

## LOCAL TAX CAPACITY

The public actors most often associated in the public's mind with natural resources conservation activities include several federal agencies, state government agencies in all 50 states, and thousands of special districts and counties. However, the role of local governments, with their powers to regulate land use is underestimated. Municipal governments often have the first and last word on whether specific parcels of land can or will be developed.

In many cases, local governments are not particularly well-suited to regulate or protect sensitive natural areas. The full benefits of conserving natural resources are rarely concentrated in a single community. But, at the same time, the costs of conservation can be highly localized. In this situation, local governments do not face the proper incentives to conserve sensitive natural resources. If the benefits of protection are under-valued because many of the benefits accrue to other areas, while the costs are fully borne locally, then local governments can be expected to do too little to protect sensitive natural areas.

This happens not because residents or public officials value the resources any less than others or behave irrationally. Natural assets clearly have value at the local level. Recent initiatives in Woodbury, Eden Prairie, Minnetonka, and St. Cloud to raise local taxes to preserve open space illustrate this.<sup>10</sup> However, local residents often receive only a small portion of the benefits of protection, biasing decisions away from conservation when made solely at the local level.

IN DNR'S CENTRAL REGION, THERE IS A GREAT DEAL OF VARIATION IN THE ABILITY OF MUNICIPALITIES TO FINANCE PUBLIC SERVICES FROM LOCAL TAXES AND LOCAL GOVERNMENTS DO NOT FACE THE PROPER INCENTIVES TO CONSERVE.

Local governments also face a variety of incentives which push them to favor development over natural resource conservation. Local tax policy and land-use regulations are closely related. Local taxes must finance municipal services like police and fire protection and public schools. The amount of revenue a local government can generate on its own depends largely on the value and types of land within its boundaries. If the property tax is the primary local tax, as it is in Minnesota, then local governments have a direct incentive to develop land-use plans that maximize the value of property. Conservation areas rarely meet this standard, at least in the short run.

Different types of development often imply different obligations on the expenditure side of local budgets as well. Commercial-industrial development might enhance the tax base without increasing the demand for school services, for instance. In the end, it is the balance of costs (expenditure needs caused by the development) and benefits (the revenues generated) that local officials care about. Since protected resources rarely generate revenues directly, they often fare poorly in local fiscal decision-making.

One very important characteristic to consider when comparing local government capacity is the ability to raise revenues locally. In Minnesota, the primary local tax instrument is the property tax. State law sets the rate structure for different types of property—the rate per dollar of assessed value is greater for commercial-industrial property than for owner-occupied residential property, for instance. A particular locality's mix of property types then determines how productive its tax base is in terms of revenue generated per dollar of property values. This is the locality's "tax capacity". Local governments then determine their overall tax rate by varying the percentage of tax capacity that they assess.

Tax capacity per household—the revenue that the property tax would generate if the locality taxed its capacity at 100 percent—is therefore the proper measure of local ability to raise tax revenue. Maps 16 and 17 show this measure in 2004 and the percentage change during the prior 11 years for each municipality in DNR's Central Region.

Maps 16 and 17 show a high degree of diversity in the capacity of local governments to absorb the potential costs of natural resource conservation. Tax capacities per household in 2004 varied from as low as \$214 per household in the City of Osakis in Todd County to as high as \$12,866 in the City of Becker in Sherburne County. The distribution increases relatively smoothly between these extremes and 90 percent of municipalities fall in the range between \$865 per household and \$4,109 per household.

Tax capacities are, in general, significantly greater in the Twin Cities metropolitan area—average capacity in the 11-county metropolitan area is \$2,429 per household compared to \$1,546 per household in the 6-county non-metropolitan portion of the region. This reflects the much greater economic vitality in the metropolitan area as well as the higher cost of living.

However, there is significant variation within each of the two parts of the 17-county region. Municipalities in the core and at the fringes of the metropolitan area share lower than average capacities for the most part, while second and third ring suburbs are largely above average. The highest capacities are in the cities located in the western and southwestern suburbs and along the St. Croix River valley.

Municipalities in the 6-county non-metropolitan portion of the region are more uniformly below the 17-county average of \$2,355. The most striking patterns here are the clusters of much-lower than average capacities in northwest Todd County and in large portions of Mille Lacs and Kanabec Counties.

The situation is not entirely negative in the non-metropolitan counties, however. Tax capacities are increasing more rapidly there, in general than in the metropolitan area—38 percent compared to just 9 percent on average in the metropolitan area—and growth rates were above average in nearly every part of the area.

Tax capacities in virtually the entire core of the metropolitan area grew more slowly than in the rest of the metropolitan area and the 17-county region. Part of the explanation for this is the changes in state law that decreased tax rates on commercial-industrial property compared to residential property. This led to decreased values of tax bases in places rich in commercial-industrial property

(like the core area) when compared to places with less commercial-industrial property (like the non-metropolitan portion of the region and many suburbs in the metropolitan area).

In sum, there is a great deal of variation in the ability of municipalities to finance public services from local taxes. If primary responsibility for conserving sensitive natural areas is left to local governments—through local planning and zoning decisions—the results would be a patchwork quilt of conservation efforts. An analogy would be each community independently planning and paying for its streets and highways with no knowledge of the timing, type, or location of roads being developed in adjacent communities or regionally. The resulting regional system would be inefficient and ineffective.



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