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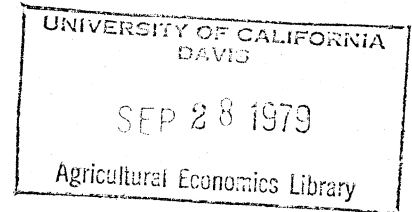
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Taxing
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STAFF PAPER



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A HALF CENTURY WITH PROPOSITION THIRTEEN

Dale Colyer

A background paper prepared for the organized symposium on "The Impacts of the Proposition 13 Movement" for the annual meeting of the American Agricultural Economics Association, Pullman Washington, July 31-August 3, 1979.

Agricultural Economics
College of Agriculture and Forestry
West Virginia University
Morgantown, WV 26506

A HALF CENTURY WITH PROPOSITION THIRTEEN

Dale Colyer

In 1932, the West Virginia Legislature adopted and in a referendum the voters approved a Tax Limitation Amendment (TLA) to the State Constitution, which had features similar to California's Proposition 13. While the economic situation at the time and in the State were very different than in California in 1977, a study of the long run impacts of the TLA can be useful in helping understand and cope with problems that arise. The major impacts of the TLA were on services, other taxes, and the transfer of functions from local government units to the State. These will be examined after a brief discussion of the TLA.

The Tax Limitation Amendment

The economic situation in 1932 was one of severe depression, unlike the prosperity which characterized California and the nation in the 1970's. The inability of people to pay their property taxes led to the adoption and passage of the West Virginia TLA. Under the depression conditions existing in the 1930's, there were high unemployment rates and sharply reduced levels of incomes. Local governments and schools, however, were forced to attempt to maintain high rates of taxation to meet their debt obligations and carry out governmental and educational functions. The maintenance of taxes combined with reduced incomes meant increased tax delinquencies and the sales of property for taxes. The TLA was developed to reduce the incidence of such tax sales.

The West Virginia amendment classified property into four categories and established a maximum tax rate for each class (West Virginia Tax Laws). Class I property consists of intangibles and farm personal property and the maximum tax rate is \$0.50 per \$100 dollars of value. The second, Class II, consists of farm real estate and owner occupied residences and the maximum rate is \$1.00 per \$100 of value - the same rate as under Proposition 13. Class III is all other property outside of municipalities and Class IV is all other property within municipalities. The maximum rates for Classes III and IV are, respectively, \$1.50 and \$2.00 per \$100 value. The amendment also allows special levies to be voted but these cannot exceed one half of the basic rate for each class of property. 1/

A unique feature of the West Virginia measure is, then, the classification of properties. It, essentially, allows for a higher tax rate on businesses than on individually owned properties. The Class IV category allows incorporated areas to raise some of the additional revenue needed for operations of the municipalities.

Impacts of the TLA

The impacts of the TLA on local and state governments in the 1930's were immediate and severe, but also have continued to affect governmental operations. Through time, however, procedures were developed to mitigate many of the effects. At the time the TLA was ratified, the State and local government units were already having difficult financial problems, there was no large surplus as existed in California when Proposition 13 was passed. Thus, an immediate impact in West Virginia was a virtual disruption of local government activities, especially since the courts ruled that the limit applied to all taxes including service on existing debt (Shamberger and Thompson). In many counties, debt service absorbed most or all of the taxes collected and left nothing to operate the government.

With time, however, the immediate effects were overcome. The current interest is on the longer run impacts of limiting property tax rates. Three broad categories of impacts are identifiable. First, the levels of services were curtailed and still lag behind those in other states. Second, there has been a substitution of other taxes and fees for property taxes to raise revenue for carrying out government services. Finally, there has been a transfer of functions and finances from local governments to the state. This latter was particularly strong for some county level functions.

Reduction in Services

Analysis of the impacts of the TLA on the provision of public services in West Virginia is complicated by the economic situation. Between the early 1950's and 1970's the economy of the State was depressed due to the decline of coal, its major industry, and to a rapidly declining agricultural sector because mechanization was not adaptable to the States terrain. Thus, while services certainly lagged in West Virginia during those years, the effects of the limitation amendment cannot easily be separated from those of the depressed economic situation.

