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Limiting Government through Direct Democracy

The Case of State Tax and Expenditure Limitations

by Michael J. New

Executive Summary

Defenders of individual freedom and limited government have often favored representative government over direct democracy. Since 1978, however, activists have proposed and passed initiatives limiting taxing and spending by state governments in the United States. State legislatures have occasionally imposed tax and expenditure limitations (TELs) on themselves.

TELs passed by initiative are more restrictive and contain fewer loopholes than those enacted by state legislatures. Regression analysis of a comprehensive data set of state government spending shows that TELs enacted by citizen initiatives cause per capita public spending to decrease; TELs enacted by state legislatures are associated with an increase in government expenditures.

Some TELs are more effective at limiting government than others. TELs that limit government spending to the inflation rate plus population growth and mandate immediate rebates of government surpluses are more effective at limiting government outlays than are other TELs.

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Initiatives can be an effective tool for limiting government.

Introduction

Direct democracy is on the rise again in the United States. Since 1978 the initiative has been used more and more in the 24 states that permit direct legislation by voters.[1] In California, for example, 9 voter initiatives made it to the ballot in the 1960s; 22 made it in the 1970s, 45 in the 1980s, and 62 in the 1990s. In the 1996 general election, American voters were confronted with more than 90 statewide initiatives, plus an estimated 200 local initiatives and referenda on environmental and land-use issues alone.[2] As information technology develops, direct and immediate rule by the people may become a real possibility.

Proponents of individual liberty and limited government have traditionally been skeptical about direct rule by a majority of voters. The reasons for that skepticism can be found in *The Federalist Papers* and in the Progressive Era's push for bigger government through direct democracy. The revival of direct democracy began, however, with a 1978 California initiative to reduce property taxes, the famous Proposition 13 put on the ballot by Howard Jarvis and Paul Gann.[3] Many subsequent successful initiatives imposed tax and expenditure limitations (TELs) on state governments. This paper will show that initiatives can be an effective tool for limiting government. Theory notwithstanding, direct democracy seems to be a good friend of liberty in some cases.

Legislatures or the People?

James Madison had little faith in pure democracy, "a Society, consisting of a small number of citizens, who assemble and administer the Government in person." He believed that direct democracy meant a tyranny of a majority over minorities, the rule of passion over reason. Pure democracy is thus "incompatible with personal security, or the rights of property." The direct rule of the people, Madison concluded, ended in faction, discord, and a violent death of the political association.

Madison thought the new American Republic overcame the ills of pure democracy. In part, his confidence came from the scope of the American Republic: by including more people and interests in the nation, the Constitution made it harder for dangerous majorities to form. Madison praised also the representative character of the new Constitution. Delegating power to legislators would "refine and enlarge" public opinion, thereby avoiding majority tyranny and perhaps attaining higher goals: "It may well happen that the public voice pronounced by the representatives of the people, will be more consonant to the public good, than if pronounced by the people themselves convened for the purpose."[4]

The Progressives turned to the initiative because they rejected both Madison's belief in representative institutions *and* his desire for limited government. They thought that, far from refining and enlarging public opinion, legislatures "enact[ed] laws for the special advantage of a few and refuse[d] to enact laws for the welfare of the many."[5] Progressives saw direct legislation as a way to bypass corrupt legislatures and to expand the ambit of government. Benjamin Parke DeWitt in 1915 said Progressives share "the rapidly growing conviction that the functions of government are too restricted and that they must be increased and extended to relieve social and economic distress."[6] Progressives expected the initiative to weaken corrupt politicians, empower the people, and thereby expand government to reform society. The initiative was instrumental for attaining their larger goal of expanding government.

Government did expand enormously during the 20th century, but economic crisis and war, not the initiative, were the most important factors driving its growth.[7] With government growth came more and higher taxes at all levels of government. Harry Hopkins' dictum "tax and tax, spend and spend, elect and elect" became the practical wisdom of America's political class.

In 1978 Proposition 13 in California tried to change that. The initiative concerned mostly property taxes, which had been rising 30 percent annually in California in the 1970s. It limited the assessed value of property, increases in assessed property value, and the tax rate for property. The proposition also required a supermajority in the legislature to raise property tax rates. At the time, experts thought that the initiative would cut government revenue by $7 billion in 1978–79. Approximately 69 percent of registered voters turned out in a June primary for Proposition 13; 65 percent of them voted in its favor.[8]

Like the Progressives, the originators of Proposition 13 believed the California legislature and state government in general had ignored the desires of citizens. They may have been correct. A contemporary public opinion poll showed that all subgroups of Californians supported Proposition 13, with the exception of blacks and "strong liberals." The legislature had not responded to the broad-based desire for lower property taxes, though it did pass a property tax cut after Proposition 13 reached the ballot.[9] In retrospect, Proposition 13 reflected the will of a broad majority of voters in California in 1978, a desire ignored by the state legislators.

As tax cutters warmed to the idea of direct rule of the people, the ideological heirs to progressivism criticized the initiative. *Washington Post* columnist David Broder warned about the danger posed to representative government by initiative campaigns.[10] He lamented the power of money in initiative efforts and concluded that powerful and wealthy special interests had taken over the initiative process.[11] Similarly, the liberal journalist Peter Schrag noted:

> In big states like California, it's impossible to even get to the table without $1 million or more to pay the lawyers, consultants, media experts, and, most important, the signature collectors. Conversely, the political consultants who run initiative campaigns also guarantee that with enough money behind it, almost any measure can at least qualify for the ballot.[12]

Writers on the left have also lamented the restraints on taxation brought by initiatives and suggested that the traditional American skepticism of government has become "an unhealthy distrust."[13]

This brief history provides defenders of limited government no clear guidance about initiatives. James Madison's concerns about majority rule and his aspirations for representative democracy are persuasive, especially considering the Progressive hope to expand government through direct democracy. Yet the initiative movement has done much to revive hopes for limited government in the states.

This study informs the larger debate by offering an empirical analysis of the effects of initiatives in the states. The evidence shows that initiatives have been more effective than state legislatures at limiting the growth of state and local government spending. That experience points to some recommendations for activists seeking to limit government through the initiative.

