Breaking the Tyranny of the Local Property Tax

March 20, 1969
Citizens League Report

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A proposal to relate tax policy to urban development in the Twin Cities area

Prepared by:
Committee on Fiscal Disparities

Earl F. Colborn, Jr., Chair

Approved by the Citizens League Board of Directors
March 20, 1969

Citizens League
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Suite 500
Minneapolis, Minnesota 55415
(612) 338-0791
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INTRODUCTION

The local government fiscal problem long has been in the background of discussions on metropolitan organization for the seven-county Twin Cities area. The problem has been acknowledged in connection with other questions, but it rarely has been confronted directly.

Discussion of the local government fiscal problem has been impeded because there is little consensus as to its nature, let alone its solution. In fact, it is incorrect to refer to a single problem because there are many of them, calling for different types of solutions.

This report touches on some of the fiscal problems common to all local governments, such as the need for non-property tax revenue. But the report's principal thrust is to another fiscal problem which exists to some degree with all local governments but which is a particular problem in the Twin Cities area. The problem is fiscal fragmentation--distribution of the area's tax base disproportionately among localities of the area.

One consequence of fiscal fragmentation is widely recognized and is not unique to the metropolitan area--the difference in property tax resources from locality to locality. This produces differing property tax burdens for an equivalent level of services among localities.

A second consequence is less evident, but far more important as it affects the growth of the Twin Cities metropolitan area. That consequence is the incentive which each local government has to take actions to improve its own tax base at the expense of its neighbors. Fiscal fragmentation has the effect of discouraging intergovernmental cooperation in the Twin Cities area. This in turn results in actions which work against the benefit of the entire area.

The report suggests a way to change the incentives of local government...to encourage cooperation. The recommendations are designed so that local governments, acting in their own best interests, will also act in the best interests of the entire metropolitan area. At the same time the tax resources of the entire area will be distributed more equitably.
SUMMARY OF RECOMMENDATIONS

Distribution of the Property Tax Base

Let each locality in the Twin Cities area keep the tax base it has now. In coming years as the tax base of the area grows, give each locality access to a part of the growth of the tax base in the entire area, regardless of how much of that growth actually occurs within its own boundaries. In effect, no one loses anything he has now, and everyone shares in the growth.

To accomplish this goal, the Legislature should change the property tax system so that one-half of the increase in non-residential valuation from now on will be shared by all units of government in the Twin Cities area, probably on the basis of population. The other one-half of the increase in non-residential valuation, plus all of the increase in residential valuation, would continue to be taxed exclusively by the units of government where the property is physically located. (See page 11 and following for a more detailed discussion.)

Non-Property Revenue for Local Government

Provide a way for local government to obtain a new non-property source of revenue. If the Legislature authorizes "local option" non-property taxes throughout the state, it should recognize the particular problems in the Twin Cities area and treat the area with a single policy to the greatest extent possible.

Modify state aid to school districts to provide special aids for programs designed for educating disadvantaged children.

Bonding

Modify the current state law relating to special state assistance to school districts with heavy bonding requirements, perhaps by broadening eligibility for state assistance and by having the state guarantee bonds rather than issue them itself.

Taxation of Electric Utilities

Replace the property tax on privately owned electric utilities in Minnesota with a gross earnings tax. Distribute all gross earnings revenue back to local government.

Research Data

Improve data-gathering procedures by state administrative agencies to assist in tax research.
I. The Problem

A. Summary—We have reviewed in detail the implications of the extreme reliance of local governments in the Twin Cities area on the property tax base and the fragmentation of this base among the 130 municipalities and townships overlaid by 49 school districts in the area.

We have found that local governments, logically, are taking actions on an individual basis calculated to improve their own tax base. Each of these actions, looked at in the context of the property tax system as it affects local government, is entirely defensible. A city council or a village council wants to do all it can to hold down local property taxes. But, in the aggregate, many of these actions by local governments are having very serious effects on the development of the Twin Cities area. Furthermore, because of geographical and transportation factors beyond the control of local governments, some localities will naturally have a strong property tax base and others, a weak base.

A locality with a strong property tax base is able to provide a higher level of service, at lower cost to its residents, than a locality with a weak base, because of the extent of the reliance on the property tax for local government.

As urban growth in the Twin Cities area has accelerated since World War II, the area has become increasingly a single business and industrial community, a single labor market. But the exact opposite has occurred in the local government sector. The fragmentation of the tax base has produced strong barriers between communities and incentives to keep the barriers rather than tear them down. Present trends indicate this fragmentation will continue and probably become greater.

B. Actions which are calculated to benefit the tax base of specific local governments, but work against the benefit of the entire area—Local governments in the Twin Cities area are engaged in "winner-take-all" competition for property tax base. Such a response is predictable. Local governments have a first obligation to their own taxpayers, even though this may produce results not beneficial to the entire metropolitan area. If one locality is fortunate enough to have a valuable industrial park within its borders, it receives all the tax benefit. Or if one locality is unfortunate enough to have the type of property tax base which produces an excessive requirement for services, it is stuck with the bill. Following are specific examples of actions which local governments are taking to improve their own tax base but which work against the benefit to the entire metropolitan area:

1. Resistance to metropolitan parks—Outlying counties in the Twin Cities area, anxious to preserve their property tax base, have been reluctant to allow large tracts of land to be used for metropolitan or state parks. Carver and Scott Counties obtained special legislation designed to keep the Hennepin County Park Reserve District from buying land in their counties without County Board approval. This was done explicitly for tax purposes after the Park Reserve District had purchased 2,700 acres in Carver County for a park. A proposal for a 15,000 acre state park on both sides of the Minnesota River in Carver and Scott Counties has been opposed by some residents of those counties because of possible
loss of tax base. Such opposition interferes with the urgent need to set aside large tracts of land for metropolitan parks in the Twin Cities area. Metropolitan parks benefit citizens of the entire area, but local tax considerations make it difficult for this benefit to be realized.

Some ten years ago the land along the south shore of the Minnesota River between the Mendota Bridge and Interstate 35W was in its natural state. But pressures for development, combined with the prospect of better tax base for the communities along the river, prevailed, and extensive industrial and residential development dots the landscape.

2. Allowing development on unsuitable land--Because of pressure to make as much land in a community available for development as possible—and thereby increase the tax base—many communities allow land to be built upon which, for the benefit of the metropolitan area as a whole, should remain open. Perhaps the most glaring example is the construction which localities have permitted in the flood plain of rivers and streams. Construction in the flood plain prompts the call for flood walls to protect the area from flooding. If this happens, it merely increases the prospects for heavier flooding upstream in some other locality. Very little zoning to protect flood plains has taken place in the metropolitan area.

Communities also allow swamps to be filled in so that development can take place. Little do they recognize that the action may help the local tax base but at the same time it eliminates a water storage area which otherwise might have helped prevent a flood in some other community.

Little, if any, incentive exists for a community to keep land along lakes and streams open for public recreation or esthetic purposes. The prospect of increasing the tax base is too strong.

Certain parts of the metropolitan area are identified as ground water recharge areas. If they are not kept in an open state, the supply of ground water available to the metropolitan area in the long run may be depleted. A locality interested only in improving its local tax base would have no incentive to keep an area open for the rest of the metropolitan area since it receives no benefit from tax base located elsewhere.

3. Resistance to annexation or merger--Discussions of annexation or mergers of small communities and townships in the Twin Cities area frequently break down and merger or annexation referendums are defeated because a township or municipality with a favored property tax position is unwilling to join with a community with a poorer tax base—despite arguments for a larger sized community to effectively provide local government services.

For example, Rosemount township successfully defeated a proposal in 1968 which would have merged Rosemount township, Rosemount village and Lebanon township. Rosemount township has a rich industrial tax base which it did not want to
share. Real or imagined tax impact was a major factor in defeat of referendums early in 1969 to enlarge some Scott County communities. Only a very few merger proposals succeed. One which did was between Edina and Morningside.

4. Interference with sensible freeway construction--State highway engineers, very anxious to build workable, safe freeways, occasionally find their goals must be compromised because they have to obtain approval from local governments interested in expanding their tax base. Local governments will insist on more interchanges than should be built, thereby raising the construction cost of the freeways, producing safety hazards because interchanges are too close together, and increasing the prospect of overloading the freeways because there are too many points of entry. Spacing standards are set very high but are compromised so frequently that it can be said the metropolitan area has almost no freeway which meets the spacing standards of the State Highway Department. There are repeated attempts to get additional interchanges on freeways which are already opened. One now is under construction on Interstate 35W in Burnsville about 800 feet south of the Highway 13 cloverleaf.

