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Limiting Government Through Tax Limitations

by Amy K. Frantz

Randall Holcombe writes in his chapter, "Tax Limits" in *Limiting Leviathan*, "Rather than being radical, or anti-government, the tax limitation movement has been an ongoing part of the American tradition of limited government and the preservation of individual rights." Indeed, the American Revolution was spurred in part by the desire to limit the power of the British government to tax American colonists. The desire to limit taxation, as part of a larger goal of limiting the power of government, remains strong even now, at the end of the 20th century, though the focus of limits has shifted from the federal to the state level.

All taxes have had some type of democratic limit placed on them, and Holcombe provides a history of tax limits, which the author uses to demonstrate that limiting the power of the government to tax has been an American tradition since the Revolutionary War.

The Articles of Confederation, which predates the Constitution, limited the taxing powers of the federal government by allowing the government to raise revenue only by requisitioning the states. The federal government under the Articles had no power of direct taxation.

The U.S. Constitution allows the federal government the power to raise revenues, but contains some limits on the government's power to tax. The Constitution specifically prohibits the government from taxing exports from any state. While this seems like a trivial limit today, most of the federal government's income prior to 1913 was from taxes on imports. Prohibiting a tax on exports may have cut the government's tax base in half.

From the Progressive movement in the late 19th and early 20th centuries emerged the voter initiative, which allows citizens to place a measure on the ballot by collecting a required number of signatures on a petition. Most of the states that now allow initiatives provided for them in their state constitutions during the Progressive movement. Only four states have adopted the initiative since 1920. States with the initiative have lower expenditures and more decentralized governments than states without the initiative, demonstrating the important impact of initiatives on government finance.

Holcombe writes that there are two roles for tax limits. Limits can restrict the amount of money a government has to spend (thus serving the same purpose as spending limits) or can limit the types of taxes the government can collect.

Conceptually, tax limits fall into one of two categories: rules or procedures. Rules state hard-and-fast limits, thus allowing less flexibility in the government's power to tax. Procedures do not place any limits, but require a tax to receive approval by some process before being implemented. Procedures are less constraining than rules, but can give citizens more power over the tax system.

Types of tax limit rules include limits on the growth of individual tax payments, limitations on total revenue growth, limitations on tax rates, limitations on the tax base, and exemptions. Procedural limits are supermajority requirements, direct voter approval of taxes, and sunsetting provisions to require periodic review and renewal of taxes. Each type of tax limitation has different effects and results, advantages and disadvantages.

California's Proposition 13, which limits property taxes, began the tax limitation movement of the late 20th century with its passage in 1978. Proposition 13, a limitation on individual property tax payments, met its goal of greatly reducing tax revenues. Rapidly escalating real estate prices had been pushing property tax assessments well above the property tax caps enacted. This has made assessments of most real estate in California unnecessary for tax purposes. However, because the tax cap is based on the sale price of property, Proposition 13 has created inequities. Virtually identical properties may have very different tax liabilities if one of the properties was recently purchased. This inequity creates a disincentive to sell, because the sale of a home can trigger a tax increase.

Most of the tax limitations discussed in Holcombe's chapter have advantages and disadvantages. The author suggests that any of them would make good public policy as long as the arguments in favor outweigh the arguments against enactment.

Of the types of limitations discussed in the chapter, Holcombe highly recommends adopting a requirement for voter approval of new taxes or increases in taxes at the local, state, and federal levels of government. "The requirement that voters approve any tax increases...appears more in the spirit of American government than any other. It merely says that the government cannot tax people unless a majority of the voters agree. In a society that is built on the principle that government acts with the consent of the governed, a referendum to assure that there is a majority consensus on tax increases would appear to merely reaffirm the principle."

To those who argue that requiring voter approval will result in insufficient revenues to allow the government to operate, Holcombe replies that "this argument loses all its force if government is seen as operating only with the consent of the governed." History has shown that the voters will approve taxes if they approve of the way their tax dollars are being spent by the government.

This Institute Brief is one in a series on the chapters of an upcoming book, Limiting Leviathan*, edited by Dr. Don Racheter, Executive Director of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chair of PII's Academic Advisory Board.* Limiting Leviathan *makes a case for limited government and discusses the types of limitations on government that are appropriate and necessary.*

The author of this chapter in Limiting Leviathan *is Dr. Randall G. Holcombe of Florida State University.*

This summary of Dr. Holcombe's chapter was written by Amy K. Frantz, a Research Analyst with Public Interest Institute.

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