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Assessment of  
**NORTH DAKOTA'S STATE AND LOCAL TAX BURDEN**

Jay A. Leitch, Richard Taylor,  
and Brett Hovde

Prepared for

North Dakota Legislative Council  
State Capitol  
600 East Boulevard  
Bismarck, North Dakota 58505-0360

Department of Agricultural Economics  
Agricultural Experiment Station  
North Dakota State University  
Fargo, North Dakota 58105-5636

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## HIGHLIGHTS

*Compared to their neighbors (Minnesota, Montana, Wyoming, South Dakota, Nebraska), North Dakota taxpayers' state and local tax burden is about average. In real terms, state and local tax collections in North Dakota increased by 66.5 percent (1.6 percent per year) from 1960 to 1992. Tax collections per capita also rose by 66.5 percent (1.6 percent per year) from \$1100 in 1960 to \$1800 in 1992. However, personal income increased by 200 percent (2.2 percent per year) over the same time period. The percent of personal income paid in state and local taxes thus decreased by 17 percent (0.5 percent per year) during this period, from 12 percent in 1960 to 10 percent in 1992.*

*Taxable values of real property decreased 62.5 percent in real dollars while property taxes collected decreased only 1 percent. Taxable values of agricultural real property decreased 67.7 percent and residential real property decreased 26.5 percent.*

*North Dakota now relies heavily on the sales tax (37 percent of all collections). Historically, property tax was the largest source of tax collections. By 1973 property tax fell into second place and remains there today (34 percent of all state and local tax collections). North Dakota relies heavily (71 percent) on tax sources that are not greatly affected by moderate swings in the economy (property and sales taxes). During a stable or declining economy this benefits the state, but does not aid state revenues during a period with a growing economy. North Dakota's heavy reliance on sales and property taxes no doubt distorts private sector economic decision making and resource allocation, but the effects are difficult to estimate. A broad mix of taxes permits raising revenue without undue dependence on any one tax.*

*Energy (9.3 percent of all state and local collections) and corporate (3.4 percent) taxes are generally hidden taxes. While not hidden at the time of collection, the yearly total paid in sales taxes is hidden. Property tax is somewhat hidden if it is escrowed into the monthly mortgage payment. Thus, much of North Dakota's tax burden is not immediately obvious to taxpayers.*

*Energy taxes, as a percentage of total collections, have varied from a low of 1.43 percent in 1973 to a high of 25.6 percent during 1982. Energy tax collection amounted to 9.3 percent of total collections in 1992. Some of the energy tax burden is borne by North Dakota residents in the form of resource owner costs, shareholder costs, or higher energy prices. The rapid increase in energy tax collections during the late 1970s and early 1980s provided a revenue increase for state government. However, since 1983 energy tax collections have fallen causing the state government to shift the tax burden to other sources.*

*North Dakota relies the least of the six states on income taxes, which accounted for 3.5 percent of all S&L collections in 1960 and 10 percent in 1991.*

*State collected taxes amount to 64 percent of total tax collected with 36 percent collected locally in 1992. In 1960 state collection was 45 percent compared to 55 percent for local.*

## Assessment of NORTH DAKOTA'S STATE AND LOCAL TAX BURDEN

Jay A. Leitch, Richard Taylor, and Brett Hovde\*

Taxpayers often contend they pay too much in taxes, they pay more taxes than their neighbors, or they pay more than they did in the past. Whether they pay too much is a subjective issue.<sup>1</sup> Whether they pay more than their neighbors or more than they did in the past can be assessed objectively. The burden of a tax system can be assessed by analyzing the types of tax collected, tax collections as a percentage of personal income, and per capita tax collections.

### PROCEDURE

Tax revenue data were assembled for the period 1960 to 1992. North Dakota's tax situation was assessed over time and compared to those of five nearby states (Minnesota, Nebraska, South Dakota, Montana, and Wyoming).

Comparing trends in tax collections over time can be misleading unless changes in the value of the dollar are considered. For example, \$10 in 1979 would buy 13 percent more goods or services than would \$10 in 1980. A \$300 tax per capita in 1960 reduced a person's disposable income more than a \$1400 tax did in 1992. Comparisons using nominal values (values not adjusted for inflation) are misleading because of a lack of a common denominator--a 1960 dollar is not worth the same (in terms of purchasing power) as a 1992 dollar. Expressing tax collections in real dollars facilitates comparisons by giving all dollars the same purchasing power. Tax collections reported in *nominal dollars* were converted to *real 1994 dollars* using the consumer price index (CPI).

*Nominal dollars are current dollars without adjusting for price level changes.*

*Real dollars are nominal dollars adjusted for changes in the price level and expressed in terms of a base year.*

### Data

Data were collected for the six states from the period 1960 to 1992. Data sources are identified in Leitch et al. (1994). More recent data were not available, but a check with each state's tax department confirmed no changes had occurred through July 1994 that would affect the trends appreciably.

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\*Professor, research associate, and former research assistant, Department of Agricultural Economics, North Dakota State University, Fargo.

<sup>1</sup>The biennial *North Dakota Tax Guide* (Hanson 1994) and Dorow et al. (1988) are good sources for general tax information in North Dakota. An assessment of the fairness of state-level taxes is reported in Baltezore et al. (1988).

## Tax Evaluation Criteria

There are many standards for evaluating taxes, some are from taxpayers' perspectives, some from a public finance perspective, and some from the perspective of elected decision makers. The tax system overall should reflect the combination of tax instruments that achieves the highest overall rating, given the norms of the community. At least thirteen standards can be used to evaluate taxes.<sup>2</sup>

**Taxpayers.** Taxpayers judge taxes and tax systems based on (1) fairness or equity, (2) ability to understand their obligations, (3) compliance costs, and (4) stability of the tax system over time.

**Public finance theory.** From a public finance perspective, a tax system should (5) have low administrative costs, (6) result in minimal shifting of the tax paying responsibility among taxpayers, (7) be reliable, (8) be adequate, (9) be neutral, and (10) be efficient.

**Elected decision makers.** Elected decision makers prefer taxes that are (11) exportable--paid by people from outside the taxing jurisdiction, (12) not detrimental to business climate, and (13) balanced. The first two of these can be described and quantified, the third is largely perception or relative to some personal standard.

## **TAX COLLECTIONS BY SOURCE/TYPE**

The five tax bases used in North Dakota are (1) property, (2) sales or consumption, (3) income, (4) sin (alcohol and tobacco), and (5) gambling. Energy taxes based on production, extraction, or severance are a variation of income taxes; while energy taxes based on estimated resources still in the ground are a variation of property taxes.

