



A Taxpayer's Bill of Rights for Montana

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Executive Summary

In 1973, California Gov. Ronald Reagan introduced Proposition 1 – the nation’s first tax and expenditure limitation (TEL), which was designed to restrain state government growth over time. Proposition 1 was voted down at the polls in November 1973. Days after the defeat, Governor Reagan wrote in the pages of *National Review*: “We have lost a battle, but this struggle will go on. The people will find a way to bring big government under control, to put a reasonable limit on how much of their income government may take in taxes. This idea will become a reality.”ⁱⁱ

Reagan was right. Tax and expenditure limits inspired by Prop.1 have become a reality. Prop. 1 led to a nationwide tax revolt that, four decades later, has resulted in the passage of 31 tax and expenditure limitations, including one in Montana. The most successful of the nation’s TELs is Colorado’s Taxpayer’s Bill of Rights (TABOR) amendment. Passed in 1992, Colorado’s TABOR (dubbed by Milton Friedman a California “Proposition 1 look alike.”ⁱⁱⁱ) limits the growth of state spending to the rate of population plus inflation. As a result, Colorado taxpayers have received more than \$3 billion in surplus revenue since 1992.

In 1981, Montana enacted a statutory limitation on state government appropriations that limited the growth of government to an average of personal income growth – a far more generous limit than Colorado’s Taxpayer’s Bill of Rights, and ultimately an ineffective one. A recent report for Americans for Prosperity Foundation graded the effectiveness of the states’ various tax and expenditure limits, based on a criterion that included five different measures. Montana’s limit earned a D+.

This report examines how Montana would benefit from a more effective tax and expenditure limit – specifically, a measure similar to Colorado’s Taxpayer’s Bill of Rights amendment. A Taxpayer’s Bill of Rights amendment for Montana would: 1) limit the growth in state spending to the growth of population plus inflation, 2) ensure surplus revenue above this amount is invested in emergency and budget stabilization funds or returned to taxpayers, and 3) require voter approval for tax increases or any weakening of the amendment’s limits.

The following analysis examines Montana’s current economic climate and simulates how a TABOR amendment would have affected that climate had it been implemented in 1990. In short, the proposed TABOR would have constrained the growth rates of revenue and spending to levels that could be justified by the state’s economic performance, and stabilized the budget over the business cycle. It also would have set the stage for billions of dollars in tax rebates and permanent tax cuts. It is also worth noting that the program proposed here does not in itself call for decreased government expenditures; rather it demonstrates the benefits and viability of placing reasonable limits on the rate of government growth.

Introduction: Tax and Expenditure Limits in the Statesⁱⁱⁱ

Tax and spending limits are designed to address two problems: the increase in government revenues and spending relative to personal income in the long run, and the volatility of government revenues and spending over the business cycle.^{iv}

Since World War II, the growth of government revenue and spending has outpaced the growth of income in most states.^v One cause of this long-term trend of government growth is the tendency of government to expand rapidly during periods of economic growth. Said another way, a “ratchet up” of taxes and revenues often accompanies the volatility in revenue over the business cycle. This is especially true in states that rely heavily on income taxes for their revenues.

In periods of prosperity, because income is rising, governments tend to increase spending to match the increase in revenues. However, when income growth slows or even contracts, as in a recession, government revenues fall. Unfortunately, the political will to reduce expenditures during these times of reduced revenues rarely exists, so there is pressure to offset the budget shortfall by increasing taxes or engaging in deficit spending. Over time, this ‘ratchet up’ effect results in increased government revenues and spending relative to private income.

