



COLORADO FISCAL POLICY INSTITUTE

March Revenue Projection and the Colorado State Budget

Issue Brief: April 6, 2009

Overview

On March 20th, Legislative Council staff released their quarterly economic projections. Each quarterly projection gives direction to the Joint Budget Committee to adjust both the current and next budget cycle to be in balance with revenue. The March projection will guide the final balancing for the current FY08-09 budget and steer budget decisions for the FY09-10 budget, which begins in July.

The news from the forecast is grim. **General Fund revenue is forecasted to plummet \$812 million or 10.5% from FY07-08 to FY08-09.** In FY09-10, General Fund revenue is projected to decrease another \$98 million or 1.4%. As a result, JBC cut or temporarily filled \$796.3 from the FY08-09 and \$786.8 million from FY09-10.

The economic downturn is causing the precipitous decline in state revenues. State economists consider the state in a deep recession stemming from high unemployment, a decline in consumer spending, and tight credit markets. However, economists believe that Colorado's relatively healthy housing market and diverse economy will buffer the state from the deeper, national recession. Economists expect a slow and modest recovery, but at the earliest, they do not expect that to begin until late 2010.

With the dramatic and deep recession hitting the state, the **revenue estimates will constrain the FY09-10 General Fund to \$6.913 billion, which is 12.7% below the original \$7.923 billion budget proposed by Governor Ritter in November 2008.** The Governor's original proposal reflected modest increases in core safety net programs to keep pace with inflation in programmatic costs. This dramatic decrease in the original proposed budget will have a profound impact on the level of services the state can provide, at a time when demand for those services is on a sharp rise.

FY2008-2009 Impacts

As the revenue projections fell over the course of the fiscal year, the legislature has been preparing to cut the current operating budget and fill budget gaps temporarily, before the fiscal year ends in June. The Governor put into place a hiring freeze for nonessential state personnel. Capital construction projects were halted. However, these efforts could not accommodate the 10.5% fall in revenues in the current fiscal year. Members of the JBC were faced with two options (1) cut the budget in the current fiscal year (FY08-09) resulting in dramatic cuts midyear; or (2) temporarily fill budget holes in FY08-09 and postpone the budget cuts to the next budget cycle (FY09-10). Lawmakers opted to temporarily patch the FY08-09 budget and leave the major cuts to the FY09-10 budget.

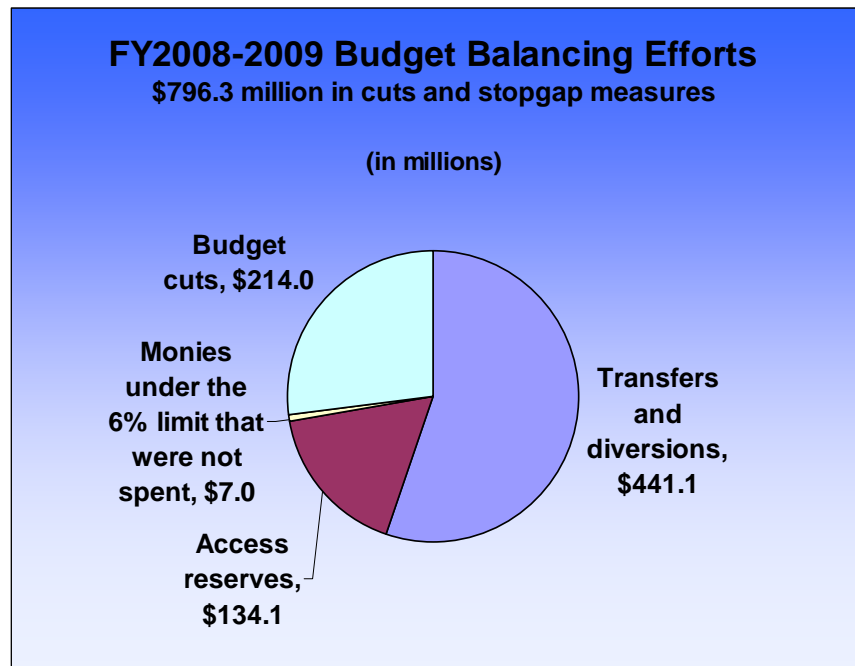
Earlier this Legislative Session, lawmakers passed a FY08-09 budget balancing package to address what was then understood to be a \$631.9 million shortfall in the GF budget. The previous chart outlines the various measures taken by the Legislature to cut and temporarily fill budget gaps for FY08-09. After the March 2009 forecast, that gap has since grown by an additional \$164.4 million to \$796.3 million.

The measures taken to address the total \$796.3 million shortfall included budget cuts of \$214.0 million, transfers and diversions of \$441.1 million from various cash funds to the General Fund, access half of the statutory reserve of

\$134.1 million, and adjust for the \$7 million that was authorized but not expended to specific programs.

