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TABOR: A Formula for Undermining Public Investments

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Executive Summary

- The proposed TABOR legislation before the General Assembly would cap growth of state General Fund appropriations to population growth plus inflation.

- The TABOR formula fails to take into account that the costs of certain services, such as health care and education, grow faster than inflation. In addition, TABOR ignores demographic shifts, such as the increasing share of North Carolina's population made up of elderly residents and college students. Therefore, the "population plus inflation" formula is not an appropriate way to measure the cost of providing basic government services and would ensure perpetually insufficient funding.

- Had North Carolina implemented TABOR in 1993, the TABOR formula would have reduced North Carolina's cumulative investment in public structures by more than $35 billion between fiscal year 1993 and the current fiscal year. In fiscal year 2008, state policymakers would have had to cut state appropriations by 23 percent to meet the TABOR limit.

- Contrary to the claims of TABOR proponents, TABOR would not prevent North Carolina from facing state budget shortfalls. TABOR did not save Colorado, the only state with a TABOR amendment, from significant state budget shortfalls in the current recession or in the early 2000s recession. In fact, Colorado faced the second-worst budget shortfall in the nation in 2003.

- Colorado passed TABOR in 1992, and its budget constraints have seriously weakened Colorado's public structures. Because of TABOR, Colorado's funding for K-12 education, colleges and universities plummeted to near the bottom for the nation. In addition, the share of low-income children without health insurance doubled in Colorado between the passage of TABOR and its suspension by voters in 2005.

- The TABOR proposal under consideration would also reduce the maximum size of the state's Rainy Day Fund, from 8 percent to only 5 percent, and harshly constrain access to the Rainy Day Fund in times of fiscal crisis. These backward provisions would weaken the state during recessions, increasing the pain felt by North Carolina families and hampering the state economy at the worst possible time.

What is TABOR?

TABOR, known by its supporters as the "Taxpayers Bill of Rights," is the general term for proposed constitutional amendments to cap the growth of state budgets at population growth plus inflation. Many states, including North Carolina,[1] have established limits or caps on state government expenditures. TABOR is much more restrictive than the limits adopted in most states.

Colorado enacted the first TABOR state constitutional amendment in 1992, and it remains the nation's strictest state spending limit. The proposed TABOR legislation before the General Assembly would impose a similar cap on North Carolina's state budget.

TABOR's population-growth-plus-inflation formula goes far beyond merely constraining growth in state-funded services. Instead, the highly restrictive formula ensures that funding for public services will be perpetually insufficient, undermining the ability of public structures to sustain critical investments in education, health and public safety. Recognizing the damage TABOR was doing to their basic public systems, Colorado voters suspended their state's TABOR for five years in 2005.

TABOR Proposal in North Carolina

Public schools, community colleges, universities, public safety systems, parks and hospitals form the foundation of North Carolina's economy and citizens' quality of life. These public structures require adequate, ongoing investments if they are to support North Carolinians' efforts to build a more prosperous future and meet the needs of today's population.

House Bill 188, the version of TABOR currently under consideration in the North Carolina House, would cap growth in state General Fund appropriations to the average rate of growth in the state's population plus inflation, as measured by the Consumer Price Index, over the course of the previous three years. The legislation would set the budget for fiscal year 2012-13 as the "base year" from which state General Fund expenditures could not exceed the TABOR formula without a two-thirds vote of the General Assembly.

This TABOR proposal would also put a second cap on the budget proposals put forth by the governor and the General Assembly, limiting proposed appropriations to the amount of revenues collected in the previous calendar year, adjusted for changes in tax law. In years when the previous

■ TABOR proposal would reduce North Carolina's Rainy Day Fund, even as other states increase theirs

North Carolina's Rainy Day Fund played an important role in protecting the state's public investments in 2009 as state revenues plummeted in the early stages of the recession. State policymakers used the fund to prevent more than $600 million in mid-year budget cuts just as the need for state services was growing quickly.[2] Other states also utilized their Rainy Day Funds to reduce the need for budget cuts and tax increases to close budget shortfalls during the early years of the recession.[3]

