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The Dakota Proposition: An Economic Analysis

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AN ECONOMIC ANALYSIS

by

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Introduction

The Dakota Proposition, an initiated proposal to amend the South Dakota State Constitution, will appear on the 1980 ballot. The Proposition would seem to have far reaching implications. Yet, what are these implications? Will the Proposition be a boon to taxpayers, a calamity for government, or both?

Three major provisions are included in the Proposition. These are:

1. A reduction or rollback of taxes on real property to one percent of Full and True value, determined by assessments performed in 1977;

2. A ceiling of two percent annual growth in the Full and True value of real property for any year during which inflation exceeds two percent. Inflation would be measured by the Consumer Price Index (CPI), an official calculation of general consumer price changes in the U.S. economy;

3. A two-thirds vote requirement for both houses of the state legislature on any tax increases, and specific prohibition of legislative changes in real property taxes or of a tax on the sale of real property.

This paper involves an examination of the likely economic impacts and implications of the first two major provisions, the rollback and the ceiling on growth of the bases, and additional analyses to assist readers in making informed decisions about the Dakota Proposition.

Rollback Provision

Figures from the South Dakota Department of Revenue reveal that real property taxes payable in 1978 (including taxes on utility property) were approximately $195.9 million.[1] If the Dakota Proposition had been in effect in 1978, however, taxes on real property would have been limited to one percent of the Full and True value as assessed in 1977. Instead of paying $195.9 million in taxes on real property, real property owners would have paid approximately $95.6 million, a savings for taxpayers

[1] Annual Statistical Report FY 1978, South Dakota Department of Revenue, Pierre, p. 28.

and a revenue loss for local governments of about $100 million or more than fifty percent.[2]

Over the past five years, property taxes in South Dakota have increased at an average annual rate of seven percent. If property taxes were to continue to increase at the same rate, by 1981 (the proposed year for initiating the Dakota Proposition), real property taxes would total approximately $240 million. The Dakota Proposition would, however, rollback real property taxes to about $101.5 million, creating a reduction in tax revenues of $138.5 million or about 58 percent.[3]

Distribution of the Rollback

Agricultural and non-agricultural properties in South Dakota are treated distinctly for purposes of taxation to support elementary and secondary schools. The first eight mills required to fund local school budgets are applied equally to agricultural and non-agricultural properties; for rates above eight mills, non-agricultural land is taxed at two mills for every one mill on agricultural property, up to a ceiling of twenty four mills for agricultural and forty mills for non-agricultural property.[4]

In effect, non-agricultural properties are, in general, taxed at a higher percentage of their assessed value. But again, the Dakota Proposition would limit the rate of taxation to one percent of Full and True value without respect to agricultural non-agricultural differences. This limit has two related consequences--

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[2]California's experience with Proposition 13 suggests that an ex post legal challenge to the Full and True assessments of 1977 might, however, arise. Such a challenge would involve an attempt to raise Full and True assessments to reflect actual market values. If the Full and True values for 1977 are adjusted by the average assessment to sales ratio for South Dakota in 1977 (79.7%) the values increase by twenty percent. Thus real property taxes (excluding utilities) would have been rolled back to $116 million, rather than $95.6 million. Taxpayers would have saved $63.7 million and local units of government would have lost about thirty-five percent of revenues from real property taxes. Sales ratio figures are from: 1977 South Dakota Assessment and Sales Information, Property Tax Division, Department of Revenue, Pierre, South Dakota.

[3]This projection assumes no ex post adjustment in the Full and True value assessment of 1977.

[4]This ceiling does not apply to bond redemption levies.

tax savings created would be more substantial for non-agricultural real property owners than for agricultural real property owners; and, local governments in more urbanized counties would lose a greater percentage of their revenues than would local governments in more agricultural counties.

Table I illustrates rollback consequences for agricultural and non-agricultural property owners in 1978. Had the Dakota Proposition been put into effect in 1978, real property taxes for agricultural lands and lots would have been reduced, on the average, by 30.0 percent. But property taxes on non-agricultural lands and lots would have been reduced, on the average, by 63.2 percent.

TABLE I*

Impact of Dakota Proposition: Ag Non-ag Property (1978)

Type of Property	Taxes Payable($)	With the Dakota Proposition ($)	Difference ($)	Change
Agricultural				
Lands	73,993,317			
Lots	253,107			
Total	74,246,424	51,955,038	22,931,386	-30.0%
Non-agricultural				
Lands	6,229,580			
Lots	99,241,632			
Total	105,471,212	38,803,261	66,667,951	-63.2%
	$179,717,636	$90,758,299	$88,959,337	-49.5%

* Source of data is South Dakota Department of Revenue, Annual Statistical Report, FY 1978.

