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Beyond the Property Tax: Local Government Revenue Diversification

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BEYOND THE PROPERTY TAX: LOCAL GOVERNMENT REVENUE DIVERSIFICATION

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ABSTRACT. Local governments in the U.S. rely less on the property tax than they have historically. This long-term trend has been accompanied by important shifts in the composition of local revenues. While the property tax still serves as one primary source of local government revenue, increasingly other sources are used to pay for local government. This paper first examines that trend, the forces behind it, and its regional impact. We then explore trends in three central states -- Iowa, Nebraska, and Arkansas -- that have experienced substantial revenue shifts in recent years. A concluding section discusses the options for the future.

THE PLACE OF THE PROPERTY TAX

The property tax is one of the oldest, most widely used, and most local of revenue sources in the United States. In the 19th century, it was a fairly comprehensive tax on wealth, as most wealth was either real property or tangible personal property. As the economy moved away from its agrarian basis, the tax also changed. It has become mainly a tax on real property and limited types of personal property, such as business machinery, equipment, inventories, and in some states, automobiles and boats. As a wealth tax it is flawed, as it is imposed only on certain types of wealth, and does so on the basis of the gross, rather than the net value. Further, the property tax is expensive for governments to administer, as it requires property valuation by assessors. Political pressures work against

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accurate and up-to-date assessment, and for some governments, assessment quality remains low (Mikesell, 1993, 1999). The property tax "is a 'lump sum' tax that is highly visible and often inconvenient to pay. It falls heavily on unrealized capital values, burdens shelter, and may be unrelated to the ability of the owner's current income." (G. Fisher, 1996, p. 209). Despite these problems, the real estate component of the property tax has the desirable features of taxing an immobile factor of production, and taxing landowners (including those who may not be residents) who benefit from certain locally provided services such as public safety, roads, and sewers and sanitation. Sokolow (1998, p. 186) in a recent review of property tax trends stated, "It's easy to pick on the property tax.... Yet as a local government revenue source, it has meritorious and unparalleled features, high revenue yield, and stability in particular." Other taxes are more difficult to levy and administer at the local level, and some jurisdictions have limited sales and income tax bases (G. Fisher, 1996). Because of these features, the general property tax has long been considered as the "best available independent source of local revenue, and made it possible for citizens to spend their own money as they collectively saw fit" (Mields, 1993, p. 16).

Many premature obituaries of the property tax have been written, often emphasizing the alleged inelasticity of the property tax. This is a fair criticism, as a review of several studies indicates that income and sales taxes are significantly more elastic relative to their tax base than is the property tax (Mikesell, 1999, p. 298). Other obituaries have stressed the limits imposed on property tax rates as a result of the general public's revolt against the tax. However, through the 1980s and into the 1990s, property tax levies typically increased, while the tax rate grew less slowly or even declined. A resurgent economy plus better assessment techniques have boosted assessed valuation in many localities, and have produced a revenue bonanza in many cities (Dearborn, 1993). Criticisms about its regressivity have been muted as more states have enacted various exemptions to the property tax (Bartle, 2000). Similarly, the popular outcry against the property tax has had to be balanced against the public's opinion that it is a relatively fair and beneficial tax (Speer, 1997). At the beginning of the twenty-first century, property taxes continue to be a significant source of funds for municipalities, counties, school districts, towns, villages, and special districts. While it is used less intensively than it was thirty years ago, most likely the property tax will survive well into the 21st century, and beyond.

TRENDS IN LOCAL REVENUE SOURCES

The durability of the property tax does not preclude the further development and growth of non-property tax revenue sources at the local level. Although total local government property taxes in the United States increased from $5.9 billion in 1948 to $228.5 billion in 1999, the role of the property tax in financing local government fell from 51.4% of total local general revenue to 27.2% (ACIR, 1998; U.S. Bureau of Census, 2001). The explanation for this change is that other sources have grown at a more rapid pace. The local purse has been augmented by several other founts: (1) intergovernmental aid (principally state aid), (2) user charges, (3) other local taxes, and (4) miscellaneous revenues (for example, interest earnings). From 1948 to 1999, intergovernmental revenue grew from 30.8% of local general revenues to 39.0%, and "charges and miscellaneous revenues" grew from 11.2% to 23.3%. Total taxes fell from 58% to 37.6% (ACIR, 1998; U.S. Bureau of Census, 2001). Other local taxes have also grown, but the second largest local tax, the general sales tax, is still only 4.3% of local general revenue, compared to 27.2% from the property tax.

Table 1 shows that from 1957 to 1987, property taxes as a share of total local taxes fell for all types of local governments. From 1987 to

TABLE 1
Property Tax Share As a Percentage of Total Local Government Taxes, 1957-1997

Year	Total Local	Cities	Counties	School Districts	Townships	Special Districts
1957	86.69	72.70	93.70	98.60	98.60	100.00
1967	86.63	69.96	92.13	98.36	92.76	100.00
1972	83.68	64.30	85.86	98.06	93.45	94.85
1977	80.51	60.00	81.20	97.46	91.67	91.20
1982	76.04	52.60	77.28	96.81	93.70	78.91
1987	73.71	49.09	73.47	97.45	92.30	72.38
1992	75.62	52.60	74.30	97.05	92.97	67.58
1997	73.33	48.70	69.44	96.85	92.39	76.49

Sources: ACIR, (1990, 1998); U.S. Bureau of Census (2000a).

