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Citizen's Budget 2013

Road Map for Sustainable Government in Colorado

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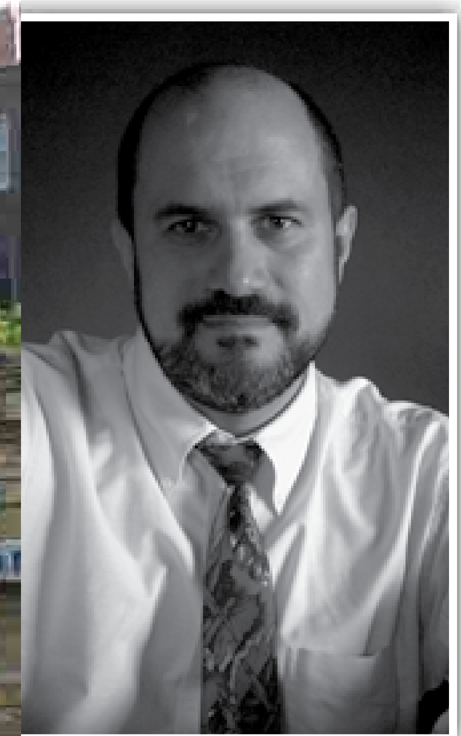
Letter from the President

Everyone calls for government to be done smarter, more effectively and more efficiently. Our team of knowledgeable public policy participants once again has written a series of reforms that sets an excellent agenda for Colorado state government.



Our practical solutions may be rejected by extremists who will not consider alternatives, but we present a core of actions around which a bipartisan coalition of innovators can rally.

In this publication you can find the resource materials, explanations and policy recommendations to create the understanding, the energy, the acceptance and the will to improve and modernize government. We offer here a Citizen's Budget for 2013, for the 69th General Assembly to follow through over the course of the next two years.

We published the first Citizen's Budget in 2010 in response to the Great Recession. The private sector was shedding jobs and the national economy was in decline. The State was faced with a potentially huge shortfall of taxes to pay for the existing level of services; some predicted a budgetary hole of $1 billion. Alarmed by the situation, people turned to the Independence Institute to provide ways to deal with the problem.

What developed was far better, more far-reaching and more fundamental than we had first envisioned. This follow-up book is a definitive guide for policy leaders and legislators.

The current outlook is brighter this time for the State government, as the state and national economies pick up, but opportunity still calls us take important steps. As our lead author Penn Pfiffner observes in his Overview chapter, this set of policy reforms can work if economic conditions continue to improve or if there is "only" another slowdown or even recession. But far larger, dramatic steps will have to be taken if instead one or more of several really bad outcomes arrive, such as roaring inflation or a worldwide depression that follows a sovereign debt debacle. We can address those issues if they come, but for now we don't include program ideas for such speculative problems.

Remember you used the 2010 Citizen's Budget for basic information, such as how the budget process works, historic trends in government size, and how public schools are funded. That sort of scholarship returns in this version, as does much of the impressive team that made the first volume so successful. We not only update information about the proposed reforms from 2010, we also add some new authors and new areas of reform.

We urge all citizens to weigh in. Use our material to engage your own fight. Be part of the process.

Straight on,

Jon Caldara

Road Map for Sustainable Government

Find in this report a series of proposals that together constitute an agenda to improve state government. The government's economic condition does not have to hang on a fiscal cliff edge in order for all residents to want to see a better set of ideas, to get more out of the funds available, and to see tax dollars used wisely.

This is the second edition of a Citizen's Budget. Our first version was released at the very end of 2010. Among the host of ideas contained in this edition, some are new, to reflect changing conditions and to address current concerns. Lots of good ideas from the first edition remain unfulfilled by the legislature. Those ideas are given fresh figures and analyses and offered here in concise form, so that you can absorb the concepts quickly and return to the full discussion either on-line or in hard copy from their introduced version.

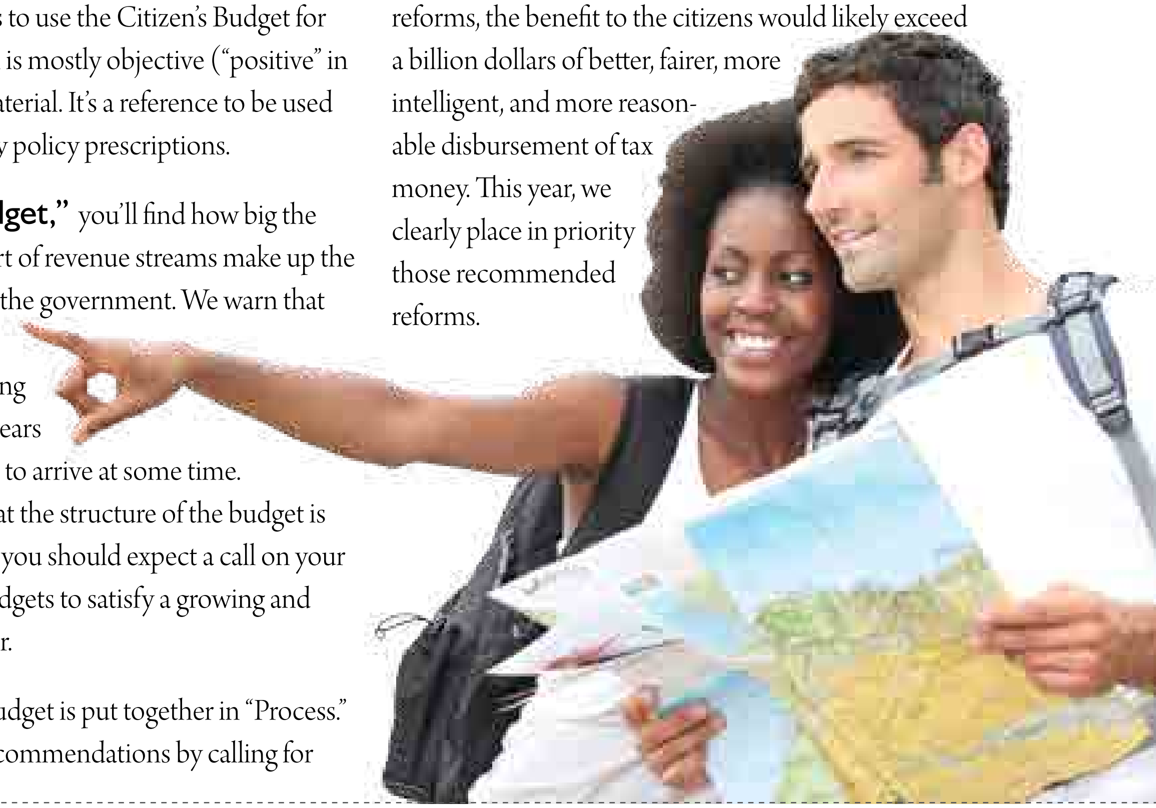
You will find two ways to use the Citizen's Budget for 2013. The first section is mostly objective ("positive" in Economics-speak) material. It's a reference to be used before formulating any policy prescriptions.

In **"The State Budget,"** you'll find how big the budget is and what sort of revenue streams make up the total income taken by the government. We warn that Colorado is not ready for potentially damaging crises, which may be years away but seem certain to arrive at some time. We make the point that the structure of the budget is set up to fail, meaning you should expect a call on your income and family budgets to satisfy a growing and rapacious public sector.

Learn how the state budget is put together in "Process." We start the book's recommendations by calling for restoration of a constitutional provision that intelligently constrained legislative profligacy and helped to guarantee investment in government buildings and other durable goods, whereas now spending focuses only on current operational demands. We call also for a modification from asking only "How much will it cost?" to a better question: "What are we getting for all these expenditures?"

"Priority Budgeting" touts the benefits of an overall reform in the process—something that has received bipartisan support but has evaded implementation. Courageous leadership in both the House and Senate will be needed to transition to a better process.

The remainder of the Citizen's Budget for 2013 has specific ideas for several major categories of spending. If legislators were to adopt these commonsense reforms, the benefit to the citizens would likely exceed a billion dollars of better, fairer, more intelligent, and more reasonable disbursement of tax money. This year, we clearly place in priority those recommended reforms.

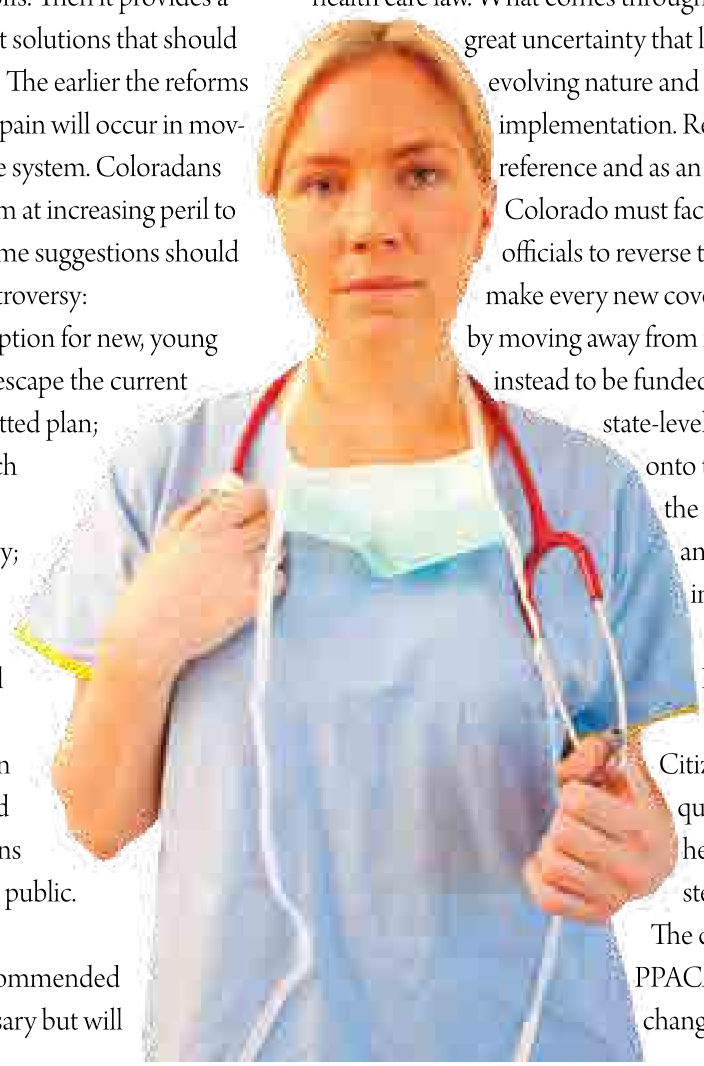


The government teacher and government worker pensions threaten to gobble up an impossibly large portion of current and future tax dollars. Our chapter shows that the promised solution to the problem imposes severe costs on the state budget, and is unlikely to fix the problem in the foreseeable future. Further, in its nearly inevitable failure, the so-called "solution" will push the system into a financial crisis from which it will emerge only with drastic reform. The **"Public Pensions"** chapter once again goes beyond a litany of problems. It should first be used by legislators, policy analysts, and political activists as a reference tool. The chapter sets out the problems and weighs the trade-offs. Then it provides a series of important solutions that should be passed into law. The earlier the reforms take place the less pain will occur in moving to a sustainable system. Coloradans ignore this problem at increasing peril to future citizens. Some suggestions should generate little controversy:

- Create an option for new, young workers to escape the current overcommitted plan;
- Ensure much improved transparency; and
- Insist on professional outside investigation of presumed contributions and make it public.

The following recommended reforms are necessary but will undoubtedly generate more resistance:

- Replace the current presumption that taxpayers must bear all the risk and responsibility for funding, including the Association's losses, by making taxpayers responsible only for the employer share of contributions and PERA responsible for gains or losses realized through investment choices;
- Move state government workers toward retiring at an age closer to that of the taxpayers who fund them; and
- Provide accountability to the existing bailout plan by setting a date at which bailout contributions by employers and employees will be phased out and those funds re-directed toward other budget priorities.



The second reform chapter, **"Medicaid,"** discusses at length the new political environment that is being changed by the federal health care law. What comes through clearly in this section is the great uncertainty that legislators now face, and the evolving nature and continued ambiguity of full implementation. Rely on the chapter both as a reference and as an analysis of the trade-offs that Colorado must face. The chapter urges elected officials to reverse their current direction and make every new covered individual better off by moving away from funding through Medicaid instead to be funded by private health care. Such state-level reform should place the cost onto the federal government, rather the state voluntarily shouldering an increased, and increasingly impossible, burden.

In addition to outright savings proposed elsewhere in the Citizen's Budget, this chapter quantifies inflation of projected health care costs and proposes steps to avoid or attenuate them. The chapter warns that, "Because PPACA makes such sweeping changes, precise estimates of annual changes in existing state Medicaid expenditures are little better than guesses." The demands of meeting all new program details probably will force government to curtail other services, or a galling demand for a lot more in taxes. We do not pretend to be able to predict with any certainty how people and businesses will engage the new system as the provisions of the federal mandates take effect. You should read this chapter to understand the dynamics that our State will face as it conforms to its required roles. We call for several specific reforms, as follows:

- Revise the commitment to Medicaid managed care, now that it has been proven to be more costly than the alternative it replaced;
- Reform the long-deferred modifications in out-of-pocket charges for people already benefitting from the government health care programs; and
- Amend the growth in administrative overhead and change the bureaucracy's objectives which favor reliance on Medicaid.

In the chapter titled **"Bridge Enterprise Fund,"** the Citizen's Budget describes how the $100 million per year "FASTER" car registration tax—and its related $300 million in new public debt—is unconstitutional, dishonest and immoral. In passing this legislation, the State violated its trust with the people and failed its fiduciary duty. We hope to see new legislation to unravel the scheme and render moot a current $1 billion lawsuit. Doing so would allow elected officials to figure out the best cure and best steps forward in a proactive manner, rather than reacting later to a solution imposed by a court. Additional savings would be found by not trying the case, which would free up resources in the community, for the Attorney General's office and for the Colorado Department of Transportation.

With the **"K-12 Funding for Education"** chapter, you will benefit this year from an increased emphasis on how the School Finance Act works, that is, the process and the extent of State support for elementary and secondary education. Publication is especially timely as considerable attention is being placed on the topic during the 2013 legislative session, and on the anticipated issue campaign that will follow. Fundamental revisions to the funding system are being contemplated. We also explain some of the ongoing poor funding decisions and urge reforms to save a quarter billion dollars:

- End the practice of paying for "Master's bumps,"
- Insist on wise use of funding by better managing overhead "business" costs,
- Initiate a statewide scholarship tax credit to improve competitiveness in the system and save some funds doing so, and
- Appeal the dangerous Amendment 23.

We include a short digression from our more academically rigorous investigations. **"A Modest Proposal"** provides some fun by suggesting that citizens and their elected servants should just ignore this entire agenda. Live for today, grapple with nothing substantive, and instead see how much more money you should throw at the problems. Waste a lot; want for nothing?

We introduce a new analysis of an area of state government that consumes a large portion of total spending. The **"Human Services"** section offers a glimpse into the size and complexity of this part of the budget. It selects two from among many different programs to explain what services they provide and to raise questions about possible needed reforms.

Why should Colorado be the only state to maintain its own Social Security type of program? In **"Old Age Pension"** we urge a measure be placed on the ballot to free up about $100 million per year. It should allow Colorado to conform to the way every other state handles welfare for the elderly.

We return you to the highest priority, of public pensions, to visit a different aspect. The pension situation is made worse by the existence of an unsustainable program of post-retirement health benefits. The chapter on **"Retirement Health Plan"** draws on extensive work in the first edition. It explains that Colorado can copy Idaho to shed a billion dollars of unfunded liability and put the government employee benefit on a stable foundation.

In a chapter on **"Higher Education,"** we identify the good foundation already in place on which to build broad reforms. We urge expansion of the College Opportunity Fund so that students make choices that more closely approximate market decisions. Such reform would also lead to better, more flexible governance of state colleges and universities. We also show that immediate savings could accrue to institutions if leaders would obtain greater teaching productivity throughout the types of college instructors and professors.

We did not find good sources to quantify all the corporate welfare used in economic development schemes at all levels of government in Colorado. It is the sole chapter with few figures and more philosophy as guidance. In **"Corporate Welfare"** we urge legislators to end the practice of picking businesses to benefit from redistribution, because in doing so, the proposed improvements to the economy backfire and make us all worse off.

There are 27 specific reforms under **"Transportation."** Broad categories include how to choose projects more objectively and how to manage them better; initiatives to rebalance the development of roads rather than transit; expansion of HOT lanes and other market-like reforms; and more and better private-public partnerships.

A chapter that appeared in the first version appears again, in **"Lottery Proceeds."** We demonstrate that elected leaders should reconsider priorities, so that lottery proceeds are redirected to support K-12 education funding, at least for the five years.

The Independence Institute urges you to make this Citizen's Budget for 2013 a central part of your debates and policy discussions as we move through the next two years of the current government, and on into the next election. Please use it as a reference to inform those discussions.

Introduction & Overview: The State's Budget

Perhaps you expect America to continue to improve its economic circumstances. If Colorado tax receipts will increase unimpeded, you will find this Citizen's Budget report useful. Everyone agrees that government should be managed as well as possible, so you can use the report to address about $1 billion in less-than-optimal spending. No one should pretend that government can have it all, so policy decisions come down to important trade-offs. Is it wise to continue to promise impossibly generous public pensions? To degrade delivery of health care, or to reduce welfare payments to the disabled in order to put strong, able-bodied people on the dole? Follow the ideas in the *Citizen's Budget for 2013* to obtain better outcomes for your taxes.

No one should pretend that government can have it all, so policy decisions come down to important trade-offs.

If on the other hand you expect the economy to slow again, you still will find this report useful. In that situation, you may follow it as a road map to matching taxes obtained by the government with the services that citizens demand of their government. Rather than become terrified by revenue shortfalls, use the *Citizen's Budget for 2013* to adjust to it.

The report is written with the assumption of continuing business stability, slow improvement in employment opportunities, and modest annual growth in income and taxes. That assumption is the post-Keynesian consensus that stock markets, government forecasters, and office holders are using. Many people point out that annual $1 trillion federal government deficits cannot go on forever, and they are right. Many also point out that fulfilling unrealistic promises of federal entitlement programs like Medicare, Medicaid, and Social Security, plus interest on the $16 trillion debt, eventually will consume government budgets, and they are right.

But few pretend to know when those crises will overwhelm the private, productive sector. We assume here that problems can be pushed off for at least a year or two, and that too few citizens or elected officials will act to prevent any massive deterioration. Such problems will be tackled after the crisis is upon us.

Economist Herbert Stein famously said, *"If something cannot go on forever, it will stop."* Whether you love the idea of the current course of government overspending and high taxation, or loathe the direction America has chosen, our individual likes and desires are immaterial. Reality cares nothing about our political preferences. The course the voting public has put us on is unsustainable, so eventually we all will have to confront the need for significant change. Please think to call us then; we already have ideas to address more dire situations.

The course the voting public has put us on is unsustainable, so eventually we all will have to confront the need for significant change.

The State is not ready for a crisis, but would be somewhat better off if the concepts in this report were used.

For now, the State's budget is growing. It will have between $789 million[1] and $865 million[2] more to spend in the current 2012-13 fiscal year than last. The Governor thinks the additional funds should go for K-12 education, Medicaid, and higher salaries for state employees.[3]

The fundamental structure of overspending at the State level went unaddressed during the economic downturn. Instead, the legislature used various accounting manipulations, relatively minor budget adjustments to discretionary items, and enhanced federal aid.

An ongoing and ignored problem is the budgeting structure in which demand for more money each year is greater than expected revenues. In spite of increased tax receipts, citizens should demand that their legislators consider whether the numerous programs are redundant or outmoded, and if they meet real needs and reflect rational operations. Legislators repeatedly have applied short-term, windfall funding to establish or continue multi-year programs, deferring solutions to out-year budgets.

The current administration, many legislators, and reporters looking for sensationalized stories paint a consistent picture: years of drastic budget cuts and nothing left to cut, state services collapsing, and the painful alternative of raising taxes as the only remaining option. Citizens instead ought to collaborate with leaders to overcome short-sighted thinking to uncover the systemic improvements. Worse, any proposal to raise taxes and fees only advances and reinforces the tax-and-spend mentality that created and continues to feed the current situation. While increased taxes and fees might provide a near-term reprieve, state government consistently and repeatedly has demonstrated a propensity to increase spending beyond any level of increased revenues, and Colorado once again will face a situation of severe budget shortfalls.

For any proposed actions to be long-lasting, the systemic nature of the current situation must be exposed. Permanent fixes can be realized only through a detailed examination of the current budget structure, identification of redundant and ineffective programs, and discovery of opportunities to redefine and reprioritize in order to bring state spending in line with current and future revenues.

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It is to the first of these steps, an examination of the current budget's structure, that we now turn our attention. Let's deal with the facts. How much does the state government collect and spend in a year?

To proffer effective and substantial recommendations, we must begin with an understanding of the size and magnitude of the State's budget. Next, we need to examine the three categories of state moneys: the General Fund, Cash Funds, and Federal Funding. The flexibility of elected officials to change the direction and amount of funding of any program is enhanced or hampered depending on the way moneys are received and restricted.

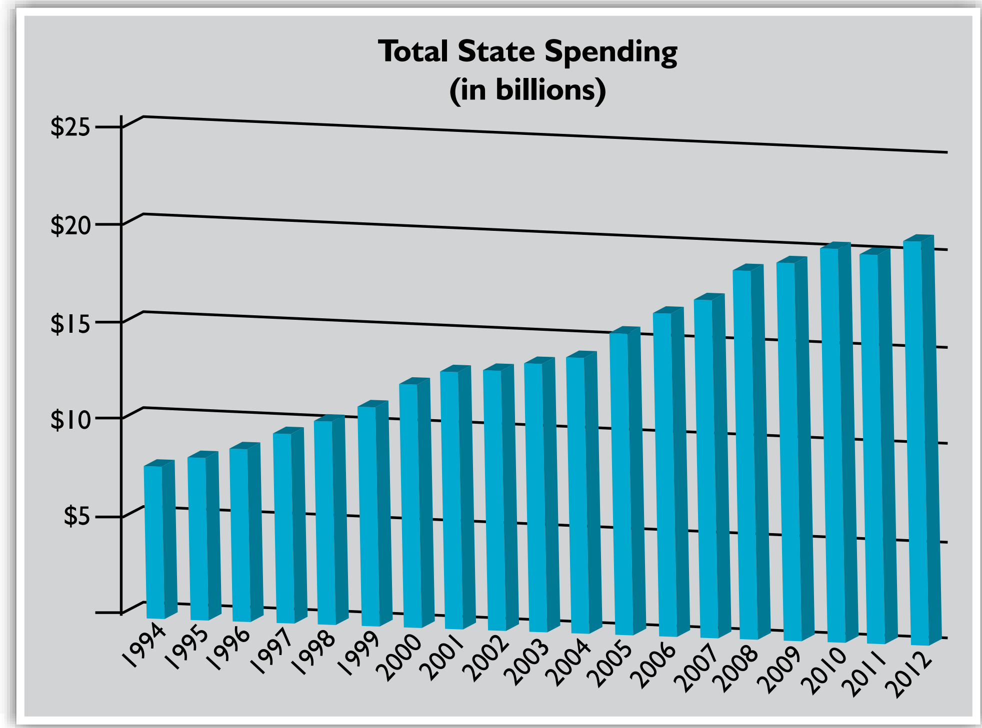
Size

Most people think of how much they earn, and spend, in one year and they generally start counting on January 1 and end at the termination of the calendar year on December 31. Governments, generally unlike families, have a different fiscal year. To understand how revenues and expenditures are timed, the reader must know that the new budget starts for Colorado on July 1, and straddles the end of the calendar year in order to wrap up its 12-month budget on June 30.[4]

Contrary to overwrought reports from the media and certain legislators, total spending has continued an upward trajectory for several decades.

For the current fiscal year that started on July 1, 2012, the State will spend a total of $20.6 billion. Contrary to overwrought reports from the media and certain legislators, total spending has continued an upward trajectory for several decades. Every year was higher than the previous, with the single exception of fiscal year 2011-12, when the federal stimulus subsidy ended, dropping federal funds by more than $400 million in one year. The current approved budget is scheduled to increase by about $850 million, or 4 percent from the previous year.

The increase in total revenues received and spent annually over the past 15 years



has more than doubled. The numerical increase spans both economic expansions and two recessions, including this most recent Great Recession. The average annual increase over that period has been roughly 4.2 percent.[5]

Put in *per capita* terms, the State's total fiscal year 2013 budget places a demand of $3,970 on every man, woman, and child living in Colorado.[6] But there are many people who do not pay taxes, mostly children and spouses working only inside the home. Adult full-time students, elderly people on exempt incomes, some indigent people below a certain threshold, and institutionalized persons also may contribute little or no taxes. Therefore, it is wiser to look at the burden on those people who earn the income and pay the taxes. The State's fiscal 2011 budget places a demand of $10,051 on every working Colorado family.[7]

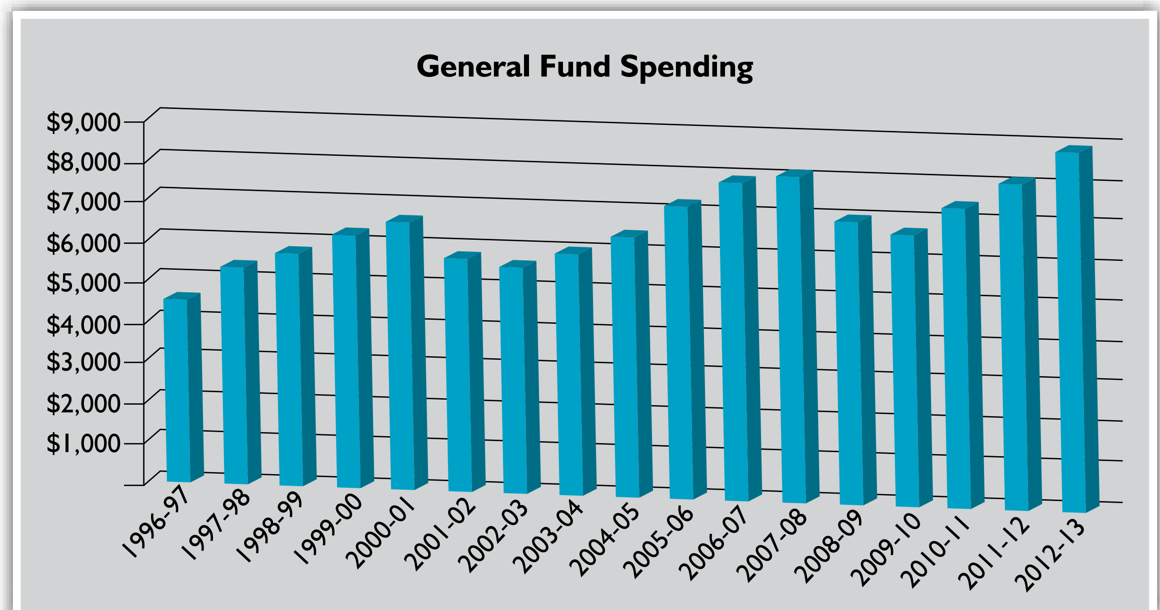
The Colorado Constitution prohibits the State from deficit spending.[8] Although Congress habitually spends more than the tax revenues generated for the federal government and borrows to fund its deficit, Colorado may not. In fact, the State has been prohibited from borrowing for any reason without prior voter approval. However, recent liberal interpretations by the Colorado Supreme Court have weakened this direct prohibition. As a result, within the past seven years, state government borrowed in order to build a medical facility and a prison, and skirted the voter requirement in doing so.[9] Otherwise, the State generally has conformed with the requirement to spend no more day-to-day, operational funds than the taxes collected.

Three Broad Categories

To understand the State's budget, you must understand that its revenues are obtained from different sources. Colorado government moneys are collected, allocated, and managed within three broad categories. Each category has distinct sources of funding and specific programs or purposes to which funds are committed.

General Fund

The most sensitive category is the General Fund, which accounts for 40 percent of the total budget and generates the most debate and disagreement. In the year just ended on June 30, 2012, General Fund spending amounted to $8.14 billion.[10] For the current fiscal year that started on July 1, 2012, General Fund spending will increase to $8.45 billion,[11] and the outlook for the following fiscal year anticipates further growth to at least $8.9 billion. General Fund moneys can be spent for any legitimate governmental purpose that the legislature determines.



On the revenue side, the General Fund receives all your personal income taxes,[12] the income taxes you pay indirectly through corporate earnings, the State's portion of sales taxes on purchases,[13] excise taxes, and other taxes on assets[14] and income.[15]

It is important to note that revenues from taxes are significantly influenced by the health of the Colorado, national and global economies. In both the most recent recession and the 2001-02 recession, revenue generation and spending in this category did not rise every year. Four of those years saw declines, although only two years experienced a reduction greater than 4 percent.

Cash Funds

The second budget category is Cash Funds, which are intended to be fees that individuals have some discretion in paying. An easily understood example is the parking fee you pay at the entrance to a State Park. If you choose to go elsewhere or to forego the opportunity to hike or camp that day, you pay nothing to the government. You make the decision whether to add to the stream of funds.

The largest cash funds, however, are not what you might think. All the tuitions that college and university students pay to state institutions are part of this category. So too is the 22-cent gas tax[16] you pay on every gallon of gasoline you put in your vehicle.[17] People who use the services pay for them; a student (or his benefactor) must pay some tuition and a driver must pay to travel. Other fees include professional registration and licensing, co-payments collected at State health clinics, and tire disposal fees. The legislature has almost no flexibility to allocate revenues that are directed to the Highway Users Trust Fund or to college and university campuses.

As proposed and enacted, moneys in the Cash Funds segment of the State's budget are supposed to pay for direct services related to the source of funding. For example, gasoline taxes are intended to help fund road maintenance, State Park fees support the construction and maintenance of park facilities, while hunting and fishing license fees are intended to help fund the Colorado Division of Wildlife.

However, in past years of lower General Fund receipts, the Legislature diverted some of these cash charges by raiding the balances in funds meant to cover direct services, and moving them to the General Fund. When individual cash fund balances are lowered too far, increases in those fees are triggered. This policy has been controversial because many people perceive the diversion as an illegitimate way to prop up spending by taking funds intended and promised for direct services. The structural changes proposed within this report are anticipated to reduce demands on the General Fund and thus avoid further raids on fee balance accounts. Ultimately, it will be up to the legislature to halt this questionable practice.

> *Using the subterfuge of calling increases in tax rates (which require advance approval by voters) an increase in fees (which do not require such votes), in 2010 the previous administration successfully pushed through a "dirty dozen" of fee increases.*

Many people acknowledge that during the Ritter administration, the legislative and executive branches obtained tax rate increases. Using the subterfuge of calling increases in tax rates (which require advance approval by voters) an increase in fees (which do not require such votes), in 2010 the previous administration successfully pushed through a "dirty dozen" of fee increases. The prior year, the highly controversial "FASTER"[18] revenues became the biggest example of such increases, in which increased taxes on car registrations were defined as "fees" and implemented without a TABOR election.

Federal Funding

The final major state budget category is federal funding. It probably surprises no one that the Air National Guard and the Army National Guard, which operate within the State's Department of Military Affairs, are funded mostly by the federal government. Other programs require the State to contribute some portion while the federal government funds the rest. Programs that originated in the national Congress provide enough support and incentive that the State enthusiastically administers them. As an example, projects funded by the federal gas tax are identified and approved in Washington, D.C., but the Colorado Department of Transportation manages the implementation of the new construction.

As an example, Colorado historically has received around 50 percent reimbursement for Medicaid payments. However, the recession prompted the federal government to apportion a larger percentage of state Medicaid funds through the American Recovery and Reinvestment Act (stimulus) program. The federal government promises to pay almost all of the costs of the new health care programs. If the federal moneys are not available, the State will have to backfill the difference.

The occurrence of matching funding in education has followed two different paths. More than 14 percent of Colorado's legislative appropriations for K-12 education are made up of federal money. Federal funds appropriated by the legislature for higher education have declined significantly to 0.63 percent, although there is more direct federal funding for colleges and universities that does not appear in the State budget.[19]

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Outlook

An official internal forecast is generated quarterly at the Capitol by a non-political, non-partisan team of economists employed by the Colorado General Assembly. The team is part of a larger group of employees collectively known as the Legislative Council staff.[20] We utilize the recent forecast here to understand that the General Assembly expects the economy to grow slowly in the next year. Even though inflation is quiescent and population growth is modest, the forecast does not anticipate that taxes will grow even to the low limit allowed this coming year under the State Constitution.[21]

Facing the State and the private sector, and not resolved before this report went to print, were several major Congressional actions. Updated federal legislation was needed to address the automatic sequestration of spending and a new, higher federal government debt limit. Pundits and observers called for delicate handling of the situation so as to avoid pushing the nation back into recession.

Although the Federal Reserve Bank has *more than tripled* the monetary base since the recession started, soaring from $900 billion to $2.7 trillion,[22] it is still pursuing a program of quantitative easing. The "federal funds"[23] rate is close to zero, as it has been since it dipped below 1.0 percent on October 16, 2008.[24] As a result, there is little room for monetary policy to become more "accommodative," and inflation is a strong possibility in some out-year. General Fund revenues are highly susceptible to fluctuations in the health of the Colorado, national, and global economies. Colorado's economic retrenching during the recent recession and subsequent slow economic recovery mirrored the experience across the nation. That circumstance was repeated in almost every other state. It should be noted that Colorado's reduction was rather modest in comparison with states that have governments in real crisis, such as New York, New Jersey, Michigan and California. But to what extent are tax-based revenues expected to recover? The sources of those federal funds have come from borrowing and not from new tax receipts. Many people see huge negative implications in the Federal Reserve System[25] buying up U.S. Treasury bonds directly, after lenders did not subscribe to the full issuance.

It is important to observe that citizens in fiscal crisis states, such as Michigan and California, do not enjoy the constitutional protections against governments growing too fast in good times and then needing to retrench severely in troubled times. Colorado is protected from excessive growth by our own constitutional tax-and-spending limitation, the Taxpayer's Bill of Rights (TABOR). That being the case, it is timely to note that TABOR has had nothing to do with restricting revenues received during the recession. It functions to curtail government from growing faster than citizens' abilities to support higher budgets, but has no immediate effect during a downturn. The only way our protection against too-rapid growth in government could apply is that legislators cannot increase tax rates or institute new taxes without going to a vote of the people. Even the ardent proponent of Keynesian economics who justifies and urges high government spending, however, knows that governments should not raise taxes in the middle of a recession for fear of killing off any nascent recovery.

The Systemic Problem

Colorado's state budget must be in balance at the end of each fiscal year—a requirement imposed from the citizens by a constitutional provision. If upon examination, the current budget and each subsequent budget face a deficit that must be closed, then we can conclude the structure has been established to grow spending faster than revenues. A systemic problem has existed in Colorado, during good years and bad, for most of the past decades. It is impossible for the private sector to gain ground on public spending if the system is rigged for increases that always will be larger on the side that demands services than the side that pays for them. That reality goes a great distance in explaining the antipathy towards TABOR manifested by supporters of bigger government and tax consumers.

