

Introduction

February 2003

Colorado now has ten years of experience with the Taxpayer's Bill of Rights (TABOR). Over the last year, the Bell Policy Center has conducted extensive research and analysis about the overall impact of this amendment at the state level. The result is this report, which examines seven specific issues that, together, help us answer the critical question: Is TABOR working for Colorado?

TABOR clearly has achieved its primary and single-minded goal of restricting the growth of government.

But this study also shows that TABOR's successes have come at a very high cost—indeed, too high a cost. **There are major structural flaws in the amendment that seriously impair the state's ability to set budgetary and programmatic priorities and to respond to the changing needs of a growing state—or to crises such as the current economic downturn. TABOR has created a state government hamstrung by inflexible rules that make it less responsive and less effective.**

TABOR is not a single provision of law. It is a collection of requirements so complex that today, it would not be allowed on the state ballot as a single measure.

Our study points to four areas of particular concern:

- **TABOR's revenue growth limit is too restrictive, even in the best of times, making it almost impossible for state government to meet critical needs;**
- **The ratcheting effect of this growth limit continually downsizes government, making cuts virtually permanent.** When the state experiences a temporary revenue shortfall during an economic downturn, TABOR makes it nearly impossible to restore program cuts in good economic times;
- TABOR contains a series of complex and often redundant provisions that **greatly restrict budget-making flexibility**, even within the overall limit on growth; and
- TABOR contains provisions that **make it very difficult for the state to take advantage of surpluses in good times (e.g. create a Rainy Day Fund) to save for bad times.**

In the end, TABOR is too restrictive and too complicated, and many of its specific provisions are unnecessary.

Policy-makers frequently talk about a family budget to explain how government can better conduct its business. Families should not live beyond their means, they say, and neither should government.

Introduction

Applying the logic of TABOR to a family's finances highlights the concerns raised in this report. A family budget, by necessity, is shaped by a mixture of immediate needs, future plans, and changing priorities. If TABOR applied to families, they would not be able to invest or save in good times in order to avoid hardship in bad times. If TABOR applied to families, those having trouble making ends meet would not be allowed to find more work to increase income—by taking a second job, perhaps, or working overtime. If TABOR applied to families, workers would have to refuse merit raises above inflation and might even have to give back any bonuses.

A family that ran its finances according to TABOR could well go bankrupt. Our fear, based on the findings in this study, is that Colorado is headed in precisely that direction.

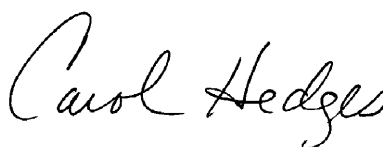
- **Without reform, the revenue limits in TABOR will continue to squeeze critical programs until they become ineffective and eventually disappear.**
- **Without reform, the ratcheting effect of TABOR will make permanent those often draconian cuts that are needed during temporary downturns in the economy. The worst of times will become the new definition of the best of times.**
- **Without reform, the state will be incapable of adjusting to the needs of a changing population—leading to an increasingly ineffective, inefficient, and ultimately irrelevant government.**
- **Without reform, TABOR will make it virtually impossible for Colorado to create a true Rainy Day Fund as a hedge against future budget cuts.**

This may be what some proponents of TABOR have in mind. But it cannot be what the people had in mind when they adopted TABOR. This is an unacceptable future for our state and its citizens.

Colorado can learn from ten years of TABOR by changing or even eliminating those provisions that are most problematic. Our hope is that this study will stimulate an informed discussion about how to make government work for all Coloradans.



—Wade Buchanan
President



—Carol Hedges
Sr. Policy Advisor and Director, Fiscal Project;
TABOR Study Author

Ten Years of TABOR: An Executive Summary

In 1992, Colorado voters approved the Taxpayer's Bill of Rights (TABOR), a constitutional amendment designed to restrain growth in government. The passage of TABOR, the most far-reaching state policy change in at least a generation, coincided with record economic expansion in Colorado, the Rocky Mountain region, and the country.

While most states operate with some tax or spending limits, **TABOR is the most restrictive limitation in the country**, with controls on the amount of revenue that can be collected and spent, as well as on how and which taxes can be raised. Some believe this restraint is necessary. The argument is that smaller government is always better, and that authority for making decisions about the level of taxation and spending should rest exclusively with voters.

