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Second Report

of the

MAYOR'S ADVISORY COMMITTEE ON FINANCE

February 3, 1981

I. INTRODUCTION

On January 10, 1981, the Committee submitted to the Mayor a report which outlined the extent of the City's projected deficit in the 1981 fiscal year and recommended, given the urgency of the situation and the lateness in the fiscal year, a $16 property tax increase, payable in six installments: two of $3 each in fiscal 1981 and four of $2.50 each in fiscal 1982.

In view of the severity of the recommendation, there has been understandable concern on the part of elected City and State officials and the citizens of Providence about the economic and social implications of the recommendation. Questions have also been raised as to whether alternatives exist, not only in the long term, but in fiscal 1981 as well.

It is the purpose of this second report to accomplish several things. First, to portray as factually as possible the urgency of the present financial crisis and the developments over the past several weeks. As explained in Section II, in the absence of extraordinary actions, it appears that the City will run short of funds within thirty days and will not be able to meet its obligations.

This report also discusses the possible long-term impacts upon the individual cities and towns of Rhode Island and on the State if such a series of events is allowed to occur in the City of Providence. In terms of higher interest costs on municipal and state borrowing during the 1980's, the long-term costs of a Providence default could dwarf the present $20 million 1981 projected City deficit which we are all attempting to address.

In Section III this report summarizes the efforts which have been made, especially under the direction of the Acting City Finance Director over the past several weeks to control and reduce City expenditures in the current year. It is as a result of these efforts that the original projected deficit of $24 million has been reduced downward to approximately $20.5 million, even though the effort was undertaken at mid-year. The Committee also outlines additional critical steps that must be taken to reduce City expenditures in fiscal 1982 and beyond. However, with seven months of the fiscal 1981 year already completed, it appears unlikely that these various efforts can have a further significant impact upon 1981 expenditures.

In Section IV, the report addresses the important question of revenue alternatives which were outlined in our initial report. It is extremely important that the City, with the cooperation of the State, develop alternative revenue sources and reduce its reliance upon the property tax. If any of these alternatives were enacted in time to have impact upon the 1981 fiscal revenues, it could reduce, to some degree, the necessity for the proposed $16 property tax increase. Given the lateness in the fiscal year and the complexity of enacting alternative revenue sources, the impact of any such efforts in the current fiscal year is minimal.

II. THE URGENCY OF THE SITUATION

Over the past several weeks it has been possible to more accurately project cash flows of the City for the next several months. The receipts of the City have covered the February 2 debt service payment and it would appear that the City payroll will be met through February. However, in the absence of extraordinary actions noted below, the mid-February debt service payment will reduce cash sufficiently to cause one or more payless paydays. While this situation will be somewhat relieved in April, the City will again run out of funds in May.

The City has already begun, with the cooperation of the Greater Providence Chamber of Commerce, to seek early payment of fourth quarter taxes normally due in April from larger corporate taxpayers. Assuming the great majority respond, approximately $2.5 million will become available to the City. This in turn will permit the City to reserve the necessary $2.1 million to meet debt service payments through March, but does not address the problem of meeting payrolls or other necessary expenditures for both general municipal operations and schools.

The City must also seek the immediate assistance and cooperation of the State in providing early payment of approximately $8.9 million in state aid to education which would normally be received at the end of April. These funds will have to be reserved for school department expenditures and payroll, but would relieve the pressure on the general fund of the City and enable the City to meet non-school obligations through April.

Should this assistance from the State not be forthcoming, the City would have no recourse but to attempt to exercise its authority under Section 6.26 of the City Charter and attempt to borrow in anticipation of fourth quarter taxes by selling short-term notes to the banking community. But there are several problems in going this route.

In order for the City to proceed under Section 6.26, the banking community must have a high degree of assurance that funds will be available to repay the notes when due. Under Section 6.26, the City may only borrow 80% of remaining uncollected property taxes. Receipts to the City from all sources would then have to be escrowed for repayment of the short-term notes. Assuming the banking and investment community were willing to purchase such tax anticipation notes, the City could borrow up to $12 million which would enable it to continue to meet operating expenses for a period of approximately four weeks. However, with such revenues to the City being escrowed for repayment of the notes, at that date, the City would finally be out of cash and would be unable to meet its expenses.

The concern of the investment community, as possible purchasers of such short-term notes, is further heightened by the recent actions of Moody's Investors Services, Inc. On January 23, 1981, Moody's again reduced the City's credit rating from A1 to A (in 1979 it was reduced from Aa to A1). In Moody's January 23, 1981, municipal credit report on Providence, the agency stated:

> The City's ability to implement remedial measure successfully will be a significant factor in future rating considerations... Actions proposed in the latest budget submission, which are characterized by City officials as requisites to budget balance, are reportedly to be acted upon within the next thirty days; the bond rating will be reviewed again at that time.

The investment community is greatly concerned given Moody's apparent intention to further reduce the City's rating by the end of February in the absence of decisive and effective action. There is a concern that a further reduction will be to a level below investment grade (Baa is the lowest investment grade). If the City's rating is dropped below investment grade, and there is no assurance of a balanced fiscal year 1981 budget, the banks could be precluded from lending the City funds, since City debt obligations would be unmarketable to the investing public. Further, once a credit rating is diminished, it should be recognized that it often takes years for an improved credit rating to be regained.

As a practical matter, credit markets are already closed to the City of Providence, thus halting all on-going major capital projects for which bonds have been authorized but not sold within the City such as court mandated improvements in the City sewerage plant, water projects, municipal wharf and harbor projects and neighborhood renewal projects, including school renovations.

It is reasonable to expect this decline in the credit rating of the City of Providence to have a direct effect upon the cost of credit for the other cities and towns in Rhode Island, as well as the State itself. Based on the total projected borrowings of these governmental units over the course of the 1980's, the total cost to the citizens of Rhode Island in terms of increased interest costs would be substantial.

Finally, it must be expected that the impact of such developments on the economic reputation of the City and State could be substantial and could affect the ability of Rhode Island towns and cities to attract new economic activity in Rhode Island.

