Minnesota AGRICULTURAL ECONOMIST

The Changing Role of the Property Tax*

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A 19th century tax economist, Seligman, wrote that "The method of taxing everyone according to his property is the first rough attempt of a property owning community . . . to assess each member according to his relative ability." In 1895, he wrote, "Practically, the general property tax as actually administered is beyond all doubt one of the worst taxes known in the civilized world. It is the cause of such crying injustice that its alteration or its abolition must become the battle cry of every statesman and reformer."

In 1966, the Research and Policy Committee of the Committee for Economic Development, an organization of top flight corporation executives and educators, wrote that the ". . . administration (of the property tax) may be accurately described as inequitable, inefficient, incompetent or corrupt."[1] Apparently, property tax administration needs reform and has needed it for a long time.

This article is not intended to praise property taxes, but neither is it intended to support their elimination. We need them too much for that. Currently, property taxes in Minnesota yield roughly $800 million per year, while the income tax yields $400 million and the sales and use tax yields $200 million. We would have to increase sales tax rates 400 percent or income tax rates 200 percent or have some combination of large increases in both to abolish property taxes. Obviously that is not feasible. So improving the administration of property taxes and reducing inequities will continue to be important. It is beyond the scope of this article to consider problems of improving property taxes. Rather, we will discuss briefly the changing role of property taxes, present the case for de-emphasizing them, and suggest ways of doing so.

Even if the administration of property taxes were perfect, there would still be a need for de-emphasizing them. Reducing property taxes is unlikely now, but hopefully we can slow down the rate of increase in such taxes or maybe stop them from increasing.

THE ROLE OF PROPERTY TAXES

For roughly half of our history, more than half of all **federal, state, and local** revenues was obtained from property taxes. Not until 1934 did property taxes account for less than half of **state and local** taxes. Minnesota relied on property taxes for more than half of its state and local taxes until 1968.

While property tax collections have risen rapidly in this century, from $706 million in 1902 to $27,747 million in 1968, their share of total federal, state, and local revenues fell from 41 percent to 10 percent during that period.

The property tax share in state and local revenues fell from 67 percent to 24 percent during that period, while the share in state revenues fell from over 43 percent to a little more than 1 percent as many states got out of property taxation.

The share of property taxes in local revenue fell from 68 percent to 38 percent between 1902 and 1968. State and federal aids and borrowing provided nearly all of the remaining 62 percent of local revenue in 1968. While property taxes provided only 38 percent of total local revenue, they provided some 90 percent of local revenue from local sources.

Table 1 demonstrates the historical relative de-emphasis of property taxes in the nation as a whole. Table 2 supplies an historical record of the de-emphasiz-

Table 1. The property tax in the United States, selected years, 1902 to 1968

Year	Property tax				
	Total, million dollars	Percentage of GNP	Percentage of federal-state-local revenue	Percentage of state-local revenue	Percentage of local revenue
1902	706	2.9	41.6	67.5	68.4
1913	1,332	3.3	44.7	65.7	68.0
1922	3,321	4.5	35.6	64.4	71.6
1927	4,730	4.9	38.8	60.4	69.0
1932	4,487	7.7	43.6	57.0	67.3
1934	4,076	6.3	35.5	48.4	57.8
1936	4,093	5.0	30.2	43.8	57.0
1938	4,440	5.2	25.2	39.8	57.3
1940	4,430	4.4	24.8	37.7	54.0
1946	4,986	2.4	8.1	31.2	49.5
1948	6,126	2.4	9.1	28.3	44.4
1950	7,349	2.6	11.0	28.6	43.6
1952	8,652	2.5	8.5	27.8	42.7
1953	9,375	2.6	8.9	28.1	42.8
1954	9,967	2.8	9.2	28.2	42.8
1955	10,735	2.7	10.1	28.6	42.8
1956	11,749	2.8	9.8	28.2	42.8
1957	12,864	2.9	9.9	28.0	42.8
1958	14,047	3.2	10.8	28.5	43.3
1959	14,983	3.1	11.2	27.8	43.1
1960	16,405	3.3	10.7	27.2	42.5
1961	18,002	3.5	11.3	27.9	42.9
1962	19,054	3.4	11.3	27.4	42.5
1963	20,089	3.4	11.1	26.7	41.7
1964	21,241	3.4	11.0	26.1	41.4
1965	22,583	3.3	11.1	25.7	40.8
1966	24,670	3.3	10.9	25.3	40.2
1967	26,280	3.3	10.4	24.4	38.9
1968	27,747	3.2	10.4	23.6	38.2

Source: Rolland F. Hatfield, *Report to Governor's Minnesota Property Tax Study Advisory Committee*, November 1970, pp. 18-19.

