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It's Elementary

A Monthly Column by EFAP Director John Yinger
June 2012

Four Flaws in New York State's Property Taxes and How to Fix Them: Levy Limits

This is the second of four columns on property taxes in New York State. This column explores the levy limits imposed on local governments, including school districts, starting in 2012. In my judgment, these limits constitute another major structural flaw in New York's property tax.

On the surface, the new levy limit in New York limits the increase in any local government's property tax levy to 2 percent per year. In practice, it is not really a 2 percent limit because it has adjustments for new property, capital spending, PILOTs, torts and a few other things.¹ For example, these adjustments require the Oswego city schools to lower their tax levy by 49.2 percent in 2012 because they are receiving a \$24 million PILOT payment from the Constellation Energy Nuclear Group for Nine Mile Point Units 1 and 2. In contrast, West Hill and North Syracuse are allowed to raise their levies by more than 4 percent because they are each making their first bond payments on capital projects.²

All these adjustments clearly undermine the transparency of the levy limits, but they seem reasonable to me. One can only hope that explanations for deviations from the 2 percent limit will be adequately explained to voters by New York State and by the affected jurisdictions.

The main problem with this limit is that it is profoundly unfair. Because the limit is expressed as a percentage of the property tax levy, rich districts that can raise extensive revenue at a given tax rate are not nearly as constrained as poor districts that levy the same rate. Consider two districts with a 2 percent effective property tax rate. The first district is a rich one with property values equal to \$1,000,000 per pupil. This may sound high, but Fire Island has property values of \$80,000,000 per pupil! The second district is a poor one with property values equal to \$135,000 per pupil, which is about level in the city of Utica. The rich district raises \$20,000 per

¹ For all the details, see New York State Department of Taxation and Finance, "The Property Tax Cap: Guidelines for Implementation," Publication 1000, October 2011. Available at: <http://www.tax.ny.gov/pdf/publications/orpts/capguidelines.pdf>. See also New York State Office of the Comptroller, "School District Tax Levy Limits," April 2012. Available at: <http://www.osc.state.ny.us/localgov/pubs/research/snapshot/schooltaxlevylimits.pdf>.

² These examples are taken from Elizabeth Doran, "Central New York Schools Wrestle with State's Tax Levy Formula," *Syracuse Post-Standard*, April 1, 2012. Despite the date, they are not a joke!

pupil and its next budget can increase this levy by 2 percent of this amount or \$400. The poor district raises \$2,700 per pupil at this tax rate and can increase its levy by only \$54.

What sense does this make? After all, poor districts generally have to raise more money per pupil to have the same impact on student performance as a rich district. Previous columns have explored this type of cost difference in detail.³ Suffice it to say that these cost differences across districts, which are well known and well documented, are completely ignored in the levy-limit legislations.

In addition, districts that are inefficient and raise more revenue than they need to provide high-quality services are rewarded with a weaker constraint than the one imposed on other districts that have been providing the same service level more efficiently.

When paired with the state education aid system, the new levy limit acts as a kind of bait and switch policy. Scholars have found that \$1.00 of state education aid leads to an increase in spending on education, but this increase is less than \$1.00, perhaps 50 or 60 cents.⁴ As a result, school districts that receive a large amount of state aid, most of which are high-poverty school districts, do not have as large a tax levy as low-poverty school districts. Indeed, this is one objective of the state aid program. When a limit on the levy increase is imposed on top of this system, it penalizes the high-poverty districts; because their levy is lower, their allowable levy increase is lower in dollar terms.

Moreover, the levy limit can be exceeded with the support of 60 percent of voters. Research from other states indicates that high-income jurisdictions, which have a relatively high demand for public services, are more likely to vote for an override of this type than are low-income jurisdictions.⁵ Thus, the inequities produced by this levy limit are very likely to grow over time.

In May 2012, about 7 percent of New York's school districts presented budgets that required an override, and about 60 percent of these budgets passed. No information is yet available on the income of these districts, and we will have to wait and see whether the override votes lead to more inequality in New York.

The impressive state education aid reforms passed in 2007 include estimates of the spending required in each district to achieve the state's student performance standards. These "required spending" estimates account, among other things, for the high cost of educating disadvantaged students. The best way to reform the levy limit for schools would be to express it as a percentage of this required spending instead of as a percentage of the district's current levy. This approach would ensure that the levy limit is fair across districts with different wealth and is based on factors outside the district's control. Rich districts and inefficient districts would no longer receive favorable treatment.

³ See, for example, the columns for January 2005, January 2008, and April 2008.

⁴ See, for example, Fisher, R.C. and Papke, L.E., "Local Government Response to Education Grants," *National Tax Journal* 53 (March 2000), pp. 153-168.

⁵ See, for example, Bradbury, K. L., "Can Local Governments Give Citizens What They Want? Referendum Outcomes in Massachusetts," *New England Economic Review*, May/June 1991, pp. 3-22.

The same concepts could be used to design reforms for the levy limit on other forms of local spending.

Of course, New York could also just get rid of the levy limit altogether. The scholarly literature finds no evidence that levy limits or tax rate limits result in higher quality services at a lower cost; instead, these limits just lead to declines in service quality and often to new forms of inequity.⁶ A better approach, it seems to me, would be to simply require districts to provide voters with extensive information about proposed budgets, including associated levy increases, and to revert to no increase in the tax rate (which is part of the levy-limit legislation) if voters rejected the proposed budget twice.

Addendum: Levy Limits and STAR

The levy limit also has implications for STAR—the subject of my last column. Recall that STAR gives voters an incentive to raise their school property tax rates. The levy limit does not prevent property tax rate increases, but it makes them more difficult—at least beyond a certain point. More specifically, any property tax rate increase that results in a levy increase beyond the 2 percent (before adjustments) that is allowed, requires a 60 percent vote. In addition, the legislation creating the levy limit was accompanied by legislation that places a 2 percent cap on the increase in STAR tax savings. This limit requires complex calculations that certainly undermine STAR’s transparency and that voters may not understand.⁷ Nevertheless, it does lower voters’ incentives to raise property taxes and may therefore reduce STAR’s incentive effects.

⁶ See, for example, Thomas A. Downes and David N. Figlio, “Do Tax and Expenditure Limits Provide a Free Lunch? Evidence on the link Between Limits and Public Sector Service Quality,” *National Tax Journal*, March 1999, pp. 113-128.

⁷ For more on STAR’s new limit on increases in tax savings, see <http://www.tax.ny.gov/pit/property/star/twopercentlimit.htm> .