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Colorado's 2015–2016 Budget and Economic Outlook

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Introduction

In a variety of ways, Colorado remains a state in transition. As is the case with many states around the nation, the economy continues to improve from the recession. Demographically, the state is becoming increasingly diverse. According to the census, more than one-fifth of state residents were Hispanic or Latino/a in 2015. Colorado's population growth of nearly eight percent since 2010 ranks third behind only Texas and North Dakota.

Politically, Colorado has been trending blue over the past several election cycles. Some have identified the migration of Californians into Colorado as a contributing factor to the state leaning further in the Democratic direction (Robinson and Noreiga 2010). The state awarded its Electoral College votes in 2008 and 2012 to the Democratic ticket, and the party appears poised to carry the state in 2016. A streak of two consecutive wins for the Democratic Party's presidential candidates has not happened since Colorado voters supported Franklin Roosevelt in 1932 and 1936.

Democrats emerged victorious in the last three gubernatorial elections and won three consecutive elections to the U.S. Senate beginning in 2004. The state's march toward blue-state status was interrupted in 2014, however, as Republican Representative Cory Gardner defeated incumbent Democratic Senator Mark Udall in a competitive race. Republican candidates in this election cycle swept three of the remaining four statewide races, and the GOP regained control of one chamber of the state legislature. The single bright spot for Democrats on election night 2014 was the reelection of incumbent Governor John Hickenlooper who narrowly edged out Republican challenger Bob Beauprez.

Colorado continues to receive national and international attention over the legalization of recreational marijuana, which has important budgetary implications. Though revenues associated with legalized recreational marijuana have fallen short of early government forecasts, marijuana tax revenue continues to grow steadily. The sale of marijuana to adults over the age of 21 became legal on January 1, 2014. By the end of the year, the state received $44 million in revenue from recreational marijuana. Combined with the preexisting medical marijuana market, the state received $76 million in 2014 (Wyatt 2015).[1] Despite an improving economy and a new stream of marijuana tax revenue, legislators remain wary about approving new spending measures. This is partly attributable to uncertainty regarding potential tax rebates mandated by the Taxpayer's Bill of Rights (TABOR).

[1] When tabulating marijuana-related revenue, the Department of Revenue includes retail and medical marijuana application and license fees.

In the current legislature, Democrats hold a slim majority in the House, while the Republican advantage in the Senate is by a single seat. An analysis of roll call voting in state legislatures concluded that the Colorado Legislature is among the most ideologically polarized in the nation (Shor and McCarty 2011). Divided government, coupled with greater ideological polarization, has made dramatic changes in spending less likely to be successful. Governor Hickenlooper's approval rating remains above 50 percent, but he faces a divided legislature and does not enjoy substantial political capital, having barely survived a close reelection (Bartels 2015).

State Economy and Budget

When submitting requests to the Office of State Planning and Budget (OSPB), departments must outline a strategic plan to accompany their request. The governor's budget request is submitted to the legislature in the fall. After consideration by the Joint Budget Committee (JBC), the full legislature typically passes the budget in May in time for the start of the fiscal year on July 1. The constitution mandates a balanced budget.

Last November, the priorities reflected in Governor Hickenlooper's proposed budget for the 2015–2016 fiscal year were similar to those in prior budgets drafted by the governor in collaboration with the OSPB. In his accompanying letter to the six-member JBC, the governor emphasized "enrollment and inflation increases for K-12 education, the return of General Fund support for transportation for the first time since FY 2007–08 pursuant to S.B. 09–228, increased caseload in the State's Medicaid program, an anticipated decrease in the federal Medicaid match rate, the continuation of existing capital construction projects, and essential projects for the state's information technology infrastructure" (Hickenlooper 2014). Spending in just two areas—K-12 education and health and human services—constitute two-thirds of all proposed General Fund appropriations.

Governor Hickenlooper's budget letter detailed how economic progress in Colorado has outpaced the nationwide recovery. In that sense, the budget reflects a cautious optimism about the state's economic wellbeing. The Bureau of Labor Statistics reports that Colorado's seasonally adjusted unemployment rate in December 2014 was just 4.0 percent. Tied for seventh lowest in the country (2015), it is a product of 35 consecutive months of job growth. The national unemployment rate for the same month was 5.6 percent.

