Taxing Simply

District of Columbia Tax Revision Commission

Taxing Fairly

Full Report

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CHAPTER M

Nontax Revenues in the District of Columbia: Current Practices and Future Prospects

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Introduction

A recent catalogue of user fees in the District listed 1,971 different fees. Yet the common perception is that user fees account for a relatively small share of District revenues. The purpose of the first part of this chapter is to explore this apparent paradox by addressing the following questions:

- To what extent does the District rely on user fees and other nontax sources as a means of generating own-source revenues?
- How does the District's reliance on user fees and other nontax revenue sources compare with that of neighboring states and other local governments?
- To the extent the District utilizes such revenue sources to a lesser degree than other competing jurisdictions, what factors contribute to the apparent underutilization of such revenue sources?

Once we have a better understanding of the current situation, we explore whether, and to what extent, the District should increase its reliance on nontax revenue sources and identify opportunities to accomplish that objective.

Nontax revenues in the District

There is a common perception that the District generates about 5 percent or 6 percent of its own-source revenues from user fees and miscellaneous nontax revenues. For example, O'Cleireacain shows that the District generated $196.6 million from fees and miscellaneous revenues in the 1995 fiscal year — 6 percent of total discretionary revenues.[1] Similarly, data in the District's *Comprehensive Annual Financial Report* indicate that licenses, permits, fines and forfeits, court fees, interest, and other miscellaneous revenues typically account for between 5 percent and 6 percent of the District's General Fund revenues (Figure M-1).

Figure M-1

D.C. General Fund Local Source Revenues Shares

	1996	1995	1994	1993	1992	1991
Business licenses	0.9%	0.9%	0.9%	0.8%	0.7%	0.5%
Nonbusiness permits	0.6	0.5	0.6	0.6	0.6	0.5
Fines and forfeits	1.2	1.3	1.5	1.5	1.6	1.7
Court fees	0.2	0.2	0.2	0.2	0.2	0.2
Interest	0.4	0.6	0.2	0.2	0.7	0.8
Other	2.1	2.5	2.6	2.2	2.5	2.2
Nontax revenues as share of total revenues	**5.4%**	**6.1%**	**5.9%**	**5.4%**	**6.3%**	**5.8%**

Note: Due to rounding, figures may not add to exact totals.
Source: D.C. Comprehensive Annual Financial Report.

Although appearing to place a comparatively low reliance on nontax revenue sources relative to other state and local governments, the District lists nearly 2,000 fees and charges. There may be several reasons why the District has so many fees and charges, while having relatively low revenues. First, many of the items on the list may exist in legislation, but may not be collected. In fact, for a large number of the fees listed there is a zero fee rate. Second, even if a fee has a nonzero rate, it may not be collected. As a result, the number of user fees and the amount of revenue collected "... should not be considered reliable financial statements, because the individual collections are not monitored or comprehensively matched to receipts."[2]

Examining up to 2,000 individual fees and how their rates are determined, analyzing collection rates and practices, and evaluating their general administration is beyond the scope of this study. The Department of Consumer and Regulatory Affairs is responsible for the bulk of individual fees and would have to be involved in any fee-by-fee analysis.

Our goal is to provide a comprehensive perspective of the District's actual reliance on nontax revenues, compare the relative importance of nontax revenues in the District with that in other jurisdictions, identify differences that might exist between the District and other jurisdictions, and analyze why such differences might exist. This section examines, in a more systematic and comprehensive manner, the hypothesis that the District relies on user fees and other nontax revenues to a lesser extent than other state and local governments. The next sec-

tion discusses factors that influence the extent of the District's reliance on nontax revenues.

It is very difficult to make fiscal comparisons between the District and other jurisdictions, be they states or local governments. First, although the District has all of the social and spatial characteristics of a municipal government, it has the revenue-raising and service-delivery responsibility of a state — making it difficult to interpret fiscal comparisons with other municipal governments.

Second, the District, like most municipalities in the Northeast, has a high concentration of low-income residents and a very skewed distribution of income. Again, fiscal comparisons between the District and states, which typically have a less skewed distribution of income and a more balanced composition of population, can be difficult to interpret. For example, the District may receive a smaller share of the costs of running its public hospitals from patient charges than Virginia, in part because the population using the District's public hospitals may have a higher concentration of poor who cannot afford to pay for the services provided.[3]

Another problem that arises in making comparisons between the District and other state and local governments — and even comparing state and local governments to each other — is that each government has its own budget definitions, classifications, and reporting requirements. Thus, data on actual revenues from annual budgets or financial reports for different jurisdictions cannot be compared easily in the aggregate, and any such comparisons may lead to incorrect or misguided conclusions.

Census data and interjurisdictional comparisons

To make comparisons between the District and other state and local governments, we need data on actual revenues collected that utilize the same definitions and reporting conventions across jurisdictions. The Governments Division of the U.S. Census Bureau constructs and reports such data in its annual report *Government Finances*. In the discussion below, we use data from *Government Finance* (1994) — the most recent data available from the Census Bureau — to compare the District's reliance on nontax revenues with other jurisdictions.

Since we are reporting Census Bureau data, we must use their definitions. The Census Bureau starts by defining general revenue as all revenue of state and local governments except those from liquor stores, utilities, or insurance trust funds. So a jurisdiction's total revenue equals general revenue plus liquor store, utility, and insurance trust revenues.

