy, which they substituted for economic development. Urban growth policy as city building did have good economic results, but the results came at a cost. This realization is what drove the Realty Regime’s taxation and municipal finance campaigns. The regime’s urban growth policy would be expensive (as well as profitable), and it schemed to pass the costs on to others, to the living in the form of tax burden shifting, and to taxpayers not yet born in the form of municipal bonds.