



TAXPAYER REPORT

Fiscal Cap Style TELs in the States: An Inventory and Evaluation

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Introduction

One could easily argue that the United States traces its political roots back to a tax revolt. The now famous statement “no taxation without representation” is one that most citizens readily identify with the War for Independence and the founding of the nation. And, since the founding period, almost every subsequent generation of Americans has fought its own battle over some aspect of taxation and, along with it, the appropriate role, scope and reach of government vis a vis individuals. Although the issue has largely remained the same, the level of sophistication of the battle and the resulting tax policies have elevated and increased in complexity since our ancestors first dumped a load of tea into Boston Harbor. “From the Boston Tea Party to the Whisky Rebellion to the repeal of Lincoln’s ‘War Tax,’ American history is replete with tax *rebellions* (emphasis in original) brought on by political and economic factors peculiar to those times. But the Tax *Revolt* (emphasis in original) – the ongoing political movement for limited government – is a more recent phenomenon...” (Sepp, 1999, p. 2). Along with the increasing sophistication of the modern tax revolt and the resulting policy instruments, came consequences, both intended and unintended, on the scope, size and reach of government, its ability to provide public services, and increasingly its ability to both tailor its tax code and respond to changing economic conditions. Each generation, thus, is left to study and analyze the ultimate consequences of its actions in this policy arena.

Although rooted in the turn of the 20th century progressive and populist era reforms (Broder, 2000; Sepp, 1999), most scholars typically date the beginning of current generation’s tax revolt, one largely centered around efforts at codifying tax and expenditure limitation language, to the 1978 passage of Proposition 13 in California (Sexton, Sheffrin, and O’Sullivan, 1999). In the wake of California’s successful initiative, citizens and legislatures in over half of the states in the nation passed limitations on taxing and spending into either their constitutions or their statutes¹ (Rafool, 1996). The legal structure of these limitation measures varies from state to state, and it is this variation, along with an inventory of the major provisions in place in each state, that is the subject of this report. As Colorado embarks on what is likely to be a year-long discussion on the future of our state’s fiscal cap TEL, the TABOR Amendment, The Center For Tax Policy hopes that this evaluation of the fiscal cap TEL activity in the other states will serve as an important resource².

¹ Or, as in the case of some states, e.g., Colorado, both.

² The data for this report comes from a 1996 National Council of State Legislatures publication authored by Mandy Rafool. The title of that publication is *State Tax and Expenditure Limits*.

Fiscal Cap Style Tax and Expenditure Limitations

Although the genesis of the modern tax revolt and TEL movement is often placed at the 1978 passage of Proposition 13 in California (Sexton, Sheffrin, and O'Sullivan, 1999), in retrospect the true legacy of the revolt is not Proposition 13³ type property tax limits but rather the more comprehensive effort at limiting the growth of government through fiscal caps (Cox and Lowery, 1990) or supermajority requirements. In fact, in the immediate aftermath of Proposition 13, only two states passed property tax limits (Cox and Lowery, 1990) while just over half of the states passed fiscal cap type limits (Cox and Lowery, 1990; Rafool, 1996; New 2003) and/or supermajority requirements. Unlike limits targeting only the property tax such as Proposition 13 or Massachusetts' Proposition 2 ½, the more common fiscal cap style TELs place limitations on future state taxing and/or spending by establishing a base and tying future revenue and/or spending growth to specific factors such as growth in personal income. Supermajority requirements restrict the growth of government by requiring some supermajority of the legislature or approval from a majority of the voters to raise taxes.

Fiscal Caps and Supermajorities

Fiscal caps and supermajorities were generally favored over specific property tax limitations due to their comprehensive approach toward curbing the growth of government. "In contrast to balanced budget requirements and property tax cuts, neither of which necessarily restricts government size, caps are explicitly designed to restrict public sector size to some proportion of the total economy" (Cox and Lowery, 1990, p. 492). Additionally, both fiscal caps and supermajority requirements are future minded. Rather than cut property taxes at the time of passage as with Proposition 13 type property tax limits, fiscal caps and supermajority requirements left current taxation and spending in place and concentrated the effect of their limitation at curbing government growth in the future. Since the future is uncertain, the true effects and

³ The other well-known property tax limit from this era is Massachusetts' Proposition 2 ½.

consequences, both intended and unintended, of such measures as tax policy is equally uncertain. However, over the last decade or two, there has been the beginning of a literature dedicated to evaluating the effects of TELs in the states. One contribution of that literature is a sound basis for evaluating and ranking TELs according to restrictiveness. The sections that follow provide both baseline information about the fiscal cap TELs operating in the states at the 1996 printing of the NCSL report⁴ as well as a ranking of those TELs for degree of restriction written into the state's tax policy.