Again, local governments cannot be blamed for wanting good freeway access, because it is a very important factor in attracting tax base. Under the present system, attracting tax base is almost an overwhelming consideration.

5. Prohibition of lower-cost housing--Many Twin Cities area suburbs have enacted stiff residential building ordinances which have the effect of preventing large numbers of lower-income families from buying homes in their communities. This usually is accomplished by increasing the minimum square footage for a house, increasing the minimum lot size, and adding such requirements as a two-car garage for every home. Suburbs also impose tight controls on mobile homes. Whatever the purpose of these actions, they can effectively keep the school population from increasing faster than the assessed valuation.

Municipal administrators talk frequently about allowing only houses which "pay their own way". This means that the house should be of sufficient value so that the taxes are high enough to finance the extra burden of local government services the family imposes.

Such policies work directly against benefiting the entire metropolitan area, because the housing options for lower-income families are severely restricted -- more often than not to older homes in the central cities. The result is that very few communities, if any, are developing populations with a wide range of income levels. The higher-income families will be concentrated in some municipalities, and the lower-income families in others, with each community financing its own services from its own tax base. If higher local government expenditures are necessary in lower-income communities, the burden falls on those communities even though they have less ability to pay.

6. Encourages "leap-frog" development--The existing property tax system is a contributing factor to the problem of urban sprawl, which, in turn, increases the costs to the entire metropolitan area of good water and sewer service, good transportation facilities, and so forth. When a locality tightens its ordinances to prevent, say, large-scale housing developments, a developer will go further out where, for example, a rural township will not have tightened its ordinances yet. A view of the Twin Cities area from the air will reveal
7. Produces conflicts in central city planning—From only a property tax base standpoint, the model cities area of south Minneapolis might best be developed at densities higher than those now existing, which is a course recommended in some quarters. But this is running into direct conflict with the citizen planners in the area who want single-family dwellings and duplexes.

The newly adopted citywide low-income housing program authorized by the Minneapolis City Council was criticized by one alderman because of homes which would be taken off the tax rolls and rented to low-income families. The result would be an erosion of the tax base and increased property taxes, the alderman said. Also, many proposals for increasing low-rent housing would, given heavy dependence on the local property tax, require more property taxes to provide the services which the residents would need.

These examples show how the interests of preserving the local property tax base may work against other interests which might benefit the entire area more.

8. Encourages preferential tax treatment—Because of the extent of the reliance upon the local property tax base, local governments can negotiate with prospective industrial developers on the level of tax assessment. A community "desperate" for tax base could grant too much of a tax break to an industry, giving, in effect, a partial tax exemption to the industry.

9. Creates obstacles to metropolitan planning—The 1967 Legislature, in establishing the Metropolitan Council, instructed the Council to prepare a comprehensive development guide for the metropolitan area. The Legislature said the guide should consist of a compilation of policy statements, goals, standards, programs and maps prescribing guides for an orderly and economic development, public and private, of the metropolitan area. With each local unit of government so dependent upon the local property tax base for financing services, it is difficult to imagine how a metropolitan development guide could be implemented. A local government is not likely to go along with any part of a metropolitan development guide which does not serve its own best tax base interests. Nor is it likely that with the present tax system the Metropolitan Council would ever be given extensive powers to influence the growth of the seven-county area. Such actions would result in special benefits to some localities and losses to others.

C. Factors affecting distribution of the tax base essentially outside the control of each locality—Some localities in the Twin Cities metropolitan area, no matter how they play the property tax base game, will be losers or winners because of factors which they have no way to influence or control. These factors include the geographical makeup of the Twin Cities area, the layout of transportation facilities, the location of tax-exempt property, and the individual decisions by private developers as to where they would like to locate. It is simply impossible, because of such factors, to assure each local government an adequate share of the area's total tax base. Following are some of the most important factors determining the location of development over which a locality can exercise little or no influence:
1. **Terrain and soil characteristics**—A wide difference exists throughout the metropolitan area in the characteristics of the terrain and soils in various communities and, consequently, their suitability for different kinds of development. A report titled "Soils of the Twin Cities Metropolitan Area and Their Relation to Urban Development", published in February, 1966, by the Agricultural Extension Service, University of Minnesota, classifies the various types of soil in the metropolitan area. The report reveals that Dakota County has the area's largest and most favorable reserve of land for urban purposes—the land is level to gently sloping, with silty or loamy surfaces and with sandy or gravelly substratum. Anoka County, in addition to its sand plain highly prized by tract housing developers, has the area's largest amount of land which, because of poor drainage, is not suitable for development. Very few municipalities have a wide variety of soil characteristics. A community may be well suited for development or poorly suited.

2. **Location of waterways**—Three major rivers— the Mississippi, the Minnesota and the St. Croix—run through the metropolitan area. Certain communities will receive the tax benefit from industrial property which must be located near the rivers for using barges, for using the river water, or for other purposes. Other communities receive none of the tax benefit from such property.

3. **Location of rail lines**—The rail lines which serve the Twin Cities metropolitan area were laid out many years ago, before urbanization. A community which finds itself with a good rail line within its borders is in a position to receive industries which depend upon rail transportation and then to receive the total benefit of the property taxes on the industries.

4. **Location of freeways**—Good access is an important aspect of commercial and industrial location. Extensive development occurs along the near the metropolitan area freeways. Industrial park developers like Gerald Rauenhorst and large merchandisers like Dayton's consciously pick their locations near the major freeways. A local government in the Twin Cities area has little to say about whether a freeway will go through its borders, though it may well affect the exact location and number of interchanges. But if a local government has no freeways, it won't get the benefit from the commercial-industrial tax base that goes with them. That benefit goes exclusively to the communities which happen to have the freeways going through.

5. **Location of airports**—Access to Minneapolis-St. Paul International Airport has been a major factor in stimulating industrial development in the communities near the airport. These few communities are able to reap the benefit from a facility which serves the entire area.

Many Anoka County public officials, desperate for a stronger tax base, have welcomed the Metropolitan Airports Commission's plan for a new major airport at Ham Lake. The prospect for the tax base overshadowed other factors, such as noise or drainage problems.

6. **Location of transit lines**—Officials of the Metropolitan Transit Commission are in the preliminary stages of planning a major rapid transit network for the Twin Cities metropolitan area. Based on experience in other cities, it is likely that extensive development will occur along the rapid transit routes. Communities through which the transit lines happen to run will receive the property tax benefit from development that occurs near these lines.
7. **Limits of ICC freight zone**—Some developing suburbs in the Twin Cities area are at a disadvantage in attracting industry because they are outside the Twin City zone, as identified by the Interstate Commerce Commission, for freight rate purpose. Industries located outside this zone often must pay higher freight rates and encounter additional shipping time. A suburb cannot control the limits of the freight zone but must suffer the disadvantage of a weaker tax base if it is unable to attract industries.

8. **Location of tax-exempt property**—The location of large amounts of tax-exempt property—for example, government buildings or a college or university—has an impact on a community's overall property tax base, but the decisions on location of tax-exempt property are generally made outside the influence of a local government.

9. **Decisions of developers**—For a variety of reasons, including location of labor force, availability of utilities, amount of land and other factors, commercial and industrial developers choose one location over another in the Twin Cities area, with all the property tax benefit going to the locality which receives the development. Some locations are determined by the proximity to the residence of the president of the firm, for example. In effect, the community takes the tax base which it is given, due to forces over which it is not able to exercise influence.

**D. Current distribution of the property tax base in the metropolitan area**—

Major shifts in the property tax base of the Twin Cities area have occurred over the last two decades. As Minneapolis and St. Paul reached their borders and growth spilled over into the suburbs, communities with balanced tax bases have disappeared. Years ago people lived, worked and shopped within the borders of the same municipality and school district. Now a person may live in a community with no shopping center. Consequently he shops at stores in other communities. His purchases help these stores pay taxes to support services in these other communities but not his own. He also may work outside his community, with taxes from his place of employment supporting services in a community other than his own. In summary, there is practically no community which can be characterized as being truly balanced, with the same proportion of wealthy, middle-income and low-income families and the same mix of residential, commercial and industrial property as is characteristic of the entire metropolitan area. Specifically, here are the facts related to the current distribution of the tax base:

1. **Assessed valuation differences**—Among the 70 municipalities with population in excess of 2,500 in the seven-county area, the community with the highest assessed valuation per capita has five times that of the lowest. To raise the same amount of property tax revenue per capita the property tax rate in the locality with the lowest assessed valuation per capita would have to be five times as great as the rate required in the locality with the highest assessed valuation per capita. State aid to school districts compensates for much of these differences. But state aid is not sufficient to offset the advantage of one school district over another because of a bigger tax base.

