WASHINGTON RESEARCH COUNCIL

SPECIAL REPORT

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Takin' It to the Limit:
A Preliminary Assessment of the Impacts of Initiatives 601 and 602

Initiatives 601 and 602, designed to limit, respectively, state expenditures and revenues, have stirred controversy over the impacts they would have on state programs and services.

In this Special Report, the Research Council outlines the provisions of the two initiatives, highlights key differences and makes estimates of their potential impacts on the state budget.

I-601 and I-602 are part of a renewed movement in the U.S. toward legal constraints on state taxing and spending. Voters in five states approved measures in 1992 to establish tax and expenditure limitations (TELs) or require extraordinary actions to raise taxes.

Overview

Washington's present revenue limitation, Initiative 62, has never been effective because of the economic conditions prevailing at the time it was enacted.

While I-601 and I-602 share a number of purposes, there are also major differences between them that have significant implications for their impacts. Chief among these are the tax rollback provision in I-602 and the requirement of voter approval for some tax increases in I-601.

The Research Council estimates that the I-601 limit, were it effective in 1993-95, would have capped general fund-state spending at $15.8 billion. The 1995-97 limit is estimated at $17.4 billion.

Calculating the I-602 limit is more difficult because it creates a broad new category of revenues that would be limited. We estimate that I-602 would limit these revenues annually to 8.8 percent of state personal income. For 1993-95, that share amounts to about $20.7 billion. This estimate suggests a general fund-state limit of between $16.4 and $17.0 billion.

Because of questions of interpretation and certain data limitations, estimates of the I-601 and I-602 limits must be preliminary. Different interpretations of key provisions in each initiative will produce different results.

I. Initiatives 601 and 602 in Perspective

The dramatic growth in state spending over the last decade and the $1.1 billion hike in taxes, fees and tuition enacted during the last session have provoked energetic initiative campaigns to place new legal constraints on the growth of Washington state government. Though it is yet uncertain whether either will gain enough support to qualify for the November ballot, both initiatives have already stirred controversy over their intent and potential impacts.

In order to increase public understanding of these measures, the Research Council attempts in this Special Report to explain key provisions of Initiatives 601 and 602 and present the most reasonable estimates attainable at this time of the fiscal impacts they would have should they become law. Questions of interpretation and difficulty of access to certain data make any such estimates preliminary. This report is thus intended to offer guidance in understanding the initiatives, but not to provide hard numbers as to the spending and revenue caps that would be created by I-601 and I-602.

Neither is it our purpose to assess the merits of either initiative. In *Washington State Fiscal Trends, 1981-83 — 1991-93*, the Research Council recommended adoption of a properly designed constitutional tax or expenditure limitation (TEL), combined with a strengthened budget reserve fund, to "reduce the amount of revenue that could be spent in periods of strong [economic] growth and make it available as a cushion against slower growth in weaker years." The Council takes no position, however, on the specific initiatives now before the public. We leave aside an analysis of the merits of Initiatives 601 and 602 until such time as they qualify for the ballot, and confine ourselves in this report to our best estimates of their fiscal impacts.

Washington's TEL: Initiative 62

In all the furor over Initiatives 601 and 602, many citizens are unaware that Washington state already has a tax and expenditure limitation, Initiative 62, approved by the voters in 1979. Intended to limit the tax revenues available to state

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government to growth in the economy, Initiative 62 instead became a case study in what can go wrong with the best-intended legal controls on state finances.

Initiative 62 (RCW 43.135.010) provides that overall revenue from state taxes may not exceed the base year's receipts multiplied by the average of personal income growth for the three previous calendar years. In this regard, it is not unlike the limits in a number of other states, such as Hawaii, Oregon and South Carolina, which attempt to restrict the growth of government to a contemporary measure of growth in the economy.

While the theory may have been sound, Initiative 62 has been a failure in practice. The initiative's limit has yet to be reached, even in years of exceptional growth in tax revenues, such as FY 1989 (11%) and FY 1990 (15%).

In its January 1989 report, *A Financial Plan for Washington*, the Governor's Committee on Washington's Financial Future, appointed by Gov. Gardner to examine the entire system of state finances, offered two reasons for the ineffectiveness of Initiative 62. First, it said, state tax revenues, adjusted for rate and base changes, tend to grow more slowly over the long term than the state's economy (a proposition not clearly supported by its data). The low elasticity of the tax system, the Committee suggested, made it unlikely that tax revenues would be affected by a limit based on personal income.[1]

The Washington Research Council reported in *Understanding Washington's Taxes*, published about the same time, that state tax revenues grew at about 90 percent of personal income over the period 1976-87. This finding was similar to that of the Governor's Committee. The Council noted, however, that that period was marked by the most severe economic downturn in the state since the Great Depression, and so did not represent the kind of "normal" experience from which one could easily draw lessons about the tax system.[2] Nor, we would add, about the usefulness of revenue limits.

There are two other problems with this explanation for the ineffectiveness of Initiative 62. First, elasticity measures are based on hypothetical revenues that assume constant rates and bases; the Initiative 62 limit is, of course, applied to actual revenues, which reflect any tax changes that might have been made by the legislature. Second, even if it can be established that Washington's tax revenues tend to grow more slowly than the economy over the long term, this would not exclude the possibility that tax collections may so exceed personal income over a short term as to trigger the limit. Indeed, according to revenue department data, growth in state taxes (constant rate/base) exceeded personal income growth in six of the last nine calendar years, including three consecutive years (1988-90), when it ran well ahead.

