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Justice and Economic Security for all Coloradans

Colorado’s revenue system has failed to keep pace with economic expansion in recent decades

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The dwindling power of state tax revenue follows the passage of the Taxpayer’s Bill of Rights, a series of tax cuts at the turn of the century, and to some extent, economic recessions.

By any measure, Colorado’s General Fund revenue has failed to keep pace with the state’s growth in the past three decades. While Colorado’s population and economic output have grown steadily since 1982, revenue from the sales and income taxes has sputtered.

An analysis of the state’s revenue trends shows that the dwindling power of state tax revenue follows the passage of the Taxpayer’s Bill of Rights, a series of tax cuts at the turn of the century, and to some extent, economic recessions. As a result, the General Fund — Colorado’s main source of revenue for schools, colleges and health care — has hit historic lows in recent years.

Budget year 2009-10 represents the lowest point in three decades for Colorado’s General Fund. Even with a slight rebound the following year, General Fund revenue has reached historic lows by any measure, whether it is economic output (Figure 1), a percentage of income, or per capita when adjusted for inflation.

General Fund as percent of Gross State Product

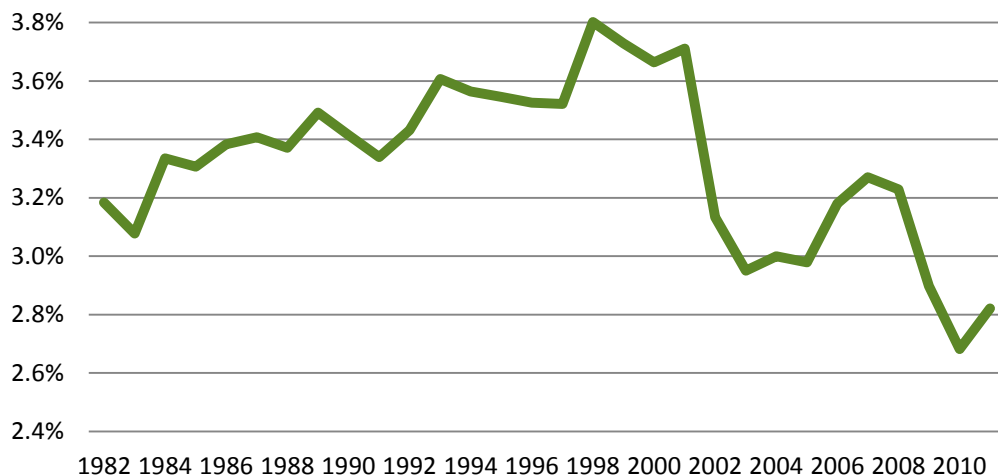


Figure 1

This detailed history of General Fund tax revenue from the past 30 years captures the period that spans fiscal years 1981-82 to 2010-11. Three clear conclusions emerged from the analysis:

- The income tax cuts of 1999 and 2000, and to a lesser extent the sales tax cut in 2001, have played a key role in reducing Colorado's General Fund revenue.
- Colorado has grown increasingly dependent on income tax revenue to pay for state services, while sales taxes and other taxes, such as taxes on cigarettes, have played a smaller and smaller role in the state budget.
- Colorado's tax revenue is more volatile than the state's economy as a whole.

As a result of the decline in tax revenue, not only is the state government playing a smaller role in Colorado's economy, but also the state's ability to provide critical services to families has been diminished.

Overview of the General Fund

The General Fund consists of revenue from several sources of taxes. Throughout the past three decades the overwhelming majority of that revenue has come from the sales and income taxes. The smaller sources of revenue have included at one time or another estate, insurance, pari-mutuel, interest income, court receipts, severance, Medicaid and gaming taxes. Not all of those taxes are currently levied.

For the purposes of this report, the term "General Fund" has been expanded from the definition used by state lawmakers to also include all income tax revenue that has been diverted from the General Fund to a special cash fund called the State Education Fund that was created after Amendment 23 was approved by voters in 2000. Including the State Education Fund revenue allows for the fairest comparison of all tax revenue across the 30 years. Also, it is worth noting that TABOR rebates were issued from 1999-00 to 2002-03. The rebates are not considered revenue in this analysis because they essentially amount to overpayment, as the money was returned to taxpayers without being spent.

