West Virginia Public Finance Program
Project Report

Municipal Finance in West Virginia: Forging a Course for Fiscal Stability*

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Executive Summary

As an important component of the local government structure in states, municipalities are constantly engaged in competition for resources. In this competitive environment, it has often been argued that West Virginia's municipalities are under financial restraint due to many factors such as demographic pressures, recent fiscal woes facing the state, and the structural problems in municipal financing. This study presents a comprehensive review of the current system of municipal finance in West Virginia with an emphasis on how it compares to other states in the Appalachian region.

Municipal financing systems operate under a broader state and local tax structure. The state government in West Virginia has consistently had a strong role in tax revenue generation over the past three decades, which goes against an overall decentralization trend in the Appalachian states. This points to a diminished role for local governments including the municipalities. Additionally, there is a decreasing trend in the share of property taxes in total state and local tax revenue over the past three decades in Appalachia. West Virginia and its surrounding states, particularly Ohio, exhibited considerable decreases in the share of property taxes.

West Virginia municipal financing system is evaluated based on three criteria: revenue adequacy, neutrality and equity. Revenue adequacy requires that financing sources raise enough funds to cover the cost of planned public expenditures. Neutrality refers to economic efficiency. It requires that the financing system should have as little impact on economic decisions as possible. Equity criterion is about "who ultimately pays for the municipal services?"

The analysis of the West Virginia municipal general revenue sources shows that business and occupation tax, property tax and the total municipal charges, licenses and service fees are the three largest revenue sources accounting for 91% of total general revenue. The business and occupation tax, which is the largest single revenue source for municipalities, is found to perform poorly in terms of both neutrality and equity. It leads to high effective tax rates, putting substantial burdens on both businesses (within corporate limits of the city) and consumers. The inflation-adjusted revenue growth between Fiscal Year 1999 and Fiscal Year 2003 has been quite weak. It nevertheless has a broad tax base that generates substantial revenue for municipalities.

There is a lack of consensus in the economics literature on the economic effects of the property tax. Despite its stable tax base, revenue generation of the property tax is impeded by the rate limits brought by the 1932 Tax Limitation Amendment. The same amendment created four taxable property classes, leading to a relatively large burden on the business property. The study points to the fact that West Virginia municipalities together account for **34%** of the total taxable valuations, while they capture only **7.8%** of the total property tax levies. A closer look at larger cities shows that 13 counties with Class I and II municipalities account for **47.6%** of the total taxable valuations, while they capture only **10%** of the total property tax levies. Finally, there has been a moderate inflation-adjusted revenue growth in the property tax between Fiscal Year 1999 and Fiscal Year 2003.

Revenue items within the total municipal, charges, licenses and service fees generally conform to the benefits-received principle in the sense that people or businesses directly pay for the public services that they actually demand. However, low-income households still pay a greater portion of their income in user charges compared to higher-income households. Total municipal, charges, licenses and service fees exhibited strong inflation-adjusted growth between Fiscal Year 1999 and Fiscal Year 2003.

The study addresses the relationship between municipal population and revenue. It is found that 75% of all West Virginia municipalities experienced population losses between 1990 and 2000 with largest losses in municipalities with populations greater than 10,000. A comparison with other Appalachian states shows that West Virginia is the only state that lacks municipalities with population greater than or equal to 75,000. West Virginia municipalities with larger populations seem to have a greater revenue-generating capability compared to municipalities with smaller population sizes. West Virginia municipalities, as a whole, have lower revenue per capita than both the average of all municipalities in Appalachian states and the average of all municipalities in the United States. Thus, low population density and population loss in West Virginia municipalities seem to be serious impediments to revenue generation.

Comparing the municipal finances in West Virginia to municipalities in the Appalachian region, it is found that:

- West Virginia's municipalities rely heavily on charges and miscellaneous general revenue. They have the highest share of charges and miscellaneous general revenue in total revenue in the Appalachian region.

- The intergovernmental revenue share in West Virginia's municipalities is the lowest among the Appalachian states and it is far below the national average. More specifically, West Virginia municipalities have the lowest share of revenue from the state government in total municipal revenue in the Appalachian region.

The study concludes with a list of alternative revenue sources and policy options that can be considered as measures to enhance revenue generation in West Virginia municipalities. These are:

- Local income taxes
- Local sales and use taxes
- Local alcohol taxes
- Local cigarette and tobacco taxes
- Local gasoline tax
- Tax increment financing
- Lottery funds
- Replace the business and occupation tax
- Statewide education levy

Municipal Finance in West Virginia: Forging a Course for Fiscal Stability

1. Introduction

Economists argue that jurisdictions compete with each other to bring in more resources to enrich their respective communities. People and businesses move to places that offer their preferred bundle of public services and taxes. This occurrence, popularly known as "voting with your feet," has been shown to lead to an efficient allocation of economic resources across communities under certain conditions (Tiebout 1956).

As an important component of the local government structure in states, municipalities are constantly engaged in competition for resources. In this competitive environment, it has often been argued that West Virginia's municipalities are under financial restraint due to many factors such as demographic pressures, recent fiscal woes facing the state, and the structural problems in municipal financing (Thompson and Kee 1968, Klase 1994, Reece 1994, Plein and Williams 1996). This study presents a comprehensive review of the current system of municipal finance in West Virginia with an emphasis on how it compares to other states in the Appalachian region.

2. Changes in State and Local Tax Systems in U.S. States and in West Virginia

Municipal financing systems operate under a broader state and local tax structure. While West Virginia's state tax system has already been examined in other studies,[1] it would be useful to examine the municipal financing structure with respect to the general state financing structure.

There have been significant changes in the state's share in total tax revenues both in West Virginia and in other states. Table 1 shows a comparison among a sample of Appalachian states. The average of state shares has not changed much over the past thirty years. However, changes for individual states are quite noteworthy. While states like South Carolina, Georgia, Alabama, New York and North Carolina exhibited considerable decentralization of tax revenues (decrease in state's share or increase in the share of local governments) between 1970 and 2000, there is a visible centralization trend in Ohio, Pennsylvania, West Virginia and Kentucky in the same period. It is interesting that this latter trend is seen mostly in West Virginia and its surrounding states. The same thing can be said for Virginia as well when we look at the period 1992-2000. We also see in Table 1 that the state's share in West Virginia remained higher than the sample average across all considered periods. In fact, in Fiscal Year 2000, West Virginia had the highest state share among the sample states. Therefore, the state government in West Virginia has consistently had a strong role in tax revenue generation over the past three

[1] Tosun and Takashima (2002) and Tosun (2002a) provide comparative analysis of the West Virginia state taxes.

decades. This points to a diminished role for local governments including the municipalities.

Table 1: State's Share in Total State and Local Tax Revenues

State	Fiscal Year 1969-70	Fiscal Year 1991-92	Fiscal Year 1999-00	Percentage Change (FY 1970 to FY 2000)	Percentage Change (FY 1992 to FY 2000)
Alabama	73.8	70.6	68.4	-7.3	-3.1
Georgia	65.8	58.4	58.1	-11.7	-0.5
Kentucky	73.0	77.0	75.6	3.6	-1.7
Maryland	57.2	56.7	56.6	-1.0	-0.1
Mississippi	74.1	71.6	74.8	0.9	4.4
New York	51.4	47.0	48.0	-6.5	2.1
North Carolina	75.3	70.9	71.4	-5.1	0.8
Ohio	46.6	56.3	57.5	23.3	2.1
Pennsylvania	58.7	61.9	61.4	4.6	-0.8
South Carolina	76.5	69.3	66.9	-12.6	-3.5
Tennessee	62.7	62.6	62.3	-0.7	-0.6
Virginia	60.4	55.2	60.0	-0.7	8.7
West Virginia	**73.3**	**78.2**	**76.6**	**4.6**	**-2.0**
Average of Sample States	65.3	64.3	64.4	-1.3	0.2

Source: U.S. Census Bureau, State and Local Government Finances.
http://www.census.gov/govs/www/estimate.html

Another visible trend is the change in the weight of property taxes within the state and local tax structure. Table 2 shows an overall decrease in the share of property taxes in total state and local tax revenue over the past three decades. The share of property tax decreased in all but two states (South Carolina and Virginia) between 1970 and 2000. In fact, South Carolina was the only state that showed any visible increase in the importance of property taxes in total state and local taxes. West Virginia and its surrounding states, particularly Ohio, exhibited considerable decreases in the share of property taxes. While the property tax share in West Virginia remained below the average share for sample states in all periods, it recorded an increase between 1992 and 2000.

Table 2: Share of Property Taxes in Total State and Local Tax Revenue

State	Fiscal Year 1969-70	Fiscal Year 1991-92	Fiscal Year 1999-00	Percentage Change (FY 1970 to FY 2000)	Percentage Change (FY 1992 to FY 2000)
Alabama	15.2	12.2	14.2	-6.4	16.6
Georgia	30.5	30.0	25.5	-16.4	-15.0
Kentucky	22.9	16.9	16.9	-26.1	0.3
Maryland	32.4	28.0	26.3	-18.8	-6.1
Mississippi	24.1	27.4	23.2	-3.7	-15.3
New York	36.4	33.4	29.0	-20.3	-13.1
North Carolina	25.3	22.1	21.5	-15.1	-2.7
Ohio	47.2	29.7	27.9	-40.9	-6.2
Pennsylvania	29.5	27.8	27.5	-6.7	-0.9
South Carolina	22.4	28.1	28.1	25.4	0.1
Tennessee	27.5	22.8	23.2	-15.5	2.0
Virginia	28.3	32.8	28.4	0.3	-13.4
West Virginia	**23.3**	**17.8**	**19.6**	**-15.9**	**10.3**
Average of Sample States	28.1	25.3	24.0	-14.7	-5.3

Source: U.S. Census Bureau, State and Local Government Finances.
http://www.census.gov/govs/www/estimate.html

3. Evaluation Criteria for Municipal Financing Systems

What is a "good" municipal financing system? This is a critical question in our evaluation of the municipal financing system in West Virginia. While the attributes of a good system of financing can be numerous, the state and local public finance literature focuses on a number of criteria.

3.1. Revenue Adequacy

One of the first things that a municipal government official would consider in evaluating a financing system is whether the financing sources will raise enough funds to cover the cost of planned public expenditures. In state and local tax systems, there is an added requirement that a state or local government balance its budget. Two related virtues of a good financing system are flexibility and stability. Flexibility is important because the public's demands for different services change over time, which requires the financing system to be flexible in its revenue generation. At the same time, certain services such as education require a stable financing system since such services are expected to persist in both the short and the long run.

3.2. Neutrality

This criterion is the same as economic efficiency or market efficiency. A financing system should not discriminate between the decision-making processes of different economic agents such as businesses and individuals. It should also have as little impact on economic decisions as possible. While any practical tax instrument would create distortions in the economy leading to efficiency costs, neutrality favors taxes that are broad based. As we address in the following sections, many municipal financing instruments, such as certain taxes and most charges and fees, are very narrowly defined and they fail to comply with the neutrality criterion.

3.3. Equity

Any tax or financing system needs to be equitable. "Who pays for the municipal services?" is a fundamental question. It is important to note the difference between "statutory" and "economic" incidence of taxes and other financing instruments. Economic incidence is defined as the change in the distribution of economic welfare due to a policy. For instance, the statutory incidence of a tax is on the taxpayer who is legally liable to remit the tax while the economic incidence of the tax is on the people who ultimately pay the tax. So the question can be rephrased as "who ultimately pays for the municipal services?"

