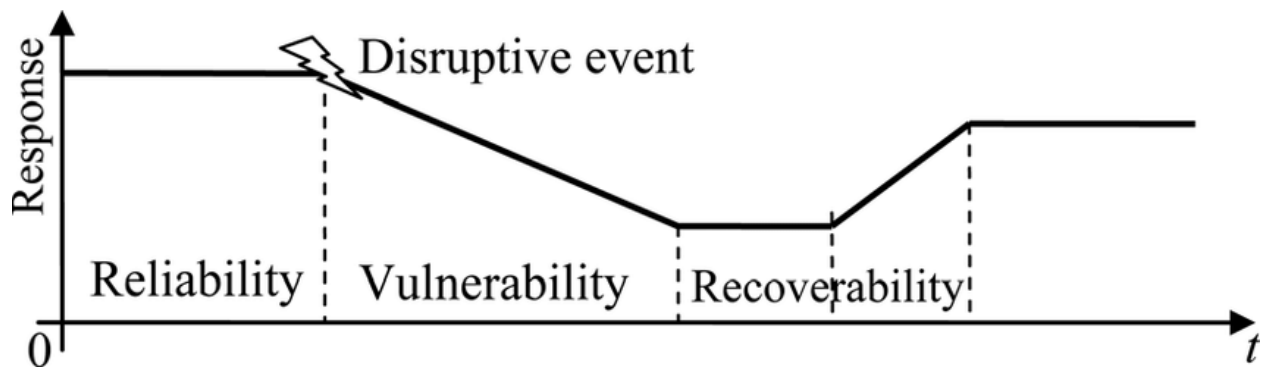


The Diversification of Local Revenue Sources in Connecticut: User Charges and Fees



A Report Prepared for the State of Connecticut's Advisory Commission on Intergovernmental Relations.

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1. EXECUTIVE SUMMARY

Connecticut's main long-term challenges are slow economic growth, very high income disparities and population shrinkage. Local revenue systems, in turn, are significantly over-reliant on the property taxes. Maintaining this structural feature is not a robust risk management strategy for local governments especially during unstable times caused by economic recessions, external shocks such as global pandemic, or other disruptive events.

Under these conditions one crucial task for policymakers is to assess holistically what kind of local revenue system reforms would help to tackle the existing structural challenges. Balanced diversification of local revenue sources is widely acknowledged as a potentially significant way to tackle, for example, income disparities and economic instability.

However, local governments have different type of reform priorities since their revenue systems are designed differently across states. Thus, there is no one-size-fit-all solution to how to diversify. Importantly, in addition to the *exceptionally high reliance* on the property taxes, another persistent policy issue for local governments is *exceptionally low reliance* on the user fees and charges.

Hence, this report focuses on the potential of user fees and charges to contribute to the local governments' revenue diversification efforts. The key data source is the U.S. Bureau of Census' data on local government finances in 2018. For example, in 2018 local governments in Connecticut derived 86 percent of own source revenue from the property taxes. This is the highest share among all states (incl. District of Columbia). In terms of property taxes as a share of total tax revenue, Connecticut's 98.6 percent is the second highest among all states (incl. District of Columbia). Moreover, in 2018 the share of current charges of own source revenue was in Connecticut the second lowest (9.4 percent) after District of Columbia (8.6 percent). Finally, in Connecticut local governments' current charges covered the respective expenditures only in the case of parking facilities. In every other service category, the current charges were

lower than the respective expenditures. In the light of these findings, it is reasonable to assume that increasing reliance on the user fees and charges is one plausible way to diversify local revenue systems in Connecticut.

However, policymakers need to pay careful attention to how the user fees and charges are priced in order to avoid increasing vertical inequities. Insofar as the increased reliance on the user fees and charges, and consequent changes in the property taxes, would positively impact low- and middle-income people's consumption options, it could improve prospects for economic growth better than policy changes that would raise the income of relatively well off. Lower income people are likely to spend a higher proportion of their income in consumption "than the wealthy, who are more likely to save" (OECD 2020, 16). Hence, increasing progressive impact of local revenue systems is likely to contribute to economic growth.

Increased reliance on the user fees and charges would most directly contribute to the balanced diversification of local revenue systems. Addressing broader economic and social challenges in Connecticut would require a more comprehensive policy changes at multiple levels (cf. Lynch 2004; Overton & Bland 2017).

This report offers five substantial recommendations:

- 1) Establish stormwater drainage utilities*
- 2) Consider breaking out services from the property tax structure*
- 3) Reexamine the existing user fees*
- 4) Consider user fees for electric vehicles*
- 5) Consider user fees for school activities*

Additionally, this report identifies a need to gather systematic statewide information on what user fees municipalities are currently charging and how they are priced. This has a potential to enhance policy learning and innovation in Connecticut. Hence:

- 6) Design a statewide reporting system regarding municipalities' user charges and fees*

2. INTRODUCTION

Negotiations over local revenue system designs, and reforms are often based on contested and potentially conflicting normative frameworks, public finance principles and policy beliefs. At the same time, multiple contextual factors, and trends (such as political will, external shocks, economic cycles, statewide and local political dynamics, socioeconomic differences and fiscal disparities across municipalities, state laws, unreliable or declining rates of intergovernmental transfers, and level of trust) constrain local governments' efforts to (re)design their revenue systems. This complexity implies the importance of having a pragmatic strategy and an understanding of the policy making context when the goal is to, for example, diversify local revenue sources as a way to better match revenues with expenditures and provide public services for citizens. (e.g. UNHabitat 2009, 14; Smoke 2013)

In 1987 Advisory Committee on Intergovernmental Relations report on *Local Revenue Diversification*, Shannon (1987, iv) pointed out that

"...an effective local revenue system should rely on a well-balanced and diversified set of taxes. In addition to avoiding the problems created by excessive reliance on any single tax source [such as property tax], a balanced and diversified revenue system will create a more favorable business climate, soothe taxpayer discontent, and provide a desirable stability of revenue throughout the course of the business cycle."

Many policy makers at different levels of government as well as citizens probably find this generic argument, not only acceptable, but also a desirable policy goal. This is likely true, for example, in Connecticut where the long-term over-reliance on property tax is a widely documented policy problem. Reflecting this, in 2015 Connecticut State Tax Panel (CTP 2015c) adopted without dissent 11 recommendations that were aimed to decrease local governments' reliance on property tax while reforming certain elements of it, and to increase the diversification of local revenue sources.

However, according one Memorandum of Comment “the Tax Panel...failed its statutory charge ‘to review the state’s overall state and local tax structure’ because it refused to consider the structure of the property tax” (CTP 2015c, 17). Moreover, the recommendations did not address user charges and fees as potentially important set of policy tools to diversify local revenue sources.

While this report does not address “the structure of the property tax”, it addresses the diversification of local revenue sources by focusing on the user charges and fees. In a general sense the diversification of local revenue sources can be understood as a risk management strategy that aims to enhance system resilience – in this case across municipalities in Connecticut. This view is relevant especially now as different levels of government attempt to recover from COVID-19 pandemic. In addition to challenges created by COVID-19 pandemic, Connecticut’s main longer-term challenges are very slow growth, very high income disparity and population shrinkage. Evaluation of local revenue systems, and how to reform them, need to consider carefully how they affect these structural challenges.

Consequently, for this report the critical question is whether the diversification of local revenue system by increasing the relative importance of user fees and charges would help to tackle these structural challenges. User fees are viewed as an attractive option to diversify local revenue sources for following reasons: i. they increase revenue, ii. they are stable revenue source during economic downturns, iii. they link the budget’s revenue and corresponding expenditure, iv. they act as indicators of the desirability of contracting or expanding services, and v. they can strengthen efficiency by rationing services to those who are willing to pay their cost (Bartle et al. 2003, 642; Sebastian & Kumodzi 2015). Of course, there are also other ways to reduce reliance on the property tax and/or increase the diversity of local revenue system. These policy tools include, for example, state aid, local income tax and local sales tax, but discussing these options is beyond the scope of this report.

Finally, this report did not adopt a strict rule of revenue neutrality. Thus, it is not assumed that an overall increase of revenue, caused by recommendations, would necessitate an identification of other revenue that would be decreased to maintain equal-yield of revenue collection. However, the report makes such recommendations that have potential to decrease the property taxes and, hence, to decrease the current overreliance on the property taxes in Connecticut. Overall, this report is in line “Principles for Guiding Connecticut Revenue Policy: Statements of the Panel’s Overarching Philosophical Framework” (CTP 2015b, Ch.1, p. 2).

3. BACKGROUND

3.1. Interplay Between Subnational and Broader Context

Local governments have had, at least, since the Great Recession of 2008, difficulties in maintaining their revenue needed to provide public services and goods to their residents (e.g. Sebastian & Kumodzi 2015). This on-going struggle over how to reform local revenue systems is a nationwide trend including the State of Connecticut.

Some of the dilemmas and challenges that Connecticut is currently facing resemble the situation in other states across the USA, but there are also challenges that are relatively unique to Connecticut. One such key challenge is the over-reliance on property taxes (e.g. CTP 2015a). However, it also is argued that Connecticut is not particularly high-tax state when one considers its per capita income. The key problem, rather, is the regressive distribution of property tax burden (O’Brien 2020, 3, 26). There are also other similar conclusions. According to Institute of Taxation and Economic Policy’s Tax Inequality Index, which measures the impact of each state’s tax system on income inequality, Connecticut has the 29th most unfair state and local tax system in the country. Incomes are more unequal in Connecticut after state and local taxes are collected than before. (ITEP 2018, 45) Thus, Connecticut’s tax system influences negatively vertical equity.

