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Effects of Housing Costs and Home Sales on Local Government Revenues and Services

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CORNELL
AGRICULTURAL ECONOMICS
STAFF PAPER

**EFFECTS OF HOUSING COSTS AND
HOME SALES ON LOCAL
GOVERNMENT REVENUES AND SERVICES**

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**EFFECTS OF HOUSING COSTS AND HOME SALES ON
LOCAL GOVERNMENT REVENUES AND SERVICES**

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**Extension of remarks at -
REGIONAL & LOCAL ECONOMIC OUTLOOK: THE IMPACT
ON HOUSING AND HOUSEHOLDS**

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EFFECTS OF HOUSING COSTS AND HOME SALES ON
LOCAL GOVERNMENT REVENUES AND SERVICES

David J. Allee

ABSTRACT: The subtitle of this paper should be " How recession and federal devolution have caused local governments to cut services and raise property taxes - - now, what should be done in response to the resulting clamor for local government consolidation?" Housing drives local government services. Home sales represent opportunities for more income and more costs. Intergovernmental competition for tax base and the role of state and federal aid to provide equity between jurisdictions are central to the quality of the results.

Recent cuts in sales taxes, plus reductions in state and federal assistance are transmitted to the voters through increases in the property tax. This has produced a reaction - consolidate! But that is advice urged and largely ignored since Woodrow Wilson included it in an 1895 textbook. To go beyond this conventional wisdom be sure to add some complementary ideas. Small governments may be at a disadvantage in producing some services, but they should have an advantage in representing preferences and that should not be overlooked. Different services will be best produced by different configurations of cooperating local governments. Thus take a service by service approach and look for the best of the many ways available to implement intergovernmental cooperation. Research suggests you may not cut expenditures much, but you will probably get better services. Get organized for a regional approach and do some strategic planning.

Besides looking inward for reform opportunities, look outside as well. Local governments have to take responsibility for coordination of the many agencies at higher levels of government that are involved in any particular type of service or it won't happen. Local officials have to bring a sharp focus on their problems. This means working through state associations with other local governments that have the same problems, and learning to lobby more effectively. A policy education approach by the housing and home building network is suggested.

INTRODUCTION & SUMMARY

Housing drives local government services. Property taxes - the one way to pay for services - have been rising rapidly. Mismanagement? Inefficiency? Consolidate? Yes, it is a time to look inside at opportunities for intergovernmental cooperation. Ask ourselves, how to organize for efficient choices? Do some strategic planning. It is also a time to look outside. Local governments coordinate the higher levels of government. You need to work through local government associations and organize with those other governments that are like you. Learn to lobby effectively. Policy education programming makes sense for the housing network.

The housing network -- those interested in how economic change will impact housing and households -- face an opportunity. The property tax serves as a shock absorber and shock transmitter for economic change. When revenues from other sources such as the sales tax or state and federal aid are cut, it raises the property tax. That attracts attention. Thus, economic depression and shifts in our political philosophy of who should pay for what are giving households a shock through the property tax. That attention creates a policy window of opportunity. How will we use it?

We need to understand what is going on. Housing drives most of the services provided by local governments. In turn these services are part of a climate for economic development that sets the base that pays for these services and helps establish the quality of life of our households. Balancing tax base and service needs requires a partnership approach between state and local government -- a partnership that has been deteriorating not strengthening.

We need to look inside our communities and their local governments. First, conventional ideas about how to make government more efficient are a start - but only a small start to the reform that is possible. Intergovernmental cooperation has more potential than is realized. Second, you also need to pay attention to how well organized you are to make choices for public services -- we suffer from "a hardening of the categories." Consider keeping control of provision, but encourage both competition and consolidation in production of public services. Third, a strategic planning approach can bring together the various sectors of the community, identifies who and where you are, what opportunities you have and what projects both can make a difference and can get done with the resources at hand.

We need to look outside - to the state and federal levels whose policies affect so much of what local people can do. First, local governments have to take responsibility to coordinate higher levels of government, not just the other way around. There are many agencies that can help and each has a number of programs, each with its own agenda. That agenda doesn't necessarily include your problem until your community shows its need and support for action.

Fitting together the different programs to add up to what you need can best be done by you. Second, issue by issue, communities have to organize with other communities with the same opportunities. Each issue has a different mix of stakeholders -- perhaps even more true at the federal and state levels than at the local. Third, we need to learn how to lobby more effectively. Each issue has its own structure of organizations, legislative committees, agencies and traditions. A most important role for local governments is lobbying to see that your needs are factored into the rapid change that characterizes state and federal government today -- indeed county government as well.

As may have already occurred to you, the needs outlined above are greater for the 1200 or so smaller general purpose governments in the State. Particularly for the people at this conference, it is important to recognize the need for policy education as a part of housing programs.

WHAT IS GOING ON?

Housing drives local government services. New construction starts mean the need for more capacity in schools, sewers, water supply, recreation and parks, streets and bridges, health and social services, waste and environment, fire and police, and on and on -- services, part for property and part for people. But bedrooms with kids have to be very plush to pay for services at an average rate of property tax. Thus, the real estate values that go with the jobs that support our households are called upon to carry part of the cost and they add their demand to the service mix.