Initiative 62, passed in 1979, is a case study in what can go wrong with the best-intended controls on state finances.

The fatal flaw in Washington's TEL is instead the second factor mentioned by the Governor's Committee: the initiative's effective date. A year of extraordinarily high economic and revenue growth, 1979, was specified as the base year from which limits for the following years would be established. The limit for each subsequent year was to be calculated not off actual revenue collections, but off the hypothetical limit for the previous year. Because the economic conditions that prevailed at the time caused the initial limit to be set very high, it became all but impossible, whatever the performance of the state's revenue system, to hit the Initiative 62 limit. "The public perception is that the Legislature has somehow evaded the intent of the voters when, in fact, Initiative 62 has turned out to be ineffective in light of the state's tax system and economy," the Governor's Committee reported.[3]

The Committee concluded that the failure of the state's TEL meant not that it should be abandoned, but that it should be improved. It recommended that Initiative 62 be replaced with a constitutional revenue limit in which tax revenues that could be appropriated in future biennia would not be allowed to exceed the share of personal income they held in the 1987-89 biennium, based on an index of the average growth rate of personal income over the most recent five-year period. (This is not dissimilar to the approach taken by Initiative 602.) Revenues collected in excess of the limit would be placed in a contingency fund. The legislature could, by a majority vote, raise revenues up to the limit when estimated biennial collections fell 5 percent or more below the level forecast when the budget was adopted. A 60 percent vote would be needed to raise revenues up to or above the limit in all other circumstances.[4]

While acknowledging that similar controls in other states had seldom been triggered, the Committee argued that "the existence of a TEL is likely to influence state budget makers and agency heads to act cautiously so as to avoid reaching the revenue or expenditure limit. . . The Committee believes that a stronger revenue limit, combined with a more productive revenue system, will have a real impact on the level of state taxes and expenditures." [5]

The Governor's Committee's recommendation for a revamped state TEL was obscured by its proposals for sweeping changes in the tax system, and was not adopted by the legislature. The issue lay dormant until the budget crisis of the last two years and the tax increase enacted this spring revived calls for new legal constraints on taxes and spending.

State TELs: What's Old is New Again

In this regard, Washington appears to be following a trend in the nation. After a period of little activity, there seems to be a renewed movement toward state tax and expenditure limitations in the 1990s.

Twenty-two states currently have some form of legal limit on taxes or spending in place. Of these, 15 (including Washington's Initiative 62) were adopted in a surge of TEL activity between 1978 and 1981, during what is considered the last major tax revolt in the states (see Figure 1). There was relatively little action on TELs during the prosperous ’80s, when the greatest fiscal worry for many states was how to dispose of large budget surpluses.

But as we are painfully aware, state budget deficits are back in the ’90s, and with them a revival of interest in tax and spending limitations. States from one coast to the other that spent lavishly during the boom of the 1980s found themselves unable to support greatly increased levels of services when the economy cooled at the end of the decade and revenue growth fell off precipitously. Faced with large, sometimes catastrophic, shortfalls, states enacted tax and fee increases of $10.3 billion in FY 1991 and $15 billion in FY 1992 (compared to an average annual $2.0 billion in the previous six years).[6]

The state TELs that have been introduced in the first part of the ’90s can be said to have two purposes: 1) to end the boom-and-bust budgeting syndrome to which many states, including Washington, fell prey in the preceding years, and 2) to avert future tax increases of the scale recently seen. Connecticut’s legislature, close on the heels of the tumultuous enactment of a personal income tax, approved a constitutional amendment in 1991 that limited most state spending to the higher of the average of inflation or personal income growth over the previous three years. The state’s voters enacted the measure into law by a wide margin in 1992. Colorado voters approved a citizen initiative the same year tying both state and local government spending to a measure of population growth and inflation, while requiring voter approval of tax increases. Rhode Island adopted its own version of the “Delaware Plan,” which limits appropriations to 98 percent of estimated revenues, in 1992 as well. Arizona, meanwhile, became the eighth state to require some form of supermajority vote for tax increases with the overwhelming approval by voters of Proposition 108.[7] Earlier that year, Oklahoma voters passed an initiative requiring a three-fourths legislative vote or a majority popular vote before a tax increase can take effect.

Figure 1

State Tax and Expenditure Limitations

State	Year Enacted	Limit Type	Limit Base	Provisions to Exceed Limit
Alaska	1982	S,E	Population + inflation	Voter approval
Arizona	1978	C,E	Personal income	2/3 of each house
California	1979	C,E	Population + inflation	Majority of each house
Colorado	1992	C,E	Population + inflation	Voter approval
Connecticut	1992	C,E	Higher of inflation or PI	3/5 of each house
Delaware	1979	S,E	98% of GF revenues	3/5 vote of each house
Hawaii	1978	C,E	Personal income	None
Idaho	1980	S,E	Personal income	2/3 vote of each house
Louisiana	1979	S,R	Personal income	Majority of each house
Massachusetts	1986	S,R	Wage and salary income	Majority of each house
Michigan	1978	C,R	Personal income	2/3 vote of each house
Missouri	1980	C,E&R	Personal income	2/3 vote of each house
Montana	1981	S,E	Personal income	2/3 vote of each house
Nevada	1979	S,E	Population + inflation	Limit not binding
Oklahoma	1985	C,R	12% growth - inflation	None
Oregon	1979	S,E	Personal income	Majority of each house
Rhode Island	1992	C,E	98% of GF revenues	Majority of each house
South Carolina	1980	S,E	Personal income	2/3 vote of each house
Tennessee	1978	C,E	Personal income	Majority of each house
Texas	1978	C,E	Personal income	Majority of each house
Utah	1979	S,E	Personal Income	2/3 vote of each house
Washington	**1979**	**S,R**	**Personal income**	**2/3 vote of each house**

