

Citizens League
545 Mobil Oil Building
Minneapolis, Minnesota 55402

Minutes of Meeting

METROPOLITAN FISCAL DISPARITIES COMMITTEE

Thursday, March 7, 1968 - 6:30 p.m.

Minneapolis Public Library, Room 253

PRESENT: Earl F. Colborn, Jr., Chairman; Arch Berreman, Bruce L. Brayton, Thomas Connelly, John J. Costello, William E. Drake, Mrs. Nicholas Duff, Vincent C. Dworak, Robert Ehlers, James C. Erickson, Richard J. FitzGerald, James A. Fougeron, Julian Garzon, Loren Gross, Robert R. Jacobson, Sen. William G. Kirchner, William V. Lahr, Leland C. Lehman, Dennis Mathisen, Gordon Moe, Mrs. Harold Nash, Don Nolte, Rep. Fred Norton, Richard Oakley, F. W. Preeshl, Thomas E. Rohricht, Rep. Martin Sabo, Robert Sands, Arne Schoeller, Willis F. Shaw, Mrs. Alpha Smaby, Mr. and Mrs. Matthew H. Thayer, Thomas Vasaly, Norman Werner, Arthur Whitney. Staff: Ted Kolderie, Paul Gilje, Jim Carney, and Neill Carter. Guest Speaker: Lynn A. Stiles. Guests: Ronald Langness, Lloyd Brandt, Tom Anding, R. W. Turnlund, Joy Griffin, and Will and Shawn Hartfeldt.

1. The meeting was called to order at 6:50 p.m. by Chairman Colborn. Mr. Colborn reviewed the assignment of the committee. He read the following statement about the committee's responsibility:

This committee will review the differences in taxable capacity, tax rates and service levels among the various municipalities and school districts in the Twin Cities area. It will examine the effect of these variations on the area's current efforts to move toward an orderly program of metropolitan development. . . with particular attention to the effects of the heavy use the system presently makes of the local property tax. Third, it will review the effects of the 1967 tax relief and reform act to determine its impact on the inter-community variations in tax resources and in services. The committee is to recommend ways to reduce disparities within the metropolitan area, and ways the fiscal system can be revised to facilitate metropolitan development objectives.

Time of meeting -- The Chairman said that it is our intention to meet weekly on Thursday evenings, and alternate our meetings between Minneapolis and St. Paul unless there is some major objection to meeting on Thursday nights. We will be holding our meetings in the downtown public libraries of the two central cities. Our meeting next week will be in the auditorium of the second floor of the St. Paul Public Library. We will meet with State Representative Howard Albertson of Stillwater and the City Manager of Bloomington and Village Manager of Roseville. The purpose of our first seven or eight meetings will be orientation. It is our intention to bring speakers before the committee who will indicate the way that

decisions are made by municipalities and other governments in the Twin Cities area to attract tax base. We hope to point out what the results of such actions are, both from the standpoint of ability of certain local governments to finance their services and on the difficulty in undertaking major metropolitan programs, such as park acquisition.

The various members of the committee and the staff were introduced.

2. Presentation by Lynn Stiles -- The Chairman introduced our speaker for the evening, Lynn A. Stiles, Senior Economist with the Federal Reserve Bank of Chicago. Mr. Stiles has been with the Federal Reserve Bank in Chicago for some 15 years. Prior to that he worked with the State Department of Finance in Chicago. He has a degree from the University of Chicago and has done graduate work. He is a nationally known authority on the problems of property tax disparities among municipalities in metropolitan areas.

