

# Tax and Expenditure Limitation:



## A Policy Perspective

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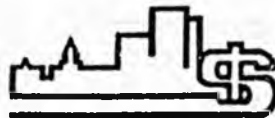
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# Table of Contents

Foreword .....	iv
Introduction .....	1
Modern Trends .....	5
Review of Policy Issues .....	9
Pressures for Tax and Expenditure Limitations .....	11
Technical Problems .....	14
Economic Indexes .....	15
The Use of a Base Year or Fiscal Period .....	16
Fund Structures .....	18
Revenues vs. Expenditures .....	19
Scope of Limitations .....	22
Methods of Control .....	23
Provisions for Exceptional Circumstances .....	24
Limitations on Local Governments .....	27
Evaluating Results .....	33
Appendixes	
I. A Review of the General Provisions .....	36
II. Historical Perspective .....	40
Early American Concerns .....	41
Modern Developments .....	43
III. Contacts .....	47

## Foreword

State governments since the nineteenth century have imposed limitations on the capacities of their local governments to raise revenues, especially property taxes. Since 1976, 18 states have also imposed limitations on their own capacities to raise revenues or spend money. In addition, a number of states have added to the traditional property tax limitations on local governments new limits on the total amounts these governments can raise or spend. All of these activities are now commonly referred to as tax and expenditure limitations (TEs). Since the passage of Proposition 13 in California in 1978, virtually every state legislature has considered one or more TEL-type proposals each year.

Attempts to limit all, or most, of a state's revenues or expenditures are very complex and raise many policy issues of critical importance to the fiscal integrity of the state and its economic and social well-being. This report focuses on the problems encountered in devising such legislation and reviews the manner in which the 18 states have dealt with them. The report is designed to raise issues for the consideration of legislators and their staffs who contemplate the adoption of such limitations for their own states. It should also be of interest to others studying this modern trend.

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Lexington, Kentucky  
February 1981

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# *Introduction*

Few events in the history of state and local government have received the attention and interest accorded the passage of Proposition 13 in California in 1978. A wave of publicity heralded a "taxpayer revolt," in which the overburdened taxpayer would wrathfully impose limits on governmental officials at all levels and force them to spend only what the average taxpayer could afford. The sponsors of the constitutional amendment in California traveled the country calling for similar actions in every state, and many elected officials in state and local governments seemed determined to lead their local movements. As the Institute for Contemporary Studies described this mood in 1978:

The passage of California's Proposition 13 last June startled the nation's taxpayers as much as it did legislators and public officials. Almost overnight, taxpayers groups started springing up in communities across the country, and a number of states began drafting similar initiatives for consideration in upcoming elections.<sup>1</sup>

Since 1978, many publications have focused on this subject and carefully traced new developments.<sup>2</sup> The acronym TEL—short for "Tax and Expenditure Limitation"—is by now familiar to all state executives and legislators. It is doubtful that any legislative session since 1978 has failed to address several such proposals, and the Council of State Governments has sought to keep its constituents abreast of these developments by reporting on proposed and adopted legislation and explaining the implications of each type of limitation. This report seeks to bring the record up to date and create a better awareness of the implications of TELs for financial and operating policies.

It is important to realize that limitations on governmental powers to raise revenues and spend money are not new. Indeed, they have been tried in various forms, especially at the local level, for more than a century. Proposition 13 is one dramatic indication that traditional tax limits have fallen short of perceived public needs in these times of rampant inflation (among other adverse economic trends). Nonetheless, a brief review of past ex-

periences with such limitations places current activities in an historical context that may temper the possibly unrealistic expectations of modern TEL zealots. This historical review is presented in Appendix II.

This report is written for the information of state legislators and executives who are considering the use of tax and expenditure limitations as means of gaining control of ever-increasing governmental costs. While such limitations are not unique in the history of American governments, in their new emendations, these constraints tie increases in revenues and taxation to economic indexes which are thought to represent the ability of people to support their governments. As a result, the emphasis overwhelmingly has been on curbing the needs of governments for revenues.

This report examines some of the more difficult analytical problems associated with the development and application of economic indexes, such as level of personal income, growth of the economy, and rise in the consumer price index. The application of these nationally developed tools to state and local purposes, the designation of base periods to which they apply, and the problems of limiting revenues that are elastic with respect to the economy all pose serious theoretical and practical problems to the drafters of TEL legislation. Attempts to limit expenditures likewise pose difficulties, given the large number of specialized funds with which most state governments operate. Finally, all of these factors must deal with the necessity of governments to provide ongoing services while being in the best possible position to meet life-threatening emergencies.

Proposition 13 focused national attention on the unpopularity of the property tax at the local level. Events since 1978, however, have also served to stress the necessarily close relationship between state and local governments in periods of fiscal stress and adjustment. The California experience has shown the need to reassess the state's role with respect to local government responsibilities, allocation of fiscal resources, and, ultimately, distribution of authority for dealing with public needs. Most states are now looking at the total revenue and expenditure picture within their states, and the policy issues being raised have profound implications for the future roles of governments at all levels.

It is not the purpose of this report to take a position for or against the adoption and use of tax and expenditure limitations. Financial administration at the state and local levels is an extremely complex process which has been complicated in modern times by the ever-increasing scope of governmental activities and the steady integration of federal, state and local responsibilities in addressing a wide variety of socioeconomic problems.

As a consequence of these developments, modern attempts to place effective constraints on the collection and use of taxes and other revenues will be extraordinarily difficult. In addition to the complexities of governmental financial administration, the variety of intergovernmental fiscal flows makes the application of limitations a very difficult undertaking. Given the bewildering array of interlocking federal-state regulatory provisions, state officials may find that reductions in certain types of expenditures may result in even greater reductions in federal assistance.

Adding to all these difficulties are the problems of developing data bases necessary to administer effective programs of limitations. No two states have the same system of accounting, so generalizations concerning the best methods of accountability (and, thus, adherence to any given TEL) are difficult to draw. Economic indexes developed by the federal government (e.g., state personal income, consumer price index, rates of inflation, levels of productivity) are approximations at best and are often very difficult to apply to highly localized circumstances. This problem is compounded when the states attempt to impose TELs on their local governments.

The report also discusses the shortcomings inherent in TELs. These types of limitations are no substitutes for the development of equitable systems of taxation, improved government productivity, and responsive and effective bureaucracies—to mention only some of the pressing issues included in the public's demand for economical and effective government. Properly developed as an integral part of a larger overall effort of governmental reform, a TEL could well play an effective role in finding a balance between the vital need for effective governmental services and the ability of citizens to pay the costs.

Eighteen states have some form of limitation on their own taxes or expenditures. There have been so few evaluations of the results of these limitations that assurance of success in curbing future governmental costs must be largely speculative at this time. Accordingly, this report seeks to direct attention to the obvious analytical problems and policy implications that will exist regardless of the objectives being pursued. Only time will tell whether these types of controls can assure the American taxpayer of more effective government.

The report is presented in two principal parts:

(1) **Modern Trends.** A brief description of the problems addressed and the techniques used in recent attempts to contain the costs of state and local governments.

(2) **Review of Policy Issues.** A detailed analysis of the technical problems with which TEL designers must contend and explanations of their implications for the operations and directions of state governments.

## *Modern Trends*

The term "tax revolt" has come to characterize the period since June 1978, when Proposition 13 passed in California. Writing in 1979, Frank Levy made the following observation about this revolt: "Proposition 13 was not a spontaneous phenomenon, but was rather the latest inning in a biennial event, a restitching of numerous earlier initiatives." Why then did Proposition 13 become such a powerful symbol which appears to have triggered a number of other efforts to put legal limitations on state and local spending? It definitely was a media event attracting national attention. In fact, as Donald Hagman pointed out in September 1978, the voters of California "were not likely voting their pocketbook. . . . They were voting an ideology that the public interest would be served by enactment of Proposition 13." Clearly, the severity of this one-time decrease in local revenues, the use of the initiative to write the limitation into the state constitution, and the confusion of many prominent political leaders in attempting to deal with the issue all contributed to the attention the action received.

It is likely that few voters understood the implications of the initiative. Some of the issues related to the proposition that did not receive a great deal of attention at the time are the following:

- Property tax is declining in significance for local governments, compared to other sources of tax revenue.
- In spite of Proposition 13's prohibition against increasing other *taxes* to make up for lost property tax revenues, local governments can use a variety of nontax sources, especially fees and service charges, to compensate.
- To the extent that the state government bails out the local governments and school districts, as California has done, there will be increasing centralization of control toward the state level.
- For people in the higher income brackets, as is the case with many homeowners in California, property tax payments provide valuable federal income tax deductions; thus, by shifting the tax burden to other forms of taxation or fee payments, the homeowners have lost an important source of deductions.

Is it likely that California voters consciously voted for increased centralization of government at the state level and lower deductions for income tax purposes? They obviously voted for the direct, pocketbook issue of lower property taxes and undoubtedly wanted to send a broader message to governments at all levels that the growth in the cost of government must be brought into line with the financial capacity of the taxpayer. The more publicity given the proposition, the greater the ideological overtones. In this process, it is not surprising that many collateral issues were overlooked by many. Nonetheless, the impact of the national attention the proposition received is still being felt.

Without comparable national attention and before the passage of Proposition 13, the states of New Jersey, Colorado and Tennessee had already adopted limitations on *state* expenditures in a manner that was much more unusual historically than California's reductions of its property taxes. In fact, New Jersey adopted a package of state-local limitations that was unprecedented at the state level. It tied increases in state *expenditures* to the growth in state per capita personal income as measured during the second quarters of each of the two years preceding the year in which the budget would go into effect. New Jersey was the first state to attempt any comprehensive limitation of its expenditures since World War II, and it was the first state ever to take advantage of federally maintained data sources concerning state economic conditions to tie the growth in state costs to the apparent ability of the citizens to pay. For state governments, this established a very significant precedent.

Many of the problems involved in adopting the New Jersey approach (similar to that taken by several states) will be discussed throughout this report. One of these problems concerns the meaning and scope of the term "state expenditures." Obviously many governmental disbursements are unrelated to the income of the state's citizens (e.g., pensions, debt retirement, trust and agency transactions), while other expenditures will rise as the income of at least some sectors of the citizenry declines (e.g., unemployment payments and welfare-related costs). Recognizing these problems, New Jersey excluded from its limitation appropriations for state aid to local governments, expenditures of federal funds, and debt service costs for indebtedness authorized by referendum. There was a provision to exceed the limit if such an increase were approved by a majority of the voters in a referendum. New Jersey also placed a limit on municipalities and county governments of 5 percent over the prior year's appropriations (with exceptions for very small governments). And, the state limited the use of

revenues from state income tax to education and property tax relief.

By the end of 1980, 18 states had placed limitations on their own expenditures or revenues. A listing of these states, together with a brief explanation of the variations employed by each, is set forth in the chart presented at the conclusion of this report as Appendix I. A wide variety of approaches has been used; however, most of them are directed toward relating increases in state (and also local, in some instances) costs and/or revenue collections to the growth in the economy or to the level of personal income of state residents. The language used in various laws includes the following (note that several states use more than one criterion):

- Growth in the "state's economy" (Hawaii, Tennessee and Texas).
- Growth in personal income (Arizona, Idaho, Louisiana, Michigan, Missouri, New Jersey, Oregon, South Carolina and Utah).
- Increase in cost of living (California and Nevada).
- Growth in population (California and Nevada).
- Relationship of current year's spending plans or revenues to the past year *or* the average of several past years (Colorado and Rhode Island).
- Relationship of current spending plans to anticipated revenue collections (Delaware and Washington).

As straightforward as these indexes may seem, many problems arise when they are applied. Included among these are the following:

- How does one determine growth in the state's "economy" for tax-support purposes?
- Are cost-of-living or personal income data suitable as criteria for a state or local government's level of spending?
- Does a limit on state expenditures include all disbursements and obligations regardless of the financial basis of their support and the purposes to which they are to be put?
- How does the government limit revenues that are elastic with respect to economic conditions?

These questions, along with others, are the concern of this report. Their answers raise serious technical and policy problems for the drafters of TEL legislation.

