Joseph Coletti

BIG GOVERNMENT, BIG PRICE TAG

PART 3

MORE SPENDING = HIGHER TAXES FOR NORTH CAROLINIANS

John Locke Foundation®

OCTOBER 2020

John Locke
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Big Government, Big Price Tag

More Spending = Higher Taxes for North Carolinians

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Contents

Keep your eye on one thing
and one thing only: how much
government is spending, because
that's the true tax. … The thing
you should keep your eye on
is what government spends,
and the real problem is to hold
down government spending as a
fraction of our income, and if you
do that, you can stop worrying
about the debt.

— Milton Friedman[1]

Introduction

Between the Great Recession (2007-2009) and the Great Suppression (2020), North Carolina state government managed to live within its means. State General Fund appropriations between Fiscal Year (FY) 2010-11 and FY 2018-19 increased at a rate of 2.8 percent, matching the rate of inflation and population growth over that time. This growth rate was considerably lower than the 5.4 percent spending growth between FY 2000-01 and FY 2008-09.

A portion of the difference went back to taxpayers through tax reforms that have saved North Carolinians $18 billion since 2011. Even with lower tax rates from those reforms, North Carolina had a $1.7 billion unreserved fund balance as of July 1, 2019. North Carolina legislators had set aside another $1.2 billion in the state's rainy-day fund, the Savings Reserve.

Gov. Roy Cooper's two most recent budget proposals would each have increased General Fund appropriations 5.6 percent on an annual basis, eliminating much of the accumulated fiscal cushion and threatening future tax increases. His previous proposals would have increased

KEY CONCLUSION

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Consistent with the literature, the experience of these three states shows that limits on spending are more effective than limits on taxes and that Colorado's Taxpayer's Bill of Rights (TABOR) is still a good guide to policy despite its flaws.

spending 4.8 percent per year. Two wish-list items for Democrats and their allies, Medicaid expansion and collective bargaining for public-sector employees, would add billions more in spending and taxes.

This paper is divided in five sections. First it examines the academic literature on government budgeting institutions, spending, taxes, and economic growth. It then reviews past attempts to limit spending and taxes through policy in California, Colorado, and North Carolina. Consistent with the literature, the experience of these three states shows that limits on spending are more effective than limits on taxes and that Colorado's Taxpayer's Bill of Rights (TABOR) is still a good guide to policy despite its flaws. The third section explores in more depth the policies and performance of Colorado and North Carolina since 1980, over which time Colorado has generally performed better economically. The fourth section incorporates theoretical and empirical findings into a dynamic economic model to consider the budgetary and economic impacts of North Carolina's current policy of limiting government growth to the combined rate of inflation and population growth compared with higher spending proposals from Gov. Cooper and advocates for public-sector collective bargaining. Finally, it provides recommendations that would make for a strong and effective constitutional tax and expenditure limit.

North Carolina governing structure features a number of institutions that keep government spending low, including its strict balanced-budget requirement. What the state lacks is a tax and expenditure limit (TEL) enshrined in the constitution. We conclude that a TEL would grow

Table S1: 5.6% Spending Growth + Medicaid Expansion + Unions with Mediation, Income Tax Rate of 6.20%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.10%
2022	$28,178	8.20%	$27,932	11.00%
2023	$29,335	4.20%	$29,496	5.60%
2024	$30,636	4.60%	$31,148	5.60%
2025	$31,998	4.60%	$32,892	5.60%

Four-Year Net Change in Real GDP from Baseline (in millions)	(–$7,070)
Annual Change in Employment from Baseline	(–5,500)

NOTE: GF = GENERAL FUND

government responsibly in North Carolina, reducing its burden on taxpayers over time while still meeting its obligations, and we discuss other aspects that can make a TEL more effective.

If North Carolina adopted collective bargaining for public-sector unions, properly accounted for the cost of Medicaid expansion, and otherwise increased spending at the same rate as Gov. Cooper has recommended, personal income taxes would need to exceed 6.2 percent, the economy would lose $7 billion from slower growth over four years, and there would be 5,500 fewer employment opportunities available each year than if spending growth were limited to 2.7 percent, similar to the rate of growth since 2011.

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BACKGROUND

The 2008 financial crisis and Great Recession led to massive government responses. National governments around the world opened the spigots of spending wide, but the economic recovery was too slow for economic growth alone to produce enough tax revenues to shrink the ensuing deficits. As governments faced having to cut spending or raise taxes, economists and policymakers talked a lot about "austerity" budgets instead of "deficit reduction."

What counts as austerity for national governments is business as usual for state governments. Every state except Vermont has a balanced-budget amendment in its constitution, though not every amendment has the same meaning nor the same adherence. Even with loosely balanced budgets, though, states live with the reality that government generally cannot and should not spend more than it receives from taxes and fees.

This is even truer for North Carolina, which has one of the nation's more stringent balanced-budget provisions. The governor must propose a balanced budget, the legislature must enact a balanced budget, and the governor must reduce expenditures if revenues fall short during the year to ensure the budget is balanced at the end of the year. Money in the Savings Reserve, the state's rainy-day fund, can be appropriated only by the General Assembly. Debt is allowed only for capital projects, not for operating expenditures, and as a rule must be approved by a vote of citizens in a referendum.

Since the recession, the General Assembly has kept spending growth at or below the rate of growth of population plus inflation. State legislators achieved such spending restraint for many years without the help of the governor and without a statutory or constitutional requirement. By keeping spending growth manageable, they held off a proposed sales tax increase and cut taxes on personal income, corporate income, and the privilege of running a business.

This paper addresses three questions that arise from policies of the past decade. Is spending restraint a good way to govern? If so, what is the best way to accomplish it? What impact would it have on North Carolina?

LITERATURE REVIEW

The primary question researchers have considered about the size of government has been its effect on economic growth. With the number of papers, it is not surprising that they have reached different conclusions on the relationship between spending, taxes, and growth. In this section, we look at the changes in spending and taxes, the overall size of government, and the institutional structures that affect size.

Spending cuts are better than tax increases, and spending reforms have more of an impact where reform is most needed. Research shows the net economic impact of tax increases is generally smaller than the change in government spending, because income taxes are distortionary, income tax revenue grows and shrinks faster than the economy, and spending and tax changes work in opposite directions. Taxes that do not distort incentives to invest or work, such as sales taxes, also have less impact on economic output. The economic model in this paper reflects these findings.

Research also finds that the ideal size of government for maximizing economic growth is smaller than present levels of government spending nationally and also at the state and local levels. While smaller government with less spending could boost growth, increased government expenditures could be something that people want more as income grows, working at cross-purposes with state efforts to limit government constitutionally. It could also be that higher-income states tend to be more Democratic, choosing to subvert the intent of spending limits by expanding regulation instead of reining in government.

Finally, there are several process institutions states use to keep government spending in check. North Carolina law already has in place most of the effective process institutions, including a 2016 law that would prevent a government shutdown in the event that state leaders could not agree upon a state budget in time. One of the key missing pieces for North Carolina, however, is a comprehensive constitutional tax and expenditure limit (TEL).

Spending, Taxes, and Economic Growth

The fundamental question facing lawmakers each year, and the question that sets the schedule for legislative sessions, is how to change government spending in the state budget. In the wake of personal and policy restrictions during COVID-19 that created the Great Suppression, this question of government spending will be even more important. If revenue availability falls behind the desired level of spending, is it better for government to cut spending or raise taxes?

Alberto Alesina wrote extensively on the impact of government spending and taxes, finding that spending cuts provided a better approach to consolidation than tax increases, which would "cause deep and long lasting recession." On the other hand, he found tax cuts to be better stimulus than spending increases.[2] But it does not automatically follow that lower spending and lower taxes result in higher growth.

KEY CONCLUSION

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Regardless of how valuable the reasons for the spending are, however, raising taxes to pay for the new spending generally slows economic growth, and distortionary taxes on income and productive assets are more of a drag on the economy than nondistortionary taxes on consumption.

Daren Acemoglu, et al., found, "Policy reform has its greatest potential effect when the prereform policies are highly distortionary. However, one would not expect a society with a functioning system of accountability and with checks on politicians to be pursuing highly distortionary policies in the first place."[3] The implication of their finding is that, because state spending and taxes are a fraction of federal spending and have little variation from state to state, state policies are even more unlikely to be highly distortionary.

Several papers have found that government spending on public infrastructure and education can be productive and accelerate economic growth. Transfer payments and spending on public services, including public order and parks and recreation, have mixed results. Regardless of how valuable the reasons for the spending are, however, raising taxes to pay for the new spending generally slows economic growth,[4] and distortionary taxes on income and productive assets are more of a drag on the economy than nondistortionary taxes on consumption.[5] Lower income taxes lead to faster economic growth.[6] Federal taxes and interstate mobility for high-income earners limit states' ability to raise taxes in any event.[7]

Given these constraints, the best way for state governments to facilitate growth appears to be by reallocating expenditures from less productive areas to more productive areas rather than by increasing total spending and increasing taxes.[8]

Ideal Size of Government

Well before most of the research into the ideal size of government had even been conducted, Milton Friedman had already succinctly summarized their key findings with his frequent admonition: “The real problem is to hold down government spending as a fraction of our income.”[9] Richard Rahn found, “Most of the studies of the optimum size of government made by reputable scholars in recent decades have indicated that total government spending (federal plus state plus local) should be no lower than 17 percent, nor larger than about 30 percent of GDP.”[10]

Following another Friedman insight that government spending is “the true tax,” we see that federal spending in 2017 was 22 percent of Gross Domestic Product (GDP) and state and local governments added another 16 percent. Netting out transfers, government’s total share of GDP was 34 percent.[11] Using combined state and local government spending data for North Carolina from the U.S. Census Bureau[12] and GDP data from the U.S. Bureau of Economic Analysis[13], we find that state and local governments’ share of GDP in North Carolina was about average, with 16.8 percent of GDP going to state and local expenditures.

Accounting for the full impact of the Great Suppression on GDP and government expenditures in the second quarter of 2020, federal spending grew to 47 percent of GDP, and state and local spending from own-source revenues grew to 15 percent. In other words, government spending accounted for 62 percent of GDP. Clearly, there is room to shrink government’s role in the economy and spur growth.

In a December 1998 report to the Joint Economic Committee on “Government Size and Economic Growth,” using data for 1957 to 1993, Richard Vedder and Lowell Gallaway wrote, “The size of state and local government that maximizes the growth rate in GDP is 11.42 percent [of GDP].”[14] In 2017, North Carolina’s state and local government spending was 16.8 percent of state GDP, down from 19.0 percent in 2011. Although the role of government shrank, it remained well above the growth-maximizing rate found by Vedder and Gallaway. Their study confirmed the common finding that transfer payments are particularly unproductive.

KEY FACT

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Matthew Mitchell found TELs are more effective when they are in the constitution and focus on spending with provisions to refund surpluses and forbid higher spending unless passed by a supermajority of legislators or approved by voters.

How to Limit Spending Growth

As in other areas of government, in the attempt to limit government spending, institutions matter. Those institutions include having separate committees for spending and taxes, whether the state has an annual or biennial budget, term limits, balanced-budget requirements, and TELs like the Taxpayer's Bill of Rights (TABOR). Dale Bails and Margie A. Tieslau examined state and local budgets from 1969 to 1994, finding that balanced-budget amendments with expenditure limits saved $202 per capita in 2020 dollars, term limits saved $157 per capita in 2020 dollars, and initiative processes saved $143 per capita in 2020 dollars.[15] Their analysis did not account for differences in balanced-budget requirements, but it is likely that states with expenditure limits had stricter balanced-budget rules as well.

James Poterba found that even in a budget crisis, anti-deficit provisions prevent deficits[16] and an effective TEL can reduce the need for tax hikes and spending cuts.[17] In fact, this resilience is one of the key lessons that Rob Natelson drew from states' experience with TELs. North Carolina's ability to manage state finances through the coronavirus pandemic provides the latest illustration of this lesson, even though North Carolina's limit was an informal goal set by legislators rather than a formal statute or constitutional amendment. Matthew Mitchell found TELs are more effective when they are in the constitution and focus on spending with provisions to refund surpluses and forbid higher spending unless passed by a supermajority of legislators or approved by voters.[18]

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Matthew Mitchell and Nick Tuszynski (2012) considered the most effective process institutions states have for reducing government expenditures. North Carolina now lacks only three: line-item vetoes or reductions, term limits, and a comprehensive, constitutional TEL.

