CONTENTS

PROLOGUE

by **ERIC SCHANSBERG**

The recent uproar over property taxes began with a Boston Tea Party of sorts: protests in the streets of Indianapolis, starting on July 4th. People in Marion County were responding to average property tax hikes of 34 percent over the previous year — and for many people, tax bills that had more than doubled. Four months later, in November, the heavily-favored mayor of Indianapolis was upset by a political upstart — as the effects of the property-tax crisis apparently continued to ripple.

Back in July, the governor's aides scrambled to meet with concerned citizens and experts in the field. The governor moved with speed as well, offering immediate short-term answers and the promise of a more permanent and substantive proposal later. By government standards, that bigger plan came quickly — in October. Other groups made proposals, but the governor's plan has the lion's share of attention and seems to be the starting point for the debate.

Now, as the 115th General Assembly is under way, legislators have mere weeks to deal with property taxes in this session. If they can't finish by mid-March, the issue presumably will continue to smolder. Will they take major action, modest action, or be unable to find common ground?

Gov. Mitch Daniels' plan was sent whole to the House floor but in the Senate split into 11 bills and three constitutional amendments.

Will the governor get what he wants — or will something quite different emerge from the legislative process? And how can the foundation best contribute to the discussion?

As an adjunct scholar, I am an applied micro-economist who spends a lot of time analyzing public policy. After participating in a meeting with the governor's aides, I crafted two op-ed pieces — one that was published in papers statewide and a longer one that appeared in *the Wall Street Journal* on July 28. Given my engagement in the policy debate, the foundation asked me to edit this issue of the journal. It has been a privilege for me to do so.

We've brought together many of those in the state with expertise in this arena, including academics from Purdue University, Ball State University and Indiana University Southeast. And we cover both the forest and the trees. The articles range from the the economics, the history and the politics of property taxes in general to an analysis of the Daniels' proposal in particular.

We start off with Dr. Dagney Faulk's summary of the history of property taxes in Indiana since 1973. From there, we move to three short essays by Dr. Larry DeBoer, who explains what caused the recent property tax "crisis," how the numbers work out for individual taxpayers and how Indiana's taxes compare to other states.

After that, Dr. Faulk returns with an article on the economics and politics of property taxes, including a discussion of what's being done in other states. We wrap up the overview with an essay by Andy Horning on the Indiana Constitution and what it says about property taxes.

Then we get specific with a detailed analysis of Governor Daniels' plan by Dr. Michael Hicks and Dr. Cecil Bohanon.

There are many other issues connected to property taxes, and we pursue two of those tangents with another piece by Dr. Bohanon and another by Dr. Hicks.

Bohanon discusses the impact of a referendum process on voter decisions to fund local government projects. Hicks explores the connection between property tax increases and Indiana's use of "tax-increment financing" (TIFs), *i.e.,* taxpayer subsidies used to try to attract businesses to the state.

Finally, the epilogue is built around an article by DeBoer asking whether we've already accomplished most of what our legislators say they are going to do for us. The closing point, basic but too easily overlooked, is this:

The size of taxation — in whatever form — depends completely on the amount of government spending. At the end of the day, if Indiana voters believe taxes are too high, it follows that their government is too large.

"The size of taxation — in whatever form — depends completely on the amount of government spending. At the end of the day, if Indiana voters believe taxes are too high, it follows that their government is too large."

D. Eric Schansberg, Ph.D., an adjunct scholar and editor of Schansblog.com, edited this special issue on Indiana tax policy. Dr. Schansberg holds a B.S. (economics) and B.A. (mathematics) from George Mason University and a doctorate in economics from Texas A&M University. He is the author of "Turn Neither to the Right nor to the Left: A Thinking Christian's Guide to Politics and Public Policy," Alertness Ltd., Greenville, S.C. Nothing written here is to be construed as reflecting the views of the Indiana Policy Review Foundation or as an attempt to aid or hinder the passage of any bill before the legislature or to further any political campaign.

A CHRONOLOGY OF INDIANA PROPERTY-TAX LAWS

Indiana's property tax made its debut in 1852. Its purpose was to pay for local schools. Since then, it has increased in size, scope and complexity. Dagney Faulk describes the relatively recent history of property-tax reform in Indiana — from Gov. Otis Bowen's ill-fated attempt in 1973, the political trade-off for which was collective bargaining for teachers, to the increasingly feverish attempts of the last decade to "fix" property taxes following a court-ordered reassessment. All this begs one question with regard to current legislative efforts: Will there be another Band-Aid, a series of minor surgeries or major surgery?

by DAGNEY FAULK

With the recent general dissatisfaction regarding the assessment of real property and the resulting property-tax bills, plus continuing localized billing problems that have followed the reassessment, property taxes have been at the forefront of the public-policy debate in Indiana for several years. This is an opportune time to review the major legislation that has affected Indiana property taxes over the past few decades to provide some context and perspective on how the system has evolved into what it is today.

In Indiana, real property and certain types of personal property are subject to the property tax. Real property includes land and improvements that are considered permanent fixtures, while personal property is tangible property not permanently affixed to real estate. The bulk of property-tax revenue (approximately 80 percent of property taxes paid in 2005) is raised through the tax on real property. Only real property is subject to periodic general reassessments to determine taxable value. In contrast, the value of personal property is self-reported by the taxpayer each year. Property owned by government and not-for-profit organizations is not subject to the property tax.

Property-tax reform in Indiana can be traced back to the Bowen Tax Package (1973).[1] This tax-reform package was passed in response to increasing local property-tax rates and levies. The reform limited local government's ability to increase property taxes, set up alternate funding mechanisms for local government and shifted some of the responsibility for revenue generation to the state. The reform package: 1) Doubled the sales tax from two percent to four percent (exempting groceries) and allocated the extra revenue to property-tax reduction (through the Property Tax Replacement Credit, PTRC); 2) permitted counties to levy local option income taxes (CAGIT) with most of the revenue used to reduce property taxes; 3) set limits on property-

Reform can be traced back to the Bowen Tax Package of 1973, passed in response to increasing local property-tax rates with a trade-off that allowed passage of the Collective Bargaining Act.

Dagney Faulk, Ph.D., an adjunct scholar, is associate professor of economics at Indiana University Southeast. She has worked at the World Bank, the U.S. Department of Housing and Urban Development and the Indiana Legislative Services Agency. Her academic research, focusing on state and local public finance and economic development issues, has appeared in leading journals including the National Tax Journal and the Review of Regional Studies. She is a frequent contributor to the Indiana Business Review, where a version of the above work was published in the summer 2004 edition.

1. See Bennett (2001) and Bennett (1992) for a more-detailed description of early property-tax reform efforts in Indiana.

> • *The current structure of property-tax administration in Indiana has resulted in systematic lack of uniformity in assessment practice and assessment results.*
>
> • *The data currently collected is not adequate for a market-value assessment system.*
>
> • *International assessment standards are not being met.*
>
> • *Administration and interpretation of assessment is not consistent among counties.*
>
> — The Indiana Fiscal Policy Institute, 2005

tax rates and levies for counties adopting CAGIT; and 4) established tax control boards. School funding was treated separately and increased through a state school-aid formula.

The 1979 General Assembly changes (effective 1980): These changes were implemented in response to reassessment and the economic environment (high inflation) of the late 1970s. They are as follow:

1. For civil units, the growth in tax levies was limited to the same growth rate as the Assessed Value Growth Quotient (AVGQ). AVGQ equals the average growth in assessed value over the prior three years, excluding reassessment, which was scheduled to occur every four years. The minimum AVGQ was set at five percent and the maximum was 10 percent. School property-tax levies were restricted using the school funding formula. Over the years, many jurisdictions would bank the difference between their actual and maximum levy growth to use in future years if needed.

2. Taxing units were allowed to appeal to the State Tax Board for an excess levy above the AVGQ normally permitted.

Court-Ordered Reassessment (1993-2000): The initial lawsuit, the Town of St. John *vs.* State Board of Tax Commissioners, was filed in 1993. The plaintiffs argued that the method of calculating true tax value in Indiana could lead to different tax values for property with the same market value thus violating the Indiana Constitution which requires a uniform and equal rate of property assessment and taxation. According to the Indiana Constitution, it is the responsibility of the General Assembly to provide for a uniform and equal rate of assessment and taxation. In total six opinions were issued by the Indiana Supreme Court and the Indiana Tax Court between 1996 and 1998 to clarify how true tax value should be determined. In 1998 the Indiana Supreme Court ruled that property should be assessed under a system that incorporates an objective reality to determine the true tax value of a property.

Objective reality does not have to be the same as market value. Subsequently, the Tax Court required the State Board of Tax Commissioners to implement a new assessment system and specified that the new regulations should be in effect by June 1, 2001, and the reassessment of real property should occur by March 1, 2002. (The last previous reassessment took place in 1995 for taxes due in 1996.)

The old assessment method calculated a true tax value of property based upon its "reproduction cost." That is, the cost to reconstruct a duplicate of the property using the same materials, design, workmanship, etc., that were used in the original property. This value was determined through tables disseminated by the State Board of Tax Commissioners that were based upon 75 percent of the value of the 1991 construction data. The current assessment, however, is based upon values that are 100 percent of 1999 construction data taken from the Marshall & Swift Assessment Manual. The Marshall & Swift 1999 data is based upon the "replacement cost" of the property rather than the reproduction cost.

Replacement cost is the current cost of constructing a structure of equal utility to the subject property using modern materials, design and workmanship. During reassessment all real property is revalued for tax purposes. Due to inflation, most property increases in value. An increase in tax value does not mean necessarily that the property owner's tax bill will increase since a lower tax rate could be used to raise the same amount of revenue as before reassessment.

A Glossary of Terms and Acronyms

AVGQ	*Assessed Value Growth Quotient*
CEDIT	*County Economic Development Income Tax*
CAGIT	*County Adjusted Gross Income Tax*
PTRC	*Property-tax Replacement Credit*
DLGF	*Department of Local Government Finance*
LSA	*Indiana Legislative Services Agency*
Real Property	*Land and improvements considered permanent fixtures*
Personal Property	*Tangible property not permanently affixed to and part of real estate*

The court-ordered reassessment exposed fundamental problems with Indiana's property-tax system. In 2005, the Indiana Fiscal Policy Institute published a Property Tax Equalization Study conducted to measure the accuracy of assessments in each of Indiana's 92 counties.[2]

The key findings of the study included:

• The current structure of property-tax administration in Indiana has resulted in systematic lack of uniformity in assessment practice and assessment results.

• The data currently collected is not adequate for a market-value assessment system.

• International assessment standards are not being met.

• Administration and interpretation of assessment is not consistent among counties.

In addition to the administrative problems listed above, the reassessment resulted in substantial increases in tax burdens for some property owners. As described below, the legislature enacted various short-term measures to provide relief to affected tax payers. The ultimate effect is a more complex and confusing tax system.

HEA 1001 (P.L. 192 — 2002 Special Session):[3] This statute included tax reforms for gaming, property taxes, business-income taxes and other taxes and provisions.

The statute changed the AVGQ formula to allow property-tax levies to increase at the rate that Indiana non-farm personal-income increases. The statute also increased the standard homestead deduction from $6,000 to $35,000 and the homestead credit to 20 percent, required counties to deduct 100 percent of the assessed value of inventory from the property-tax base by 2006, and allowed counties to impose an additional County Economic Development Income Tax (CEDIT) to provide revenue for increased homestead credits to offset the inventory tax deduction. This statute also raised the sales tax from five percent to six percent to offset the increased expenditures for property-tax relief.

Table 1, Local Government Revenue in Indiana, 2004-2005

	Value (000's)	*Distribution*
General Revenue	$22,539,554	100 percent
Intergovernmental Revenue	$8,138,122	36 percent
Own-Source	$14,401,432	64 percent
Taxes	$8,483,101	38 percent
Property	$7,630,118	34 percent
Sales, gross receipts	$84,658	0.4 percent
Individual income*	$598,112	4 percent
Corporate income	0	0.00 percent
Motor vehicle license	$34,358	0.20 percent
Other taxes	$135,854	0.60 percent
Total Charges, Misc.	$5,918,331	26.30 percent

Source: U.S. Census Bureau. State and Local Government Finances, 2005.
*Indiana Local Income Taxes are CEDIT, CAGIT and COIT.

HEA 1714 (P.L. 245-2003): This statute establishes a four-year cycle for the general reassessment of all real property in Indiana. Under this system the next general reassessment (requiring the inspection of all real property) should begin July 1, 2007 and occur every four years after 2007. The reassessment should be completed by March 1 of the next off-numbered year (2009) and used as the basis of property taxation in the next year (2010). Then another general assessment would follow in 2011. The statute also specifies that the Department of Local Government Finance should establish a system of annual adjustments to account for changes in property value in years between general assessments. These adjustments should be first applied in 2005.

SEA1 (P.L. 1-2004): The statute contains a variety of provisions to address some of the effects of the court-ordered reassessment, which became apparent in

The legislature enacted various short-term measures to provide relief to affected tax payers. The ultimate effect is a more complex and confusing tax system.

2. The Statewide Property-tax Equalization Study Policy Report by Mark Brown is available at http://www.indianafiscal.org/.

3. The Indiana Code, the various enrolled acts referred to in this document and the fiscal impact statements for each enrolled act are available through the Indiana General Assembly's website at http://www.in.gov/legislative/.

4. The Department of Local Government Finance assumed most of the functions of the State Board of Tax Commissioners beginning January 2002.

An example of only one of a myriad of exceptions and special cases, a 2006 statute extended the time in which a county fiscal body that year could adopt an ordinance to cap residential property taxes at two percent of assessed value, a so-called "circuit breaker."

2003 as the 2002 property-tax reassessments and levies were mailed to property owners. Some of the major provisions of the statute include the following: The statute authorizes the Department of Local Government Finance (DLGF)[3] to take over the 2003 general reassessment process in a county if the DLGF determines that the county's reassessment is likely to be inaccurate. It reduces the revenue-raising capacity of local governments by setting maximum rates and eliminating the banking of unused levy allowances in calculating the maximum permissible property-tax levy for a civil taxing unit, for a county Family and Children property-tax levy and for a county Children's Psychiatric Treatment Services property-tax levy. The statute allows counties to petition the DLGF to authorize property-tax payments to be made in installments, waive late-payment penalties for taxes payable in 2004 and allows automatic refunds for successful appeals for any taxpayer.

HEA 1001 (P.L. 246-2005): This was the 2005 budget bill which included options for local governments to provide additional homestead credits to property-taxpayers and established minimum and maximum limits on the amount of state property-tax replacement credits and homestead credits to be granted.

HEA 1120 (P.L. 214-2005): This statute covers a variety of state and local finance issues including a provision that allows a county to apply a property-tax credit over four years (from 2005 through 2008) for a homestead that has had an excessive tax increase in the general reassessment and specifies the amount of the credit as a percentage of the increase.

HEA 1001 (P.L. 162-2006): This statute covers various tax issues including increasing the homestead credit to 28 percent for 2006 and the homestead standard deduction to $45,000 in 2007. Beginning in 2008, counties are required to use a uniform format for property-tax statements that includes additional taxpayer information. Beginning in August 2009, counties are required to mail a notice concerning budget proceedings and proposed tax rates, tax levies and budgets to each taxpayer, and taxpayers are permitted to appeal the assessment within 45 days of the notice. The statute also extended the time in 2006 in which a county fiscal body could adopt an ordinance to cap residential property taxes at two percent of assessed value. This type of cap is commonly referred to as a "circuit breaker." The statute also establishes a cap on residential property taxes equal to two percent of the value of the residential property beginning in 2007 for Lake County and 2008 for all other counties and extends the two-percent cap to all property in 2010. It extended the time in 2006 in which an additional economic-development income tax rate could be imposed to provide property-tax relief to mitigate the effects of the elimination of the property tax on inventory and permitted a county to provide property-tax relief to other residential property, in addition to homesteads, to mitigate elimination of property tax on inventory.

SEA 260 (P.L. 154-2006): This statute covers various property-tax issues including a provision that revises the formula for determining the maximum permissible levy and banking of unused levy capacity. It also lowered the growth threshold from three percent to two percent so that counties experiencing growth in assessed value that is two percent higher than AVGQ could appeal to the DLGF for a higher maximum levy.

HEA 1001 (P.L. 234-2007): This is the statute that appropriates money for the biennial budget. The statute eliminates the minimum distribution of property-tax replacement credits and homestead credits and adjusts the timing of payments. It also provides additional homestead credits in 2007 and 2008.