Do TELs Work?

During the tax revolt in the 1970s, a number of states adopted TELs as a mechanism to limit the growth of government. TELs place a limit on how much taxes, revenues, or expenditures can increase in a state each year. By 1982 TELs had been enacted in 17 states. TEL enactment slowed along with the fervor of the tax revolt in the prosperous 1980s; only 3 states enacted TELs between 1983 and 1990. However, during the early and mid-1990s, TELs enjoyed a resurgence of sorts; by 1996, 6 additional states had enacted TELs. Currently, 26 states operate under some kind of TEL (Table 1).

Many people have questioned the effectiveness of TELs. Some argue that loopholes and accounting tricks will inevitably limit the ability of these measures to reduce government spending.[14] Others say that TELs' lack of sanctions for noncompliance raises serious questions about their enforceability. Several studies that analyze the impact of TELs on state

Proposition 13 reflected the will of a broad majority of voters in California in 1978.

Table 1

State Tax and Expenditure Limits, 1976–96

State	Year Passed	Immediate Refunds of Surpluses	Expenditures Held to Inflation Rate Plus Population Growth
	TELs Enacted through Citizen Initiatives		
Michigan	1978	Yes	No
California	1979[a]	No	No
Washington	1979	No	No
Missouri	1980	Yes	No
Massachusetts	1986	No	No
Colorado	1992	Yes	Yes
Washington	1993	No	Yes
	TELs Passed by State Legislatures		
New Jersey	1976[b]	No	No
Colorado	1977	No	No
Louisiana	1979	No	No
Oregon	1979	Yes	No
Idaho	1980	No	No
Montana	1981	No	No
Utah	1989	No	No
New Jersey	1990	No	No
Colorado	1991	No	No
North Carolina	1991	No	No
Iowa	1992	No	No
Mississippi	1992	No	No
	TELs Enacted through Constitutional Conventions		
Hawaii	1978	No	No
Tennessee	1978	No	No
	TELs Enacted through Referenda		
Arizona	1978	No	No
Delaware	1978	No	No
Texas	1978	No	No
South Carolina	1980	No	No
Alaska	1982	No	Yes
Oklahoma	1985	No	No
Louisiana	1993	No	No
Connecticut	1992	No	No
Rhode Island	1992	No	No
Florida	1994	No	No

Source: Mandy Rafool, "State Tax and Expenditure Limits," National Conference of State Legislatures Legislative Finance Paper no. 104, 1996, p. 6.

Notes: The TEL that New Jersey passed in 1976 and the TEL that Colorado passed in 1977 are included even though neither appears in the 1996 NCSL survey. In addition, the TEL that Nevada passed in 1979 is excluded because it applies only to the governor's budget proposal, not actual spending and taxing. Referenda differ from initiatives. Citizens and interest groups can place initiatives directly on the ballot for voter approval. Referenda must be approved by the state legislature before they appear on the ballot.

[a] New Jersey's first TEL expired in 1983.

[b] In 1979 California passed a TEL that limited per capita appropriations of state tax revenues to the inflation rate. However, this limit did not pertain to total state expenditures. Additionally, this limit was increased in 1988.

budgetary outcomes argue that these measures do not have a statistically significant influence on state expenditures.

Those studies, however, have three main shortcomings. First, the studies often examine a small number of states[15] for a short time, sometimes as little as a year.[16] It is difficult to draw conclusions from a limited sample; in any case, the effects of TELs may become apparent only over an extended time. Second, the existing studies of TELs often do not take into account all the factors affecting a state's budget.[17] Third, previous work does not take into account the differences among TELs.[18] Some TELs limit taxes, some expenditures; some have strict limits, others looser ceilings including waiver provisions; some are statutory, others constitutional. Analyzing the various features of TELs might well inform future efforts to limit spending and taxing.

Table 1 shows that more than two-thirds of current TELs were enacted either by initiative or by a state legislature. A comparison of TELs enacted by initiative with those enacted by state legislatures might prove instructive. Public choice analysis would suggest that legislators lack the incentive to constrain their own behavior. They might pass some kind of fiscal discipline measure to claim credit in the short term. However, legislators would make sure a TEL contained loopholes so that they would be able to avoid cutting popular programs in the long term.

Conversely, fiscal discipline measures passed by citizen initiative should be more effective in limiting state spending. Such initiatives would likely be drafted by groups interested in reducing spending and would be less likely to contain loopholes that would benefit elected officials. TELs enacted by initiative should serve as an external constraint on legislatures. Indeed, TELs passed by initiative do restrain spending and taxing and are more effective than those passed by legislatures.

Why the Initiative Is Effective

An examination of the characteristics of various TELs suggests why TELs passed by citizen initiative might be more effective than those passed by legislatures. This can be seen in four ways. First, TELs differ in the sorts of limits they set on revenues and expenditures (Table 2). A vast majority of the TELs that have been passed in this country hold increases in expenditures or revenues to growth in personal income. However, a small number of states have adopted TELs that

TELs passed by initiative do restrain spending and taxing and are more effective than those passed by legislatures.

Table 2
Limits TELs Impose on Spending and Revenue

	Method of Enactment	
Limit	Citizen Initiative (7 TELs)	Legislative Vote (12 TELs)
Inflation rate plus population growth	2 (29%)	0 (0%)
Income growth	5 (71%)	5 (42%)
Other	0 (0%)	7 (58%)

Source: Author's calculations based on Mandy Rafool, "State Tax and Expenditure Limits," National Conference of State Legislatures Legislative Finance Paper no. 104, 1996, pp. 28–33.

have more stringent limitations; they hold increases in spending or revenue to the inflation rate plus population growth. Table 1 clearly indicates that TELs passed by initiative are more likely to contain this more stringent limitation. Twenty-nine percent of the TELs passed by initiative hold increases in spending or revenues to the inflation rate plus population growth, while none of the TELs enacted by legislatures do.

