Is San Diego a Low-Tax City?

By Thad Kousser
Assistant Professor, Political Science
University of California, San Diego

Since 1996, the city of San Diego has pursued the same fiscal policy that the federal government has consistently adopted over the past three decades and that California's state government has recently experimented with: it has spent and promised more money than it has raised.

Just as fiscal imbalance has led to a federal deficit and state bailout bonds, San Diego's disparity between revenues and expenditures has taken the form of underfunded pension plans, illegitimately disguised. This deception has created particularly difficult problems, but the city's basic decision to spend more than it had is similar to the risky strategy pursued by other levels of government. What can the city do to set its fiscal house in order?

Policymakers must choose from four painful options. They can retract pension benefits, cut municipal salaries and services, raise additional revenues, and sell more bonds. While much of the recent debate has focused on the money leaving the city's coffers to provide services and pension fund payments, it is equally important to look at the other side of the equation by evaluating potential changes in the number of dollars brought in by taxes and bonds. Is it reasonable to expect San Diego residents and businesses to contribute more to city revenues? When audits of its finances are completed, can the city raise more money from bonds?

A recent report produced by the labor-affiliated Center on Policy Initiatives (CPI) argues that San Diego is a low-tax city compared to other large California municipalities. It asserts that "Businesses and households in the city of San Diego contribute far less as a proportion of their revenue or income to the provision of General Services than do the average businesses and households in the 10 largest cities in California. (CPI, 2005, p. 2)" Based on my initial analysis, it appears that the CPI report cites figures in a way that exaggerates its very strong case. Going back to the CPI's original data sources, I present tables below that use different data to answer the same basic questions about San Diego's relative tax burden.

The bottom line remains unchanged: San Diegans pay less to city government than residents in other large California cities, especially given the area's affluence. While the discrepancy is not as large as it appeared in the CPI report, it is still there. I also present data to highlight another of the city's unique fiscal characteristics. Currently, San Diego has authorized the lowest bond debt of any of the comparison cases. Using the CPI report and projections supplied by the Chamber of Commerce, I then discuss options for raising revenues. I detail how much each tax or fee increase could bring in, show what political actions would be required, and summarize the arguments for and against such a change.

Comparing San Diego's Revenues to Other Cities

To determine whether San Diego's city taxes and fees are either high or low, it is necessary to summarize those revenues and judge them against the same summary for comparable cities.

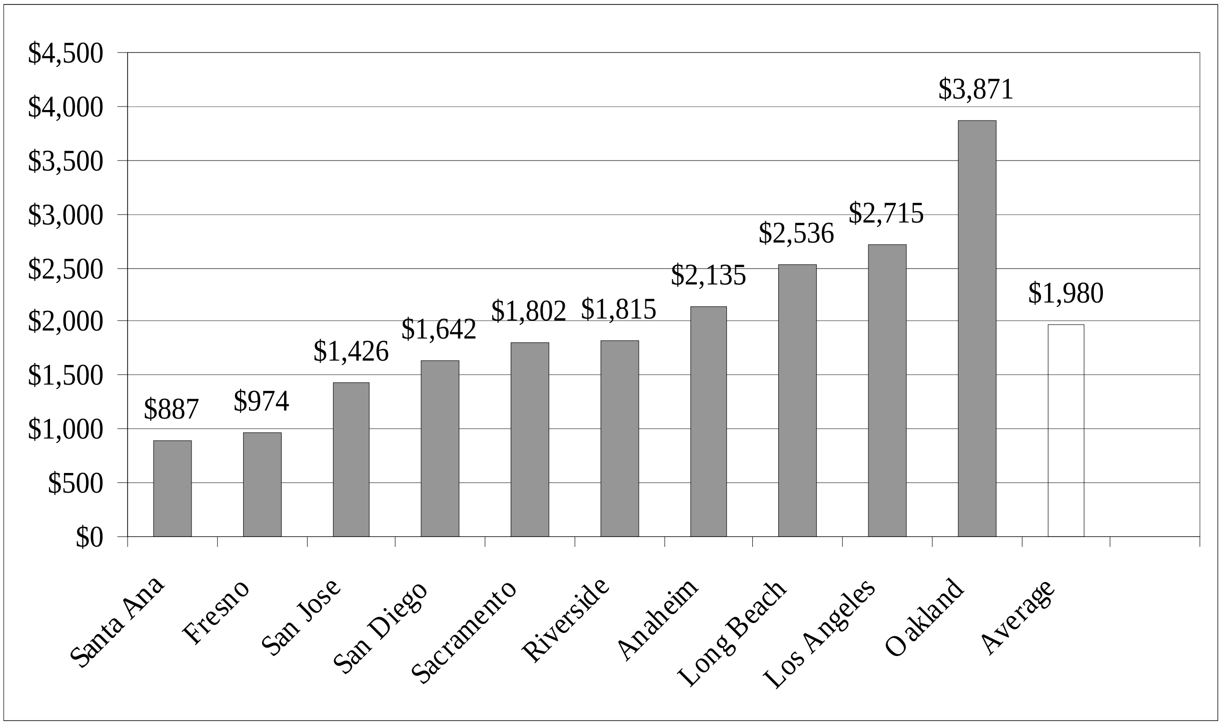
Consequently, researchers have two choices to make. What's the best summary, and what are comparable cases?

