

Locally Imposed Tax and Spending Limits

by Leah Brooks and Justin Phillips

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State limitations on the ability of cities to tax and spend are ubiquitous: Over the last 30 years almost every state has adopted some restriction on municipal fiscal behavior. Social scientists have documented the presence and extent of those limits,¹ studied why these limits are imposed,² examined their effect on expenditures and fiscal structure,³ and analyzed their effect on the distribution of taxation⁴ and service quality.⁵

¹See Mullins and Wallins (2004), and Advisory Commission on Intergovernmental Relations (1995).

²See Alm and Skidmore (1999), Cutler et al. (1999), Ladd and Wilson (1982), Ladd and Wilson (1983), Stein et al. (1983), Temple (1996), and Vigdor (2004).

³See Shadbejian (1996), Joyce and Mullins (1991), Figlio and O'Sullivan (2001), Mullins (2004), and Mullins and Joyce (1996).

⁴See Chernick and Reschovsky (1982).

⁵See Figlio and Rueben (2001), Downes, Dye, and McGuire (1998), Dye and McGuire (2001), and Downes and Figlio (1999).

Despite the wealth of knowledge on state-imposed tax and expenditure limits, there is no systematic evidence on a similar type of limit: a restriction on taxation or expenditure imposed by cities on themselves. There are many reasons to think that locally imposed limits should not exist. First, almost all cities already face at least one state-imposed tax or expenditure limit. Second, cities are by construction already constrained in their ability to raise revenue. The process of municipal incorporation includes formal limits by state governments on the amount of debt cities may issue, the tax rates they may charge, and the bases on which they may levy taxes. Third, competition between cities may limit municipalities' ability to tax (Tiebout, 1956).

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Our survey presents the first evidence on municipally imposed tax and expenditure limits. Despite the many reasons to think that municipally imposed limits should not exist, our survey shows that at least one in eight cities over 25,000 people has some type of locally imposed tax or expenditure limit. We interpret that estimate as a firm lower bound on the extent of those limits. As do state-imposed limits, the local limits focus heavily on the property tax: Almost two-thirds of local limits restrict the ability of cities to increase property tax levies. We document that cities with limits see smaller increases in own-source revenue after the limit is adopted, and that cities are likely to adopt limits when taxes are high, when a politician wants to raise one tax and promises a limit in exchange, or when a political entrepreneur wishes to build a reputation as a tax fighter.

Survey and Supplemental Data

Survey Description

In the summer of 2006, we conducted a pre-survey of 60 cities in which we attempted to verify if

Table 1.
Local Limit Examples

City	Description	Override
Baltimore, Md.	Assessment Limit: Assessments on property cannot increase by more than 4%	Majority of City Council
Eastpointe, Mich.	Property Tax Rate Limit: Property tax rate is capped at 1.5%	Majority of Voters
Lincoln, Neb.	Property Tax Levy Limit: The total property tax levy may not increase annually by more than seven percent from the 1966 baseline	Majority of Voters
Anchorage, Alaska	Revenue or Expenditure Limit: Total tax revenue cannot increase by more than the rate of inflation plus population growth	Majority of Voters
Tucson, Ariz.	Sales Tax Limit: The city cannot levy a sales tax that exceeds 2%	Majority of Voters
Columbus, Ohio	Other: The city income tax is capped at 1%	Majority of Voters

Source: Authors' survey.
Notes: This table presents an example of each type of limit about which our survey asked. Ohio has a state-level limit on municipalities' income tax rate, but the Columbus limit listed here preceded this state-level limit.

we could identify locally imposed limits by reading municipal charters or codes. In that pre-survey, we first examined each city's charter (if existing) and municipal code to find limits. We then called the cities to ask whether the city had any limits; if the answer was no and our reading suggested yes, we asked about the discrepancy. It quickly became clear that it was easy to mistake a limit mentioned in city documents for a locally imposed limit when it was, in fact, a state-imposed limit or a restriction resulting from the incorporation process.

With that knowledge in hand, in 2007 we undertook a phone survey of 347 cities. Our sample consists of all 247 cities over 100,000 people, and a random sample of 100 cities between 25,000 and 100,000 people. We used the Census of Governments 2002 Governments Integrated Directory as our sample frame and kept only cities with the following political descriptions: Charter Township, City, City and Borough, City and County, City-Parish, Consolidated Government, Municipality, Town, and Village.⁶ We refer to all those entities throughout as cities. For each city, we collected contact information from Web sites of the city's manager, budget director, and finance director and attempted to contact each of the 736 officials for whom we had information.

