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THE FUTURE OF LOCAL GOVERNMENT FINANCING IN INDIANA

CARLYN E. JOHNSON†

There is general agreement among public finance experts today that local governments in this country are in serious financial difficulty—Indiana is no exception. Much of the time of the state legislature is consumed in debate (often unresolved) over what steps the state should take to provide local governments with financial relief.

There are, in this writer’s opinion, only a limited number of viable alternative revenue sources to which local government in Indiana can look for substantial financial help. These alternatives are (1) more state aid distributed on the basis of some agreed upon formula; (2) additional authority for local units of government to levy local non-property taxes; (3) additional federal aid; and (4) assumption by the state of the cost of one or more governmental functions currently supported by local property taxes. This paper will examine briefly each of these alternatives.

PRESENT LOCAL GOVERNMENT REVENUES AND EXPENDITURES

In 1970 local government costs in Indiana will be somewhat more than $1.5 billion, about two-thirds of which will be spent to operate and maintain local public schools. Indiana local governments presently have only two significant sources of revenue—property taxes and aid from the state. In recent years the property tax has accounted for 55 to 60 per cent of local costs, aid from the state (including federal monies which are passed through the state) has paid another 30 to 35 per cent, and the remainder has come from a variety of miscellaneous sources including user charges and license fees.1 In normal, i.e., non reassessment years,2 assessed valuations of property in Indiana can be expected to increase 3 to 4 per cent annually. Since the property tax levy increases 8 to 9

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2. As of this writing total property taxes payable in 1970 have not been established. It is estimated, however, that assessed valuation may increase by as much as 20 per cent because of the statewide reassessment of real property which occurred in 1968 and 1969.
per cent annually (in 1968 and 1969, the increases were exceptionally high—15 and 10.7 per cent respectively), obviously most increases in the revenue-producing capacity of the property tax are attributable to rather substantial increases in tax rates. With effective property tax rates (i.e., the tax as a per cent of actual value) exceeding 3 per cent in some places in the state, and nominal rates exceeding $13.00, it seems clear that local governments will be fortunate if the property tax can simply maintain its present share of costs. It can hardly be expected to increase that share. Indeed, very strong pressures exist in the state to reduce property's share of the burden.

**STATE AID**

The state of Indiana makes a sizable financial contribution to its local governments each year. In fact, in the state's current fiscal year, 1970, it will pay almost 647 million dollars (or 50 per cent of its total budget) to local governments in the state. About 16 per cent of this amount is federal money, paid to the state but earmarked for payments to local government. Almost all the funds the state makes available to local units (whether from federal or the state's own sources) are "tied" grants, i.e., earmarked for some specific function. Well over half is for schools, another 20 per cent for streets and roads, and 10 per cent for welfare. The remainder is for such items as judges' salaries, local parks and other outdoor recreation functions (mostly federal money), mental health, and hospitals (again, mostly federal dollars).

<table>
<thead>
<tr>
<th>Year</th>
<th>Total State Assessed Valuation (000,000)</th>
<th>Percent of Increase over prior year</th>
<th>Total Property Tax Levy (000,000)</th>
<th>Percent of Increase over prior year</th>
<th>Average Statewide Property Tax Rate</th>
<th>Percent of Increase over prior year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>$8,979.0</td>
<td>3.0%</td>
<td>$611.2</td>
<td>7.1%</td>
<td>$6.81</td>
<td>4.0%</td>
</tr>
<tr>
<td>1966</td>
<td>9,315.9</td>
<td>3.8%</td>
<td>666.5</td>
<td>9.0%</td>
<td>7.09</td>
<td>4.1%</td>
</tr>
<tr>
<td>1967</td>
<td>9,493.1</td>
<td>1.9%</td>
<td>722.3</td>
<td>8.4%</td>
<td>7.61</td>
<td>7.3%</td>
</tr>
<tr>
<td>1968</td>
<td>9,889.9</td>
<td>4.2%</td>
<td>831.5</td>
<td>15.1%</td>
<td>8.38</td>
<td>10.1%</td>
</tr>
<tr>
<td>1969</td>
<td>10,240.2</td>
<td>3.5%</td>
<td>920.8</td>
<td>10.7%</td>
<td>8.99</td>
<td>7.3%</td>
</tr>
</tbody>
</table>

Sources: Indiana Auditor of State, Annual Reports, (1965-1968) and Indiana Taxpayers Association, Tax History of Indiana (mimeo).

