METROPOLITAN REORGANIZATION: THE FISCAL SIDE

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PART I. PREFACE

In the major reorganization of local government now going on in the United States, it may be that no metropolitan area has under way a more significant or hopeful experiment than does the Twin Cities area. Last spring, after one of the most sophisticated and most constructive discussions of "metropolitan government" we have had in this country, and in response to the growing sense that this is, indeed, for many purposes a single urban community, the Minnesota legislature laid the foundation for a new areawide governmental structure designed to cope with the emerging problems of this new metropolitan "city".

The approach to metropolitan organization embodied in the Metropolitan Council act is, in a number of important respects, unique in the nation. Its key features are worth recalling at this point:

(1) We are writing a new and unusual definition of "metropolitan government". The Metropolitan Council deliberately represents not a consolidation of local units: These are, by and large, responding effectively to the new local demands being put upon them, and most residents of the Twin Cities area clearly value highly the responsiveness of their local community governments. Rather, we are creating a new unit of government at the metropolitan level only to perform those functions which must necessarily be performed areawide.

(2) We are rediscovering the (largely neglected) potential of the state legislatures for the solution of urban problems through their constitutional authority over the organization and powers of local government.

(3) We are emphasizing the (largely unseen) truth that, in relation to the growing involvement of state and especially federal government in urban

affairs, a metropolitan unit is a local unit.

(4) We have been willing (as most metropolitan areas have not) to tackle honestly the tough question of representation at the metropolitan level . . . and have come out -- largely at the urging of our own local officials -- with a system of equal population representation on the Metropolitan Council.

(5) We are breaking new ground with our effort to coordinate the work of our areawide special districts without giving up the advantages of their separate, specialized policy boards.

(6) We are moving, perhaps as rapidly as any area, toward a meaningful commitment to the concept of a realistic program of centrally directed metropolitan development.

All this effort over the past two years has concentrated on the question of governmental structure for the metropolitan area. Now comes the question of reorganization on the fiscal side. If the Twin Cities area is to be looked at as a single community for purposes of organizing and planning sewage disposal, air pollution control, freeways, airports and transit, the financing, too, will have to be provided on an areawide basis.

Yet the first and most obvious fact about the fiscal system of the metropolitan area is the fragmentation of the property tax base which is the principal source of support for local government. Wealth -- as does tax base per capita -- varies widely from one municipality to another. So, partly as a consequence, do tax rates. And so, occasionally, do even the assessment standards supposedly made uniform by law. The key question facing the community now as we begin to move toward the planning and development of this total urban area, is how to put this fragmented tax base back together again: How the system for raising public revenue can be reorganized to provide the areawide services and facilities and how the various municipalities within the area can secure the revenue they need for local services.

A year ago, on the eve of the legislative session, our discussion of metropolitan governmental structure was drawing to a close. This year, our discussion of metropolitan finances is really only just beginning. A year from now, on the eve of the 1969 legislative session, can we be as near a consensus on fiscal reorganization as we were late in 1966 on the question of governmental structure?

PART II. METROPOLITAN FISCAL DISPARITIES

The clearest way to explain the essential nature of the metropolitan problem -- in finance as in governmental structure -- is still to set out deliberately to make one. The example used last year will serve again:

> Begin with any municipality: Minneapolis . . . St. Paul . . . Brainerd . . . Winona . . . almost any of the state's cities which is divided into wards will do. Now suppose that the governing council of this municipality is disestablished, and that each of the wards . . . each of the parts of the old "city" . . . is now incorporated as an independent municipality, with its own legal existence, its own able and aggressive city manager and its own special municipal pride. If the "city" with which we began was at all typical, the major commercial and industrial property will be somewhat unequally distributed around the community. Some of the new municipalities we have created will, therefore, be "haves" in terms of property tax base; some will be "have-nots". Each, however, will henceforth be required to finance the public services its residents demand out of the revenue from the property that exists (or can be persuaded to locate) physically within its new corporate limits. No longer will the community function, governmentally, as a unit: Now the ward which contains the downtown business district will look possessively upon that property as "its" tax base, and will resist demands for the sharing of this tax base on the grounds that this would be to "subsidize" the other new municipalities. The new municipalities which were the residential areas of the old city, on the other hand, hard-pressed now to support the public services their residents require, will set out aggressively to attract shopping centers and industrial facilities. To do so, they may offer preferential tax assessments. They may agree to bend their development standards. Despite the protests of some of their residents, they may agree to sell park land for commercial development" "What else can we do?" they tell the protesting delegations" "You want good schools, don't you?" Gradually the competition among the now-independent parts of the old "city" grows . . .

Two aspects of our current fiscal system are particularly important, as sources of difficulties in metropolitan development:

(1) The "rule" that a local unit must depend on the property tax for the bulk of its revenue . . . but can tap only that property located, or which it can persuade to locate, physically within its corporate boundaries. Winner takes all; loser gets nothing.