The CPI report focuses on a city's "General Revenues" as the best way to measure the amount of money that it brings in. These revenues typically come from property and sales taxes, business license fees, utility user taxes, and state aid, and can be spent however cities choose. CPI chose General Revenues because they are discretionary (Cohen, 2005, p. 7), which is true, but they dramatically understate the total burden on residents and businesses. Cities in California raise twice as much in "Functional Revenues" as they do from General Revenues (Westly, 2005, p. vi). These include fees for water and sewage service, vehicle code fines, and zoning fees, as well as grants from the state and federal governments. Functional revenues are paid primarily by San Diego households and businesses, so I argue that they belong in any summary of the tax burden. Because San Diego happens to rely more on Functional Revenues than other California cities, ignoring these revenues understates the city's relative tax burden.

The other choice made in the CPI report is to compare San Diego to California's 10 largest (by population) cities. Overall, this makes good sense. Even though San Diego may be competing for businesses with cities in other states such as Phoenix, Las Vegas and Austin, it is very difficult to compare city finances across states. Cities in different states assume responsibility for different services, such as schools, and have access to different revenue streams. Any observed difference may have more to do with the structure of state-local fiscal relations than it does with taxing decisions and service efficiency. So I agree that similarly-sized cities within California form the right comparison group, with one exception.

Unique among California cities, San Francisco is also a county. It assumes responsibility for more services, especially health and welfare, and has access to more revenues. Comparing it

Table 1. Comparison of Total Revenues per capita, 10 largest California cities



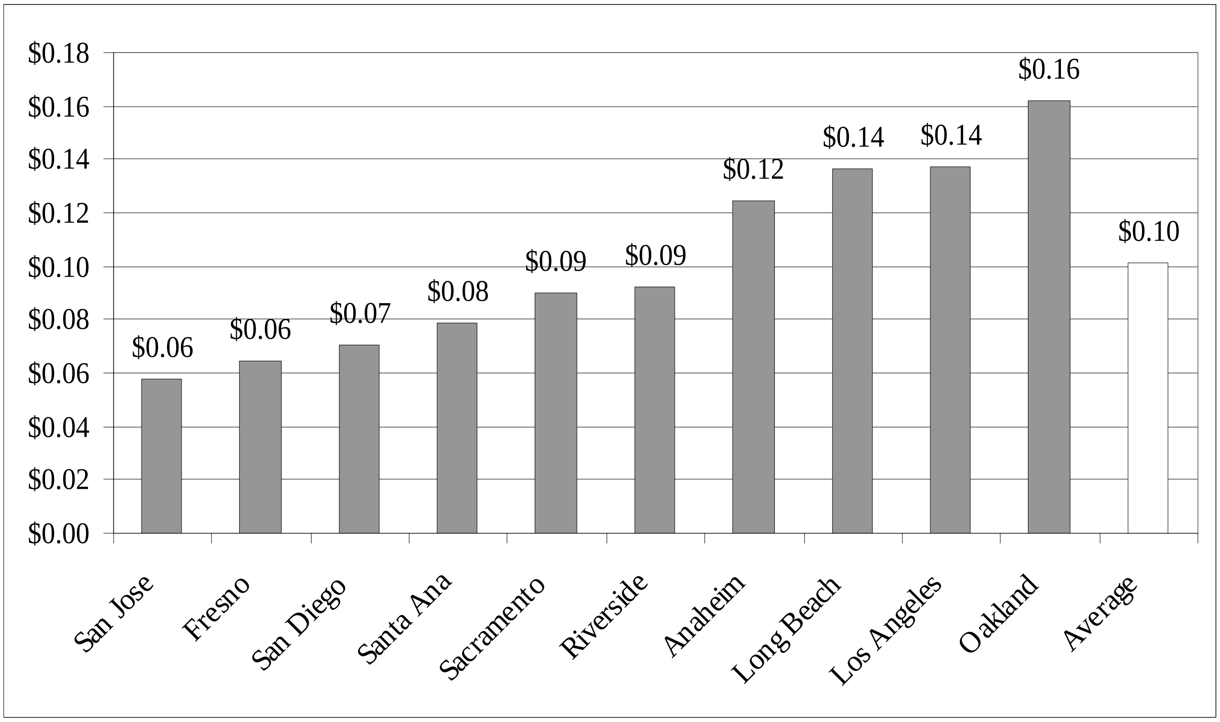
Notes: Total Revenues combine Functional Revenues and General Revenues for each city in the fiscal year that ended June 30, 2003, as reported by cities to the state Controller and published in Westly (2005). Population figures are taken from estimated June 30, 2003 populations, also reported in Westly (2005). San Francisco is excluded because it is both a city and a county.

