



Own-Source Revenues for Metropolitan Cities

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de financiamiento de ciudades

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“ As it was our origin, the city now appears to be our destiny. It is where creativity is unleashed, community solidified, and citizenship realized. If we are to be rescued, the city rather than the nation-state must be the agent of change.”

Benjamin Barber, *If Mayors Ruled the World* (2013)

Cities are engines of economic growth

- ❑ Cities are important drivers of productivity, innovation, and economic growth
- ❑ Need for “hard” services (water, sewers, and roads) and “soft” services (cultural facilities, parks, and libraries) to attract skilled workers
- ❑ Cities that fail to provide these services will lose their economic advantage
- ❑ Cities need adequate revenues to provide services and infrastructure

Outline of Presentation

- ❑ Why Own-Source Revenues?
- ❑ Characteristics of Own-Source Revenues
 - ❑ Benefit Model
 - ❑ Matching Revenue Tools to Expenditures
 - ❑ Criteria for a Good Local Tax
- ❑ Which Local Taxes and Charges?
- ❑ How to Pay for Infrastructure
- ❑ Concluding Comments

Why Own-Source Revenues?

- ❑ Own-source revenues:
 - ❑ local discretion to modify revenues
 - ❑ taxes and user fees/charges
- ❑ As much as possible, each government should finance expenditures out of own revenues:
 - ❑ Provides needed revenues (user fees and taxes)

PLUS ...

Why Own-Source Revenues?

- ❑ Local autonomy
- ❑ Accountability of public officials to taxpayers for revenues raised
- ❑ Expenditure efficiency -- provide what citizens want and not waste resources
- ❑ Fiscal responsibility – limits demand for public spending and pressure for more transfers from other levels of government
- ❑ Stability and predictability of revenues

How Much Own-Source Revenues?

- ❑ Sufficient for the wealthiest cities (largest tax base) to finance most of their expenditure responsibilities with own-source revenues
- ❑ Relatively poor cities will still need intergovernmental transfers to provide adequate services
- ❑ Transfers not part of this presentation

Benefit Model

- ❑ Those who use the service should pay for it
- ❑ Wherever possible, local governments should charge for services
- ❑ Where not possible, they should finance services from taxes borne by local residents
- ❑ Where benefits of services spill over municipal boundaries, intergovernmental transfers are appropriate

Different Types of Services – Different Financial Tools

Private

Water
Sewers
Garbage
Transit

Public

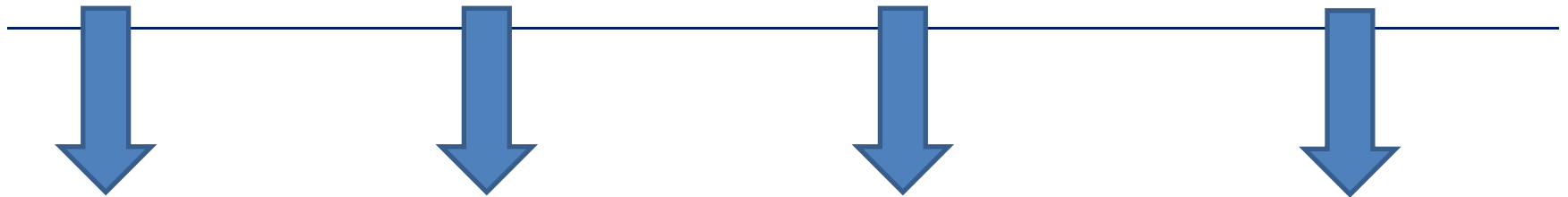
Police
Fire
Local parks
Street lights

Redistributive

Social assist.
Social housing

Spillovers

Roads/transit
Culture
Social assistance



User fees

Property tax
Sales tax

Income tax

Transfers

Criteria for a Good Local Tax

- ❑ Immobile tax base
- ❑ Adequate, stable, and predictable tax yield
- ❑ Difficult to export (unless matched by benefits)
- ❑ Visible and accountable
- ❑ Fair burden distribution
- ❑ Efficient – low distortions in economic activity or location of economic activity
- ❑ Easy to comply, administer, and collect

Which Local Taxes and Charges?

