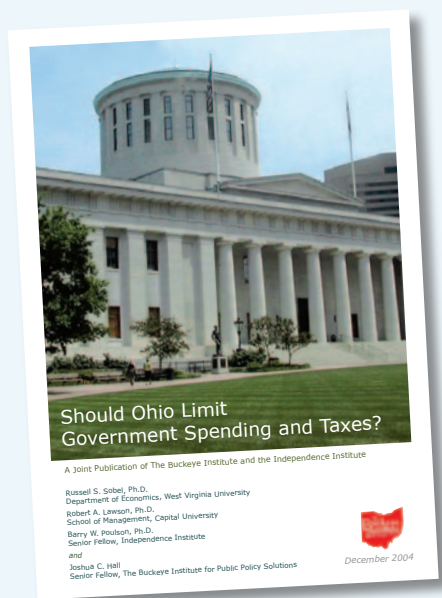


# Should Ohio Limit Government Spending and Taxes?

A Joint Publication of The Buckeye Institute and the Independence Institute

## POLICY SUMMARY



*This is a summary of the full-length policy report, **Should Ohio Limit Government Spending and Taxes?** by economists Russell Sobel, Robert Lawson, Barry Poulson, and Joshua Hall. The study is a joint publication of The Buckeye Institute for Public Policy Solutions ([www.buckeyeinstitute.org](http://www.buckeyeinstitute.org)) and the Independence Institute ([www.i2i.org](http://www.i2i.org)). The full study can be downloaded free of charge from The Buckeye Institute's web site.*

Ohio's state government spending increased by three times the inflation rate between 1994 and 2002. At this clip, the state government budget would double every 14 years. More importantly, this rate of growth outstrips income growth and exceeds our ability to pay for it. The result? Government spending as a share of Ohio's economy has increased rapidly since 1980. Ohio left the ranks of low-tax states in 1994 and has been one of the highest tax states in the nation since 2000.

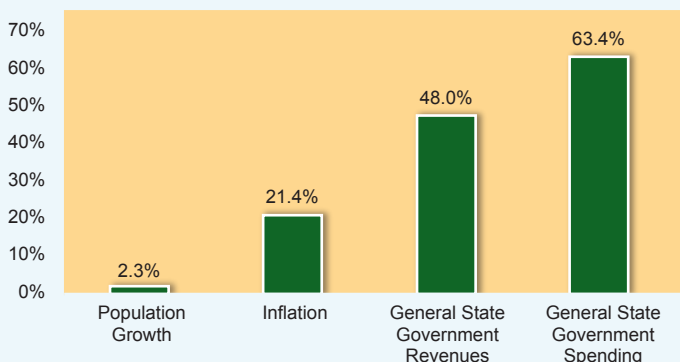
For many, the only practical and realistic solution is to try what other states have already pioneered: adopt a binding constitutional limit on how much state and local governments can spend. These initiatives are also called Tax and Expenditure Limitations, or TELs.

## How Taxes Effect Economic Growth

The academic and policy research is increasingly clear that state and local tax policies influence state economic growth. For example:

- Economist Zsolt Besci of the Federal Reserve Bank of Atlanta found that higher tax rates reduced state economic growth.
- Economic analysts Stephen Moore and Dean Stansel found that the ten states that reduced taxes the most between 1990 and 1996 enjoyed nearly 20 percent more economic growth than the ten states that increased taxes.

*Growth in Ohio Population, Inflation, Ohio State Government Revenues and Ohio State Government Spending FY 1994 to FY 2002*



- A Congressional Joint Economic Committee study found that high-tax states have economic growth rates roughly one-third lower than that of low-tax states.

Meanwhile, states with effective TELs experienced higher economic growth. In Colorado and Washington, the two states with the strongest TELs, personal income grew by 9.3 percent and 7.5 percent from 1995 to 2002, respectively. Nationally, personal income grew by 6.7 percent. Ohio's economic growth during the same period was just 5.0 percent.

