EDUCATION POLICY AND LEADERSHIP COUNCIL

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[SLIDE 1] A moment of full disclosure. I gamble. For a start…I got married. Had a kid. Ran for public office. I invest in the stock market and occasionally get on the Schuylkill Expressway. During the last ten years I have also lost money playing slot machines in two states. In fact, I lost everything I wagered…a total of $25.35.

Although I'm still irritated about having lost that money – which I could have lost just as thoroughly on the NASDAQ, I – and my co-workers -- have nothing against other people gambling for recreation. It's when people started seriously talking about using gaming receipts to finance public education that we at PEL began to focus our attention on the issues involved.

As you probably know, the Pennsylvania Economy League is a non-partisan, non-profit policy research and development organization. We have five offices around the state, and our mission since 1936 has been to stimulate public and private action to help make Pennsylvania a better place to live, work, and do business. PEL's work encompasses major regional issues like the water/sewer needs of 10 counties in southwestern Pennsylvania… and connecting I-95 and the turnpike in eastern Pennsylvania – as well as smaller but no less important issues like projecting school enrollments and helping municipalities consider boundary changes.

[SLIDE 2] But for the last two years in particular, through a project we call IssuesPA, we have been concentrating a lot of our energy and research on the issues most important to Pennsylvania's future economic competitiveness. Our goal is to stimulate a vigorous public debate about Pennsylvania's future – a debate that puts pressure on the state's governmental and civic communities to take informed action on the issues most important to the outlook for our state.

We have used independent research, polls, forums, and a great website to help bring a diversity of good ideas to the forefront,

encourage specificity and debate over strategies and philosophies, and put Pennsylvania and its regions in a better position to improve systems for lifelong learning, community vitality and sustainability, economic prosperity, and health care quality and availability.

[SLIDE 3] Last summer, when it looked as though gambling authorization might actually happen before the end of the year, we researched and wrote an extensive series of articles on gambling, which can still be found on IssuesPA.net.   We raised a number of questions about the reliability of gambling as a source of revenue, how much money could realistically be expected on a continuing basis, possible effects of an ever-increasing number of gaming options in other states, and whether state government would fill any gaps in gambling revenues with other monies.

Those initial questions remain, and the picture has become even more cluttered with conflicting legislative and administration opinions about the number of slots parlors and/or full-blown casinos, site selection, the price of licenses and how they should be acquired, protections against corruption, and what to do about Indian nations that may want a piece of the action.

Add to those even MORE differing ideas, like those about what percentage of the take should go to host counties and municipalities, about what's in it for the horseracing industry, how much should go to paying off public debt on various stadiums and convention centers, the morality of permitting gambling at all – and, of course, the voiced interests of sets of developers and lawyers – and sets of municipalities that either do or do not want casinos or racetracks in their backyards.

[SLIDE 4] Of course, what the vast majority of Pennsylvanians care about is property tax relief, pure and simple -- and a debate about exactly how that would be accomplished has been getting lost in the shuffle. It shouldn't be. The issue should be debated <u>before</u> the legislation is passed because it is, after all, our children we're talking about here.

School property tax reduction has been a favorite source of public policy discussion – and campaign promises -- for literally decades.

But in spite of much talk, effort, and very similar recommendations from various blue ribbon commissions from Governor Schafer's time on forward, successive administrations and the General Assembly have had great difficulty moving property tax relief from concept to reality.

The complexity of existing tax laws and distribution of state aid to school systems, special conditions around Pennsylvania and within individual legislative districts, and narrowly focused political interests have doomed relief packages in their early stages every time but once – and that one died because the general public didn't trust government's enormously complex solution to what looked, to them, like a simple problem.

The current property tax reduction package is obviously NOT more of the same. I'll give you a thumbnail sketch of its goals and main ideas about which there seems to be consensus – and then we can talk about impact – and policy.

While there are differences about various aspects of property tax relief, proposals being considered by the state House of Representatives, Senate and Governor Ed Rendell share the common goals of shifting part of the local school tax burden from the property tax to an earned income or personal income tax – and using revenues from slot machines to provide even greater property tax relief.

To qualify for state gambling revenue, a district's school directors – or the voters of the district through a referendum -- would be required to enact a 0.1 percent increase in the earned income tax (or the equivalent in a new local personal income tax). That action would entitle the district to receive gambling revenue that would be distributed according to this formula. [SLIDE 5]

I'm sure you will be relieved that I am NOT going to decode that for you in all its excruciating detail. Suffice it to say that every school district would be ranked according four separate factors: two separate measures of wealth (one driven by personal income, the other primarily by market value of property) and two measures of tax effort (one based on personal income, the other on market value). The

formula then uses the rankings to come up with a Property Tax Reduction Index… Are you still with me? It gets worse from here. We're only on the first line of the slide…. The formula then would factor in the size of the district's student population, a "constant" and divide by 1000. Which gets us to the NEXT line.

