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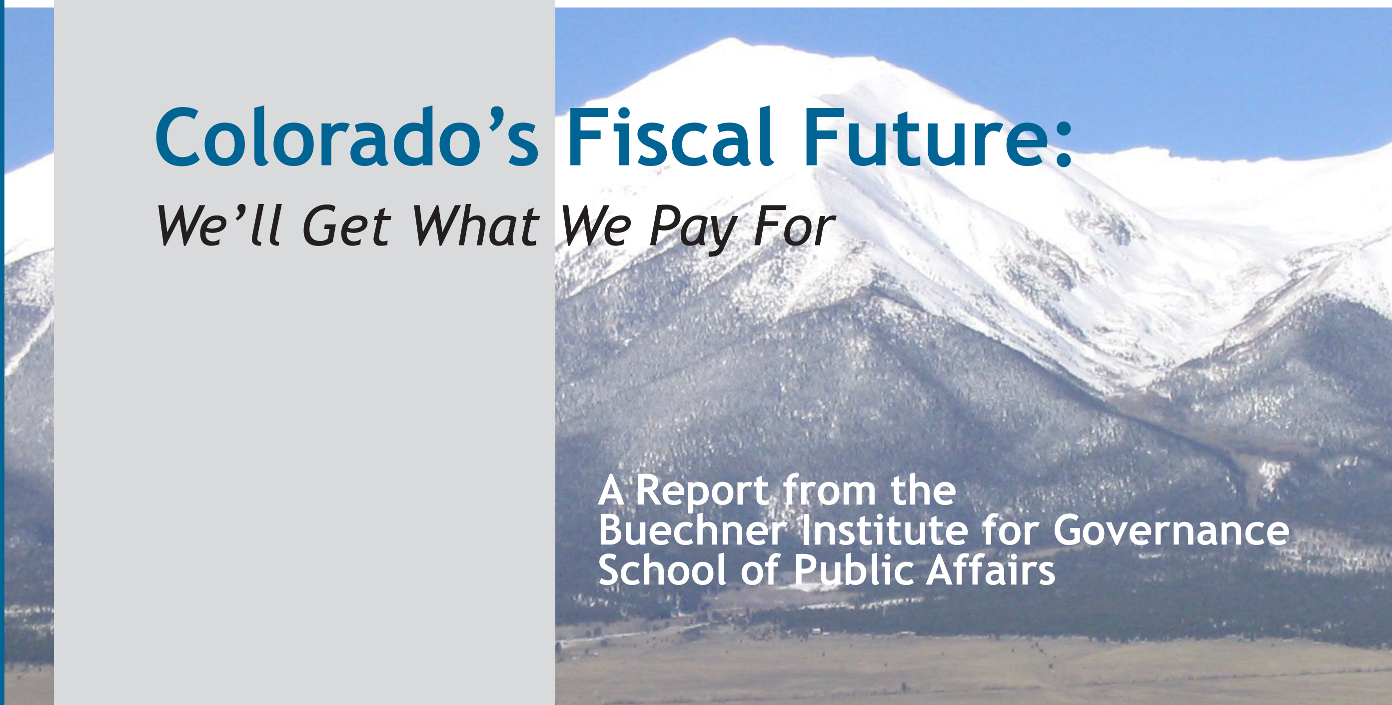

Colorado's Fiscal Future:

We'll Get What We Pay For

A Report from the
Buechner Institute for Governance
School of Public Affairs

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Executive Summary

First, the good news. Colorado is a wealthy state, ranking 12th in the nation for median household income and 15th for per capita personal income. We have a highly-educated population and a diverse economy. The state's natural beauty, moderate climate, and unlimited recreational activities make it a highly desirable place to live.

More good news — Coloradans pay relatively little in taxes. We rank 49th out of 50 states in state taxes paid as a percentage of income, and 44th in state and local taxes combined. The state's voters have supported tax and spending limitations such as the Gallagher Amendment (limiting residential property taxes) and the Taxpayer's Bill of Rights, or TABOR (limiting revenue — and therefore spending — growth in government and requiring all tax increases to be voted on by the public). In 1992, when TABOR was approved by the voters, Colorado's state taxes per $1,000 of personal income were about 30% below the national average. Today, they are more than 40% below the national average. Clearly, Colorado is a state that prides itself on "small" government and the Western value of self-reliance.

However, Coloradans also expect certain levels of services from state and local governments. State and local governments are responsible for educating children, ensuring the safety of roads and bridges, and providing health care for the less fortunate, among many other things. When services in core areas are not meeting expected levels, Colorado voters are willing to direct politicians to spend more in these as they did by passing Amendment 23 and Referendum C.

Recent indicators show that Colorado, one of the nation's wealthiest states, is among the lowest-spending states in a number of core service areas, including K-12 and higher education, health care, and transportation.

Colorado Expenditure Rankings
50-State Comparison, 2009

Expenditure area	Colorado ranking per capita	Colorado ranking per $1,000 in personal income
Total State Expenditures	45	47
K-12 Education	32	48
Higher Education	48	48
Medicaid	49	49
CHP+ Children's Health Care	31	35

Of course, low spending does not necessarily correlate with low quality or low levels of services. One could argue that Colorado is simply extremely efficient compared to other states that spend more. But, it appears that Colorado operates at least as efficiently as most other states and may actually be hindered by a lack of resources for investing in greater efficiency through infrastructure like better data management systems. Recent reports indicate that the state has passed the point where it is operating efficiently to the point where levels and quality of services are suffering:

- **Preschool through Grade 12 Education:** The state's achievement gap (the difference in outcomes between children who are from wealthy, ethnic majority families and those who are poor, ethnic minority, and/or not native English speakers) is one of the largest in the country. In a state where 43 percent of school children are ethnic minority, nearly 40 percent are from low-income families, and 14 percent are English language learners, the size and persistence of the achievement gap has tremendous implications for the state's future.

- **Higher Education:** Declining funding for higher education combined with a 49 percent increase in enrollment has resulted in the student share of tuition nearly doubling since 2001, and a rapid increase in student fees. The gap between the number of white adults and the number of Hispanic adults with higher education credentials is the second largest in the country.

- **Health Care:** Between 2000 and 2008, the rate of children in poverty in Colorado grew faster than any other state, while the state ranks 49th in insuring low-income children. Nearly 14 percent of all Coloradans are uninsured.

- **Transportation:** According to a 2007 report, transportation infrastructure in Colorado is in the midst of a "quiet crisis." The state department of transportation projects that more than half of the roads in the state highway system will be ranked in poor condition, meaning that they need major rehabilitation or complete reconstruction, by the close of fiscal year 2010. Seven percent of all bridges are also ranked in poor condition.

In this report, the Buechner Institute for Governance looked at a variety of studies and reports published over the last few years that attempted to quantify the levels of funding needed in these core services areas in order to meet stated policy goals. Put simply, it won't be cheap. For example, the Colorado Fiscal Policy Institute estimates that it would take between $3.6 billion and $5.2 billion in additional revenue just to get the state to the middle of the pack on spending (depending on the measure used). Given that current state general fund spending is around $7.5 billion, this is not small change. Other reports estimate spending needs in specific core service areas as follows:

Estimated Spending Needs for Select Service Areas

Service Area	Goal	Estimated Additional State Spending Needed	Source
PreK-12 Education	Ensure that all children are proficient in reading, writing, and mathematics	$2.9 billion/year	Colorado School Finance Project
PreK-12 Education	Implement first phase of achieving stated goals of Colorado Achievement Plan for Kids	$142.4 million	Augenblick, Palaich & Associates
Higher Education	Keep up with inflation	$240 million/year	Higher Education Strategic Planning Steering Committee
Higher Education	Place Colorado in top third of all states for higher education funding	$740 million/year	Higher Education Strategic Planning Steering Committee
Health Care	Universal health care coverage	$1.23 billion/year	Blue Ribbon Commission on Health Care Reform
Transportation	Continuation of current service levels	$461 million/year	Colorado Department of Transportation
Transportation	Improved levels of maintenance	$688 million/year	Colorado Department of Transportation
Transportation	Integrated transportation corridor planning and service	$1.3 billion/year	Colorado Department of Transportation

Increasing revenue at these levels would require a decision by Coloradans to significantly invest in core services that are critical for the future of the state. As the full report shows, it is simply not possible to raise this level of revenue through small tax increases targeted at single categories of the population, so that only a few taxpayers actually “feel the pain.” The types of revenue raising policies most states have turned to in recent years, such as increases in alcohol or tobacco taxes, gaming revenues, or severance taxes will fall far short. None of these revenue sources make up more than a small portion of total state revenues, and even substantial increases to their tax rates will fail to have enough of an impact. Nor is it likely that the state can simply find increased efficiencies to cover these costs. After the cuts in the two most recent recessions, it is hard to argue that there are hidden pockets of wasted or unspent funds. Instead, some combination of the following options will likely be required:

Estimated Revenues per Tax Rate Change

Tax Type	Tax Rate Change	Estimated Additional Revenue Raised
Individual income tax	For every 1.0 percentage point increase in tax rate	$1.0 Billion
State sales/use tax	For every 1.0 percentage point increase in tax rate	$750.0 Million
Corporate income tax	For every 1.0 percentage point increase in tax rate	$74.0 Million
Motor fuels tax	For every 1.0 cent increase in tax rate	$29.0 Million
Property tax	For every 1 mill increase in tax rate (2008 taxable values)	$88.0 Million

In the end, the strategy Colorado will need to follow if consensus forms around the need to raise significant new state revenues (say $2 to $3 billion more per year) is to combine some of the following strategies:

- Adopt either rate increases and/or tax base expansions across multiple taxes.
- Understand that relying on increasing a single tax, even the individual income tax, will result in either raising too little revenue or further distorting and destabilizing the state’s overall tax system.
- Include the primary tax revenue sources, income and sales taxes, in the mix.
- Consider new state revenue sources, such as a state property tax levy, and innovative distributions of that revenue.
- Consider phasing in changes over a number of years.

Of course, any new tax or change in tax rates will require a statewide referendum under the provisions of TABOR. Some, such as adopting a graduated individual income tax, will also require changes to the state's constitution. We can only speculate on the political feasibility of either of these approaches.

Colorado is a wealthy state. Yet as a state we have elected to keep taxes and government spending among the lowest in the nation. Without raising revenues, it is becoming increasingly clear that we will not be able to maintain even current service levels. Soon, the citizens of Colorado will have to decide what they want from their state government and whether they are willing to pay for it.

The mission of the Buechner Institute for Governance is to advance the understanding and practice of public affairs in Colorado and the Rocky Mountain West. We provide relevant and timely research, training, facilitation, and other services to local, regional, and state governments, nonprofit organizations, and other groups involved in public affairs.

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The Buechner Institute for Governance is dedicated to improving decisions and policy making in areas of public importance. Staff at the Buechner Institute conduct research and evaluation in a variety of policy areas, direct leadership development programs, and work with governments, organizations, and communities across Colorado and the Rocky Mountain West.

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Introduction

In many ways Colorado is among the most fortunate of states. In normal economic times it has a vibrant, diverse economy. It possesses strategic natural resources such as oil and natural gas. It has a well-educated population boasting one of the highest rates of adults with college degrees in the nation and consistently ranks among the top states in per capita personal income. Its natural beauty, moderate climate and unlimited recreational opportunities make it a highly desirable place to live.

