

**The Taxpayer Bill of Rights (TABOR):
A Solution to Wisconsin's Fiscal Problems
or a Prescription for Future Fiscal Crises?**

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EXECUTIVE SUMMARY

The Wisconsin Legislature is currently considering a proposal for a *Taxpayer Bill of Rights* (TABOR). This constitutional amendment, if enacted, would tie annual increases in spending by all governmental bodies in Wisconsin to population growth and the rate of inflation or some other specified index. It would also require passage of referenda for any spending increase in excess of the limits, for any tax change that causes net revenue gains, and for most government borrowing.

Supporters of the TABOR amendment argue that an amendment is necessary because:

- Tax burdens in Wisconsin have climbed to excessive rates,
- The over-taxation of businesses is hurting economic development in the state, and
- State and local government spending in Wisconsin has gotten out of hand.

In this paper, I argue that none of the above assertions can be justified by the facts. There is no evidence to suggest that our system of fiscal decision making is broken, or needs the kind of radical transformation that TABOR would bring.

Consider the following:

- School property tax rates have fallen by nearly 50 percent since 1991.
- The property tax *burden* (tax relative to median household income) on the median value house has actually **fallen** since 1994.
- Although it is true that Wisconsin has had a high state and local tax burden relative to other states, the state's burden is due in large part to the fact that Wisconsin has a relatively low level of fees and charges (including tuition). When general revenue from both taxes and fees is considered, Wisconsin ranked 15th among all states.
- There is ample evidence from numerous studies that taxes are only one of a great many factors that influence business location decisions.
- A well-trained labor force and high-quality public services are of equal or greater importance to businesses.
- Businesses in Wisconsin face a relatively low tax burden. In fact, Wisconsin ranks 49th in business taxes as a share of state and local taxes, and 35th in business taxes relative to corporate profits.
- Wisconsin is not a particularly high spending state. In 2002, Wisconsin ranked 19th in state and local government spending relative to personal income.

Historically, the growth rate of Wisconsin's economy has outpaced the rate of inflation. Thus,

by linking the growth of per capita or per pupil spending to the rate of inflation, TABOR will result in expenditures on public services becoming over time an increasingly smaller part of the economy.

The cost of providing many public services, but particularly education and health care, tends to rise faster than the rate of inflation. In order to attract teachers, doctors, nurses, and other public employees, governments must pay competitive salaries, and with rising productivity average *real* (inflation adjusted) wages increase. Faced with costs that rise faster than the rate of inflation, all governments in Wisconsin would be forced to steadily reduce the public services they provide.

To predict the likely impact of a TABOR amendment, I calculated how much governments in Wisconsin would have been able to spend if TABOR had been implemented in 1986. The version of a TABOR amendment used in my simulations assume growth in state per capita spending is limited to the rate of inflation, the growth of school district per pupil spending to the rate of inflation plus one percent, and the rate of municipal and county government spending to inflation plus the percentage increase in property values due to new construction. The results of the simulations indicate that:

- In 2003, state government spending would have been two-thirds of actual state spending. Given that many parts of the budget are impossible or very difficult to reduce, e.g. pension contribution, debt service, corrections, TABOR would likely result in

drastic reductions in funding for the University of Wisconsin System, likely elimination of the state's Shared Revenue program, which provides grants to municipal and county governments, and reductions in state government support of K-12 education.
- If TABOR had been in place since 1986, by 2003 public school spending in Wisconsin would have been 20 percent lower than the current level of spending.
- By 2003 TABOR-limited spending of municipal and county governments would have been only 7 percent below actual spending, reflecting in part the fact that local government and county spending, on average, grew much more slowly than spending on public education. TABOR, however, would have a particularly restrictive impact on municipalities which experienced little economic growth.

Supporters of TABOR argue that if voters want to spend more than the TABOR limits they can authorize extra spending through referenda. Budgetary decisions, however, are complex, and it is unlike that most voters would have the time or expertise to study the issues closely. It is more likely that many voters will be influenced by "bumper sticker" campaigns financed by various groups that want to influence their vote. Low voter turnout, especially in local elections, increases the chance that fiscal decisions in Wisconsin will represent the views of a relative small portion of the electorate.

Opposition to TABOR does not imply that Wisconsin does not face serious fiscal challenges. There are, however, much more effective policies to address these problems than the adoption of a TABOR amendment.

- **Problem 1:** The tendency of the legislature to make spending commitments, but fail to identify funding sources. **Policy response:** Follow the lead of the U.S. Congress and enact “pay as you go” budgetary rules.
- **Problem 2:** The failure to be prepared for the fiscal consequences of economic downturns. **Policy response:** Follow the example of most other states, and make a commitment to place money in a rainy day fund during periods of economic prosperity.
- **Problem 3:** Many Wisconsin residents continue to face high property tax burdens. **Policy response:** By cutting property tax rates, TABOR provides completely untargeted property tax relief. The legislature should address the problem of high property tax burdens by designing tightly targeted property tax relief to those most in need.

There is little doubt that over time TABOR would result in big reductions in programs that help the state’s most vulnerable citizens, result in serious downsizing of the University of Wisconsin System, seriously reduce the ability of the public schools to provide a quality education for our children, and risk substantial damage to our environment. And there is little question that these reductions in government services would in the long run do serious harm to the state’s economy and jeopardize the future prosperity of its citizens.

Introduction

Along with buds on the trees and green grass, the Spring of 2004 is bringing with it efforts in a number of states, including Wisconsin, to amend state constitutions by adding a so-called *Taxpayer Bill of Rights* (TABOR). These amendments, most of which are modeled on a TABOR that was enacted in Colorado in 1992, are efforts to place in state constitutions very strict limits on the growth of state and local government spending.

Starting in 1978, with California's passage of Proposition 13, voters in a number of states have passed various *tax and expenditures limitations*. While some of these limits are statutory in nature, for example, Proposition 2½ in Massachusetts, others, like Proposition 13, have been added to state constitutions. Many of these measures are designed to limit the growth of property tax rates, the rate of growth of the assessed value of property, or property tax revenues. For proponents of TABOR amendments, limiting the growth in state and local government tax revenues is not sufficient. The quite explicit objective of many supporters of TABOR is to reduce the size of state and local government (Armey, 2004). Although specific proposals for the enactment of a TABOR differ both within and across states, most TABOR proposals include the same major elements:

- Strict limits on the annual growth of per capita state and local government spending, with the rate of growth generally limited to the rate of inflation.
- Limits to the growth of per pupil spending by local school districts to the rate of inflation.
- Requirements that any tax revenue collected that exceeds the spending limits be returned to taxpayers either in the form of a cash refund or through mandated lower tax rates.
- A requirement that all major state and local government fiscal decisions require enactment through a referendum process. This means that any temporary increase in spending over the constitutional limits, any changes in the tax system that cause a net increase in tax revenue, and most borrowing through the issuance of bonds must be approved by the voters of the jurisdiction proposing these fiscal changes.

The net result of these provisions is to create a very stringent set of restrictions on state and local government expenditures, much more restrictive than all other types of tax and expenditure limits. Although efforts are underway in a number of states to enact TABOR amendments, to date only Colorado has amended their constitution to include a TABOR provision.¹ TABOR provides a radical departure from the typical way in which state and local governments make fiscal decisions. Not only would spending and revenue decisions be driven by a set of formula-based rules that are inflexible to changing economic, political, and demographic circumstances, but our nearly 250 year history of relying on representative democracy to make our basic fiscal decisions would be ended.

The only reason that Wisconsin, or any other state, would want to so dramatically change the way its state and local governments operated would be if its current fiscal system is so fundamentally flawed that drastic measures—in this case a change in the state constitution—are the only possible way to solve the state’s fiscal problems.

This paper has two objectives. First, I evaluate the nature of the state’s “fiscal problems” that have led proponents of the TABOR amendment to conclude that the only way to solve these problems is to change the state constitution. Second, I attempt to estimate the likely impact of TABOR on the state’s ability to provide its residents with public services. In a concluding section, I suggest several reform measures that the state legislature could enact that would address most of the state’s long-run fiscal problems without amending the constitution.

¹For an assessment of the impact of TABOR in Colorado see Johnson, Hedges, and Zelenski (2004) and Bell Policy Center (2003).

Why a TABOR Amendment Now?

Supporters of TABOR amendments in Wisconsin and throughout the country generally argue that the political system operates in such a way that government spending and the revenue to support this spending, primarily taxes, are higher than residents desire. The fact that concerted efforts are being made now (in 2004) to adopt TABOR amendments suggest that both taxes and spending must have risen in recent years to levels that are substantially above the levels that voters want. For this to be true, supporters of TABOR must argue that our *political* system, namely representative democracy, is broken in a fundamental way.

