When Does the Ballot Box Limit the Budget?

Politics and Spending Limits in California, Colorado, Utah and Washington

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The debate over whether to enact a spending limit in California and exactly what shape it should take has been one of the key policy battles of Arnold Schwarzenegger's governorship. During the recall campaign, Schwarzenegger voiced his support for a cap as a cold turkey cure for legislators' compulsion to spend. "They just can't help themselves," he charged. "They're addicts and they should go to an addiction place (Simerman, 2003)." The special session that he called in the fall of 2003 to focus on the state's budget deficit saw Republican legislators and the governor threatening to propose an initiative limiting total expenditures, though the eventual deal that they reached with Democrats jettisoned a spending cap in favor of tighter balanced budget requirement (Sheppard, 2004; Nissenbaum, 2004). Proposition 76, which was defeated on the November 2005 ballot, was an attempt to deal with a multibillion dollar "structural deficit" in California's fiscal policy by imposing a cap on the budget's size. Rarely mentioned in this debate over a whether California needs a spending limit, however, is the fact that it already has one.

Proposition 4, the so-called "Gann limit," was enacted in 1979 and established a formula limiting the growth of expenditures of tax dollars as part of the state's famed voter revolt against the steeply inflating tax burdens of the 1970s. Although it was modified significantly by the legislatively initiated Proposition 111 in 1990, Poterba and Rueben's (1999) cross-state analysis of fiscal limits still judges California's spending limit to be "binding." Yet California's fiscal history – along with the campaign for Proposition 76 – suggests that the Gann limit has rarely constrained the growth of state government. Since its passage, total spending in the state has continued to exceed the national average by about the same margin. In only one year did the limit force the state to give its taxpayers a rebate, and the "wiggle room" measured by the difference between state funds subject to the limit and the cap itself has averaged $4.8 billion annually since Proposition 4's passage (California

Department of Finance, 2005, Chart L). Some of this leniency was likely anticipated by the sponsors of the Gann limit, and some may be due to the way that 1978's Proposition 13 made it harder to raise taxes in the state. Still, the moral of Proposition 4's story is that California's existing spending limit binds very little, if at all.

This is not terribly surprising. Expenditure and revenue limits belong to a general class of political phenomena that attempt a tough trick: locking in the preferences of a set of political principals by constraining the future actions of potentially hostile agents. Either voters are trying to limit state lawmakers, or legislators in one era are attempting to slow the growth of government under future lawmakers.[1] Regardless, the proponents of these limits face the common principal-agent delegation problem, made especially challenging by the fact that they are trying to constrain behavior long into the future, when they are likely not to be around to monitor it.[2] This is similar to the dilemma faced by legislators attempting to control the executive branch (Kiewiet and McCubbins, 1991; Lupia and McCubbins, 1998; Epstein and O'Halloran, 1999; Huber and Shipan, 2002), legislators on the floor delegating power to committees (Fenno, 1973; Krehbiel, 1991; Rohde, 1991; Cox and McCubbins, 1993, 2005), and voters giving over power to elected officials (Lupia, 1992, Gerber and Lupia, 1995).

The general problem of political principals attempting to control their agents applies at all levels of government. At the federal level, politicians throughout U.S. history have enacted a number of procedural reforms to attempt to control spending. A brief look at the federal level suggests that it is difficult to enact budget reforms that work either at all or for

[1] Fifteen of the 53 tax or spending limits enacted in the American states (some states have enacted both types of limits, and some multiple limits of each type) were adopted through the initiative process (Mullins and Wallin, 2004, p. 13). Legislators played a role in the adoption of the others, either in an attempt to constrain future spending or to act collectively to restrain themselves from their individual incentives to spend.
[2] In fact, Proposition 4 author Paul Gann has passed away, though the "People's Advocate" anti-tax group that he founded lives on.

very long. As early as the mid-1800s Congress had enacted rules designed to control federal spending, suggesting that attempts to limit federal spending are not a recent phenomenon (Schick 1995). More recently, in 1974 Congress passed the Congressional Budget and Impoundment Control Act "to establish national budget priorities;" however, there is little evidence that the Act has significantly affected Congressional spending, even though it has changed the budgeting process (Schick 2005). In fact, since its passage, the government has only met the procedural deadline in the Act once, and other than a brief interlude in the 1990s continues to practice deficit spending. As Schick (1995) argues "no one could claim that having Congress vote on a budget resolution generated lower deficits." Other attempts at preventing future deficits through rules, such as the 1985 Gramm-Rudman-Hollings Act and the 1990 Budget Enforcement Act,[3] proved similarly ineffective. The primary lesson from the attempts to control the federal budget is pointed out by Schick (2005), who notes that "the budget process cannot do what Congress does not want it to do, and Congress itself cannot do what voters do not want."

The outcome of the various attempts to restrain federal spending suggests that such mechanisms are unlikely to be effective, or even if effective in the short term, the controls do not work for long. However, votes in many states have an additional mechanism to exert control over their political agents in the form of the initiative process, which allows voters to affect directly the rules and procedures of budgeting. Kiewiet and McCubbins (1991) lay out the *Logic of Delegation*, showing the situations in which faithful compliance on the part of the

[3] As concern over federal spending escalated, Congress in 1985 passed the Balanced Budget and Emergency Deficit Control Act, commonly called the Gramm-Rudman-Hollings Act, which was designed to reduce the federal deficit progressively between 1986 and 1990. However, the deficit exceeded the legislation's target every year between 1986 and 1990 (Schick 1995). Furthermore, the Act led to "manipulation of budget estimates, bookkeeping tricks in lieu of genuine savings, and deficits much higher than had been budgeted (Schick 1995)." After more years of mounting deficits, Congress in 1990 passed the Budget Enforcement Act, which some scholars maintain had a temporary effect on the federal budget, until the late 1990s when budget surpluses prompted Congress to remove the restraint they had temporarily displayed in the early 1990s (Schick 2005).

agent should be least likely. Tax and expenditure limits seem to fall into this category, because there is reason to believe that lawmakers charged with implementing a limit will be hostile to the goals of its backers.

If lawmaker were fiscally conservative, why would anyone need to constrain them in the first place? We expect that the lawmakers subject to a spending or revenue limit are canny operators with demanding constituencies who often want to see government grow at a faster rate than the limit prescribes. Because it can be difficult to monitor state fiscal actions, lawmakers may have the ability to circumvent limits in ways that are buried deep in the details of thousand-page budget documents. From this viewpoint, it makes sense that the first studies of tax and expenditure limits (TELs)[4] "found limitations to be less effective than their sponsors may have desired (Mullins and Wallins, 2004, p. 15)."[5] But the framers of limits are also strategic political actors who can anticipate end-runs around their limits and attempt to stop them or at least dictate their form. Especially in the most recent wave of TELs, their proponents may have figured out how to be effective principals. Whether they can be successful, to what extent, and what shape the evasions of constraints take are all important not only for assessing the policy impact of TELs but for learning about principal-agent relations in general.

To answer these questions, we propose hypotheses that consider the effects of political strategies on the effectiveness of fiscal limits, and test them using a new approach. Our main conjecture is that principal-agent problems will prevent most tax and spending limits from having their intended effect of reducing the size of state government. Their effectiveness, however, may vary, and the next section of this paper begins by reviewing

[4] We follow the literature in using the phrase "tax *and* expenditure" limit to refer to an institution that constrains either revenues *or* expenditures.
[5] This should not be surprising, since Gerber et al. (2001) found initiatives to be ineffective, or at least unenforceable, in many cases.

subsidiary hypotheses from the existing literature that look at the provisions of TEL laws to predict whether or not they will constrain spending. We agree that this is important, but what has been ignored by the public economics literature are some of the political incentives of the agents charged with implementing these laws. We propose original hypotheses about how – holding constant the provisions of a TEL – the identity of its author, the preferences of future lawmakers, the ease of amending state constitutions, and the need for the limit should influence its effectiveness. Beginning with a detailed look at California's experiences under two versions of its spending limit, we demonstrate how politics can often dampen the impact of fiscal institutions.

We then explore these hypotheses more systematically in Colorado, Utah, and Washington by using a research design that departs from the approach of much of the existing literature (Howard, 1989; Cox and Lowery, 1990; Stansel, 1994; Rueben, 1995; Poterba and Reuben, 1999, 2001; New, 2001; and Johnson and Kriz, 2005) in two ways. First, we conduct time series analyses within states that change their fiscal institutions, rather than cross-sectional analyses across states with different rules. This allows us to isolate the effect of a TEL while holding other state characteristics constant, instead of attributing all of the differences in fiscal patterns across states to the presence or absence of TELs. Second, we look at a number of indicators of state fiscal behavior at the same time, rather than exploring patterns in measures such as spending or credit ratings separately. By viewing the full picture of a state's actions, we can better determine whether its leaders are circumventing a tax and expenditure limit.[6]

[6] We are employing a non-equivalent dependent variable or pattern matching design. In abstract terms, we have a treatment, X, that we expect to affect a set of dependent variables Y_1, Y_2, Y_3, etc. We look to see if X has the pattern of outcomes in the year that we expect. We are implementing this design in multiple cases, as each state adopts a TEL.

I. Expectations about the Effects of Tax and Expenditure Limits

Much of the literature that analyzes tax and expenditure limits in order to see how they shape state fiscal behavior (Howard, 1989; Cox and Lowery, 1990, Rueben, 1995; Poterba and Reuben, 1999, 2001; Mullins and Wallin, 2004; Johnson and Kriz, 2005) or to advise anti-tax activists about how to design the most constraining laws (Stansel, 1994; New, 2001) focuses on the letter of the law. The specific provisions of TELs matter, research shows. How effective one of these laws will become can be predicted by its characteristics, looking at the building blocks of the TELs individually or by categorizing TELs into one of two basic types. Poterba and Rueben (1999) take the latter approach, classifying expenditure limits as either "binding" or "non-binding." Stansel (1994) and New (2001) explore various provisions of TELs one-by-one, asking what makes a TEL more or less binding on the actors of a government. In the first part of this section, we review the propositions and findings of this literature. The research reviewed here generates a set of hypotheses about how various TEL provisions should determine a TEL's effectiveness.

Missing from these discussions of legal provisions and their nearly automatic impacts upon fiscal policy, though, is an investigation of how the political context of a TEL might influence its effectiveness. The nature of the principal and the preferences of the agent should matter, as should the ability of the principal to oversee and reward (or punish) the agent. The structure of this delegation should exert an independent influence on the law's constraining power, even holding constant the provisions of the TEL. To supplement the expectations set forth in the literature on TELs, we propose four additional hypotheses based on the political conditions present at the creation of TELs, the partisan context of their aftermath, a state's broader political institutions, and the need for the passage of the

TEL in the first place. We believe that variations in these factors should condition the effectiveness even of two fiscal constraints with identical provisions.

The two classes of hypotheses that we lay out below – those based on the letter of TEL laws and those that take into consideration their political context – should be thought of as ceteris paribus predictions. Implicit in this statement is the assumption that we are holding factors in the other list constant. So, for example, some of our predictions show how legal provisions should make a fiscal limit potent or powerless, holding constant the political context. Others show how the political context should influence the effectiveness of a TEL, ceteris paribus. Of course, the relationships between legal provisions, political context, and the constraining impact of fiscal limits are likely to be even more complex than we present here. One variable could condition the effect of another. We do not, however, explore the interactive effects that may be present here because, at present, we do not yet have data on a sufficient number of cases to test second order hypotheses. Instead, in what follows we lay out the more straightforward hypothesis about how the provisions of laws and political realities should determine the success of TELs in limiting the growth of government.