2. **Estimated property taxes on comparable property**—The property tax burden falls unevenly on comparable property from community to community in the metropolitan area. Total mill rates among communities over 2,500 population for 1969 range from a low of 239 mills in Eagan to a high of 416 mills in Chaska. Mill
rates do not tell the whole story because of different assessment practices. After adjusting as much as possible for different assessment practices, using 1967 sales ratios, the latest available, the estimated tax on a $20,000 house ranges from $297 in Shakopee to $593 in White Bear Lake.

The property tax base by itself does not determine the wealth of a community nor is it necessarily distributed in accordance with the public service needs of a community. Communities such as Minneapolis and St. Paul are among the higher communities in assessed valuation per capita, but their family income levels are low. A report published by the Federal Housing Administration in October, 1967, estimated that 34 per cent of Minneapolis families had incomes of less than $6,000 (after federal income taxes) compared with 17 per cent in the rest of Hennepin County. Figures for St. Paul were 30 per cent and for the remainder of Ramsey County, 18 per cent. Among suburbs there are wide differences in income levels, with the highest-income families clustered in a few communities. It is not unusual for some suburbs to be "double winners", having both a high assessed value per capita and a high family income level, and for other suburbs to be "double losers", having a low assessed value per capita and a low family income level.

Further, the distribution of the property tax base bears little relationship to the difference in public service requirements. Some of the wealthiest communities have some of the lowest needs for public services. For example, a tiny wealthy suburb levies a mere 4 mills for municipal services compared with levies in the vicinity of 100 mills in the central cities. Per capita expenditures for fire and police departments are much higher in the central cities than in suburbs. Children from AFDC families make up 10 per cent of the school enrollment in the central cities and only 2 per cent in the suburbs. There is a recognized need to spend more per child in school districts with a high percentage of disadvantaged students. But as a matter of fact the highest per-child expenditures turn up in the school districts with the greatest wealth. This is a situation in which the resources are inversely proportional to needs.

E. Outlook for the future--Additional property tax base in the metropolitan area will not be distributed evenly, whether according to population or any measure of need, among the local governments of the area. According to the developers of the largest commercial and industrial complexes, the trend is clearly in the direction of larger and fewer shopping centers and industrial parks. One major developer of industrial parks in the southern part of the Twin Cities area predicts that virtually all new industrial development in the next decade will take place in pre-planned industrial parks. A corporate planner with one of the area's largest merchandisers believes that we will see fewer small commercial centers. Instead, development will cluster around the branches of the major department stores.

The results of concentration of the growth in the tax base in a few communities are clear. A few localities will share the bulk of the growth in the base. Residents of other localities will support this base with their purchases and their employment but will not receive commensurate benefit.

It is unlikely that substantial amounts of the additional property tax base will be located in communities which today have low tax base. It is more likely that the communities which are well off today will further strengthen their positions.

The need for local governments to continue restrictive development policies is likely to continue and probably accentuate, even though these policies will have an adverse effect on the entire area.
The long-term forecast can be nothing more than the further concentration of the area's resources in some communities, effectively separated from other communities.

II. General Conclusions

An attack on the problems outlined above is urgently needed. Consequences of doing nothing would be too great to tolerate. Specifically, we conclude as follows:

A. We must change the situation which encourages local governments to act directly contrary to the best interests of the entire area and holds out financial reward (a richer tax base) for doing so. A community which successfully resists a large metropolitan park receives a "bonus" by not losing any of its tax base. But a community which may choose to set aside some large tracts of open space for the benefit of the entire metropolitan area could receive a "penalty" of losing some of its tax base. Or a community which prohibits low-cost housing because it doesn't bring in enough tax base will receive a "bonus" by continuing to maintain an advantageous tax position. But a community which accepts the responsibility for low-cost housing must at the same time assume the "penalty" of a weaker tax base. Communities cannot be blamed for working for bonuses rather than penalties under the present rules of the game. But this metropolitan area needs to find a way whereby each community, acting in its own best interests, acts also in the best interests of the entire metropolitan area.

B. We must change the situation whereby the ability of a local government to obtain an adequate tax base to provide necessary public services is dependent upon the boundaries which divide the metropolitan area into 130 municipalities and townships and 49 school districts. The problem of boundaries did not really emerge until after World War II, when urban development started to spill over the city limits of Minneapolis and St. Paul. Boundaries have been drawn without regard to the likelihood of each local government having a self-sufficient tax base. If a community happens to be unfortunate enough to have a large amount of land suitable only for tract housing, then it gets only the tax base from such development. It is as if, in a metropolitan poker game, that community were dealt only low cards. It is inconceivable that, if we started over, we would allow any community to be a loser forever. Would we ever suggest making the 13 wards of Minneapolis fiscally independent, with each ward able to tap only the tax base within the ward boundaries to provide its services? Some wards, filled with low-income families and little industry, would always be losers.

C. Looking to the future we cannot let the current situation be aggravated further by the continued concentration of tax base in some communities at the expense of others. This is particularly critical because of the increasing trend toward larger and fewer shopping centers and industrial parks. Citizens of tax-poor localities will be working and shopping in tax-rich localities but receiving nothing in return to support their own local government services.

D. The critical need is to keep the existing differences in tax resources from becoming any greater in future years and gradually to reduce the magnitude of differences in fiscal capacity among local governments in the Twin Cities area. Immediate, radical shifts in existing tax resources of local governments are not necessary, and such shifts may not even be desirable, because of the disruption in the existing revenue and expenditure pattern of local governments which would result. The most important goal is to find a way for all local governments in the area to share as the tax base grows in future years in the metropolitan area.
E. We believe equal sharing of all growth in tax base is not desirable. It is important that a local government's overwhelming need to attract tax base within its own borders be reduced but by no means be eliminated. A local government needs to retain the willingness to accept commercial and industrial development and should receive appropriate financial benefit.

F. An attack on the local government fiscal problem as outlined here is intended to preserve local government in the Twin Cities area, as against some solution imposed from a higher level. This metropolitan area can demonstrate that the barriers to cooperation so characteristic of localities in other metropolitan areas throughout the nation can be broken here. These barriers in other areas have made certain urban problems almost insoluble, witness the urban unrest we have faced in recent years. The Twin Cities area has the resources. It has taken some major steps toward limited unification already, through the establishment of the Metropolitan Council. The challenge now is to replace the present incentives of local governments to do anything but cooperate with new incentives to cooperate.

III. Recommendations

A. We recommend that the State Legislature change the property tax system in the Twin Cities metropolitan area so that the entire area will share to some extent in the growth of the property tax base in years to come. We propose that the Legislature adopt a plan for sharing the growth of the property tax base which meets the following objectives:

1. Prime emphasis must be on keeping existing differences from becoming any greater and assuring that the differences will be reduced as the area grows.

2. The incentives of city and village councils to attract commercial and industrial development should be reduced but not be eliminated. If that happened, the present situation could be totally reversed, with no one wanting commercial-industrial development.

3. Local governments should continue to determine their own budgets, to be able to calculate the property tax impact on their homeowners, and to be responsible to local voters for their decisions.

B. After reviewing several alternatives for sharing the growth of the tax base, we recommend the following plan:

1. Let all increases in residential valuation (total valuation of homesteads plus rental housing, including apartments) continue to go exclusively to the units of government where located.

2. Beginning after the base year, divide the increases occurring year by year in the non-residential valuations...allocating one-half of such increases to the local base of the unit where the property is physically located and allocating the other half to a new areawide base.

3. Distribute the dollars of valuation in this areawide base, year by year, among the local units in the entire area, probably according to population.
4. Each local unit, in arriving at its total tax base, would add together the dollars of valuation in its local base and in its share of the areawide base. The total represents the base against which the locality can levy taxes and borrow.

5. Each local unit would determine its own expenditure level and determine its own revenue requirements, as at present. Knowing the size of the total base, local officials can estimate the approximate millage impact on their own residents of any proposed spending level.

6. Each local unit, as now, would certify to the county auditor the total of dollars it will require for the succeeding year. The auditor will then officially calculate the mill rate needed to raise the revenue required.

The proposal can be illustrated by use of a hypothetical example, using two communities.