(2) The "rule" that everybody pays all his own costs of development. This was not always the rule in the Twin Cities area, and it is still not the rule in many cities (the Omaha area, for example). So long as open land remained within the limits of Minneapolis or Saint Paul, the tax base of that entire city was available to help finance the cost of the new streets, schools, sewers, and so forth in the newly developing residential areas. Relatively early, however, development spilled outside the city limits. New municipalities were formed. These were not really independent of the city: They were, in truth, really neighborhoods of the physical city. But they were independent legally, and they were, as a result, cut off from access to the existing tax base. All the costs of development -- of private and public facilities alike -- now had to be assumed by these new municipalities. Typically, they went deeply into debt . . . and knowing the "game", set out aggressively to attract the commercial and industrial tax base that could help ease the burden on their residential taxpayers. Gradually these municipalities built up -- and came to have, as they put it, their facilities "in and paid for". As development continued to spread, a new ring of new suburban municipalities was formed, and the process began all over again.

As more and more of these new suburbs have been created . . . in some cases enveloping the older suburbs that were once independent communities (North Saint Paul, for example, or Anoka, or Shakopee, or White Bear Lake, or Osseo) . . . the Twin Cities metropolitan area has come to look like any other large city: A solidly built-up urban region, with some areas

residential, some areas industrial, a central business district and some outlying commercial centers; some old areas, some new areas; some areas where the rich people live, some areas where the poor people live.

The Twin Cities area has grown, as University of Minnesota geographer John Borchert puts it, in "several massive spokes" . . . particularly along the major transport corridors leading south and east from Saint Paul towards Chicago, and from Minneapolis west and northwest towards Seattle, and between the two central business districts. Along these major spokes, established early in the rail-traction era, much of the industry was established. The highest housing densities developed in two major spokes: One west from the Saint Paul downtown, another south from the Minneapolis downtown, over the level terrain into what has become Richfield and Bloomington. Around the edge of the area to the west and south, the rolling, lake-studded terrain has developed with low-density, high-value subdivisions. To the north, on the Anoka sand plain, have gone the biggest low-cost subdivisions.

Nature, history and the land-development decisions of the private economy -- which do tend to ignore political boundaries -- thus have distributed the demands for public services and the available property tax base unevenly across the seven-county area.

Since population is generally a fairly good indicator of the demand for services, and since local government depends heavily on the property tax for its revenue, one useful way to measure these metropolitan fiscal disparities is simply to rank the various municipalities in terms of assessed valuation per capita. When the Citizens League did this for major municipalities in the area in 1967, the lowest ten municipalities were all suburbs lying in the arc curving roughly from Robbinsdale north and east around the area about as far as North Saint Paul. Much the same pattern appears from a ranking of the assessed valuations per pupil among the school districts.

It needs to be pointed out that in important respects the pattern of fiscal disparities in the Twin Cities metropolitan area is different from the pattern found in other major metropolitan areas, particularly in the East. In some respect we do follow the general pattern of poor central city/wealthy suburbs, but in some respects we do not. Perhaps the simplest way to put it is to say there is a range of wealth and poverty within both our central cities and our suburban area (taken as a whole). Certainly on a simple map that plots the assessed valuations per capita by community, the central cities of Minneapolis and St. Paul show up relatively well, by comparison particularly with some of the suburban municipalities in the north half of the metropolitan area. Our central cities do not rank so high, however, in a comparison on the basis of per capita incomes -- and it is out of income, after all, that taxes are paid. There are two other complicating factors: To some extent both central cities are restricted legally and politically from tapping the admittedly substantial property tax base that does exist within their borders. And, second, the demand for services, and thus the level of public expenditure, tends to be higher in the central cities as a result of the concentration there of some of the more serious, and expensive, urban (and essentially metropolitan) problems: crime, poor health, substandard housing, traffic congestion, etc.

PART III. CONSEQUENCES OF THE DISPARITIES

Because the pattern of municipal government falls unevenly across the pattern of residential, commercial and industrial development in the Twin Cities area, the local units vary significantly in their ability to finance public services. No municipality, however, is exempt from the demand for services. And in some cases needs are greatest where the tax resources are also thinnest.

By and large, the pattern of local boundaries changes very little -- and very slowly -- to fit the pattern of urban development. Yet the need for revenue

is compelling. There is set up, as a result, a strong pressure to make the pattern of development fit the pattern of local government. Thus, increasingly, decisions about freeway design, about zoning and building standards, about the preservation of natural resources, and about the overall planning of the metropolitan area come to be dominated by tax and revenue considerations: Will it increase our local costs? Will it add to (or take away) our local tax base?

