

**State and Local Revenues
Beyond the Property Tax**

Mary Edwards

© 2006 Lincoln Institute of Land Policy

**Lincoln Institute of Land Policy
Working Paper**

The findings and conclusions of this paper are not subject to detailed review and do not necessarily reflect the official views and policies of the Lincoln Institute of Land Policy.

Please do not photocopy without permission of the Institute.
Contact the Institute directly with all questions or requests for permission.
(help@lincolninst.edu)

Lincoln Institute Product Code: WP06ME1

Abstract

This paper examines recent shifts in sources of state and local revenues beyond the property tax. The paper begins with a discussion of the changing context of federal-state-local relations and the institutional, political, social and economic trends affecting local governments today. The following sections profile the major revenue sources and trends over time and each of the revenue sources is evaluated according to the commonly accepted criteria for a good tax or revenue source. Innovative funding sources that state and local governments have turned to in an attempt to raise additional revenue are also highlighted. Finally, the last section provides ideas for classroom and training exercises for those who teach in this area.

About the Author

Mary Edwards is an Assistant Professor in the Department of Urban and Regional Planning at University of Illinois at Urbana-Champaign. Her research interests are in the areas of state and local finance, intergovernmental cooperation and plan implementation. Her most recent research project includes a national survey of planners about their use of financial tools in planning decisions.

Contact Information:

Mary Edwards
Assistant Professor
Department of Urban and Regional Planning
University of Illinois at Urbana-Champaign
111 Temple Buell Hall
611 Taft Drive
Champaign IL 61820

217-333-3211 (phone)
217-244-1717 (fax)
mmedward@uiuc.edu

The author would like to acknowledge Pam Thompson for her assistance with the tables and figures and Jack Huddleston, Emil Malizia and Roz Greenstein for their useful suggestions and recommendations. Thank you to the Lincoln Institute of Land Policy for their support.

Table of Contents

I. Introduction	1
II. Factors Shaping State and Local Revenue Strategies	1
A. State-Local Relations	1
B. Property Tax Limitations	3
C. Social, Economic and Political Dimensions	4
D. Revenue Trends	5
III. Evaluating Revenue Sources	6
A. Equity	6
B. Efficiency	7
C. Revenue Stability	8
D. Administration and Visibility	8
IV. State and Local Revenue Sources: Trends and Profiles	9
A. User Fees and Charges	9
B. Special Assessments	15
C. General Sales Tax	15
D. Excise Taxes	21
E. Income Taxes	27
F. Lottery Revenues	30
G. Summary Evaluation of Revenue Sources	34
V. Emerging Issues and Innovative Policies	34
A. Commercialization of Government	34
B. Transportation Finance	37
VI. Planning Implications	38
VII. Conclusions	40
VIII. References and Endnotes	41
IX. Appendix	46

State and Local Revenues Beyond the Property Tax

I. Introduction

State and local government finance has experienced significant change over the last several decades. Three decades ago, states and localities were battling taxpayer revolts, declining federal aid, an energy crisis and public distrust of government's ability to carry out its job. To a certain extent, these trends have persisted; however, new issues have emerged to further challenge state and local governments. Today, our governments operate in an ever-changing global economy characterized by increased international trade, continued shifts to a service- and knowledge- based economy and rapidly changing technologies. Furthermore, states and localities must plan for future shifts in demographics, projected to be dramatic, and grapple with continued political pressure to constrain spending and taxes while still providing an adequate level of services.

The fiscal responses of states and localities to trends in the broader environment are shaped by institutional factors that determine their feasible choices of revenue sources to fund their services. Over time, these institutional factors have changed and so has the significance of different revenue sources. Local governments are less reliant on the property tax than they were thirty years ago, and although the property tax endures, other revenue sources have become more important to funding local services. The relative significance of state revenue sources has also shifted gradually over time.

This paper examines recent shifts in sources of state and local revenues beyond the property tax. It profiles major revenue sources and emerging issues surrounding these revenue sources. The following section provides a brief account of the changing context of federal-state-local relations and the institutional, political, social and economic trends affecting local governments today. The ever-changing system of intergovernmental relations is complex and critical to understanding the fiscal choices of state and local governments. Section three provides a discussion of commonly-accepted criteria for a strong revenue system. Section four profiles the major revenue sources and trends over time and evaluates each of the revenue sources according to the criteria. The next section profiles innovative funding sources that state and local governments have turned to in an attempt to raise additional revenue. Finally, the last section provides ideas for classroom and training exercises for those who teach in this area.

II. Factors Shaping State and Local Revenue Strategies

A. State-Local Relations

The changing nature of state-local relationships are obviously dependent on shifts in federal policy. A period of unprecedented federal expansiveness began in 1960 and lasted through the 1970s. Financial aid to states and local governments funded infrastructure projects, including the nation's transportation network and projects in aging central cities as well as a myriad of social service programs. The most significant shift in

federal policy, the downward slide of federal aid to state and local governments, began in the late 1970s and early 1980s. Federal aid as a percentage of state and local spending reached a peak in 1978 at \$85.5 billion and has been declining since (Liner 1989). In 1979, federal aid constituted about 22 percent of state and local general revenues and by 1989, 16 percent (Berman 2003).

Many responsibilities lodged at the federal level were devolved to state and local governments. This movement toward devolution actually began in the late 1960s with the use of block grants that left states with substantial discretion as to how to allocate funding. It continued under the Nixon years with the administration's policy to transfer some functions back to states, namely education and community development. Additional block grants were enacted in 1974, including the Housing and Community Development Act (instituting the Community Development Block Grant Program). Initiatives during the Carter years included the elimination of the state portion of General Revenue Sharing, the hugely popular grant program that funneled money to both states and localities to use at their discretion; and the mandated cost-sharing arrangements to obtain federal funding for projects. The pace of devolution quickened during the Reagan years as limiting the role of the federal government was a central objective of the administration. Reagan's policies were sweeping resulting in lowered funding levels for many programs; lowered growth rates when reductions were not possible; tightened aid formulas and eligibility criteria and continued devolution of federal functions to states and local governments. The total elimination of General Revenue Sharing was completed in 1986.

In the mid 1970s the federal government compounded any financial woes caused by decreased levels of federal aid by imposing regulatory mandates rather than subsidies to encourage various states and local actions. Congress imposed costly mandates in a number of policy areas from air and water quality to labor management and corrections. Examples of congressional legislation creating unfunded mandates included the Safe Drinking Water Act and the National Voter Registration Act. Congress passed the acts and pushed much of the burden for paying for them to state and local governments (Berman 2003).

The climate of shifting programmatic responsibilities and funding obligations resulted in significant change in the traditional relationships between all levels of government. This devolutionary shift has been labeled "fend-for-yourself federalism" (Shannon 1987) and forced state governments to engage in their own form of devolution by pushing program responsibilities down to local governments. This included imposing their own unfunded mandates on local governments. So, in addition to passing along federal mandates to locals, state governments imposed their own, like requiring enhanced retirement benefits or solid waste recycling programs or even raising the salaries of county social service employees (Gold and Ritchie 1992). One estimate made in the mid-1980s was that localities dedicated over 40 percent of their expenditures to implementing both federal and state mandates (Greene 1987). This "second order" devolution also affected state aid to local governments. Although state aid to locals actually increased in dollar amounts from \$83 billion in 1980 to \$275 billion in 1998, as a proportion of total state

spending, it decreased from about 37 percent to 33 percent over that same time period (Berman 2003). Furthermore, although the dollar amount of state aid to local governments increased to about \$288 billion in 2000, it dropped to 26.9 percent of local spending, down from about 30 percent of local spending in 1991. Essentially, state aid to local governments throughout the 1990s increased by \$92.5 billion, or 47.2 percent, but this did not keep pace with the \$415 billion, or 63.3 percent increase in local government spending (Krane et al 2004).

Scholars continue to debate the extent and implications of federal devolution and state or “second order” devolution, but from the state and local government perspective, the facts are that federal assistance to state and local governments is much diminished since the 1970s and states and localities have taken on larger shares of fiscal and administrative responsibility for a number of programs. How did all of these changes affect the revenue structures of state and local governments? It is these broad institutional features that, in part, determine the feasible choices available to local governments and their responses. Other significant institutional forces are described in the next section.

B. Property Tax Limitations

Along with the slowdown in federal aid, the unfunded mandates, and the new responsibilities of state and local governments, the declining importance of the property tax is another significant feature of the fiscal environment that has implications for local revenue trends. Once thought of as the mainstay of local government, the property tax has continued to decline in significance as a proportion of local own-source revenue. In 1970, the property tax represented about 40 percent of local general revenues, and that declined to about 27 percent in 1999 (Berman 2003). The reasons for movement away from the property tax are varied and continue to be debated by scholars.

One of the common explanations is the growth in tax and expenditure limitations (TELS). Proposition 13 in California is often cited as the beginning of the TEL movement. While TELS had been imposed before then and had started to accelerate during the 1970s, Proposition 13 was a defining moment in the history of the anti-tax movement. Dissatisfaction with the property tax swept the nation and among one of its many implications is the anti-tax pledge that we hear today in political campaigns at all levels of government. Within two years of the passage of Proposition 13, 43 states had implemented some kind of property tax limitation measure, 15 states had lowered their income tax rates and 10 states indexed their income taxes to the rate of inflation (Sears and Citrin 1985). Types of TELS range from limits on property tax rates to limits on assessment increases to limits on general expenditure increases. The imposition of structural constraints on local government fiscal options forced changes in relative reliance on different sources of revenue. Following Proposition 13 and the tax revolt, studies found that the composition of local revenues had changed with local governments relying less on the property tax (Gold 1979). McCabe (2000) estimated that when states passed a combined measure limiting both tax assessments and tax rates, cities’ reliance on the property tax fell by about 5.6 percent suggesting that, especially when combined, such measures represent binding restrictions.

Others suggest that the movement away from the property tax was driven by school finance reform movements. Again, tracing the beginnings to California and the California state Supreme Court Serrano decision, Fishel (1989) notes that the spread of Serrano-like court cases across the nation contributed to dissatisfaction with the property tax. The landmark decision ruled that reliance on the property tax violated the equal protection clause of the California and U.S. Constitutions because it resulted in a system where educational opportunities were dependent on the wealth of the community. Fishel argues that this decision divorced local property wealth from school spending and converted most property taxes into deadweight loss. Voters then rejected the property tax under Proposition 13, and funding for education shifted away from the property tax to the state.

Evidence in support of all of these suggestions for reduced reliance on the property tax continue to mount and reinforce the critical point about the importance of institutional change in understanding of revenue structures.

C. Social, Economic and Political Dimensions

Beyond the ever-changing relationship between the three levels of government and institutional forces that constrain state and local government activities, myriad political, social and economic pressures also limit governments' choices surrounding fiscal decision-making. Politically, state and local governments are operating in a strongly anti-tax climate, and the pressure to constrain taxes is felt at all levels of government. In a recent survey conducted by the National League of Cities, city officials reported that public pressure to limit taxes and public perceptions of government waste will pose significant challenges over the next several years (Hoene 2005). Such political challenges make addressing social and economic trends that much more difficult. Demographic change is cited by the same survey respondents as representing a significant concern for cities. The aging of our population has major implications for state and local finance. Americans are living longer and longer, and the proportion of those age 65 and older continues to grow. By 2030, the number of Americans over the age of 65 is expected to reach 71 million or roughly twenty percent of the U.S. population (Centers for Disease Control 2003). This has implications for both service delivery and for the revenue raising potential of state and local governments. Increased demand for services such as long-term health care, nursing homes, senior housing, transportation, and recreation, among others, will be felt by state and local government alike. Moreover, older citizens may be even more unwilling to support increases in certain taxes, especially property taxes, than younger constituents (Brunori 2003). State and local governments today are also operating in a post 9/11 environment that places additional demands on funding services such as police, fire and emergency workers, as well as public health.

Finally, the changing economy has dramatic effects on state and local taxation. Although increased international trade, technological advances and the continuing shift of our own economy from goods-based to service-based, offer numerous opportunities for state and

local governments, these trends also pose significant challenges. From a public finance perspective, one problem is that most state and local taxes depend on physical location—of people and of firms. In the current global economy, location has become less significant to the way people and firms operate. All of the major revenue sources, including the property tax, sales tax and income tax, are levied according to the location of a person or firm. Today, mobility defines the economy and technology enables remote purchases, both of which make it difficult to collect taxes under traditional approaches (Brunori 2003).

D. Revenue Trends

The tables below illustrate the broad trends in state and local revenues over the past several decades. Since 1977, state governments have lessened their reliance on both the general sales tax and selective sales taxes. Selective sales taxes which include taxes on motor fuel, tobacco and alcohol went from 12.7 percent of total state general revenue to only 7.8 percent between 1977 and 2002. The general sales tax saw a similar decline from 18.3 percent to 16.9 percent during the same time period. Reliance on the individual income tax increased, but the corporate income tax has become less significant over time. Dependence on current charges, such as charges for education, hospitals, airports, parking, parks and recreation has increased steadily over the past decade.

Table 1: Mix of State General Revenues, 1977 to 2002 (all values are percents)

	1977	1982	1987	1992	1997	2002
Federal aid	27.1	24.0	22.8	26.1	26.5	29.9
General sales tax	18.3	18.3	19.0	17.9	18.1	16.9
Individual income tax	15.1	16.6	18.1	17.3	17.8	17.5
Other	14.3	18.0	18.0	17.4	16.6	16.2
Selective sales taxes	12.7	10.3	9.6	9.1	8.5	7.8
Service charges	7.1	7.7	7.6	8.7	8.9	9.4
Corporate income tax	5.4	5.1	4.9	3.6	3.8	2.4

Source for 1977 through 1997: Figure 1 in Tannenwald, Robert. 2004. Are state and local revenue systems becoming obsolete? *Research Report on America's Cities*. Metropolitan Policy Program, The Brookings Institution, The National League of Cities: Washington, D.C.