This argument has its roots in the work of William Niskanen (1968) and Thomas Romer and Howard Rosenthal (1979). These authors argue that public officials and bureaucrats are often in a monopoly position and they are able to exploit their monopoly power so as to increase public spending beyond the level desired by voters.

The evidence for this assertion is limited, but generally takes the form of survey results that purport to show that survey respondents want lower taxes and lower spending. These survey should be treated with some degree of skepticism. The questions are rarely phrased in a way that links cuts in taxes to cuts in specific public services. When survey respondents are asked whether they would like to reduce or eliminate specific government functions, the results often indicate that most people are either satisfied with the services they receive or would like their government to provide higher levels of service.²

²In an interesting paper Susan Welch (1985) discusses the “more for less paradox” where citizens appear to want both lower taxes and increased public services. She finds that when survey respondents are asked explicitly how they would fund desired increases in public spending, the majority indicate a willingness to pay more in taxes or user fees.

The supporters of a TABOR amendment suggest that Wisconsin is facing a fiscal crisis that can only be solved by enacting the amendment. Underlying the assertion that Wisconsin is in the midst of a fiscal crisis is the claim that tax burdens on Wisconsin residents have risen to intolerable levels, that the state's tax climate is leading to a loss of jobs, and that the level of state and local government spending is inexorably rising. In the next sections of the paper, I address these three claims by exploring the available data.

Wisconsin Tax Burdens

Municipal governments (cities, villages, and towns), county governments, and school districts in Wisconsin rely on the property tax as their major source of locally-raised revenue. Most discussions about taxes tend to focus on the burdens created by the property tax. In fact, criticisms of the property tax have generated legislative proposals to freeze property tax levies. With all this attention paid to the property tax, it is perhaps surprising that the average property tax burden in Wisconsin has been falling over most of the past decade.

In 1994, the legislature made a commitment to finance two-thirds of the cost of public education. In order to meet this commitment, it raised annual state education aid by more than \$1 billion. To guarantee that a large portion of this increase in state aid would be used by local school districts to reduce property taxes, the legislature placed a dollar limit on the annual increase in each district's revenue per pupil. As a result of this policy, the state average school property tax (mill) rate has been cut nearly in half--from 18.1 mills in 1992-93 to 9.7 mills in 2001-02. As a result of these large rate reductions, a substantial number of Wisconsin households actually pay less in property taxes today than they did 10 years ago.

A quite reasonable way to assess the *burden* that the property tax places on a typical

Wisconsin household is to compare the property tax paid on the median-priced Wisconsin house (calculated using the state average property tax rate) to the median household income in Wisconsin. In 1994, just prior to the passage of the state's "two-thirds" school funding initiative, this measure of property tax burden equaled 6.4 percent. By 2001, the property tax burden on the median-priced house had fallen to 5.3 percent of income—a 17 percent reduction in property tax burden. Not only have property tax burdens fallen, but also, after adjusting for inflation, the dollar amount of property tax on the median-price house in Wisconsin was actually \$158 **lower** in 2002 than in 1994.³

Farmers in Wisconsin are among the most vocal critics of the property tax. However, with the full implementation of "use-value" taxation for agricultural land in 2000, the property tax burdens faced by many Wisconsin farmers have dropped dramatically. In 2002, use value taxation of agricultural land reduced property taxes paid by farmers by \$250 million, a reduction of 82 percent (Boldt, 2002).⁴

The discussion of the tax climate in Wisconsin is broader than just a focus on property taxation. Supporters of the TABOR amendment and other tax limitation measures often cite the state's high tax ranking. They point out that based on data from the U.S. Census Bureau, Wisconsin's state and local taxes measured against personal income ranked 6th in the nation in fiscal year 2002, the most recent year for which these data are available.

³In 2002 dollars, the property tax levy on the median-price house in Wisconsin was \$2,586 in 1994. Eight years later, the levy on the median-price house was \$2,428.

⁴Because of the shifting of property taxation to improvements, the net impact of use-value taxation was a \$212 million (49 percent) reduction in property taxes on all agricultural property.

Before accepting these data as evidence that taxes in Wisconsin are too high, it is important to ask and answer three questions. First, are these data the best measure of the burden on individuals and businesses in Wisconsin of financing government services? Second, given that these data are two years old, do they reflect current realities? And third, do these data provide support for the argument that tax burdens are rising over time in Wisconsin and TABOR is needed to keep them in check?

In financing public services at both the state and local level, governments must choose between levying taxes and utilizing various fees and charges. For example, in funding state universities, legislatures must decide on a mix of state appropriations (funded by tax revenue) and tuition charged to students. Local governments must decide whether to fund trash collection, sidewalk and street repair, and public recreation facilities using through tax revenue or user fees. For reasons that are not well understood, state and local governments in Wisconsin have traditionally chosen to rely more heavily on taxes than on fees and charges than the average state.

As a result, compared with other states, Wisconsin ranks relatively high on taxes and relatively low on fees and charges.⁵ By far the best way to compare the burden on state residents of funding public services is to look at what the Census Bureau calls *state and local government general revenue from own sources*. This number (relative to personal income in each state) provides the best measure of the burden of financing state and local public services. In fiscal

⁵ During fiscal year 2002, Wisconsin ranked sixth among all states (and the District of Columbia) in taxes as a percentage of income; but ranked 26th in fees and charges relative to income

year 2002, Wisconsin ranked 15th among all states (including the District of Columbia).⁶

Although slightly above the national average, Wisconsin should hardly be considered out of line with other states in terms of the burden it places on its residents in providing public services.⁷

Although by the traditional measure of economic downturns--reductions in real Gross Domestic Product--the 2001 recession was quite mild, state governments throughout the country were hit by unprecedented and extremely large downturns in revenues (Giertz and Giertz, 2004). As a result, in the three fiscal years since 2001, states have had to close cumulative budget gaps of nearly \$200 billion (National Conference of State Legislatures, 2003). Like most other states, Wisconsin faced large budget deficits in fiscal year 2003 and 2004. Unlike many states, Wisconsin chose to close its budget gaps without increasing taxes. This recent history suggests that Wisconsin's tax and general revenue burdens have probably continued to fall relative to other states since 2002.

After repeated claims that tax burdens have become oppressive, it will come as a surprise to many people in Wisconsin that the burdens of the state's three major taxes, although they vary over time, have remained remarkably constant over the past nearly 30 years. The data in Figure 1 illustrates the tax burdens, measured as tax revenue per each \$1,000 of personal income, for each of the state governments' three major taxes, the individual income tax, the general sales tax, and the corporate income tax, and the sum of these three taxes. Over this period, revenue from

⁶These rankings are based on state and local government general revenue from own sources divided by that personal income for each state. The revenue data come from U.S. Census Bureau (2004) and the personal income data from the U.S. Department of Commerce, Bureau of Economic Analysis (2004).

⁷Wisconsin's state and local general revenue from own sources equaled 16.2 percent of personal income compared to the national average of 15.0 percent.

these three taxes, which in fiscal year 2003 account for 91.3 percent of total general fund tax revenue, has grown at approximately the same rate as personal income. While tax burdens rose during the 1990s, they have fallen quite precipitously since 2000, even though personal income growth has stagnated over the past few years, a factor that would lead to higher, rather than lower, tax burdens, if tax revenue had not fallen at an even greater rate.

Taxes and Economic Development

Supporters of a TABOR amendment often argue that the enactment of TABOR is necessary to guarantee robust economic development for the state and to spur job creation (or prevent job loss). One of the main supporters of TABOR in Wisconsin, Representative Frank Lasee (2004a), recently made this argument quite succinctly, when he stated that “if we continue to over-regulate and over-tax, businesses will continue to refuse to expand here, and some will continue to move away, causing further loss of jobs.”

The problem with this statement is that it is almost certainly wrong. First, the data do not support the contention that Wisconsin over-taxes business, and second, there is ample evidence from a great number of studies that taxes, by themselves, are not a very important factor in the locational decisions of businesses.

By a number of measures, businesses in Wisconsin face a relatively low tax burden. As documented by Vada Lindsey (2004), over the years Wisconsin has implemented a large number of tax breaks aimed at businesses. In a series of studies, Robert Tannenwald, an economist at the Federal Reserve Bank of Boston, has carefully measured the state and local taxes paid by businesses in each state. His calculations include taxes that are obviously business taxes, such as the corporate income tax, public utility taxes and licenses, workers compensation and

unemployment insurance taxes, and insurance premium taxes. He also includes in his calculations business' share of taxes that are paid by both businesses and individuals. The most important shared taxes are the property tax, the general sales tax, and selective sales taxes on motor fuel consumption.

