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CONTENTS

	PAGE
I. SUMMARY AND CONCLUSIONS	I
II. THE OVER-ALL TAX LIMITATION MOVEMENT	I
Definitions	I
Recent trends	2
Present status	3
Proposal of the real estate boards	3
III. THE PROS AND CONS OF OVER-ALL LIMITATION	3
Relief to real estate	3
Other tax reforms	7
Governmental economy	9
Tax delinquency	11
Municipal credit	11
Equitable assessment	13
Reallocation of functions	14
Constitutional limitation	15
Uniform maximum rates	16
Conclusion	16
IV. EXPERIENCE IN STATES WITH OVER-ALL LIMITS	17
Decline in property taxes	17
Replacement revenues	20
Tax delinquency	22
Indebtedness	23
Assessment of property	25
Reallocation of functions	27
Loss of municipal services	28
V. ALTERNATIVE PROPOSALS	30
Constitutional vs. statutory limits	30
Other types of over-all limits	30
Other alternatives	31
Financing capital improvements	31
Improved expenditure control	31
Equitable assessment of property	31
General tax revision	31
Governmental reorganization	31
Opinions of experts	32
VI. ASCERTAINING THE EFFECTS OF A GIVEN PROPOSAL	32
Probable effects upon local finance	33
Comparison with tax limit states	34
Effects of replacement taxes	35
Example for a single city	36

	PAGE
APPENDIX I. Effects of a Proposed Over-all Limit upon Melrose, Massachusetts	37
APPENDIX II. Over-all Tax Limitation Laws in Nine States, as of January 1, 1937	38
SELECTED BIBLIOGRAPHY	40

TABLES

	PAGE
1. Digest of Over-all Tax Limitation Laws in Nine States	2
2. Property Tax Assessments, Levies, and Average Tax Rates in Eight States with Over-all Tax Limits, 1929 to 1935	18
3. Decreases in Property Tax Levies Attributable Solely to Tax Limitation in Seven States, 1932 to 1935	19
4. Collections from Major Replacement Taxes in Seven States with Over-all Tax Limits, Fiscal Years 1933 to 1936	20
5. Replacement Revenues as Compared with Decline in Property Taxes in Seven States with Over-all Limits, Fiscal Years 1933 to 1936	21
6. Frequency Distribution: Total Tax Rates in Massachusetts Towns and Cities, 1934	34

FOREWORD

THE movement for over-all tax limits, although depression born, is still making a strong bid for popular approval. Legislatures of 1937 will witness a veritable flood of new proposals. The proponents of tax limitation are not asleep. They have been consolidating their lines all along the front for a final drive. This pamphlet is designed to furnish facts and arguments by which to judge these proposals.

The main source of revenue of local governments must be protected. Local finance officers and other public officials are urged to make a careful study of this material. Legislators should be consulted and the facts placed in their hands. Other pamphlets and articles on this subject are listed in the Selected Bibliography at the end of this study.

Many people have contributed to this report by furnishing factual material. Particularly do we wish to acknowledge the assistance rendered by:

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This acknowledgment, however, should by no means be interpreted as committing these persons either for or against over-all tax limitation. In many cases we do not know their positions on this question. The authors take full responsibility for interpretations placed upon the factual material secured. It is further to be understood that the viewpoints expressed herein are our own and not the officially adopted opinions of the organizations with which we are associated.

Chicago, Illinois
January 20, 1937

A. M. HILLHOUSE
R. B. WELCH

Tax Limits Appraised

I. Summary and Conclusions

1. An over-all tax rate limit of the type advocated by the National Association of Real Estate Boards will, if adopted, result in a substantial immediate reduction in real estate taxes, but the proposal will not bring about important governmental economies or lasting reductions in total tax burdens. The loss in property taxes will eventually be made up by replacement revenues with additional costs incident to their administration.

2. A retail sales or gross income tax has usually been adopted as the major replacement revenue. This costs the small home owner and the wage earner more than any savings which he may realize in property taxes. Instead of the tax reform promised by advocates of tax limitation, this is a decidedly backward step.

3. Although replacement revenues will eventually be found, the immediate effect of drastic over-all limitation will be disruption and substantial curtailment of essential governmental services. Real estate owners as well as others will

suffer from curtailment of current operations and from the virtual cessation of capital improvements.

4. Over-all tax limitation seriously weakens the credit of municipalities and effectively destroys a pay-as-you-go policy.

5. A constitutional over-all limitation would deprive the fiscal system of the flexibility required for adaptation to changing social and economic conditions.

6. A uniform, inflexible limit, such as proposed by the National Association of Real Estate Boards, fails to allow for differences in community needs and community resources.

7. The tax limitation movement is essentially a blind revolt of an articulate group of property owners and real estate operators aimed at a single objective—relief from real estate taxes at any cost. Some proponents are well intentioned, but their proposal is destructive rather than constructive and is opposed to the best interests of a majority of citizens.

II. The Over-All Tax Limitation Movement

PROPERTY tax rate limitation in some manner or form is a practice of long standing. The over-all limit, on the other hand, was unknown to most states until recently. This does not mean that it is a new conception. Rhode Island has had an over-all limit since 1878; Nevada since 1895; Oklahoma since 1907; and Ohio since 1911. But only as a result of the campaign of the real estate interests during the last six years, coordinated and directed by the National Association of Real Estate Boards, has widespread interest been stimulated in this device. It is not surprising, therefore, to find that there exists no general understanding of the meaning of over-all property tax limitation, much less of its probable effects upon government.

DEFINITIONS

An over-all property tax limit, in its strictest sense, is a constitutional or statutory provision fixing a maximum property tax rate or rates which may not be exceeded by the combined rates of the state and all its political subdivisions having jurisdiction within a given area. There are two respects in which the term has acquired a somewhat broader meaning. The fact that an additional levy may be made for highly restricted purposes, as, for example, the servicing of debts incurred prior to adoption of the tax limit, is not considered sufficient reason for excluding such a limit from the "over-all" category. Furthermore, there are instances in which a basic "over-all" limit has been fixed, but the exceeding

TAX LIMITS APPRAISED

this limit is permitted upon special authorization from the voters or from some state or county body. The amount of this excess may be subject to an additional over-all limit as in West Virginia, or the sky may be the limit as in Rhode Island. In either event it is commonly classified as an over-all rate.

There are several other types of property tax limits, some of which are much better known than over-all limits. It is also possible to have combinations of two or more types. The more common types are as follows:

1. "Jurisdictional" property tax rate limits, which apply to a particular level of government but do not restrict the total rate of all overlapping districts. The limits of Rhode Island and Washington are really of this type, but are included as over-all limits because the unrestricted levies are of little significance.

2. "Functional" limits, which apply to a particular function of government. Functional limits are usually jurisdictional as well.

3. "Special" property tax rate limits, which apply to a particular class of property but do not affect other classes subject to variable rates.

4. "Classified" limits, which apply to two or more classes of property and fix different maximum rates for different classes while the rates on one or more other classes are unlimited.

This study is concerned only with true over-all limits or with limits which closely approach the over-all status. The limits of eight states have been chosen for special study, all of which will be spoken of as over-all limits even though they do not precisely conform to the above definition.

The over-all limit in Nevada, although referred to occasionally in the course of this report, has not been given special study inasmuch as it is so high (5%) as to have had little or no effect throughout the major portion of the state.

RECENT TRENDS

During the last six years, thousands of dollars have been spent to promote the over-all tax limitation movement. What has been accomplished? The biggest successes came in 1932 and 1933. Indiana, Michigan, Washington, and West Virginia adopted limits in 1932. New Mexico followed in 1933. Oklahoma and Ohio the same year reduced their limits, which were already in effect prior to the depression of 1929. The movement made no headway in 1934 and 1935 except in Michigan. Seven cities in Michigan in 1934 and four cities in 1935 voted to come under the fifteen mill (1½%) limitation. Only two cities (one each year) rejected the proposal. The proponents elsewhere fought a losing game. Victories were won against them in the legislatures of New Jersey, New York, Illinois, and other states.

Again in 1936 the proponents of over-all limits fought virtually a losing game. Two victories, however, were won. Five states had the proposal on the ballot. In Colorado, Georgia, and Oregon proposed constitutional amendments were defeated. Nevada transferred a 5% statutory limit into a constitutional limit of the same rate. In Washington voters decided by initiative to continue the existing statutory tax limit for another two years. In Michigan five cities voted upon

TABLE I. DIGEST OF OVER-ALL TAX LIMITATION LAWS IN NINE STATES^a

	Constitutional or statutory?	—Basic rates—		—Additional rates requiring—	
		Urban Per Cent	Rural Per Cent	No special authorization	Special authorization
Indiana	S	1.5	1.0	Prior debt service	Unlimited
Michigan	C	1.5 ^b	1.5	Prior debt service	3.5%
Nevada	C	5.0	5.0	None	None
New Mexico...	C	2.0	2.0	All debt service	None ^c
Ohio	C	1.0 ^b	1.0	None	Unlimited
Oklahoma	C	1.7 ^d	1.7 ^d	Prior debt service ^e	School dists., 1%
Rhode Island...	S	2.5	2.5	All debt service	Unlimited
Washington ...	S	2.0 ^f	1.25 ^f	Prior debt service ^e	Unlimited
West Virginia..	C	0.5 to 2.0	0.5 to 1.5	Prior debt service ^e	50% of basic rates

^aFor complete table, see the Appendix.

^bNot all incorporated cities and villages are subject to this limit.

^cThe constitution permits unlimited additional rates upon approval of a majority of voters, provided legislation to this effect is enacted.

^dOut of this total, 0.2 per cent is reserved for counties for separate schools for whites and negroes.

^eSee the Appendix for restrictions on additional rates for prior debt service.

^fActual statutory rates are 4% and 2.5% but property is assessable by law at only 50% of full value.

proposals to come within the state-wide over-all limit and unanimously rejected them.

Results in 1934, 1935, and 1936 indicate that the movement does not have the popular appeal it had several years ago. Nevada is the only state since 1933 to adopt a constitutional limit. Even this measure is not new; a statutory limit of similar character has been on the books for nearly a half century. The Washington measure, too, merely extended the life of an existing law.

PRESENT STATUS

Nine states as of January 1, 1937 had over-all limits: Indiana, Michigan, New Mexico, Ohio, Oklahoma, Rhode Island, Washington, West Virginia, and Nevada. Five adopted their limits during the depression years of 1929 to 1936. The other four have old limits, which in two cases—Oklahoma and Ohio—have been revised since 1929. Six states have written the limit into their constitutions. Three states—Rhode Island, Indiana, and Washington—have statutory limits. Rates range from 1% in Ohio to 5% in Nevada. Only Nevada permits no additional rate for any purpose. The principal features of these laws as they existed on January 1, 1937 have been summarized in Table 1. A more detailed table will be found in the Appendix.

In Table 1 and throughout the remainder of this study, all over-all limits have been expressed

as percentages. A 2% rate means that tax levies of the state and all local units cannot exceed two per cent of the assessed valuation. This ratio is often expressed as 20 mills per dollar of assessed valuation, \$2 per \$100 assessed valuation, or \$20 per \$1,000 assessed valuation.

PROPOSAL OF THE REAL ESTATE BOARDS

Leading proponents of tax limitation, for which the National Association of Real Estate Boards is the spokesman, have not been entirely satisfied with the character of the over-all limits already passed. They have come forward with an even more drastic proposal. They insist on a rigid constitutional limit of 1%, inclusive of debt service and with no allowance for additional levies upon special authorization by the people. To quote from their literature:¹

Limitation can and should be written into the constitution of the various states simply: "The total of all taxes which shall be levied against real estate in any year by all the taxing authorities of this state shall not exceed 1% of the true value."

It is to this proposal that we specifically direct our attention. To the extent that a particular proposal deviates from the above model, the conclusions herein will require some modification.

¹National Association of Real Estate Boards, *Real Estate Tax Limitation*, Chicago, 1935, p. 16.

III. The Pros and Cons of Over-All Limitation

OVER-ALL tax limitation, like all other questions, has two sides. Each is represented by a group with its own preconceived notions concerning where truth resides. The authors of this report cannot hope to escape all charges of preconception. But they have endeavored to set forth, however briefly, a fair statement of the arguments of proponents of over-all limitation. Each such argument is followed immediately by the rebuttal and counter-argument of the opponents. In this way the issues are made to clash directly, and the unbiased reader who is not too much impressed by the length of the opposing argument should be able to judge fairly between the two schools of thought.

RELIEF TO REAL ESTATE

Argument for over-all limits: Real estate is now over-burdened with taxes, and an over-all

tax limit is the most feasible means of correcting this injustice.

The National Association of Real Estate Boards protests both as to the relative and the absolute burden of real estate taxes. By protesting the relative burden they imply that real estate bears a disproportionate share of all taxes. But whatever the amount of other taxes, the real estate interests also believe that their own taxes should be reduced from present levels.

According to recent estimates of 1932 national income "paid out," only 21.1 per cent was derived from property, as compared with 64.5 per cent from personal services and 14.4 per cent from a mixed category called "entrepreneurial withdrawals." On the other hand, about 58 per cent of total federal, state, and local tax receipts in 1932, and about 47 per cent in 1934, came from property taxes. Facts of this general character are advanced in behalf of the argument that too

much of the total tax burden rests upon property.

But beyond this, it is contended that too much of the property tax burden falls upon real estate as distinguished from personal property. The Federal Trade Commission's estimate of the 1922 value of taxable real estate was placed at only 46.9 per cent of the estimated national wealth.¹ However, real estate the country over comprised 77 per cent of the property assessed for general property tax purposes in 1932 and probably accounted for about an equal proportion of all general property taxes.² This discrepancy arose from the exemption of much tangible personal property and from the failure of assessors to discover and fairly evaluate much that was legally taxable.

Estimates of national wealth take no account of intangible property, such as stocks, bonds, mortgages, and the like. If these intangibles were added to all tangibles to make up the national wealth, real estate, instead of making up about 47 per cent of the total, would make up a much smaller percentage. No one knows precisely how much smaller this figure would be, but let us say 25 per cent by way of illustration. Many advocates of tax relief for real estate contend that this lower figure, which is the proportion of real estate in total property holdings, represents the share of the total property tax burden which should be borne by real estate, instead of the 77 per cent indicated by the 1932 figures on assessments cited above. The discrepancy between these two percentages is attributable to exemptions and failure to list both tangible and intangible personal property.

Evidence of an excessive absolute burden of real estate taxes is of a different nature. Here the contention is not that real estate is contributing a larger fraction of total taxes than it should fairly be called upon to contribute, but simply that real estate taxes, whatever their share in the total, are too high. In support of this argument, the proponents of tax limitation offer as evidence (1) high ratios of taxes to gross and net incomes from real estate, (2) high property tax delinquencies, and (3) numerous tax sales and foreclosures of tax liens.

Many advocates of tax limitation believe that an over-all limit is the most feasible, if not the only, means of lightening the burden on real

estate. It is contended that new taxes, enacted to afford some relief to real estate, result instead in increased cost of government. Tax limitation attacks the problem differently; it reduces real estate taxes and leaves the financing of deficits to the ingenuity of legislators and administrators.

Argument against: Drastic reduction in real estate taxes is unwarranted in view of the tax-paying ability which real estate represents, the benefits which it derives from government, the unearned increment included in its value, and the degree to which the present level of taxes has been allowed for in purchase prices.

The opponents of over-all tax limitation, on the other hand, contend that a clear case for blanket reduction in real estate taxes, either by reduction in total taxes or by shifting part of the tax burden elsewhere, has not been made out.

There are three basic reasons for taxing real estate: (1) Real estate ownership affords evidence of ability to pay taxes; (2) real estate enjoys specific benefits as a direct result of expenditures by governments, especially local governments; and (3) land, which constitutes an important part of real estate, derives part of its value—the so-called unearned increment—from society and not from any effort expended or service rendered by individual owners.

These reasons for taxing real estate are generally recognized. It is agreed that real estate should be taxed; but there is no agreement, even among the experts, as to the relative or absolute tax burden which it should bear. It has become the vogue to say that real estate is over-burdened with taxes, but it is time we recognize that this statement has gained authority almost entirely from repetition and not from any careful analysis of the facts. Despite the \$100,000 which has purportedly been spent by the National Association of Real Estate Boards on research into tax limitation, the ground in this field of inquiry has hardly been broken.

The arguments which have been advanced to prove relative over-burdening of real estate have been based almost exclusively upon the theory that taxes should be apportioned according to ability. There are two evidences of ability which are generally recognized by students and laymen alike. They are wealth and income. Naturally we should expect to be able to measure the proper tax contributions of real estate by reference to its contribution to total wealth and income.

Figures of this sort, some of which have been

¹Federal Trade Commission, *National Wealth and Incomes*, 1926, p. 28. In arriving at this percentage, tax-exempt real estate was deducted from total national wealth.

²U. S. Bureau of the Census, *Financial Statistics of State and Local Governments*, 1932, p. 64.

presented above, have been widely advanced in support of tax limitation. For a variety of reasons they prove nothing. Waiving the tenuous basis of some of the estimates, there are questions which are unanswerable in the present state of our knowledge. By way of illustration: How much more ability is evidenced by property income by reason of its permanency as compared with service income, which cannot endure beyond the lifetime of the worker? Does ability increase proportionately or progressively, or neither, with increases in individual holdings of property? Shall we give any weight to other theories of tax allocation, such as the benefit theory, and, if so, how much? And finally, what weight shall we attach to the charges that increases in land values are unearned and that the purchaser of land buys it at a figure which is low enough to shift any excess tax burden onto the seller? An appreciation of these and other questions has caused most authorities to reject this type of statistical approach. An important minority of the New York State Commission for the Revision of the Tax Laws, in commenting upon statistics of this sort advanced by the majority, charged that they were based upon assumptions which were "arbitrary in the extreme" and upon theories of equity in distribution of tax burdens which were "superficial and obsolete," and that they ignored or minimized "well established economic facts."⁸ These conclusions are supported by other authorities of national repute.⁴

It is impossible within the compass of this study to do much more than suggest the fallacies embodied in the glib statements about the proportions of the national income and the national wealth attributable to real estate and the way in which these proportions compare with real estate's share in total tax burdens. A few aspects of the problem must, however, receive some attention.

