DOCUMENT RESUME

ED 323 664 EA 022 260

AUTHOR Strauss, Robert P.
TITLE School Finance Reform in Pennsylvania: A Progress Report from the Trenches.
PUB DATE 21 Aug 90
NOTE 21p.; Revision of paper presented at the Annual Meeting of the American Education Finance Association (Las Vegas, NV, March 15-18, 1990). Some small print in footnotes and charts may not reproduce adequately.
PUB TYPE Speeches/Conference Papers (150)

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Blue Ribbon Commissions; Educational Equity (Finance); *Educational Finance; Elementary Secondary Education; *Finance Reform; Fiscal Capacity; *Politics of Education; Property Taxes; School Districts; Tax Allocation; Tax Deductions; *Tax Effort
IDENTIFIERS *Pennsylvania

ABSTRACT

A description and analysis of two failed local finance reform efforts in Pennsylvania between 1987 and 1989--a blue ribbon tax reform commission and a state constitutional amendment--are presented in this report. Constraints imposed during the reform design stage and two political "tar pits"--household/business proportion of local taxes, and commuter taxes--interacted to forestall successful adoption. Factors that contributed to the defeat of the reform efforts include inadequate public education; fear of increased personal income taxes; lack of governor support; inaccurate and disorganized drafting; and the development of partisan political and business factions. Most significant was the inadequacy of a short-term state commission and a special legislative session for large-scale, structural tax reform. Issues that must be addressed before financial reform efforts are undertaken are household/business local tax allocation, interdistrict fiscal tensions, and public education. Two statistical tables are included. (7 references) (LMI)

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School Finance Reform in Pennsylvania:

A Progress Report from the Trenches

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21 August 1990

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1. Introduction

From August. 1987 until May. 1989. Pennsylvania sought. first through a blue-ribbon Local Tax Reform Commission. and then through a constitutional amendment in 1989. to reform its system of local finance. The 1987 9 effort to reform Pennsylvania's local tax structure is one of a long line of [failed] efforts to reform the manner in which 500 school districts. 67 counties. and better than 2500 municipalities provide various public services to 12.000.000 Pennsylvanians

The new wave of interest in improving k-12 educational quality will necessarily turn to improving the way in which we locally finance our public schools It is my conjecture that any serious attempt to deal with local school taxing powers will ultimately raise questions of how general governments should finance themselves. since all draw resources from the same taxpayers.

The purpose of this paper is:

1 to provide a restatement of the normative reform framework of the 1987 Commission[1] which may be of general. analytical interest:

2 to compare the desired structure to current Pennsylvania local tax law:

3. to discuss the sort of real world considerations which arose during the legislative debate: and.

4. to discuss why the constitutional amendment was defeated by the electorate in May. 1989.

2. Local Finance Reform Goals and Pennsylvania's Current Local Finance Laws

2.1. Goals of A Good Local Tax Structure

As is oft-stated, a good tax system should be predictable. administrable. provide adequate revenues. and be economically neutral. Also. it should achieve socially agreed upon distributional objectives. and match the method of finance to the type of public service being provided. It is this last normative criteria which requires elaboration when local tax reform gets discussed.

It is commonplace to attempt to link the benefits received from certain public services to a pseudo tax price. For a broad class of municipal services which benefit primarily property. the local property tax. levied at a proportional tax rate, is the most appropriate revenue instrument. For services such as

[1]See The Final Report and Recommendations of the Pennsylvania Local Tax Reform Commission. [Harrisburg. Pennsylvania Commonwealth of Pennsylvania, November 6. 1987

fire and police. the primary benefit received is the protection of property It follows that the value of the property is an appropriate barometer of the amount of services enjoyed. and the proportional property tax is the appropriate form of finance. Other municipal services of narrow benefit can and should be priced and fees levied.

Where income redistribution or the provision of a merit good such as education is the major motivation for public service provision. then a broad-based. ability-to-pay revenue source is appropriate For a variety of administrative and efficiency reasons. I find the local income tax to be superior to the local sales tax as such a revenue instrument.[2]

In both the case of municipal services and various types of merit goods. there is an argument for state financial support. In the case of municipal services. state aid. or general revenue sharing. is appropriate in recognition of 1] tax exempt property which limits property tax revenues. and paticularly impacts older. central cities. and 2] non-resident/commuter use of municipal services Older. central cities have disproportionate numbers of hospitals. religious institutions. and state and federal buildings. and typically have significant numbers of commuters.[3] If municipalities can not extract pseudo-property taxes from tax exempt property and can not tax commuters. they will be forced to chronically over-tax residents and property within their boundaries with attending departures of mobile people and resources. The alternative. of course. is for state revenue sharing and some form of commuter taxation.