Specific taxes addressed in this study include property, sales, individual income, corporate income, and energy/mineral. Taxes also are grouped according to state-local source, including all local, all state, and all state and local. Comparisons are made between current and former levels in North Dakota, and between North Dakota and neighboring states.

### Trend

State sales and use taxes accounted for about 37 percent of all state and local tax collections in North Dakota in 1992, followed by property tax, which accounted for 34 percent (Figure 1). State-collected taxes are 66 percent of all state and local taxes, almost opposite of the state-local shares in 1960, when local tax collections accounted for 55 percent of all state and local tax collections (Figure 2). During the period from 1960 to 1984, the local share of the overall tax burden decreased steadily. The state and local tax burdens were about equal in 1970. By 1984, the state share was at 73 percent, a maximum for the period from 1960 through 1992.

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<sup>2</sup>Tax evaluation criteria are discussed further in Leitch et al. (1994), Dorow et al. (1988), and Hyman (1990).

Since 1984 the trend has reversed with the local portion of tax collections increasing and the state portion decreasing.

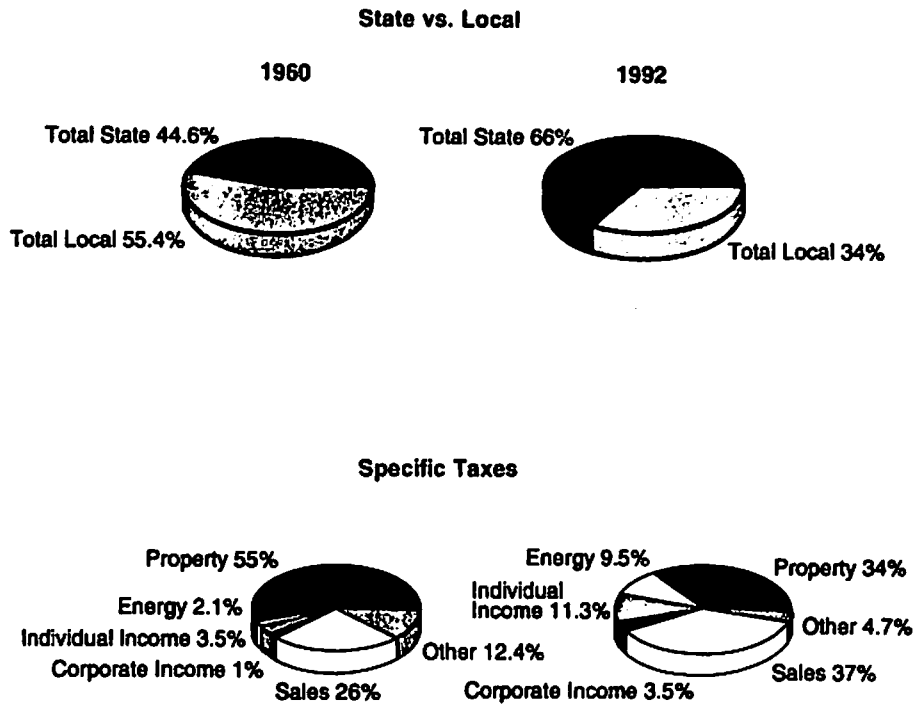


Figure 1. North Dakota's tax shares, 1992.

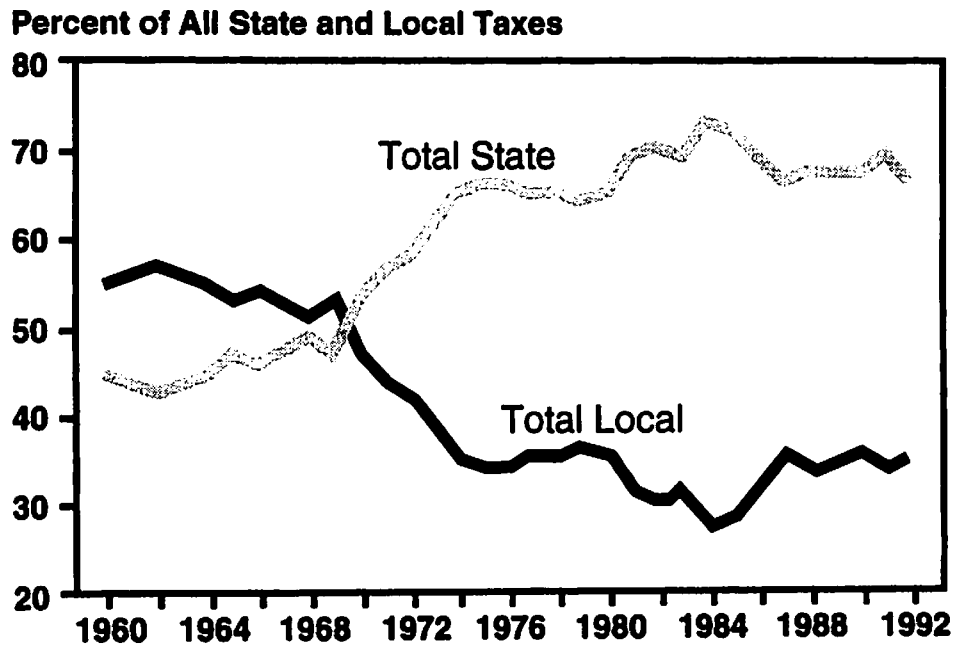


Figure 2. North Dakota state vs. local tax share, 1960-1992.

The relative share of tax collections among specific taxes also shifted over the past three decades (Figure 3). The most notable change is that the proportion of property taxes in total tax collections fell during 1960 through 1984. The steepest decline in property tax collections occurred after 1969 when personal property was exempted from the property tax base. Increases in the sales tax rate and in individual income tax collections offset the decline in government revenue resulting from the personal property exemption. Energy tax collections had a sharp peak in 1982 due to high energy prices. Decreasing energy tax revenues after 1982 were replaced by increasing sales tax and individual income tax revenues. Local sales taxes also began to be implemented during the 1980s.