There are extremely important practical and philosophical problems implicit in the whole process of considering tax and expenditure limitations. The analytical complexities attendant on the development of effective and equitable fiscal limitation systems are staggering. Experiences with similar efforts to limit governmental costs over a period of more than a century leave room to doubt the efficacy of statutory provisions alone. To assure

effectiveness, a comprehensive assessment of all the factors involved in the process of developing, implementing and assessing spending and revenue plans is essential.

## *Review of Policy Issues*

The term "policy" is used so frequently that its meaning is all too often taken for granted. Policy issues have to do both with where an organization is going and how it should get there. A number of actors, including the general public, the legislature, the executive, departments, and other agencies of state governments and their local jurisdictions, have different roles with respect to each type of policy issue. Each of these actors and entities deals with policies at one time or another—even if only to vote in an election where the issue has been raised (directly for a proposition in a referendum or for a candidate espousing certain positions with respect to a given issue).

It is probably common for even important issues to arise and be addressed with respect to only one, or a few, of its important facets, while very important aspects are ignored. For example, virtually every major policy issue has the following three dimensions:

(1) *Directional*. What should the state government, or other governmental entity, do, and which sectors of the population should benefit in what respects?

(2) *Organizational*. Who should be responsible for what is to be done (e.g., agencies, levels of government, officials) and what organizational structures should be used in the process?

(3) *Resources*. How should funds be allocated, positions authorized, and other resources provided for undertaking the authorized activities?

The principal issues involved when considering TELs clearly concern the resources to be made available to governments in order to deal effectively with the problems with which the community, region or state is faced. Much of the data appearing in the news media concerning the tax limitation question focuses only on governmental resource problems, such as increasing levels of taxation, growing size of government at all levels (e.g., number of public employees), and the increasing difficulties of taxpayers in supporting governments under these conditions. While services are sometimes allud-

ed to, the observations are usually very generalized. The term "welfare," for example, characterizes a group of services unpopular to many taxpayers. While these reports to the public are often specific about the levels of taxes and the costs of government, they seldom are equally specific about the nature of the public problems addressed by governments or the quantity and quality of service provided. There is a visceral element in discussions about increasing taxes that is absent in discussions about sewage disposal facilities or public health nurse visits.

This chapter reviews existing tax and expenditure limitations from the perspective of all types of policy considerations. That is, while resource issues are the central focus of concern, the relationship of these issues to the ability of governments to achieve their objectives and fulfill their responsibilities is emphasized throughout.

The chapter is organized in the following manner:

- **Pressures for TELs.** The most important question is whether the means of direction, control and resource allocations available to state and local policymakers are so inadequate that they must be supplemented by these types of statutory or constitutional provisions.

- **Technical Problems.** Designing and implementing TELs present numerous analytical and administrative problems, especially if the limitations proposed involve the use of economic indexes, the use of a functional period of reference (e.g., the last fiscal year), and efforts to comprehend all, or most, types of disbursements and revenues.

- **Revenues or Expenditures.** Legislators and analysts have all taken pains to distinguish between curbs on revenue sources (as with Proposition 13 and the property tax) and expenditures; however, the significance of the difference may often be misunderstood.

- **Scope of Limitations.** The problems associated with curbing revenues that are elastic with respect to the economy (e.g., sales tax and income tax), limiting types of expenditures whose dynamic characteristics are beyond budgetary discretion (e.g., pension commitments, trust and agency funds, countercyclical assistance programs), and otherwise laying the fiscal basis for economical government by statutory enactments raise significant challenges to legislative draftsmen.

- **Control Methods.** In an effort to make government affordable, legislatures are choosing between the use of flat rates (e.g., percentage increases over previous years) and indexes of economic conditions (e.g., increases in personal income, increases in the cost of living), both of which pose policy problems.

● **Provisions for Exceptional Circumstances.** Governments must be able to contend with unforeseen events which threaten the health, safety or welfare of the public; therefore, drafters of TEL legislation must face the challenge of providing for emergencies in ways that will not destroy the effectiveness of the limitations themselves.

● **Limitations on Local Governments.** The special problems faced by state governments seeking to impose revenue and expenditure limitations on local governments are similar to most of the problems listed above *and* challenge the continued integrity of home rule.

These issues are discussed in the following sections. The references to statutory variations used by the states are very brief and assume the reader will refer to the compilation of state provisions provided at the conclusion of this report.

## **Pressures for Tax and Expenditure Limitations**

It should be noted that the term "tax and expenditure limitations" is something of a misnomer. While Proposition 13 and several other limitations in use are in fact directed toward forms of taxation, most other limitations are on all, or most, *revenues*. However, in the media and many other publications, the initials TEL have become popular and recognized as referring to all of these efforts to curb governmental costs and growth. In this report, when TEL is used, "taxation" should be regarded as synonymous with "revenues" unless an exception is specifically made. In subsequent discussions in this and other sections, the significance of the casual use being made of such terms as taxation, revenue, expenditure, and income will be noted.

Of the 18 states with limitations on their own revenues or expenditures, eight have constitutional provisions. Of these, seven were imposed by referendum. In these latter instances, the question of the desirability of a limitation was not in the hands of the state legislatures. Yet, ten of the states imposed the limitations by statute, and it is likely that most of the remaining states considering such actions will have to make a conscious *legislative* decision about whether to impose such fiscal strictures on themselves. They will have to ask: Why should we limit our powers in this vitally important area of legislative prerogative?

A bedrock principle of Anglo-American governmental philosophy is that the legislature initiates spending programs and authorizes the revenues (e.g., taxes, fees) required to finance them. The great civil war in seventeenth-century England was fought primarily, though not exclusively, over this principle.<sup>3</sup> Embedded in the Constitution of the United States and every other charter of government in this nation is this supreme right of the legislature. Powers associated with this role include authorizing the spending program for each fiscal period; levying taxes and imposing fees and charges; allocating responsibilities among governments and agencies; authorizing staff complements for all agencies; authorizing the overall administrative infrastructure; imposing controls and other means for administrative accountability; and overseeing operations, evaluating results, and redirecting governmental activities. In short, the government of a state or local jurisdiction can only undertake such activities, use those resources, and operate in the ways authorized by the cognizant legislature. Historically, legislatures in England and America have been loath to give up this authority. At least in principle, these powers are adequate for any legislature wishing to reduce governmental costs and associated taxes.

Pressures for spending are nothing new in America. In the early years of the Republic, representatives of armament manufacturers, railroad developers, shipping concerns, and countless other pressure groups sought to sway public demands and make legislative cooperation as convenient and lucrative as possible. In fact, few eras in our history have seen reduced governmental spending (though a particular government might occasionally retrench) or lessened involvement of government in the private lives and business enterprises of Americans.

Undoubtedly the Great Depression and World War II placed governments at all levels in a new perspective in which they assumed increasing responsibility for the health, safety and well-being of their citizenry. In this process, not only did the number of programs and their costs increase, but the programs were also established in ways that made their escalating costs uncontrollable as far as any one session of legislatures was concerned (at least this has become a colloquial disclaimer). Hence, tying Social Security, unemployment payments, welfare assistance and similar social programs to economic indexes created a situation in which the apparently all-powerful legislature was effectively helpless in attempting to curb rising governmental costs and expanding bureaucracies. In addition, so many groups were supported, in whole or in part, by these programs, that legislative efforts to cut back could often be overcome by effective political action.

Of course, these are only some of the factors pushing the costs of government upward. During the past 20 years, the demands of organized public employees, especially at the local levels, have often been reinforced by strikes and other actions which all too often posed hopeless political dilemmas to local officeholders. Settlements of these confrontations have usually been demanded by an inconvenienced public, but these agreements were reached at great long-term cost to the taxpayer. In addition, since World War II, a continuous inflation has forced up all costs for government and taxpayer alike. Overall, an extended period of increasing public demands for personal security and governmental service, effective actions by public employees for higher wages, and ever higher costs of all governmental operations have posed to legislators at all levels of government an impossible array of obstacles to the establishment of smaller, cheaper and more efficient governments.

Under these circumstances, an imposed limitation on spending and/or taxation can be a welcome relief to the harried legislator. He or she can point to this "cap" as a point beyond which the aggregate demands for spending cannot go, leaving only the decisions of how best to allocate restricted resources. Indeed, this option may be so attractive that a legislature would like to see it imbedded in the state constitution, and a number of states have proceeded in exactly this manner.

The basic question under these circumstances is whether the legislature feels a limitation must be imposed on its power to raise revenues or appropriate funds if it is to keep the cost of government under control. Given the apparently clear language of most TELs limiting expenditures or revenues in accordance with specific criteria (e.g., percentage increase over previous year's revenues, increase in level of state personal income), this type of constraint may appear to be a simple answer to the problem of runaway budgets. A closer look at the implications of these criteria, however, discloses many technical problems and policy issues that deserve comprehensive analysis and careful consideration. This is especially the case if the legislator is as concerned with meeting the state's service responsibilities and policy objectives as he or she is in controlling costs. An examination of these problems is the subject of the remainder of this report.

## Technical Problems

The language used in the statutes and constitutional provisions concerning tax and expenditure limitations is usually straightforward and apparently easy to apply. The different approaches taken by the states to date will be discussed in a later section; however, examples will serve to illustrate some significant problems:

- Arizona limits state spending to 7 percent of the personal income of its residents.
- Colorado limits general fund spending to 7 percent more than the previous year.
- Hawaii limits the rate of growth of general fund appropriations to the estimated rate of growth of the state's economy.
- Michigan limits its revenue (defined as general and special revenues, less federal aid, with some minor adjustments) to approximately 9.84 percent of the personal income in the previous calendar year, or the average of the personal income in the three previous calendar years, whichever is greater.
- New Jersey limits increases in state expenditures to the growth in state per capita personal income as measured by changes between the second quarters of each of the two years immediately preceding the year when the budget is to go into effect (applicable to general state operations and to capital outlays).
- Texas limits the rate of growth of appropriations from tax revenues in a biennium to the estimated rate of growth of the state's economy.

While every TEL state has some variation on the theme, these are representative of the approaches used. Clearly, every effort is being made to relate costs and taxes to the apparent ability of the people to pay. Per capita personal income or total personal income is the principal, but by no means only, index in use. Estimates for these indexes are made by the U.S. Department of Commerce for each state, Standard Metropolitan Statistical Area (SMSA) and county and are used for a number of purposes. However, there are many problems in using them as guides to tax equity. In this section, the following three special problems will be addressed very briefly:

- **Use of Economic Indexes.** Are these dependable criteria of ability to pay, and are they applicable as constraints on governmental spending?
- **Use of a Base Year or Period.** Have all factors involved in calculating expenditures and receipts in a given completed fiscal period been determined in a consistent and accurate manner?

● **Fund Structures.** Considering the special purposes of most of the funds and the existing conditions controlling their receipts and disbursements, can revenue and expenditure limitations be applied to all or most of a state's financial transactions?

## **Economic Indexes**

It is important to note that the equitable imposition, assessment and collection of taxes are the subjects of an enormous body of technical literature. The incidence of sales, property, income and other taxes (especially the degree to which each type is progressive, proportional or regressive) has been studied for decades and is still being analyzed extensively. Most of these studies are directed toward the need, as most experts see it, for tax reform. The mixes of types of taxes, the allocation of powers to tax among different levels of government, the actual formulas used in imposing taxes, tax assessment practices and collection processes are all subjects of great concern. It is possible that some people regard a TEL which is based on the economic conditions of a government's population (e.g., personal income, growth in the economy) as a substitute for tax reform. This is a grave error. Problems in the distribution and incidence of taxes will remain regardless of the *level* of total taxes imposed. A regressive sales tax (usually regarded as one imposed on the basic necessities of life) is still regressive whether it is fixed at 6 percent or 10 percent. Thus, any concern about the fairness of a given state's system of taxation for each sector of the population will not be met to any significant degree by the imposition of an overall tax or expenditure limitation.