A jurisdiction's general revenues are divided into four major categories: 1) taxes; 2) intergovernmental; 3) current charges; and 4) miscellaneous general revenues. The Census Bureau defines taxes to be "… compulsory contributions exacted by a government for public purposes."[4] The important features of this definition are that taxes are compulsory and that they are *for public purposes.*

Figure M-2

District of Columbia Revenues
1994 ($ Millions)

Total revenue	**$6,432.1**
General revenue	5,629.3
Intergovernmental	2,566.9
Own source	3,062.4
Taxes	2,523.4
Charges	271.5
Misc. general	267.5
Utility/liquor store	376.0
Insurance trust	426.1

Note: Due to rounding, figures may not add to exact total.
Source: U.S. Census Bureau.

Therefore, the Census Bureau classifies as license taxes:

- licenses for manufacturing, importing, wholesaling, and retailing of alcoholic beverages;
- licenses imposed on owners or operators of motor vehicles for the right to use public highways, such as fees for title registration, license plates, vehicle inspection, and vehicle mileage and weight taxes on motor carriers;
- licenses for the privilege of driving motor vehicles, both commercial and private; and
- licenses (including examination and inspection fees) required from persons engaged in particular professions, trades, or occupations.

Revenues from all these sources are included under tax revenues by the Census Bureau because of the compulsory nature and public purpose of the payment. These revenues generally can be thought of as regulating fees, with the primary purpose of protecting the public from fraud, deception, and incompetence. Because the benefits of licensing and regulation accrue primarily to citizens in their roles as consumers, it is more useful analytically to view such license fees as taxes, not user charges.[5] Such revenues are *not* included in this paper as nontax revenues.

Using this definition of taxes, the District's nontax revenues are simply its total revenues minus its tax revenues. In 1994, the District relied on taxes for 39 percent

Figure M-3

Revenue Sources as Shares of Total Revenue
1994

	D.C.	Md.	Va.	U.S.
Total revenue	**100%**	**100%**	**100%**	**100%**
General revenue	88	86	86	83
Intergovernmental	40	14	12	16
Own source	48	72	74	66
Taxes	39	55	52	47
Charges	4	10	15	12
Misc. general	4	7	8	7
Utility/liquor store	6	2	4	5
Insurance trust	7	12	9	12

Note: Due to rounding, figures may not add to exact totals.
Source: U.S. Census Bureau.

of its total revenue and nontax sources for 61 percent of the total (Figure M-3). The District's reliance on nontax revenues is high, higher than for combined state and local governments in Maryland (45 percent), Virginia (48 percent), and the United States as a whole (53 percent) (Figure M-3).[6]

Such a broad definition of nontax revenues, however, may not be useful for District policymakers. For example, 40 percent of the District's total revenue, and two-thirds of its nontax revenues, are intergovernmental revenues. These are revenues transferred from the federal government to the District for specific purposes. Excluding intergovernmental revenues, the District receives a smaller share of its total revenues from nontax revenues (35 percent) than combined state and local governments in Maryland (37 percent), Virginia (41 percent), and the United States (44 percent).

One final adjustment is required: The Census Bureau defines *insurance trust revenues* as "amounts derived from contributions, assessments, premiums, or payroll taxes required of employers, employees, and others to finance compulsory or voluntary social insurance programs operated by the public sector. …"[7]

Thus, for the purposes of this paper, we omit revenues from insurance trusts. For policy purposes, we are left with examining the relative importance of utility/liquor store revenues, miscellaneous general revenues, and charges. This is a much broader definition of charges and miscellaneous revenues than reported in Figure M-1 (page 512), which refers only to a limited number of General Fund revenues. The data in

Figure M-4

Utility Revenue, 1994

$ Millions

	D.C.	Md.	Va.	U.S.
Water supply	$53.1	$267.2	$566.3	$22,691.6
Electric power	n/a	17.1	206.0	33,807.6
Gas supply	n/a	n/a	134.5	3,712.5
Transit	323.6	103.1	39.9	6,256.3
Total	**$376.7**	**$387.3**	**$946.6**	**$66,468.0**

Per $1,000 Personal Income

	D.C.	Md.	Va.	U.S.
Water supply	$2.90	$2.20	$3.90	$4.10
Electric power	n/a	0.10	1.40	6.00
Gas supply	n/a	n/a	0.90	0.70
Transit	18.10	0.80	0.30	1.10
Total	**$21.10**	**$3.10**	**$6.45**	**$11.90**

Note: Due to rounding, figures may not add to exact totals.

Source: U.S. Census Bureau.

Figure M-3 indicate that the District's reliance on these three sources of nontax revenue (14 percent of total revenue) is less than the combined state and local governments in Maryland (19 percent of total revenue), Virginia (27 percent of total revenue), and the United States (24 percent of total revenue). The next three sections look at each of these sources of nontax revenue in more detail.

UTILITY AND LIQUOR STORE REVENUES

The Census Bureau defines utility revenues as "gross receipts from sale of utility commodities or services to the public or other governments by publicly-owned and controlled utilities."[8]

According to the data in Figure M-3, the District actually generates a larger share of its total revenue from utility and liquor store revenue (6 percent) than combined state and local governments in Maryland (2 percent), Virginia (4 percent), or the United States (5 percent) — in spite of the fact that the District is the

only jurisdiction among this group that does not generate any revenue from liquor store operations.

