TABOR, its Ratchet, and Colorado's Economic Future

Federation of Tax Administrators
Revenue Estimating Conference
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NEW WEST ECONOMICS

Presentation Outline

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

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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

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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

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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

Major Provisions of TABOR (cont'd)

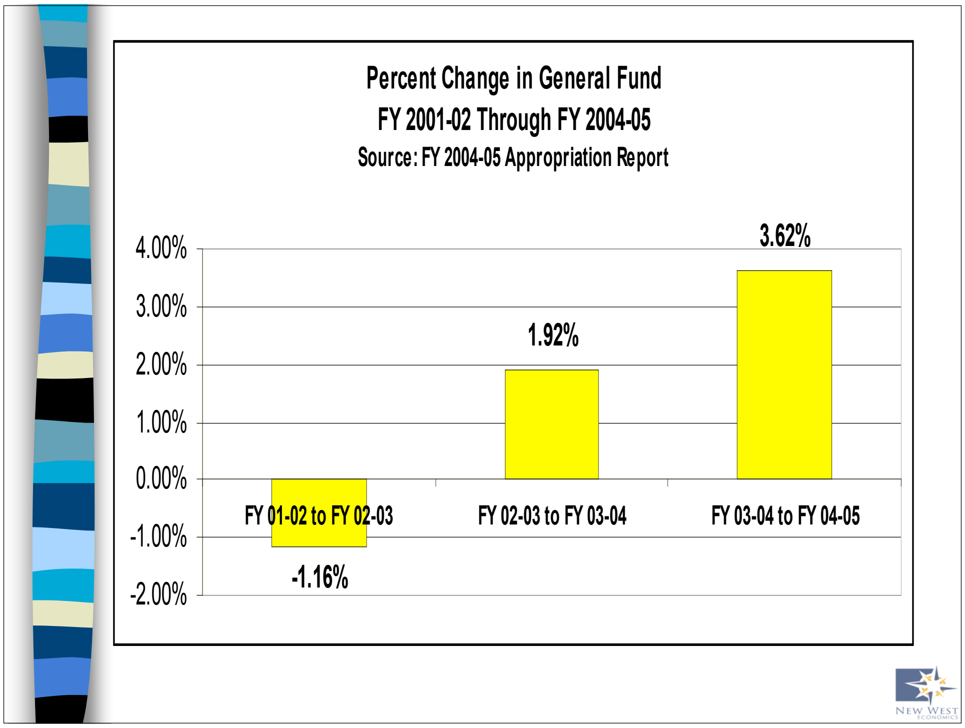
- Emergency reserve of 3% can't cover economic downturns
- Enterprise declaration by programs receiving less than 10% of revenue from state
- Direct prohibition of specific taxes such as real estate transfer taxes, state property tax, and local income tax