John Merrifield and Barry W. Poulson warned that, "Fiscal stress also spills over into off-budget spending and into on-budget funding substitutes such as regulation and more responsibility for local governments."[19] They conclude, "All of the simulations indicate significant gains from budget stabilization with spending restraint, including improved emergency preparedness, tax relief, and accelerated economic growth."[20] North Carolina's strict balanced-budget requirement and rainy-day fund (supplemented by a $1.7 billion unreserved fund balance in July 2019) provided more margin to maintain government programs despite the revenue shortfall. North Carolina was better prepared for hurricanes and the pandemic and provided significant tax relief over the past 10 years.

Shanna Rose found that strict balanced budget requirements that do not allow deficits to carry into the next year reduce deficits and that rainy-day funds with tight rules increase savings. Rose acknowledged that governments often find ways around debt limits and TELs.[21] Gov. Cooper provided a recent example of that tendency in attempting to increase operational spending by taking out $4 billion in bonds rather than pay for capital projects with current revenue set aside in a reserve.[22]

Matthew Mitchell and Nick Tuszynski (2012) considered the most effective process institutions states have for reducing government expenditures.[23] North Carolina now lacks only three: line-item vetoes or reductions, term limits, and a comprehensive, constitutional TEL.

HOW THREE STATES RESPONDED

Taxpayer revolts against state and local government growth in the 1960s and 1970s sought to reduce taxes, not spending. They aimed most squarely at unpopular property taxes. States also instituted statutory or constitutional balanced-budget requirements or TELs in response to these challenges. Notably, in Colorado, after multiple, previous attempts at tax restrictions had failed, voters approved a Taxpayer's Bill of Rights (TABOR) as a constitutional amendment in 1992.

Property Tax

In 1978, California voters approved the now-infamous Proposition 13 (the "People's Initiative to Limit Property Taxation"), resulting in distorted property markets for decades. Because it freezes private property assessments for existing homes until the next sale, it effectively penalizes people for moving. The law takes homes off the market and limits opportunities for first-time homebuyers.

Table 1: California Property Tax Example

Home Value	Rate/$100	Property Tax
$100,000	$0.80	$800
$250,000	$0.80	$2,000
$150,000	$0.80	$1,200

Table 2: Colorado Property Tax Example

Home Value	Assessment Rate	Assessed Value	Rate/$100	Property Tax
$200,000	7.15%	$14,300	$5.59	$800
$250,000	7.15%	$17,875	$5.59	$1,000
$150,000	7.15%	$10,725	$5.59	$600

Table 3: North Carolina Property Tax Example

Home Value	Rate/$100	Property Tax
$200,000	$0.40	$800
$250,000	$0.40	$1,000
$150,000	$0.40	$600

Here is how Proposition 13 affects property taxation for homeowners in California. Suppose that you bought a home in 2000 for $100,000 and that by 2020 the market value for the home was $200,000 while your property tax was $800. For property tax purposes, your home would still be valued at $100,000, but the property tax rate ($0.80 per $100, or 8.0 percent) might be twice as high as it was in order to provide the same amount of revenue to the local government. If you wanted to downsize to a home worth $150,000, you would face being hit by a property tax increase of $400. If you wanted a slightly bigger house worth $250,000, you would face a property tax hit of $1,200.

Other states only allowed taxation on a portion of the value or made other adjustments to property taxes. In 1982, the Gallagher Amendment to Colorado's constitution capped residential property at no more than 45 percent of property tax collections statewide. Nonresidential property makes up the other 55 percent and is taxed on 29 percent of the assessed value. The share of assessed value that is taxable for residential property adjusts to keep the 45/55 split. As of 2020, the assessment rate for residential property was 7.15 percent, so a $100,000 house has a taxable value of $7,150. In 2000, the assessment rate was 9.74 percent.[24]

Here is how the Gallagher amendment affects property taxation for homeowners in Colorado, using the same example of a home you bought in 2000 for $100,000 that had market value in 2020 of $200,000 and a property tax of $800. Colorado assesses home values every two years based on prior sales of comparable properties, which means your home would still be assessed at $200,000. With the assessment rate of 7.15 percent, the taxable value of your home would be $14,300, and the tax rate to generate $800 in taxes would be $5.59 per $100, or 5.59 percent. Moving to a slightly smaller or bigger house would result in a proportionally smaller or bigger property tax.

Property taxation in North Carolina is much more straightforward. Homes are assessed at regular intervals of up to eight years and taxed on the entire assessed value. Counties and cities must let property owners know the tax rate that would raise the same amount of money for the government from the existing tax base and acknowledge that any higher rate would constitute a tax increase. This information eliminates part of the fiscal illusion that forces citizens to pay higher taxes without the local government acknowledging a difference. Although individual homeowners in North Carolina may appeal the valuation, the two-step process of announcing the revenue-neutral rate with the regular property assessment and setting the final property tax rate with the spending plan makes clear that the assessment is not entirely responsible for a homeowner's higher tax bill.

In North Carolina, using the same example and assuming a recent reassessment, your home's taxable value is $200,000 and the tax rate can be a relatively low 40 cents per $100, or 0.4 percent. If you look to downsize to a $150,000 house, you would pay $200 less in taxes, but if you go up in value to $250,000, you would pay $200 more in taxes.

The Rationale Behind TELs

The logic of TELs goes back to Friedman's concern about reducing government expenditures as a share of personal income. Since there can be large swings in personal income from year to year, with rapid growth followed by large contractions, a good way to keep government on a downward track as a fraction of income is to tie spending to the rate of inflation and population growth. In most states at most times, per-capita personal income grows faster than inflation. If government spending per person grows no faster than inflation, then government will claim less money from citizens over time.

The Taxpayer's Bill of Rights in Colorado

Coloradans began with a limit on residential property taxes and eventually passed the Taxpayer's Bill of Rights (TABOR) to impose a constitutional limit on state and local spending and taxes. Under TABOR, if government revenue grows faster than the inflation rate plus the percent change in population — i.e., if government collects more money per person adjusted for inflation — then it must return the excess revenue to taxpayers. The TABOR amendment limits revenue growth for school districts (which are self-funded), municipalities, counties, and the state. Residents can approve higher taxes and spending through ballot questions, and they have done that at times.

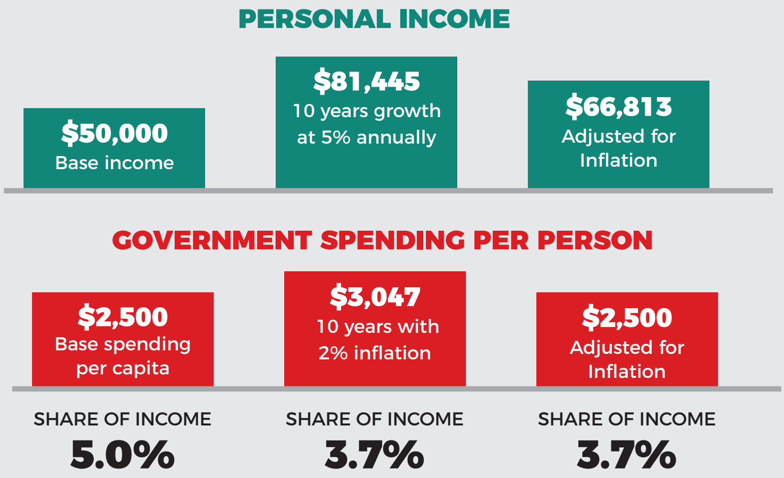
Before TABOR passed in 1992, Colorado voters had rejected a number of ballot initiatives to limit spending, including initiatives in 1976, 1978, 1986, 1988, and 1990. Colorado voters did, however, approve a legislative

Example of a TEL at Work: How Government Revenues Can Grow While Tax Burdens Decline Over Time

North Carolina has over 10 million people, and state government spends close to $25 billion from the General Fund, which is roughly $2,500 per person. If government spending keeps up with inflation of 2 percent per year and population growth of 1 percent per year, the budget would rise to $33 billion in ten years, by which time the 11 million North Carolinians would be paying $3,000 per person. After adjusting for inflation, however, that $3,000 per person would be the same as $2,500 per person as today.

Meanwhile, if per-capita personal income grows at 5 percent per year from $50,000, it would be more than $80,000 in 10 years, or nearly $67,000 adjusted for inflation. That inflation-adjusted $2,500 cost of government per person would have fallen from 5.0 percent of income to 3.7 percent in the course of a decade. This exercise matches North Carolina's experience over the past decade. Over this time, state government has been able to meet essential needs and set aside money for an emergency or the next recession while reducing the tax burden on families and businesses.

Figure 1: Government Revenue Grows, Burden of Government Lessens with a TEL



referendum for the Gallagher Amendment in 1982 to ease the property tax burden.

The Gallagher Amendment limited residential property taxes to 45 percent of tax revenue, requiring commercial property taxes to bear the other 55 percent. Commercial property was assessed at 29 percent of value, so the residential assessment rate fell to accommodate. Assessments fell immediately from 30 percent to 21 percent of value[25] and have declined since then to 7.15 percent of value for 2019 and 2020.[26] School districts in Colorado, which have the authority to tax directly, used this authority to increase tax rates to maintain revenues. TABOR put an end to that practice.

Colorado state Rep. Douglas Bruce had led the unsuccessful initiatives in 1988 and 1990, also under the name the Taxpayer's Bill of Rights, better known as TABOR, which he said was "inspired in part by Colorado's 19th century U.S. Senator Horace Tabor."[27] In 1991, Bruce won approval for a TEL in Colorado Springs, and TABOR passed statewide the next year. Bruce's role is known in part today because when Colorado cities and counties attempt to keep more tax money than TABOR would otherwise allow, it is called "debrucing."

After TABOR was adopted, advocates of more spending at the state and local level took the initiative, although their timing was not always opportune for actually increasing spending. Passed in 2000, Amendment 23 mandated that education spending grow by inflation plus 1 percent from 2001 to 2011, then by the rate of inflation after 2011. It also earmarked 0.33 percent of all income tax revenue in a State Education Fund it created and generally prohibited using money from that fund unless education funding from the General Fund grew by at least 5 percent. Amendment 23 provided an opt-out if state revenues were to fall, "as they did between 2001 and 2003."[28]

Combined with lower revenue allowances in the wake of the recession, the mandated education spending created pressure on the rest of state government. In 2005 voters passed Referendum C to provide a timeout from the revenue caps for state government between 2006 and 2011. The implication of the financial crisis and Great Recession meant the state did not have any extra revenue to spend most of those years.

Efforts to expand spending beyond TABOR limits were not constrained to statewide ballot initiatives. At the local level, 51 of 64 counties, 230 of 274 municipalities, and 174 of 181 school districts[29] have at one time or another won the approval of their voters to “debruce” (that is, temporarily keep and spend more revenue than allowed under TABOR). Courts have provided another way to exempt revenue from TABOR’s restrictions by allowing a relatively broad definition of what makes a fee.

Despite these revisions, the core elements of TABOR remain popular as evidenced by the defeat last year of Proposition CC.[30] A survey conducted for the Colorado Tax Commission found 60 percent to 70 percent approval for TABOR’s provisions to limit government spending, require rebates of surplus revenue, and require voter approval for government to raise taxes, issue debt, and retain surplus revenue.[31] Those ratios were “much higher than the majority that approved TABOR.”[32]

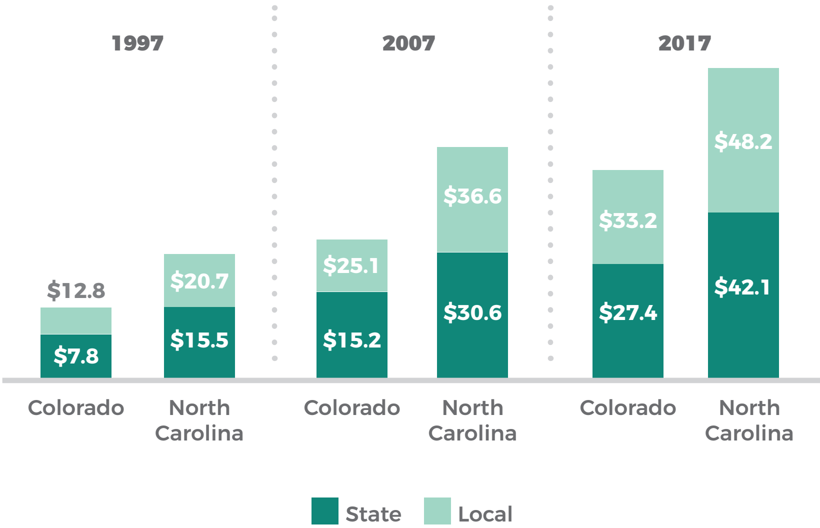
COMPARING COLORADO AND NORTH CAROLINA

This section compares government spending, taxes, employment, and incomes in Colorado since TABOR's introduction with government spending, taxes, employment, and incomes in North Carolina, which had fewer constraints on spending and tax changes.

