When the going gets tuff, state governments constrain their cities: A love story

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Introduction
Almost every state in the US has some sort of tax or expenditure limitation (TELs). These policies are designed to limit the power of the government to levy taxes or spend over a certain amount, which affects their ability to raise revenue and provide services to its citizens. There is a debate over whether or not such measures are necessary. This debate can be separated into 2 schools of thought:

Public Choice Theory

- The government acts like any other market
- People elect government officials who will enact their most preferred tax, expenditure combination
- TELs are irrational and inefficient
- Attacks local autonomy

Leviathan

- The government acts like a monopoly
- Bureaucrats will lobby to levy more taxes and spend more than the people desire in order to promote their agenda
- TELs are necessary to correct an externality
- Prevents rent-seeking

While these reasons are argued over the necessity of TELs, we can better understand how these TELs affect state and local governments by seeing when and why they are passed.

Hypothesis

When a recession occurs, the citizens increase demand for TELs in order to lower taxes. With state budgets already stretch thin, how do states react to this demand?
We believe that one way that state governments have done this is to enact TELs on local governments. Essentially, state governments will force local governments to satisfy the public’s demand for lower taxes. If this is true, when we track these TELs on state and local governments, we will see a larger amount of local government TELs right after recessions.

Methodology

To analyze this relationship, we used a TEL index created by Amiel, Deller, and Stollmann (2009). After standardizing this index, we then chart the recession that occurred during this period. By comparing these changes to the TELs proximity near recessions, we can see the role recessions play on TEL. If the vast majority of local TELs are enacted during or right after a recession, we can infer that the hypothesis could be correct.

Results

From this analysis we noticed the same states followed a pattern. So we classified these states into 4 categories: High State and Local TELs, High State, but Low Local TELs, Low State, but High Local TELs, and Low State and Local TELs. We also found some states that were hard to find a pattern for, which we labeled as “Non-discernable.” From an overall analysis of these states, we’ve noticed that there are some years in which states choose to enact TELs more than other years. To test the original hypothesis that these changes are correlated with recessions, we counted when each change for all 50 states which is displayed on the graph on the top right. Using this data, we then did a t-test to see if there was a significant difference between local and state TELs enacted after a recession, which is displayed on the table to the right.

Analysis

Using this data, we were able to find that overall, states enacted more TELs on local governments than state governments. There were 58 TELs that limited local governments’ ability to generate revenue and fund government programs while just 33 of these TELs were placed on states. The t-test revealed that states enacted significantly more TELs on local governments than the state after the early-70s recession and the “double-dip” recession in the early 80s. There was also more TELs enacted after the OPEC, stagflation recession in the mid 70s, but it was not significant. Conversely, there were more TELs enacted on the state after the early-90s recession, but this again was not significant. The dot-com bubble did not yield any TELs after its mild recession.

Conclusion

This analysis revealed insight on when and possibly why tax and expenditure limitations are enacted. The data suggest that local governments feel the brunt of the force behind TELs, particularly after a recession. As less frequent and milder recessions occur in the 1990s and 2000s, less TELs were passed for both state and local governments. This limited the ability of this research to receive insight in these TELs. More data is needed to continue the analysis of this legislation, particularly how state and local governments have responded to the most recent recession of 2007. Also, with tax and expenditure limitations being a mostly recent phenomenon, there is not a lot of data prior to 1969. The most recent history, however, has painted a rough story for local governments who endure most of the headaches associated with TELs.

We believe that this data could be use in future research concerning state and local governance. Such research includes state and local autonomy and fiscal stress with relation to TELs. This could be particularly interesting when considering the different patterns of state and local TELs for each state. It is possible that cities with higher TELs have less autonomy and/or more fiscal stress due to the implications of these TELs. Again, future research can decide this issue.

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