A. Expectations About the Letter of TEL Laws

Hypothesis A1 (Stansel 1994). A tax and expenditure limit that covers all types of spending, rather than only the expenditure of tax revenues, will be more effective.

State governments spend money raised from a broad range of revenue sources: income, sales, and property taxes, license and user fees, college tuition, receipts from bond sales, and transfers from the federal and sometimes local governments. Since taxes do not constitute the entirety of this revenue flow, a limit that covers only the expenditures of taxes will not be entirely effective at stopping spending. Whether it is intended or not, the consequence of this loophole is that states will be able to rely more heavily than before on alternative sources of funding in order to finance an uninterrupted expansion of the total size of government.

Hypothesis A2 (Stansel 1994 and New 2001). When it counts any devolution of responsibilities to local government against the overall limit or applies to both state and local governments, a tax and expenditure limit will be more effective.

One way that states can circumvent a spending or revenue limit is by shifting responsibility for state programs to local governments. This also devolves financial responsibility, allowing the state to reduce its spending even though services are still provided and the overall tax burden on citizens remains constant. Both Stansel (1994) and New (2001) predict that a prohibition of this strategy should strengthen a TEL's constraint upon total state and local spending, though neither finds evidence in favor of this contention.

Hypothesis A3 (NCSL 2005). A tax and expenditure limit determined by the rate inflation will be more effective than one that is based on the growth of personal income.

Because much of the impetus of the tax revolt of the late 1970s came from the bracket creep brought by that decade's high levels of inflation, some of the first TELs tied their limits inflation rates as well as population increases multiplied by a base year funding level. Most others used increases in personal income in their formulas (National Conference of State Legislatures, 2005). Since 1980, personal income has grown much faster than the inflation rate, meaning that the few TELs tied to population and inflation provided a much more stringent limit on the size of government during the past twenty five years.

Hypothesis A4 (Stensel 1994). When voter approval or a large legislative supermajority is required for the state to declare a fiscal emergency to suspend its tax and expenditure limit, the TEL will be more effective.

Since the easiest way to circumvent a TEL is simply to suspend it, the level of consensus that is required for an suspension should establish the state's commitment to the

TEL and thus help dictate its effectiveness. Stansel (1994) finds that TELs will have more bite when lawmakers need to obtain voter approval in order to suspend them. If the legislature is allowed to unilaterally suspend a tax and expenditure limit, the limit will not be effective unless the majority required to do so is larger than the coalition needed in order to pass the budget normally. This is the standard that Poterba and Ruebin (1999, p.9) use to characterize spending limits as binding or not.

B. Expectations About the Political Context of TEL Laws

Hypothesis B1 (Gerber et al 2001, Gerber et al 2004). Holding constant its provisions, a tax and expenditure limit passed by the legislature in a state that does not allow direct initiatives should be most effective. One that is passed by the legislature in an initiative state should be implemented less faithfully, and one imposed by an initiative should have the weakest implementation of its provisions.

Gerber and her co-authors invoke principal-agent theory to argue that legislatures and governors will be unlikely to implement initiatives, because they are external impositions of policies that lawmakers did not design and which in many cases they explicitly rejected. Even though legislators may face an electoral incentive to implement an initiative faithfully, Gerber et al. demonstrate that when it is unlikely that they will be sanctioned for their noncompliance, state lawmakers are able to "steal the initiative."

Their argument is based on the assumption that the agents who enforce an initiative have policy goals that are different from those of the principles who proposed it. Consider the probable preferences and incentives of legislators in a state that has passed a fiscal constraint. If the state lacks the direct initiative process, then the limit reflects the sincere preferences of pivotal legislators at the time. Future legislators may or may not share that exact position on future policy, but are elected from the same system and should have similar positions for at least as long as the same party governs the state. A TEL enacted in this manner should have the greatest chance of being faithfully implemented and thus effective. If, on the other hand, voters have imposed a tax or spending limit on state lawmakers, it is likely that they did so because they were unsatisfied with the growth in government. This is the story of the tax revolt. Legislators in this situation obviously have a preference for bigger government than the limit would allow,[7] or else no one would have taken the time and effort to secure passage of the TEL initiative. We expect that they will take advantage of every loophole in the TEL to allow spending to grow by as much as they think they can get away with in the next election. A limit imposed through this path should be least effective. In the middle ground is a TEL passed by the legislature in a state that allows initiatives. There is some probability that the limit reflects the sincere preferences of lawmakers at the time of passage, or it may have been enacted to head off a more stringent TEL initiative.[8] Legislatures should be more likely to hold to their own dictates than to the commands of an initiative, but the possibility that they passed a TEL for strategic reasons suggests that they will have less fidelity to the TEL than they would had they enacted it strictly of their own accord.

Note that this hypothesis is distinct from the contentions of Stansel (1994) and New (2001) that TELs passed by initiative are more effective than those imposed by legislatures because they have harsher provisions. New (2001) shows that direct democracy TELs are more likely to prevent the devolution of responsibilities to local governments, to mandate immediate rebates, to amend state constitutions, and to be tied to the inflation rate than those passed by legislatures. He expects citizen proposed limits to be more effective because they are more stringent, but not does posit any independent influence of the measure's

[7] It is not necessary for every single legislator in a house to desire bigger government than a TEL is designed to allow, and in fact most American state legislatures are composed of at least a minority of fiscal conservatives. But even though many legislators may prefer less spending overall, the impetus for a voter revolt can be created when a majority of them would like to see more money spent in their districts or on their key constituencies and the house collectively backs spending at a high level. A state legislature's failure to solve this sort of collective action problem is similar to the reasons behind the US Congress' frequent failure to pass a balanced budget.

[8] See Gerber (1996) and Lascher, Hagen, and Rochlin (1997) for discussions of the indirect effects that the threat of initiatives – the "gun behind the door" – can have on policy.

authorship (and indeed finds few significant effects of stringency). Since there are some legislatively and initiative-proposed TELs with similar provisions, it is possible to test whether or not the nature of the proposer affects their implementation, holding the letter of the law constant.

Hypothesis B2. A given tax and expenditure limit is more likely to be effective if the lawmakers who set the level of future spending are more fiscally conservative, i.e., TELs work when you don't need them.

This simply states that the preferences of the agent are important. A TEL is an attempt to force future lawmakers to act in a fiscally conservative manner, but they may wish to do so on their own. This is especially likely when a legislature imposes a limit on itself freely, or when a tax revolt leads not only to a TEL initiative but also to a rightward shift in the composition of the legislature. Regardless of the reason, fiscal conservatives have preferences that are most closely in line with those of the agent that imposed the limit. We therefore expect that a conservative state government will be more likely to hold to the spirit of a TEL law than a more liberal one, holding its provisions constant.

To construct a test of this hypothesis, we will need to be able to measure the ideology of lawmakers. Their partisanship will often reflect their preferences, but comparative state research shows that Democrats in one state may be much more conservative than Democrats in another (Erikson, Wright, and McIver, 1993). Consequently, we will look not only at which party controls a state, but also at how liberal or conservative that party is compared to other state parties by considering the ideological positions of state party legislative elites compared to their national colleagues (Erikson, Wright, and McIver, 1993, p. 108). We will focus more on legislators than on governors. In theory, the power of governors over the level of state spending should be at least as great as that of the legislature. Yet study after study has found that there is no link between party control of the governor's office and the size of state revenues or spending (see Kousser and

Philips, 2005 for a review of this puzzle of gubernatorial weakness and new evidence of executive branch influence).

Hypothesis B3 (Kiewiet and Szakaly 1996). In a state where it is easier to amend the constitution, a tax and expenditure limit is less likely to be effective.

In contrast to the federal government's founding document, most state constitutions are long, frequently amended, and concerned with many narrow policy questions. This is especially true where it is easier to amend a state's constitution.[9] The ability to change the highest law in the land opens up an opportunity for state lawmakers or interest groups to avoid the strictures of a TEL without actually altering the limit itself. Even when the TEL is enshrined in the state's constitution,[10] lawmakers or initiative backers can write an exemption into the constitution that is, *ipso facto*, a constitutionally-permissible violation of the TEL. As our case study will relate, California has done this several times by passing tax increases for cigarettes (Propositions 10 and 99) and gasoline (as part of Proposition 111) that generated revenues that were specifically exempted from Proposition 4's spending limits. This is a common way that states can avoid constitutional strictures. As Kiewiet and Szakaly (1996) show, several states have constitutional provisions that prohibit borrowing large sums of money but do so nonetheless by passing bonds as constitutional amendments.

Hypothesis B4. In a low-spending state that is not experiencing a fiscal crisis, the lack of need for a tax and expenditure limit will make it less likely to be effective in reducing spending, i.e., if it "ain't broke," TELs won't fix it.

The approach of our empirical analysis can be thought of in medical terms: we will look at how the treatment of a TEL, given in different dosage levels, affects a state's fiscal

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[9] States that allow direct citizen provisions provide perhaps the easiest route to constitutional amendment, but Bowler and Donovan (2004) show that even initiative states vary considerably in the obstacles that voters must surpass to pass initiatives.

[10] New (2001, p. 6) hypothesizes that "constitutional TELs should be more effective than statutory TELs because they are more difficult to change." Again, this is a theory about changing the provisions of a TEL, and again New does not find any evidence in favor of this proposition.

health. But what if the patient is not ill to begin with? We expect that when a TEL is passed in a state that already spends less than the rest of the nation and is not experiencing any sudden rise in expenditures, it will not produce any effects. If the state is not showing any symptoms, there will be nothing to cure. This raises the question of why any legislators or citizen groups would enact a TEL in such a situation. Although we expect that most TELs are sincere attempts to change the course of fiscal behavior in a state, others might represent attempts by a politician or organization simply to take a position on a high profile issue (Fenno, 1973). In frugal states where citizens have a strong preference for low spending, incentives for politicians or policy entrepreneurs to declare their allegiances to the anti-tax movement should be especially strong. While such a move may help their political careers, it should not have any effect on the states fiscal behavior.

It is worth discussing one final variation in the political context of a tax and expenditure limits passed through initiatives that could influence their effectiveness: the nature of the group proposing it. As Smith (2004) demonstrates, the groups that backed anti-tax initiatives in the mid-1990s differed greatly in their levels of professionalism, organizational history, grassroots reach, and campaign spending. "Once stripped of their populist rhetoric," Smith (2004, p. 109) finds, "it becomes clear that the organizations backing the 1996 initiatives were for the most part not grassroots operations." How should variation in the nature of these groups influence the effectiveness of their efforts? We expect that it alters the provisions of their proposals and their success at the ballot box, but not the TEL's effectiveness afterward. Holding constant the characteristics of the fiscal limit that they backed, the goals and resources of an initiative's authors should have no independent influence on how binding it is in action. We agree that the first part of this causal path deserves further exploration, but assume that the path ends once the letter of the law and its success are determined.

II. Measuring the Full Impact of Fiscal Institutions

All of these hypotheses detail our expectations about how our treatment, the passage of a TEL, its provisions, and the context of its implementation, affect our dependent variable, the fiscal outcomes for a state. What is the strongest research design to test these claims? In this section, we lay out the strategy of our investigation and show how it differs from the approaches of most existing work. As we mentioned in the introduction, our research design relies on time series analyses of states that change their fiscal rules and looks at multiple measure of their fiscal behavior in order to render a more complete verdict on a TEL's effectiveness.

