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TESTIMONY

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PUBLIC COMMENTS AND CHARTER AMENDMENT RECOMMENDATIONS

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Testimony before the City of St. Louis Charter Committee

TO THE HONORABLE MEMBERS OF THIS COMMISSION

My name is David Stokes, and I am director of municipal policy at the Show-Me Institute. The Show-Me Institute is a nonprofit, nonpartisan Missouri-based think tank that supports free-market solutions for state and local policy. The ideas and charter recommendations presented here are my own. Thank you for this opportunity to submit them.

ARTICLE ONE, SECTION FOUR: THE EARNINGS AND PAYROLL TAX

The right to impose a local income tax (commonly called an earnings tax) in Missouri is limited to the cities of St. Louis and Kansas City. Prior to the passage of Proposition A in 2010, other cities had the right to impose an earnings tax, but none had done so. Proposition A restricted the earnings tax to St. Louis and Kansas City permanently and requires a quinquennial vote to approve continuation of the tax in each city.

Local income taxes are bad for cities. They encourage movement of population, labor, and capital away from cities with them to surrounding communities without them.[1] This effect has been documented by numerous studies.[2] The earnings tax provides immediate tax revenues but at the cost of population, jobs, and investment in the city. Despite the evidence against earnings taxes, they remain popular with voters and local officials in both Kansas City and St. Louis. After all, who wouldn't want to tax the non-residents to help pay for the public services of the residents? The short-term political gains have to this point trumped the long-term benefits of eliminating the earnings tax.[3] Local earnings taxes are like witch-burnings: highly popular with the resident populace but nevertheless terrible public policy.

The earnings tax is set at one percent of income in each city. All residents and people who work within the cities must pay it. St. Louis has an additional income tax, the payroll tax, which is a half-percent tax on wages paid by the employers within the city.

Because of the pandemic, St. Louis changed its rules regarding nonresident workers to include income from employees who are working from home outside of the city for businesses within the city. Now St. Louis is requiring the earnings and payroll taxes to be paid on that income, which is improper and an affront to the plain reading of the state law allowing earnings taxes. Hopefully, courts or the state legislature will address these actions by St. Louis. Two courts have now ruled in favor of remote-working taxpayers attempting to acquire refunds from St. Louis, but the case may be further appealed by the city.

St. Louis should phase out its earnings and payroll taxes to create a better environment for economic growth in the long-term for those two cities. The substantial increase in working from home during and after the pandemic is one more reason to move away from depending on earnings taxes.[4] Nobody says it will be easy to replace a substantial part of those budgets, but if St. Louis and Kansas City were to phase out their earnings taxes over a 10-year period, they could replace the lost income tax revenue with a combination of[5]:

- Substantially reduced granting of various tax subsidies
- Increasing other, less economically harmful taxes, such as property taxes.
- Sharing services where possible with other governments
- Privatizing certain services and assets, such as the water departments
- Consideration of taxation of entities previously not taxed, such as property taxes on nonprofits.
- Budget cuts
- Pension reforms

While the short-term challenges of a phase-out would be complex, the long-term benefits from ending the earnings and payroll taxes to St. Louis would be significant. At the very least, St. Louis should cease enacting policies that make the city even more dependent on the earnings tax, such as narrowing the property tax base by freezing property taxes for senior citizens.

ARTICLE FOUR, SECTION 26 AND ARTICLE THIRTEEN, SECTION ELEVEN: PUBLIC WATER UTILITIES

In 2022, Eureka sold its water and sewer system to Missouri-American Water for $28 million, continuing the utility privatization trend around the state. Article 4, section 26 of the city charter should be amended to give the board of aldermen more authority to investigate privatizing the city's water division, including putting it up to a vote of the people. In recent decades, the city's water division and political leadership have followed a consistent path of keeping rates low for political purposes, underinvesting in the water system, and then only reacting with large price hikes and major system investment after the situation becomes an emergency. That is exactly what happened in 2023.[6]

While it is not mandated by the charter, the public ownership and political nature of the water division is also the primary reason the water division has never fully moved from flat-rate billing to water meters, even though metered water has many environmental and financial advantages, including increased water conservation and efficiency in distribution.[7] The fact that water meters have never been fully implemented in the City of St. Louis is an embarrassment.

