Fiscal Architecture of the District of Columbia

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Overview

• Summary of economic and demographic trends
• Impact on D.C.’s revenues
• Potential options
• “What-if”-sensitivity of trends and impacts
D.C.’s Fiscal Architecture

• Revenue and expenditures are driven by many factors including economic and demographic characteristics
  – For example: Population size, age distribution, concentration of specific economic activity
• These factors change over time and may affect the natural growth of revenues and the basket of expenditure needs
  – Growth in service sector (loss of tax handles?), growth in very young (increased demand for education?)
• Institutional context may affect ability to respond to these changes

Does D.C.’s current revenue structure capture growth in the economy?
Concept

- Simple premise:
  
  \[ \text{Revenue collection (receipts)} = \text{tax rate} \times \text{tax base} \times \text{administrative/compliance efficiency} \]

- Similar case for expenditures (though not as much a focus in this report):
  
  \[ \text{Expenditure need} = \text{client population} \times \text{per unit cost of production} \]
Driver’s of Fiscal Architecture

- Factors affecting these relationships or any component affect revenues and expenditures in the short and long-term.
- Factors studied include:

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Highlights in Trends

• Population:
  – Growth in relatively young population (labor and school aged)
  – Growth in elderly (less than the U.S. average)

• Household size/composition:
  – Smaller than average households
  – Non-family households (roommates and singles)

• Ethnic/racial diversity
  – Large black population
  – Diversity of immigrant population

• Income:
  – High median income
  – Growing income gap
Trends, con’t.

• Employment and output
  – Growth in service sector
  – Growth in education/health services
  – Decline in federal employment

• Globalization and technology
  – Continued competition for capital and labor
  – Growth in business activity via internet

• Real estate
  – Growth in residential component
  – Impact of federal policies
  – Densification
What to Expect, Options, and What-Ifs

- Population growth and employment mix
  - Projected job growth is in lower paid sectors of health and education, reducing natural growth in income tax revenue
  - Stability of commercial property tax base is uncertain (federal government decisions, densification)
  - OPTIONS TO ADDRESS:
    - Continue to make D.C. an attractive place to live and age in place (from young to old)
    - Target expansion of affordable housing
    - Use of property tax to incentivize development and commercial occupancy
  - What if?
    - Growth and age transitory
What to expect, con’t.

- **Service sector growth in employment and output**
  - Reduces tax handles, service-based industries are more difficult to identify and possibly to value
  - Employment in sector is less defined by location than by skill (outsourcing), reducing growth in income tax
  - Services less heavily taxed under traditional sales tax systems
- **OPTIONS TO ADDRESS:**
  - Broadening the base of the sales tax
  - Substituting a simplified business tax for the corporate income tax
- **What if?**
  - Federal sequestration and permanent reduction in growth
• Increase in share of elderly
  – Greater portion of their income is tax-exempt (Social security, pensions)
  – Greater share of consumption is tax-exempt (health care, food at home)
  – Property tax exemption that is not means tested
• OPTIONS TO ADDRESS:
  • Means test the exemptions
  • If D.C. seeks to have its population age in place there will be increased demand for services including transportation and healthcare
• What if?
  • Elderly migrate?
What to expect, con’t.

• Globalization and Technology increase competition and decrease labor’s share of output
  – Competition forces focus on differences in tax rates (income and sales)
  – Capital’s share of output and tax base increases, but capital provides a difficult “tax handle”
  – Internet sales will continue to pick away at the sales tax base

• OPTIONS TO ADDRESS:
  • Leadership role in rationalization of the taxation of internet sales (Streamlined Sales Tax, “Amazon Laws”)
  • Reduced reliance on corporate income/profits based tax to a simplified minimum tax
  • Reassess areas to substitute fees and charges for income taxes
What to expect, con’t.

• Disparities among the population
  – Health of children is poor (obesity)
  – Income is increasing disparate
  – Pressure on services (health care, low income support)
  – Pressure on long-term income tax growth (lower health status and migration of tax to the high income earners)
  – Increases consumption of health services
• OPTIONS TO ADDRESS:
  • Increased efficiency in public services—those valuing distribution through the tax system will increase if their own needs are met
  • Reduce tax exemptions (broaden income tax base)
• What if?
  • Affordable housing not available
Wrap-Up

• Summary:
  – Pressures on:
    • Current Individual Income Tax and Corporate Income Tax
    • Expectations/need for public services
  – Opportunities:
    • Sales tax base expansion
    • Simplified business taxes
    • Fees/charges commensurate with public service expectations
  – Institutions
    • Taxation at source?
    • Engineering the demographics