Building a Better Colorado

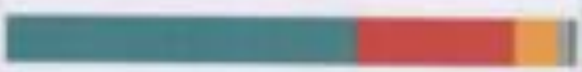
[DRAFT]

Colorado's Financial Future

Colorado Budget, 2015-16 Fig.1 (Source: Office of State Planning. Credit: http://co.abalancingact.com/)

Where the Money Goes...

Where The Money Comes From...



- **Individual Income Tax** - $6.6b
- **Sales/Use Tax** - $3.0b
- **Corporate Income Tax** - $795.4m
- **Insurance Premium Tax** - $232.2m
- **Cigarette, Tobacco, & Liquor Taxes** - $96.6m
- **Other** - $43.8m

Spending

- **K-12 Education** - $3.5b
- **Courts/Law** - $494.6m
- **Higher Education** - $868.0m
- **Environment/Natural Resources & Agriculture** - $41.3m
- **Public Safety** - $995.1m
- **Transportation** - $103.1m
- **Health and Human Services** - $3.4b
- **General Government** - $399.2m
- **TABOR Refund - December 2014 Estimate** - $186.5m
- **Other Programs** - $773.3m

PO Box 13311
Denver, CO 80202

info@betterCO.org

(720) 593-0830

Introduction

Colorado's fiscal policy – as mandated by the voters per the constitution – is unsustainable.

Given voter-approved constitutional revenue limits, Colorado can't meet a voter-approved spending requirement for K-12 education and still provide the level of services voters expect in other basic program areas, including higher education, transportation infrastructure, and programs that support children, the elderly and the disabled. Recent economic downturns exacerbated the problem, but it is not one we can grow our way out of.

The causes of our state's unsustainable fiscal situation are complex, but chief among them are an aging population, the high cost of health care and a tax system that is inflexible and increasingly ineffective. According to a 2011 study by the DU Center for Colorado's Economic Future, by 2024 the state will only have enough revenue to support its obligations for Medicaid, K-12 education, and corrections. A 2013 update of that study by CSU's Colorado Futures Center estimates a gap of $1.52 billion between the cost of General Fund Programs and General Fund revenue beginning in 2024; this gap is estimated to almost double over the ensuing five years and will force significant cuts to be made in a variety of programs funded by the General Fund. These cuts will occur at the same time the state is required to issue taxpayer refunds under TABOR.

This forecast by DU and CSU does not contemplate another recession (which is quite possible) or the state losing an ongoing lawsuit over education funding. If either of these two events occurs, then the state's currently dire fiscal situation would become dramatically worse.

We should continue to scrutinize expenditures, assess priorities, try new strategies and insist on efficient government, but we cannot ignore the fact that many essential public services are in jeopardy.

Challenges

Insufficient revenue to meet taxpayer expectations.

In simple terms, Colorado's constitution doesn't allow the state to use the revenue it has to meet our needs, even in good economic times.

- These challenges are compounded by the fact that funding for education and transportation have eroded significantly during the last two decades. Compared to 1992 and adjusted for inflation, annual state funding is down about $780 million for K-12 education (about $1,000 less per student); down about $559 million for higher education (about $3,000 per student); and down about $379 million for transportation.

- We have a limited ability to generate additional revenue. The constitution requires voters to approve all tax increases, which has proved a high bar. While voters have supported new or increased taxes on tobacco and marijuana, broader statewide taxes are difficult, if not unlikely, to pass.

Conflicting or competing constitutional provisions.

Over the last 25 years, voters have enacted significant, and often conflicting or competing fiscal policies through amendments to our state constitution.

- Our constitutional revenue limit constrains our ability to keep pace with the economy. TABOR limits revenues which, at the state level, cannot increase from one year to the next by more than the increase in population plus inflation. Over time this formula has been shown to limit government growth to less than the growth in the overall economy. That's because the current limit's reliance on inflation is based on consumer goods (the cost of toasters increasing from year-to-year, for example) when the government spends the bulk of its money on non-consumer goods (asphalt and services like education and health care) where prices often increase at a higher rate.
- In 2000, voters approved Amendment 23, which mandated increasing K-12 spending by an amount at least equal to "student enrollment + inflation." During the Great Recession, the State took the position that a component of K-12 spending was not covered by Amendment 23 (the "factors" that adjust district funding for regional differences such as cost-of-living and number of low income students) and, beginning in 2010, reduced spending on K-12 education; this annual reduction amounted to $855 million in 2015, or roughly $1,000 per student each year. The adverse impact of this reduced funding for K-12 disproportionately affects the smaller, more rural school districts because they don't have the economies of scale to absorb the impact.
- TABOR says limit revenue, and thereby spending;
  Amendment 23 says increase spending by at least the rate of inflation for K-12 education;
  and the Gallagher amendment has reduced what homeowners pay in property taxes and thereby requires the state to pay more for K-12 education because the local contribution is shrinking. Medicaid spending is increasing as a result of an aging population and, to a lesser extent, federal policy changes . In effect, we are hitting the accelerator and the brakes at the same time.
- The State Constitution requires a free, thorough and uniform system of K-12 education. Some school districts have passed local property tax increases for schools (called mill levy overrides) that have partially offset the aforementioned cuts, although most districts have not. This creates an equity concern in school funding across Colorado.

