

## Proposal 5 of 2012: An Assessment of the Supermajority Tax Vote Requirement

By Michael D. LaFaive

### Executive Summary\*

Michigan's statewide ballot in November will include Proposal 5, an amendment to the state constitution that would require a two-thirds supermajority vote of both the Michigan House and Senate, or a simple majority vote of the people in a November election, to impose new state taxes or increase any state taxes that currently require only a majority vote of the Legislature.

The wording of Proposal 5 states that the amendment "shall in no way be construed to limit or modify tax limitations otherwise created in this constitution." This language means Proposal 5 would leave unaffected the state constitution's 1978 Headlee Amendment, which contains a variety of tax and revenue limitations on state and local government. The proposal also would not change Proposal A of 1994's constitutional requirement of a three-quarters supermajority vote of both the state House and Senate for any increase in the state education property tax.

Sixteen states have a legislative supermajority tax vote requirement, while 30 have a tax or expenditure limit like the Headlee Amendment. Michigan would have both types of limitations under Proposal 5 (and to some extent already does, given the state's supermajority tax vote requirement for raising state education property taxes).

While a review of the scholarly literature on the two kinds of limitations yields somewhat mixed results, the literature suggests on balance that such limitations are

\* Citations are provided in the main text

### ABOUT THE AUTHOR

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effective at lowering state and local government taxes and revenue. The academic literature also supports the view that lower state tax burdens improve a state's economy.

If the academic literature suggests a tax limitation provision like Proposal 5 could help the state's taxpayers and economy, a review of the possible practical effects of the proposal still makes sense. For instance, if Proposal 5 makes tax increases more difficult, would it perhaps deprive state government of necessary revenue, particularly in tough economic times, when tax revenues often fall?

Michigan's recent history does not suggest that supermajority tax vote requirement would render it impossible to raise taxes. When the Legislature passed a \$1.4 billion increase in personal and business taxes in 2007, the Michigan House and Michigan Senate did not meet the two-thirds threshold that Proposal 5 would require. Nevertheless, most of the Republicans who voted against the tax hike ended up voting for much of the spending associated with the new tax revenue. If they had been faced with the possibility of not having this money due to a two-thirds tax vote requirement, many of them might have provided votes for the tax hike after all.

At the same time, it is doubtful that the state would have faced a financial disaster without that tax increase. Mackinac Center analysts have pointed out that state and local governments could reduce spending by more than \$5 billion annually simply by benchmarking public-sector benefits to those offered in the private sector. Other savings are possible as well. Failing to increase taxes in 2007 could have forced legislators to make tough but responsible spending decisions that would have lightened the burden on taxpayers during the recession that began shortly thereafter.

Similarly, it is not clear that the higher tax approval threshold would thwart important tax reforms, such the

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recent abolition of the Michigan business tax, simply because they include increases in some taxes and larger cuts in others. If state legislators were unable to muster a two-thirds supermajority for the individual tax hikes in such a reform, the entire package could be submitted for a vote of the people. The feasibility of this approach seems evident in Michigan voters' approval of Proposal A of 1994, a package that raised taxes while providing a net tax cut. Notably, Proposal A was more extensive and complex than the recent MBT reform.

It is true that several states — Mississippi, Nevada and California — with legislative supermajority tax vote requirements have been experiencing economic and financial problems. It is unclear, however, that Mississippi's long history of poverty or Nevada's recent problems with unemployment (after low unemployment before the recession and a decade of rapid population growth) are related to their supermajority tax policies. California's state budget problems are sometimes attributed to its supermajority tax vote requirement and to the constitutional spending mandates that are viewed as byproducts of that requirement, but there appears to be a better case that California's state budget problems are the result of California voters' decision in 1990 to exclude significant new transportation expenditures from the state's constitutional cap on state spending increases.

The concern that a supermajority requirement for state taxes could produce a broad shift to higher local taxes appears largely to be guarded against by the provisions of Michigan's Headlee Amendment. If such a shift were to occur, it is not evident that it would lead to a higher overall tax burden than would have developed otherwise.

Proposal 5 appears likely to provide additional protection against state tax increases. The possibility of such hikes is illustrated by the substantial state gas tax hike proposed earlier this year by the governor. It may be appropriate to ensure state lawmakers take such steps only after developing a broad consensus that more of Michiganders' private revenues should be claimed as public funds.

## Introduction

Proposal 5 of 2012 would amend the Michigan Constitution to generally require that any state-level tax increase be approved by a two-thirds supermajority vote of the Michigan House and Michigan Senate or by a simple majority vote of the people. The proposal, as it appears on the ballot, reads:

Require a 2/3 majority vote of the State House and the State Senate, or a statewide vote of the people at a November election, in order for the State of Michigan to impose new or additional taxes on taxpayers or expand the base of taxation or increasing [sic] the rate of taxation.

This section shall in no way be construed to limit or modify tax limitations otherwise created in this Constitution.

