COLORADO'S REVENUE BASE

PART 1

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Introduction

Given the constraints the Colorado Constitution has put on collecting and spending revenue in our state, it is crucial to zoom out and inspect the real amount of money that is available and how much we need as a state to bring economic mobility to every Coloradan. This first iteration of a new series from the Bell Policy Center will use research and analysis to look at the historic (post-1992) and current revenue base in Colorado and how it maps with our current budgetary commitments.

Colorado's Revenue Base Basics

A revenue base is a basic way of knowing the universe of money available for taxation that will be reliably available in a sustainable manner. For the purposes of this piece, we will look at Colorado's statewide revenue base that makes up the General Fund — the pot that houses discretionary dollars in the state budget. It is vital for policymakers and interested parties to understand the amount of money that funds programs upon which our residents rely. The General Fund mostly consists of individual income tax money (ranging from 55 percent to 66 percent of the General Fund) and sales taxes (averaging around 28 percent of the General Fund budget) being the other significant portion. The General Fund also includes corporate income taxes and insurance premium taxes.

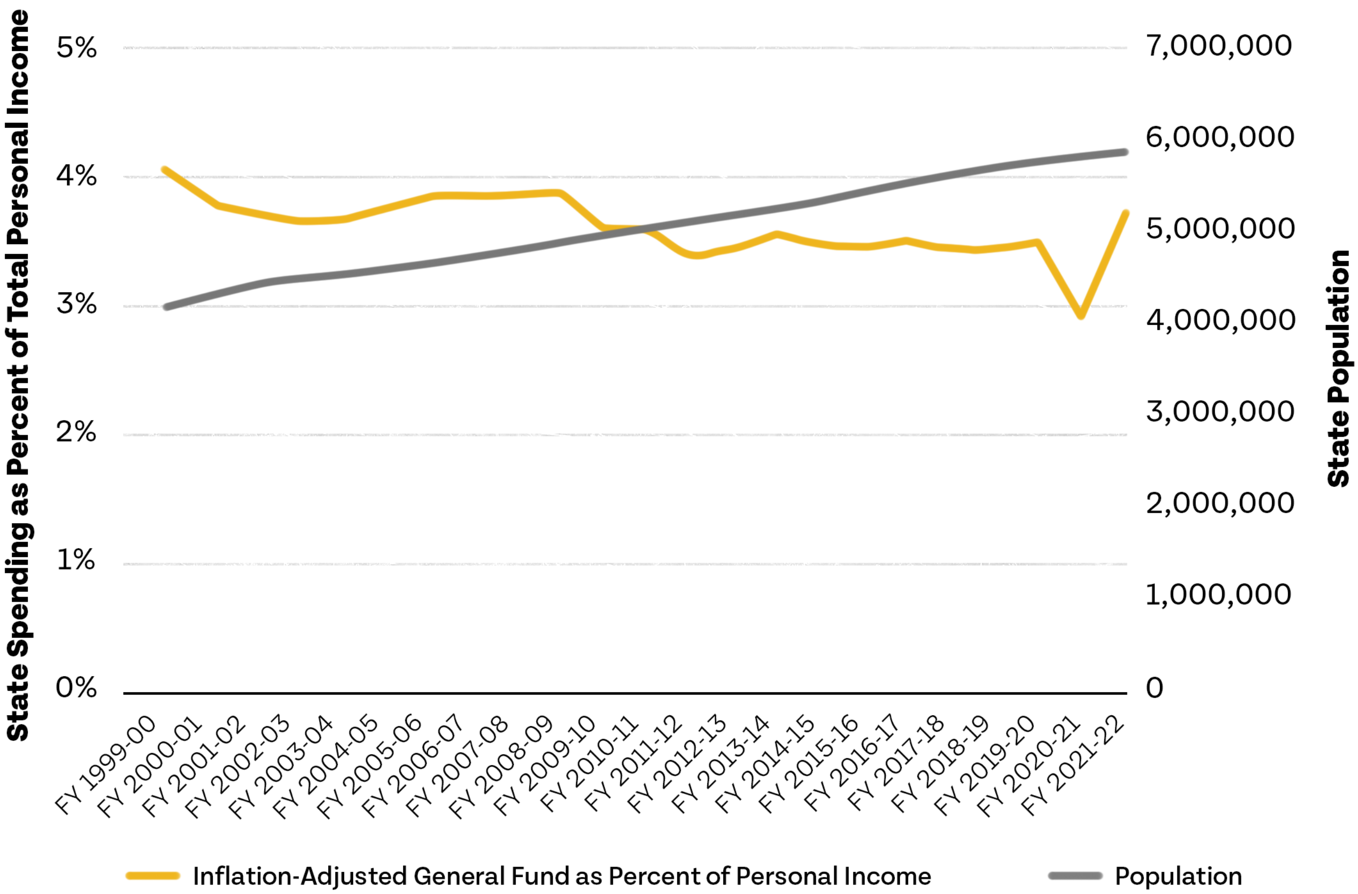
How Has Colorado's Revenue Base Changed Over Time

When looking at Colorado's revenue base over time, two trends are particularly striking. First, unsurprisingly, is the interconnectedness between income taxes and the General Fund. Second is the decreasing amount of public investment during a period of economic growth.

Income tax is the single greatest contributor to the General Fund. By adjusting for population growth and inflation, we can compare the size of the General Fund over time without fear of conflating the overall growth of our economy – measured by growth in personal income – with growth in public spending during the same time span. Income taxes comprise a majority of the General Fund, while the share of the General Fund consisting of sales taxes remains consistently around one-quarter of the overall base. Corporate income taxes make up a miniscule share of General Fund revenue, and this share has not significantly grown over time. Insurance premium taxes are also a small part of the General Fund.

