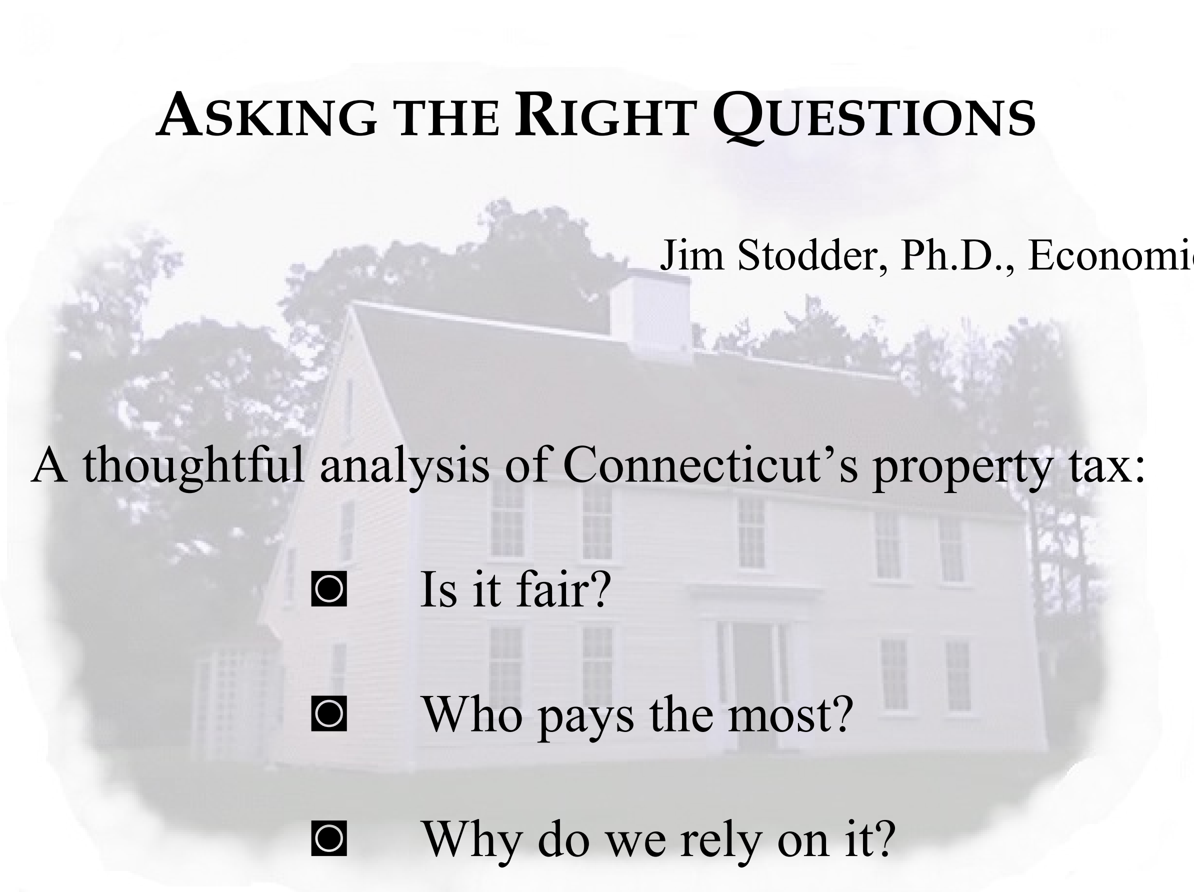
CONNECTICUT'S PROPERTY TAXES

ASKING THE RIGHT QUESTIONS



Jim Stodder, Ph.D., Economics

A thoughtful analysis of Connecticut's property tax:

- Is it fair?
- Who pays the most?
- Why do we rely on it?
- What will a cap do?
- How to fix it.

Commissioned by COUNCIL 4 AFSCME

"Obviously, a man's judgment cannot be better than the information on which he has based it."

Arthur Hayes Sulzberger, 1948
Speech to the New York State Publishers Association

This report is presented as a public service by Council 4 AFSCME, AFL-CIO to assist Connecticut's Legislators and Citizens in making good and sensible choices to reform our tax system.

Connecticut's Property Taxes

Asking the Right Questions

“Taxes are what we pay for a civilized society.”

Justice Oliver Wendell Holmes, Jr.

We should not shrink from those words. Written over 100 years ago, they seem even more relevant today, when many elected leaders have staked their reputations and futures on destroying that simple truth. It is inarguable that without proper funding at every level, government will not properly work. And if government does not properly work, what does that say about our collective dedication to the importance of “a civilized society”?

For three decades, opponents of government have shrilly, but with skill, complained about taxes. As Professor George Lakoff of the Rockridge Institute observes, tax relief suggests a condition to get rid of, like an upset stomach. Ben Franklin’s famous quip, that there is nothing as certain as death and taxes, was not a complaint about taxes; rather it was an affirmation of – and hope that – the United States Constitution would last. Of course he was referring to a document he helped write and that conferred upon the government the right to tax its citizens.

No one would argue that structure of taxes must be occasionally examined, and if inequitable, repaired. But Governor Rell has proposed a tax change which, despite her claims, is not a repair but rather a tool of destruction.

Governor Rell may appear to be responding to those in need, like the elderly on a fixed income or everyday working people struggling to keep afloat. In truth, she is responding to the smallest segment of her “constituency,” the most wealthy of Connecticut’s residents. She proposes a tax cap that will virtually destroy our local governments’ ability to operate. Her proposal will literally starve local governments.

Governor Rell has proposed a limitation on the ability of 169 towns and cities to raise funds for education, public safety, road repair and all the necessities of civilized society that are provided by this first “rubber-meets-the-road” level of government. Her proposal is plain intoxicating, for who among us would not greet a limitation on future taxes with pleasure? Her proposal sounds terrific as a sound bite, but in reality is far more than a clever and misleading phrase. It is a sure path to increased economic inequality and a guarantee of diminished services.

Donald Williams, President Pro Tem, of the Connecticut State Senate, explained it this way: “The proponents can say ‘tax relief’ in one second. In five minutes, I can explain to anyone why a property tax cap is a *very bad idea*. And that’s the problem – it takes five minutes.” Television may spend thirty seconds on the story, certainly not five minutes. This issue is of critical importance and deserves serious scrutiny. For that reason, Council 4 AFSCME – the voice of 35,000 union members who live and work in every city and town in Connecticut – has commissioned the study of the property tax proposal that begins on page 6.

We commissioned James Stodder, PhD, Clinical Associate Professor of Economics at Rensselaer Polytechnic in Hartford to author this study because of his extensive knowledge of tax policy. Our charge to him was to examine the property tax proposal and how it would affect Connecticut. We made no other stipulations or conditions.

I urge you to read this report and consider its findings carefully.

Sal Luciano

Sal Luciano, Executive Director
Council 4 AFSCME

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<u>TO CAP OR *NOT TO CAP*</u>

That <u>question</u> is of critical importance for Connecticut's future, but it's the <u>wrong</u> question.

Capping property tax is seductively simple, but it is right? Dr. Stodder's careful analysis of our tax system answers with a resounding ***<u>NO</u>!*** *"Capping merely puts a band-aid over a wound that is infected – and wholly self-inflicted."*

If you don't ask the right question, you cannot get the right answer. The *wrong question* is: Should we cap Property Taxes? The *right question* is:

<u>Why are some taxes so high, and others so low?</u>

<u>The wealthiest 1% (top 100th percentile) of the population actually pay a ***negative 1%*** in property taxes!</u>

> "[T]he very wealthiest 1% in CT sees its local property taxes not only subsidized, but <u>more than paid for</u> by [the federal mortgage interest deduction] . . . In dollar terms [that is] well over $14,000 for the richest top 1%." p. 9

<u>Connecticut taxes are upside down. The burden falls heaviest on those who can least afford it!</u>

> "Not only is the property tax burden "regressive". . . in proportion to property <u>wealth</u> . . .it is also highly regressive with regard to <u>income</u>." 80% of Connecticut's population pay between 3.8 and 4.3% of income on property tax, but the top 1% only pays 1%. p. 8

<u>Why is a cap such a bad solution?</u>

<u>A cap will lead to greater inequality from town to town, creating more inequality in education.</u>

> Wealthy towns will vote to override the tax cap *and still find property tax as a diminishing portion of their wealth.* History shows that struggling moderate and low income towns will almost never vote to override and be forced to cut services. p. 21

<u>Are there good solutions?</u>

Fortunately there are: p. 23

✔ *Real* **circuit breakers** that would guarantee rebates over a fixed percentage of income.
✔ *Fully funded* **state-wide initiatives** that evenly distribute state programs to ameliorate local cost.
✔ *Fully funded* **PILOT programs** at 100% <u>not</u> 77%.
✔ *Statewide property taxes* assessed at a flat rate to pay for education.
✔ *Splitting property tax* into <u>land</u> and <u>building</u> tax to make it more fair and minimize sprawl.

Summary of Findings

Connecticut's Property Taxes - Asking the Right Questions

by James P. Stodder, Ph.D

A Cap Will Exacerbate Inequality

Governor Rell's proposed property tax cap will limit increases to 3% per year. That sounds like relief to many state residents, who ask why property taxes are so high. But a better question is, "Why are some property taxes so high, and others so low?"

If you don't ask the right question, you're not going to get the right answer. We've had eight state property tax commissions so far, and none of them has faced the basic fact of a highly regressive tax.

The poorest 40% of Connecticut households spent 3.9% of their incomes on property taxes in 2003, after federal deductions for interest on their mortgages. (Of course, the poorest 40% don't have a lot of such deductions, since many don't own homes.) The next 40% of households did a bit better, spending 3.1% of their incomes on property tax, after deductions.

When we look at the richest 20% of state households, they spent just 1.6% of their incomes on property taxes after deductions. But the richest 1% of households actually got a rebate - averaging 1% of their incomes! That's the amount by which help they got from the Feds on mortgage interest exceeded what they paid in property taxes.

Inequality Growth

Of course, the rich have a lot more property to tax - so lower rates can still add up to nice revenues for their schools. Figures from the State Office of Policy and Management for 2005 show that the lowest tax town (Greenwich) had an effective "mill rate" (parts per thousand) a bit more than 5, or about one-half a percent of local property values.

For the town with the highest effective mill rate (Waterbury), it was a bit above 30, or more than 3% of property value - about 6 times the rate in Greenwich. This disparity has been growing, along with the increasing concentration of wealth. In 2000 the ratio of their effective mill rates was just over 4.

Unequal Education

Good questions lead to better questions. Once we see the inequality of property taxes, we get a more troubling question: "How can we provide "substantially equal" educational opportunities - as Connecticut's Supreme Court says we must - if education funding is mostly by local property taxes?" The answer is clear: we can't.

In terms of a crude dollar-per-student measure, it's not the poorest cities that are falling furthest behind, but lower income small towns. "Net Current Expenditures per Student" in Canaan (the highest spending town) vs. Watertown (the lowest) were $16,135 vs. $8,163 in 2006. That's a ratio of almost 2 to 1, and includes all state and federal sources. This ratio between highest and lowest spending town has risen every year since 2002, when the ratio was just 1.71.

The highest-spending 5% of towns spent $15,198 per student in 2006, while the lowest-spending 5% spent $8,962. That means the bottom 5% are spending 70% less, a "discount" that's fallen every year since 2000, when they spent 57% less.

Other measures of spending inequality, including the State Department of Education's "needs-based" measures, show a similar trend. So not only has state spending failed to provide "substantially equal" educational opportunities to students in rich and poor towns. It hasn't kept our substantially unequal opportunities from getting even more so.

Of course, it would take much more than equal spending to equalize student outcomes - given vastly different starting places in terms of family stability, income, and education. If the spending gap grows, however, this guarantees that outcomes will only diverge even further.

In 2006-07, a student "rich" enough to not be eligible for a subsidized lunch, had 4 to 5 times the chance of earning a "proficiency" score in the 10th grade CAPT tests, compared to a student poor enough to qualify for the lunch. This gap between has been rising since 2001 - as the State Department of Education recognizes.

There has at least been some lessening of the gap between White and Black or Hispanic students. But this smaller gap is not reflected in scores of rich and poor families, or rich and poor towns. So a smaller ethnic gap doesn't mean educational opportunities for the poor have improved. It means that a few more Black and Hispanic families are escaping poverty, poor towns, and poor schools.

What are the consequences of a cap on local property taxes? Further widening of achievement gaps and worsening suburban sprawl are the likely outcomes.

Governor Rell promises that the state will make up for slower growth in town revenues. But as most town officials will tell you, our state has a long history of such promises. California and Massachusetts passed a cap with similar promises. Nonetheless, their state funding fell in each economic downturn - just like Connecticut's.

Towns are free to vote an override on the proposed cap, but experience in California and Massachusetts shows that only wealthy towns are likely to do so. So when state funding fails, poorer towns have little choice but to cut services.

Oh, towns do have one other choice - they can always allow more sprawl. They have always had this choice, but under the cap, increasing taxable base will be the only way, baring an override, for a town to grow revenues beyond 3%. Connecticut's property taxes have already given our state the unhappy combination of development that sprawls in an economy that crawls. The cap will guarantee that this cancer continues to metastasize.

Sensible Alternatives

What are the alternatives to a cap? The list is too long to discuss here, but promising alternatives are: (1) real "circuit-breakers" to guarantee (as in Vermont) that no state residents ever spend more than low fixed-percent of their income; (2) a larger homestead exemption to keep more of a home's value off the tax rolls; (3) full state funding for any state-wide initiative and for Payments in Lieu of Taxes (PILOT); (4) more of the property-tax could be flat rate on a state-wide or regional basis; (5) taxing land and buildings separately (as in Pennsylvania and advocated by the Hartford Courant) could make abandoned urban lots and buildings much less common.

The cap is a band-aid over a wound that is badly infected. We can't build a more equal educational system on the back of something as unequal as local property taxes. Connecticut's traditions of local control and schools working with parents are good things, but we shouldn't have to live in a rich town to get them. We need to guarantee all towns, and all our kids, a more equal place at the starting gate.

James P. Stodder holds a Ph.D in Economics and is Clinical Associate Professor at the Lally School of Management & Technology, Rensselaer Polytechnic Institute at Hartford.

Introduction

Ned Lamont

Connecticut's high property taxes are a regressive tax borne by those least able to afford them; the tax falls disproportionately upon poorer communities including our cities which continually have to choose between quality education and a heavy property tax burden. The tax exacerbates the inequities between our wealthier suburbs and our cities, the result being jobs and infrastructure leaving our cities, spilling into the suburbs, with an accelerating loss of open space and increase in transportation congestion.

I urge the governor and the legislature to read Jim Stodder's analysis carefully. Our over-reliance on the property tax accelerates some negative trends in Connecticut which impact our quality of life and our ability to compete for good paying jobs. The best strategy for our future in Connecticut should focus on rebuilding our cities, which were some of the wealthiest cities in the country a century ago. Cities as a hub for entrepreneurship, commerce, and affordable housing will protect our rural areas from overdevelopment, lessen our dependence upon the automobile, and help us grow good paying jobs in a state which has been a laggard in job growth over the last generation. Growing the grand list in our cities will continue to lower the property tax burden and free up resources for education and other municipal services.

Reducing our reliance upon the property tax reduces taxes for homeowners and small business alike. The urban agenda will save the state untold capital expenses if we can avoid expanding our highway system as more and more employees can walk or take public transit to work. The lower property tax will also benefit rural areas where the high tax cost of open space forces undeveloped land into the developers' hands.

Connecticut is just now embarking upon a strategic plan which will help determine our future. Connecticut's passive approach to planning has resulted in minimal job growth, declining wages, extreme educational inequities between our urban and suburban schools, increased traffic congestion, more suburban sprawl and less open space. Reducing the property tax must be a key element of our strategic plan. The governor and the legislature must evaluate our mix of taxes, especially in comparison to our neighboring states, and our cost structure as we make reduced property taxes a key ingredient to putting Connecticut back on the winning track.

Ned Lamont, Democratic Candidate for the U.S. Senate in 2006, is a resident of Greenwich. He is an Adjunct Professor at Central Connecticut State University and Chairman of Lamont Digital Systems, Inc.

<u>Connecticut's Property Tax Burden</u>: Asking the Right Questions

Jim Stodder, Ph.D., Economics
Rensselaer Polytechnic Institute
Hartford, January 14, 2008

"*In design, it's more difficult and important to ask the right question. Once you do that, the right answer becomes obvious."*

- Armory Lovins, Environmental Systems Engineer
Feb. 2002, <u>Buildings</u> Magazine
www.buildings.com/articles/detail.aspx?ContentID=660

Introduction and Executive Summary
Many Connecticut residents are asking an obvious question – *"Why are our property taxes so high?"* But painfully obvious as it is, this is not really the right question. The hint is that property taxes are **not at all high for some** Connecticut residents when compared to their income. They are actually quite low – especially when compared to richest people in other states.

So a much better question would be, *"Why are some Connecticut property taxes so high, and others so low*?" This is the right question because it quickly leads to other basic questions. And these point to answers to the really big question: What can we <u>do</u> – to **relieve the property tax burden**, and still **provide basic services**?

This report will ask, and try to answer, the following five questions. The beginnings of an answer to each question is given, just for starters:

1. *"Why are some Connecticut property taxes so high, while others are so low?"*
   Answer: Because property itself is so **unequally distributed** in our state.

2. *"How did Connecticut get so dependent on taxing property?"*
   Answer: Because we are also the **richest state** in the US. This has meant that on average, Connecticut residents spend a far smaller percentage of their income on property tax than most other states. The burden of that spending is shared very unequally, however.

3. *"What are the consequences of this very unequal tax?"*
   Answer: Very **unequal outcomes** in basic services and increasing suburban **sprawl**. The wealthiest towns build and maintain world-class educational systems, at a low cost relative to income, keeping tight local control of how their money is spent. Poorer towns must spend an ever greater portion of their wealth on property tax (and must still go begging to the state to cover their basic needs.)
   Higher property taxes drive business from urban to suburban areas. Those suburban areas can only keep their tax rates from rising, however, by expanding their tax base – competing for more strip malls.

