TABOR, its Ratchet, and Colorado’s Economic Future

Federation of Tax Administrators
Revenue Estimating Conference
October, 2005

Presentation Outline

- Colorado’s TABOR Amendment defined
- Overview: Selected Other Limits
- Recession and the Ratchet: Colorado’s Fiscal Past and Future
- Referendum C
TABOR in Colorado

- Passed via citizen initiative as Constitutional Amendment in 1992
- One of 27 states to have such limits
- Some states, including Colorado, have more than one fiscal cap limit
- TABOR regarded most restrictive limit in nation

Major Provisions of TABOR

- Voter approval required for
  - Tax increases
  - Tax policy changes causing net revenue gains
  - Valuations for assessment rate ratio increases
- User fees may be increased without a vote
- Limits revenue, spending growth to population + inflation
- Limit applies to General Fund and Cash Funds
- Nuance: Increased fees may reduce funds available for general governance programs
Major Provisions of TABOR (cont’d)

- Revenues in excess of inflation + population (TABOR surplus) returned unless voters approve otherwise
- Subsequent year’s base set at lesser of current TABOR limit or actual revenues (the ratchet effect)
- Locks in existing limits by requiring voter approval to weaken

- Emergency reserve of 3% can’t cover economic downturns
- Enterprise declaration by programs receiving less than 10% of revenue from state
- Direct prohibition of specific taxes such as real estate transfer taxes, state property tax, and local income tax
Returning the TABOR Surplus: Targeted Refund Mechanisms

- Earned Income Credit
- Individual Development Account Credit
- Foster Care Credit
- Business Personal Property Tax Refund
- Credit for Rural Health Care Providers
- Child Care and Child Tax Credits
- Exclusion of Interest, Dividend, Capital Gains Income
- Exclusion of Capital Gains on Colorado Assets
- R & D Sales and Use Refund
- High Tech Scholarship Credit
- Reduction of Motor Vehicle Registration Fees
- Exemption for Certain Charitable Deductions
- Credit for Contributions to Telecom Education
- Sales and Use Tax Reduction on Commercial Trucks
- Sales and Use Tax Exemption for Pollution Control Equipment
- Agriculture Value-Added Development Fund Program
- Purchase of Private Health Benefit Plan Credit
- Capital Gains Deduction for Assets Held for 1-5 Years

Selected Other Limits and their Relevance to the Story

- Gallagher Amendment
  - Residential property tax limit
  - Over time shifted majority of responsibility for K-12 funding from local to state

- Arveschoug-Bird Limit
  - 6% General Fund Appropriation Limit

- Amendment 23
  - Constitutional mandate for K-12 funding increases
  - Created State Education Fund
### Percent Change in General Fund
**FY 2001-02 Through FY 2004-05**  
**Source:** FY 2004-05 Appropriation Report

<table>
<thead>
<tr>
<th>Period</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 01-02 to FY 02-03</td>
<td>-1.16%</td>
</tr>
<tr>
<td>FY 02-03 to FY 03-04</td>
<td>1.92%</td>
</tr>
<tr>
<td>FY 03-04 to FY 04-05</td>
<td>3.62%</td>
</tr>
</tbody>
</table>

### Percent Change in General Fund and its Major Obligations
**FY 2001-02 Through FY 2004-05**  
**Source:** FY 2004-05 Appropriation Report

- **Percent Change in General Fund:**
  - FY 01-02 to FY 02-03: -1.16%
  - FY 02-03 to FY 03-04: 1.92%
  - FY 03-04 to FY 04-05: 3.62%

- **Percent Change in K-12, Corrections, and HCPF:**
  - FY 01-02 to FY 02-03: 8.74%
  - FY 02-03 to FY 03-04: 3.62%
  - FY 03-04 to FY 04-05: 4.37%
The Past: The Recessionary Squeeze on the General Fund

- General Fund decreased or grew modestly
- At the same time, non-discretionary program growth outstripped General Fund growth
- Borrowed as much as possible to maintain base in General Fund; Used one-time accounting adjustments as well
- Squeezed out other discretionary programs, particularly higher ed
- Is this truly a CUT?

Recessionary Budget Cuts: FY 01-02 to FY 04-05

- Just under $1 Billion in actions taken to balance the General Fund
- Most were in the form of cuts; Some took form of one-time accounting manipulations and borrowings from other funds
Major General Fund Departments and Their Percent Share of Budget Reductions, FY 2001-02 to FY 2004-05
Total 4 year reductions $974,244,635

- Corrections 5%
- K-12 29%
- Health Care Policy 10%
- Higher Education 18%
- Human Services 12%
- Judicial 2%
- Other 24%

Source: Joint Budget Committee, November, 2004

---

Major General Fund Departments and Their Total Budget Reductions, FY 2001-02 to FY 2004-05
Total 4 year reductions $974,244,635

- Corrections
- K-12: 229,655,655
- Health Care Policy: 47,033,691
- Higher Education: 284,308,227
- Human Services: 177,355,653
- Judicial
- Other: 17,358,066

Source: Joint Budget Committee, November, 2004
What is the Ratchet?

