The Case for a Virginia Taxpayer’s Bill of Rights
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The Case for a Virginia Taxpayer's Bill of Rights

by Stephen Slivinski and Michael J. New

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EXECUTIVE SUMMARY

The 1990s saw massive budget increases in Virginia: from 1990 to 2001, state spending grew at almost twice the rate of population growth plus inflation. This spending binge led to a massive $1 billion projected deficit in the state, which prompted calls for large tax increases. Yet, despite lawmakers’ claims that they were interested in fiscal control, the suggestions of the Wilder commission—which issued a report detailing over $1 billion in budget savings—were ignored, and the largest tax increase in Virginia history was signed into law.

The sad truth is that this did not have to happen. If Virginia lawmakers had resisted the temptation to spend so much money, the state would not have been in such dire fiscal straits. Despite the claims of lawmakers that they had been dealt a bad hand by the national economic slowdown, the truth is that the problems were of their own making.

The time is ripe for consideration of a spending cap in Virginia. Modeled after the very successful Taxpayer’s Bill of Rights amendment in Colorado, a Virginia tax and expenditure limitation could control spending by holding it to the rate of population growth plus inflation. If such a limit had been in place since 1992, the Commonwealth of Virginia would have been able to avoid the deficit crunch. Indeed, the spending cap would have required the legislature to grapple with the need to reprioritize spending in the state budget and to cut unnecessary and wasteful programs.

If the tax and expenditure limit had also required tax refunds of all surplus dollars, taxpayers in Virginia would have been a cumulative $11.7 billion richer between 1992 and 2002. Even if a portion of those refunds went into a “rainy day fund,” taxpayers would still have benefited from refunds that were much larger than the annual car tax cut taxpayers actually received.
INTRODUCTION: THE NEED FOR A CONSTITUTIONAL SPENDING LIMIT IN VIRGINIA

By the end of 2002, Virginia was facing a budget gap of about $1 billion in fiscal 2003, the largest in its history. Early in 2002, Gov. Mark Warner had tasked a commission, headed by former governor Douglas Wilder, to find budget cuts and savings in the state budget. On December 12, 2002, Wilder’s commission—officially titled the Governor’s Commission on Efficiency and Effectiveness—released its final report. Within the report were detailed suggestions to save Virginia taxpayers more than $1.2 billion. Included in the suggestions were plans to privatize state-run liquor stores and power plants and to eliminate or consolidate more than a dozen state agencies.

Yet, by the end of 2003, the talk of fiscal control was all but dead. Instead, the policies endorsed by lawmakers were accompanied by the mere rhetoric of fiscal control rather than any real action to control spending. When Governor Warner proposed more than $1 billion in tax hikes, he also claimed: “We must continue to find ways to make government more efficient.” Yet, the Wilder commission report collected dust and was ignored. In April, 2004, the Republican-controlled legislature—which had previously expressed staunch opposition to any tax increases—decided to pass an even larger tax increase than the one the governor had proposed, which Warner was more than happy to sign.

By the summer of 2004, national economic growth began to pick up, and state economists predicted that $324 million more revenue than expected would flow into Virginia coffers. Yet, the sad truth was that the tax increases had not even kicked in yet: the sales tax increase, for instance, was set to take effect less than two months later.

Virginia lawmakers were clearly not able to control their appetite for spending. The past few years were not unusual in the context of the 1990s. Indeed, spending was out of control throughout the decade: from 1990 to 2001, state spending grew at almost twice the rate of population growth plus inflation. Politicians of both parties could not resist the temptation to raise taxes or pass large spending increases. Taxpayers were left bewildered, wondering how the system had failed them.

The truth is that Virginia politicians had no incentive or willpower to hold the line on spending. There was no spending cap that could have protected Virginia taxpayers from another attempt by politicians to swipe more taxpayer money. Caps of this sort have been tried in other states, and a few in particular have been remarkably successful. If recent political history is any indication, it could be time for such a cap in the Commonwealth of Virginia.
HOW VIRGINIA GOT INTO THE BUDGET MESS

Virginia, like other states, could have avoided the budget crisis if it had exercised more control over spending during the 1990s. Like their counterparts in California, legislators in Virginia acted as if the state’s high-tech boom—and accompanying windfalls from income and capital gains taxes—would continue indefinitely.

Indeed, between fiscal 1996 and 2001, state general fund spending in Virginia increased by a whopping 53 percent. Why did state expenditures increase so rapidly? An examination of Virginia’s recent fiscal history is instructive. As Table 1 indicates, Virginia failed to implement broad-based reductions in sales or income taxes during the economic boom years in the 1990s. Instead, only targeted tax cuts were enacted.