1992 there was a rebound, followed by another drop in 1997. Cities now derive less than half of their tax revenues from the property tax. For counties and special districts, the rapid decline in property tax utilization is particularly noteworthy. School districts and townships still depend heavily on the property tax.

The decline of property taxes as a proportion of total local taxes also held for most states, as indicated in Table 2. From 1970 to 1999, only five states increased the reliance of their local governments on the property tax, while the other 45 decreased their reliance. The Southwest, Rocky Mountain, and Plains states had the largest decreases. There is substantial regional variation in the use of local taxes. New England states rely most heavily on the property tax to fund local government; New Hampshire local governments draw 98.8% of their tax revenue from the property tax. Southeastern and Southwestern states are the lowest, and Alabama is the lowest in the nation in property tax reliance at 37.5%.

TABLE 2

Property Tax as a Share of Local Taxes, 1970 and 1999

State	1970	1999	Change
New England	99.0%	97.7%	-1.3%
Connecticut	99.3	98.3	-1.0
Maine	99.3	97.6	-1.7
Massachusetts	99.1	96.9	-2.2
New Hampshire	99.1	98.8	-0.3
Rhode Island	98.8	98.6	-0.2
Vermont	98.2	95.8	-2.4
Mid-Atlantic	79.1	71.8	-7.3
Delaware	89.4	79.0	-10.4
Maryland	71.6	55.2	-16.4
New Jersey	89.9	97.9	8.0
New York	74.6	57.0	-17.6
Pennsylvania	69.9	69.7	-0.2
Great Lakes	92.5	84.3	-8.2
Illinois	87.6	82.9	-4.7
Indiana	99.6	88.6	-11.0
Michigan	91.1	89.8	-1.3
Ohio	85.4	66.0	-19.4

TABLE 2 (Continued)

State	1970	1999	Change
Wisconsin	98.7	94.0	-4.7
Plains	94.5	81.2	-13.4
Iowa	99.0	90.3	-8.7
Kansas	97.2	76.5	-20.7
Minnesota	97.5	94.5	-3.0
Missouri	81.8	60.2	-21.6
Nebraska	94.1	79.6	-14.5
North Dakota	96.6	88.1	-8.5
South Dakota	95.6	78.9	-16.7
Southeast	79.7	66.5	-13.2
Alabama	48.2	37.5	-10.7
Arkansas	93.4	64.6	-28.8
Florida	93.4	64.6	-28.8
Georgia	88.6	59.5	-29.1
Kentucky	74.8	53.9	-20.9
Louisiana	57.6	39.4	-18.2
Mississippi	90.5	91.8	1.3
North Carolina	96.4	74.6	-21.8
South Carolina	94.4	84.9	-9.5
Tennessee	73.7	59.0	-14.7
Virginia	69.4	71.7	2.3
West Virginia	87.2	82.8	-4.4
Southwest	81.9	64.3	-17.6
Arizona	80.7	70.6	-10.1
New Mexico	74.2	54.2	-20.0
Oklahoma	85.0	52.7	-32.3
Texas	87.6	79.8	-7.8
Rocky Mountain	93.3	78.8	-14.5
Colorado	86.6	61.5	-25.1
Idaho	97.6	93.9	-3.7
Montana	96.1	95.3	-0.8
Utah	89.5	65.7	-23.8
Wyoming	96.6	77.6	-19.0
Far West	83.9	71.8	-12.1
Alaska	76.6	79.3	2.7
California	88.2	66.2	-22.0

TABLE 2 (Continued)

State	1970	1999	Change
Hawaii	75.5	79.6	4.1
Nevada	79.8	63.3	-16.5
Oregon	96.7	80.1	-16.6
Washington	86.5	62.4	-24.1
US Average	84.9	72.3	-12.6

Sources: ACIR (1998) and U.S. Bureau of Census (2001)

Table 3 shows the trend in local government revenue during the more recent 1986 to 1999 period. Overall, per capita general revenue increased by 95% during this period, slightly faster than the change in per capita income (87.7%) and property tax revenues (88.1%), and faster than the rate of inflation (44.5%). Intergovernmental revenue as a whole grew at about the same rate as the total, but state aid increased much faster (106.3%) than did federal aid (37.1%). Charges (130.7%) and motor fuel taxes (161.1%) increased fastest, while other miscellaneous revenue (34.3%) grew slowly, and tax revenue from alcoholic beverages and tobacco actually declined (-4.7%). Certain details not shown here are also notable; there was slow growth in revenues from liquor stores (16%) and gas utilities (17%), and particularly fast growth from employee retirement revenues (155.4%).

The simple fact that local governments draw only 37.6% of their revenue from taxes -- less than the amount from intergovernmental aid -- is profound. State aid alone is substantially larger than property taxes, and charges are equivalent to 58% of property tax revenue. Local governments simply do not rely very heavily on taxes any more.

