COMMON SENSE INSTITUTE

APRIL 2025

BUDGET FORECAST: $1.2 BILLION COULD VERY WELL BE THE TIP OF THE ICEBERG

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ABOUT THE AUTHORS

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ABOUT COMMON SENSE INSTITUTE

Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Iowa's economy. CSI is at the forefront of important discussions concerning the future of free enterprise and aims to have an impact on the issues that matter most to Iowans. CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Iowans are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the economy and individual opportunity.

TEAMS & FELLOWS STATEMENT

CSI is committed to independent, in-depth research that examines the impacts of policies, initiatives, and proposed laws so that Iowans are educated and informed on issues impacting their lives. CSI's commitment to institutional independence is rooted in the individual independence of our researchers, economists, and fellows. At the core of CSI's mission is a belief in the power of the free enterprise system. Our work explores ideas that protect and promote jobs and the economy, and the CSI team and fellows take part in this pursuit with academic freedom. Our team's work is informed by data-driven research and evidence. The views and opinions of fellows do not reflect the institutional views of CSI. CSI operates independently of any political party and does not take positions.

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KEY POINTS

- Using General Fund growth rates of 5.1% and 5.0% for fiscal years (FY) 2026 and 2027, and reported potential appropriations, Colorado is facing a projected **$1.2 billion budget hole**.
- Should the economy grow at rates consistent with the trends in employment growth and the unemployment rate, the budget hole gets larger, **on the order of $2.8 billion for fiscal years 2026 and 2027**.
- The relatively optimistic revenue growth figures does not account for downside risk. Should the economy have a moderate downturn, the budget hole becomes much larger, **around $3.9 billion**, and that is before spending pressure is considered.
- Some might consider the weak revenue picture as evidence of a revenue problem. That is not correct. Spending has exploded in recent years. For example:
  - From 2010 through 2025, total General Fund spending rose 134%.
  - Over the same period, spending from All Sources rose 127%.
  - In contrast, population growth was 19% and reported consumer inflation as measured by the Consumer Price Index was 48%.
- For two of the "big three" spending areas — healthcare and higher education — spending far outpaced population and inflation.
  - Healthcare spending rose 333% since 2010 from General Fund sources and 268% from All Sources.
  - Higher education spending increased 288% from the General Fund and 138% from All Sources.
  - These growth rates far surpassed the 19% population growth rate and 48% inflation growth rate seen over the same period.
- Current policymakers should not only slow the growth in spending in certain areas, but stop the growth completely until a clearer economic picture emerges.
- Failing to get control of spending today may lead to higher than expected tuition and other fee increases, or budget reductions, that could have been avoided.

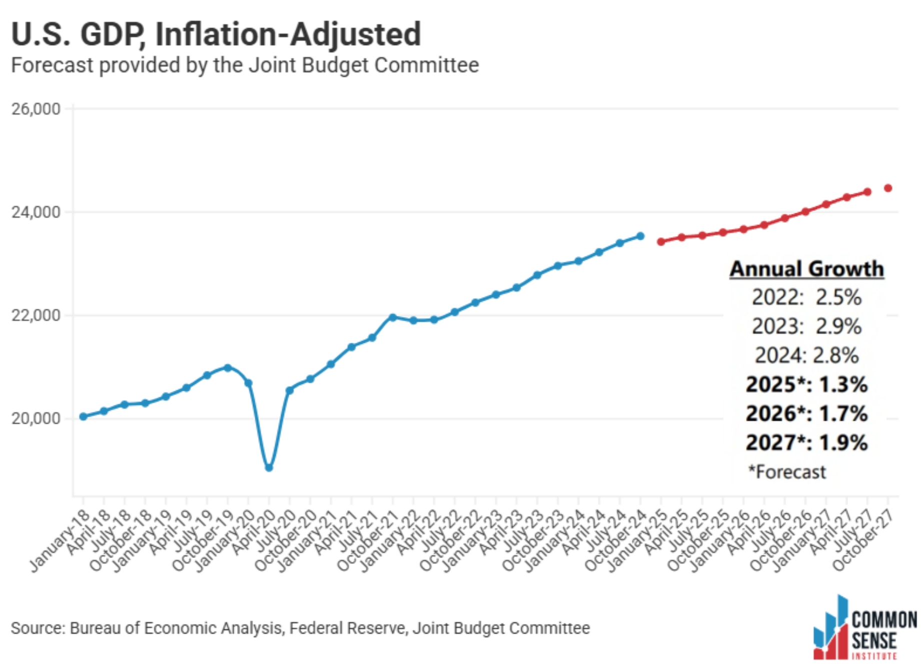
ECONOMIC BACKDROP

On St. Patrick's Day of this year, the legislature was presented with some not so welcome news from governor's office staff and legislative revenue forecasters: the budget outlook has a $1.2 billion hole for policymakers to fill.[i]

