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Author(s): Dick Netzer and Robert Berne

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# Discrepancies Between Ideal Characteristics of a Property Tax System and Current Practice in New York

DICK NETZER AND ROBERT BERNE

THE PROPERTY TAX IN PRACTICE IN NEW YORK STATE  
A "GOOD" PROPERTY TAX SYSTEM

**L**egislatures and state constitutions can and do make a wide range of policy choices with regard to the role of the property tax in the finances of that state's state-local fiscal system and with regard to the structure of the property tax itself. In all states, the property tax is a tax on the capital value of privately-owned property, but states differ with respect to:

- What types of property are subject to tax at all;
- The definition of the value of the property subject to tax; and
- What fraction of that value is the base for property taxation.

In all states, some classes of taxable property are, by law, treated more favorably than others, but states differ with respect to:

- Which classes are favored and by how much; and
- How much variation in tax burdens within major classes is acceptable.

Moreover, in all states, there are specific statutory and/or constitutional property tax preferences for narrowly-defined property uses or capital investments, with a wide range of variation in these provisions. Finally, in most states, there are statutory and/or constitutional limitations on the total amount of property taxes a local government may levy, but those limits vary considerably

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The views expressed are those of the authors, and not necessarily those of the State Education Department.

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*Dick Netzer is Professor at the Urban Research Center, New York University, and Robert Berne is Dean of the Robert F. Wagner School of Public Service at the New York University.*

among the states that impose them.

Ideally, all these choices that the voters and legislature make should add together to a system that, when implemented, is:

- Transparent and straightforward, in the sense of being comprehensible by ordinary voters and property owners;
- Systematic, in the sense of having few, if any, internal contradictions, that is, features that work to offset or negate other features for some groups of taxpayers (and therefore may be inadvertent, rather than deliberate, policy choices); and
- Reasonably related to the policy objectives that animate the various provisions, rather than clumsy and inappropriate expressions of the policy preferences.

In short, the system should be one that strikes ordinary people as essentially fair, even when many disagree with some of the specific policy choices.

A good property tax system must have not only internal consistency in policy choices but also an appropriate administrative foundation. It is impossible to know whether the policy choices are working out as intended, or if taxpayers to whom tax preferences have been extended are fully utilizing (or even aware of) those preferences, if there is erratic and unintelligible administration. Unfortunately, it is not easy to administer the property tax well. From an administrative standpoint, the real property tax is unlike all other major taxes in the American system: the other major taxes begin with self-reporting of tax liability by taxpayers, and the major task of tax administration is to verify the facts and calculations in the tax returns. That process involves computer matching of the information on returns with other computerized information and audits of a sample of tax returns. In contrast, the most important task of tax administrators with respect to the real property tax is to determine, themselves, the basis for tax liability, the taxable value of real property, parcel by parcel.

Conceptually, the key features of good administration<sup>1</sup> are:

1) An initial determination of the value of each parcel that matches the legal standard and does so uniformly and contemporaneously. In the great majority of states, the legal standard for valuation is the market value of the property (that is, the price at which the property would change hands between a willing buyer

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1. In this paper, “good administration,” “good practice” or “best practice” refer to practices recommended in the “standards” for assessment administration published by the International Association of Assessing Officers.

and willing seller in an arm's-length transaction), or some specified fraction thereof. So, good practice involves an initial determination of market value by the assessor, before any percentage is applied to convert market to taxable value. States vary in their requirements with regard to how current valuations must be. Some require, explicitly or implicitly, revaluation to current market value annually. Other require frequent reassessment cycles, such as requiring that all parcels be reassessed every four years, one-fourth done each year. Still others require only rather infrequent reassessment, such as once in a calendar decade, the Connecticut standard for many years. Best practice is considered to be annual revaluation.

2) Explicit statement of the steps that convert the initial determination of market value to taxable value, to the taxpayer in the tax bills and on the formal assessment "roll" and to the public, in the form of reports that show aggregates by property type and perhaps location within the assessing jurisdiction.

