



COLORADO FISCAL  
POLICY INSTITUTE

## **Legislative Issue Brief: State Budget**

May 2009

### **Introduction**

Over the course of the 2009 legislative session, the General Assembly shaped the FY09-10 budget to reflect a dramatic 12% decrease in tax revenue and the assistance from the federal American Recovery and Reinvestment Act monies, intended to buffer states from the downturn the economy. Ultimately, the Legislature delivered a balanced budget to the Governor that incorporated some cuts, budgeted for some necessary increases in state services, passed several sustainable revenue increases, and leaned heavily on one-time sources of funding. The FY09-10 budget was held together by fiscal duct tape and super glue, but the Legislature was largely able to preserve levels of funding that protect Coloradans living on the margins.

The worsening of the state budget came into sharper focus when the March 2009 quarterly economic projections were released. Each quarterly projection gives direction to the Joint Budget Committee (JBC) to adjust both the current and subsequent budget cycle to be in balance with available revenue. The projection of General Fund revenue was forecasted to plummet \$812 million or 10.5% for FY08-09. In FY09-10, General Fund revenue was projected to decrease another \$98 million or 1.4%.

In response to the budget gap, JBC cut or temporarily filled \$796.3million in the FY08-09 and addressed the \$1.089 billion FY09-10 budget shortfall as measured by the Governor's originally proposed budget.

### **FY2008-2009 Impacts**

To address the total \$796.3 million FY08-09 General Fund budget shortfall, the Legislature used several approaches:

- \$214.0 million in budget cuts
- \$441.1 million in transfers and diversions from various cash funds to the General Fund
- \$134.1 million access from depleting half of the statutory reserve
- \$7 million in recapturing funds that were authorized but not expended

The \$214.0 million in budget cuts included a \$17.1 million cut to General Fund appropriations to the Department of Human Services, a 2.5% cut. Additional General Fund cuts were made to most all departments including K-12 Education, the Governor's office, higher education, and the judiciary. The Department of Healthcare Policy and Financing actually received a \$41.2 million increase in General Fund appropriations, a 2.7% increase. However, the increase in funding for HCPF was in large part due to increased caseload in Medicaid.

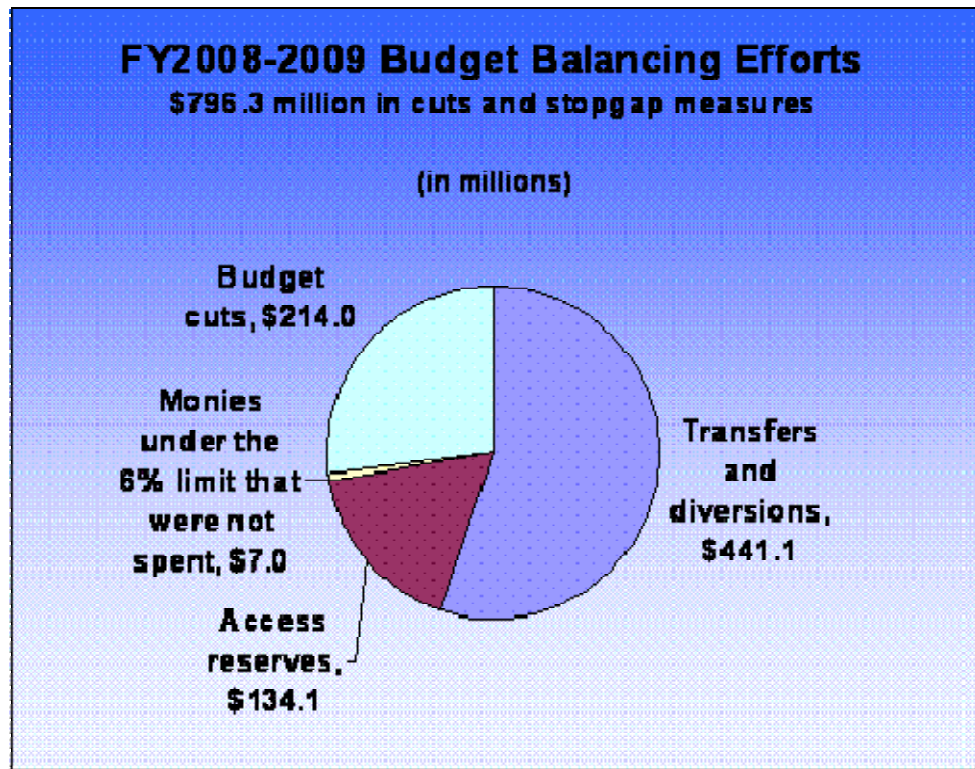
The \$441.1 million in cash fund diversions and transfers represent largely one-time, stop-gap money to temporarily fill the budget hole for FY08-09. Cash funds are created to cover various services government provides in exchange for fees and fines. Examples of cash funds used to balance the FY08-09 budget include:

- Alcohol and Drug Abuse Community Prevention and Treatment Fund

- Tobacco Programs Cash Fund
- Family-friendly Court Program Cash Fund
- Offender Services Fund
- Drug Offender Surcharge Fund
- Higher Education Maintenance and Reserve Fund
- Hazardous Substance Response Fund

While the reduced cash fund balances allow continued operations for the various programs run by their respective funds, their reserves are dramatically impacted. A cash fund transfer essentially transfers the cut to the following year,

because it is a one-time fix. If the General Fund gap is temporarily filled this year with one-time monies, those funds are not available in the next fiscal year for ongoing programs; thus, in the absence of increased revenues, programs temporarily funded by cash fund transfers this year will need to be cut in the future.



The last major budget balancing measure for the FY08-09 budget is the transfer of \$134.1 million in statutory reserves, a reduction from 4% of General Fund to 2%. By cutting the reserve in half, two problems occur. As with cash fund transfers, the one-time transfer only covers the FY08-09 budget, which creates the same problem as cash fund transfers. Also, Colorado has one of the lower required reserve balances in the country. Cutting the reserve to 2% leaves the state in a very precarious position if there is an additional dramatic decrease in revenues outlined in the June quarterly economic projection.

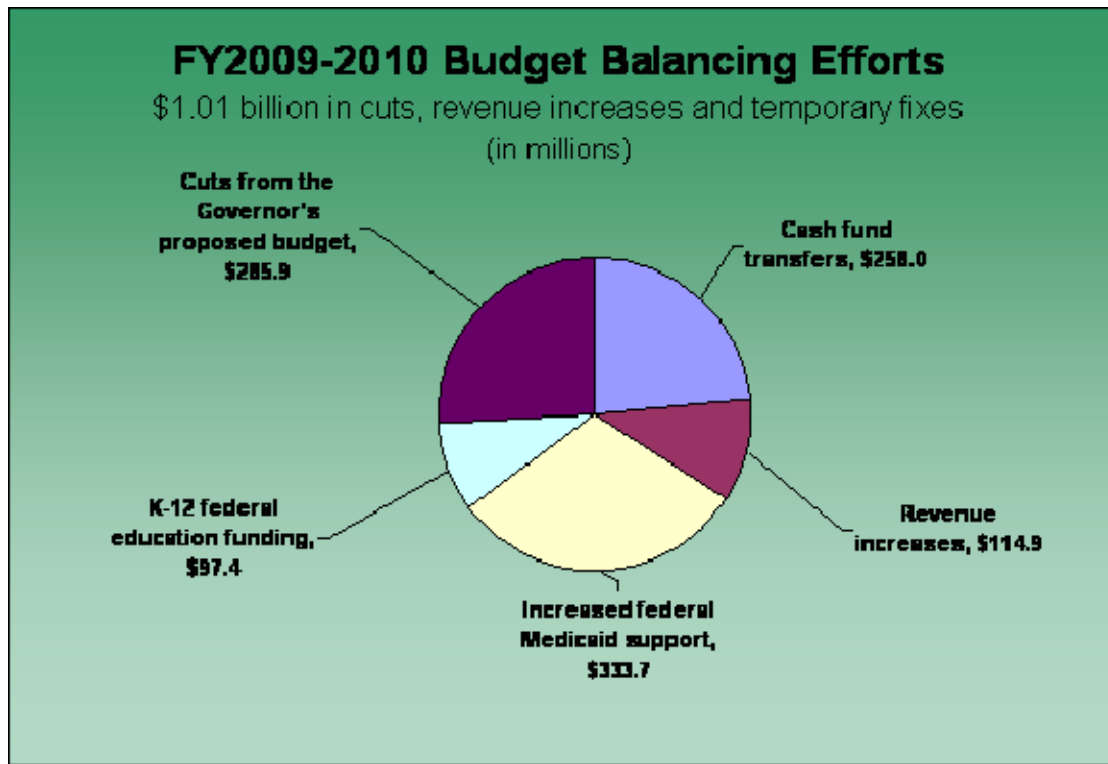
### **FY09-10 Budget**

In November 2008, the Governor proposed a \$7,922.9 million General Fund budget to the Legislature. Currently, General Fund revenue is estimated to be \$6,833.2 million. This represents a \$1,089.9 million shortfall, or a 13.8% drop. As originally proposed, the Governor's budget was a modest increase, designed to maintain levels of services and accommodate increases in inflation and caseload. A 13.8% cut from the proposed budget would have translated to disastrous cuts in services that all Coloradans rely upon.

To solve this gap, the Legislature built the \$6,833.2 base in a number of different ways:

- \$258.0 million in cash fund transfers, which are largely one time
- \$114.9 million in revenue increases, some of which are temporary
- \$333.7 million in additional federal Medicaid funds
- \$97.4 million in additional K-12 federal funding
- \$285.9 million in cuts from the Governor's proposed budget

What resulted was a \$7,647.2 million FY09-10 General Fund budget, which is a flat-lined budget from FY08-09. However, there are a number of areas of the budget such as Corrections, K-12 education and healthcare where the state must accommodate increased demands of caseload. While the budget remained static, these



increased demands, in addition to inflationary pressures, will result in a de facto cut in the level of services provided by the state.