In the second case. the argument is that the state should levy sales and/or income taxes. and provide support for a baseline education level throughout the state with matching beyond the foundation level that is inverse with the ability to pay of each school district At the local level schools should use the local income tax to pay for their portion of the costs of education. and governments which engage in the provision of health care. children's services and other forms of income redistribution should also use the income tax.[4]

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[2] Administration of the local use portion of a local sales tax is typically impossible. and any geographic dispersion of sales tax rates will lead to diversion of shopping activity to the lesser taxing area See Due and Mikesell[1983]

[3] For example. about 150,000 people work and live in Pittsburgh, and another 150.000 work in Pittsburgh and live outside it In Philadelphia, the figure is large, but the overall proportion is smaller

[4] The conclusion that schools should use a local income tax follows regardless of whether or not one believes in choice vouchers etc What is being deduced here from first principles is how the aggregate tax sum for a local district is collected and not how that sum should be used to achieve desired performance That is a separable matter

This simple framework argues for schools being financed by the state for the foundation portion of education costs, and argues for the local, additional amount being financed by a local income tax, and matched with state aid which varies inversely with, say, percapita taxable income [5]

The framework also argues for municipalities being financed by property taxes and fees, local income taxes being used for health and human services they provide, and commuter taxes which would, for administrative reasons, be levied on commuter earnings at a rate substantially below the rate on resident income. Identical remarks follow for the structure of county finances

Finally, the framework argues for state aid to municipalities in recognition of tax exempt property and, if local commuter taxation is [politically] infeasible, then state aid is needed again

2.2. Pennsylvania's Local Tax Structure

[6] Pennsylvania, like most states, allows school districts, municipalities and counties to all use the property tax For school districts, property taxes For counties, this is the only tax source they have By the mid. 1980's a substantial portion of county budgets (10-20%) were devoted to health and human services as a result of various state mandates and withdrawal of federal support.

Municipalities and school districts share two important revenue sources: 1] the earned income tax and 2] the real estate transfer tax. Generally, the earned income tax rate can not exceed 1% overall and the real estate transfer tax can not exceed 1%. If a municipality does not levy a resident earned income tax, the place of employment may do so at its resident rate. Around Pittsburgh, all municipalities levy a .5% wage tax, and all school districts levy a .5% wage tax. The local earned income tax is typically 10 to 15% of local school taxes.

It is interesting to note that the principal of using local income taxes to finance local services is well established in Pennsylvania. Pennsylvania's school districts and municipalities, which comprise 4.9% of the U.S. population, collected 17% of total local wage and income taxes nationally

Special rules exist for home rule municipalities, and for Philadelphia and Pittsburgh which

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[5] This view is somewhat different than that found in much of the educational finance literature which addresses ways to equalize the effects of local reliance on the property tax See, Cohn[1979], Chapter 10, and the references therein for a review of the traditional approaches to achieving improved equity in school finance

[6] The discussion below is obviously a simplification of what has become an enormously complex system of taxation that is scattered across many enabling statutes and various classes of boroughs, townships, and cities, and various classes of counties and school districts It captures, however, the essential flavor of this diversity See, for example Pennsylvania Tax Commission [1981] and Local Government Commission [1989] for more complete treatments of current law and Act 145

essentially permit municipal wage tax rates above .5%. and allow both Pittsburgh's school and municipal wage tax rates to be above 1%. Under special taxing laws. Philadelphia can do essentially whatever it wants to. Philadelphia's special status is discussed extensively below.

In addition. local municipalities and school districts in Pennsylvania can levy an occupational privilege tax which is a tax on the value of the occupation of the person. This form of finance is most prevalent in Central Pennsylvania. It violates any principal of equity one might appeal to. and is widely disliked. In some school districts it is as much as 25% of total local school taxes

Only Philadelphia levies a commuter tax of any consequence: nonresident workers must pay 4.3125% of wages and self-employment income to the City.

3. From Simple Design Principles to Operational Legislation: into the Political Tar Pit

The local tax reform proposal which was proposed by the blue-ribbon commission. and the one enacted by the General Assembly and signed by Governor Casey embodied many of the above design principals. Moreover, it was designed to move school finance reliance away from the property tax and to the income tax, and consequently provide significant tax relief to the retired and the elderly.[7] The question naturally arises, then, why did the reform package fail before the electorate? After all. if one structured an operational proposal that would replace much of local school property taxes with local income taxes, it should have been appealing to at least elderly home owners. Also, one would presume that business would support the reduction in property taxes since they are major local property tax taxpayers.

Yet. what finally got proposed and passed through the Pennsylvania General Assembly ultimately got stuck in the political tar pit and never successfully came out. It was opposed by the elderly and at least in part by the business community. For those who find the conceptual framework attractive and the defeat at the polls disappointing, the failure to make a succesful link from the drawing board to public consideration is of more than passing interest.

To explain what happened requires: 1] an appreciation of the constraints imposed during the design of the reform. and 2] an understanding of the two political tar pits which have faced local tax reformer enthusiasts in Pennsylvania for the last quarter of a century. The interaction of these issues ultimately forestalled successful adoption.