The local units have responded to the powerful incentives set up in our system of local finance with a series of actions that do help them, individually, attain their top-priority objective of keeping revenue and expenditure in balance. Unfortunately, a number of these actions carry, at the same time, some very serious consequences for the objectives of the area as a whole . . . and sometimes even for the objectives of the individual municipality itself over the long run. For example:

(1) Since the localities depend heavily on the property tax, and since they can tap only that property physically located within their boundaries, virtually all of them set out deliberately to create commercial and industrial centers, and to attract tax-productive business into them, whether these sites represent the most economic location for the activity, and the best allocation of resources, or not, and, of course, to install (or persuade some other unit of government to install) the public utilities necessary to make these centers attractive. As a consequence, far more land has been set aside for "industry" than could conceivably be used here in the foreseeable future. Interchanges are added to the freeway system -- at considerable expense and at a very real cost in the efficiency of the highway -- in order to provide what local officials feel will be a maximum increase in local property valuations. Commercial and industrial development is pulled toward a larger number of smaller

sites . . . each of which, of course, no matter how far from a major highway or river, must be provided with its own road and sewer service.

(2) For the same reasons, the local units also try -- sometimes quite consciously and openly -- to exclude development that does not promise to increase tax revenue . . . or at least to increase tax revenue by more than the additional cost it would impose in services. A number of suburbs operate a quasi-legal system of zoning which allows local officials to accept or reject a proposed development depending on the results of their calculations about its effect on municipal revenue. Housing developments have been affected most severely: Terrified by the prospect of a rapid increase in the number of children for whom they would be required to construct classrooms, local officials have tried to control the pace at which new housing units are built, and to restrict or eliminate the lower-income housing. Large-lot zoning is the device most often used . . . but any zoning or building regulation that would effectively guarantee the construction of only middle- or high income-housing will do. On occasion, permits for lower-cost housing subdivisions may simply be refused. The result has been to force the subdivisions available to lower income families out to some other municipality unable or unwilling to restrict them . . . and often, unfortunately, unprepared to receive them. A sprawling, low-density pattern of development is thus encouraged, and a separation of work place and residence that tends to increase the amount of travel (and hence the expenditure on roads) within the area.

(3) They have difficulty, too, holding out for a high standard of development. If the officials of one municipality threaten to be tough on design standards or building controls, a developer can easily slip away to a neighboring community -- in which case, of course, the additional tax valuation is lost to the first community entirely. In some cases local officials may be forced, in

effect, to "sell" their development controls in order to entice an industry in. The short term gains tend to be offset, however, by the long term effects of substandard development on the community: Shopping centers or subdivisions will not be replaced quickly.

This is a severe indictment -- not of our local officials, but of our system of public finance. No one should conclude from all this that the officials in local government in the Twin Cities area are anything but competent, dedicated people, or that they are behaving irrationally. They are responding intelligently and rationally to the demands of an irrational system of local public finance which has been set up -- by the accidents of history, really, not by design -- which forces them to compete rather than to cooperate with each other, and which effectively frustrates their efforts to build the attractive city of parks and well-planned development they would personally prefer.

As strong believers in effective local government, too, they cannot be happy with another fundamental result of the present system: The inevitable tendency of the state and federal governments to move into local affairs to provide the funds, and the coordination, which a metropolitan area, fragmented into competing local fiscal jurisdictions, cannot provide.

IV. REASONS FOR REMOVING THE DISPARITIES

All the foregoing will have suggested a number of reasons for reorganizing the political economy of this metropolitan area. The last 40 years have been, it is clear, a radical departure from the traditional system . . . in which -- though people could and did group new residences according to their income, or their religious, or their social preferences -- they nevertheless remained within the single fiscal system of the city. Would the magnificent park system of Minneapolis ever have been developed, for example, if each of

the outlying wards had been a legally independent municipality of its own residents, and forced to depend entirely on the tax base located within its own boundaries?

A number of other questions need to be asked:

(1) Why should the quality of library services . . . or the adequacy of public schools . . . or the availability of recreational programs for any child or any family in the area be restricted simply because either does not live where the railroad lines happened to be laid down in the 19th century?

(2) Why should the tax revenues from a major shopping center, which draws trade from a large part of the area, or a major electric generating plant built out of the revenues collected from the ratepayers of the entire area, be captured exclusively by the residents of the single municipality -- sometimes a tiny municipality of fewer than 500 persons -- in which the facility happens to be physically located?

(3) Why should we continue with a system which makes it almost impossible for the municipalities which need park and recreation space the most to secure it at all?

(4) How can we seriously hope to implement any metropolitan plan that tries to make any rational and economic allocation of land uses unless we do reorganize the fiscal system which now tyrannizes our municipal and school officials? One of the great opportunities that any metropolitan plan will attempt to seize is the opportunity to specialize: to devote certain rivers to industrial use, for example, while reserving others for recreational/residential use . . . or to concentrate major commercial facilities in order to support a greater degree of choice and variety in their offerings . . . or to locate a mass rapid transit line in a really desirable location -- with all that implies for the subsequent construction of major facilities (i.e., tax base) in certain municipalities and not in others. The present rules, which offer local officials no

way to secure tax revenue unless they can get the development physically located within their borders, sets up the greatest possible incentive for municipalities and school districts to resist any such plan of metropolitan development, whatever its advantages for the area as a whole. A change in the rules, on the other hand, opening up some source of revenue independent of local property taxes, might set up an incentive for them to support a reasonable metropolitan plan.

