



ISSUE BRIEF

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From the Colorado Fiscal Policy Institute

Referendum C Passes and Referendum D Fails: Now What for Colorado's Budget?

Statewide measure Referendum C (Ref. C) was approved by Colorado voters, 52% to 48% on November 1, while Referendum D failed, 49.3% to 50.7%. These results mean that the State will be allowed to retain all of the revenue that it receives over the next 5 years. It also means that the Constitutional TABOR revenue will, beginning in the sixth year, be the amount of actual revenue received by the State in the highest of the 5 years.

After that, the allowable revenue formula will once again be population change plus CPI, *regardless of actual revenue collections*. This in effect removes TABOR's ratchet from the Constitution.

Over the next five years, money that would have been refunded to taxpayers will be dedicated to health care, education, and transportation. The language of Ref. C reads in part, "Without raising taxes and in order to pay for education, health care, roads, bridges and other strategic transportation projects...." Funding for the fire and police pension shortfall is also included.

Arveschoug-Bird Spending Limit

It should be noted that *Colorado's General Fund is still subject to the 6% spending increase limit* contained in Arveschoug-Bird. General Fund revenue received over this amount is transferred to non-operating funds for capital construction and highways. This is an important point to emphasize. The JBC and the General Assembly will have to continue to treat the 6% spending limit as a *floor* as well as a *ceiling*, because any appropriation below a 6% growth rate becomes the basis for the next year. *Ref. C has not eliminated the ratchet effect of this 6% spending limit.*

During the 2005 Legislative session, the General Assembly also passed HB 05-1317, which provided that once the state budget again becomes obligated to make TABOR rebates due to stronger revenues, there will be a temporary income tax reduction, from 4.63% to 4.5%, if certain minimum amounts are triggered. Under HB-1317, each year's income tax rate is treated separately, so for instance, the rate goes back to 4.63% in any year when the TABOR rebate no longer reaches the statutory threshold. This temporary income tax reduction occurs prior to the 19 contingent tax credits already in law that serve as TABOR rebate mechanisms.

General Fund Appropriations

Based on the September revenue forecast, the most recent prior to the election, here is a comparison of the General Fund appropriations allowed with and without Ref. C:

General Fund Appropriations – Without Ref. C (\$millions)

<u>FY 05-06</u>	<u>FY 06-07</u>	<u>FY 07-08</u>	<u>FY 08-09</u>	<u>FY 09-10</u>	<u>FY 10-11</u>
6,181.6	6,059.8	6,423.4	6,808.8	7,083.5	7,508.5

General Fund Appropriations – With Ref. C (\$millions)

<u>FY 05-06</u>	<u>FY 06-07</u>	<u>FY 07-08</u>	<u>FY 08-09</u>	<u>FY 09-10</u>	<u>FY 10-11</u>
6,291.3	6,668.8	7,068.9	7,493.1	7,942.6	8,419.2

As can be seen, by the end of the forecast period, the state will be appropriating approximately \$910 million per year more than it could have had Ref. C not passed.

TABOR Rebates

There will be a TABOR rebate as a result of FY 2004-05, of \$44.7 million (about \$15 per taxpayer), which was not affected by Ref. C. The TABOR rebates that would have occurred without Ref. C total an additional \$4,365.5 million, according to the September revenue forecast.

SB 97-1 HUTF Transfers

Referendum C also changes the amount of funds that will be transferred from the General Fund to the Highway Users Trust Fund (HUTF). Without Ref. C, the following funds would have been transferred:

General Fund Transfers to HUTF – Without Ref. C (\$millions)

<u>FY 05-06</u>	<u>FY 06-07</u>	<u>FY 07-08</u>	<u>FY 08-09</u>	<u>FY 09-10</u>	<u>FY 10-11</u>
0	0	66.9	2.2	0	190.5

And with Ref. C:

General Fund Transfers to HUTF – With Ref. C (\$millions)

<u>FY 05-06</u>	<u>FY 06-07</u>	<u>FY 07-08</u>	<u>FY 08-09</u>	<u>FY 09-10</u>	<u>FY 10-11</u>
215.9	41.8	23.3	39.0	28.9	11.0

Thus, without Ref. C, a total of \$259.6 million would have been transferred over the next 6 years, whereas with Ref. C, the figure is \$359.9. Further, most of the money will be “front-loaded” (coming in the current fiscal year) whereas without Ref. C the bulk of it would not have occurred until FY 2010-11.

Homestead Exemption

The homestead exemption, a reimbursement to local jurisdictions for a property tax reduction for seniors on their full time residences, was suspended a couple of years ago, and pushed out to FY 2006-07. Both revenue forecasts, assuming no Ref. C, and assuming passage of Ref. C, did show the resumption of the homestead exemption beginning in FY 2006-07. However, given the level of program cuts that would have been required had Ref. C failed, there is every reason to believe that the General Assembly may have once again been forced to push out the resumption of this tax benefit, possibly indefinitely. It is our expectation that the program will resume in FY 2006-07. At least part of the Ref. C campaign made a point of mentioning this benefit. The annual amount ranges between \$60.4 and \$62.3 million per year.

