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Local Government Revenue Structure: Does Home Rule Matter?

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Abstract. This paper focuses on the question of whether home rule authority as granted under the Illinois Constitution results in changes in municipal tax structure and tax effort. Analysis of the data collected for this paper shows that home rule authority is not a significant factor in the level of taxation imposed by a municipality. Home rule authority appears to be more valuable for regulatory purposes than for its taxation powers.

1. Introduction

On December 29, 1998, a group of citizens in the city of Rolling Meadows submitted petitions containing over fourteen hundred signatures to the City Clerk's office. The petitioning citizens were concerned that the city's economic development projects were becoming extravagant. The city council, according to the petitioners, had broken its self-imposed property tax caps to finance a few large economic development projects. Rolling Meadows is a city with home rule authority; accordingly, it is not subject to the State of Illinois' property tax legislation. The council wrote its own tax cap legislation in 1992, but it amended this legislation in 1997 "to issue bonds for the \$2.8 million in public improvements the city is funding as part of the 3Com deal [an incentive package to bring 3Com Corporation to Rolling Meadows]." (Wandling 2001) The petitioners felt that the city council needed to be restrained through some mechanism that the council had no authority to alter on its own. The petitioners chose to attempt to limit the city council through the following referendum question:

"Shall the City of Rolling Meadows, presently a Home Rule municipality, elect to become a Non-Home Rule Municipality?"

Passage of this referendum would repeal the city's home rule authority in its entirety.

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While approximately 10% of the municipalities in Illinois possess home rule authority² and many have had home rule for decades, the example of Rolling Meadows shows that home rule authority cannot be taken for granted. The referendum in Rolling Meadows also illustrated a more complex issue. During the discussion and debate on the referendum, some significant issues were without clear answers. Citizens on both sides of the referendum hypothesized about the possible impact of the loss of home rule in the areas of revenue, regulation, etc. Hypothesizing was necessary for the simple reason that many significant points have no clear precedents for guidance.

Perhaps the most significant issues without clear answers were those regarding taxation. The proponents of the referendum argued that revoking the city's home rule status would decrease the taxes paid by the citizens of Rolling Meadows. Numerous petition signers reported that they had signed the petition because the petition circulator told them that the main benefit of becoming a non-home rule municipality was tax reduction. Referendum supporters asserted that if Rolling Meadows were without home rule authority, the tax burden of Rolling Meadows residents would decrease. On the opposite side of the argument, the opponents of the referendum argued that taxes would actually increase if the city lost its home rule authority. Their reasoning was that the city could be forced to stop collecting certain taxes and would be forced to cover the shortfall with increases in the taxes that remained.

Since the city council's self-imposed tax cap was at issue, referendum proponents argued that one implication of the referendum would be a tighter cap on property taxes. The loss of home rule status would make Rolling Meadows subject to the state's tax caps. In Illinois, non-home rule units are subject to the state Property Tax Extension Limitation Law, or PTELL. PTELL is a state mandate that limits annual increases in property taxes to the inflation rate or five percent, whichever is smaller. If a non-home rule unit wishes to increase its rate of taxation beyond these levels, it must receive approval for the increased rate directly from the voters. Home rule units are not subject to the provisions of PTELL. While a home rule unit, the council could ignore its own tax cap; as a non-home rule unit, the council could not ignore the state's tax cap. The opponents of the referendum responded that this position would lead to an inevitable contradiction. They asserted that a drastic increase in the property tax (among others) would be necessary to compensate for any lost forms of taxation, and the increase would break the very tax cap that the referendum supporters were trying to protect.

Another direct implication of the proponents of the referendum was that non-home rule units had lower overall tax burdens than home rule units. This line of argument is also common when municipalities have referenda to

² Rolling Meadows Review, editorial, March 25, 1999.

establish home rule authority. The assertion is that certain taxes are not available to non-home rule units and that these governments are therefore strictly limited in their ability to tax. Some other taxes, like the property tax, would be limited in growth and subject to other restrictions. Other taxes would have to be scaled back. Some would even have to be revoked. All in all, the argument went, the citizens of Rolling Meadows would get significant tax relief if the city lost its home rule authority.

The story of the referendum itself ended on April 13, 1999, when the voters of Rolling Meadows overwhelmingly rejected it with a 93% to 7% margin. However, the story of the actual substance of the debates over taxation remains unfinished. The loose ends from the electoral provided the genesis for this research project. The arguments involving taxation were discussed hypothetically by making assumptions about individual taxes, but no one really knew what the overall revenue picture of non-home rule units looked like compared to that of home rule units. This project is an effort to make such a comparison.