V. POSSIBLE ADJUSTMENTS IN THE FISCAL SYSTEM

It is possible to reorganize the fiscal system and to re-set the incentives so as to encourage cooperation rather than conflict, if we are serious about doing so. The broad outlines of the various alternatives are clear enough.

(1) We could abolish the local units and recreate the single "fisc" which existed before the appearance of the suburban municipality.

This is being done in a few metropolitan areas. Consolidation is not, however, the policy chosen here. The reorganization last spring which created our Metropolitan Council was founded on the recognition that residents of the Twin Cities area like their local governments, value their responsiveness and want them to continue.

(2) We could look increasingly to aid from higher levels of government.

To some extent this is the policy we are now beginning to follow. The sharing of aids on a statewide basis has its drawbacks, however, as our long experience with the controversy surrounding the division of road and school aids makes clear. So does the growing reliance on aids from the federal government . . . not the least of which is the (recently observed) tendency of the funds -- even those specifically intended for the areas most "in need" -- to

flow toward what are, in fact, wealthier communities, more aware of these programs and better able to compete for them politically.

(3) We could transfer the responsibility for certain functions to higher levels of government which have access to better sources of revenue and which can apply a uniform tax rate over the entire jurisdiction.

This, too, is a policy into which we have been drifting. We have been transferring municipal functions to the county, and municipal and county functions (junior colleges, for example) to the state. This is a process we can, if we wish, continue. Certainly the state could think and act for us on a regional basis. We should remember, however, that -- as a leading Hartford businessman told a conference on metropolitan cooperation and development in Connecticut in 1965 -- "as a larger and more remote gathering of interests, the state's priorities do not necessarily reflect our own".

(4) We could develop a new taxing district . . . smaller than the state but embracing the entire urban area . . . within which the revenue would be raised at a uniform rate and distributed on some formula which benefits equitably all parts of the area.

We have laid a foundation for this, perhaps in the tax revision of 1967: The new non-property tax is levied on a state rather than (as was proposed in the Metropolitan Mayors Tax Study) on a metropolitan basis. But an "override" on this or some other statewide non-property tax may be feasible, incorporating the fairly simple per-capita and per-school-child distribution formula adopted last spring. It's conceivable the base could be a property as well as non-property tax . . . comprehending at least certain categories of major commercial or industrial property, which draw their workers and their trade from far beyond the limits of the municipality in which they happen to be located, and whose valuations thus "belong" in some sense to the larger area.

(5) We could begin to raise some revenue for the construction of major public facilities by recapturing, through a new and larger type of assessment, a portion of the increase in land values created by a decision to put the improvement of that particular location.

VI. THE CONCEPT OF "EQUALIZATION"

The beginnings of a "needs" formula came into Minnesota law years ago . . . and in a sense we have been refining and extending it ever since. The notion that it is sound public policy to provide every school child with an adequate education, whether or not he lives in a local district blessed with large tax resources, is embodied in our statewide program of school aids. Much more recently, factors more closely reflecting real needs have been appearing in our program of road aids. And something like this is involved in the programs of categorical aids for public welfare, to the extent that levies are spread over a relatively large area for the benefit of a group in the population concentrated in a relatively small part of the area.

These equalizing or compensatory factors have appeared basically as we have come to accept the essential interdependence of what we perhaps once thought of as independent units. And this growing sense of interdependence is nowhere stronger, or more evident, than in the metropolitan area. Here no municipality, or even county, provides all its services exclusively for the benefit of its own residents. Any municipality's pollution control efforts benefit every city and village down river, or down wind. The benefits of a strong public health program (say, for restaurant inspection) cannot be captured solely for the benefit of the residents inside an invisible political boundary. Parks and libraries are open to all, at least for browsing. And virtually every local unit builds roads and streets for the benefit of a truly metropolitan driving public.

A significant step was taken as a result of the Metropolitan Mayors Tax Study last spring, when the decision was made to return the share of sales tax revenue earmarked for local government simply on the basis of population (and school-age children, in the school districts). We do not yet know precisely the effects of this distribution, but it should certainly tend to reduce, rather than to reinforce, the disparities that exist among local units.

One of the major questions we face now is whether to develop some more explicit equalizing formula in any new reorganization of our fiscal system.

The question will arise, too, in any program for the sharing of federal revenues. Inevitably, the urban areas will expect a share of any "bloc" grants apportioned among the states. Someone will have to decide on what basis this money is to be shared among the cities. Is it to be devoted exclusively to education? Or exclusively to non-school services? Will the money go to reduce disparities, or to reinforce them? And what is the formula to be used?