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
4.00%
3.00%
2.00%
1.00%
0.00%
-1.00%
-2.00%
3.62%
1.92%
-1.16%
FY 01-02 to FY 02-03
FY 02-03 to FY 03-04
FY 03-04 to FY 04-05
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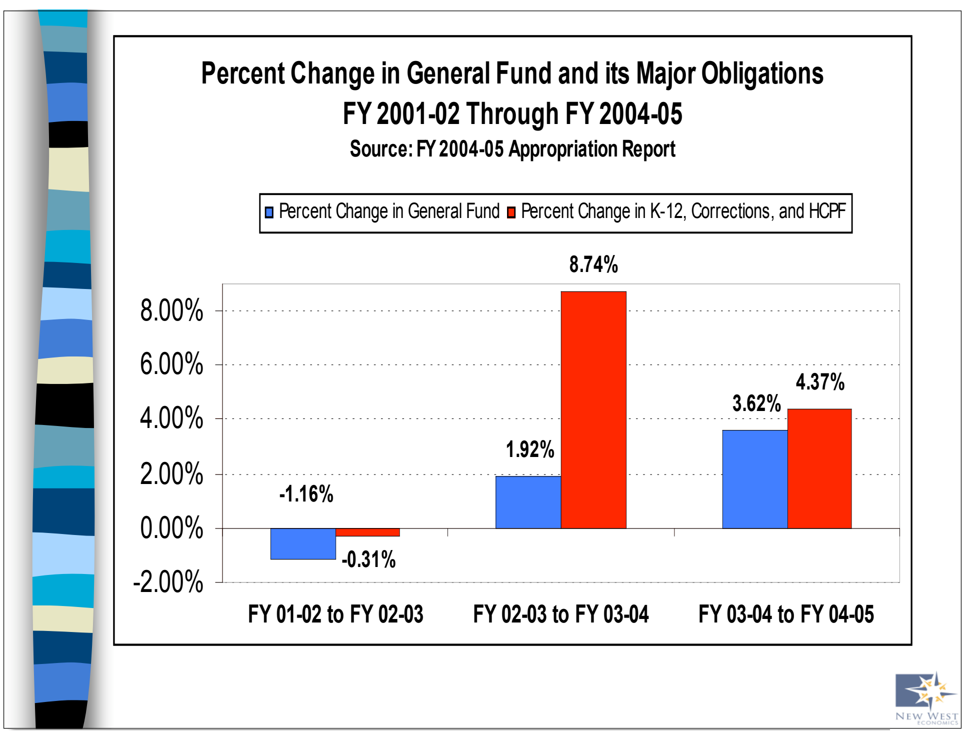
Percent Change in General Fund and its Major Obligations
FY 2001-02 Through FY 2004-05
Source: FY 2004-05 Appropriation Report
Percent Change in General Fund
Percent Change in K-12, Corrections, and HCPF
8.74%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
4.37%
3.62%
1.92%
-1.16%
-0.31%
FY 01-02 to FY 02-03
FY 02-03 to FY 03-04
FY 03-04 to FY 04-05
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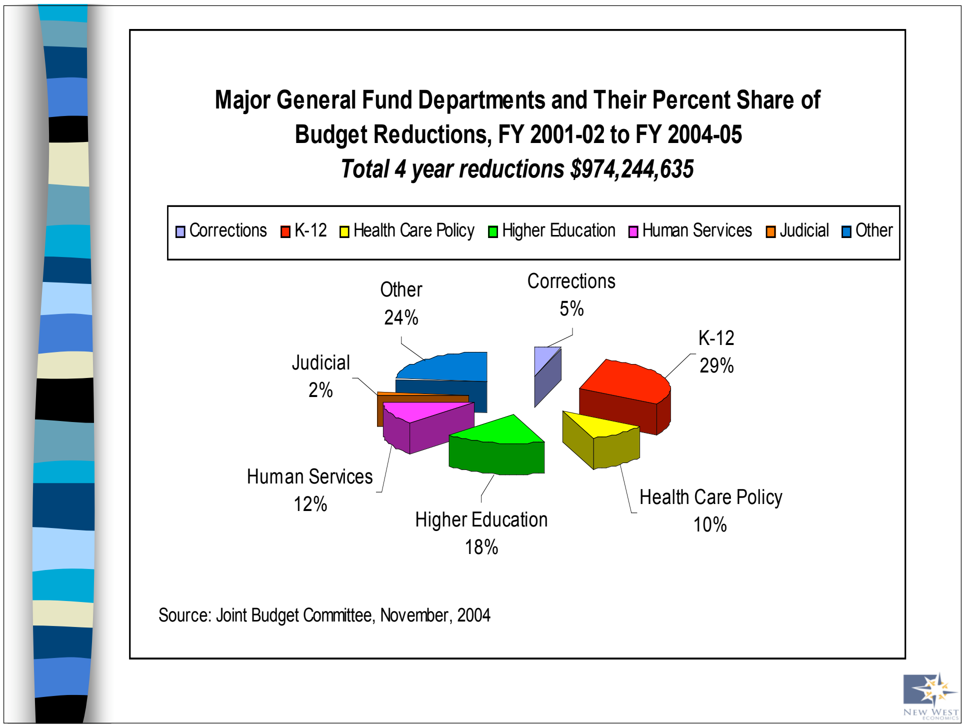
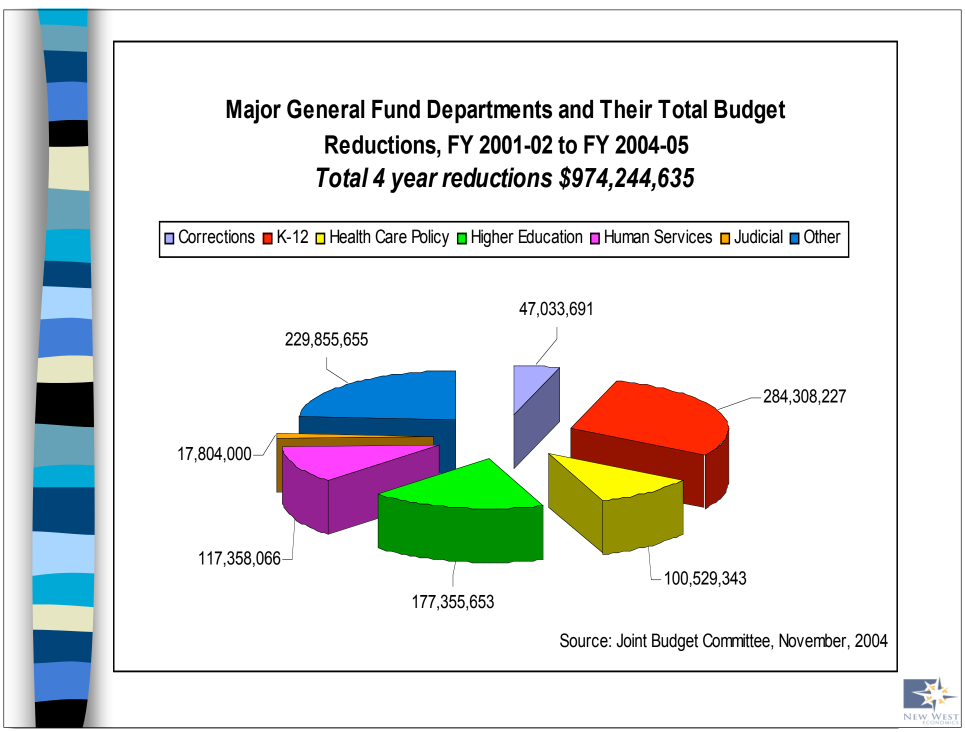
The Past: The Recessionary Squeeze on the General Fund