It is commonly assumed that since local redistributive taxation would likely generate spatial inefficiencies, the local governments should concentrate their efforts in addressing horizontal rather than vertical equity (Stone 2013, 6). Given this, one could assume (other things being equal) that increasing the relative importance of user charges and fees in states like Connecticut, where the reliance on them is nationally exceptionally low, would not be highly contentious policy goal since the main equity issue with user charges and fees is not horizontal but vertical equity.

However, Sjoquist (2015) has suggested that concerns over implications for low-income people has been, for example, in Connecticut one key reason for why local governments have been reluctant to increase the importance of user charges and fees in their revenue systems. Local revenue systems comprise of a) own-source revenue, b) intergovernmental transfers, and c) municipal borrowing (e.g. Scharff 2016).

Moreover, the existence of multiple types of property tax exemptions for certain groups of individual and institutional taxpayers, which arguably effects vertical equity negatively and causes other citizens to pay more taxes due to the erosion of the tax base, suggests that local revenue systems have in-built inequity issues. This report argues that while user charges and fees imply equity issues, they also involve potential to address concerns over equity issues by extending their use to, for example, nonprofits and by designing their rate structure properly. A rate structure is an important issue when designing, for example, road usage charge programs (e.g. ODT 2020) or other similar policy innovations aimed to address inequities of motor vehicle tax.

The data used in this report clearly suggests that increased reliance on user charges and fees has a potential to reduce the need for property tax in Connecticut. However, in practice the diversification of local revenue sources via user charges and fees is likely to have only modest implications for the over-reliance on property tax in Connecticut.

This is not a surprise since it is not feasible to assume that any single revenue policy option would in itself be sufficient solution to the longer-term challenges facing Connecticut. The key is to design a careful balance between different reform efforts and trade-offs. Without such balancing even well-designed, but isolated recommendations, may lead to poor policy reforms and below optimal economic and social outcomes. (OECD 2018)

At the same time, one needs to keep in mind that there is not any “one-size-fits-all” policy solutions to questions such as how to promote, for example, inclusive economic growth. Not only countries, but also States and even localities “differ in the challenges they are facing and have different preferences in terms of the kinds of societies they want” (OECD 2018, 2).

Moreover, local governments in different states also have differently designed revenue systems. This implies local governments have different type of reform priorities. In Connecticut local governments’ reliance on the property tax is exceptionally high while their reliance on the current charges is exceptionally low when compared to other U.S. states, as also this report demonstrates. For this reason, it makes sense to assume that increasing reliance on user charges and fees would help to “*move the system in the right direction and build a foundation for future action*” (Stone 2013, 25, *emp. added*).

3.2. Four Indicators of Social and Economic Progress

Local challenges need to be understood in a broader context. The world is currently facing many intertwined crises. COVID-19 pandemic has further exposed the structural nature of economic and racial inequalities, and their undesirable affects on people’s chances to live dignified lives as full members of the society (e.g. Villarreal 2020). Furthermore, political system and democracy are simultaneously going through a significant stress-test that has revealed the fragile nature of trust between the people and their governments. This complex situation also makes any attempt to solve challenges and problems within local revenue systems all the more difficult as municipalities aim to increase their fiscal security and resilience.

The causes of these crises both pre-date COVID-19 pandemic crisis and are further strengthened by it. A recent OECD (2020) report argues that due to the current intertwined crises there is an urgent need to develop new ways of understanding what social and economic progress are about, and what kind of policies are required to achieve them in an environmentally sustainable manner

According to this OECD (2020, 15-16) report, the four key indicators of social and economic progress under the current conditions should be:

- i. Rising wellbeing,*
- ii. Reducing inequality,*
- iii. Strengthening environmental sustainability, and*
- iv. Enhancing system resilience i.e. “the economy’s ability to withstand financial, environmental or other shocks without catastrophic and system-wide effects” (ibid., 16).*

The report focuses exclusively in national and international level and views, for example, tax policy as one important policy domain that affects the likelihood to achieve progress in terms of these indicators (OECD 2020, 18, 21-22, 25-27). However, the report also supports community wealth building strategies at local level as a way “to ensure more equitable geographical outcomes” (ibid., 26). The fiscal disparities and differences in tax burdens across municipalities arguably affects, for example, cohesion within and between municipalities (cf. CTP 2015a) and thus, indicators such as rising wellbeing and reducing inequality. Strengthening environmental sustainability is already now an important indicator of social and economic progress at local level and affects negotiations over local revenue systems and how to reform them.

Furthermore, regionalism (see e.g. CCM 2020) might be one tool to enhance system resilience across localities.

Thus, the question of how we should understand and advance economic and social progress in the post-COVID world is highly relevant also at local level even when it is acknowledged that

“reducing inequality” is not the primary task of local governments. This report addresses this question by using the report’s four indicators of social and economic progress as background guiding posts when analyzing whether and to what extent user charges and fees would help to diversify local revenue sources in efficient and equitable way.

Strengthening these indicators is not a straightforward task at the local level. It requires making decisions on interrelated questions such as

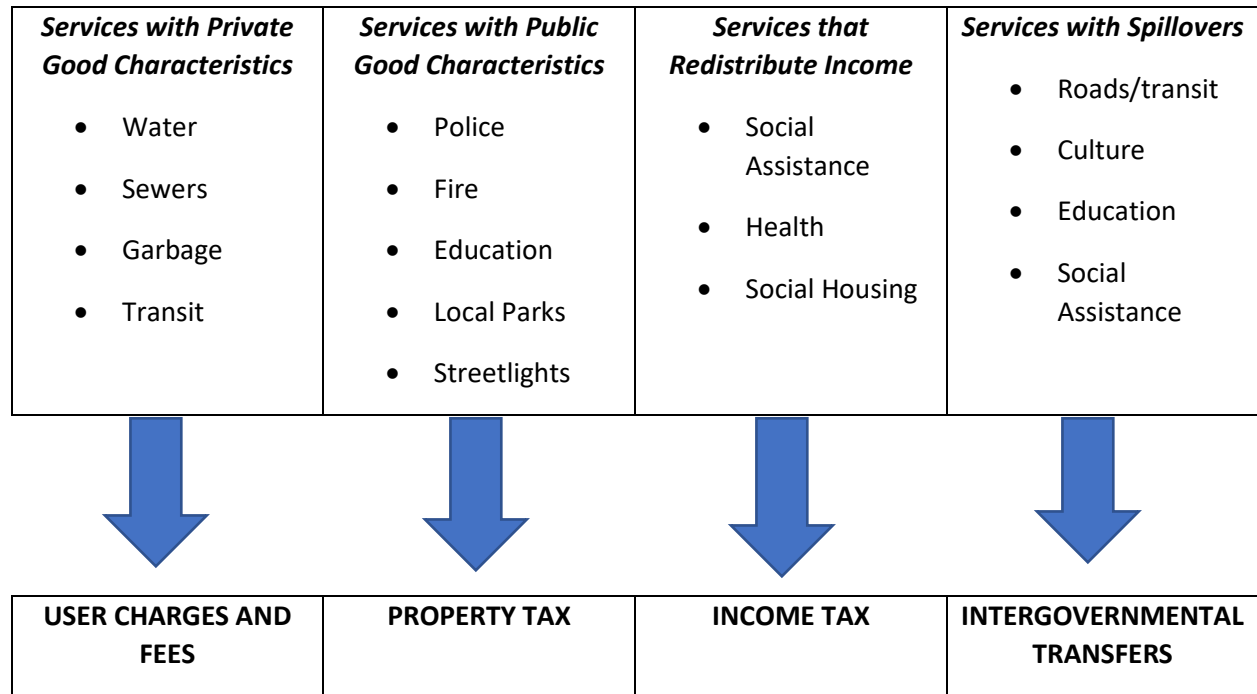
- a) what public services should be provided,
- b) what the desirable amount of those services is, and
- c) who should pay for them, and how (UNHabitat 2009, 17).

Recognizing that the category of public services is not a monolithic whole is one precondition to find such answers to these questions that make it possible to design context sensitive as well as both desirable and feasible policy change. Variation in the characteristics of public services impacts, for example, what are viewed as the ideal financing tools for services such as transportation, environmental services, protection, recreation, culture, planning and development, economic development, social services, education, housing, and health. (UNHabitat 2009)

3.3. Many Faces of Public Services and Goods

Figure A helps to explicate this dynamic feature of local revenue policy from the point of view of the *benefit model of local government finance*. This approach assumes that services and goods, provided by local governments, should be paid - whenever possible - by those who benefit from the respective services and goods (e.g. UNHabitat 2009, 18). Importantly, “whenever possible” implies that this is not one-size-fits-all model. For example, local governments in Connecticut are not allowed to levy local income taxes.

Figure A. Different Financing Tools for Different Services



Source: UNHabitat (2009, 18), modified by author

Figure A suggests, first, that user fees are the most appropriate to finance such services “where there is a clear relationship between the fees charged and the benefits received” (UNHabitat 2009, 18) by identifiable users. Second, services with public good characteristics, in turn, generate “collective benefits that are enjoyed by local residents but which cannot easily be assigned to individual beneficiaries” (ibid., 19). One suitable financing tool for such services is benefit-based property tax, which – as some have argued – can also be viewed as “a generalized, or non-specific, user charge” (ibid., referring to Kneebone & McKenzie 2003). Third, while local governments’ primary function is not to redistribute income, sometimes services have redistributive affects. The logic (direct beneficiary pays) of user fees and regressivity of property tax system imply they are not best suitable tools to finance these services. Instead, more desirable option is income tax, and more generally federal and state taxes since these “senior levels of government...have a wider range of taxes than local governments and they generally have taxes that are more closely related to ability to pay”

(ibid.). Fourth, intergovernmental transfers are particularly suited to finance “services where the benefits (or costs) spill over municipal boundaries but where local provision is still desirable” (ibid.).