Colorado's tax revenue is driven by two key factors: economic activity and tax laws. Significant changes in those two factors need to be considered in an analysis of General Fund revenue.

Since 1982, the U.S. economy has experienced four recessions:

- July 1981 to November 1982
- July 1990 to March 1991
- March 2001 to November 2001
- December 2007 to June 2009

Since 1982, seven significant changes have been made to Colorado's tax laws:

- For 15 months in 1983 and 1984 (ending Aug.1 1984) the sales tax rate was raised from 3.0 percent to 3.5 percent
- In 1987, the income tax shifted from a graduated rate to a flat-rate of 5 percent.
- In 1992, voters approve the Taxpayer's Bill of Rights, or TABOR.
- In 1999, the income tax rate was reduced to 4.75 percent.
- In 2000, the income tax rate was reduced again, this time to 4.63 percent.
- In 2001, the sales tax rate was reduced from 3 percent to 2.9 percent
- In 2005, voters approved Referendum C which allowed General Fund revenue to grow at a rate higher than TABOR would have otherwise allowed.

Total Gross General Fund Revenue (including State Education Fund)

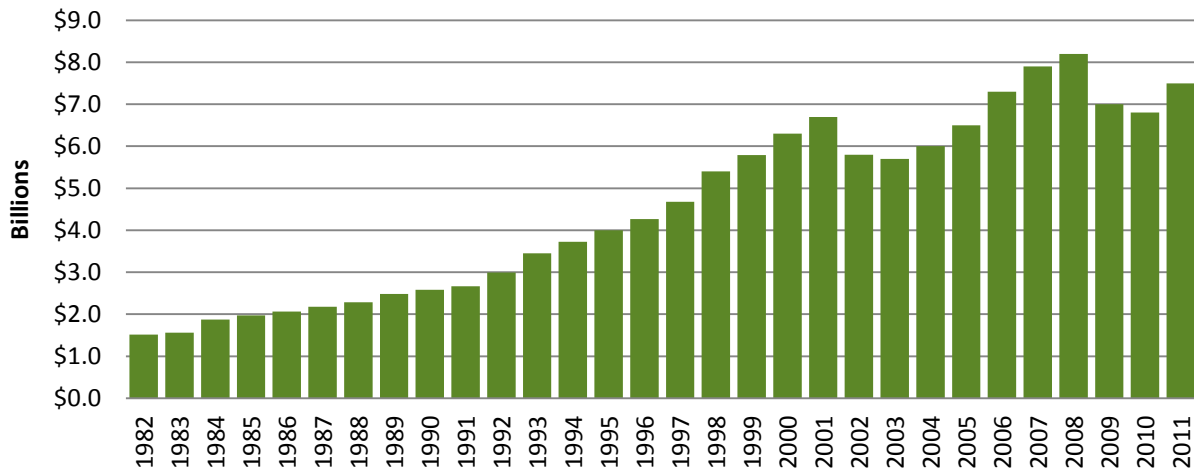


Figure 2

Figure 2 shows the nominal amount of total General Fund revenue for each fiscal year from 1981-82 (listed as 1982) through 2010-11. In 1981-82, the General Fund was a little more than \$1.5 billion. In 2010-11, it was more than \$7.4 billion. The average growth rate over the 30 years is 6.2 percent. In that time, revenue has declined four times. The years of decline occurred in the two most recent recessions. It's also worth noting that 1980-81, the most recent year not included in this analysis, saw a 2.8 percent decline in General Fund revenue.

Simply measuring the nominal growth in revenue is a grossly misleading use of the data that fails to put into perspective the role and scope of state government in Colorado. The amount of revenue collected from the income and sales taxes are linked directly to the number of people who live in Colorado and the level of economic activity in the state. As the state's population grows, more people are paying taxes and more people are benefiting from the quality of life generated and supported by tax dollars. At the same time, as the state grows, so does economic activity, which means that more goods are sold and incomes rise. Not only does an expanding economy contribute to higher tax revenues, but it also means that the cost rises for providing services within the state.