Should this proposal be approved?<sup>1</sup>

The statement that the proposal “in no way be construed to limit or modify” existing constitutional tax limitations means that the proposal would not change tax provisions of the “Headlee Amendment,” described below, or the requirement of a three-quarters supermajority vote of both the House and Senate for any increase in the state education property tax.<sup>2</sup> The latter limitation was enshrined in the state constitution as part of a 1994 school finance ballot proposal known as “Proposal A.”<sup>3</sup>

The actual language that Proposal 5 would place in the state constitution is not much longer than the 70-word ballot summary shown above. Hence, Proposal 5 is the shortest — and arguably the most straightforward — of the proposals submitted to voters in November. A “yes” vote would mandate a two-thirds vote threshold in both chambers of the Legislature to raise state taxes other than the state property tax (which would still require a three-quarter vote supermajority). A “no” vote would reject the proposal, and the state would maintain its existing vote requirements (a simple majority in every case but the state property tax).

The concept of legally restricting the ability of lawmakers to raise taxes is not new. The oldest tax limitation measure on record dates to 1875 and is designed, according to scholars Steven Deller and Judith Stallmann, to limit property tax rate growth in Missouri.<sup>4</sup> In 1932 and 1933, some 16 states, including Michigan, adopted some form of tax limitation.<sup>5</sup>

There have been notable tax limits adopted in more recent years. In June 1978, one of the most famous tax limitations — Proposition 13 in California — was adopted by that state's voters.<sup>6</sup> Among other things, it cut property tax assessments and capped their rate of increase; required both chambers of the state Legislature to obtain a two-thirds supermajority vote if they wanted to raise taxes; and mandated a two-thirds supermajority vote of the local electorate for any special taxes that might be levied.<sup>7</sup>

California’s Proposition 13 was followed quickly in Michigan by the adoption of the Headlee Amendment in November of the same year.<sup>8</sup> The measure, named for Richard Headlee, its most prominent proponent, has four main provisions, which Mackinac Center President Emeritus Lawrence W. Reed has summarized as follows:

- Capping state government revenue at 9.49 percent of personal income
- Preventing local governments from increasing taxes without a vote of the people
- Preventing the state Legislature from requiring local governments to provide a service without giving them money to finance that service
- Preventing the state Legislature from reducing money provided to local governments below 48.97 percent of state outlays.<sup>9</sup>

As noted earlier, the Headlee Amendment’s tax limits, though not involving a supermajority requirement, would themselves remain unaffected by Proposal 5, given the explicit language of the proposal.\*

Also passed around that time was Missouri’s “Hancock Amendment,” which required a vote of the electorate to approve any increase in the percentage of state income taken by state government as revenue.<sup>10</sup> Some years later, in 1992, the most restrictive tax limitation in the country was passed in Colorado. Known as the “Taxpayer Bill of Rights,” the amendment prevented state spending and revenue from growing faster than the sum of the percentage increases in population and inflation.<sup>11</sup>

Legislative supermajority tax vote requirements are arguably a type of tax limitation, though in academic discussions, they are often treated as if they constitute a separate category. A list of STVRs throughout the country, taken largely from a study published by the National Conference of State Legislatures, appears in Graphic 1.

\* The exact language that Proposal 5 would place in the Michigan Constitution on this issue is identical to the ballot summary language: “This section shall in no way be construed to limit or modify tax limitations otherwise created in this constitution.” See the Appendix of this Policy Brief for the complete language of Proposal 5 (as opposed to the ballot summary quoted in the text above); see also “Initiative Petition Amendment to the Constitution,” (Michigan Office of the Secretary of State, 2012), <http://goo.gl/PSI08> (accessed Oct. 21, 2012).

**Graphic 1: State Legislative Supermajority Tax Vote Requirements Throughout the Country**

State	Year Adopted	Initiative, Referendum or Legislative Statute	Legislative Supermajority Vote Required	Taxes Included
Arizona	1992	Initiative	2/3	All taxes
Arkansas	1934	Referendum	3/4	All taxes except sales and alcohol
California	1979	Initiative	2/3	All taxes
Delaware	1980	Referendum	3/5	All taxes
Florida	1971	Referendum	3/5	Corporate income tax <sup>1</sup>
Kentucky	2000	Referendum	3/5	All taxes <sup>2</sup>
Louisiana	1966	Referendum	2/3	All taxes
Michigan	1994	Referendum	3/4	State property tax
Mississippi	1970	Referendum	3/5	All taxes
Missouri	1996	Referendum	2/3	All taxes <sup>3</sup>
Nevada	1996	Initiative	2/3	All taxes
Oklahoma	1992	Initiative	3/4	All taxes
Oregon	1996	Referendum	3/5	All taxes
South Dakota	1996	Initiative <sup>4</sup>	2/3	All taxes
Washington	1993	Initiative	2/3	All taxes <sup>5</sup>
Wisconsin	2011	Legislative Statute	2/3	Sales, income or franchise tax rates <sup>6</sup>

Graphic sources: Bert Waisanen, “State Tax and Expenditure Limits -- 2010,” (National Conference of State Legislatures, 2010), <http://goo.gl/4uRYj> (accessed Oct. 21, 2012); Jason Mercier, “Tax Restrictions Across the Country,” (Washington Policy Center, 2012), <http://goo.gl/w9XRv> (accessed October 20); “States With a Supermajority Requirement to Raise Taxes,” (Americans for Tax Reform), <http://goo.gl/uCUYo> (accessed Oct. 25, 2012).

