

# Looking Forward

Colorado's fiscal prospects after Ref C

Fall 2007



COLORADO FISCAL  
POLICY INSTITUTE

Justice and Economic Security for all Coloradans



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Policy Center

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COLORADO  
CHILDREN'S  
CAMPAIGN

CREATING HOPE AND OPPORTUNITY  
IN COLORADO, MORE THAN  
ONE MILLION KIDS AT A TIME

## **Looking Forward Lessons**

1. State services have only partially recovered from the recession.
2. 2007 is probably as good as it gets in terms of service levels. Looking forward, it will be a challenge simply to maintain those levels.
3. Arveschoug-Bird formula will remain a major factor in how revenues will be allocated.
4. Extending the Ref C timeout will not result in additional revenues. We project being able to retain all projected revenues under the new cap.
5. State program budgets are interrelated and can only be addressed through a comprehensive and coordinated process. They cannot be addressed in isolation.

## **Goals for our fiscal work**

1. Conduct research to identify where current fiscal trends will take us.
2. Share these preliminary findings with community leaders throughout Colorado.
3. Gather feedback and input.
4. Inform and help shape the debate over Colorado's fiscal prospects after Ref C.

## **Study team:**

Research and policy staff from  
The Bell Policy Center  
Colorado Children's Campaign  
Colorado Fiscal Policy Institute

## **Study overview:**

**For fiscal years 2007-08 through 2012-13 we:**

- **Estimated state revenues under current tax rates and limitations.**
- **Estimated future appropriations needed to maintain current state services.**
- **Used actual appropriations for fiscal year 2007-08.**

**We analyzed these data to identify key factors driving Colorado's future fiscal prospects.**

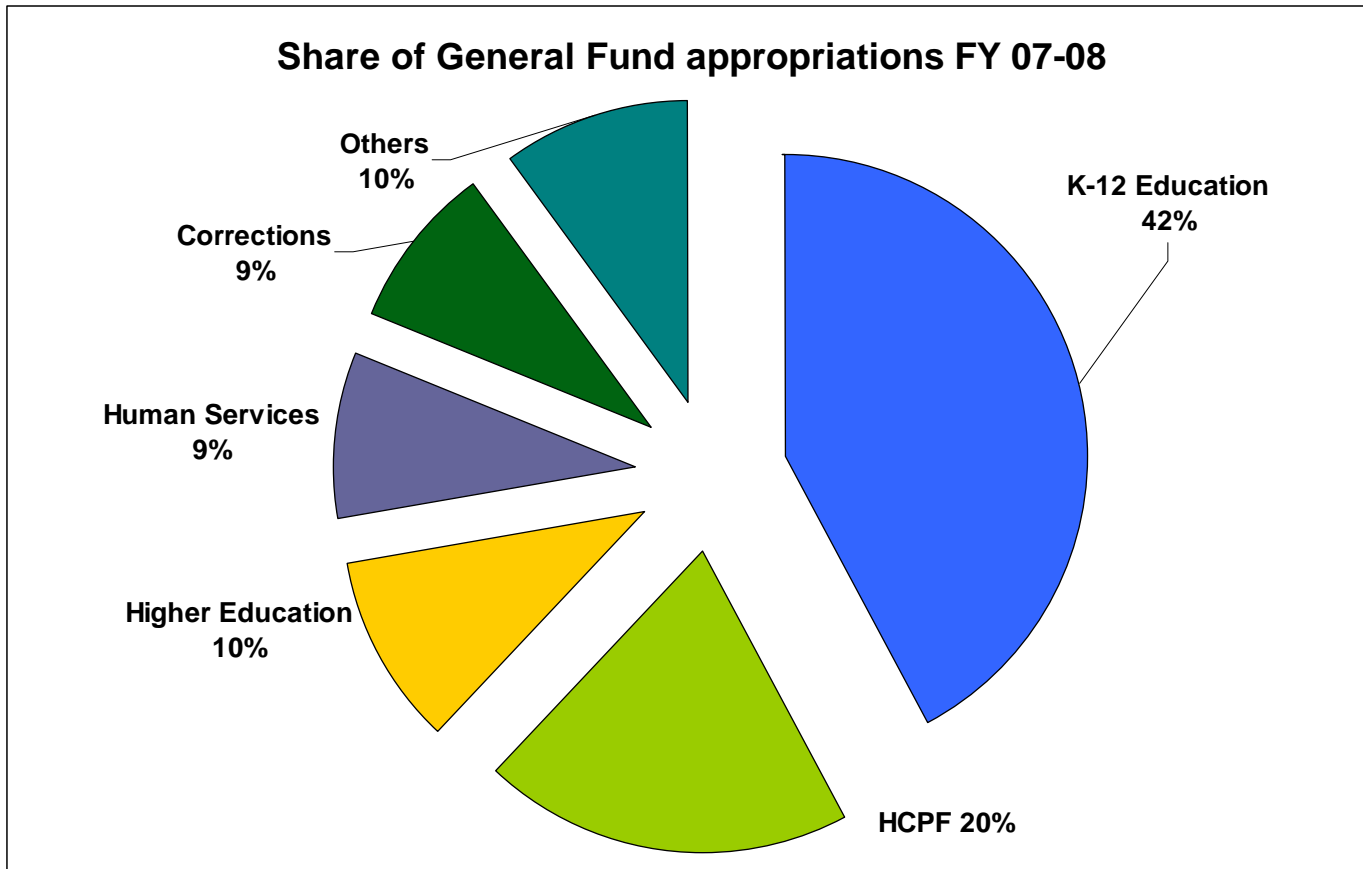
## **How we developed our revenue estimates:**

1. Used the Legislative Council staff's September 2007 revenue estimates through FY 2011-12.
2. Projected these trends to estimate revenues for FY 2012-13.
3. Calculated the 6 percent Arveschoug-Bird limit on General Fund appropriations.
4. Calculated the new "excess revenue cap" on TABOR revenues as amended by Ref C.

## **How we developed our appropriations estimates:**

1. Estimated future appropriations to maintain the 2007 levels of service:
  - Analyzed those agencies that represent 90 percent of General Fund and 75 percent of total appropriations.
  - Assumed the share of *other agencies* would remain the same as in recent fiscal years.