III. EXPENDITURE REDUCTIONS

In attempting to propose solutions for offsetting the City's potential $24 million fiscal year 1981 shortfall, the Committee first attempted to determine if significant expenditure reductions could be implemented during the remaining five months of the current fiscal year. It was the Committee's findings that approximately $4 million of the gap could be closed as a result of spending cutbacks and the identification of additional non-property tax revenues. In this regard, a number of significant steps have recently been taken; these include:

- A $3.5 million reduction in the projected fiscal year 1981 deficit due to personnel reductions and revised projections of non-property tax revenues and other miscellaneous savings.

- Implementation of purchasing control procedures that require the Acting Finance Director to approve all spending for materials and supplies.

- Technical assistance in the area of management control by experienced loaned executives from the private sector.

However, while progress has and is being made to both reduce and control expenditures, the City's ability to further reduce spending in the current fiscal year is limited by the fact that seven months of the current spending year has been completed.

Table I summarizes annual projected expenditures for fiscal year 1981 by selected major categories and functions.

Table I

Fiscal Year 1981 Expenditures by Major Category*

Category	Projected Budget
General Municipal	
Personal Services[a]	$ 49,774,366
Non-Personal	35,340,281
Total	$ 85,114,647
Schools	
Personal Services[a]	44,566,203
Non-Personal	7,711,282
Total	$ 52,277,485
Water	8,333,118
Grand Total	$ 145,725,250

*Source: City Finance Department

[a]Includes salaries, fringe benefits, unemployment compensation and all pensions.

Analysis of the information presented in Table I reveals the difficulties in further reducing the potential fiscal year 1981 operating deficit beyond that already recommended by the Committee. For instance..

A. 58.5% of the City's fiscal year 1981 budget for general municipal purposes, or $49.8 million, is for personnel costs. Additional personnel savings can principally be only achieved as a result of further layoffs. However, the City's capacity to implement and realize financial benefits from additional layoffs between February, 1981, and June 30, 1981, is severely limited by the following conditio

1. Administrative and management limitations which required approximately two months to affect the previous 183 layoffs. The Committee has no reason to project that additional layoffs can be made in a more expeditious fashion.

2. Financial savings from further layoffs are unavoidably delayed because of termination pay requirements, e.g., vacation, unemployment compensation and medical insurance.

3. Further layoff decisions must be based on decisions to either eliminate or reduce programs in order to assure orderly budgetary plans and decision making.

B. Examination of the City's general municipal non-personnel costs indicates that significant sums are for fixed costs and cannot be reduced. For instance, of the projected general municipal budget for non-personnel items, which totals \$35.3 million, \$8.6 million is for debt service and \$8.4 million is for general public assistance.

While the Finance Department has taken steps to control purchasing, as noted above, it is impossible for the Committee at this time to project any significant reductions in non-personnel spending to further offset the \$20.5 million potential deficit.

C. In fiscal year 1981 the proposed budget allocates municipal contributions to the employees' retirement system of \$7.3 million and \$1.1 million to the Laborers International pension fund. Some have suggested that these contributions not be made in fiscal year 1981 but, these contributions are mandated by law.

D. As shown in Table I, spending for schools in fiscal year 1981 represents 36% of all City spending -- \$52.3 million of total City expenditures of \$145.7 million. Furthermore, of the \$52.3 million school budget, 85.2% or \$44.6 million is for personnel costs. In view of existing contractual obligations and the fact that one-half of the school year has been completed, it is unrealistic to expect significant changes in the School Department's fiscal year 1981 spending program.

In conclusion, the Committee strongly believes that a necessary step to bring the City's budget into balance in the future is reduced spending through improved management of City resources and the more efficient delivery of City services. While much can and must be done to reduce City spending and the resultant tax burdens, the effective implementation of efficiencies and economies will take several months to realize financial benefits. It is projected that fiscal year 1982 should benefit from such savings.

Fiscal Year 1982 Spending Program

In its January 10, 1981, Interim Report, the Committee recommended that municipal spending growth in fiscal year 1982 not exceed 5% of the current spending level. Based on revised fiscal year 1981 projected spending of $145.7 million (gross budget including state aid to education), a 5% growth would allow for a budget of $153.0 million in fiscal year 1982. However, spending at this level will exceed currently projected fiscal year 1982 revenue of $149.4 million by $3.6 million (see Appendix A). It is the Committee's recommendation that the Mayor prepare a budget for fiscal year 1982 not exceeding $149.4 million. While such budget would not require an additional tax increase beyond the $16 per $1,000 assessed valuation that has already been proposed, it will require significant changes in the way the City operates to keep spending growth down to 2.5% in fiscal year 1982.

In view of the estimated contracts for personnel costs increasing by approximately 7% and 12% inflation for materials and supplies, it is obvious that a budget allowing only 2.5% growth in expenditures will require significant reductions in City services and additional economies and efficiencies in operations.

The degree of service cutbacks needed to meet the proposed $149.4 million of 2.5% growth budget for fiscal year 1982 cannot be predicted by the Committee at this time and is dependent upon actions taken prior to fiscal year 1982 to:

- Transfer operations by the sewerage treatment plant and certain like services to the regional sewer authority;
- Once-a-week garbage collections by a private contractor;
- Establishement of a water enterprise fund; and
- Implementation of management efficiency study to be performed by RIPEC and Greater Providence Chamber of Commerce.

The City's preliminary forecast of the impact of the above could mean reduced fiscal year 1982 expenditures by $4-6 million.

IV. EXAMINATION OF ALTERNATIVES/ADDITIONAL REVENUE SOURCES

The Committee has reviewed a variety of additional/alternative sources of municipal revenue that might reduce future, or even the presently proposed, property tax increase. Appendix B is a preliminary discussion paper prepared on this subject.

Alternatives considered, with estimates as to their potential impact on revenues, include:

- Payroll tax
- Sales tax
- Revised user fees
- Charges for City Services rendered to tax exempt institutions
- Sale of City property
- Water generated revenues
- Funding bond

1. Payroll Tax

The Committee recommends that further consideration be given to a flat rate 1%, local option, municipal payroll tax. It is clear that consideration of such a tax must be viewed on a statewide basis, with a local option being offered to all cities and towns, via state legislative action. For this reason, the Committee believes it is unlikely that such a tax can become effective before the City's fiscal year 1982 unless action is taken at the state level.