States already have come to realize the difficulties involved in determining and applying such indexes as personal income or economic growth. Thus, different procedures are being used to derive appropriate indexes:

- In Arizona, a three-member Economic Estimates Commission ascertains personal income.
- In Tennessee, state personal income is derived from an econometric model maintained by the University of Tennessee.
- In Texas, projections of growth in the state's economy will be taken from an econometric model developed by the State Comptroller's Office. No comment can be made here about the specific models proposed or in use. Presumably they take the most important factors into account. However, particular attention should be given to assessing the accuracy of

models that *project* economic variables for future periods since these could be of doubtful reliability.

Many other states use estimates for *earlier* periods such as those for total personal and per capita personal income prepared by the Bureau of Economic Analysis of the U.S. Department of Commerce. In using these estimates, states should take into account the fact that they are not based on special statistical surveys of each state. Rather, the Commerce Department uses more than 175 income components for a given time period to derive estimates of personal income in several different types of geographical areas (state, SMSA or county). Total and per capita personal income estimates are both developed. However, neither of these income estimates takes account of the *distribution* of income. An unusually high proportion of wealthy people could skew per capita figures upward in a manner that overlooks an even larger proportion of poor people who are very heavily burdened by regressive taxation. States with large sectors of migrant workers, high welfare rolls, increasingly large numbers of the elderly, and similar demographic characteristics have found these concerns to be far from theoretical.

The use of personal income as the index for growth in revenues or expenditures can also lead to another problem. In a recession, personal income will drop just at the time countercyclical spending (e.g., unemployment payments, welfare payments, food stamps) is triggered. Of course, all states have some type of override provisions in their limitations; however, these are usually invoked slowly, especially where a referendum is required, and could be extremely difficult to get past a determined minority in states where unusual majorities are required. The state may well find itself in a position of having to cut vital services in areas such as health, education and prisons because the TEL forces most available revenue into the countercyclical programs. Efforts made in good faith to relate taxation and expenditures to ability to pay may prove to be unsuccessful or even counterproductive unless the consequences of the formulas imposed are thoroughly understood by the drafters of the legislation.

### **The Use of a Base Year or Fiscal Period**

A number of limitations are based on the previous year's (or fiscal period's) expenditures or on averages of several years. The extent of any increase is related to increases in personal income or other economic variables. References to past years are probably unavoidable when attempting to

develop a formula limiting the growth of state expenditures; however, great care must be exercised in determining what the use of a particular base period implies.

If a state starts its new plan with the most recent or current fiscal period, it is building existing policies, administrative practices, levels of service, and many other operational and policy matters into its future. Before a base period is selected, careful consideration should be given to what economic conditions, executive/legislative policies, current emergencies and contingencies, or similar factors prevailed during the period under consideration which might make it suitable or unsuitable as a reference point for the future. If some "normal" or "representative" period is to be the base, this might well be quite different from the combination of accidental decisions and policies which, in total, constituted the preceding fiscal period.

In analyzing base-year considerations, many factors must be weighed, including the following:

- Does the accounting method (e.g., accrual, cash, modified accrual\*) provide a true picture of fiscal activities, or does it tend to report relatively higher disbursements than receipts (as might be the case with the modified accrual basis of accounting)?
- Do the accounting records accurately and comprehensively record payables and receivables so that the full scope of activities is included in the reference period?
- Have any special economic upturns, one-time federal reimbursement policies, multi-fiscal period reimbursements, or similar windfalls artificially inflated receipts? (And likewise, have downturns in the economy or unusual losses deflated receipts in a nonrepresentative manner?)
- Has the state been giving adequate support to its pension funds prescribed debt reserves, capital maintenance, and similar responsibilities (which all too often are postponed but will eventually have to be made good)?
- Have changes in regional characteristics (e.g., influx of retirees, discovery of new mineral resources, development of new industrial enterprises) occurred, or are they clearly in the process of occurring, so that demands for services and available fiscal resources may well be significantly different from the reference fiscal period?

Several states, notably Michigan and Oregon, use more than one year as the base period in an apparent effort to smooth out single year peculiarities;

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\*Modified accrual refers to a system of accounting where expenditures are charged as they are incurred but cash is accounted for only when it is received.

however, without additional analysis it is doubtful that this is a completely satisfactory technique. As is stressed throughout this report, every significant factor in the process of gaining control over costs and revenues should be subjected to intensive study and evaluation before being incorporated in any state's particular version of a TEL.

## **Fund Structures**

Based on the language used in the legislation, no state attempts to limit all disbursements or revenues, though several come very close—for example, Michigan, Missouri, New Jersey and Oregon. Most states restrict the limits (again, with exclusions) to the "general fund." This brings into focus the complexities of fund structures that control the disposition and uses of all state and local expenditures. The general fund is usually the principal means state and local governments have of providing basic governmental services. It is the principal source of revenues for the operating departments of government, and most state and local budgets in fact do no more than provide for the receipts and disbursements of the general fund.

Seldom does the general fund actually handle more than half of the moneys received and disbursed by a state government as a whole. A recent study in one major state determined that the general fund accounted for approximately one-third of the receipts and disbursements recorded by the accounting office, and this is not an unusual case. Under these conditions, a limitation dealing only with the general fund may seem to be ignoring the bulk of state costs; however, a close look at the nature and purposes of other funds may be reassuring. For example, several funds clearly do not lend themselves to this type of limitation:

- **Debt Service.** Moneys placed in these funds are generally pledged to the retirement of existing obligations.

- **Enterprises.** Both state and local governments are responsible for operations which "sell" services and products to those who choose to buy them (e.g., special recreational facilities, water and electric utilities).

- **Trust and Agency.** Large sums of money pass into and out of special funds which are handled by the state acting as a trustee or agent for individuals or organizations (e.g., contributions to retirement funds, endowment funds).

These are only a few of the examples in which tax and expenditure limitations would be of dubious value in checking rising taxes and the continued

growth of government. In fact, it is often doubtful whether these types of funds can legally be limited in this manner.

As in the case of selecting a suitable base year, a hard look must be taken at the fund structure of each particular state and local government considering the imposition of these types of limits. Sweeping exclusions of revenues and expenditures without careful attention to sources and purposes may turn out to be completely unsuitable, or actually illegal, in application.

## Revenues vs. Expenditures

The term "tax and expenditure limitations" implies a significant dichotomy that should be taken into account by those considering such legislation. In fact, Proposition 13 was a limitation on one source of taxation—the property tax. Polls taken before and after this referendum in California indicate that most people were not greatly dissatisfied with the types and quality of services they received, but they hated the property tax, believed it could be reduced, and were convinced that local governments could absorb this loss of revenue without serious cutbacks or deterioration in services.<sup>6</sup> Responses to polls consistently indicated that there was a popular belief that governments were wasteful, inefficient and unproductive.<sup>7</sup> Proposition 13 was seen as one way to make government officials start shaping up. The accuracy or fallacy of these beliefs have yet to be proven because of the support the state of California has been able to provide from existing surpluses.

Limiting a particular source of revenue such as property tax is relatively straightforward and effective, insofar as reducing that source of revenue is concerned. Limiting revenues at the state level is another matter, since most of these resources, particularly sales and income taxes, are highly elastic with respect to the economy. At the beginning of a fiscal period, a budget-maker can only speculate what the economy will provide in revenue through an 8 percent sales tax or a 10 percent tax on earnings above \$20,000. Unless it is made impossible for the state to realize a surplus by conservative budgetary estimates, the limitation is not likely to be meaningful. For example, Louisiana uses a formula by which the same percentage of personal income is taken from taxpayers each year. Any surplus resulting from unusually favorable economic developments must be deposited in a special fund for tax rebates. While this does entail a certain amount of expense to establish the machinery for calculating and making

the rebates, it is an assurance to taxpayers that, in total, this group will pay only a limited amount. The state of Missouri has similar rebate provisions.

None of the state-level revenue limitations has yet been subjected to a comprehensive and objective study. In fact, most of these laws have been enacted so recently that impact studies would be impossible as of the beginning of 1981. However, problems inherent in the revenue limitation formulas are fairly obvious. In an arrangement like that of Louisiana, for instance, the tax rebate formula will provide a serious challenge to financial analysts if equity is to be preserved. Receipts to the general fund of the state may well be from a combination of income tax, sales tax and a mixture of fees and charges. Revenues to this fund are fungible, and any surplus will be difficult to attribute to any one source of revenue. While rebates to payers of income tax (higher income people) would be a relatively simple undertaking, refunds to the payers of sales taxes (which include most of the population) will be difficult in the extreme unless purely arbitrary allocations are made. If not handled with great care and technical sophistication, rebate systems could exacerbate the inequities (to the extent they exist) inherent in the present systems of state governments.

Aside from these technical difficulties, revenue limitations obviously have only an indirect impact on expenditures unless a balanced budget is required. In that case, the formula imposed, especially during periods of recession, could force restraints on the normal level of state spending. On the other hand, in practice, it is possible for a formula such as that set forth in Louisiana (and several other states) to provide a sizable margin for additional expenditures for the state government.

Most TEL states place their limitation on expenditures. This is a more direct control, because appropriations can be fixed during the budgetary process with a much higher degree of certainty than is the case with attempts to curtail revenues. However, even expenditures cannot be limited strictly since many types of expenditures (e.g., welfare-related categories) are triggered by changes in economic conditions during the year regardless of the amounts of the original appropriations.

The advocates of revenue limitations wish to assure taxpayers that only a given amount of their money will be taken, and the advocates of expenditure controls are telling the taxpayer that governmental administrators are going to have to operate within tightly defined fiscal parameters. However, how "tight" these constraints are is subject to question. Virtually all the expenditure restrictions apply only to general fund appropriations, a condition which usually leaves most expenditures outside the limit. In addition,

several states do not include federal funds within the limits (Hawaii, Louisiana, Michigan, Missouri, New Jersey, Tennessee, Utah), and other states set forth additional exclusions, especially the cost of debt retirement.

An additional problem with expenditure limitations is that they are limited in application to the appropriation process; however, in practice, original levels of appropriations all too often bear very limited relationship to the actual patterns of disbursements during the year. Unless accounting methods, budgetary controls, and executive/legislative oversight are adequate, the apparently tight limitations set forth by the budget could be lost during the ensuing year.

An interesting feature of TELs is that, if undertaken with adequate analytical care, they pose a challenge to the entire system of financial management. Expenditure limitations in a budget mean very little if there is no adequate system of budgetary control and administration or if the competence of management throughout the system is substandard. The drafters of TEL legislation should realize that the statutory provisions may constitute little more than statements of intent unless steps are taken to provide the administrative and fiscal infrastructure necessary to implement them.

Experience has shown that neither revenue nor expenditure limitations can assure improved efficiency or increased productivity in governmental operations. Cutbacks in available revenues or authorized levels of spending may simply result in proportionate (or worse) reductions in the quality or quantity of services. This may lead to cheaper government, but it does not necessarily assure better, or even adequate, government. Without accompanying improvements in organizational structure, executive direction, administrative procedures and controls, and means of accountability, neither type of limitation will achieve improved government. Regardless of the approach used in the development of limitations, the continued capacity to meet obligations to the citizenry must be the ultimate goal.

For the drafters of TEL legislation, the overall objectives being sought should be articulated clearly at the outset and the program designed accordingly (or dropped altogether if a TEL clearly is not suited to the objective). A TEL may lighten the load on the taxpayer, or at least give him or her that feeling; however, it is only one factor among many in any program to develop more efficient and effective governmental operations.

## Scope of Limitations

Any attempt to limit *all* expenditures or revenues of government is certain to fail for the many legal and practical reasons already presented in the discussion of fund structures. As was noted, most of the limitations apply only to the general fund, and exceptions often are made even from those. A complete list of these exceptions for state TELs is presented in the chart at the conclusion of this report.

Beyond the legal limitations on dealing with trust funds and earmarked revenues of various types, the following are some of the sources of revenue that pose special problems to the framers of TEL legislation:

- **Federal Assistance.** Few states want to discourage the receipt and use of these funds, and the matching requirements and associated mandates require types and levels of disbursements the state might not ordinarily undertake during a period of austerity. Arizona, Louisiana, Missouri and New Jersey are examples of states that exclude these funds from the limitations.