The equity criterion branches into two principles of taxation: ability-to-pay principle and benefits-received principle. Ability-to-pay principle leads to notions of horizontal equity and vertical equity. Horizontal equity argues that economically similar beneficiaries of municipal services should be treated similarly. On the other hand, vertical equity argues against the case where a person's tax burden increases as his income decreases, which is called a "regressive" system. However, the issue of whether a financing system should be proportional (tax burden proportional to income level) or progressive (tax burden rises more than proportionately with income) is still much debated (see Brunori 2001). While, state and local tax systems are generally considered more regressive than the federal tax system (Pechman 1986), the degree of regressivity differs significantly among various taxes in both the state and the local financing structures. Thus, we will evaluate each major municipal financing instrument based on its inherent regressivity.

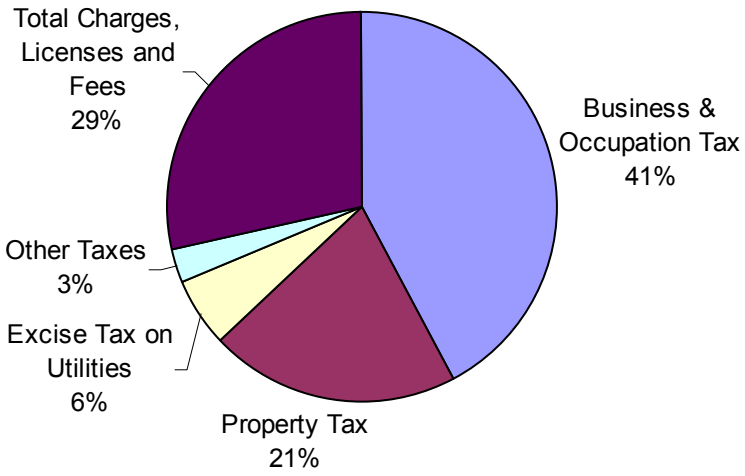
The benefits-received principle argues that taxes should be based on the benefits people receive from government services. State taxes such as the gasoline tax and user charges imposed at the state and the local level generally conform to the benefits-received principle. There are other criteria that the literature used such as administrative simplicity and tax compliance. However, these criteria are mostly institutions-related and not directly related to the nature of our analysis.

4. Analysis of the West Virginia Municipal General Revenue Sources

West Virginia municipalities derive general revenue from business and occupation tax, property tax, excise tax on utilities, total charges, licenses and municipal fees and other taxes. Figure 1 shows the composition of municipal general revenue from own sources for all West Virginia municipalities. Business and occupation (B&O) tax yields the largest revenue share (41%) in the state's municipal general revenue from own sources.

The second largest single revenue source for the local municipalities in West Virginia is the property tax, which contributes 21% to municipal general revenue from own sources. However, the total of all charges, licenses and fees surpass the share of property tax and brings 29% of total municipal general revenue from own sources. The excise taxes on utilities and other taxes that include wine and liquor, gas and oil severance, hotel occupancy, animal control and amusement taxes constitute the last two general revenue sources.

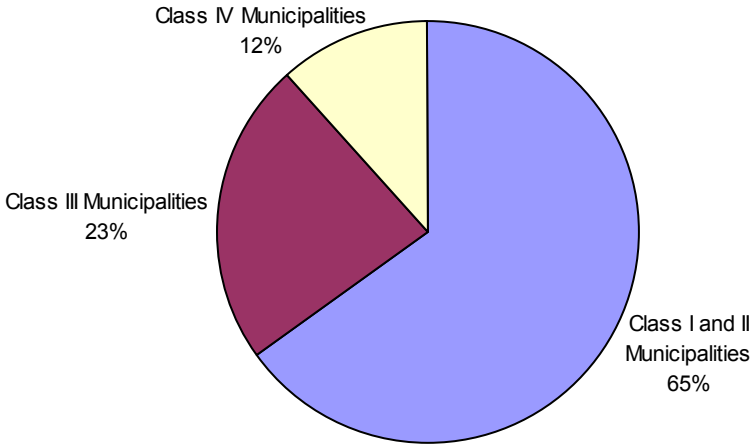
Figure 1: Composition of Budgeted Municipal General Revenue From Own Sources in West Virginia Municipalities (Fiscal Year 2003)



Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Year 2002-03.

Next, Figure 2 shows the composition of municipal general revenue by different population classes for the Fiscal Year 2003. Fifteen municipalities with the largest populations (greater than 10,000) are grouped into Class I and II municipalities. These municipalities account for 65% of the budgeted municipal general revenue. There are 49 Class III municipalities which have populations greater than 2,000 but less than or equal to 10,000. These municipalities bring 23% of budgeted municipal revenue. Finally, there are 170 Class IV municipalities with populations less than or equal to 2,000. Despite their number, these municipalities account for only 12% of budgeted municipal general revenue.

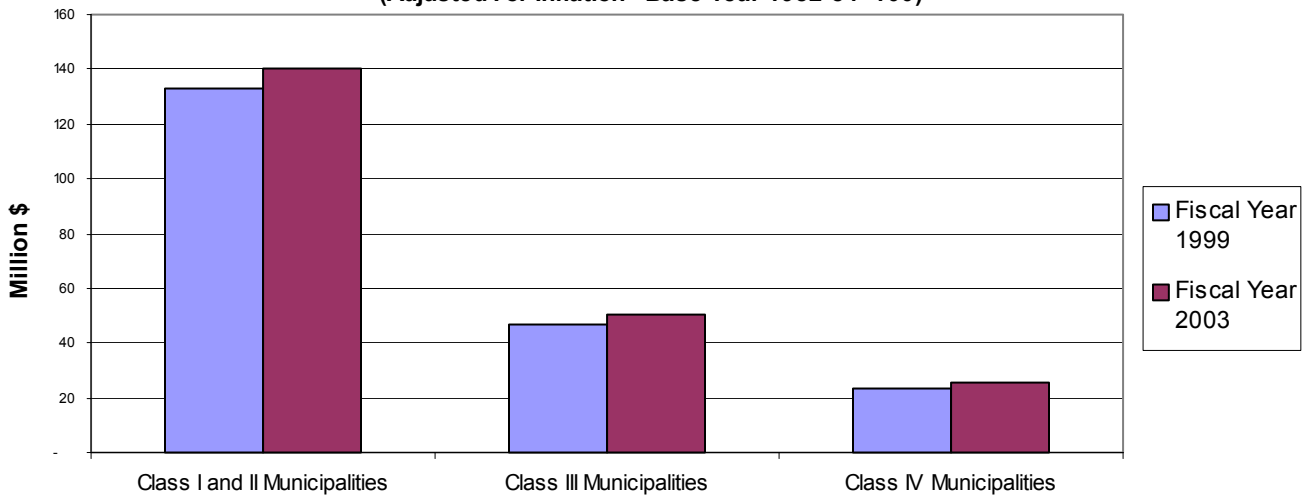
Figure 2: Composition of Budgeted Municipal General Revenue By Different Classes of West Virginia Municipalities Fiscal Year 2003



Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Year 2002-03.

To show the recent changes in municipal general revenue, Figure 3 compares the budgeted municipal general revenue between fiscal years 1999 and 2003. Municipalities in all population classes experienced increases in municipal general revenue. While per capita figures would give a better picture of real changes in revenues, municipal population data were unavailable for the years that are compared.

Figure 3: Total Budgeted Municipal General Revenue in West Virginia Municipalities By Different Size Classes* Fiscal Year 1999 and Fiscal Year 2003 (Adjusted For Inflation - Base Year 1982-84=100)



Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Year 1999 and 2003.
* Class I and II municipalities refer to municipalities with population greater than 10,000. These are combined since West Virginia has only two Class I municipalities. Class III refers to population greater than 2,000 but less than or equal to 10,000. Class IV refers to population less than or equal to 2,000.

4.1. Business and Occupation Tax

4.1.1. A General Evaluation

B&O tax is a gross receipts tax imposed on business activities or occupations within jurisdictions. As a "turnover"[2] tax, B&O tax leads to "pyramiding" of the tax since it is paid at each stage of the production of a good or service. Turnover taxes are thought to be inefficient and were replaced by alternative taxes in many countries.[3] They lead to effective tax rates that can be significantly greater than the official nominal rates depending on the number of stages of production. Turnover taxes also give incentives to vertical integration and generate a competitive advantage to vertically integrated firms. As Tosun (2002b) noted in an example:

> "… Consider a production process with three stages of production. In the first case, we have three firms, X, Y, and Z operating at stages 1, 2, and 3, respectively. Here, stage 3 is the stage where the product is delivered to the final consumer. Assume that there is a 5% tax on the gross sales of each firm involved in the production process. If the gross sales of X, Y, and Z are the same and equal to $1 million, total tax liability of these firms will be $150,000. In the second case, these three firms merge to form the single, vertically integrated firm XYZ. Since XYZ combines all three stages of production, its gross sales will only be $1 million and the total tax liability will be $50,000. This simple example illustrates that the tax liability for a vertically integrated firm will be significantly lower than the total tax liabilities when that firm is broken into a number of firms operating at different stages of producing the same good or service. Therefore, a turnover tax discriminates between firms operating at the same production sector, giving firms a strong incentive to vertically integrate."

With such characteristics, B&O tax can affect business decisions significantly and put a greater than expected burden on businesses. However, this tax can be shifted on to consumers through higher prices. To the extent that it is shifted to consumers, it will increase the regressivity of the municipal tax systems. In addition, when the B&O tax is imposed on business activity within the corporate limits of a municipality, businesses that are located outside the municipal limits do not pay this tax. Hence, it violates horizontal equity by discriminating against businesses within municipal limits.

4.1.2. Business and Occupation Tax in West Virginia

While B&O tax does poorly in terms of both efficiency and equity, it is a broad-based tax and the largest revenue source for West Virginia municipalities. In the absence of alternatives, this tax will generate adequate revenues for the municipalities. However, alternatives do exist and we will come to this point at the end of this report.

For recent changes in this tax, Table 3 lists the 15 largest West Virginia cities and the annual amount of business and occupation budgeted tax revenue from Fiscal Year 1999 to Fiscal Year 2003. In real (inflation adjusted) terms, the amount of business and occupation tax revenue increased for 8 out of 15 West Virginia cities. Morgantown and Martinsburg had the highest increases in both dollars of revenues and average annual

[2] A turnover tax is imposed on the gross sales instead of the value added.
[3] In Europe, turnover taxes were replaced by the value added tax (VAT).

growth for the period. On the other hand, Charleston and South Charleston had the highest dollar revenue decreases and Bluefield and Moundsville had the highest average annual percentage decreases. Overall, business and occupation tax revenues for the largest 15 cities grew at an average annual growth rate of only 0.68% between 1999 and 2003. However, Class III and Class IV municipalities fared worse, with average annual growth rates of –0.76% and –0.84%, respectively.

Table 3: B & O Tax Revenues in 15 Largest West Virginia Cities (Dollars Adjusted For Inflation, Base Year 1982-84=100)

City	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	Change in Dollars from 1999-2003	Average Annual Growth (%) 1999-2003
Charleston	17,395,194	18,069,995	17,577,872	16,796,974	16,447,916	-947,278	-1.39
Huntington	7,830,678	8,019,829	7,802,466	7,348,411	7,395,252	-435,426	-1.42
Beckley	3,900,967	3,956,658	3,809,767	3,790,086	3,801,643	-99,324	-0.64
Bluefield	1,460,522	1,393,326	1,340,991	1,309,535	1,342,445	-118,078	-2.09
Clarksburg	2,824,138	2,641,850	2,661,885	2,659,986	2,632,961	-191,178	-1.74
Fairmont	1,751,378	1,768,930	2,087,925	2,061,209	2,068,420	317,042	4.25
Martinsburg	1,435,556	1,762,025	1,827,651	2,095,257	2,111,390	675,834	10.13
Morgantown	3,402,892	3,563,587	4,429,080	4,423,319	5,148,939	1,746,047	10.91
Moundsville	820,764	830,854	781,173	771,171	741,840	-78,924	-2.50
Parkersburg	4,705,094	4,642,321	4,786,190	4,670,676	4,879,938	174,844	0.92
St. Albans	1,404,348	1,367,089	1,426,072	1,504,511	1,484,821	80,473	1.40
So. Charleston	3,882,243	3,949,367	3,813,317	4,300,744	3,659,302	-222,941	-1.47
Vienna	1,037,345	1,026,835	1,208,884	1,210,626	1,226,889	189,544	4.28
Weirton	1,029,855	1,002,532	1,091,649	1,105,830	1,098,493	68,638	1.63
Wheeling	4,234,890	4,623,797	4,684,092	4,795,809	4,650,765	415,874	2.37
Total of Class I and II Municipalities	57,115,866	58,618,994	59,329,013	58,844,144	58,691,013	1,575,147	0.68
Total of Class III Municipalities	14,121,231	14,422,693	14,333,577	13,947,233	13,697,850	-423,380	-0.76
Total of Class IV Municipalities	4,326,460	4,514,046	4,173,399	4,371,891	4,182,809	-143,651	-0.84

Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Years 1999-2003.