### Table 1

**Virginia’s Taxing History during the 1990s**

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>Expanded sales tax base; imposed air and water import fees.</td>
</tr>
<tr>
<td>1993</td>
<td>None.</td>
</tr>
<tr>
<td>1994</td>
<td>Postponed changes in income tax withholding; other targeted increases.</td>
</tr>
<tr>
<td>1995</td>
<td>None.</td>
</tr>
<tr>
<td>1996</td>
<td>Postponed income tax credits; postponed sales tax exemptions.</td>
</tr>
<tr>
<td>1997</td>
<td>Increased insurance premium tax.</td>
</tr>
<tr>
<td>1998</td>
<td>Reduced taxes on vehicles; expanded business tax credits; other targeted reductions.</td>
</tr>
<tr>
<td>1999</td>
<td>Reduced sales tax on food for home consumption; other targeted reductions.</td>
</tr>
<tr>
<td>2000</td>
<td>Continued phased elimination of vehicle tax; reduced sales tax on food.</td>
</tr>
<tr>
<td>2001</td>
<td>Raised trucking fees.</td>
</tr>
<tr>
<td>2002</td>
<td>Changed sales and use tax collection schedule; various targeted increases.</td>
</tr>
</tbody>
</table>

Source: National Conference of State Legislatures, *State Tax Actions* (various years).

Indeed, as Table 2 indicates, the annual tax reductions enacted by the Commonwealth of Virginia were less than the national average in every year from 1995 and 2002. Since the revenue windfall during the economic boom was spent by the legislature, Virginia’s budget grew to a level that was unsustainable when the economy slowed down in 2001 and 2002.
Overall, it is clear that Virginia’s fiscal crisis was largely caused by the sharp rate of state budgetary growth during the mid to late 1990s. So what is the best way to limit state expenditures? The strategy preferred by most fiscal conservatives is to elect sympathetic candidates to the state legislature and governor’s office. However, neither Republicans nor Democrats in Virginia have been able to provide the leadership necessary to keep spending in check. A better strategy for fiscal conservatives would be to place constitutional limits on the state government.

For instance, one measure of fiscal discipline that would be effective in Virginia is a Tax and Expenditure Limitation. TELs place a limit on how much state expenditures or revenues can increase during a given fiscal year. New Jersey was the first state to enact a TEL in 1976, and twenty-six states currently have TELs in effect.

**Table 2**

<table>
<thead>
<tr>
<th>Year</th>
<th>Virginia’s Tax Change</th>
<th>Average Tax Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>0.2%</td>
<td>1.3%</td>
</tr>
<tr>
<td>1993</td>
<td>0.0%</td>
<td>1.3%</td>
</tr>
<tr>
<td>1994</td>
<td>0.5%</td>
<td>0.6%</td>
</tr>
<tr>
<td>1995</td>
<td>0.0%</td>
<td>-0.2%</td>
</tr>
<tr>
<td>1996</td>
<td>0.0%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>1997</td>
<td>0.0%</td>
<td>-0.6%</td>
</tr>
<tr>
<td>1998</td>
<td>-1.5%</td>
<td>-1.6%</td>
</tr>
<tr>
<td>1999</td>
<td>-0.4%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>2000</td>
<td>-0.9%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>2001</td>
<td>1.0%</td>
<td>-0.3%</td>
</tr>
</tbody>
</table>

Source: National Conference of State Legislatures, *State Tax Actions* (various years).

WHAT MAKES A GOOD TEL?

Not all TELs are created equal. Some work better than others. Indeed, most of the TELs currently in place are either toothless or don’t hold spending to a strict enough baseline. There are two main properties to distinguish the effective TELs from the ineffective.
1. Limiting the Growth of Expenditures and Revenues to the Inflation Rate Plus Population Growth

An overwhelming majority of the TELs that have been passed since 1976 limit growth in state expenditures and revenues to state personal income growth. However, two states, Colorado and Washington, have recently enacted TELs that limit growth in state expenditures to the inflation rate plus population growth.

This is a more stringent limit. Over the years the rate of growth in personal income has been significantly greater than the inflation rate. Between 1980 and 1990 growth in real personal income exceeded the inflation rate plus population growth by more than 38 percentage points. It should also be noted that holding increases in expenditures to increases in personal income, as most TELs do, sets a relatively low limit for a state to maintain. Between 1980 and 1990 the ratio of state and local direct general expenditures to personal income actually fell in twenty-seven of the forty-nine states considered in our analysis.

