# Distributional and Economic Effects of Pennsylvania's Local Property Taxes

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## 1 Introduction

Chairman Rhoades, and members of the Senate Education Committee, I want to thank you for the opportunity to testify before you this afternoon on the economic and distributional effects of real estate taxes in Pennsylvania. As you may know, I have since moving in 1979 to Carnegie-Mellon been involved in numerous tax policy projects. Their overall purpose has been to rationalize the way local governments, especially school districts, finance themselves, with the overall objective of improving not only the fairness by which local services are financed, but also improving the certainty by which local governments are funded, and, ultimately, the attractiveness of Pennsylvania as place to invest, work, and live.

Either I have been unsuccessful in finding acceptable solutions to local finance problems, or they keep cropping up faster than one can do anything about them! Here is a list of my involvements in various local finance reform efforts primarily in Pennsylvania (but also in New York State):

- Director of Research Pennsylvania Tax Commission, 1979-81
- Member, Allegheny County Tax Study Commission, 1984
- Member, Pennsylvania Local Tax Reform Commission, 1987
- Member, Property Tax Transition Team, Allegheny County, 1996
- Member, Property Tax Transition Team, Allegheny County, 2000
- Member, Panel on School Finance, New York Board of Regents, 1995
- Member, School Finance Technical Advisory Panel, New York Board of Regents, 2000-.

My scholarly and public policy interests in local finance derive from two federal experiences early in my career:

- authoring the federal revenue sharing legislation in the early 1970's; that entailed successfully devising a formula to allocate $5.3 billion annually to each of the states, District of Columbia, and all of the municipal and county governments in the United States (about $84 billion overall before Congress eliminate the program in the 1980's due to chronic federal budget deficits).

  Working first at the US Treasury, and then for the Congress upon the program's renewal, figuring out how to reasonably allocate monies to 38,000 governments and find the sufficient votes in a bicameral legislature sharpened my political (and computer programming) skills.

- while working for the tax committees of the Congress, being responsible for much of the federal help that bailed out New York City in the 1970's; this taught me much about the realities of what can happen when government avoids the inevitable, and how rancorous local fiscal politics can get.

Beyond these public appointments, I have given various speeches and talks about local taxation within Pennsylvania, as well as advised elected officials and fiscal organizations in other states about how they might emerge from the Property Tax Briar Patch politically intact. Most of these are on my home page at CMU.

Two years ago this month I was invited by some of your colleagues in the Pennsylvania House to share my thoughts on Senate Bill 2, and probably helped the House forestall some very questionable ideas about local tax reform by providing a candid appraisal and some ideas about alternatives.

To my surprise, my presentation to the House was followed by a written accusation to my dean, by the author of Senate Bill 2, that I was, among other things, puerile and sexist.

As a devoted husband, and a devoted father of two teenage daughters and teenage son, this struck me as odd as it did to your colleague, Senator Vince Fumo of Philadelphia. He subsequently pointed out in writing to my dean that the author of those accusations undoubtedly protested too much, and that the bulk of my remarks (carried on PCN I hasten to add) contained suggestions on how to make Senate Bill 2 better.[1]

To finally clear up what was a major misunderstanding, let me state for the record that all references in my oral and written remarks two years ago were to the central character in the movie, Buffy the Vampire Slayer, not the central character in the TV series (also called Buffy the Vampire Slayer). Indeed, I was unaware that there was a TV series until my 13 year old daughter explained that to me. For the uninitiated, in the movie, the central character is a sympathetic figure who is well-intentioned, but quite headstrong and occasionally misguided, while in the TV series the central character comes across primarily as a ditz.

While Act 50, which resulted from Senate Bill 2 being unraveled in the House, remains Pennsylvania's answer to the real estate tax crisis, I would be remiss if I did not comment now, as I did 2 years ago, that getting it wrong or botching it can prove politically costly. Indeed, the $100 rebate that has been cobbled together is symptomatic of the accuracy of that prediction. Further, I predict that the political end game resulting from trying to Slay the Property Tax, but failing, is far from over.[2]

Perhaps later we can rejoin some of these issues, for they are not unrelated to the topic before us this afternoon.

My task is to comment on the economic and distributional effects of local real estate taxes. Given this panel meets after lunch, and I am the last speaker, I will try to be candid, helpful, and hopefully lively enough to maintain your attention.

My remarks below are organized as follows. Section 2 provides some initial definitions and background about the local property tax in Pennsylvania; Section 3 contains the economics of how local property taxes (and services) affect decision making and property values themselves; Section 4 reviews the reasons why I think Pennsylvanians dislike the local property tax so intensely, and in particular provides data on how dramatically residential property has grown as the primary source of local property tax base in 60% of Pennsylvania's school districts; Section 5 explains why poor assessment quality is another reason that tax payers are upset, and particularly in Allegheny County where assessment quality data are available by local school district; Section 6 goes through a normative analysis of how local schools **should** be financed were a state to answer that question from scratch; and Section 7 provides my views on how Pennsylvania might move forward from where it currently is in terms of state law governing the property tax as well as state law surrounding local school finances.

[1] For the curious, you can find my speech and aforementioned letters on my world wide web home page, http://www.heinz.cmu.edu/~rs9f Item 3, Online Papers and Speeches, and choose "Is Senate Bill 2 True Local Tax Reform? or will Buffy the Property Tax Slayer Slay You, Me, and the Pennsylvania Economy?"

[2] See the discussion below in Section 3.3.3 below.

## 2 Some Definitions and Facts about Property Taxes and Economic Development in Pennsylvania

### 2.1 Some Definitions and Pennsylvania's Tax Structure

Property taxation in Pennsylvania historically has meant:

- The imposition of real estate taxes by counties, municipalities and school districts;
- The imposition of personal property taxes by counties, Philadelphia, Pittsburgh, and the Pittsburgh Public Schools (until repealed in 1996 after the *Fulton* decision and awaiting the outcome of the *Annenberg* case.);
- The centralized imposition of a 30 mil real estate tax on the book value of regulated utility property, and formula redistribution of the proceeds (PURTA).

  Effective this year, production facilities of formerly regulated electric utilities are now subject to local appraisal and taxation. This creates significant revenue losses to municipalities and school districts who formerly received shared centrally imposed utility taxes, and creates potentially large windfalls to a handful of jurisdictions containing these production facilities and whose county assessors can figure out how locally to assess complex utility property.

  While small in overall dollars compared to state-wide property taxes, this alteration in the taxation of public utilities represents a 19'th century solution to a 21'st century public policy problem, and moves Pennsylvania farther away from best practice when it comes to real estate taxation among the states.

  The obvious solution to deregulation would have been for:

  (i) the state to continue to assess production facilities, but at market value to reflect the new economic reality[3]

  (ii) continue to levy a fixed millage and redistribute according to the historical formula, and possibly (iii) provide state aid, declining over time, to recipient governments to make up the local revenue loss.

  Lowering the fixed millage could readily have made the utilities as happy as they wanted to be and everybody wanted to make them, and forestalled what is now beginning to happen. Undoubtedly you will be hearing from local governments shortly about just what transpired last summer. I might add that this sort of policy confusion does little to signal to companies around the country that they might (now) have a friend in Pennsylvania. Rather, they might readily interpret they are being told that they are free to badger the local property assessor for more friendly treatment. Most businesses and their tax departments these days have better

[3] I had heard that nobody could figure out how to get around uniformity clause problems that might evolve from treating production facilities differently from those still subject to regulation, e.g. market vs. book. Shame on my former students who populate the staffs of Harrisburg! One can imagine continuation of the old system but a refund to owners of production facilities in the form of a payment (state refundable credit based on the difference between book and market value), and taking into account a possibly lower millage that might be desired on production facilities. This state payment could be wrapped up as "a competitive energy energy assistance payment" or some such high sounding mechanism devoted to furthering the Commonwealth.

things to do than spend inordinate amounts of time and money trying to romance their local assessor.

- The imposition by the state of Capital Stock and Franchise Tax on the apportioned property of domestic and foreign corporations is the other major property tax, albeit not a local one.

  While not a (local) real estate tax *per se*, the measure of *actual value* based half on capitalized income and half on shareholder's equity are measures of business property, and at 12 mils sufficiently high to dissuade capital intensive firms from locating here. I mention the Capital Stock and Franchise Tax to you this afternoon because it truly is a property tax, one that is very onerous and visible, and likely the single largest impediment at the state level to improving the standard of living in Pennsylvania. You have also committed yourselves to revisit this issue in the not too distant future.

  I hope you are aware that the pending *PPG* decision has very substantial implications for local taxation (and economic development). It is likely that the temporary patch you enacted last year failed to address the local effect of the *PPG* decision. Since this observation may not be the conventional wisdom here in Harrisburg (sentiment generally is that you forestalled the state problem and there are no local issues), let me explain this further.

  One can find throughout Pennsylvania's local tax statutes favorable tax treatment for manufacturing through the mechanism of various manufacturing exemptions.

  What the *PPG* decision seems to do is eliminate any state manufacturing exemption, and thereby invite further litigation to eliminate the *local* safe havens manufacturing enjoys from broad application of local taxes. One industry which historically has enjoyed this safe haven is the newspaper publishing industry. My reading of the *PPG* decision is that it eliminates local exemptions as well because they are discriminatory. It is therefore imaginable that once the City of Pittsburgh figures out that it can collect the Mercantile Privilege Tax from the *Pittsburgh Post-Gazette*, it likely will do so. The City of Pittsburgh certainly will need the revenues.

### 2.2 A Definition of Economic Development and A Long View of Pennsylvania's Economy

Economic development usually signifies the progress or improvement in the standard of living of a community as evidenced by the income and wealth of its inhabitants/citizens. When we talk about an economy developing, we imagine people working at higher paying jobs, living in better homes, driving new or newer cars, taking longer vacations, and enjoying better health and nutrition. Implicit in such a definition is the idea of a reference point against which such progress can be measured. Implicit comparisons might involve either the passage of time, and/or comparisons across communities.

Moreover, we likely view overall population growth to be indicative that others are attracted to such an area by the improved living standards and the availability of employment opportunities which the developing area affords viz. a viz. other areas which are developing less quickly.

There are many ways one can characterize the standard of living of Pennsylvanians, and one can readily point to areas that are doing especially well and areas that are faring poorly. From the perspective of the Commonwealth, what matters probably most is the overall average standard of living. Given short notice, I turned to available federal data sources to take a long look at the per

capita personal income and per capita wages and salaries of Pennsylvanians as a central indicator of standard of living for the period 1929-97.[4]

Personal income includes not only wage and salary disbursements but also income from capital (interest, dividends, rents and royalties), sole proprietor's income, and transfer payments less contributions for Social Security. Wage and salary income is much closer to the concept of income from employment, although it does not include sole proprietor's income.

The story that Figure 1 tells is somewhat discouraging. Compared to the US average, Pennsylvania's per capita wages and salaries have fallen below the US average since 1977, and while starting to recover from a low in 1985, actually began to fall off again since 1993. Pennsylvania's personal per capita income has fared a bit better, and since the late 1980's, it has been slightly (1 or 2%) above the US average.[5] What is striking about taking a long look at the trend in this measure of the standard of living is that there has been a long term secular decline. Just before the Great Depression Pennsylvania's per capita income and wages were 10 to 15% above the national average, and since then there has been a long term decline. After World War II there was a rebound between 1947 and 1953, but the erosion continued after that, being more pronounced for wages and salaries than personal income.

