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THE TAXPAYER BILL OF RIGHTS: A SOLUTION TO WISCONSIN'S FISCAL PROBLEMS OR A PRESCRIPTION FOR FUTURE FISCAL CRISES?

BY ANDREW RESCHOVSKY*

I. INTRODUCTION

Along with buds on the trees and green grass, the Spring of 2004 brought with it efforts in a number of states, including Wisconsin, to amend state constitutions by adding a so-called Taxpayer Bill of Rights ("TABOR").[1] These amendments, most of which are modeled on a TABOR that was enacted in Colorado in 1992,[2] 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,[3] 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[4]—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 explicit objective of many supporters of TABOR is to reduce the size of state and local government.[5] Although specific proposals for the enactment of a

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1. On November 5, 2003, Representative Frank Lasee was the principal author of proposed constitutional amendment AJR 55 to limit growth of state and local government spending; however, the proposal was subsequently withdrawn. Representative Lasee is preparing a revised version of the proposal.

2. *See* COLO. CONST. art. 10, § 20.

3. *See* CAL. CONST. art. XIIIa, § 1.

4. MASS. GEN. LAWS ch. 59, § 21C (2004).

5. *See* Dick Armey, *Change the State Budget Game; TABOR Brings a New Strategy to the Battle for Limited Government,* CITIZEN FOR A SOUND ECONOMY (Mar. 4, 2004), *at* http://www.cse.org/informed/issues_template.php?issue_id=1706.

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 its constitution to include a TABOR provision.[6] TABOR provides a radical departure from the typical way in which state and local governments make fiscal decisions. If Wisconsin enacted TABOR, spending and revenue decisions would be driven by a set of formula-based rules that are inflexible to changing economic, political, and demographic circumstances, and the state's over 150-year history of relying on representative democracy to make basic fiscal decisions would end. 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 was so fundamentally flawed that drastic measures—in this case a change in the state constitution—were the only possible way to solve the state's fiscal problem.

This Article has four major sections. First, I evaluate the nature of Wisconsin's "fiscal problems" that have led proponents of the TABOR

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6. For an assessment of the impact of TABOR in Colorado, see Nicholas Johnson et al., *Colorado's Fiscal Problems Have Been Severe and Are Likely to Continue, Colorado's Stringent "TABOR" Limit has Worsened the Problems*, CENTER ON BUDGET & POL'Y PRIORITIES (Mar. 17, 2004), *available at* http://www.cbpp.org/3-17-04sfp.pdf; *Ten Years of TABOR: A Study of Colorado's Taxpayer Bill of Rights*, BELL POL'Y CENTER (2003), *at* http://www.thebell.org/publications.html.

amendment to conclude that the only way to solve these problems is to change the state constitution. Second, I will address the use of rate of inflation to restrain growth in per capita or per pupil spending. Third, I attempt to estimate the likely impact of TABOR on the state's ability to provide its residents with public services. Finally, I suggest several reform measures that the state legislature could enact to address most of the state's long-standing fiscal problems without amending the constitution.

II. 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 to adopt TABOR amendments suggests 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 economists, who argue that public officials and bureaucrats are often in a monopoly position and are able to exploit their monopoly power so as to increase public spending beyond the level desired by voters.[7]

The evidence for this assertion is limited, but generally takes the form of survey results that purport to show that respondents want lower taxes and lower spending. These surveys 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, most people are either satisfied with the services they receive or would like their government to provide higher levels of service.[8]

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

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7. *See* William A. Niskanen, *Nonmarket Decision Making: The Peculiar Economics of Bureaucracy*, 58 AM. ECON. REV. 293, 294 (1968); Thomas Romer & Howard Rosenthal, *Bureaucrats Versus Voters: On the Political Economy of Resource Allocation by Direct Democracy*, 93 Q.J. ECON. 563 (1979).

8. In an interesting paper, Professor Susan Welch discusses the "more for less paradox" where citizens appear to want both lower taxes and increased public services. Susan Welch, *The "More for Less" Paradox: Public Attitudes on Taxing and Spending*, 49 PUB. OPINION Q. 310 (1985). 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. *Id.* at 311–12.

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 Article, I address these three claims by exploring the available data.