4. The Advisory Commission on Intergovernmental Relations has computed effective real property tax rates for the largest city in each of the fifty states for 1968. In Indianapolis, the effective rate was 3.65 per cent. In only four cities were the effective rates higher (Newark; Burlington, Vt.; Boston; and Milwaukee). When all other direct local taxes (i.e., local sales and personal income taxes) were added to the burden and the total expressed as a percent of market value of a home, only Philadelphia was added to the list of cities with higher local tax burdens than Indianapolis. Advisory Commission on Intergovernmental Relations, State Aid to Local Government, Table 29, at 103 (1969).

5. Indiana State Budget Agency, 1969-71 Biennial Budget as Passed by the 1969 General Assembly (Local Aid Section) at D2-8.
For a short time Indiana tried its own state revenue-sharing plan which provided to local governments funds with no strings attached. From January, 1967, until September, 1968, the state returned to each county 8 per cent of the sales and individual income taxes collected in that county. Unlike other forms of state aid, this money was not to be spent for a specific function, but rather was to be used to replace some portion of local government costs which would otherwise come from property tax revenues. One legitimate concern of state legislators is that despite increased appropriations each year for aid to local governments there has been no halt to the rapid increase in property taxes. Whatever may be the actual reasons for this situation, a number of legislators have concluded that the more local government gets the more it will spend, and thus legislators have concluded they will get no credit in the eyes of the public for the money they have returned to local communities. In an effort to combat this phenomenon the legislature provided in this revenue-sharing measure that local budgets and property tax rates were to be computed without regard to this money, then each tax rate in the county was to be reduced to reflect its proportionate share of the revenue-sharing funds. In fact, to demonstrate to taxpayers that these were indeed property tax replacement funds, the legislature required that in counties with a population in excess of 100,000, tax statements had to have printed on their face the amount of the rate reduction.

Unfortunately, 8 per cent of sales and individual income tax collections is dwarfed by the total property tax levy in the state. In 1968, 20.7 million dollars was distributed, amounting to 2.5 per cent of the property tax levy. In 1969 (the first year in which 8 per cent of a full year’s sales and income tax collections had been accumulated) the distribution was 28.2 million dollars, or 3.1 per cent of the levy. Tax rate reductions were measured in pennies, not dollars.

In spite of the relatively small dollar amount involved, the legislature considered this measure as at least a gesture toward reduction of property tax rates. Further, when the measure was enacted in 1967, there was a general feeling that perhaps the amounts to be shared could be increased in the future and that the amount would certainly not be reduced or eliminated. To discontinue the plan entirely would mean in every taxing unit an automatic increase in the property tax to make up the loss. But, in fact, the state legislature did discontinue the plan in

7. Although no cause and effect implication is intended, the fact is that in the two years revenue sharing was in effect, property tax levies increased by a greater percentage than in recent prior years. See footnote 3 supra.
1969. The state's other revenue needs were so great that without a state tax increase there was simply no money to continue the revenue sharing. This means that in 1970, assuming that few local governments will reduce their expenditures, in addition to normal increases in cost, an additional 28 million dollars must come from the property tax. The state's total assessed valuation is very roughly ten billion dollars, thus, in round figures, one cent in the property tax rate produces one million dollars in state-wide revenue. If assessed valuations did not change, it would take a tax rate increase of 28 cents to make up the 28 million dollar revenue which local governments received last year from the state, but will not receive this year. In fact, however, some of the shock of this increase will be cushioned by a fairly substantial increase in assessed valuation. All real property was reassessed last year (to be effective for taxes payable in 1970), and although final valuations are not available at the time of this writing, estimates are that assessments will increase about 20 per cent statewide (and much more than that in some places which have never been professionally assessed before) compared to normal increases of 3 to 4 per cent. Thus, some of the additional 28 million dollars will come from increases in assessed valuations rather than increases in tax rates.

The state legislature in recent years has considered innumerable schemes for distributing additional funds to local units of government, few of which have been adopted. The controversies over any plan seem to revolve around three principal questions. First, how much redistribution of income should there be? Second, whose taxes will be affected most? And third, what assurances are there that the plan will reduce or slow the increase in property taxes?

The method by which the state presently distributes funds to local governments results in considerable redistribution of income. These state funds come principally from income and transaction type taxes. As mentioned earlier, more than half the present state aid is distributed to local schools, much of it through a formula designed to guarantee certain minimum levels of per pupil expenditure. Thus, communities with low per pupil assessed valuations receive greater amounts of state aid than those with a high property tax base. In general, although there are some notable exceptions, communities poor in property tax base will also be poor in income and transaction tax bases. Thus, through its school distribution formula the state has redistributed income from wealthy communities to poor ones.