Most Missourians are served by private, investor-owned utilities (IOUs) for their vital gas, electric, water, and sewer needs. But that doesn't mean municipal utilities are rare. They are common, particularly water utilities. A review of data from both the Missouri Public Service Commission, a government agency,[8] and the Missouri Public Utility Association, a private association with 110 Missouri members,[9] indicates that there are approximately 550 municipal water utilities, 75 municipal electric utilities, and 40 municipal gas utilities.[10] These numbers are in line with national averages. There are other options for utility provision, including electrical co-ops and public water supply special districts, but for our current purposes we are comparing IOUs and municipal utilities.

Springfield, Independence, and Columbia are the largest cities primarily served by municipal utilities. The cities in St. Louis County (one million residents total), Jefferson City, and Joplin are the main areas entirely served by IOUs.[11] Missouri's two largest cities, Kansas City and St. Louis, have private electric and gas service but municipal water companies.

While prices, on average, are lower for public utilities, that is largely due to advantages in taxation, capital, and regulation that governments have granted government-owned utilities.[12] Another reason for lower average rates are the incentives politicians have for keeping rates low, even if that impedes necessary investments in the system.[13] As the city administrator of Arnold described the situation before Arnold privatized its sewer system in 2015:

> "The system was not in good shape. It was not well maintained," said City Administrator Bryan Richison. "And city council members were running on not raising rates, so it put us in a bad position." [14]

Private utilities face higher costs in taxes and regulations but make up much of those costs through increased business efficiency.[15]

Prices for private utilities are not always higher. The comparison between St. Louis and Springfield here is enlightening. Springfield's City Utilities (CU) charges slightly lower rates for residential electricity (both cities are low compared to other cities), but the electric IOU that serves Saint Louis, Ameren, charges significantly lower rates for commercial users. The St. Louis gas IOU, Spire, charges lower rates than CU for both residential and commercial users.[16] (The water rate comparison is not applicable as both cities have municipal water.) At least relative to Springfield, the private-utility customers in St. Louis are not being charged more for electricity and gas.[17]

Richard Wallace and Paul Junk wrote a 1970 study on the economics of municipal electrical utilities. While that paper focused on municipal electricity nationwide, it paid special attention to the city-owned Columbia electrical utility. They concluded that the tax benefits given to government-owned utilities caused too many small, municipal utilities to produce their own power instead of buying it from larger electrical providers (either public or private).[18] Wallace and Junk's study remains relevant. Hannibal stopped producing its own power in 1973 (around the time of the Wallace and Junk study) and began purchasing power from private power companies, which Hannibal then redistributes itself within the city limits. Kirkwood also buys electricity from IOUs and resells it to its residents.

Another benefit to Arnold, Eureka, and other municipalities that privatized their utility systems is that the assets of the water division after the sale went onto the tax rolls. Private utilities are generally among the largest property taxpayers within any community. Residents may pay more with private utilities, but they have lower general property taxes as a result.

The Public Service Commission and the Department of Natural Resources, along with the applicable federal agencies, regulate private utilities in Missouri. Private utilities are actually more comprehensively regulated than public utilities, even though both are monopolies.

There is certainly a role for government as a regulator in the utility field. But beyond that, private utilities are fully capable of providing the gas, electricity, and water that Missourians need. Cities that have privatized their water utilities can use the funds in whatever manner they deem best. Florissant invested in street repairs and police upgrades and created a new reserve fund. Arnold paid off debt and invested in street improvements. Alton, Illinois, used the money from its water utility sale to bolster its underfunded pensions.[19]

Saint Louis needs to carefully consider auctioning off its water division. That money could be used to fund increased policing or be part of an effort to help those cities phase out their harmful earnings taxes.