*Source for 2002: Table 4: Summary of State and Local Government Revenue by Level and Type of Government: 2001-2002, in Census of Governments. 2002. Compendium of Government Finances, Vol 4, No 5.

Local governments, as illustrated in the table below, continue to lessen their reliance on the property tax, as it represented about 34 percent of general revenue in 1977 and 27 percent in 2002. Mirroring trends in state government, reliance on user fees and charges have increased steadily over the past three decades. Federal aid has dropped off significantly, as detailed in the discussion above. In contrast to state trends, local government reliance on the sales tax has increased steadily over the past couple of decades from about 3 percent of general revenue to 4.4 percent.

Table 2: Mix of Local General Revenues, 1977 to 2002 (all values are percents)

	1977	1982	1987	1992	1997	2002
State aid	33.7	33.9	33.3	34.2	34.6	35.7
Property tax	33.7	28.1	28.3	29.9	27.9	27.1
Service charges	10.7	12.8	13.5	14.7	15.8	15.4
Federal aid	9.2	7.6	4.7	3.5	3.9	4.3
Other	7.6	12.2	14.1	11.9	11.7	11.5
General sales taxes	3.1	3.6	4.2	4.0	4.2	4.4
Individual income tax	2.1	1.8	1.9	1.8	1.9	1.7

Source for 1977 through 1997: Figure 2 in Tannenwald, Robert. 2004. Are state and local revenue systems becoming obsolete? *Research Report on America's Cities*. Metropolitan Policy Program, The Brookings Institution, The National League of Cities: Washington, D.C.

*Source for 2002: Table 4: Summary of State and Local Government Revenue by Level and Type of Government: 2001-2002, in Census of Governments. 2002. Compendium of Government Finances, Vol 4, No 5.

III. Evaluating Revenue Sources

Our revenue system has evolved in response to many changing economic, political and social dimensions. It is not based on any master plan coinciding with some agreed-upon set of principles defining a good tax system. Although taxes and revenue sources in general are not necessarily good or bad, they can be judged according to a number of criteria. These criteria have developed over the years and date back to the writings of Adam Smith. Among them are (Musgrave and Musgrave 1989; Raimondo 1992):

- The distribution of the tax burden should be equitable, meaning all should pay their “fair share” (equity)
- Taxes should not interfere with economic decisions in otherwise efficient markets (efficiency)
- The tax system should facilitate stabilization and growth objectives of fiscal policy (revenue stability).

- A tax system should be easily administered (administration).
- A tax system should be visible and understandable to the taxpayer. Furthermore, the link between taxing and spending should be apparent (visibility).

A. Equity

The term *equity* brings to mind several thoughts—justice, fairness, equality. As a matter of public policy, equity implies some notion of fairness in society’s distribution of economic resources and burdens. Everyone can probably agree that taxes should be fair and we should all pay our own fair share. The problem is how to define exactly what “fair” means. This is highly controversial and has been subject to intense debate in the area of public finance dating back to discussions by early economists in the establishment of our basic tax system. Definitions of equity include those based on principles of equality, demand, preferences, needs, distribution of income, distribution of wealth, ability to pay and benefits received. There is no single correct definition of equity, rather it is the responsibility of policy-makers to weigh each definition and consider the trade-offs among them when implementing public policy (Steinmann et al 2005).

Two fundamental concepts relate to the issue of equity in taxation. The first is the benefit principle, which states that an equitable tax system is one in which each taxpayer contributes in line with benefits received. So, each taxpayer is taxed in line with his or her demand for a public service. This principle involves not only taxes, but expenditures. It goes beyond tax policy to tax-expenditure policy.

The other concept, the ability-to-pay principle, views the tax problem by itself, independent of expenditures. A taxpayer is asked to contribute in line with his or her ability to pay. The concepts of horizontal and vertical equity clarify how a burden is distributed across taxpayers according to ability to pay. The horizontal equity rule says that people with equal capacity should pay the same. People and businesses with similar incomes and assets should be taxed similarly. Vertical equity says that people with greater ability should pay more. Income is the widely accepted measure of ability to pay, so if ability to pay is measured by income, then those with higher incomes should pay more than those with lower incomes. As discussed below, income is not the only measure of ability-to-pay, and the measure used is critical to conclusions about tax incidence, or who ultimately bears the burden of a tax.

Neither the benefit or ability to pay principle is easy to implement in its pure form. To adhere to a benefit principle, expenditure benefits for taxpayers must be known. For ability-to-pay, we must be able to measure and agree upon an appropriate measure of ability. Regardless of their limitations, both concepts are important and applicable to the evaluation of a revenue system.

B. Efficiency

The efficiency criterion says that a tax should not alter economic decisions and distort efficient choice. In the absence of taxes, individuals would make decisions about spending, saving, working and leisure based on their needs, wants and abilities. Businesses would make their decisions based on resources and opportunities. A tax or revenue source that causes a deviation from this kind of decision-making represents a burden to the taxpayer and is referred to as excess burden or deadweight loss. It violates the principle of tax neutrality. The less interference a tax or revenue source has in decision-making behavior, the more neutral it is. Taxes may affect choices among various consumer goods, between savings and consumption (or present and future consumption) and between leisure and income or goods. Distortions also arise from taxing selective products or taxing the same product at different rates.

All taxes affect the economic marketplace and economic decisions in some way, and are therefore not neutral. In fact, some excise taxes, like those on cigarettes and alcohol, are intended to affect economic decisions and individual behavior. They are imposed to further our socially desirable public health objectives of curtailing smoking and excessive alcohol consumption. Furthermore, many of these taxes are designed and rationalized as charges that reflect the external costs that consumers or producers of such products impose onto others. Taxes that raise the price of polluting products or processes, like those on fertilizers, pesticides, disposable containers and batteries, for example, illustrate use of the tax system to both further environmental objectives and internalize the external costs of such products.

The better revenue systems will minimize the unintended effects of a tax system. Generally, the broader the base and the flatter the tax rate, the more neutral a tax will be. Furthermore, tax rate differentials have the potential to cause more distortion than do flat tax rates. These general economic principles may violate some of the principles of equity, which call for progressive taxes based on ability to pay. Achieving a fair and efficient revenue system is complicated and challenging because these principles may work at cross purposes.

Another factor complicating an evaluation of the impact of taxation on the market place is the issue of incidence or who actually pays the tax. The burden of the tax may be shifted forward to the consumer of the product or it may be borne by the owner and result in lower profits. Some market conditions allow for the shifting of a tax, for example, taxes on alcohol and cigarettes are generally shifted forward to the consumer, because there are few substitutes for such products and demand is fairly price inelastic (Bland 2005).

C. Revenue Stability

State and local governments should be able to rely on the stability of a revenue source over time. A stable revenue source is one that grows at a predictable pace. This makes it easier to budget, to plan for future expenditures and to match revenues with expenditures.

D. Administration and Visibility

Finally, a revenue system should not be burdensome to administer and should be simple for the average taxpayer to understand. Complex tax rules make revenue systems difficult to understand and challenging to monitor and to enforce for state and local officials. Revenue should also be visible to the average taxpayer. Taxpayers should know what they are paying for and how much they are paying.

In the sections below, each of the major revenue sources will be evaluated according to the above criteria.

IV. State and Local Revenue Sources: Trends and Profiles

All revenue sources help local governments diversify their tax base. As public finance experts have noted over and over again, a diverse tax base enhances the stability of a revenue system. Reliance on a variety of revenue sources ensures that state and local governments can better cope with changing economic, social and political conditions. Different revenue sources are sensitive to growth, inflation, business cycles and other external factors in varying ways. Over-reliance on a single revenue source or set of revenue sources exposes governments to potential fiscal problems. This next section provides an overview of each of the major sources of revenue, including trends and emerging issues.

A. User Fees and Charges

In this political environment defined by an anti-tax mentality, state and local governments are quick to find any alternative to a “tax.” User fees and charges are one category of non-tax revenue that have gained in popularity in the current climate. User fees are voluntary payments to government for a specific good, service or privilege. They act as private market prices, and ideally, the payment reflects the marginal cost of the good or service, but in practice, it often does not. It is useful to categorize user fees and charges into three broad types (Wisconsin Legislative Audit Bureau 2004).

- Fees associated with services necessary for all residents. This includes fees for utilities, like gas, sewer and water, trash collection and recycling. Fees for these services are typically set to fully recover the cost of the services. Because fees for such services can be calculated on the basis of usage, it is understandable that these costs are charges as fees and not part of the general property tax.

- Fees associated with those services that add to the quality of life in a community. These are services that are not necessary for all residents and include fees for admission to parks and recreational areas and classes, public transportation and some health services.
- Fees associated with regulatory and administrative processes. These includes professional and personal licenses, which authorize an individual or business to engage in a specific activity, such as owning a pet or a bicycle, getting married or bartending. It also includes charges for permits for such activities as new construction, trash burning and erecting billboards.

Virtually every state and local government imposes user fees and charges on residents for services. Proponents of user fees and charges regard them as the most effective means of raising local revenue as they provide a direct relationship between consumption and cost. State and local governments impose user fees under the benefit principle, that is, individuals and firms that benefit from government services should pay for them. Fees vary in terms of cost recovery, as some, like those for utilities, attempt to recover the full cost of providing a service and others recover only part of the cost. For example, building permit fees are intended to recover the cost of building inspectors and personnel necessary to process permit applications. Ambulance fees are intended to recover part of the cost of the personnel and equipment to provide the ambulatory services. Proponents argue that user fees are the truest form of a benefits tax, as only those who receive the public good or service pay the fee or charge. Individuals who prefer not to receive a service pay no additional costs.

1. Profile of User Fees and Charges

Revenues from user fees and charges have grown steadily over the past quarter-century. Local governments raised over \$253 billion in user fees and charges in 2003, while states raised over \$118 billion. The table below illustrates the current mix of user fees and charges as a percent of total own-source revenue for state and local governments. Local governments raise more of their own source revenue from user fees and charges than do state governments. Behind the property tax, this is the most significant revenue source for local governments at nearly 36 percent of own-source revenue.

Table 3: Mix of Own-source General Revenues, 2002-03^a (all values are percents)

Revenue Source	Local Governments	State Governments
Property taxes	40.1	1.4
General sales tax	6.3	24.2
Selective sales taxes	2.7	11.7
Income taxes	2.8	27.5
Other taxes	2.7	7.1
Service charges	22.9	13.9
Utility charges	12.7	1.6
Miscellaneous	9.8	12.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03.

U.S. Bureau of the Census. State and Local Government Finances: 2003-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Different types of local governments vary in their reliance on user fees. Special districts raise nearly three-quarters of their own-source revenue from this revenue source. School districts, on the other hand, continue to raise most revenue through the property tax and rely comparatively less on user fees. Municipalities and townships raise nearly 40 percent of own-source revenue from fees and charges, representing the largest single revenue source for them.

Table 4: Mix of General Purpose Government Own-Source Revenues, 2002-03^a (all values are percents)

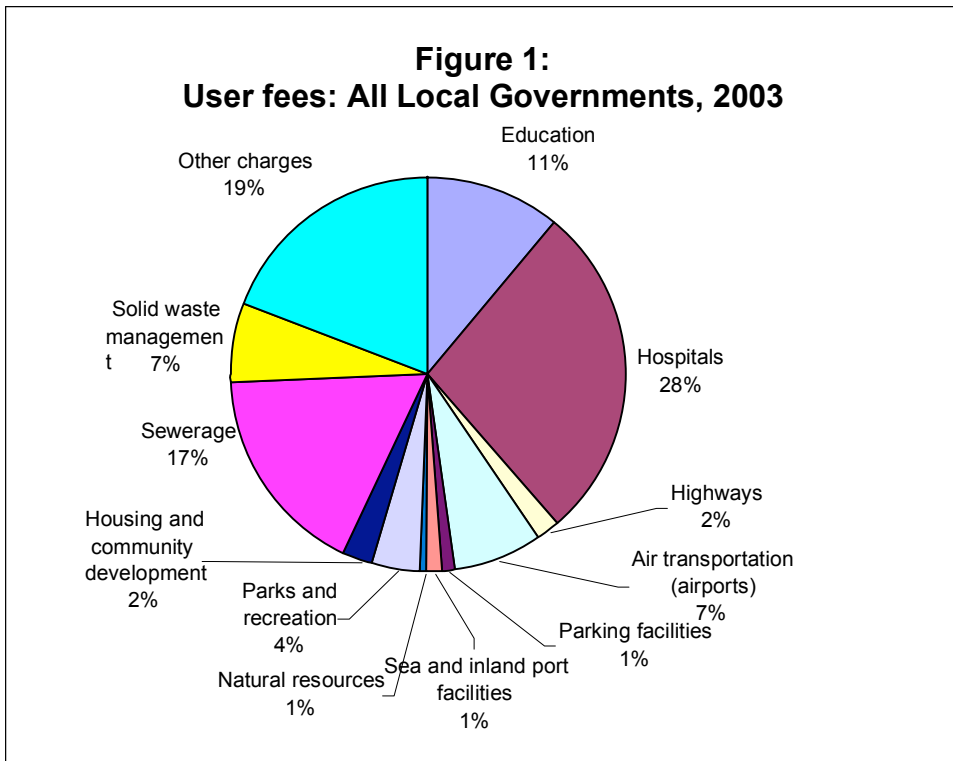
	County	Municipal & Township	Special District	School District
Property taxes	38.8	28.4	11.7	79.8
General sales tax	9.6	7.7	3.6	1.5
Selective sales taxes	2.4	5.1	0.1	0.1
Income taxes	1.9	5.4	0.0	0.8
Other taxes	2.9	4.2	0.8	0.6
Service charges	30.1	19.9	41.7	9.5
Utility charges	2.1	19.6	31.6	0.0
Miscellaneous	11.8	9.7	10.3	7.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the

Census. State and Local Government Finances: 2002-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

User fees are charged for a wide variety of goods and services at the local level. The chart below offers an overview of this variety. All local governments combined raise most revenue from charges to hospitals and health care institutions. Much of this revenue comes from county-funded hospitals. It includes charges from patients, private insurance companies and public insurance programs like Medicaid. Revenue from other charges, the next largest category, includes a myriad of fees including those collected for advertising space, cemeteries, photocopies, filing, farmers markets and many more. Fees are also collected for a variety of services offered by educational institutions, including fees for text book rental, sports equipment and advertising space.