Inventory of Fiscal Cap TELs

In the latest comprehensive survey of state-level fiscal cap style TELs, published in 1996 by the National Conference of State Legislatures (Rafool, 1996), just over half of the states in the nation had some form of fiscal cap type TEL in place⁵ (Rafool, 1996). The first of these fiscal caps passed in 1978 in Arizona, and the most recent came in 1996 in Missouri. Over the 18-year period, there was almost constant activity at the state level in enacting fiscal cap type TELs. Some states, particularly Colorado, Louisiana, and Missouri passed multiple measures during the 18 years of activity in this area. Data are not available on TELs that were proposed, either to the ballot of a particular state or in the legislative body, and defeated.

Although no two states passed exactly the same language when enacting tax and expenditure limits, the limits may be generally organized along and characterized by the following generally agreed upon distinctions (New, 2003; Rafool, 1996):

- method of codification (statutory or constitutional)
- method of approving the limit (citizen initiated vote, referred measure,

⁴ According to NCSL staff, there has been only minimal TEL activity in the states since the 1996 publication of *State Tax and Expenditure Limits*.

⁵ As will be outlined below in the data and methods section of this proposal, part of my data collection efforts will be verifying and expanding upon the latest survey of TELs performed in 1996.

- legislative action, constitutional convention)
- method by which the limit is calculated (growth tied to personal income growth, populations plus inflation, or other growth factor)
- to what does the limit apply (revenues, expenditures, appropriations)
- treatment of any surplus revenues (rainy day funds, returned to taxpayers),
- provision for waiver of the limit (declared emergency, legislative majority or supermajority, none), and
- requirements for exacting tax increases (i.e. supermajority of the legislature, popular vote).

Of the 30 limits passed in 27 states between 1978 and 1996, 13 were statutory and 17 were constitutional (Rafool, 1996). Seven of the limits were passed after being placed on the ballot by citizen initiative, 11 were enacted by state legislatures, 10 were referred to the ballot by legislatures, and 2 measures (Hawaii and Tennessee) were enacted through a constitutional convention (New, 2003). The limits generally applied to growth in appropriations, expenditures, or revenues with only one limit (in Colorado) applying to both revenues and expenditures. The majority of the limits, 24 of the 30, apply to appropriation/expenditure growth. Ten of the 30 limits have no specific dictates for treatment of surplus revenues while the remaining 20 require that surpluses be either set aside in "rainy day funds" or returned to the taxpayers.

In all but five cases, there is a provision written into the language of the TEL to provide for a procedure to override the limit. However, the threshold for override ranges from a simple majority of the legislature up to a declaration of an emergency by the governor along with a 2/3 supermajority of the legislature. Many states have also required a positive vote of a supermajority of the legislature or even a majority of the voters to increase taxes. In some states, the supermajority requirement is passed as part of the TEL language and in others, the

requirement of a supermajority to increase taxes is passed as a separate limit⁶. As of 1996, 13 states required either a supermajority or a vote of the citizens to increase taxes. Table 1 summarizes state level fiscal cap TELs according to their treatment of the variables listed above.

Taxonomy of Fiscal Cap TELs

Not all TELs are equal. There is a nearly unanimous consensus in the literature concerning the relative restrictiveness of particular provisions of TELs (New, 2003; Stansel, 1994; Sepp, 1999; Joyce and Mullins, 1996; Shadbegian, 1999). This section considers each of the characteristics of TELs separately and ranks the level of restrictiveness of the TEL accordingly. Later, these rankings, intended to be ordinal only, will be used to place the TEL states in rank order from most to least restrictive.

Method of Codification - Statutory or Constitutional

Each TEL must be codified into law somewhere in a state's code. On this characteristic of TELs, there are only 2 options. TELs are either written into the state's statutes (statutory) or passed as an amendment to the state's constitution (constitutional). Of the 30 measures passed in the 27 TEL states, 17 measures are constitutional and 13 are statutory. Constitutional TELs, because of the extraordinary process required in order to amend a state's constitution, are generally considered to be more restrictive than statutory ones that may be changed by an act of the legislature (Sepp, 1999). As a result, the rankings in terms of restrictiveness on this characteristic are as demonstrated in Table 2 below.

(Note: For the tables that follow, the higher the number, the more restrictive the tenet of the TEL. However, as mentioned above, the numbers are intended to be ordinal only. That is, the numbers themselves represent nothing about the relative intensity of the restriction.)