Spending and Revenue

TABOR limits revenue from taxes, but it leaves room for revenue from fees to grow. From 1997 to 2019, the share of Colorado government revenue subject to TABOR restrictions fell from 56 percent to 44 percent. As governments relied more on uncapped revenue sources, they also increased variability in the amount of revenue collected. Local governments relied more on sales taxes and less on property taxes than they had before, while state government relied more on income taxes than on sales taxes. In contrast, North Carolina reduced personal and corporate

Figure 2: State and Local Government Spending in Colorado and North Carolina (in billions of dollars)



income tax rates and expanded the sales tax base, which led to revenues that are more consistent from year to year.

Both states increased tuition and fees at colleges and universities, but neither increased the share of higher education funding paid from receipts. In Colorado, receipts for higher education more than tripled, from $835 million to $2.7 billion between 1994 and 2011. By 2017, receipts had increased another $300 million to $3 billion. For North Carolina, receipts for higher education climbed from $948 million to $3 billion between 1994 and 2011, then reached $3.5 billion by 2017. Receipts accounted for 42 percent of higher education spending in Colorado in 2017, down from 52 percent in 2011 and 48 percent in 1994. North Carolina was more consistent, with the share of funding from receipts at 34 percent in the earlier years and 35 percent in 2017.

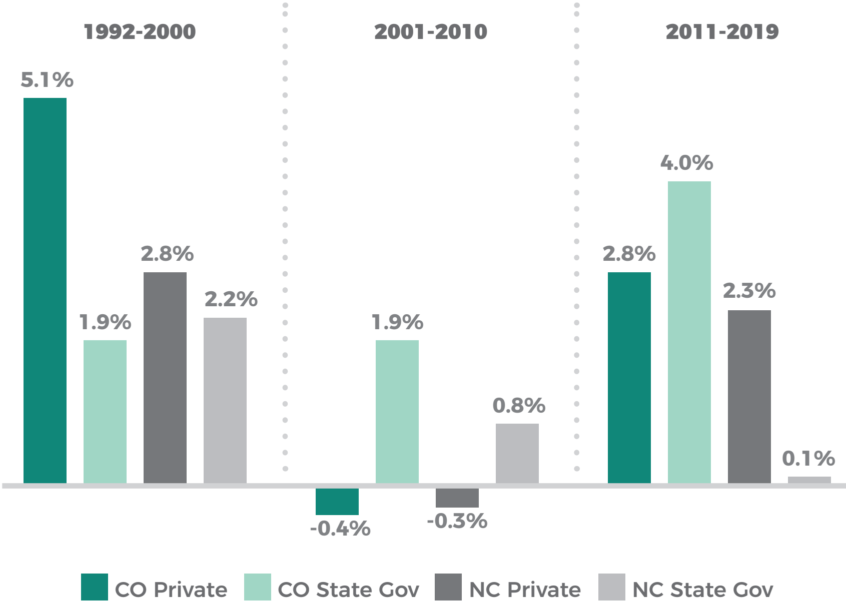
State aid to local governments more than doubled for each state between 1994 and 2011. Colorado's state support kept up with population and inflation between 1994 and 2000, then increased at a faster clip between 2000 and 2011. In contrast, North Carolina's support grew twice as fast in the 1990s, as Gov. James Hunt and the General Assembly poured money into public schools, but it grew 31 percent between 2000 and 2011 even as population and inflation increased by 50 percent. From 2011 through 2017, both Colorado and North Carolina increased support for local governments at a lower rate than the increase in population and inflation.

State support for local governments in North Carolina fell steadily from 40 percent of local general revenue to 32 percent between 2000 and 2011, and it remained at that level through 2017 (the most recent year available). Local governments in Colorado have consistently relied on the state for a quarter of their general revenue.

State and local government revenues in Colorado grew faster than in North Carolina from 1997 to 2007 and at a similar rate to North Carolina's from 2007 to 2017. The growth trajectories for the two states were different, however. Despite an inflation-adjusted 3.5 percent dip in own-source revenue as a result of the recession, federal stimulus dollars produced a 17 percent surge in revenues for North Carolina between 2007 and 2011. Colorado's own-source revenue actually continued to climb, but federal funds did not provide as much of a supplement, so revenues grew just 7 percent during that time. Since 2011, however, North Carolina's own-source revenue has grown more slowly than Colorado's, and the withdrawal of federal support has caused overall revenue to shrink 2.7 percent after adjusting for inflation. Colorado's total revenue has climbed 5 percent since 2011, after adjusting for inflation.

The difference between the two states has been clearer in expenditures. North Carolina state government spent as much per person as Colorado state government in 1997 and 2007. North Carolina state spending grew slightly faster than Colorado state spending, but Colorado's local governments were responsible for more government services than local governments were in North Carolina. Between 2007 and 2017, however, Colorado's spending grew faster than North Carolina's. Colorado's Referendum C meant government could keep and spend more, while

Figure 3: Comparing Job Growth in the Private and Public Sectors in Colorado and North Carolina



the North Carolina General Assembly limited General Fund spending increases to the forecast rate of population growth and inflation.

By 2017, North Carolina state government spent $42.1 billion and Colorado spent $27.4 billion, as measured by the U.S. Census Bureau. These spending levels translated to $4,104 per person in North Carolina and $4,874 per person in Colorado. Total state and local spending per person in Colorado that year was $10,786, exceeding spending in North Carolina by $1,986 per person.

Colorado in the 1990s under TABOR saw private employment expand at a rate of 5.1 percent per year, outstripping employment growth in state government (1.9 percent per year). Without TABOR, North Carolina's private sector in the 1990s grew at a lower rate than Colorado's, adding 2.8 percent more jobs per year, but state government employment in North Carolina grew 2.2 percent per year, slightly faster than in Colorado.

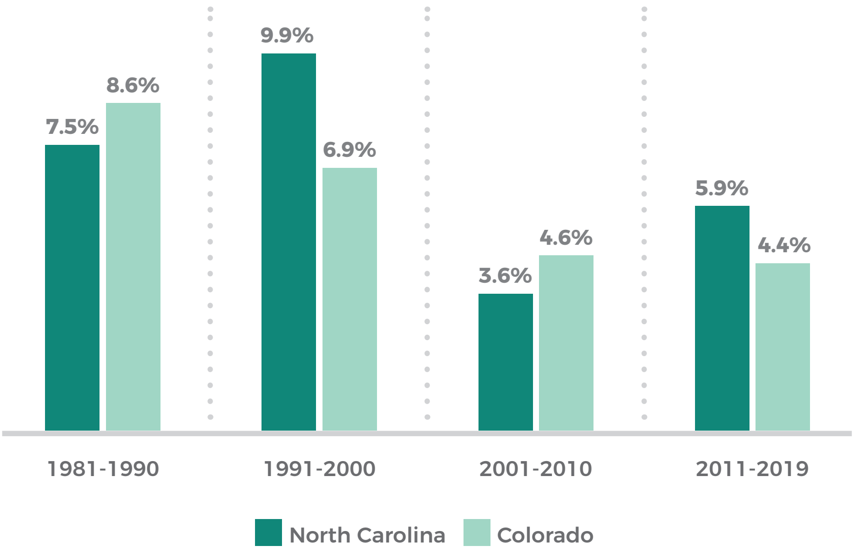
Private sector job growth for the two states was more similar in the 2000s, down 0.4 percent per year in Colorado and 0.3 percent in North Carolina, reflecting the devastating impact of the financial crisis and Great Recession. Colorado state government employment growth was steady, continuing at its 1.9 percent annual rate of growth, while the rate of growth in North Carolina state government employment slowed to 0.8 percent per year.

Since 2011, the states again had similar private sector job growth rates (2.8 percent per year in Colorado and 2.3 percent per year in North Carolina). There was a great difference between state government employment growth in the two states, clearly owing to divergent approaches to government spending. Referendum C in Colorado relaxed some spending restrictions, but the Republican-led legislature in North Carolina chose greater spending restraint. State government employment in Colorado increased by 4 percent per year, compared with North Carolina's 0.1 percent annual increase.

What was the result of the different growth rates in government jobs? Between 1991 and 2001, the number of state employees per 1,000 Coloradans fell from 20.1 to 18.1, then increased slightly to 18.6 by 2011. North Carolina government grew from 22.4 to 23.3 employees per 1,000 residents between 1991 and 2001. That number fell over the next decade, largely driven by the recession, to 21.1 state employees per 1,000 residents. State employment growth since 2011 left the states in 2019 as mirror images of where they were 30 years ago, with Colorado finishing the decade having 22.7 state employees per 1,000 residents (compared with 20.1 in 1991) and North Carolina having 19.5 (compared with 22.4 in 1991).

State economies grow through productivity, which we can measure with per-capita personal income, and through population growth. Colorado has about half as many people as North Carolina, but they have higher incomes on average than North Carolinians. Colorado's growth in both areas has also tended to outpace North Carolina's, though with variations over time as explained here.

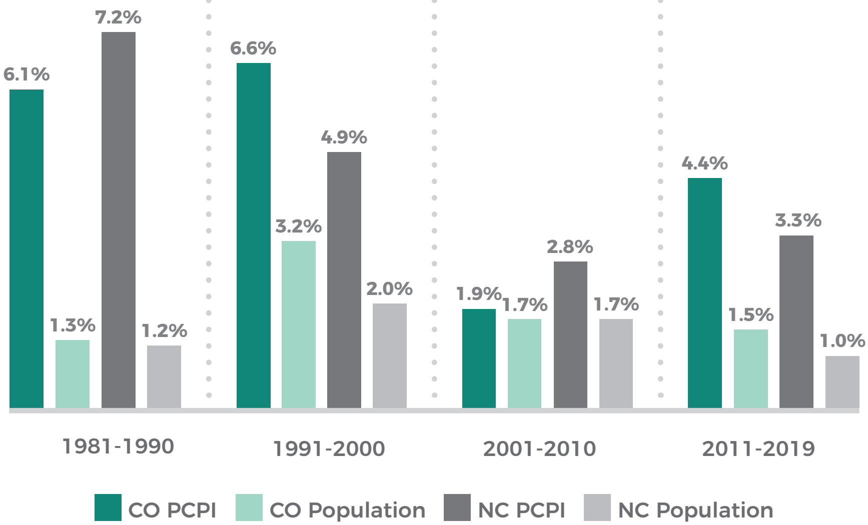
Figure 4: Personal Income Growth in Colorado and North Carolina



1981-1990: Looking further back in time and deeper into the trends, personal income growth in Colorado was nearly flat in the decade before voters adopted TABOR. From 1981 to 1990 Colorado's per-capita personal income grew by 6.1 percent annually. For North Carolina, per-capita personal income grew by 7.2 percent, but most of the growth in both states was just ahead of inflation in the early part of the decade. Inflation-adjusted per-capita personal income growth over the decade was just 0.6 percent per year in Colorado and 2.4 percent per year in North Carolina. Population growth in the two states was similar: 1.3 percent per year in Colorado and 1.2 percent per year in North Carolina.

1991-2000: With Colorado's rapid employment growth in the 1990s came annual population growth of 3.2 percent per year and per-capita personal income growth of 6.6 percent. Both of those were roughly 50 percent faster than North Carolina's 4.9 percent per-capita personal income growth and 2 percent population growth.

Figure 5: Growth in Per-Capita Personal Income and Population in Colorado and North Carolina



2001-2010: As one would expect in a decade that started and ended with recessions, incomes in both states were stagnant between 2001 and 2010. Per-capita personal income 1.9 percent per year in Colorado and 2.8 percent per year in North Carolina. Population in both states grew 1.7 percent per year.

2011-2019: Personal income in Colorado has again grown faster than in North Carolina the past decade, and so has the population. Per-capita personal income has increased at an annual rate of 4.4 percent in Colorado and 3.3 percent in North Carolina, even as Colorado's population has grown at a 1.5 percent annual rate to North Carolina's 1.0 percent annual rate.

Spending Share of Income

Tying it back to the size of government, since 2011 both states have managed to reduce the size of government as a share of income by 2017.

