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Regional Taxation in State Tax Reform

Kirk J. Stark*

ABSTRACT

This article describes and evaluates a specific subset of state tax reforms—i.e., those involving regional approaches to funding subnational public goods. Reforms examined include those where policymakers devise new multijurisdictional fiscal arrangements to address regional objectives that conventional local governments, by virtue of their more limited geographic scope, are unlikely to tackle. As used in this article, the term "region" refers to a geographic area (1) constituting less than the entire jurisdiction of a state, and (2) encompassing more than one local government jurisdiction. A "regional tax" is therefore any tax (fee, assessment, etc.…) limited in its application to a geographic area so defined. A closely related policy is "regional tax base sharing"—i.e., the imposition of a uniform region-wide tax on a base that is shared among several local jurisdictions, with the proceeds distributed among those localities. There are numerous instances of regional taxation and regional tax base sharing across the U.S. subnational public finance landscape. Some of these examples are familiar to a tax policy audience (such as the Minneapolis-St. Paul tax base sharing system), while others are less well known (such as the Denver Scientific and Cultural Facilities District). In most cases, the fiscal arrangement examined governs multiple counties spanning an entire metropolitan region. Following an evaluation of both successful and failed efforts at regional tax arrangements, the article considers possible extensions of these policies, discussing how regional taxes might be employed in contexts beyond the relatively narrow areas in which they currently apply.

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INTRODUCTION

The focus of most state and local tax reform efforts is, understandably, the tax policy of existing state and local governments. That is to say, most tax reform proposals accept as fixed the current legal and institutional architecture of state and local governments and then ask how best to fund the expenditures of those governments. The jurisdictional scope of fiscal responsibilities is not the object of reform. Rather, existing boundaries are accepted as given, leaving the tax policy analyst with seemingly ancillary questions of funding. Which taxes are most suitable for cities, counties or school districts and which are best left to the states? What is the optimal mix of tax instruments for each level of government? How might these governments reform their tax structures to make them simpler, more equitable, or more efficient?

Academic research on these questions has generated numerous insights, providing a blueprint for possible improvements in state and local tax policy.[1] Yet the prevailing assumption of fixed boundaries has unnecessarily limited the scope of possible reforms.[2] Once we dispense with that assumption, and extend tax policy analysis to include a reconsideration of jurisdictional boundaries along with tax design, a broader range of reform options comes into focus.

This article considers one class of reforms situated at the underexplored intersection of tax policy and governance structure—i.e., those involving regional approaches to funding subnational public goods. More precisely, the situations I wish to examine are those where policymakers turn to new multijurisdictional fiscal arrangements to address regional objectives that conventional local governments, by virtue of their more limited geographic scope, are unlikely to tackle. As used in this article, the term "region" refers to a geographic area (1) constituting less than the entire jurisdiction of a state, and (2) encompassing more than one local

1. *See, e.g.,* STATE AND LOCAL FISCAL POLICY: THINKING OUTSIDE THE BOX? STUDIES IN FISCAL FEDERALISM AND STATE-LOCAL FINANCE (ed. Sally Wallace 2010).

2. This is not to suggest, of course, that there is a shortage of commentary on useful reforms, but rather that the reforms considered typically involve modifying policies of existing jurisdictional units. Consider, for example, the writings of David Brunori, a leading commentator on U.S. state and local tax policy. *See* David Brunori, LOCAL TAX POLICY, A FEDERALIST PERSPECTIVE (Urban Institute Press 2003); David Brunori, STATE TAX POLICY: A PRIMER (Urban Institute Press 2016).

government jurisdiction or portions of multiple jurisdictions. A "regional tax" is therefore any tax (fee, assessment, etc.…) limited in its application to a geographic area so defined. As discussed further below, a closely related policy is "regional tax base sharing"—i.e., the imposition of a tax on a base that is shared among several local jurisdictions, with the proceeds distributed among those localities.[3]

One distinction between these two approaches lies in the nature of the expenditures financed. Regional taxes are typically imposed for the purpose of funding a specific regional public good. In the contemporary U.S. setting, the most common regional tax is the multicounty sales tax imposed to fund metropolitan mass transit systems.[4] By contrast, regional tax base sharing entails no particular regional expenditure but rather a distribution of regional tax revenues to local governments within the region. Both approaches can be understood as governance reforms that reconfigure the vertical division of fiscal responsibilities, a longstanding preoccupation in the branch of fiscal federalism research concerning tax and expenditure assignment. Here, however, rather than assigning fiscal responsibilities to pre-specified units of government, we are adjusting boundaries to alter the geographic scope of fiscal responsibilities.

There are numerous instances of regional taxation and regional tax base sharing across the U.S. subnational public finance landscape. In the sections that follow, I examine several examples of these two forms of regional fiscal innovation, illustrating how each advances or departs from normative principles developed in the literature on fiscal federalism. Some of these examples are familiar to a tax policy audience (such as the Minneapolis-St. Paul tax base sharing system), while others are less well known (such as the Denver Scientific and Cultural Facilities District). In most cases, the fiscal arrangement examined governs multiple counties spanning an entire metropolitan region. For this reason, many of these regional tax structures have garnered the attention of scholars interested in developing alternative institutions of regional governance for metropolitan

3. To be sure, alternative definitions are certainly possible. For example, one particularly intriguing possibility would be to consider how we might encourage new "regional" tax policies involving two or more states, such as a carbon tax adopted by multiple states and implemented via interstate compact. While intriguing and worthy of additional study, such institutional arrangements are beyond the scope of this article.

4. *See* discussion *infra* Part III.A.

areas.[5] If these ambitious plans for more robust institutions of metropolitan governance are ever to come to fruition, regional tax policies will likely be necessary to ensure their viability.

The remainder of this article is organized as follows. Part II provides a conceptual framework, situating regional tax arrangements within the theoretical literature on fiscal federalism relating to optimal jurisdiction size and tax/expenditure assignment. In order to give some sense of the types of arrangements already in place, Part III describes a handful of key examples of regional taxation and regional tax base sharing in operation throughout the United States. As we will see, regional taxes have emerged in several metropolitan areas, typically in connection with metropolitan transit funding and, more recently, regional cultural asset districts. The policy of regional tax base sharing is much less common, but the Minneapolis-St. Paul fiscal disparities program has been extensively studied, if not widely replicated. As a result, we have the benefit of a good deal of academic wisdom on this policy, which will be briefly summarized. Finally, Part IV considers possible extensions of these policies, discussing how regional taxes or regional tax base sharing might figure in state tax reform efforts in the future, with a particular focus on recent developments and reform options in California.

I. FISCAL FEDERALISM AND THE BOUNDARY PROBLEM

Much of the theoretical work in fiscal federalism and multilevel public finance concerns the division of fiscal responsibilities among different levels of government. An important subset of this literature examines questions of expenditure assignment and tax assignment—that is, which spending obligations and which funding instrument should be assigned to which levels of government.[6] There is a logical tendency in this literature to trifurcate the division of fiscal responsibilities among central,

5. DAVID Y. MILLER & RAYMOND W. COX III, GOVERNING THE METROPOLITAN REGION: AMERICA'S NEW FRONTIER (2014).

6. Richard M. Bird, *Rethinking Subnational Taxes: A New Look at Tax Assignment*, 20 TAX NOTES INT'L, 2069-96 (2000); Richard A. Musgrave, *Who Should Tax, Where, and What?*, *in* TAX ASSIGNMENT IN FEDERAL COUNTRIES (Charles E. McLure, Jr. ed., 1983); ROBIN BROADWAY & ANWAR SHAH, FISCAL FEDERALISM: PRINCIPLES AND PRACTICE OF MULTIORDER GOVERNANCE 133 (2009).

intermediate, and local jurisdictions, an organizing scheme that fits standard practice in most of the world's federations, including the United States.[7] Indeed, the word "assignment" itself implies a preexisting set of potential assignees among which those responsibilities are to be divided.

At a higher level of abstraction, however, the assignment question can be recast as how best to configure fiscal responsibilities across geographic space, with an infinite number of choices lying along a continuum rather than simply three levels of government. This is admittedly something of an artificial, semantic distinction, but framing the question this way helps to remind us of the foundational nature of the exercise. Boundaries are of course human constructs and subject to revision. Jurisdictions can be merged, annexed, dissolved, newly created, etc., and these boundary adjustment devices are therefore available for use as part of the fiscal policy toolkit.[8] Thus, the question is not just one of assignment but also, potentially, one of specifying new or different boundaries. That is, for any given set of public goods and tax instruments, what is the most appropriate specification of boundaries? And what principles should guide us in answering that question?

