



Does local government autonomy
promote fiscal sustainability?
*Lessons from Illinois' home rule
municipalities*

Matthew Walshe

IMFG Blanche and Sandy Van Ginkel Graduate Fellow

Institute on Municipal Finance and Governance

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Defining local government autonomy

The extent to which a local government has the “discretion in determining what [it] will do without undue constraint from higher levels of government, and... the means or capacity to do so” (Wolman et al. 2010).

- An important component of which is fiscal autonomy: the ability to set tax rates and establish the revenue base (Chapman 2003).

Operational definition of autonomy: home rule or non-home rule

The decidedly narrow focus on Illinois municipalities has a benefit and a cost:

- Complex definition and measurement of local government autonomy can be reduced to a binary outcome.
- External validity is impaired.

The benefits of enhanced autonomy

- Positive relationship with Gross Metropolitan Product (Slack 2017).
- Greater accountability of the government to its citizens (Bird 2011).
- Allow for the benefits of interjurisdictional competition to be realized (Oates and Schwab 1988, 1991, 1996).
- Governments can effectively tailor the bundle of goods and services to those preferred by their constituents (Borge et al. 2014).

My outcome of interest is fiscal sustainability

Defined as the ability to consistently meet financial responsibilities and “ensure the continued provision of the service and capital levels that the public demands” (Chapman 2008).

- Quantified using the operating surplus (Bird 2015) and the ratio of debt to revenue (PSAB 2007).

Why might autonomy promote fiscal sustainability?

- Local governments have been increasingly tasked with a broader set of responsibilities, but without commensurate increases in aid or authority (Kitchen 2002; Maher and Deller 2007).
- State governments transmit fiscal stress to their constituent localities (Gillette 2009).

But local government officials are not benevolent welfare-maximizers

- They have their own objectives that may include re-election prospects and/or budget maximization (Brennan and Buchanan 1977).
- Voting, at the booth or with one's feet, is itself an imperfect check on government behavior (Gillette 2009).
- Institutions (e.g., balanced-budget rules, TELs, term limits) may be desirable in order to bring about policies different from those that “politicians would choose if left to their own devices” (Rose 2010).

I take this question to the data

...and ask, does the local government autonomy conferred by home rule improve fiscal sustainability?

- I exploit 68 transitions into home rule that occurred between 2000 and 2016.
- Data compiled from Annual Financial Reports submitted to the Illinois' State Comptroller's Office.

McDonald (2015) finds that county charters improve fiscal health

- Of Florida's 67 county governments, 20 elected to adopt a charter between 1980 and 2012. Charter-adopting counties...
 - Reduced their ratio of total expenditure to total revenue;
 - Reduced their ratio of debt servicing expenses to revenue;
 - Reduced their dependence on intergovernmental transfers.

Outline

- Defining municipal home rule
 - Illinois' particular brand of home rule
- How do home rule and non-home rule units of government compare on demographic/ socioeconomic features and fiscal outcomes?
- Can the differences that we observe be reasonably attributed to a causal effect of home rule?

What is municipal home rule?

“Any power of self-government that may be conferred upon a city, whether the grant of such power be referable to statute or constitution” (McBain 1916).

- The “antidote to the constraints of Dillon’s Rule” (Mead 1997)

In some cases, home rule is the power to draft a charter

- Missouri's 1875 Constitution permitted the drafting of a municipal charter for cities with a population greater than 100,000.
- Nebraska's 1912 Constitution permits charters for cities with a population greater than 5,000.
- Tennessee's 1953 constitutional amendment allowed municipalities to adopt a new charter.

Home rule is not a singular concept

- Some grants of home rule provide little, if any, fiscal autonomy:
 - Indiana’s 1980 Home Rule Act denies the power to “impose any tax, except as expressly granted by statute.”
 - Iowa’s 1968 constitutional amendment states that municipalities “shall not have the power to levy any tax, unless expressly authorized by the general assembly.”

Illinois has “one of the most liberal [forms of home rule] found in any state constitution” (Cole and Gove 1973)

- A true reversal of Dillon’s Rule:
 - “A home rule unit may exercise any power and perform any function pertaining to its government and affairs” (Illinois 1970 Constitution art. VII, §6(a)), subject only to expressed limitations, including...
 - Income taxes
 - Choice of sales tax base
 - Real estate transfer taxes

There are two ways for an Illinois municipality to acquire home rule

- Home rule is granted automatically to any municipality with a population exceeding 25,000.
- Municipalities below that threshold may adopt home rule by referendum.

- Of Illinois' 1,297 municipal governments...
 - 215 are home rule units
 - 77 automatically
 - 138 by referendum

Home rule is without cost, yet it has only a 50.8% success rate in referenda

- Between 1970 and 2000, 97 out of 191 home rule referenda were successful (Northern Illinois University 2001).
- Why does it *ever* fail?
 - Residents are understandably reluctant to be subjected to new forms of taxation (e.g., sales, motor fuel, vehicle, etc.).
 - Home rule effectively repeals institutional features that ostensibly *promote* prudent fiscal practices.

Statutory property tax rate limits do not apply to home rule units

- 34 states have some form of rate limit (Anderson 2006)
- Only “potentially binding” (Mullins and Joyce 1996), especially in an environment of rapidly increasing property values.
- This might explain the desire for the Property Tax Extension and Limitation Law (PTELL).
 - Restricts the growth rate of extensions to the lesser of 5% or the rate of inflation.

The PTELL does not apply to home rule units

- PTELL reduced the growth rate of property tax revenue (Dye and McGuire 1997; Dye et al. 2005).
- TELs have little, if any, effect on total revenue, but instead induce substitution in favor of non-tax revenues (Mullins and Joyce 1996; Shadbegian 1999).
- Exception: self-imposed limits are effective (Brooks et al. 2016).