Figure A indicates the key elements of local revenue systems (such as user fees, property tax, income tax and intergovernmental transfers) are best suited to collect revenue and to finance specific type of public services, and thus, are not simply interchangeable. For example, while user fees are perhaps ideal to finance garbage collection, they hardly are the best possible way to finance police services. This linkage between services and financing tools, on the one hand, sets limits to diversify local revenue sources. On the other hand, the linkage implies that some level of diversification is warranted from the benefit principle’s point of view.

3.4. What are User Charges and Fees?

Terms “user charges and “user fees” refer to “prices a governmental agency charges for a service or product whose distribution it controls” (Gillette & Hopkins 1987, 796). In this report these terms are understood as synonyms. Also, these terms are used in this report consistently with the U.S. Bureau of the Census data for state and local governments. Thus, they refer to the following Census categories: *current charges, special assessments, and utility revenues*.

As benefit-based sources of revenue, user fees are not mandatory charges “that could be levied regardless of service usage” (ibid., 803). Instead, user fees are paid (at least in theory) voluntarily by those (non)residents who use publicly provided services, “as opposed to taxes levied to provide public services generally, whether or not those particular public services are used by individual taxpayers” (Scharff 2016, 303). For example, homeowners pay property tax irrespective of whether they have children who attend the local school.

Indeed, user charges and fees are also viewed similar to prices in the private sector because the former are usually “voluntary payments based on direct, measurable consumption of publicly provided goods and services” (ACIR 1987, 3). Such services and goods include, for example,

sewer, solid waste management, parking services, public swimming pools, public museums, health services, and parks. Financing these services by user fees also assumes that non-beneficiaries can be excluded and imposing and collecting user fees is possible with a reasonable cost (ACIR 1987, 35). Furthermore, user fees can be priced differently: a fixed charge without limitations to access, as a charge based on consumption, or they can be also subsidized (e.g. Thompson et al. 2014, 32). One pricing related issue is whether it is desirable to charge fees that recover full or only partial financial costs of providing a public service because in some cases recovering less than full costs “may avoid disincentives for individuals or firms to engage in socially [or environmentally] useful conduct” (Gillette & Hopkins 1987, 799; see also Thompson et al. 2014, 32) such as buying electric vehicles.

Finally, the idea that user fees are voluntary is not absolute. In the broadest sense, user charges and fees include a) (compulsory) utility charges, b) (voluntary) user charges and fees, c) special assessments such as “sidewalks, street paving and lightning, which provide special benefits to identifiable properties” (ACIR 1987, 5), d) with reservations also (compulsory) license fees and taxes such as “marriage licenses and occupational and business licenses” (ibid., 6), and most ambiguously, also narrow benefit taxes such as fuel taxes (ibid. 7-8).

3.5. Arguments For and Against User Fees

Arguments for user fees

Efficiency

- i. Enhance efficient allocation of public services and resources by operating as signals and direct links between users' benefits, demand and the actual cost of the public service.
- ii. May discourage overuse of public services
- iii. Strengthen accountability by giving appropriate investment signals and reducing the overproduction of services (decreasing expenditures)
- iv. Administrative costs may be relatively low
- v. Possibility to offer different levels of service depending on the willingness to pay.

Horizontal Equity

- i. Those who benefit, pay the costs. Nonusers do not have to pay
- ii. Reduce unintentional subsidies for identifiable groups of taxpayers
- iii. Also nonresidents and tax-exempt institutions pay

Source: Thompson et al. 2014; ACIR 1987; Shannon 1987

Arguments against user fees

Vertical Equity

- i. Regressive effect if lower income people would pay higher percentage of their income than higher income people
- ii. People may avoid to use needed services such as health care causing welfare losses
- iii. Potential loss of positive externalities

Efficiency

- i. Administrative costs may be relatively high

Source: Sjoquist 2015; Sepehri & Chernomas 2001; ACIR 1987; Gillett & Hopkins 1987

4. METHODOLOGY AND CRITERIA

4.1. Methods and Data

This report gathers both qualitative and quantitative data. Qualitative data consists of previous research on the diversification of local revenue systems and the role of user fees and charges in local revenue systems. Conceptual analysis is used to synthesize this data.

The key source of quantitative data, in turn, is the U.S. Census of Bureau's State & Local Government Finance Historical Datasets and Tables for year 2018. This data is used to compare local revenue systems across the USA to identify, more specifically, how Connecticut compares to other states in terms of local governments' reliance on the property taxes and the relative importance of the current changes in the local revenue systems.

4.2. Guiding Principles and Criteria

The evaluation of policy options and the identification of policy recommendations is based on the following sets of guiding principles and criteria. These sets draw on 2015 Connecticut Tax Panel (2015b) and NCSL (2007).

4.2.1. Guiding Principles

4.2.1.1. Avoid Fiscal Obsolescence

Reforming local revenue system should make fiscal sense, not only in short term, but also over the long term by adopting such revenue sources that are capable of capturing the fiscal benefits and minimizing the fiscal downside of changes in medium and long term trends in economic structure, demographic, and institutional arrangements both at state and national level, and even globally (cf. CTP 2015b, Ch. 1, p. 2). These trends and institutional arrangements both enable and restrict local level decision making.

4.2.1.2. Revenue Policy as a Part of an Intergovernmental System

Local revenue policy across Connecticut's municipalities should function as a coherent system which elements function together as a part of state and local government finance. "Although the State is ultimately responsible for determining the functions of local governments and the taxes localities they levy, it should minimize actions that limit local finance autonomy" (CTP 2015b, Ch. 1, p. 2). Given the State's "access to more productive revenue sources than its localities, there is a necessary and important role for a well-designed and fiscally certain system of intergovernmental aid" (ibid.).

4.2.1.3. Revenue Diversification & Tax Mix

Structural inefficiencies and inequities are a part of all taxes. These unwanted features are likely to become intolerable if there is overreliance on the respective tax such as the property tax. For this reason, local revenue systems "should rely on a mix revenue bases so as to not lead to an overreliance on one of a few tax sources. If transparent and coordinated for simplicity, the overlapping of local with state revenue sources need not be competing or contradictory". (CTP 2015b, Ch. 1, 2)

4.2.1.4. Broad Bases, Low Rates

The principle of broad bases and low statutory rates should be favored as a way "to minimize distortions in economic decision making for individuals and business entities alike" (CTP 2015b, Ch. 1, 2).

4.2.1.5. Public Values Built Into the Tax Law Should be Explicit

At the same time there is a need to recognize "that giving tax relief to classes of taxpayers is not inherently wrong if such treatment can be shown to satisfy and agreed upon and explicit set of policy goals and there is full disclosure in the granting of such preferential treatment" (CTP 2015b, Ch. 1, 2). This same principle applies also to the current charges when the pricing structures are designed.

4.2.1.6. Transparency

“Revenue legislation should be based on sound legislative procedures and careful analysis and taxpayers should be informed...regarding how tax assessment, collection and compliance works” (CTP 2015b, Ch. 1, 2).

4.2.1.7. Public Accountability

“There should be an explicit linking of state and local legislative decisions to the decision makers so that the citizens of Connecticut understand the relationship between the governmental unit that provides public services and the unit of government that levies taxes to pay for those services” (CTP 2015b, Ch. 1, 2).

4.2.1.8. Uniformity

Local “revenue systems should be administrated professionally and uniformly throughout the State” (CTP 2015b, Ch. 1, 2).

4.2.2. Criteria

4.2.2.1. Efficiency

Revenue sources, such as the current charges, should not trigger unintended interference with private decisions among consumers, workers, and producers. Thus, the key goal is that revenue sources “accomplish their intended objectives” and these objectives need to be stated explicitly and transparently (CTP 2015b, Ch. 1, p. 3).

4.2.2.2. Equity

Two key dimensions of equity in the case of both persons and business entities are:

- i. *Horizontal equity* requires that taxpayers in similar circumstances, in terms of wealth, income or consumption, are taxed similarly. In addition to this “equal treatment of equals” principle, . another principle of horizontal equity is “benefits received”. This principle implies “that revenue

policy should be designed such that it is beneficiaries of a flow of services who are required to pay for those services” (CTP 2015b, Ch. 1, p. 3), and

ii. *Vertical Equity*, in turn, focuses in whether the payments among taxpayers, who are not in similar circumstances especially in terms of income, are distributed fairly. Vertical equity is about whether revenue system is progressive, regressive or proportional. The key question is to what extent the distribution of taxes and fees is fair in terms of taxpayers’ “ability to pay”. (ibid., 4)

4.2.2.3. Reliability

The diversification of revenue sources should increase the reliability of revenues across the municipalities in Connecticut. Reliability has three main components: stability, certainty, and sufficiency.

i. *Stability* of revenue system implies relatively constant amount of revenue over time. Stable system would not be “subject to unpredictable fluctuations” (NCSL 2007). In practice this implies a need to design a balanced revenue system that consist of both elastic and inelastic revenue sources as a way to make the system resilient during broader economic downturns and expansions. Thus, the diversification of revenue sources is based on recognition that any sustainable and resilient “revenue system must have a mix of elastic (relatively responsive to economic base changes) and inelastic (relatively unresponsive to economic base changes) revenue tools” (CTP 2015b, Ch. 1, 4).

ii. *Certainty* of revenue system is achieved by a minimum amount of changes in revenue sources. This criterion is designed to enhance individuals and businesses’ chances to make reliable financial plans and decisions (CSTL 2007). A need for continual revenue changes is at odds with the idea of stable revenue streams.

iii. *Sufficiency*, in turn, assumes such amount of revenue that would be adequate to balance the budget in the short run by being able to finance the chosen level of services (cf. CSTL 2007).

