



COLORADO FISCAL
POLICY INSTITUTE

**TESTIMONY AS PREPARED FOR THE
INTERIM COMMITTEE ON LONG TERM FISCAL STABILITY**

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Good morning, my name is Carol Hedges and I am a Senior Fiscal Analyst for the Colorado Fiscal Policy Institute which is a project of the Colorado Center for Law and Policy.

I appreciate the focus of this group is on the long term stability of our fiscal system. The fiscal system is created and maintained solely for the purpose of providing public and common services. While nearly all budgeting activities involve allocating limited resources, Colorado operates with unique constraints that put the emphasis on the “limited” part of that activity.

The current crisis is a short term economic phenomenon but its depth and intensity in Colorado is attributable to a fiscal structure that historically reduces the amount of money available for public activities. Evidence of the effects of that continuous reduction in revenue abounds. The result? A perpetual budget crisis.

Spending as a percentage of our overall economy has declined since a high in the early 90's. The average spending as a percentage of total state personal income between 1982 and 2001 was 4.2%. In 2009 that percentage was 3.9%. In other words, government spending as a percentage of the economy has shrunk from a high of 4.7% in 1993. (Chart 1)

Historically the revenue drain is caused by economic downturns. In Colorado in recent history, the drain is a product of revenue policy that explicit keeps public revenue from keeping pace with the economy, that policy is the revenue limit in TABOR. But that is not the only source of the drain. The state income tax has been reduced twice since 1999 and the state sales tax rate once. The rate reductions mean less revenue is available to support public services. The only state tax rate increase since 1988 is an increase in the cigarette tax adopted in 2004.

Another reduction in revenue comes from the declining residential assessment rates. The Department of Local Affairs estimates that these declining assessment rates have reduced local property tax collections by \$1 billion. While these reductions in revenue are for local government, when local revenue falls, the state is expected to backfill funding for our K-12 education system.

Our response to these reductions in revenue has been to cut appropriations. And we have seen the effect of those reductions. We see it in comparisons of spending in Colorado versus other states (Chart 2) where we rank 47th in total spending per \$1000 in income. Our rankings in almost every area are in the bottom 10. And we see it in a variety of outcomes for Coloradans.

We at the Colorado Fiscal Policy Institute believe that our history shows that we cannot cut our way out of our perpetual budget crisis. Over the years, numerous organizations, including mine, have made suggestions to save money that have been rejected because we don't have enough money. Those decisions are beyond penny wise and pound foolish. They are irresponsible.

The time has come to think of this challenge not just as a mathematical puzzle to be solved but also as a moral imperative. Our Legislators are elected to uphold the laws of the state. Our current approach to revenue means that they cannot faithfully fulfill their obligations. It is time to expand the scope of our review to include the revenue side of the fiscal equation.

Review of the Revenue System

Now after all the testimony from yesterday, it is clear that state spending is dependent on how much money is collected in taxes and we learned that we don't tax our selves very much. (See Charts 3 and 4)

You received a copy of a document from NCSL, Principles of a High Quality State Revenue System and I urge you to read it. It provides a great framework for evaluating tax policy decisions of all kinds. Colorado's tax system doesn't stack up very well on many of the principles outlined by NCSL. But one of the biggest problems facing tax decision makers today is the simple lack of data available about how our current revenue system operates.

Transparency and accountability are two of the most important concepts in our system of governance. While we still have a ways to go on transparency in spending, we are miles ahead in the spending side compared to the revenue side.

Data problems

We lack data in part because we don't collect it-- our income tax computer system is 46 years old and is ill equipped to generate the data we need. We also lack information because no one is charged with the responsibility for asking the questions about the tax system. The Department of Revenue sees itself as a collection agency not a tax policy agency. The Legislature operates with very limited authority to reform the tax system and hence spends little time reviewing its function. Other states require in depth and regular analysis of tax incidence and tax expenditures. We do not. We must do a better job of providing more complete information for tax policy decision makers whether they are legislators or voters.

Tax expenditures

Our current system is designed to provide a lot of scrutiny on the appropriation and expenditure side of the system. The Joint Budget Committee spends most of its time and its staff devotes a great deal of effort determining the effects of appropriations. Yet little time is devoted to reviewing the effects and outcome of our tax credits, exemptions and other adjustments to income, even though they have the exact same impact on our ability to provide public services. The document you have received on income and sales tax credits and exemptions is a start. It does not, however, provide performance information on whether these targeted tax cuts are accomplishing their objective.