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## **How we developed our appropriations estimates:**

**Agencies analyzed: 90 percent of General Fund budget**

- K-12 education, Higher education, Health Care Policy and Financing, Human Services, Corrections

**Other agencies: 10 percent of General Fund budget**

- Agriculture, Governor's office, Judicial, Labor and Employment, Law, Legislature, Local Affairs
- Military and Veterans Affairs, Natural Resources, Personnel and Administration, Public Health and Environment
- Public Safety, Regulatory Agencies, Revenue, Treasury

**Also analyzed:**

- Capital Construction and Transportation

## **How we developed our appropriations estimates:**

2. Identified the major factors driving the budgets for each of these agencies, such as the growth in K-12 and higher education enrollment or prison population.
3. Gathered data to extend future trends for these budget drivers.
4. Used data from the Joint Budget Committee, Legislative Council staff, state agencies and other reputable sources.

## How we got here

**1982:** Voters pass Gallagher Amendment to protect residential property taxpayers.

**1991:** Legislature passes Arveschoug-Bird 6 percent annual growth limit on the General Fund.

**1992:** Voters pass TABOR Amendment.

- Requires voter approval of tax increases.

- Sets tight revenue limits that shrink government and limit its ability to rebound after economic downturns.

**1997:** Legislature passes Senate Bill 1, committing General Fund revenues to transportation.

**Late 1990s:** TABOR surpluses grow to more than \$1 billion per year. Legislature cuts income and sales taxes to avoid collecting future surpluses.

## How we got here, continued

**2000:** Voters pass Amendment 23 to mandate a minimum level of funding for public schools

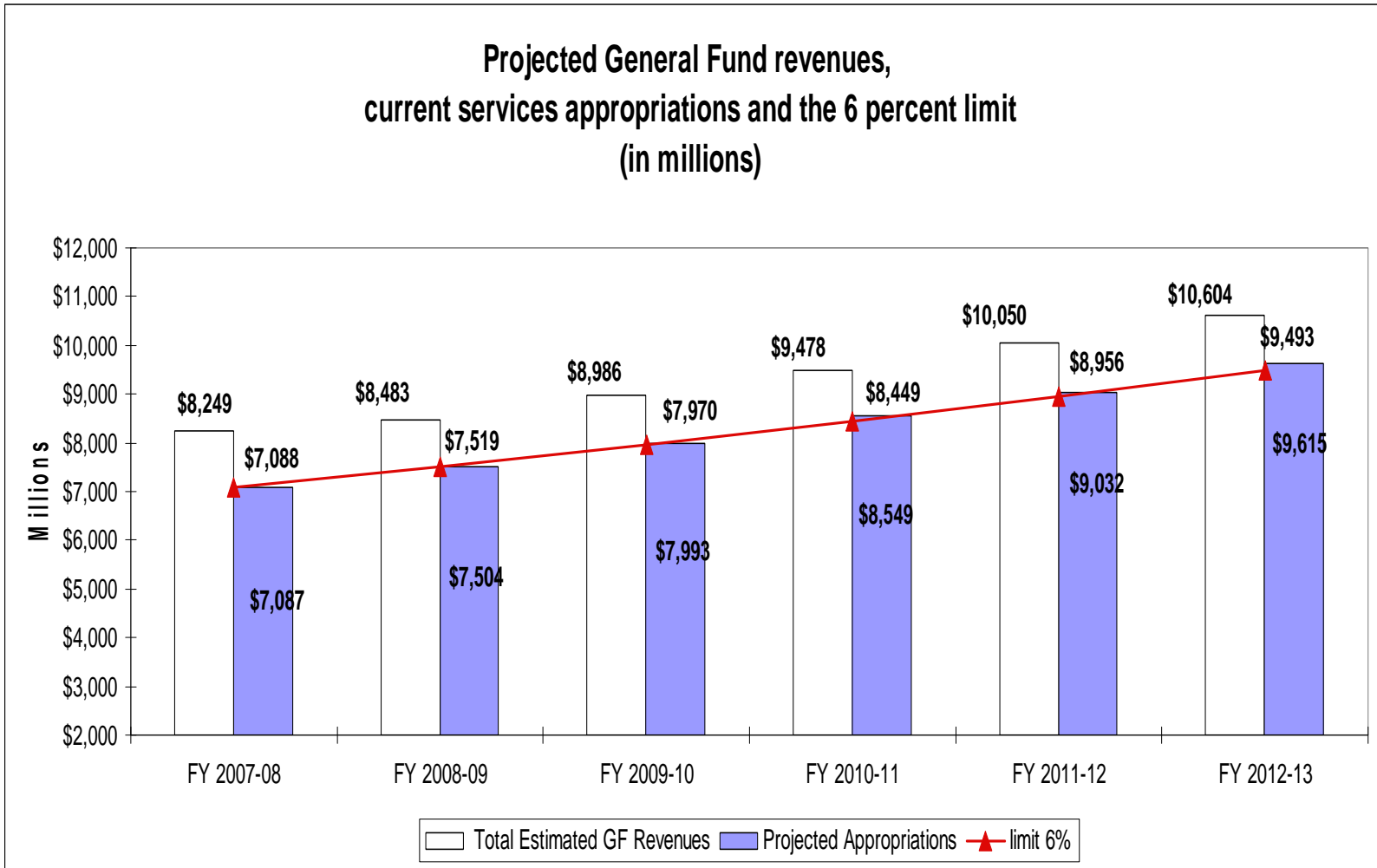
**2001-03:** Economic recession leads to historic drop in state revenues. Surpluses vanish. Legislature cuts state services by \$1 billion annually and uses one-time stop-gap measures (including moving payday for workers and borrowing from cash funds) to balance budget.

**2002:** Legislature passes House Bill 1310, committing excess General Fund revenues at the end of a year to transportation and capital construction.

**2004-05:** Economy and revenues rebound, but TABOR's "ratchet effect" prevents critical state services from joining in recovery.

**2005:** Voters pass Referendum C to take a five-year time-out from the TABOR revenue limit. Legislature is able to avoid future cuts and partially restore services.