4.2. Property Tax

4.2.1. A General Evaluation

The property tax is considered one of the most important revenue sources for local governments. The traditional view on the effects of property tax argues that it functions like an excise tax on commodities, raising the price of housing and other commodities (Netzer, 1966). Since housing and other consumption make the greater share of annual income for low-income individuals compared to higher-income individuals, property tax is considered a *regressive tax*.

In modern analysis, property tax is considered a tax on capital (Mieszkowski, 1972; Zodrow, 2001). According to this "capital tax" view, property tax distorts the local use of capital, leading to a misallocation of capital stock across local jurisdictions. As a capital tax, the burden of the property tax falls mainly on owners of capital and hence it is *progressive*.

On the other hand, the "benefit" view argues that property tax is like a user charge. According to this view, local public services funded by the property tax are capitalized into house values (Hamilton, 1975). This makes the property tax a *non-distortionary* tax without any effects on the distribution of income.

Despite the lack of a general consensus on the economic effects of the property tax, it is a significant revenue source for local governments with the much-desired characteristic of a stable tax base.

4.2.2. Property Tax In West Virginia

West Virginia has a unique property tax system. It has been much criticized in terms of efficiency, equity and revenue adequacy (White, 1991). The most important event regarding the property tax in West Virginia has been the passing of the Tax Limitation Amendment of 1932. This amendment created four taxable property classes and established rate limits.[4] Shamberger and Thompson (1950) criticize the amendment by arguing that it has curtailed local government powers to provide municipal services and that it has undermined the flexibility of municipalities to deal with changing external conditions. Still today, property tax rate limits brought by the Tax Limitation Amendment pose a serious threat to revenue generation and brings into question the revenue adequacy of this revenue source. White (1991) argues that property class division puts a relatively large burden on the business property. This can be seen in Table 4. The table shows that business property classified into Class III and Class IV has been taxed with significantly higher rates than Class I and Class II properties.

In addition to the rate disparity between different property classes, there is considerable disparity between rates imposed for state, county, school district and municipality purposes. Table 5 shows that the average rate of levy has been significantly low for municipalities compared to counties and school districts. Notice that the state government gets only a minuscule portion of the property tax revenue.

[4] See Thompson and Kee (1968) and Shamberger and Thompson (1950) for detailed descriptions of the Tax Limitation Amendment. In fact, Shamberger and Thompson's account of the Tax Limitation Amendment was one of the first publications of the Bureau of Business Research, which is the predecessor of the Bureau of Business and Economic Research.

Table 4: Average Rate of Levy on Each $100 Assessed Valuation By Property Class

Fiscal Year	Class I	Class II	Class III	Class IV	All Property
1992	$0.77	$1.40	$2.51	$3.30	$2.28
1993	0.74	1.35	2.43	3.21	2.20
1994	0.73	1.32	2.39	3.18	2.15
1995	0.69	1.22	2.23	2.94	1.96
1996	0.68	1.23	2.23	2.95	1.97
1997	0.68	1.23	2.23	2.94	1.96
1998	0.67	1.22	2.22	2.93	1.95
1999	0.66	1.22	2.22	2.94	1.98
2000	0.66	1.23	2.25	2.94	2.00
2001	0.65	1.23	2.25	2.94	2.00
2002	0.64	1.24	2.25	2.96	2.01
2003	0.62	1.24	2.26	2.95	2.01

Source: Classified Assessed Valuations and Taxes Levied, West Virginia State Tax Department. Fiscal Year 2003.

Table 5: Average Rate of Levy on Each $100 Assessed Valuation By Purpose

Fiscal Year	State	County	School	Municipal
1992	$0.008	$0.552	$1.540	$0.175
1993	0.008	0.529	1.498	0.165
1994	0.008	0.514	1.468	0.162
1995	0.008	0.474	1.331	0.150
1996	0.007	0.447	1.258	0.139
1997	0.008	0.480	1.323	0.149
1998	0.008	0.477	1.312	0.150
1999	0.008	0.491	1.332	0.153
2000	0.008	0.498	1.340	0.153
2001	0.008	0.501	1.336	0.155
2002	0.008	0.507	1.340	0.159
2003	0.008	0.510	1.337	0.156

Source: Classified Assessed Valuations and Taxes Levied, West Virginia State Tax Department. Fiscal Year 2003.

4.2.3. Tax Relief to Seniors

There is thought to be a strong relationship between the property tax system and the weight of elderly population in a state. Mackey and Carter (1994) draw special attention to property tax relief. They assert "the property tax is likely to present the most serious tax problem for the seniors" (Mackey and Carter 1994, pp. 11). A major concern is that low-income seniors may be forced to sell their homes due to the heavy burden of the property tax. This is an important issue for West Virginia due to the high share of elderly in total state population. West Virginia uses a homestead exemption program, which allows persons aged 65 and older to exempt up to $20,000 from the total assessed

value of real property owned and occupied (White, 1991). In Fiscal Year 2003, $3.4 billion in assessed value (7.5% of total assessed valuations) was exempted from total assessed valuations. Using the 2003 average rate for Class II property shown in Table 5, this translates to a $42.3 million in exempt property taxes. While a certain group of seniors indeed need a tax relief, this age-based program raises questions about fairness. White (1991) argues that having income threshold on the homestead exemption would be more effective. Moving from an age-based relief program to a need-based program could significantly improve the overall fairness of the property tax system.

4.2.4. West Virginia Property Tax Revenue Trends

As Figure 1 shows, property tax is a substantial revenue source for West Virginia municipalities. Table 6 lists the 15 largest cities in West Virginia and the annual amount of property tax revenue collected from Fiscal Year 1999 to 2003. Charleston accounted for the largest property tax revenue collection and the largest dollar increase in property tax revenue from 1999 to 2003. On the other hand, Vienna had the highest average annual growth in property tax revenues between 1999 and 2003. In Table 6, the only cities that budgeted less total property tax in 2003 than in 1999 are Bluefield, Fairmont and Weirton. Weirton had a significant decrease in budgeted property tax, with a 4.7% average annual decrease. For the total of all Class I and II cities, there has been a moderate 2% average annual growth in revenues between 1999 and 2003. While there was a similar growth in Class III municipalities, Class IV municipalities had a slight decrease.

Table 6: Property Tax Revenues in 15 Largest West Virginia Cities (Dollars Adjusted For Inflation, Base Year 1982-84=100)

City	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	Increase in Dollars from 1999-2003	Average Annual Growth (%) 1999-2003
Charleston	4,088,214	4,025,316	4,443,549	4,725,968	4,764,894	676,680	3.90
Huntington	2,849,799	2,865,879	3,079,787	3,153,047	2,986,553	136,754	1.18
Beckley	953,843	1,015,633	1,038,220	1,072,703	1,086,170	132,327	3.30
Bluefield	515,090	502,403	499,674	508,443	496,458	-18,632	-0.92
Clarksburg	807,993	844,462	844,314	848,929	844,333	36,340	1.11
Fairmont	765,366	782,604	743,458	740,991	740,716	-24,650	-0.82
Martinsburg	569,112	601,391	627,822	649,503	686,402	117,290	4.80
Morgantown	1,014,135	1,047,703	1,118,415	1,179,599	1,214,809	200,673	4.62
Moundsville	230,415	238,092	249,468	260,011	267,305	36,889	3.78
Parkersburg	1,987,685	1,989,248	1,955,575	2,012,676	2,034,852	47,168	0.59
St. Albans	680,765	702,806	701,966	779,639	785,060	104,295	3.63
So. Charleston	2,119,681	2,148,316	2,196,017	2,427,840	2,444,373	324,692	3.63
Vienna	457,036	510,806	576,338	643,092	695,875	238,839	11.08
Weirton	1,766,782	1,735,274	1,639,612	1,569,000	1,459,360	-307,423	-4.67
Wheeling	1,822,708	1,801,070	1,794,207	1,820,205	1,891,957	69,249	0.94
Total of Class I and II	20,628,625	20,811,001	21,508,422	22,391,644	22,399,117	1,770,491	2.08

Municipalities							
Total of Class III Municipalities	9,230,238	9,427,426	9,206,678	9,743,107	9,880,512	650,275	1.72
Total of Class IV Municipalities	4,712,115	4,698,755	4,624,438	4,617,422	4,703,818	-8,297	-0.04

Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Years 1999-2003.

The data on property tax levies give us further detail on the distribution of property taxes across municipalities located in different counties. We can first look at property taxes levied for the purpose of municipal financing within West Virginia counties. Figures 4 and 5 show the largest 15 West Virginia counties ranked in terms of municipal purpose current expense and excess levies[5], respectively. As shown in Figure 4, the top three West Virginia counties with highest current expense levies are Kanawha, Cabell, and Wood, respectively. Municipal purpose current expense levies in Kanawha County alone account for the 24% of total current expense levies in the 15 largest West Virginia counties, and 18% of total current expense levies in all West Virginia counties.

In Figure 5, the top three West Virginia counties in terms of municipal purpose excess property levies are Kanawha, Cabell, and Harrison, respectively. Municipal purpose excess levies in Kanawha County alone account for 47% of total excess levies in 15 largest West Virginia counties, and 44% of total excess levies in all West Virginia counties.

Figure 4: Top 15 West Virginia Counties in Terms of Municipal Purpose Current Expense Levies (Average of Fiscal Years 1994-2003)

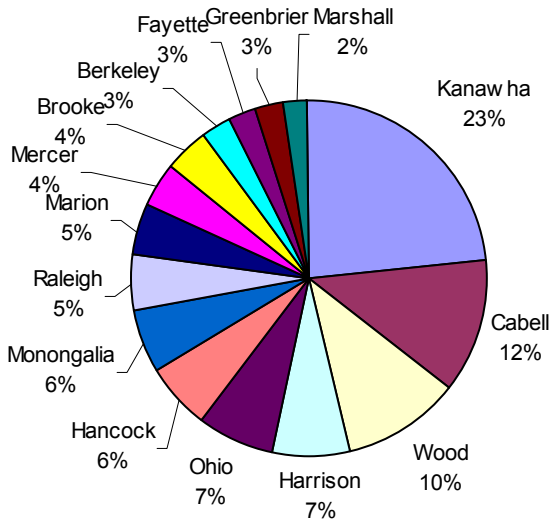
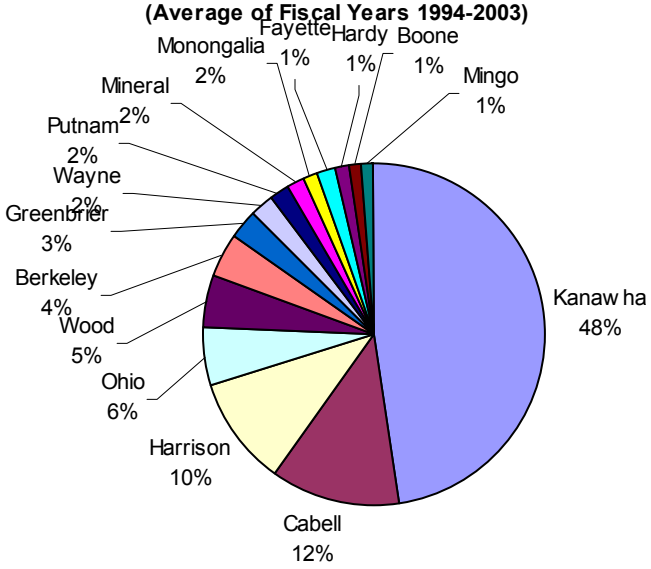


Figure 5: Top 15 West Virginia Counties in Terms of Municipal Purpose Excess Property Levies (Average of Fiscal Years 1994-2003)



Source: Classified Assessed Valuations and Taxes Levied, West Virginia State Tax Department. Fiscal Year 2003.

