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## **Fighting over Fees: Colorado’s 2016–2017 Budget and Economic Outlook**

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### **I. Introduction**

In 2015, Colorado’s population growth outpaced every state in the nation except for North Dakota (Census Bureau 2016). The sustained migration to the state is such that many expect Colorado to receive an additional congressional seat following the 2020 census and House reapportionment (Skelley 2015). This population boom has contributed to numerous economic opportunities and challenges. Many of these are reflected in the state’s budget. Governor John Hickenlooper, who narrowly won reelection over Republican challenger Bob Beauprez in 2014, submitted his budget proposal to the General Assembly in November 2015. Among the most notable features of the governor’s \$27 billion budget are \$373 million in spending reductions and \$189 million in potential refunds to state residents through the Taxpayer’s Bill of Rights (TABOR). Total General Fund spending in the governor’s budget is \$10.4 billion. Relative to the prior fiscal year, the \$27 billion in total spending represents a decrease of 0.4 percent, while the General Fund budget is a 0.9 percent increase (Hickenlooper 2015).

This year’s budgeting is characterized by more uncertainty than in previous years. A downturn in the oil and gas industry has negatively affected the state’s economy, and some economists are speculating that a recession may be on the horizon (Frank 2016b). The economic outlook from the governor’s Office of State Planning and Budgeting (OSBP) claims that although economic growth has slowed, the state is navigating the current environment relatively well. The governor’s letter to the Joint Budget Committee (JBC) claimed, “Economic conditions in Colorado remain among the most favorable in the United States” (Hickenlooper 2015). Governor Hickenlooper noted the economic gains related to individuals and businesses moving into the state. While the state’s energy industry has taken a downturn, the OSBP describes a statewide economic environment that is “positive” overall.

The preliminary estimate from the Bureau of Labor Statistics (BLS) of Colorado’s seasonally adjusted unemployment rate in January 2016 was 3.2 percent (2016). Only four states had a lower unemployment rate.<sup>1</sup> The January estimate from the BLS was below the December 2015 mark of 3.5 percent, making Colorado one of 10 states with a statistically significant decrease in month-to-month unemployment during this period. The state’s continued overall job growth is particularly notable given the importance of the energy industry to the state’s economy and when considering that 6,700 oil, gas, and mining jobs were lost in 2015. Losses in this sector, however,

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<sup>1</sup> The four states with unemployment estimates lower than Colorado were South Dakota (2.8 percent), New Hampshire (2.9 percent), Nebraska (3.0 percent), and North Dakota (3.0 percent).

were offset by gains in others as the state posted its 51st consecutive month of job growth. In fact, the January 2016 unemployment rate is nearly 1 percent lower than the January 2015 figure. After a decrease in 2009, the past six years have each witnessed increases in gross state product (GSP) averaging about 2.5 percent. The most recent GSP report from the Bureau of Economic Analysis (BEA) shows Colorado's GSP growth in the third quarter of 2015 at 2.4 percent, which outpaced national GDP growth (2016). Per capita income levels have also been increasing, although at a rate lower than most other states (BEA 2015).

For nearly 25 years, TABOR has strongly influenced Colorado's budgeting process. Ratified into the state constitution in 1992, TABOR imposes strict limits on state and local government revenue and spending. According to the National Conference of State Legislatures (NCSL), Colorado is one of only three states that impose such restrictions on both revenue and spending. Oregon and Oklahoma also have formal limitations on each. Though the specifics can become complicated, generally state residents receive tax refunds when state revenues exceed projections. All tax increases, including the imposition of new taxes, are subject to voter authorization. Past and future modifications to TABOR, such as the passage of Referendum C in 2005, also require approval from the public.