State and local governments in North Carolina still claim a larger share of income that do state and local governments in Colorado, but North Carolina has closed that gap with Colorado. In 2017, Colorado state and local government spending was 19.5 percent of per-capita personal income, down from 24.4 percent in 2011. North Carolina governments spent 19.9 percent of per-capita personal income, down from 25.1 percent in 2011.

State government spending as a share of income provides a clearer and more recent picture of the impact of North Carolina's spending restraint this decade. In 2011, Colorado state government spending took 8.7 percent of personal income, which was nearly unchanged at 8.5 percent in 2019. Total North Carolina state government spending fell from 12.4 percent of personal income in 2011 to 10.8 percent of income in 2019. Part of the reduction in both states was from the expiration of federal funds after the Great Recession. Looking at just the General Fund for each state, which receives the bulk of state-generated tax and fee revenue, Colorado's was a constant 3.1 percent of personal income in 2011 and in 2019, while North Carolina's reduced its share of personal income from 5.5 percent in 2011 to 4.8 percent in 2019.

SPENDING AND TAX INCREASE IMPLICATIONS

North Carolina has had a decade of low spending with low taxes and high savings in government. Even after powerful hurricanes in 2016 and 2018 tested the budget, North Carolina was still in a better financial position to weather the pandemic than most other states.

Higher taxes can slow economic growth and reduce employment opportunities more than higher government spending can help. Income taxes are particularly problematic because they create distortions that discourage work and penalize employment. The dynamic model used in this paper estimates these negative impacts and their effects on the total revenue generated from each tax increase. Higher personal income taxes make work less rewarding, which reduces employment and economic output. Higher corporate income taxes have a larger impact on economic output as they reduce businesses' incentive to invest in both labor and capital. Sales taxes are more neutral in their economic effects and regressive in their distributional effects. They also raise revenue quickly.

KEY FACT

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As a result, despite an $887 million loss of revenue compared with FY 2018-19 stemming from the coronavirus pandemic, North Carolina still had $1.5 billion in the unreserved fund balance and $1.2 billion in its Savings Reserve to help get through further hurricane seasons and revenue declines into FY 2020-21 and FY 2021-22. Regardless of the impact on economic growth, spending restraint has helped with fiscal preparedness.

A 2016 law that ensures a budget impasse cannot shut down state government resulted in a final working budget for FY2019-20 of $24.4 billion—$800 million less than Gov. Cooper's operating budget proposal and $300 million less than the final conference bill. It also kept $4 billion in new capital projects on hold, whether financed by debt or through the State Capital and Infrastructure Fund (SCIF). As a result, despite an $887 million loss of revenue compared with FY 2018-19 stemming from the coronavirus pandemic, North Carolina still had $1.5 billion in the unreserved fund balance and $1.2 billion in its Savings Reserve to help get through further hurricane seasons and revenue declines into FY 2020-21 and FY 2021-22. Regardless of the impact on economic growth, spending restraint has helped with fiscal preparedness.

In this section we model annual growth in General Fund appropriations under several scenarios. First we set a baseline scenario that models growth similar to what North Carolina has witnessed over the past decade. We compare the other scenarios to this baseline. They use, successively: Gov. Cooper's early spending plans, Gov. Cooper's later spending plans, Cooper's later spending plans with the Medicaid expansion, Gov. Cooper's later spending plans with collective bargaining for teachers and state employees, Gov. Cooper's later spending plans with Medicaid expansion and collective bargaining, and finally, a permanent tax cut with baseline spending. The baseline for evaluation is 2.8 percent real state GDP growth for FY 2021-22 followed by more modest growth of 2.0 percent to 2.2 percent over the following three years, similar to the economic growth over the past decade. General Fund revenue also continues to grow at roughly the same pace as it has in recent years (4.1 percent to 4.6 percent in current dollars). General Fund appropriations increase 2.7 percent per year based on forecast inflation and population growth from 2021 through 2025. Lawmakers dedicate excess revenue to the Savings Reserve. Although actual expenditures will likely remain around $24 billion for FY 2020-21, the model starts with $25.2 billion in appropriations so future spending does not “ratchet down” to the lower level.

SCENARIO 1

BASELINE FORECAST

With no tax cuts, revenue would exceed appropriations by $499 million in FY 2021-22, and up to $1.9 billion by FY 2024-25. By law, 15 percent of the annual growth in revenue would go to the Savings Reserve[33] and 25 percent of any unreserved fund balance from the previous year would go to the State Capital and Infrastructure Fund (SCIF).[34] Additional revenue each year could be dedicated to either of these purposes or to fund liabilities for retiree health and pension benefits.

Table 4: Baseline Forecast, 2.7% Spending Increase, Income Tax Rate of 5.25%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$26,334	4.6%	$25,835	2.7%
2023	$27,420	4.1%	$26,532	2.7%
2024	$28,622	4.4%	$27,247	2.7%
2025	$29,893	4.4%	$27,982	2.7%

2022 Real GDP (2012 dollars, millions)	$512,502
2022 Employment	4,667,000

NOTE: GF = GENERAL FUND

SCENARIO 2

USING GOV. ROY COOPER'S EARLY SPENDING INCREASES

The first alternative to this baseline is based on Gov. Cooper's budget recommendations in his first two years in office, 2017 and 2018, with spending increases of 4.8 percent per year. Spending by FY 2024-25 would be $2.4 billion higher, surpassing $30 billion. A tax increase to 5.4 percent would not be enough to offset appropriations over the entire four years, even without required payments to the Savings Reserve. If this scenario or any of the following scenarios with spending increases were enacted, Cooper would likely issue debt to pay for capital projects instead of relying on the SCIF. Higher taxes would more than create a drag on the economy greater than the boost from higher spending. Real state GDP would lose $1.12 billion over four years and 900 jobs each year.

Table 5: 4.8% Spending Increase, Income Tax Rate of 5.40%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$26,624	5.8%	$26,364	4.8%
2023	$27,716	4.1%	$27,629	4.8%
2024	$28,936	4.4%	$28,956	4.8%
2025	$30,213	4.4%	$30,345	4.8%

Four-Year Net Change in Real GDP from Baseline (in millions)	(–$1,120)
Annual Change in Employment from Baseline	(–900)

NOTE: GF = GENERAL FUND

SCENARIO 3

USING GOV. ROY COOPER'S LATER SPENDING INCREASES

Gov. Cooper's budget recommendations in 2019 and 2020 would have increased General Fund appropriations 5.6 percent per year. This ambitious increase in spending would require a 5.5 percent tax rate from the start, though tax revenues would fall short as early as FY 2022-23 as higher taxes reduced real state GDP by $1.86 billion over four years and left 1,500 fewer jobs each year.

Table 6: 5.6% Spending Increase, Income Tax Rate of 5.50%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$26,809	6.5%	$26,565	5.6%
2023	$27,929	4.2%	$28,053	5.6%
2024	$29,141	4.3%	$29,624	5.6%
2025	$30,435	4.4%	$31,283	5.6%

Four-Year Net Change in Real GDP from Baseline (in millions)	(–$1,860)
Annual Change in Employment from Baseline	(–1,500)

NOTE: GF = GENERAL FUND

SCENARIO 4

USING GOV. ROY COOPER'S LATER SPENDING INCREASES AND ADDING MEDICAID EXPANSION

Scenario 4 adds an estimate of the full cost of Medicaid expansion to appropriations with an income tax rate of 5.7 percent. Cooper's budgets have assumed unrealistically low costs of Medicaid expansion, even going so far as to claim in his August 2020 budget proposal that nobody would enroll in Medicaid who was already eligible.[35] His previous budget proposals included $126 million in total cost for just such people. Cooper has consistently proposed taxes on hospitals and Medicaid managed care insurers to cover nearly all of the state's $538 million share of annual Medicaid expansion costs.[36] Again, the tax increase would cover only one year. The economic drag of higher taxes would more than offset the stimulus of government spending, with GDP losing $3.35 billion over four years with 2,600 fewer jobs each year.

Table 7: 5.6% Spending Growth + Medicaid Expansion, Income Tax Rate of 5.70%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$27,204	8.1%	$27,112	7.8%
2023	$28,319	4.1%	$28,630	5.6%
2024	$29,563	4.4%	$30,233	5.6%
2025	$30,878	4.4%	$31,926	5.6%

Four-Year Net Change in Real GDP from Baseline (in millions)	(-$3,350)
Annual Change in Employment from Baseline	(-2,600)

NOTE: GF = GENERAL FUND

SCENARIO 5

USING GOV. ROY COOPER'S LATER SPENDING INCREASES AND ADDING COLLECTIVE BARGAINING

The North Carolina Association of Educators has taken to calling itself a union and engaged in more clearly union-like activities even as membership has likely declined in recent years. A key objective for union organizers is the power of collective bargaining on behalf of members for higher wages and benefits. Rules for collective bargaining can have a significant impact on the cost to the state of unionization. Scenario 5 considers state costs if unions had the power to bargain with binding arbitration, the lowest cost approach.[37] After an initial bump to $27.7 billion, spending would continue at 5.6 percent growth. The income tax rate would climb to 6.1 percent initially, with need for another tax increase in FY 2022-23. The drag on the economy would reach $6.32 billion over four years and cost 5,000 jobs each year.

Table 8: 5.6% Spending Growth + Medicaid Expansion + Unions with Arbitration, Income Tax Rate of 6.10%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$27,969	11.1%	$27,659	9.9%
2023	$29,134	4.2%	$29,208	5.6%
2024	$30,419	4.4%	$30,843	5.6%
2025	$31,764	4.4%	$32,571	5.6%

Four-Year Net Change in Real GDP from Baseline (in millions)	(-$6,320)
Annual Change in Employment from Baseline	(-5,000)

NOTE: GF = GENERAL FUND

SCENARIO 6

USING GOV. ROY COOPER'S LATER SPENDING INCREASES AND ADDING MEDICAID EXPANSION AND COLLECTIVE BARGAINING

Scenario 6 considers state costs if unions had the power to bargain with fact-finding or mediation, the highest-cost approach.[38] After an initial bump to $27.9 billion, spending would continue at 5.6 percent growth. The income tax rate would climb to 6.2 percent initially, with need for another tax increase in FY 2022-23. The drag on the economy would reach $7.07 billion over four years and cost 5,500 jobs each year.

Table 9: 5.6% Spending Growth + Medicaid Expansion + Unions with Mediation, Income Tax Rate of 6.20%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$28,178	8.2%	$27,932	11.0%
2023	$29,335	4.2%	$29,496	5.6%
2024	$30,636	4.6%	$31,148	5.6%
2025	$31,998	4.6%	$32,892	5.6%

Four-Year Net Change in Real GDP from Baseline (in millions)	(-$7,070)
Annual Change in Employment from Baseline	(-5,500)

NOTE: GF = GENERAL FUND

SCENARIO 7

USING A TEL CONSTITUTIONAL AMENDMENT

In contrast with the previous scenarios, Scenario 7 would provide an early tax rate reduction to 5.1 percent with room for additional cuts in the future. Families and businesses would be able save $1.3 billion over four years. The lower tax burden would provide fuel to the economy, resulting in state GDP being $1.16 billion higher over time and 1,000 more jobs each year, despite lower government spending.

Table 10: 2.7% Spending Growth, Income Tax Rate of 5.1%

Year	GF Revenue (current dollars, millions)	GF Revenue Growth	GF Appropriations (current dollars, millions)	GF Spending Growth
2021	$25,175		$25,156	3.1%
2022	$26,032	3.4%	$25,835	2.7%
2023	$27,101	2.9%	$26,532	2.7%
2024	$28,284	3.2%	$27,247	2.7%
2025	$29,549	3.2%	$27,982	2.7%

Four-Year Net Change in Real GDP from Baseline (in millions)	+$1,160
Annual Change in Employment from Baseline	+1,000

NOTE: GF = GENERAL FUND

The effects of a constitutional TEL would be more complicated than the direct spending and tax impacts modeled. Lawmakers have often used regulations as an alternative to spending and taxes when seeking to control behavior. As a result, our examination here only focuses on the economic effects of different levels of spending and taxes. Our evaluation also does not specifically consider the impact of higher state debt, such as the $5.3 billion Cooper proposed in August 2020, except as the higher debt service manifests later in higher spending.

