

Is it possible to design an effective tax and expenditure limitation (TEL)? Lessons from New England

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Tax and/or expenditure limit (TEL)
= growth index * base

Base: the portion of budget limited

Growth index: the rate a defined base is allowed to grow annually

State and local TELs at work in New England

- Maine (state and local)
- Rhode Island (state and local)
- Massachusetts (state and local)
- Connecticut (state)

Question: Is it possible to design an effective TEL?

The simple answer:

Yes, if your only interest is to limit government growth.

Rhode Island: Joint Resolution 2006-H7485

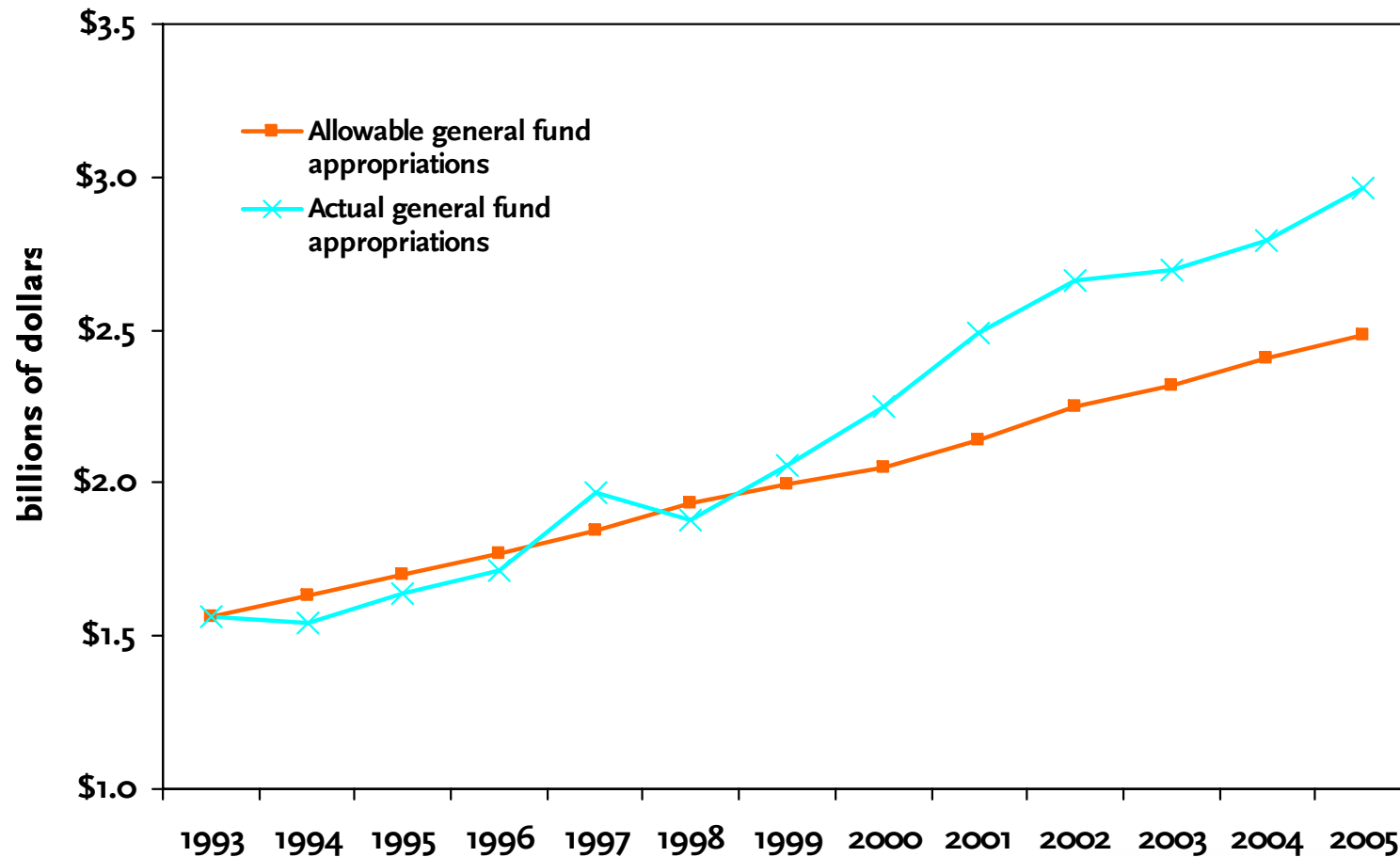
Base:

- General fund appropriations in the fiscal year after the TEL is signed into law

Growth index:

- Inflation + 1.5 percentage points
- 2/3 approval by the legislature required to override limits, only in the event of an emergency

If first applied first in 1994, general fund appropriations would have been 16 percent lower by 2005



Maine: TABOR

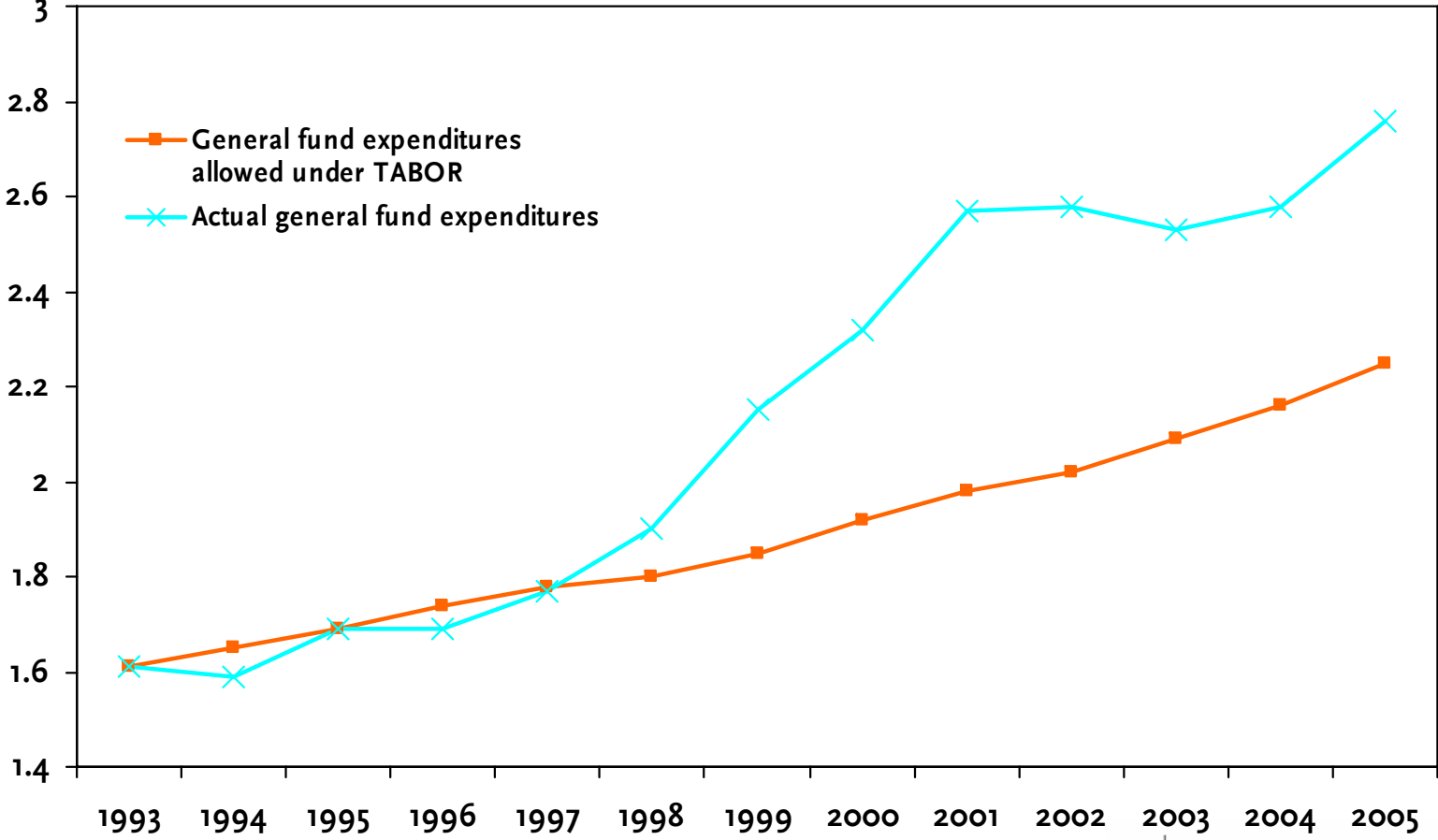
Base:

- General fund, highway fund, special revenue and quasi-governmental fund expenditures from the previous year
- Increase in revenues requires super-majority vote of both houses and voter approval

Growth index:

- Annual percentage change in population plus inflation

If first applied first in 1994, TABOR would have reduced General Fund expenditures beginning in the late 1990s



Question: Is it possible to design an effective TEL?

A better answer:

Maybe. It depends.

It depends on how you define and measure effective.
What do you want to achieve?

- More limited government growth to promote:
 - Growth rate that the public wants or needs
 - Greater government efficiency
 - More economic competitiveness
 - Improved fiscal stability

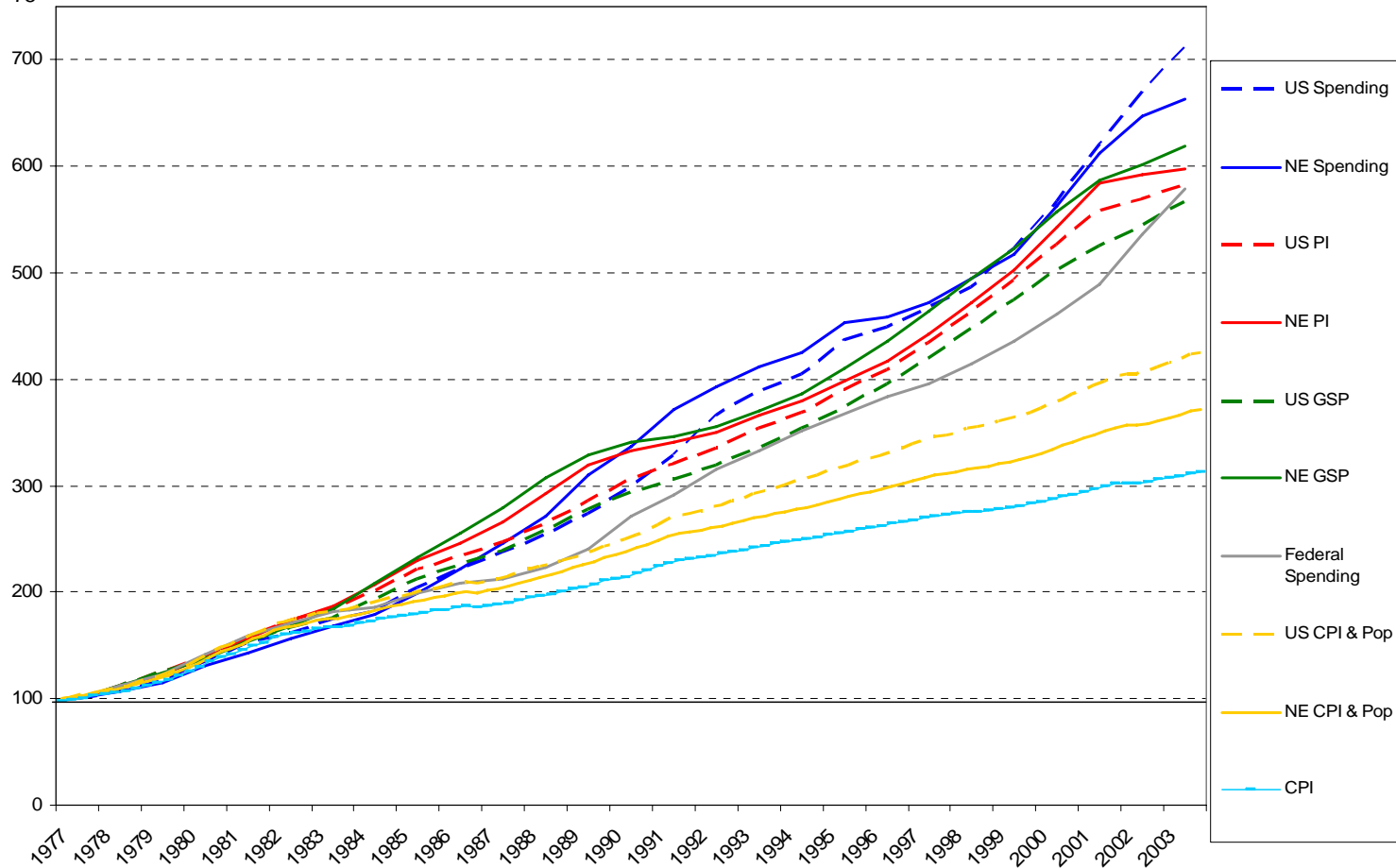
“Without a TEL, government grows faster than the public wants or needs”