In 2013, voters approved proposition AA, which imposed tax rates on recreational marijuana sales including a base sales tax of 2.9 percent plus an additional 10 percent sales tax, as well as a 15 percent excise tax. Because state revenue in the 2014–2015 fiscal year subject to the TABOR spending limit exceeded projections, Coloradans were eligible for tax refunds. Instead of automatically processing refunds, state legislators referred proposition BB to Colorado voters in the fall election. The passage of this proposition allowed the state to keep approximately \$66 million.<sup>2</sup> A unique aspect of this year's budget process is the constitutionality of the governor's proposal to reclassify hospital provider fees as a means to obviate the potential for similar taxpayer refunds next year. The controversy surrounding this proposal is discussed in detail in the following section.

Finally, Colorado continues to receive national and international attention over the legalization of recreational marijuana. Though revenues associated with the legalized recreational marijuana have fallen short of early government forecasts, marijuana tax revenue continues to steadily grow. The first year of recreational sales totaled approximately \$313 million. Medical sales totaled nearly \$386 million. These sales figures translated into about \$44 million in recreational marijuana taxes and \$76 million in total tax revenue, which also includes marijuana business application and licensing fees. Combined marijuana sales in 2015 climbed to nearly \$1 billion. Recreational marijuana sales were nearly \$588 million, while medical sales increased to \$408 million (Colorado Department of Revenue 2016). This substantial increase in sales, particularly in the retail market, increased the tax revenue collected to more than \$135 million. While state officials continue to study the societal and economic effects of marijuana legalization, the budg-

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<sup>2</sup> According to the Colorado Secretary of State's office, funds retained by the state in excess of TABOR limits would be allocated to the following: school construction (\$40.0 million); marijuana education and prevention campaigns (\$2.5 million); bullying prevention school grants (\$2.0 million); drop-out prevention school grants (\$2.0 million); youth mentoring services (\$2.0 million); poison control centers (\$1.0 million); local government marijuana impact grants (\$1.0 million); substance abuse screening, intervention, and referral (\$0.5 million); substance abuse treatment (\$0.5 million); Future Farmers of America and 4-H programs at the State Fair (\$0.3 million); and roadside impaired-driving enforcement training for peace officers (\$0.2 million).

etary aspect remains complex with many moving pieces, including the possibility of taxpayer refunds under TABOR.

The current Colorado General Assembly is closely, and often bitterly, divided by party. Democrats hold 34 of 65 seats in the House for a slim majority in the chamber. Republicans control the other chamber by a single seat with an 18–17 party division in the state Senate. 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). The presence of divided government and greater ideological polarization has produced some substantial partisan conflicts over policy and spending. However, similar to the fissures being exposed within the Republican Party in Congress, some notable party defections have occurred in the Colorado legislature when Republican legislators have voted against their party leadership. An analysis by the *Denver Post* identified eight Senate Republicans who often deviated from party leaders, particularly on taxes, spending, and social issues. The report likened these legislators to the congressional Freedom Caucus of conservative Republicans. The percolating division among Republicans was deemed “a less-noticed dynamic, poised to detonate in the election-year term,” which “threatens the party’s efforts to present a unified front” (Frank 2016a). Given the narrow margins that exist in each chamber, small numbers of partisan defections can tip the balance on closely divided issues, including the budget.

## **II. State Budget and Hospital Provider Fee Controversy**

State departments must outline their strategic plan in addition to an itemized budget request when submitting annual funding requests to the OSPB. 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. Last November, Governor Hickenlooper presented his proposed budget for the 2016–2017 fiscal year. Among the funding priorities designated in the governor’s request were K-12 and higher education, human services, corrections, transportation, and health care financing (Hickenlooper 2015). Before delving further into the specifics of the state budget, it is first important to detail the controversy surrounding hospital fees.

