Taxpayers Rights Amendment: A Sequel to Dakota Proposition?

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The Taxpayer's Rights Amendment:  
A Sequel To Dakota Proposition?

by

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Introduction

During their campaign against Dakota Proposition, some of the opponents to that proposed constitutional amendment indicated their interest in a substitute measure to limit taxes in South Dakota. The substitute would involve, they stated, tying South Dakota taxes to the rate of inflation. An example of this kind of measure known as the "Taxpayer's Rights Amendment" has been written and may be presented as a petition to change the South Dakota Constitution in a future general election.

This Staff Paper includes a brief introductory analysis of the "Taxpayer's Rights Amendment." Suggestions for future research are also offered should the proposed amendment become a definite ballot issue. A copy of the amendment is attached as an appendix.

Description of the Proposal

The "Taxpayer's Rights Amendment" contains two key provisions—a limit on state government revenues and a limit on local government expenditures. State tax revenues could not exceed, for any given fiscal year, seven and one-half percent of the average (nominal) personal income of South Dakota residents for the prior three calendar years. Local government expenditures, for any given fiscal year, could not exceed the relevant government's fiscal year 1981 expenditures except for annual adjustments because of changes in population and inflation, or changes in program responsibility as determined by the state. No specific formula for expenditure limit adjustments because of changes in population or inflation is included in the proposal.
Analysis

State Revenues

The Advisory Commission on Intergovernmental Relations publishes: 1) state and local tax revenue in relation to state personal income for selected years; and 2) state government percentage of state and local tax revenues for selected years. These two sets of data can be combined and, with extrapolations made for data gaps, a new statistic—state tax revenue as a percentage of state personal income for selected years—can be derived for South Dakota. The new statistic can then be adjusted with annual South Dakota personal income figures to find the relevant statistic—State of South Dakota taxes as a percentage of the three previous years average of state personal income. Table I shows the results of these calculations.

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<tr>
<td>Percent of Income</td>
<td>4.40</td>
<td>4.49</td>
<td>5.81</td>
<td>5.87</td>
<td>5.91</td>
<td>5.80</td>
<td>5.97</td>
<td>6.99</td>
<td>6.91</td>
<td>6.38</td>
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</table>

The table reveals that the relevant percentage has not increased during the latter part of the 1970s. Moreover, the figure was, in 1979, slightly more than one percent below the maximum which would be established by the Taxpayer's Rights Amendment. Since one percent of South Dakota's personal income is presently about $50 million, state revenues in 1979 could have been increased by about $50 million without exceeding the maximum set by the amendment.

1Significant Features of Fiscal Federalism 1979-80 Edition, p. 46
2Ibid, p. 74.
3Personal income figures are provided by the Department of Commerce, Bureau of Economic Analysis.
Local Expenditures

The amendment proposes a spending limitation for all local units of government. For a "first-cut" analysis, this paper considers only one type of local government, county government. County spending trends can be calculated and compared with historical trends for other factors. Table II shows, along the top line, total county government expenditure trends in South Dakota (CGE), for the period 1970-1979. Base year expenditures for 1970 were set at 100. To make the figures consistent for all years, county government spending for schools (which continued through 1971) was excluded from the figures.

County expenditures are compared in Table II with growth trends for other factors, including: The Consumer Price Index (CPI); state-wide annual average population growth (POP); and GNP price deflator (GNPD) for state and local expenditures. All factors are set so that 1970=100.

The GNP Deflator is a price index which is more appropriate as a measure for price changes which affect state and local governments than is the CPI. While the CPI measures price changes for a typical "market basket" of consumer goods, GNPD measures price changes for goods purchased by state and local governments.

Table II

Changes in Total County Expenditures and Other Changes 1970-1979

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<tbody>
<tr>
<td>CGE</td>
<td>100.0</td>
<td>105.0</td>
<td>113.0</td>
<td>139.1</td>
<td>163.0</td>
<td>175.3</td>
<td>167.7</td>
<td>185.2</td>
<td>209.4</td>
<td>214.0</td>
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<tr>
<td>CPI</td>
<td>100.0</td>
<td>104.3</td>
<td>107.7</td>
<td>114.4</td>
<td>127.0</td>
<td>138.6</td>
<td>146.6</td>
<td>156.1</td>
<td>168.0</td>
<td>187.0</td>
</tr>
<tr>
<td>POP</td>
<td>100.0</td>
<td>100.3</td>
<td>100.6</td>
<td>101.0</td>
<td>101.3</td>
<td>101.6</td>
<td>101.9</td>
<td>102.2</td>
<td>102.6</td>
<td>102.9</td>
</tr>
<tr>
<td>GNPD</td>
<td>100.0</td>
<td>107.0</td>
<td>113.3</td>
<td>121.5</td>
<td>134.1</td>
<td>146.9</td>
<td>157.2</td>
<td>169.9</td>
<td>183.6</td>
<td>200.7</td>
</tr>
</tbody>
</table>