With those caveats, GDP growth would slow on a nearly dollar-for-dollar basis with income tax hikes, even though the tax hikes wouldn't even raise enough to cover higher government spending. As these alternatives demonstrate, a constitutional TEL could provide a larger economy, more jobs, lower taxes now, and less risk of devastating tax increases or spending cuts in the next recession. The challenge is how to apply lessons learned from Colorado's experiences with TABOR to craft a strong and flexible TEL to delivers these benefits and avoid the pitfalls here.

A BETTER TEL FOR NORTH CAROLINA

Supporters of the Taxpayer's Bill of Rights in Colorado (TABOR) have acknowledged some of the flaws with the amendment that made possible the TABOR timeout of Referendum C in 2005, though that remedy was worse than the problem. Merrifield and Poulson have proposed improvements for future tax and expenditure limits (TELs), and Rob Natelson cataloged some of TABOR's flaws in his 2018 history of the amendment. Past proposals in North Carolina have incorporated those lessons, as does our proposed amendment (see Appendix B).

Reserve Funds and Refunds

Merrifield and Poulson recommend setting money aside in three reserve funds: a rainy-day fund for economic downturns, an emergency relief fund for disaster response, and a capital fund. Past proposals in North Carolina took differing approaches to this question, with some mirroring the Merrifield and Poulson recommendations and others creating a single fund with strict rules on minimum deposits and maximum appropriations.

KEY CONCLUSION

★ ★ ★ ★ ★ ★

Regardless if it is one fund or three, the basic concept is to apply "Dave Ramsey rules" to the state budget: Restrain spending to create an emergency fund, increase the reserve to six weeks or more of expenditures, and reduce debt.

Since 2015, the legislature has taken incremental steps to improve fiscal discipline. Under a 2017 law, the General Assembly's Fiscal Research Division and the governor's Office of State Budget and Management jointly establish a target for the Savings Reserve (rainy-day fund) based on the fiscal effects of past recessions. The current target is 11 percent, or $2.5 billion, based on past General Fund appropriations. Each year, the legislature is to appropriate 15 percent of revenue growth to the Reserve until it reaches that target.[39]

After Hurricane Matthew in 2016, the General Assembly created the Emergency Response & Disaster Relief Fund. They supplemented it in 2018 with the Hurricane Florence Disaster Recovery Reserve to hold money from the Savings Reserve. As of June 30, 2020, there was $191 million in the two funds.

Legislators created the State Capital and Infrastructure Fund (SCIF) in 2017 to set aside four percent of General Fund revenue plus a portion of any fund balance to capital projects and debt service. As the state pays down debt, more revenue becomes available for new projects and even, eventually, to create a reserve and pay down unfunded liabilities for retired state employee benefits.

Regardless if it is one fund or three, the basic concept is to apply "Dave Ramsey rules" to the state budget: Restrain spending to create an emergency fund, increase the reserve to six weeks or more of expenditures, and reduce debt.

KEY FACT

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Republican legislators ended the roller coaster when they ensured that a temporary one-cent sales tax hike expired as scheduled in 2011, and since then they have restrained General Fund appropriations growth to the rate of inflation and population growth, while setting aside more in savings and also cutting taxes for families and businesses multiple times.

Once the reserves are stocked and retiree benefits are adequately funded, additional surpluses should be returned to taxpayers. The automatic refund of tax revenue has proven to be an important feature of Colorado's TABOR. Instead of refunding money proportional to the taxes a person pays, North Carolina would do better to provide a flat refund similar to that attempted in the 2019 Taxpayer Refund Act (HB74), which would have provided $250 for married taxpayers filing jointly and $125 for other taxpayers.[40]

Expenditures or Revenues

As Milton Friedman said, spending is the real tax. He went so far as to argue that tax cuts without spending restraint are not real cuts, because the spending will eventually lead to higher taxes.[41] Before 2011, North Carolina government spending and taxes were a roller coaster. Spending grew rapidly with tax revenues when the economy grew, but when the economy slowed, spending would dip while taxes and fees would jump. Republican legislators ended the roller coaster when they ensured that a temporary one-cent sales tax hike expired as scheduled in 2011, and since then they have restrained General Fund appropriations growth to the rate of inflation and population growth, while setting aside more in savings and also cutting taxes for families and businesses multiple times.

While North Carolina restrained spending, saved, and lowered taxes, Kansas and Oklahoma tried instead to cut taxes before reining in spending. Both states later had to reverse course and raise taxes. Kansas' experience made it a national model of irresponsible budgeting, but most of its critics missed the role of high spending in Kansas' problems.

Hidden spending now can lead to higher taxes later. For example, in recent years North Carolina legislators have been sorely tempted to spend more but still keep General Fund spending low, such as in 2018, when they counted $155 million for capital projects against revenue instead of expenditures. They also gave the North Carolina Department of Transportation (NCDOT) the option to take on more debt if the agency would just spend down $2 billion in cash reserves to accelerate projects — a decision that led NCDOT to overspend by $742 million.

For his part, Gov. Cooper was more than happy to go along with the plan for more transportation debt, arguing that debt would be a better way to pay for capital projects since it would allow more spending on programs today. Cooper provided another example of hidden spending that would lead to higher taxes down the line with his August 2020 proposal to expand Medicaid. Unlike similar proposals in previous years, this one failed to acknowledge that it could cause some people already eligible for Medicaid to decide to enroll, which would saddle the state with significant costs.

As these examples should make clear, artificial limits on spending can lead to bad decisions if government leaders are intent on spending more money. It should not be surprising, then, that limits on just revenues or just expenditures lead to shenanigans and higher debt. Only when a state caps revenues and expenditures together does debt fall.

Taxes and Fees

One of the most popular provisions of TABOR allows citizens to vote on tax increases. North Carolina already has a similar provision for counties seeking a quarter-cent sales tax increase. State law even limits the votes to elections in which every precinct will already have a polling place open. To ensure the highest levels of voter awareness and participation, legislators should further restrict tax votes to coincide with statewide general elections, which take place in November in even-numbered years.

Colorado's TABOR limited tax revenues, which led state and local governments to stretch the definition of fees. After Referendum C passed, Colorado also exempted tax revenue from TABOR's requirement that excess revenue be refunded to citizens. Among the ballot initiatives in November 2020 is one that would require voter approval of any new fee projected to generate $100 million in its first five years, just as voters already must approve tax increases.[42]

For a TEL to be effective, it should define revenue broadly enough to prevent new fees from sneaking around tax limits.

General Fund or Total Budget

This logic applies not just to taxes and fees, but to all money state government receives and distributes. Traditionally, North Carolina's budget debates have focused almost entirely on the $24 billion General Fund, but transportation spending, federal funds, and revenues from the lottery, tuition payments, hospital taxes for Medicaid, unemployment taxes, court fees, and other sources more than double total state government spending to $55 billion.

Legislators and agency officials look for ways to "maximize federal dollars" and limit state General Fund appropriations. They move spending to special funds or shift responsibility for state objectives to local governments, with or without new taxing authority.

As federal funds under the 2009 American Recovery and Reinvestment Act (ARRA) stimulus ran their course, federal funding to North Carolina declined, bringing the growth in federal funds over the years between 2011 and 2019 back in line with population growth and inflation. (That decline reversed with $4.7 billion in federal coronavirus-related funds in 2020.)

KEY FACT

★★★★★★

Slowing the growth in General Fund revenue and expenditure, as we have seen, can leave state government in a better position financially to weather a fiscal storm like the Great Suppression. Even without the ability to use federal funds to offset lost revenue, North Carolina would have been able to get through 2020 and 2021 with no lower General Fund appropriations than in 2019 and no tax increases.

Slowing the growth in General Fund revenue and expenditure, as we have seen, can leave state government in a better position financially to weather a fiscal storm like the Great Suppression. Even without the ability to use federal funds to offset lost revenue, North Carolina would have been able to get through 2020 and 2021 with no lower General Fund appropriations than in 2019 and no tax increases.

Looking ahead, however, the most effective way to keep spending and taxes low is with a TEL that applies to all revenue and expenditures, not just state taxes and appropriations. The TEL would also include debt limits since the proceeds from debt financing clearly constitute spending and for which repayment would come from tax revenues.

Adjusting the Base

Although the goal of a TEL is to keep spending per person constant over time after adjusting for inflation, it is not intended to starve government in the event of a recession. One of the criticisms of the Colorado TABOR has been its "ratchet effect," in which spending and revenue are set at a lower base after a recession or other emergency. Just as the rainy-day fund is intended to maintain a level of spending in case revenues fall precipitously, the spending and revenue limit should adjust to the actual spending.

Appropriating money from the Savings Reserve, North Carolina's rainy-day fund, is appropriately a function of the legislature, as is the limit on withdrawals to 7.5 percent of the previous year's revenue upon the approval of two-thirds of "present and voting" members of each chamber. If legislators opt to use that money to offset revenue losses, rather than for disaster relief and recovery, the spending from savings should be included in the TEL base for the following year's allowable growth.

If there is such a prolonged change in revenue or government spending that legislators see a need for a tax increase or new debt, a TEL would obligate them to seek permission from voters in an already scheduled statewide election, which would occur in November of an even-numbered year. Tax cuts and revenue-neutral tax reforms, however, would not need voter approval.

A Final Caution

Even with a balanced-budget requirement in place limiting government's ability to tax and spend, Democrats and big-state Republicans can resort to more government regulation, which could impede economic growth more than high spending or taxes. In other words, a TEL on its own may not limit the size and scope of government for those determined to expand government's role in people's lives.

A Technical Note On Measuring Inflation and Population

In proposing that the state should limit taxes and spending to the rate of inflation and population growth, we should define those terms.

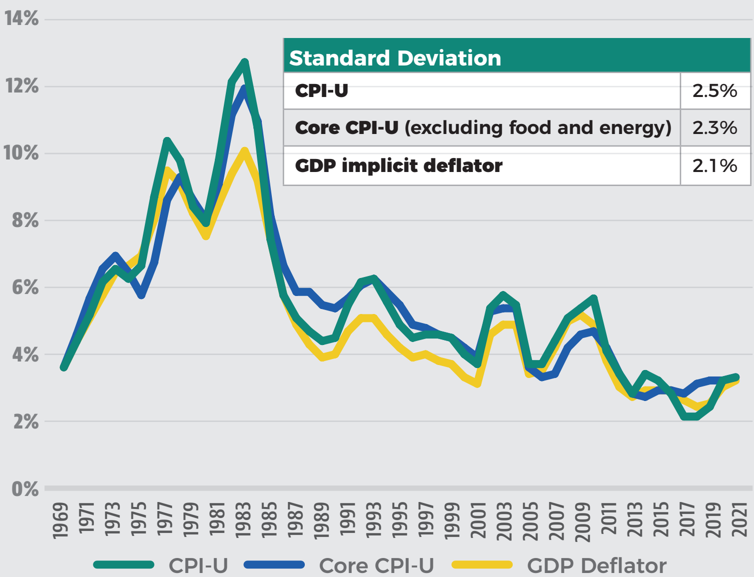
Nearly every industry has its own rate of cost and price growth, whether housing, education, health care, or government. Education spending is measured per pupil through high school and per full-time-equivalent student in community colleges and universities. Managed-care plans are paid per member per month. In addition, you can find a consumer price index or housing price index for a particular metropolitan area, for all urban areas, or for the nation as a whole. The goods included in the index may exclude food and energy prices, which vary more over time.

When setting the bar for all state government spending and revenue, we should consider total state population, though each of the subsets could still serve a function for evaluating the efficiency of spending on education, health, prison, and other government functions. For ratios of spending per person (student, member, inmate, etc.) to remain a standard of efficiency, rather than an arbitrary excuse to spend more, however, we must be careful not to assume higher spending per student, for example, necessarily means better outcomes for students.[43] [44]

We should also decide whether to use actual inflation and population from the past or rely on forecasts for the year. If we use past years' results, how many years past should we include? If we use forecasts, bear in mind they can miss the mark. A budget that seemed likely to grow less than the rate of inflation and population could be found in retrospect to have grown faster than that standard. Forecasts are also proprietary, so an outside observer would not be able to judge independently the allowable rate of spending growth. This fact matters because even one-tenth of one percent of spending is between $23 million in the General Fund and $60 million in total spending.