For Providence a 1% tax on wages earned in the City would yield an estimated $14.5 million on an annual basis. Should enactment be possible before July 1, 1981, this tax could impact the fiscal year 1981 budget by approximately $1.2 million (or approximately $1 on the tax rate) for every month in effect.

2. Sales Tax

Adoption of a 1% local sales tax in the City of Providence would yield an estimated $4 million per year (or $300,000 per month in effect). However, the Committee recommends against this alternative because of well documented experiences which indicate that such a tax could have a serious negative impact on the retail trade in the City in the absence of similar levies in other retail centers of Rhode Island.

Another alternative might be the enactment of an additional 1% of the State sales tax, to be reapportioned back to all cities and towns to reduce property taxes. It is estimated that Providence's share would be $5.6 million.

3. Revised User Fees

A comprehensive review of the City's fee and user charge program is needed. Preliminary analysis indicates that charges could be imposed for entrance into the zoo and museum, and that various license and permit fees could be increased to more realistic levels. These adjustments could generate over $1 million in new revenues for fiscal year 1982 (or $83,000 per month if imposed in fiscal year 1981), and further examination could produce additional revenues.

It is unlikely that much of this increase could be realized in fiscal year 1981 in view of the fact that many of these fees have already been collected (on an annual basis) and because of necessary start-up preparation and costs for others.

4. Service Charges for Tax Exempt Institutions

The Committee recommends that the feasibility of service charges being assessed against schools, churches, hospitals and other charitable institutions now exempt from property taxes be explored with all possible speed. Because of legal and other considerations involved in this issue, no revenue is projected for fiscal year 1981. However, under a formula that is based upon an apportioning of service costs (fire, police, highway, street cleaning, snow removal, etc.) against property values affected, using 1979 data, approximately $3 million might be raised annually.

5. Sale of City Property

Utilization of proceeds from the sale of City property or other physical assets for anything other than reduction of the City's outstanding debt is in violation of the City's Charter, and in the Committee's judgment, is unsound fiscal management. Further, utilization of such assets to meet current operating budget needs, now or in the future, could lead to unwise and expedient decisions inconsistent with the City's long term interest.

Property currently mentioned for possible sale includes Valley View, Camp Cronin, and vacant school properties for a total of perhaps $3 to $4 million, none of which probably could be realized in time to affect the fiscal year 1981 deficit. The Committee recommends against consideration of such an alternative for fiscal year 1981.

6. Water Generated Revenues

As noted, establishment of an enterprise fund to manage the Water Supply Board account is needed in fiscal year 1982 for the City to be reimbursed for services provided to the Board. In addition, the feasibility of water rates being adjusted to reflect a return on the City's investment in providing water to a number of Rhode Island communities should be determined.

Because of the many ramifications of this revenue source, it is important that it be acted upon immediately so as to provide meaningful benefit in fiscal year 1982.

An immediate investigation should be undertaken to insure the currency of payments by the cities and towns that are using Providence water.

7. Funding Bond

Early in its review of alternative solutions to the City's current financial crisis, the Committee examined the possibility of a funding bond to take the place of all or part of the property tax increase. This proposal was rejected for several reasons:

- Funding bonds merely provide cash, not an ongoing source of revenue and, therefore, merely postpone addressing the basic budgetary problem.
- Amounts needed to be raised, even on rated bonds, would require debt service costs that compound the City's financial problems.
- Bankers question whether such bonds could even be sold, given the current state of the City's finances and the already evidenced lack of confidence by bond rating agencies.

Alternative revenue sources do exist that can relieve pressures on the property tax for the future. Some of the alternatives mentioned are not, in the Committee's view, wise or proper; and in any case, the realizable impact on fiscal year 1981 is not sufficient to reduce significantly the proposed $16 tax assessment.

	Fiscal Year 1981 (4th Qtr. Only)	Fiscal Year 1982
1. Payroll tax	$ 3.60 million	$ 14.50 million
2. Sales tax	Not Recommended	
3. Revised user fees	.25 million	1.00 million
4. Service charges	-	3.00 million
5. Sale of City property*		
6. Water generated revenues	No Estimate	
7. Funding bond	Not Recommended	
	$ 3.85 million	$ 18.50 million

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*Only for debt reduction.

V. SUMMARY - FISCAL YEAR 1982 - REVENUES AND EXPENDITURES

The following is a summary of the Committee's recommendations from the information and findings set out in Section III and IV, above.

The Committee believes that any additional revenues generated by increased fees, service charges to tax exempt institutions, payroll taxes, etc., should be used to reduce property taxes. In summary, the plan proposed for fiscal year 1982 is as follows:

1. The level of City spending for fiscal year 1982 should not exceed \$149.4 million with the exception of increased water and welfare spending that can be offset by earmarked welfare and water revenues.

2. Revenues generated above the preliminary fiscal year 1982 projection of \$149.4 million should be used to reduce property taxes.

VI. CONCLUSION

Specific steps can be taken to reduce the property tax burden on Providence taxpayers in fiscal year 1982 by generating additional revenues as set out in this report, through program cutbacks and by implementing sound budgetary control and management procedures.

For fiscal year 1981 the options are less obvious in view of the time constraints and the City's serious financial condition. In this report the Committee has attempted to more clearly spell-out the fiscal year 1981 alternative approaches and their fiscal impact. Unfortunately, none of these options appear to dispel the need for producing income in fiscal year 1981 equal to that realizable from a \$16 supplemental property tax increase, payable over eighteen months.

In conclusion, the Committee has tried to make clear its unanimous belief that it is the responsibility of elected officials of the City of Providence working with State officials to provide the concerted, immediate and forceful leadership which is needed to resolve this extraordinary crisis in the life of this important city.