Policy Option 1: Maintain Current Policy

Challenge addressed: None

Pros

- Keeps most stringent tax and spending limit in the country in place.
- Keeps spending and state taxes low.

Cons

- Left unchecked the conflicting rules of spending and taxes result in cuts to public services like transportation funding, health care, public safety and education.
- Economic development is hampered by reduced spending on things like K-12, higher ed and transportation.

Policy Options 2a-c: Asking Voters to Let State Retain Revenue Above Current Limits

As allowed by TABOR and as has been done in a majority of counties, municipalities, school and special districts, voters would be asked to allow the state to retain and use the revenues it receives above the existing limit, commonly referred to as "de-Brucing." It could allow the legislature to use the additional revenues to support any service or program in the state budget, or it could limit its use only to specific programs or services. TABOR refunds would be reduced or eliminated.

In all cases, the amount retained would be limited to the amount generated by existing tax rates. State economists currently estimate this could range between $0 and $76 million this year and between $212 million and $385 million next year. The amount available for retention in subsequent years has not been projected and will be subject to a variety of factors – most notably, the strength of the economy.

2a. Ask voters to let the state retain revenue beyond current limits and allow legislature flexibility to establish funding priorities.

Challenge addressed: Insufficient revenue to meet taxpayer expectations.
Impacts: Generates limited additional revenue to be used as lawmakers see fit.

Pros

- Additional revenue without new taxes.
- Doesn't change TABOR.
- Allows elected representatives flexibility to address needs they deem to be most important.

Cons

- Eliminates potential TABOR refunds (est. at between $16 and $50 per taxpayer in FY15-16)
- Generates only limited additional resources, which would continue to force cuts in programs.

2b. Ask voters to retain revenue beyond current limits and dedicate it to specific programs or services.

Challenge addressed: Insufficient revenue to meet taxpayer expectations.
Impacts: Generates limited additional revenue to be used for specific needs.

Pros

- Additional revenue without new taxes.
- Doesn't change TABOR.
- Requires lawmakers to account for how money would be used.
- Could provide money for ongoing programs (i.e. K-12 or higher ed) or for one-time, non-recurring costs (i.e. transportation construction, building maintenance).

Cons

- Eliminates potential TABOR refunds. (est. at between $16 and $50 per taxpayer in FY15-16)
- Generates only limited additional resources, which would continue to force cuts in programs.
- Limits the authority of elected officials and the flexibility of the budget process.

2c. Ask voters to let the state retain revenue beyond current limits for budget reserves.

Challenge addressed: Insufficient revenue to meet taxpayer expectations.
Impacts: Generates limited additional revenue to be used during downturns; doesn't address imitations of the current tax system to generate enough revenue to meet current needs.

Pros

- Additional revenue without new taxes.
- Doesn't change TABOR.
- Any surplus funds used for a Rainy Day Fund could help offset cuts in operating budgets during downturns.

Cons

- Eliminates potential TABOR refunds. (est. at between $16 and $50 per taxpayer in FY15-16)
- Doesn't address our current, unsustainable fiscal policy and would continue to force cuts in education, transportation and other programs -- it's a bandage for a future problem, not our current problem.

Policy Options 3a and 3b: Address Fiscal Issues Involving TABOR, the Hospital Provider Fee and Amendment 23

The legislature, with support of the hospital community, created the Hospital Provider Fee (HPF) in 2009 to help pay for the state's share of Medicaid, a joint federal-state program providing health insurance to low-income Coloradans. Money raised from the fee on hospital revenues, which is matched by federal funds, is used to pay for health insurance coverage for 382,000 Coloradans, incentivize quality improvement programs, and support financial viability of Colorado hospitals. Because the program reduces hospitals' uncompensated care, it has led to increased savings on health care for privately-insured Coloradans. The HPF generated net revenue of $575 million last year, and brought in close to the same amount in federal funds.

The money raised by the fee is NOT exempt from state revenue limits, and inclusion and rapid growth is contributing to state revenues exceeding the TABOR limit this year (and for the foreseeable future), triggering taxpayer refunds, and forcing cuts in other unrelated programs. If the fee were exempt from TABOR, the state TABOR limit would not be exceeded and unrelated program cuts could be avoided.

3a. Exempt Hospital Provider Fee from TABOR limits

Challenges addressed: Insufficient revenue to meet taxpayer expectations.

Impact: Avoid budget cuts; Legislative flexibility

Pros

- Increases state's ability to meet its financial obligations.
- By removing these fees from revenue subject to TABOR limits, it reduces the prospect of state issuing TABOR refunds at same time it's forced to make budget cuts.
- More accurately reflects the intent of TABOR by distinguishing between dollars paid by taxpayers (revenue) and user fees collected for a specific purpose.
- Can be implemented by the legislature and therefore doesn't require voter approval.