[5] Excess levies need to be approved by voters. In Fiscal Year 2003, there are 30 West Virginia counties with excess levies.

Table 7 gives further detail by presenting total municipality-purpose property tax levies by specific West Virginia cities and by property class. As the largest city in West Virginia, Charleston comprised 21% of total property levies in the top 30 cities. It also comprised 19% of total property levies in our larger sample of 104 cities. When we look at the distribution by property classes, on average, 75% of total property levies were imposed on Class IV property, which includes all real and personal property situated inside municipalities, and 24% on Class II property, which includes all property owned, used and occupied by the owner exclusively for residential purposes.[6] By contrast, only 1% of total property levies was imposed on Class I property, which includes all tangible personal property employed exclusively in agriculture, all products of agriculture, all notes, bonds, bills and accounts receivable, stocks and any other intangible personal property.

Table 7: Top 30 West Virginia Cities with the Highest Total Property Levies in Fiscal Year 2002

		Property Class*			
City	**County**	**Class I**	**Class II**	**Class IV**	**Total City**
Charleston	Kanawha	633,846	18,681,869	58,215,610	77,531,325
Huntington	Cabell	372,568	6,636,296	29,918,773	36,927,638
So. Charleston	Kanawha	93,544	3,716,620	20,915,268	24,725,433
Parkersburg	Wood	156,403	5,247,248	20,102,337	25,505,988
Wheeling	Ohio	304,381	5,509,737	16,419,829	22,233,947
Morgantown	Monongalia	134,447	3,782,670	15,582,534	19,499,650
Weirton	Hancock	65,627	3,476,285	13,029,973	16,571,884
Beckley	Raleigh	179,311	2,899,900	12,988,357	16,067,568
Clarksburg	Harrison	92,780	1,805,821	10,635,022	12,533,623
Martinsburg	Berkeley	74,116	2,323,186	10,225,796	12,623,099
Fairmont	Marion	62,614	2,623,204	8,489,485	11,175,303
Bridgeport	Harrison	46,930	3,144,566	7,357,515	10,549,011
Vienna	Wood	27,224	3,736,871	6,745,652	10,509,748
Bluefield	Mercer	62,548	1,650,556	5,931,609	7,644,712
Weirton	Brooke	206,780	864,030	5,597,224	6,668,034
St. Albans	Kanawha	41,809	3,286,963	5,359,083	8,687,855
Follansbee	Brooke	14,231	598,685	5,220,271	5,833,187
Princeton	Mercer	56,867	659,323	4,333,108	5,049,298
Nitro	Kanawha	18,602	1,153,758	4,261,154	5,433,514
Barboursville	Cabell	24,021	541,982	4,259,158	4,825,160
Dunbar	Kanawha	13,913	1,643,732	4,177,876	5,835,521
Oak Hill	Fayette	27,560	926,544	3,344,270	4,298,373
Moundsville	Marshall	34,402	956,783	3,068,254	4,059,439
Hurricane	Putnam	34,815	1,429,079	2,358,647	3,822,540
White Hall	Marion	8,614	99,508	2,211,606	2,319,729

[6] Class II also includes all farms, including land used for horticulture and grazing, occupied and cultivated by their owners or bona fide tenants.

Glasgow	Kanawha	8,603	135,558	2,082,106	2,226,267
Westover	Monangalia	26,292	564,228	1,888,478	2,478,997
Kenova	Wayne	5,730	328,284	1,858,483	2,192,498
Pleasant Valley	Marion	3,596	613,764	1,707,932	2,325,292
Anmoore	Harrison	2,805	39,386	1,579,682	1,621,873

Source: West Virginia Municipal League.
* Class III property is not included in this table because it refers to all real and personal property located outside the municipalities.

An important issue that surfaced in our examination of the role of the property tax in West Virginia municipal finance system is the contrast between the assessed property valuations attributed to municipalities and the property taxes levied for the purpose of municipal financing. Table 8 shows this by presenting both the property tax levy amounts and the assessed taxable property valuations for municipalities in all 55 counties.

In this comparison, we see that West Virginia municipalities together account for 34% of the total taxable property valuations in the state. However, in total, they capture only 7.8% of the total property tax levies. Table 8 also shows that 13 counties with Class I and II municipalities account for 47.6% of the total taxable valuations, while they capture only 10% of the total property tax levies. The ratio of the municipalities' share in total levies to their share in total valuations ranges between 0.15 for the municipalities in Brooke County and 0.53 for the municipalities in the Hardy County. For an average of all municipalities, this ratio is 0.23. This indicates that West Virginia municipalities are getting only a small portion of the total property tax levies (maximum 53% and 23 % on average) relative to what they contribute in assessed property.

West Virginia municipalities account for 34% of the total taxable valuations, while they capture only 7.8% of the total property tax levies.

13 Counties with Class I and II municipalities account for 47.6% of the total taxable valuations, while they capture only 10% of the total property tax levies.

Table 8: Municipalities' Share in Property Tax Levies and Assessed Taxable Property Valuations in West Virginia Counties (Fiscal Year 2003)

	PROPERTY TAX LEVIES			ASSESSED PROPERTY VALUATIONS		
	Municipality Purpose	Total of All Purposes	Municipalities' Share in Total Levies (%)	Valuations Attributed to Municipalities	Total Taxable Valuations	Municipalities' Share in Total Valuations (%)
BARBOUR	240,714	4,179,331	5.76	63,950,400	252,488,987	25.33
BERKELEY	1,983,020	41,141,298	4.82	395,762,500	2,138,705,006	18.50
BOONE	450,342	25,222,620	1.79	79,822,003	1,029,536,946	7.75
BRAXTON	210,105	4,361,589	4.82	50,001,226	350,334,181	14.27
BROOKE	1,733,289	16,588,033	10.45	440,870,984	645,326,884	68.32
CABELL	6,939,727	60,341,674	11.50	1,307,534,385	2,301,782,702	56.81
CALHOUN	65,876	2,210,489	2.98	10,164,013	144,588,988	7.03
CLAY	56,774	2,914,621	1.95	12,607,252	196,276,754	6.42
DODDRIDGE	46,511	4,129,530	1.13	11,503,645	196,669,804	5.85
FAYETTE	1,188,010	18,979,517	6.26	257,999,115	824,494,985	31.29
GILMER	155,800	3,654,402	4.26	25,214,812	207,755,011	12.14
GRANT	339,601	7,525,976	4.51	64,978,462	537,071,426	12.10
GREENBRIER	1,526,518	15,958,157	9.57	296,595,410	915,552,572	32.40
HAMPSHIRE	190,728	8,867,017	2.15	52,756,919	666,098,370	7.92
HANCOCK	2,062,658	18,158,265	11.36	552,924,658	865,590,336	63.88
HARDY	579,388	5,743,148	10.09	87,763,183	462,861,633	18.96
HARRISON	4,806,025	47,212,434	10.18	902,005,051	1,913,310,964	47.14
JACKSON	683,473	17,274,421	3.96	169,798,407	816,179,952	20.80
JEFFERSON	920,621	27,294,614	3.37	263,694,594	1,540,411,206	17.12
KANAWHA	20,140,774	153,158,318	13.15	4,129,054,861	6,859,114,782	60.20
LEWIS	277,956	7,625,296	3.65	70,211,789	439,599,528	15.97
LINCOLN	76,549	6,806,367	1.12	19,030,514	311,609,509	6.11
LOGAN	479,869	17,231,666	2.78	112,008,217	728,941,809	15.37
MARION	2,021,188	25,346,278	7.97	595,048,521	1,179,459,615	50.45
MARSHALL	1,016,514	22,255,081	4.57	240,896,738	1,068,787,983	22.54
MASON	443,919	13,339,716	3.33	126,832,230	706,624,282	17.95
MCDOWELL	479,564	9,892,887	4.85	90,235,164	426,925,523	21.14
MERCER	1,672,304	23,682,031	7.06	403,391,556	1,173,603,029	34.37
MINERAL	673,087	11,045,464	6.09	118,432,871	578,817,071	20.46
MINGO	625,983	16,644,275	3.76	96,689,766	753,035,662	12.84
MONONGALIA	2,678,171	46,429,047	5.77	766,874,675	2,446,390,483	31.35
MONROE	74,390	3,075,897	2.42	18,227,474	191,374,140	9.52
MORGAN	126,410	7,620,738	1.66	34,839,563	473,363,380	7.36
NICHOLAS	658,422	12,785,293	5.15	145,884,790	712,844,291	20.47
OHIO	3,846,110	22,532,506	17.07	822,206,815	1,037,787,598	79.23
PENDLETON	86,338	2,418,213	3.57	22,492,917	242,042,836	9.29
PLEASANTS	259,870	9,136,486	2.84	52,615,847	443,890,727	11.85
POCAHONTAS	141,309	4,162,789	3.39	34,555,199	357,570,484	9.66
PRESTON	708,780	9,086,204	7.80	141,236,432	779,313,449	18.12

PUTNAM	1,277,488	32,062,455	3.98	306,721,215	1,754,954,956	17.48
RALEIGH	2,241,927	40,646,848	5.52	541,358,296	1,807,420,421	29.95
RANDOLPH	597,243	7,602,629	7.86	170,173,840	637,586,706	26.69
RITCHIE	357,157	4,591,215	7.78	61,151,291	235,500,471	25.97
ROANE	181,466	4,044,711	4.49	45,382,685	288,306,811	15.74
SUMMERS	302,812	2,966,341	10.21	47,426,355	238,967,892	19.85
TAYLOR	379,125	5,979,287	6.34	74,330,008	329,947,120	22.53
TUCKER	211,716	3,304,762	6.41	54,776,647	275,461,440	19.89
TYLER	213,674	5,909,236	3.62	49,268,039	253,817,113	19.41
UPSHUR	542,637	8,722,372	6.22	116,569,008	565,383,061	20.62
WAYNE	1,098,804	17,507,247	6.28	201,581,097	842,590,269	23.92
WEBSTER	95,442	2,994,461	3.19	21,224,934	225,011,180	9.43
WETZEL	756,997	9,592,597	7.89	199,025,794	422,035,889	47.16
WIRT	49,706	1,756,835	2.83	11,799,001	90,764,052	13.00
WOOD	5,579,058	48,503,316	11.50	1,290,025,791	2,571,249,804	50.17
WYOMING	344,450	13,477,576	2.56	56,128,385	565,139,754	9.93
13 COUNTIES WITH CLASS I AND II CITIES*	56,720,765	565,995,129	**10.0**	12,387,954,831	26,008,529,607	**47.6**
TOTAL OF ALL MUNICIPALITIES	74,896,389	965,693,575	**7.8**	16,333,655,344	48,020,269,827	**34.0**

* These 13 counties are Berkeley, Brooke, Cabell, Hancock, Harrison, Kanawha, Marion, Marshall, Mercer, Monongalia, Ohio, Raleigh, Wood

Source: Classified Assessed Valuations and Taxes Levied, West Virginia State Tax Department. Fiscal Year 2003.