The prevailing lesson many state legislatures, government finance officers, and voters learned from the recession was that many states' Rainy Day Funds were insufficient to adequately respond to declining revenues and growing demands during a recession. The Government Finance Officers Association now recommends that states accrue a reserve balance equal to at least two months' worth of General Fund expenses/revenues (about 17 percent).[4] Two of North Carolina's neighbors (South Carolina and Virginia) voted in 2010 to increase the caps on their respective Rainy Day Funds.[5]

The proposed TABOR legislation would move North Carolina in the opposite direction. Instead of raising North Carolina's Rainy Day Fund target above its current level of 8 percent, the TABOR proposal would reduce the maximum size of the state's Rainy Day Fund to only 5 percent. The legislation would also make it more difficult for the General Assembly and the governor to access the Rainy Day Fund in times of fiscal crisis by requiring a two-thirds supermajority vote of both chambers to appropriate funds in the Rainy Day Fund.

Imposing a restrictive cap on the state's Rainy Day Fund and harshly constraining access to available funds runs counter to the recommendations of state budget and finance experts and could potentially limit the ability of the state to adequately respond to future fiscal crises.

calendar year's revenues, adjusted for tax-law changes, were lower than the next fiscal year's TABOR spending limit, the calendar-year limit would place an even more stringent constraint on state appropriations. This provision would, in some cases, limit the ability of state appropriations to recover in the years following a recession.

The combined effect of the TABOR formula and the calendar-year limit would cap appropriations at the lesser of either population-growth-plus-inflation or last year's revenue levels. According to the legislation, whenever state revenue growth exceeds growth in the state's population and inflation, revenues above the cap would first be placed in an Emergency Reserve Trust Fund (a replacement for the state's current Savings Reserve Account, commonly known as the Rainy Day Fund) up to a cap of 5 percent of the previous year's General Fund appropriations. Once the Emergency Reserve Trust Fund reaches the 5-percent cap, additional revenues would be refunded to state residents in an as-yet-unspecified manner.

What If North Carolina, Like Colorado, Had Implemented TABOR in 1993?

The lessons from Colorado are clear: TABOR starves public structures of the resources necessary to effectively meet the needs and demands of state residents.

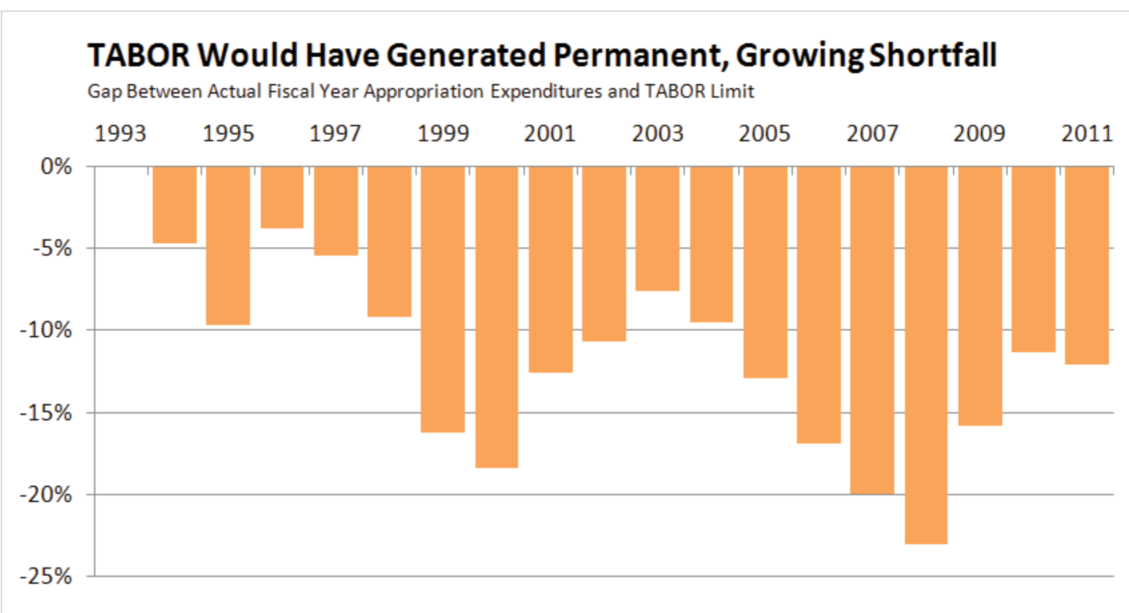
Figure 3 illustrates the shortfall between actual state appropriations and what appropriations would have been had North Carolina implemented TABOR in 1993, at the same time as Colorado. The TABOR formula would have reduced North Carolina's cumulative investment in public structures by $35 billion between fiscal year 1993 and the current fiscal year. (See Figure 1)