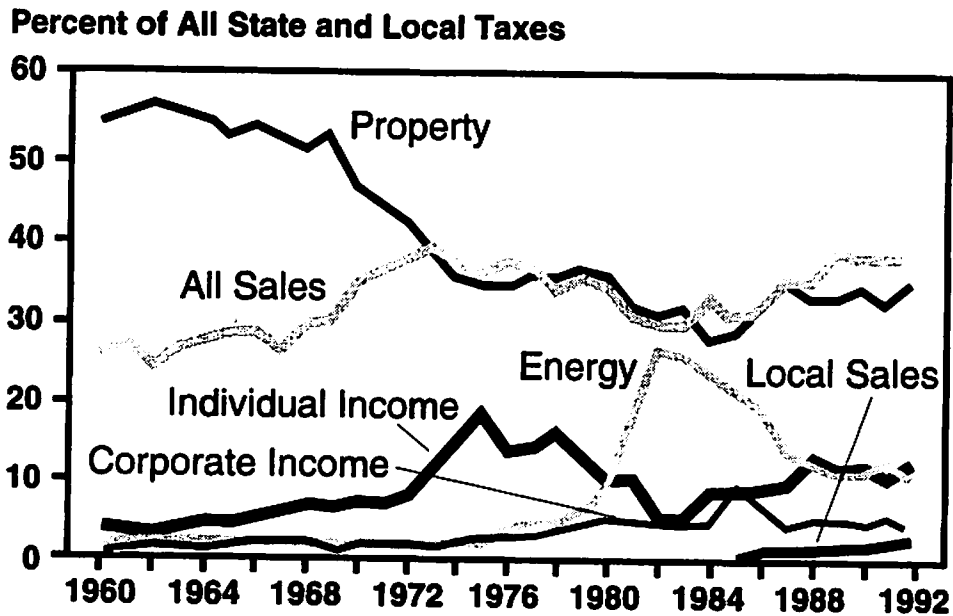


Figure 3. North Dakota's tax shares, 1960-1992.

Energy taxes levied within the state are usually not directly paid by individual taxpayers. The tax is paid ultimately by the owners of energy resources, by energy industry shareholders, and by consumers when taxed energy or products produced using taxed energy are sold within the state. The share of any tax paid by ultimate consumers depends on demand and supply conditions in the industry. When energy prices are determined on a global scale, consumers bear little of the tax placed on energy by small producers like North Dakota. But to the extent North Dakotans are owners of energy resources or share in the returns of the industry, they bear the burden of energy taxes. When energy prices are regulated, such as electricity prices, taxes may be shifted entirely to consumers.

#### Compared to Neighboring States

State shares of all state and local taxes for the study states range from 56 percent in South Dakota to 68 percent in Minnesota (Figure 4). North Dakota, with 66 percent of state and local revenues collected by the state, is above the six-state average of 63 percent.

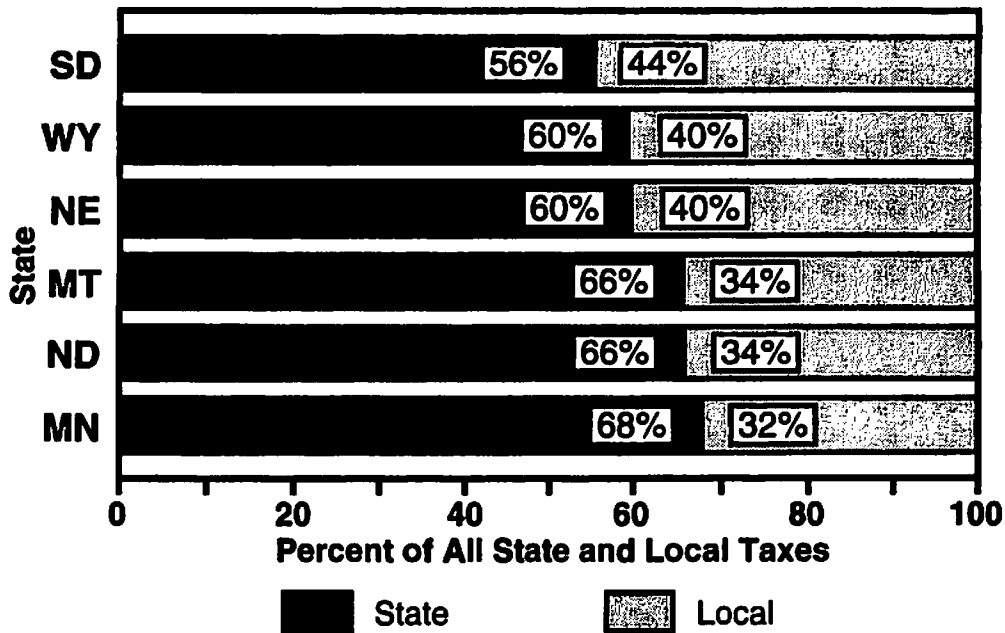


Figure 4. Recent year comparison of North Dakota's and neighboring states' total state and property tax balance, 1991.

Percentages for all sales, individual income, corporate income, and energy/mineral taxes for the six study states show some differences in the relative shares among tax bases (Figure 5). States with substantial energy resources tap those sources, allowing them to rely less on other tax bases. North Dakota and South Dakota rely most heavily on sales taxes, while Minnesota relies about evenly on sales and income taxes. Montana relies most heavily on income taxes. Wyoming and Nebraska rely on property taxes more than the other states.

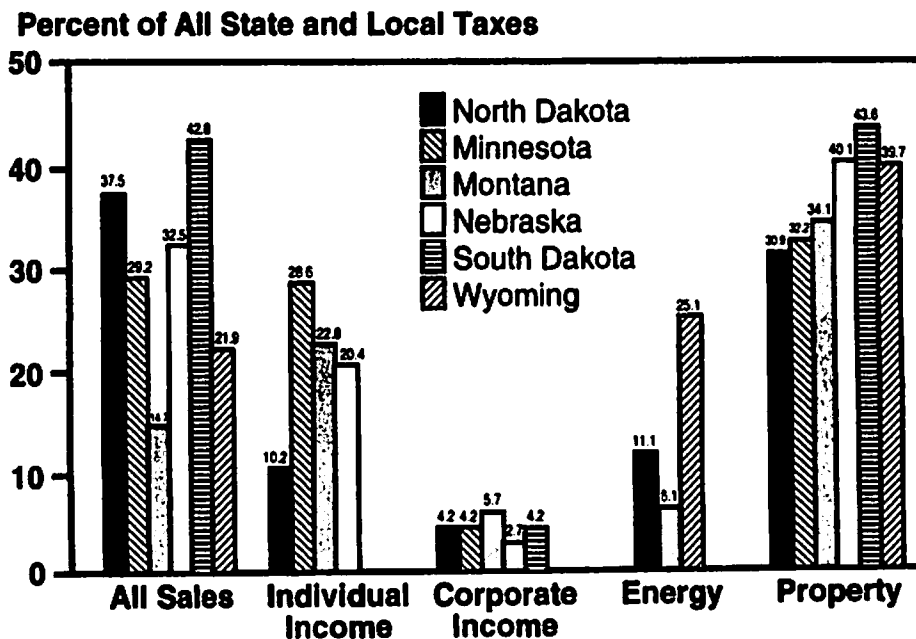


Figure 5. Share of specific taxes in North Dakota and in neighboring states, 1991.