Shamberger and Thompson documented that there had been a reduction in services, especially municipal services, between 1932 and 1952. Proponents of the TLA had claimed that there would be no effect on services, that cutting waste and inefficiency could enable services to be continued without significant changes. However, services were reduced and many have remained at reduced levels to the present, although Federal aid and the revival of the State's economy have helped reduce the gap (see the report by Mountaineers for Rural Progress for a discussion of some aspects of these reduced levels of services).

During the year ended June 30, 1977, state and local taxes in West Virginia were \$622.38 per capita, 38th among the 50 states (Book of the States). In addition, about 90% of the State and Local taxes are State in West Virginia compared with about 68% for all states. Since the levels of local services should be positively correlated to tax collections, it can be deduced that local government services are less adequately financed than in most other states. The state government does support some services not provided by many other state governments, but overall services appear to less than typical.

Data in Table 1 show per capita expenditures by the larger

Table 1. Per Capita Expenditures on Selected Public Services in Larger W. Va. Municipalities.

Service	1929	1939	1950	1955	1964	1969
Police & Fire	\$4.74	\$4.31	\$7.62	\$11.69	\$21.73	\$28.13
Sewage & Sanitation	NA	NA	NA	12.19	19.52	18.85
Streets & Highways	NA	NA	NA	12.98	10.41	13.89
Total Outlays	\$16.04	\$10.92	\$26.13	\$56.18	\$90.90	\$134.58

Source: County and City Data Book and Audit Reports of W. Va. Municipalities.

municipalities in W. Va. on selected public services. Total expenditures rose substantially from 1950 to 1969 as did those for some services such as police and fire protection. For other services, however, per capita expenditures increased very little and not at all in real terms. Substitute sources of funds have permitted some increased services in recent years, but many are still minimal.

Services by the Counties in West Virginia were reduced after the Tax Limitation Amendment due to lower tax revenues and as some functions were shifted to the State. Until the 1970's, county functions were largely limited to the traditional county office functions of the sherrif, assessor, county clerk, and county judges (commissioners). In most counties, pay levels were low and budgets limited the activities that could take place. The State, for example, had to pay for most of the cost of reappraising real estate for property tax assessments during the 1960's. Federal revenue sharing funds and a sharing by the State of an increase in the tax on coal have increased county budgets in recent years and consequently some services have been expanded in many counties.

The other primary beneficiary of the property tax is the public school system. Under the distribution formula for property taxes, the County Schools get about 50 percent of the taxes (46 percent of those collected inside of municipalities and 61 percent of those outside). In most counties, excess levies raise additional revenue for schools, but these must be voted on every five years and approved by 60 percent of the voters. However, they result in about 70 percent of all property tax revenues being used for the schools (West Virginia Tax Laws). 3/ As a result of the loss in revenue the schools suffered from the TLA, the State increased aid to the schools. For the first several years, state aid to schools was larger than in most other states and this tended to keep up school expenditures. In the 1950's, state aid to the schools was still larger in West Virginia than for the average of all other states (Table 2). By the 1960's, however, most other states were giving greater aid to their schools than West Virginia.

Table 2. Per Capita State Expenditures on Schools

	1949-50	1955-56	1959-60	1965-66	1969-70	1975-76
West Virginia	\$30.57	\$39.58	\$84.11	\$138.83	\$226.98	\$377.18
South Atlantic States	23.93	41.24	86.74	144.63	236.32	409.22
All States	20.82	34.75	164.00	169.95	259.43	452.89

With lower local property taxes being paid for the schools and lower levels of state aid, it appears that school services probably declined relative to those in other states. The quality and amounts of school services can not, of course, be equated precisely with money spent on them. However, there are other indications of the effects including the age and lack of maintenance of many of the buildings, low levels of pay for teachers and other school employees, a lack of low level of enrichment programs, etc. The early childhood program (kindergarten), for example, was not included in public schools until the 1970's. Despite this, West Virginia test scores of high school students in the State have continued to improve and West Virginia students do about as well on national performance tests as the average for the U.S. (West Virginia State-County Testing Program).