First, here is the situation in the first year, assuming no sharing of the areawide base:

<table>
<thead>
<tr>
<th>Community A</th>
<th>Community B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population: 9,000</td>
<td>Population: 4,500</td>
</tr>
<tr>
<td>Assessed Valuation: $4,500,000</td>
<td>Assessed Valuation: $4,500,000</td>
</tr>
<tr>
<td>Ass'd. Val./Capita: $500</td>
<td>Ass'd. Val./Capita: $1,000</td>
</tr>
</tbody>
</table>

Second, here is the situation in the following year, again assuming no sharing of the areawide base:

<table>
<thead>
<tr>
<th>Community A</th>
<th>Community B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population: 10,000</td>
<td>Population: 5,000</td>
</tr>
<tr>
<td>Old Ass'd. Val.: $4,500,000</td>
<td>Old Ass'd. Val.: $4,500,000</td>
</tr>
<tr>
<td>New Residential Val.: $250,000</td>
<td>New Residential Val.: $250,000</td>
</tr>
<tr>
<td>New Non-Residential Val.: None</td>
<td>New Non-Residential Val.: $1,000,000</td>
</tr>
<tr>
<td>Total Ass'd. Val.: $4,750,000</td>
<td>Total Ass'd. Val.: $5,750,000</td>
</tr>
<tr>
<td>Ass'd. Val./Capita: $475</td>
<td>Ass'd. Val./Capita: $1,150</td>
</tr>
</tbody>
</table>

The above examples show that, without sharing the base, the assessed valuation per capita decreased in Community A and increased in Community B, thereby widening the differences.

Third, here is the situation in the following year, but this time with the tax base sharing plan in effect.
### Second Year, With Sharing

<table>
<thead>
<tr>
<th>Community A</th>
<th>Community B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population: 10,000</td>
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<tr>
<td>Old Assd. Val.: $4,500,000</td>
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</tr>
<tr>
<td>New Res. Val.: 250,000</td>
<td>New Res. Val.: 250,000</td>
</tr>
<tr>
<td>50% of New Non-Res. Val.: None</td>
<td>50% of New Non-Res. Val.: None</td>
</tr>
<tr>
<td>Local Val.: $4,750,000</td>
<td>Local Val.: $5,250,000</td>
</tr>
</tbody>
</table>

#### Areawide Base

<table>
<thead>
<tr>
<th>Community A Contribution: None</th>
<th>Community B Contribution: $500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Areawide Base: $500,000</td>
<td></td>
</tr>
</tbody>
</table>

**Allocation of Areawide Base on Population Basis:**

$333,333.00 To Community A  
$166,666.66 To Community B

<table>
<thead>
<tr>
<th>Total Val.: $5,083,333</th>
<th>Total Val.: $5,416,666</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assd. Val./Capita: $508</td>
<td>Assd. Val./Capita: $1,083</td>
</tr>
</tbody>
</table>

This reveals that the assessed valuation per capita in Community A, instead of continuing to decrease, increases, and the assessed valuation per capita in Community B, while increasing, does not increase as much as otherwise.

C. The Citizens League has strongly urged in previous reports that administration of property tax assessment be improved so that differences in assessment levels from locality to locality will be minimized. Our proposal for partial sharing of the growth in the property tax base in the metropolitan area underlines the need for further improvement in property tax administration.

### IV. Questions About the Recommendations for Sharing the Growth of the Tax Base

Undoubtedly there are many questions about this proposal, because it is somewhat of a departure from previous ideas for local government. Following are some of the more common questions and the answers:

A. Can this plan apply to all taxing units--school districts, municipalities, townships, counties, etc.?—Yes. When the shared portion of the tax base is allocated to each locality, it can be distributed among the different taxing units within the locality in the same proportion as the valuation of each taxing unit in the locality bears to the total valuation of the locality.
This plan has the advantage, by one single allocation, of distributing the growth in the tax base equitably among all units of government. It will not be necessary to have a separate distribution formula for each taxing unit or to restrict the distribution of the areawide base to one taxing unit.

B. Why use simply population as the basis for distributing the growth?--It must be kept in mind that the goal is to spread a portion of the benefit of the growth in the base throughout the metropolitan area. Using population is the simplest, most direct approach to accomplish this goal. Growth will go where the people are. The goals of this distribution plan must be distinguished from other goals which might exist for distributing revenue from some tax among local units of government with different public service needs. Such a plan might well require a more sophisticated formula incorporating need and ability to pay, not just population.

C. Who would determine population?--The Metropolitan Council's annual estimates of population by municipality in the Twin Cities area would be adequate. The Council's estimates are based on extensive analysis of growth in each community. The 1965 official census for some communities in the metropolitan area proved to be very close to the estimates which the Metropolitan Council had prepared for these same communities. It is not necessary to wait for a 10-year or 5-year census. Current population estimates may, in fact, be more accurate than official census counts.

D. What do we mean by sharing one-half of the growth in the non-residential valuation?--This would apply to the valuation which is not residential. The valuation of residential property would continue to be taxed exclusively where the property is physically located. The net growth in non-residential valuation in each locality over the base year would be calculated. One-half of this growth would be shared areawide. The other one-half would continue to be taxed exclusively where the property is physically located.

E. How will we calculate property taxes on individual pieces of property?--Property taxes on residential property would be calculated as they are now. The mill rate would be determined based on the assessed valuation which is allocated to the locality. Then this mill rate would be applied directly against the valuation of residential property.

A slightly different approach would be required for the non-residential property. Each piece of non-residential valuation would be split in two parts, its local base (to which the local mill rate is applied) and its areawide base (to which the areawide mill rate is applied). The percentage of each piece of property which is placed in the areawide base will be the same percentage as the total areawide base contributed by the locality bears to the total non-residential valuation in the locality.
The areawide mill rate will be applied uniformly throughout the metropolitan area to all valuation which is shared. That uniform mill rate will be calculated automatically as a result of the individual mill rates which are set by each unit of government. It is not unusual in Minnesota property tax experience to have two mill rates applied to different parts of the same piece of property. Until just a few years ago, there were two mill rates applied to most homesteaded property. A lower mill rate was applied to that portion of the homesteaded property which qualified for the homestead exemption, and then a higher mill rate applied to the balance, if any.

F. How would this affect local government spending patterns?--It must be kept in mind that each local governing unit when it establishes its spending level will know the mill rate, as it does now, which will be applied against its residential property. The governing unit will also know at this time the mill rate which will be imposed against most of the valuation of its non-residential property. The only thing it will not know when it establishes the budget is the uniform areawide mill rate on the shared base. Under this approach the unit of government will be unable to tap the areawide base to finance its expenditures without imposing the same level of taxation against its own residential property. Its residents will know what level of taxation they will be paying and will be able to exert influence over their policy-makers accordingly. It will not be possible for a local government to have a "blank check" to tax the areawide base, because it will have to impose the same level of taxation against its own residential property.

G. Does this plan go far enough?--The impact which this approach will have on local units of government cannot be known for sure. But any unit of government which decides to take an action which might result in less tax base being physically located within its borders will know that it still will get some benefit, wherever that tax base is located within the metropolitan area. The benefit will not be as great as if the property had been physically located there, but at the same time the locality will not lose out 100 per cent.

Every citizen of the metropolitan area will be able to point to new commercial buildings and new industrial buildings, wherever they are located in the metropolitan area, and know that the new construction is benefiting him.

H. What will happen to incentives to attract commercial-industrial property?--It is not our intent to remove additional benefit to an individual locality which accepts commercial and industrial development. In the first place, such development will require additional public services. But secondly, and perhaps more important, it is not our intent to remove incentives for such development. It is most important that some of the incentives remain. If all incentives were removed, then we would find the reverse situation setting in. No one would want commercial-industrial development. We have attempted to strike a balance between giving the area a share of the entire growth and giving each local government which receives the growth within its boundaries something extra. No longer will the property tax game be "winner take all".
Under our proposal, communities which allow development which brings in substantial amounts of population, such as medium and low-income housing, will not be penalized with excessive pressure on the local tax base. The reason is simply that the more people who move into the community, the more tax base the community will receive as its share of the areawide base.

I. Wouldn't this proposal subsidize wealthy, all-residential communities? -- There are a few small suburbs with only expensive homes. Under our proposal, these localities would have allocated to them additional commercial-industrial valuation as their share of the areawide base. But even though this might have the effect of reducing a municipal rate in that locality, such wealthy suburbs are located in large school districts which cover areas with people of a broad income distribution. The real impact from the allocation of the additional commercial-industrial valuation to the wealthy suburb will be the addition to the entire school district rather than to the individual municipality.

