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Legislative
Council
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MEMORANDUM

October 21, 2009

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 September 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 percent of their 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 back some of the taxes Coloradans paid to the federal government. These funds must be spent as the federal government requires.
- *Cash fund revenue.* Cash funds are funds or accounts created for specific purposes that have specific revenue sources, such as the Highway Users Tax Fund. 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 general-purpose revenue that can be used for any purpose the state legislature deems fit, subject to constitutional requirements. About 95 percent of the General Fund comes from income taxes (64 percent) and sales taxes (31 percent).

All three sources of revenue are important in the funding 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 more than 120,000 jobs lost in the recession (**Slide 2**) and consumers and businesses having cut back spending dramatically (**Slide 3**), sales and income taxes to the General Fund came in \$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 the six largest areas of state services: K-12 education, health care, higher education, human services programs, prisons (corrections), and courts (Judicial). 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 on transportation.

- *Capital Construction.* The General Fund is the traditional primary funding source for the construction and maintenance of state government and higher education buildings and infrastructure. There is currently very little General Fund available for this and much of its funding is currently coming from cash fund sources.

How Big Is the Shortfall?

Slide 7 summarizes the size of the hole in the General Fund budget. A \$1.2 billion shortfall has already been addressed for both the FY 2008-09 budget and the FY 2009-10 (this year's) budget. This year the shortfall totals \$1.7 billion, including a shortfall of \$561 million that has not yet been addressed. The Governor has proposed and partially implemented a plan to close \$320 million of this amount. Staff arrived at the total of \$1.7 billion for FY 2009-10 by adding up the estimated impact of all of the measures that have already been enacted to fill the shortfall thus far and the remaining \$561 million shortfall that has yet to be addressed.

The state legislature and the Governor will be taking up the budget for FY 2010-11 this spring. They have \$1.3 billion fewer dollars available for spending in that year than what is currently budgeted to be spent this year, in FY 2009-10. This is a two-year cumulative shortfall - it includes the \$561 million shortfall for this year and an additional \$750 million shortfall for FY 2010-11. These shortfalls compare the amount of money that will be available to be spent next year (FY 2010-11) to the amount of money currently budgeted to be spent this year (FY 2009-10). They do not include any increases in spending that will result from rising caseloads, inflation, or constitutional requirements to increase the budget.

