Chapter 4.
Tax-Base Sharing: A Tool for Fiscal Regionalism

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Myron Orfield, the known leader in metropolitan governance and tax base sharing, remembers his thoughts on Minneapolis-Saint Paul, Minnesota in the early 1980s. He believed, “It couldn’t happen here. Not in Minneapolis-Saint Paul” (Orfield, Winter 1997). Politicians and community leaders in the Twin cities thought that they were immune to the pressing issues that were arising in metropolitan areas nationwide. They had coordinated philanthropic and governmental centers that could quickly respond to any unwanted uprising. Urban decline, inner-suburban decay, and urban sprawl would never be problems faced by the Twin cities, according to Orfield. Nonetheless, the unstoppable forces of concentrated poverty in opposition with concentrated resources marked the inevitable patterns of metropolitan polarization. How would Minneapolis-Saint Paul fix the unavoidable urban problems that hindered coordinated growth in cities all over the country?

First, it is important to identify how urban polarization originates. Polarization arises when poverty is concentrated in the center city. Middle and upper class citizens want to get away from poverty, and, thus, move to the outer realms of the city or to the suburbs. This movement leads to fiscal disparity. Need becomes concentrated in the city while tax revenue and resources become centered in the suburbs. Furthermore, cities often experience cumulative effects of economic decline, and the initial fiscal disparity leads to even more serious financial difficulties. This fiscal disparity leads to what Orfield refers to “as waves of socio-economic decline that roll outward from the center city astonishingly fast” (Winter 1997, 1). It is vital for community leaders and planners to understand the characteristics of fiscal disparity and be able to identify it when it occurs in their own community. In essence, fiscal disparity means that there is an observable difference between revenue raising capacity in a local government and the revenue raising capacity in the corresponding metropolitan area. As a result, it is difficult for the city to offer the same services to its citizens as the rest of the metro area does. Simply put, it is much easier for jurisdictions with small populations and large revenue raising capacity to offer adequate services than it is for the center city with a large population and smaller revenue raising capacity to offer the same bundle of services (Revenue Sharing, 2005). To add to the problems, the citizens living in the suburbs often rely on the services in the center city, as well. For example, here in Memphis, citizens of Collierville still rely on Memphis for infrastructure such as roads and entertainment facilities like the FedEx Forum.

FISCAL REGIONALISM

One way to deal with fiscal disparity is consolidation. Consolidation is a method of regional reform that involves two or more governments merging into one single new governmental region. All aspects of government from each original entity are combined into one process that is administered by the new consolidated government. An example of consolidation is Nashville-Davidson County in Tennessee.

Growing fiscal disparity in metropolitan areas in the United States has led to fiscal regional governance, rather than consolidation, in some areas. Fiscal regionalism is the joint effort of local governments to create a method of funding to accommodate the various public needs in the region while each local government retains their original governmental structure. Part of the rationale behind fiscal regional governance is that transportation, housing, environment, and economic issues extend the boundaries of a city or municipality and cannot be dealt with in
isolation. In addition, a large number of governments in a region lead to a fragmented region, and it is difficult for these governments to work together. Other reasons behind fiscal regional governance are that local municipalities do not want to lose their identity and that metropolitan reorganization is not usually backed by legislators. Ultimately, fiscal regionalism allows for a more equitable distribution of costs and benefits within a metro area (Miller, 2000).

There are three common forms of fiscal regionalism. Cultural Asset Districts are civic projects that are financed by the regional public, and they are the first form of fiscal regionalism. The second form of fiscal regionalism is a peaceful coexistence plan. Perhaps, one of the most successful forms of fiscal regionalism is tax base sharing. Tax base sharing means taking a portion of a regional source of revenue, typically a tax such as property tax or sales tax, and redistributing the wealth to areas within the region on the basis of need. Ultimately, the purposes of tax base sharing are summarized as creation of equity, reduction in competition for tax base, and easier land use planning (Orfield, 1999). The oldest and largest tax base sharing plan is in the Twin cities of Minnesota. The plan was adopted in 1971 and currently covers seven counties, 2.5 million people, and about 200 local jurisdictions (Miller, 2000).