4.3. Excise Tax on Utilities

4.3.1. A General Evaluation

The treatment of excise taxes on utilities is similar to the one for gross receipts tax such as the B&O tax. While it is not as broadly defined as the gross receipts tax, utility taxes can be described as consumption taxes paid by consumers of services provided by the utilities. This makes this tax relatively regressive. Due to its narrow base, it generates only limited revenue for municipalities.

4.3.2. Excise Tax on Utilities in West Virginia

West Virginia municipalities collect an excise tax for the privilege of purchasing, using or consuming public utility services and tangible personal property from public utilities. Table 9 lists the 15 largest West Virginia cities and the annual budgeted excise tax revenue from 1999 to 2003. After adjusting for inflation, only five cities experienced an increase in total revenue collected from excise tax on utilities, while the other 10 cities saw decreases at varying degrees. Martinsburg saw the largest dollar decrease and the average annual percentage decrease. While the total revenue for Class I and II municipalities declined between 1999 and 2003, Class III and Class IV municipalities experienced moderate increases in the same period.

Table 9: Revenue From Excise Taxes on Utilities in 15 Largest West Virginia Cities (Dollars Adjusted For Inflation, Base Year 1982-84=100)

City	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	Increase in Dollars from 1999-2003	Average Annual Growth (%) 1999-2003
Charleston	1,154,686	1,093,671	1,002,260	1,047,628	1,141,292	-13,394	-0.29
Huntington	973,681	924,466	1,024,663	979,413	929,012	-44,670	-1.17
Beckley	312,077	303,797	324,261	355,030	342,388	30,310	2.34
Bluefield	227,380	301,134	256,166	282,278	260,215	32,835	3.43
Clarksburg	365,131	351,190	329,802	350,577	336,852	-28,278	-2.00
Fairmont	330,802	332,111	322,492	324,125	317,793	-13,009	-1.00
Martinsburg	390,097	425,316	427,434	247,357	256,791	-133,306	-9.93
Morgantown	461,875	456,911	419,083	419,488	407,441	-54,433	-3.09
Moundsville	167,523	164,051	159,182	180,425	176,900	9,377	1.37
Parkersburg	-	-	-	-	-	-	-
St. Albans	162,280	157,975	153,287	151,324	154,074	-8,206	-1.29
So. Charleston	318,319	315,949	356,687	320,109	342,388	24,069	1.84
Vienna	159,159	154,937	150,339	148,414	156,928	-2,232	-0.35
Weirton	720,899	701,772	680,947	676,884	663,661	-57,238	-2.05
Wheeling	577,343	568,101	568,930	567,465	599,178	21,835	0.93
Total of Class I and II Municipalities	6,321,252	6,251,383	6,175,533	6,050,515	6,084,912	-236,340	-0.95
Total of Class III Municipalities	2,852,436	2,791,490	2,908,768	3,094,415	3,002,635	150,199	1.29
Total of Class IV Municipalities	1,405,049	1,425,556	1,403,546	1,550,032	1,503,285	98,236	1.70

Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Years 1999-2003.

4.4. Total Municipal Charges, Licenses and Service Fees

4.4.1. A General Evaluation

User charges are defined as "charges imposed for providing current services or for the sales of products in connection with general government activities" (NCSL, 1999). There has been a steady increase in the share of user charges in U.S. states since the 1970s as the property tax and tax revenue in general decreased in importance in state and local revenue systems (NCSL 1999, pp. 17).

Theoretically, a user charge can be imposed such that the benefit that the consumer or business receives at the margin exactly equals the user charge itself. This is called an "efficient user charge."[7] The main advantage of user charges is that people or businesses directly pay for the public services that they actually demand. An alternative is to use general fund resources to provide those services, which creates a mismatch between who pays for the public services and who benefits from those services (NCSL,

[7] See Fisher (1996, Ch.8) for an explanation of the theory of user charges.

1999). Another objection to user charges points to the fact that, despite the conformity with the benefits principle, low-income households still pay a greater portion of their income in user charges compared to higher-income households. This makes the user charges more regressive compared to some other alternatives such as local income and business taxes.

4.4.2. Municipal Charges, Licenses and Service Fees in West Virginia

West Virginia municipalities have the authority to levy and collect special charges on various licenses and other municipal services. Some of these are:

- Police and Fire protection
- Ambulance and emergency service
- Parking facilities
- Parks and recreation
- Civic Center/Coliseum
- Street cleaning
- Street lighting
- Street maintenance and improvements
- Sewerage and sewage disposal
- Jail
- Collection and disposal of garbage, refuse, waste, ashes, trash and other similar matter
- Building permits and inspection
- Parking meters and off street parking
- Cemeteries

Table 10 lists the 15 largest West Virginia cities and the amount of budgeted revenue from the total of municipal charges, licenses and services fees from 1999 to 2003. While Huntington had the highest dollar increase, Moundsville experienced the highest average annual growth with a rate of 14.25%. On the other hand, five cities experienced moderate decreases between 1999 and 2003. There has been a significant growth in municipal charges, licenses and services fees from 1999 to 2003 in all municipality classes. This is more pronounced for Class III municipalities, which, in total, had 5.7% average annual growth in this revenue source. In fact, growth in municipal charges, licenses and services fees surpassed growth in all other revenue sources. This is in line with the general trend in U.S. states towards heavier reliance on user charges.

Table 10: Municipal Charges, Licenses and Service Fees in 15 Largest West Virginia Cities (Dollars Adjusted For Inflation, Base Year 1982-84=100)

City	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	Increase in Dollars from 1999-2003	Average Annual Growth (%) 1999-2003
Charleston	5,274,114	5,358,417	5,102,029	5,021,935	5,486,588	212,474	0.99
Huntington	4,545,018	4,746,435	5,151,589	5,693,015	5,955,433	1,410,415	6.99
Beckley	367,939	377,316	402,673	374,236	379,480	11,540	0.78
Bluefield	1,822,601	1,486,303	1,328,048	1,604,124	1,583,978	-238,623	-3.45
Clarksburg	1,035,460	992,652	923,058	893,760	1,138,784	103,324	2.41
Fairmont	1,527,182	1,617,917	1,659,094	1,749,198	1,584,781	57,599	0.93
Martinsburg	976,053	1,157,891	1,125,544	1,130,592	1,160,694	184,641	4.43
Morgantown	1,785,354	1,724,449	1,758,360	1,676,696	1,741,335	-44,019	-0.62
Moundsville	651,516	821,083	775,720	727,200	1,110,021	458,505	14.25
Parkersburg	3,102,150	2,965,809	2,898,260	2,995,611	2,817,408	-284,742	-2.38
St. Albans	1,042,264	1,028,916	998,192	993,635	1,006,132	-36,132	-0.88
So. Charleston	969,000	931,747	1,011,811	1,184,606	1,270,943	301,942	7.02
Vienna	406,755	401,490	393,240	387,040	406,182	-573	-0.04
Weirton	1,919,328	1,903,716	2,216,717	2,256,939	2,365,090	445,762	5.36
Wheeling	3,281,806	3,288,304	3,657,777	3,845,494	3,676,215	394,410	2.88
Total of Class I and II Municipalities	28,706,541	28,802,446	29,402,109	30,534,081	31,683,063	2,976,522	2.50
Total of Class III Municipalities	10,343,663	10,837,335	10,407,608	11,671,440	12,914,593	2,570,930	5.71
Total of Class IV Municipalities	6,208,720	6,211,131	6,420,733	6,424,763	6,902,041	690,910	2.68

Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Years 1999-2003.

4.5. Other Municipal Taxes

Other municipal taxes include wine and liquor tax, hotel occupancy tax, oil and gas severance tax, animal control tax and amusement tax, with wine and liquor tax as the largest component.

Table 11 lists the 15 largest West Virginia cities and the amount of budgeted revenue from these other taxes from 1999 to 2003. Other taxes show an overall decreasing trend. The revenue from these taxes decreased in nine out of fifteen Class I and II cities. The highest average annual percentage decrease was in Fairmont, mainly due to a sharp decrease in budgeted wine and liquor tax revenue between Fiscal Year 2002 and Fiscal Year 2003. On the other hand, Weirton had the highest average annual percentage increase, mainly due to a hotel occupancy tax entering into the budget in 2003. In total, municipalities in all classes experienced decreases in revenue from other taxes between 1999 and 2003.

Table 11: Other Municipal Taxes in 15 Largest West Virginia Cities (Dollars Adjusted For Inflation, Base Year 1982-84=100)

City	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	Increase in Dollars from 1999-2003	Average Annual Growth (%) 1999-2003
Charleston	1,031,728	1,026,228	941,535	914,929	922,164	-109,564	-2.77
Huntington	289,138	272,628	595,166	370,780	291,828	2,690	0.23
Beckley	402,499	392,506	380,859	361,432	345,811	-56,687	-3.72
Bluefield	128,451	115,443	90,262	92,832	89,706	-38,746	-8.58
Clarksburg	80,641	84,759	79,739	77,495	76,324	-4,317	-1.37
Fairmont	69,281	50,856	70,099	78,165	30,130	-39,151	-18.79
Martinsburg	153,230	167,696	165,668	166,748	172,620	19,390	3.02
Morgantown	145,465	137,924	167,319	190,901	178,612	33,147	5.27
Moundsville	28,586	30,137	29,145	33,699	26,064	-2,522	-2.28
Parkersburg	131,073	140,841	140,274	144,922	146,941	15,869	2.90
St. Albans	30,272	29,772	25,941	21,244	20,543	-9,728	-9.24
So. Charleston	125,268	121,944	124,398	116,985	121,262	-4,006	-0.81
Vienna	34,019	33,296	34,666	34,223	33,554	-465	-0.34
Weirton	48,122	45,387	50,113	37,831	79,890	31,768	13.51
Wheeling	320,503	315,038	355,508	347,463	345,811	25,308	1.92
Total of Class I and II Municipalities	3,018,276	2,964,456	3,250,691	2,989,647	2,881,263	-137,013	-1.15
Total of Class III Municipalities	1,220,510	1,212,823	1,142,789	1,107,745	1,182,125	-38,386	-0.80
Total of Class IV Municipalities	551,653	479,527	425,959	408,904	510,201	-41,452	-1.93

Source: West Virginia State Auditor – Chief Inspector Division, Fiscal Years 1999-2003.

5. West Virginia Municipal Revenues and Municipal Population

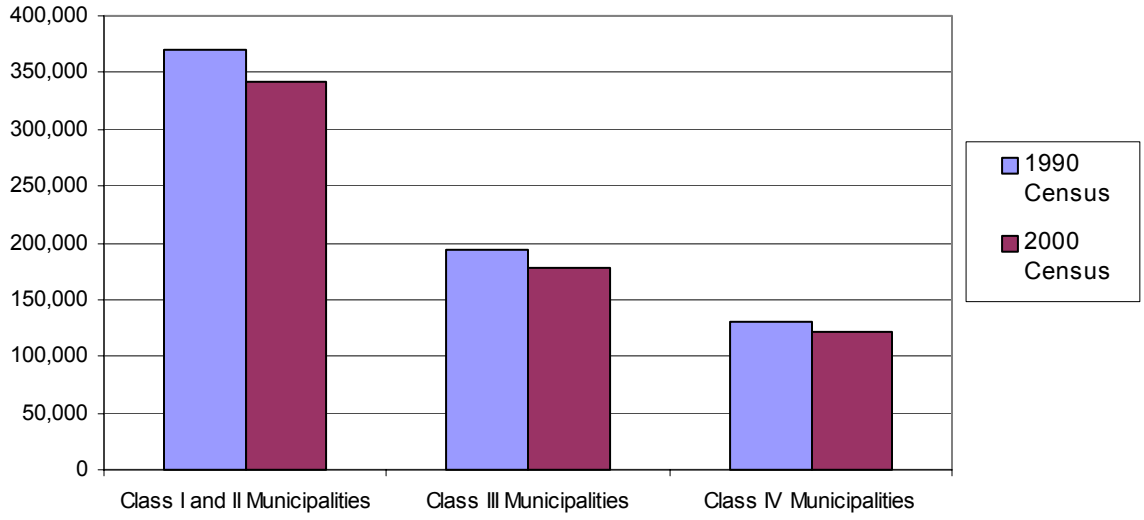
Population is an important factor in municipal financing. It provides the tax base and justifies the provision of public services. Thus, we would expect a strong relationship between population and municipal revenue.[8] West Virginia is known to have a low population density due to its rural landscape. It has had very low population growth rates in recent decades with periods of actual population losses. This also shows itself in West Virginia municipalities. Figure 6 shows that West Virginia municipalities in all population classes suffered population losses between 1990 and 2000. Fourteen of the total of fifteen (93%) of the Class I and II municipalities had population losses between these two Census counts. Greater competitive pressures faced by larger municipalities of the state can partially explain this

75% of all West Virginia municipalities experienced population losses between 1990 and 2000

[8] Mikesell (1972) highlighted this in the context of West Virginia local governments and showed that population loss affects West Virginia county and school finances. However, he has not confirmed this for a small sample of West Virginia cities.

observation. The numbers of municipalities with population losses were 41 and 116 for Class III and Class IV municipalities, respectively. These numbers correspond to 86% and 70% of total number of municipalities in respective population classes. In total, about 75% of all West Virginia municipalities suffered population losses between 1990 and 2000.

