June 2003 marks the 25th anniversary of the passage of Proposition 13, a landmark tax limitation measure approved by California voters in 1978. Proposition 13 triggered one of the nation's largest state and local tax reductions by immediately cutting California property taxes by $5 billion. But Proposition 13's impact went far beyond tax relief in California. It launched a wave of tax limitation efforts in other states and created momentum for the large federal tax cuts passed in 1981.

Although Proposition 13 limited property taxes, it failed to impose long-term discipline on state and local budgets in California. Indeed, total state and local revenues (including federal aid) in California have risen from 19.4 percent of personal income the year after Proposition 13 passed to 24.6 percent today. Rapidly expanding spending since the mid-1990s has put the state into a fiscal crisis with record budget gaps currently being reported.

Proposition 13's focus on property taxes was too narrow to limit overall state and local government budgets in California. However, a number of states in the past decade have enacted broader tax and expenditure limitations (TELs) that attempt to control overall government growth. This paper discusses how well-designed TELs can restrain spending and provide tax relief. TELs combined with other mechanisms to terminate unneeded government programs should be pursued in all state and local jurisdictions to close current budget gaps and counteract the tendency of governments to collect ever-larger shares of Americans' income.

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Introduction

California's landmark Proposition 13 was passed in a June 1978 referendum with 65 percent popular support. It slashed California property taxes from $11 billion to $6 billion between 1978 and 1979 and instituted tax limitation mechanisms that are still in force today. Proposition 13's impact went far beyond tax relief in California. It launched a wave of tax limitation efforts in other states and generated momentum for large federal tax cuts in 1981.

This study first discusses the enactment of Proposition 13 and examines California's tax and spending trends during the past 25 years. The study then focuses on lessons learned from Proposition 13 and looks at budget mechanisms in other states to discern which are the most effective at controlling spending. A statistical analysis concludes that well-designed tax and expenditure limitations (TELs) can restrain government growth. Finally, the successful budget limitations in place in Colorado and Washington State are discussed.

The Enactment of Proposition 13

Throughout the 1960s and 1970s high and rising property taxes were a persistent problem in California. Total property taxes in California jumped from $6.7 billion in 1972 to $11.0 billion in 1978. A number of groups were formed to find a solution to the problem, including the United Organization of Taxpayers created by Howard Jarvis. The UOT focused on placing initiatives on the state ballot in an attempt to reduce property taxes. In 1968, 1971, and 1976 the organization’s efforts stalled when it failed to obtain a sufficient number of signatures. However, Jarvis teamed up with Paul Gann of People's Advocate in 1977, and their campaign easily surpassed the 500,000 signatures necessary to get Proposition 13 on the ballot.

Proposition 13 limited property tax rates to 1 percent of assessed value and limited property assessment increases to 2 percent annually. It also imposed a supermajority voting requirement on the state legislature for tax increases. Though it qualified for the ballot, Proposition 13 still faced hurdles. Indeed, many voters considered Proposition 13 too radical, and for much of the spring leading up to the June vote, polls showed that the electorate was evenly split. But Jarvis and Gann received good news in May when the assessor's office in Los Angeles County proposed huge increases in property assessments for the next fiscal year. The increases were bad news for taxpayers, but they made headlines and shocked homeowners, thus providing fuel to the tax limitation movement. Indeed, the opposition never recovered from that setback, and Proposition 13 passed with 65 percent of the vote—nearly a two-to-one approval margin.

The passage of Proposition 13 had a number of favorable consequences in California and across the country. First, it triggered an immediate $5 billion reduction in property taxes in California (from $11 billion in 1978 to $6 billion in 1979). That relief was much needed because property taxes had been soaring and newspapers were filled with stories of elderly residents on fixed incomes and other families that simply could not afford the rising burden. Second, tax cuts were needed to help boost California's economy. California's state and local tax burden was among the highest in the country before Proposition 13. And like the rest of the country, California was mired in stagflation during the late 1970s. Proposition 13 was a shot in the arm. In the years immediately following its passage, California's economic growth exceeded the national average, and the state's unemployment rate fell. That belied some economists' dire predictions. In early 1978 economic forecasters from the University of California, Los Angeles, had argued that Proposition 13 would increase unemploy-
ment and hurt the state's economy. Instead, the tax cuts were followed by robust economic growth.