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[7] Pennsylvania does not tax retirement income under its income tax

3.1. Some Initial Constraints

The following confronted the well-intentioned in Pennsylvania in 1987 as well those involved in earlier attempts:

1. a constitutional uniformity clause which precludes progressive rates of taxation and precludes classification of any sort in the real property tax:[8]

2. a broad agreement among Democrats and moderate and some conservative Republicans that: a] a decreased reliance on local school property taxes. and b] an increased reliance on personal income taxes could not shift the incidence of local tax support of education towards households and away from business:

3. a continued position by *suburban* Philadelphia's's state representatives and senators that local tax reform could not occur without substantially lowering the commuter tax on suburbanites working in Philadelphia and strongly encouraging suburban school districts to use a local income tax:

4. a continued position by Philadelphia's state representatives and senators that Philadelphia residents would not pick up to cost of reducing the commuter tax on suburbanites. and that the suburbs and/or State would have to pick up a substantial portion of this revenue loss: and.

5. at the outset, opposition by Governor Casey to devoting "new", continuing money from the state budget to address the above issues, a stated hostility towards state revenue-sharing[9], and a commitment by the Governor not to raise state taxes to finance/address some of these problems.

With these constraints in mind, let us now examine the two political tar bits which have previously thwarted local tax reform enthusiasts.

3.2. Tar Pit 1: Maintaining the Balance between Business and Households Taxes

To some, the over reliance on the local property tax in support of education, compared to its being more properly supported by a local income tax, might mean that business was paying too high a share of school taxes, and households too low a share of school taxes under current law. On the other hand, realistic state politicians have observed that the desired shift to personal income taxes from

[8] Article VIII Section 1 of the Pennsylvania Constitution requires "All taxes shall be uniform upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws."

[9] The Governor announced his opposition to state revenue sharing at the first meeting of the Commission. This was personally disappointing to the author, who had been responsible for enactment of federal revenue sharing some years ago

property taxes would never voluntarily occur at school board meetings once elected board members discovered that absentee plant owners would reap what were described as "windfalls."

Over the years a variety of ingenious tax policies were constructed to ensure that, at least in the aggregate, the calculated business share of state and local taxes would remain the same after enactment of some sort of local tax reform package that would replace school property taxes with income taxes. For example, under a mid-1980's proposal, the mandatory movement to a local income tax would be accompanied by an increase in the state sales tax which would be shared back to school districts in proportion to the loss in business property taxes. Since it was estimated that 30% of the sales tax is paid by business, and the 30% figure corresponds to what was known about the business property tax burden state-wide, one could create and distribute a state-wide pot that would address the first problem without violating the uniformity clause of the Constitution.

Unfortunately, this idea violated the Governor's constraint of no new state taxes, and violated the Governor's constraint of no state revenue sharing.

We may focus the issue of maintaining the balance between business and non-business share of the property tax with a bit of notation and two simple equations. The first equation says that the old tax system and the new tax system must bring in the same amount of money, and the second equation says that *share* of total local taxes paid by business must be the same under the old and new system:

$$t_1 * T_1 + \text{Wage} + \text{Occupation} = R = t_2 * T_2 + t_p * Y \qquad (1)$$

where:

t is the property tax rate,
T is the total assessed base,
1 and 2 denote old and new law,
Wage and Occupation are the earned income and occupation taxes,
R is total revenue,
Y is the personal income tax base, and
t_p is the personal income tax rate that would be solved for to be revenue-neutral.

The assessed base, T, could differ under old and new law if, for example, a homestead exemption were enacted to reduce reliance on the property tax.

The balance requirement, *per se*, is found in the equation below:

$$(t_1 * B_1) / R = (t_2 * B_2) / R \qquad (2)$$

where B is the business property tax base in the old and new systems

If local tax reform were to mean just trading the earned income and occupation taxes for a personal income tax, then $t_1 = t_2$, and t_p = (Wage + Occupation) / Y. It follows, if $t_1 = t_2$, that (2) is satisfied automatically since the millage rate and B are unaffected by this definition of reform

If, however, one seeks to reduce property taxes as a percentage of R, then the matter becomes more complex, and one in effect needs to calculate a third equation which compares t_2T_2/R to some criterion percentage. For many school districts the current reliance on the property tax is 90% or more.

Two approaches to reducing the reliance on the property tax for school finance suggest themselves 1] some form of a homestead exemption or general per property exemption that would differentially affect residential property, or 2] a "split rate" or classified approach which would allow the residential property tax rate to be reduced while the business property tax rate remained constant. Under the second approach, it is easy to see that (2) would be maintained because the millages would be specific to business and could be chosen to guarantee (2) would be honored.

Under the first, homestead-exemption approach, it is less obvious how (2) would be maintained By providing a $10,000 or $20,000 per property exemption, subject to a 20% maximum reduction per property, one can easily reduce residential property taxes and reduce the overall reliance on the property tax to finance schools. Recall that for business properties, which are typically quite valuable, a $15,000 exemption will lead to a small percentage reduction in tax at the old millage In order to ensure that (2) is honored, the new millage needs to increase slightly to offset the impact of the exemption for business. In effect, one is merely solving (1) and (2) for two unknowns: the new millage rate and the new personal income tax rate given a decline in assessed base as a result of the homestead exemption. Whether or not the movement to the personal income tax is large enough to get the overall reliance on the property tax to an acceptable level is an empirical question that can only be answered through trial and error with actual data.