Changes in the structure of taxes are influenced most fundamentally by demographic and economic shifts (Hy & Waugh, 1995). The "baby boom" of the 1950s and 1960s combined with the late 1960s and 1970s "stagflation" pulled and pushed government expenditures and revenues upward (Steurele, 1992). Inflation running at an annual average of nearly 7% (1970-1978) increased income and property taxes as well as the cost of government services (Rabushka & Ryan, 1982). As assessed valuations rose, growth in property taxes relative to personal income fueled the movement to limit the size of government spending (Rabushka

TABLE 3
Local Revenue Per Capita, 1986-1999

Revenue Sources		FY 1999		
		Amount	% of General Revenue	
	FY 1986			Percentage Change
General Revenue	$1,579.01	$3,076.86		94.9
Intergovernmental Revenue	610.83	1,201.28	39.0	96.7
Federal	84.76	116.20	3.8	37.1
State	526.07	1,085.08	35.3	106.3
Taxes	601.46	1,158.21	37.6	92.6
Property Tax	445.32	837.77	27.2	88.1
General Sales	65.91	132.93	4.3	101.7
Motor Fuels	1.30	3.39	0.1	161.1
Alcoholic Bev. & Tobacco	1.91	1.82	0.1	-4.7
Public Utilities	16.69	30.37	1.0	82.0
Individual Income	28.82	60.67	2.0	110.5
Corporate Income	6.59	11.58	0.4	75.7
Motor Vehicle License	2.36	4.62	0.2	95.6
Other Taxes	32.56	54.26	1.8	66.6
Charges and Misc.	366.73	717.36	23.3	95.6
Charges	209.12	482.51	15.7	130.7
Education	27.31	54.77	1.8	100.5
Hospitals	68.57	126.76	4.1	84.9
Transportation	23.46	55.06	1.8	134.7
Environment and Housing	61.37	157.04	5.1	155.9
Other Charges	28.41	88.89	2.9	212.9
Interest	75.10	124.04	4.0	65.2
Other Misc. Revenue	82.51	110.81	3.6	34.3

Source: U.S. Bureau of Census (1988, 2001)

& Ryan, 1982, p. 144). The history of the various attempts to limit state or local spending is well-known. An important effect of this movement on the intergovernmental tax structure is captured concisely by Hy and Waugh (1995, p. 151) in their statement "[t]he strong opposition to property tax increases has forced many states and local governments to look for alternative revenue sources."

School enrollments continued to grow while the economy stagnated, but state and local governments managed to keep the income share per K-12 student relatively steady (O'Sullivan, 2001, p. 188). Once school desegregation had been settled by the U. S. Supreme Court, the next effort to reform schools was to address the wealth disparity between local school districts which "invidiously discriminates against the poor" (Serrano v. Priest, 5 Cal. 3d 584, 585 [1971]). The impact of school finance reform varied significantly among the states. In some cases Downes and Shah (1994) describe the reform as "strong," characterized by limits on local discretion and large reductions in inter-district spending disparities, while in other cases the reforms were "weak," preserving local discretion with smaller reductions in inter-district disparities. In general in the states with court-mandated reform, one finds a significant reduction of within-state disparity, increased expenditures in the poorest and median school districts, and a rise in the state's share of total spending on K-12 education (Evans, Murray & Schwab, 2001, p. 221-222). The interaction of demographics and economics as filtered through these two reform movements resulted in a steady erosion in property tax reliance for all forms of local government.

The shift away from a primary reliance on the property tax has been gradual. In addition to the macro effects of demographics and economics, national government policy toward states and localities has also contributed to the movement away from the property tax. Since the Nixon Administration, there has been a sustained effort to devolve policy responsibilities from Washington, D.C. back to the states, and thus reduce national government aid to states and localities. Federal aid to local governments peaked at 8.5% of local government revenues in 1978; it has since fallen to 3.8% in 1999 (Krane, 1990; U.S. Bureau of Census, 2001). "Federal assistance to cities," Eisinger (1998, pp. 310-311) explains, "is much diminished since the late 1970s [and] a much smaller portion of federal aid is devoted to urban programs than was true just a decade and a half ago." More significantly for local revenues, only 11% of federal aid to state and local governments now goes directly to local governments (Kincaid, 1999). This reduction in federal aid to places while aid to persons has increased, has prompted John Kincaid (1999, p. 136) to label this shift as a "defunding revolution."

States and localities had to respond to this slowdown in federal aid, and the trends in local government revenue reveal the choices made. Even though aggregate state aid to local governments increased from $83 billion in 1980 to $296 billion in 1999, it decreased as a portion of total state spending. In the late 1970s, state aid constituted about 33% of total state spending, but by the mid-1990s had dropped to 28% (Berman, 1998). McCue (1993) noted that state aid to localities did not keep pace with the obligations that state governments had transferred to local governments. This state aid shortfall coming on the heels of the decline in federal aid prompted local governments to seek new authority to obtain revenues by means other than the property tax. While the property tax continues to be the bedrock source of local revenues, the diversification of local revenue sources has become a significant trend which is changing the way many localities obtain their fiscal resources. The next section examines the different sources of local government revenue.