2. Refunding Surpluses to Taxpayers Immediately

Another feature that is worth examining is the provision that mandates immediate refunds of any surpluses to taxpayers. So far, four states (Colorado, Michigan, Missouri, and Oregon) have enacted TELs that mandate immediate refunds of revenues that exceed the limit established by the TEL. Such a provision would strengthen any TEL because it would make it difficult for state government to collect or spend excess revenues. In addition, it would give citizens and watchdog groups a greater incentive to see that the provisions of the TEL were enforced. The recent budgetary history of those four states indicates that such refund provisions enhance the effectiveness of TELs in another way. Namely, they create a strong incentive for state legislators to cut taxes when it appears that revenues are going to exceed the limit.

State legislators could simply allow revenues to exceed the limit and subsequently refund the revenue. However, there are logistical and political problems with doing that. First, it is difficult to refund the sales tax to only those who pay it. Also, although it is possible to enact refunds of income or property taxes, legislators dislike doing so. This is because high-income citizens would obtain a high percentage of the refunds, and legislators do not like to be charged with favoring the wealthy. This situation creates a powerful incentive for legislators to cut taxes before the end of the fiscal year so that revenues or expenditures will no longer exceed the limit. Indeed, case studies indicate that Michigan, Missouri, and Colorado (three of the four states that mandate taxpayer refunds) have enacted tax cuts in response to the prospect of having revenues exceed the limit mandated by their TELs.
**HOW WELL DO THESE SORTS OF TELs WORK?**

We used regression analysis to examine this question. In our model, the dependent variable is the annual change in per capita state and local direct general expenditures in 1996 dollars. The analysis examines the effects of TELs with provisions for immediate refunds and TELs that limit growth in expenditures to the inflation rate. Demographic and economic variables are also included to take into account the uniqueness of each state.

The results, summarized in Figure 1, support the idea that certain features can greatly enhance the effectiveness of a TEL. From this regression it appears that TELs that limit increases in spending and revenue to the inflation rate plus population growth have the most promise for reducing spending. If a state passes a TEL that limits expenditures to the inflation rate plus population growth, the regression equation predicts that every year the TEL will reduce per capita state and local direct general expenditures by approximately $114.84. The results indicate that we can be more than 98 percent confident that these TELs have a negative effect on state and local direct general expenditures.

**Figure 1**
**Effectiveness of TEL by Feature**

![Graph showing the effectiveness of TELs by feature.](image)

Source: Authors' calculations.
Likewise, if a state passes a TEL that does not limit state expenditures to the inflation rate plus population growth but includes a refund provision, the regression equation predicts that the TEL will reduce per capita direct general expenditures by $39.80 annually.

Finally, the regression analysis suggests that other TELs that neither limit expenditures to inflation nor have immediate refund provisions appear ineffective at reducing state expenditures. Indeed, the model predicts that if a state passes a TEL that has neither of those provisions, that state’s per capita direct general expenditures will actually increase by $14.59. Overall, this analysis provides strong evidence that TELs can be effective tools for limiting the growth of state expenditures, but only if they are designed properly.

The anecdotal evidence from Washington State and Colorado during the 1990s bears this out. Their experiences indicate that TELs that have low limits and that strictly curtail politicians’ ability to tinker with the system have considerable promise for effectively limiting the size of government.

**Case Study: Washington’s I-601**

In 1993 voters in Washington State enacted I-601, which limited the annual increase in state expenditures to the inflation rate plus population growth. This enjoyed some success in limiting state spending. In the four years before I-601 took effect, spending increased an average of 17.3 percent per year. However, in the four years after I-601 was enacted, spending increased by only 8.6 percent a year. Because spending was held in check, surpluses accumulated. In 1998 and 1999 voters used those surpluses to first lower, then eliminate the car tax, saving taxpayers $1.4 billion.

Unfortunately, I-601 was statutory and not constitutional. As a result, in 2000 the state legislature was able to pass a budget in excess of the limit. The long-term impact of I-601 on budgetary growth in the state of Washington remains to be seen.

**Case Study: Colorado’s TABOR Success Story**

The best example of a successful TEL is Colorado’s Taxpayer Bill of Rights. During the late 1980s and early 1990s, anti-tax activist Douglas Bruce tried to enact ballot initiatives to reduce taxes. After unsuccessful attempts in both 1988 and 1990, Bruce was finally successful in 1992 with the Taxpayer Bill of Rights (TABOR).

The Taxpayer Bill of Rights contains several features that have limited the growth of government and generated tax relief for Colorado taxpayers. TABOR
limits expenditure growth to the inflation rate plus population growth and mandates immediate refunds of surplus revenues to taxpayers. Furthermore TABOR is constitutional, not statutory and, thus, cannot be overturned by the legislature.

Shortly after TABOR was enacted, state revenue began to exceed the expenditure limit that was mandated by TABOR. As a result, Colorado taxpayers were entitled to tax rebates. Overall, between 1997 and 2002, Colorado has reduced taxes more than any other state, issuing annual tax rebates that have totaled more than $3.2 billion (see Table 3).

