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FINAL REPORT
OF THE
SENATE LIMITED TAXATION STUDY COMMITTEE

Honorable Mitch Seabaugh, Chair
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Senator, District 13

Honorable Ronnie Chance
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2006

Prepared by the
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I. INTRODUCTION

The Senate Limited Taxation Study Committee was created by the Senate Committee on Assignments under the authority granted by Senate Resolution 5. The Senate Limited Taxation (SLT) Study Committee was charged to study the benefits and detriments of applying an automatic cap on the State of Georgia's revenue and/or spending; these caps are often referred to as a "tax expenditure limitations" (TEL), and are being utilized, in some form, in a majority of states.

The SLT Study Committee was chaired by Senator Mitch Seabaugh of Coweta County. The following members served on the committee:

- Senator Joseph Carter of Tift County;
- Senator Ronnie Chance of Fayette County;
- Senator Greg Goggans of Coffee County;
- Senator Chip Pearson of Dawson County; and
- Senator Chip Rogers of Cherokee County.

The SLT Study Committee first convened on Thursday, June 15, 2006, at the State Capitol, to receive testimony regarding the recent history of and funding obligations under Georgia's budget, various spending limitations, and the history of tax expenditure limitations. The SLT Study Committee met on Thursday, August 10, 2006, to receive testimony regarding the appropriate limitations for Georgia and other states' expenditure limitations. The Wednesday, September 13, 2006, meeting of the SLT Study Committee focused on potential application of a tax expenditure limitation to Georgia's local governments, including municipalities, counties, and school systems. The fourth meeting of the SLT Study Committee on Monday, December 4, 2006, provided an opportunity for members of the committee to determine applicable indices measuring government growth and to discuss language of potential legislation.

II. EXECUTIVE SUMMARY

The SLT Study Committee found that Georgia's fiscal situation is sound; however, Georgia has no structural mechanism to control growth or limit spending other than the sole discretion of its executive and its elected, part-time legislature. Georgia is one of the only states that provides its Governor unilateral discretion in setting the annual revenue estimate. The revenue estimate serves as the barometer by which the Georgia House and Senate set the annual budget. The public tax dollars which are appropriated are limited only by the revenue estimate; the only barrier in growth in spending is that Georgia may not appropriate more than it receives through revenue (save debt assumed through bonding projects). Georgia does not have a history of exuberant spending; however, expenditures in Georgia have grown several fold during the last two decades coupled with the doubling population. As institutional and expected growth in spending continues, the State of Georgia should devise a method for ensuring that the budget remains in complement with the population, and that Georgia's tax dollars are spent efficiently and within priority of necessity.

III. PERSPECTIVE

"Governments don't reduce deficits by raising taxes on the people; governments reduce deficits by controlling spending and stimulating new wealth."
President Ronald Reagan

The purpose of the SLT Study Committee was to consider whether a TEL would benefit the citizen taxpayers of Georgia.

Where are Georgia's taxes utilized? Georgia tax revenues fund schools, state universities, highways, public safety, public health, business and professional licensing, court functions, wildlife management, and the state retirement system; moreover, over 75 percent of the state's annual budget is appropriated to education, health care, and criminal justice. These areas are growing faster in actual cost and population served than overall inflation and population growth. Since 1990, the state's Medicaid population has grown 126 percent while the state's prison population has grown 153 percent; this is significant considering the state's overall population growth was only 39 percent.

Reserved funds are dedicated sums that are required to be filled before a surplus is considered unreserved; some of these include transportation, lottery, tobacco, and Medicaid funds. It was Georgia's unreserved surplus that steadied the budget during the recession following the September 11th attacks. Georgia requires that the revenue shortfall reserve be funded equal to 4 percent of the net revenue from the previous year; the national average is only 3.8 percent. Some have advocated maintaining the "rainy day" fund at its cap of 10 percent to ensure that the state could weather another recession without relying upon the deep budget cuts which would be required to balance the budget. Funding at 10 percent is arguably necessary for the state to meet its current obligations during a revenue shortfall, or to fund state operations for about 45 days.

Some states, such as Colorado, Arkansas, Kansas, and Montana have no rainy day funds because they are not required under their state constitutions. In Fiscal Year 2007, Georgia will need $400 million to meet its basic reserve obligations.

The first tax and expenditure limitation (TEL) was enacted in California after a property tax revolt that resulted in the passage of Proposition 13 in the 1970s. Recent years have brought renewed interest in debating TELs. These budget mechanisms are intended to restrain the growth of budgets whether the concern is based on too much revenue or excess spending. According to the National Conference of State Legislatures (NCSL), several *constitutional amendments* to control spending, such as Tabor (Taxpayer Bill of Rights), SOS (Stop Overspending), or TASC (Tax and Spending Control) are on the ballot this year in Maine, Montana, Nebraska, and Oregon. Judicial decisions have suspended proposed ballot measures in Missouri, Nevada, and Oklahoma for this year. In Washington, voters will be asked to repeal the estate tax (which is dedicated wholly to education).

Over 30 states utilize some form of a TEL. Several states, such as Maine, have *statutory* spending or tax limiting mechanisms. Other states, such as Colorado, have TELs embedded in their state constitutions. Of these states, four have limits that apply to revenue, four have limits that apply to spending, and two have limits applying to both. Seventeen states have limits tied to growth in personal income, and four states have limits tied to change in population plus inflation.

No two TELs are exactly alike in their structure, for each state governs and appropriates differently. The NCSL identifies four categories of TELs in the United States: expenditure limits, revenue limits, appropriation limits, and hybrids:

- Most states with a TEL operate under an *expenditure limit*. Expenditure limits are generally tied to personal income or a growth index. In many states, the limit is tied to a growth index related to the expansion of the economy. Somewhat more restrictive are expenditure limits with refund provisions if revenues exceed the authorized spending level.

- *Revenue limits* tie an allowable, predetermined annual increase in revenue to personal income or some other type of index such as inflation or population, and the limit provides for the refund of any excess revenues to taxpayers. Missouri provides applicable refunds to taxpayers who file a state income tax return.

- *Appropriation limits* simply tie appropriations to the revenue forecast, typically allowing from 95 percent to 99 percent of expected revenues to be appropriated. These limits generally do not establish an absolute limit or tie growth to a measurable index. Delaware, Iowa, Mississippi, Oklahoma, and Rhode Island have this type of appropriation limit in operation.

- Some states also have *hybrid* components of various limits. Oregon has a state spending limit tied to personal income growth, and a provision requiring refunds if revenues are more than 2 percent above the revenue forecast. This law limits spending and, in a sense, limits revenues by tying them to the forecasted amount. Colorado is another hybrid state.

Colorado is commonly viewed as having the most restrictive set of fiscal limits; however, voters in 2005 chose to suspend the Tabor constitutional amendment originally passed in the 1990s. The Colorado law limited the state's revenue by limiting the amount that the legislature could budget. The cap could increase year to year pursuant to a formula based upon a percentage of population growth plus inflation, income, or both. Colorado would not be authorized to spend more than the formulated amount allowed, and if revenues fall below the formulated amount, then actual revenues logically serve as the cap. This is known as the "rachet-down effect." Some tax experts have argued it is better to utilize a three-year average of revenue collections as the base rather than the low point in the previous year.

Additionally, a voter approval requirement is the most restrictive type of TEL since all tax increases must receive voter approval. Only three states have adopted voter approval requirements. Currently, Colorado requires voter approval for all tax increases. Missouri and Washington require voter approval for tax increases over a certain amount.

Some states require a supermajority in the legislature to enact a tax increase; 16 states now use this supermajority requirement. Supermajority requirements dictate either three-fifths, two-thirds, or three-fourths majority vote in both chambers to pass tax increases or impose new taxes. The effectiveness of supermajority requirements depends upon the makeup of the legislature and the state's tax system. In states with one predominant party, the majority party may have enough votes to increase or block tax increases. Some of these states provide for emergency suspension of the supermajority requirement to be called by the governor; however, a fiscal crisis cannot be the cause for the emergency.

