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Legislative
Council
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MEMORANDUM

January 6, 2010

TO: Interested Persons

FROM: Natalie Mullis, Chief Economist, (303) 866-4778

SUBJECT: Summary of the State Budget Situation

This memorandum summarizes the current state budget situation, based on the December 2009 Legislative Council Staff economic and revenue forecast. It utilizes the attached slides, which will be referred to throughout the memorandum. The following three questions will be answered:

- Where does the money for the budget come from?
- How is it spent?
- How big is the shortfall?

Where Does The Money For The Budget Come From?

The money comes from taxes, fees, fines, and other revenue. The average Coloradan spends about 30 cents of each dollar of income on taxes, of which 71 percent (21 cents) goes to the federal government, 15 percent (4.5 cents) goes to local governments, and 14 percent (4.5 cents) goes to the state. The state budget has three major sources of revenue:

- *Money from the federal government.* The state receives money from the federal government, originally collected from taxpayers in Colorado and other states. These funds must be spent as the federal government requires.
- *Cash fund revenue.* Cash funds are accounts created for certain purposes that have specific sources of revenue. For example, the Highway Users Tax Fund receives motor fuel taxes and vehicle registration fees that must, pursuant to the state constitution, be used for transportation purposes.
- *General Fund revenue.* The General Fund receives revenue that can be used for any purpose the state legislature deems fit, subject to constitutional requirements. About 95 percent of General Fund revenue comes from income taxes (64 percent) and sales taxes (31 percent).

All three sources of revenue are important to the financing of state government and its services. *However, because the General Fund is where many legislative decisions are made, the remainder of this memorandum will focus on the General Fund budget.*

As shown in **Slide 1**, the recession has substantially reduced General Fund revenue. With a net 115,500 jobs lost since the beginning of the recession (**Slide 2**) and consumers and businesses having cut back spending dramatically (**Slide 3**), sales and income taxes to the General Fund were \$1 billion lower in FY 2008-09 than in FY 2007-08, falling from \$7.7 billion to \$6.7 billion. General Fund revenue is expected to fall further this year, in FY 2009-10, to \$6.5 billion. A weak economic recovery is expected and revenue is not expected to reach its pre-recession peak until some time after FY 2011-12, the end of the forecast period.

How Is The Money Spent?

The operating budget, depicted in **Slide 4**, is the largest expenditure in the General Fund. Close to 96 percent of the operating budget is spent on six types of state services: K-12 education, health care, higher education, human services programs, prisons, and the judicial system. Most of the health care budget is spent on the Medicaid and Children's Basic Health Plan programs. The Department of Human Services administers welfare programs, public mental health programs, services for people with developmental disabilities, the juvenile corrections system, and state and veterans' nursing homes.

The remaining 4 percent of the General Fund operating budget is spent by the following departments: Agriculture, Local Affairs, Military and Veterans Affairs, Natural Resources, Personnel and Administration, Public Health and Environment, Public Safety, Regulatory Agencies, Revenue, the Governor's Office, and the Legislative Branch.

Slides 5 and 6 show four other major items that are funded out of the General Fund budget. They are:

- *The Senior Property Tax Exemption.* The exemption allows homeowners age 65 and older who have owned and resided in their home for at least ten years to lower their property taxes. Worth about \$500 to the average qualified homeowner, the exemption was temporarily eliminated for tax year 2009. This is saving the state about \$90 million in FY 2009-10.
- *Fire and Police Pension Association Payments.* The state has agreed to pay for a portion of the liability of the Fire and Police Pension Association. Those payments, which are statutorily required to be at least \$25 million a year, were postponed for three years beginning in FY 2008-09.
- *Transportation.* The state's transportation construction and maintenance budget is primarily funded with motor fuel taxes, vehicle registration fees, and federal transportation dollars. However, in the past, the state legislature has

used the General Fund to augment that budget. There is currently no General Fund revenue budgeted for transportation.

- *Capital Construction.* The General Fund is the primary funding source for the construction and maintenance of state government and higher education buildings and infrastructure. Currently, a minimal amount of General Fund is available for capital construction. Instead, most of its funding currently comes from cash fund sources.

How Big Is the Shortfall?

Last Year: FY 2008-09. As shown in **Slide 7**, the original budget for FY 2008-09 was \$1.2 billion higher than the actual amount spent in FY 2008-09. When the original budget for FY 2008-09 was set, no shortfall was anticipated and the recession had not yet begun.