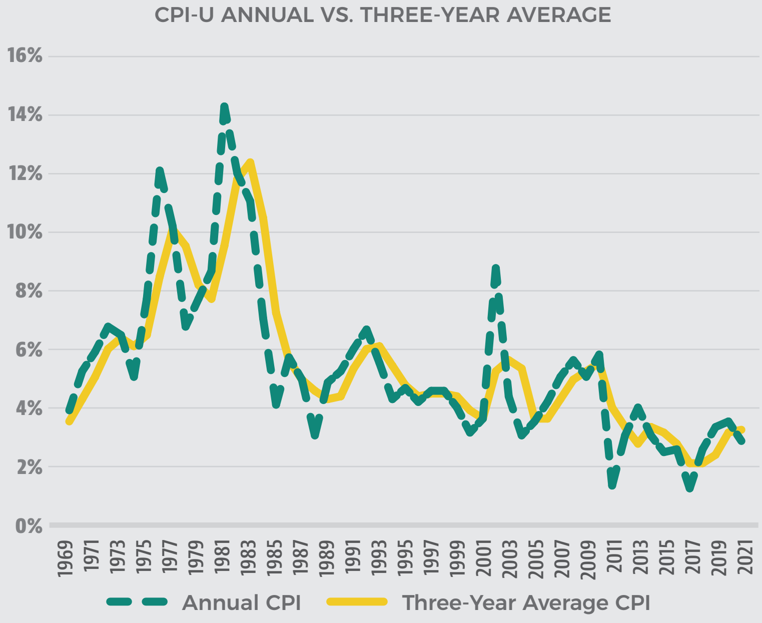
Our other goal in choosing a standard is to reduce the variation in allowed spending growth from one year to the next. Core inflation is more consistent than the ordinary consumer price index, but it does not account for substitution effects. The implicit gross domestic product (GDP) deflator is the broadest measure of inflation and the one with the least variability without removing meaning and context.

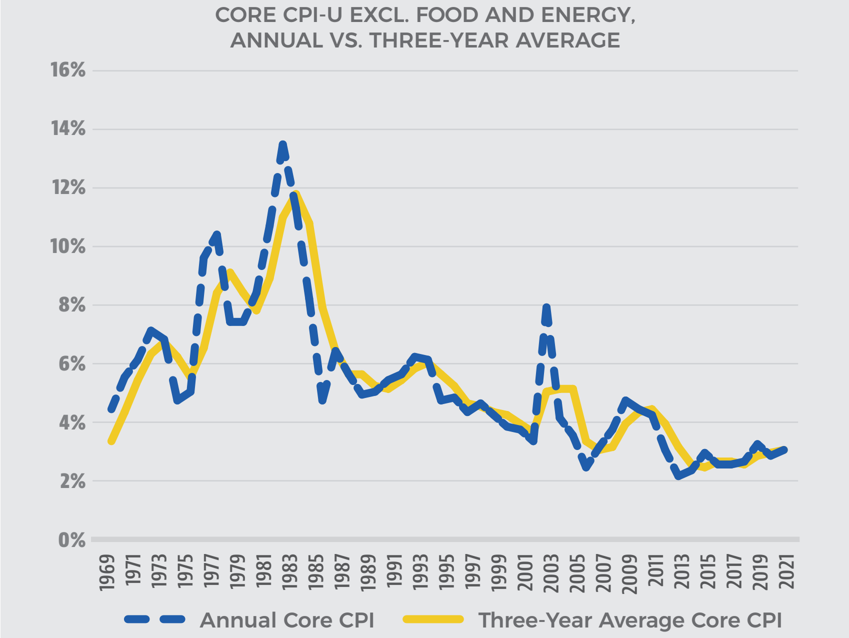
Figure 6. The GDP Deflator Is a Less Volatile Measure of Inflation Than the CPI

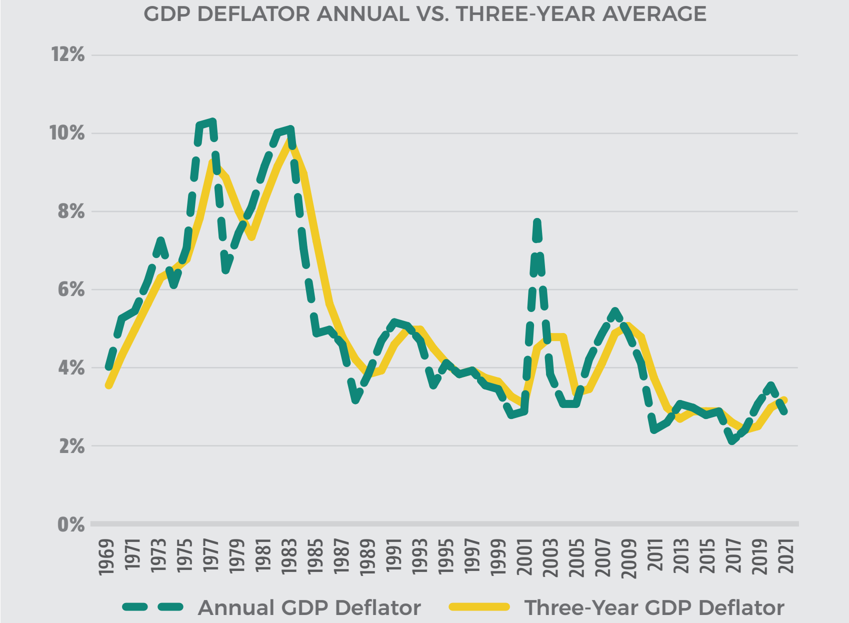


Taking a three-year average of total state population growth and inflation would offset temporary spikes or dips in those measures. Using the three years prior to the start of the fiscal year would make the allowed rate of growth known to everyone early in the budget process. For stability and predictability of allowable spending and tax growth, the state should use the average growth in the GDP deflator and population in the three years prior to the start of a fiscal year as the standard for spending growth in that fiscal year, as we do in this paper.

Figure 7. The Three-Year Average of Total Population Growth and Inflation Is More Predictable and Less Affected by One-Year Anomalies




CORE CPI-U EXCL. FOOD AND ENERGY,
ANNUAL VS. THREE-YEAR AVERAGE
16%
14%
12%
10%
8%
6%
4%
2%
0%
1969 1971 1973 1975 1977 1979 1981 1983 1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015 2017 2019 2021
Annual Core CPI
Three-Year Average Core CPI


GDP DEFLATOR ANNUAL VS. THREE-YEAR AVERAGE
12%
10%
8%
6%
4%
2%
0%
1969 1971 1973 1975 1977 1979 1981 1983 1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015 2017 2019 2021
Annual GDP Deflator
Three-Year GDP Deflator

CONCLUSION

A decade of low spending and higher saving put North Carolina in an enviable position heading into the onset of the coronavirus. The long-term impact of sustainable spending is evident in North Carolina's ability to avoid higher taxes or a significant reduction in spending to get through FY 2019-20. Continued restraint is possible without a constitutional TEL, but it is far from guaranteed.

The model in this paper is consistent with academic research on government spending, taxes, and economic growth. Higher income taxes work against higher spending to reduce economic output and employment compared with the status quo without a tax hike. In turn, the tax hike generates less revenue than projected, which could mean more tax hikes to cover the shortfall. North Carolina's experience from 2001 to 2011 reflected this pattern. Gov. Mike Easley and legislators together extended temporary taxes, added other taxes, and even passed a state education lottery in 2006, until they eventually made half of the temporary sales tax permanent in 2007. When the economy fell into recession

KEY CONCLUSION

★★★★★★

Gov. Roy Cooper's spending recommendations and the Democratic wish list for Medicaid expansion and collective bargaining would destabilize government finances, take up to $7 billion from the economy over four years and leave as many as 5,500 fewer jobs available each year for North Carolinians.

again, Gov. Bev Perdue increased taxes and furloughed employees because the state's finances had no margin for a downturn.

Gov. Roy Cooper's spending recommendations and the Democratic wish list for Medicaid expansion and collective bargaining would destabilize government finances, take up to $7 billion from the economy over four years and leave as many as 5,500 fewer jobs available each year for North Carolinians.

APPENDIX A

Colorado's TABOR Amendment

Colorado Constitution Article X, Section 20

The Taxpayer's Bill of Rights

(1) General provisions. This section takes effect December 31, 1992 or as stated. Its preferred interpretation shall reasonably restrain most the growth of government. All provisions are self-executing and severable and supersede conflicting state constitutional, state statutory, charter, or other state or local provisions. Other limits on district revenue, spending, and debt may be weakened only by future voter approval. Individual or class action enforcement suits may be filed and shall have the highest civil priority of resolution. Successful plaintiffs are allowed costs and reasonable attorney fees, but a district is not unless a suit against it be ruled frivolous. Revenue collected, kept, or spent illegally since four full fiscal years before a suit is filed shall be refunded with 10% annual simple interest from the initial conduct. Subject to judicial review, districts may use any reasonable method for refunds under this section, including temporary tax credits or rate reductions. Refunds need not be proportional when prior payments are impractical to identify or return. When annual district revenue is less than annual payments on general obligation bonds, pensions, and final court judgments, (4) (a) and (7) shall be suspended to provide for the deficiency.

(2) Term definitions. Within this section:

(a) "Ballot issue" means a non-recall petition or referred measure in an election.

(b) "District" means the state or any local government, excluding enterprises.

(c) "Emergency" excludes economic conditions, revenue shortfalls, or district salary or fringe benefit increases.

(d) "Enterprise" means a government-owned business authorized to issue its own revenue bonds and receiving under 10% of annual revenue in grants from all Colorado state and local governments combined.

(e) “Fiscal year spending” means all district expenditures and reserve increases except, as to both, those for refunds made in the current or next fiscal year or those from gifts, federal funds, collections for another government, pension contributions by employees and pension fund earnings, reserve transfers or expenditures, damage awards, or property sales.

(f) “Inflation” means the percentage change in the United States Bureau of Labor Statistics Consumer Price Index for Denver-Boulder, all items, all urban consumers, or its successor index.

(g) “Local growth” for a non-school district means a net percentage change in actual value of all real property in a district from construction of taxable real property improvements, minus destruction of similar improvements, and additions to, minus deletions from, taxable real property. For a school district, it means the percentage change in its student enrollment.

(3) Election provisions.

(a) Ballot issues shall be decided in a state general election, biennial local district election, or on the first Tuesday in November of odd-numbered years. Except for petitions, bonded debt, or charter or constitutional provisions, districts may consolidate ballot issues and voters may approve a delay of up to four years in voting on ballot issues. District actions taken during such a delay shall not extend beyond that period.

(b) At least 30 days before a ballot issue election, districts shall mail at the least cost, and as a package where districts with ballot issues overlap, a titled notice or set of notices addressed to “All Registered Voters” at each address of one or more active registered electors. The districts may coordinate the mailing required by this paragraph (b) with the distribution of the ballot information booklet required by section 1 (7.5) of article V of this constitution in order to save mailing costs. Titles shall have this order of preference: “NOTICE OF ELECTION TO INCREASE TAXES/TO INCREASE DEBT/ON A CITIZEN PETITION/ON A REFERRED MEASURE.” Except for district voter-approved additions, notices shall include only:

(i) The election date, hours, ballot title, text, and local election office address and telephone number.

(ii) For proposed district tax or bonded debt increases, the estimated or actual total of district fiscal year spending for the current year and each of the past four years, and the overall percentage and dollar change.

(iii) For the first full fiscal year of each proposed district tax increase, district estimates of the maximum dollar amount of each increase and of district fiscal year spending without the increase.

(iv) For proposed district bonded debt, its principal amount and maximum annual and total district repayment cost, and the principal balance of total current district bonded debt and its maximum annual and remaining total district repayment cost.

(v) Two summaries, up to 500 words each, one for and one against the proposal, of written comments filed with the election officer by 45 days before the election. No summary shall mention names of persons or private groups, nor any endorsements of or resolutions against the proposal. Petition representatives following these rules shall write this summary for their petition. The election officer shall maintain and accurately summarize all other relevant written comments. The provisions of this subparagraph (v) do not apply to a statewide ballot issue, which is subject to the provisions of section 1 (7.5) of article V of this constitution.

(c) Except by later voter approval, if a tax increase or fiscal year spending exceeds any estimate in (b) (iii) for the same fiscal year, the tax increase is thereafter reduced up to 100% in proportion to the combined dollar excess, and the combined excess revenue refunded in the next fiscal year. District bonded debt shall not issue on terms that could exceed its share of its maximum repayment costs in (b) (iv). Ballot titles for tax or bonded debt increases shall begin, “SHALL (DISTRICT) TAXES BE INCREASED (first, or if phased in, final, full fiscal year dollar increase) ANNUALLY…?” or “SHALL (DISTRICT) DEBT BE INCREASED (principal amount), WITH A REPAYMENT COST OF (maximum total district cost), …?”

