A TAX LIMITATION FOR GEORGIA?

The Tax Payers Bill of Rights Study Committee was established in the 2005 session of the Georgia General Assembly (HR 340) to investigate the possibility of imposing a tax or expenditure limitation for Georgia. This Policy Brief discusses the evidence that has been presented regarding the need for a tax or expenditure limitation and the issues associated with the design and effect of a tax or expenditure limitation.

No one has proposed a specific limitation, but there is a presumption that a limitation similar to what has been adopted by Colorado might be considered for Georgia. In Colorado, expenditure increases by the state government and each local government are limited to the percentage growth in population and inflation. Therefore, this Policy Brief uses that limitation as the basis for the analysis presented here.

Need For a Limitation

There have been at least two reports published regarding the possibility of imposing a tax or expenditure limitation in Georgia. The Georgia Public Policy Foundation (GPPF) argues for the need for a limitation while the Georgia Budget and Policy Institute (GBPI) argues against the need for a limitation.1

The GPPF points out that for Georgia, total state and local taxes as a percentage of total personal income (state and local tax burden) increased over the period 1970 to 2005 and that this increase was larger than the average for the other states. Thus, the GPPF concludes that, “Georgia’s elected officials have not provided a strong bulwark against increasing tax burdens.” They further state, “Georgia’s mediocre record in controlling the growth in government spending and maintaining a low tax burden on its citizens suggests [a need for the adoption of a tax limitation.]”

The GBPI, on the other hand, considers the increase in state expenditures per capita adjusted for inflation for the period 1991 to 2004. The GBPI argues that most of this increase is due to explicit policy decisions such as increasing prison sentences, raising teacher salaries, and the Homeowners Tax Relief Credit. The GBPI also notes that state tax burden between 1980 and 2005 has been relatively stable, ranging generally between 5.5 percent and 6.0 percent and for the past four years was less than 5.5 percent. Thus, the GBPI concludes that, “Georgia is not a state with a high tax burden or a state budget growing ‘out-of-control.’”
Can both organizations be correct? In terms of their facts, both organizations are correct. But is the evidence they present sufficient to draw the conclusions they do?

Consider first the evidence presented by the GPPF. The evidence that the GPPF presents makes for a very weak case in support of a limitation. According to the data presented by the GPPF, the state and local tax burden in 1982 in Georgia was 9.6 percent and in 2005 it was 9.8 percent. (These numbers are estimates generated by the Tax Foundation, and thus are subject to prediction error. Therefore, the difference may be just a statistical artifact.) While the tax burden did increase in the 1990s, it has since fallen. So, the increase in the tax burden between 1970 and 2005 actually occurred during the 1970s.

The GPPF points out that in 2005, Georgia ranked 31st in terms of tax burden while in 1970 it ranked 41st, which the GPPF suggests is further evidence that taxes are out of control. However, these ranking are sensitive to small changes in taxes. For example, if taxes for the average person in Georgia had changed by $100 in 2005, Georgia’s ranking would have been 24th if taxes had gone up and 41st if they had gone down by $100. In other words, relatively small changes in taxes can lead to large changes in the rankings.

In addition, the GPPI suggests that the increase of about $1 billion in the state budget for fiscal year 2006 is evidence that “… the democratic process (e.g., fear of reprisals from voters) is an inadequate restraint on politicians who seek to curry campaign contributions from special interests and to bring home goodies to garner voters.” One simply cannot draw such a conclusion from the fact that the budget increased. The increase comes after several years of budget cuts and slow growth; inflation adjusted per capita state budgeted expenditures for fiscal year 2006 are still less than for the pre-recession years.

More importantly, one cannot draw the conclusion that the increase in the state and local tax burden is evidence or proof of the need for a tax or expenditure limitation. The issue is whether the increase in expenditures (and thus taxes) exceeded what citizens wanted. The GPPI implicitly assumes that expenditures in 1970 were at the appropriate level, or at least closer to the appropriate level than in subsequent years. But it is also possible that current expenditures are closer to the appropriate level than the level in 1970. In 1970, according to GPPF, Georgia was ranked 41st in terms of state and local tax burden. This means that expenditures in Georgia were low relative to the rest of the country. It is thus possible that expenditures were too low in 1970 and that the growth in taxes over the past 35 years was simply an effort to get public services up to the level desired by the voters.

Voters have demands for public services like better roads, more parks, and better education just as they have demands for private goods like food, housing, and clothes. As income increases, household demands for both private goods and public services increase. Furthermore, as the population becomes more urbanized, the need or demand for public services (and thus public expenditures) increases. Income per capita in Georgia grew faster than the national average over the period 1970 to 2005 and the state has become more urbanized. Thus, it is not unexpected that in Georgia taxes as a share of income have increased relative to other states. Note, however, this argument does not imply that the increase in tax burden in Georgia was the appropriate increase.