Population and General Fund revenue

Throughout the past three decades Colorado has experienced consistent growth. The state's population ballooned from a little more than 3 million in 1982 to more than 5.3 million in 2011. General Fund revenue per capita, without any consideration for changes in the economy other than population growth, increased each year for 19 consecutive years, growing from \$495 in 1981-82 to \$1,507 in 2000-01 (figure 3). But during the past two recessions, which came after the tax cuts at the beginning of the century, General Fund revenue has failed to keep pace with population growth, even without considering inflation. Between the recessions, General Fund revenue per capita peaked at \$1,634 in 2007-08. The \$1,424 per capita amount in the most recent year, 2010-11, was still below the highest level prior to the 2001 recession.

General Fund revenue per capita

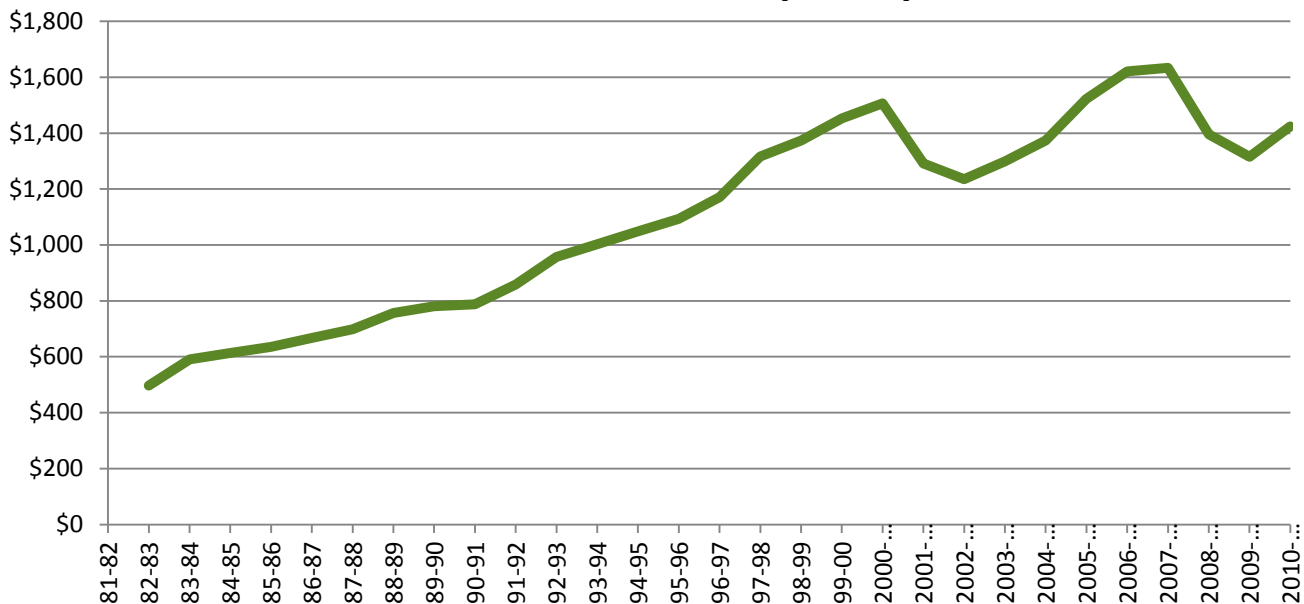


Figure 3

However, just measuring the amount of taxes paid per person over time is an insufficient measure of the health of Colorado’s revenue structure. Naturally, the cost of just about everything bought by the state government has increased in time. Figure 4 adjusts for inflation the General Fund revenue per capita.

Real General Fund revenue per capita (in 2012 dollars)