Notably, when personal income (and, subsequently, income tax revenue) drop, as they do during recessions and other types of economic downturns, the General Fund shrinks as well. While increased federal funds during recessions can help states meet the demand for services during these periods, a strong economy is needed in the long run to help ensure the state can meet mounting obligations on its spending. In short, income taxes are a critical source of funding for state expenditures. While Colorado boasts a relatively low state income tax, this source of revenue is essential to keep public services funded.

Colorado General Fund as Percent of Total Personal Income



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

Although the economy has grown, as measured by personal income, as the population continues to grow, the past two decades have resulted in a smaller share of the state's economy going toward public spending. In 1999 (when the General Fund was roughly the same size as today, adjusted for inflation and population), approximately 4 percent of the state economy, measured in total personal income, went to the General Fund. Yet through two decades of significant population and economic growth, this share has been decreasing. Before COVID-19, the share of state spending as a percentage of the economy hit 3.5 percent. This means that while our state is growing, Colorado is investing less and less in our public services. Put another way, a roughly stagnant General Fund is stretched thin as the state is required to cover more costs to support a growing population.

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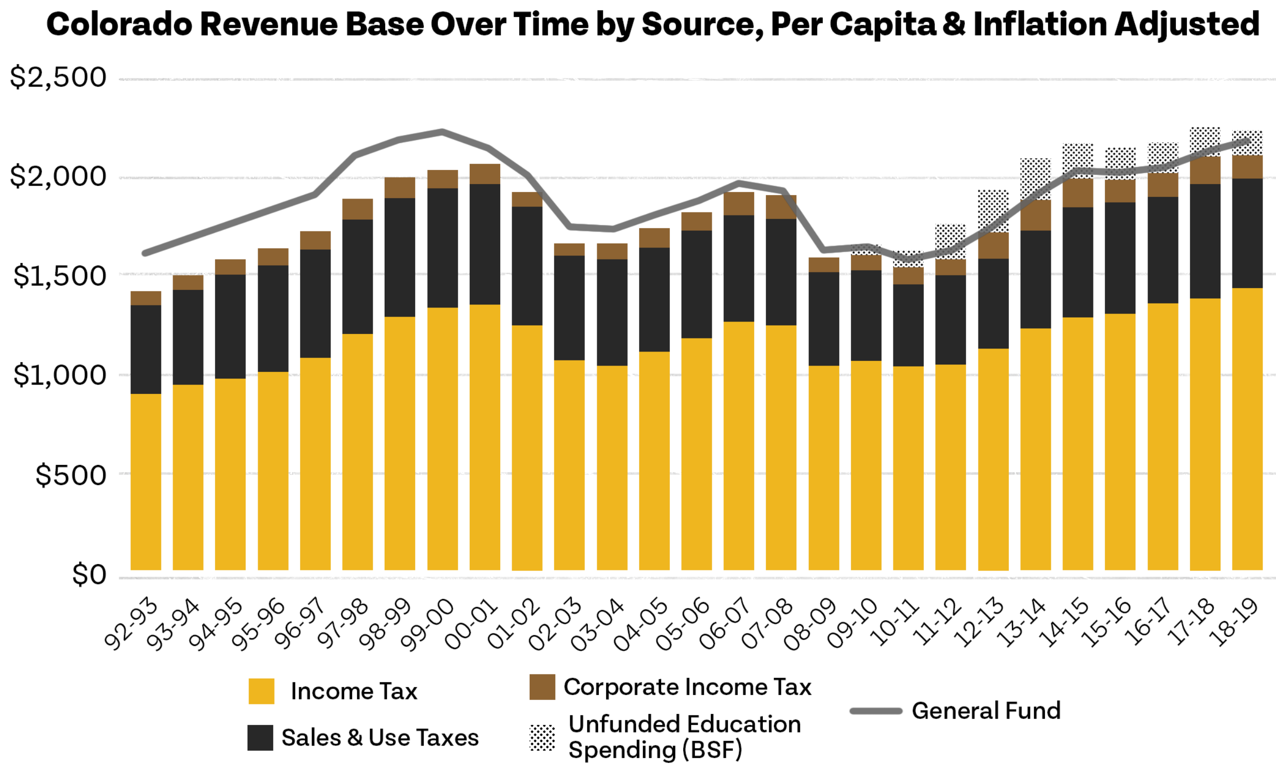
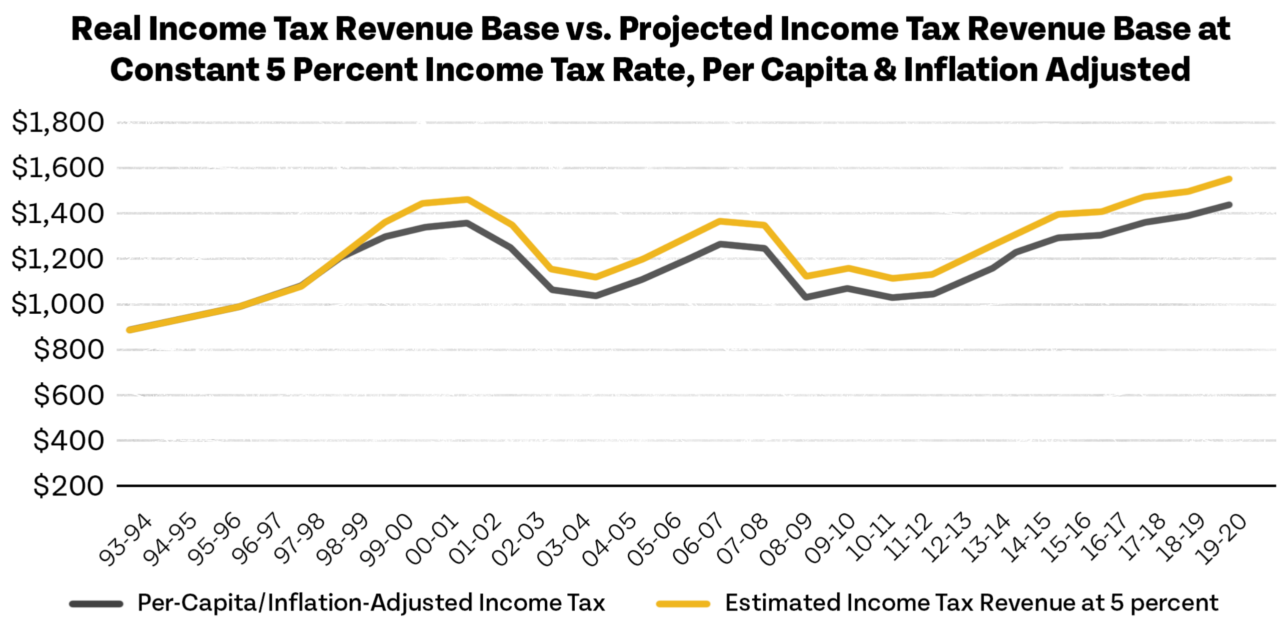