Every district would be guaranteed a minimum of 10-15 percent property tax relief – and could not exceed a maximum of 40–60 percent. The higher the amount of gambling proceeds, the higher the upper and lower percentage limits.

Once the amount of property tax relief for a given school district has been calculated – using the increased income tax revenue plus the district's share of gambling proceeds -- a homeowner's (or resident farm owner's) property tax bill would be adjusted downward. That adjustment would be based on a reduction to the assessed value of the home – resulting in a tax reduction as high as 50% of the tax levied on the median (or typical) property in that school district, an upper limit imposed by the state Constitution. The reduction in assessment would be identical for every owner-occupied property within a particular school district, no matter what the owner's income or the value of the house.

Homestead and farmstead property owners would have to apply and qualify for a homestead exemption to receive property tax relief. The county would use the qualifying applications to determine the median assessed value.
form shape; there'd be a reduction of the wage tax on city residents and commuters instead of a property tax reduction. Depending upon who's counting and the amount of gambling proceeds, the wage tax reduction could range from 6% to 14%.

[SLIDE 6] The proposals shoot for an average of $5 of property tax relief for every $1 of increased local income taxes. Of course, whether that goal is reached depends on how much gambling revenue is available…and very few districts are "average." A district's unique characteristics would help determine the actual amount of property tax relief in that given district.

Of course the proposals also impact Pennsylvania's overall school finance system – obviously including the state share of educational funding. Some estimates forecast a shift in overall state share of education funding from 34% in 2003-2004 to around 43%. Again, few districts are average, and the state share has varied and will continue to vary significantly from district to district.

The proposals also would limit the current growth in local school district tax rates. With some exceptions, school districts would need voter approval to increase tax rates beyond average increases in the Standard Average Weekly Wage and Employer Cost indexes – with the intended -- or unintended -- consequence of seriously reducing local school director control and accountability for the district's financial picture.

[SLIDE 7] If I lost you along the way, don't worry. If you want to know more or are thinking WHAT DID SHE SAY? I CAN'T WRITE THAT FAST, you can find the entire explanation at www.IssuesPA.net.

Besides, what all of this means is more important than down-and-dirty details that admittedly could change tomorrow. So I'll make some general observations about potential impact of the proposals -- and points for policy discussion.

First, the proposed goals would result in an increase in the state's share, but no increase in total spending for education. Yes, that's what I said. The current proposition would not alter in any way the amount spent per student. Sources of money would change, but not the amount. Since the focus is on property tax relief, the total amount of money available for each school district – combining state, local and federal revenues – would remain the same.

Second observation. [SLIDE 8] The proposals would provide relatively greater relief for districts with high property taxes. The formula for distributing gambling revenues is weighted evenly between tax effort and wealth. There is definitely an effort at progressivity built into the formula. However, the provisions specifying a minimum percent of property tax relief tip the scales in

favor of districts with relatively high tax effort – those in green -- which include many of the wealthiest.

To a lesser degree, because the proposals also include an upper limit on the percent of property tax relief, relief in districts with high tax effort and low wealth – the ones in red --would be restricted.

Assuming $600 million in gambling revenues available for property tax relief, almost $63 million of that would be used to bring all districts up to the minimum. [SLIDE 9] Let me give you a tale of two school districts to illustrate the power of those minimum and maximum percentages. According to the basic formula, Lower Merion School District (Montgomery County) would get $55,190 before the minimum guarantee is applied. With the minimum, Lower Merion would get $7.3 million.

At the other end of the spectrum, roughly $13 million would not be distributed to about 55 districts because they've hit the cap. Reading would receive $7.2 million under the formula if there were no cap – but only $5.3 million once the cap is applied.

The tilt toward homeowner taxpayers in high-tax-effort school districts increases as more money from gambling becomes available and the minimum and maximum percentages increase. Bottom line? High wealth school districts levying the highest property taxes would get proportionately more relief. Taxpayers in districts with high taxes and minimal wealth are second. All others seem to fall behind.

[SLIDE 10] If you take a look at tax relief per student instead of per homestead (because education is, after all, about students), you discover that the districts receiving the most dollars per student are – again -- generally wealthy districts with high tax effort (they're the ones in dark tan). At the other end, those receiving the least per student (deep blue) are primarily low-wealth school districts with relatively low tax effort. Under the current proposal, as gambling revenue grows, many of the wealthiest districts remain at the top in dollars-per-student. However, several urban districts with relatively low wealth but high tax effort join them. Those at the very bottom of the list remain essentially unchanged – still the least wealthy school districts – mostly rural.