Philosophically, these arguments are appealing: Everyone wants efficient government and a role in how our money is spent. At the same time, most of us would agree that effective government must be responsive to changing economic conditions and citizen needs.

Under TABOR, Coloradans have had an unprecedented opportunity to set state fiscal policy through the ballot box. And under TABOR, state government has grown only slightly. **But our research also points to structural flaws in the amendment that have seriously impaired the state's ability to set budgetary and programmatic priorities and respond to crises, such as the current economic downturn, and the unanticipated needs of its citizens. In short, TABOR has created a state government hamstrung by inflexible rules that make it unresponsive and less effective.**

In the following sections of this report, we present our research and specific conclusions on seven issues that we studied. The purpose of this Executive Summary is to examine the aggregate effect of these issues on state government in Colorado. In brief, here's what we found:

- TABOR's revenue limit and weakening provisions have **limited the overall growth of government, but not all programs have been impacted equally.** Programs driven by forces outside the budget process (such as federal mandates and health care costs for Medicaid) or longer-term policy decisions (such as sentencing laws and parole practices that help drive the Corrections budget) appear to have largely escaped TABOR's effect. This means that other programs (such as Higher Education and Public Health) have borne a disproportionate share of the spending reductions and will continue to do so in the future.
- **Since the passage of TABOR, Coloradans have paid less local and state taxes.** Colorado now ranks 43rd among all states in total tax collections as a percentage of personal income. What is not clear, however, is TABOR's role in that decreasing tax burden.
- **The aggregate effect of the TABOR refund mechanisms selected by the Legislature has been progressive in the strict sense of the word—**lower-income Coloradans have received a larger percentage of their overall income back than have higher-income Coloradans. On the flip side, the legislature also selected seventeen different refund mechanisms or contingent tax credits, some of which have disproportionately benefited the richest taxpayers.
- **TABOR was not in any important way responsible for Colorado's economic growth during the 1990s.**

The clearest relationship for strong economic growth during that period was regional.

- **TABOR will have a major negative impact on the ability of critical government programs to recover from the current economic downturn**, primarily because of the ratcheting effect and the inability to raise taxes without voter approval. The difficulty of establishing a Rainy Day Fund under TABOR exacerbates this problem.

- **TABOR has not increased voter participation.** It has increased the number of times voters visit the polls, but the low turnout for off-year elections (created expressly to address TABOR issues) has **resulted in less than 20% of voters deciding critical fiscal policy issues.**

- **TABOR has diminished the role of elected officials**, limiting their ability to adjust the budget to reflect changing needs and economic conditions.

TABOR AND SPENDING:

The amendment's primary stated goal is to restrict growth in state government. Between 1992 and 2002, total state spending increased more than inflation and population by slightly less than 1% per year.

To test whether TABOR's revenue limit affected Colorado spending, we examined a group of states that were similar economically (see page 29 for more information about how peer states were chosen). We found that compared to 10 peer states, Colorado's increases were roughly half the average rate of growth. This low rate was not due to sagging state revenues; in fact, it came at the same time Colorado was growing the fastest among all 50 states in personal income, the third fastest in gross state product, and the fourth fastest in employment. In real per capita spending, both in Total Funds and General Funds, Colorado had the second lowest rate of growth among the peer states. At the most basic level, **TABOR placed a limit on**

spending that in the latter part of the decade was well below the level of actual revenues. This obviously was a key factor in determining the overall growth rate of government expenditures in Colorado.

More interesting, within that new and lower spending limit, **not all programs have been equally impacted by TABOR's restrictions.** With or without spending limitations, program areas grow at different rates. However, we found a disturbingly consistent pattern to the distribution of growth in appropriations in Colorado. The programs that experienced significant growth were those where the General Assembly's options were dictated by other laws or outside forces. It is troubling that many parts of the budget that have shrunk—most notably Higher Education—are critical to opening gateways to opportunity and promoting self-sufficiency, while some of those that have grown—most notably Corrections—are not.

This is significant on several levels:

- **It supports the assertion that the decision-making role of legislators has been diminished.**

- **It suggests that those programs that were losers in this process in the 1990s will continue to be the losers in the future**, since outside and relatively fixed forces now play a more important role in determining priorities than legislators and governors.