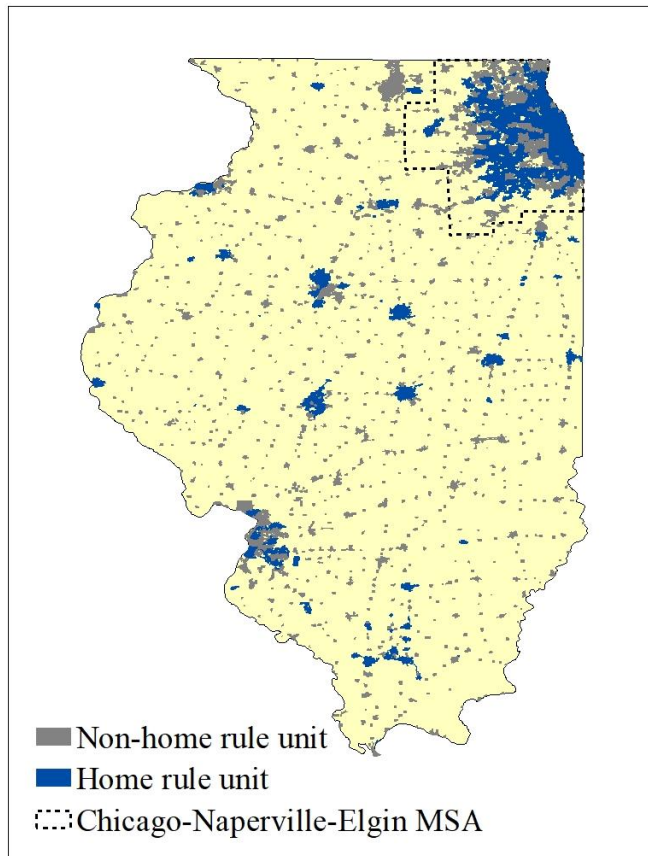
Home rule units do not face debt limits

- General obligation (GO) bond issues must be approved through referendum.
- And the balance cannot exceed 8.625% of Equalized Assessed Value (EAV).
- Debt limits have proven ineffective in reducing debt, but instead tend to induce a substitution in favor of revenue bonds and other forms of non-guaranteed debt (Farnham 1985; Von Hagen 1991; Nice 1991).

Empirical questions

- Does home rule cause the size of government to expand?
- Is home rule used as a vehicle to bypass property tax limits?
To bypass debt limits?
- Does home rule promote fiscal sustainability
 - Does it improve the operating surplus?
 - Does it reduce the debt burden?

215 of Illinois' 1,297 municipalities (17%) currently have home rule



... but this represents 63% of
the state's population.

Home rule units are predominantly urban municipalities

	Home rule	Non-home rule	Difference
Share of housing stock in urban areas	0.93	0.33	0.60*** (0.02)
Share of occupied housing that is owned	0.71	0.79	-0.08*** (0.01)
Population (thousands)	25.03	2.84	22.19*** (1.92)
Population density (thousands per km ²)	1.15	0.46	0.69*** (0.07)
Median age	37.79	40.14	-2.35*** (0.40)
Median household income (thousands)	63.59	48.83	14.76*** (2.23)

Within the Chicago MSA, the income disparity is eliminated

	Home rule	Non-home rule	Difference
Share of housing stock in urban areas	0.98	0.81	0.17*** (0.03)
Share of occupied housing that is owned	0.74	0.81	-0.07*** (0.01)
Population (thousands)	27.80	8.23	19.57*** (2.48)
Population density (thousands per km ²)	1.43	0.85	0.58*** (0.10)
Median age	37.90	39.15	-1.25* (0.63)
Median household income (thousands)	73.95	79.27	-5.32 (3.72)

Affluent, urban municipalities opt-in to home rule

	Home rule		Non-home rule
	<u>Opt-in</u>	<u>Automatic</u>	
Share of housing stock in urban areas	0.97	1.00	0.81
Share of occupied housing that is owned	0.75	0.73	0.81
Population (thousands)	14.52	48.67	8.23
Population density (thousands per km ²)	1.24	1.73	0.85
Median age	38.95	36.25	39.15
Median household income (thousands)	77.24	68.76	79.27