The GBPI, on the other hand, relies on trends in state expenditures during the period 1980 to 2005, and argues that the growth between 1991 and 2004 in inflation-adjusted per capita state spending can be largely explained by explicit policy decisions.

What about the GBPI’s evidence and explanation? First, the GBPI ignores local government spending, which grew about 4.8 percent faster than state government spending during the 1990s. Second, while explicit policy decisions are associated with the increase in state expenditures, this does not mean that the policy is what the citizens wanted or that they were good policies. Some individuals might argue that increasing prison sentences (which resulted in an increase in correction expenditures) was a bad policy. Others may suggest that increasing teacher salaries was a bad policy since it has not resulted in increased public school performance. Thus, it could be argued that having a tax or expenditure limitation would have prevented the state from implementing bad policies. (This is not to suggest that these were necessarily bad policies.) The evidence does suggest that the increases in expenditures are largely due to the adoption of explicit policies and not pork-barrel type spending.

Colorado just voted by referendum to suspend its limitation for five years. Some want to take that as evidence that such a limitation doesn’t work. But if the objective in Colorado was to strictly limit the growth in state and local expenditures, the limitation was actually very successful. But if the objective was to just to moderate the growth of expenditures in Colorado, the limitation probably failed because it did much more than moderate expenditure growth. It should be pointed out that
the budget problems in Colorado were only partly due to the limitation. One particular feature of the limitation along with a companion proposition made the limitation very difficult to deal with. One of the features of TABOR was that the growth in expenditures was based on the previous year’s actual expenditure. Thus, when the recession hit and revenues declined, that lower expenditure level became the basis for future allowable expenditures growth. Because any tax increase had to be voted on by the public, it was not politically feasible to make up for the loss in revenue due to the recession.

Colorado also adopted a proposition that required that expenditures on K-12 education increase by an amount equal to the percentage increase in enrollment plus inflation plus 1 percent. Thus, education expenditures had to increase faster than total expenditures. That meant that over time, K-12 spending was taking up a larger and larger share of total spending. Expenditures on all other public services were being squeezed.

Neither the GPPF nor the GBPI point out that unlike many states, Georgia gives the governor sole authority to determine the expenditure level since he sets the revenue estimate, and that at the end of the fiscal year, expenditures cannot exceed revenue. In many states a committee, typically comprised of the leadership from the House, Senate, budget office, and the governor, has to agree on the size of the revenue estimate. This is a process that by its nature yields compromises, frequently in the form of agreement over increases in expenditures. And, unlike Georgia, in many states the budget must balance only at the time it is proposed, so it is easy to over project revenue, thus increasing expenditures. This does not mean that expenditures in Georgia are not too high, only that the fiscal institutions make it more difficult to exceed the expenditure level the public prefers than in other states. It is relevant that all of the three bond rating agencies have given Georgia their highest possible bond rating; those rating are not given out to fiscally imprudent state governments.

If the evidence presented does not demonstrate whether there is a need for a tax or expenditure limitation, what is needed to determine whether state expenditures (and thus taxes) have increased too rapidly and thus are too large? One possible approach to answering that question involves identifying a set of expenditures that the public would agree to delete from the budget, with a commensurate cut in taxes. Of course, everyone can find something in the budget that he or she could get along without, but it might be something that someone else needs, or at least wants. If a Colorado-like limitation on expenditures had been imposed in 1990-91 in Georgia, then expenditures in fiscal year 2004 would have had to be about $1 billion less than actual expenditures of $15.8 billion. So, if one can identify $1 billion that should be cut from the adopted budget and that the public would agree should be cut, then he or she has grounds for supporting a Colorado-like tax or expenditure limitation for state government. A similar experiment could be done for local governments, although clearly that is a much harder task.

Of some relevance is a telephone survey the Fiscal Research Center conducted. In response to a question about how the state should address a revenue shortfall, 56 percent said to cut expenditures, while the other said either raise taxes or do some of both.2

Issues in Designing a Tax or Expenditure Limitation

Tax and expenditure limitations are a blunt instrument for controlling the growth in expenditures or taxes. Consider a Colorado-like limitation, which establishes expenditures per capita at the time the limitation is adopted as the maximum allowable (inflation-adjusted) per capita expenditure level. There are two problems with this limitation. First, such a limitation does not allow for increases in need or demand. As noted above, individuals have demands for public services like roads, education, and parks. Increases in income and changes in demographics will lead to increases in the per capita demand for public services. Such a limitation would be like limiting calories per family member equal to its current calorie intake. A family that currently has a small male child would have a real problem as the child turned into a six foot teenager.