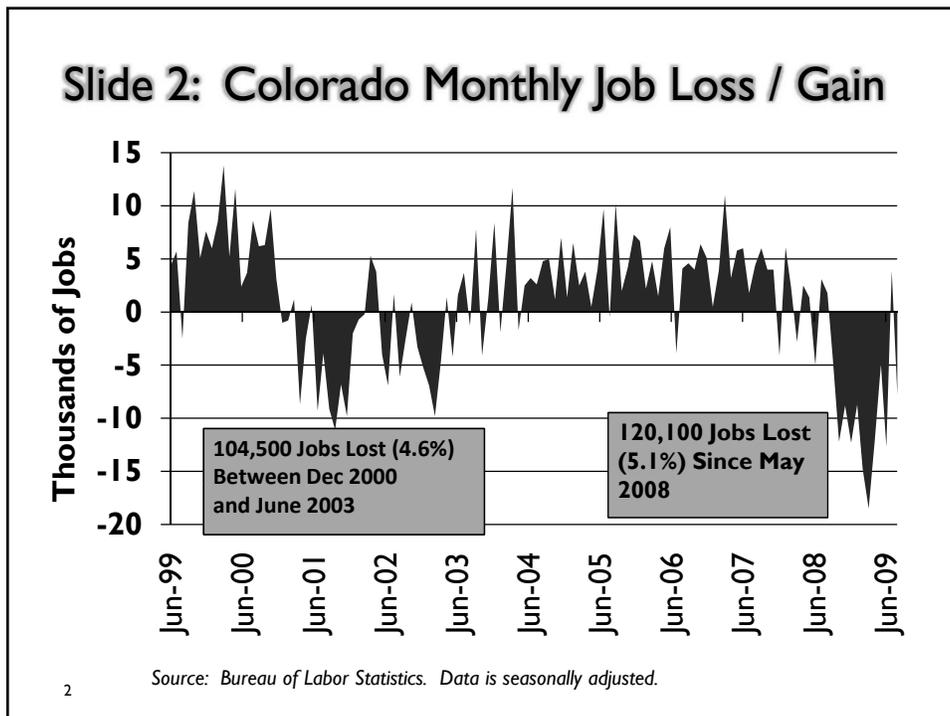
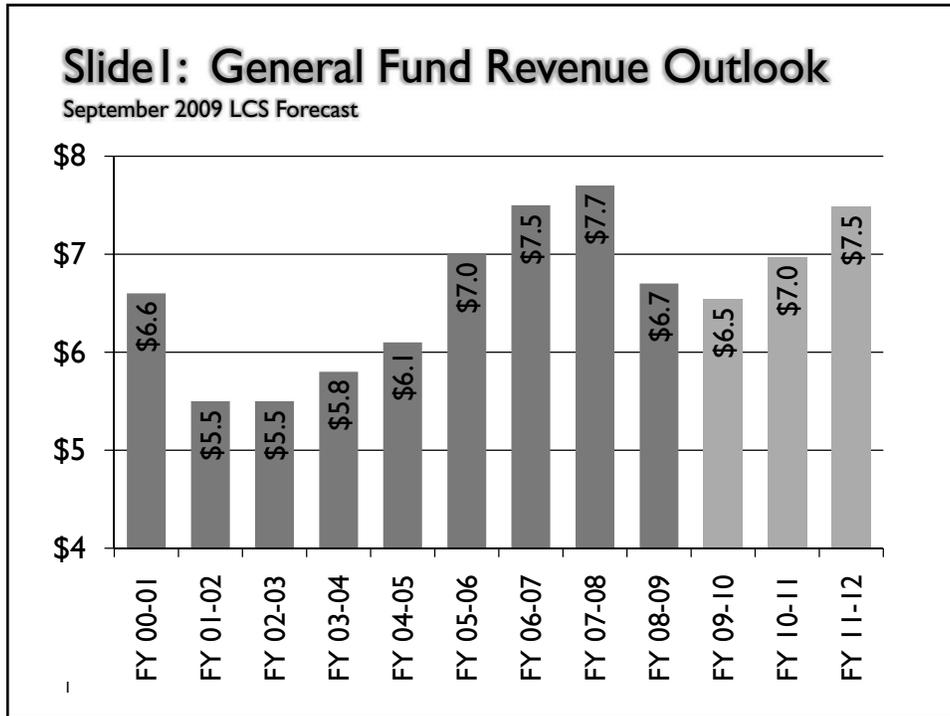
Slides 8 and 9 show the size of the shortfall for FY 2009-10 and the two-year shortfall for FY 2010-11 as a percentage of the General Fund operating budget. The assumption in these pie charts is that the shortfall will reduce the operating budget in each department by an equal percentage. However, the 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. Medicaid, which comprises most of the budget for health care, is subject to federal requirements.

The \$1.3 billion shortfall for FY 2010-11 is a two-year shortfall. What the shortfall ultimately ends up to be in FY 2010-11 will depend on how the FY 2009-10 \$561 million shortfall is addressed. 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

\$561 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 \$561 million shortfall is addressed permanently, the \$750 million shortfall in FY 2010-11 is reduced to \$189 million. In other words, the state legislature and the Governor will have to fill an *additional* shortfall of \$189 million over and above the \$561 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 you're stuck with a bill for your mortgage and nothing in your savings account with which to pay it. If the entire \$561 million shortfall is addressed with one-time sources this year, than the shortfall will remain at \$1.3 billion in FY 2010-11.

The Governor's August 24th budget balancing plan, which addressed \$320 million of this year's \$561 million shortfall, includes about \$150 million of permanent changes and \$170 million of one-time moneys.