Previous studies explore the effects of state fiscal institutions by making cross-state comparisons, often supplemented by multiple observations of each state over time. They typically regress some measure of fiscal behavior upon a dichotomous variable indicating the presence in each state of their institution of interest (a treatment) as well as a set of control factors that are meant to make the states in the cross-state comparison actually comparable. They interpret the coefficient on their treatment variable as the estimated effect of the institution. This inferential strategy relies explicitly upon the assumption that their set of control variables captures all of the other relevant differences between states and that these variables establish a proxy pretest, or baseline, against which each state's post-test behavior (its behavior after the TEL) can be judged. We find reasons to doubt this assumption, and suspect that the types of states that adopt TELs differ from non-TEL states in unmeasured ways and that these differences may also influence their fiscal behavior. In short, fiscal rules (the treatment) may be endogenous, caused by state-to-state differences that also affect a state's finances (the dependent variable).

We are not alone in our suspicions. Knight (2000) contends that supermajority tax increase requirements are endogenous, and Reuben (1995) proposes that state spending limits are endogenous. Both take the same approach of using instrumental variables to purge the estimated effects of the treatment, fiscal rules, of their bias, contamination from the fiscal outcomes. Both find that this approach significantly alters their findings. While these works are clear improvements on analyses that do not take endogeneity seriously, the utility of their approach for our purposes is limited. Most importantly, it does not allow us to compare the effectiveness of different kinds of tax and expenditure limits. The instruments that they use, primarily the ability of citizens to propose initiatives, can help to predict the presence of TELs, but not their characteristics.

A design that allows us to compare the effects of different types of limits while recognizing that they are not randomly assigned to states is the classic "interrupted time series" study (Campbell and Ross, 1968). Using their language, our treatment group is composed of states that enacted a tax or expenditure limits during the period of our study. We conduct a pre-test by observing their fiscal behavior prior to the enactment and a post-test by taking observations in the years after the treatment was applied. Because other changes may be occurring in these states over time, we guard against history and maturation threats by comparing the history of TEL states to a control group of states that never enacted a TEL.[11] We can estimate the effect of a TEL by comparing the differences between a treatment and control states before its passage to the differences afterward.

[11] Stansel (1994) provides a strong research design that approximates this approach. However, rather than comparing TEL states to a set of control cases, he compares states with a particular type of TEL to the national averages in the five years before and after they enacted their limits. This national average is calculated from

In order to see which types of TELs are most effective, and under what political circumstances, we use a block design that draws its statistical power from grouping together states with similar types of TELs and political conditions. Blocking designs reduce the amount of noise in the observed relationship between the pre-test and post-test observation. We can then compare the estimated effect of one block of TELs with the estimated effect of another block. This requires us to look at the enactment of many fiscal rule changes. In this draft of our research, we focus on the wave of TEL enactments in the West about a decade ago, which provides us with three cases. When we look at other regions and expand our data collection to cover the years leading up to the tax revolt and its aftermath (1970-1990), we will add another twenty cases. Table 1 reports the presence and timing of TEL enactments, as well as two key provisions of the laws.

Table 1. State Fiscal Institutions

	Spending Limit (year passed)	*Revenue Limit (year passed)*	*Constitutional or Statutory?*	*Income or Inflation?*
Alabama				
Alaska	1982		constitutional	inflation
Arizona	1978		constitutional	income
Arkansas				
California	1979		constitutional	income
Colorado	1992	1992	constitutional	inflation
Connecticut	1991		statutory	greater of two
Delaware				
Florida		1994	constitutional	income
Georgia				
Hawaii	1978		constitutional	income
Idaho	1980		statutory	income
Illinois				
Indiana				
Iowa				
Kansas				
Kentucky				
Louisiana	1993	1991	constitutional	income
Maine				
Maryland				

some states with other types of TELs and some states without any TELs, so the observed differences probably understate the effects of a particular sort of TEL.

	Spending Limit (year passed)	*Revenue Limit (year passed)*	*Constitutional or Statutory?*	*Income or Inflation?*
Massachusetts		1996	statutory	state wages
Michigan		1978	constitutional	income
Minnesota				
Mississippi				
Missouri	1980	1996	constitutional	state revenues
Montana	1981		statutory	income
Nebraska				
Nevada	1979		statutory	inflation
New Hampshire				
New Jersey	1990		statutory	income
New Mexico				
New York				
North Carolina	1991		statutory	income
North Dakota				
Ohio				
Oklahoma	1985		constitutional	inflation
Oregon	1979, 2001		statutory	income
		2000	constitutional	state revenues
Pennsylvania				
Rhode Island	1992		constitutional	state revenues
South Carolina	1980		constitutional	greater of two
South Dakota				
Tennessee	1978		constitutional	income
Texas	1978		constitutional	income
Utah	1989		statute	both
Vermont				
Virginia				
Washington	1993	1979	statute	inflation
West Virginia				
Wisconsin				
Wyoming				

Notes: Data on the presence and timing of TELs is taken from Poterba and Rueben (1999), and details of their constitutional status and indexing mechanism from National Conference of State Legislatures (2005). Colorado passed a statutory spending limit in 1991 and then a constitutional limit in 1992. Nevada's 1979 limit is classified as "nonbinding" in Poterba and Rueben (1999), and Oregon's recent passages of both tax and expenditure limits are taken from National Conference of State Legislatures (2005).

We also depart from most previous works by looking at a range of state fiscal behaviors at the same time. The effects of TELs on some of these measures have been studied before. Many authors study spending and revenue levels, New (2001) looks at local as well as state spending, and Poterba and Reuben (1999, 2001) and Johnson and Kriz (2005) examine the effects of TELs on state borrowing costs or credit ratings. We have not come across investigations of the effects of TELs on other aspects of state behavior, such as total debt levels and the use of charges and fees. But what is most clearly missing from the literature is an examination of the impact of TELs on the entirety of a state's fiscal situation.

This is crucially important, since a major theme in the literature is that states can travel a variety of circuitous routes to circumvent the impact of tax and spending limits. They may shift spending to local governments, raise money through direct charges and fees that are not covered by some limits, or finance more capital projects through bonds. If these paths are blocked, they may engage in budget gimmickry that avoids public scrutiny. Nonetheless, these effects are in fact noticed by bond houses that give states credit ratings. In order to capture all of these maneuvers, our empirical sections look at four indicators of state fiscal behavior:[12]

a. Total expenditures by state and local government, per capita. Reported in appropriate editions of the U.S. Census Bureau's annual *State and Local Government Finance* publication, this measure captures the totality of spending within a state. If a state is able to circumvent a TEL by shifting government responsibilities to cities and counties, state-only spending may go down but this measure will remain unchanged. We collected this time series from fiscal year 1969 to 2000.

b. Revenues raised through charges and fees, per capita. Again recorded in *State and Local Government Finance*, this measure serves as a check on whether states move through a loophole that many TELs leave open. In California, for instance, the spending limit only applies to revenues raised through taxation, allowing lawmakers to spend as much as they would like from funds obtained through college tuition, license fees, state parks admissions, and other such charges. We collected this time series from fiscal year 1969 to 2000.[13]

[12] The data and coding used for the analysis in this paper are available upon request from the authors or can be downloaded at http://www.mccubbins.org/. We are grateful to the research assistance of Geoffrey Peppler in assembling this dataset.

[13] For both total state and local spending and revenues from charges and fees, we gathered data fiscal years 1997-2000 from the Census' website, http://www.census.gov/govs/www/estimate.html, accessed in March, 2005. The data from fiscal years 1969-1996 was recorded from hard copies of the census publication by Rod Kiewiet, who has generously shared it with us. Unfortunately, the Census does not report state-by-state detailed spending and revenue figures from fiscal year 2001, ending our time series.

c. State debt, per capita. We collected aggregate debt figures from the U.S. Census Bureau's annual *State Government Finance* publication, and used population figures from *State and Local Government Finance* to convert them into per capita measures. When states are prevented from raising taxes or from spending tax revenues, they may increasing rely on borrowing to finance capital improvement projects. We collected this time series from fiscal year 1988 to 2002.[14]

d. State bond ratings, according to Moody's Investor Service. We gathered these ratings from the U.S. Census Bureau's *Statistical Abstract of the United States*, for 1995 to 2002, and from January issues of *Moody's Bond Record* for calendar years 1988 to 1994.[15] Bond raters and their clients have an immense financial stake in closely monitoring state fiscal behavior, and Johnson and Kriz (2005) show that ratings closely predict state borrowing costs. Looking at this measure allows us to see how lenders view TELs and to identify whether these constraints are combated through budget chicanery.

Our research design allows us to report our spending, revenue, and debt figures in current rather than constant dollars. Rather than directly comparing one state's figures in the period before a TEL enactment to the period after enactment, we will be looking at how states match up against a control group in both eras. When inflation spikes or nationwide changes in the responsibilities of state governments shift, these changes will affect the baseline group as well as the TEL states. Our control group is made up of the 26 states that never enacted tax or expenditure limits, through fiscal 2000. Figure 1 reports our measures for these states, giving a sense of the absolute levels for each figure and how they change over time. In our analysis of three TEL states in Section IV, we will report the ratios of each state's fiscal

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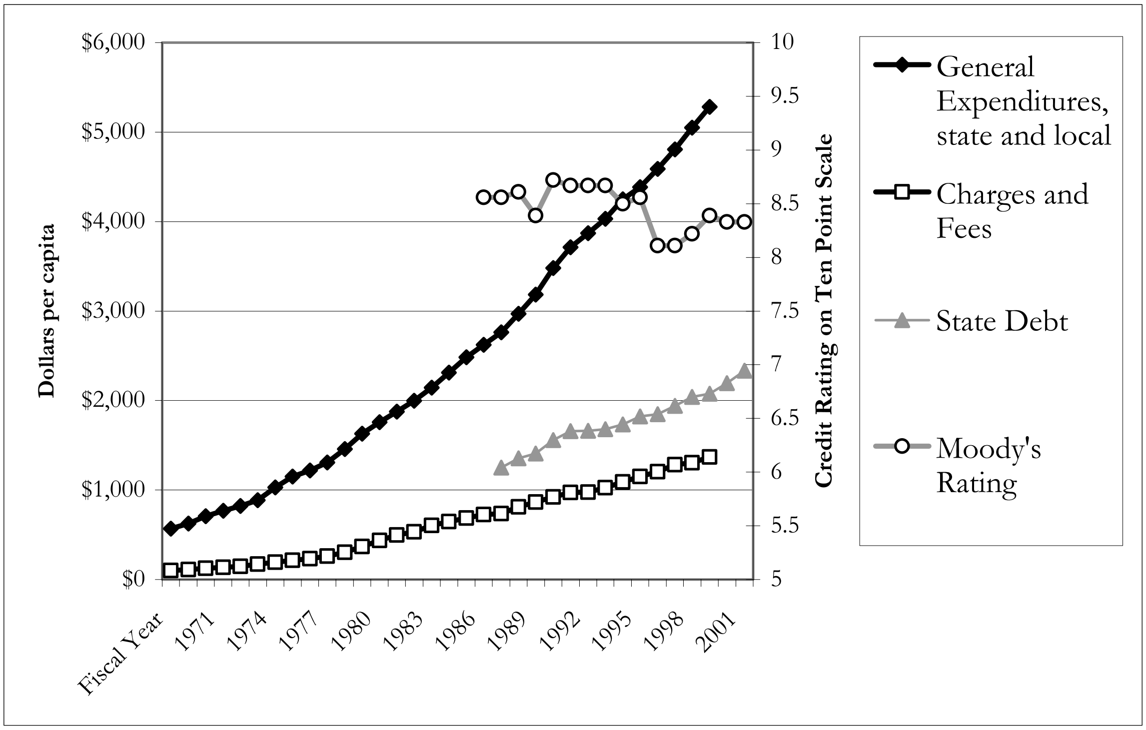
[14] Debt data from fiscal years 1992 to 2002 are available on the Census website, http://www.census.gov/govs/www/state.html, accessed in January, 2005, and data from 1988-1991 were provided to us by the Census Bureau's Ben Shelak, to whom we are grateful.