2. A Review of the History of Rule

The concept of home rule turns around the relationship that usually exists between states and municipalities. As the usual relationship is described in Dillon's Rule, municipalities exist only as creatures of the state. Accordingly, it follows that municipalities may only exercise powers that have been expressly given to them by the state. Under home rule, that presumption is turned around. A home rule municipality may exercise any powers that have not been denied to it by the state.

The home rule concept was first put into practice in the state of Missouri in 1875 (Small 1970). In that year, Missouri adopted its third state constitution "with the Southern element back in power" after ten years under a Radical Republican, Reconstruction constitution (Encyclopedia Americana 1992). The Missouri Constitution of 1875 is often cited as the beginning of home rule authority and readers can be left with the impression that the home rule gates were thrown wide open, at least in Missouri. In reality, the Missouri constitutional provision only provided home rule to two cities, St. Louis and Kansas City, in seventy years. Parallel to provisions in Illinois statutes designed to single out Chicago, home rule in Missouri was only granted to cities with a population of more than 100,000 persons (Cole 1973). (Illinois' practice of classification singles out Chicago through a 500,000 person threshold.) St. Louis was therefore the only home rule city in Missouri for nearly the first quarter century of home rule. Kansas City did not reach the population threshold for home rule until 1899, almost 25 years after the famous Missouri home rule provision was written. No other Missouri cities attained home rule status until the population threshold was lowered to only 10,000 inhabitants in 1947 (Cole 1973).

In the century and a quarter history of home rule, it has expanded to the point where “home rule, in one of its variants, is the practice in forty-five states.” (Wandling 2001 p. 14)

At the turn of the 20th century, only Missouri, California, Washington, and Minnesota had provisions for municipal home rule (Wandling 2001, p. 11). By 1912, the number of states granting home rule authority had grown to 13, and by 1937 only 21 states provided for home rule (Wandling 2001, P 11-13). In 1970, when Illinois granted home rule authority to its municipalities, it was the thirty-sixth state to do so (Small 1970, p. 235-36). Since 1970, nine more states have brought the total to 45.

3. A Review of Home Rule in Illinois

The creation of municipal home rule in 1875 came five years too late to benefit Illinois’ municipalities. The Illinois Constitution written in 1870, Illinois’ third constitution, would remain in effect for an entire century. It is certainly true that Illinois could have taken the legislative route to establishing municipal home rule, and that Illinois could have taken the constitutional route through a simple amendment. In fact, the Land of Lincoln did dabble in both procedures during the hundred year period of the third constitution. For example, a 1904 amendment to the constitution “provide[d] some home rule powers for the city [of Chicago].” (Cole 1973, p. 13) While these limited powers were of use to Chicago, they were not a grant of true home rule authority. In Alice Ebel’s review of the 1870 Constitution for the 1970 Convention, Ms. Ebel used the phrase “so-called ‘home rule’ for Chicago” (Ebel 1970, p. 235) to clarify that the powers granted through this amendment which were commonly called home rule powers were not a true grant of home rule.

As home rule powers were granted to municipalities through the 1970 Illinois Constitution, rather than the legislature, one should begin with the 1970 constitution in describing Illinois’ particular brand of home rule. The specific grant of home rule authority is found in Article VII, Section 6 of the constitution.³ The array of powers which are given the collective title “home rule” are given in the following language: “Except as limited by this Section, a home rule unit may exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; and to incur debt.”⁴ The significant limitations of “this Section” itself are:

- a) *Home rule units have constitutional limits on their taxing power.* No ad valorem property tax receipts may have a maturity period longer than

³ All citations of the Illinois Constitution come from *1970 Illinois Constitution Annotated*, David R. Miller, Illinois Legislative Council, 1980.