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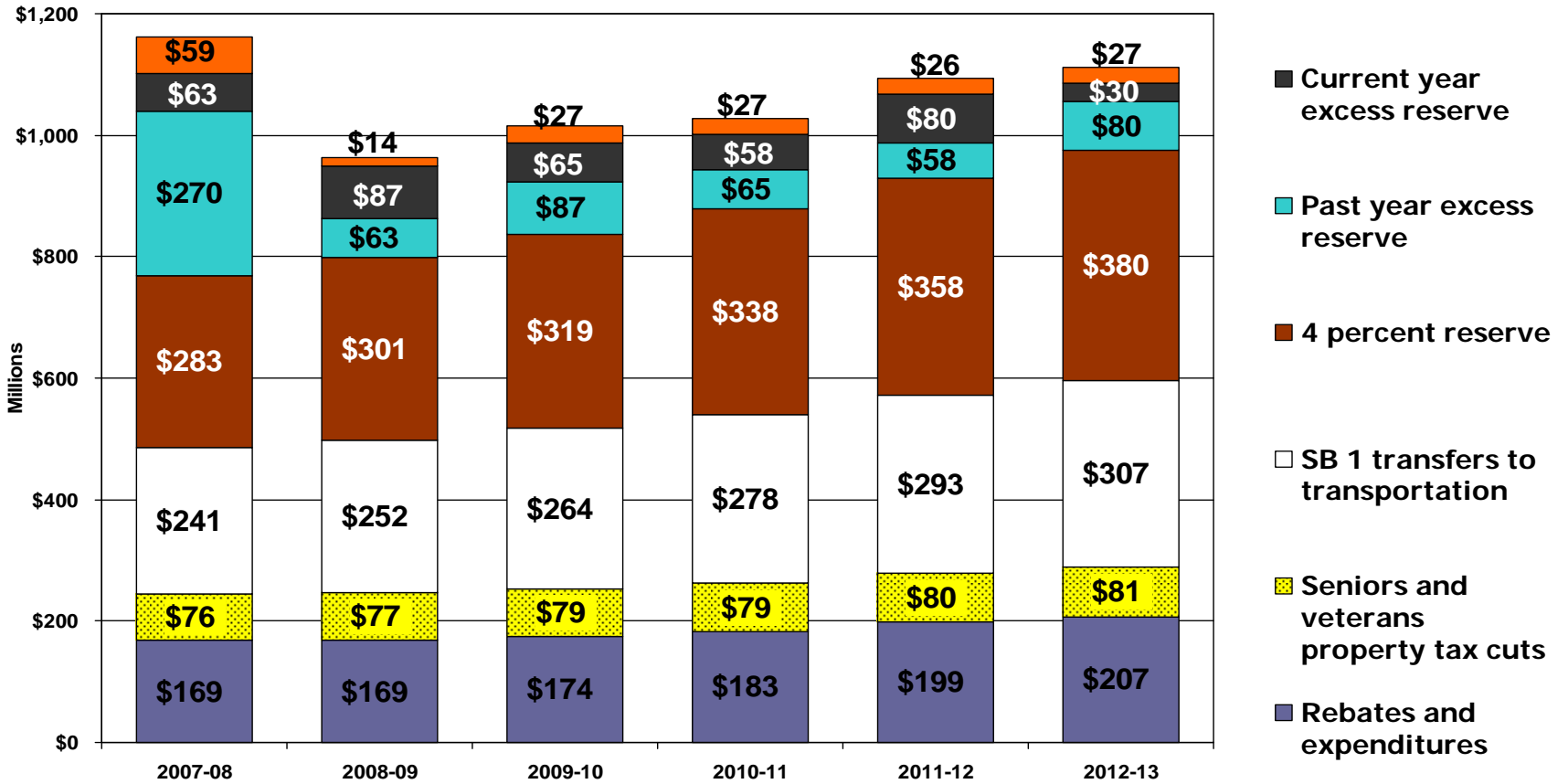


## Initial findings

- General Fund revenues will exceed the total amount needed to sustain 2007 levels of services through 2013, including K-12 and higher education, Medicaid, human services and prisons.
- However, the 6 percent spending limit may require service cuts in some years.
- Minor changes in estimates for future inflation could substantially change the projected appropriations.
  - We **only** considered inflation in estimating future appropriations for K-12 and higher education because current law requires spending in these areas be adjusted for inflation.
  - However, inflation could increase appropriations in other areas such as health care and human services above our projections.

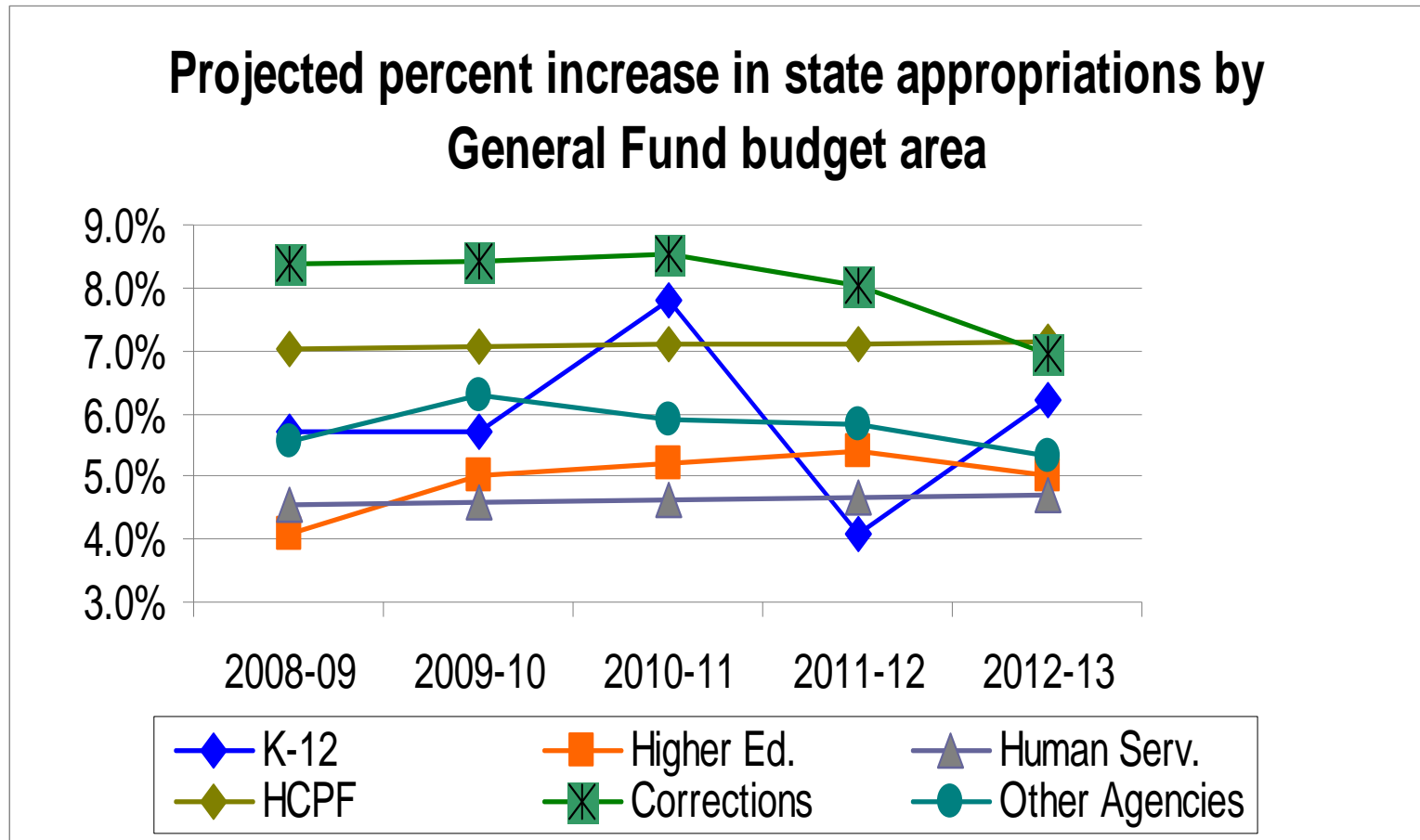
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## Allocation of General Funds outside 6% limit