- What is the assumption behind the growth index?
- Is what the public needs/wants static?

What's an ideal growth rate?

Index
1977 = 100
75

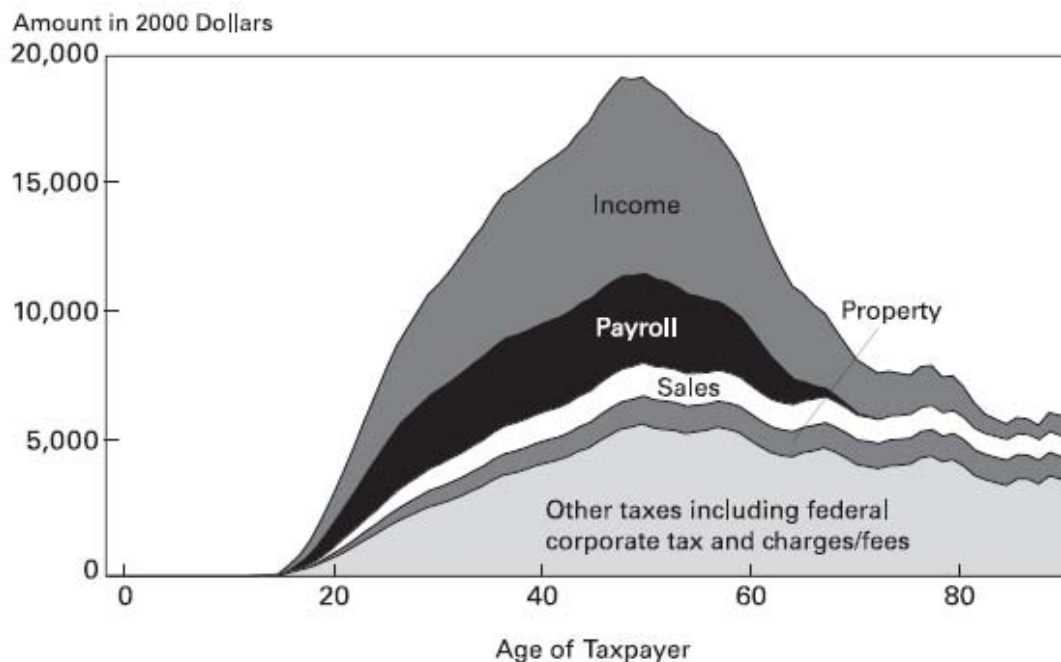
Relative Growth in State Government Expenditures,
1977-2003