IV. HEARINGS AND FINDINGS

A. Thursday, June 15, 2006

1. Mr. Kevin Fillion, Director Senate Budget & Evaluation Office

Mr. Kevin Fillion, Director of the Senate Budget & Evaluation Office, presented testimony regarding the Georgia budget, its recent history, and applicable constitutional obligations. According to Mr. Fillion, a budget surplus in Georgia exists when:

- Revenues exceed the appropriated budget; or
- Agencies and departments have lapses in their spending which may stem from unspent sums or unforeseen savings.

Overall, the Georgia budget has been sound through the recent decades; however, during Fiscal Years 1991 and 2004, the Georgia budget was less than the previous year. This indicates that Georgia has had a good record of growth. Consider, the 2003 budget shortfall was mitigated by the federal funding of $140 million to the state over a two-year period. Expenditures were less in 2004 than in 2003. The 2007 Budget needs $400 million to meet basic Reserve Obligations. Revenue from the following streams fall into reserves:

- Department of Transportation;
- University tuition;
- Lottery;
- Tobacco settlement; and
- Medicaid.

Mr. Fillion noted that the unreserved surplus has assisted Georgia in weathering the recessions of the past, and this was especially true in Fiscal Year 2001. Unappropriated amounts over 10 percent of the budget are unreserved surplus. There is a mandated annual priority to fill up to 4 percent of the budget for the rainy day fund. The rainy day fund has been a positive facet to Georgia's fiscal prudence, and it was essential to legislators not facing deep budget cuts during the first years of this decade. Considering how important Georgia's rainy day fund is to its fiscal solvency, there are four states which have no rainy day fund: Colorado, Arkansas, Kansas, and Montana.

Mr. Fillion further noted that over the last 20 years, Georgia has experienced a 2 percent constant growth in population; however, expenditures had far outpaced the population growth. Consider the following:

- Education is 54 percent of the annual budget.
- Medicaid has seen 7 percent growth annually, yet the actual dollar growth is in double digits.

The constant increase in government spending inflation is basically an increase in personnel wages. Additionally, the State Homeowners Tax Relief Credit, which takes up a "sizeable chunk" of expenditures, is really a rebate rather than appropriated expense. Annual revenue growth may be attributable to population growth leading to more income tax receipts from such growth.

Georgia currently has over 1,600 total funding sources (including federal sources); however, the state has 5 main sources of revenue.

Regarding expenditures, Georgia is spending $34 billion when including federal funds. Georgia has over 435 appropriated programs, and this number expands to 1000 programs when including subprograms; Mr. Fillion stressed that this is a conservative estimate. This does not include QBE and some Medicaid programs.

Additionally, revenue growth appears to mirror personal income growth.

Mr. Fillion opined that Georgia wisely transitioned from Object to Program Budgeting in 2005, and this was the actual first step in limiting the growth of the budget because the state's agencies and departments are now required to itemize priorities by listing first programs to receive funding over other programs. This assists in highlighting inefficient or moot programs. Mr. Fillion further expressed that a TEL compliments program budgeting.

**2. Mr. Alan Essig, Executive Director
Georgia Budget and Policy Institute**

Mr. Alan Essig, Executive Director of the Georgia Budget and Policy Institute, initiated his testimony by stating that Georgia does not have a budget problem. He noted that general departmental funding decreased from 6.5 percent to 4.3 percent of the budget, and that the budget has grown 121 percent from $7.6 billion in 1991 to $16.9 billion in Fiscal Year 2006. Mr. Essig noted that increases in the budgetary spending have been driven by teacher salaries; moreover, without teacher raises, there would have been no growth in education spending.

Mr. Essig commented that the elimination of government waste is being helped by the Commission on a New Georgia and the implementation of program budgeting. Further, there should be a concentration on the growth of Georgia's elderly population, which is projected to double in the next 20 years; elderly populations require more government services than the average Georgia resident.

Mr. Essig also provided comments regarding Colorado's TEL, known as the Tabor Amendment. Mr. Essig opined that Tabor is generally believed to be the most restrictive TEL in the country. In order to restrict spending, Tabor principally limits revenue by setting a cap on the amount of tax revenue the state can budget each year. Any collections above the cap are returned to the taxpayers; moreover, the amount the state is allowed to keep in one year is the base for calculating the next year's cap. The cap then increases each year by the percentage growth under a formula of state population plus inflation. Further, if state revenues come in below the Tabor limit, the actual revenues, not the state population plus inflation limit, serve as the budget cap. This is known as the "ratcheting down" effect.

Mr. Essig noted that he believes there are problems with using a "population plus inflation" formula as a fair limitation on state spending. First, no existing measure of inflation correctly captures the growth in the costs of the kinds of services purchased in the public sector. State governments spend most of their money on education and health care. These expenditures typically have cost increases greater than the general rate of inflation. He pointed out that, between 1993 and 2004, medical care has been growing at almost twice the rate of overall inflation; and education has been growing at almost three times the rate of the overall Consumer Price Index (CPI).

Additionally, the specific populations that state governments serve tend to grow more rapidly than the overall population growth used in the formula. In Georgia, the state population increased by 32.7 percent between 1991 and 2004. Over that same time period, the prison population increased by 117 percent, the number of students served by Board of Regents institutions increased by 43.5 percent, and the number of Medicaid recipients increased by 110 percent.

Mr. Essig stressed that a rigid population plus inflation growth formula does not allow funding of new priorities. This formula shrinks state government over time, as the general inflation rate cannot keep up with increased government costs. A Tabor-like law in Georgia would not have allowed for the teacher pay increases or the more stringent corrections policies implemented in the 1990's. A rigid formula would make it difficult to increase state funds due to increased federal mandates, such as increased state funding needed for "No Child Left Behind" and homeland security. Mr. Essig stated that the Tabor Amendment is expansive and includes the general revenue fund, money collected from unemployment insurance premiums, and college tuition; moreover, the law applies to all levels of government to include municipalities and counties. Tax increases must be approved by popular vote of the people. Certain tax increases cannot be proposed, including increasing state income tax rates; however, the Colorado Legislature is enabled to increase fees.

According to Mr. Essig, state revenues as a share of personal income in Georgia were stable between Fiscal Years 1980 and 2001. Georgians contributed 5.93 percent of personal income to support state government in 1980 and 5.97 percent in 2001; however, Georgians were only contributing 5.4 percent of their income to support state government by Fiscal Year 2005. Mr. Essig noted that rather than increasing over the past 25 years, the state tax burden has decreased significantly.

3. Mr. Kelly McCutchen, Executive Vice President Georgia Public Policy Foundation

Mr. Kelly McCutchen, Executive Vice President for the Georgia Public Policy Foundation provided testimony in support of adopting a TEL in Georgia. He opened by stating that the Georgia Public Policy Foundation has supported a tax and expenditure limit for over 10 years, and is very pleased that this idea is receiving serious attention.

Mr. McCutchen noted that Georgia is one of 20 states that has no structural impediment to government growth. Further, he stated that blindly following the lead of other states is a bad idea; however, there are several good reasons for Georgia to consider a tax and expenditure limit:

- **Stability:** Mr. McCutchen noted that many states that dramatically expanded government spending during the expansive decade of the 1990s then later had to enact equally dramatic spending cuts and/or tax increases during the last recession. This unpredictable "stop-and-go" spending pattern is not the best use of taxpayer funds and often works to the detriment of those who truly need government services – at a time when they need them most. A tax and expenditure limit linked to a budget stabilization fund will eliminate this budget roller coaster and create a predictable and steady spending pattern.

- **A tax and expenditure limit will uphold the principle of limited government**: Mr. McCutchen stated that population growth and inflation are reasonable adjustments to government spending, but growth exceeding this level equates an endorsement of inexorable growth in the size of our state government.

- **Transparency**: Increases in taxes and spending should be a conscious, public decision. A good model is the Special Purpose Local Sales Tax (SPLOST) in Georgia, which requires a public vote for a time-limited tax to fund specifically identified projects.