Note that Americans for Tax Reform would place Colorado on this list because the Colorado Constitution includes a two-thirds legislative supermajority tax vote requirement for state or local emergency taxes. See Colorado Const, Art 10, § 20(6). N.B.: Most notes below are transcribed verbatim from Waisanen’s study for the National Conference of State Legislatures, cited above.

1. Constitution limits corporate income tax rate to 5 percent. A three-fifths vote in the Legislature is needed to surpass 5 percent. If voters are asked to approve a tax hike, it must be approved by 60 percent of those voting to pass.
2. Tax and fee increases can be voted on by the Legislature in odd-numbered years.
3. If the governor declares an emergency, the Legislature can raise taxes by a two-thirds legislative vote; otherwise, tax increases over approximately \$70 million must be approved by a vote of the people.
4. The National Conference of State Legislatures indicates that South Dakota’s supermajority requirement resulted from a referendum, but the requirement appears to have been the result of an initiative.
5. Tax increases producing revenue that do not exceed the spending limit must be approved by two-thirds legislative vote; tax increases that produce revenue over the limit must receive two-thirds approval by the legislature and voters. The two-thirds tax increase supermajority was suspended for two years and reduced to a simple majority through June 30, 2007, by legislation enacted in April 2005. It was again suspended by 2010 legislation, requiring a simple majority through June 30, 2011.
6. See Wisconsin Act 9 of 2011.

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## Review of the Literature

There is not a large academic literature on STVRs, such as Proposal 5. As shown in Graphic 1 above, there are 16 states that have STVRs.\*

Tax limitation amendments like the Headlee Amendment, Hancock Amendment and Proposition 13 are more frequently studied under the heading of “tax and expenditure limitations,” a category that includes limitations on taxes, revenue, spending or some combination of these. Such TELs, according to the National Conference of State Legislatures, exist in 30 states.<sup>12</sup> TELs can be present in state constitutions or statute or both.

A review of the existing literature on STVRs and TELs reveals mixed conclusions — not uncommon on any particular topic in academic journals.<sup>†</sup> The literature on both types of tax limitations is discussed here for two reasons. First, Michigan’s Constitution already possesses both a TEL in the form of the Headlee Amendment and an STVR in the three-quarters supermajority vote requirement to raise the state education property tax. Second, both restraints effectively raise the transaction cost to public officials of expanding government by making it more difficult to increase taxes, revenues or both. The effectiveness of one may represent subsidiary evidence of the effectiveness of the other, especially since some TELs, such as California’s Proposition 13, include an STVR.

In a 2007 Rockefeller Institute Policy Brief titled “The Effects of State-Level Tax and Expenditure Limitations on Revenues and Expenditures,” authors Suho Bae and Thomas Gais attempted to estimate the spending impact of TELs at the state and local levels. To do so, they employed data on 50 states from 1977 to 2000 regarding state TELs and revenue and spending levels. They controlled for complicating variables (such as state personal income) that might influence government spending independent of the TELs.<sup>13</sup>

They found based on their regression work that the “presence or absence of a TEL” affected state and local government spending, and that states with the strictest TELs had the largest decline in spending.<sup>14</sup>

The median state in their analysis would see an estimated per-capita state and local spending decline of between

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\* If Colorado is included, the count would be 17; see the notes for Graphic 1.

† Scholars frequently review different datasets, construct divergent analytical frameworks and employ a variety of statistical techniques.

\$139 and \$207 after adoption of the stricter TELs referenced in the study.<sup>15</sup> The authors have estimates of differentials ranging from states with no TEL to states with the strictest TEL.<sup>16</sup> The authors also report negative spending impacts on the level of state and local public safety spending after adoption of a TEL, but “positive effects on the share of transportation spending in total spending (though not its actual level).”<sup>17</sup>

Summing up their own work and their review of the literature, the authors conclude: “State-level TELs appear to produce their intended effects. Although findings to date show some inconsistency, the preponderance of the evidence indicates that states with TELs experience somewhat slower growth in [government] revenues and expenditures.”<sup>18</sup>

A 2001 paper on TELs by Michael New, a scholar with the Cato Institute, dovetails with the Rockefeller Institute study. New created a statistical model based on data obtained from 49 of the 50 states from 1972 through 1996.<sup>19</sup> In his analysis, he attempted to tease out the impact that TELs have on per-capita state and local spending. He found that if a state adopts a restrictive TEL (such as TELs that link spending to population and inflation), the state may see a decline in state and local expenditures of almost \$115 per person.<sup>20</sup> This figure is remarkably close to the lower bound associated with the stricter TELs in the Rockefeller study.