Local governments differ on reliance on different sorts of fees. Table 5 below illustrates these trends. Municipalities collect the bulk of their fee revenue from charges for sewage collection and disposal, including sewer connection fees. Fees for solid waste include those for garbage collection and disposal, operation of landfills and sale of recyclable materials.

Table 5. Current Charges as Percent of Total Current Charges, 2002-03

	County	Municipal & Township	Special District	School District
Education	4.9	1.4	0.0	100.0
Hospital	39.7	11.4	46.0	0.0
Highways	1.0	2.1	3.6	0.0
Airports	3.9	10.1	10.3	0.0
Parking	0.2	2.2	0.2	0.0
Sea/Inland Port Facilities	0.4	1.6	2.5	0.0
Natural Resources	0.0	0.0	2.2	0.0
Parks	2.1	6.6	3.2	0.0
Housing	0.4	2.8	5.6	0.0
Sewer	6.5	34.2	12.7	0.0
Solid Waste	7.4	10.9	2.5	0.0
Other	33.4	16.7	11.1	0.0
Total Current Charges	100.0	100.0	100.0	100.0

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the Census. State and Local Government Finances: 2002-03.

2. Issues Surrounding the Imposition of User Fees

User fees are attractive to municipal officials for a number of reasons. User charges allow governments to impose the cost of services on those who demand the services. User fees, by imposing all or a portion of the cost on the consumer, allow market forces to set an economically efficient level of services. User fees have been shown to reduce the demand for government services and allow governments to avoid oversupplying and expanding the public sector unnecessarily (Bierhanzl and Downing 1998). Because charges are based on the quantity consumed by a user, they give local government an indication of the level of service demanded thus resulting in a better match between local supply and demand. This is in contrast to a service financed through taxes where users have no incentive to limit their use and may create artificially inflated user demand that governments feel obligated to satisfy. The fee essentially rations goods and services to consumers who place the greatest value on the good or service, thus maximizing efficiency.

A financing system that relies on user fees and charges also allows for a certain level of local control. Since these types of revenue sources are not subject to legal limitations like those imposed on other types of taxes, local governments maintain an element of control over their own finances. Generally, no approval is required to impose a user fee. The fees are also appealing to officials who argue that the imposition of fees is a fair way to capture payments from non-profit organizations and other tax exempt properties that use services but do not pay property taxes. The cost of services like fire protection and roads can be taken off the tax rolls and spread across a larger base of likely payers.

User fees are also an effective method for building incentives into a system to encourage reduced consumption of scarce resources. Many municipal water systems and sewer systems have shifted from unmetered water service funded through general revenues to metered services that allow for charges based on consumption. The user fee funding mechanism provides incentives to conserve water and reduce wastewater by industrial users (NCSL 1999).

Despite widespread support of user fees by public finance practitioners and scholars, they do have their challenges. Debate is particularly heated surrounding issues of equity. Lower income individuals are often the first to be driven out of the market for goods and services that are highly demand responsive when a charge is imposed. This is particularly apparent in the use of recreation fees. Debate over recreation fees extends from the federal to state and local levels of government. At the federal level, Congress authorized the collection of fees by federal land management agencies back in 1996 and this program was recently replaced by a new recreation fee program authorized to last for the next 10 years. This act spawned widespread use of recreation fees at state and local levels as well. The idea that fees may exclude low-income people from access to public recreation areas is the subject of recent research as more and more public agencies, eager to supplement stagnant budgets, search for new ways to fund services.

Governments have attempted to mitigate impacts on low-income residents by implementing strategies like waiving fees on certain days. Many park districts offer free days at zoos and museums. Vouchers are also often available for lower-income residents. Finally, differential pricing is used in many cases. Governments might classify users by income or by some other characteristic (elderly, youth) and vary prices to effectively offer partial subsidies to certain users.

Schools are also increasingly turning to user fees to pay for a variety of school services from participation on sports teams to lab equipment to drivers' education courses. Many of these services were once provided at no charge to students. The "pay for play" fees, as they are referred to by many school districts, are an effort to deal with budget constraints and rising expenses. While schools have resorted to fees for a number of years, the number of and price of many fees have reached unprecedented levels as they are imposed on more and more items from high-school parking spaces to acting in the school play (Chaker 2003).

School fees are not without their critics who argue that the fees are burdensome to lower and middle income students and compromise their right to an equal education. Some school districts have considered cutting extracurricular programs altogether rather than impose fees that may potentially discriminate against lower-income students. Many rationalize keeping the programs and imposing fees because such activities are important to college admissions processes. School fees are not only controversial in California, but they are now outlawed. The Santa Barbara Board of Education attempted to charge fees for participation in both athletic programs and other extracurricular activities, such as the drama club, band and cheerleading. In 1984, the California Supreme Court ruled that

imposing fees for extracurricular programs violated the state's constitutional provision that public education be free. The court reasoned that once the community has decided that a particular educational program is important enough to be provided by the public schools, a student's participation in the programs cannot be made to depend on family income or on the family's decision to pay the fee or not.¹

A final drawback of user fees cited by opponents is the lack of federal deductibility. State and local income and property taxes are deductible at the federal level, whereas user fees and charges are not.

3. Evaluation of User Fees

As discussed above, user fees and charges are often criticized on equity grounds. Take the example of a fee charged for daily entrance to a public park. A high income and lower income person are each charged the same fee for the same benefit, but the fee is regressive in that it claims a higher percentage of income from the lower income individual. This violates the principle of vertical equity. The fee could be adjusted to a sliding scale accounting for income, as some governments do, but this makes it more difficult to administer.

User fees are often justified on efficiency grounds. They are seen as an efficient revenue sources as they reflect the principle of benefit taxation. Those who benefit pay the fee, and governments are able to avoid the oversupplying of services and unnecessary expansion of government. They are seen to have minimal impact on the marketplace.

Some user fees have highly unstable returns. For example, those relating to building and construction, which may be some of the highest revenue generators, can be quite variable. This makes budgeting with these revenue sources more complicated. Critics also argue that fees have a fragmenting effect on local budgets and this is especially problematic when the money is earmarked and not reviewed along with other traditional revenue sources (Bland 2005).

One potential administrative problem with user fees is that that they are generally adopted in a piecemeal fashion in separate ordinances, so they are dispersed throughout local codes. This complicates review and updating of fees and furthermore, any change in the fee structure requires separate amendments to each of the ordinances, which takes staff time and effort (Bland 2005). Fees and charges are so varied that it is difficult to classify them as visible or not, but generally typical fees that taxpayers pay for use of the library or park facilities are quite visible.

B. Special Assessments

Like user fees, special assessments are another type of benefits-based financing of public services. Special assessments are levied on property owners to pay for public improvements to private property. They are generally used to finance sidewalks, street lighting and other street improvements like curbs, gutters and storm drainage. The intent is to capture the increased value of the private benefit created by the public improvement. The maximum assessment is this increase in private value. Every state authorizes municipalities to impose special assessments and most also offer it to counties and some to special districts. State enabling legislation generally details general procedures, including methods for determining costs (Bland 2005).

Special assessments represent a minor portion of own-source revenue across all governments. Nearly 1 percent of all county and municipal and township revenue comes from special assessments and only about 0.77 percent overall for all local governments. States rely even less on special assessment revenue, at about 0.04 percent of total own-source revenue in 2002-03. Special assessment revenue is categorized by the U.S. Census Bureau as miscellaneous revenue, which represents about 10 percent of total own-source revenue for local governments. Table 6 below illustrates special assessment revenue as a percent of all miscellaneous revenue across governments. For municipal and township governments, this revenue source has grown from about 5.7 percent of miscellaneous revenue in 1991-92 to over 9 percent in 2002-03.

Another growing source of revenue for local governments, and also used for public improvements, is impact fee revenue. Levied against new development to raise revenue for new or expanded public facilities to accommodate growth, these fees have become popular with local governments challenged with rapidly growing populations. Impact fees are addressed in a separate paper as part of this series, so please refer to it for an in-depth discussion of the issues surrounding this revenue source.

Table 6: Special Assessment Revenue as Percent of Total Miscellaneous Revenues, 2002-03

	State	Local	County	Municipal and Township	Special District	School Districts
Interest Earnings	31.1	40.8	44.5	37.7	61.5	25.1
Special Assessments	0.3	7.8	8.1	9.2	13.1	0.0
Sale of Property	0.6	1.6	1.1	2.5	2.5	0.0
Other General Revenue	67.8	49.6	46.2	50.5	22.8	74.9

Source: Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03.

U.S. Bureau of the Census. State and Local Government Finances: 2002-03.

C. The General Sales Tax

Until the Great Depression, local governments did not have access to the sales tax. Following Mississippi, which levied the first state sales tax in 1930, New York City adopted the first local sales tax in 1934. The number of states authorizing the use of the sales tax rose from one in 1950 (Mississippi) to twelve in 1963, to twenty-five in 1970 (Bartle et al 2003). The sales tax is the second most important source of own-source revenue overall for state and local governments, following current charges and license fee revenue. After the property tax, sales taxes are the most important source of revenue for local governments.

State and local sales taxes include both general sales taxes and selective sales taxes. The general sales tax is levied on a broad range of goods and services and the tax rate is assessed as a percentage of the retail value of the goods and services purchases. Selective sales taxes or excise taxes are levied on specific types of transactions. Often excise taxes, such as taxes from the sale of motor fuel, are earmarked for purposes that benefit the consumers of the good being taxed. Some goods, like tobacco products, are subject to both the general sales tax and an excise tax.

All but five states (Alaska, Delaware, Montana, New Hampshire and Oregon) impose a general sales tax at the state level. These rates range from about 3 to 5 percent of the sale of goods and services. State laws vary as to the type of transaction included in the tax base. Many states exempt food purchases from the general sales tax or tax food at a lower rate. All states exempt prescription drugs, with the exception of Illinois which imposes a 1 percent tax on prescription drugs.

Thirty-five states authorize local retail sales taxes. Alaska is unique in that although there is no state sales tax, cities and boroughs are authorized to levy a local sales tax. Maximum local rates across localities range from 1 percent to 7 percent.

1. Profile of the Sales Tax

Sales tax revenue is a substantial part of the mix of revenues for state governments as shown below. It represents nearly one-quarter of total own-source revenue. This proportion has remained virtually unchanged over the past decade. At the local level, the tax is also an important revenue generator for those governments with access to it. It represents just over 6 percent of total own-source revenue. This is a slight increase from 5.6 percent in 1992-93.

Table 7: Mix of Own-source General Revenues, 2002-03^a (all values are percents)

Revenue Source	Local Governments	State Governments
Property taxes	40.1	1.4
General sales tax	6.3	24.2
Selective sales taxes	2.7	11.7
Income taxes	2.8	27.5
All other taxes	2.7	7.1
Service charges	22.9	13.9
Utility charges	12.7	1.6
Miscellaneous	9.8	12.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03.

U.S. Bureau of the Census. State and Local Government Finances: 2003-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Local government reliance on the sales tax varies by type of government. Not all local governments have access to the sales tax. County governments rely the most on the sales tax, as it represented nearly 10 percent of county own source revenue in 2002-03.

Municipal and township governments receive nearly 8 percent of own-source revenue from the general sales tax. Very few school districts and special districts have access to this revenue source.

Table 8: Mix of General Purpose Government Own-Source Revenues, 2002-03^a (all values are percents)

	County	Municipal & Township	Special District	School District
Property taxes	38.8	28.4	11.7	79.8
General sales tax	9.6	7.7	3.6	1.5
Selective sales taxes	2.4	5.1	0.1	0.1
Income taxes	1.9	5.4	0.0	0.8
All other taxes	2.9	4.2	0.8	0.6
Service charges	30.1	19.9	41.7	9.5
Utility charges	2.1	19.6	31.6	0.0
Miscellaneous	11.8	9.7	10.3	7.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the

Census. State and Local Government Finances: 2002-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

2. Issues Surrounding the Imposition of the Sales Tax

The local option sales tax, like user fees and charges, allow local governments to maintain local autonomy over their fiscal balance sheets. This continuous source of local revenue is not dependent on a yearly appropriation from the state. The local control, however, may be somewhat limited. In most states, local governments have the authority to establish rates, (although there may be limits or maximum rates) for their sales taxes, but they do not have the authority to determine the base. Local governments can only tax those items that the state allows them to tax. Some local governments are even more constrained. In both California and Virginia, localities have no control over the rate or the base, both of which are state-established and cannot be changed by local governments. Virginia allows a 1 percent local option sales tax, but it collects the tax and returns a portion to the locality, effectively causing the tax to act as an intergovernmental transfer of revenue (Brunori 2003).

Another advantage of the sales tax is its general public acceptance. Since its implementation during the Great Depression, the sales tax has become a standard component of consumer purchases. In opinion polls on attitudes towards taxes, sales taxes are consistently identified as the least objectionable tax (Brunori 2003). However, the public's acceptance of the tax has also meant that it has become the tax to turn to when governments are in a bind. States struggling with budget problems turn to the sales tax and raise rates or expand bases to meet budget shortfalls. The standard political stance of "no new taxes" seems to apply to the property and income tax, but not to the sales tax.

