# TRANSCRIPT OF PROCEEDINGS

BEFORE THE

COLORADO DEPARTMENT OF EDUCATION COMMISSION

DENVER, COLORADO

January 8, 2014, Part 3

BE IT REMEMBERED THAT on January 8, 2014, the above-entitled meeting was conducted at the Colorado Department of Education, before the following Board Members:

Paul Lundeen (R), Chairman
Marcia Neal (R), Vice Chairman
Elaine Gantz Berman (D)
Jane Goff (D)
Pam Mazanec (R)
Debora Scheffel (R)
Angelika Schroeder (D)

CHAIRMAN LUNDEEN: -- back to order. Well, then I'll make us come back to order.

We are pleased to have with us today Charlie Brown and Dr. Phyllis Resnick to present the Colorado Sustainability Study released on December 3rd of 2013, concerning the budgetary health of the state of Colorado through the year 2030. So we're looking pretty far into the future here.

Charlie Brown is the director of the Colorado Futures Project at Colorado State University. Charlie also was the former director of the Center for Colorado's Economic Future at the University of Denver. Charlie retired from state government in 2004, after a 29-year career. Thank you for your service. His career in state government included serving as an executive -- or as the executive director of the Legislative Council staff for 17 years.

Prior to becoming Council's director, Charlie was an assistant commissioner of education for two years. Before serving as an assistant commissioner of education, he served on the Legislative Council for 11 years as the lead tax and fiscal analyst and school finance specialist. So you're familiar with this building then.

MR. BROWN: Yeah.

CHAIRMAN LUNDEEN: Also with us today is Dr. Phyllis Resnick. Dr. Resnick is the lead economist for Colorado Futures Center at Colorado State University. Previously, Dr. Resnick was the lead economic for the Center for Colorado's Economic Future and for the Colorado Economic Futures Panel, both at the University of Denver.

Welcome, and if you want to proceed we'll turn the mics immediately over to you.

MR. BROWN: Thank you.

CHAIRMAN LUNDEEN: Come on up and sit down. We've got nameplates for you. Make yourself comfortable.

MR. BROWN: Well, it's probably easier for us to present from here, if that's okay, so we can --

CHAIRMAN LUNDEEN: As long as you can tag team on the microphone so we can hear properly, I think we're fine.

MR. BROWN: Oh, it helps to turn it on.

CHAIRMAN LUNDEEN: That works well.

MR. BROWN: It's just that I'm a master of technology.

CHAIRMAN LUNDEEN: It is binary. You've got to have it switched the right way.

MR. BROWN: Anything that can go wrong will go wrong with this.

I'm always hesitant to talk to a group first thing after lunch. You know, I know what happens when the food settles and the blood goes to the stomach and out of the brain and all of that. Winston Churchill once said, "The three hardest things to do in life are to kiss a woman leaning away from you, to climb a mountain that's leaning towards you, and to speak to a group after lunch." I'm not going to attempt the other two, so we'll hopefully --

CHAIRMAN LUNDEEN: Well, we've got some puppy dogs and children coming in to walk in front of you to distract ourselves.

MR. BROWN: Okay. Good. Good.

CHAIRMAN LUNDEEN: Your loss.

MR. BROWN: That's great.

What we're going to try to do is walk you through the work that we've done. I'm told we have an hour, so we'll probably go into excruciating detail, tell you way too much information. But feel free to interrupt with questions, engage us in conversation as we go through. That's better than getting all the way to the end and then trying to double back.

So just a couple of words about what you're going to be seeing. You're going to be seeing an update to a study that we released in 2011. That work was requested by -- requested but not paid for by the legislature as part of Senate Joint Resolution 2 in the 2010 session. They asked us to look -- take a comprehensive look at all aspects of the state's revenue system, and we did that. We, I think, produced a study that was pretty in line with most of the other kinds of studies of its kind that are done throughout the country. This hadn't been done in 50 years in Colorado so it took a lot of updating to do that work.

We looked at the normal things that you look at with studies of this nature. We looked at tax incidence of each one of the major taxes, the productivity of each tax, the stability and volatility of each tax source. But we did something that most other studies don't do. We asked the question about sufficiency. So are the taxes that we're levying sufficient to pay for the services that we say we're going to be providing as a state? And as we began to look at that, that really took us off in the direction of really looking at sustainability. Are we in a sustainable situation?

We did in the way that you normally would do it if you're looking at your household budget. Are your bills growing faster than your income? This is not a budget study. We didn't attempt to look at reserves and how quickly reserves would be spent down, build multiple scenarios. We just asked the question about long-term sustainability. And to do that, to really look at sustainability, you need to examine a fairly long series of data, and look at spending relationships as they are going to be changing off into the future.

So we chose the forecast horizon of 2025 to do this work. We built a suite of models to forecast every aspect of state General Fund spending, in addition to looking at each one of the revenue sources, and then tried to line up revenues and spending off into the future, to see how the two really compared to each other.

And what we found, when we did that work, was that Colorado has a surprising and troublesome and very persistent structural budget problem that would begin to get much worse in the middle part of this decade moving forward. And our results were pretty well publicized and we decided, after leaving the University of Denver, coming to Colorado State University, which has been a wonderful home for us, to update that work.

A lot has changed in the last two years -- with the economy, with spending, with our underlying demography -- and so it was time to do an update. And so you're going to see a lot of comparisons, looking back to our previous work and how things are different now.

And basically, we came to five basic conclusions in doing this update. The first is we've had sort of the perfect storm of developments in various factors within the economy and within the state's revenue system to improve the situation. Everything sort of lined up just the right way to create about as dramatic an improvement in that structural problem as we could have guessed would be the case. But even with the spectacular revenue gains and curtailment of some of the spending drivers, we think we still have a very significant structural budget problem going forward into the future.

The lining up of this perfect storm, all the factors in the perfect storm have really served not to change the nature of the budget -- structural budget problem but just delay it, from three to five years, in our forecast horizon.

And we do see something new cropping up, something that some of us remember from a long time ago, starting to recur again, and that is we're going to be seeing some Tabor refunds starting, according to our forecast, in fiscal '17. We noticed that the Legislative Council economists are also talking about how, for fiscal '16 now, the question of Tabor refunds falls within the margin of error in their forecast. They don't forecast out to '17. We think if they did they would see things very similar -- and we'll show you some slides about how their forecast and the USPB forecast line up with our forecast in the near term.

So it creates an interesting dilemma. We think we're probably going to be seeing budget cuts over the course of the next few years, as the state grapples with this budget problem, and those cuts will accelerate and get much worse, at the same time the state begins to refund money. So this is going to -- connecting the dots on that is going to be very difficult for Colorado voters. And sort of our final conclusion is if any of these factors that have combined to make things better starts to work the other way, things could unravel very quickly.

So that's just a synopsis of what we've found. I will just kind of walk through the first couple of slides and then I'm going to turn you over to Phyllis Resnick, who will walk through most of the rest of our presentation.

So this initial graphic is a picture of what we see currently with our forecast. Our forecast horizon now goes out to fiscal '30. The blue parts of the bars are what we call the Big Three, including CDE. It's CDE, the Department of Health Care Policy and Financing and

Department of Corrections. The green part of each one of those bars is all the other departments of state government that receive General Fund spending. The line that goes across there are General Fund revenues. So you can see that we're in balance for '13-'14, only a minor problem for '14-'15, and really that problem is fairly minor out to about fiscal '17, and then things begin to unwind and unravel fairly quickly, for some reasons that we'll get into in a painful amount of detail.

CHAIRMAN LUNDEEN: So that bar -- on the graph, that portion of the bar above the yellow line is deficit?

MR. BROWN: That's right.

CHAIRMAN LUNDEEN: Okay.