In total, we spoke with 412 officials, and received responses from 320 unique cities, generating a 92

percent response rate.⁷ When a city told us that it had a local limit, we verified that limit by looking in the code or charter for evidence of the limit. If we could not find the limit, or if the evidence suggested that it was a state-imposed limit, we recontacted the city to verify the information. That led to the exclusion of several false positives. We did not do a similar exclusion for false negatives — cities that do have a limit, but that mistakenly reported that they do not. For that reason, we interpret our results as a firm lower bound on the presence of local limits: We believe their true extent to be larger than our estimate indicates.

Supplemental Data

We combine the results of our survey with a wealth of local municipal data in order to explain which types of cities adopt local limits. To describe cities' fiscal condition, we use data from the "Annual Survey of Government Finances, 1970-2004," which collects fiscal information from all larger cities with certainty, and from a random sample of smaller cities. To describe the demographic features of cities, including the metropolitan area in which each city is located, we use data from the decennial censuses of 1970, 1980, 1990, and 2000. Data on municipal political structure come from the 1987 Census of Government Organization. We use the urban Consumers Price Index to convert all of our information into 2006 dollars.

We use data on state-mandated tax and expenditure limits from Mullins and Wallins (2004), ACIR (1995), and Waisanen (2008). Also, we identify states with potentially binding limits. The set of potentially binding limits includes general revenue or

⁶Appendix Table 1 in our working paper (available on Brooks' Web site) presents summary statistics for the cities that were sampled with certainty (those over 100,000 people in 2002), and compares the 90 sampled with the 908 non-sampled cities in the 25,000 to 100,000 population range. Note that we based our sample on older population figures, so that 10 of the cities that we chose as being between 25,000 and 100,000 people moved up into the over 100,000 category. As we would expect, for all variables but one (total revenue), the average (noncertainty) sampled city is statistically insignificantly different from the average nonsampled city.

⁷In our working paper, Appendix Table 2 compares respondent and nonrespondent cities. Among the 11 fiscal and demographic characteristics we present, 10 pairs are insignificantly different; nonrespondents report significantly lower median income.

expenditure limits, property tax levy limits, or the combination of a property tax rate limit and a limit on assessment increases.

Do Limits Exist?

Forty of our 320 respondent cities, or 12.5 percent, have at least one local limit. Those 40 cities have 56 individual local limits. Table 1 presents one example of each different type of local limits about which our survey asked. Eastpointe, Mich., caps the property tax rate at 1.5 percent, and Lincoln, Neb., limits the total property tax levy to no more than a 7 percent annual increase from a 1966 baseline. Baltimore, Md., limits the growth in property assessments to no more than 4 percent, and Tucson, Ariz., limits the municipal sales tax to 2 percent. Anchorage, Alaska, has one of the most extreme local limits in our survey: It limits tax revenue growth to inflation and population growth. Columbus, Ohio, caps the municipal income tax rate at 1 percent.⁸

Table 2.
Description of Local Limits

	(1) Number	(2) Share
Type of limit		
Assessment limit	4	7
Property tax rate limit	22	39
Other	12	21
Property tax levy limit	9	16
Revenue or expenditure limit	3	5
Sales tax limit	6	11
Total	56	100
Where is the limit adopted?		
In municipal charter	38	68
In municipal code	13	23
No valid response	5	9
Is an override possible?		
No valid response	5	9
No	2	4
Yes: Majority vote of the city council	6	11
Yes: Majority vote of the electorate	36	64
Yes: Supermajority of the city council	3	5
Yes: Supermajority of the electorate	4	7
<i>Source: Authors' survey.</i>		

Table 2 shows the full distribution of types of local limits, and features of their adoption and repeal. Those laws are overwhelmingly concentrated on

⁸Columbus also has a state-imposed limit on cities' ability to levy income tax; the local limit predates the state limit.

limiting property tax revenue. Property tax rate limits and property tax levy limits, at 39 percent and 16 percent respectively, make up the majority of the limits we observe. There are three total revenue or expenditure limits, which are the strongest type of limit, placing a hard cap on increases in municipal revenue or expenditures — usually to inflation and population growth. In general, those limits may be adopted by either a vote of the city council or a vote of the citizens. While we do not observe how the limit was adopted, we do know where the limit resides, legally. Well over half of local limits are written into municipal charters, making their repeal more difficult and politically costly than a limit in the municipal code. The majority of local limits can be overridden, but in 64 percent of limits this requires a majority vote of the electorate.