According to Tannenwald's (2004) calculations, in the year 2000 Wisconsin ranks 49th among all states in business taxes as a share of total state and local taxes. When taxes paid by businesses are compared to various measures of "ability to pay," Wisconsin remains substantially below average, although not at the very bottom. When business taxes are compared to state personal income, Wisconsin ranks 37th, and when business taxes are compared to corporate profits, Wisconsin ranks 35th. Thus, by a variety of measures, business taxes are low in Wisconsin. These data suggest that one reason Wisconsin residents may complain about high taxes is precisely because, relative to business, households in Wisconsin pay a larger share of total state and local taxes, than households in almost all other states. Enacting measures, such as TABOR, designed to reduce taxes further, especially because they will also reduce the public services upon which businesses rely, is unlikely to spur economic development in Wisconsin.

The question of the importance of taxes in determining the location decisions made by businesses has generated an enormous amount of research. Over the years, there have been countless surveys of business leaders and many hundreds of statistical studies of the factors that determine business expansion. The general approach taken by the statistical studies is to gather data on taxes and government spending, and on the wide range of other factors that have a potential influence on the location decisions of businesses. Using various multi-variate statistical techniques, the analysts attempt to determine whether higher taxes result in slower

economic growth, when account is taken of all the other factors that influence growth.

Although summarizing the vast literature on taxes and economic development is difficult, the recent surveys of this literature have come to the conclusion that state and local taxation plays a very small role in the location decisions of business (Wasylenko, 1997; Lynch, 2004). One important reason that taxes aren't terribly important is that for most businesses, state and local taxes account for a small proportion of the costs of doing business, and businesses generally value the public services funded by the taxes they pay. In fact, Lynch (2004) found substantial evidence that an important factor that influences business investment and location decisions is the "quantity and quality of public services (such as schools, roads and highways, sewer systems, recreational facilities, higher education and health services) (p. 20)."

In my view, the most critical element in ensuring Wisconsin's long-term economic prosperity is the availability of an adequate and appropriately-skilled labor force. Wisconsin, like other states, will soon be facing the retirement of the baby boom generation. The result will be potentially large labor shortages. Where is the replacement labor, so important for economic growth, going to come from? For the most part, Wisconsin is not an obvious destination for foreign immigrants. In addition, we have to overcome one disadvantage relative to many of our competitors--namely, our long, cold winters. This means that Wisconsin will have to work very hard to attract (and retain) a well-educated labor force. To achieve this goal it is important that we maintain an attractive environment for both labor and business. This means we need to provide the things that attract workers to this state. This certainly includes high quality public services--good public schools, an excellent public university system, an attractive environment, and safe and clean streets. The evidence suggests very strongly that maintaining high quality

services will be a much more important element in encouraging long-run economic growth in Wisconsin than further reductions in state and local taxes.

The bottom line is that there is no credible evidence to support the argument that the enactment of TABOR is necessary to prevent job losses and to spur continued economic growth in Wisconsin. In fact, it is highly likely that TABOR would over time be detrimental to the state's economic health.

Public Spending in Wisconsin

While supporters of TABOR may agree that public services are important, they have argued that government spending is excessive in Wisconsin. The latest available data show, however, that Wisconsin is not a particularly high spending state when compared to other states. In fiscal year 2002, Wisconsin ranked 19th in state and local government spending relative to state personal income.⁸ Given the spending cuts enacted over the past couple years, it is likely that since then spending has fallen relative to other states. It is frequently assumed that during periods of economic growth, state governments focus their attention on the needy, by increasing state spending on welfare and health. The data from 1990 to 2000 show that during this period, relative to income, spending for health grew hardly at all (in Wisconsin and elsewhere), while spending on welfare (again, relative to income) remained unchanged in Wisconsin while it rose substantially in the average state. The data in Figure 2 show clearly that over the 1990s, the two areas in which annual growth in spending relative to income in Wisconsin way outstripped the national average were corrections and highways.

⁸Wisconsin's state and local direct general expenditures equaled 21.1 percent of income compared to the national average of 19.7 percent. The sources for these data (and the resulting rankings can be found in footnote 6.

Should the Growth in Public Spending be Limited to the Rate of Inflation?

In the previous section of this paper, I have argued that there is no convincing evidence that the fiscal system in Wisconsin is broken. The mix of public services enjoyed by Wisconsin residents and the financing of those services appears to be more or less in line with patterns observed in other states. And there appears to be no compelling evidence that the political system as it now exists doesn't respond to changing citizen needs and desires. Nevertheless, if the citizens of the state were to adopt a constitutional amendment to restrain the growth of public spending and taxes, it is reasonable to ask about the rationale for and the consequences of using the rate of inflation to restrain growth in per capita or per pupil spending.

Dick Armey (2004), the former Majority Leader of the House of Representatives and currently chairman of Citizens for a Sound Economy, a Washington-based group that is working for the passage of TABOR amendments in a number of states, argues that although each state's TABOR proposal may include different elements, a basic principle of TABOR amendments should be that state and local budgets not grow any faster than population growth and the rate of inflation. In Wisconsin, a proposal for a TABOR amendment was introduced into the Assembly in November 2003 as Assembly Joint Resolution 55. This resolution, which was subsequently withdrawn, would have limited the growth in per capita state spending and the growth of per pupil public school spending to the rate of inflation. Increases in municipal and county government spending would be limited to the rate of inflation and the growth in property values due to new construction. Leaders of both the Wisconsin Assembly and Senate have announced their intention to introduce revised TABOR legislation early in the legislative session starting in January 2005.

There are both, what an economist would call, *demand* and *supply* (or cost) side arguments that suggest that the inflation rate is an inappropriate standard for limiting the growth of public spending. Let me start by considering the demand side.

The Demand Side

Although we live in a market economy, most people recognize that not all goods and services can effectively be provided through the market. Most Americans would agree that we cannot rely on the market to provide for police and fire protection, for building and maintaining city streets, for municipal sewage and water provision, for elementary and secondary education, for protecting the environment, and for providing a social safety net for fellow citizens who are, for reasons beyond their control, in need of assistance. In general, individuals are willing to pay taxes to in effect “purchase” these collectively-provided goods and services.

The question we want to ask is what happens over time to citizens’ demand for these government-provided goods and services. As the years pass, not only does the state’s economy grow, but most people find that their own economic situation improves. With growing income and wealth, we observe that people increase their spending on a range of goods and services. They buy fancier cars, they move into bigger houses, buy better quality clothing, and take more elaborate vacations. Is it reasonable to think that as their income rises (and as the state’s economy grows), they also want a better public education for their children--one that better prepares them for jobs in our ever more complex economy, better police and fire protection to help protect their more valuable property, and increased help for those less fortunate than they are?

The statistical evidence from a great number of studies suggests that the answer to this

question is **yes**. While the increase in demand for all publically-provided services is certainly not proportional to the growth of income, there is ample evidence that over time, as incomes rise, demands for public services also rises, and for some publically-provided goods, at a rate even faster than the rate of growth of income.

Figure 3 displays total state and local government spending in Wisconsin relative to state personal income between 1974 and 2000. Over this period total spending increases from 17.5 to 21 percent of personal income. If annual increases in per capita state and local spending had been limited to the rate of inflation, over this period per capita state and local spending would have declined from 17.5 to 13.3 percent of personal income. During this 26 year period, as the economy of the state grew by 43 percent as measured by real (inflation-adjusted) growth in per capita personal income, state residents would have had to reduce the share of their income they can spend on the wide range of public services provided by their state and local governments. While those who want limited government may cheer, restraining government spending to a smaller and smaller share of state income would deny many residents the additional public services they desire.

The Supply (or Cost) Side

The intuitive appeal of limiting the growth of public spending to the rate of inflation is based on the presumption that the inflation rate will reflect the annual increases in costs needed by governments to continue providing existing levels of public services. For many goods and services that individuals purchase, the Consumer Price Index (CPI) does in fact provide a good measure of the additional money needed each year to continue purchasing the same quantity and quality of goods and services. However, as pointed out many years ago by William Baumol

(1967), for reasons that are out of the control of local governments, the costs of providing many public services will tend to rise at rates that are greater than the rate of inflation (as measured by the CPI).

Baumol pointed out that many public services are inherently labor intensive. This is particularly true in the case of education and health care, the two public services that collectively account for the great majority of state and local government expenditures. Although technology, in the form of computer instruction, may eventually play a more important role in educating our children, if anything, recent research seems to suggest the importance of even more labor-intensive instructional methods (in the form of lower class sizes), at least in the early grades.

Meanwhile in much of the private sector, steady increases in productivity, in most cases driven by advances in technology, are being reflected in increases in real wages, especially for college and post-college educated individuals. The consequence of rising productivity and increases in real wages is that over time the real (inflation-adjusted) wages necessary to attract individuals to public sector jobs, namely teachers, social workers, and health-care professionals, rises. The net result is that the cost of providing high quality education and health care rises at rates that consistently exceed the rate of inflation.