The second important difference between TELs passed by legislatures and those passed by citizen initiative concerns transferring government responsibilities. One frequent method of circumventing the limits established by a TEL is to devolve various functions of government to the localities. Although this practice may keep the state budget within the limits of the TEL, it will result in budget increases at the local level and will fail to effectively limit overall taxing or spending. However, some TELs include provisions that would remedy this problem. They include a provision that would mandate automatic reductions in the limit whenever a state devolves a function of government to the localities (Table 3). Elected officials would have no incentive to circumvent TELs though devolution in states where such provisions were in place. As can be seen from Table 3, TELs passed by initiative are more likely to include provisions that mandate automatic changes in the limits when responsibility for government programs is transferred.

TELs passed by initiative are more stringent than those enacted by legislatures.

Another structural difference between TELs that are passed by legislatures and those that are passed by initiative involves whether the TELs are constitutional or statutory (Table 4). Constitutional TELs should be more effective than statutory TELs because they are more difficult to change. Statutory TELs leave open the possibility that the legislature will change the definition of the item limited, often by excluding certain areas of spending or revenue. In other cases, the legislators can simply increase the limit. By definition, all TELs passed by legislatures are statutory. However, 56 percent of TELs passed by citizen initiative are constitutional. This provides further evidence that TELs passed by initiative are more stringent than those enacted by legislatures.

The final structural difference between TELs that are enacted by legislatures and TELs that are passed through citizen initiatives is their provisions for handling surpluses. Most TELs mandate that surpluses go into a reserve fund or call for taxpayer rebates only if surpluses persist for a number of years. However, a limited number of TELs require that all surplus revenues, above a crit-

Table 3
TELs and Their Provisions for Changing Their Limits: Does Limit Automatically Change When Responsibility for Government Programs Is Transferred?

	Method of Enactment	
Change	Citizen Initiative (7 TELS)	Legislative Vote (12 TELs)
Yes	5 (71%)	4 (33%)
No	2 (29%)	8 (67%)

Source: Author’s calculations based on Mandy Rafool, “State Tax and Expenditure Limits,” National Conference of State Legislatures Legislative Finance Paper no. 104, 1996, pp. 28–33.

Table 4
Legal Status of TELs

	Method of Enactment	
Legal Status	Citizen Initiative (7 TELs)	Legislative Vote (12 TELs)
Constitutional	4 (56%)	0 (0%)
Statutory	3 (44%)	12 (100%)

Source: Author's calculations from Mandy Rafool, "State Tax and Expenditure Limits," National Conference of State Legislatures Legislative Finance Paper no. 104, 1996, pp. 28–33.

ical threshold, be immediately returned to the taxpayers in the form of tax credits. TELs requiring such refunds make it difficult for state governments to generate revenues that exceed the limit and give taxpayers and watchdog groups a greater incentive to see that TELs are enforced. Once again, we see that TELs passed by citizen initiative are more likely to have provisions that mandate immediate taxpayer refunds (Table 5).

From the analysis above, it appears that TELs that are passed by citizen initiative are likely to possess a variety of structural features that render them more effective than TELs passed by legislatures. The next step will be to empirically test whether initiative TELs are more effective by analyzing the relevant budgetary data.

TELs passed by citizen initiative are more likely to have provisions that mandate immediate taxpayer refunds.

Table 5
TELs and Their Provisions for Handing Surpluses

	Method of Enactment	
Provision for Refund	Citizen Initiative (7 TELs)	Legislative Vote (12 TELs)
Immediate taxpayer refunds	3 (44%)	1 (8%)
taxpayer refunds not immediate	4 (56%)	11 (92%)

Source: Author's calculations based on Mandy Rafool, "State Tax and Expenditure Limits," National Conference of State Legislatures Legislative Finance Paper no. 104, 1996, pp. 28–33.

Note: This provision varies in stringency. Colorado's TEL mandates that all revenues above the limits be returned to the taxpayers. Missouri's and Michigan's require that revenues exceeding the limit by 1 percent be refunded to taxpayers. Oregon's TEL requires that excess revenues above 2 percent of the forecast be returned to the taxpayers. Oregon, whose refund provision is the least restrictive of the four, is the state that passed its TEL by legislative vote.

Per capita state and local expenditures will decrease by $16.29 every year after a state has passed a TEL by citizen initiative.

Analysis

The empirical test of effectiveness of initiative TELs involves a regression analysis of a new data set that includes budgetary data from 49 of the United States for every fiscal year from 1972 through 1996, inclusive.[19] Regression analysis allows us to examine the effects of various factors on the central concern of this paper, the level of spending at the state and local level. Regression analysis allows us to sort out the effects of a single variable by holding constant the effects of all other variables.

Annual per capita state and local direct general expenditures in constant 1996 dollars will be used as the dependent variable in this regression analysis.[20] I examine per capita state and local direct general expenditures because doing so best demonstrates how TELs affect the amount that state and local governments spend on individual taxpayers.

My regression analysis includes several variables that might affect state and local spending. Spending might go up, for example, because a state experienced growth in its population of young people who require more state services and hence more spending. I have included a variable measuring growth in the proportion of people between the ages of 5 and 17. Similarly, since the elderly use state services at a disproportionately high rate, an aging population might put upward pressure on the budget. Therefore, I have included a variable that measures the growth in the percentage of people over the age of 65. It is also possible that increases in population may place a strain on state services and result in budgetary increases. Hence a variable measuring state population growth is included as well. Finally, state spending may also increase because of an economic slowdown. Hence I include variables indicating each state's growth in real per capita personal income and the annual change in each state's unemployment rate.