Sources: CGE figures are from South Dakota Department of Revenue, Annual Report 1970-1979; CPI and GNPD figures are from Economic Report of the President, 1980; POP figures are from U.S. Bureau of the Census "1980 Census preliminary Press Release", 8-14-80.
Figures from Table II indicate growth in total county expenditures which exceeds CPI, POP, or the two added together. While GNPD more closely approximated CGE, county expenditures exceeded GNPD every year.

What possible explanations are there for the relatively rapid growth of CGE during the 1970s? Among the explanations are: additional county services; improved quality of county services; and/or decreased efficiency in the production of such services. In addition, federal revenue sharing to county governments began in 1973 and this is included in the above calculations.

Figure I includes various "spending factors" previously identified--CGE, GNPD and CPI--and a new factor, county government expenditures minus federal revenue sharing (CGE)-RS. The figure clearly reveals that a major portion of the growth in CGE during the 1970s was financed with revenue sharing funds rather than with revenues from our own state and local sources. Moreover, CGE-RS corresponded very closely to the most appropriate price index, GNPD. A suggested hypothesis is that county government spending from own sources just kept pace with input price increases so as to maintain the quality and quantity of county services over the decade.

Additional Considerations

Some additional considerations about the proposed amendment include the following:

1. The combination of limits on state taxes and on local expenditures will create an incentive for increased local taxes, revenues from which could then be transferred to the state for ultimate state expenditures;

2. The initiative is likely to preclude a change in the tax system to increase state taxes as a method for providing local property tax relief;
FIGURE I
A COMPARISON OF SPENDING FACTORS
3. If the Reagan Administration institutes a reordering of the federal system to reduce federal expenditures while increasing local revenue sharing or block grants, local governments in South Dakota could find it impossible to increase local expenditures so as to replace federal expenditures;

4. Local governments have responded to adverse conditions such as drought by reducing expenditures from own sources of revenue. (Evidence of this behavior is shown by the downturn of CGE-RS on Figure I for the drought year 1975). The initiative would create an incentive for local governments to maintain spending levels during adverse conditions, or would make it impossible to readjust spending upward after spending was reduced during adverse conditions.

Conclusion

If the Taxpayer's Rights Amendment becomes an issue for serious consideration, research to determine the recent spending histories of individual counties, cities, school districts and townships would reveal the extent to which the local government spending limitation could impose a reasonable (or unreasonable) constraint.

Another research project could focus on the relationship of spending and population changes within local units of government. Major differences in population change occurred within the various counties during the 1970's. For example, the range in population change for the decade was from +24.9% in Custer County to -21.9% in Campbell County. But how closely did spending change correspond with population change; and what does that relationship suggest for a constitutional limit on local government spending by tying spending to population change?
The various (and sometimes mutually conflicting) forces behind the Dakota Proposition have not disappeared with the defeat of that measure in 1980. Strong continued interest exists, for example, in further limiting state and local government taxing or spending activities.\textsuperscript{4} It is very important, however, that research on proposed limits be carried out and extended to South Dakota citizens. With detailed information, citizens can then judge for themselves how likely proposed measures could result in unanticipated consequences and how closely the proposals will provide consequences which correspond with citizens' values.

\textsuperscript{4}We presently limit local government property taxes by state laws concerning assessed values, maximum taxable values and maximum mill rate levies for the various types of local units of government.
WE, THE UNDERSIGNED duly qualified voters of the State of South Dakota, hereby petition that the following article of the South Dakota Constitution be amended and that this proposal shall be submitted to the electorate of the State of South Dakota for their approval or rejection.

