



Issue Brief

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From the Colorado Fiscal Policy Institute

Flaws in Colorado's Taxpayer's Bill of Rights (TABOR)

The Colorado Fiscal Policy Institute engages in research and education on Colorado's Taxpayer Bill of Rights (TABOR). TABOR is a 1992 constitutional amendment restricting revenue, spending, tax rates, debt, and taxing options, which applies to all levels of government within the state. Our focus has been on the state level, because the state government is in somewhat of a unique position as compared with county, city and special district entities.

This issue brief was prepared in response to inquiries that we have received from Colorado residents who have come to gain an understanding of TABOR, and would like some perspective on specific policy changes that could potentially improve TABOR. It is also in response to out of state persons who have heard of TABOR and would like to learn more about it or whose state is considering a similar amendment and wish to avoid the negative impacts experienced in Colorado. Such individuals may be aware of similar efforts in their states, and may wish to educate themselves about some of the potential effects of such an amendment in their jurisdictions.

TABOR contains almost 1,900 words, by far Colorado's longest constitutional amendment. It contains many subtle provisions that can confound even the most diligent students of governmental finances. It contains term definitions that run counter to good fiscal practice and common sense. Awkward phraseology results in meanings that were not identified until after the amendment was adopted. It is the position of the Colorado Fiscal Policy Institute that many people who voted on the amendment in 1992 were not aware of most of its provisions, and certainly could not have foreseen its practical effects.

The most central aspect of TABOR that most people believed that they were voting on, was the right for taxpayers to vote on any tax rate increases. This is one part of TABOR. However, TABOR also set up a very complex fiscal structure for the state (and local governments) that, after a decade, has now played a big part in placing the state government in an extreme fiscal crisis.

Unlike all of the other states, Colorado elected officials are unique in their utter inability to take effective action to work the state out of a fiscal hole created by the current recession.

"Flaws in Colorado's Taxpayer's Bill of Rights (TABOR)" is not intended to be a comprehensive analysis of TABOR. We do hope that it will help the lay person gain an understanding of some of the essential features of the amendment, their practical effects, and some ideas as to how certain sections could have been written in a more enlightened way to avoid the most problematic effects of TABOR.

- 1. TABOR makes permanent the budget cuts adopted in times of declining revenues. It causes a ratcheting down of government below the trend line of population-plus-inflation whenever actual government revenues fall either below that formula, or into a negative growth range.**

TABOR requires the state to use, as the base on which to apply the population-plus-inflation formula, the lower of actual revenues or the formula -- In other words, if actual revenues are above the formula, the difference is deemed "excess" and must be refunded to taxpayers. Furthermore, if actual revenues fall below the amount the formula allows, then this lower amount is the new base upon which to apply the next year's formula. In FY 2001-02, revenues fell by 15% from the prior year, *even though the state's population and inflation were both positive*. Nevertheless, the state had to start at this lower level when calculating the following year's cap. In effect, when the economy turns around, refunds will begin to occur long before revenues ever reach the population-plus-inflation trend line.

A more reasonable provision would allow the state to utilize the higher of actual revenues or the population-plus-inflation formula in calculating the following year's allowable revenues.

- 2. TABOR contains a disincentive for the state to create and maintain a rainy day fund for economic downturns.**

Since the TABOR revenue cap formula requires that all surplus revenues be refunded, none of that money can be placed into a reserve to be used in down years. While TABOR does not prohibit the state from creating such a fund, each dollar that would be placed into it must come from program spending. This is because TABOR defines "spending," to include any funds that are placed into the state's reserves. By so doing, it effectively converts the term "spending" into "revenue." And since there is a built-in tendency for available funds to ratchet down due to the requirement to use the "lower of" actual or formula, as the years go by there becomes less and less money to work with compared to the state's population and cost of doing business.

Although TABOR does require the state to maintain a 3% emergency fund, its use is highly restricted. It cannot be utilized for fiscal emergencies. If used, for example, to deal with a natural disaster, it must be paid back in full the following year, and excess revenues (under TABOR) cannot be used to pay the fund back. Thus, ongoing program spending must be reduced to deal with emergencies beyond the control of the state. This would hold true even in the case of expenses incurred as a result of war, or requirements imposed on the states by the federal government without federal funding.