S = Statutory C = Constitutional E = Expenditure R = Revenue

Sources: ACIR, *Significant Features of Fiscal Federalism, 1992*; Minnesota Taxpayers Association, *Fiscal Focus, Jan-March 1993,* and state sources.

The question of whether tax and expenditure limitations “work” is one that is much debated, and to which there is no clear answer. The 1989 report of the Governor's Committee on Washington's Financial Future found that states with TELs tend to have lower taxes in relation to personal income and to spend less in relation to income than those states without them. Another study suggests that most TEL states were low tax states before their limits were enacted, casting doubt on the impact of their TELs on their tax and spending practices.[8]

For the present it must suffice to say that the extent to which TELs achieve their purposes seems to depend on 1) what their purposes are conceived to be, 2) their design (witness Initiative 62) and 3) the presence or absence of the political will to implement them in accordance with their intent. Such a formulation, of course, raises a whole new set of questions, which unfortunately cannot be answered here. A detailed discussion of the effectiveness of TELs must await another occasion.

Comparing Initiatives 601 and 602

As shown in Figure 3, Initiatives 601 and 602 share a number of features. Each attempts to limit the growth of the state budget — variously defined — to some statistical indicator of economic growth, and prescribes the circumstances under which the limit may be exceeded. By requiring that the state abide by annual limits on revenues or expenditures, each would effectively require a return to annual budgeting. Each would require extraordinary actions to raise taxes and other state revenues. Each would establish new budget reserve, or "rainy day," funds, whose uses would be much more restricted than those of the state's present Budget Stabilization Account. Each also seeks to strengthen existing state law requiring reimbursement of local governments for the costs of any programs or responsibilities that may be shifted to them from the state.

Beyond those general features (which are common to many state TELs), there are substantial differences between Initiatives 601 and 602 that have significant implications for the state should either — or both — be enacted into law. Some of these differences are highlighted below.

What is limited?

First and most obviously, Initiative 601 seeks to limit state expenditures, while Initiative 602 would limit certain state revenues. This is in important regards a distinction without a difference. Revenue limits such as Initiative 62 and Initiative 602 are effectively spending limitations in that they restrict the amount of revenue that is available for appropriation; any revenues generated by the state's economy that exceed the limit must be placed in some form of emergency or reserve fund, and may not be appropriated under ordinary circumstances. The choice between expenditure and revenue limits is really a matter of deciding which achieves the goal of limiting spending more effectively.

While expenditure limits are much more common (see Figure 1), some analysts believe that limiting revenues avoids the vexing problem of determining which kinds of expenditures should be included under the limit, and which should not. State expenditure limitations frequently exclude spending for such purposes as debt service, capital programs, and even municipal aid from their spending caps.[9] It was for this reason that the Governor's Committee on Washington's Financial Future recommended a revenue limit instead. "The Committee opted for a revenue limitation for reasons of simplicity," it stated. "All that is required is a definition of those tax revenues to be covered under the limitation. Under an expenditure limit, a variety of potential exemptions would arguably be required due to the varying nature of expenditures, e.g., the constitutional requirement to fund basic education." [10]

Initiative 601 attempts to solve this problem by confining its limitation to general fund-state expenditures, 97 percent of which is funded by tax revenues, while stipulating that the limit would be adjusted to reflect the shift of any programs or functions from the general fund to other funds or accounts of the state. (General fund-state spending will represent about 57 percent of total expenditures in the 1993-95 biennium.)

As illustrated by Initiative 602, however, revenue limits are not without their own problems of definition, and so do not necessarily offer the simplicity presumed by the Governor's Committee in 1989. Arguments can and are made for excluding such "off-budget" or earmarked revenues as trust funds, bond funds, and special funds such as transportation funds from these limits.[11]

The authors of Initiative 602 chose to cover a relatively wide range of revenues under their limit, going well beyond the tax revenues covered by Initiative 62 to bring in a long list of state fees and other charges as well. According to the initiative, the "state revenue collections" to be limited extend to "all moneys received, collected or owed from each and every source. . ., whether or not such funds are otherwise subject to legislative appropriation, including funds maintained or deposited outside the state treasury." Special revenue funds, supported by earmarked taxes and revenues, enterprise funds (such as the State Convention and Trade Center Fund), tuition accounts, and various other dedicated revenues appear to fall under this language.

The revenues subject to I-602 are then further defined by exclusion (Figure 3). Some of the major sources of revenue excluded from the limit are federal funds, the state's dedicated highway fund, "permanent and irreducible funds" of the

Figure 2

Revenues Excluded from I-602

(1) Money received as a gift, grant, donation, aid or assistance, when the terms or conditions of those gifts, grants or etc. require their disbursement for other than the general purposes of the state.

(2) Federal grants or other assistance.

(3) Money derived from the investment of funds under the authority of the state investment board.