ALTERNATIVES TO THE LOCAL PROPERTY TAX

Local General Sales Tax

Until the Great Depression, local governments did not levy consumption or income taxes. Following the lead of Mississippi, which enacted the first state sales tax in 1930, New York City adopted the first local general sales tax in 1934. The number of states authorizing local governments to use the sales tax rose from one in 1950 (Mississippi) to 12 in 1963, 25 in 1970, 31 in 1994, and 33 in 1997 (Rogers & Temple, 1996; NCSL, 1997). Local sales and excise taxes as a portion of local general revenues grew from 3.5% in 1948, to 6.2% in 1999 with the general sales tax consisting 4.3% of local general revenue (U.S. Bureau of Census, 2001). Municipalities use the sales tax most heavily; 60% of all local sales and excise tax dollars go to municipalities (U.S. Bureau of Census, 2001). Six of the largest 38 cities – Phoenix, Nashville, Denver, Oklahoma City, Tucson and Albuquerque -- derive more than 20% of their total general revenue from this tax (U.S. Bureau of Census, 2000b).

The number of local governments collecting general sales taxes decreased from 6,705 in 1986 to 6,579 in 1994. It should be pointed out that this decrease is almost solely attributable to a restructuring in Illinois in 1990 that repealed the sales tax authority of 1,314 local governments and shifted collection of a portion of the sales tax to the state, with the state returning these funds to local governments. Among the thirty other states with local sales taxes, the number of local governments using this tax increased. New local sales taxes were adopted for counties in Florida, South Carolina, and Iowa. Large increases occurred in the number of governments levying the tax in Arkansas (municipalities and counties), Nebraska (municipalities), North Dakota (municipalities) and Wisconsin (counties) (ACIR, 1995). During this period the combined state-local sales tax rate increased in many major cities. Increases in the combined rate were due to increases in the state rate, the local rate, or both. For instance, California increased its state rate from 4.75% to 6% while local rates also increased in major cities such as Los Angeles, San Diego, and San Francisco. Local and state rates also went up in Arkansas, Florida, Texas, New Mexico, Oklahoma, South Carolina and Tennessee (ACIR, 1986, 1987, 1995). A number of major cities now have combined rates over 8%: New York, Los Angeles, San Francisco, Chicago, Dallas, Houston, San Antonio, Seattle, New Orleans, Oklahoma City, Mobile, Nashville and Memphis (District of Columbia, 1999; ACIR, 1995).

Local Income Taxes

Local income taxes are a relatively recent development. The first local income tax was in Philadelphia in 1938 (Rogers and Temple, 1996).[1] Local income taxes have gone from zero before 1938 to 0.4% of local general revenue in 1948 and 2.4% in 1999 (ACIR, 1998; U.S. Bureau of Census, 2001). Thirteen states authorize local governments to tax income; in two of these (Arkansas and Georgia) no governments currently exercise that authority. In three others (California, New Jersey and Oregon), taxes are levied on employer payrolls in certain cities. While corporate and individual income taxes account for only slightly over 2% of local revenues, in some cities they constitute half or more. Among the largest fifty cities, Cleveland, Columbus, Cincinnati, Toledo, Philadelphia, Detroit, Kansas City and Saint Louis all raise large portions of their revenue from income and earnings taxes (U. S. Bureau of Census, 1995). The number of local governments with an income tax grew from 3,517 in 1986 to 4,111 in 1994. All of this growth came in the central states. While there was no growth in the number of states authorizing an income tax, many states authorized additional local governments to use these taxes. Iowa added 318 school districts, Ohio 129 cities and school districts, Pennsylvania 53 municipalities and school districts, Kentucky 48 cities, counties, and school districts, Indiana 35 counties, Alabama eight cities and Michigan three cities (ACIR, 1995). Some major cities and counties increased their income or payroll rates during this period, in particular New York; Los Angeles; Newark; Cincinnati; Scranton; Portland (Oregon) metropolitan area; Lexington, Kentucky; Marion County, Indiana; and Montgomery County and Prince George County, Maryland. However Philadelphia; Dayton; and Allen County, Indiana, decreased their tax rates on residents (ACIR, 1987, 1995). Thus the growth in local income tax revenue is attributable more to increases in the number of governments levying the tax and the growth in income, rather than rate increases. In contrast, the trend in local sales tax collections is exactly the opposite of that for local income tax; while local sales tax rates have increased in many cases, the number of governments levying the sales tax has decreased.

Other Local Taxes

Motor fuel taxes increased faster than any other local tax during this period. As of 1997, 14 states authorize one or more local governments to levy taxes on motor fuels, and nine of these states allow statewide imposition of the tax (NCSL, 1997). Most of the states that do so give the authority to counties although some cities (for example Chicago) collect a fair amount of motor fuel revenue. Local tax collections on alcoholic beverages and tobacco fell during this period. A small number of local governments tax these sources, so this trend is more specific to the states of Illinois, New York, Tennessee, Georgia, and Alabama (Rodgers & Temple, 1996). However this trend does reflect changes in consumption patterns, as well as stable unit tax rates. Local governments in 40 states tax either the sales or gross receipts of public utilities (mainly natural gas, electric, and telephone companies). The collections from this source are largest for municipalities. During this period, collections were fairly stable, as were consumption of these services.

