

# Elasticity of the Lexington-Fayette Urban County Government Tax Structure

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# Overview

- ✦ **Research Issue**
- ✦ **Methodology**
- ✦ **Results**
- ✦ **Recommendations**

# Research Issue

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

# Methodology

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

# Methodology

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

# Methodology

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

# Results

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

# Results

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

# Recommendations

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

# Recommendations

## ✦ Stay away from a sales tax

- There is uncertainty in establishing a sales tax

- Implementation hurdles such as legislation
- Business cycle affects the tax, causing changes frequently
- It is a relatively inelastic revenue source

- It would cause burden to many payers

# Recommendations

## ✦ Limitations

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

# Summary

## ✦ Research Issue

- Analyzing the LFUCG tax elasticity performance

## ✦ Methodology

- Assessment of the tax elasticity performance through comparison with two area city-county governments

## ✦ Results

- The LFUCG tax structure measured lower in elasticity, but more constant

## ✦ Recommendations

- The LFUCG is not taking advantage of elastic property taxes
- Sales taxes are not as elastic, and would be hard to implement