COLORADO'S REVENUE BASE

PART 3

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Colorado's Revenue Base Basics

Key Findings from Reports 1 + 2:

- Income taxes comprise a large majority of the state's General Fund and are a critical source of funding for state expenditures.
- Colorado has invested in public programs at an uneven rate over the past two decades, even as the overall economy has grown.
- The General Fund has remained roughly stagnant – when adjusting for inflation and population growth – since 1999, even as the state has to cover more costs to support a growing population.
- State funding for K-12 education and Medicaid is more than 45 percent of the entire General Fund.
- The state share of Medicaid has consistently been 17-19 percent of the General Fund budget during the 2010s, even with the federal government picking up 90 percent of the cost of expanding Medicaid since 2016. As an example, in fiscal year 2018 the federal government spent $1.5 billion in Medicaid expansion costs, while Colorado spent only $99.4 million, according to the Kaiser Family Foundation.
- Funding for the Department of Corrections, K-12 education, and the state share of Medicaid combine to encompass more than 50 percent of Colorado's General Fund.

How Colorado's Revenue Base Has Changed Over Time

Colorado's sustainable, long-term funding base has been in need of serious examination. Given the uneven fiscal landscape the state has been traversing since early 2020, questions have arisen around how much money our state truly has to spend on important public programs. State lawmakers had to cut $3.3 billion in 2020 at the beginning of the pandemic, only to find out that tax revenues recovered quickly and federal stimulus helped plug many gaps. This revenue has allowed some flexibility in budgeting that Colorado hasn't seen in a very long time. There is now an opportunity to plan for the future and make smart investments that help communities across the state.

Given the nearly $4 billion allocated to Colorado from the American Rescue Plan to provide economic relief, our state has an opportunity to invest in systems and programs that work to help those that need it. But those federal dollars will only be available through 2024, leaving our state to depend on tax revenues and the General Fund to sustain our growing state into the future.

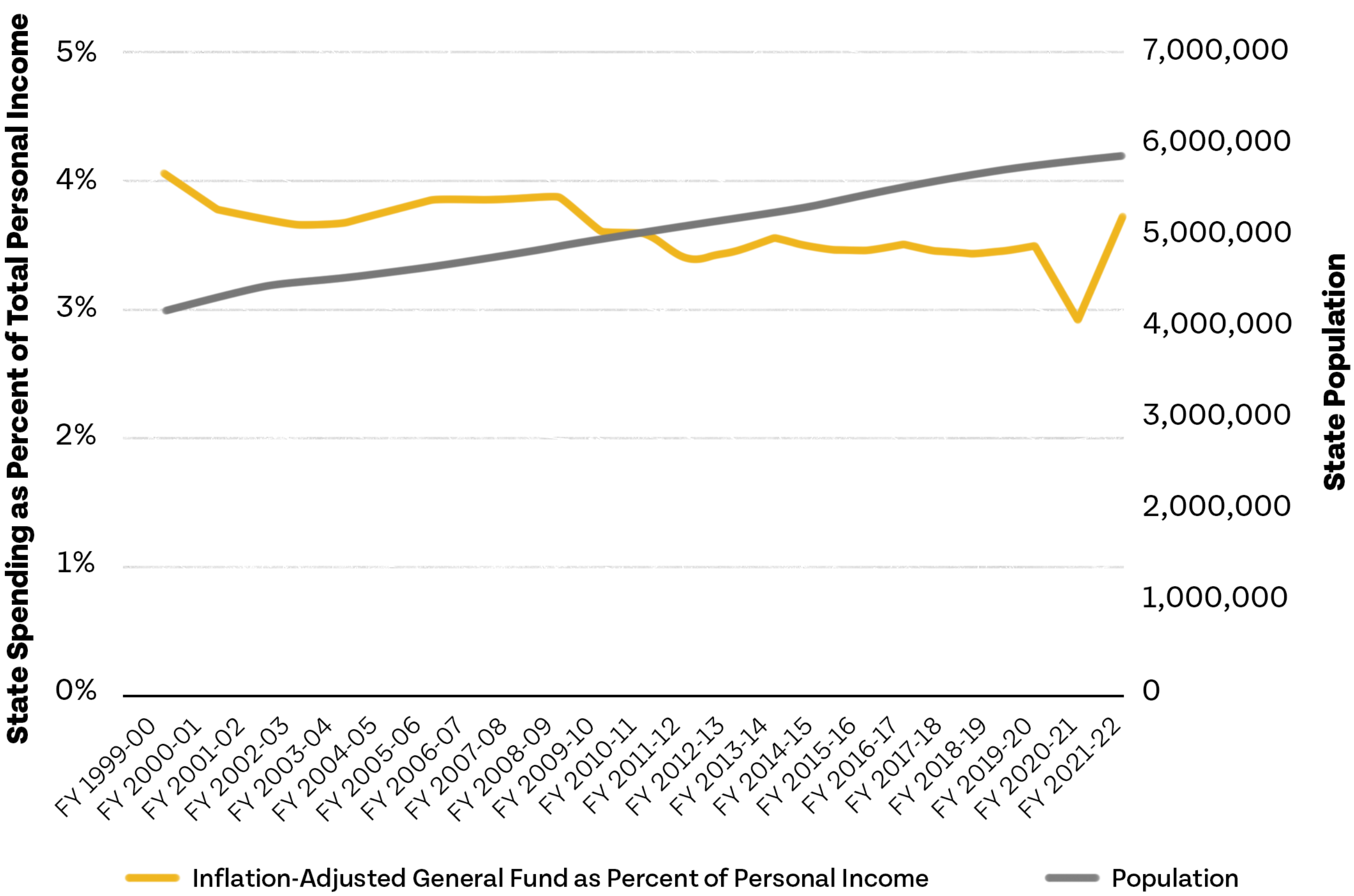
As we wrap up this series of reports, we will focus on how our revenue base will hold up over time, given the needs of our state. We will also present some hypotheticals on what would happen if various policy proposals to cut taxes come to pass. It is crucial to understand how tax cuts affect our state's ability to provide public services. There are growing efforts to reduce income tax rates at the ballot, even at a time when Coloradans are increasingly relying on public infrastructure for access to child care, health care, and education, and we need to better understand the implications of these strategies.