New also observed, “TELs passed by initiative are more restrictive and contain fewer loopholes than those enacted by state legislatures.”<sup>21</sup> This is not surprising, since TELs passed by a legislature can be changed by legislators whenever they find the tax or spending constraints problematic. In addition, lawmakers are typically lobbied by special interests seeking subsidies, tax breaks or spending increases on particular government programs.

Constitutional limits, in contrast, cannot be so easily revised. Moreover, a citizen initiative may be a function of disenchantment with government<sup>‡</sup> or its taxing and spending

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‡ The Michigan Supreme Court, for instance, described the adoption of the Headlee Amendment as follows:

Article 9, §§ 25-34 was presented to the voters under the popular term “Headlee Amendment,” named after its original proponent, Richard Headlee. It was proposed as part of a nationwide “taxpayer revolt” in which taxpayers were attempting to limit legislative expansion of requirements placed on local government, to put a freeze on what they perceived was excessive government spending, and to lower their taxes both at the local and the state level.

See *Durant v State Bd of Educ*, 424 Mich 364, 378 (1985).

policies. As Edward Hill et al. of Cleveland State University summarize in a 2006 paper on TELs: “Tax and expenditure limitations are generally the result of voter dissatisfaction with the cost of state government. The public finance environment has experienced two discernible waves of tax limitation efforts, the late 1970s and the early to mid 1990s. In both eras, dynamic individuals dedicated to reducing the size of state government led citizen tax revolt efforts.”<sup>22</sup> In a political environment of “tax revolt,” policymakers are probably more cautious about raising taxes and spending.

There are relatively few papers dedicated solely to STVRs, but economist Brian Knight’s 2000 paper, “Supermajority Voting Requirements for Tax Increases: Evidence from the States,” is often cited. Knight attempted to measure the impact that STVRs have on state tax burdens.<sup>23</sup> He observed that adoption of supermajority requirements by states predisposed to enthusiasm for taxes may cause the full effect of such requirements to be masked.<sup>24</sup> He developed a model to correct for this possibility and — after running three versions of his model — found that supermajority requirements may cause a decline in tax rates of between 8 percent and 23 percent.<sup>25</sup>

Meagan M. Jordan and Kim Hoffman, while recognizing Knight’s work, come to a different conclusion in a 2009 paper. To prepare their own analysis, they collected revenue data from 49 states from 2000 to 2006 and statistically controlled for a variety of other variables, such as state unemployment rates, per-capita income, etc. They concluded that the existence of an STVR did nothing to stem growth of revenue.<sup>26</sup>

Jordan and Hoffman’s own review of the literature on TELs and STVRs is mixed, but in comparison to the studies above, suggests less confidence that these types of tax limitation are effective at constraining state growth. Nevertheless, they observe, “The limited research on supermajority vote requirements indicates that these requirements can be effective in reducing state taxes.”<sup>27</sup>

In a similar vein, a 2006 article in the journal *Public Choice* looked at STVRs and found they have “little effect” on government revenues and spending.<sup>28</sup> The article, authored by John Bradbury and Joseph Johnson, found that supermajority vote requirements were, however, associated with a 7 percent decline in welfare spending.<sup>29</sup>

In a 2003 study, scholars Timothy Besley and Anne Case examined the political economy of several policy choices

based on “institutional rules” such as TELs.<sup>30</sup> One of their estimations “suggest[s] that state tax revenues per capita — and income tax revenues in particular — are significantly lower in states that have citizens’ initiatives.”<sup>31</sup> Their review of the literature likewise is mixed, but generally suggests that STVRs and TELs work, to varying degrees, as advertised.<sup>32</sup>

An exhaustive literature review of STVR- and TEL-related topics is beyond the scope of this Policy Brief. On balance, however, the literature indicates that TELs and STVRs do, to one extent or another, have the effect of lowering taxes and spending.

## Taxes and Economic Growth

If TELs and STVRs are effective in reducing tax burdens, do they help a state economically? The evidence indicates they do. A literature review by Scott Drenkard and Joseph Henchman of the nonprofit, Washington, D.C.-based Tax Foundation,<sup>33</sup> concluded that taxes are very important to a state’s economy, and the authors refer to “the cohesion of recent literature around the conclusion that taxes matter a great deal to business.”<sup>34</sup> They also observe that with regard to business decisions, “Every change to a state’s tax system makes its business tax climate more or less competitive compared to other states and makes the state more or less attractive to business.”<sup>35</sup>