In fiscal year 2008, the year with the largest gap between actual state appropriations and TABOR-limited appropriations, state policymakers would have had to cut state appropriations by 23 percent to meet the TABOR limit. Making cuts of that magnitude would have been equivalent to doing any one of the following:

- Cutting roughly three-fifths of the state's appropriation to K-12 public schools
- Eliminating all state funding for North Carolina's community colleges and universities, plus 90 percent of all state appropriations for prisons
- Eliminating all state funding for Medicaid, Mental Health, Child Development, and Public Health, plus all state appropriations for courts[6]

These figures may even understate the impact of the proposed TABOR legislation. The analysis presumes that state policymakers would not have responded to growing, TABOR-mandated tax refunds with permanent tax cuts. If, as in Colorado, state policymakers responded to revenue surpluses with permanent tax cuts, the second, calendar-year limitation in North Carolina's TABOR proposal could have

FIGURE 1



SOURCE: Office of State Budget and Management, FY 2011-13 Recommended Budget, Appendix Table 1A; CPI and population data from US Bureau of Labor Statistics and NC OSBM

* Actual FY 2010 and 2011 appropriations include federal Recovery Act aid to support General Fund expenditures

constrained the ability of state appropriations to recover in the wake of recent recessions.

Even the substantial cuts state policymakers have made during the Great Recession would have fallen billions short of meeting the TABOR-imposed cap on state expenditures. Instead of eliminating state budget shortfalls, as some TABOR proponents suggest, TABOR would create a permanent and growing shortfall between the cost of maintaining state investments and the funds available.

■ TABOR would not eliminate budget shortfalls during recessions

Some TABOR proponents have suggested that, had TABOR been in place in 2004, North Carolina would not have encountered such substantial budget shortfalls during the current recession. Colorado's experience suggests otherwise. During the recession of the early 2000s, after TABOR had been in place for nearly a decade, Colorado experienced significant budget shortfalls. By 2003, the National Conference of State Legislatures ranked Colorado's budget shortfall as the second-worst in the country.[7]