Overall General Fund and Revenue Cap Findings

As covered in [Part 1], our state's General Fund is the pot of money that lawmakers have the most control over. It hews closely to individual income tax revenue, and since the Great Recession, individual income tax revenue has been between 63.5 percent and 66.4 percent of the General Fund. In smaller amounts, the General Fund also includes some statewide sales and use tax, corporate income tax, and some insurance premium tax revenues. The General Fund is the foundation of most of our state government spending that is not already earmarked for certain programs.

Our General Fund has not kept pace with population growth and the overall growth of the economy. While some former programmatic expenditures have moved out of the General Fund to become enterprise funds, cash funds, and other non-discretionary items, that has just made room for other priority expenses, such as full-day kindergarten and necessary growth in other priority services areas.

Colorado General Fund as Percent of Total Personal Income

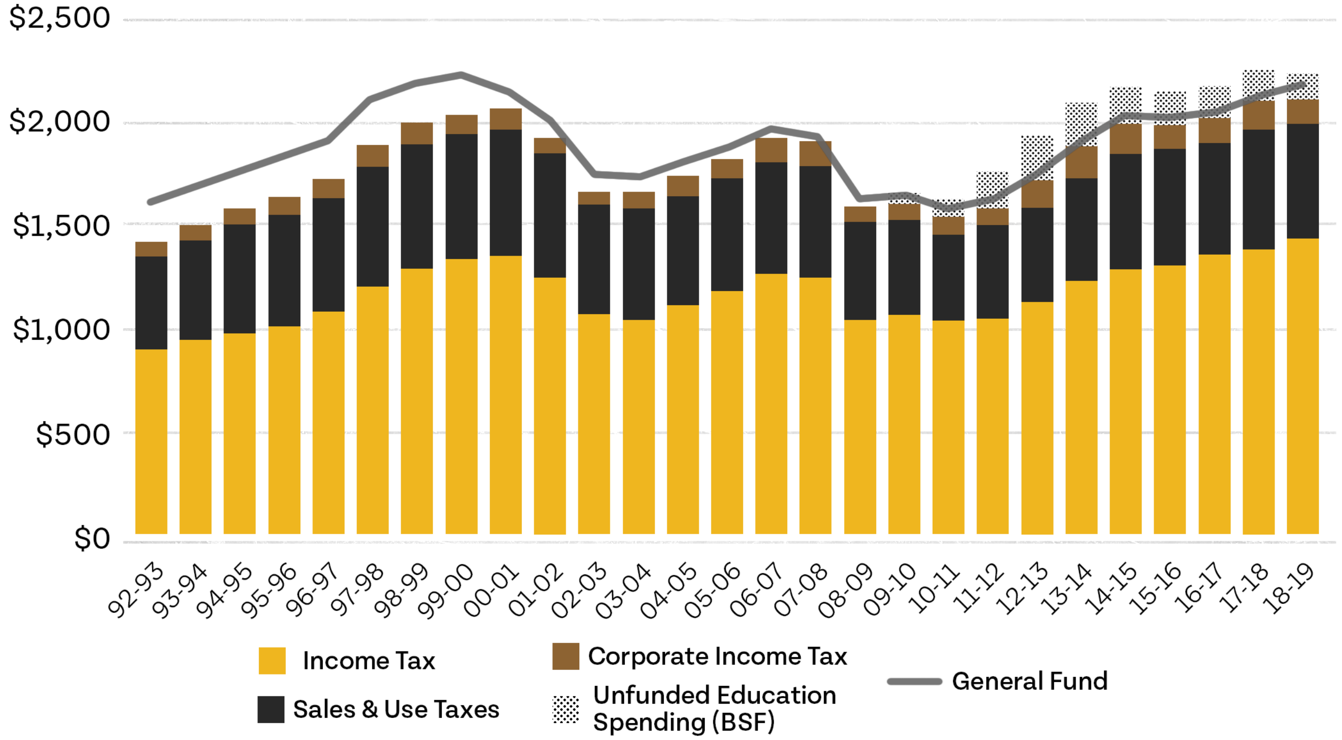


Source: Bell Policy Center analysis of Legislative Council Staff & FRED data

As the chart above shows, our current state spending as a percentage of personal income is below the level we were at in 2000. This means that even as overall income growth has occurred in Colorado, the General Fund has not matched that growth and is not currently reflective of our state's overall wealth. This trend is the result of income tax cuts and TABOR's revenue cap. The problem is that income tax cuts have reduced the available revenue for public services, and the revenue cap prohibits the state from investing all of the tax revenue that was properly paid into the system.