In a 2008 study of the economic effects of state income taxes, Barry Poulson and Jules Gordon Kaplan begin with the following summary: “A number of studies have explored the impact of taxes on state economic growth. Most, but not all, of these studies find evidence of a negative effect of taxes on various measures of state economic performance.”<sup>36</sup> In a 2006 study, W. Robert Reed examined the relationship between state taxes and economic growth in the continental United States. His analysis, using data from 1970 and through 1999, provided “evidence of a negative and statistically significant relationship between taxes and economic growth.”<sup>37</sup> Specifically, Reed reports, “A state having a tax burden that is one percentage point higher than other states is estimated to have real [per-capita personal income] growth that is lower by 0.90 percent in subsequent five-year periods.”<sup>38</sup>

Steven Deller and Judith Stallmann looked for a link specifically between TELs and state economic growth in their 2006 study, “Tax Expenditure Limitations and Economic Growth.” They used 1987 to 2004 data from all 50 states and searched for “patterns in annual growth of per capita income.”<sup>39</sup> The authors found that TELs adopted

\* The authors appear to have excluded the tax and expenditure limitations of the early 1930s.

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before 1987 (such as Michigan’s Headlee Amendment) are associated with a “1.93 percent higher growth rate in per capita income” than states without TELs.<sup>40</sup> The TELs passed after 1987 also showed higher growth rates than states without TELs, but at an average annual rate only 0.63 percent higher.<sup>41</sup>

## Prudential Concerns

The academic literature suggests that a supermajority tax limitation can be effective in reducing tax burdens and that a tax and expenditure limitation like the Headlee Amendment can do the same. In turn, lower tax burdens seem likely to stimulate economic growth.

These conclusions are based on broad trends in the research literature. While a review of the research is a reasonable basis for evaluating a policy’s effects, it is also reasonable to assess whether Proposal 5’s provisions could have unintended consequences that would vitiate the gains that might otherwise be expected.

## The Ability of the Government to Raise Needed Revenue

A question naturally raised by a consideration of Proposal 5 is whether a supermajority tax vote requirements could make it difficult for the government to raise revenues for necessary programs. The concern would seem particularly pressing in poor economic times, when tax revenues often decline.

Having to meet a higher vote threshold would make it more difficult to raise taxes; this is the inevitable effect of a supermajority requirement. That said, raising taxes under a supermajority tax vote requirement would not be impossible.

In the past decade, Michigan state government has faced a number of budget deficits. These have been addressed in part with a cigarette tax hike,<sup>42</sup> a de facto property tax increase (due to a shift in the date taxes are paid),<sup>43</sup> new fees and fee hikes<sup>44</sup> and a \$1.4 billion personal and business tax increase.<sup>45</sup> At the time of the \$1.4 billion increase, Gov. Jennifer Granholm argued that further spending cuts would be damaging to the state and that a general tax increase was needed.<sup>46</sup>

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\* It is worth noting that the authors also found that limits imposed on local governments “may actually hinder economic growth.” Deller and Stallmann, “Tax and Expenditure Limitations and Economic Growth,” (Marquette Law Review, 2006), 536, <http://goo.gl/PL4iX> (accessed Oct. 22, 2012).

If Proposal 5 had been in place in 2007, would the \$1.4 billion in tax hikes have passed? At first blush, the answer would appear to be “no.” At the time, despite assurances that the personal tax increase would only be temporary and that the new revenues would put the state on firmer fiscal ground, many state legislators balked at the idea.<sup>†</sup> Not until the final hours of the final session of the fiscal year did the package pass, and it did so largely along party lines, with Democrats generally favoring it and Republicans generally opposing it.<sup>47</sup>

A supermajority tax vote requirement would have made this increase more difficult, but probably not impossible. Consider that most of the Republicans who voted against this tax hike nevertheless voted “yes” on much of the spending that was associated with the new tax revenue.<sup>48</sup> If the choice was truly between cutting spending and raising taxes, it is very possible — perhaps likely — that the Granholm administration would have successfully marshaled the votes to pass the tax hike.

At the same time, it is unlikely that failing to pass this tax increase would have led to a financial catastrophe in state government. As has been pointed out by James Hohman of the Mackinac Center for Public Policy, state and local government could save more than \$5 billion annually by benchmarking government employee fringe benefits packages to private-sector averages.<sup>49</sup> The Mackinac Center has published other spending-reduction proposals that would have bridged the projected revenue shortfall in 2007.<sup>50</sup>

Ultimately, an inability to raise taxes in 2007 could have led to reasonable state spending cuts that kept tax burdens lower on Michigan citizens during an economic downturn. This, in turn, might have provided substantial economic benefits. Instead, between 2001 and 2010, Michigan experienced a “lost decade” of economic growth.<sup>51</sup> It’s not clear that sustaining government revenues during the downturn was the wisest course.

A related concern is that the supermajority tax vote requirement, if adopted, would grant a relative handful of lawmakers extraordinary powers. Under this

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† Notably, the scheduled 2012 rollback in the personal income tax was postponed by Gov. Rick Snyder and the Michigan Legislature. See “2011 House Bill 4361: Replace MBT, raise income tax, trim credits: Public Act 38 of 2011,” (Mackinac Center for Public Policy, 2011), Michigan Votes, <http://michiganvotes.org/2011-HB-4361> (accessed Oct. 24, 2012). The \$1.4 billion tax hike also failed to stabilize the state’s finances, and in her last year in office, Gov. Granholm proposed another \$554 million tax hike. See Jennifer M. Granholm and Robert L. Emerson, “Executive Budget: Fiscal Year 2011,” (Michigan Department of Management and Budget, 2010), A-10, <http://goo.gl/YB7UM> (accessed Oct. 24, 2012).