Source: Bell Policy Center analysis of Legislative Council Staff & Colorado Department of Revenue data

As this chart shows, income tax revenue closely tracks with overall General Fund revenues. There are several points implied by the chart that are worth enumerating:

1. While the vast majority of General Fund money is shown above with individual income taxes, sales and use taxes, and corporate income taxes, it is still not a complete picture. Other taxes, such as insurance premium taxes and severance taxes, are also part of the General Fund and subject to the TABOR cap.

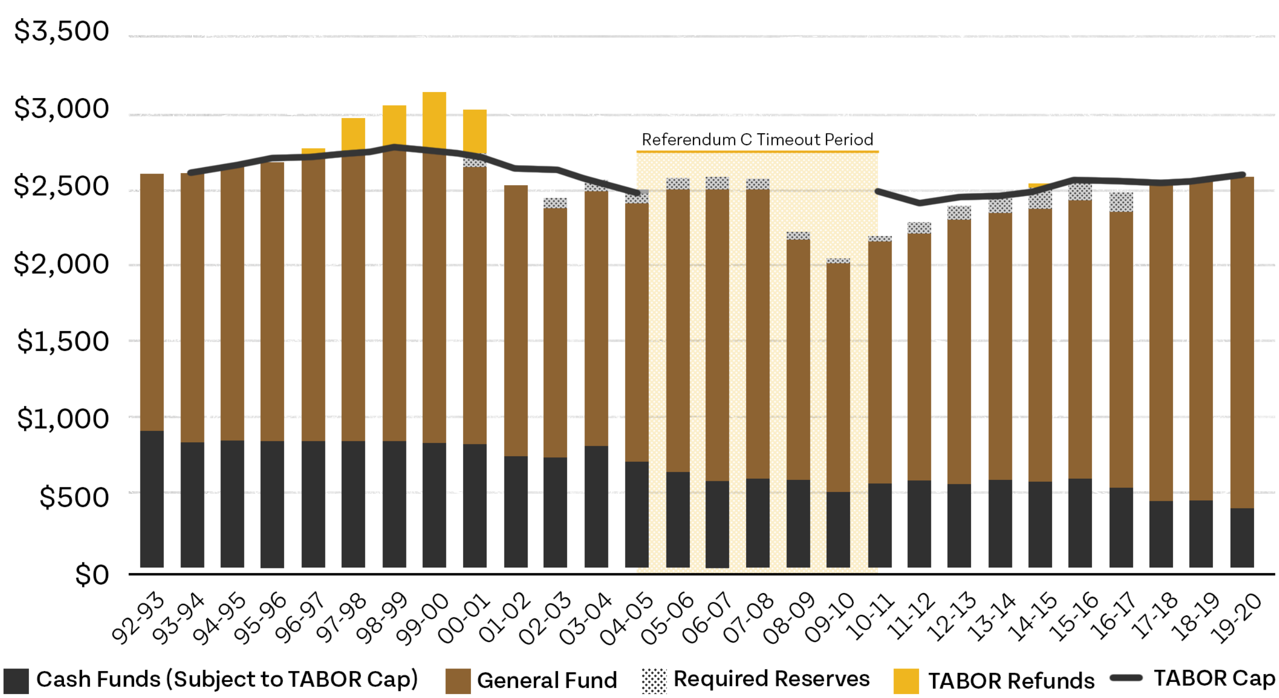


Source: Bell Policy Center Analysis of Legislative Council Staff Data

2. In 1999 and 2000, the state legislature made permanent changes to Colorado's income tax rates. In 1998 it was 5 percent, and by 2001 it was 4.63 percent. The rationale behind the rate reduction was the money would be refunded to the people because General Fund revenue would exceed the TABOR cap, and so this was a more efficient way of ensuring the money went back to the people. However, this was a permanent tax rate reduction, and when the national economy went through a recession during 2001-2003, the reduction in income tax revenue caused a sharp reduction in General Fund revenue that forced significant cuts to the budget in later years. As the chart above elucidates, the permanent reductions in income tax rates has hurt Colorado's budget picture significantly. In a hypothetical world, where income tax rates were still at 5 percent, our state would have more than $663 million (inflation adjusted) to patch holes and keep budgetary commitments in FY 2019-2020. Over the 20 years since income tax rates were lowered, it amounts to over $10 billion — again, inflation adjusted — in lost revenue.