4.2.2.4. Competitiveness

The local revenue system and the diversification of the revenue sources “should be evaluated for their effects on growth of the economic and employment base and on residential mobility” (CTP 2015b, Ch. 1, p. 4). According 2015 Connecticut Tax Panel (ibid.), if municipalities

- “(a) levy taxes that are “too high” relative to other jurisdictions and/or relative to the level and quality of services that are provided;
- (b) structure certain taxes or a package of revenues so as to unduly distort private economic transactions in an unintended manner; and/or
- (c) create a revenue system that is characterized by a high degree of uncertainty,

the result is to discourage private investment and job development with the state. If it is determined that for one (or more) of these reasons the Connecticut revenue structure unintentionally hinders or distorts job development that residents care about, then the revenue system would not be competitive”.

4.2.2.5. Simplicity

While any revenue system has some amount of complexity, the local revenue system in all municipalities “should be easy to understand by the taxpayer so as to minimize the costs of both taxpayer compliance and of revenue administration” (CTP 2015b, Chapter 1, p. 4). Unnecessary complexity may result in in extra audits and increased costs for taxpayers to keep records and filing returns. More fundamentally, complexity may decrease taxpayers’ “understanding of and trust in...the government..., which is a matter of serious concern in a democracy” (ibid.).

Given these five criteria, it is clear that policy tradeoffs and balancing among the criteria cannot be avoided when designing the diversification of revenue sources. It is unlikely that there would be any such single revenue source that would meet all the five criteria. (CTP 2015b, Chapter 1, p. 4-5).

5. REVENUE DIVERSITY AND CURRENT CHARGES IN THE USA AND CONNECTICUT

5.1. A Brief History

The boundaries and financial importance of user charges and fees for local revenue systems differ historically and across the states. Their adoption depends on, for example, which public goods and services are determined in communities as politically and socially acceptable candidates for user fee financing (ACIR 1987, 33).

In line with this, the role of user charges and fees in local revenue systems has grown in the USA during the last century though there are significant regional differences (ACIR 1987; Sjoquist 2015). While in 1942 the share of user charges and miscellaneous revenue of own source revenue was 10.5 percent, by 2012 their share had grown to 35.8 percent (Sjoquist 2015, 10). For example, during the late 1970s and 1980s policymakers became increasingly interested in strengthening the role of “prices” for publicly provided services and goods as a response to a) “fundamental realignment in federal responsibilities” (ACIR 1987, 1), or in other words, reduced federal aid, and b) “the steepest recession in 50 years” (ibid.). Other reasons have included tax limitations and reduced or unpredictable state aid (e.g. ACIR 1987, 10).

Thus, the heightened importance of user fees and charges for local revenue systems is at least partially a consequence of trends beyond the control of local governments. However, this does not mean that the regions would have adopted identical approach to user charges and fees during the mid-1980s. While the southeast region in the 1980s relied more than any other region on current charges relative to local taxes, in New England the reliance on current charges was the lowest in the USA. (ACIR 1987,14) In the New England region adaptation of user fees was slow because local governments did not spend a lot of “money on the types of

services that readily lend themselves to user fees” (Scharff 2016, 305). Thus, increased reliance on user fees has not been a uniform national trend.

Nevertheless, increased reliance on user fees has continued since the 1980s due to following reasons: i. increased use of services traditionally associated with fees, ii. a need to supplement tax revenue due to property tax assessment limits and exemptions, and iii. greater authority to impose fees, than taxes, in the absence of explicit state authorization. (Scharff 2016, 304) Also the State of Connecticut authorizes municipalities to impose user fees and charges for water and sewer services. However, “Connecticut courts have not ruled on whether municipalities can impose user fees for other services without specific statutory authorization.” (Rappa 2014, 3)ⁱ Municipalities, including in home rule states, have limited fiscal autonomy over what kind of fiscal instruments they are able to “select without state authorization” (Gillette & Hopkins 1987, 246). However, usually these options are limited to user charges and fees “that demonstrably link individual benefit and cost rather than more broad-based taxes” (ibid.).

5.2. The Current Situation

5.2.1. Level of Revenue Diversification in the USA

Regional differences still exist across the states as Table A indicates (see also Sjoquist 2015). Connecticut still relies more heavily on property taxes than most other states. Also other states in New England rank high in this respect. Local governments in Connecticut derive 86 percent of own source revenue from property taxes. This is the highest share among all states (incl. District of Columbia). Furthermore, in terms of property taxes as a share of total tax revenue, Connecticut’s 98.6 percent is the second highest among all states (incl. District of Columbia).

In contrast to this, Alabama, District of Columbia, Arkansas and Louisiana each derive less than 30 percent of own source revenue, and less than 50 percent of total taxes from property taxes.

The averages for the United States were 48.0 percent and 74.3 percent, respectively. These shares are similar to Sjoquist’s (2015) findings for year 2012.

Another, a more comprehensive way to measure revenue diversification is to calculate the Herfindahl Indexⁱⁱ “as the sum of the squares of the share of each source of own source revenue” (Sjoquist 2015, 13). The value of the Herfindahl Index indicates how diversified revenue sources are. High value of the Herfindahl Index indicates low level of diversification, and vice versa. For example, Connecticut’s value 0.749 is highest among all the states implying that the diversity of revenue sources is lowest in Connecticut. Only six states’s Herfindahl Index value is over 0.6 and all are located in North East (Connecticut, New Hampshire, New Jersey, Rhode Island, Maine and Massachusetts). The most diversified six local revenue systems are found, in turn, in New York, Missouri, Kentucky, Arkansas, Nevada and District of Columbia (each below 0.26). The average value of the Herfindahl Index for all local governments is 0.368. These Herfindahl Index findings are similar to Sjoquist (2015). As expected, they demonstrate that the least diversified local revenue systems are most reliant on the property taxes.

Table A. Measures of Local Revenue Diversity, 2018

	Property Taxes as a Share of OSR	Property taxes as a Share of Total Tax Revenue	Herfindahl Index
ALABAMA	20.3%	40.7%	0.273
ALASKA	48.3%	78.6%	0.336
ARIZONA	43.1%	62.8%	0.292
ARKANSAS	25.6%	43.1%	0.240
CALIFORNIA	37.4%	67.6%	0.284
COLORADO	39.0%	61.2%	0.272
CONNECTICUT	86.0%	98.6%	0.749
DELAWARE	54.9%	80.6%	0.387
D OF COLUMBIA	27.4%	33.1%	0.168
FLORIDA	41.5%	76.8%	0.311
GEORGIA	39.5%	66.9%	0.297
HAWAII	53.2%	71.4%	0.346
IDAHO	49.7%	93.6%	0.406
ILLINOIS	60.0%	80.8%	0.408
INDIANA	39.5%	86.4%	0.382
IOWA	49.0%	87.0%	0.380
KANSAS	44.0%	71.3%	0.296

KENTUCKY	36.0%	54.9%	0.252
LOUISIANA	29.0%	45.4%	0.269
MAINE	78.0%	98.8%	0.640
MARYLAND	43.4%	55.5%	0.285
MASSACHUSETTS	76.7%	95.1%	0.613
MICHIGAN	52.4%	91.2%	0.392
MINNESOTA	49.2%	90.7%	0.378
MISSISSIPPI	41.7%	93.9%	0.426
MISSOURI	36.1%	58.0%	0.253
MONTANA	60.0%	96.4%	0.447
NEBRASKA	50.5%	78.4%	0.348
NEVADA	33.1%	56.1%	0.237
NEW HAMPSHIRE	84.1%	98.3%	0.721
NEW JERSEY	80.7%	98.1%	0.670
NEW MEXICO	37.8%	55.6%	0.274
NEW YORK	44.1%	57.1%	0.256
NORTH CAROLINA	34.5%	71.5%	0.342
NORTH DAKOTA	50.1%	79.6%	0.330
OHIO	42.7%	63.2%	0.273
OKLAHOMA	33.2%	54.2%	0.270
OREGON	49.3%	80.2%	0.344
PENNSYLVANIA	50.6%	69.2%	0.323
RHODE ISLAND	79.8%	97.2%	0.658
SOUTH CAROLINA	37.4%	73.8%	0.330
SOUTH DAKOTA	53.4%	73.9%	0.361
TENNESSEE	33.0%	67.8%	0.287
TEXAS	57.1%	83.1%	0.397
UTAH	40.4%	66.9%	0.273
VERMONT	62.7%	94.7%	0.463
VIRGINIA	55.3%	76.0%	0.365
WASHINGTON	31.6%	55.9%	0.262
WEST VIRGINIA	49.9%	81.4%	0.359
WISCONSIN	62.9%	92.3%	0.462
WYOMING	32.3%	83.8%	0.406
U.S. AVERAGE	48.0%	74.3%	0.368

Source: 2018 U.S. Bureau of the Census, calculated by author

5.2.2. Current Charges

Table B shows more specifically local government revenue from current charges as a share of own source revenue (OSR) in all states (incl. District of Columbia). While systematic understanding regarding the shifts in the relative importance of current charges would require data from each year since 2010, the available data suggests reliance on current charges in the USA has increased during the 2010s.