Discussion over one untapped market with the potential to generate large sales tax revenues is currently on the agenda of many public agencies. Debate over the taxation of Internet services and sales has raged at the national, state and local levels for nearly a decade. Congress first passed an Internet tax moratorium in 1998 and it has been since extended to remain in effect until November 1, 2007. The current Congress is debating whether or not to make the moratorium permanent by repealing its sunset date. The moratorium bars state and local governments from imposing any new taxes on Internet access or imposing any multiple of discriminatory taxes on electronic commerce. The taxation of Internet access refers to the imposition of state and local sales and use taxes to the monthly charges that consumers pay for access to the Internet. The ban on discriminatory taxes means that transactions occurring over the Internet are to be taxed in the same way as are mail-order and telephone sales. Under current law, retailers only collect sales taxes in states where they have a physical presence. They are not required to collect taxes on purchases that are sent to other states. Technically, the consumer is required to pay a use tax on such purchases to his or her state of residence, but compliance by non-business consumers is quite low. This law stems from a 1992 Supreme Court ruling stating that forcing retailers to collect sales taxes in states where they do not have a physical presence is an undue burden on the retailers.

Supporters of the federal moratorium contend that the Internet should be protected from both the administrative and financial burdens of taxation so it is able to further Internet technology and its associated economic activity. Supporters also argue that a permanent extension would provide Internet providers and users and consumers certainty about the future of taxation on the Internet and it would eliminate the need for Congress to debate and periodically review the issue each time the moratorium nears its end.

Opponents of a permanent extension argue that the federal moratorium impinges on states' authority to levy taxes. They also argue that temporary moratoriums force Congress to periodically review the issues and effects on states. Many also argue that Internet services are given preferential tax treatment and it is fundamentally unfair (Maguire and Noto 2006).

Beyond the questions of extension of the federal moratorium, controversy surrounds the broader issue of Internet taxation. Recognizing administrative complexity in state and local systems as one significant obstacle to the taxation of Internet sales, states have joined together in an effort to simplify state and local sales taxation through the Streamlined Sales Tax Project (SSTP). The origins of the SSTP lie in the controversy and challenges of Internet taxation, but the focus of the group is on administrative simplification of the sales tax. Concerns over the complexity within states and the inconsistency across states stimulated state and local leaders to initiate their own administrative reform. SSTP, officially organized in 2000, is state initiated and controlled. Simplification includes developing uniformity in state and local tax bases, uniformity of major tax base definitions, a central electronic registration system for member states, simplification of state and local tax rates, uniform sourcing rules for all taxable transactions (transactions sourced to the state of use or the destination), simplified administration of exemptions, and simplified tax remittances and tax returns. Although the SSTP has made no direct effort to expand sales tax collection to Internet sellers, many are hoping that simplification in itself will be enough for Congress or the courts to clear the way to abolish the physical presence standard for sales tax collection (Swain and Hellerstein 2005).

As of January 2006, thirteen states were full members of the SSTP for having approved a model interstate agreement developed by the SSTP to simplify their sales tax. The agreement, the Streamlined Sales and Use Tax Agreement (SSUTA) establishes uniform definitions and requires that state and local government have one statewide tax rate for each type of product. Six states are associate members for partially complying with the Agreement (Maguire and Noto 2006). The SSUTA is simply an agreement among states who have committed to sales tax simplification, and it is left up to state legislatures to reform state statutes to comply with the stipulations of the agreement. Congress has the power to make SSUTA mandatory if it chooses to do so.

Another untapped market that has received increasing amount of attention is the service sector. A number of analysts argue that the shift from goods to services has undermined governments' ability to raise sales tax revenue. The service sector has grown substantially over time. In 1960, households in the United States allocated 41 percent of

their consumption dollars to services and by 2002, this had increased to 59 percent (Tannenwald 2004). Yet, sales taxes are not applied to most services. When state sales taxes were first implemented during the 1930s, services were found to be too difficult to tax, both from an administrative perspective and due to the fact that groups like lawyers and accountants had considerable political influence (Tannenwald 2004). Services accounted for a much smaller proportion of the economy, so this was not the issue that it is today. A few states have successfully folded services into their tax bases. Hawaii, New Mexico and South Dakota tax services comprehensively (ITEP 2005). Other states have tried over the years, but have been unsuccessful. Proponents of this policy change argue that taxing services will assist state and local governments by allowing for an increase in tax revenue without increasing rates and by enhancing the overall stability of the tax. Furthermore, this extension of the tax may reduce the overall regressivity of the general sales tax. This argument is grounded in the assumption that many of the services that can be taxed are used disproportionately by wealthier taxpayers. Finally, it will eliminate discrimination in the tax code between goods-consuming and service-consuming taxpayers. Opponents of this practice argue that the sales tax is not deductible for purposes of the federal income tax, so the better choice for additional revenue is the income or property tax. The assumption that such an extension of the sales tax will fall disproportionately on the wealthy is also challenged. Finally, the extension of the sales tax to services would simply exacerbate some of the existing flaws in the system with regard to the taxation of business inputs (Stark 2003).

3. Evaluation of the Sales Tax

The sales tax is often criticized on equity grounds. The tax is generally thought of to be a regressive tax, that is, the proportion of income paid in sales taxes decreases as income increases. State and local governments attempt to mitigate some of the regressivity through exemptions of food and drugs and services deemed as necessities. Although these exemptions help to relieve the burden on lower-income consumers, they also result in a smaller potential tax base for the government.

The choice of base plays a large role in how one assesses the tax in terms of equity. If income is used as the base, the sales tax is generally thought to violate the principles of both horizontal and vertical equity and result in a regressive tax structure. In studies of sales tax incidence, taxes paid are most often compared to income. Those with the same income do not necessarily spend at the same rate and different levels of spending result in different amounts of taxes paid for the same level of income. As individuals' income increases, studies show that the level of consumption spending also increases, but the proportion of income spent decreases. So, sales taxes paid may increase with increased income and consumption, but the proportion of income paid in sales taxes decreases, resulting in a regressive tax structure. State and local governments attempt to alleviate the regressive nature of the tax through exemptions. Many goods as services deemed necessities are exempted or taxed at a lower rate for this reason.

Although income is the most widely accepted measure of ability to pay, some argue that consumption is the better choice to reflect ability-to-pay, especially in analysis of the

sales tax. This view argues that the appropriate measure of tax incidence is the ratio of taxes paid to the amount of consumption spending. When consumption is used as the base, the sales tax generally adheres to the principles of vertical and horizontal equity. Those with identical levels of consumption spending will pay the same amount in sales taxes. As consumption increases, taxes paid increase. Under this calculation, the sales tax is a proportional tax, meaning the proportion of consumption spending paid in sales taxes remains the same as income increases.

In terms of efficiency, the imposition of sales taxes may distort consumption behavior. A sales tax can alter the choice between consumption and savings in favor of savings. The tax raises the price of goods and so discourages consumption. If the tax is raised on some goods and not others, consumers are encouraged to buy certain products over others. Finally, when taxes are raised by different amounts in different states or in different localities, the tax introduces a border problem. Consumers may travel to the place with the lower rate.

Raimondo (1992) provides estimates of revenue elasticities to determine the stability of various taxes. Revenue elasticity relates the percent change in tax collections to the percent change in personal income. Studies have shown that revenue elasticities for the sales tax range from 0.63 to 1.33, with an average of 0.94. So, for every 1 percent change in personal income, there is a 0.94 percent change in sales tax revenues. This shows that the sales tax is not unusually sensitive to changes in the economy.

Finally, estimates of costs of administration of the sales tax range between 1.5 and 2.5 percent of total tax collected (Raimondo 1992). Private vendors are responsible for much of the administration of the sales tax. State and local governments must determine the base and rates, maintain registration lists, collect taxes, monitor and audit vendors. The sales tax is built into the transaction and is not necessarily visible to the average taxpayer.

D. Excise Taxes

Excise taxes or selective sales taxes are imposed on specific products and services as transactions occur. The use of excise taxes is widespread and such taxes are imposed on cigarettes, alcohol, motor fuel, hotel/motel occupancy among other goods and services. Every state levies some type of excise tax at the state level. Counties and cities in forty-eight states report revenue from excise taxes. Connecticut and New Hampshire are the only two states reporting no local revenue from excise taxes (Bland 2005).

It is useful to classify excise taxes into three different types: benefits based, sumptuary taxes and privilege taxes. Each differs in its intent or goals and how the tax is levied.

- Benefits-based taxes are those placed on goods such as motor fuel, hotel and motel occupancy and utilities. These charges are intended to recover a partial cost of the service from the beneficiaries. Motor fuel taxes are paid by the users of the roads and the money is often earmarked for roads. Hotel and motel

occupancy revenue is paid by tourists and often targeted to tourism. Hotel and motel taxes are levied as a percentage of the value of the service, while others, like the motor fuel tax, are levied on a per-gallon basis.

- Sumptuary taxes are also known as sin taxes. These are imposed, in part, to discourage certain behaviors, like smoking and drinking. They are usually levied on a per unit basis.
- Privilege taxes are those imposed on the privilege of undertaking a particular type of transaction. Such taxes include those placed on admissions to entertainment venues, restaurant meals, cable service and deed (or real estate) transfers. These tend to be levied on gross receipts.

Excise taxes do not generate huge amounts of revenue for state governments for the most part. Nationally, states derive over 70 percent of their total tax revenue from sales and income taxes. Excise taxes represented about 15 percent of total tax revenue for the year 2005, and that represented a decline from about 16 percent in 1995. The largest source of excise tax revenue is revenue from the taxation of motor fuel. It generates about 35 percent of all excise tax revenue for state governments. The next two most important sources of excise tax revenue, taxation of tobacco products and alcoholic beverages generate about 13 percent and 5 percent (respectively) of total excise tax revenue and about 2.7 percent combined as a percentage of total tax revenue for states.

The largest source of excise tax revenue for municipalities is the tax on public utilities. Representing about 6 percent of total tax revenue in 2002-03 and up from 5.6 percent in 1991-92, this is a growing revenue source for municipalities. These taxes which are usually a fixed percentage of a utility's gross receipts, are used by municipalities in 40 states. Local governments are authorized to levy a gross receipts tax on utilities as compensation for access to public rights of ways, including streets. The tax may be part of the contract that offers the company an exclusive franchise to provide service in a community. Such taxes are imposed widely from utility providers (natural gas, electricity, water and cable service) to private waste collection companies and fiber optic phone service.

Other excise taxes include those imposed on a range of transactions. The larger items in this category include taxes on insurance companies which are based on gross premiums and on pari-mutuels, generally for amounts wagered on horse-racing, dog-racing and other games. Additionally states tax a host of other transactions, including the sale of tires, rental of personal property, car rentals, mobile homes and billboard advertising. Local governments also have access to a number of these taxes. Eleven states and the District of Columbia authorize local governments to levy deed transfer or real estate transfer taxes. These taxes are imposed when real estate is transferred for recorded for sale. The tax is generally a fixed percentage of the sales price of the property (Brunori 2003). The magnitude of the numbers shows that the imposition of a large number of small taxes can add up in terms of total revenue for a government.

1. Profile of Excise Taxes

As with the general sales tax, state governments rely more on selective sales taxes or excise taxes than do local governments. Nearly 12 percent of state own-source revenue is raised from excise taxes. This is a slight decrease from 1992-93. Most local governments do not have the authority to tax items like alcohol and tobacco and motor fuel, so these taxes represent only about 3 percent of total own-source revenue. This has been a stable source for local governments for the past decade and its share remains about the same as in 1992-93.

Table 9: Mix of Own-source General Revenues, 2002-03^a (all values are percents)

Revenue Source	Local Governments	State Governments
Property taxes	40.1	1.4
General sales tax	6.3	24.2
Selective sales taxes	2.7	11.7
Income taxes	2.8	27.5
All other taxes	2.7	7.1
Service charges	22.9	13.9
Utility charges	12.7	1.6
Miscellaneous	9.8	12.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03.

U.S. Bureau of the Census. State and Local Government Finances: 2003-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Counties, municipalities and townships rely more on selective sales taxes than do either special districts or school districts. For municipal and township governments, this is a steady source of revenue at about 5 percent of own-source revenue.

Table 10: Mix of General Purpose Government Own-Source Revenues, 2002-03^a (all values are percents)

	County	Municipal & Township	Special District	School District
Property Taxes	38.8	28.4	11.7	79.8
General sales tax	9.6	7.7	3.6	1.5
Selective sales taxes	2.4	5.1	0.1	0.1
Income taxes	1.9	5.4	0.0	0.8
All other taxes	2.9	4.2	0.8	0.6
Service charges	30.1	19.9	41.7	9.5
Utility charges	2.1	19.6	31.6	0.0
Miscellaneous	11.8	9.7	10.3	7.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the Census. State and Local Government Finances: 2002-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Of the total amount of selective sales tax revenues collected by municipalities and townships, most comes from taxes on public utilities, as previously mentioned. They represent over 60 percent of total selective sales tax revenue. Counties also receive significant amounts from public utilities, but many counties also have access to the motor fuel tax, which is a steady source of revenue for them. Motor fuel revenues are collected by either counties or municipalities or both in twelve states and the District of Columbia.² These include the states of Alabama, Florida, Hawaii, Illinois, Kansas, Missouri, Nevada, New Mexico, Ohio, Oregon and Texas. Counties in Florida make the most extensive use of the tax, collecting about \$437 million in 2003. Any county in Florida may levy a 1-6 cents tax on gasoline and diesel fuel by referendum or by a majority vote of the county commission. Counties with populations in excess of 50,000 are required to use the funds for transportation expenditures. Every county in the state levies this local option tax at its maximum rate of 6 cents per gallon. Florida counties are also authorized to levy an additional 1-5 cents tax by referendum or by a majority plus one vote of the county commission. Currently, nineteen counties levy this additional tax at rates ranging from 2-5 cents per gallon. Finally, an additional tax on just gasoline is available to counties by referendum or an extraordinary vote.³

Table 11: Selective Sales Taxes as Percent of Total Selective Sales Tax Revenue, 2002-03

	State	County	Municipal/ Township	Special District	School District
Motor Fuel	36.2	19.0	2.1	0.0	0.0
Alcoholic Beverage	4.9	2.9	1.6	0.0	0.0
Tobacco Products	12.9	1.5	1.8	0.0	0.0
Public Utilities	11.8	29.0	60.9	0.0	100.0
Other	34.2	47.6	33.7	100.0	0.0

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the Census. State and Local Government Finances: 2002-03.