After a decrease in gross state product (GSP) in 2009, the state has logged increases averaging about 2.5 percent a year for the past four years, and per capita income levels have increased. Against this backdrop of economic improvement, the governor's budget includes $26.8 billion in total spending with a General Fund allocation of $10.3 billion. The sums represent spending increases from the prior fiscal year of 7.0 percent in total funds and 9.6 percent from the General Fund (Hickenlooper 2014).

During the recent economic recession, General Fund revenue in current dollars decreased over two consecutive fiscal years. Since the low point of the 2009–2010 when the General Fund fell to $6.4 billion, this number has increased by an average of $0.65 billion over the past four years.[2] A March 2015 estimate projected that General Fund revenue was on track to grow by nearly nine percent in the current fiscal year, but contraction in oil and gas industry-related ac-

[2] Adjusted for inflation and population growth, General Fund revenues remain below the prerecession high.

tivity is projected to slow revenue gains. The projected General Fund amounts for the fiscal years beginning in 2014 and 2015 are $9.6 billion and $10.3 billion, respectively.

One novel aspect of this year's budget debate is that economic gains are substantial enough that lawmakers will have to consider tax refunds under TABOR. According to TABOR, which voters ratified in the state constitution in 1992, the state must issue tax refunds if revenues exceed the prior year's spending after accounting for inflation and population growth. TABOR refunds have not been possible for at least a decade. The governor's budget includes a rebate forecast in the amount of $167.2 million.[3] Legislators may ask voters to forego refunds in lieu of providing spending in a number of areas. The governor's budget letter outlines several contingency plans where additional legislation or voter approval may be necessary to enact the spending items it includes.

The governor's 2015–2016 budget proposed increasing appropriations from the General Fund for most state departments. Table 1 provides summary data comparing the proposed budget with spending levels from the prior year. The first items discussed in the governor's budget letter concern education, which is among the governor's highest priorities. Since Governor Hickenlooper previously campaigned for passage of Amendment 66—a tax increase to fund K-12 education—it is not surprising to see his budget propose increases in education funding in the aftermath of its defeat.

Put to voters on the 2013 ballot, Amendment 66 proposed an approximate 10 percent increase in the tax rate on income up to $75,000 and a 25 percent increase on income beyond $75,000. According to the state, the amendment would have raised taxes by $950 million in the first year following adoption. Despite the fact that supporters of the amendment raised in excess of $10 million to promote the measure, Colorado voters overwhelmingly rejected the tax increase with 64 percent of the electorate voting against it.

Following this resounding defeat, the governor's proposed budget seeks to increase education funding. The defeat of the tax increase to fund education could make more modest increases in education spending more acceptable to Republican legislators. Many Democratic lawmakers who supported the tax increase view the governor's increase in K-12 spending as all the more necessary. Accordingly, the budget for the upcoming fiscal year increases total spending on K-12 education by 8.1 percent ($480.3 million), an increase in per pupil funding of nearly $475 that brings total per pupil funding to about $7,500.

Spending on higher education will increase by over $100 million after agreement was reached in 2014 on legislation limiting undergraduate tuition increases to no more than six percent in exchange for greater direct support from the state budget.[4] General Fund increases for public institutions of higher education was set at about $75 million. This amount allocated to the governing

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[3] The OSPB claimed the following with regard to TABOR refunds, "TABOR revenue is projected to exceed the cap by $216.2 million in FY 2014–15, $120.4 million in FY 2015–16, and $316.6 million in FY 2016–17, meaning that a refund to taxpayers will occur for each of those years under this forecast, unless voters allow the state to retain the revenue. . . . However, smaller TABOR refunds than forecast would trigger the full transfer amount, creating a General Fund shortfall under the governor's budget request. Under this forecast and current law, in FY 2014–15, revenue above the Referendum C cap will be refunded through the State Earned Income Tax Credit to qualified taxpayers and the sales tax refund to all taxpayers. In FY 2015–16, revenue above the Referendum C cap will be refunded through the sales tax refund. In FY 2016–17, the refund will occur through a temporary income tax rate reduction and the sales tax refund."