## Property Tax Trends

Property taxes in North Dakota have been assessed against five types of property (1) agricultural, (2) residential, (3) commercial, (4) centrally assessed (railroads and public utilities), and (5) personal property. These taxes are collected by or for at least five government units (1) counties, (2) townships, (3) school districts, (4) cities, and (5) special districts.

**Property tax base.** The tax structure for residential, commercial, and centrally assessed properties has remained essentially unchanged since 1960. Changes that did occur were primarily accounting changes that had little effect on the property tax system. After 1981 agricultural real estate was taxed according to its productivity value and not its market value. Personal property (e.g., cars, boats, furniture, guns, jewelry) tax was discontinued in 1969 because of administrative and assessment problems.

The assessed values of agricultural, residential, and commercial property have all been increasing in real dollars. The assessed value of centrally assessed property declined slightly over the period from 1960 to 1991 (Figure 6).

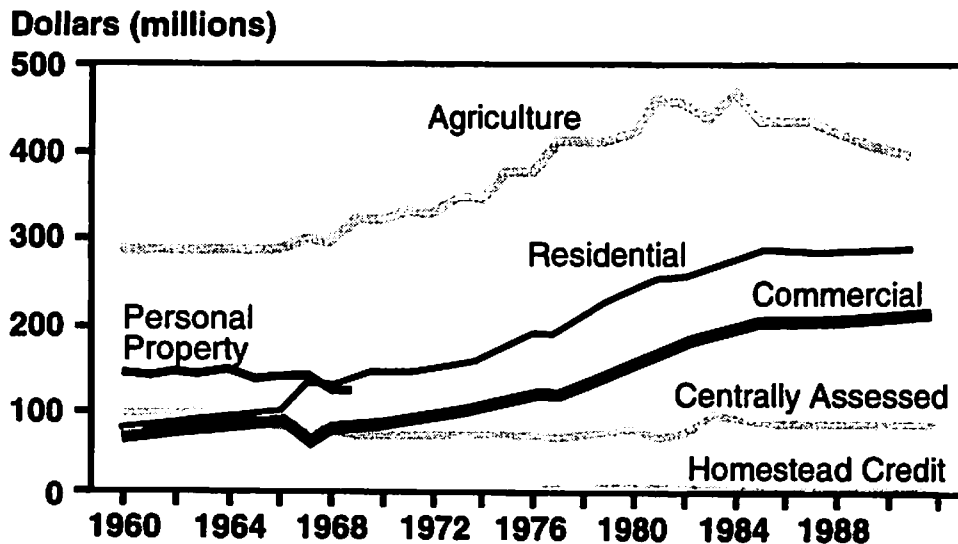


Figure 6. Taxable value (real) of specific property classes, 1960-1991.

A Homestead Credit, enacted in 1977, allows an exception from property taxes on a home owned and occupied by a person over 65 years of age, or who is blind, or disabled. There are specified financial limits which apply to homeowners' property tax credits.

**Property tax burden.** The change in property tax burden for any group depends on the rate at which the assessed values change relative to each other. For example, all agricultural property was assessed a total of \$600 million dollars in 1969 and about \$900 million in 1981 (a 50 percent increase), while all residential property was assessed at a total of \$300 million in 1969 and about \$500 million in 1981 (a 66 percent increase). Residential property values increased more than agricultural property values, indicating a shift in the tax burden to residential property. However,

the agricultural property base is relatively fixed. The amount of agricultural land has remained constant, or decreased only slightly since 1960, whereas the residential and commercial property bases have grown.

The share of the overall property tax burden borne by specific groups has changed over the past three decades years (Figure 7). Shares for agricultural and centrally assessed property have been steady or slightly declining, while shares for residential and commercial properties have increased. In 1960 residential and commercial properties represented a 10 and 11 percent share, respectively. By 1992 their shares had increased to 28 and 20 percent, respectively.

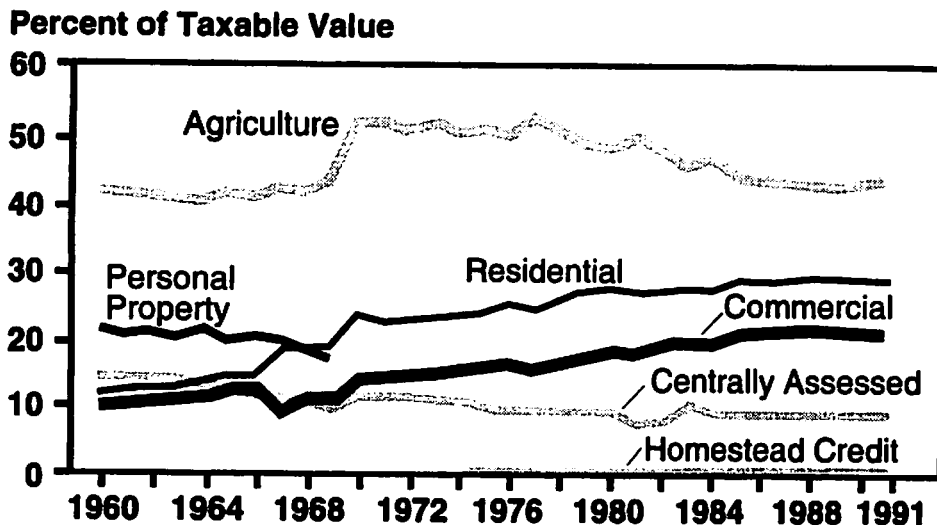


Figure 7. Specific property classes as a percentage of taxable value, 1960-1991.

Property tax collections. County, township, school district, and city property tax revenues were examined to see if any one group had changed more than the others (Figure 8). Taxes levied by school districts increased 37 percent between 1960 and 1969, but by 1981 school tax levies fell 39 percent from the 1969 high. By 1991 the levies returned to about the same as 1960. Township taxes declined by 60 percent between 1960 and 1991. County and city levies increased by 16 and 14 percent, respectively.

Special assessments by local government have risen to about \$50 million per year. Special assessments are user fees imposed by local governments primarily for infrastructure (e.g., roads, sidewalks, public utilities) development.

#### Assessment

In inflation-adjusted dollars, North Dakota's taxpayers pay more state and local taxes than they did 30 years ago. Sales and use tax is the primary state tax source. Property taxes are the primary local source. Sales taxes are generally thought to be regressive with respect to the ability to pay measure of fairness. Since North Dakota's sales tax base is relatively broad, it is likely to

be more regressive than sales taxes with narrower bases in neighboring states. It is difficult to judge the state's sales taxes on the benefits received principle, but the larger the geographic unit that collects the tax, the less likely it will be based on benefits received. Thus, overall tax collections may have become more regressive over time.