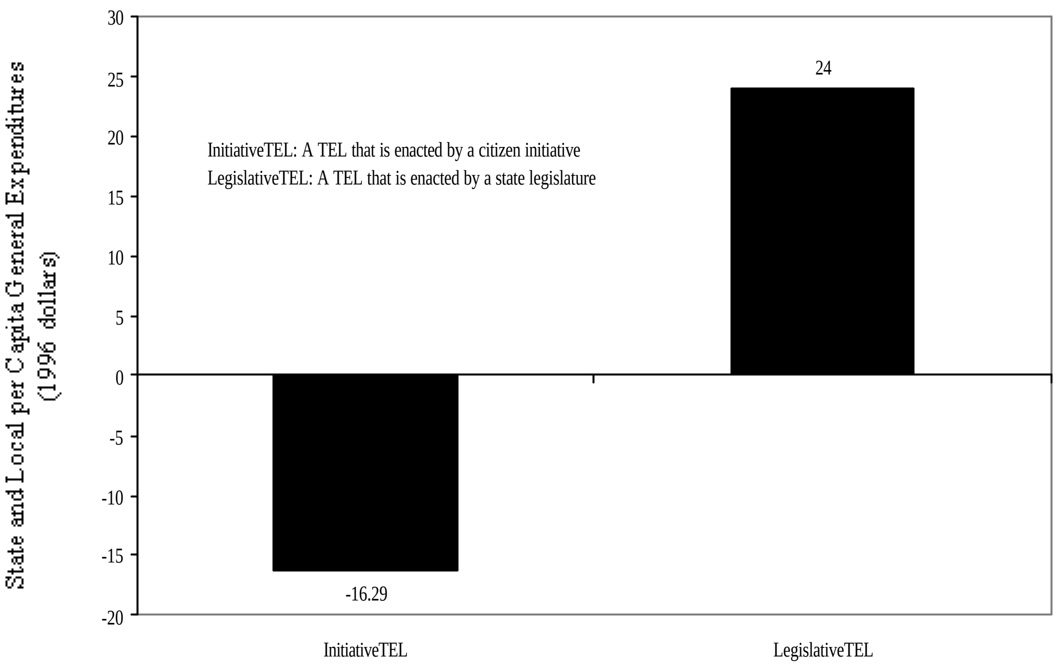
I also include in the regression analysis four separate variables that indicate whether a state has passed a TEL by initiative, by the legislature, by a constitutional convention, or by referendum.[21] This will allow me to determine if TELs passed by citizen initiative are indeed more effective at limiting the growth of spending than are TELs enacted by state legislatures.

The results of my analysis can be found in the Appendix to this paper as Regression 1. This regression lends support to my hypothesis. The regression explains over 41 percent of the variation in the dependent variable, state and local spending. From the regression results, we see that increases in the percentage of state residents aged 5 to 17 lead to increases in per capita state and local direct general expenditures. This finding is statistically significant.[22] In addition, as a state's real per capita personal income grows and as its unemployment rate declines, there is evidence that per capita state and local expenditures will decrease. Surprisingly, there is evidence that per capita expenditures decrease as the percentage of state residents over the age of 65 goes up. However, this finding fails to achieve statistical significance.

Of more interest in this study are the effects of the different kinds of TELs. These results are summarized in Figure 1. The model predicts that, if other factors are held constant, per capita state and local expenditures will decrease by $16.29 every year after a state has passed a TEL by citizen initiative. Conversely, the model predicts that TELs enacted by state legislatures will actually cause per capita expenditures to *increase* by $14.00. This finding lends support to the hypothesis that TELs enacted by citizen initiative are more effective at limiting state spending than are those passed into law by state legislatures.

Still, some TELs may be more effective than others. Perhaps the answer lies in the provisions of the TELs themselves. Earlier I demonstrated that TELs passed by initiative are more likely to have properties that would make them more effective; however, not all TELs passed by citizen initiative have those properties. If we can isolate TELs that have desirable properties, perhaps we can determine if a well-designed TEL can place even further limits on state spending.

Figure 1
Effectiveness of TELs by Method of Enactment



Two Properties That Strengthen TELs

Property 1: Limiting the Growth of Expenditures and Revenues to the Inflation Rate Plus Population Growth

An overwhelming majority of the TELs that have been passed since 1976 limit growth in state expenditures and revenues to state personal income growth. However, two states, Colorado and Washington, have recently enacted TELs that limit growth in state expenditures to the inflation rate plus population growth. This is a more stringent limit. Over the years the rate of growth in personal income has been significantly greater than the inflation rate. Between 1980 and 1990 growth in real personal income exceeded the inflation rate plus population growth by more than 38 percentage points.[23] It should also be noted that holding increases in expenditures to increases in personal income, as most TELs do, sets a relatively low limit for a state to maintain. Between 1980 and 1990 the ratio of state and local direct general expenditures to personal income actually fell in 27 of the 49 states considered in this analysis.[24] As a result, TELs that limit growth in revenues and expenditures to the inflation rate plus population growth might be more effective at limiting state and local spending.

Property 2: Refunding Surpluses to Taxpayers Immediately

Another feature that is worth examining is the provision that mandates immediate refunds of any surpluses to the taxpayers. Thus far, four states (Colorado, Michigan, Missouri, and Oregon) have enacted TELs that mandate immediate refunds of revenues that exceed the limit established by the TEL. Three of those four TELs were passed through citizen initiatives; only one (Oregon's) was enacted by the state legislature. As indicated earlier in this paper, such a provision would strengthen any TEL because it would make it difficult for the state gov-

Refund provisions create a strong incentive for state legislators to cut taxes when it appears that revenues are going to exceed the limit.

TELs that limit increases in spending and revenue to the inflation rate plus population growth have the most promise for reducing spending.

ernment to collect or spend excess revenues. In addition, it would give citizens and watchdog groups a greater incentive to see that the provisions of the TEL were enforced. An examination of the recent budgetary history of these four states indicates that such refund provisions enhance the effectiveness of TELs in another way. Namely, they create a strong incentive for state legislators to cut taxes when it appears that revenues are going to exceed the limit.

If a state enacts a TEL that mandates immediate refunds of surplus revenues, state legislators have the option of allowing revenues to exceed the limit and then subsequently refunding the revenue. However, there are logistical and political problems with doing this. First, it is nearly impossible to refund the sales tax. Also, although it is possible to enact refunds of income or property taxes, legislators dislike doing so. This is because high-income citizens would obtain a high percentage of the refunds, and legislators do not like to be charged with favoring the rich over everyone else. As a result, this creates a powerful incentive for legislators to cut taxes so that revenues or expenditures will no longer exceed the limit. Indeed, case studies indicate that Michigan, Missouri, and Colorado (three of the four states that mandate taxpayer refunds) have enacted tax cuts in response to the prospect of having revenues exceed the limit mandated by their TELs.[25]

To further study these provisions, I have constructed another regression model. Once again, the dependent variable is the annual change in per capita state and local direct general expenditures in 1996 dollars. The analysis examines the effects of TELs with provisions for immediate refunds and TELs that limit growth in expenditures to the inflation rate. The demographic and economic variables included in the first regression are included in this regression as well. The regression results can be found in the Appendix as Regression 2.

