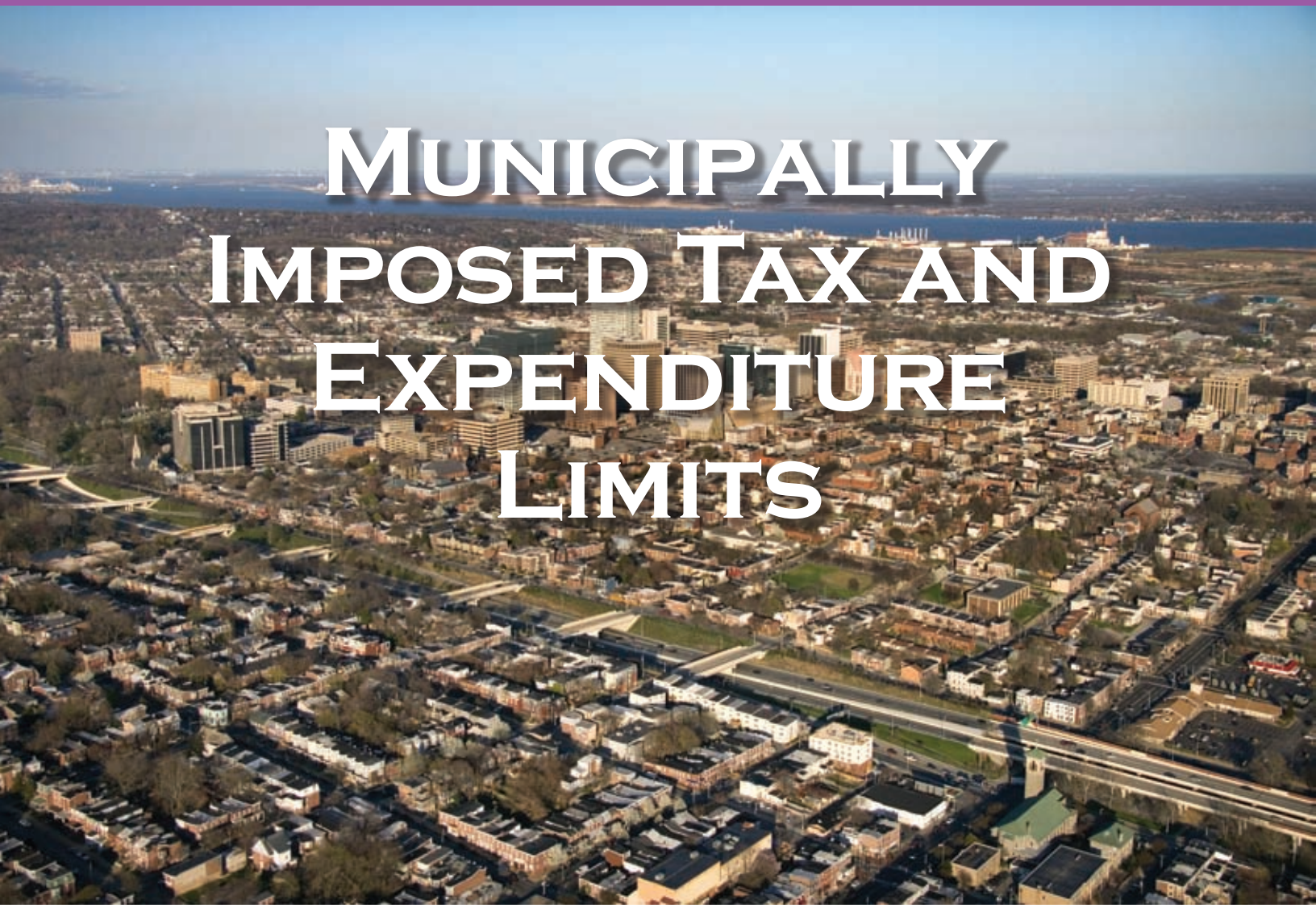
Municipally Imposed Tax and Expenditure Limits



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Baltimore, Maryland, limits annual assessment increases to 4 percent.

Leah Brooks and Justin Phillips

For many years, researchers have puzzled over the causes and consequences of voter-approved tax and expenditure limits (TELs), a fiscal rule that weakens the ability of elected officials to raise revenues or make expenditures. While TELs vary widely in form and restrictiveness, they typically aim to restrain government spending and maintain a low tax burden. Advocates argue that, absent such a structural constraint, government officials cannot be trusted to curb the growth of the public sector. Opponents argue that in the long run TELs are bad public policy.