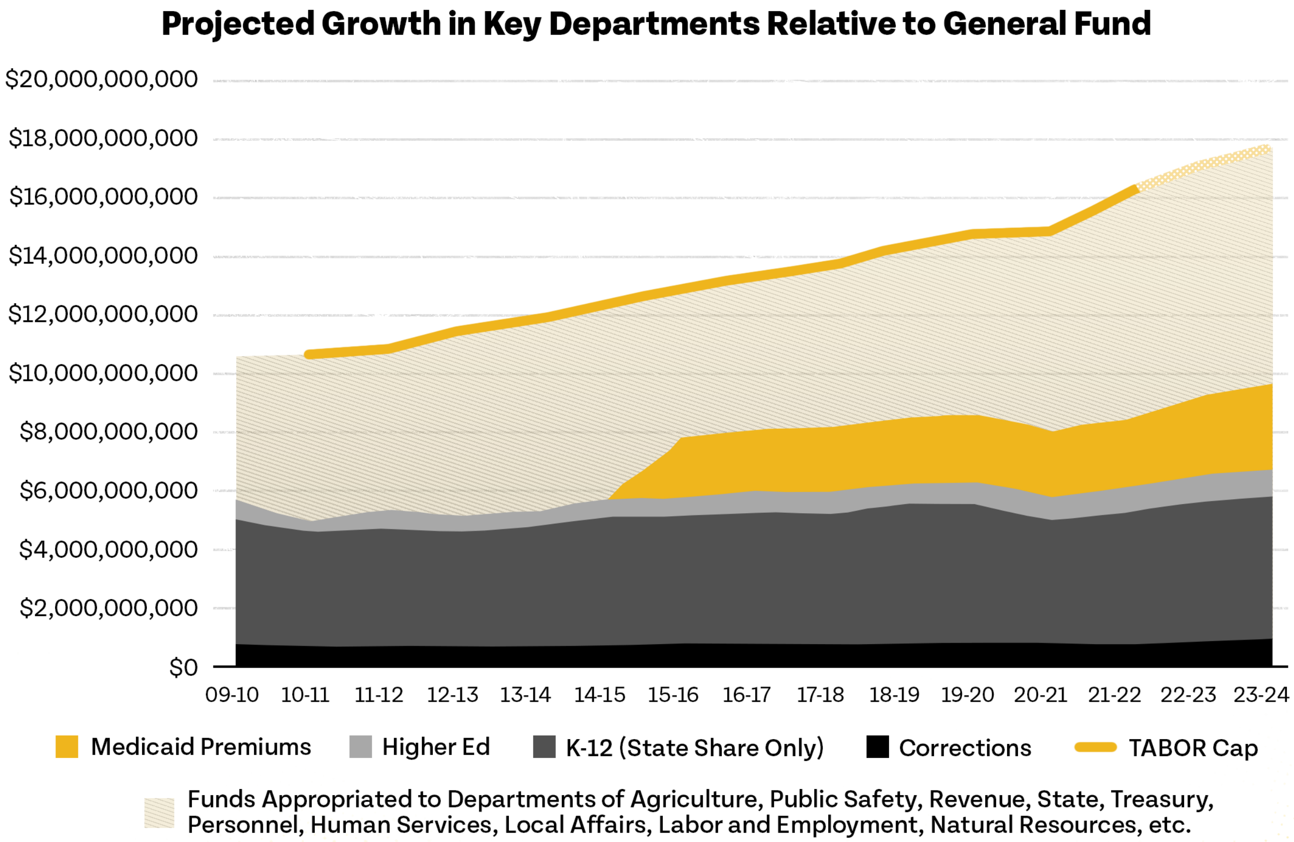
Unfortunately, short-term thinking while enacting long-term policies has been to the overall detriment of our state. Cutting taxes in good economic times – such as the legislature did in 1999 and 2000 – can make sense, but inevitable economic downturns will become worse with the permanent reduction in revenue. That lost revenue ends up resulting in cuts to services that Coloradans need.

Colorado Revenue Base Over Time by Source, Per Capita & Inflation Adjusted



Source: Bell Policy Center analysis of Legislative Council Staff & Colorado Department of Revenue data

Furthermore, preexisting spending priorities in areas like education, health care, and corrections are taking up a larger and larger share of our General Fund budget, and that trend is projected to continue going forward.



