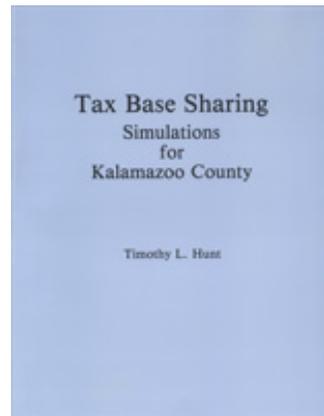


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Introduction

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TAX BASE SHARING:
SIMULATIONS FOR KALAMAZOO COUNTY

I. Introduction

Tax base sharing allows residents of participating jurisdictions in an area to share the benefits of the growth in the commercial-industrial property tax base regardless of where that growth occurs. This sharing does not create a new layer of government, however, change existing jurisdictional boundaries, or alter local decisionmaking authority.

The concept of tax base sharing may be especially apropos today for a number of reasons. Large manufacturing plants may locate next to key rail or highway links, while commercial establishments tend to agglomerate in shopping districts to improve customer traffic. These business firms serve the needs of residents throughout a broad area by providing jobs and products, yet local jurisdictional boundaries, which were established long before modern business patterns, govern the payment of local property taxes. The net result is that some jurisdictions find it difficult to support a given level of services at the same time that others are either expanding services or reducing tax burdens. Since local governments rely heavily on the property tax, these problems have been exacerbated recently by the decline in aid from other governmental sources.[1]

Another result is that local jurisdictions have a strong incentive to compete aggressively for new commercial-industrial development as long as they

1. Among others, the federal general revenue sharing program is currently slated to end December 31, 1986.

perceive the benefits to their jurisdictions to be greater than the costs. Unfortunately, the hard truth is that there are far fewer major commercial-industrial development projects today than there are localities. Witness the frenzied activity of many states and areas to attract the GM Saturn plant.

Business firms, especially those in basic industries, do not tend to think in terms of local jurisdictions. They sell their products throughout an area or export those products to other regions, states, or nations. On the other hand, their employees are likely to come from all areas within a region. Firms have a vital stake in the economic health of a region that has little to do with local jurisdictional boundaries. Economic development officials have long suggested that localities put aside their inter-jurisdictional rivalries and develop a more unified posture. The goal is to enhance regional economic growth through this unity and the pooling of available resources.

The region upon which this paper is focused is the Kalamazoo Metropolitan Statistical Area (MSA). MSAs are designated by the U.S. Bureau of the Census using a variety of criteria, all of which emphasize the degree of interdependence within a region and which thereby tend to differentiate it from other regions. The notion is that MSAs represent unique areas, in terms of local purchases, local labor markets, and commuting patterns. It turns out that the Kalamazoo MSA is synonymous with the boundaries of Kalamazoo County.

The purpose of this paper is to make a preliminary evaluation of tax base sharing for Kalamazoo County. It is written largely for a nontechnical

audience. More technical aspects of the discussion have been relegated to footnotes and appendices. There is also an extensive list of references for anyone who wishes to pursue the subject further.

The basic approach of the paper is to use historical data from the local jurisdictions within Kalamazoo County to simulate the effects of tax base sharing. The remainder of the introduction describes the key features of tax base sharing and its advantages and disadvantages. Section II briefly outlines the growth of the property tax base in Kalamazoo County. Such a description is a necessary prologue to understanding the simulations which follow in Sections III and IV. Specifically, the tax base sharing provisions adopted by the Minneapolis-St. Paul area are evaluated in Section III, while several hypothetical alternatives are evaluated in Section IV. Finally, the conclusions of the paper are drawn in Section V.

Tax base sharing became fully operational in the Minneapolis-St. Paul area in 1975, hereafter referred to as the Minnesota Plan. Since the Minnesota Plan was one of the earliest tax base sharing schemes, it has become the model on which to judge other tax base sharing plans.[2] For this reason and the sake of convenience, much of the discussion of this paper is couched in terms of

2. Other tax base sharing plans, albeit much more restrictive in scope and purpose, have been adopted in two areas, the Hackensack Meadows Redevelopment District of New Jersey and Charlottesville, Virginia. In the latter case a set millage is shared by formula between the city and remainder of the county, while in the former case school levies are shared among 14 districts affected by the redevelopment.

the Minnesota Plan even though the concept is more general and can be readily adapted to the specific needs and goals of other areas. In fact, some of the simulations presented later in this paper represent a considerable departure from the Minnesota Plan.

