Should Pennsylvania Abolish the Property Tax for Schools?

In November 2015, the Pennsylvania Senate narrowly failed to pass legislation abolishing the local school property tax and replacing it with state revenues raised by higher income and sales tax rates and the extension of the sales tax to a range of goods and services now exempt. The legislation, supported by dozens of citizen tax reform groups across Pennsylvania, was defeated 25–24 when Lt. Governor Michael Stack cast a tiebreaking vote against an amendment embodying the changes.

State Senators David Argall and Judith Schwank were principal sponsors of the legislation and vowed to continue the fight. Indeed, legislation to replace, reform, and reduce the property tax, particularly for schools, has been proposed and debated for decades, and some relief measures have been enacted, but the tax remains the principal levy to fund schools in Pennsylvania and in most states. Citizens in Pennsylvania and nationally consistently tell pollsters that it is the worst tax, and few if any elected officials will defend the levy, except on the pragmatic grounds that replacing it would require unrealistically large increases in state taxes.

COMMONWEALTH *invited Senator Argall, chair of the Senate Republican Policy Committee, and Jon Hopcraft, the committee's executive director, to sum-*

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marize the argument that the tax is an antiquated and unfair levy and should be abolished. We invited Dartmouth College economist William A. Fischel, a nationally recognized expert who attended Pennsylvania public schools, to summarize his argument that, compared to statewide taxes, the local levy provides voters—even in households without school children—with stronger incentives to support high quality public schools.

Yes, Abolish the Property Tax: It Is the Worst Tax for Schools

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At the start of his career in 1890 at Columbia University, Edwin Seligman deemed the property tax as "the worst tax known in the civilized world" (Brunori et al. 2006). One hundred twenty-six years later, Seligman's declaration would be met with raucous applause at town hall meetings across much of Pennsylvania.

The property tax is one of the oldest taxes in history—Athens levied a land tax in 596 BC (Jennings 2015). In 1982, former Pennsylvania Senate Majority Leader John Stauffer hypothesized that the first complaint about real estate taxes was likely submitted in Athens in 596 BC.

Article III, Section 14 of the Pennsylvania Constitution requires, "The General Assembly shall provide for the maintenance and support of a thorough and efficient system of public education to serve the needs of the Commonwealth."

We would challenge anyone today to argue that Pennsylvania's current school property tax system actually promotes a "thorough and efficient system of public education."

Think what has changed in Pennsylvania education since the first school property tax was enacted in the 1830s: Teachers are no longer paid partly in vegetables, our children no longer learn in one-room schoolhouses, teachers are much better educated, and students have moved from chalk and slate to textbooks and computers, but taxpayers still pay for public education through an outmoded, archaic, and unfair property tax.

Today, Pennsylvania school districts receive most of their funding from local property taxes with the state and federal governments contributing approximately 45%. Again, let us quote the late Senator Stauffer, who served in the Pennsylvania General Assembly from 1965–1988 and summed it up best: “Although [the property tax’s] use has become nearly universal, it is the most unfair, fastest-rising and most capricious tax. Property tax assessments and reassessments have become bywords for political manipulation.” According to the input we have received at countless town hall meetings, the situation has not improved since Senator Stauffer’s unsuccessful efforts to reform the school property tax system in the 1980s.

This debate has gone on for decades in the Pennsylvania General Assembly with the key question “What is the best way to fund our public schools?”

In 1953, Governor Fine enacted the state Sales and Use Tax at 1%—while this tripled state aid for education, it failed to kill off school property taxes (PHMC 2015a). In 1971, Governor Shapp won a long-fought battle with the legislature and created the state income tax at 2.3%, dubbed the “Emergency Income Tax.” Shapp increased aid to public schools and also signed a bill into law creating the Pennsylvania State Lottery with the intent to provide property tax relief to senior citizens (PHMC 2015b), but it failed to kill off the school property tax. In 2004, Governor Rendell legalized casino gaming with a portion of the revenue dedicated toward property tax relief, but the hated school property tax continued to grow. In 2006, the approval of Act 1 tied allowable school property tax increases to inflation for the first time. The exemptions in Act 1, however, have allowed school districts to raise property taxes above the Act 1 index. In 2014, the state granted exceptions to 164 public schools across the Commonwealth to raise their property taxes above the Act 1 index (Frantz 2014). Since 2008, nearly one-third of the state’s 500 public school districts annually received exceptions from the state to raise taxes above the Act 1 limit (Welton 2015).