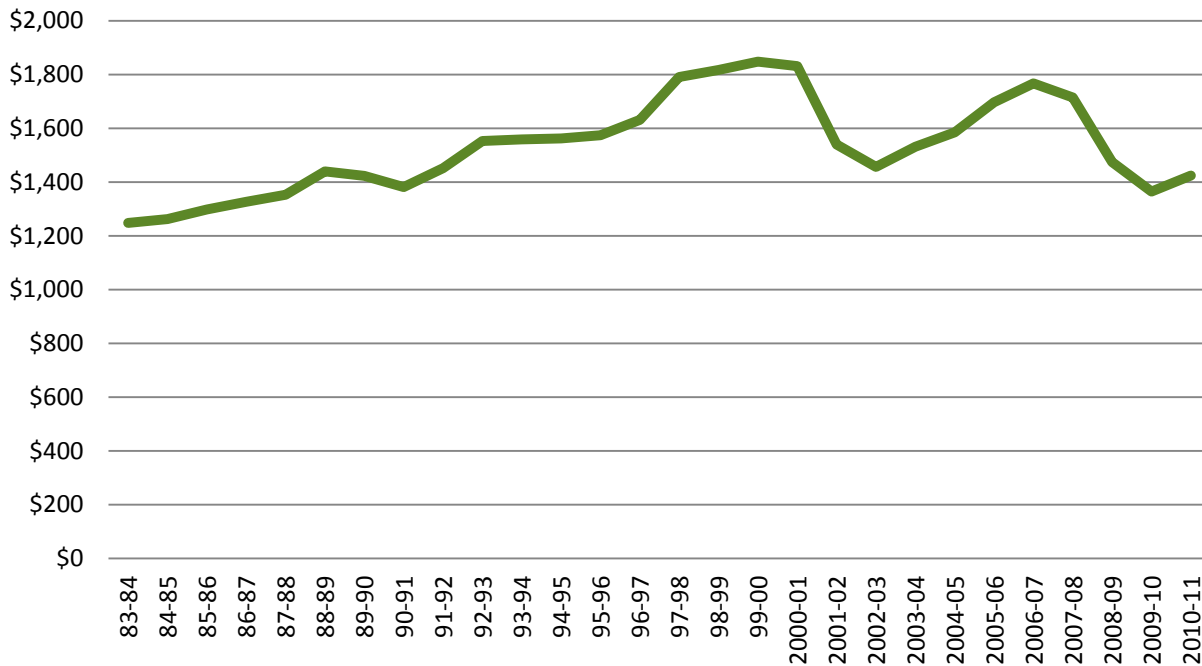


Figure 4

Adjusting for inflation calculates the “real” value. A dollar in 2011 would not buy as many goods or services as \$1 in 1982. This adjustment shows a more meaningful but also more troubling trend for state tax revenue. Real General Fund revenue per capita has declined during the two recessions that followed the tax cuts of 1999, 2000 and 2001, making 2009-10 the lowest year since 1987-88. In 2010-11 the adjusted per capita revenue was \$1,424, which is \$424 lower than the peak year of the past three decades, 1999-2000. As a result of the tax cuts at the turn of the century, real per capita revenue did not fully recover after the 2001 recession.

Personal income

A common alternative to measuring tax revenue by population is to compare tax revenue to personal income. Personal income captures a more complex change in the economy beyond just counting the additional people that result from population growth. Income captures changes in the growth of the economy, which is an important consideration for measuring the value of tax revenue that supports the purchase of goods and services. Figure 5 shows that the General Fund revenue per \$1,000 of income has declined dramatically since the tax cuts of 1999, 2000 and 2001. And the revenue per income in the past two years has been lower than at any point in the past three decades. This measure underscores again that the tax cuts at the turn of the century prevented state revenue from fully recovering from either of the two most recent recessions.