Mr. Stiles said that he would have only a few introductory remarks, preferring to spend the bulk of the time in discussion with committee members. In his opening remarks he made the following points:

- . It is good that this committee is taking a look at a long-neglected problem. It is even very surprising how little attention the matter of fiscal disparities among governmental units in a metropolitan area is ignored in Washington. Apparently, in the suburbs around Washington nothing approaching the problems we have here exists, so that there is not as much incentive to be concerned about this at the federal level. The problems in the Twin Cities area are much similar to those in Chicago, but the situation is even more aggravated in Chicago and may be more difficult to resolve.
- . Years ago, when both Minneapolis and St. Paul were still growing, and all growth was taking place within the corporate boundaries, we did not experience the fiscal disparity problem as it is experienced today. As growth occurred, the people were all part of the same municipality and therefore were all sharing in the services. Within the same taxing district there was the industrial, commercial and residential properties. However, in the burgeoning metropolitan growth since World War II we have seen a dramatic change in this situation. Suburbs on the outskirts of the central cities have grown up either with a great amount of tax base or with very little. In some cases the suburb involved has been almost exclusively residential. This has imposed a very high tax burden upon the residents there, particularly when the value of the housing is not very high. At the other extreme we have found that certain suburbs have been fortunate enough to attract a large amount of industrial and commercial properties, thereby holding down the overall tax base in that community and giving it a disproportionate share of the total.
- . Communities have frequently zoned to attract tax base and repel consumers of public services. This is known as fiscal zoning, in Mr. Stiles' words. A community will zone to bring in a new industrial plant, and the taxes raised thereby represent a net windfall to the community, since the amount of services required by the government because of its location there is very low. Frequently, the smaller the school district is in which certain industrial plants are located, the less likely it is that the children of the workers in the industrial plant will be educated by taxes raised upon that plant.

Generally the workers will live in another taxing district.

Those communities which are fortunate enough to have attracted substantial tax base and at the same time hold down the volume of housing have been able to provide for their residents a very low tax rate and of course this low tax rate applies to the industries located there as well. In effect, this has the tendency to render this industrial and commercial tax base somewhat tax exempt. By being located in a community with few residences, the overall demand for public services is low, and therefore the tax rate on the industrial and commercial properties is also low. We can see how this has a mushrooming effect, in that a community with a low tax rate is probably likely to attract additional commercial and industrial tax base, which has the result of depressing the tax rate even further. At the same time the communities which really need the tax base--those with large amounts of residential property--are unable to attract this tax base because their rates are already so high.

Consequences of fiscal zoning -- We see that each community, regardless of its position, is likely to try as hard as it can to attract industrial and commercial properties as well as residential. We have so many of these communities that we end up with a situation in which some 100 municipalities are trying to have a balanced tax base in a metropolitan area. This, of course, is impossible. But the very attempt to do so produces a less desirable metropolitan scene than if the industrial and commercial properties were located more in a cluster and where they were needed, rather than sprinkled in various communities.

The consequences of the difference in tax base also means that those communities with a large population and low tax base are not able to provide the services which a community with large tax base and small population is able to provide.

Urgency to reduce the dependence upon the property tax -- It must be kept clear that the culprit is not the property tax as such, but it is the fiscal autonomy of the governments side by side. That is, the culprit is the local property tax. The property tax would not be the culprit if the same rate were applied areawide. Then there would not be the incentive to locate certain properties in certain municipalities.

Alternatives for improving the situation -- Areawide support for schools, either at the metropolitan level or at the state level, would go a long way towards eliminating the fiscal disparities. The vast majority of expenditures for public services in communities usually is for schools. If each local taxing district did not have to rely only upon its local tax base to educate its children, then it is doubtful that communities would utilize such things as fiscal zoning. Further, a suburban community with a small amount of industrial or commercial tax base would not suffer, as it now does.

You can well make the case for an areawide property tax levy for schools in the metropolitan area rather than, say, statewide in Minnesota than you could in Illinois. In Illinois, there are some problems in connection with the taxing of major firms, such as the railroads and the utilities, which would probably dictate a statewide approach rather than a metropolitan approach.

Of course, another alternative would be the consolidation of governmental units,

but this is quite remote and then, furthermore, not urgent if you are able to eliminate the disparity in fiscal ability.