8. In some agricultural communities land values are quite high, giving them high per pupil assessed valuations, but per capita income may be very low.
It is more difficult to make such a generalization about the formula for distribution of gasoline tax revenues—which as earmarked for highways constitute the second largest function for which state funds are returned to local governments. Some of these funds are distributed on the basis of population and some on the basis of automobile registrations—both of which would tend to return tax revenues to where they came from. But the highest portion of these funds is distributed among counties on the basis of county road mileage with no account taken of intensity of use. This method favors rural counties over urban counties and to that extent results in a redistribution of wealth. That such a system was flawed is reflected in the fact that the formula for distribution of funds from the 2 cent gasoline tax increase enacted in 1969 is quite different. These new funds are distributed among counties on the basis of automobile registrations; within each county the distribution between cities and towns and the county favors the cities in the more populous counties and the county government in the more sparsely populated ones.

At the other end of the redistribution scale is the revenue-sharing scheme, now discontinued. In that case money was returned to the county where it was collected, thus the only redistribution of income would be within county boundaries. That may have been one of the principal reasons the plan was adopted. It is much easier for the legislature to agree to return money to whence it came, than to agree on a distribution formula.

In 1967, the legislature was presented with a plan somewhat similar to one used in Wisconsin for distributing state funds to local units of government on the basis of need as measured by effective property tax rates. Only those taxing units whose rates exceeded some reasonable minimum amount (e.g., $5.00 per $100 of equalized assessed valuation) would receive money. Each taxing unit would then share in the fund in the proportion that the amount of revenue it raised from its rate in excess of $5.00 bore to the total amount raised by all taxing units from rates in excess of $5.00. This scheme has the advantage of concentrating the state's aid in places where tax rates are highest and presumably relief is most needed. Unfortunately, it suffers from both psychological and practical disadvantages. Since it measures need in terms of excessive tax rates, i.e., expenditures, it rewards those who

spend the most,\(^{12}\) a fatal defect in the eyes of many legislators. And those taxing units whose rates were under the stated minimum would get nothing from such a distribution plan—a result some legislators, particularly those from rural areas, find hard to justify.

From a practical point of view, measuring need by tax rates assumes that the governmental services paid for by property taxes are the same in all like kinds of taxing units. This, however, is not the case. For example, sewer service may be a property tax function in one community, but a service charge on a water bill in another. Thus, communities with the same per capita assessed valuation could have similar per capita expenditures, but different tax rates.

Yet, if the legislature could agree that state money should be distributed to communities where costs are highest, such a plan might be possible. It might be feasible, for example, to limit the computation of each taxing unit’s share of the state fund to that portion of the property tax rate for services common to all like taxing units.

Other formulas for distribution of state funds for general local government purposes have been discussed. Money could be sent to counties on the basis of population, or average daily attendance in the schools (which would closely parallel the population distribution). A recent legislative study committee in Ohio considered an elaborate scheme for replacing general purpose local funds with state funds. Their plan included interesting innovations which would have given additional weight in the state distribution formula to areas with a large population and to school pupils from ghetto areas. But reaching agreement on a distribution formula would presumably have been as difficult in the Ohio legislature as in Indiana’s, and the plan was never adopted.\(^{13}\)

The second question legislators raise about any plan for relieving property taxes is: “Whose taxes will be affected?” There is always debate about whether property tax relief funds should be directed principally to homeowners or whether all taxpayers should share in them equally. It is, after all, homeowners, not corporations, who vote. State dollars which are used to reduce overall property tax rates (as did the revenue-sharing

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12. Whether this is a valid measure of need is debatable. If one believes that local officials make reasonable and prudent expenditure decisions, then it is. On the other hand, in an unpublished study done for the Indiana Commission on State Tax & Financing Policy in 1968, the writer attempted to correlate certain variables with per capita expenditures in different sized cities and towns in Indiana—variables such as rate of population growth, density of population, wage rates etc. The variable which correlated best with expenditures was per capita assessed valuation, leading one to the conclusion that those communities which can most afford to spend do so.

dollars) are of primary benefit to business, simply because business pays about 60 per cent of each Indiana property tax dollar paid.\textsuperscript{14} On the other hand, when efforts are made to direct property tax relief to homeowners alone, or some other selected groups by way of income tax credits or some other device, the specter of unconstitutionality is invariably raised.\textsuperscript{15} Article X, section 1 of the Indiana Constitution requires property to be assessed and taxed uniformly. By court decision this has been limited to requiring uniformity only within a given taxing unit.\textsuperscript{16} But state funds directed toward reducing only homeowners' tax rates, whether by outright grants or by way of state income tax credits (in which case, nominal tax rates would be uniform but \textit{effective} rates different) might violate that uniformity limitation.

