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Memorandum

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TO: Interested Persons

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SUBJECT: Fiscal Strategies for Budget Shortfalls

Summary

Each year, the General Assembly is tasked with balancing constitutional, statutory, and federal requirements with other legislative considerations, such as competing policy priorities, caseload pressures, and the health of the state's economy, in order to create a budget. The Colorado Constitution effectively requires that the state maintain a balanced budget, spending only what it has available to it each year in revenue or savings.¹

Budget shortfalls can arise from a number of factors, including economic downturns that reduce state tax revenue, and higher than expected demand for state services. During budget shortfalls, the Governor and General Assembly both play roles in bringing the budget back into balance, drawing from multiple policy options.

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This memorandum provides an overview of certain factors that influence budget shortfalls, including volatility over the business cycle in state revenue and demand for state services. Next, this memorandum discusses the complementary roles that the Governor and General Assembly play in responding to a budget shortfall. The memorandum then describes a variety of legislative strategies that the General Assembly, in coordination with the executive branch, has used to respond to General Fund budget shortfalls in recent years. The memorandum concludes with a discussion of fund solvency considerations.

¹Colorado's constitution specifies that total appropriations by the General Assembly may not exceed the total tax revenue collected each fiscal year, thus prohibiting deficit spending (Colo. Const., art. X, § 16). The constitution also prohibits general obligation debt, and requires voters to approve other forms of debt (Colo. Const., art. X, § 20 (4)(b), and art. XI, § 1).

Defining a Budget Shortfall

The definition of a budget shortfall varies widely among legislators and other stakeholders. Some may define a budget shortfall as any time the General Assembly identifies a need it is unable to sufficiently fund. Others may argue that a budget shortfall exists when revenue falls below prior year funding levels or revenue fails to cover projected caseload growth. Taking these viewpoints together, a budget shortfall can be measured along a continuum depending on the severity of an economic downturn, availability of federal funding, and/or level of existing state operations, among other factors.

While shortfalls can exist for cash-funded and federally funded programs, this memorandum focuses primarily on actions taken by the General Assembly to address General Fund budget shortfalls. The General Fund is the primary source for the state's general operating funding and can be spent with more flexibility than cash funds and federal funds, which are generally required to be spent for specific purposes.

General Fund Revenue Volatility

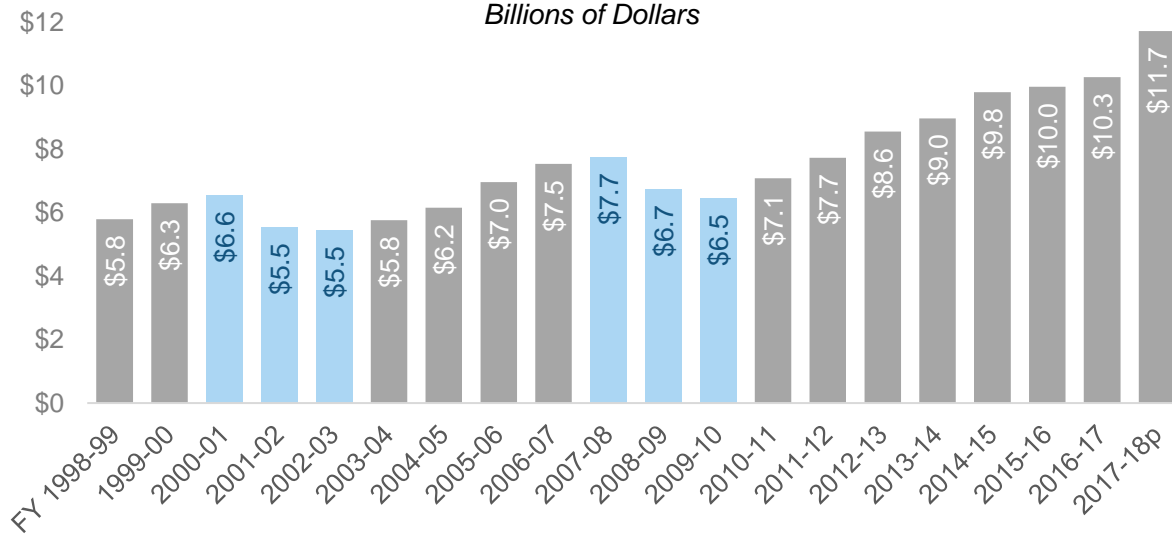
While natural disasters and other factors may strain state budgets, the most significant budget shortfalls to date have followed contractions in economic activity that cause a decline in state revenue. Since the turn of the century, two separate economic recessions occurred: the 2001 recession, and the 2007-09 recession (or "Great Recession"). Each placed significant pressure on the state's General Fund.