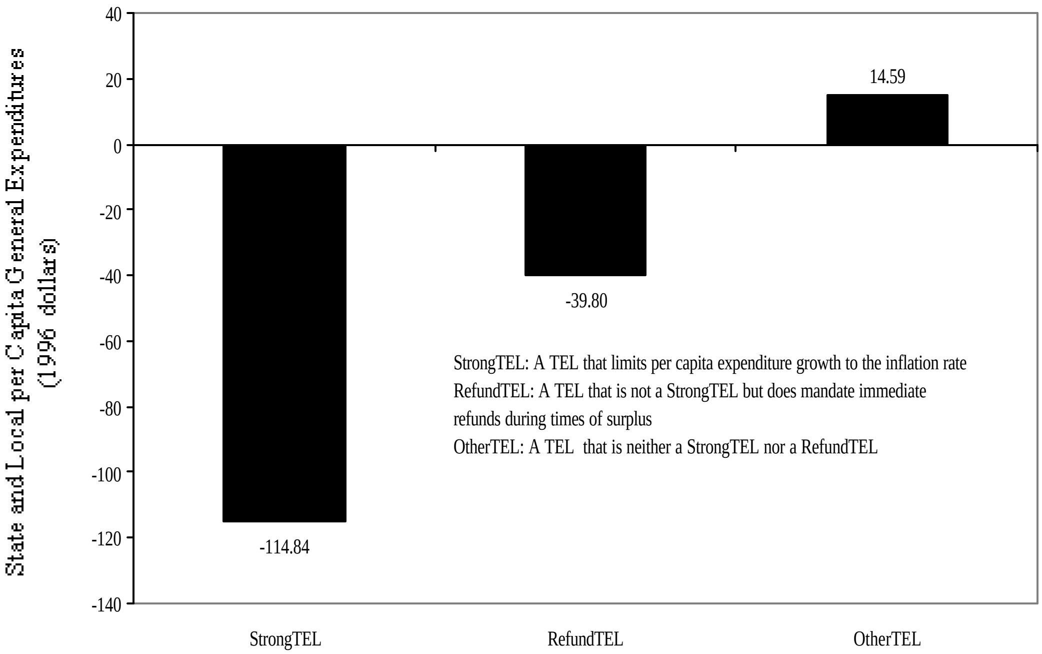
These results, which are summarized in Figure 2, support the idea that certain features can greatly enhance the effectiveness of a TEL. From this regression it appears that TELs that limit increases in spending and revenue to the inflation rate plus population growth have the most promise for reducing spending. If a state passes a TEL that limits expenditures to the inflation rate plus population growth, the regression equation predicts that every year the TEL will reduce per capita state and local direct general expenditures by approximately \$114.84. The t-statistic indicates that we can be more than 98 percent confident that these TELs have a negative effect on state and local direct general expenditures. Likewise, if a state passes a TEL that does not limit state expenditures to the inflation rate plus population growth but includes a refund provision, the regression equation predicts that the TEL will reduce per capita direct general expenditures by \$39.80 annually.

Finally, the regression analysis suggests that other TELs that neither limit expenditures to inflation nor have immediate refund provisions appear ineffective at reducing state expenditures. The model predicts that if a state passes a TEL that has neither of these two provisions, that state's per capita direct general expenditures will actually increase by \$14.59. Overall, this analysis provides strong evidence that TELs can be effective tools for limiting the growth of state expenditures, but only if they are designed properly. Moreover, since state legislatures generally lack incentives to constrain their own behavior, TELs passed by citizen initiatives are far more likely to contain the sorts of provisions that are going to place effective limits on state spending.

A Closer Look at Washington and Colorado

In general, these results seem very promising. It appears that the two TELs passed by Washington and Colorado that limit the growth of expenditures to the inflation rate have been especially effective at reducing per capita government expenditures. Unfortunate-

Figure 2
Effectiveness of TELs by Feature



ly, however, there are few data to use to analyze the impact of these TELs. Colorado's TEL was passed in 1992 and took effect in FY94, and Washington's TEL was passed in 1993 and took effect in FY96.[26] Since 1996 is the most recent year for which the Census Bureau provides data on state and local expenditures, I have only one year's data to use to analyze the impact of Washington's TEL and three years' data to use to examine Colorado's TEL. As a result, in order to further this analysis I will have to use anecdotal evidence in both cases.

Case Study: Colorado

In the past 25 years Colorado has enacted three separate TELs. In 1977 Colorado was one of the first states to adopt a general fund appropriations limit. The legislation limited increases in state appropriations to 7 percent over the previous year's general fund appropriations. Due to expire after FY83, the law was amended in 1979 and extended indefinitely. However, during the mid to late 1980s Colorado's economy suffered a downturn due to the collapse of the energy and construction industries, and revenues were consistently below the limit mandated by the TEL. In 1991 the General Assembly of Colorado adopted another statutory general fund appropriations limit. This one reduced the existing limit by one percentage point, mandating that general fund expenditures could increase by no more than 6 percent. However, this legislation included generous exemptions for spending on education and federal mandates.[27]

Colorado's citizens became increasingly frustrated by what they believed to be government inefficiency and the perceived inequities in the state tax system. Many became involved with a grassroots movement to reform state and local taxes. In 1986, 1988, and 1990 they succeeded in placing on the ballot initiatives that would limit taxes and spending. Those initiatives lost by narrower margins each time. Finally, in 1992, the Taxpayer Bill of Rights (TABOR), also known as Amendment One, passed and added Article X, sec. 20, to the state constitution.[28]

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Most people agree that the dire predictions of opponents of TABOR have not come to pass.

TABOR has three primary components. First, all tax increases have to be approved by taxpayers. Second, it mandates that the existing TELs, passed in 1977 and 1991, cannot be weakened without taxpayer approval. Third, it includes the most stringent TEL of any state. TABOR limits growth in state spending and tax increases to inflation plus population growth.[29] It mandates that any revenue collected over the limit be refunded to the taxpayers. It requires that the limit be adjusted when responsibility for government programs is transferred. Finally, the limit is constitutional, not statutory, which makes it difficult to amend.