- **A tax and expenditure limit will address all levels of government in the state:** Mr. McCutchen opined that simply limiting state spending would create the perverse incentive to pass along unfunded mandates to local governments; therefore, he added, any spending limit should also apply to all local government entities. This is particularly true in Georgia where more than half of total state and local spending is at the local level. Mr. McCutcheon added that only five states are more decentralized. Also, per capita local spending relative to other states is higher than state spending. Local spending per capita in Georgia increased from 30th in 1988 to 23rd in 2004; in comparison, Georgia's state spending per capita ranked 45th in 2004.

- **Encourages tax reform:** Mr. McCutchen commented that unless taxpayers are assured that a proposed "revenue neutral" tax reform will not, in effect, become a large tax increase, major tax reforms will not be politically possible. He offered for example, shifting education funding from local to state funds, as proposed in the last legislative session. At the local level, Georgia has enacted several measures designed to limit the growth of government. Examples include a limit of 20 mills for property taxes levied for education (unless you live in the City of Atlanta) and a limit of 7 cents sales tax (unless you live in City of Atlanta). With a spending limit in place to protect against stealth tax increases, the legislature can do away with these restrictions and give local governments the flexibility to design a tax system that best fits their needs.

Mr. McCutchen then proceeded to provide counterarguments to concerns voiced by critics of implementing a TEL in Georgia. First, he noted that critics cite:

- Referenda are not practical and are too expensive.

Mr. McCutchen notes that TELs do not require referenda; moreover, Colorado's Tabor Amendment requires tax-voter approval for tax increases. Debate in Georgia has not centered on whether any tax increases would require voter approval; however, a super-majority requirement of tax increases by the General Assembly has been discussed, and would work at the state level.

- The "ratchet-down effect" is too harsh.

Again, Mr. McCutchen referred to the "ratchet" as a requirement in the Colorado law that automatically adjusts the budget baseline to the last year's revenues when receipts fall below the previous year's revenues. He opined that to a fiscal conservative, this is good because it is difficult enough to reduce the rate of growth of government, but actually reducing the size of government is almost impossible. There are alternatives, such as using a three-year moving average as the base rather than the lowest point. Simply freezing the base so that it does not decline would be another alternative. Luckily, Georgia would be enacting this reform as a state that is relatively low in spending compared to other states. The primary concern of the Georgia Public Policy Foundation is the rate of future growth.

- General population growth is not a realistic measure since many programs are growing faster than the general population. For example, the Medicaid population grew at three times the rate of the general population from 1991 to 2004.

According to Mr. McCutchen, some of the increase in population in programs such as Medicaid were due to program eligibility expansions. Whether it is a policy decision or simply a growing population, lawmakers will always have the ability to propose a higher level of spending to adjust to unforeseen circumstances, market conditions, or federal mandates.

- General inflation is not a realistic measure since many programs are growing at a faster rate than general inflation. For example, from 1993 to 2004, the general inflation rate was 33.9 percent, the medical inflation rate was 60.7 percent, and the education inflation rate was 94.4 percent.

Mr. McCutchen stated that just spending more money does not equate to higher quality. Georgia spends a tremendous amount of money on Medicaid, yet the quality is poor. A better example is education. Over the last 20 years, Georgia increased per pupil spending more than any other state, yet it did not improve student achievement. Per pupil spending moved from 44th to 22nd highest during this time period. Again, if critical programs are in danger, then it should not be difficult to make the case for a supermajority vote.

- If a spending limit had been in place ten years ago, Georgia would not have been able to fund teacher pay increases or tough-on-crime legislation.

Mr. McCutchen said this is simply wrong. If these two issues could not get a two-thirds supermajority vote in the General Assembly, not much would receive approval. There cannot be enough emphasis on the fact that nothing being discussed would prevent spending from increasing provided that it received a supermajority vote in the legislature or a majority support of voters.

- A spending limit would put pressure on all state programs, not just high growth programs.

Mr. McCutchen notes that this is a good thing. Government should face constant pressure to identify its core functions, prioritize spending, and find efficiencies. Again, the alternative is to accept that government will grow inexorably over time. There are unlimited "good causes," but part of legislative responsibility is to make those tough decisions.

- State spending is not out of control.

Mr. McCutchen consents, but it could become out of control very quickly. From FY 1991 to FY 2004, the state budget grew by $1.5 billion more than population and inflation. This is due, in part, to teacher salary increases, prison construction, and property tax relief to local governments. It would have grown by much more if not for $1 billion in tax cuts. A spending limit is simply an insurance policy that we will have this fiscally conservative approach in the future. Further, state lottery funds should not be included in the spending limit.

- How should refunds be allocated?

Mr. McCutchen replied that the state could offer credits toward state income taxes, and local governments would probably offer credits toward property taxes. Sales taxes are paid at both levels, but it is hard to figure out who paid which amount. A better approach would be to reduce the sales tax rate. Another option would be moving revenues to a Tax Reform Account after the Budget Stabilization Fund is full. This fund would have to be zeroed out the next year and used for tax reductions, rebates, or debt reduction.

- Applying a tax and expenditure limit to local governments would be a violation of local control.

Mr. McCutchen said that the primary goal of a tax and expenditure limit is making decisions to increase taxes and/or spending more transparent. If this legislation mandated a cap on local spending without giving local government the ability to override that cap, it *would* be a violation of local control; however, the state should propose that if local elected officials want to increase the size of their government over and above a certain spending limit, they simply must gain approval of the voters, just like in a SPLOST election. This is the ultimate form of local control.

Mr. McCutchen continued by noting that to look to government to solve all of the state's unmet needs is a recipe for disaster. Certainly, the state can meet more needs without necessarily spending more money. Public charter schools like Tech High, within viewing distance from the State Capitol on Memorial Drive, is meeting needs for less money. They have the highest test scores in the City of Atlanta, and are serving predominantly low-income, minority students. They are accomplishing this with almost half the money spent in other similar schools. Health care is another example, for health care spending is consuming more and more of the state budget, but there are still too many Georgians with chronic diseases who are undiagnosed and untreated. These individuals with diabetes, high blood pressure, and other conditions could be stabilized with the correct medication, but all too often the state ends up spending more money by waiting until they develop costly complications.

Further, Mr. McCutchen added, if you look at any government over a long period of time, it is hard to think of a single one that has not gotten bigger. There is a large body of evidence and research that suggests that big, intrusive government is not good for economic growth and job creation, economic and individual opportunity, or even the environment. Abiding by the Founding Fathers' desires for a limited government is just as important today as it was 230 years ago. The legal system provides for a presumption of innocence until proven guilty. Mr. McCutchen stated that the Georgia Public Policy Foundation believes that in recognizing the principle of limited government, the burden of proof should rest with those who wish to expand government, and there should be open and public debate when these decisions are made.

B. Thursday, August 10, 1006

1. Ms. Jennifer Wolford, Deputy Director; and Mr. Jason Fernandes, Senior Analyst Senate Budget & Evaluation Office

Ms. Jennifer Wolford, Deputy Director of the Senate Budget & Evaluation Office, provided information regarding the state budget. She noted that the FY 2006 budget was built on a 5.6 growth over FY 2005, and this growth equates to approximately $883 million growth. Additionally, state revenue outpaced the Governor's estimate by 3.7 percent. Georgia collected $1.4 billion over FY 2005, and this equals 9.3 percent growth.

Ms. Wolford then commented on revenue collections. She first referenced Georgia's Personal Income Tax and Corporate Tax revenue which, at $ 9 billion, comprised 54 percent. Personal Income Taxes were up 10.4 percent compared to FY 2005, and this equals about $756 million; moreover, Corporate Income Tax collections were up 25 percent or about $178 million.

The State Sales Tax comprised 35 percent of collections equaling about $5.7 billion. These receipts grew by 8.5 percent over FY 2005, and this amount equals approximately $450 million in revenue.

These collections left the state with a budget surplus of $580 million. Of this amount, $173 million was set aside for midterm adjustment to K-12 education appropriations.