⁶ The section below dedicated to supermajority requirements will further elaborate on the use of such measures in the states.

Table 2 Method of Codification	
Constitutional or Statutory	Ordinal Value
Constitutional	2
Statutory	1

Source: New, 2003; Stansel, 1994

Method of Approving the Limit - Citizen Initiative, Referred Measure, Legislative Action, or Constitutional Convention

TELS may become law by a variety of methods. The most common among the TELS in this study is passage by a vote of the state legislature. 11 of the 30 measures passed in that manner. Closely behind, 10 of the measures were referred onto the ballot of the state by the legislature. Referred measures must pass both the legislature to get on the ballot and then also pass a vote of the citizens. Some citizens, those who live in states that allow for the initiative process, may elect to bypass the legislature and send ballot language directly to the voters via a citizen initiative. 7 of the measures passed in this manner. Finally, 2 states convened constitutional conventions to place their TELS into the state's constitution. Table 3 ranks TELS according to the restrictive nature of their method of passage.

Table 3 Method of Approving the Limit	
Method of Enactment	Ordinal Value
Citizen Initiative	4
Constitutional Convention	3
Referred Measure	2
Legislative Vote	1

Source: New, 2003; Stansel, 1994; Sepp, 1999

As a measure of restrictiveness, many studies attempt to correlate the restrictive nature of TELS with their effectiveness at limiting growth in government spending, the intended effect of a fiscal cap style TEL (Stansel, 1994; Kenyon and Benker, 1984; Howard, 1989; Cox and Lowery,

1990; Bails, 1990). That is, a TEL is considered more restrictive the more it is effective at limiting growth in government relative to some national average growth rate. On this measure, the research clearly demonstrates both that not all TELS are restrictive and that measures initiated by citizens and passed into law through the ballot box are far more effective, and therefore restrictive, than those passed by the legislature (Stansel, 1994). Intuitively, this rings true as well and the highest ranking above goes to citizen initiated measures. Constitutional conventions are the second most restrictive as they are the other mechanism for language to be placed into the constitution by citizen delegates to the convention.

Not all states have the initiative process written into their constitution. Therefore, not all citizens have the opportunity to write ballot language. In those states, the options for passing a TEL are either by a direct vote of the legislature or through a measure referred to the ballot by the legislature. Of those 2 remaining options, referred measures are found to be more restrictive due to the pressure placed on the legislature to create language that the citizens will be willing to pass. Experience confirms this intuition as states with referred measures have seen slight declines in the growth of government while those states with TELS that passed by legislative vote have historically seen a greater than average increase in the growth rate of government (Stansel, 1994). TELS passed by legislative vote are the least restrictive of all.

Method by Which the Limit is Calculated

TELS are different from Proposition 13 type limits in that TELS don't specifically limit a particular tax as was done with property taxes in California and Massachusetts. Instead, TELS limit future growth in government by limiting the growth in revenues or expenditures to a specific growth factor. Not all growth factors are equal.

The most popular of growth factors are personal income and a combination of population plus inflation. In comparing these two measures for the decade of the 1980s, Stansel (1994) notes that personal income grew at a rate 3 times that of population for the US overall. Even if one

adds inflation to population growth, the growth rate in personal income would still outstrip that of population plus inflation. Notwithstanding the argument that personal income growth is the appropriate factor because it limits public sector growth to that of the private sector, limits that use a growth rate of personal income are considered the weaker of the 2 most popular limits due to the historically strong rate of income growth (Stansel, 1994). In addition to these most popular types of limits, some states limit growth to a percentage of general fund receipts or to some percentage of projected revenue. Only projected revenue may be considered weaker than personal income since a projection, being an educated guess at best, is more easily manipulated in order to weaken the limit. Table 4 shows the relative rankings for growth limits.

Growth Factor	Ordinal Value
Population plus Inflation	4
Some Percentage of General Fund Receipts	3
Personal Income	2
Projected Revenue	1

Source: Stansel, 1994; Sepp, 1999

To What Does the Limit Apply - Revenues, Expenditures, or Appropriations?

As the section above described, all fiscal cap TELs establish growth limits in an effort to restrict the expansion of government. These growth limits must be applied to a particular base in order to be effective. As with other aspects of fiscal caps, the base against which the limit applies varies with the TEL. The most popularly used bases are revenues, expenditures/appropriations or both.