HEA 1478 (P.L. 224-2007): Another statute that covers various tax issues including capping the standard deduction for homesteads in 2008 at $45,000 and decreasing the maximum homestead deduction by $1,000 each year beginning in 2009 until it reaches $40,000. It authorizes a county to adopt an additional CAGIT or COIT rate up to one percent to replace the estimated increased in certain property-tax levies in the next year. It allows a county to impose a CAGIT or COIT tax rate of not more than one percent for property-tax replacement credits, an increase in the homestead-credit percentage, or property-tax replacement credits for qualified residential property.

It was to abolish county boards of tax adjustment on Dec. 31, 2008, and establish county boards of tax and capital projects review in each county on Jan. 1, 2009, and specify the membership of the board. In 2008 and 2009, the circuit-breaker credit for property taxes greater than two percent of assessed value applies only to homestead property (rather than qualified residential property). After 2009 the circuit-breaker credit for taxes greater than two percent of assessed value applies to homestead property and a circuit-breaker credit for taxes greater than three percent of assessed value applies to property other than homestead property (including rental property). It establishes a Circuit Breaker Relief Appeal Board so that a county or political subdivision that will have its property-tax collections reduced by at least two percent in a year as a result of the circuit-breaker credit can petition the board for relief in the application of the credit.

As illustrated by the legislation chronicled above, the Indiana General Assembly has reacted to voter unrest over property taxes by passing a variety of property-tax relief measures primarily for homeowners. These measures have provided short-term relief, but have also increased the complexity of the property-tax system and the interrelationship between state and local tax systems.

In addition, little has been done to address systemic administrative problems related to assessment. This has contributed to a public perception that the system is unfair, a perception that prompted the current defensive reaction by the political leadership to reform or even repeal the system. — *Dec. 27*

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The Indiana General Assembly has reacted to voter unrest by passing a variety of property-tax relief measures primarily for homeowners, These measures have provided short-term relief, but have also increased the complexity of the property-tax system.

Table 2, Local Govt. Expenditures in Indiana: 2004-2005

Expenditures	*Value (000's)*	*Distribution*
Total Expenditure	$23,653,334	100 percent
Intergovernmental expenditure	$12,235	0.1 percent
Direct general expenditure	$21,628,215	91 percent
Elementary & secondary	$9,639,395	41 percent
Higher education	$597	0 percent
Libraries	$385,295	2 percent
Public welfare	$441,160	2 percent
Hospitals	$2,563,880	12 percent
Health	$220,386	1 percent
Highways	$738,537	3 percent
Air trans. (airports)	$170,228	1 percent
Parking facilities	$16,535	0.1 percent
Sea, inland port facilities	$3,436	0 percent
Police protection	$819,500	4 percent
Fire protection	$592,226	3 percent
Correction	$304,991	1 percent
Protective inspect, reg.	$9,837	0 percent
Natural resources	$63,111	0.3 percent
Parks and recreation	$347,583	2 percent
Housing, development	$554,961	2 percent
Sewerage	$1,009,299	4 percent
Solid waste management	$207,430	1 percent
Governmental admin.	$1,220,456	5 percent
Interest on general debt	$662,624	3 percent
General expenditure, n.e.c.	$1,656,748	7 percent
Utility expenditure	$1,890,434	8 percent
Insurance trust expenditure	$122,450	1 percent

Source: U.S. Census Bureau. State and Local Government Finances, 2005 (n.e.c. is "not elsewhere classified")

WHAT'S BEHIND THE PROPERTY-TAX CRISIS?

Larry DeBoer has testified before several legislative tax committees and has written at length about property taxes over the last year. In these three essays he explains the four primary causes of this year's property-tax increase, illustrates how these factors affect the individual taxpayer and describes how Indiana's taxes compare to other states.

Despite a tax-reform package instituted after the court-ordered 2002-2003 reassessment, tax relief kept growing as a share of the Indiana budget. The General Assembly decided to limit it. That's one reason homeowner taxes have increased so much this year.

by LARRY DeBOER

Tax bills arrived. Homeowners were shocked. The statewide average increase in homeowner property-tax bills is expected to be 24 percent, before the end-of-year rebates. The increases were larger in Indianapolis. Taxpayers protested.

The Department of Local Government Finance ordered a reassessment in Marion County. Reassessments may be ordered in other counties, too. Gov. Mitch Daniels appointed a commission to study local government. We may have a special session of the legislature.

But why are homeowner taxes going up? To solve the problem, we need to know what's causing it.

The problem was a long time in coming. For decades we gave homeowners a tax break by under-assessing houses relative to business property. In 1998, our Supreme Court said that had to stop. Indiana had to adopt a market-value assessment system, basing assessments on predicted selling prices of property.

The 2002-2003 reassessment was based on market value, and the tax bills on many older homes jumped. The General Assembly responded with a tax reform package that increased state property-tax relief payments by about a billion dollars. Huge homeowner tax increases were reduced to "merely" big increases.

But tax relief kept growing as a share of the budget. The General Assembly decided to cap it. That's one reason homeowner taxes have increased so much this year. Without an increase in state relief, taxpayers pay the entire annual increase in property-tax collections. The cap accounts for about four percent of the 24 percent homeowner tax-bill increase.

The 2002 tax reform also scheduled the elimination of the inventory tax, which was the property tax applied to the assessed value of inventories. Indiana voters approved this policy change in a constitutional referendum in 2004.

The last 51 counties eliminated their inventory taxes this year. Someone else has to pay those taxes, and that's another reason homeowner taxes have increased. Inventory-tax elimination accounts for another four percent of the 24 percent increase. The shift to homeowners was bigger in places with a lot of inventories, such as Indianapolis.

Larry DeBoer is professor of Economics at Purdue University. An expert on state and local public policy, his computer models for analyzing tax structures and revenue have been widely used by the Indiana General Assembly, particularly during reassessment and property-tax restructuring conducted by the state. Versions of these collected essays first appeared in Capital Comments, a publication of the Purdue Extension service.

The Supreme Court says we must keep assessments close to property-selling prices. Selling prices change every year, so assessments must be adjusted. This year we tried to do that for the first time. That's trending.

This year trending adjusted assessments from 1999 selling prices to 2005 selling prices. That's six years of price change. Assessments changed a lot. But business-equipment assessments have always been updated each year, so those assessments increased just a little. Taxes shifted from business equipment to land and buildings, including homes.

Assessors "trended" homes based on evidence from the prices of similar homes that sold. Most of the time, however, there were no comparable sales of factories or office buildings. The law says that where there are no sales, other evidence must be used. Apparently this was not done everywhere. In Marion County, and maybe in other counties, business assessments were not trended. That's why Marion County was ordered to reassess. This trending error caused an additional tax shift to homeowners. About 10 percent of the 24 percent statewide increase was due to trending.

Rising local tax collections account for about six percent of the statewide 24 percent increase. In places with big government construction projects, higher tax collections contribute more. That's another reason why homeowners in some counties saw bigger increases.

Homeowner tax bills are increasing mostly because of tax shifts, from businesses to homeowners, and from the state budget to local taxpayers. In most places, big homeowner tax hikes are not the result of large increases in tax collections. Big increases in government spending are not the main problem.

Remember, some help is on the way. The end-of-year rebates should have reduced the average homeowner tax increase from 24 percent to eight percent.

Property assessment is the way we divide up the cost of local government among taxpayers. Market-value assessment says that homeowners should pay more than they did under our old system. Homeowners don't think that is fair.

Perhaps it's time to step back from the year-to-year tax crises and ask ourselves, "What is a fair way to divide up tax payments?" — *July 7*

Homeowner Property Taxes

Here's why I think homeowner property taxes increased more than usual in 2007.

Let's take a house assessed at $120,000. Last year, it received the homestead deduction of $35,000. Suppose it also got the $3,000 mortgage deduction. After deductions are subtracted, the remaining $82,000 is the "net" assessed value subject to taxes.

A typical tax rate could be $2.75 per $100 assessed value, or 2.75 percent. You can see your tax rate on the Department of Local Government Finance's Web site, at http://www.in.gov/dlgf/rates. Multiplying this rate by the net assessed value gives a $2,255 "gross" tax bill.

Now, we subtract the property tax replacement credit (PTRC) and the homestead credit. A typical PTRC rate is 25 percent, which reduces the tax bill to $1,691. A typical homestead credit is 15 percent. It's applied to the tax bill after PTRC, reducing the tax bill to $1,437. That's what this homeowner would have paid in 2006.

This tax bill changed pretty substantially in 2007. There are five major policy changes that will affect this bill — trending, the inventory exemption, an increase in the homestead deduction, a reduction in the homestead credit and a cap on state payments for property-tax relief.

Trending took effect for the first time for taxes in 2007. The idea was to keep assessed values closer to selling prices by making annual adjustments. This year, assessments were updated from their current values, based on selling prices from 1999, to values based on selling prices from 2005. That's six years of change, all at once. Suppose this house sees an increase to $140,000, about 17 percent.

Trending will affect tax rates. All land and buildings will be trended, so each jurisdiction's assessed value will increase. The tax rate can be lower and still raise the revenue that local governments need. How much tax rates fall also depends on new

There are five major policy changes that affected the 2007 tax bill: trending, the inventory exemption, an increase in the homestead deduction, a reduction in the homestead credit and, again, a limit on state payments for property-tax relief.

The author's taxes increased 17.5 percent, so it is not news to him there is pressure on this General Assembly to "do something." Considering the calculations necessary to arrive at his exact payment, he hopes there also is pressure to simplify the tax code.

construction and changes in the amount of tax revenue collected. Let's say that this homeowner's rate falls to $2.65.

It would have fallen more, but, this year, inventories are exempt from property taxes in every county. The 2002 General Assembly voted to eliminate the inventory tax, and, in 2004, we voters approved a constitutional amendment that ratified its decision. Forty-one counties eliminated the tax before this year; now, the remaining 51 will get rid of it. That reduces the total assessed value available to tax, so the tax rate must be higher to raise revenue. If we still taxed inventories, this homeowner's tax rate might have fallen as low as $2.50.

In 2006, the legislature offered homeowners a tax break by increasing the homestead credit. It cost the state budget about $100-million dollars to replace the revenue that local governments lost from this increase. The budget couldn't afford that for a second year, so this year, the rate is back where it started. Instead, the homestead deduction will rise to $45,000, for 2007 only.

The state property-tax relief cap will also affect the credits. The state pays more than $2 billion a year to local governments to replace property-tax revenue lost to the two credits. The General Assembly put a cap on the amount of tax relief paid, to help keep the state budget in balance. For the taxpayer, this means a reduction in the PTRC and homestead credit rates. Looks like these rates will be reduced by about eight percent this year.

So, the tax bill: The newly trended gross assessed value of $140,000, less the homestead and mortgage deduction of $45,000 and $3,000, leaves $92,000 to tax. The new lower tax rate of $2.65 yields a gross bill of $2,438. It would have been less if we were still taxing inventories. The PTRC rate is down to 23 percent, because of the tax relief cap, and the homestead credit drops to 10 percent, because of the cap and the 2007 rate reduction. This homeowner pays $1,689 in 2007.

That's a tax bill increase of 17.5 percent, $252 more. The General Assembly will feel pressure from taxpayers to do something.

And, looking at all the above calculations, let's hope they feel a little pressure for tax simplification, too. — *March 22*

How Do Indiana Taxes Compare?

Homeowner property taxes are going up in Indiana but how do they compare to property taxes in other states? Here's some evidence.

The U.S. Census does a survey of American households each year, called the American Community Survey (ACS). It's a survey, not a census, so you probably didn't receive a survey form. But three million Americans did, and the Census has the 2005 results on its Web site, http://factfinder.census.gov (no "www").

Here's what's exciting: The ACS asks homeowners how much they paid in property taxes. The Census Web site shows the median value for each state. The median is the payment in the middle, with half of all homeowners paying more and half paying less. That means we now can compare Indiana homeowner property taxes with those in other states.

It's always been hard to compare property taxes, because every state runs its property-tax system differently. Perhaps the best way to do it is simply to ask the taxpayers.

The ACS says that the median Indiana homeowner paid $1,079 in property taxes in 2005. That seems about right. Indiana data for 2003 showed the average homestead tax at $1,145, and the average is always higher than the median, with data like this.

Indiana's median homeowner property taxes ranked 35th-highest in the country. Among our neighbors, Illinois was seventh with an average homeowner tax bill of $2,904. Kentucky was 44th at $693. Nationwide, New Jersey was No. 1, with an average homeowner tax bill of $5,352. Louisiana was lowest, with $175. What explains that big range?

In some states, governments spend more. In others, they spend less. In some states, governments pay for a lot of their spending with property taxes. In other states, they use more sales and income taxes.

We can get some more evidence from the Federation of Tax Administrators (FTA), which has some state comparisons on its Web site at http://www.taxadmin.org. One of its tables shows the total taxes collected per person. Another shows the share of taxes that each state raises from property, sales and income taxes.

Consider Alabama. The median homeowner tax bill there was only $302 in 2005, second-lowest in the country. And Alabama state and local governments had the lowest total taxes per person. Do their governments deliver more services for the buck? Or are Alabama citizens content with fewer or lower-quality government services? Either way, they're not collecting much in taxes in Alabama.

Only 15 percent of those taxes are property taxes. That's the fifth-lowest share in the United States, Alabama homeowners pay so little in property taxes because their governments don't spend much, and they prefer sales taxes to property taxes.

Contrast that with New Jersey, with the highest homeowner property taxes in the United States, as of 2005. Jersey ranks fifth in total taxes per capita and levies 45 percent of those taxes on property, the second-highest share in the country. New Jersey homeowners pay so much because their government spends a lot, and they don't use sales or income taxes as much as other states do. (There's been new property-tax relief in New Jersey since 2005, which has helped some.)

Indiana ranks 26th in taxes per person — smack in the middle of the 50 states, plus Washington, D.C. Indiana also ranks 26th in property-tax share, at 29 percent (after state credits are accounted for). Yet Indiana homeowners rank 35th in median tax bill. Why so low?

Homeowners aren't the only ones paying property taxes. In 2005, businesses paid about half of all property taxes. Maybe Indiana had lower homeowner property taxes because it had higher business property taxes.

But that was 2005. Taxes are changing. Trending and elimination of the inventory tax have shifted property taxes from businesses to homeowners. And Indiana is reducing its property-tax share, paying more tax relief out of the state budget and encouraging local governments to adopt income taxes.

Indiana has been a moderate tax state, making moderate use of the property tax, lighter on homeowners, heavier on business. The policy debate will decide if we want to stay that way. — *Aug. 23*

Table 1, State and Local Property-tax Collections Per Capita by State 2005

State	*Capita*
New Jersey	$2,206
Connecticut	$2,044
New Hampshire	$2,028
D.C.	$1,951
New York	$1,768
Wyoming	$1,751
Vermont	$1,697
Rhode Island	$1,695
Maine	$1,632
Massachusetts	$1,607
Illinois	$1,464
Wisconsin	$1,410
Alaska	$1,345
Texas	$1,320
Michigan	$1,279
Indiana	$1,219
Nebraska	$1,195
Florida	$1,148
Kansas	$1,125
Iowa	$1,114
Pennsylvania	$1,079
Montana	$1,067
Colorado	$1,059
Washington	$1,055
Ohio	$1,044
Minnesota	$1,024
Maryland	$1,001
Oregon	$979
North Dakota	$977
Nevada	$962
California	$942
South Dakota	$942
Georgia	$899
South Carolina	$880
Arizona	$861
Missouri	$810
Idaho	$807
North Carolina	$741
Utah	$720
Mississippi	$676
Tennessee	$654
Hawaii	$643
Delaware	$577
West Virginia	$556
Louisiana	$539
Kentucky	$538
Oklahoma	$485
New Mexico	$448
Arkansas	$422
Alabama	$394

Source: Tax Foundation, Census Bureau

Indiana historically has made moderate use of the property tax — lighter on homeowners, heavier on business. The current debate in the General Assembly will decide whether it stays that way.

Who's Driving the Property-Tax Boat? Local Government Is

by RYAN CUMMINS
Terre Haute City Council, 2nd District

"It's the fault of the governor, state legislature, the assessment methodologies and lack of an inventory tax — it's not my fault," a local politician seemed to say in a recent letter to the editor.

All the entities and policies mentioned above certainly contribute to the bizarre mishmash that is our property-tax system. Speaking as a local elected council member with eight years of experience, however, I strongly assert to taxpayers that the driving force, the primary reason for the substantial increases in property tax is your local government, run by your local elected officials.

There comes a point where enough is enough, and the answer is not to elect superior or smarter people who somehow will "do better." There are plenty of good, smart people running for office or holding office now.