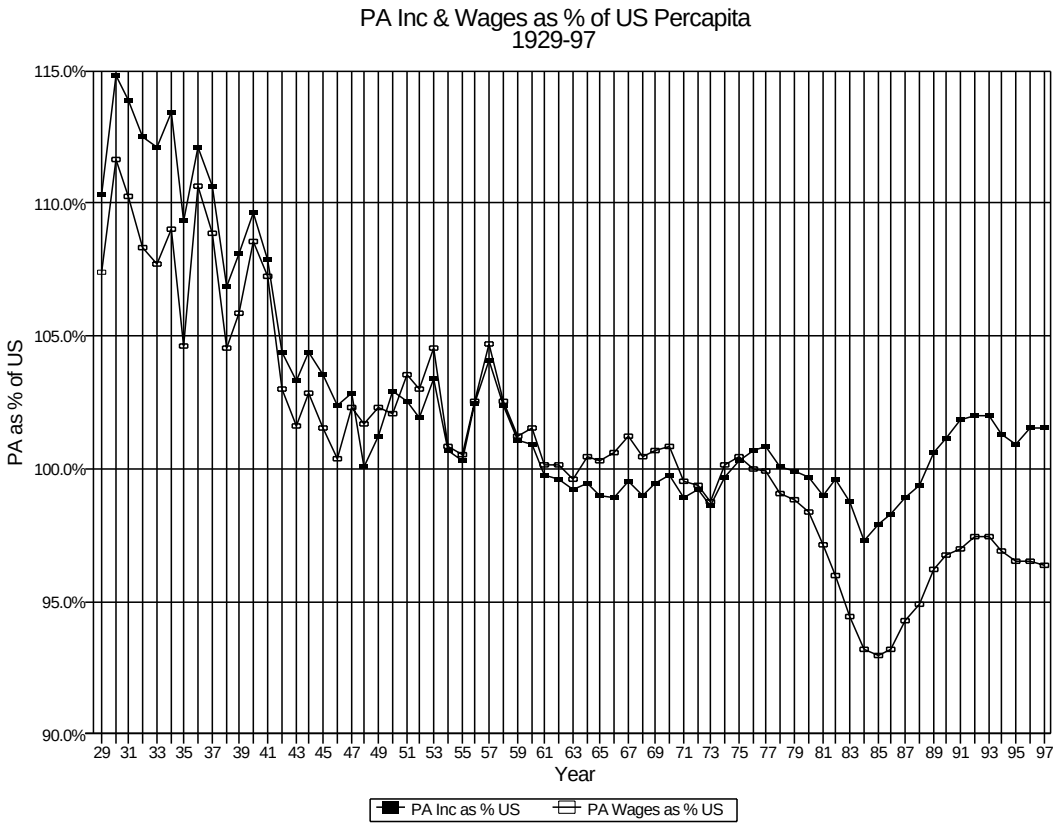
If we examine the long-term pattern of population in the Commonwealth, we find that it has been quite flat for a very long time. In 1929, Pennsylvania with 9.7 million residents accounted for 8% of the US population. Since the 1950's our population has remained flat, and we now account for only about 4.5% of the US population. Figure 2 shows what has happened to Pennsylvania's population share. Except for the upturn after World War II which ended in 1947, our share of the US population has continued to decline. This gets reflected every 10 years in the decline in our representation in the US House of Representatives, and we will lose House seats again after the 2000 Census.

I do not think these few statistics are necessarily surprising. They confirm the general notion that Pennsylvania's economy is sluggish or moribund, especially west of the Susquehanna, and that other parts of the US are enjoying far more than we are the fruits of the longest economic expansion in the history of the US economy.

[4]See US Department of Commerce, Bureau of Economic Affairs, *State Personal Income 1929-97*, CD ROM, October, 1999

[5]Given that Pennsylvania has a much higher than average elderly population, using resident population as a denominator may understand per person what is being earned.

Figure 1: Pennsylvania Percapita Income and Wages as % of US



## 3 How Local Property Taxes affect Our Standard of Living

### 3.1 Why We Tax Ourselves

The reason society taxes itself is to provide public services which the private market place, left to its own devices, will not provide and to correct some of the harsh results of the market place by providing both a safety net for the unfortunate and to make sure that young people, irrespective of their family's income or wealth, are educated so when they reach adult age they can be both responsible, informed citizens, and also gainfully employed.

There are two reasons I emphasize the rationale for taxation at the outset. First, all of us would like not to pay taxes so we can have more money for ourselves. However, we also do not want to forego the public services we, our families, and/or neighbors need and enjoy.

Throughout the US tax reform is often by implication taken to mean a reduction in taxes at least for me and maybe you. Given the necessity for state and local governments to balance their budgets, we can not all both enjoy tax cuts and if services are to be maintained at municipal, school district, county or state levels.

Second, and of at least equal importance, is the observation that public services must be provided in return for the voluntary payment of taxes by taxpayers. When citizens lose confidence in the capacity of a government to provide services in return for taxes, at a minimum voluntary compliance will suffer. Ultimately, people and business talk with their feet and find someplace else to work and live where promises made are promises kept.

### 3.2 Do Local Property Taxes Affect Household and Business Location Decisions?

When a business is seeking to expand employment and/or physical plant, it behooves it and its owners to review whether or not where it is doing business is the best place to add these resources. Attitude surveys of executives over the years indicate that the level of taxation is always on the list, as are things like proximity to markets, labor, transportation and utility costs. Other factors such as "quality of life" are typically mentioned along with such tangible factors like weather and "cost of living."

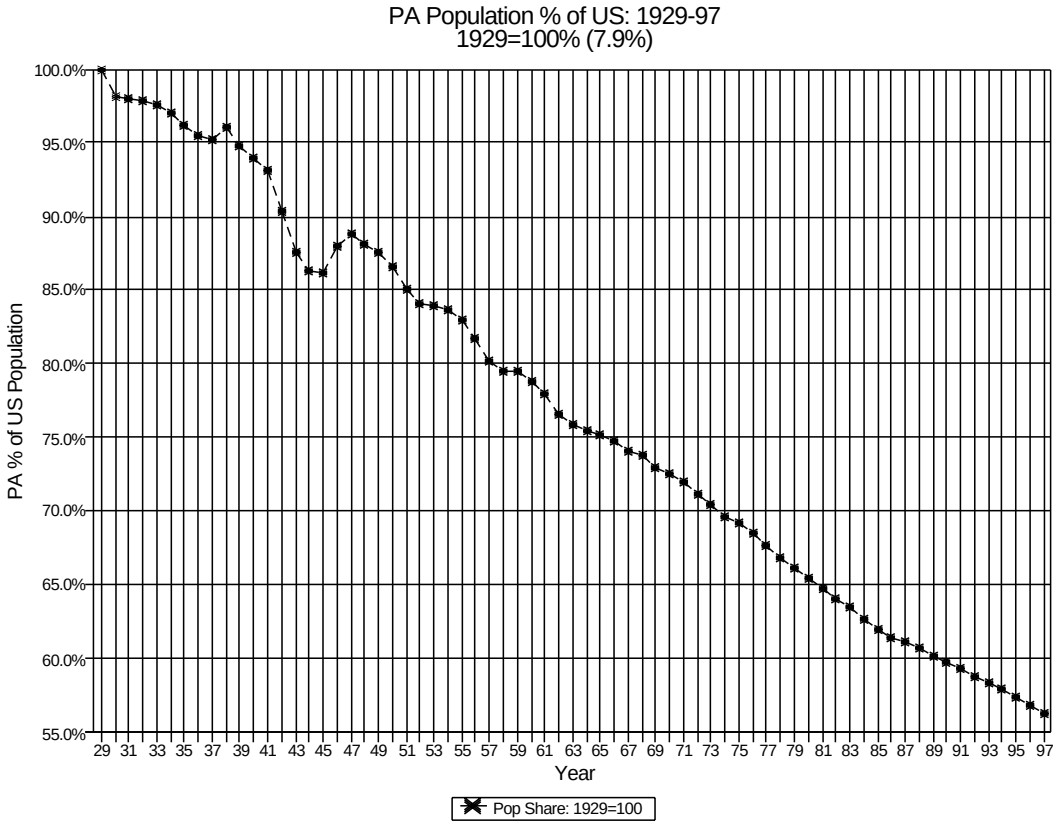
Business magazines and location consultants come up with ratings like "business climate" and changes in business climate, and state officials, especially governors, take these ratings seriously.[6]

To my knowledge no business magazine has asked the more sensible question: "Do you feel you and your employees are getting quality services in return for the taxes you pay?" That might be more meaningful.

Economic theory tells us that in the short run, both capital and labor are immobile, so that an increase in local taxes, holding everything else constant, and ignoring the services provided for such increased taxes, will not cause labor or capital to leave the high tax community for somewhere else. Over time, however, it is reasonable to expect cost conscious companies and employees to relocate, and carefully done studies show that companies over time will move their assets, and employees will move from higher taxing jurisdictions to lower taxing jurisdictions.

[6] Universities, too, are victims or beneficiaries of such ratings games as well. Were the Heinz School not rated number 4, and public finance rated number 6 by US News and World Reports, I would not mention it. The CMU Trustees evidently like such ratings, as they can take credit for such notoriety; however, I do not think it affects the way compensation is determined, or affects their concern about whether or not the School is underfunded in the annual budget lottery with the rest of the University.

Figure 2: Pennsylvania's Population Share of US: 1929-97 (1929=100%)



When we enquire what theory tells us about into how local taxes **and** local services affect location decisions, we find that the conclusion about mobility becomes less clear. If the services are valued at the amount of the taxes paid, then mobility may not occur at all. Arms length housing prices (and apartment rents) will reflect the netting out effects which property taxes (which by themselves depress on a capitalized basis the price of homes), and local service quantity and quality (especially schools), add to the price (also on a capitalized basis) of a home.

Let me give you an example of negative capitalization. Some years ago, when the federal courts forced the jointure of several suburban school districts outside Pittsburgh to form the Woodland Hills School District, home prices fell, according to some observers, by 25% in the richer suburban districts. Owners were concerned that the shot gun marriage of poor and rich districts would dilute the quality of education, and reduce the demand for houses in the rich districts.

A very careful investigation of household location decisions in suburban New Jersey by Prof. Thomas Nechyba of Duke University and myself [7] revealed that a 1% increase in per-pupil spending was associated with an increase of 1.6 to 3.1 % in the odds of someone wanting to move there, given their income and housing needs. I hasten to add that for the communities in question, there was a **perfect** correlation between per-pupil spending and SAT scores, something that does not always prevail.

Lest you think that school quality is something home buyers do not consider, or is just a phenomenon I bumped into by chance in suburban New Jersey, I suggest you talk to your local Coldwell Banker Real Estate Agent.[8] For a nominal fee, any agent can receive, updated quarterly, a CD which contains every school district in the US, the average home price, SAT scores, and local property taxes. The contents of the quarterly CD is of intense interest to home buyers, and this turns out to be an important marketing tool.

### 3.3 Defining Distributional Effects and The Case of Local Real Estate Taxes

Care is needed when talking about distributional effects of taxes, for two reasons: one intellectual, and one political. At the intellectual level, the topic quickly can get confusing as one starts the discussion with dollars paid, and then moves on to compare percentage **rate** of taxes imopsed, and then moves on to comparing to the dollars paid in relation to something else like ability to pay (household income).

At the political level, candidates for elected office routinely claim that they will (with my vote on election day) make sure that current unfairness I am being subjected to will be corrected. Notice how our presidential candidates have been promising to cut our taxes through "real" tax reform.

At the state and local level cutting taxes has to be weighed against cutting services. However, tax reform usually is heard by the electorate to mean tax cuts rather than a rearrangement of tax burdens in a more rational and ethical manner. We all hear what we want to I guess.

In your letter of invitation, you asked me to comment on the regressivity of local property taxes, so let me first explain ways to characterize fairness of taxes, and then talk about when the local property tax is regressive, and when it is not.

#### 3.3.1 Defining Equity for Tax Analysis Purposes

[7] Nechyba and Strauss(1997).

[8] I am indebted to my wife, Celeste Strauss, one such local Coldwell Banker agent, for pointing this out to me.

The equity or fairness of a tax has two meanings in terms of the legal design of the tax:

- Equal Treatment of Equals.–given two taxpayers with identical abilities to pay (they live next door to each other and their houses and land are identical), we enquire if (1) the tax system they must comply with extracts the same tax from each; this technically involves questions of whether or not the tax is horizontally equitable; as long as the taxpayers are living in the same taxing jurisdiction, the Pennsylvania Constitution says they must face the same rate of tax.

  If we are talking about local wage taxes, the rate each taxpayer faces is the same, and the dollar result is the same.

  If we are talking about local real estate taxes, the manner in which their identical houses are assessed can lead to disparate and unfair results. More on this later when I talk about why homeowners hate the local real estate tax so much.

- How Unequals Are Treated By The Tax System.

  —progressively? (Does the rate of tax rise with income?

