



Issue Brief

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From the Colorado Fiscal Policy Institute

The Colorado Economic Recovery Act Summary of HB05-1194—Referendum C

On April 18th the Colorado General Assembly approved HB05-1194, which will be sent to the voters in November 2005 as Referendum C. Referendum C is a de-brucing measure that asks voters to temporarily override the current TABOR revenue formula that limits annual growth in state revenues to the rate of change of inflation plus population. With no increase to current tax rates, Referendum C would allow the state to keep and spend the revenue it collects under current rates for the next five years. The measure does not require the governor's signature but Governor Owens has announced his support for it as part of a package of fiscal reform measures.

The Economic Recovery Package

Referendum C is part of a compromise package that includes: a proposal requiring voter approval to issue bonds for transportation, higher education and K-12 capital improvement projects (Referendum D); a proposal that would implement a temporary income tax rate reduction (4.63% to 4.5%) after the five years as the first method of refunding revenues collected above the TABOR revenue limit (HB05-1317); and at least one "implementing bill" (HB05-1350) which outlines for voters how the retained revenue will be spent.

The temporary income tax rate reduction refund mechanism bill (HB 1317) was approved and will become effective upon passage of Referendum C in 2010. HB05-1350 was approved in the final days of the legislative session.

Provisions of HB 1194-Referendum C

HB 1194-Referendum C contains three major provisions. The first temporarily sets aside the inflation-based TABOR formula and allows the state to spend or save all the revenue it collects for 5 years (2006-2010). The revenue retained by this change would be used to fund health care, public elementary and high school education and higher education, pension plans for firefighters and police officers, so long as statutorily required; and pay for projects included in the Department of Transportation's strategic transportation project investment program. Beginning in year six, the State would keep \$100 million above the limit for debt service on bonds used to finance transportation and education projects, if voters approve the accompanying bond proposal. These provisions of 1194 would provide nearly \$3.1 billion more public services over the next five years compared to the current TABOR requirements. This \$3.1 billion comes from revenue that, according to TABOR, would otherwise be returned to taxpayers.

The second major provision has the effect of eliminating the ratchet in TABOR, allowing the state to recover after future economic downturns. It establishes as the new base for the revenue

formula by allowing the state to select the fiscal year between 2006 and 2010 with the highest total state revenue. The base is adjusted for inflation and population change to determine the limit for 2011. In subsequent years, the TABOR limit is calculated by adjusting the prior years' limit for the annual inflation and population change. This new base and the approach of building the limit from the prior year's limit (not actual revenues), eliminates the ratcheting down effect in future years.

The final major provision requires the State Controller, as part of the annual compliance audit, to report on revenues that the state is authorized to retain and spend pursuant to this referendum.

Problems Presented by TABOR

The research and analysis of TABOR over the past few years has revealed four major flaws:

1. Services can't keep pace with growth in the economy due to the inflation-based formula;
2. Temporary budget cuts become permanent because of the ratchet effect;
3. Additional statutory limits (the Arveschoug-Bird 6% provision) restrict flexibility and force false choices by limiting how general fund dollars collected within the revenue limit can be spent; and
4. Saving and planning are very difficult because savings would result in further service reductions.

Referendum C has advantages and disadvantages as it addresses some of these flaws but does nothing to solve others.

Advantages of Referendum C

Referendum C is a significant improvement over the current law because it temporarily addresses the first flaw, allowing services to catch-up, and permanently solves the second, allowing state services to better keep up in the future. It provides \$3.1 billion in revenue for public services that will not be available if Referendum C is not approved. This new revenue will help the State temporarily avoid further cuts in services and may allow for some service expansions, particularly in transportation. It also eliminates the ratchet in future economic downturns. The approach embodied in this referendum accomplishes an elimination of the ratchet by setting each fiscal year's limit as the prior years' *limit* increased by inflation and population. This is a substantial improvement over the current TABOR approach that applies the inflation and population adjustment to *the lower of* what the state was allowed to keep or what it actually collects.