And, perhaps most difficult: Who is to make the decisions about how the revenue is to be shared? Congress, in the basic legislation? The regional officials of the federal agencies? The state government? Or some unit representative of the metropolitan area?

VII. CONCLUSION

Perhaps the net effect of the analysis is to underscore two central facts: The weakness of the urban area when its revenue system is fragmented into small and competing units; and the strength, or potential strength, of the urban area when its revenue system is drawn together.

Divided, we cannot gather resources for the large tasks we know we must perform, and for the facilities (particularly the specialized expensive cultural, recreational and educational facilities) we know we must develop if

the Twin Cities area is to succeed in the inter-metropolitan competition in which we are increasingly engaged.

Divided, we will be unable to carry out the program of areawide planning and development in which ten years of effort and millions of dollars have already been invested.

Divided, we cannot guide our own future, as we are compelled increasingly to turn for resources to other levels of government whose decisions we cannot fully control.

Our problem is not a lack of resources . . . either of money or of talent. This is a high-income, highly educated metropolitan area, well endowed with a strong and dedicated civic leadership which rises out of our long tradition of citizen involvement in local affairs. Our task is essentially to organize, or to reorganize, our system of local government and finance in such a way as to release these resources for the solution of our local problems . . . rearranging the incentives set up for our local units so they are encouraged to cooperate -- with each other, and in support of metropolitan objectives.

Not every area could consider such a fiscal reorganization. Few have established the climate of metropolitan cooperation, and the sense of metropolitan identity, that has developed here among civic leaders and local officials alike these past two years. This is in itself a great resource, and a competitive advantage on which we can build. And few have the very special opportunity presented to the Twin Cities area by its geographic location -- insulated by miles of farm land from the nearest competing major urban center, and for practical purposes contained entirely within the boundaries of a single state.

These, then, are the central questions:

* Is some areawide approach to local public finance desirable . . . both to equalize resources among the local units, and to provide resources for the

projects and services which must necessarily be undertaken areawide?

* Is such a reorganization technically feasible?

* Is it politically attainable?

Over the next two years the civic and governmental leadership of this area will decide.

APPENDIX A

STATE TAX POLICIES TO COMBAT INTERLOCAL DISPARITIES IN METROPOLITAN AREAS

by

The Advisory Commission on Intergovernmental Relations
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It is in the public interest that local jurisdictions in metropolitan areas provide their residents and businesses with a reasonably comparable level of basic government services. This is difficult when taxable wealth, income, and business activity as well as the need for governmental services vary drastically among the several jurisdictions comprising the area. It is made doubly difficult when State fiscal policies encourage the proliferation of local governments because the smaller the governmental units the greater the likelihood of wider fiscal disparities among them.

The larger the geographic area for which governmental services are provided, the greater the opportunity to equalize the level of services financed from the fiscal resources of the geographic area. Thus, a broad-based State tax draws funds from all parts of the State, wealthy and poor, in accordance with the way in which its taxable base is distributed. The State can then provide a comparable level of services throughout its area, regardless of where the money is collected. State functional grants-in-aid to local governments can be distributed with the same effect, so as to mitigate interlocal disparities.

The advantages of statewide financing can also be realized by the shared-tax device, provided the proceeds are shared on some equalizing basis. Michigan, for example, distributes part of its sales tax revenue to cities and towns in proportion to population, and most of the remainder to school districts on the basis of an equalization formula. Interlocal disparities are aggravated

when a State shares income or consumer taxes with its localities solely on the basis of origin of collections (i.e., residence in the case of personal income taxes; place where the sale is made in the case of consumer taxes) because income and commercial activity are unequally distributed among local jurisdictions. For example, where part of a State income tax is returned to incorporated places on the basis of the residence of taxpayer, as in Wisconsin,[1/] wealthy citizens are encouraged to settle in the suburbs and to incorporate satellite communities. By the same token, if State sales tax collections are returned to the jurisdiction in which they originate, large suburban shopping centers beyond city boundaries are encouraged to incorporate into separate municipalities. In both instances, much of the taxable wealth of the central city would be chipped away and its fiscal capacity to provide adequate governmental services diminished.

Increasingly, as the desire for more and better local government services grows and property tax burdens approach economic and legal ceilings, metropolitan communities can be expected to press State legislatures for nonproperty taxing powers. When authorizing such local nonproperty taxes, States should consider their possible effect upon local government organization. By authorizing countywide or even metropolitan-areawide local sales or income taxes, the States can discourage proliferation of local governments and relieve some of the fiscal disparities between contiguous localities. The county-preemption approach is taken by Wyoming, which allows cities to enact a supplement to the State sales tax only if the county has not done so.[2/] Once a countywide sales tax is enacted, however, the city taxes are invalid, and the

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1/ Wisconsin *Statutes*, Chap. 71, Sec. 71.14.