[15] We take the state's overall bond rating in January of a year as our measure of its average rating over that fiscal year. Although ratings from the two other major credit agencies, S&P and Fitch, are available in the Statistical Abstract beginning in 1995, we only had access to Moody's ratings for 1988-1994. However, our confidence in relying on only one rating service is bolstered by the observation that, during the 1995-2002 period, ratings from the three agencies correspond quite closely. To construct average bond ratings, we assume that ratings are interval variables for which the distance between any two points next to each other on the scale is the same as the distance between any two other adjacent points. A state with an "Aaa" rating is scored a ten, and one point is deducted with each drop of a rating level. Because many states are not typically rated by Moody's, we exclude these cases from our analysis and only have 18 states in the control group of cases that never enacted a TEL.

numbers to the non-TEL average. If enactment of a limit significantly alters this ratio, that will provide evidence of a change in behavior.

Figure 1. Fiscal Patterns in States that Never Enact TELs (26 states)



III. California's Spending Limit

A. Introduction

California's spending limit, Proposition 4, passed with 74.3% of the vote in a November, 1979 special election. The fact that the "Gann limit" won such a large share of the vote demonstrates that voters at the time agreed with proponents of the tax revolt about the need for structural limitations on state government spending. Furthermore, the mandate seemed to indicate that California voters had a vested interest in monitoring the implementation of the expenditure limit in order to ensure its effectiveness at restraining government spending, and to make necessary changes and improvements if it lacked effectiveness. Yet little research has attempted to measure the impact of the Gann limit on

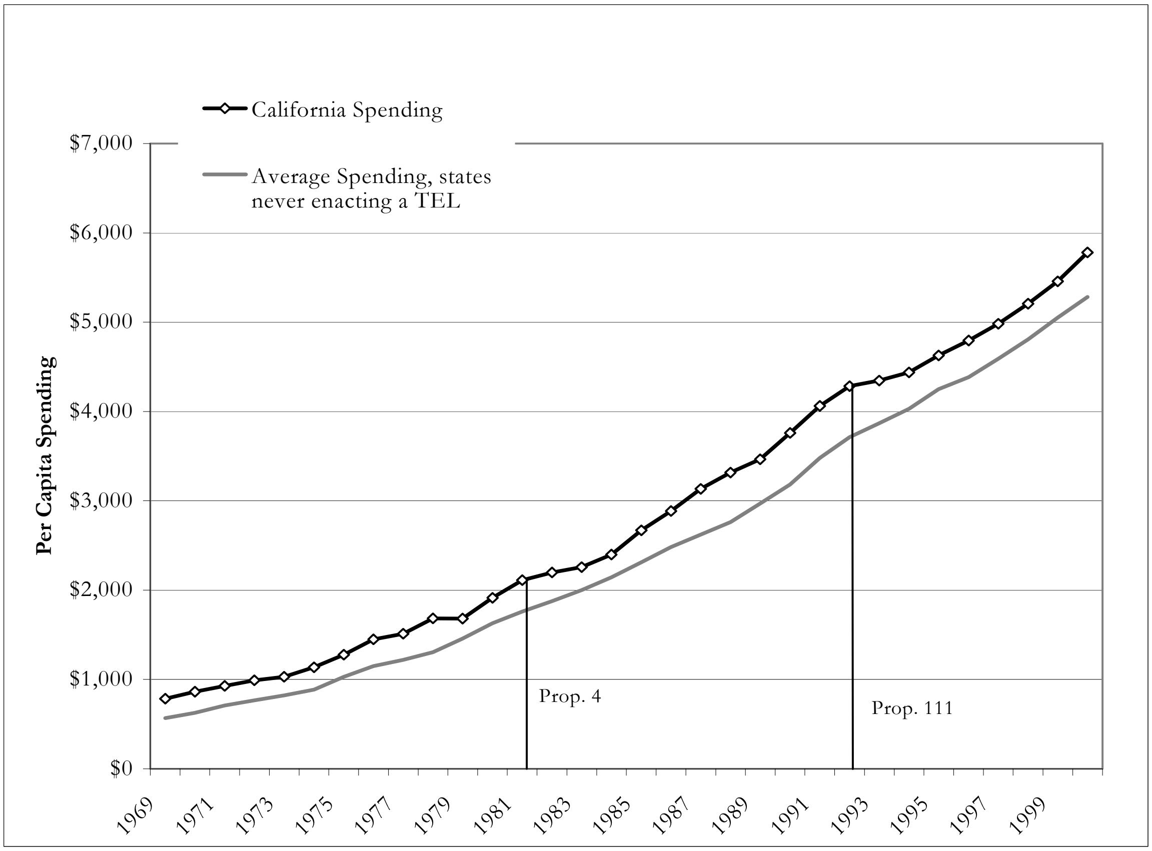
California's fiscal policy. In a study for the Cato Institute, New (2001) looked at the language of expenditure limits and found that Proposition 4 was ultimately ineffective due to, among other reasons, the fact that it did not cap total spending and its dilution by subsequent initiatives such as Proposition 111.

Our study expands on the analysis of these structural factors while undertaking a new approach that looks beyond the letter of California's law and focuses on political and institutional contexts that weakened the Gann limit's ability to constrain state spending. We agree that California's appropriations limit did little to curb spending. This becomes especially clear when we compare the state to a control group: states that have not enacted a tax limit or an expenditure limit. From its inception, the Gann limit was a mostly superficial constraint on the fiscal management of California, and it was practically gutted when the passage of Proposition 111 fueled growth in the cap to practically unreachable levels in the 1990s. Based on an in-depth look at California's experiment with the Gann limit, focusing not only on its language but also on its political and institutional environment, we elucidate the hypotheses listed earlier.

B. Did the Gann Limit Work?

Proposition 4 had little impact on the trend in California's overall state spending. To judge its growth in expenditures to a baseline, we compare California's levels of spending to the average spending of the 26 states that never enacted a tax or expenditure limit. This comparison allows us to control for any national trends in inflation, the devolution of federal programs to states, and other widespread fiscal shifts (i.e., to exclude most history threats). Figure 2 shows that California's spending continued to grow at a pre-Gann limit pace throughout the 1980s and 1990s, always exceeding the comparison group's average.

Figure 2. California's State and Local Spending and the Gann Limit



Notes: Spending figures come from appropriate editions of the U.S. Census Bureau's State and Local Government Finance. *Vertical lines denote fiscal 1981, the first budget written under the constraints of the Gann limit, and fiscal 1992, the first budget constructed under the new Prop. 111 formula.*

California clearly outspent the average non-TEL state both before and after Proposition 4's implementation, with the gap growing in the late 1980s. Figure 2 seems to refute even New's (2001) notion that the Gann limit managed to constrain spending in its early years and only became ineffective when it was amended by Proposition 111. It is of course important to note that Proposition 13, passed in 1978, kept revenues down over this period by limiting local property taxes and requiring a legislative supermajority to raise state taxes. Even in the context of the larger tax revolt, though, California's total expenditures continued to rise. If the success of the Gann limit is to be judged by how California's spending evolved in relation to states without tax or expenditure limits, then our findings show that it failed to constrain the growth of California government in the 1980s and 1990s.

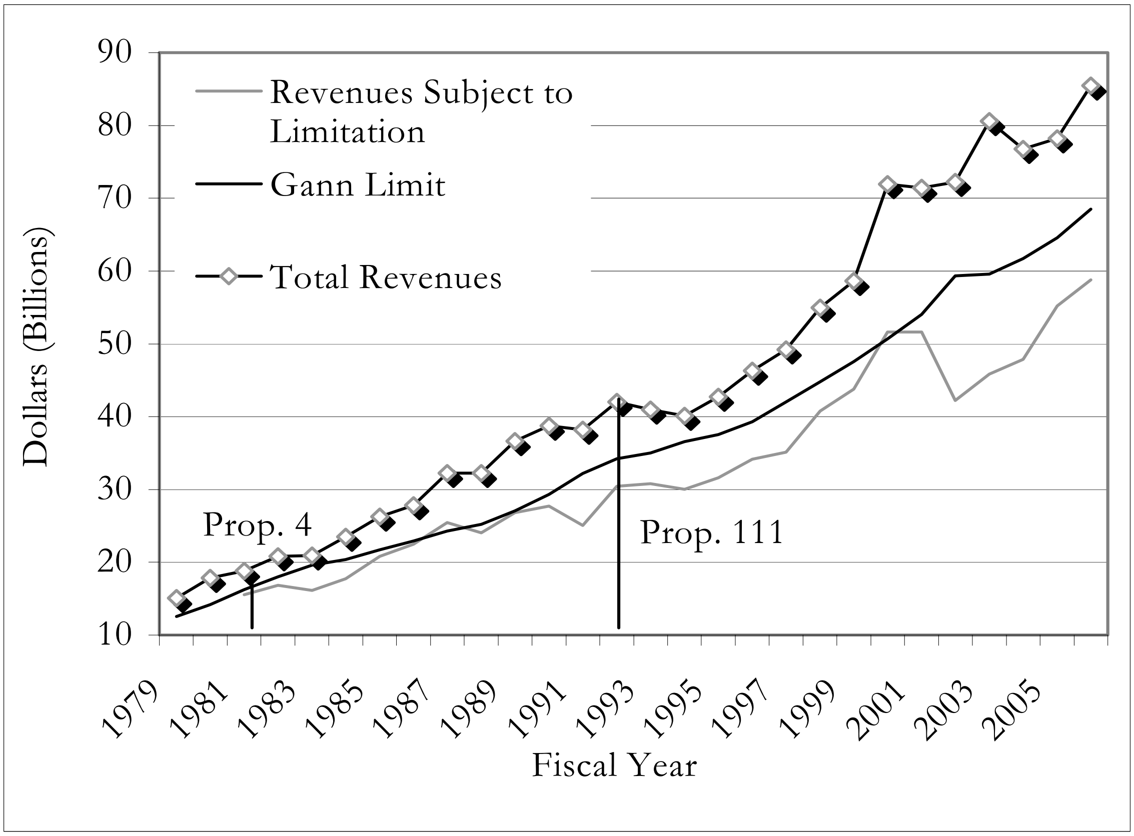
To show why the Gann limit did not lead to a drop in spending growth, we compare the rise of the limit itself to trend in the revenues that were subject to it and to total revenues overall. We find that because Proposition 4 applies only to a portion of the total revenue stream coming into state government, California lawmakers have been able to boost total spending by raising more and more money from alternate sources (which we will later detail). The Gann limit sets a cap on the expenditure of revenues from taxation, which increases over time based on a population plus inflation index.[16] Figure 3 displays the growing gap between revenues subject to limitation and total revenues. It also shows that the Gann limit rarely constrained state spending in California directly; the limit has been reached only twice since the passage of Proposition 4 in 1979. This occurred in fiscal 1987 and fiscal 2000, and only in the first case did the limit trigger a tax rebate.

It is also possible that Proposition 4 indirectly constrained the state's policymakers. They may have wished to increase taxes but realized that the Gann limit would prevent them from spending all of the money that the tax hike raised. But if this were the case, we would expect these savvy policymakers to raise revenues to just under the amount that the Gann limit allowed them to spend. Instead, there is often a wide gap between revenues subject to the limit and the ceiling itself. Graphically, the distance between the "Gann Limit" line and the "Revenues Subject to Limitation" line is one measure of how constraining the limit has been. When this gap is large, lawmakers retain great flexibility in their opportunities to raise taxes and spend the proceeds, without violating Proposition 4.