BE IT ENACTED BY THE PEOPLE OF SOUTH DAKOTA, that Article XI of the Constitution of South Dakota be amended by adding thereto new sections, known as the "Taxpayer's Rights Amendment," reading as follows:

"§ 14. A limit is hereby established on the aggregate tax revenues which may be collected in any fiscal year by the state of South Dakota. Effective with the first fiscal year beginning after the ratification of this section and in each fiscal year thereafter, the Legislature shall not impose direct or indirect taxes in any fiscal year which shall cause the aggregate tax revenues to exceed seven and one-half percent of the average personal income of South Dakota residents for the three calendar years prior to the year in which the Legislature is meeting in its regular session or any special session to consider the budget for such fiscal year. "Tax revenues" as used herein shall mean any form whatsoever of direct or indirect taxation, including any tax, fee, or charge imposed on the privilege of entering or conducting a business or profession but shall not mean any revenues derived from the voluntary purchase of goods or services from the state or its agencies by the public, provided that the state does not create a monopoly or limit the opportunity for competition to provide such goods or services other than through the provision of subsidies from tax revenues. "Personal income" of South Dakota residents as used herein means the total income received by all natural persons in South Dakota as defined and officially reported by the United States department of commerce or its successor agency.

§ 15. For any fiscal year that the state tax revenues exceed the tax revenue limit established by section 14 by two percent or more except by reason of a declaration of emergency provided under section 16, the Legislature shall provide by law for the return of at least the amount of tax revenues collected over the permissible limit to residents of South Dakota not later than the end of the second fiscal year thereafter. The return of excess tax revenues shall be accomplished through a reduction in taxes by an amount at least equal to the tax revenues which exceed allowable tax revenues as provided in section 14. If the tax revenues exceed the limit provided in section 14 by less than two percent, the Legislature may provide for the transfer of the excess to a state budget stabilization fund. Moneys in this fund may be appropriated by a separate bill requiring a two-thirds vote of all the members of each branch of the Legislature following any fiscal year in which tax revenues collected are five percent or more below the limit for tax revenues provided in section 14.

§ 16. The tax revenue limitation of section 14 of this Article may be exceeded only if all of the following conditions are met:

(1) The Governor requests the Legislature to declare an emergency;

(2) The request is specific as to the nature of the emergency, amount of funds required to meet the emergency, and the method by which the funds required to meet the emergency shall be raised; and
(3) Upon receiving the request, the legislature declares an emergency and makes provision therefor by law substantially in accord with the details of the Governor's request, by a two-thirds vote of the members elect of each house.

The emergency must be declared in accordance with this section prior to incurring any of the expenses which constitute the specific emergency request. The tax revenue limitation may be exceeded only for the fiscal year in which the emergency is declared; and in the next and subsequent fiscal years the tax revenue limitation of this Article shall again take effect.

§ 17. A new program or an increase in the level of service of an existing program shall not be required by the Legislature of units of local government unless a state appropriation is made and disbursed sufficient to pay the local unit of government for the necessary costs of the new program or necessary additional costs of the increased service level.

§ 18. The total annual expenditures subject to limitation of each local government shall not exceed the expenditure limit of such entity of government for the prior year adjusted for changes in the cost of living and population except as provided in this Article.

§ 19. Revenues received by any local government in excess of the amount which may be expended by such entity in compliance with section 18 of this Article during the appropriate fiscal year shall be returned by a revision of tax rates or fee schedules within the next two subsequent fiscal years.

§ 20. The expenditure limit for any fiscal year pursuant to section 18 of this Article shall be adjusted as follows:

(1) If the financial responsibility for providing any goods or services is transferred, in whole or part, whether by annexation, incorporation or otherwise, from one local government, authority, or political subdivision to another, then the expenditure limit of the transferee entity shall be increased by such reasonable amount as the said entities may by resolution establish. This amount, in addition to the existing expenditure limit of the transferee, shall constitute the new expenditure limit of the transferee. The expenditure limit of the transferor entity shall be decreased by the amount of its decreased cost;

(2) If the financial responsibility of providing any good or service is transferred, in whole or part, from a unit of local government to a private entity, or the financial source for the provision of any good or service is transferred, in whole or part, to regulatory licenses, user charges or user fees, then for the year of such transfer the expenditure limit of such local government shall be decreased accordingly;

(3) If the state requires a local government to establish a new program or increase the service level of an existing program in accordance with section 17 of this Article, the necessary expenditures for the new program or necessary additional expenditures for the increased service level shall be added to the base expenditure level of the local government;

(4) If the state no longer requires a local government to perform any service previously supported by state subventions and eliminates subventions for that purpose, the base expenditure level of the local government shall be decreased accordingly; and
§ 21. The expenditure limit imposed on any new or existing local government by this Article may be established or changed by the electors of such local government, subject to and in conformity with constitutional and statutory voting requirements. The duration of any such change shall be as determined by the electors, but except in the case of expenditures for debt service, the term shall not exceed four years from the most recent vote of the electors creating or continuing such change.