4. *"What are the likely consequences of trying to 'cap' the growth in property taxes?"*
   Answer: Greater inequality in services, and **more sprawl**. The richest towns can vote to override the proposed 3% annual cap, and still find that their property tax is a diminishing portion of their wealth. Struggling moderate and low income towns, however, will almost never vote such overrides; they will be forced to cut services. Since the 3% cap *specifically excludes* new additions to the tax base, increased sprawl would then be the *only way* for most towns to raise revenues.

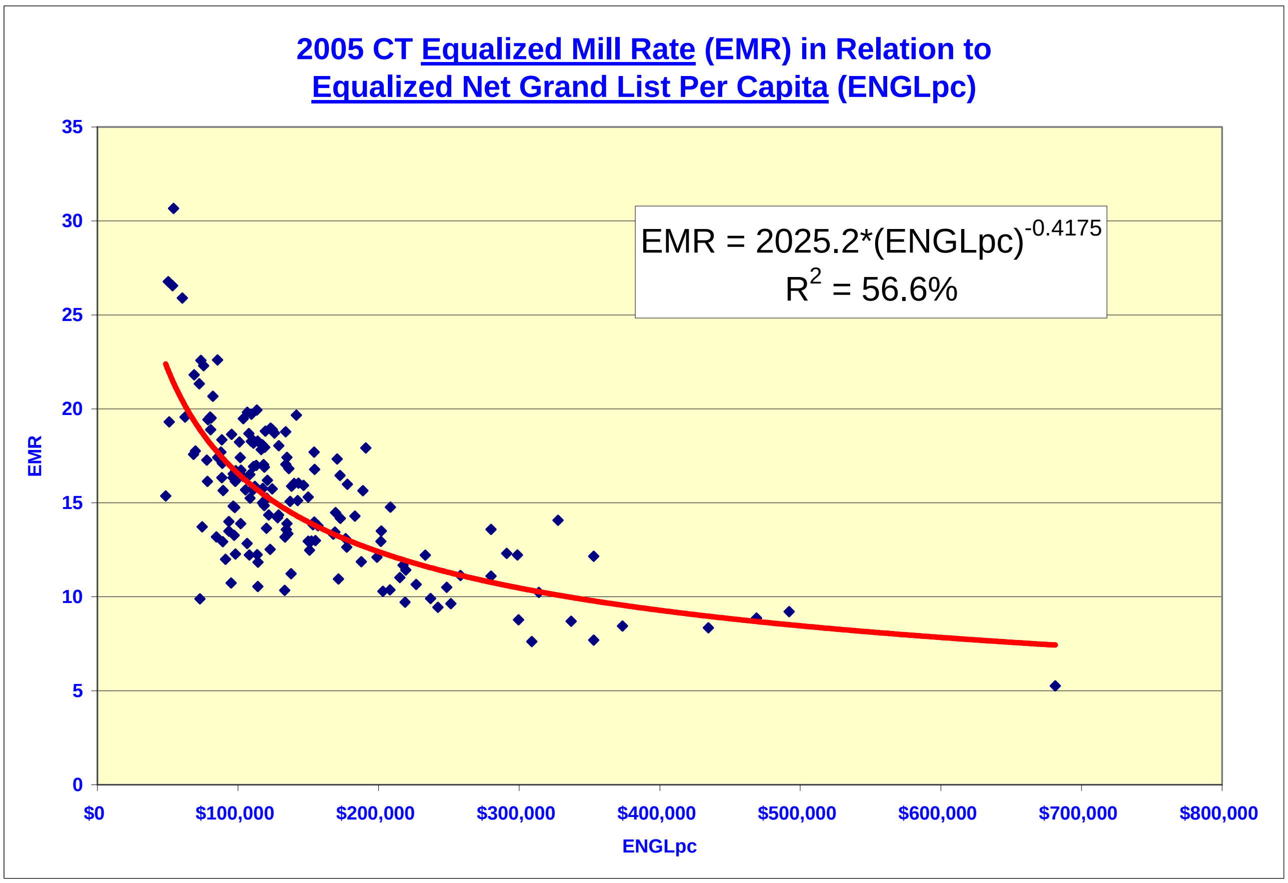
5. *"What can be done to reform the property tax system?"*
   Answer: There are several attractive options, all with real-world examples in other states:
   - State government could provide real protection from excessive property tax growth, with real "**circuit breakers**." These would **guarantee** Connecticut residents a rebate on any tax paid over a fixed percentage of their income.
   - The state should fully-subsidize state-wide initiatives.
   - *Payments-in-Lieu-of-Taxes*, or **PILOT programs**: The state should reimburse 100% -- instead of, as currently, only 77% -- of local property taxes, the full amount that would have been collected from non-profits such as Schools and Hospitals.
   - Property could be taxed on a **statewide or regional** basis, at a flat rate.
   - Sprawl can be minimized, and open spaces conserved, by **splitting the tax** into a tax on land and a tax on buildings.

Now let us examine these questions in more detail:

Question 1: *"Why are some Connecticut property taxes so high, while others are so low?"*

Answer: Because property itself is so **unequally distributed** in our state, and because higher property values means lower tax rates.

Property tax rates or "Mill Rates" (Dollars of taxes charged per thousand Dollars of assessed property value) can be lower when property values are higher, without having to sacrifice revenues. In fact, Connecticut's property is so unevenly distributed that property values in richer towns rise even faster than those towns' mill rates fall. As a result, these towns can enjoy higher property tax receipts – and at the same time, as their property values rise – pay an ever-declining portion of their accumulated property wealth out in taxes. The **next graph** shows the negative relation between our towns' per-capita town property wealth (Equalized Net Grand List per capita, or ENGLpc), and their mill rates (Equalized Mill Rate, or EMR):



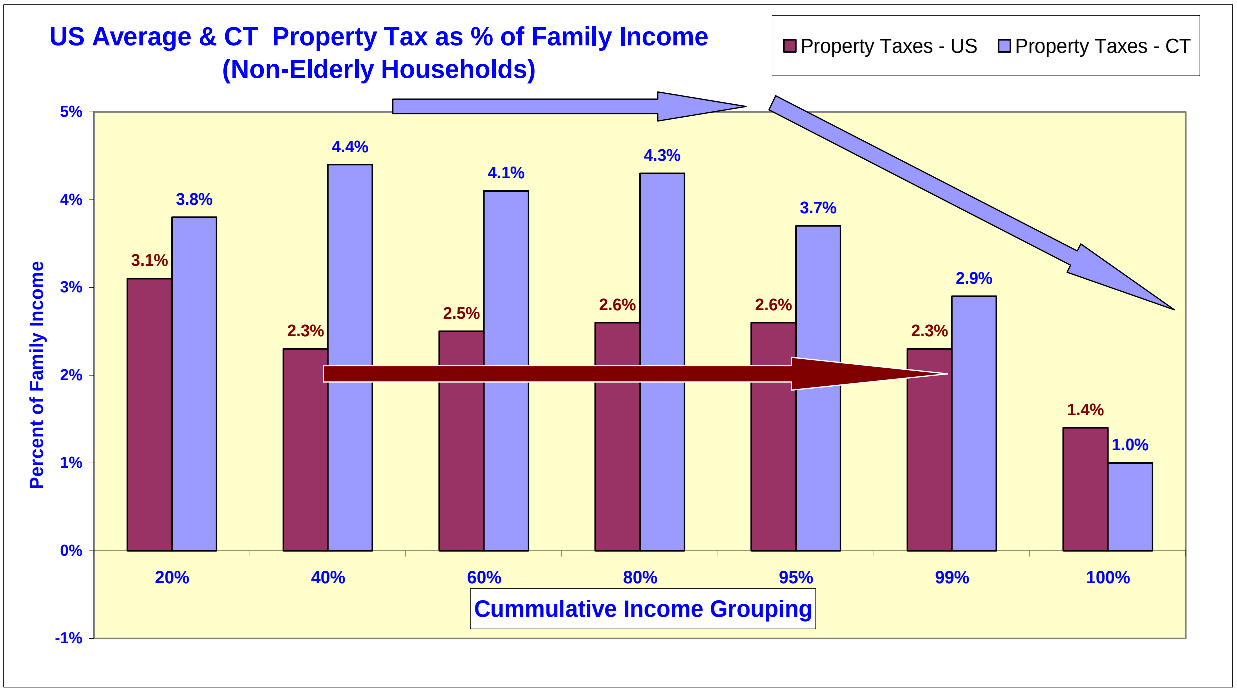
Source: ENGLpc, EMR from the CT Office of Policy and Management, "Municipal Fiscal Indicators," http://www.ct.gov/opm/cwp/view.asp?a=2984&q=383170&opmNav_GID=1807 . (The "Equalized" name of these variables means that OPM has tried to correct for different times of revaluation.)

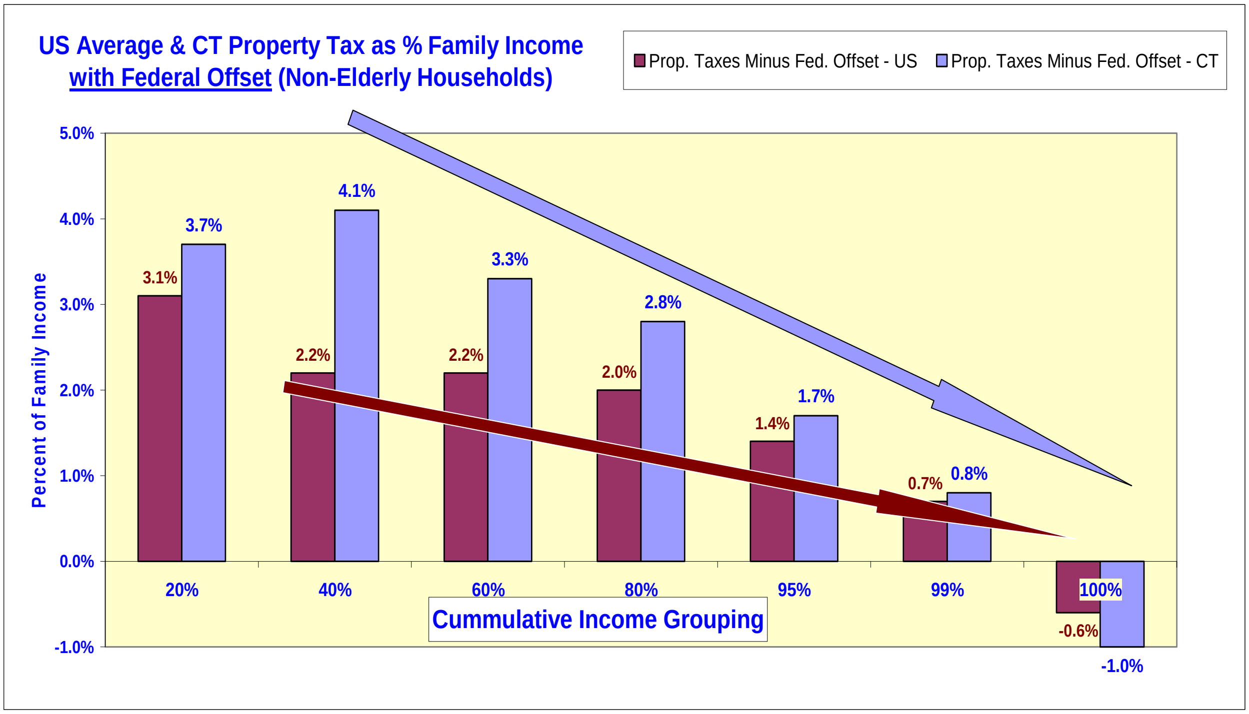
This basic negative relationship -- higher ENGLpc means lower EMR -- is summarized by the estimated equation. By its "R^2" (R-squared) statistic, this equation shows that town-by-town variation in ENGLpc (per-capita property wealth), explains over 56% of the total variation in town mill rates. In terms of statistical relationships in economics, this is a very high degree of variation explained by just one variable.

Data and town names are available from the source cited, but the 5 data points in the upper left of the graph, with the highest EMR numbers are – moving from highest to lowest – Waterbury, New Britain, Bridgeport, Hartford, and East Hartford. The 5 towns in the lower right, with the highest ENGLpc values are – moving from left to right – Roxbury, Darien, New Cannan, Westport, and Greenwich.

The **previous graph** shows property tax burden as a declining function of property wealth. But it also shows much more. It shows that even as mill rates fall, tax revenues actually increase. The equation, with its exponent of -0.4175, tells us that as property values rise by 10%, average property taxes fall by 4.175%. This means that if property values are 10% higher in town A than town B, town A's mill rates will be about 4% lower than B's. But then the tax revenues in A must actually be higher by about 6% (or10% minus 4%).

Not only is the property tax burden "regressive" or very unequally shared in proportion to property wealth. But because people with high value homes tend to have higher incomes, it is also highly regressive with regard to income. The **following two graphs**, based on 2003 incomes, should help to make this clear.





Source: "Who Pays?: A Distributional Analysis of the Tax System in All 50 States", Institute for Taxation and Economic Policy, 2nd Edition, 2003. http://www.itepnet.org/whopays.htm

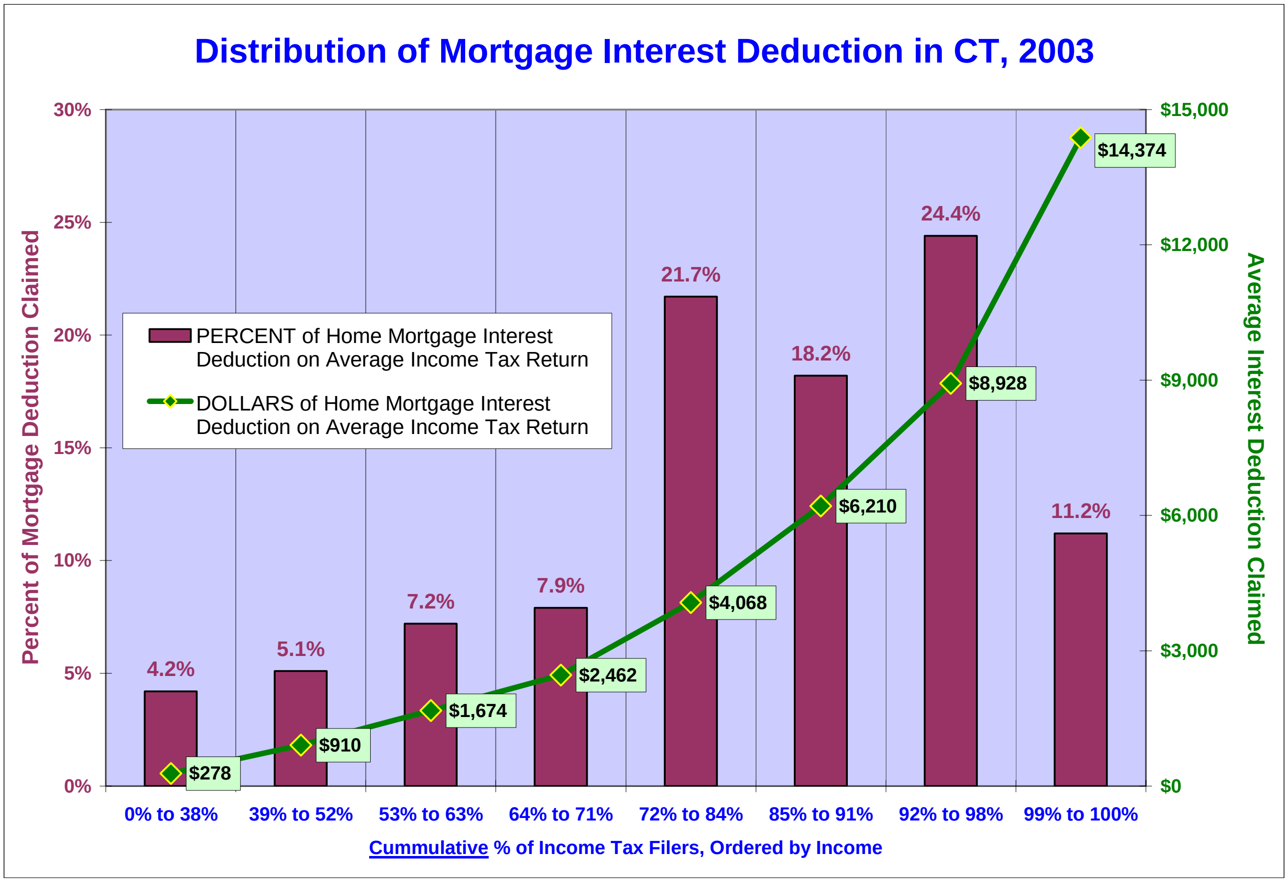
Consider the **first graph on the previous page**, “US Average and CT State Property Tax Burdens by Family Income (Non-Elderly Households).” (The elderly are excluded because of Connecticut’s “circuit breaker” provisions, a topic to which we will return.) This graph’s dark bars, the tax burden for the average US state, are almost level (as shown by the slope of the dark arrow) for all but the extremes of the US income distribution. That is, except for the poorest 20% of US families, and the very richest, at the top 1%, the tax rate as a percent of income is very stable – between 2.3% and 2.6% of income.

For the light bars, representing Connecticut’s property taxes, the burden is not only higher for every income level except the top 1% -- it is also declines from 80% on (as shown by the negative slope of the light arrow). Thus property taxes in Connecticut are not only higher, as a percent of family income, than in the US on average for almost everyone, they are also much more unevenly distributed.

Moving to the **second graph on the previous page**, we now take into account the deductibility of interest payments on federal income taxes. It is well known that this deduction disproportionately favors the rich. This second graph shows how great a favor this really is. Looking at the average US property tax rate, we see that once this subsidy is taken into account, the apparently “flat” property tax burden becomes much more regressive. Thus the dark arrow in the **previous graph** is flat, while in this one it is negatively sloped. The very richest group, the top 100th percentile, sees its property taxes as totally paid by its Federal tax deduction, plus it receives another 0.6% of income. (Thus its effective tax rate is negative).

This is generous indeed, but not as generous as the property tax treatment in Connecticut. The light CT arrow is seen to be much more negatively sloped than its counterpart, the dark US arrow – so the CT system is much more regressive. In both CT and the US average, property taxes are subsidized by the interest deduction for all income groups above the lowest 20% (few of whom own homes). This is why the percentage bars after the federal deduction, in this second graph, are lower than those in the first graph. But as for the US on average, the very wealthiest 1% in CT sees its local property taxes not only subsidized, but more than paid for by this interest deduction. And whereas for the US this “over-subsidy” to the top percent comes out to an extra half-percent, for CT it comes to an extra full percent of family income. (Moreover, incomes in CT, the wealthiest state in the nation, are substantially higher.)