This particular ballot initiative generated a firestorm of controversy. Gov. Roy Romer, a Democrat, sharply criticized the measure on numerous occasions. He said that defeating the measure was the "moral equivalent of fighting the Nazis at the Battle of the Bulge." He warned of an economic Armageddon with passage of TABOR and said that the Colorado border would soon have to be posted with signs reading "Colorado is closed for business."[30] Public employee unions and the education lobby quickly lined up in opposition to TABOR. Even the *New York Times* criticized TABOR, calling it potentially the most radical change in any state government that year.[31] Others argued that TABOR was bad policy because the demands for state services, such as schools, prisons, and highways, seemed likely to increase faster than the rate of inflation. They also contended that Colorado needed to spend more on those services because, in previous years, Colorado's spending increases for education and highways had been considerably below the national average.[32] Despite those warnings, TABOR passed with more than 53 percent of the vote in 1992 and took effect in FY94.

Since 1994 the legislature has had to rebate substantial amounts of tax revenues to stay underneath the limit. Colorado enacted taxpayer refunds of $139 million in 1997, $563 million in 1998, $679 million in 1999, and $941 million in 2000.[33] In addition to its rebate provisions, TABOR forces both state and local government to obtain voter approval to raise taxes. Although many municipalities have sought and won voter approval to increase taxes,[34] statewide initiatives have fared poorly. In every year from 1993 to 1999 a proposal to either increase taxes or circumvent TABOR was on the Colorado ballot. Those included a 1993 initiative to increase the sales tax, a 1997 gas tax increase, and a 1999 effort to use part of the surplus for road and school construction. Each of those statewide initiatives was defeated.[35] However, in 2000 Colorado residents did approve Amendment 23, which increased state aid to public education and reduced the TABOR surplus for both 2000 and 2001.[36] Most people agree that the dire predictions of opponents of TABOR have not come to pass. However, many argue that when the economy slows down, it will become more difficult for the state legislature to stay within the limit.[37]

Case Study: Washington State

During the past 20 years Washington State has passed two TELs by citizen initiative. The first one, Initiative 62, was passed in 1979 and limited increases in state revenues to the rate of growth in personal income. However, the state suffered a recession shortly after passage of the initiative, and it never became a serious constraint since the limit was higher than what the state could spend. In fact, in 1993 the legislature was able to pass a $1 billion tax increase to balance the FY94–95 budget and remain within the limit. However, that tax increase provoked a backlash and provided the impetus for putting another TEL, Initiative 601, on the ballot in 1993.[38]

Initiative 601 imposed a limit that was more strict than the limit set by Initiative 62. Initiative 601 limited increases in state expenditures to the inflation rate. In addition, it stopped the legislature from circumventing the limit by devolving functions of government to the localities. It explicitly prohibited the legislature to impose on local governments any responsibility for new programs unless the legislature fully reimbursed the local governments for the cost of the programs. Initiative 601 passed by 1 percent of the vote.[39]

In 1994 the Washington legislature passed a supplemental budget to ensure that it was in compliance with the TEL that was scheduled to take effect in FY96. The legislature instituted some targeted budget cuts, mostly in administration, social services, and prisons, to save more than $120 million in the new biennium. The legislature increased spending for some items, such as highways and school construction, on the grounds that those were one-time-only expenses and would be off budget in FY96. As a result, the budget base was not swollen from previous spending levels and would be easier to sustain in the new biennium. Finally, some agencies were directed to begin planning for cuts. For instance, public colleges were directed to trim expenses by $39 million to help pay for faculty and staff pay raises.[40]

Because of those spending reductions, the budget was under the TEL's limit in FY96 and FY97. In subsequent years the state legislature took steps to reduce taxes when it appeared that the government was collecting high levels of revenue. In FY98 and FY99 the legislature instituted modest targeted tax cuts of $38.5 million and $19.7 million, respectively.[41] Since spending was being restrained, voters in the state of Washington desired more substantial tax relief. In 1998 Washington voters passed Initiative 695, which reduced the motor vehicle excise tax by $30 and saved taxpayers $256 million. In 1999 Washington residents voted to repeal the motor vehicle excise tax. That reduced the tax burden on Washington residents by an additional $1.1 billion.[42]

However, Washington's Initiative 601 was weaker than Colorado's Taxpayer Bill of Rights in one important respect. Initiative 601 was a statutory measure whereas TABOR is a constitutional amendment. This makes Initiative 601 easier to amend, and possibly weaken. Indeed, that is precisely what happened in the spring of 2000 when the Washington legislature wanted to pass a budget that would have exceeded the limit mandated by the TEL. The legislature succeeded in obtaining the necessary supermajority to suspend the TEL, and the governor signed the budget into law.[43] The long-term effects on the budgetary practices of the state of Washington remain to be seen.

Conclusion

I have used regression analysis to examine the impact of various TELs on state and local expenditures. The approach is comprehensive, as budgetary data from 49 states for more than 25 years are used. Most important, special attention is paid to the manner in which the TELs were enacted. This provides a number of interesting insights. The analysis indicates that TELs passed by citizen initiative procedures are more effective in limiting state spending and revenues than are TELs passed by legislatures.

Certain features make some TELs more effective than others. There is solid evidence that TELs that require immediate taxpayer refunds of surpluses are effective in reducing expenditures. There is even stronger evidence that TELs that impose more stringent limits on expenditures are also effective at restraining government growth. This is demonstrated by statistical analysis and case studies of budgetary outcomes in Colorado and Washington State. The data indicate that activists wishing to restrain government growth should focus on passing TELs that include immediate taxpayer refunds of surpluses and hold spending increases to the inflation rate plus population growth.

TELs that impose more stringent limits on expenditures are also effective at restraining government growth.

Appendix: Regression Results

Regression 1

Technique: WLS, panel corrected standard errors fixed effects model with state and year indicator variables.

Dependent variable: Annual change in per capita state and local direct general expenditures in 1996 dollars for 49 states from 1972 through 1996.