  —proportionately? (Is the rate of tax constant across incomes?)

  —regressively? (Does the rate of tax statutorily fall as income rises?

  Given two taxpayers with differing abilities to pay (e.g. income of household one is twice as large as the income of household two), how does the tax system treat each? The Pennsylvania Constitution says, with the exception of the poor, that our income tax rates can not vary with income, and as a result of court decisions, exemptions and deductions which might accomplish this indirectly, are not permitted.

  In the case of the local real estate tax, you have amended the Constitution to permit homestead exemptions if voters vote to do so.

### 3.3.2 Is the Local Real Estate Tax Progressive, Regressive or Proportional?

In a state with a very heavy elderly population, it is commonplace to claim that the local property tax is regressive. Consider the following thought-experiment and table of data. I send some CMU graduate students into a Pennsylvania county, and tell them to ask a sample of the residents what their income is, and what property taxes they paid. The respondents go to their records, and write down their Pennsylvania taxable income, and their property taxes paid. The graduate students collect the data and bring it back to the University for analysis.

Imagine the graduate students' data collection effort leads to Table 3.3.2. The results of the data collection effort show, in col (5) that the effective rate of tax declines as income rises, even though the amount of property tax paid goes up a bit in each income class. Did the graduate students find the property tax rosetta stone? Is this what all the complaining is always about?

Table 1: Hypothetical Table of Data Showing Regressivity of Property Tax

| (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|
| | Pa Taxable Income Class | Average Income | Average Real Estat Taxes | Average Effective Tax Rate (%) |
| 1 | \$0-\$999 | \$750 | \$1,200 | 160.0% |
| 2 | \$1,000-\$4,999 | \$2,500 | \$1,800 | 72.0% |
| 3 | \$5,000-\$9,000 | \$7,500 | \$2,300 | 30.7% |
| 4 | \$10,000-\$14,999 | \$12,500 | \$2,700 | 21.6% |
| 5 | \$15,000-\$19,000 | \$17,500 | \$3,200 | 18.3% |
| 6 | \$20,000-\$29,999 | \$25,000 | \$4,000 | 16.4% |
| 7 | \$30,000-\$49,000 | \$40,000 | \$5,200 | 13.0% |
| 8 | \$50,000-\$100,00 | \$75,000 | \$6,500 | 8.7% |

Some of you may ask, precisely where in this county did the students collect the data? Suppose the County has 5 school districts, and 25 municipalities. Two of the school districts have shopping malls inside their taxing boundaries as do two municipalities. Another school district has a big chemical plant, but it has been closed for a year.

The students get embarassed when asked. Obviously millages and assessed values will vary. What a mess! (Probably, they had not taken any courses from me yet, they just did this as a project).

But, I am willing to concede that if the students went out and concentrated on a sample of households in the same municipality, and therefore in the same school district, one might find, again, data such as that portrayed in Table 3.3.2. Is the local property tax, as assessed in that county, and given the millages of that municipality and school district, still regressive when comparing the taxes due against Pennsylvania taxable income?

Perhaps the trick in the data has to do with using Pennsylvania taxable income as the measure of ability to pay. As I understand our personal income tax, Pennsylvania taxable income does not include Social Security or private pension payments. No wonder those income intervals look so low.

To which you might well respond, "Professor Strauss, do you think we are so crazy as to think about including Social Security and private pension payments into Pennsylvania taxable income? This is an election year, and those people vote. Let us leave the measure of ability to pay alone, and assume that income is properly measured."

### 3.3.3 Widow Jones vs. The Smith Family's Property Taxes

Before we conclude that the property tax in this example is truly regressive, perhaps we should look at two taxpayers who filled out the survey form: Widow Jones and The Smith Family.

Consider Widow Jones, living in her \$300,000 house that her late husband, Edward, left her and her four grown children (\$300,000 in true market value, \$75,000 in assessed value (25% assessment ratio). Widow Jones has income from investments that her late husband made of \$14,999/year, and pays \$3,000/year in combined real estate taxes or 20% of her Pennsylvania Taxable Income.[9]

[9]She probably also gets \$9,000/year in Social Security and another \$24,000 in retirement income from her husband's pension; however, let's just assume she has \$14,999 of income/year.

Next, consider down the street, Frank and Sally Smith, who run an E-Business, also have the same house, 3 school age children, and also pay $3,000 annually in real estate taxes. They have salaries which combine to $150,000/year in Pennsylvania taxable income, and thus pay only 2% of their income in property taxes.

If we look carefully at the real estate tax, it is the same dollar amount for Widow Jones and the Smith family.

Is the property tax *per se* proportional? When viewed against the value of the property, Yes.

Is the property tax regressive? When the taxes due ($3,000) are compared to Pennsylvania Taxable Income? Yes.

Further, Widow Jones will tell you that the property taxes will drive her out of her family home. But how did she ever get into such a big house to begin with? When her beloved Edward was alive, his income was high, and they raised a family there. When he was alive, suppose he too made $150,000/year. Then, they paid 2% of *current* income in property taxes. Over time, the long run payments of property taxes will reflect what their housing needs and tastes (and what their income allows them to afford) are. The right way to look at the distributional effects of the property tax are to compare the long-run property taxes paid to the long-run income earned.

The usual wisdom about the long-run distributional effects of the property tax is that it depends in the long-run on the income elasticity of demand for housing. If the income elasticity of demand for housing is greater than unity, then the property tax is progressive. If the income elasticity of demand is less than unity, then it is regressive. Most long run estimates of this crucial are about 1.15.

Now, you may wonder what planet I am living to say that the property tax could well be, in the long-run, progressive. What about the Widow Jones problem? To which I might observe to Widow Jones:

> "...that's a mighty big house you live in, Mrs. Jones. Don't you expect the police and fire to take very good care of such a big house? Shouldn't those services be paid for by the person who enjoys them? Those were very fine schools you sent your children to, and you should being willing to support others go to such fine schools, shouldn't you?"

To which you may be thinking, these damn college professors, especially those from private colleges and universities. Every time you ask them a question, they come up with the wrong answer! Worse, this Professor has written and spoken against the property tax in support of public education for decades. And now he is babbling that the property tax is progressive in the long-run.

Rest assured, political cover to worry about the effect of the property tax on the elderly will follow. However, the property tax problems of the elderly have to be seen for what they are: Widow Jones primary problem is financial illiquidity more than anything else. The problem is less one of distribution than illiquidity.

Second, there is a solution that only requires a one-time injection of cash. The correct answer, in my view, in terms of state policy is to capitalize a revolving fund at the state level which creates a partial property tax exemption for the elderly when property taxes as a percentage of their income rise above what one thinks is unacceptable (15%?), and the payment to the local governments of the excess property tax in conjunction with Mrs. Jones agreeing to give the state a lien against her property as she exempts out of "excess property taxes."[10] When Mrs. Jones passes, her estate pays off the lien back to the revolving fund, and the balance of monies is divided among her children etc.

[10] I would imagine that such a program could be run through the existing property tax rent rebate program and thereby not run afoul of the Uniformity Clause.

Vermont has done this for years. There they fight over how much of the local revenue loss should be made up by the state out of the revolving fund.

Capitalization of such a lien system might be a better one time use of the state surplus about to be spent on $100 property tax rebates, by the way, and still be politically popular. After all, everybody loves their parents and grandparents. Everybody wants them to be able to live in the family house in their twilight years to host Thanksgiving and Christmas dinners with their kids and grandchildren running around. Nobody wants their parents and grandparents chased by onerous local property taxes out of the family home to live in an apartment or on the street. Moreover, this sort of policy initiative, once capitalized, would go on **forever** and thereby allow those who voted for it here in Harrisburg with the foresight to have used a one-shot surplus to take credit **forever**.

## 4 Why Do Taxpayers Hate the Property Tax So Much?

### 4.1 Four Reasons for Public Outcry against the Property Tax

Above I have gone through an economic analysis of real estate taxes in the state, and while I am willing to concede they are possibly regressive in the short run, that hardly explains why people are upset about them. Here I wish to explain the property tax revolt. Three reasons are usually offered:

1. property taxes have likely grown more rapidly in the 1970's, 1980's and 1990's in key regions of states than personal income has grown;

2. while real per pupil spending has generally risen, outcome results such as test scores have not which in turn has tempered public support for education; [11]

3. school age population as a percentage of the total population has experienced a long term decline until recently with the implication that its political constituency has gotten smaller as contrasted with those over age 65.

While each of these factors may be at work, I would like to forward a fourth reason for increased taxpayer sensitivity to rising property taxes. In particular, there has been a long-term increase in the *relative* tax burden of residential real estate viz. a viz. commercial and industrial real property that has had distinct, political effects. Since home owners tend to be voters, it is this increased relative burden which has prompted the property tax revolt, and has created strong interest in many states to move from the local property tax to broad based income and/or consumption taxes as happened in Michigan in 1993 and Oregon in 1994.

Several factors have slowed the growth in commercial and industrial property assessments viz. a viz. their residential counterparts. First, they are technically more difficult to accomplish. Second, if one looks at post-WWII federal tax policy, it has been designed with few exceptions to encourage investment in equipment rather than plant. Since federal marginal income tax rates historically have dominated business planning decisions, it should not be surprising that the plant component of investment has generally lagged. Third, if one examines long-term demographic trends, the post-WWII era witnessed an explosion in family formation and subsequent home ownership that was encouraged by favorable federal tax treatment of mortgage interest payments as well as local property taxes. Fourth, the difficulties of US manufacturing in the 1970's and 1980's was ultimately reflected in the sluggish or declining assessed values of industrial real estate.

With regard to commercial real estate, the shortened federal tax lives of real property under the Accelerated Cost Recovery System in 1981 created an enormous commercial property boom which began to reduce residential properties burden in many states. However, since the creation and imposition of the passive loss rules on loss income from real estate in the Tax Reform Act of 1986, investment in commercial real estate has languished, and so have their assessed values.

Table 2 shows the results of measuring the shift in the composition of the property tax base in 18 states, including Pennsylvania. Remember, if local budgets grow faster than state and federal aid, it follows that the local school property tax must make up the short-fall.

[11] See Hanushek *et al* (1994) for a review of management and effectiveness issues. For evidence on the conjecture that the quality of school teachers, as measured by teacher test scores, affects pupil performance, see Strauss and Sawyer (1986), and Ferguson (1991).

So, if the local base is increasingly residential, then home owners pay an increasing share of each additional dollar raised. This creates a political reaction by taxpayers and also by school boards who hear the complaints. It is not surprising that statistical analysis of New York and Pennsylvania spending patterns show that as the local property tax base becomes increasingly residential, the willingness of the local electorate to spend on public education declines markedly.

Table 2: Residential Property's Share of Total Assessed Value in 18 States

| Col 1 | Col 2 | Col 3 | Col 4 | Col 5 | Col 6 | Col 7 | Col 8 |
|---|---|---|---|---|---|---|---|
| | Time Period of Data | Lowest Residential Share | Year of Lowest Share | Highest Residential Share | Year of Highest Share | % Points of Change | % Change in Res. Share |
| | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| Colorado | 1984-95 | 54.1% | 1984 | 70.8% | 1995 | 16.7% | 30.9% |
| Illinois (EV) | 1981-92 | 49.6% | 1981 | 53.1% | 1992 | 3.5% | 7.1% |
| Indiana | 1972-92 | 44.9% | 1972 | 48.0% | 1992 | 3.1% | 6.9% |
| Iowa | 1981-94 | 43.6% | 1981 | 47.7% | 1994 | 4.1% | 9.4% |
| Kansas | 1976-94 | 41.1% | 1976 | 73.3% | 1994 | 32.2% | 78.3% |
| Maryland | 1962-93 | 71.5% | 1962 | 74.1% | 1993 | 2.6% | 3.6% |
| Massachusetts | 1983-95 | 64.4% | 1983 | 78.5% | 1995 | 14.1% | 21.9% |
| Michigan | 1966-94 | 59.2% | 1966 | 70.9% | 1994 | 11.7% | 19.8% |
| Minnesota (MV) | 1974-92 | 49.4% | 1974 | 56.3% | 1994 | 6.9% | 14.0% |
| Missouri | 1979-94 | 33.5% | 1984 | 43.3% | 1994 | 9.8% | 29.3% |
| Nebraska | 1989-94 | 34.5% | 1990 | 37.6 | 1994 | 3.1% | 9.0% |
| New Mexico | 1979-94 | 29.1% | 1981 | 48.1% | 1994 | 19.0% | 65.3% |
| Nevada | 1989-92 | 36.9% | 1989 | 45.0% | 1992 | 8.1% | 22.0% |
| Oregon | 1976-93 | 34.6% | 1976 | 46.7% | 1993 | 12.1% | 35.0% |
| Pennsylvania | 1977-92 | 62.5% | 1977 | 67.3% | 1990 | 4.8% | 7.7% |
| Texas | 1983-94 | 33.0% | 1983 | 41.3% | 1994 | 8.3% | 25.2% |
| Washington | 1989-94 | 59.5% | 1989 | 64.3% | 1994 | 4.8% | 8.1% |
| Wisconsin | 1951-92 | 49.6% | 1951 | 66.5% | 1992 | 16.9% | 34.1% |

Source: Robert P. Strauss, "Why Property Taxpayers Hate the Property Tax So Much," *State Tax Notes*, 13, June 16, 1997, 1802-1806.