Figure 3 shows that this gap is often wide, leaving lawmakers with considerable wiggle room under the Gann limit even when their total spending on state government far exceeds the cap. Furthermore, 1990's Proposition 111 changed the calculation of the

[16] Proposition 4 calls for the use of the lower of the following two: CPI or per capita personal income. Every year before Proposition 111, the former was lower than the latter.

Figure 3. California's Spending Cap and Revenue Levels



Notes: Figures taken from Chart A-1 and Chart L of California Department of Finance (2005). Vertical lines denote fiscal 1981, the first budget written under the constraints of the Gann limit, and fiscal 1992, the first budget constructed under the new Prop. 111 formula.

spending cap from one based on inflation to one based on personal income, accelerating the limit's growth rate. Opponents to the proposition warned that the initiative "guts the Gann limit on government spending – under the formula being proposed, government would never reach a spending limit. (Eu, 1990, p. 20)" Indeed, Figure 3 supports this notion, as the gap between the Gann limit and revenues subject to limitation reached unprecedented levels after 1991.

Circumstances surrounding the two instances in which the Gann limit was reached put into question the effectiveness of Proposition 4 in limiting California's spending. The more celebrated of the two occurrences was in fiscal year 1987, when revenues subject to limitation under Proposition 4 exceeded the appropriations limits by $1,183,000,000

(California Department of Finance, 2005, Chart L). Proponents of Proposition 4 hailed the subsequent $1.1 billion tax refund as proof of the effectiveness of a successfully implemented expenditure limit. New (2004) cites this as evidence that "the Gann Limit proved to be relatively effective at keeping spending in check." The large excess in revenues subject to limitation in 1987, however, was due not to careless spending in Sacramento, but rather to federal tax reform that provoked massive sell-off in capital gains.[17] Therefore, the one instance in which the Gann limit seemed to effectively constrain the spending of the state was due to an exogenous shock of no bearing on the fiscal motivations of state lawmakers before or after 1987.

Proposition 111's amendment of the limit, which requires two consecutive years of excess revenues before legislative actions must be taken, made it even less likely that taxpayers would get a refund. The second instance in which tax revenues exceeded the Gann limit was in fiscal 2000, when an excess of $975,000,000 was collected by the state (California Department of Finance, 2005, Chart L). However, revenues subject to the limit were $2,425,000,000 below it the next year, more than wiping out the surplus from the previous year and leaving lawmakers free to spend all of these funds. The unambiguous lesson from the recent history of state spending in California is that Gann limit did not bring a major shift in the fiscal policy choices of California's lawmakers.

C. Why did the Gann Limit Fail to Slow State Spending Growth?

It is clear, therefore, that Proposition 4 failed to meet the demands of voters who supported the initiative. Instead, the Gann limit faded into obscurity and, other than a tax

[17] The link between the federal tax reform and California's finances was explained to us by Fred Silva, former California State Senate budget advisor, in a phone interview conducted by the authors on February 17, 2005. According to Moore and Silvia (1995), "The 1986 Tax Reform Act constituted the largest capital gains tax hike in more than 50 years, raising the top marginal tax rate on long-term capital gains (assets held for more than one year) from 20 percent to 28 percent--a 40 percent increase." California residents realized many capital gains in sales conducted just before this tax increase took effect, bring a large one-time boost to the state coffers.

rebate in 1987, became seemingly a non-issue in the state's fiscal planning. How and why did California's lawmakers manage to cope with Proposition 4 to the point where it had no lasting, discernable impact on state spending? The remainder of our analysis will focus on explaining some of the main reasons for the ineffectiveness of the Gann limit. First, we analyze how the language of Proposition 4 intentionally allowed lawmakers to continue spending at relatively high levels by relying more on non-tax revenues like debt and user charges and fees. We then observe how changes to the language of the limit itself, particularly those enacted by Proposition 111, have further restricted its effectiveness. Second, holding the "letter of the law" constant, we explore why the enactment of the Gann limit as an initiative, and the political and institutional context in which it was created and has existed ever since, made California's expenditure limit ultimately a dead letter.

D. The Letter of the Law

A fundamental analysis of the effectiveness of an expenditure limit begins with a full understanding of its actual language and structure. No two expenditure limits are alike as they can vary across numerous legal and political dimensions. Mullins and Wallin (2004, p.9) note that state government TELs take the form of revenue limits, expenditure limits, a combination of both, or restrictions on "growth in general fund expenditures or appropriations," and that they can be "tied to growth in population, income, prices, the economy, or wages." Poterba and Rubin (1999) argue that they can be binding or not. The provisions of California's particular brand of spending limit help to explain its impact. We show that the Gann limit's exclusion of non-tax revenues from the limit and the formula that Proposition 111 used to calculate the cap left California's spending limit incapable of taming total state spending.

The state's expenditure limit is a ceiling based on annual appropriations for the prior fiscal year. In practice, Proposition 4's formula adjusted this limit according to changes in population and inflation. Revenues that are subject to limit and that exceed it must be returned to taxpayers, either by a rebate or tax rate change.[18] The key detail that hindered the Gann limit's impact on state spending, however, was that it limited only expenditures of revenues from taxation. The circumscribed reach of Proposition 4 fit with the intent of its authors, according to one of them. Craig Stubblebine, now an emeritus economics professor at Claremont McKenna College, was a member of the committee that drafted the Gann initiative. It exempted non-tax revenues from its limits, he reports, "Because if the state provides the services and people want to buy it, and they have other suppliers to chose from, then why limit that?" When asked if the exemption was a political compromise, Stubblebine replied, "Oh, heavens no, it was a way to make sure that the limit didn't stop people who wanted to buy five copies of a marriage license from doing so."[19]

The exclusion of non-tax revenues in the calculation of the Gann limit left many avenues open for the state to raise money that it could spend freely. Figure 4 traces out one of these avenues, "charges and fees." Funds raised from university tuitions, state parks and recreation admissions, state solid waste management and utility revenues, license fees, and other non-tax revenue streams are not subject to California's spending limit. Historically, California has been a state that relied less on charges and fees as a percentage of revenue

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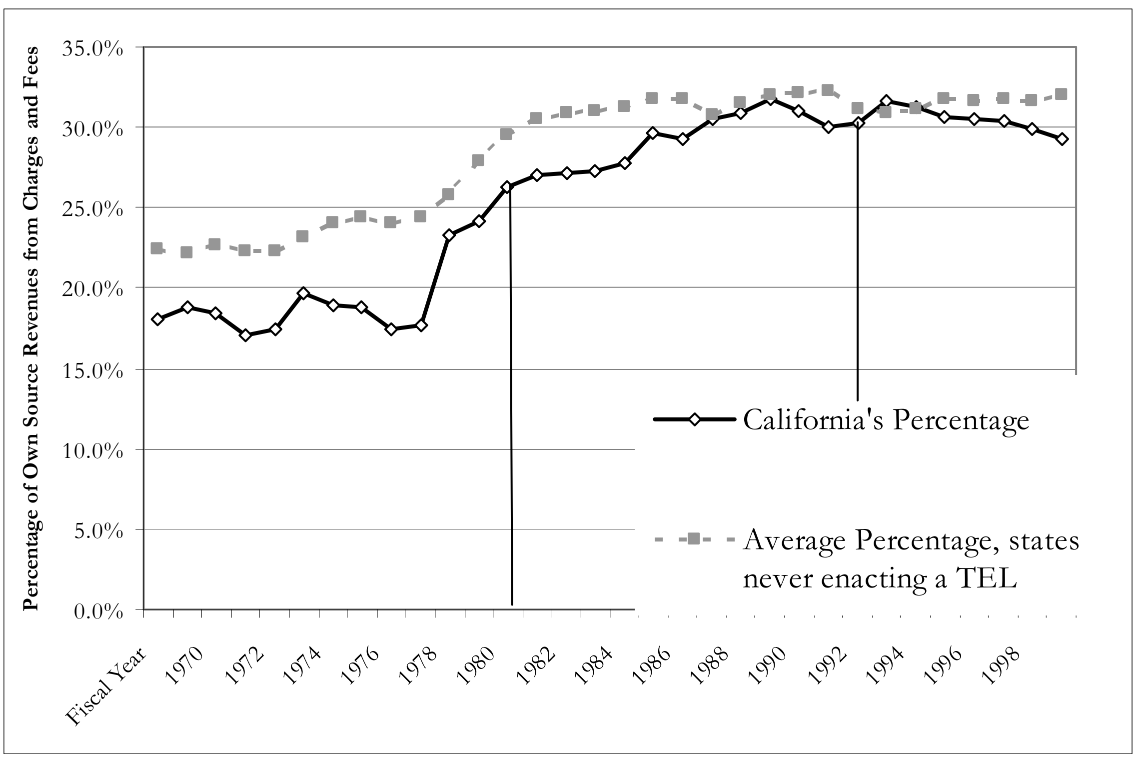
[18] According the ballot issue summary accessed at http://traynor.uchastings.edu/cgi-bin/starfinder/9361/calprop.txt in February, 2005, proceeds from taxes include: tax revenues, proceeds from the investment of tax revenues, and service charges and fees determined to be in excess of the costs of providing them. Revenues not subject to state limitation include: "State financial assistance to local governments . . ., payments to beneficiaries from retirement, disability insurance, and unemployment insurance funds, payments for interest and redemption chares on state debt . . ., appropriations needed to pas for state's cost of complying with mandates imposed by federal laws and regulations or courts order." Since our study focuses on the effects of expenditure limits on state governments, we do not go into detail about the provisions of Proposition 4 that limit local appropriations, though they are similar to those of the state.

[19] Telephone interview conducted by Thad Kousser on March 25, 2005.

than the comparison group. But in fiscal year 1979 and years following, California witnessed a sharp increase in the portion of its revenues that it raised from charges and fees. In fiscal year 1969, fees and charges made up 18.1% of the state's revenue (compared to 22.4% in the average non-TEL state); by 1979, the state's figure increased to 23.3% (compared to 25.8% in the comparison group). By 1994, California's proportion, 31.6%, exceeded the control group average of 30.9%. Many studies attest that Proposition 13, which drastically lowered a major revenue source in property tax and required a 2/3rds majority to pass new taxes, is the most likely cause of California's increased reliance on user fees and charges (Lyon 2000; Shires 1999). One year later, the passage of Proposition 4 further promoted the use of charges and fees as they were categorized with non-tax revenues and therefore not subject to limitation.