to San Diego makes as little sense as comparing San Diego to a city in another state. The state Controller's office recognizes this, and excludes the city and county of San Francisco from all of its summary analyses. I will follow their lead.

Looking only at General Revenues and including San Francisco, the CPI report finds that San Diego raises $464 per capita compared to an average of $693 per capita in the top 10 cities, making our revenues just 67 percent of the average. The figures that I provide in Table 1 (above) look at Functional as well as General Revenues, and replace San Francisco with the state's 11th most populous city, Riverside. The table shows that San Diego is still below average, though not by as much. Our total revenues of $1,642 per capita are 83 percent as large as the average of $1,980.

Even if our taxes are low, can San Diegans afford to pay this much? In order to answer this question, I follow the approach of the CPI report and compare total revenues to the total household income in each city. By this analysis, the city looks especially frugal, because San Diegans earn relatively high incomes. According to the U.S. Census Bureau's 2003 American Community Survey, San Diego's median household income of $47,631 places it second only to San Jose among the 10 comparison cases. Using total household income as a baseline, Table 2 shows that San Diego's revenues are low given this measure of residents' ability to pay. For every dollar of household income generated in the city, the city takes in 7 cents of revenues (coming directly from residents and businesses in the form of local taxes and fees, and indirectly through transfers from the state and federal governments). San Diego's figure is only 70 percent of the average revenues to income ratio.

Table 2. Total Revenues, per dollar of total household income



Notes: Bars represent the ratio of Total Revenues for each city in the fiscal year that ended June 30, 2003 (Westly, 2005), divided by the total household income in each city, taken from the U.S. Census Bureau's 2003 American Community Survey.