§ 22. Each local government may establish such contingency, emergency, unemployment, reserve, retirement, sinking fund, trust, or similar funds as it deems appropriate. Contributions to such funds, to the extent that such contributions are derived from the proceeds of taxes, shall for the purposes of this Article constitute expenditures subject to limitation in the year of contribution. Neither withdrawals from any such fund, nor expenditures of or authorizations to expend such withdrawals, nor transfers between or among such funds, shall for the purpose of this Article constitute expenditures subject to limitation. Except as otherwise provided in this section, expenditures subject to limitation shall not include investment of the funds of a local government in accounts at financial institutions or in liquid securities.

§ 23. Nothing in sections 18 to 26, inclusive, shall be construed to impair the ability of any local government to meet its obligations with respect to bonded indebtedness existing as of the effective date of sections 18 to 26, inclusive, or any future bonded indebtedness approved by the electors of the local government. Bonded indebtedness shall be considered the first obligation to be taken from expenditures subject to limitation of a local government.

§ 24. Terms used in sections 18 to 26, inclusive, of this Article, except as otherwise expressly provided herein, mean:

(1) "Expenditures subject to limitation of a local government," any authorization to expend during a fiscal year the proceeds of taxes levied by or for that local government and the proceeds of state subventions to the local government including the expenditure of state funds subvened in accord with subdivision (3) of section 20 of this Article, but shall not include tax refunds;

(2) "Proceeds of taxes," all tax revenues and the proceeds of a local government including, but not restricted to, revenues and proceeds from (i) regulatory licenses, user charges, and user fees to the extent that such proceeds exceed the cost reasonably borne by such local government in providing the regulation, product, or service, (ii) the investment of tax revenues, and (iii) the proceeds of state subventions to the local government including state funds subvened in accord with subdivision (3) of section 20 of this Article;

(3) "Local government," any unit of local government organized and classified by the Legislature pursuant to Article IX, section 1, or by the electors pursuant to Article IX, section 2;
(4) "Cost of living," the consumer price index for the United States as reported by the United States department of labor, or its successor agency, provided that for the purposes of section 18 of this Article the change in the cost of living from the proceeding year shall in no event exceed the mean of the change in the South Dakota per capita personal income for the proceeding three years as reported by the United States department of commerce or its successor agency;

(5) "Population," the number of residents of a local government, other than a school district, for expenditure limitation purposes, which shall be determined by a method prescribed by the Legislature by law, provided that the determination shall be revised by law, as necessary, to reflect the periodic census conducted by the United States department of commerce, or its successor agency. The population of any school district shall be the school district's average daily membership as determined by a method prescribed by the Legislature by law;

(6) "Debt service," expenditures required to pay the interest and redemption charges, including the funding of any reserve or sinking fund required in connection therewith, on indebtedness existing or legally authorized on the effective date of this Article or on indebtedness thereafter approved according to law by a vote of the electors of the issuing local government voting in an election for that purpose; and

(7) "Expenditure limit," the amount which total annual appropriations subject to limitation for each local government may not exceed under section 18 and section 20 of this Article.

§ 25. "Expenditures subject to limitation" for each local government shall not include:

(1) Debt service to the extent provided in this Article;

(2) Expenditures required for the purposes of complying with mandates of the courts or the federal government which, without discretion, require an expenditure for additional services or which unavoidably make the providing of existing services more costly;

(3) Expenditures of any special district which existed on January 1, 1980, and which did not levy an ad valorem tax on property in excess of fifteen cents per one hundred dollars of assessed value; or the expenditure of any special district then existing or thereafter created by a vote of the people which is totally funded by other than the proceeds of taxes.

§ 26. This Article shall be effective for each local government commencing with the first day of its fiscal year following its adoption unless such entity has adopted a budget for such fiscal year prior to the date on which this Article will become effective, in which case this Article shall be effective for the next subsequent fiscal year. Each local government subject to this Article shall calculate its budget limitation for the first fiscal year for which this Article is effective as if its expenditure base was established by its fiscal year 1981 budget and this Article had been effective for each subsequent budget."