ARTICLE TWENTY, SECTION ONE: LICENSING AND LICENSES TAXES

While much professional licensure in Missouri is done at the state level, municipalities in Missouri are also authorized to license certain businesses, trades, and occupations. St. Louis certainly takes advantage of that authority.

Approximately 60 years ago, economist Simon Rottenberg made a few observations and projections about licensing laws:[20]

1. Requests for licensing will always come from current practitioners of the trade, not from the public.
2. Licensing standards will be established by boards of people within the occupation, who have a vested interest in restricting their own competition.
3. When licensing is instituted, current practitioners will be grandfathered in and future entrants into the trade will later seek their own benefits by attempting to impose newer and tighter requirements on those who follow.

These observations are still true for licensing at every level, including in St. Louis.

Some of the occupations and trades that are commonly licensed by larger cities in Missouri include: electricians, plumbers, pawnbrokers, door-to-door salesmen, security guards, contractors, and taxi drivers. Some of these licenses are anachronisms now (e.g., door-to-door salesmen and, more recently, taxi drivers). Some of these licenses are due to an industry relationship with vice (e.g., massage therapists and "adult" entertainers) and may be a reasonable attempt to control those activities. Some of them (if not most of them) are due, as Rottenberg described, to the effective use of influence, also called capture, by certain groups to limit their competition in the name of public safety.

The concern that a licensing program could become a select cartel is neither unfounded nor unimportant. It is well founded because regulatory and licensing rules, once established, are often captured by special interests. For example, the pipefitters union has successfully sought and enforced strict licensing in St. Louis and other areas to favor union heating and air conditioning (HVAC) workers over non-union workers.[21] The taxicab industry used licensing laws to limit competition for decades. Later, companies in the taxicab industry used licensing laws to attempt to prevent ride-sharing companies like Uber and Lyft from entering the market in St. Louis. They succeeded at first, but were eventually overwhelmed by consumer demand for mobile ride-sharing services.

These concerns are important because studies have shown that these types of overly regulated systems can have effects that go beyond longer waits and limited options. A famous study in the field found that areas with more stringent licensing of electricians have higher rates of electrocution.[22] The reasoning behind that counterintuitive finding is fairly simple. More stringent licensing leads to fewer electricians (which is often the intent in the first place). Fewer electricians lead to higher prices to hire one. Higher prices lead to more homeowner do-it-yourself work, and more do-it-yourself work leads to more electrocutions. Another study found that dentists' incomes and dental-care prices were 12 to 15 percent higher in states with more restrictive dental licensing.[23]

People do not select their electricians, dentists, or plumbers randomly, with only a government license to protect the public interest. People generally choose these services based on the advice and experience of family, neighbors, or business associates. The reputation and skill of the tradesman is what matters to their continued success, not the license. Municipalities that choose to enact local licensing rules should make certain that the license truly benefits the public, is the minimum regulatory effort needed to accomplish that goal, and is established in such a way that one group, such as a union, can't dominate the system. As the above conditions are rarely met with occupational licensing, new licensing laws should generally be avoided and many current licensing laws should be repealed. St. Louis does not need to license valet parkers,[24] used merchandise dealers,[25] or private waste haulers.[26] Just as with the studies cited above, the harms to consumers from restricted competition will outweigh any purported public benefits from these licenses.

There are some areas where technological changes have led (or should lead) to consideration of new licensing rules. Specifically, there can be a role for municipalities in the regulation of the short-term rental (STR) industry (e.g., AirBNB and VRBO) to help ensure that the use of STR does not overly impact nearby residents. A basic registration requirement and monetary fine system for unruly guests are policies that could be enacted and enforced by local government. Regulations like these have been considered or enacted by many cities around Missouri, including St. Louis.

One occupation that the City of St. Louis has intentionally not licensed are professional engineers who are licensed by the state, as almost all are. The authorizing state legislation allows St. Louis to license such engineers only if they have an office within the city, which the city has appropriately chosen not to do.[27] The same state legislation gives the city similar flexibility with regard to architects—but in their case the city *has* chosen require licenses. Why the city feels it needs to locally license architects but not engineers is unclear, but it shows that there is a path forward for the city to choose not to license certain occupations even in cases when it is allowed to license them.