We can also look at this property tax subsidy in dollar terms, and as a percent of mortgage interest payments in Connecticut. The **graph on the next page** plots this out, using figures from a study by the Tax Foundation, a conservative Washington think tank. As a percent of actual mortgage interest payments, the interest rate deduction rises with income, except for the very richest one percent of tax filers. In dollar terms, however, the subsidy rises steadily and steeply, from $238 for the bottom 38% of tax filers, to well over $14,000 for the richest top 1%.



Source: 'Who Benefits from the Home Mortgage Interest Deduction?" Fiscal Fact No. 49, by Gerald Prante, Feb. 6, 2006, The Tax Foundation, Washington, D.C., http://www.taxfoundation.org/news/show/1341.html .

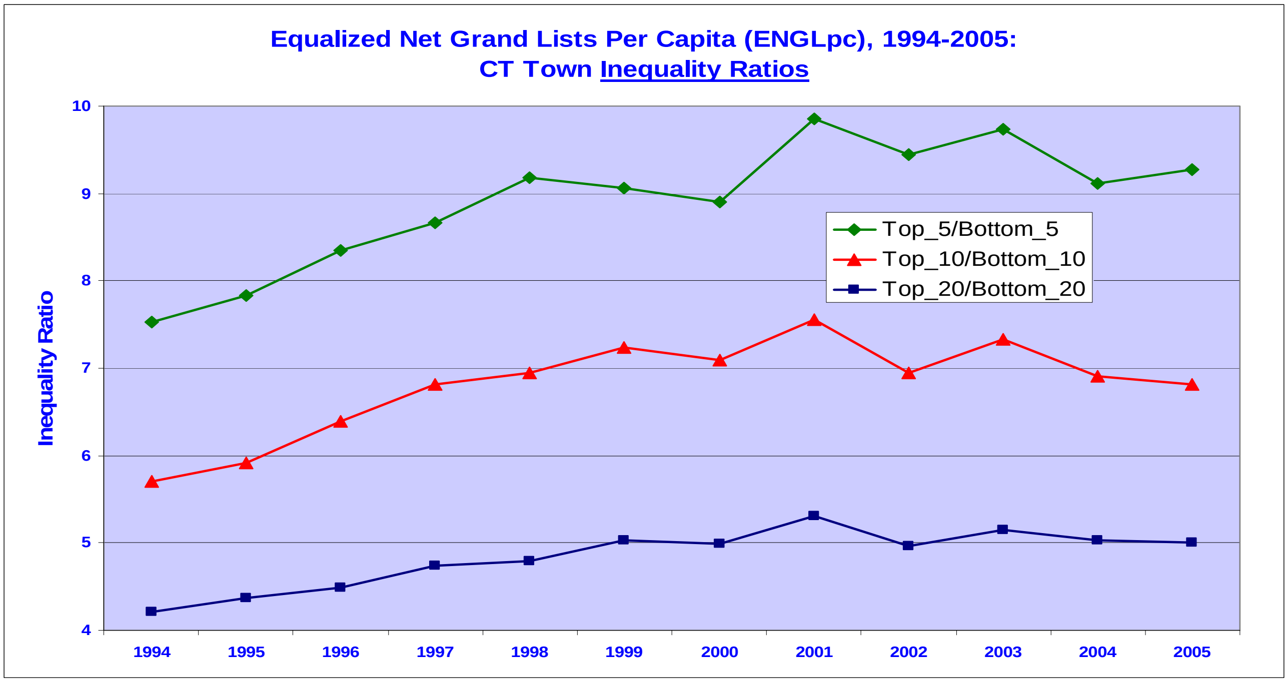
Focusing our question on the distribution of property points to another important problem. Not only is the burden of property taxation unequally shared – because income and property are becoming ever more unequally distributed in Connecticut and the nation as a whole, the burden of a property-based tax is also becoming every more unequal. This is shown quite clearly by the **two graphs on the following page**.

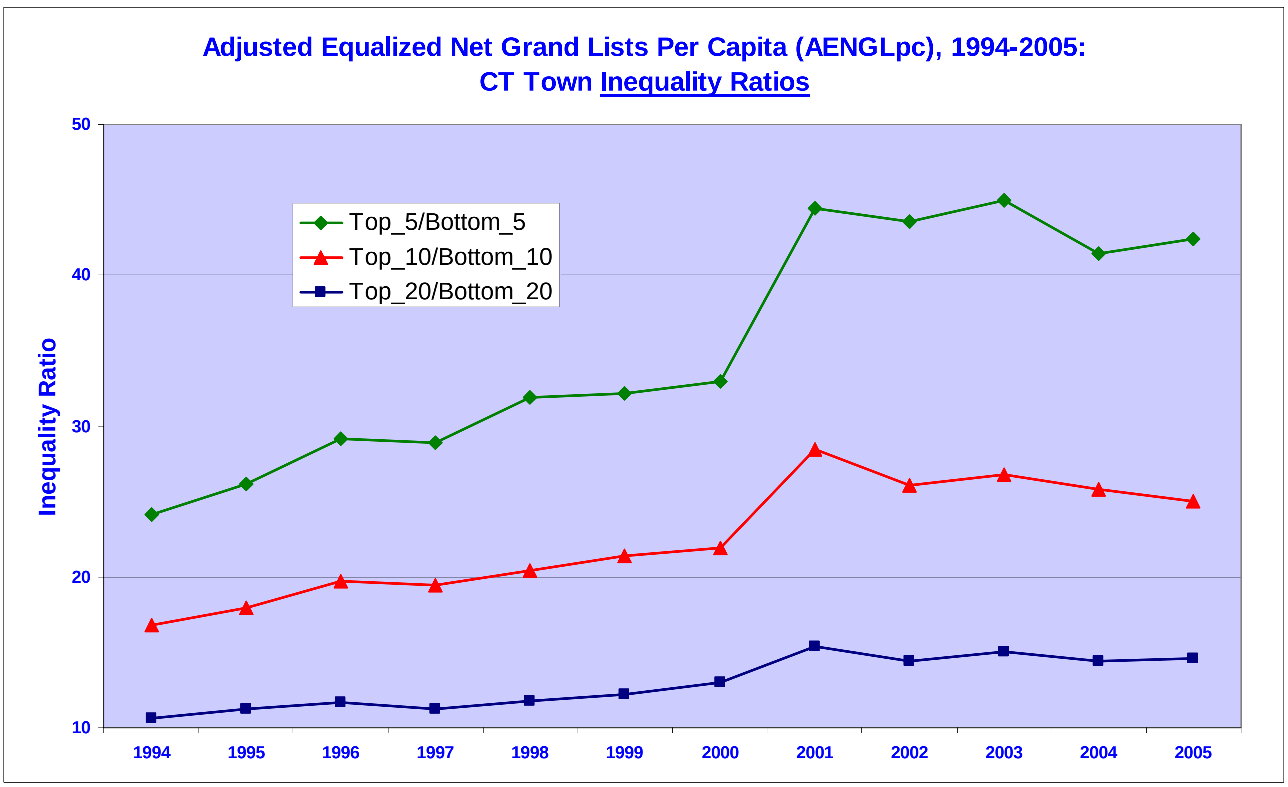
The **first graph on the next page**, "Equalized Net Grand Lists Per Capita (ENGLpc), 1994-2005: CT Town Inequality Ratios," shows that the ratio of property wealth per capita in the richer as compared to the poorest towns has been rising over the last decade. Looking at the most extreme degree of inequality, the ratio of property wealth per capita that between the 5 richest and 5 poorest towns has risen from 7 ½ to almost 9 ½.

The Connecticut State Department of Education does not look just at property values when considering measures of economic inequality between towns in our state. It also considers relative income, the ratio by which a towns per capita income exceeds the state average, to devise a measure it calls "Adjusted Equalized Net Grand List Per Capita." (This is abbreviated as AENGLC in official publications, but I will refer to it here as ANGLEpc, for consistency with my earlier term ENGLpc.) Measures of the economic inequality between towns turn out to be even more extreme by this measure, as the **graphs on the next page** show.

Thus we see in this **second graph**, "Adjusted Equalized Net Grand Lists Per Capita (AENGLpc), 1994-2005: CT Town Inequality Ratios," that the ratio of economic resources between the five richest and five poorest Connecticut towns has increased, over the last decade, from 25 to more than 40.

To conclude this section, there may be a problem with funding local services, especially education, by taxing something as unequally distributed as property. If this inequality of resources is a problem, the graphs above show that it is only getting more so. Any proposed "solution" to the property tax crisis that does not recognize this brute fact of inequality, cannot address the main cause of the crisis. It cannot even recognize why this tax's burden has been getting worse for most of Connecticut.





Source: Data for this and the previous graph are from the State Department of Education, Bureau of Grants Management, http://www.sde.ct.gov/sde/cwp/view.asp?a=2635&q=320584. (*)

(*) Note that the Department of Education refers to the ENGLpc in this series as running between 1994 and 2005, as shown on the lower axes of both graphs. The AENGLpc, however, while itself based on the same ENGLpc data, plus income data of the same vintage, it is identified as running 4 years later, from 1998 to 2009. This is for reasons of the planning and school funding. But for purposes of comparison between ENGLpc and AENGLpc, it seems better to keep the year-to-year comparison consistent.

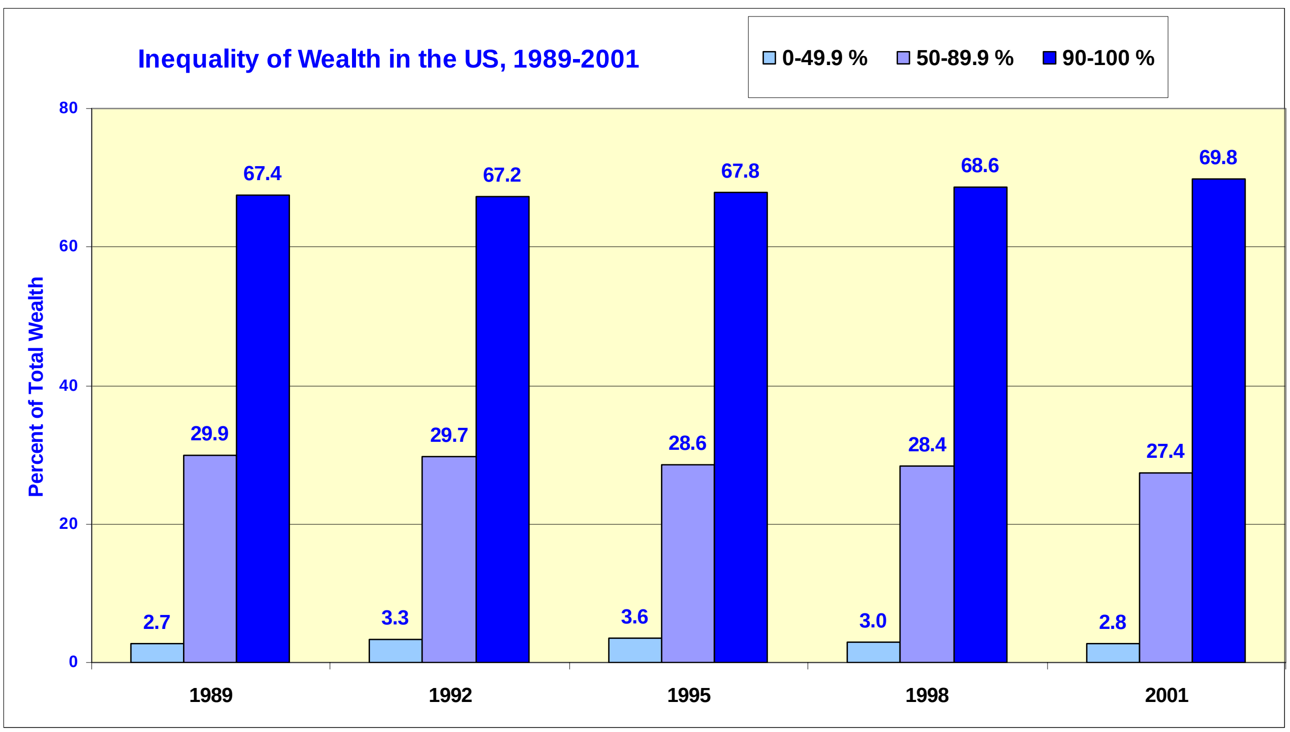
Question 2: *"How did Connecticut get so dependent on taxing property?"*

Answer: Because we are the **richest state** in the US.

That Connecticut has long been the richest state in the nation in per capita terms is well known. By 2005, personal income in Connecticut was $47,819 per-capita – more than 38% above that of the US as a whole, and more than 9% above the next-highest state, New Jersey (Based on US Bureau of Economic Analysis figures, http://www.infoplease.com/ipa/A0104652.html).

But this substantial income gap between states is greatly magnified by the inequality in terms of their accumulated wealth. It is hardly news that rich people are able to save more than poor people and can invest those savings at higher rates of return. But these simple facts have dramatic implications for the accumulation of resources. As income flows trickle into stores of accumulated wealth (of which real estate is but one form) this inequality of savings rates means that any existing inequality of incomes will be greatly **magnified,** as a much more focused concentration of wealth.

Extensive surveys on wealth concentration are not carried out regularly. Nevertheless, the **following graph** shows that the share of wealth held by the top 10% (90-100% of the wealth distribution) has been increasing over the last decade, while the share of the bottom 49.9% and next 40% have both been falling. Since income concentration has continued to increase since 2001, it is a virtual certainty that the concentration of wealth has done so as well.

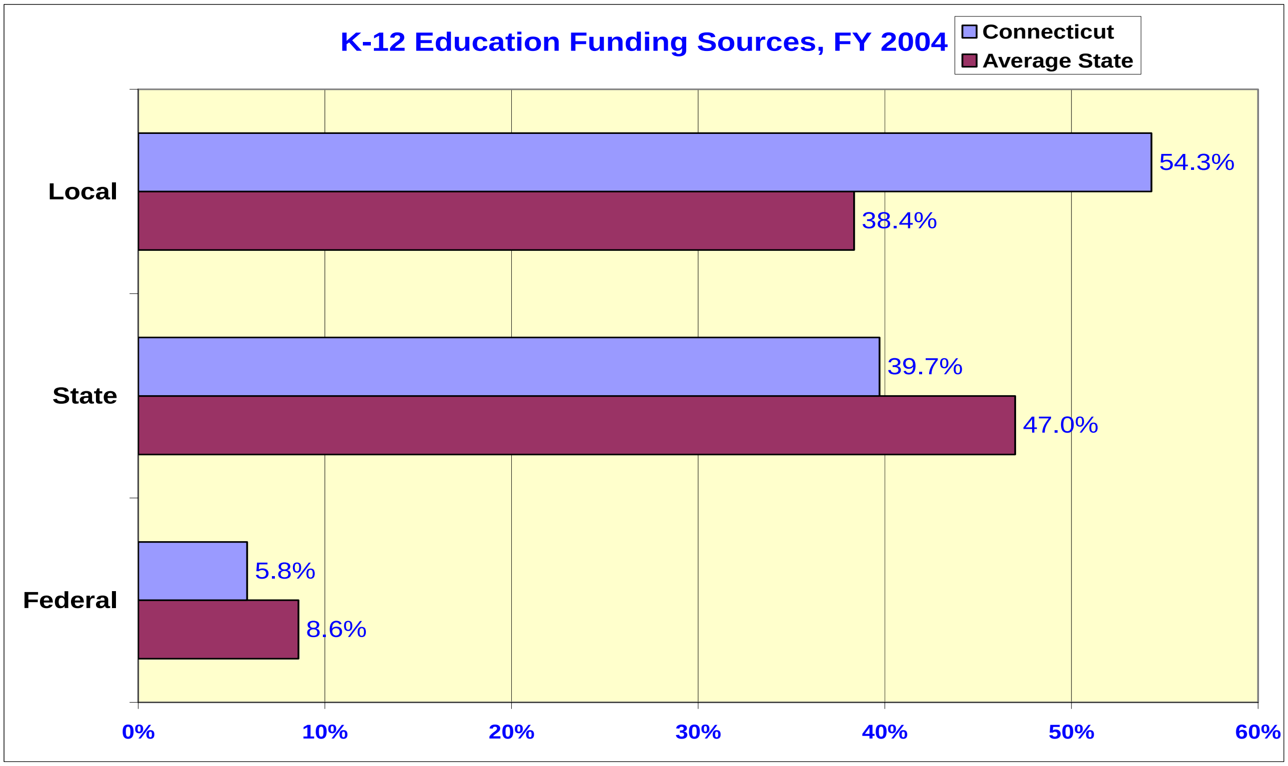


Source: Chicago Federal Reserve Bank, "Wealth Inequality: Data and Models," WP2005-10, www.chicagofed.org/economic_research_and_data/wp_abstract.cfm?pubsID=732

Comprehensive comparisons of property wealth by state are not readily available, but since Connecticut has been the richest state in terms of income per capita for many decades, it will also be by far the wealthiest in terms of accumulated property.[1]

1. There are studies of median housing values and tax rates by state, and of average values and tax rates in major cities, both from the Tax Foundation: http://www.taxfoundation.org/research/topic/9.html. Somewhat more detailed, but still not fully comprehensive is the study by the Minnesota Taxpayers Association, "50-State Property Tax Comparison Study, 2006".

It is well known Connecticut raises more money from property taxes than any other tax, and the great bulk of property tax revenues go to public education. The **following graph** shows that -- unlike the average state in the US -- Connecticut gets most of its revenues for K-12 education from local sources: not from the state.



Source: "Public Elementary and Secondary Estimated Finances, 1990 to 2004 and by State, 2004," Table 245, http://www.census.gov/compendia/statab/tables/07s0245.xls.

In terms of the other 49 states, the data behind the **above graph** will show that Connecticut's percentage of local funding is the 7th highest -- behind only (in descending order): Rhode Island (in first place), New Jersey, Illinois, Pennsylvania, Missouri, and Massachusetts (in 6th place). However, in terms of state spending we are in 34th place, and for federal spending we are 40th. (This low last ranking is not surprising, as federal spending is mildly redistributive, and Connecticut is the richest state).