* A version of this paper was given as a lecture to assessors at the University of Minnesota Property Tax Short Course, 1970.

[1] Rolland F. Hatfield, *Report to Governor's Minnesota Property Tax Study Advisory Committee*, November 1970, Chapter 1, pp. 1, 16, 17.

Table 2. Relative importance of property taxes in state and local tax structures

	Per capita property taxes			Ratio of property taxes to total state and local taxes		
	1942	1957	1968	1942	1957	1968
	millions of dollars					
United States	33.88	75.54	138.83	50.1	44.6	41.1
Minnesota	41.45	93.61	152.26	56.4	51.8	41.1
Wisconsin	41.79	95.05	160.02	55.9	51.8	41.5
Iowa	34.96	85.93	172.17	55.3	48.8	48.4
North Dakota	50.89	88.25	151.68	67.0	52.8	48.0
South Dakota	41.51	94.66	181.78	61.5	58.2	55.6

Source: Rolland F. Hatfield, *Report to Governor's Minnesota Property Tax Study Advisory Committee*, November 1970, pp. 30-33.

ing of property taxes in Minnesota and adjoining states. Minnesota and its neighbors have lagged behind the rest of the country in the rate of shifting to other taxes to take the pressure off property owners. The ratio of property taxes to total state and local taxes in Minnesota fell to 41.1 percent in 1968, a ratio equal to the national average.[2] However, this was a temporary dip caused by rebates given when the 1967 sales tax law was passed. Since then the ratio of property taxes to total state and local taxes in Minnesota has increased. The relative importance of different taxes in Minnesota for the sixties and 1970 is shown in table 3.

WHY DE-EMPHASIZE PROPERTY TAXES?

Property taxes should be de-emphasized for two reasons: they are highly regressive and unevenly so; and local public services, especially education and welfare, should be financed by taxes that are spread over a wider area because of the increasing mobility of our population.

Property taxes are regressive for at least three reasons: (1) as family income rises, the ratio of tangible property to income falls: people with higher incomes accumulate intangibles that are not subject to property taxes; (2) the higher the market value of the property, the lower the ratio of assessed value to market value in a given jurisdiction tends to be; and (3) incomes in areas of falling population are smaller, and essential public services have to be financed by fewer and fewer people.

Improved administration can reduce if not eliminate the second reason for regressivity, but not the other two.

Hatfield's study revealed that property taxes are highly regressive, ranging from over 6 percent of Minnesota gross income for homeowners with incomes of $2,000 per year to about 1.5 percent for those with incomes of $20,000, to less than 1.5 percent for higher incomes, see the figure.[3] The regressive impact of property taxes is even greater as it applies to tenants who pay indirectly the higher taxes levied on landlords. The homestead exemption reduces regressivity among homeowners, an effect taken into account by Hatfield. But it increases regressivity between homeowners and renters.

Income taxes are progressive, but twice as much is collected from property taxes as from income taxes. Table 4 shows the effects of this regressivity in different areas of the state. Notice that the richer an area is, as measured by gross income per capita (column 4), the lower the percentage of its income is taxed away by the property tax (column 6) and the higher the percentage taxed away by personal income taxes (column 8). The property tax swamps the income tax, as shown in column 9, where the burden is measured by combining property taxes and income taxes. Notice that the regional distribution of state aids to schools helps to alleviate the inequity in tax burdens (columns 10 and 11). The figures, however, suggest reconsideration of state aid formulas.