Figure M-4 presents information on the various components of utility revenue. According to this data, 86 percent of the District's utility revenue comes from the public transit category. The public transit category includes all revenues for the regional transit authority, thereby overstating the District's utility revenue significantly, because the Census Bureau does not have the capacity to allocate these totals among the three jurisdictions served by the regional transit authority. The only other category where the District generates any utility revenue is in the water supply category. However, this category accounts for only about 14 percent of the District's utility revenue, compared with nearly 35 percent for combined state and local governments nationally, and nearly 60 percent and 70 percent for combined state and local governments in Virginia and Maryland, respectively.

Miscellaneous general revenues

The Census Bureau defines miscellaneous general revenues to include "… revenues which do not fall into one of the above tax, intergovernmental revenue or current charges categories."[9]

The major components of miscellaneous general revenues include:

Special assessments. Compulsory contributions and reimbursements from owners of property who benefit from specific public improvements and impact fees to fund extension of water, sewer, roads, and other infrastructure facilities in new developments.

Sale of property. Includes amounts received from sale of real property, buildings, improvements to them, land easements, rights of way, and other capital assets.

Interest earnings. Amounts from interest on all interest-bearing deposits and accounts, accrued interest on investment securities sold, interest on funds held for construction, and interest related to public debt for private purposes.

Fines and forfeits. Receipts from penalties imposed for violations of law, civil penalties, court fees, and forfeits of deposits held for performance guarantees or against loss or damage.

Rents and royalties. Compensation for temporary possession, use, or development of a building, land, other property, or a right.

Net lottery. Proceeds from the operation of government-sponsored lotteries after deducting the cost of prizes.

Figure M-3 shows that the District receives a smaller share of its total revenue from miscellaneous general revenue sources (4 percent) than combined state and local governments in Maryland (7 percent), Virginia (8 percent), or the United

Figure M-5

Miscellaneous General Revenue, 1994

$ Millions

	D.C.	Md.	Va.	U.S.
Interest earnings	$61.1	$751.2	$1,017.7	$48,676.7
Special assessments	2.5	103.4	2.8	2,989.5
Sale of property	8.3	5.9	11.2	765.6
Other general revenue	195.5	906.7	1,045.0	45,871.2
Total	**$267.5**	**$1,767.2**	**$2,076.7**	**$98,303.0**

Per $1,000 Personal Income

	D.C.	Md.	Va.	U.S.
Interest earnings	$3.54	$6.33	$7.28	$9.08
Special assessments	0.15	0.87	0.02	0.56
Sale of property	0.48	0.05	0.08	0.14
Other general revenue	11.33	7.63	7.47	8.56
Total	**$15.50**	**$14.88**	**$14.85**	**$18.34**

Note: Due to rounding, figures may not add to exact totals.
Source: U.S. Census Bureau, 1993/1994 data.

States (7 percent). Nearly three-fourths of the District's miscellaneous general revenue is classified as "other general revenue," which primarily represents lottery revenues (Figure M-5). The pattern of interest earnings also stands out. Combined state and local governments in Maryland, Virginia and the United States generate between 43 percent and 50 percent of their miscellaneous general revenues from interest earnings, while the District earns just 23 percent of its own miscellaneous general revenues.

CURRENT CHARGES

The Census Bureau defines current charges to include "amounts received from the public for performance of specific services which benefit the person charged, and from sale of commodities or services other than utilities and liquor stores … . Charges are distinguished from license taxes, which are privileges granted by a government or fees collected to finance regulatory activities."[10]

Figure M-6

State Current Charge
by Category per $1,000 Personal Income

	D.C.	Md.	Va.	U.S.
Current charges	**$15.73**	**$20.75**	**$28.60**	**$30.07**
Education	0.85	8.21	9.98	8.30
Higher education	0.73	6.79	8.71	6.91
School lunch sales	0.10	0.60	0.93	0.75
Hospitals	4.14	1.00	7.39	8.25
Airports	0.00	0.71	0.72	1.32
Parking facilities	0.80	0.46	0.14	0.20
Water transport	0.00	0.35	0.03	0.33
Natural resources	0.00	0.12	0.07	0.39
Parks and recreation	1.19	0.67	0.50	0.80
Housing and community development	1.12	0.74	0.47	0.63
Sewerage	4.06	3.68	3.46	3.42
Solid waste management	0.17	1.63	1.82	1.53
Other charges	3.40	1.93	2.50	3.93

Note: Due to rounding, figures may not add to exact totals.
Source: U.S. Census Bureau, 1993/1994 data.

The important characteristics of current charges are that payments are made for a service or benefit received and are usually made by the person or group consuming the service or realizing the benefit.

The District generates a smaller share of its total revenues from current charges (4 percent) than combined state and local governments in Maryland (10 percent), Virginia (15 percent), or the United States (12 percent) (Figure M-3, page 515). Similarly, current charges account for a smaller share of District own-source revenues (9 percent) than combined state and local governments in Maryland (14 percent), Virginia (20 percent), or the United States (18 percent).