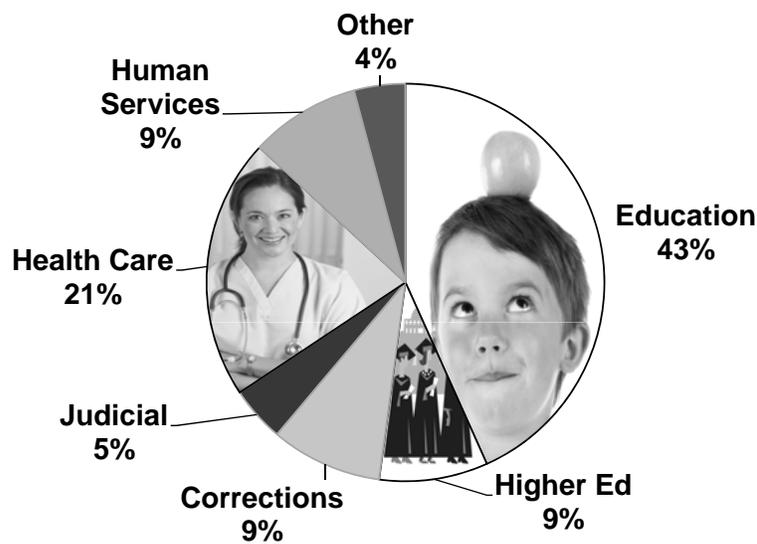


Slide 3: Consumers: They've Hit The Reset Button



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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: General Fund Budget Shortfalls

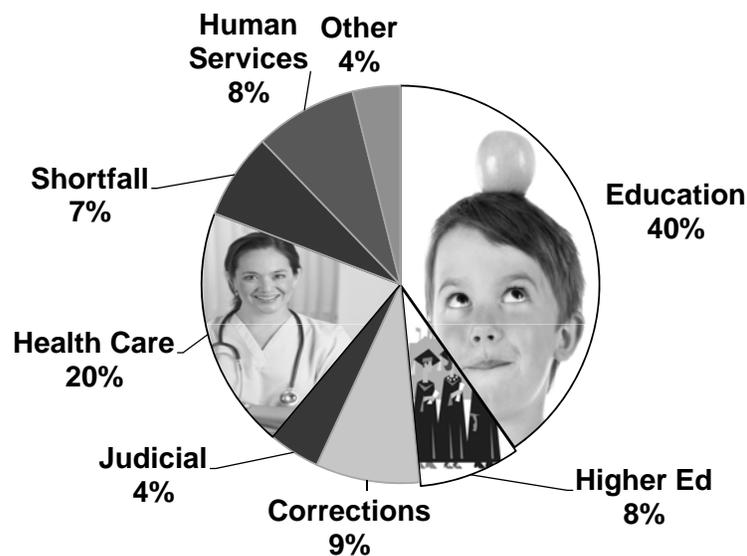
- FY 2008-09: \$1.2 billion (15.1%)
 - Fully addressed

- FY 2009-10: \$1.7 billion
 - \$561 million still not addressed

- Cumulative thru FY 2010-11: \$1.3 billion
 - Next year depends on what happens this year

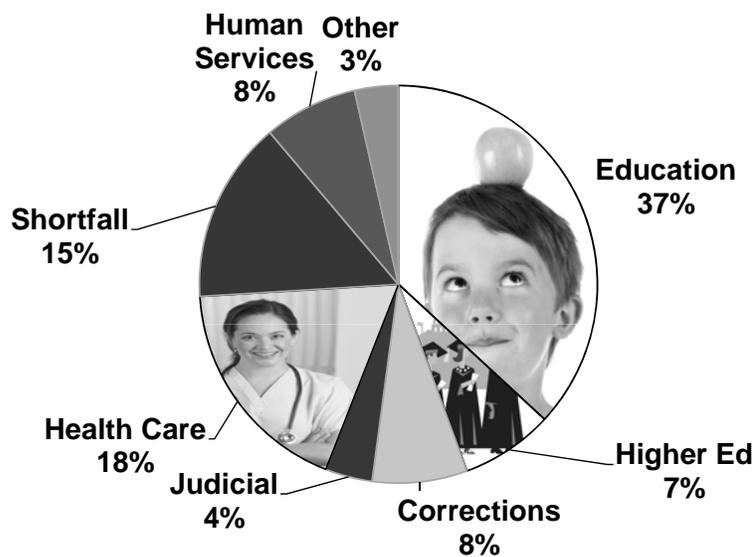
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Slide 8: FY 2009-10 Shortfall: \$561 million



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Slide 9: FY 2010-II Cumulative Two-Year Shortfall: \$1.3 billion



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