It is often assumed that all that need be done to prove that real estate taxes are all out of proportion to the financial ability which real estate confers upon its owners is to point to the vast quantities of intangible property which are known to escape taxation by legal or illegal means. This assumption is unwarranted. It should be clear that intangibles do not add to, or

detract from, the value of tangible property; they merely redistribute its ownership and its income. When a piece of land worth \$10,000 is mortgaged for \$5,000, the community wealth is not increased by the amount of the mortgage, nor is the value of the land decreased by that amount. What has happened is that the value of the owner's equity in the land has been reduced by \$5,000, offset by the creation of a mortgage worth \$5,000. And as a number of states have discovered, it makes no great difference, after adjustments have been made, whether the land be taxed on a \$10,000 assessment and the mortgage exempted or the owner's equity in the land and the mortgage each be taxed on a \$5,000 assessment. The owner of the land will pay the tax either directly or in the guise of a higher rate of interest. To say that the total assessment should be \$15,000 and that real estate should make up only two-thirds of the total is to indulge in double counting. Nor can other intangibles be added in with tangible property without multiple counting of the same sort.

Despite the fact that the real estate tax is partially justified on the basis of ability to pay, it is largely a benefit tax. The general theory of a benefit tax is that a person receiving services from government should pay in taxes the cost of providing such services. Hence this theory is primarily concerned with absolute, rather than relative, tax burdens.

The New York State Commission for the Revision of the Tax Laws made a study a few years ago to determine as nearly as possible what current services and what long-run benefits are obtained by real estate owners from the activities of the local governments which they help to support. The following services were considered to be directly beneficial to property owners: Collection and disposal of waste, sewer maintenance and operation, flood control, care of streets, tree culture, street lighting, fire fighting and prevention, police protection, and municipal utilities providing services at less than private rates. Another group of services were considered beneficial to property owners but perhaps even more beneficial to others. This group included planning and zoning, traffic regulation, building inspection, and the courts. Finally, it was recognized that the maintenance of schools and libraries, museums, parks, playgrounds, board of health activities, and public buildings benefit property owners because of their favorable influence upon property values. The conclusion was that on the average more than half of the general property tax revenue goes to pay for

⁸ *Report*, Feb. 15, 1932, pp. 41-46.

⁴ *New Jersey Commission to Investigate County and Municipal Taxation and Expenditures, Report No. 6, 1931, p. 138; Connecticut Temporary Commission to Study the Tax Laws, Report, 1934, pp. 79-80.*

maintenance, interest, and capital outlays for services directly beneficial to property owners.⁵

This is not to be interpreted as meaning that real estate should contribute only half of all general property taxes. Presumably the whole tax burden might be divided into two parts, one of which is to be distributed according to benefits and another according to ability. Real estate ownership would still constitute a measure of ability in spreading the second portion of the total tax burden.

One further important conclusion is to be drawn from this discussion of government benefits to real estate. It shows quite conclusively that real estate owners would gain little from a reduction of total taxes, since that would mean the loss of services directly beneficial to them. Community stagnation, evidenced by inability to finance an adequate public works program, is the last thing that is desired by property owners, and it is hard to escape the conclusion that, once tax limitation is installed, real estate operators will again be in the forefront pressing for additional public expenditures—to be borne this time by some other tax source than real estate.

There is still a third reason for taxing real estate. This reason, like the preceding, is concerned with the absolute burden of real estate taxes, although it is often associated in thought with relative burdens because it was popularized under the nomenclature of the "single tax." The single tax doctrine conceived of a tax on land which, unaided, would support all governments. Few now believe this within the range of possibility, but there are many reputable economists who believe that land is a peculiarly fit subject of taxation which should at least be taxed more heavily than other wealth. Increase in land values, especially in urban communities, arises in part from the growth of population and in part from government expenditures, for neither of which landowners, as such, deserve any particular credit. This unearned increment represents a source of wealth of considerable magnitude, and the property tax, inadequate as it is for the purpose, is the only device we now have for reaching it. Up to the amount of the unearned increment, a real estate tax represents simply a recapture by society of socially created values.

But whether or not the present level of real

estate taxes is justified by the three reasons elaborated above, there is a very important reason, from the standpoint of tax equity, why sudden and drastic reductions in either the absolute or the relative burden of real estate taxes should be avoided now that the present level has been reached.

Real estate tax reduction can be brought about by a drastic over-all tax limit. The benefits of such reduction would, however, be conferred largely upon present owners; they would extend only in limited degree to future purchasers or renters of real estate and not at all to those who have recently sold or lost their properties, many of them through no fault of their own. This is the result of the well-established economic principle of tax capitalization. The sales price of a parcel of real estate, or the terms of a long-term lease contract, represent, under normal conditions, the market estimate of the discounted value of anticipated net income. Taxes are treated as an expense and are deducted from gross income in arriving at net income. If taxes are high, the anticipated net income is low and the capital value is also low. Under these conditions, one who purchases real property, or leases it for long terms agreeing to pay taxes, acquires it at a figure which reflects the high taxes. Similarly, if taxes are low, purchasers or lessees pay a high price in recognition of the high anticipated net income.

This principle throws considerable light upon the proposal for drastic over-all limitation. For one thing, it imposes important qualifications on the usual argument that tax limitation will encourage home ownership. Land becomes more difficult to purchase after a lowering of land taxes, because one must either put up a higher price or mortgage it more heavily than would otherwise be required. It is true that the purchaser's tax payments will be lower than they would otherwise have been, but not, as a rule, sufficiently low to offset the interest on the additional mortgage.⁶

In the second place, the principle of capitalization adds substantially to the preceding discussion of the fallacies of statistical analyses advanced to prove over-taxation of real estate. In this connection, we quote from the recent report of the Connecticut Temporary Commission to Study the Tax Laws:⁷

⁵Edwin H. Spengler, "Is the Real Estate Tax a Benefit Tax?", p. 85; published as Memorandum No. 5, *Report of the New York State Commission for the Revision of the Tax Laws*, Feb. 15, 1932.

⁶Harry G. Brown, *The Economic Basis of Tax Reform*, Lucas, Columbia, Mo., 1932, pp. 227-28.

⁷Report, 1934, p. 82.

Even if statistics could be compiled to establish without question that real property constituted, for example, only 25 per cent of the wealth of the state, while it accounted for 75 per cent of the state and local taxes, this of itself would not prove that the owners of real property were inequitably taxed. As a matter of fact, all those owners of real estate who had purchased their property after the existing tax system and tax rates went into effect would presumably be suffering no injustice as compared with other taxpaying classes. They bought real estate in full knowledge of the taxes it was bearing, and they paid prices which were adjusted to such tax burden. Injustice to present owners of real estate would exist only to the extent that the taxes on real property had increased more than the taxes on other property since the dates when they purchased their present holdings. As to the rest, the injustice done by disproportionate real estate taxes was all borne, once for all, by the former owners when they sold to the present owners at prices reduced by capitalization of taxes.

Another study, made for the New York State Commission for the Revision of the Tax Laws, attempted to discover the frequency with which real property was sold and an opportunity afforded for purchasers to acquire it at a price which in effect freed it of any excessive tax that existed at the time of purchase. It was concluded that more than one-third of the rural owners and more than two-thirds of the urban owners had acquired title within a decade, and that from one-half to three-quarters of all titles had been acquired within the past twenty years. It was further found that real estate tax rates in the majority of the localities studied had not increased over the levels established in 1920 or earlier. It followed that upwards of one-half of the 1930 owners of real property had purchased it at prices which should have fully allowed for the level of taxes existing in 1930.⁸

The proponents of tax limitation ask for reductions in real property taxes far greater than the increases which have occurred in the past decade. In so doing they are asking that many present owners be repaid for losses which they have shifted to former owners by purchasing their real estate at prices which allowed for taxes at somewhere near the present level. Furthermore they are asking, in substance if not in so many words, that this reduction be financed by means of taxes which will rest in part upon the very persons who suffered this injustice.

⁸Edwin H. Spengler, "Turnover of Title to Real Property in New York," p. 45; published as Memorandum No. 4, *Report of the New York State Commission for the Revision of the Tax Laws*, Feb. 15, 1932.

One further thought should be expressed at this point. Real estate taxes will be reduced by over-all limitation, but real estate owners are not a distinct class insulated from all other tax obligations. Real estate owners are consumers, they are income receivers, and some of them no doubt indulge in such "luxuries" as tobacco and liquor. Real estate tax reductions must in all probability be replaced by taxes of other sorts. Some of these will reach property owners and no others, as, for example, special service fees for street lighting or street repairs. Others will reach property owners along with all others who receive income or buy groceries. Not all property owners will gain more in real estate tax reductions than they lose in new tax payments.

The parties which will stand the best chance of gaining are those whose real estate holdings are large, relative to other possible criteria of their tax liabilities. Specifically, these parties will usually include large corporations, especially public utilities, real estate speculators, and owners of large income and down-town properties. The small home owner, the small business man or farmer, and the wage earner will usually lose more than they gain.

OTHER TAX REFORMS

Argument for over-all limits: Present state and local tax systems lack diversity and rest upon too small a proportion of the population. A forced reduction in property taxes will compel a revamping of the whole fiscal structure in the interests of tax reform.

Although a reduction in property taxes is their prime objective, real estate interests go further and contend that state and local fiscal systems should be altered in two other respects. It is urged that taxes should be collected from more sources and from more people. By diversifying tax sources, municipalities will avoid the dangers inherent in dependency upon a single source and will supposedly uncover hitherto untapped sources of tax-paying ability. By increasing the number of people who are consciously contributing to the support of government, civic responsibility will be awakened, waste and extravagance curbed, and a more equitable distribution of tax burdens effected.

An over-all tax limit, if sufficiently drastic, may be relied upon to force recourse to revenues other than property taxes, since a reduction in property tax revenues cannot entirely be met by a reduction in operating costs and by elimination of governmental functions. Occasionally

this has meant the raising of the rates of other taxes, but more frequently it has meant widening their bases or the enactment of new tax measures. In either of the latter events the tax base will be "broadened."

Argument against: Revisions of tax systems which have followed the adoption of tax limits have been characterized by indirect, regressive taxes and as such represent retrogression rather than reform.

The claim that tax limitation brings tax reform is discredited by the facts. Tax limitation has caused law makers to seek new sources of taxation, and in desperation and haste they have seized upon the tax which has been advocated, for obvious reasons, by real estate interests, manufacturers, and big income taxpayers, namely, the sales tax. No competent authority, we believe, would call the sales tax a reform. It broadens the tax base it is true, but in the wrong direction. The poorer the man, the heavier his tax in proportion to his means. The renter will most certainly pay out more in sales taxes than any small savings which he may realize in lower rents. Generally the home owner and the small farmer will lose too. Their property taxes may be cut, but they will have to pay a general sales tax on most of what they buy, and the balance will usually be on the wrong side of the ledger. These are the classes which are least able to increase at this time their contributions to government. Yet they are the inevitable scapegoats.

A second objectionable feature of the more expedient replacement taxes is that they are collected from persons other than those who are expected to bear the final burden. Walter Lippmann has recently stressed the effects of such indirect taxes upon government expenditures. "It is plain," he writes, "that unless some way can be found to make the costs as visible as the expenditures, the power to spend will be exercised irresponsibly and will be at the mercy of pressure groups. There is no way to keep expenditures in check, if the people do not realize that they are paying the bill."⁹

One other aspect of tax limitation has hitherto escaped the notice of many proponents. A prime reason for the slow advent of tax reform in many states has been a clash of interests between urban and rural elements. Tax limitation simply adds to this conflict and constitutes a further obstacle to reform. In the first place, some administrative

machinery has to be set up to allocate the over-all limit between the several local governments. Examples are the county tax adjustment board in Indiana, the county budget commission in Ohio, and the county tax allocation board in Michigan. A fight naturally follows between the rural and urban units in each county for control of these boards or commissions. In the second place, the rural and urban areas fight over allocation of the state-collected, locally shared replacement taxes. Complaints on one side or the other are endless. The following excerpt comes from an Ohio newspaper editorial, favorable in principle to tax limitation, but regretful of the urban-rural conflict:¹⁰

The three-cornered controversy in Columbus—among school, city and county officials—over the distribution of sales tax revenues is illuminating if not pleasant. It emphasizes the fact that tax limitation policies, however admirable in principle, have made local units increasingly dependent upon state aid; hence have developed bitter rivalry for funds allocated by the state. The roots of this controversy go back to the 10-mill tax limitation.

What have the authorities to say about the so-called "tax reform" which is brought about by over-all limitations? Professor Jensen of the University of Kansas, after examining the tax structures of tax limit states, concluded that tax limitation tends to bring about a "broader" tax base. But he adds:¹¹

I am not disposed to claim this forcing power as a merit for tax limitation. On the contrary, I should regard this aspect as a serious objection to tax limitation. . . . It has stampeded the states into the adoption of a tax which I for one consider a bad tax, and has retarded, perhaps, the adoption of a better tax, namely one on income. On the score of the income tax it certainly can not be said that tax limitation has tended to force its adoption.

Professor Jensen goes even further and suggests that tax limitation prevents citizens from giving adequate consideration to their fiscal problems. He ascribes, in part, the low rank to which Ohio's tax system has generally been relegated to the fact that the money, energy, and intelligence of tax-interested citizens have been drained off into a more or less futile controversy over tax limitation.

R. C. Atkinson of The Ohio Institute offers evidence that Ohio, by drastic tax limitation, has

⁹ *Today and Tomorrow* (syndicated article), Jan. 16, 1936.

¹⁰ *The Dayton Herald*, Dec. 16, 1936.

¹¹ "Property Tax Limitations," *Taxbits*, Feb. 1935, pp. 6-7.

secured inequitable shifts in the tax burden rather than tax reform:¹²

. . . the cost of local government has been thrust more largely onto the class without property and upon the small home owner who is undoubtedly paying more in sales taxes than he is saving in his property tax bill. On the other hand, the large real estate holder and the corporation, which is exempt from the sales tax on most of its purchases, are enjoying a substantial degree of tax reduction.

Professor Lutz of Princeton University writes:¹³

Resort to tax limitation in order to force tax reform seems like a combination of unnecessary effort and bad logic. It suggests the crazy man's way of preventing the bath tub from overflowing by dipping out the water instead of closing the tap. The voters who do not own property must be persuaded to approve tax relief for the other fellow, namely the property owner, as a preliminary to securing the adoption of taxes to which they will surely contribute, such as those on sales, incomes or commodities.

Suffice it to add that more than a dozen of the country's highest authorities on tax matters have condemned tax limitation in no uncertain terms. These authorities are not defenders of the *status quo*. Many of them are in the forefront of the battle for equitable tax revision. But they recognize in tax limitation an opponent rather than an ally in their fight.

GOVERNMENTAL ECONOMY

Argument for over-all limits: State and local government expenditures are excessive because of waste, inefficiency, and extravagance. Tax limitation, by reducing revenues and broadening the tax base, will effectively curb such excesses.

The proponents of over-all tax limitation have built their case largely upon two propositions: (1) Real estate should bear a smaller proportion of the total tax burden; and (2) the total tax burden should be reduced by cutting governmental costs. The first of these propositions has been presented in an earlier section; it is to the second that we now turn.

Tax limitation is expected by its advocates to reduce property taxes by more than the amount

of any replacement revenues which they may occasion. It is not anticipated that the difference will be made up out of borrowing, but rather that budgets will be slashed. This retrenchment, forced by revenue reductions, will come largely, it is contended, from that part of the budget now devoted to "waste, inefficiency, and extravagance." It is admitted that this is not a painless process.

Neither is a surgical operation. But when the patient's life is saved, and he is assured of good health in the future, the operation is deemed successful. This is happening in the tax field, but it is taking drastic action to bring it about.¹⁴

Moreover, a broadening of the tax base, by placing more people in the taxpayer category, is expected to stimulate a greater citizen interest in government. This in itself should tend to curb waste and inefficiency.

Argument against: There is little or no reason to expect the removal or substantial reduction of sheer waste and inefficiency through the channels of tax limitation. The major reductions will come in essential governmental services.

In identifying themselves with the opponents of governmental extravagance, the real estate interests have invited the support of all public-spirited citizens. In these tactics they have kept on safe ground. No one condones waste and inefficiency; and the public has always been quick to believe the worst of the city hall. The charge carries enough truth to lend it plausibility. There is much room for improvement in public administration, just as there is throughout a large segment of private business. But one must be gullible indeed to think that this will come through tax limitation. The proponents are saying in substance that if the tax rate is limited by the constitution to a figure sufficient to raise funds adequate only for the bare public necessities, economically and honestly administered, though the administration be carried on by the same inefficient and perhaps corrupt officials, the extravagances and the corruption will automatically slough off, and the funds so limited will be efficiently, economically, and honestly applied in the places where the public need is greatest.

The only way to put an end to all extravagance in government is to put an end to government itself. Much can be done to reduce

¹²"Stringent Tax Limitation and Its Effects in Ohio," *Property Tax Limitation Laws*, edited by Glen Leet and Robert M. Faige, Public Administration Service No. 36, Chicago, 1936, p. 74.

¹³"Motives Behind the Tax Limitation Movement," *Property Tax Limitation Laws*, p. 18.

¹⁴National Association of Real Estate Boards, *op. cit.*, p. 10.

inefficiency, however, if the problem is approached directly and in a constructive manner. Tax limitation fails in this respect. It does little or nothing to improve government structure, procedures, or personnel. It is first and last a self-centered movement for reduction of property taxes.

Dr. Mabel Walker, Executive Secretary of the Tax Policy League, has effectively answered the efficiency argument.¹⁵

As a cure for governmental extravagance tax limitation is a simple solution; but unfortunately, like many simple remedies, the results prove disappointing. The fever that comes with a cold will not be satisfactorily disposed of by placing the patient in a draft and applying ice packs. Some more scientific technique is necessary to restore physical health to the patient. It is equally futile to try to bring about a healthy condition of efficiency and economy in local governments by forcing them into financial strait-jackets caused by rigorous tax limits.

Over-all tax limitation is apt to weaken the effectiveness of local budgetary practices. The ordinary procedure under an over-all limit is to set up a county board which allocates available local tax rates among local governments in accordance with what are presumed to be their respective needs. As a means of establishing needs, budgets are submitted by all local units. This might at first glance appear to be a stimulus to good budgeting, but this is not true of municipalities in states which have well conceived and effective local budget laws. The reason for this failure is not far to seek. The budgeting body of each municipality is anxious to impress the county board with its own needs. What better means than by padding the budget? At best it will have little enough to run the government, and there is little danger that citizens will protest this practice.