MR. BROWN: Yeah. It's not a deficit, in a sense --

CHAIRMAN LUNDEEN: It's a shortfall projection.

MR. BROWN: -- because they will have to balance the budget every year. But it's the amount of imbalance between revenue and spending.

And you can see the red parts of the bars there, creeping in in fiscal '17 and growing fairly substantially, contributing to that amount of deficit.

Another way of looking at this is to just look at the growth of the two largest departments, CDE and the Department of Health Care Policy and Financing. CDE is the green line -- and I want to stop at this point and just make a note of the fact that when we did our forecast we assumed full funding of the School Finance Act, the elimination of the negative factor. Maybe not the elimination but certainly not employing that negative factor to cut schools.

And the reason we did that was really twofold. We wanted to recognize the spending drivers that are in Amendment 23 and in the School Finance Act, on the one hand, and then, secondly, we wanted to be agnostic about where the cuts would need to be taken. We didn't want to assume that they would all have to come out of the schools in order to fund other parts of state government. So we tried to present a whole picture here and not necessarily be prescriptive in terms of where these cuts are going to occur.

And you can see that the blue line is our revenue forecast. Revenue is growing at about 95 percent, CDE, during this forecast horizon, growing at about 113 percent, and then Health Care Policy and Financing, principally driven by the state's share of the Medicaid program, driving -- growing at more than double that rate. So that's a snapshot of really the two major bills that occupy about 66 percent of the state's overall General Fund spending, growing much faster than its income.

UNIDENTIFIED VOICE: So if you hadn't made the assumption about getting rid of the negative factor and that being fully funded, et cetera, what would that line look like?

MR. BROWN: The line would be different. We would see -- we actually did some calculations based on taking the negative factor to its maximum of 20 percent, and that basically accomplishes all the cuts that are necessary through about fiscal '20, but then, very quickly, those other departments would start needing to be cut, and that cut would be -- I've forgotten, Phyllis, in the range of about two-thirds, I think, of their overall General Fund would need to be eliminated by fiscal '30.

So this is a problem. I mean, one of the things that you need to sort of focus on here is we have relative stability over the next couple of years. You know, it's not going to be pretty and there's going to need to be probably a negative factor. There may need to be some other kinds of budget cuts and tradeoffs in the budget. But after that, you know, it's really starting in about fiscal '17 and moving forward that we see the wheels coming off, in terms of our overall funding structure.

So the question is, how did we get to these conclusions? I'll turn it over to my colleague, Dr. Phyllis Resnick.

MS. RESNICK: Thank you. So compared to when we did this work two, three years ago, I think there's sort of three themes that are running through our project this time, that were kind of all surprises. And two of them actually are working very much in our favor. I'll take you through those two first, and then the third one, as Charlie alluded to, is related to Tabor, which is serving to actually make the problem get slightly worse.

The first one is on the revenue side, and when we did our work a couple of years ago -- and I can speak to this because I did the modeling -- we used about the most aggressive forecast we could possibly justify using. We forecast a recovery that, if it had truly happened, would have been miraculous. We forecast I think the state adding almost 300,000 jobs over the four-year period in the wake of the recession. We are nowhere near that.

And we left in that very, very aggressive recovery scenario for one reason only, and that is we wanted to be as conservative as we could be with our assumptions. And since we were looking to see if there was a structural problem facing the state we thought, well, we're doing this work in the midst of the worst recession ever. If we assume a full and robust recovery and we still have a problem in the year 2025, we're pretty sure we still have a problem.

So we went ahead and we left that very aggressive recovery scenario in and we built a revenue scenario around that scenario, thinking, you know, this is the best we could ever ask for, and, in fact, our revenues have exceeded that. And we think our revenues have exceeded that largely because one thing we did not anticipate when we did our work a few years ago was that the Federal Reserve, through monetary policy, would be as involved in the economy as its been in the wake of the recession.

So there was no way we could have anticipated $85 billion worth of bond buying monthly. They've now, as you know, tailored it back to $75 billion, you know, just a mere $75 billion a month they're pumping into the economy. That's done a lot to pump up equity market, it's done a lot to turn around housing, and when those two things happen we see a bump in state revenues because income taxes and sales taxes come in more strongly related to those two phenomena.

So even though we had the most robust economic recovery we could imagine, and we did not achieve that, we have actually, in the short term, achieved revenues that exceeded our expectations. And since we do our forecasts as trends off the current year we don't try and predict the variation in the economy. We're now trending off a much higher place than we thought we would be, so we have revenue built into our model that is actually more aggressive and more optimistic than we thought.

This graphic here -- and I will use this pointer if it works; oh, there it is -- the green and the yellow bars in this graphic here show you our two revenue forecasts. So the green bar shows you what we forecast when we did this work back in the year 2010, essentially. So that was our forecast for the year 2014, back when we were performing this work in 2010.

The yellow bar -- notice pretty much everything that's our work will be green and yellow. We tried to use CSU colors. The yellow bar is our current forecast. So you can see how much we've brought it up compared to the forecast we had running through this model a couple of years ago. These three years here are all history, so everything looks flat or consistent across all four revenue models.

The red bar in this forecast is the latest forecast from the Legislative Council staff, the forecast that came out in December, right before the holidays, and the blue bar is the forecast from the governor's economist. So, as you know, every quarter we get two forecasts from the state. We have found ourselves -- right now we look much more aligned with Council. When we did this work and compared to their September forecast we found ourselves sandwiched right in between the Council's forecast and the governor's forecast, which we thought was a very comfortable place to be. Economists, when you're doing this forecasting, misery loves company, so to be right smack in the middle felt good to us.

But my point here is that we have brought up this revenue base a lot higher than we thought it was going to be, and on the revenue projection that Charlie showed you, that was running up that summary chart, is a revenue projection that's essentially growing off this much more robust base than we thought it was going to be.

With that, though, we remain concerned about state revenues. So there's kind of a mixed picture here. We've had this short-term boost that we think is very much related to the kind of stimulus that's running through the economy. When we project out to the year 2030, we don't see that kind of very robust growth continuing. And, in fact, we see revenue growth falling to a long-term average that's actually slightly lower, particularly with respect to the sales tax, than we have had in the past. So the green bar on this line shows you -- or on this graphic, shows you year-over-year changes in sales tax revenues. The yellow bar shows you the historical average, and the blue bar shows you that our projection for sales tax growth out into the future is actually falling below its long-term trend, and there are some real reasons for that.

CHAIRMAN LUNDEEN: Can I interrupt you --

MS. RESNICK: Sure.

CHAIRMAN LUNDEEN: -- just to ask you to back up and kind of speak to some of the assumptions that are underlying the modeling and the thinking. You said your best-case scenario fell -- or you fell 300,000 jobs short of your best-case scenario, yet because of the Fed's activity you're showing these large numbers. As the Fed tails back, or tapers back its actions, what do you expect to happen? Can you speak to the consequences of that? And, quite frankly, can you speak to what I would describe as the fragileness of your assumptions, based on the fact that it's predicated upon the Federal Reserve's action, which is kind of an unknown variable at this point.

MS. RESNICK: Right. Well, so let me see if I can drive this thing and back up. So when I -- to the extent that we have history in the books already under monetary stimulus, obviously we are where we are, right. So we have had revenue growth that was stronger than we thought it would be when we did this work a couple of years ago, we think tied to the Fed's actions.

And to give you more detail about that, of course when we have equity market performance like we've had over the last few years, you have more folks taking capital gains and so you have more income taxes being paid. When you see housing recover to the extent that it did, which we believe was buoyed by Fed actions -- they brought long-term interest rates down which brought mortgage rates down, which helped housing recover -- it's everything they hoped, you know, would happen, you see people going out and furnishing those homes and buying things for those homes. And so we saw sales tax bump a little bit.

