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Colorado's Unique Constraints: TABOR, A/B, GALLAGHER and 23



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Colorado is Uniquely Constrained Fiscally

Constitution has been used to limit
government

Initiative process has made the constraints
possible

Interpretations of policy have typically been
conservative



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Major Constraints

- TABOR—Constitutional—Limits Government
- Arveschoug-Bird—Statutory—Directs how money can be spent
- Gallagher Amendment—Constitutional—Property Taxes
- Amendment 23—Constitutional—Compels Spending for K-12 Education



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TABOR



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TABOR-Taxpayer Bill of Rights

Adopted by voters in 1992 on the third try

Encompasses a philosophy of shrinking the size of government relative to the economy, “preferred interpretation shall reasonably restrain most the growth of government”

Attempts to adopt in other states failed largely based on the Colorado experience



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TABOR's Major Provisions

Voter Approval of Tax
Increases

Revenue Limits

Spending Limits

Limits on Revenue Options



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The first major provision: **VOTER APPROVAL OF TAX INCREASES**

TABOR requires voter approval of any new tax, tax rate increase, debt increase, increase in mill levies, and any tax policy change that will result in a net revenue gain.



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The second major provision: REVENUE LIMITS

- Imposes a limit on how much revenue that is collected by government can be kept.
- Constitution contains different formulas for growth at different levels of government but all are based on a calculation of inflation and growth.
- Each growth formula is applied to the prior year's "fiscal year spending" which translates to actual revenue collections or the formula-limited collections, whichever is lower.



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Revenue Limits: TABOR Formulas

Amount of revenue each district is allowed to keep is an increase equal to:

State

% POPULATION CHANGE + RATE OF INFLATION

Local Government

NET NEW CONSTRUCTION + RATE OF INFLATION

School Districts

% CHANGE IN STUDENT ENROLLMENT+ RATE OF INFLATION



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Revenue Limits: What counts as revenue?

REVENUE

- General Fund Revenue— income taxes, sales & use taxes, estate taxes, excise taxes
- Cash Funds—Tuition, license fees, gas tax, UI tax

NOT REVENUE for TABOR purposes

- Federal Funds
- Litigation settlements
- Enterprise revenue – enterprises defined narrowly in TABOR



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Revenue Limits: What if revenue exceeds the limit?

VOTERS MUST APPROVE KEEPING IT
Often called a De-Brucing measure.

Or

IT MUST BE REFUNDED

TABOR does not specify the manner or mechanism to refund the surplus. It allows for any “reasonable” method.



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Revenue Limits: How has revenue been refunded?

- Automatic, temporary reduction in income taxes
- Contingent Tax Credits (TABOR refund mechanisms)
- 6-Tier Sales Tax Refund on individual tax returns
- Local Mill Levy Reductions
- Tax Free Days
- Free Public Service Days



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Revenue Limits: How much revenue has been refunded?

Between 1997 and 2002--\$3.2 billion was
refunded

No contingent tax credits or sales tax refund will
be funded in years without surplus



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The third major provision: **SPENDING LIMITS**

TABOR prohibits weakening of other “limits on district revenue, spending and debt...” without voter approval

Arveschoug-Bird is a statute that says it limits state general fund appropriations to a growth rate of 6% or 5% of personal income, whichever is less.

Applies to state general fund operating budgets.



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Spending Limits: Weakening provision

It has been interpreted to mean that this statute cannot be “weakened” without voter approval.

Alternative interpretation concludes that it is not a “limit” as defined by TABOR since it does not limit the amount of general fund spent but how it can be spent.



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The fourth major provision: **LIMITS ON REVENUE OPTIONS**

No new or increased real estate transfer taxes

No state real property taxes

No local district income taxes

No new state income tax rate or definition of taxable income shall apply before the next tax year



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TABOR Constrains Public Services

TABOR limits the relative size of government to its relative size in 1992.