- **Dedicated Funds.** Receipts from fuel taxes (usually dedicated to highway maintenance), tolls or similarly earmarked receipts obviously are already limited in application.

- **Self-Supporting Enterprises.** For those services that are supported entirely by fees, as is the case with most government-owned public utilities, a spending limit may simply deny people a service for which they are willing to pay; however, the trend to transfer vital services (e.g., garbage collection, police protection) from a tax- to a fee-supported basis can be very inequitable with respect to the poor and people on fixed, tight incomes.

- **Pensions.** Many state and local pension funds are in such bad shape that their conditions have sometimes been regarded as a serious national problem.<sup>8</sup> Any overall limitation that ignores this continuing condition in a state with this problem may well be fiscally irresponsible.

- **Debt Service.** Debt which has been properly approved constitutes an obligation that legally and morally must be met. Inclusion of these expenditures within the limitation can have repercussions on the bond market and can also act to encourage a government to delay undertaking necessary capital maintenance and initiating important projects during periods in which such delays can be extremely costly.

- **Bond Funds.** Directly related to debt service is the question of whether receipts from the sales of bonds should be excluded from the limit. Again, steps which discourage the timely building of necessary facilities or adequate maintenance of existing facilities can be very costly in the long run.

On the other hand, every effort must be made to discourage the use of these funds for operating purposes.

- **Local Assistance.** Where state-collected taxes are distributed to local units of government (including schools), the question arises as to where the limitations (if any) should be imposed. If the state collects the funds on behalf of the local governments, as with proportions of the sales or income taxes in some states, then state-imposed limits are of dubious propriety unless the entire arrangement is reexamined.

These are some of the more obvious problems inherent in imposing truly comprehensive limitations on revenues or expenditures. As has been stressed repeatedly, the ultimate objectives of the limitation process must be articulated in advance or the inclusion within the limits of certain types of expenditures or revenues may defeat these purposes and prove extremely costly in the long run.

## Methods of Control

Most states with TELs have sought to relate expenditures and revenues to some index of the apparent ability of the taxpayers to support operations. By and large, some form of index is used to warrant increases in expenditures proportionate to increases in personal income (or another surrogate for "the economy"). The general problems associated with the application of indexes to a given base period were discussed earlier. At this point, attention will be given to some specific arrangements which have been made and their principal implications.

Every state has taken its own approach to the development of a formula for tying costs to ability to pay. Any categorization of these approaches is a risky matter since the classifications are really in the eye of the beholder. From the perspective of this report, however, the 18 states appear to fall into the following five categories:

- **Expenditures Related to Personal Income.** Growth in expenditures is related to increases (or the rate of increases) in personal income in Arizona, Hawaii, Idaho, New Jersey, Oregon, South Carolina, Tennessee, Texas and Utah.

- **Revenues Related to Personal Income.** Revenues are limited by the level of personal income in Louisiana, Michigan, Missouri and Washington.

- **Combined Cost-of-Living and Demographic Formula.** Formulas combining increases in the cost of living with changes in population are used in California and Nevada.

- **Expenditures Tied to Revenue Estimates.** Expenditures are limited to 98 percent of estimated general fund revenue in Delaware.

- **Expenditures Limited by a Flat Rate.** Expenditures are limited to a flat percentage over the previous year's expenditures in Colorado and Rhode Island (though the latter is only a suggested limitation which is not binding on the legislature).

As can be seen in Appendix I, the actual formulas in use are more complicated than the above indicates, and there are usually exceptions to the prescribed limitations. While nearly half of the states with TELs relate increases in expenditures to increases in personal income (the first option listed above), none of them is exactly alike. In fact, no two states have adopted the same methods; however, the net results, for most practical purposes, are probably the same in all states except Nevada, California, Delaware, Colorado and Rhode Island. Nevada and California are very concerned about coping with continuing growth. Delaware and Colorado seem determined to tie themselves tightly to current levels of expenditures. Rhode Island has not actually committed itself to any limitation, though an 8 percent increase in the budget is given to the governor as a guideline.

For the drafters of new TEL legislation, there is no clear pattern among the states which have already taken this step. Unfortunately, very little has been done to evaluate the results of these various approaches. Most are too new to have established track records, and several states have been hit so hard by the recession that revenues have not reached the legislative limitations. Under these circumstances, each state will have to rely heavily on its own theoretical analysis to establish the approach best suited to its objectives.

## **Provisions for Exceptional Circumstances**

Every state that has its TEL embodied in its constitution has an explicit arrangement for an emergency override. Most of the statutory states, such as Colorado, Idaho, Louisiana, Nevada, Oregon, Rhode Island and South Carolina, do not make such provisions; however, their limitations can be changed in the course of the normal legislative process. Presumably, the same perceived pressures that lead to limitations tend to impose conditions that make escape from these conditions more difficult than passage of the average piece of legislation. Thus, Arizona, Hawaii, Michigan, Missouri,

Utah and Washington all require a two-thirds vote of both houses of the legislature (though some additional conditions must also be met in several instances) to override the limitation, and New Jersey requires all exceptions to be approved by a majority of the voters in a referendum.

While the governor of Michigan and the legislatures of Missouri, Utah and Washington must declare an emergency as a condition of override, many states leave the entire process up to whatever circumstances arise. It does not appear that any state with a TEL has defined just what constitutes an emergency.

The recognition that exceptional circumstances threatening the health, safety or welfare of the people may arise which warrant taxation or spending without preconceived limitations poses at least a theoretical challenge to the entire concept of a TEL. Obviously, a state legislature must be able to meet the vital needs of its citizens to the extent its powers and resources permit. A TEL seems to say that these needs can be met only up to a certain point which is related to the apparent ability of the citizens to afford this service—except, of course, when emergencies arise. However, state and local governments are in business to deal with emergency conditions all the time. Staff and facilities are always available to deal with fires, crimes, riots, natural disasters, severe economic developments, sickness, epidemics, threats to the environment and many other adversities. The vast system of regulations imposed and enforced by state and local governments is designed to avoid many of these emergencies. Facilities such as modern highways, hospitals, fire stations, civil defense shelters and street lights also work as preventives to accidents and threats of calamity.

Under these circumstances, if a TEL is to be imposed, there must be an assumption of the adequacy of the standing machinery of government and the associated capital infrastructure with respect to some preconceived level or range of emergencies. Presumably, something like an occasional outbreak of flu could be handled routinely, but a devastating epidemic would require extra manpower, facilities, supplies and other costly actions. Storms, riots or similar misfortunes that cannot be anticipated when budgets are formulated can be provided for by override provisions to TELs. However, the fact that these unusual conditions almost invariably arise with little or no warning and pose serious threats to the lives and health of the citizens would seem to require governmental machinery ready, willing and able to respond quickly and adequately. Some might well feel, as appears from news reports following any disaster, that the true test of the worth of government is its ability to respond in exactly these situations.

Under the conditions of most current TELs, it is exactly at the point of the unusual or extreme emergency, when the resources of the state under normal conditions are inadequate, that additional resources can be provided only if an emergency is somehow declared and two-thirds of both houses of the legislature (or three-fifths in Delaware or a referendum in New Jersey) agree. The danger of delay in these instances is manifest; yet a relatively small minority of the legislature (in most cases just one-third of the members of just one of the houses) may effectively block action at the time when the overwhelming majority of the people and the legislators might be convinced that action is essential.

In practice, the situation may be even more difficult than first appears. Major floods, epidemics or similar calamities almost certainly would elicit an appropriate response with reasonable speed (though not necessarily as fast as the victims might like); however, it is the borderline case that may well pose the most serious headaches and lead to delays in undertaking appropriate preventive actions. Thus, unusual or less-than-overwhelming economic downturns could lead to the need for exceptional, but not drastic, increases in public assistance and economic development. Could the need for such tempered action overcome the likely objectives of enough legislators to get the necessary programs under way? Much the same thing could be said about incremental deteriorations in the environment, correctional systems, hospital and health facilities and services, or the educational system. At what points do adverse trends or conditions merit "emergency" status so that overwhelming majorities can be raised to meet them?

For the drafters of TEL legislation, these are serious and extremely difficult problems with which to deal. It does not appear that any of the existing legislation is this finely tuned, and it may well be that it is impossible to strike exactly the right balance. Certainly, setting forth override provisions that are so easy to invoke that the limitation is worthless, or establishing barriers to effective action when action is most sorely needed, provides alternatives that are not attractive to anyone. Nonetheless, it is exactly in this middle ground that the challenges to the development of reasonable and effective limitations rest historically.

## Limitations on Local Governments

This report does not review the policy implications of actions local governments have taken to limit their own activities or of popularly initiated efforts by referendum to place limitations on costs or revenues at the local level. Thus, movements that truly emulate Proposition 13 are not included here, though they may be alluded to for limited purposes as examples. Most states traditionally have imposed limitations on local governments with respect to various aspects of property taxation. In recent years, state governments have imposed new forms of limitations which relate to all or most local expenditures or revenues. These trends have profound implications for the future of state-local relations and should be considered by drafters of TEL legislation.

Before going into the specific steps that have been taken in several states, a brief look should be taken at the nature of "local governments" and the roles they play in the intergovernmental system. Overall, our system of government has always been torn by centrifugal and centripetal forces. For example, while it is well understood that local governments are creatures of the state, forces for home rule have succeeded in establishing rights for local governments which often provide a high degree of independence from their state governments. In deciding whether to impose new limitations on local governments with respect to their powers of taxation and expenditure, many state governments must contend with the provisions of special charters and provisions in their constitutions which limit their powers to make these demands.

Beyond the legalities, however, lie the complexities of applying any blanket limitations. The brief observations which follow should be kept in mind if such steps are contemplated:

- **Education.** School districts nationally have a long-standing tradition of local control, and today they are faced with special problems of tax equity and nondiscrimination which are court-imposed, highly controversial and costly to solve. Additional TEL-type limitations, which neglect the special difficulties of many school districts, can only exacerbate already difficult situations.

- **Municipalities.** Even within the boundaries of a single state (especially the larger, more urbanized ones), municipal governments present a maze of variations in powers, services, forms of government, organizational arrangements, and methods of financing. General municipal laws that establish different classes of municipal governments are often supplemented

by special charters. General, across-the-board limitations can have widely varying impact on these jurisdictions and may well serve to place the large urban areas, contending with the ravages of crime, poverty and other socioeconomic problems, in very difficult positions.

● **Counties.** In general, the powers and duties of county governments vary from being full-fledged urban governments (as with Nassau County, N.Y.) to little more than geographical designations (as with Connecticut counties, just across Long Island Sound). In most states with large urban concentrations that still rely on the county form of government for basic services, bridging the gaps between urban and rural counties is extremely difficult. These differences pose additional difficulties to the imposition of local TELs.

● **Special Districts.** These districts continue to comprise the majority of "governments" in the United States, and it has been fashionable for a number of years to decry their continued existence and, in some cases, proliferation. Nonetheless, they are part of the local government scene and are often virtually the only practical means of dealing with large-scale, specialized, multijurisdictional problems such as water supply, sewage disposal, regional parks, port facilities, river improvements and environmental controls. Generalized limitations must be imposed here only with great caution and careful consideration of the nature of services each district is designed to provide.

Further complicating this difficult situation is the fact that it is often virtually impossible to get accurate, detailed information concerning economic activities in particular communities or governmental regions. Few states (if any) have undertaken economic base studies of each of the principal economic regions within their borders. The federal government maintains its economic data by the types of regions that suit its analytical needs. Thus, attempting to tie a municipal government's revenues or expenditures to cost-of-living data for its area could prove to be an arbitrary exercise, and apparently no state has tried to do this. This leaves the state with much less refined tools to use when it chooses to apply TEL-type limitations locally, as will be seen below.