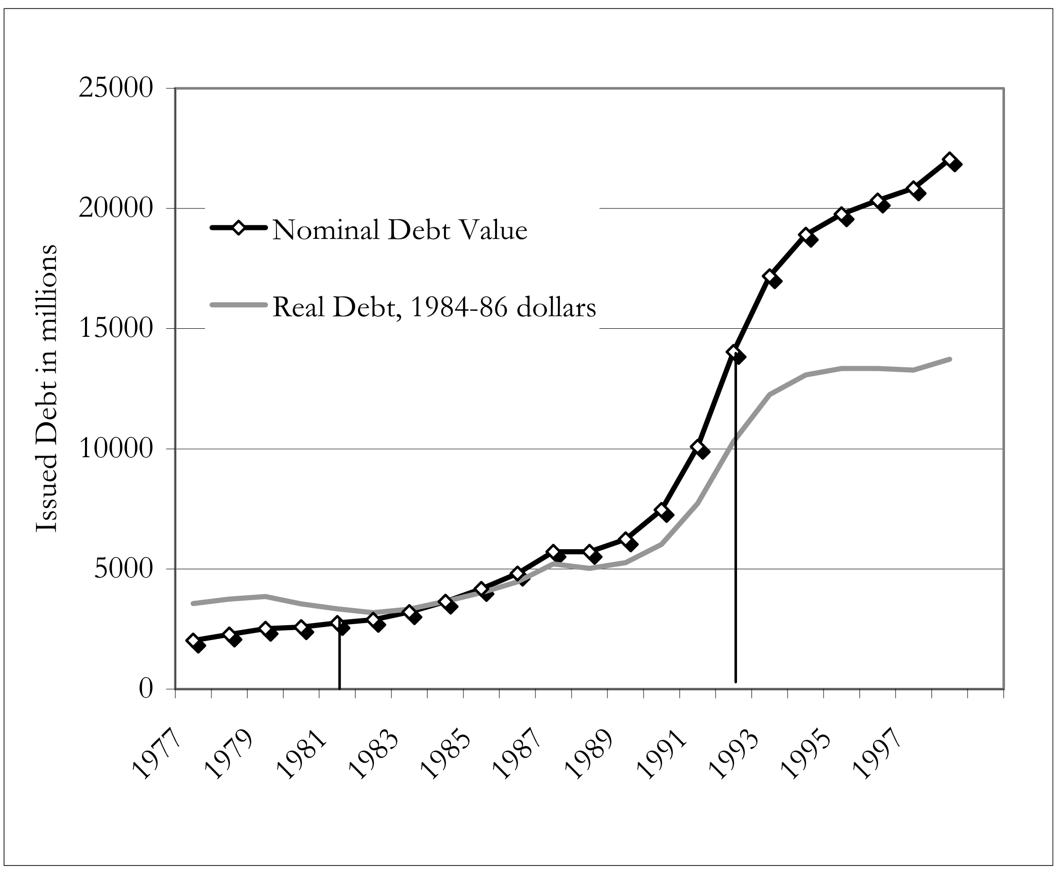
Figure 4. California's Growing Reliance on Revenue from Charge and Fees



Notes: Revenue figures come from appropriate editions of the U.S. Census Bureau's State and Local Government Finance. *Vertical lines denote fiscal 1981, the first budget written under the constraints of the Gann limit, and fiscal 1992, the first budget constructed under the new Prop. 111 formula.*

Borrowing more money through bonds became another means by which lawmakers could continue to spend at pre-Proposition 4 levels well into the 1980s and 1990s. As Figure 5 shows, growth in California's real debt accelerated in the mid 1980s and early 1990s. We believe that the delay between the enactment of Proposition 4 and the actual increase in debt is due to the time it takes to put a bond authorization on the ballot, have it pass, and then issue all of the bonds associated with it. Regardless, California began to borrow much more after the passage of its spending limit, especially during the 1990s. None of these revenues counted against the spending cap. New issues of bonds became another means by which lawmakers could, through the use of non-tax revenues, dampen the effects of the tax revolt.

Figure 5. California's Rising Debt



Notes: Debt figures come from appropriate editions of the U.S. Census Bureau's State Government Finance. *Vertical lines denote fiscal 1981, the first budget written under the constraints of the Gann limit, and fiscal 1992, the first budget constructed under the new Prop. 111 formula.*

Yet it is important to note again that policymakers, and the drafters of Proposition 4, were in fact fully aware that the exclusion of non-tax revenues would allow increases in spending to continue by shifting reliance to these alternate revenue sources. Fred Silva, former senate budget staffer and current senior advisor at the PPIC, explains that "The reason I am sensitive to saying that the governor or the legislature made an end run around the initiative was that the way it was structured was narrow in its limitation from the beginning." Even the Proposition 4's ballot summary clearly stated that "The Impact of this Measure will depend upon future actions of state and local governments with regard to appropriations that are not subject to the limitation of this measure."[20] From its conception, therefore, the Gann limit's fate as an effective expenditure limit rested on what the letter of its law did not do, rather than in what it did.

By turning to alternate sources of revenue, such as debt and user charges, lawmakers are able to undermine the spirit of the tax revolt era and spend freely. Following the trail of money as it enters in the form of revenues until its exit as expenditures is a tenuous and difficult task. One way to uncover the presence of "budget games," that is, if legislators are employing budget gimmicks that shift funds around to avoid the Gann limit, is to look at a state's credit rating. Bond agency ratings may punish states for engaging in such tricks, or they may simply change a state's rating as a mark of approval or disapproval of at TEL's passage and the fiscal implications that it brings.

Several studies have shown that credit agencies closely monitor the fiscal institutions and management of a state to judge its default risk, particularly its ability to make interest payments in the face of adverse events (Poterba and Rueben 2000, Johnson and Kriz 2005). Johnson and Kriz (2005) lay out the groundwork for why "a state's credit rating and its fiscal

[20] Fred Silva was interviewed by the authors by telephone on February 17, 2005, and the ballot issue summary was accessed at http://traynor.uchastings.edu/cgi-bin/starfinder/9361/calprop.txt in February, 2005.

institutions are highly correlated."[21] While Poterba and Rueben (2000, p.iv) find that "expenditure limits such as Proposition 4 lower borrowing costs because they make it easier for the state to service its debt," we have already noted our concerns about their cross-sectional research design. In fact, the history of bond ratings in California tells a different story: lenders penalized the state for passing the Gann limit.

In 1980, following the passage of Proposition 4, Moody's Investor Service lowered California's bond rating from Aaa to Aa, and Standard and Poor's Corporation (S&P) lowered it from AAA to AA+.[22] The state's own report on its bond history cited as the primary reason for the downgrades the "uncertainty over impact of Proposition 13 and the Gann spending limit (California Department of Finance, 2005, Chart K-6)." In 1980 and 1994, credit agencies attributed downgrades in California's credit rating to the state's increasing debt burden, which we categorize as one type of budget avenue lawmakers have pursued to avoid the Gann limit.

One final way in which the letter of the Gann limit is self-defeating results from how its expenditure cap is formulated to increase over time. For a TEL to be a binding constraint on state spending, the rate of growth of the limit must closely resemble the growth in resources available to a state. Proposition 4 indexed the limit to increases in population and, because turned out to be lower than growth in personal income, to inflation. Though Stansel (1994) and New (2001) have pointed out that an "inflation plus population growth" index for an expenditure limit is most effective at limiting spending, we find that in

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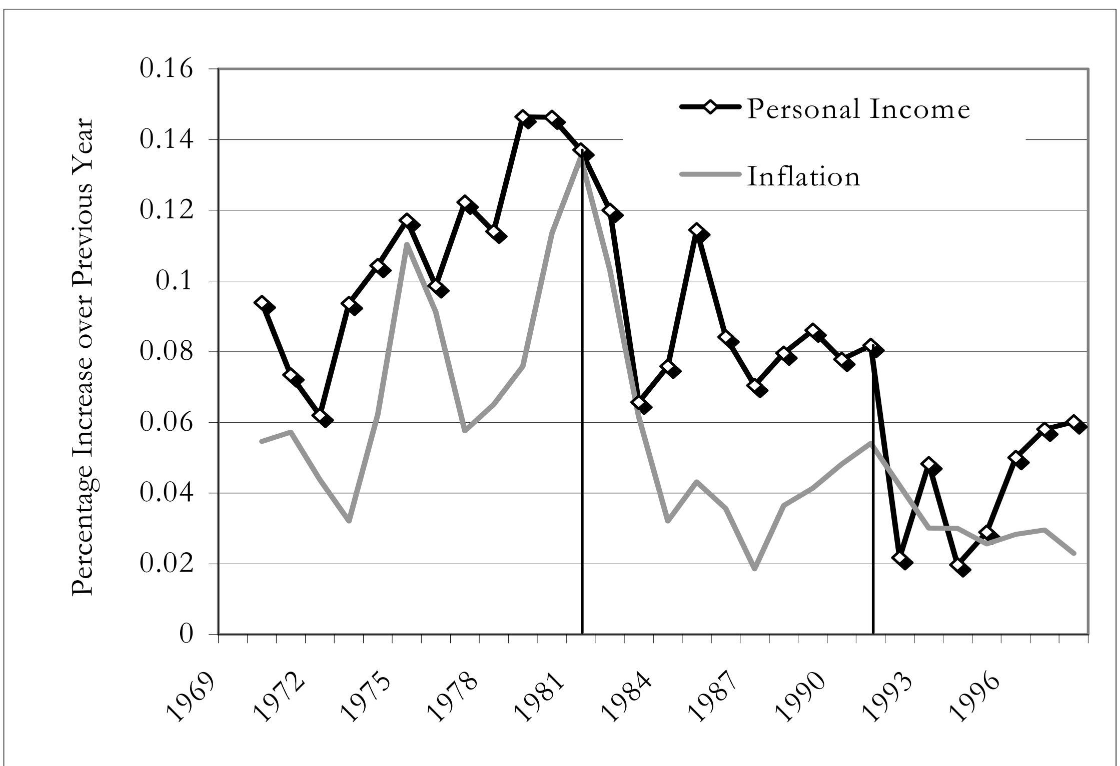
[21] "The financial and debt factors rating agencies consider, such as the government's operating financial condition, tax rate levels, spending levels, and debt burden are directly related to the factors that fiscal institutions exert influences over (Johnson and Kriz 2005, P. 88)."

[22] Bond ratings are for General Obligation Bonds. Summary reports appear in California Department of Finance (2005, Charts K-1 through K-6). S&P and Fitch's run on an index with the following ranking, highest to poorest: AAA, AA, A, BBB, with + (higher rating) and – (poorer rating) used to denote levels in between (AA+ is better than AA-). Moody's index has the following rank ordering, from best to worst: Aaa, Aa, A, Baa, with numbers 1-3 denoting levels in between (AA1 is a better rating than Aa2, which is better than Aa3).

California's case it is still an imperfect tool for gauging the optimal rate of increase for state spending. The infrequency of Gann limit breaches since 1979 seems to support the notion that California's calculation of its appropriation's limit was set too high for constraining state expenditures. Studies have found that many early-stage revenue and expenditure limitations during the tax revolt era failed to limit spending due to over-inflated growth in the limit itself (Kiewiet and Szakaly 1996).

Proposition 111, which switched the cap to an index of the growth in personal income and attendance in public schools, pushed the limit to grow even faster. Figure 6 shows that the high growth rate in the Gann limit following Proposition 111 is due to a historical trend in which growth in personal income has exceeded inflation (as measured by

Figure 6. Comparing Inflation to the Growth of Personal Income



Notes: Figures come from appropriate editions of the U.S. Census Bureau's State Government Finance. *Vertical lines denote fiscal 1981, the first budget written under the constraints of the Gann limit, and fiscal 1992, the first budget constructed under the new Prop. 111 formula.*

the CPI) in every year between 1969 and 1992. This trend helps to explain the increasing gap after 1991 between the appropriations limit and revenues subject to limitation, seen in Figure 3. Proposition 111, therefore, made an already weak Gann limit obsolete as its levels exceeded any reasonable increase in revenues.

E. Political Reactions to a TEL: The Case of the Gann Initiative

For the remainder of this case study, we look at the strategies of circumvention in California. Following our simple principal-agent analogy, we would expect better implementation of an expenditure limit in states without an initiative process, and therefore in places where they were enacted by a willing legislature. This would follow the typical path of public policy, in which the principal delegates the decision-making process to a willing agent, resulting in the enactment and subsequent enforcement of an effective expenditure limit. The prediction is the opposite for states where an expenditure limit is passed through an initiative process. We expect that in these instances, legislatures will circumvent the provisions of the TEL, if at all possible, as the TEL seeks to force the agent (the legislature) to implement a law at odds with its other incentives (to win reelection, to keep power, and so on). In California, the legislature failed to pass a bill proposed by state legislator Robert Boatwright that would have created a spending limit, and the state's residents responded by forcing upon its representatives in the capital the duties of enforcing an expenditure limit that they had actively opposed.