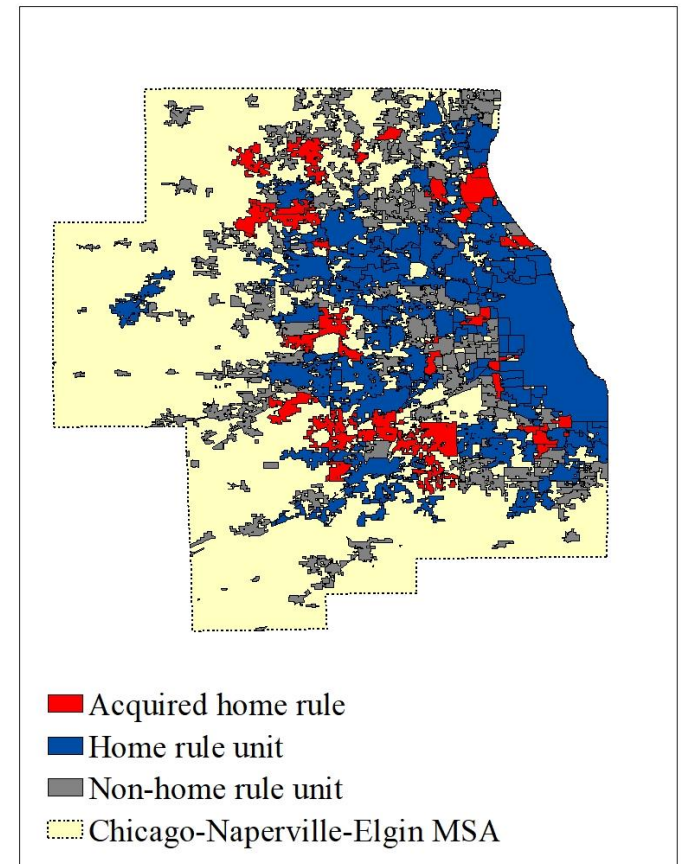
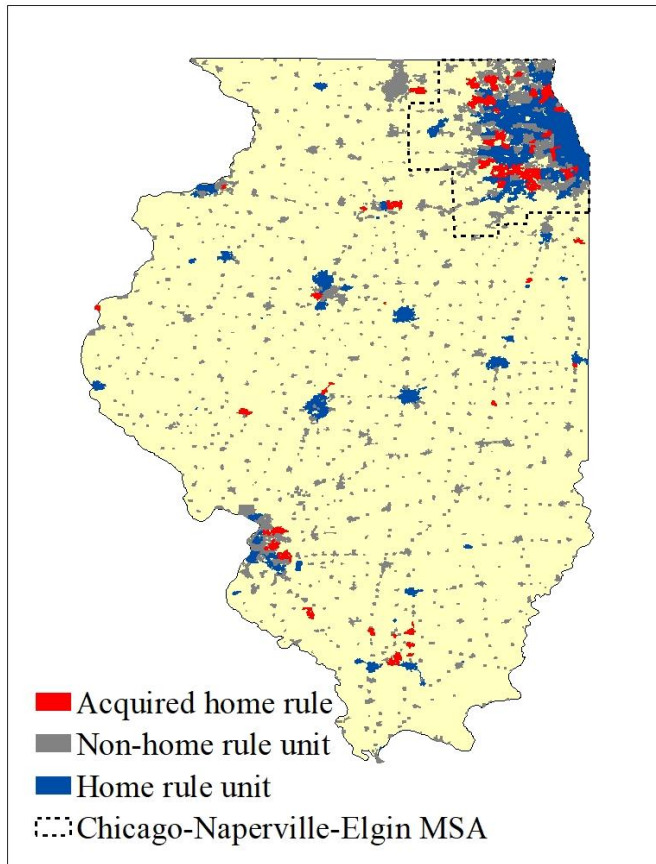
Home rule governments are larger and more tax dependent

	Home rule	Non-home rule	Difference
Own-source revenue (dollars per capita)	1,226.51	711.68	514.84*** (75.82)
Share of local taxes in own-source revenue	0.36	0.28	0.08*** (0.01)
Operating expenditure (dollars per capita)	1,493.72	872.73	620.98*** (105.78)
Ratio of debt balance to revenue	1.09	0.92	0.17 (0.12)
Ratio of GO bond balance to revenue	0.60	0.22	0.38*** (0.06)
Ratio of other debt balance to revenue	0.49	0.70	-0.21* (0.10)

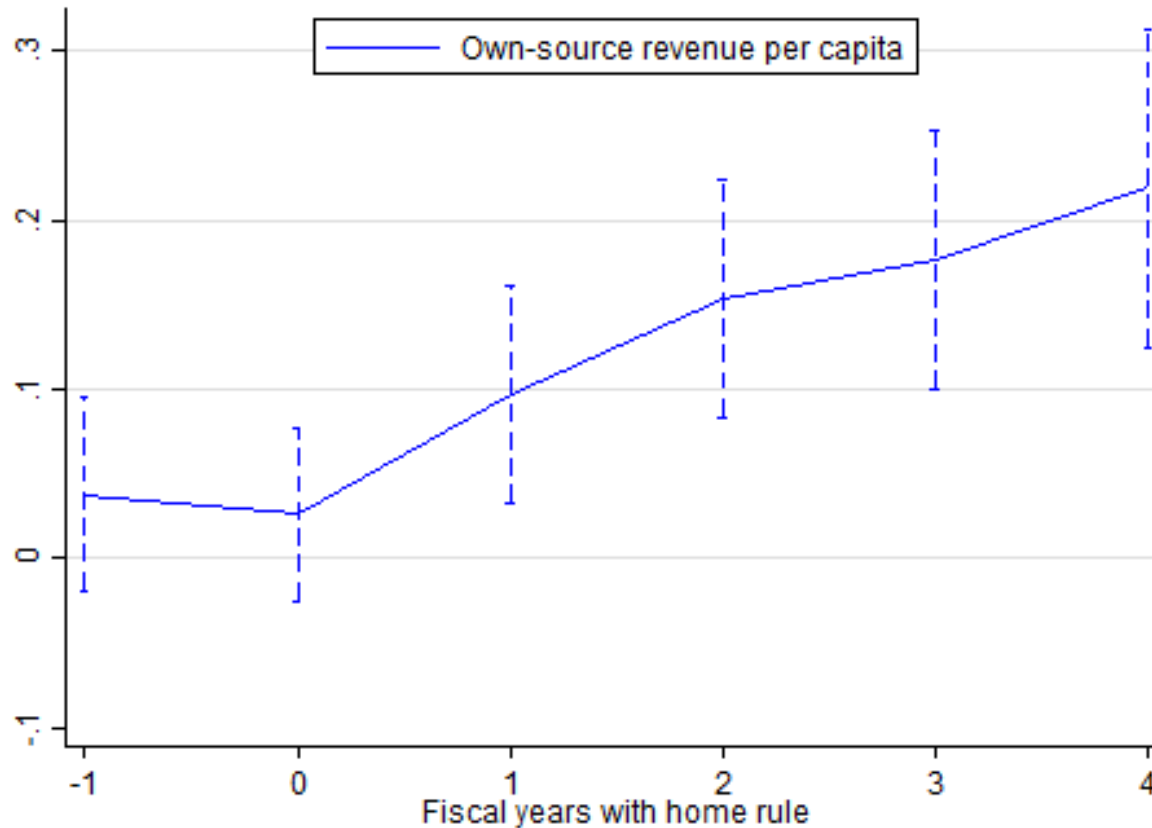
... and this is especially true of opt-in home rule units