Figure M-6 lists the major components of current charges and their relative importance in the District and for combined state and local governments in Maryland, Virginia, and the United States. The District receives:

Figure M-7

Relative Importance of Nontax Revenues
1994

General Own-Source Revenue	D.C.	Baltimore	Boston	Indianapolis	Jacksonville	San Francisco
Taxes	83%	76%	71%	69%	48%	52%
Property taxes	27	53	66	56	31	26
General sales taxes	16	0	0	0	6	5
Selective sales taxes	10	5	3	3	10	1
Individual income taxes	27	14	0	7	0	0
Current charges	9	11	22	26	23	32
Miscellaneous general revenues	8	13	8	5	29	17

Source: U.S. Census Bureau.

- $4 per $1,000 personal income for hospital services, much lower than in Virginia or the United States, but much higher than in Maryland, which does hot have publicly operated and funded hospitals.[11]
- no current charges from highways, because it does not have toll roads like Maryland, Virginia, and other states;
- no current charges from water transport or airports, as there is no port in the District and none of the regional airports are within its boundaries;
- no current charges from natural resources because the District has no agricultural, forestry, or mineral resources;
- an above-average share of personal income paid for parks and recreation services, housing and community development, and sewerage; and
- a significantly smaller share of personal income paid for solid waste management than paid for by other governments.

Similar patterns are found when the District is compared to other municipal governments.[12] For example, Figure M-7 indicates that the District's reliance on cur-

Figure M-8

City Current Charge

by Category per $1,000 Personal Income

	D.C.	Baltimore	Boston	Indianapolis	Jacksonville	San Francisco	Seattle
Current charges	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Education	5	4	1	0	0	0	0
School lunch	1	4	1	0	0	0	0
Other local charges	0	1	0	0	0	0	0
Higher education	5	0	0	0	0	0	0
Highway	0	1	0	0	0	0	0
Hospital	26	0	37	25	0	25	0
Sewerage	26	48	45	22	39	19	40
Solid waste	1	13	0	9	14	0	34
Parks and recreation	8	5	0	6	1	7	11
Housing and community development	7	0	2	1	2	1	0
Airports	0	0	0	24	15	31	0
Water transportation	0	0	0	0	14	5	0
Parking facilities	5	16	5	1	2	4	6
Miscellaneous commercial activity	0	6	0	0	0	0	0
Other	21	6	8	11	13	8	9

Note: Due to rounding, figures may not add to exact totals.

Source: U.S. Census Bureau.

Figure M-9

Current Charges Revenues as Share of Expenditures
by Category and State

	D.C.	Md.	Va.	U.S.
Education	2.0%	13.8%	15.8%	12.6%
Higher education	12.4	41.9	51.4	40.8
Hospitals	21.4	37.6	83.8	67.9
Highways	0.0	13.1	5.3	7.2
Airports	n/a	100.0	66.0	75.1
Parking facilities	507.9	217.9	187.9	147.8
Water transportation	n/a	68.2	12.7	67.9
Parks and recreation	32.1	19.7	20.4	25.8
Housing and community development	8.7	16.3	14.4	16.9
Sewerage	52.8	107.6	83.1	84.7
Solid waste management	7.2	41.4	63.2	58.3

Note: Due to rounding, figures may not add to exact totals.
Source: U.S. Census Bureau.

rent charges for own-source revenues (9 percent) is lower than in all of the comparison cities, which range from 11 percent in Baltimore to 32 percent in San Francisco and 31 percent in Seattle. When looking at the composition of current charges across municipalities, it is clear that the responsibilities of a municipality dictate the level of current charges. For example, municipalities that provide access to public hospital services (the District, Boston, Indianapolis, and San Francisco) receive between one-fourth and one-third of their current charges revenue from those public hospitals. Similarly, municipalities with airports receive between 15 percent and 31 percent of their current charges revenue from those airport activities, while municipalities with ports receive between 5 percent and 14 percent of their current charges from their port activity. Like the District, no municipalities received revenue from toll roads or natural resources (Figure M-8). Thus, it appears that the composition of municipal activities influences to a significant degree the relative importance of current charges as a source of total and own-source revenues.

Figure M-10

Current Charges Revenues as Share of Expenditures
by Category and City, 1994

	D.C.	Baltimore	Boston	Indianapolis	Jacksonville	San Francisco	Seattle
Education	2.0%	0.8%	0.7%	0.0%	n/a	0.0%	n/a
Highways	0.0	1.0	0.0	0.4	0.1	2.2	0.0
Hospitals	21.4	n/a	35.8	28.9	0.0	42.8	n/a
Sewerage	52.8	56.4	87.4	76.8	139.4	73.7	100.5
Solid waste management	7.2	28.0	0.0	42.1	44.5	16.6	94.7
Parks and recreation	32.1	9.6	2.2	5.6	2.4	22.6	21.0
Housing and community development	8.7	0.0	9.0	2.4	5.5	5.4	0.0
Airports	n/a	n/a	n/a	82.4	141.9	142.1	n/a
Water transportation	n/a	533.0	n/a	n/a	71.5	71.4	n/a
Parking facilities	507.9	246.7	327.9	82.3	120.2	203.5	3,554.6

Note: Due to rounding, figures may not add to exact totals.
Source: U.S. Census Bureau.

Factors influencing the District's reliance on nontax revenues

In part, the more limited reliance of the District on nontax revenues reflects the composition of the services provided, or not provided, by the District. Alternatively, the District's reliance on current charges may be relatively low because rates in the District are low.