## **Initial findings**

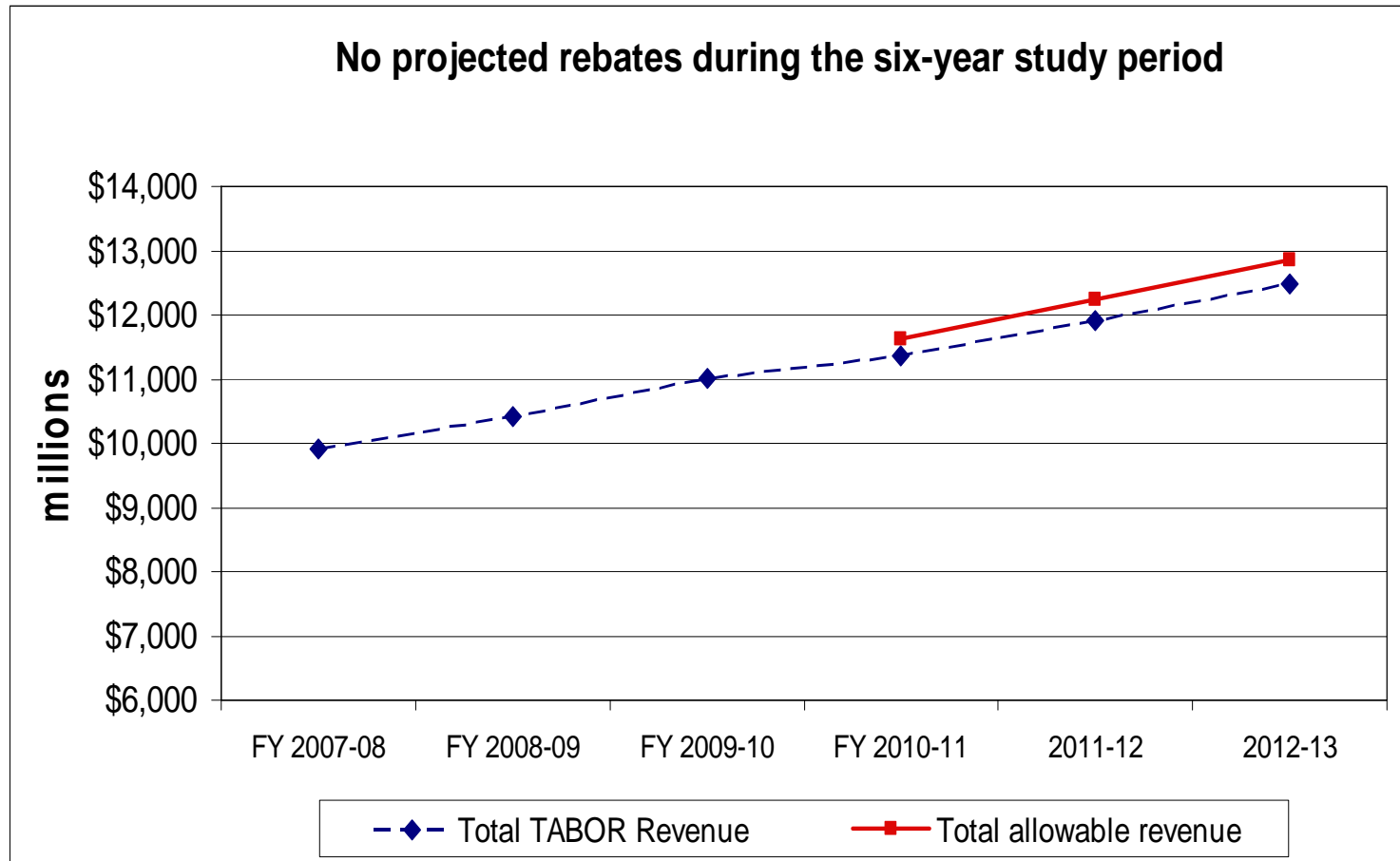
- Revenues outside the 6 percent limit do not represent savings. Under current law, they are fully allocated to other areas such as transportation, statutory reserve, property tax cuts and rebates and expenditures.
- Transportation has become increasingly dependent on the spill-over of General Fund revenues to make up for the declining purchasing power of traditional revenue sources, such as the gasoline tax.
- Removing the 6 percent limit will not result in additional revenue because the money outside of it is already being used.



## **Initial findings**

- Looking forward, we project that General Fund appropriations to some agencies will grow significantly faster than others. As a result, the relative share of projected General Fund appropriations will shift among the major agencies.
  - Over the study period, the share going to Corrections will increase 1 percent each.
  - Over the study period, the share going to Human Services will decline by 1 percent each.

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## Initial findings

- Projected revenues will not result in TABOR rebates during the last three years of the study period.
- Extending the Ref C timeout will not provide additional revenue during the study period because we project being able to retain all of the revenue generated under the new cap
- However, minor changes in inflation or population growth could change these projections.
- Revenues are projected to grow faster than increases in inflation and population growth over time and **we anticipate there will be TABOR rebates** in the future.

# Observations

1. 2007 levels of service are likely to be as good as it gets under projected revenues.
2. The 6 percent limit will constrain services at the 2007 level for General Fund programs, even if there are sufficient revenues to do more.
3. However, because all of the money outside the 6 percent limit is already being used, removing the limit will not add more revenue to the system.
4. Extending the Ref C timeout will not result in the state retaining additional revenues over the study period and will not help us fund additional services.

## Observations

5. Our estimated appropriations include the effects of inflation in the K-12 and higher education budgets only. Increases in inflation could drive costs beyond our projections in other areas.
6. If we want to fund additional services we must cut current services or find additional sources of revenue.
7. Our revenue estimates **do not** assume an economic downturn. If one occurs, revenues are likely to be lower, forcing services below 2007 levels.

