



No Silver Bullet

Tax and Spending Limits, Though Often Useful, Can't Cure All Budgetary Ills

BY BETTY JOYCE NASH

Think you can balance your state's checkbook better than your state legislators can? In 24 states — none in the Fifth District — citizens can collect signatures and pass tax-and-spend limits (or other laws) via the ballot box. Alas, the limits have not immunized participating states from current financial illness.

For instance, in 1994 Colorado instituted spending limits by constitutional amendment, the Taxpayer Bill of Rights or TABOR. The amendment stipulates that tax increases be approved by voters. It also limits growth in state spending and limits tax increases to inflation plus the population growth and says excess revenue must be refunded. But Colorado is in the midst of its worst fiscal crisis in more than 50 years.

Nationwide, states are still in the hole by about \$21.5 billion in the current fiscal year, 2003, according to the National Conference of State Legislatures. And in 2004, 41 states expect a cumulative gap of more than \$78.4 billion.

"What really happened is the revenue disappeared," says Nicholas Jenny, senior policy analyst with the Nelson A. Rockefeller Institute of Government's Fiscal Studies Program. The National Association of State Budget Officers' Stacey Mazer observes that Wyoming, a state operating with tax-and-spend limits driven by voter initiative, is weathering the crisis nicely but for different reasons.

"Their sources of revenue aren't personal income but resources," she says, referring to the state's coal, oil, and gas production. "They're one of the few states without a budget problem [but] I would not attribute it to the [tax-and-spend limit] initiatives." States whose budgets depend on personal income taxes have fared the worst, she says.

Historically, most of the states with constitutional authority to use voter initiatives are west of the Mississippi River. The first such effort took place in South Dakota in 1898 at the dawn of the Progressive Era. Eighteen states followed in the next 30 years and six more followed in the last half of the 20th century. The concept didn't catch on in the East probably because Easterners were afraid that newly arrived immigrant populations would upset the status quo. Today, the Eastern states that permit voter initiatives are Florida, Maine, Massachusetts, and Mississippi.

"The populist movement was strong in the West, where many people believed that corporations and business interests controlled state governments," says Alan Tarr, of the Center for State Constitutional Studies at Rutgers University. Also, Western states were just putting their constitutions in place at the turn of the last century. "[That] gave an opportunity to make direct democracy part of the original constitutional design."

Research by John Matsusaka, an economist at the University of Southern California, shows that state spending was about 4 percent per capita lower in states with voter initiatives than in pure representative states. Matsusaka used 30 years of data to compare fiscal behavior in states that permit voter initiatives and states that allow only legislators to pass laws. While spending in voter initiative states was lower, local spending was higher. "After one controls for income, population density, metropolitan population, population growth, mineral production, ideology of U.S. senators, and federal aid, initiative states have lower combined state and local direct general

expenditure, spend more locally and less at the state level, and rely less on taxes and more on charges to generate revenue than pure representative states," explains Matsusaka.

"The initiative process in theory and practice can have an effect on fiscal policy independent of there being a TEL [Tax and Expenditure Limitation]," he says. "Simply the fact that it's out there and it's a threat has an effect on the way the legislature behaves."

Barry Poulson, an economics professor at the University of Colorado, attributes that state's current fiscal crisis partly to changes in the tax system, namely a flat tax enacted in the late 1980s that increased income taxes as a source of revenue. And that's made revenues more volatile, according to Poulson. Colorado's constitution includes tax-and-spend limits but also includes an amendment that mandates spending for public education.

"It is fair to say that no one predicted how these constitutional constraints would impact state fiscal policy in the current recession, nor is it clear how to unravel this constitutional puzzle," Poulson notes. Poulson advocates a budget stabilization fund linked to a revenue limit. In good times, surplus revenue could go to a rainy day account and a portion to tax refunds and cuts. He further suggests that constitutional constraints on taxes and spending could be nonbinding in recession years and become binding again in good times.

Colorado's experience could be instructive to Fifth District states considering solutions to fiscal problems. Properly constructed, there seems to be some evidence that tax-and-spend limits may check government growth. But they are not a panacea. **RF**