For more than a century, state-imposed limitations on property taxes have been commonplace in the United States. Thirty-eight states now have millage limits, either set forth as mills or as dollars of taxation per hundred dollars of assessed valuation. Of the 12 that do not, half are the New England states (Connecticut, Maine, Massachusetts, New Hampshire, Vermont and Rhode Island). The variations in the imposition, levels, techni-

ques of assessment and collection practices are exceedingly complex and are beyond the scope of this report except for noting the precedents they establish for state involvement in the limitation process at the local levels of government. In addition, considering the commonplace, almost universal nature of these types of controls, it is surprising that Proposition 13 received the attention and had the impact it did. By contrast, the passage of Proposition 4 in California in November 1979 received much less nationwide attention, though it tied the growth of state and local appropriations financed by taxation to increases in the cost of living and changes in population—a much more novel and far-reaching change than that imposed by Proposition 13.

The general public may not be as interested in comprehensive controls over expenditures as it is in slashing attacks on the hated property tax. In furtherance of this mood, in the last half of the 1970s, 19 states added overall collection limitations to existing millage limitations. As was the case with state TELs, these new limits included arrangements that tied increases in revenues to increases in the cost of living (Michigan), fixed percentage increases over previous years (Arizona, Colorado, Florida, Indiana, Iowa, Massachusetts, Oregon and Washington), a fixed percentage of the value of the property (Alabama, California and Idaho), a fixed percentage increase over the previous year plus allowance for population growth (Minnesota and Nebraska), a percentage growth equal to the percentage growth of statewide equalized valuation (Wisconsin), or a formula designed to disallow revenue growth due solely to inflationary factors (Kansas and Ohio). Nevada has placed special controls on school districts which recognize both enrollment growth and a five-year average of the consumer price index. Interestingly, a constitutional amendment ratified by the voters of Alabama adds to other limits the restriction that "all taxable property shall be forever taxed at the same rate." Clearly, property taxes will continue to be the target of limitation movements for some time to come with little objection on the part of the public.

It is at least questionable whether these added property tax controls will have long-term significance except to the extent that local governments shift their dependence on revenues to other sources or that service responsibilities are shifted to other jurisdictions—probably from the local to the state levels, in many instances. When only one or a few sources of income are restricted, successful efforts have been made in the past to get around them, as is shown in Appendix II. The use of special districts for this purpose has been common for at least 75 years. Proposition 13 has had limited impact

on the operations of California's local governments because the state has been in a position to provide relief almost to the same extent that property tax revenues have been reduced, and this relief apparently will continue on a reduced scale until June 1981.<sup>9</sup> In fact, most municipal governments in the United States have depended on property taxes to a much lesser extent since World War II than before. All the trends are toward restricting the use of this source of revenue, and the process of restructuring state and local responsibilities and revenue configurations promises much more profound long-range changes than the current limitations themselves.

An indication of the new approaches to local limitations is seen in the eight states that have imposed tax and revenue limitations on their local governments. Given the additional sources of revenues (especially sales and some form of wage tax) and the lessening dependence of local jurisdictions on property tax, any effective attempts to limit local costs will have to be more inclusive than in the past; and, as these eight states demonstrate, they are more comprehensive:

- Arizona requires counties, cities and towns to hold public hearings as a condition of any increase in expenditures over the previous year; and in no event (except a state-certified emergency) can the budget or levy increase by more than 10 percent.

- California limits increases in total annual appropriations to increases in the cost of living and growth of population.

- Kansas places a limit on educational operating expenses per pupil of 16 percent more than the previous year's budgeted amount, or to 6 percent of median budget per pupil in the 1978-79 school year, whichever is less.

- Massachusetts, for the years 1980 and 1981, limits local government units to 104 percent of their 1979 appropriations and property tax levy. (Note: Massachusetts does not have millage limitations, so this is the only restraint on local spending and taxation.)

- Nebraska limits the combined receipts of local governments to a 7 percent increase over the prior year, and additional increases may be added that are proportionate to increases in the population.

- Nevada limits local appropriations to those of the 1978-79 fiscal year, with increases permitted for growth in population plus 80 percent of the previous five years' average change in the national consumer price index.

- New Jersey limits increases for municipalities to 5 percent of the prior year's tax levy and increases for school districts to approximately three-fourths of the annual increase in the value of real estate (though this differs from one school district to another to some degree).

- Utah limits increases in revenue to local governments to 90 percent of the state's per capita personal income growth plus an allowance for population growth.

As can be seen, all of these limitations dodge the tough problems posed by limited local economic data by not tying local appropriations to changes in *local* economic conditions. Where economic data are used at all, state or national indexes serve as surrogates for the local economy in spite of the very difficult problems such generalized standards may pose for the affected jurisdictions. Clearly, in many of these states the differences in general wealth and the economic bases that distinguish one jurisdiction from another may leave the more impoverished communities in very straitened circumstances. An overall imposition of this type poses serious questions of equity among communities. In addition, in California, Proposition 4 spending limits now overlap the earlier Proposition 13 limits on property taxes which, in turn, overlap a myriad of traditional millage limitations. When these layers of conditions are then applied to the overlapping spending and taxation practices of cities, counties, school districts and other layers of government in any one area, the prospects for the taxpayer are bewildering. Even more important, the development of an equitable revenue system throughout the entire state will be extremely difficult.

When anticipating future efforts of state governments to control and limit the overall expenditure and revenue patterns of local governments, a profound look must be taken at current notions of home rule. Just as each of the 18 states has taken its own route to establishing TELs, it is reasonable to expect that local units of government within any given state will have varied requirements if they are to meet the special needs of their citizens under the prevailing socioeconomic conditions. The extreme variations in missions, scope of operations and other administrative conditions of these governments have already been emphasized by way of stressing the dangers inherent in using the designation "local" as the basis for imposing standard, undifferentiated fiscal limitations. The impact of a 4 percent limitation on any increase in expenditures, for example, may have profoundly different effects on a county, municipality and school district serving exactly the same group of citizens. The use of base fiscal periods by no means indicates each of these entities is starting from the same point of need, service levels, or fiscal resources since any one year is the result of a long history of plans, operations, changing service demands, governing policies, referendums and similar factors in each and every jurisdiction. The complexity of this problem is reflected, in part, by the differences

represented in the approaches of each one of the states that have imposed such limitations.

In addition to overlapping governmental structures, wide variances in the conditions from one locality to the next within a state, and the absence of accurate, local economic data, TELs for local governments have exactly the same range of problems with economic indexes, base years, scope of coverage, method of control, and similar matters which have been discussed above with respect to the TELs states have imposed upon themselves. These local governments have similar types of fund structures, use federal funds (with matching requirements and mandates), operate self-supporting enterprises, have pension problems (except where pensions are included in the state systems), and borrow money and retire debt. To the extent that state governments have difficulty coping with these problems in developing effective overall limitations at their own level, caution should be exercised in treating local units in generalized, undifferentiated ways.

## *Evaluating Results*

Sponsors of limitation proposals obviously seek effective means of curbing the rate of increase in governmental costs. These objectives, however, are not always clearly enunciated. Especially since the adoption of Proposition 13 in California, leaders of the tax revolt have made sweeping claims for the value of limitations as restrictions on expenditures and revenues. These claims include predictions that the costs of government will plummet and that a new mind-set on the part of governmental officials at all levels will sensitize them to the needs of the beleaguered taxpayer. Certainly the activities of the past two years have resulted in an increase in awareness by government officials and the public of the rising costs of government, especially at the state and local levels. As indicated earlier in this report, virtually every state has dealt with limitation proposals during the past few years.

Beyond these generalizations, however, it is difficult to provide much objective information concerning the efficacy of existing TELs. The earliest limitation at the state level (the level with which this report is most concerned) was passed by statute in New Jersey in 1976; however, most of this activity has occurred since 1978 when Tennessee adopted a constitutional amendment to limit expenditures. Of 18 states with TELs, only seven enacted the statutes or constitutional provisions before 1979. Any statistical analysis of governmental tax and expenditure policies will require several years' experience. Presumably such studies would include incidence of tax policies, changes in quality and quantity of services, adjustments in intergovernmental patterns of responsibility and authority, development of improved administrative procedures, and changes in taxpayers' attitudes. Unfortunately, at this time, there is little upon which the analyst can rely.

In the process of writing this report, a telephone survey was made of the seven states which passed their limitations before 1979 (New Jersey, Colorado, Tennessee, Arizona, Hawaii, Michigan and Texas). Only one of these, New Jersey, has undertaken any formal study of the results of its

limitations. Three states (Hawaii, Michigan and Texas) indicated that it is too soon to determine any results at all. Three other states (Tennessee, Colorado and Arizona) indicated that because of revenue shortfalls, their limitations have not been reached. In fact, all of the seven states have been able to operate well within their limitations due to adverse economic conditions during the past two years. There has not been an instance in which the emergency override provisions came into play, so this feature of the limitations could not be evaluated.

New Jersey's statute is extremely complicated and relates as much to local taxation as it does to state activities. As a result, its evaluation concentrated principally on the results of using revenue from the state income tax to provide property tax relief at the local level. The study did not result in unequivocal conclusions concerning the efficacy of these limitations at any level of government. It was perceived that expenditures at the state level were somewhat stabilized.

In general, state officials have found that imposed limits have provided adequate margins for normal operations under prevailing economic conditions. There was no indication that the limitations should be dropped or changed significantly at this time. However, no state has been put to a test because of emergencies or the types of economic conditions that would challenge the assumptions upon which the limitations are based. On balance, it is just too soon to reach conclusions.

## Notes

1. Editorial, *Taxing and Spending*, October/November 1978, p. 5.
2. State public interest groups have released a number of publications concerning tax and expenditure limitations, including the following: The Council of State Governments, *Limiting State Taxes and Expenditures*, November 1978; National Governors' Association, *Tax and Expenditure Limitations, 1978*, December 1978; National Conference of State Legislatures, *A Legislator's Guide to State Tax and Spending Limits*, March 1979.
3. Frank Levy, "On Understanding Proposition 13," *The Public Interest*, Summer 1979.
4. Donald G. Hagman, "Proposition 13: A Prostitution of Conservative Principles," *Tax Review*, September 1978, p. 39.
5. The clearest statement of this principle is to be found in the "Petition of Right," Third Parliament of Charles I, May 1628, which laid the basis for Parliament's undeviating demand that only it could authorize taxes.
6. Education Finance Center, *Public Opinion and Proposition 13*, Education Commission of the States, Denver, Colo., February 1979.

7. National Governors' Association, *State Tax Policy*, 1979, p. 14.
8. U.S. General Accounting Office, Comptroller General, *Funding of State and Local Government Pension Plans: A National Problem*, Aug. 30, 1979.
9. Winnifred M. Austermann and Dan Pilcher, "The Tax Revolt Transformed," *State Legislatures*, July-August 1980, p. 32.

# Appendix I

## LIMITS ON STATE EXPENDITURES AND REVENUES: A REVIEW OF THE GENERAL PROVISIONS AS OF OCTOBER 1980

<i>State Year-Basis Application</i>	<i>Method of control</i>	<i>Scope</i>	<i>Provisions for waiver</i>
Arizona 1977—C Expenditures	Limits state expenditures to 7 percent of the personal income of residents. A committee establishes the level of income to be used as the index.	Includes all tax funds appropriated by legislature.	To override provisions requires two-thirds approval of both houses of the legislature.
California 1979—C Expenditures	Limits increases in state appropriations to changes in cost of living and the level of population. Revenues exceeding this amount must be offset by changes in the tax schedules over the ensuing two years.	Excludes approximately 60 percent of state expenditures—debt service, federal court mandates, tax refunds, various insurance funds.	An override permitted; however, extra costs must be compensated for by reduced expenditures in the three ensuing years. Voters also can vote an increase, but this approval is operative for only four years.
Colorado 1977—S Expenditures	Limits General Fund spending to 7 percent of the preceding year. Any receipts exceeding this limit by 4 percent must be used for tax relief.	Applies to all General Fund appropriations.	No special provisions; however, statute can be amended at any time.
Delaware 1980—C Expenditures	Limits General Fund appropriations to a maximum of 98 percent of estimated revenue for that year. Excess revenue goes to a reserve account which cannot accumulate to more than 5 percent of estimated General Fund revenue.	Applies to all General Fund appropriations.	Upon approval of 60 percent of each house voting, the additional 2 percent may be used in an emergency, or the reserve fund balance may be so utilized.