Substitute Tax Sources

The reduction in property tax revenues was immediate and severe. However, the combined total of state and local tax revenues and government expenditures soon increased back to original levels. Subsequently these have increased in this state as in others although

the total per capita taxes and expenditures in West Virginia remain one of the lower ones in the Nation. To make up for the loss of property taxes, other taxes were either raised or instituted. The tax limitation amendment specifically provided for the imposition of an income tax, but except for a brief period in the late 1930's was not implemented until the 1960's.

In the years immediately following ratification of the TLA, the more important sources of increased state revenue were from increases in the classified business and occupational tax (B&O) and the gasoline tax plus the imposition in 1933 of a general 2 percent sales tax. The B&O tax is a gross receipts tax with different rates applied to different types of businesses. A small net income tax was passed in 1935 and repealed in 1943. Finally, a progressive income tax was passed in 1961. License fees, tobacco and alcohol taxes, a beverage tax, privilege taxes and numerous other minor taxes also are used to raise revenue. ^{2/} In addition, the state operates a monopoly on alcoholic beverages (except beer) through the operation of state owned package stores which raises revenue from their profits. The sales tax has been increased to three percent, gasoline taxes to 10.5¢ per gallon, cigarette taxes increased, and the privilege tax on automobile sales raised to 5 percent. Starting in 1979 the sales tax in food is to be eliminated over a three year period.

The distribution of tax revenues by major sources for 1928, 1951, 1961 and 1976 are shown in Figure 1. The shifts in major sources of state revenues are quite striking. These include the virtual elimination of property taxes as a source, the domination by the B&O tax in the middle period and then an increased importance of corporate and personal income taxes. An equally notable change is the increasing importance of Federal Funds - from 6 percent of the total in 1927-28, to 15 percent in 1951, 29 percent in 1976 and 30.6 percent in 1976. Of course, a similar development has occurred in every state.

Municipal governments also were forced to seek other sources of revenue as the property tax made up 75 percent of their revenue prior to the passage of the TLA. For the larger cities, for which data are available, this was reduced to about 32 percent in 1950 and to just over 14 percent in 1975. To make up for lost property taxes the state passed permissive legislation to let municipalities impose various taxes and fees, including a municipal gross sales (B&O) tax which accounted for 21 percent of the municipalities' revenue in 1949-50 but which had declined in relative importance by the 1970's. Other new sources were a liquor tax, utilities franchise tax, and an amusement tax. Fees also are charged for services such as garbage pickup, sewer services, fire services, etc. The State provides for relatively little of the revenue received by the cities and towns, although Federal aid has become a more important source of local revenue since development of the revenue sharing act, CETA and related programs. ^{4/} In 1975 the larger cities (25,000 population or greater) received 22 percent of their revenue from other government units - 88 percent of this was from the Federal