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view, senators or representatives who might provide the additional votes needed to meet the two-thirds requirement could demand political favors that drive up the cost and inefficiency of government.

This situation does not appear to be fundamentally different, however, from what occurs when a handful of legislators represent the decisive votes for a simple majority vote requirement on a controversial issue. The 2007 vote to raise personal income taxes was narrowly decided in the Michigan House and Michigan Senate.<sup>52</sup> It would be naive to assume that the legislators who provided the last few votes for this majority approval did not have considerable leverage with lawmakers and lobbyists seeking to sway them.

## The Ability of the Government to Reform the Tax System

Gov. Rick Snyder and others have questioned whether large, positive tax reforms would be possible under Proposal 5. The governor points to the 2011 reform of the Michigan business tax — a revision he spearheaded — as a case in point.

In this reform, Gov. Snyder prevailed upon legislators to repeal the MBT and replace it with a flat rate corporate income tax. The result of that and myriad other tax changes — including an effective tax hike on pensions — was a net tax cut<sup>53</sup> and the termination of a state business tax that was considered among the nation's worst.<sup>54</sup>

Would such a reform have been possible if Proposal 5 had been in effect? No doubt the parts of the deal that involved increasing certain taxes would have been more difficult under a supermajority requirement. This is the nature of such a provision.

But it is worth remembering that only the components of the plan involving a tax increase would have required a two-thirds supermajority — not the entire reform package. Proposal 5 does not prohibit taxes from being cut, just as they have been in the past, by a simple majority vote of both chambers of the Legislature.

No one can really say how Gov. Snyder's MBT reforms would have played out. The package would probably have been subject to more horse trading, but not all of this bargaining would have been prohibitively difficult or necessarily bad. For example, under the two-thirds supermajority vote requirement, lawmakers intent on tax reform might have been forced to set priorities and cut

spending from the state budget\* and thus avoid hitting pensioners with a higher tax bill. In that scenario, a tax shift would have become a straight tax cut precisely because a supermajority tax vote requirement raised the political cost of tax increases of any kind.

Obtaining a legislative supermajority is not the only way a major tax reform could occur under Proposal 5; a simple majority vote of the electorate at a November election would also suffice. Michigan's voters have in fact proved themselves capable of enacting a major tax reform. In 1994, voters passed Proposal A, which involved the creation of a new statewide property tax, caps on local property tax growth, an increase in the state sales tax and changes in the financing of public schools.<sup>55</sup> These changes were significant, and they were similar in magnitude to the replacement of the MBT.

## The Record of Some States With Supermajority Tax Limitations

While the academic literature suggests that TELs and STVRs can be effective in reducing state tax burdens and spending, some states with tax limitations appear to be fiscally and economically troubled. Might the experience of such states as California, Mississippi and Nevada indicate that however positive the average result of STVRs and TELs can be, there could be considerable risk?†

Mississippi is America's poorest state in terms of per-capita personal income, and in September, Nevada had the nation's highest unemployment rate.<sup>56</sup> California's state government has logged significant fiscal deficits in recent years.<sup>57</sup>

Mississippi has a three-fifths supermajority requirement in the state Legislature for new taxes.<sup>58</sup> It is unclear,

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\* In addition to the state spending-cut suggestions mentioned in the previous section, the author has identified numerous other possible spending reductions. See, for instance, Michael D. LaFaive, Project Manager, "Recommendations to Strengthen Civil Society and Balance Michigan's State Budget," (Mackinac Center for Public Policy, 2003), <http://goo.gl/MUSwn> (accessed Oct. 22, 2012); ———, "Recommendations to Strengthen Civil Society and Balance Michigan's State Budget," (Mackinac Center for Public Policy, 2004), <http://goo.gl/0Rq9I> (accessed Oct. 24, 2012). Other possible spending cuts can be found in Jack McHugh, "Replacing Michigan's New Taxes With Budget Reductions: Curing \$1.358 Billion in Overspending With 55 Specific Recommendations," (Mackinac Center for Public Policy, 2007), <http://goo.gl/WQFtw> (accessed Oct. 24, 2012).

† For instance, supermajority tax requirements have been characterized as "proven to ruin economies" in both Mississippi and Nevada, and California has been held up as a cautionary example. See "Bipartisan Group Forms To Fight Two Thirds Proposal," MIRS Capitol Capsule, July 26, 2012. See also Ron Fisher and Rob Wassmer, "Approving Proposal 5 sure path to deficits and debt," *The Detroit News*, Oct. 18, 2012, <http://goo.gl/IQK27> (accessed Oct. 23, 2012).