In efforts to counter this ratcheting up effect, a variety of different tax and expenditure limits (TEs) have been implemented in the states. In total, 31 states have implemented such limits.^{vi} Recent studies show that the most effective of these TEs constrain the growth of government revenue and spending to the sum of inflation and population growth. Four states have taken this approach: California, Colorado, Missouri, and Washington. In all four states, the tax and spending limit has at various points both constrained the growth of government and stabilized the budget over the business cycle – forcing the states to prepare for economic downturns by restraining the growth of government spending during periods of rapid economic growth.^{vii} Of these, Colorado’s TABOR amendment has proven to be the most effective.^{viii}

Colorado’s Taxpayer’s Bill of Rights (TABOR) Amendment

In 1992, Colorado voters approved a TABOR amendment with a 54 percent majority of the ballot.^{ix} TABOR is a constitutional amendment that includes the following provisions:

- Voter approval for all tax increases,
- Limits the amount that state and local governments may increase spending to the rate of population growth plus inflation,
- Surplus revenues above this amount must be returned to taxpayers, and
- Existing limits may not be weakened without voter approval.

Since TABOR was passed in 1992, Colorado's legislature has not enacted a single state tax increase, and more than \$3 billion in surplus revenue has been returned to taxpayers through tax rebates and tax cuts.

The Taxpayer's Bill of Rights amendment also set the stage for fundamental tax reform in Colorado. Colorado has reduced state income taxes, the state sales taxes, and a wide range of other taxes, such as the business personal property tax. As a result, a recent survey found that more than 60 percent of Coloradans support the Taxpayer's Bill of Rights amendment – more than when it was passed a decade ago – suggesting that TABOR has become more popular over time.^x

Despite this popularity, the TABOR amendment has come under fire recently in Colorado because of the so-called 'ratchet down' effect.^{xi} An important refinement in Montana's TABOR proposal corrects for this. The refinement is to link TABOR to a budget stabilization fund. In periods of economic growth, some surplus revenue would be set aside in a budget stabilization fund and then used to offset revenue shortfalls in periods of recession and maintain baseline budget levels. This modified TABOR Amendment is the basis for a model tax and spending limit recently adopted by the American Legislative Exchange Council.^{xii} It is also the basis for the proposed Taxpayer's Bill of Rights amendment for Montana – the focus of this report.^{xiii}

Rationale for a Montana Taxpayer's Bill of Rights

Montana is an Underachiever in Economic Growth

To understand the rationale for a TABOR amendment in Montana, one must explore Montana's under-achievement in economic growth, and link that underachievement to government fiscal policies.

Income per capita in Montana is significantly below the national average, ranking 42th in the nation in 2006.^{xiv} The per capita income in Montana, \$30,688, is only 85 percent of the national average – a gap of almost \$5,000 per person. Only two of the surrounding states have income per capita lower than Montana, Idaho and Utah. Montana has made some headway in improving income per capita relative to other states, moving from 46th to 42nd since 2002.

However, population growth has been rather sluggish in recent years. From 2000 to 2007 population grew only 6.2%, well below the national population growth of 7.2%. Only three states in the region had lower population growth than Montana over this period: North Dakota, South Dakota, and Wyoming.

Employment in Montana fell more than 2% when recession hit in 2001, and was stagnant in 2002. Since then employment has recovered sharply. Over the period from 2000 to 2006 employment increased 7.1%, well above the national employment growth of 5.5%. This has resulted in a condition of near full employment but with relatively small population

and personal income gains. Clearly something is hindering economic growth and creating a climate that hinders business development. That “something” is a fiscal policy that creates disincentives to growth.

Montana’s Flawed Fiscal Policies

Many factors have contributed to Montana’s underachievement in economic growth, but the major factor in recent years has been flawed fiscal policies, the fatal one being unconstrained growth in spending. The legislature has increased spending at an unprecedented rate and, in the process, has created a structural deficit in the state budget. This finding may come as a surprise to Montana taxpayers who have been led to believe that their state government has been pursuing prudent fiscal policies. The problem is that the budget process is designed to obfuscate the true nature of the state’s fiscal policies. To understand this profligacy requires a bit of detective work.

The key to understanding Montana’s fiscal policies is to identify ‘off budget’ as well as ‘on budget’ expenditures. ‘On budget’ expenditures are those included in general appropriations and subject to legislative scrutiny. ‘Off budget’ expenditures are all the disbursements not included in general appropriations, and are often not subjected to legislative scrutiny as part of standard budgetary procedures.