	Home rule		Non-home rule
	<u>Opt-in</u>	<u>Automatic</u>	
Own-source revenue (dollars per capita)	1,325.67	1,080.48	711.68
Share of local taxes in own-source revenue	0.38	0.34	0.28
Operating expenditure (dollars per capita)	1,663.44	1,243.76	872.73
Ratio of debt balance to revenue	1.17	0.98	0.92
Ratio of GO bond balance to revenue	0.65	0.52	0.22
Ratio of other debt balance to revenue	0.52	0.46	0.70

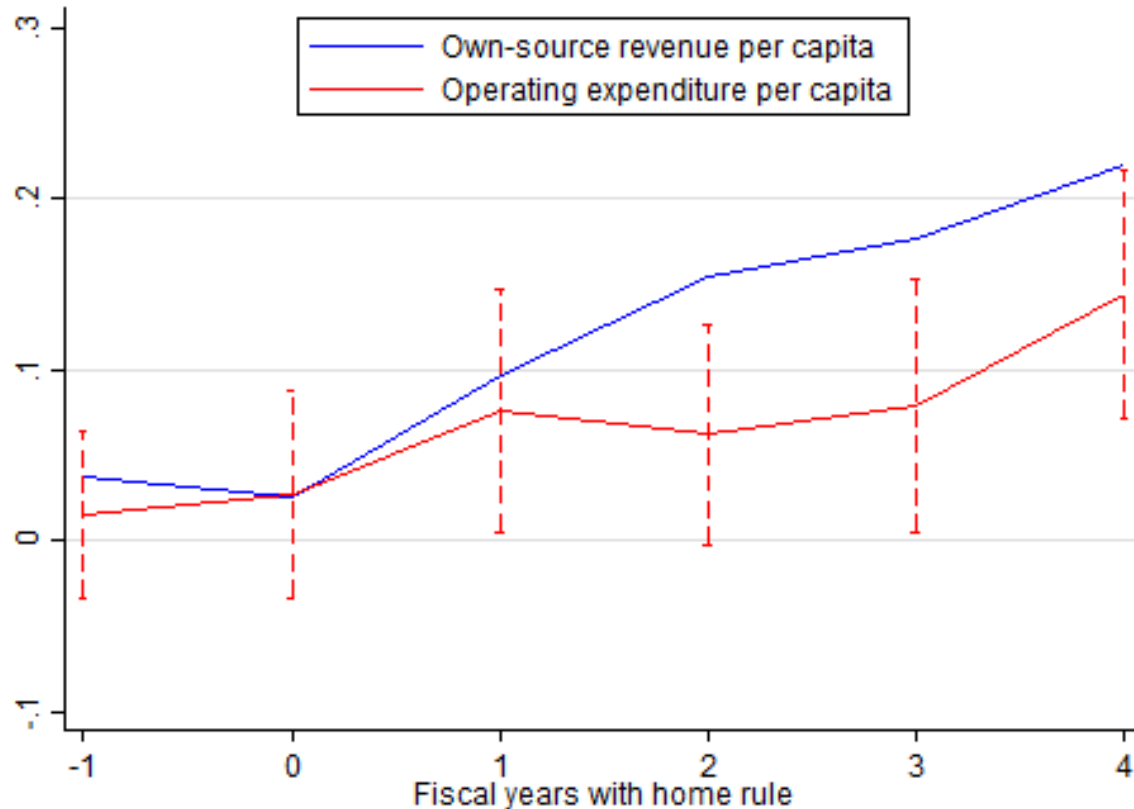
68 municipalities acquired home rule between 2000 and 2016