The Center on Budget and Policy Priorities (2005, 14) writes that TELs significantly weaken the ability of governments to "cope with unanticipated changes, initiate policy changes, accommodate voter and court mandates, or even maintain current service levels." Evidence suggests this has been true in the case of the nation's most famous TEL, the State of Colorado's Taxpayers' Bill of Rights (TABOR). This set of provisions limits the annual increase in state tax revenue to the sum of the state's population growth rate and its inflation rate, and led to a serious fiscal crisis following an economic downturn in 2001 and 2002.

State-imposed tax and expenditure limitations on municipalities have generated a great deal of media and scholarly attention (see Mullins and Wallins 2004). However, to date there has been no systematic examination of TELs adopted at the local level. Our recent study exploring whether municipal citizens have voted to limit their own government's ability to tax or spend found many such examples.

In a comprehensive survey of local officials, sponsored by Columbia and McGill universities and the Lincoln Institute of Land Policy, we contacted

officials in a random sample of more than 300 U.S. cities to ask about local TEL adoption. Our results provide many insights regarding the frequency and features of municipal TELs, differences between TEL adopters and nonadopters, and the effects of TELs on cities' budgetary policies (for a more detailed and technical analysis, see Brooks and Phillips 2009).

Survey of Municipalities

We began in 2006 with a pilot survey of 60 randomly sampled cities to establish whether enough places had enacted a tax and expenditure limitation (TEL) to warrant a larger-scale investigation. We reviewed the charters of each sampled city and spoke directly with local budget officials. While responses to our investigation were varied, our early research and interviews suggested that locally imposed TELs are prevalent, and that these TELs are virtually impossible to identify simply by reading municipal charters and codes.

We subsequently expanded this effort to include all 246 cities with populations greater than 100,000 and a random sample of 100 cities with populations between 25,000 and 100,000 (slightly less than 10 percent of all such cities). We asked officials whether their municipality had adopted a TEL, what its characteristics are, and what the respondent perceived to be its effects on local budgetary policies. We contacted the city manager, finance director, and budget director for each municipality by phone or email. While the questions were not sensitive in nature, we assured all participants that their identities would remain confidential.

These officials were exceedingly helpful, and we received usable responses from 320 cities, a response rate of over 92 percent. We spoke with or received written responses from 45 states in all regions of the country. The aggregate economic and demographic characteristics of the cities that responded to our survey closely match those of the country as a whole. Thus, we are confident that our final sample is representative and that our results do not overestimate the extent of municipally imposed TELs.

We are also confident in our results because the respondents were professionals who understood the topic and were well-suited to provide accurate answers. Furthermore, when a response indicated that a local TEL was in effect, we verified its existence by searching the municipal charter and code, and sometimes contacted the city attorney's office for assistance. We located a legal reference for all but one of the cities coded in our dataset as having a TEL. We suspect that our survey underestimates the extent of municipally imposed TELs. While we were able to discard cities that incorrectly reported TEL adoption, we had no parallel method for verifying that TELs did exist when responses indicated they did not.

TEL Adoption

Forty cities, or one out of every eight that responded, have enacted a TEL distinct from (and more stringent than) any fiscal restriction imposed by their state government. While most of these cities have a single TEL, nine have more than one such restriction. Two cities in the West—Mesa, Arizona, and Colorado Springs, Colorado—have adopted four TELs each.

The survey results suggest that the adoption of municipal tax and expenditure limitations follows a different temporal trend than does the adoption of state-imposed TELs. There was a flurry of TEL adoption at the state level in the late 1970s through the early 1980s, the period in American politics most strongly associated with the voter revolt against taxation. This period was followed by a much smaller burst of TEL adoption in the mid- to late 1990s (ACIR 1995; Mullins and Wallins 2004).

However, only one-fifth of current municipal TELs can be traced to the period associated with the tax revolt. The plurality of the TELs identified by our survey respondents (more than 35 percent)

Colorado Springs, Colorado, has adopted four different tax and expenditure limits.