Table 3
Total Tax Rebates in Colorado under TABOR

<table>
<thead>
<tr>
<th>Year</th>
<th>Rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>$139 million</td>
</tr>
<tr>
<td>1998</td>
<td>$563 million</td>
</tr>
<tr>
<td>1999</td>
<td>$679 million</td>
</tr>
<tr>
<td>2000</td>
<td>$941 million</td>
</tr>
<tr>
<td>2001</td>
<td>$927 million</td>
</tr>
<tr>
<td>Total</td>
<td>$3.2 billion</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on Colorado Department of Revenue, www.revenue.state.co.us.

Although $3.2 billion sounds like a sizable reduction in taxes, how much relief does it provide to a typical taxpayer? Overall, a Colorado resident who earned $30,000 a year between 1997 and 2002 would have received close to $900 in tax rebates from the state government (see Table 4). In contrast, during the same period, that taxpayer would have received only a one-time rebate worth $300 from the federal government. Consequently, over the past five years, that Colorado resident would have received almost three times as much tax relief from the state government as from the federal government.

Table 4
Annual Tax Rebates for a Colorado Resident Earning $30,000

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal Government</th>
<th>State Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>---</td>
<td>$60</td>
</tr>
<tr>
<td>1998</td>
<td>---</td>
<td>$195</td>
</tr>
<tr>
<td>1999</td>
<td>---</td>
<td>$212</td>
</tr>
<tr>
<td>2000</td>
<td>---</td>
<td>$245</td>
</tr>
<tr>
<td>2001</td>
<td>$300</td>
<td>$187</td>
</tr>
<tr>
<td>Total</td>
<td>$300</td>
<td>$899</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on Colorado Department of Revenue, www.revenue.state.co.us.
Even before TABOR was enacted, its political opposition sensed and feared its potency. The *New York Times* demonized it at the “most radical ballot initiative in the nation.” During the 1992 campaign, Gov. Roy Romer repeatedly denounced TABOR, saying that defeating TABOR was the “moral equivalent of defeating the Nazis at the Battle of the Bulge.” He personally attacked TABOR’s author Douglas Bruce, calling him “a terrorist who would lob a hand grenade into a schoolyard full of children.” Finally, Romer predicted that TABOR would result in an economic Armageddon and warned that the Colorado border would have to be posted with signs reading “Colorado is closed for business.”

Since 1992, however, nothing of the sort has happened. In fact, Colorado’s economy has been exceptionally strong. Between 1995 and 2000 Colorado ranked first among all states in gross state product growth. Additionally, during the same period it ranked second in the nation in personal income growth.

In addition to providing tax relief and fostering economic growth, TABOR has also forced Colorado residents to see the costs inherent in government programs. In other states, residents often support higher government spending because they can see the benefits of a particular program, but remain blissfully unaware of the costs that they and other taxpayers will be forced to bear.

However, in Colorado the annual tax rebates bring those tradeoffs clearly into perspective. In every year from 1993 to 1999 there was a proposal on the ballot to either raise taxes or increase spending in excess of the TABOR limit. Knowing these initiatives would markedly reduce the size of their annual tax rebate, voters soundly defeated each of these measures. In 2000, an initiative to increase spending for Colorado schools—Amendment 23—did pass. However, Colorado taxpayers still received tax rebates totaling more than $900 million from fiscal 2001 revenues.

**Refuting the Challenges to TABOR**

Recently, there has been criticism of the Colorado TABOR amendment. Some of this criticism is relevant to a discussion of TELs broadly. Addressing the concerns of critics will allow supporters of TELs to craft a stronger defense of constitutional spending limits and create a better set of rules and assumptions to integrate into the next generation of TELs.

Incidentally, the critics of TABOR in Colorado don’t actually claim that TABOR was ineffective at restraining budget growth. As the Bell Policy Center—the organization that is the leading critic of TABOR in Colorado—states in their February 2003 critique: “While it is not possible to say exactly how much more
Most of criticism of TABOR revolves around the incentives that TABOR creates for legislators and the effect the limit has on certain welfare programs. Those criticisms are explained below, followed by a discussion of their merits.

**TABOR was not able to keep Colorado out of a budget deficit.** It is true that Colorado, like almost every state in the U.S. over the past few years, was plunged into a budget deficit when the U.S. economy slowed. TABOR, however, was never sold to voters as something that could ward off the business cycle or budget deficits. Indeed, the budget deficit would have been far worse if TABOR had not been as effective as it was at restraining spending.

In fact, Colorado voters approved a weakening of the TABOR limit in 2000 by passing Amendment 23. This amendment removed education spending from the TABOR limit and mandated increases in the education rate of spending that equals inflation plus enrollment growth each year. That number has been higher than population plus inflation since 2000, which created a wedge in the budget that contributed to the state deficit. In short, TABOR did not cause the deficit, but voting to weaken it did.