The theoretical literature on fiscal federalism provides a framework for addressing these questions. In his classic treatise on fiscal federalism, Wallace Oates captures the essence of the boundary problem through the development of his "correspondence principle."[9] In the simplest case, the Oates analysis suggests that the optimal structure of federalism is that "in which the jurisdiction that determines the level of provision of each public good includes precisely the set of individuals who consume the good"—i.e., "a case of *perfect correspondence* in the provision of public goods."[10]

But the simplest case is quickly complicated by factors such as preference heterogeneity, interjurisdictional spillovers, and cost differences associated with public goods provision at different levels of aggregation. As Oates explains, where there is local variation in

7. See, e.g., Charles E. McLure, Jr., *The Tax Assignment Problem: Ruminations on How Theory and Practice Depend on History*, 54 NAT'L TAX J. 339, 340 (2001).
8. *See, e.g.*, David Rusk, *Annexation and the Fiscal Fate of Cities*, THE BROOKINGS INSTITUTION, METROPOLITAN POLICY PROGRAM (Aug. 2006), https://www.brookings.edu/wp-content/uploads/2016/06/20060810_fateofcities.pdf (discussing the fiscal effects of boundary modification via annexation).
9. WALLACE E. OATES, FISCAL FEDERALISM 31-53 (1972).
10. *Id.* at 34. (emphasis added).

preferences regarding the level of public goods, and no difference in cost between central and local provision, centralized provision is likely to be suboptimal. This "decentralization theorem" provides a theoretical basis for local provision of public goods without regard to the effect of taxpayer mobility considered in the Tiebout model. At the same time, however, Oates emphasizes that there are likely benefits associated with the provision of public goods at a higher level of government, either from economies of scale or in limiting the interjurisdictional spillovers associated with decentralized provision.[11] In combination, these factors suggest a tradeoff between, as Fisher puts it, "having governments big enough to avoid cost or benefit spillovers but small enough to allow uniform desired amounts of public service."[12]

It is apparent from this formulation of Oates' principle that the existence or degree of correspondence between boundaries and benefits is heavily dependent on the spatial characteristics of the particular public good in question.[13] Each public good likely has its own spatial characteristics, ranging from purely local to purely global.[14] In theory, there is an optimal fiscal arrangement that is unique to each public good. As Mancur Olson notes in his discussion of "fiscal equivalence"—a concept with close parallels to Oates's correspondence principle—"there is a need for a separate governmental institution for every collective good with a unique boundary, so that there can be a match between those who receive the benefits of a collective good and those who pay for it."[15]

Taken to its logical extreme, one could imagine separate governments for each and every local public good, all of them with their own unique boundaries set to match the population of beneficiaries as closely as

11. *Id.*
12. RONALD C. FISHER, STATE & LOCAL PUBLIC FINANCE 125 (4th ed. 2015).
13. Vito Tanzi emphasizes this point in an insightful 1996 essay on the subject. *See* Vito Tanzi, *Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects*, *in* 1995 ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 295, 298-299 (1996).
14. In practice, public goods rarely fit neatly into the categories of "purely local" or "purely global." Nevertheless, some public goods are more local in nature while others have a global dimension. In the former category we might include an access road that enables residents of a particular locality to reach a particular area, while an example of the latter would be projects designed to mitigate the effects of climate change.
15. Mancur Olson, Jr., *The Principle of "Fiscal Equivalence": The Division of Responsibilities Among Different Levels of Government*, 59 AM. ECON. REV. 479, 483 (1969).

possible. This multiplicity of function-specific local governments, or something approximating it, seems to be at the heart of a concept developed by Swiss economists Reiner Eichenberger and Bruno Frey, who envision a system of "Functional, Overlapping and Competing Jurisdictions" (FOCJ) for local public goods.[16] As Eichenberger and Frey explain, jurisdictional boundaries must be sufficiently flexible to adapt to the "geography of problems."[17] In the U.S. setting, the current mix of general purpose cities and counties, along with numerous function-specific special districts (ranging from school districts to goose pond maintenance) seems to capture something of a middle ground.

For purposes of the present analysis, the key theoretical insight from both Oates and Olson is that public goods should be provided by a government whose jurisdictional boundaries correspond, to the maximum degree practicable, with the population of individuals likely to benefit from their provision (subject to the countervailing considerations regarding interjurisdictional spillovers and economies of scale). In addition, these same groupings should, in theory, generally be responsible for financing the public goods they receive, so as to ensure as tight a linkage as possible between burden and benefit. All of these theoretical insights are subject to the caveat that history, politics, and administrative practicalities are likely to exert a strong influence on real-world arrangements. Nevertheless, attention to these principles in crafting fiscal policy should exert some general pressure in the direction of an optimal level of public goods, as well as a minimization of jurisdictional spillovers.

Once a determination is made regarding the proper geographic scope of public goods provision, we are still left with the question of how best to finance those goods. This is the question of tax assignment or, as Musgrave put it, "Who should tax, where, and what?"[18] A vast literature

16. Bruno Frey, *Functional Overlapping, Competing Jurisdictions: Redrawing the Geographic Borders of Administration*, 5 EUR. J.L. REFORM 543, 546 (2003); Reiner Eichenberger & Bruno S. Frey, *Functional, Overlapping, and Competing Jurisdictions (FOCJ): A Complement and Alternative to Today's Federalism*, *in* HANDBOOK OF FISCAL FEDERALISM 154–81 (Ehtisham Ahmad & Giorgio Brosio eds. 2006).

17. Reiner Eichenberger and Bruno S. Frey, *Democratic Governance for a Globalized World*, 55 KYKLOS 265, 267 (2002).

18. Musgrave, *supra* note 6.

spanning several decades has examined these questions, but the insights of that work is perhaps best summarized by the following three principles offered by Oates:

> (1) Lower levels of government... should, as much as possible, rely on benefit taxation of mobile economic units, including households and mobile factors of production.
>
> (2) To the extent that non-benefit taxes need to be employed on mobile economic units, perhaps for redistributive purposes, this should be done at higher levels of...government; and
>
> (3) To the extent that local governments make use of non-benefit taxes, they should employ them on tax bases that are relatively immobile across local jurisdictions.[19]

One distressing implication of these principles is that the choice of tax instruments for local governments is extremely circumscribed. The only tax instruments regarded as suitable for local utilization are property taxes and user fees[20] In practice, of course, local governments rely on a much broader array of taxes, including income and sales taxes, as well as other miscellaneous taxes.[21] The fact that we observe local taxes other than user fees and property taxes is not necessarily inconsistent with standard principles of tax assignment. For example, reliance on local income taxes may reflect a local preference for some measure of redistribution.[22] Over the long term, however, systematic deviation from these principles is likely to result in various costs such as an erosion of the tax base through interjurisdictional competition and corresponding distortions in firms'

19. Wallace E. Oates, *Taxation in a Federal System: The Tax-assignment Problem*, 1 PUB. ECON. REV. 35 (1996), *quoted in* Richard M. Bird, *Rethinking Subnational Taxes: A New Look At Tax Assignment*, 20 TAX NOTES INT'L 2069, 2070 (2000).
20. Bev Dahlby, *Taxing Choices: Issues in the Assignment of Taxes in Federations*, 167 INT'L SOC. SCI. J. 93 (2001).
21. For a sense of the variety of taxes relied upon by local governments, see Christine R. Martell & Adam Greenwade, *Profiles of Local Government Finance*, *available in* THE OXFORD HANDBOOK OF STATE AND LOCAL GOVERNMENT FINANCE 184 (eds. Robert D. Ebel & John E. Petersen 2012).
22. Mark V. Pauly, *Income Redistribution as a Local Public Good*, 2 J. PUB. ECON. 35 (1973); Michael Craw, *Deciding to Provide: Local Decisions on Providing Social Welfare*, 54 AM. J. POL. SCI. 906 (2010); Michael Craw, *Caught at the Bottom? Redistribution and Local Government in an Era of Devolution*, 47 STATE & LOCAL GOV'T REV. 68 (2015); CLAYTON GILLETTE, LOCAL REDISTRIBUTION AND LOCAL DEMOCRACY (Yale Univ. Press 2011)

locational decisions.[23]

In keeping with the perspective noted earlier—i.e., that boundary adjustments can be utilized as an alternative to "assigning" fiscal responsibilities to pre-specified units of government—we can augment Oates's three principles of tax assignment to include *boundary adjustment* as a method by which to manipulate the "local-ness" of any given tax. In Oates' language, there are "lower levels of government" and "higher levels of government" and the decision-making axis concerns the question of which taxes should be assigned to which level.[24] An alternative approach, however, is to specify some revenue instrument and then to craft geographic boundaries that provide the best "fit" for that revenue source.