For a more complete understanding of the budget process, see that section, page 19. Here it is enough to observe that budgets from one year to the next are meant to be funded by streams of income that are repeated year-over-year, reasonably predictable and relatively stable. For example, the tax on communications that nearly every citizen pays with every phone bill most certainly qualifies as a recurring source of government income. By way of comparison, however, anyone can see that using money to build the base from a one-time occurrence—say the sale of an excess government building—is not repeatable or stable. Therefore, you are urged to see that a mistake has been made by the legislature in this fashion. Dr. Barry Poulson's presentation to the Long-Term Stability Commission in 2009[26] warned:

> ***Another source of the structural deficit in the state budget is annualization—i.e., the use of one-time money to fund ongoing programs. This problem has been exacerbated by the elimination of the cap on general fund spending. With that spending cap in place, general fund expenditures were funded with permanent sources of revenue. One-time money was used primarily to fund specific projects in transportation and capital construction.*** ***The elimination of the general fund spending cap means that one-time money now will be used to fund ongoing programs. Not only will this change leave less money for transportation and capital projects, it will exacerbate the structural deficit in the state budget*** *[emphasis added]. This is why a very important step towards fiscal responsibility would be repeal of the legislation that abolished the cap on general fund spending.*

For several years, the Colorado Legislature has used one-time, windfall moneys to establish long-term programs, thereby systemically and structurally creating an unsustainable burden on state resources and upon state taxpayers. Solutions have been deferred year after year. In the previous decade, relatively small budget shortfalls were handled by shifting money around between various funding buckets. To deal with perennial budget shortfalls, such short-term financial manipulations were made as shifting a payroll into the next budget cycle, deferring state building maintenance, raiding cash funds, and raising fees.

The current administration and the current class of legislators favors only increasing the revenue side of the equation by promoting higher fees and increased taxes. Continued tax rate increases will promise short-term solutions in order to quiet budgetary concerns. Even those steps may backfire, though, if increased rates drive such disincentives that the changes lead to lower actual revenues. Certainly the long-term impact of any tax increase is likely to drive high-income earners out of the state, as has happened in California, New York, New Jersey, and other high-tax states. Further, higher taxes will not permanently resolve the internal conflicts for ever-more public services and higher costs. States with higher tax rates uniformly have seen them turned into disproportionate salaries for government workers, creating further disparities between government professionals and the citizens who pay their wages.

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The answer to the dilemma is to pursue the specific policy concepts offered in this paper – to address the systemic problem of agencies established with short-term funds that carry long-term liabilities. Together, the newly-elected General Assembly and governor must make the hard choices that will restore Colorado to fiscal sanity. They will create a budget that does not flow year-to-year from one crisis to another. Citizens still may obtain the basic services that few argue should be central to the properly defined role of government.

Acknowledgements

Penn R. Pfiffner was the primary author of this section. See his biography in the authors section.

The Honorable John K. Andrews, Jr. reviewed the section for clarity and factual interpretation. Mr. Andrews was President of the Colorado Senate, 2003-2005. He is currently director of the Centennial Institute at Colorado Christian University, a regular commentator for Colorado Public Television and a *Denver Post* columnist. He founded the Independence Institute in 1985, helped establish the State Policy Network in 1991, and headed the Texas Public Policy Foundation 1993-94. He was educated at Principia College.

We extend our thanks to **Natalie Mullis**, Chief Economist for Legislative Council, who patiently compared our budget facts and figures to the information reported by her office and other government entities. Our understanding and statistical statements were improved by her comments, and any remaining mistakes in figures are our own.

We extend our appreciation to **Thomas Ryan**, who helped to write the original introductory chapter, on which a great deal of this year's updated chapter is based. Mr. Ryan is the Chief Research Officer and co-owner of Analyst Strategy Group, a consulting firm providing marketing consulting services to high-tech companies. He founded Reclaiming Moral Government, a company providing educational programs focused on civic responsibility for churches, schools, and clubs. His earlier career included working as the Chief Information Officer for EchoStar, and as a strategic consultant at KPMG Consulting. He holds an MBA and a Bachelor of Science in Business/Economics, both from Regis University.

Endnotes

1 Colorado Legislative Council Staff, "Focus Colorado: Economic and Revenue Forecast," Economics Section, December 20, 2012, Table 1, line 6, p. 4. http://www.colorado.gov/legcouncil/Forecast/12decemberforecast.pdf.

2 Governor's Office of State Planning and Budget, "The Colorado Outlook. Economic and Fiscal Review," December 20, 2012, p.2,http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251843184456&ssbinary=true.

3 Ivan Moreno, Associated Press, "CO budget plan focuses on investments, not cuts," Reported in the *Denver Post*, November 1, 2012, http://www.denverpost.com/ci_21902754/hickenlooper-unveil-next-colo-budget?IADID=Search-www.denverpost.com-www.denverpost.com.

4 The federal government's fiscal year runs from October 1 to September 30 of the next year. Its current budget year started on October 1, 2012, and will end on September 30, 2013.

5 This figure is not adjusted for inflation. Over the same period, from 1999 to 2013, inflation averaged 2.4 percent per year. See http://inflationdata.com/Inflation/Inflation_Rate/HistoricalInflation.aspx.

6 There are approximately 5,189,000 residents of Colorado. See http://www.colorado.gov/cs/Satellite?c=Page&childpagename=DOLA-Main%2FCBONLayout&cid=1251593346834&pagename=CBONWrapper

7 There are approximately 2,049,600 families living in Colorado. See https://dola.colorado.gov/households/forecastsParameters.jsf. Choose statewide, 2012, all households, total (age groups)

8 Article X, Section 16.

9 Governments issue "certificates of participation" (COPs) to get around the existing restriction. That type of security instrument is amortized like a bond, pays interest and returns principal like a bond, but is not called a bond because the legislative body that authorizes it must re-authorize it every year. By taking that *pro forma* vote once a year, the debt is officially not a multi-year obligation and therefore legally exempt from prior voter approval.

10 Revenue Summary Report, Fiscal Year 2011-12, http://www.colorado.gov/dpa/dfp/sco/rs.htm. The amount comes from "Total General Fund Revenues" in the column "Year-to-Date Accrual Basis Actual." Using the number that most closely represents the total taxes paid into the General Fund every year was confirmed through an interview with State Controller David J. McDermott CPA, on November 23, 2012, and refined in a telephone call on February 18, 2013.

11 "Focus Colorado," ibid. See Table 1, p. 4, "General Fund Overview," column FY2012-13, line 16, "Amount Available for Expenditure." It is imperative to note that the funds diverted by Amendment 23 into the State Education Fund are used to fund K-12 education directly and are not included in line 16. They therefore must be included in annual spending calculations by adding line 26, "Amount Directed… by Amendment 23."

12 The rate for Colorado is based on the "adjusted gross income" from the income tax return filed with the federal government. After deductions and exemptions, a flat rate of 4.63 cents is paid on every dollar earned.

13 Although purchases of some items such as food and medicine are not taxed, a flat rate of 2.9 cents is paid on every dollar of most goods bought in Colorado.

14 There is an estate tax (death tax), taxes on insurance premiums, gambling and more. Property taxes are local. At the time that the TABOR amendment passed, there was not a significant statewide property tax in place and the TABOR Amendment (paragraph 8) clearly inserts a constitutional prohibition that "No new state real property tax ……. shall be imposed."

15 Income from dividends, interest, some capital gains, royalties and net rental income is rolled up in the income tax form reported to the Internal Revenue Service, and Colorado depends on the Form 1040 report.

16 In addition, the federal government collects another 18 cents gas tax on every gallon.

17 Fuel put into vehicles that do not travel on local or state roads, such as farm tractors, is exempted from the gas tax.

18 Senate Bill 09-108.

19 http://www.state.co.us/gov_dir/leg_dir/jbc/FY12-13apprept.pdf, Part II, Summary Tables, p. 14.

20 The group should not be confused with the similarly-named committee of state legislators, elected as leaders from among all the legislators, who make the final executive decisions about how the Legislative Branch is run.

21 Article X, Section 20 (TABOR) allows spending based on the current budget to be increased automatically by the percentage growth in inflation, plus another percentage increase to reflect changes in population.

22 Federal Reserve Economic Data, Federal Reserve Bank of St. Louis: *Adjusted Monetary Base* http://research.stlouisfed.org/fred2/graph/?s[1][id]=AMBNS.

23 The interest rate that banks charge for short-term loans to each other.

24 http://research.stlouisfed.org/fred2/data/FEDFUNDS.txt.

25 The nation's central bank, which creates the money supply.

26 Barry W. Poulson, Ph.D., "A Fiscal Roadmap for Colorado: Remarks prepared for the Long-Term Fiscal Stability Commission, July 9, 2009," reprinted in July 2009 as Independence Institute Paper Issue Paper 8-2009, http://old.i2i.org/articles/IP_8_2009_a.pdf.

State Budget Process

Overview

The material describes how the State Budget is created and makes recommendations for reform. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations

- Budget for outcomes, not just inputs
- Restore the limit on general fund growth (re-implement Arveschoug-Bird)

The State of Colorado's budget is developed annually by the legislature. The process culminates in one piece of legislation that funds the executive and judicial branches for the year, known as the Long Bill. The Long Bill is organized by department. It includes authorization for each division and program for the number of state employees it may have, and covers the expected overhead costs such as imputed value of building space, cost of leased vehicles allowed and payroll burdens, such as PERA contributions and health insurance costs.[1]

Budget limits are established by quarterly forecasts[2] generated by economists working in Legislative Council staff, the research arm of the legislature. There are also quarterly forecasts developed by the Governor's Office of State Planning and Budgeting (OSPB). Each forecast includes anticipated economic conditions at the national and state levels, which in turn are used to create specific forecasts of State revenues. During years with strong revenue increases, TABOR restrains the total budget limit for State revenues.[3]

Other states depend on their governors' budget submittals to a far greater extent than Colorado, which uses legislators and legislative staff to create an initial budget. The governor is required to submit a budget by November 1 of each year.[4] That budget may be the starting point, but often is not the guiding document. Instead, the budget is generated by the Joint Budget Committee (JBC) of the legislature. Historically, the governor's input has been more influential when the majority party in both houses of the General Assembly has been the same as the governor's party. If the legislature is controlled by the party other than the governor's, however, the executive branch's influence tends to be less.

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Three representatives and three senators comprise the JBC. The majority party in each house appoints two and the minority party one. Senate Committee members are selected by a vote of each party's caucus, and Representatives are appointed by their respective leaders within the parties' caucuses. The JBC staff director runs the nonpartisan JBC staff of 13 policy analysts. They develop proposed budgets for state agencies using data obtained in presentations before the JBC, past funding figures and State Auditor reports.

The JBC usually convenes in November immediately following the election and two months prior to the legislature convening its regular session in January. The Committee establishes "common policies" for departments such as salary increase percentage, motor vehicle lease rates from the state motor pool, building lease rates, equipment depreciation and information technology costs. During the early budget process, the Committee meets in order to hear department heads present their program requests and funding needs. At that point, the JBC raises questions and concerns about requests, but provides time to department directors for research and analysis. Answers are compiled in an overall briefing document from which the JBC and its staff build each department's budget. Often the JBC asks for full investigations and intricate reviews by the departments, which occasionally have taken as much as a year to resolve.

Executive branch input is provided through the OSPB, which assembles the initial funding requests. The Schedule 3 form submitted by OSPB presents funding in great detail by type of expenditure. Each kind of expense is summarized as a line item, intended to become a final spending authority. Its five columns of data compare the request with the past two year's expenditures, current appropriations and current year adjustments.

The JBC relies on detailed annual lists for major maintenance, upgrades and new construction of State buildings and for facilities at state colleges and universities. These lists are created by the Capital Development Committee, a standing legislative committee with its own, smaller staff. The JBC's statewide budget recommends a certain level of spending for buildings, which then is applied as far down the capital development list as funds allow.

Certain programs are established as permanently revolving funds, such as construction and maintenance of county, municipal and local water supplies. A local government borrows from this source, which is "continuously appropriated," and will pay back the loans through user charges. The moneys return to the fund and are made available for the next approved application. The legislature has the opportunity to review the projects, which are listed in a separate bill each year.[5] In other respects, those funds are outside the budget debate.

Federal funds are "appropriated" in the Long Bill, allowing for specific spending through the State for programs directed from Washington, D.C. Unlike appropriations of state revenues, the JBC has no control over how federal program spending is disbursed.

JBC staff includes responses to the inquiries to bring a revised proposal to the JBC, which further adjusts the budgets at the most detailed level. The Committee takes responsibility to prepare a state budget that conforms to revenue limitations, reserve requirements caps and provisions of the Taxpayer's Bill of Rights, paring as necessary. The JBC aims for consensus to close out each department and to vote out the entire budget.

The JBC typically advocates for the Long Bill in floor action. Over the years the JBC mostly demonstrates a strong desire to operate by an internal agreement, adopted before the convening of each budget writing session, to function with a unanimous front, defending each line item as initially recommended. The other 94 legislators may of course amend the Long Bill, but rarely succeed in making more than minimal alterations. Many legislators have objected to this process, but it has been the common practice.

Over the years the JBC mostly demonstrates a strong desire to operate by an internal agreement, adopted before the convening of each budget writing session, to function with a unanimous front, defending each line item as initially recommended. The other 94 legislators may of course amend the Long Bill, but rarely succeed in making more than minimal alterations.

Unforeseen circumstances and exigencies force departments to come back midyear for changes. "Supplemental funding "can be increases or decreases to line items within the budget, as the agencies discover changes in program demands throughout the year. Greater or lesser receipts also mean the State will adjust its budget to spend more or less, unless during strong business expansions certain limits have already been reached. Supplementals must by law be submitted by the first day of January,[6] and are habitually the first budget actions voted on in each legislative session.

Problems

We started our Citizen's Budget stating that the structure of the State budget must be challenged and altered. A critical observation is that the process starts from the prior year's spending. By law, the JBC had the authority to request a zero-based budget,[7] but rarely had the time and resources to make more than a modest attempt. That authority was repealed in 2010 by House Bill 1119.

We recommend a different way of identifying spending priorities. It is such an important discussion that we give its own separate chapter, below.

Focus on results, not inputs

In addition to tackling priorities, we identify as a significant weakness that budgets are put together by compiling the quantity of *inputs* that agencies believe are necessary. A better formulation would be to start with metrics about *outcomes*. Rarely does the legislature argue over outcomes, just the inputs. Some executive branch agencies have performance metrics written into their strategic plans, but the process for the legislature has not been results-oriented. For example, "How many people are removed from the homeless rolls?" would be a better question than "How many employees need to drive what number of leased vehicles?" to address the problem.

In addition to tackling priorities, we identify as a significant weakness that budgets are put together by compiling the quantity of inputs that agencies believe are necessary. A better formulation would be to start with metrics about outcomes.

Greater accountability can be demanded if Colorado is able to compare outcomes with other states' results. If our Human Services is handling only 90 percent of welfare cases for the same money as another state, that situation would suggest an immediate opportunity for greater efficiency. If reading programs are 50 percent more expensive than in similar neighboring school districts, likewise a change may be indicated.

In order to resolve structural problems in the budget, the legislature must alter the process by which it decides the budget. It must understand what product or service is being purchased, since there will never be more than a few people who can know definitively the right number of inputs to solve a problem. Accountability will entail forcing agencies to set realistic but rigorous goals for government programs, and then clearly demonstrating they are organized and managed to succeed. Once elected officials figure out what is a proper taxpayer-funded service, citizens have the right to know that what is purchased is designed to tackle and hopefully improve or solve a societal problem. Should the program fail to meet its objectives, a resolute decision must be made to end the failure and demand a new approach.

Once elected officials figure out what is a proper taxpayer-funded service, citizens have the right to know that what is purchased is designed to tackle and hopefully improve or solve a societal problem.

As things stand now, we have it backwards. Failure is offered as reason for the legislature to pour more money into a failed project. Although the legislature has yet to implement a performance-based system, it appeared to take a large step in that direction by passing new legislation in 2010[8] that builds on output-based concepts. Leaders should not retreat from the new process, but rather should embrace it enthusiastically.

Restore the Arveschoug-Bird spending limitation

A limitation on how quickly General Fund spending may increase predates TABOR. In 1991 the legislature imposed a statutory measure to ensure appropriations for operations would not expend more than 6 percent over the prior year.[9] (It is known by its sponsors' names: Representative Steve Arveschoug and Senator Mike Bird.) Proponents of TABOR intended to protect the rule from subsequent relaxation by stating, "Other limits on … spending … may be weakened only by future voter approval." The legislature was convinced to ignore that constitutional phrase and recently removed the restriction by itself.[10]

Exempted from the Arveschoug-Bird limitation are the state's expenditures for building maintenance and new capital projects. This spending is known as "capital development funding."

Most years there has been money left over after the Arveschoug-Bird limitation was applied, money that could be spent under the more generous TABOR limitation. Those funds have been used for "one-time" expenditures. Capital development moneys are used to catch up on deferred maintenance, to fund highway maintenance or construction, or to erect or remodel new state buildings and college facilities.

The 2010-11 Budget Instructions[11] state, "The amount of resources left unexpended .... is considered a reversion." We want to reverse any incentives for waste. The instructions motivate agencies, however, to spend up to the allocated amount designated for each line item of a department's budget. The alternative for the agency is to suffer a budget reversion. The reversion also provides a disincentive to spend below the amount allocated in order to avoid a continued lower level of spending in succeeding years.

Continuing without Arveschoug-Bird will mean that day-to-day operations can, and likely will, consume all the General Fund revenues.

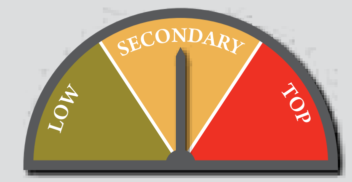
Continuing without Arveschoug-Bird will mean that day-to-day operations can, and likely will, consume all the General Fund revenues. Money for capital outlays has dried up, so building upkeep, remodeling, and new construction will continue to be deferred. The new system has already provided incentive to spend any unused funds in whatever fashion will max out the annual appropriation, however inefficacious that expenditure may be.

Endnotes

1. The objective descriptions of JBC operations and organization are derived substantially from "Role of the JBC," Joint Budget Committee at http://www.state.co.us/gov_dir/leg_dir/jbc/jbcrole.htm.
2. Forecasts are expected to be released on March 20, June 20, September 20 and December 20.
3. Federal funds do not count in computing the TABOR limit, nor do funds going towards Amendment 23's State Education Fund or for the national tobacco settlement. Other funds exempted from TABOR include gifts and other lawsuit settlements and awards, but these last are not significant revenue factors.
4. Colo. Rev. Stat. § 24-37-304(b).
5. The Water Conservation Board may give loans under $10 million directly to entities without action by the legislature. For projects over $10 million, the Board either may loan funds if authorized by legislation or the Board may instead grant money to the entity that does not need to be repaid, but that too must be authorized in a bill.
6. Colo. Rev. Stat. § 24-37-304(b.5)
7. Colo. Rev. Stat. § 2-3-207.
8. House Bill 1119.
9. The limitation also must conform to a growth limit of a change in personal income over 5 percent, but this economic measure of the entire economy will rarely come into play.
10. Senate Bill 2009-228 by Senator Morse and Representatives Marostica and Court, "Concerning an Increase in the Flexibility of the General Assembly to Determine the Appropriate Use of State Revenues."
11. Page 6-3.

Budgeting Within Our Means

Priority



Overview

The chapter describes an improvement in the budgeting process. Used in a couple other states, the process allows legislators to make better use of the time spent generating and revising the proposed state budget. It is the second time this chapter has appeared in a Citizen's Budget.

Savings

No specific savings.

Original Article

The entire original chapter can be found at http://tax.i2i.org/files/2010/11/CB_PriorityBudgeting.pdf.

We recommend that the legislature move to a "priority-based budgeting" system. It is crucial that the structure for setting a state budget more closely conform to the reality of expected income for each year. Washington State and New Jersey have used this type of budget reform.

The process of creating a budget in Colorado would likely to evolve the current system into one that works somewhat differently. The role of the 94 legislators would expand in generating a budget, which would improve the process by providing broader information for the Joint Budget Committee (JBC) to use in its deliberations.

The move toward reforming and improving the budget process is not a partisan issue. For example, for years the Democratic Leadership Council actively has lobbied its members to embrace the related reform of outcome-based budgeting:

> *That citizens want value for their money is no mystery. We all want as much value as we can get from each dollar we spend—including what we spent on government. The price and value of government are up against the price and value of housing, food, clothing, health care and countless other goods and services that meet people's needs. The price of government is limited, therefore, by the value that citizens want—and get—from government, compared with the value they want and get elsewhere. Government can compete—and stay relevant—only by delivering more value per dollar. But the only way to accomplish this is to reinvent the way we do the public's business. Our public institutions must learn to work harder, but more important, they must learn to work smarter.*[1]

The states with the worst budget problems are New York, California, and Illinois. These worst-case states have, respectively, the 1st, 4th, and 11th highest state and local combined tax burdens.[2] Collecting more taxes does not shield a state from budgetary woes. Counter-intuitively, it even appears to exacerbate the woes.

Collecting more taxes does not shield a state from budgetary woes. Counter-intuitively, it even appears to exacerbate the woes.

Regardless of the mechanism through which priority-based budgeting is implemented, this change will require a new way of thinking that breaks the traditional mold of business-as-usual budgeting.

a. Currently, each program begins on a relatively equal footing simply because it was funded in the previous year. A small program that helps few people, or might be nearly incapable of reaching its goals, is afforded the same time and focus as one of the programs that make up the largest and most central of government responsibilities. A new system would deal first and foremost with the core functions.

b. Programs would have to change from defending their costs, expenses or inputs, and would instead be defended by the extent to which stated outcomes are fulfilled. The JBC holds hearings with the cabinet officers for each department, and detailed discussions can focus on specific line items within a program budget. The process is long and involved, but frequently misses the bigger picture. This important description of the current process is addressed in the chapter on "Budget Process."

c. Many more clear choices and trade-offs would be available to legislators, who then would be able to concentrate on how their decisions impact taxes and spending. They will be able to address such questions as: "Is it better to perform a program with lackluster support in order to add another program, or is it better to finance the more-highly desired program at the full level, even if it means ending or not starting another program?" There undoubtedly will be different conclusions reached at different times on trade-offs such as these, but the recommended system likely would give focus to the real costs of legislative choices.

Many more clear choices and trade-offs would be available to legislators, who then would be able to concentrate on how their decisions impact taxes and spending.

d. The present system lacks priorities. The recommended system would provide them.

Colorado's legislature—with support, cooperation and collaboration of the executive branch—would need to answer the following questions based on Washington's model:

1. **What is the forecasted revenue for the next budget cycle?**
   The expected revenues, as limited by the Constitution, establish the outer bounds of what can be spent. A small reserve to handle fluctuations must exist, too. Colorado already performs this step.

2. **What are the essential services the state must deliver to citizens?**
   What should state government do, and in what priority? Colorado's elected leaders should develop a meaningful set of core government principles. All existing programs should fit within one of the core functions, or they should be abolished. For each core function, measurable outcomes should be identified and agency activities prioritized.

Colorado's elected leaders should develop a meaningful set of core government principles. All existing programs should fit within one of the core functions, or they should be abolished.

After core functions are identified, legislators prioritize activities within these functions to deliver the expected outcomes. Otherwise, state budgets resemble an iceberg, with decades worth of spending unseen and unexamined under the water. Meanwhile, the debate rages year after year over the small part that sticks out of the water. The longer state lawmakers continue to use the cost-plus model, the more "hardwired" their funding problems will become.

Taxpayers understand priority-based budgeting is the better way of doing business, but elected officials who urge its acceptance must explain the process in simple, compelling terms: If Colorado families and businesses must set priorities and live within their means, then state government can be expected to do the same.

This new type of budgeting protects the programs deemed most important from budget cuts. It holds agency directors responsible for spending taxpayers' dollars in the best way possible to deliver the best services possible. It protects vulnerable programs from election-year rhetoric. The worst solution is to absorb ever-more taxpayer dollars but not to deliver proportional improvements.

3. **How will the state measure its progress in accomplishing those goals?**
   As priorities are established, elected leaders develop measureable outcomes for each of the identified core functions. Then agency programs can be prioritized further, based on how effectively and efficiently each will help meet the goals. A priority-based system must include these indicators of success; and delivery of desired services must be measurable. The Budget Process section tackles in greater detail the need to move from focusing only on the cost inputs (e.g., how many employees, leased space, vehicles, etc.) to focusing on the outcomes of expenditures. Nowhere does the need become more clear than in a priority-based system. It also highlights that the governor's administration must accept the idea of change, since legislators do not have the staff, time or constitutional authority that would allow them to determine outcomes independently. One weakness in the transition is that a governor whose positions about spending reform are antithetical to the recommended change could drag out the process, or even thwart it.

A priority-based system must include these indicators of success; and delivery of desired services must be measurable.

4. **What is the most effective way to accomplish the state's goals with the funds available?**
   The first three questions in performance-based budgeting are about developing meaningful and measurable goals. This question, by contrast, is about using market forces and competition to deliver those goals effectively and efficiently without compromising cost and quality.

To make the process functional, each state agency should develop what it believes to be its mission as established by law. Once its mission is defined, the agency must outline the goals and objectives necessary to accomplish it. Each activity should be categorized as high-, medium-, or low-priority, and performance indicators should be identified. The agency's budget request should reflect those priorities and guidelines. At the point where agencies complete an analysis of mission and goals, the legislature steps into action. It is the role of the legislature to review, and ultimately determine, the proper mission, objectives, and performance indicators for all agencies under their jurisdiction in order to determine whether or not they comply with the core functions of government adopted in the joint resolution.

It is the role of the legislature to review, and ultimately determine, the proper mission, objectives, and performance indicators for all agencies under their jurisdiction in order to determine whether or not they comply with the core functions of government adopted in the joint resolution.

This step leads directly to legislators debating the "make or buy" issue. By following this budget process, a government "buy list" is created, directing the discussion away from "cuts" instead to what outcomes are being purchased. Performance-based budgeting provides a logical process for measuring the activities of government against desired performance outcomes and using that as a tool to make decisions accordingly. This budget process also greatly increases spending efficiency and economy.

As described by an Evergreen Freedom Foundation report, Washington State instituted the process:

> *Top managers used a three-point prioritization program to determine where the cuts should be made.*
>
> *Managers defined the mission for each program, prioritizing major components. These priorities established the guidelines and criteria for budget-cutting decisions. Cuts in 'priority three' services were generally acceptable. 'Priority two' cuts would reduce the department's effectiveness and 'priority one' cuts would destroy its purpose.*[3]

At the margin, government leaders will be able to show they have been able to fund the most important functions. If the leaders wish to implore citizens to buy more public goods rather than keep the funds in the hands of families, the trade-offs will become clear. It is important that the structure reinforces the selection of the most important functions.

Washington State's agencies provided details on the specific services they delivered, who benefited, how much the services cost, and what results the agencies expected to achieve. Agencies further designated all their activities as high-, medium-, or low-priority, with at least one-third of the agency's expenditures in the low-priority category. By focusing on specific activities—not programs or agencies—the governor's budget staff created lists across the entire government for each of the core functions and proposed to fund those activities which contributed most directly to each core function.

The results generated from this process surprised nearly everyone, especially those who initially believed it was just another public relations program.

The results generated from this process surprised nearly everyone, especially those who initially believed it was just another public relations program. Its success scared agency directors, unions, many lobbyists, and lots of lazy legislators who suddenly realized they had to pay attention and say "No" to special interests that could not prove high value for a dollar spent.

Colorado can achieve similar favorable results by following the steps that Washington took. The legislature has yet to implement such a system, yet a large, and perhaps adequate, step in that direction has provided a very hopeful sign. Legislation adopted in 2010,[4] carried by the now-incoming Speaker of the House, promised to use the concepts of priority-based budgeting. Just as we lauded the commitment in the same legislation to use results-oriented measures, we call for leaders not to retreat from the intention to start a new process, but rather to embrace it enthusiastically.

A priority-based budgeting system would not reach its final form within one year. Rather, it will be an evolutionary process of improvement. Strong, visionary leadership is needed to push this reform forward and to keep it progressing. Implementation might unfold as follows:

A. In the first, transitional year the budget already will have been prepared using the current methodology. Near the beginning of the 2013 legislative session, the General Assembly would have to come to a decision to modify the structure.

B. Beyond arriving at a decision to alter the system, the only new action the legislature need accomplish would be to delineate core government functions and to place them in priority. The creation of a rather simple list would be immensely difficult and require scheduling by legislative leadership. The process likely would mean each body would caucus for one or two days before beginning the debate on the Resolution, which itself would probably absorb two or three days in each chamber.

Beyond arriving at a decision to alter the system, the only new action the legislature need accomplish would be to delineate core government functions and to place them in priority.

C. Establishing broad priorities reasonably early in the session should assist in defining the acceptable changes in the 2013-14 budget that must be approved before the end of the session in May. It also will set up the process for the next year.

D. In the case where a downturn reduces the budget from one year to the next, a possible evolution would involve the 10 Committees of Reference, or standing committees. Each of these committees is tasked with oversight of one or more executive branch departments.

The emphasis would change from a question of "How do we fund everything?" to "How do we fund the most important mix of government services?"

Within the limits laid down in the Resolution, each committee could propose cuts for the JBC to consider and compile. The emphasis would change from a question of "How do we fund everything?" to "How do we fund the most important mix of government services?"

Acknowledgements

Penn R. Pfiffner of the Independence Institute and **Brett Davis** of the Freedom Foundation (formerly known as the Evergreen Freedom Foundation) in Olympia, Washington, were the original authors of this section.

Endnotes

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2 National Tax Foundation, "State and Local Tax Burdens: All States," October 23, 2012, http://taxfoundation.org/article/state-and-local-tax-burdens-all-states-one-year-1977-2010.

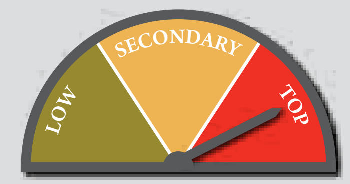
3 Evergreen Freedom Foundation, "The Washington State Budget, A Herd of Sacred Cows," 1995.

4 Colorado General Assembly, House Bill 10-1119.

Policy Changes to Make a Difference

Public Pensions

Priority



Legislation Offered

Multiple bills in 68th General Assembly

Overview

The material describes the magnitude of the overpromise for public pensions and makes recommendations. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations

- Isolate current costs from bailout costs to create transparency and end inter-generational theft
- Provide retirement choice and "catch-up" option for young workers
- Sunset the AED and SAED payments to make PERA accountable for reaching fully-funded status
- Relieve taxpayers from the responsibility of future bailouts

Original Article

The entire original article can be found at http://tax.i2i.org/files/2010/11/CB_PensionLiability.pdf.

Summary

Colorado state government and school districts will pay more than $1 billion to the Public Employers Retirement Association (PERA) in 2013. Despite accounting for an estimated 13.5 percent of the state general fund budget, PERA ignores the cost to K-12 education and state colleges and universities.

In 2013, the cost of the PERA "rescue" will be nearly $400 million – funds from the state budget that might otherwise have been spent on priorities like education, transportation and public safety that would build a stronger future and a solid economic foundation.

Since 2004, state lawmakers approved three separate bills to increase PERA funding with the intent of digging out from its $25 billion deficit.

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These rescue payments—which reduce wages and benefits paid to teachers and state employees—will increase to more than $621 million annually by 2018 and, under current law, continue indefinitely.

Schools, students, and teachers are severely affected by the cost of the PERA rescue, which currently costs $299 per student, or nearly $6,000 for a classroom of 20 students. By 2018, this cost will soar to more than $467 per student, or $9,340 for a classroom of 20.

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According to PERA's own calculations, these payments will continue for at least 35 years, by which time almost all of PERA's current management will be retired and every seat in the state Senate and House of Representatives will have changed hands at least five times. As a result, there is virtually no accountability to ensure that the current bailout plan does not extend for an additional 10, 20 or 30 years.

While PERA members have a reasonable expectation to receive basic retirement benefits that are promised by state law, it is unconscionable for lawmakers and the PERA Board of Trustees to continue to promise benefits that are unaffordable and unsustainable – and to do so at the expense of new teachers and state employees who will be hired in the coming years.

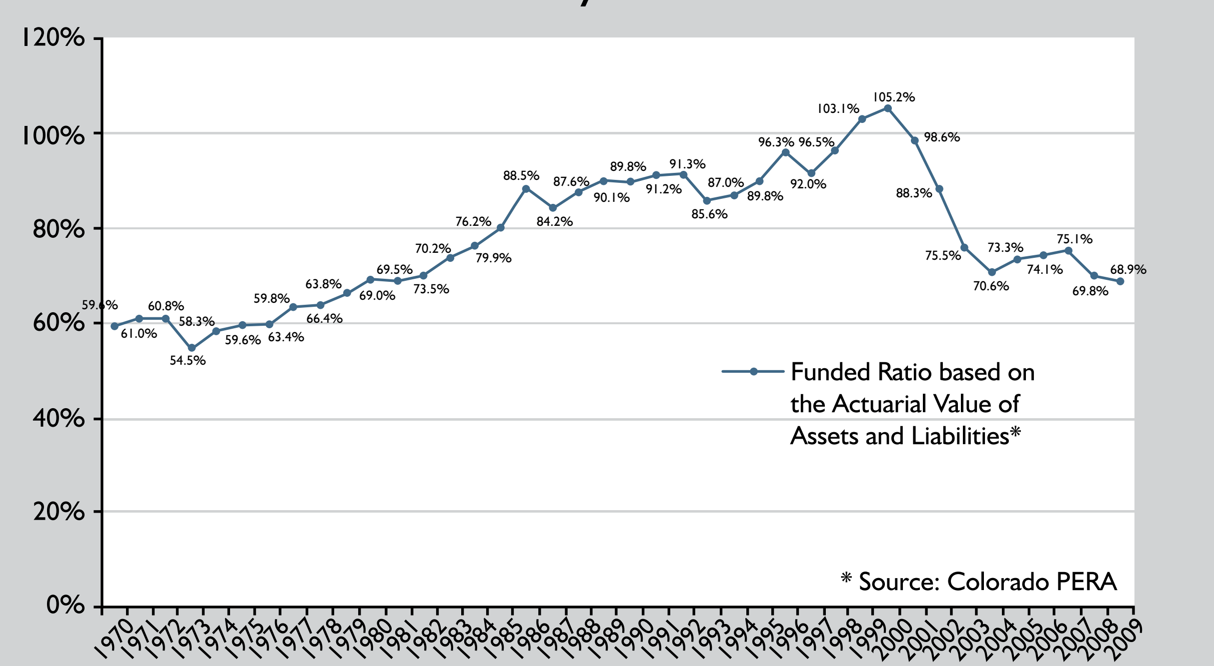
Situation

The financial status of PERA, Colorado's largest pension system, is a growing problem for state and, especially, school district budgets. However, the debate over how to remedy PERA's problems so often becomes mired in the argument over whether to replace or preserve the current system that an in-depth, dispassionate look at PERA's mathematical problems gets lost in the crossfire. Meanwhile, the magnitude of the problem grows even larger, consuming tremendous resources—more than $341 million just in 2012—that could otherwise be spent on education, transportation, public safety or other budget priorities.

This chapter will not focus on arguments for or against various reform measures, although it will suggest some policy solutions. Instead, it will focus on the cost of existing measures passed by the legislature to improve PERA's financial status and the impacts of those measures on employees, schools, students and the state budget.

Ironically, the budget of Colorado state government does not itemize the cost of PERA, so the best available estimates must be extrapolated from PERA's 2011 Certified Annual Financial Report, published in the summer of 2012 and containing data that was current as of December 31, 2011. To the extent that the state budget does address PERA's cost, it nonetheless ignores the cost to K-12 education and state colleges and universities.

Figure 1
Colorado PERA Funded Ratio History for all Divisions Combined: 1970 - 2009



According to the 2011 report, PERA held $37.5 billion in assets and owed $62.5 billion in promised benefits, making its funding ratio 59.9 percent. Those two factors result in an acknowledged funding shortfall (aka "unfunded actuarially assumed liability" or UAAL) of more than $25 billion.[1]

PERA's funding ratio has been declining since 2000 when it reached 105 percent, riding the booming stock market performances of the 1990s. When the tech bubble burst and the stock market faltered still more following the terrorist attacks of September 11, 2001, PERA's funding ratio fell to 70.6 percent by the end of 2004. The funding ratio improved to 75.1 percent by 2007, but has fallen since, most notably due to the stock market's precipitous decline during the financial crisis of 2008.