An analysis of data for Allgheny County sheds some light on this issue. Table 3-1 below displays for the major school districts in Allgheny County the major components of their own-source taxes in 1985-6. It indicates that property taxes were 80 to 90% of local taxes with the notable exception of Pittsburgh School District which raised only 60% of its local taxes in the form of property taxes Note also that non-residential property taxes varied considerably in importance: from a low of 9.3% to a high of 49.7%.

Were a $10,000 improvements exemption enacted, the percapita taxes eliminated, and the local wage

Table 3-1: 1985-6 School District Taxes in Allegheny County

		Current Law Taxes			Analysis	
ID	School District	Act 511 Percap Wage Tax	Property Tax	1985-6 Total Tax	Property Tax as % of Total	Non-Res Property as %Total
A	B	C	D	E	F	G
1	Allegheny	386,466	3,688.508	4,074,974	90.5%	38.6%
2	Avonworth	509,020	3,117,336	3,626,356	86.0%	9.4%
4	Baldwin Whiteh	1,889,513	12,793,413	14,682,926	87.1%	11.4%
5	Bethel Park	2,263,218	14,108,292	16,371,510	86.2%	21.3%
6	Brentwood	485,327	3,211,272	3,696,599	86.9%	16.4%
7	Carlyton	654,950	5,090,475	5,745,425	88.6%	22.4%
8	Chartiers Vall	1,632,545	10,393,622	12,026,167	86.4%	24.2%
10	Clairton	251,388	2,312,616	2,564,004	90.2%	24.3%
11	Cornell	310,119	3,925,121	4,235,240	92.7%	49.7%
12	Deer Lakes	519,245	3,694,660	4,213,905	87.7%	13.8%
13	Duquesne	142,214	2,130,034	2,272,248	93.7%	40.5%
14	East Allegheny	640,930	5,513,597	6,154,527	89.6%	27.0%
16	Elizabeth Forw	773,140	4,914,626	5,687,766	86.4%	17.7%
17	Fox Chapel	2,164,466	12,763,092	14,927,558	85.5%	20.5%
20	Hampton	945,906	6,426,843	7,372,749	87.2%	14.1%
21	HIghlands	889,447	6,634,472	7,523,919	88.2%	21.2%
22	Keystone Oaks	1,161,949	8,473,603	9,635,552	87.9%	36.7%
23	McKeesport	1,375,560	9,045,331	10,420,891	86.8%	17.8%
18	Monroeville-Ga	2,600,073	14,685,639	17,285,712	85.0%	41.6%
24	Montour	1,054,124	9,131,997	10,186,121	89.7%	35.0%
25	Moon	1,725,849	8,827,847	10,553,696	83.6%	27 9%
26	Mt Lebanon	2,730,096	18,428,944	21,159,040	87.1%	10.4%
27	North Alleghen	3,065,594	17,153,806	20,219,400	84.8%	15.8%
28	North Hills	2,596,220	13,811,119	16,407,339	84.2%	25.1%
29	Northgate	623,507	3,780,262	4,403,769	85.8%	17.5%
30	Penn Hills	2,015,823	16,965,445	18,981,268	89.4%	14.1%
47	Pittsburgh	45,783,643	68,791,855	114,575,498	60.0%	31.2%
31	Plum	1,390,547	6,609,829	8,000,376	82.6%	15.5%
32	Quaker Valley	1,037,906	6,353,953	7,391,859	86.0%	13.4%
33	Riverview	383,419	3,469,205	3,852,624	90.0%	24.2%
34	Shaler	2,056,111	12,952,946	15,009,057	86.3%	11.8%
35	South Alleghen	384,806	2,653,605	3,038,411	87.3%	9.5%
36	South Fayette	427,410	2,772,691	3,200,101	86.6%	23.5%
37	South Park	704,864	3,960,217	4,665,081	84.9%	9.3%
38	Steel Valley	522,400	6,067,688	6,590,088	92.1%	24.3%
39	Sto-Rox	511,283	3,627,395	4,138,678	87.6%	28.7%
42	Upper St Clair	1,971,813	12,858,580	14,830,393	86.7%	12.3%
43	West Allegheny	568,589	4,756,883	5,325,472	89.3%	43.8%
44	West Jefferson	1,598,555	6,083,832	7,682,387	79.2%	21.4%
45	West Mifflin	1,571,074	9,808,665	11,379,739	86.2%	39.3%
46	Wilkinsburgh	716,876	4,738,083	5,454,959	86.9%	24.3%
	Woodland Hills	2,566,611	19,004,418	21,571,029	88.1%	23.3%

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tax replaced by a local income tax, residential property taxes would fall considerably, and the level of reliance would be no more than 81% (See Column [I] in Table 3-2) and as low as 52% in the case of Pittsburgh. Local income tax rates would typically be from .9 to 1.25%. Note that in order to satisfy the various constraints, millages would have to go up, typically by 2 to 4%. We see from this analysis that it is feasible to shift reliance from the local property tax to a local income tax residential property taxes are reduced by 15 to 40% in the process.

