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Elasticity of the Lexington-Fayette Urban County Government Tax Structure

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Overview

- Research Issue
- Methodology
- Results
- Recommendations

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Research Issue

- The motive for study is a general interest in LFUCG tax structure performance
  - How does revenue growth match up with other city-county governments?
- Elasticity is a proxy measure of adequacy
  - Adequacy refers to whether revenues meet expenditures or not
  - Elasticity is how well revenues grow with the economy

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Methodology

- Regional city-county governments are used for comparison
  - Indianapolis and Nashville are comparison cities
  - Eliminates interference of multiple governments in one area
- 2001 through 2003 chosen as years of study
  - Short-term elasticity is measured in this time frame

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Methodology

- The standard tax elasticity formula used to calculate elasticities
  - Percent change in revenue divided by percent change in personal income
    - Percent change is found by *Year X* subtracted from *Year Y*, then dividing that result by *Year X*
  - Elasticity is measured with 1.00 being perfectly elastic
    - Lower than 1 is inelastic, or stable
    - Greater than one is elastic, or volatile

Methodology

- Property taxes, sales taxes, and other revenues were separated and elasticities for each were calculated
  - This breakdown of tax structure showed most elastic revenues and which were most relied on
- There were a few caveats
  - Lexington and Indianapolis 2001 CAFRs were unavailable
    - Lexington's 2002 CAFR had language that allowed estimation of revenues
    - Indianapolis 2003 budget executive summary supplied revenues for 2001

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Results

- Lexington rated below other two cities in short-term elasticity
  - Lexington's numbers were more constant
    - Lexington's change was 0.75
    - Indianapolis' change was 1.61
    - Nashville's change was 4.5
- Lexington's revenue growth rate experienced less of a drop than the other two cities
  - Lexington's revenue growth dropped by 0.34%
  - Indianapolis' revenue growth dropped by 3.38%
  - Nashville's revenue growth dropped by 19.09%

Results

- Lexington relies more heavily on other revenues than property tax
  - In 2003, Lexington, Indianapolis, and Nashville relied on property taxes for 18%, 46% and 52%, respectively, for their revenues
- Lexington's other revenues elasticity was 1.06
  - Lexington's property tax elasticity was 2.21
    - Lexington can take advantage of personal income growth more with property taxes than with other revenues

Recommendations

- Expand property tax revenues to take advantage of higher elasticity
  - Lure major property tax payers
    - Large businesses would pay more property taxes, as well as provide employment
- Improve progressivity of property tax
  - Progressive taxes will bring in more property taxes
    - New property is excluded from the 4% rule established by HB 44 in 1979

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Recommendations

- Stay away from a sales tax
  - There is uncertainty in establishing a sales tax
    - Implementation hurdles such as legislation
    - Business cycle affects the tax, causing changes frequently
    - It is a relatively inelastic revenue source
  - It would cause burden to many payers

Recommendations

- Limitations
  - Tax elasticities are never permanent
    - Recent history is not a good predictor of the future
    - Personal income is affected by outside sources
    - Gyrations of the business cycle affect elasticities because of natural ups and downs of economy
  - Short time frame of study
    - Short-term elasticity was studied, which may not be an indicator of long-term elasticity

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Summary

- Research Issue
  - Analyzing the LFUCG tax elasticity performance
- Methodology
  - Assessment of the tax elasticity performance through comparison with two area city-county governments
- Results
  - The LFUCG tax structure measured lower in elasticity, but more constant
- Recommendations
  - The LFUCG is not taking advantage of elastic property taxes
  - Sales taxes are not as elastic, and would be hard to implement

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