For many years, PERA rebuffed suggestions that a 100 percent funding ratio was necessary. However, in November 2007, the Board of Trustees adopted a funding policy wherein it acknowledged the necessity of "achieving and maintaining a minimum 100 percent funding ratio."[2]

Market value is the more accurate and reliable standard, representing the difference, on any given date, between the current market value of assets and actuarial estimate of liabilities (i.e., benefits owed to PERA members).

PERA's funding ratio can be difficult to identify precisely at times because it can be calculated on two bases: market value and actuarial value.

Market value is the more accurate and reliable standard, representing the difference, on any given date, between the current market value of assets and actuarial estimate of liabilities (i.e., benefits owed to PERA members). Actuarial value is a more arcane measure because, rather than use the current market value, it calculates the "actuarial value" of assets using a "smoothing method" that spreads gains and losses over four years. For example, the 2008 stock market decline was only partially included in that year's actuarial value and wasn't fully realized on paper until 2011. The "smoothing method" was adopted to diffuse the obvious impact of large gains or losses in the market and to thereby discourage "overreaction" to market changes.

In addition to peaks and valleys in the stock market, PERA's funded status is affected by legislation that changes contribution rates, benefit payments, and retirement eligibility criteria. The PERA Board of Trustees also plays a role by adopting policies that address actuarial details, most notably assumed return on investments (ROI) and the price charged to members who wish to purchase additional years of service credit in order to bolster their benefits at retirement.

Membership

PERA boasts more than 483,467 members, including active workers, retirees and beneficiaries, and inactive members who are no longer working for a PERA employer and not receiving benefits. PERA reports that retirees and beneficiaries live in all 50 states and that 87 percent reside in Colorado.[3]

In 2011, PERA's State Division trust fund comprised almost 32 percent of the total assets managed by PERA. The State Division included 54,956 active members, 33,212 retirees and other beneficiaries, and 58,597 inactive members. State Division payroll totaled $2.393 billion. (This analysis does not include PERA's Judicial Division which includes employees of Colorado's 22 judicial districts, as well as county courts, totaling 654 current or retired employees and a payroll of $39 million.)

The School Division was larger still, accounting for 51.3 percent of PERA's funds in 2011. It consisted of 114,820 active members, 51,898 retirees and other beneficiaries, and 89,225 inactive members. School Division payroll totaled $3.821 billion. Denver Public Schools Retirement System, which merged with PERA in 2010, brought 13,571 active members, 6,311 retirees and $491 million in covered payroll.

Significantly, 44 percent (88,304) of active members in 2011 were not yet "vested." That is, though they are paying into the system and their employer is paying on their behalf, they are not eligible to receive benefits upon retirement because they have not worked for a PERA employer for a minimum of five years.

When a PERA member becomes "inactive" by terminating work for an employer who participates in PERA, they can either leave "their" money with PERA or withdraw it. Inactive members who choose to withdraw receive only their own contribution plus 3 percent interest. They do not receive any of the contributions that their employer made on their behalf. Further, inactive members – despite numbering 168,670 of PERA's 483,467 total members – have no representation on the PERA Board of Trustees.

Legislation

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At first glance, it may appear that PERA's shortfall is due to lagging investment returns or insufficient contributions by state government and school district employers. In reality, however, the cost driver is a benefit structure that simply cannot be supported by normal economic conditions.

From 2004 to 2010, the state legislature passed three PERA "rescue" bills (Senate Bill 2004-257, Senate Bill 2006-235, and Senate Bill 2010-001) intended to help PERA shore up its declining fund ratio.

PERA's 2011 financial report explains: "The Board worked extensively in 2004 and 2006 with elected officials to pass Senate Bill 04-257 and Senate Bill 06-235 which were designed to move Colorado PERA toward full funding over the coming decades."

Both measures relied heavily on the optimistic assumption that PERA's investments would return an average of 8.5 percent annually over 30 years. Despite both of those measures, the financial crisis of 2008 devastated PERA which lost 26 percent of the value of its investment assets in that single year.[4]

Nonetheless, PERA resisted making any changes to its plan during the 2009 session of the state legislature before proposing legislation in 2010. In advocating for Senate Bill 10-001, PERA asked for additional contribution increases and, for the first time, took the position that the annual cost of living adjustment (COLA) could be reduced for all members, including those already retired. In some cases, PERA suggested stronger medicine than the legislature was willing to swallow – asking that benefits be based on the highest average salary for five years and that the retirement age be raised to 60 for those hired in 2011 or later. Instead, legislators allowed the average-salary calculation to remain at just three years and left the current retirement age (58) in place for anyone hired before 2017 – almost seven years after the legislation was adopted.

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Funding

For each employee, PERA receives a 10.15 percent contribution from the employer, and an 8 percent contribution deducted from the paycheck of each employee. However, the rescue bills added a supplemental contribution that increases the employer contribution by an additional 10 percent of payroll by 2018.

When the rescue legislation is fully implemented, state and school districts will send a check to PERA for just over 20 percent of their payroll. Add to that the 8 percent deducted from employees' paychecks, and PERA will receive contributions equal to 28 percent of the combined payroll (nearly $7 billion in 2011) of all covered employees.

Yet when state government and some school districts froze salaries to cope with budget shortfalls, those state and school employers were still required by law to increase PERA contributions on behalf of their employees.

The 2006 and 2010 legislation included a mechanism intended to require working PERA members to share the burden for half of the additional contributions by trading a portion of their annual wage increases and for a correspondingly larger contribution to PERA to shore up their retirement benefits. Yet when state government and some school districts froze salaries to cope with budget shortfalls, those state and school employers were still required by law to increase PERA contributions on behalf of their employees. The requirement persists, despite the absence of any salary increase from which the PERA contribution could be subtracted.

Yet for employees of school districts and other government entities for which personnel costs constitute the lion's share of the budget, the inescapable reality is that increased contributions to PERA most certainly suppress wages and other benefits (as demonstrated below). No other line item in these budgets is large enough to produce the savings necessary to pay for the tremendous cost of the PERA rescue plan.

In 2011, state government contributed $283 million, while state employees contributed another $259 million. That year's data is skewed by legislation that temporarily shifted 2.5 percent of the required contribution from employers to employees, reducing the state government contribution by almost $62 million and increasing the employee contribution by the same amount.

Employers in the school division contributed $542 million to PERA in 2011; employees contributed $316 million. (The 2.5 percent shift to employees applied only to state government, not to other employers.)

In total, PERA received just over $2 billion in contributions in 2011.

PERA's 2011 financial report suggests that from an actuarial perspective schools and the state still are not paying enough, although the PERA administration has been careful not to advocate for still higher contributions.

PERA calculates that from 2007 to 2011, contributions by government employers were $1.68 billion below the amount necessary to adequately fund the retirement plan. Actuarially "insufficient" payments by schools represented $895 million of that shortfall.

"Even with SB 2010-001, the deficiency is expected to continue until statutory benefit and contribution changes are fully implemented (in 2018)," the financial report states.[5]

In order for government employers, funded by taxpayers, to fully finance PERA's benefit structure, employer contribution rates would need to be increased to 20.01 percent of payroll for the State Division and 19.79 percent for the School Division. These rates would be in addition to the 8 percent contribution deducted from employees' paychecks.

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Are school districts and other government employers under-funding PERA? The legal answer is obviously, "no." Employers are making the contributions required by state law. Unlike other states, Colorado is not "borrowing" from its pension fund to balance its budget, and PERA has not suggested any quick-fix schemes like derivatives and interest-rate swaps that have backfired elsewhere.

However, some actuaries would contend that PERA is under-funded simply because PERA employers are contributing less than the "actuarially required contribution" necessary for PERA to amortize its liabilities within 30 years. That theory dubiously assumes that benefits are unalterable and that means of balancing the equation is by demanding higher contributions from schools and other government employers.

How can it be that a pension system that receives more than $2 billion a year in contributions has seen its funding ratio decline in nine of the past 12 years? Because it currently pays out $3.9 billion a year in benefits.[6] Even after earning $725 million in investment income, PERA ran a deficit of nearly $1.2 billion in 2011 alone. (2011 CAFR, p. 23)

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For example, an employee who averaged $65,000 in his or her final three years of work and worked for PERA employers for 30 years would be entitled to receive $48,750 per year in retirement benefits. Those benefits increase each year by inflation as measured by the consumer price index (CPI) – but, per Senate Bill 2010-001, not by more than 2 percent per year.

The COLA reduction in Senate Bill 2010-001 is the focus of an as-yet-unresolved lawsuit — *Justus vs. Colorado* — in which plaintiffs, representing PERA beneficiaries, claim a contractual right, for the rest of their lives, to the COLA rate in effect when they retired. Many PERA beneficiaries retired when the COLA was a guaranteed 3.5 percent, regardless of the rate of inflation. Although a district court ruled that PERA members have no contractual right to the COLA, a three-judge panel on the Court of Appeals reversed that ruling but declined to rule on the constitutionality of the legislation, instead remanding the case to district court to consider "whether the (COLA) reduction was reasonable and necessary.[7]

For most PERA members, retirement age is governed by a Rule of 80 or Rule of 85, meaning they can retire when their age and years of work for a PERA employer total 80 or 85. A PERA member with 30 years of service can retire at age 55 and receive 75 percent of his highest average salary. Senate Bill 2010-001 made modest changes to the retirement age, increasing to 58 for those hired from 2011 to 2016 and to 60 for those hired after January 1, 2017. Those changes applied only to future PERA workers; not to anyone working for PERA when the legislation was passed.[8] It should be noted that this analysis is not intended to criticize PERA members for receiving the retirement benefits that have been promised according to Colorado statute. While groups purporting to represent PERA members actively lobby against any benefit reductions and by doing so make necessary change more difficult to accomplish, the responsibility for ensuring that the benefit structure is sustainable rests with the PERA Board of Trustees and staff and, ultimately, with state legislators and the governor.

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Pressure on Investment

Nothing is more important to the financial health of a pension fund than its investments and the income they generate. Over the past 30 years, PERA's investment income ($43.9 billion) has been far greater than the contributions ($31.1 billion) it receives from employers and employees. At the same time, PERA has paid out just under $40 billion in benefits. Meanwhile, its funding ratio grew from 73.5 percent in 1982 to 105.2 percent in 2000 but has since fallen to 59.9 percent, erasing more than 20 years of gains.[9]

In good years, pension funds can pay for all required benefits from contributions and a fraction of their investment income. For example, PERA's actuarial models are presently based on an 8 percent annual return on investment. For 2011, an 8 percent return would have yielded $3.9 billion, virtually the same amount it paid out in benefits and expenses. At that rate, PERA could add the entire $2 billion it receives in contributions to its investment portfolio.

Instead, PERA's investments returned 1.9 percent (or $724 million). Not only was PERA required to use all of its contributions and investment income to pay benefits, but it was also forced to cash out almost $1.2 billion of its investments to pay the balance of its benefit obligations.[10]

If 2011 was bad, 2008 was disastrous – not just for PERA but for all investors. In PERA's case, it lost $12.3 billion in net assets in 2008 alone. As a result, PERA has been treading water financially for the past five years, during which its net assets have grown by slightly more than 1 percent.[11]

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That performance came on the heels of heavy losses from 2001 to 2004 when PERA's investments fell by $7.8 billion.[12]

However, it's not that PERA is investing poorly compared to others in the market. In 2011, PERA's meager 1.9 percent return was considerably better than its comparative benchmark, which produced a 1.3 percent return. In fact, PERA has exceeded its benchmarks, albeit by modest amounts, in three of the past five years. Likewise PERA's rate of return compares favorably with Standard & Poor's 500 or the Dow Jones Industrial Average. One hundred dollars invested in the S&P 500 on Jan. 1, 2007, would be worth $98.63 as of Dec. 31, 2011; the same amount invested in the DJIA would be worth $97.99. Apply PERA's actual performance during the same period and the $100 grows to $111.01.

PERA's problem is not investment performance but rather that its benefit structure puts extreme pressure on PERA investment managers to cover that deficiency.

Colorado statute calls for PERA to be able to amortize its benefit obligations over a 30-year period in order to be deemed actuarially sound.[13] PERA has been unable to comply, even after the series of rescue measures passed by the legislature. PERA projects that when all of the rescue measures are fully implemented—and with an 8 percent annual return on investments—the State and School divisions can be 100 percent funded in 35 years.

But what if PERA fails to realize its projected 8 percent return on investment? After all, if PERA had averaged 8 percent ROI over the previous five years it would have reaped an additional $15 billion in investment income with total assets of $55 billion, rather than the current $40 billion. (Assets in all PERA funds total $40 billion; the total in PERA pension and health care trust funds is $37.5 billion.) While most investors would consider the massive losses scattered over the past 12 years to be an event from which a full recovery is unlikely, PERA continues to project an 8 percent rate of return over a 30-year horizon.

If the ROI is reduced to just 7.5 percent, PERA's shortfall (UAAL) grows from $25 billion to $28.5 billion. Reduce the projection from 8 percent to 6.5 percent and the shortfall explodes to $36.5 billion.

For many of today's investors, a 6.5 percent annual return sounds optimistic, notwithstanding that the 30-year average return for most indexes from 1980 to 2010 ranges from 8.3 percent to 11.3 percent. Still, even a 6.5 percent average annual return would be disastrous for PERA. It would have dire consequences for PERA beneficiaries because, as demonstrated below, state government and school districts can hardly afford the cost of the current PERA rescue payments which grow and continue indefinitely.

Hidden Cost

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The PERA rescue legislation of 2004, 2006 and 2010 combined to increase employer contributions from 10.15 percent of salary to 20.15 percent of salary by 2018. For 2013, that contribution will be 16.55 percent of salary – in addition to the 8 percent paid directly by employees.

As a result, employers in the State Division will pay an estimated $243 million for the standard contribution (10.15 percent) and another $153 million for the 6.4 percent rescue contribution, based on the most recent data available. Employers in the School Division will pay about $388 million toward the standard contribution and some $244 million for the rescue plan. (Although school district payroll costs are not specifically provided in the state budget, public schools receive an average of 63.6 percent of their total program funding from state funds.) If school districts were not required to pay for the PERA rescue, they could spend that $244 million on improving education for students.

Thus, the combined impact of PERA on the state budget reaches more than $1.028 billion – of which $398 million is paid to help rescue PERA from its $25 billion deficit. If the rescue plan were to be fully and immediately implemented to a rate of 10 percent of salary, the cost would rise to $621 million. If that seems like an unbelievable figure, recall that PERA's financial report confirms that PERA members in the State and School divisions were paid a combined $6.2 billion in salary in 2011.

Now consider that these rescue payments continue indefinitely until PERA reaches 103 percent funding — a goal estimated to be 35 years away even under PERA's own optimistic projections and which it has reached just one time in 81 years.[14] Allowing for annual payroll increases of 5 percent, the state and school districts will spend an estimated $56 billion over the next 35 years just for PERA's rescue plan – in addition to the $57 billion it will pay as the standard employer contribution.

Now consider the enormous impact of these payments on other budget priorities.

The $398 million cost of the rescue plan for 2013 is greater than the combined general and cash funds budgets for nine entire departments in state government: Agriculture ($35 million), Governor's Office ($52 million), Labor & Employment ($60 million), Law ($21 million), Legislature ($36 million), Military & Veterans Affairs ($8 million), Personnel ($19 million), Regulatory Agencies ($73 million), and State ($20 million). When fully implemented in 2018, the rescue plan will be more costly than the current general fund expenditure for any state department except for the four largest: Education, Corrections, Health Care Policy & Finance, and Human Services.[15]

Hardship for Schools

Since 2010, Colorado has reduced funding for K-12 education by $604 per student, in order to balance the state budget amid poor economic conditions and reduced tax revenues.[16]

Although the cost of the PERA rescue plan is severely understated in the state budget, the $244 million expense paid by employers in the School Division equates to $299 for each of the 817,221 full-time equivalent students funded by the School Finance Act. That is nearly twice the cost of the 2009-10 mid-year budget cuts ($129 million) that hit school districts particularly hard. Rescuing PERA costs nearly $6,000 in a classroom of 20 students.

Moreover, the cost of the PERA rescue will increase by another 56 percent when fully implemented in 2018 and for at least 35 years — by which time the children of today's first graders will be old enough to drive. When fully implemented, the cost will soar to more than $467 per student or $9,340 per classroom.

Ultimately, policymakers must ask whether spending nearly $1,000 per student or 14.5 percent of the total K-12 program on pensions is in the best interest of our students.

These figures count only the rescue payment that schools send to PERA. The standard employer contribution is another 10.15 percent or $474 per student.

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Squeezing Teachers

Like students, teachers are being squeezed by PERA's costly rescue plan.

In August 2012, Adams 12 School District teachers protested a 2 percent salary reduction that the school district enacted explicitly to offset the rising cost of PERA's rescue contribution. For 2012-13, Adams 12 will pay $190 million in salaries, plus $36 million for PERA and Medicaid, with PERA accounting for well over $30 million.

In 2010-11, Colorado Springs School District 11 paid $21 million to PERA, according to the *Colorado Springs Independent*. Those payments, combined with funding reductions by the state legislature, led the district to close schools and make cuts that affected everything from textbooks to class size to laying off teachers and suspending pay increases.

District 11 chief financial officer Glenn Gustafson "desperately wants to impress upon you … why the Public Employees Retirement Association is eating the district alive," wrote reporter Pam Zubeck.

"PERA is going to force us down this road that's not the road we wanted to go down, because we don't think it's the best road for the district," Gustafson told the *Independent*.

"To improve student achievement, it's more important than ever to attract qualified and talented teachers. But we're shifting a disproportionate amount of compensation to retirement benefits and health care. We will be challenged to give any pay increases."[17]

Gustafson cited the disadvantage for Colorado schools when competing to hire the best teachers against schools in Nebraska and Wyoming that can pay 21 percent and 11 percent more, respectively. A Dallas suburb pays starting teachers 48 percent more than District 11 can offer.

In November 2011, Burlington School District RE-6J, a small school with a total enrollment of 738 funded pupils, faced a

$300,000 budget deficit and asked voters for a mill levy increase. For the fourth time in as many years, voters rejected the tax increase.

In the 2011-12 fiscal year, the district paid just over $3 million in salaries, a figure that has steadily declined in recent years. PERA received an employer contribution of $449,361, of which $149,294 went solely toward the rescue plan. Because of the mandated expense of paying for PERA's rescue plan, the district had to double its budget cuts. For 2012-13, the district decreased salaries by another $54,399 but the mandatory PERA contribution *increased* by $38,594.

Penalizing Young Workers

The PERA rescue plan is particularly pernicious to young teachers and other newly-hired workers, who are paid less while they work, earn lower retirement benefits, and work longer to reach retirement age – all to preserve benefits for older workers and retirees.

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Because some 80 percent of a school district's budget pays for salaries and benefits, employees necessarily will bear the burden of paying for PERA's rising contribution rates. No other budget item can be cut or reduced to provide the necessary savings to pay for PERA. The timing of these increases is particularly painful for school districts that have cut their budgets to account for declining state funding.

For recently-hired employees, the situation is even worse.

As previously detailed, PERA actuarial analysts do not expect the funding to reach 100 percent for at least 35 years in the State and School divisions. That means the "rescue" payments will rise from 6.4 percent of salary in 2013 to 10 percent in 2018 — and stay there until today's twenty-somethings are ready to retire.

Every teacher or state employee who starts work today will see their wages and benefits reduced by 10 percent in perpetuity. Adding insult to injury, lower salaries result in lower retirement benefits. Put another way, teachers and other government employees essentially lose a full year's pay every 10 years to pay for the PERA bailout.

All the while, older PERA members retire at an earlier age and collect their promised benefits – minus a slightly reduced annual COLA.

To any PERA member, this inequitable situation should reveal the insincerity of PERA's Statement of Funding Policy: "The Board's minimum 100 percent funded ratio goal over time avoids externalizing the costs of amortizing unfunded accrued liabilities *onto others in the future, and provides for fairness and intergenerational equity* for taxpayers, employers and employees with respect to the costs of providing benefits"[18] (emphasis added).

It could be understood if younger PERA members—working for less, working longer, and receiving less in benefits—view the pronouncement with appropriate skepticism. After all, while some form of PERA rescue may be necessary, younger workers should not be forced to pay both for their own retirement and PERA's past debts. Annual payments that will soon exceed $600 million a year with no end in sight are simply unaffordable and unsustainable, especially when they undermine spending on priorities, like education, that are crucial for our future.

Policy Proposals

1. **Create transparency and end inter-generational theft**
   Under PERA's current funding structure, young workers and those hired in the next three decades will pay a large share of the cost to provide pension benefits for today's retirees and workers nearing retirement age. This structure penalizes younger workers who will receive lower salaries while working, earn lower benefits at retirement, and work longer to reach retirement age.

   PERA uses the complexity of its current pension system—which relies on contributions from today's workers to ensure benefits of today's retirees—to conflate the costs of bailing out PERA's financial losses with the cost of paying benefits for today's younger workers when they reach retirement age.

   The actuarial tables in PERA's annual financial report justify speculation that the rescue payments which force employers to pay an amount equal to 20 percent of workers' wages to PERA will continue past our lifetime. Lawmakers should require an independent actuarial analysis to determine what level of benefits can be sustained solely from PERA's standard employer and employee contributions of 10.15 percent and 8 percent, respectively, and require PERA to structure benefits accordingly.

   By isolating these costs, lawmakers can separate the actual cost of pension benefits from the ongoing cost of three PERA bailouts.

2. **Provide retirement choice and "catch-up" option for young workers**
   All new hires should be allowed the option of transferring to a defined contribution program with individual accounts, whereby they can exercise greater control over their retirement investments. For those choosing the defined contribution option, the SAED and AED contribution to PERA should be reduced by half so that employees can regain a portion of the wages lost to the PERA rescue payments.

   All current PERA members should be allowed the option of taking the same amount they could withdraw from PERA if they ceased working for a State or School division employer and transfer that amount to a defined contribution plan. Those who have less than five years of service with a PERA employer should also have the SAED and AED contributions made on their behalf reduced by half and transferred to salary.

3. **Sunset the AED and SAED payments to make PERA accountable for reaching fully-funded status.**
   Under current law, PERA expects the state and local school districts to continue making bailout payments (AED and SAED contributions) for at least 35 more years in the State and School Divisions. By that time, every seat in the State Senate and House of Representatives will change hands at least five times and almost all of PERA's current officials will be retired, as well. Moreover, those 35 years will see nearly three full generations of students start kindergarten and graduate from high school, while their school budgets are being severely restricted by the cost of the PERA bailout. As a result, there is virtually no accountability to ensure the current bailout plan does not extend for an additional 10, 20 or 30 years, taking billions more away from other priorities, like education, transportation and public safety.

4. **Relieve taxpayers from the responsibility of future bailouts**.
   In the past decade, lawmakers have passed three bills designed to rescue PERA from investment losses and costly benefits. Only the last bill took significant steps to reduce the future cost of benefits, but all three obligated employers or

employees to pay still more to help PERA attain solvency someday. Even after the latest "fix," Senate Bill 2010-001, PERA does not expect to fully amortize its liabilities for 35 years or more. To reach that goal, PERA needs an average return on investment of 8 percent per year.

Under current law if PERA's investments fail to realize its lofty projections, taxpayers are still on the hook to make PERA whole, even though taxpayers have no control over PERA's investment choices.

It's time to end this "heads we win, tails you lose" racket. Taxpayers cannot afford it. Neither can young employees whose earnings are reduced in order to fully fund the retirement of earlier workers and retirees.

If PERA's investments fail to achieve returns necessary to pay benefits, then lawmakers should require PERA's Board of Trustees to equitably reduce the cost of benefits to all members – not simply increase the burden on younger workers.

The state, public schools and young public employees can scarcely afford the current schedule of bailout payments, which takes funds from other budget priorities. Additional bailout payments must be off the table, and PERA must be required to return to funding its pension plan from contributions which are affordable and sustainable both to employers and employees.

5. **Link the retirement age to the age for Social Security eligibility.**

A key policy question for lawmakers to consider is whether PERA should serve as a plan that supports workers in retirement or an investment plan that provides supplemental income to able-bodied workers who "retire" from a PERA-covered job and go to work for another employer while collecting a PERA pension. Linking the retirement age for PERA members to that of Social Security would provide two public policy benefits:

First, it would create equity between taxpayers and the government employees whose salaries and retirement benefits are largely financed by taxpayers. It's simply unfair to expect ordinary Coloradans to work longer to rescue a pension plan that allows state workers to retire as early as age 50 or 55. Just as importantly, this policy change could significantly reduce future benefit costs.

Second, by reducing the cost of PERA's benefit structure and returning PERA to its intended purpose of providing retirement benefits, rather than a supplemental income plan for those who "retire" at 50 or 55 so they can collect PERA benefits, plus a salary from a non-PERA employer.

A PERA member's average age at retirement is 58.19 According to the U.S. Department of Health and Human Services, a 58-year-old male can expect to live another 20.4 years and a 58-year-old female can expect to live another 24.6 years. The approximate average of 22.5 years leads to age 81. By contrast, a 67-year-old male can expect to live another 14.8 years and a female another 18.4 years — an approximate average of 16.6 years. By linking PERA's retirement age to that of Social Security (at least for current PERA members under age 40 and for all new hires), PERA could reduce the duration of its retirement benefits from an expected average of 22.5 years per affected retiree to 16.6 years[20] – a reduction of 5.9 years or approximately 26 percent. Raising the retirement age also would have the benefit of deferring the expected payout period by nine years if the retirement age were raised from 58 to the private sector's age of 67 years. If combined, both factors could reduce the costs for the affected portion of the plan by 20 percent to 35 percent.

Any change that would reduce the cost of benefits by one-fourth would be a significant step toward making PERA sustainable. Reducing the cost of the plan would allow the state and school districts to reduce PERA payments and put those funds into other priorities, like classrooms and salaries thereby reducing the burden on young workers to pay both the cost of their own retirement and that of current retirees.

Acknowledgements

Mark Hillman was the author of this chapter. See his biographical information in the major authors section.

Barry Poulson reviewed the chapter for accuracy and interpretation. He is a retired professor of Economics at the University of Colorado at Boulder. He serves as a Scholar for both the Heritage Foundation and for the Americans for Prosperity, as an Advisor for the American Legislative Exchange Council and as a Senior Fellow with the Independence Institute. He was president of the North American Economics and Finance Association and served on the Colorado Tax Commission.

Joshua Sharf also reviewed the chapter. Mr. Sharf is employed in the finance consulting industry and has a background as a web developer. He also worked as a defense and intelligence analyst. He currently volunteers at the Independence Institute with the PERA Project, located within the Fiscal Policy Center. Mr. Sharf holds both an MBA and an M.S. in Finance from the University of Denver.

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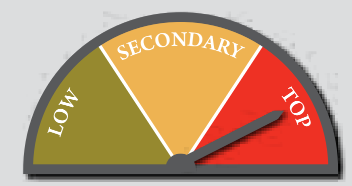
Medicaid

Priority



Overview

The material describes the scope and size of the health care programs run by the State government. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations

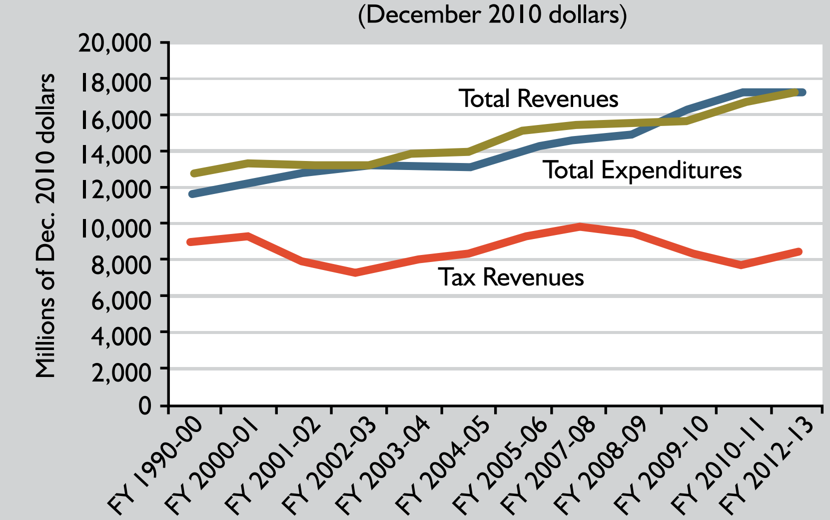
- Revise the commitment to Medicaid managed care now that it has been proven to be more costly than the alternative it replaced
- Reform the long-deferred modifications in out-of-pocket charges for people already benefitting from the government health care programs
- Amend the growth in administrative overhead and change the bureaucracy's objectives which favor reliance on Medicaid

The Patient Protection and Affordable Care Act (PPACA) of 2010 offers large subsidies for the purchase of health insurance to people who are not eligible for Medicaid. If the Colorado legislature takes advantage of PPACA by pruning the current Colorado Medicaid program, it could make current Medicaid clients better off by making them eligible to purchase heavily subsidized commercial health coverage. Also, it could possibly cure Colorado's structural budget imbalance by simultaneously reducing Medicaid and child health insurance program spending.

If it works as advertised, the federally subsidized commercial health coverage offered through the PPACA health benefits exchange will provide better health coverage for the basically healthy adults and children who make up the largest part of the Colorado Medicaid caseload. But people are eligible for subsidized coverage through PPACA only if they are ineligible for Medicaid. In order to allow people to receive the full benefit of PPACA, the state's Medicaid program should be cut back rather than expanded.

Commercial coverage likely will benefit the majority of Medicaid beneficiaries because it has historically provided better access to care than Medicaid. Commercial policies have reimbursed at significantly higher rates, making it easier to find a physician and to arrange for timely care.[1] A number of recent papers in the medical literature report that Medicaid coverage is an independent predictor for increased mortality, extended hospital stays, and higher costs, even after adjusting for known risks. In some cases, Medicaid patients have worse outcomes than uninsured patients.[2] Although the extent to which the actions of patients in the Medicaid program

Figure 1
Colorado Inflation-Adjusted
Tax Revenues and Expenditures
(December 2010 dollars)



contribute to these differences remains unknown, mainstream academic studies of health disparities generally assume that different patient populations behave similarly.

If state officials expand Medicaid in order to take advantage of near term funding in the PPACA, they prevent people from taking advantage of its commercial coverage subsidies. They also will worsen Colorado's existing structural budget imbalance over the next decade. Contrary to popular impression, the state must pay administrative costs for the Medicaid expansion and commit matching funds beginning in 2017. Current growth in the Medicaid budget imperils the state's ability to fund schools, roads, and other core functions of state government. Medicaid expansion means there will be less money for these activities.

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Since the end of the recession in June 2009, Colorado's economy has made a slow recovery. State tax revenues have begun to climb back to historically normal levels. Unfortunately, even normal tax revenues are not sufficient to support the current size of state government. As California, Illinois, and New York have shown, it is unlikely Colorado can increase state tax revenues enough to close the gap. Many of the state's residents and businesses are mobile, and in recent years Colorado's business tax climate has begun to deteriorate relative to other states. According to the Tax Foundation, Colorado now ranks a middling 18th in the quality of its business tax climate. In its region, it is behind Wyoming, Washington, Utah, Texas, Nevada, Montana, and South Dakota.[3] The Tax Foundation also reports that Colorado's combined state and local sales tax rates are the 15th highest in the country. At a per capita average of $816, the state's individual income tax is already more lucrative than that in 31 other states.[4]

Many of Colorado's residents and businesses were attracted to the state by its reasonable tax and regulatory climates. If these climates deteriorate, taxpayers will depart for other, more hospitable, states.

How Realistic Are Claims that All Medicaid Expansion Costs Will be Borne by the Federal Government?

Advocates for Medicaid expansion often ignore the large uncertainties associated with the subsidies that PPACA promises. First, it is entirely possible that unintended consequences from PPACA's other effects on Colorado Medicaid will add significantly to the state expenditures . No money then will be left to expand Medicaid eligibility, regardless of its apparent low cost. The federal government currently promises to pay 100 percent of the cost of additional enrollees who result from expanding Medicaid to cover everyone with an income of less than 133 percent of the federal poverty level. However, this level of coverage lasts for only three years. The match rate floats down beginning in 2017, stabilizing at 90 percent in 2020. Due to income set-asides included in the law, the operative coverage extends to those with incomes up to 138 percent of the poverty level, a slightly larger population than those with incomes of 133 percent.

Advocates for Medicaid expansion often ignore the large uncertainties associated with the subsidies that PPACA promises.

If the federal government changes the matching rate to the blended rate already proposed by the Obama administration, state costs will increase significantly. Colorado Medicaid spending would increase by $376.7 million from 2014 to 2019 and by $684.1 million from 2014 to 2022. Because the 100 percent federal match does not cover new administrative costs, Medicaid expansion will add to state expenses. Edmund F. Haislmaier

and Drew Gonshorowski of the Heritage Foundation estimate that "Nationally, on average, every additional $100 of state Medicaid spending generates about $5.50 in new administrative costs, of which states pay around $2.48."[5] They also caution that federal matching rates can be changed by legislation, and that reducing the federal matching rate for Medicaid expansion has already been proposed in the Obama administration's FY 2013 budget.

Colorado's decision to set up a state-run health benefits exchange rather than to let the federal government foot the bill may impose additional costs.

Colorado's decision to set up a state-run health benefits exchange rather than to let the federal government foot the bill may impose additional costs. Colorado's Health Benefits Exchange must begin supporting itself by January 1, 2015. The Massachusetts Commonwealth Connector Authority is its closest real world example. The Connector Authority supports itself by charging Massachusetts Medicaid for performing Medicaid enrollment. If the Colorado health benefits exchange plans to charge for Medicaid enrollment services, then State Medicaid costs are likely to increase. They also will increase if CIVHC, the 501(c)3 organization that manages Colorado's All Payer Claims Database, begins charging Colorado for its data services.

Estimates of the effect of PPACA Medicaid expansion vary widely. However, virtually all existing estimates agree that Medicaid expansion adds to state costs. In 2010, Legislative Council estimated that PPACA would extend Colorado Medicaid from covering almost everyone with household incomes up to 100 percent of the Federal Poverty Level (FPL) to covering everyone with incomes up to 133 percent of the FPL. It estimated that Colorado could cover an additional 35,600 people at no cost in FY 2012-14. By FY 2019-20, 144,500 additional people would be covered at an additional annual cost of $66.4 million.[6]

Because PPACA makes such sweeping changes, precise estimates of annual changes in existing state Medicaid expenditures are little better than guesses. Those who do produce estimates typically quote changes for a range of years, usually before and after the PPACA 100 percent matching ends, or as a single period. Using data from the Congressional Budget Office's March 2012 baseline for Medicaid spending, Haislmaier and Gonshorowski estimate that expanding Medicaid to 138 percent of the Federal Poverty Level under PPACA conditions will add $53 million to the Colorado state budget from 2014 to 2019, an average of slightly more than $10 million a year. From 2014 to 2022, it will add $155.5 million to the Colorado state budget, or an average of roughly $50 million a year due to the decline in the federal match decline.

Because PPACA makes such sweeping changes, precise estimates of annual changes in existing state Medicaid expenditures are little better than guesses

More recently, Urban Institute researchers have estimated that Medicaid expansion will increase Colorado Medicaid spending by $581 million from 2013 to 2022, with most of the increase probably occurring after the federal matching rate declines.[7] This estimate includes savings of $277 million based on the estimated decline in the uninsured as a result of the expansion and a reduction in uncompensated care.

