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The Effectiveness of Tax-Expenditure Limitations: A Re-evaluation:

In 19 States They Resulted in Virtually No Success in Limiting Growth in Their Budgets

By DALE G. BAILS*

ABSTRACT. A 1982 study of the efficacy and impact of *tax and expenditure limitations* (TEL) is updated. Utilizing various statistical comparisons, *growth in expenditures and revenues in states* with TELs is compared to growth in states without a TEL in place. This comparison matches growth in the *pre-tax revolt* years with growth in the post-revolt years. In all cases the statistical tests show that the existence of a TEL has had virtually no impact on the growth of statewide expenditures or revenues. Additionally, while aggregate state expenditures and revenues exhibited some decline during the tax revolt years, this decline was short-lived and has since been reversed. Thus, the primary implication is that TELs as presently construed are an ineffective means of limiting growth in *state budgets*.

I

Introduction

THE PURPORTED PURPOSE of tax and expenditure limitations (TELs) is to limit either the size or the rate of growth of the governmental budget. As stated in my 1982 study, "it is an almost universally accepted fact that once TELs are in place they will slow or reverse the growth in state government expenditures or revenues."¹ Thus, in a very general sense this present study investigates the actual impact of these limitations upon the growth of state tax revenues or expenditures. That is, the time frame has been sufficient to warrant an answer to the question: Are tax and expenditure limitations an appropriate remedy to excessive growth in state governmental budgets?

Specifically, the admittedly modest goals of this research are to address the following three issues:

(1). Have tax/expenditure limitations actually led to a reduction in the growth of the applicable category of the state budget?

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TABLE 1
DESCRIPTION OF STATE TAX AND EXPENDITURE LIMITATIONS

STATE	YEAR OF ADOPTION	METHOD OF APPROVAL	TYPE AND DESCRIPTION OF LIMITATION	
ALASKA	1982	STAT	EXPENDITURES	INFLATION AND POPULATION GROWTH
ARIZONA	1978	CONST	EXPENDITURES	7% OF PERSONAL INCOME
CALIFORNIA	1979	STAT	EXPENDITURES	INFLATION AND POPULATION GROWTH
COLORADO	1979	STAT	EXPENDITURES	7% ANNUAL INCREASE
HAWAII	1978	CONST	EXPENDITURES	PERSONAL INCOME GROWTH
IDAHO	1980	STAT	EXPENDITURES	5 1/3% OF PERSONAL INCOME
LOUISIANA	1979	STAT	REVENUES	PERSONAL INCOME GROWTH
MICHIGAN	1978	CONST	REVENUES	RATIO OF REVENUE TO INCOME IN BASE YEAR
MISSOURI	1980	CONST	REVENUES	RATIO OF REVENUE TO INCOME IN BASE YEAR
MONTANA	1981	STAT	EXPENDITURES	PERSONAL INCOME GROWTH
NEVADA	1979	STAT	EXPENDITURES	INFLATION AND POPULATION GROWTH
NEW JERSEY	1976	STAT	EXPENDITURES	PER CAPITA INCOME
OREGON	1979	STAT	EXPENDITURES	PERSONAL INCOME GROWTH
RHODE ISLAND	1977	STAT	EXPENDITURES	8% ANNUAL INCREASE
SOUTH CAROLINA	1980	STAT	EXPENDITURES	PERSONAL INCOME GROWTH
TENNESSEE	1978	CONST	EXPENDITURES	PERSONAL INCOME GROWTH
TEXAS	1978	CONST	EXPENDITURES	PERSONAL INCOME GROWTH
UTAH	1979	STAT	EXPENDITURES	PERSONAL INCOME GROWTH * 0.85
WASHINGTON	1979	STAT	REVENUES	PERSONAL INCOME GROWTH

(2). Has the proportion of income paid to finance state government spending been altered as a result of the enactment of TELs?

(3). Have state legislatures adhered to the limits set forth in TEL legislation?

II

Description of Existing Tax and Expenditure Limitations

THE FIRST STATE to place a limit on state taxing or spending powers was New Jersey in 1976. Colorado and Rhode Island then followed suit in 1977 with

Tennessee joining the ranks in 1978. With the passage of Proposition 13 in California, fifteen additional states then proceeded to enact some form of tax or expenditure limitation. Table 1 contains a brief description of all nineteen state level TELs in existence at the end of 1985.² It is based on a 1986 study by the Advisory Commission on Intergovernmental Relations (ACIR).