So we have a base right now that's sitting right here, or, you know, in fiscal '14, if our forecasts are correct, right around here. When we do our models, as I mentioned, we forecast trends off of the current base. So the extent the Fed actions are already affecting our revenues, we're sort of building off the base that currently exists. Going forward, we, one, expect monetary stimulus to start to taper, which will, in our model, slow the rate of growth. We did not assume it would create another recession. So where we've been growing at, you know, 7, 8, 9 percent a year, we expect it to come back to a more normal rate of like 3, 4, 5, 6 percent a year.

And then we have, really, I think, the more important and the more salient issue is some other factors that are weighing on our revenues, particularly the sales tax, that are completely independent of the kind of stimulus we've had, and to some extent very independent of the recession, that I'll take you through in a second.

So our assumptions around the future are that the curtaining of monetary stimulus will slow the rate of growth, that, you know, hopefully the economy -- we have built in an assumption that the economy is resilient enough to not have it kick us back into another recession, just to get to a more sustainable level of growth that, in fact, will be slightly lower, or, you know, quite a bit lower than these sort of boom years we had coming out of the recession with sort of stimulated economy.

Does that answer you --

CHAIRMAN LUNDEEN: I think it did. So kind of the headline I'd put on a set of assumptions is, you know, kind of a rosy scenario, Federal Reserve taper. Fair enough? I mean, you're kind of expecting the Fed is going to get --

MS. RESNICK: Absolutely.

CHAIRMAN LUNDEEN: -- they're going be able to do what they think they can do --

MS. RESNICK: Right.

CHAIRMAN LUNDEEN: -- even though we're in uncharted waters --

MS. RESNICK: Right.

CHAIRMAN LUNDEEN: -- with these behaviors.

MS. RESNICK: Right. We did not -- to get into the real kind of nitty-gritty about the way we model, and probably too much detail, but we do our models for the state based upon a national model that's built by the folks at Loudie's-economy-dot-com (ph). And they run seven or eight scenarios on the economy. We use their baseline scenario. They have an alternative scenario that we jokingly call total economic collapse. We did not use that one as the basis for our assumptions.

So, you know, I mean, we could have picked -- they have, you know, baseline, they have some more optimistic scenarios and they have a bunch of more pessimistic scenarios. We didn't choose one of their alternatives. We chose their baseline, and their baseline is that the Fed will be able to gracefully exist and the economy will have, you know, picked up enough internal velocity to keep itself going. And so while we don't expect outpaced growth we expect growth to continue.

CHAIRMAN LUNDEEN: Okay. Let's label baseline, for the sake of opinion, I'd say, fragile, but I understand where you're coming from. Thank you.

MS. RESNICK: Yeah. And actually, if I can go to this, so the two major revenues sources at the state, as you know, are the income tax and the sales tax. The real workhorse is the income tax. We'll talk about that briefly because it's not as problematic as the sales tax. The sales tax is the revenue source that we see having the most vulnerability going forward, and to some extent it really has nothing to do with the recession. The recession is a small picture of it.

But there are some factors that are going to weigh on the sales tax that we think have already started weighing on the sales tax, but will continue to weigh on the sales tax and are leading to this conclusion we have that the long-term growth in the sales tax will fall short of its historical growth rates.

The first one is -- and I'll go through these rather quickly -- but you'll see the little yellow bar here, which doesn't look very big against mortgages. But if we took this off the graphic and only graph these five bars, you would see that student loans are now the second -- student loan data are now the second-largest component of household debt on household balance sheets in the United States. This is national data, not Colorado data.

But, you know, we educate some of our own folks and we import lots of folks from elsewhere in the country, and those folks are likely to come to Colorado to take jobs, start their careers, with a lot more debt than most of us walked out of college with. When you have a lot of debt like that, you are not spending on other things that would otherwise be subject to the sales tax -- buying a new car, furnishing a house, all of those things that, you know, when you make purchases create sales tax revenue for the state.

So this is a very new situation. This is the first time student loan debt has gotten close to $1 trillion nationally. And it is the only form of household debt, as you can see from this red line that's running up the graphic, that continued its upward trajectory all the way through the recession. Households deleveraged almost every other kind of debt. They deleveraged mortgages pretty significantly. Some of that was through default. Some of that was through paying those down. They deleveraged almost every other form of debt. The yellow line here, which is the only other one that's slightly trending up is auto debt, which we would expect to be cyclical with the economy. There was a lot of pent-up demand for automobiles that weren't replaced during the recession years. But every other form of debt started, and has continued to deleverage all the way through the recession except for student loan debt.

That is coupled with a recovery, that I've already mentioned, that has been, you know, more jobless than we anticipated, and that jobless recovery has hurt young people the most. So the green line on this graphic -- or, I'm sorry, the yellow line is the unemployment rate for folks in the 16-to-24-year-old age cohort. If you notice, they are still sitting at 15 percent unemployment nationally. So not only do you have young folks who are coming out of college with more debt than ever before, but they're also having harder times finding jobs.

The combination of those two things has led to a few things. It's the, you know, your son or daughter comes back from college and moves into your basement phenomena, which is a very real phenomena which will -- well, I think it's probably happened somewhere. And presumably those young folks who aren't buying homes and moving forward with their own families aren't spending as much money on things to furnish homes and buying new cars and all that. And so we expect that to be a long-term hangover from this recession.

I don't think those kids will live in basements forever. I think they will eventually move on. But they will move into their early jobs with more debt and with possibly taking a job that doesn't put them on the earnings trajectory that, you know, many of us were able to get on coming straight out of college, which we think will weigh on sales tax revenue for the duration of our forecast period.

Something else that's been happening, we all know about it. We're right after the holiday season. If you paid any attention -- and how could you not? -- in December, the real growth in sales, this year particularly, was remote sales, internet sales, ecommerce, as opposed to brick-and-mortar sales. I am firmly in the camp that by the year 2030 we are going to have to do something about capturing those sales in our tax bases but we don't do a very good job of that now. Because there is no law around that now, our models are built on the assumption that this erosion to ecommerce will continue to erode our sales taxes in the state. Obviously, if Congress could ever get its act together and pass some national legislation about this we would have to go back and remodel our sales tax assumptions to capture a lot of that base that is migrating to the internet.

You can see here, also, this is Census Bureau data that shows there's been this steady migration that continues to happen. We don't see that turning around. I don't -- you know, we're going to have to deal with the tax side of it because we're not going to change people's behavior away from buying goods remotely.

The next thing that's happening to the sales tax that we think will continue to happen is we have moved from an economy or consumers who buy stuff into ones who buy services. So the sales tax base, or the sales tax laws in this state, as they're written, tax things that I like to say if you pick them up and you drop them on your foot they would hurt you. We tax the purchase of tangible goods.

Charlie likes to tell the story that, you know, this graphic, which starts back in the late 1950s, where the purchase of those goods represented between 55 and 60 percent of all of our household purchases -- so, you know, 55 cents on every dollar was spent on those goods and services, which are represented in this graphic by the yellow line, accounted for -- oh, I'm sorry, yeah, the yellow line -- accounted for like 45 percent of all purchases. We've completely flipped that situation now to the power where we spend -- about where are we here, 2011 -- we spend about 66 or 67 cents out of every dollar on services and about 33 or 34 cents on goods.

So Charlie's story is, you know, back in the late 1950s, when you moved into your first house, the first thing you did was run out and buy a lawn mower so you could mow your lawn. Now, if you get out of the basement and move into your first house and you have a lawn the first thing you do is call up someone and say, "Hey, how much can I pay you to mow my lawn?"

So instead of every household buying a lawn mower, one person buys a lawn mower and then provides a service to everyone else. So instead of us being consumers of goods, we have become consumers of services. And you think of many other stories like that, where you used to go out and buy things and do things yourself, where now we pay service providers to do them.