**TABOR encourages a ratchet-down effect.** Opponents of TABOR have pointed out that when there is a net decline in state revenue and spending cuts are made to balance the budget, the new benchmark on which the TABOR limit is assessed is subsequently lower. As a result, it may take a number of years for spending to catch up to the level it was before the spending cuts were enacted. In other words, real per capita spending drops in a situation like this. This “ratchet-down” effect is claimed to be an inherent flaw in TABOR.

Those who argue the ratchet-down effect is an inherent flaw in TABOR are ignoring a key element of TABOR—namely, that voters have the option of approving or declining changes to TABOR that would allow increased rates of spending. If voters are truly unhappy with the TABOR rate of spending growth in the wake of budget cuts, they can remedy the situation at the ballot box provided there is a surplus to spend. (If there is no surplus, increasing spending at a faster rate is a moot point—balanced budgets, after all, are still a requirement in Colorado and most other states.) This criticism of TABOR assumes that there will be surpluses to remedy the ratchet-down effect in subsequent years—surpluses that are arguably a main result of TABOR, not something that occurs in spite of it.

Those who argue the ratchet-down effect is undesirable are substituting their preferences for bigger government for the preferences of voters. If voters prefer
bigger government and share the concerns of TABOR opponents, they can vote to weaken the limit. Yet, TABOR in its current form still garners overwhelming support in public opinion polls. Even during Colorado’s budget crisis, 60 percent supported TABOR in April 2003.25 Electoral outcomes since TABOR’s initial victory in 1992 imply the same thing—voters have turned down all but one weakening of TABOR since then. Colorado voters seem unlikely to prefer big government any time soon.

While ratchet-down effects are arguably overstated at worst and no cause for concern at best, supporters of a TABOR-like amendment in other states might still feel the need to support elements that would mitigate criticism of the limit on those grounds. Ratchet-down effects could be lessened by a TEL that, while it has all of the revenue restrictions of TABOR, is coupled with a budget stabilization or “rainy day” fund. This fund could be used to maintain a level of spending when revenues dip, ensuring that the spending baseline would never drop below a certain floor.

**TABOR encourages sacrificing some programs in the budget for others.** In every state budget, different programs grow at different rates. Because TABOR puts a limit on the overall budget but not on program growth within the budget, some programs will get squeezed for the benefit of other programs. The crowding-out problem is compounded when formula-driven programs like Medicaid take up a larger share of the state budget each year.

Yet, one of the most important incentives that TABOR provides to legislators is the essential need to reprioritize spending in the face of a stringent overall spending cap. The crowding-out phenomenon is inevitable with a universal limit on revenues and expenditures like TABOR.

The fact that legislators have not addressed the pressing need to get spiraling Medicare spending under control is hardly the fault of TABOR. Even though federal mandates often tie the hands of state legislatures, there are plenty of alternatives to the current government-run indigent health-care systems that can be undertaken at the state level.26 Indeed, the same argument applies to any costly government program that expands every year. Creating the political momentum to reform costly programs in the budget is made easier by TABOR, not harder. It may take time to get the attention of legislators—perhaps when Medicare takes a much larger share of the budget than it currently does—but the incentive structure of TABOR is much better than the circumstances most states currently face: a budget system that allows spending to grow without bound.

Incidentally, this critique of TABOR implies the use of baseline budgets—a budgetary assumption where every spending program is assured a percentage increase each year, and legislated declines in the rate of increase are criticized as
“cuts” when they are not in fact net dollar spending cuts. A healthier approach to budgeting would be to assume that no government program can get a free pass each year during the budget cycle. The incentives provided by TABOR reveal in stark terms the problem of allowing any government program to exist on autopilot.

**The formula for TABOR refunds are complicated and encourage class warfare politics.** TABOR requires that any surpluses generated as a result of spending limits must be returned to taxpayers unless voters allow legislators to spend them. However, the TABOR amendment itself does not outline exactly how the process of returning the surplus would work.

This is not a flaw inherent to TABOR, but a reality that often exists as a result of legal necessity. Amendments to state constitutions that are clear and straightforward are not as prone to misinterpretation by the courts or by voters who are being asked to add the amendment to the state constitution. In fact, many states with an initiative process that allows changes to the state constitution require the legislature to pass “enacting” legislation that carries out the mandates in the constitutional amendment. It is this legislation that created the TABOR refund mechanism in Colorado.