- TABOR’S mechanism that rebases state’s allowable budget at lower of actual revenue collections or previous year’s limit.
- Generally will only happen during recession when revenues fail to support fiscal year spending up to the allowed limit.

![Graph showing TABOR Limit and TABOR Revenue](image)
The Ratchet: Impact During Recession and Recovery

- Ratchet did not cause the recessionary cuts; Decline in revenue did
- Ratchet will be fully felt upon economic recovery
- Ratchet essentially “created” the surplus; Without ratchet all projected revenue would be available to state

The Ratchet Imposed Squeeze on the General Fund

- Largely caused by interaction of TABOR and 6% limits
- Structural deficit is legacy of this interaction and ratchet
- Closing structural deficit requires either revenue increase (impossible under TABOR limit) or decrease in expenditures
- Under TABOR, only means to close structural deficit is cuts, even as General Fund grows modestly and state revenue sufficient for 6% growth
The Structural Deficit and TABOR Refunds

<table>
<thead>
<tr>
<th></th>
<th>FY 05-06</th>
<th>FY 06-07</th>
<th>FY 07-08</th>
<th>FY 08-09</th>
<th>FY 09-10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual</td>
<td>$55</td>
<td>$339.3</td>
<td>$161</td>
<td>$33.4</td>
<td>$39.2</td>
</tr>
<tr>
<td>Cumulative</td>
<td>$55</td>
<td>$394.3</td>
<td>$555.3</td>
<td>$588.7</td>
<td>$627.9</td>
</tr>
<tr>
<td>Est'd Annual TABOR Refund</td>
<td>$116.7</td>
<td>$490.5</td>
<td>$618.7</td>
<td>$799.1</td>
<td>$881.5</td>
</tr>
</tbody>
</table>

Source: Legislative Council June 21, 2001 Forecast

Closing the Structural Deficit: Sample of Scenarios

- Scenario 1: Allocate future actions in proportion to past ones
- Scenario 2: Eliminate departments deemed “discretionary”
- Scenario 3: Targeted reductions
  - Medicaid Optional Services
  - Higher Education College Opportunity Fund (COF)
- Scenario 4: Creation of Additional Enterprises
Scenario One

Closing the Structural Deficit:
Cuts as a Percentage of Estimated FY 09-10 Budget

Infeasibility of Scenario One

- Eliminates Treasury almost twice
- Not possible to backfill K-12 cuts with State Education Fund
- Higher Education funding changed with SB 189; Would likely need to modify the COF
- Over 50% decrease in 4 departments; Probably not sustainable
- RESULT: More directed cuts
Scenario Two

- 95% of General Fund budget in 6 largest departments
- Elimination of 13 other departments that receive General Fund appropriation would only close approximately 73% of structural deficit at end of FY 06-07

The 95% and the 5%

- 95% Departments
  - Higher Education
  - Education
  - Judicial
  - Corrections
  - HCPF
  - Human Services

[Image of pie chart showing allocation of FY 2005-06 General Fund appropriation]
The 5% Departments: Really Disposable?

- Regulatory Agencies
- Military and Veterans Affairs
- Agriculture
- Law
- Personnel and Administration
- Local Affairs
- Public Health and the Environment
- Governor
- Natural Resources
- Treasury
- Legislature
- Public Safety
- Revenue

Scenario Three

- Dedicated cuts to specific services
  - Higher Education COF
  - Medicaid Optional Services
The College Opportunity Fund

- Around 132,000 student FTEs according to CCHE’s latest estimates
- Current level of the COF is $2400 per FTE
- At that rate elimination of the COF would yield just over $317 Million
- Would not close the FY 06-07 structural deficit

Medicaid Optional Services

- Estimated FY 05-06 General Fund Medicaid premium expenditures = approximately $1B
- FY 01-02 approximately 48% of Medicaid premiums were for optional services and populations
- $480M of General Fund expenditures associated with optional services and populations
- In FY 06-07 cumulative structural deficit estimated at just under $400 M
- Every state dollar cut foregoes federal matching funds
Scenario Four

- Create additional enterprises and fund with fees
- Leading candidate is state parks
- Eliminating General Fund appropriation for Parks would close 1.25% of FY 2006-07 structural deficit
- Funding for Parks would become more vulnerable to vacillations in economy and weather

Referendum C:
Colorado’s Proposed Solution

- Allows state to retain TABOR surplus revenue for 5 years without regard for revenue limits
- Earmarks retained revenue for education and health care
- Would allow 6% growth in General Fund and eliminate structural deficit
- Rebases budget and eliminates ratchet effect in the future