Yet, not all is well. One could reasonably argue that Colorado has yet to realize its full potential and faces increasingly difficult challenges in doing so in the years ahead. While the state does well on the measures discussed above, other measures paint a different picture. Colorado consistently ranks lower than average in areas such as closing the achievement gap in education, funding higher education, caring for its vulnerable populations, and maintaining its physical infrastructure. Internal needs assessments show that the state is not meeting the demand for such fundamental services as safe roads, bridges, and school buildings.

For example, serious concerns abound over whether Colorado can afford to provide the type of world-class education needed to further expand its economy in high-tech and high-value areas. While the state's work force is well educated, many of those with college degrees are imported from other states. Colorado ranks in the bottom half of the country in producing its own college graduates. A doubling of tuition costs of the past decade has made higher education in the state even less affordable for low and middle income students (Higher Education Strategic Planning Steering Committee, 2010).

Overall, it appears that our elementary and high school students perform well on national assessments in comparison to other states. However, our students who are poor, minority, or whose first language is not English perform much worse than their white and affluent peers. According to the most recent Education Week *Quality Counts* report, Colorado possesses one of the largest achievement gaps in the country between affluent and poor students, a troubling statistic in a state with a large and growing Hispanic population. And the gap in Colorado continues to grow at an alarming rate while on average it is closing in the rest of the country (Education Week, 2011).

The state is failing at caring for its children in other ways as well. According to the most recent *Kids Count* report, between 2000 and 2008 Colorado experienced the nation's largest growth rate in child poverty, an increase of 72% (Colorado Children's Campaign, 2010). Colorado ranks only 49th among the states in insuring low income children, one of the reasons why there are more children under the age of 18 in Colorado without health insurance than the national average.

Our public infrastructure, particularly transportation, is deteriorating from lack of investment in basic maintenance and repair while becoming increasingly inadequate for supporting our growing population. According to the Colorado Department of Transportation, the state must spend nearly half a billion dollars per year more simply to prevent highways and bridges from deteriorating further.

There is a reason why the state funds these programs and activities at lower rates – it simply has less money to spend. Colorado ranks 47th in the nation in total state expenditures per $1,000 of personal income, and 49th in state taxes per $1,000 of personal income (44th in combined state and local taxes). Although Colorado is a wealthy state, collectively we have decided to invest relatively little in our public sector. Instead, we have decided the question is: can we afford to continue along this path without risking our economic competiveness and quality of life?

The purpose of this report is to bring together the best information currently available on the following questions:

- How much are we currently investing in core state government services such as K-12 and higher education, health care and transportation? How efficiently is our state government providing these services?

- Are these investments adequate, and if not, how much more do we need to invest?

- How much in revenues is our current state tax system generating? How does it compare to other states? What effect have state fiscal policies such as the Taxpayers' Bill of Rights (TABOR) and Gallagher had on the state's ability to raise revenues and manage the state budget?

- If we in fact choose to increase state investments, what sort of tax increase strategy is realistically necessary to generate the additional revenues required? Can Coloradans afford to pay more in taxes?

In the next section of this report we will highlight recent studies which raise some red flags over the need for additional spending on core state programs and the potential consequences if we fail to act. This is followed by a brief overview of Colorado's state tax system, including how much revenue each tax raises, how much each contributes to the total revenue pie, and how Colorado's tax levels compare nationally. The next section describes the major state fiscal policies, such as the Gallagher Amendment, TABOR, and Amendment 23, that have driven revenue and expenditure levels over the past quarter century. We then look at how much Coloradans currently pay in state taxes and how this compares nationally. We then summarize some of the recent fiscal reform efforts in the state and the solutions, if any, they recommend. Finally, we present several scenarios of how Colorado could go about raising a significant amount of new state revenues, should it choose to do so. In particular, we examine the nature and size of tax increase strategies that would be required to raise significantly more state revenues — perhaps as much as $2 to $4 billion dollars per year.

Measuring Colorado's Fiscal Need

It could certainly be argued that addressing Colorado's complex and often contradictory fiscal policies would be a worthwhile effort simply from a good government perspective. Among the more dysfunctional aspects of the state's fiscal system are contradictory policies locked in the state's constitution (for example TABOR and Amendment 23 , the combination of which both limits revenues and mandates spending), further restrictions on specific revenue sources such as the property tax (Gallagher Amendment), and most importantly, the combined effect these provisions have on legislative discretion over the state budget, in effect placing much of the state budget on a form of autopilot. Taken together, the ongoing piecemeal tinkering through legislation and the ballot box has nearly rendered the state fiscally unmanageable. Not only have the various policies adopted over time severely restricted the ability of elected officials to address fiscal shocks such as occurred during the recession of 2001-2003 and today's ongoing economic crisis, but there is the more fundamental question of whether the state possesses the ability to raise the revenues required to provide basic services in a sustainable manner.

The question of whether or not Colorado is providing an appropriate level of public services is rightly a political question. However, there are measures available that suggest Colorado may be under-investing in key governmental services that are not only important for supporting the wellbeing of its citizens but for sustaining a vibrant economy as well.

One way of gauging Colorado's relative fiscal need is to use the comparative analysis *Aiming for the Middle: Benchmarks for Colorado's Future*, first released in 2007 by the Colorado Fiscal Policy Institute (COFPI) and updated in 2009 (COFPI, 2007, 2009). *Aiming for the Middle* provides an analysis of where Colorado ranks among states in spending per capita and per $1,000 of personal income on basic state services such as education, health care and transportation, and estimates what the cost would be to achieve either the national average in spending in these areas or to rank as the 25th, or median, state. The 2009 rankings are summarized in Table 1 below.

Table 1
Colorado Expenditure Rankings 50 State Comparison

Expenditure Area	Colorado Ranking Per Capita	Colorado Ranking Per $1,000 PI
Total State Expenditures	45	47
K-12 Education	32	48
Higher Education	48	48
Medicaid	49	49
CHP+ Children's Health Care	31	35

Source: Colorado Fiscal Policy Institute

The results of the *Aiming for the Middle* study show that Colorado ranks near the bottom among states in each of these areas of state spending, and well below the mean or median state.

Table 2
Expenditures Per Capita and Per $1,000 of Personal Income (PI)
Colorado and the U.S. Average

Expenditure Area	Colorado Expenditures Per Capita	Colorado Expenditures Per $1,000 PI	US Average Expenditures Per Capita	US Average Expenditures Per $1,000 PI
Total State Expenditures	$4,386.74	$106.49	$5,246	$140.52
K-12 Education	$1,523.11	$41.16	$1,746.59	$50.67
Higher Education	$149.35	$3.52	$269.70	$7.16
Medicaid	$539.98	$13.11	$1,015.71	$27.74
CHP+ Children's Health Care	$21.06	$0.51	$25.36	$0.68

Source: Colorado Fiscal Policy Institute

COFPI estimates that for Colorado to reach the U.S. average for total state per capita spending it would have to increase spending by $3.6 billion overall, while to attain the state average spending level per $1,000 in personal income, spending would have to increase by $4.9 billion. To reach the level of spending of the median state, it would have to increase spending by nearly $3.9 billion on a per capita basis and $6.2 billion based on personal income. Given that the state's total fiscal year 2007 general fund expenditures were $6.8 billion, and total operating expenditures of $16.3 billion from all funds (the corresponding expenditure amounts for fiscal year 2010-11 are $7.5 billion in general fund spending and $19.0 billion for all funds), it is clear that attaining the modest goal of "aiming for the middle" would entail significantly higher spending levels than the state has historically approached.

To reach the national average level of overall state funding, the state would have to increase expenditures between 63% and 91% of current general fund spending (depending on whether the measure is expenditures per capita or per $1,000 in personal income), or by between 24% and 38% of total spending from all funds. An increase in state spending of this magnitude would require tax and/or fee increases at levels that have not been supported by the general public in Colorado historically.

According to COFPI, increasing expenditure levels to the national average for the four major program areas of K-12 education, higher education, health care, and transportation, which account for roughly 75% of the state's budget, would require additional spending of $3.8 million annually to reach the national average on a per capita basis and $4.7 million on a per $1,000 of personal income basis.[1]

[1] A fifth major area of spending, corrections, accounts for another 6% of state spending (14% of general fund spending), but was not specifically addressed in the *Aiming for the Middle* report and is not discussed in this analysis.

Regardless of the specifics, these all represent unprecedented increases in spending at the state level in Colorado. However, simply increasing expenditures to the national average does not provide any insight into what the resulting service levels will be. What additional instructional services will students receive by increasing K-12 education spending by more than $1 billion? Smaller class sizes? Better prepared teachers? A higher-quality curriculum? How will health care outcomes for the poor improve by increasing Medicaid expenditures by $1 billion? Are the increases in these areas adequate to raise service levels up to a point that Coloradans need or expect?

While raising spending levels to the national average may not tell much about the qualitative impacts on public programs, recent studies undertaken in Colorado in four of the five largest program areas provide a more explicit link between increased spending and specific service quality benchmarks. That is, these analyses began by defining in various ways what sort of service levels Colorado needs, and then attached the additional costs required to attain them. These studies also parallel the program areas examined in *Aiming for the Middle* - K-12 education, higher education, health care, and transportation. The following briefly summarizes each of these studies.

PK-12 Education

Concerns over the deterioration of funding for K-12 education have persisted since the passage of TABOR. As state funding declined from 1988 levels throughout the 1990s, efforts to stabilize revenues culminated with the passage of Amendment 23 in 2000, which was designed to gradually restore PK-12 funding back to 1988 levels by 2011 and continue growing by at least the rate of inflation thereafter. However, even with the funding floor provided by Amendment 23, PK-12 funding has remained far behind the rest of the nation. According to *Education Week's* annual *Quality Counts* report (2010), Colorado's per pupil funding, adjusted for regional cost differences, was more than $1,900 below the nation average.

In 2005, education advocates again attempted to tackle the school funding issue by filing a lawsuit against the state, *Lobato vs State*, on behalf of parents and school districts claiming that the state's school finance system was inadequately funded in violation of the state constitution's education clause mandating a "thorough and uniform" school system. In 2003, and again in 2006, costing out studies were conducted to estimate what the total state cost would be for meeting state education standards. This study found that an additional $2.9 billion per year in education funding would be required for all students to achieve proficiency in reading, writing and mathematics (Colorado School Finance Project, 2008). These additional revenues would be used to provide smaller class sizes, universal preschool, more technology, and other educational services. Note that the recommended funding level of this study, based on an analysis of educational need, is more than a billion dollars more annually than COFPI's estimated cost of reaching the national average in per pupil funding.

While the costing out study provides an estimate of what state funding for PK-12 education should be given Colorado's stated learning goals, a second study provides estimates of what Colorado must spend to implement reforms already enacted by the state. The Colorado Achievement Plan for Kids, or CAP4K, was enacted in 2008 as Governor Ritter's signature education policy achievement. Under CAP4K, the state Departments of Education and Higher Education were directed to design and implement by 2012 a program of new, integrated standards and assessments designed to prepare all students for higher education and work. While the full cost of implementing and sustaining CAP4K is not yet known, preliminary findings of a study of the cost of early implementation tasks, such as defining standards, developing curriculum, and providing teacher staff development, estimated the costs for these tasks will run between $131.5 to $142.4 million (Augenblick, Palaich and

Associates, 2010). Among the costs not addressed by the study are the development and administration of new assessments or additional instructional costs of PK-12 school districts and higher education institutions.