Figure 1 shows General Fund revenue over the last two business cycles. General Fund revenue fell by \$1.0 billion in both FY 2001-02 and FY 2008-09, the years following the start of each recession, with further decreases in the second year. Although the causes and severity of the two recessions differed, both resulted in a similar percentage loss in revenue over a two-year period. Notably, the revenue decrease in FY 2001-02 would have been smaller if not for state and federal income tax cuts.²

The most volatile revenue sources to the General Fund are corporate income taxes and individual income taxes on capital gains and business income. By comparison, sales taxes and individual income taxes on employee wages experience less volatility over the business cycle. Combined, income and sales taxes make up more than 95 percent of General Fund revenue.

²The state income tax rate was reduced from 4.75 percent to 4.63 percent in tax year 2000, and the state sales tax rate was reduced from 3.0 percent to 2.9 percent in 2001. Additionally, the federal Economic Growth and Tax Relief Reconciliation Act of 2001 reduced federal taxable income by increasing the standard deduction, limits on student loan interest deduction, and deductions for contributions to certain retirement funds, all of which reduced state taxable income. The changes under the 2001 act and subsequent federal legislation also effectively eliminated the state estate tax.

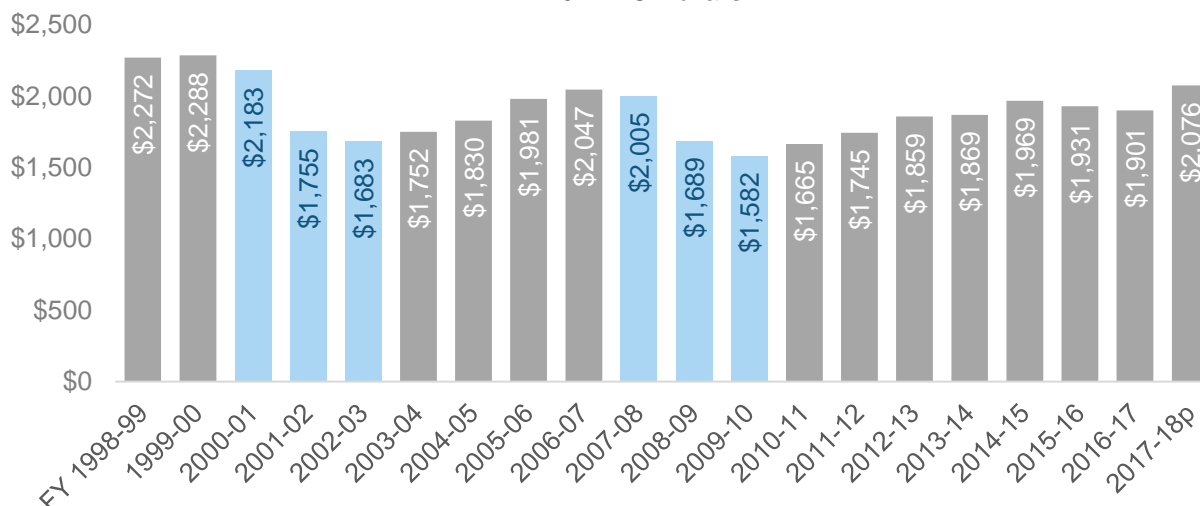
Figure 1
General Fund Revenue
Billions of Dollars



Source: Colorado State Controller's Office. p = Preliminary. Note: Light blue bars indicate a period of recession.

Figure 2 shows inflation-adjusted per capita General Fund revenue, which measures the amount of General Fund revenue paid per person in Colorado, holding the value of the dollar constant over time. Following the Great Recession, it took 11 years for inflation-adjusted per capita General Fund revenue to return to pre-recessionary levels in FY 2017-18. Limited growth in revenue over this period is in part attributable to Colorado's aging population, where a rising share of the taxpayer population is aging out of prime working (and prime income earning) age and aging into retirement. This demographic trend has constrained growth in both sales and income tax collections.