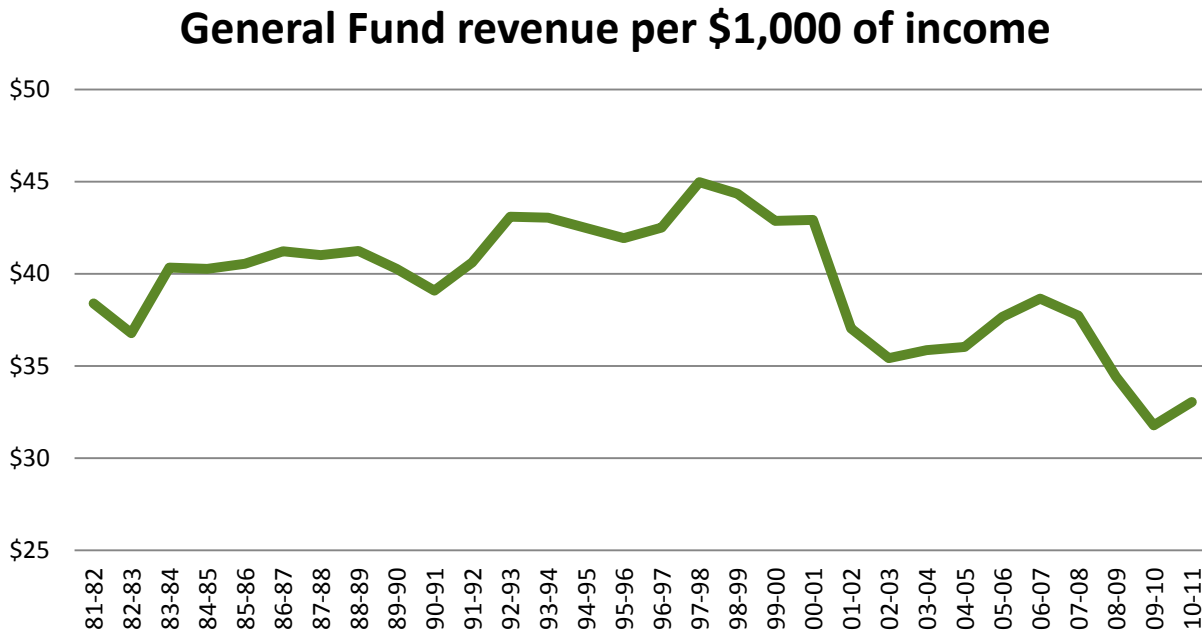


Figure 5

Colorado GSP

Perhaps the best indicator of the size of Colorado’s economy is the Gross State Product, which measures at the state level what the Gross Domestic Product measures on the national level. Figure 6 represents the annual GSP in Colorado. In nominal terms, GSP has grown more consistently in the past three decades than General Fund revenue. GSP increased all but one year, 2009. Since 1982, the state GSP has increased an average annual rate of 6.2 percent, which is roughly equivalent to the average annual increase for General Fund revenue.

Colorado Gross State Product

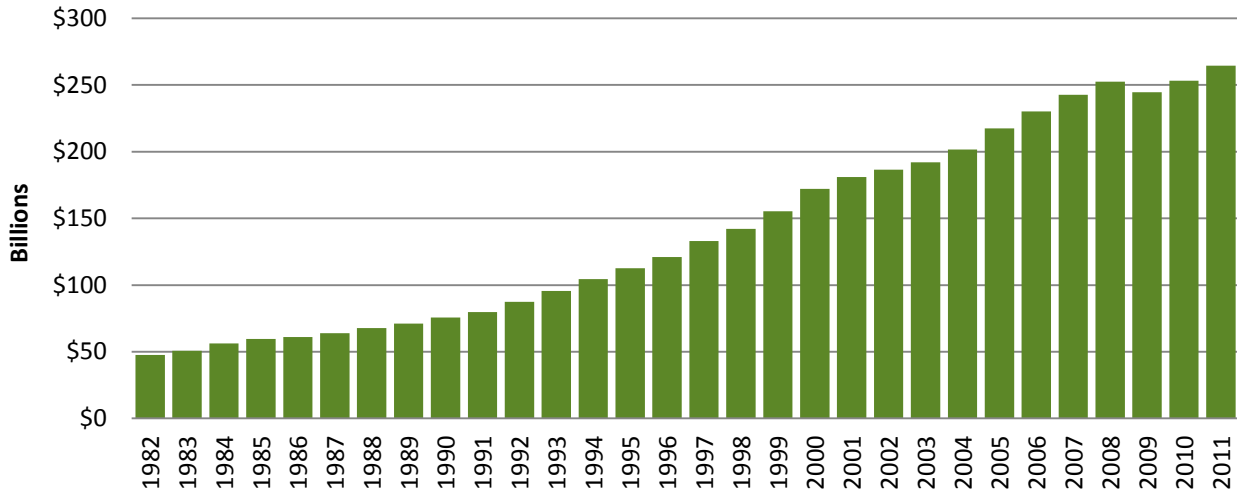


Figure 6

Figure 7, which is identical to Figure 1 on Page 1, captures the long-term change in the relationship of taxes and the economy. Simply put, tax revenue has shrunk. Or more precisely, General Fund revenue as a percentage of the state GSP has declined in the past three decades.