[4] Senate Bill 14-001 signed by Governor Hickenlooper on May 1, 2014.

Table 1. Proposed General Fund Appropriations Changes

Department	FY 2014–15 Spending (in millions of dollars)	FY 2015–16 Request (in millions of dollars)	Percent Change
Agriculture	9.31	9.66	3.76
Corrections	720.43	749.31	4.01
Education	3,357.90	3,599.24	7.19
Health Care Policy and Financing	2,264.47	2,483.54	9.67
Higher Education	761.98	869.04	14.05
Human Services	782.00	807.02	3.20
Judicial	444.08	476.29	7.25
Labor and Employment	0.64	1.25	96.83
Law	13.53	14.64	8.17
Legislative	40.95	43.35	5.88
Local Affairs	21.66	25.84	19.32
Military and Veterans Affairs	8.19	8.25	0.82
Natural Resources	26.23	26.43	0.76
Personnel and Administration	6.77	8.45	24.85
Public Health and Environment	63.97	45.64	-28.65
Public Safety	133.60	122.30	-8.46
Regulatory Agencies	1.88	1.98	5.10
Revenue	101.67	94.55	-7.0
Transportation	0.70	0	-100.0
Treasury	121.63	124.81	2.62

Note: Data from Governor Hickenlooper's FY 2015–2016 budget request.

boards of higher education institutions reflects an increase of 12.5 percent in General Fund spending. An additional $30 million would be allocated to a new Colorado Opportunity Scholarship Initiative, which would go toward student scholarships funded jointly by public and private sources. The budget from the previous year included about $60 million from the General Fund to institutional support with $40 million designated for student financial aid.

After education, the second largest increase in spending is proposed to go to the Department of Health Care Policy and Financing where, as in previous years, caseload increases have necessitated greater funding. Accordingly, the budget includes an increase of $82 million from the General Fund. An additional $154.7 million in General Fund spending ($654.7 million total funds) is pegged for future casework and modernization related to Medicaid, children's health plans, and other health programs. Another notable increase in health care spending is a proposed increase of $11.4 million ($32.9 million total funds) for 1.0 percent raises in provider and targeted service rates. Nearly $7 million of a $25 million General Fund increase in Department of Human Services spending is proposed to allow counties to hire 130 additional child welfare caseworkers, and mental health and juvenile correctional institutions are scheduled to hire more than 100 new full-time employees.

The governor's budget continues to make investments in improving the Department of Corrections. Interest in directing greater funds to this area grew after the murder of Department of Corrections Director Tom Clements in 2013. The new director, Rick Raemisch, has championed meaningful prison reform. After increasing General Fund spending for the department by more than six percent last year, the 2015–2016 budget proposes a more modest increase of 4.0 percent, or nearly $30 million. The department estimates a small increase in the number of offenders housed in its facilities, and greater funding will allow the department to improve operations and facilities, including the addition of 330 beds. The state expects to hire more than 20 full-time employees to better assist people in the criminal justice system with mental health issues. A 1.0 percent provider rate increase is also included in the budget.

The only departments with proposed reductions in General Fund spending were Public Health and Environment, Public Safety, and Revenue. Funding requested for the Department of Public Safety is 8.5 percent lower due to the absence of nearly $10 million in funding allocated to purchase aircraft and equipment for an aerial firefighting fleet. These funds made it into the prior year's budget after the state experienced one of the most devastating wildfire seasons in its history. Partially filling this void is a proposed additional $2.7 million in funding to go toward two new Colorado Bureau of Investigation forensic labs and a 1.0 percent increase for state community corrections program providers.

Funding proposed for the Department of Public Health and Environment is 28 percent lower largely due to the absence of appropriations made last year to help communities recover from widespread flooding that occurred in September 2013. General Fund spending for the Department of Revenue is slated for reduction with the loss of a one-time appropriation of $6.2 million in the prior year's budget to help the department modernize its operations. These anomalies explain most of the larger cuts in General Fund spending. The budget preserves the status quo in most areas with a few targeted increases. The marijuana tax revenue makes spending increases more palatable to legislators.