If we focus only on the ‘on budget’ expenditures it would appear that the Montana legislature is pursuing prudent fiscal policies. In the most recent 2007 biennium general fund revenues and expenditures increased less than 5 percent a year. In fact, the expenditures growth was below the growth in personal income; therefore, Montana’s tax and expenditure limit has not been a binding constraint on the growth in state spending. Table 1 shows general fund revenue and expenditures over the last decade, excluding Federal funding sources.

Table 1 – General Fund Revenues & Expenditures, 1984 - 2007 (millions of dollars)

Year	Revenue	Spending
1984	572	619
1985	645	651
1986	602	648
1987	609	674
1988	667	652
1989	687	667
1990	730	719
1991	805	849
1992	880	921
1993	952	928
1994	891	904
1995	935	945
1996	963	984
1997	986	997

1998	1,034	1,020
1999	1,068	1,043
2000	1,163	1,106
2001	1,269	1,269
2002	1,265	1,356
2003	1,246	1,276
2004	1,382	1,282
2005	1,398	1,370
2006	1,421	1,428
2007	1,466	1,463

The detective work in this analysis requires an examination of ‘off budget’ expenditures. When we include these ‘off budget’ expenditures with ‘on budget’ expenditures we find that Montana has been pursuing very profligate expenditure policies. This analysis reveals the flaws in the state’s fiscal policies and tax and expenditure limits.

It is not surprising to find the ‘off budget’ expenditures buried in the legislative budget report. In the following table ‘off budget’ expenditures are equal to the difference between general fund expenditures and total disbursements. Note that general fund expenditures are equal to total disbursements prior to 2005, i.e. there are no ‘off budget’ expenditures in these years. Beginning in 2004 there is a sharp increase in revenue, and revenue continues to increase at double digit rates over the next three years. While general fund expenditures continue to increase at a modest rate, total disbursements accelerate with some lag in the acceleration in revenue growth. In 2006 total disbursements increased 15.7%, and are estimated to continue to increase at double digit rates in 2007 and 2008. This acceleration in total disbursements is explained entirely by ‘off budget’ disbursements. Over this three year period ‘off budget’ disbursements are estimated to average between 15% and 20% of total disbursements. This is clearly an unsustainable growth in expenditures and has introduced a structural deficit in the state budget. It will be argued that some of these are one-time expenditures. However, when these funds are used to finance ongoing programs that is not the case.

Table 2 – Total Revenues & Expenditures, 2002 - 2007 (millions of dollars)

Year	Revenue	Spending	‘Off Budget Spending
2002	1,266	1,356	0
2003	1,246	1,276	0
2004	1,382	1,282	0
2005	1,531	1,354	(16)
2006	1,708	1,567	139
2007*	1,762	1,732	269
2008*	1798	2015	400
2009*	1875	1941	287

* estimated for 2007-2009

How do we explain this discontinuous increase in ‘off budget’ expenditures? Clearly special interests who benefit from this increased spending have been successful in lobbying the legislature for more funds. But ultimately the blame lies with the Montana legislature. Not only have legislators responded to these special interests, they have in effect hidden these expenditures from public scrutiny. By shifting a fifth of total expenditures ‘off budget,’ legislators have denied the public scrutiny that would have occurred if these expenditures had been subjected to standard budgetary procedures.

Fiscal policies in Montana are typical of states that rely heavily on a highly graduated income tax. Income tax revenues are more volatile than other sources of revenue over the business cycle, increasing very rapidly in periods of expansion, and contracting sharply in periods of recession. Expenditure increases typically equal or exceed the increase in revenues in periods of expansion. But it is very difficult to reduce expenditures and balance the budget in periods of recession.

The data for Montana show that, in recession years, expenditures increased more rapidly than revenue. The result has been a persistent structural deficit in the state budget. In the recent recession, the state incurred a structural deficit in the biennium budget of \$120 million.

States often respond to a structural deficit by increasing taxes or debt. The result is a ratcheting up of government from one business cycle to the next. Montana can end this ratchet up of government by adopting the TABOR discussed in the following sections of the report.