There are also other factors that tend to push annual cost increases for many public services above the rate of inflation. Within the next decade the baby boom generation will begin reaching retirement age. As the population ages, there will be increased pressure particularly on Medicaid. Already, the largest share of annual Medicaid spending is used to provide long-term care (generally in nursing homes) for the indigent elderly. In addition, other costs faced by the state and local governments are growing much faster than the rate of inflation. Particularly

noteworthy is the rapid increase in the cost of employee health insurance in both the public and the private sectors. Health insurance premiums grew by 10.3 percent in 2001 and by 10.9 percent in 2002 (Levit, et al., 2004). By comparison, the consumer price index in Wisconsin rose by 1.8 and 1.3 percent in these two years.

Predicting the Impacts of TABOR in Wisconsin

Predicting the future is always a risky business. However, history can often provide a very useful guide to the future. In this section, I ask the question: *if a TABOR amendment had been enacted in Wisconsin several decades ago, how would the level of public expenditures from then until now have differed from the actual pattern of spending.* To answer this question, I assume that the citizens of Wisconsin amended the state constitution in 1985 to include a provision that limited the growth of state government expenditures to the rate of growth of the population plus the rate of inflation, limited the growth of school district spending to the rate of growth of public school enrollment plus the rate of inflation plus 1 percent, and limited the growth of municipal and county spending to the inflation rate plus the value of net new construction relative to the existing value of property. Inflation is measured by percentage change in three-year moving averages of the Consumer Price Index for the Milwaukee-Racine metropolitan area.⁹ These limits are the same ones outlined by the chief Assembly sponsor of TABOR, Representative Frank Lasee (2004b) in an April 8, 2004 memorandum. It is important to emphasize that the simulations of TABOR presented in this section ignore the possibility that voters in the state, in individual school districts, and in counties, or municipalities are free to

⁹The use of 1985 as the starting date for my simulations was due to the fact that the data on elementary and secondary education expenditures was only available back to that year.

attempt to override the TABOR limits on spending through the referendum process. After presenting the simulation results, I will discuss the probability of successful voter overrides of the spending limits.

TABOR's Impact on State Government Spending

As shown in Figure 4, if a TABOR amendment of the type described above had been put in place starting in 1986, 10 years later, in 1995, state expenditures as limited by TABOR would have been 82 percent of actual spending, a difference of over \$2.9 billion (in 1995 dollars). By fiscal year 2003, the level of spending as limited by TABOR would have been two-thirds of actual state government spending. In dollar terms, the difference between what TABOR would have allowed the state government to spend, assuming no successful override referenda, and actual spending, would have been nearly \$8.4 billion. Figure 5 demonstrates that with TABOR in place, state spending would be limited to a continuously falling share of state personal income. In 1985, state spending was 13.3 percent of personal income. With TABOR in effect, spending would have been limited to 10.1 percent of personal income by 2003.

I suspect that readers' reactions to the numbers presented in Figure 4 will depend in large part on their prior attitudes concerning the wisdom of adopting a TABOR amendment. Some would applaud the downsizing of state government by one-third because it would imply sharply lower state taxes, while others would despair at the elimination of valued public services. A full discussion of the impact of TABOR requires that we translate discussions of spending reductions into discussions of the reduction in funding of specific public services. While predicting what decisions our political leaders would have made in response to TABOR (or for that matter, would make in the future) is very difficult, a look at the state budget sheds some light on the

decisions that would most likely be made.

The first thing to note is that the legislature is subject to a substantial number of constraints in its search for ways to cut state spending. For example, state employee pension obligations and interest on the state debt can not be reduced. Mandates imposed by the federal government, such as requirements to provide education services for children with disabilities and nursing home care for the poor elderly, further reduce the options available to the legislature for cutting spending. In addition to federal government mandates, federal matching grant requirements, particularly for Medicaid, mean that for every dollar that the state reduces its own spending, the federal government will reduce its grants to the state by more than a dollar.

Other constraints on cutting spending may well come from the courts, which may require that the state government either maintain or increase spending in order to fulfill various state constitutional mandates. For example, in a 2000 decision, *Vincent v. Voight*, the Wisconsin State Supreme Court asserted that all students are entitled to “an equal opportunity for a sound basic education” that will equip them “for their roles as citizens and enable them to succeed economically and personally.” Courts in a number of other states have declared their systems of school finance unconstitutional because their state legislatures failed to provide public schools with sufficient resources to guarantee that all students had an opportunity to receive what has come to be called, an *adequate* education. It is unclear how the Wisconsin court would react if, as a result of spending constraints on both the state and on local school districts, the quality of public education in the state declined.

For reasons, outlined above, many parts of the state budget are difficult to cut. For this reason it is useful to look at the portion of the budget that is easiest to reduce, namely General

Fund Appropriations. Figure 6 summarizes General Fund appropriations for the current (2004-05) fiscal year. If TABOR had been in place, since 1986, and given the impossibility of cutting many other parts of the state budget, there is little question that General Fund appropriations would have to be dramatically reduced from their current level.

It is interesting to speculate where the cuts would have come. The first three categories of spending, state education aid to local school districts, Medicaid, and corrections, account for 64 percent of General Fund appropriations. Substantial cuts in these areas would have been unlikely. This implies that meeting the TABOR limits would in all likelihood have resulted in drastic reductions in most of rest of state government functions. Likely casualties would be state funding for the University of Wisconsin System and Shared Revenues, the state's system of general-purpose grants to municipal and county governments.

TABOR's Impact on Public School Spending

Figure 7 compares actual spending of the state's 426 school districts since 1985 with the maximum spending allowed if a TABOR amendment went into effect in 1986 and no referenda were passed to override the spending limits. The data show that by 2003, public school spending would have been 20 percent lower than actual spending, with the difference equal to about \$1.7 billion. During the past few years, a period when the rate of inflation has been quite modest, the TABOR limit would have restricted the annual increase in per pupil spending in the average spending district to an amount that is substantially lower than the maximum annual per pupil increase allowed under existing law. Since the mid-1990s, all school districts in Wisconsin have operated under *revenue limits*, which in 2003 limited the annual increase in revenue to approxi-

mately \$240 per student.¹⁰

Figure 8 demonstrates that since 1991, spending by local school districts in Wisconsin has been equal to about 5 percent of personal income. The TABOR limit would have limited school spending to about 4 percent of personal income.

Although these simulation result assume that no school district was successful in overriding the TABOR spending limits, actual experience over the past few years with attempts by school districts to win voter approval to raise revenue in excess of the school district revenue limits suggests that successful attempts to override the TABOR limits would be relatively infrequent. Of the 426 Wisconsin school districts, only 11 districts in 2002 and 10 districts in 2003 were successfully in passing referenda to override the revenue limits.

TABOR's Impact on County and Municipal Spending

Figure 9 illustrates that in aggregate, TABOR limits will not be very binding on total county and municipal spending, even without the passage of override referenda. If a TABOR amendment that restricted the growth of spending to the rate of inflation and the rate of net new construction in each jurisdiction had gone into effect in 1986, by 2000 allowable spending would only be 6 percent lower than actual spending, with allowable spending \$690 million less than actual spending. There are two reasons why in the aggregate, TABOR would be less binding on county and municipal governments than on the state government and on local school districts. First, the TABOR limit on municipal and county governments, which is tied in part to the rate of increase in property value due to new construction, results in a larger allowable annual percent-

¹⁰For a detailed description of Wisconsin's system of school finance, see Reschovsky (2002a).

age increase in spending than the limits faced by school districts and the state. Second, for about the last 10 years, municipal governments that wanted to receive state funds through the state's Expenditure Restraint Program were required to keep their annual increase in spending to no more than the rate of inflation. Without this provision, actual municipal spending may well have been higher than it was.

Individual municipalities or counties that experience above-average rates of growth will be able to increase spending at faster annual rates than communities that grow at lower rates. This suggests that while TABOR may not restrict spending in some jurisdictions, in municipalities with limited growth the limits on spending would be very strict.¹¹

Predicting which municipalities and counties would be successful in passing referenda to allow spending in excess of the TABOR limit is difficult. However, the experience with fiscal referenda in Massachusetts may shed some light on what we could expect in Wisconsin. In 1980 voters in Massachusetts enacted Proposition 2½, which among other things, limited the annual increase in property tax revenue in each municipality to 2½ percent plus an allowance for new construction. A local referendum was required to override this limit. In a careful study of the results of override elections, Bradbury (1991) found that the probability of both holding an override election and successfully passing one was greater in smaller communities and in municipalities with higher levels of income and property value per capita. If this pattern were to hold in Wisconsin, then over time the disparities among municipalities in public services would grow, with quality of public services most likely to suffer in many of the state's urban, property

¹¹In a revised version of this paper, I will provide estimates of the impact of TABOR in a sample of both slow and fast growing communities.

poor communities.