### 4.2 The Rising Residential Share in Pennsylvania Counties

In conjunction with developing Table 2, I obtained historical data from our State Tax Equalization Board by county area. Table 3 shows the at the county level the percent residential in 1977 and 1994, the change from 1977 to 1994, and the percent change. The counties are ranked from largest increase in residential property tax burden to the lowest.

Between 1977 and 1994, Wayne County's residential property tax share of the assessed base went from 48.8% to 66.4%—I would conjecture that Wayne's homeowners are absolutely incensed at the change.

Right behind Wayne County, ranked number 2 in terms of increased relative burden on residential property, is Susquehanna County: it went from 50 to 63% residential. The shift in Bucks and Beaver counties were also quite large but reflect very different economic situations: in Bucks the population and residential housing stock grew dramatically from 1977 to 1994, while in Beaver, the population was stagnant and major industrial facilities closed their doors with the result that the same number of residents had to shoulder a higher share of a (growing) property tax bill. These figures may well explain the pressure for these hearings.

Note that in some areas of the state, the residential share actually declined. Philadelphia, as usual, provided no property tax data to STEB, so I could not do the calculations for it.

Table 3: Shift in Composition of Pennsylvania's Property Tax Base: County Aggregates 1977-94

| Rank | County | % Resid.'77 | % Resid.'94 | '94-'77 | % Chg. Resid. |
|---|---|---|---|---|---|
| 1 | Wayne County | 48.8% | 66.4% | 17.6% | 36.0% |
| 2 | Susquehanna County | 50.4% | 63.7% | 13.3% | 26.4% |
| 3 | Pike County | 56.6% | 69.9% | 13.3% | 23.4% |
| 4 | Bucks County | 61.3% | 75.4% | 14.1% | 22.9% |
| 5 | Beaver County | 59.8% | 72.7% | 12.9% | 21.6% |
| 6 | Lancaster County | 58.2% | 70.3% | 12.1% | 20.8% |
| 7 | Perry County | 56.6% | 68.0% | 11.3% | 20.0% |
| 8 | Schuylkill County | 61.7% | 71.9% | 10.2% | 16.5% |
| 9 | Monroe County | 59.8% | 69.5% | 9.8% | 16.3% |
| 10 | Chester County | 63.3% | 73.0% | 9.8% | 15.4% |
| 11 | Elk County | 61.3% | 70.7% | 9.4% | 15.3% |
| 12 | Montgomery County | 60.9% | 69.9% | 9.0% | 14.7% |
| 13 | Berks County | 62.1% | 70.3% | 8.2% | 13.2% |
| 14 | Carbon County | 64.5% | 72.7% | 8.2% | 12.7% |
| 15 | Lebanon County | 62.9% | 70.3% | 7.4% | 11.8% |
| 16 | Juniata County | 57.0% | 63.7% | 6.6% | 11.6% |
| 17 | Washington County | 59.0% | 65.6% | 6.6% | 11.3% |
| 18 | Northampton County | 66.0% | 73.0% | 7.0% | 10.7% |
| 19 | Crawford County | 55.1% | 60.9% | 5.9% | 10.6% |
| 20 | Adams County | 53.1% | 58.6% | 5.5% | 10.3% |
| 21 | Jefferson County | 57.8% | 63.3% | 5.5% | 9.5% |
| 22 | Lawrence County | 62.5% | 68.0% | 5.5% | 8.8% |
| 23 | Lycoming County | 65.6% | 70.7% | 5.1% | 7.7% |
| 24 | Butler County | 59.0% | 63.3% | 4.3% | 7.3% |
| 25 | Armstrong County | 59.8% | 64.1% | 4.3% | 7.2% |

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| Rank | County | % Resid.'77 | % Resid.'94 | '94-'77 | % Chg. Resid. |
|---|---|---|---|---|---|
| 26 | Erie County | 59.8% | 64.1% | 4.3% | 7.2% |
| 27 | Snyder County | 57.0% | 60.5% | 3.5% | 6.2% |
| 28 | Montour County | 57.4% | 60.9% | 3.5% | 6.1% |
| 29 | Delaware County | 69.9% | 73.8% | 3.9% | 5.6% |
| 30 | York County | 62.5% | 65.6% | 3.1% | 5.0% |
| 31 | Somerset County | 57.0% | 59.8% | 2.7% | 4.8% |
| 32 | Bedford County | 54.3% | 56.6% | 2.3% | 4.3% |
| 33 | Blair County | 64.1% | 66.8% | 2.7% | 4.3% |
| 34 | Allegheny County | 64.5% | 67.2% | 2.7% | 4.2% |
| 35 | Venango County | 60.9% | 63.3% | 2.3% | 3.8% |
| 36 | Franklin County | 64.8% | 67.2% | 2.3% | 3.6% |
| 37 | Fayette County | 63.7% | 65.6% | 2.0% | 3.1% |
| 38 | Dauphin County | 56.6% | 58.2% | 1.6% | 2.8% |
| 39 | Indiana County | 59.8% | 61.3% | 1.6% | 2.6% |
| 40 | Clarion County | 51.6% | 52.7% | 1.2% | 2.3% |
| 41 | Mckean County | 59.4% | 60.5% | 1.2% | 2.0% |
| 42 | Lehigh County | 64.5% | 65.6% | 1.2% | 1.8% |
| 43 | Centre County | 57.4% | 58.2% | 0.8% | 1.4% |
| 44 | Clinton County | 59.4% | 59.8% | 0.4% | 0.7% |
| 45 | Westmoreland County | 69.9% | 69.5% | -0.4% | -0.6% |
| 46 | Mercer County | 59.8% | 59.0% | -0.8% | -1.3% |
| 47 | Cambria County | 66.0% | 64.5% | -1.6% | -2.4% |
| 48 | Clearfield County | 62.5% | 60.9% | -1.6% | -2.5% |
| 49 | Cameron County | 63.3% | 60.9% | -2.3% | -3.7% |
| 50 | Greene County | 29.7% | 28.5% | -1.2% | -3.9% |
| 51 | Union County | 62.5% | 59.8% | -2.7% | -4.4% |
| 52 | Cumberland County | 67.6% | 64.5% | -3.1% | -4.6% |
| 53 | Huntingdon County | 58.2% | 55.5% | -2.7% | -4.7% |
| 54 | Northumberland County | 65.2% | 61.7% | -3.5% | -5.4% |
| 55 | Warren County | 63.3% | 59.8% | -3.5% | -5.6% |
| 56 | Mifflin County | 68.4% | 64.1% | -4.3% | -6.3% |
| 57 | Luzerne County | 72.7% | 67.6% | -5.1% | -7.0% |
| 58 | Sullivan County | 53.1% | 49.2% | -3.9% | -7.4% |
| 59 | Lackawanna County | 70.3% | 63.7% | -6.6% | -9.4% |
| 60 | Fulton County | 53.5% | 47.3% | -6.3% | -11.7% |
| 61 | Wyoming County | 60.9% | 53.1% | -7.8% | -12.8% |
| 62 | Tioga County | 54.3% | 45.9% | -8.4% | -15.5% |
| 63 | Potter County | 56.6% | 47.1% | -9.6% | -16.9% |
| 64 | Columbia County | 65.6% | 51.6% | -14.1% | -21.4% |
| 65 | Bradford County | 66.4% | 44.5% | -21.9% | -32.9% |
| 66 | Forest County | 61.7% | 33.4% | -28.3% | -45.9% |
| 67 | Philadelphia | 26.2% | 0.0% | . | . |

Source: Calculations with STEB data.

### 4.3 The Rising Residential Share of Assessed Value in Pennsylvania School Districts

In preparation for this afternoon's testimony, I revisited the STEB data which I used to generate generate Table 3, and performed the identical calculations by school districts. Remarkably, there are many more districts which experienced a marked increase in proportion of residential property over 1977-94: fully 325 or better than 3/5 or 60% of Pennsylvania's school districts had positive increases of some sort. Ten districts had a 50% or greater increase in the proportion of assessed value that was residential between 1977-94. The Duquesne City School district experienced a 71.3% increase, while Aliquippa Borough School District experienced a 73.5% increase.

Table 4 displays districts which had a 10% relative increase or more in the fraction of assessed value between 1977 and 1994 that was residential. In Schuylkill County, two (Tri-Valley and Blue Mountain) of the top 20 districts can be found and four (Williams Valley and Schuykill Haven) of the top 60 districts can be found. I would be surprised if these districts have not been visiting to express the sort of resistance to higher property taxes they are hearing from homeowners.

Table 4: Shift in Composition of Pennsylvania's School District Property Tax Base: 1977-94

| Rank | County | MSA | SD | % Chg Res | % Res 1977 | % Res 1994 |
|---|---|---|---|---|---|---|
| 1 | Beaver County | Beaver | Midland Boro S D | 169.9% | 20.4% | 55.1% |
| 2 | Allegheny County | Pittsburgh | Steel Valley S D | 126.9% | 36.3% | 82.4% |
| 3 | Berks County | Reading | Twin Valley S D | 126.6% | 27.9% | 63.3% |
| 4 | Allegheny County | Pittsburgh | Clairton City S D | 114.5% | 35.0% | 75.0% |
| 5 | Adams County | York | Fairfield Area S D | 73.6% | 35.5% | 61.7% |
| 6 | Somerset County | Johnstown | Shanksville-Stnycrk S D | 73.6% | 35.5% | 61.7% |
| 7 | Beaver County | Beaver | Aliquippa Borough S D | 73.5% | 42.8% | 74.2% |
| 8 | Erie County | Erie | Iroquois S D | 72.1% | 42.0% | 72.3% |
| 9 | Allegheny County | Pittsburgh | Duquesne City S D | 71.3% | 39.5% | 67.6% |
| 10 | Franklin County | Non-MSA | Fannett Metal S D | 55.3% | 40.2% | 62.5% |
| 11 | Delaware County | Philadelphi | Chichester S D | 51.3% | 37.7% | 57.0% |
| 12 | Wayne County | Non-MSA | Western Wayne S D | 48.3% | 46.9% | 69.5% |
| 13 | Chester County | Philadelphi | Avon Grove S D | 43.7% | 55.5% | 79.7% |
| 14 | Bucks County | Philadelphi | Council Rock S D | 40.9% | 62.1% | 87.5% |
| 15 | Beaver County | Beaver | Center Area S D | 40.4% | 45.9% | 64.5% |
| 16 | Schuylkill County | Non-MSA | Tri-Valley S D | 40.2% | 49.6% | 69.5% |
| 17 | Washington County | Pittsburgh | California A S O | 39.6% | 52.3% | 73.0% |
| 18 | Carbon County | Allentown | Jim Thorpe AREA S D | 39.4% | 53.5% | 74.6% |
| 19 | Schuylkill County | Non-MSA | Blue Mountain S D | 39.4% | 51.6% | 71.9% |
| 20 | Montgomery County | Philadelphi | Spring Ford AREA S D | 39.3% | 47.7% | 66.4% |
| 21 | Montgomery County | Philadelphi | Pottsgrove S D | 39.3% | 56.6% | 78.9% |
| 22 | Perry County | Harrisburg | West Perry S D | 38.1% | 46.1% | 63.7% |
| 23 | Susquehanna County | Non-MSA | Elk Lake S D | 38.1% | 38.5% | 53.1% |
| 24 | Bucks County | Philadelphi | Pennsbury S D | 38.0% | 55.5% | 76.6% |
| 25 | Montgomery County | Philadelphi | Pottstown S D | 37.8% | 49.6% | 68.4% |
| 26 | Cambria County | Johnstown | Conemaugh Valley S D | 37.6% | 52.0% | 71.5% |
| 27 | Susquehanna County | Non-MSA | Mountain View S D | 34.5% | 46.5% | 62.5% |
| 28 | Lancaster County | Lancaster | Manheim Central S D | 33.8% | 56.6% | 75.8% |
| 29 | Lehigh County | Allentown | Northwestern Lehigh S D | 33.3% | 50.4% | 67.2% |
| 30 | Washington County | Pittsburgh | Bethlehem-Center S D | 33.3% | 51.6% | 68.8% |
| 31 | Lancaster County | Lancaster | Pequea Valley S D | 33.1% | 53.1% | 70.7% |