The most commonly used local non-property tax is the lodging tax, which is permitted in 43 states. The seven states that do not permit local lodging taxes impose a state lodging tax. In 31 states both counties and cities have the authority to levy this tax (NCSL, 1997). In 27 states, local governments have the authority to tax restaurant meals. This power is most commonly granted to cities and counties. Four states allow special districts to levy these taxes (NCSL, 1997).

Non-Tax Revenue Sources

From 1948 to 1999, charges and miscellaneous revenue grew from 11.2% of total local revenue to 23.3% (ACIR, 1998; U.S. Bureau of Census, 2001). User charges in most functional areas other than education also increased rapidly during the 1986 to 1999 period. This reflects in part a resistance to property tax increases as well as an increasing acceptance of benefits-based charges. For example, one study found that restrictive tax limits led to increased reliance on user fees in counties, and that states actually provided more aid to those counties that shifted from taxes to fees (Johnston, Pagano & Russo, 2000).

In some cases, user fees offset expenditures to a significant degree. Local parking revenues exceeded parking expenditures, and in other areas (water and air transportation and sewerage) charges are close to covering local expenditures in the aggregate. In other areas (hospitals, solid waste, and parks and recreation) expenditures are substantially higher than revenues, but charges are increasing. Special districts, especially those providing utility services, collect a larger percentage of their revenue from user charges than do other types of local governments. Counties and municipalities are also high in this area while townships and school districts are low (Downing & Bierhanzl, 1996; R. Fisher, 1996).

While charges have increased rapidly, utility revenues have grown more slowly than total revenues, by 89.3% from 1986 to 1999. Gas supply revenues increased only 28.7%, transit revenues by 76.3%, and electric power by 82.4%. Only water utility revenues increased faster than total revenue, by 119%. In large part, this slowdown is attributable to rates. For all of these utilities, expenditures increased faster than revenues over a 50-year period. Water supply revenues were only 85% of expenditures in 1999, compared to 149% in 1953 and 131% in 1973, indicating that general revenues are now used to subsidize consumption. Electric power revenues are 107% of expenditures and gas revenues are 103%, so these utilities are on a more self-funded basis. For transit however, revenues are only 28% of expenditures, compared to 94% in 1953 (Aronson & Hilley, 1986; U.S. Bureau of Census, 2001).

REVENUE DIVERSIFICATION IN THREE CENTRAL STATES

Nebraska

Nebraska has a small population (1.7 million), but ranks fifteenth in the nation in geographic size. The state has a disproportionately large number of local government jurisdictions: 93 counties, 544 municipalities, 452 townships, and 668 school districts (Krane, 2001). In addition, there are approximately 1,200 single-purpose special districts and 276 Sanitary Improvement Districts (Ebdon & Bartle, 2000).

Table 4 identifies the composition of Nebraska's local general revenues in fiscal years 1987 and 1999. Total general revenue increased by 87.7% over this period. Property tax fell from 41.8% of total general revenues in 1987 to 34.4%. The general sales tax represented only 3.8% of the total in 1999, but this source increased by 156.2% in this period. State aid increased by 180%, and made up more than one-quarter of all local general revenues in 1999.

Local property tax statewide increased by 414% between 1968 and 1996; in real dollars, however, the increase was 24%. Over this period, schools were the major users of the property tax, comprising 62% of total property tax across the state. Cities used 16% of the total property tax in 1968, but comprised only 12% of its use by 1996. The county share of property tax increased from 14% to 15% over this period, while special district use increased from 8% to 11%. During this time, the tax base was changed to reduce the valuation of agricultural property. Currently, agricultural property must be assessed at 80% of full value, while other property must be between 92-100% of full value (Committee on Revenue, 1996).

In 1989, state aid to school districts in Nebraska was only 24.8% of total revenues, while property tax comprised 67.2% of school revenues. This ranked the state 47th in its support of schools. Concerns about equity across districts, as well as public complaints about property tax levels, led the state to increase aid to schools in 1990 (Cordes, 1998). To further

TABLE 4
Nebraska's Local General Revenues, 1987-1999 (In %)

Revenue Source	Percent of Total Revenue, 1987	Percent of Total Revenue, 1999	Percent Change
Federal Aid	4.8	3.3	28.7
State Aid	19.3	28.7	180.0
Property Tax	41.8	34.4	54.6
General Sales Tax	2.8	3.8	156.2
Other Taxes	1.6	5.0	387.6
Current Charges	20.2	16.8	56.2
Other Non-Tax	9.3	8.0	60.8
Total General Revenue	100.0	100.0	87.7

Source: U.S. Bureau of the Census (1988, 2001) reduce property tax reliance, state legislation was adopted in 1996 to limit local property tax rates. The property tax rate limit, which does not apply to bonded debt and several other purposes, varies among seven types of jurisdictions: cities ($0.45 per $100 of assessed value), counties ($0.45), school districts ($1.10, to decrease to $1.00 in 2002), and four types of special district (Ebdon & Bartle, 1998). In the first effective year for the property tax limits (1999), property tax levies decreased by 4.8% over the prior year. In 43 of the 93 counties, levies decreased by more than 8%, and 12 reduced levies by at least 15% (Reed, 1999). To some extent, state aid has been used as a substitute for property tax. Equalization funds of $5 million were established for needy cities and counties. School districts received an additional $110 million in state aid in 1998 (Ebdon & Bartle, 1998). By 1999, property taxes were only 44.1% of total school district revenues, with state aid up to 48.4%, close to the 51% national average (Cordes, 1998).