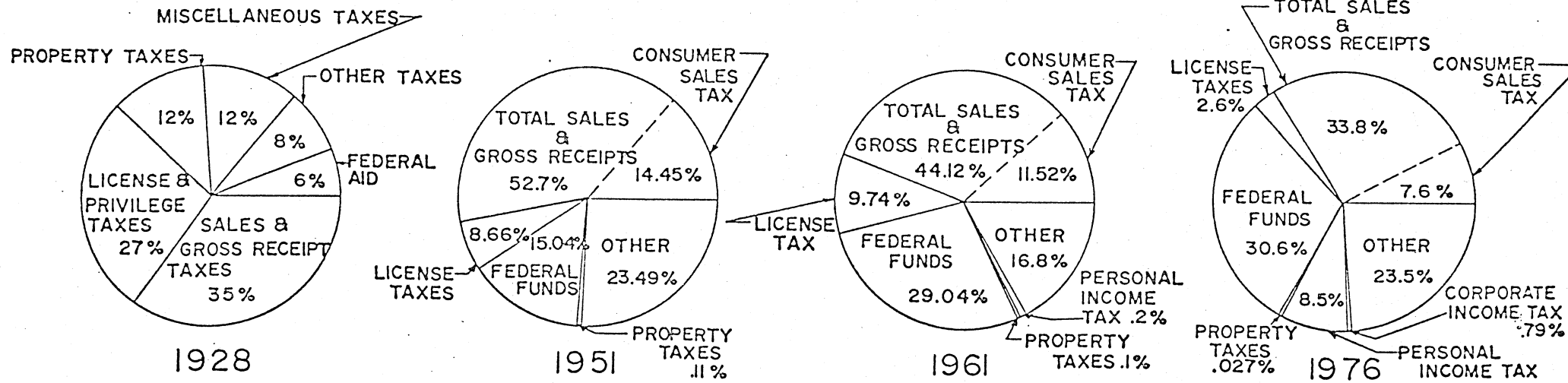


Figure 1. Composition of State Revenue, West Virginia 1928, 1951, 1961, 1976

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government. The cities and towns also depend quite heavily on various kinds of fees and charges, which are not deductible for Federal Income Tax purposes. 5/

County governments did not have the alternative sources of revenue that the cities and towns were permitted to develop. The primary effect on the counties was to reduce services. Some services were taken over by the State, others reduced or eliminated. In recent years, revenue sharing funds plus a sharing by the state of the B&O tax on coal have allowed the counties to expand services. In 1975 the state raised the B&O tax on coal to \$3.85 per \$100 of coal produced. Of the B&O taxes on coal, 35¢ per \$100 value goes to the counties; the largest portion goes to the counties where the coal is produced, but all counties and cities share to some extent (West Virginia Tax Laws).

School revenues were cut with the passage of the TLA. This forced the state to start providing state aid to the primary and secondary schools. Prior to the TLA the state had provided about 6 percent of the public schools support but by 1950 it had increased aid to 60 percent and in the 1978-79 it was 67 percent of the state and local funds - Federal aid also had increased. The State also established a county unit school system in 1933 as an endeavor to increase the efficiency and symplify the process of administering state aid to the local schools. Residents of most counties in the State also have passed special levies every five years to help support the local schools.

Assumption of Functions by the State

The third major impact of the TLA in West Virginia was the assumption by the State of some functions formerly performed locally. Through this procedure the counties, in particular, were relieved of providing services, substantially lessening their revenue needs.

One of the primary functions assumed by the state was the responsibility for building and maintaining the former county-district roads. This meant the incorporation in 1933 of some 30,000 miles of roads into the state system. The state has continued to carryout this function and consequently sustains a substantial financial burden. For many years West Virginia lagged in building interstates, largely due to a lack of funds. By 1976-77 the state owned and maintained some 33,500 miles of secondary roads with a total cost of \$480 million, over 25 percent of the budget. The improvement of the secondary roads system was a major plank in Governor Rockefeller's 1976 election campaign.

As indicated in the preceeding section, the State took over a substantial share of the financial responsibility for the school system and converted the local school districts into county units. Some of the decision making power went with those changes - the State through legislative action, for example, generally decides the size pay raises teachers are to receive.

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A major result of the State assuming so many of the local governmental functions has been a lack of adequate funding for state functions. The financing of local roads drained (and drains) money from that needed for the interstates and other state highways, the financing of local schools left less for colleges and universities, the assumption of local assessment functions by the State Tax Department may have resulted in less funds for other functions.^{6/} Similarly, with State funds limited, any State money spent on functions once supported by property taxes means less can be spent on some other program or it means higher State taxes. Both of these have actually occurred.

Concluding Comments

Several observations can be made from the 47 years of experience with a strict limitation on property tax rates in West Virginia. Perhaps the most important one is that there is relatively little support for eliminating the State's TLA - although several groups do advocate higher property taxes to support schools and other local services. Most of the efforts to raise property taxes focus on such approaches as increasing the assessment rate to 100 percent of the appraised value of the properties, i.e., to raising assessment levels to values more nearly in line with market values. Another approach has been to suggest that large property holders have been treated too favorably and their assessments should be raised - large amounts of land are owned by land holding companies, timber concerns, railroads, mining companies, and others. Mineral rights, in particular, have been assessed and taxed at very low rates in relation to their values - and often have not been taxed at all. However, a reappraisal program, being conducted by the State Tax Department, has raised taxes on minerals substantially. Despite the low property taxes in West Virginia, the State's residents tend to consider their taxes as being too high and any attempt to repeal the TLA would receive little support. Thus, an important observation is that once such a limitation is implemented it tends to become a permanent feature in a state's tax structure.