Although PK-12 education represents an enormous investment by the state, comprising more than 40% of its general fund budget, higher levels of education pays dividends through increased tax revenues and budget savings over the long term. Individuals with a high school diploma earn over a third more during their lifetime than those who did not graduate from high school, while college graduates earn twice what high school graduates do (Higher Education Strategic Planning Steering Committee, 2010). This results in higher state tax revenues, as higher income individuals pay more in income taxes, and because they also purchase more goods, higher sales tax revenues as well. Studies also show that higher education levels are associated with greater economic output and lower crime rates and costs for welfare and other social services (Alliance for Excellent Education, 2008).

Higher Education

In 2009, Governor Ritter appointed the Higher Education Strategic Planning Steering Committee (HESP) to develop a strategic plan, including exploring sustainable funding options, for higher education in the state. The Committee's plan focused on improving affordability and access to higher education while improving program quality and completion rates. A key factor identified by the panel for achieving these goals is to provide an adequate and stable funding stream for the state's higher education systems. Specific recommendations made by the Committee include making post-secondary education more affordable for all students meeting admissions requirements, better aligning the higher education and PK-12 educational systems, and strengthening higher education governance and accountability (Higher Education Strategic Planning Steering Committee, 2010).

There is no question that Colorado has retreated on its support of higher education. Over the past 20 years state support for higher education has declined from a 20% share of the state's general fund to 9% today while tuition has nearly doubled. Tuition has become such an important tool for offsetting state funding cutbacks that the General Assembly passed SB 10-003 granting higher education governing boards the authority for the next five years to raise tuition by up to 9% without legislative approval. Governing boards may raise tuition even more with approval from the Colorado Commission on Higher Education. In 1991, 57% of total higher education funding in Colorado was from state appropriations while 43% was raised through tuition. By 2008, these proportions were almost reversed, with state appropriations accounting for only 42% of total funding and tuition 58%. By comparison, in 2008 the national average funding proportions were 64% state appropriations and 36% tuition (National Center for Higher Education Management Systems, 2010).

Colorado's declining investment in higher education has forced the state system to work more efficiently. The state's higher education institutions currently rank second lowest in the nation in total costs per degree or certification granted (Higher Education Strategic Planning Steering Committee, 2010). Nevertheless, these institutions are falling behind in the task of preparing young adults for careers in our high-skill, knowledge-based economy. Governor Ritter's goal of doubling the number of degrees and certificates granted by Colorado's post-secondary institutions by 2020 will require more than doubling the state's college completion rate from the current 1.7% per year to 5.0% per year. To accomplish this will require dramatically improving upon Colorado's current high school graduation and college completion performance. Out of every 100 students entering 9th grade, only 70% graduate from high school and, more startling, only 22 graduate from college within six years (Higher Education Strategic Planning Steering Committee, 2010).

What is the cost of achieving these goals? The Committee estimates that general fund support for Colorado's higher education system would have to increase over current funding levels by between $240 million and $740 million per year in order to begin achieving the strategic plan's goals. An increase of $240 million, which would bring overall funding up to $1 billion annually, would simply allow the system to keep up with inflation. Increasing funding by $740 million, to $1.5 billion in total expenditures on higher education annually, would place Colorado among the top one-third of states in state support for higher education, a significant leap from the state's current 48th place ranking.

The Committee also presented five options for raising the revenues required to increase support for higher education. These include increasing individual income tax and sales tax rates, expanding the sales tax to services, imposing a surcharge on mineral extraction, and establishing a 4.0 mill state property tax for higher education. The estimated amount of new revenue raised by each of these options ranges from $150 million to $445 million annually.

Health Care

Improving health care is a third major policy area within the state for which a cost study was recently conducted - this one under the auspices of the Blue Ribbon Commission on Health Care Reform established by the General Assembly in 2006. Charged with the tasks of finding alternatives for controlling health care costs while expanding coverage to the state's uninsured, the Commission issued a request for proposals for comprehensive reform plans. Out of 31 responses, the Commission selected four for further analysis and cost modeling. The Commission ultimately developed its own plan as well and submitted a report to the General Assembly presenting the five comprehensive plans and 32 recommendations for reforming Colorado's system of health care (Blue Ribbon Commission for Health Care Reform, 2008). Four of the five plans provided for universal health care coverage by expanding access to Medicaid and CHP+, and premium subsidies for families ineligible for these public programs. The fifth plan called for a universal single payer system. Similar to the national health care reform plan recently passed by Congress, the Commission recommended creating an individual mandate for health insurance while providing financial support to those who either are unable to obtain health insurance through their employer or purchase it on the individual market through the expansion of existing public health care programs such as Medicaid and the Children's Health Plan Plus, or by providing premium subsidies on a sliding scale based on income.

The Lewin Group, a health care consulting firm, was hired to provide cost estimates for each of the four plans submitted to the Commission and for the Commission's own plan (The Lewin Group, 2008). The cost estimates for these plans ranged from $980 million to $26.5 billion per year. Some of the costs of each plan would be offset by current spending for existing programs that would be folded into or replaced by the new plan and by drawing down additional federal funds. But, each also required additional state funding ranging from $389 million to more than $2 billion annually. The organizations submitting plans were required to show how they would raise any additional state dollars required under their plans. Each of the five plans proposed increasing "sin" taxes on some combination of tobacco, alcohol or low nutrition snack foods. Other revenue raising strategies included a premium tax on health insurers; a provider tax on hospitals, clinics and doctors; an employer fee for uninsured workers; and an increase in the state income tax rate. Table 3 below summarizes revenues by source for each of the five health care reform plans.

Table 3
Revenue Estimates (in Millions) for
Blue Ribbon Commission for Health Care Reform Proposals

Funding Sources	Proposal 1 Care for Colorado	Proposal 2 Solutions for a Healthy Colorado	Proposal 3 A Plan for Covering Coloradans	Proposal 4 Health Services Program	Proposal 5 Commission Proposal
Federal	$560	$334	$941	$8,425	$1,269
State Offsets	$31	$179	$191	$3,128	$179
New State Revenue	$389	$853	$2,014	$15,025	$1,232
Total State and Federal	$980	$1,366	$3,146	$26,578	$2,680

Source: The Lewin Group (2008). State offsets represent existing state funds that would be reallocated under the new plans.

Colorado has taken a first step toward expanding health care access to low income individuals and children with the passage in 2009 of the Colorado Health Care Affordability Act. Under this legislation the state levies a provider fee on Colorado's hospitals and uses the money to draw down additional federal Medicaid and CHP+ funding. The hospital provider fee, which raises an estimated $425.8 million in 2010-11, is expected to expand health care coverage to more than 100,000 low income Coloradans (Legislative Council, 2010).[2]

Transportation

According to the Colorado Transportation Finance and Implementation Panel (2008) appointed by Governor Ritter in 2007, transportation infrastructure in Colorado is in the midst of a "quiet crisis." While state highway miles driven increased by more than 60% since 1990, transportation's primary source of revenue, the state motor fuels tax, has lost ground to inflation and more fuel efficient cars and trucks. Revenue transfers from the general fund and FASTER's (Funding Advancement for Surface Transportation and Economic Recovery) $250 million per year increase in vehicle registration fees, along with $385 million in one-time federal American Reinvestment and Recovery Act funds, have helped to offset some of the motor fuels tax losses, but the system remains woefully underfunded for maintaining current highways, let alone expanding the system for meeting the needs of a growing population.

The Panel's 2008 report provided alternative recommendations for increasing annual funding for transportation infrastructure by between $500 million and $2 billion. Its preferred plan, totaling an additional $1.5 billion per year, was considered the most suitable for building and maintaining a comprehensive transportation system. The Panel proposed paying for its plan through a combination of increased fees, motor fuels taxes, sales taxes, and severance taxes.

[2] The estimate of individuals served was provided by the Colorado Department of Health Care Policy and Financing.

In its annual T*ransportation Deficit Report*, the Colorado Department of Transportation (2010) provided an update on the state's transportation infrastructure needs and the associated costs of meeting them. Currently, only 50% of Colorado's state highways are classified as being in good/fair condition and 125, or nearly 7%, of its bridges are considered to be in poor condition. In its report, the Department provided estimates of the investment required for each of its three primary program areas – highway repair, bridge repair and maintenance - under three different goal levels. Under the first goal, over the next 10 years the Department would simply continue current performance levels, meaning that only 50% of highways would be maintained to good/fair condition, 7% of bridges would continue to be listed as poor, and maintenance levels would continue at what the Department currently rates as a "C+" service level. Under the second goal, over the next 10 years the proportion of highways listed as good/fair would increase to 60%, the proportion of "poor" bridges would be reduced to 5%, and maintenance would increase to a "B" service level. The third and most ambitious goal calls for sustaining corridor vision service levels over the next decade. Corridor vision service levels assume long-range, comprehensive planning and programming for each targeted transportation corridor. A corridor vision plan anticipates and plans for future growth, addresses multiple transportation modes and accommodates local community, economic and environmental factors.

As shown in Table 4, total *additional* annual costs for all three program areas combined range from $461 million for maintaining the status quo to $1.3 billion for achieving the corridor vision level of service.

Table 4
Estimated Additional Revenue Required by Goal Level (Millions)

	Goal 1	Goal 2	Goal 3
Highway Repairs	$380	$500	$830
Bridge Repairs	$31	$57	$276
Maintenance	$50	$131	$203
Total	$461	$688	$1,309

Source: Colorado Department of Transportation's Transportation Deficit Report

Overall

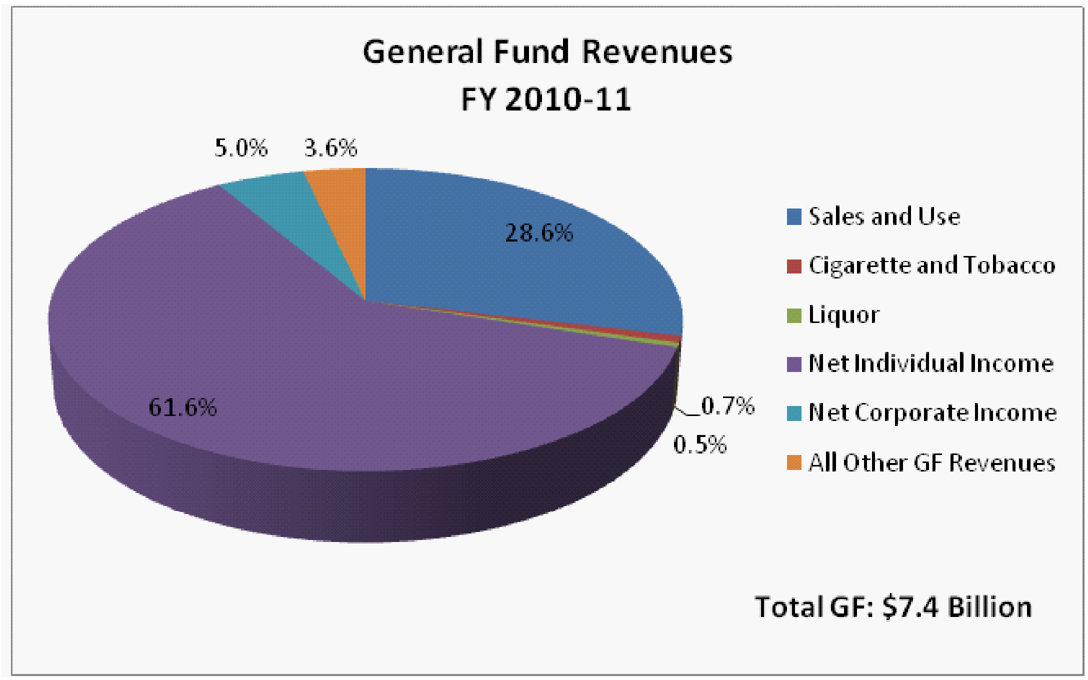
Given the above discussion, how much more would Colorado need to spend per year to meet the recommended service levels in the four core service areas outlined above? In short, it depends. Based on COFPI's Aiming for the Middle analysis, the range is between $3.6 billion and $6.2 billion, depending on whether your goal is to simply raise overall state expenditure levels to the national average or to the level of the median state, and whether your measure is based on per capita expenditures or expenditures per $1,000 of personal income (which is a better measure of a state's capacity to support government services).