Key Features

Tax base sharing is a method whereby local jurisdictions may agree to share some portion of the growth in their property tax base. As practiced in the Minnesota Plan, localities contribute 40 percent of the growth in the commercial-industrial property tax base to an areawide pool. The tax base in the regional pool is redistributed back to the jurisdictions using a predetermined formula. After this allocation, local authorities establish their spending requirements and derive the tax rate necessary to meet those requirements. This tax rate is applied equally to all classes of property physically within each jurisdiction, except that a regionwide average tax rate is applied to business property nominally in the regional pool.

The details of the Minnesota Plan are discussed in Section III, but it is important at the outset to identify a number of key features of tax base sharing. First, tax base sharing generally does not establish a new layer of government in the local area because both the contribution and distribution formulas are predetermined and made a part of the tax base sharing agreement itself. In the Minnesota Plan local jurisdictions continue to independently set spending priorities just as they have always done in the past. It does not restrict the spending authority of local governments in any way.

Second, it should be mentioned that tax base sharing does not involve the imposition of any additional taxes in the region overall. This remains true as long as the contributions of tax base to the regional pool are exactly matched by the distributions of tax base from that same pool. Of course, individual jurisdictions, firms, and residents may be net recipients or contributors, depending on the location of future growth.

The third key feature of tax base sharing is that the distribution formula does have redistributive aspects. Although such redistribution may be controversial, the goal is to redress to some degree the fiscal imbalances alluded to earlier in this introduction. These imbalances are created by the concentration of businesses in a few districts, whereas the spending required to support the local population (which tends to be much more dispersed) is the responsibility of many jurisdictions.

The final key feature of tax base sharing is that local jurisdictions share a portion of the future growth in the tax base rather than the existing tax base. This means that initially tax base sharing has little effect on a region. As the region grows and prospers, the shared base also grows and becomes relatively more important. Since only 40 percent of the growth in the commercial-industrial tax base is shared, however, the bulk of all future growth remains in the local jurisdiction. Furthermore, the Minnesota Plan includes a limiter that effectively insures that each locality always receives a minimum distribution from the shared tax base.

Advantages

There is no agreement about the advantages or disadvantages of tax base sharing. In broad terms, it appears that proponents emphasize the importance of reducing fiscal disparities, sharing the benefits of regional growth, and retaining local autonomy and decisionmaking. Each of these aspects of tax base sharing is now discussed in turn.

In general, the Advisory Commission on Intergovernmental Relations defines state-local fiscal disparities as the "...imbalance between the financing ability of state-local governments and the responsibilities they bear, and the imbalance among different abilities of state and local governments to raise revenue." (ACIR, 1980: iii) Obviously, local tax base sharing does not address questions pertaining to what level of government -- local, state, or federal -- can or should be responsible for financing specific government services. The state and federal tax structure is basically assumed given, although questions may arise about the interaction of local tax base sharing with other existing intergovernmental aid programs.[3]

The presumption in tax base sharing is that the concentration of business firms in a few areas has led to the existence of considerable fiscal disparities among local jurisdictions in their abilities to raise revenue. In other words, at the local level an uneven distribution of property tax base is

3. These questions, legal and otherwise, are not addressed in this paper.

sufficient evidence that fiscal disparities exist.[4] Local tax base sharing then attempts to partially reduce these disparities by sharing the growth in the business tax base that occurs anywhere in the region.

In the late 1960s and the early 1970s, the residents of the Twin cities area were sensitive to the existence of fiscal disparities. That experience will be discussed in detail in Section III. Suffice it to say now that tax base sharing was actually authorized by the Minnesota Fiscal Disparities Law, and it is still commonly referred to in Minnesota simply as "Fiscal Disparities." Thus, there should be no question that tax base sharing was adopted at least in part to ameliorate the fiscal disparities that were perceived to exist in the Twin Cities area.