Second, it assumes that the current level is the appropriate level, and does not allow for adjustment if it is not the appropriate level. Consider school systems in Georgia. There are substantial differences in expenditures per student, with a ratio of better than 2 to 1 between the highest and lowest spending system. A Colorado-like limitation would make those differences permanent. If a low spending district decided it needed to increase spending per student, or the property tax base increased so that the community could afford to increase spending, it would not be allowed to do so.

In addition, the year that is select as the base is arbitrary but can have a major influence in the effect of a limitation. For example, if a limitation had been imposed in Georgia beginning in fiscal year 1989-90, then in 2004 allowable state expenditure would have been $14.8 billion, which is $1 billion less than
actual expenditures. However, if the limitation had started one year later, in 1990-91, allowable expenditure in 2004 would have been only $13.8 billion, which is $2 billion less than actual expenditures. Allowable expenditures thus differ by $1 billion depending on which of the two years was the start date.

Presumably, the rational for using population growth and inflation is to account for increases in the population served and in the cost of providing a given level of service. But, as the GBPI points out, population may not be the appropriate benchmark for public service needs, and changes in the consumer price index may not reflect increases in the cost of providing government services.

There are 23 states that have a state tax or expenditure limitation. Of these, 4 (Alaska, Colorado, Nevada, and Washington) have a state limitation that uses population growth and inflation to determine the allowable increase in expenditures or taxes. Only Colorado bases the allowable increase on the prior year’s revenue. The other 3 states base the limitation on a base year and calculate the allowable increase from that base. There are 18 states that limit expenditures or taxes to either the growth in personal income to some fixed percent of income, with the percents varying from 5 percent to 9.5 percent. One state has a fixed allowable percentage increase in spending. While most states have imposed some sort of limitation on property taxes, 5 states have imposed limits on the growth of total expenditures or revenues of municipalities and counties. Three of these states use population growth and inflation as the basis for allowable growth.

If Georgia is going to have a limitation, and the objective is to moderate the growth in government spending, then setting the limit as a maximum percentage of income would be a better policy option than a Colorado-like limitation. Furthermore, as the GPPF suggests, there needs to be some override provision to allow for special circumstances and emergencies. Requiring a vote of the citizens probably would not provide sufficient flexibility to allow the government to respond to an emergency. Ten of the states with limitations allow overrides by supermajority votes (60 percent, 66 percent, or 75 percent) of the representative body, while 3 also require a voter approval.

Imposing a limit on expenditures usually is for the purposes of controlling taxes. Exemptions are allowed for expenditures funded by grants, legal settlements, etc. Such exemptions should be part of any Georgia limitation.

If a limitation is imposed in Georgia, there are likely to be efforts by governments and citizens to circumvent the limitation. There will likely be increased attempts to use tax credits to avoid the limitation. For example, rather than making payments to Pre-K programs directly to the schools, the state could have the parents pay tuition and then give a 100 percent refundable credit to the parent for the tuition they pay. The latter keeps the expenditure and taxes off the books, but accomplishes the same objective, government financing of Pre-K programs. One should also expect that special associations will arise to provide public services that are cut out of the budget. Such privately provided public services, however, will be available only to those citizens willing and able to pay. And there is substantial evidence that a tax limitation will result in an increase in fees.

A tax or expenditure limitation would be a significant change to Georgia’s fiscal apparatus. If improperly designed, it could have very undesired consequences. Georgia has a reputation for being fiscal conservative, and thus it should require substantial evidence of the need for a limitation, and the magnitude of the problem before acting. If it is determined that the growth in expenditures has not been substantially larger than what would be appropriate, the state would be wise to consider more tailored alternatives before adopting a tax or expenditure limitation.

NOTES:


ABOUT THE AUTHOR

David L. Sjoquist is Professor of Economics, holder of the Dan E. Sweat Distinguished Scholar Chair in Educational and Community Policy, and Director of the Fiscal Research Center of the Andrew Young School of Policy Studies at Georgia State University. He has published widely on topics related to state and local public finance and urban economics. He holds a Ph.D from the University of Minnesota.
ABOUT FRC

The Fiscal Research Center provides nonpartisan research, technical assistance, and education in the evaluation and design of state and local fiscal and economic policy, including both tax and expenditure issues. The Center’s mission is to promote development of sound public policy and public understanding of issues of concern to state and local governments.