Uncompensated care savings of this magnitude are unlikely to materialize. Similar claims were made in Massachusetts and yet, as Haislmaier reports, there was no reduction in payments for uncompensated care even with virtually universal coverage because "safety-net hospitals successfully lobbied to continue receiving over $200 million in supplemental payments from state taxpayers."[8]

In fact, Medicaid expansion is more likely to expand uncompensated care costs. Medicaid is itself a source of uncompensated care because it reimburses at rates far below both the list price quoted by hospitals and the negotiated rates paid by private commercial insurance. If most of the expansion population in need of medical care is already covered either by Medicaid via programs for the acutely ill and disabled or by private coverage, it is possible that the uninsured generate less uncompensated care uncovered than they would if they were enrolled in Medicaid.

In general, there is no particular reason to believe that covering the uninsured reduces costs. The uninsured tend to be healthier than those who sign up for coverage. They also pay for about half of their own health care, which gives them an incentive to minimize their health care use. Existing evidence suggests that changing status from being uninsured to being covered by Medicaid increases individual health care utilization, and thus the uncompensated care generated by Medicaid, by an estimated 25 percent.[9]

It is also important to remember that a surprisingly high proportion of people in the lowest income groups already have private coverage. Using 2000 data, Pauly and Bundorf estimated that 36 percent of people with incomes below 150 percent of the poverty level had private health insurance.[10] Among people with incomes below the poverty level, 28.5 percent had purchased private insurance. If able-bodied people who work minimal hours to get health insurance are offered "free" Medicaid coverage, they may stop working, drop their private coverage, and increase both uncompensated care costs and Medicaid program costs. In 2007, economists Jonathan Gruber and Kosali Simon found that crowd-out rates for the federal Children's Health Insurance Program approached 60 percent.[11] In 2012, Antwi et al. found that PPACA's requirement that family coverage be extended to "children" up to age 26 reduced work-hours by roughly 5 percent. It also reduced the prevalence of full-time work.[12]

Even if Medicaid is not Expanded, Spending on the Existing Medicaid Program Will Increase Due to PPACA Provisions

Figure 2 describes Colorado's existing health subsidy programs. In general, able-bodied adults aged 19 to 65 are not eligible for Medicaid. Those with medical needs are helped by the Colorado Indigent Care Program which aids in the purchase of medical care from participating providers.

Under PPACA, people who are not enrolled in Medicaid, Medicare, or another acceptable health coverage plans as of January 1, 2014, will be required either to become insured or to pay a penalty. For those who meet certain income requirements, generous subsidies for purchasing health coverage are available. The subsidies, and the maximum annual premiums required, are shown in table #1 [maximum out-of-pocket premium payments].

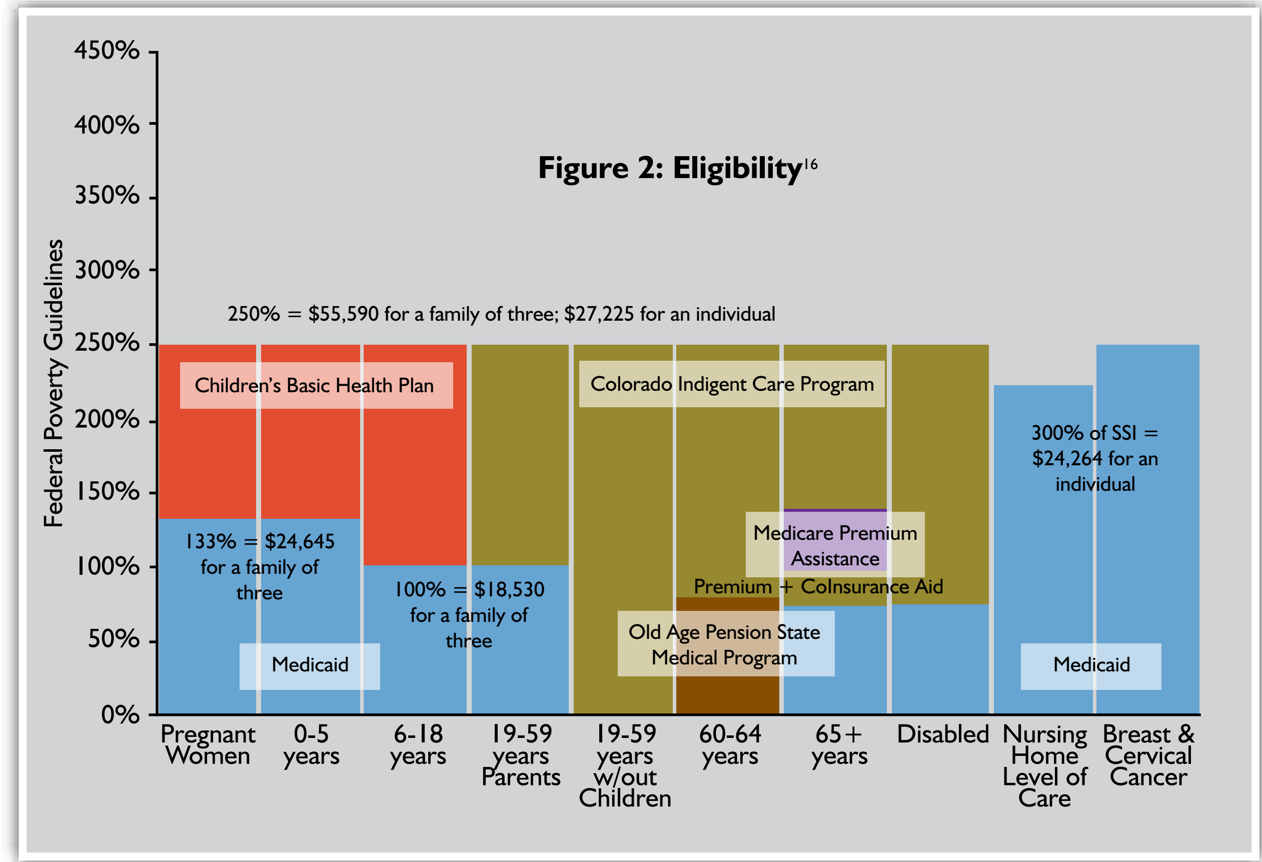
Table 1. Maximum Out-of-Pocket Premium Payments Under PPACA, If Currently Implemented
for the 48 contiguous states and the District of Columbia

Federal Poverty Line (FPL)	Max. Premium as a % of Income (2014)	Max. Annual Premium (current), by Family Size			
		1	2	3	4
100%	2.0%	$217	$291	$366	$441
133.00%	2.0%	$288	$388	$487	$587
133.01%	3.0%	$487	$656	$824	$992
150%	4.0%	$650	$874	$1,099	$1,323
200%	6.3%	$$1,365	$1,836	$2,307	$2,778
250%	8.05%	$2,130	$2,932	$3,685	$4,438
300%	9.5%	$3,087	$4,152	$5,218	$6,284
350%	9.5%	$3,601	$4,845	$6,088	$7,332
400%	9.5%	$4,115	$5,537	$6,958	$8,379

Sources: CRS computations based on "Annual Update of the HHS Poverty Guidelines," 74 *Federal Register* 4200, January 23, 2009, http://aspe.hhs.gov/poverty/09fedreg.pdf, and PPACA, for the second least expensive silver plan available to eligible individuals. If individuals choose more expensive plans, they would be responsible for additional premiums.

Source: Hinda Chaikind et al. April 15, 2010. Private Health Insurance Provisions in PPACA (P.L. 111-148). R40942, Congressional Research Service. http://assets.opencrs.com/rpts/R40942_20100415.pdf, accessed November 13, 2012.

Those persons who do not buy coverage will be penalized. By 2016 and beyond,



the penalty is $695 per adult and $347.50 per child, up to $2,085 for a family or 2.5 percent of family income, whichever is greater.[13] Some experts believe that the fines, coupled with greater outreach, will encourage people who are already eligible for Medicaid but not enrolled to sign up. Estimates from the Census Bureau and others suggest that these people make up 20 to 30 percent of the uninsured population.[14] The 100 percent federal matching rate will not apply to newly enrolled people who already would have been eligible for Colorado's existing Medicaid program.

By 2016 and beyond, the penalty is $695 per adult and $347.50 per child, up to $2,085 for a family or 2.5 percent of family income, whichever is greater.

Other experts believe that the penalty is unenforceable as long as taxpayers never overpay their taxes.[15] Coupled with the high cost of purchasing PPACA's high cost coverage and the statute's guaranteed issue requirement, which makes it possible to wait to get coverage until one is sick enough to need it, the inability to enforce the penalty could encourage people to remain uninsured and dependent on state safety-net programs. If that happens, safety-net program costs could increase, and the state will need to budget extra safety-net funding.

In addition to extra safety-net funding, the state will need to cover the Medicaid costs of people who are currently eligible for Medicaid and CHP+, have not yet signed up, but will sign up when the coverage mandate takes effect on January 1, 2014. In 2009, the Colorado Health Institute revised its estimates of the number of Colorado children who were eligible for Medicaid and CHP+ but not enrolled. An estimated 47,603 children up to the age of 18 were eligible for Medicaid but not enrolled, almost 20 percent of the existing caseload.[17] The number of children eligible but not enrolled in CHP+ was 30,625, 40 percent of the caseload. If just half of the 78,228 children enroll and the state pays $1,000 per child, the average per capita Medicaid rate

In addition to extra safety-net funding, the state will need to cover the Medicaid costs of people who are currently eligible for Medicaid and CHP+, have not yet signed up, but will sign up when the coverage mandate takes effect on January 1, 2014.

for a healthy child in FY 2010-11, the additional cost to the state would be $39 million a year.

Colorado already covers parents with incomes below 60 percent of the poverty level. The Hospital Provider Fee, passed in 2009, instituted a provider tax on hospital bills. Its proceeds may be used to expand eligibility to adults up to 100 percent of the federal poverty guidelines ($11,170 for one person, $15,130 for two people in 2012), children in CHP+, and, with an unspecified "premium," pregnant women up to 250 percent of the federal poverty guideline ($37,825 for a two people, $57,625 for a family of four). A person earning the Colorado hourly minimum wage of $7.64 who works the standard 2,080 hours a year would earn $15,891 before payroll taxes.

As eligibility expands up the income scale, program enrollments become more expensive simply because there are more people in higher income categories. The American Community Survey estimates roughly 47,000 Colorado families with incomes below $10,000. They are eligible for a number of programs that provide housing, transportation, and food subsidies that are not counted as money income. For comparison, more than 86,000 families have incomes between $15,000 and $24,999, while 155,960 families have incomes between $35,000 and $49,999.

As eligibility expands up the income scale, program enrollments become more expensive simply because there are more people in higher income categories.

Higher Medicaid caseloads could also result if employers respond to PPACA incentives by ending employer-provided health plans. To encourage employers to offer health insurance, PPACA fines businesses with more than 50 employees. The fines are $2,000 for the 31st employee and every employee thereafter if any employee applies for health insurance at a state exchange. The cost of the fine is below the current cost of providing an employee with PPACA-dictated health coverage, even without the accompanying administrative costs. The wording of the statute suggests that employers in states in which the federal government runs the exchange are not subject to such fines, yet another reason for allowing the federal government to fund a state's health benefits exchange.

Offering coverage also puts employers at risk for a potential $3,000 penalty per employee. The penalty applies if an employer offers coverage but fails to meet the PPACA affordability test. The test is based on employee household income, data that employers typically do not have. No one knows how employers will react, but at least one large firm is experimenting with limiting employee work hours to the maximum at which it can eliminate health coverage without paying any fines.[18] By altering the income of low-wage workers, an employer flight from health coverage likely will increase both Medicaid caseloads and Colorado's Medicaid expenditures.

The State Should Begin Investigating Possible Cost Savings from Moving People From Medicaid to Federally Subsidized Commercial Plans When the PPACA Maintenance of Effort Requirements Expire in January 2014

The long-term question posed by the PPACA health insurance subsidies is the extent to which Colorado can save money and better serve its citizens by cutting back its Medicaid program. Given the low reimbursement rates for Medicaid and the difficulty of accessing care, state officials should give serious consideration to freeing people from the Medicaid program. They could do so by concentrating state efforts on those who need benefits not provided by the commercial insurance products offered through the federally-qualified health benefits exchange. State officials should also consider legislation that aligns the premiums charged for state coverage programs with the payments required under PPACA. People are not eligible for federal health coverage subsidies as long as they are eligible for state Medicaid programs. As the Urban Institute researchers point out, "it is possible that states could achieve additional savings through maintenance of effort reductions. For example, states could discontinue Medicaid eligibility currently provided through Section 1931 and 1115 waivers and move those adults to federally subsidized coverage in the exchange." States also could eliminate Medicaid eligibility for adults "between 100% and 138% of the FPL and mov[e] them into federally subsidized coverage in the exchange." [19]

Given the low reimbursement rates for Medicaid and the difficulty of accessing care, state officials should give serious consideration to freeing people from the Medicaid program.

In addition to having more easily accessible networks, commercial policies may also do a better job of controlling health expenditures than Medicaid does.

In addition to having more easily accessible networks, commercial policies may also do a better job of controlling health expenditures than Medicaid does. Their relative freedom from the political process allows them to structure their policies in ways that give patients the incentive to use health care wisely. In contrast, Medicaid's structure encourages patients to use health care as if it is free. Although Colorado health policy circles were recently surprised by a report showing that Medicaid patients use emergency rooms for routine care simply because they are more convenient than appointments at Medicaid clinics,[20] firms offering commercial coverage have long adjusted incentives to control this kind of behavior. In 1993, for example, Northern California Kaiser Permanente experimented with an emergency department copayment of $25 to $35. It reported a 15 percent reduction in inappropriate utilization with no detectable adverse effects on health.[21]

Revamping the Colorado's Child Health Plan (CHP+) to give more children in their own federally subsidized coverage plans would improve coverage for children. PPACA coverage is more extensive than previous commercial products, and the federal government pays all costs of the insurance subsidy through the exchange.

The State Should Revisit Increasing CHP+ Enrollment Fees

State officials should note that the federally acceptable affordable premium rates for PPACA are far above the $35 annual premium that Colorado charges families for CHP+ membership. The state could save millions on this program simply by bringing its premiums in line with the means-tested premiums for federally subsidized commercial policies. Last year's effort to raise CHP+ premiums to a reasonable level failed when Governor Hickenlooper vetoed the bill, fearing it might increase the number of uninsured.

The state could save millions on this program simply by bringing its premiums in line with the means-tested premiums for federally subsidized commercial policies.

With the passage of PPACA and its measures to prevent people from being uninsured, these concerns have considerably less force. The Department of Health Care Policy and Financing's proposed alternate solution was to increase copays for a variety of services by a few dollars. This proposal adds unnecessary complexity to the system and makes it impossible for low-income people to know how much they will have to pay in advance should they become ill. Purchasing behavior in the individual market suggests consumers prefer policies that make their financial exposure clear so that they know exactly how much they might have to pay.

In view of PPACA's determination of affordability, last year's legislation to increase CHP+ premiums should be reintroduced, and last year's veto should be reconsidered. PPACA annual premiums for commercial coverage for people at 100 percent of the Federal Poverty Level ($11,170 in 2012 monetary income) are limited to $217 for a single person. They increase by about $75 for each additional person.

Federal poverty level income refers only to cash income. It understates the living standards of families eligible for various benefits programs because it does not take into account subsidies from programs like those that provide means-tested assistance for food, housing, transportation, childcare, or heat. According to the 2010 Consumer Expenditure Survey, people in spending groups with under $10,000 a year in pretax money income spent about $1,000 on entertainment, $1,000 on food away from home, and more than $2,000 on private vehicle transportation.

The State Should Repeal the Legislation that Established the Colorado Health Benefit Exchange

PPACA gives states the option of setting up health benefits exchanges. As of mid-December 2012, 26 states have decided their citizens are better off if the federal government runs the exchange. The first reason states have taken this approach is that exchanges are proving to be more expensive to set up and operate than was foreseen. The software required is technically demanding, and little information has been released about the status of the federal data hubs into which states will connect. Ohio declined because it estimated $43 million in annual costs for a state-run exchange and only $1.6 million a year to participate in a federally-run exchange.[22]

The second reason for reversing the decision to operate a state health benefits exchange is that it may substantially reduce the cost of complying with PPACA.

The second reason for reversing the decision to operate a state health benefits exchange is that it may substantially reduce the cost of complying with PPACA. States have little freedom to operate exchanges as they see fit. In early September, for example, the Colorado Department of Insurance correctly decided the state lacked the expertise to operate the reinsurance and risk adjustment function of the Colorado exchange. It ceded the function to the federal government. The Colorado exchange thus is likely to use the Centers for Medicare and Medicaid Services risk adjustment pricing model. Evidence suggests the federal model underestimates the cost of taking care of people who are seriously ill, sets payments for them too low, and therefore encourages plans to discriminate against them. If the state exchange uses the federal pricing method, it might as well let the federal government operate the exchange. No state funding would be required, and the federal government has announced that fees will be limited to a 3.5 percent fee for policies sold through the exchange.

Third, opting out of a state exchange may protect state businesses from the $2,000 per employee fines for not offering a health plan. Alert state officials understand that having a job is more important than having employer-provided health insurance and that the fines operate as an employment tax. As a result, they have moved to protect their citizens from a job-killing tax.

Alert state officials understand that having a job is more important than having employer-provided health insurance and that the fines operate as an employment tax.

Other Budget Considerations

Medicaid Managed Care Increases Costs. Stop Forcing People Into It

Rather than pay for health needs on an as-needed basis, the Department of Health Care Policy and Financing has responded to a decade of federal pressure to enroll people in managed care programs. Managed care programs require state taxpayers to pay managed care providers a specific amount per client regardless of whether that person ever visits the doctor. The Department admits managed care is more expensive, in part because managerial overhead seems to be higher.[23]

A 2012 synthesis report from the Robert Wood Johnson Foundation reviews the literature on Medicaid managed care and finds that claims of lower costs and better access are not well supported. In fact, like the State of Colorado, a number of researchers have found that managed care increases costs.[24] Failed managed care projects cost money. In 2006, the University of Colorado Hospital Authority wrote off $600,000 in principal when Colorado Access failed.[25] There is no particular reason to believe the new Accountable Care Organizations, which the state is using federal money to set up, will fare better. State officials should explore the possibility that moving away from managed care now will save taxpayers money in the long run despite the fact the move would agitate the special interests currently profiting from the Medicaid managed care movement.

State officials should explore the possibility that moving away from managed care now will save taxpayers money in the long run despite the fact the move would agitate the special interests currently profiting from the Medicaid managed care movement.

Establish Adequate Reserves to Account for the Stress that Medicare Reimbursement Cuts Will Impose on the Incomes of State-Owned Hospitals

The Medicare reimbursement cuts present another important budgetary consideration because they are likely to increase uncompensated care costs at state hospitals. PPACA penalizes Medicare providers for economy-wide productivity improvements, whether or not they take place in health care. The 2012 Medicare Trustees Report calculates that these cuts will "result in negative total facility margins for an estimated 15 percent of hospitals, skilled nursing facilities, and home health agencies."[26]

The University of Colorado Hospital Authority's primary revenue source is patient service revenue. The Authority recently entered into an agreement to combine with Memorial Health System in Colorado Springs and Poudre Valley Health Care to create the University of Colorado Health System. At present, the University of Colorado Hospital Authority receives roughly 25 percent of its revenues from Medicare and 10 percent of its revenues from Medicaid. After adjusting for differences between the hospital's billing rates and Medicare and Medicaid reimbursements, its net patient-service revenue from the Medicare and Medicaid programs was $251.9 million in FY 2010-11. It received Disproportionate Share Payments equal to $52.3 million.[27] State funding for indigent patients was approximately $20 million in 1999 and 2000, and $34.2 million in FY 2009-10.

PPACA's Medicare cuts are likely to affect the Hospital Authority's balance sheet, which may require increased subsidies from state taxpayers. In addition, the future of the Disproportionate Share Payment program is uncertain. PPACA cuts federal disproportionate share payments by $18.1 billion and Medicaid disproportionate share spending by $22.1 billion over the years 2014-2020.

PPACA's Medicare cuts are likely to affect the Hospital Authority's balance sheet, which may require increased subsidies from state taxpayers.

Encourage the Department of Health Care Policy and Financing to Move Away from Performance Goals that Encourage it to Maximize Medicaid and CHP+ Caseload Towards Performance Goals that Measure Actual Program Cost and Quality

The Department of Health Care Policy and Financing suffers from managerial weaknesses that reduce its ability to control Medicaid spending. The Department also has weaknesses in its accounting and program controls. Of the 11 Material Weaknesses identified by the State Auditor in the accounting and program controls throughout state government, HCPF had seven.[28]

Under Colorado statute, unlimited over-budget expenditures are allowed for the Medicaid program, provided the program can take money from state cash funds to cover its spending. Total over-expenditures for the Medicaid program were roughly $42.6 million. At the end of FY 2010-11, the Department of Health Care Policy and Financing was more than $6.1 million in the red, as shown by the State's General Fund Surplus Schedule. In part, this is a carry-over from poor fiscal management in FY 2009-10. In order to meet departmental budget targets that year, state officials authorized cooking the books. The Department made vendors who already had done work for Medicaid to wait an additional two weeks to be paid. The $28.1 million in payments were added to this year's budget.

The Department sometimes appears to have difficulty distinguishing between reducing expenditures and reducing health care costs. Reducing expenditures means less spending, a goal that can be achieved by reducing costs or by denying people needed health care. Reducing health care costs means reducing how much it costs suppliers to do business. States reduce costs by reducing regulatory overhead, eliminating unnecessary taxes, and generally reducing the cost of doing business. One way to reduce the cost of producing health care in Colorado would be to let private physicians and hospitals operate under the same malpractice standards as those enjoyed by physicians and hospitals that work for the state. Another way to reduce health care costs would be to eliminate the Hospital Provider Fee. The fee increases expenses for people who pay for their own health care, in order to subsidize Medicaid expansions.

One way to reduce the cost of producing health care in Colorado would be to let private physicians and hospitals operate under the same malpractice standards as those enjoyed by physicians and hospitals that work for the state.

The Department apparently believes it can reduce already low Medicaid reimbursement rates without affecting the quality of health care offered to people covered by the Medicaid program. This belief has been encouraged by researchers in the Dartmouth Atlas Project. A growing body of academic evidence suggests the Project incorrectly concludes that arbitrary reimbursement reductions harm health care quality, and that at current levels higher spending improves patient outcomes.[29]

The Department's most recent budget documents unrealistically state that it will save money with reimbursement cuts while simultaneously improving access for Medicaid clients. Given that the Department receives almost 58 percent of its appropriated budget from the federal government,[30] and the federal government has long promoted Medicaid managed care, it is not surprising that the Department wants to put clients into yet another federally supported, but untested, managed care organization. The Department apparently has no plans to develop measures to show whether these organizations are reducing costs by denying members necessary care or by expanding wait times and the difficulty of getting services.

The bureaucratic sprawl is becoming too big for even interested parties to provide effective advice and oversight for rule making. State officials should consider reducing the number of committees empowered to affect state health care policy.

The bureaucratic sprawl is becoming too big for even interested parties to provide effective advice and oversight for rule making. State officials should consider reducing the number of committees empowered to affect state health care policy.

Julie Reiskin of the Colorado Cross Disabilities Commission writes that her group has to keep track of the following committees just to follow Department changes to programs for the disabled:

- Community Living Advisory Group
- Community First Choice Implementation Council
- Long Term Care Advisory Committee (a main committee and four subcommittees)
- Dual Eligible Advisory Committee
- Accountable Care Advisory Committee (each Regional Care Coordination Organization has between one and four committees)
- Medical Services Board
- Human Services Board

- HB 1294 implementation committee (about regulatory reform, which is adding regulations at a rapid rate)
- HB 1281 advisory committee (about payment reform)
- CDASS Advisory (called Participant Directed Programs Policy Collaborative)
- Benefits Collaborative with a new committee for each benefit (PT/OT, home health, and medical necessity in general)
- Medical Advisory Committee
- Rule Review Meetings
- Eligibility Reform Committees.

The Department's FY 2013-14 strategic plan, reinforces the notion that it is more interested in increasing enrollment in government coverage programs than in ensuring the people who are enrolled have the ability to get the kind of health care they need. The Department's goals are as follows:

- Enroll more people in Medicaid by expanding the program using money from a fee/tax on sick people's hospital bills.
- Improving selected health outcomes. (Unfortunately, the measures chosen are inappropriate in that they ignore the needs of the severely ill and disabled. For example, the FY 2013-14 health quality improvement goals consist of increasing the percentage of enrolled children who have a "dental service" from 49 percent in FY 2010-11 to 59 percent in FY 2017-18, and increasing annual depression screenings for adolescent depression.[31])
- Contain health expenditures by putting the Medicaid population into untested Accountable Care Collaboratives, limiting hospital readmissions within 30 days of discharge, and reducing reimbursements to nursing homes.
- Increase the fraction of Medicaid patients in managed care, which increases expenditures. Figure out how to get people who provide medical services to participate in Medicaid despite its low reimbursements.

In budget documents, the Department unrealistically proposes to contain Medicaid costs by containing what it calls the 10 Medicaid cost drivers. Six of the 10 are the result of labor and delivery, and of routine physician visits by children. One of the six was uncomplicated vaginal delivery. State Joint Budget Committee staff trenchantly asked whether, in view of this goal, the Department plans to reduce vaginal deliveries by reducing the number of births.[32]

A more reasonable set of goals would measure progress towards reducing the Medicaid caseload by moving people from Medicaid to federally-subsidized private insurance policies. They would measure the Department's progress towards setting up Cash & Counseling type incentive programs that give Medicaid clients a budget and an incentive to spend it wisely. They would include measures for waiting time and inappropriate denial of care. And because real accountability requires real choice, they would measure the state's progress towards assuring that people covered by Medicaid have a choice of private providers—thanks to reasonable levels of payment, providing meaningful choice between private care and Medicaid managed care.

And because real accountability requires real choice, they would measure the state's progress towards assuring that people covered by Medicaid have a choice of private providers—thanks to reasonable levels of payment, providing meaningful choice between private care and Medicaid managed care.

Acknowledgements

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Merrill Matthews offered insights, improvements and corrections to the work. He is a resident scholar at the Institute for Policy Innovation and specializes in health policy. Dr. Matthews served

for 10 years as the medical ethicist for the University of Texas Southwestern Medical Center's Institutional Review Board for Human Experimentation, has contributed chapters to several books and has been published in numerous journals and newspapers. He writes the Right Directions column for Forbes.com, was an award-winning political analyst for the USA Radio Network, and provided a daily commentary on Sirius-XM for several years. He received his Ph.D. in Humanities from the University of Texas at Dallas.

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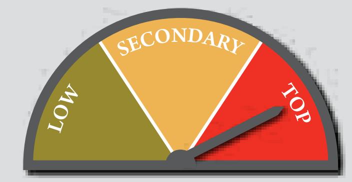
Bridge Enterprise Fund

Priority



Overview

The material describes a corrupt and dishonest scheme that violates the State Constitution and diverts funds off-budget. It is the first time this chapter has appeared in a Citizen's Budget.[1]

Recommendations

TOTAL RECOMMENDED REVISION = $1 BILLION IN DEBT
New legislation could render moot the current lawsuit, *TABOR Foundation vs. Colorado*[2], allowing the representatives to figure out the best cure and best steps forward in a proactive manner, rather than reacting later to a system in crisis. Additional savings would be found by not trying the case, freeing up resources in the community, for the Attorney General's office and the Colorado Department of Transportation.

The legislature has an opportunity to take control of a very bad situation, render moot a current lawsuit against the State, and renew its commitment to uphold Colorado's Constitution. The alternative is to do nothing and let the courts decide the issue, with the real potential of a fiscal and legal crisis if the courts rule against the State.

The Colorado Bridge Enterprise, enacted as part of the "FASTER" legislation in 2009, is the poster child of government run amok. It hides potentially billions in expenditures and debt by moving those dollars off-budget and operates as a pseudo-government agency that is unaccountable to elected officials.

The Colorado Bridge Enterprise, enacted as part of the "FASTER" legislation in 2009, is the poster child of government run amok. It hides potentially billions in expenditures and debt by moving those dollars off-budget and operates as a pseudo-government agency that is unaccountable to elected officials. In creating the Enterprise, the Legislature distorted the plain meaning of the Colorado Constitution by denying the right of voters to approve any tax hike or debt issuance before it occurs. The details below are harrowing in that they show Colorado state government to operate in the basest and least responsible fashion, with utter disregard for the people it should serve. Current legislators should reverse this egregiously corrupt scheme, and if they still want to move forward with the tax and debt, let the people vote on the issue, as mandated by The Taxpayer's Bill of Rights (TABOR).

If the Colorado Bridge Enterprise is allowed to stand without a vote of the people, future lawmakers will have a proven mechanism with which to enact any tax and raise any debt—for any project—they wish.

But there is a much bigger, and more concerning, issue. If the Colorado Bridge Enterprise is allowed to stand without a vote of the people, future lawmakers will have a proven mechanism with which to enact any tax and raise any debt—for any project—they wish. The legislature will have an open checkbook for virtually unlimited off-budget spending, taxing, and issuance of debt, with limited to non-existent legislative oversight. Voter-approved constitutional constraints on government will go out the window. This cannot be allowed to happen.[3]

Background - The wrong answer to a real problem

In 2009, our legislature considered the declining condition of many of our state's bridges. A CDOT study listed 128 bridges that were "structurally deficient, functionally obsolete or rated as poor." But the legislature decided not to appropriate funds to CDOT to fix the bridges, as legislators voted to spend limited money on other priorities.

The legislature, as guided by TABOR, could have gone to voters with a proposal to raise a tax and issue debt to fix the bridges. Legislators could have made their case that the condition of the bridges justified a tax hike and new debt, and let voters decide. But the legislature decided not to take the straightforward, transparent road, apparently fearing that voters might turn them down.

Legislators could have made their case that the condition of the bridges justified a tax hike and new debt, and let voters decide. But the legislature decided not to take the straightforward, transparent road, apparently fearing that voters might turn them down.

Instead, in 2009 the General Assembly passed Senate Bill108, commonly known as FASTER. The legislation requires every car owner to pay a tax from $13 to $39 each year. The amount of the tax is based on the vehicle's gross weight, with the average Coloradan required to pay $23 every year.[4] On an individual Coloradan's car registration receipt, the amount paid is listed as a "Bridge Safety Surcharge." The total amount of the tax is approximately $100 million per year.[5]

FASTER also created the Colorado Bridge Enterprise, a government-owned business chartered to repair and maintain bridges within the state—work still performed directly by the Colorado Department of Transportation (CDOT). The "Bridge Safety Surcharge" tax is used to fund the Colorado Bridge Enterprise. Under TABOR, government-owned enterprises must operate independently of state government and be self-supporting via fees charged directly to those benefiting from the activities of the business. Government-owned enterprises cannot be funded through taxes.[6] Yet the Bridge Safety Surcharge, called a fee by the State but a tax in practice, funds the entity. To make matters worse, in 2010 the Bridge Enterprise issued $300 million of debt, backed by these same taxpayer-paid funds, with the goal of issuing up to $1 billion in total debt.

TABOR, enshrined in the Colorado Constitution, clearly states that our legislature cannot enact a tax or issue debt without a vote of the people. Yet the FASTER legislation enacted a tax and provided for the issuance of debt all without a vote of the people. In 2012, the TABOR Foundation brought suit against the State requesting the Court find the FASTER legislation unconstitutional. That suit is awaiting its first hearing in District Court.

Below we provide the arguments detailing how FASTER fails Constitutional muster.

Legal Fiction #1: The Bridge Safety Surcharge is a Tax - NOT a Fee

Despite the careful wording within FASTER designating the Bridge Safety Surcharge as a fee, the assessment is in fact a tax. This conclusion is based on official guidance from the General Assembly's own Office of Legislative Legal Services. Shortly after the adoption of TABOR, the legislature sought the assistance of the Office in determining which revenues are properly considered taxes and which qualify as fees. In January 1993 the Office outlined a logical sequence of questions, leading to classification of any proposed revenue initiative as a tax or fee.[7] The Surcharge qualifies as a fee under only one of the five tests presented in Step 3 of the guidance, the criterion that the charge not be referred to in the language of the bill as a "tax." In defiance of common sense, FASTER carefully ensures that all references to the Surcharge call it a fee. Otherwise, classification of the Surcharge as a fee fails each of the remaining four tests.

Despite the careful wording within FASTER designating the Bridge Safety Surcharge as a fee, the assessment is in fact a tax. This conclusion is based on official guidance from the General Assembly's own Office of Legislative Legal Services.

In addition to the Office of Legislative Legal Services, the Colorado Supreme Court has weighed in on the issue of "fee" versus "tax". The Supreme Court has held that a fee is distinct from a tax in that, "unlike a tax, a special fee is not designed to raise revenues to defray the general expenses of government, but rather is a charge

imposed upon persons or property for the purpose of defraying the cost of a particular government service."[8] Ever since the first publicly-owned bridges were constructed in the State, bridge maintenance always has been considered a general function and a general expense of government. The Court further held that "imposition of assessment upon particular class of taxpayers can be justified only to the extent that such taxes are equivalent to special benefits conferred upon those taxpayers"[9] and that the "amount of special fee must be reasonably related to overall costs of particular governmental services being supported."[10] In other words, fees are imposed only on the people who directly benefit from the government service. Furthermore, the fee charged must be in-line with the actual cost of the service.

There are numerous examples of legitimate fees levied by the State. For example, dorm residents at a state-run university are charged fees for use of the dormitory. Drivers who park their cars in a government-operated parking garage pay parking fees. But if a Coloradan does not live in the dorm or park in the lot, he is not assessed the fee to pay for those services.

The FASTER legislation makes no attempt to align the application of the surcharge to persons directly benefiting from Bridge Enterprise projects.

The FASTER legislation makes no attempt to align the application of the surcharge to persons directly benefiting from Bridge Enterprise projects. The legislation could have called for a toll to be charged each time a driver uses a designated bridge. In this way, only the users of a designated bridge pay for its upkeep. If the legislature had taken this approach, there would be little argument that the toll charged is a fee and not a tax. Instead, the legislature declared that every Colorado car owner benefits directly from the upkeep of every single designated bridge, whether or not the owner actually uses that bridge. Every owner pays the same amount of tax, whether his car crosses one of the bridges once, a thousand times, or never.

Given the geographical dispersion of the bridges, it's clear that not every Colorado car owner uses each and every bridge.

Given the geographical dispersion of the bridges, it's clear that not every Colorado car owner uses each and every bridge. Consider:

1. Residents of 29 counties are subject to the tax, even though not a single bridge within these counties is targeted for maintenance or repair under the Bridge Enterprise's plan.[11]
2. The fee is imposed on farm vehicles that likely never leave the immediate property.
3. A Denver resident arguably receives greater benefit from the 51 bridges targeted for maintenance in the seven-county metro area than does a Grand Junction resident who receives benefit from only two bridges targeted within the combined area of Moffat, Rio Blanco, Garfield, Mesa, Delta, Montrose, San Miguel, Dolores, and Montezuma counties—an area covering the entire western boundary of the State from Wyoming to New Mexico. Yet Denver and Grand Junction residents are subject to the same fixed amount of tax.
4. Out-of-state residents pay no tax, even though they may drive in our state and use designated bridges more than locals.

The only rationale for creating the Bridge Enterprise entity and funding it through a tax masquerading as a fee was to circumvent TABOR and deny the citizens of Colorado their constitutional right to choose whether improved bridge infrastructure justifies $100 million in additional annual taxation.

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The Bridge Enterprise Issues Massive Debt

TABOR also provides citizens the final determination before our state borrows money. FASTER subverted citizens' rights to vote on debt issues. The law allows an unelected group of bureaucrats to appoint an unelected administrator and together borrow whatever amounts of debt can be backed by FASTER funds. On December 1, 2010, these unelected political appointees did just that by issuing $300 million of bonds. The program plans would support approximately $1 billion of total debt, all without prior voter approval.[12]

The law allows an unelected group of bureaucrats to appoint an unelected administrator and together borrow whatever amounts of debt can be backed by FASTER funds.