State governments vary in their reliance on selective sales taxes. Table 12 provides a summary of this dependence. Nevada collects a significant amount of taxes on amusements, representing nearly 19 percent of total tax revenue. The majority of states, however, collect less than 1 percent of total tax revenue from amusements and many receive no tax revenue from this source. Motor fuel tax revenues also vary widely from a low of about 1.1 percent of total tax revenue in New York to a high of just over 11 percent in South Dakota and nearly 11 percent in Montana. Rates vary widely also, and New York State does have the lowest excise tax on motor fuel.

Table 12: Selective Sales as Percent of Total Tax Revenue, by State, 2005

	Alcoholic beverages	Amusements	Motor Fuel	Tobacco Products	Other	Total Selective Sales Taxes
United States	0.7	0.8	5.3	2.0	6.3	15.2
Alabama	1.8	0.0	7.2	2.0	14.1	25.1
Alaska	1.9	0.1	2.1	3.0	3.1	10.3
Arizona	0.5	0.0	6.4	2.6	4.0	13.5
Arkansas	0.7	X	6.7	2.3	3.9	13.5
California	0.3	X	3.4	1.1	3.0	7.8
Colorado	0.4	1.3	7.7	1.7	2.7	13.8
Connecticut	0.4	3.6	4.1	2.4	5.6	16.1
Delaware	0.5	X	4.2	3.0	6.9	14.6
Florida	1.8	X	6.2	1.4	9.6	19.0
Georgia	1.0	X	5.9	1.6	2.1	10.6
Hawaii	1.0	X	1.9	1.9	8.9	13.8
Idaho	0.2	X	7.5	1.8	3.2	12.7
Illinois	0.6	3.1	5.4	2.5	11.8	23.3
Indiana	0.3	6.2	6.3	2.7	1.6	17.1
Iowa	0.2	3.9	7.6	1.7	2.4	15.7
Kansas	1.6	0.0	7.6	2.2	2.6	14.1

Kentucky	0.9	0.0	5.5	0.4	11.4	18.2
Louisiana	0.6	5.9	7.0	1.2	5.2	20.0
Maine	0.4	X	7.4	3.0	3.1	13.9
Maryland	0.2	0.1	5.6	2.0	9.8	17.7
Massachusetts	0.4	0.0	3.8	2.4	3.9	10.5
Michigan	0.6	0.6	4.4	4.8	3.7	14.2
Minnesota	0.4	0.3	4.1	1.1	9.4	15.3
Mississippi	0.7	4.1	8.0	1.0	3.3	17.2
Missouri	0.3	3.4	7.8	1.2	3.7	16.4
Montana	1.2	3.0	10.7	3.4	7.1	25.5
Nebraska	0.6	0.2	8.0	1.9	1.3	12.0
Nevada	0.7	18.7	6.1	2.7	5.3	33.6
New Hampshire	0.6	0.0	6.5	5.0	22.7	34.9
New Jersey	0.4	2.1	2.3	3.5	7.5	15.8
New Mexico	0.8	1.0	5.0	1.1	5.8	13.7
New York	0.4	0.0	1.1	1.9	6.9	10.3
North Carolina	1.2	0.1	7.2	0.2	7.5	16.2
North Dakota	0.4	0.7	8.7	1.5	10.1	21.3
Ohio	0.4	X	7.0	2.4	2.5	12.3
Oklahoma	1.0	0.1	6.0	1.9	3.2	12.2
Oregon	0.2	0.0	5.7	3.7	1.1	10.7
Pennsylvania	0.9	0.0	7.0	3.8	7.3	18.9
Rhode Island	0.4	X	5.0	5.2	9.6	20.3
South Carolina	1.9	0.5	6.6	0.4	3.9	13.4
South Dakota	1.1	0.0	11.3	2.6	10.5	25.4
Tennessee	1.0	X	8.4	1.2	4.7	15.3
Texas	1.9	0.1	9.0	1.8	16.2	29.0
Utah	0.6	X	7.5	1.3	3.8	13.2
Vermont	0.8	X	3.8	2.2	14.0	20.8
Virginia	1.0	0.0	5.7	0.6	7.6	15.0
Washington	1.3	0.0	6.3	2.4	6.8	16.8
West Virginia	0.2	X	7.4	2.4	14.6	24.6
Wisconsin	0.4	0.0	7.1	4.5	3.2	15.2
Wyoming	0.1	X	3.9	1.6	1.3	6.9

Source: U.S. Bureau of the Census, State Government Tax Collections, 2005.

Notes: X Not Applicable

2. Issues Surrounding the Imposition of Excise Taxes: The Case of the Cigarette Tax

The cigarette tax is believed by many to be an important tool to discourage tobacco consumption, especially among young people, and to achieve a healthier population. The argument is that an increase in the tax level will reduce demand and that in turn will improve public health. Cigarette taxes are levied on a per-pack basis and vary widely across states. Rhode Island leads the states with a levy of \$2.46 on each pack and New Jersey is close behind at \$2.40 per pack. At the other end of the spectrum are states like Missouri at 17 cents per pack, Mississippi at 18 cents, Tennessee at 20 cents and Kentucky at 30 cents per pack. In addition, the federal government imposes a uniform excise tax of 39 cents per pack. On top of this, the Master Tobacco Settlement Agreement (MTSA) was signed in 1998 and tobacco companies are required to pay out \$206 billion to states over a period of 25 years, ending in 2025. These payments are settlements for actual and potential product liability suits. In 2002, states received \$8.9 billion, or about 31 cents per pack of cigarettes. This is seen as additional excise tax revenue (Cnossen and Smart 2005).

States continue to look to the cigarette tax for additional revenue. Nearly every state has increased its cigarette tax since 2002. Cigarette tax revenue also varies by state. As a percent of total tax revenue, Rhode Island collects 5.2 percent of its total tax revenue from cigarette taxes, whereas Kentucky collects 0.4 percent, although it has the highest percentage of adult smokers of any state in the nation. Table 12 illustrates the variation among state governments. Those tobacco-producing states with low excise taxes also collect relatively lower amounts in tax revenue.

Cigarette taxes are levied to raise revenue, but also to encourage changes in behavior, especially among the youth. Numerous studies support this claim. Estimates from studies of cigarette demand find that the price elasticity of demand for cigarettes ranges from about -0.3 to -0.5. A ten percent increase in price would reduce overall consumption by 3 to 5 percent. Economic theory also suggests that youths will be even more responsive to price changes for a number of reasons. Youth smokers are less likely to be addicted than are adult smokers. The share of disposable income spent on smoking is higher and finally, peer influences are stronger for youth smoking, and reductions in teen smoking may be intensified by additional reductions due simply to lower prevalence rates. Various studies have shown that youth are more sensitive to price than are adults, although results across studies are mixed.⁴

Critics argue that tobacco taxes, like other selective taxes, are both discriminatory and regressive. Today, about 21 percent of all adults in the United States are smokers, ranging from a high of nearly 28 percent in Kentucky to a low of about 10 percent in Utah. However, cigarette smoking is more common among adults who live below the poverty level (29.1 percent) than those who live above poverty (20.6 percent). Smoking rates also vary by level of education. Eight percent of adults with graduate degrees smoke, while cigarette smoking rates are highest for adults with a General Education Diploma (GED) at nearly 40 percent and for those with 9-11 years of education at about 34 percent (CDC 2005). Wagner (2005: 8) argues that "It is tax discrimination against

people of modest means for the benefit of the well-to-do”. Tobacco taxes are also classified by many as regressive taxes. Even assuming the prevalence of smoking is the same across incomes, the poor would spend a higher share of their income on cigarettes than higher wealth individuals would. Since we know that lower income groups have higher rates of smoking, the regressivity problem is exacerbated. However, studies have also shown that the price elasticity of demand is higher for lower-income persons, so increase in the tax result in larger reductions in smoking among lower income groups. Others point out that, to the extent that revenues generated by the tax are spent on programs targeted to lower income populations, regressivity of the tax may be lower.⁵

Cigarette taxes are also levied locally, although only a handful of states permit a local levy (either city, county or both) on cigarette sales. Over 450 local jurisdictions have their own cigarette tax, raising more than \$500 million in annual revenues. These include cities and counties in Alabama, Illinois, Missouri, Ohio, New York, Tennessee and Virginia. Just as do states, localities continue to look to the cigarette tax to bolster revenues. A review of recent changes to the cigarette tax in the Chicago illustrates the popularity of this revenue source among all levels of government.

The year 2005 began with an increased city of Chicago cigarette tax that went up 32 cents a pack (from 16 cents to 48 cents). In February of the same year, the Governor proposed a 75-cent per pack state tax increase, from 98 cents to \$1.73. Although that was not approved by the state legislature, the state Department of Revenue began an aggressive campaign to collect more than \$2 million in back taxes and penalties from those purchasing cigarettes on the internet and not paying applicable taxes. In November, the city approved yet another 20 cent per pack increase to 68 cents. Finally, at the end of the year, the Cook County Board unveiled its 2006 budget calling for an increase from \$1 to \$2 per pack. Today City of Chicago smokers pay the highest combined cigarette tax in the nation. The total tax on one pack of cigarettes is \$4.05, including the 39 cent federal tax, a 98 cent state tax, a 68 cent city tax and a \$2.00 county tax (Zorn 2005).

3. Evaluation of Excise Taxes

In addition to the cigarette tax, the two other main forms of excise taxes, the motor fuel tax, alcohol taxes, are also criticized for being regressive. Arguments surrounding regressivity of the general sales tax also apply to excise taxes.

Taxing the selective products of alcohol, motor fuel, and cigarettes also introduces inefficiency. However, part of the rationale behind taxation of these products is to discourage their consumption. When consumption is reduced, the tax is meeting its intended effects. Differing rates of excise taxes across states and localities, however, do introduce border problems similar to those introduced with varying general sales tax rates.

Excise taxes may be more variable than the general sales tax. For example, higher tobacco taxes are meant to discourage smoking and most studies find that they do.

Researchers report that over the longer term, rates will continue to decline, making cigarette taxes a poor choice for funding regular government operations (Lav 2002).

As is the case with the sales tax, private vendors are also responsible for the administration of excise taxes. State and local governments have the same responsibilities as with the sales tax. Again, these taxes are also often built into each transaction and not visible to the average taxpayer.

E. Income Taxes

The income tax is an important revenue generator for nearly all state governments and many local governments. Seven states have no income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Two others, New Hampshire and Tennessee, tax only dividend and interest income. State income tax revenue represented about 40 percent of total tax revenue in 2005. Tax rates vary widely across states from lows of around 1 percent to highs of over 8 percent. Most states impose a graduated rate structure. Many states have some elements of the federal system of exemptions and deductions built into their systems.

The local-option income tax is another viable alternative for local governments, but few states actually authorize its use, so it never became a substantial revenue-producer at the local level. Local-option taxes are generally either wage (or payroll) taxes or general income taxes. Wage taxes are the more common form of taxing income, and these taxes are imposed as a flat percentage of wages or earnings, excluding unearned income like capital gains and interest. Under most systems, the tax is imposed by the locality where the individual resides or works. The tax is generally administered by the local government. General income taxes, also known as piggyback taxes, are levied on residents' income, so this allows for a much broader base to be taxed. This tax is administered by the state which remits the local portion to the localities.

Philadelphia was the first to adopt a modern version of a local-option income tax back in 1938. Cities in Ohio began to impose the tax during the 1940s. The greatest expansion of the tax occurred during the 1960s when Michigan cities, Maryland counties, Baltimore and New York City all began levying a local income tax. In 1973, Indiana became the last state to date to authorize the local income tax. Since then, most new adoptions of the tax have occurred in Kentucky and Ohio (Bland 2005).

Only fifteen states actually authorize the use of the local income tax. Arkansas and Georgia localities have the option to levy the tax, but none have opted to exercise that option. Since cities and counties in Georgia have the option of levying either a local income tax or local sales tax, but not both, and most already levy the sales tax, it is unlikely that the tax will be used in the state of Georgia. Broad use of the tax occurs in six states: Indiana, Kentucky, Maryland, Michigan, Ohio and Pennsylvania.

1. Profile of the Income Tax

The income tax is an important generator of revenue for state governments. It has remained a steady source of income for state governments over the past decade, falling slightly from about 29 percent of total own-source revenue in 1992-93 to about 27 percent today. Local governments rely less on the income tax, as most do not have access to it.

Table 13 : Mix of Own-source General Revenues, 2002-03^a (all values are percents)

Revenue Source	Local Governments	State Governments
Property taxes	40.1	1.4
General sales tax	6.3	24.2
Selective sales taxes	2.7	11.7
Income taxes	2.8	27.5
All other taxes	2.7	7.1
Service charges	22.9	13.9
Utility charges	12.7	1.6
Miscellaneous	9.8	12.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03.