While any debate about fiscal disparities tends to stress fairness and tax equity, it is also thought that there are separate and distinguishable advantages from sharing the benefits of regional growth.[5] There would be fewer interjurisdictional rivalries for firms because "winners" would only be certain of keeping 60 percent of the growth, while "losers" would be assured of some benefits from that growth even though it didn't occur within their own jurisdictions. At the same time, business tax rates would slowly begin to move

4. It should also be clear that jurisdictions may differ in the amount of public services their residents desire. Therefore, economists define fiscal disparities as a situation where the tax price for the same bundle of services differs.

5. Lyall (1975) stresses this advantage of tax base sharing and actually identifies it as the primary reason to support tax base sharing.

toward the regional average as the shared pool grew. These developments would tend to encourage more regional thinking, both on the part of firms and local governments. The notion is that a broader framework for decisionmaking would lead to a more efficient rationalization of the development of the region and enhance economic growth generally.

Conceptually, tax base sharing does indeed reduce the incentives for competition among local governments and encourages them to work for the growth of the area as a whole. Just as important to sharing the benefits of regional development is that the growth of the tax base and therefore tax capacity of local governments becomes more stable. Paul Gilje of the Citizens League (Gilje, 1977: 38) compares this aspect of tax base sharing to purchasing an insurance policy. In exchange for the premium of 40 percent of the growth in the commercial-industrial tax base, a locality receives a guaranteed share of the region's growth. The question is whether or not a locality wants to gamble and go it alone or whether it is willing to give up the possibility of a large gain for a smaller but more certain share of the regionwide gain in the business tax base.

The final advantage of tax base sharing is that it retains the autonomy and local decisionmaking authority of local government. Although the tax base is shared, local governments continue to decide the size and composition of local spending. Tax base sharing therefore tends to equalize the capacity to tax rather than actual budgets. Although it will be seen later that tax base sharing adds significantly to administrative requirements, it does not add a new layer of government to the local area.

Disadvantages

Tax base sharing has had its share of critics. The disadvantages appear to fall into three areas. First, since tax base sharing does not create, at least directly, either new tax base or new revenues, it is very difficult to gain political consensus about any tax base sharing proposal because local jurisdictions can always utilize historical data to determine if they would have been a "winner" or "loser." In fact, John Kari and Eugene Knaff (1982) suggest that the "winners-losers" problem may account for the limited acceptance of tax base sharing nationwide.[6]

It is very important to understand the "winners-losers" problem because this paper will also present empirical simulations of the impacts of tax base sharing using historical data. Under these tax base sharing procedures, it is future growth which is shared, not historical growth. It is extremely dangerous to presume that past growth patterns will be perpetuated ad infinitum. In addition, the "winners-losers" can change cyclically or sometimes even abruptly from year to year. Try to imagine the impact that the GM Saturn plant would have had on Schoolcraft Township and Kalamazoo County generally. Does anyone pretend to know what local jurisdiction will be adversely affected by the next plant closure?

6. See footnote (2) for the other two areas which have adopted some form of tax base sharing. The author is unaware of any other localities in the U.S. which have adopted tax base sharing.

The Minnesota experience with tax base sharing has verified that there may be many changes in the fortunes of local jurisdictions over the years. For example, the cities of Minneapolis and St. Paul were initially net recipients of tax base, but recently they have been net contributors (Minnesota Journal, November 19, 1985: 1). The primary reason for this change has been a resurgence in the construction of office buildings downtown. A recent research report from the Minnesota House of Representatives details the dynamic nature of the program (Baker and Hinze, 1984).

It should be stressed that historical comparisons by their very nature tend to be artificial. The implicit assumption is that all decisions and developments would have occurred identically with or without the hypothesized program change (in this case, tax base sharing). But one of the goals of tax base sharing is to change incentives and influence both the pattern and pace of regional economic growth and development. Unfortunately, it does not appear to be possible to conduct historical simulations and capture these effects.