This *projected* budget shortfall, presented to the Joint Budget Committee,[ii] is due in part to a deterioration in key federal and state economic indicators.

As Figure 1 shows, following economic growth rates of 2.5%, 2.9%, and 2.8% in 2022, 2023, and 2024, respectively, budget forecasters now expect the U.S. economy to expand by 1.3%, 1.7%, and 1.9% in 2025, 2026, and 2027, respectively[iii]. Additionally, CSI's economic momentum index has deteriorated from the highs seen from 2015 to 2018. Slowing job creation, lower relative growth in the labor force participation rate, and a slight increase in poverty rates after 2020 have all led to diminished economic momentum relative to other states.[iv]

FIGURE 1[v]

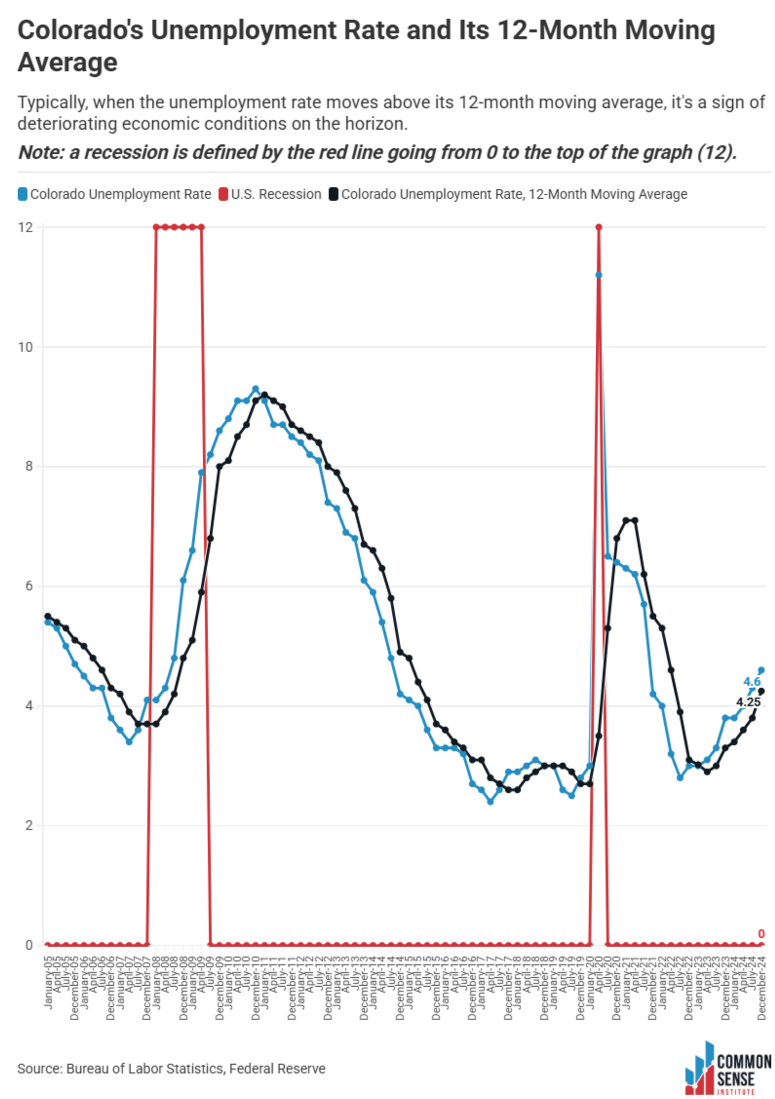


Revenues depends in large part of jobs — people working. Unfortunately, as Figure 2 indicates, the the state's job growth is predicted to be 0.8%[vi] in 2026. The rate in the United States is expected to be 1.2%.[vii]

The revenue picture is further clouded by the state's unemployment rate relative to its 12-month moving average. Overall, at 4.6%, the rate is 0.35 percentage points higher than its 12-month moving average and is trending higher. Typically, this movement indicates weaker future economic conditions. The unemployment rate typically trends higher than its 12-month moving average prior to the onset of a recession. Although not unheard of, as Figure 3 indicates, **the current trend of a rising unemployment rate compared to its 12-month history has been the case for seven months — a long period by historical standards without a recession**.

