THE NEW LOCAL REVENUE ROLLER COASTER:
GROWTH AND STABILITY IMPLICATIONS FOR
INCREASING LOCAL SALES TAX RELIANCE IN GEORGIA

Introduction

One of the most important changes in Georgia's local tax systems over the past two and a half decades has been the authorization and adoption of new sales taxes. In 1975, the only local sales tax in Georgia funded the Metropolitan Atlanta Rapid Transit Authority (MARTA). By the end of 1998, more than half of Georgia counties used three one-percent sales taxes. The state now features a Local Option Sales Tax, a Special Purpose Local Option Sales Tax, a Homestead Option Sales Tax, and the most recent sales tax for educational purposes. Since two of these taxes are supposed to reduce local reliance on the property tax, the substitution clearly brings new tax policy issues.

If local governments increase reliance on the sales tax, two important issues are:

- How do revenue growth patterns change?
- How does revenue responsiveness to the business cycle change?

Using state tax collections as a guide, one finds that the sales tax base grows slowly relative to the Georgia economy and that sales tax cycles are surprisingly large. For example, state collections increased by less than one percent in 1992 (over collections for the previous year) and 10.6 percent in 1993. If local sales taxes follow this uneven growth path, greater local sales tax reliance has serious consequences for local budgets.

In this study, we use the term revenue performance to include the dual issues of long-run tax base growth and short-run tax base cycles. There is no reason to believe that local governments cannot survive with poor revenue performers – slow revenue growth or sizable revenue fluctuations – but new revenue structures bring new revenue performance. Unexpected revenue changes should make the budgetary process more difficult – short-run changes may be mistaken for long-run changes and long-run changes may not be promptly identified.

In this paper, we examine revenue performance for sales and property taxes at the Georgia county level, building towards an understanding of the revenue structure-revenue performance issues in four steps. The first step is to calculate growth and stability estimates for each county property tax base and each county sales tax base from 1975 to 1992 (the most consistent available series reported by the Georgia Department of Revenue). The second step is to compare and contrast these estimates according to county type. Toward this end, we have chosen metropolitan status and population growth history as the classifications for examination. In the third step, we use regression analysis to identify the county characteristics that influence revenue growth and revenue stability. In
the third step, we use regression analysis to identify the county characteristics that influence revenue growth and revenue stability. In the fourth step, the data are used to simulate the effects of county consolidation on revenue performance. As a final revenue performance topic, we discuss the expected consequences on revenue performance of a state-mandated food exemption for some new local sales taxes.

Throughout the analysis we hold tax rates constant so that revenue growth is the same as tax base growth.

A. Growth and Stability of Sales and Property Tax Bases

With regard to the first step, the estimates indicate that the long-run growth path of the sales tax base (in real, per-capita terms) is negative for the average county. Nominal revenues increase over time, but the increase disappears when one adjusts for inflation and population growth.

Conversely, the property tax base increased in the average county over time (again in real, per-capita terms). Without tax rate adjustments, counties with greater property tax reliance should have experienced stronger revenue growth. In fact, taxable spending (i.e., sales tax base) grew faster than the property tax digest in only eight Georgia counties.

Turning to revenue stability, the property tax is a more stable revenue source in 125 of the 159 Georgia counties. When revenue sources are distinct, greater sales tax reliance increases revenue instability. But if revenue sources are pooled, however, the revenue stability consequences are not as clear. In about 60 percent of Georgia counties, a simulated increase in sales tax reliance reduced total sales and property tax instability. If local policymakers could transfer unexpected surpluses in either revenue source account, additional sales tax reliance in those counties would have increased revenue stability.

B. County Characteristics Associated with Revenue Performance

For the second and third steps, we examine the relationship between revenue performance characteristics and selected county characteristics. Counties in metropolitan areas and counties with rapid population growth are found to have greater revenue instability with respect to both the property tax and the sales tax. Regarding growth, metropolitan counties had faster growth than non-metropolitan countries, but with a more comprehensive regression analysis that includes other explanatory variables the metro/non-metro distinction is not statistically significant. Since increasing income definitely boosts the tax base (for both sources), the metropolitan differential is probably the result of income growth in Georgia’s urban and suburban counties. Not surprisingly, per-capita tax base growth appears unaffected by population growth. In other words, there is no adjusted advantage (or disadvantage) to fast growth.

The size of the construction industry is an important connection between a county economy and its sales tax base. When construction increases, sales tax collections on building materials increase local revenue growth. But this cyclical industry also destabilizes local sales tax revenue.

C. Effects on Revenue Performance of Consolidation

The estimates in this study are also used to examine the revenue-stability consequences of county consolidation. Two county consolidations are simulated here: one for a four-county region south of Columbus, and the other for a five-county region west of Albany. The simulations indicate that sales tax instability dramatically improves when small local revenue sources are combined. Property tax instability also improves, on average, but not every county fairs better under a regional revenue system.

D. The Effect of Exempting Food

Sales tax revenue performance changes when the composition of the tax base changes. Since the Georgia food exemption applies to some new local sales taxes, these taxes should produce less revenue and exhibit different growth and stability properties. In general, grocery food is a slow-growth spending category for households and we expect any local sales tax with a food exemption to grow faster over time. The literature suggests, however, that food expenditures are fairly stable over the business cycle and that larger tax bases are less sensitive to specific price changes. Thus, one can probably expect a new local sales tax with a food exemption to be more volatile in the short run.

References


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