In Maryland, Fiscal Discipline Is the Budget Limit

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Maryland does not limit spending or revenues pursuant to a constitutional or statutory formula. It has developed a unique response to fiscal difficulties, which does not abdicate fiscal policy to formulas as happens under traditional limitation regimes. The process used in Maryland is called Spending Affordability, and it serves to cause policymakers to prospectively focus on the relationship of public spending to the state's economy without altering the budget-making process. This article examines the Spending Affordability model in use in Maryland.

INTRODUCTION

As happens from time to time, a document prepared by the National Council of State Legislatures crossed my desk. It was a discussion of tax and expenditure limitations applicable in the states, complete with a map shading the dominions in which limits of various stripes apply.[1] As is usually the case with such surveys, Maryland's outline was unadorned.

The reason is simple. Maryland does not limit spending or revenues pursuant to a constitutional or statutory formula. This is not because it has been immune from fiscal difficulty or because its taxpayers are quiescent: far from it. It is because Maryland has developed a unique response to those pressures, one that does not abdicate fiscal policy to formulas as happens under traditional limitation regimes. Instead, Maryland has opted for a process that, without altering the budget-making process, causes policymakers to prospectively focus on the relationship of public spending to the state's economy. We call it Spending Affordability.

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A LITTLE HISTORY

The 1970s saw a rapid growth in Maryland's state government in both absolute and relative terms, sustained in part by a controversial increase in the state sales tax enacted in 1977. This growth in spending and increase in taxes did not pass unnoticed, and stimulated a taxpayer movement similar to that occurring at the same time in California and elsewhere. In the 1978 elections, fiscal limits animated several successful suburban legislative campaigns, initiating a discussion that extended through the four year legislative term.[2]

The result of this debate was the enactment of legislation in 1982 which stated that its goal was "to limit the rate of growth of state spending to a level that does not exceed the rate of growth of the state's economy."[3] Contrary to the wishes of those who advocated strict formulaic limits on spending or revenues, however, responsibility for implementing this goal was vested in a legislative committee created under the statute, the Spending Affordability Committee.

SPENDING AFFORDABILITY PROCESS

The Committee today consists of eighteen legislators, including the majority and minority leaders of the House and Senate, and a four member advisory committee of private citizens. Under the law, the Committee must "review in detail the status and projections of revenues and expenditures of the state and the status and projections of the economy of the state."[4]

Each December, the Committee must recommend to the Governor a spending ceiling for the budget to be submitted to the General Assembly the following January. The Governor is not bound by the limit, but, in the event the budget submitted should exceed the limit recommended, a statement of explanation must accompany the budget submission. Likewise, the General Assembly may approve a budget that exceeds the limit with explanation.

The details of implementation are not defined in law. Nevertheless, the process for arriving at a limit has remained consistent since it was first applied in fiscal year 1983. The limit applies to the sum of appropriations from state source revenues proposed for the next fiscal year and any deficiency appropriations requested for the current fiscal year. Growth is measured with reference to like appropriations made at the preceding legislative session.

Certain appropriations are excluded from the calculation based on the source of funds or the purpose of appropriation. In recent years, the limit has applied to roughly 70 percent of all appropriated funds and about 90 percent of funds appropriated from state sources. Major items outside the limit are:

- Federal funds, restricted fund appropriations in higher education,[5] and local funds that pass through the state budget. The basis for this exclusion is primarily that these funds are generated from non-state sources and are outside direct state control.

- Pay-as-you-go (PAYGO) capital appropriations made in the operating budget.[6] These include capital appropriations for higher education, housing, economic development, transportation and the environment. Several rationales support the exclusion. The exclusion helps to avoid diversion of construction and maintenance outlays to operating expenses. Relatedly, use of PAYGO capital appropriations has been favored as a means of reducing reliance on debt financing. Also, because of its presumably non-recurring nature, PAYGO construction has been considered an appropriate use for unanticipated surpluses. A final, practical aspect is that there have been peaks and valleys in capital appropriations, particularly for transportation projects, that would distort the operation of an appropriation based limit.
- Contributions to certain accounts of the State Reserve Fund. These do not truly represent spending as they are additions to fund balances set aside to offset effects of future economic downturns, state tax reductions, or federal fiscal policies attaching state finances.

DOES IT WORK?

The record of tax and spending limits in achieving the intended effects is mixed, the National Conference of State Legislatures (NCSL) reports.[7] In Maryland, the record also is mixed, but the overall effect has been to restrain and reduce the State budget in relation to the State's economy.