FIGURE 2

FIGURE 3



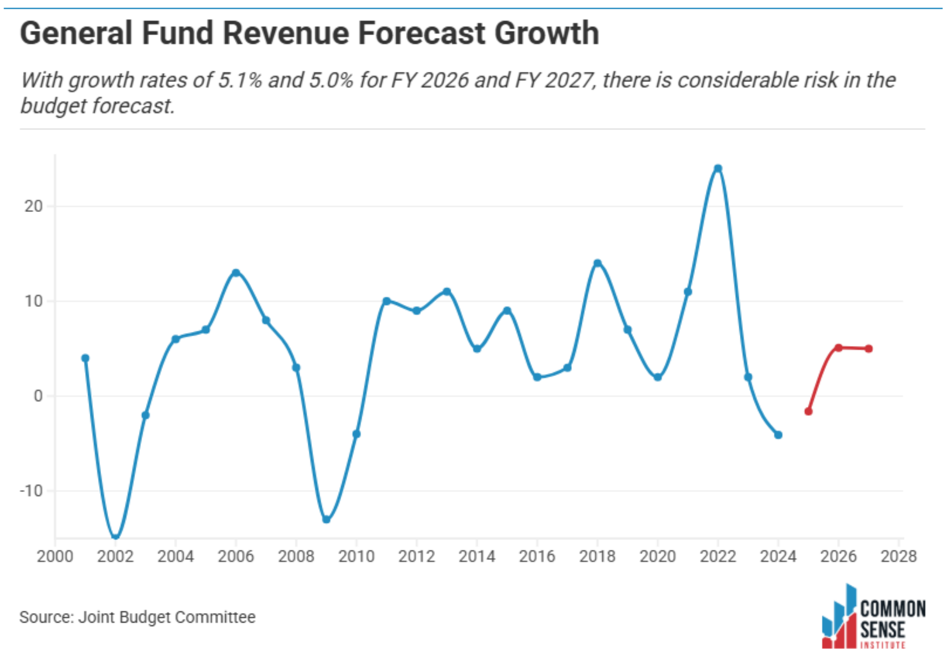
REVENUE RISKS

Given this background, how much risk is there on the horizon for the state's budget? Per the Joint Budget Committee[viii] and as Figure 4 indicates, the March 2025 forecast assumes revenue growth of 5.1% for FY 2026 and 5.0% for FY 2027.

Using these revenue growth figures and assumptions on Excess Reserve, 2024-2025 Long Bill Supplementals, FY 2025-26 Long Bill Appropriations, Capital Transfers, and Proposition 130, the Excess Reserve is -$1.161 billion, a $1.2 billion shortfall. Using Table 1E from the Economic and Revenue Forecast document, the budget hole is $1.2125 billion (Scenario B).

Given the revenue growth assumptions, how likely is it that the $1.2 billion shortfall is optimistic? One way to judge this likelihood is to use historical revenue growth. For the 27 years examined in Figure 4, the FY 2026 forecast ranks as the 13th best and the FY 2027 forecast would be 14th best, or right in the middle of historical revenue performance.

FIGURE 4



Given the trends in employment, unemployment, and national economy, however, it is unlikely growth in Colorado will even hits its averages.

Using state employment and unemployment trends, along with reported projections for the national economy, the FY 2026 prediction of +5.1% is likely to be too optimistic. Using a model that adjusts for outliers in the historical growth rates and the aforementioned employment growth and unemployment rates, our CSI model suggests a revenue growth range between -3.1% and +4.6% for FY 2026 and between 1.2% and 8.8% in FY 2027. This calculation is illustrated in Figure 5.