While in 2012 local governments generated on average 22.9 percent of own source revenue from current charges (Sjoquist 2015), in 2018 they generated on average 27.9 percent of own

source revenue from current charges. Reflecting this, in 2012 there was 11 states where current charges generated over 30 percent of own source revenue, but in 2018 this number had increased to 18 states. However, of the 6 states that rely least on user charges and fees, 4 are in New England (U.S. Bureau of Census 2020, calculated by author).

Moreover, in 2018 36 states (incl. District of Columbia) had increased the share of current charges of own source revenue when compared to 2012. Connecticut was among these states by modestly increasing their share from 8.6 percent to 9.4 percent. This was the second lowest share of current charges after District of Columbia (8.6 percent). Wyoming had climbed above Mississippi as the state with the highest share at 54.3 percent.

Table B. Current Charges as a Share of OSR in 2012 and 2018

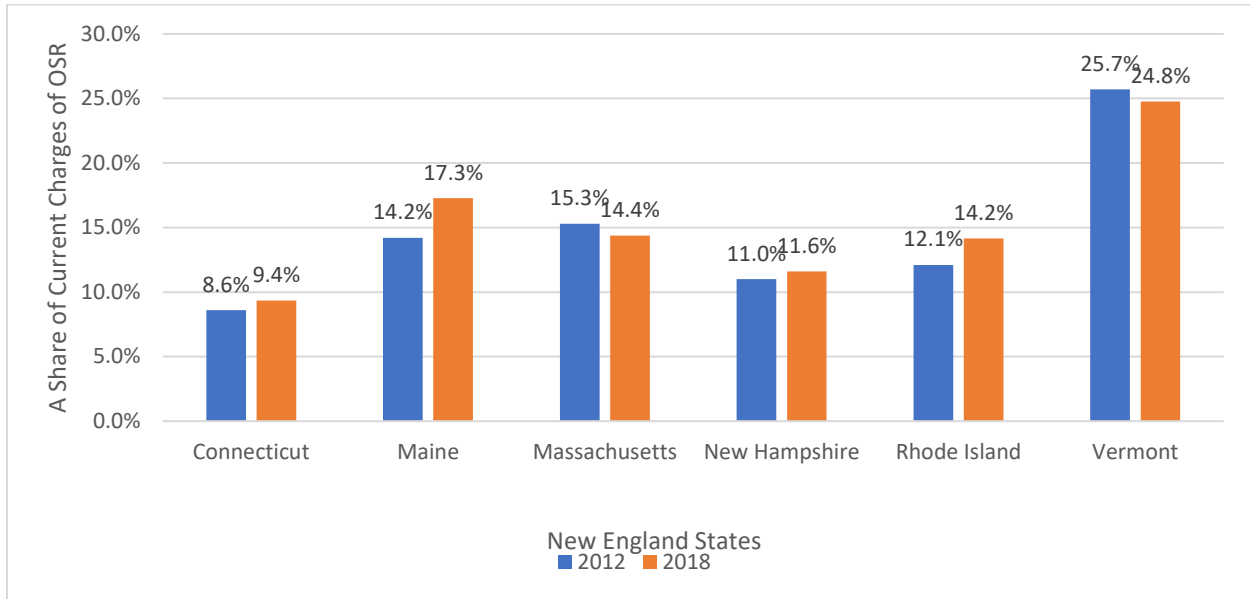
	Current Charges as a Share of OSR in 2012	Current Charges as a Share of OSR in 2018
Wyoming	38.1%	54.3%
Mississippi	51.1%	49.8%
Indiana	37.0%	46.8%
North Carolina	33.3%	45.6%
Alabama	20.0%	42.8%
South Carolina	22.5%	42.3%
Idaho	34.6%	39.0%
Tennessee	33.8%	38.9%
Iowa	32.7%	36.5%
Washington	25.2%	36.1%
Minnesota	29.5%	35.3%
California	29.3%	34.8%
Florida	28.3%	34.7%
Georgia	18.4%	34.2%
Michigan	31.9%	32.8%
West Virginia	26.7%	31.3%
Oklahoma	32.1%	30.5%
Nevada	32.4%	30.1%
Alaska	30.0%	29.5%
Oregon	26.2%	29.4%
Missouri	25.4%	29.4%
Louisiana	26.9%	28.8%
Arkansas	27.8%	28.3%
Kentucky	27.4%	28.3%
Nebraska	25.3%	28.3%
Utah	24.1%	28.2%
Montana	25.8%	27.5%
Kansas	25.0%	26.6%
Colorado	25.7%	26.1%
Delaware	20.5%	26.0%
Vermont	25.7%	24.8%

Wisconsin	22.7%	24.4%
Texas	22.1%	23.9%
Arizona	22.5%	23.4%
New Mexico	23.6%	23.2%
Ohio	22.8%	23.2%
South Dakota	22.0%	22.3%
Hawaii	22.4%	21.8%
Virginia	14.8%	21.6%
Pennsylvania	15.9%	20.6%
North Dakota	20.9%	20.3%
Illinois	16.2%	18.5%
Maine	14.2%	17.3%
Maryland	18.2%	16.7%
New York	14.6%	16.6%
Massachusetts	15.3%	14.4%
Rhode Island	12.1%	14.2%
New Jersey	13.4%	12.9%
New Hampshire	11.0%	11.6%
Connecticut	8.6%	9.4%
District of Columbia	8.5%	8.6%
U.S. Average	22.9%	27.9%

Sources: Sjoquist 2015; 2020 US Bureau of Census, calculated by author

Table C shows local government revenue from current charges as a share of OSR in New England states. While the states of Connecticut, Maine, New Hampshire, and Rhode Island each increased the reliance on current charges in 2018 compared to 2012, Massachusetts and Vermont decreased their reliance. Connecticut’s reliance on current charges was the lowest in New England region on both years (see also Urban Institute 2020 for similar findings in 2017).

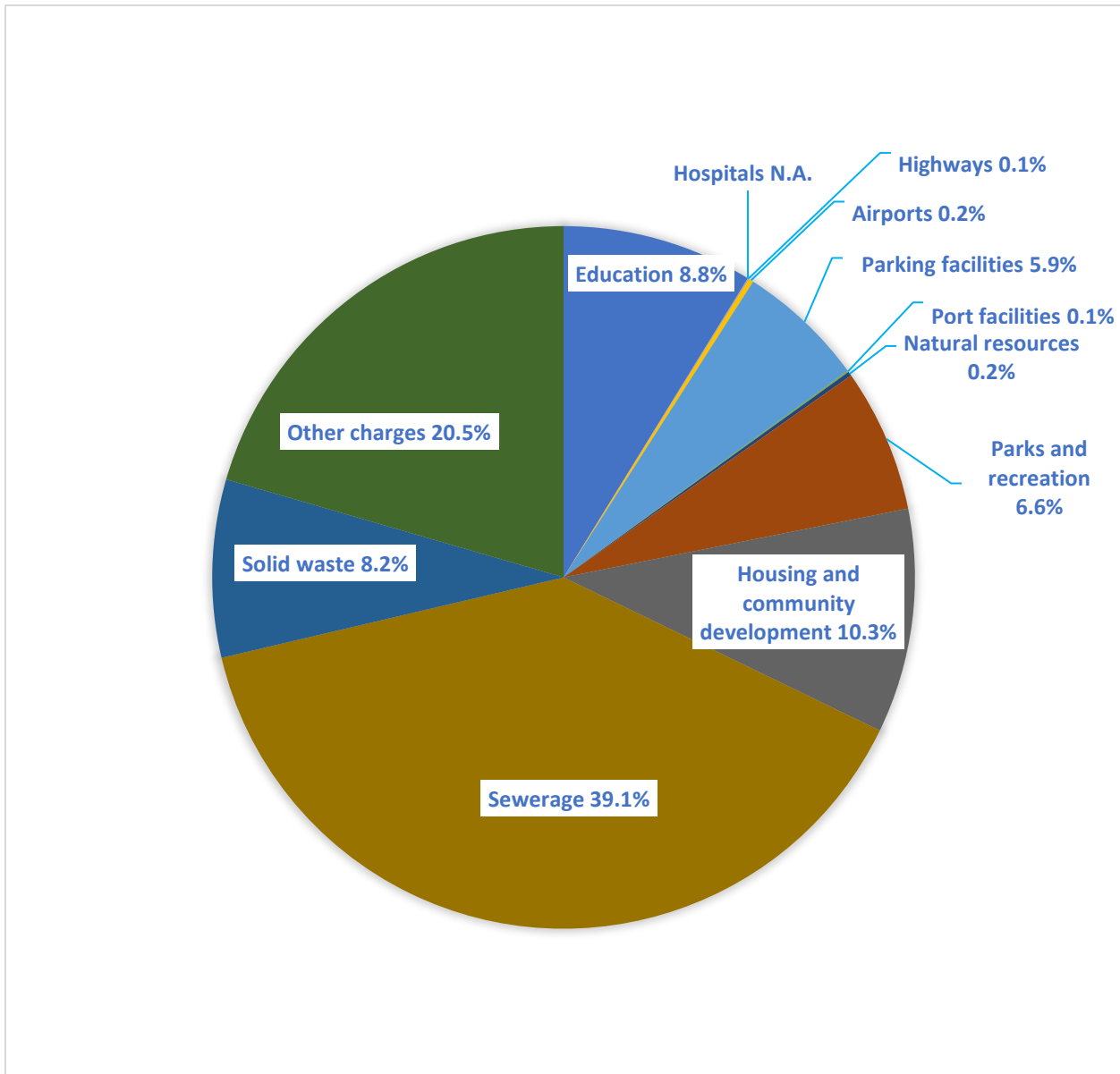
Table C. Current Charges as a Share of OSR in New England, 2012 and 2018



Source: 2020 U.S Bureau of Census, calculated by author

Table D presents a share of each service category of total charges for Connecticut. When compared to 2012 data (Sjoquist 2015), the most significant changes have occurred in education (decreasing from 14.0 percent to 8.8 percent), parks and recreation (decreasing from 10.1 percent to 6.6 percent), housing and community development (increasing from 0.4 percent to 10.3 percent)ⁱⁱⁱ, sewerage (increasing from 34.4 percent to 39.1 percent), and other charges (decreasing from 27.6 percent to 20.5 percent).