General Fund revenue as percentage of GSP

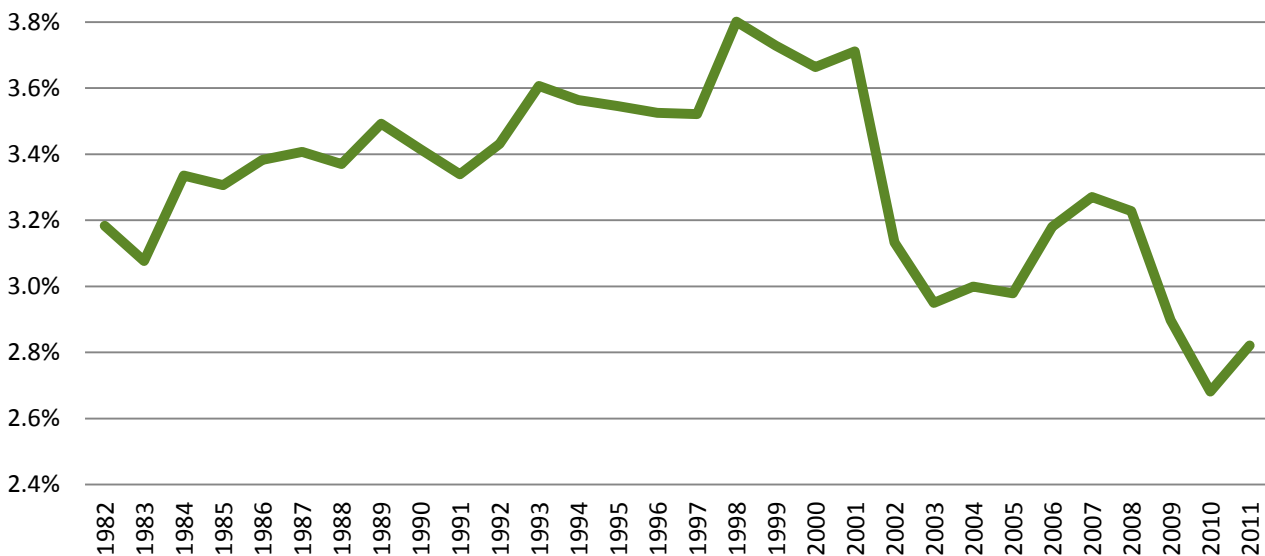


Figure 7

Over the past 30 years, the General Fund revenue as a percentage of the state GSP has averaged 3.27 percent. But as the chart shows, that average is driven higher by the first two decades of the survey. The last 10-year period (2002-2011) has told a different story. During the past decade, General Fund revenue as a percentage of state GSP has averaged 2.87 percent. In 2011, it stood at 2.68 percent.

Again, the chart shows that after the economy recovered from the 2001 recession, the tax cuts of 1999, 2000 and 2001 prevented General Fund revenue from returning to its previous levels. And although the economy has not fully recovered from the most recent recession, General Fund revenue would have to grow by \$1.5 billion in 2012 in order to return to the same percentage of GSP as it represented in 2007. General Fund revenue would have to increase by nearly \$3 billion to match the year of peak level of state government involvement in in the economy, 1998. That gap demonstrates the shrinking role that state government now plays in Colorado’s economy.

Income tax accounts for largest share of General Fund revenue

Figure 8 underscores how even as the income tax has declined, it has played an increasingly larger role in funding state services through the General Fund. The chart captures income tax revenue, sales tax revenue and all other tax revenue as a percentage of their contributions to the General Fund. The long-term trend is clear: Colorado has an increasing dependence on the income tax while depending less and less on all other taxes. Figure 8 captures the income tax cuts of 1999 and 2000 as the percentage of the income tax portion of the General Fund dipped in the first few years following the tax cut.