- General Fund decreased or grew modestly
- At 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

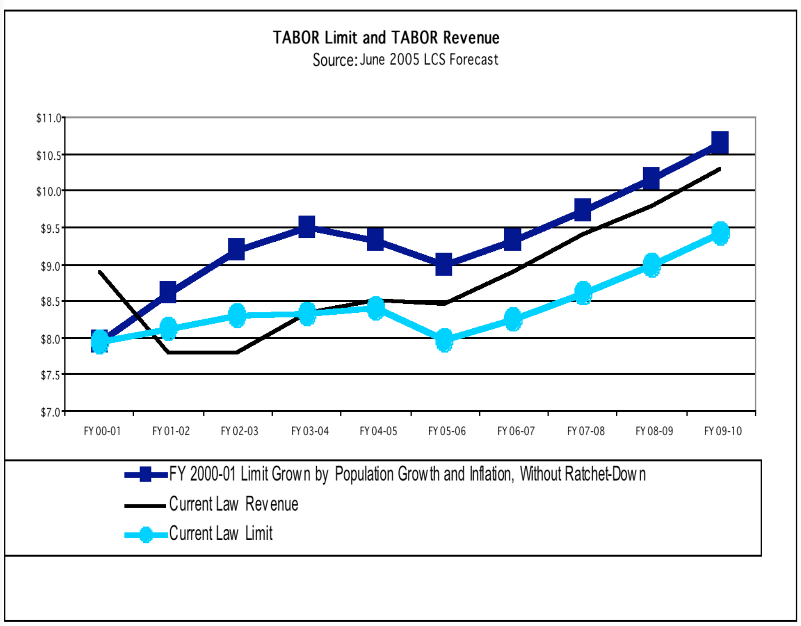
- Just under $1 Billion in actions taken to balance the General Fund
- Most were in the form of cuts; Some took form of one-time accounting manipulations and borrowings from other funds