The pattern over the last six decades is clear—any temporary tax becomes permanent and any tax relief effort is temporary. Due to the state government’s inability to prevent school property taxes from rising each year, the calls to *eliminate*—not reform—this hated tax continue to grow louder each year.

Why do people across Pennsylvania hate the school property tax? Here’s one major reason: From 1993–1994 to 2012–2013, while the average annual regional Consumer Price Index increased approximately 2.5%, the annual average school district property tax increased by nearly *double* the inflation rate at 4.9%. In other words, over that period, as Figure 1 indicates, the Consumer Price Index

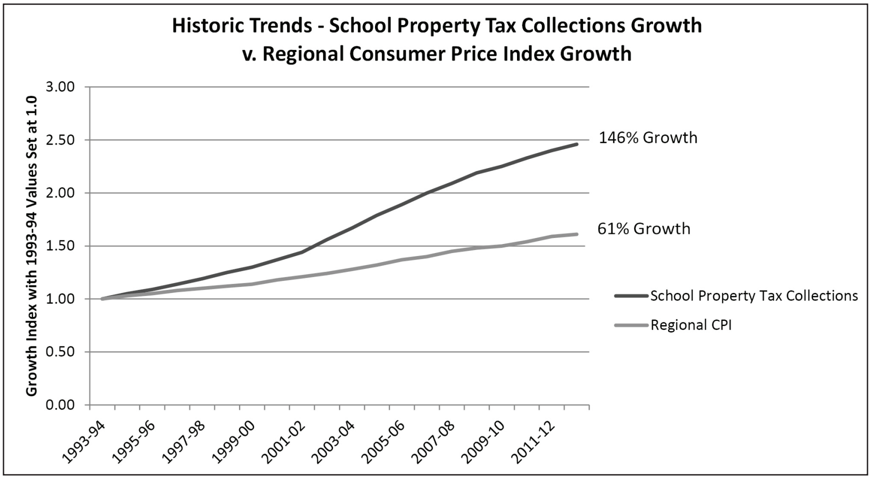

Figure 1. Historic Trends. *(Data Source: U.S. Census Bureau, 2015.)*

cumulatively increased by 61% while the school property tax increased by 146% (Independent Fiscal Office 2013). The annual increases to school property taxes continue to outpace any other economic indicator despite Act 1 limitations. This is why so many people show up at town hall meetings across Pennsylvania to demand the elimination of school property taxes. Tweaking this hated tax or reforming this unfair and archaic system is *not* what people are requesting. They are demanding its complete elimination.

Article VIII, Section 1 of the Pennsylvania Constitution requires, "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws." The subjective nature of the school property tax flies in the face of the uniformity clause.

Today, property owners are subject to higher property taxes based on a variety of outmoded factors, including when the property was purchased, upgrades to the interior and/or exterior of a dwelling, reverse appeals, additions to the dwelling, changes to the productive use of the land, among several others factors. Cherry-picking homeowners based on the sale of or upgrades to the property not only discourages individuals from purchasing property in certain school districts but also removes any incentive to improve properties due to the threat of future tax increases. The school district property tax is, at best, only remotely tied to an individual's ability to pay. Is this really how we want to fund the education of Pennsylvania's students in the 21st century? The only way to eliminate the unfairness of the school property tax system is to kill it off once and for all.

The plan to eliminate school property taxes in Pennsylvania was first developed and drafted by more than 70 grassroots taxpayer advocacy groups from across the state known as the Pennsylvania Coalition of Taxpayer Associations. The coalition brought us a plan that would eliminate—not reduce—school property taxes in Pennsylvania by shifting to an increased Personal Income Tax (increasing the rate from 3.07% to 4.95%) and an increased and expanded Sales and Use Tax (increasing the rate from 6% to 7% and broadening the tax base). Each year, school districts would receive a cost of living adjustment tied to the Statewide Average Weekly Wage. The plan would also allow school districts to raise additional revenue through a local Personal Income Tax or Earned Income Tax increase contingent on voter approval. To put that in perspective, 34 other states require school districts to receive voter approval to levy or increase the local tax rate (Paul 2015).