TABOR does not prohibit the State or a district government from borrowing money; it only stipulates that citizens must be asked first. In this age of exploding government debt, it is only prudent that citizens be asked before any new debt is incurred. But legislatures have manipulated an exception in TABOR that allows them to avoid such a vote. TABOR exempts an "Enterprise," defined as "a government-owned business" that receives "under 10% of annual revenue in grants from all Colorado state and local governments combined."[13] In other words, an Enterprise is meant to be a self-supporting business that is owned by the government but receives little funding from taxpayers.

The original provision anticipated that some government services could be self-funding, such as constructing a parking lot with bonds that are paid off over time by fees from people parking their cars. Since the enterprise is assumed to be a self-supporting business, it does not live under the restraints voters have placed on general government spending and debt. Well-known examples of government enterprises are the State Lottery and the state nursing home system. They sell a good or service to customers, and compete with alternate providers. Only willing buyers who actually use the service pay for it. These entities clearly fit the common definition of a business, and they receive minimal government funding. So when organizations owned by the government operate as truly independent businesses, they are legitimately exempt from the "Ask Citizens First" requirement before raising fees or taking on debt.

Legal Fiction #2: The Colorado Bridge Enterprise is Not a Legitimate Enterprise as Defined in the Constitution

The legitimacy of issuing massive amounts of debt without voter approval rests on whether the Bridge Enterprise is a true enterprise as defined in TABOR. Consider:

1. **The Bridge Enterprise and CDOT do the same work overseen by the same managers.** The executive officers of CDOT are the executive officers of the Bridge Enterprise. The Colorado Transportation Commission members who oversee CDOT are the same people who comprise the Board of Directors of the Bridge Enterprise. There is no attempt to run the Bridge Enterprise as an "independent business;" it is interwoven with CDOT. The Bridge Enterprise is a task force operating under the direct control of CDOT.

2. **A true enterprise receives less than 10 percent of its funding from the government.** The Bridge Enterprise is in the business of fixing bridges, but the bridges have been owned by the State of Colorado. In order to maintain the pretense, the state government periodically "transfers" the bridges to the Enterprise. In 2010, 77 bridges were transferred to the Enterprise. To comply with TABOR's enterprise funding restrictions, the total value of the transferred bridges had to be less than $6.8 million (10 percent of the $68 million collected via the Bridge Safety Surcharge in 2010). CDOT claimed that only two of the 77 bridges had value, and that their combined value was only $1.4 million. The other 75 bridges were claimed to have zero value. By using this strained logic, the value of the transferred bridges was said to be less than the 10 percent subsidy cap, therefore upholding the pretense that the Bridge Enterprise did not violate TABOR's revenue guidelines.

   By using this strained logic, the value of the transferred bridges was said to be less than the 10 percent subsidy cap, therefore upholding the pretense that the Bridge Enterprise did not violate TABOR's revenue guidelines.

   Can 75 bridges be worthless? In an accounting sense, yes. Under standard accounting procedure, CDOT's accountants simply assumed that after 40 years a bridge would have no value, and lowered the value of the bridge by 2.5 percent (1/40th) every year. Since almost all the bridges transferred to the Bridge Enterprise are older than 40 years, CDOT deems them to have no book value. And that is the problem. The bridges were transferred at book value, whereas any arms-length movement of assets from the State to an independent business takes place at fair market value.

   In the real world in which we live and drive our cars, the bridges still have tremendous value. After all, the bridges are still in use. If a bridge was in such disrepair that it truly had no functional value, CDOT should have taken it out of service long ago. And if a bridge really were not usable, its scrap metal still has value greater than zero. Clearly the bridges transferred to the Bridge Enterprise have tremendous value, and therefore violate the requirement that enterprises receive little funding from government.

3. **The legislature failed to ask for a legal opinion concerning whether the Bridge Enterprise really qualifies as an "enterprise" under our state's Constitution.** In the past, when an entity has decided to seek enterprise status, the State Auditor has ruled on the designation and then audits the enterprise each year to ensure compliance with the Constitution.

   Not so with the Bridge Enterprise. The legislature simply declared in the FASTER legislation that "The Bridge Enterprise shall constitute an Enterprise for purposes … of the State Constitution." The legislature further declared that since "the power to impose taxes is inconsistent with 'Enterprise' status under … the State Constitution, the General Assembly finds and declares that a bridge safety surcharge … is not a tax but instead a fee."

   So no need to follow the rules to ask the State Auditor. The General Assembly simply declared the Bridge Enterprise Fund to be an "enterprise," and the tax it charged to be a "fee." The legislature bypassed any check or balance of its dictum.

What to do

The simple solution is to repeal the FASTER legislation and do away with its annual car tax since it was never voter-approved. But the $300 million in outstanding debt makes outright repeal of FASTER problematic. If the FASTER tax is repealed and no other funding mechanism is put in its place, the Bridge Enterprise will default on its bonds. The Bridge Enterprise bondholders have no legal right to go to the State for money. However, a default by the Bridge Enterprise likely will have future ramifications on the cost and ability of other legitimate Colorado government agencies to issue debt.

If the FASTER tax is repealed and no other funding mechanism is put in its place, the Bridge Enterprise will default on its bonds.

Of the $300 million in existing debt, $43 million matures in 2027, while the remaining $257 million matures in 2040, so this debt will be with us for decades if nothing is done.

There are at least four options worth considering:

1. **Scrap the FASTER fees, and default on the existing debt.** This approach may have repercussions on future State borrowing.

2. **Scrap the FASTER fees, and simply appropriate enough money from the General Fund each year to make necessary bridge repairs and debt payments.** Scheduled payments on the $300 million debt are $18.2 million per year from 2012 to 2025, and then average approximately $28 million each year until the debt is paid off in 2040. The legislature could appropriate this money each year from normal revenues.

3. **Continue to Collect The Fee for Three Years and Pay Off the Majority of the Debt.** The Bridge Enterprise could redeem early the $257 million of debt due in 2040. A clause in the bond agreement allows the $257 million of debt to be redeemed at any time with a small penalty (the penalty is determined by current level of interest rates), while the remaining $43 million cannot be redeemed until 2020. The state legislature could direct the Bridge Enterprise Board to collect the $93 million tax each year but not spend it. After three years, the Board will have collected enough money to pay off the first $257 million of debt.

   Colorado citizens will still be on the hook for the remaining $43 million of debt, which cannot be redeemed until 2020. But after three years the legislature could direct the Bridge Enterprise to lower the annual fee paid by car owners to a level only sufficient to cover the remaining debt payments each year. This will dramatically lower the fee paid each year by car owners.

4. **Some combination of 2 and 3 above could be enacted** (early redemption of bonds coupled with the legislature making required debt payments as part of the normal appropriations process).

Either of these options can be pursued in 2 manners:

5. **Hold a vote of the people to decide the fate of the FASTER tax and debt.** Built into such a vote must be language that explains how the existing debt would be addressed in the event the tax and debt are rejected by the voters. A vote of the people should have been held prior to the passage of FASTER, but better late than never.

6. **Even in the absence of a citizen referendum on the FASTER fees and debt, the legislature could enact 2 and/or 3 above.**

Regardless of which of the previous options is pursued regarding the imposition of the Bridge Safety Surcharge and the outstanding debt, it must be recognized that the Bridge Enterprise does not qualify as an "enterprise" under Colorado's constitution. The legislature should take immediate steps to de-charter the Bridge Enterprise and reestablish responsibility for all bridge maintenance and repair back with CDOT. This action alone would resolve most of the claims within the current lawsuit.

The legislature should take immediate steps to de-charter the Bridge Enterprise and reestablish responsibility for all bridge maintenance and repair back with CDOT.

Conclusion

Legislators swear an oath to preserve, protect, and defend the Constitution of the State of Colorado. FASTER and the Bridge Safety Surcharge were unconstitutional the day they were proposed, and remain so today. This legal fiction must be undone, or future legislatures will use the mechanism over and over to enact tax hikes and issue debt. State government must not be allowed to ignore citizens' Constitutional rights.

Acknowledgements

Richard Sokol was the primary author of this chapter. See his biographical material in the major authors section.

Dick Murphy reviewed the chapter for accuracy and interpretation. Mr. Murphy has made a career as an institutional money manager and financial advisor, operating his own firm since 1991. He earned a Ph.D. in Economics from Iowa State University and taught at various colleges and universities before coming to Colorado in 1974. At a couple points in his career, Dr. Murphy worked in the State Treasurer's Office, including a position as Deputy State Treasury.

Endnotes

1 A chapter in the first Citizen's Budget, written by Dick Murphy, Ph.D., on "CDOT Debt" was solicited to document the remaining T-Rex highway debt. To his great credit, Mr. Murphy took the initiative to bring attention for the first time on the existence of the scheme. http://tax.i2i.org/files/2010/11/CB_CDOTDebt.pdf.

2 *Nota bene*, as a matter of full disclosure, the lead author of the Citizen's Budget, Penn R. Pfiffner, is also the Chairman of the TABOR Foundation, which is the plaintiff in the lawsuit. Also note that Mr. Pfiffner has nothing to gain personally from the lawsuit, and was led to urge action by the organization when the nature of the scheme was exposed. Plaintiff's attorney is Mountain States Legal Foundation.

3 To see a TV interview with the authors of this scholarship, turn to "A FASTER Way to Ignore TABOR" on *Devil's Advocate*, which aired May 20, 2011, found at http://www.youtube.com/watch?v=XgQlvgbshfo&feature=player_embedded. Jon Caldara tries to wrap his brain around such a preposterous scheme.

4 Colorado Senate Bill 09-108, "An Act Concerning the Improvement of the Transportation System of the State, and, in connection therewith, Providing Additional Sources of Funding for Transportation and Modifying the Transportation Planning Process," 67th General Assembly, 1st Regular Session. The section of the Bill creating the Bridge Enterprise can be found in Colo. Rev. Statutes § 43-4-805.

5 The first section of this chapter draws directly and exclusively from a Backgrounder by Tom Ryan, "Colorado Bridge Enterprise: A Case Study in Contravening Colorado's Constitution," Independence Institute Issue Backgrounder 2011-C (May 2011), http://tax.i2i.org/files/2012/05/IB_2011_C_rev_05_2012.pdf. The scholarship is entirely Mr. Ryan's. Large portions of that work are reproduced here, with permission.

6 Article X, Section 20 of the State Constitution allows only a maximum of 10 percent tax subsidy. See paragraph (2)(d), which provides the definition of "Enterprise."

7 Office of Legislative Legal Services memo to the Legislative Council Executive Committee, January 6, 1993; Test to be applied in determining what is a tax under [TABOR].

8 *Bloom v. City of Fort Collins*, 784 P.2d 304 (Colo. 1989).

9 Ibid.

10 Ibid.

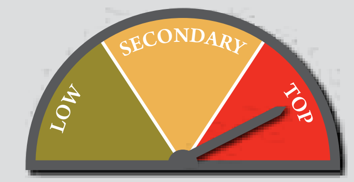
11 Colorado Bridge Enterprise Annual Report, January 14, 2011, Appendix A, List of 128 Designated FASTER Bridges.

12 For a more complete description of this material, see Richard Sokol, "How Colorado Has Raised $300 Million in Debt Without Asking Its Citizens: The Colorado Bridge Enterprise," Independence Institute Issue Backgrounder 2011-B (May 2011), http://liberty.i2i.org/files/2011/05/IB_2011_B_2.pdf.

13 Colorado Constitution, Article X, § 20, (2)(d).

K-12 Education

Priority



Savings

Total Recommended Savings = $268.7 million

Overview

The chapter describes the magnitude of public school funding and analyzes the state contribution. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations/Savings

Recommendation	Savings
• Eliminate ineffective "master's bumps" from teacher pay formulas.	$114.6 million
• Provide sensible reduction in business support service costs.	$136.0 million
• Enact tax credits for private school tuition scholarships.	$18.1 million
• Repeal Amendment 23 to restore fiscal flexibility.	

Original Article

The entire original article can be found at http://tax.i2i.org/files/2010/12/CB_K_12.pdf

Background

For fiscal year 2012-13, appropriations to K-12 education comprise the largest share of the state's general fund, (39.8 percent). It is notable that the percentage of the budget fell from more than 45 percent two years ago. When federal and other state designated funds are included, the state appropriated $4.4 billion, an $81 million increase from $4.3 billion in 2011-12. Colorado's K-12 state-appropriated funding has remained relatively flat at real 2007-08 dollar levels during the past couple years.[1]

Static appropriation levels have worked to slow the long-term growth trend. In the past quarter century, state funding of Colorado K-12 education grew both in real terms and as a share of total education funding. The annual amount of real state-appropriated dollars per pupil rose by 42.2 percent from 1986-87 to 2011-12.[2] The state today assumes a significantly greater share of the elementary and secondary education funding burden than 25, or even 10, years ago.

Rising expenditures for public schools are mandated in the state constitution. In 2000 Colorado voters narrowly approved Amendment 23. The law mandated annual increases to School Finance Act and categorical funding of 1 percent above inflation through 2010-11, and at the rate of inflation in years thereafter. Amendment 23 also created the State Education Fund through a designated transfer of state income tax revenue. Additionally, Amendment 23 enacted a "maintenance of effort" provision that requires a 5 percent annual increase in General Fund contributions to K-12 education—except when the state economy slows and personal income growth fails to reach 4.5 percent.

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During the 1990s—before Amendment 23 was enacted—the General Fund contribution to K-12 education grew every year in real dollars while decreasing as a share of General Fund contributions from 40.8 percent to 37.8 percent. In the decade after Amendment 23, K-12 education took greater shares of General Fund moneys, increasing to 45.6 percent in 2010-11. K-12 education's share of the General Fund has dropped off since. Still, with the rapid rise in federal funds and Amendment 23's creation of a separate State Education Fund, the General Fund now only provides 68.2 percent of state-appropriated K-12 education dollars as opposed to 84 percent in 2000-01.[3]

Since Amendment 23, the state's share of the K-12 education funding burden has increased greatly, and placed limits on legislative flexibility. The law obligated the State to underwrite unending increases regardless of stalled total tax receipts, but was silent on incentives to enhance learning. Though a technical provision has enabled the legislature to bypass the measure's intended purpose, the provisions at the heart of Amendment 23 need to be revisited.

K-12 Funding and Recent Colorado Policy Debates

The public is woefully uninformed about how much money is spent in public K-12 education. A 2007 Education Next-PEPG survey of nearly 2,000 American adults found more than 90 percent of respondents underestimated their school district's per-pupil expenditure. The median response of $2,000 was more than 80 percent below the actual figure[4] of roughly $10,000. In a 2011 follow-up survey, the share of 2,600 respondents who supported increases in K-12 spending fell from 59 percent to 46 percent, when informed of current local spending amounts.[5]

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The accelerated increases in Colorado's K-12 per-pupil spending during the recent decade largely can be attributed to voter approval 12 years ago of Amendment 23. That constitutional change promised and largely guaranteed a decade's worth of spending increases above the rate of inflation for the School Finance Act and categorical programs, representing the core of public school budgets.

Several subsequent state-level tax-hike efforts have been predicated on increasing taxes "for the children." The largest successful measure raised $3.5 billion[6] during its first five years and in 2012-13 will maintain state taxes $1.16 billion higher[7] than would have occurred in its absence. Most proponents of 2005's narrowly-approved Referendum C promised one-third of enhanced tax collections would be committed to K-12 education funding. Further, in 2007 the General Assembly enacted a property tax mill levy rate freeze. The action was a change in fiscal policy resulting in increased tax burden. The legislation became law without a popular vote, despite a strong case that it violated the Taxpayer's Bill of Rights. Once again, the change was presented primarily as a way to slow the growth of the state's share of school funding and to free extra funds to spend on preschool, full-day kindergarten and other education programs.[8]

In 2008 Amendment 59 sought to dismantle the Taxpayer's Bill of Rights by taking dollars available for TABOR refunds and dedicating them to fill requests for funding increases to K-12 education. Fifty-five percent of Colorado voters rejected the measure.[9] In 2011 Coloradans rejected Proposition 103 even more soundly, 64 to 36 percent.[10] The latter proposal to raise state sales and income tax rates to generate more education revenue won majorities of votes in only three of Colorado's 64 counties.[11] Local school tax elections also lost at a historically high rate. Of 38 K-12 mill levy and bond proposals before Colorado voters in 2011, only 12 were adopted.[12]

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School Finance Act

The Colorado state constitution guarantees the provision of "a thorough and uniform system of free public schools."[13] The lion's share of funding for public schools comes in the form of tax revenue collected by state and local governments. Most funding to the state's 178 local school districts—and to the Charter School Institute, a special authorizer created in 2004—is administered through the School Finance Act. The Act's basic existing framework was adopted in 1994, though it has been amended regularly in subsequent years. A broad coalition of interest groups and leaders has been building momentum to introduce a legislative School Finance Act overhaul in the near future.

The core funding each district receives through the School Finance Act is known as its total program. The total program amount is derived from a statutory formula that factors in a funded pupil count (the number in the current year or an average of up to five years of actual October pupil counts to protect districts with declining student enrollments), a base funding amount and various factors that attempt to reflect the cost of providing education services in different parts of the state:

- A factor that expresses the difference in cost of living between a metropolitan Denver suburb, a rural farm community and an upscale mountain resort town
- A factor that accounts for local and regional personnel costs, as employee salary and benefits make up the dominant share—typically more than 80 percent--of local education budgets
- A factor that compensates for a school district's size, recognizing especially the constraints on purchasing power in a geographically large rural district

Additional considerations that drive the formula and determine a district's total program amount include:

- The number of at-risk students (i.e., students eligible for the federal free lunch program due to limited family income, and some students for whom English is a second language) increases the amount of funds received; and
- Students enrolled in an online education program that operates across district lines are funded at a standard rate lower than statewide average per-pupil funding.

Total program funding for 2012-13 is estimated to be $5.291 billion, a full billion dollars less than the amount provided for under Amendment 23. It marks the third consecutive year the General Assembly has employed a "negative factor," formerly known as the "budget stabilization factor," to offset or eliminate required inflationary increases. At its peak in 2009-10, Colorado total program funding reached $5.717 billion. A district's total program amount divided by the funded pupil count yields the amount of PPR, or per-pupil revenue. Individual district PPR amounts range from $6,059 for Branson School District Re-82 in Las Animas County (because most students are enrolled statewide through a special online program) to $15,099 for Pawnee School District Re-12 in Weld County. Larger districts like Jefferson County Public Schools and Denver Public Schools receive PPR of $6,308 and $6,868, respectively.[14]

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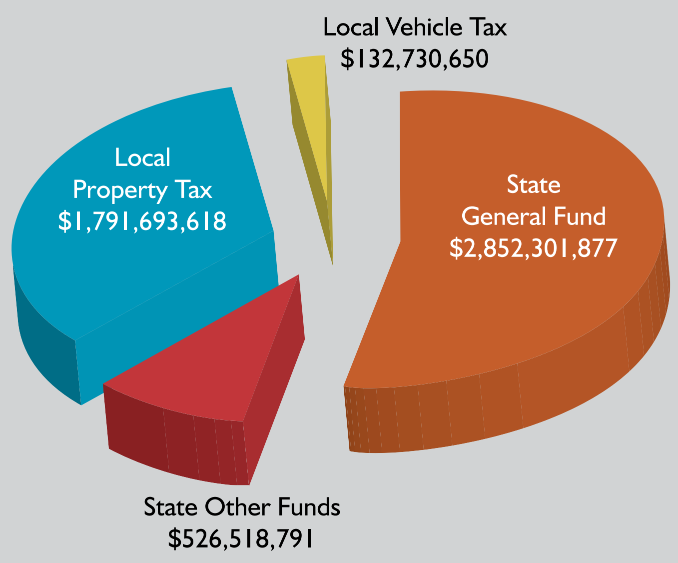
Earmarked Revenue

As currently amended, the School Finance Act only has one statutory obligation on local districts for the use of total program funding. At least three-fourths of the dollars received to provide at-risk student funding must be designated "to school or district-wide instructional programs for at-risk pupils or to staff development associated with teaching at-risk pupils in each district."[15]

Before 2009-10 the School Finance Act required specified minimum amounts of total program funding to be allocated to instructional supplies (including textbooks), as well as to reserve funds for capital and insurance purposes. The General Assembly concluded in 2009 that local education agencies needed fewer earmarked revenues and greater discretion over the use of general education dollars.

Public charter schools are entitled to receive 100 percent of PPR based on October 1 enrollment count. Authorizing districts with more than 500 students may charge up to 5 percent of PPR for administrative services. Authorizing districts with fewer than 500 students may charge up to 15 percent of PPR.[16]

Figure 1: Colorado School Finance Act Funding: Local vs. State Revenue, FY 2012-13



State vs. Local Share

Funds generated locally through property taxes on homes and businesses furnish $1.792 billion of the School Finance Act's $5.291 billion. Total program mill levy rates vary by district—from 1.68 mills in rural southern Colorado's Primero School District to 27 mills, the maximum allowed by statute, which is imposed on 38 districts.[17] An additional $132.7 million in the Act comes from locally-collected vehicle ownership taxes. These two local revenue sources provide the foundation of School Finance Act funding: $1.925 billion, or 36 percent.

In most districts, the combined property and vehicle ownership tax revenue falls short of the total program formula amount defined in statute. The remaining funds are backfilled through income taxes and other funds collected at the state level. In 2012-13 nearly 85 percent of state dollars used to pay for the School Finance Act comes directly from the general fund, $2.852 billion.[18] The remainder is appropriated from the State Education Fund (created by Amendment 23) and the State Public School Fund.

As shown in figure 1 above, the state's share of total program funding for the current budget year (2012-13) is projected to be 63.7 percent, or $3.379 billion. Largely, state funds have grown in the past couple years to offset declining revenues from local tax dollars. Two years ago, seven districts depended exclusively on local tax revenues for total program aid: Aspen, Clear Creek Re-1, Estes Park R-3, Gunnison Watershed Re-1J, Park County Re-2, Summit Re-1 and West Grand 1-Jt. In 2012-13, every one of Colorado's 178 districts is estimated to receive at least some state aid through the School Finance Act, though for four districts the amount is nominal (less than $1,000). Eight districts receive more than 90 percent of total program funding from state coffers. None is more heavily dependent than Edison School District 54JT in rural El Paso County, slated to receive the greatest share of state aid at 95.9 percent.[19]

Additional Funding Sources

Other major sources of public revenue are available to school districts beyond the total program in the School Finance Act. In 2011-12, state lawmakers designated $235.5 million in state-generated funds for **categorical programs** to serve disabled students, gifted students, students with limited English proficiency, and expelled and at-risk students, as well as to provide extra aid for transportation, vocational training, comprehensive health services and small attendance centers. This amount represents an appropriations increase 31.8 percent above inflation since 2000-01, compared with 17.9 percent growth in student enrollment over the same 11-year period.[20]

State statute also authorizes local districts to seek voter approval for **mill levy overrides**. The amount of override a district can receive generally is capped according to the size of its total program funding.[21] As with the total program mill levy, override revenues are determined by multiplying the mill levy rate to the property's assessed valuation: 7.96 percent for homes and 29 percent for commercial properties. In 2011-12, 109 school districts generated a total of $649.3 million in override revenues.[22]

Example: *A school district has a voter-approved override of 10 mills (.010), with total assessed residential property value of $100 million and total assessed commercial property value of $100 million. The assessed valuation for homes is* ***$7.96 million*** *(7.96 percent of $100 million), and the assessed business valuation is* ***$29 million*** *(29 percent of $100 million), for a total valuation of $36.96 million. At 10 mills, the school district each year would collect 1 percent of* ***$36.96 million****, or* ***$369,600****. As long as the district's currently funded "total program" is $1,478,400 or higher, that amount of funding would not exceed the override cap of 25 percent.*[23]

Further, the federal government authorizes spending to support local schools. Federal money includes the Title I program for low-income schools and support for categorical programs,[24] in addition to a wide range of other U.S. Department of Education funds. These comprise a significant share of Colorado K-12 funding. In 2010-11, the state's public schools received slightly more than $1 billion in federal funds administered through state and local education agencies, comprising nearly 11 percent of total revenues.[25] Federal funds appropriated through the Colorado Department of Education peaked at a whopping $826.9 million in 2009-10 before receding to an estimated $628.7 million in 2012-13. Even so, the 30-year compound annual growth rate in Colorado's K-12 federal funding stands at a healthy 7.58 percent.[26]

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One particular case shows why a thorough understanding demands school funding calculations include additional revenue sources beyond the School Finance Act. Colorado public charter schools by law receive the same PPR as district schools, in most cases minus 5 percent for district administrative overhead (as explained previously). Yet a 2010 study from Ball State University shows that charter schools in 2006-07 on average received 15 percent fewer dollars per student than their traditional public school counterparts. The discrepancy is explained primarily by two factors: 1) The state's charter schools receive significantly less funding from the U.S. Department of Education's Title I program for low-income schools, and 2) Before 2009 charter schools were not eligible to receive a share of local mill levy overrides.[27]

Capital Construction Funding

The State of Colorado also makes funds available to local schools (including district and charter schools) through the Building Excellent Schools Today (BEST) program, enacted by the General Assembly in 2008. Through BEST, a combination of income generated from state trust lands and matching funds at the local level finances qualifying capital construction projects throughout the state. Over five years, BEST has awarded a total of more than $700 million in state funds, in addition to $300 million in local matching fund requirements. More than one-third of the BEST funding recently secured State Board of Education approval during the 2012-13 grant cycle.[28]

The State of Colorado also makes funds available to local schools (including district and charter schools) through the Building Excellent Schools Today (BEST) program, enacted by the General Assembly in 2008.

To finance the cost of building new schools local Colorado districts frequently issue voter-approved bonds, or may also create a local mill levy-backed Special Building and Technology Fund. For districts growing in student population, the state treasurer also may provide capital construction loans—provided voters have approved the debt, payment method and length of repayment period beyond one year.[29]

The Big Picture: Funding Rankings and Facts

Traditional media outlets, elected officials and other public figures typically cite current expenditures per pupil in drawing comparisons between states and local school agencies in the area of K-12 education finance. Current expenditures exclude money allotted for capital projects and for financing bonded debt. Yet using different assumptions, competing sources yield diverse numbers and rankings, allowing for selective manipulation of statistics.

For 2009-10, the U.S. Census Bureau records Colorado's current expenditures at $8,853 per pupil, ranked 40th in the nation. Meanwhile, the National Education Association offers substantially different information, placing Colorado at $9,631 per pupil, or 29th in the nation. (A third source for public school expenditures, the U.S. Department of Education, has not yet released any financial figures beyond 2008-09.)

Regardless of the source, the long-term trend remains clear. According to the U.S. Department of Education, real current per-pupil expenditures nationwide roughly doubled between 1970 and 2000, and grew by an additional 20 percent following the turn of the millennium.

Regardless of the source, the long-term trend remains clear. According to the U.S. Department of Education, real current per-pupil expenditures nationwide roughly doubled between 1970 and 2000, and grew by an additional 20 percent following the turn of the millennium. Colorado's spending growth outpaced most states during the 1970s but has tended to lag them during the subsequent three decades.[30]

Representing the most recent data, the Colorado Department of Education reports that the state's K-12 schools in 2010-11 spent $7.518 billion on "current" operating expenditures, or $9,808 per pupil.[31] Measured in real dollars, Colorado K-12 current expenditures have risen by more than 34 percent since 2000-01, nearly twice as great as the 10-year student enrollment growth of 16.4 percent.[32]

Total Per-Pupil Expenditures

The U.S. Department of Education also measures total expenditures per pupil—including capital construction and debt financing costs. On a statewide basis, comparisons using these statistics provide a fuller picture of the financial resources available to public schools. Federal data show Colorado spent nearly $8.73 billion on K-12 education in the 2008-09 school year, or $10,669 per pupil. Colorado ranked 38th in total per-pupil spending, about $1,700 below the national average of $12,384.[33]

Measuring the growth of dollars spent is more meaningful than comparing rankings, as states almost universally have increased expenditures beyond student enrollment for years and decades. Starting in the 1988-89 school year, the U.S. Department of Education began reporting consistent yearly information on total K-12 expenditures by state. Within two decades Colorado's total spending grew by 23 percent in real dollars per student, a substantial increase but smaller than the national increase of more than 41 percent.[34]

Measuring the growth of dollars spent is more meaningful than comparing rankings, as states almost universally have increased expenditures beyond student enrollment for years and decades.

Some interest and advocacy groups frequently seize on this disparity to make comparisons showing Colorado lagging national spending averages. A commonly-used misleading chart displays the red line of Colorado's long-term per-pupil spending going down—an effect that only works by making the steadily-rising national spending average into a flat line.[35] If Colorado had matched the nation's inflation-adjusted K-12 spending increases since 1988-89, the state would have spent $12,263 per student in 2008-09—ranking the state at 21st and just below the national average. An additional $1.3 billion in funding from state revenue or other sources would have been required for that year alone.

Table 1. Total K-12 Per Pupil Spending, Colorado vs. Regional States (2008-09)

Wyoming	$18,922	Colorado	$10,600
Nebraska	$12,703	Nevada	$10,449
New Mexico	$11,835	Arizona	$9,552
Montana	$11,463	Oklahoma	$8,696
Kansas	$11,427	Idaho	$8,601
Texas	$11,085	Utah	$8,446

In Context: Comparing with Other States

Colorado's 2008-09 total per-pupil spending is comparable to or greater than most neighboring and other regional states. Along with actual spending, our state's relative standing in student-level expenditure slipped from the previous year. As indicated in table 1, Colorado ($10,600) still ranked slightly higher than Nevada and significantly ahead of Arizona, Oklahoma, Idaho, and Utah. Kansas, Montana, and Texas spent less than $1,000 more per student than Colorado, while New Mexico and Nebraska paid out substantially more. Rural Wyoming (which has no income tax but funds its schools largely through oil and gas revenues) stands far ahead at $18,922 per student.[36] In fact, Wyoming is only outspent nationally by the District of Columbia ($27,155) and New York ($19,983). Rounding out the top five spenders are New Jersey ($18,549), and Alaska ($18,058).[37]

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No clear correlation exists between significantly greater amounts of money spent per student and academic results. According to a comprehensive analysis performed in the late 1990s, two-thirds of 163 academic studies showed insignificant correlations and a handful showed a negative relationship. Only 27 percent demonstrated "a statistically significant relationship between increased per-pupil spending and student performance."

A 2012 Harvard study further affirms the body of research that challenges increased spending as a strategy to improve educational outcomes. Analyzing "trends in student performance," the report found that additional per-student education expenditures and the related state-by-state gains on national achievement tests had but a very small, statistically insignificant correlation. The same report found that of six other regional states with comparable data, only Texas reaped higher achievement gains than Colorado. Wyoming, which has much higher overall spending and has increased spending much more greatly, produced lower results.[39]

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49th in Funding?

Some advocates of increased spending claim Colorado ranks 49th in K-12 education funding, but few explain the context. The reference is to the amount of dollars spent as a share of residents' personal incomes. Because Colorado is a wealthier state, the income denominator is high. More dollars need to be spent per student than in poorer states to achieve a comparable ranking. Those who say Colorado ranks near the bottom in education funding use a statistical comparison that implies the more money you make, the more you should spend on education programs—no matter how well those programs work.[40]

U.S. Census Bureau data for 2009-10 ranks Colorado 45th in public school revenues and 46th in expenditures as a share of $1,000 in personal income. When measured against personal income, Colorado's spending on school administration and general administration rank 27th and 37th, respectively.[41] Measuring data from 2008-09, the National Education Association ranks Colorado 42nd in spending as a share of personal income. About 3.7 percent of all earnings in the state are spent on K-12 public school current operating expenditures, compared to the national average of about 4.3 percent.[42]

How Dollars Are Spent

State-Level Administration and Miscellaneous Appropriations

The Colorado Department of Education (CDE) is budgeted to take in $80 million for 2012-13 to fulfill the functions of governance, oversight, professional licensure, TCAP assessment administration, the Charter School Institute and information management. This amount represents a substantial increase from previous years' appropriations, primarily but not exclusively driven by the legislative mandates to implement a statewide educator effectiveness system and to develop new standardized assessments. Roughly one-fourth of the appropriation for management and administration ($20.3 million) is slated to come from federal funds. Other smaller appropriations have been made for the Colorado School for the Deaf and Blind ($14.4 million) and library-related programs ($7.0 million). To provide perspective, state-appropriated "assistance to public schools" for the current fiscal year is projected to be $4.261 billion.[43]

Spending Categories

For ease of comparison among states, the U.S. Department of Education has defined expenditure categories. Table 2 provides a comparative overview that breaks down Colorado's reported current operational spending versus the national average for the 2008-09 school year, the most recent for which data are available[44]:

Table 2. K-12 Spending Categories, Colorado vs. U.S. Average (2008-09)

Category	Colorado	US Average
Instructional (Classroom Teachers, Textbooks)	57.6%	61.0%
General Administration (Boards, Executive, Legal)	1.6%	2.0%
School Administration (Principals and Office Staff)	6.8%	5.6%
Student Support (Guidance, Health, Intervention)	4.7%	5.4%
Instructional Support (Libraries, Teacher Training)	5.5%	4.8%
Student Transportation	3.0%	4.2%
Operation / Maintenance / Food Service	13.1%	13.6%
Other Support (Business, Research, Personnel)	7.1%	3.2%
Enterprise Operations	0.5%	0.2%
TOTAL	**100.0%**	**100.0%**

As shown in table 2, nearly 58 percent of Colorado's K-12 operating budgets is reported to reach the classroom level. After generally decreasing through much of the decade, the state's ratio of enrolled students to full-time equivalent (FTE) teachers in 2010-11 (17.4) was identical to the ratio in 2000-01.[45] The NEA reports that Colorado has the eighth-highest student-teacher ratio nationally, above the national average of 15.6 but lower than regional counterparts in Utah, Arizona, Idaho and Nevada.[46] (Student-teacher ratio is not the same as average class size, which in grades K-3 typically exceeds the ratio by 9 or 10. Therefore, the average early elementary class size in Colorado stands at about 27, compared to 25 nationwide.[47])

Only 47.5 percent of K-12 personnel were reported to be teachers in 2009-10, a significant drop from 51.2 percent 10 years earlier.