One can almost imagine setting fiscal boundaries via a computerized zoom function, zooming in or out over a given metropolitan region to capture the appropriate geographic scope of different tax instruments. Enlarging the geographic scope of the jurisdiction, from local to regional, alters certain factors that would ordinarily be considered in making tax assignment judgments. In a regional setting, taxpayers will have fewer exit options as compared to a local setting, and interjurisdictional competition is correspondingly diminished. These are not necessarily positive attributes of regional taxation in every case; the pros and cons of regionalization are likely to vary by the specific tax under consideration. The important point here is that there is value in configuring the geographic scope of a particular tax that is wholly independent of the geographic characteristics of the public goods or services being financed. Regardless of what is being funded, some taxes are better suited for use within more confined geographic areas (e.g., property taxes) while other taxes are better suited for use across larger areas (e.g., corporate income taxes).

A similar point is developed, albeit without specific reference to regional taxes, in Oates's discussion of the value of *tax harmonization* among decentralized units of government. Tax harmonization is the conceptual equivalent of a boundary modification that encompasses all the

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23. *See, e.g.*, Andrew Haughwout et al., *Local Revenue Hills: Evidence from Four U.S. Cities,* 86 REV. ECON. & STAT. 570 (2004).
24. *See* Oates, *supra* note 19; *see also* Wallace Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120, 1121, 1126 (1999).

jurisdictions whose taxes are harmonized. For example, consider a region that consists of four jurisdictions that each impose a wage tax but with different rates and different base definitions. In such a context, it would be reasonable to expect taxpayers to make decisions regarding which jurisdiction to live or work in based on these differences in tax rates and tax base. However, if a rule is adopted requiring harmonization of tax rates and bases among these jurisdictions, taxpayers will no longer have the ability to change the tax rate or base rule to which they are subject by opting for a particular jurisdiction (since all tax rates and bases are now, by assumption, identical). Of course, this would also be true if the region as a whole simply adopted a single, uniform income tax and distributed the revenues among the four jurisdictions.

As this example illustrates, a fully harmonized tax system, with no interjurisdictional variation in the rate or base, is the functional equivalent of a centralized tax coupled with a system of intergovernmental grants where the grants are distributed among the subunits based on a source principle. The act of legal harmonization involves subsuming the sovereign prerogatives of those jurisdictions whose taxes are harmonized, with the taxpayer left facing a legal regime indistinguishable from a single centralized tax. There are many benefits to such harmonization, especially in the case of taxes on mobile economic actors. Most significantly, under a fully harmonized tax system, individuals and firms would no longer have an incentive to migrate on account of interjurisdictional tax differences. In addition, because taxpayers face only one set of rules, harmonizing taxes across jurisdictions promotes administrative simplicity, easing compliance burdens. On the other hand, in a regime of tight harmonization the potential efficiency benefits derived from respecting preference heterogeneity as to local tax burdens is lost. This is an inescapable downside of requiring tax harmony across jurisdictions as taxpayers can no longer choose from a variety of local tax regimes. The challenge of fiscal policy in a multijurisdictional setting is finding the optimal balance between local fiscal autonomy (promoting variety and choice) and centralized coordination (minimizing the costs associated with variety and choice). Fiscal arrangements involving regions—again, defined here as a jurisdiction encompassing less than an entire state but more than one local jurisdiction—provide an additional tool for policymakers to strike that balance.

II. EXAMPLES OF REGIONAL TAXATION IN U.S. SUBNATIONAL PUBLIC FINANCE

Local government in the United States typically features both general-purpose governments, which include cities and counties, and several function-specific special districts, the most common being the K-12 school district.[25] As explained below, regional tax arrangements have emerged in both settings—i.e., (1) through the establishment of region-wide special districts given independent taxing authority, and (2) through coordinated taxing arrangements involving multiple general-purpose governments.

A. Taxes Imposed by Regional Transit Districts

Regional tax arrangements are most prevalent in the area of transportation finance. Historically, public transportation projects in the United States were financed by local property taxes. Because of the relationship between transportation projects and land values, the property tax served as a type of benefit tax on local landowners. This tight connection between burdens and benefits in transportation tax policy began to erode in the early 20th century as technological, political, and fiscal changes shifted the landscape of U.S. transportation finance. Goldman and Wachs identify the introduction of the automobile in the 1920's as the key development triggering state and federal involvement in transportation finance.[26] Over the ensuing half-century a complex web of intergovernmental partnerships emerged to handle the construction and maintenance of highways, streets, roads, and mass transit systems. During this period user fees (including tolls/fares, motor fuel taxes, vehicle license fees, truck weight charges) came to dominate transportation finance, though by the late 20th century these sources could no longer keep pace

25. Special districts are such a pervasive feature of the modern U.S. local government setting that John Oliver devoted an entire segment to the subject on his HBO show, *Last Week Tonight*. *See* Melissa Locker, *John Oliver Dedicates a Special Episode of Last Week Tonight to Special Districts*, TIME (Mar. 7, 2016), time.com/4249255/john-oliver-last-week-tonight-special-districts.
26. Todd Goldman & Martin Wachs, *A Quiet Revolution in Transportation Finance: The Rise of Local Transportation Taxes*, 57 TRANSP. Q., Winter 2003, at 19, 19.

with spending demands. To fill that funding gap, many states and localities turned to local option sales taxes, most commonly approved via local ballot initiative and earmarked for specific transportation projects.[27] Goldman and Wachs describe this development as a "quiet revolution" in transportation finance, noting that various types of local option taxes, but mostly sales taxes, have now supplanted the previous user fee model.[28] Local option taxes—typically though not always sales taxes—are now a major feature of transit agency finance, accounting for 28% of operating funds (second only to fares) and 33% of capital funds (second only to federal assistance).[29]

This increased reliance on local option sales taxes to fund transportation projects has been accompanied by related developments in transportation federalism. In 1962, as part of the Federal-Aid Highway Act, Congress required the states to establish Metropolitan Planning Organizations (MPOs) to coordinate and prioritize transportation projects financed with federal tax dollars.[30] Congress later significantly expanded the power and responsibilities of MPOs through the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA).[31] These regional entities now play a central role in regional transportation planning, though they typically have no independent taxing authority but rather channel federal resources to local projects. These two developments—the rise of local option sales tax funding and the enhanced role of the federally-mandated MPO—have given rise to a mismatch between funding and governance. While the taxes to finance metro-level transportation projects are derived increasingly from fragmented local jurisdictions, federal law explicitly requires a planning process that takes account of regional-metropolitan needs.

The regional sales taxes adopted in several metropolitan regions can be viewed as an effort to address that mismatch – i.e., a step in the direction

27. *Id.* at 19-20.
28. *Id.*
29. OFFICE OF BUDGET & POLICY, U.S. DEP'T OF TRANSP., TRANSIT PROFILES: 2013 REPORT YEAR SUMMARY (2014).
30. The history of the establishment of metropolitan planning organizations is usefully recounted in a 1988 Department of Transportation report, the most relevant excerpts of which are available on the website of the Association of Metropolitan Planning Organizations. *See A Brief History*, ASS'N METROPOLITAN PLANNING ORGS., www.ampo.org/about-us/about-mpos/ (last visited Mar. 3, 2019).
31. Robert W. Gage & Bruce D. McDowell, *ISTEA and the Role of MPOs in the New Transportation Environment: A Midterm Assessment* 25 PUBLIUS 133 (1995).

of developing a metropolitan fiscal structure more in keeping with the coordinated regional planning process envisioned by federal transportation law. Multi-county transportation taxes are now in place in numerous metropolitan regions, including Chicago (covering 6 counties), Denver (covering 8 counties), Portland (covering 3 counties), San Francisco (covering 3 counties), and Seattle (covering 3 counties), to name just a few. The regional tax adopted to fund the Seattle transit district—the Central Puget Sound Regional Transit Authority (i.e., Sound Transit)—raises several interesting issues about regional taxation more generally.