J. Won't this proposal work at the disadvantage of newly-emerging suburbs? -- It can be claimed that sharing the growth of the base would mean that newly emerging suburbs would not get the full amount of the growth they had expected. Instead some of the growth would be given to communities which already are built up. But there is little guarantee that newly emerging suburbs will receive strong tax base. In many cases, residential development precedes commercial and industrial growth. Second, in the long run there is no "built-up" community in the metropolitan area. There will be a continual process of building and rebuilding the area in years to come.

One more point...without a sharing of the growth of the tax base of this area, some localities will gain at the expense of others. To the extent that there is a winner, there will be also a loser. It is our concept that for the benefit of the entire metropolitan area we should all be winners.

K. How will this affect state aid to school districts? -- Currently, the amount of state aid a school district receives is related to its assessed valuation. This will continue under our proposal. A school district's assessed valuation for school aid purposes will be the valuation assigned to it as a result of the sharing. It may be more or less than the valuation of the property physically located in the school district.
V. Additional Approaches to the Problem

Some observers of the metropolitan fiscal problem contend that sharing the tax base of the metropolitan area really means treating the symptom rather than the cause of the problem. They suggest that the basic problem is that we have too many local governments and that not enough functions are handled at the metropolitan level.

We reviewed a possible recommendation to shift local functions which impose heavy burdens on the local tax base to the metropolitan level to be administered by a metropolitan authority or authorities, financed by a metropolitan tax. This approach would automatically reduce the importance of differences in tax base among local governments because their revenue requirements would no longer be as high. In addition, this approach might include recommendations for legislation to restrict local governments from taking actions which, while calculated to benefit the local tax base, would work against the benefit of the entire metropolitan area. If it were possible to move a sufficient number of expensive local functions to the metropolitan level and to pass strong legislation to bar localities from actions which work against the benefit of the area, then this alternative could work.

Our proposal for sharing the growth of the tax base does not rule out the desirability of public incentives to increase the size of municipal units or of deliberate efforts to refrain from subsidizing small, inefficient units of government. Our proposal, however, accepts the local government system essentially as it is in the Twin Cities area. It assumes that municipalities and school districts will continue to have fairly substantial responsibilities. It does not assume that no more functions will be moved to the metropolitan level (which may be desirable in some cases and which will help solve the local government fiscal problem) nor that the Legislature will not pass some laws against arbitrary zoning actions. But it does assume that these localities will continue to exercise a considerable degree of autonomy.
NON-PROPERTY FUNDS FOR LOCAL GOVERNMENT

I. The Need for Additional Non-Property Revenue

A. The unresponsiveness of the property tax -- The property tax is the basic source of revenue for financing local government. The base of the property tax does not respond to growth of the economy as quickly as sales and income taxes -- the principal non-property taxes. During the 11-year period from 1955 to 1965, property tax collections in the Twin Cities metropolitan area rose an average annual rate of 9.7 per cent. At constant millage rates, the revenue collected from property taxes during this period would have risen at an average annual rate of 4.4 per cent. The other 5.3 per cent had to be made up by millage increases ... increases in the rate of property taxation. The continuing, often abrupt, increases in mill rates in the metropolitan area reveal that the property tax base is not growing fast enough as requirements for services increase. There is no indication that this problem is leveling off. The problem is even more serious for some local governments in the metropolitan area. The fragmentation of the property tax base among many local governments produces a situation where the responsiveness of the growth in the tax base for some local governments is far less than the overall average for the property tax. During the past year some localities experienced record millage increases.

On a national basis the whole picture of revenue needs and tax-raising ability is very hopeful. The federal income tax is the most responsive to growth in the economy. Corporate and individual federal income tax receipts are increasing at a rate of $10 billion a year simply because of growth of the economy. With the exception of the demands of the Vietnam War it appears that revenue at the federal level will far exceed the need. At the state government level it appears that generally the rate of growth in revenue from state taxes will be sufficient to meet needs, but without any likely surplus. At the local government level, however, growth in revenue from the property tax, as noted above, lags far behind the growth in the economy and the demand for local government services. Because of the revenue-raising capability of the federal government there is continuing discussion at the federal, state and local levels of direct federal revenue-sharing with the states and local governments.

B. Defects of the property tax -- Whether a dollar in local government revenue is raised from the property tax or any other type of tax doesn't really concern the local government, so long as it gets the dollars. However, there are some particular problems with the property tax. These problems can be categorized as follows:

1. Administration -- There has always been the very difficult problem of valuing property equitably within a taxing district and between taxing districts. This results in the improper distribution of the total tax burden. Assessment practices in the state have not been good in the past, though much action has been taken to improve the situation. The evidence would indicate, however, that major differences continue to persist. It may be the inherent difficulty of valuing property that will make these differences continue, though they can be reduced rather than allowed to increase.
2. **Distribution of the tax burden**—Of the three major types of taxes—income, sales and property—the property tax is least directly related to ability to pay. The 1967 Mayor’s Tax Study pointed out that at the lower income levels up to 10 per cent of income goes to pay property taxes. If the dollars of property taxes can be kept stable by using the other taxes for increased governmental costs, the disparity between the property tax burden and the low income property owner's ability to pay will become progressively less meaningful.

3. **Deterrent to improving property**—Because improvements added to property very frequently result in increased property taxes, property owners can be somewhat deterred from making improvements. This can be a very special problem where a property owner may be reluctant to repair a dilapidated dwelling. On the other hand, if property owners are granted a tax deferment as encouragement to improve property, a local government is denied access to an urgently needed larger tax base.

4. **Tax exemptions and favorable classifications**—Because of classifications of certain types of property, some property owners are exempted from paying taxes altogether, while others pay at a lower effective rate, meaning that the services necessary to support these owners must be provided by funds raised on the other properties. The problem of tax-exempt property in the state is increasing very fast.

5. **Lack of relationship to needs for public services**—The property tax base used to bear a fairly close relationship to the needs for public services, since public services were very frequently mainly related to property. But such is no longer the case. The increase in the cost of local government in modern times is attributable to the offering of services more related to people than to property.

C. **Existing non-property revenue not sufficient**—One-fourth of the receipts from the present 3 per cent sales tax is earmarked for municipalities and school districts. As sales tax revenue increases, local governments will automatically receive additional funds, without the requirement for another act of the Legislature. The revenue, therefore, is not state aid, but really is a new source, with built-in growth. The 1967 Legislature moved in the right direction to give local governments a non-property revenue source. But the dollars directly available to local governments are not sufficient to do the job in the face of rapidly increasing property taxes. About $38 million were distributed in 1968 to school districts, municipalities, and townships, which is less than 10 per cent of the $500 million in property taxes collected in that year for school districts, municipalities, and townships.

A substantial portion of the balance of the sales tax receipts, plus some additional state funds in the Property Tax Relief Fund, goes to local government, but it is in the form of replacement of dollars for property tax relief granted principally to homeowners and business and farm property owners. Consequently, it is not available as additional non-property revenue for local government. It has had the effect, however, of blunting increases in property taxes, which otherwise would have been much greater.

D. **Meeting special local government service needs**—We were made acutely aware of the need to improve substantially the level of government services in certain parts of the Twin Cities area. Meeting the problems of educating the disadvantaged
cannot be done by allocating the same number of dollars as for middle-class youngsters. If such services are to be adequately financed, it is totally unrealistic to expect the bill to be paid only from the local property tax. None of the existing state aids is distributed to finance these types of special local government service needs.

In summary, we believe all local governments will be needing additional non-property revenue to ease, and hopefully stop, continued increases in property tax rates. But it is urgent that some non-property funds be made available now to finance special local services in communities facing critical urban problems.

II. Level of Government To Collect Non-Property Revenue

The approach to the question of what level of government should impose local non-property taxes is very closely related to the problem of differences in fiscal capacity among units of government as outlined in the first part of this report. We believe that the first question which must be faced is at what level--state, metropolitan, county or municipal--the tax is to be collected and then distributed to local government. This question must be answered before other questions, such as how much non-property revenue is needed, what source should be used and what governments should share.

The question of what level of government should impose the tax has become increasingly important in recent months. We are aware of discussions in the State Legislature for some form of "local option" non-property taxes. The concept of a local option tax is to let local governing boards, not the State Legislature, decide whether to impose a new or additional non-property tax for local government purposes. Under this approach the Legislature would pass appropriate legislation to allow local governments to impose non-property taxes if they desired and then to be responsible to their own electorate for the action. Under this approach, state legislators would not have to "take the heat" for imposing non-property taxes which are requested by local governments.