Citizens must demand that those who want skate parks, swimming pools, downtown parking spaces, rides to shopping, money to invest in their businesses or their particular "good idea" to show some personal responsibility and pay for it themselves. — *July 19*

THE ECONOMICS AND POLITICS OF PROPERTY TAXES

Dagney Faulk breaks down the discussion from the viewpoints of the economist, the voter and the politician. She closes with a description of property-tax limits as imposed by California and Massachusetts. Similar limits proposed by Gov. Mitch Daniels would often tighten local spending or require local governments to find other revenue sources.

An efficient tax is a tax that does not cause people to change their behavior in response. Raising the sales tax rate to seven percent is a policy likely to cause people to change their shopping behavior.

by **DAGNEY FAULK**

In the U.S. system, state and local governments have traditionally been funded through three revenue sources — property, sales and income taxes. More recently, gaming taxes have contributed a growing portion of tax revenue in some states. Property taxes continue to be the largest source of revenue for local governments in Indiana, providing 53 percent of own-source revenue (local taxes, fees and charges) in 2005 — which is the 15th-highest of the 50 states and the District of Columbia. Table 1 shows that there is much variation among local government's reliance on property taxes. Local governments in Connecticut, for example, raised 83.6 percent of own-source revenue from property taxes in 2005 while Alabama raised 18.4 percent.

This article summarizes the advantages and disadvantages of the property tax as a revenue source for local governments, and when possible cites evidence in support of these views from more detailed studies. The article concludes with a summary of studies examining the effects of property-tax limits in California and Massachusetts — two of the most-studied cases in the U.S.

Taxes are analyzed according to some basic principles: equity, efficiency, administration, compliance and revenue stability.

Horizontal Equity

Horizontal equity proposes that people in equal positions should be treated equally. In terms of property taxation, horizontal equity requires that people with equal property values pay equal property taxes.

One of the issues with property taxes is that people with equal property values may not have the same ability to pay (usually measured by income). For example, senior citizens living on fixed incomes may not be able to afford substantial increases in property taxes. As a result, property-tax credits and deductions are introduced to reduce tax burdens and horizontal inequities result. In addition, property-tax relief for one group such as senior citizens or owner-occupied units shifts the property-tax burden onto other groups such as businesses.

As described below, property-tax limits can also have implications for horizontal equity.

'Efficient' Taxation

An "efficient" tax is a tax that does not cause people to change their behavior in response to the tax. For example, one of the current proposals to reduce property taxes in Indiana includes raising the sales tax rate

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to seven percent. Increasing the sales-tax rate is likely to cause people to change their shopping behavior. A higher sales-tax rate would introduce a rate differential with bordering states which would affect sales in border and nearby counties, particularly for big-ticket items.

A sales-tax rate of seven percent would be higher than all border states (Illinois 6.25 percent, Michigan six percent, Ohio five and a half percent). In a study examining the effects of sales-tax differentials on bordering counties, Fox (1986) shows that increases in the general sales-tax rate reduce retail activity and employment.

Economic Benefits

In the U.S., local governments are expected to provide certain services such as fire, police and primary and secondary education. As such, the property tax can be viewed as a benefits tax. The higher the assessed value the more tax one pays. The higher the property value the more the owner benefits when the fire department comes to put out a fire or the police come if there is a burglary.

Local governments are "efficient" providers of these services, meaning that they can best ascertain the level of service provision demanded by citizens. The property tax is the only tax that allows local control over service provision. Brunori (2003) argues that to maintain a system of strong local governments, these governments must have substantial control over local taxes and the associated revenues and that the property tax is the only tax that allows local control over service provision. Sales tax is redistributed from state government. The local income tax is constrained by state statute.

It should be relatively easy for taxpayers to comply with the property tax. Each property owner is sent a property-tax bill each year. The property owner pays the bill. However, in the last reassessment several counties were late sending out tax bills. This diminished confidence in the system and led to further irritation.

Another advantage of the property tax is that it is a stable source of revenue. Giertz (2006) shows that the property tax is not only a stable revenue source but is revenue elastic — *i.e.,* keeps pace with the economy. According to his analysis the property tax has been a "growing and consistent" source of revenues for local governments since the late 1980s.

General sales and income tax (both individual and corporate) revenues are more variable. Table 2 illustrates this point. The last recession occurred in 2001. Between 2000 and 2001, sales and individual income-tax revenue grew at a slower rate and corporate income-tax revenue decreased.

The increase in sales-tax revenue in 2001 and 2002 is due to the increase in the sales tax rate from five to six percent in December 2002.

Political Problems

Whatever their merits, property taxes are the least popular tax for a number of reason. Brunori (2003, 7) and other analysts have suggested that this is because it is highly visible, paid in large lump sums (twice a year in Indiana). Administrative problems stemming from

Table 1, Property Taxes as a Percentage of Own-Source Revenue

State	Property Taxes as a Percentage of Own-Source Revenue (2005)	Rank (1=highest)
Alabama	18.4%	51
Alaska	49.7%	19
Arizona	40.9%	34
Arkansas	20.8%	50
California	33.2%	44
Connecticut	83.6%	1
Delaware	42.4%	29
District of Colu	21.5%	49
Florida	42.6%	28
Georgia	42.0%	30
Hawaii	54.1%	14
Idaho	46.3%	23
Illinois	59.1%	8
Indiana	53.0%	15
Iowa	50.2%	18
Kansas	48.9%	20
Kentucky	32.8%	45
Louisiana	26.6%	48
Maine	77.6%	4
Maryland	36.8%	40
Massachusetts	74.7%	6
Michigan	54.3%	13
Minnesota	42.6%	27
Mississippi	40.5%	35
Missouri	39.4%	36
Montana	55.0%	11
Nebraska	48.7%	22
Nevada	34.7%	43
New Hampshir	81.0%	3
New Jersey	76.2%	5
New Mexico	31.6%	46
New York	41.8%	31
North Carolina	39.4%	37
North Dakota	54.4%	12
Ohio	44.7%	26
Oklahoma	31.0%	47
Oregon	45.5%	25
Pennsylvania	48.8%	21
Rhode Island	81.8%	2
South Carolina	41.6%	32
South Dakota	52.4%	16
Tennessee	34.9%	42
Texas	56.1%	10
Utah	41.3%	33
Vermont	56.7%	9
Virginia	50.4%	17
Washington	35.2%	41
West Virginia	46.1%	24
Wisconsin	65.7%	7
Wyoming	37.4%	38
United States *	45.8%	

Source: Author's calculations from U.S. Census Bureau, State and Local Government Finances, 2005.
**For local governments general revenue from own sources primarily includes taxes and charges.*

Table 2, Selected Indiana Tax Revenues (in millions of dollars, not adjusted for inflation)

	1998	1999	2000	2001	2002*	2003	2004	2005	2006
Sales Tax	$3,278	$3,423	$3,687	$3,723	$3,799	$4,210	$4,759	$5,001	$5,337
State Individual Income Tax	$3,433	$3,699	$3,753	$3,780	$3,541	$3,644	$3,808	$4,213	$4,382
Corporate Income Tax	$951	$1,007	$950	$843	$688	$573	$443	$608	$796
Riverboat Taxes (state share)	$261	$246	$281	$295	$323	$492	$625	$609	$617
TOTAL (state revenue)	$9,678	$9,766	$9,933	$9,894	$9,619	$10,642	$11,439	$12,282	$13,026

Source: Indiana Legislative Services Agency. Indiana Handbook of Taxes Revenues and Appropriations, various years.
** Dec. 1, 2002, the sales tax rate increased from 5% to 6% of the sales price.*

Alternatives to reducing the overall local tax burden for residents are 1) to reduce the size of government, 2) reduce the functions of government, or 3) make government more efficient. That last requires getting the same level of services at a lower cost, which, to come full circle, most likely entails a reduction in the size of government.

difficulties in accurately valuing property also contribute to its unpopularity. Dramatic increases in property-tax bills and actual or perceived inequities in assessed value have led to widespread dissatisfaction with the system.

In addition, proposed differential treatment of owner-occupied versus other residential (rental) and business property has fueled dissatisfaction. As analyzed in the Indiana Fiscal Policy Institute's "Statewide Property-tax Equalization Study Policy Report," there are severe problems with the administration of the property tax in Indiana.

Another contributor to the unpopularity of the tax is its shrinking tax base. Exemptions for nonprofit organizations and a variety of property-tax deductions and exemptions granted to firms for economic-development purposes reduced the property-tax base and shift the burden of the tax onto residents and other businesses.

Finally, as Fischel (2001) argues, when states take over public-school finance local support for the property tax diminishes. State intervention in the property-tax system resulted from inequities in school funding. Differences in revenue capacity of local areas led to court-ordered mandates for state government to intervene to equalize funding.

Another idiosyncrasy of the property tax is that the rate can vary from year to year to fund the levy, unlike the sales and income tax where the rates are set, which contributes to taxpayer uncertainty over the tax bill.

Trade-Offs

A drive around cities and towns in Indiana reveals a smattering of yard signs calling for the repeal of property taxes. Would this make the average citizen or property owner better off? Property-tax revenue is likely to be replaced with higher local income taxes and state sales taxes. There is no guarantee that the taxpayer's total tax burden will decrease.

Options for replacing the property tax each have their own issues. Property-tax relief in Indiana is currently funded through the riverboat wagering tax, sales tax, Indiana individual income tax, corporate gross income tax, all of which fund the property-tax replacement credit. The three local-option income taxes, which fund the property-tax replacement credit (CAGIT), replace revenue from additional homestead credits (COIT and CEDIT) or inventory tax deduction (CEDIT).

Estimates by the Legislative Services Agency (LSA) suggest that in order to eliminate the property tax and raise the same amount of revenue from other sources, the state sales tax rate would have to be 13.2 percent (currently six percent) or the state income tax would have to be nine percent (currently 3.4 percent), either of which has negative implications for economic development.

To reduce the overall local tax burden for residents, alternatives are to decrease the size of government, reduce the functions of government or make government more efficient. To get an efficiency gain, the same level of services must be provided a lower cost, which most likely entails a reduction in the size of government. Reducing the size of local government in Indiana is the primary recommendation of the Indiana Commission on Local Government Reform.

An alternative that is often mentioned but rarely implemented is the split-rate property tax. Under a split-rate tax, land is taxed at a higher rate than improvements which provides an incentive to renovate existing structures or build new structures on vacant land. Pittsburgh, Pa., is the only major city in the U.S. to implement this type of tax. Implemented in 1979 and taxing land at five times the rate of structures, the tax was analyzed by Oates and Schwab (1997). They concluded that while excess demand for commercial space was the primary force, the split-rate tax played a supporting role primarily in increasing commercial development and residential development to a lesser extent because the higher tax on land decreased reliance on other taxes that hinder economic development.

A Note On Property-Tax Limits

The three most common types of property-tax limitations are revenue limits, tax-rate limits and limits on increases in the taxable value (usually assessed value) of property. These limits constrain individual property-tax payments. Revenue and tax-rate limits constrain local government behavior by ultimately limiting spending. Limits on taxable value do not necessarily limit spending if the tax rate can vary to raise the specified levy.

In 2006, 43 of the 48 lower states had at least one of these types of limitations on property taxes. Anderson (2006) argues that there are two reasons that taxpayers approve property-tax limits: 1) To constrain local government expenditures; and 2) to prevent unexpected increases in individual property-tax liability.

In Indiana, the latter appears to be the dominant factor driving property-tax reform. Residential property owners (both owner-occupied and rental) have experienced a "sticker shock" that was the impetus for a variety of property-tax protests that ranged from marches to yard signs.

California Proposition 13 — The effects of Proposition 13 in California and Proposition 2 ½ in Massachusetts have been studied extensively. California's Proposition 13 was enacted in 1978 and is one of the most severe property-tax limitation measures.

The maximum property-tax rate there was capped at one percent. Assessed value of property was rolled back to its 1975-1976 level. When a property is sold it is reassessed at market value but capped at no more than two percent growth per year. These measures decreased the property-tax rate and restrained annual increases in property-tax liabilities but also resulted in severe inequities. A recently purchased house would have a different property-tax liability than a similar house that was purchased many years before. That is true even if the two houses have equal market values.

In their analysis of the effects of Proposition 13, Sexton, Sheffrin and O'Sullivan (1999) show that:

• Infrequent movers (low-income households and senior citizens) benefit from lower property-tax burdens.

• Severe horizontal inequities occurred depending on when property is purchased.

• Local governments have increased reliance on other sources of revenue such as fees, special-assessment districts, tax-increment financing and lease-purchase plans.

• The complex apportionment rules developed to distribute property-tax revenue to local jurisdictions resulted in residents in jurisdictions with relatively low tax rates before the imposition of Proposition 13 subsidizing residents in jurisdictions with relatively high tax rates.

• And finally, a fiscal crisis at the state level caused the state to redirect over $3 billion from counties, cities and special districts to school districts.

In addition, Downs and Figlio (1999) argue that tax and expenditure limits have led to lower performance of public school students.

It is these later two findings that are perhaps most disturbing for local government. Without a dedicated source of funding, local governments are at the mercy of the state. When states experience fiscal crises, revenues can be redirected from local governments.

Massachusetts Proposition 2½ — Massachusetts voters approved Proposition 2½ in 1980. This caps the property-tax rate at 2.5 percent and limits nominal growth in annual property-tax revenues (the levy) to 2.5 percent plus an allowance for new growth. The proposition also establishes a levy ceiling restricting total property-tax revenue to less than 2.5 percent of total property value even if this means less than 2.5 percent growth in annual tax revenue. Voters can increase taxes above the jurisdiction's levy limit if a majority approves an override or exclusion resolution in a direct election. Exclusions are temporary increases that can be used for debt or capital projects. Overrides are permanent increases that can grow 2.5 percent each year. Overrides can be enacted for any purpose, but the purpose must be specified. Despite these constraints, local governments in Massachusetts continue to raise a substantial portion (74.7 percent) of own-source revenue from the property tax in 2005 (Table 1).

Recent analysis of the effect of Proposition 2 ½ has focused on overrides where voters allowed local government to increase property-tax revenue; the impact

It is argued that there are two reasons that taxpayers approve property-tax limits: 1) To constrain local government expenditures; and 2) to prevent unexpected increases in individual property-tax liability. In Indiana, the latter appears to be the dominant factor.

Despite problems associated with the various property-tax limitation measures that have been implemented over the past three decades, the benefits must outweigh the costs — at least politically.

of the proposition in restraining school spending, and the effect on property values. Cutler, Elmendorf and Zeckhauser (1999) find that the primary determinants of voter support for Proposition 2 ½ is the view that that government is wasteful, *i.e.,* finances projects and services that voters do not value and the view that government is inefficient because individual tax burdens are too high.

They also find that voters in communities with large initial tax cuts in the 1980s supported more overrides and exclusions in the 1990s suggesting that voters either regret the severity of the tax limits or that the tax limits have accomplished the objective and voters were willing to authorize more spending. Voter support for the proposition was higher in communities with higher per-capita taxes and voters were less likely to support overrides or exclusions.

Bradbury, Mayer and Case (2001) analyze the 1990-94 period which was a time that local governments in Massachusetts experienced reductions in state aid and increases in school enrollment.

They find that Proposition 2½ constrained spending in some communities with the largest impact on school spending. Constrained communities experienced increases in property values if they were able to increase school spending despite the limitations, and changes in non-school spending had no substantial effect on property values.

Conclusion

Despite problems associated with the various property-tax limitation measures that have been implemented over the past three decades, the benefits must outweigh the costs — at least politically. As McGuire (1999) points out, few property-tax limits have been repealed.

The findings of the studies summarized above suggest that policy-makers need to consider how property-tax limits will affect horizontal equity, local spending during state fiscal crises and school spending when constructing these sorts of policies in order to mitigate negative effects on education quality and property values.

— Dec. 27

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WHAT DOES THE INDIANA CONSTITUTION SAY ABOUT TAXES?

Andy Horning reminds citizens and their political representatives of the the need to stick to the federal and state constitutions or risk arbitrary and capricious laws. Here he lays out what the Indiana Constitution says about the powers of government, its ability to impose property taxes and the rationale for property taxes. Ultimately, he explains how our failure in the past to follow the Indiana Constitution has led to our current taxation problems.

by ANDY HORNING

A collection plate may prompt a little uneasiness as it passes by. Nevertheless, for fully functioning adults, the various forms of "passing the hat" are the civilized means of raising money. Nothing is more civilized than a truly free market, where all transactions are voluntary.

Taxation, on the other hand — that strange species of theft legitimized by abstractions, lies and guns — is an odd thing in a republic that claims to be free. We'd like to think otherwise, but taxation is the extraction of money by violence.

Of course politicians say that taxation is the price of civilization. But it's no ticket to civility. Taxation is the wage of politicians. And politicians are known for everything but civilized behavior.