An examination of Table 1 suggests several summary comments:

1. The majority of the TELs concentrate on limiting expenditures rather than revenues.
2. The peak period for adoption was 1978–1980.
3. The method of approval column refers to whether the limitation is by statute (STAT) or by constitutional (CONST) amendment.
4. Fourteen of these limitations are linked in some way to the growth of personal income. Three of the TELs are based upon the sum of the inflation rate and the growth in population while the remaining two states have a limit based upon a fixed annual percentage increase.
5. All of the limitations apply to future growth in expenditures or revenues rather than a reduction in the current size of the budget.
6. The limitations in Nevada and in Rhode Island do not limit state spending but refer to the budget request of the governor; in Utah the legislature has not enacted the enabling legislation. Additionally, the limitation in New Jersey was by law temporary and expired in 1983. Thus, there are fifteen states with limitations currently in existence.

III

TELS and Aggregate Growth in Revenues/Expenditures

THE FIRST of the hypotheses to be tested regarding the effectiveness of tax and expenditure limitations is the hypothesis that the tax revolt may have had spillover effects in that it sent a “go slow on tax increases” message to all state legislatures. In the words of Steven D. Gold:

. . . A fourth product of the Tax Revolt involved negative rather than positive actions like cutting taxes and enacting limitations. The Tax Revolt inhibited states from raising their taxes. For a time, tax increases were “unthinkable” in many states.³

It is generally agreed that the “tax revolt” began in 1978; therefore, the years 1973–77 are referred to as the pre-revolt years, the years 1977–81 the tax revolt years and the years 1981–1985 as the post-revolt years. The “go slow” on tax increases argument implies that tax increases in the post-revolt years should be less than tax increases in the pre-revolt years. Table 2 contains the information necessary to test the validity of this “go slow” argument.⁴

TABLE 2
REAL CHANGE IN STATE REVENUES, 1973-1985
(Totals in millions of dollars and per capita in dollars)

YEARS	TAXES		CHARGES AND USER FEES		OWN REVENUES	
	TOTAL	PER CAPITA	TOTAL	PER CAPITA	TOTAL	PER CAPITA
PRE-TAX REVOLT YEARS						
1973-74	- 93	- 7	2,710	12	2,617	5
1974-75	-2,252	-17	357	0	-1,895	-17
1975-76	6,282	23	714	2	6,996	25
1976-77	8,749	34	1,119	4	9,868	38
TOTALS	12,686	33	4,900	18	21,376	51
TAX REVOLT YEARS						
1977-78	6,671	22	1,118	3	7,789	25
1978-79	2,045	2	2,083	8	4,128	10
1979-80	1,032	- 4	4,486	18	5,518	-14
1980-81	- 65	-10	2,476	9	2,411	- 1
TOTALS	9,683	10	10,163	38	19,846	20
POST-TAX REVOLT YEARS						
1981-82	3,362	8	3,300	13	6,662	21
1982-83	2,347	3	1,236	3	3,583	6
1983-84	17,382	67	4,078	26	21,460	83
1984-85	10,725	39	5,252	20	15,977	59
TOTALS	33,816	117	13,866	62	47,682	169

The information on percentage changes between the three distinct periods is summarized in Table 3 for all categories. A comparison of the three revenue categories between the pre- and post-tax revolt years indicates that any claim of a "go slow on tax increases" message is clearly illusory. The fact that there were some declines during the tax revolt years relative to the pre-tax revolt years further suggests that, when viewed on an aggregate level, the impact of the tax revolt, if any, was short-lived.

An alternative test of the "go slow" hypothesis can be conducted by evaluating the differences in linear trend during different time periods. Specifically, if the tax revolt has had any impact on aggregate state spending, the trend rate of growth after 1977 should have declined. Table 4 depicts the estimates for the three revenue categories for the pre and post-tax revolt periods.

While there are some minor differences between growth rates, none of the differences are statistically significant when tested using the Chow test for structural stability.⁵ The relatively small decline in per capita real tax revenues was more than offset by the relatively large increases in charges with the result that total own revenues increased during the post-revolt period when compared with the pre-revolt period.

All of the preceding tests are based upon a cardinal ranking and comparison of revenues, hence are subject to being unduly influenced by extreme values.