## Observations

### 8. Our estimates **do not** include funding for:

- Initiatives to reduce drop-out rates, respond to proposals from the P-20 Council, or to meet requirements under No Child Left Behind
- Proposals from Blue Ribbon (208) Commission for Health Care Reform
- Child Health Plan Plus (CHP+) the State Child Health Insurance Plan
- Expansion of traditional Medicaid
- Raising higher education to the average level of peer institutions in other states
- Maintaining highways at current levels
- Expanding the rainy day fund (up from the present 4 percent reserve to the desired 8-10 percent of General Fund)
- Increased support for veterans
- Eliminate waiting list for services for developmentally disabled adults
- New capital construction projects
- Likely slower growth in federal funding

# Federal Budget Expectations

## Growing Deficit

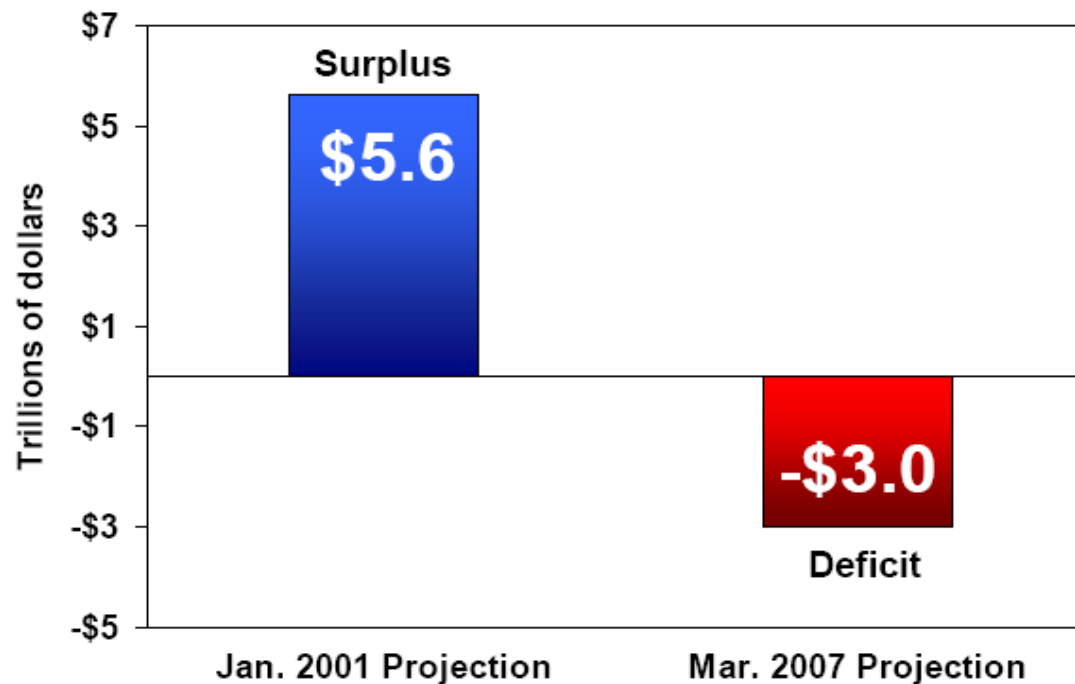
- 2001 and 2003 tax cuts
- Medicare, Medicaid, Social Security

## Consequences

- Cuts to discretionary spending
- Shifting of burdens to states if balanced deficit reduction is not pursued

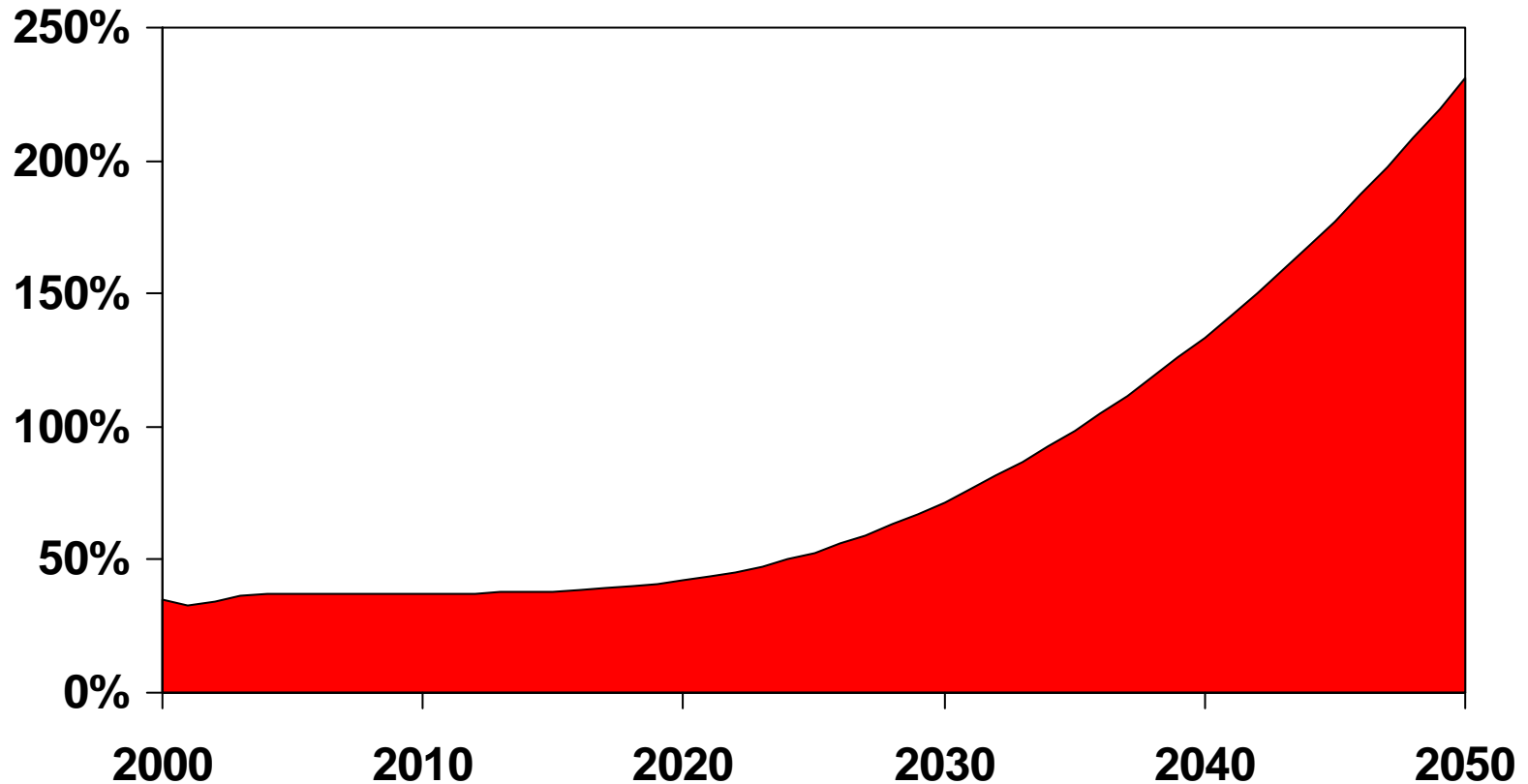
## From Large Surpluses to Large Deficits in Just 6 Years

*Cumulative Surpluses/Deficits, 2002-2011*



Source: CBPP calculations based on Congressional Budget Office data.