3. The other sharp reduction in this chart is from the Great Recession from 2008 to 2011. What is most interesting about this time period is how revenue ticked back up slightly in FY 2009-2010. This was [mostly a result of measures adopted by the General Assembly] to increase revenue through cash fund transfers, changes in income tax credits and deductions, as well as federal stimulus that temporarily boosted tax returns. However, all of these measures were temporary and the General Fund took several years to recover. The lesson is while short-term measures and federal stimulus can help bridge some gaps, it only papers over structural problems and it is crucial for states to plan for when the economy normalizes.

Revenue Base vs. TABOR Cap, Per Capita & Inflation Adjusted



Source: Office of State Controller via Legislative Council Service

4. Colorado voters passed Referendum C in 2004 to take a five-year "timeout" from the TABOR revenue cap (as shown by the line in the graph above) and to undo the "ratchet" provision that allowed the limit to decrease when the economic conditions depressed statewide. When the TABOR revenue limit was reinstated and adjusted in 2010, it was higher and allowed for slightly more revenue growth in the General Fund. However, because the new cap was to be based on economic conditions during the timeout, the cap ended up lower than anticipated when Referendum C passed, because the Great Recession hit during the timeout.

5. By statute, the state is obligated to have reserves that can be tapped in times of budget distress. As the chart above shows, the amount of reserves can vary wildly, and becomes whatever is left of the budget after much of the funding has been decided. A more functional system would allow policymakers to be more prescriptive about reserves to ensure that there is a buffer in place for economic downturns. But because of the limitations in place, the reserves are less about how much our state needs to put aside and more about how much we can afford to use so as not to squeeze other programs.

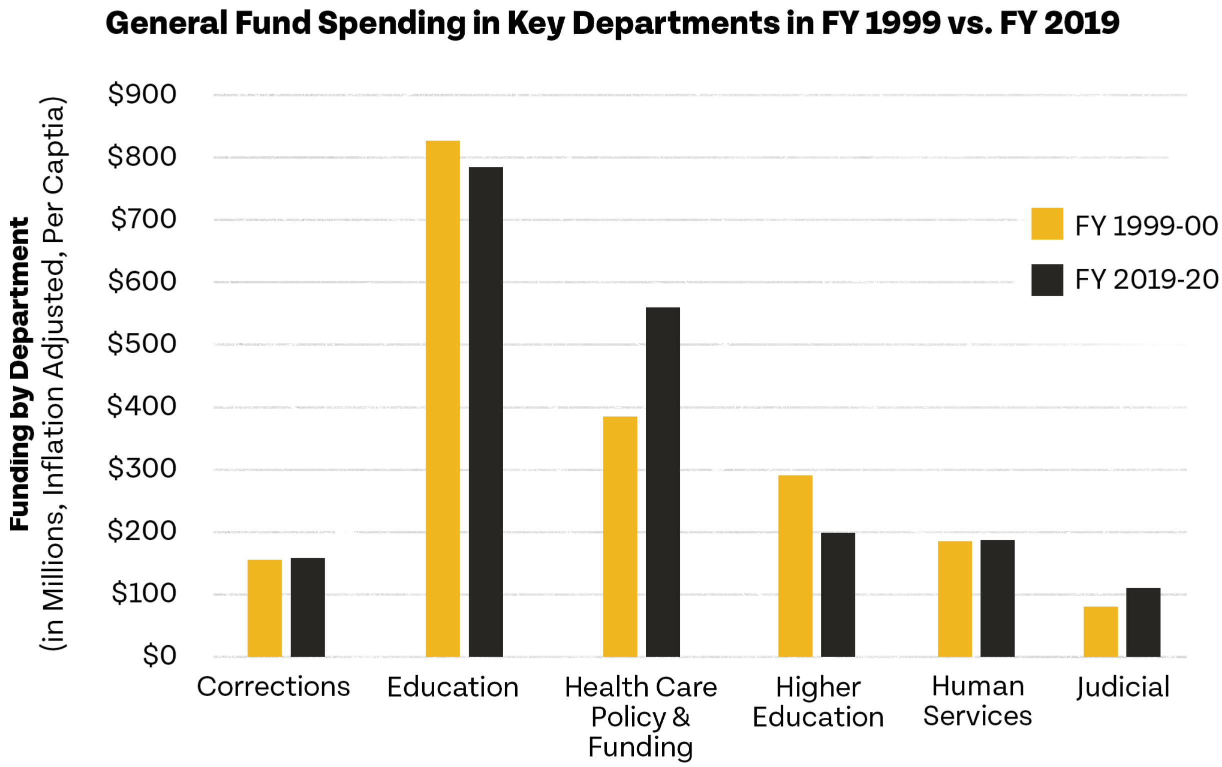
6. With the TABOR cap in place, legislators are very conscious of how to allocate and appropriate dollars to ensure dollars are going to the right places, without too much left over. However, with necessary growth in the budget due to demographic shifts year over year, as well as cash funds that can fluctuate, that is difficult and can squeeze programs in need of funding.

7. Over the past two decades the population of Colorado has grown by over 1 million people. During this same time, the share of the economy going toward the General Fund has decreased by over 13 percent (not including the COVID-19 budget year) to 3.49 percent.