This problem may, however, become moot in the near future. The 1969 General Assembly enacted an amendment to Article X, section 1 of the state constitution designed to allow the legislature to classify property for \textit{ad valorem} tax purposes.\textsuperscript{17} If this amendment is approved by the 1971 General Assembly and then by the electorate, presumably the legislature would be free to provide tax relief to homeowners, assuming "owner occupied property" to be a reasonable classification. Since many states grant a so-called "homestead exemption," there is little reason to think it is not.

A third issue in deciding on distribution of state funds is whether or not the funds will actually serve to reduce or slow the rate of increase in property taxes. Indiana legislators are understandably wary of appropriating large sums of money for "property tax relief" only to have the property tax continue its rapid increase as has happened in the past. They find the argument, that property tax rates would have been even higher without the state appropriation, has worn thin with their constituents. Therefore, much time and effort on the part of the legislature is devoted to finding ways to limit local government spending.

Since the 1930's Indiana has had statutory property tax rate limits —limits which are honored only in the amount by which they are exceeded. The limits are $1.25 and $2.00 in unincorporated and in-

\begin{itemize}
  \item \textsuperscript{14} About 40 per cent of the state's total assessed valuation is personal property which (with the exception of automobiles) is paid entirely by business. About 45 per cent of the state's real property assessments are industrial, commercial and farm property.
  \item \textsuperscript{15} Wisconsin and Minnesota both grant state income tax credits to persons over 65 for a portion of their property taxes which they pay. \textsc{Minn. Stat. Ann.} § 290.0601-065 (1969 Supp.), \textsc{Wts. Stat. Ann.} § 71.09(7). A similar scheme was presented to the 1969 General Assembly (S.B. 539) but was not adopted.
  \item \textsuperscript{16} \textsc{Bright v McCollough}, 27 Ind. 223, 230 (1866).
  \item \textsuperscript{17} \textsc{Ch. 458 [1969] Ind. Acts.}
\end{itemize}
corporated areas, respectively. They can be exceeded, however, by authority of the State Board of Tax Commissioners if there is "reasonable necessity" for doing so. Every taxing unit in the state now exceeds these limits. Legislators are aware of this and their recent efforts have, therefore, been directed toward limitations on expenditures rather than on property tax rates. Most recently, the 1969 General Assembly approached the problem by attempting to limit local expenditures to a stated percentage above the prior year's spending—with allowance to exceed that percentage only for certain reasons specified in the statutes—and for no other reasons. There was to be no "reasonable necessity" or "extraordinary emergency" escape valve. To draft and analyze such legislation, however, is to realize that absolute, state-imposed, limits on local spending are unworkable. The functions and problems of the more than 3,000 local government units in Indiana are so diverse that no single piece of legislation could cover them all. Looking only at schools, for example, exceptions from a spending limit must be provided for the school with a sudden influx of children, for the school which must equip and open a new building, for schools which must institute new state-mandated programs, for schools which can demonstrate a need for new or additional programs, for schools which have been overly frugal in the past (in order to keep within school rate limits) and who now must increase spending to provide quality education, and

20. Both Houses of the 1969 General Assembly agreed in principle and did pass an expenditure limitation bill although in slightly different form (H.B. 1772). The conference committee report which was written and adopted in the Senate was never presented in the House. It is likely, however, that if presented it would have been adopted. The expenditure limitations in this final version of the bill were as follows:

- schools were limited to 107 per cent of the greater of their actual cost per pupil or $560 times their average daily attendance (excluding from the limit any expenditures to repay debt). The 107 per cent limitation could be increased to 109 per cent if the school could show
  - state mandated new programs
  - a demonstrated need for new or expanded programs
  - a need for capital equipment
  - an emergency due to some natural disaster
  - that the prior year's expenditures were held below prevailing standards in order to remain within the tax rate ceiling.

- all other units of local government were limited to 107 percent of the previous year's budget (again, excluding from the limit any expenditures to repay debt) unless the unit could show
  - a population increase greater than the statewide average
  - state mandated new programs
  - an emergency due to some natural disaster
  - an increase of more than 7 per cent in the Consumer Price Index.

The reader is left to judge for himself whether such an act would have had any effect on local spending.
for schools where some natural disaster (such as a fire or flood) has occurred. Similar kinds of examples could be listed for every type of taxing unit. Clearly, if an exception were made to cover these situations, spending limitations would become almost meaningless.