(4) Money received from peformance bonds and deposits.

(5) Money paid into or received from certain industrial insurance funds.

(6) Money paid into or received from trust funds created before Dec. 31, 1992.

(7) Money paid into or received from "permanent and irreducible" funds created before Dec. 31, 1992.

(8) Money received from the sale of bonds or "other evidences of indebtedness."

(9) Money paid into or deposited to funds or accounts created before Dec. 31, 1992 "for disbursement to political subdivisions of the state."

(10) Money received under Article 2, Sec. 40 of the state constitution (i.e., the state highway fund).

(11) Money paid into or received from the revenue reserve fund to be created under this initiative.

(12) Money paid into or received from the general obligation debt reduction account to be created under this initiative.

state, such as the Common School Fund, several enumerated industrial insurance funds, trust funds created before Dec. 31, 1992, money in funds created before Dec. 31, 1992 for disbursement to local governments, and money received from the sale of bonds or the investment of state funds. Because of the exclusion of the constitutionally protected highway fund, the state's gas tax would not be covered by the I-602 limit.

Limitation Measures

A second, readily apparent difference between Initiatives 601 and 602 is that the former limits the growth of government to inflation and population growth, and the latter to personal income growth.

Personal income has been a more frequent measure of allowable growth under state TELs than inflation and population. It is notable, however, that the four states that use inflation and population to limit spending or revenues are all in the West, where population growth has been much more of a budget concern than in other parts of the country.

It may be argued that the choice of economic indicator is yet another distinction without a difference, in that inflation and population increases are major determinants of the growth of personal income. These two factors alone, however, do not account for variations in worker productivity, in components of population change, and in real wages and salaries that may cause personal income growth to differ considerably from what would be produced by the mere combination of inflation and population.

The choice of the one or other measure also suggests (whether intentionally or not) a somewhat different philosophy behind each initiative. In limiting spending to inflation and population growth, Initiative 601 aims to confine the growth of government to the estimated "normal" increase in its costs. In pegging its limit to personal income growth, on the other hand, Initiative 602 implies that government should not be allowed to expand beyond a measure of the state economy's ability to support it.

The choice of economic indices against which to measure spending and revenue growth is not a matter of indifference. The total growth in a state's population, for example, may not say very much about the service demands generated by the specific kind of population growth experienced. As we are seeing now in Washington, rapid growth in the age 5-17 population cohort helps drive up school expenditures, while growth in the number of elderly means higher health care costs. California is struggling with higher demands for social services as a result of a tide of immigration to the state by economically and socially disadvantaged persons.

Even personal income has its critics as a limitation factor. Massachusetts opted to limit spending to growth in salaries and wages rather than total personal income when it constructed its TEL in 1986. Economist Robert Tannenwald of the Federal Reserve Bank of Boston argues that personal income minus transfer payments provides yet a better measure of a state's fiscal capacity.[12]

Ultimately, the manner in which Initiatives 601 and 602 apply their indices to state expenditures and revenues is a more important consideration in assessing their impact than which indices they've chosen. We examine how this data is used to calculate the I-601 and I-602 limits in a section to follow.

Repealing the '93 Session

A third and perhaps the most contentious point of difference between the two initiatives is the stances they take on the revenue increases adopted by the legislature in the 1993 session.

Immediately on passage of Initiative 602, all state taxes, fees and other in-state sources of revenue would revert to those in place on Dec. 31, 1992. This provision effectively repeals the package of revenue increases that was adopted by the legislature in special session this year. No part of the package would appear to be exempt from the repeal requirement. According to a staff analysis by the Senate Ways and Means Committee, a total of $952 million in taxes, fees and tuition would be rolled back as of the Dec. 2, 1993 effective date of the initiative. In repealing the '93 revenue package, I-602 also effectively repeals the 1993-95 budget.

Initiative 601 contains no provisions with regard to the 1993 revenue package, and would have no direct effect on those tax and fee increases.

Power to the People

Both Initiative 601 and Initiative 602 would make Washington the 10th state to require extraordinary action of some kind to raise taxes and other revenues. The theory behind such requirements is that the effects of tax increases are so profound, and the incentives built into the political system toward higher spending so great, that raising taxes should be made more difficult than other, more ordinary actions of the legislature.

Initiative 602 erects considerable hurdles to tax increases, requiring a 60 percent vote of both houses to increase any "revenue measures," which are defined very broadly, within the limit, and a 75 percent vote to raise them above it.

Initiative 601 goes a step further, vesting much authority to raise state levies directly in the citizenry. From the date of passage of I-601 until July 1, 1995, any tax changes contemplated by the legislature not only to raise taxes but to make "revenue-neutral tax shifts" would require approval by the voters at a November general election before they could become effective. It would thus force to the ballot any ostensibly revenue-neutral "tax reform" efforts that might be launched next year. With the beginning of FY 1996, tax increases or shifts under the limit could be accomplished only with a two-thirds vote of the legislature, while increases that would push spending over the limit would require a vote of the people.