Sound Transit operates the regional mass transit system spanning King, Snohomish, and Pierce counties in Washington, an area that accounts for nearly half of the state's population.[32] Its services include light rail, commuter rail, and a regional express bus system, as well as the construction and maintenance of other transit-related facilities (e.g., HOV lanes, transit stations).[33]

The district was established by legislation enacted by the Washington state legislature in 1992.[34] This legislation was based on a finding that a single agency spanning all three counties was necessary to address the mobility needs of the region's growing population.[35] Among other things, Sound Transit's enabling legislation transferred governmental powers previously vested in local governments to the new multicounty district, including the power to impose a variety of new taxes for transportation purposes.[36]

The Seattle experience with Sound Transit provides a useful illustration of the value of regionalizing the provision and financing of an important public good. It is an example of a community responding to the changing "geography of problems" by devising alternative jurisdictional arrangements more suited to the task at hand. The formation of a new

32. *See infra* Figure 1.
33. SOUND TRANSIT 3: THE REGIONAL TRANSIT SYSTEM PLAN FOR CENTRAL PUGET SOUND (June 2016) (at https://st32.blob.core.windows.net/media/Default/Document%20Library%20Featured/8-22-16/ST3_System-Plan_2016_web.pdf)
34. WASH. REV. CODE ANN. § 81.112 (2018).
35. SOUND MOVE: LAUNCHING A RAPID TRANSIT SYSTEM FOR THE PUGET SOUND REGION (1996) (a photo image of the original 1996 document is available at https://www.soundtransit.org/sites/default/file s/documents/199605-sound-move-ten-year-regional-transit-system-plan.pdf)
36. WASH. REV. CODE ANN. § 81.112.100 (2018).

multi-county district with independent taxing powers marks a recognition that existing local governments, with their more circumscribed geographic scope, were not equipped to meet the demands of providing this new public good (i.e., coordinated region-wide public transportation). Likewise, the state government, whose geographical boundaries encompass territory beyond the affected region, lacks the necessary correspondence with the benefitted area.

Initially Sound Transit relied on three separate regional taxes to fund its operations, including a 0.9% sales tax, a 0.8% rental car tax, and a 0.3% motor vehicle tax (MVET). As required by state law, all of Sound Transit's taxes have been approved by voters in the three participating counties at elections held in 1996 (approval of the "Sound Move" transit plan) and 2008 (approval of the "Sound Transit 2" plan). In addition, as part of the "Sound Transit 3" plan approved in November 2016, voters adopted a new regional property tax.[37] In combination, these four taxes generated roughly $1.5 billion in revenue for Sound Transit in 2017 with the regional sales tax constituting over $1.1 billion of that amount.[38]

The purpose of these taxes is, of course, to fund the regional transit operations of the organization. Interestingly, however, each of the Sound Transit plans for the use of these revenues has incorporated a requirement of "subarea equity" according to which tax revenues must be used "for projects and services which benefit the subareas generally in proportion to the level of revenues each subarea generates."[39] A Harvard case study detailing the political history of Sound Transit explains that this requirement was a "controversial, but arguably essential, compromise" to ensure approval of the original transit plan in November 1996.[40] All subsequent iterations of the Sound Transit plan approved by voters,

37. PAYING FOR REGIONAL TRANSIT: VOTER-APPROVED TAXES THAT PAY FOR NEW TRANSIT, *available at* https://www.soundtransit.org/get-to-know-us/paying-regional-transit).

38. DRAFT TRANSIT DEVELOPMENT PLAN 2018-2023 AND 2017 ANNUAL REPORT (2018) (see Table VIII at page 26).

39. This language was included as a component of the original 1996 proposal, titled "Sound Move" (*supra* note 34). For a discussion of this background, see page 4-5 of Central Puget Sound Regional Transit Authority, 2016 Financial Plan (June 2016) (at https://www.soundtransit.org/sites/defaultt/files/ 2016-Financial-Plan.pdf)

40. SUSAN ROSEGRANT, HARVARD UNIVERSITY, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, SOUND MOVE (A): THE DEBATE OVER SEATTLE'S REGIONAL TRANSIT SYSTEM 10 (2001).

including ST3 in November 2016, have included the same subarea equity provision. Under the terms of this proviso, the entire transit region is divided into five subareas consisting of Snohomish County, Seattle/North King County, East King County, South King County, and Pierce County. The district is required to fund projects for each subarea reflecting its contribution to tax revenues, unless the district's board of directors suspended the requirement by a two-thirds vote.[41] An annual "Subarea Equity Report" provides a detailed accounting specifying the geographic sources and uses of Sound Transit funds by subarea.[42]

Sound Transit's subarea equity rule reflects the powerful political pull of what some have called a "return to source" principle, whereby revenues generated in a particular geographic area are channeled to projects specifically benefitting that area.[43] The role such a principle should play in regional taxing arrangements is not self-evident. On the one hand, a return to source approach might be justified on the basis that it establishes a stronger burden-benefit linkage, ensuring that each subarea's tax burden more closely approximates price-like "benefit taxes." Reliance on benefit taxes is one of the hallmark features of an efficient system of local public finance.[44] To the extent that local tax burdens deviate from the benefit principle, mobile economic units are more likely to respond by relocating to a jurisdiction that offer more advantageous pricing of local public goods.[45]

On the other hand, returning locally-generated taxes to the communities that generate them arguably defeats the purpose of undertaking projects at a regional level. If the purpose of establishing *regional* taxes is to fund *regional* public goods, then directing tax proceeds according to a "return

41. *Id.*
42. KPMG, CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY: SCHEDULE OF SOURCES AND USES OF FUNDS BY SUBAREA, YEAR ENDING DECEMBER 31, 2014 (2015); KPMG, CENTRAL PUGET SOUND REGIONAL TRANSIT AUTHORITY: SCHEDULE OF SOURCES AND USES OF FUNDS BY SUBAREA, YEAR ENDING DECEMBER 31, 2015 (2016).
43. For a useful discussion of return-to-source equity concepts in the transportation finance setting, see Alan Altshuler, *Equity, Pricing, and Surface Transportation Politics*, 46 URB. AFF. REV.155 (2010).
44. Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).
45. Keith Dowding et al., *Tiebout: A Survey of the Empirical Literature*, 31 URB. STUD. 767 (1994).

to source" principle seems counter to that rationale.[46] In addition, in the particular case of Sound Transit, the bottom line effect of the subarea equity was, at least according to some, very regressive. For example, Greg Nickels, one of the key participants involved in the formulation of the plan, noted that the chief beneficiary of subarea equity was East King County, which includes some of the most affluent communities in the region. Nickels noted that "East King County has a very healthy tax base, people are buying BMWs all the time, so they have lots of motor vehicle tax money. But you can't use that financial strength for any other place but East King County."[47] Whatever the merits of the subarea equity principle in theory, as a practical matter it appears that it was essential to the program's passage. The inclusion of this requirement as part of the voter-approved transit plan suggests that voters were sufficiently wary of ongoing distributive conflicts within the region that a constitutional principle was perceived to be necessary to secure the plan's approval.

Ensuring compliance with Sound Transit's principle of subarea equity has not been without controversy, as evidenced by news headlines such as "The Inequity of Sound Transit Subarea Equity"[48] and "Subarea Equity: A Stupid Policy is a Stupid Policy is a Stupid Policy."[49] Of course, few issues in local politics ever escape this kind of sophomoric sniping. The point is to illustrate the practical and political difficulty in carrying out any new regional taxing arrangement. The subarea equity requirement might suggest political acceptance of Olson's principle of fiscal equivalence[50]—

46. Sound Transit's subarea equity principle, where a portion of the tax revenue is required to be returned to the geographic areas that contributed it, stands in contrast to the "local return" program of the Los Angeles Metro system. Under the LA Metro's local return program, 25% of revenue must be returned to local governments for local projects, but that revenue is distributed among local governments according to population rather than based on a determination regarding the source of the revenue. *See* LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY, LOCAL RETURN PROGRAM: ENHANCING TRANSPORTATION IN OUR CITIES, COMMUNITIES & LOCAL NEIGHBORHOODS (June 2016), http://media.metro.net/projects_studies/local_return/images/report_localreturn_2016-06.pdf

47. ROSEGRANT, *supra* note 39, at 10.

48. James W. MacIsaac, *The Inequity of Sound Transit Subarea Equity*, EASTSIDE TRANSP. ASS'N (June 11, 2011), http://www.eastsideta.com/docs/The%20Inequity%20of%20Sound%20Transit%20Subarea%20Equity.pdf

49. Goldy, *Subarea Equity: A Stupid Policy Is a Stupid Policy Is a Stupid Policy*, THE STRANGER (April 25, 2013), https://www.thestranger.com/slog/archives/2013/04/25/a-stupid-policy-is-a-stupid-policy-is-a-stupid-policy.