We do not know at this time how seriously the question of local option taxes will be considered by the Legislature, but we have some concerns about an appropriate definition of "local" in the seven-county Twin Cities metropolitan area. These concerns are as follows:

A. Likelihood of accentuating problems of differences in fiscal capacity--As we pointed out with the property tax, very serious problems result in a metropolitan area when all taxes raised within the borders of a single local government remain there. Can we imagine, for example, Brooklyn Center receiving all the revenue from a piggy-back sales tax at the Brookdale Shopping Center? Or Edina receiving all the revenue from a similar tax at Southdale? Or Roseville from Rosedale, or Minnetonka from the soon-to-be-built 12 Oaks? Such local taxes merely would aggravate all the problems which have occurred in the Twin Cities area because of the fragmentation of the property tax base.

B. Difficulty in distributing revenue to different types of local government--With a local option tax it is not clear whether the revenue would be exclusively for the unit of government which levies the tax, say, local municipal governments. If local municipal governments were authorized to impose piggy-back sales taxes, it...
would be extremely difficult—even if the municipal governments wanted to—-to dis-
tribute revenue to other units of government, such as school districts, because of
the difference in borders. If, for example, the village of Minnetonka were to im-
pose a sales tax, how could it allocate school funds among the three school dis-
tricts into which it is divided? Only in Minneapolis and St. Paul are school dis-
trict and municipal borders coterminous.

C. Inability of a metropolitan area municipal government to act independently--
In effect, there could be no true local option tax in the Twin Cities area, that
is, a tax which some localities would choose to adopt and others would not. It
would be almost impossible in the metropolitan area for a local government to enact
a local non-property tax without affecting its neighbors or being affected by them.
If a number of local governments in the area impose a tax it is unlikely that others
could choose to refrain from following suit, because they would find themselves pay-
ing taxes to other governments but not collecting any themselves.

Because of these factors we cannot accept a definition of "local"—for
collection and distribution of non-property revenue—which is anything less than
the entire seven counties in the Twin Cities area.

III. Distribution of Non-Property Revenue

We did not review in detail the specific questions which need to be answered
in distributing non-property revenue to local government. They relate to the rela-
tive needs and ability to pay of different localities as well as the relative needs
and ability to pay of different types of local government. But we believe these
questions are of such importance that they must be directly faced by the Legisla-
ture as decisions are reached on non-property revenue for local government. Fol-
lowing are some of the most important questions:

A. Allocation among different types of local government--Municipalities,
school districts and counties all have a legitimate claim, though perhaps not
equally, to a non-property source of revenue. In addition, the question must be
faced in the Twin Cities area whether the Metropolitan Council also should be con-
sidered. Non-property revenue could be earmarked exclusively to one type of local
government, leaving the property tax for the others. Or all local governments
could share.

B. Distribution to each specific unit of government--For each municipality,
school district and county to share in the revenue, a distribution plan must be
worked out. If the distribution is based on "need" for non-property revenue, then
it is important that a definition of what constitutes "need" be determined. If
distribution is to be based also on ability to pay, then definitions must be worked
out as to how ability to pay is to be calculated. The relative weight to be given
to need and ability to pay must be agreed upon.

C. Relationship of distribution to local effort--A recurring question in the
debate over non-property revenue for local government in the Twin Cities area is
whether some communities, because of special property tax limitations, are failing
to exert sufficient "local effort" now. If they are not doing their share, then,
some persons claim, they should not receive a full portion of non-property revenue. It is important that the Legislature determine whether some school districts and municipalities should continue to have different property tax limitations from others.

D. Relationship of distribution to size of local community—If too much non-property funds are channeled into small localities, the question can arise whether the distribution plan has the effect of subsidizing inefficiency. The Legislature needs to decide whether all communities, regardless of size, should share equally in non-property revenue.

The complexity of the above questions indicates clearly to us that the Legislature needs to arrange for the appropriate study to resolve these issues.

IV. Recommendations

A. The Legislature urgently needs to provide a way for local government to obtain a new non-property source of revenue.

B. If the Legislature authorizes "local option" non-property taxes throughout the state, it should recognize the particular problems in the Twin Cities area and treat the area with a single policy to the greatest extent possible. It needs to provide a way for the entire metropolitan area to decide whether to levy non-property taxes. It is logical that the decision be given to the appropriate local government with jurisdiction over the entire area—the Metropolitan Council. This would require that the Legislature take the necessary steps to make the Metropolitan Council responsible to the electorate for its decision, that is, making the Council elective by popular vote of the people. An alternative way for the area to decide would be to provide that a non-property tax would go into effect over the entire area if the governing boards of municipalities with a sufficient majority of the population of the area passed resolutions requesting the tax.

C. If the Legislature accepts the importance of treating the metropolitan area with a single policy, but does not provide the means whereby the area itself can decide on whether to enact a "local option" non-property tax, then the Legislature itself should make the decision for the metropolitan area.

D. The distribution formula for an area-wide non-property tax should recognize the differing public service needs from locality to locality and the differences in fiscal ability. We do not believe that a straight per capita distribution plan is sufficient because such a plan does not take account of enough different factors. The distribution formula suggested by the Metropolitan Section of the League of Minnesota Municipalities moves in the direction we would like to go. That formula proposes that a local government's need for funds and its ability to pay be taken into consideration. According to the proposal, "need" from a school district standpoint would be a pupil unit figure weighted according to the number of students with special educational requirements. "Need" for other local governments would be tax levy per capita. "Ability to pay" for school districts and other local governments would be a combination of assessed value per capita and personal income per capita.

We believe the distribution formula for local governments in the Twin Cities area should be determined by the Legislature, with a provision that the formula can be changed if the area itself wants to change the formula. This could be accomplished by empowering the Metropolitan Council to change the formula, if it becomes elective, or allowing school districts with 80 per cent of the school enrollment
to change the distribution formula for school districts and municipalities with 80 per cent of the population to change the formula for municipalities.

E. We have indicated in detail why it is not desirable in the Twin Cities area for individual municipalities to levy their own non-property taxes. Such action would serve to compound all the problems we have found with the fragmentation of the property tax base. Only if the Legislature consciously rejects giving the entire metropolitan area the option to impose a non-property tax for local government or consciously rejects making the decision for the metropolitan area itself, should local governments within the area impose non-property taxes by themselves.

F. The Legislature should treat municipalities and school districts equally to the extent that any fixed dollar per capita or millage limitations are imposed on them. Restrictive limits in some communities which deny them as much access to the property tax as in others must be changed.

G. Aside from the question of a new non-property source of revenue, the 1969 Legislature should recognize the needs for higher levels of certain public services in some communities. Specifically, we recommend a modification in state aid to school districts to provide special aids for programs designed for educating disadvantaged children. The Legislature should obtain cost figures from school districts with substantial enrollment of disadvantaged children as to the specific amounts of additional funds needed and the procedures for identifying the disadvantaged. The Legislature then can assess the magnitude of the needs and allocate funds accordingly.
BONDING

I. The Problem

Interest rates paid by municipalities and school districts when bonding for capital improvements vary widely in the metropolitan area. At a given point in time one local government may pay 1% or more in additional interest than another for the same amount of dollars and with the same maturity of the bonds. On a $1 million bond issue retired over 20 years a difference of 1% in the interest rate costs about $130,000. If the amount were $10 million in bonds over 20 years a difference of 1% in the interest rate would mean that one local unit of government would have to pay more than $1 million more in interest than the other unit of government.

Different localities pay different interest rates because, in the minds of the bond buyers, some are higher risks than others. National rating services give localities different credit ratings, based on many factors. Such factors as assessed valuation per capita, debt per capita, and the amount of commercial and industrial valuation are important in determining the relative risk in each locality. Generally, a community with a high assessed valuation per capita has a better bond rating than a community with a low assessed valuation per capita. The community with a low assessed valuation has what could be called a double liability. With low assessed valuation, higher mill rates are required to finance operating expenses. If the community also must pay higher interest in bonding, more dollars must go to pay interest. A school district, for example, with a low assessed valuation per capita is forced to put more dollars into interest payments which otherwise could go for educational services.

The State Legislature has recognized the difficulty which some school districts encounter because of unusually high capital building requirements. A school district which is bonded to 98 percent of its debt limit may apply to the state for a capital loan at 3½ percent interest to build and equip new schools approved by voters. The Legislature also allows school districts to apply for loans to meet debt service payments for school districts with a heavy debt problem. A debt service loan will be made if a school district's tax levy for debt service exceeds 5.5 mills on the actual market value (about 55 mills on the assessed valuation). The state loan program is intended to give assistance to those school districts which are bonded at a very high level. It is not intended to compensate, on a broad basis, for the different interest rates paid by school districts.