Why Not Rely on Referenda to Make Spending and Taxing Decisions?

Under our current system, local voters make fiscal decisions by electing state and local public officials who, in turn, are responsible for deciding on the level and mix of public services to provide and the amount of taxes to raise. The passage of a TABOR amendment would shift the spending and taxing decisions made by all governments in Wisconsin from elected public officials directly to the voters in each community. In this section, I briefly discuss several reasons why making budget decisions through the referendum process may not improve the process of public decision making in Wisconsin and may have unintended negative consequences.

Budget decisions are almost always complex. They require careful analysis and the weighing of tradeoffs. Elected officials, whether they be members of the legislature, county boards, city councils, boards of supervisors, or school boards, generally invest a substantial amount of time in making fiscal decisions. They hold extensive hearings, pose questions to government administrators, study detailed budget documents, and read various position papers in preparation for making decisions on spending programs.

It is not likely that most voters in a spending or tax referendum will have the time (nor the expertise) to study complex fiscal issues in sufficient detail to make informed decisions. Rather, it is likely that many voters, if in fact they choose to vote, will be influenced by “bumper sticker” campaigns financed by various groups that want to influence their vote. It is certainly not clear that the spending and taxing decisions that result from this process would provide a more accurate reflection of the true preferences of the citizens of Wisconsin than our current

system of fiscal decision making.

Referenda on public spending are very blunt instruments. Voters have only two choices; they can either vote yes or no on the referendum question. A vote of *no* on a proposal calling for an increase in school district or municipal spending, only indicates that the voter was opposed to the particular spending proposal. The vote provides no information about whether the voter was in fact opposed to all increases in public spending, or instead in favor of additional spending, but on a different set of public services?

It is well known that voter turnout for most local elections is very low. This suggests that the results of spending and tax referenda may be unduly influenced by special interests. Contrary to the claim of some supporters of TABOR that fiscal referenda better reflect the “will of the people,” the result of these referenda may well represent the views of the relatively small portion of the electorate who have plenty of time to vote, e.g. retirees, or of those with a particularly strong interest in the outcome, e.g. public employees.

Alternative Policies to Address Wisconsin’s Fiscal Problems

Arguing that the enactment of a TABOR amendment would be a bad for Wisconsin does not imply that the state faces no fiscal problems. In this section, I briefly discuss three fiscal problems that have plagued the state for a number of years, and suggest alternative policy responses to these problems.

Like the most other states, Wisconsin has had to weather several years of large state government deficits. Solving the budget deficit was made more difficult in Wisconsin because the state had failed to put money into a “rainy day” or more formally, a budget stabilization fund. In 2001, when state government revenues began to fall, the large majority of state governments

around the country turned to their rainy day funds to help close their budget deficits. The fact that most states had not only established rainy days funds, but had put, by historical standards, substantial amounts of money into these funds, provides ample evidence that state legislatures can establish and utilize these funds to cushion the fiscal impacts of recessions. As most other states have established rainy day funds outside their states' constitutions, there is no reason why the legislature and the governor could not agree to establish statutory procedures for putting money into and taking money out of a rainy day fund, and as the economy improves, begin making contributions to the fund.

The budget deficits faced by the state over the past several years were clearly exacerbated by the fact that since at least the mid-1990s the state's budget was *structurally* out of balance. The problem began when the legislature made its commitment to fund "two-thirds" of the cost of public education, but failed to identify a source of funds to pay for this large, ongoing expenditure of state funds.¹² Unexpected revenue increases during the economic boom of the late 1990s, allowed the legislature to put off the hard decisions about how to fund their school finance commitments.

One way that the legislature could prevent the emergence of future structural deficits would be to pass strict "pay as you go" rules. These rules require that the legislature explicitly finance any new spending commitments, and also requires that any tax reduction be matched with offsetting spending cuts. The U.S. Congress operated quite successfully under these kind of "budget rules" during most of the 1990s, actually achieving a balanced budget by the end of the

¹²For a full discussion of the causes of Wisconsin's structural deficit, see Reschovsky (2002b).

decade. Both Congress and the Wisconsin legislature should consider adopting these kinds of strict budgetary procedures.

Over the past couple decades, the legislature has taken a great many steps to reduce property taxes. I suspect that many supporters of the current efforts to enact a TABOR amendment see the amendment as another way to bring down property taxes in Wisconsin. TABOR as well as most previous efforts by the legislature to reduce property tax burdens, such as the expansion of state aid to public schools combined with revenue limits, achieve their result by reducing property tax **rates**. Unfortunately the strategy of reducing rates is a very inefficient way to deliver property tax relief.

The basic problem is that while rate reductions result in lower property taxes, these rate reductions apply equally to all taxpayers, including landlords, corporate owners of commercial and industrial property, nonresident owners of vacation homes, and homeowners whose property tax burdens are not particularly high. By failing to target property tax relief to those Wisconsin residents facing the highest tax burdens, for example many elderly and low-income homeowners, the state spreads out property tax relief and fails to provide real meaningful relief to those facing the highest burdens. The legislature could address this problem in a number of ways. For example, it could raise the income eligibility for the homestead credit to the states's individual income tax. Not only would no constitutional amendment be needed, but real property tax relief could be delivered in a timely fashion.

Conclusions

In this paper, I have argued that there is no compelling reasons for adding an amendment to the state constitution that would permanently reduce the ability of all governments in Wisconsin to make decision about spending and taxation. Government spending in Wisconsin is

not particularly high, and it is widely recognized that the state government and local governments provide the citizens of Wisconsin with a high level of public services. Although the average tax burden is above the national average, over the past decade both state and local taxes have been reduced. Business tax burdens are among the lowest in the country and the legislature and the administration have taken steps to simplify the regulatory environment. I have also argued that there are a number of good economic reasons why government spending should not be tied to the rate of inflation. There are also good reasons to believe that making spending and taxing decisions through the referendum process will be very unlikely to result in fiscal outcomes that accurately reflect the wishes of the residents of Wisconsin.

To quantify the impact of TABOR limits on state and local government public services, I simulated the impact of TABOR assuming that it had been in place since 1986. The results of the simulations indicate that TABOR would have required a dramatic reduction in state government and school district spending. There is little doubt that over time TABOR would result in big reductions in programs that help the state's most vulnerable citizens, result in serious downsizing of the University of Wisconsin system, seriously reduce the ability of the public schools to provide a quality education for our children, and risk substantial damage to our environment. And there is little question that these reductions in government services would in the long run do serious harm to the state's economy and jeopardize the future prosperity of its citizens.