**TAX BASE SHARING**

Tax base sharing is referred to as regional tax base sharing and fiscal disparities law. All of these terms simply refer to a mechanism that pools a portion some type of tax from the municipalities of a region and redistributes the fund (Park, 2003). Tax base sharing is needed in certain regions because local government behavior can sometimes adversely affect economic development within other parts of the metro area. For example, local governments compete with other municipalities in their region for tax base increases. Each jurisdiction wants to boost their revenue by adding new residents to their community. Often local governments will offer service packages as an incentive for new residents to move to their municipality. As a result, the municipality faces increased fiscal pressure in order to provide the promised services. Industry recruitment effort is another aspect that supports the need for regional tax base sharing. In competing for industry, local governments will offer tax abatements, subsidized services, and even new infrastructure to persuade industry to locate in their community. However, these incentives reduce the net fiscal benefit of the development to residents. Locally unwanted land use also supports the need for coordination among local governments. Land use regulations may prohibit locally unwanted land uses such as power plants, transmission lines, pipelines, and landfills. While they are unappealing to residents, most industries find communities that have these facilities more attractive. Since residents do not benefit much from the locally unwanted land uses, the uses are often prohibited within local jurisdictions. If one jurisdiction does have these facilities, neighboring municipalities can free ride off of that local facility. As a result, the locally unwanted land uses end up being prohibited throughout the region. Losses in attendant jobs, tax base, and other net benefits from industry activity result. Finally, the conditions caused by high concentrations of poverty in the central city and the resulting flight from it support the need for intergovernmental cooperation. Efforts to mitigate the outward migration that leads to fiscal disparity can benefit all municipalities in a region, but none are able single-handedly counteract the forces at work. Intergovernmental fiscal cooperation is essential for metropolitan areas facing flight-from-blight (Turnbull, 2002).

Tax base sharing is not only justified because of its effort to achieve an equitable distribution of tax revenue across a region, but it also can help align local government policies that have effects on neighboring jurisdictions. Spillover effects from decisions within one jurisdiction inevitably lead to benefits or costs on a neighboring municipality. Tax base sharing is a government-coordinated approach that can internalize the resulting externalities of local government policies. Sometimes, economic development requires a joint effort from municipalities within a region.
Tax base sharing rewards the localities involved in their effort to increase the development’s net value to the region as a whole (Turnbull, 2002).

Tax base sharing has five main purposes. First, tax base sharing creates equity in the provision of public services. All local governments need to provide the basic services such as schools, roads, sewers, parks, police, and fire protection for their residents. Higher tax rates result in areas with a small tax base, while those with a larger tax base have lower tax rates. Thus, there is an increased tax burden on lower income households. Tax base sharing lightens some of this burden.

Secondly, tax base sharing helps alleviate the difference between social needs and tax base resources. The young, poor, and elderly populations need the highest amount of services, yet they are often the groups with the lowest ability to pay. Tax base sharing reallocates regional resources to those who need it the most.

Thirdly, tax base sharing decreases incentives for local governments within a metro area to compete with one another for tax base. Since commercial and industrial properties typically pay more in taxes than they receive in services, a local government is willing to compete for them to locate in their jurisdiction (Park, 2003). However, there are costs associated with this competition. Typically municipalities compete by using tax abatements. Therefore, the first cost of competition is foregone tax revenue. Furthermore, giving tax abatements to particular industries changes the effective tax rates for other industries within the local jurisdiction. Thus, there are also costs associated with the tax equity effects of competition. Tax efficiency effects also result. The tax abatement policy resulting from competition for tax base creates a competitive disadvantage for those industries who do no threaten to move elsewhere (Turnbull, 2002).