Cons

- Postpones the triggering of TABOR refunds. (est. at between $16 and $50 per taxpayer in FY15-16)

3b. Ask voters to approve a ballot measure that pairs option 3a. with a temporary "timeout" from Amendment 23's mandated increases for K-12 spending during times of recession.

Challenges addressed: Insufficient revenue to meet taxpayer expectations.; Competing or conflicting constitutional provisions
Impact: Avoid budget cuts; Legislative flexibility.

Pros

- Increases state's ability to meet its financial obligations.
- Reduces prospect of state issuing TABOR refunds at the same time it's slashing budgets.
- Allows elected representatives flexibility to address needs they deem most important for a period of time.

Cons

- Postpones the triggering of TABOR refunds. (est. at between $16 and $50 per taxpayer in FY15-16)
- Generates only limited additional resources which would continue to force cuts in programs (same as the de-brucing options above)
- Likely reduces funding for education during economic downturns.

Policy Option 4: Ask Voters to Change State Revenue Limit to a Formula Based on Fixed Percentage of Economy

Challenge addressed: Insufficient revenue to meet taxpayer expectations, Conflicting or competing Constitutional provisions
Impact: Changes TABOR limit; Legislative flexibility; Avoids budget cuts

Background

Voters would be asked to replace the existing state revenue limit (growth + inflation) with a new revenue limit based on a set percentage of the overall state economy.

The new limit would be a set percentage of either of two widely accepted measures of the size of the overall state economy: Gross Domestic Product or Total State Personal Income. The measure could set a specific percentage or it could designate a base year and require that state revenues always be less, as a percentage of the economy, than they were in that year.

As is currently the law, any revenues above the new limit would be rebated to taxpayers unless voters approve their retention. The selection of the base year is critical in order to establish a funding amount that is sustainable over time. For example, in 2006 (during an economic recovery), TABOR revenues equaled 4.14 percent of state GDP. Two years later in 2008 (as the Great Recession took hold), TABOR revenues dropped to 3.55 percent of state GDP. If 2006 were the base year, then in 2016 the state would be able to retain and spend $692 million more than what the existing limit is projected to allow. However, if 2008 were the base year, in 2016 the state would be able to retain $1.27 billion LESS than what the existing limit is project to allow.

Pros

- Still maintains a TABOR limit.
- Allows public expenditures to grow more in line with the economy and the need for services. The current limit of "population + inflation" is based on consumer goods (toasters), whereas the government spends the bulk of its money on non-consumer goods like asphalt and services like education, corrections, and health care (the cost of which is influenced by factors not measured by the Consumer Price Index and which usually grow faster than consumer goods).
- A simple formula using clear data from an established and credible source.

Cons

- Depending on the year selected, could reduce or postpone TABOR refunds in the future. (est. at between $16 and $50 per taxpayer in FY15-16)

Policy Option 5: Ask Voters to Approve Measure Creating an Education Fund Separate from General Fund

Challenges addressed: Insufficient revenue to meet taxpayer expectations.; Conflicting or competing Constitutional provisions
Impact: Avoid budget cuts; Legislative flexibility; No TABOR limit for education; Eliminates Amendment 23

Currently, the state pays for education out of the state General Fund. The existing state General Fund would be divided into two independent funds, one for education and one for everything else the General Fund currently supports. The new education fund would be allotted all the money currently spent on K-12 education. The fund could also include higher education and the state preschool program, in which case the fund would be allotted revenues equal to the total currently appropriated to all three areas.

The new education fund would be exempt from the TABOR revenue limits. The General Assembly could be authorized to raise taxes solely for this fund in exchange for eliminating Amendment 23's spending mandates.This authority could be limited to achieve a certain base level of funding. Local school districts might also be authorized to increase local revenues, again possibly limited to a certain target level.

The remaining General Fund would continue to be subject to the TABOR revenue limit and the requirement that voters approve any new or increased taxes.

Pros

- Retains TABOR limit on the General Fund.
- Because this removes the education budget – the largest part of the state budget – from the state's general fund, it could be a major contribution to ensuring the state's long-term fiscal stability.
- Allows legislature to fund education in line with people's expectations and available revenue.
- Eliminates Amendment 23 and its mandate that education spending increase annually.

Cons

- Voters would have to relinquish to the legislature authority for funding education.
- Eliminates Amendment 23 and changes TABOR, both of which were passed by the electorate.
- Leaves more latitude for the legislature to cut education in economic downturns.
- Creates a system of different fiscal rules for different budget priorities, which potentially gives advantage to some programs over others.

Goal	Options
Higher TABOR Limit	2a,2b,2c, 4,
Legislative Flexibility	2a, 3a, 3b, 4, 5
Additional K-12 Resources	5, Not guaranteed
Additional Transportation Resources	1a, 1b, 1c, A lesser extent 2c
Avoid Budget Cuts	2a, 3a, 3b, 4,5
Have a crisis	1

Table Notes: With a higher TABOR limit, the amount of money retained may or may not be new resources in the General Fund. This is because cash funds can cause a rebate in the General Fund. In that case, the rebates retained are cuts that were avoided.

Fig. 2