



# ISSUE BRIEF

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## **If It Ain't Broke, Don't Fix It** Oregon's current spending limit ties spending to what Oregonians can afford

Opponents of public services, claiming that Oregon has a spending problem, seek to impose on the State a new "spending limit" that would undermine state government's capacity to deliver quality public services.

Oregon has a revenue problem, not a spending problem. The budget cuts of the last few years resulted from the economic downturn and the associated decline in tax receipts. Over the last 20 years, state government spending in Oregon has grown on par with growth in other states and in line with the growth of Oregonians' income.

Because it addresses the wrong ill, a new spending limit will not ease Oregon's budget pains. On the contrary, swallowing such a poison pill would seriously damage Oregon's fiscal health for years to come.

A new spending limit would do nothing to protect Oregon's economy and state budget from the inevitable impacts of the business cycle. The primary reason Oregon's recession and resulting state budget woes were more severe than in many other states was Oregon's heavy reliance upon the high technology sector.<sup>1</sup> A new spending limit would do nothing to alter this.

Spending limits tend to diminish the public's ability to choose what kind of government it wants. They use a formula to narrow the range of decisions available for democratic debate. Spending limit formulas are too often blind to public needs for goods and services from government.

A new spending limit would likely encourage legislators to mask additional spending by creating tax breaks and loopholes. Since spending through the budget would be so severely limited, spending through the tax code would likely expand, with some taxpayers singled out for special tax reductions at the expense of other taxpayers. Once tax expenditures are in place, they are very difficult to eliminate because, in general, doing so requires a three-fifths vote of both houses of the Legislature.

While no spending limit is an adequate replacement for vigorous debate and legislative decision-making, some spending limits are better than others. Oregon's current spending limit – significantly strengthened and improved in 2001 – is relatively fiscally responsible compared to the proposals for new spending limits being circulated by anti-government groups and their legislative supporters. The current limit does not deeply undermine the state's capacity to deliver quality public services in the long term, the key to maintaining a strong business environment and healthy communities.

## **The 1979 spending limit: Based on Oregonians' past income growth**

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Oregon first adopted a spending limit in 1979, as part of a tax relief plan passed by the Legislative Assembly and voters in the wake of California's passage in 1977 of Proposition 13, a property tax limit. Oregon's 1979 tax relief plan also created the "kicker," a mechanism that provides tax cuts when actual biennial revenues exceed projections by two percent or more.<sup>2</sup>

The 1979 limit was based on how much personal income grew in the two previous years compared to the two years before that. Hence, the upcoming budget could grow no faster than personal income grew over a recent budget cycle. For instance, the 1981-83 limit was set at the percentage growth in personal income from calendar years 1977-78 to 1979-80. The limit was statutory and could be exceeded by a majority vote of both houses of the Legislative Assembly. It applied only to General Fund appropriations. The law exempted tax relief and debt services from the appropriations base and allowed adjustments to the base if programs were shifted between the General Fund and other state funding streams. The Legislature voted to exceed the limit during three budget cycles in the late 1980s and early 1990s.

## **Oregon's current spending limit: Based on what Oregonians will be able to afford**

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In 2001, the Legislative Assembly overwhelmingly enacted Oregon's current statutory spending limit. Eleven members of today's Joint Committee on Tax Reform voted for the limit in 2001.

The current spending limit caps state expenditures for governmental activities as a percentage of the projected income of Oregonians in the upcoming budget cycle.<sup>3</sup> The 1979 spending limit capped future spending based on how much Oregonians' income increased in *prior* years.

The current spending cap also covers more state spending than the 1979 limit, which covered only General Fund appropriations and allowed certain exemptions and adjustments. The current limit includes appropriations of most state revenue sources including most General Fund revenue, lottery revenue, interest earnings, liquor sales revenue, and income from charges and fees. More precisely, all state government appropriations are covered under the current cap *except*:

- (a) Appropriations for the construction or acquisition of assets that are financed by state bonds or other forms of borrowing.
- (b) Appropriations of federal government monies.
- (c) Appropriations for fee remission programs of the Department of Higher Education.
- (d) Appropriations of donations to a state agency.
- (e) Appropriations of money generated by the approval of a ballot measure.
- (f) Appropriations for program funding resulting from the approval of a ballot measure.

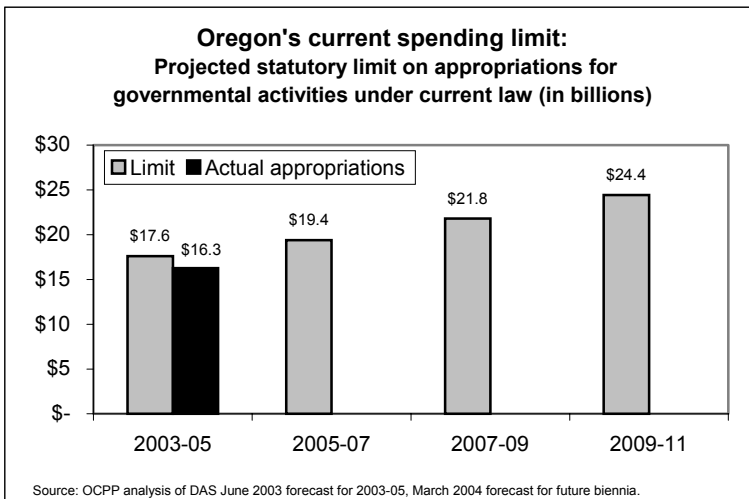
In addition to capping the growth of funds from more funding sources than the 1979 limit, Oregon's current spending limit is more difficult to exceed. The current limit may be exceeded only if the Governor declares an emergency and three-fifths of the members in each house of the Legislative Assembly vote to exceed the limit. As mentioned earlier, the 1979 limit could be exceeded following a majority vote.<sup>4</sup>

## **How much spending does the current limit allow?**

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In the current biennium, the law allows Oregon to spend \$17.6 billion for governmental activities covered under the limit. With the failure of Measure 30, actual state spending will be \$1.3 billion, or seven percent, below the limit, at about \$16.3 billion (see graph, next page).