TABLE 3
PERCENTAGE CHANGES IN TOTAL AND PER CAPITA REVENUES

TIME PERIOD	PRE-REVOLT VS TAX REVOLT	PRE-REVOLT VS POST-REVOLT	TAX REVOLT VS POST-REVOLT
TOTAL TAXES	- 24	167	249
P/C TAXES	- 70	255	1,070
TOTAL CHARGES	107	183	36
P/C CHARGES	111	244	63
TOTAL OWN	- 7	123	140
P/C OWN	- 61	231	252

In order to eliminate this possibility, the “go slow” hypothesis can be checked via the non-parametric rank test.⁶ The null hypothesis to be tested is:

$$H_0: \text{Tax increases in the post-revolt years are equal to those in pre-revolt years, and}$$

conversely, the alternative hypothesis is:

$$H_1: \text{Tax increases in the post-revolt years are less than in pre-revolt years.}$$

The null hypothesis as stated is a one-tailed test and implies that if we rank the annual tax increases, the post-tax revolt years should be smaller hence be ranked lower. For our data, the one-sided Prob Values are 17.1, for both total taxes and own revenues. This level of statistical significance provides weak evidence that revenue increases during the post-revolt years have been less than occurred during the pre-revolt years.

There is one additional possibility with respect to the validity of the “go slow” argument that warrants consideration. It is possible that the threat of TEL legislation has led to a decline in the percentage of income claimed by state governments in the form of either taxes or the sum of taxes and and charges (own revenue). The use of personal income as an aggregate economic measure is based on the belief that this is the most comprehensive measure of ability to pay on a statewide basis. Table 5 contains information regarding the relationship between taxes, own revenues and personal income for the years 1973–1985.

TABLE 4
LINEAR TREND ESTIMATES OF GROWTH IN SELECTED REVENUE CATEGORIES (1970 - 1985)
(Millions of real dollars)

	PRE-TAX REVOLT (1970-1977)	POST-TAX REVOLT (1978-1985)
PER CAPITA REAL TAXES	15.976	12.690
PER CAPITA REAL OWN REVENUES	20.345	24.500

TABLE 5
TAXES AND OWN REVENUE AS A PERCENTAGE OF PERSONAL INCOME
1971-1985

YEAR	TAXES	TOTAL OWN REVENUES
PRE-TAX REVOLT YEARS		
1971	5.80	6.90
1972	6.13	7.24
1973	6.22	7.34
1974	6.16	7.40
1975	6.13	7.40
1976	6.17	7.43
AVERAGE OF PRE-TAX REVOLT YEARS		
	6.10	7.29
TAX REVOLT YEARS		
1977	6.31	7.57
1978	6.27	7.51
1979	6.16	7.45
1980	6.09	7.52
1981	5.96	7.46
AVERAGE OF TAX REVOLT YEARS		
	6.16	7.50
POST-TAX REVOLT YEARS		
1982	6.11	7.74
1983	6.05	7.69
1984	6.35	8.04
1985	6.50	8.31
AVERAGE OF POST-TAX REVOLT YEARS		
	6.25	7.95

The hypothesis of a significant difference between the means across the three time periods would be rejected at a 95% or greater level of significance. From a historical perspective, the percentage of income paid in taxes reached record levels in 1985. Indeed, it is the case that both real per capita taxes and own revenues have increased in the post-revolt period relative to earlier time periods. Thus, on an aggregate level, the impact of the tax revolt has been minimal and the validity of the "go slow on tax increases" is highly questionable.

IV

TEL States versus Non-TEL States

A SECOND MAJOR HYPOTHESIS to be tested is that, since TELs are arguably designed to restrict growth in state taxes or expenditures, states with TELs should have experienced lower growth than states without TELs. While the most desirable comparison between these two groups of states would involve holding all other factors constant, there are several complicating factors which make this task virtually impossible. First and foremost the wide variability in existing TEL provisions (coverage of TEL, revenues versus expenditures, ease of waiver) makes invoking this constancy assumption impractical. Secondly, differences in state economies and recessions in 1980 and 1981-1982 render a time series approach extremely difficult.

TABLE 6
AVERAGE PERCENT CHANGE IN PER CAPITA MEASURE OF
EXPENDITURES OR REVENUES, 1981-1985

CATEGORY	TEL STATES	NON-TEL STATES	90% C. I.
TOTAL GENERAL REVENUES	29.95	36.28	- 6.33 p 7.01
TOTAL TAX REVENUE	38.28	40.91	- 2.63 p 5.19
MISCELLANEOUS CHARGES	42.11	56.05	-13.95 p 10.68
TOTAL DIRECT EXPENDITURES	29.04	30.04	- 1.00 p 3.57
EXP'S ON CURRENT OPERATIONS	30.39	33.72	- 3.33 p 3.41