[SLIDE 11] The Reading-Lower Merion comparison again. Assuming $600 million from gaming, Lower Merion would receive $8.37 per student under the formula before the minimum, $1,111 per student after the minimum take is in place. Reading would receive $503 per student under the first part of the formula, but only $370 per student after imposition of the cap.

[SLIDE 12] Third observation. Given the amount of money spent on public education in Pennsylvania – approximately $17 billion from combined sources – it is not surprising that even the lofty goals for gambling revenue do not radically change the resource picture in any district.   Here are some representative school districts from this part of the state, assuming $600 million from gambling. If you squint very hard and have good seats, you can see faintly bigger red areas – representing increased income tax revenue – and slightly larger yellow areas – state assistance.

[SLIDE 13] Observation four: The proposals reward taxpayers in districts with understated personal income. No, we're not talking about tax cheats. Because the formula uses the state personal income tax as its base, only taxable income will be taken into account.

The biggest omission is retirement income. The second is income earned in New York by residents of bedroom communities in northeastern Pennsylvania. That New York income isn't reported to Pennsylvania because the two states don't have a reciprocity agreement regarding state income taxes.

The "hidden" retirement and New York income results in an understated income base for the state formula in districts with a high proportion of people with untaxed income, making the districts appear less wealthy than they really are, thereby increasing their share of gambling revenue.

As I said earlier, there is a degree of progressivity built into the proposal, but it's more the result of the state Constitution than of the formula itself. Property tax relief for middle-income homeowners is greater, as a percentage of income, than it is for high-income

homeowners. Why? Because relief is administered through a homestead exemption. The reduction on assessed value-- and therefore the amount of relief per homestead – will be the same for all homeowners within a school district, regardless of assessed property value or homeowner income.

In many cases, total tax relief will also be greater for typical working middle-income homeowners than for high-income homeowners – both as a percentage of income and dollar-for-dollar. The reason is because the increased local income taxes on high income homeowners will offset relatively more of their property tax relief.

If you're a working renter (except in Philadelphia), condolences. You'll likely face higher earned income taxes with no offsetting property tax relief.   Whether that's wise in a state trying to attract young people is open to discussion.

If you're a retired homeowner (again, except in Philadelphia), you're a winner.   Property tax relief… no income tax increase.

If you're a suburban homeowner who commutes into Philadelphia to work, WOW! A twofer! Property tax relief at home AND a commuter tax decrease on the job.

If you're someone who wants reliable sources of revenue for education, you may have a problem. For all its faults, the property tax is pretty dependable. Nobody is making that claim for gambling revenues.

And finally, back to the issue of referenda. The most-often voiced complaint against referenda for increases in local school taxes is that the requirements reduce the authority – and accountability -- of elected school directors. It seems to me that an equally serious concern is what tax increase referenda requirements may do to school district finances – inadvertently.

Districts in growing communities would be able to increase spending simply because of a growing tax base, but districts in struggling parts of the state predictably would continue to face shrinking tax bases and limited ability to raise revenues. Longer term, the referenda

could create incentives for school districts to raise taxes in order to get a relatively larger share of property tax relief from the state. Wealthier districts are more likely to do this than poor because, overall, an increase in school taxes represents a smaller portion of individual income. The potential result? A widening spending gap between rich and poor districts.

SLIDE 14] So what are we hearing from "sources" about what topics for legislative and administration amendment will be? The referenda requirements, for sure.

The minimums and maximums will also continue to be a source of controversy.   Balancing the need to get suburban votes with the plight of the poor urban and rural districts is difficult. The maps I showed you before demonstrate what the policymakers are up against.

There is also a move afoot in the Senate to strike out the requirement for an income tax increase. While the income tax is arguably more equitable than the property tax, school districts in the Philadelphia area and northeastern Pennsylvania that do not have an income tax now are probably in no mood to set up a tax collection system for a lousy 0.1 percent.

And while I personally think that the state's personal income tax base is fairer than is the earned income tax, whoever inserted language in the proposal to allow school districts to switch from the earned income to personal income tax – and have it locally administered – badly needs some time in the real world of local government.

The legislation on the table also needs some serious clean-up work. For instance, 87 school districts cross county lines. Cross-county referenda could be a serious problem, let alone the effects of different assessment practices and common level ratios.

And, of course, we really don't know if and when gambling legislation will pass at all! But when it comes down to it, it's still easy to get caught up in the rhetoric: Property tax relief for everyone! However, it's just as easy to get stuck with "tax reform" that really isn't. There's still time to deal with issues of risk, benefits, and fairness before state

policymakers place this big bet for Pennsylvanians. Later may be too late, because it's a bet we – and our children – can't afford to lose.