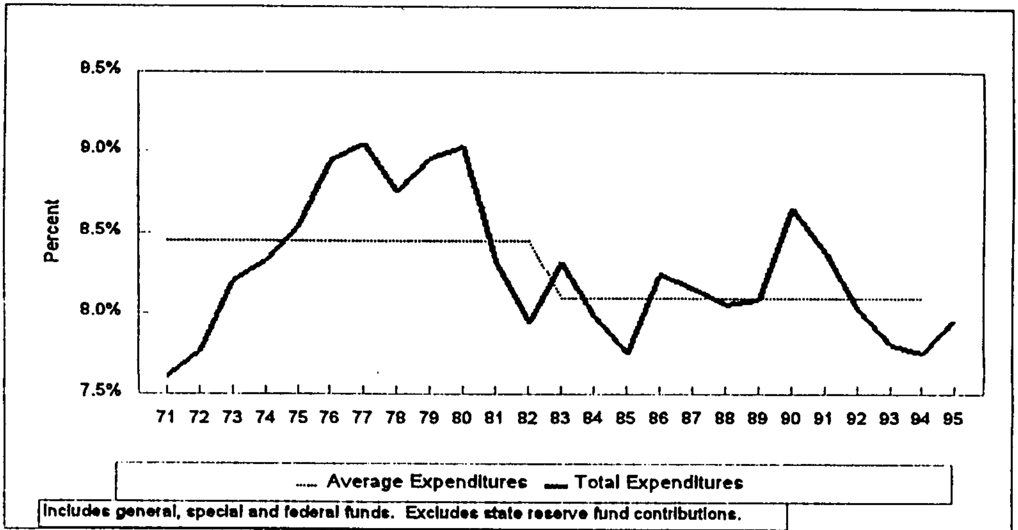
Since 1983, governors commonly have submitted budgets that exceed the appropriations limit recommended by the Spending Affordability Committee. Sometimes this occurred because of differences with the legislature over how to classify appropriations. Other times the limit conflicted with executive priorities.[8] The legislature, however, has reduced the budget to the extent needed to observe the limit in all but two of the fifteen years the process has been in effect.[9]

However, the goal of the process has not been merely to set a limit and observe it, but to actually restrain the growth in state spending in relation to the economy. As Figure 1 relates, there is evidence that it has done so. Using Maryland personal income levels to measure the state economy and state-sourced expenditures as the spending measure, the graph documents the rapid increase in public spending that precipitated limitation efforts. In the dozen years preceding application of the limit, state expenditures averaged about 8.5 percent of personal income, peaking at 9.1 percent in fiscal year 1977. Since the process began in 1983, the state-sourced spending has averaged about 8.1 percent of personal income. The post 1983 peaks were reached at 8.7 percent in fiscal 1990 and 8.4 percent in fiscal 1991 and reflected overly optimistic economic forecasts and slow adjustment to the reality of the early '90s recession.[10]

OBSERVATIONS AND IMPLICATIONS

It seems confidence in government is at low ebb nationally. One of the expressions of this condition has been the popularity of tax or spending limitations. What limits seem to say is that left to their own devices, government institutions lack the discipline to live within the people's means. To the extent that they are effective, such limits additionally restrict the ability of governors and legislators to make fundamental fiscal decisions.

FIGURE 1
Maryland State Spending as Percent of Personal Income



To the extent they are merely cosmetic, they serve only to fuel public cynicism.

Faced with a significant challenge to the integrity of the state's fiscal processes, Maryland chose a middle way. Legislators resisted adopting a constitutional or statutory formula to set fiscal parameters for them. Instead, they elected to do so for themselves. In so doing, they have integrated the concept of affordability formally into the decision process without precluding that value from being weighed against other values in the making of each budget.

As reported above, the results have not been perfect. The process presumes that a consensus can be reached on an appropriation ceiling. That has not always been the case. Also, spending in relation to personal income has not been so stable as it might were a strict limit in place. There is evidence, however, that the spending affordability process has more formally injected fiscal discipline into the political calculus of the state. The spending pattern of the later 1970s was not repeated in the late 1980s, even as the state's economy was growing at 10 percent per year.