That is, the record for any parcel would show clearly:

- The market value determined by the assessor;
- That value times the assessment percentage specified by law (whether for all classes of property uniformly or differentially by class of property) or, if local option is permitted, the percentage used in that jurisdiction;
- The amounts of any partial exemptions, like homestead or veterans exemptions and the reductions in taxable value resulting from other provisions of the tax law, like abatements for selected new investments; and
- The net taxable value.

Good practice is most likely to be achieved by professional property tax administration organizations that can take advantage of the very large economies of scale inherent in tax administration and that can deploy the specialized knowledge and experience needed to value some types of property including most non-residential property. Thus, in more than 40 states, property tax administration is done largely by county-level organizations, rather than by smaller units of government. Valuation of public utility and transportation carrier property is done by a state agency in 42 states. In a few states, major types of commercial and industrial property is valued by a state agency. In many states, a state agency is authorized to provide assistance to local assessors in the valuation of specialized types of property, and frequently does so.

Another step in the property tax administration process in

nearly all states is inter-jurisdictional equalization of values by a state agency. Equalization is necessary both for the implementation of statewide policies (in state school-aid calculations and for determining tax and debt limits) and for the determination of the tax liabilities of individual taxpayers whenever there are overlapping taxing and assessing jurisdictions, like state agency assessment of the value of utility property or school district boundaries that are not coincident with the boundaries of the assessing jurisdiction. The equalization process should be understandable, it should yield results that truly do equalize among jurisdictions, and it should be seen as essentially fair. Most states use the county as the unit for equalization, because primary assessment is done at that level, rely primarily on evidence derived from actual market sales of real property and based the equalization rates on data that are quite up-to-date.

#### WHAT IS WRONG WITH THE PROPERTY TAX SYSTEM IN NEW YORK?

The one-word answer is, for all practical purposes, “everything.” Although there are numerous local assessment jurisdictions that do a competent and effective job, within the boundaries set by state law, the Real Property Tax Law mandates many bad practices and permits other local assessors to persist in even worse ones. At one time, New York State was a leader in state and local government tax policy and tax administration, including property tax policy and administration. For example, it was the first state to establish a state-level equalization process about 140 years ago. But innovation in tax policy and administration largely stopped in the early 1930s, and New York did not deign to copy the innovations developed in other states. By the end of the 1930s, New York State had become among the laggards in almost every aspect of property tax policy and administration. Few New Yorkers, including those active in the formation of tax policy, are at all aware of this backwardness.

New York State in effect has two somewhat different property tax systems, one that is in effect only in New York City and Nassau County and one that applies to the rest of the state. There also are some provisions that apply statewide, to New York City and Nassau as well as to the rest of the state. The discussion of deficiencies that follows begins with provisions and conditions that are statewide in application; the discussion ends with provisions unique to New York City and Nassau.

*Deficiencies in the Property Tax System.* There has been no

standard of value specified in the Real Property Tax Law since 1981 (there was, for nearly 200 years before that). As noted earlier, most states have, in their laws or constitutions, a specific requirement that property subject to tax be assessed uniformly at its “true value” or “full value”—almost invariably construed to be market value—or some specified percentage of market value (possibly differing by class of property). In deciding on cases, New York courts have required some degree of “uniformity” in assessments, but the courts have no clear statutory guidelines.

*Local Assessment is Problematic.* Local assessment is largely done at the city and town level, not countywide (in some cases, there is village assessment, as well). A state agency participates in primary assessment in only one instance, the valuation of railroads. Although some local assessors do a valiant job, many do not; many have very limited professional experience and training (although state law encourages training for local assessors). Systematic differences in levels of assessment among different types of property (residential, commercial, industrial, etc.) are widespread, although such differences are explicitly authorized by statute only in three cases: for railroad property, for land used for agriculture and for New York City and Nassau County generally. Large variations in the level of assessment of individual properties of the same type are the rule, rather than the exception. Annual revaluation is unknown and, typically, re-assessment is infrequent. Despite court rulings, “welcome stranger” re-assessment, under which the only property reassessed will be property sold in the preceding year, is common in some parts of the state. The result of infrequent reassessment often is a markedly lower level of assessment of properties that have increased most in value recently, compared to those whose value has increased modestly or even declined.