## Under Current Policies, Debt Will Reach 231 Percent of GDP in 2050

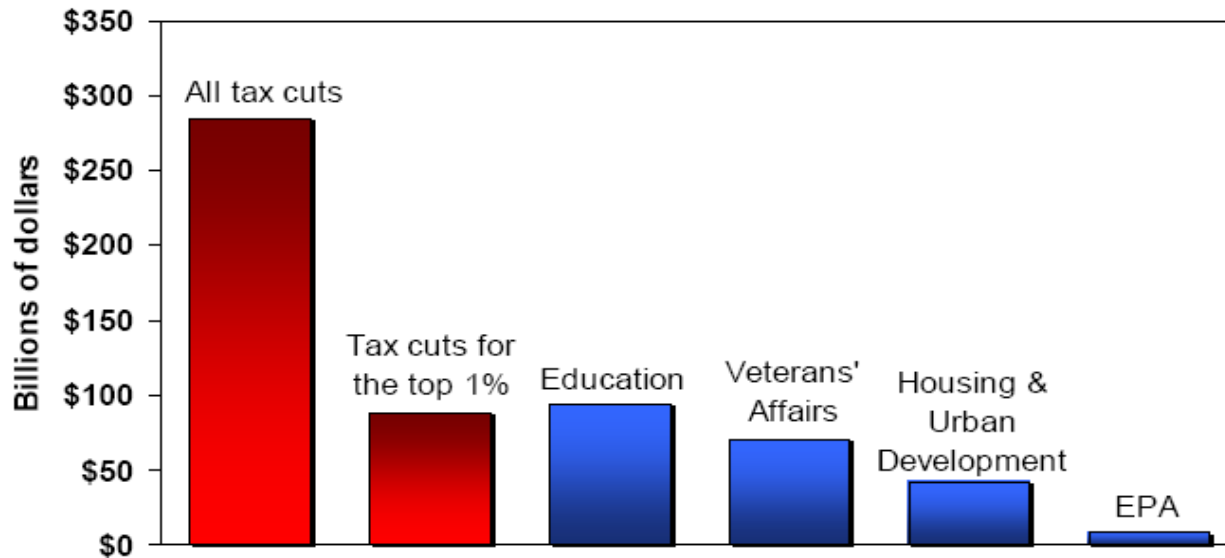


# Deficit Driver: Tax Policy

- The 2001 and 2003 tax cuts are set to expire at the end of 2010
- Tax cuts have a significant impact on federal revenues
- The cost of the tax cuts is 2 percent of GDP or 10 percent of all annual federal revenues

## Under Current Policies, Debt Will Reach Tax Cuts Cost More Than Most Agency Budgets

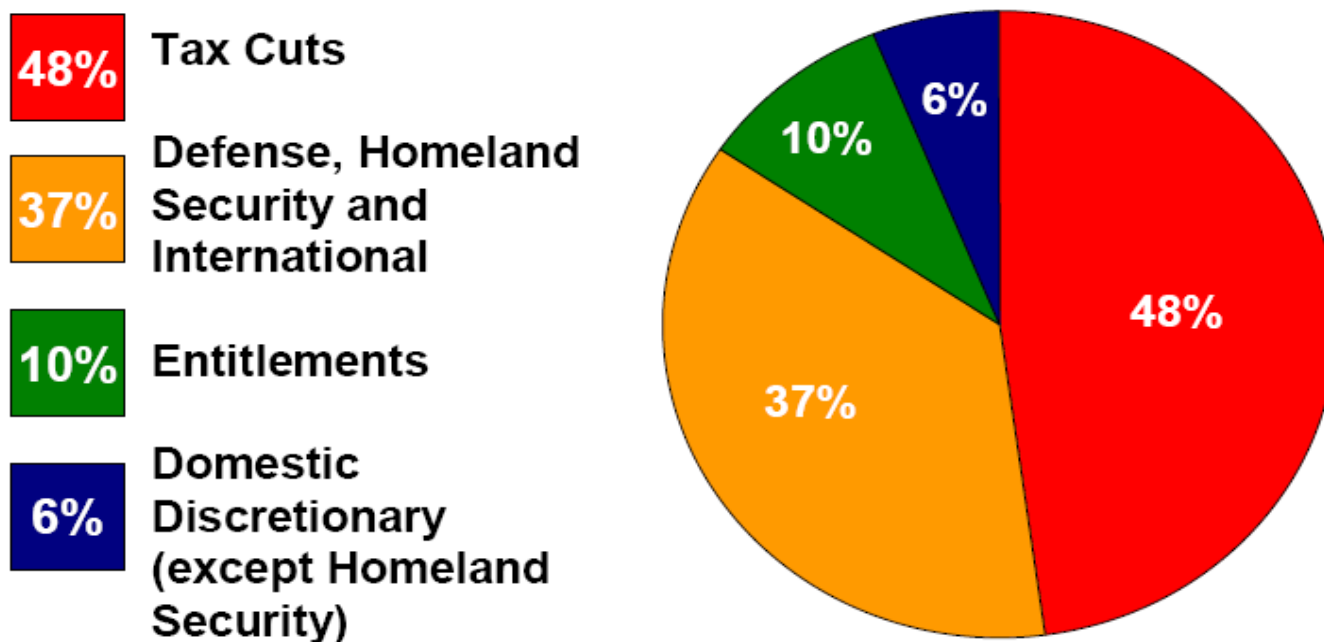
*2006 Agency Budgets, Tax Cuts if Fully in Effect in 2006*



Source: CBPP calculations based on Office of Management and Budget, Congressional Budget Office, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data.