And indeed, the California legislature did not look like a likely place where expenditure limits would be implemented. The ideology of the state's legislators and governors can provide an accurate prediction of the willingness of California lawmakers to implement any kind of expenditure limit, and especially one forced upon them through the initiative process. We would expect compliance with an expenditure limit to be an increasing function of the conservatism of a state's legislatures and governors. Based on Erikson, Wright, and McIver's (1993) finding that more conservative states tend to spend less money, fiscal conservatism should promote an expenditure limit and help assure its implementation. According to an index of party elite ideology measured around the time of the passage of Proposition 4, California's Democratic political elites were the most liberal in the country, while its Republican elites were more in the middle of the pack (Erikson, Wright, and McIver, 1993, p.102-3).[23] Unfortunately for the backers of the Gann initiative, Democrats have controlled both houses of the legislature in every year but one since its passage. It is not surprising, then, that they took many actions to maintain high governmental spending.[24]

The ease of amending California's constitution provides an institutional reason to doubt that the Gann limit would be binding. In fact, the limit constantly faces the threat of being sidestepped by constitutional amendments. The clearest example comes in the recent history of cigarette, tobacco and gas taxes in California. In 1988, Proposition 99 created an additional tax on cigarette and tobacco distributors. Proposition 111 raised the California gas tax and truck weight fees in 1990. In 1998, Proposition 10 further increased the cigarette tax, this time by $.50 per pack.[25] All these propositions exempted the tax revenues that they

[23] Using a composite of ideology studies from the 1970s and 1980s, Erikson, Wright, and McIver generate an index of scores that compares the following: "State scores for the activist (county chairs plus convention delegates) and electoral (congressional candidates plus state legislators) components as well as for the overall samples of party elites." Moving away from zero into positive numbers indicates increasingly liberal ideologies, while moving towards negative numbers indicates increasingly conservative ideologies. The Democratic elite overall score of 7.47 decomposes as follows: 3.44 for activists and 4.03 for electoral elites. The Republican elite overall score of -3.44 decomposes as follows: -2.12 for activists and -1.28 for electoral elites.

[24] One of Proposition 4's authors, Craig Stubblebine, notes that just as political realities dictated the effectiveness of the Gann limit, the extent to which politicians circumvented the initiative may have dictated their political fates: "If you had applied the original Gann limit, the state wouldn't have gotten into the problem that it got into in the early 2000s. It would have smoothed out the spending increase in the late 1990s that came from the .com boom, and Gray Davis would still be governor." (Telephone interview conducted by Thad Kousser on March 25, 2005.)

[25] Details of all three propositions can be found at the Hastings Law Library's California Ballot Measures Database, posted at http://holmes.uchastings.edu/library/Research%20Databases/CA%20Ballot%20Measures/ca_ballot_measures_main.htm.

raised from the spending limit, showing how easily a constitutional amendment can be overridden by subsequent constitutional changes.[26]

One of the Gann limit's authors, Craig Stubblebine, explains the problem faced by TEL supporters in language similar to our Hypothesis B3. "If people find the limits too constraining, they will find a way out of them. That means voters, legislators, interest groups. Here's the dilemma, in my judgment. Take a state like California that has a very well developed initiative process. That's a godsend for passing the Gann limit, but it also provides an avenue for anyone who wants to get around them… The easier it is to do an initiative, the less effect a limit will have over time.[27]"

Lessons from California

Our case study of California shows that both legal and political factors can prevent an expenditure limit from effectively constraining state spending. We expect our findings to successfully extend to other states. Our analysis of trends in California's total spending levels, use of charges and fees, debt, bond ratings, and cost of living indexes lead us to conclude that Proposition 4 was and is incapable of constraining state spending. We will use similar measurements for determining the effectiveness of other types of expenditure limits in our multiple state analysis.

Holding the letter of the law constant, we found that the effectiveness of expenditure limits also depends on the political and institutional context in which they exist. In California, where constitutional amendments were employed to raise gas and tobacco taxes, the expenditure limit was enacted through the initiative process and targeted at an unreceptive legislature, and where the liberal ideology of the policymakers undermined

[26] This only includes those instances when a proposition passed. There were also attempts to levy taxes on alcohol (Alcohol Surtax Fund, 1990 General Election) and gas (Public Transportation Trust Funds, 1994 General Election).
[27] Telephone interview conducted by Thad Kousser on March 25, 2005.

implementation, we found high levels of circumvention that made the Gann limit a nonbinding constraint on state spending. In our multiple state analysis, we expect to find a pattern of results similar to what we found in California. Limits passed by initiative, those enacted in states where it is easier to amend the constitutional, and those depend upon liberal lawmakers for implementation will all be less effective. Our case study of California's experiment with an appropriations limit allows us to understand in greater detail how the design of TELs and the context in which they are born affect their potential for constraining state spending.

IV. Other Tax and Expenditure Limits

This section explores whether the ineffectiveness of the Gann limit is a phenomenon unique to California, or whether a similar story holds in other states. The scope of our multiple state investigation is limited by data availability. Many states passed their TELs in the first wave of the tax revolt, but our comprehensive fiscal measures only start in the mid-1980s. Because we do not yet have the full picture of the policies chosen by Arizona, Idaho, Montana, Nevada, and Oregon in the 1970s, we cannot analyze the effects of their circa 1979 TEL enactments at this time. We focus instead on Colorado, Utah, and Washington, the states that passed revenue and spending limits during our period of study.

We look at each state individually, comparing its fiscal patterns to the averages in our group of control states (those that never enact a TEL). Our tables track four facets of fiscal behavior over time, reporting the ratio of a western state's levels to the control group's average. To measure a TEL's overall effectiveness, we look at whether it changes total state and local spending levels. If it does not reduce the size of government, relative to the control group average, then we look at other measures to see how lawmakers may have circumvented their limit. Did they begin to raise more money from fees, or sell more bonds? How did credit agencies respond to the new fiscal rules? Our four time series allow us to answer these questions. Finally, we compare the effectiveness of limits in these three states. Paying attention to the letter of each TEL law and the political conditions under which it went into effect allows a tentative exploration of our hypotheses.

Colorado's Taxpayer's Bill of Rights (TABOR) initiative, passed in 1992, has many of the characteristics that prior research would suggest are necessary to ensure its success.[28] This constitutional amendment limits all taxes and revenues at the state and local level, and requires voter approval for any tax increases or to change TABOR itself. The caps on expenditures and revenues are indexed to inflation, rather than personal income (National Conference of State Legislatures, 2005). The amendment's drafters appear to have learned from the mistakes of past TELs. Political conditions in Colorado also generally bode well for the initiative's effectiveness. Colorado had a Republican-controlled legislature throughout the period of our study, but TABOR came into effect just when gubernatorial party control was beginning to shift. The state was moving from the era of moderate Democratic governors Dick Lamm (1974-1986) and Roy Romer (1986-1998) into conservative Republican Bill Owens' tenure. Presumably, a unified Republican government would be unlikely to attempt to circumvent the spirit of a TEL. Even though it was externally imposed by a citizen initiative, TABOR set limits that subsequent state lawmakers, especially after 1998, would want to follow.

Figure 7 shows that Colorado's strict spending and revenue limits appear, at first, to constrain the size of government. Prior to TABOR's passage, total spending in Colorado

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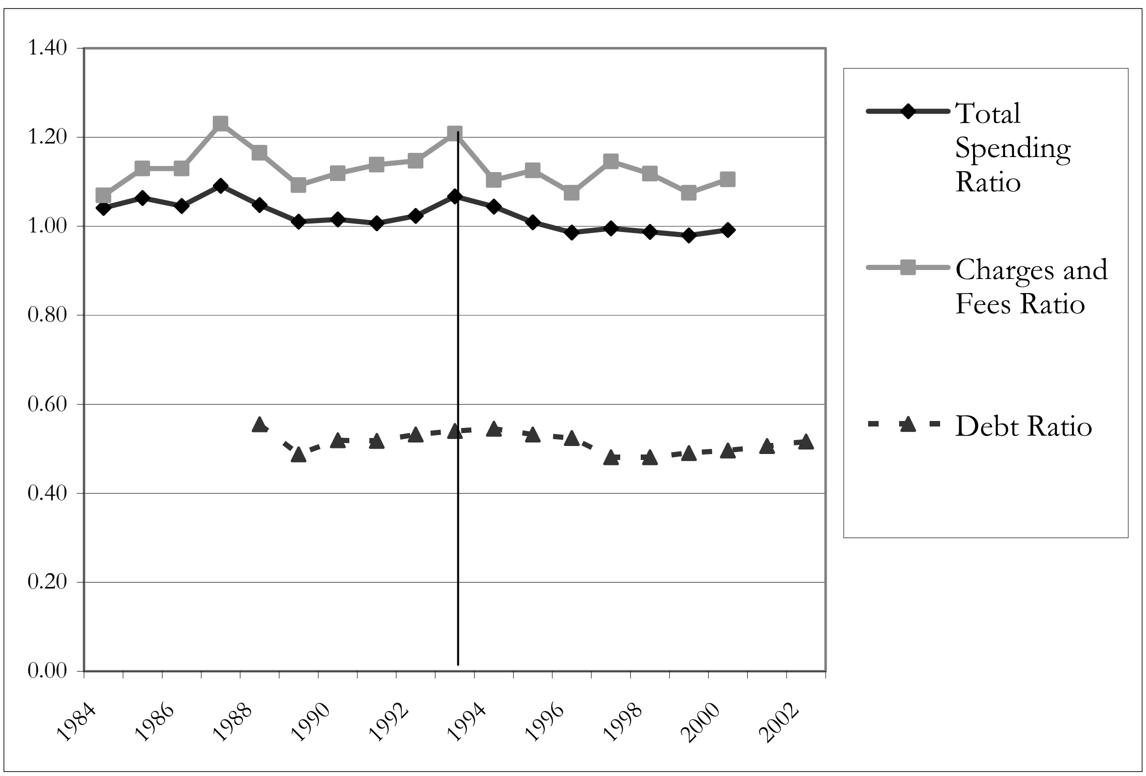
[28] The Colorado General Assembly did pass a spending limit in 1991 (National Conference of State Legislatures, 2005), but since TABOR came in the next year, it is not possible to measure the impact of this TEL.

hovered a bit above the control group average, and spiked in fiscal 1993 on the eve of its implementation. But state and local expenditures have declined since then, moving below the control case average in fiscal 1996 and staying below until 2002 (or 2003??). Total spending dropped from a mean of 4% above the control state average from fiscal 1984-1993 to just at the national average over the 1994-2000 period. Non-tax fees and long-term borrowing decline slightly as well, consistent with the limit's overall effectiveness. Credit agencies do not typically rate Colorado, so we cannot use their informed judgments here. Still, the clear story, at least until fiscal 2000, is that TABOR brought a moderate decline in the size of Colorado government, relative to states without TELs.[29]

Figure 7. Colorado's 1992 TABOR Tax and Expenditure Limit



Note: Vertical line denotes fiscal 1994, the first budget written under the constraints of TABOR.

[29] Colorado is a prime example of a phenomenon we have discussed in a previous paper (Kousser and McCubbins 2005) about the difficulty voters have in making tradeoffs during the initiative process. Colorado state expenditures are restricted by TABOR but another initiative (Amendment 23 approved by voters in 2000) requires annual increases in D-12 education. See http://www.coloradobudget.com/amend23_101.cfm for a brief discussion of how TABOR and Amendment 23 interact.