A more reasonable provision would allow the state to set aside some portion, for example, one-half of excess revenues towards a rainy day fund. Such a fund should be available to spend, under certain constraints, anytime actual revenues fall below the formula. An alternative would be to exempt spending on a certain list of events (such as natural disasters, war, unfunded federal spending requirements, and economic downturns). Another alternative would be to exempt from the revenue limits any deposits into reserve funds.

3. TABOR's revenue limit is too broad. It includes revenues in its allowable revenue limit that are inappropriate from a public policy standpoint. This results in a lack of flexibility in the state's fiscal management.

Tuition payments by students at higher education institutions, clearly payments for the provision of a discrete service (not a tax payment), must be included within the TABOR revenue limits, unless the state converts higher education (or a given college or university) into an "enterprise." TABOR defines enterprise as a government-owned business that receives less than 10% of its income from taxes. This definition is not only inflexible, but causes perverse results in the funding of higher education. Since during the years 1996 – 2002, Colorado was refunding a total of \$3.25 billion to taxpayers in excess revenues, any additional money collected through tuition increases to keep up with would have been sent right back to taxpayers dollar-for-dollar. As a result, the General Assembly approved only nominal tuition increases, resulting in the college and university system becoming starved for funds. Thus, funding for higher education fell dramatically during the first decade of TABOR, and tuition levels at four-year schools are substantially behind regional competitors. The universities have to make draconian cuts to all parts of the system, thus potentially crippling what has in the past been a nationally recognized educational system. The only way to free higher education from this straight jacket would be to convert some or all of it to enterprise status, clearly an unanticipated consequence of TABOR.

The tuition case is just an example that illustrates how an understandable desire to keep a lid on taxes has resulted in unreasonable restrictions on fee- (not tax-) based services that Colorado citizens may wish to expand. Colorado's tuition levels for four-year institutions are well below regional averages, with the result that Colorado is losing competitive advantage in a vital state service. State law prohibits fees set at a level that exceeds the cost of service provision. Freeing up fee-based services from TABOR's revenue limitations would move the state towards a more business-like fiscal structure.

A more reasonable provision would be to count only revenues from taxes in the TABOR allowable revenue cap. Fees for direct services should be exempt from revenue limits. Current law prohibits state and local governments from charging a higher fee than that necessary to cover the cost of providing a service.

4. TABOR double counts the same dollar of revenue anytime one level of government provides funding to another level.

The state of Colorado operates a number of programs whereby it distributes state money to counties, and counties distribute portions of county-generated money to cities. Examples include (state) fuel tax money for highway projects, and (county) road and bridge property taxes. TABOR requires both levels of government (grantor and recipient) to count the same dollar of revenue within their respective TABOR limits. This provision constrains intergovernmental cooperation, a longstanding practice that helps make government more effective and efficient.

A more reasonable provision would exempt any money that had been counted once against another government's TABOR limit.

5. TABOR's revenue limit is too restrictive; it doesn't recognize the true costs of delivering government services. It utilizes an illogical formula to restrict the growth of state revenues.

TABOR limits revenue growth according to a formula that adds estimated population growth to the change in the consumer price index (population-plus-inflation). This formula is not appropriate to govern the growth of the public sector in relation to the private economy, for several reasons. Under the new federalism, states are now required to take care of an ever-larger portion of the nation's economic/social safety net, matching federal dollars with "own-source" funds (money generated through state taxes). These safety net programs are counter-cyclical by their very nature, that is, they are intended to grow during recessions and shrink during boom times.

Since states must balance their budgets each year, unlike the federal government there is no opportunity to run deficits during recession and surpluses during a boom. If a state is to continue to deliver these vital safety net services, other ongoing state programs must be crowded out. Because TABOR makes the creation and maintenance of a rainy day fund very difficult, TABOR is clearly incompatible with the states' ever growing role in providing these counter-cyclical services.

A stated goal of TABOR's author was to keep government growing no faster than the private economy. Population-plus-inflation together with the "lower of" language does not accomplish this. In fact, it has caused the size of Colorado state and local government to shrink as a percentage of the private economy, and now that the first major ratcheting experience has occurred, this shrinkage will begin to accelerate. According to the conservative Tax Foundation, Colorado's state and local tax burden as a percentage of personal income fell from 9.8% in 1991 (25th among the states), to 8.4% in 2001 (47th among the states). This is a dramatic reduction in the role of the public sector in just one decade. Thus the actual effect of TABOR is to shrink the role of government rather than simply maintaining it.

