



ISSUE BRIEF

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From the Colorado Fiscal Policy Institute

WHY SHOULD COLORADO EXEMPT THE UNEMPLOYMENT COMPENSATION FUND FROM TABOR'S DEFINITION OF FISCAL YEAR SPENDING?

INTRODUCTION:

Passed by Colorado voters in 1992, the Taxpayer's Bill of Rights (TABOR) has proven to be the most significant policy change in Colorado in at least a generation. It applies to every level of government and is, by all accounts, one of the most restrictive and comprehensive tax and expenditure limitations in the United States. Over the course of a decade, TABOR has fundamentally altered the way government in Colorado operates and controls virtually every revenue and spending decision made in the state. Despite TABOR's far-reaching effects, at first glance it seems to have little, if anything, to do with the unemployment insurance (UI) system. However, upon closer examination it becomes clear that TABOR prevents the UI system from functioning to the full benefit of employers, workers and the State.

BACKGROUND:

THE TAX PAYER'S BILL OF RIGHTS

While the actual text of TABOR is more than 1900 words, TABOR has essentially four major provisions:

- 1. Voter approval of tax increases.** This includes all new taxes or increases in tax rates, new or increased debt, any increase in the mill levy or any tax policy change that will result in a net revenue gain for the state. All total, TABOR requires voter approval of at least 14 different types of propositions.
- 2. Limits on the amount of revenue the State can collect and retain.** The formula for calculating the allowable revenue at the state level is the percent of population change (+ or -) plus the rate of inflation (Denver/Boulder CPI). The formula is always applied to the prior year's allowable revenue.

TABOR includes in the definition of *Revenue* all General Funds, such as revenue collected from income taxes, sales and use taxes, estate and excise taxes, and Cash Funds, such as money collected from unemployment insurance premiums, college tuition, fishing license fees and document recording fees. In Colorado, as in most states, Cash Funds are generally restricted funds, generated by fees or fines, which can only be used for the purpose or program for which the fee is collected. The only monies exempt from the definition of *Revenue* under TABOR are federal funds, litigation settlements, gifts and money earned by Enterprises. TABOR narrowly defines "enterprise" as any government owned entity that receives less than 10% of its total funding from government. There have been no successful statewide attempts to allow the state to retain excess revenue.

If the revenue the State collects from all sources exceeds the limits of the formula, it must be refunded to taxpayers UNLESS voters grant prior approval for the state to retain and spend the excess funds. While both cash funds and general funds count toward the state's fiscal year spending limit, all excess revenues are refunded out of the General Fund. For example, if unemployment insurance premiums or higher education tuition (both cash funds with restricted uses) drive the state over the TABOR revenue limit, the excess is refunded from the State's general operating budget.

3. Limits on growth in state spending. TABOR contains a specific provision that prohibits the weakening of any tax or spending limit that was in place prior to 1992. When TABOR passed, Colorado had an existing statute that limited the growth of general fund appropriations to six percent over the prior year's general fund spending. That statutory spending limit is now, in effect, locked into the constitution. *The legislature cannot increase general fund program spending* by more than six percent without prior voter approval or amending the constitution. This is true regardless of general fund program demands, increasing inflation or the amount of revenue collected under the overall TABOR limit.

4. Limits on revenue options. Under TABOR, there can be no new or increased real estate transfer taxes, no state real property taxes, no local district income taxes, no new state income tax rate and no graduated state income tax.

UNEMPLOYMENT INSURANCE:

Established by Congress in 1935, the unemployment insurance (UI) program was created to attenuate the hardships of involuntary job loss and stabilize the economy by supporting the consumption patterns of the unemployed. Benefits and eligibility are determined at the state level under guidelines mandated by the federal government. The majority of the program's funding comes from state-level employer taxes. Employer tax rates vary by state and employer. To give you an idea of the tax burden in Colorado, during the year preceding December 2002, Colorado employers paid on average .3 percent of total wages in UI taxes. Under federal law, UI trust funds are restricted dollars that can only be used to pay for UI benefits or UI program administration.

Like many other insurance programs, UI was designed to be "forward funded."¹ In other words, funds should accumulate during periods of economic health to be automatically and easily drawn down in times of recession. In short, the UI trust fund should operate like a rainy day fund. States need reserves big enough to survive recessions without raising UI payroll taxes on employers when they can least afford it, or restricting UI benefits to workers when they and the economy can least afford it.