One way to gauge whether rates in the District may be low relative to rates in other jurisdictions is to calculate revenue from current charges as a percent of expenditures for selected services (Figure M-9). Current charges as a percent of expenditures for 11 expenditure categories indicate that current charges accounted for 12.4 percent of expenditures on higher education in the District, compared

with 42 percent in Maryland, 51 percent in Virginia, and 41 percent for state and local governments in the United States. These numbers are difficult to interpret, however, because we are comparing the University of the District of Columbia with systems of higher education in the other states that include junior colleges, state colleges, and universities — each of which has a different mix of funding mechanisms (tuition, general funds, research grants, charitable contributions, etc.).

Another example may be hospitals. The data in Figure M-9 indicate that current charges revenue from hospitals accounted for only 21 percent of hospital expenditures in the District, compared with 38 percent in Maryland, 84 percent in Virginia, and 68 percent for combined state and local governments in the United States. A similar pattern emerges when looking at municipalities that provide public hospital services. Current charges accounted for 36 percent of hospital expenditures in Boston, 29 percent in Indianapolis, and 43 percent in San Francisco. The District funds a much smaller share of its hospital expenditures from user charges than do other jurisdictions (Figure M-10).

A similar scenario emerges when looking at solid waste management. The District generates very little current charges revenue from solid waste management and, as a result, recoups a very small share of solid waste expenditures from such revenues — just 7 percent. This compares with 41 percent for Maryland, 63 percent for Virginia, and 58 percent for state and local governments nationally. Similarly, all of the comparison cities recoup a larger share of solid waste expenditures from current charges than the District — ranging from 17 percent in San Francisco to 95 percent in Seattle.

Again, these comparisons are difficult to interpret for several reasons. First, institutional arrangements for delivering and financing services vary across jurisdictions. For example, the District is restricted by law to collecting solid waste only from buildings with three or fewer units. All residential buildings with more than three units, commercial properties, and the federal government use private-sector providers. Thus, the District government is responsible for solid waste management for a small minority of nonsingle family housing properties and a smaller share of total solid waste.

In addition, the District does not charge an explicit fee for the solid waste services it actually does provide. The vast majority of funding for solid waste services in the District comes from the general fund, rather than a separate, earmarked portion of residents' taxes or more direct user charges. Of the user charges collected for solid waste management services, the vast majority come from the tipping fee charged to private haulers and a recycling surcharge tacked on the tipping fee. The tipping fee is recognized to be extraordinarily high within the region, largely due to the surcharge. This noncompetitive tipping fee reduces total revenue because private haulers avoid payment of the tipping fee by dumping in landfills outside of the District. It also results in the drastically lower percentage of expenditures funded by current charges versus the comparison group.

Second, the District may collect a smaller share of funds expended from user charges because of the relatively high concentration of low-income residents who may not be able to pay the full cost of services received. Third, the share of expenditures attributable to user charges may be relatively low in the District because of the collection and reporting problems described by O'Cleireacain.

Overall, it appears the District does not generally recoup a significant share of its expenditures from user charges relative to the other jurisdictions examined here. Downing used 1984 Census Bureau data to compute the variation in user-charge reliance for 943 cities with populations of 5,000 or more for selected services.[13] It is likely that user-charge reliance for these services, across these local governments, has increased significantly since then. In 1984, 747 of the local governments examined provided sewerage services, and two-thirds of them recouped a greater share of expenditures from current charges than the District did in 1994. Similarly, 527 of the local governments examined provided solid waste services, and three-fourths of them recouped a greater share of expenditures from current charges than the District in 1994. Finally, only 56 of the local governments examined provided public hospital services, but 95 percent of them recouped a greater percentage of expenditures from current charges than the District did in 1994.

Summary

This section considered the extent to which the District relies on nontax revenues, compared that reliance with other jurisdictions, and explained why any discrepancies arose. We found:

- The District relies on nontax revenues, defined here to include current charges, miscellaneous general revenues, and utility revenues, for 14 percent of its total revenues — a significantly higher share than the commonly perceived 5 percent or 6 percent.
- The District relies much less on such nontax revenues than do combined state and local governments in Maryland, Virginia, and the United States, as well as a number of comparison municipalities.
- In part, the District's lower reliance on nontax revenues is a result of the composition of services provided, or not provided. Specifically, the District does not receive any revenues from current charges for toll roads, airports, ports, and natural resources or utility revenues from the sale of natural gas or electricity. Also, the District has a state-like revenue structure, which generates more revenues from taxes.

- In part, the District's lower reliance on nontax revenues may be the result of fees that are relatively low in those instances where fees are charged — specifically in the case of higher education, hospitals, sewerage treatment, water supply, and solid waste management.
- In part, the District's lower reliance on nontax revenues also may be the result of the relatively high concentration of low-income families in the District, especially when comparing the District with state and local governments in the aggregate.

From a policy perspective, should we care that the District relies on nontax revenues to a lesser extent than neighboring state and local governments or other municipalities? To the degree that the reduced reliance is a result of the composition of services provided, or not provided, by the District — probably not. For example, no one would argue the District should build a port or another airport just to increase nontax revenues. To the degree that the reduced reliance is a result of not charging for certain services, or charging too little (or in some cases too much) for some services — the answer is probably "yes."