Base Commitments & Accrued Liabilities

There have been additions and subtractions to our state's funding commitments over the last couple of decades. However, the main programs that are funded through the General Fund have not changed, although they have shifted.

In FY 1993, the top four places funded through General Fund dollars were K-12 education (40 percent of General Fund dollars), health and human services (28.4 percent), higher education (15.7 percent), and corrections and the judiciary (9 percent). In FY 2019, K-12 education was at 36.1 percent, health and human services was at 34.4 percent, higher education was at 9.1 percent, and corrections and the judiciary was at 12.3 percent.



Source: Bell Policy Center analysis of Legislative Council Staff data

1. Health Care

The one place in the Colorado budget that has significantly grown over the last two decades is in the health care budget line item. Colorado passed Medicaid expansion in the wake of the federal government passing the Affordable Care Act. This expansion covered more than 380,000 Coloradans who were previously uninsured, and ensured many low-income Coloradans who needed health care were accounted for in the system, instead of the state paying their costs after they arrived at the hospital. Also, much of Medicaid goes towards long-term care for older and disabled Coloradans. Covering those costs is expensive and has led to increased state government spending. The federal government paid 100 percent of the cost of expansion from 2014 (when Colorado officially expanded Medicaid access) through 2016, but that dropped to 90 percent in 2017, leaving the state to pick up the extra 10 percent, resulting in higher health care spending than before. However, with the federal government paying nearly all of the cost going forward, Colorado's investment in health care has led to significantly more insured residents at a lower cost than it would have been otherwise. It also ensures we can use our state dollars to leverage the federal funding in greater ways, instead of turning away millions in federal dollars that goes to helping give hundreds of thousands of Coloradans health care.

In addition, growth in health care spending can also be traced to the cost of health care rising significantly faster than overall inflation. According to the St. Louis Federal Reserve in 2017: "In the past 20 years, in the regime of stable inflation, headline [Consumer Price Index] has grown at an average annual rate of 2.2 percent, whereas the price level of medical care has grown at an average annual rate of 3.6 percent – about 70 percent faster."

It is also important to note the health care numbers above do not include the hospital provider fee, which was pulled out of the General Fund and into an enterprise fund in the 2017 legislative session. The hospital provider fee is a fee levied by the state on hospitals that treat patients without health insurance. That revenue is then matched by the federal government to ensure expanded eligibility for Medicaid and Children's Health Plan Plus (CHP+). The measure to pull the revenue from the fee out of the General Fund was made so health care spending did not crowd out all other types of state spending.

