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Issue Backgrounder

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What Is At Stake In The Current Battle Over Colorado's Tax and Spending Limits?

IB-2009-C • March 2009

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Eliminating the Arveschoug-Bird Cap on General Fund Spending

This year the Colorado legislature is debating a bill, (SB228) that would eliminate the Arveschoug-Bird Amendment. That Amendment was enacted by the legislature in 1992, a few months before the voters of Colorado enacted the Taxpayer's Bill of Rights (TABOR) Amendment. Arveschoug-Bird caps the growth of general fund spending at 6 percent per year. With the 6 percent cap in place, surplus revenue above this limit is transferred into the Highway Users Trust Fund and to capital construction.

The bill would eliminate what has proven to be a very effective constraint on the growth in general fund expenditures, and also on how state revenues are allocated between transportation and capital projects, and other expenditures.

Critics argue that the 6 percent cap constrains general fund expenditures for health care, human services, education, and other state programs. They argue that the 6 percent cap should be removed to allow legislators to reallocate that surplus revenue to these state programs.

There are several reasons why this bill would be fiscally irresponsible. The bill would eliminate what has proven to be a very effective constraint on the growth in general fund expenditures, and also on how state revenues are allocated between transportation and capital projects, and other expenditures. The bill also raises constitutional issues and the role of the initiative and referendum process in amending the constitution.

The Impact on Economic Growth

The reallocation of general fund money that would result from elimination of the 6 percent cap would clearly have a negative impact on expenditures for highways and capital projects. Economists distinguish between government expenditures that have a positive impact on economic growth, and other expenditures that have a zero or negative impact on growth.

Given the significant demands for expenditures to maintain our highway system over the next few decades because of growing population, now is not the time to shortchange highway capital spending.

Expenditures for highways, capital projects, and other infrastructures tend to have the most significant positive impact on long run rates of economic growth.[1] These government expenditures expand the productive capacity of the economy, with positive effects on private investment and productivity. These are the most productive expenditures the state makes, expanding the productive capacity of the economy and generating higher rates of economic growth. Given the significant demands for expenditures to maintain our highway system over the next few decades because of growing population, now is not the time to shortchange highway capital spending.

General funds are likely to be reallocated to other state programs that have a zero or negative impact on economic growth; and this is especially true of funds spent for Medicaid and social welfare, that are essentially income transfers and subsidies.[2]

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Reducing general fund expenditures for highways and capital projects would also have negative effects in short run periods of recession, such as we are currently experiencing. Given balanced budget requirements, it is difficult for states to use counter-cyclical fiscal policy; but, expenditures for infrastructure projects are an effective countercyclical policy. Those expenditures are likely to offset underutilization of labor and capital in the construction industry. In periods of recession the state can invest in highways and capital projects at lower cost because of lower prices for labor and capital in those industries.[3]

Exacerbating the Structural Deficit in the State Budget

Eliminating the 6 percent cap on general fund expenditure growth would exacerbate a structural deficit in the state budget. It would create a problem economists refer to as 'annualization', i.e. the expenditure of one time money for ongoing state programs.

Surplus revenue above the 6 percent cap tends to emerge in periods of economic growth when revenues are increasing rapidly, and to disappear in periods of recession and revenue shortfall. Thus the surplus revenue is best viewed as one time money that will not always be available. With the 6 percent cap, that surplus revenue is spent for highways and other projects with a finite capital budget. If the 6 percent cap is removed the funds are likely to be spent for ongoing programs with an annual budget. In effect this expenditure of surplus revenue for ongoing programs is a form of 'annualization' that creates a structural deficit in the budget. Expenditure for ongoing programs are boosted in periods of economic expansion. In periods of recession and revenue shortfall it is difficult to sustain all of these ongoing programs.

With the 6 percent cap earmarking funds for transportation and capital projects there is also less pressure to issue debt. The more that transportation and capital projects are funded from general fund revenues the less need for new debt. When the state does ask citizens to approve new debt for transportation projects, voters are more likely to understand the need for that debt and approve it, as occurred in 2000. If the 6 percent cap is removed, general fund revenues will no longer be earmarked for highways and capital projects, and we should expect the state to finance those expenditures with new debt.