Hawaii  
1978—C  
Expenditures

Limits increases in General Fund expenditures to the estimated rate of growth of the state's economy [in practice, state personal income is the index]. If General Fund surplus exceeds 5 percent of revenue two consecutive years, tax refunds or credits must be provided.

Applies to all General Fund expenditures except those using federal funds.

Upon the governor recommending a definite amount required, a two-thirds vote of each house may approve.

Idaho  
1980—S  
Expenditures

Limits General Fund expenditures to 5-1/3 percent of total state personal income.

Applies to all General Fund expenditures.

Statute can be amended at any time.

Louisiana  
1979—S  
Revenues

Limits state revenues to a percentage applied to current state personal income. The percentage is derived by dividing FY 78-79 revenues by 1977 state personal income. Excess revenues are deposited in a surplus fund which can only be used for tax refunds.

There are numerous exclusions, including federal funds, severance taxes, utility income.

No special provisions; however, statute can be amended at any time.

Michigan  
1978—C  
Revenues

Limits state revenues to a ratio (derived by dividing state revenue received in the prior fiscal year by state personal income the year before that) applied to state personal income reported during the prior year. [Note: In deriving the ratio, a three-year average of personal income may be substituted for the prior year if it will result in a higher percentage.]

Federal funds are not included in the calculations of state revenues. In addition, the cost of general obligation debt service and loans to school districts are excluded.

Upon declaration of an emergency by the governor, and designation of amount required and method of funding, may be approved by a two-thirds vote of each house.

**Missouri**  
1980—C  
Revenues

Limits state revenues to a ratio (derived by dividing state revenues in FY 81 by state personal income in calendar year 1979) applied to personal income in the calendar year prior to the year of appropriations. [Note: In determining personal income, a three-year average may be substituted if it results in a greater amount than the one-year level.]

Neither federal funds nor revenues raised to retire voter-approved debt are included in the revenue limitation.

Governor must request legislature declare an emergency and indicate the reasons and the amount required to meet it. In 1981-82, a simple majority of both houses is required. In subsequent years, a two-thirds vote of each house will be required. If revenues exceed limit by 1 percent or more, they must be used as refunds to income taxpayers.

**Nevada**  
1979—S  
Expenditures

Limits executive budgetary requests (no legislative action) to the rate of inflation and population growth using the biennium 1975-77 as the base fiscal period.

Applies to all appropriations included in the budget request.

Legislature is not limited.

**New Jersey**  
1976—S  
Expenditures

Limits expenditures for state operations and capital outlays to increases in state per capita income as measured between the second quarters of the preceding two years.

Excluded are appropriations supported by state aid to local governments, federal assistance, and retirement of debt authorized by referendums.

Limit can be exceeded only if approved by the majority of voters in a statewide referendum.

**Oregon**  
1979—S  
Expenditures

Limits expenditures to the rate of growth of state personal income for the preceding two years. If revenues exceed limit by more than 2 percent, they must be used as refunds to corporate and personal income taxpayers.

Excluded are debt service and appropriations for tax relief.

Statute may be amended at any time.

Rhode Island  
1977—S  
Expenditures

Suggests that the governor limit his budget request to an 8 percent increase over the preceding year's appropriations.

Applies to all General Fund appropriations.

Statute can be amended at any time.

South Carolina  
1980—S  
Expenditures

Limits increases in state expenditures over the preceding year to the growth of personal income averaged over the preceding three years.

Applies to all state expenditures.

Statute can be amended at any time.

Tennessee  
1978—C  
Expenditures

Limits the growth of appropriations financed by tax revenues to the growth in the state's economy. In practice, the increase in personal income is used as the index.

Applies only to appropriations funded by tax revenues.

Legislature can approve a specific act by majority vote delineating exact amount required.

Texas  
1978—C  
Expenditures

Limits growth in state appropriations to the growth of the state's economy. In practice, growth in state personal income is used as the index.

Excludes revenues dedicated by the state constitution.

Legislature may find an emergency and authorize a specific amount by majority vote.

Utah  
1979—S  
Expenditures

Limits increases in appropriations to 85 percent of the increase in state personal income.

Exclusions include federal funds, debt service, and user charges.

Upon declaration of an emergency by the legislature, the limit can be overridden by a two-thirds vote of each house.

Washington  
1979—S  
Revenues

Limits tax revenues to the rate of increase in state personal income as averaged over the preceding three years. Any excess receipts become part of the tax revenue for the next year.

Applies to all state tax revenues.

Upon declaration of an emergency by the legislature, a specified amount may be approved by a two-thirds vote of each house.

## *Appendix II*

### **Historical Perspective**

Tax limitations have a long history in America, and anyone proposing these types of constraints would do well to review past efforts. This special section seeks to highlight conditions and public actions in the past which many people today seem to feel are unique to the present.

#### **Proposition 13**

In spite of the attention it received, Proposition 13 was directed toward a very limited objective—reduction of property taxes. The proposition was aimed only at this one source of revenue at the local level of government. The proposition had the following principal provisions:

(1) It limited real property taxes to 1 percent of market value—a step designed to cut revenues from this source by more than half.

(2) It set assessable “market value” at that established during the 1975-76 fiscal year, with increases to be made in evaluations only at the time of subsequent new construction or when ownership changed hands—probably the first time in history when values were legally frozen to give preferential treatment to existing property owners over developers and new purchasers.

(3) It placed a limit on increases in assessed values of 2 percent annually, regardless of actual market values.

(4) It prohibited increases in other taxes to offset property tax reductions unless such increases are endorsed by two-thirds of all members of both houses of the state legislature or by two-thirds of those eligible to vote at the local level at a referendum.

Proposition 13 was unique only in its severity and the amount of publicity it received. It was the result of an interesting set of circumstances that bear inspection. Per capita taxes in California increased overall by 151 percent from 1969 through 1978—a lower rate of increase than state and local taxes nationally. However, local governments in California were heavily dependent on the property tax. For example, in 1976, property tax in California was \$64 per \$1,000 of personal income, compared to a national average of \$45. In addition, California communities were very aggressive in reevaluating property. Given the spectacular increases in housing prices in California during the 1970s, local governments were able to reap large

dividends in additional receipts while keeping tax rates fairly steady. For the average homeowner who held on to his property and depended on a regular salary, this tax on unearned income became burdensome to the point of intolerance.<sup>1</sup> It is well recognized that property tax is the most unpopular tax nationally, and these circumstances were greatly exacerbated in California. It is little wonder Proposition 13 passed by such a large margin. In many ways, this was a special case.

## Early American Concerns

A brief look at the long history of limits on taxation in the United States will help place the California experience in perspective. Since the basic purpose of this report is to provide policy guidance to state legislators considering the adoption of some form of TEL, this retrospective necessarily will be selective and brief; however, it will serve to demonstrate the difficulties inherent historically in the use of statutory and constitutional limits to control spending.

In New York state, the Constitutional Convention of 1846 was concerned with "evidence of local graft, corruption and extravagance." The Convention amended the Constitution to make it the duty of the Legislature "to restrict" the local power to tax and borrow "so as to prevent abuses." In the following years, the New York Legislature set up boards to oversee local expenditures, required submissions to the state of local budgets for review, and established a 2 percent real estate tax limitation on New York City. It was subsequently determined that all of these actions "failed to eliminate or substantially reduce the incidence of graft, corruption and extravagance." As a result, in 1884, a new constitutional provision placed a limit of 2 percent of assessed value (real and personal) on taxes throughout the state, and these limitations were tightened further in 1938.<sup>2</sup> As will be seen, none of these actions achieved the desired results.

New York was not unique in its problems and concerns. Especially after the Civil War, there was a boom in the activities of Northern cities in terms of capital improvements and services. Costs-per-capita for governmental operations soared, and a great deal of debt was incurred. Much of this was "floating debt," carried forward from year to year, to pay for current operating expenses. As the prominent urban historian Ernest S. Griffith explains, "In 1872-73 this had gone so far in Chicago that its tax levies went mostly for interest on the debt and redemption of the scrip."<sup>3</sup>

The "extravagance, overoptimism, and dubious and corrupt decisions" that characterized many state and local governmental activities after the Civil War received a severe jolt with the crash of 1873. This financial panic was a serious blow to every city government in the nation—especially the cities of the South. As a consequence of economic conditions, Pensacola, Fla.; Memphis, Tenn.; Fayetteville, Ark.; Mobile, Ala.; Duluth, Minn.; Elizabeth, N.J.; and a number of other smaller cities forfeited their charters. Selma, Ala., had its charter annulled by the governor, and Nashville's fiscal affairs went into the hands of a receiver. So serious was the situation overall, writes Griffith, that: "During the decade, it was estimated that one-fifth of the total municipal debt at one time or another was at least technically in arrears in interest, and much was in actual default."<sup>4</sup>

The 1873 crash led to demands from many quarters for more economical government by making it "impossible to spend more or to incur a greater debt." These demands led, in the 1870s, to "charter, statutory, or constitutional tax and debt limits." In most instances, limitations on taxes were based upon a percentage of the assessed valuation of property. As a result of these developments, by 1880, 10 states had such limitations, and by 1901, two-thirds of the cities had tax limits. It should be noted that: "One-half of the cities with a legal tax limit taxed up to the limit."<sup>5</sup> This latter observation is interesting because it is often contended that "limits" in fact constitute "floors" for revenue estimation purposes in many jurisdictions today.

With the imposition of these types of limitations on property taxes, cities started looking for alternative sources of revenues; however, they could not easily continue use of debt because: "By 1880, more than half of the states had constitutional limitations of city debt in one form or another."<sup>6</sup> Other methods were pursued. Increased use of charges and fees for services became commonplace. Chicago found itself in a very difficult situation by the turn of the century and began turning to the use of special districts with independent taxing and borrowing powers as a device for getting around restrictions on the city's taxing and borrowing powers. This approach became so popular throughout the nation that these types of districts are far more numerous today than any other form of local government in the United States.

Largely as a result of these pressures to avoid limitations, the reforms of the late nineteenth century, which sought economy in government, did not produce the desired results. As Griffith notes: "A great majority of states

continued to employ such tax and debt limits, even though these were impaired or even failing for a number of reasons." For example, a special legislative committee in Massachusetts in 1912-13 concluded that both tax and debt limits were failures, and generally resulted in bond issues for current expenses. In 1913, limits were removed on all local governments in Massachusetts other than Boston.<sup>7</sup>

A number of different devices were being used to control expenditures during the first two decades of the twentieth century. By 1920, several states based tax limitations on the taxes or tax rates of the previous year, varying from the same to 110 percent. As seen in this report, these controls were virtually identical to those imposed by several states in the late 1970s. Indiana was one of these earlier states. In addition to normal limitations, it also established a State Tax Commission to review and, if possible, reduce local budgets. It went through a stormy period between 1919 and 1921 but stayed in business until 1937.

Following World War I, there was much discouragement among reformers about the effectiveness of tax and debt limitations. In 1920 in New York state, the Davenport Committee issued a report that included these observations:

... there is no way in a democracy of blocking a genuine popular demand for increased governmental service through an arbitrary limitation on the tax levy. The only effective method of securing reduction of tax levies lies along the line of centering full responsibility upon a single elected official through (a) a comprehensive budget, (b) a sound bonding act, (c) a wide distribution of the direct tax burden.<sup>8</sup>

Expenditure constraints during the 1920s were not limited to tax and debt limitations. Oregon tried expenditure constraints in the early 1920s whereby a "limitation was fixed at 106 percent of the previous year unless the voters approved an increase above this figure." Interestingly, in 1979 Oregon passed a statute which limits increases in appropriations to the growth in state personal income. Two other states (Colorado and Rhode Island) in 1977 tied increases in appropriations to fixed percentages over the previous year's appropriations.