Source: Bell Policy Center analysis of Joint Budget Committee data

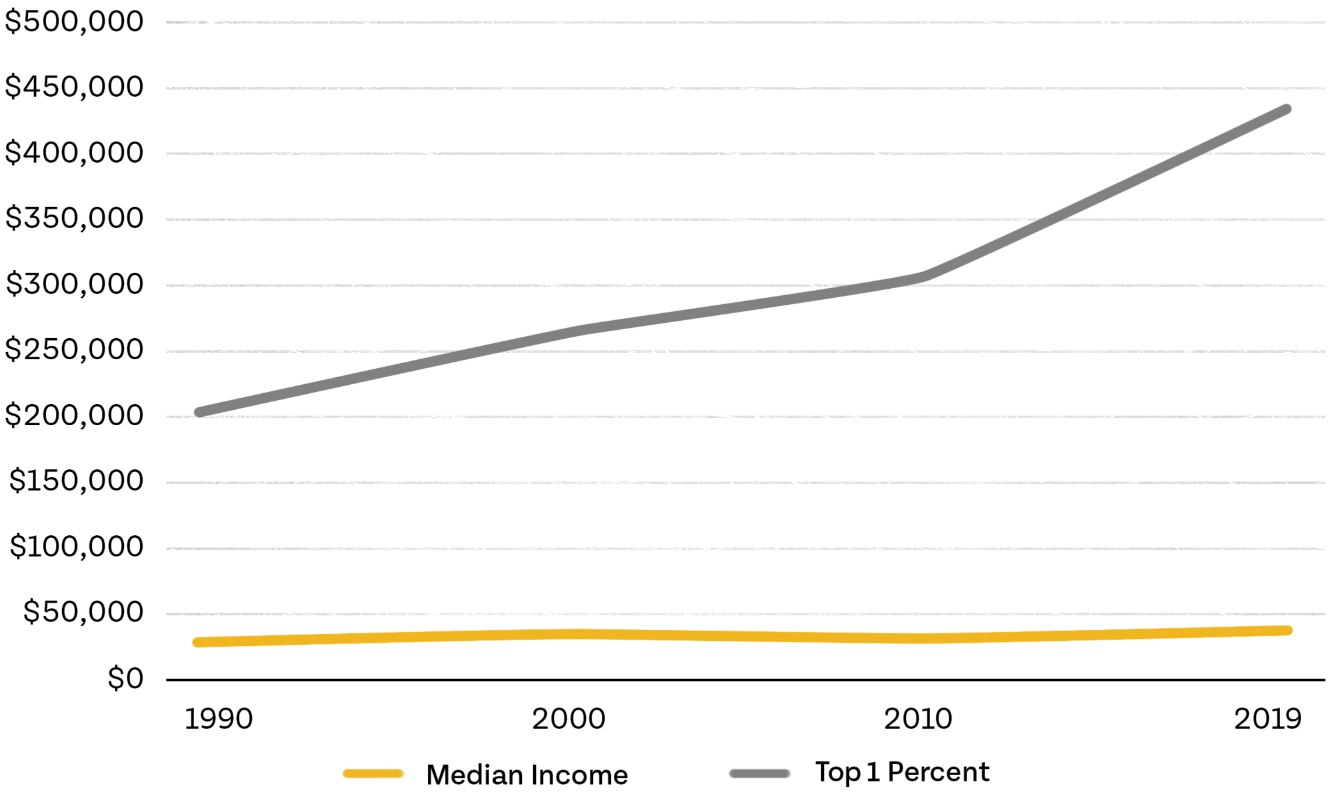
Unanticipated costs must be taken into account, and they will only shrink the available funds for other programs. While Colorado has taken steps to increase some revenue to account for increased spending – SB21-260 ensured that a steady stream of money from various fees can go towards transportation – there are still many liabilities that will either have to be funded through the General Fund or by finding a new revenue source. For example:

1. The Colorado legislature passed legislation funding full-day kindergarten in 2019, which has proven to be very beneficial to parents and children. Without identifying new revenue to fund it, however, the state has obligated existing revenue from the General Fund to pay for it.
2. Colorado voters passed Proposition EE in 2020 to guarantee 10 hours of preschool for all 4 year old Coloradans through an increase in nicotine and tobacco taxes. However, expanding this program – which will be important, as 10 hours of preschool is not enough for households with two working parents – will likely cost more than the tax revenue coming from Proposition EE.
3. SB18-200 was passed into law so that the Public Employees Retirement Association (PERA) would be on a sustainable funding path. The bill mandated that the legislature put aside $225 million every year from the General Fund for PERA.
4. Orphan oil and gas wells could eventually cost the state more than $8 billion over time, unless new regulations ensure that oil and gas operators bond more money up front to cover the costs of plugging a well. This is just one example of the unforeseen costs that will arise due to the changing climate and the need for environmental protection.
5. Colorado is a young state that is expected to age fairly rapidly. The cost of caring for many older Coloradans will fall to state programs that could dwarf today's Medicaid costs.

Finally, Colorado's constitution doesn't allow our state to keep all of the tax revenue existing tax rates and economic growth generate. The revenue cap as part of the Taxpayer Bill of Rights (TABOR) ensures that in good economic times – which are forecasted over the next three fiscal years – money has to be sent to taxpayers instead of invested in our communities. According to projections, $5.6 billion will go to taxpayers instead of being invested into education, environmental protection, health care, and other vital public programs. Yet not all taxpayers will see a net benefit from this policy. Given that the revenue will disproportionately go to the wealthy, the money will not provide enough relief for families that really need it.

Looking at personal income data from 1990 to 2020, it is easy to see the growth in inequality. In inflation-adjusted terms, since 1990 median personal income in Colorado has grown 33 percent. The top 1 percent's personal income, however, has grown 111 percent, dwarfing the gains of the vast majority of Coloradans.

Inflation-Adjusted Income Growth by Income Level



Source: Bell Policy Center analysis of US Census data

Because our state's revenue cap adjusts for population and inflation, the gains from the wealthy have been significantly higher than the revenue cap increases. This is projected to result in record rebates for taxpayers. However, given the status quo of our tax code and rebate mechanisms, much of that rebate will go to the wealthiest Coloradans. The arbitrary revenue cap must be re-evaluated through the lens of far greater inequality than existed when it was rewritten by Referendum C in 2005. Our systems and programs would be much better off if, like every other state in the country, we could invest this rise in income and wealth into our communities. We could pay teachers more, bolster environmental protection, bring down health care costs, invest in child care for families, and support many other important elements of our infrastructure, but for the fact that this money gets redirected into the hands of the wealthiest taxpayers.

Later in this report, we will examine how much this revenue could help our state if it were available for public infrastructure.