Figure 6: Population Changes in West Virginia Municipalities By Population Class (1990 Census to 2000 Census)



Source: U.S. Census Bureau, 1990 and 2000 Censuses.

Another way to examine West Virginia municipal revenues is to look at the distribution of those revenues across municipalities of different sizes. Table 12 shows that a majority of West Virginia's municipalities (94%) had a population of less than 10,000 in 1997. This share was considerably greater than the share for the total of the United States of 87%. There were also no municipalities in West Virginia in 1997 with a population of 75,000 or more. The two municipalities with the largest populations had greater tax revenue per capita and intergovernmental revenue per capita than municipalities in all other population classes. Revenue from the federal government was particularly high for these municipalities compared to municipalities in other population classes. However, municipalities belonging to the second largest population class had greater total revenue and general revenue per capita than other municipalities. These municipalities also had unusually high per capita charges and miscellaneous revenues.[9] These revenue characteristics can also be seen in Figure 7.

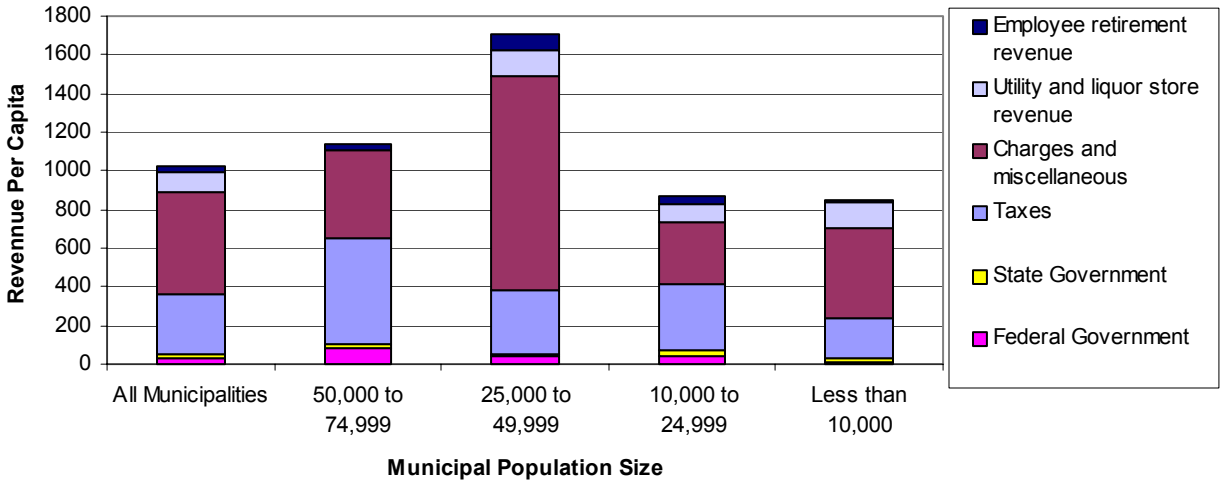
[9] This revenue source is made up of current charges and miscellaneous general revenue. Current charges include fees, assessments, and other reimbursements for services such as hospitals, sewerage, solid waste management and other services. Miscellaneous general revenue includes interest earnings, special assessments, sale of property and all other general revenue.

Table 12: West Virginia Municipal Revenues by Population Size (1996-97)

	All Municipalities	50,000 to 74,999	25,000 to 49,999	10,000 to 24,999	Less than 10,000
Number of municipalities	232	2	3	10	217
Population, 1996	666,039	110,039	92,996	150,939	312,065
Per capita amounts (dollars)					
Total Revenue	1,022	1,142	1,712	870	846
General revenue	890	1,112	1,497	734	706
Intergovernmental revenue	55	108	57	72	27
Federal Government	33	88	42	41	8
State Government	20	17	12	31	18
From own sources	835	1,004	1,441	662	679
Taxes	312	547	334	342	208
Property	88	137	89	87	71
Other	224	410	245	255	137
Charges and miscellaneous	523	457	1,107	320	471
Utility and liquor store revenue	104	0	135	93	137
Employee retirement revenue	28	30	79	43	4

Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

Figure 7: Total Revenue Per Capita for West Virginia Municipalities by Source and Population Size: 1996-97 (dollars)



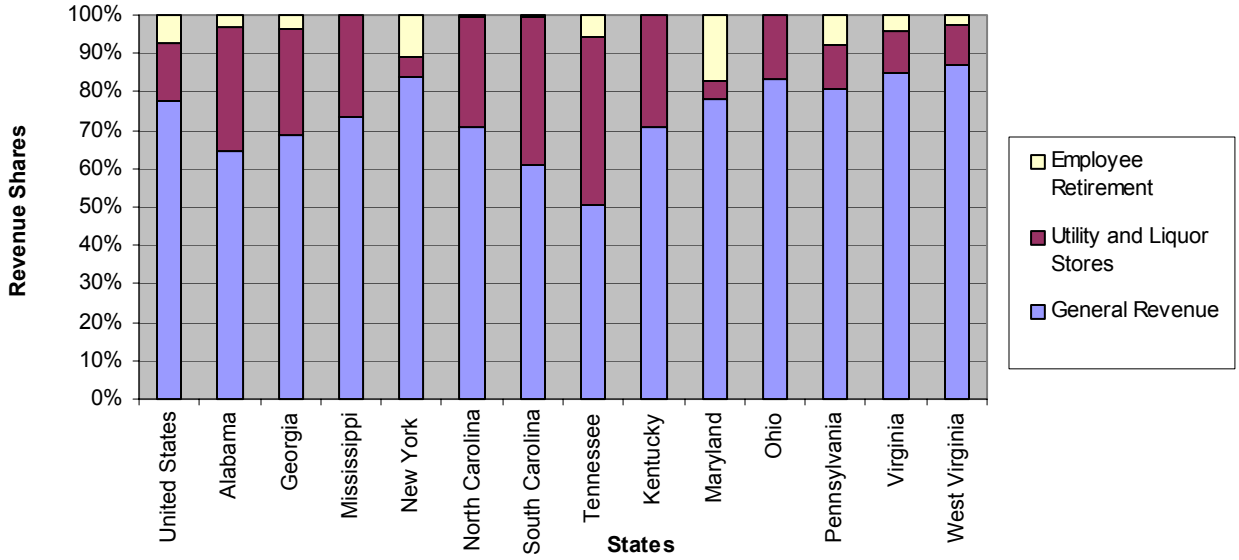
Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

6. Comparison of Municipal Finances in West Virginia to Municipalities in the Appalachian Region

According to the Appalachian Regional Commission, all of West Virginia and parts of twelve other states: Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia

together make up the 200,000 square-mile Appalachian region.[10] These 13 states form a natural sample for a comparison of municipal finance systems. The composition of municipal finances differs significantly from state to state and can reveal interesting peculiarities. Figure 8 shows that the share of general revenue in West Virginia's municipal finances is so high that it ranks West Virginia well above the neighboring states and national average. This implies that West Virginia's municipalities rely most heavily on general revenue, which includes intergovernmental revenue, various taxes, and charges and miscellaneous fees, as the primary revenue source compared to many other states.

Figure 8: Municipal Government Finances By State: 1996-97
Total Revenue Components (% of total)



Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

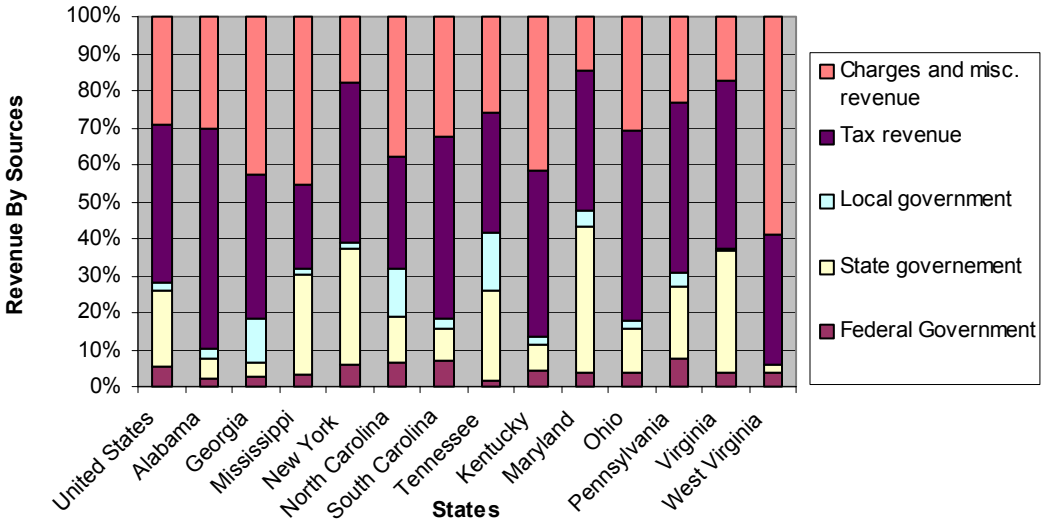
The share of employee retirement revenue in municipal revenues differs radically across the states. Among the neighboring states, the employee retirement revenue is nonexistent in Ohio, while it contributes a significant share to the total municipal revenue in Maryland. The share of general revenue in West Virginia and in most of the neighboring states (except for Kentucky) is significantly higher than that share in other Appalachian states. The same share is also higher than the U.S. average.

A further decomposition of municipal general revenue in Figure 9 indicates that West Virginia's municipalities rely heavily on charges and miscellaneous general revenue and taxes as the primary revenue sources. The intergovernmental revenue share in West Virginia's municipalities is the lowest among the Appalachian states and it is far below the national average. The share of revenue from state government is particularly

[10] Information on the Appalachian region can be found at http://www.arc.gov.

low for West Virginia municipalities compared to counterparts in both the neighboring states and in Appalachia in general.

Figure 9: General Revenue of Municipal Governments By Source and State: 1996-97



Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

Low population density and population loss in West Virginia municipalities are serious impediments to revenue generation. In Table 13, we compare West Virginia municipalities with the municipalities of the Appalachian states by looking at the revenue structures of those municipalities that are grouped into eight population-size classes.

Low population density and population loss in West Virginia municipalities are serious impediments to revenue generation.