On enactment of Initiative 601, Washington would join Colorado, Missouri and Oklahoma as the only states to require a popular vote to raise state taxes. (Missouri's Hancock Amendment, adopted in 1980, applies to both state and local taxes.) While requirements for popular votes on local tax increases are common to many states (including Washington), experience with such requirements at the state level is thus far too limited to judge their effects.[13]

Figure 3

Comparing Initiatives 601 and 602

Feature	Initiative 601	Initiative 602
What is limited?	Annual general fund-state expenditures, adjusted for any shifts that may be made of the costs of state programs or functions to other funds or sources of funding.	Annual "state revenue collections," as defined by the initiative. Includes "all moneys received, collected or owed from each and every source," including funds not appropriated by the legislature and funds maintained outside the treasury. Excludes several specific kinds of revenues, including moneys paid into the state's highway fund, certain industrial insurance funds, and trust funds and "permanent and irreducible funds of the state" created before Dec. 31, 1992.
Limitation	An annual "fiscal growth factor," defined as the average of the sum of the percentage change in inflation and population for each of the previous three fiscal years.	An annual "limitation factor," defined as the percentage share of total state revenue collections of total state personal income for the fiscal years 1988 through 1992.
Disposition of funds over the limit	General fund-state revenues in excess of the expenditure limit are deposited in a new emergency reserve fund. Money may only be appropriated from the fund with a vote of 2/3 of each house of the legislature. Any balance in the fund in excess of 5 percent of biennial general fund-state revenues is transferred to a new education construction fund. A 2/3 vote of each house and a vote of the people are required to appropriate money from this fund for any purposes other than school or higher education construction.	State revenue collections in excess of the revenue limit are deposited in a new revenue reserve fund. The state treasurer is required to transfer to the general fund from the revenue reserve fund an amount sufficient to make up any difference between the revenue collection limit and estimated collections. The balance in the revenue reserve fund is limited to 2 percent of the preceding fiscal year's revenue collection limit. Any revenues in the fund in excess of this amount are transferred to a new fund to reduce general obligation debt.
Requirements to raise taxes	Until July 1, 1995, all actions to raise existing taxes, impose new taxes, or make revenue-neutral tax shifts require approval by a majority of voters at a November general election. After July 1, 1995, any actions by the legislature to raise state revenues or effect revenue-neutral tax shifts that do not result in exceeding the state expenditure limit require a 2/3 vote of each house. Any actions that result in expenditures in excess of the limit require approval by a vote of the people at a November general election. Additional taxes may be imposed under a declaration of emergency only if the revenues deposited in the education construction fund have been exhausted. Taxes may then be increased only until 30 days following the next general election, unless the voters approve an extension at that general election.	Taxes and other revenue measures may be increased with a 60 percent vote of each house of the legislature to make up any difference that may exist, after transfer of the balance in the revenue reserve fund, between estimated revenues and the revenue collection limit. These revenue increases automatically sunset after 24 months. Actions to increase revenues that will cause the revenue collection limit to be exceeded require a declaration of emergency by the governor and a 3/4 vote of each house. These increases automatically sunset after 24 months, or after expiration of the declaration of emergency, whichever comes first.

Feature	Initiative 601	Initiative 602
Requirements to increase fees	Effective immediately, no fee may be increased in any fiscal year by a percentage in excess of the "fiscal growth factor" for that year without prior approval by the legislature.	No separate provision. Fees are included in the definition of "revenue measures," and are subject to the same restrictions on increases as are taxes.
Provisions to exceed limit	Requires a declaration of emergency by the governor, which may not exceed 24 months, and a 2/3 vote of each house of the legislature. Emergencies are limited to "natural disasters that require immediate government action."	Requires a declaration of emergency by the governor, which may not exceed 24 months, and a 3/4 vote of each house of the legislature.
Tax and fee rollback	None.	Upon voter approval of this initiative, all legislative actions that have the result of increasing state revenues over those that would have been obtained under existing law as of Dec. 31, 1992 are repealed. Upon repeal, all taxes, fees and other revenue measures revert to those in effect on Dec. 31, 1992.
Intangibles taxes	Prohibits the state or local governments from imposing any taxes on intangible property, which includes stocks, bonds, and other property in money or credit.	No provision.
Cost-shifting to local governments	The state may not impose responsibility for new programs or increased levels of service under existing programs on any political subdivisions unless the subdivision is fully reimbursed by specific appropriations for the new costs.	The state must reimburse political subdivisions for any new programs or increased levels of service that may result from actions of the legislature.
Effective dates	The limitation on fee increases is effective on passage. The prohibition on any tax changes without a vote of the people is effective on passage, but sunsets on July 1, 1995. All other provisions, including the spending limit, are effective July 1, 1995.	Effective on passage. (The state constitution makes initiatives effective 30 days after the election date.) The state revenue collection limit is thus effective for fiscal 1994.

III. ESTIMATING THE LIMITS

In the following, the Research Council attempts to arrive at some preliminary estimates of the limits on state expenditures and revenues, respectively, that would be imposed by Initiatives 601 and 602. The potential impacts of the initiatives on state programs is a separate question, as much a matter of political as fiscal calculus, and are beyond the scope of this report.

Initiative 601

Figure 4 illustrates how general fund-state spending would be limited by Initiative 601. General fund-state expenditures in fiscal 1990 are chosen as the base from which to estimate a spending cap which first becomes effective in fiscal 1996. According to Section 2 of the initiative, an initial calculation is made by adding a "fiscal growth factor," defined as "the average of the sum of inflation and population change for each of the prior three fiscal years," to the base FY 1990 figure. This produces a hypothetical limit for FY 1991 from which the limits for future years are calculated according to the same formula, moving forward to FY 1996. The initiative instructs the Office of Financial Management to adjust the preceding year's limit each November and calculate the next two years' limits on the basis of the most recent fiscal growth factor data.