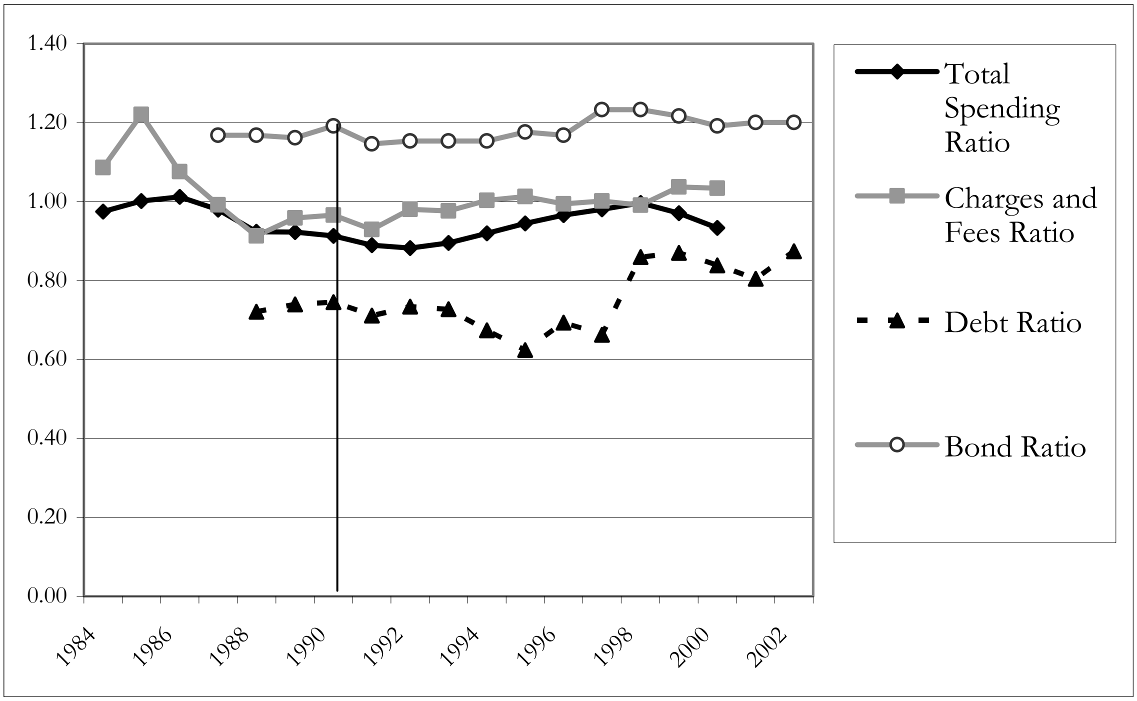
The acid test of its effectiveness came in the next fiscal year, however, when the Democrats gained control of both houses of the state's legislature. Since then, the Colorado legislature passed a higher education voucher plan which awards money to students who then take the money to a state university or one of a few private universities participating in the plan. Prior to the higher education voucher plan, state money was given directly to the universities and tuition was subject to TABOR revenue limits; however, with money now flowing directly to students, college tuition is no longer capped by TABOR and state universities can raise tuition as they see fit (Frates 2005). The design of this voucher plan is a classic example of how political agents attempt to work around the limits imposed by their principals, and suggests that even if TABOR appears successful on its face we have to be aware of how the state has increased tuition and/or fees in other areas that used to be funded by the state.

Finally, the epilogue to the TABOR story illustrates our Hypothesis B3 by showing that spending limits can be most easily undone in the states where it is easiest to amend the constitution. By 2005, anticipated cuts under TABOR were so severe that Colorado's Republican Governor Bill Owens, a fiscal conservative, backed a drive to call a five year "Timeout for TABOR" (Halper, 2005). Because Colorado has the initiative process, Owens was able to work with legislative leaders and the state's political establishment to place this temporary suspension of the state's spending cap on the November 1st, 2005 ballot as Proposition C. In an election that featured only half as much turnout as the contest in which TABOR first passed, Prop. C won with 52% of the vote while its companion Prop. D – which would have earmarked how state officials could spend their new money – failed (Brown, 2005). At least for the next five years, Colorado lawmakers will be able to spend what they can raise in any way they choose, thanks to their ability to amend the state's constitution.

Utah's legislature imposed a spending limit upon itself in 1989, an important political consideration auguring for its potential success. But note that the legislature's action may not have reflect a since inclination to cut spending, because the presence of the initiative process in the state means that lawmakers may have been attempting to avoid a more stringent citizen spending cap. Their motivations are also puzzling given that Utah has traditionally had a frugal state budget, in keeping with its political culture. This may be a case in which there was no illness that required the treatment of a TEL. Regardless, the preferences of future lawmakers are promising for the implementation of the law. Utah Republicans, firmly in control of the state government, have traditionally ranked among the most conservative elected officials in the nation, and even the state's Democrats lean toward the right side of the spectrum (Erikson, Wright, and McIver, 1993, p. 103). Many of the political conditions in the state set its limit up for success, as does the letter of its law. The limit is indexed to inflation, requires a supermajority to override, and automatically adjusts if programs are transferred from state to local governments (National Conference of State Legislatures, 2005).

Yet Figure 8 shows that the limit has failed to restrain spending growth. Utah's total state and local spending was $230 per capita below the control group average the year the limit passed, but it grew during the 1990s and caught up with the baseline in fiscal 1998. Looking at other fiscal indicators hints at how this has happened. Utah has increasingly turned to non-tax charges and fees, and began taking out more debt in the late 1990s (though its credit rating remained perfect throughout the entire time series). The overall story from this traditionally conservative state is that its lawmakers were good fiscal stewards

Figure 8. Utah's 1989 Legislative Spending Limit

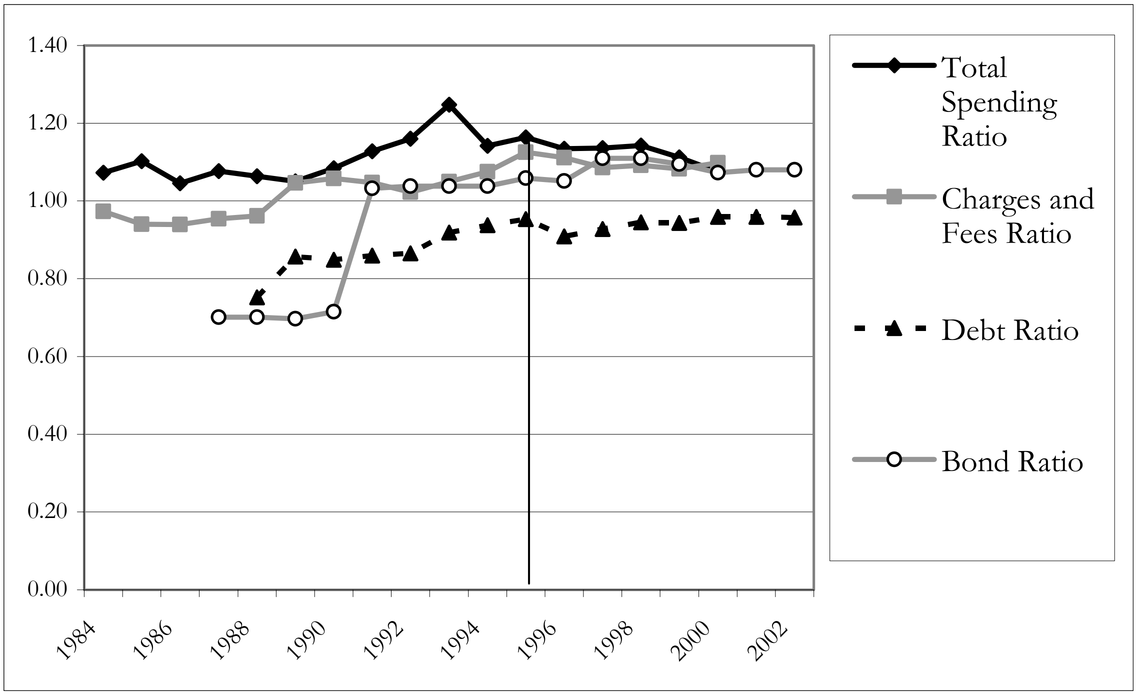


Note: Vertical line denotes fiscal 1990, the first budget written under the constraints of Utah's spending limit.

prior to the treatment and are good fiscal stewards afterward. The constraint was never needed, which seems to explain why it has not been effective.

Voters in our final western state, Washington, passed a direct initiative to limit spending in November, 1993. They did so presumably to stop the spending growth that began in the late 1980s and peaked in fiscal 1993 under Democratic control of both legislative houses. The following year, voters gave Republicans overwhelming control of the lower house of the state legislature. But Democrats made gains in both houses, gaining full control of Washington government by the end of the decade along with Governor Gary Locke (National Conference of State Legislatures, 2002). These political conditions – an externally imposed initiative seeking to limit the actions of a government increasingly sympathetic to spending growth – do not set it up for success. Neither did the letter of the

Figure 9. Washington's 1993 Spending Limit Initiative



Note: Vertical line denotes fiscal 1995, the first budget written under the constraints of Washington's spending limit.

law. Washington's limit is statutory rather than constitutional, and even though it is tied to inflation, it works on a three year average (National Conference of State Legislatures, 2005).

Figure 9 shows that it has not constrained the growth of government in Washington. Total spending had already dropped from its peak in the fiscal 1994 budget written just before the initiative passed. In the 11 fiscal years of our study before the limit went into effect, Washington spent on average 11% more than the control group states. In the six years after the limit was passed, total state and local spending in Washington was 13% higher than states without TELs. The other indicators shows that Washington's government has also begun to charge more fees and to borrow more, relative to other states, since its voters imposed a limit. Just as in Utah and in California, Washington's spending limit has not brought any discernible drop in its expenditures. Table 2 summarizes our findings in this section, reporting the factors likely to influence a TEL's success in each state and its ultimate level of effectiveness.

Table 2. Characteristics and Effectiveness of TELs in Case Study States

	TEL Provisions	*Political Context*	*Need for a TEL?*	*Effectiveness*
California	Weak	Unfavorable	Yes	Ineffective
Colorado	Strong	Favorable	Yes	Effective
Utah	Strong	Favorable	No	Ineffective
Washington	Weak	Unfavorable	Yes	Ineffective

V. Conclusions

Our close analysis of fiscal behavior before and after the enactment of spending limits in four western states does not provide us with enough cases to test our subsidiary hypotheses about when ballot box budgeting will be most likely to bite. It does, however, present clear evidence in favor of our central conjecture. Based upon the logic of principal-agent relationships, we doubted that those who enact tax and spending limits would be able to constrain the future actions of lawmakers possessed of different goals and direct control of state purse strings. Our data confirmed our doubts. Records of spending patterns show that TELs failed to constrain the size of government in three of the four states that we examined, and in the fourth state there is anecdotal evidence that politicians are finding their way around the limits. Looking at other measures of fiscal behavior also suggest the ways in which lawmakers have been able to circumvent limits. These findings are consistent with the general failure of attempts to limit the federal budget. There may be some short-term effect while attention is directed at the political agents, but once attention is diverted, the change in process appears to have little effect.

Johnson and Kriz (2005, p. 85) declare that "taxpayers use fiscal institutions as a vehicle to reduce their basic principal-agent problem that government officials may use taxpayers' resources in ways that are not in the taxpayers' best interest." We agree that TELs represent attempts at this difficult task. However, our preliminary comparisons show that those who wanted to keep taxes low in California, Utah, and Washington did not make themselves any better off than taxpayers in states without spending limits.

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