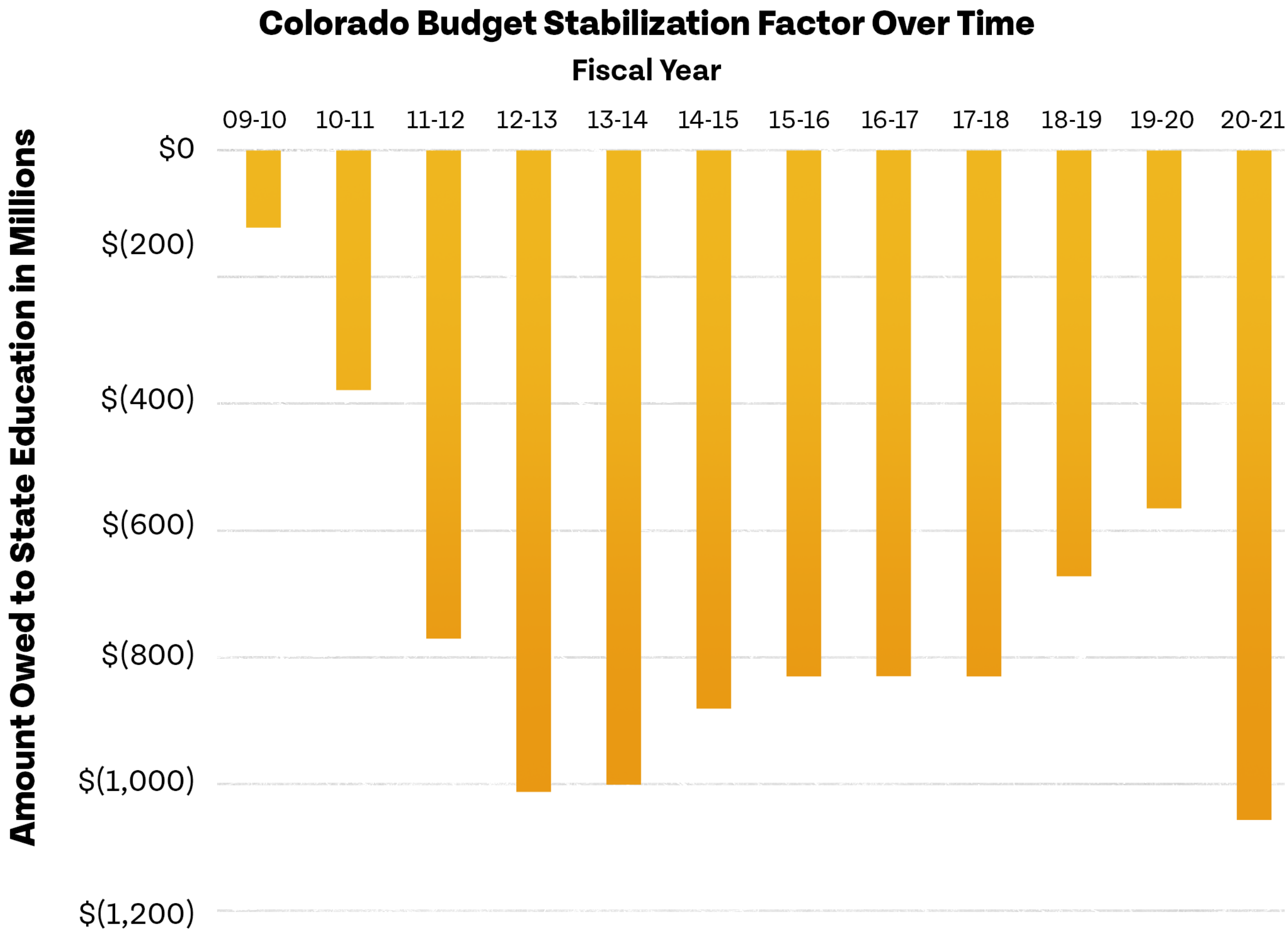
2. Education

Looking at the chart, it is easy to see education – both K-12 and higher education – has seen significant decreases in government spending. For K-12 education, the lack of funding is easy to quantify, as it is represented in the budget with a number known as the budget stabilization factor (BS factor). That number is the amount the state owes to school districts it cannot fund.

The BS factor can be traced back to 2000. In that election, Colorado voters passed Amendment 23 to boost public school funding throughout the state. The measure increased K-12 education funding by 1 percent annually for 10 years, as well as mandated a minimum amount of education funding from the General Fund every year. The amount transferred to the State Education Fund from the General Fund is generally around 5 percent of the General Fund budget, or about $8 billion total over the past 20 years. When the Great Recession hit in 2008, Colorado's General Assembly was forced to make tough choices, and as a result, it could not fill the constitutional obligation under Amendment 23. The BS factor, then known as the "negative factor," was created to keep tabs on what the state owes school districts.

The consequences of these funding choices are wide ranging. Because this is money the state owes to local school districts it is not paying, many municipalities and school districts have to find other ways to compensate. Local property taxes are meant to be the first line of support for local education. But because property tax collections have dropped as a percent of the value of property, the state has had to backfill hundreds of millions of dollars. The state was never meant to contribute this much to local school districts. But with rising property values in many parts of the state, local governments are reticent – or local voters will not let local governments – raise property taxes to make up for that gap. This results in the substitution of a more regressive form of taxation instead of the intended progressive approach. The downstream results of these choices end up hurting low- and middle-income families the most.

From FY 2009-2010 through FY 2020-2021, the state has averaged nearly $750 million in IOUs to school districts throughout the state, with the current number at nearly $1 billion. Cumulatively, school districts have lost over $9 billion since the introduction of the BS factor. The year-by-year breakdown can be seen in the chart below.



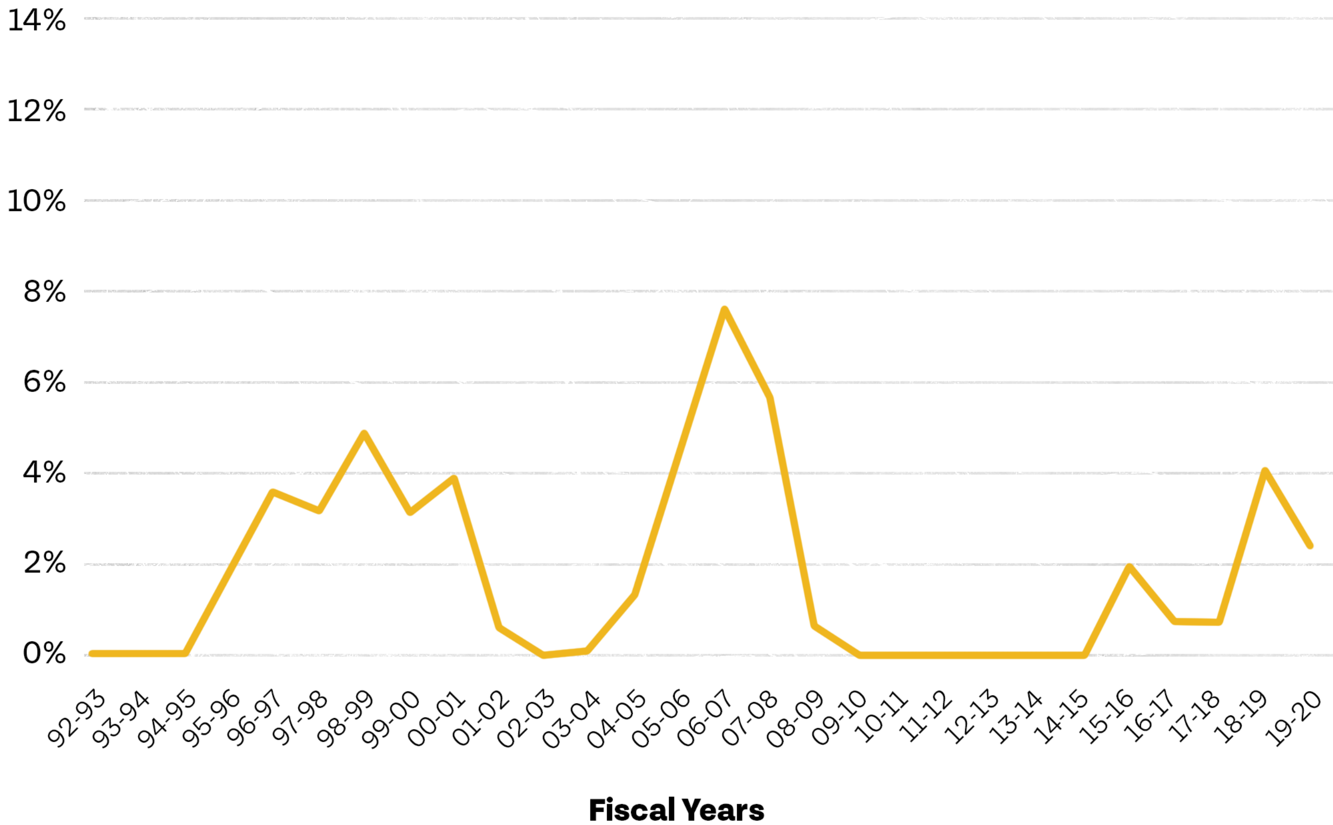
Source: Bell Policy Center analysis of Colorado School Financing Project data

This is one of the most visible ways the Colorado General Assembly has underfunded crucial public programs because of the lack of funds available to use under the General Fund.