This section presents an immediate problem of interpretation which gives rise to alternative estimates of the I-601 limit. A narrow reading of the relevant language in Sec. 2 dictates that the "three prior years" for which the inflation and population indices are to be taken are the three years prior to FY 1990, that is, FY 1989, 1988 and 1987. Considered biennially for purposes of better understanding, the subsequent calculations result in a hypothetical spending limit of $15.8 billion for 1993-95, or about $360 million less than the $16.2 billion budget enacted by the legislature. The projected cap for the biennium in which the initiative is first effective, 1995-97, is $17.4 billion. This limit, if implemented, would allow general fund-state spending growth of about 8 percent in the biennium (assuming no changes in the 1993-95 budget).

An alternative interpretation would read the ambiguous language in Sec. 2(4) to mean that the "three prior years" from which the data is drawn for the key initial calculation are the three years prior to FY 1991, that is, FY 1990, 1989 and 1988. We find this interpretation plausible, but believe that our own is more consistent with the language of the initiative and, in the absence of an expression of intent to the contrary, preferable for present purposes. The alternative interpretation would produce somewhat higher spending limits of $15.9 billion in 1993-95 (about $213 million less than adopted), and $17.6 billion in 1995-97.

Because each year's limit is calculated off the preceding year's limit (rather than off actual expenditures), the choice of 1990 as the base year is critical to the impact of the initiative. Choice of a later base year would produce a quite different result. We also assume that the base figure for FY 1990 adjusts for the shifting of tuition-supported higher education expenditures out of the general fund beginning in 1992 and for other budget formatting changes made after 1990. The initiative requires OFM to make such adjustments for future years, but is silent as to historical budget data. The use of an unadjusted, higher figure for FY 1990 expenditures will produce a higher spending limit for 1995-97.[14]

Initiative 602

Once critical assumptions are made, calculating the I-601 limit is a relatively simple matter. Initiative 602, because it departs from the established budgeting system and creates new requirements for the accounting of revenues, presents greater challenges.

The first and most difficult step is to identify and estimate the broad new category of revenues that would be limited by the initiative. Because "state revenue collections" are essentially defined by exclusion, and brought together in no single present system, estimating "state revenue collections" becomes a complex problem of both definition and accounting.

According to preliminary estimates made for the Research Council by former state revenue department director Don Burrows, "state revenue collections" in fiscal 1992 amounted to approximately $9,198.5 million. By comparison, general fund-state revenues were estimated in November 1992 at $7,297.5 million, and state tax revenues subject to the existing Initiative 62 limit at $7,051.5 million.

State revenue collections, once estimated and reported by the Office of Forecast Council, would then be limited to a share of state personal income, termed the "limitation factor." This factor is defined in the initiative as "the percentage created by dividing the sum of total state revenue collections for fiscal years 1988 through 1992 by the sum of total state personal income" for the same years. Burrows estimates this percentage, reflecting the total share represented by these revenues of personal income over this period, at 8.80 percent.

Unlike TELs in some other states, in which revenues are limited to a rolling average of personal income growth reflecting recent state economic activity, Initiative 602 would set a fixed limit based on revenue and economic experience in the 1988-92 period. The effect is to create a maximum effective tax rate for the state. The assumption seems to be that because revenues generally rose rapidly relative to personal income during this period, a limit constructed in this manner would allow enough future growth in revenues to support needed public services, but prevent state government from claiming any larger share of the state's economy than it presently does.

Unlike Initiative 601, the Initiative 602 limit would take effect upon passage in fiscal 1994. As seen in Figure 5, applying the limitation factor of 8.8 percent to forecast revenues limits the revenues available for expenditure in the next two years to $10.0 billion in FY 1994 and $10.7 billion in FY 1995, for a 1993-95 biennium total of $20.7 billion. Any moneys generated by the state's revenue system in excess of these limits would be deposited first in a "revenue reserve fund," capped at 2.5 percent of the previous year's limit, and then in a fund to reduce general obligation debt.

Figure 4

Estimating the I-601 Limit

Base Year

	Inflation	Pop.	Totals
1987	3.3%	1.5%	4.7%
1988	4.3%	2.0%	6.3%
1989	4.7%	2.4%	7.1%

FY 90 expenditures	$5,922.8 million
Growth factor	6.0%
Increase	**$357.7**
FY 91 expenditure limit	***$6,280.5***

* I-601 leaves some uncertainty as to which three years are to be used to make the base year calculation. An alternative interpretation would use fiscal years 1988, 1989 and 1990.

Calculating the Expenditure Limit

Fiscal Growth Factor

✓ Find the annual change in the implicit price deflator and the state population for the three years prior to the new fiscal year expenditure limit in question.

✓ Add the annual percent growth of the IPD and population for each of the three years.

✓ Add the totals of the three years together, then calculate the average.

Calculating FY 92's Expenditure Limit

	Inflation	Population	Totals
1989	4.7%	2.4%	7.1%
1990	4.8%	2.9%	7.7%
1991	5.4%	2.7%	8.1%
			22.9%

22.9% / 3 = 7.6%

Increase

✓ Multiply the current expenditure limit by the growth factor.