These conditions produce the fundamental flaw in Montana’s fiscal policies, which is unconstrained growth in state spending. Until spending is brought under control the state will continue to encounter revenue shortfalls and structural deficits in the state budget.

The consequences of these profligate fiscal policies will be felt in Montana for years to come. While Montana has benefited from the rapid recovery from the recent recession, that growth rate is not likely to continue. The business cycle has not been repealed, and during the next recession Montana will face some tough fiscal decisions. A revenue shortfall will make it very difficult for the state to sustain recent years’ spending levels. The reserve balance will quickly be depleted, and there will be tremendous pressure to raise taxes and issue debt. Montana can ill afford another round of profligate fiscal policies.

A TABOR limit would impose an effective growth limit on state government spending. With an effective limit on spending growth, the state would have to prioritize programs and goals. This in turn would shift the debate about state spending entirely.

For example, the current debate regarding funding for K-12 education is driven by the education lobby’s demand for higher wages and fringe benefits, and more recently by court ordered mandates to increase that spending. With an effective budget constraint the question becomes how to improve the quality of education per dollar spent, not how to increase spending. That in turn would force a thoughtful debate on the state’s constitutional

requirements in providing a quality education for Montana’s children. Only in this context is the state likely to consider fundamental reform of the education system to expand parental choice through vouchers, charter schools, contracting out, and so on. Learning to live with an effective budget constraint and prioritizing government programs within those constraints would lead to fundamental reform in other state programs as well

A Discontinuous Increase in the Tax Burden

Over the past five years the national economy has recovered from recession. Five straight years of economic expansion have been accompanied by a sharp increase in state and local revenue. Indeed, state and local taxes as a share of personal income are at an all time high of 11.0%.

The Montana economy has recovered along with the national economy. State and local revenue in Montana have increased at a rapid pace over the past five years. State and local tax revenue as a share of personal income increased from 9.3 percent in 2003 to 9.7 percent in 2007.

Montana’s state and local tax burden is low compared to other states in the region. In 2007 the regional average state and local tax burden was 10.2 percent, well above that for Montana. Only two states in the region have lower tax burdens than Montana, South Dakota and Wyoming.

Table 3. State and Local Tax Burdens in the Region

State	State and local taxes (dollars per capita)	Share of Personal Income (percent)	U.S. Rank
California	4965	11.5	12
Colorado	4509	10.4	30
Idaho	3367	10.1	35
Montana	3353	9.7	41
Nevada	4127	10.1	36
North Dakota	3626	9.9	39
Oregon	3747	10.0	37
South Dakota	3435	9.0	44
Utah	3452	10.7	27
Washington	4604	11.1	16
Wyoming	4340	9.5	42
U.S. average	4422	11.0	
Regional Average	3957	10.2	

Montana's Individual Income Tax System

While Montana has a history as a low tax state in terms of total tax burdens, that is certainly not the case with regard to the individual income tax. In fact, until recently Montana had the highest marginal income tax rate in the country. In 1970 Montana had a top marginal income tax rate of 12.1 percent. A decade later the top marginal rate had been reduced to 11.0 percent, and remained at the level until 2000. Only in the past four years has the top marginal rate been reduced to 6.9 percent. Montana has now relinquished the dubious honor of having the highest marginal income tax rate to Massachusetts. Montana's current rate ranks as the 15th highest in the nation.

Montana's personal income tax collects 2.5% off personal income in the state, which is above the national average. Most of the states in the region either collect no income tax, or impose a lower tax burden than Montana.

Montana's Corporate Income Tax System

Montana has been somewhat more prudent in imposing corporate income taxes. It has imposed a flat rate 6.75 percent corporate income tax rate for the past three decades. That is the 29th highest rate among the states imposing a corporate income tax. Among states in the region four impose no corporate income taxes, Nevada, South Dakota, Washington, and Wyoming; and four states impose a lower corporate income tax rate than Montana, Colorado, North Dakota, Oregon, and Utah. Only two states in the region impose a higher corporate income tax rate than Montana, California, and Idaho.