If we focus on the additional spending that expert panels have identified for the four major program areas of K-12 education, higher education, health care, and transportation infrastructure, we find a startling range of $1.7 billion to $31.5 billion. The lower number assumes only funding the currently identified costs of implementing CAP4K for PK-12 education plus the low estimates for the other three policy areas. The higher number assumes funding PK-12 at the adequacy level identified in the Colorado School Finance Project's costing out study plus the high estimates for the other three spending areas. Regardless of the approach, even the minimum increase identified here represents a significant increase of financial support over Colorado's current state general fund spending of $7.5 billion. Nevertheless, these numbers still fail to take into consideration other areas of the state budget that have been chronically underfunded or have seen their funding eroded in recent years, such as human services (social safety net programs) and the state parks system. Addressing these program areas would add millions more to these cost estimates.

An Overview of Colorado's Tax System

State revenues in Colorado are estimated to total just over $10 billion for fiscal year 2010-11.[3] The revenues that flow into the state are assigned for the most part to two funds: the general fund where most general purpose revenues are deposited to pay for state government administration, education, human services, and other state services; and the cash fund, in which revenues dedicated to specific purposes are typically deposited. These include revenues that are collected to fund state programs such as highway and other state transportation infrastructure maintenance and construction, expended health care and parks and recreation. Figures 1 and 2 show revenues by source for both the general and cash funds for fiscal year 2010-11.

Figure 1

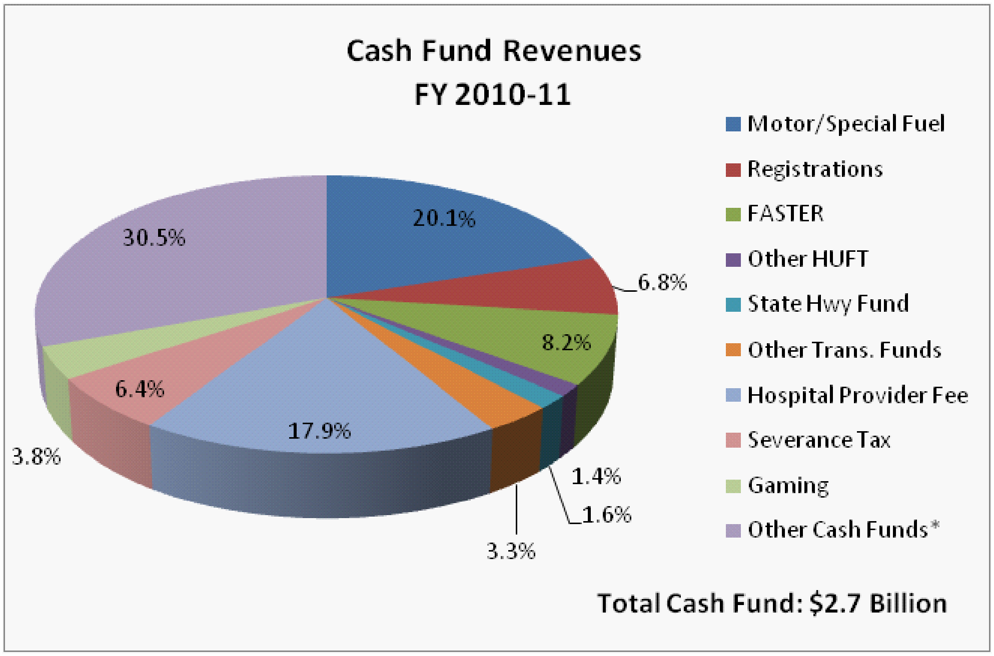


Source: Legislative Council, December 2010 *Economic and Revenue Forecast*

As Figure 1 shows, the individual income tax makes up more than 60% of general fund revenues. Together with the state sales and use tax, the two taxes account for 90% of general fund revenues. The next largest general fund source is the corporate income tax, which accounts for 5% of general fund revenues. All other general fund revenues combined make up the remaining 5%.

[3] This amount does not include the include the state's unemployment insurance fund, which is estimated to have total revenues of $1.0 billion in 2010-11 but a negative net balance of $206.4 million.

Figure 2



Source: Legislative Council, December 2010 *Economic and Revenue Forecast*

A good share of the state's cash fund consists of revenues which are dedicated for transportation projects, such as the motor fuels tax and vehicle registrations. Combined, transportation-related revenues make up more than 40% of the state cash fund. Other revenue sources for the cash fund include the hospital provider fee for supporting expansion of Medicaid and CHP+ programs, gaming receipts, the severance tax, court fines and fees, and state park and other agency fees. Figure 2 shows the percentage of all cash funds that each of the major revenue sources contributes.

The vast majority of state revenues are subject to the constitutionally prescribed revenue limits outlined in the Taxpayer Bill of Rights. Of the totals shown above, only $244 million in cash funds have been designated as exempt from TABOR's revenue cap.[4] TABOR is described in greater detail later in this report.

Table 5 below shows how the mix of state revenues in Colorado compares to the nation. Compared to the rest of the nation, Colorado is more reliant on revenues from the individual income tax while relying less on the other types of revenue sources. In Colorado, the individual income tax accounted for fully half of state revenues, compared to just over a third on average among the other states.

[5] Again, excluding the state unemployment insurance fund.

Table 5

Tax Type as Percentage Share of Total State Taxes (All Funds)
Fiscal Year 2007-08

Tax Type	Colorado Percent of Total	Colorado Rank	U.S. Percent of Total
Property	--	--	1.8
General Sales	24.5	44	31.9
Selective Sales	13.5	36	16.0
Individual Income	50.7	12	34.4
Corporate Income	3.8	40	5.6
Other	7.5	32	10.3

Source: Federation of Tax Administrators 2008. Includes all funds.

Colorado is one of 19 states that do not levy a state property tax. The state also shares the sales tax with counties and municipalities. The general sales tax amount shown above represents the proceeds only from the state's share, raised by a tax rate of 2.9%. Local governments may levy up to an additional 5.1% for a maximum sales tax rate of 8%.

The selective sales tax category consists primarily of the state motor fuels, alcohol and tobacco, and insurance premium taxes. These taxes account for 16% of state tax revenues nationally, but only 13.5% in Colorado. The Other Taxes category consists primarily of severance, financial transaction, estate, and gift taxes. At 7.5% of total taxes, Colorado's share is again less than the national average of 10% of total revenues.

Table 5 also shows that Colorado raises substantially less of its total revenues from the corporate income tax in comparison to other states, although the tax does not represent a large proportion of state revenues generally. Only 3.8% of state revenues were derived from the corporate income tax in Colorado compared to 5.6% nationally, ranking Colorado only 40th in the share of corporate income taxes collected.

Colorado is unique in that it is one of only five states in which local revenues make up the majority of state and local revenues. In 2008, local revenues made up 53.6% of total state and local revenues, with state revenues accounting for 46.4%. This compares to the national average of 54.9% state revenues and 45.1% local revenues. The other four states where local revenues exceed those of the state are Florida, Georgia, Nevada, and New York. Texas is virtually evenly split between state and local revenues. Table 6 shows the proportion of total state and local taxes raised by each of the tax types.

Table 6

Tax Type as Percentage Share of Total State and Local Taxes
Fiscal 2008

Tax Type	Colorado Percent of Total	Colorado Rank	U.S.Percent of Total
Property	31.2	22	30.8
General Sales	26.8	23	22.9
Selective Sales	7.8	46	10.8
Individual Income	25.8	27	22.9
Corporate Income	2.6	46	4.3
Other	5.8	37	8.2

Source: Federation of Tax Administrators 2008 State and Local Tax Comparisons Rankings include 50 states and DC except for state only ranking. Includes all funds.

When looking at combined state and local taxes, Colorado's share of general sales taxes collected becomes somewhat higher than the average among states. Its ranking jumps from 44th for state taxes only to 23rd for state and local taxes combined. The state's property tax collections are also somewhat higher than the average across states.

Colorado's low tax rankings are not accidental. Over the past several decades state policymakers and the voters have enacted provisions that intentionally curtail the state's ability to raise and spend revenues. The following section provides a brief overview of the major tax and expenditure limits (TELs) adopted since 1980.

A Primer on Colorado Fiscal Policy

Colorado has historically ranked low among states in terms of taxing and spending. The small government leanings of many of the state's voters have been largely institutionalized with the help of one of the nation's most lenient ballot initiative processes for amending the state's constitution or directly enacting laws. With one of the lowest petition signature requirements in the country and no requirement for the geographical distribution of signatures, individuals and organizations have little trouble placing a provision on the ballot, especially if they have resources to pay for signature gathering and advertising. As a result, several provisions affecting taxation and government spending have been enacted through the ballot box as well as through the legislative process. This section briefly summarizes those provisions that have played a role in shaping Colorado's current fiscal climate.

Gallagher Amendment

On the heels of the tax backlash of the 1970s, first demonstrated with the passage of California's Prop 13 property tax limitation, Colorado voters reacted to rapidly rising property values, and in turn taxes, by passing a constitutional amendment in 1982 (known as the Gallagher Amendment) that froze residential property's share of total property taxes at about 45%. With residential property values rising much faster than commercial values, the assessment rate for residential property has fallen dramatically to maintain the 45/55 allocation of total property taxes between residential and commercial property. As a result, local governments effectively lost the opportunity to benefit from the soaring residential property values beginning in the latter half of the 1990s. Over time the passage of Gallagher has, at least in part, constrained the growth of assessed valuation and taxes overall, with per capita tax levels remaining stagnant since its passage, when adjusted for inflation (Center for Tax Policy, 2007). Compared to the rest of the nation, Colorado ranks 31st in state and local property taxes per $1,000 of personal income, and its per capita state and local property tax amount of $1,242 is $104 below the national average.[5]

Arveschoug-Bird

Passed in 1991, the Arveschoug-Bird provision was enacted by the state legislature to place a 6% cap on the annual growth of general fund spending. However, the law did not actually limit spending, but instead redirected general fund revenues in excess of the 6% cap to other purposes, such as transportation and capital construction. The provision also had a so-called "ratchet" effect under which in years where general fund spending declined from one year to the next, such as during the current economic recession, the expenditure base was permanently reduced. Thus, when the economy did begin to recover the state was not able to catch up, since the base going forward reflected the lower expenditure levels. Ironically, the law was passed to pre-empt passage of TABOR which nevertheless was approved by voters the following year (Martell & Teske, 2007).