The fourth purpose of tax base sharing is it undermines local fiscal incentives supporting exclusionary zoning and sprawl. Many local governments require large lots in zoning ordinances to increase the tax base. Increases in low-density housing result, which leads to sprawl. Tax base sharing reduces the incentive for each municipality to increase its tax base, and increases will help the region as a whole, not just the local jurisdiction.

The last main purpose of tax base sharing is that it makes regional land-use policies possible. Since tax base sharing decreases the local governments’ need to increase the tax base, they are free to develop land use policies that stress important land use patterns such as protection of the environment and more efficient patterns of development (Park, 2003).

In structuring a local tax base sharing scheme, many decisions must be made. First, there are two types of tax base sharing models. The pure sharing model is characterized by local governments pooling either a portion or all of their revenue from a specified tax base and then reallocating the revenue among the local governments according to a certain formula based on need. The second model is the regional service model, in which the common pool of revenues goes towards the costs of specified services that accommodate the entire region. This approach sometimes includes a governmental body that represents all of the contributing local governments, and it is responsible for the provision of the specified services to the residents of the region. The pure sharing model is most effective in creating intergovernmental cooperation because it reduces the reward for adding to one’s own tax base and increases the reward for adding to other jurisdictions’ tax bases. On the other hand, the regional service approach uses revenues to support a service with a regional impact such as mass transit or drinking water. In this case, each local government can provide the service on their own as long as they agree that all shared revenues only be spent on the agreed purpose (Turnbull, 2002).
Another choice in deciding on a local tax base sharing plan is choosing a decision-making framework. The two types of decision-making framework are top-down and bottom-up. Top-down approach means that the tax base sharing is structured at the state level and administered downward on local governments. The bottom-up approach is when the local governments structure and manage the tax base sharing plan. There are potential problems with each scenario. The top-down approach violates a principle of fiscal federalism. More specifically, the governmental jurisdiction that is closest to the voters is not responsible for the tax base sharing policy. While the bottom-up approach allows for maximum interaction with the citizens of the region, it can lead to decision-making gridlock. Decision-making can be further complicated by the existence of larger dominant jurisdictions (Turnbull, 2002).

Another choice that is faced when preparing a tax base sharing plan is whether decision-making will be primarily centralized or decentralized. If the region decides on decentralized decision-making, then each local government is required to allocate their share of the revenue according the regional agreement. The regional body only coordinates the tax base sharing scheme. However, if the region decides on centralized decision-making, the regional body actually maintains decision-making power regarding the local tax base sharing. Other factors that come into play with tax base sharing scenarios are dynamic flexibility and lifespan. A region must decide on a time frame in which the revenue sharing plan is active upon adoption of the sharing plan. This type of decision involves not only the lifespan of the plan, but also terms regarding modifications to the plan and the process for renewal of the plan. Furthermore, the spatial extent of the region is likely to change while the tax base sharing plan is in action, and it is essential for the tax base sharing agreement to include how the agreement affects growth within the region (Turnbull, 2002).

Perhaps, the most important decision to be made in a tax base sharing agreement is the tax base definition. First, will the tax base be dependent upon sales, property, or income tax? Most existing tax base sharing agreements use property taxes. If a property tax base sharing plan is decided on, will all property, only residential property, or all non-residential property be included? The Minneapolis-Saint Paul tax base sharing plan, for example, defines their tax base by commercial and industrial property only. The Charlottesville-Albemarle County, Virginia plan, however, defines its tax base as all property, including residential. On the other hand, Sacramento, California uses a sales tax base sharing agreement (Turnbull, 2002).

Another important concern in tax base sharing agreements is how the agreement will pertain to other development incentives that are offered by local governments. For example, how is property within existing tax increment financing (TIF) districts handled? If some property is exempt from the tax base sharing plan due to other incentives, will the incentive be able to be renewed? Will local governments be able to create new tax increment financing districts under the tax base sharing plan? All of these questions must be answered by the regional agreement before it is voted upon (Turnbull, 2002).