The sales tax has become an increasing source of revenue for cities in Nebraska: they have the option, with voter approval, to impose a 0.5%, 1.0%, or 1.5% sales tax on retail sales within the city, on top of the state's 5.0% rate. In some cases, the sales tax is used for general purposes, while in others it is designated for specific purposes. Omaha was the first city in the state to adopt this tax, in 1969. By 2001, 108 cities in Nebraska were using the local-option sales tax: two at a 0.5% tax rate, 75 at 1%, and 31 at 1.5%. Seventy-six, or 70%, of these cities adopted the sales tax after 1990, with 45% using this source only in the last five years (State of Nebraska, 2001). In the larger cities in the state, the local option sales tax has overtaken property tax as the leading revenue source. Sales tax revenues constitute 26% of total revenues for Omaha, compared to property tax at 22% (City of Omaha, 2000). In Lincoln, sales tax comprises 46% and property tax 29% of total revenues (City of Lincoln, 2000).

Other taxes are only a small part of total local general revenues, but grew by 387.6% between 1987 and 1999. This trend is in part due to increased use of the occupation tax on cable television fees, telephone bills, and other activities such as car rentals. The cities of Omaha, Kearney and North Platte have in the past decade also begun to levy an occupation tax on hotel/motel rooms to finance tourist attractions, such as stadiums and museums (Hammel, 1999).

Iowa

Iowa's population is 2.5 million. The state has 99 counties and 950 cities (Coates, Whitmer & Bredeweg, 2001), as well as 375 school districts (Iowa Association of School Boards, 2000). Local property taxes are highly restricted in Iowa, following 1976 state legislation that limits growth in annual taxable values. Currently, the "rollback" amount allows governments to tax less than 60% of the market value. In addition, the tax rate is limited for cities to $8.10 per $1,000 for the general fund; two-thirds of all cities are at this maximum rate. A trust and agency fund may be used for specific employee benefits, with taxes levied as needed; an emergency fund may also be established with an additional $0.27 tax rate authority. County tax levies are restricted to $3.50 per $1,000 for the general levy and $3.95 for the rural services levy (Coates, Whitmer & Bredeweg, 2001).

Diversification of local revenues in Iowa can be seen in Table 5. State aid comprises 35.9% of total local general revenues, with property taxes 31.2%. The proportion of property taxes decreased over this period, and property tax revenues grew more slowly than overall general revenues. In 2000, the property tax equaled $2.65 billion, of which 45.3% went to school districts, 22.2% to counties, and 26.3% to cities, with the remainder to other districts (Iowa Department of Revenue and Finance, 2000).

General sales tax was a small component of total general revenues in 1999, but use of this source has increased dramatically recently. Counties were given the authority to levy a local option sales tax in 1985, which is distributed to municipalities within the county. In 1994, this option was exercised in 27 counties (Pagano, 1999). By 2001, 75 counties were using this tax, with distributions made to 687 incorporated municipalities (Iowa Department of Revenue and Finance, 2002). Total local option sales taxes totaled $142.9 million in 2000 (Iowa Department of Revenue and Finance, 2000).

School districts were also given local-option sales tax authority in 1998. The sales tax can be used for school repairs and construction, as well as debt repayment, but must be approved by a majority of voters. It is levied on a county-wide basis, with the revenues shared between all school districts in the county. By 2002, schools in 23 counties were using

TABLE 5
Iowa's Local General Revenues, 1987-1999 (In %)

Revenue Source	Percent of Total Revenue, 1987	Percent of Total Revenue, 1999	Percent Change
Federal Aid	4.1	2.7	20.2
State Aid	33.6	35.9	94.4
Property Tax	36.8	31.2	54.5
General Sales Tax	0	1.6	7,713.0
Indiv. Income Tax	0	0.5	60,793.8
Other Taxes	0.8	1.3	216.1
Current Charges	15.7	19.9	131.1
Other Non-Tax	8.9	6.9	40.5
Total General Revenue	100.0	100.0	82.2

Source: U.S. Bureau of the Census, (1988, 2001)

this tax source (Iowa Department of Revenue and Finance, 2002). One reason some school districts favor this approach over bonding for infrastructure needs is that the sales tax requires only a majority vote, while bonds require a 60% super-majority. Of the school bond ballot measures that failed in the past 20 years, one-half received a majority vote but not the required 60% in favor of the bond (Clayton, 2000). This source raised $49.5 million in 2000 (Iowa Department of Revenue and Finance, 2000).