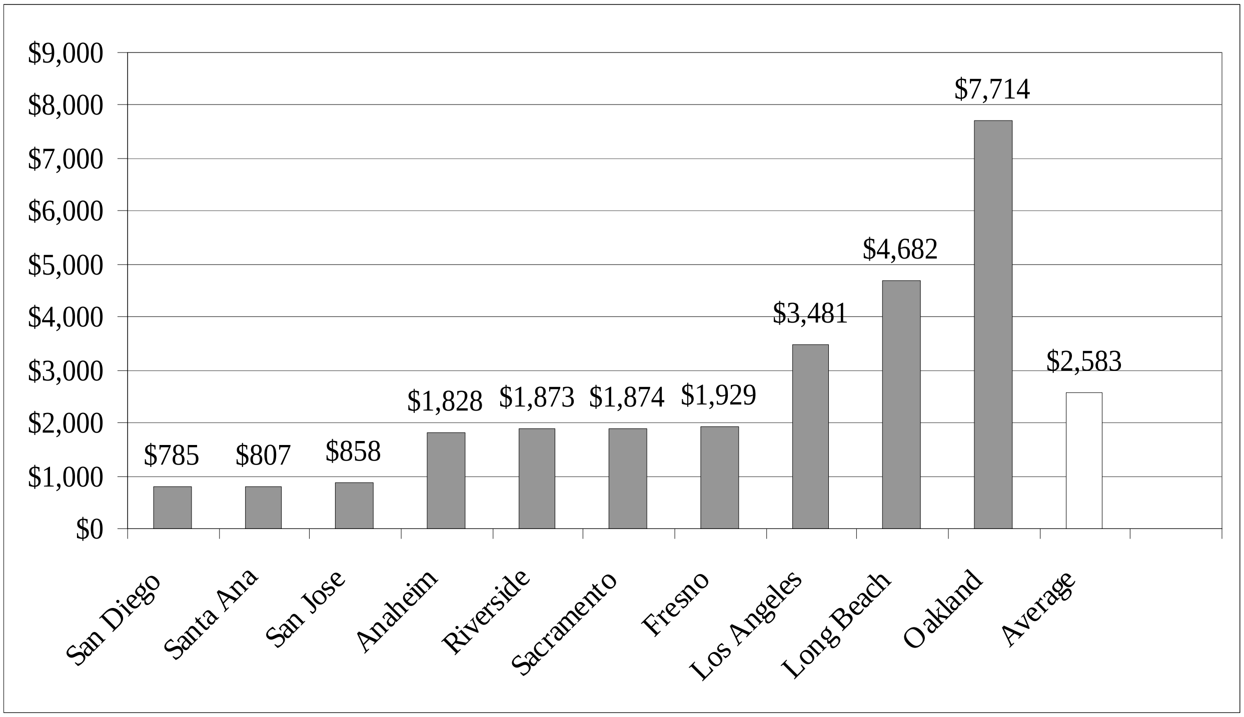
Comparing San Diego's Debt to Other Cities

While it is important to note that an underfunded pension plan is another form of debt, and that San Diego cannot currently increase its bond debt because the city's credit rating has been suspended, one long-term option for the city is to spread the pain of the pension crisis over time by borrowing more. Local bonds can be used to build infrastructure, improve city facilities, and fund public safety infrastructure systems, needs that might otherwise go unmet in a time of cutbacks. Currently, San Diego has authorized and issued just over a billion dollars worth of bonds. Compared to other large cities in California, is this a large figure?

Table 3 (below) shows that it is not, that San Diego's debt per capita is the lowest of the ten comparison cases. At $785 for every resident, it is only 30 percent of the average value. Note that these figures come from 2003, before the suspension of the city's credit rating. San Diego's low level of debt seems particularly puzzling given the high value of property in the city. Charter law cities in California, like San Diego, generally follow the guideline of borrowing no more than an amount equal to 15 percent of the assessed value of property in the city (Westly, 2005, p. xxviii). Since San Diego's property values are so much higher than most cities, one would expect that our city would borrow more than others. One possible explanation of the lack of city borrowing may be that other government entities that overlap with the city, such as the San Diego Public Facilities Financing Authority and the San Diego

Facilities and Leasing Corp., have issued sizable bonds. Still, based on the data reported by the state controller, San Diego has issued much less debt relative to its population and property values than other California cities.

Table 3. Bond Debt, per capita



Notes: Bond debt figures taken from the "Statement of Long-Term Indebtedness, Amount Authorized" for each city, as listed in Westly (2005). Population figures are taken from estimated June 30, 2003 populations, also reported in Westly (2005).

Evaluating San Diego's Options for Raising Revenues

A. Charge All Residents for Refuse Collection

-- How Much Could It Raise? Currently, the city provides free residential refuse collection, spending $8.64 per month per household. According the CPI report, charging a fee to these households that is just large enough to recover these costs would bring a $47.9 million increase in annual city revenues (CPI, 2005, p.13). Another option for the city that the Chamber of Commerce has explored would be to contract for these services privately (San Diego Regional Chamber of Commerce, 2005), saving the $47.9 million that it currently spends to provide them and charging the contractor a 5-13 percent franchise fee.