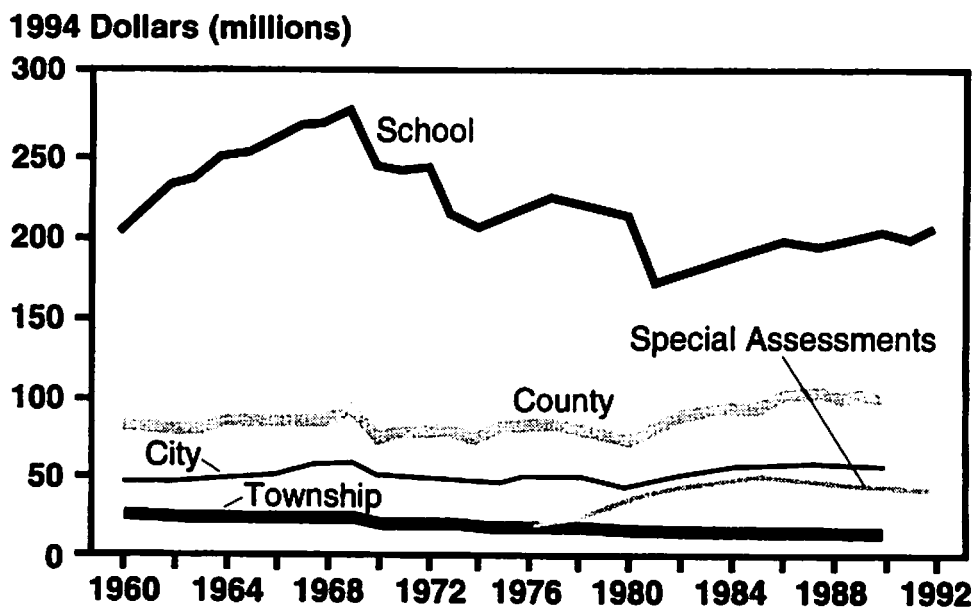


Figure 8. General property and special taxes levied by specific governments of North Dakota (real dollars), 1960-1992.

A substantial shift occurred in the state vs. local share of the overall tax burden. Where the state collected about two-fifths of the total in 1960, it now collects two-thirds. However, without further evaluation it is difficult to determine if the ultimate burden on individuals has changed. Since the state's new wealth is generated by so few industries, the ultimate taxpayer may not change much with shifts among tax types. Visibility of the tax or the pocket that taxes are taken from may be the greatest change.

North Dakota has relied heavily on stable tax sources (with the exception of energy taxes), such as sales and property. This maintains collections in times of a stable or declining economy, but does not capture as much of the benefits of a growing economy as would heavier reliance on an income tax, which grows with the economy. Reliance on energy taxes, which are subject to the state of the world economy and the vagaries of the international oil market, also decreases the degree of reliability of the system to generate a given flow of revenue.

In short, assessing North Dakota's tax system by how the burden is shared among tax bases and between state and local taxpayers indicates a stable, but somewhat regressive structure. With the exception of energy taxes, North Dakota's state and local taxes are static with respect to the economy. Since nearly 70 percent of the total tax collected comes from sales or property taxes, the system is more regressive than one that relies more heavily on other types of taxes.

## TAX COLLECTIONS AS A PERCENTAGE OF PERSONAL INCOME

The state and local tax burden borne by North Dakotans can be estimated by expressing overall tax collections as a percentage of personal income. As personal incomes rise, people generally pay more in taxes. However, while the absolute amount of taxes paid may be higher, if the relative amount with respect to personal income is constant, the burden in one sense has not changed.

### Trend

North Dakotans pay nearly 10 percent of personal income in state and local taxes, down from about 12 percent in the early 1960s (Figure 9). State taxes have been consuming an increasing share of personal income, while local taxes have decreased as a share of personal income.

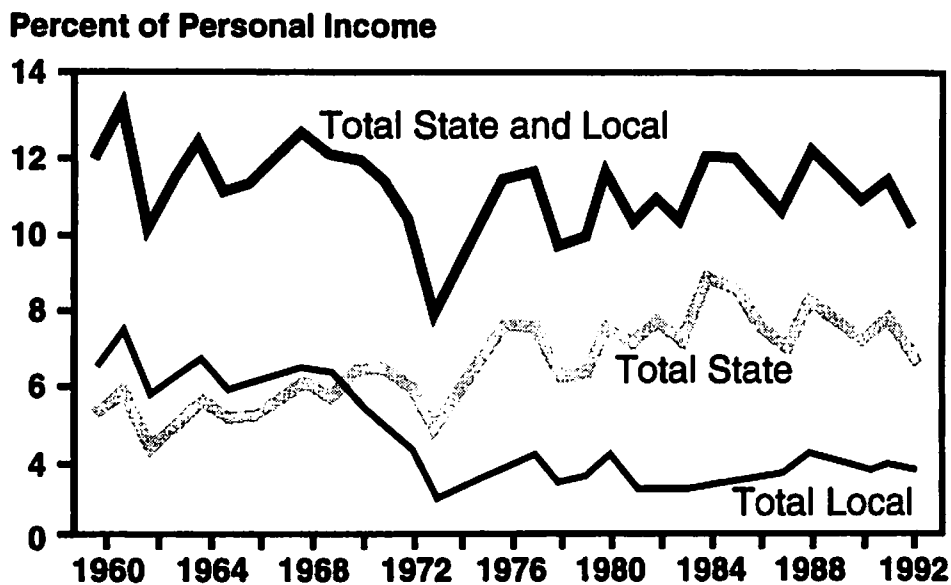


Figure 9. Percent of personal income North Dakotans paid in taxes, 1960-1992.

The percentage of personal income paid in taxes varies due to changes in either tax laws or in the level of personal income. If personal income for the present year is lower than it was for the previous year and there were no changes in tax rules, then tax collections will represent an increased share of personal income (in states with stable tax sources).

### Compared to Neighboring States

State and local collections as a percentage of personal income ranged from 8 percent in South Dakota to 13 percent in Wyoming (Figure 10). Property tax is the local tax that all of North Dakota's neighbors levy. Property tax collections ranged from 3.3 percent of personal income in North Dakota to 5.27 percent in Wyoming.