Table D. Current Charges as a Share of Total Charges in Connecticut, 2018



Source: 2020 U.S. Bureau of Census, calculated by author

Table E compares same information between Connecticut and the USA. Additionally, table presents the share of the expenditures financed by current charges. In line with 2012 data (Sjoquist 2015), the major sources of local current charge revenue in the USA are hospitals, sewerage and other charges. In Connecticut three largest service categories are housing and community development, sewerage and other charges. Another significant change has occurred in other charges which share had decreased from 27.6 percent to 20.5 percent.

In Connecticut local governments collect almost in all cases a smaller percentage of expenditures through current charges than the average for the USA. Two exceptions are Parks and Recreation, and Housing and Community Development. Just like in 2012 (Sjoquist 2015), there are significant differences across service categories both in the USA and Connecticut in terms of the extent to which current charges in each service category cover the respective local government services. Revenue from parking facilities exceed expenditures on these services both in the USA and Connecticut. Especially education, highways, natural resources, housing and community development had low current charge revenue to expenditure ratios both in the USA and Connecticut.

Table E. Current Charges by Service Category, 2018

Service Category	Current Charges as a Share of Total Charges		Current Charges as a Share of Expenditures	
	USA	Connecticut	USA	Connecticut
Education	7.7%	8.8%	3.3%	1.1%
Hospitals	30.4%	0	85.6%	N.A.
Highways	2.9%	0.1%	12.1%	0.1
(Air transportation) Airports	7.4%	0.2%	88.5%	46.7%
Parking facilities	1.0%	5.9%	142.9%	134.8%
Sea and inland port facilities	1.3%	0.1%	96.4%	75.3%
Natural Resources	0.7%	0.2%	21.6%	15.7%
Parks and recreation	3.2%	6.6%	25.1%	33.1%
Housing and community development	2.1%	10.3%	14.3%	22.2%
Sewerage	19.2%	39.1%	104.25%	71.5%
Solid waste management	6.0%	8.2%	74.5%	49.2%
Other charges	18.1%	20.5%	4.0%	4.8%

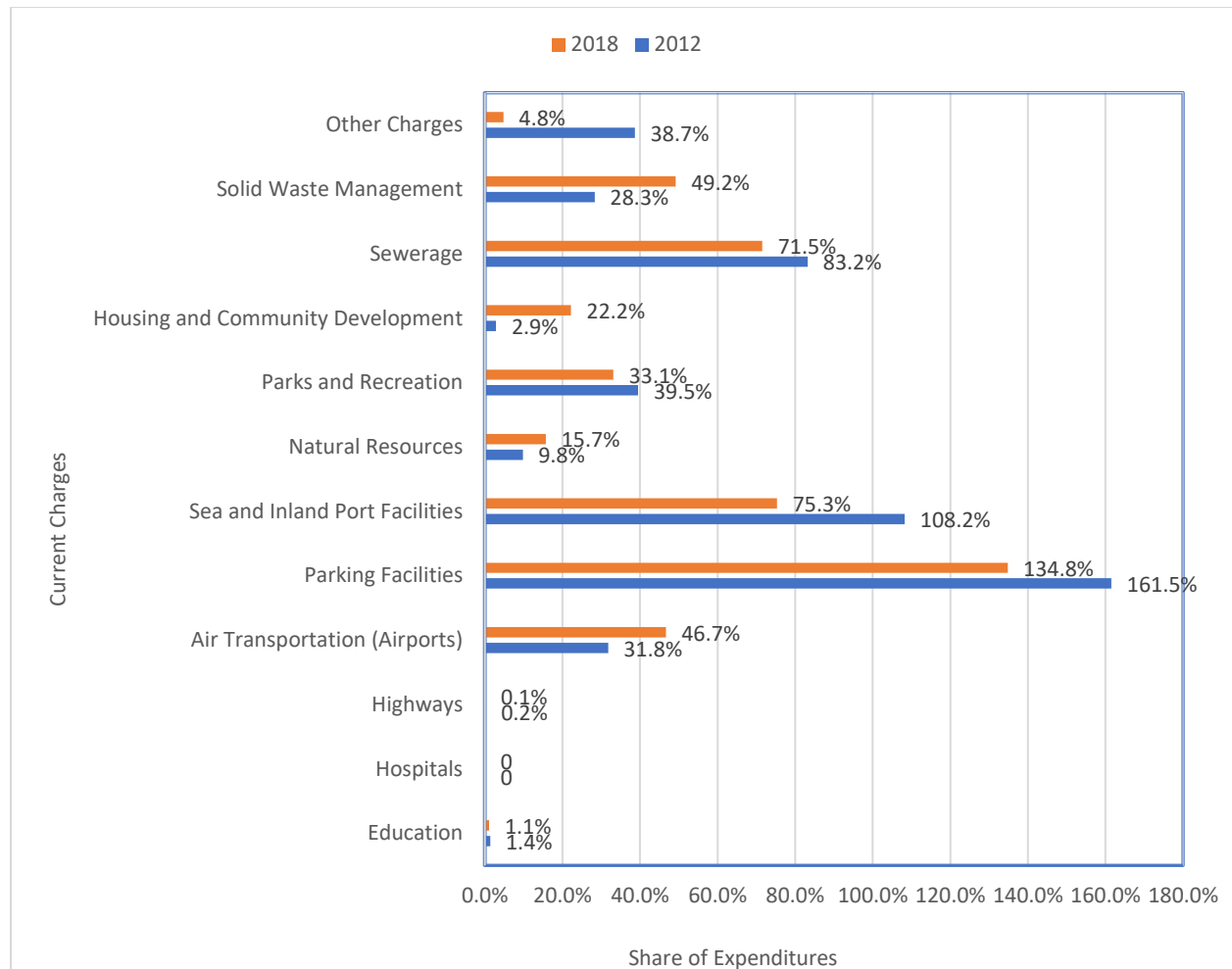
Source: 2020 U.S. Bureau of Census, calculated by author

Table F indicates that when we compare 2012 and 2018 data in terms of the extent to which current charges were used to cover the respective expenditures in Connecticut, some notable changes can be identified. For example, Solid Waste Management increased the coverage from 28.3 percent to 49.2 percent. The most significant drop occurred in Parking facilities. While in

2012 the respective charges covered 161.5 percent of the expenditures, in 2018 they covered 134.8 percent. Another significant drop can be noticed in Sea and Inland Port Facilities.

Significant change in Other charges^{iv} as a share of respective expenditures is likely a result of differences in terms of which expenditure categories were included in calculations. Also, in 2012 Housing and Community Development charges covered 2.9 percent and in 2018 22.2 percent of the expenditures. However, this difference is at least partially a result of either an error in the calculation in Sjoquist (2015) or the original U.S. Census of Bureau data for 2012 included a significant error.

Table F. Current Charges as a Share of Expenditures in Connecticut, 2012 and 2018



Source: Sjoquist 2015; 2020 U.S. Bureau of Census, calculated by author

The available data, unfortunately, does not allow to make comparisons across municipalities in Connecticut, because municipalities do not report their user charges and fees. Furthermore, municipalities may categorize their services differently and charge fees for different services under the same label depending on whether or how they bundle services together. Importantly, the Western Connecticut Council of Governments has started to gather systematic data to create an inventory of user charges and fees within the region (18 municipalities). This gap in data and how to address it is discussed in the Recommendations section.

5.2.3. To Expand or Not to Expand Current Charges in Connecticut?

Previous discussion suggests there is room to increase the relative importance of current charges local revenue systems as a way to diversify revenue sources and reduce the reliance on the property taxes. Two key reasons support this:

- 1) The share of current charges of own source revenue is still relatively low in municipalities in Connecticut when compared to the majority of the U.S. states, and
- 2) A share of current charges in covering the respective expenditures is relatively low in many service categories even when compared to in certain respects similar states.

However, obviously these reasons are not sufficient to make a consequent change in local revenue policies across Connecticut. For this reason, it is important to identify potential reasons for why municipalities' reliance on the current charges continue to remain so low:

- 1) under 10 percent while the U.S. average is almost 28 percent and
- 2) Connecticut also ranks last among other states in New England region.

A brief reminder of the key issues related to the current charges provides a useful platform to address these potential reasons. As already pointed out, the main issue with the current charges is their adverse impact on vertical equity (e.g. UNHabitat 2009; Sjoquist 2015). In other words, "user fees often have a regressive effect: they absorb a higher percentage of lower-

income individuals' or households' income when compared with higher-income individuals or households" (Thompson et al. 2014, 32).