2/ *Wyoming Statutes Annotated*, Sec. 39-288.

county tax is shared with all the cities on a per capita basis.

In contrast, the city-preemption approach to local sales taxation, adopted by California, tends to encourage municipal incorporations.[1/] There, both counties and cities are authorized to impose a supplement to the State sales tax. The county and city sales taxes together may not exceed one percent. If both the county and city levy such a tax, the county is required to allow a credit for the city tax. Thus, a city can preempt the entire local sales tax that originates within its jurisdiction. In these circumstances, it could be advantageous for a group of people living in the unincorporated part of a county to incorporate around a large suburban shopping center and thus retain the sales tax in its own jurisdiction.

When authority for local income or sales taxes is limited to cities, it has the same proliferation-disparity effects as a State-shared tax distributed on an origin basis. Wealthy central city residents subject to local income taxes levied to finance costly public municipal services, such as education, public welfare, and crime prevention, the costs of which are attributable mainly to the economically disadvantaged residents, may well move out. Their local taxes would thereby contribute nothing to the central city from which they earn their livelihood. Michigan has mitigated this problem by coupling the authority for a municipal income tax with the requirement that the proceeds be shared equally by both the city of residence and the city of employment if both levy the tax.[2/] However, the county or metropolitan-areawide approach to local sales or income taxation is preferable.

1/ California Revenue and Taxation Code, Sec. 7200.

2/ Compiled Laws of the State of Michigan, 1948, Sec. 141.501-141.699 (Act 284 of 1964).

The county-preemption approach to local sales taxation is adaptable for use in multi-county metropolitan areas. A State which contains such areas could require concomitant enactment of the local sales tax by all counties in the metropolitan area. Maryland adopted this approach in 1965 when it authorized the city of Baltimore, Baltimore County, and Anne Arundel County, comprising the Baltimore metropolitan area, to impose a sales tax supplement to the State general sales tax by "mutual and unanimous agreement."[1/]

An attempt to accomplish a similar objective in the Denver area was halted by the Colorado Supreme Court. The State legislature adopted an enabling act in 1961 authorizing Denver and the three counties in the Denver metropolitan area to establish a metropolitan capital improvement district to be financed by a 2 percent areawide sales tax.[2/] The Denver Metropolitan Capital Improvement District began to collect the 2 percent sales tax in January 1962, the proceeds to be allocated to the respective jurisdictions on a per capita basis. However, the State Supreme Court declared the State enabling act unconstitutional on the ground that it interfered with the home rule powers granted by the State Constitution to one of the municipalities encompassed by the capital improvement district whose voters had rejected the proposal.[3/]

This multiple county approach to local sales taxation holds significant promise, particularly in those metropolitan areas where capital improvement programs would be facilitated by areawide handling. Those states considering

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1/ Annotated Code of Maryland, 1957, Art. 81, Sec. 411A. The communities involved have not acted upon this authorization.

2/ Colorado Laws of 1961, Chap. 179.

3/ Four-County Metropolitan Capital Improvement District, et. al. v. The Board of County Commissioners of Adams County, et. al. (1962), 149 Colo. 284, 369 P. (2d) 67.

its usefulness will need to anticipate the implications of their constitutional home rule provisions, possibly by including in their enabling legislation explicit language to waive otherwise applicable home rule provisions in the case of jurisdictions in the affected metropolitan areas.

APPENDIX B

FISCAL REFORM IN MARYLAND

by

Joseph Pechman*

Last week, the Maryland State Legislature enacted a wholesale reform of its fiscal structure that will stand as a model of responsibility and fiscal soundness for a long time to come. Fiscal action by a state usually merits little attention outside its borders. But Maryland has done quite a few things that should make the other states -- and the Federal Government -- sit up and take notice.

Like most states, Maryland was suffering from an antiquated and unfair tax structure, niggardly grants-in-aid that forced local governments to rely too heavily on the property tax, a major city (Baltimore) that had little hope of replacing its antiquated schools, meeting its growing burden of welfare payments and modernizing its police force, and recurrent fiscal crises caused by a tax system that did not respond adequately to economic growth.

In last week's action, the Maryland Legislature adopted the following note-worthy reforms:

- It replaced a flat-rate income tax by a graduated tax and included capital gains in taxable income for the first time.
- It wiped off the books three county income taxes and the Baltimore City payroll tax, and substituted in their place a mandatory "piggy-back" local income tax of at least 20

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percent of the State tax and gave the local governments the option to go up to 50 percent.

- It fashioned a new system of grants that will be of greatest help to the poorest counties and needy Baltimore.

The old income tax was expected to yield $162 million in 1968; the new tax will raise this amount by $120 million, a whopping 74 percent. The graduated rates will shift tax burdens from low to high incomes: Single persons with incomes below $4200 and 4-person families with incomes below $6700 will pay less tax; those above those levels will pay more.