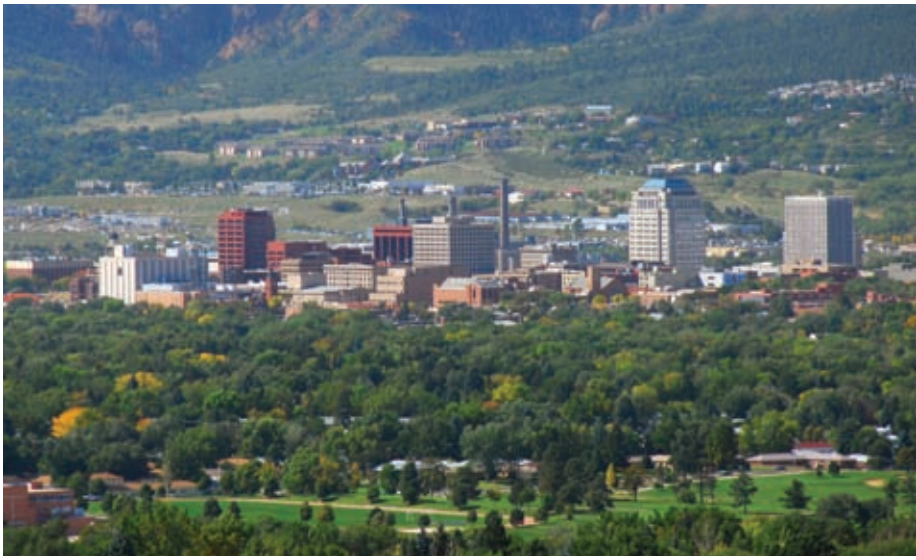

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TABLE 1
Tax and Expenditure Limitations (TELs) by Type

TEL Type	Number	% of Total
Assessment Limit	4	7.3
Property Tax Rate Caps	23	41.8
Property Tax Levy Limit	8	14.5
General Revenue or Expenditure Limit	3	5.5
Sales Tax Limit	5	9.1
Other	12	21.8
Total	55	100

TABLE 2
Sampled Cities with a Locally Imposed TEL, by Census Region

	All Cities		Cities with TELs	
Region	Number	Share	Number	Share
Northeast	61	17.6	3	7.5
Midwest	63	18.2	14	35.0
South	103	29.7	13	32.5
West	120	34.6	10	25.0
Total Responses	347	100	40	100

TABLE 3
Income, Home Rule, and State TEL Status, by Local TEL Status

	Number of Cities		Share of Cities	
	With TEL	Without TEL	With TEL	Without TEL
Quartile of Median Income				
1 (low)	11	64	23.4	27.5
2	11	66	24.1	27.5
3	13	67	24.5	32.5
4 (high)	5	77	28.1	12.5
City Has Home Rule Government				
Yes	31	132	79.5	54.8
No	8	109	20.5	45.2
State Has a Binding TEL				
No	8	82	29.9	20.0
Yes	32	192	70.1	80.0

were adopted well before 1970, with an average of just over 15 percent being adopted in each subsequent decade. This suggests that the adoption of TELs by municipal officials and local voters has been an incremental process that is separate from the state-level tax revolt.

Our survey also reveals a great deal of variation in the types of municipal TELs, particularly in the mechanisms used to restrain government fiscal behavior. Table 1 indicates the six categories of municipal TELs in our sample. The first three (assessment limits, property tax rate caps, and levy limits) apply to property taxation. Assessment limits are intended to restrict a city's ability to "automatically" increase revenues from rising property values or through administrative reassessments of value by capping the annual increase in property assessments. For instance, Baltimore, Maryland, and Washington, DC, limit annual assessment increases to 4 percent and 10 percent respectively.

Property tax rate caps set a maximum ceiling on the city's property tax rate, and levy limits constrain the total amount of money that can be generated from the property tax (independent of the overall tax rate). Examples of the former include Eastpointe, Michigan, whose charter caps the property tax rate at 1.5 percent of assessed value, and Corpus Christi, Texas, whose charter prohibits property taxes greater than $0.68 per $100 of assessed property. Both cities allow these rates to be exceeded only by referendum.

Property tax limits are, by a wide margin, the most common type of municipal TEL. Almost two-thirds of the TELs in our survey are designed to constrain the ability of local government to generate revenue from the property tax, with rate caps being the most widely adopted type of restriction. Property taxes are a natural target for municipal tax limits because historically they have been the largest source of local revenue in the United States. The property tax is also the target of most state-imposed TELs (Sokolow 1998).

The most restrictive and comprehensive type of municipal TEL in our survey is a general revenue or expenditure limit, found in 5.5 percent of the sample cities. Revenue limits cap the amount of tax that can be collected, while expenditure limits constrain government spending. Both are typically expressed as an annual allowable percentage increase. Anchorage, Alaska, limits increases in the total amount of municipal tax revenue to increases

in inflation and population growth. Colorado Springs, Colorado, similarly limits revenue increases. Such TELs are very difficult to circumvent because they restrict revenue or expenditures from all sources, except for intergovernmental transfers.