Opponents frequently argue that income and sales taxes are too volatile for school funding. They usually fail to mention, however, that Pennsylvania's overall state budget receives over 70% of its revenue from the Personal Income Tax and Sales and Use Tax. Why should we require school districts to depend upon hated and unfair property taxes when the state has long since decided that the sales and income taxes are much fairer and more appropriate taxes to meet our needs?

The plan created by the Pennsylvania Coalition of Taxpayer Associations is a shift from an unfair, archaic school property tax to a hybrid income and sales tax-based approach. When Pennsylvania voters are asked, they agree with this concept. Here's a sampling of the polling data: Harper Polling determined that Pennsylvanians believe that the property tax is the worst tax in Pennsylvania (50%)—eclipsing the combined dislike of income (27%) and sales (14%) taxes (Harper Polling 2015). Local tax reform continues to be a key priority statewide, narrowly trailing education funding as the top issue for Pennsylvania voters (Klinger 2015). During a telephone town hall event on October 6, 2015, with Berks and Schuylkill County residents, participants overwhelmingly supported elimination (81%) over reduction (11%) and caps on future growth (8%). KQV Radio in Pittsburgh in April of 2012 found 85% of their listeners support a plan to eliminate school property taxes; the *York Dispatch* in May of 2012 asked a similar question with 73% support of complete elimination; the *Easton Express Times* surveyed readers in March of 2015 asking about supporting a state budget deal or school property tax elimination with 84% supporting the latter.

This proposal, Senate Bill 76 and House Bill 76, would change our archaic school property system to one more in line with what taxpayers can afford to pay. Property owners would no longer bear the primary burden of funding public schools. Utilization of the income and sales tax will broaden the tax base creating fairness and uniformity in taxation. Urban areas with population outmigration would no longer be tied to an eroding tax base for future revenue needs. Instead, more than 12.7 million Pennsylvanians plus tourists and other visitors would contribute to the state's public education system.

After a comprehensive review, the Pennsylvania Independent Fiscal Office determined that eliminating school property taxes would provide the largest relative tax cut to retired homeowners and increase disposable income for homeowners (Independent Fiscal Office 2012). Seniors and homeowners of all ages continue to be the strongest advocates for this legislation.

When the plan was first introduced in the state Senate in 2011, it garnered the support of roughly one-quarter of the Senators. After considerable grassroots lobbying across Pennsylvania, the number of Senate cosponsors has doubled. The plan was reintroduced in 2013 by 14 Republicans and 11 Democrats, and again in 2015 with one-half of the Senate cosponsoring the measure. On November 23, 2015, the Senate debated this proposal for the first time in history. The result was a 24–24 tie vote, which was then defeated by the lieutenant governor's vote against the measure.

How can we finally resolve this decades-long debate and eliminate our archaic school property tax system? We are now meeting with the proponents and the opponents of the measure to find ways to improve the bill. Every day, we are searching for that one additional vote that we need to secure passage in the Senate and send it to the House for its consideration.

We now face a unique window of opportunity in Harrisburg. Franklin and Marshall College Professor G. Terry Madonna and consultant Michael Young believe that this issue could unite—not further divide—state government leaders during this era of extraordinary partisanship in Harrisburg. In an often quoted column titled "RIP: The School Property Tax," Madonna and Young (2015) wrote:

> Pennsylvania's property tax, like property taxes in many other states, is a fossilized artifact from the 19th century that faltered badly in the 20th century and failed spectacularly into the 21st century. . . . Now in the 21st century, talking about "reforming" the 19th century property tax really is just rearranging the deck chairs on the Titanic long after the iceberg has been hit. The property tax cannot be reformed—but it can be abolished. . . . Both sides really want the same thing here—a sane tax system in support of a stable revenue source for schools. Realizing that comity of interest is half the journey. Getting rid of the

property tax means Wolf wins, the GOP wins—and most important of all, the long-suffering taxpayers of Pennsylvania win.

