Tax Efficiency & Equity

Budgeting in Local Government

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Conversations about TAX

• When you discuss taxes and revenues, how do those conversations go?
  • Administrators
  • Elected officials
  • Citizens

Perspectives

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

• Discuss the trade-offs

• May have limited impact what your options are, but it informs the conversation and provides and underlying understanding
  • Dillon’s Rule
Evaluating Tax Systems

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

Efficiency

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

Evaluating the Efficiency of a Tax

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

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

Equity

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

Ability to Pay Principle

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

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

Vertical Equity

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

Benefit Principle

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

- Revenue Raising Capacity
  - The ability of the tax to produce a significant amount of revenue at reasonable tax rates.
  - The broader the tax base the lower the tax rate can be to produce the same amount of revenue.

- Stability
  - Revenue raised over time remains relatively constant.
  - Tax elasticity
    - How well do tax revenues keep up with changes in income?
    - We want revenues to grow with budget needs.
    - These can be in contrast with each other.

Feasibility

- Administrative Feasibility
  - Compliance costs?
  - Easy to administer?

- Political Feasibility
  - Visibility
  - Exportability

Prompt

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

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

Property Taxes

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

Sales Taxes

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

- Equity
  - Ability to pay
  - Benefit Principle

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

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Final Thought

- Taxes are only one side of the equation… do not forget expenditures.
- For citizens especially
- What are the trade-offs?
- What are the services provided?

- Taxpayer receipt:
  - The White House provides one
  - Example of how to construct one at the local level:
    - [http://sogpubs.unc.edu/electronicversions/pdfs/pmb08.pdf](http://sogpubs.unc.edu/electronicversions/pdfs/pmb08.pdf)

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Thank you

- Please feel free to contact me with any questions!

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