Other dire predictions also failed to come true. Proposition 13 was strongly opposed by special interests, including unions, some big corporations, and various good-government groups. Those opponents argued that Proposition 13 would cripple vital government services. That did not occur, but after the initiative passed, the legislature did allocate part of the state surplus to local governments. Although some needed cutbacks in government spending were made, the predicted crisis did not materialize.

Finally, Proposition 13 generated nationwide momentum for tax cuts and tax limitations. Property taxes were an obvious focus for tax limitation efforts. Property taxes are highly visible to homeowners, and polls have consistently found that they are among the most unpopular taxes. A number of subsequent property tax limitation efforts were successful; Massachusetts's Proposition 2½ is the most prominent. Also, numerous states enacted a variety of tax and spending limitations in 1978 and 1979.

The Legal Aftermath of Proposition 13

Since its passage, Proposition 13 has come under numerous legal attacks, but it has remained largely intact. The attacks began even before Proposition 13 was enacted. In April 1978 government lawyers gathered in San Jose to map out a strategy for overturning Proposition 13 in court if it passed. Theirs was a three-pronged plan. First, they argued that Proposition 13 violated the single subject rule of the California Constitution. That rule requires that all ballot initiatives deal with only one subject. Second, they argued that different assessments of similar properties violated the equal protection clauses of the California and U.S. Constitutions. Third, they argued that Proposition 13 was unconstitutional because the revenue reductions would force local governments to breach contracts.

Shortly after Proposition 13 was passed, a lawsuit was filed. To gain maximum sympathy for the lawsuit, the lawyers decided to use school districts to front for Proposition 13's opponents. However, on September 22, 1978, the state supreme court rejected all three arguments and upheld by a six-to-one vote the constitutionality of Proposition 13.

Nonetheless, legal challenges continued through the 1980s and 1990s. One series of attacks centered around the ability of local governments to levy nonproperty taxes. Section 4 of Proposition 13 states, “Cities, counties, and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes.” Jarvis intended that provision to cover all the taxes that local governments were authorized to impose. However, in San Francisco v. Farrell, the California Supreme Court ruled that “special taxes” meant “taxes which are levied for a specific purpose rather than a levy placed in the general fund to be utilized for general government purposes.” That decision allowed localities to impose or increase any locally authorized general tax without voter approval.

California voters reversed that court decision in 1986 when they approved Proposition 62. That initiative required that general taxes imposed by local governments be approved by a majority popular vote. In 1991 a California appellate court ruled that Proposition 62 was unconstitutional. However, that decision was reversed by the California Supreme Court in 1995. In 1996 California voters approved Proposition 218, a constitutional rule backed by the UOT, that required that all local general taxes secure majority approval and that special taxes secure two-thirds voter approval.

Another series of legal attacks on Proposition 13 centered on the equal protection clause. Proposition 13 led to disparities in property assessments and thus property tax burdens. Annual assessment increases were limited for particular homeowners, but
when property was sold, it was reassessed at market value. As a result, owners of similar homes might face different tax burdens depending on when they purchased their property. The test case that reached the U.S. Supreme Court involved Los Angeles County homeowner Stephanie Nordlinger. Nordlinger purchased a home in November 1988 for $170,000. She argued that the state was violating the equal protection clause because her property taxes were five times higher than the taxes paid by owners of comparable homes.²⁸

In an eight-to-one decision, the Court on June 18, 1992, upheld the constitutionality of Proposition 13. Justice Harry Blackmun wrote in the decision that “the appropriate standard of review is whether the difference in treatment between newer and older owners rationally furthers a legitimate state interest.” Blackmun found two compelling state interests: neighborhood preservation and continuity, and the protection of existing property owners who purchase property with certain tax expectations.²⁹ That case marked the last major legal attempt to overturn Proposition 13.

California Taxation and Spending since Proposition 13

Proposition 13 and the broader tax revolt in California have had a mixed long-term impact. Proposition 13 was both an immediate tax cut and a longer-term tax limitation. As a cut, it successfully reduced sky-high homeowner tax burdens. However, it has enjoyed less success at controlling overall tax burdens in the state. In the years following the passage of Proposition 13, the state government raised the general sales tax rate and tax rates on beer, wine, gasoline, cigarettes, and other items.³⁰

Figure 1 shows Census data on California state and local revenues from property taxes compared to the sum of revenue from general sales taxes and income taxes (individual and corporate).³¹ Property taxes dropped substantially in the late 1970s and have not exceeded 3 percent of state personal income since then. Sales and income taxes rose sharply in the 1970s and again during the 1990s. California personal income grew at an average annual rate of 7.3 percent between 1979 and 2000, while property taxes grew at
7.2 percent. But income taxes grew at 9.3 percent and total state and local government revenue rose at an average annual rate of 8.5 percent during the period.