But it is vital to recognize that high as our local share of K-12 funding is, the wealth of our state means that this imposes a very low relative cost in terms of our total personal income. Data from 2003 show that Connecticut spends only 5.5% of its Total Personal Income – a percentage that puts us in 47th place. (States with a slightly lower percentage are Massachusetts, Nevada, and in 50th place, Florida, at 5.3%.) [2]

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Making Connecticut's property wealth the basis for K-12 education is a double-edged sword:

- Connecticut's high average wealth is largely the basis for the quality of its K-12 education system – but only **on average**. Connecticut scores high on standardized tests like the SAT, with our state average higher than the US average in both reading and writing over the last decade, but slightly behind in math.[3] These high scores are highly concentrated in richer towns, however.
- Given our growing inequality of wealth, **local control by the wealthy towns** means that the **poorer towns are increasingly dependent on the state for assistance**. Without state funding, most poor to moderate towns can never approach the per-student funding of the rich towns. But this state funding is neither large enough, secure enough, nor well enough focused to even begin equalizing outcomes, as the answers to Question #3 below (page 11) will show.

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[2] See Table H-4. State & Local Govt. Expenditures for All Education, 2002–03, per $1,000 of Personal Income in 2003 ($), http://www.nea.org/edstats/index.html.

[3] "Connecticut's Class of 2007 Exceeds National Average on SAT Writing Test", CT Dept. of Education News, August 28, 2007: http://www.sde.ct.gov/sde/lib/sde/pdf/Pressroom/SATPressRelease2007.pdf.

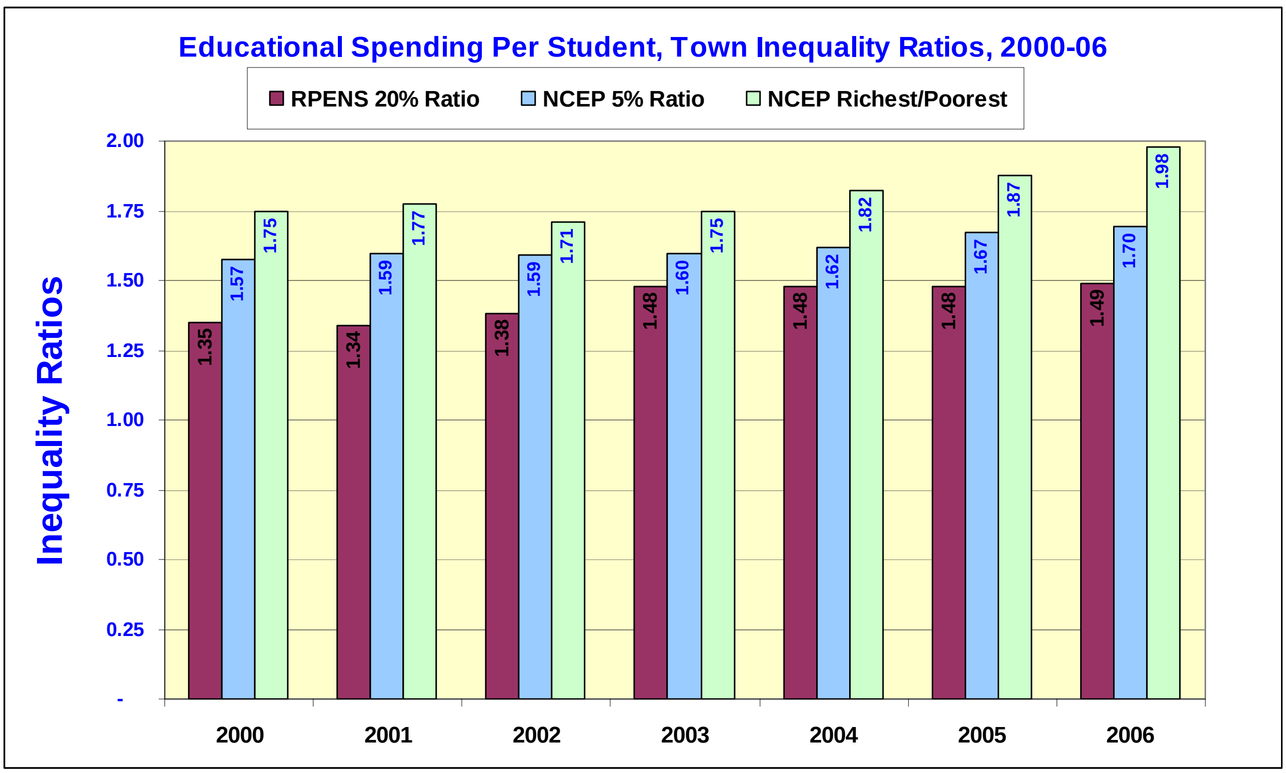
So on the positive side of the ledger, Connecticut's property-tax arrangement has given our wealthy towns what they want – local control and a first-class public school systems at a very low cost relative to their income and wealth. These interests have fought hard to maintain the current system, which benefits them in terms of their children's future, their real estate values, and their total tax bill.

But these achievements must be set against gaps in educational outcomes – between towns, income groups, and ethnic groups. These gaps show no clear signs of diminishing, as the State Department of Education itself recognizes.[4] Indeed, as we shall see in the next section, there is much evidence to the contrary.

Connecticut's state expenditures have failed to achieve "substantial equality of opportunity" in terms of per-pupil spending between rich and poor districts. The **following graph** shows the inequality ratios between richer and poorer towns for Net Current Expenditure per Pupil (NCEP): total spending directly on student, *from all sources*. Inequality ratios are shown by the lighter bars, comparing average NCEP in the highest vs. lowest 5% of towns, and in the very richest vs. the very poorest town. It is obvious that state funding has not only failed to achieve "substantial equality," but has failed to halt the rising trend of inequality.

But even if there were perfect equality of dollar spending, this would not mean equality of opportunity. Given vastly different student starting points in terms of parental incomes and education, there is need for increased state funding under the provisions of Educational Cost Sharing (ECS). With growing student needs in the poorer communities, the Dept. of Education's ratio of expenditures **weighted to student needs**, Regular Program Expenditures per Needs (RPENS), shown by the darker bars below, has also grown in recent years.

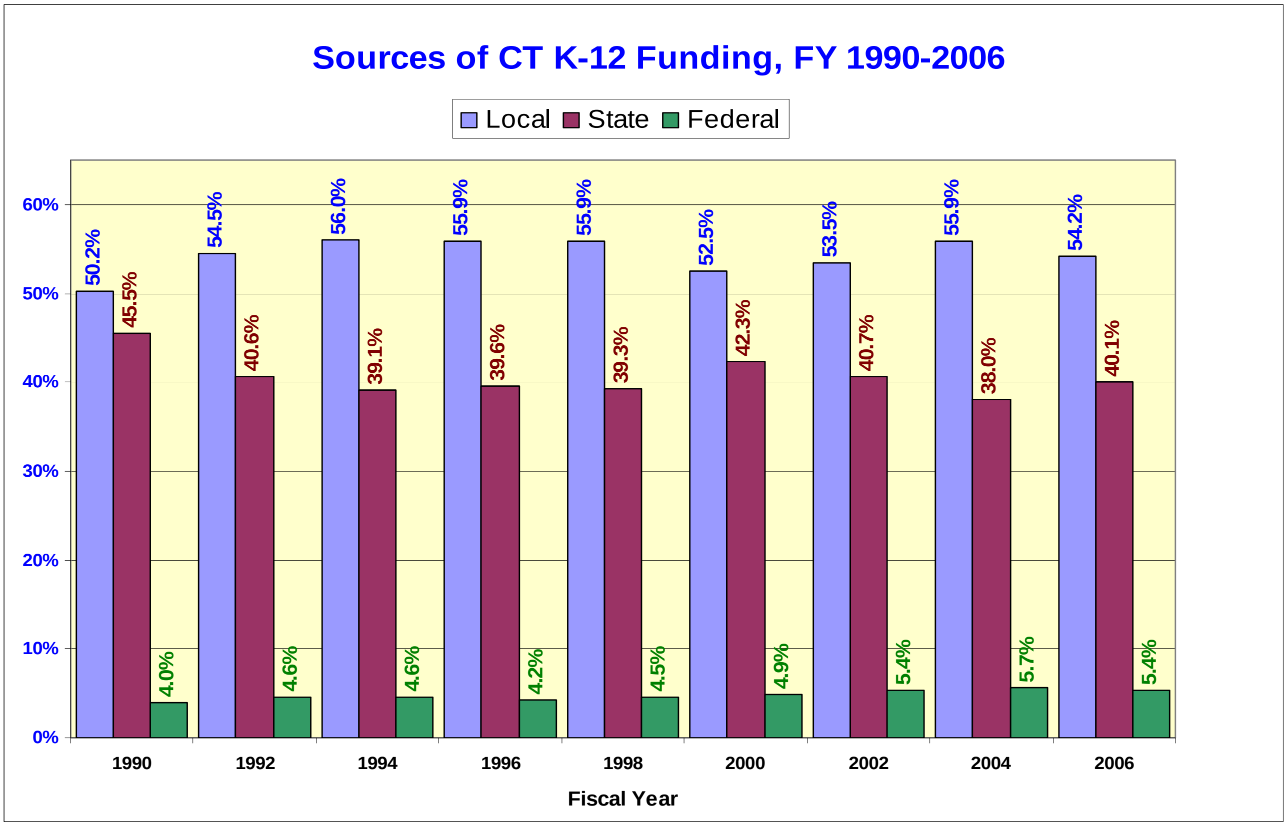
RPENS is an imperfect measure, looking just at local (not state and federal) spending and the effects of unmet student needs. Nonetheless, it has been the basis of the ECS commitment of the state. As we will see, achievement gaps give strong evidence that student needs in these poorer communities are not being met. Therefore, current proposals to **reduce the weight given to poverty** in RPENS measures are steps in the wrong direction – and would further reduce the state's sharing under ECS. (For testimony on proposed changes, see www.ctkidslink.org/testimony/022007edugovernorsrecs.pdf.)



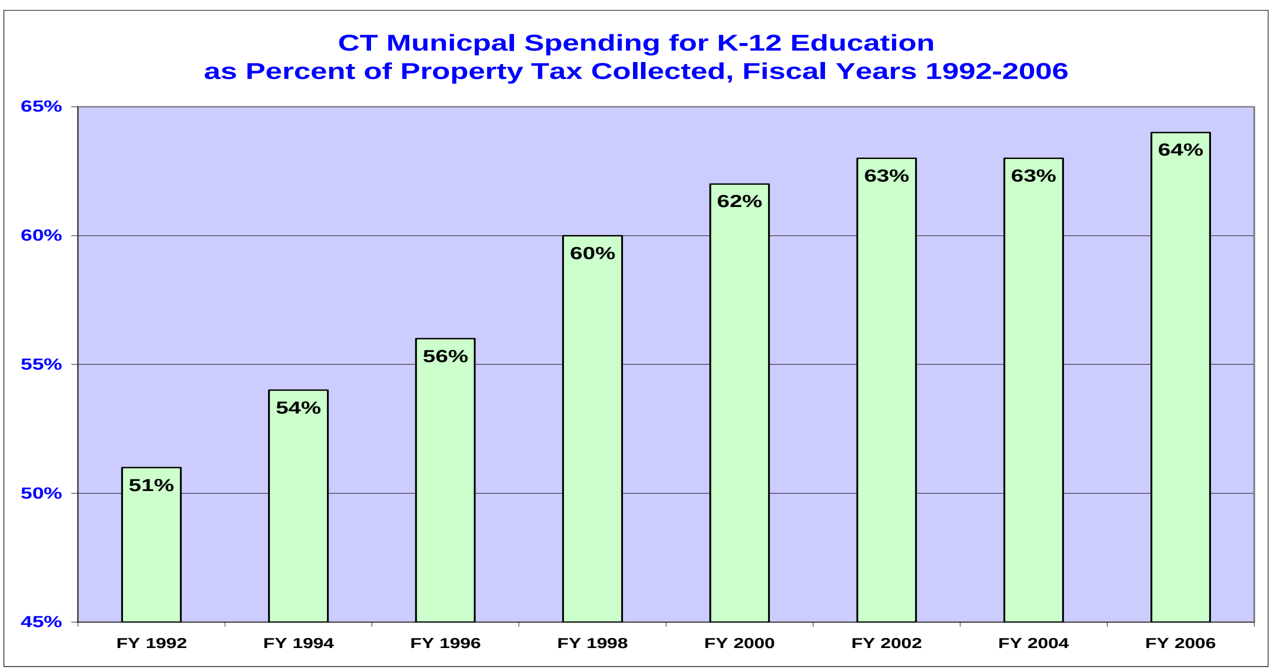
Source: State Dept. Education, www.sde.ct.gov/sde/cwp/view.asp?a=2635&q=320576

4 "Achievement Gaps are Not Closing," CT Dept. of Education News, July 27, 2007: www.sde.ct.gov/sde/lib/sde/pdf/pressroom/CMT2007_final.pdf

The state's share to total K-12 education spending has **declined since the late 1990s**, as **the graph below** shows. Correspondingly, more local dollars must go towards education.



In the **graph above**, notice that the cuts in state funding coincided with the recessions of the early 1990s and 2000s. Despite this unreliable state funding, importance of education to town residents has forced them to dedicate ever greater shares of their property taxes to K-12, as **the graph below** shows. This has put tremendous fiscal pressures on most Connecticut towns, as we shall see.

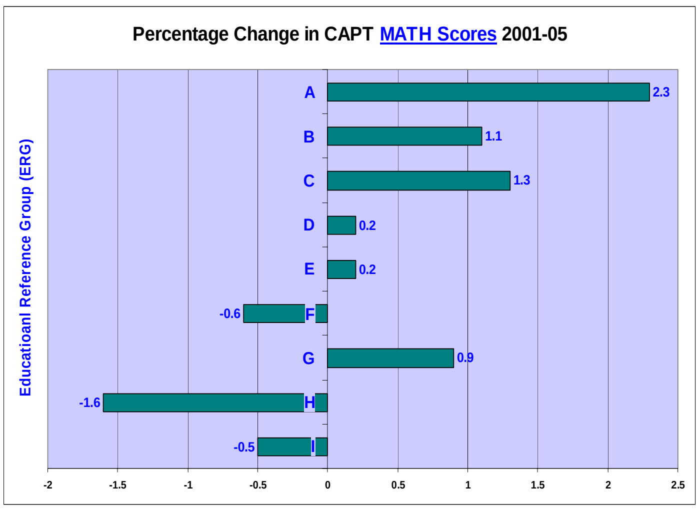


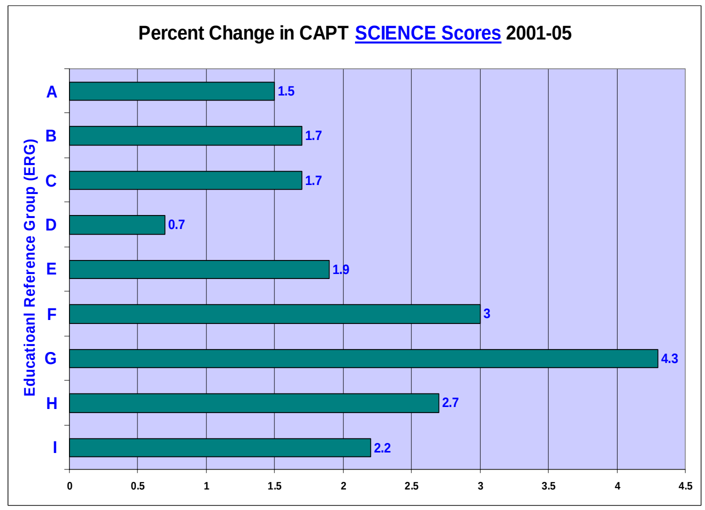
Sources: For this and the previous graph, data from State Dept. of Education and Office of Policy & Mgmt.

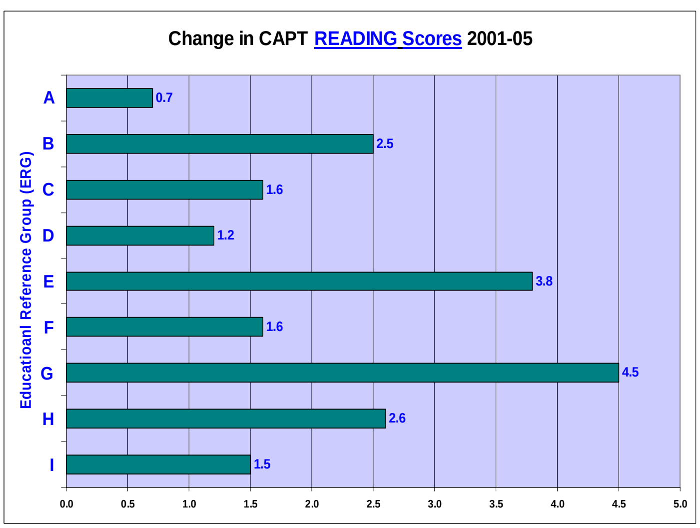
Question 3. *"What are the consequences of this very unequal tax?"*

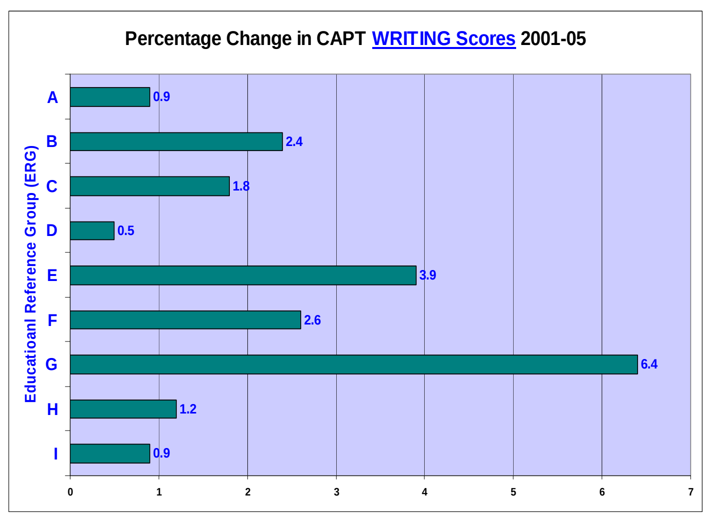
Answer: Very **unequal outcomes** in basic services, and more suburban **sprawl**. The clearest evidence is the persistent gaps in student achievement: whether by town wealth, family income, or ethnic groups. Towns were grouped by the State Dept. of Education, formally called Educational Reference Groups (ERGs), and recently by District Reference Groups (DRGs). (To make a multi-year series, we will stick with the earlier definition.) Towns are grouped in ERGs A through I, from most to least endowed with wealth and parental education.