Furthermore, at the time spending limits are imposed, they freeze into the system all the spending patterns which have existed in the past—good and bad. The profligate community can continue to be so and the frugal must forever economize. It is probably inevitable that whatever limits are imposed will soon become not only a ceiling above which local spending cannot go, but also a floor below which it will not fall. It seems reasonable to expect that teacher organizations and municipal employee unions would gear their annual wage demands to the maximum expenditure limits. As was argued during the 1969 session of the General Assembly, a maximum limit on school expenditures effectively takes the matter of teacher salary negotiations out of the hands of the local school boards. Teachers will know exactly how much money the board can spend and will quite obviously (and not unreasonably) settle for no less.

In sum, considering the difficulty which legislators have had in agreeing on a distribution formula, on the group at which relief should be directed, and on a scheme to assure themselves that property taxes will not continue to increase, it seems unlikely that, in the near future, the state can increase its general purpose aid to local governments by an amount sufficient to have a noticeable effect on local property tax rates.

LOCAL NON-PROPERTY TAXES

Many states have given non-property taxing authority to local governments, and this form of local government financing is becoming more and more widespread. Local sales and income taxes in 1965 accounted for 6.4 per cent of local government's revenue from its own sources (i.e., excluding aid from state and federal governments). In 1940 they accounted for only 2.5 per cent of such revenue. Although the percentage increase has been great, the absolute number of dollars is still very small compared to property taxes. Yet the number of states allowing local governments to make significant use of such taxes remains quite small. In 1968, only sixteen states made use of local sales taxes and only eight allowed use of local income taxes.

22. There is a great variation among states in the intensity of use of these taxes. In Illinois, for example, more than 1,200 units levy the tax, while only 17 do so in
In Indiana, of course, local governmets do not have such authority. In fact, in Indiana, local governments find that almost 80 per cent of the revenue derived from their own sources is generated by the property tax. In Ohio, on the other hand, where local income taxes are common, the comparable percentage is 66 per cent.23

Most discussion of local non-property taxes in Indiana centers on local sales or income taxes utilizing the same base as the state sales or adjusted gross income tax. From an administrative point of view, these local taxes present no insurmountable problem. Presumably, the local levy could simply be added to the already existing state levy, collected by the state, with the proceeds returned to the local unit. This kind of state administered local tax is utilized in many states. Illinois is a notable example where the state collects a local sales tax for more than a thousand cities and towns and charges each one for the administrative service. Such an arrangement should produce a fairly efficient local tax collection system.

The problems in enacting such a local non-property tax center principally on what unit of government should be given authority to enact the tax and on the relationship between the need for property tax relief and the productivity of a local sales or income tax.

One of the arguments made in opposition to local non-property taxes is that they will cause economic dislocations, i.e., a locally imposed sales tax will cause people to shop outside the area. Obviously, the smaller the unit of government imposing the local tax, the easier it will be for these dislocations to occur. If the jurisdiction of the local sales tax stops at an arbitrary city or town line, the retailers just outside are likely to benefit—particularly those who sell high-priced goods such as automobiles.24 In the case of local income taxes, the smaller the unit the more complex the problems of division of the tax between the taxpayer's place of residence and place of work; and, if the local tax extends to corporations, the greater their problem in apportioning their income to the taxing unit. To a lesser extent, the same thing is true of county-wide local taxes. County lines are arbitrary too and bear no necessary relationship to the economic life of the area. The U.S. Bureau of the Census, for example, defines the Indianapolis Standard Metropolitan Statistical Area as...
as Marion County plus the six surrounding counties. This S.M.S.A. makes up an economic region, and it would be reasonable to impose a local tax over the entire economic region. Local government in Indiana, however, is a long way from that kind of regional cooperation.

The second problem is relating need to resources. Based on 1968 data, a one per cent local addition to the state sales or individual adjusted gross income tax would produce approximately 90 million dollars if levied in every county in the state—or about 11 per cent of the 1968 property tax levy. But the variations between counties in the amounts produced are very high. In Marion County, for example, an additional one per cent added to the state sales tax base would produce 24 dollars per capita, or 11.7 per cent of the property tax levy. In Warren County, the same tax would produce only six dollars per capita, or 3.3 per cent of the property tax levy.  

To the extent that urban property taxes are high, a local sales or income tax would help because sales and incomes tend to be highest in those areas too (assuming the jurisdiction of the local tax is large enough). Yet in some rural areas, where property taxes are high (because farm land is assessed at relatively high rates) while incomes are low, local non-property taxes will not be of much help.

This brief discussion has not touched upon the two difficult political problems of whether the local tax should be on sales, or income, or both, and who should have the authority to levy the tax—local government officials or the electorate. These are very real questions, however, on which the legislature spends much time, and their complexity limits the usefulness of the local sales or income tax as practical alternatives for reform.