The specific issue to be addressed here is: Have states with TELs experienced lower budgetary growth than occurred in non-TEL states? The methodology utilized to compare TEL states with non-TEL states, while admittedly simple, does serve to provide some insight into differences in growth rates. In order to test the comparable growth hypothesis for as long a period as possible while still including as many TEL states as possible, only those states with TELs in effect for the entire 1981-1985 time period were examined. The specific test used to check for significant differences between the two groups of states is the "t" test for differences between means.⁷

Eleven states can be classified as TEL states—Arizona, California, Colorado, Louisiana, Michigan, Missouri, Montana, Oregon, Tennessee, Texas and Washington. There were eight states which have some experience with TELs (Alaska, Hawaii, Idaho, Nevada, New Jersey, Rhode Island, South Carolina and Utah) but were excluded either because the TEL was not binding or it had not been in force for the entire time period. The remaining thirty-one states make up the non-TEL category.

Table 6 contains information on the average percentage change in various revenue and expenditure categories on a per capita basis over the 1981-1985 time period.

For all revenue and expenditure categories TEL states as a group had slightly smaller average percentage changes than did the non-TEL states. However, as shown by the 90% confidence intervals, the only difference which is statistically significant occurs in miscellaneous charges.

Table 7 depicts the percentage of income paid as taxes for three distinct years for the thirty-one non-TEL states and the eleven TEL states. The percentage of

TABLE 7
PERCENT OF INCOME PAID IN TAXES: 1975-1980-1985

Classification	1975	1980	1985
TEL STATES	6.07	5.84	6.34
NON-TEL STATES	6.45	6.28	6.92

income paid in taxes is lower in all years in the TEL states; however, the difference between these percentages either before or after the tax revolt years is not statistically significant. During the 1975–1980 time period the decline in percentage of income paid as taxes was 0.23 in TEL states and 0.17 in non-TEL states while during the 1980–1985 time period, the increase in percentage of income paid as taxes was 0.50 in TEL states and 0.64 in non-TEL states.

V

Trend Growth Within TEL States

DESPITE THE PRECEDING CONCLUSIONS that states with TELs have not experienced significantly lower growth in either revenues or expenditures and that the tax revolt has not had a lasting effect on budgetary growth, it nonetheless remains possible that those states wherein a TEL has been put in place have experienced declines in either the size or growth of their public sectors. In essence there are two questions which must be answered. First, have state legislatures stayed within the guidelines of the specific limitation and secondly, have existing limitations led to a reduction in taxes as a percentage of personal income?

Prior to conducting various tests of growth within TEL states, there is one caveat that must be noted. The specific details of a state's limitation can make one TEL more restrictive than another. For example, while both South Carolina and Tennessee restrict growth in expenditures to the rate of growth in state personal income, the South Carolina limitation provides for an averaging provision that allows for computing the average growth in personal income over the three preceding years. Thus, while the long run impact of both TELs will be virtually identical, the South Carolina provision for averaging will be less restrictive in the face of an economic downturn.

Another potential difficulty occurs when comparing, for example, Michigan and Missouri. While it is true that both limitations restrict the growth in revenues to a ratio which existed in the base year, the base year chosen can have a significant impact on the restrictiveness of the TEL. As it has happened, the base year selected in Michigan has rendered this limitation more restrictive than is the case for Missouri where the base year was selected such that the impact of the limitation has been minimal. Finally, as noted in Table 2, some of the limitations apply to expenditures while others apply to revenues.

Table 8 presents a comparison of the average annual percentage growth in the applicable public sector category for the post- and pre-revolt time periods for those states which have enacted some type of a TEL.

To provide an exact interpretation of the information in Table 8, consider the case of Texas and Washington. In the case of Texas where an expenditure TEL

TABLE 8
AVERAGE ANNUAL PERCENTAGE CHANGE IN REAL REVENUES
OR EXPENDITURES: 1970-1985

STATE	AVERAGE ANNUAL PERCENTAGE CHANGE	
	PRE-REVOLT YEARS	POST-REVOLT YEARS
ARIZONA	0.64	2.68
CALIFORNIA *	3.27	1.44
COLORADO	0.54	2.84
HAWAII	-0.74	2.15
IDAHO	-0.32	1.80
LOUISIANA	1.82	3.42
MICHIGAN *	1.78	1.37
MISSOURI	0.68	4.70
MONTANA	0.13	3.36
NEVADA *	0.88	-1.48
NEW JERSEY *	7.13	0.13
OREGON	1.52	1.48
RHODE ISLAND *	4.85	2.78
SOUTH CAROLINA	1.42	2.18
TENNESSEE *	2.62	1.71
TEXAS	0.15	1.82
UTAH	0.45	3.10
WASHINGTON	0.30	3.78

has been applicable since 1981, the average annual growth in expenditures between 1981 and 1985 was 1.82%. By way of comparison, the average annual growth in the years from 1970 until enactment of the TEL was 0.15%. In Washington where the TEL applies to tax revenues, the average annual growth in tax revenues during the years from 1970 until enactment in 1981 was 0.3% while during the TEL years the average annual increase in taxes was 3.78%. All other values in Table 8 carry a similar interpretation.