Inequities in the distribution of tax burdens (ratios of property taxes and income taxes to total income) are found intra-regionally as well as inter-regionally. Thirty of the state's 87 counties had per capita incomes higher than their regional averages. Thirteen of them had tax burden ratios higher than their regional burden, while 17 had lower ratios. Fifty-seven counties had per capita incomes lower than their regional averages. Of these, 32 had tax burden ratios higher than their regional averages, while 25 had lower ratios. The burdens are distributed regressively, but they are not at all consistent.

In a simple agrarian world such as ours was a hundred years ago, reliance on property taxes was tolerable because property ownership had a relatively close relationship to income, and almost exclusive use of local taxes for local services was more appropriate when people were immobile. Reliance on local tax sources to finance public services, especially education, which absorbs an average of half the property taxes, was more feasible when people stayed put.

The principal expenditure of state and local govenments is for education. This is an investment expenditure. Educating people increases their productivity just as

[2] *Ibid.*, pp. 18-33.

[3] *Ibid.*, Chapter III, p. 37.

Table 3. Minnesota state and local tax collections, 1960-70

	State tax collections, fiscal years										
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
	millions of dollars										
Sales and use taxes	..	..	..	..	..	..	..	..	113	174	196
Other sales taxes	124	133	137	145	164	173	182	194	216	231	267
Licenses	54	55	56	58	62	64	68	71	77	78	85
Individual income taxes	89	97	123	140	145	170	221	248	273	304	346
Corporation net income taxes	40	37	35	37	40	44	67	64	58	74	70
Bank excise taxes	..	..	..	5	5	5	8	5	8	8	10
Property taxes, state	23	25	24	25	30	29	29	41	33	4*	5*
Death and gift taxes	7	10	9	15	16	14	15	14	18	21	20
Severance taxes	15	25	17	15	15	17	21	21	18	16	19
Other	0.2	1	2	2	3	3	4	1	2	3	3
Total	352	383	403	442	480	519	615	660	815	914	1,021
	local tax collections, calendar years										
Property taxes	395.6	427.3	460.4	490.6	519.7	556.2	578.9	617.4	555.1	668.9	765.4
Local property taxes ÷ total state and local taxes	52.9	52.7	53.3	52.6	51.8	51.7	48.5	48.3	40.5	42.3	42.8

* Almost all from mobile home registrations and air flight property.
Source: Minnesota Department of Taxation.

Table 4. Comparisons of taxes and school aids and income for the various regions of Minnesota

Regions* 1	Population, 1966 (estimated) 2	1966 Minnesota gross income 3	Gross income per capita 4	Property taxes, assessed 1966, paid 1967 5	Ratio of property taxes to income 6	Personal income taxes, 1966 7	Ratio of personal income taxes to income 8	Ratio of property taxes and income taxes to income 9	State aids to schools, fiscal 1967 10	Ratio of state aids to income taxes 11
		thousand dollars	dollars	thousand dollars	percent	thousand dollars	percent	percent	thousand dollars	percent
11 (Minneapolis)	1,692,660	4,607,403	2,722	335,131	7.27	139,139	3.01	10.29	86,358	57.0
3 (Duluth)	333,082	691,552	2,076	66,325	9.59	20,265	2.93	12.52	23,719	117.0
10 (Rochester)	361,078	714,924	1,980	66,514	9.30	19,516	2.72	12.03	18,600	95.0
9 (Mankato)	211,436	371,632	1,757	38,400	10.33	9,619	2.58	12.92	7,663	79.0
6 (Willmar)	162,455	254,158	1,564	28,391	11.17	6,312	2.48	13.65	8,738	138.0
8 (Marshall)	142,740	222,582	1,559	26,810	12.04	5,799	2.60	14.65	6,912	119.0
7 (St. Cloud)	227,691	341,532	1,504	27,493	8.05	8,171	2.39	10.44	13,083	160.0
4 (Moorhead)	182,300	263,530	1,446	27,624	10.48	6,213	2.36	12.84	11,172	180.0
1 (Thief River Falls)	97,026	131,921	1,360	16,435	12.50	3,116	2.36	14.86	6,087	195.0
5 (Brainerd)	111,885	140,710	1,258	14,648	10.41	3,301	2.35	12.76	8,771	266.0
2 (Bemidji)	49,659	58,547	1,179	6,078	10.38	1,360	2.32	12.70	4,128	304.0
Minnesota	3,572,012	8,024,000	2,250	653,850	8.15	227,978	2.84	10.99	189,235	83.0

* Regions are arranged by size of income per capita. The largest city in each region is listed to help the reader identify the area.
Source: Compiled from information provided by the Minnesota Department of Taxation.