Carving Out A Privileged Position for the Education lobby in the State Budget

It is clear that a major beneficiary of removing the 6 percent cap is the education K-12 lobby. In fact, this bill to remove the 6 percent cap is the latest in a long series of attempts by the education lobby to carve out a privileged position in the state budget. A similar measure on the ballot last November, Amendment 59, was soundly defeated by voters. This was not surprising because the education lobby has already captured a large and growing share of the state budget through such efforts.

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Amendment 23, enacted in 2000, earmarks income tax revenue for the Education Trust Fund. Amendment 23 also mandates that the state must increase spending for education K-12 at the rate of inflation plus one percent over this decade, and at the rate of inflation thereafter. The education lobby also was successful in enacting Referendum C, in 2005, allowing the state to spend an estimated $6.4 billion in surplus revenue above the TABOR cap, much of it earmarked for education K-12.

No interest group should have such a privileged position in the state budget. If legislators want more discretion in how they allocate state revenues they should consider a referendum to eliminate Amendment 23.

Weakening and Eliminating Colorado's Tax and Spending Limits

The Bill to eliminate the 6 percent cap on the growth of general fund expenditures is only the latest in a series of efforts by the special interests to weaken and even eliminate tax and expenditure limits in Colorado.

Referendum C weakened the TABOR limit so as to allow unlimited growth in total state revenue and spending over the next five years. Although referendum C, passed in 2005, led to sharp increases in state government spending and in state government tax revenues, the current recession has reduced government revenues. According to legislative staff projections, over the next five years, total state revenue and total state spending will not exceed the TABOR limit.

But while TABOR directly controls total state revenue and total spending, Arveschoug-Bird is focused on the General Fund. Over the coming five-year period, General Fund revenues are projected to grow relatively quickly. If the General Fund revenues were used for General Fund expenditures, then the General Fund expenditures would rise more quickly than is allowed by the 6 percent Arveschoug-Bird limit. So eliminating the 6 percent cap on the growth in General Fund spending means that Colorado would have no effective constraint on the growth of state spending for the foreseeable future.

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Of course unconstrained spending is the objective of the special interests, and if they are successful we should expect Colorado's fiscal policies to look like they did prior to 1992 when Arveschoug-Bird and the Taxpayer's Bill of Rights were enacted. Prior to 1992, state revenue and spending grew more rapidly than personal income; after 1992, state revenue and spending grew less rapidly than personal income. With tax and spending limits in place, the state reduced the tax burdens at all levels of government. The state reduced the income sales, and personal property tax. Local governments across the state reduced property taxes. Prior to 1992 Colorado's rate of economic growth was lower than that for most states; with our tax and spending limits in place after 1992 Colorado achieved one of the highest rates of economic growth in the country.

If Colorado's tax and spending limits are eliminated, fiscal policies will look more like those in California. In the late 1980's the special interest lobbies were successful in gutting the California's GANN Amendment, which was a tax and spending limit similar to the TABOR Amendment. Since then, the growth in state revenue and spending has far outstripped the growth in personal income in California. To sustain that growth in spending, California has repeatedly increased taxes, and issued $42 billion in debt. The state continues to incur huge deficits and accumulate more and more debt. Businesses and people are leaving California to escape the burden of taxation, and they are coming to states such as Colorado with a more favorable business tax climate. If Colorado follows the lead of California and eliminates our effective tax and spending limits, we could be looking at the end of our prosperity as well.

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Constitutional Issues

The bill to eliminate the 6 percent cap appears to violate the Constitution.

"Section 20. The Taxpayer's Bill of Rights.

1. **General provisions.** This section takes effect December 31, 1992 or as stated. Its preferred interpretation shall reasonably restrain most

the growth of government. All provisions are self-executing and severable and supersede conflicting state constitutional, state statutory, charter, or other state or local provisions. Other limits on district revenue, spending, and debt may be weakened only by future voter approval."[4]

The TABOR Amendment provides that other tax and spending limits, such as Arveschoug-Bird can only be changed with a vote of the people. In effect, TABOR incorporated Arveschoug-Bird into the Colorado Constitution. Eliminating or changing the 6 percent cap on general fund expenditures requires a vote of the people.