Montana Levies No Sales Tax; Gasoline and Cigarette Taxes among the Highest in the Nation

Montana levies no general sales or use tax on consumers, joining Delaware, Alaska, New Hampshire and Oregon as the only states to do so. Montana levies excise taxes on gasoline, alcohol, tobacco, hotel and lodgings, and other products. Gasoline and cigarette taxes are among the highest in the nation. Montana collects \$18.75 in excise taxes per \$1000 of income, ranking as the 4th highest in the nation. Only one state in the region imposes higher excise taxes than Montana, Nevada.

Montana Property Taxes: Comparatively High

Montana collects property taxes at both the state and local level. Local property taxes as a share of personal income are about average compared to the nation as a whole; but, state property taxes are significantly above the national average. As a result total state and local property taxes are also well above the national average. Recent studies show that the effective property tax rate in Montana exceeds that for surrounding states for both residential and business property.

The Business Tax Climate

Assessing the business tax climate in Montana also requires some detective work. Different studies provide conflicting evidence on the business tax climate in Montana. The key to sorting out this issue is distinguishing between the total tax burden discussed above, and that portion of the tax burden imposed on business. The Tax Foundation provides evidence on the business tax climate based on the total tax burden. As you would expect from their evidence of a relatively low total tax burden compared to other states they rate Montana as having a good business tax climate.

A more accurate measure of the business tax climate is based not on the total tax burden in the state, but rather on that portion of the tax burden imposed on business. A study of the business tax climate by Ernst and Young is based on estimates of the state and local taxes imposed on business.^{xv} The study analyzes business property taxes, sales and excise taxes paid by business on their input purchases, gross receipts taxes, corporate income and franchise taxes, business and corporate license taxes, unemployment payroll taxes, individual income taxes paid by owners of non-corporate (pass-through) businesses, and other state and local taxes that are the statutory liability of business taxpayers.

Table 4. Business Taxes as a Share of State and Local Taxes, and Gross State Product FY 2006 (percent)

State	State	Local	State and Local	Gross State Product
California	40.0	46.9	42.3	5.2
Colorado	35.9	53.1	44.4	4.2
Idaho	32.9	62.6	41.2	4.6
Montana	44.2	66.2	50.9	6.3
Nevada	44.4	52.9	47.4	4.7
North Dakota	57.2	70.6	61.5	7.3
Oregon	27.1	50.6	36.1	3.9
South Dakota	55.3	73.8	64.0	5.4
Utah	33.0	48.1	38.0	4.2
Washington	55.1	48.8	52.9	6.2
Wyoming	79.3	71.7	77.0	10.8
U.S. average	39.9	52.5	44.9	5.1

Montana business taxes as a share of local and state taxes are high, 50.9 percent, compared to a national average of 44.9 percent. Within the region there are only three states that impose a higher share of state and local taxes on business, North Dakota, South Dakota, and Wyoming.

Table 5. Change in State and Local Business Taxes FY 2002 to FY 2006 (percent)

State	total state and local business taxes (percentage change)	Business share of tax revenue growth (percent)
California	44.8	42.5
Colorado	41.1	53.1
Idaho	32.1	55.4
Montana	47.7	54.8
Nevada	59.8	47.3
North Dakota	54.7	72.8
Oregon	45.6	37.5
South Dakota	34.8	71.3
Utah	54.6	45.9
Washington	31.4	52.5
Wyoming	102.5	87.4
U.S. average	39.7	48.6

Much of the increased tax burden on Montana business has occurred in recent years. Over the past four years businesses have paid more than half of the increase in state and local taxes in Montana, 54.8 percent. That is significantly above the average for the nation as a whole, 48.6 percent. In only four states within the region have businesses accounted for a greater share of the increased tax burden in recent years, Idaho, North Dakota, South Dakota, and Wyoming.

Greater insight is provided by exploring the composition of business taxes in Montana. Three taxes account for a disproportionate share of the business tax burden in Montana: property taxes, excise and gross receipts taxes, and license and other taxes.