Homeownership has been the bedrock of the American Dream, but how can one achieve true homeownership when you are merely renting it from a school district? Eliminating the 1830s school property tax system and replacing it with a broader, fairer, and more equitable system will not only remove one of the biggest hurdles to achieving the American Dream, it will finally bring Pennsylvania's public education financing system into the 21st century.

If you do not believe us, come with us to our next town hall meeting. The constituents of the 29th Senatorial District would love to share their thoughts with you on this issue.

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No, Keep the Property Tax: It Is the Best Tax for Schools

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The local property tax is an important part of funding public school systems in most states. It should be clear from the outset that it would be unwise to rely *entirely* on local taxes of any sort to fund a system of public schools. Some school districts contain a disproportionate number of poor and disadvantaged students, and such districts may need state assistance to give their children an adequate education. State mandates for special-needs students should also be accompanied by funds to pay for the additional expense. But aside from these exceptions, a properly and fairly administered system of local property taxation gives local voters—even those without school-age children—the right incentives to provide a thorough and efficient education.

The Basic Argument for Property Taxes

Here is the basic economic argument, which is a distillation of an important paper by Stanford's Caroline Hoxby (1999). Suppose that the local school superintendent, after consulting with principals and teachers, decides that the local high school needs to hire a group of teachers to teach in a newly created STEM (Science, Technology, Engineering, and Math) program. The voters are asked, directly in a referendum or indirectly through the school board, to finance this program with an increase in local property taxes.

In most communities, almost two-thirds of the voters will not have any direct interest in this because they have no children in schools (Kurban, Gallagher, and Persky 2012). An increase in property taxes will seem quite unpalatable to them. Considered in isolation, the tax increase would lower their home values (Do and Sirmans 1994).

But the superintendent points out that the STEM program will make the school district more attractive to families with school-age children. If the STEM program has this effect, it will raise the value of existing homes, which offsets the adverse effect of the property tax rise. This will apply even to voters who currently have no children in school, as long as their homes could be purchased by a family with children. If the offsetting rise is greater than the reduction caused by the tax, most voters would regard this as a desirable program. And from an economic standpoint, a net gain in the value of homes is an indicator that the program is efficient (Brueckner 1982).

It also follows that if there are no gains in home values from the program, or there are net losses, then the project is inefficient—the costs are registered as being less than the benefits. In this case, local property taxation provides incentives to reject boondoggles, since the net effect of the tax increase and the misconceived project will reduce home values. Local property taxation encourages local voters and their school boards to accept cost-effective projects and reject those that are losers in the eyes of homebuyers.

That's the basic theory: Local property taxation subjects school spending to an effective benefit-cost test. The rest of this note will briefly address the evidence supporting this theory—there's plenty more than I can review here—and add a personal, Pennsylvania story to illustrate some overlooked advantages of local control.

Evidence from Economic Studies

The connection between school quality, property taxes, and local home values has been established in literally hundreds of studies, starting with a pioneering study of New Jersey cities by Wallace Oates (1969). Controlling for differences in location, size, and condition of the homes, Oates found that levels of school spending and property taxes affected—were "capitalized in"—the average value of houses in each community. He concluded that this provided a test for the efficiency of local decisions: "[F]or an increase in property taxes unaccompanied by an increase in the output of local public services, the bulk of the rise in taxes will be capitalized in the form of reduced property values. On the other hand, if a community increases its tax rates and employs the receipts to improve its school system, the coefficients indicate that the increased benefits from the expenditure side of the budget will roughly offset (or perhaps even more than offset) the depressive effect of the higher tax rates on local property values" (Oates 1969, 968).

Studies since then have shown that voters are actually motivated by the connection between their property's value and the effects of the program (Sonstelie and Portney 1980). Homeowners are especially attuned to local public decisions because so much of their personal wealth is tied up in their homes (Fischel 2001). That local voters without children still support schools because of their beneficial effects on property values is well established (Hilber and Mayer 2009).