Legislative attempts to weaken and eliminate tax and spending limits, without a vote of the people, undermines the initiative and referendum process. The initiative and referendum is a long established procedure for amending the Colorado Constitution. Hundreds of initiative and referenda have been introduced, many dealing with fiscal issues; and a large share of these have been enacted. The initiative and referendum have given Colorado citizens a powerful voice in fiscal policy decisions, and surveys reveal that they value that voice. A recent survey reveals that more than 70 percent of citizens support the TABOR Amendment provisions that constrain government spending, and that give them a vote on tax and debt increases, and expenditure of surplus revenue.[5] Tax and spending limits have allowed Colorado Citizens to get the amount of government they want and are willing to pay for.

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If politicians are unhappy with the tax and spending limits incorporated in the Colorado Constitution then they have the option of placing referenda on the ballot to change the Constitution. They should not attempt to circumvent the Constitution by weakening and eliminating these limits without a vote of the people. If they are unhappy with the initiative and referendum process they also have the option of placing measures on the ballot to change those provisions of the Constitution as well. But, they should not attempt to undermine the initiative and referendum process *sub rosa*.

It is important to preserve the procedural constraints provided by initiative and referendum in the Colorado constitution. It is important to preserve the rule of law in Colorado.

Many states, including Colorado, are attempting to improve transparency and accountability in state government. If Colorado legislators are serious about transparency and accountability then they should be honest about their efforts to weaken and eliminate tax and spending limits. They should place these measures on the ballot and let voters decide. What is at stake is not just preserving effective Constitutional limits on the power of the state to tax and spend. It is important to preserve the procedural constraints provided by initiative and referendum in the Colorado constitution. It is important to preserve the rule of law in Colorado.

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ADDITIONAL RESOURCES on this subject can be found at: http://www.independenceinstitute.org/

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Endnotes

[1] For a discussion of the cyclical nature of quality and price in the construction industry see Gerald Finkel, 'The Economics of the Construction Industry', M. E. Sharpe, Armonk, New York, 1997; for a discussion of the positive impact of expenditures for construction and capital projects on economic growth see John Merrifield and Derek Monson, 'Simulation Analysis of a Taxpayer Bill of Rights', paper presented at the Public Choice Society meetings, Las Vegas, Nevada, March 7, 2009.

[2] A number of studies make this distinction between government expenditures that have a positive impact on economic growth and other expenditures that have a zero or negative impact on growth. See for example "The Sources of Economic Growth in OECD Countries", Organization for Economic Cooperation and Development", (OECD), Paris, 2003; James Gwartney, Randall Holcombe, and Robert Lawson, "The Scope of Government and the wealth of Nations", Cato Journal, Vol. 18, no.2, Fall, 1998.; "The Long Term Economic Effects of Some Alternative Budget Policies", Congressional Budget Office report to the Committee on the Budget of the U.S. House of Representatives, Washington D.C., May 19, 2008; John Merrifield and Derek Monson, 'Simulation Analysis of a Taxpayer Bill of Rights', paper presented at the Public Choice Society meetings, Las Vegas, Nevada, March 7, 2009.

[3] Op. Cit. Gerald Finkel, 'The Economics of the Construction Industry', M. E. Sharpe, Armonk, New York, 1997; for a discussion of the positive impact of expenditures for construction and capital projects on economic growth see John Merrifield and Derek Monson, 'Simulation Analysis of a Taxpayer Bill of Rights', paper presented at the Public Choice Society meetings, Las Vegas, Nevada, March 7, 2009.

[4] Colorado Constitution/CONSTITUTION OF THE STATE OF COLORADO /ARTICLE X REVENUE /Section 20. The Taxpayer's Bill of Rights.

[5] Colorado Commission on Taxation Statewide Survey, Ciruli Associates, Denver, Colorado, April 15, 2003; "Even in Budget Crises Coloradoans Support TABOR Amendment Limits on Taxes and Government Spending", Poll Analysis Ciruli Associates, Denver, Colorado, April 15, 2003.