There is another reason why tax limitation will tend to weaken budgeting. Citizens lose interest in the budget as an instrument for expenditure control when they are led to believe that expenditures are pegged at a certain level and when budgeting processes are complicated beyond ordinary comprehension, as in West Virginia. There is still less citizen interest when they realize that some other authority, such as a county budget commission, really has the final control. No adequate substitute in a local representative democracy has been found for citizen interest in ex-

penditures. The American cities which rank highest in civic achievement are those in which there is a strong local pride and an active citizen participation in the governmental process. Losses of such intangibles cannot be measured by statistical means, but they are none the less real.

Proponents would perhaps not claim that all tax rates in excess of the proposed maximum limit represent unnecessary expenditures, nor that variations in tax rates between different localities are due wholly to differences in efficiency. Yet such is the logic of a proposal for rigid and uniform tax limitation.

Since differences in tax rates are due more to differences in services than to differences in efficiency, the reductions effected by tax limitation cannot possibly be confined to wasteful aspects of the budget. It is, in fact, entirely possible that the percentage cuts in essential services may exceed those in other portions of the budget. Of course, it must be recognized that there is no agreement as to what are essential services and what are extravagances. Those things which appear least necessary to the proponents of tax limitation may prove the most inflexible portions of the budget.

It is possible, of course, that tax limitation may be accompanied or followed by what appear to be more or less adequate replacement revenues. In this event loss of essential governmental services may be largely avoided. But there is almost inevitably some disruption in services, either because of a time lag between the loss of property taxes and the receipt of replacement revenues, or because the replacement revenues, though aggregating as much as the reduction in property taxes, are distributed to the various levels of local governments disproportionately to their losses of property tax revenue.

The *National Municipal Review*, which is representative of citizens' reform organizations the country over, has tilted its lance sufficiently often at waste and inefficiency in local government to be able to escape the charge of defending or condoning any such conditions. If tax limitation were a means to the end of eliminating waste and producing efficiency in government, the *Review* would be found among the loudest of its defenders. Instead, it finds after careful scrutiny of experience "that tax limitation represents probably the most serious immediate menace with which local self-government and sound public finance is faced at the present time."¹⁶

¹⁵ "Tax Limits Prove Unwise," *Taxbits*, Dec. 1933, p. 2.

¹⁶ Editorial comment, Nov. 1935, p. 605.

TAX DELINQUENCY

Argument for over-all limits: Over-all tax limitation will reduce tax delinquency.

Undoubtedly tax delinquency is an undesirable thing. It disrupts fiscal operations, increases the cost of tax collection, dislocates the tax burden, and, when carried to the point of tax sales or foreclosures of tax liens, results in loss of property and other hardships to taxpayers. The sheer burden of property taxes is advanced by the proponents of limitation as an important cause of tax delinquency, and over-all tax limitation has been an effective means of reducing property taxes in most states where adopted. It would be expected that over-all limits would reduce tax delinquency; in fact, proponents maintain that in some jurisdictions the decrease in delinquencies has more than offset the decrease in tax levies so that cash collections have actually been increased in the face of lower levies.¹⁷

Rebuttal

This argument is plausible, but its proponents have brought forth little or no evidence in its support. The mere fact that delinquency has been reduced in tax limit states is meaningless in view of similar reports from non-tax limit states. Available data are meager and scattered, but such as they are, they suggest that tax reductions in tax limit states have been of little significance in improving collections. (See Chapter IV.) It is our conclusion that tax limitations ignore the more important causes of delinquency, such as improper land development, inequitable assessment, and lax collection procedures. The campaign against tax delinquency must be carried on along a much broader front if it is to be truly effective. In view of the many objections to tax limitation, we feel that the small contribution which it offers in the way of reduced delinquency would be dearly purchased.

MUNICIPAL CREDIT

Argument for over-all limits: An over-all tax limit which includes levies for interest and principal on debts subsequently incurred will discourage borrowing and improve the public credit.

Proponents claim that municipal credit will be improved because of such alleged results of over-all tax limitation as improvement in real estate values, reduction in tax delinquency, a more equitable tax system, and more economical gov-

ernment. But their main contention concerning the improvement of municipal credit is that further borrowing will be restricted and that cities will shift to a pay-as-you-go basis.

Argument against: Over-all tax limitation seriously injures municipal credit and effectively destroys a pay-as-you-go policy.

Part of the proponents' argument cannot be taken seriously. Increases in real estate values are of no real significance to creditors if municipalities are deprived of powers to tax them at rates which will produce as much revenue as can be raised in the absence of tax limits. Nor is the creditor interested in a more equitable tax system; what is important to him is an adequate and stable tax revenue, and few if any sources of revenue have proved more reliable in these respects than the locally administered property tax. Economical government is of interest to the creditor if the economy does not extend to debt service. But the creditor is always confronted under over-all tax limitation with the danger that the city will default rather than sacrifice any large measure of governmental services.

The constitutional measure advocated by proponents would bring all debt service, whether for prior or future debt, within the over-all limit. But first two other ways of treating debt service will be briefly discussed.

An over-all limit may exclude all debt service. On the surface, it would appear that municipal credit would not be affected by such a measure since debt service would be payable out of an unlimited ad valorem tax. But if the limit were low, debt service might still be affected. Unable to finance all services under the limit, the temptation might be to resort to bond issues for operating expenses, or to allow judgments to be taken against the city and later to fund these judgments. If such temptations were too often yielded to, the city's credit would be seriously weakened. Nevertheless a limit of this type would be less drastic in its immediate effects than if debt service in whole or in part were brought within the limit.

Another type of limit includes all debt service on obligations incurred after adoption of the measure, but excludes debt service on all prior debt. Under such a limit a city may have two types of debt outstanding, one but indirectly affected by tax limitation, the other directly. For a time at least the price of bonds outside the limit might not react unfavorably or conceivably might even rise. Obviously it would be unfair to cite

¹⁷National Association of Real Estate Boards, *op. cit.*, p. 8.

either price reaction as an example that tax limitation is not adverse to municipal credit, since it is not indicative of current borrowing power. Eventually, however, prior debts might be affected adversely. If the limit were drastic, the city might be tempted to divert to current purposes the money for servicing prior debt. The prices of these bonds would then suffer. Moreover, since retirement would not ease the strain under the debt limit, there would be no great incentive to reduce this indebtedness.

The measure generally advocated would bring all debt service under the limit. If coupled with a low rate, this is the most drastic type of over-all limitation. It will be assumed throughout the succeeding discussion that the limit is low, that the result is a drastic cut in rates available for current operating expenses, and that pressure will be exerted to maintain municipal services at as high a level as possible.

First, what will be the effect on municipal credit? There are two common evidences of the credit status of a given municipality: (1) The price at which outstanding bonds are selling; and (2) the price which may be obtained on new issues bearing a given rate of interest. Both evidences will reflect the unfavorable reaction of investors to enactment of the above type of limit. Prices on bonds outstanding will fall because of doubt as to the ability or willingness of the municipality to meet its debt payments when essential municipal services go begging. The prices on new flotations will also be adversely affected, because the attorney's opinion must be that the bonds are payable out of limited ad valorem taxes. Bonds with qualified opinions do not invite the confidence of investors. Bid prices will be low, and interest rates must be set high because of the risk factor.

The effect of the proponents' measure on future debt growth must also be considered. A drastic limit encourages the accumulation of debt, even though the sale of bonds and the usual channels of short-term borrowing are partially closed. As long as services are required and some confidence remains, accumulations of unpaid bills for goods and services are, in time of need, inevitable. When the volume of floating debt becomes sufficiently large, the obligations can be funded, reduced to judgments, or otherwise formally acknowledged. Thus new channels of forced borrowing are utilized. Sooner or later these debts must be paid or defaulted.

If funding of current operating expenses is not possible under the law, other methods may

be resorted to in the desperate attempt to maintain services. The debt laws of the state may allow deficiency bond issues. This kind of borrowing can go on for several years until debt service assumes such a large share of the budget that the process must cease. Still another method may be open. All debt falling due can be refunded, and money that would ordinarily go for debt retirement can be used for operating expenses or urgent capital needs. These refunding bonds are really deficiency bonds in disguise. Eventually, it may be necessary, though illegal, to divert sinking fund moneys if a decent level of municipal services is to be maintained. Use of one or more of these methods may result in an increase in municipal debt greater than would have occurred in the absence of the over-all limit. At least the general disrepute attaching to deficiency financing would seriously injure municipal credit.

The proponents' measure may also lead to defaults. If debt service on borrowings for current expenses gradually assumes a larger and larger share in the current budget, the point will be reached where either essential services must be cut still further or the municipality must default. Citizen pressure may force a default so that all debt service moneys can be used for operating expense or capital improvements.

Many authorities point to the disastrous effects upon municipal credit. Dr. Frederick L. Bird, Director of Municipal Research for Dun & Bradstreet, the nation's most reliable credit agency, writes unequivocally:¹⁸

One of the most serious consequences of tax rate limits is their detrimental effect on municipal credit. This in itself should be sufficient to insure abandonment of the movement, because good credit is indispensable to the functioning of local government.

John S. Linen, Vice President of the Chase National Bank and Chairman of the Municipal Securities Committee of the Investment Bankers' Association of America, has declared that tax limits will substantially increase the cost of municipal borrowing because of their effect upon the security afforded creditors.¹⁹ Henry Hart, Detroit investment banker, has condemned tax limits without qualification. "It is nothing less than tragic," he writes, "to see the progress of this movement, promoted by those so largely responsible for one of the major causes

¹⁸"The Effect of Tax Rate Limits on Municipal Credit," *National Municipal Review*, Nov. 1935, p. 607.

¹⁹"Tax Limitation: Increased Tendency to Enact Legislation," *Investment Banking*, Jan. 31, 1936, pp. 172-173.

of the financial ills of our cities today—unjustified real estate expansion. It hits municipal credit a blow between the eyes."²⁰

The Investment Bankers' Association has long been opposed to tax limits. Its Municipal Securities Committee maintains that debt limits should be stressed, not tax limits. If local governments are borrowing too much, the solution is to restrict their borrowing power. No restrictions, however, should be placed on the ability of a municipality to pay its obligations, once they have been incurred.

The reaction of investors to tax limitation has already closed certain markets to bonds issued under over-all tax limits. The federal government makes no PWA general obligation loans to municipalities which are unable to pledge unlimited ad valorem taxes for their payment. The New York Banking Law has been amended so that savings banks in New York State will not be allowed to purchase bonds issued after December 31, 1938 which are payable from limited tax levies. In Illinois one qualification of legal investments for insurance companies is that the bonds be payable from unlimited ad valorem taxes. Many other examples are available of poor or non-existent money markets which would show the low status of municipal credit resulting from over-all limitation.

Nor must we ignore the effects of the proposed limit on a pay-as-you-go policy, though there are few cities today in any state on such a basis. Generally the policy is not possible for small cities and villages, and medium-sized cities can adopt such a plan but partially. Probably only the large metropolitan governments can finance their capital needs 100 per cent on a pay-as-you-go basis. But proponents claim that "cities" will be forced to adopt such a policy. The argument ignores the impracticability of pay-as-you-go for most cities; also that the very essence of a tax rate limit is its rigidity. If capital improvements are to be financed out of current budgets, the tax rate must go up in years when capital improvement needs are extraordinary.

If a city is now on a pay-as-you-go basis, either partially or wholly, the effect of an over-all limit is predictable. Farsightedness would dictate that the city continue on this policy, even though levies in the current budget for capital needs would have to be reduced. Pressure, however, would be placed on public officials to adopt a short-run viewpoint, that is, to use the entire cur-

rent budget for operating expenses and to borrow for capital needs.

If a city is not already on a total or partial pay-as-you-go plan, there is no reason to expect it to shift to that basis under the compulsion of an over-all limit. If there is a margin under the limit for capital improvement levies, there is a still greater margin for the payment of debt service on new borrowings. The pressure will be to use the entire tax rate for current services. Eventually, however, if further borrowing becomes impossible, the city will have to choose between levies for current expenses and levies for replacements or betterments. Before that alternative is reached, of course, default as a "way out" may have been resorted to.

The consensus of experts seems to be that under a low over-all limit, the levies of most municipalities will be exhausted for operating expenses and existing debt service, so that it will be necessary to borrow for all capital needs or allow the community to stagnate for lack of improvements. Harold D. Smith, Secretary of the Michigan Municipal League, comments on the Michigan situation:²¹

A pay-as-you-go program for capital improvements is equally impossible under such a rigid tax limitation. As the pressure for capital improvements increases, without doubt the amendment will be modified in this respect.

Carl H. Chatters, Executive Director of the Municipal Finance Officers' Association of the United States and Canada, strongly condemns tax limitations because of their effect on the pay-as-you-go policy. To quote from a speech made by him in New Jersey:²²

Perhaps the greatest condemnation of the plan, aside from its failure to provide replacement taxes, is the fact that it closes the door to the most adequate financial remedy, namely, the adoption of a pay-as-you-go plan for future improvements. Cities would be forced to borrow for all improvements and would find it necessary to refund existing debt. Since the principal difficulty in New Jersey is the debt burden, it is difficult to see how such a limitation could bring about anything but absolute chaos.

EQUITABLE ASSESSMENT

Argument for over-all limits: Over-all limitation will result in more equitable assessment of property for tax purposes.

²⁰"Tax Limitation in Michigan," *Property Tax Limitation Laws*, p. 67.

²²"Tax Limitation—A Movement Backwards," *New Jersey Municipalities*, Mar. 1936, p. 10.

²⁰"A Bond Man Views Municipal Credit," *Municipal Finance*, Nov. 1934, p. 29.

The proponents contend that gross inequalities now exist in the assessment of property. Much personalty, especially intangible property, is not placed on the rolls, and many individual parcels of real estate likewise escape their share of the tax burden because they are under-assessed in comparison with other property. Adoption of their proposal, it is claimed, will assist substantially in remedying this situation.

This argument is two-fold. First, it is contended that the lower rate under the over-all limit will encourage fuller declaration by taxpayers of personal property, both tangible and intangible, thereby promoting equity among taxpayers. Secondly, with a lower tax rate a larger total assessment will be necessary to raise a given amount of taxes. It is expected that pressure for revenue will induce assessors to raise the value of property already on the rolls more nearly to its full assessable value. Although the attainment of the statutory assessment level may seem secondary to the attainment of uniformity at any level, it is generally agreed that uniformity is more likely to obtain when the assessment level closely approaches full value than when it is low.

Argument against: Tax limitation, although it is mildly conducive to fuller declaration of property, encourages manipulation of assessments to meet local fiscal needs and tends to weaken the effectiveness of state supervision of local assessment practices.

It is true that a lower tax rate should make for some disclosure of property which is now withheld from the assessment rolls on the ground that taxes are confiscatory. However, most of the property now escaping is intangible property, which will not respond readily to a reduction of tax rates even to the impossibly low level proposed by the National Association of Real Estate Boards. Three things are needed to bring intangibles onto the tax rolls: (1) Greater vigor and resourcefulness on the part of assessors; (2) a tax rate of only a few mills per dollar; and (3) other laws which will assist the assessor in his efforts to locate such property. None is dependent upon over-all tax limitation for real estate, except the dependence be one of political expediency.

Under the traditional organization of local governments in this country the assessor has no control over tax levies. He has the sole duty of assessing property; the amount of the levy is fixed by adoption of the budget; and the tax rate is determined by dividing the levy by the assessment. When an over-all limit is enacted, the

assessor becomes an assessor of taxes as well as of property. Tremendous pressure is then exerted to induce him to manipulate the level of assessments. Three alternatives are open to the him: (1) He can make an honest and courageous effort to adhere to the assessment standard prescribed by law; (2) he can purposely keep assessments low to protect taxpayers from high levies; (3) he can purposely inflate assessments to permit a levy which he or those to whom he is responsible believe adequate for the conduct of government.

If the over-all limit were drastic, the tax rate would be predetermined as the maximum rate. The assessor would then be urged to produce a total assessment which would bring in the needed funds at this rate. This would often encourage substantial over-assessment. The evils of over-assessment, if not as well known from experience, are as patent as those of under-assessment. Inequalities are almost certain to develop, complaints to reviewing agencies multiply, the debt base is inflated, and a false picture of municipal affairs is created. On the other hand, particularly if assessors are elected, property owners will exert pressure to keep the assessment level low, whereas, in the absence of tax limitation, they are primarily concerned with a uniform assessment level.

At the same time that over-all tax limitation encourages manipulation of local assessments it weakens state control of assessment procedures. In four of the nine tax limit states, the state government has retired from the property tax field, leaving the full amount of the maximum tax rate to its political subdivisions. In at least three of these states this "separation of sources" may be traced directly to the tax limitation movement. The result, if we may judge from the experience of other states, will be a deterioration in local assessments not only for lack of state equalization but because vigorous state supervision is jeopardized when the state's financial stake in the property tax is lost. There is no question but that the movement for separation of state and local revenue sources, though generally discredited by tax students the country over, has been given new life by over-all tax limitation.

REALLOCATION OF FUNCTIONS

Argument for over-all limits: Over-all tax limitation will bring about needed reallocation of administrative and financial responsibilities for governmental functions.

The reduction in property taxes effected by over-all tax limitation usually makes it necessary for the state to utilize its broader taxing powers

either to perform, or to give financial support to, functions which were formerly locally administered and locally financed. It is also contended that functional transfers between state and local governments and among local governments are encouraged by the pressure for economy resulting from loss of property taxes. The proponents of tax limitation point to these reallocations of functions and financial responsibilities as governmental reforms. The argument rests upon the two-fold assumption of greater economy and better equalization of tax burdens in support of functions which are state-wide in character.

Argument against: Reallocation as forced by tax limitation tends to undermine home rule and to destroy local initiative. Furthermore, it relaxes expenditure control by separating too widely the responsibility for collection of funds and their expenditure.

Many of the transfers of administrative and financial responsibilities between the state and its political subdivisions, and among local governments themselves, which have occurred during the last six years have not been the result of over-all tax limitation but of other pressures for governmental economy and reorganization. Greater state participation in school costs, for example, has by no means been confined to tax limit states.

Of course, all possible transfers of functions to state governments do not result in more efficient and economical administration, else there would be little excuse for the continued existence of local governments. This has generally been recognized in tax limit states; the reallocations have largely been restricted to shifts in financial responsibility. But there are those who view with alarm any substantial increase in the financial dependence of local governments. We are reminded that he who pays the piper calls the tune, and that encroachment upon home rule is the inevitable price of increased state aid. Local initiative and local interest are sacrificed with loss of local control. It is true that state participation in local affairs is desirable in the interests of higher standards and better coordination of efforts, but, if this participation is carried too far, it will jeopardize many of the values which now exist in our system of local government.