Arveschoug-Bird's 6% limit was repealed in 2009, but a secondary cap limiting general fund expenditures to no more than 5% of total state personal income was left in place. However, this is a much higher standard, and general fund appropriations have fallen well below this standard since strong personal income growth began in the mid 1990s (Mullis, 2009).

[5] Based on 2008 U.S. Census data.

Taxpayer Bill of Rights

Despite the general fund spending limitations contained in Arveschoug-Bird, voters passed TABOR the following year. TABOR, which is generally considered the most stringent tax limitation provision in the country (Martell & Teske, 2007), restricts annual growth in both state and local revenues to the increase in population and the consumer price index. TABOR also requires that all tax increases, as well as the ability to retain any revenues raised in excess of the cap, must be approved by the voters. Although local governments have had success in convincing voters to override TABOR's revenue limitation, no general tax increase at the state level have been approved since TABOR's passage. For example, of the more than 1,100 local elections between 1993 and 1999 to relieve TABOR's revenue limitation, 93% were successful (Bell Policy Center, 2003), and all but three of Colorado's 178 school districts have won local elections exempting them from TABOR's revenue limit.[6]

The impact of TABOR early on was largely disguised by the strong economic growth both nationally and in Colorado from the mid-1990s through the early 2000s. While the state's economy was booming, state and local governments experienced moderate revenue growth while annual refunds to taxpayers under TABOR totaled \$3.3 billion between 1996-97 and 2004-05.[7] In response to the large annual TABOR rebates, the Legislature voted to reduce both the state's income tax and sales tax rates, thus stymieing efforts at financial recovery following the 2001-2003 recession.

Like the Arveschoug-Bird provision, TABOR also contained a ratchet effect. During economic downturns where state revenues decreased from one year to the next, the TABOR limit would reset the TABOR base to the lower amount, causing these revenues to be lost permanently. The impact of the ratchet effect was so severe during the 2001-2003 recession that a broad-based coalition of governmental, business and nonprofit groups sponsored a successful ballot measure in 2005 to provide a five-year time out from TABOR's revenue limitation. The measure, known as Referendum C, allowed the state to retain revenues above TABOR's revenue cap for the five-year period 2005-06 through 2009-10. During the timeout period, the state retained a total of \$3.6 billion under Referendum C that would otherwise have been refunded to taxpayers. This amount represents approximately \$720 million per year in additional funds for supporting state services such as PK-12 and higher education, health care, and human services programs.

The measure also eliminated TABOR's ratchet effect by resetting the cap on state revenues from the prior year plus changes in population and inflation, to the highest total state revenue for a fiscal year during the timeout period plus the adjustments for population and inflation (Bell Policy Center, 2006). According to the Legislative Council's December 2010 revenue forecast, this provision of Referendum C will allow the state to retain nearly \$2.7 billion in additional revenues between FY 2010-11 and FY 2012-13.

However, at some point in the future when the economy is again growing at historical rates, TABOR will inevitably place constraints on state revenues and spending. Studies of long-term state and local fiscal trends show that key governmental services, including education, health care, human services, and transportation all increase at rates higher than population growth and inflation (Ward & Dadayan, 2009). Through its very design, TABOR will again cause state and local governments to contract.

[6] Taken from Colorado Department of Education school district elections data.

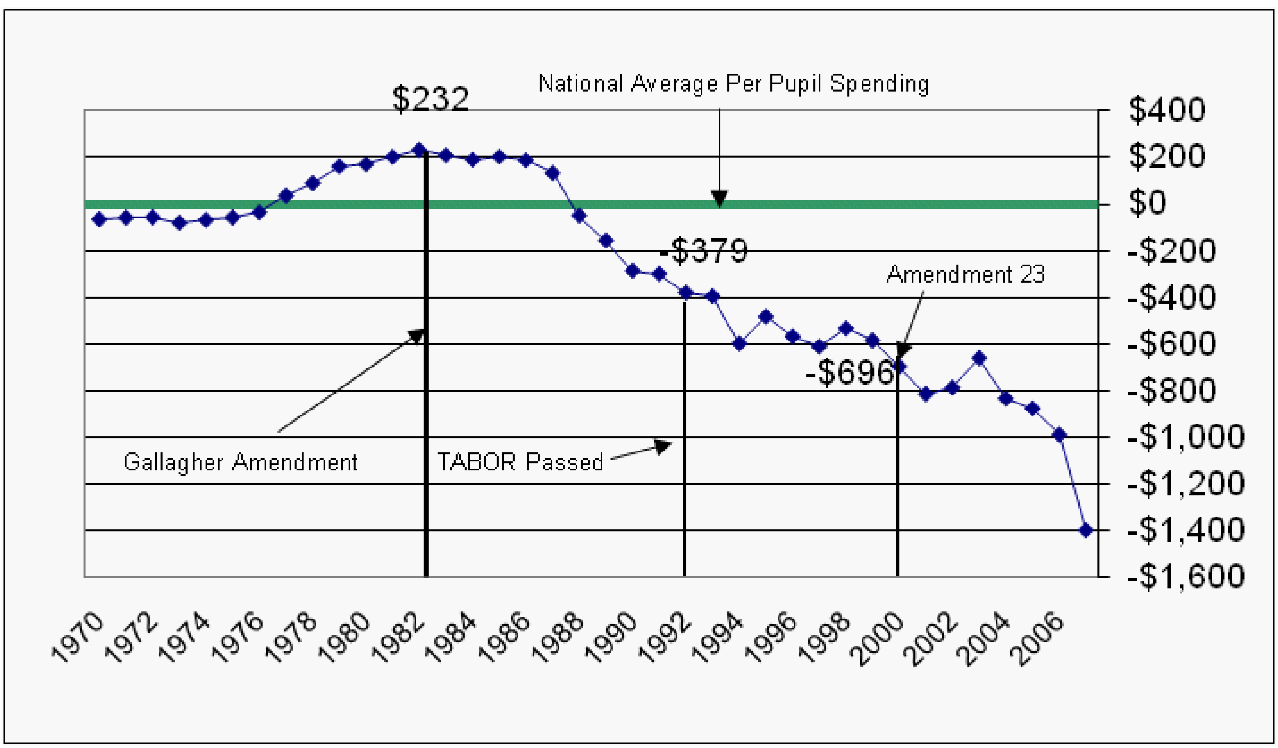
[7] Legislative Council memorandum to the Long-Term Fiscal Stability Commission, July 6, 2009.

Amendment 23

Unlike the other provisions described above, Amendment 23 does not limit either revenues or spending, but instead establishes a minimum expenditure level for PK-12 education. After more than a decade of stagnant funding for PK-12 education, first due to a flat economy, then to the downward pressure on spending resulting from the effects of Gallagher, Arveschoug-Bird and TABOR, groups concerned with Colorado's declining support for education relative to the rest of the nation (between 1988 and 2000 Colorado's per pupil funding fell from 25th to 40th in the nation) submitted Amendment 23 as a constitutional amendment guaranteeing that per pupil funding for PK-12 education would grow by at least the rate of inflation. For the first 10 years of the provision, through FY 2010-11, minimum growth included an additional 1% over inflation in an effort to restore spending to inflation-adjusted 1988 levels of per student spending.

Figure 3 below shows the trajectory of Colorado's K-12 per student spending following the passage of each of the tax and spending limitations discussed above. In 1982 per student spending in Colorado was about equal to the national average, but began to decline relative to the nation soon after the passage of the Gallagher Amendment and the start of a steep economic recession in Colorado in the late 1980s. Colorado spending continued to decline relative to the nation with the passage of TABOR, stabilized with the passage of Amendment 23, but then continued to decline again during the recession of the early 2000s. Colorado's spending has hovered around $1,400 below the nation average since then.

Figure 3



Source: Great Education Colorado and the Bell Policy Center

Over time it has become clear that the ramifications of these provisions, individually and in concert, have had a tremendous impact upon Colorado's fiscal health. Their impact goes beyond restraining revenues and expenditures to impairing the state's ability to effectively manage its financial affairs.

They have, to a significant extent, put the state budget on a form of autopilot. Their provisions have effectively limited the authority of the legislative and executive branches for increasing revenues when necessary or prudent. An increase in the significant state revenue generators, such as the income and sales taxes, cannot be enacted by the General Assembly, but requires a statewide referendum. Even retaining revenues raised under current tax rates that exceed the TABOR cap may not occur without a statewide vote. As a result, state policymakers are unable to either increase general tax revenues during tight budget times or build up a rainy day fund when economic times are good. Instead, the primary options available for dealing with budget shortfalls consist of raising fees (which constitute a relatively small share of total state revenues but are exempt from TABOR), cutting spending, or resorting to budget gimmicks.

Policymakers' ability to respond to fiscal imbalances is further constrained by limitations on where they may make budget cuts when necessary. The program areas of PK-12 education, health care and corrections make up approximately 70% of the general fund budget, yet are the most difficult areas to cut. Amendment 23 largely protects PK-12 education through its constitutionally mandated funding floor. Health care programs such as Medicare and Medicaid are difficult to reduce because the state also loses matching federal funds for every state dollar cut. And in corrections, prisoners must still be secured and cared for regardless of the condition of the state's budget. As a result the program areas constituting the remaining 30% of the general fund budget typically absorb a much higher proportion of cuts. Between 2007-08 and 2010-11 the two remaining large appropriation areas within the general fund, higher education and human services, saw real decreases in their appropriation levels of 14% and 1.5% respectively (Joint Budget Committee, 2010).

Finally, state policymakers' control over fiscal policy has been further eroded by state agencies' response to shrinking general fund revenues. Increasingly, state agencies are shifting program funding to enterprise status, under which they are supported by dedicated fees rather than general fund revenues (Martel & Teske, 2007). This shift exempts these revenue streams from TABOR but also places them largely outside the purview of the legislative budgeting process. For example, all but two of the states' university campuses have acquired enterprise status to protect tuition and fees.

At the local level, more and more services, such as fire protection, water and sanitation provision, and recreation are being provided by special taxing districts rather than traditional governmental entities such as counties and cities. These programs can be provided outside of the TABOR revenue limit if they are exempted at the time of creation. While spinning off these essential services to special taxing districts provides an end-around from TABOR, the proliferation of these districts, and the accompanying duplication of governance structures, leads to greater fragmentation and inefficiency in local governance. By 2005 these special taxing districts represented 87% of all local governments in Colorado (Martel & Teske, 2007).

Is Colorado's State Government Efficient?

One may argue that even though Colorado is a low tax and expenditure state, it still manages to produce adequate levels of necessary and desired state services, such as education and highways, because state government here operates more efficiently than in other states. If this were true, then our state government could produce more and higher quality services for less money. Therefore, there would be no real need to increase expenditure levels. Conversely, if Colorado is not operating efficiently, then the remedy may be to do more with better using the resources we have rather than increasing revenue.

Is there a way to measure just how efficiently Colorado provides state services relative to other states? Measuring how efficiently any state government uses it financial resources often requires complex and data-intensive econometric modeling techniques that are beyond the scope of this paper (Geys & Moesen, 2009). However, there are a few examples of more straightforward, albeit less precise, efficiency measures and studies.

