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THE TAX REVOLT

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Citizen petition drives designed to limit government taxing and spending authority have existed for some time. Interest in these measures appears to have peaked during the period between 1978 and 1980 with the passage of constitutional amendments in six states and by statute in 12 states. No state has enacted such a measure by constitutional amendment since Missouri in 1980.

During the past year, however, there appears to have been a rebirth in the tax revolt movement. A number of states including Florida, California, Michigan, and Ohio have faced or will face some form of tax initiative before the elections are over in November.

The purpose of this presentation is to evaluate this rebirth from the context of past tax expenditure limitation measures and from events that have occurred since 1980. Special attention will be placed on Florida's Amendment 1, which appeared to signal a change in direction from previous tax revolt movements. While the Florida amendment was removed from the ballot by the state supreme court, the Florida experience is important in understanding the current direction of the tax revolt movement.

The tax limitation measures that have passed prior to 1980 have taken two general forms: individual tax limitations and tax expenditure limitations.

Individual Tax Limitations — These limitations were primarily directed at an unpopular taxing source, such as the property or the income tax. Limitations of this type were not directed at the overall size of government but rather at the excessive use of a specific tax.

California's "Proposition 13" is an example of this type of limitation. It provided immediate property tax relief and restricted growth in property taxes subsequent to its implementation. Most states have some type of individual tax limitation in their constitutions. Florida is a leader in this movement in having constitutional prohibitions against levying either a personal income tax or an inheritance tax, in requiring an extraordinary vote on increases in the corporate income tax rate, in limiting local government property taxes, and in providing for partial homestead exemptions from property taxes.

Tax Expenditure Limitations — Nineteen states have enacted tax expenditure limitations (TEL's). Seven states including California have enacted TEL's by constitution (Table 1) and 12 have enacted them by statute (Table 2). This type of limitation is not directed at individual

TABLE 1

CONSTITUTIONAL STATE LIMITATION MEASURES

State	Year Adopted	Limitation Applied To	Nature of Limitation
Arizona	1978	Expenditures	7% of personal income
California	1979	Expenditures	Inflation and population growth
Hawaii	1978	Expenditures	Growth of personal income
Michigan	1978	Revenues	Ratio of revenue to personal income in base year
Missouri	1980	Revenues	Growth of personal income
Tennessee	1978	Expenditures	Growth of personal income
Texas	1978	Expenditures	Growth of personal income
Florida	N/A*	Revenues	Two-thirds of Consumer Price Index

*On November, 1984 ballot.

Source: *State Tax and Spending Limitations: Paper Tigers or Slumbering Giants?*, Legislative Finance Paper #33, National Conference of State Legislatures, January, 1983.

TABLE 2

STATUTORY STATE LIMITATION MEASURES

State	Year Adopted	Limitation Applied To	Nature of Limitation
Alaska	1982	Expenditures	Inflation and population growth
Colorado	1979	Expenditures	7% annual incease
Idaho	1980	Expenditures	5 ⅓% of personal income
Louisiana	1979	Revenues	Growth of personal income
Montana	1981	Expenditures	Growth of personal income
Nevada(1)	1979	Expenditures	Inflation and population growth
New Jersey(2)	1976	Expenditures	Growth of personal income per capita
Oregon	1979	Expenditures	Growth of personal income
Rhode Island(1)	1977	Expenditures	8% annual incease
South Carolina	1980	Expenditures	Growth of personal income
Utah(2)	1979	Expenditures	Growth of personal income × .85
Washington	1979	Revenues	Growth of personal income

Note: (1) Limitation applies to Governor's budget request, not to legislative action.
(2) Has never been implemented by the Legislature.

Source: *State Tax and Spending Limitations: Paper Tigers or Slumbering Giants?*, Legislative Finance Paper #33, National Conference of State Legislatures, January, 1983.

taxing sources but at the overall size of government. The size of government is managed by a formula which restricts its growth.

Of the seven states which have enacted a TEL by constitutional amendment, each has used a formula which allows government to grow in proportion to growth in the private economy. California's formula, for example, allows for growth in population plus inflation. The other six states provide for growth in total state personal income. The philosophy underlying these TEL's is to have the growth in government parallel the growth in the private sector.

Of the 12 statutory TEL's, only two have chosen to limit the growth in revenues. The remaining ten restrict the growth in expenditures. Seven states index their limitation to the change in personal income and are thus sensitive to changes in population, inflation, and real growth. One state, New Jersey, uses growth in per capita personal income while two states, Alaska and Nevada, use population plus inflation. Finally, two states chose a fixed percentage growth limit on expenditures. Colorado provided for 7 percent growth and Rhode Island for 8 percent growth. Two states, Nevada and Rhode Island, only limit the governor's budget recommending authority, which is not binding on the legislature. In Utah, an expenditure limitation equal to 85 percent of growth in personal income was enacted by statute but was never implemented.