The remaining TELs apply to the local sales tax rate or any number of other sources of government revenues. Tucson, Arizona, for instance, amended its charter to prohibit any transaction privilege tax above 2 percent, while Pomona, California, has adopted an ordinance limiting the amount of utility tax that can be charged to any one payer. Many, though not all, of the TELs that fall into the "other" category apply to sources of revenue that are less significant than the property tax, and therefore may not have the same impact on local budgeting practices.

Two additional variations in local TELs are worth noting, since they affect a city's ability to repeal or directly circumvent the restrictions. First, the vast majority of TELs (roughly 70 percent) were adopted as an amendment to the municipal charter; others were enacted as city council ordinances. Presumably, ordinances are more easily reversible than charters, so the predominance of charter adoption confirms that such TELs require more effort to be changed.

Second, tax and expenditure limitations often have override mechanisms that allow the city to increase taxes or expenditures above the specified amount, sometimes for a limited time period. For those local TELs for which the override mechanism is known, 74 percent require a majority vote of the electorate, another 6 percent require a super-majority vote of the electorate, and the remaining 20 percent require either a majority or super-majority vote of the city council.

Characteristics of TEL-Adopting Cities

We found a number of notable patterns in the geographic, economic, and demographic characteristics of cities that have adopted tax and expenditure limits. First, while municipally adopted TELs are relatively common, there exist stark regional differences in their rate of adoption. Table 2 displays the number of cities that replied to our survey by census region, as well as the number and share of cities with at least one TEL. Cities in the Midwest and the South are more likely to adopt a TEL than their counterparts elsewhere. Midwestern cities account for just over 18 percent of all cities in our sample, but 35 percent of cities with locally imposed TELs. In contrast, cities in the Northeast account for almost 18 percent of sampled cities, but less than 8 percent of the cities with TELs.

Tucson, Arizona, cannot levy a sales tax that exceeds 2 percent.

Cities that adopt tax and expenditure limitations are similar along many, but not all, dimensions to cities that do not adopt limits. Table 3 presents three categorical city variables by local TEL status —income level, home rule status, and existence of a state TEL. When all cities are divided into one of four quartiles by median income, we find that cities that adopt TELs are substantially underrepresented in the highest quartile. This is the first piece of evidence that is consistent with the hypothesis that voters adopt local TELs as insurance against increases in taxes or spending. In this case, wealthier voters, who may be better able to weather tax shocks, are perhaps less likely to need the kind of insurance a local TEL provides.

Cities with local TELs also are substantially more likely to have home rule government. A home rule city is one that has adopted its own charter, distinct from the basic rules that govern municipal behavior in a state. Again, this evidence is consistent with the hypothesis that voters adopt local TELs as insurance. Since home rule cities tend to have greater autonomy, voters may wish to add rules that restrict that behavior. This difference is statis-

TABLE 4
Characteristics of Cities With and Without TELs

	With TEL	Without TEL
Population	349,289	227,844
Share African-American	15.2%	15.2%
Share Hispanic	19.7%	18.4%
Share of People with 4-Year College or More	15.8%	17.3%
Share of People Aged 65 or Over	10.6%	10.9%
Number of Cities in Metropolitan Area	19.3	41.0
Own Source Revenues Per Capita	$1,471	$1,595
Property Tax Revenues Per Capita	$369	$417

TABLE 5
Effects of Tax and Expenditure Limitations in TEL-adopting Cities

	Number	Share
Has Your City Reached the TEL Cap?		
N/A	2	7.2
No, not close	9	38.8
No, but close	1	5.0
Yes, it is binding	11	48.9
Has the TEL Affected Practices in Your City?		
N/A	4	8.3
No clear effect	19	39.9
Other	8	16.0
City has increased borrowing	1	2.1
City has new revenue sources	6	12.8
City has reduced service provision	9	19.9
Affects long-term projects only	1	1.1

Note: Respondents could choose more than one way the TEL could affect their city's practices.

tically meaningful, and persists even when we control for the effects of other variables. In contrast, cities with local TELs are only somewhat more likely to be in states that have potentially binding state-imposed TELs, and the result is not statistically significant.

In terms of demographic characteristics, cities with local TELs are slightly larger than those without TELs, and their citizens are slightly less educated, but these differences are not statistically meaningful (see table 4). There are virtually no differences between the two groups of cities in terms of their minority or age composition. A comparison of total tax revenues also reveals relatively minor differences. Per capita revenues in TEL-adopting communities are $124 lower than those in non-TEL-adopting communities, although this difference is not statistically significant. About $48 of this difference is due to lower property tax revenue collections in cities with local TELs.

