Maine Policy Review

Volume 6 | Issue 2

1997

# Tax Commentary: A Legislative Perspective

Steven Rowe

# Commentary

# More on Tax Reform

# Tax commentary-A legislative perspective

**Maine Policy Review (1997). Volume 6, Number2**

**by Steven Rowe**

The tax reform articles by Josephine LaPlante and Christopher St. John' were interesting and informative. Professor LaPlante reviewed changes that are reshaping Maine's state and local budgetary environment and concluded that taking charge of the state's fiscal house must include both tax reform and controlling the costs of producing public services. St. John measured recent tax reform proposals against generally accepted taxation principles and offered his perspective on the practical and political difficulties of structural tax reform.

Reading the articles helped strengthen my belief that in order to control tax effort, all levels of government within the state must work together as partners in a single fiscal system. The articles also strengthened my belief that we must act quickly and responsibly to relieve the over-burdened municipal property tax. This commentary addresses the rationale for tax reform and recommends reforms to bring Maine's state and local revenue systems in line with our state's modern economy. This commentary also contains reflections on tax reform efforts during the recent legislative session.

***The rationale for tax reform***

The primary objective of tax reform, as with any public policy initiative, should be to further the public good. But just how do we change tax policy to further the public good? Reducing taxes and allowing people to keep more of their earnings may further the public good in the short term, but if essential government services decline, the benefits of tax relief may be fleeting. Recent statistics show that Maine's combined state and local per capita revenues are twenty-second-highest in the nation. Reality suggests that Maine probably will never rank near the bottom nationally in terms of total per capita tax-burden. That's because, as LaPlante pointed out, Maine has a low population density, strong infrastructure demands, and below-average income levels.

But do we really want to be near the bottom of the nation in terms of tax burden? Considerable agreement exists that a state's tax burden is less important than the quality of its work force, the availability of business-related infrastructure, the quality of public services, and energy costs to businesses considering relocation. If the effect of cutting taxes is to reduce the state's investment in public education or our highways and ports, the result likely will be a loss, rather than again, in business development.

The optimal state tax structure should generate adequate revenues to pay for desired government services. It should treat taxpayers fairly and equitably, balance revenue sources, and provide for stable, predictable revenues. Maine's revenue structure misses the mark in the latter categories. As St. John pointed out, on the measures of stability and balance, Maine ranked thirty-sixth nationally in the Corporation for Enterprise Development's latest Development Report Card for the States. Our narrow sales tax base is one of the major reasons for our low stability ranking. In addition, our heavy reliance on the property tax contributes significantly to our low balance ranking.

Maine applies its sales tax predominantly to tangible goods. This concept made sense forty years ago, but it is outmoded in today's service economy In1930, one-third of our nation's gross national product was from services. In1990, more than half was service-based.! Today in Maine, about 70 percent of our gross state product is service-based. Yet we tax few services. As the state's economy changes, so, it would seem, should its revenue system.

Expansion of the sales tax to services would help increase and stabilize revenues. The additional revenues could be used to either reduce the sales tax rate itself (which LaPlante advocates in her article) or reduce the local property tax burden. The Maine Municipal Association's proposal to use the additional revenues to provide a homestead exemption to homeowners is one form of property tax relief. Dedicating the revenues to offset property tax funding for local education is another.

The property tax accounts for about 85 percent of total municipal general fund revenues generated by municipal sources. Between 1988 and 1994, property tax collections increased by an average of nearly 9 percent per year. The heavy reliance and the great disparity in property tax rates across municipalities continue to fuel efforts to cap property tax collections. Unless the Legislature and governor take action to provide meaningful property tax relief, a restrictive, citizen-initiated property tax cap proposal eventually may take hold with the voters. An unreasonably low cap could have disastrous consequences for municipal governments. Basic services such as fire, police, roads, and education could be placed in jeopardy.

***Intergovernmental cooperation***

In her article, LaPlante recommends that we improve our capacity to monitor, evaluate, and, to the extent possible, control factors that influence state and local expenditure needs, the costs of producing services, and the tax effort required to finance those services. I agree. These actions are required to respond to public demand in Maine and to emerging federal policy. While the decision by Congress to convert state aid to block grants will reduce the volatility of our federal government's finances, it will serve conversely to exacerbate the unpredictability of state expenditures. With federal aid fixed, states must find ways to weather recessions without additional federal funds. In other words, we must look for ways to do more with less.

For years, we have given lip service to the need to create an intergovernmental structure in which state, county and municipal governments work together to offer services cooperatively and, when possible, consolidate services to achieve efficiency and reduce the overall tax burden. Thanks to the work of the Task Force on Maine's Intergovernmental Structure, we may now actually be much closer to creating such a structure.

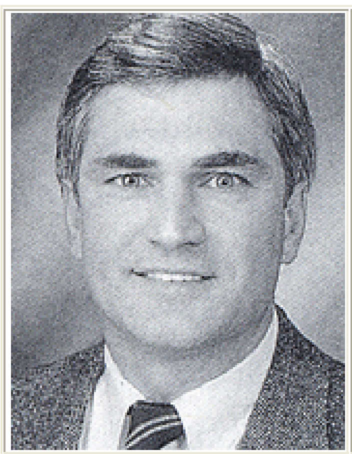
In its preliminary report, the taskforce recommended that the state assume financial responsibility for services it has traditionally demanded of county government, that county government be repositioned so that municipalities are its primary customers, and that a system of incentives be created to encourage municipalities to enter into inter-local cooperative service agreements with other municipalities and counties. These recommendations are sure to engender much criticism and resistance. Change is often difficult to accept even in the best of circumstances. Here, that difficulty likely will be compounded by the mistrust that exists among the different levels of government, as well as by Maine citizens' preference for local control. Regardless of the obstacles, the recommendations of the taskforce should be given serious consideration by policy makers.

***Reflections on the past legislative session***

As the first regular session of the118th Maine Legislature (1997) began, I felt some restructuring of the state's tax code was important to bring tax policy inline with the reality of today's economy. Change also was important to reduce the reliance on the property tax as well as the volatility of state revenues. Many of my legislative colleagues agreed. We knew that enacting major tax reform legislation would be difficult. But we believed it was possible. Our optimism was due in large part to the growing public discontent over the municipal property tax burden. In a July 1996 citizen poll commissioned by the Maine Municipal Association, 65 percent of those surveyed felt state and local governments should rely less on the property tax and more on sales and income taxes. Revenue statistics showed that the public's opinion was well founded. In 1996, the regressive property tax accounted for44 percent of total revenues from the "big three" of sales, income, and property taxes.

Tax reform advocates' optimism began to fade as reform proposals were introduced and special-interest lobbyists shifted their opposition efforts into high gear. In the end, only a few important changes to the tax code were enacted into law. These included expanding eligibility and increasing the benefit cap for the property tax "circuit breaker" program and removing the income tax return filing requirement for individuals with taxable income of $2,000 or less.

The session taught us that it is relatively easy to get lawmakers to nod their heads in agreement with broad taxation principles written on a flip chart. In fact, most lawmakers can even agree about the characteristics of a well-structured tax system. Disagreement sets in when specific changes are proposed to implement those principles and achieve those changes. In retrospect, the major structural tax reform proposals were probably too bold and the expectations of tax reform advocates too high. Instead of trying to jump across the stream in a single leap, perhaps reform advocates should have begun placing stepping stones in the stream.



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**Full cite:** Rowe, Steven. 1997. ***Tax commentary-A legislative perspective.*** Vol. 6(2): 64-66.