II. Alternative Solutions

A. Broaden the Eligibility for the Maximum Effort School Loan Fund--It would be possible to make school districts eligible for state loans at lower interest rates much earlier than the 98 percent level. If this were to occur the state would have to sell many more bonds than it now does. The question arises whether the State Legislature would be willing to do this. This act still would not substantially change the problem which now exists of one district being forced to spend more money on interest than another district.

B. Special Compensation--The state or the metropolitan area could provide a special fund which could be used to assist school districts which are forced to pay high interest. In effect, if a district is required to pay a higher rate of
interest the rest of the area would help it pay that amount. Thus no school district would be penalized by itself because of a lack of assessed valuation in having to spend more dollars on interest.

C. State or Metropolitan Guarantee of Bonds--This is a very frequently mentioned alternative by persons who are concerned about the difference in interest rates. We understand that a key requirement is that the bond holder be able to enforce an unlimited mill rate against property to pay off the bonds.

D. Take No Action--Some people have pointed out that even though the difference in interest payments does exist it is not serious enough to merit a change and that all we have to do is make sure that there are sufficient funds available for the distressed school districts which are bonded to their limit.

III. Our Proposal

The idea of the state giving help to school districts with unusually high bonding requirements moves in the direction we prefer. We suggest, however, that consideration be given to:

---Lowering the eligibility for assistance below the current figure of 98 per cent of the debt limit.

---Changing the method of assistance. Instead of having the state actually issue bonds and make loans to school districts in need of assistance, perhaps the state should guarantee the bonds, with the local school districts issuing them.
TAXATION OF ELECTRIC UTILITIES

I. The Problem

Under current Minnesota law, investor-owned electric utility plants are treated the same as any industrial plant for tax purposes, with the plants subject to property taxation only by the local units of government where the plants are located.

Electric plants are being built larger and larger at fewer and fewer locations, meaning that in future years the revenue from the property tax on these plants will be even more concentrated in a few local units of government.

Actually, the electric plant becomes more of a tax collector than a taxpayer. Users of electricity generated at the plant pay a rate which includes the property tax on the plant. The tax is then distributed to the locality where the plant is located. It must be acknowledged there is some indirect statewide benefit, even though property taxes are distributed only where the plant is located. That benefit results from the fact that less state aid will be given to the school district where the plant is located, because the valuation of the plant is counted as part of the wealth of the school district.

We have been informed that during the next 21 years approximately $3.3 billion worth of additional investment in generating capacity and transmission lines are planned by the electric utilities in Minnesota. Although the amount of investment at various locations is not known, plants now are being built with a generating capacity of one million kilowatts or more, which cost at least $200 million. It is understood that as much as $600 million will be invested at one site. That could be $60 million of assessed valuation at one site, about as much as the entire city of Bloomington has today. These sites generally will be located outside the population centers, meaning that the property tax revenue will serve only a small portion of the total population.

Furthermore, a substantial amount of the power used in Minnesota in the future will come from power plants outside the state which, of course, are not available for property taxation by the state. For example, major plans are under way for plants on the Nelson River in northern Manitoba to supply Minnesota with part of its electric power needs.

We were informed that as larger, more efficient power plants are built, many of the smaller plants in cities throughout the state will be retired from service. This means that many cities will lose a substantial amount of the property tax revenue they now receive from the electric utilities.
II. Alternative Solutions

A. Statewide Property Tax--It would be possible to levy a uniform property tax rate on electric utilities in the state and distribute the revenues back to local governments. This would eliminate the possibility of the tax haven, making the benefit from the taxation on electric utilities applicable statewide. A disadvantage of this approach is that it does not provide a way for the state to obtain tax revenue from power supplied by plants outside the state.

B. Substitute a Gross Earnings Tax--This alternative was first suggested to the 1967 Legislature by Rolland F. Hatfield, State Commissioner of Administration. It provides a way to spread the tax revenues throughout the state and also enables the state to tax the power supplied from sources outside the state.

III. Our Proposal

We believe the problem of the property tax on electric utilities urgently needs to be corrected. Electric utilities can be treated separately from other types of commercial-industrial property because of their uniqueness.

We recommend a statewide gross earnings tax be imposed on electric utilities to replace the property tax. We support the plan generally as suggested by Commissioner Hatfield in 1967.

We believe that all revenues from the gross earnings tax should be specifically earmarked for local government, and not be placed in the state general revenue fund, as was suggested in 1967. The 1967 proposal suggested a $15 per capita distribution to municipalities and a $7.50 distribution to townships, with the funds apportioned to each taxing unit in the municipalities and townships in proportion to each unit's share of the total property tax levies. We have no quarrel with this distribution formula, but believe that it is unwise to have a flat per capita grant provided for in the law. As revenues from the gross earnings tax increase in coming years it is very likely that the per capita figures will be much greater. Local units of government have very few "growth" sources of revenue. The state does not now share in the revenues from electric utilities, so there is no reason for the state to do so in the future.

We support a plan to assure local governments as much in revenue from the gross earnings tax as they now are receiving from the electric utilities, but we are not prepared to make this permanent. Perhaps the amount can gradually be phased out over a sufficient number of years to avoid an undue burden on the localities.

We believe a local government which receives an electric plant should receive something extra from the gross earnings tax, but not an amount as large as suggested in the 1967 bill, which would have been up to $500,000. Such is too great a bonus to a small locality in a rural part of Minnesota. It might be much better to provide extra funds according to the extra costs imposed on a local government because of the presence of the electric plant.
The background work on this report pointed up many instances where additional data is needed for better analysis of the tax system. The State Legislature has recognized the need in the past to collect certain information solely for the purpose of analysis, even though the data is not directly related to administration of a tax. For example, the adjusted market value of tax-exempt property is estimated, by different classifications, in each municipality every six years. The information is used only for analysis of the tax system. Without the information we would have no knowledge at all about the increasing amount of tax-exempt property.

Following are urgent data needs we found:

I. Classification of Property

The State Department of Taxation needs authority from the State Legislature to require county officials to certify the valuation of property by uniform classifications according to the use of the property. The valuations should be reported by municipality, but with a breakdown within each municipality of the valuations in each school district. Specifically, the Department of Taxation should be given the authority to require:

-- Total residential valuation (market value and assessed value) by taxing unit, with a breakdown between homestead and rental property. It is now impossible to determine the assessed valuation of residential property because all rental property is lumped in the same classification with commercial-industrial.

-- Total commercial and industrial valuation (market value and assessed value) by taxing unit.

-- Number of parcels of property in each classification requested by the Department of Taxation.

-- Distribution of housing values by taxing unit.

II. Income Data

The Department of Taxation, using federal and/or Minnesota income tax returns, should be required to compile and publish annually median family income by municipality, school district and county, plus the percentage of families at different income levels.

III. Reporting and Accounting of Property Tax Relief Fund Disbursements

The Legislature should require county auditors to report to the State Department of Taxation the exact dollar amount of distribution of each type of property tax relief under the 1967 Property Tax Relief and Reform Act to each municipality, school district, special district and county. This would include the following:

-- The exempt personal property replacement to each taxing unit.

-- The 35% homestead credit reimbursement to each taxing unit.
-- The per capita funds to each municipality and the per child aids to each school district under the act.

-- The special property tax credit for the aged and renters by municipality, including the number of claimants, average value of credit and associated income distribution status of claimant by municipality.

IV. Assessment Ratios

The Legislature should require the State Department of Taxation to undertake statewide appraisal and sampling to evaluate the relationship between market value and assessed value in various municipalities and to publish ratios based on these studies.

The Legislature should require the publication by the Department of Taxation of its sales ratios on commercial and industrial property and residential property which now are prepared by the Equalization Aid Review Committee.
BACKGROUND OF THE REPORT

The Citizens League has had a continuing interest in problems of local government finance in the Twin Cities area. In a number of reports over the years it has pointed out the urgent need to improve property tax assessment procedures. In 1967 the Citizens League published a major report on the need for non-property revenue for local government in the Twin Cities area. The Citizens League proposed a 3 per cent sales tax with two-thirds of its receipts to be dedicated to school districts and municipalities, equally. This recommendation was submitted to the 1967 Legislature at the time when the Legislature was in the midst of working out its tax reform package. The Legislature passed a 3 per cent sales tax with one-fourth of its receipts earmarked specifically as new non-property revenue for school districts and municipalities. The bulk of the other funds was earmarked for property tax relief for property owners.

As part of the 1967 study, the Citizens League became increasingly aware of the differences in fiscal capacity among local governments in the Twin Cities area. Meanwhile, another Citizens League committee had finished its recommendations on the establishment of the Metropolitan Council. The effect of the local government tax structure on metropolitan development had been made very clear.