An examination of the two columns reveals that in six of the states—California, Michigan, Nevada, New Jersey, Rhode Island and Tennessee—the average annual changes during the post-TEL years were lower than in the years preceding enactment of the limitation. (However, in Nevada and Rhode Island the limitation applies to the governor’s budget request, not to appropriations.) In the case of Oregon, there was virtually no difference while in the remaining 11 states the growth in either expenditures or revenues was greater in the years after the TEL was enacted.

To test for the possibility that taxpayers within TEL states have seen the portion of their income paid in taxes change, Table 9 contains information on the percentage paid in taxes in the year in which the TEL was enacted and 1985.

The only state where the percentage of income paid in taxes declined after the enactment of a TEL was Colorado. In all other states, taxpayers are actually paying a higher proportion of their income in taxes than they were in the year in which the TEL was put in place.

Another aspect of the relative effectiveness of existing TELs involves a comparison of growth in actual expenditures or revenues as compared with permissible expenditures or revenues as dictated by the specific limitation. To

TABLE 9
PER CAPITA TAXES AS A PERCENTAGE OF PER CAPITA INCOME
YEAR TEL ENACTED AND 1985

STATE	YEAR TEL ENACTED	PERCENT	1985
ARIZONA	1980	6.67	7.22
CALIFORNIA	1981	6.65	6.84
COLORADO	1979	5.35	4.77
HAWAII	1982	9.06	9.36
IDAHO	1982	6.33	6.57
LOUISIANA	1980	6.49	7.63
MICHIGAN	1981	6.17	7.02
MISSOURI	1982	4.32	5.03
MONTANA	1982	6.52	7.07
NEW JERSEY	1976	4.08	5.56** (1983)
OREGON	1981	5.79	5.85
SOUTH CAROLINA	1982	6.98	7.71
TENNESSEE	1979	5.52	5.60
TEXAS	1981	4.97	5.23
WASHINGTON	1981	6.32	7.49

** The New Jersey limitation expired in 1983

illustrate the procedure utilized to compute the information presented in Table 10, consider the case of Washington. In Washington the limitation applies to tax revenues. Specifically, growth in tax revenues should not exceed the average rate of growth of state personal income over the preceding 3 years.

The first year in which the limitation was applicable was 1981. The average rate of growth of personal income over the preceding three years was 10.7% and when applied to actual tax revenues in 1980 yields a limitation based permissible level of \$3,357,007 whereas actual tax revenues for 1981 were \$3,125,815. The difference between actual and permissible tax revenues equals -231,192 which indicates that the actual level of tax revenues was less than those permissible under the auspices of the limitation. A similar computation was made for the remaining years of 1982 to 1985. The use of the entire time period for purposes of this actual versus permissible computation is designed to minimize the adverse effects of any cyclical reversal. The permissible and actual levels of tax revenues were then summed and a percentage change computed. In the case of Washington, the actual level of tax revenues over the five year period was equal to \$19,973,157 while permissible tax revenues equalled \$20,025,683. Thus, permissible tax revenues exceeded actual tax revenues by \$52,526 or 0.3% over the five year period. This suggests that in the case of the Washington tax revenue limitation, taxes could have been higher by 0.3% and still satisfied the requirements of the limitation. A negative sign indicates that permissible tax revenues (or expenditures where applicable) exceeded actual tax revenues. Alternatively, actual tax revenues were less than those permissible under the guidelines specified by the limitation. The remaining percentages depicted in Table 10 were computed in an identical fashion except that in states