About 58 percent of Colorado K-12 operational spending is directed toward the classroom. Only 47.5 percent of K-12 personnel were reported to be teachers in 2009-10, a significant drop from 51.2 percent 10 years earlier.[48] During the same span, the national ratio of teachers to total K-12 employees fell only slightly from 53.3 to 52.9 percent. For a variety of reasons the nationwide ratio has changed dramatically over the past half-century. In 1960 the national ratio of teachers to non-teacher K-12 employees was 2 to 1.[49]

Personnel Salaries and Benefits

The U.S. Department of Education also breaks down spending by object. From 1999-2000 to 2008-09, Colorado's share of reported K-12 current operational expenditures dedicated to employee salaries and benefits grew from 76.1 to nearly 79 percent.[50] Thus, Colorado's increased K-12 spending during the recent decade largely can be attributed to increased personnel hiring and/or compensation rates. Between 1999-2000 and 2009-10 Colorado's public school enrollment grew by 17.5 percent—from 708,109 to 832,368. During the same 10-year span the number of full-time equivalent (FTE) public school employees increased by almost 30 percent.[51]

In 2010-11, Colorado taxpayers spent $5.85 billion on K-12 employee salaries and benefits, including retirement contributions. Nearly two-thirds of compensation went to teachers and about 8 percent to administrators, a ratio virtually unchanged from two years earlier. All other employees made up slightly more than a quarter of the payroll.[52] The average teacher's base salary was $49,228, with an extra 24 percent typically received in benefits. Average teacher salaries ranged from $26,726 in rural Kim Reorganized 88 to $61,590 in Cherry Creek Schools.[53] According to the National Education Association, Colorado's average public school teacher salary was 27th highest nationwide in 2010-11.[54]

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A teacher with a bachelor's degree in Adams 12 (Northglenn-Thornton) —the median school district for teacher pay in the Denver metropolitan area—started at $28,133 in base salary for the 2003-04 school year. As a ninth-year teacher in 2011-12 he earned $45,314 plus benefits with a B.A., a 36.5 percent rise in real earnings, or an average annual increase of 4 percent. If the same teacher has completed a master's degree and earns $52,366, the increase would be 57.8 percent in real earnings, or an average annual increase of 8.25 percent. Adams 12 teachers holding only bachelor's degrees top out base pay earnings at $46,755 after 10 years of service. But an employee in his 20th year earns $67,956 by obtaining a master's degree or $78,592 with a doctorate.[55]

The average principal or assistant principal's base salary was $81,333 in 2010-11, while the average base salary for superintendents (including assistant superintendents) was $109,648. Administrators typically receive an additional 22 percent in benefits.[56] Beyond the documented salary and benefits, the deferred compensation in pension guarantees for government employees who become vested through extended years of service yields a high value.[57]

Costs of Collective Compensation

For most Colorado public school teachers, compensation is subject to the political pressures of budget negotiations and the rigid formulae of service years on one hand and graduate-level credits and degrees on the other. However, these factors do not align with effective teaching. In fact, less than 3 percent of assessed student learning and other instructional outputs can be explained by experience and academic credentials. About 97 percent of a teacher's effectiveness is determined by other factors.[58] Of 34 quality studies that address the question to account for year-to-year academic growth, precisely zero "found a relationship between a teacher's earning a master's degree and student achievement."[59]

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A 2012 report by the Left-leaning Center for American Progress noted that Colorado spent a full 3 percent of its current K-12 expenditures on "master's bumps"—rewarding teachers with automatic bonuses for master's degree achievement.[60] Similarly, pay raises for seniority ignore the fact that most studies find teacher quality plateaus after the fourth or fifth year and in some cases even may decline as an instructor approaches retirement age.[61]

Since negotiated bargaining agreements and salary schedules determine that teachers are compensated collectively, determining whether individual teachers are adequately paid is a highly difficult proposition. The average teacher works far fewer days per year than other white-collar professionals. Some teachers complete many hours of additional take-home work, such as grading papers, but no known effective comparison has been made to other professionals' amount of take-home work. Due to the nature of the subjects they teach or to other factors, other instructors complete all their work within the contract hours at school. Undifferentiated collective compensation obscures both the value of teacher inputs and outputs that affect student learning.

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A 2011 analysis by economists Jason Richwine and Andrew Biggs concluded, based on academic proficiency and the lack of rigor in postsecondary education courses, that public school teacher salaries fall in line with private-sector earnings. However, due to added job security and fringe benefits, career teachers who become vested in their pension plans garner a 52 percent compensation premium.[62] For new teachers, earnings more often lag or stand equivalent to their academic peers. But seniority and longevity are heavily rewarded in K-12 public education, regardless of measurable impacts on student learning.

Achievement Results

The U.S. Department of Education's National Assessment of Educational Progress (NAEP) remains the gold standard of testing. Math and reading tests have been administered to statistically representative samples of fourth- and eighth-grade students in states every other year since 2003. Before 2003, the tests were given at less frequent intervals. On each of the four tests, Colorado ranks slightly ahead of the national average in performance, with the state's progress closely tracking most of its peers nationwide.[63]

In 2011-12 the Transitional Colorado Assessment Program (TCAP) replaced the Colorado State Assessment Program (CSAP), as the state works to adopt a new testing regiment aligned with updated academic standards. Like its predecessor, TCAP is administered statewide to public school students in four subject areas, the first three in every year from third through 10th grade:[64]

- **Reading** proficiency since 2002 has shown significant gains in grades 4 through 7 with smaller progress in the other grades
- **Writing** proficiency since 2002 has shown significant to large gains in grades 5 through 8 and has been flat in the other grades
- **Mathematics** proficiency since 2005 has mostly moved up, with significant gains in grades 6 through 9
- **Science** proficiency (tested in three grades only) since 2008 has shown significant improvement at the fifth grade level and slightly positive results in eighth and 10th grade, though still remains below 50 percent at all three grade levels

Official calculations for Colorado's high school completion rate have changed, making valid long-term comparisons extremely difficult. In recent years the state's graduation rate has hovered around 75 percent.[65]

Proposed Reforms

A wide range of reforms that promote more efficient and effective use of K-12 education resources should be contemplated:

1. **Tuition tax credits** provide offsetting tax benefits to individuals and/or corporations that provide funds to help enable a student attend non-public school. Setting the scholarship value below a student's share of per-pupil revenue not only empowers more families to afford a private education but also ensures marginal cost savings. With sufficient demand expressed by education consumers, the state will save resources both in the short and long term while ensuring students have access to a wider range of quality education options.

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The Cato Institute in Washington, D.C., has developed a formula to measure the fiscal impact of education tax credits, based on current financial and enrollment data and the specific design of the program. The tax credit program would provide private tuition coverage to K-12 students, through non-refundable deductions to state corporate and personal income taxes. Student eligibility is not limited by family income, with participation capped for students who are not transferring from public schools.[66]

A reasonable estimate of the **marginal cost** for Colorado public schools is needed to determine cost savings.[67] Table 3 shows how changes to the tax credit's maximum value as a percentage of state-funded per-pupil revenue (roughly $4,140 in fiscal year 2011-12) affect savings. At 50 percent, a public school student could use about $2,070 in tax-credited family savings or a tax-funded scholarship to supplement tuition for his new enrollment at a non-public school. The model predicts more than 52,000 students would choose this incentive over time to leave a public school in order to pursue private education.

During the first three years, when only public school "switchers" receive the benefit, the state would realize **$18.1 million** in savings by having fewer students to fund. In intermediate years the growth of state savings would slow, but would continue to accumulate over time. Most financial benefit would be achieved at the local school district level, as combined in the 10-year savings calculation. A larger scholarship size decreases the state's savings but necessarily increases the number of students expected to choose a non-public school. Over 10 years state savings would reach $149.6 million, with more than $780 million in cumulative savings realized at the district level. (See **Appendix** of K-12 chapter in 2010 Citizen's Budget for more details on calculations, including regional breakdowns of student migrations from public to non-public schools.)

Although a strict calculation cannot be projected, it should be noted that further long-term savings also may be realized by a reduced need for new school construction. The potential savings in the area of capital costs presents an additional opportunity to lower the financial burden on the state of Colorado in coming decades.

In addition to the fiscal benefits, research has shown that the competitive effects of Florida's private school tuition tax credit program significantly increased the academic performance of public school

Table 3. Colorado Public Education Tax Credit, Projected Migration and Savings

Tax Credit	Migration	State Savings: 3 Yrs	SAVINGS: 10 YEARS		
			State	District	Total
10%	38,228	$23,885,632	$297,045,681	$573,462,748	$870,508,429
20%	40,978	$22,765,441	$268,265,980	$614,598,394	$882,864,374
25%	42,499	$22,138,825	$252,217,927	$637,358,459	$889,576,386
33%	45,173	$21,027,713	$223,837,995	$677,334,659	$901,172,655
40%	47,792	$19,928,237	$195,837,860	$716,472,203	$912,310,063
50%	52,082	$18,106,581	$149,591,999	$780,548,957	$930,140,956
60%	57,182	$15,914,060	$94,109,971	$856,651,592	$950,761,563
67%	61,367	$14,098,805	$48,271,801	$919,017,723	$967,289,524
75%	66,956	$11,666,553	($13,029,359)	$1,002,030,229	$989,000,871
80%	71,025	$9,915,356	($57,179,965)	$1,061,967,275	$1,004,787,309
90%	107,877	$9,414,754	($115,143,737)	$1,368,761,897	$1,253,618,159
100%	120,226	$0	($304,241,583)	$1,552,662,780	$1,248,421,197

students.[68] A subsequent study by one of the same researchers found small but statistically significant learning gains for the students who received a tax credit scholarship through Florida's program.[69] Tax credit scholarships also stand on strong legal ground, as a 5-4 U.S. Supreme Court majority ruled in 2009 that taxpayer plaintiffs lacked standing to protest the use of privately expended funds to support students who attend private religious schools.[70]

2. **Repeal Amendment 23**. The effect on the State budget could not be felt until after voters passed the repeal measure, so the next fiscal year would experience no flexibility from this reform. The earliest the legislature could place this measure on the ballot would likely be the general election in November 2014. Some might argue persuasively that the proffered change could be designated as a TABOR issue and therefore could go on the ballot in 2013, but that might not stand the inevitable court challenge. If delayed as expected, the next budget for 2013-14 would have no relief from this quarter and other cuts would have to be found.

The proposed solution is complicated by the fact state officials since 2010 have violated the spirit of Amendment 23. The legislature has used the "budget stabilization factor," or "negative factor," in the annual School Finance Act renewal three consecutive years to bypass the requirement for scheduled increases in per-pupil revenue (PPR). Two different governors have signed the School Finance Act into law with factored reductions to the funding formula. The practice, which has been used to offset budget demands from other areas in the General Fund, has not been legally challenged. One practical effect of the "negative factor" has been to demonstrate the annual funding increases are more pliable than automatic. Nonetheless, the case for more flexibility in the State's K-12 education budget still may require formal repeal to avoid or minimize potential legal action.

An effective way in which Colorado's K-12 system can move towards greater productivity is through expanded innovations in blended learning, allotting dollars more directly to fund student needs.

3. An effective way in which Colorado's K-12 system can move towards greater productivity is through expanded innovations in **blended learning**, allotting dollars more directly to fund student needs. Many secondary students in particular may benefit from enhanced opportunities to choose combinations of digital course offerings with traditional face-to-face learning models. The ability to "self-blend" courses in this manner is significantly inhibited by the current model of school finance that counts students once a year, funds districts rather than students, and limits students to full-time or half-time status. The following menu of reforms, among its other benefits, ultimately should lead to a more cost-effective instructional delivery system and reduce fiscal pressures on K-12 education agencies:[71]

- Funds should be distributed to schools based on multiple count dates rather than the current single October 1 enrollment count, using school membership rather than attendance;
- Dollars should be divided beyond full-time and part-time to reach the course level, using a tiered funding structure to differentiate costs based on course content;
- PPR and categorical funds should be combined and allotted to individual K-12 students, weighted according to need, and directed to their chosen school and/or courses; and
- At least 50 percent of funding should be withheld from providers until successful course completion, with bonuses contemplated for measurable excellent achievement.

Short-term savings to the state budget from a student-centered, course-level funding system cannot be easily calculated. But the greater flexibility and productivity achieved through enacting these student-centered school finance reforms inevitably should lead to lower costs.

Unlike the savings proposed through a tuition tax credit program, the State could not immediately realize the savings estimated from the proposals to repeal Amendment 23 and adapt funding for blended learning innovation. As previously explained, Amendment 23 constitutionally mandates minimum amounts for the School Finance Act—the core piece of K-12 funding. Any efficiencies achieved therefore would result in local agencies using the funds for other purposes. The State's total bill would be unchanged. The two proposals provide salient examples of how local schools and districts could achieve real, significant efficiencies with modest reductions in state funding for K-12 education.

4. **Colorado's local school boards retain the authority to dictate employee pay scales and policies.** Still, the General Assembly should consider using its prerogatives to impose an effective statewide cap on salary increases. A formal recognition that educators should not be compensated for earned master's degrees, which show no connection to improved student learning, is one crucial strategy. This observation could be due to the fact that about 90 percent of teacher master's degrees are awarded from schools of education.[72] An exception to the phase-out could be considered for master's degrees in subject content areas relevant to the teaching assignment. The **phased-out elimination of ineffective "master's bumps"** would remove as much as $229.2 million in ineffective spending per year.[73] If even half the dollars were reinvested into performance pay systems that aligned with student success, the State would still save **$114.6 million** otherwise backfilled into local K-12 budgets.

A formal recognition that educators should not be compensated for earned master's degrees, which show no connection to improved student learning, is one crucial strategy.

5. As indicated previously, Colorado spends about 3 percentage points less of its current expenditures on classroom instruction than the national average: 57.6 compared to 60.8 percent. The only spending category where Colorado is more out of line with national trends is in the area of other support services, defined by the U.S. Department of Education as follows:

> Expenditures for business support services (activities concerned with the fiscal operation of the [Local Education Agency]), central support services (activities, other than general administration, which support each of the other instructional and support services programs, including planning, research, development, evaluation, information, and data processing services), and other support services expenditures not reported elsewhere.[74]

In 2008-09, Colorado spent 7.1 percent of its current operating budget, or roughly $625 per student, on "other support services"—as compared with 3.2 percent, or $343 per student, nationwide. Only the District of Columbia spends more dollars per pupil on this category than Colorado does.[75] **Colorado spends 81 percent more on "other support services" than the average state.** This disparity is due in part to Colorado's inclusion of certain purchased service expenditures in the category that some other states may leave out.[76] Even after factoring out these questionable expenditures, Colorado would still rank 4th nationally in the share of dollars spent on "other support services" at 5.8 percent, or $509 per student, in 2008-09.

If the amount (not the rate) Colorado K-12 agencies spend on "other support services" were brought in line with the national average, significant cost savings would occur. Even after the questionable purchased service expenditures are factored out, to bring Colorado's $509 spent per student on "other support services" in line with the $343 per student national average would yield a savings of $136 million. Under such a scenario, Colorado still rank in the top 10 nationally in the share of current expenditures used for "planning, research, development, evaluation, information, and data processing services."[77]

If the amount (not the rate) Colorado K-12 agencies spend on "other support services" were brought in line with the national average, significant cost savings would occur.

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Acknowledgments

Ben DeGrow was the primary author of this chapter. See his biographical material in the major authors section.

A Modest Proposal for the Citizen's Budget

In 1729, famous author Jonathan Swift used satire to make a point. His outrageous idea was presented in straightforward manner; all the more to make the underlying point of *A Modest Proposal*.[1] In a similar vein, we offer here the same idea: Keep traveling the same public policy path and avoid the reforms suggested in the Citizen's Budget. After all, most Colorado legislators are good at that. The Independence Institute put forth dozens of ideas in 2010. Some nine of them were offered by legislators in 2011; none made it all the way through the system. We strongly suggest legislators just keep on ignoring these simple reforms.[2]

1. Take a deep breath and repeat "Senate Bill 1[3] resolved the PERA problem. Everything will work out just fine, now." Ignore the $25 billion unfunded liability, including the $1 billion unfunded liability for public pension health care benefits. Once it becomes clear that annual employee and employer contributions need to go up, we can deal with it then. In the absence of reform, however, we could just start today paying down those debts, like paying a mortgage. (First, recognize only 6.5 percent internal rate of return.) Over the next 30 years, each taxpaying family can solve the problem by writing another $1,233 every year to PERA.[4] Please send your first check right away.

Take a deep breath and repeat "Senate Bill 1 resolved the PERA problem. Everything will work out just fine, now."

2. Leadership during a past General Assembly led the charge to establish a health insurance exchange that is estimated to cost at least $30 million a year to operate. In states that declined to participate, the federal government will run the exchange at no cost to the state, and unless the law is changed, employers may be exempt from the $2,000 per employee ObamaCare tax. Uh-oh. We already took the bait.

   Let's subsidize 160,000[5] more Colorado residents on Medicaid for an annual increase in taxes to cover the increased costs of $68 million. At least the federal government is certain to pick up the other $610 million that the new health care program will cost. Rest assured. We forget to mention there will be few new health care providers when this all starts in two years. But really, who minds waiting hours more each time you need to see a physician? If Medicaid is so great for people with low incomes, why doesn't the state clone the program and forcibly enroll state employees in it?

If Medicaid is so great for people with low incomes, why doesn't the state clone the program and forcibly enroll state employees in it?

3. Do not resist the funding problems when the *Lobato vs. State of Colorado* lawsuit is ruled for the plaintiffs. The lawsuit already has worked its way to the Supreme Court once to determine the judicial branch could decide how much to fund K-12 education. Plaintiffs are asking for as much as another $4.5 billion per year, and the trial judge already found for the plaintiffs. Only the pesky appeals process stands in the way of really damaging the promised nirvana. Tell taxpayers they must either raise sales taxes from 2.9 percent to 9.1 percent, or raise the individual income state tax rate from 4.63 percent to 8.8 percent.

4. Colorado is the only state with its own Social Security program. Laid out in the constitution, its upper spending limit is 20 times what the program currently costs. See then, how much higher it could go! All any qualifying person 60

years old or older needs to do is to declare state residency so he never has to contribute one red cent. Colorado could attract more poor elderly people dependent on the government by raising the monthly free pension from $699 to $725 and adding a new dental benefit. Oh, wait. The legislature already did this in 2012.[6]

5. A long-held rule-of-thumb was that college students were to be subsidized two-thirds by taxpayers and the colleges, while tuition was only one-third the cost. Institutions of higher education look longingly at the free money that represented, when 21.1 percent of the State's general fund budget went towards those subsidies. They complain it is only 6.4 percent today.[7] Now, legislators are conforming to Amendment 23's mandate for K-12 education, and for increased costs for public health care, public health insurance and welfare programs. Something has to give. Think of government's needs first and forget about taxpayers. They're flush and don't need the money. Raise taxes by $540 per year for every family to return higher education to its historic level, including those people able to pay the full ride. Ignore calls for reform in productivity, governance, or for instituting means-based stipends. Prevent any improvements and gains from managed competition in service delivery.

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6. The people were asked to volunteer to pay more on their heating and electricity bills in order to fund solar and wind energy. That was going too slowly for residents worried that not enough families were cheerfully paying more for energy. Rather, families wasted their income on food, transportation, housing and even entertainment! Full conversion lagged. In 2004, the majority of voters approved a constitutional amendment forcing ratepayers served by Investor Owned Utilities (IOU) to purchase 10 percent of their electricity for homes and businesses from sources besides coal and natural gas. The ballot measure promised that the monthly cost would not exceed 50 cents. Seeing that coercion moved the needle faster than allowing people to make their own choices, the legislature has mandated the new goal to be 30 percent no later than 2020. In 2012 alone, this mandate cost Xcel Energy ratepayers more than $343 million, or $245 per ratepayer in just one year. It's not a tax, not in the strict dictionary sense of the word. No reform is needed to drive the annual cost up by 13 percent per family over what it would have been in the absence of a mandate.

Seeing that coercion moved the needle faster than allowing people to make their own choices, the legislature has mandated the new goal to be 30 percent no later than 2020.

Altogether, in order to avoid reforms as suggested by the Citizen's Budget in 2010 and this current edition, *A Citizen's Budget for 2013*, taxes need to go up $3,787 per year per family. The big mistake we are making, however, is that this calculation is incomplete. Economists call it *static* analysis. This lazy way of thinking assumes that people just pay up. A better and more complete way to look at it would incorporate *dynamic* analysis to anticipate what might happen as people respond. It will slow the economy and "at the margin," lead entrepreneurs and workers to move away or to stay away. At higher tax rates, investments will become less profitable, and some will not be made as a consequence. How much higher would it really become?

This is only the start of all kinds of potential new spending and the pressure to raise taxes. We can think of much more, and will certainly be asked for new programs on lots more corporate welfare and other fantastic ideas to turn Colorado into another Illinois, or California, or New York. Denver can emulate Detroit, or St. Louis or Stockton, California. Imagine the changes looming ahead and how you can be led to visit your children and grandchildren in their new homes where they can escape the changes—in states that give people hope and opportunity, like Texas or Wyoming or Utah. Rah!

Endnotes

1. A Modest Proposal for Preventing the Children of Poor People From Being a Burden on Their Parents or Country, and for Making Them Beneficial to the Publick.
2. Oh yes, let's address those quibblers and humorless folk who protest that the tax and spending increases might be off hundreds of dollars per year. How is anyone going to come up with a dependable total? The estimate discloses more than it hides in this case, however. A Modest Proposal leads us to ask just how bad it might get. Take these totals as back-of-the-envelope calculations to see that truth can be discovered all the while tongue is planted firmly in cheek.
3. Senate Bill 2010-1, "Concerning Modifications to the Public Employees' Retirement Association Necessary to Reach a One Hundred Percent Funded Ratio Within the Next Thirty Years" by Brandon Schaffer (D-Longmont) and Josh Penry (R-Grand Junction).
4. Robert Novy-Marx and Joshua D. Rauh, "The Revenue Demands of Public Employee Pension Promises, September 2012. Novy-Marx is at the University of Rochester and National Bureau of Economic Research (NBER) and Rauh is at the Stanford Graduate School of Business, Hoover Institution, and NBER.
5. House Minority Leader Mark Waller during a legislative forum sponsored by the Centennial Institute, January 21, 2013.
6. House Bill 1326, "Concerning Assistance to the Elderly," sponsored by Cindy Acree (R - Aurora)
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Colorado Department of Human Services

Overview

The material describes the scope and size of the Department responsible for welfare programs. It is the first time this chapter has appeared in a Citizen's Budget.

U.S. taxpayers spent more than $927 billion on welfare programs in 2011.[1] The Heritage Foundation compiled national spending data to show how total expenditures have risen during the past 60 years. The trend shows no likelihood of abating its upward course. In fact, the recent recession and ensuing economic weakness have increased the rate of growth.

Today, over 80 different social programs provide assistance from medical care and childcare, to food and nutrition, housing, and cash.[2]

The federal government is not the only entity to supply welfare funding, and it does not directly administer the majority of program operations. State and local governments not only spend their own funds, but these governments also deliver federal spending on welfare programs and public assistance to citizens. The federal government determines the amount of aid sent to each state based on each state's population and the extent of its own spending on public assistance.

Talk of cuts to social services spending ignites propaganda of cutting off food for the hungry, eliminating shelter funding for homeless children, or turning off heat and electricity to the elderly in the cold winter months. However, these fears are unwarranted. Even the federal Government Accountability Office (GAO) testified to Congress several times in the last two years about the high and escalating costs of fraud, inefficiency, ineffectiveness, and duplication found in Temporary Aid for Needy Families (TANF) and Foster programs.[3] Improving the efficiency of the administration of state welfare agencies will help make the safety net function better.

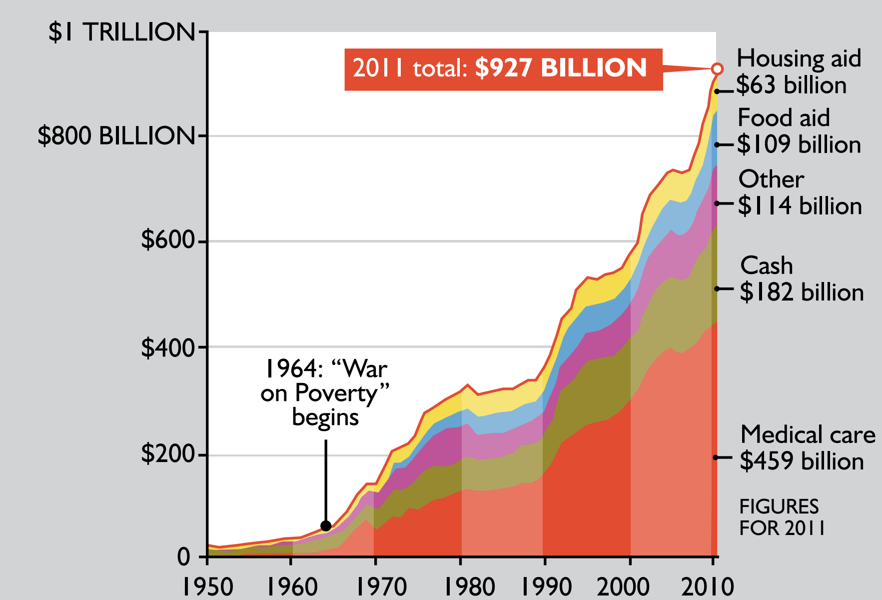
Colorado

The Colorado Department of Human Services (CDHS) was established to provide welfare assistance to families, the elderly,

Welfare Spending Reaches Nearly $1 Trillion a Year

In 2011, the total cost of federal and state means-tested welfare programs was $927 billion, an all-time high. That includes over 80 federal programs but does not include spending on Social Security or Medicare. The amount is 16 times higher than it was in 1964 when the government began the "War on Poverty."

TOTAL WELFARE SPENDING, IN 2011 INFLATION-ADJUSTED DOLLARS



Source: Heritage Foundation research

individual citizens requiring short-term or emergency assistance for necessities, and underprivileged children. Welfare spending in Colorado through the CDHS exceeds $2 billion in 2012. The federal government transfers about $640 million into the CDHS budget, while Colorado taxpayers fund the remaining $1.4 billion through state and local taxes.[4]

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CDHS operates 11 different divisions; six divisions deliver services, while five are administrative. The State's role is to budget, design and oversee welfare distribution, but county governments conduct program operations. For example, a Colorado Springs family applying for welfare goes to an office run by El Paso County. They do not visit a state agency to go through the process.

A few states have met with success in adopting strategies to simplify the processes. It is critical both to the population served by government programs and to the program budgets that Colorado finds a way to generally overhaul the "fragmentation and overlap among government programs or activities as these can be harbingers of unnecessary duplication."[5]

Analysis of portions of the CDHS budget suggests further investigation for reform in two important programs:

1. In 2012, TANF remains as a shadow of the original, more robust program designed to lend government assistance to Americans in need of a temporary helping hand, assisting them to be self-sufficient again as quickly as possible. CDHS must direct its agency, Colorado Works, to return TANF standards to those put in place 15 years ago.
2. Since 2007, Colorado's Foster Care Program has failed to meet national standards for its adolescent population.

TANF Detailed

The predecessor to the current welfare program was Aid to Families with Dependent Children (AFDC). It was established by the Social Security Act of 1935 as a grant program to enable states to provide cash welfare payments for needy children who had been deprived of parental support or care because their father or mother was absent from the home, incapacitated, deceased, or unemployed.[6] The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) replaced AFDC with the Temporary Aid for Needy Families, commonly called the TANF program, originally designed as a cash welfare block grant. The program includes a five-year lifetime limit on assistance that a family with an adult can receive, and requires increasing work participation.[7]

TANF provided government support for 12,552 Colorado families in 2011.[8] Much of the funding supports the bureaucracy and does not go directly to the people in need of assistance. If the government had delivered funds directly to the applicants, then the average Colorado tax-financed value of TANF would have been $11,316 per family. Adding the value of federal tax-financed TANF funds used ($16,168 per family for such costs as transportation, prevention of out-of-wedlock births, childcare, and administration), the total value of TANF if paid directly to the participating families would top $27,483 a year.[9]

Much of the funding supports the bureaucracy and does not go directly to the people in need of assistance.

The Colorado budget calls for $298 million spending on TANF in fiscal year 2012-13, about 14.5 percent of the $2 billion CDHS budget. Colorado's general funds pay for $34.7 million of the TANF bill,[10] from line items under the Office of Self Sufficiency, program administration employs about 10 percent of CDHS personnel. However, these figures do not represent a full accounting of TANF expenses. Under the budget heading *County Administration*, costs that directly support the county offices will top $38 million in FY 2012-13. The county locations, where intake specialists interview potential recipients and customer service employees distribute benefits, incur direct TANF costs to Colorado's taxpayers, which should count as such.

In addition, the reporting system excludes indirect overhead costs. About $50 million in salaries and $125 million in general overhead costs are budgeted for the Executive Director's Office, the Office of Information Technology Services, and the Office of Operations, which together employ more than 550 full-time employees. The correct overhead proportion should be included in the costs for our state government to run the TANF program. A quick analysis suggests that the $34.7 million listed as direct costs to the taxpayer for TANF is higher—between $44 and $59 million.[11]

An accurate accounting of the direct and indirect costs attributed to running all CDHS programs, including TANF, should be a standard practice. Absent this information, policymakers and citizens are acting—and voting—blindly. Legislators must require transparency at all levels of reporting. A full and accurate accounting of attributed overhead and county-level costs to each program's budget is essential for informed policymaking.

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Colorado implemented TANF in 1997 when the state's population was 3.97 million. By 2011, more than 5.12 million call Colorado home, an increase of 29 percent.[12] Both the number of people qualifying for TANF and spending has grown faster than population.[13] Part of the increase in demand for services since 2008 must be attributed to the recession, when a large number of people applied to be covered. As part of the American Recovery and Reinvestment Act of 2009 (also known as the "stimulus"), Congress created the TANF Emergency Fund to provide states an additional $5 billion in temporary emergency cash relief to the states.[14] In 2008, federal TANF funds awarded to the states totaled $5.8 billion for cash, childcare, transportation, and emergency funds. That amount represented 40 percent of the total available for temporary assistance of $14.47 billion in 2008.[15] Colorado's two-year share of the stimulus funds was $68 million.[16]

Along with the funding increase, the federal government relaxed eligibility rules, which greatly increased the number of families who received benefits. Changes in work requirements over the past decade also have allowed participants to maintain eligibility for TANF while not bettering their current or future employment prospects. More than 32,100 Coloradans received TANF benefits in 2011.[17] The increased population receiving TANF funds compelled CDHS' agency, Colorado Works, to distribute the total lower assistance to a larger pool of eligible citizens. The result has been less aid available for the most vulnerable cohort that traditionally received funding.

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Changes to the TANF Work Rules

Research and policy experts from across the spectrum of political and social views generally agree that the 1996 Welfare Reform Act worked.[18] The reforms were based on ideals that hearken back to the nation's founding, when safety nets formed organically out of the community, charity, or church to provide for the indigent. Simple theories on self-sufficiency and liberty state that governments and able-bodied persons ought to conform to the following guidelines:

1. bear their own weight,
2. not spend more than they earn,
3. be responsible for their actions and inactions,
4. be held accountable to the consequences of the same, and
5. act or be represented fairly in matters of taxation for local and national security, and for provisions to those less able.

Scholars writing for the American Psychological Association (APA) observe:

> *In "Making 'Welfare to work' really work careful review of hundreds of successful community interventions reveals that although underfunded, expedient, shallow programs almost always fail, intensive, creative, highly flexible, well-funded programs led by energetic visionaries succeed beyond anyone's dreams (Schorr & Schorr, 1988). For example, many community-based housing programs, often without federal assistance, such as Habitat for Humanity, combine volunteers, private funding, and work by residents to build and rehabilitate housing.*[19]

According to the Colorado State Plan for TANF, "All work eligible individuals are required to participate in a state or county defined work activity except those with a domestic violence waiver or those single parents with a child under age six for whom childcare is unavailable. Single custodial parents with a child under age one is not exempt unless specified by county policy."[20] However, HHS loosened the rules in a July 12, 2012 memorandum. A state is authorized to "test approaches and methods other than those set forth … , including definitions of work activities and engagement, specified limitations, verification procedures, and the calculation of participation rates."[21]

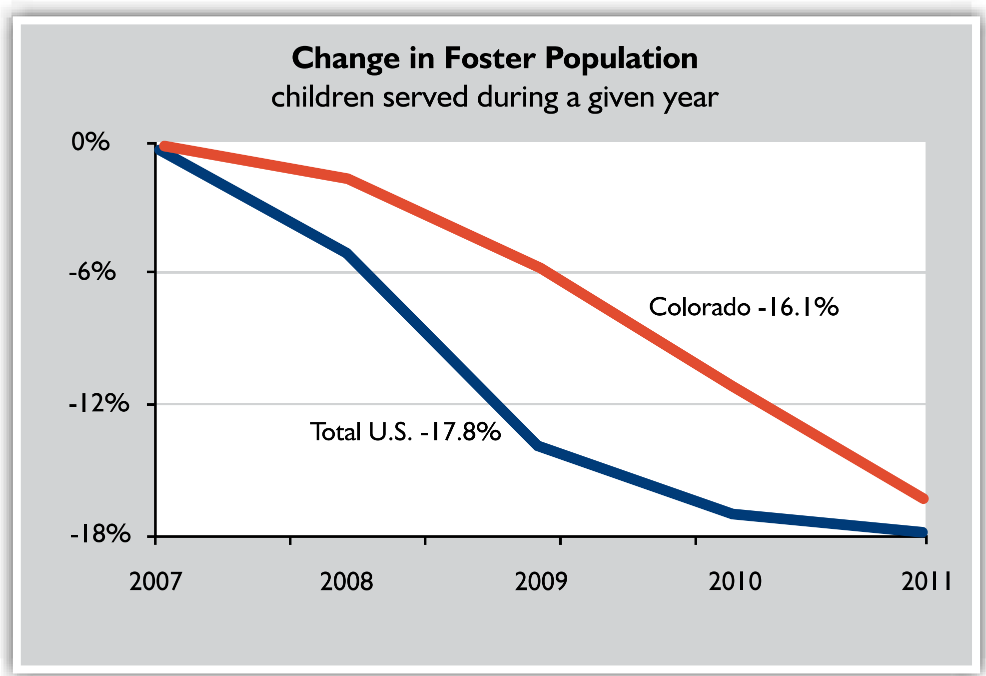
The policy change was controversial. Many people were concerned that such modification would move welfare policy to pre-Clinton reform measures, which had been perceived as failures. Heritage Foundation's Robert Rector observed: "Gutting TANF's work requirements also means that only two of the nation's 80-plus welfare programs will require able-bodied recipients to work or prepare for work as a condition of receiving aid … ."[22] Elsewhere he notes, "At present, half of the work-eligible TANF recipients receive checks while doing nothing."[23]

Foster Care System

Colorado's fiscal year 2012-13 budget for the Division of Child Welfare is $402 million from all sources. Of that total, the Foster Care programs spend $203 million, just over half, from the general fund.[24] The Executive Director of Jefferson County's Human Services, Lynn Johnson, described foster care services as a way to help "provide safe and stable out-of-home care for children until the children are safely returned home, placed permanently with adoptive families, or placed in other planned arrangements for permanency."[25]

The Foster Care program is broken into three functional areas. First, Core Services administers the Child Protection Response system that provides functions such as temporary and emergency foster care, foster family placements until adoptions are final, services to help keep families together, and services to facilitate reunification when possible.

Out of Home placement operates adolescent group homes and provides mental health and substance abuse treatment facilities. Out of Home placements are more expensive relative to traditional foster care, but necessary for some at-risk or delinquent youth who require special services. According to Johnson, the current general fund budget for these two programs adds up to over $220 million. Another $38 million funds community-based services for adolescents in foster care who are at risk for out of home placement, often as the result of a delinquent act. The Division spends the balance of the budget on administration and support, specifically for employee training; foster family recruitment, training and support; adoptive parent recruitment and post placement programs and services.



The trends nationally and in Colorado are toward fewer foster placements. Foster placements in the U.S. are the lowest they have been for the last two decades at 5.4 placements per 1,000 children after a high of 8.1 in 1999.[26] Colorado placed 4.3 children per 1,000 in 2011.[27] Since 2007, 17.8 percent fewer children have needed foster care nationally. Similarly, 16.1 percent (or 2,062) fewer Colorado children have needed foster care services.[28]

The most recent data indicate that the average time between the termination of parental rights and adoption in Colorado is 15.9 months, slower than the national average of 13.6 months, placing Colorado in 38th.

However, Colorado still lags behind the nation on several important benchmarks. The most recent data indicate that the average time between the termination of parental rights and adoption in Colorado is 15.9 months, slower than the national average of 13.6 months, placing Colorado in 38th.[29] Seven states average fewer than eight months in the foster system. On average, children spend 39.6 months in Colorado's foster system, versus the national average of 23.9 months—an additional year and four months.[30]

Acknowledgments

Tamara Hannaway was the author of this section. She is an Associate Professor of Economics and Policy at Colorado Christian University and the head of the Economics program within the School of Business and Leadership. She also teaches in the graduate program at CU Denver's School of Public Affairs. Her corporate career spanned over 19 years in sales, management, and forecasting for three Fortune 1000 companies. She has been a professor for 10 years. She earned her Ph.D. in Public Affairs from the University of Colorado Denver's School of Public Administration, where her research focused on the effects of governance corruption on public budgets and income inequality. Dr. Hannaway maintains several small businesses and consults on increasing businesses efficiencies, and as economic advisor.