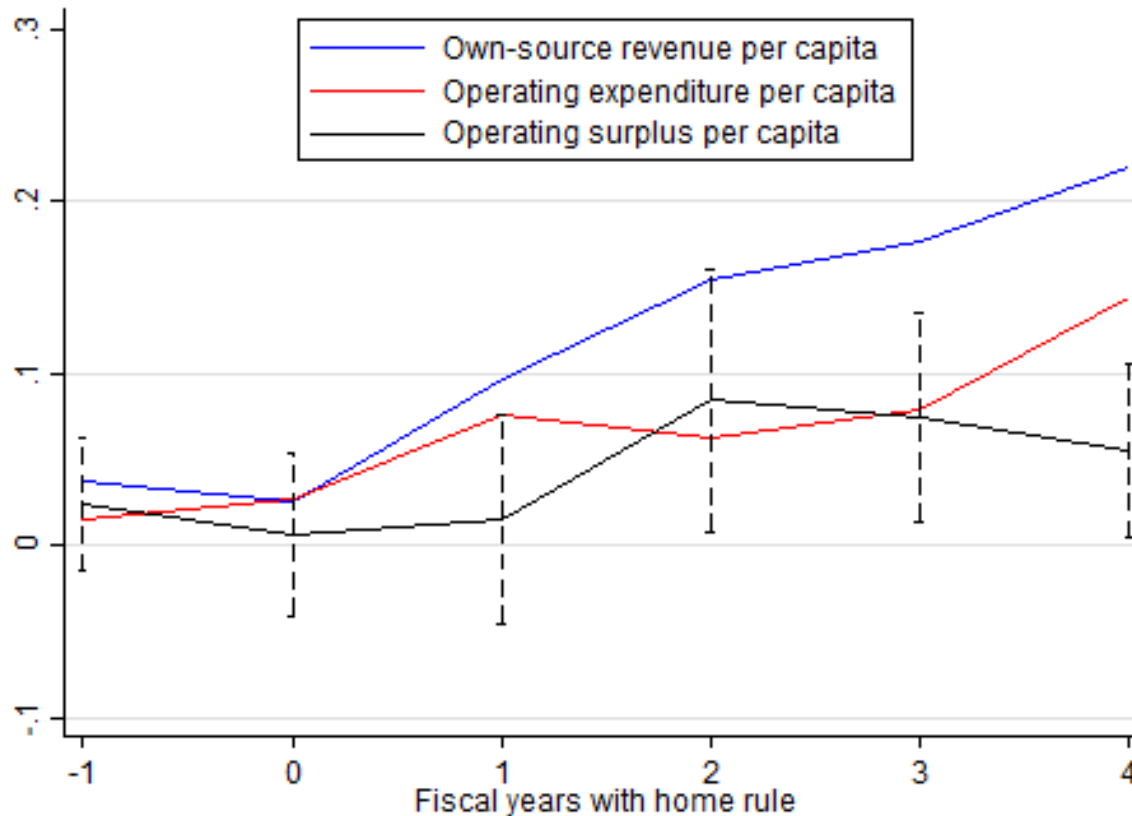
Home rule increases own-source revenue by 21.9% (\$156 per capita)



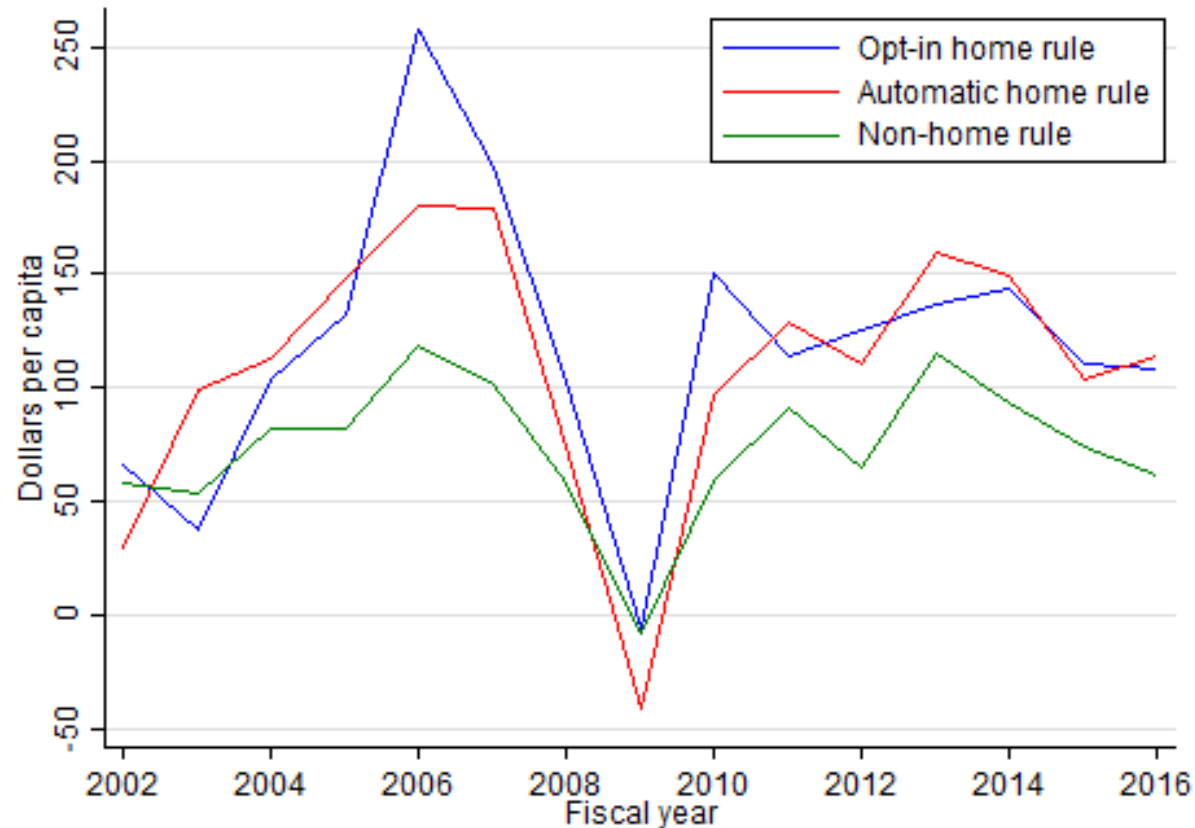
... increases operating expenditure by 14.4% (\$103 per capita)