Figure 2 shows total state and local government revenues in California since 1977 in constant 2000 dollars.²² (This is a broad Census measure of revenues; it includes federal aid and various nontax receipts). Figure 2 illustrates that after Proposition 13 cut revenues in 1979 it took a few years for the government to regain ground. However, during the economic booms of the late 1980s and the late 1990s, revenue soared. In sum, California taxpayers were winners in the late 1970s but have lost ground to the government since then.

Supporters of tax limitation in California have long recognized that Proposition 13 alone was not enough to control state and local government growth. In 1979 Gann gathered enough signatures to place Proposition 4 on the ballot.³³ Proposition 4, which became known as the Gann Amendment, limited increases in state and local appropriations from tax revenue to population growth plus inflation (now limited to personal income growth).³⁴ Interestingly, Jarvis was ambivalent about Proposition 4. He focused mainly on reducing taxes, not spending, and did not endorse Proposition 4 until the end of the campaign.³⁵ Nonetheless, Proposition 4 passed by nearly a three-to-one margin.³⁶ Initially, Proposition 4 was modestly successful at reducing state spending growth. Indeed, California taxpayers received tax rebates from the state government in 1987 when revenue exceeded the imposed budget limit.³⁷

However, the long-term effectiveness of Proposition 4 was reduced by a number of factors. Proposition 4 established a limit on appropriations from tax revenue, not on overall spending.³⁸ As a result, California began to rely more heavily on revenue from fees and other nontax sources. More important, the budget limit was undermined in 1990 when California voters passed Proposition 111, which mandated increases in California’s education spending and watered down the Proposition 4 budget limit to pay for them.³⁹

California’s rank among the 50 states in per capita state spending fell from 7th highest in 1980 to 16th highest in 1991, partly as
a result of the Proposition 4 limit. Then as the limit was weakened, California's rank rose to 12th by 2000. A similar pattern occurred for per capita state taxes and overall state revenues. In the early 1990s the passage of Proposition 111 did not immediately cause a state spending increase because California had to cut spending to balance its budget during the recession. But spending soared in the 1990s, as illustrated in Figure 3, which shows state general fund spending in 2003 constant dollars. With regard to the current state budget crunch, Figure 3 shows that real spending dipped slightly in 2002 and 2003 but is still far higher than in 2000. If spending had been held to the original Proposition 4 limit since 1994, it would have been $25 billion lower in 2003, and the state could have averted its current fiscal crisis.

**Finding Tax and Expenditure Limitations That Work**

California's experience shows that broader rather than narrower limitations on taxes and spending are needed to restrain government growth. TELs establish broad caps on annual growth in government budgets. New Jersey passed the first state TEL in 1976, and 26 states currently have TELs on the books. A number of academic studies have concluded that TELs are ineffective. However, some recent evidence shows that the particular design of a TEL is important to its effectiveness. If properly designed, a TEL can be a useful mechanism for enforcing state fiscal discipline.

Two provisions, in particular, can dramatically enhance the effectiveness of a TEL: a provision that limits the growth of government spending to a baseline of inflation plus population growth and a mandate that the government immediately refund surplus revenues above that limit to taxpayers.

**Limiting Expenditure Growth to Inflation Plus Population Growth**

Most of the state TELs passed since 1976 limit growth in spending and revenues to state personal income growth. However, Colorado and Washington State have more stringent measures that limit spending growth to infla-
tion plus population growth. That limit is preferable to personal income growth because income tends to grow faster over time than population plus inflation. Holding spending increases to personal income growth, as most TELs do, does not provide an effective check on government growth.

Refunding Surplus Revenues to Taxpayers

A second effective TEL provision is a requirement for the immediate refund of surplus revenues to taxpayers. Four states (Colorado, Michigan, Missouri, and Oregon) have TELs that require the return of excess revenues that exceed limits. Rebate provisions strengthen TELs by making it more difficult for governments to spend the excess. In addition, they give citizens and watchdog groups an incentive to see that the limits are enforced.