Moreover, Colorado Governor Bill Owens recently argued that Colorado's TEL stabilized the budget during tough economic times. By restraining spending during strong periods of economic growth, Colorado's limit enabled the state legislature to more effectively cope with revenue shortfalls during the recession.

## Colorado, Washington State, and Michigan Lead the Way

Three states have TELs in place with features that citizens and policymakers should consider for Ohio.

The most well-known example is in **Colorado**. Colorado citizens adopted a TEL in 1978, but it was a statutory and not a constitutional limit. A citizen initiative made the TEL binding in 1992, by:

- Limiting state and local government spending to the inflation rate plus population growth;
- Requiring the state legislature to rebate any surplus revenue to taxpayers;
- Requiring voter approval for new tax increases, extending an expiring tax, or approving a tax policy change that increases net revenues for government; and
- Requiring voter approval for spending above the limits set by the TEL.

Colorado is currently facing a fiscal crisis, but this is largely attributed to two non-TEL factors. The first is Amendment 23, a citizen initiative that requires K-12 education spending to increase at a constant rate. The second is the lack of a rainy day fund to smooth out revenue shortfalls over the business cycle.

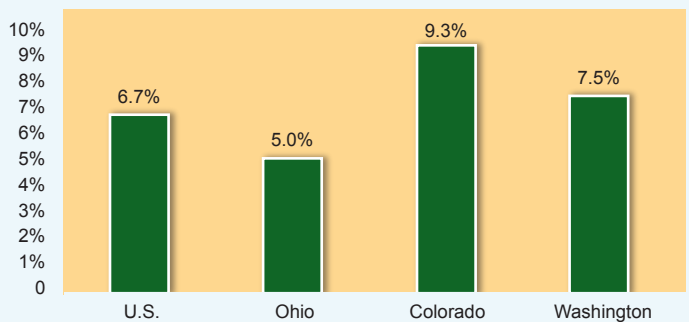
**Washington** adopted Initiative 601 in 1996, limiting state spending to inflation plus population growth. The initiative forced the legislature to cut spending and enact tax cuts to return surplus revenue.

Unfortunately, unlike Colorado and Michigan, Washington's limit was statutory, not a constitutional amendment. Washington's TEL ceased to be effective around 2000, after legislators mustered the necessary supermajorities to increase spending beyond the TEL limit and suspend the law's provisions. Thus, the TEL in Washington is only as safe as the current legislature.

**Michigan** also adopted its TEL, the Headlee Amendment, in 1978, limiting government revenue growth to a fixed share of personal income. This has effectively kept the size of state government to a certain level. If revenue exceeds the limit set by the Headlee Amendment, the excess is refunded to taxpayers based on the Michigan income tax schedule.

Another innovative feature of Michigan's TEL is that it allocates a proportion of the revenues generated from personal income growth in excess of 2 percent to a budget stabilization fund. Michigan's TEL has thus been able to stabilize the state's budget over the business cycle. During the recent recession, the state was able to transfer close to \$1 billion from the rainy day fund to offset revenue shortfalls.

Annual Increase in State Personal Income:  
Ohio Versus "Strong" TEL States, 1995-2002



Richard Vedder, *Grinding to a Halt: Ohio's Tax Policy and Its Impact on Economic Growth* (Columbus, Ohio: The Buckeye Institute for Public Policy Solutions, 2002), Figure 3, page 6.

## Designing an Effective Tax and Expenditure Limitation for Ohio

TELs can significantly reduce state and local spending if designed properly. Based on the experience of the 27 states that have TELs, three rules appear to be necessary:

1. Effective TELs are written into state constitutions;
2. Effective TELs use a formula to limit the growth of government spending to inflation plus population growth; and
3. Effective TELs provide immediate refunds of surplus revenue above the specified limit.