3.3. Political Tar Pit 2: Reducing the Philadelphia Commuter Tax and Getting non-Philadelphians to Pay for the Revenue Loss

To many a commuter tax rate of 4.3125% imposed on earned income must surely exceed the fair value of services consumed by commuters who work in Philadelphia. Moreover, the loss of 150,000 jobs to the suburbs as a result of this tax surely should encourage Philadelphians to lower the rate. Unfortunately, this analysis ignores the small matter of how to make up the lost revenues should the commuter tax be reduced.

3.3.1. Some Background

In 1932, State Representative Sterling of Philadelphia succeeded in enacting separate taxing authority for Philadelphia that permitted Philadelphia to do essentially whatever it wished to raise revenues.[10] The most pronounced and now hated feature of the Sterling Act, as it interacts with the laws which allow the suburbs to levy 1% wage taxes, has been the practical result that suburbs can not derive any wage taxes from their residents who commute until the suburban rate of wage tax exceeds Philadelphia's commuter tax rate. In effect, Philadelphia has always had first claim on a tax on commuters wages.

Since Philadelphia's suburbs have been historically limited to a combined municipal-school district wage tax rate of 1%, since there has been a substantial commuter inflow from the suburbs into the City over the years, and since the City has taxed commuters at a rate since 1966 of at least 2% suburban school districts and municipalities have been essentially precluded from levying a wage tax at all. Suburban school districts which have been rapidly growing over the years have reached their state millage limits and in some instances had to ask their residents to make charitable contributions to the districts in order to provide the level of educational services which are being demanded

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[10] Act 45 of 1932 stated: " the City of Philadelphia may levy such taxes for general purposes as it determines on persons transactions, occupations, privileges, and subjects within the City "

Table 3-2: Impact of $10,000 Improvements Exemption on Allgeheny County School Districts

ID	School District	Reform Tax Structure			Analysis				
		Reform Prop Tax	Reform Income Tax	Reform Tot Tax	% Cut in Resident. Prop Tax	Income Tax Rate	Non-Res Prop % Share	Prop Tax % Reliance	% Change Millage
		[A]	[B]	[C]	[D]	[E]	[F]	[G]	[H]
1	Allegheny	3,169,250	905,697	4,074,947	-24.5%	0.89%	38.6%	77.8%	2.3%
2	Avonworth	2,725,339	901,014	3,626,353	-14.1%	1.02%	9.4%	75.2%	6.0%
4	Baldwin Whiteh	10,915,136	3,767,671	14,682,807	-16.9%	0.96%	11.4%	74.3%	3.0%
5	Bethel Park	12,521,539	3,849,963	16,371,503	-14.9%	0.95%	21.3%	76.5%	1.9%
6	Brentwood	2,690,490	1,006,098	3,696,589	-20.0%	1.04%	16.4%	72.8%	4.3%
7	Carlyton	4,407,982	1,337,442	5,745,424	-17.9%	0.86%	22.4%	76.7%	5.0%
8	Chartiers Vall	8,981,106	3,045,059	12,026,165	-18.9%	1.03%	24.2%	74.7%	2.5%
10	Clairton	1,646,205	917,782	2,563,987	-39.5%	1.55%	24.3%	64.2%	7.1%
11	Cornell	3,452,773	782,454	4,235,227	-25.9%	1.34%	49.7%	81.5%	2.7%
12	Deer Lakes	2,997,272	1,216,630	4,213,902	-22.4%	1.05%	13.8%	71.1%	6.7%
13	Duquesne	1,632,984	639,263	2,272,248	-41.1%	1.72%	40.5%	71.9%	2.5%
14	East Allegheny	4,441,591	1,712,936	6,154,527	-27.8%	1.34%	27.0%	72.2%	3.1%
16	Elizabeth Forw	4,337,008	1,350,757	5,687,765	-14.8%	0.77%	17.7%	76.3%	15.2%
17	Fox Chapel	11,830,255	3,097,301	14,927,556	-9.6%	0.58%	20.5%	79.3%	2.6%
20	Hampton	5,809,392	1,563,353	7,372,745	-11.5%	0.85%	14.1%	78.8%	3.5%
21	Highlands	5,293,720	2,230,199	7,523,919	-26.6%	1.23%	21.2%	70.4%	5.5%
22	Keystone Oaks	7,502,006	2,133,533	9,635,539	-19.7%	0.97%	36.7%	77.9%	1.6%
23	McKeesport	6,941,580	3,479,311	10,420,891	-29.3%	1.39%	17.8%	66.6%	4.1%
18	Monroeville-Ga	13,304,413	3,981,300	17,285,712	-18.4%	1.15%	41.6%	77.0%	1.0%
24	Montour	8,159,891	2,026,208	10,186,099	-17.5%	0.88%	35.0%	80.1%	1.8%
25	Moon	7,928,330	2,625,365	10,553,695	-15.3%	1.07%	27.9%	75.1%	2.7%
26	Mt Lebanon	16,731,258	4,427,782	21,159,040	-10.5%	0.74%	10.4%	79.1%	2.4%
27	North Alleghen	15,806,850	4,412,550	20,219,400	-9.7%	0.80%	15.8%	78.2%	2.4%
28	North Hills	12,211,982	4,195,357	16,407,339	-16.5%	0.91%	25.1%	74.4%	1.9%
29	Northgate	3,190,920	1,212,849	4,403,769	-19.6%	0.99%	17.5%	72.5%	4.1%
30	Penn Hills	13,949,538	5,031,730	18,981,268	-21.1%	1.05%	14.1%	73.5%	3.1%
47	Pittsburgh	60,140,580	54,434,917	114,575,497	-26.2%	1.89%	31.2%	52.5%	1.4%
31	Plum	5,616,432	2,383,562	7,999,994	-18.5%	0.95%	15.5%	70.2%	3.0%
32	Quaker Valley	5,888,491	1,503,368	7,391,859	-8.7%	0.59%	13.4%	79.7%	4.0%
33	Riverview	3,095,120	757,504	3,852,624	-14.7%	0.78%	24.2%	80.3%	4.8%
34	Shaler	11,108,001	3,901,040	15,009,041	-16.5%	0.94%	11.8%	74.0%	5.3%
35	South Alleghen	1,922,522	1,115,889	3,038,411	-30.9%	1.24%	9.5%	63.3%	5.9%
36	South Fayette	2,397,645	802,638	3,200,284	-18.6%	0.9[illegible]%	23.5%	74.9%	4.1%
37	South Park	3,465,776	1,199,305	4,665,081	-14.0%	0.89%	9.3%	74.3%	5.9%
38	Steel Valley	4,808,026	1,782,061	6,590,087	-28.2%	1.39%	24.3%	73.0%	3.7%
39	Sto-Rox	2,852,225	1,286,453	4,138,678	-31.8%	1.38%	28.7%	68.9%	7.0%
42	Upper St Clair	11,913,322	2,917,071	14,830,393	-8.6%	0.72%	12.3%	80.3%	0.7%
43	West Allegheny	4,191,750	1,133,722	5,325,472	-23.3%	0.85%	43.8%	78.7%	2.4%
44	West Jefferson	5,355,939	2,326,448	7,682,387	-16.4%	1.21%	21.4%	69.7%	2.6%
45	West Mifflin	8,448,117	2,931,621	11,379,739	-25.5%	1.52%	39.3%	74.2%	0.9%
46	Wilkinsburgh	3,880,986	1,573,973	5,454,959	-25.1%	0.99%	24.3%	71.1%	5.8%
	Woodland Hills	15,994,406	5,575,623	21,571,029	-21.5%	1.00%	23.3%	74.1%	3.4%