*Valuation of Utilities and Transportation.* The property of utilities and transportation carriers is valued in ways that are used in almost no other state. In nearly all other states, valuation is done by a state agency and the enterprise is valued as an entity, using market-related data to set value; in New York, the utility property within a jurisdiction is valued by local assessors on a basis almost wholly unrelated to the value of taxed assets as operating utility property. The rules result in very high levels of taxation of utility property, with bonanzas for some jurisdictions at expense of everyone else in that utility’s service area.<sup>2</sup> An outstanding example is the Village of Shoreham in Suffolk County and the Shoreham school district, which for years received very large property tax

payments from LILCO for the nuclear generating plant (which did not operate), payments that derived from higher utility rates paid by all LILCO customers. In any other state, the Shoreham plant would have reduced the utility's property tax payments.

*Complicated Tax Exemptions.* All real property tax preferences, whether they are widely available or very narrow in scope, are framed in exceedingly complex terms, difficult for taxpayers to obtain without expensive professional assistance and, in most places, obscured from public view, in detail or even in the aggregate (New York City is the exception, with regard to providing public information on tax exemptions and abatements). For example, for many years, the standard form of the veterans exemption provided that the amount of the exemption was determined by the amount of Federal veterans benefits the applicant had received, so that the applicant had to obtain a complete record of prior benefits and the assessor had to go through an elaborate translation of that record into the exemption amount. Every other state that provided a veterans property tax exemption offered a flat dollar amount (perhaps higher for disabled veterans). All the varied housing preferences require the submission of more or less complicated forms, because none of them are unconditional (like the homestead exemptions of many states, always a flat dollar amount).<sup>3</sup> The quantitatively more important preferences, like those for industrial development and some types of housing, usually involve administrative discretion and can lead to protracted negotiations (and inconsistent determinations).

*Equalization Process Complicated.* Because there are so many small assessment jurisdictions in New York, the equalization process is inherently difficult and imperfect. For example, the State Board of Equalization and Assessment cannot rely on data on sales of real property nearly to extent done by its counterparts elsewhere simply because there are so few sales in a given year in many small places. Also, small jurisdictions are more vulnerable to market-indicated changes in equalization rates than are larger places, so SBEA has developed a process that substantially mutes the effects of year-to-year market changes. Further, considerations of cost and staffing require SBEA to use shortcut methods of es-

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2. The transportation property of railroads is assessed by a state agency, the State Board of Equalization and Assessment, under rules that also produce very high levels of property taxation, compared to the treatment of railroad property in all other states.

3. A flat dollar exemption is progressive with respect to income or wealth, by definition; the complexity in New York's preferences often does nothing to assure progressivity.

timating: it is far more costly to perform inter-jurisdictional equalization when there are nearly 1,000 assessment jurisdictions than when there are 100 or fewer counties to equalize, the case in most other states. A final problem is that the Legislature, unlike those in other states, freely intervenes in the process and may direct the SBEA to adopt “special equalization rates” for particular places.

One awkward result of the process stems from the interaction of the process itself with the heavy extent of overlapping boundaries. Segments of a school district may be found in several towns and villages with separate assessment machinery. It is not uncommon for a school district property tax levy increase in a year of less than 10 percent to result in a 50 percent increase in school taxes in one or more segments of the district. The numbers of taxpayers in such cases may be small, but the situation adds to the public conviction that the New York property tax is not only incomprehensible but also fundamentally unfair.

*Ineffectiveness of New York’s Circuit-Breaker.* One of the most important property tax reforms of the past generation has been the widespread adoption of the “circuit breaker,” a credit (either against the state income tax or, in most states, refundable in cash if there is no income tax liability) to offset property tax payments that are large percentages of household income. The purpose of the circuit breaker is to reduce or eliminate the regressivity of the residential component of the property tax in states in which property taxes are relatively high (see below for more on this point). New York’s circuit breaker is significantly more difficult for taxpayers to claim than in most other states with the circuit breaker, and is very modest in amount.