This Year: FY 2009-10. As shown in **Slide 8**, this year's shortfall totals \$1.7 billion, of which \$1.1 billion was addressed by the state legislature during the 2009 legislative session. The remaining shortfall of \$601 million will need to be addressed during the 2010 session. This \$601 million shortfall grows to \$631 million when an estimated \$30 million of unexpected Medicaid costs is included. The Governor has proposed and partially implemented a plan to close \$591 million of this amount.

This year's \$1.7 billion shortfall cannot be directly compared to last year's \$1.2 billion shortfall. This is true for two reasons. First, some of the measures used to address last year's shortfall are pushing part of it into this year. Therefore, some of this year's \$1.7 billion shortfall was also a part of last year's \$1.2 billion shortfall. Second, unlike the budget for FY 2008-09, it is unknown what this year's budget would have been had the recession not occurred.

Slide 9 shows this year's unaddressed shortfall of \$601 million as a percentage of the General Fund operating budget under current law. The General Fund operating budget already incorporates the actions taken to address the other \$1.1 billion. This chart assumes that the shortfall will reduce the operating budget in each department by an equal percentage. However, the state legislature and the Governor cannot legally address the shortfall in this manner. For example, the state constitution requires that the budget for K-12 education increase by a formulaic amount each year. In addition, Medicaid, which comprises most of the budget for health care, is subject to federal requirements.

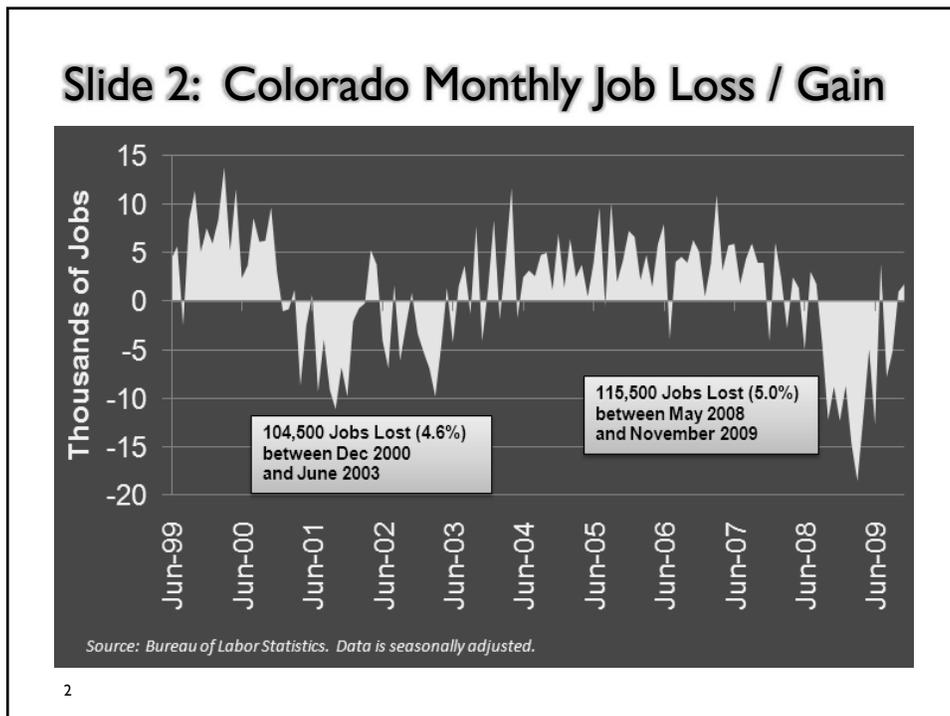
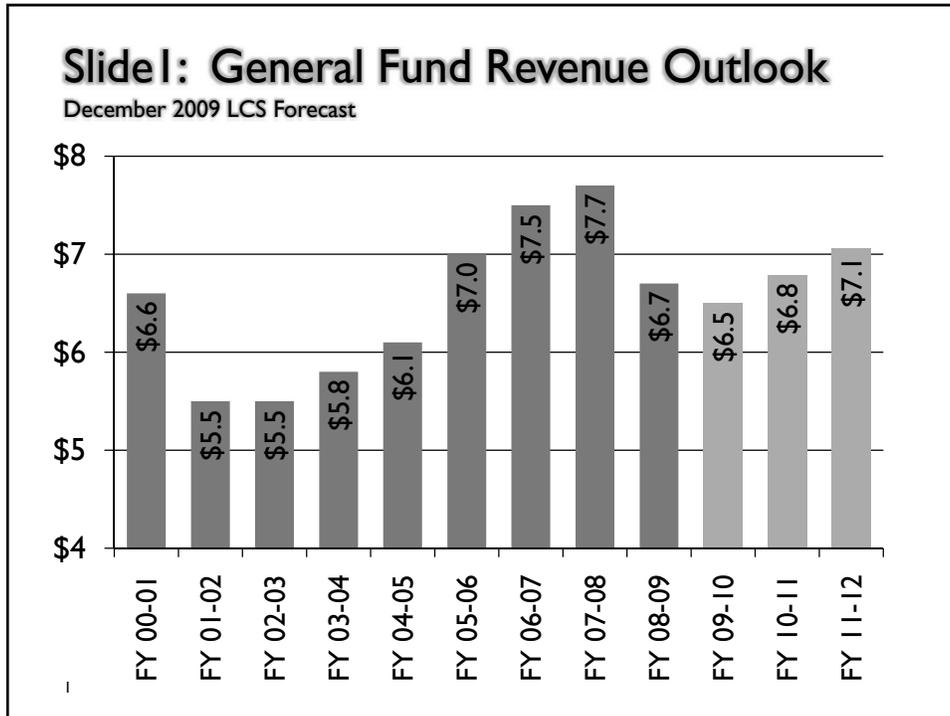
Next Year: FY 2010-11. The state legislature and the Governor will be taking up the budget for FY 2010-11 this spring. As show in **Slide 10**, they will have \$1.5 billion fewer dollars available for spending next year than what was originally budgeted to be spent this year, in FY 2009-10. **Slide 11** shows \$1.5 billion as a percentage of this year's General Fund operating budget.