Supporters of constitutional limits on government revenue and spending should remember that many states require that ballot initiatives pass a “one-issue test.” This means that a proposed constitutional amendment may only deal with one particular issue. It could be argued that a constitutional amendment that not only limited spending but also outlined how the surplus must be refunded—not to mention whether a refund of a surplus is considered an appropriation or a foregone revenue collection—might be considered two separate issues.27

So, as a matter of law, the legislature in Colorado had to create an enacting statute that outlined the refund process. As expected, this process was drenched in politics. Far from being a simple transaction of dividing the dollar amount of the surplus by the number of citizens in the state, the refund statutes in the wake of TABOR have set up a complex system of credits and a hierarchy of which taxes should be refunded first and, if there is money left over, which should be refunded thereafter.28

Because most state money is fungible, the question of what sort of tax should be refunded is an important question. If only income tax revenue is being refunded, then only income tax filers would receive a refund. But if sales tax refunds were desired, virtually everyone in the state would receive a check, since virtually all Colorado residents pay some sort of sales tax. The largest portion of TABOR surpluses are refunded to Colorado residents in the form of a refund check in this way.
Some supporters of TABOR have critiqued how the rest of the surplus in Colorado is refunded and are concerned about class-warfare politics and a complication of the tax code. That is a valid concern, and one that must be addressed by TABOR supporters. The remedy is likely to be different in each state.

There are benefits and drawbacks to various refund mechanisms. The benefit to refunding the surplus underscores the political calculus inherent in the requirement that the state legislature cannot pass a bill that spends in excess of the TABOR limit without voter approval. Refunds make the tradeoff between future refunds and current spending—and the consequences of increasing the TABOR limit which would amount to a smaller refund later—more obvious. Before TABOR, the support for various government programs was widespread since everybody assumed someone else would be hit with the taxes to pay for it all. TABOR refunds remind individual taxpayers that they are the ones paying for government.

On the other hand, widespread TABOR refunds—such as cutting a check to each citizen—may end up seeming like a redistribution plan, especially if a large number of the refund recipients don’t pay any income taxes or only a small share of sales taxes. Indeed, the Bell Center has pointed out that one of the parts of TABOR it likes is that the convoluted refund mechanism has created a “somewhat more progressive” tax system since the tax credits aimed at poor families were funded from TABOR surpluses.29

Different states may prefer different refund mechanisms. An important lesson that should be learned from the Colorado experience, however, is that refunds should only be returned to those who pay taxes in the first place.

**WHAT SHOULD A VIRGINIA TEL LOOK LIKE?**

A TEL for the Commonwealth of Virginia should include limits on the growth of spending and revenue. That is to say, state spending and revenue should not grow in excess of the sum of population growth plus inflation. The source of data for this calculation (such as the U.S. Census Bureau) should be clearly outlined in the amendment to avoid political gaming of the underlying benchmark for the TEL.

Defining what spending the limit restricting is vital. Putting a cap on too narrow a base of expenditures, or only for particular “on-budget” expenditures, will encourage politicians to move more spending “off-budget” or increase spending in noncapped categories. Thus, it is important to define the spending subject to the cap broadly. The spending that is capped should include all state fiscal year spending...
except expenditures for refunds of any kind or expenditures of money received from the federal government; money received as grants, gifts or donations, which is expended for a purpose specified by the donor; money that is collected for another government; and money received for pension contributions by employees and pension fund earnings, reserve transfers, or expenditures.  

It is also important to define revenue properly in the limit. Most importantly, the definition of state revenue subject to the cap must be identical to the type of spending that is subject to the cap. A TEL could quickly lose its effectiveness if the definitions of the spending and revenue flows subject to the cap differ.

When there is a surplus, two alternatives in regard to the disposition of the excess revenue would be available to the legislature: depositing a portion in the “revenue stabilization fund” and refunding the rest to taxpayers. Virginia already has a stabilization fund that is capped at 10 percent of average annual tax revenues on income and retail sales for the three years immediately preceding. How much of each surplus should be devoted to replenishing the reserve fund (but only if needed, of course) is an open question. However, it is important that, in the case where a surplus is big enough to replenish the entire reserve fund, the surplus not be used entirely for this purpose. In every year there is a surplus, it is important to refund at least some of it, no matter how small the refund. It is also important to place any additional reserve fund deposits under the TEL cap. Additional deposits to the reserve fund should be considered additional spending: after all, any money in the reserve fund is going to be used to pay for future spending and, therefore, should be subject to the TEL limit.

In some respects, the requirement of a refund is an important element of the TEL, yet one of the most difficult to implement. By the same token, restraining spending to the rate of population growth plus inflation and forcing refunds of surplus revenue would encourage the legislature to cut taxes in the current fiscal year. After all, lowering the amount of expected tax collections through rate cuts avoids the hassle of refunding surplus revenue in the future, not to mention that it provides the additional advantage of lowering the tax burden in the best way possible: by lowering marginal tax rates.