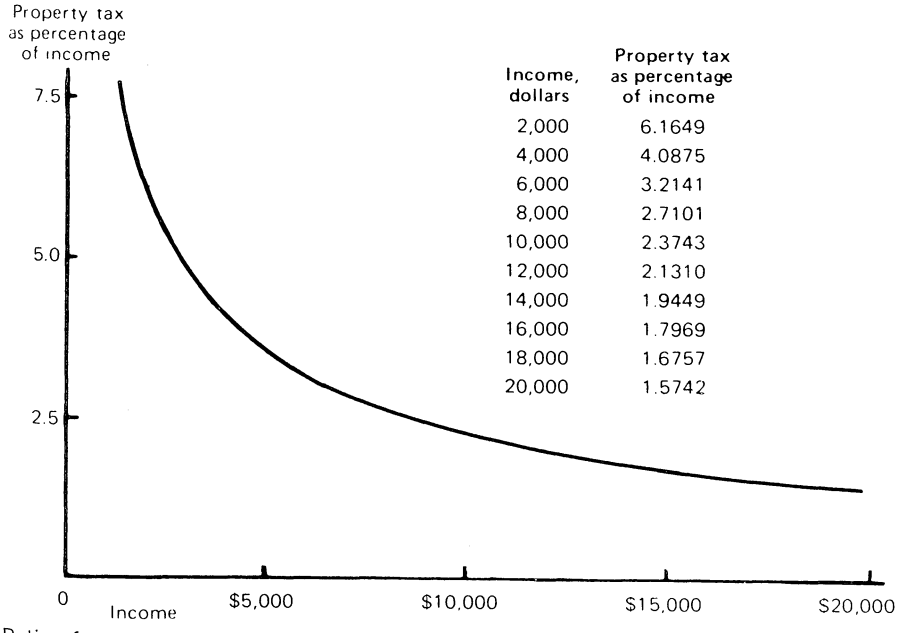
buying capital goods does. A community can afford to tax itself to pay for educating its people and recoup the cost of the education, with interest, out of the increased income its people can produce because they received the education. But the community has changed immensely. A hundred years ago people were relatively immobile, so the village or city or county that educated them could recoup by taxing them. But when people leave a community, they take their tax-paying ability with them. Fifty years ago it was still true that most people stayed put, but enough of them left agrarian counties, putting them beyond the reach of the local tax collector, to make the small community suffer financially. This development explains the birth of state aids.

Thirty-seven of Minnesota's 87 counties lost population between 1950 and 1960, and 49 counties lost population between 1960 and 1970. Outmigration was larger than the natural population increase. Most of the other counties also lost young people through outmigration, but not enough to offset the natural population increase (excess of births over deaths). As outmigration has accelerated, states have been forced to increase state aids, but they have not done so equitably or rapidly enough to relieve the financial problems of areas of declining population. Of course, many migrators, who were educated at rural expense, have not only left rural counties but have left the state, putting them beyond the reach of the state tax collector as well as the local tax collector. This sort of inequity can only be relieved by federal aids that have just been started but which undoubtedly will increase.

What I am suggesting is that local taxes finance education only to the extent that the locality keeps its graduates. To the extent that citizens move elsewhere within the state, the state should finance education via state aids. To the extent that citizens leave the state, the federal govenment should finance education via federal aids.

There are school districts in Minnesota that export as many as 90 percent of their high school graduates. This suggests that these districts should receive no more than 10 percent of their school revenues from local taxes if equity is considered important.

The increasing cost of public services and urbanization makes it necessary to shift more of the costs to the state and federal governments. The increasingly poor relationship between tangible property holdings and income and the consequent increasing regressiveness of property taxes make it necessary to re-



Income, dollars	Property tax as percentage of income
2,000	6.1649
4,000	4.0875
6,000	3.2141
8,000	2.7101
10,000	2.3743
12,000	2.1310
14,000	1.9449
16,000	1.7969
18,000	1.6757
20,000	1.5742

Ratio of property tax (nonagricultural homestead property) to income, Minnesota, 1968.