On top of that, we have just changed our preferences. We are seeing this shift in preferences away from stuff and toward experiences, that I think will probably only amplify as the millennial generation moves into their consuming years. At least in their early years, they are seriously suggesting that they don't want to behave the way the baby boom generation did. And so as that shifts, and we move our relative purchasing away from goods and towards services, and we don't have services in our sales tax base, we are eroding the base, year over year. The folks at economy.com see this situation continuing, with services eventually becoming well over 70 percent of all of our purchases and goods falling down to about 28 percent.

One thing I will say about this service line is that it includes health care. If you take health care out you still see services growing to over 50 percent of our total consumption.

CHAIRMAN LUNDEEN: You're getting to a question I was going to ask. Define services. What all is in your bundle?

MS. RESNICK: Services are -- that would include health care, it would include any kind of recreational services, it would include any kind of entertainment services, it would include personal services like --

CHAIRMAN LUNDEEN: Does government fit into this?

MS. RESNICK: No. It's things that you --

CHAIRMAN LUNDEEN: That's excluded.

MS. RESNICK: -- it's in household consumption.

CHAIRMAN LUNDEEN: Okay.

MS. RESNICK: So it's things -- and then it's all those sorts of personal services like getting your hair cut, getting your dog groomed, getting your car repaired, getting your pool cleaned, getting your house cleaned, you know, all that kind of stuff. And then it would also have professional services in it as well -- so lawyers, accountants, actuaries, architects, all those type folks.

UNIDENTIFIED VOICE: So before you go on, so this graph could lead one to believe that our society is becoming less materialistic, which is hard for any of us to believe.

MS. RESNICK: Well, you have to remember this is against a growing pie, right? So the pie is getting better, and our preferences are shifting away from goods and towards services, for -- okay, for a few reasons. One is, you know, some of what I already talked about. This is also the dollar value of goods. You know, this is looking at, out of every dollar you spend, what share of it is going to goods and what share of it is going to services.  There's another phenomena running through here that, in many cases, the goods we're buying are actually getting cheaper instead of getting more expensive.  So I could point to every one of these computers that are sitting on your desks, and if you had bought that computer 20 years ago it probably would have cost four times what it costs today.  If you go out and buy a big-screen TV today it's about a third the price it was five years ago.

So while we are perhaps still buying stuff, the stuff we're buying is not inflating in cost as quickly as the cost of the services that we're purchasing, so our relative share of the dollar, both because we are shifting preferences -- I mean, we're still materialistic but we do contract out a lot more than we used to do, you know, within our homes.  I think the -- you know, the lawn mower example is just one of many.

I gave a talk similar to this some years ago in Ouray, and the folks there were saying, "You know, we deal with this every day because we have a lot of ice climbing recreation in our town.  And if folks would come to town and actually buy ice-climbing equipment we would collect sales tax on that.  But instead what they do is they come to town and they hire a guide service who gives them all the equipment to use and we don't tax guide services."

So, you know, you get people who are making decisions about renting, borrowing, all that kind of stuff. So while we are certainly not a non-materialistic society, as a share of every dollar for all of those reasons, we're seeing this phenomenon happen. And we tax off of this line. This represents what's happening to our sales tax base over time. So that's one of the other reasons why we see kind of head winds ahead for the sales tax.

And finally, the last one is -- oh, go ahead.

CHAIRMAN LUNDEEN: Before you run off that slide let me -- so I make $100 and I spend my $100 on a number of things. The first thing I spend is on government services. Where would that be on this slide?

MS. RESNICK: It's not. This is just household consumptions.

CHAIRMAN LUNDEEN: Is that data you have? I mean, because, obviously, it's on the line. I made $100, and believe me, a big share of it went to government services, and what does that line look like over time? I'd be interested to see that on this graph.

MS. RESNICK: Yeah.

UNIDENTIFIED VOICE: Aren't government services taxes?

CHAIRMAN LUNDEEN: No.

UNIDENTIFIED VOICE: But what are government services?

CHAIRMAN LUNDEEN: Well, taxes. Yeah, absolutely. Taxes in terms of -- what I'm -- my -- the portion --

MS. RESNICK: I mean, that would be -- we could conceivably do that but I don't know if we could compare it to this data. This is looking at the two forms of household consumption. So --

CHAIRMAN LUNDEEN: But expressed another way, the two forms of just one piece of where people spend their money.

MS. RESNICK: Right, but this is as a share of -- so in the national income accounts, if we want to get really, you know, into the details, total national income is consumption plus investment plus government plus essentially net exports. This is the breakdown of the C part of that equation only, because this is serving as the basis for our sales tax revenue.

CHAIRMAN LUNDEEN: Sure. Sure.

MS. RESNICK: I mean, I could do a different graph to show of every dollar that comes into a household what share goes to C, what share goes to I, what share goes to G, and what share goes to exports.

CHAIRMAN LUNDEEN: And that would --

MS. RESNICK: My guess is consumption would be the absolutely largest share. I mean, consumption is about 70 percent of our economy. It dwarfs government spending.

CHAIRMAN LUNDEEN: And as a matter of personal interest I'd love to see those other charts on a similar scale so that I could see what's happened with those over time as well.

MS. RESNICK: Yeah. Okay.

CHAIRMAN LUNDEEN: That's an offline conversation.

UNIDENTIFIED VOICE: That's not relevant to income for Colorado.

CHAIRMAN LUNDEEN: Absolutely. The assumption that you're pursuing is state tax revenue.

MS. RESNICK: Right.

CHAIRMAN LUNDEEN: I'm looking at from the experience of the individual, the taxpayer, so to speak. So I'd -- and we'll take that offline and I'll follow up with you later.

MS. RESNICK: Okay. Okay.

CHAIRMAN LUNDEEN: But I'd like to see that.

MS. RESNICK: Okay.

The last thing that's affecting sales tax, and it's actually going to affect the income tax as well, is we are aging in this state. We are aging across the country. We are aging in this state slightly more dramatically because we were very much younger for a long time. While other states have started to deal with the impacts of aging on both their revenues and their expenditures, it's a relatively more new phenomenon in Colorado. You see the demographers' projections, where, in 2013, about 12 percent of the population was in the 65-and-over cohort. That's projected to grow to 18 percent by the year 2030.

One thing we know from historical fact, that we expect to continue, is that as folks age they spend less of their consumption dollars on things that are subject to the sales tax. So, in fact, if you talk to people who are heading toward or in this age cohort -- my parents, unfortunately, are no longer alive but my friends whose parents are alive, when Christmastime comes around their parents tell them "don't buy us anything we can't consume right away. You can bring us food, you can take us out to dinner, but we don't want any more stuff. In fact, here, why don't you take this stuff back home with you?"

So as more and more of our households are headed by people who are looking to get rid of stuff instead of buy stuff, that's going to be a headwind on the sales tax as well.

So taking all those together, we see some real issues around sales tax, the way it is comprised in our state. There's a national survey that's done about every five or six years. On that national survey of the sales tax levying states, we tax the fewest services of any state in the country. And so while some states have started to recognize this and started to shift their base to capture some of where the consumption is now happening, we have not done that yet in Colorado.

Aging is also an issue for the income tax. As you know, in our income tax code we exempt a fairly significant portion of pension income. So we have folks who move into their fixed-income retirement years, they're making slightly less, and then we exempt some of that from the income tax. So while we've been in a situation right now where we've seen spreads between -- the green line here is the change in income taxes at the state level and the yellow line here is the growth in personal income year over year in the state -- while we've seen this spread persist since the recession has ended, we don't expect that to continue forever. We expect those lines to start to come back together. This is largely, we think, a phenomenon of the impact of Federal Reserve policy on the income tax through capital gains. That is a more short-term phenomenon.