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Figure 1

Wisconsin Tax Burdens: 1975-2004

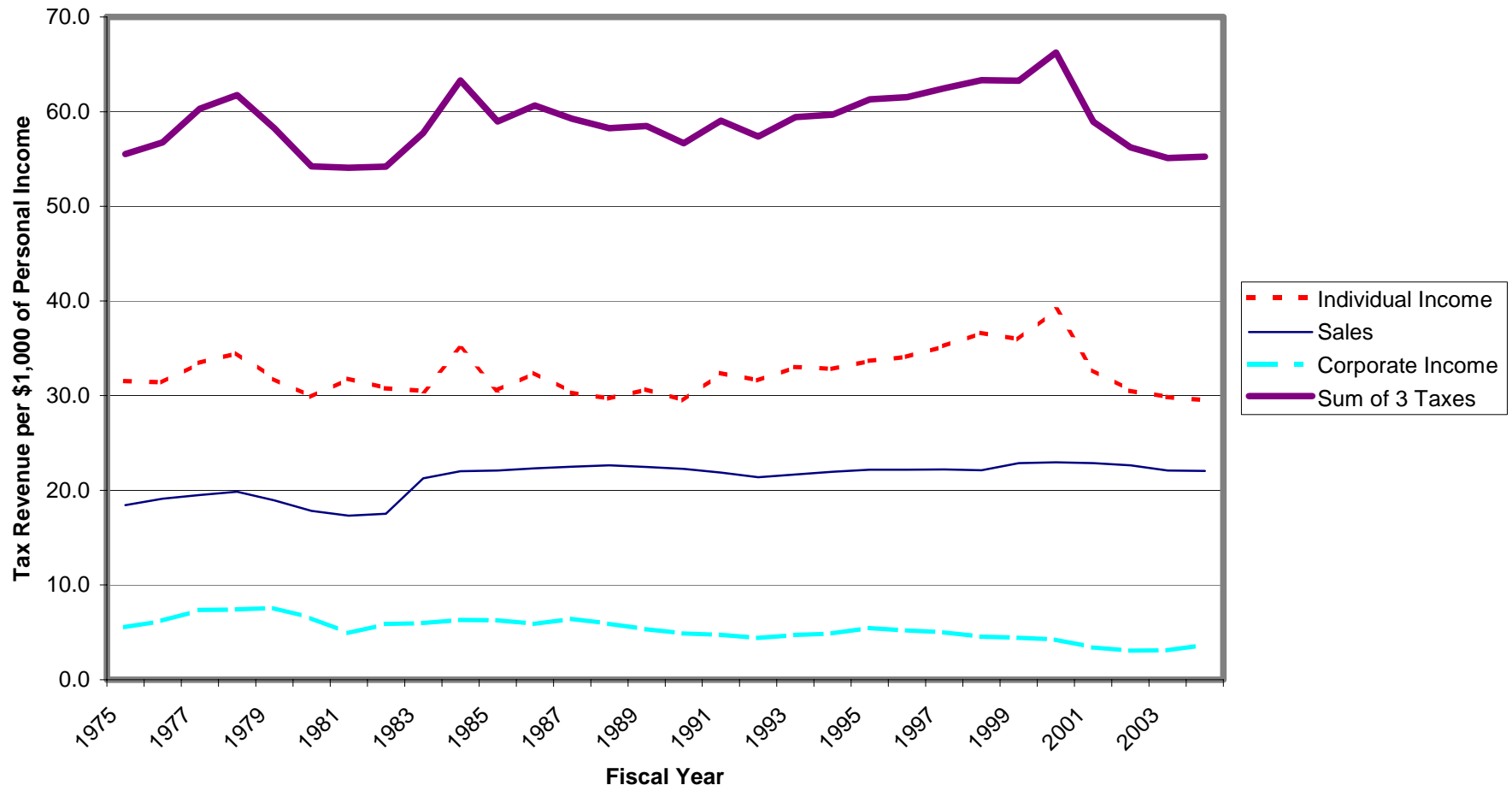


Figure 2

Wisconsin Compared With United States
Average Annual % Change in State and Local Expenditures Per \$100 of Personal Income
1990 to 2000

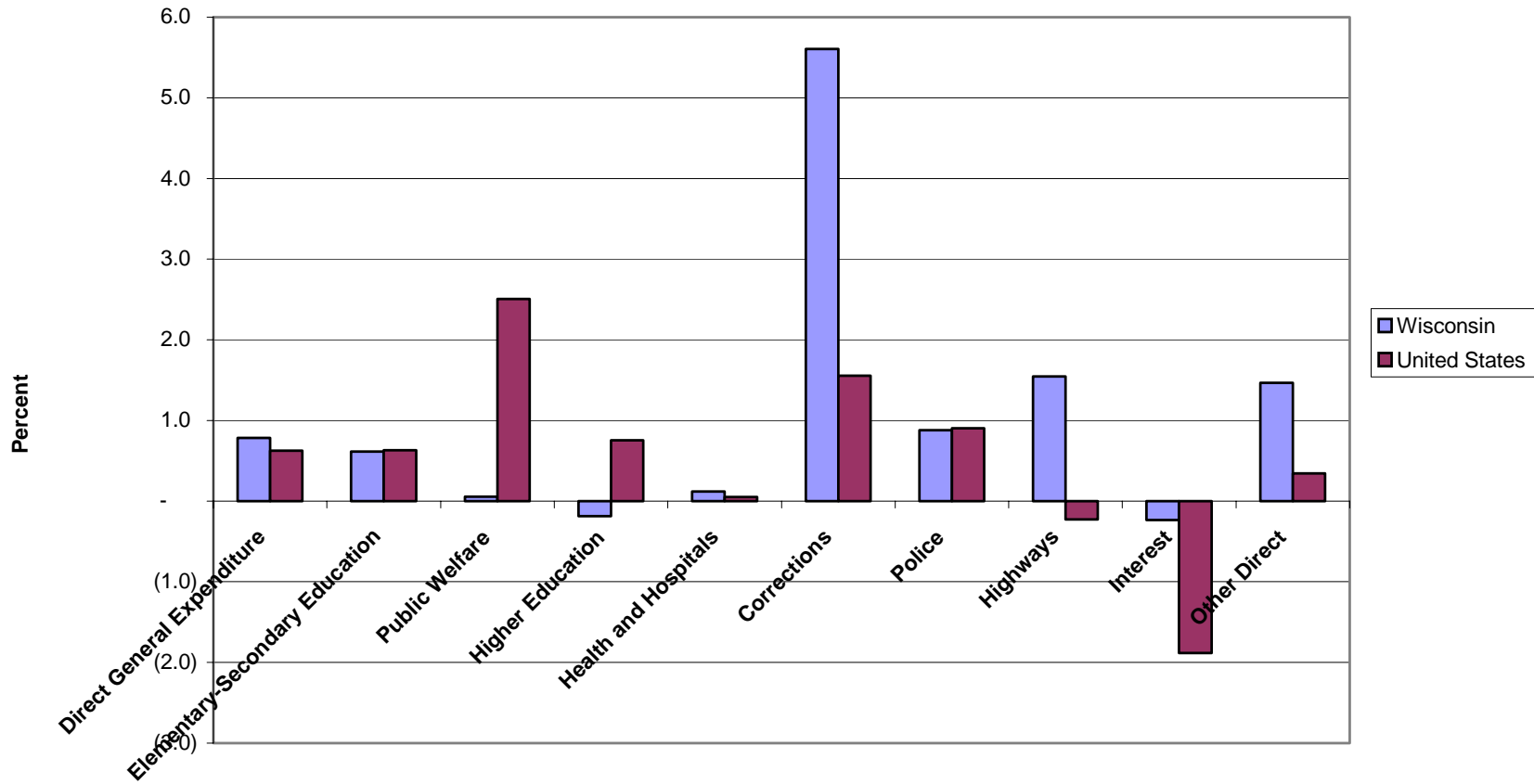


Figure 3
State and Local Spending Relative to Income
The Impact of Limiting Spending to the Rate of Inflation