The one difference that is statistically meaningful, and which persists even when we control for other variables, is the number of cities in each municipality's metropolitan area. Cities that do adopt local TELs are in metropolitan areas with an average of 18 other cities; cities that do not adopt local TELs are in metropolitan areas with an average of 40 other cities. This finding is also consistent with our contention that cities adopt limits as insurance on politician behavior. In metropolitan areas with many cities, voters have insurance "built in" if their local politicians spend too much: they can move to one of the many other local jurisdictions. In metropolitan areas with fewer choices, voters do not have this type of insurance. Our results are consistent with the hypothesis that voters turn instead to the ballot box for insurance against higher taxes.

Does the TEL Constrain Behavior?

Systematically determining the effects of tax and expenditure limitations on municipal budgeting has proved difficult. Critics of these fiscal restrictions argue that TELs may lead to the underprovision of local public services. Existing studies in the social science literature have tried to evaluate this possibility through complicated statistical analyses, but have produced inconclusive results (Chernick and Reschovsky 1982; Downes, Dye, and McGuire 1998; Downes and Figlio 1999; Dye and McGuire 2001; Figlio and Rueben 2001; and Joyce and Mullins 1991). We explored the consequences of these fiscal restrictions by analyzing whether a city has reached the cap established by its TEL (i.e., whether it is now binding) and whether the TEL has affected the city's budgetary policies.

Table 5 shows that almost half of all municipal TELs are currently binding, with another 5 percent nearing the established limit. If a TEL is binding, the city must either turn to another revenue source to continue service provision at the same level, or decrease services. Furthermore, municipal tax and expenditure limitations appear to affect budgets. About 40 percent of the officials from TEL-adopting cities reported that their TEL

has had no clear effect, with about 36 percent indicating it had altered some aspect of budgeting. Almost 20 percent of TEL-adopting cities reported that the TEL had reduced service provision, while another 13 percent said their city sought out new revenue sources. For example, a respondent from Minneapolis indicated that the city's property tax levy limit has forced some reductions in infrastructure investments. The City of Ann Arbor's ceiling on the property tax, which is coupled with a state restriction on assessment increases, has forced the city to lay off some municipal employees and seek greater efficiency in using its expenditures.

Conclusion

The results of our survey allow us to draw two main conclusions about municipally imposed tax and expenditure limitations. First, these fiscal restrictions do exist and are widespread: one in eight cities surveyed has a local TEL. These limits focus substantially, but not exclusively, on the property tax, and are not used only by state lawmakers. Indeed, there is strong support in many areas for restricting the budgetary powers of local governments above and beyond the restrictions imposed by state governments, and the property tax, in particular, remains unpopular.

Second, we find evidence consistent with the hypothesis that voters may adopt a local TEL as a way to insure themselves against future tax increases. All the key ways in which TEL-adopting cities differ from the nonadopting cities—less wealthy, more likely to be home rule cities, and more likely to be in metropolitan areas with fewer cities—are consistent with this hypothesis. Voters in these cities may seek more insurance through the ballot box, since they are unable to self-insure (by income), insure by competition (many other cities in the metropolitan area), or insure through legislation (the limited ability of cities without home rule to make fiscal changes).

While this analysis sheds a great deal of light on the adoption and likely consequences of municipal TELs, we recognize that this research may be just the beginning of the exploration of TELs adopted below the state level. What are the systematic patterns of TEL adoption in counties, school districts, or other local jurisdictions? Future work may also consider how state-imposed and municipal TELs may interact to alter the fiscal practices of local governments.

ABOUT THE AUTHORS

LEAH BROOKS *is assistant professor of economics at the University of Toronto, and has also taught at McGill University in Montreal. She received her Ph.D. from University of California at Los Angeles in 2005, where she used a Lincoln Institute Dissertation Fellowship to study business improvement districts (BIDs). Her research interests are in the areas of local political economy, including BIDs, the Community Development Block Grant program, and local land use issues. Contact: leah.brooks@utoronto.ca*

JUSTIN PHILLIPS *is an assistant professor in Department of Political Science at Columbia University. He received his Ph.D. from the University of California at San Diego in 2005. His research interests include state and local politics, political economy, and public opinion. Contact: jhp2121@columbia.edu*

The authors acknowledge the substantial contributions of Emily Gaus, Michelle Segal, and Kieran Shah, who conducted the survey as undergraduate students at McGill University. Gaus is now studying urban planning at Queens University in Kingston, Ontario. Segal and Shah are graduate students at the University of Toronto; Segal is studying law, and Shah is working toward a master's degree in public policy.

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