It's important to understand taxation's violent foundation because that foundation is a bigger problem than is any kind or degree of tax.

Despite what you've been told about the cause of our Revolutionary War, you'll be half-way through our Declaration of Independence before you see it mentioned, and then only in regard to imposing taxes on us without our consent.

The real reason our founders declared independence from England was King George's refusal to assent to laws, the most wholesome and necessary for the public good. The Declaration cites the King for 27 violations of rights that Englishmen were due by written law. It was Rule of Law instead of rule of tyrants that our founders wanted — not anything unreasonable or even new.

Yet in the 216 years since the Bill of Rights was ratified, we have allowed our politicians to sneak away from that hard-won Rule of Law. Instead of constitutional restraint and separation of powers, we have Executive Orders — or as a former Clinton advisor boasted to *the New York Times,* "Stroke of the pen . . . Law of the Land. Kinda cool." [1]

That is literally a criminal shame. People fought and died to get constitutions written, signed and enforced because history has proven that constitutions are

"Stroke of the pen . . . Law of the Land . . . Kinda cool."

— Paul Begala, former Clinton advisor commenting on the Executive Order

Andrew Horning was the Republican candidate for the 7th District congressional seat in 2004, losing to the incumbent, the late Julia Carson, with 44 percent of the vote. Last summer, Horning helped organize the first tax protest at the governor's residence. Nothing written here is to be construed as reflecting the views of the foundation or as an attempt to aid or hinder the passage of any bill before the legislature or to further any political campaign.

1. Paul Begala, a senior advisor to President Bill Clinton, to the New York Times, July 5, 1998.

While there is much to say regarding the relative merits of one tax versus another, we should also check the signed contract (the constitution). Not only is the law better than current practice but the law really is the law.

crucial to liberty and prosperity. And history has proven that ours, both federal and state, are special constitutions.

So, while there is much to say regarding the relative merits of one tax versus another, we should also check the signed contract. Not only is the law better than current practice but the law really is the law.

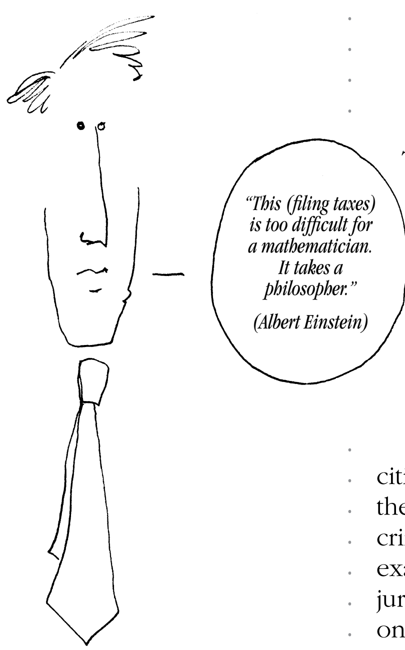
Article 1, Section 25, of the Indiana Constitution, which is something like the federal Constitution's 10th Amendment, inarguably limits the power of politicians to what is granted by the Constitution:

> *No law shall be passed, the taking effect of which shall be made to depend upon any authority, except as provided in this Constitution.*

This means that no law can contravene the Indiana Constitution. No state authority can exceed it. No legal state power exists outside what's written into the constitution. The constitution can be amended, but the constitution is to be obeyed — as written.

And what about interpretations from the bench?

> *Article 3, Section 20. Every act and joint resolution shall be plainly worded, avoiding, as far as practicable, the use of technical terms.*



Plainly worded. No decoder required. The constitution that expressed this sense for all laws is itself supposed to be read with the same clear common-sense approach to human language. More to the point, how can you interpret what follows?

> *Article 1, Section 19. In all criminal cases whatever, the jury shall have the right to determine the law and the facts.*

This clearly written law means that citizen jurors (not judges) decide what the law means, and how it applies to any criminal case (including tax evasion, for example). Yet, we've been told through jury instructions and judicial decrees that only judges can say what lawmakers meant by their words. Such lawmaking authority is not written anywhere in any U.S. constitution, state or federal.

Don't believe politicians' relatively new yarn about Marbury *vs.* Madison. In that 1803 ruling Chief Justice Marshall wrote that "it is emphatically the province and duty of the judicial department to say what the law is." Since Franklin D. Roosevelt's court-packing scheme (the "Switch in Time that Saved Nine")[2], the phrase "to say what the law is" has been increasingly transformed into "say what the law means."[3]

But Marshall never said or meant that. Even in that same ruling, Marshall said that "the particular phraseology of the constitution of the United States confirms and strengthens the principle, supposed to be essential to all written constitutions, that a law repugnant to the constitution is void; and that courts, as well as other departments, are bound by that instrument."

What isn't clear should be clarified by amendment. What is wrong or missing is to be fixed by amendment. But again, constitutions are to be obeyed — again, as written.

Not clear enough? The writers of the Indiana Constitution wanted this to be crystal clear:

> *Article 3, Section 1. The powers of the Government are divided into three separate departments; the Legislative, the Executive including the Administrative, and the Judicial: and no person, charged with official duties under one of these departments, shall exercise any of the functions of another, except as in this Constitution expressly provided.*

So in Indiana it is unequivocal that neither judges nor executives can make laws. And if there were any remaining doubt about the authorization and limitation of all governing powers:

> *Article 15, Section 4. Every person elected or appointed to any office under this Constitution, shall, before entering on the duties thereof, take an oath or affirmation, to support the Constitution of this State, and of the United States, and also an oath of office.*

Why make every single constitutional official take such an oath? Because just

2. President Roosevelt proposed the Judiciary Reorganization Bill of 1937 in response to the Supreme Court's opposition to New Deal proposals. The bill would have allowed Roosevelt to appoint six new justices to make the court do his bidding, but the U.S. Congress did not pass it. Ironically, the court then surrendered, and allowed the New Deal anyway.

3. It is no joke that in his Aug. 18, 1998, Grand Jury testimony, President Bill Clinton said, "It depends on what the meaning of the word 'is' is."

as un-policed police are dangerous, ungoverned government is fatal. So politicians swear an oath to support the laws that authorize their powers, or those powers are null and void.

Having established the authority of the Indiana Constitution in all matters of governing power, and before examining the specific matters of tax, what does it say about the government's power over citizens' labor and property?

> *Article 1, Section 21. No person's particular services shall be demanded, without just compensation. No person's property shall be taken by law, without just compensation; nor, except in case of the State, without such compensation first assessed and tendered.*

There are more limits to the state's claim to our property:

> *Article 1, Section 22. The privilege of the debtor to enjoy the necessary comforts of life, shall be recognized by wholesome laws, exempting a reasonable amount of property from seizure or sale, for the payment of any debt or liability hereafter contracted: and there shall be no imprisonment for debt, except in case of fraud.*

Of course the phrase, "reasonable amount," has no meaning to politicians but surely a home must at some point be an indivisible unit. After all, who'd want to buy a home encumbered with a state debtor living in the bathroom? And what could be just compensation (Art. 1, Sec. 21) for taking a person's home?

Unless there is some unknown but compelling sort of justice by which homes should be seized and sold to pay a debt to the state, an awful lot of Hoosiers have had their homes stolen by lawbreaking politicians.

Which brings us to Article 10. I know I had previously praised U.S. constitutions, both federal and state; but here I must recant. Article 10, Section 1, of Indiana's 1851 constitution was so poorly conceived and so badly amended that it cries out for an amendment to eliminate it:

Article 10. Finance, Section 1, Property Assessment and Taxation

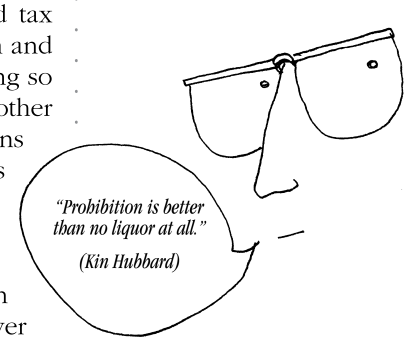
> *a) The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal. The General Assembly may exempt from property taxation any property in any of the following classes:*
>
> *1) Property being used for municipal, educational, literary, scientific, religious or charitable purposes;*
>
> *2) Tangible personal property other than property being held for sale in the ordinary course of a trade or business, property being held, used or consumed in connection with the production of income, or property being held as an investment;*
>
> *3) Intangible personal property.*
>
> *b) The General Assembly may exempt any motor vehicles, mobile homes, airplanes, boats, trailers or similar property, provided that an excise tax in lieu of the property tax is substituted therefore.*

This is the law, but unlike Land Value Tax,[4] which taxes only unimproved land area, it is impossible to assess and tax most kinds of property in a uniform and equal way; particularly after itemizing so many possible exemptions. With all other property still on the table (even spoons and tablecloths are taxable under this article), any assessment of property is prone to cheating, corruption, injustice and honest mistakes.

The value of any property is known only when sold. That's when a buyer and a seller agree to a price that's worth giving and taking. So a sales tax can be accurately assessed. But there is no static, intrinsic, objective or universal value to any kind of property.

Also, that phrase "may exempt from property taxation" is so open-ended as to allow the possibility that intangible personal property may be taxed, and that nothing at all has been exempted except by the innumerable, unfathomable and legally more equivocal statutes and codes outside the Constitution. This article's wording allows that intellectual property, and even your own body, may be assessed for taxation. That is as impractical as it is evil.

Unless there is some unknown but compelling sort of justice by which homes should be seized and sold to pay a debt to the state, an awful lot of Hoosiers have had their homes stolen by lawbreaking politicians.



4. During the 2000 Indiana governor's race I had proposed a "land rent" or Land Value Tax (LVT) similar to the proposals of a 19th-century economist, Henry George, to replace our current scheme of property tax. LVT is assessed solely upon land area, excluding all "improvements." The constitutional problem is that LVT is only a real-property tax, not a personal-property tax, and the constitution would still have to be amended to preclude other kinds of "property" tax.

About half of the property tax collected in Indiana goes to government schools. And school policy is perhaps the area in which Indiana policy has most dramatically departed from the law.

Sadly, Article 10 is one of the few parts of the Indiana Constitution that politicians obey. The law allows for unlimited, thoughtless taxation — and that's what we're getting.

With an important exception: The phrase in Article 10, Section 1, "just valuation for taxation," speaks to the legal basis upon which our politicians demand our money at all. And that is something to ponder.

> *"The moment you abandon the cardinal principle of extracting from all individuals the same proportion of their income or their property, you are at sea without rudder or compass, and there is no amount of injustice or folly you may not commit."*
>
> *— J.R. McCulloch, early 19th-century American economist*

Indiana's original 1816 constitution was quite good, and failed only in its breach. A new one was written in 1851, partly to keep "Negroes" out,[5] but mostly because the state went broke investing (unconstitutionally, of course) in the canal-building craze of the early mid-1800s. Subsequently, lawmakers wanted to prevent such out-of-control government spending from ever happening again. In other words, they wrote new laws to make illegal what was already unconstitutional:

> *Article 10, Section 5. No law shall authorize any debt to be contracted, on behalf of the State, except in the following cases: to meet casual deficits in the revenue; to pay the interest on the State Debt; to repel invasion, suppress insurrection, or, if hostilities be threatened, provide for the public defense.*

You will note that deficits in the revenue are not the same as deficits in desired spending. And it gets better . . .

> *Article 10, Section 6. No county shall subscribe for stock in any incorporated company, unless the same be paid for at the time of such subscription; nor shall any county loan its credit to any incorporated company, nor borrow money for the purpose of taking stock in any such company; nor shall the General Assembly ever, on behalf of the State, assume the debts of any county, city, town, or township; nor of any corporation whatever.*

If that isn't clear enough, how about:

> *Article 11, Section 12. The State shall not be a stockholder in any bank; nor shall the credit of the State ever be given, or loaned, in aid of any person, association or corporation; nor shall the State become a stockholder in any corporation or association.*

So, while such spending was never authorized in any U.S. constitution, Indiana's rewritten constitution specifically prohibits political subsidies to the likes of the Colts, Pacers, mall-builders, foreign auto companies or any other campaign contributors. In other words, much of what government now spends our money on is illegal spending — not just immoral spending. It was unconstitutional in 1816, and it's unconstitutional now. And unconstitutional is a euphemism for dangerously illegal.

We must talk about school policy. About half of the property tax collected in Indiana goes to government schools. And school policy is perhaps the area in which Indiana policy has most dramatically departed from the law.

> *Article 8, Section 1, mandates "a general and uniform system of Common Schools, wherein tuition shall be without charge, and equally open to all."*

Before the Indiana Constitution was rewritten, Horace Mann argued that "Common Schools should be the Great Equalizer;" that politics must intervene to provide this identical "ladder of opportunity" to rich and poor alike. What Indiana law mandates, in other words, is identical schools all across the state where nobody gets a palace, nobody gets a dump.

This would be much better than trucking children on costly buses to be a tiny fish in a huge ocean without the opportunities (in both education and sport) that children had in years past with more, smaller schools.

And school was understood to be more about books than about sports. Perversely and unconstitutionally in Indiana, books cost extra while sports get school priority over anything else (like books, musical instruments, science equipment). People shouldn't lose their homes to sports. And

5. *Article 13, Section 1. "No negro or mulatto shall come into or settle in the State, after the adoption of this Constitution." This embarrassment was repealed in 1881.*

we certainly don't need taxation to build poorer schools for poorer people.

> *Article 8, Section 3. The principal of the Common School fund shall remain a perpetual fund, which may be increased, but shall never be diminished; and the income thereof shall be inviolably appropriated to the support of Common Schools, and to no other purpose whatever.*

We're supposed to pay for Common Schools with an endowed fund. Of course there is no Common School fund now. Legally, there is supposed to be an inviolable one. And in all the specific maintenance funding mentioned in Article 8, Section 2, you'll see that personal property tax is not mentioned. Only "Taxes on the property of corporations, that may be assessed by the General Assembly for Common-School purposes."

So constitutionally, only corporate property tax is to be used for Common Schools. Indiana government is not authorized to tax personal property, real or otherwise, for Common Schools. So between this and the aforementioned prohibitions on government spending, most of your property-tax bill shouldn't be there.

Surprised? Angry? Well, there's a solution for that:

> *Article 1, Section 1: All free governments are, and of right ought to be, founded on their authority, and instituted for their peace, safety and well-being. For the advancement of these ends, the People have, at all times, an indefeasible right to alter and reform their government.*

How? Well, that's the rub. How are people to reform a government unwilling to be reformed? How do people govern their government?

We've turned elections into a game of money and odds-making — and the game is stacked against us. Our politicians control education, public communication, and have slopped up impenetrable layers of bureaucratic goo such that we feel helpless. Politicians allow zero tolerance for us, yet we have granted them absolute impunity. Sure, our founders warned us about the monster that we'd create, but now what do we do?

Article 1, Section 32, was written to address this *in extremis*. Short of that scary option, we should protest in every way possible. Of course we should fire the politicians who abuse us. Maybe even more powerful than guns; the deduction from Article 10, Section 1, "just valuation for taxation," is that we shouldn't pay unjust taxation.

But first we need to learn the laws that guarantee our freedom. Then we should take a step we've somehow missed. We should ask our politicians to obey written laws — as written.

Could it be so simple? It's worth a try. — *Dec. 18*

We've turned elections into a game of money and odds-making — and the game is stacked against us.

A Torturous Tax Debate

Anyone studying the various tax-reform proposals can be forgiven for falling into a scene from "Brazil," the classic dystopic comedy by Terry Gilliam:

> *A receptionist is seen casually transcribing an off-screen conversation. When interrupted by the main character, she tilts her headphones off of her ears, allowing us to hear the pained sounds of someone undergoing severe torture. After cheerfully addressing the main character, she continues to dutifully record the nearly unintelligible pleas and screams. — Wikipedia*

The pain of Indiana taxpayers is being transcribed by officials determined to maintain decorum. The screams of a buckling economy are barely audible. And as was the case with Gilliam's receptionist, many of the villains are neither malicious nor sadistic — they are merely doing their jobs

In reviewing the tax plans on the table comes a troubling realization: The tax system that American colonists found unbearable to the point of revolution was a better deal. One can imagine a blogging Jefferson exhorting his Internet visitors to "throw off such government, and to provide new guards for your future security."

For King George III was just another official protecting another treasury. In contrast, though, he asked only that the colonists pay a user tax on paper, glass and tea to defray the cost of defending North America from the French and the Indians.