Local governments often recognize that they are in competition with other localities in the region to attract the pluses (tax base) and the minuses (service demands) of new development. Households relocate at the rate of one in five to one in four each year. They tend to seek the mix of services and taxes that fit their preferences and incomes. Businesses are at least equally mobile.

Local leaders often hope that growth in the future will correct imbalances of tax base and service costs that have arisen in the past. As the courts have reminded us, in the case of schools, these imbalances can be extreme. To the point that fifty or even seventy times more assessed valuation per child, not made up for by state and federal aid, violates our constitutional rights to equal protection before the law.

Is the result efficient? Is it fair? It is common place to observe that there are too many local governments. Are there? For what purposes? All purposes or just for some? Would we really be better served if there were fewer providers and producers of local services. Is it that simple? A look at the way the property tax works and doesn't work and who spends it may help answer some of these points.

New York towns, villages, and cities do essentially the same kinds of things -- mostly services to property. Counties can be found that do any of the services done by the other local governments but their recent emphasis as a group has been on expanding social services usually as an extension of state and federal programming. Property taxes, sales taxes, and fees are important means to pay for these services with different mixes by type of government. Towns use the property tax more; counties the sales tax.

State assistance is important to equity and efficiency as we've seen in the case of schools. State expenditures in 1989-90 were 37% to education mostly to local school districts and 32% to health and welfare services much of them produced by county governments. About 3% of state expenditure was in aid and grants to local governments.

State and federal funding have been falling as a proportion of local spending for over a decade. They covered 40% of the local bills in 1979; 24% in 1989. It is argued that this reflects a shift in the nation's political philosophy about equity and who should pay for what.

The year 1989-90 saw an average 10% increase in the property taxes raised by four-fifths of New York cities and villages. The year 1990-91 will see a higher percentage increase in both the proportion that need to raise property taxes and in the size of the increase. In 1991-92 increases are projected by some to be just as gloomy. Declines in state and federal assistance are not the only reason.

Devolution of funding responsibility from state and federal levels, even when aggravated by depression induced decreases in sales tax and fees, are not the end of the story. Inflation in costs, particularly the wages needed to attract and hold the higher skills needed, is another factor, not particularly aggravated by recession. Perhaps the most important element in the revenue/expenditure equation is aggravated by recession and that is the explosion in the demands for services. AIDS and drugs, infrastructure deterioration, the needs of education in the age of world markets and computers, the growing dependant care needs, are just some of the longer term trends expanding the demand for services. But in recession those out of jobs not only reduce local revenues by spending less, but also increase the claims for a wide variety of welfare and social service assistance. Emergency service needs also increase. These all put pressure on the property tax.

The property tax serves as shock absorber for many changes and they have all been happening. For several decades adding revenue from the sales tax reduced the pressure on the property tax to meet new needs and higher wages and prices. Recessions cut household and business expenditures and thus sales taxes.

Recently fees for services have found favor as innovations to match costs to those who require the service. In the use of fees on new construction a recent unfavorable court case was not so chilling in effect as the impact of the recession on building starts and sales.

Local governments do not have access to wealth based taxes such as the income tax or securities transactions. Perhaps they should in order to give them more flexibility. A recent study suggests the result might not be much different in terms of progressiveness of burden by income group than the existing state revenue sharing system.

A local government has to do its budget by estimating what revenues from fees, aid and sales tax will be. These amounts subtracted from the proposed budget set the amount to be raised by the property tax. If the other income estimates are too high, costs must be cut or money borrowed, and/or property taxes raised. The property tax is the residual claimant.

The property tax is increasingly viewed as an unfair tax. Assessed valuation of a property is poorly related to either services required or ability to pay.

A positive thing that can be said about the property tax is that it is an attention getter. Local officials dread raising property taxes. Perhaps because they know that the media will give it more space and the phone is more likely to ring. In our political culture, a raise in the property tax is often used as evidence that efficiency in government is deteriorating. This suggests the conventional wisdom prescription for government efficiency -- consolidation.

Formal and informal study groups are exploring consolidation opportunities in every part of the state and at every level. This is an opportunity for constructive change. Simple consolidation is not the answer. To only address complete mergers is an exercise in futility and some students of the problem argue it is not where the significant efficiency gains are to be found.

Note that in the last several decades only a dozen simple consolidations have taken place, usually town and village mergers, more than offset by the twice as many new villages formed. At the same time, hundreds and perhaps thousands of cases of intergovernmental cooperation have taken place. The housing network has played a key role in this trend and can do more.

LOOK INSIDE IN THREE WAYS

Very little can be predicted. The recession will turn around -- they always have. Trends in political philosophy will change too, but what new federal-state-local concepts will evolve to modify the recent trends in devolution is more than I can guess. The demand for services will express some new mix with only a few elements made more predictable by demographic trends. Who predicted AIDS or the energy crisis? Global competition is sure to become more intense but how and where?