One big concern that exists when the top-down approach is followed is uniformity. Many different types of local economies exist within the borders of a state. Thus, it is important for the state to develop flexibility in the implementation of tax base sharing. Tax base sharing is a strong policy in that it can be adapted to any region, regardless of its needs and concerns. So many versions of tax base sharing scenarios are able to be developed that any local economy can benefit. Even though uniformity is often required, states’ using the top-down approach must retain a sufficient amount of flexibility in order to accommodate the specific concerns of each region (Turnbull, 2002). All but two states have a uniformity clause that requires uniformity in the taxation of real and personal property. Tax base sharing maintains the practice of taxing property equally, and it is only a small hurdle for tax base sharing implementation. In fact, Minnesota’s court has already
set precedence since they have approved the tax base sharing plan for the Twin cities (Park, 2003).

While the numerous advantages of tax base sharing have been discussed, there are a few problems that exist with the tax base sharing models. Many critics of tax base sharing have pointed out that models that do not reallocate revenue on the basis of need reward spending. Some local jurisdictions spend and reinvest more money in their community to lower their financial status and appear as though they need a higher portion of the shared tax revenue. These critics advocated for tax base sharing models that distribute regional tax revenue according to need on the basis of indicators such as the age and density of housing stock, population density, percent of state’s population living under the poverty level, and the number of children that receive free lunches (Huck, 2000). Tax base sharing also decreases the incentive for property owners to make repairs that would end up increasing their property value because their increased property tax revenue would go into the shared pool and would be redistributed to other areas of the region. For the same reason, tax base sharing decreases a community’s incentive to increase jobs and wealth through commercial development. Tax base sharing models also reduce the bargaining power of developers. Some may see this as a disadvantage, while others may see it as an asset of tax base sharing. Some critics have stated that tax base sharing disrupts the efficient market behavior that exists when industries are deciding where to locate. During this process, cities basically weigh the costs and benefits of industrial development in terms of negative externalities and increases in tax revenue that come along with industry. The last potential problem with tax base sharing that I will address is that it requires that all communities within the region participate. It is expected that the net losers, those who live in high-income areas, will not want to take part in tax base sharing; but, without the net losers, there would be no net winners (Park, 2003).

CASE STUDIES

While forms of tax base sharing programs have been used in several cities throughout the nation, I will focus on the Twin Cities in Minnesota, Dayton, Ohio, and Allegheny County, Pennsylvania. Numerous studies have been commissioned, but relatively few tax base sharing programs have actually been implemented. Each of the three case studies that I have chosen differs from one another. Since tax base sharing models are so flexible, tax base sharing plans are designed to accommodate the specific needs of each region (Orfield 2002). I will begin my discussion with the tax base sharing plan in Minneapolis-Saint Paul, Minnesota.

TWIN CITIES

The Twin Cities Fiscal Disparity Plan was approved in 1971; however, it was not actually enacted until 1975. It was the nation’s first tax base sharing program, and, today, it is the largest revenue sharing plan in the United States (Park, 2003). The tax base sharing plan in the Twin cities resulted from socio-economic indicators in the metropolitan area. Fiscal disparity was becoming more evident in the Twin cities as inner ring suburbs began experiencing economic decline. The center city areas had been experiencing this decline for over a decade, but when the economic trend began occurring in inner suburbs, leaders in the Twin cities community began to take notice. Myron Orfield concluded, “When poverty is seen as ‘just an inner-city problem,’ it has no political legs. It’s when poverty becomes a suburban problem that you can do something politically” (qtd in Rusk, 1999).

Myron Orfield was the leader in the political push for a tax base sharing program in the Twin Cities. In fact, he popularized the map as a prime political tool during the process. More specifically, Orfield’s maps show economic indicators such as poverty, crime, school spending, number of children receiving reduced cost or free lunches, and minority enrollment in schools by jurisdiction. The maps of the Twin Cities time and again show the decline that occurred in the
center city and inner suburbs and the rise in the more affluent outer suburbs (Rusk, 1999). Estimates have shown that tax base disparities could be represented by a ratio of 50:1 before the Fiscal Disparity Plan was developed in Minneapolis-Saint Paul (Orfield, 1999).