A. 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.

The falling property tax burden is due in large part to the legislature's 1994 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. Consequently, 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%. By 2001, the property tax burden on the median-priced house had fallen to 5.3% of income—a 17% reduction in property tax burden. Not only had property tax burdens fallen, but also, after adjusting for inflation, the dollar amount of property tax on the median-priced house in Wisconsin was actually $158 *lower* in 2002 than in 1994.[9]

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9. In 1994, the net property tax levy on the median-priced house in Wisconsin was $2586. Eight years later, the levy on a median-priced house was $2428. Rick Olin, *Property Tax Level in Wisconsin, Informational Paper 13,* LEGIS. FISCAL BUREAU 9 (2003), *available at* http://www.legis.state.wi.us/lfo/Informationalpapers/13.pdf. The actual net tax levy for 1994 was $2199, but when adjusted for inflation using the Consumer Price Index, the net property tax levy equaled $2586.

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 $251 million, a reduction of 82%.[10]

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.[11] However, before accepting these data as evidence that taxes in Wisconsin are too high, it is important to address 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 in any way reflect current realities? 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 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.[12] By far the best way to compare the burden on state

10. Rebecca Boldt, *Impact of Use Valuation on Agricultural Land Values and Property Taxes,* WIS. DEPT. OF REV., DIV. OF RES. & POL'Y 10 (Oct. 1, 2002), *available at* http://www.dor.state.wi.us/ra/agipro02.pdf. Because of the shifting of property taxation to improvements, the net impact of use-value taxation was a $212 million (49%) reduction in property taxes on all agricultural property. *Id.* at 12.

11. *See 2002 State & Local Revenue as a Percentage of Personal Income,* U.S. BUREAU OF CENSUS & BUREAU OF ECON. ANALYSIS, *at* http://www.taxadmin.org/fta/rate/02stl_pi.html.

12. During Fiscal Year 2002, Wisconsin ranked 6th 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, based on the author's calculations using revenue data from U.S. Census Bureau, *State and Local Government Finances,* Table 1: State and Local Government Finances by Level of Government and by State, 2001–02, *available at* http://www.census.gov/govs/www/estimate02.html, and personal income data from the U.S. Department of Commerce, Bureau of Economic Analysis, *available at*

residents of funding public services is to look at what the Census Bureau calls *state and local government general revenue from own sources.*[13] In Fiscal Year 2002, Wisconsin ranked 15th among all states (including the District of Columbia) in state and local government general revenue burdens.[14] 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.[15]

Although by the traditional measure of economic downturn 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.[16] As a result, in the three fiscal years since 2001, states have had to close cumulative budget gaps of nearly $200 billion.[17] Although there are no data available that allow us to compare state and local revenue burdens across states for any date more recent than Fiscal Year 2002, the manner in which Wisconsin chose to balance its budget suggests that, when they are finally available, data for the Fiscal Year 2004 will show that Wisconsin has lowered both its tax and general revenue burdens relative to other states. Like most other states, Wisconsin faced large budget deficits in Fiscal Years 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 (individual, sales, and corporate), although they vary over time, have remained remarkably constant over the past nearly 30 years. The data in Figure 1 illustrates tax burdens, measured as tax revenue per each

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http://www.bea.doc.gov/bea/regional/spi.

13. General revenue consists of taxes, charges and fees, and miscellaneous general revenue (including special assessments and interest income). For a detailed definition of general revenue see U.S. Census Bureau, *Government Finance and Employment Classification Manual*, Chapter 7: Revenue, *available at* http://www.census.gov/govs/www/class_ch7.html.

14. Based on the author's calculations using revenue data from U.S. Census Bureau, *State and Local Government Finances*, Table 1: State and Local Government Finances by Level of Government and by State, 2001–02, *available at* http://www.census.gov/govs/www/estimate02.html, and personal income data from the U.S. Department of Commerce, Bureau of Economic Analysis *available at* http://www.bea.doc.gov/bea/regional/spi.