Also impacting the level of service provided by government, the budget places significant burden on state employees. They will be responsible for increased workloads due to higher demands and the statewide hiring freeze, and the Legislature all but eliminated performance and cost-of-living pay increases. Additionally, non-essential personnel will be required to take unpaid furlough days to balance the budget. These strains on the state workforce may limit access to critical services, create the strained dynamic of “doing more with less,” and create difficulties in recruiting and retaining top-quality state employees.

Aside from across-the-board cuts to state personnel, below are outlined the major budget decisions made for the 6 largest state departments that comprise 96% of the state General Fund budget: Corrections, Education (K-12), Healthcare Policy and Financing, Higher Education, Human Services and the Judiciary.

### **Corrections**

The FY09-10 Department of Corrections had a 0.3% increase in General Fund appropriation, or \$2.02 million. However, the Department is anticipating an annual growth in inmate population of 2.7%. To accommodate the growth in prison population within a 0.3% growth of budget, \$30.5 million in General Fund appropriations were cut. These areas included:

- \$16.5 million cut by postponing the opening of the Colorado State Penitentiary II in Canon City
- \$5.2 million cut by forgoing additional parole staff that was intended to supervise increases in parolee population
- \$5.2 million cut by closing the Colorado Women’s Correctional Facility

As the corrections budget is forced to do more with less, impacts may be felt throughout other programs throughout the state, including a potential for increased recidivism.

## **K-12 Education**

Thanks to direction provided to the Legislature by Amendment 23, K-12 education funding experienced an increase of 4.68% in their FY09-10 budget, or \$144.97 million. However, much of this increase is due to fund transfers and using the State Education Fund (SEF) to prop up programs that have traditionally been funded through General Fund spending. The SEF was intended to provide a stable long-term funding source for K-12 education, but by accessing the corpus of the funds, the Legislature continues to compromise its intended purpose and brings insolvency much closer than forecasted. Several examples of this use of the SEF to backfill General Fund K-12 spending include:

- \$15.7 million for funding of the Colorado Student Assessment Program
- \$27.9 million to accommodate the absolute minimum of General Fund assistance for the School Finance Act, allowing the State Education Fund to backfill the difference
- \$33.0 million to backfill cuts to K-12 categorical programs

The steady decline of the State Education Fund will cause long-term problems for the state. The projected FY09-10 year-end balance for the SEF will be \$222.7 million. By FY17-18, the fund is projected to have a balance of \$1.5 million, potentially causing significant budgeting problems for the state's ability to fulfill its constitutional mandate of an equitable delivery of education for children throughout the state.