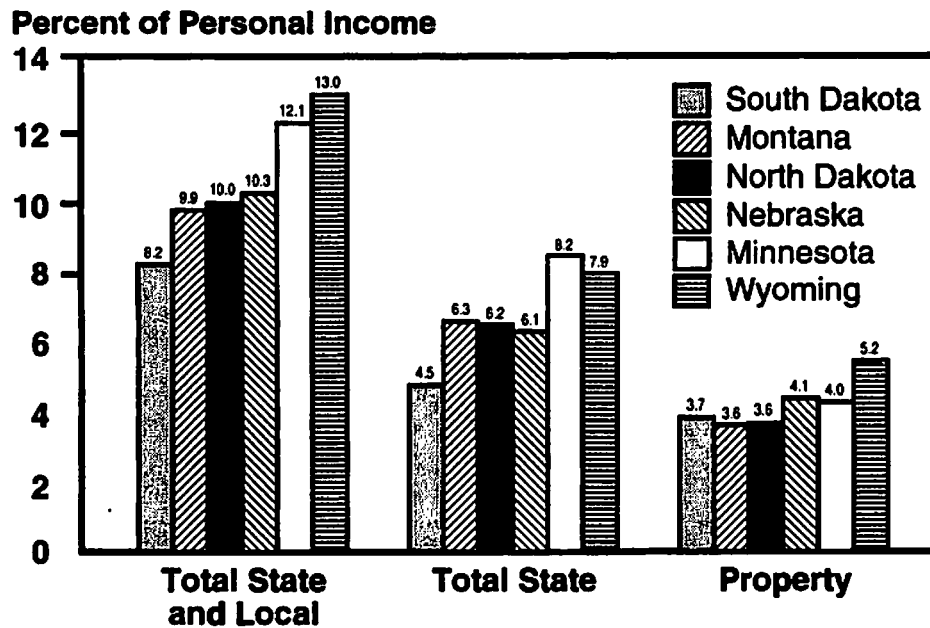


Figure 10. Recent year comparison of state and local tax collections in North Dakota and neighboring states.

A difference not evident in these percentages is the amount of taxes exported. While Wyoming has the highest percentage of personal income paid in taxes, much of that is exported (the energy taxes) and not paid directly by citizen taxpayers. However, it is difficult to determine how much of the exported taxes find their way back into the states in the form of higher prices or reduced returns to the owners of energy resources.

Another subtle distinction that could be made is the effect of higher deductible state and local taxes on the amount of federal income taxes paid (Figure 11). For example, a Minnesota taxpayer equal in all ways to one in North Dakota would pay less federal income taxes than the North Dakota resident. This is because a greater share of Minnesota's state and local tax burden is deductible from federal income subject to taxation (68 percent compared to 46 percent). Minnesota relies heavily on a progressive state income tax, but a portion of that is exported to other federal taxpayers in the form of federal tax deductions.

### Assessment

Taxes as a percent of personal income do not differ widely among the six study states, especially when other factors are considered, such as federal tax liability and energy tax shifting. The difference is mainly the perception of the burden, based on the type of tax. For example, Minnesota's income taxes are highly visible with most taxpayers realizing exactly how much they pay each year. On the other hand, North Dakota's sales taxes may not be perceived as onerous, especially when few taxpayers know precisely how much they pay each year. Even less visible are the energy and commercial property and income taxes, which may be hidden in the prices of products, many of which are subject to additional sales taxes, and/or borne by citizen shareholders. However, when viewed another way, the small differences in terms of percentage

points, are a large difference in terms of percent change. For example, a 4 percentage point difference between 8 and 12 percent is a 50 percent change (Figure 10). Thus, total state and local taxes are roughly 50 percent higher in Minnesota than in South Dakota before consideration of other factors.

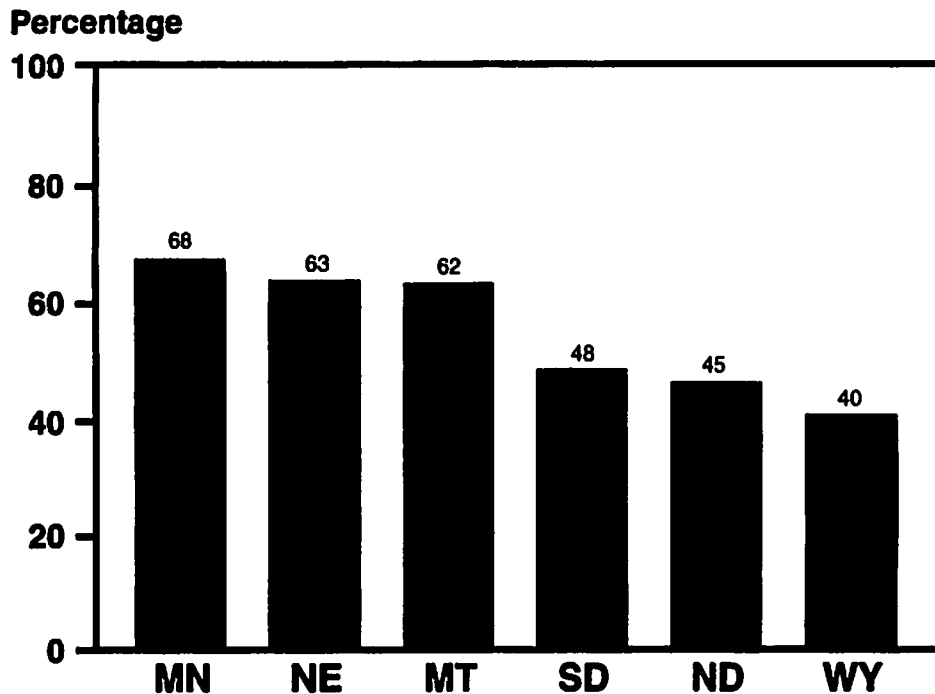


Figure 11. Percentage of state and local taxes that are deductible from federal income tax, 1991.

### TAX COLLECTIONS PER CAPITA

Tax collections per capita over time reflect changes in population as well as changes in tax laws and economic conditions. North Dakota's population changed very little over the past three decades, so the tax revenue changes witnessed are due mainly to tax law changes and changes in economic activity in the state.

#### Trend

Real (adjusted for inflation) total state and local tax collections in North Dakota rose from about \$1100 per capita in 1960 to \$1800 per capita in 1992 (Figure 12) which was 96 percent of the national average tax per capita in 1992 (Tax Foundation 1994). The rise in tax liability per capita is due to increases in state-level taxes, since property taxes are essentially unchanged.

Of the specific North Dakota taxes, sales tax and energy tax have been the most dynamic. Sales tax collections per capita more than doubled since 1960, reflecting a change in the rate

(from 2 percent to 5 percent). Energy taxes per capita ranged from nearly nothing in 1960 to more than \$400 in 1982 and back to approximately \$200 in 1992 (Figure 12).