- Growth formula keeps government from occupying a larger share of economy than it did in 1992.
- Envisioned that any new demands beyond population growth or inflation would be funded by eliminating waste or by not funding something else the government did in 1992.



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TABOR Makes Budgeting Political

- Increases in revenue require elections
- Keeping up with the economy requires elections
- Pits one interest against another—not special interests but basic interests
- Pits locals versus state



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TABOR Constrains Local as well as State Resources

Override elections and revenue enhancements more successful at local level but rules still hamper ability to provide services—reserve requirements, etc.



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Arveschoug-Bird

(R-ves-scow)



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The 6% Problem

The Arveschoug Bird provision is an independent constraint.

Debate on whether the Legislature can change it without voter approval.

Compounds the problems created by TABOR



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THE RATCHET EFFECT

Spending

Limitation applies to general fund operating appropriations.

Any time appropriations do not reach 6% above the prior year's level, the un-appropriated amount is lost forever.

- Reduces the size of the base against which all future increases apply.
- Even if it is “saved”, it can't be spent in another year in excess of the spending limits.



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THE RATCHET EFFECT

Spending

- Makes the effect of cuts in spending permanent.
- Never recover cuts that occur during times of declining revenue.
- Makes the worst of times the best of times.



The Crowding Out Effect

Total general fund operating expenditure increases are subject to the 6% statutory limit.

The costs of certain categories in the budget increase much more quickly than 6% each year e.g. Medicaid, Corrections.

Increases are the result of either inflation greater than CPI, service demand greater than population growth or a function of increased marginal costs.



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Gallagher



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Gallagher

Constitutional Residential Property Tax Relief

Caps Non-Residential Assessment Rate at 29%, Residential at 21%

Establishes that 55% of total property tax collections statewide must come from non residential sources and 45% from residential sources

In order to maintain this statewide ratio over time, the residential assessment rate has fallen from 21% in 1982 to 7.96% in 2003



TABOR And Gallagher

Prior to TABOR, mill levies could float up or down, allowing local governments to maintain funding levels.

TABOR prohibits mill levy increases without a vote. As the residential assessment rate falls to maintain statewide ratio, same mill levy raises less money.

$$\$100,000 \times 30\% \times .020 = \$600$$

VS

$$\$100,000 \times 7.96\% \times .020 = \$159$$



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TABOR And Gallagher

Amount/value of residential property has increased more rapidly than non-residential.

Per unit burden, in general, has shifted to non residential property.

Statewide averages play out differently in different locations.



TABOR And Gallagher

Total value of properties is \$500,000--residential \$300,000, non-residential \$200,000—no growth in value

1982 -- \$300,000 X .21 X .020= \$1260

--\$200,000 X .30 X .020= \$1200

2002 -- \$300,000 X .0796 X .020= \$479

--\$200,000 X .29 X .020= \$1160

Total value of property in 1982 is \$500,000. Assume Residential grew at 40% and non residential at 30%

1982 -- \$300,000 X .21 X .020= \$1260

--\$200,000 X .30 X .020= \$1200

2002 -- \$420,000 X .0796 X .020= \$669

--\$260,000 X .29 X .020= \$1508



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Amendment 23



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Amendment 23

Reaction to TABOR's and Gallagher's effect on public education funding.

Statistically, state support for public education had fallen dramatically since passage of TABOR.