How does the Fiscal Disparity Plan work? Each local government jurisdiction within the metropolitan region contributes forty percent of its growth in property taxes from industry and commercial property to a common pool, as illustrated in Figure 1 below. All commercial and industrial property that was taxed prior to 1971 is exempt from the revenue sharing plan. Then, the pool is distributed back to the local government jurisdictions based on their revenue raising capacity. The municipalities with low revenue raising capacity receive more from the pool while those with higher capacity receive little revenue from the common pool. This method of distribution essentially allocates the revenue to local governments within the region on the basis of need (Orfield, 1997). The system has helped the Twin Cities region balance fiscal disparity in the region. It is estimated that the program reduced tax base disparity in the metro area to a ratio of 12:1. The Minnesota model for tax base sharing has been most effective in reducing competition for tax base (Orfield, 1999).

Figure 1. Minnesota Model for Tax Base Sharing

While the Minnesota model has made progress in equalizing fiscal disparity across does have some shortfalls. First of all, the tax base sharing program does nothing to change inequity that existed prior to 1971 since the model uses only increases in property values as opposed to total property values (Huck, 2000). Secondly, the model might be more thorough if it used residential property as well as industrial and commercial. Communities that have low-value homes and better than average commercial or industrial development end up being net contributors, and communities made up of mostly high-value homes end up being net receivers (Orfield, 1999). Lastly, the Twin Cities Fiscal Disparity Plan only accounts for property value. It could have been more beneficial to the region to develop a tax base sharing plan that pools revenue based on income (Huck, 2000).
The problems resulting from excluding residential property in the tax base sharing model became obvious to community and political leaders in the Twin Cities. In 1995, the Minnesota legislature passed Fiscal Disparities II: The Metro Area Tax Cut. The bill allowed for the region to share revenue from residential growth. A percentage of property taxes from home valued over $200,000 would be contributed to a tax base sharing pool. The bill was titled as a tax cut because it allowed local municipalities under the model to use the increased tax base to cut property tax rates during the first two years (Orfield, 1999). There was much support for the bill because it changed the ratio of net-givers and net-recipients from 26-74 to 17-83. Nevertheless, Fiscal Disparities II: The Metro Area Tax Cut was never passed since the governor of Minnesota vetoed the bill (Rusk, 1999).

Although the tax base sharing model in Minneapolis-Saint Paul is not perfect, it has led to more equitable and efficient taxation in the region. Over the 30 years that the Fiscal Disparity Plan has been in action, changes in local fiscal methods have occurred that have been unparalleled in terms of equity by any other form of governance in the United States. The question remains, could such a model work elsewhere? To be honest, I believe so. The Minnesota tax base sharing model was not immune to controversy. Community leaders battled to persuade legislators to approve the plan (Toland 2004). They also had to deal with the suburban governments that did not want the plan to be approved since they knew that they would be net losers (Orfield, 1999). The key to tax base sharing success in Minnesota was the economic decline in inner-ring suburbs paired with the formidable persistence of community leaders.

**Dayton, Ohio**

Dayton, Ohio was one of the country’s premier manufacturing centers during the 1970s; however, Dayton and the surrounding Montgomery County were declining economically by 1989. Between 1970 and 1989, Montgomery County, Ohio had experienced population decreases of over 25,000, and Dayton’s population had declined by 25%. Tax base competition became fiercer than ever. Dayton competed along 18 other municipalities in Montgomery County as well as local governments in neighboring counties. In 1989, the Community Cooperation Task Force was developed to create a joint economic development and tax-sharing program. The task force had decided against using a formula like the Twin Cities’ tax-base sharing formula because it did not include residential property. The whole idea of tax-base sharing was continually opposed by township members. Furthermore, city and township administrators hoped to limit the amount of tax revenues that would be shared. On the other hand, Montgomery County wanted at least five million dollars to be pooled to cover the cost of the economic development fund. Gridlock resulted since neither side wanted to compromise. In the end, the County conceded. It was agreed that the maximum contribution of any local government would be 13% of the local government’s growth in payroll and property taxes. The growth in payroll taxes had to be added to finance the economic development fund in addition to distributions to the participating governments (Rusk, 1999).