### 1994 Real Dollars Per Capita

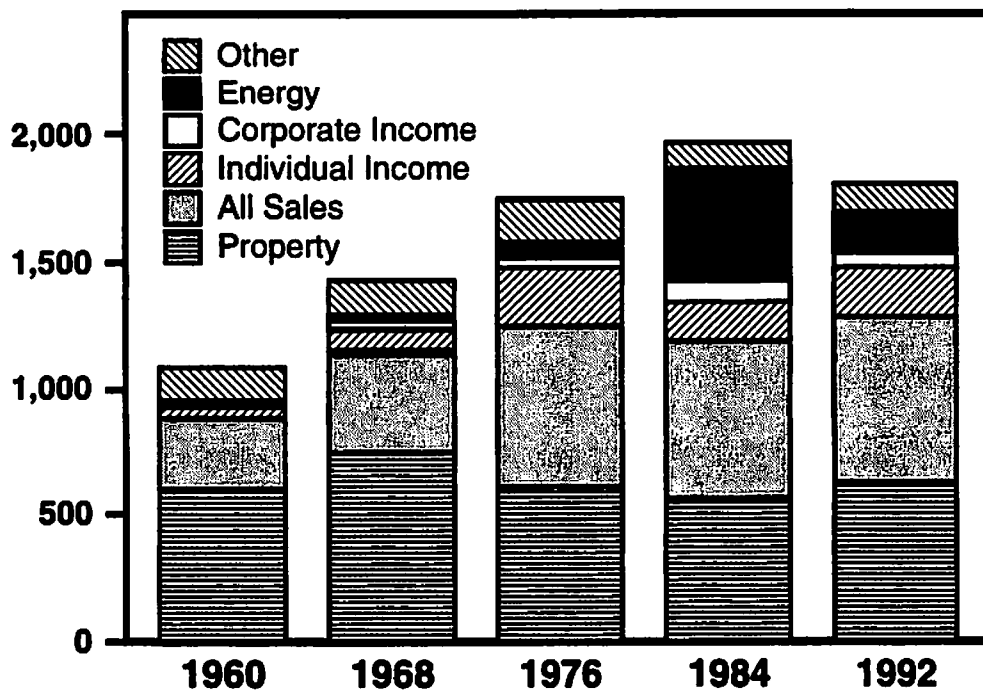


Figure 12. North Dakota tax collections per capita, 1960-1992.

### Compared to Neighboring States

Comparison of North Dakota with its neighboring states shows that North Dakota collects an average amount of tax per capita. Minnesota, Wyoming, and Nebraska collect more taxes per capita, while Montana and South Dakota collect less (Figure 13). Wyoming collects nearly as much per capita as Minnesota, with much of that, about 25 percent, in energy taxes.

North Dakotans paid the highest percentage of their income in state and local taxes during the 1960-63 period with Nebraska being the lowest (Figure 14). During the 1974-77 period Minnesota, Montana, and Wyoming residents paid more state and local taxes than North Dakotans. One possible reason is during the early to mid-1970s increases in crop prices raised personal income relatively more than tax collections in North Dakota, South Dakota, and Nebraska. By the 1988-91 period Wyoming was most heavily taxed. North Dakota and Montana fell to a tie for third.

### Assessment

- As a percentage of personal income, taxes in North Dakota fell from 11.7 percent in 1960 to 11.2 percent in 1991. The only other state with a reduction was South Dakota. Wyoming's tax burden

increased the most of any of the six states, with a major portion of the increase due to energy taxes.

### 1994 Real Dollars Per Capita

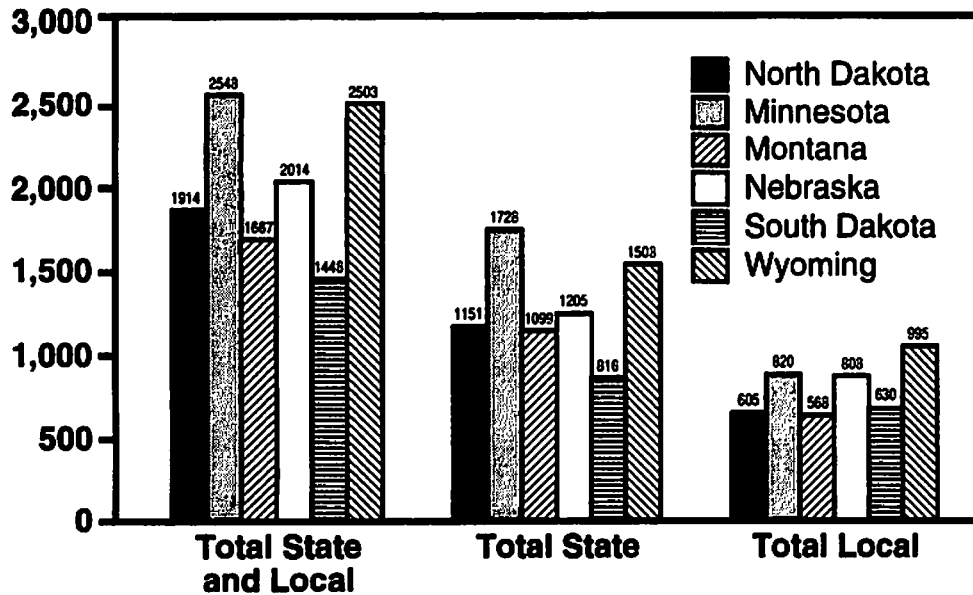


Figure 13. State and local per capita tax collections for North Dakota and neighboring states, 1991.

### Percent of Personal Income

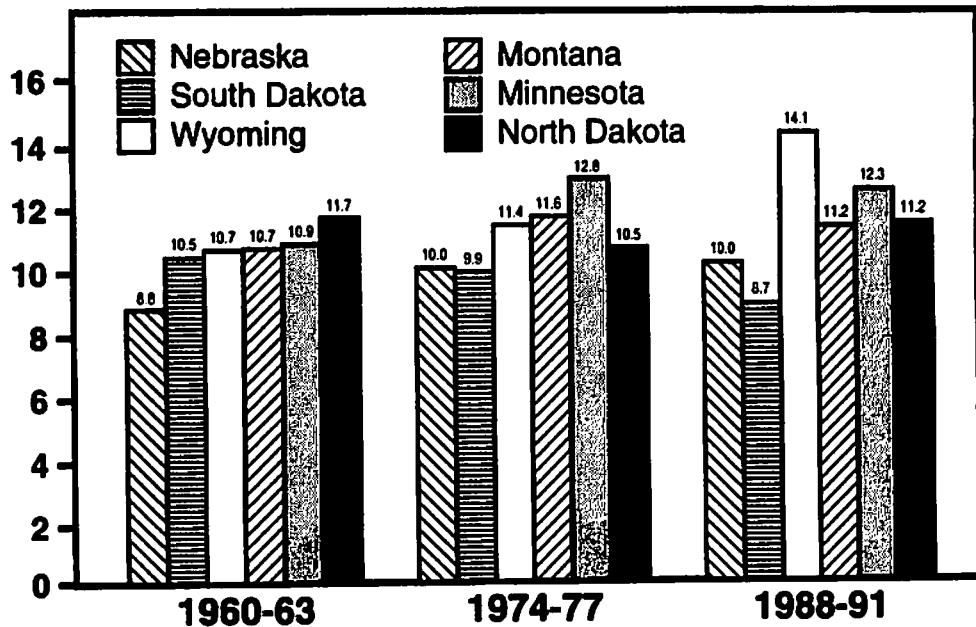


Figure 14. Total state and local tax collections by state, four-year average.