## Modern Developments

Beyond the use of tax and debt limitations, it is difficult to compare governments in the 1870s with those in the 1970s. Griffith makes this very important observation in this respect: "No city in 1880 even approached the

imagination and concern for all its citizens that constitute the standards accepted for the American cities of the 1970s."<sup>9</sup> This statement could be extended to all levels of government. Indeed, it is this concern for all citizens that characterizes much of the reason for the modern levels of governmental costs.

As has been seen, people were concerned with extravagant government throughout the nineteenth century; however, the total burden of governmental costs was far below what it has been in modern times. The Tax Foundation recently summarized current trends. In 1950, expenditures for all governments were \$70.3 billion—8.4 percent of the 1979 level of \$830 billion. Federal expenditures increased from \$44.8 billion in 1950 to \$531.8 billion in 1979, or 1,087 percent, while state and local expenditures increased from \$25.5 billion in 1950 to \$297.8 billion in 1979, or 1,069 percent. Of course, for a true comparison, these data should be changed to constant dollars, a step which would reduce the disparity; however, the gross scope of the change in a period of less than 20 years is startling.<sup>10</sup>

A great deal of attention has been given in recent years to the apparently extraordinary increases in state and local expenditures. Between 1968 and 1978, general tax collections (excluding unemployment insurance) increased by nearly 187 percent. During this same period, the nation's population increased by only 9 percent, consumer prices by 88 percent, and personal income by 151 percent. In fact, also during this period, federal tax collections increased by 161 percent—26 percent less than the state and local increases. On the other hand, the Foundation points out the following:

In the last four years, from 1975 to 1979, Federal spending growth has outpaced that of state and local governments by a significant margin. Federal spending has increased at the rate of 11.8 percent annually, 50 percent faster than the 7.9 percent annual growth in state-local spending.<sup>11</sup>

Some of the reasons for these increases become more apparent in another Tax Foundation report which cites the following conditions with which modern governments are faced:

. . . from 1950 to 1978 the number of persons aged 65 and over, together with the number of persons of school and college age (5 to 24 years) increased by more than 42 million, or 72 percent. Population in the remaining ages rose by only 24 million, or 26 percent. . . . The 65-and-over age group gained 12 million persons, or a 94 percent increase. For the school-age group, the rise was 31 million, or 66 percent.<sup>12</sup>

As the Foundation went on to observe, "These two age groups traditionally are major beneficiaries of government programs." For example, major programs for the elderly (e.g., OASI, railroad retirement, public employee retirement, Supplemental Security Income, old age assistance, hospital and

medical insurance, and Medicaid) increased from \$3.26 billion in 1950 to \$152.7 billion in 1978, while public education costs increased from \$7 billion in 1950 to \$103.1 billion in 1978. Nor should it be forgotten that these are only two types of social programs underwritten by American governments. Since 1950, equally impressive increases could be cited in such programs as housing, welfare and health.

The principal point in this brief review is to stress the fact that increases in governmental costs in modern times have not been due to the "graft, corruption and extravagance" that worried the delegates to New York's 1846 Constitutional Convention. The reasons for these increases today are tied to an infinitely intricate web of socioeconomic and demographic circumstances largely beyond the control of governmental officials. The people demand (as do their representatives in local, state and federal governments) that the ravages of poverty and old age be ameliorated, that excellent educational resources be provided to our youth, and that governments otherwise provide for safe and healthy communities. As the 1920 New York Davenport Committee said, given these "popular demands," increased governmental services (and associated costs) are inevitable.

It would be improper to conclude from this summary of pressures for higher levels of governmental costs that limitations on state and local expenditures are useless and a waste of time to impose. In the absence of significant economic changes, sudden increases or decreases in population, or other factors which tend to put unusual strains on the availability of revenue or the demands for services, these types of limitations clearly do influence the decisions of executives and legislators in state and local governments. Budget directors routinely use the prescribed limitations to determine total available resources or expenditure limits, and these constraints are cited constantly in negotiations with governmental employee representatives. Without these limitations over the years, governmental costs undoubtedly would have increased significantly more than they did.

On the other hand, history has shown that significant socioeconomic developments and unremitting demands for increased or improved services will result in the limitations either being changed or avoided in some way. Modern adaptations of these types of limitations attempt to provide for some flexibility in the traditional system. The nature of these new efforts has been the subject of this report. In the years to come, everyone concerned with the costs of government will be watching them, and their successes and failures will continue to be the subjects of studies and reports.

## Notes

1. C. Lowell Harriss, "Property Taxation after the California Vote," *Tax Review*, August 1978, p. 35.
2. State of New York, Temporary State Commission on the Constitutional Convention, *Local Finance*, Volume 3 (New York: Temporary State Commission on the Constitutional Convention, 1967), p. 48.
3. Ernest S. Griffith, *A History of American City Government, 1870-1900* (New York: Praeger Publishers, 1974), p. 15.
4. *Ibid.*, p. 5.
5. *Ibid.*, p. 230.
6. *Ibid.*, p. 21.
7. Ernest S. Griffith, *A History of American City Government, 1900-1920* (New York: Praeger Publishers, 1974), p. 179.
8. *Ibid.*, p. 180.
9. Griffith, *American City Government, 1870-1900*, p. 22.
10. Tax Foundation, *Monthly Tax Features*, August 1979, p. 1.
11. *Ibid.*
12. Tax Foundation, *Monthly Tax Features*, November-December 1979, p. 1.

# Appendix III

The following is a list of knowledgeable officials in the 18 states with tax and expenditure limitations. This list is current as of January 1981.

## ARIZONA

Hank Reardon  
Joint Legislative Budget Committee  
1812 W. Monroe, Room 201  
Phoenix, AZ 85007  
602-255-3042

## CALIFORNIA

Bion Gregory  
State Legislative Counsel  
3021 State Capitol  
Sacramento, CA 95814  
961-445-3057

## COLORADO

Douglas G. Brown, Director  
Legislative Drafting Office  
Room 30, State Capitol  
Denver, CO 80203  
303-866-2045

## DELAWARE

Nathan Hayward III  
Office of Management, Budget  
and Planning  
Townsend Building, 3rd Floor  
P.O. Box 1401  
Dover, DE 19901  
302-736-4271

## HAWAII

Rick Kahle  
Legislative Bureau  
Rm. 004, State Capitol  
Honolulu, HI 96813  
808-548-6237

## IDAHO

Myron H. Schlechte, Director  
Legislative Council  
Rm. 334, State Capitol  
Boise, ID 83720  
208-334-2475

## LOUISIANA

Donald Vandal  
Deputy Legislative Fiscal Officer  
Legislative Fiscal Office  
P.O. Box 44097, Capitol Station  
Baton Rouge, LA 70804  
504-342-7233

## MICHIGAN

Douglas C. Drake, Co-Director  
House Democratic Research Staff  
Office of the Speaker  
State Capitol  
Lansing, MI 48909  
517-373-8615

## MISSOURI

Frank M. Masters, Director  
Committee on Legislative Research  
Rm. 117-A, Capitol Building  
Jefferson City, MO 65101  
314-751-4223

## NEVADA

Ron Sparks, Director  
Legislative Fiscal Division  
or  
Dan Miles, Deputy Fiscal Analyst  
Assembly Taxation Committee  
Rm. 341, Legislative Building  
Carson City, NV 89710  
702-885-5640

## NEW JERSEY

Maurice Shier  
609-292-8872  
or  
Larry Levit  
609-292-8254  
Office of Legislative Services  
Rm. 232, State House  
Trenton, NJ 08625

**OREGON**

Richard Munn  
Legislative Revenue Office  
Rm. 140, State Capitol  
Salem, OR 97310  
503-378-8873

**RHODE ISLAND**

James F. Mahoney  
House Finance Commission  
Rm. 306, State House  
Providence, RI 02903  
402-277-2738

**SOUTH CAROLINA**

Robert Heilman  
Chief Staff Attorney  
Legislative Council  
P.O. Box 11417  
Columbia, SC 29211  
803-758-2334

**TENNESSEE**

Don Borton  
Fiscal Review Committee  
G-19 War Memorial Building  
Nashville, TN 37219  
615-741-2564

**TEXAS**

Tom Keel, Director  
Legislative Budget Board  
P.O. Box 12666, Capitol Station  
Austin, TX 78711  
512-475-3426

**UTAH**

Melvin Leslie  
Legislative General Counsel  
Rm. 403, State Capitol Building  
Salt Lake City, UT 84114  
801-533-6581

**WASHINGTON**

Greg Pierce  
House Revenue Committee  
Rm. 213, House Office Building  
Olympia, WA 98504  
206-753-3962

# STATE OF ALASKA

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION  
POUCH WF--STATE CAPITOL  
JUNEAU, ALASKA 99811  
PHONE: (907) 465-3795

### MEMORANDUM

TO: Honorable Ed Dankworth,  
Co-chairman  
Senate Finance Committee

FROM: Milt Barker, Fiscal Analyst  
Legislative Finance Division

DATE: January 22, 1981

SUBJECT: FY 82 Budget Under Proposed Constitutional Limits

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Following are estimates of what FY 82 budgets would be permitted if various proposed constitutional limits on budget growth were now in effect.

#### SJR 3 by Colletta

This limits growth of appropriations, except those for capital projects and contributions to the permanent fund, to growth of the economy. For calendar 1979, Alaska personal income grew 4.55%. Applied to an FY 81 operating budget of \$1,282.0 million (see attached Table I), this would permit an FY 82 operating budget of \$1,340.3 million. The Governor has proposed a general fund operating budget of \$1,826.5 million.

#### HJR 5 & SJR 4 by Request of the Governor

This limits growth of appropriations to inflation in the calendar year preceding the Governor's budget submission plus the average yearly growth in the State's population as measured by the last two federal censuses. Using the most recent Anchorage consumer price index figures and the 1970 and preliminary 1980 census data, the permitted growth rate for the FY 82 budget would be 12.8% to 14.0%, depending on which of two Anchorage consumer price indices is used.

The limitation does not apply to:

- 1) permanent fund contributions
- 2) permanent fund dividends
- 3) loan fund capitalization (but loan subsidies are limited)
- 4) capital projects approved by voters
- 5) debt service
- 6) disaster reserve funds
- 7) increases in state expenditures resulting from court order or federal law
- 8) 1/4 of the income from contributions to the permanent fund above the 25% minimum

Referring to Table I again, the following FY 81 expenditures would be subject to growth limits:

Operating	\$ 1,282.0
Capital	72.1
Special Appropriations	64.7
Renewable Resources	125.0
HB 60	580.8
Loan Subsidies <sup>1/</sup>	144.7
<b>TOTAL</b>	<b>\$ 2,269.3</b>

The 12.8% or 14.0% growth rates applied to this figure, plus 1/4 of 10% interest on \$900 million excess permanent fund contributions, would permit FY 82 budgets for restricted expenditures of \$2,582.2 or \$2,609.5 million. The Governor's FY 82 budget for such items totals \$2,286.9 million:

Operating	\$ 1,826.5
Loan Subsidies <sup>1/</sup>	233.0
Capital	227.4
<b>TOTAL</b>	<b>\$ 2,286.9</b>

HJR. 4 - by Gardiner

This limits growth of appropriations, except for appropriations to the permanent fund and for loans, to growth of the economy. Using the 4.55% growth in personal income in 1979 and an FY 81 base from Table I of \$2,474.6 million,

Operating	\$ 1,282.0
Capital (less native claims)	72.1
Special Appropriations (includes general fund reserve)	414.7
HB 60	580.8
Renewable Resources	125.0
<b>TOTAL</b>	<b>\$ 2,474.6</b>

1. Figures provided by Budget and Management.

the permitted FY 82 budget would be \$2,587.1 million. For these same restricted items, the Governor's FY 82 budget proposes \$2,703.9 million:

Operating	\$ 1,826.5
Capital	227.4
Rainy Day Funds (general fund reserve)	350.0
Escrow Account	300.0
<b>TOTAL</b>	<b>\$ 2,703.9</b>

MB:dh

# STATE OF ALASKA

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION  
POUCH W- STATE CAPITOL  
JUNEAU, ALASKA 99811  
PHONE: (907) 465-3795

### MEMORANDUM

TO: Honorable Ed Dankworth,  
Co-chairman  
Senate Finance Committee

FROM: Milt Barker, <sup>MB</sup> Fiscal Analyst  
Legislative Finance Division

DATE: January 22, 1981

SUBJECT: FY 82 Budget Under Proposed Constitutional Limits

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Operating	\$ 1,826.5
Loan Subsidies <sup>1/</sup>	233.0
Capital	227.4
TOTAL	\$ 2,286.9

HJR 4 - by Gardiner

This limits growth of appropriations, except for appropriations to the permanent fund and for loans, to growth of the economy. Using the 4.55% growth in personal income in 1979 and an FY 81 base from Table I of \$2,474.6 million,

Operating	\$ 1,282.0
Capital (less native claims)	72.1
Special Appropriations (includes general fund reserve)	414.7
HB 60	580.8
Renewable Resources	125.0
TOTAL	\$ 2,474.6

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1. Figures provided by Budget and Management.

the permitted FY 82 budget would be \$2,587.1 million. For these same restricted items, the Governor's FY 82 budget proposes \$2,703.9 million:

Operating	\$ 1,826.5
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Rainy Day Funds (general fund reserve)	350.0
Escrow Account	300.0
	<hr/>
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MB:dh

Introduced: 2/4/81  
Referred: Finance and  
Judiciary

1 IN THE HOUSE

BY THE RULES COMMITTEE BY  
REQUEST OF THE GOVERNOR

2 HOUSE JOINT RESOLUTION NO. 5  
3 IN THE LEGISLATURE OF THE STATE OF ALASKA  
4 TWELFTH LEGISLATURE - FIRST SESSION

5 Proposing an amendment to the Constitu-  
6 tion of the State of Alaska relating to  
7 limitations on appropriations of state  
8 money.