3. Transportation

Transportation has been a notorious sticking point in General Fund budget discussions over the years. However, the General Fund is historically not a place for transportation investments. As detailed above, Colorado has had difficulty funding the programs that are constitutionally mandated to be funded by the General Fund, and so transportation has been inconsistently funded – only in good economic years, for the most part. From 1992 through 2019, the General Fund has averaged only $165 million in annual funding (inflation adjusted) for transportation. That is an average of 1.8 percent of General Fund spending in that time period. It is weighed down by a total of seven years where the General Assembly has not funded transportation through the General Fund. The year-by-year breakdown is below, and the years where there has been zero General Fund dollars going to transportation match up with years of economic hardships for Colorado.

Transportation Funding as Percent of General Fund (Inflation Adjusted)



The problem is Colorado is supposed to rely on the gas tax – which hasn't been increased since 1992 and is currently the ninth lowest in the nation – for funding transportation. This has become an insufficient mechanism and has left Colorado with crumbling transportation and inadequate transit. Local governments in Colorado have had to turn to regressive taxes to fund transportation, putting the burden on families with the lowest incomes. These are the choices forced upon the state by an inadequate revenue base and fiscal picture, and leads to underfunding of crucial priorities.

During the 2021 legislative session, Colorado legislators passed a bipartisan transportation bill that will provide sustainable funding for our state's roads, bridges, and transit. SB21-260 put in place new fees on gasoline, retail deliveries, electric vehicles, ridesharing, and other services that will raise about $200 million annually for upgraded infrastructure across our state. By providing sustainable revenue sources, the legislature has removed pressure to fund transportation from General Fund over the near and medium term, thereby freeing up those dollars for other programs Coloradans rely upon.

4. Public Employees Retirement

Finally, the Public Employee Retirement Association (PERA) is another example of how Colorado has to constantly shift costs to try and keep adequate public funding at sustainable levels. PERA is the state pension system for public employees, and Colorado, like many states, has had difficulty in maintaining proper funding for this system. In years of budget distress, policymakers have chosen to forego General Fund payments to the pension system. For example, the Colorado legislature passed legislation in 2018 to shore up what was then a $32 billion unfunded liability to PERA. Part of the legislation ensured $225 million would go from the General Fund every year to eventually pay off that liability. When the COVID-19 pandemic hit and there was a severe budget crunch due to the economic downturn, the budget writers eliminated that payment from the budget. Because the PERA system uses contributions from employers, employees, and the state to invest over time, this was actually a nearly $1 billion hit to the pension system. These short-term fiscal decisions that are prudent in the moment end up being significant long-term hits to the whole fiscal picture of the state.

> **It is also crucial to mention elected officials and voters have continually added commitments to base funding needs, while at the same time permanently shrinking the revenue base through tax cuts.**

5. Full-Day Kindergarten

Full-day kindergarten is an example of a relatively small increase in budgetary commitments that further shrink the pot of money available for other vital public programs. In 2019, the legislature passed a bill to provide funding for all kindergartners across Colorado to have access to full-day kindergarten. This increased the funding for K-12 education across the state by more than $182 million, or about 4.2 percent of all school funding. Of course, this is on top of the money owed to school districts under the aforementioned budget stabilization factor.

Education funding is informative because it shows how little room legislators have had to fund more public programs, and that lack of funding has hampered our state's ability to respond to pressing needs in other areas. There is continuous talk from across the state that we need to invest dedicated money into transportation and infrastructure. But if we were to commit more General Fund dollars to another program without paying for it, that would just reduce the amount we could appropriate to key places, like education, Coloradans rely upon.

6. Voter Fiscal Choices Not Accounted for in General Fund

In Colorado, voters have tremendous direct power over the state's fiscal future. However, it can be confusing where the money we voted for goes and how it affects funding for key programs and services. Many voters may have thought voting for the below measures increased General Fund dollars to be spent on important programs. But instead, these are add-ons that do not increase money toward the revenue base. Below are some prime examples how some well-intentioned measures have distorted the true fiscal picture in many Coloradans' eyes.

Amendment 50 in 2008: This adopted amendment allowed for increased hours and betting in cities with existing casinos (Cripple Creek, Black Hawk, and Central City) with some of the increased revenue going to support financial aid at community colleges. That money would not go through the General Fund and was in the tens of millions dollars annually, a small percentage of the more than $115 million (inflation adjusted) from the General Fund that annually goes to community colleges since 1994 on average.

Proposition AA in 2013: Proposition AA was a measure to tax recreational marijuana, which became legal as a result of Amendment 64 the year prior. The measure implemented a sales and excise tax on recreational marijuana that was estimated at the time to raise approximately $70 million annually. The first $40 million would be used to finance public schools capital construction, with the rest used to regulate and monitor the recreational marijuana industry and enforce the laws as written. That money does not go into the General Fund, and because it is for capital construction, as opposed to general operating, is not accounted for when looking at annual school funding numbers. While $40 million for schools was important money, it was just a drop in the bucket compared to the needs of the schools across our state, which have been underfunded by an average of $746 million since 2009-2010.