## Legislation Adding to Deficits: Mostly Tax Cuts and Defense

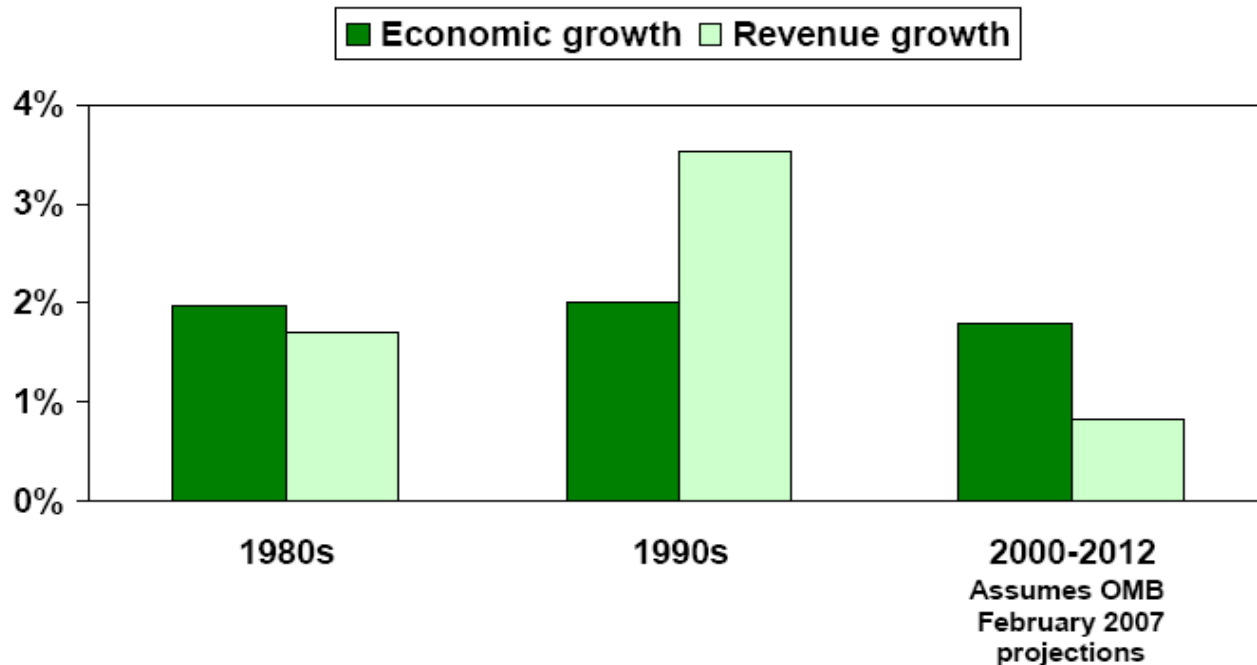
*Cost, 2002-2011, of policy changes since January 2001*



Source: CBPP calculations based on Congressional Budget Office data. Assumes extension of the President's tax cuts, continuation of Alternative Minimum Tax relief, a gradual phasedown of operations in Iraq and Afghanistan, and underlying defense spending in line with the President's FY 2008 budget.

## Economic and Revenue Growth Following 1980s and Recent Tax Cuts and 1990s Tax Increases

*Growth Rates, Adjusted for Inflation and Population Growth*



Source: CBPP calculations based on Commerce Department and Office of Management and Budget data.

# Deficit Driver: “Big Three” Expenditures

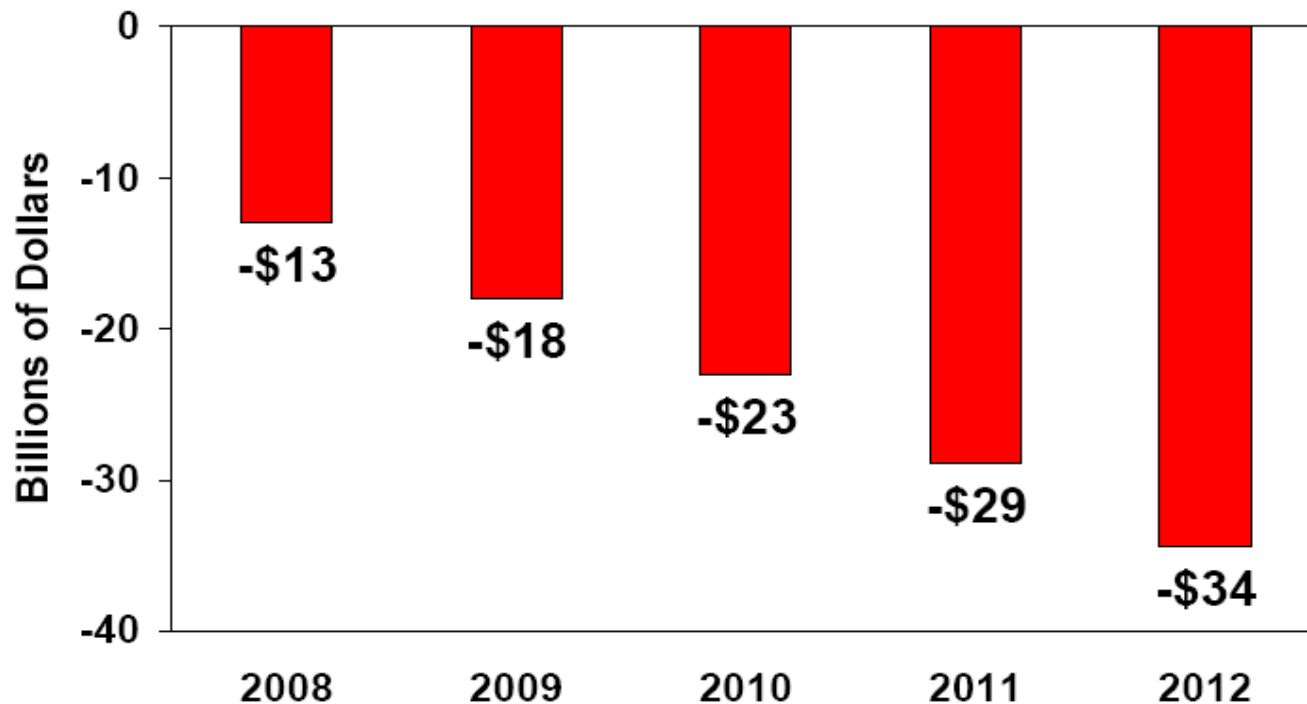
- The “big three” (Medicaid, Medicare, Social Security) entitlements are the most significant budget driver on the expenditure side
- Health care costs and changes in demographics are driving these costs
- Cost drivers are system wide; they are not specific to government programs. Solutions must also address the system.

