
Options for Mobilizing Local Revenues

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Outline of Presentation

- Matching revenue tools to expenditure responsibilities
- What is a local tax?
- Criteria for a good local tax
- Which local taxes and charges?
- International patterns of local taxation
- The need for a mix of taxes
- Concluding comments

Matching Revenue Tools to Expenditure Responsibilities

- As much as possible, each government should finance expenditures out of own revenues:
 - Local autonomy
 - Responsibility and accountability
 - Stability and predictability of revenues
- Presentation focuses on local options for revenue mobilization

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

Income tax

Transfers

What is a “Local” Tax?

- A local tax is one where the local government:
 - ❑ determines whether the tax is imposed
 - ❑ determines the tax base
 - ❑ sets the tax rate
 - ❑ collects the revenue and enforces the tax
 - ❑ receives the revenue

What is a “Local” Tax?

- Rarely are all decisions made by local governments
- Local tax rate setting is essential to being a local tax
- The level of government making the spending decisions should set the tax rate

Criteria for a Good Local Tax

- Immobile tax base
- Adequate, stable and predictable tax yield
- Difficult to export
- Visible and accountable
- Fair
- Minimize harmful inter-municipal competition
- Easy to administer and collect

Not all criteria can be met at the same time

Which Local Taxes and Charges?

- User charges
- Property tax
- Personal income tax
- Consumption taxes
 - General sales tax
 - Specific excise taxes (e.g. vehicle registration)

User Charges: Types

- Service fees – e.g. license fees
- Public prices – from the sale of private goods and services e.g. water, transit, garbage collection, recreation
- Specific benefit taxes – compulsory contributions to local revenues; related to benefits received e.g. supplementary property taxes to pay for sidewalks or street lighting

User Charges

- Promote efficient use of resources in the public sector (when properly designed) because they 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)
- Give appropriate capital investment signals – reduces demand for infrastructure

User Charges: Problems

- Can be costly to price (e.g. metering for water)
- Need cost information (e.g. need to know long-term capital costs, infrastructure investments)
- Distributional consequences may be undesirable
- Need to be able to identify the beneficiaries and exclude those who don't pay
- Hard to increase public sector prices (e.g. transit fares)
- Rarely implemented correctly

Property Tax: Advantages

- Property cannot run away and hide from tax collectors
- There is a connection between municipal services and property values (equitable based on benefits received)
- It is visible and accountable
- It can promote local autonomy
- It is not necessarily regressive (equitable based on ability to pay)

Property Tax: Problems

- Not based on benefits-received for some services
- 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
- Costly administration (identification, assessment, collection and enforcement)

Personal Income Tax: Advantages

- 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

Personal Income Tax: Problems

- Competition with central government
- Potential for inter-municipal tax competition
- May create need for equalization

General Sales Tax: Advantages

- Visible on each transaction
- Elastic revenue source
- Taxes benefits enjoyed by commuters and visitors
- Low administrative costs if piggybacked onto existing system

General Sales Tax: Problems

- It can be regressive
- Competition with central government
- Potential for inter-municipal competition

Excise 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 behaviour e.g. taxes on cigarettes reduce smoking; vehicle taxes reduce automobile use
- Can create economic distortions – base is small so rates may be high; high rates increase potential for evasion

Excise Taxes: Motor Vehicle Taxes

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

Local Taxation in OECD Countries: Property Taxes

- Account for more than 90% of all local tax revenue in Australia, Canada, Ireland, New Zealand, United Kingdom (almost 90% in Mexico)
- Less than 10% of local tax revenue in Belgium, Czech Republic, Denmark, France, Luxembourg, Norway, Sweden

Local Taxation in OECD Countries: Personal and Corporate Income Taxes

- 80% of local tax revenue in Belgium, Switzerland, Denmark, Finland, Norway, Sweden, Iceland, & Luxembourg
- No local income taxes in Australia, Canada, Mexico, France, Greece, Ireland, Netherlands, New Zealand and the United Kingdom

Local Taxation in OECD Countries:

Sales Tax

- More than 20% of total local tax revenue in Austria, US, Czech Republic, Greece, Hungary, Italy, Japan, Korea, Netherlands, Portugal, Slovak Republic, Spain, Turkey
- Non-existent in Australia, Finland, Ireland, Sweden, UK
- Close to zero in Canada, Mexico, Switzerland, Denmark, Luxembourg, Norway, Poland

Observations from International Experience

- No consistent or uniform approach to local government taxation
- Some countries have only one local tax; others have two taxes, and still others have three taxes
- Generally, broader spending responsibilities come with greater diversity of taxes.

Observations from International Experience

- Access to taxes depends on:
 - types of expenditures that must be funded;
 - local government's capacity to administer a tax;
 - willingness of a senior government to assign taxes to local government; and
 - constitutional and legislative requirements

The Need for a Mix of Taxes

- A mix of taxes is appropriate:
 - One tax may create distortions offset by a mix of taxes
 - Improves flexibility in adapting to local conditions and circumstances
 - Increases revenue elasticity

Concluding Comments

- As much as possible, local governments should raise the revenues they spend
- User fees should fund services where beneficiaries can be identified e.g. water/sewers, electricity, waste collection
- Local taxes should fund services that provide collective benefits to the local community
- Local governments need a mix of taxes

Concluding Comments

- Local governments should set their own tax rates
- The property tax is a good tax for local governments
- The extent of revenue mobilization for the property tax and other taxes depends on the characteristics of the tax: what is included in the tax base, the level of tax rates, the ability to administer and collect taxes