- **This dynamic has led advocates for specific issues to seek ways to protect their programs from the effects of TABOR.** The most obvious example of this is Amendment 23, in which voters essentially created a mandate for education funding. Other races to the ballot would further marginalize programs that must bear an increasing burden of cuts.

Talking TABOR: Defining Terms

A number of terms in this publication, ranging from “debrucing” and “ratcheting” to “total funds” and “weakening provision” are included in a Glossary that begins on page 60.

TABOR AND TAXES:

Colorado has never been a big “tax and spend” state. Between 1989-2000, the amount of taxes paid as a percentage of personal income actually dropped—from 10.1% to 9.8%. Historically, Colorado’s ranking of combined state and local taxes as a percentage of income has hovered around the middle of all states—22nd in 1979 and 28th in 1989. Since TABOR’s passage, Colorado’s ranking has dropped to 43rd.

TABOR’s role in reducing the overall tax burden, however, is unclear. **There are two reasons the burden has declined over the last ten years: growth in personal income and permanent tax cuts. Neither is linked directly to TABOR.**

From 1998-2002, the tax burden fell beyond what can be explained by growing revenue and falling permanent tax rates. The contingent tax credits adopted by the Legislature to refund revenue collected in excess of the TABOR limit lowered the burden in 2000, for example, from 9.8% to 9.1%. The reduction in tax burden was limited to the years when the state had significant revenue growth.

Have the contingent tax credits benefited the poor more than the middle class and wealthy?

We found that the General Assembly’s plan to refund excess revenue through contingent tax credits resulted in the average low-income taxpayer receiving a higher portion of his income in refunds than did the average high-income taxpayer. The average refund for the taxpayers earning under \$26,000 was \$252 compared to an average of \$1,630 for taxpayers earning more than \$126,000.

We also found that individual refund mechanisms benefited groups of taxpayers differently. For example, the ten largest filers for the Colorado Capital Gains Tax Refund received an average payment of over \$671,000. The maximum refund given for the Earned Income Tax Credit, generally available to low-income individuals and families, was \$388.

It is also important to remember that individual taxpayer refunds were short-lived. Most of these tax credits were only funded in tax years 2000 and 2001. Current projections are that the credits will not be available again until at least 2005.

TABOR AND THE ECONOMY:

Did moving tax revenue into the hands of individuals stimulate our economy? **There is nothing to indicate that either the passage of TABOR in 1992 or the beginning of state refunds in 1998 had a specific effect on the rate of economic growth.**

Colorado had one of the strongest economies in the nation in the 1990s— third overall in growth in Gross State Product and fourth in employment growth. Both trends started before the passage of TABOR in 1992 (and before we reached the state TABOR limit for the first time in 1997). **The strong growth is more likely attributable to characteristics Colorado shares with other states in the region—climate, environment, lifestyle, clean industry, and diversifying economies.** In addition to Colorado, the fastest growing states in the 1990s included Arizona, Utah, Idaho, and Nevada.

A generally conservative approach to fiscal and tax policy may be one of the characteristics of western states that contributed to high growth, which may also explain why all have adopted growth limits. Even so, states with less-stringent provisions, more generous growth allowances, and easier waiver provisions still fared very well economically. **This suggests that if TABOR played any role at all in the strong economy, it was not due to its more stringent provisions that are missing in other states.**

While we found no relationship between TABOR’s strict provisions and the economic growth of the 1990s, **we did find evidence that TABOR will make it more difficult for state spending in Colorado to recover from the current economic downturn.**

Colorado's revenue has dropped dramatically during the current economic slowdown. We project that the method of calculating growth in the revenue limit will result in **the state not being able to ever recover the costs associated with inflation and population growth experienced in 2001, 2002, and possibly 2003. This effect, known as ratcheting, restricts growth so that if the state experiences falling revenue, it becomes impossible for spending to keep pace with growth in population and inflation.**

Further, we found that the nature of the growth formula calculation provides a disincentive for the

state to save for poor economic times. The resulting lack of a Rainy Day Fund has meant deeper budget cuts in the last 18 months.

