Fiscal Analysis Department
Minnesota House of Representatives

ISSUE BRIEF

Revenue and Expenditure Limits

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Proposals have been introduced in the Legislature for statutory or constitutional limits on Minnesota governmental revenue and spending.

According to information from the National Conference of State Legislatures, 21 states have some type of tax or spending limit. Limits included in this number range from the constitutional revenue limit of population growth plus inflation in Colorado, to a statutory spending limit of the average growth in personal income for the previous five years or change in inflation from the prior year in Connecticut.

As seen by the examples listed above, what is limited (revenue or expenditures) and the mechanism for determining the limit vary significantly. The Colorado revenue limit is increased by inflation plus population change. The Connecticut spending limit increases by the greater of the average personal income growth over the previous five years or the increase in inflation over the previous year.

Of the 21 states, four have limits that apply to revenue, 15 have limits that apply to spending, and two have limits that apply to both revenue and spending.

Seventeen of the 21 states have limits tied to the growth in personal income in the state and four states have limits tied to change in population plus inflation.

Not included in the number above are an Oklahoma limit on expenditure growth of 12 percent plus inflation and a Nevada limit on spending of population growth plus inflation that applies to the *proposed* budget. Also not included in the number above are four states that have limits on expenditures as a percent of revenues. (These limits attempt to assure a balanced budget and to maintain a budget balance.)

To help in thinking about these proposals, the following are a series of questions that might be asked. The questions and issues are intended to explore various options that might be considered in designing and discussing the proposed limits.

1. What is limited, revenues or expenditures?

- If revenues, does the limit apply to all revenues, general fund revenues, tax only revenues (non-tax revenue would primarily be fees)? Is higher education tuition included? Is federal revenue included?

- If expenditures, does the limit apply to all spending, or general fund spending only, or general fund and some other funds? Is spending of federal funds included? Is "spending" to increase budget reserves included?

- If expenditures, is there an exception for spending to reduce taxes (i.e. state expenditures for property tax refunds or property tax credits)?

- If expenditures, is the cost of bonding projects included in the limit or only the annual debt service on bonding projects (technically, the cost of bonding projects are appropriations from the state bond fund)?

2. Should growth be limited by population growth plus inflation, or by growth in personal income in the state?

- If population plus inflation, how should they be measured?
  - a) What measure of inflation should used?
    - i. Consumer price index (CPI) national, Midwest regional CPI, or Minneapolis - St. Paul CPI.
    - ii. Gross domestic product price deflator.
    - iii. State and local government price index – the price index for state and local government consumption expenditures and gross investment.
  - b) What measure of population change should be used?
    - i. State demographic estimates.
    - ii. Census Bureau data.
    - iii. Should this measure be annual change or some average?

- If personal income, how should income in the state be measured?
  - a) Most states use personal income as measured by the U.S. Department of Commerce. This income measure is used by the Department of Finance in calculating the price of government measure.
  - b) One state uses wages and salary income.

3. How is the growth measure calculated?

- Is the measure an estimate of future growth for the year being limited (an estimate of personal income change between 2004 and 2005) or is it actual measure of past change?

- Should the measure be an annual change (i.e. FY 2005 adjusted by annual CPI change compared to FY 2003) or an average (i.e. FY 2005 adjusted by a three or five year average change compared to FY 2003)?

4. Is the baseline revenue or spending a one-year amount or an average of several years?

- Is the limit based on revenue or spending in one base year (i.e. FY 2005)? Does it float (third previous year)?

- Another perspective, if spending or revenue falls short of the capped level in one budget period, does this result in a lower limit for the next year? (Use it or lose it?) Or is it the *limit* that grows each year?

5. Once adopted, how often must the limit be adjusted?

- Must the limit be adjusted when updated data for a year is available? If adjustment is not required, is it an option?

- How does the limit interact with forecasted expenditures? For example, if the limit is on expenditures and expenditures are at the limit, then the number of K-12 education students increases in the second year of the biennium, are any adjustments in state expenditures required or allowed?

6. **If the limit is a revenue limit, is there a threshold after which revenue must be rebated?**

- For example, a rebate is only in effect if revenue collection exceeds the limit by more than a certain percent. (On a $14 billion annual budget, ½ of one percent would be $70 million.) This could eliminate rebating relatively small amounts.

- What are the permissible uses of the excess revenue beyond the limit? Can they be used to fund *any* tax cut? Or only "rebates" or tax cuts of a specified nature?

7. Is there an exception for disasters or emergencies (such as tornado relief)?

8. Is an adjustment to the limit allowed for a major change in state/local funding relationships (such as the state takeover of the general education levy)?

9. Can a limit be overridden by a super-majority vote of the Legislature?

10. Is there a sunset date on the revenue or spending limit (for example, expiration after 8 years)?

11. Are any limits placed on revenue or spending of local governments?

For more information, contact Bill Marx, Chief Fiscal Analyst, at 651-296-7176 or at bill.marx@house.mn or Paul Wilson, Fiscal Analyst, at 651-297-8405 or at paul.wilson@house.mn