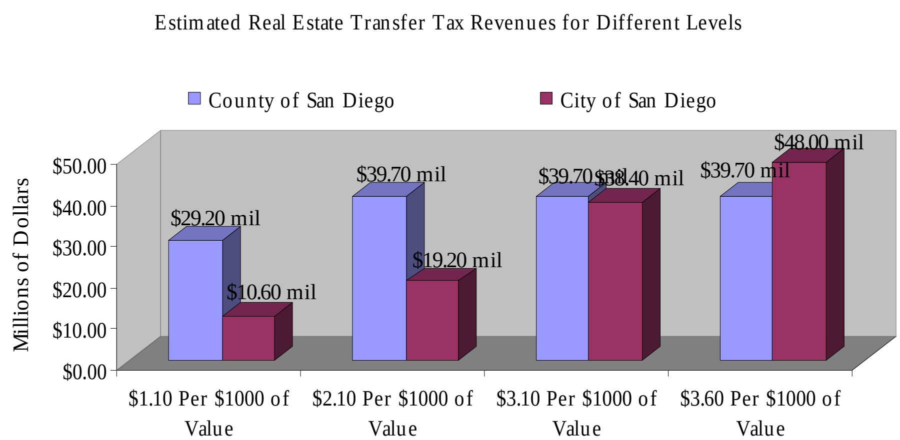
-- What Political Actions Are Necessary? A fee for residential refuse collection would require an amendment to the city charter, approved by voters.

-- Arguments in Favor. Residents of California's other large cities and of neighboring cities all pay fees for trash collection, receiving a clear service in return for their payments. Charging for this service would equally treat residents who live on public streets (and currently pay no fees for their garbage collection) and those who live in private housing associations which must contract for curbside refuse collection today.

-- Arguments Against. This is not a progressive tax, because it would cost all residents the same amount, and an additional $8.64 a month could burden residents living on fixed incomes.

B. Increase the City Tax on Real Estate Transfers.
-- How Much Could It Raise? Although San Diego in 2002 had the highest value of real estate transfers in the state (CPI, 2005, p. 10), it taxes these transfers at a rate of only 0.055 percent. This is the same rate that four of California's other large cities charge, but it is much lower than the rates charged by San Jose (0.330 percent), Los Angeles (0.450 percent), or Oakland (1.5 percent). The Chamber of Commerce supplied the graph below, estimating the increases in revenues that would be generated by raising the transfer tax to three possible levels. It could raise between $10.6 million and $48 million annually.

-- What Political Actions Are Necessary? If not earmarked for a specific purpose, this would likely be categorized as a "general tax" and thus, under Proposition 218, require the approval of a simple majority of San Diego voters.



Source: The Economic Research Bureau of the San Diego Regional Chamber of Commerce

-- Arguments in Favor. Real estate transfer taxes would be paid by only both those involved in the selling of real estate in San Diego, which in recent years has been a profitable enterprise.

-- Arguments Against. Housing affordability is a chronic problem in San Diego, and any tax that might be passed on to home buyers could make this problem slightly worse.

C. Enact a Surtax on the Use of Utilities
-- How Much Could It Raise? San Diego, Fresno and Anaheim are the only large California cities that do not charge a utility users tax, collected by the third-party utility. Other cities

collect an average of $92.21 a year per resident from such taxes, and San Diego could raise $112.6 million annually if it met this average (CPI, 2005, p. 13).

-- What Political Actions Are Necessary?
If not earmarked for a specific purpose, this would likely be categorized as a "general tax" and thus, under Proposition 218, require the approval of a simple majority of San Diego voters.

-- Arguments in Favor. These surtaxes are used in many other cities, and their impact is spread out across all residents according to how much they spend on utilities.

-- Arguments Against. Similar to a sales tax, this is not a progressive form of taxation, and it does not directly pay for a service that the city provides.

D. Increase the Transient Occupancy Tax
-- How Much Could It Raise? San Diego's 10.5 percent room tax is lower than the average tax in other large California cities, which ranges from 9 percent in Santa Ana to 12 percent in Long Beach, Fresno and Sacramento to 15 percent in Anaheim. If San Diego increased its transient occupancy tax rate to 12.4 percent, this would generate an annual revenue increase of $9.9 million (CPI, 2005, p. 9).