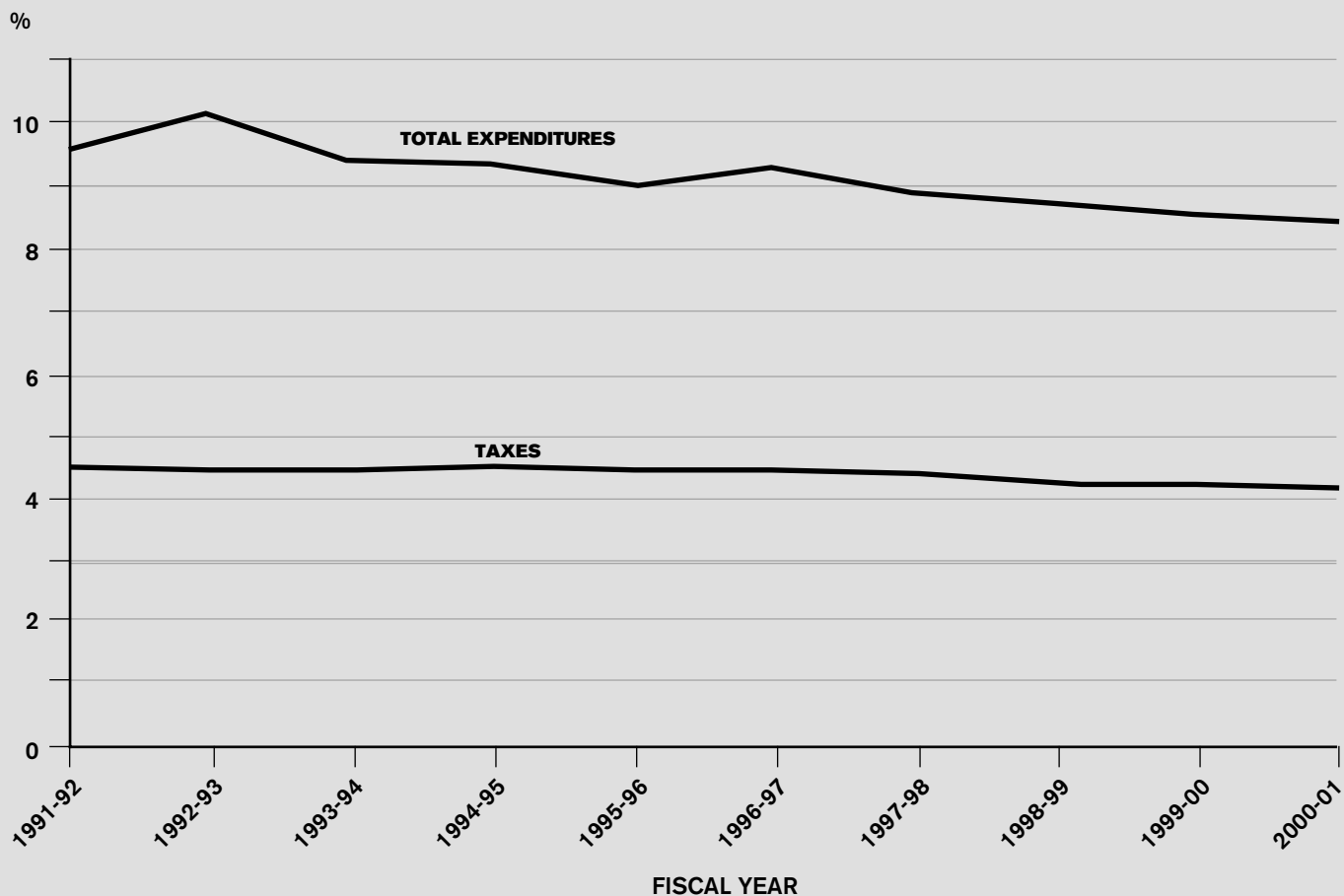
TABOR AND REPRESENTATIVE DEMOCRACY:

TABOR requires voter involvement in a wide variety of financial activities, from approval of all tax and revenue increases to whether governments can keep revenue collected in excess of the TABOR limit. Our review of voter participation data for statewide elections since 1982 indicated that **since the passage**

TABOR AND GROWTH IN GOVERNMENT

TABOR has not restricted growth in government; it has shrunk it. This means that government expenditures and taxes have fallen as a percentage of state gross product.