There is another objection to large increases in state aid which should be mentioned in passing. It is argued by some that the political unit which spends funds should be required to raise them directly from its own citizens. The extension of state-collected, locally shared taxes is looked upon

in the same light as an extension of indirect taxation. Money which is handed out from the state treasury is spent much more lightly than money which must be raised locally.

Citizens are most familiar with local governments and can give closest attention to them. It is difficult to believe that removing local control and focusing attention upon the state as the central source of municipal activity would improve administration of these local units. The property tax is the only major revenue that is locally assessed, locally collected, and locally expended, and it should not be traded too hastily for a tin cup and a pair of dark glasses.

CONSTITUTIONAL LIMITATION

Argument for over-all limits: Over-all limitation should be placed beyond legislative control in order to assure real estate of more or less permanent relief from an excessive tax burden.

The proponents of over-all limitation are not content with statutory limitation; they would imbed their proposal in state constitutions. This they feel to be necessary if relief to real estate is to be prolonged for more than a few years. Experience demonstrates a tendency for the cost of government to rise almost uninterruptedly. In the absence of constitutional restrictions on the legislative power, it is believed that new costs of government will quickly induce restoration of property taxes to the level from which they may have been reduced by statutory limitation.

Argument against: A constitutional over-all limit precludes ready adaptation of the fiscal system to changing conditions.

Leading tax students the country over have waged a long battle against state constitutional restrictions upon the taxing power. The wisdom of their position is attested by experience. Those state legislatures acting under little or no constitutional restriction, far from adopting radical or vicious tax measures, have exercised their powers with judicious restraint. At the same time, they have in several cases pioneered in the development of taxes which have later been adopted throughout the nation. In states with constitutional restrictions, unless constitutional amendment has been greatly facilitated, quite a different picture obtains. Tax systems are out-of-date and changes are frustrated, not through understanding protests against change, but out of the inertia, fear, and general misunderstanding which permeate votes upon constitutional matters.

None of us is capable of predicting the future.

The path of the recent depression is strewn with the wrecks of those who mistook their powers of hindsight for the gift of foresight. Yet the proponents of over-all limitation would have us attempt now to solve the problems of the next generation, for—let no one delude himself—constitutional tax limits, once adopted, will persist in the face of apparently overwhelming objection.

Constitutions are not the place for such matters as property tax limitation. Such instruments have been adopted in order to set up the framework of government and to preserve to the people the right of continued self-government. Constitutional tax limitation is the very negation of these purposes. It has nothing to do with the framework of government, and, instead of preserving self-government, it effectively restricts the exercise of one of its most important aspects—the power to provide funds with which to operate as a self-sustaining unit. Good practice demands broad and general constitutional provisions capable of meeting the variety of conditions which, if they do not already exist, are bound to develop in any political body.

It will probably be admitted that the rigid limitation of all taxes by constitutional means would be fatal to the orderly conduct of government. Why then should the bars be lowered to one group and not to another? If owners of real estate find shelter under the constitution, why not the theatergoers? the smokers? the owners of motor vehicles? the consumers? the wage earners? Constitutional protection of this sort must not be reserved to those who can form the most effective pressure group. It must be extended to all alike—or denied to all.

UNIFORM MAXIMUM RATES

Argument against over-all limits: An over-all limit which applies uniformly throughout a state fails to allow for differences in local resources and local needs.

On its very face an over-all tax limit is an unsound approach to an adequate control of local government expenditures. A rigid over-all rate as low as that proposed by the real estate boards is virtually the equivalent of a fixed rate. Yet it is well known that communities now levy widely different rates. If these differences were due solely to differences in assessment levels or differences in the efficiency of local government, there would be more virtue in the strait-jacket method proposed. But there are other more important causes of rate differentials, such as dif-

ferences in local resources, differences in the services demanded of and performed by local governments, and differences in the whole scale of government operations.

Differences in community resources are well illustrated by a comparison of the cities of Brookline and Lawrence, Massachusetts. Brookline, a wealthy community within the Boston metropolitan area, has a per capita assessment of \$3,400 and a tax rate of a little over 2%. Lawrence, on the other hand, is an industrial city with a per capita assessment of just under \$1,000 and a tax rate of nearly 4%. Moreover a large city presents problems totally different from those of a small village. With a more crowded population there is greater need for police and fire protection, for traffic control, for health and sanitation measures, for business regulation, for recreational facilities. These needs are not offset by equally high resources or by economies in large scale operations; hence the present necessity for higher property tax rates in urban districts. Drastic constitutional tax limitation simply ignores these inherent and long-standing differences. Each community in turn is laid in a Procrustean bed so short that few escape the knife.

Any state may be chosen at random to prove the existence of wide variations in total tax rates applied to property within various municipalities. Massachusetts 1936 rates ranged from 1.3% in Greenwich to 5.6% in Savoy; Connecticut 1935 rates, from 0.5% in Sherman to 3.7% in Voluntown; New Jersey 1935 rates, from 1% in Roseland Borough to 12.5% in Bornegat City Borough; and Colorado 1936 rates, from 0.5% in Minturn to 11.7% in Aurora. New York cities levied 1935 rates varying from 2.2% in Auburn to 6.7% in Plattsburg; and 1933 urban rates in Wisconsin ranged from 1.6% in Green County to 4.3% in Forest County.

If there is any virtue at all in tax limitation, it surely does not lie in the drastic, uniform measure which is being pressed by the real estate interests. A speed limit which is suitable for push carts is hardly adaptable to bicycles, horses, and automobiles alike.

CONCLUSION

In conclusion it may be stated that tax limitation is not the constructive plan for better government that it purports to be but, instead, a movement for the benefit of a restricted group of property owners.

The over-all tax limitation movement is well designed to accomplish one end—reduction in

real estate taxes. All of its other objectives are professed in order to give it wider public appeal and cloak it in the guise of a movement for good government.

In the beginning tax limitation proponents were more frank about their purpose. As one stated: "I heartily agree with Mr.—, who simply states that real estate must be relieved of inequitable taxes and he doesn't care how!" But they soon realized that the movement needed identification with social objectives, that if the aims of tax limitation were stated in broad terms—tax reform, simplification of the structure of government, equitable assessment, reduction of waste and inefficiency—the movement would not lack for supporters.

If tax limitation were really intended to reduce the cost of government, it would be coupled with a constructive program for budgeting and auditing, better personnel, centralized purchasing, and governmental reorganization. If proponents were sincere about improved assessments, they would more directly address themselves to the major problems of assessors. And if tax limitation were a true reform measure, it would be accompanied by adequate and equitable replacement revenues.

Many have doubtless rallied behind the tax limitation movement in the sincere belief that it represents a constructive force for good government. The following statement from a leading sponsor of the movement should serve to disillusion all such:²³

I attribute much of our success in Ohio in attaining the 1 per cent limitation amendment to an unusual and widespread public support by "butchers, bakers, and candlestick makers." We religiously avoided even peeping the words "sales tax," "income tax," and "other taxes." We kept our hands strictly off any suggestions for new taxes. Had we begun to suggest a state sales tax, or an income tax, or some other form of tax, we would immediately have incurred the enmity of groups and individuals specifically touched by such new taxes advocated. As it was, we aroused no antagonism by suggesting where the tax should be placed. We only used simple slogans such as "Save Our Home," "Fair Taxes for Real Estate," etc.

Attempt after attempt was made by a certain group opposed to our limitation amendment to get us to come out specifically and state where replacement taxes should fall. They knew that would be our "Achilles' heel" and they were out to strike us in a weak and vulnerable spot.

Whenever the protectors of other forms of wealth carry on their lobbying activities and organizations, they are not particularly interested where taxes fall so long as taxes do not fall on the particular thing they are trying to protect. Why, then, should the real estate interests seek to execute themselves and lose chances for their own protection by being pulled into this trap? *I will agree that this is not the enlightened way to look upon the problem of solving our taxation mess.*

This quotation speaks for itself. Here we have a frank and open statement of the objective and the tactics of the proponents of this measure.

IV. Experience in States with Over-All Limits

FORTUNATELY no state need step blindly into over-all tax limitation. Rhode Island has had an over-all tax limit since 1878; Oklahoma since 1907; Ohio since 1911; Indiana, Michigan, Washington, and West Virginia since 1932; and New Mexico since 1933. The experience of these eight states is available to those who choose to use it.¹

Many commentators on tax limits have badly distorted and obscured the facts. Both opponents and proponents have been guilty of selecting their data to fit their case. We have attempted to escape a similar charge by marshalling all of the available facts for each of the eight states, whether or

not they support our conviction that tax rate limits are unwise. Where data are omitted, it is because they could not be secured and not because they did not support our position.

DECLINE IN PROPERTY TAXES

The earlier over-all limits were designed to prevent or obstruct a rise in property taxes rather than to bring about an actual decline. This is particularly evident throughout the long history of tax limitation in Rhode Island and in the 3.15% limit placed in the Oklahoma Constitution of 1907. It was also true of the early Ohio law.² But the recent movement for tax limits has had a different purpose. The aim now is to force substantial reductions in property taxes. This ob-

¹First tax letter from Adam Schantz, III, Chairman of National Committee on State and Local Taxation, National Association of Real Estate Boards. Italics are the authors.

²Nevada experience is of little or no value because of its unusually high rate (5%).

³R. C. Atkinson, "Stringent Tax Limitation and Its Effects in Ohio," *Property Tax Limitation Laws*, p. 69.

TABLE 2. PROPERTY TAX ASSESSMENTS, LEVIES, AND AVERAGE TAX RATES IN EIGHT STATES WITH OVER-ALL TAX LIMITS, 1929 TO 1935
(ooo omitted in assessed valuations and total levies)

	INDIANA ^a			MICHIGAN			NEW MEXICO			OHIO ^b		
	Assessed valuation	Total levy	Ave. tax rate ^f %	Assessed valuation	Total levy	Ave. tax rate ^f %	Assessed valuation	Total levy	Ave. tax rate ^f %	Assessed valuation	Total levy	Ave. tax rate ^f %
1929	\$5,166,896	\$144,598	2.799	\$8,813,513	\$278,869	3.164	\$309,934	\$11,439	3.691	\$13,677,716	\$303,197	2.216
1930	5,161,073	133,928	2.595	8,907,421	280,878	3.153	332,305	11,536	3.472	13,452,947	301,873	2.243
1931	5,073,241	140,094	2.761	8,262,954	267,394	3.236	331,801	12,107	3.649	10,003,960 ^e	222,270 ^e	2.221 ^e
1932	3,994,598 ^g	98,155 ^g	2.457 ^g	6,958,338	228,207	3.280	315,074	10,819	3.434	10,032,242	221,437	2.207
1933	3,660,832	99,199	2.710	6,166,414 ^g	168,920 ^g	2.739 ^g	285,643	9,946	3.482	8,782,651	197,238	2.246
1934	3,673,918	91,515	2.491	6,024,227	167,271	2.779	291,890 ^g	7,761 ^g	2.659 ^g	8,683,861 ^g	166,129 ^g	1.913 ^g
1935	3,693,896	96,434	2.611	5,652,288	147,499	2.610	285,002	7,877	2.764			
	OKLAHOMA ^c			RHODE ISLAND ^c			WASHINGTON ^d			WEST VIRGINIA ^a		
			%			%			%			%
1929	\$1,829,675			\$1,147,610	\$26,242	2.287	\$1,250,904	\$81,905	6.548	\$2,033,993	\$54,034	2.656
1930	1,851,602			1,170,579	26,681	2.279	1,263,470	79,995	6.331	2,010,264	53,184	2.645
1931	1,753,690	\$68,944	3.931	1,201,808	27,786	2.312	1,248,894	73,346	5.873	1,877,968	50,657	2.697
1932	1,409,664			1,179,899	27,603	2.339	1,055,100	66,442	6.297	1,671,276	43,846	2.623
1933	1,232,731	56,182	4.558	1,141,842	26,438	2.315	991,366 ^g	53,789 ^g	5.426 ^g	1,545,659 ^g	26,026 ^g	1.684 ^g
1934	1,258,686 ^g	41,942 ^g	3.332 ^g	1,136,219	26,304	2.315	965,151	48,368	5.011	1,537,685	25,640	1.668
1935	1,233,781	44,123	3.576	1,123,623	26,102	2.323	975,534	42,144	4.320	1,535,535	25,331	1.650

Source: Official state reports.

^aIntangibles excluded, 1933 ff.

^bIntangibles excluded, 1931 ff.

^cIntangibles excluded, 1929 ff.

^dIntangibles exempt from property taxation.

^eIncludes real estate and public utility general property only.

^fAverage tax rates were computed by dividing total levies by assessed valuation.

^gYear of adoption or substantial reduction of over-all tax rate limit.

jective has been realized to a degree which has been gratifying, but not entirely satisfactory, to real estate interests. Having won partial victories, they are now campaigning for more stringent limitations which will allow of no increase over the basic rates by means of popular vote and which will embrace all debt service as well as all expenditures on functional activities.

Table 2 shows for each of the eight states the recent trend in property assessments, total property tax levies, and average tax rates. The columns showing total levies clearly indicate substantial reductions in property taxes in each year following the adoption of an over-all limit.³ It is customary to credit all such reductions to the operation of the tax limit.⁴ But to do so is to ignore the downward trend in property tax levies which existed over this period in most non-tax limit states as well as in tax limit states. This downward trend can be ascribed to a variety of causes. Probably the chief cause was the decline in property values which occurred between 1930 and 1935, and which in turn forced a decline in assessed valuations. Lower total assessments would have necessitated higher tax rates had tax levies been maintained at their previous levels. But as Dr. Frederick L. Bird has so well remarked, "Even where there are no restrictive limits to the rate, the taxpayers' traditional mental attitude renders it politically inexpedient and difficult to offset, even partially, the shrinkage in valuation by an increase in rate."⁵ Another contributing cause, appearing both in Ohio and Indiana during the period covered by this table, was the segregation of intangibles for special taxation at a low rate.

It is impossible to say what would have been the levy in any of these eight states in the absence of tax limits, but there is at least a presumption that levies would have declined somewhat in proportion to the decline in assessed valuations in order to prevent an increase in average tax rates. If this assumption is warranted, the decline in property taxes attributable to over-all limits is more clearly evidenced by the columns in which average tax rates are listed. This decline, while not as precipitous as the decline in levies, has been substantial in most of the states.⁶

³Throughout the tables in this chapter, the reduction in the Ohio over-all limit from 1.5% to 1% in 1933 and the Oklahoma reduction from 3.15% to 1.7% in the same year are treated in the same manner as original adoptions of over-all limits in other states.

⁴National Association of Real Estate Boards, *op. cit.*, p. 16.

⁵*The Municipal Debt Load in 1935*, Dun & Bradstreet, Inc., New York, 1935, p. 6.

⁶It is admittedly true that average property tax rates have

On the basis of this somewhat arbitrary assumption—that in the absence of tax limits, declines in assessed valuations would have produced proportionate declines in levies—we have shown in Table 3 the declines attributable solely to tax limitation. These data were computed by multiplying total assessed valuations, in years in which the tax limit existed, by the tax rate which existed in the last year prior to the tax limitation law.⁷ For example, it was assumed that the 1932 average tax rate in Indiana would have been 2.761% (the 1931 average rate) in the absence of an over-all limit. The actual average rate for 1932 was 0.304% less than this. When this 0.304% rate is applied to the 1932 assessment of 3,995 million dollars, a reduction of \$12,144,000 in the levy is secured. Presumably this constituted the reduction attributable exclusively to the over-all limit. Rhode Island is omitted from this table because no substantial change has occurred in its over-all tax limitation law since 1920.

TABLE 3. DECREASES IN PROPERTY TAX LEVIES ATTRIBUTABLE SOLELY TO TAX LIMITATION IN SEVEN STATES, 1932 TO 1935 (000 omitted)

	1932	1933	1934	1935
Indiana	\$12,144	\$ 1,867	\$ 9,920	\$ 5,541
Michigan	—	33,360	30,181	37,870
New Mexico	—	—	2,402	2,046
Ohio	—	—	28,917	^b
Oklahoma	—	—	15,431	11,992
Washington	—	8,635	12,412	19,286
West Virginia ^a	—	16,763	16,568	16,828
Total	12,144	60,625	115,831	^b

^aTax reduction in West Virginia was computed by applying the 1932 average tax rate to total assessments (including intangible property) for succeeding years. Figures in Table 2, on the other hand, do not cover intangible property because it is subject to the special rate of 0.5%.

^bNot available.

It is interesting to note how much average tax rates in most of these states exceed the basic over-all rates. It may be that the decline in average rates will be a progressive matter in such of these states as now exclude prior debt service from the rate limit but require the servicing within the limitation of debt incurred subsequent to the adoption of the tax limit. As indebtedness out-

increased slightly in many non-tax limit states, so that this assumption is not completely in accord with the evidence. On the other hand, stringent limits on property tax rates sometimes force a higher level of assessments than would obtain in their absence, as, for example, in West Virginia. These two factors are at least partially offsetting.

⁷See footnote 3 above.

standing upon the inauguration of the limit is retired—assuming that it is not refunded—the average tax rate tends to approach the basic over-all limit. On the other hand, it is possible that the tax limit may be exceeded more often and by larger amounts by vote of the electorate or, in the case of Indiana, by vote of the county board of tax adjustment. It is thus difficult to say whether the reduction of well over a hundred million dollars a year which is now being realized in these seven states by reason of over-all limitation will be increased or decreased in the next few years.

REPLACEMENT REVENUES

Replacement revenues are those revenues which are secured to offset, in part or in whole, a decline or cessation of revenues from other sources, and which would not have been secured in the absence of such decline or cessation. Most states which have introduced over-all tax limits have accompanied them sooner or later with replacement revenues. Yet it is not always easy to

identify such revenues. An excellent example is found in liquor licenses and taxes. Since the return of liquor was more or less coincident with the enthusiasm for over-all tax limitation, liquor revenues are sometimes classified as replacement revenues. They do not, however, qualify under the definition given above, because they would have been seized upon in tax limit states as inevitably in the absence of tax limits as they were in non-tax limit states. Moreover, in some instances a particular tax measure is partially a levy which would have come about without tax limits, yet we usually have no means of segregating the two parts. At the other extreme are revenues, such as front foot charges for street lighting, which have clearly been introduced as replacement revenues.

Despite the impossibility of achieving a scientific classification of new revenues into replacement and non-replacement revenues, Table 4 has been compiled to show how much has been raised in tax limit states by taxes which are commonly reported as the results of property tax limitation.

