POLICY BRIEF

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Pennsylvania Should Adopt Tax and Spend Limits

The Pennsylvania Senate just passed a bill limiting how much the Commonwealth can increase spending each year. Whether or not this bill moves through the House and makes it past Governor Rendell's veto pen is quite another matter. Critics are already complaining that a budget cap would negatively affect citizens who rely on state handouts. One senator remarked that a cap was unnecessary because legislators should have a big say in the budget. "We should work to discipline ourselves." Is this the same "discipline" that failed to keep them from unconstitutionally raising their own salaries?

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, over the last ten years, the State's general fund expenditures have grown from $16.1 billion to $23.8 billion—an increase of 48 percent. Meanwhile, inflation during the same period was only 30 percent and the state's population has been essentially flat. As a result, government per capita outlays have been rising about 60 percent 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 by then Governor Ronald Reagan (Prop 1) and have spread throughout the nation. TELs set the rules for the legislature to follow regarding how much tax revenue they can collect and 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 TELs can be a very effective method for reducing the growth of government—depending on how the TEL came into being. TELs that were originated through voter initiative tend to be more restrictive than those created by legislators. Indeed, one study indicates that TELs enacted by state legislatures are not effective in limiting spending growth. Legislature-initiated TELs often give the appearance of fiscal prudence, but can be written to allow for exceptions or can be rewritten to suit the needs of the legislature.

The specific TEL mechanism has played a key role in determining effectiveness. TELs have been linked to economic variables such as the change in GDP, inflation, or the growth in personal income or it can be linked to demographic information such as population changes. Empirical evidence show that TELs linked to population growth *and* inflation are better at constraining government spending than those linked to personal income changes.

Successful TELs must address not only the surpluses that can accumulate in economic booms but also shortages that develop during recessions. Most states have provisions to set aside a portion of surplus funds into a "rainy day" account to help offset deficits in recessions. Some TELs, such as those in Colorado, Michigan, Missouri, and Oregon, mandate that budget surpluses be refunded to taxpayers. These refunds can be direct or through a tax cut. Obviously, "rainy day" rules must be in place to govern how much can be transferred to the budget in lean years and how surpluses are to be returned to taxpayers.

One shortcoming of a TEL is the ability of lawmakers and the courts to find loopholes and thereby render them ineffective. 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.

Another concern often raised regarding TELs is the possibility of an unintended shifting of financial burdens to other levels of government. For example, if the terms of a TEL 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 TEL that requires any mandates imposed on local governments be accompanied by the proper financing through priority set asides if need be.

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 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 high cost of the Commonwealth's government and subsequent tax burden on its citizens hampers its economic and employment growth. A proven method for restoring fiscal sanity, reducing the growth of government and taxes while improving economic performance is to give taxpayers more control over the ability of our lawmakers to tax and enact severe, hard-to- avoid spending limits. Pennsylvania's TEL should also include a requirement that all local governments and school districts get referendum approval for any tax increase.

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