Our taxes today tend to be more confiscatory and regressive, not less. It is even arguable, considering the power of gerrymandered incumbency and multi-issue legislation, whether we enjoy the meaningful democratic representation that the Revolution promised. And the great bulk of our tax money is spent not on roads, bridges or even public safety but on perpetual "wars" of doubtful outcome. these wars, foreign and domestic, are against shifting political definitions of national security, poverty, ignorance, poor health —and debt, don't forget how much of our money goes just to interest payments.

King George, only fractionally more ensconced and arrogant than today's rulers, at least won the war in whose name he taxed.

— *Craig Ladwig in the Oct. 31 Northwest Indiana Times*

A PRELIMINARY ANALYSIS OF THE DANIELS PROPERTY AND SALES TAX PROPOSAL

With Michael Hicks leading the way, the Bureau of Business Research at Ball State University has been aggressive in analyzing the various proposals for property-tax reform. Hicks analyzes the plans of the Indiana Farm Bureau and of Rep. David Orentlicher at length, while he discusses other plans more generally. With one exception, Hicks sees all of these plans as credible but notes that they differ in the amount of local government spending cuts they propose, the extent to which they require higher sales or income taxes to offset the property-tax cuts and whether or not they cap property taxes. He rejects plans that call for the elimination of property taxes, estimating they would require local spending be reduced by 60 percent — a level inconsistent with "basic Constitutional provisions."

Hoosiers enjoy a tax system that to this point has been less burdensome than in most states (in terms of per capita collections). However, the instability in revenues and uncertainty surrounding property-tax costs are a concern for policy-makers and citizens alike.

by MICHAEL HICKS and CECIL BOHANON

On Tuesday, Oct. 22, Indiana Governor Mitch Daniels unveiled a tax proposal aimed to remedy a number of problems with property taxes. His proposal calls for the reduction of property-tax collections by one-third with additional revenue sources generated by a one percentage-point increase in the general sales tax.[1] The proposal offers to cap the remaining property taxes with a three-tiered property-tax rate (residential one percent, rental two percent and commercial three percent), and effectively consolidates taxation and budgetary decision-making from the taxing authority to the county level. The proposal also shifts the revenue burden of remaining school expenditures from local government to the state government.[2]

This proposal affects both individuals and businesses by changing the incentives for investing and consuming, and by reducing uncertainty regarding future tax rates. The plan will also potentially result in smaller local government.[3] In order to understand the magnitude of these proposals it is important to evaluate several issues regarding taxation in general, Indiana's tax experience and the specific effects of the proposals themselves.

This preliminary estimate of the economic consequences offers an evaluation of four issues. First, we review the current Indiana tax system and contrast the proposed changes. This step also recognizes the chief elements of an effective tax system and compares Indiana's taxes to other states. Second,


Michael J. Hicks, Ph.D. (left), is director of the Bureau of Business Research and an associate professor of economics at Ball State University. Hicks earned doctoral and master's degrees in economics from the University of Tennessee. He has written two books and more than 60 scholarly works focusing on state and local public policy with an emphasis on tax and expenditure. Cecil E. Bohanon, Ph.D., an adjunct scholar, is a professor of economics at Ball State University. He received his Ph.D. from Virginia Polytechnic Institute and State University in 1981. A version of this article was first published by the university and is accessible through its web site at http://www.bsu.edu/cob/bbr/.

1. Indiana's sales tax is formally a Sales and Use Tax. We'll shorten the name for ease of exposition.

2. See "Governor Daniels' Property-Tax Plan: Fair, Far-Reaching and Final Property Tax Relief for Hoosier Homeowners," Oct. 23, 2007, http://www.in.gov/gov/3105.htm.

3. We address the issue of potential government efficiency gains elsewhere.

we evaluate the change in the direct incidence of taxes under the proposed plan. This step focuses on consumers, with some discussion of businesses. Third, we evaluate the economic consequences of the proposed plan. That is, we estimate business and consumer response to the tax proposal on overall economic activity. This is followed by a discussion of the limitations of this analysis.

Current Indiana Taxes

Indiana levies four broad taxes on: wealth, income, consumption and activities. Like most states, Indiana taxes these areas with the goals of revenue stability, adequacy and efficiency in mind. These goals of any tax policy are useful, but it is important to keep in mind that individual goals may be mutually exclusive. Economists refer to this as the law of the second-best. Thus any tax plan may have individual elements that could be altered to meet goals of revenue stability, adequacy and efficiency but which would negatively affect other goals.

Stability and adequacy are theoretically straightforward (even if difficult to quantify), but efficiency is more complex. When economists refer to tax efficiency we often use the term "marginal-efficiency cost" to refer to the combination of administrative difficulty and incentive effects (on businesses and consumer decisions) which accompany the tax.

Our per-capita tax burden in Indiana is lower than the national average for both state and local spending. (For a regional comparison, see Table 1.)[4] We have consistently ranked at the top of the bottom-third for total government expenditures. However, local spending growth has outpaced the national growth in local government by more than half a percentage point per year.

The state levies taxes on income generated by corporations and individuals.[5] Indiana's Corporate Adjusted Gross Income Taxes are a flat 8.5 percent, without local option taxes.[6] Individual income taxes in Indiana have both a state and local option component. (See Table 2.) The state component of individual income taxes is based on Federal Adjusted Income. The state personal income tax is a flat 3.4 percent with secondary exemptions (effectively one per family member).

The local option personal income taxes are comprised of three different instruments — the County Adjusted Gross Income Tax (CAGIT), the County Option Income Tax (COIT) and the County Economic Development Income Tax (CEDIT).[7] In addition a new tax, the Local Option Income Tax (LOIT), was enacted in 2007. The new LOIT may be used to meet budgetary needs or offset local property taxes. It is capped at 2.25 percent, and is introduced in three different stages of the budgetary process.

Indiana taxes consumption through excise taxes and sales taxes. Though we currently have a high nominal rate of sales tax, the effective rate is far lower due to the exclusion of most services, food and prescription medicines in our sales-tax formulation. (See Table 3.) Further, our

Table 1, Per-Capita State and Local Government Expenditures

	Amount	National Rank
Illinois	$7,038	12
Indiana	$5,971	28
Kentucky	$6,145	25
Michigan	$6,997	14
Ohio	$4,522	44

Economists recognize a "law of the second-best." It says that any tax plan may have individual elements that could be altered to meet goals of revenue stability, adequacy and efficiency but which would negatively affect other goals.

Table 2, Regional Income and Payroll Taxes

	Low	High	Number of Brackets	Local Option (Income or Payroll)
Illinois	3.0	–	1	No
Indiana	3.4	–	1	Yes
Kentucky	2.0	6.0	6	Yes
Michigan	3.9	–	1	No
Ohio	0.649	6.55	9	Yes

4. Tax data on surrounding states collected from the Tax Foundation, various reports.

5. Non-corporate businesses are typically taxed as individuals.

6. There are 28 separate adjustments for differing activities from worker training to alternative-fuel production that influence the actual rate experienced by a wide variety of Indiana firms.

7. Tax instrument data and descriptions drawn from the Indiana Handbook on Taxes, Revenues and Appropriations, 2006, Indiana Legislative Services Agency Office of Fiscal and Management Analysis.

Governor Daniels' proposal is initially adequate to meet the current demands of local public finance. However, significant alteration in the cost of government may change this conclusion.

Table 3, Sales Taxes in Surrounding States

	Tax Rates	Local Option	Food	Prescription Meds	Non-Prescription Meds
Illinois	6.25	3.75	1%	1%	1%
Indiana	6	no	no	no	no
Kentucky	6	no	no	no	no
Michigan	6	no	no	no	no
Ohio	5.5	3	no	no	no

state excise taxes (such as the gasoline tax) are well below the national average.[8] Our current state sales tax rate is six percent, with local options for hotel-motel and restaurant taxes.

It is again worth mentioning that Indiana sales taxes do not apply to services, and so a significant and growing level of economic activity is not subject to sales taxes.

Indiana taxes wealth through property taxes. (See Table 4.) While there are other wealth taxes, real and personal-property taxes represent the bulk of wealth-related tax revenues. It is the analysis of this tax that comprises much of the current analysis.

In sum, Indiana's income taxes and business taxes are lower than the national average. Our current sales taxes (fully loaded with excise taxes and adjusted for food and medical exclusions) are modestly above-average. Our current property taxes are at about the national average. Overall our tax expenditures are below the national average, but growing relatively quickly.

Hoosiers enjoy a tax system that is less burdensome than in most states (in terms of per capita collections). However, the instability in revenues and uncertainty surrounding property-tax costs for businesses and residents are major concerns for policy makers and citizens alike.

Some Preliminary Comments

The metrics for evaluating a tax proposal include equity, stability and adequacy. This proposal addresses revenue stability, which is among the most crucial elements of state tax policy. Several proposals abolishing the property tax have been made public. The loss of stable property-tax revenues would have burdened the state with an inevitable budget crisis akin to the early part of this decade whenever the next national recession affects our economy.[9]

Governor Daniels' proposal is initially adequate to meet the current demands of local public finance. However, significant alteration in the cost of government may change this conclusion. Further, the caps offer significant untapped revenue sources for commercial property taxes.

Finally, this proposal is more regressive than the current tax system. However, the impact is modest due to the food and prescription drug exclusion and the relatively low excise taxes in Indiana. A more urgent equity concern is the treatment of individual taxpayers across geographic boundaries. This proposal significantly

Table 4, Summary of Indiana Property-Tax Changes *($millions based on 2006 data)*

	Assessed	Current Net Levy	Maximum Under Proposed Cap	Expected New Levy	Change from Expected New Levy
Total	$205,986	$3,893	$3,555	$3,231	($661)
Residential	$131,213	$2,479	$1,312	$1,312	($1,167)
Commercial	$74,773	$1,413	$2,243	$14,139	$0

8. *Indiana also imposes a sales tax on gasoline, in addition to the excise tax.*

9. *See "Why Keep Indiana's Property Taxes" Bureau of Business Research, Ball State University, November 2007.*

reduces the level of tax inequity across political boundaries (primarily townships) in the state.

The proposal does not address income taxes. Our state income tax is relatively modest (3.4 percent), but is burdened by three older local option income taxes and a new local option income tax. The presence of these local option income taxes makes difficult the role of income taxation as an instrument to blunt overall regressivity in state and local taxes.

The proposal does not address the absence of a sales tax on services. Services are a rapidly growing segment of our economy, which are largely free from sales tax. The equitable treatment of non-service producing firms and the available revenue sources potentially derived from a tax on services may be an attractive option for mitigating the increase in general sales taxes. Admittedly though, taxes on services are administratively difficult to collect. As of this writing, none of the alternative plans have offered additional taxes on services. However, the overall tax plan proposed by Governor Daniels has several facets with important analytical requirements. It is to these that we turn our attention.

Residential Property-Tax Effects

The proposed tax plan would cap residential property-tax rates at one percent of assessed value. Even with this cap, the actual rate may vary dramatically across counties. In order to estimate whether the proposed cap is likely to result in a property-tax increase or decrease we can calculate the expenditure gap resulting from the shift of school and child welfare costs shifting to state government.

We thus assume revenue neutrality on other instruments (local option income taxes and excise taxes). As part of the plan, the Governor released a series of questions and answers to hypothetical queries about the plan. In this Q&A sheet, the plan argues that local governments will be responsible for any budget shortfall ensuing from the caps.

They have a choice of reducing spending or bolstering revenues through the new LOIT. As we will do in other assessments we apply this argument to our analysis and simply note the magnitude of the remaining local budgetary requirements.

In order to model the overall impact on residential property owners we evaluate rates that decline to one percent of assessed value. The effects on businesses will thus be a tax increase (to meet the budgetary requirements) which we discuss later. Table 4 illustrates the 2006 assessment and levies, that rate under the proposed cap and the expected value with the change.

This has both individual and aggregate effects. In order to illustrate the individual effects we construct three representative households with home values that are at the median, significantly above and below. We apply the statewide property-tax net assessment. This net assessment includes all exemptions (*e.g.,* mortgage and homestead) as well as the Property-tax Replacement Credits.[10] We represent two differing rates: the total current requirements, and the maximum rate. Obviously, this is a highly stylized representative of individual experiences with property-tax rates, but it is instructive in evaluating the effects on individuals of the proposed plan. We note, that as with the other proposals, treatment of existing exemptions is not explicit.[11] See table 5.[12] The aggregate effects of the

Table 5, Representative Consumer Tax Impacts

	Home Value	Current Average Tax Liability	Proposed Plan	Change
High	$250,000	$4,725	$2,500	($2,225)
Median	$110,000	$2,079	$1,100	($979)
Low	$75,000	$1,418	$750	($668)

The equitable treatment of non-service producing firms and the available revenue sources potentially derived from a tax on services may be an attractive political option for mitigating the increase in general sales taxes.

10. The gross levy rate is 2.51 percent while the net (less exemptions and PTRC) is 1.89 percent across both residential and commercial property.

11. Treatment of exemptions is an important part of the final deliberations of plans. For example, under the one, two, three percent plan, the homestead exemption no longer is realistically useful. Few Hoosiers own more than one home in Indiana that is not a rental property. Thus, we would have perhaps 99.5 percent of Hoosier households filing exemptions annually to collect extra taxes on the remaining half a percent.

12. The estimates of current liability are the state-average value.

The median Indiana family will see a roughly $268 increase in sales tax burden each year as a result of the proposed sales-tax increase.

proposal on revenues are also an important issue. They are unfortunately one that requires significant analysis of regional property-tax rate variability on residential property. With this concern in mind, we will portray the aggregate impact of the proposed plan on residential property-tax collections as a shift from both the gross and net levies statewide. The purpose for doing so is to evaluate the fullness of the property-tax plan should the elimination of the Property-tax Replacement Credits (PTRC) be included in the analysis of total effects.

Under the proposed plan, the gross levy rate is 2.51 percent. Applied against all residential property assessments statewide this gives a gross levy of roughly $3.3 billion.[13] The net levy yields total collections statewide of roughly $2.49 billion. Under the plan, the cap of one percent of home values provides a maximum of about $1.3 billion in property-tax levies. Thus, the savings to consumers in property taxes range about $1.1 billion from the current net levy.

Commercial Property-Tax Effects

The proposed plan has two separate rate caps for commercial property: two percent for rental units and three percent for other business property. Unfortunately there is tremendous regional- and firm-specific variation in these rates across the state. The regional variation is due to the varying need for local communities to pay for services in regions with highly disparate industry mixes. The firm-specific variation is due to an extensive patchwork of property-tax abatements across the state.

In light of these factors, and other as yet undeveloped details surrounding the proposed plan, estimates of commercial property-tax effects are less likely to be representative of individual experience than the other proposals. However, we will proceed with this caution into a preliminary analysis, employing assumptions that may be relaxed in subsequent versions of this analysis.

As with the residential property tax, we illustrate a single scenario that assumes revenue neutrality in other instruments. Current commercial-property owners experience a net levy of 1.89 percent. Their aggregate tax liability is roughly $1.41 billion. Applying the circuit breaker to this leaves total business taxes unchanged.

Rental property is a subset of commercial property which, under the proposed plan, would be subject to a rental cap of two percent. According to the 2002 Industrial Census, Indiana has over 1,800 rental establishments with annual revenues of over $1.33 billion. This Census did not include private rental agreements. I have included these data in the commercial property estimates above, though the proposed rate cap is lower for rental property. Importantly, as with any taxes, the incidence of the proposed property tax ultimately rests heavily with the consumers — either commercial or residential.

Effects on Consumers of Sales-Tax Adjustments

The proposed sales tax changes add one cent to applicable purchases. Taxable purchases of goods covered directly by Indiana's general sales taxes include consumer durables and non-durables, with the exception of food for home consumption and prescription medications. In order to capture the tax liability of the proposed tax we construct a representative consumer in Indiana. The data on expenditures is drawn from the Consumer Expenditure Survey performed by the Bureau of Labor Statistics. This survey collects data on consumer units (effectively families) annually, and provides a detailed description of these expenditures by category. The survey is national, and the most recent available survey was conducted in 2005.

Using the Consumer Expenditure Survey we scaled the national average income to reflect the median income in Indiana ($44,806) and proportionately scaled all consumption expenditures. The representative family is headed by an adult, aged 48.5 in a family with 1.3 wage-earners, a total of 2.5 persons and 1.9 automobiles. By applying the proposed

13. We employ the estimates of residential share from the Governor's current proposal, which is 63.7 percent of total property taxes.