Table 3.
Officials' Impression of Limits' Impact

	(1) Number	(2) Share
Has Your City Reached the Limits?		
No valid response	3	7.4
No, but close	3	7.4
No, not close	16	39.3
Yes	19	45.9
Has the Limit Affected Practices in Your City?		
Effects long-term projects only	1	1.6
No valid response	9	14.1
No clear effect	22	34.4
Other	9	14.1
We have increased borrowing	1	1.6
We have new revenue sources	11	17.2
We have reduced service provision	11	17.2
<i>Source: Authors' survey.</i>		
<i>Notes: Responses to the question of whether a city had reached its limit came from officials; this table uses the average response of officials by city and thus does not exactly total to 40 cities. We allowed respondents to choose more than one way the local limit could affect practices in their city, so this question has more answers than there are cities with limits.</i>		

Table 3 reports officials' impressions of the effect of those limits, aggregated to the city level. Of the 40 cities with limits, roughly half report that they have reached the limits, while another 5 percent report being close. We also asked officials if they thought the limit had affected fiscal practices in their city, and slightly over half suggest that the limit has had some effect: Approximately one-fifth report finding new revenue sources, and another roughly one-fifth report reducing service provision.

How are municipal limits distributed across the county? Table 4 (next page) reports that cities with limits are strongly overrepresented in the Midwest,

and modestly overrepresented in the South. Municipalities in the Northeast have few limits and municipalities in the West are somewhat underrepresented among cities with limits. When we rank the surveyed cities by quartile of median family income, we find that adopting cities are underrepresented in the wealthiest quartile.

Table 4.
Limit Status by Region and Income

	(1)	(2)	(3)	(4)
	Number of Cities by Local Limit Status		Share of Cities by Local Limit Status	
	Yes	No	Yes	No
Region				
Northeast	3	51	0.08	0.19
Midwest	14	42	0.35	0.15
South	13	77	0.33	0.28
West	10	104	0.25	0.38
Quartile of Income				
1 (lowest)	11	64	0.28	0.23
2	11	66	0.28	0.24
3	13	67	0.33	0.24
4 (highest)	5	77	0.13	0.28
<i>Source:</i> Authors' survey; region and income data are from the 2000 Decennial census.				
<i>Note:</i> Shares are column shares. For example, 7 percent of cities with a local limit are in the Northeast; 19 percent of cities without a local limit are located in the Northeast.				

Are local limits more or less likely in places with state limits? Table 5 shows the share of cities with a given local limit by type of state limit. Cities with property tax rate or levy limits are likely to also have similar state limits. For example, 91 percent of cities with a locally imposed property tax rate limit are in a state that also has a property tax rate limit on cities. For the remaining types of limits that we can measure at both the state-imposed and city level, the limits don't overlap much. For example, no cities with an assessment limit have a state-imposed revenue or expenditure limit, and only one quarter of cities with an assessment limit are in a state with a state-imposed assessment limit.

Do Limits Change Spending?

While the data clearly show that local limits are pervasive, it is not obvious that they are consequential. Using regression analysis (see our working paper for complete technical details), we examine whether cities that adopt limits collect less revenue from their own sources after the limit is adopted. Our method nets out any factors that are fixed within a city over time (for example, municipal institutions, location), and any factors that are fixed across all cities in a given year (for example, general macroeconomic shocks).

We compare the trend in revenue for cities without limits to the trend in cities with limits, before and after the limit. We find that in nonlimited cities, average real own-source revenue increase by 3.8 percent per year. In cities with limits, before the limit is adopted, revenue increased at an average rate of 5.1 percent per year. After the limit, revenue increases at a statistically distinguishable 3.3 percent per year.

Well over half of local limits are written into municipal charters, making their repeal difficult.

To what can that decline in the revenue trend be attributed? Our analysis cannot distinguish between multiple plausible hypotheses. First, it may be that the limits do, on average, really constrain the amount of revenue that politicians are able to raise. Second, it may be that limits do not mechanically constrain politicians, but do serve to put politicians on notice that citizens take a dim view of tax increases. Third, it may be that places that adopt limits are already on a downward spending trend. This last hypothesis is partially refutable. When we do the same analysis, replacing the true year of adoption with a randomly assigned year of adoption, we find that the difference in revenue trends is no longer significantly different. From that, we take that there is something critical about the timing of the local limit.

Reasons for Adoption

What leads a city to impose a limit on itself? We look at this question quantitatively and qualitatively. Quantitatively, we look at whether long-term features of cities — for example, size and institutional characteristics — differ between limited and nonlimited cities, and we examine whether there are temporal patterns to when limits are adopted. Qualitatively, we use case study evidence on the limits we were able to investigate and identify three significant reasons for adoption.