⁴ Article VII, Section 6, Subsection (a)

forty years. Home rule units may not “license for revenue or impose taxes upon or measured by income or earnings or upon occupations.”⁵

- b) *Home rule units have constitutional debt limits.* The General Assembly may, by a three-fifths vote, limit debt incurred which is payable through any funds other than ad valorem property tax receipts. When debt is secured through property taxes, the General Assembly may set limits and require referenda for any amounts over the following limits:

- “(1) if its population is 500,000 or more, an aggregate of three percent [of the assessed value of its taxable property].
- (2) if its population is more than 25,000 and less than 500,000 an aggregate of one percent [of the assessed value of its taxable property].
- (3) if its population is 25,000 or less, an aggregate of one-half percent [of the assessed value of its taxable property].”⁶

- c) *Home rule units have constitutional limits on their power to punish.* No home rule unit may “define or provide for felonies,”⁷ nor can any home rule unit define or provide for any Class A misdemeanors without specific statutory authority from the General Assembly.

In addition to the constitutional limits on home rule authority, legislative restrictions are also allowed. The General Assembly’s authority to limit home rule legislatively is divided into two classes, each with a different voting threshold. The state legislature may preempt home rule authority by simple majority when it is willing to reserve for itself the exercise of a specific power. In these cases, the state must be willing to shoulder the burden in order to deny a particular power to home rule units. The second class involves situations in which the state does not wish to take control of the issue but still wishes to restrict the municipalities from doing so. In such cases, the standard Illinois supermajority vote, three-fifths, is required. Through either of these mechanisms, the state must be willing to put a certain degree of extra effort into attempts to restrict home rule powers.

While the Illinois Constitution constrains home rule municipalities in the ways described above, it provides some important protections for them as well. For example, Cook County is constitutionally a home rule county, and other counties could choose to meet the constitutional criteria to become

⁵ Article VII, Section 6, Subsection (e)(2)

⁶ Article VII, Section 6, Subsection (k)

⁷ Article VII, Section 6, Subsection (d)(2)

home rule counties. The 1970 Constitutional Convention rejected a proposal which would have made county home rule dependent upon a population threshold of 100,000. Instead, the Convention decided that county home rule needed a county executive to be effective, so the presence of such an executive officer is the constitutional requirement for county home rule (Cole 1973, p. 17). Jurisdictional disputes between a county and its home rule municipalities could be very problematic without some standard for decision. The framers of the Illinois Constitution provided such a standard, and the standard is favorable to the municipalities: "If a home rule county ordinance conflicts with an ordinance of a municipality, the municipal ordinance shall prevail within its jurisdiction."⁸ Further, the General Assembly is prohibited by the Constitution from interfering with home rule municipalities in the area of special services assessments. Finally, the last subsection of Section 6 states that "Powers and functions of home rule units shall be construed liberally."⁹ These provisions form a solid basis that gives home rule authority real substance in Illinois.

4. Project Design

Database

To test the hypothesis that home rule authority increases the tax burden placed upon residents and businesses of a city, a database was created to support various statistical analyses. The two hundred and sixty-seven municipalities in Cook County and the "collar counties" of DuPage, Kane, Lake, McHenry, and Will Counties were chosen for this study. Mr. Allan Mayer of the Illinois Comptroller's office completed a basic study of all Illinois municipalities in the Comptroller's *FY 1999 Fiscal Report Card*. For this project, however, Cook and the collar counties were chosen:

- a) to limit the scope of the study, and
- b) to recognize the reality that this area, comprising almost two-thirds of the population of Illinois¹⁰, is qualitatively different from "down-state"

Additionally, according to Mr. Mayer's report, there are 110 home rule municipalities in Illinois. Of those municipalities, 103 are in the six counties studied here.

Information from these cities was coded to allow basic analysis of revenue structure. The database itself contains the following general fields:

⁸ Article VII, Section 6, Subsection (c)

⁹ Article VII, Section 6, Subsection (m)

¹⁰ *Ibid.*

- County of the municipality
- Name of the municipality
- Presence of home rule authority
- Population
- Equalized Assessed Value
- Per capita EAV
- Total revenue
- Per capita revenue
- Per capita revenue
- Own source revenue
- Per capita own source revenue
- Own source as a % of revenue
- Property tax rate
- Property tax revenue
- Property tax as a % of revenue
- Property tax as a % of own source
- Sales tax as a % of revenue
- Sales tax/property tax ratio
- Municipal library
- Municipal fire department

In addition to these basic fields, a larger version of this database contains additional fields to note the presence or absence of various specific assessments in the total property tax levy.

Data Collection

The information for this project came from various places. A list of municipalities in the six counties was obtained from the Illinois Municipal League (IML). The IML's list indicated the home rule status of the municipality, and it provided a method for coding municipalities that happen to cross county boundaries.