FY 91 $6,280.5 million

$6,280.5 x 7.6% = **$480.0 million increase**

New Expenditure Limit

✓ Add the increase to the current fiscal year's expenditure limit to calculate the next fiscal year's expenditure limit.

$6,280.5 million + $480.0 million = $6,760.5 million

$6,760.5 million expenditure limit for FY 92

Annual Percent Change

Fiscal Year	Inflation	Population
1987	3.3%	1.5%
1988	4.3%	2.0%
1989	4.7%	2.4%
1990	4.8%	2.9%
1991	5.4%	2.7%
1992	3.4%	2.3%
1993	2.7%	2.3%
1994	2.6%	2.2%
1995	3.0%	2.2%
1996	3.0%	1.7%

1993-95

FY 93 expenditure limit	$7,245.8 million
Growth factor	x 6.3%
increase	**$454.5 million**
FY 94 expenditure limit	***$7,700.3 million***
FY 94 expenditure limit	$7,700.3 million
Growth factor	x 5.2 %
increase	**$399.8 million**
FY 95 expenditure limit	***$8,100.1 million***
Biennium limit	$15,800.4 million
Adopted Budget for 1993-95	$16,161.6 million

1995-97

FY 95 expenditure limit	$8,100.1 million
Growth factor	x 5.0 %
increase	**$407.0 million**
FY 96 expenditure limit	***$8,507.1 million***
FY 96 expenditure limit	$8,507.1 million
Growth factor	x 4.9 %
increase	**$420.5 million**
FY 97 expenditure limit	***$8,927.6 million***
Biennium limit	$17,434.8 million

Figure 5

Estimating the I-602 Limit

Revenue Limitation Factor

✓ Calculate total personal income for fiscal years 1988, 1989, 1990, 1991 and 1992, as reported in the Nov. 1992 *Economic and Revenue Forecast* prepared by the Office of the Forecast Council.

Fiscal Year	Personal Income (millions)
1988	$73,509.0
1989	79,907.0
1990	87,956.0
1991	95,007.0
1992	101,090.0
Total	**$437,469.0 million**

✓ Calculate total state revenue collections as defined by Initiative 602 for fiscal years 1988, 1989, 1990, 1991 and 1992.

Fiscal Year	State Revenue (millions)
1988	$6,098.0
1989	6,788.0
1990	7,875.9
1991	8,553.8
1992	9,198.5
Total	**$38,514.2 million**

✓ Calculate the limitation factor by dividing total state revenues from FY 88 through FY 92 by total personal income for the same set of years.

$$\frac{\$38,514.2}{\$437,469.0} = 8.8\%$$

Limitation Factor = 8.8 %

Calculating Revenue Limits
FY 94 and FY 95

✓ Multiply the personal income by the limitation factor to calculate new limit.

FY 94

Projected FY 94 PI	$113,849.0 million
	x 8.8 %
FY 94 limit	**$10,018.7 million**

* The initiative specifies that the FY 94 revenue limit will use the personal income figure as reported in the Nov. 1992 *Economic and Revenue Forecast.*

FY 95

Projected FY 95 PI	$121,933.0 million
	x 8.8 %
FY 95 limit	**$10,730.1 million**

1993-95 biennium total $20,748.8 million

* The initiative provides that revenue limits for fiscal years after FY 94 will use personal income figures as reported in the November *Economic and Revenue Forecast* of the preceding year.

Data Limitations

The state revenue collections totals used above have two limitations. First, they do not include revenues from local funds held outside the State Treasury which would fall under the provisions of I-602. These revenues will have to be isolated from other funds by the Office of Financial Management. Second, the final list of revenues to be included under the initiative will be determined by state officials after the act has been voted into law. The language in question may require interpretation by the Attorney General's office.

Initiative 602 poses some practical difficulties to understanding its impact that are not present with I-601. Because “state revenue collections” is a data construct devised by the initiative, estimates such as we have made above bear no comparison with any historical revenue data. They therefore tell us little about the “real world” effect the initiative would have on the budget. This problem is aggravated by the fact that Initiative 602 makes no specific provision for calculating or reporting the amount of revenue the legislature would be allowed to appropriate within the present budgeting system.

In order to provide a more immediate idea of the impact of the I-602 limit, the Research Council calculated the shares of state revenue collections represented by general fund-state revenues over the five-year period used to establish the limitation factor. From 1988 to 1992, according to the Burrows estimates, the general fund declined from 86 percent to 79 percent of the revenues that would be limited by I-602, reflecting at least in part a tendency by the legislature to dedicate more revenues and shift more spending outside the general fund.

Lacking reliable data on the general fund share of budgeted 1993-95 revenues that would be subject to the I-602 limit, we believe the average share for the most recent five years provides the most reasonable estimate. Assuming, then, a general fund share at the average of slightly more than 82 percent, and applying it to the estimated revenue collections limit, we estimate that the practical, if not official, limit on general fund-state revenues in 1993-95 would be about $17.0 billion, or $800 million more than was actually adopted for 1993-95.

If the assumed general fund share is lowered to 79 percent (the low point in the five year range), the hypothetical general fund-state limit for 1993-95 would be lowered to about $16.4 billion.

Whether Initiative 602 “works” is largely in the eye of the beholder.

In either case, under the terms of the initiative tax increases would require the 60 percent majority vote prescribed for raising revenues to the limit, rather than the declaration of emergency and 75 percent majority required if budgeted revenues were over the limit.