Since the higher ERGs score significantly above the lowest ones, the gap on standardized test scores will only begin to close if lower ERG groups make larger gains on these tests than the higher towns. Seen in this light, the results of the Connecticut Academic Performance Test (CAPT) gains are mixed. As **the graph below** shows, the trend for Math is clearly regressive, with the higher-wealth towns making the largest gains, and lower-wealth towns (except for G) seeing their scores fall. For the Reading test there is no clear trend. Scores in Sciences and Writing have shown larger gains for lower-wealth towns, so this trend is progressive.



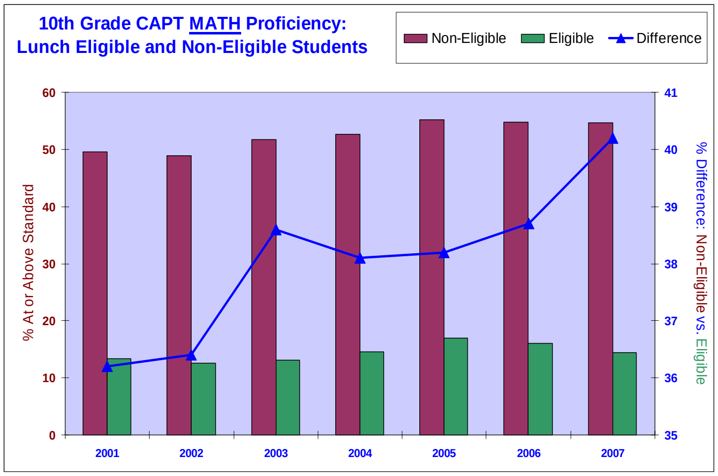


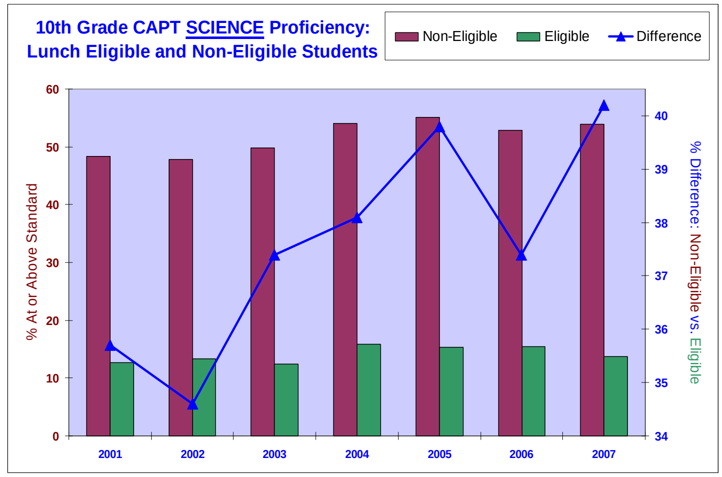


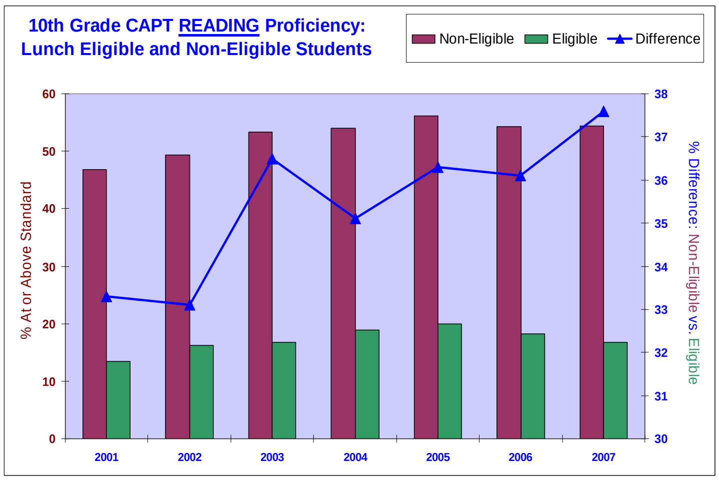


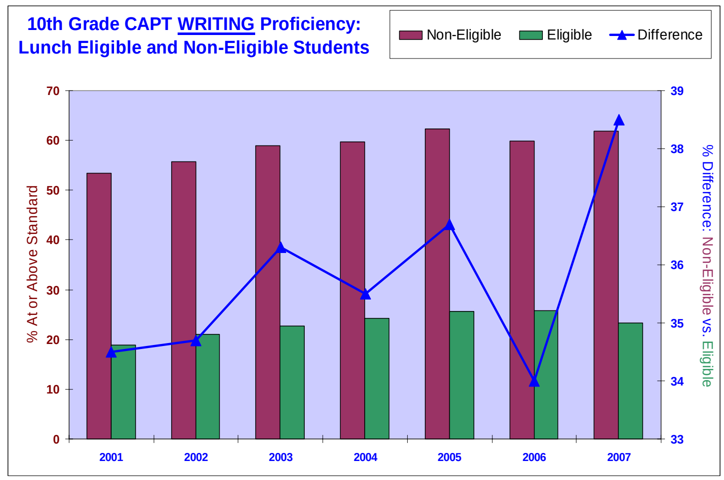
Source: State Department of Education, "Data Interaction for CAPT" website, www.captreprots.com.

Turning to a basic indicator of poverty, in the **graphs on the next page** we look at CAPT scores of students eligible for free or reduced-price school lunch programs and those not eligible. Data are available for an 8 year period, from 2000 to 2007. In all four subject areas, the percentage gap for proficiency (shown by the line graph and right-hand axis) *has only increased* between higher (non-eligible) and lower income (eligible) students. Even in years when this gap falls, such as 2006 for the Science and Writing scores, this is due to a fall in the high-income (non-eligible) scores, rather than a rise in low-income (eligible) scores.









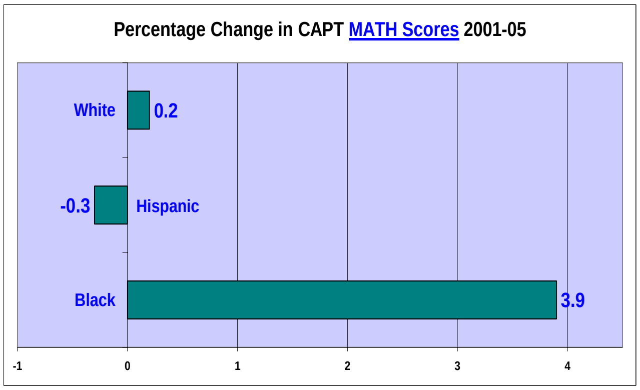
Source: State Department of Education, "Data Interaction for CAPT" website, www.captreprots.com.

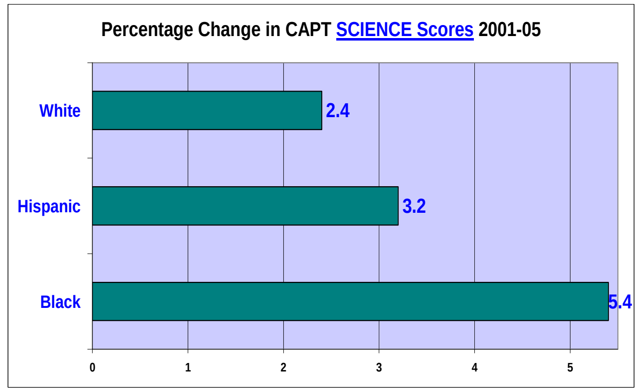
The news is not all bad. There has been a **slow narrowing of the gap between ethnic groups**, as **graphs on the following page** show. Except for Hispanic students' scores on Math and Reading, these ethnic gaps are narrowing. Given the size of the gaps and the slowness of gains, however, it will take **many decades** to close these gaps. The gap between proficiency percentages for white and black Students in Math, for example, was 41% in 2005 (81% vs. 45%). At this 2001-05 growth rate -- less than 4% for a 5-year period -- it would **take more than 50 years** to close this gap. Size and progress on other ethnic gaps are comparable.

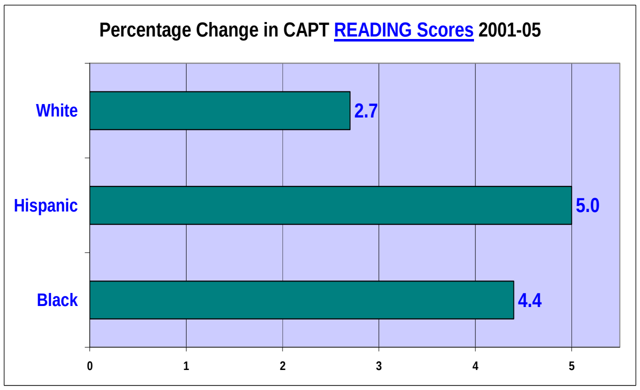
Even this slightly positive trend is not reflected in the **income-based data,** however. As seen in **previous graphs**, the gaps along lines of town wealth (previous page) and school lunch eligibility (this page) have not closed. This suggests that the improvement in ethnic outcomes may have more to do with **increased economic mobility** than with improvements in the **schools that mostly serve the poor**.

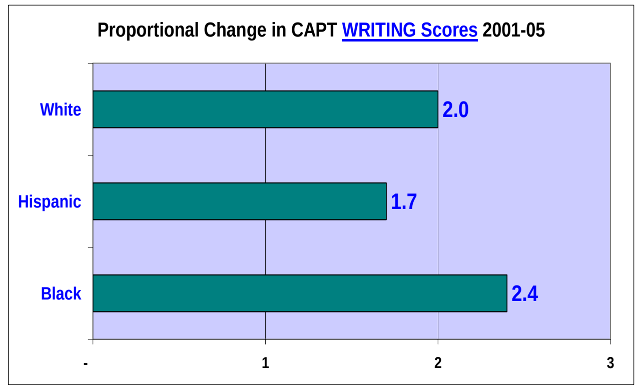
To put it simply, the children of the poor and of the non-poor are still pulling apart in their academic outcomes – as is shown by the outcomes of the school lunch eligible and non-eligible students. It is just that as **more Hispanics and Blacks are leaving the ranks of the poor**, they are no longer eligible for free lunches. This is certainly a good thing in terms of decreased economic discrimination. But it in no way vindicates the poor performance of our urban school systems – it means only that more Blacks and Hispanics are managing to escape those systems.

Connecticut's property-based school system is still one of **educational apartheid**, where the best schools are largely off-limits to the poor. The basis of discrimination is not race, but income. As the income gap between Connecticut's communities grows, income-based gaps in its education system are also growing.









Connecticut's increasing **sprawl** is also closely connected to our property-tax system. "Sprawl" is generally taken to mean the spreading out of a city and its suburbs over rural or uncultivated land. This involves the conversion of open space into built-up, developed land over time. This pattern is shown by a recent study by UConn's Center for Land-use Education and Research (CLEAR), as shown in the **graph below**.

Source: University of Connecticut — Center for Land-use Education and Research (CLEAR), and Connecticut Council of Municipalities (CCM), June 2006.

Earlier Census estimates show a similar pattern, focused here just on metropolitan growth:

Urbanized Areas in Connecticut with top Growth of Sprawl, 1970-1990

Urban Center	State Area	Growth of Sprawl
Hartford-Middletown	CT	110.8 sq.mi.
New Haven-Meriden	CT	80.4 sq.mi.
Springfield Area	MA-CT	64.1 sq.mi.
Worcester Area	MA-CT	54.3 sq.mi.
Bridgeport-Milford	CT	11.9 sq.mi.

Source: US Census figures, http://www.sprawlcity.org/hbis

The above figures add up to 321 square miles. But note that this is only around urban centers, and stops in 1990. A 2002 study at the Harvard Design School, "Promoting Smart Growth in Connecticut" estimates that the state has lost a further 400,000 acres (625 sq. miles) of farmlands and forests to sprawl since 1988. Just adding those two numbers – a \ conservative total due to the urban limitation of the first estimate – gives us at least 946 square miles from 1970 to 2000.

The total area of Connecticut, including waterways, is only 5,544 square miles. Since the city of Hartford is only 18.4 square miles, 946 square miles of sprawl means we have added more than 50 new "Hartfords" into the area that has been gobbled up since 1970. All of this was during a period when Connecticut's population growth was minimal – and even negative in the early 1990s.

This sprawl destroys the traditional character of our towns, and hurts property values. It also means longer commutes. A table from the 2000 census shows the 20 longest commuting times in Connecticut. Boston Globe website, http://www.boston.com/census/#commuting.The average time is 24.4 minutes each way, and this average increased by 16% between 1990 and 2000. Undoubtedly, it has gotten even longer since then.

With this statewide average is 24.4 minutes one way, we can calculate that a person working 50 weeks, 5 days a week, logs over 200 hours commuting time each year. Based on a 40 hour week, and 5 days a week of work, this is equivalent to **5 extra weeks of regular work time**. Or to put it another way, if a worker gets 2 weeks vacation, then driving time is 2.5 times greater than his or her time off. These figures are certain to be very conservative.

What do property taxes have to do with sprawl? The two word answer has become the buzzword of town finance -- "fiscal zoning". Fiscal zoning means attracting new properties that mean a greater tax base, and keeping out families with school age children. It means commercial development is at a premium.

Fiscal zoning means that family housing, if it cannot be avoided, should only be allowed in the form of

a) large lot sizes, with big expensive houses that mean lots of taxes per child, or
b) retirement gated communities, with no children at all.

Attracting commercial development and keeping out children are attained by exclusionary zoning, tax credits to attract office/industrial parks and commercial malls, and political support for new roadways to bring traffic to these developments. All these policies are biased against efficient use of older housing and infrastructure (which tends to be higher-density) and biased for maximal development of open land.

This is obviously short-sighted and is literally choking off the traditional beauty of our towns and open spaces. But if towns are forced to rely on property taxes for virtually all of their local needs, then they have no choice. For all but the richest towns, fiscal zoning – i.e., trying to attract large-scale commercial development and McMansions – is the only alternative to (a) reduced services, (b) increased taxes, or (c) municipal bankruptcy.

In the final section of this report (Question #5) we will consider ways that the property-tax system could be reformed, to remove the worst of these features.

Question 4: *"What are the likely outcomes of trying to 'cap' the growth in property taxes?"*

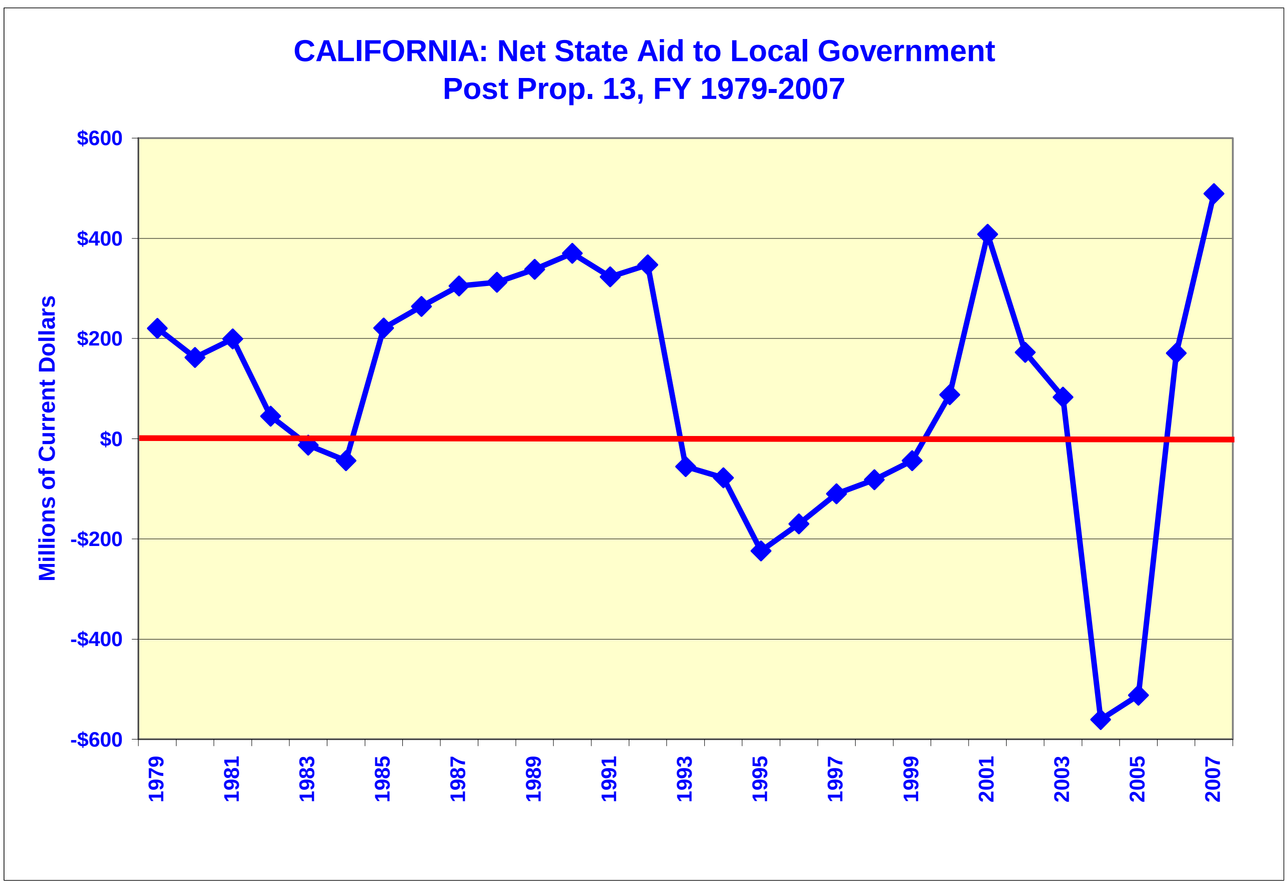
Answer: Greater inequality in services, and **more sprawl**.

The most expensive (and many would say, the most important) service paid for out of local property taxes is our system of locally-based public schools. As we have seen, Connecticut's towns are stretching more and more of their property tax dollars to pay for this need. The evidence is clear that educational services are not being provided in proportion that is adequate to the needs of poorer communities and students. Outcomes are highly unequal for different income groups, and getting more so.