Proposition DD in 2019: Colorado voters adopted this measure to legalize and tax sports betting in the state. The revenue from the taxes would go to regulating gambling and toward the Colorado Water Plan. It was estimated up to $27 million annually would go to the water plan. That was less than 30 percent of the estimated cost of implementing the water plan – an annual cost of about $100 million – leaving the state to figure out how to find revenue for the rest of the plan within very limited existing funds.

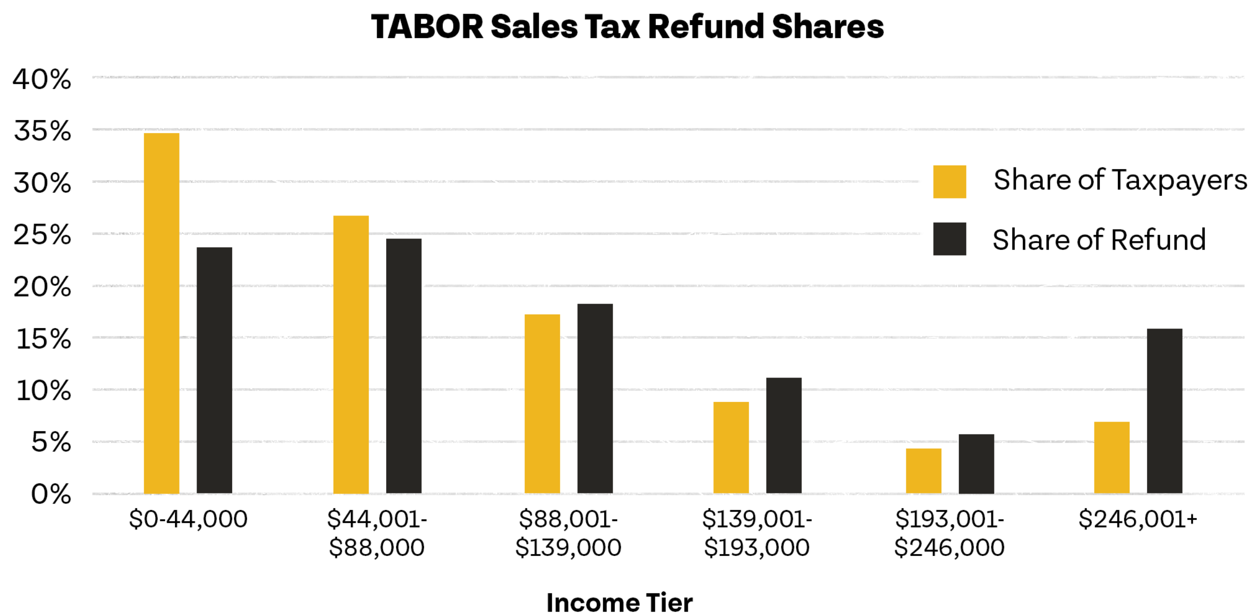
Proposition EE in 2020: Narrowly adopted in 2020, Proposition EE gradually raised nicotine taxes and gradually implemented a tax on tobacco vaping products. The money raised from these taxes is meant to fund preschool in Colorado. In 2027, when the taxes are fully phased in, it is expected to raise over $275 million annually, with much of that going to fund preschool programs. However, if the measure works and smoking and vaping decreases, then the money would likely come in lower, leaving the state on the hook to make up the funding gaps. Even if smoking and vaping do not decrease, it is likely the state will have to use some extra discretionary money to actually provide at least 10 hours of preschool a week to all 4-year-old Coloradans.

What these measures show is voters in Colorado want to provide public money for important uses across the state, but it also shows us "sin taxes" are not sufficient for fully funding these programs. As a result, the state ends up having to use General Fund money to make up for any gaps over time. This just adds more and more liabilities to the budget ledger, in a time with very constrained budgets.

Where We Are

Colorado's discretionary funds correlate fairly closely with income tax revenues. In the past, when Colorado has had trouble meeting the needs of its people, it is mostly because of national recessionary conditions that cause a drop in income tax receipts. This has been exacerbated by choices made to reduce the rate of income taxes collected and increase funding for specific programs through sales and use taxes and excise taxes – a combination that puts the burden for raising revenue on lower-income Coloradans.

Furthermore, since TABOR was passed at the ballot in 1992, Colorado has refunded nearly $4 billion back to the people, even as the state has continually underfunded important sectors of the state. While the mechanisms for delivering these refunds have varied over the years, the vast majority of TABOR refunds from 1992 through 2018 came in the form of a tiered sales tax refund. In 1999, the largest refund during that time period occurred, and according to data from the Department of Revenue, was refunded in a highly regressive manner. The below graph, with the Department of Revenue data, shows how the same 1999 sales tax refund would look if implemented at 2021 income levels.



These interactions have made it difficult to have a sustainable system of funding in our state. Going forward, our state will have to grapple with the difficult choices in front of us: Do we need to raise more money in order to fully fund programs people care about? Do we further cut programs to ensure no one in Colorado pays more in taxes? How do we ensure revenues coming to the state are collected in equitable and fair ways?

Looking back gives us some context for these questions, but looking forward will illuminate some of the ways we can answer these in a fully informed manner. In the next part of this series, we will look at the ongoing needs of our state and what kind of impact expected statewide growth will look like in the future.