Table 6. State and Local Business Taxes by Type as a Share of Total Business Taxes FY 2005 (percent)

State	Property tax	Sales tax on business inputs	Excise and Gross Receipts Tax	Corporate income tax
California	27.5	23.9	13.3	13.1
Colorado	37.9	31.3	8.8	4.4
Idaho	41.5	19.9	9.5	7.1
Montana	53.9	_____	14.4	7.9
Nevada	31.2	27.9	16.3	_____
North Dakota	35.8	13.4	12.3	6.0
Oregon	42.0	_____	10.0	8.5

South Dakota	45.4	31.2	10.1	3.7
Utah	31.8	27.6	15.1	6.9
Washington	23.6	45.4	15.1	___
Wyoming	33.3	18.5	3.2	___

Table 6. State and Local Business Taxes by Type as a Share of Total Business Taxes FY 2005 (percent) Continued

State	Unemployment insurance tax	Individual income tax	License and other taxes	Total business taxes
California	7.9	6.1	8.2	100.0
Colorado	6.6	6.3	4.7	100.0
Idaho	7.9	6.2	7.9	100.0
Montana	6.1	6.2	11.5	100.0
Nevada	7.2	___	17.4	100.0
North Dakota	4.6	2.5	25.4	100.0
Oregon	18.0	8.9	12.6	100.0
South Dakota	1.4	___	8.2	100.0
Utah	6.9	6.1	5.7	100.0
Washington	11.3	___	4.6	100.0
Wyoming	1.7	___	43.4	100.0

Montana has implemented some modest reforms in the tax system in recent years, but if the state is to compete with other states in promoting economic growth it will have to implement more fundamental reform. An important recent reform was the reduction in the income tax rate. A more fundamental reform would be to introduce a revenue-neutral flat rate income tax designed to cut the income tax rate in half. This could be achieved by eliminating the many credits, deductions, and exemptions, and by broadening the base of the income tax. Combined with the more generous standard deduction and personal exemption in the federal income tax, this reform would improve the equity as well as the efficiency of the tax system.

The TABOR proposed in this study could set the stage for such fundamental tax reforms. A TABOR would constrain the growth of revenue and spending. In this environment serious discussion of tax reform is more likely. The following section traces the growth of state revenue and spending, demonstrating the need for this fiscal discipline.

Revisiting Montana's Tax and Spending Limit

Montana citizens may be surprised to learn that the state has had a tax and spending limit in place since 1981. They would probably be even more surprised to discover that a

recent study of tax and spending limits in the states awarded Montana a D+. ^{xvi} To understand why this tax and spending limit has failed to impose fiscal discipline, one needs only to examine two key components of that legislation.

First, the existing tax and spending limit is poorly designed. The limit is based on personal income growth, which simply locks in spending as a share of income. There is no provision for returning surplus revenue to tax payers. In addition, tying taxing and spending growth to personal income growth does not decouple state budgets from normal business cycles, resulting in the ratcheting up affect discussed earlier.

And second, because the current limit is statutory, it is very easy for legislators to ignore or exceed it. In recent years legislators have done so by shifting more appropriations ‘off budget’ as previously noted. Thus, it appears that they are pursuing prudent fiscal policies because the ‘on budget’ appropriations are within the limit.

Another failure that results from a mere legislative limit on taxing and spending is that the baseline budget from which growth is calculated can be manipulated. One means of doing this is by using the “Present Law Adjustment” process, wherein the biennial budget’s base (first) year’s bottom line is increased just prior to the end of that fiscal year, often under the pretense of ‘emergency spending.’ This increase is continued into the second budgetary fiscal year, and results in a higher baseline for calculating subsequent biennial budgets. This process results in an after the fact adjustment over which there are no effective controls, as was shown at the end of the 2007 legislative session when the FY2006-2007 budget was retroactively increased by the Executive with little or no legislative input or oversight.