State Expenditures and Tax Revenue as a Percent of Gross State Product



Source: Comprehensive Annual Financial Report, June 30, 2002, State Controller's Office, CO Department of Personnel and Administration.

of TABOR, the number of fiscal policy issues considered by voters has increased. We also found that in off-year elections, which are devoted exclusively to fiscal matters, a very small number (30%) of voters participate—less than half of those who voted in the prior presidential election. The end result is that fewer than 20% of voters actually decide fiscal policy in off-year elections.

TABOR has, at the same time, reduced the role of elected officials in the fiscal and budget process.

Nearly all the elected officials we interviewed told us that TABOR had made the budgeting process less flexible, which decreased their ability to make decisions on behalf of their constituents. Most also said that TABOR had made them less likely to

propose or support ballot measures to raise revenue. The majority of respondents expressed frustration at the additional bureaucracy and cost incurred in implementing TABOR.

THE REPORT:

These and other findings are discussed in detail in the following chapters, which are grouped around the seven questions that formed the basis for our research. More information about this study is on our website at www.thebell.org.

THE BELL STUDY:

In 2002, the Bell set out to study the impact of ten years of TABOR. We surveyed a broad spectrum of opinion leaders from around the state to identify the most common perceptions about the amendment. We identified seven main issues to study. Following is a list of our most important research findings:

1. Has TABOR affected state expenditures in education, health care, human services, public safety, or other programs?

- Colorado's overall per capita real dollar appropriations grew slower than all but one of the peer states (Arizona).
- Colorado's growth in per capita real dollar funding for K-12, Higher Education, and Public Health ranked last or next to last compared to our peer states.
- Within the state budget, funding for Higher Education, Public Health, and K-12 Education grew slower than the overall budget, while

funding for Transportation, Human Services, Medicaid, and Corrections grew more quickly. Specifically:

- Real dollar funding for Higher Education and Public Health in Colorado actually declined in the last 10 years.
- The growth rates for Medicaid and Corrections in Colorado were four times higher than the growth rate of overall spending during the last ten years.
- As a percentage of overall state spending between 1982 and 2002, K-12 and Higher Education declined while Corrections and Medicaid grew.

2. Has TABOR affected the tax burden of Coloradans?

- Individual tax burden has fallen since 1979 as compared to other states. That year, Colorado ranked 22nd among all 50 states in state and local tax burden. In 1989,

Colorado ranked 28th, and by 2000, Colorado's ranking dropped to 43rd.

- The tax burden in 2000 was 9.8% of income compared to the national average of 10.8%.

- That same year, TABOR's contingent tax credits dropped the tax burden to 9.1% of personal income, tying it with two other states for the ranking of 46th.

3. Has TABOR created an overall tax system that is less regressive?

- Taxpayers reporting annual income less than \$26,000 received an average refund from all contingent tax credits of \$252, or 1.98% of the average adjusted gross income for filers in the income class.

- Taxpayers reporting annual income of more than \$126,000 received average refunds from all contingent tax credits of \$1,629.80, or .38% of the average adjusted gross income for filers in the income class.

- The contingent tax credits benefited different groups differently. The ten largest tax filers for the Capital Gains Tax Refund received average refunds of \$671,000, or 157% of the average Adjusted Gross Income (AGI) for filers in the income class \$126,000 and over.

- The ten largest filers for the Earned Income Tax Credit received an average of \$57, or .15% of the average AGI for filers in the income class \$26,001-\$53,000.

4. Has TABOR played a role in the growth of the state economy since 1992?

- Colorado had one of the strongest economies in the nation in the 1990s—third overall in Gross State Product (GSP) growth and fourth in employment growth.

- The five fastest-growing states in the nation (measured by employment) were Utah, Colorado, Arizona, Nevada, and Idaho. Five of the six top growing states (all in the West) have some form of tax or spending limitation; none is as stringent as Colorado's.

- Neither passage of TABOR nor implementation of refunds changed the rate of growth in either GSP or employment, which appear to be linked most closely to regional factors.