## **Healthcare Policy and Financing**

The Department of Healthcare Policy and Financing is responsible for administering Medicaid in Colorado, along with a number of other healthcare programs. The Department experienced a \$107.93 million increase in its General Fund appropriation, or about 6%. Again, while seemingly significant, the 6% increase in state support is overshadowed by the projected 8.3% growth in caseload. If the economy worsens further, caseload will likely rise above projections. In order to budget for the increase in caseload, several cuts were made to balance the HCPF budget and limit budget growth:

- \$3.2 million by eliminating the expansion of the Children's Basic Health Plan
- \$35.6 million in one-time savings by delaying managed care payments to providers
- \$28.8 million by reducing provider rates 2%, causing potential problems of access for clients if providers choose not to participate in Medicaid
- \$51.4 million in savings by refinancing programs with Amendment 35, Breast and Cervical Cancer, and Old Age Pension funds that would have been paid by General Fund

FY09-10 will be the second year that that federal ARRA funds will benefit HCPF's budget substantially. As part of the program, the one-to-one match that is ordinarily provided Colorado through the federal Medicaid program has shifted to approximately a three-to-two match. This means an additional \$333.7 million in additional funding to the state. The monies will expire midway through state FY10-11.

Unlike other areas of the budget that may see a potential evaporation of funds in future years, Medicaid will experience an influx of additional monies with the passage of HB09-1293. Proposed and supported by the Colorado Hospital Association, hospitals will contribute to a state fund based on each hospital stay. Those funds are then matched with the federal Medicaid match. Once given the final green-light from the federal government, Colorado is slated to receive at least an additional \$270 million in federal Medicaid monies.

## **Higher Education**

The struggle to maintain funding for higher education is a perennial problem in the state. For FY09-10, higher education was subjected to a \$122.46 million cut in General Fund support, or 15.6%. This cut is mostly filled by \$120.66 million in federal funds made available by ARRA. However, when these funds expire, public higher education in the state will be at a crossroads.

The legislature also authorized 9% tuition increases for resident undergraduates. Nonresident and all graduate tuition rate increases may be set by each governing board in relation to the going market rate. Dramatic increases in tuition can have a substantial impact to the most cost-sensitive students, who are usually the first generation in their family to attend college and/or low-income.

With the increases in tuition and federal funds to shore up the higher education budget, the total budget increase for all higher education institutions is approximately 1.22%. This will place significant strain on institutions as they experience increased enrollment, inflationary pressures, and competition from better funded higher education systems in other states.

### **Human Services**

The Department of Human Services was cut \$4.51 million in state support for FY09-10, about 0.66%. This cut in state funding was offset by a \$21 million increase in federal support from ARRA. However, the department is on the front lines of this economic crisis and is witnessing increased demands for all programs as the economy worsens. The federal dollars were able to provide additional funding in several key areas, including:

- \$7.5 million for new placements in programs servicing the developmentally disabled
- \$2.7 million for caseload growth within child welfare programs

However, a number of cuts were implemented throughout the department:

- \$2.9 million by closing the general hospital at the Colorado Mental Health Institute at Pueblo
- \$3.5 million by delaying the implementation of a children's mental health pilot
- \$4.0 million by shifting a sunset date, in effect accelerating the counties' share of child welfare residential facilities

### **Judicial**

The Judicial Department, which houses state courts and related services, experienced a \$10.5 million increase for FY09-10, approximately a 3.23% increase in General Fund support. One of the key improvements was an additional 36 attorneys and 50 support staff for the Public Defender's Office to serve individuals who cannot afford to hire an attorney. Additional resources were placed in the Office of the Child's Representative as well. The Judicial Department was largely spared significant transfers of cash funds to supplant state General Fund support.