U.S. Bureau of the Census. State and Local Government Finances: 2003-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Across local governments, municipalities and townships rely the most on the local income tax. Again, of all local governments, municipalities have the most access to the tax. Special districts do not have access to the income tax and some school districts in Ohio share income taxes with municipalities.

Table 14: Mix of General Purpose Government Own-Source Revenues, 2002-03^a (all values are percents)

	County	Municipal & Township	Special District	School District
Property taxes	38.8	28.4	11.7	79.8
General sales tax	9.6	7.7	3.6	1.5
Selective sales taxes	2.4	5.1	0.1	0.1
Income taxes	1.9	5.4	0.0	0.8
All other taxes	2.9	4.2	0.8	0.6
Service charges	30.1	19.9	41.7	9.5
Utility charges	2.1	19.6	31.6	0.0
Miscellaneous	11.8	9.7	10.3	7.5

Source: Table 2: Summary of General Purpose Government Finances by Type of Government: 2002-03. U.S. Bureau of the Census. State and Local Government Finances: 2002-03.

^a Own source revenue excludes intergovernmental aid, liquor store income and insurance trust revenue.

Ohio municipalities make extensive use of the local income tax, raising nearly 42 percent of own-source revenue from the tax. Municipalities are authorized to levy a maximum rate of 1.0 percent without voter approval. A tax exceeding 1.0 percent can be imposed only with voter approval. Rates throughout the state vary from a low of .25 percent to a high of 2.85 percent and over half of the rates are at 1.0 percent. The tax is generally imposed on wages, salaries and other compensation earned both by residents of the municipality and non-residents working in the municipality and on the net profits of businesses. Kentucky authorizes a 2.25 percent tax on income for work and services performed within the urban county of Lexington-Fayette. Louisville-Jefferson County imposes an annual license fee on wages earned by every employee and net profits of businesses at a total rate of 2.2 percent. Cities in Michigan may impose a 1.0 percent tax on residents and a 0.5 percent tax on non-residents. In Pennsylvania, Philadelphia and Pittsburgh both levy taxes on salaries, wages and net profits at rates varying from 1.0 percent to over 4 percent (Ohio Department of Taxation 2006).

Table 15: Local income tax revenue as percent of own-source revenue, 2001-02

	Local Revenue	Percent
Indiana	600,409	7.8
Kentucky	691,027	20.4
Maryland	2,939,815	24.8
Michigan	5,464,348	9.1
Ohio	3,303,100	41.9
Pennsylvania	1,948,568	28.0

Source: U.S. Census Bureau Table 2: Local Government Finances by Type of Government and State, 2001-02. Census of Governments 2002.

2. Issues Surrounding the Imposition of the Income Tax: Professional Athletes as Targets

Many states have extended the income tax to professional athletes traveling to and playing in their states. Today, of the 24 states that have at least one professional sports team in the NFL, NBA, NHL or Major League Baseball (MLB), 20 have instituted a so-called “jock tax.” The taxes rely on a legal principle that says that states may tax nonresidents on income earned for services performed while they are in their border. Taxing visiting athletes has proved to be a fairly simple way to raise more money from the income tax, as it does not take much to figure out what is owed. Players’ salaries are published, as are team schedules. These schedules allow state tax auditors to calculate the number of days athletes worked in their states. The athletes are then taxed on the portion of their total salary earned in that state. Auditors can run the numbers and send the bills. As a result, athletes may be paying taxes in a dozen or more cities and states each year. State laws differ somewhat. Illinois does not tax residents of states that do not have an income tax. However, Illinois also taxes the entire salary of their athletes and

does not allow credits for taxes paid to other states. Most states allow athletes credits for taxes paid to other states (Brown 2000).

Critics of this practice, which is sometimes a separate law, but more often seen by states as a simple extension of an income tax to nonresidents, claim that it is deceptive, arbitrary and unfair. The deception lies in the fact that the tax may be seen by the public as a tax on multimillionaires who can afford to pay more taxes, but it is actually a tax that hits all players, regardless of their salary, and the support staff of teams in the four professional leagues. Critics say it is arbitrary since it targets a specific occupation, while others in other occupations also travel for business and do not have to pay taxes in each state where they may work. Finally, they say it is burdensome to file numerous state income tax forms (Hoffman and Hodge 2004). Nevertheless, state officials defend the tax. One Wisconsin official argues that any person who earns more than \$2,000 in income while they are in Wisconsin must pay an income tax and this rule applies to all workers. In the year 2000, Wisconsin collected a total of \$11.2 million in income taxes from professional athletes doing business in Wisconsin. Although this was a small portion of total income taxes collected, it is still money the state believes it has a right to collect (Walker 2002).

3. Evaluation of the Income Tax

Individuals with the same income can pay varying amounts of income taxes depending on the types of deductions, exemptions and exclusions granted that are often designed to benefit specific groups of people like homeowners and veterans. These practices compromise the principle of horizontal equity. In terms of vertical equity, state systems lean generally toward progressivity, and the state income tax is viewed by many as the most equitable of all state taxes. Most states use a graduated tax structure, but the degree of progressivity does vary by state (Brunori 2001).

The most obvious inefficiency with the income tax is its potential to discourage work. However, there are more allegations against the tax than there is evidence to support this claim. Empirical studies generally find negligible changes in hours worked with the imposition of an income tax. The tax is also alleged to distort location decisions as taxes vary across states, but again, there is little evidence to support this claim (Raimondo 1992).

Personal income taxes are also found to be relatively stable sources of revenues. Studies show that for most states, revenue elasticities vary from 0.50 to 1.50.

Administration of the income tax requires determination of the base, rate structure, details regarding exemptions and deductions, taxpayer compliance and enforcement. Some states and local governments piggyback their income tax systems onto the next highest level of government. Estimates are that administrative costs for the income tax can be as high as 5 percent (Raimondo 1992).

The tax may be seen as highly visible, as we have to complete an accounting of income annually and many of us pay (if we owe) in an annual lump sum. However, income taxes are integrated with every labor market transaction and are less visible on a day-to-day basis.

F. Lottery Revenues

Gambling in one form or another is now legal in every state with the exception of Hawaii and Utah. State-run lotteries, present in forty-two states, are the most popular form of gambling in the United States. According to 2004 Gallup data, two of three Americans reported participating in some form of gambling within the past 12 months. (Kearney 2005) North Carolina is the latest state to offer a state-run lottery, as its legislature approved the game in August 2005.

New Hampshire offered the first lottery in 1964 and lotteries spread throughout the nation soon after, first throughout the Northeast (New York, 1967 and New Jersey, 1970) and then to the West and Midwest and finally to the South. In 1985, Maine, New Hampshire and Vermont joined to form the first multi-state lottery, and since, a number of others have joined in providing multi-state games. Motivations to the adoption of state lotteries vary. Many saw the lottery as a politically viable revenue-raising strategy during times when other revenue sources were strictly off-limits. Others were pressured by losing money to neighboring states implementing their own lotteries. Finally, the lottery industry is a force that includes numerous retailers and suppliers, all viewing the lottery as a profit-making machine in one way or another (Hansen 2004).

Lottery tickets cost between 50 cents and \$10, with \$1 being the standard cost. In 2004, lotteries generated \$48 billion in consumer spending across the United States, increasing from \$45 billion in 2003 and \$42 billion in 2002. Lottery sales per capita in 2004 ranged from about \$53 in Nebraska to around \$200 in a number of states (NASPL 2006).

1. Profile of Lottery Revenues

Lottery revenues contribute a modest amount to the revenue base, but they have grown over the years. Table 15 provides a summary of this revenue source across states. As a percent of own source state revenue, lottery revenues range from between nearly 1 percent to over 8 percent. West Virginia has the distinction of being ranked first in terms of the proportion of own-source revenue raised from the lottery at 8.7 percent and this is up from 7.7 percent in 2002. Minnesota's lottery proportion of own-source revenue is the lowest at 0.6 percent, up slightly from 0.5 percent in 2002. Overall, state lottery revenue as a proportion of own-source revenue has increased slightly since 2002, from 2.09 percent to 2.2 percent.

Table 16: Lottery Revenue as Percent of State Own-source Revenue, 2004

State	Revenue	Rank	State	Revenue	Rank
United States	2.2	-	Missouri	2.0	21
Arizona	1.2	28	Montana	0.6	37
California	1.1	30	Nebraska	0.8	36
			New		
Colorado	1.6	24	Hampshire	2.7	16
Connecticut	2.8	15	New Jersey	3.0	11
Delaware	8.0	3	New Mexico	0.9	35
Florida	2.9	12	New York	3.4	9
Georgia	4.7	7	Ohio	2.8	13
Idaho	1.0	32	Oregon	4.8	6
Illinois	1.9	22	Pennsylvania	2.5	18
Indiana	1.4	25	Rhode Island	8.1	2
			South		
Iowa	1.0	31	Carolina	2.8	14
Kansas	1.3	26	South Dakota	7.3	4
Kentucky	2.1	20	Texas	3.1	10
Louisiana	1.2	29	Vermont	1.2	27
Maine	1.7	23	Virginia	2.6	17
Maryland	3.7	8	Washington	1.0	33
Massachusetts	5.1	5	West Virginia	8.7	1
Michigan	2.2	19	Wisconsin	1.0	34
Minnesota	0.6	38			

Source: U.S. Census Bureau, Governments Division, 2004 Annual Survey of State Government Finances, January 2006.

Notes: Net Lottery Revenue is calculated as lottery income (ticket sales) less prize money. The table above does not include states that have recently instituted lotteries like OK and NC.

2. Issues Surrounding the Implementation of the Lottery

The lottery industry stands out in the gambling industry due to several unique features. First, it is the most widespread form of gambling in the United States and second, it is a virtual state government-operated monopoly. This has caused concern for some who see a contradictory role for state governments as active promoters of lotteries while imposing heavy sin taxes on the lottery buyers. State governments have become dependent on lottery sales and they have also justified lotteries to the public for earmarking these revenues to certain causes.

Most states earmark their lottery proceeds to education. The Georgia lottery money is used for the HOPE Scholarship Program, which provides college scholarships, and for kindergarten education. Georgia also sets aside money for gambling treatment programs. Other states use funds for a broad array of services from economic development to tax relief. Although earmarking might help a state to sell its lottery, whether or not lottery

proceeds actually make a difference is questioned by critics. There is nothing to prevent a legislature from allocating general funds away from earmarked uses, thus negating the benefits of earmarking (NGISC 1999).

Critics of lotteries also claim that state lotteries prey on minorities and the poor and that spending on lotteries displaces consumption and savings. Studies have examined who plays the lottery and many have concluded that on average, state lotteries are disproportionately supported by lower-income people. Lower income households spend a larger percentage of their wealth on lottery products than do other households.⁶ Studies have also shown that the regressivity varies with type of product or type of game. Instant tickets are more often purchased by lower-income people and higher-income players are more likely to purchase tickets for a jackpot lotto game. This is an important finding for state policy makers who may want to address the problem of regressivity, as a state could mitigate regressivity by moving away from instant games. Many states, however, are moving towards more instant games (Kearney 2005a). Proponents of lotteries answer these critics by reminding them that the lottery is purely voluntary and the state does not require anyone to participate in the game.

3. Evaluation of Lottery Revenues

As discussed above, lottery revenues are criticized for their distributional impacts due to the fact that many studies conclude that the burden falls disproportionately on lower-income players, thus violating principles of equity.

Just as with selective sales taxes, the lottery represents a tax on a specific good and this has the potential to distort consumer spending. Critics see it as an economically inefficient tax, violating the principle of neutrality. One product is singled out for a high tax rate, and this product is generally consumed by a subset of the population. Consumers may also shift away from the product to find a less highly taxed substitute (Hansen 2005).

Lottery proceeds have seen slight, but steady increases over the years. However, as other types of gambling become more popular, lottery revenues may be squeezed out as people substitute other types of gambling (Elliott and Navin 2002).

Technological advances that have played a major role in lottery growth have also made it easier to administer for state officials. However, there are complaints against the high administrative costs of the lottery. This is one area where data are collected by state on costs to administer. Overall, in 2004, states spent about 15 percent of total net lottery revenue to administer the programs. This varies widely by state. New York spends about 10 percent of net lottery proceeds on administration, while Oregon spends over 55 percent.⁷

Critics also often point to the lack of visibility of this revenue source. For a tax to be visible, taxpayers should understand what is being taxed and at what rate.

Because the lottery tax is built into the price of the ticket, transparency or visibility is not achieved. Taxpayers do not know how much money the state actually retains and how it might be spent.

G. Summary Evaluation of Revenue Sources

The table below provides a summary evaluation of each revenue source according to the five criteria for a good tax. It illustrates how well each source satisfies each criterion and highlights the comparative strengths and limitations of the revenues. The revenue sources are ranked along a continuum where 1 means that the revenue source adequately meets the criterion; 2 means that the source meets the criterion somewhat; and 3 means that the source generally does not meet the criterion.

Table 17: Evaluation of Revenue Sources

Revenue Source/Criteria	Equity	Efficiency	Stability	Ease of Administration	Visibility
User Fees	3	1	2	2	1
Sales Tax	2	2	1	2	3
Excise Taxes	2	2	2	2	3
Income Tax	2	2	1	2	1
Lottery Proceeds	3	2	2	2	3

V. Emerging Issues and Innovative Policies

The following discussion includes a series of examples and case studies from communities that are attempting to implement innovative revenue policies to raise more money and to encourage or discourage certain behaviors.

A. Commercialization of Government: Paid Advertising on Public Property:

1. On-line Advertising on Official Government Web Sites

With the growth of government Web sites and e-government services, online advertisers are anxious to break into this relatively new market. Experts say the government Web sites are unique in conveying a sense of legitimacy that most commercial sites do not. People who visit government Web sites believe the information is carefully edited and accurate. Furthermore, people are generally looking for specific information and this, advertisers believe, will make them more likely to read pages in detail rather than scanning. For all of these reasons, this market extremely attractive to advertisers.