Counties with relatively more non-agricultural properties are, by definition, the more urbanized counties of the state. Table II lists South Dakota counties and shows the absolute and percentage decline in annual real property tax revenues which local governments in the counties would have experienced had the Dakota Proposition taken effect in 1978.[5] Note that one agricultural county, Sully, would have experienced a tax increase.

[5] Appendix I shows county impacts given an ex post adjustment of Full and True value for 1977 using the "all average" assessment-sales ratios, by county, 1977.

TABLE II

Impact of the Dakota Proposition By County (1978)

County	Decrease (or Increase) in Tax Revenues ($)	Percentage Decrease (or Increase) (%)
Aurora	429,805.77	37
Beadle	3,496,457.27	58
Bennett	527,283.19	62
Bon Homme	1,209,708.12	54
Brookings	3,259,553.46	54
Brown	6,666,362.71	56
Brule	660,685.77	43
Buffalo	11,558.70	05
Butte	1,241,218.61	49
Campbell	206,591.10	26
Charles Mix	1,115,899.15	46
Clark	550,999.85	34
Clay	1,752,652.86	50
Codington	3,202,150.80	59
Corson	210,968.16	17
Custer	783.217.70	56
Davison	3,225,957.80	69
Day	1,127,304.05	45
Deuel	834,345.20	51
Dewey	197,196.33	29
Douglas	385,564.35	38
Edmunds	750,273.25	37
Fall River	1,152,243.50	57
Shannon	63,770.91	38
Faulk	409,767.96	30
Grant	1,805,276.78	42
Gregory	947,081.58	50
Haakon	301,931.72	32
Hamlin	643,283.07	43
Hand	619,085.74	31
Hanson	513,895.96	48
Harding	428,148.26	48
Hughes	2,106,228.44	49
Hutchinson	1,481,177.43	49
Hyde	88,321.14	11
Jackson	85,234.74	19
Washabaugh	2,251.95	01
Jerauld	350,670.18	38
Jones	331,678.61	55
Kingsbury	927,833.38	42
Lake	1,435,107.79	54
Lawrence	3,930,182.92	67
Lincoln	1,711,637.69	45
Lyman	358,742.52	25
McCook	895,524.04	47
McPherson	603,610.94	38
Marshall	572,352.73	36
Meade	1,579,922.58	52
Mellette	813,401.95	29
Miner	550,569.35	48
Minnehaha	18,914,970.36	60
Moody	934,293.16	44
Pennington	12,248,521.96	63
Perkins	126,327.27	08
Potter	330,767.39	25
Roberts	1,421,977.42	53
Sanborn	524,486.31	48
Spink	1,127,847.73	36
Stanley	430,453.16	40
Sully	(26,970.54)	(02)
Tripp	795,177.41	34
Todd	178,960.17	38
Turner	1,031,553.88	41
Union	1,799,148.38	54
Walworth	1,213,545.49	51
Yankton	3,180,095.38	59
Ziebach	95,693.69	18
Total	100,256,482.68	
Averages Per County	1,496,365.41	41

Study of Table II reveals that, in general, real property tax reductions for more rural counties would have been less than for more urban counties. Yet, there are exceptions. Among the more rural counties of the state, for example, Bennet County would have had a reduction of 62 percent — a greater percentage reduction than either Minnehaha or Brown County.

A second explanation for the difference in impact among counties lies in tax rate differences. Those counties which tax property at a higher mill levey rate would have a greater reduction in revenues with Dakota Proposition. Two counties might even have property of equal market value and might obtain equal tax revenues. Yet if assessed values and mill rates differed, that county with a lower assessed value (and higher mill rates) would be more affected by Dakota Proposition than would the county with a higher assessed value (and lower mill rates).

Thus Table II reveals that those counties which have the highest tax rates (highest mill levies relative to assessed values) would be most affected by Dakota Proposition. Having a high tax rate may reflect: (1) a high proportion of nonagricultural real property relative to agricultural property; (2) a strategy of keeping assessments low and mill levies high; or, (3) simply a willingness to impose a relatively high tax rate to yield revenues for desired services.