Taxes and spending remain lively topics in Maryland, as they do elsewhere I am sure.[11] They do so, however, in a policy context which already consciously seeks to restrain budget growth. As NCSL properly notes, Maryland does not have a tax or spending limit as commonly defined. It does, however, have its spending affordability process, which quite possibly contributes to another of its attributes, a bond rating of AAA from the three rating agencies.[12]

Is the Maryland model transferable? Maryland has a unique constitutional arrangement under which the legislature may only reduce most appropriations and may not reallocate or increase funding beyond levels requested by the governor.[13] Spending affordability, which serves to focus and amplify the legislature's limited power here, might be less effective elsewhere. But all legislatures can reduce budgets, and arguably could secure comparable benefits relative to the executive branch.

The essence of Maryland's process is having a public body deliberate prospectively and publicly about the relationship of the state budget to its economy, and having its judgments guide the budgetary process. While the specifics of the affordability process are Maryland's, the concept is shared by at least one other state. In 1994, Minnesota adopted a law under which a target is established for combined state and local revenues in relation to personal income. However, as in Maryland, Minnesota's limit is not binding.[14] So its area, too, is unmarked on the map of budget limits.

NOTES

The author wishes to acknowledge the assistance of the many colleagues who reviewed and offered helpful comments on the draft and, particularly, William S. Ratchford II, Director of the Department of Fiscal Services, for sharing the insight and perspective that comes from thirty-four years of legislative fiscal analysis.

1. Mandy Rafool, *State Tax and Expenditure Limits*, National Conference of State Legislatures, August/September 1996. Voters must approve any tax increase in Colorado, and certain ones in Missouri and Washington. Indexed revenue limits apply in Colorado, Florida, Louisiana, Massachusetts, Michigan, and Missouri. Indexed expenditure limits apply in North Carolina, Utah, Colorado, California, Oregon and Hawaii. Spending cannot exceed a stipulated percentage of revenues in Delaware, Iowa, Mississippi, Oklahoma and Rhode Island.
2. Among those first elected in 1978 was Delegate Ellen Sauerbrey, who championed a constitutional tax limitation. Building on this issue, she subsequently became Republican minority leader in the House of Delegates and in 1994 came within 6,000 votes of being elected Governor.
3. Codified as Article 2, Subtitle 10, State Government Article, Annotated Code of Maryland.
4. This is accomplished over three or four meetings spread over the autumn months at which the Committee is provided spending, revenue and economic forecasts prepared by the legislature's Department of Fiscal Services. In arriving at a recommendation, the spending outlook is viewed in the context of the anticipated growth in personal income in the upcoming fiscal year.
5. Restricted funds consist primarily of federal and other grants and contracts for designated purposes. Unrestricted funds derived from tuition, student fees and like sources are subject to the spending limit.
6. Unlike some states, Maryland does not enact a separate comprehensive capital budget. Bond bills are enacted annually for certain state projects and various local projects. Much capital spending, including the state's transportation construction program, is appropriated through the operating budget.
7. Rafool, 1996.
8. Under Governors Hughes (1979–87) and Glendening (1995–), the executive generally sought to comply with the limit. Variances typically resulted from differences in classification of expenditures for purposes of applying the limit. In recent years budget coding structures and spending affordability accounting methods have been refined to facilitate counting. For Governor William Donald Schaefer (1987–95), the legislative limit was not a significant factor in executive budget formulation.

9. Fifteen budgets have been approved since the Spending Affordability statute was enacted. In the first year of implementation, a difference with the Governor over funding the budget with pension savings resulted in the limit being exceeded in the enacted budget. In 1992, political consensus could not be achieved prior to budget debate on the mix of taxes and budget reductions needed to address the fiscal impacts of the recession. Accordingly, the Spending Affordability Committee did not report.
10. A relationship between spending affordability and lower spending in relation to the economy can be further supported statistically. A regression equation in which expenditures as a percent of personal income was the dependent variable and independent variables consisted of a dummy variable indicating presence or absence of the spending affordability process and annual change in Maryland personal income, run against data for fiscal 1971–95 yields a modest but meaningful r-square of .288.
11. The 1994 governor's race was animated in large part by Ellen Saurbrey's pledge to reduce income taxes by 24 percent in four years. Governor Glendening has recently presented a 10 percent phased income tax reduction to the 1997 General Assembly.
12. Other states with AAA ratings from all three agencies are Missouri, North Carolina, South Carolina (upgraded by Standard and Poors in July of 1996), Utah and Virginia.
13. Article III, Section 52, Constitution of Maryland.
14. Cited in National Association of State Budget Officers, "Budget Stability: A Policy Framework for the States," 1995.

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