Source: US Census Bureau

The middle-aged pay the most in taxes

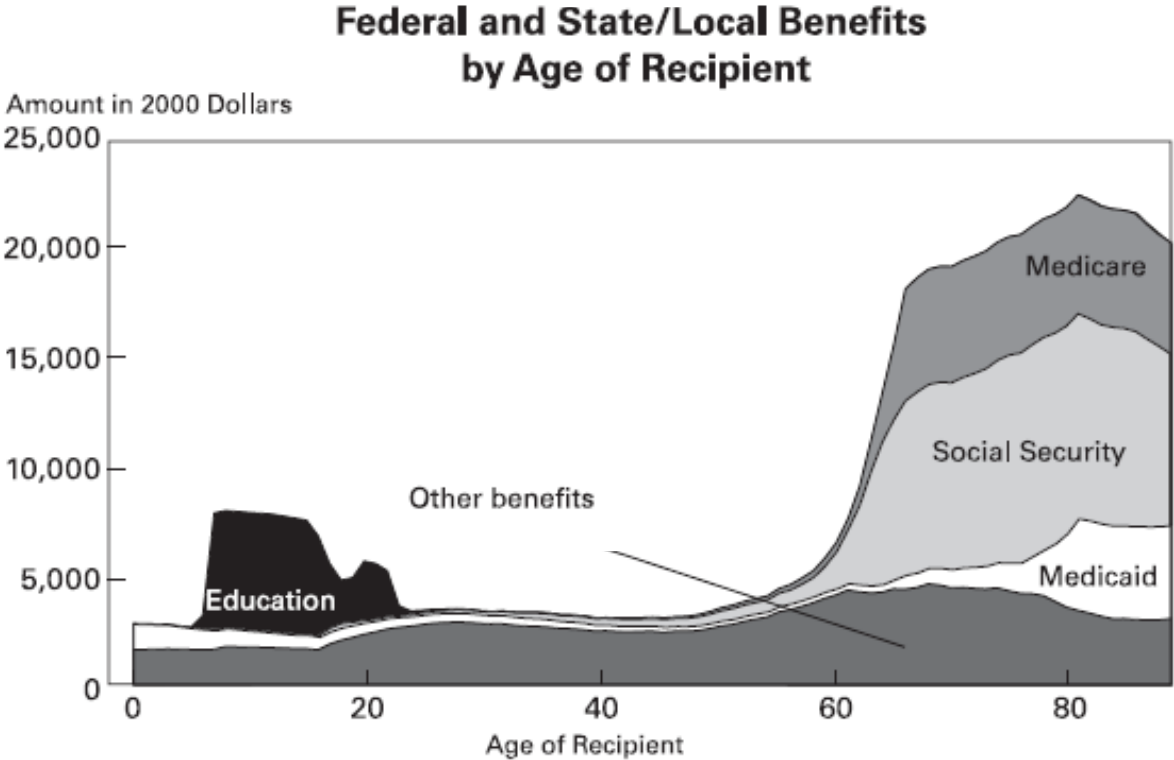
Federal and State/Local Taxes by Age of Taxpayer



Source: Based on data from the U.S. Bureau of the Census, March Current Population Surveys of 1994 and 1995, inflated to 2000 levels.