Of the seven states that enacted TEL's by constitution, the most common trigger used was the rate of change in personal income. Six states use growth in personal income as the basis from which to measure the tax expenditure limit. Three states, Hawaii, Tennessee, and Texas, provide that the growth in expenditures cannot exceed growth in state personal income. Two other states, Michigan and Missouri, achieve the same growth rates by indexing state revenue growth to personal income growth in a base year. Since the ratio is fixed, revenues can grow only as fast as state personal income grows. In the sixth constitutional TEL, this same objective is achieved by requiring that state expenditures not exceed 7 percent of state personal income. By indexing the rate of growth in expenditures or revenues to the growth in state personal income, these six states have taken into consideration in their growth formula the changes in population, inflation, and real growth in the state's economy that produce changes in aggregate personal income.

California is the only state with a constitutional limitation that does not use growth in personal income in its formula. California's "Proposition 4" provides that state expenditures cannot exceed in any fiscal year the rate of increase in inflation and population. This mechanism provides directly for population and inflation considerations but does not allow for real economic growth.

On this coming November ballot there will be at least seven tax limitation measures. While it is difficult to generalize as to why the

sudden rebirth in the tax revolt has occurred, there are at least four factors that lend some insight into this recent resurgence including: (1) recession induced tax increases, (2) growth in tax revolt organizations, (3) performance of existing tax limitations, and (4) voter resentment.

(1) *Recession Induced Tax Increases* — Since 1980, the national economy has experienced two recessions — the short, so-called "credit card", recession of 1980 and the 1982-83 recession which was the longest recession since the great depression. State's tax and expenditure structures are very sensitive to major swings in economic activity. This sensitivity to these structures is compounded by forecasters' inability to accurately anticipate critical turning points in the business cycle.

On the revenue side, unanticipated recessions, which were certainly the case with the past two recessions, are typically followed with revenue shortfalls, rainy day reserves and mid-year slashing of government services.

While recessions reduce state revenues, the demand for state services typically increases dramatically during recessions. Social services caseloads such as Aid to Families with Dependent Children and Medicaid increase; crime increases with a corresponding increase in court caseload and prison population and support services; vocational education enrollments increase; and there tends to be a shift from private schools to public schools. Thus, while revenues are being slashed, demand for services increase.

The combination of falling revenues and increasing demand for state services puts tremendous pressure on state tax structures. During recessions, states lay off employees, freeze pay, cut out travel, and eliminate programs. When recovery begins, there is typically a lag between the timing of the recovery and the increased demand for state services slowing. It is during this period that state governments pass tax increases. Since 1970, Florida has experienced four major taxing sessions. Each occurred following a national recession. Recessions breed tax increases. Tax increases breed voter tax revolt.

The two recessions that have occurred since 1980 provide both an explanation for the apparent lull in the tax revolt and the recent rebirth in the movement. During recessions, citizens observe state governments contracting services as the citizens become more dependent on government, thus the apparent lull that occurred between 1980 through 1983. In the post recovery period almost all states have raised taxes to restore services. Raising taxes particularly after difficult economic times is rarely popular thus leading to the rebirth of the tax revolt.

(2) *Growth in the Tax Revolt Movement* — Since California's "Proposition 13" there has been a movement to establish tax revolt organizations. The authors of Florida's "Amendment 1" had a large state

organization. They had studied the national movement, were familiar with other state activities, raised funds, collected signatures, went to court, and waged a campaign.

The existence of organized citizens familiar with the various states' constitutions and initative procedures seem to indicate that states will have to respond to the tax revolt for some time.

(3) *Performance of Existing Tax Limitations* — Of the tax limitation measures that have been in place thus far, few have achieved the desired effect. Those states that enacted individual tax limitation such as California's "Proposition 13" or those states that indexed or limited the use of the personal income tax simply limited the use of a single taxing source. To the extent that governments were able to use alternative revenue sources, the tax burden was simply shifted and the actual size of government was not substantially reduced. Under these conditions those taxpayers that were concerned with specific tax relief benefited, but those that were concerned with the size of government did not.

Those states that enacted tax expenditure limitation chose growth limitations that were indexed either to personal income or population plus inflation. For most of these states the two national recessions that have occurred since 1980 provided considerably more restraint on government than the TEL funding formula. It has become clear to many observers that a growth limitation formula provides less government only if the growth formula is more restrictive than the natural growth in government. Since most states that have enacted TEL's chose flexible formulas or delegated the actual growth formula to the legislative process, very little of the perceived benefits of TEL's have actually materialized.