West Virginia is the only state that lacks municipalities with population greater than or equal to 75,000. West Virginia municipalities with larger populations seem to have had a greater revenue-generating capability compared to municipalities with smaller population sizes. At the same time, West Virginia municipalities are below the Appalachian states' average in both total and general revenue per capita in all population-size classes except the "25,000 to 49,999" class. In terms of tax revenue per capita, only the West Virginia municipalities in the "50,000 to 74,999" class rank above the average for the Appalachian states. In all three revenue definitions shown in Table 13, West Virginia municipalities, as a whole, have lower revenue per capita than both the average of all municipalities in Appalachian states and the average of all municipalities in the United States.

Table 13: Total, General and Tax Revenue Per Capita in Appalachian States By Population Class (1996-97)

Total Revenue Per Capita by State and Municipal Population: 1996-97 (Dollars)

	All Municipalities	300,000 or more	200,000 to 299,999	100,000 to 199,999	75,000 to 99,999	50,000 to 74,999	25,000 to 49,999	10,000 to 24,999	Less than 10,000
United States	1,752	3,109	1,600	1,517	1,389	1,269	1,215	1,166	1,029
Alabama	1,433	0	1,386	1,766	825	2,409	1,629	1,409	1,089
Georgia	1,504	2,484	0	1,195	1,633	1,822	1,347	1,693	1,144
Mississippi	1,217	0	0	883	0	2,846	1,170	1,304	1,068
New York	5,095	6,981	3,021	2,132	0	1,252	1,259	1,086	910
North Carolina	1,556	1,757	1,039	1,449	2,054	1,761	1,665	1,712	1,339
South Carolina	1,178	0	0	1,221	0	1,562	1,108	1,314	986
Tennessee	3,162	4,194	0	4,099	1,388	3,177	1,981	2,298	2,284
Kentucky	1,195	0	1,381	0	0	2,129	1,823	1,147	784
Maryland	2,262	3,787	0	0	0	0	957	789	765
Ohio	1,165	1,585	1,401	1,688	862	1,036	932	1,065	940
Pennsylvania	1,338	2,917	0	955	782	1,002	690	603	467
Virginia	2,578	2,091	3,510	3,059	3,304	2,775	2,315	2,416	1,311
West Virginia	**1,022**	**0**	**0**	**0**	**0**	**1,142**	**1,712**	**870**	**846**
Average of Appalachia	1,900	3,225	1,956	1,845	1,550	1,909	1,430	1,362	1,072

General Revenue Per Capita by State and Municipal Population: 1996-97 (Dollars)

	All Municipalities	300,000 or more	200,000 to 299,999	100,000 to 199,999	75,000 to 99,999	50,000 to 74,999	25,000 to 49,999	10,000 to 24,999	Less than 10,000
United States	1,358	2,386	1,314	1,210	1,106	1,010	985	887	756
Alabama	928	0	1,167	895	654	1,462	1,021	857	724
Georgia	1,034	2,025	0	1,013	1,092	990	938	977	649
Mississippi	895	0	0	802	0	2,802	897	947	605
New York	4,264	5,798	2,891	2,065	0	1,157	1,105	981	764
North Carolina	1,100	1,627	986	1,307	1,160	913	980	927	959
South Carolina	716	0	0	977	0	1,256	741	510	527
Tennessee	1,597	2,259	0	1,704	505	1,541	1,384	1,084	1,013
Kentucky	847	0	1,232	0	0	819	980	828	529
Maryland	1,762	2,892	0	0	0	0	812	651	657
Ohio	971	1,321	1,247	1,488	766	827	765	918	740
Pennsylvania	1,078	2,301	0	738	668	786	651	496	401
Virginia	2,193	1,998	2,947	2,656	2,773	2,152	1,730	2,022	1,009
West Virginia	**890**	**0**	**0**	**0**	**0**	**1,112**	**1,497**	**734**	**706**
Average of Appalachia	1,406	2,528	1,745	1,365	1,088	1,318	1,039	918	714

Table 13 cont'd.
Tax Revenue Per Capita by State and Municipal Population: 1996-97 (Dollars)

	All Municipalities	300,000 or more	200,000 to 299,999	100,000 to 199,999	75,000 to 99,999	50,000 to 74,999	25,000 to 49,999	10,000 to 24,999	Less than 10,000
United States	577	1,010	514	508	497	442	438	393	299
Alabama	551	0	773	582	238	678	635	566	358
Georgia	400	600	0	506	447	400	294	405	251
Mississippi	202	0	0	270	0	329	296	169	126
New York	1,860	2,533	690	698	0	467	487	504	427
North Carolina	337	471	400	422	394	275	302	280	265
South Carolina	352	0	0	381	0	650	362	258	268
Tennessee	520	830	0	615	144	410	338	307	245
Kentucky	377	0	580	0	0	273	473	344	220
Maryland	662	1,034	0	0	0	0	370	301	272
Ohio	501	644	665	698	392	427	383	508	400
Pennsylvania	495	1,073	0	303	352	279	310	231	176
Virginia	990	1,017	1,051	1,185	1,197	833	845	1,022	485
West Virginia	**312**	**0**	**0**	**0**	**0**	**547**	**334**	**342**	**208**
Average of Appalachia	581	1,025	693	566	452	464	418	403	285

Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

A final comparison highlights the unique features of the West Virginia municipal revenue structure that we have been examining so far. Table 14 shows the percentage distribution of total municipal revenues for the Appalachian region states and the United States as a whole. West Virginia has both the highest share of general revenue in total revenue and the highest share of general revenue from own sources in total revenue. It also has the highest share of charges and miscellaneous general revenue in total revenue among the states. On the other hand, it has the lowest share of intergovernmental revenue in total revenue and, more specifically, the lowest share of revenue from state government in total municipal revenue. In terms of tax revenues, West Virginia municipalities have one of the lowest shares of property tax revenues and one of the highest shares of public utilities tax revenues. Overall, the share of total tax revenues in total revenues is slightly lower than the U.S. average.

West Virginia municipalities have the highest share of charges and miscellaneous general revenue in total revenue in the Appalachian region.

West Virginia municipalities have the lowest share of revenue from the state government in total municipal revenue in the Appalachian region.

Table 14: Shares of Municipal Revenues in Total Revenue of Municipalities in Appalachian States: 1996-97 (Percentages)

	United States	Alabama	Georgia	Mississippi	New York	North Carolina	South Carolina	Tennessee	Kentucky	Maryland	Ohio	Pennsylvania	Virginia	West Virginia
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
General revenue	77.5	64.8	68.8	73.6	83.7	70.7	60.8	50.5	70.9	77.9	83.4	80.6	85.1	87.1
Intergovernmental revenue	21.9	6.7	12.7	23.6	32.3	22.3	11.2	21.0	9.6	37.2	14.8	24.7	31.9	5.4
Federal Government	4.1	1.4	2.0	2.3	4.9	4.6	4.2	0.8	3.1	2.9	3.3	6.2	3.3	3.3
State Government	16.0	3.4	2.4	19.9	26.3	8.9	5.3	12.2	5.1	30.8	9.7	15.5	28.0	1.9
Local Government	1.8	1.9	8.3	1.5	1.1	8.9	1.8	8.0	1.4	3.5	1.9	3.0	0.6	0.2
From own sources	55.6	58.1	56.1	49.9	51.3	48.3	49.6	29.5	61.3	40.7	68.5	55.9	53.2	81.7
Taxes	32.9	38.4	26.6	16.6	36.5	21.7	29.9	16.4	31.6	29.3	43.0	37.0	38.4	30.5
Property	16.0	5.7	11.9	12.9	15.5	18.8	16.2	10.0	8.5	21.4	7.9	12.3	25.0	8.6
Tot. Sales & Gross Receipts	9.5	24.3	11.7	2.7	7.1	1.0	4.8	5.2	1.5	1.7	0.8	2.3	9.6	4.0
General	5.7	21.4	3.6	0.0	5.3	0.0	1.7	3.2	0.0	0.0	0.0	1.1	3.6	0.0
Motor Fuel	0.1	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Alcoholic Beverages	0.1	0.4	1.5	0.0	0.0	0.0	0.0	0.8	0.2	0.0	0.0	0.0	0.0	0.6
Tobacco	0.0	0.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0
Public Utilities	2.3	0.7	3.0	1.8	0.7	0.1	2.8	0.4	1.1	0.8	0.0	0.0	3.0	2.9
Other	1.3	1.1	3.6	0.9	1.1	0.9	0.3	0.9	0.2	0.8	0.8	1.1	2.6	0.5
Income	4.8	2.0	0.0	0.0	12.6	0.0	0.0	0.0	15.4	4.0	31.9	15.7	0.0	0.0
Motor Vehicle Licenses	0.2	0.2	0.0	0.0	0.2	0.4	0.0	0.3	0.1	0.0	0.3	0.0	0.5	0.0
Other	2.4	6.2	3.0	1.0	1.2	1.4	8.9	1.0	6.1	2.2	2.0	6.8	3.3	17.9
Charges and miscellaneous	22.7	19.7	29.5	33.3	14.8	26.6	19.7	13.0	29.7	11.4	25.6	18.8	14.8	51.2
Utility and liquor store revenue	15.2	32.2	27.4	26.3	5.4	28.8	38.9	43.7	29.1	5.1	16.6	11.9	10.8	10.2
Employee retirement revenue	7.3	3.1	3.9	0.1	10.9	0.5	0.3	5.8	0.0	17.0	0.0	7.6	4.1	2.7

Source: U.S. Census Bureau: 1997 Census of Governments, Volume 4: Government Finances, Finances of Municipal and Township Governments.

7. Alternative Revenue Sources and Policy Options

The above review of West Virginia's municipal financing system shows the many challenges faced by West Virginia localities. These challenges generally point to the limited revenue generating-capability of municipalities. Therefore, the next important question is "What can municipalities do to raise more revenues?" This section lists various local revenue sources currently used by other states and discusses policy options.

7.1. Local Income Taxes

Local income taxes have been used in many U.S. states predominantly by cities.[11] A local income tax can take the form of a local personal income tax or a local business income tax. Local income taxes have many advantages. Their relatively broad base can enhance revenue generation. At the same time, they can increase the progressivity of the local tax systems particularly when they replace an existing business tax such as the B&O tax. Besides, they can be imposed on top of the state personal income or corporate income tax as "piggy back" taxes, which mean that they can be collected as a share of the total state tax liability. Piggy back method has the advantage of decreasing the administrative costs of these taxes and makes the implementation easier for cities. However, West Virginia already has high personal income and corporate income tax rates compared to its neighbors (Tosun and Takashima, 2002). Piggy back method may create substantial personal income and corporate income rate differentials with West Virginia's neighbors.

It is argued that local income taxes vary substantially with the level of economic activity (Goldman, Corbett and Wachs, 2001). Thus they may not be as stable as some existing local taxes like the property tax. Local income taxes also raise inter-jurisdictional issues. They may fuel intense local competition between jurisdictions. Taxation of commuters is also problematic since a person may be taxed both in the jurisdiction that she lives and also in the jurisdiction that she works.[12]

7.2. Local Sales and Use Taxes

Local sales and use taxes are considered the most popular among the local option taxes (NCSL, 1997). They can work similar to a state sales tax, and like local income taxes, they can take the form of a piggy back tax where a portion of the state sales tax is reserved for cities and other local governments. A local sales tax can enhance revenue generation and ranks high in revenue adequacy due to its stable and broad tax base. However, it raises serious equity issues. Sales taxes are considered to be regressive because low-income households spend larger portion of their incomes on general consumption items compared to higher-income households. A local sales tax imposed as a piggy back tax on the state sales tax would increase the regressivity of both the

[11] Other local authorities that impose local income taxes are counties and school districts. See NCSL (1997) for more on the local implementation of income taxes.

[12] This arises when the income tax takes the form of a local payroll tax which taxes income based on the place of employment rather than residence.

municipal revenue system and the total state and local tax system. This is particularly important for West Virginia since there is no sales tax exemption for food products.

