What are tax and expenditure limits?

Tax and expenditure limits (TELs) restrict the growth of government revenues or spending by either capping them at fixed dollar amount or limiting their growth rate to match increases in population, inflation, personal income, or some combination of those factors. As of 2015, 28 states had at least one TEL on spending or rev-

DESIGNING TAX AND EXPENDITURE LIMITS

Spending versus revenue limits. Limits can be placed on revenue, appropriations, or both. Many states, for example, have a mechanism in place to restrict the growth of property taxes, but this is more often a restraint imposed by the state on local governments. Typically, states limit the ability to appropriate or spend funds rather than limit revenue collected. In 2015, 26 states imposed limits on their own government spending. By contrast, only two limited revenue; these two also capped spending.

Mechanism. The means used to limit spending and revenue varies. The limit can either be a cap on growth or a restriction on the level. The most common formula restricts expenditure growth to the pace of personal income. But some states include population and inflation growth in the formula. And others restrict expenditures to a level determined by a formula, such as a set percentage of personal income.

Idaho, for example, limits expenditures to 5.33 percent of state personal income, thereby allowing expenditures to grow at the same rate as personal income. Another method is to restrict expenditures to a percentage of projected revenue, maintaining a cushion in case revenues fall short of the projection.

Stringency. In general, TELs set in state constitutions are more difficult to change or override than statutory TELs. By the same token, TELs imposed directly by voters rather than legislators are more restrictive (New 2010).

Some TELs prohibit lawmakers from evading the limit through unfunded mandates or transfers of program responsibility to local governments, but more often, the measure of a TEL’s stringency is the ability of the governor and legislature to override the cap. Several states have what at first glance appear to be restrictive TELs, but those states only require simple legislative majorities to override, which is the same threshold for approving budgets. Six states—Alaska, California, Colorado, Missouri, South Carolina, and Texas—require popular votes to exceed the limits (figure 1).
There are also 14 states with legislative supermajority (usually three-fifths or two-thirds of the legislature) and voter approval requirements for new taxes. These requirements may pertain to all taxes or only to specific revenue sources, such as corporate or sales taxes. The most stringent revenue limits require that surplus revenues go back to taxpayers as rebates or be sequestered in rainy day funds. Oregon’s “Kicker” rebate and Colorado’s Taxpayer Bill of Rights (see box) are examples. Thirteen states require supermajorities to increase taxes; Colorado requires a voter referendum.

TELs can also interact with other constraints. Knight (2000) found that states with both TELs and supermajority requirements to raise taxes had lower expenditures than states with just one constraint or the other. Poterba and Rueben (1999) found that TELs affect the costs of state borrowing in two ways: not surprisingly, spending limits lower the costs, and revenue limits increase them.

BACKGROUND

Most TELs emerged during the “tax revolt” of the late 1970s or the economic recession of the early 1990s. Although many of the best-known local property tax limits, such as California’s Proposition 13 and Massachusetts’s Proposition 2½, were adopted through citizen initiatives, most state TELs originated in their legislatures. As of 2015, legislatures had enacted 17 TELs, nine were passed as voter initiatives and two emerged from constitutional conventions.
Evidence on whether TELs limit state and local spending is mixed (Gordon 2008). Rueben (1996) found that specific details of the laws matter and that TELs requiring a legislative supermajority or popular vote to modify spending led to a 2 percent reduction in state general fund expenditures. However, those savings were offset in part by higher local spending. New (2010) found that TELs adopted through citizen referendum were more effective than those adopted by legislatures.

PROPERTY TAX LIMITS

Property tax limits constitute a special category because, in most cases, the limits are set by state governments but apply to local governments. Only four states—Connecticut, Hawaii, New Hampshire, and Vermont—do not limit property taxes. State restrictions can apply to the property, to the jurisdiction, or both. Rate limits impose maximum rates on jurisdictions (e.g., counties, municipalities, and school districts) and apply to properties. Limits on how much assessments can increase are typically applied to properties.

For example, Arizona limits combined state and local tax rates to a maximum of 1 percent; restricts governments’ taxing authority to levy property taxes at 2 percent over the previous year; caps local government expenditure growth financed by property taxes to inflation and the growth in population; and limits residential property assessment to 10 percent growth.

Colorado’s Taxpayer Bill of Rights (TABOR)

Colorado enacted a TABOR in 1992 that is arguably the nation’s most restrictive TEL. The TABOR applies to all taxing districts in the state, and requires that voters directly approve all tax rate and property tax assessment increases as well as the imposition of new levies. The law also explicitly prohibits particular types of taxes.

The TABOR also limits general revenues to the previous year’s revenues adjusted for population growth and inflation. All excess revenues must go back to Coloradans through tax reductions or cash rebates. Only voters can override these provisions or any other spending or revenue limits. However, in November 2005, Colorado voters did agree to suspend the revenue cap for five years. (McGuire and Rueben 2006)

DATA SOURCES

National Association of State Budget Officers, Budget Processes in the States. Table 11. “Tax and Expenditure Limitations (TELs).”


WORKS CITED AND FURTHER READING