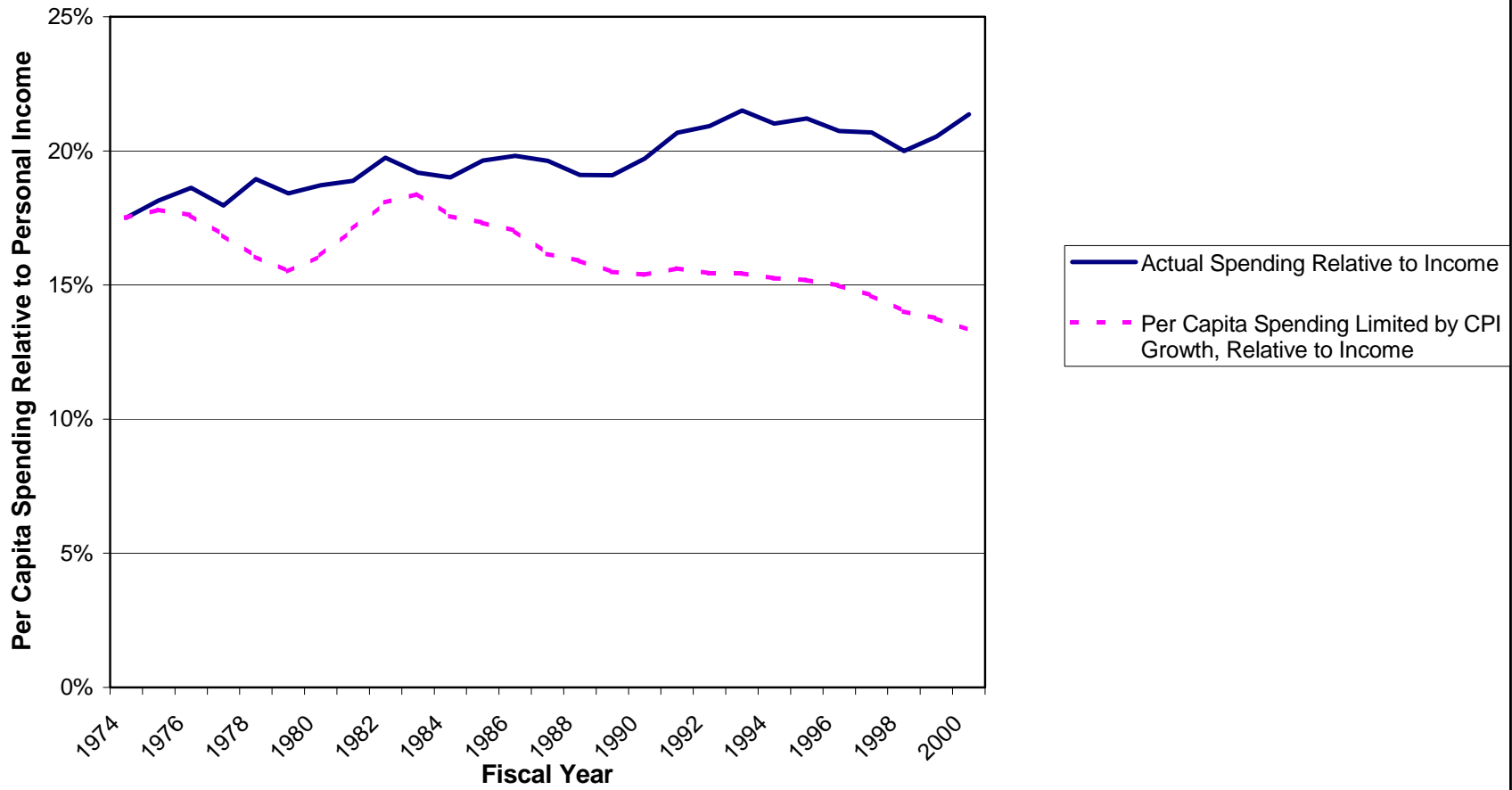


Figure 4

The Impact of TABOR on State Government Spending

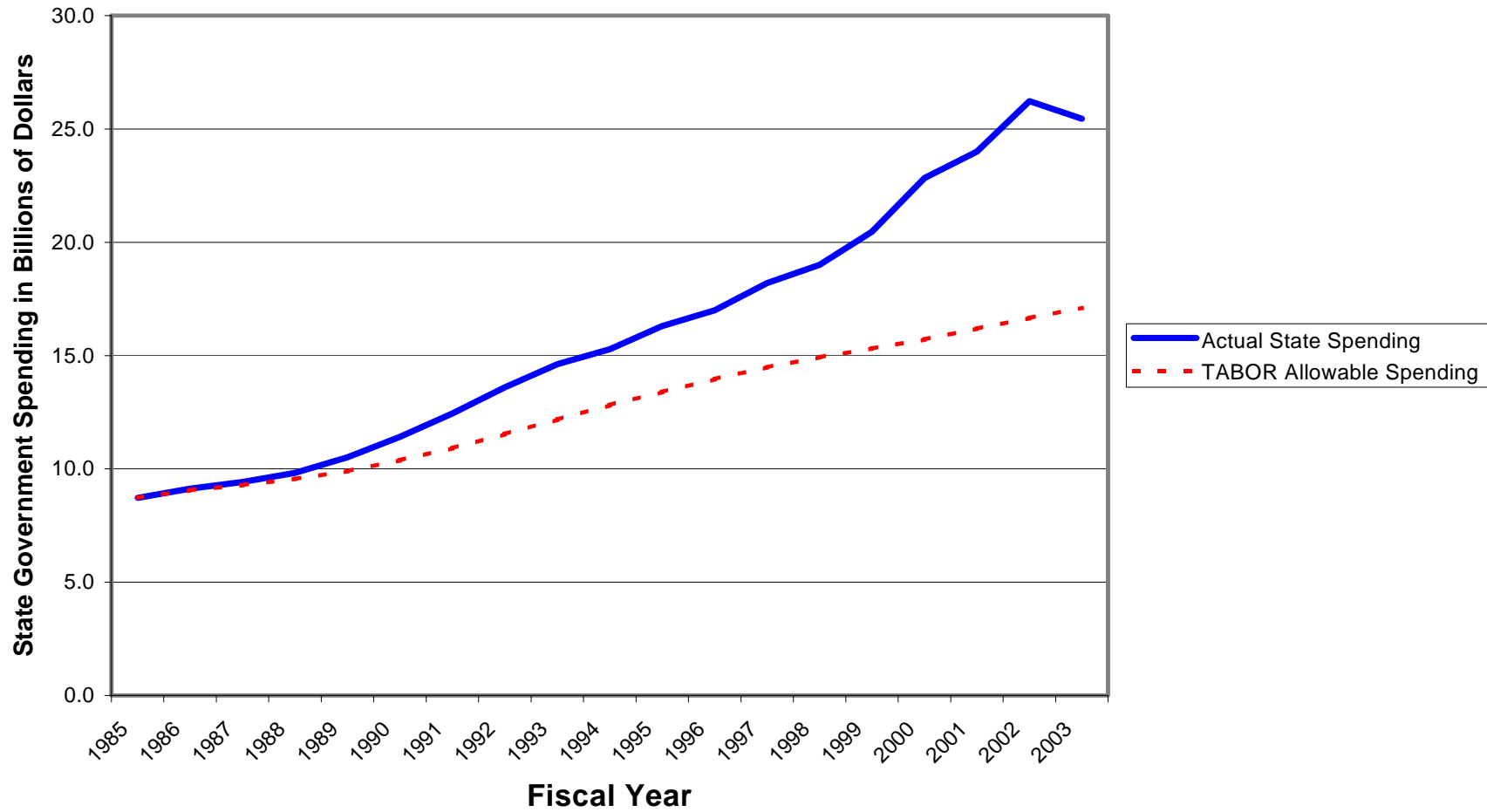


Figure 5

The Impact of TABOR on State Government Spending Relative to Income

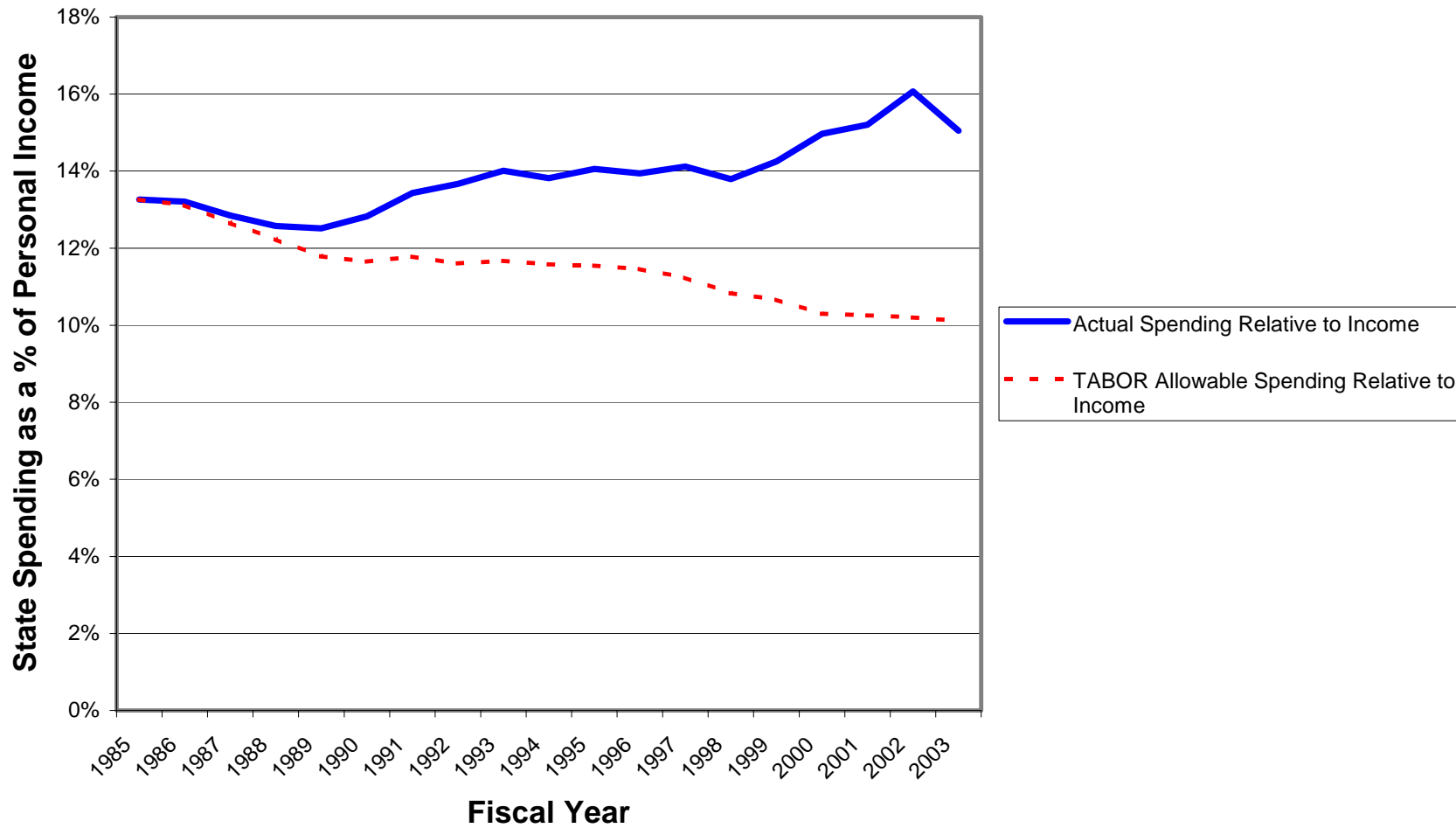


Figure 6

Distribution of 2004-05 General Fund Appropriations

	Amount (millions of \$s)	% of Total
K-12 school aids (including school levy credit)	5,218.4	43.7%
Medical Assistance	1,434.6	12.0%
Corrections	1,034.6	8.7%
UW System	927.1	7.8%
Shared Revenue	750.9	6.3%
Judicial and Legal Services	163.0	1.4%
Public Assistance	155.6	1.3%
SSI (assistance for poor elderly and disabled)	128.3	1.1%
Other aid to individuals	635.1	5.3%
Other local governemnt assistance	547.3	4.6%
Other state operations	942.6	7.9%
Total General Fund Appropriations	11,937.5	100.0%

Source: Author's calculations based on data from Table 10, Wisconsin Legislative Fiscal Bureau (2003).