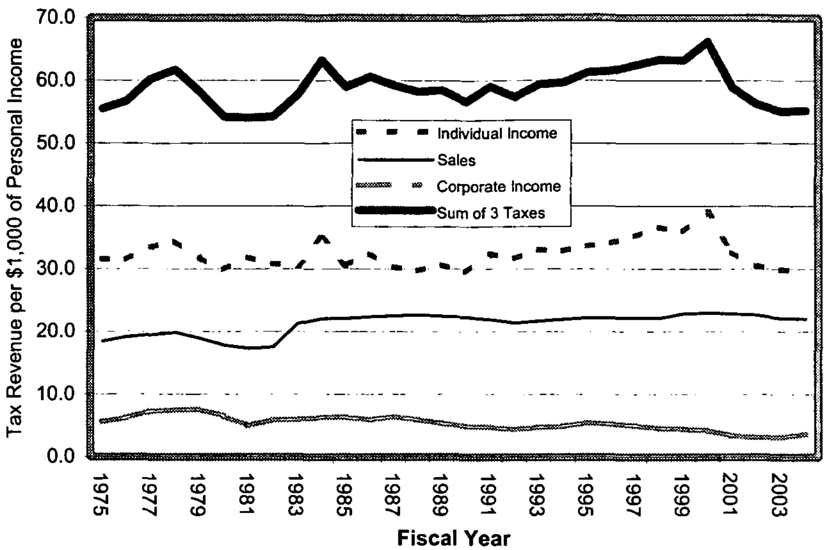
15. Wisconsin's state and local general revenue from its own sources equaled 16.2% of personal income compared to the national average of 15%. *See id.*

16. J. Fred Giertz & Seth H. Giertz, *The 2002 Downturn in State Revenues: A Comparative Review and Analysis*, 57 NAT'L TAX J. 111, 114 (2004).

17. *State Budget and Tax Actions Preliminary Report 2003*, NAT'L CONF. OF STATE LEGISLATURES (2003), *available at* http://www.ncsl.org/programs/fiscal/presbta03.htm.

$1000 of personal income, for each of the state government's three major taxes and the sum of these three taxes.

Figure 1
Wisconsin Tax Burdens: 1975-2004



Over this period, revenue from these three taxes, which in fiscal year 2003 account for 91.3% 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.

B. *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). Representative Frank Lasee, one of the main supporters of TABOR in Wisconsin, recently made this argument quite succinctly, when he stated that "[i]f 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."[18] The problem with this statement is that it is almost certainly wrong. First, the data do not support the contention that Wisconsin over-taxes businesses. 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 Professor Vada Waters Lindsey, over the years Wisconsin has implemented a large number of tax breaks aimed at businesses, and the corporate tax is not a significant generator of state revenue.[19] In addition, 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.[20] 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 businesses' 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 calculations, in the year 2000, Wisconsin ranked 50th among all states (and the District of Columbia) in business taxes as a share of total state and local taxes.[21] 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 38th, and when business taxes are compared to corporate profits, Wisconsin ranks 35th.[22] 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

18. Frank Lasee, *Statement of Rep. Frank Lasee, Author of Lasee-Wood Taxpayer Bill of Rights* (Mar. 12, 2004), *at* www.wiscities.org/TABOR-lasee-3-12.pdf.

19. *See* Vada Waters Lindsey, *The Vulnerability of Using Tax Incentives in Wisconsin*, 88 MARQ. L. REV. 107 (2004).

20. Robert Tannenwald, *A (Not So Quick) and (Not Too Dirty) Way to Compare States in Terms of Business Tax Burden*, 96TH ANNUAL CONFERENCE OF TAXATION, NAT'L TAX ASSN. (2003).

21. *Id.* at Table 1.

22. *See id.*

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 multivariate 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.[23] One important reason that taxes are not 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, 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).[24]

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 the state's 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 the 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

23. *See* Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development* (2004); Michael Wasylenko, *Taxation and Economic Development: The State of the Economic Literature*, NEW ENG. ECON. REV. 37 (1997).

24. *See* Lynch, *supra* note 23, at 20.

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.[25]

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.