5. Will TABOR affect the ability of state spending and services to recover from the current economic downturn?

- According to a November 2002 report of the National Conference of State Legislatures, Colorado had the third worst budget gap, at 9.2%. The national average was 3.6%.

- The ratcheting effect is real. By 2008, the revenue limit will be \$2 billion lower than it would be if the current downturn had not occurred.

6. Has TABOR increased citizen participation in fiscal issues?

- Since TABOR, the number of fiscal policy issues considered by voters has increased.

- Most voters vote “down the ballot” to make a choice on fiscal issues. In other words, if voters come to the polls to vote on “big” items, such as for president or governor, they also vote on the fiscal issues on the ballot.

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- The smallest percentage of voters—roughly 30%—participate in off-year elections, when many fiscal issues are considered.

7. Has TABOR changed the role of elected officials in determining fiscal policy?

- TABOR has made it more difficult for elected officials to adjust spending limits and set budget priorities in response to citizen needs or changes in the economy.
- More than three-quarters of elected officials surveyed said that implementing TABOR has increased costs.
- The majority of those officials said TABOR made them less likely to propose or support a tax increase.

TABOR &
Government

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Understanding TABOR: A Primer

The TABOR amendment contains numerous provisions that directly affect the government's ability to raise and spend revenue. TABOR applies to all levels of government in Colorado, from special districts such as fire protection and schools to county and state governments. Although various levels are treated differently, TABOR'S primary objective is to "restrain most the growth of government" (Colorado Constitution, Article X, Sec. 20 (1)). Four of the most significant provisions of TABOR are:

1. TABOR Requires Voter Approval of Revenue Increases

TABOR requires advance voter approval of "any new tax, tax rate increase, mill levy above that for the prior year, valuation for assessment ratio increase for a property class, extension of an expiring tax or a tax policy change directly causing a net tax revenue gain" for any government. Tax rates, mill levies, and debt limits can be lowered without voter approval, but increasing them requires a positive vote.

2. TABOR Limits Revenue Collections

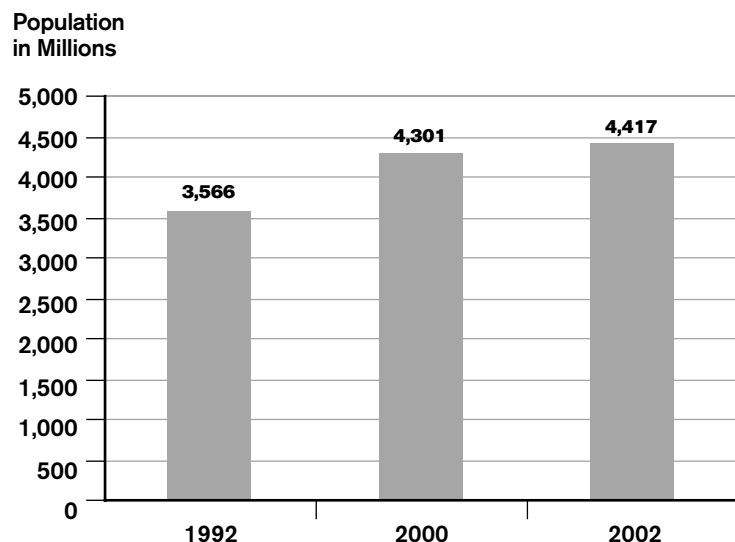
Referred to as spending limits in the state constitution, TABOR effectively limits the amount of revenue that a government can collect and keep by prescribing a formula for growth in spending (see box on next page) and requiring that all revenue in excess of that amount be returned to taxpayers.

In effect, TABOR prescribes that state government cannot grow faster each year than household-consumer prices (inflation) plus population growth, and that local government cannot grow faster each year than the value of net new construction plus the increase in inflation. Revenue collected in excess of these limits must be returned to the taxpayers in the following fiscal year by any "reasonable means,"

including refunds or temporary tax credits, unless voters approve of the government keeping and spending it.

Population change is one measure included in the TABOR growth formula at the state level. During the 1990s, Colorado's population increased an average of 2.3% per year—the third highest growth rate in the country. Between 1992-2002, the state's population grew to over 4.4 million people.