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| Rank | County | MSA | SD | % Chg Res | % Res 1977 | % Res 1994 |
|---|---|---|---|---|---|---|
| 32 | Lancaster County | Lancaster | Solanco S D | 32.6% | 53.9% | 71.5% |
| 33 | Montgomery County | Philadelphi | North Penn S D | 32.5% | 48.6% | 64.5% |
| 34 | Montgomery County | Philadelphi | Upper Dublin S D | 31.7% | 56.6% | 74.6% |
| 35 | Wayne County | Non-MSA | Wallenpaupack Area S D | 31.4% | 53.5% | 70.3% |
| 36 | Chester County | Philadelphi | Unionville-Chadds FORD | 31.1% | 59.0% | 77.3% |
| 37 | Montgomery County | Philadelphi | Jenkintown S D | 31.0% | 49.8% | 65.2% |
| 38 | Wayne County | Non-MSA | Wayne Highlands S D | 30.8% | 46.9% | 61.3% |
| 39 | Bucks County | Philadelphi | Bensalem Township S D | 30.2% | 42.0% | 54.7% |
| 40 | Beaver County | Beaver | Ambridge Area S D | 30.0% | 62.5% | 81.3% |
| 41 | Chester County | Philadelphi | Downingtown Area S D | 29.9% | 61.3% | 79.7% |
| 42 | Chester County | Philadelphi | Coatesville Area S D | 29.5% | 58.2% | 75.4% |
| 43 | Washington County | Pittsburgh | Bentworth S D | 29.5% | 44.3% | 57.4% |
| 44 | Northampton County | Allentown | Bethlehem Area S D | 28.7% | 58.6% | 75.4% |
| 45 | Allegheny County | Pittsburgh | Sto-Rox S D | 27.4% | 52.7% | 67.2% |
| 46 | Montgomery County | Philadelphi | Wissahickon S D | 27.4% | 52.7% | 67.2% |
| 47 | Schuylkill County | Non-MSA | Williams Valley S D | 27.2% | 66.0% | 84.0% |
| 48 | Berks County | Reading | Reading S D | 27.2% | 57.4% | 73.0% |
| 49 | Bucks County | Philadelphi | New Hope-SOLEBURY S D | 27.0% | 63.7% | 80.9% |
| 50 | Susquehanna County | Non-MSA | Susquehanna Comm S D | 26.9% | 52.3% | 66.4% |
| 51 | Beaver County | Beaver | Big Beaver FALLS A S D | 26.1% | 52.3% | 66.0% |
| 52 | Bucks County | Philadelphi | Palisades S D | 25.8% | 60.5% | 76.2% |
| 53 | Mercer County | Sharon | Jamestown Area S D | 25.4% | 53.9% | 67.6% |
| 54 | Northampton County | Allentown | Wilson Area S D | 25.2% | 60.5% | 75.8% |
| 55 | Allegheny County | Pittsburgh | Deer Lakes S D | 25.0% | 67.2% | 84.0% |
| 56 | Bucks County | Philadelphi | Bristol Boro S D | 24.6% | 52.3% | 65.2% |
| 57 | Adams County | York | Bermudian Springs S D | 24.6% | 50.8% | 63.3% |
| 58 | Beaver County | Beaver | Rochester Area S D | 24.5% | 59.0% | 73.4% |
| 59 | Schuylkill County | Non-MSA | Schuylkill Haven A S D | 24.2% | 64.5% | 80.1% |
| 60 | Pike County | Non-MSA | Delaware Valley S D | 24.1% | 56.6% | 70.3% |
| 61 | Delaware County | Philadelphi | Chester-Upland S D | 23.8% | 50.8% | 62.9% |
| 62 | Lycoming County | Williamspor | East Lycoming S D | 23.6% | 57.8% | 71.5% |
| 63 | Allegheny County | Pittsburgh | Northgate S D | 23.6% | 64.5% | 79.7% |
| 64 | Monroe County | Scranton | Pocono Mountain S D | 23.3% | 57.0% | 70.3% |
| 65 | Allegheny County | Pittsburgh | East Allegheny S D | 23.1% | 55.9% | 68.8% |
| 66 | Bucks County | Philadelphi | Pennridge S D | 22.9% | 64.8% | 79.7% |
| 67 | Montgomery County | Philadelphi | Hatboro-Horsham S D | 22.6% | 47.5% | 58.2% |
| 68 | Lancaster County | Lancaster | Donegal S D | 22.6% | 57.0% | 69.9% |
| 69 | Dauphin County | Harrisburg | Steelton-Highspire S D | 22.3% | 47.3% | 57.8% |
| 70 | Allegheny County | Pittsburgh | Allegheny Valley S D | 22.3% | 48.2% | 59.0% |
| 71 | Blair County | Altoona | Williamsburg Comm S D | 22.0% | 51.6% | 62.9% |
| 72 | Washington County | Pittsburgh | Trinity Area S D | 21.4% | 49.2% | 59.8% |
| 73 | Perry County | Harrisburg | Greenwood S D | 21.2% | 51.6% | 62.5% |
| 74 | Lancaster County | Lancaster | Eastern Lancaster CO SD | 21.2% | 53.5% | 64.8% |
| 75 | Northampton County | Allentown | Easton Area S D | 21.1% | 62.9% | 76.2% |
| 76 | Allegheny County | Pittsburgh | Woodland Hills S D | 21.1% | 59.4% | 71.9% |
| 77 | Chester County | Philadelphi | Oxford Area S D | 20.8% | 48.8% | 59.0% |
| 78 | Montgomery County | Philadelphi | Perkiomen Valley S D | 20.8% | 69.5% | 84.0% |
| 79 | Somerset County | Johnstown | Rockwood Area S D | 20.7% | 52.7% | 63.7% |
| 80 | Allegheny County | Pittsburgh | Highlands S D | 20.7% | 64.1% | 77.3% |
| 81 | Lawrence County | Non-MSA | Union Area S D | 20.7% | 75.4% | 91.0% |
| 82 | Bucks County | Philadelphi | Quakertown Comm S D | 20.7% | 58.6% | 70.7% |

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| Rank | County | MSA | SD | % Chg Res | % Res 1977 | % Res 1994 |
|---|---|---|---|---|---|---|
| 83 | Lancaster County | Lancaster | Conestoga Valley S D | 20.5% | 43.8% | 52.7% |
| 84 | Lancaster County | Lancaster | Lancaster S D | 20.0% | 52.7% | 63.3% |
| 85 | Lebanon County | Harrisburg | Northern Lebanon S D | 19.9% | 59.0% | 70.7% |
| 86 | Lancaster County | Lancaster | Hempfield S D | 19.7% | 61.3% | 73.4% |
| 87 | Susquehanna County | Non-MSA | Blue Ridge S D | 19.7% | 55.5% | 66.4% |
| 88 | Crawford County | Non-MSA | Penncrest S D | 19.3% | 47.5% | 56.6% |
| 89 | Susquehanna County | Non-MSA | Montrose Area S D | 19.1% | 53.1% | 63.3% |
| 90 | Berks County | Reading | Boyertown Area S D | 18.8% | 64.5% | 76.6% |
| 91 | Schuylkill County | Non-MSA | North Schuylkill S D | 18.8% | 68.8% | 81.6% |
| 92 | Indiana County | Non-MSA | United S D | 18.5% | 50.8% | 60.2% |
| 93 | Lycoming County | Williamspor | Montgomery Area S D | 18.4% | 57.4% | 68.0% |
| 94 | Lancaster County | Lancaster | Penn Manor S D | 18.0% | 69.5% | 82.0% |
| 95 | Chester County | Philadelphi | Phoenixville Area S D | 17.9% | 69.9% | 82.4% |
| 96 | Berks County | Reading | Daniel Boone AREA S D | 17.8% | 68.0% | 80.1% |
| 97 | Elk County | Non-MSA | St Marys AREA S D | 17.5% | 60.2% | 70.7% |
| 98 | Schuylkill County | Non-MSA | Pottsville Area S D | 17.5% | 62.5% | 73.4% |
| 99 | Armstrong County | Non-MSA | Leechburg Area S D | 17.4% | 60.5% | 71.1% |
| 100 | Franklin County | Non-MSA | Greencastle-Antrim S D | 17.2% | 50.0% | 58.6% |
| 101 | Bucks County | Philadelphi | Central Bucks S D | 17.1% | 68.4% | 80.1% |
| 102 | Susquehanna County | Non-MSA | Forest City REGN S D | 17.1% | 57.0% | 66.8% |
| 103 | Elk County | Non-MSA | Johnsonburg Area S D | 17.0% | 59.8% | 69.9% |
| 104 | York County | York | South Eastern S D | 17.0% | 59.8% | 69.9% |
| 105 | Lancaster County | Lancaster | Ephrata Area S D | 17.0% | 66.8% | 78.1% |
| 106 | Indiana County | Non-MSA | Penns Manor AREA S D | 16.8% | 55.9% | 65.2% |
| 107 | Lycoming County | Williamspor | Montoursville Area S D | 16.7% | 68.0% | 79.3% |
| 108 | Allegheny County | Pittsburgh | Quaker Valley S D | 16.5% | 68.8% | 80.1% |
| 109 | Lancaster County | Lancaster | Warwick S D | 16.3% | 69.5% | 80.9% |
| 110 | Berks County | Reading | Kutztown Area S D | 16.2% | 55.5% | 64.5% |
| 111 | Montgomery County | Philadelphi | Bryn Athyn S D | 16.0% | 58.6% | 68.0% |
| 112 | Greene County | Non-MSA | Jefferson-Morgan S D | 15.9% | 44.1% | 51.2% |
| 113 | Lancaster County | Lancaster | Elizabethtown Area S D | 15.9% | 66.4% | 77.0% |
| 114 | Berks County | Reading | Brandywine Hgts AREA SD | 15.9% | 64.1% | 74.2% |
| 115 | Lancaster County | Lancaster | Manheim Twp S D | 15.8% | 59.4% | 68.8% |
| 116 | Lebanon County | Harrisburg | Eastern Lebanon CO S D | 15.6% | 57.4% | 66.4% |
| 117 | Montgomery County | Philadelphi | Souderton Area S D | 15.6% | 67.6% | 78.1% |
| 118 | Bucks County | Philadelphi | Neshaminy S D | 15.5% | 62.9% | 72.7% |
| 119 | Berks County | Reading | Tulpehocken Area S D | 15.4% | 55.9% | 64.5% |
| 120 | Crawford County | Non-MSA | Conneaut S D | 15.2% | 53.9% | 62.1% |
| 121 | Clarion County | Non-MSA | Redbank Valley S D | 15.2% | 48.8% | 56.3% |
| 122 | Carbon County | Allentown | Palmerton Area S D | 15.2% | 64.5% | 74.2% |
| 123 | Mercer County | Sharon | Farrell Area S D | 15.2% | 38.7% | 44.5% |
| 124 | Chester County | Philadelphi | Octorara Area S D | 15.1% | 54.3% | 62.5% |
| 125 | Washington County | Pittsburgh | Avella Area S D | 15.1% | 38.9% | 44.7% |
| 126 | Erie County | Erie | Union City AREA S D | 15.0% | 52.0% | 59.8% |
| 127 | Monroe County | Scranton | East Strousbg AREA S D | 14.8% | 60.5% | 69.5% |
| 128 | Berks County | Reading | Wyomissing Area S D | 14.8% | 71.1% | 81.6% |
| 129 | Lawrence County | Non-MSA | New Castle AREA S D | 14.7% | 55.9% | 64.1% |
| 130 | Montgomery County | Philadelphi | Lower Merion S D | 14.6% | 69.5% | 79.7% |
| 131 | Berks County | Reading | Fleetwood Area S D | 14.3% | 57.4% | 65.6% |
| 132 | Schuylkill County | Non-MSA | Shenandoah Valley S D | 14.3% | 62.9% | 71.9% |
| 133 | Lehigh County | Allentown | Whitehall Coplay S D | 14.1% | 52.7% | 60.2% |