Appendix A

Preliminary FY1982 Revenue Projections

RECEIPTS	1980-1981	1981-1982
Property Taxes & Excise Taxes	$ 71,931,000	$ 94,098,257[a]
State Shared Taxes	1,166,000	1,124,626[b]
Business & Non-Business Licenses	615,000	615,000
Special Assessments	-0-	-0-
Fines, Forfeits & Escheats	725,000	725,000
Grants-in-Aid (R.I. & Federal)	-0-	-0-
School Department		
School Construction	388,000	386,000[d]
State-Providence Plan, Section 4	621,775	621,775
Federal - Through R.I.	143,108	143,108
State Aid to Education	17,935,807	20,331,342[d]
General Public Assistance, R.I.	8,350,000	8,350,000
In Lieu of Intangible Taxes, R.I.	981,583	981,583[b]
In Lieu of Manufacturers Machinery Equipment & Inventory Tax, R.I.	2,212,860	2,443,648[b]
Donations	8,000	-0-
Rents & Interest	1,535,000	1,535,000
General Departments	4,600,000	4,300,000[c]
Sale of Surplus City Property	230,000	-0-
Sewer Rental	550,000	600,000[c]
Federal Revenue Sharing	4,851,047	4,875,000[b]
Water Fund	8,300,000	8,300,000
TOTAL RECEIPTS	$ 125,144,180	-0-
Supplemental Tax Requested for Approval	20,581,070	-0-
	$ 145,725,250	$ 149,430,339

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[a] See attached; $1,351,800 x 96% = $1,297,728 x $72.51 = $94,098,825

[b] Department of Community Affairs

[c] City Tax Collector

[d] State Department of Education

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The following figures are after exemption credits have been applied and/or estimated.

Category	Certified 1979	Certified 1980	Projected 1981*
Real Estate	998,949,700	999,478,810	1,007,500,000
Tangible Personal Property	177,923,050	188,801,650	195,800,000
Manufacturers Machinery/Equip	14,515,000	11,002,200	7,500,000
Motor Vehicles	127,437,811	134,667,491	141,000,000
Total	1,308,825,561	1,333,950,151	1,351,800,000 (+$17,849,849 over 1980)

*Note: These figures are early projections without benefit of original pricing data (especially in the category of the motor vehicles) from the computer.

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The 1981 projections includes the following losses:

1. the transfer of the post office building from Interlex Corporation (taxable) to the United States Government - exempt - for a loss of $3,937,800

2. Abatements of $6,550,000

3. The manufacturer's machinery and equipment phase out for a loss of $3,500,000

4. Additional properties that have been transferred from taxable ownership to tax exempt ownership with a loss of $650,000

5. Loss from razed buildings - $800,000

Through October, 1980, properties transferred from exempt organization to taxable owners represent $55,000 in assessed valuation.

Appendix B

DISCUSSION PAPER

ADDITIONAL MUNICIPAL REVENUE SOURCES

CITY OF PROVIDENCE

1. Income/Payroll Tax

Background - At present, more than 4,400 jurisdictions in eleven states have adopted a local income tax. Where authorized, the tax is levied by cities and counties; however, Kentucky, Iowa, and Pennsylvania school systems are also permitted to levy the tax. Although local income taxes are used in eleven states, widespread coverage of the population by the local income tax is restricted to five states (Kentucky, Maryland, Michigan, Pennsylvania and Ohio). Table I sets forth a summary of the use of local income taxes as of October 1, 1979.

Three alternative forms of a local income or payroll tax can be considered by a municipality. These include a flat rate tax on gross income, a "stand alone" progressive income tax, and a municipal income tax "piggy-backed" on the state income tax structure. A majority of local governments that levy a local income tax use the flat rate method. However, New York City has a progressive income tax, and Maryland has installed a "piggyback" local income tax.

A progressive city tax on all income suffers the primary disadvantage of high administrative costs along with reduced yield.

A "piggyback" local income tax concept involves the tying of the local tax to the federal or state income concept, rather than being modeled aft[illegible] it. Administrative costs are reduced, but the city commits itself to an acceptance of federal or state definitions of income.[1] Piggybacking a Providence income tax on the present state income tax would not produce significant revenues. Statewide, the State Budget Officer estimates that

(1) Income Taxes and Local Government, R. I. House Fiscal Advisory Staff, December, 1980, p. 19.

TABLE I

LOCAL INCOME TAX RATES, OCTOBER 1, 1979, AND JULY 1, 1976

	October 1, 1979		July 1, 1976	
State & Local Government	No. of Local Governments	Rates (Percent)	No. of Local Governments	Rates (Percent)
New England	--	--	--	--
Mideast:				
Delaware--Municipalities	1	1.0	1	1.25
Maryland--Counties, 1 City	24	20 to 50% of state tax	24	20 to 50% of state
New York--New York City	1	0.9 to 4.3	1	0.9 to 4.3
Pennsylvania--Cities, Boroughs, Towns, Townships, and School Districts	3,865(approx.)	0.25 to 1.0 1/	3,515(approx.)	0.25 to 1.0 1/
Great Lakes:				
Indiana--Counties	37	0.5 to 1.0	38	0.5 to 1.0
Michigan--Cities	16	1.0 2/	16	1.0 2/
Ohio--Cities and Villages	417	0.25 to 2.0	385	0.25 to 2.0
--School Districts	3/			
Plains:				
Iowa--School Districts	21	1.75 to 4.0	3	1.75 to 4.0
Missouri--Cities	2	1.0	2	1.0
Southeast:				
Alabama--Cities	5	1.0 or 2.0	6	1.0 or 2.0
Arkansas	4/		4/	
Georgia	5/		5/	
Kentucky--Cities and Counties	67	0.25 to 2.5	59	0.25 to 2.5
Southwest	--	--	--	--
Rocky Mountain	--	--	--	--
Far West	--	--	--	--
Total	4,456		4,050	

1/ Except for Philadelphia, Pittsburgh, Scranton, and Wilkes Barre.
2/ Except for Detroit where the rate is 2.0 percent.
3/ Effective June 30, 1979, school districts may levy an income tax subject to voter approval at either 1/4 of 1 percent, 1/2 of 1 percent, 3/4 of 1 percent, or 1 percent. Such tax would be state administered and collected.
4/ Specific authority for first class cities to levy an income tax was enacted in 1971, subject to voter approval. To data no city income tax has been enacted.
5/ Specific authority for counties and municipalities to levy a 1 percent tax was enacted in 1975, subject to voter approval. To date no localities have levied the tax.