So taken altogether, we expect to see revenues at the state -- even though we've had this, you know, nice little bump in these early years, we expect to see them fall to a steady-state growth rate of around 4 1/2 percent, which is lower than the long-term historical average, which was about 6 1/4 percent, for those two reasons, for the two drags that are going to come on the two state -- the largest two revenue sources to the state, the income tax and the sales tax.

So that's kind of where the story kind of backs up that revenue line that you saw in that first graph that Charlie showed you.

There was another effect that we really didn't anticipate when we did our work a couple of years ago, and that is that some of the echoes of the recession have actually really helped us out on the spending side, and two in particular. The first one is even with $85 billion a month going into the economy, we have had virtually no inflation, which I don't think anyone really thought could possibly ever happen. So where -- if you look up, you know, the commentary around price growth in the economy, the concern is really more about deflation than inflation right now. And so we're running about 1 percent inflation right now. We expect that to, you know, rise a little bit. But when we did this work a few years ago we expected inflation to be not significantly higher but a bit higher than it has turned out to be.

As you know, from where you're sitting, and as most folks in Colorado know, we have programs in the state budget that are either implicitly or explicitly tired to the rate of growth of inflation. The School Finance Act calls for per-pupil funding to grow with inflation. Inflation is a significant driver in health care costs, and so Medicaid grows with inflation as do a lot of the other programs in the state budget. So when inflation came in lower than we expected, we got kind of a reprieve in the rate of growth pressure on some of those large programs in the budget.

The second thing that happened, and I alluded to it a little bit, is folks who normally would have gone out and started forming households in their middle 20s are still living in basements. And so this delay in household formation has brought down all the forecasts around fertility and childbearing and the number of young folks that are going to be in our society over the next 15 years, and that has significantly brought down our forecasts around pressure on school finance, because a child that's not born today is not going to be in school 10 years from now. So the demographer's forecast has about 120,000 fewer kids in the year 2030, in her current iteration of her forecast, than the iteration that we used when we did this work two years ago. We did not really necessarily see that coming.

The inflation is something that could turn around on a dime, if we have economic conditions that, you know, start to drive cost pressures. It's unlikely that the household formation and population growth will turn around as quickly. You know, you have a certain amount of years to have children and if you delay that for long enough you may still have children but you may not have as many. And so when I talked to the demographer about that she's pretty convinced that that is kind of a persistent and permanent echo of the recession that we will have over the next 30 years.

CHAIRMAN LUNDEEN: Unlikely to have this but the demographer's number, how many students in 2030, K-12 students?

MS. RESNICK: I don't know.

CHAIRMAN LUNDEEN: But is that identifiable? Is that something I could follow up with you on later?

MS. RESNICK: Yeah, and in fact --

CHAIRMAN LUNDEEN: Yeah (indiscernible).

MS. RESNICK: -- mm-hmm, yeah. And we probably even have a model. I just have the population numbers in my -- in our graphics, but we probably have, deep in our models, the student count forecast too.

CHAIRMAN LUNDEEN: Thanks.

MS. RESNICK: So this shows you our comparison of our inflation forecast, and then this one here is the N here, in the demographer's forecast for the under-18 age cohort, and you can see how significantly she brought down the forecast for the number of under-18-year-olds in Colorado.

I think this is where I turn it back to Charlie for a few minutes.

MR. BROWN: I'll give Phyllis's voice a break for a second here and go through some spending slides.

This chart really is the Big Three departments that I described earlier, CDE being in yellow. The Department of Corrections is the blue base part of that, and then HCPF, Health Care Policy and Financing, is in the green. And it's a comparison. You can see, through fiscal '25 of our previous forecast to our existing forecast. So this just gives you a sense as to how far down we have brought our spending forecast as a result of that.

And really, probably the thing to look at the most here --

CHAIRMAN LUNDEEN: A question on percentages growth. We've got this nice sweep --

MR. BROWN: Right.

CHAIRMAN LUNDEEN: -- that we saw in the revenue projections, a sub 5 percent growth. What's the expected government activity growth?

MS. RESNICK: My guess is it's probably in the, like, 7 to 8 (indiscernible).

MR. BROWN: Yeah.

CHAIRMAN LUNDEEN: So we were expecting annualized 7 percent year-over-year growth in government.

MS. RESNICK: Don't quote me on that.

CHAIRMAN LUNDEEN: But -- just, okay. Again, that's a detail I'd like to get at if we're projecting this. So we're going to grow the government 7 percent but we're expecting our revenue to grow 5 percent. That's obviously where the delta comes in.

MR. BROWN: Yeah. I think that's safe. Seven percent sounds high to me.

MS. RESNICK: It might be a little high.

MR. BROWN: And there are some reasons for that that are sort of structural in nature, based on the way we're funding schools, based on the component of eligibility and the cost driver for Medicaid, for especially the over-age-65 population for long-term care.

CHAIRMAN LUNDEEN: Sure. And that's -- I mean, I think you just put your thumb on the whole reason that we asked you to come in, is we've got structural issues --

MR. BROWN: Right.

CHAIRMAN LUNDEEN: -- that are going to just eat our lunch if we don't get to the conversation around what those structural issues are, sooner rather than later.

MR. BROWN: Right.

CHAIRMAN LUNDEEN: So, please, don't let me drag you off --

MR. BROWN: Oh, no, no, no. It's -- I think our sort of bottom-line pitch in all of this is that structural problems require structural solutions.

CHAIRMAN LUNDEEN: Exactly.

MR. BROWN: The budget cuts that are across-the-board in nature are not structural and don't yield, you know, the kind of alignment of spending and revenue that we want to see. Flat across-the-board tax increases are the same way. You know, we need to think differently and structurally about the services the state is providing and how we're going to pay for those things going forward if we're going to bring these two things into some alignment here.

So that's sort of our bottom-line finding here, and you can see, you know, from our previous forecast to our current forecast, about a three-year delay in the level of spending that we foresaw the last time through this, for those. In this graphic we throw in basically the kitchen sink -- TABOR refunds, Senate Bill 228, all the other departments -- and essentially it looks the same because those three departments drive so much of the overall General Fund.

This is my favorite graphic in every presentation, and it's, I think, intuitively obvious what this means but it may bear a little bit of explanation here. Two scatter plots, '93-'94 on the left, 2012-'13 on the right. And what we've done with these scatter plots is take school districts and plot their mill levies on the vertical axis against their percent state share on the horizontal axis. I can remember back in 1988, the '88 School Finance Act actually had a stated goal of moving all school districts to a uniform levy, so no matter where you lived in the state, pretty much, unless you lived in a super, you know, high property wealth area, you'd pay 40 mills to support your local schools. And the state would backfill in the difference between what the School Finance Act entitled you to have and what that 40 mills would raise. Very straightforward.

Well, by '93-'94, TABOR was enacted in '92, so we're about two years into TABOR. You can see that we still have most districts clustered around that 40 mill line there, and obviously the farther you get out to the right-hand side, those districts are districts that levy their 40 mills and get a larger percentage of their overall total program paid for from the state share.

But you begin to see this sort of falling off of school districts that are going below the 40 mill levy there. There are changes, both in terms of enrollment of those school districts and in terms of the growth of the tax base at that time that begin to not play well with the TABOR overall property tax revenue limit for schools, which is enrollment and inflation. So if you had districts that were growing faster than that property tax revenue limit, it forced their levy down, and when it forced the levy down it didn't necessarily mean they could fund more of their program locally. They still had to maintain their overall share of funding -- the state had to maintain their overall share of funding. So in many cases, as those mill levies declined, the actual share of state aid went up.