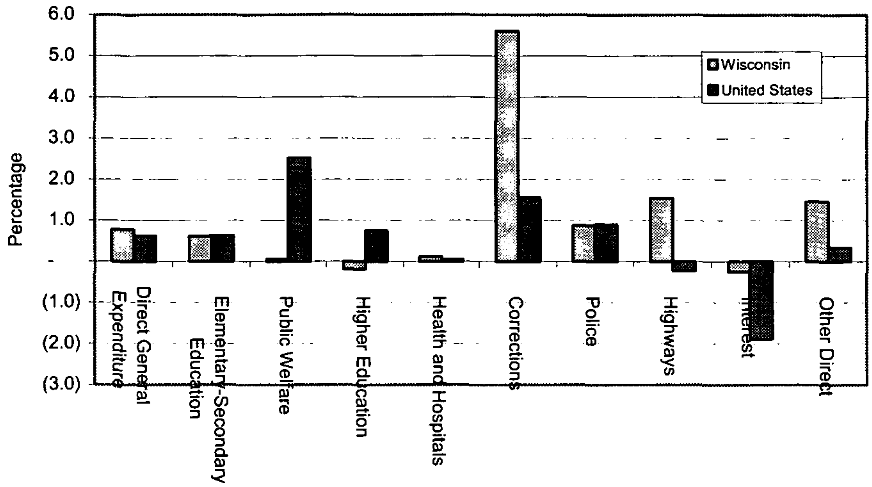
C. Public Spending in Wisconsin

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.[26] 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); however, 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 during the 1990s, the two areas in which annual growth in spending relative to income in Wisconsin significantly outstripped the national average were corrections and highways.

25. *See also* Lindsey, *supra* note 19.

26. Wisconsin's state and local direct general expenditures equaled 21.1% of income compared to the national average of 19.7%. These calculations are made by dividing each state's Fiscal Year 2001–02 spending by the average of state personal income for calendar years 2001 and 2002. The expenditure data are from the U.S. Census Bureau, 2004, *State and Local Government Finances,* "Table 1. State and Local Government Finances by Level of Government and by State: 2001–02," *at* http://www.census.gov/govs/www/estimate02.html. The personal income data are from the U.S. Department of Commerce, Bureau of Economic Analysis (2004) *at Regional Economic Accounts,* "Annual State Personal Income," *available at* http://www.bea.doc.gov/bea/regional/spi/.

Figure 2
Wisconsin Compared With United States
Average Annual % Change in State and Local Expenditures Per $100 of Personal Income--1990 to 2000



III. SHOULD THE GROWTH IN PUBLIC SPENDING BE LIMITED TO THE RATE OF INFLATION?

In the previous section of this Article, 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 appear to be more or less in line with patterns observed in other states. Additionally, there is no compelling evidence that the political system as it now exists does not 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, the former Majority Leader of the House of Representatives and current 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 faster than population growth and the rate of inflation.[27] 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 have been 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 *demand* and *supply* (or cost) side arguments that suggest that the inflation rate is an inappropriate standard for limiting the growth of public spending. With respect to 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 the building and maintaining of city streets, for municipal sewage and water provisions, for elementary and secondary education, for protection of the environment, and for provision of 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.

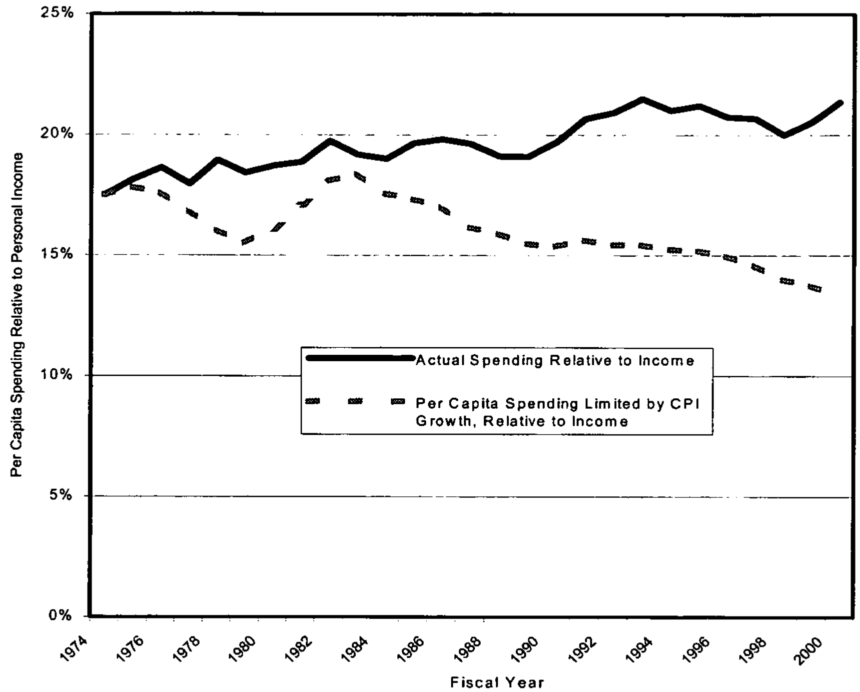
The issue that needs to be addressed is what happens over time to citizens' demand for these government-provided goods and services. As the years pass, not only does the state's economy grow, but most people find that their own economic situation improves. With growing income and wealth, people increase their spending on a range of goods and services. They buy fancier cars, move into bigger houses, buy better quality clothing, and take more elaborate vacations. It is 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 to better prepare 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 the less fortunate. While the increase in demand for all publicly-provided services is certainly not proportional to the growth of income, there is ample statistical evidence that over time, as incomes rise, demands for public services also rise, and for some publicly-provided goods, at a rate even faster than the rate of growth of income.