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. The Department of Healthcare Policy and Financing is actually receiving a \$41.2 million increase in General Fund appropriations, a 2.7% increase. However, the increase in HCPF is due, in part, 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 the budget of various services government provides in exchange for fees. Fees are also added to various fines to fund related programs. Examples of the 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 will be able to allow continued operations for the various programs run by their respective funds, their reserves are dramatically impacted. Additionally, these monies will not be available to balance the FY09-10 budget. A cash fund transfer essentially transfers the cut to the following year, because it is a one-time fix. If the 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 transfer 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 \$166.3 million in statutory reserves. The level of statutory reserves has generally been kept at 4% of General Fund. By cutting the reserve in half, two problems occur. As with cash funds 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 to weather economic uncertainty that may occur in the remaining 3 months of FY08-09 or in future years.

FY2009-2010 Impacts

With the shift of budget cuts from the FY08-09 budget to FY09-10, there is approximately \$1.01 billion to cut from the governor's initial budget request. As the JBC has just finalized their decisions for the FY09-10 budget, only a preliminary overview of potential cuts can be given from the Governor's request from January 27th to adjust his initial budget request. The Long Bill will be introduced in the Senate on April 6, 2009.

We know the general guidelines suggested by the Governor to the JBC for targets for departmental reduction. The Department of Human Services budget is proposed to be cut \$29.385 million from the initial FY08-09 GF budget, a 4.2% cut from the FY08-09 budget and a 7.3% cut from the Governor's initially proposed FY09-10 budget. DHS will be required to accommodate caseload increases and inflation in the reduced budget. Actual program cuts have not been finalized.

The Department of Healthcare Policy and Financing is slated for a 14.9% decrease, a cut of \$244.3 million, as proposed by the Governor. However, this cut is supplanted by the anticipated increase of \$302.7 million in federal assistance to Medicaid, which provides budget relief to the rest of the General Fund.

Additional updates will follow as specific cuts are included in the final FY09-10 budget as it is approved by the legislature.

Federal Recovery Package

The silver lining to the bleak budget picture lies with the American Recovery and Reinvestment Act (ARRA), signed into law by President Obama in February 2009, in Denver. The federal government is temporarily increasing their share paid to states for the Medicaid program and the federal government is providing direct spending assistance to states to shore up budgets. Preliminary calculations show that Colorado stands to benefit with \$2.9 billion in direct federal spending assistance, most of which will take place over the next two years

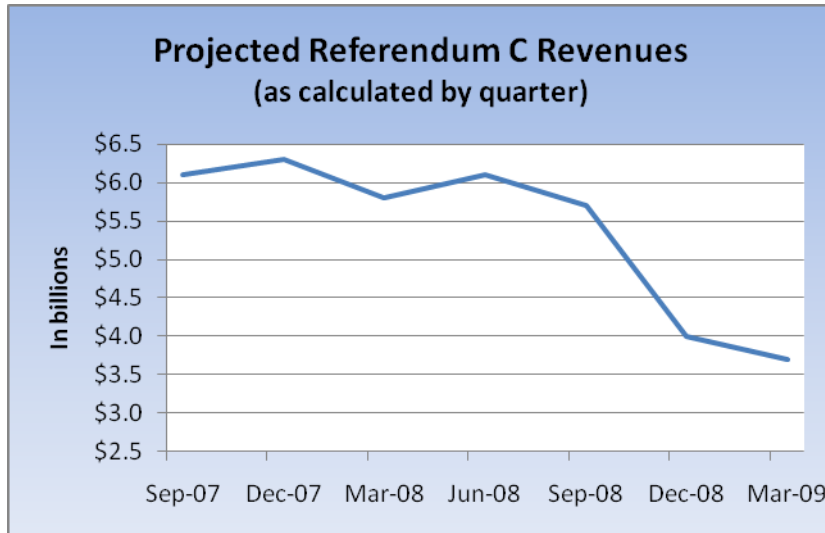
As noted above, the state is currently poised to receive an additional \$196.6 million in additional Medicaid assistance in FY 08-09. An additional \$302.7 million will be available in FY09-10. These figures are conservatively estimated by JBC staff.

The additional funds for Medicaid are due to a shift in the one-to-one match traditionally provided by the federal government. With ARRA, the new ratio for federal Medicaid support is 56.2 : 43.8. Given recent increases in the unemployment rate, Colorado is eligible for an additional FMAP bonus which will take the matching ratio for federal to state support to 60.2:39.8.