Marijuana Tax Revenue

In 2012, when nearly 55 percent of Colorado voters cast ballots in favor of legalizing recreational marijuana use by adults over the age of 21 the state's counties were nearly evenly divided on the issue. Thirty-three of the 64 counties had a majority voting in favor of legalization, while 31 counties were had more no voters. One of many reasons for the ultimate success of the measure was that localities were given the option to prohibit marijuana business."[5] A year-end analysis in *The Denver Post* noted that 23 Colorado counties (35 percent) currently permit marijuana cul-

[5] The constitutional amendment specified, "A locality may prohibit the operation of marijuana cultivation facilities, marijuana product manufacturing facilities, marijuana testing facilities, or retail marijuana stores through the enactment of an ordinance or through an initiated or referred measure."

tivation, sales, or both (Murray and Aguilar 2014). Within these counties, 53 cities or towns permit recreational marijuana sale. As of March 2015, the state had licensed a total of 341 retail stores to sell marijuana. Including those authorized to sell medicinal marijuana, the number of outlets is over 500 (Colorado Department of Revenue 2015).[6]

A study by the Marijuana Policy Group found that the demand for marijuana in the state likely far exceeds prior estimates, although the total amount of tax revenue generated by the first year of legal recreational sales fell short of expectations (Light et al. 2014). Using survey data, the study estimates about 13 percent of Colorado's population used marijuana at least once in 2010 or 2011. Approximately nine percent of adults reported consuming cannabis in some form at least once a month. Based on a survey about frequency of use, Light et al. estimate that the total marijuana demand in the state is 121.4 metric tons annually (2014). According to their methodology, individuals that consume cannabis daily constitute about one-fifth of marijuana users, but about two-thirds of total demand.

Results from this study, when considered in conjunction with tax data, present a paradox. If the demand for marijuana was previously underestimated, why have tax revenues associated with the new marketplace fallen short of expectations? One of many possible explanations is that many individuals continue to take advantage of the black or medical markets to avoid the taxes associated with higher-priced retail marijuana.

Given the novelty of recreational marijuana legalization, substantial uncertainty existed regarding the economic benefits that would ensue. Taxes on recreational marijuana include a base sales tax of 2.9 percent, an additional 10 percent sales tax, and a 15 percent excise tax. By the end of 2014, recreational and medicinal marijuana sales totaled nearly $700 million (Baca 2015), with about 45 percent of the total from retail sales.

During the first month of recreational sales, few retail outlets were operational, and sales of medical marijuana were more than double the nearly $15 million in recreational marijuana sales. Recreational marijuana sales increased every month through August by an average of $2.8 million. August was the first month that recreational sales exceeded medicinal sales.