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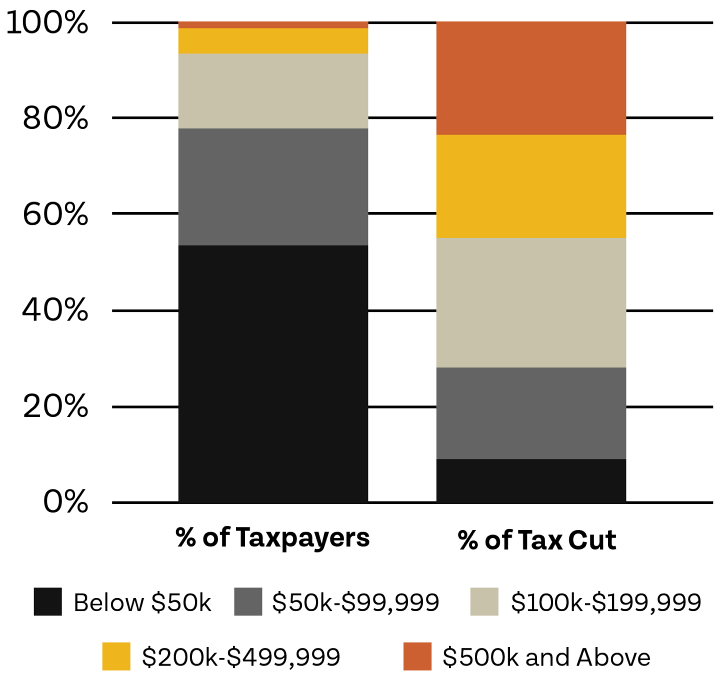
How Across-The-Board Tax Cuts Would Affect Our Revenue

Voters have been presented with numerous tax reduction measures on the ballot recently. Furthermore, multiple bills have been introduced in the legislature on the same topic just this session. The Bell Policy Center has written over the years about how our current state and local tax code is regressive: low- and middle-income families pay a higher percentage of their income in taxes than the wealthy. And across-the-board tax cuts, which are the only kind of income tax cuts permitted under our current state constitution, only worsen that problem. The top 1 percent of Coloradans – those making over $500,000 in income annually – would see 23 percent of the tax cut.

As Coloradans contemplate how tax reductions would affect our state's ability to provide important services, it is important to look at the math. Our General Fund would see significant reductions, and most of the money that would be diverted from the General Fund would stay in the hands of the already wealthy.

If Colorado were to cut the income tax rate from the current 4.55 percent to 4.4 percent, as proposed on the 2022 ballot, Legislative Council Services estimates the loss to the General Fund at $970 million over the next two years, and $400 million annually going forward. Not only would that money be lost from important programs, but $225 million of it would go to the top 1 percent of Coloradans.

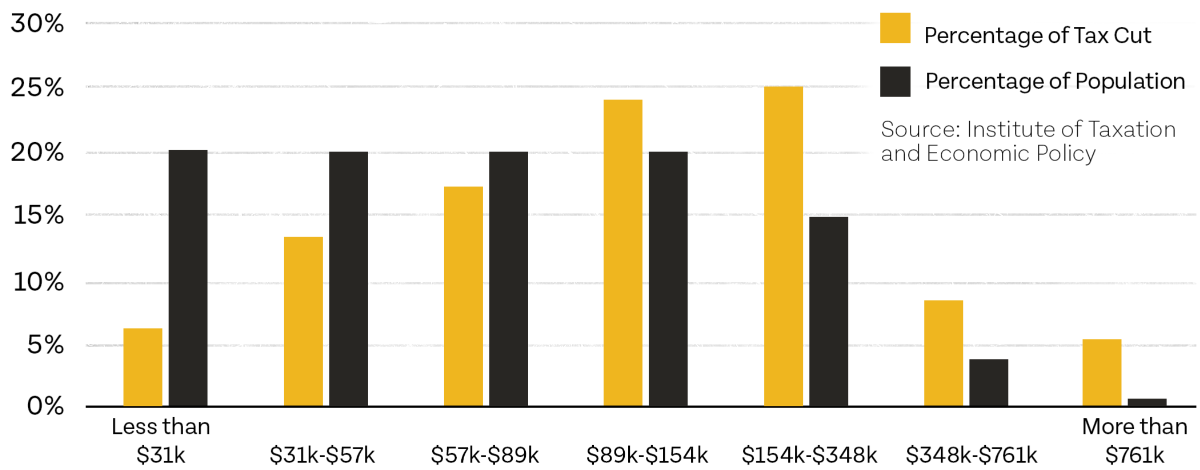
Income Tax Cut Distribution



Source: Bell analysis of Department of Revenue Data

There is also a proposal to cut the statewide sales tax by .01 percent. This is a small change and would only cost the state $15 million annually. This loss of revenue would compound over time, however, and would represent opportunities lost repaying incurred liabilities like the budget stabilization factor or investment in improved public services in areas like early childhood education and infrastructure. Furthermore, the savings would again go to the wealthiest Coloradans. The top 5 percent – those making more than $384,000 annually – would get 14 percent of the benefits. Those making $57,000 – the bottom 40 percent of Coloradans – would only see 19 percent of the dollars lost to our communities.

Sales Tax Cut Distribution



These tax cuts would be permanent, and would force real programmatic cuts from our budget in future years. If an economic downturn were to happen after reducing tax rates, lawmakers would have to cut even more to make up for the lost revenue from tax rates and an economic slowdown. Enacting permanent reductions at a time of temporary tax revenue surplus is dangerous because when economic conditions change, that tax revenue will be crucial to restoring Colorado's economic health. And the people that rely on government services and programs in our communities would be the ones who would see the least from the tax cut.

Even if we look at an example from our recent past – Colorado cut the statewide income tax rate in 1999 and 2000 to go from 5 percent to 4.63 percent – we can plainly see the effects. Those tax cuts cost the state a total of $10 billion in public dollars from 1999 through 2019. In 2019 alone, our General Fund had $663 million less than it would have otherwise. That would have covered the entire cost of the Budget Stabilization Factor (BS Factor) and fully funded our state share of K-12 education, with $80 million left over for other priorities.

