Fiscal Issues and Economic Development - The Fiscal Pressures of Growth

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Fiscal Authority and Stability

Tax Revenue = Tax Rate x Tax Base

where...

Tax Base is a function of the Economic Base
Fiscal Authority and Stability

“Something is seriously out of sync in California. Many of its cities’ revenue sources aren’t well aligned with their communities’ changing service demands. Diminishing local control over their finances and the unprecedented dominance of the state in local affairs has left city officials frustrated as they work to respond to the growing needs of their communities.

When legislators do seek to reform the current system of state-local finance, they encounter hundreds of distrustful local officials and technical complexities in a situation where almost any change helps some communities and harms others.”

- Coleman and Colantuono (2003)
Three Characteristics to Consider

- The degree of local control and discretion, including:
  - Control of the *tax base* (who pays).
  - Control of the *tax rate* (how much they pay).

- The degree of economic risk, including:
  - *Sustainability* (the capacity of the revenue to grow comparably to growth in service demand).
  - *Volatility* (the level of year-to-year fluctuation).

- The degree of political risk (the vulnerability of revenues to appropriation or reallocation by the state or federal government including the courts).
Local Control and Discretion

- Rate, Base, and Use – Discretion and Control?

- Degree of Flexibility:
  - Setting the rate(s) level.
  - Determining who pays and on what basis (the base of the revenue measure).
  - Using the revenues.
<table>
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<th>City Revenue Source</th>
<th>Strongly Sensitive To:</th>
<th>Not Sensitive To:</th>
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<tr>
<td>Service Charges and User Fees</td>
<td>Service Demand</td>
<td>Inflation (unless built into rate structure)</td>
</tr>
<tr>
<td>Sales &amp; Use Tax</td>
<td>Taxable sales, inflation, commercial activity</td>
<td>Resident population</td>
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<td>Property Tax</td>
<td>Real property values, sales</td>
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<td>Vehicle License Fee</td>
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<td>Utility User’s Tax</td>
<td>Sales of utility services, population, commercial activity, utility rates, inflation</td>
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<td>Business License Tax</td>
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<td>Transient Occupancy Tax</td>
<td>Hotel activity and rates, inflation</td>
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<td>Gas Tax</td>
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<td>Local Assessments</td>
<td>Number of rate payers</td>
<td>Inflations (unless built into rate structure)</td>
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<td>Real Property Transfer Tax</td>
<td>Real estate sales, property values</td>
<td></td>
</tr>
</tbody>
</table>

Figure 1 – How Sustainable Are Major City Revenues?
Economic Risk

Two Aspects of Long-Term Stability:

1. Sustainability: “A tax is best suited to fund programs where the demand for service changes in proportion to the proceeds of the tax…provides sufficient revenue to cover service costs even as service demands change over time.”
   - Services to People
   - Services to Property
   - Services to Businesses
Economic Risk

Two Aspects of Long-Term Stability:

2. Volatility: “…a measure of the degree of annual fluctuation from the average annual growth of a revenue source.” Generally unacceptable, except for when:

– The source provides strong return in relation to service demand over time.

– Sufficient reserves and use of one-time programming can be used to cushion the impacts of fluctuation.

– The revenue budget contains a mix of other sources with different performance characteristics that mitigate volatility.
Political Risk

“Local revenue stability is also affected by the potential for the state or federal governments (or courts) to reduce the revenue, which we label ‘political risk’.

To the extent that this delegation of authority is accomplished by the state Constitution, the risk of state actions impacting local finances and powers is reduced.”

Nevada? End of the 2015 Session?
Political Risk

- **Impacts on Fiscal Planning:**

  “...certain bells cannot be unrung. Once a serious proposal is made to transfer a revenue stream on which local government has relied, the dependability of that revenue stream for long-range fiscal planning is significantly damaged for as long as the political memory of the debate remains.”

- **Impacts on the Cost of Financing Government:**

  “Political risk means uncertainty, and in finance – whether public or private – uncertainty means at the very least higher costs and may mean complete frustration of important fiscal goals for a community.”
“In recent decades, local home rule in California (Nevada?) has been substantially eroded, particularly in municipal fiscal affairs…Meanwhile, the state’s economy and society are evolving, and finance officers are becoming increasingly concerned about the stability of city revenues.”
Thank You.

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