In January 2016, the *Colorado Independent* declared that in advance of the commencement of the new legislative session, “three words have dominated debate at the Capitol: Hospital Provider Fee” (Hutchins 2016). The issue came to prominence when Governor Hickenlooper proposed reclassifying the fee as the means to circumvent TABOR restrictions. Hospitals are charged fees of various amounts per nightly stays and outpatient services provided. The state received nearly \$700 million in revenue from these hospital fees in the prior fiscal year (Hutchins 2016). The importance of these fees is magnified when considering the federal government provides matching funds designated for the state to use on a variety of health care related services and programs. For future years, the governor’s proposal seeks to reclassify the hospital provider fee as an enterprise, or government-owned business. From the governor’s perspective, the benefit of such a reclassification would be that hospital provider fees would be designated as enterprise funds, which would not count toward the state revenue figure under TABOR. If the proposal were to fail, taxpayer refunds would most likely be triggered for the following year.

Republicans have largely opposed Hickenlooper’s proposal, although an opinion recently issued by Republican Attorney General Cynthia Coffman held that the proposal to create an enterprise to oversee and administer the hospital provider fee would be constitutional. Coffman ar-

gued that such a proposal would meet the three qualifications necessary to create an enterprise. The opinion concludes by stating,

The term “government-owned business” has, for purposes of TABOR, been broadly interpreted by the courts, and the General Assembly has repeatedly relied on the enterprise exception to enact fiscal policy at the state level without seeking voter approval. The purpose of this formal opinion, and any other, is not to comment upon the wisdom or desirability of the General Assembly’s past or prospective legislation or the courts’ decisions; it is only to apply independent judgment to a question of law, in light of current legal authority. Based on these considerations, this formal opinion concludes that organizing HPF [Hospital Provider Fee] as a TABOR-exempt enterprise would not contravene current law (Coffman 2016, 15–16).

Prior to this opinion’s release, the Senate minority leader touted a legal opinion from the Office of Legislative Legal Services arguing that the reclassification of hospital provider fees into an enterprise would be unconstitutional. While it is possible that Coffman’s opinion may be influential in the ensuing debate over the issue, Republican opposition to the proposal in the legislature is expected to remain robust. All 31 House Republicans voted against a May 2015 bill to reclassify and administer the fee as an enterprise. Despite this unanimous opposition, the bill passed the chamber with all Democrats voting in favor (HB 15-1389). The measure died in the Republican-controlled Senate without a vote. Since the two chambers remain divided, a similar result in 2016 would not be surprising. Other aspects of the budget, including those surrounding education, will also be subject to partisan divisions.

Due in large part to constitutionally mandated funding increases, spending on K-12 education is expected to consume 36 percent of all General Fund appropriations. Proposed spending on health and human services represents an additional 33 percent. Table 1 reports the General Fund spending requests in the upcoming fiscal year in addition to the current funding levels.

The governor’s 2016–2017 budget proposed increasing appropriations from the General Fund for most state departments with modest to substantial decreases to others. The General Fund appropriation for K-12 education is proposed to increase by \$225 million (6.3 percent) to a total amount of \$3.79 billion. Adequately funding education has been a priority of Governor Hickenlooper throughout his two terms in office. After unsuccessfully campaigning for the passage of Amendment 66, which would have increased personal income tax rates to generate revenue earmarked for K-12 education, Hickenlooper has worked to increase education funding annually in the aftermath of its defeat. The budget for the upcoming fiscal year increases total spending on K-12 education by more than 2 percent to a total fund allocation of nearly \$5.5 billion, which equates to an increase in per-pupil funding of \$103, bringing total per pupil funding to about \$7,400. Though this increase is substantial, especially when considered relative to other departments, the spending increases in this area are disproportionately less than in recent years.

Higher education is among those areas proposed to receive funding cuts to offset the increase in K-12 spending. The share of the budget devoted to higher education is nearly \$19 million less than last year’s amount, which corresponds to a 2.2 percent reduction in General Fund spending. A funding cut of this magnitude is expected to produce subsequent tuition increases around 9 percent. Since tuition increases were capped at 6 percent in 2015 by virtue of a budgetary agreement, larger increases next year could make it more challenging for families to afford college.