Thus, tax base sharing will create "winners" and "losers" in the sense that "after the fact" jurisdictions will always be able to calculate if they would have been better off or worse off because of tax base sharing alone. Even though such comparisons tend to be artificial, historical simulations will be conducted in this paper because there does not appear to be any other satisfactory way to develop a baseline or gain additional insight into how tax base sharing might impact Kalamazoo County. It can only be hoped that the results of this paper will be interpreted cautiously and that narrow self-interest will not be the only criteria used to evaluate tax base sharing.

The second major disadvantage of tax base sharing actually questions the existence of fiscal disparities and/or whether the changes brought about by sharing are desirable. Tiebout (1956) suggests that the existence of many local jurisdictions permits a matching of the preferences of households for public services with the production of those public services by local governments. Fox (1981a) approaches the issue somewhat differently but reaches the same conclusion as Tiebout. Fox suggests that any perceived revenue surplus created by business firms is actually compensation to residents of the local jurisdictions for undesirable external costs (pollution, traffic congestion, etc.) created by those business firms. According to Fox, the existence of zoning laws is evidence that business firms are undesirable neighbors.

It is far beyond the scope of this paper to critique the theoretical arguments for or against the existence of fiscal disparities.[7] Suffice it to say that if one concludes that either the status quo is optimal or the fiscal benefits from growth represent payment for the undesirable features of business firms, then it is obvious that any new program such as tax base sharing constitutes a movement away from optimality.

The proponents of tax base sharing obviously reject the notion that the existing distribution of tax base, public services, or tax rates resembles

7. The interested reader should consult an earlier Upjohn Institute paper by Wayne Wendling (1981c) which specifically addresses the theoretical issues.

anything close to optimal conditions.[8] They frequently appeal to the Serrano vs. Priest decision as evidence that the courts found extreme disparities in the abilities of localities to finance public education. Unlike the solution for public education, however, the goal of tax base sharing is not to provide identical government services to all residents, but to smooth out the capacity of local governments to provide those services. Each jurisdiction is then allowed to respond to the needs and desires of its own citizens.

Proponents of tax base sharing argue that it is at least an incremental step toward optimality. While that tends to be true overall for a region, it is not necessarily true for each jurisdiction within the region. For example, it is possible for a locality to be above average in terms of its property tax base and yet contain virtually no business property. In this situation the above average district would add modestly to its wealth through tax base sharing because each district always receives a minimum share of the regional growth, even if no business growth occurs locally.[9] In other words, tax base sharing assumes a more equal distribution of the business property tax base is desirable per se, without regard to other factors.[10] That this might not be

8. The exchange between Fox (1981a) and Reschovsky (1981) represents a brief but reasonable summary of the opposing situations.

9. Vogt (1979) found this to be true when he applied a version of the Minnesota Plan for tax base sharing to San Diego County, California.

10. Of course, it is possible to account for other factors in a tax base sharing plan.

the case highlights the need for careful study of tax base sharing before implementation in any region.

The third and final disadvantage of tax base sharing is one of perception only. Tax base sharing has sometimes been misconstrued with other efforts to reduce the reliance of local governments on the property tax to raise revenue, but there appears to be absolutely no valid reason to think that property tax bills will fall with the adoption of tax base sharing.

II. Growth of the Property Tax Base in Kalamazoo County[11]

Simulations of the impacts of tax base sharing on the local jurisdictions in Kalamazoo County will be presented in Sections III and IV of this paper. First, however, a brief overview of the growth in the property tax base in the county and its local jurisdictions is presented. This approach provides the necessary institutional framework for the later empirical analysis. The discussion includes the effects of property tax abatements and inflationary growth in the property tax base because both impact the available property tax base to be shared. The section ends with a consideration of some measures of fiscal disparities.

11. The raw property tax data discussed in this section and later sections were kindly provided by the Kalamazoo County Equalization Office. The author also benefited from several long discussions with the Director of that office, James Ringler, and with the Kalamazoo County Controller, Wesley Freeland. However, the author retains full responsibility for the interpretation and subsequent data manipulations.