However, we need to remember that public services are not monolithic. Some public services may not involve (at least) direct distributional concerns, and nonresidents (who may not pay local taxes) participate in financing at least some public services through user charges and fees. Also, in case of some recreational services – such as golf – user fees do not subsidize higher income individuals as long as they are the main beneficiaries of a given service. Moreover, user fees may help to prevent the recipients of a service to impose “external costs on society, such as pollution or a safety hazard” (Gillett & Hopkins 1987, 818). In these types of cases well designed user fees seem to be rather uncontroversial policy tools.

Nevertheless, in many cases the current charges imply that lower income families and individuals, indeed, quite likely end up paying a larger percentage of their income than higher income families and individuals. Of course, what the exact percentage difference between income groups is, would vary between services. (Sjoquist 2015) This regressive outcome of, or unfair burden caused by, user charges and fees can be addressed at least to some extent by pricing structure (e.g. ACIR 1987; Thompson et al. 2014).

There are several possible reasons for municipalities' low reliance on current charges in Connecticut:

First, regional as well as state- and local-level historical, political and socio-economic conditions might reduce “the range of goods and services which are considered politically acceptable candidates for user charge financing” (ACIR 1987, 33) when compared to other areas in the USA. This suggests, for example, that once municipalities have made some critical decisions regarding their local revenue systems it is difficult to “step away” from the chosen path. This path dependency may contribute to a long-term status quo in respect to the current charges' relative importance in the local revenue systems.

Second, the state limits the size of the fees that can be charged at least for some services such as the issuance of marriage licenses (Sjoquist 2015, 53).

Third, municipalities do not perform certain services, such as hospital services and public transportation, that local governments provide in other states. (Sjoquist 2015, 53) Importantly, *if the current charges for hospitals is excluded in calculating current charges as a share of own source revenue, the USA average decreases from 27.9 percent to 19 percent based on 2018 U.S. Bureau of Census data. In 2012 the drop was from 22.9 percent to 17.8 percent (ibid.). This alone narrows the gap between Connecticut and the U.S. average quite substantially.*

Fourth, some services are financed as a part of the property tax. Municipalities hesitate to change this, because government officials are concerned that residents would “view the implementation of a charge for waste collection not as a way to reduce property taxes but as an addition payment to the government”, and for that reason “would oppose such a fee” (Sjoquist 2015, 53).

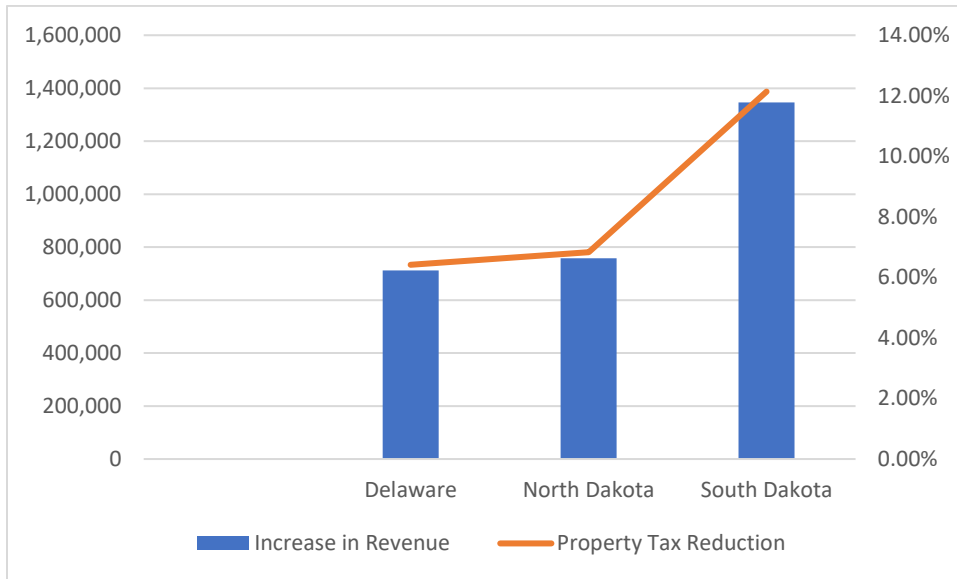
Fifth, officials do not want to increase charges and fees, because they are concerned it would “impose a substantial burden on low-income households” (Sjoquist 2015, 53).

Sixth, because Connecticut does not have geographically large cities, opportunities are limited to collect user charges and fees (Sjoquist 2015, 53).

However, Sjoquist (ibid.) estimated that while Delaware, North Dakota and South Dakota do not have large cities, they nevertheless ranked in 2012 much closer to the U.S. average than Connecticut in terms of current charges as a share of own source revenue. Similar calculation based on 2018 U.S. Census data supports this. In contrast to Sjoquist I did not include hospitals to my calculation since they do not generate revenue for local municipalities in Connecticut.

Even with this change, Table G shows that if Connecticut would increase its local “revenue from current charges to cover the same percentage of expenditures in each expenditure category as” (Sjoquist 2015, 54) Delaware, North Dakota, and South Dakota, increase in revenue could be between around \$700 million and \$1,300 million. This would imply around 6 percent – 12 percent reduction in the property taxes.

Table G. Potential Increase in Revenue (\$) and Decrease in Property Tax (%), 2018



Source: 2020 U.S. Bureau of Census, calculated by author

Thus, Table G further supports that raising more revenue from user charges and fees to reduce the reliance on the property taxes, other things being equal, is a real possibility in Connecticut. This is a significant finding when it is remembered that the local revenue systems in Connecticut violate, according to Bell (2015, 3), two significant financing criteria because of exempting certain properties – such as nonprofits - from paying the property taxes.

First, these two criteria are:

- i. “taxes should be designed to avoid unintended interference with private economic decisions”, and

ii. “the structure of the tax system should treat taxpayers in similar circumstances similarly” (ibid.).

Second, these criteria are violated because property tax

i. exemptions provide “an incentive to buy more real property, or more expensive real property, than would be the case” (ibid.) without exemptions, and

ii. exemptions imply “a smaller tax base requiring a higher tax rate to collect a given amount of revenue resulting in higher taxes...than they would pay if the property tax had a broader tax base and collected the same revenue with a lower tax rate. As a result, two similar properties, one exempt the other not, are not treated equally” (ibid.).

Based on this, Bell (ibid., 4) argues that “if Connecticut is to address the economic efficiency and equity concerns associated with exempting individual properties from paying property taxes, it will need to consider options for collecting revenues from the individual exempt property owners”. While there are many potential policy responses to address this (see e.g. Bell 2015) such as lower property tax mill rates for nonprofits or fully funded PILOT programs, user charges and fees offer another option to address these violations (see e.g. Kenyon & Langley 2011a, 5). However, as discussed in the Background section (see Figure A, page 11) user charges and fees alone should not be expected to be ideal policy tools to address all the systematic problems in local revenue systems.

6. POLICY OPTIONS

How should municipalities reform their user charges and fees policies?	Option A: Continue status quo	Option B: Improve conditions for policy learning and innovation	Option C: Increase prices for existing user charges and fees	Option D: Adopt new user charges and fees
Criteria 1: Efficiency	No	Likely	Likely	Likely
Criteria 2: Equity	No	Depends largely on the pricing structure	Depends largely on the pricing structure	Depends largely on the pricing structure
Criteria 3: Reliability	Stability: no Certainty: yes Sufficiency: no	Stability: yes Certainty: yes Sufficiency: no	Stability: yes Certainty: no Sufficiency: no	Stability: yes Certainty: no Sufficiency: no
Criteria 4: Competitiveness	No	Likely yes	Likely yes	Likely yes
Criteria 5: Simplicity	Neutral	Yes	Neutral	No
Recommend?	No	Yes	Yes	Yes

Evaluating whether user fees and charges are efficient is a complex task due to, for example, differences in how heavily a public service is used, how large a group is using a service, or whether providing a service for one additional user would cost anything. Given that currently the user fees in majority of the service categories do not cover the respective costs, the least desirable option is to continue status quo (Option A).

In terms of equity the key question is different policy options would affect horizontal equity. Whether the current system (exceptionally low reliance on the current charges) would be more or equitable than other policy options, depends largely on the pricing structure of the current charges. The recommendations in this report (Chapter 7) are based on assumption that all the changes to the current system would be designed so that they would, whenever possible, increase vertical equity.

Reliability consists of three sub-criteria i.e. stability, certainty and sufficiency. Exceptionally low reliance on the current charges (Option A) does not enhance fiscal stability. In this respect other

policy options would be more desirable options since they each are aimed to increase a share of the current charges of own source revenue. In terms of certainty, Options C-D would create short-term uncertainty as they would alter the current status quo by increasing the current prices and/or by introducing new user fees and charges. Local governments are able to tackle this issue by investing in how they communicate changes to the taxpayers. Option B would likely increase certainty among local governments by increasing understanding of the current state of affairs in respect to user fees and charges across Connecticut (see Recommendation f). None of the options would meet the criterion of sufficiency.

Options B-D have potential to increase competitiveness by reducing the current overreliance on the property taxes and, thus, helping to change a general perception of Connecticut as a State where the property taxes are exceptionally high. In general, user fees and charges are less visible payments than the property taxes.

Option B could increase simplicity at the state level by making transparent what type of user fees and charges municipalities are currently using. This could enhance convergence between municipalities though it is, of course, likely that differences would prevail given, for example, fiscal disparities between municipalities. The affects of Options A and C would be neutral. Option D would increase complexity by introducing new user charges and fees.