Since the property tax burden in Connecticut is borne most heavily by those with low to moderate incomes – as the **graphs on** **page 3** clearly show – it may seem that "capping" the rate of property tax increases will benefit lower-income communities more than any. And indeed it would – if alternative state funding of their community needs were guaranteed.

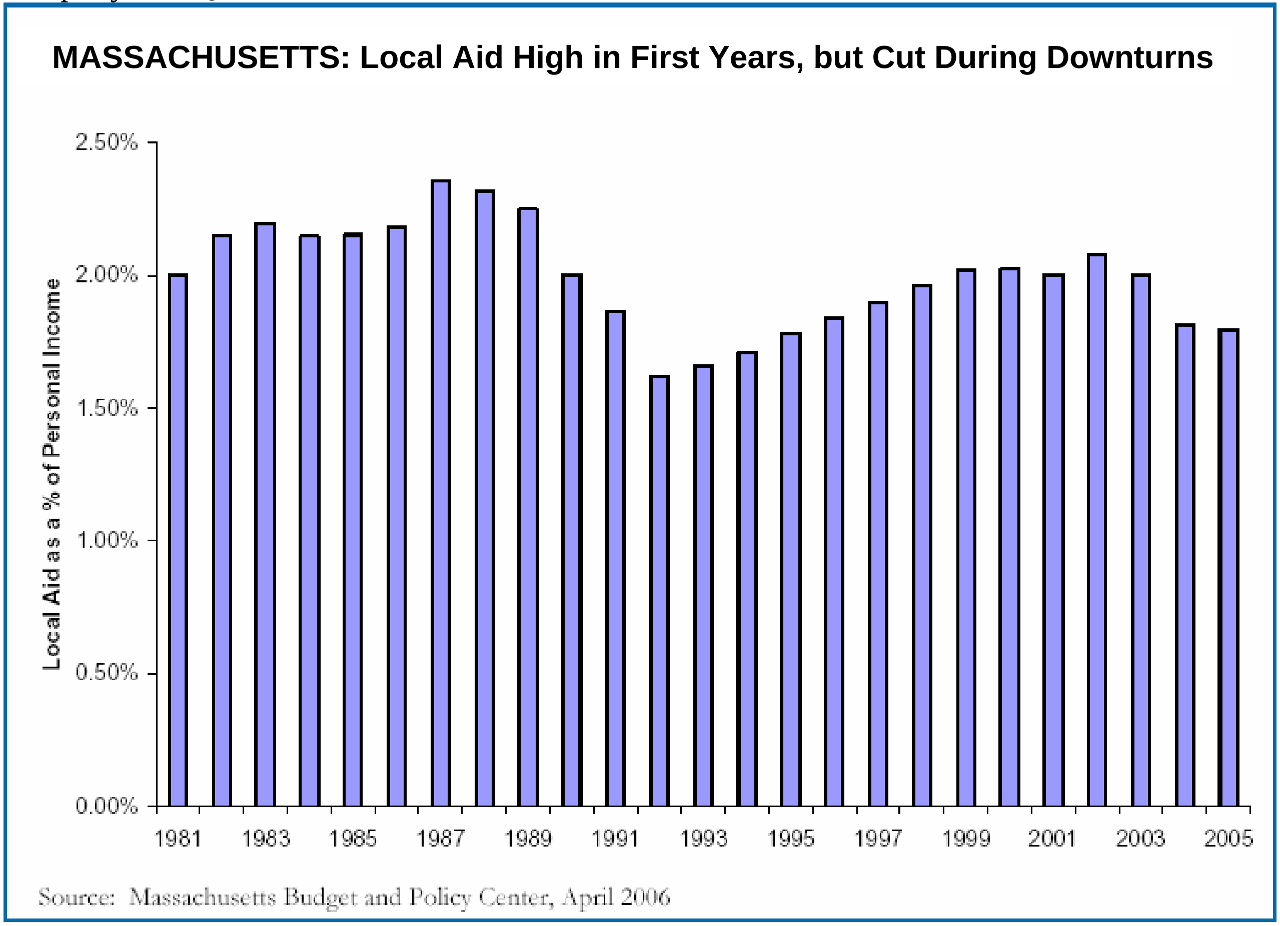
Governor Rell's proposed 3% cap on property tax growth comes with **no such guarantee**, however, but only the **promise** of increased state funding. How likely are these promises to be honored?

The fiscal record in other states is not encouraging in this regard. The best known property tax limitation, California's Proposition 13, was passed in 1978 – with similar promises of state aid. But total net state aid to California municipalities – essentially grants minus charges – have been highly "pro-cyclical", rising and falling with the business cycle. Note the sharp downturns occurring in the recessions of the early 1990s and early 2000s. As **the graph below** shows, over the years net grants have risen by as much as they have fallen.



Source: "California City-State Gives and Takes since Proposition 13," www.californiacityfinance.com/#ERAF

Massachusetts has had a provision similar to that being considered in Connecticut, "Proposition 2 ½," so-called because it limited property tax increases to 2.5%. As in California, in the **graph on the next page,** one can see sharp downturns in the amount of state funding in the recessions starting around 1990 and 2001.



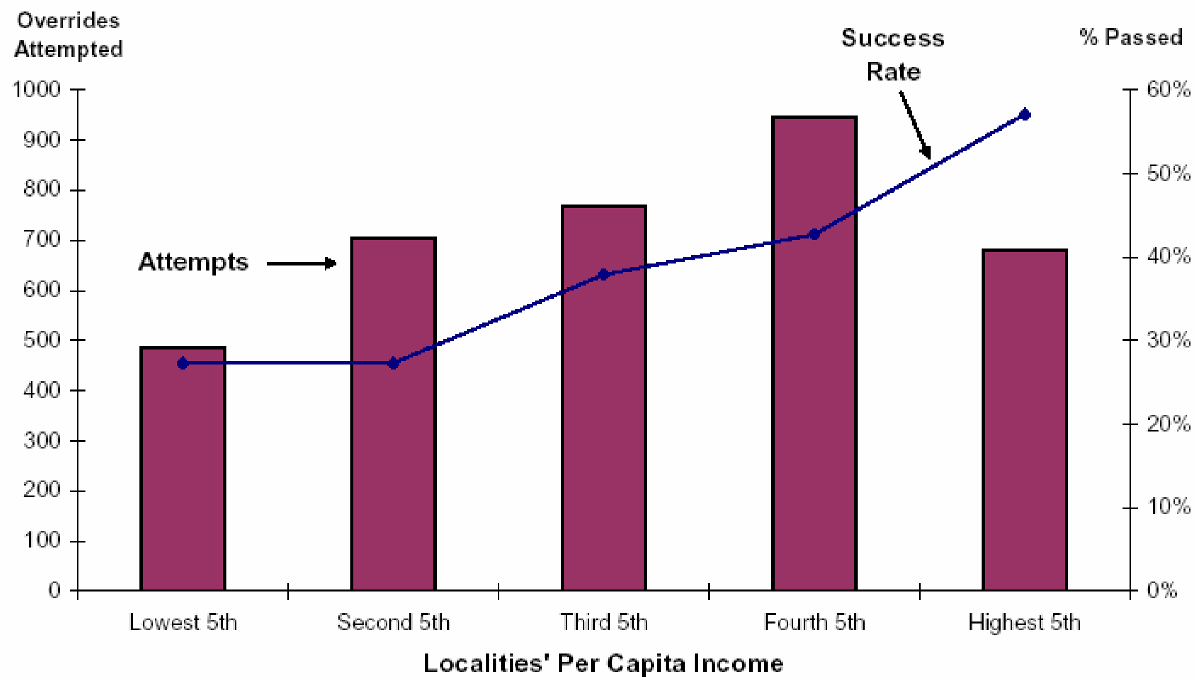
There is no reason to expect that Connecticut's state government would behave any differently. The **graph on the top of page 10** shows that our state government's aid to education has been similarly "pro-cyclical" – cutting its contributions whenever there is a serious economic downturn. In the words of former Lieutenant Governor Kevin Sullivan, "The fiscal highway in Connecticut is already littered with the remains of state government's past broken promises." (See his **Hartford Courant** op-ed, "Lifting Property Tax Burden," April 17, 2007. The same point about the state's unreliability is made by Connecticut Conference of Municipalities (CCM) Executive Director James J. Finley Jr., in his **Hartford Courant** op-ed piece, "A Tax Cap? Only If State Steps Up", May 23, 2007.)

Governor Rell's proposed 3% cap comes with an override proviso – so Connecticut towns that feel they really need larger increases can vote to override the cap. The record in other states confirms what should be obvious – that the property-wealthy towns are much more likely to support such overrides. This is shown very clearly by the Massachusetts experience, as shown in the **graph on the following page.**

There have been literally thousands of local override attempts since 1980, when Massachusetts's Proposition 2 ½ was enacted. The record of success is highly correlated with income, however, as the blue line and right-hand axis show. Massachusetts towns rated among the highest 20% in terms of their per-capita income had success in about 60% of their override attempts. Override attempts in towns among the lowest 20% of per-capita incomes succeeded only about 30% of the time. Boston has **never** approved an override attempt. (Massachusetts Municipal Finance Task Force, "Local Communities At Risk: Revisiting the Fiscal Partnership Between the Commonwealth and Cities and Towns," September 2005, www.mapc.org.)

What would the effect of such a pattern be on the distribution of burdens and resources among Connecticut towns? Wealthy residents of the richest towns have never felt burdened by local property taxes: as noted on page 8, Connecticut has the **4th lowest contribution** towards K-12 funding of all 50 states, as a percentage of personal income. Our rich towns can afford a world-class education for their kids, at a comfortable price.

MASSACHUSETTS: Richer Localities Attempted More Overrides, and Had Greater Success Rate



Source: Massachusetts Municipal Finance Task Force, "Local Communities At Risk: Revisiting the Fiscal Partnership Between the. Commonwealth and Cities and Towns," September 2005, http://www.mapc.org/Municipal_Finance_Task_Force_/Local%20Communities%20At%20Risk%20Report.pdf.

As long as their income and wealth continue to rise faster than property taxes, as they have been for at least two decades, they will gladly pass overrides – as their Massachusetts counterparts have been doing for the past quarter of a century. When state aid is cut to the poorer and moderate income towns – as it almost surely will be in the next recession – they will have no choice but to cut social services.

Consistent with this prediction, the record in California and Massachusetts has been one of falling educational provision. California's per-pupil spending was $600 above the national average when Proposition 13 was passed.[5] By FY 2004 it was more than $600 below: $7,701 in California as opposed to $8,340 for the US as a whole.[6] Academic studies have shown that the impact of these cuts is, not surprisingly, tougher on the poorer towns and for poorer individuals. As Daniel Mullins writes, "TEL [tax and expenditure limits] are most constraining on the ability of governments serving economically less prosperous and at-risk populations to meet public service needs."[7]

The previous paragraphs may seem unduly pessimistic, so we should admit that there actually is another choice low and moderate income communities will have when they cannot raise property taxes beyond 3%. We mean an alternative *besides* cutting resources. *They can encourage **more sprawl**.*

5 Sloan McCombs and Stephen J. Carroll, "Who Is Accountable for Education If Everybody Fails?" RAND, 2005, www.rand.org/publications/randreview/issues/spring2005/ulttest.html.

6 National Education Association, "Rankings and Estimates, 2006", Table H-9. www.nea.org.

7 Daniel R. Mullins, "Tax and Expenditure Limitations and the Fiscal Response of Local Government: Asymmetric Intra-Local Fiscal Effects," *Public Budgeting & Finance,* 24:4 (2004), pp. 111-147.

As we showed under the previous Question 3, Connecticut has been a "leader" in sprawl, despite rates of population and average income growth that have lagged well behind the rest of the US. Governor Rell's proposed property-tax cap will give an added impetus to our already "heroic" spawning of sprawl. It does this by **explicitly excluding from the 3% cap** additions to the Grand List – any new development. If sprawl was always a tempting option for fiscally-stressed Connecticut towns, it will now become inevitable.

There is abundant evidence that cost of most of the items in municipal budgets – law enforcement, education, insurance, fire services, and pensions – have been rising at rates far beyond the rate of inflation. ("The Problems with Property Tax Revenue Caps, Karen Lyons and Iris J. Lav, *Council on Budget and Policy Priorities*, July 2007, www.cbpp.org.) The only hope of towns keeping up with these prices will be aggressive "fiscal zoning" – i.e., sprawl plus "McMansions", developments zoned to maximize taxable property value per school-age child.

Instead of limiting the inequities and environment damage imposed by Connecticut's history of reliance on property taxes, such a cap will only make it worse. There must be better ways to do this, and there are.

Question 5: *"What can be done to reform the property tax system?"*

Answer: There are several attractive options, all with real-world examples in other states and countries: circuit breakers and exemptions, state-wide or regional property tax, and split-level taxes.

Option #1 -- CIRCUIT BREAKERS: State government could provide real protection from excessive property tax growth, with real "circuit breakers." These would **guarantee** Connecticut residents a rebate on any tax paid, over a fixed percent of their income.

Existing Connecticut "circuit breaker" provisions fall far short of what that term means in most states:

- Unlike in most states with circuit breaker programs, Connecticut's tax relief does not guarantee that no one must pay over a certain fixed percentage of their income in property tax. Instead, the amount of the rebate declines with income, according to a schedule. The absolute rebate is set at a rebate of $1,250.

- Connecticut's income limits are set quite low. The maximum rebate just mentioned is only available to married couples with an annual income not exceeding $35,300, or 70% above the 2007 Federal Poverty Level for a family of four (http://aspe.hhs.gov/poverty/07poverty.shtml).

- Connecticut's tax relief goes only to a sub-class of indigent homeowners, the elderly or disabled. Indeed, the OPM program is termed the "Homeowners' - Elderly/Disabled (Circuit Breaker) Tax Relief Program" (http://www.ct.gov/opm/cwp/view.asp?a=2985&Q=383136).

Our neighboring states of Rhode Island and Vermont, for example, have property tax circuit breakers that are much simpler, rebating the full amount by which the tax paid exceeds 3% and 3.5%, respectively, of the taxpayer's income. *Real* circuit breakers (see "The Property Tax Circuit Breaker," *Center for Budget and Policy Priorities*, 2007 www.cbpp.org), are superior to Connecticut's so-called circuit breakers for several reasons:

- They provide a **guaranteed tax security** for every family. The maximum rebate of $1,250 specified by Connecticut is a dollar amount that has not increased since at least 1998. For property taxes paid above this amount in Connecticut, there is no relief.

- To illustrate, consider the graph on page 2. The mid-range of Equalized Mill Rates in 2005 was about 15, and for Equalized Net Grand Lists per capita, about $100,000. These figures imply that an average family of 4 would be paying about $6,000 in property taxes. Assume this family is making the maximal allowable income of $35,300. Then after their rebate, this family would still be paying $6,000 - $1,250 = $4,750, or **more than 13% of its gross income**. This is well beyond the income percentages specified by our neighboring states. A "circuit breaker" topping out at $1,250 leaves families quite vulnerable – to fiscal "electrocution."

- Such a guarantee is efficient in **targeting fiscal relief** where it is needed most. Property tax caps, on the other hand, benefit rich and poor alike, while imposing on towns a fixed formula on how much revenue they can be raise.

- Unlike the current proposal's promises of increased state aid, a real circuit breaker is **automatic** and cannot be easily withdrawn. It is written into the tax code.

- Not only do real circuit breakers provide fiscal security to the towns – it is what macro-economists call an "automatic stabilizer." By increasing state aid, rather than cutting it, just when it is needed most, such a system is "counter-cyclical" rather than "pro-cyclical". As such, it helps to **stabilize the regional economy**. The historic pattern of state budget cuts, by contrast, adds "fuel to the fire" by forcing layoffs as a recession is getting underway.

Option #2: HOMESTEAD EXEMPTION – This fixes a "floor" or set amount of the home's value that is tax free. Similar to the first dollars of tax-free income on income tax, such floors are progressive: – they benefit those with lower-value homes much more than those with very expensive homes. This program can and should be greatly expanded.

Option # 3: FULLY FUND STATEWIDE INITIATIVES to the Towns – such as for Special Education. It is unfair for the state, with its vastly greater fiscal resources, to impose obligations on the towns that it does not wish to pay for itself. It is a cheap way of buying politically favored programs without paying their cost, or facing voter resentment, for the resulting higher taxes. The Connecticut Conference of Municipalities, the group representing Connecticut's towns, has recently called for such funding, noting that:

> … a property tax cap without significantly increased education and non-education municipal aid, land-use reform and relief from unfunded and underfunded state mandates is not real property tax relief or reform. Such a property tax cap is look-good, feel-good public policy that will deliver only pain to residential and business property taxpayers.[8]

Option # 4: Payments in Lieu of Taxes (PILOT) – could be expanded by the state to reimburse towns for all tax-exempt properties. Currently, the state must reimburse towns at a rate of 77% of the taxes the towns would have otherwise received. PILOT, enacted in 1978, provides municipalities a "grant in lieu of taxes with respect to real property owned by any private nonprofit institution of higher education or any nonprofit general hospital facility".

But why should Connecticut expand its PILOT program – already one of the most generous in the United States?[9] The answer is the **economic dependence our region on highly educated labor,** and the vitally important role private colleges and hospitals have in attracting and building such talent.

