

# Economic Impact of City Government Fiscal Decisions

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# Outline

- My Goals:
  - Discuss how the City Government Impacts Citizens
  - Discuss how to measure the quality of life the City Government provides
  - Present recent research on how well the City of Houston is doing through 2002
  - Discuss implications of recent decisions

# What is the Economic Role of Local Government?

- In the US, we believe that the residents should receive as much satisfaction as possible= “efficiency”
- The economic theory is that private markets do the best at “allocation”
  - using least costs for most benefit
- In which case, the role of government is to fill the “holes” that private markets leave

# Theory of Private Markets

- So to understand how governments fill the holes in private markets, we need to appreciate private markets
- A market is where buyers and sellers get together- for voluntary trades- thus both parties are “better off”
- The price has to be high enough for the seller, and low enough for the buyer, to get them to trade

# Theory of Public Administration

- Goal of the City Government
  - Improve welfare of its citizens, by filling “holes” left by the private economy
    - Safety
    - Streets
    - Infrastructure
  - Taxes: Two theories
    - Approximately based on services received
    - OR, Based on ability to pay
      - Only can be successful if people are willing to pay (which depends on alternatives)

# Economics of a City

- Cities are also economic entities (why not have everyone equally distributed across the county?)
- Firms get together for “agglomeration”
- And residents want to be near firms
- The implication is that downtown is very dense (and high land prices), and land gets less expensive the farther it is from downtown

# Advantages for City Government

- The City of Houston is (generally) the government for the areas closest to downtown
- Which is the most valuable land
- And which has the most firms relative to households
- So the City has access to the highest tax base
  - And also the engine for growth for the entire metro area
- But, there is a lot of competition for these valuable assets

# Competition for the City Government

- The first source is the economy itself. The problem with downtown is congestion
  - The market response to congestion has been employment subcenters
- The second source is other governments
  - Especially if workers work in the outlying subcenters
  - But also other metro areas
- New workers to town compare tax and expenditure packages, among other things

# Tax Price

- Cities are in a very competitive situation
  - From other cities
  - From suburbs
- If you need to be a resident of a local government to benefit from its public services, then you may be willing to pay a “tax price”
- In which case, maybe no (little) change in behavior despite taxes
  - People are willing to pay if they perceive value

# Consequences of City Government Performance

- City can make residents better off- by filling the “holes” left by private markets
- At the same time, the City receives continuous report cards on its “efficiency”
- If the “Tax Price” isn’t worth it, residents will (slowly) leave- without being replaced
- So lets look at some evidence...

# Research Study

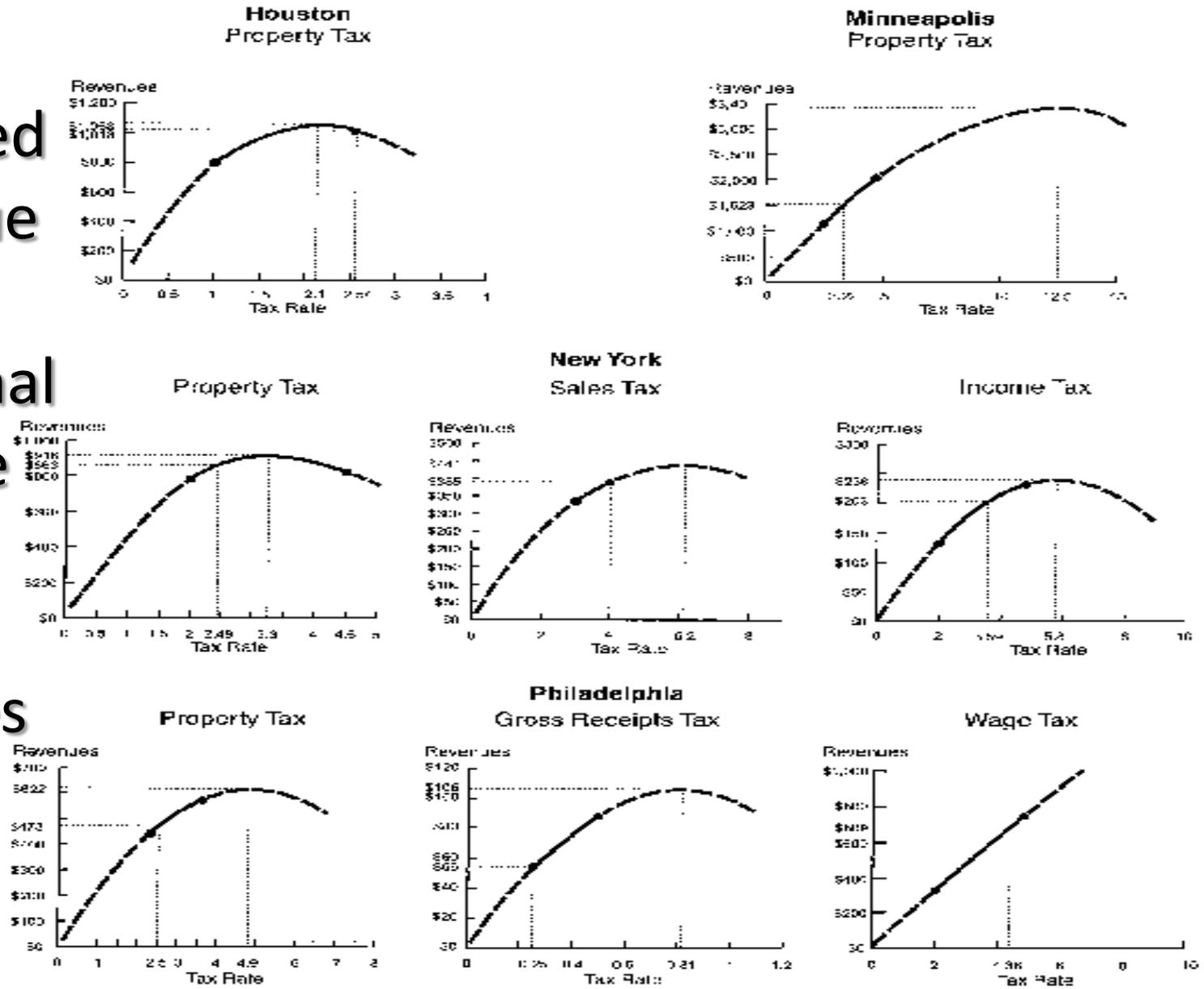
- If people do not want to live here, what happens?
- If firms do not want to locate here, what happens?
- If the tax rate rises, will property values fall?
  - This depends on whether the public sector output is valuable to residents
- If they do leave, tax revenue will rise more slowly than rate increases