TABLE 4. COLLECTIONS FROM MAJOR REPLACEMENT TAXES IN SEVEN STATES WITH OVER-ALL TAX LIMITS, FISCAL YEARS 1933 TO 1936
(000 omitted)

	Major replacement taxes	1933	1934	1935	1936
Indiana	Gross income tax	....	\$10,388	\$13,608	\$16,548
	Intangibles tax	\$ 790	2,360	2,542	2,930
Michigan	Retail sales tax	....	31,361	38,660	45,642
New Mexico	Gross income tax	....	109	2,112	2,362
Ohio	Retail sales tax ^a	....	....	47,848	58,552
Oklahoma	Cigarette tax	....	....	613	1,937
	Retail sales tax	....	3,825	4,768	5,835
	Increased net income taxes	....	....	460 ^b	2,727 ^b
	Increased gross production tax (oil)	....	....	1,602 ^c	7,018 ^c
Washington	Business and public utility (gross income) taxes ^a	1,239	5,413	5,755	5,710 ^c
	Cigarette tax ^a	....	....	664	900 ^c
	General sales tax ^a	....	....	4,361	9,312 ^c
West Virginia	Consumer's (retail) sales tax	....	1,769	6,836	7,612
	Individual income tax ^d	....	593	972	1,148
	Increased privilege (gross income) tax	....	4,619 ^e	8,950 ^e	8,335 ^e

Source: U. S. Treasury Department, *Collections from Selected State-Imposed Taxes, 1930-1936*, Washington, Nov. 1936; *Washington Taxpayer*, July 1936; official state reports.

^a Figures are for calendar years.

^b Figures represent the excess of actual collections over \$2 million, the approximate figure reached in the fiscal year ending June 30, 1933.

^c Estimated.

^d This was a gross income tax until 1935; thereafter, a net income tax.

^e Figures represent the excess of actual collections over \$4 million, the highest figure reached in any year prior to the 1932 amendment.

There are two significant aspects to Table 4: (1) The amount raised by replacement taxes; and (2) the type of replacement taxes adopted.

Table 5 combines certain data from Tables 2, 3, and 4 for the purpose of comparing replacement revenue collections with declines in property tax levies. Replacement revenues are reported on the basis of actual collections, usually for fiscal years ending on June 30th. It has therefore been necessary to tabulate property tax levies according to the collection year instead of the year of levy as in previous tables. This is ac-

complished with substantial accuracy by assuming that the collection year is the fiscal year ending next after the calendar year of levy. For example, the decline registered in the Indiana 1932 levy is credited to the fiscal year ending June 30, 1933, the probability being that the lower levy in 1932 was reflected largely in collections of the 1933 fiscal year. The total decline in property taxes is in each instance the difference between the levy of a given year and the levy in the last year prior to the adoption of the over-all limit.

TABLE 5. REPLACEMENT REVENUES AS COMPARED WITH DECLINE IN PROPERTY TAXES IN SEVEN STATES WITH OVER-ALL TAX LIMITS, FISCAL YEARS 1933 TO 1936
(000 omitted)

Fiscal Year	INDIANA			MICHIGAN		
	Total decline in property tax levies	Decline attributed to tax limits	Replacement revenues	Total decline in property tax levies	Decline attributed to tax limits	Replacement revenues
1933	\$41,939	\$12,144	\$ 790	—	—	—
1934	40,895	1,867	12,748	\$ 59,287	\$ 33,360	\$ 31,361
1935	48,579	9,920	16,150	60,936	30,181	38,660
1936	43,660	5,541	19,478	80,708	37,870	45,642
	NEW MEXICO			OHIO ^a		
1933	—	—	—	—	—	—
1934	—	—	\$ 109	—	—	—
1935	\$ 2,185	\$ 2,402	2,112	\$ 31,109	\$ 28,917	\$ 47,848
1936	2,159	2,046	2,362	b	b	58,552
	OKLAHOMA			WASHINGTON ^a		
1933	—	—	—	—	—	\$ 1,239
1934	—	—	\$ 3,825	\$ 12,653	\$ 8,635	5,413
1935	\$14,240	\$15,431	7,443	8,074	12,412	10,780
1936	12,059	11,992	17,517	24,298	19,286	15,922
	WEST VIRGINIA			ALL SEVEN STATES		
1933	—	—	—	\$ 41,939	\$ 12,144	\$ 2,029
1934	\$17,820	\$16,763	\$ 6,981	130,655	60,625	60,437
1935	18,206	16,568	16,758	183,329	115,831	139,751
1936	18,515	16,282	17,095	b	b	176,568

^a All figures are for calendar years.

^b Not available.

It is apparent from this table that replacement revenues, while they have often equalled or even exceeded the decline in property tax levies attributed solely to over-all tax limits, have been considerably less in amount than the total decline in property tax levies. Declines in property tax levies have also occurred in non-tax limit states and replacement taxes have been enacted as in the tax limit states. But the replacement taxes in non-tax limit states have been more effective in maintaining total taxes at pre-depression levels. Total state and local tax revenues for 1934

fiscal years (the latest date for which complete data are available) were 92.4% of 1932 revenues for the country as a whole, as compared with 76.4% for Indiana, 81.9% for Ohio, 85% for Michigan, 92.7% for Washington, and 77.6 per cent for West Virginia.⁸ Thus in all states within which tax limits had been effective for a period sufficient to be reflected in 1934 revenues,

⁸ Computed from data in *Cost of Government in the United States, 1933-35*, National Industrial Conference Board, New York, 1936, p. 46.

with the single exception of Washington, percentage declines in total tax revenues between 1932 and 1934 were substantially greater than in the country as a whole. Whether this tax reduction proves to be more than a temporary phenomenon remains to be seen.

In considering the type of replacement taxes adopted, one is struck with the dominance of gross income and sales taxes. While there have doubtless been minor replacement revenues of other sorts not accounted for in this table, these two constitute the backbone of the replacement revenues in each of the seven states. Every tax limit state except Rhode Island and Nevada now has some form of general sales or gross income tax. It is true that many non-tax limit states have such taxes too, but the proportion is only about one in four states instead of seven out of nine as in the tax limit states, or seven out of eight if we omit Nevada.

To these major replacement taxes there should properly be added other revenues to which some local governments have been forced to resort upon the failure of their principal source of revenue, the property tax. Some of these revenues have taken the form of service charges for collection of garbage, sewer rentals, and even personal protection charges. Most of them are collected directly from property owners or tenants and in this sense are virtually equivalent in incidence, if not in administration or amount, to the property taxes which they have replaced.

No comprehensive information is available on revenues of the latter type. We do know, however, that there are 19 cities in West Virginia levying fees for waste collection and disposal, three with sewer rentals, and seven with street cleaning and street lighting charges based on frontage. Revenues from these sources in West Virginia have been small relative to the property tax receipts formerly available for these and other municipal services.⁹ Many cities in tax limit states have also found a partial substitute for property taxes in the profits of municipally owned utilities.

Only three of the nine tax limit states have personal net income taxes, and only two of these—Oklahoma and West Virginia—have added such taxes to their fiscal systems since adopting an over-all tax limit. Oklahoma's original net income tax, which was enacted in 1908, is not ordinarily attributed to the 3.15% tax limit in the constitution of 1907. It is conceded, however,

that the greater importance which it has attained by reason of amendments in 1935 is due in part to the reduction of the over-all limit in 1933. In West Virginia, constitutional authorization for a net income tax was embodied in the tax limitation amendment, but resort was had to several gross income and sales taxes before an individual net income tax was finally enacted in 1935. The third tax limit state with a net income tax is New Mexico. This tax was imposed by the 1933 legislature some months before the tax limitation amendment was adopted, and, although the same legislature initiated the tax limitation amendment, it hardly appears that the net income tax can be considered a replacement revenue.¹⁰ In Washington a comprehensive net income tax was enacted by initiative in the election in which tax limitation was first adopted. The income tax was then held unconstitutional, and a constitutional amendment was defeated in 1934. Legislative enactments in 1935 of modified individual and corporate net income taxes have met with a similar fate at the hands of the courts.

The other five tax limit states have enacted no net income tax laws. As compared with three out of nine tax limit states (or eight if Nevada be omitted) with individual net income taxes, there are 24 out of 39 (or 40) non-tax limit states with such taxes. It is thus readily apparent that there is a strong inverse correlation between tax limitation and individual net income taxes and a strong positive correlation between tax limitation and gross income or sales taxes.

TAX DELINQUENCY

Very few statistics of comprehensive character are available on tax delinquency, but such as there are seem to demonstrate that over-all rate limitation has been a factor of little importance in improving collections.

The latest United States Census Bureau report, entitled "Realty Tax Delinquency," shows total delinquency as of December 31, 1933, on levies collectible in whole or in any part within the twelve months previous to June 30, 1933. This report, like much other available financial data, is not recent enough to throw much light on our problem. It is interesting to note, however, that, as compared with delinquency for the country as a whole of 20.5 per cent of the levy, Ohio, which was then operating under a 1.5%

⁹Letter from Hume K. Nowlan, Secretary of the West Virginia League of Municipalities, Dec. 29, 1936.

¹⁰Whether or not it is so considered is of minor consequence, since it has yielded less than 10% of the revenue derived from the gross income tax.

constitutional over-all limit, showed delinquencies of 26 per cent; Oklahoma, with a constitutional over-all limit of 3.15%, showed 25.5 per cent delinquency; and Rhode Island, with a statutory over-all limit of 2.5%, showed delinquencies of 17.5 per cent. Two out of the three tax limit states were above the national average, and Ohio, with the lowest over-all limit, was the highest of the three.

A number of more recent tax delinquency studies are available covering a restricted group of states and political subdivisions. One of the best is published annually by the Municipal Service Department of Dun & Bradstreet.¹¹ This report covers 190 of the 191 cities having a 1930 population of over 50,000. Forty-one of these cities are in tax limit states, but complete data are not available for all of them, and the list includes seven Michigan and two Ohio cities (Cincinnati and Akron) which are subject to charter, rather than state-wide, over-all limits. The median delinquency for all 190 cities at the end of 1935 fiscal years, expressed as a percentage of levies for such years, was 18.0%. Sixteen cities subject to state-wide over-all limits showed a median delinquency of 20.3%, and 24 cities subject either to state-wide or charter over-all limits showed a median delinquency of exactly 20%. For 1934, the nation-wide median was 23.05%, as compared with 20.1% for 18 cities subject to state-wide over-all limits and 20.7% for 37 cities subject to state-wide or charter limits. It is apparent that over-all tax limitation, if it has had any effect at all upon tax delinquency, has not in any sense dominated the situation.

INDEBTEDNESS

It is reasonable to assume that an over-all limit will exert pressure to borrow for activities which would better be financed on a pay-as-you-go basis if the taxing power were not so restricted. The extent of the pressure will, however, depend upon a variety of factors. *A priori* reasoning leads to the conclusion that a limit will encourage borrowing if it has the following three elements: (1) A low over-all rate; (2) permission to service outside the tax rate limit debts which are incurred after the limit is adopted; and (3) no provision for exceeding the limit by special authorization. Debt statistics for the only three states—Rhode Island, Oklahoma and Ohio—which have had a long enough experience under tax limitation to show how different types of

limits affect debt policies seem to bear out this conclusion.

The Rhode Island limit, in addition to its moderately low rate,¹² has had from 1878 to date (with the exception of a single year) the second element above, and the third of these elements from 1878 to 1932. Thus up to 1932 Rhode Island had the type of limit which should encourage borrowing. It is not surprising then to find that the 1932 per capita indebtedness (less sinking funds) of the state and its political subdivisions was \$158.55, the highest figure in any New England state and the eleventh highest in the whole country. New England as a whole had a per capita debt of only \$100.81 and the national per capita was \$141.17.¹³ Between 1912 and 1932 the Rhode Island per capita debt was slightly more than tripled, while that of all New England was not even doubled. The only other New England state which tripled its debt was Vermont, and this was due in no small measure to flood bonds issued for rehabilitation work after the disastrous floods of 1927. Other factors besides tax limitation undoubtedly encouraged Rhode Island local governments to borrow, but tax limitation played a part.

For the past thirty years, Rhode Island cities and towns have been rather liberal borrowers. While debt has not gotten out of hand in any of these communities, the record is not particularly favorable. It is probably true that had it been possible for cities and towns to increase the tax levies without fear of encountering the over-all limit, less borrowing and greater direct payments on outlays would have resulted. Obviously this is a matter of opinion.¹⁴

The Oklahoma over-all limit from 1907 to 1933 was in marked contrast to that in Rhode Island. The rate was high, 3.15% until 1933. All debt service was subject to the limit. The limit could be exceeded by special authorization. These three aspects of the Oklahoma limit were the very opposite of those which should encourage borrowing. An examination of the 1932 per capita state and local debt figure seems to bear out the hypothesis that the Oklahoma limit did not encourage borrowing. The figure of \$79.77 was slightly over half the per capita state and local debt for the country as a whole and less than that of any neighboring state. If the Oklahoma limit encouraged local borrowing (as believed

¹¹The over-all rate was 1% from 1878 to 1902, 1½% from 1902 to 1920, and 2½% from 1920 to date.

¹²U. S. Bureau of the Census, *Financial Statistics of State and Local Governments, 1932*, pp. 62-63.

¹³Letter from Robert M. Goodrich, Executive Director, Providence Governmental Research Bureau, Dec. 12, 1936.

¹⁴Frederick L. Bird, *Trend of Tax Delinquency, 1930-1935*, New York, 1936.

by two students of fiscal affairs in that state), the impetus could not have been very great.

Ohio stands between the two extremes. A description of the Ohio experience from 1911 to 1934 must be divided into two periods: 1911 to 1921 and 1922 to 1934. During the first period the limit was relatively inflexible. Three elements in the law affected borrowing: (1) A low rate—1% with possible additional levies which could total only $\frac{1}{2}\%$; ¹⁵ (2) inclusion of all debt service within the 1%-1 $\frac{1}{2}\%$ limit; ¹⁶ (3) the absence of a provision for exceeding the limit by special authorization. The first and third elements are those which encourage borrowing, and they outweighed the second. Ohio in 1922 had the highest per capita local net debt of any one of the five East North Central States.¹⁷

	1912	1922
Ohio	\$47.22	\$107.20
Indiana	23.92	50.43
Illinois	23.23	52.58
Michigan	18.02	80.84
Wisconsin	15.63	38.01

The above per capita figures are inclusive of special assessment debt. Figures for Ohio special assessment debt by levels of government are incomplete.¹⁸ The available data show large increases during the period 1912 to 1922.

	1912	1922
Counties	\$ 2,108,323	\$25,141,000
Incorporated places	20,448,680	59,462,000

R. C. Atkinson, the leading student of Ohio tax limitation, has given the best account of what happened in the decade 1911-1921. The pay-as-you-go policy for school and other construction was early abandoned. Deficits became quite common and cities began to go into debt for current operating expenses. By 1921 Ohio local governments had some \$39 millions of deficiency bonds outstanding in a total debt of \$608 millions. Other financial abuses grew up, such as using sinking fund assets for current operations.

The total burden saddled on subsequent taxpayers by this decade of rigid tax limitation cannot be determined. Counting deficiency bonds and other

¹⁵With the exception of emergency levies for floods, epidemics, etc.

¹⁶Except that a 1919 law excluded service for debt previously incurred.

¹⁷U. S. Bureau of the Census, *Financial Statistics of State and Local Governments*, 1932.

¹⁸U. S. Bureau of the Census, *County and Municipal Indebtedness, 1913, 1902, 1890*, Washington, 1915, Tables 4 and 5.

bonds for current operation and for improvements which would normally have been financed from direct taxation, the interest on these bonds, the failure to maintain sinking funds, and the added years of interest necessitated by the refunding of maturing indebtedness, it is not unlikely that the Smith Law shifted a burden of around \$100,000,000 onto the backs of later taxpayers.¹⁹

The second period, 1922-1934, was characterized by a less stringent limit. All debt service was originally either within the 1% or the additional $\frac{1}{2}\%$ levy, but in the recognition of serious local financial conditions, permission was granted in 1919 to service existing indebtedness outside these limits. Finally in 1923 the electorate, by a 60% vote, was permitted to exclude payments of principal and interest on new indebtedness. By legislation enacted in 1919, 1920, and 1921, further additional levies for other purposes were allowed to all local taxing districts upon approval of the voters. Thus during the second period the Ohio limit had the following important elements: (1) A low rate of 1 $\frac{1}{2}\%$; (2) from 1923 on, a provision that all debt service on new indebtedness could be excluded by a 60 per cent vote; and (3) provision for exceeding the limit by special authorization. The first and second elements tended to encourage borrowing, the third promoted conservative financing. The voters had to be educated to the process of special authorization of additional levies, but gradually levies were increased and budgets brought into balance. A comparison between the growth of local debt from 1912 to 1922 and from 1922 to 1932 shows that the less stringent limit during the second period had less disastrous effects upon borrowing. The per capita local debt was \$47.22 in 1912, \$107.20 in 1922, and \$128.74 in 1932. The increase in net debt from 1912 to 1922 was 172.5 per cent; whereas from 1922 to 1932 it was only 35.7 per cent. These net debt figures are inclusive of special assessments.

Other legislation during the second period had as important a part in improving expenditure and borrowing policies as did relaxation of rigidities in the tax limit. A new debt law went into effect in 1922, which fixed more rigid percentage limitations on local government borrowing and also limited to a fairly low percentage the amount of bonds which could be issued without vote of the people, special assessment bonds and self-supporting utility bonds being exempted. A compulsory budget law was passed in 1925; a uniform bond act of the same year ended the

¹⁹"Stringent Tax Limitation and Its Effects in Ohio," *Property Tax Limitation Laws*, p. 71.

practice (until this law was relaxed in 1934) of issuing deficiency bonds.

No other state besides these three has had a long enough experience under an over-all limit to afford much proof or disproof of the proposition that tax limitation will force an increase in indebtedness. An attempt was made to compare the growth of debt in tax limit states with the growth in states which have adopted new or revised limits since 1932, but statistics were for the most part unavailable. Such data as were secured in 1934 rather general reduction in state and local indebtedness in both tax limit and non-tax limit states since the revival of the over-all tax limitation movement in 1932. Indiana, for example, which had a gross state debt of \$4,906,000 and a gross local government debt of \$196,304,000 in 1931, had a gross state debt of \$2,771,000 and a gross local debt of \$151,088,000 in 1935.²⁰ Public bonded indebtedness was decreased in New Mexico and West Virginia, but data are not available on unfunded debt.