In addition to higher education, the corrections and revenue departments will also likely experience substantial funding reductions. The proposed reduction in funding the Department of Corrections is less than 1 percent of its previous year’s budget. This follows several years of in-

**Table 1. Proposed Colorado General Fund Appropriations**

<b>Department</b>	<b>FY 2015–16 Spending</b>	<b>FY 2016–17 Request</b>	<b>Percent Change</b>
Agriculture	9.71	10.09	3.9
Corrections	780.62	775.06	-0.7
Education	3,567.99	3,793.01	6.3
Health Care Policy and Financing	2,507.08	2,642.65	5.4
Higher Education	857.42	838.52	-2.2
Human Services	811.91	836.37	3.0
Judicial	478.77	485.14	1.3
Labor and Employment	8.01	13.95	74.2
Law	15.06	15.23	1.2
Legislative	43.30	44.24	2.2
Local Affairs	23.63	23.37	-1.1
Military and Veterans Affairs	8.29	8.30	0.2
Natural Resources	27.67	28.86	4.3
Personnel	11.71	13.00	11.0
Public Health and Environment	44.52	47.35	6.4
Public Safety	125.17	125.44	0.2
Regulatory Agencies	1.92	1.78	-7.6
Revenue	97.62	94.17	-3.5
Treasury	135.07	156.81	16.1

Note: Numbers reported are in millions. Data from Governor Hickenlooper’s FY 2016–2017 budget request.

creased funding for correctional facilities and programs. Over \$6 million in savings from the correctional budget came as a result of the state’s total prison population for the year being significantly less than projected. This substantial reduction was partially offset by proposed inflationary and other rate increases.

In absolute terms, the proposed increase in health care spending is second only to K-12. The Department of Health Care Policy and Planning oversees the state’s Medicaid and children’s health insurance programs in addition to numerous other public health programs and initiatives. The proposed \$135.5 million in new health care spending would be an increase of greater than 5 percent from the previous year. As usual, greater spending in this area is driven in part by greater caseload and program participation. The state’s Medicaid and children’s health insurance caseloads are each projected to grow by nearly 5 percent. Such an increase would bring the Medicaid caseload to include more than 1.3 million Coloradans. This number corresponds to about one out of every four state residents, more than half of whom are either children or senior citizens.

### III. Marijuana Sales and Tax Revenue

Colorado is now several years into the legalized marijuana experiment. According to the Department of Revenue's Marijuana Enforcement Division, the state has approved recreational marijuana licenses for 424 dispensaries as of March 2016 (Colorado Department of Revenue 2016). In addition to these retail outlets, officials have approved licenses for over 500 recreational marijuana cultivation operations and nearly 175 marijuana product-manufacturing facilities. Licenses awarded for medical marijuana sales (514), cultivation (753), and manufacturing (206) exceed these recreational numbers, although the disparity between the two continues to shrink (Colorado Department of Revenue 2016).