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Any time assessment reform or more broadly local tax reform has been discussed in Pennsylvania legislators in South Eastern Pennsylvania have created a roadblock. In particular, the political price that South Eastern Pennsylvania has placed on allowing local tax reform for the rest of the state to happen has been that there must be a solution to the commuter tax problem in Philadelphia In particular, Philadelphia's state legislators have insisted that the revenue loss from cutting the commuter tax be borne be paid for by those outside Philadelphia. Given the sizable representation of the Philadelphia delegation in the General Assembly, this has been an impossible hurdle to overcome.

No-one should underestimate the anger suburbanites feel for having to pay 4.3125% of their earnings to Philadelphia, or the adverse economic effect it has had in the last decade of chasing employers and employees out of Philadelphia to the suburbs.[11] The issue not only involves the matter of double taxation, but also differences in political affiliation and race Philadelphia's suburbs are predominantly white and Republican while the City is predominantly Democratic and black

Some elementary fiscal arithmetic will define the size of the hurdle, or depth of this second political tar pit. About 40% of Philadelphia's wage tax receipts are from non-residents. Also, 1/3 of the non residents are from New Jersey and Delaware.[12] To get the commuter tax rate down from 4.3125% to 3.0%, an oft-described definition of commuter tax reform by suburban legislators, involves a revenue loss to Philadelphia of about $90 million at 1985 levels. Suburbanites in Pennsylvania obviously do not want to pay the $90 million, especially since 1/3 of that should be paid by those from New Jersey and Delaware. There is, however, no practical constitutional way at the local level to recover that amount from New Jersey and Delaware once Philadelphia lowers its commuter tax on them.

The way out of this tar pit most often discussed involves some form of state assistance to finance the commuter tax reduction; however, legislators from outside South Eastern Pennsylvania always insist that the funds flow broadly from Harrisburg, and not just to the Philadelphia metropolitan area

A bit more fiscal arithmetic shows that finding enough state dollars to reduce the commuter tax is non-trivial if it is done state-wide. Philadelphia has about 12% of the state's population, received 19% of the total local allocation per year through General Revenue Sharing formula, and gets 19% out of a state formula that redistributes property tax levies on public utilities To get $90 million to

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[11] For example, Robert Inmann[1987] estimates that over a 15 year period Philadelphia lost 150,000 jobs as a result of the commuter tax

[12] See Studies in Local Tax Reform Issues in Pennsylvania, School of Urban and Public Affairs, Carnegie Mellon University May, 1988

Philadelphia via the General Revenue Sharing formula would require a state-wide pot of $90 million/.19 or $473 million in 1985 dollars. If one were to use a population-based formula, the size of the state-wide pot would grow to $750 million in 1985 dollars ($90 million/.12 = $750 million) which would be over one additional percentage point on the state sales tax. Either approach violated the Governor's constraint of no state-revenue sharing and would require a state tax increase which he also opposed.