A reduction was also effected in Ohio, where local debt was decreased from \$941,000,000 in 1931 to \$800,000,000 in 1935.²¹ But serious debt troubles in scores of individual Ohio municipalities are being accumulated because of the widespread practice of funding operating deficits. Local governments in a measure are repeating the same pattern followed from 1911 to 1921, and, before an adequate municipal revenue program can be worked out, many local units will have seriously increased their indebtedness. Tax limitation has not been the main cause of defaults in Ohio, but it has been one of three major factors. Ohio in 1934 had in default more cities of 10,000 or more population than any other state. In addition, tax limitation has been the chief cause of a poor bond market for Ohio municipals.

There is no question in my mind but that the bonds of Ohio municipalities payable inside the tax limitations are from $\frac{1}{2}\%$ to 1% higher than they would otherwise be if it were not for the 10-mill tax limitation law. A review of bond sales will prove that practically all bonds of Ohio municipalities have been purchased by Ohio dealers. If eastern bidders or even the Chicago market could be interested in Ohio bonds I am sure interest rates would be somewhat lower. I have been told many times by bond purchasers that they are not interested in

bidding on Ohio bonds under present conditions.²²

A correspondent from Oklahoma advises that the 1933 amendment has not affected local borrowing powers. In Washington tax limitation has brought about certain material changes in city borrowing policies because it is no longer an easy matter to float bond issues. In the first place special electoral consent is necessary and this has not been given in very many cases, and in the second place, the bond market has been rather poor. This has resulted in cities issuing warrants instead of bonds and has, in general, intensified the financial crises of Washington cities. A few municipalities have been able to issue revenue bonds for certain public utility and quasi-public utility funds.²³

It was concluded in Chapter III that the proponents' over-all limit would encourage borrowing. The experience examined above supports that conclusion. The proponents have offered a limit with the following elements: (1) A low over-all rate; (2) a requirement that all debt service be brought within the limit; and (3) the absence of a provision for exceeding the limit by special authorization. The first and third elements ought to encourage borrowing; the second should discourage borrowing. The conclusion seems sound that the two elements will outweigh the other, as was true in Ohio during the first period 1911-1921, resulting in increased borrowing. If proponents would discourage debt incurrence, the Oklahoma limit, rather than the early Ohio limit, should serve as a model.

ASSESSMENT OF PROPERTY

As pointed out in Chapter III, one of the claims of real estate interests is that over-all tax limitation will improve assessment procedure by encouraging a fuller declaration of taxable property, especially intangible personal property which is seldom assessed unless voluntarily declared, and by forcing a more equitable assessment of property already on the rolls, especially real estate.

The effectiveness of tax limitation in inducing fuller declarations of personal property appears to depend upon the character of the limit. In West Virginia the tax limit is of a classified type, with intangibles and some tangible personalty subject to a maximum rate of only one-half of one per cent. As any student of taxation would

²⁰U. S. Bureau of the Census, *Financial Statistics of State and Local Governments, 1932*, p. 525; letter from Albert E. Dickens, Indiana Department of Inspection and Supervision, Dec. 16, 1936.

²¹Auditor of State, *Comparative Statistics, Counties of Ohio, 1935*, p. 27.

²²Letter from Earl E. Hagerman, Director of Finance, Dayton, Ohio, Dec. 23, 1936.

²³Letter from Jesse Epstein, Research Assistant, Association of Washington Cities, Seattle, Jan. 5, 1937.

have predicted, this act resulted in a large increase in the assessment of intangibles. In fact, the assessment was increased from \$45,541,000 in 1932 to \$185,745,000 in 1933. Consequently the assessed value of real estate dropped from 52.46% of total assessments to 47.18%, and real estate tax levies declined from 52.38% to 48.68% of the total. Personal property assessments, including both tangibles and intangibles, increased from \$231,867,000 to \$340,958,000, but, because of the favorable tax rates available to this class, personal property tax levies decreased from 14.07% to 13.47% of total property tax levies. The third property category—public utilities—made up approximately the same percentage of total assessments before and after adoption of the tax limit, but its contribution to the total levy increased from 33.55% to 37.85%.

In all of the remaining states the over-all limit is of the general type, without differentiation in favor of any class of property. These states do, however, divide themselves into two classes: (1) States taxing most intangibles at general property tax rates (Michigan and New Mexico); and (2) states exempting most intangibles (Washington) or classifying them for taxation at a fixed low rate (Indiana, Ohio, and Oklahoma). In Michigan the division of total assessments among real property, personal property, and public utilities was unaffected by tax limitation. In the first year in which the limit was effective, personal property assessments declined from 15.87 per cent to 14.89 per cent of the total, but a subsequent increase in 1934 brought them back almost to their former level. In New Mexico, on the other hand, there is some indication that tax rate limitation improved the assessment of personal property. In the first year the assessment was \$41,875,000 as compared with \$35,014,000 in the preceding year, but this increase left the assessment far behind the level of 1932 and preceding years and may well be ascribable to other causes than tax limitation.

All three states with low-rate intangibles taxes assess far more intangible property than they would if it were subject to general property tax rates. This is attributable to tax limitation only in a restricted sense in two states. The Ohio tax limit was first put into the constitution in 1929 in order to secure rural support for the classification amendment permitting low-rate taxes on intangibles; and the Indiana intangibles taxes are considered by some to be replacement taxes called into being by the limitation of general property taxes.

Available data do not permit a careful analysis of the recent effects of over-all limitation upon tangible personal property assessments in Ohio. It is significant, however, that the 1911 act, which first introduced over-all limitation in the state, failed to increase the relative importance of personal property in the assessment rolls. The proportion of real estate to total assessments continued to rise despite the fact that its assessed value was allowed to lag far behind true values.²⁴

Assessments of personal property in Indiana, although they decreased from \$873,722,000 in 1931 to \$712,600,000 in 1932, did not decline by as large a percentage as real property. They comprised, in the first year of tax limitation, 17.84 per cent of the total assessment rolls of the state as compared with 17.22 per cent in the preceding year. This increase is negligible. As a matter of fact, however, reduction in the average tax rate for the state was also small and could hardly have been expected to have any effect upon the disclosure of property to assessors. In 1933, intangibles were removed from the scope of the general property tax, and personal property made up only 13.65 per cent of total assessments.

In Oklahoma reduction from 3.15% to 1.7% in the constitutional over-all limit in 1933 was accompanied by an increase in the assessment of tangible personal property from 13.70 per cent of total assessments to 15.03 per cent, with an offsetting decrease in real estate assessments. In Washington the assessment of all major classes of property declined in the first year of tax limitation (1933) but, contrary to the Oklahoma experience, the assessed valuation of real estate bore a larger proportion to total assessments than in the preceding year. Although this situation was slightly reversed in the following two years, real estate still constituted 70.28 per cent of total equalized assessments in 1935, as compared with 69.81 per cent in 1932.

In summary it may be said that a classified over-all limit which forces the taxation of intangibles at a much lower rate than anything yet proposed for real estate will greatly increase the assessment, if not the revenue, from intangibles. This is a worthy objective. Whatever its fiscal effects, it will produce far greater justice for those who do list such property and will make it reasonably possible for assessors to discharge the duties imposed upon them by law. But such a reform has no necessary dependence upon over-all tax limitation. Although it seems to have been

²⁴R. C. Atkinson, "Stringent Tax Limitation and Its Effects in Ohio," *Property Tax Limitation Laws*, p. 70.

associated with tax limitation to some degree in Ohio, West Virginia, and possibly Indiana, the failure to adopt tax limitation has had no noticeable effect in forestalling similar developments in non-tax limit states. Among the nine over-all tax limit states, Michigan, New Mexico, and Nevada—two out of eight if we omit Nevada—still attempt to reach intangibles through the general property tax. About eleven out of thirty-nine non-tax limit states (or 40 including Nevada) fall into this category, this being nearly as small a proportion as in tax limit states. The division of states into those with low-rate intangibles taxes and those entirely exempting intangibles from property taxation is also in approximately the same proportion within the tax limit and non-tax limit groups. As for the assessment of intangibles in those tax limit states which do not provide a lower rate than for tangible property, there is no evidence of improvement as a result of tax limitation. Nor is there much indication of an increase in tangible personal property assessments, although here the evidence is mixed.

The experience of the several states is probably not yet adequate to test at all fully the contention that tax limitation forces a more equitable assessment of property already listed on the rolls. To the best of our knowledge, no assessment ratio studies covering a period in which over-all limits were in force have been published for any state except Ohio. In this one state a study of rural assessment ratios in 1925 showed a rather high degree of inequality. The coefficient of dispersion, which is the statistical measure of inequality, was computed by Martin and Stephenson to be 24.83%.²⁵ It is true that Ohio ranked fifth highest out of 24 states for which such a measure was obtained for rural land, and that rural land appeared to be assessed at more nearly full value in Ohio than in any other of the 24 states except Minnesota. But the evidence is fragmentary at best, and it cannot be stated with confidence that this high rank is ascribable largely, or even partially, to tax limitation. There are so many factors which affect the quality of assessments that much more evidence is needed as a basis for generalization.

Any pressure which over-all limits may exert to bring assessment levels up to full value is probably helpful in bringing about greater

²⁵ James W. Martin and C. M. Stephenson, "Aspects of the Movement Toward Separation of Sources of State and Local Revenue," *Tax Magazine*, v. 9 (1933), p. 81. The amount of a tax which is misplaced is half of the coefficient of dispersion—12.41% in this case.

equality. If, however, they force assessments in excess of full value, inequality is likely to ensue. In Rhode Island the complaint is made that excessive assessments have been induced by the over-all limit. In West Virginia the small decline in total assessments of real property since 1932, relative to declines in other states, indicates either over-assessment or correction of an extremely low assessment ratio of previous years. In other tax limit states the decline in total assessments during the depression was more commensurate with declines in true values and was apparently affected but little by tax limitation.²⁶

It is our conclusion that experience does not support the contention that over-all tax limitations, in the form advocated by the National Association of Real Estate Boards, will materially improve assessment practice.

REALLOCATION OF FUNCTIONS

There have been some shifts in functions and some realignments of financial responsibility for other functions which may be ascribed to over-all tax limits. But the fragmentary information which can be briefly outlined for each state is not very convincing; neither does it lend itself to statistical treatment.

No important reallocation of functions has occurred in Ohio. On the other hand, substantial financial responsibility for public school costs has been shifted to the state, though state support has not yet been pegged at any given level. Schools now receive approximately \$44,600,000 state aid, of which about \$25,800,000 represent allocations from the state-collected retail sales tax.²⁷ This is 37 per cent of the total public school costs, as compared with a state contribution of only 3.77 per cent in 1930.²⁸ The exemption of food from the retail sales tax, approved by the electorate last November, will greatly lessen the total amount allocated to local governments, although the schools may be able to force other levels of local government to bear this reduction. Since the legislature is largely controlled by representatives from the smaller counties, the state may also gradually assume support for other rural local government functions.

In West Virginia the tax limitation measure forced the reallocation of two important func-

²⁶ Frederick L. Bird, *The Municipal Debt Load in 1935*, Dun & Bradstreet, Inc., New York, 1935, p. 11.

²⁷ Arch D. Schultz, *State Aid to Common Schools*, Ohio Chamber of Commerce, Columbus, 1935, pp. 14 and 21.

²⁸ Paul R. Mort, *State Support of Public Education*, American Council on Education, Washington, 1933, pp. 303 and 358.

tions—schools and roads—and shifted to the state a large share of the burden of support. The county was established in 1933 as the unit for school administration, thereby reducing the number of school units from 398 to 55. State appropriations for local schools were increased from about \$1,000,000 in 1932 and former years to about \$11,500,000 annually. The state now bears approximately 53 per cent of the total cost as opposed to 5 per cent in 1932.²⁹ All county and district roads were placed under state control and the counties relieved of the burden of their maintenance and construction, which accounted for approximately half of their former total expenditures.³⁰

In Michigan, as in Ohio, there has been no important reallocation of functions, but the state has assumed a larger share of the cost of schools. The amount of state aid for schools has been increased from \$24,000,000 in 1931 to \$36,000,000 in 1935-36, or an increase from 31 to 53 per cent of total public school revenue.³¹ These funds come in considerable part from the retail sales tax, the public utility taxes from which they were previously derived having been reduced by tax limitation. Despite this aid the schools have been more seriously affected by the tax limitation amendment than any other unit of government. Another major shift in financial responsibility to the state, namely, local welfare (supplemented, of course, by federal grants), cannot be attributed to tax limitation.

Tax limitation in Oklahoma has been responsible for only one minor reallocation of functions. All township roads were placed in the county highway system, to be maintained and improved out of county revenues. But the 1933 amendment has undoubtedly resulted in an expansion of state grants-in-aid. The local school districts, in particular, are receiving more financial aid from the state. The proportion of school revenue contributed by the state increased from 10% to 39%.³² The counties receive a share in the state gasoline tax revenue and in other minor state revenues. Thus far cities have not participated in the apportionment of the new state-collected taxes. Much of this increased state support of local government, however, is due not so much to tax limitation as to a decline of one-third in

assessed valuations since 1930, which has forced the local units to turn to the state for financial assistance.

No shift in functions has occurred in Indiana as the result of tax limitation, although an expansion of state-collected, locally shared taxes has resulted. It was necessary to develop new revenues to replace property tax revenues, and these have been shared with the counties, towns, cities, and school districts. Further, the operation of the tax limit law has shifted more responsibility for local budgets to the county tax adjustment boards and the state board of tax commissioners. Very little home rule has now been left to local units in matters of financing, but this does not seem to cause much concern in the state.³³

Some minor functional changes have occurred in the state of Washington as the result of tax limitation. The state has taken over from the counties the construction and maintenance of county roads. Greater financial support is also being given by the state to the public schools. The state's apportionment for the latter purpose has increased from \$8,284,000 in 1929 to \$13,376,000 in 1936. The counties' contribution, on the other hand, has decreased about 10 per cent.³⁴ Municipalities have shared but little in replacement revenues.

The tax limitation measure in Rhode Island is a matter of long standing and has not caused any recent reallocation of functions or of financial responsibilities. Nor have any important changes resulted from the adoption of an overall limit in New Mexico.

LOSS OF MUNICIPAL SERVICES

No attempt to measure statistically the effect of tax limits upon the quantity and quality of municipal services has been made. Reports on a state-wide basis include little on the quantity of municipal services performed and nothing on their quality. Were such information available, the other major difficulty, namely, that of determining how much loss of municipal services could be attributed to tax limitation and how much to depression conditions common to all states, could be partially surmounted. In the absence of statistical data on municipal services, the opinions of correspondents in the individual states have been relied upon.

After the one per cent limitation in Ohio be-

²⁹Don. C. Sowers, *The Effect of Tax Limitation Upon State and Local Governments in Colorado*, University of Colorado, Boulder, 1936, p. 45.

³⁰John F. Sly and George A. Shipman, "Tax Limitation in West Virginia," *Property Tax Limitation Laws*, p. 82.

³¹Sowers, *op. cit.*, p. 26.

³²Sowers, *op. cit.*, p. 37.

³³Virgil Sheppard, "Indiana Tax Limitations," *Property Tax Limitation Laws*, p. 53.

³⁴Sowers, *op. cit.*, pp. 39-41.

came effective (January 1, 1934), all essential local government services except schools had to be curtailed. For a brief transition period even schools were disrupted, but subsequently allocations from the replacement sales tax rescued this governmental function. Drastic reductions in strictly municipal services, however, have continued. Numerous examples could be cited of cities that have been forced to dismiss employees; close fire stations; reduce police and fire forces; and eliminate or greatly reduce street lighting, garbage collection, and health inspection. The procedure of voting bonds for operating expenses (deficiency bond issues) has enabled some municipalities to function at more nearly a normal level, but the delay caused by the necessity of a referendum has hampered the orderly administration of government. Other municipalities, unable to secure the voters' approval of deficiency bond issues, have been seriously crippled.

In West Virginia a widespread breakdown of local government occurred as soon as a State Supreme Court decision made it clear how drastic the limitation measure was. Many cities in the state, particularly the larger ones, promptly admitted their inability to carry on the normal functions of government. Numbers of schools were closed. One city emptied its jails, another dismissed all its employees and closed the city hall, still another continued to function only because sufficient employees volunteered their services. Within a few weeks dozens of other cities, with but meager funds on hand after providing for the year's debt service needs, discharged employees, cut off street lights, reduced fire and police protection, discontinued garbage collection, and eliminated many essential services. Thus the first effect of this financial fiasco was a breakdown of local government and wholesale discontinuance of municipal services. The situation was indeed serious, for the cities had lost 52% of the funds normally used by them to maintain municipal services.

However, the state came to the rescue of the schools, and new state-collected replacement revenues gradually restored school services to approximately their former level, although lower salary schedules for teachers and principals still remain. The state has also taken over the support of roads. But municipalities proper were largely left to their own ingenuity. The early policy of complete surrender was later modified to one of attempting to operate on an emergency basis. This necessarily entailed reductions in the number of employees, salary and wage slashes ranging

from twenty to seventy per cent, complete abandonment of maintenance and repair operations, abolition of welfare departments, drastic curtailment of public health services, relinquishment of control over traffic, deplorable reductions in number and size of street lights, and the crippling of fire protection facilities.

Since 1932 West Virginia cities have either been building up operating deficits and tearing down public confidence in municipal government, or have been operating within strangulation budgets—attended by much citizen dissatisfaction and the destruction of public service morale.⁸⁵

A few cities have been able to function because of profits from municipally owned utilities. A few resorted to consumers' sales taxes; many more to direct service charges for garbage collection, sewers, and even fire and police protection. But all such efforts have netted but a negligible amount of replacement revenue. The West Virginia League of Municipalities estimates that only about 10 per cent of the 1933 service discontinuances have been restored by direct service charges. Tax limitation in West Virginia continues to be a "fiscal nightmare."

In Michigan, while tax limitation has upset fiscal affairs in many communities, the schools have taken the severest blows. Harold D. Smith, Secretary of the Michigan Municipal League, writes:⁸⁶

The impact of the tax-limitation amendment upon the schools has probably been more serious than upon any other unit. . . . It has been necessary to reduce the teaching staffs and shorten the school year, as well as reduce teachers' salaries.