50. *See* Olson, *supra* note 15.

transit projects should be undertaken to ensure that each subarea gets as much back as it puts in—but deviations from that principle (as well as *perceived* deviations) reveal the continuing influence of sub-regional political dynamics in devising new regional fiscal institutions.

In summary, the Seattle region's experience with Sound Transit reveals both the promise and complications of regional taxing arrangements. Most observers seem to agree that the region-wide public benefits of a metropolitan transit system are substantial. A recent poll of the region's voters undertaken by EMC Research shows that support for giving Sound Transit additional taxing authority for expanded projects is at an all-time high.[51] The District's new plan, ST3, which appeared on the ballot in November 2016, was approved by 54 percent of voters in the three counties. While the measure was approved on the required district-wide basis, including approval by 58 percent in King County and 52 percent in Snohomish County, it bears noting that 56 percent of voters in Pierce County rejected ST3.[52] This observation draws attention to the fact that, by reconfiguring boundaries, regional measures also reconstitute the possibilities for political support, perhaps creating opportunities for a type of "fiscal gerrymandering" to ensure passage. The possibility of redrawing fiscal borders carries with it the opportunity to include or exclude those who favor or oppose fiscal measures proposed to be undertaken.

The Sound Transit experience—especially with respect to ongoing conflicts regarding the subarea equity requirement—reveals that regional taxing arrangements are unlikely to eliminate inter-local fiscal conflict, but rather simply channel that conflict through new political institutions.

B. Taxes Imposed by Regional Cultural Asset Districts

While regional taxes are most commonly observed in the context of

51. Adam Lynn, *New Long Term Taxes Would Pay for Sound Transit Expansion*, TACOMA NEWS TRIBUNE (Apr. 16, 2016), www.wsdot.wa.gov/partners/erp/background/newsclips_re_ST3_April-May2
016.pdf

52. *Washington Proposition 1 – Sound Transit 3 Builds 62 Miles of Light Rail – Results Approved*, N.Y. TIMES (Aug. 1, 2017), http://www.nytimes.com/elections/2016/results/washington-ballot-measure
-1-sound-transit-3.

metropolitan transit funding, it is not the only area where these taxes have emerged. More recently, a small number of metropolitan regions have begun to rely on region-wide taxes to fund so-called "cultural assets" such as museums, theaters, and zoos. So-called "cultural tax districts" have been established in metropolitan areas of Denver, Portland, St. Louis, Salt Lake City, and a handful of other, smaller jurisdictions.[53] The emergence of these new regional districts is interesting in part because they shed light on a concept from the theoretical public finance literature known as the "zoo effect." Oates describes the zoo effect through the following simple example:

Suppose that the annual cost of a municipal zoo is $1 million. Suppose further that the willingness to pay of each individual for 'zoo services' is $1 per annum. If local fiscal choices are made efficiently, we would expect to find jurisdictions with populations in excess of 1 million providing zoos, while jurisdictions with populations under 1 million would not deem it worthwhile to have a zoo.[54]

The Denver experience provides a useful illustration of this phenomenon. In 1987, the Colorado legislature enacted legislation authorizing the establishment of a Scientific and Cultural Facilities District (SCFD) that would cover seven counties through the Denver metropolitan area.[55]

The idea of establishing a region-wide cultural asset district emerged in the wake of budget cuts in 1981 that jeopardized the continued operation of several city-operated cultural institutions—the Denver Art Museum, the Denver Zoo, the Museum of Natural History, the Denver Center for the Performing Arts, and the Denver Botanic Gardens. Prior to the formation of the SCFD, each of these institutions was financed through user fees and tax revenue from the City of Denver.[56] By contrast, the SCFD enabling legislation authorizes the imposition of a region-wide sales tax, applicable

53. For a review of the experience with cultural tax districts in select cities, see VANDERBILT CENTER FOR NASHVILLE STUDIES, CULTURAL TAX DISTRICT: A REVIEW AND ANALYSIS OF CURRENT IMPLICATIONS (2010), *available at* https://www.vanderbilt.edu/vcns/Cultural_Tax_Report.pdf.

54. Wallace Oates, *On the Measurement of Congestion in the Provision of Local Public Goods*, 24 J. URB. ECON. 85, 88 (1988).

55. *See infra* Figure 2.

56. See *Why Was SCFD Created?*, SCIENTIFIC & CULTURAL ACTIVITIES DISTRICT, scfd.org/blog-entry/49/2014-05-22-why-was-scfd-created.html (last visited Mar. 3, 2019).

across all seven counties, and subject to approval by voters in the entire district.[57]

One possible explanation for the emergence of the SCFD as a regional solution derives from the "zoo effect" noted above. In the standard narrative of SCFD's formation, the budget cuts of the early 1980s are portrayed as an exogenous factor that threatened the viability of the city's key cultural institutions. But another interpretation is that city residents no longer valued these local "cultural services" at a high enough level to support their continued existence. Put differently, for whatever reason (economic recession, changing voter preferences for public goods, etc.), the average Denver voter's willingness to pay for these public goods dipped below the critical threshold required for public provision to make sense. Rather than terminating the programs, policy entrepreneurs formulated an alternative approach enlarging the boundaries of the taxing jurisdiction so as to reduce per capita cost of the providing the public good.

In 1994 and 2004, SCFD voters approved a sales tax of 0.1% to support SCFD funding. The tax currently generates just over $50 million per year in revenue that is allocated through a three-tiered system that differentiates among small, medium, and large recipients. From the outset, the SCFD funding formula has largely favored the large "Tier I" entities constituting the key Denver-based cultural facilities. These organizations receive roughly two-thirds of all SCFD funding. This approach is not surprising, as it was the preservation of these facilities that motivated the creation of the SCFD in the first place. Nevertheless, this allocation arrangement has come under criticism in recent years, in part due to demands from constituencies outside of Denver who feel that the allocation formula favors the City of Denver over other parts of the region. In effect, these groups are pushing for a "return to source" principle for revenue sharing similar to the "subarea equity" requirement in operation in Seattle's Sound Transit district. While the SCFD is not subject to a formal requirement like the Sound Transit, the 2016 reauthorization of the District and its sales tax prompted public debate about the allocation formula.[58] Under the terms of

57. COLO. REV. STAT. ANN. § 32-13 (1987).
58. Maggie Hodge Kwan, *Denver's Contentious Arts and Culture Funding Splinters Community*, NONPROFIT Q. (Aug. 24, 2015), https://nonprofitquarterly.org/2015/08/24/denvers-contentious-arts-

the 2016 reapproval, Tier II and Tier III organizations (chiefly outside Denver) received significantly greater resources.

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The examples of regional taxation discussed above illustrate how different communities, facing complex questions about whether and how to provide certain public goods, have grappled with the question of scale and the geographic scope of tax policy. Should these goods be provided at the local level? Or is a regional approach more appropriate? These are difficult question even from a theoretical perspective, involving, as they must, factors such as preference heterogeneity, economies of scale, and interjurisdictional spillovers. The Seattle and Denver examples illustrate that the reality on the ground is substantially "messier" than the elegant world of theory since it involves myriad other variables. Nevertheless, the examples reveal the powerful pull of concepts such as Oates' correspondence principle and Olson's principle of fiscal equivalence. By broadening the scope of fiscal benefits and burden to the regional level, these communities are aiming for a tighter fit between burden and benefit. For the specific public goods in question, local governments are either unable or unlikely to provide the financing, while state-wide constituencies are often too broad and diverse to ensure political support. Regional arrangements constitute an intermediate approach where the geographic parameters offer a better fit with the spatial characteristics of the services in question.