3. During the question and answer session with Mr. Stiles the following points were raised:

- . Absolute equality among areas -- Asked whether he felt each school district should spend exactly the same amount of dollars per child and receive all its funds from an areawide or state source, Mr. Stiles said that he would prefer an approach by which there would be areawide support for schools at a level of, say, \$600 per pupil. This would be at a level at which a child could receive a good education. Then, a local school district, if it wished, could spend extra dollars. It might be desirable, though, it was pointed out, to restrict a local community's ability to finance extra school services to a tax rate imposed only upon the residential property.

Discussing this question further, Mr. Stiles said that undoubtedly the cost of education will vary within a metropolitan area and within a state. Conceivably you might have a situation in which those outstate school districts which are very large but very sparsely populated, would have a high per-pupil aid. This could be, for example, \$800 per pupil. Then this amount could go down gradually, and there is another figure for the typical school district of larger enrollment. Then you might increase the aid again when you get to the most heavily populated school districts in the central cities, where your costs of education are probably higher.

Clarifying further his thoughts about education in the core city, Mr. Stiles indicated he believes substantial federal aids are probably the real way to attack the problem of providing extra money for the core cities. In order to provide a good quality education for all children in the core city, you might be talking about an expenditure per pupil of something in excess of \$1,000.

- . Lack of incentive for tax base -- A committee member questioned whether local units of government would want industrial and commercial property within their borders anymore if you took away the incentive for tax base for support of schools. Mr. Stiles responded that from a constitutional standpoint there are limits to the extent to which a community would zone to exclude industrial and commercial properties. Further, it can be expected that with a market for land a property owner is going to be able to exert significant influence to be able to sell his land for commercial or industrial development. Even more important, it was noted, is that even if you provide areawide support for schools there still can be the incentive to enhance the local tax base for municipal services. This incentive will not be as great and the impact on the taxpayer will not be as great either. The municipal services generally make up a relatively small portion of the total tax burden. Mr. Stiles also argued that a certain amount of difference in the municipal services provided by municipalities in a metropolitan area is in fact desirable. That is, the disparities among municipal units can have the effect of prompting certain individuals to reside in certain communities with the knowledge that the services are high and that the taxes also are. On the other hand, they may wish to reside in a community which does not have these services. The issue of education of children is a moral one and is listed in the constitution as important to provide equal educational opportunity for all. A person who wishes to have good municipal refuse collection, good parks, and so forth, might choose to live in a community which provides a

high level of these services. On the other hand, he may deliberately wish to live in a community which does not provide these services at a high level.

- . The tax situation in Chicago -- Mr. Stiles said that state school foundation aids in Illinois are paid out of the general revenue fund. Illinois has no state income tax or state property tax. The basic source of revenue for the state general revenue fund is a 4½% state sales tax. Then, of course, there is also the liquor, cigarette and inheritance taxes. There is only a local property tax in Illinois. The level of property taxes as a per cent of market value in the Chicago area was indicated by Mr. Stiles on a chart he brought with him. This chart showed that the level of taxes ranged from 1.4% of market value to 2.9% of market value among 76 communities in the Chicago area. The city of Chicago itself ranked toward the bottom at 1.95%. The surprising thing is that when you include only school services the per cent varies from .8% to 2.2% with, in this case, Chicago next to the lowest. This would indicate that the city of Chicago, though hard pressed for funds, has an ability to finance additional school services out of the property tax.
 - . Equalization impact on capital improvements -- Mr. Stiles was asked whether a system of total areawide support or state support for schools might result in a situation by which local school districts would no longer borrow for capital improvements but would finance out of local revenues. Mr. Stiles was not sure exactly what the impact of such a plan would be on capital outlay. He thinks that you could build a realistic depreciation formula into the total cost of education. Discussing this issue further, he said it is entirely possible you might build into such a formula a factor that would recognize rapidly growing districts and their needs as distinguished from established districts.
 - . Control over increasing costs -- A committee member pointed out that under the present situation, with a local school board responsible to the taxpayers, the school board is kept in line and cannot spend wildly. The fear was expressed that with total areawide or state support of schools you would lose this incentive to hold down costs. Mr. Stiles said he is not entirely sure that the presence of a local school board has that effect and furthermore we can assume that the Legislature can be a responsible body and can exercise overall control.
 - . Central city school problems -- It was pointed out in the discussion that even though the property tax levy for schools in a central city is low, this is partially due to the fact that the central must finance certain municipal services out of the property tax that suburban schools do not have to service. Further, the problems of the central city have arisen from circumstances that began in other locations. He noted that in Chicago there has been a migration of minority groups over the years into the central city. These people lack skills, and their children are dependent upon the big city schools to educate them and the big city school system is unprepared.
- There was also the question that the persons who occupy positions of leadership in the major business and industrial firms in Chicago themselves live outside the city and therefore they are not prompted to support substantial increases in taxes which will hit their firms.
- . Regressivity of the property tax -- A questioner noted that the property tax is the most regressive of all taxes, and in a central city there is a high