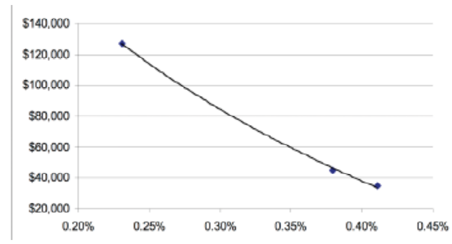
sales-tax changes to each of the applicable consumption categories we can calculate the incremental tax burden of the average family. The results appear in Table 6.[14, 15]

As is clear in this table, the median Indiana family will see a roughly $268 increase in sales-tax burden each year as a result of the proposed sales tax increase. Importantly, this estimate does not provide a good revenue forecast due to variability of taxable consumption across income groups. For that purpose, a rough estimate can be performed by calculating a one percentage-point sales-tax increase across the 2006 sales-tax collections. The result is a roughly $1.26 billion-increase in sales-tax collections. This should be viewed as the upper bound of the result, as it does not account for potential reduced consumption due to the higher costs of consuming goods.

Aggregating this value yields roughly $640 million in additional sales taxes on residents. Businesses also pay sales taxes, at about 42 percent by our estimates.[16] This would result in an additional $50 million resulting in additional total sales taxes of $1.1 billion. This is still below the $1.26 we noted in the previous paragraph. There will also be significant sales-tax payments by out-of-state visitors. We are heartened by the proximity of the two estimates using a top-down and bottom-up approach.

An additional consideration beyond the representative family impact is the regressive nature of sales taxes. Since consumption mix changes as family income rises, we observe in increasing proportion of consumption held in consumer goods subject to sales tax as income drops. This decline is not linear, and the presence of a food and prescription-drug exclusion

Figure 1



Regressivity of Proposed Sales Tax (change in proportion of income collected as sales tax by income)

dramatically dampens the regressivity of the sales tax, particularly on the lowest-income consumers (who consume higher proportions of food in their consumption mix). Nonetheless, sales taxes are regressive and the estimate of the regressivity rate appears in Figure 1. The incremental changes to the proportion of taxes paid by consumers in different income categories in response to the increase in sales taxes in this proposal are quite modest. For example a $100,000 change in earnings would change the proportion of income collected through sales tax from roughly 0.23 to 0.44 percent.[17]

The Economic Consequences of the Tax Plan

Consumers and businesses will undoubtedly respond to the incentives for investment and consumption inherent in the Governor's tax plan. The salient question is the magnitude of these responses. Before providing an estimate

Consumers and businesses will undoubtedly respond to the incentives for investment and consumption inherent in the Governor's tax plan. The salient question is the magnitude of these responses.

Table 6, Additional Sales Tax Expenditures, Median Indiana Family

Food away from home	$19.96
Alcoholic beverages	$3.76
Utilities, fuels, and public services	$24.00
Household operations	$6.17
Housekeeping supplies	$4.87
Household furnishings and equipment	$13.50
Other lodging	$5.00
Apparel and services	$14.89
Transportation	$63.97
Health care	$21.11
Entertainment	$18.19
Personal care products and services	$4.76
Reading	$1.07
Education	$7.42
Tobacco products and smoking supplies	$2.36
Miscellaneous	$56.75
Total	$267.52

14. Data from Consumer Expenditure Survey, Table 665. Average Annual Expenditures of All Consumer Units by Type of Expenditure. The values have been adjusted linearly to match Indiana median household income.

15. Alcohol, tobacco and some miscellaneous items are subject to other excise taxes in addition to sales taxes.

16. Estimates of business shares of sales taxes range from just over 30 percent to more than 50 percent of the total.

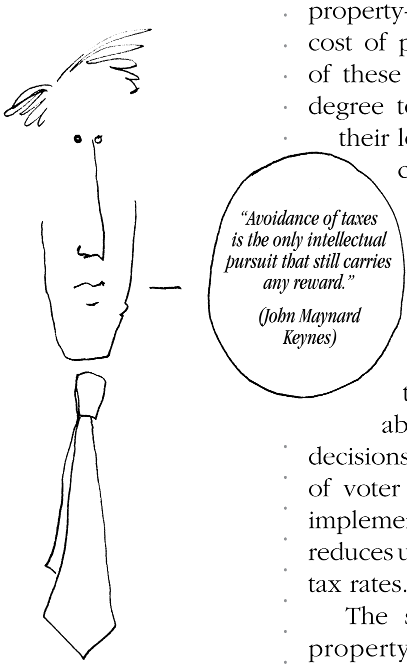
17. We discuss this in more detail in "The Relative Regressivity of Indiana's Sales Tax," Bureau of Business Research, Ball State University, November, 2007.

The shift of revenue sources from property to sales taxes will reduce consumption of taxed goods, alter consumption patterns from taxed to untaxed goods and will alter local choices for the consumption of taxed goods.

of these responses, it is useful to review the theory behind the consumption and investment incentives in this plan.

The change in property-tax rates implicit in this plan will alter investment decision for consumers and businesses. Lower tax rates on residences motivate more home consumption, both in magnitude and location. More simply, consumers will be motivated to purchase homes, purchase more expensive homes or to choose Indiana over other locations if tax rates decline (as our preceding analysis suggests). Similarly, any change in rental costs will motivate home ownership rates at the margin.[18]

Businesses likewise respond to property-tax changes as they alter the cost of physical capital. The magnitude of these results is dependent upon the degree to which firms are footloose in their location choices, the structure or competitiveness of the industry and ultimately the elasticity of their product to consumers.



Both businesses and consumers also respond favorably to reduction in uncertainty regarding property-tax rates. The past uncertainty about rates altered firm location decisions and has been a significant source of voter discontent in recent years.[19] If implemented, this plan unambiguously reduces uncertainty surrounding property-tax rates.

The shift of revenue sources from property to sales taxes will reduce consumption of taxed goods, alter consumption patterns from taxed to untaxed goods and will alter local choices for the consumption of taxed goods. Also, the increased governmental efficiency proposed in this plan will have a positive economic impact, if realized. However, the impact will not be felt for several years, and will not be included in this simulation.

In order to model the economic consequences of Governor Daniels' proposed plan, we will employ the REMI, Inc., regional model. This model includes a short-run input-output model and a long-run dynamic adjustment to factor prices and taxes. We examine only the five-year impact of the tax proposal.

Our simulation provides an estimate of the impact of a tax reduction on residential property from the current net assessment to the level required to meet current non-school, non- child welfare budgetary demands in the state.

This simulation provides estimates that are similar both in magnitude and duration with an earlier analysis of property-tax changes in Indiana. This earlier study analyzed the impact of transferring some property-tax revenues to other instruments. Revenue-neutral transfers resulted in significant investment and economic growth under several alternative scenarios.[20]

Finally, we evaluate the role property-tax uncertainty plays in economic activity in the state. Our REMI, Inc., model is not well-suited to this type of modeling, which requires a dynamic estimate. To perform this analysis we construct two econometric models of property-tax volatility and economic growth. The first model evaluates aggregate county-level personal income growth rates from 1988 through 2005 as a function of the variance of property-tax rates and regional control variables. The results of this model suggest that a one percentage-point change in property-tax variance (about 20 percent of the total variance) results in a growth rate reduction of 3.5 percent over the nearly two-decade period of observation.

Our second model was constructed to account for some technical concerns in

18. See "The Influence of Property Taxes on Rental Rates," Bureau of Business Research, Ball State University, November, 2007.

19. See Michael J. Hicks, "Transportation Infrastructure, Retail Clustering and Local Public Finance: Evidence from Wal-Mart's Expansion," Regional Economic Development, Vol. 2(2), Winter 2006.

20. Cecil E. Bohanon and James E. McClure, "The Impact of Property-tax Reform on Economic Growth in Indiana," Department of Economics, Ball State University, Jan. 13, 1998.

21. Endogeneity is a concern in the first model (i.e., income variability leads to property tax variability). In the second model, lagged property-tax variability, with a trend are used to exclude endogeneity in these series. Also, since real personal income is non-stationary, the year-to-year changes were employed in the model.

the first model, and to evaluate the level of spatial interactions between counties.[21] This model evaluates all of Indiana's counties annually from 1988 through 2005 and tests the impact of property-tax variability and rates in adjacent counties on personal income growth. The results strongly suggest that high variability in property-tax rates reduces growth. The magnitude of the effect is at about the same level as the first econometric model. Interestingly, the higher adjacent county property-tax rates, the higher own-county personal income growth. This is strong evidence of intra-state shifts in population and income due to property taxes. Under both estimates, the elimination of property-tax rate variability motivates significant economic activity, with potential employment results of more than 6,700 annually.

Summary and Further Research

Governor Daniels' proposed property-tax plan provides an alternative tax plan that is adequate to current revenue requirements, reduces uncertainty in taxation and preserves the stability that property-tax revenues provide state governments. The plan makes the overall tax climate modestly more regressive.

The ultimate economic consequences are dependent upon the revenue demands of local governments. At the current revenue level for local government, the state economy will experience significant growth as individuals invest in new property and improvements and spend income freed by the lower taxes. The sales-tax increase will reduce employment.

The growth of economic activity due to the elimination of uncertainty regarding the property-tax rates, however, is the single-largest economic consequence of this plan. When combined with the benefits of reduced uncertainty, the total effects on the economy of Governor Daniels' plan range from modestly positive (perhaps 3,000 additional jobs) to large (more than 11,000 in the first year). So, the ultimate economic impact of this tax proposal is dependent upon the ultimate cost of providing local government services across the state.

The lay reader may be puzzled by the net effects of what is, in many ways, the shifting of tax burden from one instrument to another.[22] However, it is entirely consistent with the expectation that changes to individual and business incentives will alter economic outcomes. So, the combination of tax adjustments — with a shift away from residential property taxes to sales taxes combined with the increase in business property taxes combine to increase overall economic activity, albeit modestly. This result is generated by the incentives presented by changes in the tax system which makes the state more attractive to workers, who then relocate to the region.

The observation that the net economic results are positive should not be viewed as the only potential goal of the tax plan. Indeed, were the shifts in tax burdens to be away from business investment and toward a more broad-based sales tax (that included services) the long-run economic consequences would be more favorable. However, this has not appeared as an element in any current proposal. There is an extensive menu of tax options that could replace the property taxes. We anticipate more fully developing this analysis in subsequent versions of this study.

This preliminary analysis is designed to outline an analytical framework for tax reform in Indiana, to include alternative proposals to the one evaluated in this research. However, even this analysis suffers several significant shortcomings that must be addressed in subsequent analysis. First, more-refined geographic analysis is necessary, as is a better understanding of effective property-tax rates on Indiana businesses. Second, this analysis assumes a significant simplification of property-tax exemptions that were not clearly described within the Governor's proposal. Also, cost-reductions associated with more efficient local government were not modeled, nor were a more detailed treatment of rental property.

These factors, as well as comparisons with alternative proposals will be incorporated into later research.

— *Nov. 2*

Were the shifts in tax burdens to be away from business investment and toward a more broad-based sales tax (that included services) the long-run economic consequences would be more favorable.

22. While that is not a fair characterization of Governor Daniels' plan, we have modeled the impacts as if no governmental efficiency gains have occurred in order to simplify this analysis.

THE IMPLICATIONS OF PROPERTY-TAX REFORM ON THE POLITICAL ECONOMY OF LOCAL GOVERNMENT

Cecil Bohanon explores the incentives under which federal and local governments provide services to local communities. He finds that federal funding of local projects is both inequitable and inefficient. And, when funding is decided at a local level, he wrestles with the use of voter referenda and their impact on various property-tax reform proposals.

Meet the Bremigans, typical Indiana homeowners. How can the family's preferences regarding the size and expense of a park be analyzed?

by **CECIL BOHANON**

A number of proposals to modify the tax structure of Indiana are currently under discussion. This essay analyzes the impact some of the proposed changes could have on local communities' public-spending choices. A number of methods can be used to determine spending for local capital projects. The goal is to compare and contrast the likely outcomes of these different institutional arrangements.

Individual Voter Preferences For Local Capital Projects

The analysis begins with a focus on a typical household in an Indiana community. Suppose the Bremigans are homeowners in Pleasantville, Indiana. The community is considering the construction of a local park and recreation facility. The relevant margin in the local discussion is whether the city should construct a 10-acre, 20-acre, 30-acre or 40-acre park. How can the Bremigans' preferences over park size be analyzed?

Economics argues that the best measure of household preferences over any good or service is the household's willingness to pay for that good and service. If the Bremigans buy three gallons of milk a week at a $3 price per gallon, they are revealing their willingness to pay at least $3 for the third gallon of milk. If milk prices rise to $5 a gallon and the Bremigans cut back their consumption to two gallons, we can surmise that their willingness to pay for the third gallon of milk is at or below $5 a gallon. As consumers vary their milk purchases when milk prices change, they reveal their individual marginal valuations.

Using rather sophisticated statistical techniques economists can observe consumer behavior in markets to surmise: 1) consumer responsiveness to price changes; and 2) how much dollar gains consumers obtain from prices decreases (or losses from price increases) Figure 1 models this. The horizontal axis represents the quantity of milk, in gallons, the household consumes per week, the vertical axis measures dollars. The curve labeled DBREMIGANS/milk indicates the household's "willingness to pay" or marginal valuation of milk. Another name for this is the household's "demand curve," perhaps the most commonly used and known tool of economic analysis.

As shown at a price of $3, three gallons of milk are consumed; at a price of $5 two gallons are consumed. The shaded area in the diagram represents the loss the family incurs when milk prices rise from $3 to $5. Note that the family is worse off because the milk price hike: 1) decreases the quantity of milk they consume and 2)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increases the price they must pay for those units of milk they continue to consume. The amount is readily calculable to be $5 per week, or $260 on an annual basis. (Alternatively the area represents the gain the household obtains when milk prices fall from $5 to $3.)

Market prices and market behavior reveal to the economist consumers' valuations — willingness to pay for the goods. This is a powerful tool for assessing behavior, a tool for assessing consumer gains from market interactions and for analyzing how those gains change as market conditions vary.

Conceptually the same framework can be applied to public spending decisions. Households have a willingness to pay for publicly provided goods and services such as parks, just as they have a willingness to pay for market-provided goods such as milk.

Figure 2 models this. The horizontal axis indicates the quantity of park services provided, measures in terms of acre size of the park, while the vertical axis reflects dollar values. The curve DBREMIGANS/parks in Figure 2 indicates the household's willingness to pay for additional increments to the proposed local park on an annual basis. Note the willingness to pay for additional units of a local park declines just as it does for milk. The amount the household is willing to pay for any increment of park provision is calculable. For example the area under DBREMIGANS/parks from 0-40 units reveals the family is willing to sacrifice $800 on an annual basis for access for a 40-acre park. While consumers' valuations of publicly provided goods are conceptually similar to their valuations of market-provided goods the question is what is the public equivalent of the price of milk? Attention is now turned to this issue.

Taxes as Prices?

Before attention is turned to the cost of the publicly provided park to local residents, let us specify a number of additional assumptions about costs of constructing and maintaining the park and about the community of Pleasantville. Let it be assumed that the annual cost of constructing, maintaining and operating the park depend exclusively on the size of the park. Let it also be assumed that theses annual costs are a constant $20,000 per acre, so that a 10-acre park costs $200,000, a 20-acre park cost $400,000, etc.[1]

Also assume that there are exactly 1,000 residents in Pleasantville who all own properties identically valued at $200,000 each. Finally, suppose that the willingness to pay for parks varies among the residents; some households place higher valuations on the park (of any size) than other households.

Suppose an eccentric philanthropist makes the following offer to the town of Pleasantville: "I will finance the construction, maintenance and operation of any park in your fair community on a permanent basis: simply name the size of the park, up to 40 acres, and your wish is my command."

It takes little acumen to surmise what the Bremigans' and all other community members' preferences will be to accept the scions generous offer and a 40-acre park will be ordered up.

Change the context so that a federal office-holder on a re-election campaign makes a stop in Pleasantville. One can hear the rhetoric: "I am pleased to announce that I am responsible for passing a bill ensuring permanent federal funding for a new 40-acre park for your community." One expects the response of the citizens of Pleasantville to be exactly the same: pleasant shock and joy.

But wait, one may argue, isn't there a fundamental difference? The philanthropist is financing the park from his own personal wealth, while the federal official is financing the park from the tax contributions of residents of the entire United States, including those from Pleasantville.