Population 1992 through 2002

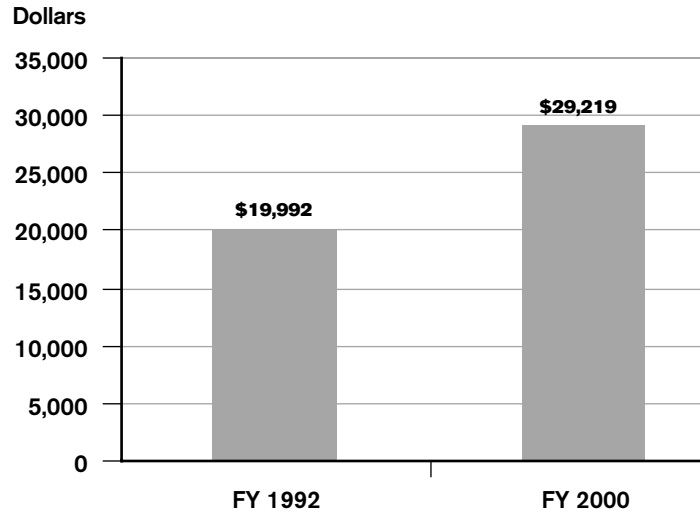


Inflation is the other factor used in the TABOR growth formula at the state level. The index of inflation used is the Denver-Boulder-Greeley Consumer Price Index (CPI). The CPI measures the costs of goods purchased by urban consumers in these areas. The CPI rose 24.2% from 1992 to 1998.¹

In 1997, the state exceeded the revenue limitation for the first time. From 1997 to 2001, the state exceeded the limit and used a combination of temporary tax credits and refunds to return the money to taxpayers.

The revenue collected in excess of the TABOR limit means that over \$3.2 billion has been returned by the state to taxpayers through a variety of refund mechanisms, including tax credits and sales tax refunds. Local governments also have refunded significant amounts to taxpayers. Permanent tax cuts and falling revenue due to the economic downturn have meant revenue collections have not exceeded the allowable limit since 2001.

**Per Capita Personal Income
1992 and 1998**



The second factor in the revenue equation is tax rates. For 1992-1998, state tax rates remained relatively stable. The state adopted permanent tax cuts in 1999 and 2000.

The combined effect of increasing personal income and stable or falling tax rates was that state revenue collections exceeded the TABOR limit each year between 1997 and 2001.

TABOR Formulas for Calculating Allowable Growth in Government Spending

CPI = Denver-Boulder-Greeley Consumer Price Index

State	Local	School Districts
CPI + % Change in Population	CPI + % Change in Net New Construction	CPI + % Change in Enrollment

3. TABOR Limits Spending

TABOR limits the ability of government to spend the revenue it raises. TABOR states that “other limits on...revenue spending and debt may be weakened only by future voter approval.” This rule, often referred to as the weakening provision, locked into place a 1991 state statute that limited growth in state General Fund appropriations to 6% over the prior year’s appropriation (or, if it is less, to an amount equal to 5% of state personal income). This 6% limit often is referred to as the Arveschoug-Bird Limit, named for its legislative sponsors. Similarly, some local governments had imposed spending limits which, after TABOR, could not be weakened without voter approval.

The primary factor affecting revenue at the state level is personal income. During the 1990s, Colorado’s per capita income grew the fastest in the nation. Between 1992 and 1998, per capita personal income grew over 46%. For 1998, per capita personal income was \$29,219. (1998 is the latest year that estimates of personal income are available from the U.S. Census Bureau.)

Expenditures can be lower than the statutory limits, but any money that is not spent in one fiscal year cannot be “saved” for use in the next year without being counted in the limit for that second year. Since the provision allows a percentage increase based on actual expenditures, any savings in one year effectively reduces the spending amounts in subsequent years.

The state limitation applies to General Fund operating expenditures for state programs and agencies. Growth in other expenditures, such as capital construction and cash funded programs, is limited only by the TABOR revenue limitation (CPI plus population growth) explained in item #2 above.

4. TABOR Limits Taxation Options

TABOR places limitations on the kinds of taxes that can be proposed and implemented. The amendment specifically prohibits new real estate transfer taxes, local income taxes and state property taxes. It requires that any state income tax change have a single rate, with no surcharges, and that all income tax increases begin in the year following their enactment.