TABLE 10
PERCENT DIFFERENCE BETWEEN ACTUAL AND PERMISSIBLE
REVENUES OR EXPENDITURES: NUMBER OF YEARS IN PLACE

STATE	PERCENT DIFFERENCE	YEARS IN PLACE	ANNUAL AVERAGE
ARIZONA	-3.98	6	- 0.66
CALIFORNIA	-0.60	6	- 0.10
COLORADO	3.83	7	0.55
HAWAII	-0.10	4	- 0.02
IDAHO	4.90	4	1.22
LOUISIANA	-18.50	6	- 3.08
MICHIGAN	4.00	7	0.57
MISSOURI	2.50	6	0.42
MONTANA	2.00	5	0.40
NEVADA	-1.60	5	- 0.32
NEW JERSEY	-0.70	7	- 0.10
OREGON	0.80	6	0.13
RHODE ISLAND	1.40	8	0.18
SOUTH CAROLINA	-3.60	4	- 0.90
TENNESSEE	-4.20	7	- 0.60
TEXAS	0.70	5	0.14
UTAH	3.30	5	0.66
WASHINGTON	-0.30	5	- 0.06

where the limitation applies to expenditures, expenditure data was utilized and the time frame that was used for the comparison was dependent upon the year in which the limitation was to take effect.

An examination of Table 10 indicates that in nine of the states—Arizona, California, Hawaii, Louisiana, Nevada, New Jersey, South Carolina, Tennessee and Washington—actual levels of expenditures or revenues were less than those permitted by the limitation. However, when this difference is converted to an annual average the only states where the limitation appears to have had a significant impact were Arizona, Louisiana, South Carolina and Tennessee. Furthermore, in the case of Louisiana, the tax limitation specifically excludes tax revenue from severance taxes, the largest single source of revenue in the state. In the remaining nine states, the limitation has clearly been ineffective in the sense that actual expenditures or revenues have exceeded those permissible by the limitation.

These results are generally in accordance with the responses to an ACIR survey question.⁸ This survey directed the following open-ended question to those states with existing limits:

. . . What has been the effect of your state's expenditure (revenue) limitation? For example, was your expenditure (revenue) limitation a consideration in any recent tax or spending change? . . .

The response in three states (Colorado, Hawaii, and Rhode Island) was affirmative, suggesting that state fiscal policies had clearly been altered because of the limitation. For five states (Alaska, Arizona, Missouri, South Carolina and Texas) the survey respondents implied that the limitation may have had an effect or that the limit might be effective in the future. In the remaining ten

states the respondents indicated that the limitation had no effect whatsoever and that they anticipated no effect on the level of spending or taxes in the future. State legislators clearly feel that as currently formulated, TELs have been or will be ineffective in limiting the growth of the public sector.

VI

TELs as Minimas Rather Than Maximas

ONE OF THE MORE speculative arguments made in the original paper was that while the tendency was to treat TELs as placing a cap on tax increases, it was also possible that they could evolve into tax minima. That is, state legislatures could argue that any tax increases up to the level set forth in the limitation were justified.

In order to test this hypothesis, the first procedure involves computing the actual change in expenditures or taxes and then comparing this to the permissible increase over the time period covered by the TEL. The results of this computation are presented in Table 11. The use of revenue or expenditure figures is entirely dependent upon the type of limitation in effect in each of the states.

The annual average column was computed by subtracting the permissible growth from the actual growth and dividing by the number of years the limitation has been in force. An examination of these annual differences indicates that as a general rule actual growth exceeded permissible growth. This observation, when combined with the fact that virtually all of the annual averages are relatively small, certainly lends credence to the argument that existing TELs could just as

TABLE 11
DIFFERENCE BETWEEN ACTUAL INCREASES IN TAXES OR
EXPENDITURES OVER TIME PERIOD COVERED BY TEL
(millions of dollars)

STATE	NUMBER OF YEARS COVERED	GROWTH IN TAXES/ ACTUAL	EXPENDITURES/ PERMISSIBLE	ANNUAL AVERAGE
ARIZONA	6	75.7	61.6	2.35
CALIFORNIA	6	49.5	48.6	0.15
COLORADO	7	93.0	98.3	- 0.76
HAWAII	4	27.8	18.3	2.38
IDAHO	4	22.8	22.1	0.70
LOUISIANA	6	66.2	53.8	2.07
MICHIGAN	7	52.6	46.3	0.90
MISSOURI	7	70.4	47.7	3.25
MONTANA	4	43.7	31.2	3.12
NEVADA	5	21.6	10.9	2.14
NEW JERSEY	7	58.8	66.7	- 1.13
OREGON	6	44.1	47.8	- 0.62
RHODE ISLAND	8	90.9	92.2	- 0.16
SOUTH CAROLINA	4	25.8	4.2	5.40
TENNESSEE	7	66.9	54.9	1.71
TEXAS	5	43.4	36.1	1.46
UTAH	5	49.2	35.3	2.78
WASHINGTON	5	46.7	43.2	0.70

readily be treated as legalized minima. That is, in virtually all eighteen states the difference between actual and permissible growth is minimal and suggests that state legislatures are expanding the public sector by at least as much as is permitted by the limitation. Indeed in fourteen of the states, actual growth exceeded permissible growth.