Because next year's budget and any bills to address the shortfall have not been passed, it is impossible to know the amount of the actual shortfall. Instead, the figure shown in **Slide 10** compares the amount of money that will be available to be spent next year to the amount of money currently budgeted to be spent this year. Thus, this is a two-year cumulative shortfall — it includes the \$601 million shortfall yet to be addressed this year and an additional \$900 million shortfall for FY 2010-11. It does not include any increases in spending that will result from rising caseloads, inflation, or constitutional requirements to increase the budget. What the shortfall ultimately ends up being in FY 2010-11 will depend on these cost increases and how this year's unaddressed \$601 million shortfall is filled.

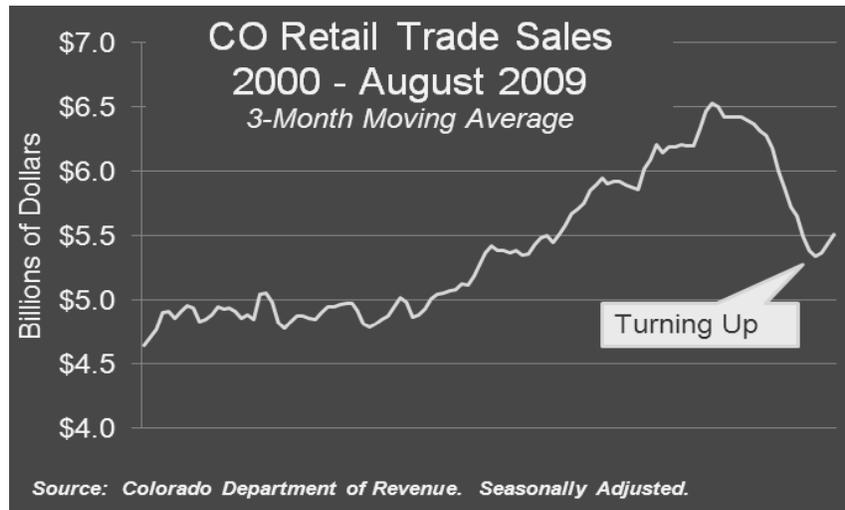
The operating budget shown in **Slide 4**, which makes up the majority of the General Fund budget, is ongoing in nature. It must be spent every year, much like a mortgage payment or a utility bill. If the state legislature permanently cuts \$601 million of ongoing spending this year, they will not only cut that out of the budget for this year, but also for every year in the future, including FY 2010-11. The same is true if the state legislature finds a new and permanent revenue source to address the shortfall. If the \$601 million shortfall is addressed permanently, the \$900 million shortfall in FY 2010-11 would be reduced to \$297 million. In other words, the state legislature and the Governor will have to fill an *additional* shortfall of \$297 million over and above the \$601 million shortfall already addressed.