Note: Excludes Washington, D.C., which has a graduated net income tax that is more closely akin to a state tax than to the municipal income taxes. Also excludes Denver Employee Occupational Privilege Tax of $2 per employee per month, which applies only to employees earning at least $250 per month; the Newark 1/2% payroll tax imposed on employers, profit and nonprofit, having a payroll over $2,500 per calendar quarter; the San Francisco 1.1% payroll expense tax; the 6/10 of 1% quarterly payroll tax on employers imposed in the Tri-county Metropolitan Transit District (encompassing all of Washington, Clackamas and Multnomah counties, Oregon); the 0.54 percent payroll tax imposed on employers in the Lane County Oregon Mass Transit District; and the Portland business license tax of 2.2% of net income. The rates shown apply to residents. In many instances the rates for nonresidents are less.

Source: ACIR staff compilation based on Commerce Clearing House, State Tax Reporter and supplemental local government data.

each 1% of the Rhode Island income tax will generate $11.1 million in fiscal year 1982 ($211.1 million projected yield ÷ 19% rate = $11.1 million).

As noted, the majority of local income taxes are of one type: A flat rate tax levied on earned income or net profits, with no exemptions or personal deductions. The flat rate tax on salaries, wages and net profits has the advantage of administrative simplicity with attendant low costs. Furthermore, due to the low rates which are usually levied (0.5 - 2%) in flat rate structures, such a system does not exert inequities and distortions to any large amount.(2)

The Advisory Commission on Intergovernmental Relations concluded on the point of tax equity:

> Concerns for equity effects of a flat rate local income tax - which are generally centered on their application to low income groups - can be partially resolved by the fact that the actual rates used are low and further mitigated by the inclusion of unearned income to the local tax base. Nor can it be argued that equity is best defended on the basis of progressivity. The introduction of progressivity into the local tax structure via graduated rates requires a defense of a specific graduated structure, with a given degree of progression, rather than a defense of the general concept itself. Seemingly, equity is easiest to defend on the grounds of equivalent rates applied to a broad income tax base.(3)

Flat Rate Tax in Providence - Based on the following assumptions, a flat-rate payroll tax in the City of Providence could generate approximately $14.5 million and thus reduce the need for future property tax increases:

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(2) Income Taxes and Local Government, R. I. House Fiscal Advisory Staff, December, 1980, p. 4.

(3) Local Revenue Diversification, The Advisory Commission on Intergovernmental Relations, Washington, D. C., Oct., 1974, p. 56.

Assumptions Used For A Providence Payroll Tax

a.	1% tax on wages and salaries paid in the City of Providence	=	$17,000,000[4]
b.	Less 5% administrative start-up cost	=	850,000
c.	Less slippage factor of 10%	=	1,700,000
	Projected Yield		$14,450,000

If the tax was also levied against corporate net profits, the yield of $14.5 million would obviously be increased. Applying the tax to corporate net income would raise administrative problems and be a disincentive for economic growth in the City.

Advantages and Disadvantages - Advocates and opponents of a local payroll tax have developed several arguments supporting their respective positions.

Proponents argue:

1. The local income tax broadens the jurisdictional reach of the local unit.
2. Local income taxes are generally preferred by the local population to increases in the property taxes.
3. Income taxation injects some element of ability to pay.
4. Local income taxation permits a municipality to tax those that use city services but do not directly pay for them.

Those against the proposition hold that:

1. A local income tax adds a third layer of taxation to the already overburdened area of income.
2. A local income tax requires skilled and expensive enforcement apparatus.
3. Local income taxes discriminate against wages and salaries.
4. Local income taxes contribute to the balkanization of urban areas.

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(4) Rhode Island Department of Economic Development estimates the annual payroll in Providence to total $1,700,000,000.

5. Local income taxes aggravate fiscal disparities among neighboring communities.

6. The local income tax can lead to individual and business decisions to relocate elsewhere.

Observations - While interlocal tax differentials can effect individual and business decisions to relocate, the generally low rates of municipal income taxes do not appear to cause any serious movement away from the imposing jurisdiction.[5]

As one study of the local income tax found:

> ... major cities in New York, Pennsylvania, Ohio, Kentucky, Missouri and Michigan have imposed local income taxes without the simultaneous enactment of identical taxes in the surrounding metropolitan area. This disparity has probably resulted in some emigration by city dwellers seeking to escape the local income tax, but the movement has not yet been significant enough to lead to the repeal of local income taxes in the central cities. Three factors have helped to minimize such emigration. First, low rates have limited the incentive to relocate. Second, most local income taxes apply to the income earned in the city, regardless of the worker's residence. Third, particularly in Pennsylvania, suburbs surrounding the central city often follow its lead, quickly imposing comparable local income taxes. Hence the incentive to flee the city for the suburbs has been somewhat reduced.[6]

The same finding emerged from a more broadly based questionnaire which specifically asked: "In your opinion, has the imposition of an income tax by your jurisdiction resulted in the loss of individuals or business firms to other jurisdictions?" From the 54 responses to this question, only six indicated an adverse effect while 48 felt the use of the local income tax did not distort location decisions.[7]

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(5) Local Revenue Diversification. Advisory Commission on Intergovernmental Relations, October, 1974, p. 58.

(6) R. Stafford Smith. Local Income Taxes: Economic Effects and Equity, Institute of Governmental Studies, University of California, Berkeley, 1972, p. 9.

(7) op. cit., ACIR, p. 59.