We appreciate the observations and comments on the chapter by **Peter deLeon**. He is a retired professor from the School of Public Affairs at the University of Colorado at Denver. His earlier career included positions as senior policy analyst for both The RAND Corporation and the National Renewable Energy Laboratories. He taught at Columbia University in New York City until 1986.

Don Klingner also reviewed the chapter for accuracy and interpretation. He is a Distinguished Professor in the School of Public Affairs at the University of Colorado at Colorado Springs. He is an elected Fellow of the National Academy of Public Administration and was President of the American Society for Public Administration. He was a Fulbright Senior Scholar in Central America, a visiting professor at UNAM, Mexico, and a consultant to the United Nations, the World Bank, and the Interamerican Development Bank on public management capacity building. His prior faculty appointments were a IUPUI and Florida International University. He worked for the US Civil Service Commission. He earned a PhD in Public Administration from the University of Southern California.

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11 Ibid.; House Bill 12-1335. The Office of Self Sufficiency employs over 10 percent of the total CDHS staff, and TANF represents over 14.5 percent of the CDHS budget. We did not locate a TANF report of total administrative costs. If we distribute fairly the $108 million in overhead over the CDHS programs, we derive a reasonable estimate that additional TANF costs from the General and Cash funds is between $10 and $15 million, for a total between $44 million and $59 million for fiscal year 2012.

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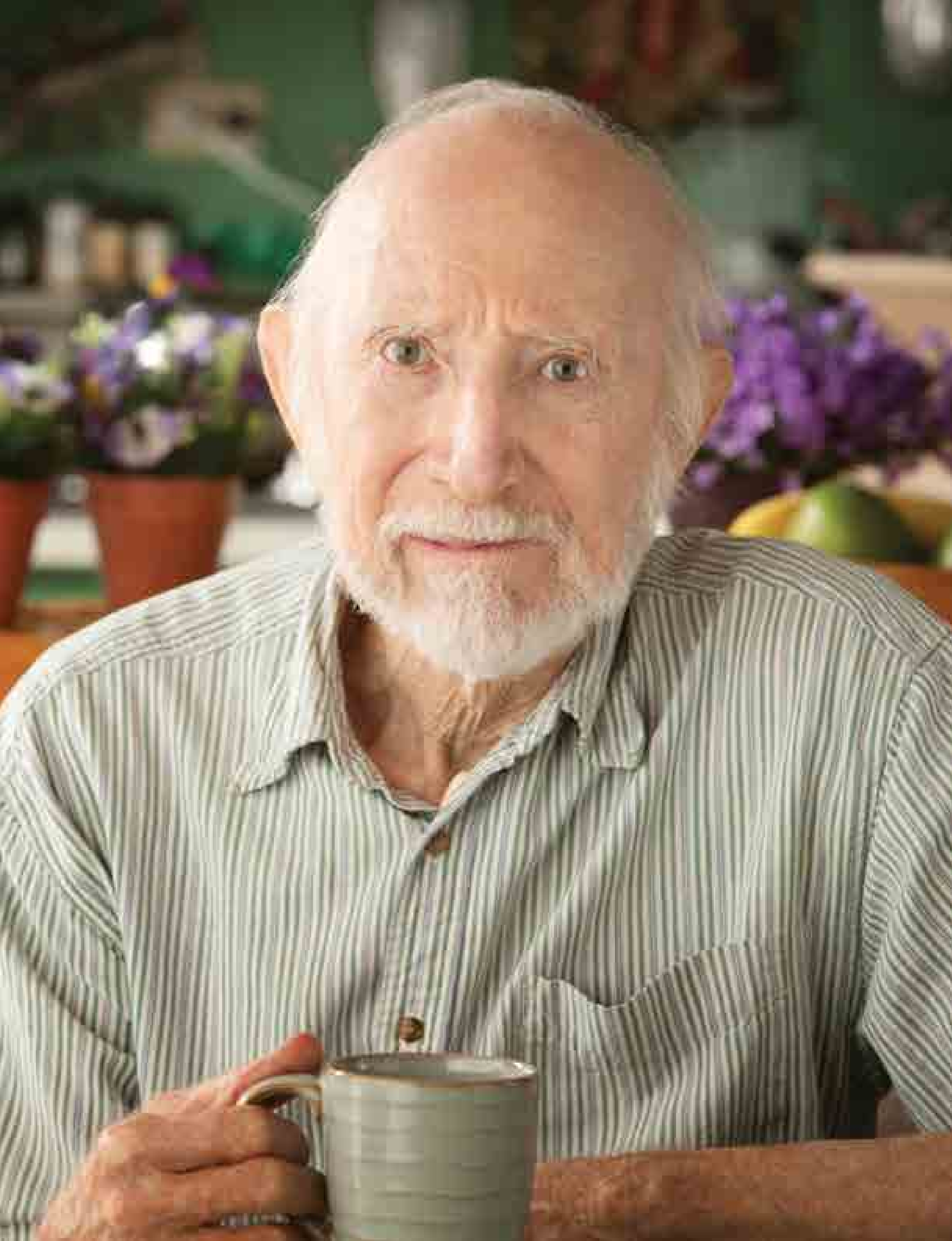
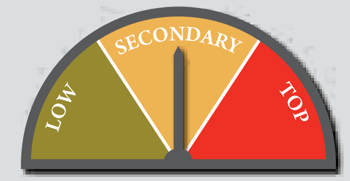


Old Age Pension Plan

Priority



Overview

The material describes the how Colorado maintains its own Social Security program. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations

Put on the 2014 general election ballot a proposal to delete this program from the Colorado constitution.

Savings

Total Recommended Savings = $87.1 million

Citizens are rightly concerned about the future stability of the Social Security Administration in Washington. They know that the promised benefits are higher than the expected income from FICA taxes.

Even so, Colorado has maintained the Old Age Pension Plan since its inception in 1937. A recipient may qualify even if he or she has never paid any taxes in Colorado. From the sales taxes collected for the State, the Colorado Constitution requires that 85 percent be diverted to this program. Only after the program is fully funded may the rest of the diverted funds be returned to the General Fund. The funding is automatic and off-budget, as far as the legislature's ability to adjust either the flow of funding or the amount spent each year. The total cost of the program in fiscal year 2012-13 is expected to be $87.1 million .[1] The program is an entitlement, so that anyone who qualifies may obtain the distribution. Funds are continually appropriated based on program demands and not budgeted by the legislature.

Colorado has maintained the Old Age Pension Plan since its inception in 1937. A recipient may qualify even if he or she has never paid any taxes in Colorado.

Back in the depths of the Great Depression, 38 states (of the then-48 states) operated old-age assistance plans, and Colorado's was the most generous.[2] The pension plan was passed in the 1936 general election as Article XXIV of the State constitution. The structure was modified in the 1956 general election to its current status. With the establishment and expansion of the federal Social Security System, most other states quickly dropped their programs. Colorado today is the only state with its own old age pension plan.[3]

To qualify, one must be a resident of Colorado over age 60 and meet the need-based standard for eligibility. On the first day a person declares himself a Colorado resident, he becomes eligible to receive a free pension from taxpayers. A requirement that the beneficiary needed to reside in Colorado for 35 years was overturned by the Colorado Supreme Court in 1979.[4] A person does not even need to be a U.S. citizen.[5] A legal immigrant may receive these benefits, as long as the sponsor rules have been met.[6] The Old Age Pension provides financial benefits up to $725 per month to nearly 23,000 beneficiaries.[7] The amount was raised just this past year and a new dental care benefit added.[8]

To qualify, one must be a resident of Colorado over age 60 and meet the need-based standard for eligibility. On the first day a person declares himself a Colorado resident, he becomes eligible to receive a free pension from taxpayers.

Many forms of income—such as wages, social security benefits, disability benefits, pension, or Veteran's Assistance—can reduce the amount paid by the Old Age Pension. Some applicants are required to apply for federal Supplemental Security Income benefits as a condition of receiving the Old Age Pension and the SSI benefits reduce the amount of the Old Age Pension. However, owning a residence does not disqualify a Colorado resident from receiving the pension and there is no limit to the size and value of that property. The presence of relatives who may be able to contribute to the pensioner's upkeep is no condition for disqualification by law. Beneficiaries never need to pay back the moneys, even if they come into an extraordinary amount of new income or assets.

Plenty of existing state and federally funded programs assist the elderly with their living expenses, including energy rebates, Meals on Wheels, Medicaid and Medicare. Colorado allows income tax filers to shelter a portion of pension earnings from the state income tax. In strong revenue years for the State, many elderly residents do not pay property taxes on the first $200,000 of their homes' values. The Old Age Pension Plan is the only program to offer direct income assistance through stipend payments.

There are a host of other funded assistance programs for the elderly. The Old Age Pension is a redundancy and an anachronism.

The Plan is even more generous than Social Security in the sense that, unlike the federal program, beneficiaries do not need to show they have ever earned income, lived in the state before applying for benefits, nor ever paid any taxes of any nature to Colorado.

There are a host of other funded assistance programs for the elderly. The Old Age Pension is a redundancy and an anachronism. To repeal the Old Age Pension Plan would take a vote of the people, and one that could not be scheduled before the next general election in 2014. If it were to pass, some modest transition time would likely be built into the measure, so the reduction in spending would likely impact the 2014-15 budget year.

Acknowledgements

Penn R. Pfiffner was the primary author the original edition of this section. See his biographical material in the Authors section.

Endnotes

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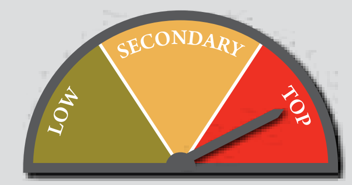
7 Bickel, ibid.

8 House Bill 1326, "Concerning Assistance to the Elderly," sponsored by Rep. Cindy Acree (R - Aurora).

Retirement Health Plan

Priority



Original Article

This chapter is a condensed and updated version of the 2010 publication. For the fully developed work, see http://tax.i2i.org/files/2010/11/CB_PERA.pdf.

Overview

The material describes the magnitude of the overpromise for public pensions' additional benefit that pays for retirement health insurance, and makes recommendations. It is the second time this chapter has appeared in a Citizen's Budget.

Legislation Offered

House Bill12-1250 PERA Health Care Trust Fund Employer Contributions. Prime sponsor was Chris Holbert. http://www.leg.state.co.us/clics/clics2012a/csl.nsf/fsbillcont/79E8367F60F0989887257981007F345B?Open&file=1250_01.pdf.

Recommendations/Savings

Recommendation	Savings
• Revise defined benefit to defined contribution for health care benefits	$10 million
• Eliminate health care benefits to retirees who are already Medicare-eligible	

Savings

- Total Recommended Savings = $10 million
- Avoids = $1 billion in unfunded liabilities
- Additional Savings to Other Government Employers = $42 million

The Colorado Public Employees' Retirement Association (PERA) administers a retiree health plan. The PERA Health Care Program is a cost sharing multiple-employer plan. The "employers" in this context are the various governments that hire most public employees, such as public school teachers, fire fighters, police officers and state employees. Under this program, PERA subsidizes a portion of the premium for health care coverage, and the retiree pays any remaining amount of that premium.

The State government continues to promise public employees that the retiree health care benefit will be part of their total remuneration. As the predicted shortfall in funding for the retiree health plan materializes, taxpayers will be on the hook to make up the funding deficiency.

More than $1 billion in unfunded liabilities have been incurred in the PERA retiree health plan. Prospects are for continued volatility and deterioration in the funding status of PERA's retiree health plan.

More than $1 billion in unfunded liabilities have been incurred in the PERA retiree health plan.

Colorado should replace PERA's retiree health plan with a defined contribution plan, similar to that enacted in Idaho. We estimate that in the short run this reform would reduce the employer annual required contribution to the plan from $72.6 million to $29.0 million. In addition, the annual subsidy from the State to the PERA Trust Fund would be reduced from $24.6 million to $14.5 million, a savings of $10.1 million per year. More importantly, this reform would reduce the accrued actuarial liabilities in the plan, and enable the state to pay off the $1 billion in unfunded liabilities over a 30-year period.

The Budgetary Impact of a Defined Contribution Retiree Health Plan

With the defined contribution retiree health plan in place, the state contribution to the plan could also be significantly reduced. Currently the state contributes 1.02 percent of gross covered wages to the Health Care Trust. In fiscal year 2008-09 the state contributed $24.6 million to the plan. The State's savings rise if it shares proportionately with employers, thereby achieving the 59 percent reduction.

More important than the immediate budgetary impact is the long-run savings that would result from the proposed defined contribution retiree health plan. It is difficult to estimate long term savings because of the dynamic response of employees and employers to the new incentives created by this reform. For example, when employees assume responsibility for costs we expect them to purchase less costly health insurance plans.

The proposed reform would significantly reduce the long-term cost of the retiree health plan to the government. The savings estimate above would be captured over the actuarial life of the plan. Note the dramatic reduction in actuarial accrued liabilities in the Idaho plan following a similar reform. We would expect a similar reduction in actuarial accrued liabilities in the proposed defined contribution retiree health proposed for Colorado. Most important, Colorado would be able to pay of these liabilities over the 30 year amortization period required by investment standards. Colorado could eliminate $1 billion in actuarial accrued liabilities in the current retiree health plan.

The proposed reform would significantly reduce the long-term cost of the retiree health plan to the government.

When the section was originally written in 2010, the retiree health plan was not meeting rules that must be followed, as laid down the Government Accounting Standard Board (GASB). The GASB guidelines require that employers amortize unfunded liabilities in the plan over a 30-year actuarial time period. The estimated amortization for the Colorado plan was 39 years. There is no reason to believe that this problem has significantly improved.

The $1 billion in unfunded liabilities in the Health Care Trust Fund would not appear to be a crisis if there was some prospect that the liabilities could be paid off within 30 years to meet GASB standards. Unfortunately, there are a number of reasons why the funding status in the plan is likely to deteriorate for the foreseeable future.

There is a fatal flaw in PERA's administration of the Health Care Trust Fund, as well as its administration of pension funds. The flaw is to assume an 8.0 percent rate of return on assets in these plans. The actual rate of return on assets in these plans has been zero or negative over the past decade. The best economic analysis of public sector pension and health plans, such as PERA, suggests that a more realistic rate of return on assets that is about half or less than that assumed by PERA.[1]

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The Case for a Defined Contribution Retiree Health Plan

The basic principle of a defined contribution *health* plan is similar to that for a defined contribution *pension* plan. Instead of a promise to cover all or most of the cost of health insurance, the state contracts to make a contribution toward that cost. The contribution may take different forms. Most often it is a contract to pay a dollar amount toward the health care premium. That dollar amount may be specified in absolute dollars, or relative to the years of service. In some cases the dollar amount is linked to funds the employee has accumulated in sick leave, disability or other accounts. In other cases the promise is made as a percentage of health insurance premiums paid by the government.

Most private sector employers have now either eliminated defined benefit retiree health plans, or replaced them with defined contribution plans.[2] While most state and local governments have not eliminated health plans for their retirees, they have enacted a number of reforms to reduce

the cost of those plans, including replacing defined benefit plans with defined contribution plans.

Abstracting from the complex health insurance plans offered to retirees, we can identify plans in which the employer contracts to cover most of the cost of the health insurance premium as defined-benefit plans. In a defined-benefit plan the state is exposed to the risk of high and volatile levels of health care costs. This exposure makes it difficult for the state to project the unfunded liabilities that will be incurred by the plans, and to fund those liabilities.

In a defined-benefit plan the state is exposed to the risk of high and volatile levels of health care costs. This exposure makes it difficult for the state to project the unfunded liabilities that will be incurred by the plans, and to fund those liabilities.

There are several flaws in the design of defined benefit plans in the public sector. One flaw is assumptions regarding health care costs. These government plans continue to assume a rate of inflation in the cost of health service far below the actual rate of inflation. Health care costs have been increasing at double-digit rates in recent years, and there is no reason to assume they will increase less rapidly in future years. This forecast is especially true with the new federal health legislation that will significantly increase demand for health care services, while restricting the supply.

The fatal flaw in defined benefit retiree health plans in the public sector is moral hazard. **Politicians have promised retiree health benefits they can't pay for.** They offer public sector retirees generous health benefits as an alternative to better compensation because the cost of retiree health benefits is deferred to future generations. Public sector employee unions encourage this activity because it is less likely to generate taxpayer resistance than higher salary compensation, which must be funded from current revenue. Only with the transparency created by GASB rules are taxpayers honestly informed of the magnitude of unfunded liabilities accumulating in these plans. It is increasingly clear that defined benefit retiree health plans in many states are not sustainable in the long run.[3]

Learning from Idaho's experience

Among the most successful public sector retiree health benefit reforms is that enacted in Idaho. In 2009 the Idaho legislature faced unfunded liabilities of $353 million, with skyrocketing numbers forecast for out-years. Like many states, Idaho was not meeting the promises made to retirees in their health plan.

Faced with revenue and budgets problems much like Colorado, Idaho enacted a successful reform. With about one-fifth the population of Colorado, it shed over $300 million in unfunded liabilities and reduced the annual cost to the State.

To follow the Idaho plan, **Colorado would replace the current retiree health plan with a defined contribution plan.** It would reduce the dollar amount that employers are required to contribute to the retiree health plan. Currently, PERA subsidizes a portion of the monthly premium for health insurance. The subsidy is $230 per month for benefit recipients who are under the age of 65 and who are not eligible for Medicare. Setting the **maximum amount of that subsidy per benefit recipient at $155 per month** would reduce the cost of that health insurance to employers by almost half.[4]

To follow the Idaho plan, Colorado would replace the current retiree health plan with a defined contribution plan.

Colorado also must restrict eligibility. Currently, retirees who are eligible for Medicare are also covered by PERA's retiree health plan. The subsidy is $115 per month for Medicare-eligible retirees. **Limiting eligibility in the defined contribution plan to retirees under the age of 65 who are not eligible for Medicare would eliminate this cost to employers.**[5]

Acknowledgements

Barry W. Poulson, Ph.D. was primarily responsible for the content of this chapter. Dr. Poulson is retired Professor of Economics at the University of Colorado. He has been a Visiting Professor at universities in Mexico, United Kingdom, Japan and Spain.

He is the author of numerous books and articles in the fields of economic development and economic history. His current research focuses on fiscal policies and fiscal constitutions. Professor Poulson is currently Americans for Prosperity Foundation's Distinguished Scholar. His studies and articles for AFPF include research and analysis of the Taxpayer's Bill of Rights.

He has served on the Colorado Tax Commission and as Vice Chair of the State Treasurer's Advisory Group on Constitutional Amendments in Colorado. Professor Poulson is Past President of the North American Economics and Finance Association. He is an Adjunct Scholar of the Heritage Foundation, advises the Task Force on Tax and Fiscal Policy of the American Legislative Exchange Council and serves as a consultant on fiscal policy and fiscal constitutions to a number of state and national think tanks, including Colorado's Independence Institute.

Endnotes

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Higher Education

Original Article

The entire original chapter can be found at http://tax.i2i.org/files/2010/11/CB_HigherEd.pdf.

Overview

The chapter provides analysis and recommendations about state colleges and universities. It is the second time the topic has been addressed in a Citizen's Budget.

Savings

Total Recommended Savings = $50+ million

Recommendations/Savings

Recommendation	Savings
• Complete the transition to subsidies through stipends, ending the practice of the State paying fees directly to the institutions	
• Expand the stipend program to use at all private, accredited colleges and universities	
• Increase productivity of all faculty	$50+ million

Findings

We find that the College Opportunity Fund program should be retained because it forms an excellent base on which to build changes. It must be expanded and modified to conform to the real needs.

We find that the College Opportunity Fund program should be retained because it forms an excellent base on which to build changes.

After a review of how state colleges and universities are operated as independent government enterprises, we conclude that the situation should be extended and made permanent. We address what the real reform would entail and urge reform that does not involve changing ownership to a form of private holdings.

We urge that the institutions reform themselves by initiating audits regarding teaching productivity, and thereby lead the nation in reducing low-priority publication in favor of more direct instruction. We know that the standings of highly-rated institutions, dependent on research dollars, should not be called into question.

Discussion

As elected officials grapple with the determination of the best set of priorities for citizens, they must address a fundamental understanding about higher education. Is the system primarily for society's benefit? If so, then ever higher amounts of support will be justified and students should understand that completing their educations implies that they owe some return to the government. If on the other hand, furthering one's education is done primarily so that an individual can improve his understanding of the world and his professional production, then subsidy can be justified only for those for whom higher education is otherwise unattainable. The general justification for college subsidies is that successful pursuit of a degree can lift an individual out of perpetual poverty. Is higher education primarily for society's benefit, or for the individual's benefit?

The general justification for college subsidies is that successful pursuit of a degree can lift an individual out of perpetual poverty. Is higher education primarily for society's benefit, or for the individual's benefit?

Funding Adequacy

Critics argue that higher education is underfunded, especially in Colorado, and that the state should allocate more subsidies to higher education.[1] The argument that higher education is underfunded has been challenged in the economics literature. Barry Poulson explores this argument in 2010 Independence Institute publication "The Funding Crisis in Colorado's Higher Education System."[2]

Colorado's legislators have allowed colleges and universities to increase tuition to offset the budget cuts in periods of recession. In periods of growth legislators have provided more generous funding for higher education.

There have been efforts to raise taxes earmarked for higher education. In 2008, Initiative 119 would have earmarked severance tax revenues for higher education; but the initiative was withdrawn by the sponsor prior to hearing. Amendment 58, which also earmarked severance tax revenue for higher education, made it to the ballot box, but was rejected by the voters. Amendment 59 would have earmarked TABOR surplus revenue for higher education, and was also defeated at the ballot box. Voters passed a citizen initiative, Amendment 50, earmarking gaming tax revenue for community colleges. House Bill 09-1272 was passed to implement Amendment 50, allocates a modest amount of gaming revenues to the community college system.[3]

Solving a structural deficit requires fundamental reforms to stabilize higher education funding, and balance the state budget without federal handouts and federal unfunded mandates.

College Opportunity Fund: Already Begun

As the funding crisis in Colorado's higher education system emerged in the early part of this decade, elected officials began to search for alternative ways to fund higher education.[4] In 2004 the legislature enacted the College Opportunity Fund (COF). This Fund created a voucher system to replace some direct funding to public higher education institutions. The vouchers, referred to as stipends, were set at $2,400 per year per full-time student to be used to offset tuition. Vouchers were to be portable among Colorado's public higher education institutions and some private institutions.[5]

In 2004 the legislature enacted the College Opportunity Fund (COF). This Fund created a voucher system to replace some direct funding to public higher education institutions.

Block grants in the form of direct funding contracts for specific purposes were provided to each institution reflecting their different mission statements. These included graduate-level education, specialized education services, and professional degrees. Performance contracts are negotiated between the administrations in higher education institutions and the Department of Higher Education (DHE).[6]

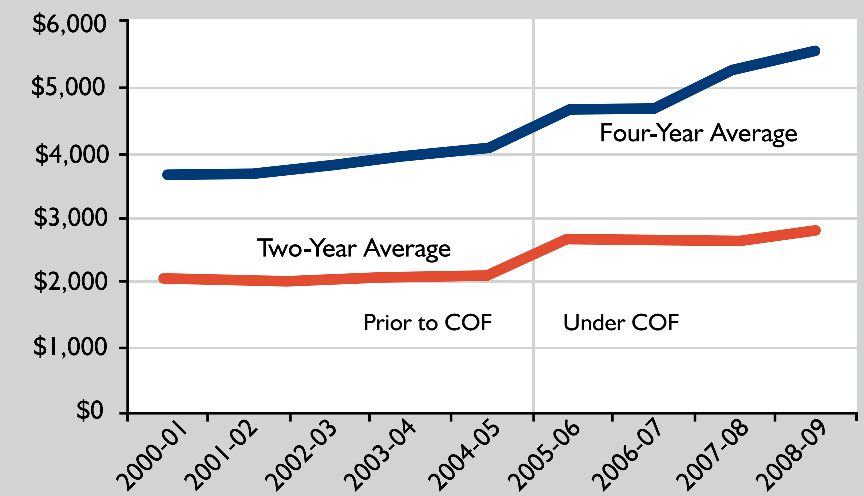
Because the vouchers replaced some direct funding to institutions of higher education, the share of state general funds allocated to some institutions fell below 10 percent of their total funding. This change allowed these institutions to acquire enterprise status, which made them exempt from the Taxpayer's Bill of Rights (TABOR) restrictions. Most importantly, these institutions could raise tuition without triggering the TABOR limit on state revenue and spending. Thus, higher education institutions could raise tuition without requiring cuts in other state programs. The institutions with enterprise status also had greater flexibility in issuing debt. The *quid pro quo* of enterprise status is what motivated administrators in higher education to support the COF plan.

This change allowed these institutions to acquire enterprise status, which made them exempt from the Taxpayer's Bill of Rights (TABOR) restrictions. Most importantly, these institutions could raise tuition without triggering the TABOR limit on state revenue and spending.

The COF legislation included specific language that vouchers were designed to make college more affordable to low-income students. In this regard COF has not fulfilled expectations. In the same year that COF became effective, 2005-06, institutions raised tuition significantly. Average tuition for full-time students, after deducting the value of the COF voucher, increased $507 (23.5 percent) at community colleges, and $545 (13.3 percent) at four-year institutions. **Much of the benefit of COF has been captured by institutions rather than students.**[7] Across the nation, public subsidies to higher education have increased very rapidly in recent years; and, recent research suggests that much of this public subsidy has been captured by professors, administrators, and other stakeholders in higher education.[8] There has been a virtual explosion of recent studies critical of the rising cost and diminished quality of public higher education.[9]

With few exceptions, financial aid has not kept pace with published tuition in most states, including Colorado. As a result, net tuition has been increasing more rapidly than published tuition.

Figure 1. Average Published Tuition & Fees at COF-Eligible Public Institutions by Sector, 2000-01 to 2008-09



Note: Data reflect the student share of published in-state tuition after applying the COF stipend.
Source: Western Interstate Commission on Higher Education, 2008b.

The Level of Public Support for Higher Education

Much of the criticism of Colorado's higher education system is the low level of state and local government support. **There is an important qualification to this evidence regarding state and local funding for higher education in Colorado. The observations are based on General Fund appropriations to higher education. The money for COF vouchers and direct funding contracts for special purposes is reported separately from state appropriations to higher education. Adding that money to state higher education appropriations, Colorado compares more favorably with other states.** Further, economists measuring the efficiency of higher education have found that Colorado ranks significantly above the national average, and above other states in the region.[10]

A measure of efficiency takes a ratio of the index for graduation rates divided by an index for total higher education revenues per FTE. This is a comprehensive measure because it compares graduation rates with total education resources per FTE. While higher education efficiency in Colorado is about equal to the national average using this measure, it falls below three other states in the region.

Why Has the COF Plan Not Fulfilled Expectations?

Our analysis suggests that while Colorado has a relatively efficient higher education system, room for improvement certainly remains for other measures of performance. Particularly troubling is the evidence of deterioration over the past two decades in measures of access and affordability. The voucher plan has not fulfilled many of the expectations of the higher education system when the plan was enacted. The question is why the voucher plan has not been successful in fulfilling these expectations.

The Western Interstate Commission for Higher Education report explains that vouchers were combined with service contract funding so as to protect the revenue and budgets of higher education institutions.[11] Service contract funding undermines incentive effects of the voucher plan. DHE provides estimates of enrollments that then are used to determine voucher funding each year. When these projections underestimate the use of vouchers, the state covers any shortfall from the fee-for-service fund. Money is redistributed from service contract funding to voucher funding so as to leave total state funding to that institution unchanged. Thus, enrollment growth is not actually funded by the state, and institutions have no incentive to increase enrollment. There is no incentive in this funding policy to induce institutions to compete for any students, let alone in-state students or underrepresented populations.

The Western Interstate Commission for Higher Education found that even though the state designed performance contracts for each institution, no penalties or rewards for performance were established. No rewards were created to attract more students, to attract in-state students, or to target underrepresented populations. No penalties were adopted for students who failed to progress or graduate in a timely manner. The performance contracts became another bureaucratic requirement, without impacting decision-making. The result was business as usual in higher education institutions. Universities also correctly anticipated that service contracts combined with the voucher plan would leave their revenues and budgets unharmed. Community colleges that attracted more students did not receive the additional promised voucher money. Some universities that failed to attract the projected number of voucher students nonetheless received the voucher funding for those missing students.

The legal monopoly held by public colleges and universities will not be broken by the small numbers of students and limited funding impacted by vouchers at two private universities.

The amount of voucher revenue received by private higher education institutions was a little more than $1 million, equal to a miniscule 0.3 percent of total voucher funds. Therefore, it is not surprising that voucher funding to private institutions has created little competition for public college and universities.

Eligibility limitations on where vouchers can be cashed are too restricted. The legal monopoly held by public colleges and universities will not be broken by the small numbers of students and limited funding impacted by vouchers at two private universities. As long as these constraints are imposed, one should not expect much incentive effect from vouchers through increased competition in the higher education system.

A New Stipend Plan

Funds currently allocated to higher education from the General Fund, and service contract funding, would be used to fund the stipend plan. Stipends would be extended to students attending all qualified postsecondary institutions, including for-profit as well as nonprofit institutions. The stipend plan would be phased in over five years to give higher education institutions time to adjust to the new system.

A goal of the stipend plan is to create competition among all qualified postsecondary institutions. This stipend-based higher education system would create incentives for these institutions to deliver quality education at lower cost. Replacing the current system of direct state funding to higher education institutions with a stipend plan funding students and families will generate public support, and reverse the downward trend in state support for higher education.

This stipend-based higher education system would create incentives for these institutions to deliver quality education at lower cost.

Reservations regarding state funding for higher education are not new. Half a century ago Milton Friedman challenged the rationale for government subsidies to higher education based on 'social benefits.'[12] Friedman pointed to potential negative social impacts from public subsidies to higher education. One of those impacts is certainly evident in current government subsidies to higher education, increased government regulation and intervention in higher education.

As Friedman observed, many of the presumed benefits of higher education to a democratic society are difficult to measure, and controversial.[13] The extent to which college graduates capture the benefits of higher education in higher earnings represents a transfer of wealth from taxpayers to college graduates.

Friedman argued that if the state does subsidize higher education, the funding should be issued in the form of student vouchers rather than direct state funding to colleges and universities. The vouchers should be extended to students attending all higher education institutions, private and public. Friedman and others have argued a voucher system should create a more competitive higher education system in which institutions have an incentive to deliver quality education at a low cost.

A wealth of economic analysis now supports Friedman's proposed system for higher education.[14] Some studies provide empirical support that such a system can increase efficiency and equity in higher education. Barry Poulson has reviewed empirical literature on the impact of a voucher system in an earlier study,[15] and also explored the rationale for voucher system including all qualified postsecondary institutions in Colorado.[16]

Does the State further control costs by imposing a means test so that wealthy families are not eligible for a stipend, but lower-income families are eligible?

Should every Colorado resident student be guaranteed a stipend?

A very difficult public policy issue will emerge. Does the State further control costs by imposing a means test so that wealthy families are not eligible for a stipend, but lower-income families are eligible? Do policymakers limit the number of credit hours that stipends will cover, or can a student enroll for many hours in addition to the minimum to earn a degree? Two strong, opposing arguments present themselves:

1. Citizens have already paid the taxes used to fund stipends. To argue that some families who are eligible should receive smaller stipends in order to subsidize other students with higher stipends is an implicit tax. Stipends should be set at the same level for all students eligible for the stipends. The stipend plan should not be used to redistribute income from one Colorado family to another.

2. Our nation is at risk now due to unsustainable entitlement spending. A universal college stipend would entitle a resident to government funds merely by being a resident. To avoid creating yet another broad entitlement program, stipends should be means-tested. Experience shows that entitlements tend to grow over time, and are very difficult to cut during periods of budget pressure. Therefore the legislature will lose even more control over the budget. Finally, some people choose never to pursue a college degree; universal stipends would redistribute income from these people to other people.

For the time being, it is not necessary to resolve this debate in order to start improving Colorado's stipend system.

A New Stipend Plan for Higher Education

As this chapter has detailed, the flaw is not in stipends per se, but rather in the way in which the COF plan was designed and implemented. We propose a new stipend plan to replace the COF plan, to be implemented over a five-year period. Several provisions in the proposed stipend plan would correct flaws in the COF plan.

Stipends Replace All Direct State Funding to Higher Education

Stipends would replace all direct funding to public higher education institutions. Funds currently allocated directly from the General Fund to these institutions would be allocated instead to the stipend plan. The 2010 Independence Institute paper by Barry Poulson, "Colorado's College Opportunity Fund: A Critical Appraisal"[17] details how to manage a five-year transition period.

The goal should be a stipend voucher system to create competition among all institutions of higher education. Students should be eligible to apply stipends toward tuition at all postsecondary institutions in the state, including public, private for-profit, and non-profit private institutions. We should then expect improved outcomes from wider incentives as COF is fully enacted.

Stipends and the Flagship Institutions

The University of Colorado and Colorado State Systems would no longer receive direct funding from the state. Their students would continue to receive funding in the form of stipends.

These flagship institutions receive "enterprise" status as long as direct state funding is below 10 percent of the institutions' total budgets. With enterprise status they have had greater flexibility in raising tuition and in issuing debt. They have had greater freedom to design academic programs in response to market forces. These institutions can offset the loss of direct state funding by improving efficiency. While the evidence suggests they have not always taken advantage of this freedom, a stipend system will create more incentives to implement reforms.

The economics literature suggests that in a more competitive environment, in which funding is provided through stipends rather than through direct funding, the flagship institutions of higher education will be the most competitive.

The economics literature suggests that in a more competitive environment, in which funding is provided through stipends rather than through direct funding, the flagship institutions of higher education will be the most competitive.[18] We can predict that these institutions will increase tuition more rapidly than other public institutions. Further, the tuition of flagship institutions will tend to converge with the tuition at private colleges and universities. In turn, this convergence will create greater calls for merit and need-based scholarships. The flagship institutions will continue to attract students even with higher tuitions, because of the higher quality of their undergraduate programs. The higher tuition revenues will enable the flagship institutions to provide better quality undergraduate education, using tuition revenues to offset the loss in direct funding. The current differential in tuition between private and public colleges and universities would decline.[19]

The flagship institutions already have adjusted tuitions to target disadvantaged students. Colorado State University funds families with incomes below the poverty line at half tuition; and students eligible for PELL grants pay no tuition. Expect these institutions to continue to target disadvantaged students, even without direct funding from the state.

While the flagship institutions would have five years to adapt to a full stipend system, some of their programs could adjust immediately. Because COF voucher funding is not available to fund graduate programs, the graduate programs in Medicine, Law, Engineering, and Business should immediately begin funding themselves entirely from tuition, and, of course, from donations provided by alumni, corporations, and foundations. Students in the graduate programs capture the benefits of their graduate degree in higher lifetime earnings. Tuition charges for these graduate programs already have been adjusted to reflect their greater cost, but graduate program rates would likely increase to closer to the full cost of the programs. This increase would not preclude graduate students from continuing to receive financial support from sources other than state funding.

Because COF voucher funding is not available to fund graduate programs, the graduate programs in Medicine, Law, Engineering, and Business should immediately begin funding themselves entirely from tuition, and, of course, from donations provided by alumni, corporations, and foundations.

At the other end of the spectrum are the institutions' undergraduate, such as Arts and Sciences, which depend heavily on public subsidy. Some have argued that CU and CSU shortchange undergraduate programs in order to fund expensive graduate programs and to pursue other agendas. To the extent this argument is true, it will be more difficult for the undergraduate programs to compete in a stipend system, and they will likely need more time to adjust.