-- What Political Actions Are Necessary? Since half of the revenues generated by this tax are earmarked for a specific purpose, it would be categorized as a "special tax" under Proposition 218, and require the approval of a two-thirds majority of San Diego voters.

-- Arguments in Favor. This tax would be paid not by San Diego residents but by visitors to the city, whose visits do require the city to spend additional money on services.

-- Arguments Against. San Diego's tourist industry has rebounded in the wake of Sept. 11, but an increase in the transient occupancy tax could threaten its health by making convention bookers less likely to choose San Diego.

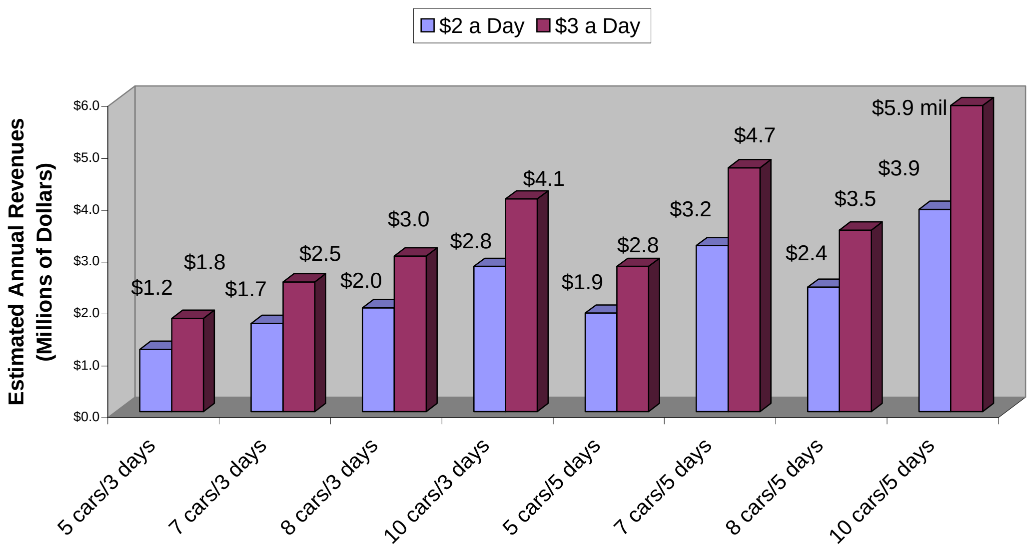
E. Charge a Daily Fee on Rental Cars.
-- How Much Could It Raise? According to the graph (below) supplied by the Chamber of Commerce, charging San Diego's rental car dealerships a daily fee of $2 or $3 per rental would generate between $1.2 million and $5.9 million in annual revenues, depending on how many cars they are able to rent.

-- What Political Actions Are Necessary? If this is explicitly worded as a fee, rather than a tax, it may require only the approval of elected city officials rather than voter approval.

-- Arguments in Favor. Rental car fees are paid primarily by out-of-town visitors and by insurance companies paying for the rentals of San Diego residents who have been in accidents.

-- Arguments Against. This fee might discourage out-of-town visitors from renting cars.

Estimated Annual Revenue Generated by a Rental Car Tax in the City of San Diego



There are 108 Car Rental businesses operating within the City of San Diego according to the city's financial services department. Assuming that each company rents an average of 5 cars a day, with each rental lasting 3 days, an estimate of total daliy revenues is generated. Multiplying those estimates by the total number of days in a year produces an estimat of total annual revenues generated. Using the same calculation estimates of total annual revenue from a rental car tax were generated using 7 car and 5 day

Source: The Economic Research Bureau of the San Diego Regional Chamber of Commerce

Works Cited:

Center on Policy Initiatives, 2005. Revenues, Expenditures and Services of the City of San Diego: A Comparative Analysis (San Diego: Center on Policy Initiatives).

San Diego Regional Chamber of Commerce, Economic Research Bureau, 2005. City of San Diego Waste Management Practices (San Diego: San Diego Regional Chamber of Commerce).

U.S. Census Bureau, 2005. 2003 American Community Survey: 2003 Data Profiles. Accessed at http://www.census.gov/acs/www/ *in May, 2005.*

Westly, Steve. California State Controller. Cities Annual Report, Fiscal Year 2002-2003. (Sacramento, CA: California State Controller).