Further it does not contain any information about adjustments against corporate income or policies that affect where and how corporate income is allocated. These seem so technical and so boring, but they may be costing us millions of dollars that could be used to reduce tuition costs, decrease class sizes, provide health insurance or build roads. For example, currently Colorado tax law allows corporations to carry forward net operating losses for 20 years and Colorado does not require withholding for out of

state tax payers. These are two provisions that are fairly unique to Colorado and should be scrutinized along with budget cuts and other tax expenditures.

At a very minimum tax policy of all kinds should receive the same level of regular scrutiny that is applied to appropriations for programs. And not just at the time they are adopted but regularly to make sure the outcome matches the expectations. Decision makers need to have the conversation about the tradeoffs of giving money away before it comes in as versus appropriating money for services.

Who Pays?

One of the NCSL principles refers to treating individuals equitably and minimizing taxes on the lowest income. While Colorado taxes all “taxable” income at the same rate that does not mean everyone pays the same percent of their income in taxes. When combined with local taxes, Colorado’s tax system is highly regressive assigning a higher tax responsibility to lower income taxpayers. Taxpayers with taxable income less than \$10,000 pay 11.3% in taxes compared to the 7.3% paid by taxpayers with taxable income greater than \$100,000. Unfortunately, the data available is insufficient to get a complete picture of who pays. For example, the group with taxable income over \$100,000 is a broad category encompassing a large number of taxpayers. More in depth data analysis shows more regressivity particularly when the highest income categories are segregated. (Chart 5 and Chart 6)

Further, isn’t it time to have a conversation about the definition of “equitably”. Do we in Colorado think that a single rate is the best approach or do we prefer an ability to pay definition of equitable. I am not here to suggest an answer to that question but to urge a conversation about it and its implications for providing services that support the common good.

Federal Conformity

Why do we allow ourselves to be buffeted by changes in federal tax policy? Over the past decade Colorado has seen significant reductions in revenue due to a change in federal tax law. The Supreme Court of Colorado has made it clear that the Legislature has the authority to make tax policy decisions that do not involve rate increases or new taxes. This body should review some of the federal changes and their effect on our ability to provide services we need here in Colorado.

Collection practices

Another of the NCSL principles is fair and efficient administration of the tax system and one of the most basic tenets of a fair system is making sure everyone who owes, pays. Yet today on the Department of Revenue website the list of delinquent taxpayers, those who owe more than \$20,000 for longer than 6 months, includes 1300 individuals and 389 corporations. Assuming the minimum liability to be listed, making good on these delinquent bills would yield over \$33 million. Yet the Department of Revenue lacks the staff and computer resources to collect on those delinquencies and another 10% reduction in funding will probably not improve that situation. The department has nearly 100 fewer employees today than it did in 1988.

Our fiscal situation reminds me of the car I drove as a college student. It developed a slow oil leak. I found that I could ignore the leak for a while and while I am sure it wasn’t great for the engine, I could drive it. At some point, the oil light would come on, Most of the time I would then put in some oil and deal with the problem. One time, however, I was in the middle of finals, and I was broke and I thought it would be okay to drive home and well....My dad was not happy when we had to replace the engine.

Colorado's fiscal environment is a lot like my car. We develop a leak in our revenue system in 1992 when the TABOR amendment was added to the constitution. Our leak increased with tax rate reductions and increases in tax credits and exemptions. The recession in 2001 caused the light to come on. We added a little oil with the passage of Ref C, but the 2007-08 recession increased the size of the leak. Since we've been driving with the light on since 2001, we can no longer afford to ignore the warning sign. A decision to try to cut more simply means more job loss, higher uninsured rates, increased tuition, and worse education outcome—the equivalent of a blown engine.

A robust public sector is not the sole component of a robust economy, but we all know it is an important piece of the solution to our perpetual fiscal crisis. And while critics will surely bemoan the size of government, recall my earlier point that size is not the issue. Service is the issue. What kind of service are Coloradans getting from their government? What kind of investment are we making in our future? Will today's commitments improve our outlook or undermine our success?

I listened with great interest and respect yesterday as you all described your backgrounds--So many of you spoke lovingly of this great state of ours and of your desire to share it with your kids and grand kids. I share that desire and I know that we inherited a fabulous place, in part, because the generations that came before us made commitments and sacrifices that built public schools, universities, roads and health systems--the very foundation of the economic and social successes we enjoy today. I want the legacy of our generation to build on the sacrifices of those who came before us and I worry about our success if we continue on this path of smaller and smaller commitments to the common good.

These are serious times. And it is all of our responsibility to be serious about looking not just at our budget, but at our revenue system, and asking ourselves and our neighbors just what kind of Colorado we want.

Thank you, Mr Chairman and members of the Commission.