Some other public higher education institutions could adapt quickly to a stipend system. The Colorado School of Mines already has received enterprise status with a great deal of autonomy from state regulations. It shares some of the characteristics of the flagship institutions, such as a reputation for quality undergraduate programs that attract students. The School of Mines also could raise tuition and continue to attract students.

State support has enabled other public higher education institutions to set tuition levels below that at flagship institutions, and well below tuition levels at private institutions. Students are attracted to these other public institutions by the low cost, even when they receive an inferior quality of education. The other institutions may raise tuition, but not to the extent of flagship institutions. It is more difficult for the other public institutions to raise tuition to offset the loss of direct funding. They are more likely to expand enrollments to sustain revenues.

If flagship institutions increase tuition more rapidly than other public higher education institutions, it could result in an expansion of enrollments at community colleges and other public institutions relative to enrollments at flagship institutions.

A stipend system may change the composition of enrollments within public higher education. If flagship institutions increase tuition more rapidly than other public higher education institutions, it could result in an expansion of enrollments at community colleges and other public institutions relative to enrollments at flagship institutions. Such a shift would not be a bad option from an economic standpoint, because the cost of educating students at the other public higher education institutions tends to be significantly lower than at flagship institutions.[20]

Other public higher education institutions also should have greater freedom to design academic programs in response to market forces. These institutions can offset the loss of direct state funding by improving efficiency.

The response of low-income students to the tuition changes under a stipend system is predicted to be far greater than that for middle- and higher-income students. Thus, an important result of this stipend system would be to expand postsecondary education to a broader group of students, including low-income students.[21]

... an important result of this stipend system would be to expand postsecondary education to a broader group of students, including low-income students.

With expansion of the stipend system to all postsecondary institutions the incentive effects of stipends will lead to more efficient delivery of education services. Students will be able to make more rational choices in postsecondary education based on the quality of education relative to price. Their decisions will not be biased by the ability to capture subsidy at public institutions but not private institutions. In order to attract students all postsecondary institutions will need to enact reforms to deliver better quality education at lower cost.

Reforming Public Higher Education

The new system of postsecondary education will drive public institutions that have depended on direct subsidies as well as stipends to enact reforms to compete with their private counterparts. Each public institution should be allowed to design the reforms; the last thing the state should do is be prescriptive. However, a number of reforms have proven to be successful when public higher education institutions are subject to greater competition. The following is not a prescription, but rather a menu of potential reforms institutions should consider. Some of the reforms already have been enacted in Colorado public higher education institutions, but the imperative for reform will be greater with a full stipend system.

Improve productivity

Almost all college and university teachers are hired with the explicit expectation to do more work than just give lectures. As used in this section, "teacher" is a generic term that is meant to include all tenured and tenure-track faculty at all levels. Professors, associate professors, lecturers, and some instructors all fall within this definition.

If the experience on only one campus is correct, a formal change at all the state institutions of higher education would improve productivity by 15 to 20 percent and would save between $50 million and $67 million per year in faculty salaries.

If the experience on only one campus is correct,[22] a formal change at all the state institutions of higher education would improve productivity by 15 to 20 percent and would save between $50 million and $67 million per year in faculty salaries. The steps to accomplish these savings are likely to be different for each level of institution. The Board of Regents, for example, could alter the University of Colorado system, while statutory change might be necessary for state colleges.

For many decades, expectations placed upon college teachers were stable. The former rule of thumb was that professors taught 15 credit-hours per semester. But more recently, the accepted guidelines for faculty employment have been eroded. The current rule of thumb for time distribution is that 40 percent goes to instruction, 30 percent for service (which is usually poorly defined or not defined at all), and 30 percent (internally-funded) research.

Research is an integral and central aspect of an academic career, and nothing in this section would suggest otherwise. It becomes more central to the job description, the closer a teacher moves from the community college system to the flagship research universities. An important distinction emerges as we look closer at the way research is initiated and paid for. The "internally-funded" research is part and parcel of the salary paid to have the teacher on campus. It manifests itself in staying current on developments within the individual's field of study, in writing, and in collaborating and reviewing others' works.

The second type is the externally-funded research. In that circumstance, the contract brings in new funding to finance the many resources that might be required. Beyond covering materials and research assistants, it includes a salary for the teacher that is meant to fund the portion of the time the professor otherwise would be engaged in instruction and internal research. We urge that the legislature and the Department of Higher Education do nothing to interfere or impact externally funded research performed by those faculty members. Compute the productivity measures after removing the externally funded research from the equation.

Freedom to Set Tuition Rates

All postsecondary institutions should have the freedom to set their own tuition rates. Economic research predicts a convergence of tuitions when all public funding is provided to students through stipends rather than allocated directly to public institutions. Tuition at public institutions will tend to rise, while at private institutions it will tend to fall.

Tuition at public institutions will tend to rise, while at private institutions it will tend to fall.

All postsecondary institutions, including public colleges and universities, should set tuitions to reflect supply and demand. Thus, the more costly programs, in business and engineering, should have higher tuition charges than other programs, such as Arts and Sciences. The net effect will be for students to use their stipends more efficiently.

As noted earlier in this study some public institutions have adjusted tuition levels to reflect family income, and they should have the freedom to do so in a privatized system. Privatizing postsecondary education will open up more opportunities for low-income families to have access to vouchers they can use at private as well as public institutions. These students will continue to be eligible for other means-tested support, such as the PELL program.

Create Incentives for Higher Education to Provided High Quality Education at Lower Cost

Reform will create incentives for institutions to engage in entrepreneurial activities to generate other sources of revenue, including research grants, private donations, and ancillary activities. Given the limited resources that likely will be available from the state for the foreseeable future, higher education institutions must look for other sources of revenue. Some of the institutions with less than 10 percent funding from the state are already well on their way toward privatization. With enterprise status these institutions should be free to aggressively pursue other sources of revenue, without constraints or interference from the state.

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More efficient utilization of facilities, improved management of assets, and reallocation of resources to academic activities from non-academic activities such as sports, recreation, food, and housing, would generate net income. Other innovation would make better use of new technologies in teaching and administration, increase the ease with which students can transfer between institutions, and create incentives for students to complete a degree in a timely manner. If stipends would not be available to fund tuition costs of remedial courses, demand would grow for high school students to obtain at least a valid diploma, and opportunities would grow to take an accelerated college preparation program.

Acknowledgements

Barry W. Poulson, Ph.D. was primarily responsible for the content of this chapter. Dr. Poulson is retired Professor of Economics at the University of Colorado. He has been a Visiting Professor at universities in Mexico, United Kingdom, Japan and Spain.

He is the author of numerous books and articles in the fields of economic development and economic history. His current research focuses on fiscal policies and fiscal constitutions. Professor Poulson is currently Americans for Prosperity Foundation's Distinguished Scholar. His studies and articles for AFPF include research and analysis of the Taxpayer's Bill of Rights.

He has served on the Colorado Tax Commission and as Vice Chair of the State Treasurer's Advisory Group on Constitutional Amendments in Colorado. Professor Poulson is Past President of the North American Economics and Finance Association. He is an Adjunct Scholar of the Heritage Foundation, advises the Task Force on Tax and Fiscal Policy of the American Legislative Exchange Council and serves as a consultant on fiscal policy and fiscal constitutions to a number of state and national think tanks, including Colorado's Independence Institute.

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Corporate Welfare

This section uses the inflammatory term "corporate welfare" to draw attention to a proposal that significantly rethinks policies executed at the state level. The proposal is likely to bring together fiscal conservatives and libertarians with liberals and progressives who are doubtful about direct subsidies to business.

Many elected leaders have pushed for government to contribute tax dollars to private businesses. In Colorado government involvement has reached small start-ups and has focused on the creation of a "green energy" industry. The intent of such redistribution programs is for government to intervene in the economy so that new jobs are created where otherwise none would be. These jobs then supposedly will multiply through the economy as employee wages along with purchases of materials and other inputs provide new income to supporting businesses. It was the dream, vision and expressed intent behind the Obama administration's American Recovery and Reinvestment Act stimulus funding, and the hope of governments at all levels. Yet it is increasingly understood that such programs actually result in a lower general standard of living.

Policy makers often overlook that resources given to a business must come from somewhere else where they could have been better used in alternate ways. Economists observe that "the real cost of something is what you have to give up to get it." The real costs of green energy jobs are all the lost opportunities to use the labor, resources and capital for other, more productive things in the economy. Misunderstanding this crucial point is the fallacy of the broken window writ large. [1]

A person will decide what to purchase based on an opinion of what will improve his or her lot. When government steps in with a prohibition, a regulation or an incentive, it adversely changes the decision and prevents the actor from taking that best step. If a state-provided incentive is used, the cost is lowered for the decision-maker by forcing someone else to pay the difference.

The cost of competing with other states to win the favor of firms wastes resources. Studies going back decades call the practice into question. A comprehensive paper on the practice found:

> *Some evidence exists that incentives have the potential to move jobs from one state to another intraregionally; but no evidence exists that incentives actually create new jobs. This intraregional job heist has been dubbed 'begger (sic) thy neighbor' strategy by Timothy Schellhardt of the Wall Street Journal (1983).*

The "broken window fallacy" is an allegory of a young hoodlum breaking a baker's window. The townspeople are happy that the glass maker is now employed and that the moneys will invariably filter into the local economy. The young hoodlum is viewed as a benefactor to the town's economy. The fallacy is in "what is not seen." The baker would have used the money on something that would make him happier, such as buying a new suit. The tailor in turn is deprived of an income, the baker is worse off for buying something he already possessed, and the townspeople are deprived of a tangible good in their economy. The result is that the community has one less display window, a net loss. The "young hoodlum" can serve as a metaphor for governmental manipulation of the economy.

> *The fact that states continue to compete among themselves through business inducements despite the evidence that the competition is generally counterproductive is an obvious anomaly for students of state government and policy. Furthermore, this competition is more than a theoretical concern since these inducements represent a substantial investment of state resources.*[2]

Others' research has led to a call for terminating the programs:

> *Some economists claim that so long as incentives are directing firms to areas with high unemployment, these policies are wonderful. In fact, the free market already does this, directing resources to where they are in greatest demand and cheapest to employ. State financial packages can only distort prices and resource allocation.*
>
> *The whole institution of the state development agency needs to be scrapped as a futile and frequently corrupt effort in economic planning that only ends up redistributing other people's money. What we need is a free market within the states and economic competition among states, not a war among state government agencies.*[3]

The progressive Economic Policy Institute has come to similar conclusions, based on the research of Robert Lynch of Washington College, who has studied the issue of corporate welfare for 20 years. Lynch argues that these incentive packages "rarely cause firms to expand in geographic areas that they would not have otherwise expanded to without state incentives."[4]

In some instances a state can buy the favor of a firm with a large incentive package. Milwaukee bought 200 Frontier Airline maintenance jobs, wooing them from Colorado by offering $27 million in incentives compared to the $16.5 million Colorado offered.[5] Milwaukee now has 200 jobs that it may have gained in any case, but arguably it is not 200 jobs richer. Paying $135,000 for each new job is likely to have caused net damage to the City's economy.[6]

In the words of economist Russ Roberts, "it's like taking a bucket of water from the deep end of a pool and dumping it into the shallow end. Funny thing—the water in the shallow end doesn't get any deeper."[7] To make things even worse, there are economic "leakages" that take place—the inefficiencies, false starts and mistakes that occur when someone in charge does not have his own money at risk. It is like moving swimming pool water with a bucket that has holes poked in it. The faster you try to move the water, the faster resources are depleted and wasted, and the more our standard of living declines.

Local and state economic development agencies have been too silent about failures. Projects and businesses financed with tax dollars occasionally fail or do not permanently relocate to Colorado. The Intel plant in Colorado Springs was a high priority for people looking to secure a "basic industry" for the state and generous tax incentives were used to lure the company. When the market for computer chips changed soon thereafter, Intel closed the plant and moved its operations out of state. First Data Corporation moved its headquarters from Greenwood Village to Atlanta in 2009. Economic incentives did not matter when the new C.E.O. decided that Atlanta was closer to the company's customers.[8]

Local and state economic development agencies have been too silent about failures.

The central justification for making the incentive decisions is that the elected officials and the government employees who serve them are expert, knowledgeable people who know better than the citizen or individual investor about what business is best suited to be wooed. The economist Hayek calls this justification the "fatal conceit" that hands over unwarranted power to people who cannot possibly have all the information that resides in the millions of actors who make up a market.

We believe the entire "green energy" effort is slowing economic recovery and very likely does not represent the strongest investment. The state legislature[9] has mandated that fossil fuel-based energy sources be curtailed and that 30 percent of the energy consumed in Colorado by 2020 be generated from solar and wind power.[10] Direct costs paid by energy consumers to a utility provider act as a new tax, but we are focused here only on the economic development part of the equation.

We believe the entire "green energy" effort is slowing economic recovery and very likely does not represent the strongest investment.

From 2005 to 2009 the legislatively-created and politically-appointed Economic Development Commission and local governments spent just under $13 million in direct subsidies. Matching funds from local agencies and governments more than double the cost to $27 million. Tax credits undoubtedly were a far larger part of subsidizing businesses. The economic development function, housed within the Governor's budget, will spend $8.5 million of General Fund moneys in the current fiscal year, and an additional $2.7 million for job training.[11] Much of the funding historically has been given to large, publicly-traded international and national companies.[12]

Colorado has paid for bioscience grants.[13] The theoretical justification for the state's funding of bioscience is the alleged existence of a "market failure" and the inability to serve the public good at optimal levels without the state's intervention. The cost to the taxpayer was also that the free market would have employed researchers to pursue alternatives with higher potential. By contrast, computer technology also benefits society, but the state was not central in the development of the computer industry. Even without state intervention, rapid advancement of technological efficiency continues as computers become faster and cost less.

Another unstated assumption has to be that the target company does not know and cannot accurately predict the extent of its contribution. If a company understands the cost-benefit analysis for each community under consideration, it can continue to negotiate increasingly higher subsidies. A rational economic development agency will stop only when the analysis shows the additional costs of bringing in the new company begin to exceed the benefits.[14] At that point, there is no net gain to the town or state that attracted the new company. Instead, the agency must hope the target company has inept negotiators or is unable to quantify on its own how much net value a subsidy is worth—usually not a good bet. Where negotiations are successful for the agency, look to the strong possibility that the investing private firm had already decided to move into the community, but was looking for a hand-out to sweeten the deal.

When it comes to economic development, citizens should demand that governments at all levels enforce contracts, protect property rights, and curtail "externalities." Individuals should be left to function unimpeded by bureaucrats, undirected by politicians and left to enjoy their work rather than have it spread around by agents who neither started the enterprises nor contributed to the value the enterprises created. In 1680 the powerful French finance minister Jean-Baptiste Colbert asked a delegation of merchants and other men of commerce what the state could do to help them. Their answer was simple and resonates today: "Leave us alone."[15]

When it comes to economic development, citizens should demand that governments at all levels enforce contracts, protect property rights, and curtail "externalities."

Colorado benefits from the reminder that the state constitution strictly prohibits taking on public debt for companies and very explicitly prohibits any appropriation to be made "for charitable, industrial, educational or benevolent purposes to any person, corporation or community not under absolute control of the state . . ."[16] "Corporate welfare" on its face is a violation of the state constitution.

Acknowledgements

This chapter appeared in the first edition of the Citizen's Budget. Penn Pfiffner was the primary author. See his complete biography in the authors section at the end.

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9. Before the legislative mandate, a plebiscite started the trend. In 2004, then-Speaker of the House Lola Spradley led an initiative that demanded 10 percent of alternative forms of energy constitute citizens' energy consumption on or before 2015. Amendment 37 passed by 52-48.
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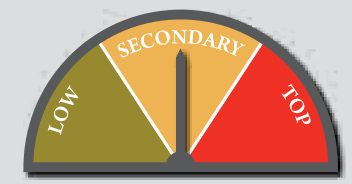
15. "*Laissez-nous faire*," from which the term "laissez-faire capitalism" is derived. Compare with the interventionist policies of public-private partnerships and other government direction of the economy. The French economist and statesman Anne-Robert-Jacques Turgot writes of this episode in *Eloge de Vincent de Gournay* (1759). Quoted in Murray N. Rothbard, "Biography of A.R.J. Turgot," http://www.Mises.org/resources/3244.
16. Article XI, Section 1. "Pledging credit of state, county, city, town or school district forbidden," and
Article XI, Section 2. "No aid to corporations - no joint ownership by state, county, city, town, or school district," and Article V, Section 34. "Appropriations to private institutions forbidden."

Transportation

Priority



Overview

The material describes reforms for development of transportation construction, maintenance and management, and makes recommendations. It is the second time this chapter has appeared in a Citizen's Budget.

Original Article

The original chapter can be found at http://tax.i2i.org/files/2010/11/CB_Transportation.pdf.

Funding for state highways comes from a "Highway Users Trust Fund" separate from the General Fund. Most of its revenues come from the State's portion of the tax assessed every time a gallon of gasoline is purchased at the pump, or from the moneys appropriated by Congress to the States. Deferred maintenance and long-deferred road expansion cry out for funding and cause officials to demand money from new taxes and other sources. Fewer new dollars would be needed, if instead of more funding for a broken system, the Governor could operate this vast bureaucracy in ways that materially improve productivity. More beneficial use of the current stream of funds should be the objective. Citizens know what leaders have yet to recognize: A new paradigm is possible, one that can yield more benefits at less expense.

> *Fewer new dollars would be needed, if instead of more funding for a broken system, the Governor could operate this vast bureaucracy in ways that materially improve productivity.*

The State must be willing to change its thinking and approach. Bold leadership and a willingness to use modern ideas will be necessary to get Colorado out of the mire of long obsolete procedures. Significant changes need to be made.

Action Recommendations

Establish a New System of Performance Measurements

1. Governments' incentives are wrong. "In government all of the incentive is in the direction of not making mistakes," as Ted Gaebler and David Osborne wrote in *Reinventing Government*.[1] Public works investments should be guided by clearly stated performance objectives.[2] Legislate that CDOT employ industry-wide measures of performance for all operational, maintenance, and construction activities. Gaebler and Osborne observed that "Most governments have no idea how much it costs to deliver the services they offer."[3] Insist that managers and workers use the information to improve effectiveness. Make the information available for public scrutiny. Report annually to the Senate and House Transportation Committees with comparative outcomes from other states.
2. Implement real world, practical accounting metrics. Gaelber and Osborne: "At all levels of government, accounting records almost entirely ignore what assets are owned, their state of repair, and their value. These systems imply that it costs nothing to use existing assets."[4] Operated similarly, any business or family would fail. Armed with better cost information, dedicated government managers not only will be empowered to become better managers, but also will find and implement alternative service delivery methods that will bring

> *"At all levels of government, accounting records almost entirely ignore what assets are owned, their state of repair, and their value. These systems imply that it costs nothing to use existing assets."*

greater efficiency to public service.

Choose Projects Differently

3. It is time for Colorado Transportation Commission (CTC) to be critically reexamined and potentially restructured. Alter its makeup to redefine its role and the process it uses to prioritize projects. Less political influence can be achieved by applying a minimum benefit over costs to each project assessment: simply stop funding projects with ratios below the required minimum. Colorado taxpayers have been underserved by the failure to establish rational transportation policy priorities. Irrational transportation funding priorities inject special interest politics in the process, the very danger from which the CTC was created to protect Colorado. Further, capital projects can be prioritized by benefit-cost to insure maximum benefits.

It is time for Colorado Transportation Commission (CTC) to be critically reexamined and potentially restructured.

Competition Improves Quality and Reduces Costs

4. Divest or outsource maintenance and operations.
5. Establish a committee of non-CDOT staff to review and approve proposals from CDOT work groups who wish to continue to perform their same work duties at a lower cost to CDOT as independent contractors. Such a reform would support a transition towards a broader efficiency by capturing untapped staff energy and innovation.
6. **Reward CDOT employees who provide efficiency-creating ideas.** Those most familiar with government waste and in the best position to root it out are government workers. Programs should be devised that invite and reward innovative cost-saving reforms by government workers. Innumerable untapped ideas and innovations are being suffocated by the lack of a mechanism to receive, evaluate and implement them.

Transit Contribution

7. **Pass a statute requiring transit projects to enhance mobility in order to be funded.** The legislature should challenge CDOT to maintain service levels while keeping congestion levels low, roads open and safe, and a general level of mobility that most effectively moves people, goods and information. Use of the term "multi-modal" creates a perverse anti-mobility incentive within CDOT to apply funds not necessarily to their most effective use. Offering consumers a rarely-used alternative to the automobile is hardly defensible when far greater mobility can be offered to far more citizens for far less money. The politicization of Colorado's transportation policy has resulted in disproportionate and wasteful outlays for transit. What transit extremists advocate—making central cities as dense as they were a century ago–cannot work. A century ago transit was an effective mode of mobility. Americans in large numbers lived in tenements and worked in factories. As Americans grew wealthier, dependence on transit declined. As market share fell, government transit subsidies grew to be exorbitant. Currently, most bus trips receive about an 80 percent taxpayer subsidy, and rail trips are subsidized at nearly 95 percent when capital costs are counted. Because traditional transit arose at a time when cities were more centralized, transit remains centralized in its approach. A new vision with a decentralized design is needed.

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8. The Denver Regional Council of Governments (DRCOG) reports for the Denver metro area that between 2008 and 2011, of the $1.8 billion state and federal transportation funds for transportation "two-thirds is for transit."[5] It is now common knowledge that RTD's FasTracks 67 percent tax increase, approved in 2004, cannot construct light rail anywhere near the promised cost or deliver the promised reductions in traffic congestion. RTD has violated its agreement, commitment and trust with voters. Normally, such violation voids a contract. Because RTD cannot deliver what was promised, the legislature should prohibit RTD from incurring additional expenses until a new FasTracks proposal is approved by voters.
9. Convene a grand jury or other independent body to investigate and review objectively the false claims presented to the public about mass transit. Hold officials accountable for deliberate deception.
10. Allow RTD to compete for revenues from a Mobility Fund; RTD can earn revenue from the fund based how much mobility the outlay will provide. Establish the Mobility Fund using taxes currently going to RTD.

Implement Market Reforms

11. Direct CDOT to present a proposal to the legislature within one year to implement a network of HOT lanes throughout the Denver metro area as a way to eliminate traffic congestion. Generally, congested traffic generates 2.5 times[6] the air emissions as free-flowing traffic does.[7] The Texas Transportation Institute[8] reports that the annual cost of traffic congestion throughout the U.S. nearly equals the amount of money needed to eliminate it. Traffic congestion in Colorado costs drivers $1.35 billion per year.[9] In the Denver metropolitan area, the annual average cost of traffic congestion is $913 per person.[10] The HOT lane network would be self-funding, should be implemented in no more than 10 years, and may necessitate the use of a public-private partnership to access capital and expertise external to CDOT. The new T-REX lane should be converted to a HOT lane as the first portion of the network, dedicating its revenues to conversion costs, expansion and to enhancing corridor capacity.
12. FasTracks implemented as bus rapid transit would cost less than half of the light rail / heavy rail plan. If operated jointly with HOT lanes, bus rapid transit would offer a revenue source and economic benefits that rail-based FasTracks cannot. The I-25 HOT lane should be converted to dynamic pricing. Dedicate its revenues first to cover conversion costs and second to corridor enhancements. Although small, it may be a potential PPP (Public Private Partnership) project.

The new T-REX lane should be converted to a HOT lane as the first portion of the network, dedicating its revenues to conversion costs, expansion and to enhancing corridor capacity.

13. Trucks and automobiles are not particularly compatible. Their use of the same facilities drives up operation and maintenance costs, as well as construction costs, while reducing safety and carrying capacity. Truck traffic counts comprise about 10 percent of vehicles but consume nearly 30 percent of highway capacity. Thus, removing trucks from some highways would increase capacity by 30 percent for automobiles. Trucks pay a lot in taxes and fees which, if isolated for exclusive use of trucks, might be enough revenue to construct truck-only lanes.[11] Direct CDOT to produce a report on the practicality of improving mobility on U.S. 287 to Texas by establishing new truck-fee-financed, truck-only lanes. Truckers must be consulted to know the feasibility and limits of multi-trailer rigs and whether the new lanes would merit the expense.
14. Establish a trial program using transportation vouchers to grow the number of transit providers. A statute is needed to remove regulations that prohibit entry into this market. Direct CDOT's Transit Division (or State Auditor) to commission a study and report on the feasibility of implementing the Miami decentralized transit approach in

Colorado.

15. Regulations that prohibit transit competition should be loosened or eliminated. Regulatory protectionism benefits special interests that advocate for such regulation at the expense of consumers. Several industries for which market competition was once, incorrectly, thought to be impossible have been deregulated; these include airlines (1977), trucking (1980), railroads (1980), natural gas (1984), and long distance telephone (1984).

Change the Way the State Finances Transportation

16. Public-private partnerships (PPP), also known in Colorado as Public Private Initiatives (PPI), introduce opportunities to bring external talent, expertise, and resources to the table. Resources are virtually unlimited and may range from capital (as with the construction of E-470) to design-build (as with T-REX) that can shave both dollars and years from a project, to operation and/or maintenance of facilities to anything, or to any combination. Various other states have experimented with PPPs, but CDOT experience has been limited. CDOT's PPI guidelines should be reformed to become simpler, more inviting, more accessible, more readily known, and more rewarding to idea-generating people. The process should be easily understood and widely publicized. One key finding from CDOT's 2001 best practices study[12] was that states such as Florida, Texas, and Virginia were able to access billions of dollars in new private capital via transportation concessions. To help CDOT become more open to PPPs and to learn how to capture their benefits for Colorado, establish a goal (requirement) that CDOT accept one PPP per year for each of the next five years.

CDOT's PPI guidelines should be reformed to become simpler, more inviting, more accessible, more readily known, and more rewarding to idea-generating people.

17. Devolve the federal gas tax. The federal government does not own any highways. The federal gas tax of 18.4 cents per gallon generates about $40 billion per year nationally. Washington, D.C. takes a Colorado gas tax dollar but once diversions to other states, diversions to transit and the administrative burden are removed, only about 70 cents[13] is left when it gets home. Devolution of the gas tax to the states would equal 4.82 cent per gallon[14] revenue windfall to Colorado, equating to about $100 million per year in money paid by Colorado taxpayers. In 2003 the Colorado General Assembly passed Senate Joint Resolution 42 by a vote of 97 to 3, asking that the Federal gas tax be devolved to the states. If legislators passed the same resolution every year, other states may follow Colorado's lead. With resolutions from many states, Congress eventually might act.

Acknowledgements

Dennis Polhill authored the original chapter. He spent a decade in local government with the cities of Urbana, Illinois; Cumberland, Maryland; and Lakewood, Colorado, including an assignment as City Engineer and Director of Public Works. His private sector experience included founding a consulting engineering and management firm, Pavement Management Systems, Inc.

Mr. Polhill became a Registered Professional Engineer in 12 states and was active in many professional associations. He served as President of American Public Works Association. Mr. Polhill is a Senior Fellow in Public Infrastructure at the Independence Institute. In addition to infrastructure and transportation, he writes about economics, role of government, and democracy issues. He earned a Master's degree in Transportation Engineering and a separate Master's degree in Public Works Management from the University of Pittsburgh. His undergraduate work was completed at the University of Illinois in Mathematics and General Engineering.

Endnotes

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12 Dr. Porter Wheeler and Sasha Page, *Review of the Public-Private Initiatives Program of the Colorado Department of Transportation*, Report No. CDOT-DTD-R-2001-2.

13 Bob Poole, *Defederalizing Transportation Funding*, Reason Policy Study 216 (October 1996), http://reason.org/files/4883e8bd01480c4d96ce788feb1f2e05.pdf.

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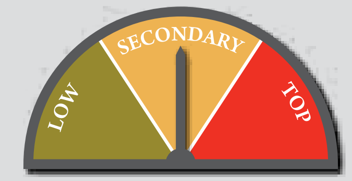
Lottery Proceeds

Priority



Overview

The chapter urges fresh consideration of where to spend the net earnings from the Colorado lottery.

Recommendations

Place on the 2014 ballot a measure to consider a five-year "time-out" for spending on GOCO and Open Space funds, redirecting them to K-12 education spending.

Original Article

The original, longer chapter is available at http://tax.i2i.org/files/2010/11/CB_Lottery.pdf.

Change

Total Recommended Change = $56 million

Lottery games run by Colorado state government bring in about $142 million per year.[1] It is time that citizens and the legislature revisit how the money is spent. Net proceeds are allocated by formula as follows: 40 percent to the Conservation Trust Fund for distribution to local governments, 10 percent to State Parks for specific projects, and the remaining 50 percent to Great Outdoors Colorado (GOCO).

Colorado differs notably from other states in where it places its lottery proceeds. All but two of the 43 other states that conduct lotteries do so to generate K-12 education revenues and to provide higher education scholarships, although several states fund programs in addition to education.

Of the half that goes to GOCO, proceeds are dispersed equally among different categories:

- Wildlife;
- Parks and outdoor recreation;
- Competitive grants for open space; and
- Competitive matching grants to local government for open lands and parks.

The GOCO fund was capped, with the upper limit being adjusted for inflation each year.[2] The remaining moneys are given to the School Capital Construction Assistance Fund for school facility improvements. In 2011, $56 million was disbursed to GOCO from lottery revenues, and $662,000 was contributed for school facility improvements.[3]

That Colorado's lottery provides revenue for the state from a source other than taxation does not make the revenue any less valuable. Concerns over open space in 1992 when GOCO was started may be surpassed today by more pressing needs. We urge the legislature to offer for public approval the permanent redirection of lottery proceeds to the General Fund. A less desirable, but perhaps more politically palatable, change would allow the legislature to divert funds for other uses only for a certain number of years. Any change would have to amend the state constitution. Legislators could only put the question to voters on the 2014 general election ballot. If approved, implementation could only occur for the 2015-16 fiscal year.

Penn Pfiffner was the primary author of this section. See the Author's section at the end for his biography.

Endnotes

1. Colorado Lottery Annual Report, Fiscal Year 2011, p. 65. http://www.coloradolottery.com/ABOUT/SERVING-COLORADO/ANNUAL-REPORTS/
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3. Colorado Lottery Annual Report, FY11, p. 29.

Authors

Penn R. Pfiffner

Penn is a former state representative, having served in the Colorado legislature from 1993 through 2000.

His major bills included the enhanced sentences for dangerous pedophiles, the state's first full-restitution policy and the ground-breaking performance-based pay for state employees. His legislation created the Privatization Committee, which he chaired, and the findings and suggestions received national attention. He authored the repeal of the capital gains tax, wrote the major deregulation bill of the decade (trucking) and rewrote the state employee compensation statutes.

He was an early leader and proponent of the Taxpayer's Bill of Rights, serving as a Regional Coordinator in the 1986 effort, and serving on the TABOR Committee in subsequent years.

His business is financial and managerial consulting to architects, engineers and contractors. He also conducts economic analyses such as forecasting and valuing closely-held stock. He opened his practice, Construction Economics, LLC in 1983.

He taught college Economics at night school, at both the graduate and undergraduate level, for thirteen years.

Penn earned his Masters in Finance from the University of Colorado at Denver and his undergraduate degrees in Economics and Political Science from CU-Boulder.

He is the former President of the Denver Association of Business Economists. In the 1980's, he was a member of the national ASTM's (Association of Standards, Testing and Materials) Building Economics Subcommittee, which established standards for life-cycle costing and the use of net present value analysis. He was one of 300 economists polled nationally by the National Association of Business Economists for quarterly forecasts of the economy.

He is currently a Senior Fellow in Fiscal Policy at the Independence Institute. Penn hosted the Institute's weekly talk radio show on KNRC for its five-month run. He served six years as the President of the Colorado Union of Taxpayers and still sits on that organization's Board of Directors. He is currently Chairman of the TABOR Committee, which grew out of the Strike a Better Balance issue committee that defeated Amendment 59 in 2008.

Penn and Karen are the parents of three adult children. He helps out as a merit badge counselor and served as an Assistant Scoutmaster for Lakewood's Troop 748 for nearly two decades and as a member of the Timberline Executive Committee for a half dozen years.

He is a veteran, having served as an officer in the Navy, assigned to U.S.S. Oklahoma City (CG5), based out of Yokosuka, Japan from 1977 to the end of 1979.

Ben DeGrow

Ben DeGrow is a Colorado-based public policy analyst with a focus on education labor issues. Since joining the Independence Institute in 2003, Ben has advanced its research in the areas of collective bargaining, teacher unionism, teacher employment, and school finance. He oversees the Education Policy Center's informational Web site for teachers and coordinates the Institute's outreach to teachers.

Ben has authored seven Issue Papers, 17 Issue Backgrounders, and numerous opinion-editorials for the Independence Institute. His writings have appeared in such Colorado publications as the *Rocky Mountain News, Denver Post, Pueblo Chieftain, Colorado Springs Gazette, Greeley Tribune, Longmont Times-Call, Colorado Statesman, Colorado Daily, HeadFirst Colorado, Grand County Daily Tribune, Denver Daily News* and *Vail Mountaineer.* He is a contributing editor for the national monthly *School Reform News*, and serves as the regular free market blogger voice on Education News Colorado.

Ben has made many guest appearances on Colorado radio and television programs to discuss policy issues. He has testified before legislative committees and has given presentations to community groups, legislators, candidates, and national conferences.
Ben was born in Pontiac, and grew up in the greater Detroit metropolitan area. He graduated summa cum laude from Hillsdale College in 1999 with a B.A. in History (Political Science minor) and received an M.A. in History in 2001 from The Pennsylvania State University.

Ben's experiences in the classroom include leading recitations and discussions as a university graduate assistant and a term as a substitute teacher in public elementary and middle schools in Michigan. He also spent nearly a year on the editorial staff of the *Hillsdale Daily News*, where he earned Associated Press honors for local sports writing.

Linda Gorman

Linda Gorman is a Senior Fellow and Director of the Health Care Policy Center at the Independence Institute.

A former academic economist, she has written extensively about the problems created by government interference in health care decisions and the promise of consumer directed health care. Her articles on minimum wages, education, and discrimination appear in the *Concise Encyclopedia of Economics.*

A frequent contributor to John Goodman's Health Policy blog, she is also a member of the Galen Institute's Health Policy Consensus Group and was appointed to the Colorado Blue Ribbon Commission for Healthcare Reform where she co-authored one of the Commission's minority reports. She holds a Ph.D. in economics.

Mark Hillman

Mark Hillman is a Colorado native, farmer, and a "recovering journalist." He was elected two terms in the Colorado State Senate and served as Majority Leader, as well as Colorado State Treasurer. In 2008, Mark was elected to represent Colorado on the Republican National Committee.

In the Colorado Senate, Mark was a leader in the fight to protecting the rights of private property owners against government takings, halting frivolous lawsuits and demanding personal responsibility, promoting economic opportunity in rural communities, and empowering parents through educational choice and accountability.

His dynamic, common sense leadership earned recognition as National Legislator of the Year, Champion of the Taxpayer, and Guardian of Small Business.

His commentaries have appeared in the *Wall Street Journal, Rocky Mountain News, Denver Post*, Townhall.com and numerous other publications. He frequently comments as a guest or host on The Mike Rosen Show on Denver's 850 KOA.

Mark raises hard red winter wheat on his family's farm near Burlington, where he also grazes cattle and breeds quarter horses and thoroughbreds.

Richard Sokol

Richard Sokol is a local business owner, focusing on real estate and investments. He serves as the Vice Chairman of the South Metro Fire Rescue District Board, is on the Board of the Colorado Republican Business Coalition, and sits on the Advisory Board of the Leadership Program of the Rockies. He is also a Contributing Editor to *Line of Sight*, a monthly policy-oriented e-magazine. Mr. Sokol earned a degree in Economics from Yale University, and holds an MBA from Harvard Business School. He is married with two daughters, and is an avid Denver Nuggets fan.

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