Ms. Wolford referenced a chart prepared by the Senate Budget & Evaluation Office titled *Chart 1: Selected Fund Balances Chart.* The chart shows the history of the Revenue Shortfall Reserve back to 1993. Referencing the chart, Ms. Wolford noted that between 1995 and 2002, the state applied revenue to unreserved surplus ranging from $12 million in FY 1995 to $906 million in FY 2000. The state surplus stands at $580 million less the $173 million applied during the midterm adjustment for education plus the $257 million reserved surplus from FY 2005 which sets the Revenue Shortfall Reserve (RSR) at $664 million. This is the highest amount since FY 2002.

According to Ms. Wolford, the state law governing the RSR changed during the 2005 Legislative Session. Prior to then, the RSR was an accounting maneuver set up by the State Auditor on June 30th of each year in the amount of no less than 3 percent and no more than 5 percent of the net revenue collections of the applicable fiscal year. Although 1 percent was set aside for the midterm adjustment, there was no specifically stated purpose for that 1 percent amount.

Under House Bill 509, the RSR is now set up in an accrual account, and is administered as follows:

- The first 1 percent of the current year's revenue is set aside specifically for K12 needs in the midyear;
- The RSR is not to exceed 10 percent.

Ms. Wolford stressed that bonding agencies prefer up to 5 percent of reserves.

Mr. Jason Fernades, Senior Budget Analyst with the Senate Budget & Evaluation Office, commented on the history of State General Funds as referred to in *Chart 2: Funds Available Less Expenditures*. Mr. Fernandes stated that since 1985, the state failed to meet revenue estimates in seven different fiscal years. During these years, the state had to use reserves or cut the budget. The other fifteen years of surplus were applied to the RSR.

Ms. Wolford then discussed how the state managed funds through recession. In the early years of this decade, it took $1.5 billion in reserves to maintain the current level of services (with one reduction to the budget occurring in FY 2004). Further, the state needs at least 10 percent of revenue to maintain current levels of service in a recession. Ms. Wolford said the question that should be asked remains:

"Is the current level of services what we want to be providing?"

- If the answer is negative, and the state desires an increase in services, it will take a larger percentage.
- If the answer is negative, and the state desires a reduction of services, you will need a smaller percentage.

This leads to the fundamental question of how the budget is set in Georgia. Ms. Wolford reported that, currently, Georgia budgets to capacity meaning it makes incremental changes to the budget based on availability of funds. There is rarely a thorough evaluation of what is in the base budget, or articulated another way: throughout the budget process, who is looking at what is already funded? Additionally, are the true needs of the state being assessed so the budget may be set accordingly? Another process to consider is known as "Home Budgeting" which also referred to as "bottom up budgeting." Under this process, the state assesses the needs from the ground up in priority order (food, clothing, shelter, savings, etc.); the state currently budgets under the practice of "top down" budgeting.

Mr. Fernandes reported on the current FY 2007 budget. He stated that the General Assembly passed the budget based on 4.8 percent growth over FY 2006 revenue collections. According to July 2006 statistics, Personal Income tax collections rose 19.3 percent, or $97 million. Sales tax collections grew by 12.1 percent, or $55 million. Additionally, Motor Fuel Tax collections were up 13.7 percent over FY 2006 to $78 million.

Further, Mr. Fernandes explained how the Fuel Sales tax is determined. The motor fuel tax is made up of two portions that are constitutionally allocated only for Georgia's roads and bridges. The first and original portion is an excise tax of 7 ½ cents per gallon (except for Aviation Gasoline, which is subject to a 1 cent per gallon excise tax). The second portion, created in 1979, is a sales tax that is calculated every six months and becomes effective January 1st and July 1st annually. The tax is 4 percent (1 percent of this tax goes to the general fund with the other 3 percent going to roads and bridges) of the price paid for a gallon of motor vehicle fuel. Mr. Fernandes noted that this is a little misleading because the actual price of gasoline that is paid at the pump is not used in determining the cost used; an average of the cost, determined semiannually by the Department of Revenue, is used. The rate is posted on the Department of Revenue web site and a revision is required if there is a 25 percent change in the average selling price of any motor fuel during the period.[1]

Ms. Wolford provided a summary of the current budget:

Quick Facts:

State Funds	$18,654,564,058
Federal Funds	$16,830,724,074
Agency Funds	$ 3,526,678,647
Total Funds	$31,916,591,736

Ms. Wolford concluded by stating that the Comprehensive Annual Financial Report (CAFR) showed that there exists an approximate $8 billion variance between the final budget and actual expenditures. The variances are $3.3 billion in federal funds, $3 billion in state agency funds, and $1.5 billion in carry-over funds from previous years.

2. Ms. Kelsey Zahourek, State Coalitions Manager Americans for Tax Reform

Ms. Kelly Zahourek, State Coalitions Manager for Americans for Tax Reform, provided testimony regarding the merits of tax reform including implementation of a TEL in Georgia. Ms. Zahourek began with stating that there is a taxpayer movement sweeping the nation and that momentum is building for constitutional spending limits. According to Ms. Zahourek, the Americans for Tax Reform seek to advance the cause of limited government and economic growth. She claimed that the chief driver of budget crises, and of ever-increasing tax rates, is unsustainable spending growth. Constitutional spending limits are meant to address this root cause of crisis by imposing a predictable, moderate discipline on state budget growth.

Ms. Zahourek stated spending limits offer several benefits to a state government. First, she argued, that a sound, constitutional spending limit is the best method yet to avoid such budget crises. A spending limit amendment stabilizes budgets and assures

[1] This 25 percent revision requirement was automatically enacted when motor fuel prices fluctuated downward between July 1, 2006, and January 1, 2007.

predictability to all those who manage or depend upon government funding, but this stabilization is only one of the advantages of a sound spending limit.

She furthered noted that a well-designed spending limit will curtail spending growth to a moderate level of inflation plus population growth or by utilizing a multi-year average of household income growth. This cap assures that no part of the budget will face an expenditure cut in real terms; however, inflation-adjusted dollars per person will continue unchanged. By limiting growth to a level near the long-run trend in inflation and economic growth, it avoids the boom-bust cycle that most states so painfully experienced in the past couple years.

Second, Ms. Zahourek continued, a well-designed spending limit will have provisions to save some excess revenues during good times in a reserve fund. Such provisions add to stability and predictability to state budgeting and to recipients of funds. A particularly difficult recession could force revenues even lower than the inflation plus population growth threshold, triggering a budget shortfall (though not as severe as it might be without a spending limit). The reserve fund could then be utilized to maintain services during the recession without resorting to new taxes.

Over time, a well-designed spending limit tends to reduce the burden on taxpayers while maintaining services. By restricting the growth of spending at a level below personal income growth, the wealth of society should grow faster than the burden of government. The resulting excess funds can be used to fund tax cuts or rebates. And leaving more wealth in the people's hands leaves more money for parents to save for college, more money for small businesses to invest and hire workers, and more money for workers to save for retirement. Spending limits lead to a wealthier society.

Ms. Zahourek noted that along with the tax relief that is a product of a spending limit comes the chance for economic growth. There have been numerous studies over several decades comparing the economic performance of high tax states versus low tax states which point to much higher growth and prosperity in low tax states. By freeing up money to reduce tax burdens, and minimizing the public sector portion of the economy, spending limits advance the economic growth of the state.

According to Ms. Zahourek, two states have passed model spending limit provisions in recent times.

Colorado is one model. Passed in 1992, Colorado's Tabor Amendment mandates three broad issues:

- Spending can increase no faster than inflation plus population growth;
- A supermajority vote of the legislature is required to raise taxes; and
- Any surplus revenue over the spending cap is immediately rebated to taxpayers each year.