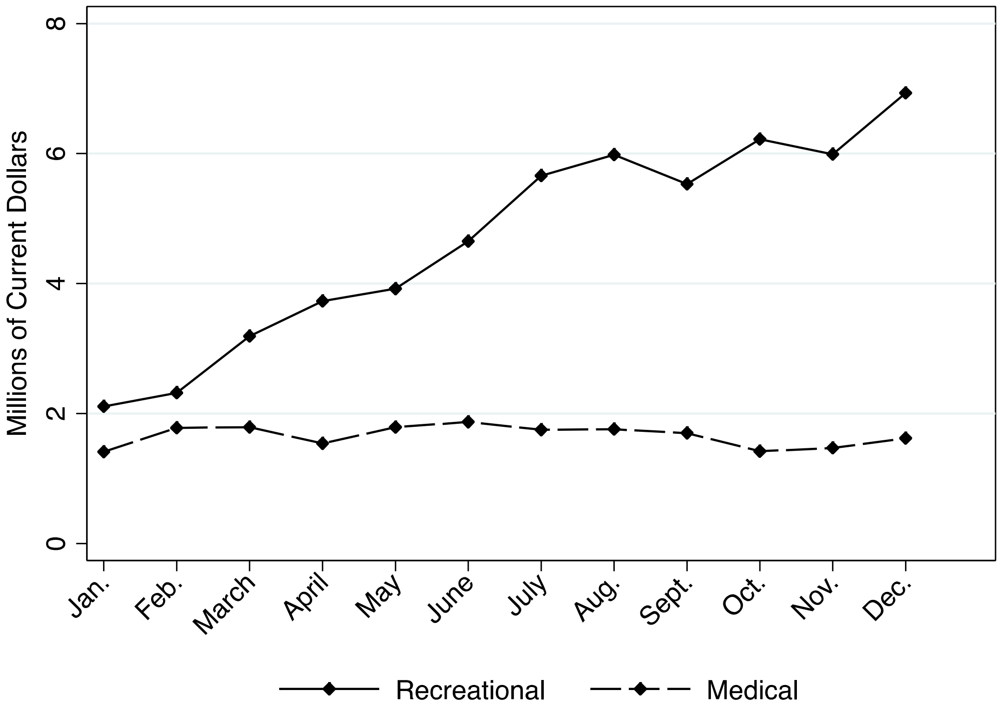
Recreational sales decreased for the first time in September and held steady at about $31 million over the next few months. December brought another increase as recreational sales passed $35 million for the first time. Recreational sales in January 2015 came in at nearly $36.5 million, so it remains yet to be seen at what point sales will plateau (Colorado Department of Revenue 2015). Tax revenue associated with the sales has been well below most prior projections. Figure 1 provides monthly tax, licensing, and fee revenue data for both recreational and medical marijuana in 2014. All data are from the Colorado Department of Revenue.

As seen in the figure, revenue from medicinal sales remained relatively constant in 2014, ranging from a low of $1.41 million to a high of $1.87 million. Some expected the number of medicinal marijuana patients to decrease with the rollout of recreational marijuana, but the number of residents with a valid red card actually increased by over 4,000 to reach a total of 115,467 (Colorado Department of Public Health & Environment 2015).

Governor Hickenlooper originally estimated the state would receive $134 million in marijuana tax revenue in the 2014–2015 fiscal year. This figure was revised in April to approximately $114 million (Wyatt 2014). When the final tax revenues from 2014 were tabulated, the state had collected $76 million, $63.4 million in taxes and the remaining revenue from licensing and other fees. The state of Washington collected approximately $22.7 million in tax revenues and fees for marijuana sales that began in July (Wyatt 2015).

[6] See Appendix 1 for a list of these towns and the number of dispensaries located in each.

Figure 1. Recreational and Medical Marijuana Tax, Licensing, and Fee Revenue: 2014



Note: Data from the Colorado Department of Revenue (2015).

Under the tax structure approved by voters, the first $40 million in marijuana excise tax revenue is mandated to go toward school construction. Revenue beyond this amount is not designated for particular purposes. In 2014, excise tax revenue totaled $13.3 million, which fell below expectations. January 2015 showed signs of greater optimism as $36.4 million in recreational marijuana was sold, resulting in over $2.35 million in excise tax revenue for schools. This is the first month excise tax revenue exceeded $2 million. In January 2014, excise tax revenue totaled just $200,000 (Colorado Department of Revenue 2015). In sum, revenue from legal recreational and medicinal marijuana continues to grow steadily, despite the fact that revenue levels have not approached what many originally projected.

For numerous reasons, the continued unfolding of the recreational marijuana market merits watching. Stricter packaging rules for edible marijuana products were recently adopted. In March 2015, the state had to defend legalized marijuana in federal court for the first time in response to a lawsuit filed by Nebraska and Oklahoma officials. One aspect of the state's marijuana industry in a nascent phase is marijuana tourism. A recent study estimated that "out-of-state visitors currently represent about 44 percent of metro area retail sales and about 90 percent of retail sales in heavily visited mountain communities. Visitor demand is most prevalent in the state's mountain counties, where combined medical and retail marijuana sales more than doubled after retail sales were legalized in January, 2014" (Light et al. 2014, 3). In some areas, much of the revenue generated through marijuana sales comes from out-of-state visitors. Regulations initially imposed differentiated sales limits whereby state residents could purchase four times the amount of marijuana per day than an out-of-state visitor. The tiered limits were intended to limit the amount of marijuana transported across state borders. Proposals to equalize these limits would likely spur greater tax revenue collection in certain parts of the state.