27. *See* Armey, *supra* note 5.

Figure 3 displays total state and local government spending in Wisconsin relative to state personal income between 1974 and 2000.

Figure 3

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



Over this period, total spending increased from 17.5% to 21% 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% of personal income. During this 26-year period, as the economy of the state grew by 43% 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 could 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 share of state income would deny many residents the additional public services they desire.

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 by Professor William Baumol, for reasons that are beyond 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.[28]

Professor Baumol pointed out that many public services are inherently labor intensive.[29] This is particularly true in the case of education and health care, two of the 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, 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 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 expenditures 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.

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28. William J. Baumol, *Macroeconomics of Unbalanced Growth: The Anatomy of the Urban Crisis*, 57 AMER. ECON. REV. 415, 423 (1967).

29. *See id.* at 423.

Health insurance premiums grew by 10.3% in 2001 and by 10.9% in 2002.[30] By comparison, Wisconsin's CPI rose by 1.8% and 1.3% in these two years.

IV. 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%, 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 CPI for the Milwaukee-Racine metropolitan area.[31] These limits are the same ones outlined by Representative Frank Lasee, the chief assembly sponsor of TABOR, in an April 8, 2004 memorandum. It is important to emphasize that the simulations of TABOR presented in this Part ignore the possibility that voters in the state, individual school districts, counties, and municipalities are free to 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.

30. Katharine Levit et al., *Health Spending Rebound Continues in 2002*, 23 HEALTH AFFAIRS 147 (2004).

31. The 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 available only back to that year.

Figure 4
The Impact of TABOR on State Government Spending

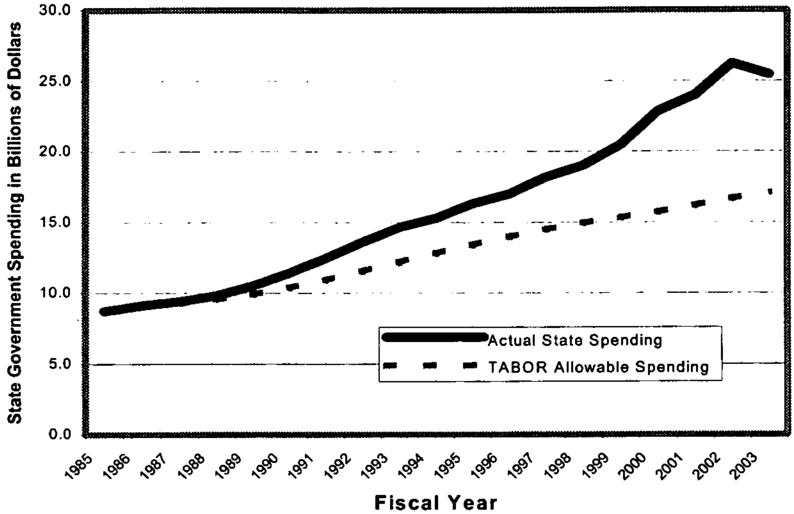
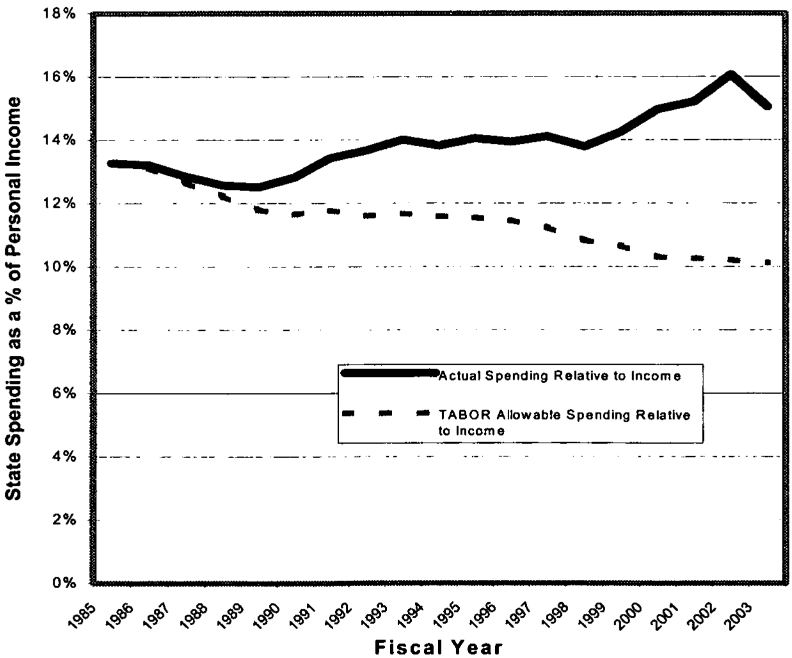