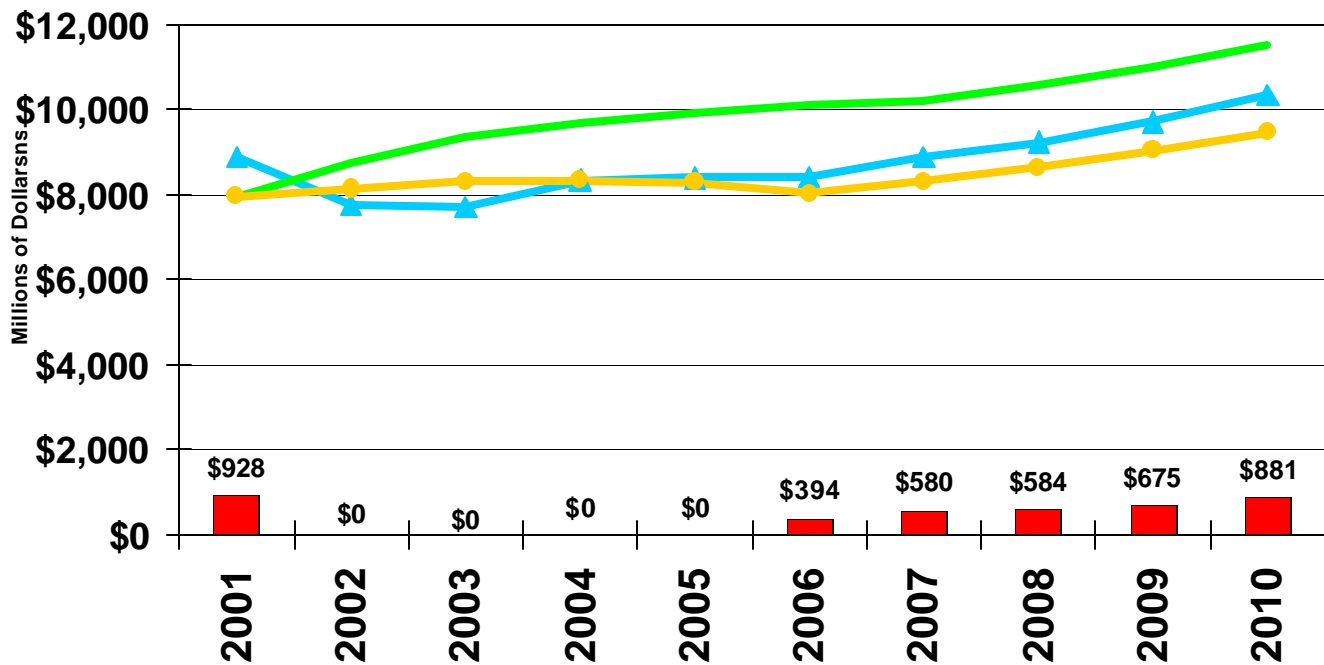
The strongest selling point for Referendum C is the broad coalition of support that has developed for this measure. The Governor has endorsed it along with Democratic Leadership in both Houses of the General Assembly. It received strong bipartisan support from rank and file members in both chambers as well. The business community and other community organizations have not only endorsed this approach but begun to organize a campaign effort to support its passage in November.

Limitations of Referendum C

While Referendum C addresses the issues of the inflation-based formula for the next five years, it is not a permanent solution to Colorado’s structural fiscal problems. When the provisions of Referendum C expire, the state will be faced with the same dilemma that we currently face — a formula that does not keep pace with economic growth or changing need.

Also, Referendum C does not allow for services that were cut during the recession to be fully restored. The amount of services that can be provided is limited by the amount of revenue the state collects or, as is the case because of TABOR, is allowed to keep and use. Referendum C would allow the state to keep nearly \$580 million more than current law. That amount, however, is not large enough to allow the state to restore spending to FY 2001 levels.

Services Can't Recover After Recession



- ? TABOR Revenue
- ? TABOR Limit
- ? Inflation + population from 2001
- Refunds

The difference between what the state would have had to spend to maintain FY2001 spending levels in FY2007 and what the TABOR formula would allow the state to spend in FY2007 is \$1.9 billion (the difference between Constant Spending and Allowable Spending). In other words, without Referendum C, the state will provide \$1.9 billion less in services in FY2007 than in FY2001. Even if Referendum C passes, however, and the \$580 in taxpayer rebates are

retained, the state still will not be able to provide the same level of services it provided in FY2001.

Another concern is that Referendum C does nothing to relieve the pressure of the Arveschoug Bird statutory 6% spending limit. This statutory restriction limits annual increases in the General Fund operating budget to 6%. This statutory limit will mean that between FY2006 and FY2010, there will be almost \$640 million in general fund dollars that will be kept but can't be used for operating programs and must instead be transferred to highways and capital construction. This statutory limit is responsible for many of the program cuts that occurred during the late 1990s, prior to the recession.

Further, any new mandated programs the Legislature may adopt, as part of the earmarking package, will reduce or eliminate current services. The additional revenue retained by Referendum C is needed to cover the regular increasing costs of providing current services. If a portion of it is earmarked for new services, i.e., things not currently in statute, then current services will have to be scaled back.

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