The economic development and tax revenue sharing plan was called the ED/GE plan (Economic Development/Government Equity). Some local governments still did not support the plan; but by 1996, twenty-eight of the twenty-nine local governments in Montgomery County, Ohio had voluntarily agreed to the nine year contract. While the economic development fund was quite successful, giving $34 million to 152 projects, the government equity or tax base sharing part of the plan had only made moderate improvements for the local governments. The largest amount of money distributed in a single year was $612,680. The tax base sharing portion of Dayton’s ED/GE plan has been characterized as merely symbolic. The Montgomery County, Ohio government equity plan results in contributions equivalent to $1 per resident. The Twin Cities tax base sharing plan amounts to $150 per resident across the region. Another large difference between the two tax base sharing plans is that Dayton’s ED/GE plan was a voluntary agreement.
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among the municipalities in Montgomery County, and the Twin Cities tax base sharing plan is a state mandated program (Rusk, 1999).

Pittsburgh, Pennsylvania

Like the two case studies above, the city of Pittsburgh had been a center of business and industrial development. In 1948, 73% of the business activity in Allegheny County, Pennsylvania occurred inside the city of Pittsburgh, and by the 1980s, that 73% had fallen to a mere 38%. The outer suburbs were doing very well economically, as in the previous cases, yet the center city was suffering. Meanwhile, Pittsburgh was also funding, through no specific mechanism, its various cultural assets such as the zoo, conservatory, and sports stadium. In effort to fund the development of existing and new cultural assets and bring together the fragmented structure of government throughout the region, the fiscal disparity within the city led to the development of the Allegheny Regional Asset District in 1993 (Conte, Harps, & Wilcos, 2001).

The Allegheny Regional Asset District legislation was made up of two components. An additional 1% sales tax would finance both components. The first component was the actual regional asset fund. The 0.5% sales tax addition would generate $60 million each year, and it would be used to fund the cultural assets in the city of Pittsburgh such as libraries, parks, stadiums, and zoo. The second component of the Allegheny Regional Asset District legislation was the tax sharing component. The other 0.5% sales tax addition would generate $60 million. Half of the money generated would go toward the Allegheny County government, and the other half would be distributed the participating local governments on the basis of need. The Allegheny, Pennsylvania model is illustrated in Figure 2 below. The Allegheny County, Pennsylvania tax base sharing program is the second largest tax base sharing program in the United States, and it is second only to the Twin Cities revenue sharing program. On average, the Allegheny County tax base sharing program distributes about $15 per person (Miller, 2000).

Figure 2. Allegheny County Tax Base Sharing Model

CONCLUSION
Yes, tax base sharing programs have their “fair share” of problems, but no other fiscal mechanism has been as successful in eliminating urban polarization. Tax base sharing reduces tax base competition in metropolitan regions. It promotes equal provision of services throughout the region. It makes land use planning more effective. In essence, tax base sharing programs support economic stability throughout a metropolitan region. This economic stability is not limited to the few local governments that have adopted tax base plans such as the Twin Cities. A determined group of community leaders have a passion for tax equity can make tax base sharing happen. There will always be opposition, but cities like Pittsburg, Dayton, and Minneapolis-Saint Paul have demonstrated that, with the right leadership, tax base sharing programs get implemented. Tax base sharing can alleviate fiscal disparity in your metropolitan area.

WORKS CITED