Figure 5
The Impact of TABOR on State Government Spending Relative to Income



A. 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% of actual spending, a difference of over $2.9 billion (measured 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% of personal income. With TABOR in effect, spending would have been limited to 10.1% of personal income by 2003.

Individuals' reactions to Figures 4 and 5 will vary. Some might 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 employees pension obligations and interest on the state debt cannot 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 elderly who lack sufficient resources, further reduce the options available to the legislature for spending cuts. 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 spending cuts may well come from the courts, which may require the state government to either maintain or increase spending in order to fulfill various state constitutional mandates. For example, in *Vincent* *v. Voight*,[32] petitioners challenged the constitutionality of the state school finance system on the basis that it failed to equalize the tax base among school districts. The Wisconsin Supreme Court, while concluding that the finance system was constitutional, held that all students in Wisconsin 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."[33] In nine other states, courts 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.[34] It is unclear how the Wisconsin court would react if, as a result of spending constraints on both the state and local school districts, the quality of public education in the state declined.

Because of the constraints on spending cuts, it is useful to look at the portion of the budget that is easiest to reduce, namely General Fund appropriations. Figure 6[35] summarizes General Fund appropriations for the 2004–05 fiscal year.

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%

32. 236 Wis. 2d 588, 614 N.W.2d 388 (2000).

33. *Id.* at 600, 614 N.W.2d at 396.

34. *See* Jennifer Park, *School Finance, Education Week* (2004), *available at* www.edweek.org/context/topics/issuespage.cfm?id=22.

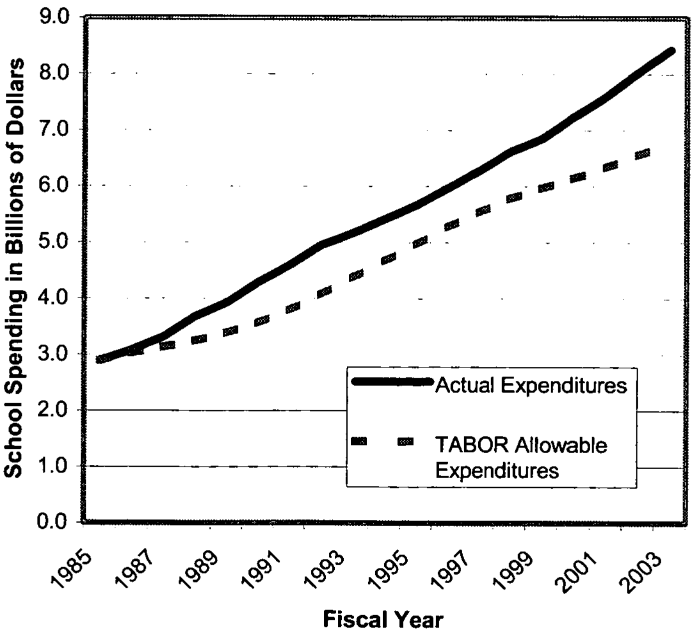
35. Author's calculations based on data from Table 10, WIS. LEGIS. FISCAL BUREAU (2003).

If TABOR had been in place since 1986, there is little question that the General Fund appropriations would have to be dramatically reduced from their current level because of the constraints on cutting other parts of the state budget. The first three categories of spending summarized in Figure 6, state education aid to local school districts, Medicaid, and corrections, account for 64% 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 the 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.