While the motivation for the regional districts discussed above was to fund particular public goods, the arrangements also shed light on the question of "tax harmonization." By definition, a financing scheme consisting of a single region-wide tax exhibits greater uniformity than one that relies on separate local taxes to provide local public goods. Individuals or firms who might have changed their behavior in response to inter-local variation in tax burdens, whether through locational decisions

and-culture-funding-splinters-community/?utm_source=email&utm_medium=social&utm_campaign=SocialWarfare; Mark Ray Rinaldi, *Colorado Arts Groups Take Sides in a Battle Over Millions in Funding*, THE DENVER POST (Aug. 31, 2015), https://www.denverpost.com/2015/08/30/colorado-arts-groups-take-sides-in-a-battle-over-millions-in-funding/.

or otherwise, face a diminished opportunity set in world of regional taxes. Their choice now is among regions rather than among localities. This feature is not unique to regional tax arrangements funding regional public goods but is also present (though perhaps to a lesser degree) in the case of regional tax base sharing.

C. Regional Tax Base Sharing

A close cousin to regional taxation is regional tax base sharing. The chief distinction between the two types of arrangements concerns the use of the funds generated by a region-wide tax. In the case of the taxes discussed above, the decision to establish regional taxing districts arose chiefly from the desire to fund specific public goods or services with spatial characteristics that were more regional than local. In the case of regional tax-base sharing, however, there is no particular funding objective other than the activities of general-purpose local governments within the region. While this policy is far less common than the regional taxes discussed above, the best known example—the longstanding tax base sharing policy in effect in the St. Paul-Minneapolis region—has spawned a large academic literature across several disciplines assessing its pros and cons.

The Twin Cities fiscal disparities regime has been in place for over 40 years.[59] The Minnesota legislature adopted the program via the Metropolitan Fiscal Disparities Act in 1971 following several years of controversy over urban growth issues in the Twin Cities.[60] After litigation over the constitutionality of the statute was resolved by a Minnesota Supreme Court decision in 1974,[61] the new policy took effect in 1975. The Act governs the seven-county metropolitan area of Minneapolis-St. Paul[62] and provides a mechanism by which 40% of the increased revenue resulting from a uniform property tax on commercial and industrial

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59. Myron Orfield & Nicholas Wallace, *The Minnesota Fiscal Disparities Act of 1971: The Twin Cities' Struggle and Blueprint for Regional Cooperation*, 33 WILLIAM MITCHELL L. REV. 591 (2007) (discussing history of Minnesota Fiscal Disparities legislation).
60. MINN. STAT. ANN. § 473F.001 (West 1992).
61. Vill. of Burnsville v. Onischuk, 22 N.W.2d 523 (Minn. 1974), *appeal dismissed*, 420 U.S. 916 (1975).
62. *See infra* Figure 3.

property is pooled and redistributed to communities according to their relative fiscal capacity.

The Minnesota statute lists six purposes:

(1) to provide a way for local governments to share in the resources generated by the growth of the area, without removing any resources which local governments already have;

(2) to increase the likelihood of orderly urban development by reducing the impact of fiscal considerations on the location of business and residential growth and of highways, transit facilities and airports;

(3) to establish incentives for all parts of the area to work for the growth of the area as a whole;

(4) to provide a way whereby the area's resources can be made available within and through the existing system of local governments and local decision making;

(5) to help communities in different stages of development by making resources increasingly available to communities at those early stages of development and redevelopment when financial pressures on them are the greatest; and

(6) to encourage protection of the environment by reducing the impact of fiscal considerations so that flood plains can be protected and land for parks and open space can be preserved.[63]

Leaving aside for the moment whether or not the Twin Cities tax sharing arrangement adopted actually accomplishes these objectives, such a system has certain features that one might regard as desirable from the perspective of normative fiscal federalism.

First, the sharing arrangement regionalizes that portion of the commercial and industrial tax base that is contributed to the region-wide pool. In the Twin Cities, this means that the commercial-industrial property tax is effectively bifurcated into two separate taxes: a *local* portion to which differentiated local rates continue apply and a *regional* portion to which a uniform “area-wide rate” applies. The local portion of the tax base consists of that portion of the commercial-industrial tax base that is not subject to region-wide pooling (i.e., 100% of the pre-1971 commercial-industrial tax base plus 60% of the growth in the commercial-

63. MINN. STAT. ANN. Ch. § 473F.001 et seq. (2017).

industrial tax base). In effect, the tax base sharing system provides for "partial tax harmonization" across the region—i.e., to the extent of 40% of the post-1971 growth in the tax base. Because it is partial, such a regime does not eliminate the influence of local property tax rate differentials on firms' locational decisions—or the corresponding competition for tax base among local communities—however, it should reduce the effect of those forces. By requiring that the revenue benefits of commercial-industrial property must be shared, the system discourages beggar-thy-neighbor policies associated with interjurisdictional tax competition.

Second, the manner in which the pooled revenues are distributed among local communities (i.e., cities and townships) should further reduce tax induced migration. Under the tax sharing arrangement, the proceeds from the uniform tax on commercial-industrial property are required to be returned to communities in inverse relation to each community's per capita fiscal capacity.[64] This means that municipalities with below average fiscal capacity (as measured by the non-pooled portion of the property tax) receive a larger share of the pooled funds than if determined by their population share alone. For 2016, the top five net recipients were St. Paul, Brooklyn Park, Coon Rapids, Brooklyn Center, and Columbia Heights.[65] Likewise, communities with above average fiscal capacity will receive a smaller share. For 2016, the top five net contributors were Bloomington (home to the Mall of America), Eden Prairie, Minnetonka, Plymouth, and Edina.[66]

The region's tax sharing arrangement reduces, but does not eliminate, property tax disparities among the region's municipalities and townships. By doing so, the regime should also reduce the influence of those disparities on household and firm locational decisions, at least insofar as those disparities might have otherwise influenced private actors' locational decisions. In effect, equalization grants improve the terms of fiscal

64. For a useful and accessible overview of the program, see *Fiscal Disparities: Tax-Base Sharing in the Metro Area*, METRO. COUNCIL, https://metrocouncil.org/Communities/Planning/Local-Planning-As
sistance/Fiscal-Disparities-(2).aspx (last visited Mar. 3, 2019).

65. *See Fiscal Disparities in Twin Cities: Key Findings for Taxes Payable in 2016*, METRO. COUNCIL (Nov. 2016), https://metrocouncil.org/Communities/Publications-And-Resources/Fiscal-Disparities-Ke
y-Findings.aspx.

66. *Id.*

exchange in low-capacity jurisdictions, neutralizing the influence of interjurisdictional fiscal capacity differentials on locational decisions. Early theoretical work on fiscal equalization identified this effect as a key efficiency justification for employing equalization grants in a federal regime.[67]

Shortly after the Minnesota statute was enacted, several researchers undertook studies to evaluate its merits and likely effects. Perhaps the most critical analysis was offered by Fischel who relied on a theory of tax payments as compensation for firms' undesirable neighborhood effects to conclude that the program would likely have inefficient land use effects.[68] Fischel also expressed skepticism that Twin Cities program would have the desired distributional effects based on a simulation of a similar hypothetical program using family income data from Newark, New Jersey.[69] Fisher was also critical of the program but for different reasons.[70] Analogizing the Minnesota statute to a system of equalization grants, Fisher highlighted certain perverse results. First, by pooling only the post-1971 *growth* in the commercial-industrial tax base, the program was necessarily limited in its ability to achieve any meaningful reduction in fiscal disparities. Thus, by definition, any fiscal disparities in place as of 1971 would be unaffected by the new program. Second, this same feature, in combination with the distribution formula (which envisions only positive distributions from the pool), essentially "cripples the ability of the Minnesota plan to redistribute tax base away from wealthy communities which have not experienced growth in commercial industrial tax base."[71]

A more positive analysis was offered by Reschovsky who found the Minnesota plan to be "moderately successful" with regard to its equity objectives of reducing fiscal disparities among participating communities.[72] However, as to the plan's effect on encouraging efficient

67. James M. Buchanan, *Federalism and Fiscal Equity*, 40 AM. ECON. REV. 583, 591-93 (1950).
68. William A. Fischel, *Fiscal and Environmental Considerations in the Location of Firms in Suburban Communities*, *in* FISCAL ZONING AND LAND USE CONTROLS 119 (Edwin S. Mills & Wallace E. Oates eds., 1975).
69. *Id.*
70. Peter S. Fisher, *Regional Tax-Base Sharing: An Analysis and Simulation of Alternative Approaches*, 58 LAND ECON. 497 (1982).
71. *Id.*
72. Andrew Reschovsky, *An Evaluation of Metropolitan Area Tax Base Sharing*, 33 NAT'L TAX J. 55, 62-63 (1980).