First of all, New England, the historic birthplace of higher education in colonial North America, is till the national leader in terms of the proportion of its population that is college educated. The **graph on the following page**, from a recent Federal Reserve Bank of Boston study[10], makes this clear:

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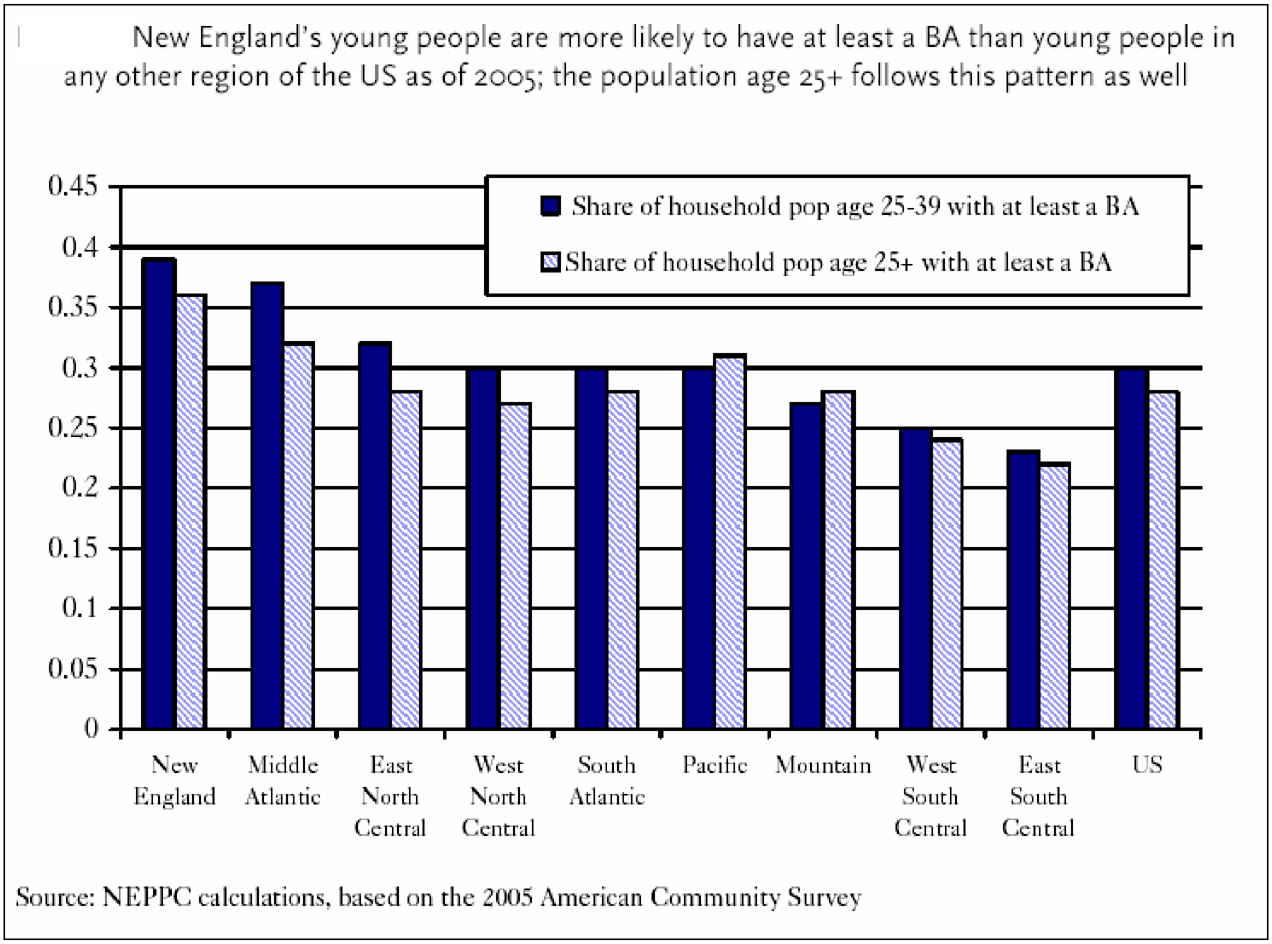
8 "A Tax Cap? Only If State Steps Up," by James J. Finley Jr, Hartford Courant, May 23, 2007, www.ccm-ct.org/advocacy/2006-2007/052307a.html.

9 Judith B. Greiman, Connecticut Conference of Independent Colleges, (CCIC), "Connecticut's Payment-in-Lieu-of-Taxes Program: a Model for the Nation," Quarterly Newsletter, March 2004; "CCIC to Celebrate 75th Anniversary", January 2007, www.theccic.org/newsletters/news_0304.pdf; www.theccic.org/newsletters/news_0107.pdf.

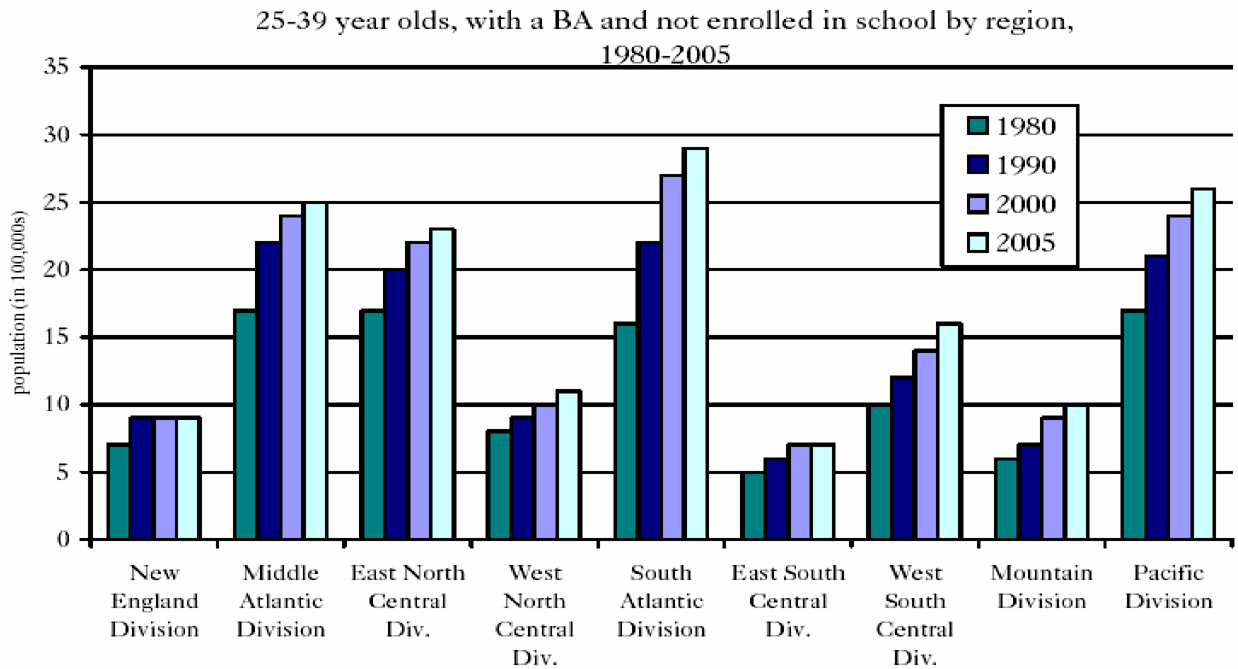
10 "Is New England experiencing a 'brain drain'? Facts about demographic change and young professionals," by Heather Brome, New England Public Policy Center, Discussion Paper 07-3, November 2007, www.bos.frb.org/economic/neppc/dp/2007/neppcdp0703.pdf.



The graph above, as reproduced from the "Is New England Experiencing a 'Brain Drain'?" study of the Boston Fed, shows Census area Divisions of the US: New England: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont; Middle Atlantic: New Jersey, New York, and Pennsylvania; East North Central: Illinois, Indiana, Michigan, Ohio, and Wisconsin; West North Central: Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota; South Atlantic: Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, and West Virginia; Pacific: Alaska, California, Hawaii, Oregon, and Washington; Mountain: Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming; West South Central: Arkansas, Louisiana, Oklahoma, and Texas; East South Central: Alabama, Kentucky, Mississippi, and Tennessee.

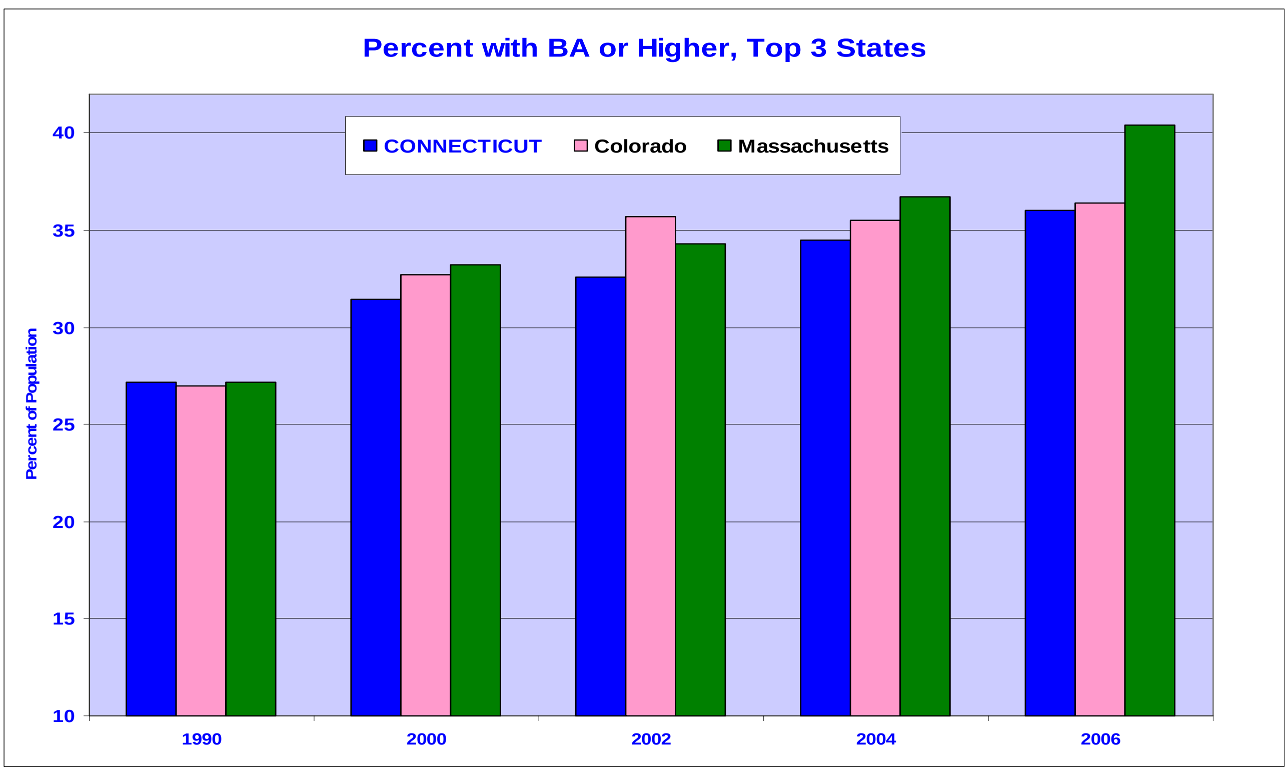
This educational advantage is a large part of the reason that New England is still the leading center of medical, pharmaceutical, cybernetic, and financial research and business. At the same time, however, *New England may be losing this competitive edge* – other regions are growing their high-education base considerably faster than New England. A **graph on the next page**, taken from the same Boston Fed study, shows a flat New England trend from 1990 to 2005, while other regions except for East South Central (the poorest region of the country) are sprinting ahead:

While the population of young professionals in New England is holding steady, it is growing in all other regions



Source: NEPPC calculations from 1980, 1990, and 2000 Censuses and 2005 ACS.

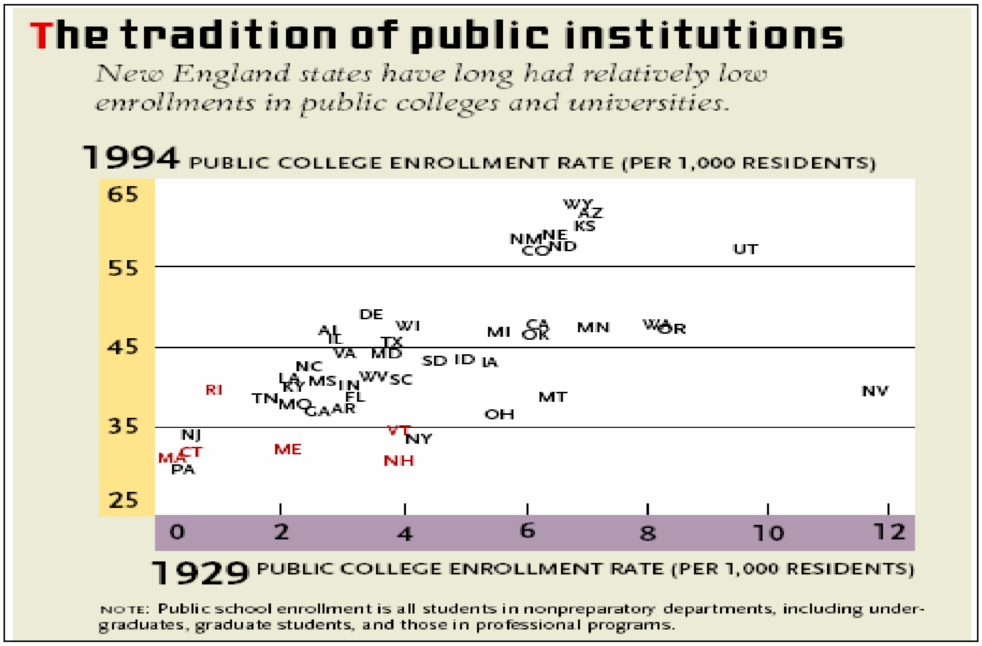
Nor is Connecticut keeping its place, even within New England. As a matter of fact, it has been falling ever further behind the leader, Massachusetts, as the following graph makes clear:



Source: Census Bureau, Educational Attainment, www.census.gov/population/www/socdemo/educ-attn.html.

Looking at the **graph on the previous page** and the three states that have consistently been educational leaders, we see that while Connecticut was in a virtual dead heat with Colorado and Massachusetts in 1990, it has since continued to fall behind.

To the extent that New England is still the educational leader of the US, it is uniquely dependent on private educational institutions for its place. With some of the oldest and most venerable institutions of higher learning in the US, it has traditionally spent far less on public education than other regions. This is shown in the following graph by Harvard economics professors Claudia Goldman and Lawrence F. Katz, which shows the rates of public enrollment in 1929 and 1994. As can be seen in the graph below, Massachusetts and Connecticut, the home of Harvard and Yale respectively, were near 0% public enrollment in the early 20th century, and were still near the bottom (around 30 residents per thousand) by late 20th century. (The other New England states, and Northeastern neighbors like New York and New Jersey, are also laggards in public enrollments). Our region of the country is uniquely dependent on private institutions for its higher education.



Source: "The Shaping of Higher Education in the United States and New England," by Claudia Goldin and Lawrence F. Katz, Regional Review, Federal Reserve Bank of Boston, Quarter 4, 2001.

It is good that Connecticut has been increasing spending on UConn, and raising its profile. But given the overwhelming importance of private higher education in Connecticut, we need to do more to grow and retain educated workers in this state. A more generous PILOT program can be part of this.

While Connecticut is still a leader in Hospitals and Medical care, it is facing critical shortages in many areas, for example in vacancies for Registered Nurses. A 2001 study from the Federal Reserve Bank of Boston shows that Connecticut is well behind other New England states in this regard, as seen in **the graph on the following page.**

Even more than for higher education resources, the great majority of hospitals in our state are not state administered, but dependent private non-profits. Given the crucial importance of university and medical industry to our area, there is no reason that individual towns should bear such a disproportionate burden in effectively subsidizing these non-profit institutions through tax-exemption – while still providing full local services to the hospitals and hospital employees.

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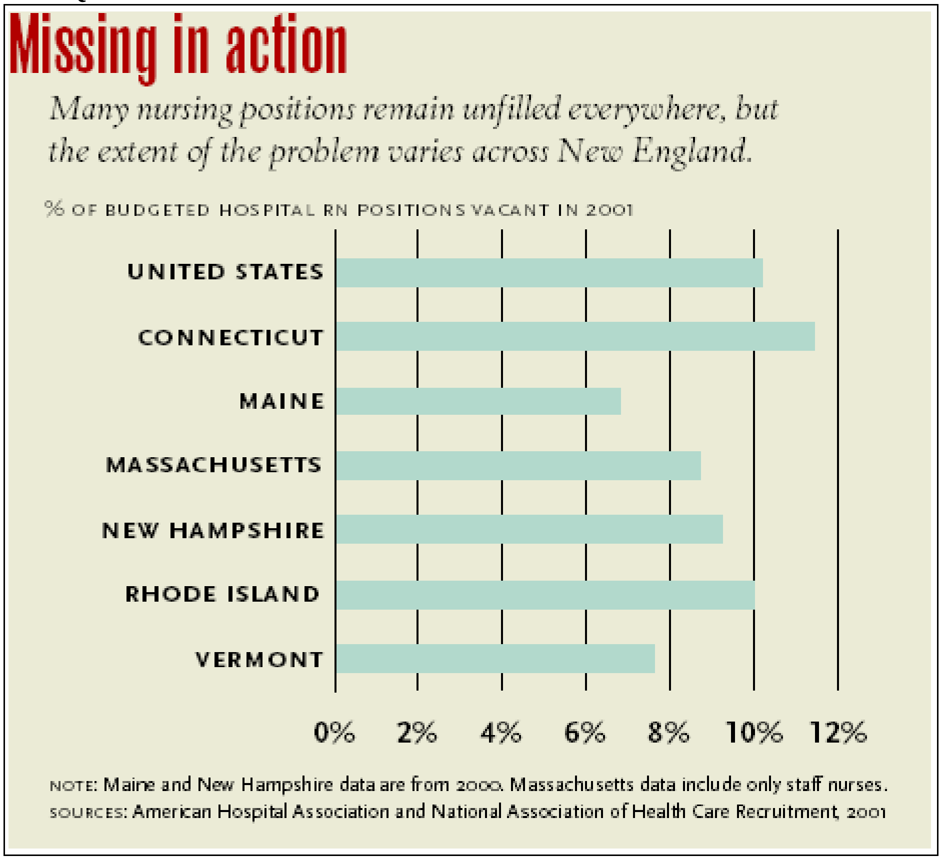


Source: "Diagnosis: Shortage", by Carrie Conaway, Regional Review, Federal Reserve Bank of Boston, Quarter 3, 2001.