B. TABOR's Impact on Public School Spending

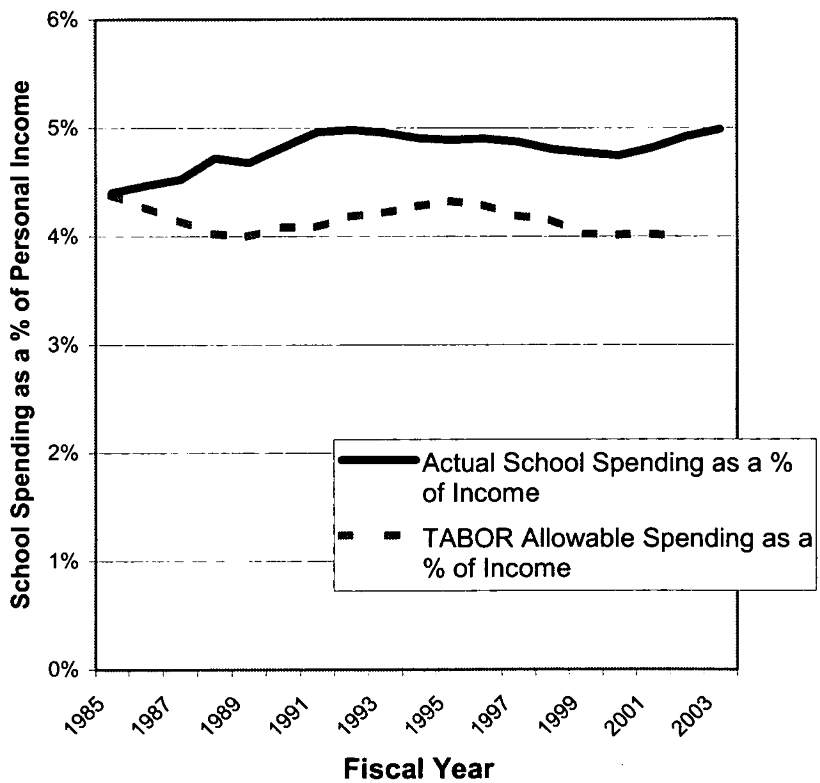
Figure 7 compares actual spending of the state's 426 school districts since 1985 with the maximum spending allowed if a TABOR amendment went into effect in 1986 and no referenda were passed to override the spending limits.

Figure 7
The Impact of TABOR on K-12 Education Spending



The data show that by 2003, public school spending would have been 20% 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 approximately $240 per student.[36]

Figure 8
The Impact of TABOR on School Spending Relative to Income



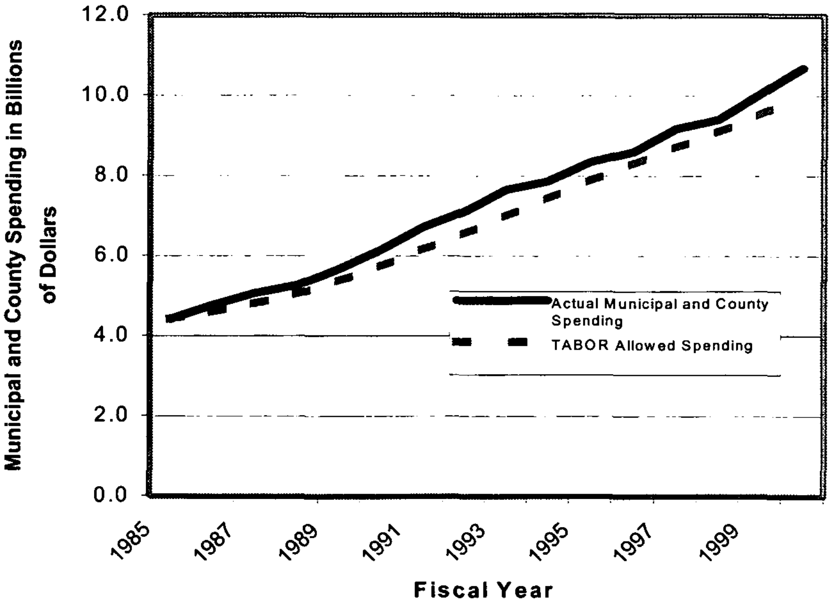
36. For a detailed description of Wisconsin's system of school finance, see Andrew Reschovsky, *Wisconsin's School Finance: A Policy Primer* at 13 (2002), *available at* www.lafollette.wisc.edu/publications/otherpublications/wisconsinprimer/2002.SchoolPrimer2002.pdf.