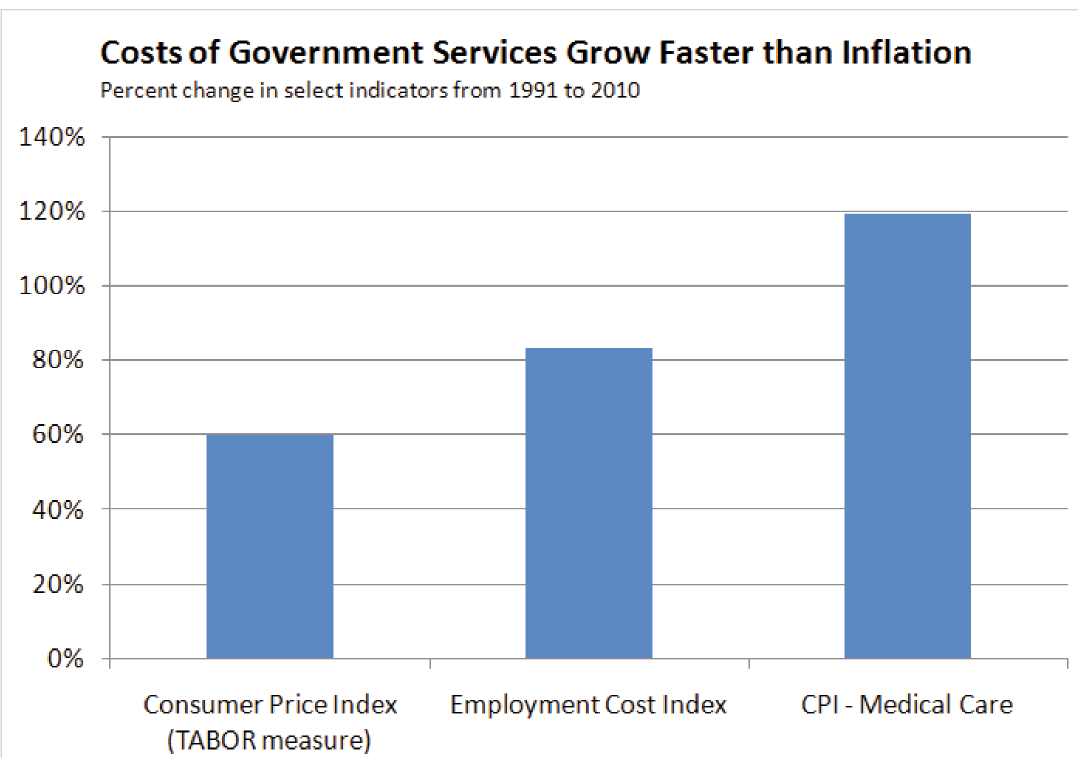
Not only did Colorado experience some of the deepest state budget shortfalls in the country, the design of Colorado's TABOR formula locked in depressed revenue levels and prevented revenues from recovering with the economy. Thus, while other states were able to gradually restore some of the worst cuts made during the early 2000s recession, TABOR forced Colorado to continue cutting state services even as the state's economy recovered. By 2005, the perennial state budget cuts prompted state residents to vote to suspend TABOR's population-plus-inflation formula for five years.

TABOR Formula Leads Inevitably to Devastating Cuts to Key Public Structures

Overall inflation is an inadequate measure for determining normal growth in the cost of providing basic government services over time.

TABOR's measure of inflation, the Consumer Price Index (CPI), cannot accurately assess the cost of providing government services. The CPI measures changes in the cost of goods and services purchased by urban households.[8] However, state government spends most of its money on labor costs and health care. That makes sense – most of the services the state provides are labor-intensive, such as K-12 education. In addition, the state offers health care coverage to most of its employees and pays for many health care services for people who cannot afford them in the private market. Because health care is expensive, paying for these services takes up a significant share of the budget. Altogether, pay, benefits and health care accounted for

FIGURE 2



SOURCE: US Bureau of Labor Statistics

roughly 9 of every 10 dollars of the state's General Fund budget in the most recent fiscal year.[9]