# Consequences: Cuts to Discretionary Spending

--We have already seen cuts to non-defense discretionary spending

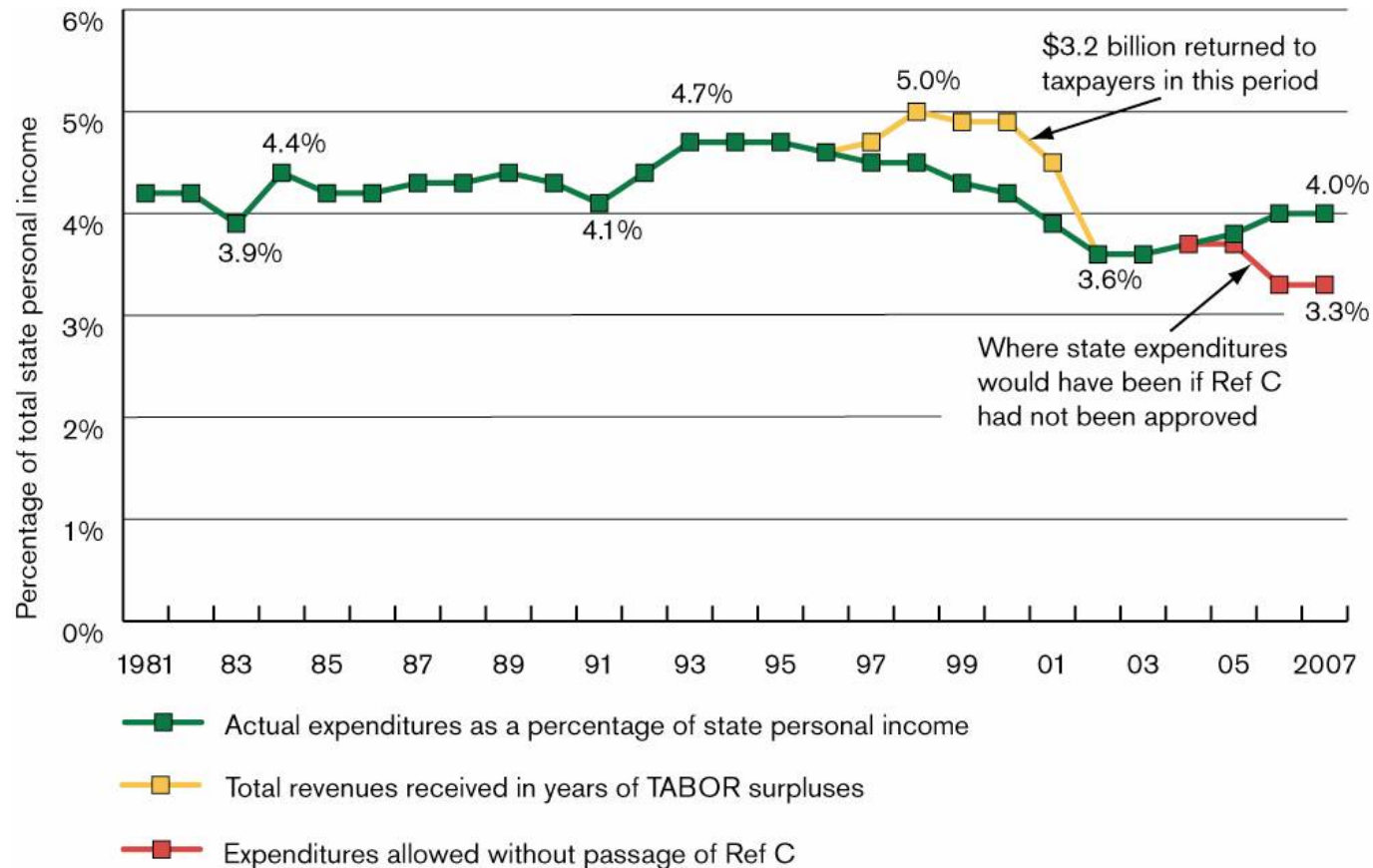
--When the President's budget is released the first week of February, we can expect it to reflect additional cuts to non-defense discretionary spending.

## President's Proposed Cuts in Domestic Discretionary Funding Grow Deeper Over Time



Source: CBPP calculations based on CBO's analysis of the President's budget, CBO's March baseline, and OMB documents.

## What does "2007 level of services" mean?



## What does “2007 level of services” mean?

<b>Total Expenditures</b>	<b>State Ranking</b>
per \$1000 of income	49
per capita	44
<b>K-12 education</b>	
per \$1000 of income	49
per capita	34
<b>Medicaid</b>	
per \$1000 of income	49
per capita	47
<b>Higher Education</b>	
per \$1000 of income	48
per capita	48
<b>Highways</b>	
per \$1000 of income	44
per capita	39

Source: “Aiming for the Middle,” by Carol Hedges, Colorado Fiscal Policy Institute, 2007.

## Total State General Fund Expenditures

State Spending per \$1000 of personal Income	<b>RANK</b>	<b>49</b>	Additional State funds needed
	US	\$144.30	
	25th	\$156.21	
	<b>CO</b>	<b>\$107.30</b>	
	Amt below US average	\$37.00	<b>\$4.918 B</b>
State Spending Per Capita	<b>RANK</b>	<b>44</b>	
	Amt below US average		<b>\$3.331 B</b>

# Observations

9. We are all in this together. Colorado's schools, colleges and universities, health care safety net, human service programs, prisons, transportation system, and building maintenance all depend on General Fund revenues for much of their funding. The issues they face are interrelated and cannot be understood or addressed in isolation.

**We now know  
where we are headed.**

**Is that where we want to go?**

## **The Looking Forward research team**

Rich Jones, Robin Baker and Frank Waterous  
The Bell Policy Center  
303.297.0456  
[jones@thebell.org](mailto:jones@thebell.org)  
[baker@thebell.org](mailto:baker@thebell.org)  
[waterous@thebell.org](mailto:waterous@thebell.org)

Alex Medler, Scott Groginsky, Mark Fermanich  
Colorado Children's Campaign  
303.839.1580  
[alex@coloradokids.org](mailto:alex@coloradokids.org)  
[scott@coloradokids.org](mailto:scott@coloradokids.org)  
[mark@coloradokids.org](mailto:mark@coloradokids.org)

Carol Hedges  
Colorado Fiscal Policy Institute  
303.573.5669 ext. 309  
[chedges@cclponline.org](mailto:chedges@cclponline.org)

Ed Bowditch  
Fiscal Consultant  
[edbowditch@aol.com](mailto:edbowditch@aol.com)

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[comments@thebell.org](mailto:comments@thebell.org)

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Director of Outreach  
The Bell Policy Center

(303) 297-0456  
(866) 283-8051

[zeller@thebell.org](mailto:zeller@thebell.org)

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