[continued on next page]

| Rank | County | MSA | SD | % Chg Res | % Res 1977 | % Res 1994 |
|---|---|---|---|---|---|---|
| 134 | Montgomery County | Philadelphi | Colonial S D | 14.1% | 52.7% | 60.2% |
| 135 | Beaver County | Beaver | Beaver Area S D | 13.9% | 70.3% | 80.1% |
| 136 | Snyder County | Non-MSA | Midd-West S D | 13.9% | 53.5% | 60.9% |
| 137 | York County | York | Spring Grove AREA S D | 13.8% | 62.1% | 70.7% |
| 138 | Washington County | Pittsburgh | Ringgold S D | 13.8% | 65.2% | 74.2% |
| 139 | Blair County | Altoona | Claysburg-Kimmel S D | 13.6% | 54.7% | 62.1% |
| 140 | Butler County | Non-MSA | South Butler CO S D | 13.5% | 57.8% | 65.6% |
| 141 | Schuylkill County | Non-MSA | Tamaqua Area S D | 13.5% | 63.7% | 72.3% |
| 142 | Berks County | Reading | Conrad Weiser A S D | 13.4% | 64.1% | 72.7% |
| 143 | Lycoming County | Williamspor | Jersey Shore AREA S D | 13.4% | 67.2% | 76.2% |
| 144 | York County | York | South Western S D | 13.3% | 61.7% | 69.9% |
| 145 | Bucks County | Philadelphi | Morrisville Boro S D | 13.0% | 71.9% | 81.3% |
| 146 | Berks County | Reading | Oley Valley S D | 13.0% | 66.0% | 74.6% |
| 147 | Lebanon County | Harrisburg | Lebanon S D | 12.9% | 57.4% | 64.8% |
| 148 | Greene County | Non-MSA | Southeastern Greene S D | 12.9% | 36.3% | 41.0% |
| 149 | Allegheny County | Pittsburgh | West Jefferson HILLS SD | 12.9% | 63.7% | 71.9% |
| 150 | Allegheny County | Pittsburgh | Wilkinsburg Borough S D | 12.9% | 66.8% | 75.4% |
| 151 | Montgomery County | Philadelphi | Norristown Area S D | 12.7% | 64.5% | 72.7% |
| 152 | Jefferson County | Non-MSA | Brookville Area S D | 12.5% | 53.1% | 59.8% |
| 153 | Cumberland County | Harrisburg | Big Spring S D | 12.4% | 53.5% | 60.2% |
| 154 | Juniata County | Non-MSA | Juniata County S D | 12.3% | 57.0% | 64.1% |
| 155 | Chester County | Philadelphi | Kennett Consolidatd S D | 12.2% | 60.9% | 68.4% |
| 156 | Beaver County | Beaver | Hopewell Area S D | 12.0% | 71.5% | 80.1% |
| 157 | Erie County | Erie | North East S D | 11.9% | 52.7% | 59.0% |
| 158 | Montgomery County | Philadelphi | Cheltenham Twp S D | 11.7% | 69.9% | 78.1% |
| 159 | Bedford County | Non-MSA | Northern Bedford CO S D | 11.6% | 50.4% | 56.3% |
| 160 | Venango County | Non-MSA | Franklin Area S D | 11.6% | 57.4% | 64.1% |
| 161 | Cumberland County | Harrisburg | South Middleton S D | 11.3% | 58.6% | 65.2% |
| 162 | Adams County | York | Littlestown Area S D | 11.3% | 62.5% | 69.5% |
| 163 | Indiana County | Non-MSA | Purchase Line S D | 11.2% | 48.8% | 54.3% |
| 164 | Delaware County | Philadelphi | Ridley S D | 11.0% | 64.1% | 71.1% |
| 165 | Perry County | Harrisburg | Newport S D | 10.8% | 57.8% | 64.1% |
| 166 | Lancaster County | Lancaster | Columbia Boro S D | 10.7% | 65.6% | 72.7% |
| 167 | Allegheny County | Pittsburgh | South Fayette TWP S D | 10.7% | 62.1% | 68.8% |
| 168 | Chester County | Philadelphi | West Chester AREA S D | 10.5% | 66.8% | 73.8% |
| 169 | Montgomery County | Philadelphi | Upper Perkiomen S D | 10.5% | 63.3% | 69.9% |
| 170 | Beaver County | Beaver | Monaca S D | 10.5% | 67.2% | 74.2% |
| 171 | Butler County | Non-MSA | Butler Area S D | 10.5% | 59.8% | 66.0% |
| 172 | Lebanon County | Harrisburg | Cornwall-Lebanon S D | 10.4% | 63.7% | 70.3% |
| 173 | Schuylkill County | Non-MSA | Minersville Area S D | 10.3% | 71.9% | 79.3% |
| 174 | Lancaster County | Lancaster | Cocalico S D | 10.1% | 62.1% | 68.4% |
| 175 | Allegheny County | Pittsburgh | South Allegheny S D | 10.1% | 77.7% | 85.5% |

Source: Author's tabulations.

## 5 The Quality of Residential Property Assessment: Allegheny County

Earlier, in Section 4, I explained why nationally homeowners dislike the local property tax so much and have shown how marked the shifts towards residential property have been here in Pennsylvania.

There is another reason, not peculiar to Pennsylvania, why the property tax is intensely disliked. However, this reason is actually more important in Pennsylvania than in other states which have elimianted or substantially reduced the role of the property tax in school finance (Michigan and Oregon come to mind). The fifth reason for taxpayer dislike of the local property tax has to do with the low quality of assessments through out Pennsylvania.[12]

The last time the Census Bureau measured the quality or fairness of residential assessments, Pennsylvania ranked 44'th, just before New York in terms of the extent to which identical properties' assessments within the same taxing jurisdiction can vary.

The International Association of Assessing Officers suggests that a high quality assessment system is one in which variation from the stated or predetermined ratio should be 5 to 15%.[13]

I am afraid the Pennsylvania House and Senate know better than I do how bad the assessments are in the state, and it is precisely because they are so bad that you likely choose to let the problem fester. What happens, of course, is that somebody else has had to address the assessment problem. Over time the assessment of real estate in Pennsylvania has become a ward of the local courts. In Allegheny County, twice in the last 25 years a local judge has put himself in charge of assessments, and wrested away control of assessments from the Board of Property Assessments, Appeals and Review. In both cases I would venture to say that the judges quickly wearied of these new found responsibilities.

How bad are assessments? Let us look at the data for the 1990's in Allegheny County. I should note parenthetically that assessments in Allegheny County are **better**, according to Penn State's Environmental Resources Research Institute, than the bulk of the counties in Pennsylvania. So what we see below, while deeply troubling, is still better than most of the state, but worse than most of the Nation.

### 5.1 Property Tax Horizontal Inequities: 1994 Data

Five years ago, at the request of the late Tom Foerster, I did a rather in-depth analysis of the quality of assessments by school district, and reproduce one of the tables below. Recall that up until 1999, Allegheny County had a predetermined ratio of 25%. Late in 1999 the Board of Property Assessment, Appeals and Review raised it to 100%.

Column (3) of Table 5 shows by school district[14] how many residential properties transacted in 1994; the remaining columns show the effective assessment ratio (ratio of assessed value to actual selling price) for the distribution of effective assessment ratios, ranked from lowest to highest. If

[12]Some years ago I had the privilege of addressing the New York Board of Regents on the issue of teacher hiring practices in Pennsylvania and remarked that while our teachers unions were tougher than theirs, New York held the edge in having worse property assessments than Pennsylvania. Nobody thought either remark was funny; however, nobody disputed the accuracy of both observations. Interestingly, the New York Board of Regents has just authorized a study of teacher supply and demand patterned after my work for the Pennsylvania State Board some years ago.

[13]See IAOO, Improving Real Property Assessment, A Reference Manual, p. 5. This standard is usually stated in terms of a percentage deviation from the median assessment ratio.

[14]Please note that in this table, Duquesne School District data was combined with Clairton.

assessments were being performed perfectly, than the table would be filled with 25.0% throughout. It obviously is not.

For example, Allegheny Valley SD had 170 residential sales in 1994. The median or 50'th percentile assessment ratio was 20.0%, rather than the predetermined ratio of 25%. This means that if one ranked the 170 properties from lowest to highest ratio, the 85'th property had a ratio of 20%.

If one were to look earlier in the distribution of ratios to the 42nd property or 25'th percentile, it had a ratio of 15.8% or 36.8% ( 25.0-15.8%=9.2% / 25%=36.8%) below the stated 25% predetermined ratio. If one looks beyond the median to the 128'th ratio at the 75'th percentile, one finds that the ratio is 21.7%; close to the median but below the predetermined ratio of 25.0%. A few school districts (Clairton and Wilkinsburg) have evidence of over-assessments, both had the top 1/4 of their sales above 25%.

If the distribution of ratios was simply low with little dispersion, say at 20% plus or minus .5%, then the assessments would be fair. But, any skim of the table reveals very wide dispersion in the assessment results.

Table 5: Quality of 1994 Assessments in Allegheny County: Distribution of Assessed to Actual Sales Price Ratios

| | 1996 Median Pa. Taxable Inc. | No. of 1994 Sales | 25'th % | 50'th % | 75'th % |
|---|---|---|---|---|---|
| Allegheny Valley | $16,270 | 170 | 15.8% | 20.0% | 21.7% |
| Avonworth | $25,374 | 159 | 13.7% | 17.1% | 22.0% |
| Baldwin Whitehall | $18,216 | 392 | 17.5% | 19.4% | 22.0% |
| Bethel Park | $22,492 | 438 | 16.0% | 18.0% | 19.9% |
| Brentwood Boro | $19,004 | 129 | 15.9% | 17.7% | 21.8% |
| Carlynton | $18,323 | 185 | 14.8% | 17.0% | 21.9% |
| Chartiers Valley | $18,922 | 405 | 15.8% | 18.1% | 20.8% |
| Clairton City | $11,138 | 130 | 18.0% | 23.7% | 31.4% |
| Cornell | $16,767 | 103 | 16.7% | 20.8% | 25.2% |
| Deer Lakes | $19,727 | 229 | 15.8% | 18.2% | 21.7% |
| Duquesne City | $9,467 | . | . | . | . |
| East Allegheny | $14,462 | 199 | 15.5% | 18.5% | 23.5% |
| Elizabeth Forward | $17,320 | 208 | 13.5% | 16.8% | 21.4% |
| Fox Chapel Area | $21,472 | 461 | 14.6% | 18.1% | 22.0% |
| Gateway | $19,121 | 432 | 16.9% | 19.1% | 20.9% |
| Hampton Township | $27,167 | 221 | 13.9% | 17.2% | 20.9% |
| Highlands | $14,536 | 296 | 15.0% | 18.5% | 24.5% |
| Keystone Oaks | $19,520 | 303 | 14.7% | 17.3% | 20.7% |
| Mckeesport Area | $12,090 | 531 | 16.7% | 21.9% | 25.0% |
| Montour | $23,116 | 354 | 16.1% | 19.0% | 22.1% |
| Moon Area | $27,415 | 408 | 17.0% | 19.7% | 21.9% |
| Mount Lebanon | $26,777 | 564 | 16.3% | 19.2% | 21.8% |
| North Allegheny | $29,728 | 849 | 17.4% | 20.5% | 23.1% |
| North Hills | $22,228 | 541 | 17.4% | 19.5% | 22.0% |
| Northgate | $18,053 | 201 | 15.7% | 19.0% | 22.3% |
| Penn Hills Township | $17,917 | 659 | 17.7% | 19.9% | 23.7% |
| Pine-Richland | $26,349 | 252 | 16.7% | 21.1% | 23.0% |
| Pittsburgh | $15,635 | 4,304 | 15.4% | 19.4% | 25.0% |
| Plum Borough | $24,464 | 357 | 16.6% | 18.5% | 22.0% |
| Quaker Valley | $21,534 | 234 | 17.9% | 21.0% | 24.4% |
| Riverview | $18,100 | 145 | 16.1% | 19.8% | 23.4% |
| Shaler Area | $19,575 | 543 | 16.0% | 18.8% | 22.2% |
| South Allegheny | $12,764 | 156 | 15.7% | 19.0% | 23.5% |
| South Fayette Townsh | $27,101 | 194 | 17.4% | 19.4% | 21.7% |
| South Park | $26,321 | 185 | 16.7% | 18.8% | 22.0% |
| Steel Valley | $12,921 | 249 | 15.4% | 18.4% | 23.1% |
| Sto Rox | $12,264 | 187 | 17.3% | 21.5% | 26.8% |
| Upper Saint Clair To | $29,876 | 292 | 17.8% | 19.6% | 21.8% |
| West Allegheny | $26,167 | 266 | 18.8% | 21.9% | 24.0% |
| West Jefferson Hills | $20,618 | 211 | 16.4% | 19.5% | 21.3% |
| West Mifflin Area | $14,610 | 251 | 16.3% | 18.9% | 22.3% |
| Wilkinsburg Borough | $17,523 | 288 | 19.0% | 23.1% | 28.8% |
| Woodland Hills | $16,076 | 732 | 16.4% | 20.0% | 25.0% |