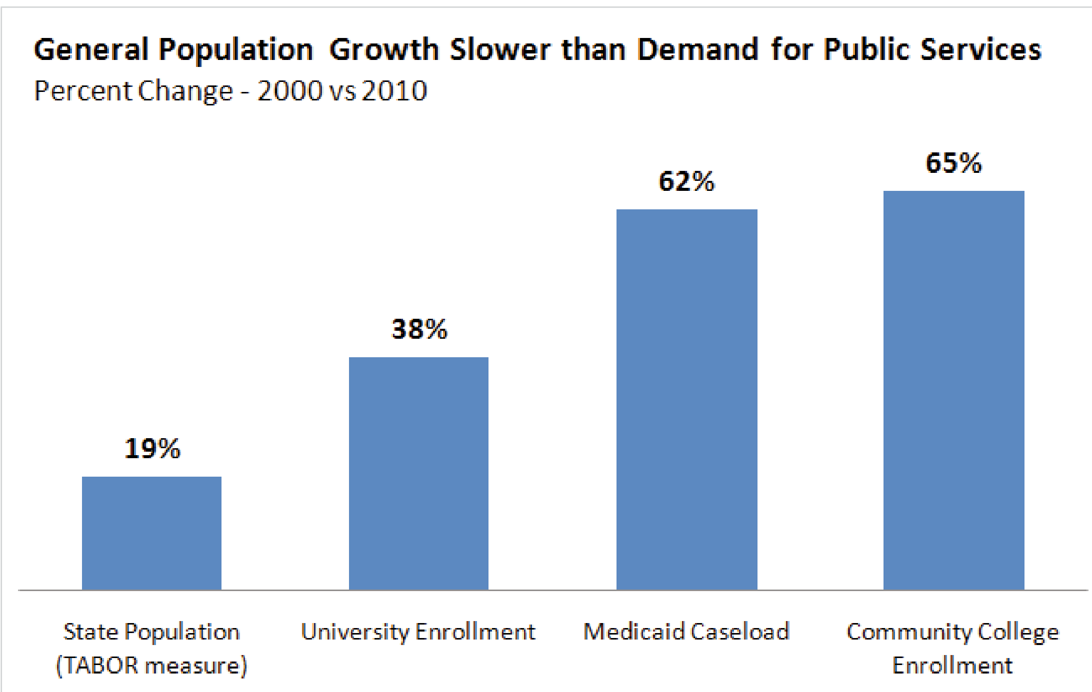
Furthermore, the costs relevant to providing government services tend to grow faster than household-based inflation, as measured by the Consumer Price Index. Over the past twenty years, the employment cost index—a national measure of labor costs—has grown more than a third faster than inflation. Per capita personal income in North Carolina has grown two-thirds faster than inflation.[10] The price of medical care has grown twice as fast.[11] (See Figure 2)

Not only have the costs of providing government services grown faster than inflation, some population groups most directly reliant on government services—for example, college students and people eligible for Medicaid—have also grown faster than the rest of the population. The recent census showed North Carolina's population grew by 18.5 percent from 2000 and 2010.[12] During the same time, however, the number of students in the state university system grew more than twice as fast, and the state's Medicaid caseload and the number of full-time-equivalent students at the state's community colleges both grew more than three times faster than the general population.[13] (See Figure 3)

Looking ahead, North Carolina's elderly population is expected to grow 3.5 times faster than the state's non-elderly population between 2011 and 2030, putting enormous pressure on state-funded services for the elderly over the next twenty years.[14] Already, elderly North Carolinians account for only 10 percent of Medicaid recipients but more than 20 percent of Medicaid costs.[15]

TABOR's formula, however, would fail to account for the state's rapidly aging population and the increased educational needs of the state's population, putting an additional fiscal burden on state-funded services. As a result, TABOR would lead inevitably to declining state investments in the services necessary for a healthy population and a productive workforce.

FIGURE 3



SOURCE: NC OSBM and NC Fiscal Research Division

Nearly Two Decades of TABOR Weakened Colorado's Public Structures

Colorado passed TABOR in 1992 and remains the only state with a TABOR amendment. Nearly two decades of TABOR have seriously weakened Colorado's public structures, driving down Colorado's funding for K-12 education, colleges and universities, public health and transportation to near the bottom for the nation.[16]

After the passage of TABOR in 1992, Colorado experienced a considerable, sustained decrease in the quality and availability of public services in the state:

- From 1992 to 2001, Colorado's per-pupil funding in K-12 education as a share of personal income declined from 35th to 49th in the nation.[17]

- From 1992 to 2004, Colorado's college and university funding as a share of personal income declined from 35th to 48th in the nation.[18]
- The share of low-income children without health insurance doubled in Colorado between the passage of TABOR and its suspension in 2005. As of 2008, Colorado ranked 47th among the 50 states on this measure.[19]
- Funding for public health initiatives declined significantly, with Colorado falling to 48th in the nation in pregnant women's access to prenatal care and to 50th in the nation for the share of children receiving full vaccinations.[20]

■ What Do Coloradans Have to Say About TABOR?

"Coloradans were told in 1992 . . . that [TABOR] guaranteed them a right to vote on any and all tax increases. . . . What the public didn't realize was that it would contain the strictest tax and spending limitation of any state in the country, and long term would hobble us economically."

— Tom Clark, executive vice president, Metro Denver Economic Development Corporation

"The [TABOR] formula . . . has an insidious effect where it shrinks government every year, year after year after year after year; it's never small enough. . . . That is not the best way to form public policy."