7. POLICY RECOMMENDATIONS

The State of Connecticut is one of the most visible national outliers in terms local revenue systems' overreliance on the property tax. The following recommendations are aimed to tackle this persistent policy problem. The aim of these recommendations is to offer local governments policy tools to decrease their reliance on the property taxes as a way to make their local revenue systems more balanced and diversified. While a revenue reform based on increasing the role of the current charges would not create sufficient conditions to eliminate Connecticut's structural challenges, it has a potential to i. ease taxpayer discontent over high property taxes,

ii. increase revenue stability, and iii. address income disparities. However, this will require systematic attention on, for example, how the pricing structure of user fees and charges are designed. Without systematic attention on pricing, increased reliance on user fees and charges could have regressive effects.

Furthermore, increased revenue from the user fee reform could be used to, for example, reform the motor vehicle tax (e.g. a statewide cap or uniform mill rate). This would address especially horizontal equity issues caused by the current motor vehicle property tax system. Furthermore, statewide mill rate reform could be combined with a higher valuation of antique cars.

a) Establish stormwater utilities

Adopting user charges and fees that would be paid also by nonprofits would help to address inequitable property tax burdens. One such example is stormwater drainage fee. Municipal stormwater systems have been funded traditionally by property taxes, but this model has been replaced in a growing number of localities across the USA by stormwater drainage fee for using stormwater infrastructure (Rogers & Rhodes-Conway 2014, 153). Stormwater utilities can be organized by each municipality (as is already done in New London, CT), but there also exist regional models (see UCONN 2019; MAPC 2018; Waterworld 2008).

There are several benefits associated to stormwater drainage fee. First, it would help local governments meet the requirements of MS4 stormwater permit that ensures stormwater is clean before it enters streams and rivers. Second, it provides reliable and predictable “funding source for maintenance, upgrades, and regulatory costs” (UCONN 2019) of controlling overflows and runoffs. The amount of fee is commonly based on square footage of impervious surface area. This implies that large buildings (e.g. industrial and commercial facilities) and parking lots, which burden the stormwater system disproportionately, would pay their fair share. (Rogers & Rhodes-Conway 2014) Reflecting this, it is argued that fee-based stormwater system

would provide “an equitable and flexible distribution of cost” (UCONN 2019; also Rhodes & Conway 2014). Fourth, all, including tax-exempt, properties would pay stormwater drainage fee – just like they pay for water and electricity - as is the case, for example, in New London (see UCONN 2019).

Despite of these benefits, the pricing structure requires careful planning: “When too much of the cost burden is placed on residential customers, stormwater fees can quickly lose traction and support. In Detroit, for example, an increase in residential storm-water fees left many of the city’s low-income families unable to pay their monthly water bill. As a result, many of these residents had their water turned off. This serves as an example of what can happen when the structure of storm-water fees is not carefully considered. To address the impact of a storm-water fee on low-income customers, cities have developed a variety of assistance programs to help low-income customers pay their storm-water bills.” (Rogers & Rhodes-Conway 2014, 154)

b) Consider breaking out services from the property tax structure

Municipalities should review their property tax structures to identify if any such service is included that could be broken out of the property tax. After this municipalities should analyze if it would be more desirable to cover the cost of the respective service by user fee instead of charging it as a part of the property taxes.

c) Reexamine the existing user fees

The available data suggests that many of the municipalities’ current charges do not cover full costs of the respective services. Municipalities should reexamine their existing user fees to identify especially those fees that cover least of the costs.

One example, even if not fiscally the most urgent one, is a statewide reexamination of dog licenses, since the existing data shows that the existing system causes statewide financial

losses. There are multiple ways to address this unwanted situation: extend the duration of license (e.g. three years to match rabies shot); adopt a statewide software to search for lost dogs; have vets to issue a statewide tag for a fee, or make a statewide contract with the private sector. This is an illustrative example of what benefits efficiently conducted reexamination of the existing current charges might provide for local governments.

There are also other public services that are worthy of a closer examination: consider changing a pricing structures for services such as trash collection. For example, a unit-based trash collection fee would encourage recycling. This is an important example since all localities have to identify ways to enhance their ecological sustainability due to on-going climate crisis.

d) Consider user fees for electric vehicles

As motor vehicles have become much more fuel-efficient when compared to previous century and electric vehicles are increasing their popularity among population, fuel taxes are increasingly inefficient tool to collect revenue for municipalities and states (Rogers & Rhodes-Conway 2014, 157-158). Under these trends and conditions, a road use tax based on mileages for electric vehicles and, alternatively, kwh tax for electric vehicles have started to emerge as considerable policy tools for local governments. The latter, less known option, is fundamentally an electric counterpart to the gas tax. A road usage tax is more privacy intrusive than a kwh tax, while a kwh tax is not based as accurately as a road usage tax on the actual use of the roads (cf. vehicle miles traveled fee vs. gas tax). Both these policy tools would serve the purpose of paying for local road maintenance and construction. Furthermore, these tools could be combined with a) a uniform statewide mill rate for motor vehicles and, b) elimination of the antique car discount.

Probably the most common argument against these policy tools is that they disincentivize people to buy electric vehicles. One counterargument to this is that as the popularity of electric vehicles increases so does a need to find policy solutions to how to finance the maintenance

and the construction of local roads. Moreover, it is estimated that electric cars might become less expensive option, even without subsidies, than equivalent petrol and diesel models between 2023 and 2025. The main reason for this is falling battery prices (e.g. Bloomberg 2020; Carrington 2021).

e) Consider user fees for school activities

School activities such as sports and arts programs play an important role in students' physical, emotional, and cognitive development. Hence, when considering school activity fees, it is important to evaluate different pricing models for these fees as a way to enhance equity of participation among all the ethnic, and socio-economic groups. Options to address vertical equity issues include, for example, waivers and scholarships. (see Mostafavi 2016) Since school activities create short- and long-term external benefits for the children, their families and a broader society, municipalities should consider fee-levels that would be below the costs.

f) Design a statewide reporting system regarding municipalities' user charges and fees

Set aside funds to design a statewide reporting system to gather consistent information on what user fees municipalities are charging, and how they are designed including their pricing structure. Transparent, comprehensive, and annually updated information could enhance policy learning and innovation between municipalities (benchmarking) which, in turn, could help them to improve local revenue systems in their unique socio-economic conditions due to increased information on how to improve the design of already implemented fees, what kind of new user fees there could be available or if it would be plausible and desirable to replace some user fee with a better one. Also, systematic reporting would likely help to analyze to what extent the municipalities charge different user fees as a part of their property taxes and would it more reasonable to cut off these user fees from the property taxes. To advance this recommendation, it would be important to design incentives for municipalities to submit systematic and consistent annual reports.

8. CONCLUSION

This report concentrated in analyzing the current level of revenue diversity in municipalities across Connecticut. The existing data suggests that the relative importance of the current charges in the local revenue systems is a plausible way to decrease exceptionally high overreliance on the property taxes. The recommendations of this report are in line with the policy goal of reducing reliance on the regressive property tax system. However, user charges and fees may impact negatively especially vertical equity. For this reason, it is highly important to examine and design such pricing structures that would not affect negatively vertical equity.

This type of diversification alone is not, of course, capable of solving persistent structural problems such as slow economic growth, inequities, and population shrinkage. Nevertheless, if this diversification strategy is implemented so that the lower income people would have more income for consumption than previously, that could affect economic growth positively. The current economic thinking increasingly emphasizes that low-income people “tend to spend a higher proportion of their income than the wealthy, who are more likely to save. So improving the earnings of poorer people has a much larger impact on consumption and aggregate demand, and therefore growth, than raising the income and wealth of the relatively well off” (OECD 2020, 16).

Moreover, the full assessment of the efficiency and equity implications of the suggested recommendations of this paper need to be done in relation to the overall revenue system as well as trends in intergovernmental transfer systems. With this in mind, I hope this report is in line with the idea of *Connecticut Cohesion* as articulated in 2015 Tax Panel report (CTP 2015, 1). Indeed, a non-technical and a broader meaning of any local revenue system as “an expression of community relationships – between individuals and between the people and their government” (ibid) is an important insight. Local revenue systems have potential to enhance social cohesion if they are based on fair revenue collection. The latter, in turn, can be enhanced if municipalities would have more local autonomy in diversifying their fiscal tools.

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ⁱ “Consequently, these fees could be challenged as unauthorized taxes. But courts in other states have upheld such fees if they: 1. were charged in exchange for a service that benefits only the party receiving the service, 2. were imposed on a service a party can choose not to receive, and 3. covered only the cost of delivering the service (McQuillin, *Municipal Corporations*, § 44:24).” (Rappa 2014, 3)

ⁱⁱ The Index was calculated by taking into account the following revenue sources: property tax, general sales tax, specific selective sales taxes, personal income taxes, corporate income taxes, other taxes, motor vehicle licenses, current charges and miscellaneous revenue. This is slightly different method than used by Sjoquist (2015) and should not change much the rankings of states. For more details, see Sjoquist (2015, Appendix A).

ⁱⁱⁱ However, either the calculation in Sjoquist (2015) included an error or the original U.S. Census of Bureau data for 2012 included a significant error.

^{iv} Based on email communication with the U.S. Bureau of Census and their 2006 Classification book, the used expenditure categories to match Other Charges include libraries, public welfare, health, Police Protection, Fire Protection, Correction, Protective Inspection, Financial Administration, Judicial and legal, General public buildings, Other governmental administration, Miscellaneous commercial activities and Other and unallocable.