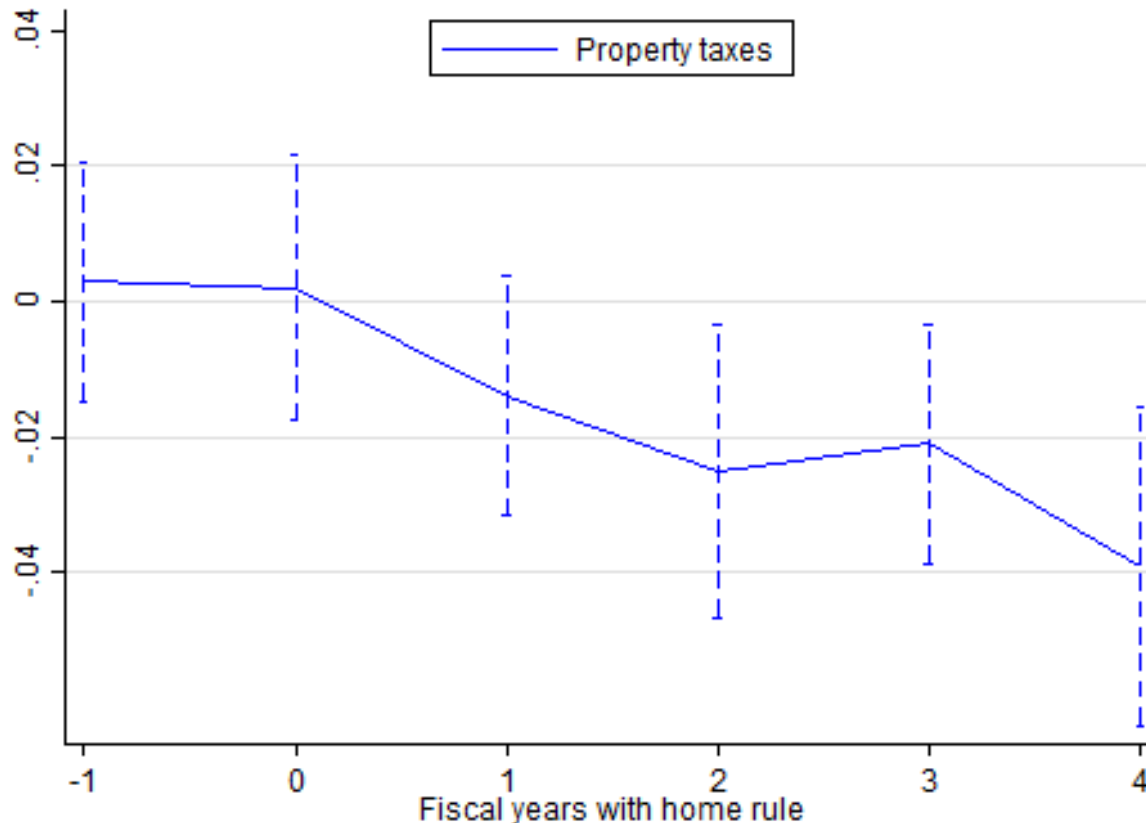
... and increases the operating surplus by 5.5% (\$60 per capita)



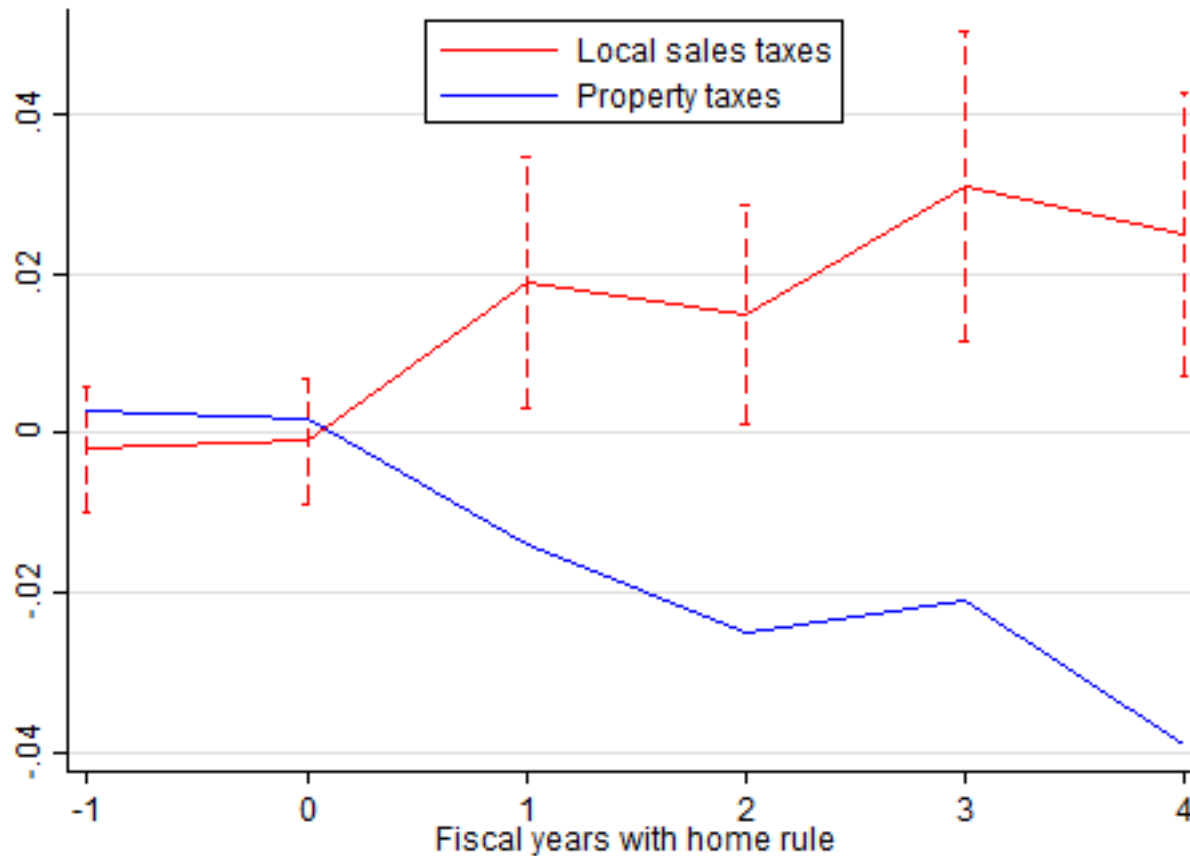
Outside of the recession, home rule units ran higher operating surpluses