A second observation is that the governmental system adapts in various ways including reduced services, increases in other taxes, and a shifting of responsibilities among governmental units. As indicated in the analysis, all of these adjustments were made in West Virginia with the State government becoming much more involved in local affairs. County government units lost more functions than either municipalities or schools, because State aid was increased for the schools and the municipalities were permitted to develop alternative sources of revenue. In recent years, there has been a movement to provide better financing and enhance the powers of the counties and other local government units. Substantial amounts of the increased funds for the local units came from Federal sources, but much of the added B&O tax on coal went to counties. This increased the funds controlled by the County Commissioners and enhanced their powers.

The assumption by the State of functions that normally belong to local government increases the burden on State agencies, reducing their financial capability to adequately perform the normal state functions. Thus, the Highway Department's ability to build and maintain the State's main highways is affected by having to build and maintain many thousands of miles of local roads. Although responsibilities for the highways have not been returned to the Counties, some other functions, such as health, transportation, education, planning that were partially assumed by the State have been returned in part to local governments or made regional functions. Thus, the ebb and flow of power, money, and duties are not constant. As circumstances, finances, capabilities, and policies permit the functions assumed by the State or other units of government tend to move back to those units where they are normally performed. The transformation has not been completed and some functions, once transferred, may never be returned to the original jurisdiction.

Finally, although many impacts can be attributed to the TLA, there were many other forces affecting what actually occurred. Some re-enforced the impacts of the TLA - others caused counter actions. The economic situation was of particular significance. Because of the depressed conditions which typified all of Appalachia in the 1950's and 60's, the impacts of the TLA were prolonged and to some extent deepened. If adequate funding had been available from alternative sources, many of the unfavorable impacts probably would have been alleviated much sooner than they were. Furthermore, social and political attitudes and views have helped shape the State's property tax procedures and while not all are unique to the West Virginia they are not identical to those in, say, California. Thus, the West Virginia experience is not a blueprint for other states which have accepted or are on the verge of accepting a proposition 13 type of property tax program. Adaptation to any effective TLA that is implemented is unavoidable, but the actual impacts can vary tremendously - almost infinitely as there are so many variations in what can be done. This examination of the West Virginia experience can be an aid in understanding some of the problems that must be faced, including the longer as well as the shorter run effects, and responses that can be made where limitations on taxes are implemented.

Footnotes

Dale Colyer is Professor of Agricultural Economics and Chairman of the Division of Resource Management, West Virginia University. Helpful reviews of the manuscript were received from Arnold Margolin, Harold Shamberger, and Anthony Ferrise.

- 1/ These may be voted to support schols, libraries and for other purposes. The levies have to be voted on every three years, and must be approved by 60% of the votes. A later amendment provided that school levies must be voted on each five years and can be for 100 percent or more of the basic rates.
- 2/ West Virginia Tax Laws list the following State taxes for the 1977-78 fiscal year: Business Franchise Registration Tax, Corporation Charter Tax, Business and Occupation Tax, Corporation Net Income Tax, Carrier Income Tax, Sales and Use Tax, Personal Income Tax, Inheritance Tax, Gasoline and Special Fuel Excise Tax, Motor Carrier Road Tax, Cigarette Tax, Soft Drink Tax, Property Tax, Property Transfer Tax.
- 3/ Information provided by the State Tax Department indicates that in the most recent year for which data are available the total property taxes in the State were distributed as follows:
- | | | |
|---------------------|---------------|--------|
| Municipalities | \$ 19,274,014 | 7.68% |
| Boards of Education | \$176,865,855 | 70.50% |
| County Government | \$ 53,911,439 | 21.50% |
| State Government | \$ 912,408 | .32% |
- 4/ Until amended in 1972, the State Constitution prohibited State aid to municipalities. However, relatively little has been provided since then.
- 5/ If the municipalities levied additional taxes to provide such services the taxes could be deducted by persons who itemize deductions for Federal income taxes. These fees are not deductible. However, if such fees are paid by businesses they are deductible as a business expense.
- 6/ The legislature does budget the property appraisal money separately for the Tax Department. With total funds limited, however, the amount expended on some other program within or outside of the Tax Department, would have to be reduced to finance the appraisal program.

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