A Taxpayer’s Bill of Rights Amendment for Montana

Designing a Taxpayer’s Bill of Rights Amendment for Montana

The fatal flaw in Montana’s fiscal policies is unconstrained, unmanaged growth in spending that has created a structural deficit in the state budget. Even with the recovery from the last recession, revenue growth has been insufficient to fund projected spending under current policies, and indications all point towards another downturn on the horizon. Solving Montana’s fiscal crisis in the long run requires the elimination of the structural deficit. The most effective way to constrain spending is to incorporate a Taxpayer’s Bill of Rights (TABOR) amendment in the constitution. ^{xvii}

Important Refinements for Montana’s Taxpayer’s Bill of Rights Amendment

A TABOR amendment could be designed to both constrain the growth of spending and stabilize the budget over the business cycle. Colorado’s TABOR amendment has several essential features:

- It is a constitutional rather than statutory tax and spending limit.
- It requires voter approval for any increase in taxes or debt.

- It limits the growth of revenue and spending to the sum of inflation and population growth.
- It requires that surplus revenues be returned to taxpayers through tax rebates/cuts.

In addition to these features, Montana’s amendment should include several important refinements of Colorado’s TABOR. First, Montana’s TABOR amendment should include an emergency fund and budget stabilization fund. In periods of prosperity, when revenue growth exceeds the TABOR limit, surplus revenue should be allocated to an emergency fund and a budget stabilization fund. When the cap on these funds is reached, surplus revenue is then returned to taxpayers through tax rebates/cuts. When the economy enters a recession, money is transferred from the budget stabilization fund to the general fund to offset revenue shortfalls and stabilize the budget.

Simulating a TABOR Limit

The following table simulates a TABOR amendment for Montana. It shows how a TABOR Amendment would have impacted the state’s fiscal policies had it been implemented in 1990. The simulation makes several simplifying assumptions. The TABOR limit is defined as the sum of inflation plus population growth. This limit constrains the growth in revenue the state can keep and spend each year.

A generous budget stabilization fund equal to 10 percent of revenues is assumed to stabilize the budget over the business cycle. This generous budget stabilization fund would permit the state to offset revenue shortfalls during periods of economic decline and maintain flat spending levels.

Table 1 – Simulating a Taxpayer’s Bill of Rights Amendment with an Emergency and Budget Stabilization Fund and Rebates

Year	Revenue	Tabor Limit	Revenue Surplus	Emergency and Budget Stabilization Fund (annual)	Emergency and Budget Stabilization Fund (total)	Tax Rebates
1990	730	720	10	10	10	
1991	805	759	46	46	56	
1992	881	800	80	34	80	46
1993	953	840	112	4	84	108
1994	892	885	7	7	89	2
1995	935	925	10	10	93	6
1996	963	967	-	-	89	-
1997	987	967	20	8	97	12
1998	1034	994	40	2	99	38
1999	1068	1012	56	2	101	54

2000	1164	1040	124	3	104	121
2001	1269	1083	186	4	108	182
2002	1266	1103	163	2	110	161
2003	1246	1135	111	4	114	107
2004	1382	1166	216	3	117	213
2005	1531	1216	315	5	122	310
2006	1708	1270	438	5	127	433
2007	1762	1317	445	5	132	440

Beginning in 1990 and 1991, surplus revenue is allocated to the emergency and budget stabilization fund. In subsequent years, when the 10 percent cap is reached on the emergency and budget stabilization fund, additional surplus revenue is allocated to tax rebates.

In 1996 there is a revenue shortfall with actual revenue falling below the TABOR limit. The budget stabilization fund is used to offset this shortfall and the TABOR limit is held constant in the following year.

After 1996 revenue recovers and surplus revenue is again allocated to the emergency fund, budget stabilization fund, and tax rebates.

In all, over \$2.2 billion dollars is returned to Montanans, setting the stage for permanent tax reform. With revenue and spending constrained by the TABOR limit, it is possible to offset the surplus revenue with permanent tax cuts rather than tax rebates. We would expect the legislature to enact permanent tax cuts as the size of tax rebates increases.

It is clear that the design of a Taxpayer's Bill of Rights amendment is unique to each state. A TABOR Amendment is especially important for a state such as Montana due to its heavy reliance on income tax revenues. As the data has demonstrated, income tax revenues are volatile compared to most taxes. Even if Montana enacted permanent reductions in income tax rates, income tax revenues would likely remain the major source of revenue.