Ms. Zahourek continued by stating that Colorado's experience shows all three theoretical benefits of sound spending limits. First, budget stability: Colorado avoided the severe budget crises that gripped almost every other state during 2002 and 2003. While Colorado did experience a minor shortfall each year, it was smaller in magnitude than California's $38 billion, Texas's $10 billion, Minnesota's $4.2 billion, or Maryland's nearly $2 billion shortfall in 2003. Colorado's budget went from $5.6 billion to $5.4 billion to $5.5 billion during a three-year cycle. She opined that while some cuts were necessary, dealing with a shortfall in the range of a hundred million is much easier than one in the range of two billion.

Something to consider, Ms. Zahourek noted, is that Colorado's Tabor has no provision for a small percentage of excess revenue to go into a reserve fund, for every extra dollar is rebated to taxpayers. The presence of a reserve fund would have helped Colorado cope with the economic downturn.

According to Ms. Zahourek, Colorado residents enjoyed the most tax relief of anyone in the nation during the 1990's. Between 1997 and 2002, Colorado taxpayers received a rebate every year totaling $3.2 billion, and this money left in private hands, combined with a less burdensome government, provided big dividends for Colorado's economy. It was first in the nation in Gross State Product growth from 1995 to 2000; it was second in the nation in personal income growth during the same period.

The Corporation for Enterprise Development has ranked Colorado's business climate as best in the nation. All in all, Colorado residents benefited much more than just the $3.2 billion they saved.

Ms. Zahourek noted that Washington State implemented a statutory spending cap; it is the second model state. In the beginning, the law was remarkably effective, but after a few years, it demonstrated the inadequacy of the statuary approach.

Passed in 1993, Washington's spending limit soon began to rack up large surpluses. That extra money was used first to reduce, then to eliminate, Washington's car tax, saving voters about $1 billion. Unfortunately, by the late 1990's, the Washington legislature discovered it could rewrite the spending limit since it was not written into the constitution. Since 1999 or 2000, there has been little effective limit on spending in the state.

In November 2005, Colorado taxpayers voted to suspend Tabor for five years, allowing the government to keep an estimated $3.7 billion. Ms. Zahourek stressed that there is a lesson to be learned from the Colorado experience. The spending limit was not the source of Colorado's budgetary problems, as evidenced by the economic growth that occurred in the state under Tabor, but it was the mandated spending provisions that undermined the positive effects of Tabor. Colorado's Constitutional Amendment 23, passed in 2000, required that government spending on "education" increase faster than inflation (inflation plus 1 percent). This put the spending pressure of Amendment 23 and the spending limit of Tabor on a collision course.

Ms. Zahourek expressed that the spending limit did not fail, but that the spending interests' tool to destroy reasonable limits succeeded in damaging Tabor.

Ms. Zahourek continued that Washington State and Colorado were the vanguard states. Washington demonstrated the weaknesses of statutory limits, while Colorado demonstrated the strength of constitutional limits undermined by spending exemptions.

Several states across the country were successful in pushing tax and expenditure limitation and similar amendments. Activists in Maine, Michigan, Oregon, Oklahoma, Nevada, Nebraska, and Montana led petition drives to put constitutional spending limit measures on the November 2006 ballot.[2] These aptly-named "Stop Over Spending" (SOS) initiatives would amend the state constitution to limit the annual growth in government.

The SOS measure controls state expenditures to grow no faster than the rate of annual population growth plus inflation, and restricts tax increases or spending above the limit unless expressly approved by voters. The measures also go further by adding a provision that states' surplus revenue above the expenditure growth limit will accrue in a rainy day fund with a smaller portion returned to the taxpayers.

The state legislatures in Ohio and Rhode Island passed spending limit measures. Though these are statutory, according to Ms. Zahourek, it is a positive first step.

Ms. Zahourek concluded by stating that it will take time to build momentum. If Georgia's leaders have the foresight to approve the measure, Georgia will position itself as a dynamic state that attracts the best new businesses, technology and knowledge workers, and rising incomes.

3. Dr. Frank Stephenson, Chair
Department of Economics
Campbell School of Business at Berry College

Dr. Frank Stephenson, Chair of the Department of Economics at Berry College provided testimony regarding the benefits of a TEL for Georgia.

Dr. Stephenson stated that one of the most important factors in determining a state's quality of life and economic environment is the size of its government and the ability, via structural restrictions or the exercise of self-restraint by elected officials, to limit the tax burden that the state government and its local subsidiaries impose on the citizenry. He cited fact that Georgia, unlike many states, has no structural impediments to governmental growth and must rely solely on its elected officials to limit government spending.[3]

[2] The initiatives only appeared on the ballot in three of these states due to judicial intervention; voters in Maine, Nebraska, and Oregon rejected tax expenditure limitations on the November 2006 ballot.
[3] Citing a study by Barry Poulson, "Grading the States' Tax and Expenditure Limits," Americans for Prosperity Foundation, June 2005.

Dr. Stephenson warned that special interests seeking government favors and politicians trying to charm voters are reasons to doubt that elected officials provide an effective buffer against expanding government. Examining recent behavior of state and local spending in Georgia, he noted, shows that Georgia's elected officials have not provided a strong defense against increasing tax burdens.

Dr. Stephenson shared information showing Georgia residents' tax burden was 8.7 percent of their income in 1970, but gradually crept up to 10.2 percent by 1989. Georgia's state and local tax burden remained over 10 percent throughout the 1990s until a modest retrenchment in government spending following the recession of 2001 reduced Georgians' tax burden to 9.8 percent of their income. Further, Georgia's combined state and local tax burden increased 1.1 percentage points during the 1970-2005 period.[4]

Dr. Stephenson explained that "tax" is defined as all revenue sources except intergovernment transfers.

Additionally, Dr. Stephenson noted that in 1970, Georgia had the 41st-highest tax burden, making it one of the lowest-taxed states in the nation; however, between 1970 and 1990, Georgia jumped up to the 17th-highest tax burden. Since then, robust economic growth reduced Georgians' tax burden to the 31st-highest among the 50 states. Consider, Georgia's strong population growth is not the cause of Georgia's increased tax burden between 1970 and 2005; moreover, states such as Maine, Rhode Island, and Louisiana have had both larger tax burden increases and slower population growth than Georgia.

Dr. Stephenson claims that Georgia's mediocre record in controlling the growth of spending and maintaining a low tax burden on its citizens suggests that reform might be a useful constraint on politicians. He pointed out that the approximately $1 billion spent, and sometimes borrowed, enacted in the 2005 Legislative Session shows that the traditional democratic process is inadequate to restrain politicians.

Further, Dr. Stephenson stated that a TEL that is linked to Georgia's rainy day fund would provide greater stability in government spending. Legislators should avoid a rapid increase in government spending in years when a robust economy generates increasing tax revenue; instead, the state should divert some of the revenue to Georgia's rainy day fund so the state could use the fund to offset reduced tax revenues such as those of the 2001-2003 period.

Dr. Stephens suggested the following criteria be included in an effective TEL in Georgia:

- The TEL must be enshrined in a state's constitution;
- The TEL's base must be defined to include most, if not all, categories of government expenditure. In Georgia, few, if any, forms of spending other than the Georgia Lottery's HOPE and Pre-K programs should be exempt;

[4] Citing a report by The Tax Foundation, Tax Data, Georgia's State and Local Tax Burden, 1970-2005, found at *www.taxfoundation.org/taxdata/show/448.html*

- A TEL should include both state and local government spending. One reason for including both state and local government spending is that limiting only state spending is an invitation for the state government to impose unfunded mandates on local governments. A second reason for including both state and local government spending is that Georgia is among the most decentralized states in the country, for only 51 percent of government spending in Georgia is centralized in Atlanta;
- The TEL should be limited to inflation plus population growth. There are two significant advantages of tying the TEL to inflation plus population growth rather than the rate of income growth. One advantage is that a population plus inflation TEL will lead to smaller government spending in the long run because the TEL will not adjust upward with economic growth. Another advantage is that a population growth and inflation TEL provides a more stable path of government spending over time. Population growth and inflation tend to grow at a relatively steady pace over time; by contrast, income growth is more variable over time and can experience sharp downturns during recessions;
- A TEL must require either a supermajority vote or a referendum in order to exceed the limited amount of spending. The same override mechanism does not have to apply at both the state and local levels. For example, a TEL could require a referendum for local governments to exceed the spending limit but require a supermajority of the legislature for the state government to exceed the spending limit. A supermajority could be set at two-thirds or three-fourths of the elected legislature; and
- A TEL must have explicit rules for handling tax revenue above the spending limit. During robust economic times, tax revenue often grows faster than inflation plus population growth. Georgia should place such funds into its rainy day fund until that fund meets a pre-set target for adequate funding. Adequate funding for the rainy day fund should be set at 10 to 12 percent of the state or local government's budget. Once the rainy day fund has been fully funded, any excess revenue should automatically be refunded to taxpayers. He further noted that Colorado would have been better served to have required excess revenues in a reserve fund, and its failure to do so is one of the causes of the budget problems in the Rocky Mountain State.