However, due to the unique demographic characteristics of the State of Rhode Island, the question of a local income tax in the City of Providence cannot be viewed apart from a consideration of the entire state-local tax structure and the state-local public service delivery system. For instance, if the General Assembly grants Providence the authority to levy a local income or payroll tax, should not this ability be granted to all 39 cities and towns? If all cities and towns are given the option of taxing income, the state must declare either the place of residence or the place of employment as the tax situs. If the place of employment is the tax situs, "the tax burden of the worker, in the city with the payroll tax, may be excessive because in all likelihood the place of residence taxes the worker through ... a relatively higher property tax."(8) Conversely, if the area of domicile is used, commuters may not pay a "fair share" of the city's municipal services in the city of employment. Clearly, the issue of the apportionment of tax liability between the commuter's area of residence and his area of employment must be determined if a local option payroll/income tax is to be granted to Rhode Island's cities and towns.

2. Local Option Sales Tax

Background - Sales taxes at the local level do not have some of the problems associated with a local payroll tax. A local government that is given the option of levying a local sales tax, at the risk of competitive retail disadvantage, encounters no significant administrative or jurisdictional problems.

Local general sales taxes are currently levied within 26 states, taking in almost 5,500 units of local government. Table II sets forth a summary of local general sales tax rates by jurisdiction. Local sales taxes generally have the following characteristics:

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(8) L. L. Ecker-Racz, The Politics and Economics of State-Local Finance, 1970, p. 110.

TABLE II

LOCAL GENERAL SALES TAX RATES, OCTOBER 1, 1979[1]

State and Type of Local Government	State Tax Rate (Percent)[2]	Local Government Tax Rates[2]: 1/2 Percent	3/4 Percent	1 Percent	2 Percent	3 Percent
Alabama	4					
270 Municipalities[3]	...	3	...	176	80	2
31 Counties	...	1	...	26	4	...
Alaska	...					
86 Municipalities[4]	...	...	...	9	38	34
7 Boroughs[5]	...	...	...	3	1	1
Arizona	4					
39 Municipalities	...	...	...	35	4	...
Arkansas	3					
1 Municipality	...	...	...	...	1	...
California	4 3/4					
381 Municipalities	...	...	...	381[6]	...	...
58 Counties[7]	...	...	...	...	...	...
3 Transit Districts[8]	...	3	...	...	...	...
Colorado	3					
144 Municipalities[9]	...	...	...	44	78	17
20 Counties	...	1	...	13	6	...
1 Special Distict	...	1	...	...	...	...
Georgia	3					
3 Municipalities	...	...	...	2	...	...
80 Counties	...	...	...	14	...	...
1 Transit District	...	...	...	1	...	...
Illinois	4					
1,256 Municipalities (approx.)	...	23	60	1,173	...	...
102 Counties	...	...	...	102	...	...
1 Transit District[10]	...	...	...	1[10]	...	...
Kansas	3					
15 Municipalities	...	15	...	...	...	...
5 Counties	...	4	...	1	...	...
Louisiana	3					
136 Municipalities[11]	...	1	...	116	11	...
21 Parishes[11]	...	...	...	15	3	...
60 School Districts[11]	...	3	1	44	3	1
Minnesota	4					
1 Municipality	...	...	...	1	...	...
Missouri	3 1/8					
214 Municipalities[12]	...	2	...	209	...	...
3 Transit Districts	...	3	...	...	...	...
1 County	...	...	...	1	...	...
Nebraska	3					
4 Municipalities[13]	...	...	...	3	...	...
Nevada	3[14]					
12 Counties	...	12	...	...	...	...
1 Municipality	...	1	...	...	...	...

See footnotes at the end of table.

LOCAL GENERAL SALES TAX RATES, OCTOBER 1, 1979[1/]

State and Type of Local Government	State Tax Rate (Percent)[2/]	Local Government Tax Rates[2/] 1/2 Percent	3/4 Percent	1 Percent	2 Percent	3 Percent
New Mexico	3 3/4					
93 Municipalities[15/]	...	23	28	...	...	...
6 Counties[16/]	...	...	...	...	...	...
New York	4					
25 Municipalities[17/]	...	...	...	1	6	4
45 Counties	...	...	...	3	7	35
North Carolina	3					
99 Counties	...	...	...	99	...	...
Ohio	4					
50 Counties	...	50	...	...	...	...
1 Transit District	...	...	...	1	...	...
Oklahoma	2					
398 Municipalities	...	...	...	124	258	16
South Dakota	4					
46 Municipalities[18/]	...	...	...	43	2	...
Tennessee	4 1/2					
12 Municipalities[19/]	...	4	1	5[20/]	...	...
92 Counties[21/]	...	...	...	9[20/]	9	...
Texas	4					
921 Municipalities	...	...	...	921	...	...
25 Municipal Transit Authorities	...	8	...	17	...	...
Utah[22/]	4					
201 Municipalities	...	201	...	...	...	...
29 Counties	...		29	...	...	...
Virginia	3					
41 Cities[23/]	...	...	...	41	...	...
95 Counties[23/]	...	...	...	95	...	...
Washington	4 1/2					
264 Municipalities	...	264[24/]	...	...	...	...
38 Counties[25/]	...	35[24/]	...	...	...	...
Wyoming	3					
13 Counties	...	...	...	13	...	...

1/ This tabulation includes only those local sales taxes which authorative information is available.

2/ The rates shown are applicable to general sales of tangible personal property at retail, and exclude numerous limited sales taxes.

3/ Includes 7 cities with a 1½ percent rate and 2 with a 2½ percent rate. In some cases the legislation authorizing county sales taxes takes account of any city sales taxes in the county. Numerous cities specify that the rate outside the city but within its police jurisdiction is ½ of the rate applicable within the city.

4/ Includes one city with a 2½ percent rate, one with a 4 percent rate, and three with a 5 percent rate. Several of these cities are located in the seven boroughs that also impose a sales tax. Sales in these cities are subject to both taxes.

Footnotes continued on the next page.

LOCAL GENERAL SALES TAX RATES, OCTOBER 1, 1979[1]

(Footnotes continued from previous page.)