One basic methodology for measuring governmental efficiency consists of calculating a rough estimate of state service "output" per full-time equivalent (FTE) employee by dividing total state expenditures, excluding debt, by total FTE of state employees (O'Dwyer & Ziblatt, 2006; Wilensky, 2002). Using this method, we find that Colorado is about average in administrative efficiency with a ranking of 28th among the 50 states. The average value output by a Colorado state employee, using 2008 expenditure and employment data from the U.S. Census, was $328,617. Nationally, the average was $397,430 per FTE. However, one could argue that this method is biased toward favoring states with higher state benefit levels, such as Medicare reimbursements, or higher employee salaries, since paying higher levels of both may not necessarily require more employees to administer but will increase expenditures per employee. This may be illustrated by the fact that California ranked as the most efficient state using this methodology, producing $626,119 in state services per state employee FTE.

A recent report by the PEW Center on the States may provide additional insight into how efficiently state government in Colorado operates. In 2008, the PEW Charitable Trust (PEW Center on the States, 2008), in partnership with *Governing Magazine* evaluated the management performance of all 50 states, ranking each in the following management areas:

- How well each state manages its human resources function to ensure a stable, high quality public workforce;
- How well each state maintains its infrastructure (such as roads, bridges and public buildings) through activities such as strategic capital planning, project monitoring, maintenance, and coordination with other jurisdictions;
- How well each state uses data and information technology to measure the effectiveness of its programs, guide decision making, and communicate with its citizens; and
- How well each state manages its finances, including prospects for long-term stability, balancing revenues and expenditures, transparency of its budgeting process, and the effective management of contracting, purchasing, financial controls, and reporting.

While the PEW analysis did not measure efficiency per se, it did assess the administrative performance of state governments in these four critical areas. Overall, the PEW analysis gave Colorado a grade of C+, just below the national average grade of B-. Only nine states scored lower than a C+, while nine other states received that same grade as Colorado.

In compiling Colorado's overall grade, PEW found that Colorado scored highest in the areas of infrastructure and financial management, each receiving a C+. The national average in these two areas was B-. In evaluating these two areas, the PEW researchers suggested that the state needed to improve processes for developing long-range plans and prioritizing capital funding. In particular they noted that the state should strengthen its long-term fiscal and budget perspective and highlighted the impact of the Arveschoug-Bird 6% limit on general fund expenditure growth (this report was compiled prior to the amending of Arveschoug-Bird in 2009) and the conflicting constitutional provisions of TABOR and Amendment 23.

These two measures of state government efficiency or performance would suggest that Colorado is about average to slightly below average in comparison to other states. Given this, it is unlikely that significant increases in service levels can be realized simply from savings from increased administrative efficiencies. Nor can we assume that Colorado is generating higher levels of services for less money than other states. Colorado certainly has room to improve, but improving efficiency will not result in notably higher service levels for education, health care or transportation.

If increasing state government's efficiency is insufficient for addressing the program challenges discussed earlier, is it reasonable to ask Colorado's citizens to pay more for their government? The following section examines the current tax burden in the state.

How Much Do Coloradans Pay in Taxes?

In 2010-11 Colorado taxpayers paid more than $8 billion in taxes ranging from the income tax, to sales taxes, to alcohol and tobacco taxes. While that may sound like a considerable sum, Coloradans are among the lowest taxed in the country. If we look at what Colorado residents pay in taxes per $1,000 of personal income (perhaps the most useful measure for comparing tax levels because it takes into consideration taxpayers' ability to pay), Colorado ranked 49th out of the 50 states in total state taxes paid. If local taxes are included, Colorado still ranks near the bottom among states at 44th. Table 7 below shows where each of Colorado's state taxes ranks among the 50 states and how the tax amount per $1,000 of personal income compares to the national average, as well as to the highest and lowest ranked states.

As the table shows, all of Colorado's state taxes rank among the bottom half of states, with the sales and use, corporate income, and liquor tax ranking in the bottom 10. Only the individual income tax ranks near the national average.

Table 7
Colorado State Taxes Per $1,000 of Personal Income
Compared to Nation
FY 2008-09

Colorado			Nation		
State Taxes	Rank	Tax Amount	High	Low	Average
Total Taxes	49 of 50	$40.89	$163.89	$37.50	$58.50
Sales and Use	44 of 45	$10.89	$48.35	$0.00	$19.68
Individual Income	28 of 43	$20.74	$39.51	$0.00	$20.12
Corporate Income	42 of 46	$1.55	$20.91	$0.00	$3.29
Motor Fuels	32 of 50	$2.90	$6.70	$0.33	$2.89
Liquor	43 of 50	$0.17	$1.31	$0.06	$0.44
Tobacco	35 of 50	$1.02	$3.55	$0.21	$1.37

Source: Legislative Council

While Colorado has historically had low levels of taxation, particularly since the passage of TABOR, the two national recessions have made the state revenue picture worse. Table 8 below shows that between 1998-99 and 2008-09, state tax collections have actually decreased in real terms. Only tobacco tax revenues increased during the 10 year period, largely due to the tax increase contained in Amendment 35 which was approved by voters in 2004. The largest decreases occurred in the corporate income tax, which fell by 39%, followed by the sales and use tax, which decreased by 24%, and the liquor tax, which decreased by nearly 23%. Because the sales and use tax comprises such a large portion of general fund revenues, more than 28% of the total, its decline has contributed significantly to the annual budget crises experienced by the state since 2008.

Table 8
Ten Year Colorado State Tax Trends
Taxes Per $1,000 of Personal Income
FY 1998-99 to 2008-09

Tax	FY 1998-99	FY 2008-09	Change
Individual Income	$23.69	$20.74	- 12.5%
Sales and Use	$14.73	$10.89	- 24.2%
Corporate Income	$2.54	$1.55	- 39.0%
Motor Fuels	$4.35	$2.90	- 3.3%
Liquor	$0.22	$0.17	- 22.7%
Tobacco	$0.57	$1.02	78.9%

Source: Legislative Council

What Can Coloradans Afford to Pay?

As noted above, personal income is often used as a measure of individuals' ability to afford state and local taxes. In short, those with higher incomes possess a greater ability to pay taxes than those with lower incomes. Colorado's fiscal capacity in terms of personal income is among the highest in the nation. Between 2000 and 2009, Colorado ranked among the top 10 states for personal income for five of the 10 years, slipping to its lowest ranking of the decade, 16th, in 2009 (BEA, 2010). Table 9 below shows Colorado's ranking in per capita personal income over the 10 year period 2000 to 2009, the most recent year for which data were available.

Table 9
Colorado Personal Income Trends
2000 - 2009

Year	Colorado		Nation
	Amount	Rank	Amount
2009	$ 41,839	16	$ 39,626
2008	$ 43,509	13	$ 40,673
2007	$ 42,367	11	$ 39,458
2006	$ 40,898	11	$ 37,698
2005	$ 38,555	10	$ 35,424
2004	$ 36,652	11	$ 33,881
2003	$ 35,156	9	$ 32,271
2002	$ 35,023	8	$ 31,461
2001	$ 35,296	7	$ 31,145
2000	$ 33,977	8	$ 30,318

Source for PI: U.S. Department of Commerce, Bureau of Economic Analysis

In 2009, the top earning area was the District of Columbia, with per capita personal income of $68,013. The highest earning state was Connecticut at $55,063. The state with the lowest income in 2009 was Mississippi, with an average income of $30,426. The impact of the recession on earnings can be seen in the table above, with personal income falling by nearly 4% in Colorado and 2.5% nationally between 2008 and 2009.

Table 10 shows the percent of personal income paid in taxes in nine states with personal income rankings similar to Colorado's in 2008. Data from 2008 were used for this comparison because it was the latest year for which tax rankings were available. These data show that while the relationship between state personal income and state and local taxes paid varies, only New Hampshire compares to Colorado in the size of the gap between ability to pay and the level of taxes paid. While Colorado ranked 13th in personal income in 2008 it ranked only 49th in state taxes paid as a percent of personal income. All of the other comparison states except New Hampshire dedicated a much higher proportion of their incomes to supporting state services, particularly North Dakota, Delaware, Hawaii, and Minnesota, which all ranked lower than Colorado in personal income but paid a much higher percentage of income in state taxes. For example, North Dakota, which ranked 18th in personal income, ranked 4th in the nation in state taxes as a percent of personal income. Conversely, New Hampshire ranked 12th in personal income but was the one state behind Colorado, at 50th, in taxes paid as a percent of personal income.

While the specific rankings change when both state and local taxes are taken into consideration, the general trends remain the same. Adding local taxes to the equation only moves Colorado's ranking for the percent of income paid in taxes from 49th to 45th. New Hampshire remains ranked 50th.

Table 10
Selected State Rankings on Personal Income, State Taxes and State and Local Taxes as a Percent of Personal Income
2008

State	Rank Personal Income	Rank State Taxes as Percent of Personal Income	Rank State/Local Taxes as Percent of Personal Income
California	10	20	12
Washington	11	32	31
New Hampshire	12	50	50
Colorado	13	49	45
Minnesota	14	9	19
Illinois	15	37	24
Hawaii	16	5	6
Rhode Island	17	30	17
North Dakota	18	4	5
Delaware	19	8	26
Pennsylvania	20	29	21

Current Reform Initiatives

The current economic and budget crisis has spurred a great deal of activity for not only dealing with current budget shortfalls, but for reforms addressing the long-term health and stability of Colorado's government finances. Most of these efforts focus on one of two priorities: 1) raising additional revenues or 2) reforming the state's initiative and referendum process and reducing or eliminating the provisions in the state constitution that affect fiscal policy. The following is not an exhaustive list, but does include some of the more high-profile and substantive efforts underway currently or in the recent past.

Long-Term Fiscal Stability Commission

The bipartisan, joint legislative Long-Term Fiscal Stability Commission was tasked with studying the fiscal stability of Colorado's state government and developing a strategic plan for attaining greater financial stability. The Commission's charge included finding more stable sources of funding for education, health care, transportation, capital projects, and a new state rainy day fund. The Commission's final report, issued in December of 2009, called for creating a state rainy day fund, improving the efficiency of the state's higher education system through greater administrative flexibility, encouraging public-private initiatives with non-profit organizations, commissioning a comprehensive study of the state's tax policies, and a resolution for referring a measure to the ballot creating a Fiscal Policy Constitutional Commission charged with reviewing constitutional provisions affecting fiscal policy in the state and making recommendation for necessary reforms.

Colorado Reform Roundtable

The Colorado Reform Roundtable is made up of a coalition of business and public interest groups and interested citizens formed to explore solutions to the fiscal challenges faced by Colorado. The organization is overseen by a Committee of the Whole and includes three subcommittees, each assigned a specific task:

- The Fiscal Reform Subcommittee is responsible for analyzing and disseminating information about Colorado's current tax and spending laws and exploring reform options — possibly including a fall 2011 ballot measure for raising additional revenues.

- The Constitutional Reform Subcommittee's role is to explore options for reforming Colorado' referendum and initiative process and to identify and seek solutions for conflicting constitutional provisions affecting state and local fiscal policy.

- The Outreach and Education Subcommittee serves as a central clearinghouse for information about fiscal issues in Colorado for Roundtable participants and to coordinate public education and outreach efforts.