patterns of economic development, Reschovsky concluded that the most that could be said is that "base sharing may have a marginal influence on development patterns."[73] Reschovsky offers an additional justification for the regime relating to its symbolic value, noting that "base sharing may create an awareness among metropolitan area citizens and local governments of the economic and environmental interrelationships that exist within the area."[74]

Note that, with respect to the area-wide rate, the commercial-industrial property tax for the Minneapolis-St. Paul region is the equivalent to a regional tax, similar to the regional taxes in Seattle and Denver, discussed above.[75] Unlike those taxes, however, there is no specific regional public good financed by the Minneapolis-St. Paul regional property tax. Rather, the revenues are distributed to (and from) the various general-purpose governments within the seven-county area. Thus, the rationale for "going regional" is not (and could not be) the spatial characteristics of some specific public good/service. Rather, the justification for imposing a regional tax inheres in the nature of the tax itself. By imposing a commercial-industrial property tax on a region-wide basis, rather than on a local basis, taxpayer exit opportunities and the resulting interjurisdictional tax competition are diminished. Thus, the attraction of regional tax base sharing consists of its tax assignment properties — i.e., the superiority of imposing at least certain taxes at a level of government representing broader geographic scope.

This approach could prove useful for certain taxes relied upon by local governments that could be more effectively designed as regional taxes. For example, local government reliance on retail sales taxes introduces predictable distortions in cross-border shopping (who may choose where to shop based on sales tax rate differentials) and locational decisions of retailers (who may demand concessions from local governments in exchange for locating a store likely to generate significant sales tax revenues). These problems could be avoided, or at least mitigated, by shifting local retail sales taxes to a regional level and apportioning the revenue among general-purpose local governments within the region. It

73. *Id.* at 64.
74. *Id.* at 65.
75. *See supra* Parts III.A & III.B.

bears noting that, even if the revenues were not distributed among local governments according to relative fiscal capacity (as in the Twin Cities program), this reform would alleviate the adverse effects of local reliance on retail sales taxes. Put differently, tax base sharing has independent value as a tax assignment tool, even if it is not used as a mechanism for alleviating fiscal disparities among the local governments within the region.

III. IMAGINING A BROADER ROLE FOR REGIONAL TAXES: CALIFORNIA

Each of the examples considered in the previous section has its own peculiar, organic history. Each is responsive to a unique constellation of economic, political, and institutional circumstances. Nevertheless, it is worth asking whether and how other states might make use of the some of the regional fiscal innovations discussed above.

In California, for example, some commentators have raised the possibility of including "regional financing powers" on the agenda for state tax reform as a means of increasing local revenue authority.[76] In a 2015 report on reforming California's tax system, California Forward notes that, at present, California regions "do not have a method for financing investments (in infrastructure, say) on a regional scale." The organization therefore raises for consideration the idea of creating "a regional financing authority for regional infrastructure projects—from transit systems and housing to next-generation water facilities."[77]

There are some preliminary indications of interest in regional taxing arrangements in the Golden State. One noteworthy example is the approval in June 2016 of a new region-wide parcel tax adopted by the San Francisco Bay Restoration Authority to fund shoreline projects promoting bay restoration efforts in the Authority's 9-county region.[78] A key selling

76. CA FWD, *Financing the Future: How will California pay for tomorrow? Ch. 3: From revenue to results: Considering today's tax proposals* (2015), https://app.box.com/embed/preview/5zjogpla3ahj95 cmfdaxhc5ein0eapmm?theme=dark.

77. *Id.* at 18.

78. Melody Gutierrez, SF Bay Protection: Measure AA Passes, SFGATE (June 8, 2016), http://www.s

point for the Measure AA enacting the regional tax was the need to fund projects designed to mitigate the effects of climate change, including the implications of rising sea levels on bay ecology.[79] The San Francisco Bay borders on nine counties, but due to spillover effects no one county would have the incentive to act alone to address the restoration projects to be undertaken by the regional authority. Put differently, just like metropolitan wide transit systems or regional cultural districts, the spatial characteristics of bay restoration do not correspond with the boundaries of existing general-purpose governments. To use the language of Eichenberger and Frey, climate change has introduced a new "geography of problems" for the San Francisco Bay, requiring a reconfiguration of conventional jurisdictional boundaries to respond effectively.[80]

As with the Sound Transit example discussed above, the political dynamics of a regional approach to bay restoration were also an important dimension of the success of the parcel tax. Under California law, a "special" tax earmarked for a particular purpose requires approval of two-thirds of voters in the taxing district.[81] Measure AA was approved by 70.32 percent of voters, but only exceeded the two-thirds threshold in five of the nine counties. Strong supermajorities in the three largest counties (Santa Clara, Alameda, and San Francisco) helped to make up for the failure of the measure to secure supermajority support in other counties.[82] This outcome suggests a possible alternative rationale for turning to regional (or other multijurisdictional) arrangements – i.e., the ability to draw boundaries in such a manner as to ensure political support for the fiscal measures undertaken.

Beyond the new parcel tax of the San Francisco Bay Restoration Authority, and the existing transit taxes in both the Bay Area and Los Angeles County (Measure R, Measure M), there are very few examples of regional taxes in California. However, there are a variety of contexts in which such regional taxes might make sense. In a recent report on regional

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fgate.com/politics/article/SF-Bay-protection-Measure-AA-passes-7970365.phb

79. Jed Kim, *San Francisco Area Voters Pave the Way for Climate Adaptation*, MARKETPLACE (Nov. 7, 2016), https://www.marketplace.org/2016/11/02/sustainability/san-francisco-area-voters-paved-way-climate-adaptation.

80. Eichenberger & Frey, *supra* note 17.

81. CAL. GOV'T CODE § 53722 (West 2017).

82. Guttierez, *supra* note 78.

economic development, for example, the Bay Area Council Economic Institute highlighted the absence of any funding source for regional projects.[83] Many of the problems identified in the report—e.g., infrastructure development, affordable housing—are fundamentally regional problems, but there is no regional entity with taxing authority to address these issues. Significantly, there appears to be some political momentum, albeit preliminary, to develop regional tax policies to address these issues. Most recently, a group of Bay Area stakeholders convened by the region's Metropolitan Transportation Commission and ABAG (Association of Bay Area Governments) proposed a "regional housing tax" designed to raise $1.5 billion to address affordable housing in the region.[84]

With regard to regional tax base sharing, perhaps the most obvious candidate for reform in California is the existing patchwork of local sales taxes, a common characteristic in most sales tax states that permit local option sales taxes as add-on to the state sales tax rate. Beginning in the 1950s, California allowed municipalities to impose a 1% sales tax, authorized through the Bradley-Burns Uniform Sales/Use Tax statute.[85] In addition, many localities impose additional local sales tax for specific purposes (e.g., transportation projects) beyond the Bradley-Burns levy.[86] Because these taxes apply on a point-of-sale basis, municipalities have a very strong incentive to attract big-box retailers, car dealerships, and other firms that are likely to generate significant sales tax receipts. The resulting interlocal competition for these retailers is a symptom of the fundamental mis-assignment of the sales tax to local governments. It is not uncommon for localities to promise to rebate a significant share of the sales tax revenues to the retailer in order to attract them to locate their facilities in the city.[87] The result is that consumers face a different sales tax rate

83. BAY AREA COUNCIL ECON. INST., A ROADMAP FOR ECONOMIC RESILIENCE: THE BAY AREA ECONOMIC STRATEGY 25 (2015), http://www.bayareaeconomy.org/files/pdf/BACEI-RES-Report.pdf.
84. Elaine Goodman, *Regional Housing Tax in the Works – 9-county Agency Looks to Raise $1.5 Billion a Year*, PALO ALTO DAILY POST (October 5, 2018), https://padailypost.com/2018/10/06/regional -housing-tax-in-the-works-9-county-agency-looks-to-raise-1-5-billion-a-year/.
85. CAL. REV. & TAX. CODE § 72002 (West 2017).
86. *See Local Countryside Trasportation Sales Taxes*, CALIFORNIACITYFINANCE.COM, Sept. 27, 2010, www.californiacityfinance.com/trasnsptrusetax.pdf
87. RICHARD B. FULTON, THE RELUCTANT METROPOLIS: THE POLITICS OF URBAN GROWTH IN LOS

depending on where they purchase an item, and revenue from the local portion of the sales tax is diminished by the rebates provided by the municipality.