9 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 \* Section 1. Article IX of the Constitution of the State of Alaska is  
11 amended by adding new sections to read:

12 SECTION 16. APPROPRIATION LIMITATIONS. The amount of State money  
13 appropriated during a fiscal year shall not exceed the amount appropri-  
14 ated in the preceding fiscal year by more than the increase in the fed-  
15 eral consumer price index for the state for the calendar year preceding  
16 the governor's submission of the budget under section 12 of this arti-  
17 cle plus a percentage equal to the average yearly growth in the State's  
18 population as shown by the last two federal censuses or enumerations.  
19 Money appropriated under any exception prescribed by section 17 of this  
20 article shall not be included in the base for determining the allowable  
21 increase from year to year.

22 SECTION 17. EXCEPTIONS FROM APPROPRIATION LIMITATIONS. The limi-  
23 tations on increases in appropriations do not apply to appropriations  
24 of money to be deposited in the permanent fund; money appropriated to  
25 pay permanent fund dividends; money appropriated to capitalize loan  
26 funds, but the money to subsidize low interest loans must be appro-  
27 priated separately and is subject to the limitations; money appropriated  
28 to construct capital improvements, whether of bond proceeds or other-  
29 wise, where the appropriation for the capital improvements is approved

1 by the voters; money appropriated to escrow accounts or otherwise to  
2 repay general obligation bonds; money appropriated as a reserve for  
3 disasters of natural or human origin or other emergencies; money appro-  
4 priated to coincide with increases in user fees; money appropriated to  
5 meet increases in costs to the State resulting from court orders or a  
6 transfer of authority or responsibility to the State from the federal  
7 government; money derived from one-quarter of the income from those  
8 contributions made to the permanent fund which exceed the minimum  
9 required by this constitution; or money appropriated by a vote of  
10 two-thirds of the membership of each house and approved by the governor  
11 to meet disasters of natural or human origin which are declared by the  
12 governor.

13 \* Sec. 2. The amendment proposed by this resolution shall be placed be-  
14 fore the voters of the state at the next general election in conformity with  
15 art. XIII, sec. 1, Constitution of the State of Alaska, and the election  
16 laws of the state.

HR 5

January 13, 1981

Speaker of the House  
Alaska State Legislature  
Pouch V  
Juneau, AK 99811

Dear Mr. Speaker:

Under art. III, sec. 18, of the Alaska Constitution, I am transmitting a proposed constitutional amendment on spending limitations for the consideration of the legislature.

My proposal would amend the constitution's finance article to add two sections, one setting forth spending limitations and the other prescribing ten specific exceptions. Each of the exceptions is reasonably necessary, and some of them are for appropriations of money to be invested rather than expended, and, to that extent, do not really involve actual expenditures.

The proposed amendment limits annual increases in appropriations of state money -- but not of money from other, non-state sources such as federal money -- to the increase in the federal consumer price index for Alaska for the preceding year plus a percent equal to the state's average yearly growth in population.

At the present time, the only federal consumer price index for Alaska is that done for the Anchorage area. It appears that one will also be prepared for Fairbanks sometime soon. And indexes may also be prepared for other Alaskan cities in the future. The index for the state will consist of the weighted average of those indexes, that is, in proportion to each community's relative population.

The measure of the state's average yearly population growth is the federal decennial census and the interim reenumeration to be taken at five year intervals. The latter, while called for by federal law, has yet to be funded. Nevertheless, even without a reenumeration, the decennial census provides an accurate measure of the state's average yearly growth.

The use of data prepared exclusively by the United States is deliberate and essential. The pressure to shape cost and population data to justify increased expenditures would be enormous if those data were prepared by state or local agencies. Using data developed by an independent and separate government avoids that problem completely.

These two measures of growth, while not always coincident with all governmental needs, will allow the state to keep abreast of most needs and yet hold growth to reasonable and responsible limits. To the extent that the state still lags behind its sister states in some areas of governmental services and facilities, the exceptions prescribed by the second section will allow it to catch up, if that is what the electorate wants. Each of these exceptions will be discussed in turn, below.

The first exception is for appropriations of money to be deposited in the permanent fund, and the second is to pay permanent fund dividends to the people. It is self-evident that neither needs to be limited. The third exception is to capitalize loan funds, that is, appropriations of the money which will be loaned and repaid with interest under the state's loan programs. To the extent that low interest loans are subsidized, the appropriations for that purpose must be separate, and they are not within the terms of the exception. The fourth exception is for appropriations for capital improvements which have been approved by the voters. This includes those funded by appropriation from the general fund and those funded by bond proceeds. Voter approval is a must for the appropriations to be within the exception. But if the voters approve, there are no limits on appropriations for capital improvements.

The term "capital improvements" is used in the amendment in the same sense as it is used in sections 8 and 9 of the finance article relating to state and local debt. It refers, generally speaking, to public works or facilities of a permanent character as described in the case of City of Juneau v. Hixson, 373 P.2d 743 (Alaska 1962).

The fifth exception is for appropriations made to escrow accounts or otherwise to repay general obligation bonds. As a practical matter, it may be to the state's great advantage at any time to make a large payment, either into escrow or directly, to repay outstanding general obligation bonds. That kind of a payment would not constitute a true increase in expenditures, and it is, therefore, made one of the exceptions.

The sixth exception is for money appropriated as a reserve account for disasters of natural or human origin.

The device has been called a rainy-day account, and it is simply a means of setting aside a financial cushion for the state during a fiscal year in case of exceptional need. At the present time the Reserve for Emergency Operating Expenses Account has been established under AS 37.05.159 to meet this need. It will be superseded by this amendment, and in order to spend money appropriated to the reserve account, the provisions of the tenth exception will have to be followed.

The seventh exception is for money appropriated to coincide with increases in user fees. The term "user fees" includes all kinds of taxes or charges which are levied upon those who use a government facility or service. They range from hunting and fishing licenses to boiler inspection fees. So long as users are paying the money, no purpose would be served by placing this category within the limitations on expenditures. No big increases are foreseen at this time, but should users wish to have them, there is no reason to place a constitutional bar in their way.

The eighth exception is for appropriations required by court orders or by a transfer of functions from the federal to the state government. Transfers from local to the state government are within the legislature's control, and therefore are subject to the limitation. Court orders -- and that would include judgments for damages or orders for future relief -- are not within the legislature's control and could cause significant, temporary increases from time to time. The same could happen if the federal government were, for instance, to shift all of the social services or education burden to states. While one hopes this exception will be little used, prudence dictates its existence.

The ninth exception is for appropriations of money derived from one-quarter of the income from extra appropriations made to the permanent fund. The purpose of this exception is to encourage those who would spend more money to save more money. The more money that is placed in the fund, the more money there will be available under this exception to spend.

The tenth and final exception is for natural disasters. As safeguards against spurious spending under this exception, the disaster must be declared by the governor in the first instance and the appropriation bill must be passed by a two-thirds majority of the membership of each house and approved by the governor. If the governor does not approve the appropriation or vetoes it to reduce or strike any item, his veto is final. The purpose of the absolute veto is to preclude any excess spending on non-emergency items in a bill appropriating money for

disaster relief. Without an absolute veto, this exception would create an unacceptably large loophole.

The proposed amendment is conservative, responsible, and workable. It will not hobble the state or prevent the performance of any needed governmental function. It will set limits where they are needed, and it will not set limits where they are not needed. It will be good for both the private sector and the public sector, and I urge its favorable consideration.

Sincerely,

S/SSH

Jay S. Hammond  
Governor

COMMITTEE REPORT

HOUSE

<sup>4</sup>  
2/3/81

FURTHER: JUDICIARY

(11)

Date: \_\_\_\_\_

Mr. Speaker:

The Committee on FINANCE has had HJR 5

Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.

under consideration and (a majority of the committee) (the committee) reports it back with the following recommendations:

- do pass  do not pass
- do pass with attached amendments(s)
- replace with CS for \_\_\_\_\_  same title  
 new title
- and recommends \_\_\_\_\_
- AND attaches a "Letter of Intent"  New Fiscal Note
- reports it back without recommendation
- referred to the \_\_\_\_\_ Committee

MEMBERS SIGNING  
DO PASS

MEMBERS HAVING  
OTHER RECOMMENDATIONS:

\_\_\_\_\_

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\_\_\_\_\_  
CHAIRMAN

Introduced: 2/4/81  
Referred: Finance and  
Judiciary

*Letter*

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BY THE RULES COMMITTEE BY  
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Sincerely,

S/JSH

Jay S. Hammond  
Governor

**ALASKA STATE LEGISLATURE**

TWELFTH Legislature FIRST... Session

HOUSE JOINT RES. .... NO. ..5.....

By THE RULES COMMITTEE BY.....  
REQUEST OF THE GOVERNOR

Proposing an amendment to the  
Constitution of the State of  
Alaska relating to limitations  
on appropriations of state  
money.

Ak Constitution amend.  
limitations on appro. of  
state money

Introduced in the House .....2/4., 1981.

**HISTORY IN THE HOUSE**

19 81

Feb. 6

Read first time and referred  
to Committee on  
**Finance and Judiciary**

Reported back with  
recommendation that

Read second time and

Read third time and

<b>PASS</b>	<b>Effective Date</b>
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

**Reconsideration**

<b>PASS</b>	<b>Effective Date</b>
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

Reported correctly engrossed  
Signed by Speaker  
Sent to Senate

CHIEF CLERK OF THE HOUSE

**HISTORY IN THE SENATE**

19

Read first time and referred  
to Committee on

Reported back with  
recommendation that

Read second time and

Read third time and

<b>PASS</b>	<b>Effective Date</b>
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

**Reconsideration**

<b>PASS</b>	<b>Effective Date</b>
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

Reported correctly engrossed  
Signed by President  
Returned to House

SECRETARY OF THE SENATE

**HISTORY IN THE HOUSE**

19

Received from Senate

Concurred in Senate amendment  
thus adopting:  
**VOTE**

Failed to concur in Senate amend-  
ment; asked Senate to recede  
**VOTE**

Senate receded from amendment  
**VOTE**

Senate failed to recede from  
amendment  
**VOTE**

CC appointed by House

CC appointed by Senate

CC adopted by House  
**VOTE**

CC adopted by Senate  
**VOTE**

To enrolling  
Reported correctly enrolled  
Sent to Governor

..... by Governor

Filed with Lt. Governor

Chapter No. ....