In addition, policymakers must consider:

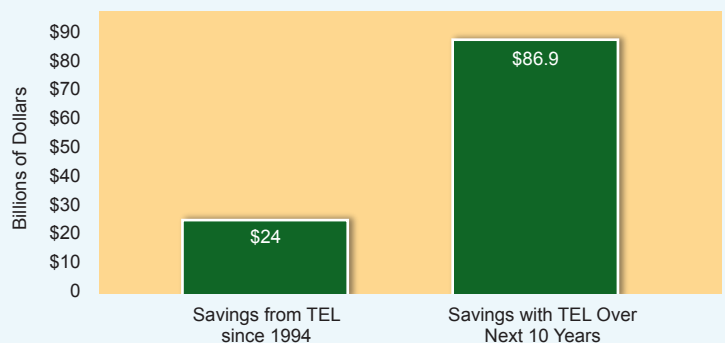
- How broad the spending or tax “base” will be—TELs that exclude major programs (e.g., K-12 education spending or Medicaid) are much less effective than those applied to a comprehensive base; and
- How revenue surpluses will be linked to the Budget Stabilization Fund (“Rainy Day Fund”) to smooth out spending over the business cycle.

## What Could a TEL Do For Ohio?

What would a TEL have accomplished for Ohio over the last decade?

- State government spending in Ohio would have been \$8.5 billion lower (23.2 percent) in 2002 if a TEL had restricted revenue growth to the inflation rate plus population growth since 1994;
- Cumulative savings between 1994 and 2002 would have been about \$24 billion; and
- Adopting a TEL now that limits state government spending to inflation plus population growth would save \$86.9 billion over the next ten years.

*Possible Savings to Ohioans from a Colorado Style TEL*



## Conclusion

A well-constructed Tax and Expenditure Limitation might be the only thing that will force Ohio policymakers to hold the line on spending.



## About The Buckeye Institute for Public Policy Solutions

The Buckeye Institute for Public Policy Solutions is an independent, nonprofit, privately funded public policy research and education institute, or think tank, based in Columbus, Ohio, founded in 1994. The Institute researches and promotes market-oriented approaches to key public policy issues facing Ohioans and works with a Board of Research Advisors consisting of more than 40 academics in 23 Ohio universities and colleges.

Additional information can be obtained from The Buckeye Institute for Public Policy Solutions, 88 E. Broad Street, Suite 1120, Columbus, Ohio, 43215, tel. 614.224.4422, [www.buckeyeinstitute.org](http://www.buckeyeinstitute.org).



## About the Independence Institute

The Independence Institute is a nonprofit, non-partisan Colorado think tank founded in 1985. It is governed by a statewide Board of Trustees and holds a 501(c)(3) tax exemption from the IRS.

Additional information can be obtained from the Independence Institute, 3952 Denver West Pkwy, Suite 400, Golden, Colorado, 80401, tel. 303.279.6536, [www.ii.org](http://www.ii.org).

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## Selected Publications of The Buckeye Institute

Samuel R. Staley, *New Directions for Fiscal Policy in Ohio: Citizen Attitudes Toward Spending and Taxation*, Public Policy Brief, February 2004, <http://www.buckeyeinstitute.org/Policy%20Reports/newdirections.pdf>

Samuel R. Staley and Joshua C. Hall, *Five Steps to Fundamental Tax Reform: A Pro-Growth Blueprint*, Public Policy Brief, February 2004, <http://www.buckeyeinstitute.org/Policy%20Reports/fivesteps.pdf>

Russell Sobel and Robert Lawson, *Income Tax Progressivity in Ohio*, Policy Report, April 2003, <http://www.buckeyeinstitute.org/Policy%20Reports/ITP.pdf>

Michael Bond, John C. Goodman, Ronald Lindsey, *Reforming Medicaid in Ohio*, Policy Report, March 2003, <http://www.buckeyeinstitute.org/Policy%20Reports/Medicaid%20Study.pdf>

Richard Vedder, *Grinding to a Halt: Ohio Tax Policy and Its Impact on Economic Growth*, Policy Report, September 2002, <http://www.buckeyeinstitute.org/Policy%20Reports/Grinding%20halt%20study.pdf>