A solution to this longstanding problem would be to re-assign the local portion of the sales tax to a higher level of government and allocate the revenue to all municipalities. While one option for doing this would be to have all sales taxes collected by the state, a less disruptive alternative would be to convert local sales taxes within any given region to a uniform region-wide sales tax, the proceeds of which be allocated among local governments within the region.

Yet another possibility is would be the use of the state's new Enhanced Infrastructure Financing Districts (EIFDs) as a possible vehicle through which regional financing authorities could be established. The EIFD legislation, which took effect in early 2015, permits a city or county (as well as multiple cities or counties) to establish a district, arrange for property tax increment financing, and issue bonds (subject to voter approval) for a wide range of infrastructure needs, including transportation, sewage and water facilities, parks, libraries, and various other projects.[88] Because the EIFD legislation is so new, no city or county has yet established a district under the new law. At present, the only project under consideration is the use of an EIFD to fund a revitalization of the Los Angeles River.[89]

In imagining a role for regional fiscal arrangements in California, one possibility would be vesting EIFDs or EIFD-type entities with the power to tax. The California Forward report referenced above raises the possibility of assigning to a new regional authority the power to impose vehicle license fees, water usage and waste management charges, or even a local income tax.[90] The choice of revenue instrument would no doubt depend on the nature of the district, its specific responsibilities, and its

ANGELES 255-282 (2001).

88. LEAGUE OF CALIFORNIA CITIES, PRIMER ON CALIFORNIA'S NEW TAX INCREMENT FINANCING TOOLS (2017), https://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/New-Tax-Increment-Tools/CALED-TIF-Primer-3-17-FINAL.aspx.

89. Rachel Kaufman, *New California Financing Twist Could Help L.A. River Makeover*, NEXT CITY (Feb. 5, 2015), https://nextcity.org/daily/entry/new-california-funding-tool-eifd-financing-la-river-make
over.

90. CA Fwd, *supra* note 76, at 18.

geographic scope.

The possibility of a regional income tax, earmarked for some specific regional program, is particularly intriguing. The consensus view in the tax assignment literature is that income taxes should generally be reserved for the federal or state governments.[91] This view accords with the more general admonition in the literature against local reliance on ability-to-pay taxes, which might induce migration both on the part of high-earners seeking to avoid redistribution and low-earners seeking to benefit from it. On the other hand, there are several advantages of relying on income taxes (most notably the ability to piggy-back on existing federal and state income taxes), and the disadvantages from relying on them in the local setting may be less acute in a regional setting. For example, a modest income tax covering the six-county region of the Southern California Association of Governments (SCAG)—which spans 38,000 square miles (an area larger than thirteen states) is significantly less likely to raise migration concerns than a tax imposed by the City of Santa Monica.

Another regional tax option deserving consideration involves the commercial and industrial component of the California property tax. For several years, there has been discussion of the state possibly adopting a "split roll" property tax whereby commercial and industrial property would be periodically reassessed at its fair market value.[92] Under current law (Proposition 13), real property is generally assessed at its purchase price, with a maximum growth in the assessed value of 2 percent per year or reassessed to market value upon a change of ownership.[93] Revenue estimates indicate that adoption of a split roll on a statewide basis could generate as much as $5-$10 billion per year.[94] But these estimates vary significantly by region, as does the political appetite for amending Proposition 13. An optional region-wide split roll (perhaps even coupled

91. *See, e.g.*, Bev Dahlby, *Taxing Choices: Issues in the Assignment of Taxes in Federations*, INT'L SOC. SCI. J., Dec. 16, 2002, at 91, 96.

92. *See* Kirk J. Stark, *Reforming Proposition 13 to Tax Land More and Buildings Less*, *available in* CALIFORNIA POLICY OPTIONS 2016 (ed. Daniel J.B. Mitchell 2016); Matt Levin, *Prop 13 Could Be Partly Undone in 2020—Here's What You Should Know*, CALMATTERS (Aug. 14, 2018).

93. CAL.CONST. art. XIIIA.

94. JENNIFER ITO ET AL., GETTING REAL ABOUT REFORM: ESTIMATING REVENUE GAINS FROM CHANGES TO CALIFORNIA'S SYSTEM OF ASSESSING COMMERCIAL REAL ESTATE (May 2015), https://do rnsife.usc.edu/assets/sites/242/docs/Commercial_Property_Tax_Brief_PERE_web_updated2.pdf.

with some flexibility in the setting of the rate) could provide an additional source of revenue for regional initiatives. One might even imagine a tax base sharing arrangement among counties, along the lines of the St. Paul-Minneapolis fiscal disparities program.

The adoption of new regional taxes, whether in California or elsewhere, is not without potential downsides. Taxpayers already face local taxes, state taxes, and federal taxes. Introducing regional taxes into the mix would bring greater institutional complexity, increasing the costs of administration and compliance. Additionally, layering in regional tax arrangements on top of existing taxes could make it more difficult to understand the source and function of different tax payments, triggering a type of information overload for taxpayers facing a web of overlapping tax obligations. These are legitimate concerns relevant to any new policy or institutional arrangement. While there are no doubt several benefits to be derived from considering regional tax policies, policymakers must exercise caution in evaluating alternative policies, weighing not just the benefits but also the potential costs.

CONCLUSION

To date, regional tax arrangements have emerged chiefly in the context of what might be termed "boutique" public finance, i.e., very particularized circumstances relating to relatively narrow topics such as metropolitan transit finance and cultural districts. And while regional tax base sharing has drawn considerable academic interest, efforts to extend such programs beyond the Twin Cities have never gained much traction. Thus, there is reason to regard calls for greater "regionalism" in state/local tax reform with some skepticism – or at least a dose of realism given the dominant influence of political inertia and path dependence on the design of fiscal institutions.

Nevertheless, the potential benefits of these policies are substantial enough to warrant inclusion on anyone's agenda of possible future SALT reforms. Regional fiscal institutions, whether by granting independent taxing authority to regional authorities or tax sharing arrangements among existing local governments, hold promise as a device for mitigating some of the adverse fiscal effects of fragmented local government.

Figure 1: Region Governed by Central Puget Sound Transit District

Figure 2: Region Governed by Denver's Scientific and Cultural Facilities District

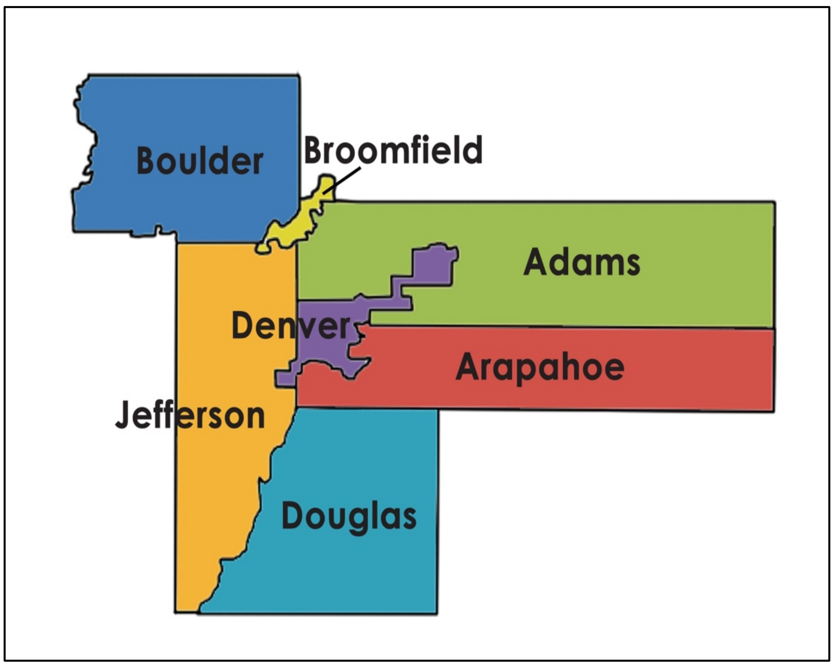

Figure 3: Region Governed by Minnesota Fiscal Disparities Act