— Brad Young, former Colorado state representative (R) and chair of the Joint Budget Committee

"[Business leaders] have figured out that no business would survive if it were run like the TABOR faithful say Colorado should be run — with withering tax support for college and universities, underfunded public schools and a future of crumbling roads and bridges."

— Neil Westergaard, editor of the Denver Business Journal[22]

TABOR's impact on Colorado's public structures led to business and community leaders from across the political spectrum coming together to call for the suspension of TABOR in 2005. Even five years after voters suspended TABOR, however, Colorado's public structures have failed to recover from sustained inadequate funding over the course of more than a decade.

Policymakers and voters in other states have taken notice of the devastating impact of TABOR in Colorado. Although legislators in almost half of all states have proposed TABOR and TABOR-like amendments since 2005, TABOR advanced to the ballot only five times. In each case — in Nebraska, Oregon, Washington, and twice in Maine — voters soundly rejected it.[21]

TABOR is the Wrong Formula for North Carolina's Future

TABOR's inherent flaws and the experience of Colorado make it clear that TABOR is the wrong formula for North Carolina's future. North Carolina's public structures—public schools, community colleges and universities, hospitals and courts—are already compromised by several years of cuts during the Great Recession. Additional cuts likely in the next biennium will further weaken the ability of North Carolina's public structures to meet the needs of the state.

Brightening economic prospects, targeted efficiencies, and the possibility of a balanced approach to closing the state's current budget shortfall may help to mitigate the depth and duration of the harmful state budget cuts to education, health and public safety. TABOR's fiscal straightjacket would eliminate this possibility. Instead, TABOR would permanently lock in the budget cuts made during this recession and further starve the state's public structures of the resources necessary to put North Carolina and its economy on the path to recovery and future prosperity.

1 NC General Statute § 143C 4 6 caps state General Fund expenditures at seven percent of projected state personal income. http://www.ncga.state.nc.us/enactedlegislation/statutes/html/bysection/chapter_143c/gs_143c-4-6.html

2 NC Office of the State Controller. "General Fund Monthly Financial Reports: FY2009" Available at http://www.ncosc.net/financial/m_repts.html

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5 BallotPedia. "Rainy Day Fund measures get voter backing on Election Day." November 5, 2010. http://www.ballotpedia.org/wiki/index.php/Rainy_Day_Fund_measures_get_voter_backing_on_Election_Day

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8 US Bureau of Labor Statistics. "Consumer Price Index: Frequently Asked Questions." Available at http://www.bls.gov/cpi/cpifaq.htm#Question_6

9 Special request to NC Fiscal Research Division for pay and benefits data. Health care includes non-administrative costs for State Health Plan, Medicaid, Mental Health, NC Health Choice, and Public Health appropriations.

10 US Bureau of Labor Statistics (CPI & ECI). US Bureau of Economic Analysis (State Personal Income). NC Office of State Budget and Management (NC population)

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12 US Census Bureau. "2010 Census Data: North Carolina." Available at http://2010.census.gov/2010census/data/

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14 NC Office of State Budget and Management. "County/State Population Projections." Available at http://www.osbm.state.nc.us/ncosbm/facts_and_figures/socioeconomic_data/population_estimates/county_projections.shtm

15 Christine Kushner. "Medicaid and North Carolina's Aging Population." North Carolina Center for Public Policy Research. January 10, 2010. http://www.nccppr.org/drupal/content/insightarticle/272/medicaid-and-north-carolinas-aging-population

16 Michael Leachman, Iris Lav, and Erica Williams. "Education, Health, Public Safety, and Infrastructure Would Decline Under SJR 2420's Proposed TABOR Limit." Center on Budget and Policy Priorities. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3170

17 Ibid.

18 Ibid.

19 Ibid.

20 Ibid.

21 Iris Lav and Erica Williams. "A Formula for Decline: Lessons from Colorado for States Considering TABOR." March 15, 2010. Center on Budget and Policy Priorities. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=753

22 Ibid.

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