However, in the event that surplus revenue is collected, the refund mechanism should be properly defined. Barry Poulson of the University of Colorado at Boulder has suggested in his proposed TEL for the state of Kansas that refunds should be provided to “taxpayers who paid the state ad valorem property taxes or state income, sales or other excise taxes . . . in a manner that is proportional, on a pro rata basis, to the manner in which such taxes were collected from such taxpayers.” This, in theory, eliminates the problem of class-warfare politics being encouraged by the refund mechanism as happened in Colorado where the surplus has fueled
various and sundry nonrefundable tax credits that have made the tax system more complex and given surplus tax money to those who don’t even pay taxes. The Poulson method is preferable since only those who pay taxes receive the refund.

Although it is easy to determine who paid property taxes and income taxes, determining who pays sales taxes is a more difficult matter. A per person rebate, in which a check is sent to everyone regardless of tax burden, would end up refunding a portion of the surplus to those who never paid taxes. A better idea would be for those who paid state property and income taxes to receive either a credit on their next year’s tax return or a refund check. Sales tax rates could be cut by a specific amount that would equal the remaining surplus revenue, thereby giving those who only pay sales taxes (i.e., those who do not have net income tax liability) a form of a “refund” when they shop. Indeed, lower sales tax rates would be a boon to any shopper, rich or poor. In any case, the most important rule to keep in mind about the TEL refund provision is that it should return money to those who deserve it: the citizens of Virginia who pay taxes.

The final important element of a Virginia TEL would require the state legislature to ask for approval from voters to raise the spending limit. Allowing legislators to overturn the limit, even by a supermajority vote—such as two-thirds of both legislative houses, as some states allow—would weaken the limit. If there is one thing that most legislatures across the nation have proven, it is that there exists a broad bipartisan consensus in favor of big government. Getting a supermajority for the destruction of a spending cap is too easy. Voters must be consulted when government wants to undertake expensive new duties: they must be the ones who make the ultimate decision about whether to raise the spending cap or not.

Adding a TEL to the Virginia constitution is complicated by a factor unique to Virginia: the state does not have an initiative and referendum process by which voters can collect signatures and place a TEL on the election ballot. At the moment, only the legislature can place such an issue on the ballot. The likelihood, however, of the legislature allowing voters to restrict their power of the purse is low. Consider also that the most effective TELs have been those that have been imposed on legislatures by voters fed up with big government. There have not been any effective TELs imposed by legislatures upon themselves. However, there is the chance that a majority of legislators could be moved to allow voters to pass a TEL if they are forcefully confronted by visible voter disgust with big government and the legislators who abet it. Or, a politically savvy governor who wants to make spending control the centerpiece of his or her administration might persuade the legislature to submit a TEL to voters.
One thing is for sure: the fight for a Virginia TEL will not be easy. It has the potential, however, to be one of the most important government reforms the state has ever seen.

THE ROAD NOT TAKEN

What if Virginia, like Colorado, had enacted a TEL in 1992 that limited annual expenditure increases to the inflation rate plus population growth? An examination of the relevant budgetary data indicates that expenditures, as shown in Figure 2, would have been restrained and the state could have largely avoided the fiscal crises that it faced in recent years. Expenditures would have been $2 billion lower in both 2001 and 2002, meaning the proposed tax increases in 2003 and 2004 could have been neatly avoided.

Figure 2
Expenditures in Virginia

Furthermore, if Virginia, like Colorado, had refunded this excess revenue, Virginia taxpayers would have received a tax rebate every year since 1995. Table 5 indicates the size of these tax rebates for every year between 1995 and 2002. In total,
Virginia taxpayers would have received $11.7 billion in tax rebates during these eight years.

**Table 5**

Rebates Virginia Taxpayers Would Have Received under a TEL Enacted in 1992

<table>
<thead>
<tr>
<th>Year</th>
<th>Rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>$318 million</td>
</tr>
<tr>
<td>1996</td>
<td>$261 million</td>
</tr>
<tr>
<td>1997</td>
<td>$603 million</td>
</tr>
<tr>
<td>1998</td>
<td>$935 million</td>
</tr>
<tr>
<td>1999</td>
<td>$1,450 million</td>
</tr>
<tr>
<td>2000</td>
<td>$3,095 million</td>
</tr>
<tr>
<td>2001</td>
<td>$2,750 million</td>
</tr>
<tr>
<td>2002</td>
<td>$2,377 million</td>
</tr>
<tr>
<td>Total</td>
<td>$11.7 billion</td>
</tr>
</tbody>
</table>

Source: Authors' calculations. See Appendix for methodology.