- User charges
- Property tax
- Personal income tax
- Local business taxes
- Selective sales taxes (e.g. vehicle registration)

User Charges

- ❑ Appropriate to pay for water, sewers, transit, recreation, garbage collection, parking ...
- ❑ Economic efficiency
- ❑ Provide information to government on how much citizens are willing to pay for services
- ❑ Ensure what public sector provides is valued by citizens
- ❑ Link expenditures and revenues
- ❑ Reduce over-consumption (when consumers are required to pay the cost)
- ❑ Reduce apparent need for investment in under-priced infrastructure
- ❑ Encourage more efficient land use

User Charges

- ❑ Need to identify the beneficiaries and exclude those who don't pay
- ❑ Difficult to charge for services that have historically been free
- ❑ Can be costly to price (e.g. metering for water)
- ❑ Distributional consequences perceived to be undesirable (but low prices subsidize higher income residents)
- ❑ Prices tend to be “sticky” (e.g. transit fares, water prices)

Road Pricing

- ❑ Users of streets, roads and highways do not look at external costs (congestion and pollution); over-use relative to what is economically efficient
- ❑ Under-pricing of auto congestion externality results in excessive dispersion – inefficiently low residential densities and sprawl
- ❑ Road tolls – incentive to make efficient decisions with respect to modal choice, trip frequency, trip timing, route choice
- ❑ Examples – London, Singapore, Toronto
- ❑ Need alternatives e.g. bus transit in London
- ❑ Technology makes it easier to price (but not to have it accepted!)

Property Tax

- ❑ Immovable tax base
- ❑ Tax on residences borne by local residents
- ❑ Improves accountability -- connection between municipal services and property values
- ❑ Visibility and accountability
- ❑ Local autonomy
- ❑ Revenue potential and stability
- ❑ Can be progressive in developing countries (e.g. rate progressivity, low-income or low-value exemptions)

Property Tax

- ❑ Unpopular with taxpayers because of visibility (especially those on fixed income)
- ❑ Can distort decisions to invest in property
- ❑ Inelastic (especially if assessments are not updated)
- ❑ Can be volatile (not stable and predictable for taxpayers)
- ❑ Tendency to over-tax business properties (tax exporting)
- ❑ Costly administration (identification, assessment, collection and enforcement)

Property Tax

- ❑ Good tax for local government

BUT

- ❑ No country seems to be able to raise more than 10 percent of revenues from property taxes
- ❑ Restricts the scope of services that big cities can provide from own revenues

Betterment Levies

- ❑ Form of property taxation
- ❑ Upfront, lump-sum payments from homeowners for public service improvements e.g. sidewalks, street lights
- ❑ Services benefit property values
- ❑ Valorización example in Colombia

Income Tax

- ❑ Appropriate to address issues of poverty, crime, social services
- ❑ Large metro areas more able to levy tax because of large geographic area
- ❑ Elastic revenue source
- ❑ Taxes commuters if levied on the basis of origin (place of employment)
- ❑ Equitable based on ability to pay and benefits received
- ❑ Administrative costs low if piggyback onto existing system (central limits on maximum and minimum tax rates)
- ❑ Local income tax can be consistent with national income tax but also different at the same time

Local Business Taxes

- ❑ Businesses should pay for services to businesses
- ❑ Business taxes and fees act as benefit taxes for services and infrastructure for businesses
- ❑ Broad-based levies that are neutral to factor mix in production are best (e.g. origin-based business value tax)

Selective Sales Taxes

- ❑ Low administrative cost (limited number of vendors)
- ❑ Some are benefit-related (e.g. vehicle registration tax is related to road use and external effects such as pollution and congestion)
- ❑ Can affect consumer behavior e.g. vehicle taxes reduce automobile use
- ❑ Can create economic distortions – base is small so rates may be high; high rates increase potential for evasion