C. Wednesday, September 13, 2006

1. Dr. David Sjoquist, Director
Fiscal Research Center
Andrew Young School of Policy Studies at Georgia State University

Dr. David Sjoquist, Director of the Fiscal Research Center at the Andrew Young School of Policy Studies and Professor of Economics at Georgia State University, provided testimony regarding the merits and effects of a TEL in Georgia. Dr. Sjoquist noted that tax and expenditure limitations are blunt instruments for controlling growth in expenditure or taxes. He stated that Georgia has a reputation for being fiscally conservative, and that any TEL should require substantial evidence of a spending problem before being enacted.

Dr. Sjoquist explained that there exists two contrasting views of government:

1. Representative Democracy: Competition for voters leads elected officials to be responsive to the preferences of voters; and
2. Legislative-Bureaucracy: Control over information allows elected and appointed officials to control the budget.

There are three primary types of TELs. The first is a property tax TEL which may apply to overall tax rate limitations, specific tax rate limitations, levy limit, or assessment increase limitation. Property tax limitations have a small effect on total expenditure; moreover, as property tax revenues are limited, local governments would be more reliant upon state aid, licenses, user fees, and various charges to balance the difference. Dr. Sjoquist then discussed how local property tax burden is growing in Georgia:

1980
$199 per capita; 66 percent of the national average
$23.53 per $1000 of income; 79 percent of national average

- Increase of 6.5 percent per year

2004
$880 per capita; 81 percent of national average
$29.54 per $1000 of income; 90 percent of national average

- Increase of 1 percent per year

Dr. Sjoquist explained that one possible answer to why per capita property taxes have increased is because local governments needed to provide more services. Another possible answer is that locally elected officials simply wanted to control a larger budget. There does not exist any direct empirical evidence that could determine which of those two possibilities is correct; however, it is estimated that about 46 percent of the increase is associated with an increase in the Consumer Price Index. The property tax base has increased faster than property tax revenue, so the effective property tax rate has fallen, but not by much.

The second type of TEL is the general revenue or expenditure increase limitation; these are the type of TELs that are being implemented across the United States, and are the main focus of the SLT Study Committee.[5]

The third type is known as Truth in Taxation or Full Disclosure. For all of these types of TELs, typical overrides are made available for the legislative or executive branch.

[5] Total government revenue as a share of Gross Domestic Product in the United States is about 32 percent. Federal share is about two-thirds, state and local share is about one-third.

Dr. Sjoquist then questioned the necessity of implementing a TEL in Georgia. He explained that the General Assembly perhaps should focus on the fact that property taxes continue to escalate, and are heavily relied upon by local governments. Additionally, it should be discussed whether the 2005 state expenditures were not as high as compared to the fact the 1970 state expenditures might have been low. Another point made was the issue that the local governments' budgets have grown faster than the state's budget.

Voters might support a TEL in Georgia because of the general desire for lower taxes or more efficient government; however, voters would not approve of reduced or diminished public services that they expect. Generally, as income increases, the demand for better public services increases to compliment high incomes. He pointed out that there is nothing inherently wrong with a democratic society having high government spending if it is in response to voter preferences for more parks and smaller backyards, for better roads and less fancy cars, for better public schools and less eating out; however, high tax rates would be required to fund those services. It is important to note that higher tax rates lead to disincentives to invest and to work, which lead to lower economic growth and depressed incomes. It is generally accepted that for this reason that prominent economists argue against high marginal tax rates.

Dr. Sjoquist responded to a question concerning whether voters should be able to vote on the size of government. He answered that he believe voters should have much say about what government does, but one reason this government is a representative democracy is so that the elected officials can become better informed than most citizens. This should foster better informed decision-making by elected officials on behalf of the public at large. One example of this practice is perfecting the state budget.

Dr. Sjoquist then addressed the link between income and public expenditures. To an economist, he explained, there is no difference in principle between someone's demand for parks or police protection and the demand for bread. That demand will depend on the price, the person's income, and preferences. Considering parks, if the community is poor, the voters will say they cannot afford a park so they do not demand it. As income increases, some of that increase will be spent on better housing, better food, perhaps a car, or luxury items; however, the citizenry may also now desire a park, and are then willing to use some of their additional income to finance the new park. Additionally, as income increases, the citizenry may desire more amenities in the park, more benches, fountains, or a grass infield on the baseball field.

Again, Dr. Sjoquist explained, that economists expect that government expenditures will increase with a rise in personal income. It is another question as to whether government expenditures as a share of income should increase or decrease as income increases. The percent of income spent on food for home consumption (and other necessities) falls as income increases, while expenditure on eating out (a luxury) increases as income rises. He notes that it is an empirical question whether public services are more like necessities or luxuries.

Dr. Sjoquist then addressed whether basing the allowable dollar growth under a TEL on the three-year rolling average of expenditures rather than the most recent year solves the "rachet-down" effect as experienced under the Colorado Tabor; he answered in the negative.[6] The allowable expenditures in the year following a recession (i.e., a year in which the actual expenditures are less than allowable under the Tabor) will be larger using a three-year average; however, as growth resumes, the three-year average will be less than the most recent year's expenditures. This means that the growth in allowable expenditures will be less under the three-year average rule than the previous year rule.

Dr. Sjoquist also addressed the fact that unlike in many states, Georgia gives the governor sole authority to determine expenditure levels since the executive branch sets the revenue estimate. He noted that most states authorize committees forged of the executive and legislative branches to set the revenue estimate; these committees often give rise to compromises in the forms of increased expenditures. Georgia's unique revenue estimating procedure is one of the components that enables it to continue to receive from the three bond rating agencies their highest bond ratings.

2. Ms. Gwin Hall, Associate General Counsel
Georgia Municipal Association; and
Mr. Clint Mueller, Director of Policy Development/Revenue and Finance
Association County Commissioners of Georgia

Ms. Gwin Hall, Associate General Counsel for the Georgia Municipal Association, and Mr. Clint Mueller, Director of Policy Development for the Association County Commissioners of Georgia, presented joint testimony regarding the effects of imposing a TEL on local government budgets. Accompanying Ms. Hall and Mr. Mueller were Mr. Ned Sanders, Chairman of the Houston County Commission; Mr. Ron Gracy, the Commissioner for Catoosa County; and Mr. Terry Horton, City Councilman for the City of Warner Robins.

Ms. Hall and Mr. Mueller began by speculating that as costs increase for some state budget items at a greater rate, other items have to be cut; there is potential for unfunded federal mandates that may result in reduced funding for other state programs; and there is the possibility of loss of matching grants. These possibilities remove legislative flexibility to budget and appropriate with its greatest discretion.

Ms. Hall proffered the questions of how will enacting a TEL on the state affect local governments. She answered that the State of Georgia will be under greater pressure to shift service responsibilities to the local level including, but not limited to, tags and titles, environmental regulations, and housing state prisoners. Additionally, the state may need to reduce its share of jointly funded services such as public health, indigent defense, and district attorneys' offices; moreover, state departments and agencies will be under even greater pressure to locate their facilities in the local jurisdiction that can afford to provide

[6] Dr. Sjoquist reminded the Committee that Colorado voters suspended the Tabor Amendment for five years

the most local subsidization including State Patrol posts, GBI facilities, or Department of Driver's Services offices.