Of the 30 measures identified in this study, 24 limit expenditure growth, 5 limit revenue growth, and one, the TEL in Colorado, applies to both revenues and expenditures. Of these three bases for government growth, the combination of

revenue and expenditures is considered the most restrictive since it limits both sides of the ledger concurrently. For limits that apply to one side of the budget or another, expenditure limits are considered more restrictive than revenue ones. In most budgets, revenues are mere projections established from a base of assumptions about the state of the economy. Actual experience with revenues often fluctuates significantly from projections. Because of this, revenue projections are far more amenable to manipulation than are expenditure budgets (Stansel, 1994). This latitude in the revenue number permits for circumvention of the limit in ways that a limit based on expenditures does not. Table 5 presents the rankings for the base of the limit.

Limit Applies to	Ordinal Value
Expenditures and Revenue	3
Expenditures/ Appropriations	2
Projected Revenue	1

Source: Joyce and Mullins, 1996; Shadbegian, 1999; Stansel, 1994

Treatment of Surplus Revenues - Rainy Day Funds, Returned to Taxpayers

Fiscal cap TELs limit the growth of government by capping the total that government may either collect, spend or both. Often, actual revenue collections at the state level exceed the amount allowable by the TEL. In that instance, there is often a provision in the law for treatment of those surplus revenues.

In general, there are three broad categories addressing treatment of surplus revenues. The most restrictive requirement for surpluses is that that the excess is returned to the citizens through some sort of refund mechanism. In this instance, none of the surplus is available for any governmental use. In some cases, surplus revenues may be either used for particular approved uses such as the retirement of debt or may be placed into state rainy day funds to be used for emergencies. This is considered a less

restrictive requirement for surplus revenues. Finally, some states' TELs are silent on the treatment of surpluses. Table 6 presents the rankings for treatment of the surplus.

Treatment of Surplus	Ordinal Value
Refunds	3
Rainy Day Fund or Other Approved Government Use	2
No Specific Provision	1

Provision For Waiver of the Limit - Declared Emergency, Legislative Majority or Supermajority
 Finally, state TELs vary in their requirements, if any, for overriding the limit. Many states write into their laws a provision to override the limit providing a certain threshold is met. The most common provision for override is some combination of a gubernatorial declared emergency and some majority or supermajority of the legislature. However, some states have written in more stringent requirements for override. The most restrictive of these is that a majority of the voters approve overriding the limit through a vote. Often, the citizen approval must be coupled with a declared emergency. Finally, of those states that provide a specific requirement for overriding the limit, the least strict of these are the TELs that may be overridden by a simple majority of the state legislature. Table 7 presents the ranking for override provisions.

Provision for Waiver	Ordinal Value
Citizen Approval	5
Gubernatorial Declared Emergency and 2/3 of Legislature	4
Supermajority of Legislature	3
Majority of Legislature	2
No Specific Provision	1
<i>Source/Justification for Valuation: Stansel, 1994</i>	

Most fiscal cap TELs speak to the 6 major categories summarized and classified above. Some TELs, however, go a step further and require a supermajority of the legislature or majority approval of the voters to enact a tax increase. While some states include so called supermajority requirements into the language of their TEL, other states pass supermajority requirements separately from the fiscal cap TEL. Not all TELs include supermajority requirements and some states pass stand-alone supermajority requirements without any other provisions of the traditional fiscal cap TEL. The section below outlines the supermajority requirements that are on the books in the states, both those that are passed in conjunction with the TEL and those that are separate from any other activity.

Supermajority Requirements

Another form of state level TEL is the supermajority requirement⁷. States vary in their use of the supermajority requirement. States such as Colorado, California, Missouri, and Washington passed their supermajority requirement as part of their fiscal cap TEL. Other states, Oregon, Arizona, Nevada, Delaware, Florida, Louisiana, and Oklahoma, and Mississippi passed supermajority requirements

⁷ For the purposes of this study, and consistent with the literature, the term supermajority requirement will refer to both the requirement for a supermajority of the legislature or a vote of the citizens to increase a tax.

as pieces of law separate from their fiscal cap TELs. In those cases, the two restrictions then work together to limit the scope of government. Finally, Arkansas and South Dakota have limited their experience with TELs to supermajority requirements only. These three states have no fiscal caps in place separate from the supermajority requirement. Table 8 summarizes the supermajority requirements in the states.