What do these figures mean for the broader budget picture? The $1.2 billion budget hole becomes larger — not only because the revenue picture is weakening, but because the expenditure side also deteriorates. For just the revenue picture, the budget hole worsens **by $764 million in FY 2026 and $807 million in FY 2027, or another $1.6 billion over two fiscal years**. In such a situation, the expenditure side of the balance sheet would put upward pressure on spending, making the budget situation materially more difficult.

FIGURE 5

General Fund Revenue Forecast Growth Rates for FY 2026 and FY 2027

Date	Lower End	Midpoint	Upper
2026	-3.05	0.77	4.59
2027	1.16	4.98	8.80

Source: CSI Research and Modeling

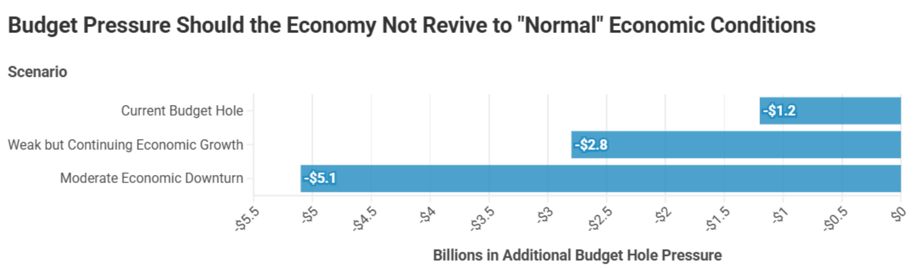
WHAT IF THE ECONOMY EXPERIENCES A MODERATE DOWNTURN AND SPENDING STAYS THE SAME?

The state's revenue assumptions do not account for a moderate economic downturn.

What does the budget picture look like if General Fund revenue growth experiences a decline of 5% as opposed to a 5% rise in FY 2026 and a weak recovery in FY 2027 of just 3%? How much of a budget hole would policymakers face?

From the revenue side, **the budget picture worsens by $1.7 billion in FY 2026 and by $2.2 billion in FY 2027, totaling about $3.9 billion over two fiscal years**. As Figure 6 indicates, upward pressure on the expenditure side of the balance sheet would make the budget picture even more bleak. In fact, it would add **more than $5 billion in funding issues on top of the $3.9 billion from the revenue side**.

FIGURE 6



Source: Joint Budget Committee, CSI Modeling and Analysis

What Is the Problem with Assuming Healthy Revenue Growth When the Economy is Slowing?

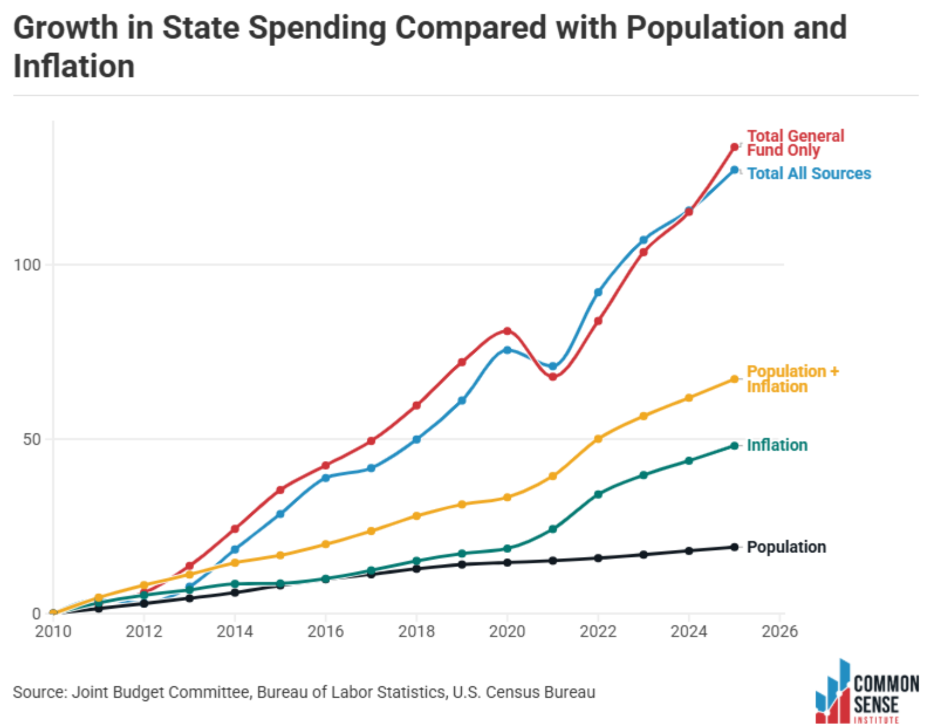
Adhering to rosier revenue predictions could make budget discussions more difficult in the coming years. Rather than kicking the can down the road and making future policymakers' jobs more difficult, current policymakers should slow the growth in spending in certain areas, and stop the growth completely in others until a clearer economic picture emerges.