**FEDERAL AID**

Federal revenue sharing is much in the news currently and is sometimes thought of as state and local governments' answer to their pressing financial woes. Revenue sharing may ultimately be a significant source of local revenue, but it is doubtful that it will be so in the near future.

The current federal administration's proposal for revenue sharing would begin with distribution in fiscal year 1971 of 500 million dollars increasing to about 5 billion dollars in 1976.  

money to the states on a population basis, modified by a "revenue effort" factor, i.e., the ratio of a state's total state and local tax collections to its personal income, compared to the national average.

Indiana has approximately 2.5 per cent of the nation's population, and would receive about 25 million dollars for every one billion dollars in the revenue-sharing pot—before the "revenue effort" adjustment. In 1967, Indiana's tax effort was 95 per cent of the national average, thus the 25 million dollars would be reduced to just over 24 million dollars for each one billion dollars distributed. The current proposal requires that each state share some of the money it receives with its general purpose local governments. The amount which must be shared is based on the proportion of locally raised general revenues to total state and local revenues. Each general purpose local unit is to receive an amount based on the proportion raised by it of total local revenues raised by all such units.

On this basis, Indiana would receive 12.1 million dollars in the first year (increasing to 121 million dollars by 1976), of which 2.7 million dollars would go to some units of local government. Assuming a very conservative property tax levy of one billion dollars by 1971, the available revenue-sharing funds will be three-tenths of one per cent of the levy. Even by 1976 Indiana local governments would receive only about 26 million dollars from revenue sharing which will probably amount to less than 2 per cent of the property tax levy by then. Thus, at best, federal aid in the form of revenue-sharing cannot be looked to by local governments for any substantial sums in the near future.

STATE ASSUMPTION OF THE COST OF LOCAL PUBLIC SCHOOLS

Perhaps the most promising avenue for relief for beleaguered local governments is an assumption by the state of substantially all the costs of local public schools. As stated earlier, education is by far the largest single consumer of property tax revenue. Consistently since 1960, public schools have accounted for about 57 per cent of the total property

27. These figures are based on the data supplied the Congress when S.2948 was introduced. They appear in 115 Cong. Rec. S.11,110 (daily ed. Sept. 23, 1969).

28. The levy in 1969 was $920 billion, an increase of 10.7 per cent over the previous year. Based on only a 10 per cent annual increase, the levy by 1971 would be $1,223,000,000.

If most of this cost were borne by state taxes, the property tax would be more than adequate to pay for other truly local services.

There is ample justification for state assumption of school costs. Of all the functions performed by local governments, education probably has the widest "spill-over" benefits. In an increasingly mobile society it is clear that a high-quality education will benefit many more jurisdictions than the immediate school district. Thus the entire state (perhaps the entire nation) has an interest in seeing that a quality education is provided in each school district in the state. The quality of education ought not be left to the vagaries of the geographic distribution of property tax wealth or any other kind of local tax. To some extent there are "spill-over" benefits from any governmental function. Certainly everyone downriver has an interest in how well the community above them disposes of its sewage. The state's citizens all have an interest in how well law and order is maintained everywhere in the state, because disorder may spread or it may cause economic disruptions which affect others outside the community. Yet, one of the objections raised to a general distribution of state funds to local governments based on need is that there is little reason why one community should pay for another's parks or fire protection or garbage collection or other local services.

Education, however, is no longer a local function. To some extent Indiana recognizes this fact and distributes some funds to schools, on an "equalizing" basis, to compensate for differences in the amount of property tax wealth behind each pupil. The formula assures each school corporation a certain minimum amount of money per child regardless of local property tax base. Indiana's school distribution formula was changed by the 1969 legislature to provide that in exchange for levy of a local property tax rate of 2.15 dollars, the state will provide the difference between what that rate raises and a foundation level of 415 dollars per pupil. (The foundation level will increase to 430 dollars in 1971.) The closer the foundation level is to actual per pupil costs, the greater the degree of equalization. This is true because each dollar spent above the foundation level must come from the property tax (except for relatively minor amounts of federal money and relatively small amounts of state money distributed on a nonequalizing basis), and the poorer the com-

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30. Percentage is calculated from Indiana Auditor of State Annual Reports (1960-1968).

31. In the 1968-69 school year per pupil assessed valuations varied from more than $42,000 in East Chicago, to less than $3,000 in several rural townships. The statewide average was $9,150.
munity in terms of tax base the higher the rate it must levy to raise those dollars.