A second question in the ACIR survey related the maximum dollar expenditures or revenues permitted under the relevant state limit for the 1983–1984 and 1984–1985 fiscal years to the projected expenditures or revenues for those fiscal years. Using the responses to this question, the ACIR computed a “headroom” figure, where headroom for an expenditure (revenue) TEL was defined as the amount by which permitted expenditures (revenues) exceed predicted expenditures (revenues) and is expressed as a percentage of predicted expenditures (revenues).⁹ In 7 of the responding states, predicted spending and revenue levels closely approximate the maxima allowable under the existing TEL. Additionally, for 9 of the 13 states for which data were available, expected headroom fell from the 1984 to the 1985 fiscal year. The 13 state average headroom as a percentage of total state expenditures or revenues was expected to fall from 11% in fiscal year 1984 to 5% in fiscal year 1985. All of these results indicate that revenue and expenditure levels are expanded to at least the allowable level as specified by the limitation.

VII

Reasons for Ineffectiveness of Existing TELs

THE PREPONDERANCE of the evidence suggests that existing state tax and expenditure limitations are relatively ineffective in constraining either growth in spending or the proportion of income paid in taxes. There are a number of likely explanations for these phenomena. First, the enabling legislation for state TELs is simply not very stringent. There are several aspects associated with this argument:

1. The escape clauses are ambiguously written such that it is relatively painless for the legislature to declare a “fiscal emergency.”
2. In several of the states, significant categories of either expenditures or revenues are excluded from the TEL. In Colorado, “tax relief funding” is not included in the 7% limit and as a result the state legislature has construed state aid to school districts as tax relief. The Louisiana limitation exempts severance taxes and royalties. Since income tax revenue in New Jersey is utilized for local school aid, it is excluded from the TEL.
3. In Tennessee, the original legislation was statutorily amended to allow spending to grow at the same rate as personal income plus 5%.

4. Another aspect of the original legislation relates to the determination of the base upon which future growth is to be estimated. In the case of California, more than \$500 million was appropriated during fiscal year 1980 for transportation programs not requiring funding that year.¹⁰

A second explanation relates to the fact that many of the state level TELs are designed by the state legislatures themselves. Of the 19 TELs, 13 were enacted through the legislative process. Since the impetus for these limitations was the failure of state governments to act in a "fiscally responsible" fashion, allowing these same legislators to design the limitation will likely prove to be fruitless. It is also reasonable to hypothesize that many of the statutory limitations were enacted so as to negate the need for a more stringent limitation.

A third potential explanation for observed ineffectiveness of existing TELs is based upon the belief that these limits are not inherently ineffective, but because of economic conditions during the majority of time that TELs have been in place, they have not directly limited growth in spending or taxes.¹¹ The two recessions directly following the 1978–1980 tax revolt years made it less likely that a limitation would be constraining. In the ACIR survey, 6 of the states with expenditure limitations indicated that lack of revenue was their real fiscal constraint.¹² Furthermore, recessions could account for the ineffectiveness of revenue based TELs in those states with an overall revenue elasticity greater than one.

Perhaps the most important facet of the TELs currently in place is their lack of comprehensiveness. Indeed, it is likely that one of the primary reasons for the ineffectiveness of TELs in limiting growth is that in no case do TELs apply to 100% of state revenues or expenditures. The results of a survey conducted by the Advisory Commission on Intergovernmental Relations regarding the breadth of coverage of existing TELs is presented in Table 12.¹³

While it is true that on average, 60% of taxes or spending are covered by existing limitations, it is worth noting that the specific percentages range from a low of 25 percent in Oregon to a high of approximately 86 percent in Alaska. All TEL states exclude intergovernmental revenue (federal aid), insurance trust funds and, except for Rhode Island, bond funds. Revenue appropriations used for local tax relief are excluded in California, Colorado, Montana and Oregon. User charges and fees are not covered by the TEL in Louisiana, Tennessee, and Texas. Louisiana excludes severance taxes. This lack of comprehensiveness can be regarded as the political decision makers' "escape clause." This viewpoint was best espoused by Say when he argued that if the sovereign introduced more "order and economy" into the tax-collection process, no saving would accrue to the taxpayer. For if this happened, government officials would artificially increase the cost of some other attribute of the government goods package