Source: Lee and Edwards, 2001

The young & old consume more services

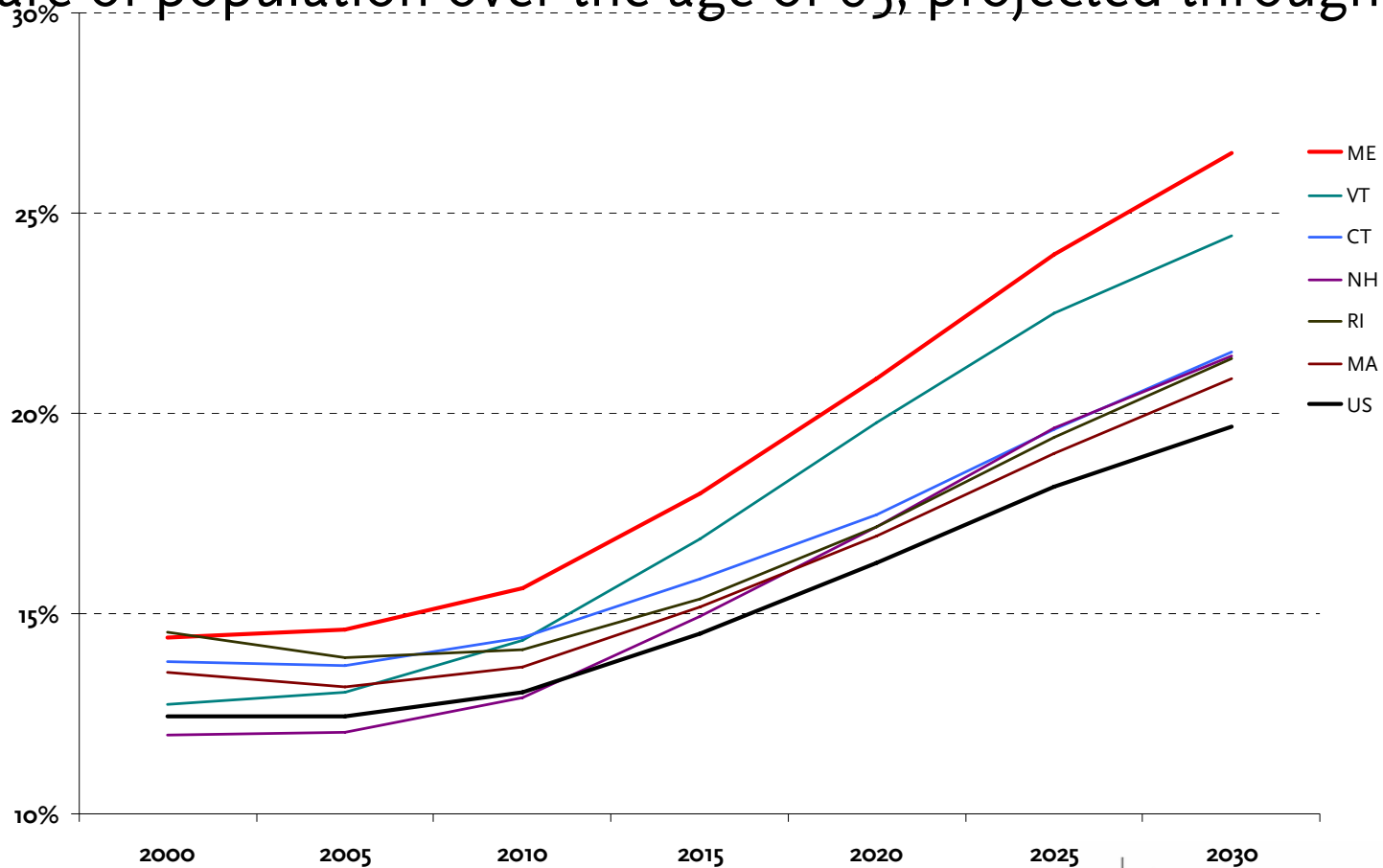


Source: Based on data from the U.S. Bureau of the Census, March Current Population Surveys of 1994 and 1995, inflated to 2000 levels.

Source: Lee and Edwards, 2001

And New England is facing changing demographics

Share of population over the age of 65, projected through 2030



What the growth index limits is also important

- Tax and/or expenditure limit (TEL)
= growth index * base
- What part(s) of the budget are limited?
 - Expenditures
 - Revenues
 - Both?
 - Specific components of each?

What is limited affects the ability of a TEL to limit government growth

LD-1 base:

- General fund appropriations from the previous year
-

TABOR base:

- General fund, highway fund, special revenue and quasi governmental fund expenditures from the previous year
- Increases in revenues requires super-majority approval of both houses of the legislature and voter approval

Does more limited government growth equal more competitiveness?

- Difficult to find definitive, stable empirical evidence about the degree that taxes matter
- Other factors may be important
 - Fiscal stability
 - Government services and investment

Does more limited government growth yield greater fiscal stability?

- Poterba, 1994
 - Following a recession, states with TELs experienced lower tax increases than those without them
- Poterba and Reuben, 1999
 - States with **binding revenue limitations** had increased borrowing costs
 - States with **binding expenditure TELs** had lower borrowing costs

Does more limited government growth yield greater efficiency?

- Limited growth does not necessarily result in greater efficiency
- TELs generally do not prescribe what to cut
- One person's wasteful spending is another person's essential government program

New TELs on the horizon

Maine

- Increase stringency of LD-1 override provisions from majority to super-majority approval
- Governor proposes limiting increases in homestead property valuation to time of purchase

Vermont

- Governor proposes capping annual increases in local education spending at 4 percent; 60 percent of voters required to override cap

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