There is an additional \$760 million available in state stabilization monies from the federal government that can be used to shore up funding for early childhood education, elementary, secondary and postsecondary education, and general government services. However, these funds will be distributed to the Governor, and it is unclear at this time how the funds will be incorporated into the FY09-010 budget. These funds may be spent on healthcare, human services, and other programs that have seen their budgets slashed due to the recession and budget cuts. These grants are crucial to maintaining service levels around the state for Colorado's most vulnerable populations. These funds can also be used for school modernization, renovation and repair.

Referendum C Monies

Another area of concern in the March economic projections is the revised amount that is expected to be retained by the state under Referendum C. As originally projected, the state would retain \$3.7 billion in additional tax dollars during the 5-year TABOR timeout. While that figure rose as high as \$6 billion when the economy grew, economists are now projecting again a total \$3.7 billion will be retained during the timeout period. However, if the recession continues to worsen, the amount retained by Referendum C



could continue to decline. This is of significant concern, as Referendum C was a relatively conservative solution to enable the state to maintain state services and rebuild from the last recession. If there is a continued significant decline in Referendum C revenue, the longer-term intentions for passing Referendum C may not be realized.

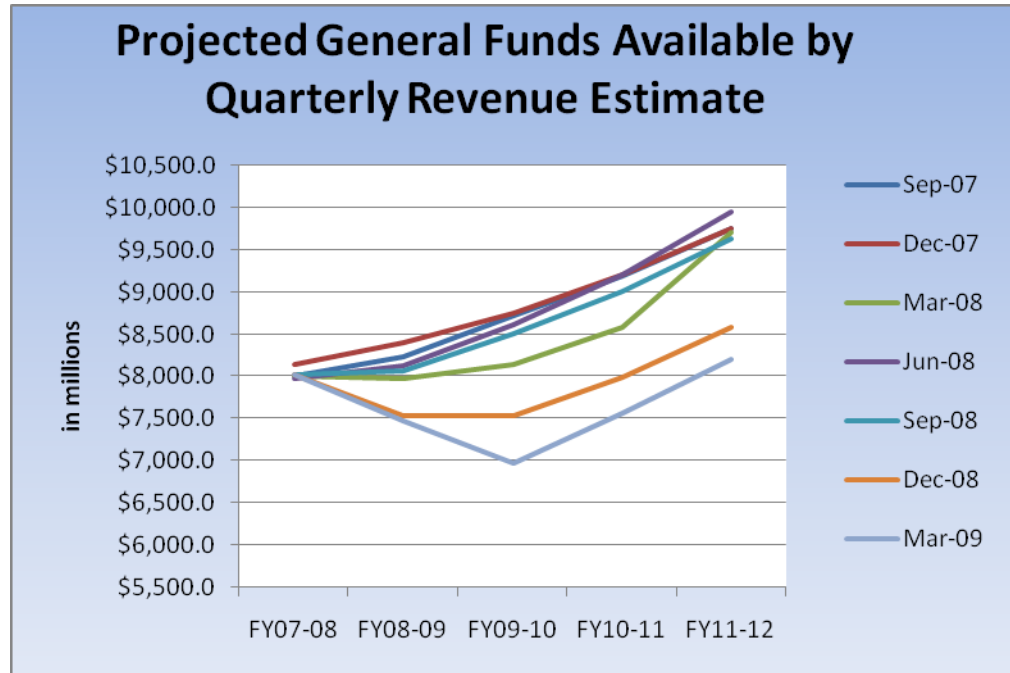
Conclusion

The state budget is in dire fiscal straights. The economic downturn will continue to create uncertainty in the ability of the state to provide safety-net services to lower-income families and other vulnerable communities in Colorado.

As demonstrated in the adjacent chart, state budgets were projected to be healthy as recent as September 2008. In December 2008, there was the first significant drop in state revenues, and the decline in subsequent projections has been precipitous. It is uncertain if Colorado is currently at the lowest point in the economic downturn or if we have yet to hit bottom, though many economists speculate that indicators like unemployment will get worse before they get better.

While the national economic downturn has certainly provided a dramatic impact on Colorado’s economy, it must be noted that a big part of the reason Colorado was so vulnerable entering this current recession is the state had recovered from the last recession in 2001. This is due in no small part to Colorado’s fiscal system, which is woefully outdated and ill-equipped to address, withstand, and recover from a recession.

As a result, the state’s safety-net services for unemployed workers, lower-income families, and others struggling to make ends meet are bare-bones at best.



At worst, in times of high demand and decreased revenues, the tangled fiscal knot in Colorado can exacerbate and artificially extend a recession, as well as inhibit the state’s ability to invest in job-creating priorities like education, healthcare, higher education, energy, transportation, and more.

Until Colorado enacts meaningful budget reform, the economic security of the state and its families will continue to be jeopardized with every dip and decline in the economy.

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