Figure 7

The Impact of TABOR on K-12 Education Spending

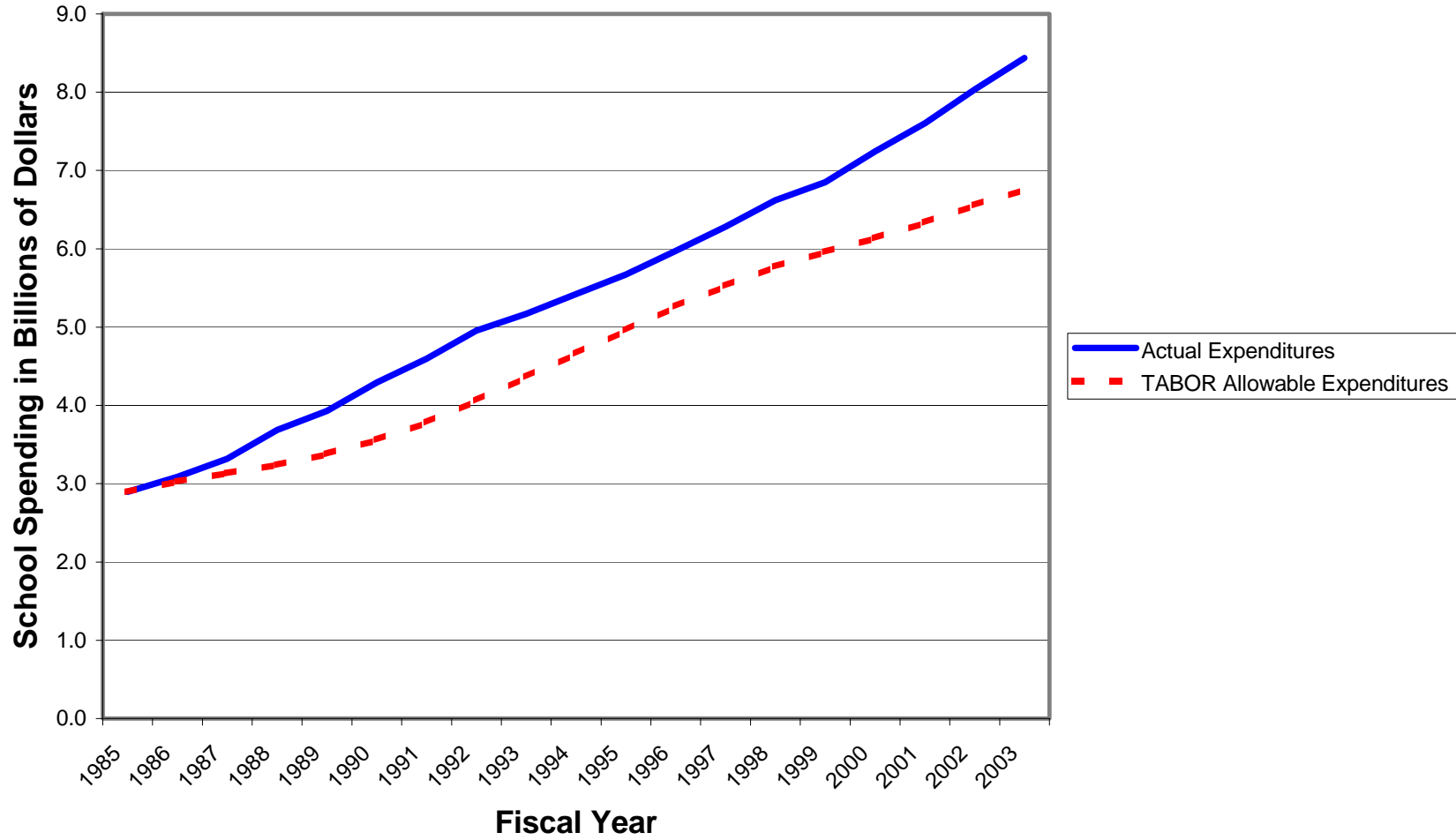


Figure 8

The Impact of TABOR on School Spending Relative to Income

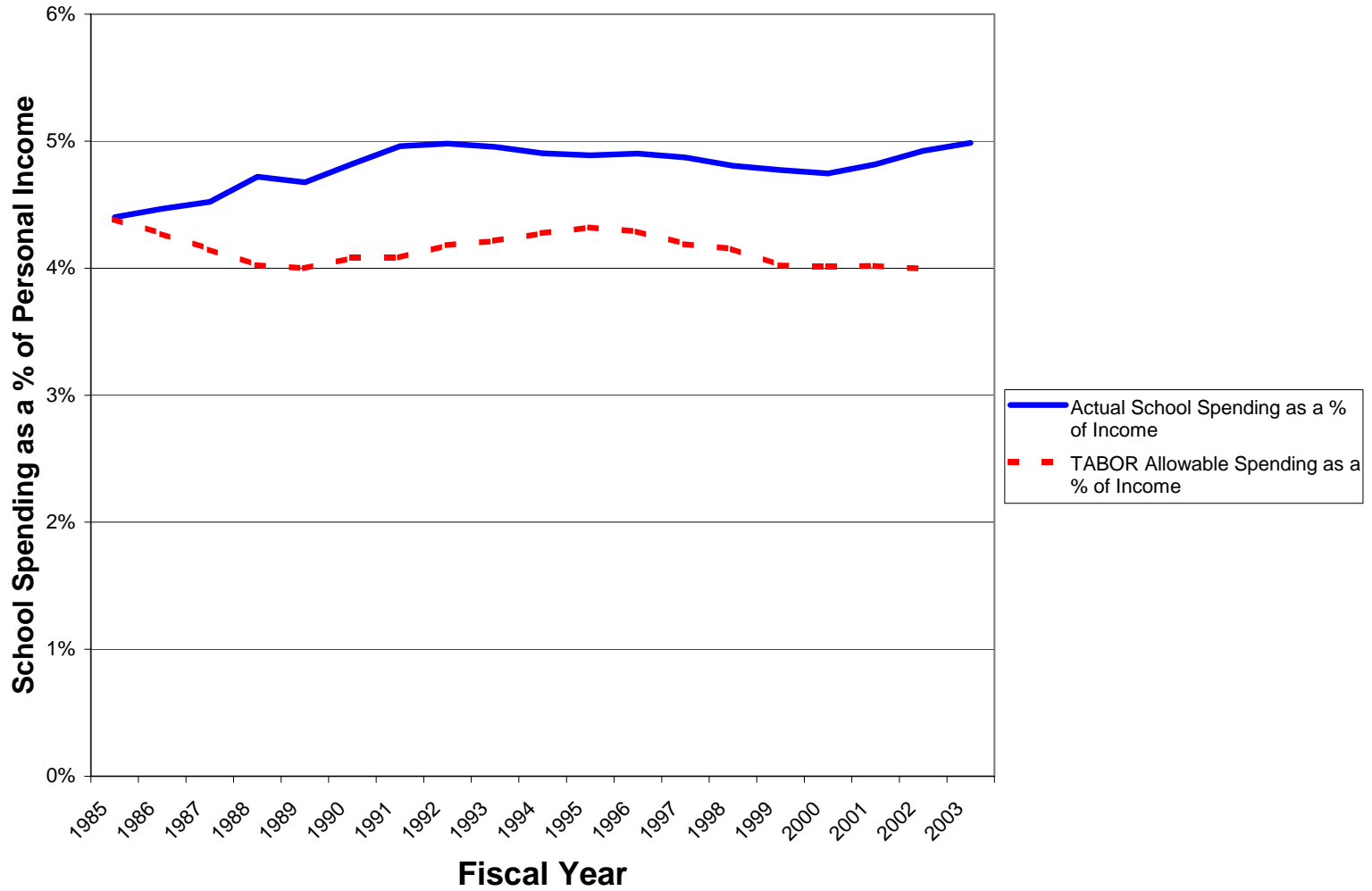


Figure 9

The Impact of TABOR on Municipal and County Spending