Share of General Fund revenue, by sources

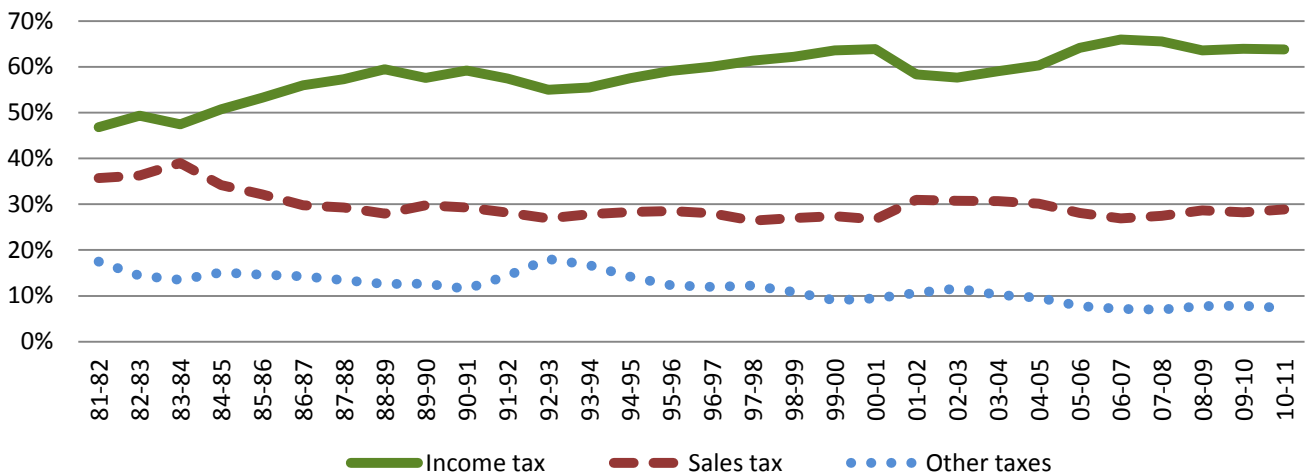


Figure 8

Note that income tax includes both corporate and individual income taxes. The “other” category includes cigarette, tobacco, liquor, estate, insurance, pari-mutuel, interest income, court receipts, severance, Medicaid, gaming and other unidentified taxes. Of those, severance is no longer treated as a General Fund source, Medicaid was eliminated in 2003 and some excise tax was reduced in 1997.

It’s also worth noting the state has become less dependent on sin taxes. As a group, sin taxes (cigarettes, tobacco, liquor, gaming and pari-mutuel) accounted for 4.78 percent of the General Fund in 1981-82 but just 1.56 percent in 2010-11. The combination of cigarette and tobacco taxes alone dropped from 2.45 percent to 0.75 percent.

General Fund revenue is more volatile than the economy

In the past three decades, General Fund revenue has been more volatile than Colorado’s economy as a whole. That is to say that in good times, and in bad times, state tax revenue fluctuates to greater extremes than the state’s economy. For example, when incomes stall, or actually decline, due to changes in the economy, such as a recession, General Fund revenue drops even more dramatically. The challenge for state lawmakers during these downturns is further exasperated by the increase in demand for services

that typically follows recessions. Figure 9 and Figure 10 use slightly different measures to tell this same story.