Will the state recognize the need for a stronger partnership with local governments? For example, will the state give local governments more access to wealth based sources of revenue? A percentage piggy-backed onto the state income tax would be simple enough to administer, but most may reject it as regressive, even though it wouldn't be on a comparative analysis basis. Will development fees flourish in New York as they have in some other states? Predicting the agreement needed for the state to make such changes is an uncertain business at best.

Local governments need more capacity to manage change -- change that no one can predict. How to get that capacity is a major question facing those who are studying the opportunities in consolidation.

Start with the conventional wisdom of how to make local government more efficient -- simple consolidation, the complete merger of two or more governments. It is based upon the debateable proposition that the more power is divided, the more inefficient it becomes. Fragmentation, overlap, duplication, unclear lines of authority and responsibility, and other familiar notions are indications of potential to increase the efficiency of government. In 1895, before he left academe to run for governor of New Jersey, Woodrow Wilson wrote a definitive textbook for the time that laid out these concepts. As noted we have rarely followed the simple consolidation prescription.

Other notions such as more professional civil service, business like bidding and accounting practices, capital budgeting and expanded training and technical assistance have also interested reformers. In the last several decades some ideas have been added to the mix that fundamentally challenge the basic Wilsonian analysis, that there are too many local governments.

One such challenge has been to argue that efficiency in production is different than efficiency in provision. In other words, a larger unit may be able to find efficiencies on the supply side, but a smaller unit may make sense on the demand side. Many small governments should be able to better match the mix of preferences and incomes if they have the flexibility and incentives to do so. For example, one small community may prefer more police patrols and

a complex zoning system, while another would rather spend its extra money on keeping toxics out of the groundwater. Would a complete merger make this fine tuning as possible?

The trick then is to organize so that the opportunity for choice is preserved. Small should be beautiful if it more effectively represents real differences in preferences and needs, and shops around to get the best deal on production from whoever is in the business. In other words, hang on to the power to provide but produce it yourself only if someone else can't do it cheaper.

These challengers to Woodrow Wilson point out that the boundaries for the most efficient cooperation are apt to be quite different from service to service. Why should joint police services and a common approach to watershed management use the same boundaries? Wouldn't it make sense to have state and federal participation differ depending on the problem? Thus, different federations of local, state, and federal governments for different problems can be expected to be preferable.

The results from working through Woodrow Wilson's concepts and adding the problem of how to get organized for better choices may be less important than the process of doing so. A strategic planning process that helps officials and community leaders identify some opportunities to take action -- some projects to make things better -- is a capacity building activity. It helps people ask questions about themselves and learn to work with each other on the answers.

The housing network has particular advantages in asking and answering questions like "How do we fit into the regional system?" Where are those jobs coming from that will help pay for the services we need? What local governments should cooperate with each other to produce services more efficiently? What service or services are limiting desirable adjustments?

LOOK OUTSIDE

An important local government function, to improve the efficiency of government, is to coordinate the other levels of government. Local officials should know the problems best, even if they may not know all the solutions best. Most long run solutions require their active support and participation. It is the rare problem where all the different agencies that have a role are focusing on it as it is actually occurring in your jurisdiction. It takes a strong local input to make that happen.

Coordinating higher levels of government requires a problem by problem approach. A water problem can involve at least three state agencies, several federal and four county agencies. Economic development needs can be addressed through even more agencies at each level. Not only the players will differ from game to game, but also the territory.

Other communities in your region are not likely to be the only ones interested in the problem your strategic planning process has identified. You will learn a lot from investigating what other regions have done. They are also likely to be good partners in the process of working with other levels of government. Associations of local governments, of which there are several major ones, each with many affiliates, can be a prime vehicle to use in finding out who has this problem. Their meetings can be informative on how others solve similar problems, but also they can serve as a vehicle to identify what policy and program action state and federal governments might take. An example is the group of members of the New York Conference of Mayors that meet to compare notes on the problems of being a college town.

Local officials are elected and appointed not only to provide services but also to represent the interests of their communities to other decision makers -- to serve as partners in the enterprise of governance. To do this effectively they need skills as lobbyists. Every issue has its own organizational structure. Power clusters take some effort to understand. Interest groups that pay attention to your issue can be well organized at local levels or not, at state and federal levels or not. Programs have their traditions and professional groups. Again local government associations have staff and activist members that can help. The key is probably regular contact with state and federal legislators and their staffs. Volunteer based governments need to take special pains to be sure that such contacts are maintained.

In sum, to be successful looking inside and looking outside policy education programming may be as useful as any other approach to improving the performance of local government. The housing network has great potential in bringing this about. Policy education combines process and content to facilitate more effective public decisions. At each stage of the policy cycle, different questions need to be asked and answered. For example, in the problem defining stage verification of need to act and understanding cause and effect are important. People that don't have this information will not be as ready to consider alternatives and consequences. A decision stage that hasn't had available alternatives that treat the different stakeholders in ways they feel are fair can be hard pressed to make a decision that sticks. Failure to articulate these questions and to provide information to answer them has stalled many housing policy changes. The housing network should consider how it can facilitate the policy education process needed.

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