#### DEFICIENCIES IN THE TAX SYSTEM PERTAINING SPECIFICALLY TO NEW YORK CITY AND NASSAU COUNTY

The system that is specific to New York City and Nassau County has its own special deficiencies. In a dozen other states, there is what is known as “classification,” under which property is divided into classes—types of property, usually related to the use of the property—and taxed at different effective rates (that is, the tax paid in one class is a different percentage of market value than that paid in other classes). Ordinarily, the classification system is quite straightforward; usually, the different classes are assessed at different percentage of market value. For example, the assessment percentages might be the following:

- 30 percent, for agricultural and small residential properties;



- 40 percent, for commercial and industrial and apartment properties; and
- 50 percent, for utility property.

Such a system is simple in application and simple to comprehend.

When New York's Legislature enacted the NYC-Nassau classification system in 1981 (over the governor's veto, a rare occurrence in New York), it chose instead to adopt a system that was anything but simple, but rather one that was fiendishly complicated and internally contradictory, and required almost constant legislative tinkering to correct for the unintended effects.

The instrument for assuring different tax treatment of the different classes in this system is not a differential in the assessment percentage (or differential tax rate, as is occasionally done elsewhere), but a freezing of the "class share" of the total tax levy, that is, the percentages of total property taxes levied in a given year paid by all the properties within each class: in concept, if, in the base year, a class of property paid 20 percent of the total levy, that share would remain at 20 percent.<sup>4</sup> The base year was 1982. The law provided for four classes: one-, two- and three-family houses (Class I), other residential property (Class II), utility property (Class III) and all other, essentially business, property (Class IV).

The law provided that the local governing body could change the share of a class by up to 5 percent (not five percentage points) each year, and that class shares had to be revised every five years on the basis of changes in underlying values of property. Because the value of Class I residential property rose sharply during the 1980s, local legislators used their authority to reduce its share by the maximum amount and persuaded the legislature to permit them to defer the five-year updating of class shares. The result has been a large decline in property taxes on Class I property.

But the freezing of class shares was only the first step in the new system. Other steps included:

- A very low ceiling on the permitted annual increases in the assessed value of individual Class I properties (not more than 20 percent over a five-year period), which complicated the process of assigning class shares. But a more

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4. Massachusetts voters had approved a constitutional amendment providing for classification on a "class-share" basis a few years before 1981. By 1981, it was abundantly clear that the mathematical properties of that system lead to preposterous and unacceptable results in many places, and the Massachusetts system was substantially changed. If Massachusetts was the model for the framers of the New York law, they apparently stopped reading about Massachusetts too soon.

important consequence was the effect on the relative tax burdens within Class I. In the prime residential neighborhoods, in which residential property values increased especially rapidly during the 1980s, the ratio of assessed to market value declined substantially more than was the case for other residential neighborhoods. Homeowners in the prime neighborhoods tend to be much more affluent than those in ordinary residential neighborhoods, so that the tax burden within the class tended to shift from the best-off homeowners to the least well-off homeowners.

- The Legislature provided that cooperative and condominium apartments buildings could not be valued as such, but rather had to be valued as if they were rental buildings; in New York City, with rent regulation, the per unit value of a cooperative building can be ten or more times that of a comparable rental building.
- In all classes other than Class I, assessment increases for individual properties had to be phased in over a five-year period, even if the increase was a correction for decades of gross underassessment.
- The very favorable treatment of Class I produced demands for parallel treatment, and the Legislature responded with the creation of new subclasses and the shifting of property into Class I, including most of the vacant privately-owned land in New York City.<sup>5</sup>
- Because of the many contradictions within the system (some the result of simple arithmetic), the Legislature has found it necessary to make transitory adjustments to the system almost every session.

#### REFORMING NEW YORK'S PROPERTY TAX

Reform should make the property tax in New York more like the tax that is used by the great majority of the states. Although New York, like every other state, is unique in some respects, it shares a long list of American institutions, traditions, values, and economic characteristics. It is not plausible that, when New York practices depart from practices in all other states as much as they do with regard to the property tax, New York is right and all other Americans are wrong—especially when many of the New York

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5. Because vacant land was under-assessed even in comparison with 1-3 family houses in 1981, this will, within a few years, make vacant land effectively tax-exempt, the opposite of sound tax policy.

idiosyncrasies stem from not changing practices that are a century or more old when everyone else has done so.