Indeed, further inspection reveals the bill authorizing the funding for the

Figure 1

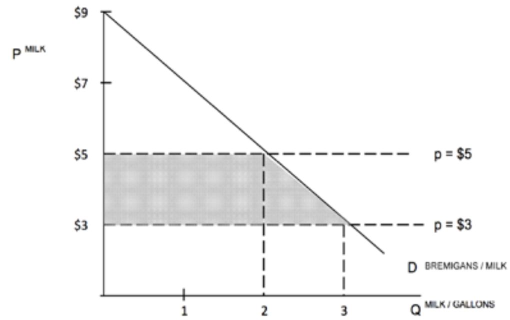
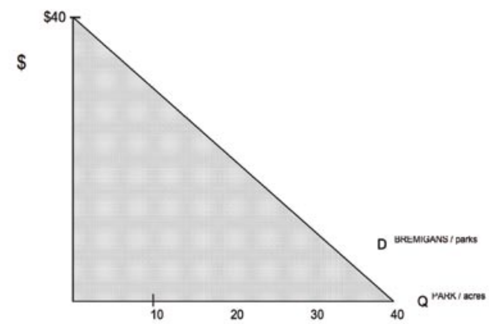


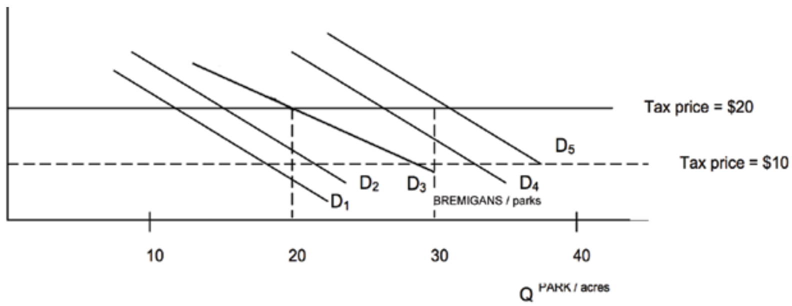
Figure 2



Measurement of the Bremigans' "willingness to pay" is an economist's tool for assessing behavior, for assessing consumer gains from market interactions and for analyzing how those gains change as market conditions vary.

(Note: Copies of full-sized charts and figures are available to members and accredited academics by writing the foundation.)

Figure 3



It is the incentive of every member of a local community' to minimize his or her tax contribution while maximize the take from the treasury. Although on the whole this system is irrational, it is perfectly rational (indeed, irresistible) for any local community to accept these "free" goods offered by politicians.

Pleasantville Park is also funding thousands of other local expenditures at similarly inflated levels. All this is likely true and even understood by the townsfolk. Yet the people of Pleasantville are likely to react as they did before. The $800,000 annual cost for constructing, operating and maintaining the park for Pleasantville is spread among literally millions of U.S. households. Removing the park from the appropriation bill will at best save Pleasantville taxpayers fractions of pennies. (Some quick math: $800,000 divided by 100 million households = $.008, or eight-tenths of one cent a year.)

The previous example points out the poor incentives established by the intergovernmental finance of locally provided public goods and services. It is every local community's incentive to minimize their tax contribution, while they maximize their take from the treasury. Although on the whole the system is irrational, it is perfectly rational, indeed, irresistible for any local community to accept the "free" goods offered by the politician.

The Median Voter Model, Case 1: Direct Referendum with Pair-wise Alternatives, Full Property-tax Finance

What if the Pleasantville Park can only be financed by taxing the residents of the community? Figure 3 replicates and extends the information of Figure 2. Note that DBREMIGANS/parks which is also labeled D3, represents the incremental willingness to pay for the park by the Bremigan household. Curves D1, D2, D4, and D5 all represent other households' willingness to pay for the park which as outlined above are assumed to differ from one another. We will hitherto refer to these curves as the households' demand curves. For the sake of expositional clarity suppose that these five demand curves represent five equal-sized groups in the community, with the Bremigan household representing the median group.

Given this framework it is relatively straightforward to assess the likely outcome of using the property tax to finance the park in the presence of a referendum that offers two choices to the voter-taxpayers. In this simplified example, it is clear that the costs of the park are equally shared by each household: for every additional acre constructed and maintained the community must provide an annual appropriation of $20,000; in this setting each household will pay an additional $20 for every one-acre increment of park provision. Put another way, the tax-price of the park is $20 per acre per year to each household. The Bremigans are willing to pay more than $20 a year for an acre of park for acres one through 19, and willing to pay exactly $20 a year for acre 20. Given the property-tax method of financing the park they would prefer a park of 20 acres. Any provision above 20 would generate an additional tax bill to the household of $20 a year, while the corresponding benefit of the additional acre is less than $20.

Just as the individual household's demand curve for milk indicates how much milk the household chooses to purchase at each price, the individual household's demand curve for parks indicates the level of park provision the household prefers. There is, however, an important difference between the household milk and park demand curves. Unlike milk consumption where individual households can have different levels of consumption, the nature of the publicly provided good is that all the residents of the community share the same level of provision. In the example only one group can have its desired level of park provision, while all five representative individuals have different desired levels of provision. What will a community vote on the matter yield?

At this juncture a specific voting mechanism must be considered. Let the ballot contain two proposed levels of park size and let the option that garners a simple majority of the vote prevail. A simple but powerful result emerges in this case: the option that is closest to the preferences of the median voter will be the option that prevails. To see this consider the following scenario: the 30-acre option is paired against the 20-acre option. Voter groups four and five, the groups that exhibit a high willingness to pay for parks vote for the 30-acre park, but voter groups one and two who have a low willingness to pay for parks join with the median group to form a voting majority. In this example it is clear that the 20-acre proposition will always garner more votes than any other proposition. More generally it is clear that if voter preferences can be arrayed on a continuum then the preferences of the median voter will always dominate any pair-wise vote.

A number of points should be made about the nature of the median voter outcome and the conditions necessary for the result to emerge. Is median-voter result likely? Is a median-voter outcome desirable?

First, it is important that taxpayer-voters be aware of the tax price they face for incremental units of public spending. As outlined above, if tax payments are simply deposited in the treasuries of higher units of government, and revenues for local projects are dispensed from those treasuries, voters will correctly perceive that the cost of local public goods is zero. But even if local tax bases are used to provide local publicly provided services the tax price of any one of those services can be obscured if taxes are collected and deposited into a single local-revenue pool. If Pleasantville citizens pay one-half of one percent of their income and one percent of their property value to the local treasury and park finance is drawn from that general fund it is hard to identify what portion of taxes pays for what. If on the other hand, financing the park is from a specific tax base, the property tax in the example, it is much easier to discern how much additional increments of park services cost. One can make a strong case that the property tax is especially amenable to such an earmark. The proposed 20-acre park adds 0.2 percent times \$200,000 = \$400 to each household's property-tax bill. This is a readily derived and readily discernible figure.[2]

Second, it is important that there be a pair-wise vote or at the very least a low-cost mechanism for considering alternatives to a single proposal. It is likely that those proposing a public construction project are simultaneously those who have higher-than-average demands for those projects. If only the options they propose can be considered and/or further voting is costly, then the voting decision becomes an all-or-nothing offer. Either accept a 35-acre park, or have no parks at all. In the above-given example a 35-acre park would receive the support of voter groups four and five and the reluctant acquiescence of voter group three. It is important that the agenda be flexible and accessible for the median-voter result to emerge.

Third, the well-known problem of rational ignorance must be overcome. Unlike a private choice, such as how much milk to buy for one's household, where the individual is decisive in making the consumption decision, public choices made by the voting process include the entire voting community. The likelihood that a single individual's vote is decisive in determining the collective outcome is low, and certainly well below that of a private choice. If all 2,000 voters in the example vote, the outcome will be 1,200 votes for a 20-acre park, 800 votes for a 30-acre park. But if this is expected why vote? Independent of one's preferences the outcome will not be affected. But then if one's vote is not likely to be decisive why bother assessing the relative merits of either proposal? This rational ignorance problem bedevils public-sector decision-making and is a thorn in the side of the democratic process.

Two comments, however, can be made. First, to the extent the group voting on the public spending is small one would expect the rational ignorance problems to be smaller. A community of 1,000 will

If the Bremigans pay one-half of one percent of their income and one percent of their property value to the local treasury, and if park finance is drawn from that general fund, it is hard to identify what portion of taxes pays for what. If, on the other hand, financing the park is from a specific tax base (the property tax in this case), it is much easier for the Bremigans to discern how much additional increments of park services cost.

1. The up-front costs of construction are amortized into this annual amount.

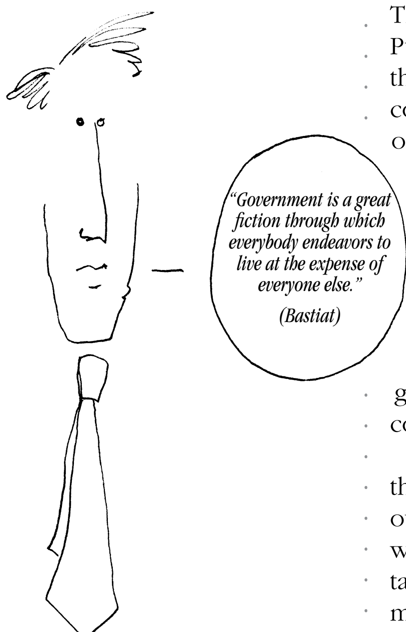
2. For an important and Indiana-relevant analysis of information about local capital projects see Abbott, Jeff (2007), "Can Our Community 'Afford' This Bond Issue for Our School?" Available at http://www.inpolicy.org/. Abbott's analysis argues citizen information is key to constraining growing capital levies from schools.

Adam Smith's "invisible hand" that drives a competitive market equilibrium to the point where resources are efficiently allocated to the production of a private good has no counterpart in conventional collective voting mechanisms.

face less of a problem than a community of 10,000,000. Second, to the extent that the public spending decision entails a commitment of a large-dollar amount for an extended time frame it is more likely to "get the voters' attention" than a smaller amount.

If the parks' elections in our example are perceived to be close — suppose a household perceives there is likely a five percent chance their vote might be decisive — and the difference between the two proposals is significant — to the Bremigans a 20-acre park is reasonably valued at a discounted present value of $500 above a 30-acre park — then the problem of rational ignorance might be overcome. Certainly local financing of local public goods utilizing transparent and local tax bases, coupled with accurate and informed spending estimates are the best hope for generating informed public sector outcomes.

Finally, is the median-voter outcome desirable? Is relying on the preferences of the median voter the best way to allocate resources to publicly provided goods? This is clearly a normative question. Public choice theorists have long known that the median-voter outcome does not coincide with the economically efficient outcome: however, there is no known readily applicable public-sector decision-making mechanism that systematically generates an efficient outcome. Adam Smith's "invisible hand" that drives a competitive-market equilibrium to the point where resources are efficiently allocated to the production of a private good has no counterpart in conventional collective-voting mechanisms.



Perhaps a better way of considering the question is to ask if the median voter outcome (likely to emerge if voter are well-informed about public sector costs, taxes are transparent and a direct voting mechanism is used) is better or worse than the outcome that is likely to emerge under other institutional arrangements? The median-voter outcome may not be perfect, but it is arguably among the better options in an imperfect world.

Case 2: Direct Referendum with Pair-wise Alternatives, Property-Tax Finance with 50 percent Property-Tax Replacement Credits or State Grants for Capital Funding

An important component of several property-tax reform proposals is the abolition of the state financed property-tax replacement and homestead credit. The property-tax replacement and homestead credit currently cost the state over $2.1 billion. Both the homestead credit and the replacement credits lower the net property-tax liability of the taxpayer by paying a percentage of the taxpayer's bill. Since the mid-1980s replacement credits have not been granted for debt-financed capital projects. The homeowner's credit, however, has been applied to the total property-tax liability and can be viewed as a subsidy to all local government activities financed by the property tax. The purpose of this section, however, is to model the general impact of property-tax replacement credits on fiscal decisions.[3]

Returning to the aforementioned example, suppose that the state government provides a 50-percent property-tax replacement credit on capital projects, but capital projects must be approved by local voters. In such a case of every dollar of property-tax costs, 50 cents is picked up by the state government. Although individual taxpayers undoubtedly contribute to the "common treasury pool" that finances the property-tax replacements (as in the case of federal funding) they do not rationally perceive the financing of a local public project costs them anything. In effect, the 50-percent property-tax replacement credit lowers the tax prices of all the residents of Pleasantville from $20 per acre to $10 an acre. All the voter-taxpayers desire a larger park, and the median voter, group three proxied by the Bremigans, now votes for a 30-acre park.

Compare this result with a simple annual "flat grant" from the state to support the park of $100,000 a year. Note this grant would support a five-acre park "in full." Put another way, the state government

3 For more detail on the Indiana property tax system, see Professor Larry DeBoer's Purdue website at http://www.agecon.purdue.edu/crd/localgov/Second%20Level%20pages/topic_ptax_overview.htm#Propert y%20Tax%20Replacement%20Credits.

covers the first $100 of each household's park expenditures. The question emerges what would such a state grant do to the community's choice of park size? The marginal reasoning of the economic science is crucial to understanding the answer. Note that all five of the groups' demand curves reveal a willingness to pay for the sixth acre of park in excess of $20 a year. Indeed, absent of the state grant shifting their demand curves for a park, each household's desired level of parks is the same as in the case when local funding financed the park.[4]

This implies that although the $100,000 grant would be welcomed by Pleasantville residents, it would have no impact on the median-voter outcome, and therefore, no impact on the size of the park.

This is an important issue as it comments on the likely impact of alternative forms of state aid to local communities that use the property tax for construction projects and are envisioned to use a local referendum method to approve the projects. State aid directed toward property-tax replacement credits are likely to lead to larger projects, while flat state grants are not,

Case 3: Single Alternative Remonstrances and Property-Tax Finance

Does the tax-price median-voter model have relevance in a setting where pair-wise voting on public projects is not the collective decision rule? The answer is yes, in that the willingness to pay tax-cost framework can be used to analyze the decision-making of an informed taxpayer.

Public construction projects in the state of Indiana have not been authorized by voting referenda. Indeed, establishing a referenda procedure for such projects is a major institutional and policy innovation. Under the current system it is the government entity that proposes a project and provides information to the public about its details. Although the projects must be approved by a state board, the real roadblock to their approval lies in the remonstrance process.[5]

Under a remonstrance a citizen group against the proposal in the community collects taxpayer signatures over a limited time frame, while the proposers of the project also collect taxpayer signatures in favor of the project. At first blush such a procedure is similar to a voting referendum and seems to imply a similar result. More careful reflection, however, reveals a major difference. First, a remonstrance must be initiated by a taxpayer group. Moreover, the group must also bear the cost of soliciting fellow taxpayers to sign the petition against the project. These organization costs can act as a deterrent to active opposition.

Nevertheless, the willingness of a member of any of the demand groups to sign the petitions of either side of a remonstrance depends, in the final analysis on their willingness to pay, the costs they will bear, the information they have about those costs and the alternatives they perceive. Further research is necessary to distinguish the differences between the two public-choice mechanisms.

Both remonstrances and referendum are subject to the problem of agenda-setting by the likely advocates of the project. As noted above, those proposing the project are likely to be the high-demanders in the community. There is extensive academic literature suggesting that public administrators and bureaucrats find it in their own self-interest to support higher levels of capital expenditures than those preferred by the median-voter. The ability of the advocates to "set the agenda" and couch the issue in an all-or-nothing fashion gives advocates an edge. Crucial to the median-voter result is the assumption of a pair-wise agenda. Methods for placing alternatives in front of the voters are necessary to generate an outcome reflective of median-voter preference. — *Dec. 3*

The research suggests that public administrators and bureaucrats find it in their own self-interest to support higher levels of capital expenditures than those preferred by the median voter.

4. The economic question becomes whether the $100 pick-up of park spending by the state confers a positive and significant income effect on the residents with respect to their demand for parks. If it does we would expect to see a slight shift in each group's demand for parks to the right, implying a park slightly larger than a 20-acre park. However, recall that state funding for the grant must come from state taxpayers. Therefore if Pleasantville is an average payer of state taxes, the $100 per household park grant must be offset by $100 in additional tax payments to the state which neutralizes any income effect.

5. See Abbott (2007) op. cit (footnote 2) for a more extensive discussion of this topic.

PROPERTY-TAX RATES AND TAX INCREMENT FINANCING

Michael Hicks combines two critical topics in the tax discussion: property-tax reform and the use of tax-increment financing, that is, subsidies used to attract business to a state or county. He reiterates the findings of the academic literature — that such inducements are not effective for promoting economic growth. Further, he argues that the use of tax incentives at the local level may drive up property-tax rates.

"(There) are good reasons (theoretical, empirical and practical) to believe that economic-development incentives have little or no impact on firm location and investment decisions."

— Alan Peters and Peter Fisher in the Journal of the American Planning Association

by MICHAEL HICKS

Indiana is among the more-conservative applicants of economic-development incentives in the nation. As of this writing there are a little more than a dozen major incentive programs (with more than $1,000,000 in business-related revenues abated annually).

Local tax abatements and Tax-increment Financing (TIF) comprise the two dominant property-tax abatement efforts in the state.