This should not be a surprising outcome. Because the I-602 revenue limit is set as a fixed share of personal income (derived from a period of mostly strong revenue growth), it is not likely to be reached when revenues are forecast to grow more slowly than personal income, as is the case for the next biennium.

Whether Initiative 602 “works” is therefore largely in the eye of the beholder. We come back again to the first factor we mentioned in judging the effectiveness of tax and expenditure limitations: What are their purposes conceived to be? If the primary goal is to prevent unsustainable increases in available revenues (and thus spending) in periods of rapid economic growth, then Initiative 602 cannot be judged a failure on the basis of its estimated impact on a period of slow growth. The true test of the I-602 limit, should it be enacted into law, would come if and when the state returned to 1980s-style economic activity, and revenues again began to grow well ahead of personal income. In that set of circumstances the limit should be reached or exceeded.

The lack of official forecasts of personal income for fiscal 1996 and 1997 makes it imprudent to venture estimates of the impact the initiative would have in the 1995-97 biennium.

We would not want to leave this subject without drawing attention to some important limitations on our estimates of the I-602 limits that permit us less confidence in them than in our estimates for I-601. First, our estimates of “state revenue collections” for FY 1988-92 do not include revenues from “local” funds maintained outside the state treasury. Information on these funds, which might include everything from student activities funds at the state universities to vending machine receipts, is not routinely reported in published documents, and was not accessible to us. Their effect, if included, would be to raise the projected limit somewhat, but not, according to our research, by enough to make a substantial difference in our estimates. Second, as has been the case with previous such initiatives, some provisions of Initiative 602, most prominently the definition of “state revenue collections,” will probably require interpretation from the Attorney General’s office. Any major differences in the understanding of that concept from our own may produce major differences in estimates of the revenue limit.

A Closing Word

Ultimately, questions of interpretation make any estimates of the fiscal impacts of Initiatives 601 and 602 provisory. Neither the Research Council nor any agencies of state government should be looked to for definitive answers as to the effects that either initiative would have. It is not unlikely that both, should they emerge successful from the polls, would pass from the hands of the voters to the embrace of the judicial system, where the only truly definitive assessments of their impacts might take place.

Further questions will arise should both initiatives win voter approval. Can the two initiatives, differing in so many ways, coexist? If not, how will conflicts between the two be resolved?

Such imponderables add to the complexity of the task facing voters in evaluating these initiatives. It is our hope that studies like this one will make that task a little easier.

Report prepared by John S. Archer, Donald R. Burrows, Richard S. Davis and Kim L. Gorsuch.

Endnotes

1. The Governor's Committee on Washington's Financial Future, *A Financial Plan for Washington* (January 1989), p. 5-3, 5-12.
2. Washington Research Council, *Understanding Washington's Taxes* (October 1988), p. 8.
3. Governor's Committee, p. 5-3.
4. Governor's Committee, 5-8. Also see the Committee's defense of its recommendation against alternative proposals, pp. 5-11–13.
5. Governor's Committee, p. 5-4.
6. National Governor's Association and National Association of State Budget Officers, *Fiscal Survey of the States*, April 1992 (Washington, D.C.: 1992), p. 11.
7. Washington Research Council, "Voters approve fiscal controls, spurn tax hikes," *WRC Notebook*, December 1992, p. 5. The Iowa Senate approved a Delaware-type spending limit last year, but it was rejected by its House. State TEL proposals were also considered in Florida.
8. Minnesota Taxpayers Association, "How Effective are Tax and Expenditure Limitations? *Fiscal Focus*, XVIV:1 (Jan.-March 1993), p. 4. For other views on the effectiveness of TELs see California Tax Foundation, *Up to the Limit: Article XIIIB 7 Years Later*. Sacramento, Calif.: March 1987; Connecticut Public Expenditure Council, *Tax and Spending Limitations for Connecticut: Needed Discipline or Excessive Constraint?* Hartford, Conn.: December 1990; Gold, Steven D., *State Tax and Spending Limitations: Paper Tigers or Slumbering Giants?* Denver: National Conference of State Legislatures, 1983; Howard, Marcia A., *State Tax and Expenditure Limitations: There Is No Story*. Washington, D.C.: National Association of State Budget Officers, 1988; and Public Affairs Research Institute of New Jersey, "The Spending Limit Proposal: An Analysis," *Public Affairs Focus*, Issue No. 14 (June 1990).
9. Connecticut Public Expenditure Council, *Tax and Spending Limitations*, p. 18.
10. Governor's Committee, p. 5-11.
11. Connecticut Public Expenditure Council, *Tax and Spending Limitations*, p. 18.
12. Robert Tannenwald, "Constructing a Tax or Expenditure Limitation," in CPEC, *Tax and Spending Limitations for Connecticut*, p. 13.
13. According to a report by the Heartland Institute, between 1981 and 1992 personal income in Missouri grew 1.76 percent per year faster than it would have if the Hancock Amendment had not been in place. How much of this is attributable to the effects of the amendment on state taxes only is unclear. Thomas L. Wyrick, "The Hancock Amendment and Economic Growth in Missouri," *Heartland Policy Study No. 49*, June 1992.
14. Small variations are also possible in the population data chosen. We have interpreted the initiative to require the use of the population estimates published by OFM in its year-end reports. The use of revised estimates that OFM may make from time to time will produce a slightly different estimate of the I-601 limit.

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