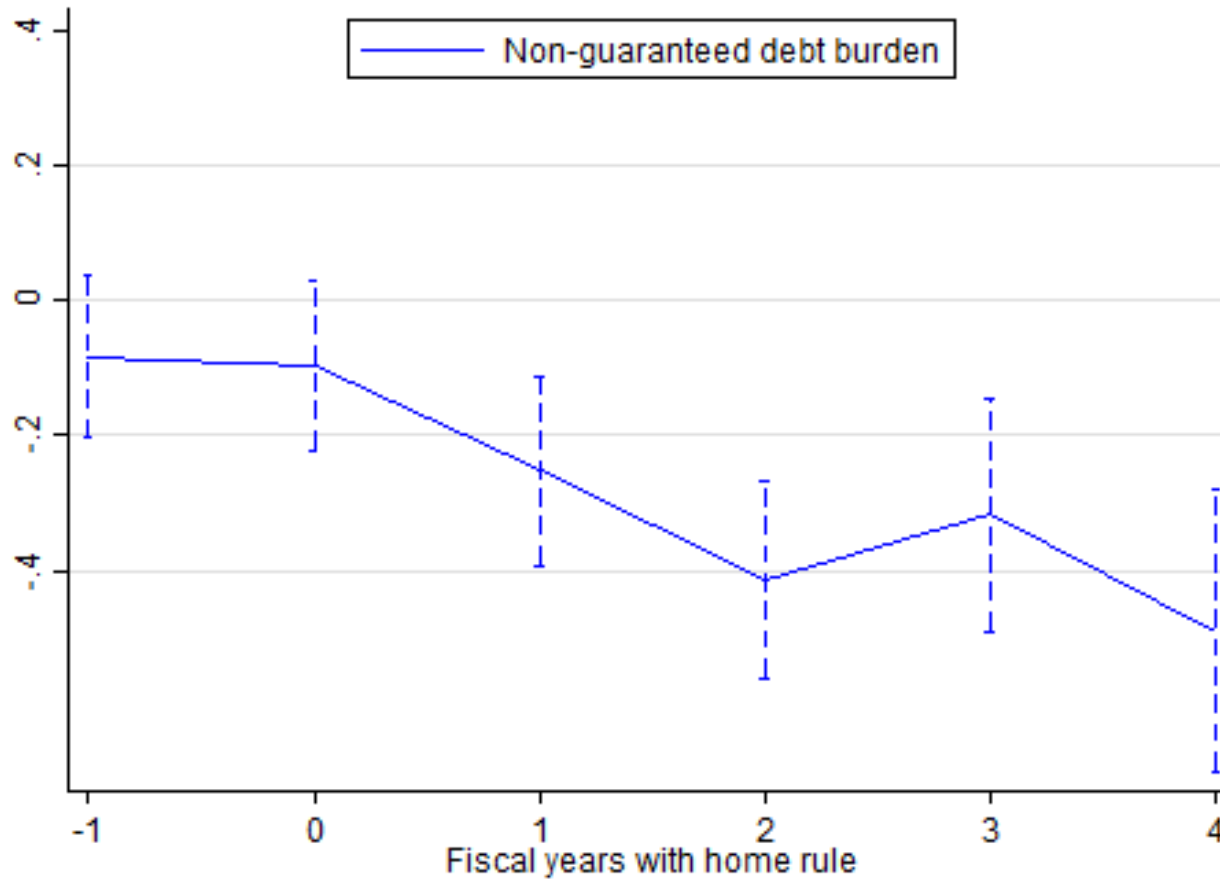
As a share of own-source revenue, property taxes decrease by 3.9 p.p.