Since 1978 there have been enacted a wide range of tax expenditure limitations and there has elapsed a period of time sufficient to evaluate the effects of these proposals. A portion of the recent rebirth of TEL's can be attributed to a dissatisfaction with the performance of the original TEL. A number of states will address reforms or adjustments to the original proposals rather than adopting radically different proposals.

(4) *Voter Resistance* — There appears to be very little correlation between those states that have enacted TEL's and individual tax burden. The last state to pass a constitutional TEL was Missouri in 1980. At that time Missouri was ranked 50th in the nation in per capita tax burden. Florida, which currently ranks 46th in the nation in per captia tax burden, had to respond to a very restrictive tax expenditure limitation.

Why do states with low tax burden still have a tax revolt? A partial explanation rests with the services which state governments provide and the mix of taxes which states have to deliver services.

A public finance textbook typically defines four types of government services: (1) a pure public good such as police, fire, or transportation which provides services to all residents within the taxing district, (2) natural monopolies such as utilities and water and sewer tend to provide services to residents on a fee for service basis, (3) user fees are typically charged for recreational activities and tend to cover the cost, and (4) income redistribution uses taxing authority to redistribute income to provide social services or provide subsidies for critical services.

The types of services that state and local governments provide vary widely in terms of their basic type. Local governments tend to provide services which either benefit all residents such as police and fire or are charged fees for services received such as garbage collection and water and sewer services.

State governments, on the other hand, tend to provide services which are partially income redistribution such as public education, welfare, Medicaid, or health care services. Outside of transportation, the vast majority of state services are income redistributive in nature.

In addition to providing redistributive services, state governments provide services primarily to children and young adults. Public education *directly* benefits only those families that have children in the public school system. If families have no children or choose to provide them with a private education or send them out of state for higher education, they receive no *direct* benefit from public education. Social services such as Aid to Families with Dependent Children, the AFDC caseload in Medicaid, youthful offender programs, adoption programs, and retardation services are primarily directed to a few children and young adults. The criminal justice system, which in theory serves all residents, is not typically perceived as a state responsibility. While states fund the court system, states' attorneys, public defenders, and the state prisons, the public tends to view criminal justice as a local service provided by local police and sheriff functions.

State governments are primarily designed to provide services to segments of the state population, particularly children and young adults. These services tend to be expensive and in many cases directed only to a small portion of the population. As a result, there can be a significant portion of the states' population that pays taxes but actually receives few *direct* benefits. A review of the types of services which state governments provide and the actual population served affords some insight into the source of the tax revolt.

In conclusion, the tax revolt went through a heightened period of activity from 1978 through 1980 and then a prolonged lull from 1980 through 1983. During the lull many observers felt that the tax revolt movement had ended and citizens' initiatives designed to limit state and local government taxing and spending authority through constitutional amendment would cease.

With the sudden surge in the tax revolt at the end of 1983 and 1984, it appears that the tax revolt is an evolutionary process. It emerges and submerges in response to economic conditions and specific events. The movement, which is organized and undergoing a continuous education process, studies the tax structures of various states and the processes by which they can be changed.

The tax revolt movement itself covers a very broad range of concepts and ideas. Limitations on specific taxes such as property tax and personal income taxes have been around for some time. Almost every state has constitutions which limit specific taxes. Most states have balanced budget requirements in their constitutions.

Tax expenditure limitations are a relatively new concept. They are designed to index the rate of growth in government to some measure of growth in the private sector. The effect of this type of limitation requires sophisticated balancing of the public's demand for state services with the growth in the private sector. Since the private sector has been declining or exhibiting slow rates of growth, the existing TEL's have had little restraint on the size of government.

Florida's experience with "Amendment 1" demonstrates that the tax revolt can go beyond tax relief or managing the growth of government. Because of the restrictive nature of the limitation of Florida's "Amendment 1", the need for government as a necessary entity was directly challenged. The basic purpose and thrust of the approach was to privatize government. That is, turn over essential public services to the private sector.

It is clear that the tax revolt encompasses a very wide range of interests. The tax revolt in one state may be indexing the personal income tax and replacing the lost revenues with a value added tax. It may be property tax relief. It may be repealing last year's tax increases or insuring that government can never grow as fast as the private sector. It may be no government at all.

Citizens' petition drives designed to alter taxing and spending decisions must be evaluated on an individual basis within the context of the state's demand for services, the state economy, its taxing structure, and existing constitutional restrictions. Because of the diversity within the overall movement it is extremely difficult to generalize about the overall impact. Each proposal typically requires detailed analysis before the merits and demerits can be determined.