# Comparison of Four Cities

- Houston, Minneapolis, Philadelphia, New York
- Using data from late 1970's to 2002
- Compare property tax rates and changes over time in tax revenue
- The property tax rates are “averages”
  - Accounting for government overlap
  - And special provisions (homestead, elderly)

FIGURE 1.—CITY REVENUE HILLS

Estimated  
 “Revenue  
 Hills”  
 Additional  
 Revenue  
 from  
 Raising  
 Tax Rates



The solid lines between dashes represent the portion of the hill which spans the range of our data for city tax rates; the long dashed portions of each hill are projections beyond the sample's range. Dotted lines relate tax rates to revenues, first for the current (2001) tax rate, and then for the revenue-maximizing rate to illustrate each tax's revenue potential.

# Study Conclusion

- City of Houston, despite lower tax rates, is in a very competitive situation compared to other cities
- This situation implies that raising tax rates will not be successful over time- people will not pay- so they exit- driving down tax base (property values)
- What has happened since?

# Change from 2002

<u>Category</u>	<u>2002 US \$000s</u>	<u>2009 US \$000</u>	<u>% Change</u>
General	225,950	219,584	-2.82%
Safety	616,324	1,460,992	+137.05%
Public works	293,757	417,953	+42.28%
health	107,783	136,766	+26.89%
housing	57,482	62,793	+9.24%
parks	91,034	97,398	+6.99%
library	40,723	48,015	+17.91%
TOTAL	1,433,053	2,443,501	+70.51%
Inflation			+19.7%
Population			+12.2%

Source: Census

# Analysis of Safety

• Employees	2002	2008
•		
• Police (uniformed)	5,588	4,863
• Other Police	1,867	1,385
• <i>Total Police</i>	<i>7,455</i>	<i>6,248</i>
• Fire (uniformed)	3,730	3,823
• Other Fire	481	375
• <i>Total Fire</i>	<i>4,211</i>	<i>4,198</i>

# Safety Output (maybe)

• Police	2002	2008
• Arrests	105,623	110,058
• Fire		
• Calls	256,257	281,574
• Inspections	36,171	31,800
• Growth		
Police		+4.2%
Fire		+9.9%
Inspections		-12.1%

# Description of Drainage Fee

- This is a fee to each entity (firms, households, universities, other governments)
- Based on the amount of covered area (impervious area)
  - The idea is where water cannot drain
- Pier and beam type construction is charged a lower rate than slab
- All revenue is required to be spent each year

# Drainage Fee Analysis

## A Story of Three Problems (Distortions)

1. Distorts the choice of when to build on vacant land
2. Distorts the choice of whether to build in the City, or suburbs- because it creates a positive externality for the suburbs
3. Distorts the choice of whether to live in the City because it uses current tax revenue to pay for capital projects

# Future of the City

- The City is still growing
  - 2010 Pop is 2.1M, 2000 was 1.95M 1990 was 1.63M
- Until the end of the petroleum age our area will have a strong economy
- But, it is not automatic
- The suburbs are growing faster
  - Natural by economics, but nonetheless is creating a strong alternative