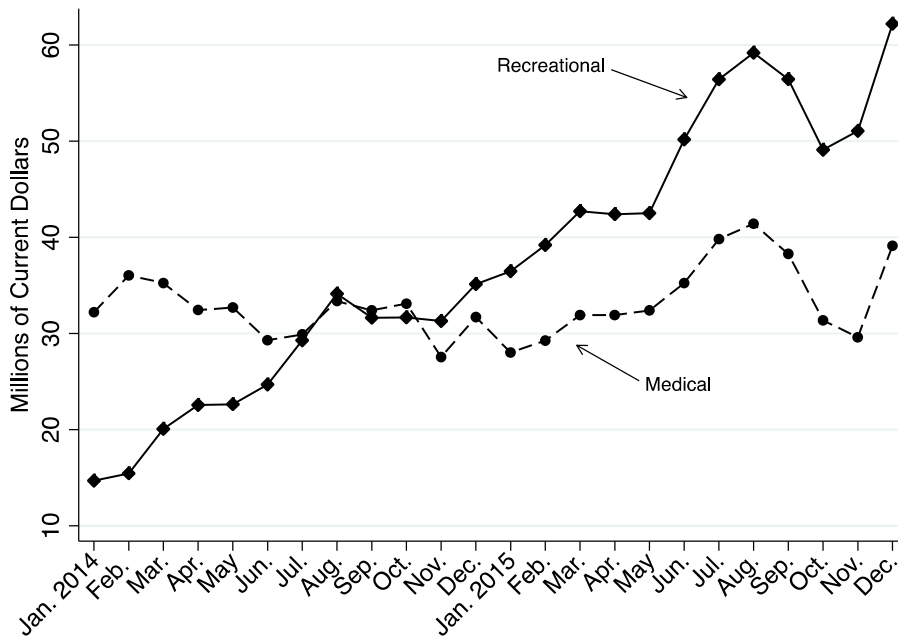
The increase in the number of marijuana business licenses has correlated positively with sales. By the end of 2014, recreational and medicinal marijuana sales totaled nearly \$700 million. In total, state marijuana sales in 2015 approached \$1 billion. The year's official cumulative sales totaled \$996,184,788. Though tax revenues have been considerable, the actual amounts generated have fallen short of most projections. Figure 1 provides monthly sales data for recreational and medical marijuana in 2014 and 2015. Figure 2 reports monthly tax, licensing, and fee revenue data for the two markets. All data are from the Colorado Department of Revenue.

As seen in Figure 1, recreational sales lagged behind medical sales for the first seven months of 2014. This is partially because retail dispensary licenses were initially limited to those with a preexisting medical marijuana business license. Over time, the number of retail outlets has grown considerably. Sales have increased as well. Recreational sales have surpassed medical sales every month since November 2014. Medical sales exhibited more stability over the course of 2014 through the first half of 2015. Sales increased over the summer months and surpassed \$40 million for the first time in August before falling again through the winter. In November, the number of residents on the medical marijuana registry dipped below 110,000 for the first time in 28 months.

Figure 2 reports the tax, fee, and licensing revenue from the recreational and medical marijuana markets during 2014 and 2015. As mandated by the constitutional amendment ratified by voters, the first \$40 million in marijuana excise tax revenue is mandated to go toward school construction. The legislature has more control over revenues beyond that amount. The original estimate from the governor's office was that marijuana tax revenue in the first fiscal year would exceed \$130 million. Though the projection was lowered on several subsequent occasions, combined tax revenues totaled \$76 million—\$63.4 million from taxes and \$12.6 million from licensing and fees (Colorado Department of Revenue 2016).

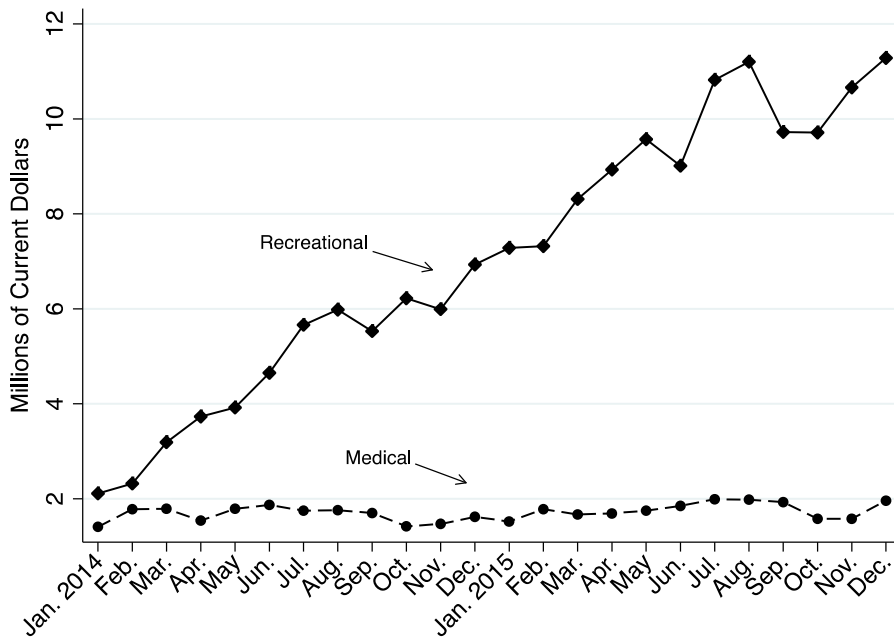
Revenue from the more modest medical marijuana taxes has been relatively stable over this two-year span, ranging from \$1.41 million to \$1.99 million. Though it has demonstrated more variability in recent months, the growth in recreational marijuana tax revenue has been fairly linear. Over these two years, recreational tax revenue has grown by an average of \$400,000 every month. Tax revenue surpassed \$10 million in four of the last six months in 2015. The \$11.28 million collected in December 2015 is the highest amount to date. One would expect the growth in sales and taxes to taper off at some point. The decline in sales during the fall of 2015 was perhaps a sign that the markets were reaching a plateau; however, the trend reversed with strong sales reports in the final months of the year. In sum, the state continues to receive a reliable amount of medical tax revenue coupled with increasingly larger sums from recreational taxes and fees. If sales continue to climb, the tax revenues in the current fiscal year may approach what was originally forecast for the 2014 fiscal year as the market becomes more developed.