School districts can also levy a local income tax in Iowa. While only three districts used this option in 1976, 59 districts in 1990 levied the tax and 379 by 1994 (Pagano, 1999). The income tax revenue for schools amounted to $38 million in 1999 (Iowa Department of Revenue and Finance, 2000). School districts in Iowa have also begun to establish nonprofit foundations to raise donations from within the local community. Approximately 150 school districts, or 40%, have a school foundation. This number has increased from 60 in 1997 (Iowa Association of School Boards, 2000).

The City of Des Moines still relies heavily on the property tax relative to other taxes. Property tax represented 22% of the total 2001 budget, compared to 1.3% for other taxes. However, intergovernmental aid comprises 27% of the total budget. Charges for service also represent a greater share of the budget than property taxes, at 27% of the total (City of Des Moines, 2001).

Arkansas

Arkansas has a population of 2.5 million, with 75 counties, 490 cities, 324 school districts, and about 584 special districts. Property taxes have been under fire recently in Arkansas. In 1998, a constitutional amendment was proposed that would have eliminated property taxes in the state. It did not pass due to legal issues (Reid & Miller, 2001), but municipalities are restricted to a rate limit of five mills.

Shifts in revenue sources over the decade between 1987 and 1999 are shown in Table 6. Total general revenues for local governments increased by 123.7% over this decade, to $5 billion in 1999. State aid grew slightly faster, and local governments remain dependent on state aid for over 40% of general revenues. Property tax increased slower than total general revenues over this period, and the dependence on this source decreased, from 20.8% to 19.0% of the total.

General sales tax as of 1999 was 8.3% of total general revenues. This source grew by almost 600% since 1987. Cities and counties were given authority to adopt a local-option sales tax in 1981. Counties can currently

TABLE 6
Arkansas' Local General Revenues, 1987-1999 (In %)

Revenue Source	Percent of Total Revenue, 1987	Percent of Total Revenue, 1999	Percent Change
Federal Aid	4.8	2.7	26.1
State Aid	39.6	41.1	132.1
Property Tax	20.8	19.0	104.3
General Sales Tax	2.7	8.3	589.6
Other Taxes	5.8	2.1	66.8
Current Charges	17.5	18.5	136.4
Other Non-Tax	11.8	8.3	57.3
Total General Revenue	100.0	100.0	123.7

Source: U.S. Bureau of the Census, (1988, 2001) tax up to three cents, with two cents for operating expenditures and one cent for capital purposes. Cities may levy up to four cents with voter approval, two cents may be used for operating purposes, one cent for park improvements, and one cent for capital. (Reid & Miller, 2001). In 1986, only 59 municipalities and 19 counties used the local option sales tax. By 1994, these numbers had increased to 192 cities and 69 counties (Pagano, 1999). As of 2000, 228 cities received sales tax revenue directly (Arkansas Municipal League, 2000). County sales tax revenues are also distributed to municipalities within the county, primarily based on population (Schoen, 2000).

Cities and counties also have the authority to levy an income tax in Arkansas. However, none currently use this option (Reid & Miller, 2001). This is attributed to the political difficulty of imposing a new tax on income (Hayes, 2000). Other taxes have increased slowly, and now comprise only 2.1% of total revenues. The primary reason for this change was that the state rescinded the power for local governments to tax motor fuels during this period.

An example of the decreased reliance on the property tax can be clearly seen in the City of Little Rock. Of the $152.8 million 2000 budget, property tax is 7.2% of total revenues, while sales tax is the largest source at 32.3%. Enterprise fund revenues comprise 26.6% of the total, with utility franchise fees at 12.8% (City of Little Rock, 2000).

Cross-State Trends

The property tax as a percentage of total state and local taxes has declined slowly but steadily over the past thirty years in these three states. To what alternative revenue sources did officials in these three states turn? The figures displayed in Tables 4, 5, and 6, suggest that the answer varies from state to state. The biggest increase for Arkansas is the general sales tax; for Iowa, the individual income tax; and for Nebraska, "other taxes". The common trends across these three states are an increase in state aid to localities and the diversification of local government revenue sources. State aid increased from 1986 to 1999 by 180% in Nebraska, by 94% in Iowa, and by 132% in Arkansas. This boost in state aid reflects the national response of state governments to the "defunding" of local governments that accompanied the effort to devolve many domestic programs to the states.

But revenue diversification is the more important trend. Each state is now less reliant on the property tax and has turned to multiple sources of revenue to support local governments. In Arkansas, the three largest sources of local government revenues, other than state aid, are: (1) property taxes [19.0%], (2) current charges [18.5%], and (3) other non-tax revenues and sales tax [both 8.3%]. In Iowa, the three largest sources of local revenues are (1) property taxes [31.2%], (2) current charges [19.9%], and (3) other non-tax revenues [6.9%]. In Nebraska, the three largest local revenue sources are: (1) property taxes [34.4%], (2) current charges [16.8%], and (3) other non-tax revenues [8.0%]. To be sure, the property tax remains a mainstay of local government funds, but in each case, localities also draw deeply from other sources, especially current charges and non-tax revenues. In all three states, the use of local sales taxes is on the rise and we expect that the proportion of local revenues accounted for by property taxes will continue to fall as more localities turn to the sales tax. The same can be said of the recent adoption of the income tax in Iowa. The move away from the property tax will most likely occur at a faster rate among municipalities, with counties moving more slowly. This trend can be seen in Nebraska where property taxes constitute 50% of county own source revenue, but only between 22% and 36% of municipal own source revenues.