Current charges have some very important advantages that local governments should consider. For example, Osborne and Gaebler argue that the safest way to raise nontax revenue is simply to charge fees to those who use public services. What is fairer, they ask, than a system in which those who benefit from a service — and can afford to pay for it — do so, while those who do not benefit do not have to pay? They argue that current charges have two advantages: They raise money and they lower demand for public services.[14]

Current charges establish a direct link between the expenditure and revenue sides of the local budget for specific governmental services. As a result, such charges contribute to an efficient allocation of public resources by providing valuable information on consumer preferences and by constraining demand for government goods and services. Ultimately, such charges strengthen political accountability at the local level and lead to a more efficient mix and level of public spending.[15]

In addition, it should be noted that focusing solely on the revenue potential of current charges tends to give too narrow a view of their potential *net* impact on local budgets. One of the primary arguments favoring current charges over general tax financing is that wasteful consumption will be eliminated and the costs of production reduced to more efficient levels. These adjustments lead to lower expenditures at the same time that revenues increase. Both adjustments reduce the need for local tax revenues. In fact, the reduction in current and future expenditures may be more important, from a budgetary perspective, than the increase in revenues from a greater reliance on current charges for own-source revenues.

Downing argues that there is great potential for almost all jurisdictions to increase nontax revenues.[16] This is especially true for the District, since it places a

lower reliance on nontax revenues than all of our comparison jurisdictions. This situation offers the opportunity to explore possibilities for increasing the District's reliance on user charges, while keeping its fees and charges competitive within the region and compared to the rest of the nation.

The second part of this chapter discusses the potential advantages of user charges as a mechanism to fund locally provided services, identifies some caveats that must be kept in mind when designing and implementing specific user charges, and outlines a number of opportunities for raising additional nontax revenues in the District.

Opportunities for raising additional nontax revenues in the District

There is evidence that the District places less reliance on nontax revenues than other jurisdictions. In part, it is because the District has a different mix of services than other jurisdictions, e.g., no airport, natural resources, or port; in part, it is because the District recoups a smaller share of certain expenditures from user fees than other jurisdictions; and in part, it is because the District does not utilize user fees in some circumstances that other jurisdictions might. This section constructs a framework for designing and implementing user fees and provides some illustrative examples of how such fees might be utilized in the District.

A FRAMEWORK FOR DESIGNING USER CHARGES

User charges are most appropriate when the benefits of the good or service accrue principally to identifiable consumers, and their demand for the good or service is sensitive to price changes. In such situations, the user charge should be set equal to the marginal cost of providing an additional unit of the good or service.

There are other efficiency advantages of funding public goods and services with user charges. For example, it contributes to increased political accountability in the local budget process. Similarly, increased reliance on user charges may reduce other economic distortions caused by high marginal tax rates on income, sales, or property values. Finally, if consumers are willing to pay for what they get, increased reliance on user charges may lead to different levels of service being provided in some neighborhoods. The recent explosion of *special benefits districts* in urban areas is one manifestation of this benefit.

One caveat is in order, however. To achieve the efficiency gains attributed to user fees, there must be a market for the good or service being produced. That means potential consumers must have the income to translate their needs and/or desires into market transactions. If there is a high percentage of the population with very low incomes, they do not have many votes in the marketplace. Care must be taken in designing user fees to be sensitive to the needs of the less fortunate in society.

Increased reliance on user charges has several important equity benefits as well. First, by providing a direct and visible link between consumption benefits and payments, the extent of unintentional subsidies provided to specific, identifiable groups of citizens may be reduced. User charges also provide a mechanism for charging nonresidents and those occupying tax-exempt properties for public services received.

The Advisory Commission on Intergovernmental Relations developed guidelines for determining when it is appropriate (or inappropriate) to consider expanding the role of user charges in financing public goods and services.[17] In summary, they argue that the use of pricing mechanisms for funding the provision of public goods and services is justifiable when:

- benefits are primarily direct, so that charges will not cause significant loss of external benefits;
- demand has some elasticity, so that the use of prices aids resource allocation and eliminates excessive utilization;
- charges do not result in inequities to lower-income groups, on the basis of accepted standards; and
- costs of collection of charges are relatively low, or alternate taxes measured by use can be employed.

Use of charges is more questionable when:

- external benefits are significant and will be lost in part if charges are made;
- demand is perfectly inelastic, so that resource allocation is insensitive to the pricing system (even so, however, prices may be warranted on equity grounds);
- equity standards require that the lower-income groups be assured of obtaining the services; or
- collection costs are relatively high and alternative tax measures related to usage cannot be devised.

OPPORTUNITIES FOR USER CHARGES IN THE DISTRICT

The District is undergoing significant changes in how local government operates and is financed. These changes include major restructuring in several areas funded by user fees. For example, new institutions recently have been created for water and sewer services and for the municipal hospital. Similarly, the University of the District of Columbia has been engaged in a process of reinventing itself. Given the difficult dynamics of these transitions, we do not attempt to prescribe how these new institutions should set fees. Our only observation would be that they should follow the general guidelines set out in the framework described above. In addition,

it is beyond the scope of this paper to evaluate systematically current and prospective user fees in the District within the framework developed here. There are real and significant potential benefits from increasing the relative importance of user-fee revenues in the District. The purpose of this section is to discuss representative illustrations of how such fees might be utilized in the District. Two specific examples are presented — solid waste management and transportation utility fees.