A more reasonable formula to utilize to limit revenue growth would be change in total state personal income. This formula would ensure that the public sector would indeed maintain its proportion with the private economy.

6. The language of TABOR leads to perverse interpretations of its "tax policy change" clause.

TABOR requires voter approval not only for tax rate increases and the creation of debt, but also for any "tax policy change directly causing a net tax revenue gain..." In practice, this has been interpreted by Legislative Legal Services to include any action by the state to decouple it from a federal tax reduction or elimination to which the state is tied. In 2001, Congress adopted a phase-out of the federal estate tax. Many states, including Colorado, tie their estate taxes to the federal tax, receiving a "share-back" of that tax. Dozens of states "decoupled" from the federal estate tax so they would not lose this *existing* revenue stream. Colorado Legislative Legal Counsel determined that the Colorado General Assembly could not do so because the action, while not resulting in an increased revenue stream from the historical stream, would result in greater revenue than if the federal phase-out were allowed to proceed.

A more reasonable provision would be to narrow the voter approval requirement to include only tax rate increases and the incurrence of public debt.

7. TABOR automatically converted existing statutory spending, revenue, tax and debt limitations into constitutional provisions by reference. As a result, it has created multiple and confusing limitations that inhibit the Legislature's ability to make rational budget decisions.

Many governmental jurisdictions, including the State of Colorado, had previously adopted limitations on spending, revenues, taxation and debt, that were approved as statutes, ordinances, charter provisions, or resolutions. TABOR contains language that requires that any such limitations in place prior to 1992 (when TABOR was approved) can only be "weakened" by a vote of the people. Thus, by a single action, dozens of provisions in statute, city charter, ordinance and resolution that were not originally intended to be in the state constitution, have now been given constitutional status (these new provisions are in addition to the limits expressed in TABOR, cited elsewhere in this paper).

Prior to TABOR, the State of Colorado had adopted a provision that limits general fund operating spending to 6% over the prior year. Under TABOR, this spending limit constitutes a separate and parallel cap that compounds the ratcheting effect of the revenue limits. There are years when the state needs to spend more on capital projects and less on operations; other years, the reverse is true. Now, any general funds above the 6% spending cap must be shifted into capital-type spending regardless of the state's needs each year.

A more reasonable provision would be to return these statutory provisions or those passed by municipal ordinance or charter, or county resolution, to their former legal status.

8. Tax rate reductions passed by statute, ordinance or resolution after 1992 may not be reversed by statute, ordinance or resolution.

Since TABOR requires an election to raise any tax rate, an action taken by a legislative body to lower a tax rate is effectively irreversible. The Colorado General Assembly lowered income and sales tax rates three times during 1999 and 2000, reducing net state revenues by an estimated \$550 million per year. These actions cannot be reversed by the same type of action. Locking in tax rate reductions reduces elected officials' incentives to lower taxes, since tax rates may not be raised again if needed. TABOR thus reduces the ability of elected officials to govern, as well as their flexibility to respond to the changing demands on the state.

A more reasonable provision would be to exempt from the election provision the reversal of any tax-rate reduction adopted by statute, ordinance, or resolution after 1992 (when TABOR was adopted).

Conclusion

TABOR's authors wanted to limit the growth of government in Colorado. The amendment was passed at a time when Colorado's *state and local taxes as a percentage of personal income* fell midway on the list of the 50 states, being ranked 25th in 1991 according to The Tax Foundation. In a mere decade, it fell to 47th. Clearly, TABOR has reduced, not merely maintained, government's relative size in the economy. The tax, revenue and spending mechanisms in TABOR are inherently set up to limit government's growth when robust revenues would normally enable it to catch up with a backlog of needs. And it ratchets down the base when revenues fall below an artificial and inappropriate formula. In a modern society, this trend is unsustainable because state government is being required to shoulder an ever-increasing part of the social and economic safety net in America.

Colorado has already begun to experience the dismantling of its safety net. But it is also seeing its higher education system, K-12 education, judicial and correctional systems, and its ability to respond to public needs fall to dangerous levels in a time of internal and external security concerns. And the most serious issue facing Colorado today and in the coming generation is its inability to take effective action to pull itself out of this crisis, due primarily to TABOR.