Following the 1967 session of the Legislature, the Citizens League Board of Directors authorized the formation of a research committee with the following assignment:

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

COMMITTEE MEMBERSHIP

A total of 29 Citizens League members participated actively in the deliberations of this committee. The chairman was Earl F. Colborn, Jr., a Minneapolis lawyer. Other members were Arch Berreman, Francis M. Boddy, Bruce Brayton, Thomas Connelly, John Costello, Mrs. Nicholas Duff, Robert L. Ehlers, James C. Erickson, Julian Garzon, Loren Gross, State Rep. George F. Humphrey, Peter Meintsma, Gordon Moe, Thomas R. Mulcahy, Mrs. Harold Nash, Donald S. Nolte, Mrs. Vernon Olsen, Mrs. Stanley G. Peterson, F. Warren Preeshl, Thomas E. Reiersgord, State Rep. Martin Sabo, Arne Schoeller, Willis F. Shaw, Matthew H. Thayer, Thomas Vasaly, Donald Wahlund, Norman Werner, and Arthur Whitney. The committee was assisted by Paul A. Gilje, Citizens League Research Director. The full committee originally was much larger, with 54 members, but the additional members did not participate in the deliberations.
COMMITTEE PROCEDURES

The committee met 39 times between March 7, 1968, and March 13, 1969. The vast majority of the meetings were three-hour evening meetings. Detailed minutes of each meeting were prepared, running on the average of five pages each, single-spaced. These minutes were made available to non-members as well. A large number of public officials and civic leaders interested in the subject were placed on the mailing list to keep abreast of developments.

A considerable amount of research information was made available to the committee concerning tax rates, expenditures, valuations, community income, and so forth. Background materials prepared for the committee are available at the Citizens League office for use by interested persons.

The committee was kept informed of developments at the national level, particularly with respect to recommendations from the Advisory Commission on Intergovernmental Relations.

The committee relied heavily for information from a large number of resource people in the Twin Cities area and from outside the state.

Lynn A. Stiles, senior economist, Federal Reserve Bank of Chicago, was the guest speaker at the first meeting of the committee. Mr. Stiles is a nationally known authority on the problems of property tax disparities among localities in metropolitan areas. Near the end of committee deliberations the committee met with Wilbur Thompson, professor of economics, Wayne State University, Detroit, Michigan, a nationally known urban economist. Some committee members were able to hear presentations by Kurt Bauer, executive director, Southeastern Wisconsin Regional Planning Commission; Dick Netzer, professor of economics, New York University, and William G. Coleman, executive director of the Advisory Commission on Intergovernmental Relations, when they were in the Twin Cities area at different times meeting with other groups.

The committee attempted to obtain a broad spectrum of opinion from local and state public officials and others. Among the resource persons who met with the committee were:

John Pidgeon, Bloomington city manager.
R. W. Turnlund, Roseville village manager.
Rollin H. Crawford, mayor of West St. Paul.
Joseph F. Summers, corporation counsel, City of St. Paul.
Dan Cohen, president, Minneapolis City Council.
William Koniariski, chairman, Scott County Board of Commissioners.
Bernard F. Schneider, Carver County Commissioner.
State Representative Howard Albertson.
State Representative Ernest Lindstrom.
State Representative Robert W. Johnson.
Rolland F. Hatfield, State Commissioner of Administration.
Arthur Roemer, Deputy State Tax Commissioner.
Duane Mattheis, State Commissioner of Education.
S. Walter Harvey, research director, State Department of Education.
Larry Laukka, vice-president and marketing manager, Pemtom, Inc.
A number of members of the Citizens League committee were "resource persons" in their own right. Included in the committee membership were a school board member, a municipal finance officer, a city assessor, a school finance officer, and persons who in their private business deal regularly with municipal and school district finance problems.

The staff of the committee received excellent cooperation from municipal officials, county assessors, county auditors, and representatives of the Metropolitan Council, State Department of Education, State Public Examiner, State Department of Taxation, and State Department of Administration. Requests for information were always handled promptly. Without this kind of cooperation the committee's work would have been much more difficult.

Much of the testimony before the committee was completed early in the summer of 1968, but the deliberations of the committee took longer than expected, because of the complexity of the issue.

MINORITY REPORT

A minority report was submitted by Robert L. Ehlers, a committee member. Willis F. Shaw and Arthur Whitney asked to be recorded as concurring "to a great extent" with Ehler's dissent. Ehlers' report expresses opposition to:

A. Sharing the growth of commercial-industrial valuation.

B. Non-property taxes as a substitute for additional property taxes for local government.

C. A gross earnings tax to replace the property tax on electric utilities.

A complete copy of Ehlers' dissent is available upon request at the Citizens League office.
School Shopper Help for Parents

THE SCHOOL BOOK: 1990-91
A Comprehensive Guide to Elementary Schools in the Twin Cities

Minnesota parents who are selecting schools now have a concise source of comparative information. The School Book, A Comprehensive Guide to Elementary Schools in the Twin Cities, a new publication from the Citizens League, is now available. The book profiles 449 public and private elementary schools in the metropolitan area.

The book features information about each school's curriculum, foreign languages, building and facilities, extracurricular activities, number of students and teachers, class size, use of technology, grading system, parent organizations and communications, and services such as latchkey and breakfast. Each school profile includes a self-description of the school's teaching philosophy and strengths.

The School Book also includes information about what to consider when choosing a school, an explanation of Minnesota's school choice law, an application for the open enrollment program, and a Metropolitan Council map of public schools and districts in the region.

You can get a copy of The School Book by calling the Citizens League at 612/338-0791 or by using the enclosed order form. League members can buy the book for $10.00; the nonmember price is $12.95.

Public Affairs Directory 1991-1992 Available This Summer


Report highlights Minnesota health care marketplace

Minnesota HMO Review 1989

After three consecutive years of losses, Minnesota’s health maintenance organization (HMO) industry returned to profitability in 1989. Nevertheless, concerns remain over HMOs' finances and their increasing use of hospital care.

A report by the Citizens League provides valuable information about Minnesota’s HMO industry. The report, Minnesota HMO Review 1989, also analyzes key trends in enrollment, hospital utilization, and management arrangements and costs. With 1.1 million Minnesotans enrolled, HMOs affect most businesses, medical providers, and families in the state. Besides losing $26 million in the late 1980s, HMOs faced widely publicized provider revolts, a 9 percent enrollment decrease and tougher state rules.

Minnesota HMO Review 1989 is a valuable reference for people who need to keep up with Minnesota’s dynamic health care marketplace. League members can buy the report for $5.00; nonmember price is $10.00. To order your copy, please use the enclosed form or call the League at 612/338-0791.

The data set developed by the League staff in preparing its analysis is also available. Call the League office for details.

WATCH FOR NEW, EXPANDED EDITION:
Minnesota Managed Care Review 1990 will be published in May 1991.
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This report, *Breaking the Tyranny of the Local Property Tax*, was originally approved and published in 1969 and was reprinted in 1991.

The League's board, officers, and staff at the time the report was first published are listed below, as their names appeared in the original edition of the report.

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WHAT THE CITIZENS LEAGUE IS

The Citizens League has been an active and effective public affairs research and education organization in the Twin Cities metropolitan area since 1952.

Volunteer research committees of League members study policy issues in depth and develop informational reports that propose specific workable solutions to public issues. Recommendations in these reports often become law.

Over the years, League reports have been a reliable source of information for governmental officials, community leaders, and citizens concerned with public policy issues of our area.

The League depends upon the support of individual members and contributions from businesses, foundations, and other organizations throughout the metropolitan area. For membership information, please call 612/338-0791.

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IMPACT

Being a member of the Citizens League means you care about what happens in Minnesota and believe that good public policy depends upon an informed citizenry. League membership gives you an opportunity to participate in shaping public policy. Membership also offers these additional benefits:

PUBLICATIONS

- Minnesota Journal — 22 issues a year of timely public affairs news, analysis and commentary, including the League’s annual property tax survey.
- Public Affairs Directory — a handy listing of agencies, organizations and officials involved in making public policy.
- The School Book — a comprehensive guide to elementary schools in the Twin Cities.
- Citizens League reports — full reports and statements on topics studied — available upon request.

MEETINGS

- Mind-Opener breakfast meetings — every Tuesday from Labor Day to Memorial Day. Public officials, community and business leaders meet with League audiences to discuss and debate timely issues.
- The DeSantis Series: Neighborhood Issues in Focus — Speakers explore issues of neighborhood economic development.
- Seminars -- occasional, in-depth discussion of issues.