Growth Ceiling Provision

A second major provision of the Dakota Proposition is the creation of a ceiling on changes in the assessed value of real property subsequent to the Full and True assessment of 1977. Changes in assessed value would be tied to a measure of prices paid by consumers, the Consumer Price Index (CPI).

Assessed values for real property could change on an annual basis in direct proportion to changes in CPI (either positive or negative changes), except that if the CPI rose by more than two percent, assessed value growth would be limited to two percent only. Since the CPI will almost inevitably rise by more than two percent annually, for the forseeable future, this provision will efectively limit growth in assessed real property values to less than the rate of general consumer inflation.

Prices paid for state and local government purchases in recent years have, however, been rising at a rate above the CPI. Rapid increases in government purchase prices reflect both general inflation in the economy and supply-demand conditions which increase the prices for particular products. For example, government units, as large purchasers of petroleum products, would be significantly affected by price increases resulting from crude oil shortages.

One measure of prices paid by state and local governments is the GNP Deflator for State and Local Purchases. The Deflator reveals, for example, that from 1967 to 1978, prices paid by state and local governments for purchases increased by 121.4 percent. The CPI increase for the corresponding period of time was 95.4 percent.

Implications of the growth ceiling provision can be viewed in a series of two graphs. Graph #1 shows that the nominal growth in property taxes collected in South Dakota during the period 1970 through 1977 was 55.6 percent. If the Dakota Proposition had been in effect during that period, however, growth in property taxes would have been limited to 14.9 percent.[6]

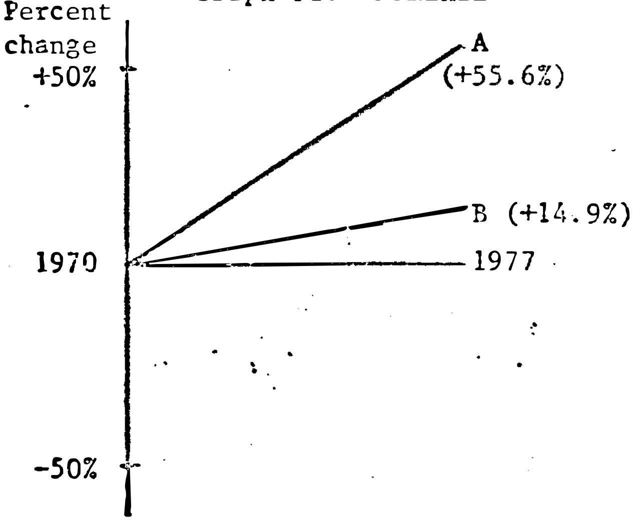
Nominal changes do not involve any consideration of the impact of inflation, however, Graph #2 incorporates the effect of inflation on tax revenues by deflating

[6]Nominal per capita personal income grew in South Dakota by 91.7 percent during the same period.

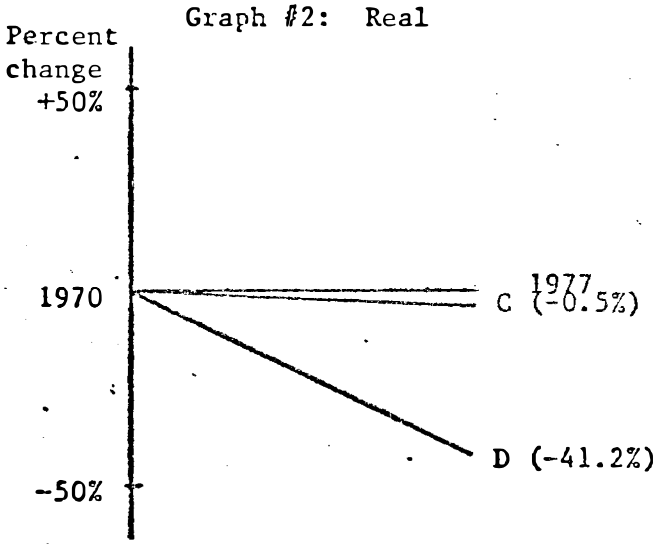
revenues through the use of the CPI. If the change in property taxes collected from 1970 through 1977 is calculated in 1970 dollars, so as to reveal changes the actual <u>purchasing power</u> of property taxes collected, such purchasing power was reduced by 0.5 percent.[7] The nominal growth in property tax virtually kept pace with general inflation so that the dollars in revenue collected in 1977 could purchase approximately the same amount of goods in 1977 as in 1970. If the Dakota Proposition had been in effect during that period, however, the purchasing power of property taxes collected (as adjusted by the CPI) would have declined by 41.2 percent.