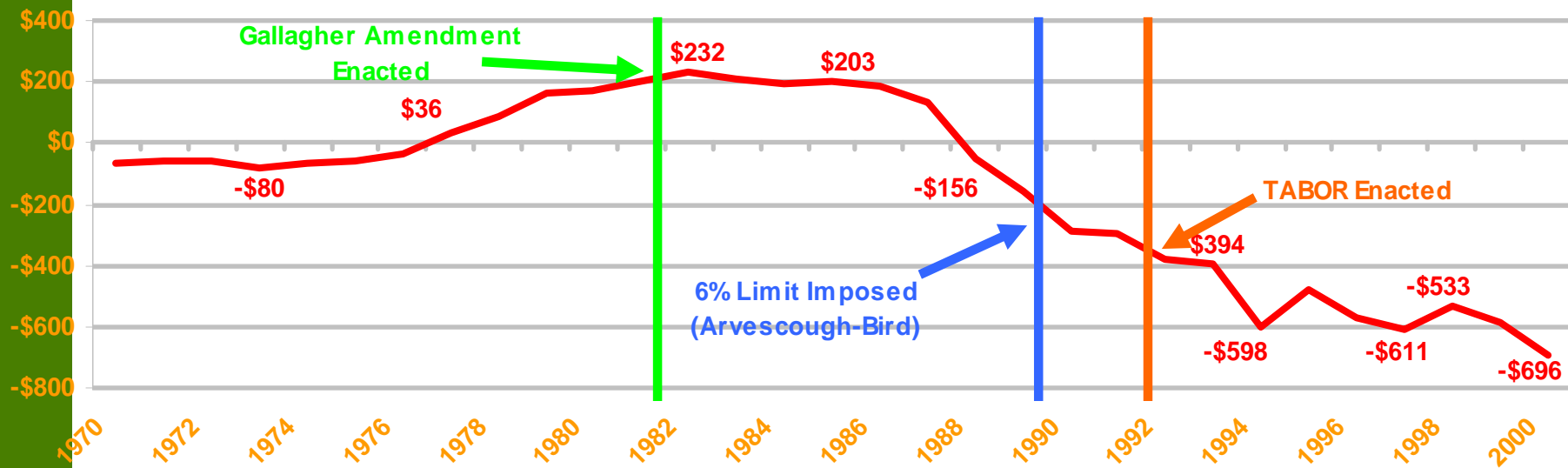
As a percentage of personal income, Colorado's total state spending on education was 49th in the country.



How Colorado Compares

K-12 Per-Pupil Funding: Colorado vs. National Average

Source: National Center for Education Statistics





Amendment 23

Amendment 23 mandated increased levels of funding for K-12 public education

- Base K-12 education funding should increase by a rate of inflation plus 1% for ten years.

- After 2010, base K-12 education funding should increase by the rate of inflation.



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Amendment 23

Mandated increases funded by increased general funds and the new State Education Fund (SEF) established in the law.

The SEF is capitalized by annual deposits of 33% of 1% of income tax revenue.

The SEF was to grow and compound to support expanded funding for the long term.



The Wreck

The huge drop in revenue in 2002 resulted in the Legislature using balances in the State Education Fund to offset increased funding from the General Fund.

- Increases in personal income of less than 4.5% triggered a provision in Amendment 23 that allows the Legislature to draw more heavily from the State Education Fund.
- The SEF is no longer capable of supporting the required funding for K-12.



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The Wreck

Amendment 23 hastened the problem by mandating funding increases.

But, even without 23, the structure of education funding is unsustainable.

- The Gallagher/TABOR combo has resulted in a shift from primarily local funding for schools to primarily state funding for schools
- A provision of the School Finance Act exacerbates the problem—requires a reduction in the mill levy when local property tax revenue exceeds the TABOR limit
- There has been no recognition of this phenomenon in the financing structure



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Referendum C



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Referendum C

Adopted by voters in November 2005

Authorized the state to keep money collected in excess of the limit for 5 years

Changed the calculation of the base to eliminate the constitutional revenue ratchet effect in the future

Voters told retained revenue would be used for Higher Education, K-12, Health Care



Referendum C

Because it didn't suspend Arveschoug Bird, much of the retained revenue can't be spent on priority areas

Increased significantly the general fund revenue for transportation and other capital expenditures

Current revenue projections exceed election projections by \$800 m (down from an estimated \$3B above original projections)



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Other Constraints

Single subject provision

Prohibition on debt

Balanced budget requirement

SB 97-01

HB 03-1310

Low tax rates