**CONCLUSION**

Virginia’s budgetary shortfalls stem not from a shortage of revenue, but instead from an excess of spending. Indeed, Virginia’s increases in per capita expenditures have consistently exceeded the inflation rate for the past two decades. In fact, Virginia’s general fund revenues doubled between 1980 and 1990 and nearly doubled again between 1990 and 2000.34

The best strategy to control the spending predilections of the state legislature is a strong TEL. If Virginia had enacted a TEL similar to Colorado’s TABOR in 1992, Virginia would have avoided the fiscal crisis each of the past two years and taxpayers would have received $13.3 billion in tax refunds. Given the successful track records in Washington and Colorado, policymakers in Virginia should consider adopting a TEL to restrain spending, generate tax relief, and possibly prevent future fiscal crises.
APPENDIX A

Calculating Tax Rebates under a Virginia TABOR

<table>
<thead>
<tr>
<th>Year</th>
<th>Inflation</th>
<th>Population Growth</th>
<th>Actual Expenditures</th>
<th>Limited Expenditures</th>
<th>Rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>2.83%</td>
<td>1.3%</td>
<td>6,800</td>
<td>6,800</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>2.95%</td>
<td>1.2%</td>
<td>7,400</td>
<td>7,082</td>
<td>$318 million</td>
</tr>
<tr>
<td>1996</td>
<td>2.29%</td>
<td>1.2%</td>
<td>7,600</td>
<td>7,329</td>
<td>$261 million</td>
</tr>
<tr>
<td>1997</td>
<td>1.56%</td>
<td>1.2%</td>
<td>8,134</td>
<td>7,531</td>
<td>$603 million</td>
</tr>
<tr>
<td>1998</td>
<td>2.21%</td>
<td>1.1%</td>
<td>8,715</td>
<td>7,780</td>
<td>$935 million</td>
</tr>
<tr>
<td>1999</td>
<td>3.36%</td>
<td>1.4%</td>
<td>9,600</td>
<td>8,150</td>
<td>$1,450 million</td>
</tr>
<tr>
<td>2000</td>
<td>2.85%</td>
<td>1.5%</td>
<td>11,600</td>
<td>8,505</td>
<td>$3,095 million</td>
</tr>
<tr>
<td>2001</td>
<td>1.58%</td>
<td>1.3%</td>
<td>11,500</td>
<td>8,750</td>
<td>$2,750 million</td>
</tr>
<tr>
<td>2002</td>
<td>2.28%</td>
<td>1.3%</td>
<td>11,400</td>
<td>9,063</td>
<td>$2,337 million</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$11,749 million</td>
</tr>
</tbody>
</table>

Source: Inflation data obtained from Federal Reserve Bank of Minneapolis Consumer Price Index Calculator, http://minneapolisfed.org/research/data/us/calc/. Population Growth data obtained from the Bureau of Economic Analysis www.doc.bea.gov. Expenditure data received from Virginia’s Department of Planning and Budget www.dpb.state.va.us. Limit expenditure calculated by using the following formula: Limit Expenditure = Previous Year’s Limit Expenditure*(1 + Previous Year’s Inflation Rate + Previous Year’s Population Growth). Calculations by authors.

ENDNOTES


Authors’ calculations based on data from the Virginia Department of Planning and Budget http://www.dpb.state.va.us.


Ibid.


Ibid.


Authors’ calculation based on data on Gross State Product, from the Bureau of Economic Analysis, www.bea.doc.gov.

Authors’ calculation based on data on State Personal Income Growth, from the Bureau of Economic Analysis, www.bea.doc.gov.


Ibid, p. 17.


For more information on these options, see Steve Moses, “The Long Term Care Dilemma: What States Are Doing Right and Wrong,” American Legislative Exchange Council, September 8, 2004.

Incidentally, the “one-issue test” was enacted in Colorado after 1992. Therefore, TABOR was not subject to it. The issue of whether the refund of the surplus should be counted as an appropriation or as a foregone collection is a legal issue that has to be addressed by supporters of a TABOR amendment. Each state faces different budget rules and accounting procedures that make a one-size-fits-all prescription of this element of TABOR impossible.

For an explanation of the tax refund hierarchy, see “The TABOR Surplus,” Colorado Governor’s Office of State Planning and Budgeting, July 2002.
29 Hedges, p. 35.

30 This definition comes from Barry Poulson, “Tax and Spending Limits: Theory, Analysis, and Policy,” Independence Institute, January 2004, Appendix, which features model legislation for a TEL in Kansas.


32 In his proposal for the state of Kansas, Poulson suggests that the amount of the surplus that can be deposited in the “emergency reserve fund” be limited to 3 percent of the total state revenue limitation for the ensuing state fiscal year.

33 Ibid.


35 Authors’ calculations based on data from the Virginia Department of Planning and Budget, http://www.dpb.state.va.us.
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