We examine long-term features of cities using data from 2002, comparing averages in cities with limits to cities without. Three differences stood out as being statistically significant. The average city with a limit has a median family income of \$55,000 — substantially lower than the \$62,000 median family income in unlimited cities. The average city with a limit is in a metropolitan area with 19 cities, while the average nonlimited city is in a metropolitan area with 41 cities. Finally, fourth-fifths of limited cities are home rule (as opposed to general law) cities, while only about half of nonlimited cities are home rule. Those differences are intriguing, but none of them remain significant in a regression

Table 5.
Share of Cities With Local Limit by Type of State Limit

	(1)	(2)	(3)	(4)
	State Limit			
Local Limit	Property Tax Rate	Property Tax Levy	Assessment	Revenue or Expenditure
Property tax rate	0.91	0.91	0.36	0.18
Property tax levy	0.89	0.89	0.11	0.33
Assessment	0.25	0.25	0.25	0.00
Revenue or expenditure	1.00	1.00	0.00	0.50

Sources: Local limit information from authors' survey. State limit data from the Advisory Commission on Intergovernmental Relations (1995) and Mullins and Wallins (2004).
Notes: Each cell in this table presents the share of cities with the local limit in that row that also have the state-imposed limit in that column.

framework with multiple controls. We suspect that is because of our small sample. We also used statistical methods to examine whether cities adopt limits in response to changing demographics or revenue variation. Again, we do not find any statistically significant effects. That could be because of our small sample size and to the limited variation in some of the demographic figures, which are measured only once every 10 years.

We also use case studies to see if the detailed histories could illuminate why limits were adopted. For each of the 41 (of 56 total) limits where we knew the year of adoption, we examined local newspaper articles for coverage of the limit adoption. We found useful information on 17 of those 41 limits. Most of the cases where we could not find information were from limits adopted before full-text newspaper coverage was available.

Our case studies reveal causes that fall into three broad categories: taxes are too high, a trade-off of a current tax increase for future tax limits, and political entrepreneurs make hay. Seven of the 17 limits reveal evidence that a limit was adopted because taxes were perceived as being too high. For example, in 1990 Maryland state law required counties and Baltimore to cap increases in property assessments at 10 percent per year. That was in a period of rapidly rising property values, and concomitant increasing taxes. Fearing that the white middle class would desert the city because of increased property taxes, Baltimore policymakers capped assessments at 4 percent per year.

Our case studies also reveal three examples in which politicians get consent for current tax increases by promising to adopt a limit on future tax increases. Columbus, Ohio, has had an income tax since 1947, and for a long period the rate was 0.5 percent. When the city wanted to raise the rate to 1 percent in 1956, it added a limit requiring a public vote to increase the rate beyond 1 percent. In the mid-1950s, voters in Pueblo, Colo., were concerned about the city's reliance on property tax, particu-

larly in light of rapidly rising property values. To get voters to agree to a sales tax, the new charter included a cap on property tax rates.

The last prominent theme from our case study work is the importance of political entrepreneurs. Seven of the 17 limits were the clear work of individuals or small groups with deep beliefs in tax limitation. The most prominent of these is the Coloradoan Douglas Bruce, who tried two times without success to pass a state-level limit on municipalities in Colorado in the late 1980s and early 1990s. He put a similar measure in the ballot in Colorado Springs in 1991, and its successful passage paved the way for the passage of the 1992 statewide Taxpayer Bill of Rights, one of the nation's most stringent tax limitations. Bruce went on to become a county commissioner, and then a state representative until his career was derailed when he kicked a photographer.

Conclusion

In sum, locally imposed tax and expenditure limits are strikingly pervasive. Our survey, which is surely an underestimate of their prevalence, finds that at least one in eight cities has such a limit. While the majority of limits target the property tax in one form or another, we also find limits on sales, income, and entertainment taxes.

We find that after limits are adopted, cities decrease the rate of revenue increase. That may be because the limit truly constrains revenue sources, or it may be because politicians take the implicit threat embodied in the limit seriously. Our case study evidence shows that there are three main reasons for adoption of a local limit: in response to concerns about higher taxes, as a promise for future good behavior in return for a current tax increase, and as a way to build an individual political reputation.

We believe that our study highlights a potentially important institution that constrains the activities of local governments. While locally imposed limits

may be overshadowed by their more easily quantifiable cousins of state limits on cities, our study shows that they are correlated with changes in revenue collection.

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