Local Government as a Homeowners Association: Implications for GDP and Productivity

Rachel H Soloveichik
Bureau of Economic Analysis

Jon Samuels
Bureau of Economic Analysis

Paper Abstract: The current treatment of property taxes in SNA2008 distorts comparisons over time and across countries. To demonstrate the distortions, we investigate a stylized economy where property owners can use three funding options to pay for current local services:

1) Property owners can pay dues for services provided by property associations. In the United States, residential property associations are commonly called 'homeowners associations' and commercial property associations are commonly called 'business improvement districts'.

2) Property owners can pay property taxes now. The local governments then use that revenue to provide current services to property owners.

3) Property owners can pay property taxes later. In that case, the local government borrows money to pay for local services now and repays the borrowed money with future taxes.

Landlords, tenants, home owners, and businesses all are indifferent to the funding mechanism in this stylized economy. SNA's current methodology, however, treats these three funding options differently. Dues paid to homeowners associations or business improvement districts are considered an intermediate expense and therefore not counted in final demand. In contrast, property taxes paid to local governments are considered part of value-added and therefore counted in final demand in the year paid. As a result, measured nominal GDP depends on how and when local services are funded. Furthermore, measured real GDP and productivity embed the assumption that property taxes are included in the user cost of capital.

This paper develops an alternative methodology where measured GDP is invariant to the local funding mechanism. In the alternative methodology, local property taxes are classified as intermediate expenses. Conceptually, our approach is similar to treating local governments as if they were homeowners associations or business improvement districts. We also apply property taxes to the year when services occur and obligations are accrued, rather than the year they are paid. This is analogous to the accrual-based treatment of pensions.

We apply our alternative methodology to both US time series data and OECD cross-country data. In the United States, our alternative methodology reduces the nominal level of GDP by $634 billion in 2012, a 4% drop. Between 1947 and 2012, our alternative methodology reduces

nominal GDP growth by 0.06% annually and real GDP growth by 0.04% annually. The changes in measured value-added and productivity are larger for industries with relatively high property taxes, and particularly Real Estate. Across other OECD countries, our alternative methodology reduces the nominal level of GDP by 3%. The larger US drop occurs because the United States has higher property taxes and more local government than the rest of the OECD.