A big problem with statewide income tax cuts is that the money is generally made up elsewhere, in more regressive ways. If our state has less revenue to spend, localities will not be able to count on the state plugging holes in education, mental health services, environmental protection, and other services vital to the populace. Because counties, municipalities, and special districts can only rely on more regressive forms of taxation – TABOR prohibits counties and cities from levying income taxes or, in the case of property taxes, differentiating between different property values – any increase in taxation at the local level will put a larger burden on low- and middle-income Coloradans.

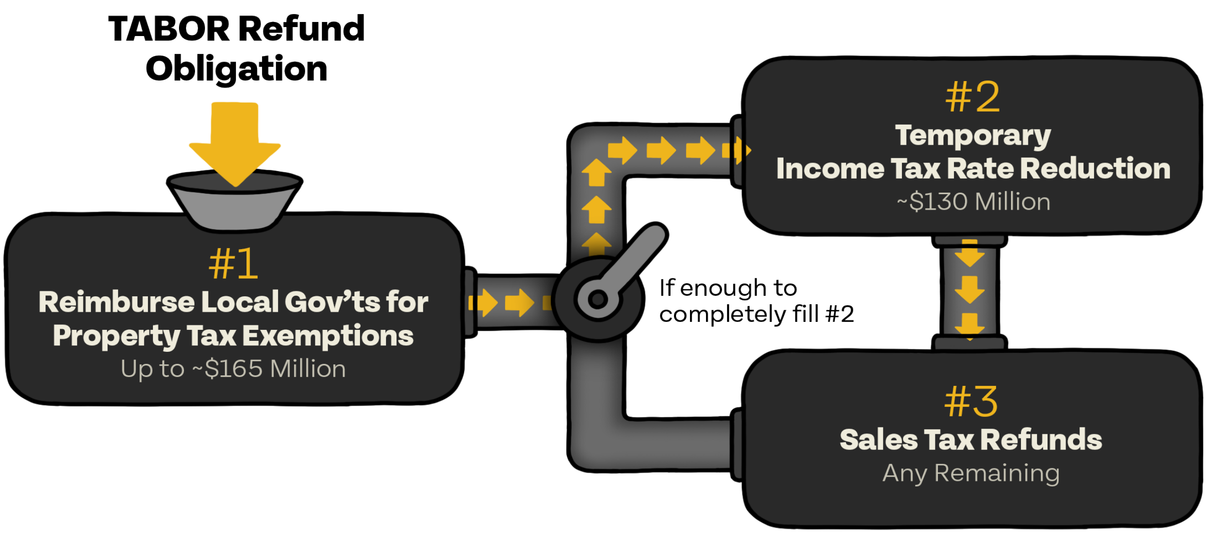
The reliance on local taxation to provide services for residents has become a significant problem in our tax code. [Colorado's statewide taxes] are 45th in the country, but local taxes as a percentage of total taxes are 5th highest, according to the Department of Revenue. In real terms, Colorado has limited its methods of progressive taxation in favor of more regressive taxation, hurting our low- and middle-income families.

Revenue Cap Costs Colorado Investments in Communities

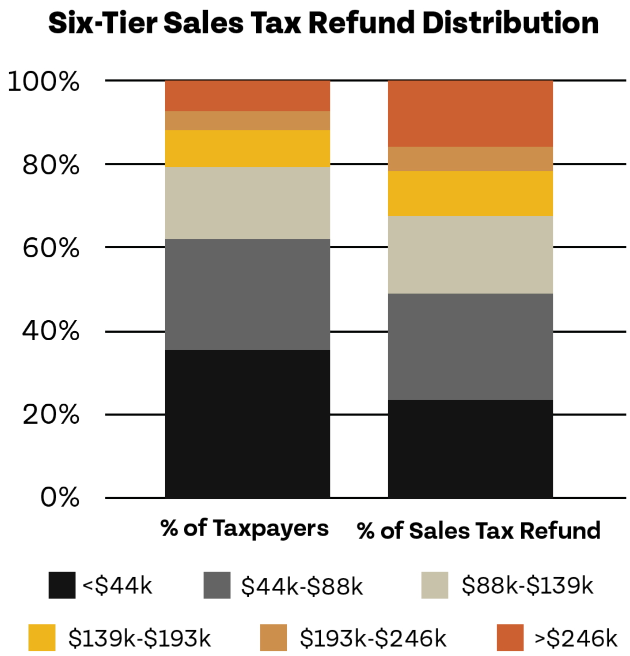
Colorado's unique budget constraints have further hampered our ability to continually invest in communities across the state. As was discussed in Part 1 of this series, since the Taxpayer Bill of Rights was enacted in 1992, Colorado has doled out money from the General Fund to taxpayers a total of six times, costing our communities a total of $5.48 billion (inflation-adjusted to 2020 dollars). These dollars could have gone to boost teacher salaries, increase environmental protections, reduce the waitlist for the Colorado Child Care Assistance Program, or other important public priorities.