Conclusion

Tax and spending limits are designed to address two problems: the increased burden of government taxation and spending in the long run; and the instability of revenue and spending over the business cycle. A Taxpayer's Bill of Rights (TABOR) amendment could be introduced in Montana to address both of these problems.

This study simulates the impact of a TABOR amendment in the Montana economy. A TABOR amendment could both constrain the growth of government and stabilize the budget over the business cycle. This would set the stage for much needed reform in Montana's fiscal policies. Income tax rates could be lowered to reduce the heavy tax burden on Montana citizens. This would improve the business climate, attracting new investment

and jobs. Higher rates of economic growth could allow income per capita in Montana to begin converging toward the national average.

Unfortunately, in the current environment, proposals to introduce a TABOR amendment have not made much headway. The major hurdle is educating Montana citizens about the need for fiscal discipline, which has been sorely lacking in the state. Only with this grassroots citizen support will politicians begin to undertake fundamental fiscal reform, such as the introduction of a TABOR amendment in the constitution, and begin to pursue more prudent fiscal policies.

The Montana Policy Institute is a nonpartisan public policy research center dedicated to the principles of limited government, individual rights, and individual responsibility. To find out more, please visit us at www.montanapolicy.org.

End Notes

ⁱ Ronald Reagan, “Reflections on the Failure of Proposition #1,” *National Review*, December 7, 1973.

ⁱⁱ Milton Friedman, “Freedom’s Friend,” *The Wall Street Journal*, June 11, 2004.

ⁱⁱⁱ Much of this discussion is from Barry W. Poulson, “Tax and Spending Limits: Theory, Analysis, and Policy,” Issur Paper 2-2004, *Independence Institute*, Golden, Colorado, January, 2004.

^{iv} The definition of the business cycle is based on the National Bureau of Economic Research measures of peaks and troughs in the growth of aggregate economic activity as measured by Gross National Product or Gross Domestic Product. For example, a recession is defined to occur after several continuous decreases in quarterly Gross National Product.

^v David Hoffman, Ed., Facts and Figures on Government Finance, *The Tax Foundation*, Washington, D.C. Nov. 2004, pp.191-271.

^{vi} Op. Cit. Poulson, “Tax and Spending Limits: Theory Analysis and Policy”.

^{vii} For a discussion of the experience with tax and spending limits in these states, see Ibid.pp.10-16.

^{viii} Ibid, pp.10-16.

^{ix} Barry W. Poulson, “Colorado’s TABOR Amendment: Past Trends and Future Prospects,” *Americans for Prosperity Foundation*, Washington, D.C., July 2004.

^x Even in Budget Crises Coloradoans Support TABOR Amendment Limits on Taxes and Government Spending, Poll Analysis, Ciruli Associates, Denver, Colorado, April 15, 2003.

^{xi}Op. Cit. Poulson, “Colorado’s TABOR amendment”

^{xii} Ibid, passim.

^{xiii} Unfortunately Colorado legislators have chosen not to introduce this refinement to TABOR. Referendums have been placed on the ballot calling for increase spending and debt, without the provision for a budget stabilization fund. If passed these referendums will make it more difficult to balance the budget in the next recession.

^{xiv} U.S. Census Bureau, Statistical Abstract of the United States, 2004-2005, <http://www.census.gov/statab/ranks/rank29.html>.

^{xv} Robert Cline, Tom Neubig, and Andrew Phillips. “Total State and Local Business Taxes: Nationally 1980 – 2005, by State 2002-2005, and by Industry 2005”, Council on State Taxation, March 2006; and “Total State and Local Business Taxes 50-State Estimates for Fiscal Year 2006, February 2007.

^{xvi} Barry W. Poulson, “Grading the States’ Tax and Expenditure Limits”, *Americans for Prosperity Foundation*, Washington, D.C., June 2005.

^{xvii} The discussion in this section is based on Op. Cit. Poulson, “Tax and Spending Limits: Theory Analysis and Policy,” and Poulson, “Colorado’s TABOR Amendment: Past Trends and Future Prospects”.