### **Long-term budget reform – Senate Bill 228**

Most of the FY09-10 budget was propped up by temporary transfers and federal dollars. However, once the economy begins to recover and revenues begin to rebound, the state budget would have faced significant constraints on budget flexibility.

To address this future problem, the General Assembly passed Senate Bill 228, a substantial fiscal reform. **SB 228 was perhaps the most important bill passed the 2009 General Assembly.** The bill repeals the Arveschoug-Bird 6% general fund budget formula and thereby eliminates the ratchet effect created by the annual restriction on the state General Fund operating budget. It restores legislative authority to make priority decisions based on economic conditions rather than rigid, unchangeable formulas. SB 228 is an attempt to recognize the broad range of priority needs of the state. It balances the desire to have some upper limits on government spending with the need to use limited resources as appropriate in changing economic circumstances. It allows funding for the operating budget to increase beyond 6% over the prior year, but also recognizes that transportation and capital construction are important functions of state government. SB 228 represents the kind of thoughtful fiscal reform that is possible when wide ranging interests work together on behalf of the greater good of the state and will prove essential as the state economy rebounds.

### **Specific provisions of SB 228:**

- Retains the provision that General Fund appropriations shall not exceed an amount equal to 5% of total personal income. This provision is in the current statute, but it was accompanied by the statement that total general fund appropriations shall be the lesser of the 5% of personal income or 6% over the prior years' appropriation. This year, General Fund appropriations were approximately \$3 billion dollars below the threshold of 5% of total personal income.
- In order to establish baseline funding for transportation, SB 228 creates a transfer of an amount equal to 2% of general fund appropriations to the HUTF (transportation) in FY 2012-2013, IF state total personal income increases by 5% between calendar years 2011 and 2012. If triggered, the transfer occurs for five years. If personal income increases less than 5% in FY 2012-2013, the initial transfer is deferred until it does.
- In order to establish baseline funding for capital construction, SB 228 creates a transfer of an amount equal to 0.5% of general fund appropriations for capital construction in FY 2012-2013 and FY 2013-2014, IF state total personal income increases by 5% between calendar years 2011 and 2012. If triggered, the transfer occurs for five years. If personal income increases less than 5% in FY 2012-2013, the initial transfer is deferred until it does. In the last three years of the five year period, the capital construction transfer grows to 1%.
- Starting in FY 2012-2013, the statutory reserve amount grows by 0.5% for each of the five years in the transfer period, and the intent is that it will continue to increase until it reaches 10% of general fund appropriations. Colorado's current 4% statutory reserve is half of what the majority of states maintain.
- If state revenue exceeds the TABOR limit, the transfers will be modified in the following ways: If TABOR required rebates are between 1% and 3% of general fund appropriations the transfers will be reduced by 50%; if TABOR rebates exceed 3% of general fund appropriations, the transfers will be eliminated.

All these provisions are statutory and are therefore subject to review and modification by the General Assembly.

### **Conclusion**

In light of the 12% drop in General Fund revenues, the legislature did a commendable job with a seemingly impossible mission – protecting services for all Coloradans, while balancing increased demands for state services and dramatically falling resources. However, this year's budget did further expose serious limitations and underlying problems with the state's budget and revenue system. The Legislature did take the bold step in restructuring how future budgets can be shaped, through the passage of Senate Bill 228. This will certainly strengthen the state's ability to withstand and recover from recessions, but serious problems will persist as Colorado struggles to fund state priorities with an outdated tax and revenue system.

What remains after the FY09-10 budget are several key issues:

- What will happen if the economy worsens further, and additional cuts need to be made during FY09-10?
- When federal American Recovery and Reinvestment Act funds evaporate, will the level of state services be able to be maintained?
- As the economy rebounds, will increased revenues be enough to replace the reliance on one-time monies the FY09-10 budget relied upon?

The impacts of this recession will continue to be felt for many years in the Colorado state budget. As the dust settles, an underlying question will remain for the Colorado budget – does the state have revenue that can sustain current levels of services and infrastructure? If not, there is little duct tape left in the fiscal toolbox to patch the budget.

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