Cash Funds

Cash fund revenues have been increasing in comparison with prior forecasts – in fact, over the September 2005 five year forecast period, Legislative Council increased its total cash funds forecast by \$319.3 million. Had Ref. C failed, this additional \$319.3 million would have caused the amount of the TABOR

rebates to swell (and thus impact General Fund services dollar for dollar), because TABOR rebates are made from the General Fund, not from the cash funds that drove the additional revenue.

Unemployment Insurance (UI) fund revenue will rise by an additional \$376.5 million; severance taxes will rise by an additional \$217.7 million; and transportation cash funds (including fuel taxes) are expected to *decline* by \$198.0 million (apparently due to conservation behavior on the part of motorists and a decrease in the use of SUV's). We question the latter assumption, as the demand for motor fuel is likely quite inelastic, resulting in some driver behavior modification, but not enough to more than counter unit prices. There is also a question whether over the long run there will be a decline in gasoline prices. Gas prices have certainly come down from a month or two ago. In any case, the passage of Ref. C reduces the importance of the problem of cash funds "crowding out" General Fund programs. The reason is that for the foreseeable future, *it is the spending limit of Arveschoug-Bird that will be the effective cap on General Fund programs*, not the TABOR formula of population and CPI.

General Fund Adequacy

In prior fiscal quarters, the Joint Budget Committee staff has provided estimates of the annual General Fund increases that are required to maintain State services under State law ("current law"). This is a rough approximation of a current services budget. The annual increases are due to caseload and population increases (as the "big five" General Fund departments – Medicaid, Education, Human Services, Corrections and Judicial are highly case- or population driven), and changes in unit costs (for example, medical inflation can easily run several percentage points higher than the CPI in a given year).

Typically, to continue under current law, appropriations must grow by \$300-400 million per year in order to avoid service cuts. With the passage of Ref. C, appropriations growth over the 5-year forecast range from \$356 million (FY 05-06) to \$476 million (FY 2010-11). Thus, it appears that Ref. C has provided sufficient resources to continue current services plus perhaps \$50-75 million more.

However, given increasing demands on the State and "current law" programs, there is certainly no sense that the State will have extra money. Among these demands are: the lawsuit settlement that requires the State to fund the reconstruction of unsafe K-12 school buildings, funding the fire and police pension fund, restoring recessionary program cuts, and repaying cash funds used to balance the budget during the recession.

Referendum D

Referendum D would have allowed the State to issue bonds (for up to \$2.072 billion in principal) for transportation projects, K-12 and higher education facility maintenance, and fire and police pension obligations. Some 82% of the money could have been used for transportation, 7% for K-12 school capital construction, 2.4% for college & university construction, and 8.4% for the fire and police pension shortfall. The money to cover principle and interest would have come from the TABOR rebate money, and beginning in year 6, Ref. D also would have allowed the first \$100 million of the TABOR refund in any year to be used first for bond retirement. In the event that the economy slowed such that the TABOR rebate in any year was less than \$100 million, then, given the contractual nature of the bonds, the debt service payments would have "crowded out" general fund programmatic spending.

Because Ref. D did not pass, the above-listed capital and pension needs will be handled on a pay-as-you-go basis. As mentioned above ("SB 97-1 HUTF Transfers"), roads and bridges will be receiving "spillover" general fund money whenever the Arveschoug-Bird spending limit is exceeded. The line item for other capital construction needs currently has only nominal amounts (approximately \$20 million per year in FY 2007-08 – FY 2010-11) for existing obligations. Thus, it will be necessary for the JBC and the General Assembly to find the money for the non-transportation capital needs as well as the fire and police pension fund.

Conclusion

The passage of Ref. C helped the State of Colorado avoid substantial additional program cuts on the heels of approximately \$1 billion in cuts made during the recent recession. The ratchet embedded in TABOR has been eliminated because after a five year time-out from the revenue limits, the revenue formula in year 6 and beyond (a) will be based on the highest actual revenue of the first 5 years, and (b) the revenue limit will thereafter be simply the population plus CPI formula applied to the *allowed* revenue, not applied to the lower of actual or allowed revenue.

In most years going forward, the Arveschoug-Bird 6% General Fund spending cap on operating appropriations will now be the effective limit on the growth of State government. Thus, in the dynamics of annual budgeting, this spending limit will be treated as a “floor” as well as a ceiling, because any appropriation below a 6% growth rate becomes the basis for the next year. If the economy grows at a healthy pace, driving income and sales tax revenues, general fund revenues in excess of the 6% will automatically spill over into highways and capital.

The State will still have to find the money to cover such needs as K-12 and college school building construction, and fire and police pension funding. In addition, it will likely allow the senior citizen homestead exemption, suspended till FY 2006-07, to resume. As to whether there will be the resources and the will to repay some or all of the cash funds that were tapped to balance the General Fund during the recession, is anyone’s guess. A 2005 court decision ruled that the General Assembly is not required to repay these funds.

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