Of the eleven Michigan cities which have adopted the 15 mill limit, some have had to abandon essential municipal services in the struggle to live within the limit. Others have found increased collection of delinquent taxes a revenue "cushion" and have not fared so badly. But now that the incentive to pay accumulated delinquencies has been removed by a State Supreme Court decision, resulting in another postponement of the May tax sale, it remains to be seen what other remedies can be used in the desperate attempt to maintain governmental services. Already steadily increasing liabilities are being accumulated in the

⁸⁵Statement by Hume K. Nowlan, Secretary, West Virginia League of Municipalities, *Another Way to Municipal Chaos*, New York State Conference of Mayors, Albany, 1936, pp. 12-13.

⁸⁶"Tax Limitation in Michigan," *Property Tax Limitation Laws*, p. 68.

way of street maintenance. According to the director of public works in one of these cities, it will soon be necessary to barricade and placard some of the badly neglected streets with a sign reading "Travel at your own risk."

Municipal services in Oklahoma, so far as can be ascertained, have not been materially injured as a result of property tax limitation. Some cities might have been forced to curtail their activities had they not received sufficient revenue from their water departments or light plants to enable them to keep up a full governmental program. One effect of both the original and the 1933 limitation clauses has been the placing of municipally owned utilities on a profit basis.

There have been no important reductions of municipal services in Indiana because of the case with which the statutory limit can be exceeded. In every year except 1932 the average rate for cities has been more than twice the maximum allowed by law. The result has been that municipalities have not, since the first year of the law, found it necessary to reduce services.

Municipal governments in Washington have been affected adversely by tax limitation. The 1934 property tax levy for all cities and towns was 46% under the 1929 levy, and state-collected, locally shared revenues (shares in the gasoline tax and liquor store profits) have offset only about a fourth of the loss.⁸⁷ Cities have enacted business license ordinances and special utility license taxes and transferred earnings of municipal enterprises to the general fund, but these have been inadequate to make up the deficit. Drastic reductions in budgets have been effected, the number of employees and salaries have been reduced and essential functions neglected. The metropolitan centers, in particular, have been seriously affected.

The New Mexico measure has not resulted in any serious impairment of local government services, largely because the 20 mill limit applies only to operating expenses and not to debt service or to certain special levies. In Rhode Island the fact that only a very few cities and towns levy the maximum rate demonstrates that municipal services have not been appreciably affected.

V. Alternative Proposals

THE program of the real estate boards has been outlined and discussed in the preceding chapters. If it is agreed that their proposal is unwise, what are the alternatives? Admittedly there are some over-all property tax limits which are less objectionable. There is less objection to a statutory limit than to a constitutional limit; to a limit of 5% than to one of 1%; to one that allows additional levies outside the limit, upon special authorization of the voters, than to one which allows no such additional levies; and to a limit which excludes prior debt service than to one which includes all debt service.

CONSTITUTIONAL VS. STATUTORY LIMITS

One of the main objections to the proposal of the National Association of Real Estate Boards is that it is to be written into the state constitution. Tax limitation, if it must be adopted, should be by legislative act and not by constitutional amendment. The objections to constitutional tax limitation have been pointed out in Chapter III and need not be repeated at this point. Voters of Georgia, Colorado, and Oregon wisely defeated proposals for constitutional over-all limitations

in November 1936. Unwillingness to open their constitutions to this type of pressure was a major reason for rejection.

OTHER TYPES OF OVER-ALL LIMITS

More flexible over-all limits which allow for the individual needs and resources of municipalities can be devised. One proposal would limit the real estate tax to a certain percentage of the total expenditures of each city or town. Such a limit would not necessarily curtail total expenditures but would prevent the financing of new expenditures solely by means of real estate taxes. Another proposal would restrict property tax levies to the average for the preceding five years, thereby furnishing some protection against further increases in taxation. This proposal might be modified to allow additional levies to the extent of the average tax rate for the preceding five years upon the value of new improvements.

The over-all limit proposal which the Oregon voters rejected in November, 1936, like the two preceding proposals, would have recognized differences between municipalities, but it introduced one additional feature, namely, a sliding scale of reduction. Briefly, the proposal provided for (1) a state tax rate limit declining by one twenty-fifth in each of five successive years and

⁸⁷ Sowers, *op. cit.*, p. 42.

remaining stable thereafter; (2) a tax rate limit for each local government beginning at the rate actually levied in 1935, declining by one twenty-fifth in each of five successive years, and remaining stable thereafter; and (3) additional levies as authorized by the voters.

The distinctive feature about all three of the above proposals is that they contemplate limits which would recognize inherent or long-established differences between individual cities and towns and their expenditure needs. In this respect they are improvements upon the over-all limit advocated by the National Association of Real Estate Boards. All, however, are open to serious objections.

OTHER ALTERNATIVES

Fortunately there are other and less objectionable methods of bringing relief to real estate. More equitable results would be obtained from: (1) Sounder policies for financing capital improvements; (2) improvements in expenditure control; (3) more equitable assessment of property; (4) a general revision of the state's tax structure; and (5) governmental reorganization, both external and internal.

Financing capital improvements. The state and the larger municipal governments should adhere strictly to a pay-as-you-go policy in all periods except depressions. During depression periods, when real estate earnings fall, municipalities would well borrow more heavily and shift the tax burden forward to a different stage of the business cycle. This debt should not only be paid off in good times, but taxes should be sufficient to place most capital improvements on a pay-as-you-go basis. Great savings in interest charges could be effected by such a program.

There are a number of legislative devices which may be used to supplement the slow and uncertain educational process hitherto relied upon in most states for the attainment of this objective. Attention is called to the recommendations of the recent Connecticut Special Tax Commission,¹ and to the Massachusetts and New Jersey local debt laws, which require that, when capital improvements are made, the current budget must include a stated percentage of the cost of the improvement. Unlike tax limits, which weaken or destroy municipal credit, laws of this character conserve credit by controlling its use.

Improved expenditure control. Elimination of

the major portion of waste and inefficiency in local government can be accomplished without "hamstringing" cities and other local units. Experience has shown that true expenditure control must come through legislative and administrative provisions governing local debts and local budgets. The types of debt prohibitions and restrictions needed are known, and several states have already had success with the establishment and supervision of local budgetary practices. Such measures require a careful reappraisal of local government activities, but can be made effective without depriving municipalities of home rule in expenditure matters.

Equitable assessment of property. More scientific assessment of real property would go far toward removing inequalities in assessment as between individual parcels of property. The relief would accrue, of course, not to real estate as a whole, but to individual property owners. Improved assessment of tangible personalty and more effective means of taxing intangible property would, however, lighten the relative burden, and perhaps the absolute burden, upon real estate.

General tax revision. Tax reform can be an orderly, planned process. Many states have achieved notable developments in their tax systems without the pressure of tax limitation. If the real estate interests would work as hard for tax reforms as they have for over-all limits, most of the needed changes could be easily effected. Replacement taxes, such as special taxes on luxury sales (as opposed to a general retail sales tax), higher individual income and inheritance tax rates, new business taxes, net worth taxes, and land value increment taxes, might well be considered as a program of general relief to real estate.

Governmental reorganization. Finally, some economies in local government could be effected through both external and internal reorganization of state and local governments. The general structure of local government must be simplified and each public activity carried on by the unit best able to perform it. There are too many inefficient local governments; some should be abolished, others should modernize their internal organization and procedure. The employment of trained and competent personnel; the adoption of improved audit control, adequate accounting procedures, and centralized purchasing; and a wider use of other business-like methods in government would make real governmental economy possible.

¹Report of the Connecticut Temporary Commission to Study the Tax Laws . . . , 1934, pp. 216-226.

OPINIONS OF EXPERTS

Some of the leading fiscal experts in the United States have suggested alternatives to tax limitation.¹

All of the objectives sought by proponents of property tax limitation have been achieved in most of the progressive American states without resorting to tax limitation and its attendant disastrous effects upon local governments, particularly upon municipalities.

If the purpose of tax limitation is to check or reduce government expenditures, this can only be done by the adoption of effective budget procedure and sound bonding policies. . . . If the problems of real economy and real expenditure control were attacked directly, significant and far reaching economies could be achieved. The technique of securing real economy and efficiency in the operation of government has been known and has been applied with outstanding success in many state and local governments during the past 25 years.—*Don C. Sowers, Director, Bureau of Business and Government Research, University of Colorado.*²

I am confident that in the long run a more effective control over expenditures can be achieved by a proper and orderly system of accounting, budgeting, auditing, and reporting, supplemented by as wide a distribution of direct tax burdens as possible, than can ever be effected through arbitrary limitations on revenue.—*Benjamin P. Whitaker, Research Director, Connecticut Special Tax Commission.*³

Tax limits strive to limit income from a particular source and thus attempt to solve by indirection the real cause of the trouble—the excessive expenditure of public funds. Such expenditures derive from the following principal sources—

a. Public debt.

b. Mandatory operating costs.

c. Controllable operating costs.

If public debt is responsible for excessive taxation, the indebtedness should be limited and not the ability to pay such debt. The fact that the antiquated debt limitation laws which apply in New York State have not been effective in accomplishing this, is not a sufficient answer as effective laws can be written.

If mandatory operating costs are responsible for excessive taxation, the proper procedure is to attack the question directly rather than undermine the structure upon which a good government and credit is built.

If controllable operating costs are responsible, modern budgetary legislation and suitable supervision of budgets is the best means of assuring the desired economies.

Tax limits do not of themselves bring reforms in operations or economies in government. They do, on occasions, serve as an expedient in forcing other forms of taxation with the result that the final aggregate cost of government to the citizens is higher than before, because operating costs are not reduced and all new borrowing is at a substantially higher rate.—*John S. Linn, Vice President, Chase National Bank, New York City.*⁴

"What a pity so much energy could not have been devoted to an intelligent effort to improve state and local fiscal systems."—*Simeon E. Leland, Chairman, Illinois Tax Commission.*⁵

The ills in local government admittedly are many. Progress in improved administration is being made. But the above fiscal doctors and others will testify to the fact that no panacea has yet been found. Certainly, it does not lie in an inflexible over-all constitutional tax rate limit.

VI. Ascertaining the Effects of a Given Proposal

THIS pamphlet has been addressed to the over-all tax limit advocated by the National Association of Real Estate Boards and is therefore general in application. Proposals in individual states vary widely, and citizens, finance officers, and other public officials will want to ascertain the probable effects of these specific proposals. This chapter presents a method of approach which can be used either by one studying the effects on a state-wide basis or by one interested in a single municipality. An analysis of the first type might be profitably undertaken by a state municipal league or by a

state chapter of the Municipal Finance Officers Association, and one of the second type by a local official or private citizen. At the end of the chapter an actual example is given to show the computation of the effects of a proposed over-all tax limit upon the finances of a single city.

In order to ascertain how a proposal will work out on a state-wide basis, three analyses should be made:

(1) Estimate the effects of the proposal upon city, village, and other local government finance within the state;

¹"Expenditure Control vs. Tax Limitations," *New Jersey Municipalities*, Feb. 1936, p. 23.

²"Probable Effects of Tax Limitation in Illinois," *Nation Municipal Review*, Nov. 1935, p. 655.

³*Op. cit.*, pp. 62-63.

⁴*Property Tax Limitation Laws*, p. 16.

(2) Examine the actual results in states which already have over-all limits comparable to the proposed limit;

(3) Attempt to estimate the probable effects of replacement taxes upon municipal finance and upon certain economic groups within the state.

PROBABLE EFFECTS UPON LOCAL FINANCE

In determining the probable effects of a proposed over-all limit upon local government finance, the first step is to estimate the reduction in property taxes which would be effected. This can be done roughly for the state as a whole by multiplying the proposed over-all rate by the total assessed valuation and subtracting the product from the total amount of property taxes now levied. This will be approximately the amount of reduction necessary if all debt service is within the proposed limit. If interest and principal payments on prior debt can be made outside the proposed limit, the amount of all such payments chargeable to property taxes, as last reported for all levels of government, should be deducted from the preceding figure. The estimate so made will be comparatively accurate if there are no important portions of the state in which the proposed over-all rate exceeds the rate at which property is now taxed for all purposes, or for all purposes except prior debt service if the limit does not apply to such service.

It will probably be desired, however, to make a more accurate state-wide estimate and also to make estimates for individual cities within the state. The following steps are suggested:

1. Secure the total tax rate on property within each incorporated city (town or village) within the state. This rate should be made up of the state rate, the county rate, city rate, the school district rate, and any other special district rates. If there are two or more school or special districts within the city, get an average rate by adding their levies and dividing by the total assessed valuation of the city.

2. If prior debt service is not subject to the limit, the next step is to secure the total property tax rate required within each city for this purpose. Only debt payable out of property taxes by the several levels of government should be considered in this connection. Payments on revenue or special assessment bonds, temporary loans incurred and retired in the same year, and state debt payments financed by other revenues are the principal examples of items which should not be included. If the amount of levy for debt service,

but not the tax rate for that purpose, is available, the levy can be translated into a rate by dividing it by the total assessment for the area over which the rate applies.

3. The difference between the present rate in a city and the maximum allowable rate under the proposal (assuming that the present rate is the higher) may be called the "deficiency rate." This deficiency rate can be computed for each city from the total of the tax rates for all levels of government, or from the total of these tax rates minus debt service rates as indicated above.

4. The deficiency rate may be translated into a deficiency amount by multiplying the rate by the city's assessed valuation. If the method outlined in this chapter is extended to all areas outside cities, deficiency amounts may be totaled to determine with considerable accuracy the total deficiency for the state.

5. It is ordinarily impossible to tell how the deficiency within any city will be shared with the various overlapping districts. Unless the tax limitation measure is specific in this respect, some assumptions will have to be made at this point. It may appear reasonable, for example, to assume that the state will abandon the property tax entirely, and that any remaining deficit will be shared by local governments in direct proportion to their present tax rates. In any case, the deficiency amount should be apportioned on some basis to the various overlapping governments.

6. The deficiency amount for the city may now be compared with present revenues from property taxes, with the total city budget, or with those portions of the budget which are more or less flexible. The last mentioned comparison is one of the best. It demonstrates the extent to which losses will be sustained in certain current services and in capital improvement programs. These losses will be the greater because there are some items in the budget, such as interest, principal of indebtedness, and pensions, which are not reducible even in the face of drastic property tax reductions.

7. As these various data are computed, they should be tabulated in convenient form. The table captions will depend upon the form in which necessary data are available, but the following suggestions may be helpful:

1. Name of city.
2. Assessed valuation of city.
3. Property tax rates.
 - a. State.
 - b. County.
 - c. City.

- d. School district.
- e. Other special districts.
- f. Total.
- 4. Debt service payable out of property taxes (expressed as a tax rate).¹
 - a. State.
 - b. County.
 - c. City.
 - d. School district.
 - e. Other special districts.
 - f. Total.
- 5. Tax rate subject to limitation (this is item 3f if all debt service is within the limit, or item 3f minus item 4f if not).
- 6. Deficiencies.
 - a. Rate (item 5 minus proposed over-all rate).
 - b. Amount (item 6a times item 2).
- 7. Apportionment of deficiency amount.
 - a. State.
 - b. County.
 - c. City.
 - d. School district.
 - e. Other special districts.

8. Some of the results might also well be presented in frequency distributions, as illustrated below. This device would be particularly useful for showing the following:

- (1) Present total tax rates on property in each city. The reader could readily see therefrom how many cities would have to slash their budgets.
- (2) Deficiency rates. Such a frequency distribution would emphasize how drastic the budgetary cuts would have to be.
- (3) Percentage reduction in flexible items of the budget. This would show how the deficiency rates would affect municipal services.

The following frequency distribution of tax rates which must be brought within the proposed over-all limit is submitted to illustrate the makeup of a frequency distribution. These are Massachusetts figures to show the effect of a proposed 2½% (\$25 per \$1,000) over-all limit. This table indicates at a glance that only 54 out of a total of 355 towns and cities could operate under the proposed \$25 limit without cutting their budgets.

COMPARISON WITH TAX LIMIT STATES

The amounts by which local budgets have to be cut and what items would have to bear the brunt of the slashes will have been calculated by use of the method described above. But there are

¹These data are not required if all debt service must be held within the proposed limit.

TABLE 6. FREQUENCY DISTRIBUTION: TOTAL TAX RATES IN MASSACHUSETTS TOWNS AND CITIES, 1934

Tax Rate	No. of towns and cities	Cumulative total
\$10.00 to \$14.99	3	3
15.00 to 19.99	9	12
20.00 to 24.99	42	54
25.00 to 29.99	72	126
30.00 to 34.99	124	250
35.00 to 39.99	62	312
40.00 to 44.99	38	350
45.00 to 49.99	4	354
50.00 to 54.99	1	355

Source: *Annual Report of the Commissioner of Corporations and Taxation, 1934*, pp. 261-26.

many other results of an over-all tax limit which cannot be measured mathematically, such as effects on assessment practices, loss of municipal services, and the kinds of replacement taxes that would be adopted. These results can only be predicted by studying the experience of states which already have over-all limits.

But in drawing deductions from Chapter IV of this study as to the probable effects of a proposal, it must be remembered that over-all limits vary in a number of respects.

1. A so-called over-all limit may exclude certain taxing districts, such as home rule cities in Michigan.

2. Debt service may be within the limit or outside the limit. The former is, of course, a much more drastic measure.

3. The over-all limit (so-called) may apply to all property; to real estate and tangible personalty only; to real estate only; or property may be classified and different over-all rates applied to each class, as in West Virginia.

4. Over-all tax limit rates vary considerably. Obviously it would be unfair to compare the effects of a 5% rate with those of a 1% rate.

5. Whether additional levies outside the limit can be authorized is also an important difference.

With these variations in mind, one should attempt to find a state where the over-all tax limit now in operation agrees in its main particulars with the proposal to be analyzed. Lessons may be drawn from that state's experience. But if differences between the proposed limit and limits actually in operation are wide, the experience in other states may not be very helpful.

Moreover, if a state is found whose limit closely approximates the limit being proposed, at least

one precautionary step should be taken. Compare the actual deficiency rates which occurred in that state with the expected deficiency rates in your state. Two over-all limits might be the same, yet one might force a more drastic reduction than the other because of a higher level of rates when the over-all limit went into effect. Furthermore, the effects on individual cities cannot be judged by state-wide comparisons.

EFFECTS OF REPLACEMENT TAXES

Some of the more important results of an over-all limit flow from the character and incidence of the taxes adopted to offset the reduction in property tax revenues. How far can one go in estimating the probable effects of replacement taxes?

1. The first step is to ascertain how much replacement revenue will be necessary. This requires calculation of the probable loss in property tax revenues by one of the methods set forth above.