SPENDING PRESSURE

Overall Expenditures

Added to the weak revenue picture is the fact that, over the last 15 years, spending has exploded. From 2010 through 2025, total General Fund spending rose 134% (or 86% on an inflation-adjusted basis) and spending from all sources increased 127%. In contrast, as Figure 7 shows, population growth was 19% and reported consumer inflation as measured by the Consumer Price Index is up 48%.

FIGURE 7



The "Big Three"

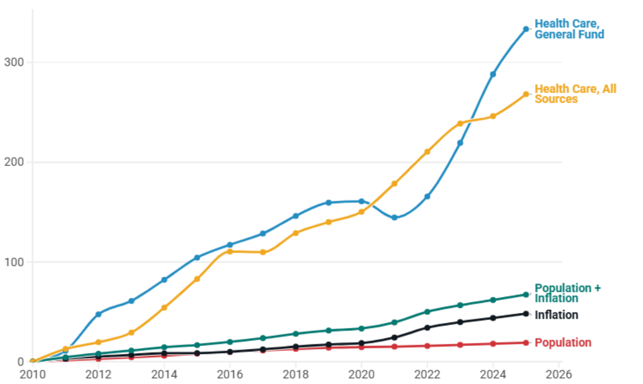
The overall spending increase has been driven by education, higher education, and healthcare. These categories are known as the "big three" because they will soon surpass 70% of all spending and more than 75% of General Fund spending.

As Figure 8 indicates, when compared with population and inflation, healthcare spending has exploded, rising 333% since 2010 from General Fund sources and increasing 268% from All Sources.

Higher education has also seen an enormous rise in spending, increasing 288% from the General Fund and 138% from All Sources. As with healthcare spending, spending on higher education has grown much faster than population and inflation. Figure 9 illustrates the contrast between higher education spending increases and population and the CPI.

FIGURE 8

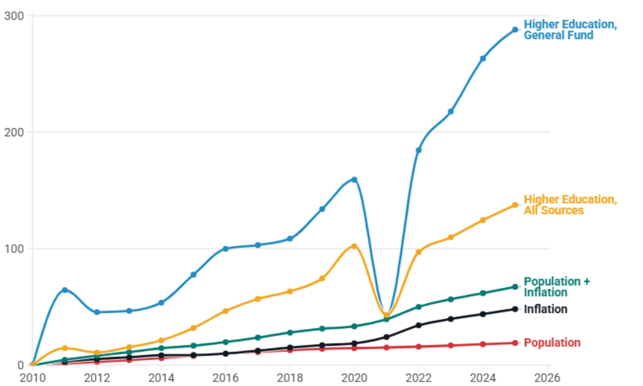
Growth in Health Care Spending Compared with Population and Inflation



Source: Joint Budget Committee, Bureau of Labor Statistics, U.S. Census Bureau

FIGURE 9

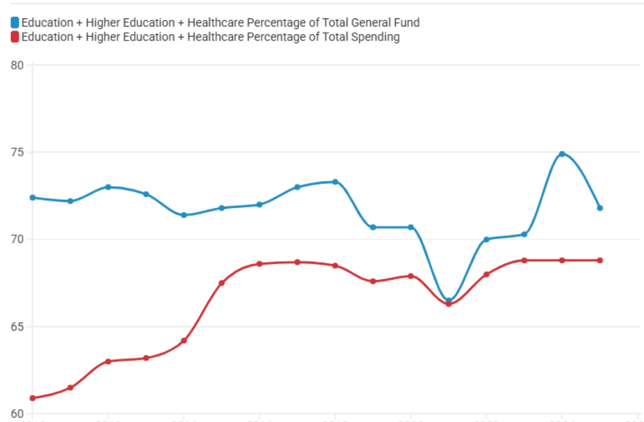
Growth in Higher Education Spending Compared with Population and Inflation