Thus far, beyond funds earmarked for school construction, marijuana revenue has financed the regulatory apparatus necessary to oversee the state's growing recreational and medical marijuana marketplace. Marijuana revenue has also been allocated to youth drug prevention, public safety, and public education. State officials have launched several advertising campaigns to inform residents and tourists about marijuana laws and regulations regarding its use. To date, more than $5 million has been spent on these public awareness campaigns with more to come. The amount the state is permitted to spend may depend on whether voters collectively decide to let it keep revenues in excess of TABOR limits.

Conclusion

Governor Hickenlooper's 2015–2016 budget proposal does not contain many surprises and is generally in line with his previous budgets. In many respects the budget is cautious, partially out of necessity given the uncertainty regarding potential TABOR tax rebates. While the governor's budget highlights economic gains in the state, some policymakers remain concerned about the economy's fragility. Continued decreases in the price of oil, for example, could have substantial economic consequences given the size of the state's oil and gas industry.

The political landscape with divided partisan control of the legislature is not conducive to major policy reforms or substantial increases in spending. As a case in point, the ongoing debate over the imposition of a felony DUI law demonstrates how legislative proposals with considerable support may encounter obstacles in the current legislative climate simply because they necessitate increased spending to implement. Nearly every state in the nation has a felony DUI penalty; Colorado is one of the few remaining states where no such law exists.[7]

With sponsors from both parties in the current legislative session, House Bill 1043 sought to impose a felony DUI penalty at a cost of approximately $1.4 million in enforcement over the first year. Many legislators bristled at the cost of the measure, which was estimated to increase during subsequent years to several times beyond the first-year cost. Similar proposals, such as a ban on ivory products akin to those recently passed in New York and New Jersey, have failed in recent sessions due to what some have termed "fiscal triage"—when bills enjoying bipartisan support are shelved due to their cost (Hudson 2015).

In a committee hearing held at the end of March, the standard to be eligible for a felony DUI conviction was modified from three DUI's over a span of seven years to four lifetime DUI's. After the cost-cutting amendment was approved, the bill unanimously passed the finance committee. In the current political environment, incremental policy changes are possible, but government spending remains a substantial point of contention between the parties. Given the circumstances, the state's budget for the 2015–2016 fiscal year represents a stay-the-course approach that seeks to continue Colorado's emergence from the recession while seeking greater funding in areas deemed worthy of investment.

[7] The other states without a felony DUI penalty are Maryland, Maine, Pennsylvania, and New Jersey.

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Appendix 1.

Colorado Localities with Marijuana Dispensaries

City	Total	Recreational	City	Total	Recreational
Alma	3	2	Idaho Springs	6	3
Aspen	11	5	Lafayette	2	1
Aurora	24	24	Leadville	4	3
Basalt	3	2	Log Lane Village	4	2
Black Hawk	4	2	Louisville	3	2
Boulder	36	17	Lyons	4	1
Breckenridge	7	4	Mancos	2	1
Carbondale	6	4	Mountain View	3	1
Central City	5	3	Nederland	3	1
Cortez	6	2	Northglenn	10	4
Crested Butte	5	3	Oak Creek	1	0
De Beque	2	2	Pueblo	8	3
Denver	200	129	Ridgeway	5	3
Dillon	1	1	Rifle	5	0
Durango	11	3	Salida	4	2
Eagle	2	1	Sedgwick	2	1
Edgewater	12	6	Silt	2	2
Empire	1	1	Silver Plume	2	1
Fort Collins	21	7	Silverthorne	2	1
Fraser	3	2	Silverton	1	1
Frisco	5	2	Steamboat Springs	6	3
Garden City	8	4	Telluride	8	4
Georgetown	2	1	Trinidad	5	2
Glendale	4	1	Wheat Ridge	8	4
Glenwood Springs	8	3			

Note: Data from Murray and Aguilar (2014).