GROWTH LIMITATION PROVISION

Graph #1: Nominal



Graph #2: Real



A = Nominal Property Tax Collected

B = Maximum growth w/ Dakota Proposition

C = Real Property Tax Collected

D = Real Maximum Growth w/ Dakota Proposition

Recall, however, that prices paid for purchases by state and local government have <u>exceeded</u> the general rate of inflation for consumer purchases. Thus the analysis of the loss of purchasing power as measured by the CPI results is a conservative estimate. If the change in property taxes collected between 1970 and 1977 is adjusted by the GNP Deflator a 12.5 percent, decline in purchasing power is revealed. If the Dakota Proposition had been in effect during that same period, however, the purchasing power of property taxes collected (as adjusted by the GNP Deflator) would have declined by 53.2 percent.

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[7]During the same period, the purchasing power of per capita personal incomes in South Dakota increased by 22.8 percent.

The conclusion of this analysis of the growth ceiling provision is that if, as expected, general inflation significantly exceeds two percent annually, this provision would create a significant and continuous decline in the purchasing power of the real property tax in South Dakota. Any price increases over and above general inflation for purchases made by state and local governments would further reduce the purchasing power of the property tax.

Additional Implications of the Proposition

A number of additional implications of the Dakota Proposition exist—both for the public and private sectors.

Public Sector--State and Local

The passage of Proposition 13 in California in 1978 resulted in massive state aid to local governments. Such aid is unlikely in South Dakota, given the minimal state surplus and the estimated size of the rollback amount relative to the total state budget. Marked increases in state aid would require additional state taxes.

At the local government level, elementary and secondary schools will be the units of government most adversely affected by reductions in property tax revenues. Table III revels that the 1978 property tax was distributed in such a way that primary and secondary schools received almost two thirds of the revenues obtained. Moreover, schools in South Dakota obtain approximately 70 percent of their finances from the local property tax, so that the quantity and quality of primary and secondary educational services depend heavily on property tax revenues.

Table III

Distribution of South Dakota Property Tax Revenues (1978)

Local Government Units	Percent
Schools	63.11
Counties	20.61
Cities and Towns	13.89
Townships and Sp. Districts	2.39
	100.00

Source: Department of Revenue Annual Report FY 1978, p. 26.

Schools also do not have the ability to charge user fees or to enact new taxes. General purpose governments, in contrast, would have the ability and the incentive, given property tax reductions, to charge or increase fees for goods and services such as trash collection, water, building inspection, parks, sewage disposal, etc. Cities in South Dakota would also have the incentive and the ability, with voter approval, to enact or to increase municipal sales taxes.

Private Sector

Additional implications in the private sector may be traced as well. Land owners would be more likely to construct or repair homes and other improvements since the disincentive to improving property created by the property tax would be lessened.

Current land owners would reap the windfall of the roll back and the expected reduction in future property taxes. The windfall could be taken either as a reduced tax burden with continued ownership or capitalized into the sales price of property. Passage of the Dakota Proposition, other things equal, would mean that prices for land would tend to increase. Prices for homes and other imporvements are likely to rise initially, then decline again as increased supplies of capital drive prices downward.

Purchasers of services provided by investor-owned utilities would likely find their monthly bills for electricity, gas, or telephone had fallen. Regulated utilities have rates set relative to their costs of business so that decreased taxes are likely to be passed along as decreased rates for consumers.

Values and Trade-Offs

Values, our sense of the goodness and badness of persons, events, and things, will influence our decisions about the Dakota Proposition and about taxation and government activities in general. It is important to recognize that the decision about how to react to the Dakota Proposition and to taxation and government in South Dakota can involve an objective examination of our own values and the values of others.[8]

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[8]By an objective examination is meant one that is coherent and clear, one open to critique by others, and one which results in decisions which appear to have been right.

Burdensome Nature of Property Tax

Two commonly held values are likely to prompt citizens to support the Dakota Proposition. First, some citizens may regard the property tax in South Dakota as too burdensome. Indeed, statistics may be cited to support this view. In South Dakota in 1975, for example: the property tax was $57 per $1000 of personal income, placing the state seventh among all states; the property tax was $491 per $1000 of state and local revenue (fifth among all states); state aid was $249 per $1000 of local revenue (48th among all states and thereby implying that other states rely relatively more on sales and income taxes); state and local taxes were $116 per $1000 income (29th among all states and implying that the total tax burden was not unusual in South Dakota even while the dependence on the property tax was unusually high).[9]

But although the Dakota Proposition would significantly reduce the property tax burden in South Dakota, other potential consequences should also be considered. For that individual who holds the view that the property tax is too burdensome, these other potential consequences are likely to be regarded as undesirable. These consequences would become trade-offs if the individual decided to support the Proposition.