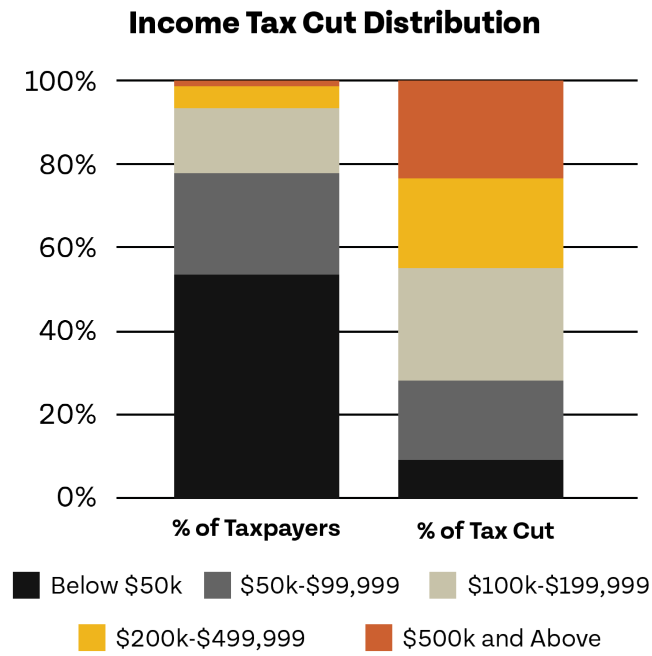
However, these numbers pale in comparison to what Colorado's nonpartisan economists forecast. Over the next three fiscal years – 2021-22, 2022-23, and 2023-24 – Colorado is projected to forego $5.6 billion in General Fund revenues. Again, that money could go to community priorities, but instead will just go to Colorado taxpayers, often through regressive mechanisms.

TABOR Refund Mechanisms



The first $165 million goes to reimburse counties for the Senior and Disabled Veteran Homestead Property Tax Exemption. The other mechanisms, which will account for at least $1.6 billion in each of the three years, end up giving the wealthiest Coloradans a far larger share than the average Colorado taxpayer. An across-the-board tax cut always ends up accruing most money to wealthy taxpayers, and the six-tier sales tax refund mechanism is written in statute in a way that is highly regressive as well. The law was written in the late 1990s and supposedly modeled on consumer spending habits, which gives a significant percentage of the dollars to the wealthy. But this idea is outdated and unfair. The charts below show the distributional effects of these mechanisms:





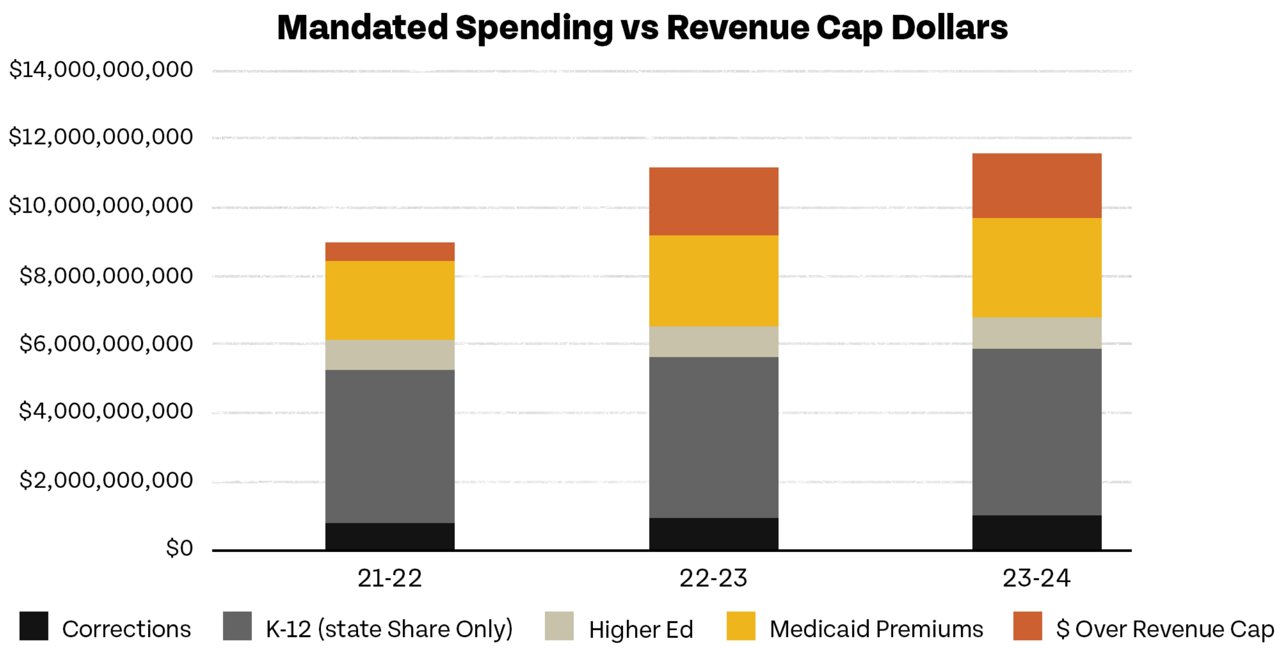
Source: Bell analysis of Department of Revenue Data

