The Changing Landscape of Local Public Revenues

Public revenues are a focal point for hard-pressed state and local governments facing budget deficits because the recent recession has increased service demand and reduced proceeds from taxes, fees, and intergovernmental transfers. The Lincoln Institute's fourth annual land policy conference in June 2009 reviewed trends, insights, and new developments in local revenues. Varied practices across states and localities make it difficult to construct a typical case, yet offer opportunities to assess the performance of different revenue instruments.

Gregory K. Ingram

Local Taxes

Local governments have been reducing their reliance on the property tax and moving to other revenue sources including local sales taxes, income taxes, and user fees. Revenues from these sources are normally more volatile than property tax receipts, and some of them—especially local sales taxes—are much more regressive than the property tax. While the low volatility of property tax revenues is viewed as a virtue by local governments, the stability of property tax payments may in fact contribute to the tax's unpopularity.

Taxes often affect the decisions and behavior of firms and households, but the resulting economic distortions caused by taxes are better known to scholars than to policy makers. Simple calculations indicate that taxes on businesses and nonresidents have larger distortions than those on residents, largely because firms and nonresidents are better able to adjust, and even to relocate.

Conference participants supported the use of regional taxes, including local taxes mandated to be uniform across a region's jurisdictions, to avoid cross-border spillovers. For example, a regionally uniform sales tax would mitigate many of the border effects that plague local sales taxes. Most regional taxes now in place relate only to transportation, parks, and environmental agencies.

Local communities are also increasing their reliance on revenue from user fees that are likely to promote efficiency in both production and consumption of services such as utilities. These fees often secure bonds that are not subject to voter approval, especially when the fees are collected by an independent entity or special district.

State and Municipal Issues

While supporting more uniform regional tax systems, conference participants were concerned about the growth of state mandates and restrictions on local taxes. These regulations can reduce local autonomy and diminish a community's ability to differentiate fiscal tax and expenditure offerings in response to their residents' preferences, thereby reducing the benefits of civic participation.

Many local governments have ceded responsibility for the current costs of providing local public goods (e.g., road and sidewalk maintenance, street lighting, trash collection, recreation facilities) to homeowner associations, including condominiums, cooperatives, and private communities. Such associations provide services to about 50 million people and constitute about half the residences constructed in the U.S. in the past two decades. While these associations cover mainly current and not capital expenses, some are also part of community facility districts now widely used in fast-growing areas to finance capital improvements through bonds that must be repaid by community residents.

Nontax Revenue Sources

Developers prefer impact fees to regulations, which involve more risk for them. However, there is little evidence that communities control development by using one of these approaches much more than the other. Theory suggests that levying impact fees will lower property tax rates, but empirical support for this view is also scarce. Although impact fees are used widely, there is virtually no evidence from ex post studies that the impact fees charged correspond to the actual expenditures communities incur from development.

Business improvement districts (BIDs) are also widespread—more than 700 are located in 46 states. Some analysts hypothesize that BID expenditures substitute for public spending, while others suggest that they complement and increase public expenditures. A careful analysis of their impacts suggests that any effects are small, amounting to no more than one percent of public expenditures in most cities.

More details on these points and related topics will be published in the conference volume in May 2010.