(4) Required elections. Starting November 4, 1992, districts must have voter approval in advance for:

(a) Unless (1) or (6) applies, any new tax, tax rate increase, mill levy above that for the prior year, valuation for assessment ratio increase for a property class, or extension of an expiring tax, or a tax policy change directly causing a net tax revenue gain to any district.

(b) Except for refinancing district bonded debt at a lower interest rate or adding new employees to existing district pension plans, creation of any multiple-fiscal year direct or indirect district debt or other financial obligation whatsoever without adequate present cash reserves pledged irrevocably and held for payments in all future fiscal years.

(5) Emergency reserves. To use for declared emergencies only, each district shall reserve for 1993 1% or more, for 1994 2% or more, and for all later years 3% or more of its fiscal year spending excluding bonded debt service. Unused reserves apply to the next year's reserve.

(6) Emergency taxes. This subsection grants no new taxing power. Emergency property taxes are prohibited. Emergency tax revenue is excluded for purposes of (3) (c) and (7), even if later ratified by voters. Emergency taxes shall also meet all of the following conditions:

(a) A 2/3 majority of the members of each house of the general assembly or of a local district board declares the emergency and imposes the tax by separate recorded roll call votes.

(b) Emergency tax revenue shall be spent only after emergency reserves are depleted, and shall be refunded within 180 days after the emergency ends if not spent on the emergency.

(c) A tax not approved on the next election date 60 days or more after the declaration shall end with that election month.

(7) Spending limits.

(a) The maximum annual percentage change in state fiscal year spending equals inflation plus the percentage change in state population in the prior calendar year, adjusted for revenue changes approved by voters after 1991. Population shall be determined by annual federal census estimates and such number shall be adjusted every decade to match the federal census.

(b) The maximum annual percentage change in each local district's fiscal year spending equals inflation in the prior calendar year plus annual local growth, adjusted for revenue changes approved by voters after 1991 and (8) (b) and (9) reductions.

(c) The maximum annual percentage change in each district's property tax revenue equals inflation in the prior calendar year plus annual local growth, adjusted for property tax revenue changes approved by voters after 1991 and (8) (b) and (9) reductions.

(d) If revenue from sources not excluded from fiscal year spending exceeds these limits in dollars for that fiscal year, the excess shall be refunded in the next fiscal year unless voters approve a revenue change as an offset. Initial district bases are current fiscal year spending and 1991 property tax collected in 1992. Qualification or disqualification as an enterprise shall change district bases and future year limits. Future creation of district bonded debt shall increase, and retiring or refinancing district bonded debt shall lower, fiscal year spending and property tax revenue by the annual debt service so funded. Debt service changes, reductions, (1) and (3) (c) refunds, and voter-approved revenue changes are dollar amounts that are exceptions to, and not part of, any district base. Voter-approved revenue changes do not require a tax rate change.

(8) Revenue limits.

(a) New or increased transfer tax rates on real property are prohibited. No new state real property tax or local district income tax shall be imposed. Neither an income tax rate increase nor a new state definition of taxable income shall apply before the next tax year. Any income tax law change after July 1, 1992 shall also require all taxable net income to be taxed at one rate, excluding refund tax credits or voter-approved tax credits, with no added tax or surcharge.

(b) Each district may enact cumulative uniform exemptions and credits to reduce or end business personal property taxes.

(c) Regardless of reassessment frequency, valuation notices shall be mailed annually and may be appealed annually, with no presumption in favor of any pending valuation. Past or future sales by a lender or government shall also be considered as comparable market sales and their sales prices kept as public records. Actual value shall be stated on all property tax bills and valuation notices and, for residential real property, determined solely by the market approach to appraisal.

(9) State mandates. Except for public education through grade 12 or as required of a local district by federal law, a local district may reduce or end its subsidy to any program delegated to it by the general assembly for administration. For current programs, the state may require 90 days notice and that the adjustment occur in a maximum of three equal annual installments.

APPENDIX B

Past Proposals in North Carolina

Since Coloradans passed the Taxpayer's Bill of Rights amendment to their state constitution in 1992, North Carolina legislators have regularly introduced similar bills, none of which were passed into law. At least one bill was introduced each session from 1995-96 through 2015-16. Even the earliest of them would have limited spending growth in a fiscal year to the annual rate of growth in population and inflation as measured by U.S. Bureau of Labor Statistics' Consumer Price Index (CPI) for the three previous calendar years (e.g., 2017–2019 for FY 2020-21). The 2015 amendment would measure core inflation using a CPI measure that excludes food and fuel in order to reduce variability. In this paper, we use a broader inflation measure, the GDP deflator, to further reduce variability.

The state's first TEL constitutional amendment was proposed in 1997. A more thorough amendment was offered in 2005. From 2007 to 2013, TEL legislation combined statutory language with a constitutional amendment, all with minor revisions to one of the original bills first introduced in 1995. The 2015 bill contained only a proposed constitutional amendment with no accompanying statutory language. It simplified some of the provisions from previous iterations. Both the 2013 and 2015 amendments provide a strong foundation for a new constitutional amendment.

TEL Legislation Proposed in the NC General Assembly, 1993-2012

1993-1994

SB 832/HB1028—Taxpayer Bill of Rights: procedural rights before Department of Revenue, not cost of government

1995-1996

HB3/SB66 Taxpayer Protection Act
HB129/SB36 Taxpayer Bill of Rights

1997-1998

HB928 Taxpayer Protection Act
HB1067 Taxpayer Protection Act

1999-2000

HB919/SB1097 Taxpayer Protection Act

SB1419 Taxpayer Protection Act

2001-2002

HB764 Taxpayer Protection Act

HB1292 Taxpayer Protection Act

2003-2004

HB1011 Taxpayer Protection Act

HB1292 Taxpayer Protection Act

2005-2006

SB1323 Taxpayer Protection Act

HB1292 Taxpayer Protection Act

2007-2008

HB1773 Taxpayer Bill of Rights

2009-2010

HB159 Taxpayer Bill of Rights

2011-2012

HB188 Taxpayer Bill of Rights

The Proposed Taxpayer Bill of Rights of 2013

Following is the text from HB 274, the Taxpayer Bill of Rights of 2013:

SECTION 1. G.S.143C-1-1(d) is amended by adding the following new subdivisions to read:

"(12a) Fiscal growth factor. – The average of the sum of inflation and population change for each of the preceding three calendar years. If either inflation or the population change for the preceding three calendar years is negative, then that change shall be counted as zero.

(16b) Inflation. – The percentage change in the consumer price index for the United States for each calendar year as published by the Federal Bureau of Labor Statistics.
(21a) Population change. – The percentage change in State population for each calendar year as reported by the Office of State Budget and Management."

SECTION 2. Article 4 of Chapter 143C of the General Statutes is amended by adding the following new sections to read:

"§ 143C-4-8. Determination of General Fund expenditure limit.

(a) General Fund Expenditure Limit. – The General Fund expenditure limit for each fiscal year shall be the previous fiscal year's General Fund expenditure limit increased by a percentage rate that equals the fiscal growth factor.

(b) Base Fiscal Year for General Fund Expenditure Limit. – The total authorized General Fund for the fiscal year beginning July 1, 2015, increased by the fiscal growth factor shall be used to determine the General Fund expenditure limit for the fiscal year beginning July 1, 2016, which will then be used to determine the General Fund expenditure limit for succeeding fiscal years.

(c) Decreases in General Fund Expenditure Limit. – If, on or after December 31, 2015, the cost of any State program or function is shifted from the General Fund to another source of funding, including, but not limited to, counties or other units of local government, or if moneys are transferred from the General Fund to another fund or account, the General Fund expenditure limit shall be reduced by a like amount.

(d) Fiscal Reports. – On or before March 15 of each year, the Fiscal Research Division and the Office of State Budget and Management shall issue a determination of the General Fund expenditure limit for the fiscal year beginning July 1 of that year and a projection of the General Fund expenditure limit for the next fiscal year. If the Fiscal Research Division and the Office of State Budget and Management do not agree on the General Fund expenditure limit, the lowest determination and projection shall be used.

"§ 143C-4-9. Increase in General Fund expenditure limited.

(a) Governor Bound by General Fund Expenditure Limit. – In preparing the budget for a fiscal year, the Governor shall not propose expenditures from the General Fund for the ensuing fiscal period in excess of the projected General Fund expenditure limit established under G.S. 143C-4-8.

(b) General Assembly Bound by General Fund Expenditure Limit. – In enacting the budget for a fiscal year, the General Assembly shall not make appropriations from the General Fund in excess of the General Fund expenditure limit established under G.S. 143C-4-8.

(c) No State Moneys to Be Paid in Excess of General Fund Expenditure Limit. – Except as provided in G.S. 143C-4-10, no money shall be drawn from the State treasury if the withdrawal will result in a State expenditure for any fiscal year in excess of the General Fund expenditure limit established under G.S. 143C-4-8. Except as provided in G.S. 143C-4-10, the Governor, the State Treasurer, and the State Controller shall not issue or redeem any draft, check, warrant, or voucher that will result in a State expenditure for any fiscal year in excess of the General Fund expenditure limit established under G.S. 143C-4-8.

(d) Revenue in Excess of General Fund Expenditure Limit Credited to Emergency Reserve Trust Fund. – All General Fund revenue collected in excess of the General Fund expenditure limit shall be credited to the Emergency Reserve Trust Fund at the end of each fiscal year.

"§ 143C-4-10. Two-thirds vote of General Assembly required to exceed General Fund expenditure limit.

The General Assembly may, by an affirmative vote of two-thirds of the members of each house, make General Fund appropriations for nonrecurring expenses in excess of the General Fund expenditure limit for a period not to exceed 12 months beginning on the effective date of the appropriations."

SECTION 3. G.S. 143C-4-2 reads as rewritten:

"§ 143C-4-2. ~~Savings Reserve Account~~ Emergency Reserve Trust Fund and appropriation of General Fund unreserved fund balance.

(a) Creation and Source of Funds. – The ~~Savings Reserve Account~~ Emergency Reserve Trust Fund is established as a reserve in the General Fund. The Controller shall reserve to the ~~Savings Reserve Account~~ Emergency Reserve Trust Fund one-fourth of any unreserved fund balance, as determined on a cash basis, remaining in the General Fund at the end of each fiscal year. The Emergency Reserve Trust Fund shall also include revenue in excess of the General Fund expenditure limit credited in accordance with G.S. 143C-4-9(c).

(b) ~~Use of Funds.~~ Two-Thirds Vote Required to Appropriate Funds From the Emergency Reserve Trust Fund. – The ~~Savings Reserve Account~~ Emergency Reserve Trust Fund is a component of the unappropriated General Fund balance. Funds reserved to the ~~Savings Reserve Account~~ Emergency Reserve Trust Fund shall be available for expenditure only upon an act of appropriation by the General ~~Assembly~~. Assembly that passes by an affirmative vote of two-thirds of the members of each house.

~~(c) Goal for Savings Reserve Account Balance. – The General Assembly recognizes the need to establish and maintain sufficient reserves to address unanticipated events and circumstances such as natural disasters, economic downturns, threats to public safety, health, and welfare, and other emergencies. It is a goal of the General Assembly and the State to accumulate and maintain a balance in the Savings Reserve Account equal to or greater than eight percent (8%) of the prior year's General Fund operating budget.~~

(d) Transfers From Emergency Reserve Trust Fund Permissible to Pay Appropriations When Budgeted Funds Are Insufficient. – If the Director

<u>of the Budget determines that (i) pursuant to the provisions of G.S. 143C-6-2, the aggregate revenues collected and available during a fiscal year are not sufficient to pay all of the appropriations for that fiscal year in full or (ii) pursuant to the provisions of Section 5(3) of Article III of the North Carolina Constitution, receipts during a fiscal year when added to the surplus remaining in the State treasury at the beginning of the fiscal year will not be sufficient to meet budgeted expenditures, treasury at the beginning of the fiscal year will not be sufficient to meet budgeted expenditures,</u>

<u>(e) Excess Funds to Be Returned to Taxpayers. – If the total funds in the Emergency Reserve Trust Fund at the end of the fiscal year exceed an amount equal to five percent (5%) of the total General Fund appropriation for the prior fiscal year, the excess over five percent (5%) shall be reserved to provide tax relief to the citizens of North Carolina."</u>

SECTION 4. The funds in the Savings Reserve Account are transferred to the Emergency Reserve Trust Fund established by G.S. 143C-4-2.