The estimated current expenditure per pupil in average daily attendance in 1968-69 in Indiana is 640 dollars. With a 5 per cent per year increase, current costs for 1969-70 would be 670 dollars. Assuming that at least 75 per cent of all amounts above the 415 dollars must come from the property tax (i.e., 191 dollars), a school corporation with a per pupil assessed valuation of 7,000 dollars would be required to levy an additional tax rate of 2.72 dollars to raise that amount while a wealthier corporation with assessed valuation of 12,500 dollars behind each pupil could raise that amount with a rate of 1.52 dollars. A school corporation like that of East Chicago with 42,000 dollars assessed valuation per child could do it for 45 cents. And obviously, the corporation with a 4,000 dollar per pupil wealth cannot possibly raise enough money locally to have even average per pupil expenditures.

Thus, although Indiana does have an equalizing school distribution formula, local wealth remains a very important factor in the level of local school expenditures. Yet, two major hurdles must be overcome before school financing can be assumed by the state. One is revenue, and the other is control.

The state is currently paying approximately one-third of local school costs. Total school costs in 1968 were 831.5 million dollars and will exceed 900 million dollars for the 1968-69 school year. In 1969, the property tax levy for schools exceeded 530 million dollars or 85 per cent of the entire state general fund revenue for that year. For the state to assume an additional expenditure of that magnitude would require very nearly a doubling of its general fund revenues. A 100 per cent increase in the state sales and individual income tax would not

33. Some of the expenditures above the foundation level will be paid from non-equalizing flat grant (per pupil) distributions from the state and some from federal money.
34. These, of course, are not total school tax rates. The qualifying levy ($2.15) must be added to them, plus any levies for debt service or cumulative capital funds.
35. Consider the plight of property owners in a school corporation which crosses county lines of which Indiana has several. The assessing unit in Indiana is the township. When the reassessment of real property occurred last year, some townships were assessed by professional appraisers. Others were done by the local township assessor. Understandably, the valuations arrived at were different for similar kinds of property. When a school corporation encompasses areas assessed by different standards, the residents of that school district are paying different effective tax rates for exactly the same service.
produce that much money.\textsuperscript{38} Thus, relieving the property tax of the entire cost of local schools is probably a political impossibility.

One alternative, however, would be to trade only a portion of the school property tax for higher state sales and income taxes, and to rely on some reasonable \textit{statewide} uniform property tax rate for the remaining portion, a single rate levied by the \textit{state} on all taxable property, to be paid into a state school fund along with whatever other state funds were needed. Such a scheme would allow the state to tap property wealth for schools while circumventing the equalization problem. The property tax resources of the entire state would be available for the benefit of all the schools in the state. Suppose, for example, it were determined the 2.00 dollars per 100 dollars of equalized assessed valuation\textsuperscript{37} would not be an unreasonable property tax rate for schools. (Total school tax rates currently range from less than 3.00 dollars to more than 8.00 dollars.) In very round figures a 2.00 dollar tax rate would raise 200 million dollars in revenue or about 38 per cent of what would have been needed for total replacement of the school property tax in 1969 (\textit{i.e.}, 530 million). The magnitude of state funds needed in addition to these property revenues would not be quite such a shock to state legislators.

The National Advisory Commission on Intergovernmental Relations recommends that states assume the full cost of education and suggests that many state could do so by making more intensive use of their sales and income taxes.\textsuperscript{38} If, for example, each state in 1966 had imposed a sales and personal income tax at a level comparable to the average use of these taxes in the ten states using each of them most intensively, 22 states could have substituted these levies for school property taxes and come out even or with a net addition to their state general fund. Indiana, however, was not among them. According to the Commission's figures it would have fallen short of the goal by 173 million dollars.\textsuperscript{39}

36. Indiana’s present corporate tax structure (discussed elsewhere in this issue) presents an eternal stumbling block to major tax and fiscal change such as is suggested here. It is not assumed that the entire school property tax burden (60 per cent of which is paid by business) should be shifted to sales and individual income taxes only. But there is some general agreement that Indiana’s corporate gross income tax cannot equitably be increased, which acts as an effective deterrent to increases in the corporate adjusted gross income tax.

37. For a statewide property tax for schools to be equitable, property throughout the state must be assessed at the same ratio of assessed to actual value. If property is to continue to be assessed locally, the State Board of Tax Commissioners would need authority to raise or lower assessments to conform to some statewide uniform ratio.


The Advisory Commission suggests that the biggest hurdle to state financing of schools will be finding sources of funding. In a state like Indiana, however, an even more difficult problem may be agreeing on how the money should be distributed and who will make expenditure decisions—a state agency or local school boards. Whatever the words "local control of local schools" may or may not mean, they nevertheless have a powerful psychological impact.