Solid waste management

In the District, private haulers collect and dispose of waste for all residential buildings with more than three units, commercial properties, and the federal government. The District government provides this service to residential buildings with three or fewer units. This service is financed through general revenues, so that all taxpayers effectively subsidize solid waste collection and disposal for residents living in residential buildings with three or fewer units.

The cost of solid waste management reflects the costs of both the collection and disposal of solid waste. Collection and disposal costs, in turn, depend on the amount and type of refuse and should also reflect the associated environmental costs. A user charge to cover these costs should vary by type of service provided (e.g., the collection and disposal cost of a pound of household garbage vs. that of a pound of used nuclear fuel).[18]

An important administrative problem with applying such a user fee is measuring how much solid waste is collected from each household. One innovative solution is to require that all refuse be deposited in specific bags sold by the local government or in bags with special stickers sold by the government. In order to reduce their personal expenditures on waste removal, citizens would be more cognizant of what they threw out. Many would increase recycling and composting efforts, as well as consider waste volume when making purchases and consumption decisions.

Clearly not all residents would change their behavior. Numerous cities, however, have realized an added benefit of reduced waste volume after initiating a user fee of this type. A Duke University study found that 14 cities employing volume pricing experienced waste reductions from 18 percent to 65 percent, with an average reduction of 44 percent.[19] Another study examined the results of unit pricing for municipal solid waste in 21 cities. They found that there were significant reductions in waste disposed in landfills in the year following the introduction of the unit pricing system. Overall, the average reduction in tonnage landfilled was 40 percent, ranging from a high of 74 percent to a low of 17 percent.[20]

On the disposal side, another potential option for generating significant nontax revenues, currently underutilized by the government of the District of Columbia, is charging fees to the numerous private haulers operating in the District. The tipping fee is recognized to be extraordinarily high within the region, largely due to the

recycling surcharge. This noncompetitive tipping fee reduces total revenue because private haulers avoid payment of the tipping fee by illegal dumping or by dumping in landfills outside of the District. Significant revenues could be generated if the fee were reduced to a level competitive within the region. Alternatively, additional revenues could be generated by restructuring the prices charged at transfer stations to reflect the costs of processing an additional unit through each station.

Transportation utility fee

Typically, local governments like the District finance operation and maintenance of local road networks from property taxes, special assessments, or other general revenues. Often, however, road needs (especially in older central cities) outpace the ability to raise additional revenues from traditional sources. In the last several years a number of local governments have implemented transportation utility fees. The first jurisdiction to impose such a fee was Fort Collins, Col., in 1981, but it was not declared valid until 1989.

In jurisdictions with transportation utility fees, the local road network is treated as a public utility, and developed properties are charged a fee for service in much the same way they are charged for water, sewer, and trash collection. Transportation utility fees are imposed on a jurisdictionwide basis and provide financing of ongoing operations and maintenance activities. The primary advantage of a transportation utility fee is that every local traffic generator pays to support the local transportation network, and responsibility for supporting that network is distributed across properties in relation to their use of the system.[21] The District might consider developing a transportation utility fee as a way to finance road operation and maintenance.

The objective of a transportation utility fee is to make it a financing mechanism for local road operations and maintenance that is as much like a fee and as little like a tax as possible. The distinctive feature of a user fee is the direct link between the service consumed and the fee paid. Therefore, a transportation utility fee should be based on the amount of traffic that typically is generated by different types of development on a property. For each type of land use, expected traffic can be estimated based on average trip generation rates per acre. The rationale for basing the fee upon trip generation is that each vehicle trip entering or leaving a site creates an impact upon the street systems that can be associated with increased maintenance costs.[22]

Austin, Texas, recently implemented a transportation utility fee. Their fee structure uses trip-generation rates from the Institute of Transportation Engineers as the basic source of traffic projections. Normally, trip generation is figured on the basis of the number of units for residential uses or the square footage of floor area for nonresidential uses. In order to place all land uses on an equal footing for development of the fee, Austin adjusted the trip-generation rates to use acreage as the standard unit of comparison.

In addition to linking the fee to actual usage, the fee structure must reasonably reflect the cost of providing the service. This is one area where administrative concerns might mitigate for something other than the pure marginal cost pricing rule. For example, the "cost" of a trip may vary by location and time of day. However, monitoring such variation is extremely costly and the resulting complex fee structure would be difficult to understand and sell to the public. For these reasons, Austin and most cities with transportation utility fees use average costs as a basis for the fee.

To reinforce the notion that transportation utility fees are utility fees, most jurisdictions collect it in conjunction with other utility fees. Austin includes the transportation utility fee part on electric utility bills. Other jurisdictions add the fee to water and sewer fees, trash collection fees, etc. In most cases, no additional collection costs are incurred by the local jurisdiction once the transportation utility fee has been implemented. Finally, jurisdictions typically enforce payment of fees by cutting off the other public utilities billed with transportation utility fees.

Transportation utility fees must provide an avenue for consumers to file an appeal. Any property owner in Austin can dispute the category of land development, size of commercial developed property, or amount of fee assessed and petition the Director of the Department of Public Works and Transportation for a hearing on a modification of the determination. A petitioner should be able to demonstrate that the trips characteristics of his or her property are significantly different from those of other properties similarly classified, either because the intensity of the development is different from the average or because the use itself does not generate the amount of traffic that would normally be expected.