University of Denver Tax Study

One of the recommendations of the bipartisan legislative Fiscal Stability Commission was to commission the first comprehensive study of Colorado's tax and fiscal policies since the McNichols tax study was completed in 1959. The resolution calling for the study directed the University of Denver to conduct the analysis using private funding and report back to the General Assembly in early 2011. The study is privately funded and is under the direction of Charlie Brown, Director of the Center for Colorado's Economic Future at the University of Denver.

Strategic Issues Panel

The Strategic Issues Panel at the University of Denver is exploring the future of state government, including examining the basic questions of what state government should do, how it should be organized and how it should be financed. The Panel's final report is due in the summer of 2011.

Colorado Fiscal Policy Institute

The Colorado Fiscal Policy Institute (COFPI) has long argued that Colorado has a revenue rather than a spending problem. COFPI has submitted proposals for a fall 2011 ballot measure increasing income taxes to the Legislative Council for review and comment.

Revenue Raising Scenarios

The previous sections of this white paper have attempted to make a reasonable argument that Colorado's state government has been underfunded at least since the passage of TABOR in 1992. The combination of statutory and constitutional limitations on state taxes and expenditures, such as Arveschoug-Bird, Gallagher and TABOR, have caused state government to contract over the past two decades while other provisions such as Amendment 23 have further tied the hands of policymakers in making sound fiscal policy.

But, what if suddenly the fiscal policy slate was wiped clean and a political consensus came together in support of greater spending for core state services? Certainly, achieving the highest estimates of fiscal need discussed earlier is not politically realistic, but what if the state embraced the more modest objective of attaining the national average in state expenditures? As the *Aiming for the Middle* report estimated, an additional $3.6 billion in annual state spending would be required to reach the national average per capita state spending level, or an additional $4.9 billion to attain the national average on a per $1,000 of personal income basis. What sort of tax increase, or multiple tax increases, would be necessary to raise an additional $3.0 to $4.0 billion dollars annually? Would merely raising "sin" taxes, such as alcohol and tobacco, or increasing gaming revenue — both revenue raising strategies that most often seem to garner voter support — be sufficient?

This section explores the revenue raising potential of various state revenue sources and presents five hypothetical scenarios, ranging from doing nothing to raising sufficient state revenues to reach the national average for per capita spending. Scenario 2 has received some support from various groups and policymakers as being a reasonable revenue raising option. The remaining three scenarios represent different approaches to raising significant new state revenues — in excess of $2 billion or more.

Tax Revenue Options[9]

Colorado's total general fund revenues were $7.4 billion in 2010-11 and combined general and cash fund totaled $10.0 billion. Of this total, more than 80% was raised via the various state taxes such as income, sales, motor fuels, and severance taxes. Increasing revenues by the roughly $3.6 billion needed to reach a national average expenditure level represents a nearly a 44% increase in state taxes. The following examines the revenue raising potential for each of the state taxes currently levied and the property tax, for which the state does not currently have a state levy, but which is a potentially significant source of revenue.

The estimates presented here of the revenue generated by tax rate increases are not our own, but were taken from other analyses, including analyses performed for the Higher Education Strategic Planning Steering Committee and the Colorado Department of Transportation. It should be noted that any estimate of the revenues generated by tax rate increases includes some level of imprecision, as the additional cost of the tax may alter the behavior of wage earners, consumers, or corporations in an effort to avoid the tax, resulting in lower than expected tax yields.

[9] The tax revenue amounts shown here are from the Legislative Council's December revenue forecast for fiscal year 2010-11, except for the property tax, which is from Department of Local Affairs data. The source of the tax rankings shown is the Federation of Tax Administrators. The rankings are for fiscal year 2007-08 and are based on tax revenues per $1,000 of person income.

"Sin" Taxes. Sin taxes are taxes on products or activities that are generally considered vices, such as drinking alcohol, smoking, or gambling. While many states have significantly raised their tax rates on these activities, often on the policy grounds of discouraging the activity, it is also true that this is one of the few areas of taxation that consistently receives political and public support for increases in the tax. Unfortunately, in Colorado the cigarette, tobacco, and liquor taxes combined only account for 1.2% of state general fund revenues and state-sanctioned gaming revenues total about 4% of total cash funds. These taxes would have to be increased many fold to begin making progress toward the goal of three-plus billion dollars.

Total revenues:
Cigarette and tobacco tax: $54.8 million
Liquor tax: $35.8 million
Gaming Revenue: $105.8 million

Fees. Most recent efforts at increasing revenues have consisted of increasing fees, such as college tuition or vehicle registration. However, like the alcohol and tobacco taxes, fees make up a relatively small proportion of state revenues. In 2010-11 fees and other miscellaneous revenue sources made up less than 20% of total state revenues.[10] Politically unpalatable increases in state fees would be necessary to make any significant progress toward a goal of national average state expenditures.

Total revenues:
Fees and other revenues: $1.8 billion

Severance Taxes. Severance taxes are levied on the extraction of natural resources such as minerals, oil and natural gas. According to the Legislative Council, Colorado has one of the lowest effective severance tax rates in the nation. When compared to neighboring states with severance tax revenue (New Mexico, Oklahoma, Utah, and Wyoming) Colorado ranks fourth in severance tax collections (Harris, 2010). Under current rates, Colorado's severance tax generates only 7% of total cash funds. According to a Colorado Fiscal Policy Institute analysis, raising collections to the average of the five surrounding states would raise an additional $115 million, and to the highest rate among the five states an additional $378 million. While the latter rate increase would generate significant new revenues, it is unlikely that political support exists for such a drastic change in severance tax collections. Amendment 58, which proposed increasing the severance tax by $321 million to support community colleges, failed in the 2008 fall election.

Total revenues:
$176.7 million

[10] Other revenues includes various revenue sources credited to cash funds, investment earnings, court fees and fines, and fees paid to the state park system and the Secretary of State's Office.

Corporate Income Tax. Colorado's corporate income is taxed at a rate of 4.63%, the same as the individual income tax. The rate was reduced from 5% in 1999 when the individual income tax rate was also lowered. The corporate income tax accounts for about 5% of general fund revenues. Nationally, the state's corporate income tax is comparatively low, ranking only 42nd out of 46 states with the tax. An estimated $74.0 million is raised with each percentage point increase in the tax rate.

Total revenues:

$374.1 million

Motor Fuels Tax. The current rate of the motor fuels tax, $0.22 per gallon, has not been increased since 1992. This has become increasingly problematic as greater fuel economy has eroded the tax's base. The motor fuels tax accounts for just over 22% of total cash fund revenues. An additional penny of the tax is estimated to raise about $29 million.

Total revenues:

$555.9 million

Property Tax. Colorado does not currently levy a state property tax, although according to U.S. Census data 36 of the 50 states do have some form of state property tax. The state does not necessarily have to adopt a state property tax to benefit from a property tax increase. This is because under the state's school funding formula school districts are required to levy a school property tax at a predetermined rate. If these local property tax revenues are insufficient to raise the state-determined per student revenue amount, the state backfills with state aid to make up the difference. As a result, if the per student revenue amount is held constant, any increase in local property taxes results in an equal reduction in state aid revenues, saving the state general fund money. Colorado's property tax revenues rank 29th nationally. Nevertheless, the property tax is a major source of revenue for local governments and nearly equals the amount of total state general fund appropriations. An increase of 1 mill in property tax rates statewide is estimated to raise about $88 million, based on 2008 assessed valuations.

Total revenues:

$6.8 billion total for all local jurisdictions

Sales and Use Tax. Colorado's state sales and use tax rate is 2.9%, but may reach as high as 8% for specific jurisdictions when local county/municipal tax rates are included. The state rate was reduced from 3% in 2001. The state portion of the tax ranks 44th out of the 45 states with a sales and use tax, and 23rd when local taxes are included. Each additional percentage point on the state rate is estimated to raise about $750 million.

Colorado's sales tax is levied almost exclusively on the sales of tangible personal property. A total of 64 items are exempted from the tax, the largest being the sales of component parts of manufactured products or services and food for home consumption. The total cost of these exemptions was an estimated $1.7 billion in 2009. Colorado currently taxes only 14 services, the lowest number in the nation. The policy of not taxing services has led to an erosion of the sales tax base as the proportion of services to total sales has grown from just over 65% in 1963 to almost 80% by 2008 (Colorado Fiscal Policy Institute, 2011).

Total revenues:

$2.2 billion

Individual Income Tax. The state's individual income tax currently has a tax rate of 4.63%, the same as the corporate income tax. This rate was also reduced from 5% in 1999 in an effort to halt what at the time were sizable annual tax rebates to taxpayers under TABOR. Colorado's individual income tax ranks 28th out of the 43 states with the tax. Each additional percentage point on the tax rate is estimated to raise about $1.0 billion.

Total revenues:
$4.6 billion

Table 11 below summarizes estimated additional revenue raised per incremental rate increase for the taxes listed.

Table 11
Estimated Revenues Per Tax Rate Change

Tax Type	Tax Rate Change	Estimated Additional Revenue Raised
Individual income tax	For every 1.0 percentage point increase in tax rate	$1.0 Billion
State sales/use tax	For every 1.0 percentage point increase in tax rate	$750.0 Million
Corporate income tax	For every 1.0 percentage point increase in tax rate	$74.0 Million
Motor fuels tax	For every 1.0 cent increase in tax rate	$29.0 Million
Property tax	For every 1 mill increase in tax rate (2008 taxable values)	$88.0 Million

Tax Increase Scenarios

The following five hypothetical tax increase scenarios range from doing nothing, e.g. continuing current tax levels, to raising significant new revenues through increasing multiple tax rates and expanding the sales and use tax base to services. These are not intended as specific recommendations, but instead as realistic illustrations of how much additional state revenue may be raised under various tax increase strategies.

Scenario 1: Do Nothing

Under Scenario 1 we assume that no action is taken to significantly increase state revenues. This would likely occur if no proposals for increasing revenues are made at this time due to concern over the economy, or because supporters' arguments in the fall campaign fail to sway the voters. Regardless, the state's tax rates remain the same for the foreseeable future. What does this mean for the state's budget and the services it supports?

According to the Legislative Council's December 2010 revenue forecast, if no steps are taken to increase general fund revenues, state revenues for fiscal year 2012-13 will be about the same as they were in 2006-07. Therefore, even though the state's population will have increased and the state will be serving more students in K-12 public schools and state higher institutions, and with the recession, more individuals and families will become eligible for Medicaid and CHP+, the state will have no additional revenues with which to provide these services. The situation is made more dire by the fact that more than $1.0 billion in federal American Recovery and Reinvestment Act funding received by the state will be spent by the end of 2010-11. Again, according to the Legislative Council, this could leave as much as a $1.0 billion hole in the state's budget. But these are only the short term impacts.

Over the long run, without significant additional revenues Colorado will continue to fall behind the rest of the country in support of core services such as K-12 and higher education, health care for low income families and children, and transportation. As the reports described earlier in this paper illustrate, the status quo in funding levels for all of these programs will hinder efforts for sustaining and accelerating school improvement in low performing schools, implementing CAP4K along with new, aligned state assessments, and improving the condition of school facilities. It is also likely to lead to further deterioration to the accessibility and quality of higher education and the condition and safety of the state's highways and bridges.