The real heart of the problem is going to be who makes the decision about teacher's salaries which are the major part of school costs. In the 1967-68 school year, 70 per cent of school operating budgets (55 per cent of total school budgets) was spent for salaries.40

It seems clear that if the state is to pay the bill for all school costs from statewide tax levies (whether sales, income, or property levies), it can hardly continue to allow more than 300 separate school corporations to make the decision about the magnitude of more than half that bill. Inevitably state financing of schools will lead to a statewide teacher's salary scale—adjusted (perhaps, by some form of a salary commission) for variations in costs of living and to assure an adequate supply of teachers in all areas. Teacher organizations probably can be expected to oppose such a scheme. Teachers might consider themselves better off financially if they could continue to promote salary competition between local school corporations.

State financing of schools may not be the radical change which it seems to be at first blush. Although much of the funding for schools now comes from local sources, the amounts which schools spend are quite effectively controlled by the state and state agencies. School general fund property tax rates are limited to 4.95 dollars per 100 dollars of adjusted assessed valuation. Last year 69 schools were levying their maximum allowable rate and 46 more were within 25 cents of the maximum.41

40. Percentage figure calculated by Fiscal and Management Analysis Division of the Indiana Legislative Council from data supplied by the Indiana Department of Public Instruction.

41. Fewer school corporations will need to levy their maximum rates this year, because the new school distribution formula has raised the foundation level from $185 to $415. Although the qualifying tax rate has also been raised, substantial increases in assessed valuations should keep most schools under their maximum levies. Predictions about 1970 school levies are very hazardous at the date of this writing because most taxing units assessed valuations and tax rates have not yet been approved by the State Board of Tax Commissioners. Furthermore, all real property in the state was reassessed last year and because the Board has reviewed all these assessments (and changed some of them) they have decreed that assessments are uniform throughout the state, that is, all property is assessed at the same ratio of assessed to actual value. Therefore, in accord with an Indiana Attorney General's opinion no adjustment to equalize valuations is necessary, [1962] IND. ATT'Y GEN. Op. at 253.

Every county's maximum school general fund tax rate levy will be $4.95 (except in
Thus, although local school boards were making teacher salary negotiations, the state, through the school distribution formula and tax rate limits, had effectively limited amount of money available. Cumulative building fund levies are limited by statute, and although levies for debt service are not, approval for construction of new school buildings must come from the State Board of Tax Commissioners.

To the extent that schools are now spending the maximum or close to the maximum amount of money available to them, the range of alternative expenditure decisions for them to make locally would be no more limited under a state funding arrangement than it is now. Thus, state funding of schools may not require as much relinquishment of local control over local schools as might first appear. Decisions about salaries, numbers of teachers, and numbers of administrative personnel may be made by the state, but decisions concerning deployment of staff, curriculum, programs to meet special local needs, etc., could continue to be locally made. Further, as Dr. James Allen, former U.S. Commissioner of Education, has said, “local control of schools in areas lacking in enrollment, area, and resources becomes control of unduly limited opportunities and restricted choices.”

It would be naive to assume that total state financing of public schools will occur soon or without enormous difficulties. Wealthy school corporations are reluctant to share their resources with other schools even within their own county—to say nothing of the entire state. Taxpayers must be convinced that it is in their own economic as well as social interest to assure the resources for a quality education everywhere in the state. And they must be convinced that they will benefit from trading higher sales and income taxes for lower property taxes.

**Conclusion**

The prospect of the state making substantial grants of unrestricted state aid to local governments seems remote because of the difficulty of

Lake County where no decision has yet been made). For some counties which, in the past, have been underassessed, this means a substantial decrease in their maximum school rate. For Marion County which has been assessed at a ratio higher than the state average, it means an increase in the maximum school rate of more than $1.00.


43. Interestingly the highest and very nearly the lowest school tax rates in the state occur within the same county, namely, Lake. In 1969, the Whiting School City rate was $2.94 and the rate for the Griffith Community Schools was $8.99. *Indiana Department of Public Instruction, Report of Statistical Information for Indiana School Corporations, Report I (1968-69).*
agreeing on a formula for distribution of the money and because of lack of assurances that the property tax will not continue to increase. Local non-property taxes hold some promise for help for the urban areas, but cannot be looked to for much help elsewhere. Federal revenue sharing, in the amounts currently being discussed, cannot possibly reduce the property tax by any significant amount. In sum, the most promising avenue for a permanent lowering of local property taxes is to shift the costliest function it supports, namely, education, to statewide levies.