Finally, equity issues need to be addressed. For example, families without an automobile are typically exempted from the fee. Similarly, vacant land and unoccupied structures are typically exempt from paying the fee. Finally, the problems of the low-income must be addressed. In Austin, taxpayers are allowed to contribute to a fund that helps low-income residents pay their utility bills. Austin also discovered that some income support programs could be used to help pay transportation utility fee obligations for low-income families.

Policy options

The District relies on nontax revenues for a smaller share of its own-source revenues than the compared jurisdictions examined in this chapter. In part, this reflects the unique mix of goods and services provided by the District. However, when comparisons of specific expenditure categories are made, the data indicate that the District often does not recoup a share of expenditures from user fees equivalent to that of other jurisdictions. This evidence suggests the District's relatively low reliance on

nontax revenues is in part due to the relatively low implementation of user charges. Finally, there may be opportunities to fund, or partially fund, the cost of certain goods or services via user fees that are not being exploited in the District.

Given the benefits associated with greater reliance on user charges as a source of local revenues, it is recommended that the District set a target share of own-source revenues that could be generated by user charges — perhaps that 20 percent of total own-source revenues come from nontax revenues.

To achieve this target, two initiatives need to be undertaken. First, it is recommended that the Office of Tax and Economic Policy, in cooperation with the Department of Consumer and Regulatory Affairs, undertake a systematic and comprehensive initiative to rationalize the current system of user charges in the District.

Rationalizing the current fee structure in the District is necessary, but not totally sufficient, to increase the reliance on user fees as a source of local revenue. In addition, new creative uses for such charges and fees need to be explored. It is recommended that new creative application of the user fee concept be identified and explored in the District. Such new creative uses could include: developing a transportation user fee to finance the operation and maintenance of the local road network; establishing payment-in-lieu-of-taxes programs for government agencies and nonprofit organizations to share the cost of delivering the locally produced goods and services they consume; or exploring the use of special assessments as a means of financing certain types of infrastructure investments.

Increasing reliance on user fees as a means of financing locally provided goods and services is not a panacea for the District. In fact, given the District's recent budget surplus, increasing reliance on user charges may seem almost irrelevant. However, increased reliance on local user fees reduces the reliance on other tax revenues. As a result, tax rates in the District would be lower than they otherwise would have been, thereby reducing distortions that result from tax rates higher than in surrounding jurisdictions. Also, increased reliance on user charges can make government more efficient and improve the overall level and quality of service provided at a reduced "price" to the taxpayer.

Endnotes

[1] Carol O'Cleireacain, *The Orphaned Capital: Adopting the Right Revenues for the District of Columbia* (Washington D.C.: Brookings Institution, 1997), p. 7.
[2] Ibid.
[3] For example, Medicaid revenues show up in Census Bureau numbers as intergovernmental aid from the federal government, not as current charges revenue to the hospital.

[4] U.S. Census Bureau, *Government Finance and Employment Classification Manual* (Washington, D.C.: Government Printing Office, June 1992), Section 7.21.
[5] Advisory Commission on Intergovernmental Relations, *Local Revenue Diversification: User Charges*, Staff Report SR-6 (Washington D.C.: Advisory Commission on Intergovernmental Relations, October 1996), p. 6.
[6] For purposes of comparison, total state and local figures are reported for Maryland, Virginia, and the United States. This makes the comparisons more reasonable since the District has both state and local revenue-raising and service-delivery responsibilities.
[7] U.S. Census Bureau, op. cit., p. 38.
[8] Ibid., p. 36.
[9] Ibid., p. 32.
[10] Ibid., p. 25.
[11] Maryland State Department of Budget and Management, "Fees and User Charges" (Annapolis, Md.: October 1996), p. 1.
[12] Interpreting comparisons between the District and other municipal governments is difficult, since each of the 50 state and local systems allocates revenue-raising and service-delivery responsibilities between the state and various local governments differently. We selected several cities that the District is routinely compared with and several municipalities that are city/county consolidations so their revenue- raising and service-delivery responsibilities are more like the District's.
[13] Paul B. Downing, "The Revenue Potential of User Charges in Municipal Finance," *Public Finance Quarterly*, Vol. 20, No. 4 (October 1992), pp. 512–527. See Table 2.
[14] David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit Is Transforming the Public Sector* (Addison-Wesley Publishing Co., 1992), pp. 203–205.
[15] Advisory Commission on Intergovernmental Relations, op. cit., p. 3.
[16] Downing, op. cit.
[17] Ibid., pp. 25–26.
[18] Fisher, op. cit., p. 195.
[19] U.S. Environmental Protection Agency, *Pay-As-You-Throw: Lessons Learned About Unit Pricing* (Washington D.C.: Government Printing Office, 1994), p. 9.
[20] Marie Lynn Miranda, Jess W. Everett, Daniel Blume, and Barbeau A. Roy, Jr., "Market-Based Incentives and Residential Municipal Solid Waste," *Journal of Policy Analysis and Management*, Vol. 13 (Winter 1994), pp. 681–698, cited in Fisher, op. cit., pp. 195–196.
[21] Reid Ewing, "Transportation Utility Fees," *Government Finance Review* (June 1994), pp. 13–17.
[22] Ibid.