proportion of low income people. Therefore you are imposing an undue burden upon them when you increase the property tax. Mr. Stiles was asked whether the property tax is regressive. He responded that, for the purposes we are discussing here, it is an irrelevant question. He did not expand on his reason.

- . Teachers' salaries in Chicago -- The salaries of teachers in Chicago are on par with those of the suburbs. The teachers in Chicago themselves are firmly opposed to granting premium pay to teachers in ghetto areas. He said he understands that the starting salary this fall in Chicago will be \$7,350.
- . Federal aid -- Mr. Stiles feels quite strongly that in the long run we are going to have to look to federal aid to education as a primary source of funding. He contends that the local and state fiscal systems are incapable of responding to the needs. He noted that in West Virginia and similar states there have been technological revolutions which have seriously hampered their economies. In West Virginia, for example, we find that the state is a major coal producer but with the shift to uses of other fuel this has had an impact on its fiscal ability. Thus, we cannot expect to have the citizens of West Virginia themselves finance all the costs of education of those children. The education of children is a national responsibility.
- . Piggyback taxes -- It was noted that in Illinois local governments can levy another one half per cent on the sales tax. This money is returned to the jurisdiction where it was raised. Therefore it is just another source of fiscal disparity. Those communities with the commercial centers will get the benefit of the tax.
- . Areawide tax versus statewide tax -- Mr. Stiles was asked again why it might be easier in Minnesota to have an areawide tax than in Illinois, where a statewide tax would probably be required forequalization. He said that this is because of the way that Illinois taxes its railroad property. The benefit goes directly to the communities where the railroads are located. This is also true of certain major utilities, where all the revenue goes where the utility has its principal place of business. He noted that a large electric utility has its principal place of business in Monticello, Illinois, which is a very small community. All the tax revenue goes into that little town. This has the effect of depressing the property tax rate in that community to a very low figure and thereby means that the utility pays a very low tax itself. This is a partial de facto tax exemption for the utility.
- . Specific example of a fiscal disparity in the Chicago area -- Asked to give an example in his area of where the dependence upon local property tax has had an adverse effect on urban development, he referred to the small suburb in which he lives. This suburb is about two thirds residential. There is a large area nearby that people for years have feared would turn into a mass housing development. Near this tract was an area which had been selected for a forest preserve. The village fathers threw out the forest preserve designation and so arranged to have the property zoned industrial. Industrial development has come in, and this has had the effect not only of throwing out the possibilities for some good forest preserve land but has also effectively precluded development of the other area for residential, because people won't want to locate near the industrial property.

Another example was an abortive effort recently to merge the six elementary school districts which are located within the boundaries of one high school district. The opposition came from those elementary school districts that had a favorable tax base which they didn't want to share with the other elementary school districts. In Illinois there are separate school districts for elementary and secondary education.

- . Designation of major industrial and commercial centers -- He acknowledged that with a fragmented tax base you clearly cannot designate or zone certain major centers in certain municipalities and then not let other municipalities share in the revenue from these.
4. The Chairman thanked Mr. Stiles for coming to the Twin Cities to meet with us, and adjourned the meeting at 9:00 p.m.

Paul Gilje
Staff