5/ Includes one borough with a 1½ percent rate, and one with a 4 percent rate.
6/ The 1% city tax is credited against the 1¼% county tax, so that in effect, cities usually receive 80% of the collections under the Bradley-Burns law.
7/ The tax rate for the 58 counties (including the city-county of San Francisco) under the Bradley-Burns law is 1¼%.
8/ The tax is in addition to the present combined State and local sales and use tax rate of 5%.
9/ Includes one city with a 2½ percent rate; and four with a 4% rate.
10/ The Chicago area Regional Transport Authority (RTA). One percent in Cook County and 1/4 of 1 percent in DuPage, Kane, Lake, McHenry and Will Counties. Effective November 1, 1979.
11/ Includes 2 cities with a 1¼ percent rate, and six with a 1½ percent rate; one parish with a 1/2 percent rate, one with a 1½ percent rate, and one with a 2.45 percent rate; two school districts with ¼% rate, three with a 1¼% rate, and three with a 1½% rate. Because of overlapping, a 2% or 3% local rate is in effect in several municipalities and parishes; municipal rate plus parish or school district rate in municipalities, and parish rate plus school district rate in several parishes.
12/ Includes three cities with a 7/8 of 1% rate.
13/ Includes one city with a 1½% rate.
14/ The mandatory 1% "local school support tax" is included in the State rate.
15/ Includes 42 cities with a 1/4% rate.
16/ The tax rates are 1/4 of one percent.
17/ Includes thirteen cities with a 1½ percent rate. The statutory maximum combined city and county local rate is 3 percent except in N.Y.C. and Yonkers. The New York City 4% tax now imposed as a state tax (8% state tax in New York City) effective July 1, 1975. The revenues from this tax will be distributed to the municipal assistance corporation created to assist New York City in meeting its financial obligations until the notes and bonds of the corporation are paid.
18/ Includes one city with a 1¼% rate.
19/ Includes two cities with a 1½% rate.
20/ The maximum tax on a single transaction is $5.
21/ Includes 53 counties with a 1½ percent rate; 7 with a 1 3/4 percent rate; 14 with a 2¼ percent rate; and a maximum of $7.50 on a single transaction.
22/ In addition, counties or municipalities located in transit districts may levy 1/4 of 1 percent tax, subject to voter approval. Three counties and one municipality have enacted the tax.
23/ Local sales tax levied by every county and "independent" city in the State.
24/ County rates must be 1/2 of 1%, city rates may not exceed 1/2 of 1%. If the county in which the city is located imposes a tax, the rate of the city tax may not exceed 0.425%. County tax must allow credit for full amount of any city tax.
25/ Includes two countes (King and Snohomish) with an 8/10 of 1% rate, 3/10 of 1% to finance public transportation systems, and Grays Harbor with a 7/10 of 1% rate , 2/10 of 1% for public transportation systems.

SOURCE: ACIR staff compilation based on Commerce Clearing House, *State Tax Reporter*.

- Conformity with the state base,
- Universal or widespread coverage of the population by the tax,
- State collection and administration of the tax,
- A local option, within a specified range, as to the tax rate, and
- The establishment of tax liability at vendor location rather than place of customer residence.

Economic Impact - Several studies using a variety of testing techniques have considered the question of whether a local sales tax will drive consumers to neighboring non-tax communities. The Advisory Commission on Intergovernmental Relations and the Municipal Finance Officers Association asked:

> "In your opinion, has the imposition of the local general sales tax by your jurisdiction resulted in the loss of business or altered the shopping habits of individuals to the detriment of your community?" Of the 178 responses to this question, 173 indicated that there were no material or adverse effects resulting from the imposition of the local sales tax. In those cases where the respondents elaborated on their "no" answers, the reason generally cited for the lack of a significant adverse consequence was the absence of a major sales tax differential between the jurisdiction imposing this levy and the neighboring communities.[9]

This analysis indicates that imposition of a local sales tax does not have an adverse economic consequence to the taxing jurisdiction when the neighboring communities also impose such a tax.

A study by a Special Subcommittee on State Taxation of Interstate Commerce found:

> ...tax saving is most likely to induce crossing the borders for occasional major purchases where the tax can be a significant consideration. While the overall effect on retailing is probably slight, particular stores may be significantly disadvantaged by sales tax border effects. But even if the

[9] Local Revenue Diversification, Advisory Commission on Intergovernmental Relations, October, 1974.

> demonstrable effect is slight, it would seem undesirable for the retail merchant to be subjected to this kind of competition.(10)

Providence Sales Tax - The Rhode Island Department of Economic Development reports that total retail sales in Providence subject to the Rhode Island sales tax totalled approximately $409 million in fiscal year 1979. Therefore, at the rate of 1% a Providence sales tax could be projected to generate $4,000,000. However, because the Rhode Island sales tax is basically a tax on durable goods the literature suggests that such a tax could adversely impact retail sales if Providence was the only city in the area to levy such a tax. Furthermore, it should be noted that in 1966, 38.6% of all retail sales subject to the sales tax in Rhode Island occurred in Providence; by 1978 the percent was 17.7%.

3. Service Charges

Background - Exemptions from property taxes in the City of Providence have eroded the tax base substantially. According to the City's Tax Assessor, 28% of all property is exempt from property taxes in the City of Providence. This figure is likely to be conservative considering the fact that tax exempt properties are likely to be under-assessed. Property tax exemptions in Providence are varied. Some are attempts to aid private causes that are deemed to hold public importance and others promote social reforms. However, it must be remembered that exemptions from property taxes are a form of subsidy. These subsidies do not appear on the City's budget or accounting records and thus tend to receive approval with less scrutiny than would direct appropriations for the same purposes. Furthermore, providing necessary municipal services for tax exempt properties places additional burdens on other property taxpayers.

(10) Special Subcommittee on State Taxation of Interstate Commerce, House Judiciary Committee, Report on State Taxation of Interstate Commerce, House Report 565, 89th Congress, 1st Session, Vol. 3., 1965, p. 769.