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however, that this requirement is related to the state's poverty. Mississippi has been relatively poor for decades; it was ranked as the poorest state in America, for example, in 1936.<sup>59</sup> The state's three-fifths supermajority mandate did not begin until 1970, a year in which Mississippi was again the poorest state.<sup>60</sup>

Nor is there an apparent connection in Nevada. Until the Great Recession, Nevada had one of America's lower unemployment rates. In 2006, Nevada's annual average unemployment rate was 4.2 percent, below the U.S. average.<sup>61</sup> This was 10 years after adopting a two-thirds supermajority tax vote mandate.<sup>62</sup> Moreover, from 2000 to 2010, the population of Nevada grew more quickly than that of any other state.<sup>63</sup>

California's budget dynamics are complex. In the 2006 study "State Budgetary Processes and Reforms: The California Story," authors Juliet Musso, Elizabeth Graddy and Jennifer Grizard suggested that a counterproductive reaction may have followed the tax limitations in Proposition 13 of 1978 and a subsequent constraint on state spending growth in Proposition 4 of 1979.

Referring to a 2005 state tax and spending proposal, the authors remarked, "The history of California initiatives suggests that such stricter [tax and spending] strategies may spawn additional measures to create protected budgets (e.g., [a 1988 proposition on schools]), earmark funding sources (e.g., [1988, 1998 and 2002 propositions on cigarette taxes and fuel taxes]), or relax the limitations that begin to constrain spending (e.g., [a 1990 transportation proposition])."<sup>64</sup> They further observe, "The revenue restrictions of Proposition 13, coupled with restrictions on spending authority contained in other measures, have constrained state and local fiscal flexibility."<sup>65</sup>

Nevertheless, the authors do not place the principal blame for California's budget dysfunctions on Proposition 13:

We argue that the primary procedural norms violated by the California budgetary process are those of comprehensiveness, unity, periodicity, clarity, and publicity. The installation through the initiative process of constitutionally mandated formulas, and the existence of protected funds and off-budget departments has seriously eroded the comprehensiveness and unity of the budget process.<sup>66</sup>

Among the plausible concerns over Proposal 5 is that special interests will rush to enshrine guaranteed spending or spending growth into the state constitution.

With a strict tax limitation in place, factions that want to ensure their subsidies or grants are not cut in the future may introduce ballot initiatives that mandate higher spending. Under this scenario, such initiatives could press spending upward even as Proposal 5 restricted revenue growth, leading to unbalanced budgets.

This worst-case scenario does not seem unavoidable, however. Michigan has tax and spending constraints in the Headlee Amendment, and these have not led to a series of constitutional spending mandates. The three-quarter supermajority vote requirement for raising the state education property tax hasn't done so either. Consider, for instance, Proposal 5 of 2006, a citizen initiative to mandate in the Michigan Constitution that spending on public schools, community colleges and state universities go up annually by at least the rate of inflation.<sup>67</sup> Despite the popularity of public education in Michigan and the seemingly modest indexing of education spending to inflation, the proposal failed by a decisive margin.<sup>68</sup>

Nor is it clear that constitutional spending constraints and mandates are the root of California's budget problem, a point made in a 2009 analysis by Reason Foundation analysts Shikha Dalmia, Adam Summers and Adrian Moore.<sup>69</sup> The primary spending mandate in the California state budget is that 40 percent of the state budget be dedicated to primary schools, secondary schools and community colleges.<sup>70</sup> As the Reason analysts note, however, a 2003 study by John G. Matsusaka of the University of Southern California calculated that California legislators' hands were tied in only a third or less of California's state appropriations, while a 2009 review by the state's nonpartisan Legislative Analyst's Office concluded, "Despite these restrictions, the legislature maintains considerable control over the state budget — particularly over the longer term."<sup>71</sup>

Indeed, the 40 percent spending mandated by the education spending initiative was similar to the state's typical spending levels before passage of the initiative, and the figure represents roughly the median percentage of state general fund spending on primary and secondary education among the 50 states.<sup>72</sup> In other words, the mandate, however wise or unwise, does not appear to have placed an excessive burden on state lawmakers.

The Reason analysts instead focused on California voters' decision in 1990 to exempt certain transportation spending from a state spending increase cap established in 1979.<sup>73</sup> Summers, in a separate Reason Foundation



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analysis in April 2009, concluded that had the original spending limit been observed, the state would have realized a \$15 billion surplus in 2009 rather than a \$42 billion deficit.<sup>74</sup> If Californians abandoned a spending limit and caused an imbalance in state budgets, the problem may be less the presence of tax and spending constraints than the absence of them.

The question of whether a particular state's voters will demand spending discipline probably depends on factors other than the presence of a supermajority tax increase requirement. Such a requirement is one that many states have adopted without experiencing California's budget problems.