In upcoming budget periods, Oregon's spending limit will allow state spending to change as the income of Oregonians changes. Based on their expectations for modest economic growth and continued increases in population, state economists predict modest total state personal income



growth over the next few years. Increasing in line with the anticipated growth in personal income, the current cap is expected to rise between 10 and 12 percent in upcoming budget cycles (see graph). Appropriations may not grow as quickly as growth in personal income would allow. Just as tax revenues this biennium do not meet the limit, tax revenues in the future may lag behind the limit.

### Hasn't the current limit failed to limit anything?

Because the current limit was established in 2001 at the beginning of the economic downturn, it has been operating largely during a period of declining tax receipts. As the economy begins to improve and tax receipts once again grow, the limit may come into play. An analysis by the Legislative Fiscal Office in 2001 found that if Oregon's current spending limit had been in place in the 1999-01 biennium, it would have restricted spending in that budget cycle. The reason was that tax receipts soared with the booming economy.<sup>5</sup> If the economy again takes off and tax revenues rise substantially faster than personal income, then the limit will likely restrain government spending.

### As spending limits go, Oregon's is relatively fiscally responsible

Spending limits are by definition arbitrary formulas that are blind to changes in circumstance. As such, they tend to limit flexibility in fiscal decision-making. That said, some spending limits are better than others.

#### *The current limit is based on ability to pay*

Unlike population and inflation limits or other outright limits in the growth of spending that have no relationship to the ability of taxpayers to pay for government services, the current limit is based on Oregonians' income, or their ability to pay. By limiting changes in government spending to changes in the amount of money Oregonians have available to spend, the current limit ties government spending to what taxpayers can afford.

#### *The current limit recognizes that government costs don't necessarily go down over time*

Limits that force government to grow more slowly than personal income growth require that government services get increasingly cheap over time. That is, these limits require that government services absorb a smaller percentage of Oregonians' personal incomes over time. It is highly unlikely that the cost of providing services through state government can get continually cheaper without degrading the quality of those public services and damaging the state's competitive position.

#### *The current limit does not have a ratcheting effect*

Many spending limits are deliberately designed to shrink public institutions over the course of business cycles. These limits contain a hidden ratcheting mechanism that reduces state

spending during recessions and assures that many of the spending cuts made during economic downturns will be permanent.

Under these limits, spending growth is restricted, either by the limit or by actual revenue growth, *whichever is less*. When recessions hit, actual revenues likely fall below what the limit would have allowed. Lower actual revenues lead to state service cuts. Then, after programs are cut in the recession, the formulas allow only slow growth from the lowered base when economic recovery begins. That is, the base for determining allowable spending gets ratcheted down by the recession, forcing permanent reductions in public services.

Oregon's current limit, by contrast, does not have a ratcheting effect. If a recession forces a decline in actual revenues, spending in the next budget cycle is not affected. The current limit ignores what happened in the past; it is simply based on how much Oregonians can afford in the upcoming budget cycle. Its base is not adjusted permanently downward during recessions.

### *The current limit lets voters demand new spending through initiatives without forcing cuts in other areas*

Spending limits tend to diminish the ability of voters to choose the kind of government they want. If voters decide to improve or add state services, the spending limits tend to force unwanted cuts in other priority services.

Oregon's current spending limit recognizes that voters may approve ballot initiatives that require new state spending. To meet voters' demands for new state spending without necessarily reducing spending for existing programs and services that voters support, the current limit does not encompass the increased state appropriations necessary to implement voter initiatives. Oregon's current spending limit provides appropriate flexibility to adjust to voter enacted spending decisions.

## Conclusion

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Oregon's current spending limit is restricted by the ability of Oregonians to afford state services. It does not force government to provide services at an increasingly cheaper cost relative to personal incomes over time. It also does not substantially limit the state's flexibility to adapt to changing circumstances or to fund new programs created by voter initiative. It contains no hidden ratcheting effect designed to force cuts in state services over time. Legislators ought to embrace this current limit, just passed in 2001, and reject calls for new, fiscally irresponsible spending limits.

### Endnotes:

<sup>1</sup> In a August 2, 2002 speech at Embassy Suites in Portland, Robert Parry, President of the Federal Reserve Bank of San Francisco said that Oregon's "high-tech success in the 1990s has been a mixed blessing," because it "propelled strong growth during the expansion," but left the state "more exposed to the downturn." Speech text available at [www.frbsf.org/news/speeches/index.html](http://www.frbsf.org/news/speeches/index.html). See also Tripp, Julie, "Double dip not on menu, Federal Reserve Bank CEO says," *The Oregonian*, 8/5/2002.

<sup>2</sup> The spending limit and kicker were passed during the 1979 session and took effect immediately, but were referred to and approved by voters in 1980. See Legislative Revenue Office, *Oregon's State Spending Limit and 2% Surplus Kicker*, Research Report #1-96, March 1, 1996, p. 3.

<sup>3</sup> The limit is set at 8 percent of projected personal income.

<sup>4</sup> The Legislature could amend the current statute with a simple majority vote. However, the politics of such an end-run around the three-fifths requirement make that unlikely, or at least more difficult than a typical simple majority vote.

<sup>5</sup> Law, Steve. "Panel Endorses State Spending Limit," *Statesman Journal*, June 23, 2001, p. 3C.

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