The priorities should be:

- 1) Adopt market value as the legal standard of value and explicitly require uniformity in terms of market value. If local option regarding the percentage of market value at which assessments are to be made is desired, the law should be explicit about how that percentage assessment level is to be adopted and by whom.
- 2) Adopt statutory rules on the degree of intra-class inequity that is permissible (or, at least, a statutory statement of intent to guide the courts), and on the frequency of re-valuation.
- 3) Explicitly require local assessors to begin the valuation process by establishing and publicly recording a market value for each parcel, and only then making adjustments (also publicly recorded) to arrive at taxable assessed value.
- 4) Strongly encourage the shift of primary assessment to the county government level (by constitutional amendment if necessary).
- 5) Encourage local assessors to ask the state property tax agency to help or take over the primary assessment of hard-to-assess classes. Consider a constitutional amendment to transfer authority state-wide for certain types of commercial and industrial property, as is done in several other states.
- 6) Reform both the process and substance of valuing utility and railroad property to match the prevailing system in the majority of the states, if need be by constitutional amendment.
- 7) Simplify tax preferences, make more of them automatic rather than discretionary and reduce the number of separate provisions by consolidation.
- 8) These reforms will permit a more straightforward equalization process, with greater reliance on market transactions, less administrative adjustment and more up-to-date results.
- 9) Wholesale reform of the New York City-Nassau system by adopting a conventional type of classification system, perhaps by using assessment percentages or tax rates that reflect the status quo, but allowing changes over time that reflect relative changes in market values.

None of these reforms can be implemented instantaneously upon passage of the requisite legislation, so a period of transition to the new arrangements is inevitable; the deadlines for implementation are likely to be three or more years after passage. For those reforms that do require constitutional amendment, time before full implementation will be especially long. Therefore, it seems unnecessary to provide explicitly for transitional arrangements for individual taxpayers, except perhaps in extreme cases—for example, phasing in increases in property tax liability (not assessments) of more than some high percentage over several years (a 100 percent increase in all assessments in a given jurisdiction is unlikely to increase anyone's tax liability by much, if at all).

#### REGRESSIVITY OF THE PROPERTY TAX IN NEW YORK, IN PRACTICE

##### THE INCIDENCE OF THE PROPERTY TAX, IN THEORY

There is little dispute among public finance economists about the distribution of the burden of the American property tax by income class in concept. The conventional wisdom is as follows. The American property tax is a tax on the value of a large fraction of the physical capital stock of the nation. The immediate impact of the imposition of such a tax, or an increase in the rate of an existing tax, is to lower the rate of return on the capital that is subject to the tax. Because capital is relatively mobile over time between uses of capital (that is, taxed versus not taxed, in this case) and places, the impact of the tax will be diffused in time over the entire stock of capital. But, by and large, the size of the entire stock of capital is not very sensitive to its overall rate of return, so the burden of the tax in time take the form of a reduction in the rate of return on capital. Because ownership of capital increases sharply with income, the overall burden of the property tax must be distributed progressively.

There are some qualifications to the general proposition. First, the supply of capital is not entirely insensitive to the rate of return; the more sensitive it is, the less progressive the distribution of the tax burden. Second, the sensitivity of the supply of capital in any one country, even the U.S., is increased, the more open to the global economy that country is. So, increasing global economic integration reduces the overall regressivity of the American property tax.

But the property tax is not a national tax that changes uniformly across the country. It is a local tax, with enormous varia-

tions in structures, rates, and amount and direction of change. The nation-wide effects are the end result of many local economic changes, as capital shifts among uses and places in response to tax changes in particular places. When a local government increases its property tax by more than all other places are increasing their taxes, that will encourage capital to move to those other places.

Over time, places with above-average property tax rates will suffer shrinkages in the local capital stock. The migration of capital from high-tax states (and especially from the very highest tax localities within those states) to low-tax states will be associated with the migration of other mobile resources, notably the most skilled and talented people, to the low-tax places. The result is that the burden of the high property taxes is borne by the least mobile economic actors in the high-tax community: relatively unskilled workers, the demand for whose services declines as the economy contracts; consumers who are tied to that location, who face higher prices for consumer goods and services; owners of existing businesses that can't be moved to other locations; and owners of land. The higher the tax rates relative to the national average, the more the tax burden is borne this way. By and large, this "excise tax" component of the local property tax is regressive in incidence.