## The Effect on Local Taxes

Another possible concern is that Proposal 5's supermajority legislative requirement on state tax increases would, by lowering access to new state tax revenues, increase the pressure for local tax hikes.<sup>75</sup> Perhaps state revenue constraints could lead state legislators to reduce state transfers to local governments, increasing the incentive for local governments to seek tax hikes.

At first glance, this outcome might seem like a classic unintended consequence of trying to regulate state spending. But this possibility should be viewed in the context of existing Michigan law. The state constitution already places a floor on how much the Legislature can reduce the state revenues it provides to local government.<sup>76</sup> This floor is a provision of the Headlee Amendment.

In addition, it should be noted that the Headlee Amendment also protects local units from being forced to finance unfunded state legislative mandates. Under Article 9, Section 29, of the state constitution, state government must provide local governments with the money to cover any costs it imposes on them through legislative directives.<sup>77</sup>

The Headlee Amendment to the Michigan Constitution also requires a vote of the people on any local tax increases.<sup>78</sup> This means that under Proposal 5, it would be no more difficult to get a tax increase approved by the people at the state level than it already is at the local level, given that Proposal 5 allows voters to approve state tax increases through a simple majority vote. Arguably, then, Proposal 5 would redress an existing constitutional imbalance that favors higher state taxes over higher local ones.

If state voters pass a supermajority tax requirement, it seems unlikely that they will, in large numbers, vote for new local taxes. If they do vote for such taxes, it is unclear that they will have a higher tax burden than they would have had if state taxes had been raised instead.

## Conclusion

Proposal 5's supermajority requirement to raise state taxes would grant taxpayers extra protection against state tax hikes. It would still be possible to raise taxes — either with a two-thirds vote in the House and Senate, or by a majority vote of the people; it would just be harder. Given the academic literature on the subject, the requirement is likely to be effective and to help the state's economy.

Michigan citizens arguably need more protection from tax and spending increases than currently afforded by the Headlee Amendment. Indeed, as of the close of fiscal 2011, Michigan legislators could still have taken nearly \$5.6 billion more from Michigan citizens than they did before bumping up against Headlee's state revenue limitation.<sup>79</sup>

Arguably, Proposal 5 would have benefited from the incorporation of a stricter state spending limitation, such as the one that exists in the state of Colorado. In 2006, a "Stop Overspending" initiative was proposed that would have done just that by restricting state spending to annual increases in population plus inflation.<sup>80</sup> This was a promising idea; it ultimately failed to make the ballot.

The taxpayer protections offered by Proposal 5 arrive against an interesting backdrop. At the national level, taxpayers are looking at the so-called "fiscal cliff" also known as "Taxmageddon."<sup>81</sup> This represents a tax hike that is scheduled for Jan. 1, 2013 and that the Washington, D.C.-based Heritage Foundation estimates at \$494 billion annually.<sup>82</sup> The increase is the result of the expiration of temporary federal tax cuts, as well as new taxes related to the federal Patient Protection and Affordable Care Act. The expiring payroll tax alone will reportedly affect 163 million Americans and cost the average worker \$1,000 annually.<sup>83</sup>

At the state level, tax reform has made news, but so have tax proposals. Earlier this year, Gov. Snyder proposed a gas tax increase. Had his proposal been adopted, Michigan would have had the second-highest gas tax in the nation, behind only New York.<sup>84</sup> A gas tax increase could be attempted again next year.

Proposal 5 would provide a larger check on that impulse. Whether this is appropriate could depend on one's views.

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Still, it is worth recalling that a shortage of government revenue during an economic downturn is just the tip of an iceberg. The bulk of the iceberg, less visible, is the shortage of revenue in households, businesses and the private economy. It may be appropriate to ensure that state legislators think hard before requiring families and businesses to give up more money to help legislators balance the state budget.

## **Appendix A: Proposal 5's Ballot Description and Language**

### **The Ballot Description**

The following description of Proposal 5 will appear on the November 2012 ballot:

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#### **PROPOSAL 12-5**

#### **A PROPOSAL TO AMEND THE STATE CONSTITUTION TO LIMIT THE ENACTMENT OF NEW TAXES BY STATE GOVERNMENT**

This proposal would:

Require a 2/3 majority vote of the State House and the State Senate, or a statewide vote of the people at a November election, in order for the State of Michigan to impose new or additional taxes on taxpayers or expand the base of taxation or increasing [sic] the rate of taxation.

This section shall in no way be construed to limit or modify tax limitations otherwise created in this Constitution.

**Should this proposal be approved?**

**YES** \_\_\_\_

**NO** \_\_\_\_

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### **The Complete Language of Proposal 5**

Proposal 5 would amend the Michigan Constitution by adding the following Section 26a to Article IX.

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No new or additional taxes shall be imposed by the state government, nor shall it expand the base of taxation, nor

shall it increase the rate of taxation unless:

(a) by the vote of two-thirds of all the elected members of each branch of the Legislature; or

(b) by a statewide vote of Michigan electors at a November election.

This section shall in no way be construed to limit or modify tax limitations otherwise created in this constitution.

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