TABLE 12
REVENUES OR EXPENDITURES COVERED BY TEL LEGISLATION

STATE	TYPE OF LIMIT	PERCENTAGE COVERED
ALASKA	EXPENDITURE	83 - 89
ARIZONA	EXPENDITURE	73
CALIFORNIA	EXPENDITURE	40 - 45
COLORADO	EXPENDITURE	44
HAWAII	EXPENDITURE	57
IDAHO	EXPENDITURE	40 - 50
LOUISIANA	REVENUE	38 - 41
MICHIGAN	REVENUE	70
MISSOURI	REVENUE	70
MONTANA	EXPENDITURE	55 - 60
NEVADA	EXPENDITURE	70
NEW JERSEY	EXPENDITURE	40
OREGON	EXPENDITURE	25
RHODE ISLAND	EXPENDITURE	74
SOUTH CAROLINA	EXPENDITURE	55 - 60
TENNESSEE	EXPENDITURE	57 - 70
TEXAS	EXPENDITURE	57
UTAH	EXPENDITURE	75
WASHINGTON	REVENUE	79

thereby preventing a decrease in the total tax bill.¹⁴ While Say's argument focuses on cost savings, it can easily be extended to the implementation of tax and expenditure limitations. State legislatures simply do not want TELs to be effective in the sense that revenue or expenditure growth is curtailed.

VIII

Conclusion

IT IS ALMOST UNIVERSALLY ACCEPTED that once tax-expenditure limitations are in place they will slow or reverse the growth trend in state government. The primary conclusion which can be reached on the basis of this study is that tax-expenditure limitations as currently structured have had a limited impact in terms of restricting the growth or size of the state budget.

A comparison of growth in states with TELs and those without a limitation indicates that there is no significant difference in expenditure or revenue growth between the two groupings. That is, states with limitations have experienced virtually the same growth as have those states without limitations.

A second conclusion, which is at least suggested by the analysis conducted here, is that existing TELs have functioned as much as legalized minimums as they have maximums.

Thirdly, the relatively low percentage of revenues or expenditures that are covered by existing TELs appears to provide political decision makers with sufficient tools to continue expanding the public sector relative to the private sector. In particular, the exclusion of intergovernmental revenues, miscellaneous

charges and fees, and specific revenue sources most certainly provides state governments with the authority to continue spending.

If the objective of TELs is to limit the growth of state government budgets a more direct approach might prove effective. Specifically, limitations could be formulated such that the total magnitude of government's revenue take is constrained, *e.g.*, tax revenues could be no higher than some absolute amount or higher than a specified percentage of per capita personal income.

Notes

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3. Steven D. Gold, "State Tax Increases of 1983: Prelude to Another Tax Revolt?" *National Tax Journal*. Vol. 37, p. 12.

4. *State Government Finances*, selected issues. U.S. Department of Commerce, Bureau of the Census. Washington, D.C.: U.S. Government Printing Office.

5. Dale G. Bails and Larry C. Peppers, *Business Fluctuations: Forecasting Techniques and Applications*. Englewood Cliffs, N.J.: Prentice-Hall. 1982. pp. 270–72.

6. Thomas H. Wonnacott and Ronald J. Wonnacott, *Introductory Statistics for Business and Economics*. 2nd ed. New York: John Wiley & Sons, 1977, pp. 481–85.

7. *Ibid.*, pp. 212–16.

8. Advisory Commission on Intergovernmental Relations, Chapter 2, pp. 8–9.

9. Advisory Commission on Intergovernmental Relations, Chapter 2, pp. 9–11.

10. Gold, pp. 5–10.

11. Gold, pp. 3–10.

12. Advisory Commission on Intergovernmental Relations, Chapter 2, pp. 17.

13. Advisory Commission on Intergovernmental Relations. *Fiscal Discipline Tools Developed by State Governments: Tax and Expenditure Limits and Other Mechanisms*. Unpublished Report, September 1984. pp. 13.

14. Jean Baptiste Say, *A Treatise on Political Economy* New York: A. M. Kelley. 1971. pp. 450–51.

Wise Saying

SO DOLEFUL a contemplation is it to think the world should be destroyed by those men, who by God were ordained to save it!

JOHN WISE 1717

Prestige

CRITICISM IS A STUDY by which men grow important and formidable at very small expense.

SAMUEL JOHNSON