Determining Service Charges - A study prepared for the Rhode Island Department of Community Affairs suggests that service charges can be determined on two general bases:

> ... the cost of providing the service depends upon the level of usage, a rate based on the number of units of output should be used. On the other hand if the cost of providing a service does not depend on its level of usage but rather on its availability, the service charge can take the form of an annual flat rate fee. For example, cost of providing water supply and sewage disposal increases almost proportionately to the volume or level of its use; consequently, the price charged for these services should be based on the amount of usage.
>
> Public safety items like fire protection and police protection costs are determined by their availability rather than by the volume of their use. Therefore, an annual flat rate fee could be charged in these instances.(11)

In the first category, level of usage, fees can be determined much as they are at the present time with water supply. In the second category, flat rate charge, a basis for setting the charge must be determined.

One method to use in determining service charge payments for municipal services not based on the level of usage is as follows:

a. Identify services for which service charges can be justified. The criterion used would be those services which the City performs that maintain the value of all properties within the City. Such services include police and fire protection, highway and street maintenance and construction, snow removal and street lighting.

b. Determine the total annual municipal appropriations for these services. This figure represents the tax levy that the City would have to raise to support the identified services.

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(11) Peter R. Moore, Property Tax Exemption and the Use of Local Service Charges, Rhode Island Department of Community Affairs, 1977, pp. 11-12.

c. Calculate a tax rate for the services identified by using the total appropriation for the service as the tax levy and the assessed value of all taxable property plus the assessed value of the tax exempt institutions.

$$\frac{\text{Tax Levy}}{\text{Assessed Valuation}} \times \$1{,}000 = \begin{array}{l}\text{Service Charge Rate for}\\ \text{Tax Exempt Institutions}\end{array}$$

d. Determine the service charge payment for each institution by multiplying the service charge rate (c.) by the assessed value of the institution.

e. Determine the service charge for each institution by multiplying the tax rate for the service by the assessed value of the institution.

Table III sets forth a projection of potential service charges the City would have received in fiscal year 1979 if this method of assessing service charges was operative. As shown in this Table, the potential revenues to the City would have totalled $2.3 million. Allowing for inflation and possible payments by the state government, this figure could total over $3.0 million in fiscal year 1982.

4. User Charge Financing

In the Advisory Committee's interim report it was suggested that a complete analysis of the City's fee structure should be conducted to determine if additional revenues might be generated from non-property tax sources. To date such an analysis has not been undertaken, and a comprehensive review of this subject will probably have to await the comprehensive management study of all City operations. However, in the interim, certain preliminary observations and suggestions can be considered.

Consideration of user charge financing can be divided into four areas:

a. Charges for the use of specific City facilities;

b. Charges for specific activities that are used by both City residents and non-residents;

c. Charges for City services used by residents such as sewage and sanitation; and

d. Charges for licenses and permits.

TABLE III

Explanation:
This table illustrates service charge revenues and tax rates that would have derived from tax exempt properties in fiscal year 1979.

The horizontal axis shows the service charge revenue and tax rate which would apply to each tax exempt category or combination of categories for each service or combination of services as listed in column 1.

The last column (Total), reading vertically, shows the total revenue and tax rate for each of the services listed if all tax exempt properties were assessed service charges. Therefore, if Hospitals, Schools, Churches and Charitable Organizations had paid a service charge for Fire, Police, Highway, Street Cleaning, Snow Removal and Street Lighting the service charge rate would have been $15.18 per $1,000 of assessed valuation and the total revenue realized would have been $2,302,335.

Fiscal Year 1979	Hospitals	Schools	Churches	Charitable	Total
1. Fire Department Expenditure = $8,766,555	$ 305,378 ($6.54)	$ 440,879 ($6.43)	$ 156,310 ($6.65)	$ 86,586 ($6.71)	$ 919,114 ($6.06)
2. Police Department Expenditure = $9,058,980	315,650 ($6.76)	455,963 ($6.65)	161,481 ($6.87)	89,425 ($6.93)	949,448 ($6.26)
3. Highway, Street Cleaning, Snow Removal, Street Lighting Expenditure = $4,122,233	143,350 ($3.07)	207,069 ($3.02)	73,571 ($3.13)	40,648 ($3.15)	432,257 ($2.85)
4. Police, Fire and Other Expenditure = $21,947,768	764,378 ($16.37)	1,103,911 ($16.10)	391,362 ($16.65)	216,659 ($16.79)	2,302,335 ($15.18)
5. Assessed Value 12/31/78	$46,693,830	$68,565,920	$23,505,200	$12,904,030	$151,668,980

Source: State Department of Community Affairs. Estimates based upon actual FY '79 expenditures and property assessments as of December 31, 1978.

<u>Zoo and Museum</u> - In fiscal year 1981, property taxpayers in Providence will be asked to spend $512,000 to operate a zoo that is used and enjoyed by people throughout the entire region, and $121,000 to operate a museum.

<u>Licenses and Permits</u> - Permits and licenses are frequently issued to business as a part of a general regulatory process. Generally, they involve an inspection or examination as a condition of obtaining or keeping the permit or license. Because of the large number of different permits and the relatively modest size of individual fees, local jurisdictions often fail to maintain a realistic fee structure. Because of the continuous increase in the general price level and in real wage rates (both the paperwork and the inspections are very labor intensive in nature), the failure to update fees short changes the local exchequer.

For instance, immediate steps can be taken to generate another $400,000 in fees for licenses and permits as shown below:

<u>License and Permit Fees</u>

Department	Revenues	Expenditures
Building Codes and Inspection		
Administrative	$ - -	$145,286
Structure & Zoning	115,000	154,404
Plumbing, Drainage & Gas Pipe	20,000	88,760
Electrical Inspect.	35,000	59,284
Mechanical Equipment & Installation	35,000	72,377
Zoning Board of Review	4,000	49,469
Building Board of Review	1,500	11,415
Housing Board of Review	100	5,696
Total - Building Code & Inspection	$210,600	$586,691

Furthermore, with the exception of fees set by the state (such as liquor licenses), license fees for entertainment, victualling, petroleum storage, and parking and traffic violations can be increased. For instance, if these were doubled, an additional $700,000 might be generated (Bureau of Licenses - entertainment, victualling, etc., $85,000; petroleum storage, $10,000; and parking and traffic violations, $600,000 est.).