Mr. Mueller stated that the state will be less likely to offer state financial assistance and support services to the local level such as:

LARP	Indigent Defense
State Aid	GEFA
Public Health Funding	Governor's Homestead Relief Grant
Tax Assessor Training	Solid Waste Trust Fund
Peace Officer Training	Hazardous Waste Trust Fund
Crime Lab Assistance	

The issue of applying a TEL to the local government budgets was then discussed. Ms. Hall warned that services shifted down from the state will have to be funded, and local governments will have a difficult time complying with federal environmental mandates. Local governments will have to find revenues to comply with these regulations mandated by the state's agencies; moreover, absent the flexibility to increase local revenues and expenditures, the level of services that the local community requires may have to be dramatically cut.

Additionally, local governments will have a difficult time complying with court ordered mandates such as:

- Mandatory facility construction;
- New staff to relieve jail overcrowding;
- Providing Constitutionally-required indigent defense; and
- Environmental mandates.

There could be added pressure on local governments to curb development which burdens government services and infrastructure. It was argued that it may become harder for local governments to obtain and maintain high bond ratings; in furtherance, the need for local governments to issue debt will increase greater liability for future generations. It is possible that local governments will be more likely to defer maintenance in infrastructure; this is not considering the ability of local governments to effectively manage crises, for not all governments maintain reserves. Other potential budget cuts which may be necessary if a TEL is applied to local governments could be:

- Reduce or eliminate services that are desired but are not mandatory, such as park and recreation and libraries;
- Lower service levels for law enforcement, fire, health care, education, and transportation;
- Less funds available to promote economic development; and
- Less funds available for capitol improvement projects such as new roads, repairs to roads, and expansion, repair, and maintenance to water and sewer systems.

It was expressed that governments cannot sustain the existing level of services over time and comply with TEL restrictions at the local level. Local governments are part of the service-based economy that is only partially accounted for in inflationary indexes such as the Consumer Price Index (CPI). It is important to note that the service sector of the economy has grown much faster than the economy in general due to demographic shifts which disproportionately increase demand for local government services.

Regarding demographics, Georgia's elderly population will grow twice as fast as the general population during the next 40 years. This will place a greater need in services for health care, emergency care, hospitals, public health, transportation, and social services, and these will not be accounted for under a TEL formula.

Citizens benefit from local governments applying annual increases to cover costs in lieu of large intermittent increases to fund services such as:

- Water and sewer treatment plant upgrades and pipeline maintenance;
- Storm water utilities;
- Public safety equipment;
- Road maintenance and expansion;
- Airport improvement and expansion; and
- Employee benefits.

It was noted that the largest expense for local governments is personnel. The largest increases in personnel costs are health care costs which grow faster than the CPI; moreover, public sector personnel cost is very different from private sector cost. Imposing a TEL on local government budgets could result in the inability to attract a competent workforce to serve the citizens of Georgia's counties and cities. Mr. Mueller expressed that other expenses growing at a faster rate than CPI and population include:

- Liability insurance;
- Worker Compensation;
- Road pacing;
- Road construction; and
- Construction generally.

Ms. Hall stated that there could be unintended consequences of imposing a TEL on local governments. One of those is the inability to effectively react to emergencies. Cited as examples were: Dougherty County in 1994, following flooding; and the City of Helen, White County, in 2005, following a tornado. Another unintended consequence would be a dramatic shift in the local economy, where Twiggs County was cited following the departure of a major employer. Additionally, unexpected delays in projects could be affected. The City of Vienna, Dooly County, and Coweta County were provided as examples.

Further, local governments cannot control the increase in the restricted revenues streams of the Special Purpose Local Option Sales Tax (SPLOST), Hotel Motel Tax, building permits, and Emergency 911 fees. These are statutorily required to fund specific programs and may not be reallocated elsewhere. It was suggested that if an increase in revenue for a SPLOST grows faster than the cap in any given year, a greater roll back will have to be applied to the property tax to offset the increase in that revenue stream;

moreover, this rollback could result in less operating revenues for the local government for that year than in the previous year leading to cuts in services.

Among the comments made by the accompanying County Commissioners and the City Councilman, it was noted that local governments are very sensitive to change in budgetary processes and alterations in revenue streams; that there is no "fluff" in local government budgets. Additionally, it was stated that conservative politicians speak freely of local control of government decisions, but that a TEL application to local governments would be contrary to that idealogical principal.

3. Ms. Angela Palm, Director
Government Relations
Georgia School Boards Association

Ms. Angela Palm, Government Relations, Georgia School Boards Association, appeared before the Committee to discuss the effects of a Georgia TEL on local school boards. She commenced by stating that there has been a long history of concern about how big government should be and which level of government should be stronger. She noted that public policy has tried to balance the government's primary obligations with voter mandates for additional services and taxpayers' demands for efficient government, for there have been outcries at various times over the cost of government and the number of services provided.

Ms. Palm stated that TEL proposals bring this issue to the forefront again. In evaluating this concept, it is important to first determine what needs to be accomplished, and then the best method for meeting that goal can be considered. If the State of Georgia wishes to limit government spending, then the legislature should determine what services the government is required to provide.

Importantly, one requirement, made clear in the Georgia Constitution is education:

"The provision of an adequate public education for the citizens shall be a primary obligation of the State of Georgia. Public education for the citizens prior to the college or postsecondary level shall be free and shall be provided for by taxation."[7]

It was noted that in some programs, costs can be contained through eligibility requirements, and that welfare reform used that strategy. Ms. Palm stressed that public education is a different matter, for there are no eligibility requirements. In addition, the government has no control over the demand, nor does any one level or branch of government solely control the regulations that may be added.

Further, Ms. Palm stated that the cost of running a school system is determined by the number of students, the learning needs of those students, the dispersion of the students across the geographic area, and the cost of meeting regulatory requirements. Georgia's Full Time Enrollment (FTE) has grown every year since 1984, and it is projected to

[7] Ga. Const. Art. 8, Sec. 1, P. 1.

continue to grow at a faster rate through the next decade. She stressed that more and more students require special education services, and transportation costs are escalating. Regulatory requirements change frequently, but they never decrease.

Education funding is at a difficult stage. Due to the recent recession, the state was forced to cut its share of the Quality Basic Education (QBE) formula funding by over $1 billion; moreover, any funds added to the budget were earmarked for specific programs; consider that 89 percent of QBE formula earnings must be spent as directed by the expenditure controls. In addition to those controls, 65 percent of all revenue must be spent in the classroom, as defined under new state law beginning FY 2008.

It was explained by Ms. Palm that high school class sizes must be reduced next school year to a maximum classroom capacity of 28 students. With the required teacher planning period, this class size will require that more local dollars be spent on teacher salaries. Several systems have already reached the 20 mill maximum. Thirty-one systems levy 18 or more mills. Ms. Palm asked that the SLT Study Committee understand that a TEL in addition to of all these emerging issues creates a quandary as to how Georgia's school boards can meet the needs of the state's students.

Ms. Palm confirmed that the arguments for TELs seem to center around accountability and efficiency, and the effect of a TEL appears to put fiscal policy on remote control rather than going through the "sometimes ugly" legislative budgetary process. The arguments against TELs often go to the details of the plan.

Ms. Palm questioned how Georgia measures the growth in the cost of providing required services? If the group served, as in K-12, is growing at a faster rate than the overall population, how does the state capture that? How does Georgia allow for funding of new initiatives such as smaller class sizes or common planning periods? How do the school boards manage new mandates from courts or the federal government that do not come with dedicated revenue? How does any government handle sudden shifts due to an economic crisis or natural disaster?

Ms. Palm concluded by suggesting that the Georgia tax code, in its entirety, needs, to be studied, and that it should be further studied to consider current and projected needs, as well as projected revenue. She requested that the legislature build on the work of the separate, yet concurrent, House Comprehensive Tax Reform Study Committee and Senate Comprehensive Tax Reform Study Committee, and move forward judiciously with a comprehensive effort; moreover, any tax policy change done in isolation is short-sighted, and serves the best interest of no one in the long term.