An examination of the recent budgetary histories of Colorado, Michigan, Missouri, and Oregon illustrates another positive incentive created by TELs with rebate mechanisms. When state legislators see that revenues will exceed limits, they often proactively cut taxes to reduce revenue inflows to the government. That is a politically appealing way for legislators to return excess revenues to taxpayers. It can also provide taxpayers more economically beneficial permanent cuts, not just temporary rebates.

It is simpler for legislators to proactively cut taxes than to deal with rebate mechanisms. While property and income taxes can be rebated, it is difficult to rebate sales taxes. Also, if refunds are proportional to overall taxes paid, they appear to favor the rich, which concerns some legislators. As a result, legislators have an incentive to cut taxes before automatic refunds take effect. Indeed, Colorado, Michigan, and Missouri (three of the four states that have TELs with mandated refunds) have enacted tax cuts when revenues have exceeded the mandated limits.

Regression Analysis of TEL Provisions

A regression analysis of state budget data between 1972 and 1996 sheds light on which TEL provisions are the most effective. The results demonstrate that a spending limit equal to population growth plus inflation is an effective structure for a TEL. Under such a limit, the regression equation predicts that state and local spending per capita will be reduced by $115 per year.

Refund provisions are also effective. If a TEL does not include a population plus inflation growth limit but does include a refund provision, the regression predicts that per capita spending will be reduced by $40 per year. The analysis also suggests that TELs with neither of those two provisions will not be effective at controlling spending. In sum, statistical analysis provides evidence that TELs can be an effective tool for limiting state government growth, but only if they are well designed.

A Closer Look at Washington and Colorado

The TELs passed in Washington State and Colorado have been particularly effective. TELs in both states limit annual spending growth to the sum of population growth plus inflation. Washington’s limit, passed in 1993, took effect in fiscal 1996. Colorado’s limit, passed in 1992, took effect in fiscal 1994. This section presents case studies of those two states.

Washington’s Initiative 601

In response to a tax hike passed by the state legislature in early 1993, voters in Washington State enacted a TEL called Initiative 601. Initiative 601 had two features that made it particularly effective at limiting spending. First, it limited annual state spending growth to population growth plus inflation. Second, it prevented the legislature from circumventing the limit by devolving functions of government to the localities.

After Initiative 601 was enacted, the state legislature passed a supplemental budget to ensure that it was in compliance with the
limit. The legislature instituted some targeted budget cuts in administration, social services, prisons, and elsewhere to save more than $120 million in the new biennium. Public colleges were directed to trim expenses by $39 million.\(^57\)

Initiative 601 was effective at limiting state spending growth. In the four years before the initiative took effect, spending increased by an average of 17.3 percent annually. In the four years after the initiative took effect, spending increased by 8.6 percent annually.\(^58\) In the late 1990s the legislature took steps to reduce taxes when it appeared that the government was collecting excessive revenue. The legislature enacted tax cuts of $38.5 million and $19.7 million for fiscal 1998 and 1999, respectively.\(^59\)

Washington voters desired even greater tax relief. In 1998 voters passed Initiative 695, which reduced the motor vehicle excise tax by $256 million. In 1999 voters repealed the motor vehicle excise tax, reducing the tax burden by an additional $1.1 billion.\(^60\) A taste of tax reduction under Initiative 601 apparently led to demands for further tax cuts.

Initiative 601's main shortcoming is that it is statutory, not constitutional, which makes its limitations subject to legislative override. In the spring of 2000, the state legislature obtained the necessary supermajority to suspend the limit, and the governor signed that year's budget into law.\(^61\) As it turned out, lifting the limit in 2000 was very poorly timed because it led to spending increases that were unsustainable in the economic slowdown that began in 2001.

**Colorado’s Taxpayer Bill of Rights**

The most successful TEL is Colorado’s Taxpayer Bill of Rights. During the late 1980s and early 1990s, anti-tax activist Douglas Bruce led efforts to enact ballot measures to reduce taxes in the state. After unsuccessful attempts in 1988 and 1990,\(^62\) Colorado passed TABOR in 1992.\(^63\)

Like Washington’s Initiative 601, Colorado’s TABOR limits spending growth to population growth plus inflation and mandates immediate refunds of surplus revenues above that limit.\(^64\) Unlike the Washington law, TABOR is a constitutional provision and thus the legislature cannot override it.\(^65\)