Figure 8 demonstrates that since 1991, spending by local school districts in Wisconsin has been equal to about 5% of personal income. The TABOR limit would have limited school spending to about 4% of personal income. Although these simulation results 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 successful in passing referenda to override the revenue limits.

C. TABOR's Impact on County and Municipal Spending

Figure 9 illustrates that in the aggregate, TABOR limits will not be binding on total county and municipal spending, even without the passage of override referenda.

Figure 9
The Impact of TABOR on Municipal and County Spending



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 be only 6% 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 percentage 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"[37] 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 will be very strict.

Predicting which municipalities would be successful in passing referenda to allow spending in excess of the TABOR limit is difficult. However, 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 2.5% plus an allowance for new construction.[38] A local referendum was required to override this limit.[39] In a careful study of the results of override elections, it was determined 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.[40] 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-poor communities.

There are additional shortcomings of relying on referenda to make spending and taxing decisions. Under our current system, local voters make

37. The "Expenditure Restraint Program" was created to provide unrestricted aid to towns, villages, and cities meeting certain eligibility criteria. For additional information on the program, see Curt Witynski, *Shared Revenue and Related Municipal Aid Programs: A Primer*, *available at* http://www.lwm-info.org/legislative/revenueprimer.html.

38. MASS. GEN. LAWS ch. 59, § 21C(b) (2004).

39. *Id.* § 21C(c).

40. Katharine L. Bradbury, *Can Local Governments Give Citizens What they Want? Referendum Outcomes in Massachusetts*, NEW ENG. ECON. REV. 3, 10–11 (1991).

fiscal decisions by electing state and local public officials who, in turn, are responsible for deciding the level and mix of public services and level of taxation. 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.

Budget decisions are almost always complex. They require careful analysis and the weighing of tradeoffs. Elected officials, whether they are 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. This suggests that the results of spending and tax referenda may be unduly influenced by special interests. 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 decisionmaking.

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, indicates only 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. Moreover, it is well known that voter turnout for most local elections is very low. 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).

V. ALTERNATIVE POLICIES TO ADDRESS WISCONSIN'S FISCAL PROBLEMS

Arguing that the enactment of a TABOR amendment would be bad for Wisconsin does not imply that the state does not face fiscal problems. In this

Part, 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 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.[41] 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.[42] The fact that most states had not only established rainy-day 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 state 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.[43] 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 require that any tax reduction be matched with offsetting spending cuts. The U.S. Congress operated quite successfully under these kinds of "budget rules" during most of the 1990s, actually achieving a balanced budget by the end of the decade. Both Congress and the Wisconsin Legislature should

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41. Wisconsin enacted a rainy-day fund in 1986, but no monies have ever been transferred to the fund. *See* WIS. STAT. ANN. § 25.60 (West 2004).

42. For a discussion of the use states have made of their rainy day funds, see Bob Zahradnik & Nick Johnson, *State Rainy Day Funds: What to Do When it Rains?* CENTER ON BUDGET & POL'Y PRIORITIES (2002), *available at* http://www.cbpp.org/1-31-02sfp2_htm.

43. For a full discussion of the causes of Wisconsin's structural deficit, see Andrew Reschovsky, *Wisconsin's Structural Deficit: Our Fiscal Future at the Crossroads,* ROBERT M. LAFOLLETTE SCHOOL OF PUB. AFF. (2002), *available at* http://wwwlafollette.wisc.edu/publications/otherpublications/wisconsinprimer/2002/StructuralDeficit2002.pdf.

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. It is likely that many supporters of the current efforts to enact a TABOR amendment see it as another way to reduce 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, achieves its 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 state's individual income tax. No constitutional amendment would be needed, but real property tax relief could be delivered in a timely fashion.

VI. CONCLUSION

In this Article, I have argued that there are no compelling reasons for adding an amendment to the state constitution that would permanently reduce the ability of all governments in Wisconsin to make decisions about spending and taxation. Government spending in Wisconsin is not particularly high, and it is widely recognized that the state 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 administration have taken steps to simplify the regulatory environment. 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 most likely result in fiscal outcomes that do not 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. Finally, these reductions in government services would in the long run do serious harm to the state's economy and jeopardize the future prosperity of Wisconsin's citizens.