**Figure 1. Recreational and Medical Marijuana Sales: 2014–2015**



Note: Data from the Colorado Department of Revenue (2016).

**Figure 2. Recreational and Medical Marijuana Tax, Licensing, and Fee Revenue: 2014–2015**



Note: Data from the Colorado Department of Revenue (2016).



## IV. Conclusion

Many expected the uncertainty surrounding Colorado's budget for the next fiscal year to come into better focus upon the resolution of the hospital provider fee controversy. House Speaker Dickey Lee Hullinghorst sponsored legislation to reclassify the fee into an enterprise just one day after Attorney General Coffman issued the formal opinion supporting the proposal's constitutionality. Though supporters of the reform had some reasons to be more optimistic about the prospects for success in 2016, chief among them the supportive opinion from the state's Republican attorney general, the proposal to reclassify the hospital provider fee died in the Senate once again as it had the year before. In May, the Senate Finance Committee voted along party lines to defeat the measure (HB 16-1420). Substantial partisan disagreement on the issue is emblematic of broader conflicts in the legislature on matters of policy and spending.

In many respects the governor's budget for the upcoming fiscal year is cautious, partially out of necessity given the uncertainty that exists regarding the hospital provider fee, potential income tax rebates triggered by TABOR, and slowed economic growth. Legislators are scheduled to begin work on the budget "long bill" beginning on March 28. To further complicate matters, the Legislative Council's chief economist recently informed JBC that General Fund revenue for the next fiscal year will likely be \$90 million less than previously expected. This will almost certainly result in further funding cuts to different parts of the budget, some of which have already been targeted for reductions.

State officials continue to study and refine the legal and regulatory framework surrounding the medical and recreational marijuana industries in the state. In addition to those designated for school construction, legislators have used marijuana taxes to oversee the state's marijuana industry. Tax revenue has also been allocated to youth drug prevention, public safety, and public education campaigns. Last year, legislators adopted stricter packaging rules for edible marijuana products. In March 2016, the state announced the largest recall to date of marijuana products when laboratory testing reported the presence of a nonapproved pesticide. Officials have not released data on the scope of the recall in terms of number of plants or products affected. During the same week that the recall was announced, the Supreme Court announced that it would not hear a case filed by officials in Oklahoma and Nebraska challenging the legalization of recreational marijuana in Colorado.<sup>3</sup> As the market becomes more developed, officials in other states considering legalization will have guidance in the form of Colorado and Washington.

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<sup>3</sup> The vote was 6–2 in favor of denying cert with Justices Clarence Thomas and Samuel Alito dissenting.

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