Can Colorado afford to let its investments in these areas continue to decline? While low taxes are often considered the hallmark of a state's business climate, the Colorado Competitive Council of the Denver Metro Chamber of Commerce recognizes the need to invest in key state assets in order to build and maintain a strong economy. Among its list of strategies for growing jobs in key industries in Colorado, the Competitive Council argues that the state must ensure that the state's K-12 and higher education systems "produce qualified employees for future growth" and that it improve critical infrastructure such as its transportation network.[11]

Scenario 2: Restore Income and Sales Tax Rates

One of the suggestions for raising revenues that has garnered a certain amount of support is to return to the tax rates in place during the 1990s for the individual and corporate income taxes and state sales tax. A recent bipartisan panel of former state legislators endorsed this plan to help address Colorado's impending $1.0 billion budget deficit ("Difficult Solutions," 2011).

During the booming dot.com years of the late 1990s, Colorado was refunding billions of tax dollars in excess of the TABOR revenue limit to taxpayers. Ultimately, the legislature decided that reducing state tax rates was more efficient than collecting and then returning excess tax revenues.

The tax rates for both the individual and corporate income taxes were reduced from 5% in two stages. First, in 1999 they were reduced to 4.76% and then to the current 4.63% in 2000. The state's sales tax rate was cut from 3% to the current rate of 2.9% in 2001. A reasonable argument can be made for returning to these rates since they had been in place for some time and were reduced only because the state's economy was generating unprecedented revenues at the time.

[11] See the Colorado Competitive Council on the Denver Metro Chamber of Commerce website at http://www.denverchamber.org/page.aspx?pkey=C3

Restoring these tax rates to pre-2000 levels is estimated to raise $470 million annually for a relatively modest 7% increase in general fund taxes. However, while this action may represent a good first step, the revenues raised would still fall far short of addressing many of Colorado's needs. What would an additional $470 million buy Colorado given the program needs documented above? This plan would provide the revenues required to address any one of the following programmatic needs:

- Increase state expenditures to about 1/8th of what is needed to reach the *Aiming for the Middle* goal of achieving the national average in state per capita spending.

- Increase state expenditures to about 1/12th of what is needed to reach the *Aiming for the Middle* goal of achieving the national average in state spending on a per $1,000 of personal income basis.

- Pay for about 1/6th of the additional K-12 education funding deemed adequate by the Colorado School Finance Project's cost study for getting all, or nearly all, students to meet or exceed state learning standards. But, it would provide more than twice the funding needed for paying for early implementation of CAP4K.

- Pay for about 1/10th of the annual school facilities improvements over the next 3 years as identified in the Colorado Department of Education study.

- Provide nearly twice the revenue necessary for the state's higher education system to keep up with inflation.

- Pay for the lowest cost health insurance option submitted to the Blue Ribbon Panel on Health Care Re form.

- Allow the Colorado Department of Transportation to maintain the current state of highway and bridge conditions. In other words, the percent of roads and bridges in poor condition would not lessen, but also would not increase over time.

Obviously, restoring state income and sales tax rates to pre-2000 levels enables the state to meet some of its unmet fiscal needs, but falls far short of meeting our hypothetical goal of achieving national average state spending.

Scenario 3: Increase individual Income Tax Only

A third scenario for raising state revenues would be to rely solely on the state income tax to achieve the additional $3.6 billion in revenues required to reach the national average for state expenditures. There are several arguments for focusing on the income tax. First, it is the largest source of state revenue and, with a national ranking of 28th, has some room to increase without placing Colorado within the top tier of states for income tax collections. The income tax is also the least regressive of Colorado's major taxes, even given its current flat tax structure. A graduated income tax with multiple tax brackets, as Colorado had until 1987, would do even more to improve the progressivity of Colorado's tax system.

The individual income tax rate would have to be raised by 3.5 percentage points to generate enough additional revenue to meet the national average spending goal. A 3 percentage point increase would raise about $3.0

billion — about $600 million shy of the $3.6 billion goal. However, increasing the state's individual income tax rate to 7.63% would make Colorado's rate the highest among states with a single tax rate. At 6%, Tennessee currently has the highest single rate income tax rate.

Increasing the state income tax to this degree would also make Colorado even more reliant on income tax revenues. Under the current rate, 62% of the state's general fund revenues are derived from the individual income tax, an amount that is already above the national average. Also, given how volatile the income tax can be during swings in the business cycle, an increase in the income tax of this magnitude would likely make state revenues even less stable than they currently are.

Scenario 4: Increase State Sales/Use Tax Only

The second largest source of state general fund revenue is the sales and use tax. By itself, the state rate of 2.9% is among the lowest in the country, although adding on local sales tax rates places Colorado near the national average rate. To raise $3.6 billion through the state sales tax alone, without broadening the tax base, would require more than doubling the state rate to nearly 8%. With the current allowable local rates, the state's total sales and use tax rate would climb to nearly 13%. This would give Colorado the highest combined sales and use tax rate in the country — exceeding California's current 10.75% combined rate.

If we were to raise the state rate by the same 3 percentage points as we did with the individual income tax scenario, the state rate would increase to 5.9% and raise an additional $2.3 billion. This represents about two-thirds of the amount of new revenues needed to reach the national average for state expenditures. However, under this scenario the maximum combined state and local rate would equal 11%, again giving Colorado the nation's highest rate. Another disadvantage to increasing the sales and use tax to this extent is that the tax is very regressive and would disproportionately impact lower income taxpayers. Finally, with the growth of online shopping and the increasing tilt of personal consumption toward services, the sales tax as currently constituted may experience slower growth over time (McClure, 2000).

Scenario 5: Increase Multiple Taxes

The final scenario resembles most closely the approach Colorado will likely have to follow to increase state revenues by a significant amount. That is, it will have to look at increasing a variety of state taxes to both raise sufficient additional revenues and to maintain balance within the overall tax system. The following presents one possible mix of tax increases that would enable Colorado to reach the hypothetical goal of increasing revenues by $3.6 billion:

- Increase the individual income tax by 2.37 percentage points to 7%, or adopt a graduated income tax that raises an equivalent amount of revenue. Amount raised: $2.4 billion.

- Extend the state sales tax to services while keeping the rate at 2.9%. Amount raised: $550 million.

- Adopt a new state property tax levy of 3 mills. Amount raised: $265 million.

- Increase the motor fuels tax by 7 cents per gallon. Amount raised: $200 million.

- Increase the corporate income tax to 7%. Amount raised: $175 million.

Total new revenues raised: $3.6 billion

Under this scenario Colorado would still surpass Tennessee for the highest single rate tax rate in the country, although this could be avoided by substituting a graduated income tax. However, increasing the corporate income tax to the same 7% rate would represent just the average rate of the 30 states with a single tax rate.

By expanding the sales and use tax base to include services without raising the rate, the state would raise significant new revenues while at the same time helping to stabilize the tax as services comprise a greater share of the consumer economy. Other options for raising an equivalent amount of new revenue from the sales tax include raising the state's rate to 3.6%, repealing some of the current exemptions, or some combination of both actions.

The increase in the motor fuels tax to 29 cents per gallon still leaves the tax rate 5 cents below what the rate would be if adjusted for inflation since it was last increased in 1992. Increasing the tax to an inflation adjusted 34 cents would raise an additional $145 million. However, there is cause for concern over the long-term prospects of the motor-fuels tax as vehicle fuel efficiency and the prevalence of alternative fuel vehicles continues to increase.

Perhaps the most controversial provision included in this scenario is the imposition of a state property tax levy. This would require a constitutional amendment to enact. An alternative to adopting a state levy would be to raise the required school district education levy by 3 mills. This would increase local education revenues and free up state general funds for either an increase in overall education funding or for other purposes.

Conclusion

The question of how much government citizens want and how much we are willing to pay for it has long been a subject of debate in Colorado. The state's voters have seemingly indicated their desire for less government, or at least less costly government, through their support of tax and spending limitations such as the Gallagher Amendment and TABOR. Conversely, taxpayers have also expressed concern when they feel they are not receiving the level of services they expect, and react by supporting provisions increasing taxes and spending such as Referendum C and Amendment 23. But long term trends, exacerbated further by the recession of 2001-03 and the current economic crisis, seem to indicate that Colorado is on a fiscal collision course.

The analyses presented in this white paper show that Colorado is among the lowest spending states in a number of core service areas, including K-12 and higher education, health care, and transportation. Recent reports issued by governmental agencies and nonprofits indicate that Colorado is slipping further behind the rest of the country and may not be able to continue to compete when it comes to educating our children, providing accessible yet high quality post-secondary programs, protecting our most vulnerable citizens, or maintaining an efficient and safe transportation system.

The data examined here also show that Colorado ranks among the lowest states in terms of the state and local taxes it collects to pay for public services, despite the fact that it ranks among the top 15 states in per capita personal income. Further, the gap between Colorado and the rest of the nation appears to be growing. In 1992, when TABOR was approved by the voters, Colorado's state taxes per $1,000 of personal income were about 30% below the national average. Today, they are more than 40% below the national average.[12]

One could argue that if only state government operated more efficiently we could enjoy higher levels of services for the same cost. But, it appears that Colorado operates at least as efficiently as most other states and may actually be hindered in improving efficiency by a lack of resources for investing in better data management systems and other state infrastructure.

Admittedly the question of government tax and spending levels is typically one guided by ideology and politics, but a reasonable reading of the data presented here would indicate that Colorado is failing to adequately invest in its public services. Without increasing revenues is clear that the state will be unable to even maintain current levels of services. Further, in order to attain the rather modest benchmark of reaching the national average in state per capita spending, Colorado would have to increase revenues by $3.6 billion annually — an increase of nearly 45% in current state tax revenues. To meet the programmatic needs described above would cost billions of dollars more.

Clearly, if Colorado is to raise its public investment to a more mainstream level, the most politically palatable avenues for generating the revenues to get there will not be sufficient. The types of revenue raising policies most states have turned to in recent years, such as increases in alcohol or tobacco taxes, gaming revenues, or severance taxes, will fall far short. None of these revenue sources make up more than a small portion of total state revenues, and even substantial increases to their tax rates will fail to have enough of an impact.

Another strategy generating some recent interest, of returning to the state income and sales tax rates in place in the late 1990s, will generate close to a half-billion dollars in additional revenues. But again, given the

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[12] Source: U.S. Census historical data on total state tax collections and Bureau of Economic Analysis state personal income data.

budgetary needs detailed in recent reports concerning major state program areas, even this will only partially address the shortages in one or two of the program areas.

In the end, the strategy Colorado will need to follow if consensus forms around the need to raise significant new state revenues (say $2 to $3 billion more per year) is to:

1. Adopt either rate increases and/or tax base expansions across multiple taxes.

2. Understand that relying on increasing a single tax, even the individual income tax, will result in either raising too little revenue or further distorting and destabilizing the state's overall tax system.

3. Include the primary tax revenue sources, income and sales taxes, in the mix.

4. Consider new state revenue sources, such as a state property tax levy, and innovative distributions of that revenue.

5. Consider phasing in changes over a number of years.

Of course, any change in tax rates will require a statewide referendum under the provisions of TABOR. Some, such as adopting a graduated individual income tax, will also require changes to the state's constitution. We can only speculate on the political feasibility of either of these approaches.

Colorado is a wealthy state. Yet as a state we have elected to keep taxes and government spending among the lowest in the nation. Without raising revenues, it is becoming increasingly clear that we will not be able to maintain even current service levels. Soon, the citizens of Colorado will have to decide what they want from their state government and whether they are willing to pay for it.

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