

Tax Efficiency & Equity

Budgeting in Local Government

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Conversations about TAX

When you discuss taxes and revenues, how do those conversations go?

Administrators

Elected officials

Citizens



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Perspectives

This afternoon we are going to briefly talk about underlying theory and criteria on tax policy

Discuss the trade-offs

May have limited impact what your options are, but it informs the conversation and provides and underlying understanding

Dillion's Rule

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Evaluating Tax Systems

- How do you discuss if tax policy is “good”?
- Defining and measuring the criteria for judging the effects of a tax
 - Efficiency
 - Equity
 - Adequacy
 - Feasibility



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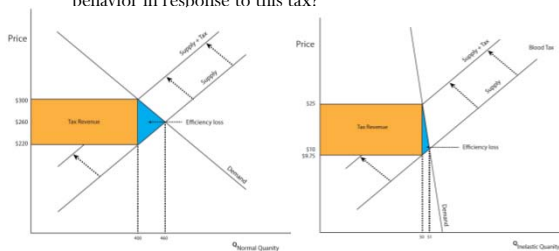
Efficiency

- For most things the “efficient” point is where the market supplies and prices the good
 - Taxes move us away from that point
- Taxes will change behavior more (create larger efficiency losses) when those goods are “elastic”
- Key concept: efficiency, elasticity

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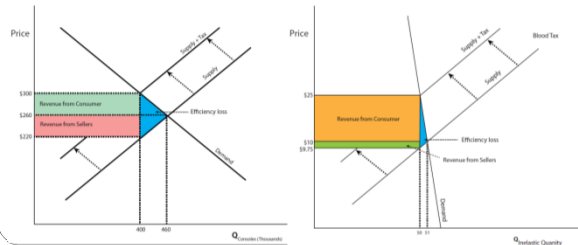
Evaluating the Efficiency of a Tax

- What relative price will this tax distort?
- How much will consumers and producers change their behavior in response to this tax?



Tax Incidence

- Who pays the tax?
 - Another way of asking this question is: Who bears the economic burden of the tax



Equity

- Equity standards assess the *fairness* of a tax
- Equity objectives may be explicitly considered in setting a tax rate structure
- Equity considerations may represent trade-offs or unintended consequences from a tax

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Ability to Pay Principle

- People pay taxes based on their ability to pay for them.
- Two different notions exist of the ability-to-pay principle:
 - Horizontal Equity
 - Vertical Equity
- Key concept: Effective tax rate

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Horizontal Equity

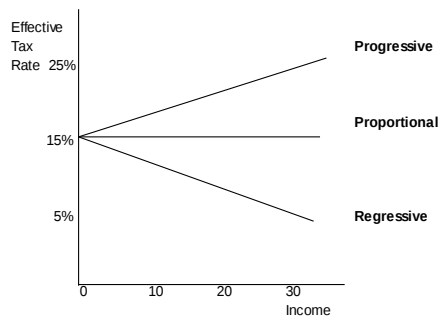
- People with the same ability to pay, should pay the same
 - What should be included when gauging ability to pay?

Vertical Equity

- People with different abilities to pay, should have different burdens
 - Key Issue: Progressivity

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Vertical Equity



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Benefit Principle

- Cost of public expenditures should be borne by those who benefit from them
- People pay directly for the benefits they receive
- Fairness is based on the relationship between consumption and payment

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Adequacy

- Revenue Raising Capacity
 - The ability of the tax to produce a significant amount of revenue at reasonable tax rates.
 - The broader the tax base the lower the tax rate can be to produce the same amount of revenue
- Stability
 - Revenue raised over time remains relatively constant
 - Tax elasticity
 - How well do tax revenues keep up with changes in income?
 - We want revenues to grow with budget needs
 - These can be in contrast with each other

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Feasibility

- Administrative Feasibility
 - Compliance costs?
 - Easy to administer?
- Political Feasibility
 - Visibility
 - Exportability

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Prompt

- Work in groups of about 5.
 - Pull out your calculators!
 - *You do not have to really calculate the actual fees and revenue, just think about them in broad terms.*
- We will take about 10 minutes
- Decide on which option you are choosing and the two most crucial reasons why it is the best choice.
 - Then choose someone to share them with the whole group.

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Prompt

- Are parks necessary?
- Are they a part of what local governments are entrusted to provide their citizens?
- Whom do they serve? Who benefits from them?
- Colorado Springs example.

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Property Taxes

- Efficient:
 - Elastic?
 - Size of base
 - Deductions and exemptions
- Unpopular
 - Visible
 - Inequitable
 - Horizontally
 - Vertically

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Sales Taxes

- Elastic:
 - It depends on what is included (excluded)
 - Food, clothes, etc?
 - Change to NC law last year
 - Luxury taxes vs sin taxes
 - Competition
- Equitable?
 - Make more = spend more?

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User Fees

- Equity
 - Ability to pay
 - Benefit Principle
- Efficiency
 - What are examples of user fees in your government?
 - Are they inelastic? (sensitive to price)

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Final Thought

- Taxes are only one side of the equation... do not forget expenditures.
 - For citizens especially
 - What are the trade-offs?
 - What are the services provided?
- Taxpayer receipt:
 - The White House provides one
 - Example of how to construct one at the local level:
 - <http://sogpubs.unc.edu/electronicversions/pdfs/pmb08.pdf>

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Thank you

- Please feel free to contact me with any questions!
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