SECTION 5. The State Budget Act, Chapter 143C of the General Statutes, is amended by adding the following new section to read:

<u>"§ 143C-3-6. Collections for prior calendar year to be revenue estimates for next fiscal year.</u>

<u>(a) In preparing the budget for a fiscal year, the Governor shall use as the State funds revenue estimate for the General Fund no more than the total State funds received for the calendar year ending December 31 immediately prior to the fiscal year, with the following changes only:</u>

1. <u>If any revenue decreases were effective for only part of that calendar year, the revenue estimate shall be reduced by an annualized total of the impact of such decreases.</u>

2. <u>If the budget proposes any revenue reductions to be effective during the fiscal year, the revenue estimate shall be reduced by the total estimated amount of such reductions during the fiscal year.</u>

3. Any onetime revenues in the prior calendar year shall not be included in the revenue estimates.

4. If the budget proposes any revenue increases due to increases in taxes or fees to be enacted or new taxes or fees to be enacted, an estimate of collections of such increased or new taxes or fees may be made.

(b) In enacting the budget for a fiscal year, the General Assembly shall use as the revenue estimate no more than the total State funds received for the calendar year ending December 31 immediately prior to the fiscal year, with the following changes only:

1. If any revenue decreases were effective for only part of that calendar year, the revenue estimate shall be reduced by an annualized total of the impact of such decreases.

2. If the budget proposes or assumes any revenue reductions to be effective during the fiscal year, the revenue estimate shall be reduced by the total estimated amount of such reductions during the fiscal year.

3. Any onetime revenues in the prior calendar year shall not be included in the revenue estimates.

4. If the budget proposes any revenue increases due to increases in taxes or fees to be enacted or new taxes or fees to be enacted, an estimate of collections of such increased or new taxes or fees may be made, but the revenue estimate for that fiscal year may not exceed the lower of an estimate made by the Fiscal Research Division or an estimate made by the Office of State Budget and Management.

(c) If the budget contains an estimate of any credit balance at the end of the fiscal year ending immediately prior to the beginning of the fiscal year covered by the budget, one-half of that credit balance may be proposed only for capital projects or other projects with a fiscal impact only in that fiscal year.

(d) Revenue from borrowings in the prior calendar year shall not be included in the estimates unless expenditure of the funds is proposed during the fiscal year covered by the proposed budget. Proposed revenue from borrowing in the proposed budget shall only be included to the extent that appropriations against such borrowings are budgeted.

(e) If the General Assembly appropriates any credit balance in the State treasury at the end of the fiscal year ending immediately prior to the beginning of the fiscal year covered by the budget, one-half of that credit balance may be appropriated only for capital projects or other projects with a fiscal impact only in that fiscal year."

SECTION 6. Article V of the North Carolina Constitution is amended by adding a new section to read:

"Sec. 15. General Fund expenditure limit.

(1) Definitions. The following definitions apply in this section:

(a) Fiscal growth factor. The average of the sum of inflation and population change for each of the preceding three calendar years. If either inflation or the population change for the preceding three calendar years is negative, then that change shall be counted as zero.

(b) Inflation. The percentage change in the consumer price index for the United States for each calendar year as published by the Federal Bureau of Labor Statistics.

(c) Population Change. The percent change in State Population for each calendar year as reported by the Office of State Budget and Management.

(2) General Fund expenditure limit. The General Fund expenditure limit for each fiscal year shall be the previous year's General Fund expenditure limit increased by a percentage rate that equals the fiscal growth factor. The Governor shall not propose expenditures from the General Fund for the ensuing fiscal period in excess of the projected

General Fund expenditure limit. In enacting the budget for the fiscal year, the General Assembly shall not make appropriations from the General Fund in excess of the General Fund limit.

(3) Base fiscal year for General Fund expenditure limit. The total authorized General Fund budget for the fiscal year beginning July 1, 2015, increased by the fiscal growth factor, shall be used to determine the General Fund expenditure limit for the fiscal year beginning July 1, 2016, which will then be used to determine the General Fund expenditure limit for succeeding fiscal years.

(4) Decreases in General Fund expenditure limit. If, on or after December 31, 2015, the cost of any State program or function is shifted from the General Fund to another source of funding, including, but not limited to, counties or other units of local government or if moneys are transferred from the General Fund to another fund or account, the General Fund expenditure limit shall be reduced by a like amount.

(5) Two-thirds vote of General Assembly required to exceed General Fund expenditure limit. The General Assembly may, by an affirmative vote of two-thirds of the members of each house, make General Fund appropriations for nonrecurring expenses in excess of the General Fund expenditure limit for a period not to exceed 12 months beginning on the effective date of the appropriations.

(6) Any funds that are unexpended as a result of this provision that exceed five percent (5%) of the General Fund appropriation for the prior fiscal year shall be returned to the taxpayers."

SECTION 7. The amendment set out in Section 6 of this act shall be submitted to the qualified voters of the State at the general election in November of 2014, which election shall be conducted under the laws then governing elections in the State. Ballots, voting systems, or both may be used in accordance with Chapter 163 of the General Statutes. The question to be used in the voting systems and ballots shall be:

"[ ] FOR [ ] AGAINST

Constitutional amendment to limit the General Fund expenditures for each fiscal year to an amount that does not exceed the previous year's General Fund expenditure limit increased by a percentage rate that equals the fiscal growth factor and to provide that the base fiscal year for the General Fund expenditure limit shall be the total authorized General Fund budget for the fiscal year beginning July 1, 2015, increased by the fiscal growth factor. That baseline shall be used to determine the General Fund expenditure limit for the fiscal year beginning July 1, 2016, which will then be used to determine the General Fund expenditure limit for succeeding fiscal years."

SECTION 8. If a majority of the votes cast on the ballot question, as set out in Section 7 of this act, are in favor of the amendment set out in Section 6 of this act, the State Board of Elections shall certify the amendment to the Secretary of State. The amendment becomes effective upon this certification. The Secretary of State shall enroll the amendment so certified among the permanent records of that office.

SECTION 9. Sections 1 through 5 of this act become effective only if the constitutional amendment set out in Section 6 of this act is approved by the qualified voters of the State, as provided in Section 7 of this act. In such case, Section 5 of this act is effective beginning with the budget for fiscal year 2016-2017.

SECTION 10. This act is effective when it becomes law.

The Proposed Taxpayer Protection Act of 2015

Following is the text from SB 607, the Taxpayer Act of 2015:

SECTION 1.(a) The Constitution of North Carolina is amended by adding the following Article:

"ARTICLE V-A
"TAXPAYER PROTECTIONS

"Sec. 1. Limit on growth of State spending.

(1) Fiscal year spending limit. Except as provided in subsection (2) of this section, the maximum annual percentage increase in State fiscal year spending shall not exceed the average inflation growth for the prior three calendar years plus the average growth in State population for the prior three fiscal years. "Fiscal year spending" means the General Fund appropriations for current operations, excluding appropriations from General Fund receipts. "Inflation growth" means the percentage increase in the Consumer Price Index for All Urban Consumers (excluding Energy and Food), or its successor, for the calendar year directly preceding the fiscal year. "Population" means the number of people residing in the State, excluding Armed Forces stationed overseas, as reported annually by the United States Census Bureau.

(2) Modification by supermajority vote. The General Assembly may vote to increase the spending limit established under this section for a fiscal year. An increase in the spending limit for a fiscal year shall be made by an act passed by two-thirds of all the members of each house.

"Sec. 2. Establishment of Emergency Savings Reserve Fund.

(1) The Emergency Savings Reserve Fund is established in the State Treasury. Interest on money in the Emergency Savings Reserve Fund shall remain in the Fund.

(2) Except as provided in subsection (3) of this section, the General

Assembly shall reserve to the Emergency Savings Reserve Fund each fiscal year an amount equal to two percent of the amount appropriated from the General Fund, excluding General Fund receipts, for capital and operating expenses for the prior fiscal year until the Fund contains an amount equal to twelve and one-half percent of the amount appropriated from the General Fund, excluding General Fund receipts, for capital and operating expenses for the prior fiscal year. The General Assembly may by statute provide for the deposit of additional funds in the Emergency Savings Reserve Fund.

(3) The General Assembly may decline to reserve funds to the Emergency Savings Reserve Fund, provide for the expenditure of funds from the Emergency Savings Reserve Fund, or both. An act declining to reserve funds to the Emergency Savings Reserve Fund, providing for the expenditure of funds in the Emergency Savings Reserve Fund, or both, shall become law only if two-thirds of all the members of each house vote to pass the bill.

(4) No money shall be drawn from the Emergency Savings Reserve Fund but in consequence of appropriations from the Fund made by an act passed by two-thirds of all the members of each house. The constitutional powers of the Governor do not authorize (i) the expenditure of money in the Emergency Savings Reserve Fund without an appropriation by the General Assembly or (ii) the diversion for other purposes of money appropriated from the Emergency Savings Reserve Fund by the General Assembly.

(5) This section shall not be construed to prevent the General Assembly from authorizing by statute the use of money in the Emergency Savings Reserve Fund on a temporary basis to meet the cash flow needs of the State.

“Sec. 3. Income tax rate limited to five percent.

The rate of tax on incomes shall not in any case exceed five percent, and there shall be allowed personal exemptions and deductions so that only net incomes are taxed.”

SECTION 1.(b) Section 2 of Article V of the Constitution of North Carolina reads as rewritten:

"Sec. 2. State and local taxation.

...

(6) Income tax. ~~The rate of tax on incomes shall not in any case exceed ten percent, and there shall be allowed personal exemptions and deductions so that only net incomes are taxed~~. Tax on incomes shall be subject to the provisions of Section 3 of Article V-A of this Constitution."

SECTION 1.(c) Section 22 of Article II of the Constitution of North Carolina is amended by adding two new subdivisions to read:

"(3a) Bills increasing the fiscal year spending limit established under Section 1 of Article V-A of this Constitution. Every bill increasing the fiscal year spending limit and containing no other matter shall be read three times in each house before it becomes law and shall be signed by the presiding officers of both houses.

(3b) Bills declining to reserve funds to the Emergency Savings Reserve Fund, providing for the expenditure of funds from the Emergency Savings Reserve Fund, or both as provided in Section 2 of Article V-A of this Constitution. Every bill declining to reserve funds to the Emergency Savings Reserve Fund, providing for the expenditure of funds from the Emergency Savings Reserve Fund, or both and containing no other matter shall be read three times in each house before it becomes law and shall be signed by the presiding officers of both houses."

SECTION 2. The amendments set out in Section 1 of this act shall be submitted to the qualified voters of the State at a statewide general election to be held November 8, 2016, which election shall be conducted under the laws then governing elections in the State. Ballots, voting systems, or both may be used in accordance with Chapter 163 of the General Statutes. The question to be used in the voting systems and ballots shall be:

"[ ] FOR [ ] AGAINST

Constitutional amendments adding the Taxpayer Protection Act to the North Carolina Constitution that would limit the growth of State spending to inflation plus population growth, establish and require yearly deposits in an Emergency Savings Reserve Fund in the State Treasury, and reduce the maximum allowable income tax rate in North Carolina from ten percent (10%) to five percent (5%)."

SECTION 3. If a majority of votes cast on the question are in favor of the amendments set out in Section 1 of this act, the State Board of Elections shall certify the amendments to the Secretary of State. The constitutional amendments become effective upon such certification and apply as follows:

1. Section 1 of Article V-A applies to fiscal years beginning on or after July 1, 2017.
2. Section 2 of Article V-A applies to fiscal years beginning on or after July 1, 2016.
3. Section 3 of Article V-A applies to taxable years beginning on or after January 1, 2020. The amendment to Section 2 of Article V applies to taxable years beginning on or after January 1, 2020.
4. Section 22(3a) and Section 22(3b) of Article II apply upon certification by the Secretary of State.

The Secretary of State shall enroll the amendments so certified among the permanent records of that office.

SECTION 4. Except as otherwise provided, this act is effective when it becomes law.

Endnotes

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About the Author

As Senior Fellow, Joseph Coletti examines fiscal and tax policy. He previously headed the North Carolina Government Efficiency and Reform initiative within the Office of State Budget and Management, which led to changes in automotive fleet management, natural and cultural resources, and state contracting. He has spent his career improving operations and strategies at for-profit, nonprofit, and government entities. He has degrees from Johns Hopkins SAIS and the University of Michigan in Ann Arbor.

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