Thank you again for this opportunity to submit these comments and recommendations.

NOTES

1. Haslag, Joseph, "How an Earnings Tax Harms Cities Like St. Louis and Kansas City," Show-Me Institute Policy Study No. 1, March 2006.
2. Glaeser, Edward, "Triumph of the City," Penguin Books, 2011, p. 59.
3. Wall, Howard, "Updated Estimates of the Effects of Earnings Taxes on City Growth," Show-Me Institute Essay, September 2014.
4. Gurley, Gabrielle, " Remote Workers Punch Holes in City Revenues," *The American Prospect,* January 13, 2022, https://prospect.org/economy/remote-workers-punch-holes-in-city-revenues/.
5. Some of these, such as nonprofit taxation, would require changes to state or local law.
6. To its credit, the board of aldermen did pass legislation enacting automatic rate hikes starting in 2026, which will mitigate this problem in the future.
7. Pettinger, Tejvan, "Benefits of Water Meters," March 31, 2009, https://www.economicshelp.org/blog/1468/economics/benefits-of-water-meters.
8. Missouri PSC website, accessed May 4, 2023, https://psc.mo.gov/UtilityLocator.aspx.
9. MPUA website, accessed May 3, 2023, https://mpua.org/page/history.
10. Ibid. It is possible for some cities to have municipal utilities but not belong to the MPUA.
11. With the partial exception of Kirkwood in St. Louis County, which has a municipal water and electric utility but simply buys the power and water from private utilities and resells it to its residents. Joplin also has a municipal sewer system.
12. Meyer, Robert. "Publicly Owned Versus Privately Owned Utilities: A Policy Choice." The Review of Economics and Statistics, Vol. 57, No. 4. November 1975, p. 398.
13. Peltzman, Sam. "Pricing in Public and Private Enterprises: Electric Utilities in the United States." The Journal of Law and Economics." 1971, p. 136.
14. Heffernan, Erin, "Eureka is selling its water system. Missouri consumers are going to pay for it," *St. Louis Post-Dispatch*, August 8, 2022.
15. Hollas, Daniel, and Stanley Stansell. "The Economic Efficiency of Public Vs. Private Gas Distribution Utilities." Annals of Public and Private Economics. Vol. 65, No. 2, April 1994, p. 296.
16. With one exception, the category of residential users who use an extremely small amount (10 CC) of gas each month.
17. The Source for this information is the Memphis Light, Gas, and Water Division's "2022 Utility Bill Comparisons for Selected U.S. Cities," View online here: file:///Y:/Free%20Market%20Guide%20Project/2022%20Annual%20Utility%20Rate%20Survey_web.pdf
18. Wallace, Richard, and Paul Junk. "Economic Inefficiency of Small Municipal Electric Generating Systems," Land Economics. Vol. 46, No. 1. 1970, pp. 98–104.
19. Heffernan, Erin, "Eureka is selling its water system. Missouri consumers are going to pay for it," St. Louis Post-Dispatch, August 8, 2022.
20. Rottenberg, Simon, "The Economics of Occupational Licensing," Aspects of Labor Economics, Princeton, Princeton University Press, 1962, pp. 3–20.
21. Downs, Peter, "Pipe Schemes," *Riverfront Times*, October 11, 2000, https://www.riverfronttimes.com/news/pipe-schemes-2473457.
22. Carroll, Sidney L., and Robert J. Gaston, "Occupational Restrictions and the Quality of Service Received: Some Evidence," Southern Economic Journal, vol. 47, no. 4, April 1981, pp. 959–976.
23. Shepard, Lawrence. "Licensing Restrictions and the Cost of Dental Care," The Journal of Law and Economics, vol. 21, no. 1, April 1978, pp. 187–201.

24. St. Louis City Revised Ordinances 17.25.

25. St. Louis City Revised Ordinances 8.82.

26. St. Louis City Revised Ordinances 11.02.265.

27. St. Louis City Charter, article 20, section 1.

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