## SUMMARY, CONCLUSIONS, AND IMPLICATIONS

Results of this study provide an assessment of relative state and local tax collections for North Dakota and five of its neighboring states. The assessment is from the perspective of taxpayers in general. Tax burdens faced by individuals will likely be different than the averages presented herein.

### Summary and Conclusions

The source of North Dakota tax revenues shifted between 1960 and 1992. In 1960, 55 percent were local collections, and in 1992, local collections fell to 34 percent of total state and local tax collections.

Energy taxes remained stable at about 3 percent of total state and local tax revenues, between 1960 and 1975. After 1975 they rose to 26 percent of total state and local taxes in 1982. By 1992 they fell to 10 percent of state and local taxes.

North Dakota relies on sales taxes more than the other states except for South Dakota. North Dakota's sales and use taxes paid by a typical family of four is the highest of any state in the study. North Dakota's tax system has become more regressive with increased reliance on sales taxes.

North Dakota's reliance on property tax is the lowest of the six states in the study. Some of the burden of property taxes has shifted from agriculture and centrally assessed (railroads and utilities) to residential and commercial property.

Taxes levied by specific government units varied during the last three decades. School taxes levied in 1960 were at the same real dollar level as 1992, although they varied considerably over time. In 1969 levies were 37 percent higher than 1960. By 1981 school tax levies fell to 70 percent of the 1960 level.

Assessment of the size of the tax bite, its burden on taxpayers, and its adherence to the principles of public finance depend in large part on perspective. North Dakota's burden has shifted from local to state sources while increasing in real terms and, at the same time, decreasing relative to income. Personal income has grown faster than the cost of government in North Dakota, causing taxes as a percent of personal income to decline. Compared to their neighbors, North Dakota taxpayers face a tax structure that is about average in amount collected and in distribution of the burden (Figure 15).

### Implications

Any change in a tax or a tax system's status quo is likely to affect some people favorably and others adversely. In addition, any change is likely to be an improvement with respect to one evaluation standard and a detriment with respect to another.

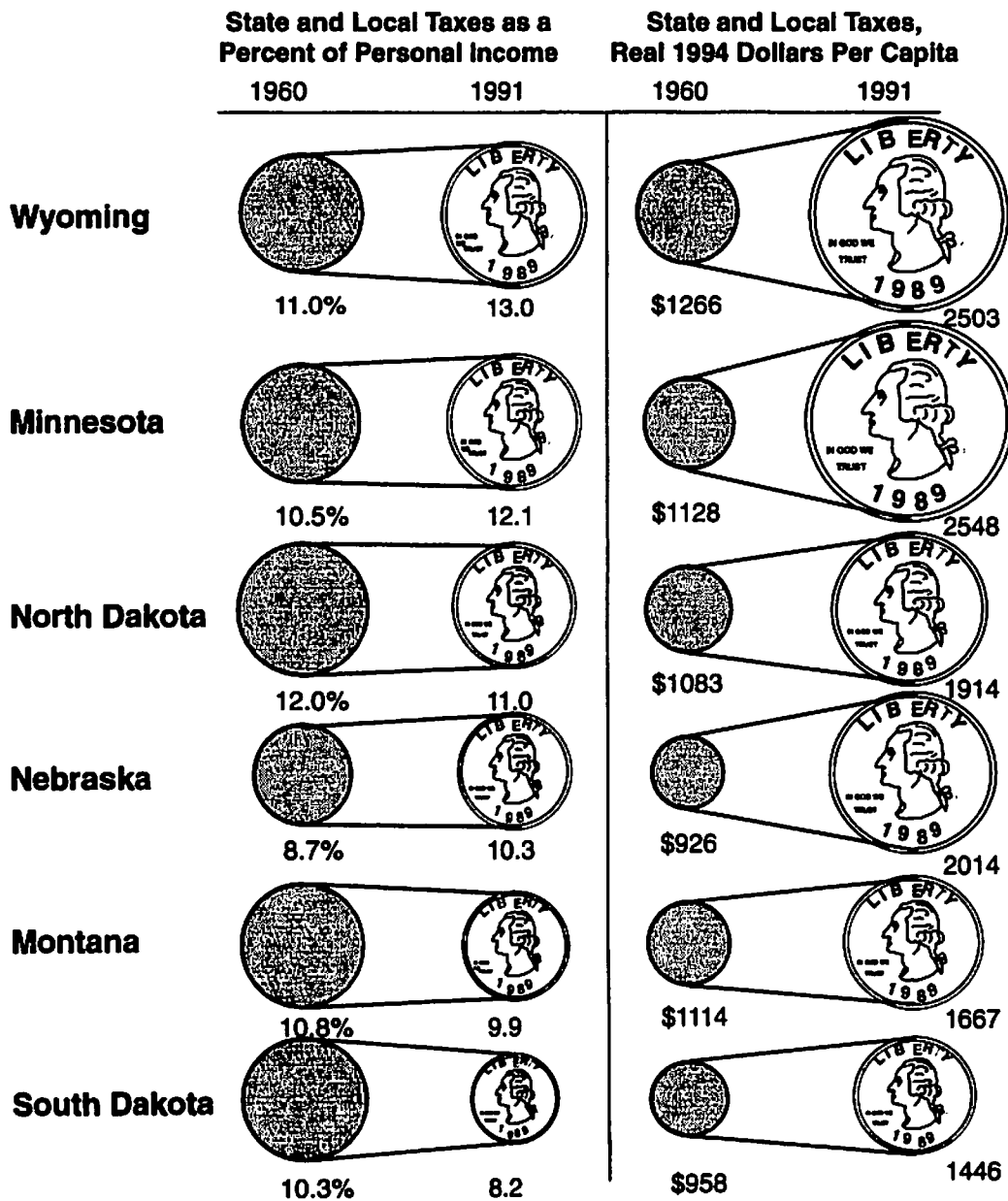


Figure 15. Comparison of percent of personal income and per capita tax burden for North Dakota and neighboring states.

The state and local tax burden is spread in different ways by our neighbors. If we want to be like them, we must also endorse their standards of tax fairness and adherence to other tax standards.

In a state with few basic sectors generating new wealth, many tax shifts are merely from one pocket to another pocket of the same taxpayer. These shifts however, should be assessed in terms of their effects on fairness, stability, and other tax evaluation criteria.

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