4. Ms. Jamie Self, Director
Public Policy
Ms. Emily Daniels, Policy Analyst
Georgia Family Council

Ms. Jamie Self, Director of Public Policy, and Ms. Emily Daniels, Policy Analyst for the Georgia Family Council, provided testimony regarding the merits of a TEL in Georgia. Ms. Self began with testimony explaining why this is an issue for which the Georgia Family Council would be involved. Ms. Self explained that the same principals that legislative leaders seek to place on the Georgia budget are rooted in the reality that Georgia families face daily. She noted that budgeting, balancing, and saving are the means by which families have to ensure that they can make "ends meet" month to month. The basic criteria for which a TEL would place on the Georgia General Assembly during its budgetary process is no different than the checkbook process that families experience. For this reason, the Georgia Family Council supports the discussion of a Georgia TEL.

Ms. Daniels then explained the research and assessments she conducted regarding historical trends of the Georgia budget had a TEL been in place. She showed that her analysis of the volatility of state appropriations as compared with other variables which could serve as potential formulas for the TEL. Her research showed that Georgia's budget has expanded and contracted over 25 years with fluctuations over 20 percent.[8]

She also explained that Georgia's population had consistently grown at approximately 2 percent annually; however, Georgia's total personal income and CPI has shown to have been more erratic (with inflation the more constant of the two). She further argued that merging inflation plus population to the volatility comparison proves to be a more constant formula; that formula shows growth between five and ten percent annually between FY 1983 and 1999. Since the turn of the century, that number has hovered near 5 percent annual growth. Among the variables discussed, it was the population plus inflation that provided the most constant and predictable rate of growth against the budget over the same time period.

Further, Ms. Daniels noted that since 1980, Georgia's expenditures have grown over 470 percent while the CPI has grown approximately 130 percent in the same period. Georgia's budget expanded the most in FY 1986, 1990, and 2001; the budget grew the least in FY 1991 or even contracted in FY 1992, 2002, and 2004.[9]

Ms. Daniels then discussed how Georgia's budget would have grown under various formula scenarios: Total Personal Income (TPI) along with the Three Year Average of the TPI; and the Inflation Plus Population (I&P) along with the Three Year Average of I&P. Her analysis was conducted with 1980 as the base year, and it showed that Georgia's budget in that year was $2,894,616,394. Under TPI, Georgia's budget could have grown to $20,924,510,112, and up to over $24 billion under the TPI with its three year average! Conversely, Ms. Daniels pointed out that the I&P formula was more

[8] Ms. Daniels chose 1980 as the base year.
[9] This analysis has not been adjusted to inflationary numbers but used the raw numbers.

conservative. It showed that Georgia's budget would have grown to only $13,652,189,329 under I&P, and up to over $14 billion under the I&P and its three year average.[10]

Further, Ms. Daniels showed that using a formula of I&P and its three year rolling average, Georgia's budget would have been growing at a double digit rate in the early 1980s, but that the growth would have moderated to around 5 percent growth since 1985; moreover, Ms. Daniels explained that under her research, she found that Georgia would have exceeded its budget limit 14 times since 1980.[11]

In summation, Ms. Daniels noted, it is the position of the Georgia Family Council that any benevolence or transgression of public policy can be determined by its impact on the family unit; moreover, tax policy greatly affects the family. Whatever tax policy changes the state reviews and considers, it is the goal of the Georgia Family Council to ensure that the economic integrity of the home is honored and the interests of Georgia's hardworking families are protected.

D. Monday, December 4, 2006

1. Mr. Kevin Fillion, Director
Senate Budget & Evaluation Office

Mr. Fillion returned to appear before the final SLT Study Committee to proffer several questions that should be asked and to discuss various price indices to measure appropriate level and growth in spending. He noted that the SLT Study Committee should seek the following:

1. What is the most appropriate price index to measure growth?
2. What amounts of appropriations should be applied to a TEL?
3. Which population estimate should be used if a formula measuring population growth is utilized?

It was noted that the general CPI measure does not apply to government expenditures. Further, if Georgia chooses to not use the traditional CPI within a TEL formula, it would be the first state to do so. Additionally, while measuring growth, it is important to remember that government typically purchases and consumes in bulk.

1. **Gross Output of General Government:** This index is derived from the Bureau of Economic Analysis Table 3.10.4 "Price Indexes for Government Consumption Expenditures and General Government Gross Output." This index tracks the value of state and local government production as measured by its inputs. This measure includes compensation of employees, consumption of fixed capital assets, and intermediate goods and services

[10] These numbers do not reflect actual totals expenditures which generally include federal funding.
[11] The budget would have exceeded its growth limit in FY 1984, 1985, 1986, 1988, 1989, 1990, 1993, 1994, 1995, 1996, 1997, 1999, 2000, and 2001.

produced. While generally providing government services without charge, there are two notable exceptions: tuition and health care costs.

Tuition and third party health care payments (insurance and co-payments) contribute to government services. The Gross Output of General Government index does include the payments in its index. (For an index that factors out these "Sales to Other Sectors" refer to 3.10.4 "State and Local Consumption Expenditures"). This table is updated quarterly. Further, it is important to note that tuition funding policy should be addressed because it affects annual budget numbers and growth.

The Gross Output of General Government tracks the experience of state and local governments in all regions of the country. Governments that initiate expenditure shifts or experience regional price changes not in line with Georgia's policies or price pressures would still impact the index.

2. **Consumer Price Index for All Urban Consumers** (CPI-U): This index is derived from the Bureau of Labor Statistics, and tracks the average change over time of the prices paid by urban consumers for a variety of goods and services. Mr. Fillion noted that there is not an index that reflects the experiences of price change for rural populations. The CPI-Atlanta index specifically concentrates on price change in the Atlanta metropolitan area. The CPI-U index is updated monthly; however, the CPI-Atlanta index is updated bimonthly.

   The CPI-U is designed to measure the price change of the United States' urban population and may not accurately reflect consumption by rural populations.

3. **Producer Price Index for Finished Goods** (PPI): This index is also derived from the Bureau of Labor Statistics. It tracks the average change in prices over time of domestically produced and consumed commodities. The PPI does not track the prices of services. This table is updated monthly.

   The CPI-U, CPI-Atlanta, and PPI do not account for the economies of scale that state and local governments currently enjoy, but residents do not enjoy.

   Additionally, Mr. Fillion, concluded that the Georgia Tax Code is not linked to appropriations in that revenues are directly attributed to tax policy decisions; however, the tax code does alter itself as market forces fluctuate.

V. CONCLUSION AND RECOMMENDATIONS

The SLT Study Committee declares that the Georgia budget should be mandated to grow at a natural and predictable rate, and further declares that any excess revenues should be required to fund reserves, satisfy outstanding debt, or refunded to the state's taxpayers. Georgia taxpayers deserve constitutional protection to ensure that tax dollars are spent efficiently and prudently. The annual revenue estimate should no longer serve as the sole barometer for budgetary spending; moreover, there must exist a fair and stringent mechanism for budgetary growth. This is especially true as Georgia's population continues to expand above that of the national rate.

Georgia's budget should accurately reflect its own population growth and that of the inflation in prices of consumable goods; the Georgia budget should be directly tied to annual population growth as determined by the United States Census Bureau and by any change as shown by the Consumer Price Index. If these indices fail to show any growth, then the Georgia General Assembly should be able to determine the next fiscal year budget from any of the most recent budget amounts in order to prevent inadequate funding following a recession cycle.

An effective Georgia TEL should include, or would be complimented by, a supermajority requirement for tax and fee increase approval by the General Assembly. If spending is to be controlled then so should the ability to levy additional burden on taxpayers.

This SLT Study Committee concludes that the budgetary purse in Georgia is ultimately controlled by the Georgia taxpayer, and that the public should be entitled to an expectation of how much the budget will grow annually. The government of this state should strive to budget and spend taxpayer dollars in an open and transparent manner.

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