Local tax abatements and TIFs are expressly designed for two purposes: To lure new firms to areas that would otherwise not see new economic activity and to subsidize infrastructure costs through targeting property-tax revenues.

Several dozen of each type of incentive are offered annually (and may persist for up to one year). Indiana provides specific amounts (by percent), which may be abated. In practice, both Tax Abatements and TIFs often are used to subsidize infrastructure investment. While the use of a TIF to pay for specific road or water-service improvements is fairly obvious, Indiana's tax abatements are often used in a similar fashion.

For example, a tax abatement may be offered to a new firm with the agreement that the firm provide specific local infrastructure improvements as part of the abatement. This infrastructure improvement may come at a much-lower cost than public-sector work on the same project. So, paradoxically, tax abatements may result in lower public-sector costs for infrastructure improvements.[1]

Indiana's experience with tax incentives is far more conservative and considered than most state programs. Research on other programs has a long history, and is worthy of consideration when examining incentives.

Existing Studies Analysis of the role of tax policy on economic growth enjoys an extensive treatment by economists. A 1997 Federal Reserve Bank review of research findings cited over 90 studies that evaluated the role of fiscal policy in economic growth in the United States (Wasylenko, 1997). If anything, the past few years have seen an acceleration of this analysis accompanied by the development and widespread application of more-

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1. The author notes that he has written several papers and a book on tax incentives that would fairly be characterized as among the most critical of their application in the academic literature.

robust statistical techniques that enable analysts to evaluate results.

Many of these papers attempt to explain differences in growth, wages and industrial composition through analysis of interstate tax policy. An equally large number of studies also evaluate whether expenditures (as evidenced by infrastructure) influence growth (Fox and Porca, 2002).

A considerably smaller number of studies have attempted to evaluate the influence of individual targeted tax policies on economic growth (see Bartik, 2002).

Scholarship on business tax-incentive programs is mixed as to the impact of government economic-development efforts to create jobs and additional wealth or other announced economic goals of these programs. Gabe and Kraybill [2002] examined state economic-development incentives on 366 Ohio manufacturing and non-manufacturing establishments that began large expansions between 1993 and 1995. They found empirical evidence to suggest that the incentives offered these firms had little if any actual impact on expected employment growth and what little was found suggested a slightly negative effect on actual growth.[2]

A review of more than 300 scholarly papers on economic-development programs found that "studies of specific taxes are split over whether incentives are effective, although most report negative results" (Buss, 2001).[3]

Fisher and Peters (2004) explain the findings of their meta-review of academic literature. They examined three questions surrounding government business development programs. First, do incentives improve growth and development where offered more than would occur on its own? Second, is this development directed to low-income populations? Lastly, they ask "how costly to government is the provision of these incentives compared to alternative policies?"[4]

Their conclusion also was mixed, as are many literature reviews, but on balance Fisher and Peters surmise that these programs are either ineffective or carry costs that exceed the alleged benefits derived from them. As to their first question, they conclude that:

> The upshot of all of this is that on this most basic question of all — whether incentives induce significant new investment or jobs — we simply do not know the answer. Since these programs probably cost state and local governments about $40-$50 billion a year, one would expect some clear and undisputed evidence of their success. This is not the case. In fact, there are very good reasons — theoretical, empirical, and practical — to believe that economic-development incentives have little or no impact on firm location and investment decisions.[5]

Fisher and Peters [2001] think there may still be a role for government to play in economic development, but it should focus more on the fundamentals, such as infrastructure and education, as well as worker training. They conclude: "(T)he most fundamental problem is that many public officials appear to believe that they can influence the course of their state economies through incentives and subsidies to a degree far beyond anything supported by even the most optimistic evidence."[6]

In addition to the presence of a range of findings in the literature, policy recommendations are further challenged by the absence of few findings extrapolated to a benefit-cost framework. Even if a robust econometric finding of a positive impact of targeted fiscal incentives is made, this does not necessarily translate into a clear policy recommendation. For instance, if a study of a state or region concluded that there was a statistically significant link between targeted-tax incentives and new jobs, the tax incentives might still be bad policy if the ensuing net benefits are non-positive.

Even if a study of a state or region concluded that there was a statistically significant link between targeted-tax incentives and new jobs, the tax incentives might still be bad policy if the ensuing net benefits are non-positive.

2. Todd Gabe and David Kraybill. "The Effect of State Economic Development Incentives on Employment Growth of Establishments," Journal of Regional Science, Vol. 42, No. 4, 2002, p. 703.

3. Terry Buss. "The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature," Economic Development Quarterly, Vol. 15, No. 1, Feb. 2001: p. 99.

4. Alan Peters and Peter Fisher, "The Failures of Economic Development Incentives," American Planning Association, Journal of the American Planning Association, Winter 2004, 70, p. 27.

5. Ibid., p. 32

6. Ibid., p. 35.

Existing research on tax incentives does not provide a strong call for their use. However, Indiana's policies toward incentives is far more restrained and likely more efficacious than the programs evaluated by scholars for other states.

Further, evaluation of targeted incentives has been more sporadic than analysis of general fiscal policy. Also, the methods employed by state economic-development agencies are better-suited to management efforts than evaluation of economic growth.[7]

Thus, a review of findings regarding targeted-tax incentives will leave an unbiased reader hungry for more substantive analysis.

Hicks and LaFaive (2005) evaluated Michigan's MEGA economic-development incentive program from 1995-2003. They found that the roughly $1.5 billion in tax abatements had none of the intended consequences. The program, which targeted manufacturing, wholesale, high technology and corporate headquarters only managed to influence construction jobs. The job creation in construction came at a revenue cost of roughly $125,000 per job.

Bartik (2002) provides an admirable survey of methods for evaluating targeted incentive policies. The estimation provided in this study is a direct result of Bartik's recommendations, and conforms to the multiple methods of econometric estimation reviewed in his paper.

Tax Incentives and Property-Tax Rates

In order to evaluate the role tax incentives play on local property-tax rates we construct a model of Indiana counties from 1988 through 2003. Using annual data on tax rates and tax abatements (including TIFs) from the Department of Local Government Finance we estimate the impact tax abatements in any year have on tax rates in subsequent years. The values are the county total abatements (in inflation adjusted dollars) and county average property-tax rates.

From this basic model we attempt several versions extending the lagged effect through three years, examine changes (not levels) in property-tax rates and examine the possibility that non-linear relationships exist. We tested for several different statistical concerns and transformed the data into percentages, weighted the regions by population, incomes and created variables that account for "unobserved region-specific variation."[8]

No specification offered the hint of a positive relationship between property-tax rates and previous (or current) tax abatements. Indeed, the most recurring result was a modest negative relationship between property-tax rates and property-tax incentives. These results require additional analysis before this linkage is asserted more broadly. What we can conclude, without reservation, is that there is no evidence that tax abatements lead to higher property-tax rates at the county level.

An under-appreciated body of research on local property-tax rates and incentives was offered by Zorn, Mikesell and Dalehite (2003, 2005). Their examination of tax incentives and local property-tax rates provided both an innovative case study of one Indiana county and a finding that tax incentives did influence local tax rates at the township level.

Summary

Existing research on tax incentives does not provide a strong call for their use. However, Indiana's policies toward incentives is far more restrained and likely more efficacious than the programs evaluated by scholars for other states. Contrast with Michigan's MEGA program, which showed absolutely no signs of efficacy are but one example. However, the purpose of this paper is to examine the role these incentives play on local property-tax rates.

When combining the findings presented here, that examine county-level property-tax rates and assessments for more than a decade, with the careful work by Zorn, Mikesell and Dalehite, two findings and one policy recommendation emerge. First, at the county level, tax incentives have not caused rates to climb, but at the local level they might. This argues strongly for consolidation of property-tax decision-making at the county level — not a complete overhaul of the abatement and TIF programs. — *Dec. 20*

7. Specifically, the use of firm specific reports of gross job flows may be a useful management tool, but is particularly ill-suited to economic analysis.

8. We are most concerned about the traditional spherical errors and endogeneity.

by LARRY DeBOER

Is it possible that we've already solved our Indiana property-tax problem but we just don't know it yet? I'm not sure that I believe it either. But consider the following.

Many homeowners are demanding immediate property-tax relief. The General Assembly already has passed $300 million in extra relief for this year and another $250 million for next year. Homeowners were to receive rebate checks at the end of the year, or early next year, averaging about $240. Those who pay more taxes will receive bigger rebates. The checks should have reduced that 24-percent-average-homeowner tax increase to eight percent in 2007. Next year's relief will show up on tax bills as a bigger homestead credit.

Perhaps we rely too much on property taxes to pay for local services. Perhaps we should shift to other tax bases such as income or sales. The General Assembly already has created a new local-option income tax, which would shift taxation from property to income. If all the counties adopted at maximum rates, total property taxes would drop by at least 20 percent. If the tax relief were designated for homeowners only, homeowner property-tax bills would be cut in half statewide. That would help retired homeowners on fixed incomes especially.

Some taxpayers get hit with particularly large tax bills. The "circuit-breaker" credit, which takes effect in 2008 for homeowners and in 2010 for all taxpayers, will put a ceiling on what taxpayers owe. In 2008, no homeowner will have to pay property taxes above two percent of the market value of their home. In 2010, all other taxpayers will have their taxes capped at three percent of market value.

We're concerned that our local assessors may not be up to the task of doing assessments correctly. The General Assembly passed legislation in 2007 that requires township assessors and trustee-assessors to be certified before they take office. Certification requires taking a course and passing a test administered by the state. Township trustees who aren't certified must cede their assessing duties to the county. The law takes effect in July.

To do market value assessment properly, we need a state agency to enforce the rules. Suddenly this summer, the Department of Local Government Finance began aggressive enforcement. They've ordered reassessments or scheduled hearings in nine counties so far.

One of the worst problems with our property tax is its unpredictability. Homeowners don't know what their property-tax payments will be in future years, which makes it hard to budget. Sudden tax hikes sometimes force homeowners to sell. Home buyers find it hard to know if they can afford a home.

Unpredictable jumps in property taxes happen when we finally adjust assessments after many years. That's partly what happened with the reassessment in 2003, and that's what was happening with trending in 2007. Assessments based on 1999 prices were being updated to 2005 prices. From now on, though, trending will make just a one-year adjustment in 2008 from 2005 to 2006 prices. And come the next statewide reassessment for taxes in 2012, no big adjustment will be needed. We'll have spread that big adjustment over the preceding years, in a bunch of little steps.

Big construction projects are another concern. The taxes required to pay back the borrowing for these projects can cause big increases in tax bills. A new law already passed will create a capital projects review board in every county in 2009. The board will be made up of representatives of local governments, plus two elected members. Most local government construction projects will require the board's approval before they can go forward.

That's seven new policies — but perhaps it still isn't enough. Do we want to shift more taxes from property to income or sales? Provide more relief for those on fixed incomes or for owners of rental property? Think about the appropriate division of taxes between homeowners and businesses?

Or . . . maybe it's time to let it alone for a while. Many county officials would welcome a chance to catch up with all the policy changes. Once we've caught up, we may find that we're further along toward a solution to the property-tax problem than we thought. — *Sept. 27 in "Capital Comments"*

by ERIC SCHANSBERG

Dr. DeBoer makes an excellent point: Applying a number of significant changes to a complex policy may or may not have the desired outcomes.

Beyond the scope of what we've covered, there are other significant proposals to consider as well — for example, whether local building projects should be determined by voter referenda and whether property-assessment responsibilities should be consolidated by eliminating township assessors and relying on county assessors.

One other thing bears mention: Given the caps, the Legislative Services Agency now estimates that property-tax revenues would fall by $380 million — about five percent of total local spending. In all, 66 of Indiana's 92 counties would be affected. Most counties would be affected only modestly, but there are notable exceptions: Lake County spending would be cut by 27 percent or would require a four percent increase in the Local Option Income Tax (LOIT); Delaware County and St. Joseph County would need to cut spending by 10 to 11 percent (or impose a LOIT of more than one percent); Cass, Knox, Montgomery and Madison counties would need to cut spending by six to seven percent (or impose a LOIT of less than one percent).

Some have proposed that we just get rid of property taxes, replacing the revenue with other sources. Although this may be attractive politically — and perhaps even economically — earlier essays in this journal made the point that moving to other taxes might be more troublesome. For example, moving the sales tax from six percent to seven percent is, itself, a 17 percent increase in the sales-tax rate.

Along the same lines, it's worth noting that no state has come close to eliminating property taxes. This is not surprising, given that they account for, on average, one-third of state and local tax revenues.

All of that said, people simply don't like their property taxes. And that is true not just in Indiana. Nationwide, local and state property-tax revenues increased by 28 percent from 2000-2006 (after inflation). And as noted earlier in this issue, many states have passed or considered legislation to cap property taxes.

Ultimately, dissatisfaction with taxes — or a particular tax — has at least four explanations:

• First, there might be relative satisfaction with the amount of taxes paid but dissatisfaction with the manner in which those taxes are collected. This seems to be a significant issue with property taxes. Above and beyond the amounts being paid, there is considerable frustration with a process that is seemingly incompetent at times and not particularly transparent. Moreover, 35 years of political "solutions" have increased skepticism. Growing cynicism about the tax mechanism and the related political process has undermined what is typically a stable and unexciting source of revenue for state and local governments.

• Second, taxes might disproportionately burden some taxpayers to the point they are politically activated. At least on the surface, this seems to be at most a modest concern in this context. The property-tax base is quite broad, and the distribution of beneficiaries from state government spending is relatively broad as well. That said, clearly, many property owners would benefit from a tax regime that reduces property taxes while increasing sales or income taxes.

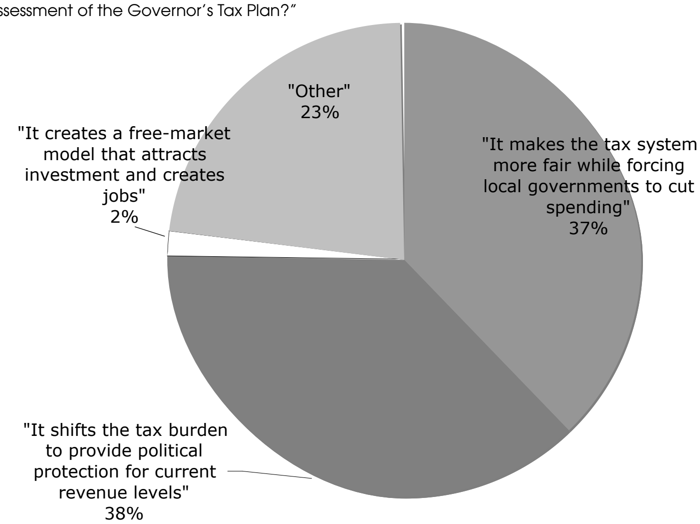
• Third, out of ignorance, people might dislike taxes without fully understanding that taxes are required to pay for government programs. One gets a sense of this from some of the "repeal the property tax" folk. It would be great fun to get rid of property taxes — and who wouldn't love lower taxes? But if government spending doesn't decrease — and there's been precious little talk of that in an election year — then revenue-neutrality is required and consequently, lower property taxes must be offset by higher taxes of some other sort. It is not at all clear that this would be a net improvement. Worse, it's not clear that all of those who want to reduce or repeal property taxes have wrestled appropriately with this vital question.

• Finally, for a variety of ethical and practical reasons, people might be dissatisfied with both taxes and the size of government. There is good reason for this dissatisfaction. At the national level, Tax Freedom Day for Hoosiers is now April 23rd. (This is better than the national average of April 30th, but it's not exciting to work nearly four months to pay one's annual taxes.) And for Hoosiers, their state and local tax burden is an average of $3,387 — or 10.7 percent of their per-capita income (25th in the nation). That's a lot of money, especially for the working poor and the middle class.

For those who want a large government, there are no easy ways to raise the money required to finance it. And there are no efficient ways to raise it either. And of course, finding an equitable way to raise a lot of money will be difficult — at least in the eyes of those who are being taxed.

In conclusion, property taxes are only a symptom of the larger problems that go along with trying to fund large-scale government — and fund it through the activity of politicians, interest groups and a public that doesn't pay much attention to the inequities and inefficiencies of political behavior. — *Jan. 14*

THE BARBER POLL: "Which Best Describes Your Assessment of the Governor's Tax Plan?"



This quarter's Barber Poll (Dec. 3 to Dec. 11) drew only 61 responses from 364 correspondents, perhaps reflecting uncertainty over the governor's tax plan. Respondents perfectly split between two survey choices. Another 23 percent rejected all three choices for "Other" to add an individual assessment in "Comments." Members can obtain a copy of the poll results by writing barberpoll@inpolicy.org.