Source: Joint Budget Committee, Bureau of Labor Statistics, U.S. Census Bureau

FIGURE 10

Percentage of the Budget for the Big Three from All Funds and Just the General Fund

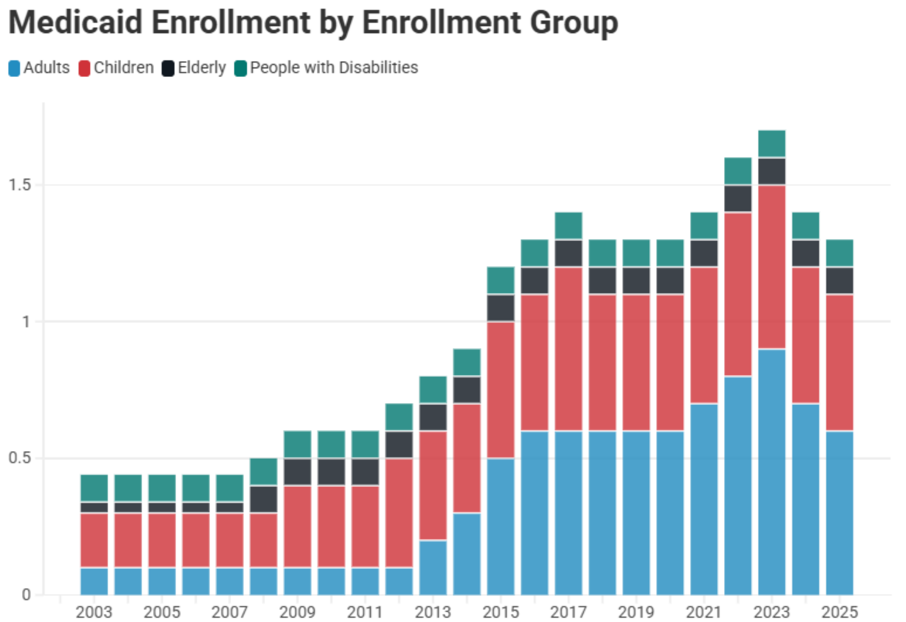


Source: Joint Budget Committee

In Some Budget Areas, Spending Pressure Goes up When the Economy Deteriorates

In times of economic distress, balancing the budget becomes more difficult because demand for government services rises. For instance, as shown in Figure 11, Medicaid demand rises as unemployment rises. When the economy performed well between 2017 and 2020, Medicaid enrollment declined marginally. (Other policy-related factors also affected enrollment during that period too.) When the economy weakened after the pandemic, enrollment rose.

FIGURE 11



Source: Medicaid and Enrollment Expenditures from Explore Colorado's Budget • Note: enrollment figures are rounded to the nearest 100,000 each year.

BOTTOM LINE

Current projections for a $1.2 billion budget hole are too optimistic, especially if economic conditions continue to weaken. In a slower growth scenario, the revenue picture deteriorates by an additional $1.6 billion from FY 2025 and 2026 through FY 2027. Revenue side pressure adds another $3.9 billion in funding problems to the already $1.2 billion and, when spending pressures are added in, the budget hole could rise to more than $5 billion. Given the large increases in spending over the past decade, policymakers may be wise to start trimming spending now rather than assuming growth will rebound. By acting now, tuition-paying college students may be saved from higher than expected tuition increases. Moderately painful budget decisions now can make future budget discussions less painful in coming years.

REFERENCES

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ii https://leg.colorado.gov/sites/default/files/march_2025_forecast_presentation.pdf

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iv https://www.commonsenseinstituteus.org/colorado/filesimages/Research%20Page/Free%20Enterprise%20Report/CSI_FreeEnterpriseReport_d4_spreads.pdf

v Adapted from the Bureau of Economic Analysis and https://leg.colorado.gov/sites/default/files/mar2025forecastwithcover.pdf.

vi https://fred.stlouisfed.org/series/CONA

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viii https://leg.colorado.gov/sites/default/files/march_2025_forecast_presentation.pdf