From the government perspective, the driving force behind advertising on government Web sites is revenue. Advertising funding sources are particularly attractive because they enhance the revenue stream and are politically acceptable, at least, relative to the alternative of raising additional revenue from traditional sources. The amount of

potential revenue from on-line advertising varies significantly across governments. Advertising prices are based on the number of people who see or hear advertisements, known as impressions. Pricing for online advertising is expressed in CPM, or cost per thousand impressions. Pricing varies widely by demographics and demand for space. Fairfax County Virginia began to contemplate online advertising a few years ago and expected to earn between \$500,000 and \$1 million annually. To date, there is still no advertisement on the County's website. Honolulu County's website receives over 4 million visits per month, so the County could easily raise \$600,000 per year using a standard CPM pricing structure.

There are legitimate concerns amongst government officials to using this approach to raising revenue. Many argue simply that government institutions should be insulated from any commercial advertising. Others point to the administrative and potential legal problems. Some ads automatically track which sites and pages an individual visits, so although the governments may not be receiving and analyzing the data, somebody is, and governments could be challenged or at least seen as violating a public trust. Using paid advertising will take some administration and this function must be either outsourced or delegated to someone in-house who has the knowledge to guide the process of accepting and placing advertising, negotiating prices and billing and accounting. There is also the question of where the revenues are targeted. If the ad appears on the Department of Public Works page, does that department receive a greater share of the revenue? Finally, there are questions of free speech and how government may or may not limit this. Can the government discriminate between different types of activities or different viewpoints? Can they accept commercial advertising and not political advertising? Although, this is a potentially lucrative revenue source for some governments, the idea is still new and not well-tested and presents a number of challenges and potential pitfalls (Elberg, et al 2001).

2. Police Cars as Billboards

Another recent trend falling under this same broad theme is that of commercial advertisements on public police cars. Government Acquisitions LLC, a firm in Charlotte, NC, began promoting this idea several years ago and already has a number of interested police departments on board. Faced with declining dollars and aging vehicle fleets, police departments may obtain vehicles for \$1 each, if they agree to have commercial advertisements on them. One of the first towns to approve the idea was Springfield, FL, which purchased fifteen new cars that include the logos of local businesses. Since, departments from around the country have participated in the program, many of them in the southern states (Fluery-Steiner and Wiles 2003).

This revenue raising strategy is fraught with challenges and has sparked much criticism from legal scholars. Scholars argue that this particular type of advertising on public property is different from advertisements in stadiums or civic auditoriums. Advertisements on police cars are different in that there is the danger of the appearance of impropriety. Furthermore, there are practical issues in terms of the public being able to identify police cars (Wood 2002). Other critics note such negative consequences as the possibility for increased bias in public policing, and question whether law-breaking

by people connected to commercial sponsors creates a conflict of interest for officers. Does law enforcement risk being co-opted by commercial interests who may use the threat of sponsorship revocation as a form of control? Finally, does this undermine the symbolic authority of police vehicles? (Fluery-Steiner and Wiles 2003).

3. Coca-Cola in the Schools

The use of public schools as advertising outlets has grown substantially over the past decade. Advertisers find appealing the fact that they can reach large numbers of youth in a contained setting and schools, like other local governments, are merely looking for new and politically feasible and publicly acceptable sources of revenue. Schools receive cash, equipment, supplies and other assistance from advertisers. Commercial activities in schools are broad and varied and include those related to product sales, direct advertising, indirect advertising and market research with students. Examples of product sales include exclusionary contracts between schools and bottlers to sell soft drinks on school grounds and contracts with fast food companies to sell food in schools. This also includes short-term sales of candy, magazines, gift wrap and other items to benefit the school. Direct advertising is placed on billboards and in corridors and stadiums. Indirect advertising includes promotional materials from organizations encouraging energy conservation or nutritional awareness. Market research includes surveys and polls of students. A recent US General Accounting Office report found that food sales were the most prevalent type of commercial activity in schools (GAO 2000).

The GAO also found that prior to 2000, 28 states had passed some sort of provision addressing commercial activities in schools and since 2000, 13 states have established regulations or statutes regarding such activities (GAO 2004). However, state laws governing commercial advertisement in schools vary widely. Some states allow or restrict certain kinds of activities. For example, New Mexico permits advertising on and in school buses, while Virginia prohibits such advertising. In many of the states, laws are not comprehensive and address only some types of commercial activities. In the majority of states, local school officials are responsible for setting policy on commercial activities and it is usually accomplished on a case-by-case basis. Most local school boards delegate the responsibility to superintendents and principals. Due to this piecemeal approach to regulation and decision-making, policies across districts are inconsistent.

Certain commercial activities, such as large soft drink contracts and logos on sports uniforms, have generated controversy and extensive media coverage. Groups have organized to limit such commercial activities and members of Congress have questioned the activities and their potential infringement on students' rights to privacy. Nevertheless, commercialism in schools is widespread and showing few signs of slowing down. This is due, for the most part, to the potential revenue that can be generated. These revenue amounts, however, also vary widely. A beverage contract in one district examined by the GAO (2000) had the potential to generate up to \$1.5 million per year to

fund various projects and activities. In other districts, such contracts generated as little as about \$12 per year. One high school principal interviewed by the GAO (2004) reported that his contract generated about \$67,000 in up-front revenue, but only about \$12 per student over the life of the contract.

Schools also use these revenues in different ways, depending on the nature of the specific agreement. One high-school received an initial payment from a beverage company to build a track. Others dedicate revenues specifically for athletic programs or other student activities. Much of the advertising in schools, beyond the beverage contracts, is displayed in exchange for free equipment or to reduce the cost of supplies or even yearbooks. Again, such revenues vary and the media has reported large revenue windfalls from advertising contracts. A district in Texas was reported to have generated several thousand dollars through advertising on school buses (GAO 2004).

4. Dollars for Naming Rights

The city of Chicago plans to receive a windfall of \$3 million in FY2006 for the sale of naming rights to the Chicago Skyway, a 7.8 mile toll bridge connecting the city to the state of Indiana. Selling off naming rights has become a growing strategy for municipalities to raise revenue, although this is the first example of its use on a crowded toll road. The city will not only rename the toll bridge, but it will also offer businesses the opportunity to place their names on over 100 highway signs along the highway. Millions of cars travel the highway each year, which is appealing to advertisers (Janega 2006).

Naming rights are gaining increased attention in cash-poor cities. The phenomenon took off during the 1990s and by the late 1990s and into the early 2000s, naming rights for sports stadiums agreements involved large figures. At last 15 agreements have exceeded \$100 million. Naming rights of stadiums also give rise to naming rights of seating sections, hospitality suites, lobbies, corporate boxes and even entrance gates

B. Transportation Finance:

1. Congestion Charging

The San Francisco County Transportation Authority recently received funding to study how to implement a program similar to London's 3-year old system of charging to drive downtown during business hours. The London program, which became fully operational in February 2003, operates its congestion charge from 7 am to 6:30 pm Monday thru Friday and charges motorists a flat fee of \$14 to enter the downtown zone. Motorists must pay the fee before or on the day of travel by telephone, the Internet, at shops or gas stations. A system of cameras scans license plates and tracks vehicles entering the zone. If the motorist fails to pay the charge by midnight of the day of entry to the zone, a fine is imposed (Ison and Rye 2006). The fee has raised about \$350 since implementation in London and it has reduced congestion by about 30 percent and vehicle emissions by

about 12 percent (Bowman 2006). The revenue raised from the congestion charge is invested in the improvement of London's infrastructure and transportation services.

Although this idea has not been implemented widely, a number of cities have studied congestion charges. Implementing such a system is a complex undertaking and a series of issues must be discussed and resolved. First and foremost, for such a strategy to be acceptable, a sympathetic local environment must exist. This means that there has to be agreement that the level of congestion is severe enough to warrant such a policy and the presentation of the new initiative to the public must be strategically timed to not conflict with other significant initiatives that may affect residents. The city must also be able to present clear objectives in terms of reducing congestion and emissions and in terms of how revenue is to be used. There are also issues of equity and exemptions that must be addressed. The London system includes a number of exemptions and discounts for alternative fuel vehicles, vehicles driven by or carrying disabled people, emergency vehicles, vehicles with nine or more seats, mopeds and motorbikes and residents within the charging zone (Ison and Rye 2006). San Francisco County Transportation Authority staff members are studying this approach and focusing on questions of where charging should occur, pricing schemes, and payment and enforcement methods.

2. High Occupancy Toll (HOT) Lanes

High occupancy vehicle (HOV) lanes, highway lanes designated for use by vehicles with two, three or more travelers, have been in use across the country for years. Recently some of these lanes are being considered for a make-over. Studies have shown that the number of vehicles using HOV lanes is often below the capacity of the lane, leaving them underutilized. An alternative, high occupancy toll lanes, may remedy this problem. HOT lanes can be used by both high-occupancy vehicles for free or for a reduced rate and by single-occupancy users for a charge. The toll is set high enough during peak hours to keep the number of users down and the speed of vehicles on the road up. HOT lanes provide drivers with the option of paying a toll and moving more rapidly or not paying and dealing with congestion. HOT lanes have been used successfully in southern California since 1995. They have reduced overall commuting times (Downs 2002). HOT lanes, like congestion charging, have the effect of both congestion management and the generation of additional revenues.

VI. Planning Implications

All of the revenue sources detailed above have the potential to affect economic activity and therefore, may affect land use. The mix of revenue sources at the local level varies widely by municipality, so impacts on land use decisions are likely to be more apparent at the local level than at the state level.

While there is a body of literature addressing the land use implications of the property tax and much of it focusing on property taxes as they affect investment decisions of businesses, research addressing the land use implications of other revenue sources is

scant. Yet, today these other revenue sources provide the bulk of financing for local governments. This section will discuss the planning implications of these changing trends in revenue structures and revenue policies.

How does the revenue structure of a municipality affect the type of development pursued? This is the topic of a recent paper by Michael Pagano that examines this issue of the changing role of local revenues and the impact on land use decisions (Pagano 2003). In his analysis of fifteen case study projects from the cities of Columbus, OH, Oklahoma City, OK and Columbia, SC, he attempts to understand this relationship between revenue reliance and land use. Based on analysis of the projects including interviews with local officials and staff, he draws some telling conclusions about how planners think and act on this relationship between a city's overall revenue structure and its land development strategy. In Columbia, a city that relies relatively more on the property tax, Pagano reports that the city is motivated to preserve property values and re-use land more because of its impact on property tax revenue as opposed to its potential to influence sales tax revenue. In contrast, Oklahoma City, which relies more on the sales tax as a local funding source, the broad land development strategy encourages retail sales centers at the borders of the city, while focusing on cultural and entertainment venues in the downtown. Increasing the value of property is less important than attracting new retailers. In Columbus, with its heavy reliance on the local income tax, city officials encourage the expansion of state offices, university and hospital facilities and other tax-exempt organizations. The goal is job creation and more employees and higher paying jobs. He concludes this section of his paper with some thoughts on the implications of this research on standard fiscal impact analysis methods. Rather than relying on standard approaches that focus on the property tax as the driver of local revenues, he argues that the increasing reliance on other revenue sources indicates a need for more inclusive treatment of revenue sources in implementation of our fiscal impact analysis methods.

Another aspect of this same research examines how the diversity in revenue structures in cities affects the amount of vacant land that exists. Based on a vacant land survey sent to cities with populations greater than 50,000, Pagano found through difference of means testing that cities with diversified tax structures have more vacant land than cities relying predominantly on the property tax. Furthermore, the number of abandoned structures is higher in cities with diversified bases. He concludes that the fiscal imperative to convert nonproductive land and structures is greater in those cities relying relatively more heavily on the property tax. The same imperative is weaker in those cities relying instead on sales and income taxes because their fiscal health is less influenced by the improvement of land and structures.

To further analyze the revenue structure-vacant land relationships, he also developed a regression model to determine the causes of land vacancies. Contrary the results from the survey above, this analysis showed that dependence on the property tax was not associated reductions in vacant land. The fact that a city relied primarily on the property, income or sales tax did not matter to the vacant land amounts. This suggests the need for further research into this area that accounts for local decision-making behavior.

Other research analyzing the impacts of revenue sources, beyond the property tax, and their influence on land use includes a recent study of the retail sales tax and its implications for California cities. Lewis (2001) examines local officials' attitudes toward various types of growth and development. According to the city managers surveyed, retail development is the most desirable land use for both development of vacant land and redevelopment of land. The next desirable land use is office development. Retail uses were also the most likely to win incentives in these communities. The top motivation in the perceived importance of new development is new sales taxes generated. Officials were also asked about their motivations for annexation and responded that the gain of future tax revenues ranks high on this list of motivating factors, second behind the desire to control the development of surrounding areas. Despite the preferences and perceptions of city managers, Lewis concludes that the built environment is not altered due to reliance on the sales tax. In examining per capita sales tax revenues over time, he finds no major shifts in cities' relative positions. He concludes that "the result is largely a fiscalization of municipalities' land-use orientations rather than a fiscalization of land use outcomes" (31). He does note that this orientation toward gaining sales tax revenue may result in the land use effect of overzoning for retail growth and thus underzoning for other types of land use.

Another body of research examines the effect of taxes on local economic development. Again, there is a large body of research examining this question using the property tax as the significant tax measure, but researchers have extended this literature to include other types of taxes. In a recent study, Haughwat et al (2003) examine the cities of Houston, Minneapolis, New York and Philadelphia and find that local income and wage tax rates have negative effects on city employment levels. Using time series analysis, Mark et al (2000) examine the effect of sales and personal property taxes on household and business location decisions in the Washington D.C. metropolitan area. They conclude that employment growth rates are highly sensitive to both the sales tax and the personal property tax. In an earlier piece of research, Bradbury and Ladd (1987) examined the effect of local taxes on the size of a city's property tax base. Their analysis included 86 major central cities, and they conclude that local income taxes reduce the size of a city's tax base, but local sales taxes do not.