The situation is the opposite in places in lower than average property tax rates, or which lower their tax rates relative to what most places are doing simultaneously. Here there is a negative "excise tax" effect, which is likely to be progressive in incidence. So, from the standpoint of a single school district, or even that of all the school districts in a single state, a decision to raise school property taxes will tend to make the local tax system more regressive; a decision to lower school property tax tends to make the local tax system more progressive.

#### THE INCIDENCE OF THE PROPERTY TAX IN PRACTICE

So, what is the situation in New York State? To begin with, in most of the state, effective property tax rates are well above the U.S. average; this is especially the case for business property.<sup>6</sup> Over the long period during which these disparities developed,

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6. In New York City, Class I residential property is taxed at effective rates that match some of the lowest-tax states in the country, but apartment and business property is taxed at effective rates that probably are higher than those in any other places, other than devastated small industrial cities like Camden, NJ, and East St. Louis, IL.

an important degree of regressivity became a characteristic of the property tax in New York.

This has been greatly exaggerated by administrative practices and the nature of tax preferences, which have produced very large variations in effective tax rates within individual jurisdictions that typically vary inversely with the wealth and income of those who bear the tax burden. For example, infrequent revaluation of residential property, or the assessment increase limits in the New York City-Nassau system, must result in reduction over time in the effective rates on property in the better parts of a city or town relative to the effective rates in the less desirable sections. It is inconceivable that property owners in the less desirable neighborhoods will have higher incomes than those in the most desirable neighborhoods. Another example is the almost universal undervaluation of vacant land (nonagricultural) relative to other property, often by drastic margins. Poor people are not landowners, whatever New York City real estate developers may claim. The ownership of urban land may be more concentrated than that of any other form of wealth.

Among the tax preferences, the most spectacularly regressive examples are found in the New York City-Nassau classification system, notably the taxation of rental apartment property at much higher effective rates than those applied to owner-occupied small buildings, coops and condominiums: income levels of renters are far below those of owner-occupants. An important degree of regressivity stems from the very high property taxes in New York on public utility property. Such taxes are reflected in customers' utility bills; consumer expenditure for utility services is quite regressive.

Indeed, it is difficult to think of a feature of the property tax system in New York that differs greatly from the usual practice in other states that does not add to the regressivity of the tax in New York.

#### HOW TO MAKE THE PROPERTY TAX LESS REGRESSIVE

Clearly, reducing property taxes relative to what is happening in the rest of the nation is the most direct way to reduce the regressivity of the property tax in New York. But it is also the most expensive way to do so, and will have the desired progressive effects mainly in the long run. There are more immediate and less costly steps that can be taken, however. The structural and administrative reforms suggested in Section I, above, would go a long way to reduce some of the most egregious forms of

regressivity, when fully implemented.

But beyond these reforms, a substantial enlargement of the circuit breaker (the “real property tax credit”) would be desirable. The property tax is relatively important in state-local finance in New York, especially for schools, and there is every sign that, if anything, it will become more important as a consequence of the State government’s fiscal problems (rather than a deliberate decision that heavier reliance on the property tax is a good thing). The regressive results of this can be mitigated by making the circuit breaker more generous and simplifying the process of applying for it, to ensure a high take-up rate.

Much of the impetus behind the circuit breaker in New York and most other states has been concern for elderly homeowners with modest incomes and more valuable houses bought when their incomes, before retirement, were relatively higher. In New York and elsewhere, the circuit breaker for senior citizens usually is more generous than that for younger households. Logically, the income-poor/house-rich condition of many senior citizens could be better addressed by tax deferrals, like reverse-equity mortgages held by the taxing jurisdictions, for the problem is not one of poverty but of liquidity. Forgiving taxes rather than deferring them amounts to a transfer from other taxpayers to future heirs, and is likely to be regressive in most cases. However, tax deferrals of this type are unpopular among both senior-citizen homeowners and their potential heirs, and have not fared well in the few states that have offered them.