These reforms capitalized on the incentive provided by the Federal Government to enact progressive taxes. Since state taxes are deductible in arriving at income subject to Federal tax, the Federal Government pays up to 70 percent of the bill for those who itemize their deductions. It has been estimated that 25 percent of the additional tax collected in Maryland would come out of the Federal treasury. This is no sleight-of-hand: The deductibility feature is kept in the Federal law to encourage states to strengthen their income taxes if they have them and to enact them if they don't.

Maryland is one of 27 states with both an income tax and a sales tax. At one time, the reaction to these two taxes was both emotional and partisan, but doctrinaire attitudes have softened in the face of the urgent needs for State revenues. Provided there is a good income tax, the sales tax is a solid revenue base for State use. The income tax adds equity and much-needed automatic growth to the tax system. The yield of the Maryland income tax will double in seven years without any change in rates, an excellent safeguard against the recurrent fiscal squeeze that usually accompanies growth.

State-local fiscal relations were as messy in Maryland before the reform as they are in most states. The new system tackled both the tax and expenditure sides of the question.

On the tax side, the State gave notice that it will not tolerate independent local taxes that raise the insoluble resident vs. commuter problem, and impose unnecessary compliance burdens on the taxpayer. A small town or county or even a large city is not a proper jurisdiction for levying an income tax, because it is easy to move out to avoid the tax. By imposing a state-wide tax and limiting the local piggyback taxes to reasonable limits, there will be virtually no incentive to move.

Furthermore, all local taxes will be collected by the State, thus eliminating the triple income tax filing requirement (to the local as well as Federal and state governments). Another step to ease compliance was the enactment of the Federal definition of income, modified only to the extent needed to adapt it for state purposes (for example, Federal bond interest is excluded while interest on bonds issued by other states is included).

On the expenditure side, the State revamped its grant-in-aid system to help the poorer units of government. The opposition from the selfish, wealthy suburban counties was great, but the equalization principle carried the day. The new grants and the piggyback local taxes will prevent a property tax increase of as much as 60 cents per $100 assessed valuation in the counties and Baltimore City.

The Maryland experience is very relevant to some of the recent discussions of the idea that the Federal Government should share some of its revenues with the states. The plan would allocate a portion of Federal income taxes to be used for general-purpose grants to the state governments. Disbursements from the fund would be made primarily on a per capita basis in the first instance, with the understanding that major share would be passed through to the local governments.

Opposition to revenue sharing comes mainly from those who are skeptical about state government. One criticism is that the states have not put their own tax systems in order; another is that they can't be trusted to use the funds to help the local governments. On the whole, however, the states have been doing a fairly good job on both counts, although there are exceptions. The case for revenue sharing would be all the more persuasive if the laggards were to follow Maryland's lead.

APPENDIX C

Excerpts from

THE PROPERTY TAX AND ALTERNATIVES IN URBAN DEVELOPMENT

by

Dick Netzer*

. . . Suburban communities with high residential property values, high incomes, high quality public services, and low effective tax rates are kept that way by high prices for residential properties and by zoning: One cannot choose to get the benefit of high services and low taxes in a high-priced community by building there an unusually inexpensive house on an unusually small lot. . . .

The fiscal incentive of the present system encourages zoning and other land use planning on a basis which is far from optimal when viewed from a regionwide standpoint and, therefore, from a national standpoint as well, if metropolitan regions are meaningful economic entities. Lynn Stiles has elegantly and extensively discussed this "fiscal mercantilism" on a number of occasions. Encouraged, or perhaps deluded, by the examples of industrial tax colonies and semi-rural high-income havens, communities zone to attract tax base and repel consumers of public services, rather than on the basis of larger notions of suitability of land use.

In its extreme formulation, the common effort - especially visible just west of the Hudson River, where the property tax provides two-thirds of all state-local tax revenues - to attract industry (and, on occasion, shopping centers) but to keep out industrial employees with moderate incomes and large

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families, finds expression in the grotesque notion that each taxing jurisdiction in a metropolitan area should be a "balanced community" with its own industrial district, commercial area and zones of upper middle and upper income housing. . . More generally, this kind of mercantilist zoning encourages industry to disperse rather than concentrate and, because of ready availability of land in low-tax jurisdictions, to locate in sections of the metropolitan area which may be far from the lowest-cost locations from an overall standpoint. . .

The trend to low-density zoning on the periphery of metropolitan areas is a strong one . . . This is hardly optimal. For one thing, it involves a prodigious rate of consumption of land. . . Present trends in zoning imply levels of income and income distribution which seem wildly incongruous with what might be expected for the outer portions of metropolitan areas on the basis of recent history, family size, location of employment concentration, and similar factors. The probable result is that families with school-age children, whose income fall below, say, at the top quartile of the income distribution, but for whom a suburban or outer ring location makes sense, would not locate on the basis of free consumer choice or overall social costs, but will be herded into those communities where zoning is weak or non-existent and where property tax rates are apt to be high. . .