General Fund growth vs. personal income growth

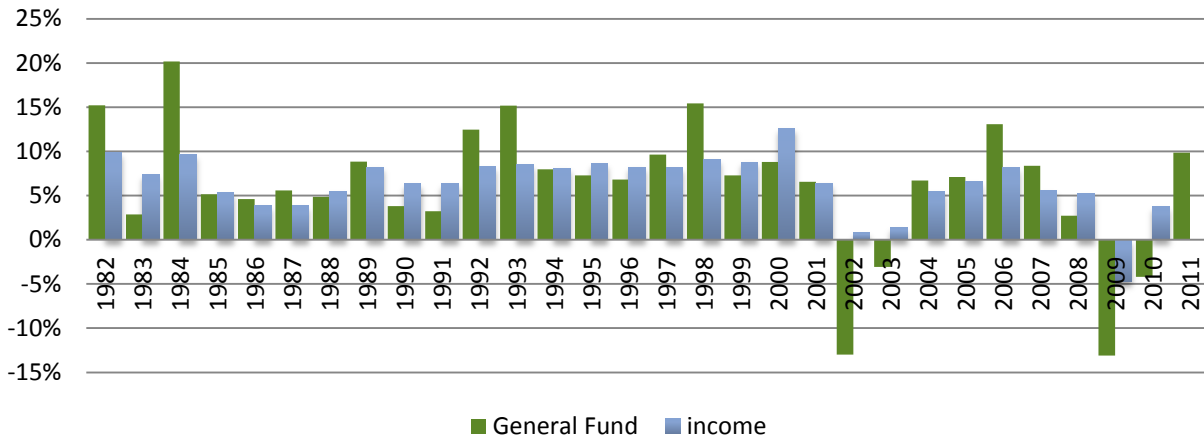


Figure 9

Figure 9 compares the annual changes in personal income to changes in General Fund revenue. The green bars represent the annual percentage of change in the General Fund. The blue bars represent the percentage of change in personal income from year to year. Personal income declined only once, in 2009, and the General Fund declined four times.

General Fund vs. GSP growth

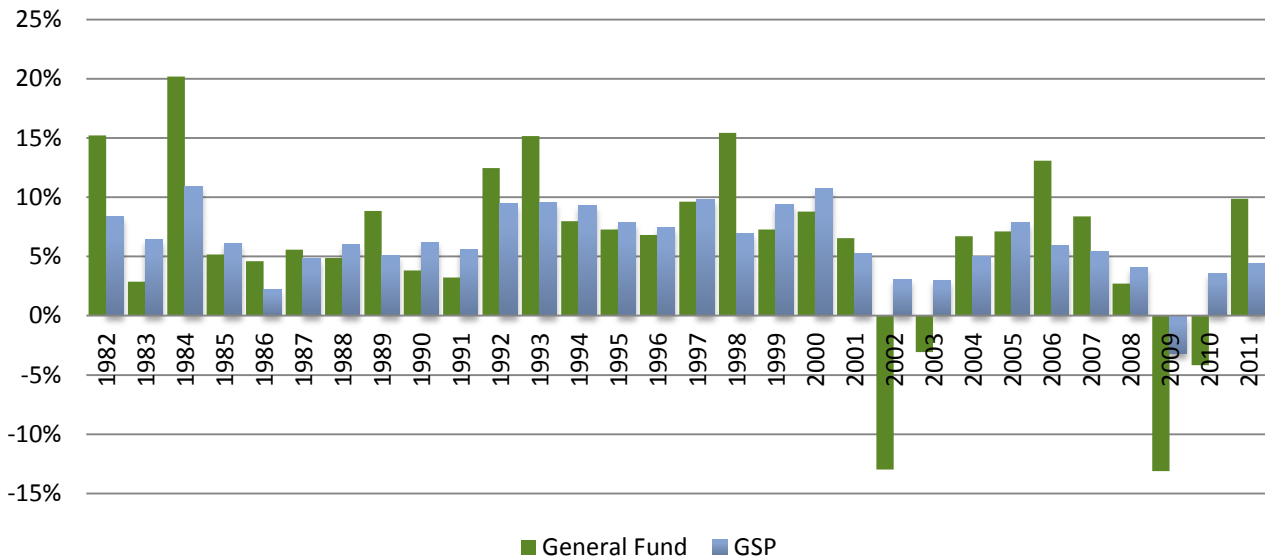


Figure 10

Figure 10 compares the percentage of General Fund revenue change each year to the percentage change in GSP. Similar to Figure 9, Figure 10 underscores how changes in General Fund revenue are more volatile than changes in the economy. The green bars represent the annual percentage change in General Fund revenue. The blue bar represents the annual percentage change in GSP. While the General Fund has experienced growth of 13 percent or higher four times in the past 30 years, the state GSP has had

just two years when growth exceeded 10 percent. And while the General Fund experienced a decrease in revenue four times, the state GSP declined just once.

Conclusion

The data presented here rebuke the theory advanced by some policymakers that tax cuts lead to increased revenue. Tax cuts enacted by the General Assembly in 1999, 2000 and 2001 shrank the size of Colorado's General Fund tax revenue. Taxes paid by Coloradans account for a smaller share for the state's economy. Coloradans are paying less in General Fund taxes when measured as a percentage of their income. And, when inflation is taken into consideration, Coloradans are paying less per person. By any measure, tax revenue has failed to keep pace with growth in Colorado. The decline in revenue places at risk the public services that families depend on such as Medicaid, public schools, and colleges.