Motor Vehicle Taxes

- ❑ Related to benefits received from road use
- ❑ Tax is visible and enforceable
- ❑ Taxes are productive in terms of revenue
- ❑ Reasonably progressive
- ❑ Discourages road use (but not as good as tolls)

A Portfolio of Taxes

- ❑ No one tax meets all of the criteria for a good tax
- ❑ Best approach may be to provide metropolitan cities with access to a portfolio of taxes
- ❑ Provide a stable source of revenue through the property tax and enough elasticity through good income, sales, or business taxes to meet growing expenditure demands of expanding metropolitan cities

DIFFERENT INFRASTRUCTURE – DIFFERENT FISCAL TOOLS

Taxes



short asset life
(police cars,
computers)

User fees



identifiable beneficiaries
(transit, water)

Borrowing



large scale assets
with long life
(roads, bridges)

DIFFERENT INFRASTRUCTURE – DIFFERENT FISCAL TOOLS

Development levies

P3s

Land value capture taxes



growth-related costs;
new development or
redevelopment
(water, roads, sewers)



large in scale;
revenue stream;
measurable results
(toll roads)



increase property values
(transit)

Borrowing

- ❑ Inter-generational equity -- synchronizes costs and benefits over time
 - ❑ Lumpiness of capital expenditures
 - ❑ Lack of liquidity of local governments
- BUT
- ❑ Need rules to preserve fiscal discipline (e.g. borrowing only for capital investments; limits to the amount of borrowing)
 - ❑ To borrow in the capital market, need creditworthy local governments (improved by transparent budgeting and accounting, own-source revenues)

Development Levies

- ❑ One-time charge to cover growth-related capital costs associated with new development
- ❑ Off-site infrastructure (e.g. highways, sewer lines, etc.)
- ❑ New growth pays for itself and is not a burden on existing taxpayers
- ❑ Social cost may be higher if paid by private rather than public borrowing

Development Levies

- ❑ Developers will develop at the efficient time and place if they face the full social cost of their development
- ❑ If levy differentiated by location, density, type of development – then efficient development
- ❑ A uniform charge will subsidize inefficient land uses
- ❑ If levied on a development by development basis, development charges can lead to efficient land use decisions

Land Value Capture

- ❑ Capture the increment in land value resulting from public investments (e.g. roads, transit, water supply)
- ❑ Tax increment financing (TIF) in the U.S. – property value increment is estimated as the difference between property taxes after public infrastructure investment and before investment
- ❑ TIF revenue earmarked to pay for the investment for a period of 15-35 years; then reverts back to general revenues
- ❑ Risk that development won't occur and increment will not be sufficient to pay back the investment

- ❑ Plusvalía and valorización examples in Colombia

Public-Private Partnerships

- ❑ New source of capital
- ❑ Public sector can draw on private sector expertise; innovation
- ❑ Potential for cost savings with competition
- ❑ Potential loss of control for the public sector
- ❑ Private borrowing costs may be greater than public borrowing costs

Concluding Comments

- ❑ As much as possible, local governments should raise the revenues they spend -- match revenue tools with expenditure responsibilities
- ❑ User fees should fund services where beneficiaries can be identified e.g. water/sewers, electricity, waste collection
- ❑ Pricing services correctly creates the right incentives for efficient use of resources and efficient land use
- ❑ Local taxes should fund services that provide collective benefits to the local community
- ❑ Local governments need a mix of taxes

Concluding Comments

- ❑ Appropriate methods for financing infrastructure – borrowing, development levies, land value capture taxes, public-private partnerships
- ❑ Metro areas should have greater fiscal autonomy than other urban or rural areas – for local services and taxes
- ❑ Governance and finance are linked – need to design effective metropolitan governance structure and then appropriate fiscal structure