#### SCHOOL DISTRICT FISCAL DEPENDENCY

With the exception of the five largest cities in New York State, all of the other more than 700 school districts are fiscally independent entities that are in effect special purpose local governments. In the five largest cities – Buffalo, New York City, Rochester, Syracuse, and Yonkers – the school district is part of the city government. Because there are over 700 of one type of school district (fiscally independent) and only five of the other (fiscally dependent), questions will be asked why all school districts are not fiscally independent.

The most recent example is the report of the New York State Special Commission on Educational Structure, Policies and Practices which, in its final report, “Putting Children First,” released in December 1993, recommended that “New York State’s five largest city school districts should be given fiscal independence.”<sup>7</sup> The arguments presented to justify the recommendation included

a lack of direct control over their budgets by the school districts and an absence of accountability to the voters. The report states, “[F]iscal independence for the Big 5 city school districts would align resources with authority and make school officials more accountable for school performance. Schools could truly put children first. Children would not be placed in direct competition for resources with municipal services.”<sup>8</sup> The call for fiscal independence also has been a response to the actions of city governments in tough fiscal times, where increases in state aid for education is apparently used to lower local taxes or increase spending on other municipal services, rather than to raise school spending. “[I]n addition, fiscal independence can protect school programs from disproportional budget reductions in difficult financial times when city officials look to protect city operations at the expense of schools.”<sup>9</sup>

In this brief section, the issues surrounding the question of fiscal independence are presented for review by the policy community. It is important to recognize at the outset that the issue of fiscal independence should be examined as part of a broader set of governance and finance issues. That is, it should not be viewed in isolation from questions such as how schools are financed, who is responsible for decision-making, and the nature of accountability.

There are at least three simultaneous decisions that citizens need to make to arrive at a choice about school finance. First, citizens need to decide the division between public and private spending. Embedded in this decision is the complexity of a Federal system of government, but let us assume that there is a choice between public and private spending that translates into the local government budget. Second, citizens need to make choices among education and other public services such as police, fire protection, day care, health care, roads, and recreation. Third, citizens will want to influence how the funds for education are spent, for example on basic education, support services, extracurricular activities, and so on. The traditional criteria that are used to judge these decisions include efficiency and equity. Thus we could assess whether alternative designs of governance and finance sys-

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7. New York State Special Commission on Educational Structure, Policies and Practices, *Putting Children First* (Albany, NY: Temporary State Commission on Educational Structure, Policies and Practices, December 1993), 45.

8. *Ibid.*, at 45.

9. *Ibid.*



tems produce efficient and equitable decisions about public and private spending, spending on education versus other public services, and the specific nature of education spending.

Although this may be a reasonable conceptual approach with which to assess the advantages and disadvantages of fiscal independence versus dependence, it is not the typical starting point for the debate as the quotes from the recent commission suggest. Instead, an argument is often presented that there is an apparent “preference” for education that somehow gets subverted when the school district and the local government are the same entity. The argument about putting children first and eliminating the direct competition for funding between education and other public services is not consistent with the efficient and equitable three part decision framework presented above.

In fact, there is little reason to believe that fiscal independence would actually address the problems commonly cited as reasons for the change. For example, if a citizen had to choose a tax rate for the city government separate from the school district, what would be the conceptual or practical arguments to suggest that education spending would be favored in such an arrangement? Or if two tax rates are set, why would the citizen be prevented from using school aid to lower local contributions or to increase spending on other municipal services? In fact, if those were the citizen preferences, they could be accomplished with a separate school district and a separate local government, or when the schools are part of the local government. An explanation for the preference for fiscally independent school districts may lie in the idea that a separate school district governance system would differentially encourage participation among those with greater preferences for education such as those with school age children, but this seems to be equivalent to designing a hurdle or imperfection in the system (the need to vote twice) to stack the deck in favor of those who desire more education spending. (It is also possible that this system brings out those with preferences for less education spending, such as those who are retired.) The real question is whether the advocates for fiscal independence actually want “better” decisionmaking, or really want more funding for schools, and see fiscal independence as a way to accomplish that goal.

