

Senate Republican Policy Committee

April 26, 2007

Testimony for Senate Bill 7

Comments on State Spending Limits

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Chairman and members of the committee, thank you for the opportunity to offer my thoughts on Senate Bill 7 that will amend the Pennsylvania Constitution to impose spending limitations on State government. In the interest of brevity, I will focus my remarks on a few points.

As long time advocates of spending restraints, we believe this Bill is an idea that is long overdue. As a key element of needed government reform, a constitutional amendment limiting spending growth ranks as one of the most important steps we can and ought to take. The recent budget submitted by the Governor continues and accelerates the trend of spending increases above the inflation rate. These increases in spending will require an increase in taxes for Pennsylvania's residents and businesses, either through an increase in existing taxes or through new levies. Neither can be a welcome development in state already struggling to stay competitive.

Some claim that tax and spend limits are unnecessary since there is already a Constitutional provision requiring budgets to be balanced. However, balancing the budget does not necessarily mean spending is being constrained. Indeed, since 1995, the State's general fund expenditures have grown from \$16.1 billion to \$26.1 billion—an increase of 62 percent. Meanwhile, inflation during the same period was only 35 percent and the state's population has been essentially flat. As a result, government per capita outlays have been rising much faster than the cost of living. Of course, this spending has been accompanied by rapidly escalating tax revenues. In view of the profligacy shown by the state government, there can be little doubt that the time has come for taxpayers to have more control over the ability of state lawmakers to tax and spend.

In that regard, thirty states have some form of government spending control commonly known as a "tax and spending limit" (TEL). TELs were first introduced in California in the early 1970s and have spread throughout the nation. TELs set the rules for the legislature to follow regarding how much spending can increase from one budget to the next. TELs run the gamut from very restrictive and enforceable to lax and not well enforced.

Studies show that a TEL can be a very effective method for reducing the growth of government. However, its effectiveness will depend on how it is written. Will it allow for exceptions or can it be rewritten to suit the needs of the legislature? If either is the case then it will not be a very effective control on spending.

Thus, as you move ahead with Senate Bill 7, we hope you will work hard to close loopholes such as those found in the discussion of "emergencies" exemptions. The Bill should contain very specific language as to what constitutes an emergency in order to avoid misuse of the exception. To that end, we suggest that a study of previous episodes requiring emergency outlays over the last 50 years be conducted to assess the size and scope of probable emergencies and the unbudgeted expenditures necessary to cope with them.

An emergency reserve fund could be established for such contingencies. It could be funded from the Taxpayer Protection Fund and built up gradually to an amount virtually guaranteed to be adequate for all but the most calamitous events. In all likelihood, the emergency fund will require no more than \$500 million or 2 percent of the budget. Further, we recommend that any emergency necessitating payments of less than \$25 million could be handled by the Governor without prior legislature approval. Beyond that amount, legislative approval should be required. If the legislature is not in session and the needs are urgent, approval by the caucus leaders would suffice.

An area of strength in the legislation is the language specifying that a two-thirds vote of each house of the General Assembly is needed to release funds for an emergency. However, we believe that should be further tightened to require a three-fourths vote. If an emergency proves severe enough to consume the entire \$500 million emergency reserve fund, a three-fourths approval of more funding vote would be easily attainable.

Another concern is the inclusion of language that allows “other situations” for the Governor to request exemptions from the spending limitations. California’s TEL was made ineffective through the actions of lawmakers and the education lobby to exempt K-12 spending from limitations. This is regarded as a principal reason for California’s large structural deficit. A similar failure occurred in Missouri where the courts decided that newly enacted taxes and their revenues were exempted from that state’s TEL. These backdoors to getting around the spending limit in Pennsylvania must be firmly closed.

Another concern often raised regarding spending limits is the possibility of an unintended shifting of financial burdens to other levels of government. For example, if the terms of a spending limit preclude a legislature from fully funding a program such as education, then the burden might be shifted to the local government. One way to prevent such an eventuality is to write language into the law requiring any mandates imposed on local governments be accompanied by the proper financing through priority set asides if need be. The upside is that fewer mandates will be forthcoming since there is no way to fund them without cutting other areas.

Perhaps the most successful TEL is the Taxpayer Bill of Rights (TABOR) in Colorado. Prior to the enactment of TABOR (1992), Colorado residents endured increases in personal income and gasoline taxes and Colorado’s economic performance lagged most other states. The passage of TABOR, which limits state and local spending growth to the rate of inflation plus population growth as well as mandating voter approval for tax increases, gave Colorado the national lead in personal income and job growth—and has led to increased tax revenues for the state.

Critics point to Colorado’s recent woes with TABOR as reasons for other legislatures to reject spending limits. Colorado’s troubles resulted in large part from a voter initiative that excluded K-12 spending from TABOR requirements. As a result, K-12 outlays accelerated faster than overall spending, forcing lawmakers to make cuts in other areas of the budget. Another contributing factor was the recession of 2001 and the ratcheting down effect TABOR has on spending. The state’s spending baseline was lowered

because revenues had fallen. Proposals to mitigate the ratcheting down effect are in the works and TABOR still has the support of Coloradans.

The specific spending limit mechanism will play a key role in determining effectiveness. Limits have been linked to economic variables such as the change in GDP, inflation, the growth in personal income or to population changes. Empirical evidence show that spending limits linked to population growth *and* inflation, such as is suggested in SB 7, are better at constraining government spending than those linked to personal income changes.

To further strengthen the amendment, the term “personal income” should be replaced with “taxable income” since pensions, welfare, and other transfer payments are not subject to state taxation. Using “personal income” could lead to faster expenditures growth in some situations than “taxable income” might. And it is taxable income that must bear the burden of taxation.

Finally, amending the Constitution, the goal of this legislation, will take quite some time to play out. Meanwhile, we believe the Senate should go ahead now and adopt a Senate rule to require a two-thirds vote for any new tax or tax rate increase as a way of slowing down outsized spending and tax hikes this year.

The high cost of the Commonwealth’s government and the consequent tax burden on citizens are hobbling employment and income growth. A surefire way to restore fiscal sanity and reduce the growth of government and taxes is to enact strict, hard-to-avoid spending limits. We wish you well in getting this amendment legislation passed.

Thank you.