In most states, UI taxes are separate from the overall state budget and general revenue appropriations. As noted above, UI trust funds in Colorado, as in other states, are restricted for UI benefits and administration. However, in Colorado, TABOR creates an odd intermingling of the State's general fund budget with the UI system. Even though they are restricted cash funds, UI trust fund dollars count against the State's total allowable revenue limit (fiscal year spending) under TABOR. This means that every dollar brought into the UI trust fund that sends the State over the allowable TABOR revenue limit a dollar is refunded out of the General Fund. This discourages, rather than encourages, the growth of the trust fund during economic booms, and therefore reduces the effectiveness of the UI program overall. It forces the Colorado Department of Labor and Employment and the legislature to strike a balance between what's good for the trust fund and what's good for the general fund, preventing either from operating as effectively or as efficiently as possible. For instance, despite the fact that Colorado employers enjoy one of the lowest UI tax burdens in the country, during the 2001 session, the General Assembly adopted a temporary employer tax credit designed to prevent a growing UI trust fund from forcing a refund. Qualified employers receive a 20 percent credit against their unemployment insurance taxes otherwise owed when the UI trust fund balance reaches 1.1 percent of the total amount of insured wages paid in Colorado during the calendar year. The credit was made permanent in 2002.

WHY SHOULD COLORADO EXEMPT THE UNEMPLOYMENT COMPENSATION FUND FROM TABOR'S DEFINITION OF FISCAL YEAR SPENDING?

A well-functioning UI system benefits employers, families and the state.

Benefits to Colorado Employers:

In Colorado, employer UI tax rates can fluctuate due to a number of factors. First, the size of the trust fund triggers changes in rate schedules – lower rate schedules go into effect as the trust fund balance grows. Second, employers are experience rated, meaning like car insurance their rates go up if the number of claims against them increase as often happens during recessions. Finally, employers pay a solvency surcharge when the trust fund balance drops to .9 percent of total wages paid in the state. Colorado implemented the solvency surcharge after the fund became insolvent during the recession of the 1980s. Any time a state’s trust fund becomes insolvent, the state must borrow money from the federal government to cover benefits and repay with interest.

Exempting the UI trust fund from the TABOR revenue limits removes the incentive to artificially suppress the size of the fund and encourages the growth of a healthy trust fund during economic expansions. An adequate trust fund will help ensure that employers pay the lowest rates possible during booms and busts.

- Entering a recession with a healthy fund balance can delay or avoid a shift to a higher rate schedule when employers are more likely to see their rates increasing due to experience rating.
- A healthy trust fund can help avoid triggering the solvency surcharge at the very time that employers face higher rates due to experience rating and possible schedule shifts.

Benefits to the Economy:

Allowing the UI system to better act as a counter-cyclical program also benefits the economy and will help Colorado recover from future recessions more quickly. An extensive study commissioned by the U.S. Department of Labor found that UI has greatly reduced the negative impact of the last five recessions.²

- UI saved an average of 131,000 jobs in each downturn.
- UI prevented a drop in the GDP by 15%.
- Every \$1 of UI benefits creates a ripple effect of \$2.15 in the local economy as jobless workers spend money on rent, gasoline, food, household consumer goods and other basic necessities.
- UI reduces the chances that a worker will be forced to sell the family home by almost one-half and prevents a potential 23% drop in spending on rental or mortgage payments.³
- UI helps maintain skill levels of the labor force and provides an incentive for workers to stay in the local labor market.

Benefits to workers:

By creating a more effective UI system, Colorado can ensure that jobless Coloradans weather the hardships of recessions more easily.

- UI benefits help workers and their families meet their basic needs while searching for suitable work.

In summary, exempting the UI trust fund from the TABOR revenue limit allows the system to work more effectively as a counter-cyclical program and automatic economic stabilizer.

¹ Rick McHugh, Andrew Stettner & Carrie Thomas, “Financing an Effective Unemployment System: Protecting Working Families, Our Communities and Minnesota’s Economy,” National Employment Law Project, 2003.

² Lawrence Chimerine, et al. “Unemployment Insurance as an Economic Stabilizer: Evidence of Effectiveness over Three Decades,” U.S. Department of Labor, Unemployment Insurance Occasional Paper 99-8, 1999.

³ Jonathan Gruber “Unemployment Insurance, Consumption Smoothing, and Private Insurance: Evidence from the PSID and CEX,” *Advisory Council on Unemployment Insurance Background Papers*, Vol. 1, 1995.