2. The field of possible replacement taxes should next be canvassed in order to find one or more which would yield sufficient replacement revenue. Or it may be determined that increases in rates of taxes already in operation would partially or wholly fill the gap.

3. The feasibility, the character, and the incidence of possible replacement taxes should next be examined. Repeated failures of income tax proposals in a given state, for example, might dictate the conclusion that it was not likely that an income tax would be adopted as a replacement tax. The character and the incidence of certain other more feasible replacement taxes are well enough known so that it could be concluded whether they would be desirable tax changes or not.

4. If it seems likely that the most common replacement tax—the retail sales tax—would be used, then by all means the probable sales tax rate should be computed. The method is fairly simple. The amount of replacement revenue needed will already have been calculated. Ascertain from the *Retail Census for 1933* the volume of retail sales in your state.² This figure may be adjusted to 1937 conditions by using the department store sales indexes reported in the monthly bulletin of your Federal Reserve Bank. Then divide the volume of adjusted sales into the needed replacement revenue amount. The quo-

tient will approximate the retail sales tax rate that must be adopted.

5. Next, estimate the effect of such a retail sales tax upon the average small home owner's budget and the average renter's budget. For a representative group of cities and villages in the state, secure, if possible, the following information:³

- (a) Average value of one-family, owner-occupied dwellings and the average value of one-family, rented dwellings.
- (b) Average assessed valuation of each of the above types.
- (c) The average annual rental per dwelling unit, in the case of rented dwellings.
- (d) The owner-occupiers' average annual income and the tenant families' average annual income.

With the above information, use the following procedure in showing the effect on the average owner-occupier of an over-all limit and a retail sales replacement tax. Estimate from the assessed valuation and present tax rates the property tax reduction which would accrue by virtue of the over-all limit. Apply the sales tax rate to two-thirds of the owner-occupier's income and see how much sales tax he will have to pay.⁴ Then compare his property tax reduction with his estimated sales tax burden.

The procedure varies but slightly in calculating the effects on the average renter's budget. Estimate from the assessed valuation the property tax reduction which will accrue to the owner of an average rented dwelling unit. Assume that this tax reduction will, in whole or in part (depending upon the supply and demand for rented homes), be passed on to the tenant in the form of a rent reduction. Apply the sales tax rate to two-thirds of the average renter's income, and see how much sales tax he will have to pay. Then compare his probable rent reduction with his added sales tax burden.

Finally, some thought must be given to the probable allocation of replacement revenues as between the various levels of government. The experience in several states (particularly Ohio and West Virginia) has been that the schools and counties have secured the lion's share. City and

³Some of this information can be obtained from *The Financial Survey of Urban Housing*, (in course of publication) U. S. Department of Commerce. In computing averages, it is suggested that the median be used in preference to the arithmetic mean.

⁴The figure "2/3" is used as a fair estimate of the proportion of the average home owner's income spent on goods ordinarily subject to a sales tax.

²See *United States Summary Of The Retail Census For 1933*, U. S. Department of Commerce, Washington, 1934. A later census of retail sales is now being compiled.

TAX LIMITS APPRAISED

village officials in a state where an over-all tax limit is being proposed should consider ways to forestall this unfortunate situation.

Municipal financial statistics in many states are not gathered and published on a state-wide basis. Consequently conclusions may have to be drawn from a representative sample of cities. This is a valid statistical procedure. Care must be taken that the sample is large enough and that the cities are representative.

EXAMPLE FOR A SINGLE CITY

The analysis which should be undertaken to show the effects of an over-all limit upon a single municipality is identical with the foregoing. For purposes of illustration, let us consider the effects upon the city of Melrose, Massachusetts of a proposal which is now under consideration in that state. The proposed limit is \$25 per \$1,000 assessed valuation and includes levies for all debt service. The tax districts which overlap the city are the county and the state, both of whose rates are covered in the city rate and whose taxes are paid out of the city budget. It has been assumed, for lack of evidence to the contrary, that the state and county rates would not be reduced by the

proposed limit, so that its full effects would fall upon the city. This assumption may require modification elsewhere. The order of arrangement is that suggested above for the state-wide analysis table.⁵

1. City—Melrose, Massachusetts.
2. Assessed valuation (1936)—\$36,656,250.
3. Total tax rate (1936)—\$32.00 per thousand.
4. Tax rate for debt service—(not required).
5. Same as item 3.
6. Deficiency under proposal.
 - a. Rate (item 3 less \$25.00)—\$7.00.
 - b. Amount (item 6a times item 2)—\$256,594.
7. Apportionment of deficiency amount.
 - a. State—none.
 - b. County—none.
 - c. City—\$256,594.

In this particular city, a reduction of \$256,594 in property tax receipts means a reduction of flexible items of the budget by about one-third. (See Appendix.)

⁵The Appendix contains the original computation as made by City Auditor G. B. Wardwell. It well illustrates how a local finance officer can compute the effects of over-all tax limitation upon his own municipality.

Appendices

I. EFFECTS OF A PROPOSED OVER-ALL LIMIT UPON MELROSE, MASSACHUSETTS

The following letter, addressed to the Editor of the *Melrose Free Press* by City Auditor G. B. Wardwell, is an excellent example of the type of data which can readily be compiled by any local finance officer for the information of the public.

October 27, 1936

To: Editor
Melrose Free Press.

Dear Sir:

I have been requested by many citizens of Melrose to state briefly what effect a \$25.00 over-all tax limit would have on the City of Melrose, and I would appreciate your publishing the following for the benefit of those who might be interested.

The following figures are a comparison of the 1936 tax rate of \$32.00 and the resultant figures had a \$25.00 over-all tax limitation been in effect in 1936.

In reviewing the expenditures of any municipality there are certain so-called "fixed charges" over which the cities and towns have no direct control. The following items, in my opinion, represent such "fixed charges" as was raised by taxation in 1936:—

State and County Taxes.....	\$145,332
Bonded Indebtedness	101,733
Interest	36,684
Public Welfare	84,773
Soldiers' Benefits	30,331
Pensions	13,350
Total	<u>\$412,203</u>

Under the \$32.00 tax rate there was raised by taxation the following amounts:—

On Real and Personal Property Valuation of \$36,656,250 at \$32.00 per thousand	\$1,173,000
On Polls	15,154
Total Amount Raised	<u>\$1,188,154</u>
Deducting fixed charges as above....	<u>412,203</u>

Amount available for Other City Depts. \$775,951

Applying an "over-all" limit of \$25.00 the following would have been the result for 1936:—

On Real and Personal Property Valuation of \$36,656,250 at \$25.00 per thousand	\$916,406
On Polls	15,154
Total Amount Raised	<u>\$931,560</u>
Deducting fixed charges as above....	<u>412,203</u>

Amount available for Other City Depts. \$519,357

The following table shows the amounts available to operate various City Departments with the \$32.00 tax rate and the amounts that would be available under a \$25.00 "over-all" tax limit.

	With a \$32 Rate	With a \$25 Rate
Education (Schools)	\$285,089	\$190,810
Protection of Life and Property (Police and Fire)	141,864	94,950
Highways	96,726	64,739
Health and Sanitation	63,170	42,297
General Government	89,299	59,770
Recreation	23,039	15,417
Public Service (Water)	23,221	15,542
Overlay for abatements	15,660	10,481
Libraries	14,034	9,393
Reserve for Contingencies	10,003	6,695
Cemeteries	13,846	9,263
Totals	<u>\$775,951</u>	<u>\$519,357</u>

From the foregoing, it will be noted that under the \$25.00 "over-all" tax limit, there would be a reduction of 33% (plus) in the amounts available for the operation of City Departments. Were this reduction spread equally over all departments it is very evident that the services rendered to the taxpayers would have to be drastically curtailed.

The service now rendered for the collection of ashes, rubbish and garbage, the removal of snow from streets and sidewalks and other similar services undoubtedly would have to be paid for directly by each resident. The care and maintenance of streets, sidewalks and sewers would be neglected while water service and street lighting would be greatly reduced.

Considering first the largest department in our city i.e. that of Education:

Of the amount of \$285,089 raised under the \$32.00 rate the sum of \$251,620 was for salaries. This latter amount is \$60,810 greater than the total appropriation for Education under a \$25.00 "over-all" rate. We would therefore be forced to pay inadequate salaries and our educational system would soon become very inferior to that of other states having no tax limit.

The second largest item of City Departments is that of Protection of Life and Property which, under the \$32.00 rate, is \$141,864, while under the \$25.00 "over-all" limit there would be available \$91,950.

Were the activities of our Fire Department curtailed it is my belief that insurance rates would increase to such an extent that the cost of insurance would exceed any savings that might be effected in this Department.

Where a tax limit law has been in operation the chief beneficiaries have been large property owners, non-resident property owners and corporations.

Should such a law be adopted other means of providing funds for the Cities and Towns would have to be found, and the three most prominent methods would undoubtedly be:—Increased Valuations, Increased Borrowings and a General Sales Tax.

The Commissioner of Corporations and Taxation of Massachusetts and the Massachusetts Federation of Taxpayers' Associations have strongly opposed this proposed "Over-all" Tax Limitation.

Very truly yours,
 G. B. WARDWELL, *City Auditor*

TAX LIMITS APPRAISED

II. OVER-ALL TAX LIMITATION LAWS IN NINE STATES

As of January 1, 1937

State	Year First Adopted	Citation to Present Law	Constitutional or Statutory?	Basic Rates	Allocation of Basic Rates Among Tax Districts			
					State	County	Town or City	Other Districts
Indiana	1932	Acts, 1933, ch. 237	S	1.5% in incorporated towns and cities; 1% outside	0.15%	As fixed by county board of tax adjustment, with appeal to state board of tax commissioners		
Michigan	1932	Const., Art. X, sec. 21 (1932); Pub. Acts, 1933, No. 62; 1934, No. 30; 262 Mich. 338, 699	C	1.5%	None	As fixed by county tax allocation board, with appeal to state tax commission		
Nevada	1895	Const., Art. X, sec. 2 (1936); Comp. Laws, 1929, sec. 6524	C	5%	—			
New Mexico	1933	Const., Art. VII, sec. 2 (1933); Comp. Laws, 1929, sec. 141-507 (8)	C	2%	1%	As fixed by state tax commission		
Ohio	1911	Const., Art. XII, sec. 2 (1933); Laws, 1934 (3rd Sp.), H.B. No. 9	C	1%	None	As fixed by county budget commission, with appeal to state tax commission		
Oklahoma	1907	Const., Art. X, sec. 9 (1933)	C	1.7%	None	As fixed by county excise board (0.2% is available only to counties for separate schools for whites and negroes)		
Rhode Island	1878	Acts, 1933, ch. 2028	S	2.5%	None	None	All	None
Washington	1932	Init. Meas., 1936, No. 114	S	4% on 50% statutory assessment level	0.2%	1%	1.5%	School districts, 1%; road districts, 0.3%
West Virginia	1932	Const., Art. X, Sec. 1 (1932); Laws, 1933 (2nd Sp.), H.B.No. 234	C	0.5% to 2%*	0.3% to 0.9%*	0.1565% to 0.625%*	0% to 0.5%*	School districts 0.1885 to 0.785%*

*Cities which have voted to adopt the state-wide over-all limit are: Battle Creek, Belding, Flint, Grand Rapids, Ionia, Jackson, Muskegon, Muskegon Heights, North Muskegon, Pontiac, and Saginaw.

*Akron and Cincinnati not subject to state-wide limit.

*Tax rate limits existing prior to the 1933 amendment were: State, 0.35%; county, 0.8%; township, 0.5%; city or town, 1.0%; school district, 0.5%; total 3.15%. Additional rates were permitted for schools (1.0%) and for public buildings (0.5%).

*An additional rate, not to exceed 5 mills or the amount necessary to prevent impairment of contracts, whichever is larger, may be imposed for service of general obligation bonds outstanding on Dec. 3, 1936. An additional rate of unlimited amount may be imposed by any district other than the state for service at the rate

provided by statute of any warrants outstanding on December 8, 1932.

*Rates vary with type of property and its location as follows: Class I—Intangible property and personal property used in agriculture, 0.5%; Class II—Homesteads and tenant-operated farms, 1%; Class III—Other property outside municipalities, 1.5%; Class IV—Other property within municipalities, 2%.

*With the approval of the tax commissioner, any tax district not requiring the full amount of the rates available to it for payment of contractual indebtedness outstanding on Nov. 8, 1932 (state, .02% to .08%; counties, .0625% to .25%; school districts, .03% to .12%; municipalities, .0375% to .15%) is to extend such excess to the next smaller tax district within its boundaries to be used solely for the payment of contractual indebtedness outstanding on Nov. 8, 1932. If such requirements of all lesser tax districts of the same class are so met, any excess is then extended to the next larger

II. OVER-ALL TAX LIMITATION LAWS IN NINE STATES (Continued)

As of January 1, 1937

Additional Rates Requiring No Special Authorization	Additional Rates Requiring Special Authorization			Tax Districts Not Subject To Limit
	Amount	Authorizing Agency	No. Years to Which Authorization Applies	
Rates necessary for service of debts outstanding Aug. 8, 1932, and for judgments	Unlimited for emergency purposes of local governments	5/7 of members of county board of tax adjustment	1	None
Rate necessary for service of debts outstanding Dec. 1932	3.5%	2/3 of electorate voting on proposition	Not more than 5	Cities and villages subject to different over-all rate limit by charter provision ¹
None	None	—	—	None
Rate necessary for service of any debts; special levies on specific classes of property	Unlimited provided enabling legislation is passed	Majority of electorate voting on provision	Not specified	None
Rate necessary for service of debts issued or authorized prior to Jan. 1, 1934, provided they were issued or authorized outside the former 1.5% limit	Unlimited except for statutory limits for special expenditures	For current school expenses and certain debt service, majority of electorate voting on proposition; for other purposes, 65% of electorate	Not more than 5, except in case of debt service, not more than life of indebtedness	Incorporated municipalities subject to different over-all rate limits or to rate limits for operating expense by charter ²
Rate necessary for service of debts outstanding on Aug. 15, 1933, within such limits as existed prior to said date ³	1% for school purposes	Majority of electorate casting ballots	Not specified	None
Rate necessary for service of any debts	Unlimited	State budget director upon petition of town or city council	1	Special districts
Rate required for service of specified debts ⁴	Unlimited for counties and other local tax districts	60% of those voting on proposition, provided at least 40% as many vote as voted for governor at last election	1	Port districts; special tax districts not coterminous with a county other than road and school districts
Excess of rates required for service of indebtedness outstanding on Nov. 8, 1932 over 30% of basic rates. ⁷	50% of basic rates	2/3 of qualified electorate	Not more than 3	None

tax district and used by it in the same manner as if originally available to it for payment of contractual indebtedness outstanding on Nov. 8, 1932. If, in passing on an excess, two or more tax districts

are within the class entitled to receive it, the tax commissioner may apportion it among them. Tax rates originally available to tax districts by classes of property are as follows:

	Class I		Class II		Class III		Class IV	
	Prior debt	Other purposes	Prior debt	Other purposes	Prior debt	Other purposes	Prior debt	Other purposes
State	.02%	.01%	.04%	.01%	.08%	.01%	.08%	.01%
Counties	.0625	.0940	.125	.187	.25	.375	.25	.375
School districts	.03	.1585	.06	.328	.12	.665	.12	.665
Municipalities	.0375	.0875	.075	.175	—	—	.15	.35
Total	.15	.35	.30	.70	.45	1.05	.60	1.40

¹ This additional levy requires approval of tax commissioner. Additional levies are made in the following ratios: Class I, 1%; Class II, 2%; Class III and IV, 4%.

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II. OVER-ALL TAX LIMITATION LAWS IN NINE STATES (Continued)

As of January 1, 1937

Additional Rates Requiring No Special Authorization	Additional Rates Requiring Special Authorization			Tax Districts Not Subject To Limit
	Amount	Authorizing Agency	No. Years to Which Authorization Applies	
Rates necessary for service of debts outstanding Aug. 8, 1932, and for judgments	Unlimited for emergency purposes of local governments	5/7 of members of county board of tax adjustment	1	None
Rate necessary for service of debts outstanding Dec. 1932	3.5%	2/3 of electorate voting on proposition	Not more than 5	Cities and villages subject to different over-all rate limit by charter provision ¹
None	None	—	—	None
Rate necessary for service of any debts; special levies on specific classes of property	Unlimited provided enabling legislation is passed	Majority of electorate voting on provision	Not specified	None
Rate necessary for service of debts issued or authorized prior to Jan. 1, 1934, provided they were issued or authorized outside the former 1.5% limit	Unlimited except for statutory limits for special expenditures	For current school expenses and certain debt service, majority of electorate voting on proposition; for other purposes, 65% of electorate	Not more than 5, except in case of debt service, not more than life of indebtedness	Incorporated municipalities subject to different over-all rate limits or to rate limits for operating expense by charter ²
Rate necessary for service of debts outstanding on Aug. 15, 1933, within such limits as existed prior to said date ³	1% for school purposes	Majority of electorate casting ballots	Not specified	None
Rate necessary for service of any debts	Unlimited	State budget director upon petition of town or city council	1	Special districts
Rate required for service of specified debts ⁴	Unlimited for counties and other local tax districts	60% of those voting on proposition, provided at least 40% as many vote as voted for governor at last election	1	Port districts; special tax districts not coterminous with a county other than road and school districts
Excess of rates required for service of indebtedness outstanding on Nov. 8, 1932 over 30% of basic rates. ⁷	50% of basic rates	2/3 of qualified electorate	Not more than 3	None

tax district and used by it in the same manner as if originally available to it for payment of contractual indebtedness outstanding on Nov. 8, 1932. If, in passing on an excess, two or more tax districts

are within the class entitled to receive it, the tax commissioner may apportion it among them. Tax rates originally available to tax districts by classes of property are as follows:

	Class I		Class II		Class III		Class IV	
	Prior debt	Other purposes	Prior debt	Other purposes	Prior debt	Other purposes	Prior debt	Other purposes
State	.02%	.01%	.04%	.01%	.08%	.01%	.08%	.01%
Counties	.0625	.0940	.125	.187	.25	.375	.25	.375
School districts	.03	.1585	.06	.328	.12	.665	.12	.665
Municipalities	.0375	.0875	.075	.175	—	—	.15	.35
Total	.15	.35	.30	.70	.45	1.05	.60	1.40

¹ This additional levy requires approval of tax commissioner. Additional levies are made in the following ratios: Class I, 1%; Class II, 2%; Class III and IV, 4%.

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