My favorite example here is obviously Gilpin County. Limited stakes gaming came in, a lot of hotel and casino construction up there, accompanied by no new real enrollment in the schools in those areas. But property wealth skyrocketed, so that increase in property wealth -- you can see the dot here, in '93-'94, that's below 10 mills but still getting about 40 percent of its overall total program coming from the state. That's Gilpin County. Their levy fell over a couple of years from 40 mills all the way down, at that point, to about 7 mills, and the state still contributing a major portion of the overall funding of public schools in those areas.

Well, you fast-forward to '12-'13. We actually, when we were with DU, had this animated on our website, and it really looks like this sort of downward, strong winds coming from the left-hand side of the chart. You see this downward snowstorm of these dots moving from the 40 mill line down and to the right. And what that actually means is we have a number of districts that are cutting their levies pretty substantially, through no plan of their own, through no decision made by an elected official. This is purely the consequence of the collision of TABOR, the School Finance Act, and local circumstances that are causing this to happen.

So in 2012-13, we actually have 20 school districts that are levying less than 10 mills to support their schools, one-fourth of where many other districts are, or about, a little bit more than a fourth, but probably about a third of what other school districts are.  Fourteen of those 20 are receiving more than 50 percent of their money through state aid.  Our favorite example there is the Primero School District, which I'm sure you're familiar with, that levies 1.68 mills and gets 75 percent of its money coming from the state.

So we've sort of backed into this policy of creating basically an extremely favorable no-levy subsidy for certain school districts to hold their levies down. So state aid appropriations by the General Assembly go first to fund these subsidies and then, secondly, to backfill in the local share, and then, thirdly, to provide the growth in per-pupil funding that's in the law.

We think this is the sort of bumper sticker for the structural breakage in the existing School Finance Act.  We don't try to get into how much school districts ought to spend, or what they should be entitled to have, but just if we're going to have this sharing relationship, this is sort of a snapshot of how badly broken that relationship is.

UNIDENTIFIED VOICE: Don't leave that one yet.

CHAIRMAN LUNDEEN: Go ahead.

UNIDENTIFIED VOICE: So the amendment that was on the ballot this past November that failed tried to address this, but from an economist's perspective, how should this be addressed?

MR. BROWN: This is a really tough nut to crack.

UNIDENTIFIED VOICE: We know that. We know that.

MR. BROWN: You know, I mean, it's -- there are, I think, in our previous work we modeled a ten-year phase-in of a return to the uniform levy. To do that, you know, I mean, you're going to have some school districts going from 3, 4, 5, 8 mills to support their schools to 27, 28 mills, a tripling of their levy over time. I don't know of anybody in those school districts that would run for office with that kind of a platform. You know, I mean, other options would be essentially to eliminate property tax support for schools and for the state to fund 100 percent.

You know, we have this sort of representation of state and local partnership but it's really not much of a partnership anymore. The imposition of a statewide levy to support schools, imposing a state levy, eliminating local levies to support schools -- there are a number of different options, none of them particularly politically palatable.

So I think what Amendment 66 attempted to do was to create some incentives for school districts to begin to raise their levies over time, back towards where they should be, and we all know what the outcome of that election was. We didn't do an exhaustive analysis of Amendment 66, so to what extent that would have corrected this going forward in our forecast we didn't have time to really examine.

MS. BERMAN: So the uniform levy -- I mean, we're all policy people and I know you're giving us an economic analysis we're going to the policy piece of this. So the uniform levy would seem to me to create huge hardships for the smaller districts that have very low property taxes, which is the case you were making.

MR. BROWN: Well, I think a uniform levy would say -- I mean, I go sort of back to 1973 in my experience with the School Finance Act --

MS. BERMAN: That's okay. It wasn't a bad year.

MR. BROWN: So, I mean, over time, looking sort of back over a more, I think, geographic kind of time span, there used to be more of a connection between having high levies and high spending. The '88 act and then the '94 act sort of broke that connection. And so we moved in the direction of saying, you know, if you should be spending at a higher rate, based on the factors that are in the School Finance Act, you know, the at-risk populations, cost of living, and size factors, principally, you shouldn't necessarily have to spend -- you shouldn't have to levy more mills to get there.

Everybody should levy pretty much statewide at the same level. I mean, if you're poor and you levy your 40 mills, that may only generate 5 percent of your total program. The state would then backfill in the other 95 percent. But if you're wealthy, you might generate 95 percent of your total program with that uniform rate, and it's not more of a hardship in any one school district than another, than the state would only backfill in 5 percent.

And what you should see would be on the left-hand axis there, some school districts that are able to be totally self-sufficient, levying at less than 40 mills. And so, you know, they were sort of looking for this perfect, you know, distribution on these scatter plots, where you'd have school districts either on the left-hand margin below 40 mills, or clustered, you know, along that horizontal axis.

We looked at, in Primero School District, with the 1.68 mill levy, at the median value of a house, and their contribution, the median impact of funding schools in that school district is about $28 per year -- $27 and change. And, you know, that's not thought of as a wealthy area, but they have a high degree of mineral wealth and natural resource wealth there, which is the reason for, you know, them falling so far in terms of their overall levy. I just keep talking here. I'm not sure I'm answering your question.

CHAIRMAN LUNDEEN: Can we move on, Elaine?

MS. BERMAN: Well, yes. It sounds to me like you think that the uniform mill levy would be something for consideration at the policy level.

MR. BROWN: We do hope, on our research agenda for this next year, we have a project teed up to pitch to a funder, to take a much harder look at this and get into more of the details, to try to find some answers. As you know, this is a very complex area. You know, the devil is indeed in the details when you're dealing with 178 school districts and different factors that are driving enrollments --

MS. BERMAN: I hope you get the funding.

MR. BROWN: -- and property value.

Other kinds of spending changes from our last study, as Phyllis alluded to, money has come in strongly and some cuts have been restored, to certain departments.  In going through and looking at the kinds of spending decisions that were made by the legislature and the governor, I really noticed a trend of more sort of one-time spending, you know, one- to three-year programmatic spending that would then go away after that one- to three-year period.  Reserved savings -- I'm sure you're all aware of how much sits in balance in the State Education Fund currently.  Legislation to increase the overall General Fund reserve from its historic rate of 4 percent up to about 7 percent.

And basically I think elected officials have done what families would do, coming out of a recession, coming out of tough times.  Essentially, they've been cautious with their money.  They've not gone into more long-term consumer debt.  They've tended to spend their money in more of a targeted way, without obligating themselves into the future.  And then they paid off one of their credit cards.  This old Fire and Police Pension was paid off several years in advance and that scheduled payment was then diverted into the State Education Fund.

There have been some revenue reductions that have been made permanent.  The earned income tax credit, which I think it was Senate Bill 1 created this to be in the first year of the TABOR refund, one of the refund mechanisms. But once that refund mechanism is triggered it becomes a permanent feature of the state income tax code, and that's $80 to $100 million a year, as a permanent tax cut.

The child credit is triggered based on the federal passage of the Marketplace Fairness Act. We're not convinced that Congress can agree on much of anything these days so we have not put this into our revenue forecast.

And then, finally, the Elderly and Disabled Veteran Homestead Exemption was restored in the fall.

So with that I will turn this back over to Phyllis to explain the hospital provider fee.

MS. RESNICK: So I'll try and take you through the rest of this pretty quickly, but, so what we've taken you through so far were really two sets of findings, both on the revenue side and on the expenditure side, as Charlie alluded to in his opening remarks, that created sort of the perfect storm of good news for the state. So expenditure pressures were lessened because of household formation and inflation, and revenues came in more strongly and that served to close the gap from where we had forecast it the last time.