The most important of the social costs exported by the tax-sheltered high-income areas and industrial havens to the whole metropolitan region are transport costs. To the individual as a property taxpayer, or to the governing body of the local jurisdiction, transport costs are not very visible. They are not the concern of the local unit, and are not readily affected by individual actions. In fact, local land-use decisions are made almost as if transportation were a free good. But the dispersed pattern of industry and residences, with

extensive cross-movements for business, journey to work, and all other purposes, imposes huge transportation costs on the metropolitan region. . .

To mitigate the fiscal pressures for mercantilist land use planning, one obvious remedy is to homogenize, to some extent, the property tax base of the metropolitan area by tapping the taxpaying capacity of the larger regional economy in order to support public services, rather than by chopping it into disparate and highly uneven fragments. Fiscal federation (to use the Stiles term) is one such device.

APPENDIX D
to the
Background Paper for the
ST. THOMAS CONFERENCE

The area generally known as "local government finance" is a rough and forbidding territory . . . not fully explored, and not very well mapped. Here - as a guide - are a few high points, and a few landmarks, which may serve as a kind of "road map" to the traveler.

* Statewide, in Minnesota, taxes account for just about two-thirds of local public revenue. About 16% comes in the form of aids from other agencies - including federal aid. The remainder comes from a variety of special assessments, license fees, earnings from public enterprises, service charges, etc.

* Within the seven-county Twin Cities area just over a third of a billion dollars a year is collected in taxes on real and personal property - or was in 1965, according to the Metropolitan Mayors' Tax Study. The exact figure for that year was $338,790,469. Total spending (including non-tax revenues) of course exceeds this substantially. The seven-county area spends roughly a quarter of a billion dollars a year for schools alone, and probably something exceeding that for city and municipal government combined. The average annual increase in property tax collections, for the ten years 1955 to 1965, was about 9.7% per year. Something more than half of this is attributable to increases in property tax rates. The remainder, and the smaller portion, is attributable to the growth of the tax base. The level of government increasing its relative share of the public tax dollar at the most rapid rate during that period was the school districts . . . followed by the counties, then by the state and then by the cities and villages and by the townships. Of the total collections, school taxes accounted for about 41%. Municipal government took about 33%. The counties took about 22%. The remainder went to the state and to the townships.

* Hennepin and Ramsey Counties together dominate the local fiscal picture. Measured in terms of property tax collections, they account for about 90% of all collections. Measured in income terms, they account for about 85% of total gross income.

* In 1965, according to the Metropolitan Mayors' Tax Study, the City of Minneapolis raised just over $31 million from the property tax - about 64% of its total revenue. In the same year St. Paul raised just over $19 million from the property tax, about 67% of its total revenue.

* Here is another indication of the relationship among the counties:

  As of 1965, Anoka County had 5.4% of the total property tax collections, and 7.5% of the total population. Carver County had 1.1% of the property tax collections and 1.5% of the population. Dakota County had 5.7% of the property tax collections and 6.2% of the population. Hennepin County had 57.2% of the property tax collections and 53.2% of the population. Ramsey County had 26.1% of the property tax collections and 26.1% of the total population. Scott County had 1.1% of the property tax collections and 1.6% of the total population. Washington County had 3.4% of the property tax collections and 4.0% of the total population.

* Another indicator of the relative fiscal situation of the various communities is the debt being carried for the basic municipal services - sewer, water, streets, parks, etc. (The following figures are for municipal debt only, excluding schools. Bear in mind, too, that some - but not all - of the municipalities are currently in different stages of their development.)

  In Anoka County the debt per capita ranges from a high of $579 in Spring Lake Park through $305 in the City of Anoka, $282 in the City of Coon Rapids, to a low of $164 in Columbia Heights.

  In Carver and Scott Counties the debt ranges from $342 per capita in the City of Chaska to $42 per capita in the City of Shakopee.

  In Dakota County, Burnsville has a total debt of $414 per capita, West St. Paul $204, and South St. Paul $154.

  In Ramsey County, as of 1966, the village of Moundsview had a per capita debt of $677, Little Canada $447, Maplewood $387, St. Paul $241, North St. Paul $165, and Roseville $47.

  In Hennepin County, Mound had a per capita debt of $904, New Hope $662, Golden Valley $590, Bloomington $306, Edina $329, Orono $258, Richfield $262, St. Louis Park $196, Wayzata $155, Minneapolis $138, Minnetonka $61, Hopkins $53, Robbinsdale $39, Deephaven $11, and Shorewood $9.

  (Debt figures were secured from reports of the County Auditor, who was requested to supply, in each case, total debt of all kinds - whether general obligation, special assessment, or revenue. Again: school debt is excluded.)