Approval of the Dakota Proposition would increase the probability (not make inevitable) some combination of a loss of local control, a loss of desired programs or levels of services, or an addition to state taxes.

Consider first the probability of a loss of local control. If state and national governments are called upon to support local government units which have sustained

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[9]All statistics were gatherd from "Significant Features of Fiscal Federalism, 1976-77 Edition: Vol. II Revenue and Debt," Advisory Commission in Intergovernmental Relations, Washington, D.C. 20575, March 1977. Elimination of approximately one fifth of the property tax through the personal property tax repeal will reduce the burden of the total property tax per se.

substantial revenue losses, that support is likely to involve guidelines, requirements, and other "strings" on how money may be spent. Moreover, substantial aid from the state could not be made without a new state tax program--probably an income tax, the only common and major tax method not used in the state.

If, in contrast, local governments attempt to sustain very large reductions in revenues without assistance from the state, the quantity or quality of some programs such as elementary and secondary education would be jeopardized. Although the Dakota Proposition, if passed would rollback real property tax revenues to approximately the 1969 level, general inflation as measured by the CPI has reduced the value of the 1979 dollar to only about half of the 1969 dollar; purchasing power of revenues is greatly reduced.[10] The argument, sometimes heard, that passage of the Dakota Proposition would only result in a reduction of local services back to the 1969 level ignores inflation and the decrease in revenue purchasing power subsequent to 1969.

Inequity of the Property Tax

A second value behind the move to approve the Dakota Proposition may well be the belief that the property tax is an inequitable tax. If ability of pay is measured by income, the property tax is not necessarily tied to ability to pay.[11] A common example used by those who hold that the property tax is inequitable is the retiree whose income is reduced by retirement but whose property tax remains at the same level.

The property tax may also tax equal income earners unequally. Two neighbors with equal incomes but with different consumption patterns are likely to be taxed unequally--that individual who prefers to own real property would likely pay more property tax than that individual who prefers to own personal property.

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[10]Moreover, the cost of education and other publically provided services, tends to rise relatively faster than the prices of other goods because cost reducing technological innovations are less prevelant in education or other public services than in goods in general.

[11]Some would measure ability to pay by wealth. Since the property tax is a tax on wealth held in certain kinds of property, the real property tax would be tied to the ability to pay if ability were measured by wealth.

Finally, the property tax often is not tied to benefits received. Through tax contributions to public education, for example, families with real property but without children help subsidize families with children.[12]

For those individuals, however, who support the Dakota Proposition because they hold the view that the property tax is inequitable, some likely trade-offs resulting from passage of the proposition should be considered. If local public programs are reduced by the loss of local revenues, those reductions may themselves result in what some would view as inequities. Quantity or quality of educational programs, assistance to the needy, and programs for the elderly might all be threatened. Moreover, if program reductions are avoided by the passage of new tax measures, those new sales taxes, income taxes, or user charges will not necessarily be more equitable than the property tax itself.

Conclusion

The so-called "tax payer rebellion," a movement which has taken on national dimensions, is manifesting itself in South Dakota in proposals such as the Dakota Proposition and various other attempts to limit or reduce taxpayer outgo and government income. Such proposals create the opportunity and indeed the responsibility to reexamine what the state and local governments do and how government is financed in South Dakota.

Our state has a unique tax system--one that is heavily dependent on the local property tax, one that involves relatively small contributions from the state to local governments, and one that does not utilize a major tax option--the state income tax. Tax systems require reevaluation as social and economic conditions change. Should government services in South Dakota be reduced? Should counties have a sales tax option? Should the state have an income tax to reduce the property tax burden

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[12]It should be noted, however, that many local public services, including education, create benefits which extend beyond the direct recipients of those services. For example, public education creates benefits not only for a child and his family, but for the whole community, through a better educated populace.

and/or increase support for local governmental units such as schools? Should the property tax be redesigned so that limits are placed on amounts of tax liability relative to personal income? These questions are ours to answer as citizens of this state because ultimately, the quality of government decisions is dependent upon our willingness to be informed and involved.