The information regarding municipalities with multiple county jurisdictions was further refined with documents from the Illinois Department of Revenue (IDOR). The Department's "Sales Tax Receipts Reported by Standard Industrial Classification" contains a front section listing cities with multiple jurisdictions. Where the IML list and IDOR list differed, the IDOR list was given precedence.

The IDOR document was also the source of the sales tax information in the database created for this project. Both the fields for state sales tax receipts and home rule sales tax receipts were completed with information from this document. For these variables, the numbers in this sheet were given precedence over other information, such as the financial database from the Illinois Comptroller's office. The comptroller's sales tax data often varies from that of the IDOR document, although the variations are within reason. It is the author's assumption that the IDOR document contains more stable data because of its status as the primary source. The comptroller's data is a compilation of data supplied by the municipalities through their annual financial reports. Additionally, the differing fiscal years of the municipalities could, in theory at least, alter the data, as could the distinction between the liability periods and the collection periods of the taxes. The IDOR document identifies its data as "for the liability period(s) of January 1, 1999 thru [sic] December 31, 1999, collected in February 1, 1999 thru [sic] January 31, 2000." This data is therefore reliably uniform, in addition to being the primary source of such information.

The comptroller's database is the main source used in this project for each of the variables concerning the revenue ratios. In each of the fields that have a total revenue figure as part of the calculation, the total revenue amount was taken from the comptroller's database. The different fields separating own source revenue from intergovernmental revenue were also compiled using information from the comptroller's database. The term "own source revenue" was operationally defined to include the following categories from the comptroller's data:

- Property Tax
- Sales Tax (HR or referendum ROT)
- Utility Tax
- Other local taxes
- State sales tax
- All licenses and permits
- Fines and forfeitures
- Charges for service
- Interest
- Miscellaneous

Another large portion of the data in the fields for this project came from the individual municipalities' tax extension records on file in each county clerk's office. Records were obtained from the clerk's offices in the counties of Cook, DuPage, Kane, Lake, McHenry, and Will. These records contained the Equalized Assessed Values (EAV) of the communities, the total property tax rates, and the separate property tax rates for each fund. There were cases in which one county's EAV figures were different (within reason) from those of another county with jurisdiction over the same municipality. In these cases, the figure of the county that controlled a greater portion of EAV was used.

5. Data Analysis

Ms. Carol Reckamp of the Comptroller's Chicago office estimated a 95% compliance rate for municipalities submitting proper Annual Financial Report (AFR) data.¹¹ This compliance rate is accurate in the sample of six counties used for this project. Of the 267 municipalities examined in the six counties, 13 did not appear in the comptroller's AFR data. These municipalities are: Blue Island, Dixmoor, Dolton, Greenwood, Lily Lake, Lyons, Markham, Melrose Park, Minooka, Monee, Prospect Heights, Robbins, and Trout Valley. Other municipalities either provided insufficient information to the comptroller's office or the Comptroller's database contained errors which could not be rectified by the author and which resulted in incomplete information. Municipalities with incomplete information were: Elburn, Riverwoods, Union, and Westchester. These municipalities were removed from statistical analysis for any variable calculated with incomplete information.

¹¹ Phone interview between Ms. Reckamp and the author, February 2001.

Dummy variables used to control for the presence of municipal libraries and municipal fire departments turned out to be critical to the data analysis. These controls were not in place when some of the preliminary regressions were run. In these preliminary regressions, some very fundamental relationships that must be true for home rule communities did not appear to be supported by the data. Once the data accounted for the presence of municipal libraries and municipal fire departments, the values produced by the regressions changed.

Hypothesis #1: Property tax revenue will be a smaller proportion of own source revenue in home rule units.

The reasoning behind the hypothesis seems intuitive. Home rule units have the ability to generate revenue from sources that are unavailable to non-home rule units. It seems logical to assume that home rule units would avail themselves of their additional tax authority and be less dependent upon property tax. However, the data do not support this hypothesis. The proportion of revenue that is derived from property tax seems to be slightly lower than non-home rule units, but the finding is not statistically significant. The factors of:

- a) the proportion of total revenue derived from sales tax, and
- b) the presence of a municipal fire department were statistically significant indicators.