7.3. Local Alcohol Taxes

West Virginia imposes state taxes on beer and wine and a local tax on wine and liquor sales. "Beer barrel tax" is levied at a rate of $0.177 on a gallon ($5.50 per barrel). "Wine liter tax" is imposed on wine sold by suppliers to distributors[13] at a rate of 26.406 cents per liter. There is also a wine and liquor tax imposed at the municipal level at a rate of 5% of the retail purchase price of wine and liquor sold within municipalities and counties including sales to private clubs. This is in addition to the 6% sales tax imposed on these sales. Collections from the 5% municipal tax on wine and liquor sales are distributed back to municipalities and counties.

While wine sales are taxed at both state and local levels, beer is taxed only at the state level. A local beer tax can generate additional revenue for municipalities. For example, a local beer tax can be particularly effective in raising revenues in cities with fairly large college populations. However, a local beer tax may lead to significant local competition especially for cities that are in border counties. Among the neighboring states, West Virginia already has the third highest state beer tax rate of $0.177 per gallon after Virginia's $0.256 per gallon and Ohio's $0.18 per gallon rates. This rate is also significantly higher than the ones for Kentucky ($0.08), Maryland ($0.09) and Pennsylvania ($0.08). Thus a local beer tax would make the total state and local tax rate on beer in West Virginia relatively high compared to its neighbors. Furthermore, a local beer tax such as a local beer tax would increase the overall regressivity of the municipal revenue system. Young and Bielinska-Kwapisz (2002) shows that excise taxes on alcohol can be over-shifted to consumers by raising the retail price by more than the full amount of the tax. This would put a greater burden on the consumers of alcohol than previously suggested. Another caveat of a local beer tax or excise beer taxes in general is revenue erosion due to inflation. Beer taxes are levied on a per-gallon or per-barrel basis rather than on the percentage of the price. Thus, tax collections do not increase with inflation. Tosun and Yakovlev (2003) showed that per capita beer barrel tax collections declined between 1997 and 2002 when they are adjusted for beer price increases in that period. They compared this to wine and liquor tax collections, which kept up with wine and liquor price increases between 1997 and 2002. The key difference is that, unlike the beer tax, wine and liquor tax is an ad valorem tax imposed as a percentage of the retail purchase price. Therefore, a local beer tax imposed on a per-gallon or per-barrel basis would be subject to similar revenue erosion in the presence of beer price increases.

7.4. Local Cigarette and Tobacco Taxes

West Virginia imposes a state tax on the purchases of cigarettes at a rate of $0.55 per pack of cigarettes. However, there are no local taxes on cigarettes or other tobacco products in West Virginia. There have been substantial cigarette tax hikes in many U.S. states in response to recent state budget shortfalls. Among the cities that tax cigarettes,

[13] This excludes wine sold to Alcohol Beverage Control Administration.

New York City raised its rate by $1.42 per pack bringing the new rate to $1.50.[14] While a local cigarette or tobacco tax is considered a popular option especially in recent years, there are concerns related to its fairness and revenue adequacy. For one thing, the burden of cigarette tax is likely to be borne by lower income households. This would make the municipal revenue system more regressive. The experiences of states also show that cigarette tax collections are negatively affected by reduced smoking. In addition, the real value of tax collections decline due to inflation. Similar to the beer tax mentioned above, a cigarette tax levied on a per-pack basis does not keep up with increasing prices over time. These bring into question the revenue adequacy of a local cigarette tax. Municipalities cannot rely on a local cigarette tax as an adequate revenue source in the longer term. Additionally, a local cigarette tax on top of the state tax can lead to rate differences between bordering states. This would affect West Virginia municipalities at the border counties mainly through reduced cross-border sales to non-residents. This would in turn have a negative effect on the cigarette tax revenue collection at those municipalities.

7.5. Local Gasoline Tax

A local gasoline tax is another revenue option that is currently used by a number of states. State gasoline taxes are more widespread and they are earmarked for state highway financing. Thus, a local gasoline tax can be earmarked for street and other transportation expenditures of municipal governments. This would release funds to be used for other expenditure items in municipal budgets.

However, the local gasoline tax raises many issues regarding equity and revenue adequacy. While, it is considered a fair tax from a benefits-received perspective (Goldman, Corbett and Wachs, 2001), it is also argued that it may intensify fiscal disparities between regions (NCSL, 1997). It would favor cities that are close to major roads and highways.[15] Thus, the local gasoline tax may lead to regional inequities. In terms of revenue adequacy, local gasoline tax suffers from the same weakness that other excise taxes like beer tax and cigarette tax suffer from. It is levied on a per-gallon basis and is subject to revenue erosion due to inflation.

7.6. Tax Increment Financing

Tax increment financing (TIF) refers to a local government financing method that is currently used by local governments in more than 46 U.S. states. In TIF, a local government issues bonds to raise the necessary funds to develop a blighted area. The development project financed through TIF is expected to increase local private investment and raise property values. This would result in higher property tax revenues collected from the developing area. The increment by which the property tax revenue increases is used to retire the issued bonds. West Virginia residents ratified the West

[14] See the Federation of Tax Administrators web site at http://www.taxadmin.org/fta/rate/cig_inc02.html to see the complete list of most recent cigarette tax rate changes.

[15] NCSL (1997) argues that these cities would have an additional benefit of exporting the local gasoline tax to non-residents. On the other hand, cities that are not strategically located would not benefit from the same strong tax base and their residents would bear the burden of this tax.

Virginia Tax Increment Financing Act of 2002 as an amendment to state constitution in November 2002.

The ultimate goal of a TIF program is to help a local area develop, with related goals of lower unemployment, higher wages, higher property values, business attraction, industrial development, downtown development, overall infrastructure improvement, and increases in local tax revenues. As shown by Tosun and Yakovlev (2002), this financing method has already been used by municipalities in states that are structurally similar to West Virginia. Thus, it can be a useful development tool for West Virginia and it can lead to significantly improved tax bases in West Virginia municipalities.

Tosun and Yakovlev (2002) mention population losses in West Virginia as one of the major risks to the successful implementation of TIF programs in West Virginia. This is due to the evidence from some of the states that growing cities may be more likely to use TIF compared to cities experiencing population losses. The authors also mention potential problems with the revenue-generating capability of the TIF mechanism in West Virginia. Due to property tax rate limits imposed by the Tax Limitation Amendment and the uncertainties surrounding the actual property value growth in cities that used TIF in the past, revenue generation required for bond retirement would be in jeopardy.[16] Thus, municipalities may approach this financing method with skepticism.

7.7. Lottery Funds

West Virginia has a unique lottery program that expanded quite remarkably since its introduction in 1986. The West Virginia Lottery introduced three major types of games: instant games, on-line games, and video lottery games. The latest addition to the lottery structure in West Virginia, video lottery is the largest source of lottery revenue, accounting for about 73% of total lottery sales in 2001 (Tosun and Rogers, 2002).

The net proceeds from West Virginia lottery sales go to financing education, tourism, and senior citizen programs. Since lottery funds are already earmarked for these substantial government programs, diversion to municipal budgets wouldn't be an easy task. However, tremendous increase in video lottery revenues in recent years keeps this revenue source as an option particularly for municipalities suffering from economic and fiscal stress. Hence, diversion from lottery funds to municipal budgets during fiscal crisis remains as a short-run policy option. Nevertheless, uncertainties surrounding the future revenue-generating capabilities of the West Virginia Lottery preclude the longer-term use of the lottery funds in municipal budgets. These uncertainties mainly refer to the increasing possibility of multi-state lottery game and video lottery adoptions in surrounding states. Such lottery game adoptions are expected to have negative impacts on West Virginia lottery revenues particularly in counties that are bordering the adopting states (Tosun and Skidmore, 2002).

[16] The exclusion of excess property levies from the TIF may further weaken the revenue flow (Tosun and Yakovlev, 2002).

7.8. Replace the Business and Occupation Tax

As mentioned earlier in the report, B&O tax performs poorly in terms of both efficiency and equity. There are strong arguments against the use of this gross receipts tax in the municipal financing structure. These arguments point to the elimination of the B&O tax. However, the B&O tax is the largest single revenue source for municipalities and removing it will cause the loss of much needed revenue. Therefore, any proposal to eliminate the B&O tax should be complemented with a replacement strategy. The only two types of taxes among the local options listed above that have tax bases similar to that of the B&O tax are local income taxes and local sales and use taxes.

A third tax that is not mentioned above and not widely used in the U.S. is the value added tax (VAT). VAT is a tax on value added which is the difference between what is received from the sales of goods or services and what is purchased as inputs (Tosun, 2002b). VAT does not discriminate between factors of production (taxes both capital and labor inputs) or between different forms of business organizations. It is a stable source of revenue with a broad tax base. The only American states that currently employ a VAT in their tax systems are Michigan and New Hampshire. Michigan's single business tax (SBT) was adopted in 1976 while New Hampshire adopted its business enterprise tax (BET) in 1993. Michigan's relatively long experience with the VAT shows that its base could erode over time due to political interference that give way to various exemptions and other special provisions. There is also no example of a local VAT from the U.S. states. Thus, it is an untested revenue source in the U.S.

7.9. Statewide Education Levy

Another policy option is aimed at reducing the imbalance between what municipalities contribute to the property tax system in terms of total taxable assessed valuations (34% of the total) and what they get in return in terms of property tax levies (7.8% of the total). This can be accomplished by imposing a statewide education levy to partially finance education spending. The idea is to free a portion of the property tax revenue devoted to school districts while keeping the level of education spending at the same level as before and increase the municipalities' property tax revenues. While such a statewide levy would need constitutional amendment, it may be useful to consider some hypothetical examples. For this, the education levy is assumed to be based on personal income and it works like a piggyback tax on the state personal income tax.[17]

In one scenario, education levy is added as a percent tax on top of the graduated personal income tax rates, excluding the lowest income group.[18] This scenario would

[17] BBER's personal income tax calculator (PITCALC) is used to simulate the effect of the education levy on total personal income tax liability. PITCALC calculates personal income tax liabilities of West Virginia residents by utilizing state income tax return data and the personal income tax rate schedule.

[18] The education levy schedule is determined arbitrarily as follows (for individuals filing as single, married filing jointly, head of household and widow(er) with dependent child): no additional tax on individuals with income less than $10,000, 0.3% on individuals with income greater than or equal to $10,000 but less than $25,000, 0.5% on individuals with income greater than or equal to $25,000 but less than $40,000, 1% on individuals with income greater than or equal to $40,000 but less than $60,000, 2% on individuals with income greater than or equal to $60,000. Similar rate schedule is used for individuals that file as "married filing separately" with income cut-offs equal to half of the cut-offs in the above schedule.

bring about $100 million of additional revenue, which can be used for education spending. Under this policy option, the property tax revenue going to school districts would be reduced by $100 million and the property tax revenue flowing into municipalities' budgets would be raised by $100 million such that total property tax liability is unchanged.[19] Using the Fiscal Year 2003 property tax levy data, this would increase property tax levies for municipality purposes from $75 million to $175 million and the municipalities' share in total levies from 7.8% to 18%.

In another scenario the same rate schedule shown in footnote 18 is used with the addition that increase in municipal purpose property levies would be less than $100 million. This means that total property tax liability would decrease. As an example, let's assume that municipal purpose levy rate can be raised so that total property tax revenue to municipalities increases by $25 million. This would increase the municipalities' share in total property levies from 7.8% to 11.2% while decreasing the total property tax liability by about 8%. In both scenarios, the total amount of revenue earmarked for school districts remains the same. While rate changes in above policy examples are arbitrary, these examples show that it is possible to fund education at its current levels, decrease total property tax burden and at the same time increase the share of property tax revenue captured by municipalities. However, these hypothetical examples are not revenue neutral experiments. They would increase the overall state and local tax burden.

[19] Here the rate of levy for school districts would be decreased and the rate of levy for municipalities would be increased. It requires further analysis to determine the optimal size of these rate changes.

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