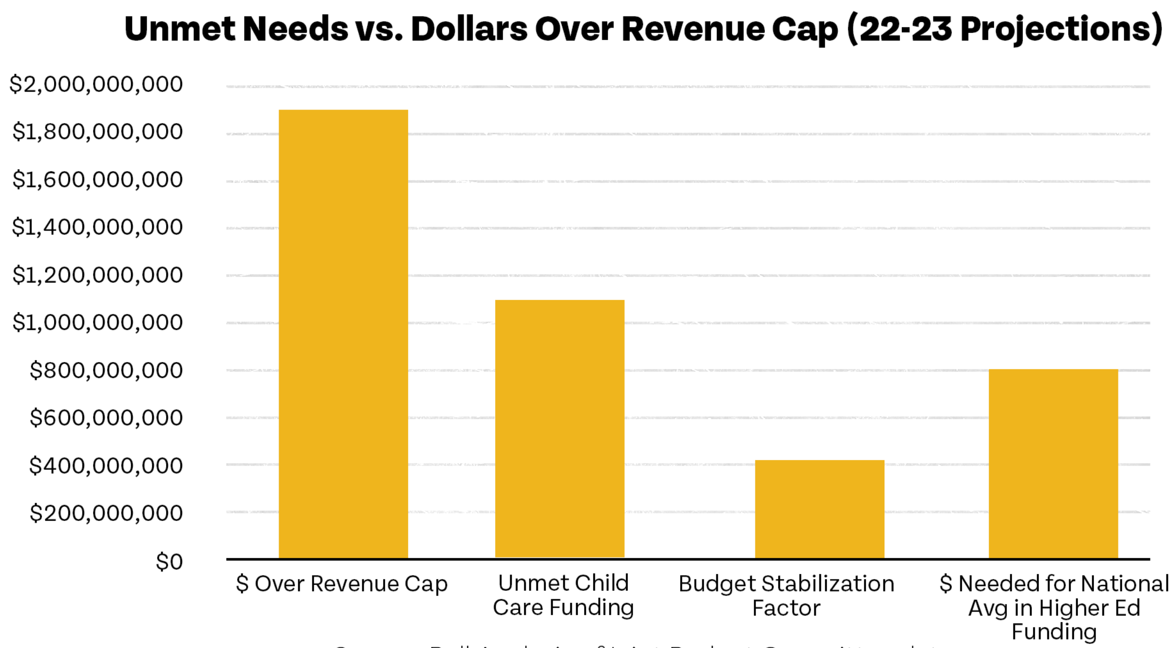
Colorado has the most restrictive limit on government spending of any state. Unlike nearly every other state, Colorado is not allowed to use all tax revenue to bolster public investments. That means that in good economic times, states use higher tax revenues to make up for loss of funding in leaner economic years. But Colorado, instead, sends money that is over the arbitrary revenue cap to taxpayers in a highly regressive way. So as every other state uses higher than expected tax revenue to invest in families, workers, and communities, Colorado gives much of it to wealthy individuals who do not need it. Our statewide funding might look significantly different if we could put this money to use in our communities.

Looking at K-12 education, investing just a portion of the revenue over the cap would boost per pupil funding measurably. If Colorado was to put $1 billion more into education, the state would erase the Budget Stabilization Factor, and per pupil funding would go up $1,200. This would move the state from the bottom third in the country to the middle. This money would help recruit teachers, mental health professionals, updated textbooks and classroom technology, and many other educational improvements to help students become their best academic selves.

Another example can be found in higher education. If Colorado put $1 billion in revenues that are currently over the revenue cap towards higher education, our state would move from last in the country in per-capita spending, to 20th and way above the national average. Currently, Colorado spends just over $100 per capita on higher education. The national average is $288 per capita. Redirecting that $1 billion towards higher education would bring our per capita dollar figure to nearly $310, showing the impact that public investment can have in our state.

Finally, we can also look to child care in Colorado. Our state has very expensive child care, as demonstrated by the Economic Policy Institute. To use one statistic, infant care for one child in Colorado costs 21 percent of the median salary in the state. The Bell Policy Center worked on a cost of care model to show how much money is needed to sustain and improve the child care system. Putting $1 billion of money over the revenue cap into child care would transform this public program in immense ways. Using that $1 billion would allow base wages for child care workers – the current median child care worker wage is around $26,000 – to approach the average salary of a kindergarten teacher at about $45,000 and bridge the current child care funding gap in our state. This would eliminate many accessibility and availability issues that parents of young children are facing across the state, as well as give workers a more livable wage.





Source: Bell Analysis of Joint Budget Committee data

While existing revenue could largely support two of the three examples above, given current projections, anything more would have to be supplemented with new, sustainable revenue sources. Given how regressive our tax code currently is, piling on more sales taxes and sin taxes will only hurt the people that need the help the most. In order to fund our educational system – not to mention environmental protection, health care, and other vital public programs – raising taxes on the wealthiest Coloradans is the most direct way to provide the services expected of our growing state.

Conclusion

Colorado is in a good position in 2022 to use state and federal revenue to invest in communities and provide help for families that need it. This infusion of funding should not be confused with a sustainable solution to our long-term inability to invest in our community priorities.

Colorado's General Fund – in inflation-adjusted terms – has remained stagnant since the legislature cut taxes in 1999. More than half of the General Fund is being taken up by just K-12 education, health care, and corrections, and our budget will not be able to handle our state's growth and needs under the current tax rates and caps we have in place. Without reform or significant changes to our fiscal system, this situation would lead to budget triage, as we severely cut some programs, just to maintain adequate funding in other areas.

It is crucial for not just legislators and governors to wrestle with these facts. In Colorado, voters have to make complicated decisions on tax policy at the ballot box and understand the fiscal impact that revenue reduction policies are having on our future. We need to take into account the long-term sustainability and fairness of Colorado's revenue when thinking about taxes, fees, new programs, and other budgetary issues.

Our state is growing and needs are changing, but our tax code and fiscal system have yet to catch up. What once constituted adequate funding in 1999, no longer does after rising income inequality, recessions, and multiple rounds of tax cuts. Our current revenue policies are preventing our communities from meeting the needs of a growing and changing state.

It is time to focus on the long-term economic health of Colorado, our communities, and the people who make up our state. That means funding our public infrastructure in a responsible way through a fair tax code that asks everyone to pay their fair share. Investing in education for all ages, health care, environmental protection, and our workforce will make our economy stronger and our budget more resilient.