Shortly after TABOR was enacted, Colorado revenues began to exceed the limit and taxpayers were entitled to tax rebates. From 1997 to 2001 Colorado reduced taxes more than any other state, issuing annual tax rebates of $139 million in 1997, $563 million in 1998, $679 million in 1999, $941 million in 2000, and $927 million in 2001, for a total of $3.2 billion.\(^66\) State data show that a taxpayer earning $30,000 would have received total rebates of about $900 over this period.\(^67\)

Although TABOR has provided modest rebates, political opposition has demonized it as being far too radical. When TABOR was initially being debated, the New York Times called it the “most radical ballot initiative in the nation.”\(^68\) Gov. Roy Romer said that defeating TABOR was the “moral equivalent of defeating the Nazis at the Battle of the Bulge.”\(^69\) He called TABOR champion Bruce “a terrorist who would lob a hand grenade into a schoolyard full of children.”\(^70\) Romer also predicted that TABOR would damage the state economy.\(^71\)

None of those dire predictions came true. In fact, Colorado’s economy has been exceptionally strong. Between 1995 and 2000 Colorado had the fastest growth in gross state product of any state and the second fastest growth in personal income.\(^72\) In addition to providing tax relief and spurring economic growth, TABOR allows Colorado residents to appreciate the tradeoffs of expanding or contracting the state government at the margin. Every year from 1993 to 1999 there was a proposal on the ballot to either raise taxes or increase spending in excess of the limit. Knowing that those initiatives would reduce the size of their tax rebate, voters soundly defeated each measure.\(^73\) In 2001 an initiative to increase school spending did pass.\(^74\) However, TABOR had been so effective at keeping spending in check that the state government had enough surplus rev-
enue to increase school spending in 2001 and still issue tax rebates that year.\textsuperscript{75}

**Conclusion**

California's Proposition 13 remains a landmark victory for taxpayers seeking to impose limits on government expansion. It resulted in substantial and ongoing property tax relief in the state and generated nationwide momentum for tax reform. However, Proposition 13 did not impose overall discipline on state and local spending in California. Indeed, California's rapid spending increases during the 1990s caused the large budget crisis that the state currently faces.

The good news is that Proposition 13 spawned policy innovations in other states, and a number of states provide models of effective TELs. A well-designed TEL, such as Colorado's TABOR, can restrain spending growth and provide tax relief.

In addition to implementing budget growth limitations, state policymakers should always look for unneeded programs to terminate or privatize. Some states, such as Texas, have “sunset” commissions that examine state programs in detail on a rotating schedule to look for waste and duplication.\textsuperscript{76} Widespread sunsetting would reduce overspending by reforming programs on an ongoing basis. While TELs focus on aggregate state budget figures, sunset mechanisms are a great complement to cut unneeded programs and provide the lean and efficient state governments that America's taxpayers deserve.

**Notes**

5. Ibid., pp. 70–72.
7. Ibid., pp. 73–74.
8. Ibid., pp. 74–75.
9. Ibid., p. 80.
10. Ibid.
11. Ibid., p. 75.
15. Kuttner, pp. 69–70.
16. Ibid., p. 72.
17. Ibid., pp. 81–83.
18. Rabushka and Ryan, pp. 129–30. See also Kuttner, pp. 84–90.
19. Ibid.
22. Ibid.
23. Ibid., p. 159.
24. Ibid., p. 185.
25. Ibid.
26. Ibid., p. 205.
27. Ibid., pp. 304–5.
28. Ibid., p. 259.
29. Ibid., p. 260.


32. Ibid. See also U.S. Bureau of the Census, State and Local Governmental Finances. Figure 2 uses the broadest Census measure of revenues, which includes federal aid, fees, charges, and insurance trust revenue.

33. Kuttner, p. 304.


35. Kuttner, p. 305.

36. Ibid., p. 306.


41. Doerr, p. 246.


43. Rabushka and Ryan, p. 186.


47. Ibid., pp. 13, 18.

48. Ibid., pp. 27–33.


50. See New, pp. 9–10, for the full statistical results of this analysis.

51. Ibid., pp. 10–11.

52. Ibid.

53. Ibid.


55. Ibid., p. 17.

56. Ibid., p. 18.

57. Ibid.


63. Ibid.

65. Ibid., p. 13.


67. Ibid. Calculations by the author.


70. Quoted in ibid.

71. Ibid.


74. James, p. 10.