A larger proportion of sales tax is directly related to a smaller proportion of property tax revenue, as might be logically deduced. However, this connection is not directly affected by home rule. One would be tempted to think that home rule communities would be likely to have a greater proportion of revenue derived from sales tax; after all, they have the authority to assess an additional sales tax in 0.25% increments. Non-home rule units did not possess this ability during the time period studied in this project. This assumption turns out to be false. The correlation between proportion of sales tax revenue and home rule authority is not statistically significant. Indeed, one need only take a cursory look at the communities that obtain one-third or more of their revenue from sales tax. More than half of these communities are non-home rule units. Of the home rule units in this category, the majority of them do not assess an additional home rule sales tax. The proportion of revenue comprised of sales tax does not have a significant connection with home rule.

Similarly, the presence of a municipal fire department is also not directly related to home rule authority. Many cities without home rule authority have municipal fire departments, and some home rule communities are served by fire protection districts rather than municipal departments.

Home rule does not have a significant impact on the property tax percentage of own source revenue, and the significant impact of the proportion of sales tax revenue is not related to home rule.

Hypothesis #2: Own source revenue will be a higher proportion of total revenue in home rule units.

Again, this hypothesis seems intuitive. With additional own source tax possibilities available to home rule units, one would think that home rule units would generate more own source revenue. Nevertheless, the data do not support this hypothesis. When tested with some variables, home rule only increases this proportion slightly; when tested with other variables, home rule only decreases this proportion slightly. More importantly, in all tests, home rule authority is not a statistically significant factor. Of the variables tested, per capita EAV is directly correlated at a significant level (with a very minor positive effect) and proportion of sales tax is directly correlated at a significant level (with a more pronounced positive effect). There is no hidden home rule impact in either variable.

Hypothesis #3. Per capita revenue will be higher in home rule units.

To come full circle, a form of the hypothesis of the Rolling Meadows petitioners was tested. The petitioners argued that the taxes of home rule communities were higher than those of non-home rule units. Their reasoning also seemed intuitive; home rule units can tax more, so they will. Per capita revenue seemed to be a good choice as a measurement of the level of taxation. Regressions with per capita revenue as the dependent variable do not support the petitioners' hypothesis. To give the petitioners their due, home rule units do seem to have higher per capita revenue, but the data show that the connection is spurious. Home rule authority is not statistically significant as a determinant.

6. Conclusions

The data show that home rule authority is not significant determinant of a community's taxation level, even when considering the level of taxation under different operational definitions. These findings confirm the findings of Allan Mayer of the Illinois Comptroller's Office. In a study of the data of all municipalities in Illinois, Mr. Mayer found that "other factors [than home rule authority] are more likely to determine a municipality's dependence on property taxes (Mayer ND)." On the basis of the data for this report, the same conclusion can be made regarding the proportion of own source revenue and the general level of taxation. Home rule is not a key factor. For the questions regarding general level of taxation, further study must be done; the data in this report do not point to any critical factors.

The question remains, then: Why does home rule authority not have the effect on taxation that either side in the Rolling Meadows home rule debate expected it to have?

A plausible explanation would seem to be that home rule authority is really more about regulation and other municipal powers that are not related to taxation. Some anecdotal evidence supports this conclusion. In a previous phase of this project, information was obtained from the four cities in Illinois whose home rule authority was revoked: Lisle, Lombard, Rockford, and Villa Park.

Interviews with various officials in these cities showed a common pattern. All the officials stated that their towns were not particularly interested in trying to regain home rule authority. Mr. Bill Lichter, Village Manager of Lombard, stated that if his village were to become interested in regaining home rule, the taxation issues would not be the driving force. From his perspective, the only revenue issue of any concern was the restriction of non-home rule units in their use of revenue raised by the hotel/motel tax. The rest of the discussion involved regulation issues, not financial issues. Mr. Ron Schultz, Legal Director of the City of Rockford, also said that his city would, hypothetically, be more interested in the regulatory powers of home rule than the taxation powers. As an example, he cited the fact that the City of Rockford used to be able to license electricians according to their own standards. With the loss of home rule, Rockford no longer has the authority to set these standards. Home rule seems to affect the regulatory operations of a municipality much more than it affects a municipality's revenue structure.

Analysis of the data collected for this paper shows that home rule authority is not a significant factor in the level of taxation imposed by a municipality. Home rule authority does not manifest itself in a higher level of taxation, as the proponents of the Rolling Meadows referendum argued. Neither does home rule manifest itself in a lower level of taxation, as the opponents of the Rolling Meadows referendum argued. None of the taxation factors tested in this project point directly to home rule as a contributing factor. Home rule authority is more valuable to municipality for regulatory powers than for tax purposes.

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