3.3.2. Various Approaches in the 1987 Local Tax Reform Commission Report

During the life of the Local Tax Reform Commission, the Philadelphia commuter tax problem was easily the most divisive and complicated issue that was dealt with. In the spirit of compromise, a menu was generated of three solutions from which Governor Casey and the Special Session of the General Assembly could choose from.

The first solution, which was favored by the largest plurality of Commission members, created a regional sales tax solution to the problem that was, in my view, facially unconstitutional.[13] This did not faze the state legislators on the Commission who supported it; as lawyers and state legislators they evidently took the view that what is unconstitutional is what the Pennsylvania Supreme Court says is unconstitutional, and with some push and luck, things might work out.

A second solution, devised by the author, enabled the suburban counties to impose an income tax and enabled Philadelphia 1] to levy a "regional amenities fee" upon the suburban county governments not to exceed .0008 of the taxable income of suburban county residents. Proceeds of the fee would be used to reduce the commuter tax. This option, while clearly constitutional, was exceedingly unpopular with elected officials outside of Philadelphia.

A third solution, favored by the Governor, created a tax credit onlly for suburban Philadelphia's commuters against their State income tax liability. Everyone, including the General Counsel to the Governor, ultimately realized this approach would violate the Commonwealth's uniformity clause, because of its limited geographic benefit as contrasted with the state-wide tax. After submission of the Report, this solution ceased being of interest to anyone.

[13] See my dissent at footnote 31 of the Final Report of the Pennsylvania Local Tax Reform Commission

4. Act 145: Enacted Solutions to the Business-Household Balance and Philadelphia Commuter Tax Problems

Retelling the complete history of how the Pennsylvania General Assembly actually passed local tax reform is well beyond the scope of this paper. There simply is not enough space or time. Suffice it to say it was one of the remarkable and surprising turn of events one could have ever predicted in fiscal politics. Much credit lies with Governor Casey's fortitude and flexibility, and the willingness of retiring Senate Majority Leader, Jack Stauffer to push his Republican colleagues to do something constructive. Perhaps the fact that both political leaders had serious heart attacks and major bypass surgery after the passage of the 1987-8 budget augured for final passage: Stauffer suffered his heart attach in July of 1987, and Casey his in October of 1987.

In any event, what is of interest here is the nature of the solutions which moved local tax reform out of the General Assembly and to the electorate.

4.1. Out of Tar Pit 1: Maintaining the Business-Household Balance Post Tax Reform

In the course of enacting Act 145, both types of solutions to the problem of maintaining business share of local taxes were successfully voted on. The House initially passed a split rate approach, but managed to write language which would have allowed localities to actually increase the property tax rate on business rather than simply lowering the property tax rate on households and increasing the personal income tax. This "technical error" did not go unnoticed by the business community, and angry letters were sent to the various House and Senate leadership groups.

The Senate, both in majority caucus and subsequently in the special tax reform committee, passed a revised and corrected version of the split rate approach which permitted only a reduction in residential millage rates to the extent the revenue loss was offset by higher personal income taxes. On the floor of the Senate, the entire body inexplicably threw out the corrected split rate approach and replaced it with a universal homestead exemption. The House then adopted the corrected split rate approach which the Senate inexplicably agreed to on the floor of the Senate.

Opponents of local tax reform made actual implementation of the split rate approach, and implementation of the myriad of other features of the legislation, dependent on successful acceptance of an amendment to the uniformity clause of the constitution by the general electorate in May, 1989

4.2. Out of Tar Pit 2: Solving the Philadelphia Commuter Tax Problem

While the solution to the balance issue followed the menu of choices in the *Final Report of the Pennsylvania Local Tax Commission*, the gyrations surrounding the commuter tax issue were of a different sort.

The Governor and General Assembly decided not to pick any of the menu items discussed above but tried to solve the problem in other ways. They did so by partially violating one of the original constraints, by partially ignoring the fact that the proposed solution would not solve the economic problem that the commuter tax had created and Philadelphia's representatives had avowed to solve, and completely violating the no-revenue sharing constraint.

Act 145 had a number of components: first, about $70 million was found in the state budget for a revenue sharing program for Philadelphia; the specific vehicle was a $70 million increase in the South Eastern Pennsylvania Transit Authority's state payment. Second, county governments state-wide were given an optional sales tax, with Philadelphia's rate being allowed to be higher than others, and it was hoped that when Philadelphia levied its sales tax, the suburban counties would as well. This was obviously not only wishful thinking about what the suburbs would do, but also a denial that a higher sales tax rate would cause anything but diversion of shopping to the suburban malls to the west of Philadelphia, and across the river to Delaware which has no state sales tax. Nonetheless, this was acceptable to suburban and city legislators, and they voted for it in the final analysis.

Third, the state agreed to share back on a source-basis some of its 1% of the realty transfer tax. This obviously violated the original no-revenue sharing constraint as well, but to the Governor's credit, he went along with this in the interests of political realism.