### 5.2 Property Tax Horizontal Inequities: 1998 Data

Through happenstance last year, 1998 sales data turned up at the University, and I was able to analyze it for the testimony this afternoon. Table 6 displays the same calculations show in Table 5 based on 1998 sales data. For the 1998 data, I have also shown the 10'th and 90'th percentiles of

the distribution of effective assessment ratios.

The variations are very, very large and explain why the assessment system is in judicial receivorship. The effective assessment ratios in Duquesne City vary from 14.1% at the 10'th percentile to 97.5% at the 90'th percentile! In Clairton City, the effective assessment ratios vary from 11.2% to 45.3%. For those who represent areas of Allegheny County or have followed the chaos there over the past five years, you know that the assessment process is a hot button topic.

I could go on, but I urge the Committee to ponder very carefully the extreme variations in effective sales ratios in Table 6. Combined with the aforementioned long-term drift in greater reliance on residential property, the assessments are the ingredients for a very major explosion in taxpayer sentiment.

This summer Allegheny County will receive for all 500,000 properties the estimated market values from Sabre Systems which has been hired to do the reappraisal effectively under court supervision. While it is evident that properties are generally badly underassessed in Allegheny County, it is also very clear that coming up with reasonable estimates of market values for unsold properties will cause huge increases in property taxes for those who have been underassessed, and huge reductions in property taxes for those who have been overassessed. I seriously doubt that the newly elected home rule officials or judge really understand what lies before them despite having been told.

Table 6: Quality of 1998 Assessments in Allegheny County: Distribution of Assessed to Actual Sales Price Ratios

| | 1996 Median Pa. Taxable Inc. | No. of 1998 Sales | 10'th % | 25'th % | 50'th % | 75'th % | 90'th % |
|---|---|---|---|---|---|---|---|
| Allegheny Valley | $16,270 | 167 | 11.2% | 13.9% | 17.6% | 21.8% | 25.8% |
| Avonworth | $25,374 | 149 | 9.2% | 12.9% | 15.5% | 18.8% | 22.0% |
| Baldwin Whitehall | $18,216 | 420 | 12.8% | 16.2% | 18.5% | 21.0% | 24.2% |
| Bethel Park | $22,492 | 450 | 13.8% | 15.5% | 17.4% | 19.1% | 21.2% |
| Brentwood Boro | $19,004 | 133 | 13.8% | 15.5% | 17.3% | 20.1% | 22.7% |
| Carlynton | $18,323 | 175 | 11.0% | 13.3% | 16.4% | 19.8% | 30.0% |
| Chartiers Valley | $18,922 | 378 | 7.5% | 14.1% | 16.7% | 19.0% | 23.0% |
| Clairton City | $11,138 | 110 | 11.2% | 15.0% | 18.2% | 29.4% | 45.3% |
| Cornell | $16,767 | 114 | 10.7% | 13.3% | 16.7% | 22.5% | 39.0% |
| Deer Lakes | $19,727 | 160 | 5.3% | 11.6% | 15.9% | 18.0% | 23.7% |
| Duquesne City | $9,467 | 100 | 14.1% | 17.9% | 28.6% | 53.3% | 97.5% |
| East Allegheny | $14,462 | 199 | 9.7% | 13.7% | 16.7% | 21.8% | 30.5% |
| Elizabeth Forward | $17,320 | 182 | 8.5% | 12.0% | 15.8% | 18.6% | 25.1% |
| Fox Chapel Area | $21,472 | 411 | 11.8% | 14.9% | 18.1% | 21.0% | 25.0% |
| Gateway | $19,121 | 382 | 12.2% | 14.7% | 17.3% | 19.5% | 23.0% |
| Hampton Township | $27,167 | 271 | 9.5% | 14.2% | 17.1% | 20.3% | 23.4% |
| Highlands | $14,536 | 256 | 10.9% | 13.5% | 16.6% | 22.1% | 31.9% |
| Keystone Oaks | $19,520 | 294 | 12.2% | 14.1% | 16.7% | 19.9% | 22.8% |
| Mckeesport Area | $12,090 | 484 | 11.3% | 14.4% | 18.4% | 28.5% | 55.4% |
| Montour | $23,116 | 355 | 10.3% | 14.9% | 17.9% | 20.8% | 24.2% |
| Moon Area | $27,415 | 425 | 0.7% | 14.2% | 17.8% | 20.1% | 22.3% |
| Mount Lebanon | $26,777 | 619 | 13.4% | 15.8% | 18.3% | 21.4% | 24.3% |
| North Allegheny | $29,728 | 934 | 6.4% | 15.9% | 19.5% | 22.2% | 24.8% |
| North Hills | $22,228 | 542 | 13.4% | 16.0% | 18.6% | 21.2% | 24.2% |
| Northgate | $18,053 | 179 | 11.7% | 14.3% | 17.8% | 23.8% | 36.9% |
| Penn Hills Township | $17,917 | 633 | 14.8% | 16.9% | 19.4% | 22.8% | 29.3% |
| Pine-Richland | $26,349 | 308 | 0.1% | 11.5% | 17.3% | 22.1% | 24.4% |
| Pittsburgh | $15,635 | 4,100 | 10.9% | 13.9% | 17.9% | 24.6% | 40.5% |
| Plum Borough | $24,464 | 322 | 9.9% | 15.1% | 17.0% | 20.2% | 25.2% |
| Quaker Valley | $21,534 | 271 | 11.1% | 14.3% | 18.2% | 21.1% | 25.3% |
| Riverview | $18,100 | 139 | 2.7% | 14.2% | 17.7% | 21.6% | 28.0% |
| Shaler Area | $19,575 | 507 | 12.3% | 15.3% | 17.8% | 20.6% | 25.8% |
| South Allegheny | $12,764 | 148 | 11.0% | 13.4% | 16.7% | 22.2% | 37.0% |
| South Fayette Townsh | $27,101 | 234 | 0.1% | 15.2% | 18.4% | 20.2% | 21.6% |
| South Park | $26,321 | 159 | 13.3% | 15.8% | 17.8% | 19.9% | 22.1% |
| Steel Valley | $12,921 | 247 | 11.7% | 14.6% | 18.0% | 24.9% | 43.5% |
| Sto Rox | $12,264 | 171 | 13.1% | 15.6% | 20.0% | 28.4% | 43.0% |
| Upper Saint Clair | $29,876 | 401 | 13.8% | 16.6% | 19.4% | 21.9% | 24.9% |
| West Allegheny | $26,167 | 274 | 0.2% | 12.7% | 19.1% | 21.5% | 23.8% |
| West Jefferson Hills | $20,618 | 241 | 9.5% | 14.7% | 17.7% | 20.5% | 25.7% |
| West Mifflin Area | $14,610 | 253 | 12.6% | 15.0% | 17.6% | 21.5% | 33.2% |
| Wilkinsburg Borough | $17,523 | 264 | 13.2% | 18.4% | 21.6% | 33.4% | 61.8% |
| Woodland Hills | $16,076 | 729 | 12.9% | 16.0% | 19.4% | 24.3% | 36.3% |

# 6 If We Had A Clean Piece of Paper to Redesign Education Finance, then What?

Above I have analyzed Pennsylvania's real estate taxes from economic, fairness, and historical points of view. Now, I would like to change the point of view to a purely normative one, and ask the question, if we were to rewrite from scratch how we finance just public education in Pennsylvania, how might we think about it?

The conclusion I reach from first principles is that an income tax rather than a property tax is the intellectually correct answer.[15] Finally, you may be thinking, the Professor has returned to familiar themes!

However, several things should be kept in mind as you read these arguments: First, we do not have a clean piece of paper to work from, we have the mess above I have empirically documented. Second, county and municipal government, which raise something on the order of $2.5 billion or 33% of Pennsylvania's $8 billion in local property taxes, will still need to collec property taxes to pay for county and municipal services.[16]

## 6.1 A Purely Normative Analysis of Educational Finance

Public support of k-12 education has been traditionally argued in the U.S. as the single most important way that children of any socioeconomic background can further themselves, and through their subsequent efforts in the world of work, further economic growth. Not only are there likely to be economic benefits which will accrue to children of various backgrounds which can not be readily predicted by their parents, society, or private capital markets, but, as Weisbrod (1964) argued, education generates externalities through a better educated public which improves the overall quality of life for all.

Public education thus functions as a form of insurance to ensure that the private sector will be as productive as possible, and also as a way to create future public benefits for society. We obligate ourselves through state and local taxation to support the costs of public education for these efficiency and public goods purposes. Moreover, public education is viewed by many as a "Merit Good" whose uniform provision reflects our distributional values.

If one agrees that public education represents an important form of income redistribution, it follows that it should be financed out of broad, ability to pay taxes.[17] Under this theory of taxation, each of us should sacrifice according to our ability to pay to support such redistributive or "Merit Goods." Typically, a broad income or consumption tax is viewed as the appropriate instrument to effect ability to pay taxation.

Municipal services, which are of narrow benefit, on the other hand should be financed by local property taxes.

It is quite apparent that, while income and/or broad consumption taxation is a rational source of school finance, this analysis says nothing about whether or not there should be a division of responsibility between state and local government to finance public education, and what role, if any, there should be for the real property tax.

[15] This section of my remarks is drawn largely from Strauss(1995).

[16] These are 1995 figures and the dollar amounts are no doubt higher with the passage of five years.

[17] If the reader finds this unpersuasive, perhaps favoring the opposite, benefit taxes or charges on a voluntary basis to finance income redistributional services, indicates why the first argument is meritorious.

However, if redistribution is a primary purpose of public education, if follows that the higher level of government (the state) has a primary responsibility to ensure that the pattern of educational services is consistent with distributional values. Given the uneven distribution of wealth, income, and differential problems of educating children, this usually leads to the conclusion of either full or very substantial state funding of local public education, and the use of equalizing state aid to poor local districts. Of course, the resulting pattern of services, taxes, and housing are important to families making location decisions. For these reasons one may argue for a *fixed* local income tax rate rather than variable ones in support of merit goods to forestall families moving because of favorable tax rates imposed to support redistributional services. [18] The primary rationale for a local contribution at a fixed rate of tax in conjunction with state equalizing aid is encourage local accountability which the payment of local taxes presumably engenders.