The Fiscal Research Center (FRC) was established in 1995 in order to provide a stronger research foundation for setting fiscal policy for state and local governments and for better-informed decision making. The FRC, one of several prominent policy research centers and academic departments housed in the School of Policy Studies, has a full-time staff and affiliated faculty from throughout Georgia State University and elsewhere who lead the research efforts in many organized projects.

The FRC maintains a position of neutrality on public policy issues in order to safeguard the academic freedom of authors. Thus, interpretations or conclusions in FRC publications should be understood to be solely those of the author. For more information on the Fiscal Research Center, call 404-651-2782.

RECENT PUBLICATIONS

A Tax Limitation for Georgia? This brief examines the need for a tax limitation in Georgia and the issues of design of tax or expenditure limitations. (December 2005)

Georgia’s Aging Population: What to Expect and How to Cope. This report analyzes the impacts of Georgia’s aging population on state finances. (December 2005)

Potential Effect of Eliminating the State Corporate Income Tax on State Economic Activity. This report analyzes the effects of state employment and investment of eliminating the state corporate income tax. (October 2005)

Financing an Increased State Role in Funding K-12 Education: An Analysis of Issues and Options. This report presents an analysis of replacing school property tax with alternative state revenue sources. (October 2005)

Neighborhood Dynamics and Price Effects of Superfund Site Clean-Up. This report uses census data to analyze the price effects of superfund site clean-up, inclusive of both direct price effects and indirect effects through clean-up’s effect on neighborhood demographic transitions and reinvestment in the housing stock. (October 2005)

Perfect Competition, Spatial Competition, and Tax Incidence in the Retail Gasoline Market. This report uses monthly gas price data for all 50 U.S. states over the period 1984-1999 to examine the incidence of state gasoline excise taxes. (September 2005)

The Research and Development Tax Credit for Georgia. This report describes the existing Georgia State R&D tax credit and explores the implications of modifying its current design. (September 2005)

Cooperation on Competition: The Multistate Tax Commission and State Corporate Tax Uniformity. This report explores how interstate uniformity of state corporate income taxes has varied over time, the role played by the MTC, and how likely it is that uniformity will be achieved. (August 2005)

Tax Revenue Volatility and a State-Wide Education Sales Tax. This brief examines issues of revenue source stability raised by proposals to shift K-12 education costs from local property taxes to a state-wide sales tax. (June 2005)

Accountability for Economic Development Incentives in Georgia. This report identifies Georgia’s major economic development incentives and other forms of public finance support and calls for a comprehensive evaluation of public expenditures in this area. (July 2005)

Teen Childbearing and Public Assistance in Georgia. This brief examines the link between teen births and welfare. (May 2005)

The Link Between Teen Childbearing and Employment in Georgia. This brief analyzes teen births and employment of teen mothers. (May 2005)

What Georgians Are Thinking About Taxes III. This brief is the third of three briefs reporting on telephone surveys of Georgians. (April 2005)

What Georgians Are Thinking About Taxes II. This brief is the second of three briefs reporting on telephone surveys of Georgians. (April 2005)

Fiscal Capacity of Counties in Georgia. This brief examines the fiscal strength of Georgia’s counties. (April 2005)

Status of Health and Pension Benefits for Employees of the State of Georgia in 2004. This report analyzes the Health and Retirement Package offer to employees of the State of Georgia. (April 2005)

What Georgians Are Thinking About Taxes I. This brief is the first of three briefs reporting on telephone surveys of Georgians. (March 2005)

A Historical Perspective of Georgia’s Economy. This report chronicles the history of Georgia’s economy from the 1950s to the present and provides an outlook for the future growth areas in Georgia. (February 2005)

How Different are Sales Tax Rates Along Georgia’s Border? This brief provides a comparison of sales tax rates in counties on Georgia’s borders. (January 2005)

An Initial Evaluation of a Proposed Statewide Education Sales Tax. This report provides a preliminary analysis of a proposal to replace education property taxes with a statewide sales tax. (December 2004)

For a free copy of any of the publications listed, call the Fiscal Research Center at 404-651-4342, or fax us at 404-651-2737. All reports are available on our webpage at: //frc.aysps.gsu.edu/frc/index.html.
A Tax Limitation for Georgia? - Brief

**Publisher(s):** Fiscal Research Center of the Andrew Young School of Policy Studies

**Author(s):** David L. Sjoquist

**Date Published:** 2005-12-01

**Rights:** Copyright 2005 Fiscal Research Center of the Andrew Young School of Policy Studies

**Subject(s):** Community and Economic Development; Government Reform