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duce the relative importance of property taxes in the tax structure.

Minnesota's principal effort to cope with the local govenments' financial problems has been the program for state aids financed by income taxes until 1968 and since then financed by income taxes and sales taxes. But these aids are too small and are inequitably distributed.

HOW TO DE-EMPHASIZE PROPERTY TAXES

Three approaches to reduce reliance on property taxes are: (1) increase the size and improve the distribution of state aids; (2) share state taxes with local governments by piggybacking a local income or sales tax onto the state tax; and (3) have the state take over 100 or near 100 percent financing of the schools.

If we choose the first approach, we would have to increase some state taxes and introduce new factors in determining the distribution of the aids. Currently the distribution is largely determined by the assessed valuation of property and the number of public school children. Income should be introduced as a factor and given more weight than assessed valuation of property, all school age children should be considered, and the size of the nonschool population and the proportion of aged and disadvantaged also should be considered.

If we choose the second approach, we might simply increase the income tax, or the sales tax by say 20 percent, and remit the increase to the locality that paid the tax or remit the increase to local governments according to population (with possibly some adjustments), with or without strings attached.

If we choose the third approach, 100 percent state financing, the state would probably have to take over the school levy part of property taxes and pay for the balance of the cost of operating schools out of other state tax receipts. This approach has two advantages. If the state collected the school levy part of the property tax, roughly half of total property taxes, it would have to equalize the levy throughout the state, which would make the property tax considerably more equitable and less regressive. When the schools need more money, the state can increase nonproperty taxes to supply it. Local governments can only increase property taxes. In the view of many, a disadvantage of this approach is that increased or total state financing of schools will mean increased or total state control. Such control might be the case, but it need not be. Currently, some school districts are largely state financed, while others are largely locally financed, but there is little difference in amount of local control retained. It seems reasonable that people can retain the amount of local control that they want to retain.

SHOULD TOTAL SPENDING BE CUT?

There are many who argue that the way to cut property taxes (and other taxes, too) is to cut government spending. These same people point out that Minnesota is a high tax state. It is true that Minnesota is a high tax state, high in dollars of taxes collected per capita and high in taxes as a percentage of personal income. What these critics fail to consider are the reasons why Minnesota is a high tax state.

Generally, the largest public expenditures of state and local govenments, including Minnesota, are for education, highways, and welfare, in that order. In all three categories, Minnesota's expenditures exceed the national average. The excess of Minnesota expenditures for education and highways over the national average more than accounts for the difference between total state and local expenditures in Minnesota and the national average.

Minnesota's expenditures for education are higher than the national average primarily because we have relatively more children. In 1966-67, Minnesota had 73.3 children, age 0 to 18, per 100 people 18 to 65 years old (July 1967 estimate) compared to a nationwide average of 65.4. Minnesota ranked 9th in ratio of children to people 18 to 65, and 10th in percentage of personal income used to pay for education. Six of the eight states with relatively more children than Minnesota also spend a higher percentage of personal income on education. The two that do not are Louisiana and Mississippi.[4]

As a percentage of personal income, Minnesota's expenditures for highways are higher than the national average, primarily because its population density (42.7 per square mile in Minnesota and 50.5 per square mile in the United States as a whole) is lower and because highway maintenance costs more where winters are rugged.

Minnesota's welfare expenditures are higher because we have a relatively large share of aged people as well as children. Besides having a larger than average proportion of children, Minnesota had 21.4 aged (over 65) per 100 people aged 18 to 65 compared to a national average of 17.4 in 1966-67.[5]

Unless we are willing to give our children an inferior education, unless we are willing to give up driving cars in winter, unless we are willing to let our needy children and aged suffer, we will continue to be a high tax state.

Property tax relief simply will not come by the route of reduced state and local spending in Minnesota. It will come from increased reliance on nonproperty taxes, particularly state taxes. In the long run, some relief may come from federal revenue sharing.

[4] *Government Finances in 1966-67*, U.S. Bureau of the Census, 1968, pp. 50-52.
[5] *Ibid.*, p. 52.

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