As a historical matter, local school districts were devised as an administrative means for states, often legislatures, to honor their constitutional obligations for providing "thorough and efficient" education to young people. Local school boards were devised to be instrumentalities of state government to implement state policy. To that end, taxing power was also accorded, and in the Great Depression, as states moved to excise and consumption taxes, the local property tax was reserved as the primary source of local school finance.

The chief virtues of the local property tax are usually argued to be its stability of tax base[19], the fact that it already is in place, and, for some, its ability to reach to business at the local level.[20]

Aside from the problems of ensuring equitable and timely assessment practices, the local property tax is not usually viewed as an ability to pay revenue source. Indeed, the argument most often used for the property tax is that it is a benefit tax which best measures the use of municipal, as contrasted with educational, services.[21]

### 6.2 Realism and the Property Tax

Another objection to reliance on the local school property tax involves the empirical question of whether or not high wealth districts will always be able to spend more per pupil than any matching program of state aid can successfully induce poor districts to spend to adequate levels. As Feldstein (1975) pointed out, and a number of researchers have found[22] the use of a district power equalizing formula that provides more generous matching rates to poorer districts will not in

[18]See Nechyba(1995) for the most recent analysis of "sorting out" by families shopping among areas for local public services and housing when the public service in question is a local public good rather than a merit good or one involving income redistribution.

[19]However, see Strauss(1995a) for an empirical, comparative analysis of New York State's property and income tax bases, and the finding that the local property tax base was actually *more* volatile than would have been a local income tax base.

[20]See Ladd and Harris(1995) on this; they also fashion the argument for state-wide taxation of non residential property in the support of public education with empirical analysis for New York.

[21]Helen Ladd argues that because public education may positively be capitalized into housing values, i.e. Rosen and Fullerton(1977), the local property tax is logical source of educational finance. Of course, poor education or low test scores can be negatively capitalized and thereby reduce housing values. In this case, it is not clear to me how persuasive the argument becomes.

Ladd and Harris(1995) also fashion the argument for state-wide taxation of non residential property in the support of public education with empirical analysis for New York. Also, see Ladd(1976) for an earlier analysis in the Massachusetts' context. Also, see Netzer(1966) for a general discussion of the advantages and disadvantages of the property tax, and Netzer, Berne, and Stiefel(1995) that details a variety of problems with the current New York property tax. Lankford and Wyckoff(1995) discuss the distributional aspects of New York's property tax.

[22]See, for example, DiPasquale(1979)

most circumstances overcome the wealth elasticity demand for educational spending. That is, the income effects will generally be stronger than the relative price effects with the result that fiscal equalization, or post-fisc equity, will not be fully achieved. For power equalizing to be effective, the elasticity of per-pupil spending with regard to wealth must be zero.[23]

As I have demonstrated above empirically, horizontal equity issues also arise once one recognizes the role of non-residential property in school finance. For some local school districts, the residential property tax is the minor source of local revenue, while the tax on commercial and industrial property is the major source of local school finance.

The presence of major utilities or shopping centers confer tax windfalls to local residents and their children, in the sense that the local costs of public education are borne by the owners and customers of these facilities rather than the residents of the school district. As a result, residents bear little of the costs of education, and can, with very low millages, provide very substantial resources to public education. Others in districts with more residential property or agricultural property, by contrast, must directly bear the burden of local school finance. Such circumstances raise questions of fairness and horizontal equity.

### 6.3 Replacing the School Property Tax with An Income Tax

Using an income tax to replace all or the residential portion of the local school property tax can be done entirely at the state level, or in conjunction with reforms of state school aid formulas. Replacement of the local school property tax with a foundation aid formula and a fixed, flat rate local income tax can insure that fiscal equalization, in the sense of providing the resources to support base-line educational services, can be achieved. Under a foundation grant program, the local, mandatory contribution, aid to the i'th district, $A_i$, is the difference between the number of students (often weighted) multiplied times the state-defined foundation amount, $F$, and a state-mandated (minimum) local contribution: $t * Base_i$ where $Base_i$ is total community taxable income or adjusted gross income, and $t$ is a mandated income tax rate:

$$A_i = [F * ENR_i] - [t * Base_i] \tag{1}$$

As of 1992, 38 states used some form of a foundation program; 23 had a mandatory local effort (a local minimum tax rate is set), while 15 did not require local effort.[24]

Under the foundation grant and local income tax approach, the crucial determination that needs to be made involves ascertaining what each district's per pupil spending needs are, the foundation amount, and then comparing this guaranteed level of spending with local resources to find a residual which the state makes up with current or augmented state resources.

It should be emphasized that the foundation amount should be a scientific measure of the resources needed to educate a child in grades K-12 to achieve at an acceptable level of performance. Indeed, one can imagine that an actual foundation amount would vary across districts once hard data were developed on what is necessary to attract and retain quality teachers, desired minimum and maximum class sizes, the sorts of capital and other operating services necessary to obtain desired levels of outcomes, differential costs of living between urban and rural areas, and the nature of the student body. That is, one can imagine determining $F_i$ for each i'th district by taking into account the above considerations which affect the costs of providing educational services.

[23] See Reschovsky(1994) for a thoughtful review of varying concepts of fiscal equalization and school resources.

[24] See Gold *et al* (1992), Table 4, p. 18.

### 6.4 The Political Economy of Moving from the Property Tax to the Income Tax

Whether one replaces the school property tax with an income tax based on the normative and behavioral arguments in Section 6.1, the above-described economic pressures encourage state legislatures to reduce or eliminate school property taxes. However, the actual shift away from property to income taxes will ultimately raise questions about the increased first-round burden of school finance which falls on households.

While it is certain that households pay business taxes one way or another, either in their role as consumers, employees (and as actual or potential pension beneficiaries), and/or as owners of corporate interests, this perceived shift in burden will cause problems for elected officials.

Several responses to this shift are possible. First, whether what we now observe represents a proper distribution of financial burden is correct or desirable is not at all clear. Certainly, forcing households to pay relatively more than they do currently may encourage greater care and interest in the spending of local school monies. If the arguments in Section 6.1 are persuasive, then it could also be the case that business property is currently "over-taxed" in the support of local education, and the increased burden on households that results from moving to an income tax is appropriate.

On the other hand, elected officials of any political persuasion may find the shift from industrial and commercial property to households to be untenable, and argue for shifting to an income tax but, at the same time, retaining local business property taxes. If one does wish to maintain the current (or pre-reform) balance between business and household taxation[25], one may classify the local property tax, and replace only the residential property tax with a local income tax, or one can provide some form of property tax exemption (usually called a homestead exemption) which will have the general effect of reducing household but not industrial or commercial property taxes.[26]

Classification usually means that the assessment ratio applied to market value can vary by type of property or the property tax rate on assessed value can vary by type of property.[27]

As you are well aware, the business community often finds offensive the differential classification of real property in terms of tax rates or stated assessment ratios. Their concern revolves around the possibility that business property will be more heavily taxed than before once it is isolated from residential property.

There are a number of techniques to forestall such subsequent fiscal shifts. One way is to provide through state law mandatory assessment ratios for different types of property, and provide for reasonable standards of evidence upon appeal. Alternatively, if 100 percent market value is the assessment standard, then state limitations on differential millages can be provided through law, again with reasonable standards of evidence upon appeal. To the extent that movement from the residential property tax to a local income tax is at the discretion of local school districts, then

[25]The issue of balance has been of legislative concern in other states.

For example, Illinois has a constitutional provision that puts a maximum on the ratio of the state corporate net income tax rate to the personal income tax rate. In Pennsylvania, the issue of relationship between business and personal income taxes was part of the political agreement underlying a constitutional amendment permitting a state personal income tax in 1972.

[26]See Strauss(1993) for an analysis of the effects on school finances of a homestead exemption in Allegheny County, and Strauss(1995) for an analysis of the effects of replacing the residential school property tax with a local income tax and a foundation program for all school in New York State.

[27]The Census Bureau(1994) reports as of 1991 that 14 states permit differential assessment ratios or equalization categories–Alabama(3), Arizona(13), Colorado(3), Kansas(4), Louisiana(5), Michigan(6), Mississippi(5), Missouri(3+), Montana(9), North Dakota(4), South Carolina(7), Tennessee(3), Utah(2) and Wyoming(2). California has 2 standards for assessment that looks at date of ownership. Massachusetts and the District of Columbia permit different tax rates, while Minnesota applies "percentage adjustments" to market value data to achieve classification.

one can require that personal income tax receipts be offset, dollar for dollar, by local residential property tax reductions, and/or provide for a limited amount of revenue growth (inflation plus enrollment growth rates, for example).

As may be obvious to some, the wholesale replacement of the local property tax by local income taxes will move the relative burden of school finance further to households as contrasted to the non-household sector since there will be no corresponding local (or state) non-household income tax increase to compensate for the non-household property tax decrease.

The second approach, constitutionally approved here, but not implemented to any discernible degree so far, is to provide for a homestead exemption. This approach works like a standard deduction in the federal personal income tax.

## 7 Some Final Things to Think About

I hope this review of the local property tax in Pennsylvania has proven helpful, and would like to close with a few thoughts about where I think the Commonwealth might think about going in terms of school finance policy.

First, the long-run decline in our average, relative standard of living reflects monumental economic forces which a state, let alone a region or municipality can NOT effectively repeal. Government can enable improvements in our standard of living by providing valuable public services (education, transportation, and public safety), and financing these services on a simple, transparent basis through taxes and fees. Business and households can decide to stay or move here if the combination of public spending and taxes "work." Conversely, business and households will move on, in the long-run, if the combination of public spending and taxes "do not work."

Second, my sense of opinion here in Pennsylvania is that the public does not like the effects of the property tax. The various data I have reviewed with you explain why they do not like it.

Third, it is my impression when speaking with tax executives from major US corporations around the country that they know about the property tax mess here in Pennsylvania, and it is a major impediment to their investing in the state. They also know about the Capital Stock and Franchise tax and what it means for them to have a presence here. The issues surrounding the property tax are not little secrets that I am sharing with you that only we, residents and voters in the state, just figured out.

Some may argue that by providing long-term property tax exemptions or Tax Increment Financing that the horrors of the local property tax can be overcome, and investors will flock to these tax havens with employment opportunities to follow. Perhaps. On the other hand, the more thoughtful may wonder if the ineptitude or worse that led to such a bad property tax system is matched on the spending side of the public budget. Then what? Roads that don't work? Schools that don't work?

Fourth, given what I know about the statutory basis under which public education operates in Pennsylvania, I am not sanguine about the Commonwealth taking on a greater responsibility for financing public education (say the magic 50%), as well as bringing up the resource base that poor districts have, without some fairly major changes in the statutes that govern public education.

Some rich districts squander taxpayers money and some poor districts squander taxpayers money. And, some rich districts do outstanding things with taxpayers money, and some poor districts do outstanding things with taxpayers money. But, as I said some years ago, if the state were to put more state tax dollars into public schools, under the guise of reducing the local property tax, and do nothing else, it likely will simply improve the quality of automobiles teachers drive. It will not deal with the vast inequities in the assessment of local property tax, and unless you do something really dramatic like eliminate the school and municipal property tax, it will do nothing for Widow Jones.

When Widow Jones and her children figure out that she still has to sell her house and move into an apartment, even after you have declared victory and a new age, what will happen? When she can no longer have the children and grandchildren over for Thanksgiving and Christmas, because you did not get it right, then maybe they will start wondering who they should vote for next time.

Fifth, the hard work to fixing the property tax does not require any original thinking, just political will. The 1981 *Final Report of the Pennsylvania Tax Commission*, and the 1987 *Final Report and Recommendations of the Pennsylvania Local Tax Reform Commission*, both of which I drafted and got various people to endorse, contain good advice:

1. separation of the assessment function from the appeals function

2. 100% market value standard

3. state standards, evaluations and sanctions

4. mandatory reassessment when assessment quality deteriorates

5. state assistance for collection, processing, maintenance and analysis of local property data

To these I would add the capitalization of a state property tax circuit breaker that provides for elderly tax property tax foregiveness and the collection of liens on such properties when they are transacted.

Sixth, let me simply offer to the Committee a promise to return, if you so invite me, with a list and explanation of accountability proposals which would warrant the state becoming more fiscally involved in supporting the costs of public education.

Thank you for the opportunity for testifying before you this afternoon. I am happy to answer any questions you may have on my remarks.

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