But we are Colorado and we do have fiscal policy in the constitution that serves to always kind of cloud situations here. And so TABOR is not something all of us have, at least with respect to refunds, have thought about for very many years, and we thought with Referendum C it would be a very long time before we would see TABOR refunds again. And, in fact, that would have been the case. Our forecasts tell us that if it were not for one decision that was made back in 2009, we would not be looking at a TABOR refund all the way through to the year 2030. We passed Referendum C in 2005. We essentially rebased the limit. We had about $1 billion of room under the limit, and we would have probably chugged along and maybe slowly eroded that but not really ever quite caught up.

However, in 2009, the legislature made a decision to pass something called the hospital provider fee. It was House Bill 1293 in 2009, and it was -- we're not the only state that's done this. However, we're the only state that's done this and has TABOR.

And so what this is, is it's a fee that hospitals have agreed to impose upon themselves to create a pool of money to give to the state to leverage federal dollars in order to expand the Medicaid program. And many states are doing that, and we did that back in 2009.

Because we did it as a fee and didn't go to the voters for approval, there was not the opportunity at the time it was passed to exempt it from the TABOR limit. It would've had to have gone to a vote and be an approved revenue change in order to be exempt from the TABOR limit.

So we passed this fee back in 2009, and as you know, health care grows at a rate far quicker than pretty much any other revenue or spending factor in the economy. So that fee has been growing each year and it's been eating up some of that room, that billion-dollar room between the limit and the level of revenues subject to the limit at the state level. Last year we made a decision to further extend the use of that hospital provider fee in order to do a second Medicaid expansion under the Affordable Care Act.

Now, a couple of things have happened since 2009. The first thing is that all those folks to whom we expanded Medicaid under the original bill in 2009, will be eligible for the federal-enhanced match, starting four days ago. So those folks who came onto Medicaid coverage back in 2009, at the time when the state paid 50 percent of their care through the hospital provider fee and the Feds paid 50 percent of their care, right now, sitting here today, are fully funded 100 percent by the Federal

Government because they're considered an expansion population under the ACA. Everyone else we've expanded to, since the legislature made the decision last year to expand Medicaid, is also fully funded by the Federal Government.

That will last for three years. Once that three-year period ends, then the federal contribution starts to ramp down and the state contribution has to start to ramp up to the point where when it rests, at the end, those folks will be 90 percent federal and 10 percent state. The 10 percent state we are paying for with the hospital provider fee, for all of those expansion populations.

We are also using that provider fee to make some other payments to hospitals around indigent care and supplemental payments to bring rates up to the Medicare reimbursement rate, and if you put all of that together the hospital provider fee becomes a very fast grower in terms of revenues in the state budget, to the point where they are contributing -- and, actually, the sole reason that we will have TABOR refunds starting in the year 2017 and all the way in our forecast through to year 2030.

So this graphic here just shows you the size of the TABOR refund we expect. It's very small in our forecast in the year 2017. It's a little over $100 million. As Charlie mention, you know, we and the legislative economists all think this is within the margin of error in forecasting. It could happen in 2016. It could happen in 2018. But it will start out pretty small, but it grows pretty quickly to the point where, in the year 2030, we see a TABOR refund of almost $900 million.

It is fully driven by the fact that we have that hospital provider fee subject to TABOR. This graphic has a pairing of bars for each year. The green and yellow bars show us General Fund and Cash Fund revenue to the state under current law. So in that yellow part of each one of these bars is the hospital provider fee. The blue/red combination bars show you what revenues would have been if we didn't have the hospital provider fee as a revenue coming into the state, and the green line running up this graph is the TABOR limit.

So if we go all the way to the last year and every year in between you can see that the blue/red combination bars, which would be revenues to the state if we didn't have the hospital provider fee, do not trigger a TABOR limit. They never reach the limit. Because we have that hospital provider fee in this yellow part of these bars, the Cash Fund part, we start to breach the limit in 2017 and we continue to do it every year throughout.

So in a perverse story that you couldn't make up, in Colorado, the fact that we used a mechanism to expand Medicaid that is a common mechanism used in pretty much every other state in the country, we are creating a situation, because we've chosen to pay TABOR refunds out of the General Fund, where money coming into the state to expand Medicaid is causing the General Fund to bear a refund to the citizens out the other end, because that revenue source is breaching our TABOR limit.

So if we look at the gap that -- so the green bar in this graphic is essentially that delta or that deficit that you identified in the early part of the presentation.  This is a bar chart representation of the size of the gap.  The yellow bar shows you what the size of the gap would be if we didn't have the TABOR refund causing the General Fund to have to foot, by the year 2030, almost a billion dollars in refunds.

And this is just another way of showing you that by that last year, by the year 2030, the TABOR refunds, solely caused by the hospital provider fee, are contributing about a third to the total gap that we see the state facing in the out years.  So while we've had some things that have worked in our favor, this is something that has really served to hurt our fiscal picture going forward, the fact that we're going to be forced to bear the burden of those TABOR refunds.

So the question is, what do we do about the fact that we clearly have this gap? As Charlie mentioned, we firmly believe that structural problems require structural solutions, that straight across-the-board cuts don't really solve the problem. I would also add that straight across-the-board revenue increases don't really solve the problem either. We could just bump up tax rates, and if you bump them up parallel that gap is going to reopen again in the future anyway.

However, we are always asked, "What would it look like if we tried to cut our way out of this problem?" And so we scratch our heads every time we do this work and we say, okay, what would a cut scenario look like? It's a little hard to build a cut scenario because there's almost infinite ways you could cut. But we did one and we just said, "What would it look like if we cut every department except for those three largest departments, proportionally?"

So we're going to protect HCPF, Education, and Corrections, and we're going to basically make all the other departments in state government bear the burden of the cuts. If I can direct your attention to this last year, this is the representation in the out year of what that would look like. So here are all the other departments. If they could grow by what we think is driving their natural rate of growth in our forecast, and if we had to balance the budget by cutting them, this is what we would have left to fund them. It turns out we'd have about a quarter of what we need. We'd have to cut about 75 percent out of each one of those departments.

However, when you look in more detail about what's in all those other departments -- I'll start with the yellow part of the chart and work my way clockwise, for a very particular reason -- the largest department in that all other is Human Services. As you know, Human Services is a very highly federally leveraged department. Every dollar we spend at the state we get money from the Federal Government. So it becomes a very difficult area to cut, plus we're providing, you know, some very basic safety net services there.

It's unlikely we're going to cut the Judiciary all the way down to nothing. I can't point to a democracy that doesn't have a working court system. We're unlikely to cut Public Safety to nothing. We're unlikely to cut very much out of the Department of Revenue. They're the folks who collect all these revenues that pay for our programs, so if you get rid of them you kind of don't have a revenue system. And then we're left with all these other departments that only represent a little more than 8 percent of the pie.

So when you look at all of these areas it's unlikely we're not only going to take 75 percent from them, we may not even take a quarter from them. It's very hard to cut them all the way to the bone -- which leaves this green part of the bar, or the pie. Every time we do a cut scenario it always points back to one place, and it's higher education. It's hard to think of a way you could cut your way out of this problem and continue to publicly fund higher education at the state level.

So given that we don't really love that as a recommendation for how to deal with the structural problem, we decided to posit some alternatives. And the one that we're working with right now is to say there are two things the state could do that aren't necessarily painless but they're discrete and they are perhaps somewhat understandable, that could actually take care of a good part of this problem through the end of the decade.

The first one is to find a way to get that hospital provider fee outside of the TABOR limit. Now there are two ways you could do that. You could try and go to the voters and in 30 seconds or less explain what we've been explaining to you in an hour, and hope that, you know, they're going to follow you the whole time and then go and vote to exempt that revenue. We think that's a little unlikely.

The other way to do it, as you know, we've done it before in the state, is to create an enterprise structure around that revenue, give them some revenue bonding authority over it, and make sure that that enterprise doesn't get more than 10 percent of its revenue from the state general sources of revenue.