VII. Conclusions

There is no doubt that state and local governments will confront even more challenges in the coming years. The economy continues to shift to a service and knowledge based one, with ever-broadening global markets. We are in the midst of dramatic demographic change, from an aging population to a growing immigrant population. There is continuous pressure to limit the growth of government and to resist new taxes. While these broad trends will challenge state and local government, technological advances will also continue to pose new avenues for raising revenues in innovative ways.

VIII. References

- Bartle, John R., Carol Ebdon and Dale Krane. 2003. Beyond the Property Tax: Local Government Revenue Diversification. *Journal of Budgeting, Accounting and Financial Management*, 15 (4): 622-648.
- Berman, David R. 2003. *Local Government and the States: Autonomy, Politics and Policy*. Armonk, New York: M.E. Sharpe, Inc.
- Bierhanzl, Edward J. and Paul B. Downing. 1998. User Charges and Bureaucratic Inefficiency. *Atlantic Economic Journal* 26(June) 175-89.
- Bland, Robert. 2005. *A Revenue Guide for Local Government*. Washington DC: International City/County Management Association.
- Bowman, Becky. 2006. *Move to Charge Toll for Driving in Core of Downtown Area: County Transit Panel to Receive \$1 million from U.S. for Study*. San Francisco Chronicle. March 28 (on-line version)
- Bradbury, Katharine L. and Helen F. Ladd. 1987. *City Taxes and Property Tax Bases*. National Bureau of Economic Research. Working Paper No. 2197. Cambridge, MA.
- Brown, Mark. 2000. Squeeze Play. *Illinois Issues*. June.
- Brunori, David. 2003. *Local Tax Policy: A Federalist Perspective*. Washington D.C.: The Urban Insitute Press.
- Brunori, David. 2001. *State Tax Policy: A Political Perspective*. Washington D.C.: The Urban Insitute Press.
- Centers for Disease Control (CDC). Department of Health and Human Services. 2005. Cigarette Smoking Among Adults-United States, 2004. *Morbidity and Mortality Weekly Report* 54, 44: 1121-1124. November 11.
- Centers for Disease Control and Prevention. *Public Health and Aging: Trends in Aging—United States and Worldwide*. MMWR 52(06): 101-106.
- Chaker, Anne Marie. 2003. Public Schools Pile on Fees; Cash Strapped Districts Charge Students To Play Sports, Join the Band; \$60 for Drama Club. *Wall Street Journal* (Eastern Edition) New York: NY. Sep. 3, 2003.
- Chaloupka, Frank J. 1998. *The Impact of Proposed Cigarette Price Increases*, based on a paper prepared for the Bureau of Economic Research. May.

Cnossen, Sijbren. 2005. Taxation of Tobacco, in *Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting and Driving*. Sijbren Cnossen (ed) Oxford University Press Inc. New York.

Downs, Anthony, 2002. *Some Like it HOT: High Occupancy Toll Lanes Work Best on High-Traffic Roads*. *Governing Magazine*, May.

Elberg, Dana, Fritz Grupe and James Drake. 2001. Online Advertising as an Alternative Revenue Source. *Government Finance Review*, December.

Elliott, Donald S. and John C. Navin. 2002. Has Riverboat Gambling Reduced State Lottery Revenue. *Public Finance Review*, Vol. 30 No. 3: 235-247. May.

Federation of Tax Administrators (FTA). 2006. "State Excise Tax Rates on Cigarettes, January 1, 2006. (www.taxadmin.org/fta/rate/cigarette.html)

Fishel, William A. 2001. *The Homeowner Hypothesis: How Home Values Influence Local Government Taxation, School Finance and Land Use Policies*. Cambridge, MA: Harvard University Press.

Fishel, William. 1989. Did Serrano Cause Proposition 13? *National Tax Journal* 42(4): 465-473.

Fleury-Steiner, Benjamin and Kristian Wiles. 2003. The Use of Commercial Advertisements of Public Police Cars in the United States Post 9/11. *Policing and Society* 13, 4: 441-450.

Gold, Stephen D. and Sarah Ritchie. 1992. State Policies Affecting Cities and counties in 1991: Shifting Federalism. *Public Budgeting and Finance*. Spring: 23-46.

Gold, S. D. 1979. *Property Tax Relief*. Lexington, MA: Lexington Books.

Greene, Barbara P. 1987. Counties and the Fiscal Challenges of the 1980s. *Intergovernmental Perspective* 13: 14-16. Winter.

Hansen, Alicia. 2005. *State Run Lotteries as a Form of Taxation*. Speech given at the National Coalition Against legalized Gambling, 12th annual Conference, October 8, 2005. Tax Foundation.

Hansen, Alicia. 2004. *Lotteries and Fiscal Policy*. Tax Foundation. October 2004, No. 46.

Haughwout, Andrew F., Robert P. Inman, Steven Craig and Thomas Luce. 2003. *Local Revenue Hills: Evidence from Four U.S. Cities*. National Bureau of Economic Research. Cambridge, MA. May.

Hoene, Christopher. 2005. *Local Budget and Tax Policy in the U.S.: Perceptions of City Officials*. Washington DC: National League of Cities.

Hoffman, David K. and Scott A. Hodge. 2004. *Nonresident State and Local Income Taxes in the United States: The Continuing Spread of "Jock Taxes"* Tax Foundation Special Report, No. 130, July.

ITEP (Institute on Taxation and Economic Policy). 2005. *Should Sales Taxes Apply to Services*. Talking Taxes Policy Brief 3.

Ison, Stephen and Tom Rye. 2005. *Implementing Road User Charging: The Lessons Learnt from Hong Kong, Cambridge and Central London*. Transport Reviews, Vol. 25, No. 4: 451-465. July.

Janega, James. 2006. City to Seek Bids for Skyway Naming Rights. *Chicago Tribune*, April 25, 2006, page 1, section 1.

Kearney, Melissa Schettini. 2005a. The Economic Winners and Losers of Legalized Gambling. *National Tax Journal*. Vol. LVIII, No. 2: 281-302. June.

Kearney, Melissa Schettini. 2005b. State Lotteries and Consumer Behavior. *Journal of Public Economics* 89: 2269-2999.

Krane, Dale, Carol Ebdon and John Bartle. 2004. Devolution, Fiscal Federalism and Changing Patterns of Municipal Revenues: The Mismatch between Theory and Reality. *Journal of Public Administration Research and Theory*, 14, 4: 513-533.

Lav, Iris J. 2002. *Cigarette Tax Increases: Cautions and Considerations*. Center on Budget and Policy Priorities. Washington D.C.

Lewis, Paul G. 2001. Retail Politics: Local Sales Taxes and the Fiscalization of Land Use. *Economic Development Quarterly*, 15, 1: 21-35.

Liner, E. Blaine (ed) 1989. *Sorting Out State Local Relations in A Decade of Devolution: Perspectives on State-Local Relations*. Washington D.C: The Urban Institute Press.

Maguire, Steven and Nonna A. Noto. 2006. *Internet Taxation: Issues and Legislation in the 109th Congress*. Washington D.C.: Congressional Research Service.

Mark, Stephen T. and Therese J. McGuire and Leslie Papke. 2000. The Influence of Taxes on Employment and Population Growth: Evidence from the Washington D.C. Metropolitan Area. *National Tax Journal* Vol. LIII, No. 1: 105-123.

McCabe, Barbara Coyle. 2000. State Institutions and City Property Taxes: Revisiting the Effects of the Tax Revolt. *Journal of Public Budgeting, Accounting and Financial Management* 12(2): 205-229.

- Mikesell, John L. The American Retail Sales Tax: Considerations on their Structure, Operations and Potential as a Foundation for a Federal Sales in *Tax Policy in the Real World*, Joel Slemrod, ed. Cambridge University Press, Cambridge, UK.
- Musgrave, Richard A. and Peggy B. Musgrave. 1984. *Public Finance in Theory and Practice*. New York: McGraw Hill Inc.
- National Gambling Impact Study Commission (NGISC). 1999. *Final Report*. Washington DC.
- NASPL (North American Association of State and Provincial Lotteries). *Fiscal Years 2002, 2003 and 2004 Lottery Sales and Profits* (<http://www.naspl.org/sales&profits.html>)
- NCSL (National Conference of State Legislatures. 1999. The Appropriate Role of User Fees and Charges in State and Local Finance. Washington D.C.
- Ohio Department of Taxation. 2006. *The Municipal Tax* (<http://tax.ohio.gov>)
- Pagano, Michael A. 2003. *City Fiscal Structures and Land Development*. A Discussion Paper Prepared for the Brookings Institution Center on Urban and Metropolitan Policy.
- Raimondo, Henry J. 1992. *Economics of State and Local Government*. Praeger Publishers, New York, NY.
- Rubin, Irene. 2006. *The Politics of Public Budgeting*. Washington DC: CQ Press.
- Sears, David O. and Jack Citrin 1985. Tax Revolt: Something for Nothing in California. Cambridge, MA: Harvard University Press.
- Shannon, John. 1987. The Return to Fend-for-Yourself Federalism. *Intergovernmental Perspective*. Summer-Fall.
- Stark, Kirk J. 2003. The Uneasy Case for Extending the Sales Tax to Services. *Florida State University Law Review*. Spring.
- Steinemann, Anne C., William C. Apgar and H. James Brown. 2005. *Microeconomics for Public Decisions*. Mason, OH: South-Western.
- Swain, John A. and Walter Hellerstein. 2005. The Political Economy of the Streamlined Sales and Use Tax Agreement. *National Tax Journal*. Vol. LVIII, No. 3.
- Tannenwald, Robert. 2004. *Are State and Local Revenue Systems Becoming Obsolete?* Washington D.C: National League of Cities.

United States Government Accountability Office (GAO). 2004. *Commercial Activities in Schools*. Washington D.C.: Government Accountability Office. GAO-04-810

United States General Accounting Office (GAO). 2000. *Public Education: Commercial Activities in Schools*. Washington D.C.: Government Accountability Office. GAO/HEHS-00-156.

Walker, Don. 2002. A Closer Look at the Jock Tax. *Milwaukee Journal Sentinel*. July 9.

Wagner, Richard E. 2005. *State Excise Taxation: Horse-and-Buggy Taxes in an Electronic Age*. Tax Foundation Background Paper. Washington DC: The Tax Foundation. No. 48. May.

Wisconsin Legislative Audit Bureau. *Best Practices Report: Local Government User Fees*. Madison, WI.

Wood, Daniel B. 2002. Your Ad Here: Cop Cars as the Next Billboards. *Christian Science Monitor*, 3 October p. 1

Zorn, Eric. 2005. *Burned: Cigarette Taxes are Unfair to Smokers*. Chicago Tribune. December 22. (on-line edition)

Endnotes

¹ See *Hartzell v. Connell* (1984) 35 Cal.3d 899.

² Counts are taken from U.S. Bureau of the Census, Table 2 Local Government Finances by Type of Government and State: 2001-02. 2002 Census of Governments.

³ Office of Economic and Demographic Research, The Florida Legislature. *2006 Tax Handbook*.

⁴ For a review of studies on the distributional impacts of the cigarette tax, see “The Impact of Proposed Cigarette Price Increases” based on a paper by Frank J. Chaloupka for the National Bureau of Economic Research, May 1998.

⁵ For a review and citations of studies on the cigarette tax and regressivity, see www.tobaccofreekids.org.

⁶ For a review of studies on the distributional impacts of state lotteries, see Kearney, Melissa Schettini. 2005. The Economic winners and Losers of Legalized Gambling. *National Tax Journal*. June; and Kearney, Melissa Schettini. 2005. State Lotteries and Consumer Behavior. *Journal of Public Economics* 89: 2269-2999.

⁷ U. S. Census Bureau, Governments Division, 2004 Annual Survey of Government Finances, January 2006. Table: Income and Apportionment of State-Administered Lottery Funds, 2004.

IX. Appendix: Activities for the Classroom

A. Evaluation of Revenue Sources

In this exercise, I ask students to work in groups to evaluate each these revenue sources themselves in terms of the criteria discussed above. Students are required to fill out an expanded (in size) version of this matrix. They must think through questions like, do each of these sources of revenue satisfy the principles of equity and why or why not? Are they efficient revenue sources? If not, how are inefficiencies created? Are they stable, easily administered and visible to the taxpayer? I also ask them to use examples to bolster their arguments.

Revenue Source/Criteria	Equity	Efficiency	Stability	Ease of Administration	Visibility
Property Tax					
User Fees					
Sales Tax					
Excise Taxes					
Income Tax					
Lottery Proceeds					

B. Develop your Ideal Local Revenue Structure:

In this exercise, I ask students to work in groups to develop their ideal revenue structure and defend it against the status quo. If their ideal structure mirrors the status quo, they must defend that.

C. Evaluation of Local Budget: Revenue Analysis

In this exercise, I ask students to choose a community and analyze its budget. Many budgets are on-line, and they are free to choose one found on-line or through other avenues. Any budget is acceptable, as long as it includes enough information to enable the student to answer the following questions:

- What are the major local revenue sources? What are the trends over time? Have they remained stable sources of revenue?
- How diverse is the city's revenue structure? Given the diversification, do you see any challenges ahead for the city?
- What factors have influenced changing revenue patterns? (local, regional, state or national factors (economic, social, demographic, etc.))
- Are there alternative revenue sources that this city might use? What are the advantages and disadvantages to turning to other sources?
- What are the revenue forecasts? How are they determined? Do these seem accurate to you? Why or why not?