5. Into Tar Pit 3: Amending the Pennsylvania Constitution to Allow a Solution to the Business Balance Issue

This bit of modern political history does not have a happy ending as indicated at the outset. Undoubtedly, the reader must be wondering, how could it be that Pennsylvania's General Assembly, never noted as being ahead of the public on any issues since it moved from Philadephia to Harrisburg, would fashion solutions to get out of Tar Pit 1 & 2, yet have the electorate vote it down 3:1 and throw the matter back into the Tar Pit 3 from whence it has yet to emerge?

There are ten considerations, in retrospect, which probably led to such an overwhelming defeat.

First, it was clear that the public was never educated about why local government needed a new system of taxation. The media never really properly described how first the federal government and second state government took a walk away from historical commitments to funding education and local public services.

Second. the federal tax reform fever of the 1980's always meant personal tax cuts. and the electorate generally believed that local tax reform would mean more of the same.

Third. early opinion polls in the fall of 1988 showed it to be in trouble. Governor Casey read these polls as severe personal danger signals. and increasingly distanced himself from the referenda issue.

Fourth. the campaign to pass the constitutional amendment never had plausible empirical data about winners and losers, and never effectively made the philosophical arguments for local tax reform.

Fifth. Act 145 contained a large number of drafting errors and hidden provisions which were divisive and reflected badly on the overall effort. Experienced staff of the House and Senate were excluded from final drafting. and relative novices were allowed to make decisions which resulted in adverse publicity later on.

Sixth, those Republican Senators who were opposed to the legislation said they could write a better bill and urged the electorate to vote this constitutional amendment down in order to be given an opportunity to try. Some suspect that the possibility that a Democratic governor would get credit for major reform was a consideration which encouraged Republican opposition to it. On the other hand. a significant number of House Republicans endorsed the amendment because it meant that in many of their districts the widely disliked occupation tax would be eliminated.

Seventh. the business community got angry at the introduction of classification into the property tax system. even though they had been apprised that the "windfall" was politically unacceptable. and some sort of classification was necessary to stabilize the business share of taxes. Still recovering from the massive federal tax increases in the Tax Reform Act of 1986. they took a neutral to negative position on the constitutional amendment.

Eighth, the organized opposition to the amendment began a scare campaign to the effect that the amendment could easily lead to tax increases. Hearing that it could mean tax increases or paying one kind of tax instead of another created fear which opponents exploited.

Ninth, much of the media did not understand the mechanics or need for the legislation as it was very complicated.

Tenth. and perhaps of penultimate hindsight value is the observation that a short-run commission and special session of the legislature are probably the worst vehicles for seeking large-scale. structural tax reform. While the participants were conversant in Harrisburg because the issues had been debated for 25 years. the wisdom of the final political compromises was never passed on to the public and accepted in any way. The public was simply asked to vote up or down on a constitutional amendment which was easy to misconstrue.

Short run commissions and emergency sessions of legislatures are best at finding emergency revenues. and not structuring long-term reform.

6. Epilogue I: Some Lessons for Other States

There are a number of things of universal interest that can be gleaned from all this

First. replacing the property tax with ability to pay taxes at the local level inevitably will raise the same issue of what happens to the household/business share of local taxes. It seems endemic to the general subject matter. Moreover, it seems unlikely that one can simply shift the burden to households and expect that local school boards will go along. As a result. the issue needs to be dealt with at the outset. To the extent that state constitutions have no impediment for classification. then the solutions outlined above are of immediate value, and one does not have to face the electorate for a constitutional amendment.

Second, it seems increasingly likely that big city-suburban-rural fiscal tensions will grow in all states. It is difficult to envision that school finance reform can be handled in isolation from the problems that general governments face. New York City, Chicago. and Philadelphia and many other cities are now facing substantial operating deficits. Funneling more state funds into local school districts without addressing these central city issues seems fraught with the risk of paralysis in the state legislatures.

Third, the issue of educating broad segments of the population about the philosophic rationales for straightening out local taxing powers is central to public acceptance. To accomplish this. it is important to get major sectors to agree ahead of time to avoid getting sandbagged. The Local Tax Reform Commission was flawed because it did not have business. labor. governmental groups and consumer interests represented. and because the output of the Commission went immediately into the legislature. Getting communities of interest beyond the political community to accept a set of solutions is. in retrospect, the key failure of the recent Pennsylvania attempt at local tax reform

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7. Epilogue 2: Implications for Educational Institutions

To those cloistered in academe, this view from the trenches in Pennsylvania may appear to be unrelated to one's own well being. Beware! Even the Chronicle of Higher Education has noted the fall-out of the above travails on Pittsburgh. In avid search of revenues, Pittsburgh has begun an aggressive attack on tax-exempt institutions.

Currently, the City of Pittsburgh is trying to levy a property tax on the University of Pittsburgh President's week-day residence, the Pitt football stadium and several Pitt hospitals. Moreover, the City has threatened that it will levy a gross receipts tax on all federal research grants to the University of Pittsburgh and Carnegie-Mellon.

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