Multiple R	.642
R square	.413
Standard error	111.092

	coef	s.e.	t-stat	sig t
UnemploymentCH	2.88	4.90	0.76	.4474
Age5to17CH	59.93	27.35	2.19	.0287*
Age65CH	-1.67	13.93	0.12	.9045
PopulationGrowth	43.69	5.19	8.91	.0000*
IncomeGrowth	-2.67	1.41	-1.89	.0590
InitiativeTEL	-16.29	20.05	-0.81	.4181
LegislativeTEL	14.00	16.59	0.84	.4011
ConventionTEL	61.67	38.97	1.58	.1144
ReferendumTEL	-1.95	18.59	-0.10	.9204
Constant	165.07	29.23	5.65	.0000*

*Statistically significant.

Regression 2

Technique: WLS, panel corrected standard errors fixed effects model with state and year indicator variables.

Dependent variable: Annual change in per capita state and local direct general expenditures in 1996 dollars for 49 states from 1972 through 1996.

Multiple R	.646
R square	.417
Standard error	108.922

	coef	s.e.	t-stat	sig t
UnemploymentCH	2.59	3.78	0.68	.4966*
Age5to17CH	63.22	27.48	2.30	.0216*
Age65CH	-2.31	13.99	-0.16	.8729
PopulationGrowth	43.29	4.95	8.75	.0000*
IncomeGrowth	-2.61	1.41	-1.85	.0645
StrongTEL	-114.84	53.57	-2.14	.0326*
RefundTEL	-39.80	24.04	-1.66	.0972
OtherTEL	14.59	12.61	1.16	.2463
Constant	172.82	24.37	7.09	.0000*

*Statistically significant.

Explanation of Dependent Variables

UnemploymentCH indicates the annual percentage point change in the state's unemployment rate.

Age5to17CH indicates the annual percentage point change in the number of state residents who are between the ages of 5 and 17.

Age65CH indicates the annual percentage point change in the number of state residents who are over the age of 65.

PopulationGrowth indicates the growth in population in each state.

IncomeGrowth indicates the annual change in per capita personal income in each state, adjusted for inflation.

StrongTEL is an indicator variable that is scored a 1 if a state has passed a TEL that limits growth in per capita expenditures to the inflation rate, zero otherwise.

RefundTEL is an indicator variable that is scored a 1 if a state has passed a TEL that is not a StrongTEL but does mandate immediate taxpayer refunds during times of surplus, zero otherwise.

OtherTEL is an indicator variables that is scored a 1 if a state has passed a TEL that is neither a StrongTEL nor a RefundTEL, zero otherwise.

Notes to Appendix

The reported statistical significance for the coefficients is two tailed.

Data are weighted to correct for heteroskedasticity.

Both a White test and a Breusch Pagan Godfrey test indicate that there is no statistically significant evidence of heteroskedasticity in the residuals. An Asymptotic test indicates that there is no statistically significant evidence of serial correlation in the residuals.

The technique that Nathaniel Beck and Jonathan Katz describe in "What to Do (And Not to Do) with Time-Series Cross-Sectional Data," *American Political Science Review* 89, no. 3 (September 1995): 634–47, is used to do the panel corrections.

Notes

1. David S. Broder, *Democracy Derailed: Initiative Campaigns and the Power of Money* (New York: Harcourt, 2000), p. 7.

2. Peter Schrag, "Rule by Referendum," A*merican Prospect,* July 17, 2000, p. 38.

3. Properly defined, Proposition 13 is not a statewide tax and expenditure limitation but a property tax limitation. However, its passage did mark the beginning of the tax revolt, which is why it is mentioned here.

4. James Madison, *Federalist* no. 10 (1787), in *The Founders' Constitution*, ed. Philip B. Kurland and Ralph Lerner. (Chicago: University of Chicago Press, 1978), vol. 1, pp. 128–30. Alexander Hamilton at the Constitutional Convention was even less favorable toward direct democracy: "It has been observed, by an honorable gentleman, that a pure democracy, if it were practicable, would be the most perfect government. Experience has proved that no position in politics is more false than this. The ancient democracies, in which the people themselves deliberated, never possessed one feature of good government. Their very character was tyranny; their figure, deformity. When they assembled, the field of debate presented an ungovernable mob, not only incapable of deliberation, but prepared for every enormity." *Debates on the Adoption of the Federal Constitution,* ed. Jonathan Elliott (Washington: privately printed, 1836), vol. 2, p. 253.

5. David Magleby, *Direct Legislation: Voting on Ballot Propositions in the United States* (Baltimore: Johns Hopkins University Press, 1984), p. 22. See also John M. Allswang, *The Initiative and Referendum in California 1898–1998* (Stanford: Stanford University Press, 2000).

6. Quoted in Magleby, p. 23.

7. Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987), passim.

8. Allswang, pp. 105–7.

9. Ibid., pp. 108–9.

10. Broder, p. 16.

11. Ibid., chap. 4.

12. Schrag, "Rule by Referendum," p. 38.

13. Broder, p. 20. See also Peter Schrag, *Paradise Lost: California's Experience, America's Future* (New York: New Press, 1998).

14. James Bennett and Thomas DiLorenzo, "Off-Budget Activities of Local Governments: The Bane of the Tax Revolt," *Public Choice* 39, no. 3 (1982): 333–34.

15. James Cox and David Lowery, "The Impact of Tax Revolt Era State Fiscal Caps," *Social Science Quarterly* 3 (1990): 492–509; and David Lowery and Tyson King-Meadows, "The Impact of Tax Revolt Era State Fiscal Caps: A Research Update," *Public Budgeting and Finance* 16, no. 1 (1996): 102–12.

16. Burton Abrams and William Dougan, "The Effects of Constitutional Restraint on Government Spending," *Public Choice* 49, no. 2 (1986): 101–16; and Dale Bails and Margaret Tieslau, "The Impact of Fiscal Constitution on State and Local Expenditures," *Cato Journal* 20, no. 2 (2000): 255–77.