The discipline of local funding from property taxes and the encouragement it provides for local improvements explains why states that rely more on locally controlled property taxes have better schools. Thomas Husted and Larry Kenny (2000) found that states that reduced their reliance on local property taxes and increased state funds ended up with lower SAT scores and other indicators of overall educational quality. Joshua Hall (2007) concluded that Ohio districts that relied more heavily on property taxation performed better than those that got more money from the state. In my own review of a national study of SAT scores and state financing that ranked states from highest to lowest, I found that "In their top ten, none had more than 50 percent state funding. In the bottom ten, all but three states had more than 50 percent state funding" (Fischel 2002, 98).

The most dramatic and long-lasting experiment in school finance centralization—and rejection of local property tax financing—occurred in California in 1978. The state's voters approved Proposition 13, which cut most property taxes by more than half and left funding for the public school system almost entirely up to the state (O'Sullivan, Sexton, and Sheffrin 1995). Because of this tax revolt and because the state's court had severely constrained most local districts' ability to use local funds, California provides what economists call a "natural experiment" in school finance (Fischel 1989). It was "natural" in that Prop 13 was sudden and unexpected by most state and local officials.

The results of this clean shift from local to state funding could not be more stark. Total spending declined, educational quality declined, and more affluent families abandoned the system for private schools. Spending in the poorest districts was increased somewhat, but the gap in test scores between the affluent and poorer districts did not narrow at all (Brunner and Sonstelie 2006).

The local property tax also has the advantage of stability. In 2012 North Dakota voters were invited to eliminate the local property tax and substitute for it the state's swelling revenue from oil extraction (fracking) taxes (Davey 2012). The voters rejected this plan overwhelmingly, and it turned out to be a wise choice: Oil prices have since tumbled, and the state's school spending would have suffered as well. Voters may not love the property tax when considered in isolation, but they appear to realize that it is a more dependable source of revenue for services they care about.

Local Control: A Family Story

As an economist, I have emphasized the economic benefits providing for public education through local taxation. It has a long history in America, and it flourished during the period in which the American high school became the world leader in education (Goldin and Katz 2008). But local control of education through the property tax also has a less quantifiable aspect. Political scientists have mentioned the community-building aspects of local education finance. Alvin Sokolow (1998, 182), observes: "In its traditional and relatively unlimited version, the property tax also contributes to representative democracy in two interconnected ways: (1) by giving locally elected officials the discretion to allocate resources in a fashion that represents community priorities; and (2) by engaging citizen-taxpayers directly in the actions of government." I will illustrate this with a family story.

I grew up in Lower Saucon Township, just outside of Bethlehem, Pennsylvania. The home my parents built and that my four siblings and I were raised in was then (in the 1950s) in a semirural area. The township schools were mostly remnants of one-room schools of the 19th century. Although they were not run as traditional one-room schools (all ages in one room), most of them were "doubled up" with two grades per room.

Despite the antiquarian appeal of the system, my parents were not too pleased with this arrangement, and my mother persuaded my dad to run for the school board. Despite a retiring personality and a complete absence of campaign activity, he won the election. He and other new board members helped consolidate the elementary schools into a new facility that offered a much better education (one grade per classroom). After 12 years on the board, he declined to run again. One of my proudest moments for my dad was when a delegation of neighbors arrived one evening to try to persuade him to run again.

I would be projecting too much on this to say that Dad was motivated by a concern for property values. He did own a fair amount of land and paid property taxes on it, but his chief concern was for the education of his children and that of other children in the township. The point I want to make here is that this virtue does not run contrary to the financial incentives of a system that ties local schools to local property taxes. Had the state of Pennsylvania built and paid for all public schools from statewide taxes, it is more than possible that education would have progressed much more slowly.

Harvard economists Claudia Goldin and Larry Katz (2008) contrast the robust expansion of locally financed American education in the early 20th century to the lagging European system, which was centrally financed. In Europe, advances in education standards had to wait until a national consensus was reached. In America, local school directors like my dad could seize the initiative and move the system ahead with only local approval. Such initiatives would be noticed by other districts, who would worry that they might fall behind (and have their home values decline). This benign competition results in more experimentation and keeps education in the forefront of public issues. The property tax as an institution helps make "doing good" match up with "doing well."

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