However, the state legislature and the Governor could choose to fill the shortfall with one-time sources of money, which include temporary spending cuts. One-time sources of money are the same as using a savings account to pay your mortgage. It's there to pay your mortgage this month, but next month the bill for your mortgage remains with smaller savings or no savings available to pay it. If the entire \$601 million shortfall is addressed with one-time sources this year, than the shortfall will remain at \$1.5 billion in FY 2010-11. Approximately 82 percent, or all but about \$100 million, of the Governor's budget balancing plan for FY 2009-10 is one-time in nature.

The FY 2010-11 shortfall cannot be directly compared to either last year's or this year's shortfall. Measures that used one-time money to address last year's and this year's shortfall are pushing part of the shortfall into FY 2010-11. In addition, because next year's budget has not yet been passed and it is unknown what the budget would have been had the recession not occurred, it is impossible to know the actual amount of the shortfall.

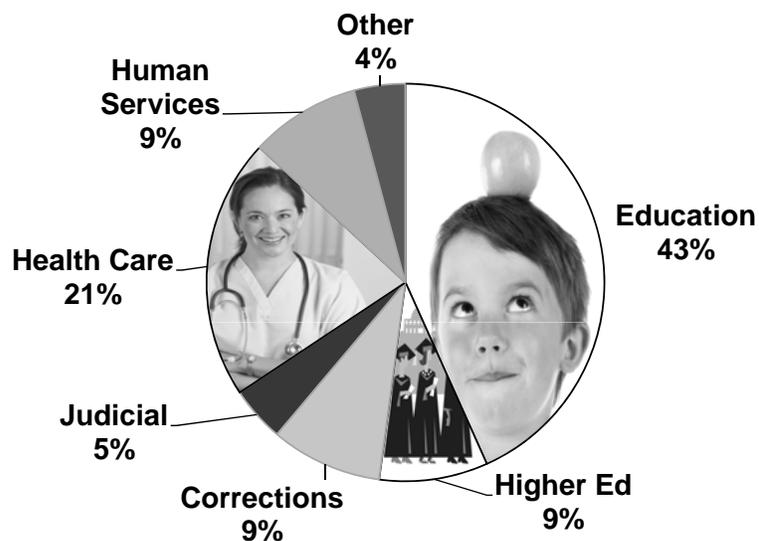


Slide 3: Consumers: Still Down, But Feeling Slightly Better



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Slide 4: FY 2009-10 General Fund Operating Budget: \$7.5 billion



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Slide 5: Other Major General Fund Expenditures

■ Senior Property Tax Exemption



Gone for tax year 2009
\$90 million

■ Fire and Police Pension Association

Postponed
\$25 million / year



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Slide 6: Transportation & Capital



Cash Funds &
Federal Dollars



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Slide 7: Last Year's Budget Shortfall:

- FY 2008-09: \$1.2 billion (15.1%)
 - The original FY 2008-09 budget
less
the amount actually spent



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Slide 8: This Year's Budget Shortfall

- FY 2009-10: \$1.7 billion
 - \$1.1 billion already addressed
plus
\$601 million not yet addressed

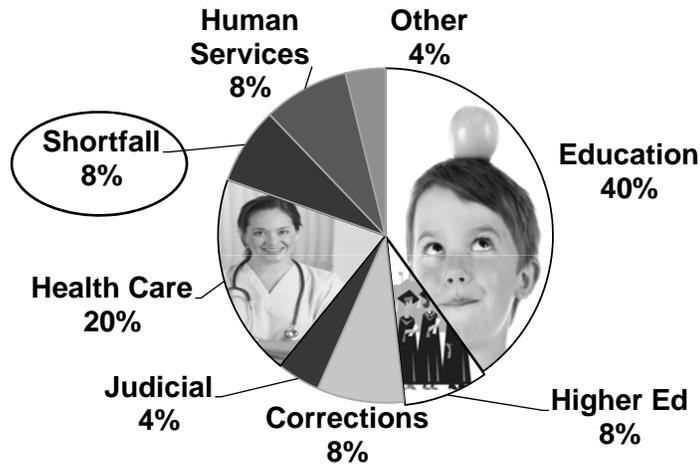


We do not know what the budget would have been had the recession not occurred. The \$1.1 billion shown above is the sum total of the estimated impact of all bills passed to address the shortfall during the 2009 legislative session.

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Slide 9: This Year (FY 2009-10) Unaddressed Shortfall: \$601 million

As A Percent of This Year's Budget



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Slide 10: Next Year's Budget Shortfall

■ FY 2010-11:

\$1.5 billion

less money available to spend
than currently budgeted this year



Because next year's budget has not yet been passed and we don't know what it would have been had the recession not occurred, it is impossible to know the actual amount of the shortfall.

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