17. Marcia Howard, "State Tax and Expenditure Limitations: There Is No Story," *Public Budgeting and Finance* 9, no. 2 (1989): 83–90; Dean Stansel, "Taming Leviathan: Are State Tax and Spending Limits the Answer?" Cato Institute Policy Analysis no. 213, July 25, 1994; Dale Bails, "The Effectiveness of Tax and Expenditure Limits: A Re-evaluation," *American Journal of Economics and Sociology* 49, no. 2 (1990): 223; and Daphne Kenyon and Karen Benker, "Fiscal Discipline: Lessons from the State Experience," *National Tax Journal* 37, no. 3 (1984): 433–46.

18. Phillip Joyce and Dan Mullins, "The Changing Fiscal Structure of the State and Local Sector: The Impact of Tax and Expenditure Limitations," *Public Administration Review* 51, no. 3 (1991): 240–52; Phillip Joyce and Dan Mullins, "Tax and Expenditure Limitations and State and Local Fiscal Structure: An Empirical Assessment," *Public Budgeting and Finance* 16, no. 1 (1996): 75–101; and Ronald Shadbegian, "Do Tax and Expenditure Limitations Affect the Size and Growth of Government?" *Contemporary Economic Policy* 14, no. 2 (1996): 22–35.

19. Alaska receives a high percentage of its revenue from severance taxes on oil produced and minerals mined in the state. Since shifts in the prices of those commodities cause a great deal of fluctuation in Alaska's budgetary outcomes, Alaska is omitted from this analysis.

20. It should also be noted that in this analysis combined state and local data will be used instead of state data because the combined data tend to be more stable. In addition, state and local data provide a more accurate indication of the level of expenditures in each state. As was mentioned earlier, some states are able to create phantom reductions in taxes and spending without reducing the overall tax burden by simply devolving functions of state government to the localities. That could yield some potentially misleading results if only state data were used. However, this problem is neatly avoided by using data that combine state and local expenditures.

21. However, in this paper no hypotheses are going to be posed about TELs passed by constitutional conventions for a couple reasons. First, only two states in this analysis, Tennessee and Hawaii, have passed a TEL though constitutional convention, and, as a result, there is a paucity of data. Second, I lack the details about these particular conventions needed to make an informed hypothesis about the strength of the TELs. If most of the delegates to constitutional conventions are legislators, then I would expect the TEL to be weak. However, if most of the delegates are not elected officials, there exists a possibility that a more stringent TEL may be enacted. However, I do not possess the necessary details about these particular conventions to make an informed judgment.

Likewise, no hypotheses are going to be posed about TELs that are enacted through referendum procedures. Since a referendum must be approved by the legislature before being placed on the ballot, it is difficult to predict the effectiveness of this sort of TEL. It is reasonable to assume that a legislature would be unlikely to approve a ballot proposal that would impose severe restrictions on its behavior. However, since there is a possibility that the referendum will fail to get the necessary majority, legislators might be more willing to place a restrictive TEL on the ballot than to enact a restrictive TEL directly. As a result, I would anticipate that TELs passed by referendum would be less effective than those passed by initiative but more effective than those passed by legislatures. However, a formal hypothesis about this kind of TEL will not be put forth.

22. Saying that a variable is statistically significant means that we can be at least 95 percent certain that the given variable actually has a nonzero effect on state and local expenditures. In other words, the probability that chance variation within the data caused an effect as great or greater is 5 percent or less.

23. Bureau of the Census, *Statistical Abstract of the United States: 2000* (Washington: Government Printing Office, 2000), p. 485; Bureau of the Census, *Statistical Abstract of the United States: 1992* (Washington: Government Printing Office, 1992), p. 438; and Bureau of the Census, *Statistical Abstract of the United States: 1991* (Washington: Government Printing Office, 1991), p. 22.

24. Bureau of the Census, *Governmental Finances* (Washington: Government Printing Office, 1980 and 1990).

25. Mandy Rafool, "State Tax and Expenditure Limitations," National Conference of State Legislatures Legislative Finance Paper no. 104,

1996, p. 14; David Webber, "The Missouri Experience with State Revenue Limits—The Hancock Amendment," Paper presented at Policy Collaborative on Tax and Spending Limits in the States, Colorado University, Denver, July 2001, p. 13; and Franklin James, "Tax and Spending Limits on Colorado," Paper presented at Policy Collaborative on Tax and Spending Limits in the States, Colorado University, Denver, July 2001, p. 10.

26. Rafool, "State Tax and Expenditure Limits," p. 18.

27. Ibid., p. 13.

28. Ibid.

29. Rafool, "State Tax and Expenditure Limitations," p. 28.

30. Stephen Moore and Dean Stansel, "The Great Tax Revolt of 1994," *Reason,* October 1994, p. 20.

31. Dirk Johnson, "Taxpayer Revolt in Colorado Raises Alarm about Lost Services," *New York Times,* November 15, 1992, p. 18.

32. Nicholas Johnson, "The Taxpayer Bill of Rights and Referendum B: Assessing the Availability of Public Services and Investment," Center for Budget and Policy Priorities, Washington, 1998, p. 3–7.

33. Colorado Department of Revenue Web sites: www.revenue.state.co.us/refund2000.html; www.revenue.state.co.us/refund99.html; www.revenue.state.co.us/refund98.html; and www.revenue.state.co.us/refund.html.

34. John Sanko, "'92 Election Was Fiscal Face Lift," *Rocky Mountain News,* August 3, 1999, p. 14A.

35. "TABOR Legislative Handbook," Independence Institute Paper, 1999, pp. 1–2.

36. James, p. 11.

37. Rafool, "State Tax and Expenditure Limits," p. 14.

38. Ibid., p. 17.

39. Ibid., p. 18.

40. Ibid.

41. Judy Zelio, *State Tax Actions 1997* (Denver: National Conference of State Legislatures, 1998), p. 15; and Judy Zelio, Scott Mackey, and Mandy Rafool, *State Tax Actions 1998* (Denver: National Conference of State Legislatures, 1999), p. 11.

42. Mandy Rafool, *State Tax Actions 1999* (Denver, Colo: National Conference of State Legislatures, 2000), p. 39.

43. Bob Williams, "House Budget Shreds Spending Limit (I-601)," Evergreen Freedom Foundation, Olympia, Washington, Policy Highlighter, 2000.

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