And then you can exempt that revenue from TABOR. We've done that with higher ed tuition. We've done it with unemployment. I think we did it with the lottery early on. And so there is precedent for that.

Since we've started talking about this there has been conversations bubbling around finding a way to deal with the hospital provider fee and the TABOR. If we could do that, the yellow part -- the green part here is again a representation of the size of the gap. The yellow bar next to it shows you how much of that gap we could close by eliminating the hospital provider fee from the TABOR limit.

What's represented in the blue part is something that we posited the last time, but I think we're saying more strongly this time. We've got to find a way to reconstitute our sales tax base, which is part of the reason we spent so much time talking about all of the headwinds that are facing the sales tax. And what we're looking at is what if we could bring some subset of those services we just talked about into the base.

And we picked a scenario where we just brought in personal services, the kinds of things I explained earlier, like getting your hair cut, getting your nails done, going to the spa, recreational services, getting your auto repaired. Right now you pay tax on the parts but not on the labor. All of those things that pretty much households purchase. We left out business services, more professional type services, and we left out medical.

The reason we left out medical is we think it would be politically completely unpalatable to ever propose sales tax on medical services. And we left out professional services because you end up with something called pyramiding when you try and put a sales tax on professional services, because they are often purchased business-to-business, as intermediate transactions, before the final transaction to the end seller. So you end up taxing the tax a lot.

If we did include them we'd raise an awful lot of money. There are states that do that, like New Mexico and Hawaii. But we did not model that. We modeled simply the very basic household services, and that's represented by the blue part of this bar.

So if we could take those two, admittedly not easy actions, we could come pretty close to closing this gap. I mean, you know, there's a little bit of a gap left that could perhaps be in our, you know, forecast error, or would require some other small changes or some cuts, but we could come pretty close, through the early part of the next decade, and buy ourselves some time to then think about the more structural type solutions that are going to be necessary as we get out toward the end of the next decade.

If we did that, we recognize that doesn't solve the problem forever. And so, as Charlie alluded to, we think closing the remaining gap, the linchpin to that is really about figuring out a more viable model for funding schools, which is something that we'd like to spend some time looking at in the next year.

So just to finish off, you know, whenever you do forecast work, especially out to the year 2030, I always joke about this and then I heard Ben Bernanke say the same thing at some Fed meeting, that the nice thing about forecasting out this long is that, you know, you might not be around to have to account for your forecast. The first time I gave this presentation, the Chancellor said, "Well, the good thing is no one in this room will be alive in 2030," and I said, "Well, I would like to still be alive in 2030."

But there are certainly risks. You know, another recession. We got lucky with this recession because coming out of it we had some phenomena that helped us. That won't necessarily happen again. As you all know, as well as all of us know, we live in a state where our citizens are very active with the ballot, and so we could have something that gets put on our ballot that ends up hurting us.

Pensions are an issue around the country, long-term pension liabilities. We don't -- we have not done an exhaustive study of Colorado pensions. We often don't turn up at the top of the list of real pension offenders, but in every state, if market performance doesn't come in where the models are, if other things were to happen, pension liabilities could be an issue.

And just generally, I think our last pitch is we can't take our eye off this ball. Things look a little better right now because we have had these things fall in our favor. That could reverse very quickly.

So to your point, for, you know -- and thank you for inviting us -- we all need to be talking about the fact that even though things do look better, and we got a little bit of a reprieve, we still face a long-0term structural problem in this state that we need to deal with.

I will, you know, close, and some of you may have heard me quip about this before, but when we did our first study I was talking to a colleague of mine who does aging policy work at the national level, and I was explaining to him all that we were finding and how much of it was related to the change of behavior as people age. And he said to me, "Well, I don't understand. I was at a meeting and the speaker got up and said, 'We have plenty of time to deal with the impending retirement and aging of the baby boom.'" And I looked at him and I said, "Bill, how can that be? It's already happening?" He said, "Well, what I didn't tell you was that meeting was in 1984."

So we all saw this coming and, you know, we pervertedly decided to kick the can down the road. Well, the time for kicking is pretty much done. So it's really time to roll up our sleeves and figure out a way out of this problem.

The last couple of things, just real quickly, and then I think we're out of time but we can take some questions, I just want to acknowledge three folks who worked very hard on this study with us. Dr. Steven Fisher, Deb Godshall, who some of you may actually know, who is a guru on school finance, and Warren Olson, who does all our work around health care and corrections.

You have our materials and you have this in your slides, but if, you know, want to share it with anyone else they're online at our website. And we're very thankful to the Colorado Trust for supporting a lot of our outreach. So our ability to get out and talk about this is being very graciously funded by the trust, so we would like to publicly thank them as well, and thank you for letting us probably put a real damper in your afternoon. I suggest a cocktail now but we are happy to answer questions.

CHAIRMAN LUNDEEN: Questions? Angelika. And let's keep them brief. We're way over time here.

MS. SCHROEDER: Well, it's not a question but the suggestion that there's a -- there probably was an upside to the recession. But I think if you talk to every superintendent and school board in the state of Colorado they would say the billion-dollar negative factor is not an upside at all. I mean, I think there's been a price paid perhaps by our kids.

CHAIRMAN LUNDEEN: Question? Other

questions, comments?

Thank you for the presentation. Interesting, I think, and we certainly don't have the time to unpack this now. But if we roll all the way back to the assumptions, if we take a look at the different perspectives that could be brought to this conversation, you've brought some very interesting conclusions.

I would posit that if we had more time to break it out further, in fact, some of the data shows significant growth in government, regardless of the various classifications within it, and an increasing gap between the revenues coming in. But it doesn't really get into the question of, you know, how could we reshape, how could we re-envision -- that's something Angelika brought up earlier in the day with regard to another issue, is have we, in fact, in our government services piece -- and specifically we were talking at the time about education services -- have we kept up with the transformations that have happened in other areas of service provision? And could that, in fact, be an additional lens, instead of just using this, what I would call kind of shopworn perspective of trying to protect and preserve what we have, can we completely re-envision, perhaps, the way some of the things that we provide, that government provides as a service, are provided in a transformed or more efficient or more contemporary, and therefore more relevant way?

So we appreciate the presentation, grateful for it. Thank you for the information.

MS. RESNICK: If I could just leave you with one thought about that.

CHAIRMAN LUNDEEN: Sure.

MS. RESNICK: I will leave you to ponder this line. We didn't spend a lot of time talking about it but this is the line for Medicaid, and this is not the expansion population. These are the folks who have been in Medicaid for, you know, many years. What is largely driving that upward slope is aging, and Charlie alluded to it, is long-term care. So to your point, I will often say -- and that's driving a lot of this gap. That's the biggest grower in terms of rates and growth. We have got to find a way, at the national level, at the state level, at every level, to get a handle on health care costs, and particularly around aging health care costs, because that's what's killing us, really.

You know, in every other way, our growth projections are very modest. We grew every other department with population plus inflation, so we don't have outsized growth. It's health care.

CHAIRMAN LUNDEEN: So you would argue that's the bogey to take a look at.

MS. RESNICK: This is what needs to be discussed.

CHAIRMAN LUNDEEN: Excellent. Thank you very much for your time.

UNIDENTIFIED VOICE: Thank you very much. That was fantastic.

(Applause)

(Meeting adjourned)

C E R T I F I C A T E

I, Kimberly C. McCright, Certified Vendor and Notary, do hereby certify that the above-mentioned matter occurred as hereinbefore set out.

I FURTHER CERTIFY THAT the proceedings of such were reported by me or under my supervision, later reduced to typewritten form under my supervision and control and that the foregoing pages are a full, true and correct transcription of the original notes.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 25th day of February, 2019.

/s/ Kimberly C. McCright
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