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 K-12 Health Care Policy Higher Education Human Services Judicial Other
Other 24%
Corrections 5%
K-12 29%
Judicial 2%
Human Services 12%
Higher Education 18%
Health Care Policy 10%
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 Health Care Policy Higher Education Human Services Judicial Other
47,033,691
229,855,655
284,308,227
17,804,000
117,358,066
177,355,653
100,529,343
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



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

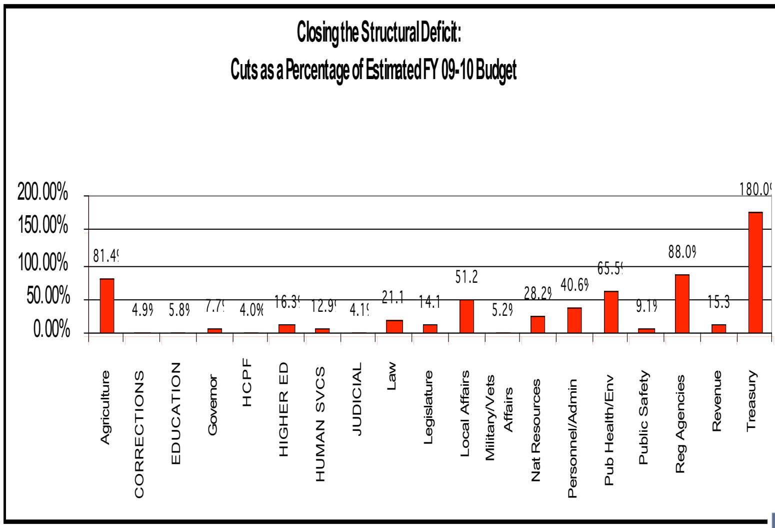
The Structural Deficit and TABOR Refunds

Annual and Cumulative Estimate of Structural Deficit and TABOR Refunds					
Dollars in Millions					
	FY 05-06	FY 06-07	FY 07-08	FY 08-09	FY 09-10
Annual	$55	$339.3	$161	$33.4	$39.2
Cumulative	$55	$394.3	$555.3	$588.7	$627.9
Est'd Annual TABOR Refund	$116.7	$490.5	$618.7	$799.1	$881.5
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



Infeasibility of Scenario One

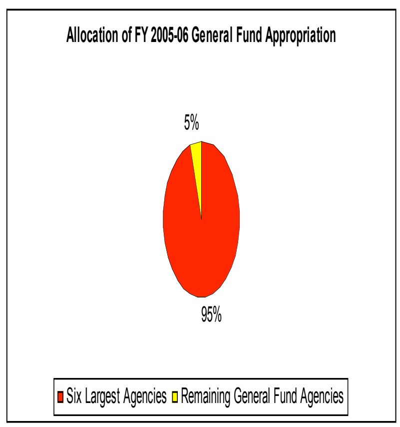
- Eliminates Treasury almost twice
- Not possible to backfill K-12 cuts with State Education Fund
- Higher Education funding changed with SB 189; Would likely need to modify the COF
- Over 50% decrease in 4 departments; Probably not sustainable
- RESULT: More directed cuts

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



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