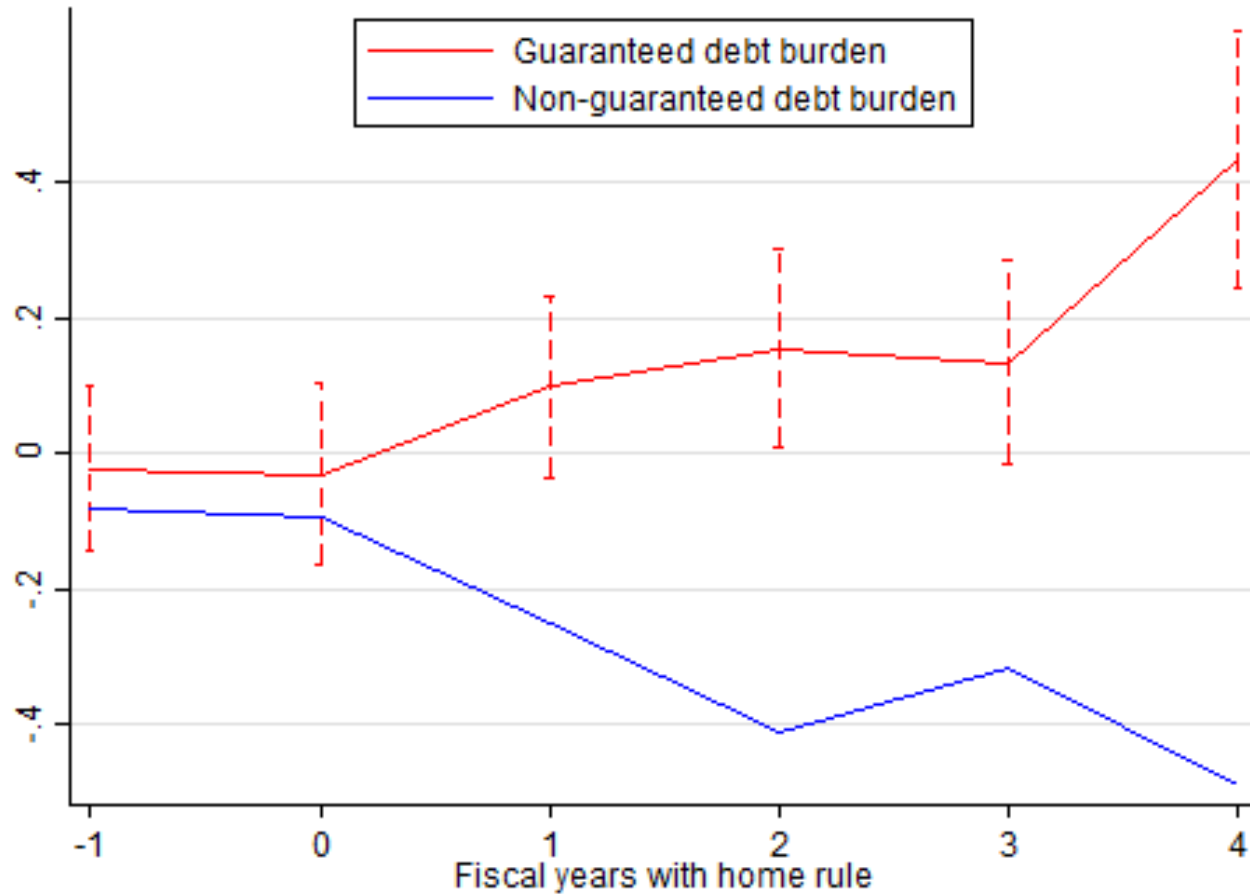
... and local sales taxes increase by 2.5 p.p.



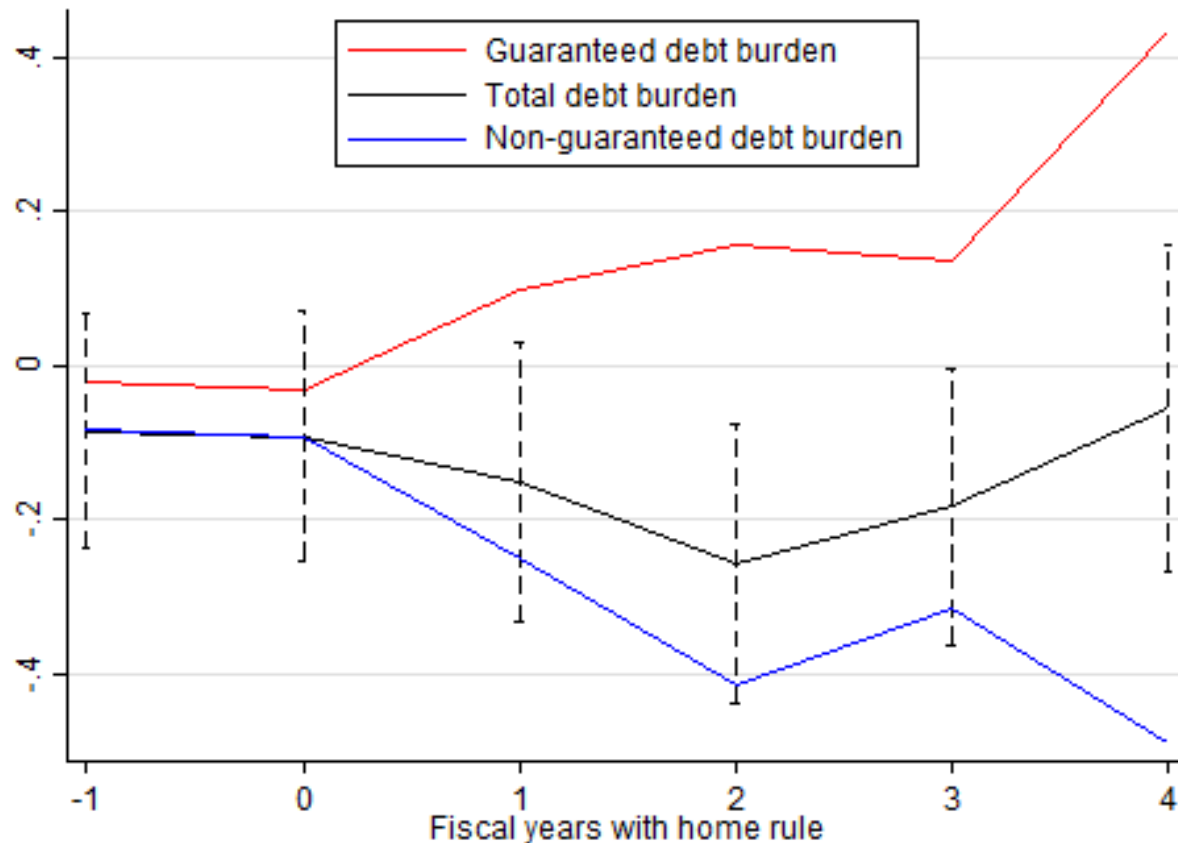
Home rule units retire non-guaranteed debt



... issue more guaranteed debt



... but experience no statistical change in their overall debt burden



Summary

- Home rule increases the size of government, but improves the operating surplus.
- Home rule units substitute GO bonds for other forms of debt, but do not increase their overall debt burden.
- Home rule is not used as a vehicle to bypass property tax limits; rather, property tax dependence is reduced.



Thank you.

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