State	Year Passed	Method of Enactment	Majority Required
Arizona	1992	Initiative	2/3 of Legislature
Arkansas	1934	Referendum	3/4 of Legislature
California	1979	Initiative	2/3 of Legislature
Colorado	1992	Initiative	Majority of Voters
Delaware	1980	Referendum	3/5 of Legislature
Florida	1971	Referendum	3/5 of Legislature
Louisiana	1966	Referendum	2/3 of Legislature
Mississippi	1970	Referendum	3/5 of Legislature
Missouri	1996	Initiative	Majority of Voters for tax increase over \$50 million or 1% of state revenues
Nevada	1996	Initiative	2/3 of Legislature
Oklahoma	1992	Initiative	3/4 of Legislature
Oregon	1996	Referendum	2/3 of Legislature
South Dakota	1996	Referendum	3/5 of Legislature
Washington	1993	Initiative	2/3 of Legislature if not over the fiscal cap,

			majority of voters if exceeds fiscal cap
Source: Rafool, 1996			

As with all of the other aspects of TELs reviewed above, it is possible to classify the restrictiveness of supermajority type requirements according to the majority required. Table 9 lists supermajority requirements from most to least restrictive in nature.

Supermajority Requirement	Ordinal Value
Popular Vote	4
3/4 of Legislature	3
2/3 of Legislature	2
3/5 of Legislature	1
Source: Rafool, 1996	

Rankings

Using the taxonomy of TELs outlined above, it is possible to qualitatively rank state TELs according to the degree of restrictiveness written into the law. For example, the most restrictive state TEL would have the following characteristics:

- It would be constitutional
- It would be a citizen initiated measure
- It would limit growth in both revenues and expenditures
- The growth in government would be limited by population plus inflation
- It would require that surplus revenues be returned to the citizens
- It would require citizen approval for waiving the limit, and
- It would require a majority of the voters to approve any tax increase.

According to these criteria, Colorado's 1992 fiscal cap limit is the strictest in the nation. The

remaining limits may be ordinally ranked behind Colorado on this scale. The rankings were derived by quantifying the ordinal rankings provided in Tables 2 through 7 and in Table 9. Any state whose TEL characteristic was most restrictive on the above rankings received a score of 3 for that characteristic. For characteristics that were in the middle of the ordinal rankings, a score of 2 was assigned. A TEL's characteristic that was at the bottom of the ordinal rankings received a score of 1. So, for example, any state that had a TEL that was referred to the voters by the legislature would receive a score of 2 on that characteristic. If a state had a citizen initiated TEL, the score would be 3 and a state with a legislatively approved TEL would receive a score of 1. Totaling the scores for all 7 characteristics of TELs (including supermajority requirements, where applicable) yielded the rankings listed in Table 10, with the higher scores representing more restrictive TELs. It is important to emphasize that even these numerical rankings are still ordinal in nature. That is, a higher score represents a more restrictive TEL; however, the scores in and of themselves say nothing of the intensity of the ranking. For example, from Table 10 we know that Colorado's 1992 measure is the most restrictive in the nation. But it would not be correct to say that it is twice as restrictive as the measures in Louisiana, Massachusetts, and Rhode Island, whose scores were about half that of Colorado.

Conclusion

Although over half the states in the nation have adopted fiscal cap style TELs and/or supermajority requirements, not all measures are created equally. This report, based off of the 1996 inventory of tax and expenditure limits compiled by the National Council of State Legislatures, attempts to highlight the differences in states' TELs as well as to provide a ranking of restrictiveness of the measures currently operational in the states. It is our hope that this sort of comparative analysis of fiscal cap style TELs will serve to inform some of the discussions currently occurring concerning tax policy in Colorado, particularly as reform options are developed and debated.

Table 10 State Rankings		
State	Year Passed (<i>First date is for fiscal cap, second date for supermajority requirement, if different</i>)	Score
Colorado	1992	21
California	1979	16
Louisiana	1993, 1966	15
Missouri	1996	15
Washington	1993	15
Arizona	1978	14
Hawaii	1978	14
Missouri	1980	14
Oklahoma	1985, 1992	14
Alaska	1982	13
Connecticut	1992	13
Delaware	1978, 1980	13
Florida	1994, 1971	13
Michigan	1978	13
South Carolina	1980	13
Nevada	1979, 1996	12
Oregon	1979, 1996	12
Tennessee	1978	12
Texas	1978	12
Louisiana	1979, 1966	11
Massachusetts	1986	11
Rhode Island	1992	11

North Carolina	1991	10
Utah	1989	10
Colorado	1991	9
Iowa	1992	9
Mississippi	1992, 1970	9
Montana	1981	9
New Jersey	1990	9
Idaho	1980	8
Arkansas (Supermajority Requirement Only)	1934	2
South Dakota (Supermajority Requirement Only)	1996	1

<http://www.gov.harvard.edu/colloquium/american%20politics%20papers/New.pdf>

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