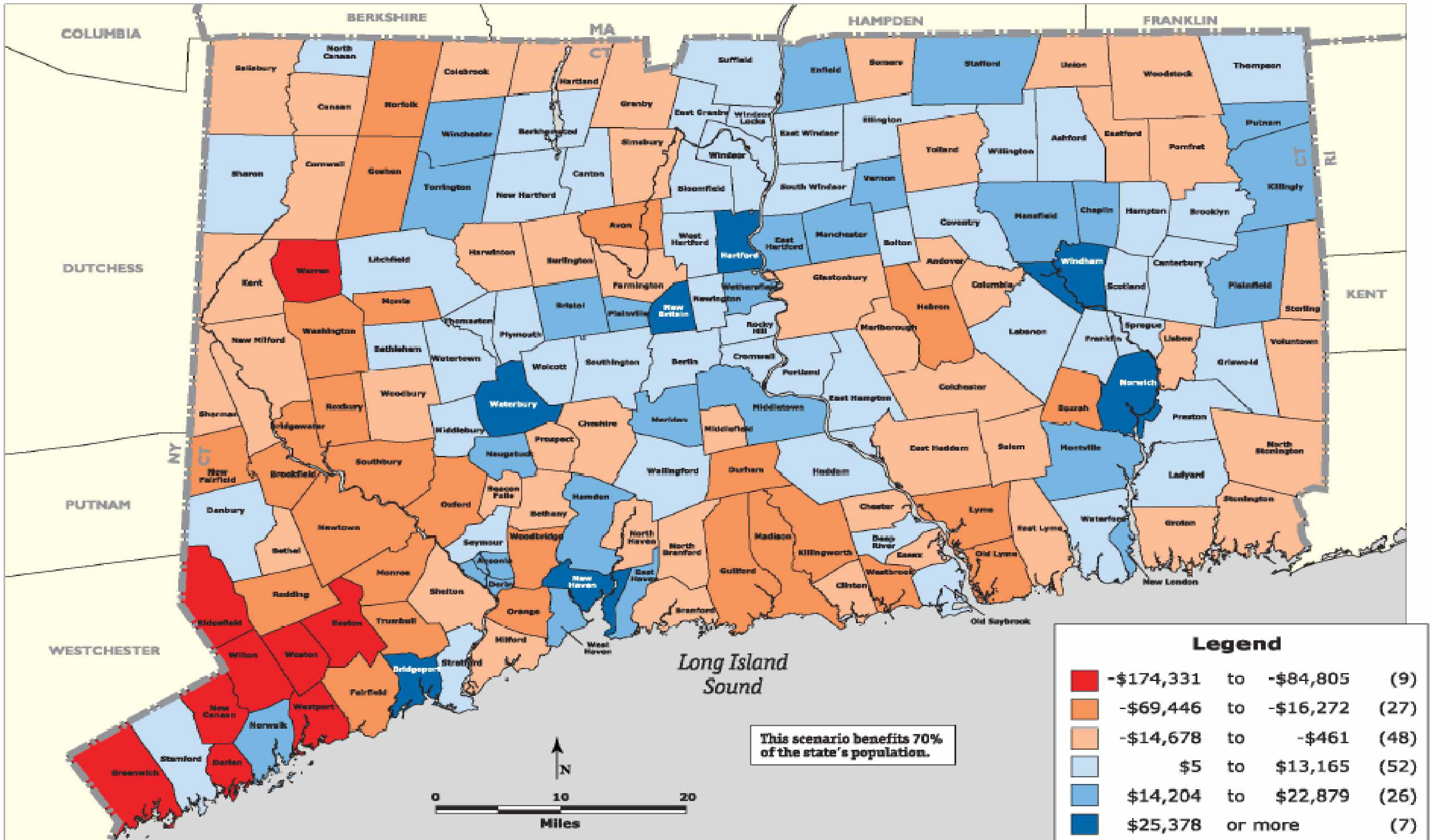
Option #5: Property can be taxed on a statewide or regional basis – Given how unequal Connecticut's property is distributed, taxing even some small part of it at a flat rate would be remarkably "progressive." The current structure of mill rates, where property-rich towns pay much less, is – as we have seen – remarkably regressive. Two of our neighboring states, Vermont and New Hampshire, have property partially taxed on an equalized state-wide basis. (For recent Federal Reserve Bank of Boston studies, see research papers on the Vermont www.bos.frb.org/economic/neppc/dp/2007/neppcdp0701.pdf and the New Hampshire systems www.bos.frb.org/economic/neppc/dp/2006/neppcdp0602.pdf.)

Regional and state-wide taxation are also important from the point of view of environmental sustainability and rational land-use. That is to say, property taxation should be about more than just the raising of revenue. It should also be used to "fill-in" the difference between the *private costs* of development (how much it costs a company to build a shopping center), and its *social costs* (the costs that shopping center imposes in terms of environmental sustainability, loss of open space, and traffic congestion. Reduced property taxes can also be used to incentivize for *social benefits* (effects upon surrounding real-estate values and employment) that are not likely to be captured directly by the private developer.

Varying property taxes to account for such economic "spillovers" – both positive (increased local property values) and negative (congestion) – has been advocated by leading economists for over half a century. Many economists advocate that property development be taxed at a lower rate in decaying urban centers (to encourage positive spillovers) and at a higher rate in sprawling suburbs (to discourage negative spillovers). The map of Connecticut tax rates, however, is precisely the reverse, as the graph on page 2 made clear.

The **map on the following page**, produced for the "Connecticut MetroPatterns Report" of the CenterEdge Project, shows the change in tax *basis* (not in taxes themselves) that would be occasioned by a *very partial* regionalization of taxes. Under this plan, it takes 9 years for the first 8% of the total state's tax basis to migrate into a regional "pool". A majority of a town's tax base would remain under the control of the town itself. (See next page.) But there would be a gradual change in the direction of equalizing taxable resources. Such a statewide or regional property taxation can be quite naturally combined with a split-rate property tax system – as we will see in the next section.

MAP 16: SIMULATED CHANGE IN TAX-BASE PER HOUSEHOLD RESULTING FROM A TAX-BASE-SHARING PROGRAM, 1990-1999



Data Sources: Connecticut Office of Policy and Management; U.S. Census Bureau; Metropolitan Area Research Corporation.

TAX-BASE SHARING can both reduce inequality among municipalities and decrease the incentives for wasteful competition for tax base. Because all communities keep a majority (but not all) of the growth within their borders, the program reduces the incentives for inter-local competition for tax base while still allowing communities to cover the local costs of development. The tax-base sharing scenario also reduced tax-base disparities among communities. The ratio between the 95th and 5th percentile places in 2000 dropped from 5.3 without tax-base sharing to 4.1 with tax-base sharing — a decrease of 22 percent. The tax base-sharing pool — representing 8 percent of the total tax base statewide after nine years — increased the local tax base available to 70 percent of the state's population.

Source: "Connecticut Metropatterns", the Center Edge Report, by Myron Orlfield, http://www.oua-adh.org/Connecticut_Jan29.pdf.

Option # 6: Split-Rate, or Land-Value Taxation – According to William Vickrey of Columbia University, a Nobel Prize winning economist,

> The property tax is … a combination of one of the worst taxes – the part that is assessed on real estate improvements – and one of the best taxes – the tax on land or site value… A tax on land, properly assessed …, is virtually free of distortionary effects… while the tax on improvements imposes serious burdens on construction. (Wenzer, Kenneth, 1999, *Land-Value Taxation*, Armonk, NY: M.E. Sharpe Publishers, pp. 17-18.)

Land-value taxes (also referred to as two-tier or split-rate taxation) have been seen by many economists as conserving open space and protecting against sprawl. In his widely cited report, "Connecticut MetroPatterns," Myron Orlfield of the University of Minnesota notes that:

> By shifting the tax burden from the improvements to the land itself, participating municipalities **promote smart growth by encouraging construction where road and sewer services already exist**. The effects of the split-rate tax have been especially impressive in Pittsburgh. In seven of the eight largest metropolitan areas in Pennsylvania, the property tax base per household in the central cities is just 46 to 66 percent of the regional average, indicating how much greater the property tax bases are in the suburbs surrounding the central cities. But central city Pittsburgh's property tax base is **a startling 90 percent of the regional average**, bolstered in part by the split-rate tax. See Wallace E. Oates and Robert M. Schwab, "The Pittsburgh Experience with Land-Value Taxation," in Helen F. Ladd. ed., *Local Government Tax and Land Use Policies in the United States*, Helen F. Ladd, (Boston: Lincoln Institute of Land Policy 1998). (**emphasis added**)

The 90% of regional taxable value noted here will seem truly remarkable to anyone familiar with Connecticut's property taxes. As seen in the graph on page 2, Connecticut's 5 poorest cities (the dots on the upper left of the graph) have an Equalized Grand Lists per capita of about $51,500 each. That is just 34% of the value for Connecticut as a whole, at about $150,000. The smart-growth tax policies of Pittsburgh have led to urban investment, revitalization and growth, rather than the urban abandonment that is so evident in Connecticut.

A split-rate tax has been advocated by Hartford's Mayor Perez, and was recently endorsed by the <u>Hartford Courant</u> in its end of the year *Commentary* Section ("For Hartford", December 30, 2007):

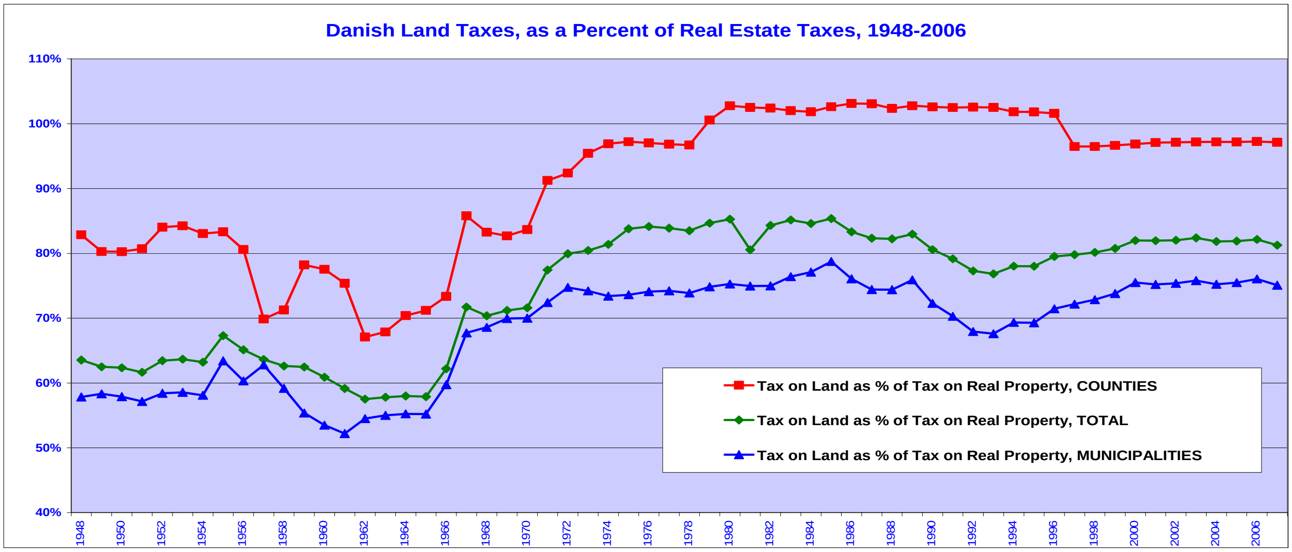
> As is clear to anyone walking through downtown Hartford, there are too many empty spaces. Too much of this historic and attractive city has been sacrificed for surface parking. If downtown is to again achieve a healthy urban density, those spaces have to be filled.
>
> One way to encourage that result would be a change in how property taxes are levied. At present, the city taxes buildings at a much higher rate than it taxes land. This has encouraged owners to tear down buildings to save on tax bills — and it is one reason The Hartford is considering razing the former MassMutual building for a parking lot. Perhaps it might reconsider, if the city changed its policy so that the land is more heavily taxed, as has been done in Harrisburg and some other Pennsylvania cities. This motivates developers to get the most out of their property by building on it.

It might seem difficult to asses the value land and buildings separately, given that they have one market price. But the methods for assessing separate values are well-established. To take a simple example, say we have two properties in the same neighborhood, with houses of similar size and condition. Let's say the first one has a market value of $300K, while the second one, with twice the land area, costs $400K. Then the joint value of Land (L) plus House (H) on the two properties can be represented by two equations:

$$(1) \qquad L + H = \$300K$$
$$(2) \qquad 2L + H = \$400K$$

This has the solution L = $100K, H = $200K. Thus properties (1) and (2) would have the same valuation on their houses, at H = $200K, while (1) would have its land valued at L = $100K, while the land of (2) would be worth twice as much, at 2L = $200K. In principle this is not different from current practice, when a tax assessor must figure the value of *a new structure,* one recently added onto a pre-existing property.

The country most closely associated with Land Value taxation is Denmark – a country with a population about 50% greater, but a per-capita income quite comparable to Connecticut's. Denmark is rated among the 10 "Greenest" countries in the world in 2007 by Mathew Kahn, a UCLA environmental economist, and author of *Green Cities: Urban Growth and the Environment* (Brookings Institution Press 2006; http://www.rd.com/content/best-places-to-live-green/). For over 30 years, a fairly stable 80% of the tax on Danish on real estate has been the tax on land itself. (See the **graph below**.)



Source: Statistics Denmark, http://www.statbank.dk/statbank5a/default.asp?w=1280

The jump in the County and Municipal tax rates – shown as occurring in the mid 1960s – was due to the phasing out of *national* land-value taxes, so *total* tax rates were little changed. Still, it will be seen that the County rate on land-taxation (the top line) has always been substantially higher than the Municipal rate (the bottom line). This makes sense in terms of regional planning: Land values are a result of many factors in a broad geographic area, whereas property values are more determined by what goes up on the individual site itself. Therefore, if split-rate taxation is to be considered, it makes sense to do so in the context of statewide or regional property taxation – as discussed in the previous section.

With land is valued and taxed in this manner, everyone will understand that land is no longer a "free" resource to be wasted on decaying urban structures, parking lots, and big box stores. It has rather been recognized as a value to be economized. Connecticut needs to do the same.

CONCLUSION:

Education is the basis of the most important industries of our science-based, information-technology age. This is nowhere more true than in Connecticut, a state with the highest per-capita incomes (and many of the highest costs) in the US. There is no way Connecticut can maintain its position as a high-income state without continuing to invest wisely in its educational infrastructure.

And yet there is overwhelming evidence that Connecticut's local property tax system – a legacy of isolated agricultural villages in the18th century – is no longer suitable as the basis of 21st century education in our highly technological state. The local property tax is not only the basis for K-12 education. It also directly subsidizes Connecticut's disproportionate reliance on private higher education and hospitals. (A tax-free status is just a different form subsidy, and it is local towns that are paying this cost.)

Connecticut's growing gaps in educational attainment imperil our status as an educational leader, and ultimately our status as a high-income state. There is no way that this system can be remedied in a piece work fashion based on local property taxes, even with the aid of inconsistent state assistance.

The problems of property taxes and failed educational systems are concentrated most glaringly, and at greatest human cost, in the decline of our state's major cities. But they are also apparent in the poor educational performance of many of our stressed "inner-ring" suburbs.

Connecticut's "Gold Coast" towns offer some of the highest educational standards and highest quality of life in the United States. But it is uncertain how much longer this quality of life can continue in the face of failing inner cities and an inadequately trained workforce. Spreading suburban sprawl, longer commutes, and worsening congestion are problems that effect us all, regardless of where we live.

It is time to break our reliance on local property taxes for education funding – an educationally unequal, economically inefficient, and ecologically unsustainable system. "Capping" property taxes merely puts a band-aid over a wound that is already badly infected – and wholly self-inflicted.

In the short and medium term, there are many ways that the disproportionate burden of property taxes can be moderated for low-to-moderate income households and communities: real circuit breakers, increased homestead exemptions, funding of unfunded mandates, full compensation for PILOT programs, state-wide or regional property taxes, and a split-rate property tax system.

Except for the last two, however most of these options require increased state funding from other, non-property-based revenue sources. This is to recognize that in the longer run, Connecticut needs to move away from primary reliance on local property taxes as the basis of our state educational system.

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Selected Refereed Publications:

1) Basuchoudhary *et al*., "Price Discrimination and Resale: A Classroom Experiment," forthcoming in ***Journal of Economic Education***.
2) "Strategic Voting and Coalitions: Condorcet and Ben-Gurion," ***Int'l Review of Econ. Education***, **4**(2), (2005), www.economicsnetwork.ac.uk/iree/v4n2/stodder.htm.
3) "Corporate Barter and Macroeconomic Stabilization," ***International Journal of Community Currencies,*** **2**(1), (Spring 1998), www.geog.le.ac.uk/ijccr/vol1-3/2toc.htm.
4) "Complexity Aversion: Simplification in the Herrnstein and Allais Behaviors," ***Eastern Economic Journal,*** **(23)**1, (Winter 1997).
5) "The Evolution of Externality Rights: Flexibility versus Ambiguity," ***European Journal of Law and Economics***, (March 1996).
6) "Ex-Communist Economics: Capital Reform," ***New York Econ. Review***, (Fall 1993).

Working Papers:

1) (Co-authored with Houman Younessi) "Transparency and Credible Commitment: Most-Favored-Customer Provisions and Global Price Discrimination," 2007.
2) "Reciprocal Exchange and Macroeconomic Stability," *Fifth Central Bank Microfinance Seminar*, *Banco Central do Brasil*, 2006.

Other Publications, Presentations:

1) "China: Threat and Opportunity," ***Hartford Courant*** (Sunday, September 23, 2007)
2) ***Better Thinking, Better Results: Using the Power of Lean as a Total Business Solution,*** (co-authored with Bob Emiliani, *et al.*) Center for Lean Business Management – winner of the *Shingo Prize for Research on Lean Management*, 2003.
3) "Connecticut's 'Tax Expenditures' -- A Form of Spending Best Left in the Dark?" *Testimony before Joint Finance Committee of the CT State Legislature*, April 2005.
4) "How Regressive are Connecticut Property Taxes?" ***The Connecticut Economy***, University of Connecticut (Fall 2002).
5) Pro Bono testimony on behalf of relatives of September 11th victims, Federal Victims' Compensation Fund (with Attorney Katherine Emmett of Stamford, CT), 2003.

With 1.5 million members, the American Federation of State, County and Municipal Employees (AFSCME) is one of America's largest unions. Over 45,000 AFSCME members live or work in all of Connecticut's towns and cities. Council 4 AFSCME represents 35,000 state, municipal and private sector workers. With over 400 affiliated local unions, **Council 4** represents public employees who work for 153 of Connecticut's 169 municipalities.

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