If greater spending on education is the real goal of the advocates of fiscal independence, even this more narrow rationale is subject to question. First, in all but the Big Five cities the school districts are fiscally independent, but in the 57 other cities with

fewer than 125,000 people that have fiscally independent school districts, the tax rate is set by the elected school board, not by a popular vote as is the case in the other 650 school districts. Thus, it is not a direct citizen vote, but instead a decision by elected officials. But why, other than because of some imperfections in the political process, would elected school board members be more likely to spend greater amounts on education than the current elected mayor and the elected city council? Again, it may be related to those who care about education differentially participating in the separate school governance process.

Second, in the Big Five cities if they had fiscally independent school districts, what is the tax base that would be used by the schools? The likely answer is the property tax, but it is not clear that this would lead to greater education spending. In particular currently in New York City, the local tax revenues are composed of a combination of the property, sales, and income taxes. If, as would be likely, a newly created independent school district had to rely solely on the property tax and lose access to the sales and income tax, there is some evidence to suggest that education spending could be less. For example, in New York City the City Council and the last two mayors have stated publicly that the property tax should be frozen, despite the fact that single family homeowners face a relatively low tax burden and there exists allowable taxing capacity under the constitutional limit. Moreover, the entire tax and spending limitation movement of the last decade and a half has been, in part, a reaction to high and increasing property taxes. Finally, surveys of the popularity of various taxes repeatedly show that the property tax is among the least popular taxes, and the regressive nature of the property tax in New York State is discussed earlier in this paper. Thus, the result of a switch to a sole reliance on the property tax in New York City could possibly result in less spending on education than currently is the case and a more regressive tax structure.

The argument presented by advocates of fiscal independence for the Big Five school districts that has not been addressed is the so-called mismatch between those who raise the resources for schools (in this case the city government) and those who are responsible for school performance (in this case the school boards of the Big 5 city school districts).<sup>10</sup> The so-called mismatch can be addressed on the “governance” side of the equation as well.

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10. The school boards are elected in Buffalo, Rochester, and Syracuse, and appointed in New York City and Yonkers.

For example, many who have studied the admittedly dysfunctional school governance system in New York City have argued for a closer alignment of fiscal responsibility and education performance by giving the Mayor the power to appoint more than just two of the seven members of the school board, which is the current case. In 1991, the Temporary State Commission on New York City School Governance recommended that the Mayor be given four out of nine appointments, with the other five going to each of the borough presidents.<sup>11</sup> Not surprisingly, mayors have advocated for a majority of the appointments on the school board. The point here is that fiscal responsibility and educational performance can be made more consistent without changing fiscal dependency but instead by changing the nature of the governance system.

If the most compelling arguments for fiscal independence are based on the notion that municipal governments somehow “steal” state aid that is intended for education, then a policy option worth considering is the use of matching grants that provide city school districts with  $x$  dollars of state aid for every  $y$  dollars of local spending, a state aid mechanism that is common in states other than New York. The matching rate could even vary to take into account fiscal stress or ability to pay; Massachusetts developed such a plan based on research by Helen Ladd and her colleagues. The effect of the matching rate would be to deter local governments from using state aid to lower local contributions; the higher the matching rate, the larger the deterrence.

While the specific arguments in favor of fiscal independence do not appear to be strong, there are no compelling arguments that suggest that a fiscally dependent school system will lead to inefficient or inequitable decisions about public versus private spending, education versus noneducation spending, and the specific components of educational expenditures. The need for reform and professionalization is equally strong for city governments and urban school systems. It is possible that the arguments for fiscal independence stem from a preference for education, that upon closer inspection is not likely to be addressed with a change from the current system.

At a time when there is increased attention to the integration of education and non-education services for children (that is education and services delivered by municipalities and the State), especially in urban areas, the advantages and disadvantages of

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11. Temporary State Commission on New York City School Governance, *Governing for Results: Decentralization with Accountability*, (New York: Temporary State Commission on New York City School Governance, April 1991), p. 16.

fiscal independence need to be analyzed carefully. It might not be too far-fetched to think that with some changes in governance and finance, we can maintain independent school boards and improve local services by making all school districts fiscally dependent and coterminous with local governments.