Fiscal Architecture of the District of Columbia

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Overview

- Concept and scope of report
- 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
What to expect, con’t.

• 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