The fiscal trends we have presented demonstrate the diversification of local revenue sources that one finds underway especially in the central region of the nation. Local and state officials are expanding the repertoire of revenues from which they pay for local government activities. More sources of revenues have important consequences for local governance; for example, additional funding sources allow local officials to spread the burden of taxation across different sectors of the local economy. Alternative sources of taxes also make possible more stability in cash management, more flexibility in budgetary planning, and perhaps offer some room to maneuver in regards to tax resistance. If one contrasts the current trend toward revenue diversification to the historic dependence of U.S. localities on the property tax, then the current trend provides more legs to stand on and thus better fiscal balance for local governments.

CHOICES AND ISSUES

The trend toward revenue diversification poses a number of important choices and issues about the future mix of local government revenue sources. Local and state policy makers, as they reduce the dependence of local jurisdictions on the property tax, will confront important choices about the shape and impact of the local tax base. Proposals to alter the revenue options available to local governments should be evaluated by commonly accepted goals of taxation. Four principles are particularly appropriate. First, revenue structures should be equitable. Either the benefits-received principle or the ability-to-pay principle may be compelling. The benefits-received principle recommends the development of devices such as user fees and special assessments to make a more explicit connection in fiscal decision-making. The ability-to-pay principle is most appropriate for redistributive programs. The second goal is economic efficiency. Fees that charge appropriate prices for goods previously provided free will increase economic efficiency. Also taxes and fees that internalize external costs, such as effluent taxes and solid waste disposal fees, will improve economic efficiency. Third, a good tax should have a high yield and be stable and predictable. In general, this can be achieved by broadening the tax base, which also improves horizontal equity, efficiency, and administrative simplicity. Fourth, a tax should be administered in a way that minimizes administrative and compliance costs in a way compatible with other goals. Fair administration is essential to establish credibility with citizens.

There will be a growing justification for allowing some local governments to use the income tax in the future. Counties in particular are increasingly funding redistributive services that are not logically related to the property tax such as corrections, health care, welfare, hospitals, and the courts. In Indiana and Kentucky, counties are increasingly using the income tax, as all Maryland counties do. Also, large cities use the income tax more heavily than most local governments; six of the twenty-four largest cities collect more than 30% of their taxes from income or payroll taxes. States can accommodate local governments in making this change with relatively little political fallout if they reduce their own income taxes at the same time.

In five states (Arkansas, Florida, South Carolina, Iowa, and Wisconsin) the number of counties using the sales tax has substantially increased over the last dozen years. These trends will likely continue. Recently however, problems of the sales tax have come into sharper contrast as more retail sales are made across state lines and a smaller percentage of sales are taxable. One recent study found that the sales tax base decreased from 59 % to 42 % of personal income between 1979 and

1996 (Hoene, 2001). The sales tax is not meant for all local governments, but some will find it attractive. To the extent that it continues to be less unpopular than the property tax, its role will also grow at the local level.

Expansion of user charges is an attractive option. Charges are attractive for four reasons: they raise additional revenue, they create a link between the revenue and expenditure parts of the budget that can improve fiscal decision-making, they provide public managers an indicator of the desirability of expanding or contracting service supply, and they can enhance efficiency by rationing services to those who value them enough to pay their cost. This approach does raise some issues of access to public services and therefore equity, and the administrative costs may be high. Recreation probably should rely more heavily on fees, especially during peak times and seasons. Also, more cities are charging for trash removal, which encourages recycling and reduces disposal costs. Other possibilities for expansion of fees include storm water run-off, bridges, airports, and development charges. Local utility services are recouping a smaller and smaller percentage of their costs, which suggests an opportunity to increase revenue. It makes much more sense for these to be self-funded than to draw property tax revenues to cover expenses. One exception is with local public transit, which can justify its use of the property tax because it reduces traffic congestion.

For good or for bad, local governments are diversifying their sources of revenues. The property tax is unpopular and perceived by some to be unfair. State aid is one key source of local government funds; but if local jurisdictions are to avoid becoming, quite literally, wards of the state, then they need the authority to raise a significant portion of revenue to pay for local activities. Local sales and income taxes are the most powerful engines to accomplish this. User charges have increased substantially and have the capacity to be increased even more. Miscellaneous revenues and other taxes will likely fill small, but potentially important roles in funding local activities. While these revenue sources all have drawbacks, greater local discretion to use them is a positive development that we believe should continue. This recent movement to diversify local government revenue sources is an important and surprising new trend that bears watching as it continues to unfold.

NOTES

1. Rodgers and Temple (1996, p. 256) write, "Charleston, South Carolina adopted an income tax in the early nineteenth century but abandoned it. New York City adopted a local income tax in 1934 but repealed the ordinance in 1935 before any collections were made."

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