Figure 2
Inflation-Adjusted Per Capita General Fund Revenue
FY 2017-18 Dollars

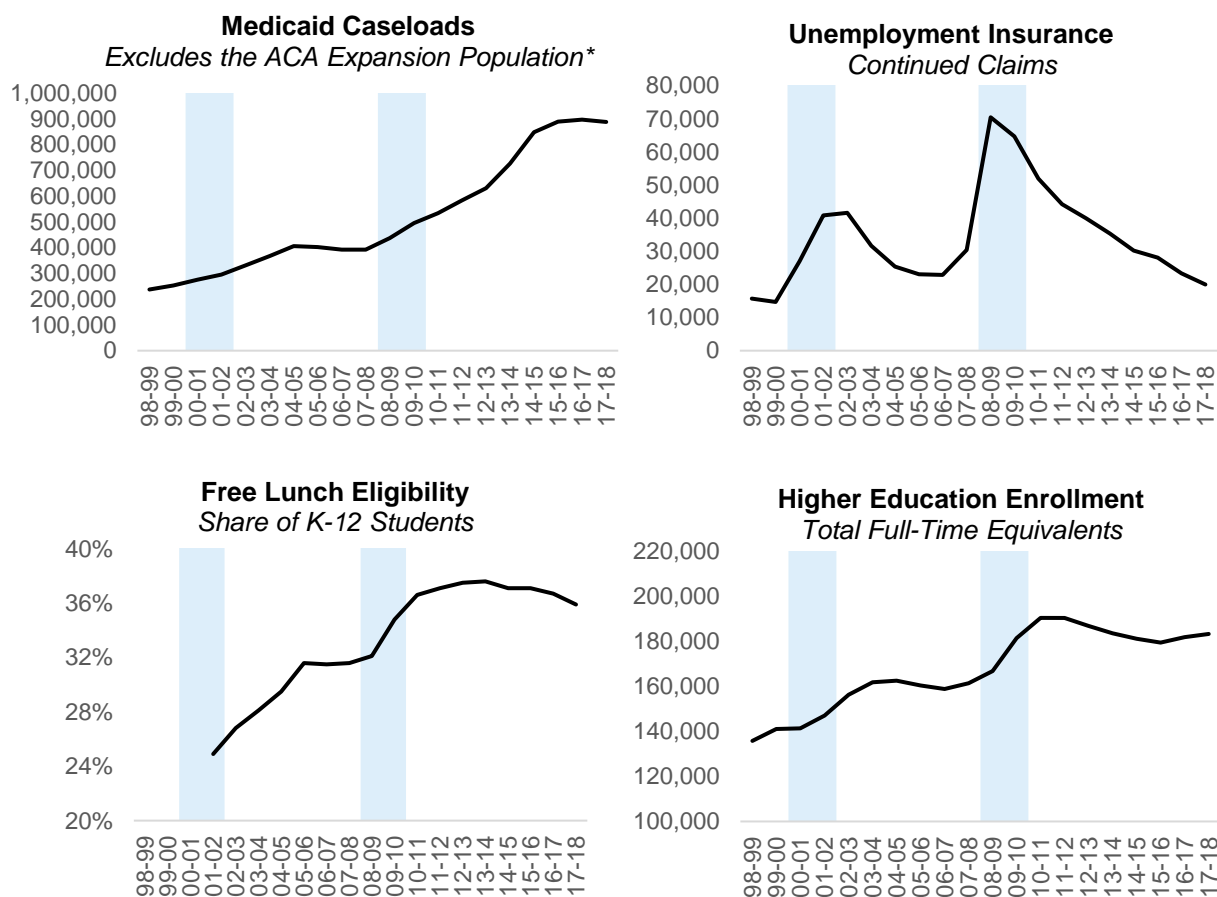


Source: Colorado State Controller's Office with Legislative Council Staff calculations, using data from the U.S. Bureau of Labor Statistics (Denver-Aurora-Lakewood CPI-U inflation), and U.S. Census Bureau. p = Preliminary. Note: Light blue bars indicate a period of recession.

Changes in Demand for State Government Services

During economic downturns, demand for local, state, and federal government services tend to rise, contributing to government budgetary pressures. In particular, programs that serve low-income populations and the unemployed or underemployed experience a rise in qualifying participants. State-funded programs that serve these populations include Medicaid (funded in part with General Fund moneys), unemployment insurance (which is cash-funded using fees paid by employers), and free lunch (eligibility for which is used to determine state funding for K-12 education, funded with moneys from the General Fund and State Education Fund). College and university enrollment also rises during economic downturns, as many workers seek additional training in response to job loss or decreased job opportunities in their existing field. Figure 3 illustrates the impact of economic downturns on caseload growth among three state-funded programs.

Figure 3
Caseload Growth for Selected State Programs



Sources: Colorado Departments of Health Care Policy and Financing, Labor and Employment, Education, and Higher Education.

Note: Light blue bars indicate a period of economic recession.

*Excludes expanded caseloads under the federal Affordable Care Act to illustrate underlying cyclical trends.

Authority and Responsibility to Address Shortfalls

Because the Governor and the General Assembly have complementary roles in shaping the state's annual budget, each has different fiscal policy tools available to respond to a budget shortfall. The regular legislative session begins no later than the second Wednesday in January and lasts for 120 days.³ During the session, the General Assembly can address budget shortfalls through the legislative process. During the interim, the Governor has certain authority to take more immediate action. The General Assembly may then codify such interim actions by enacting legislation during the following legislative session.

Authority of the Governor. In the event of an anticipated budget shortfall, the Governor's budget request, submitted annually on November 1, will typically reflect the budget reductions that he or she determines are necessary. To address budget shortfalls, the Governor may also implement mid-year spending reductions by executive order⁴ or call a special session by proclamation.⁵ For example, special legislative sessions were called to address fiscal emergencies in 1986 and 1988.

To handle unanticipated, one-time state obligations and emergency situations, the state maintains a statutorily required General Fund reserve, equal to a specified percentage of General Fund operating appropriations in a given fiscal year.⁶ Under current law, the required reserve is 7.25 percent in FY 2018-19 and all future years. If the Governor's revenue forecast projects General Fund revenue to decline such that existing appropriations will use up more than half of the General Fund reserve, the Governor must reduce General Fund spending to preserve at least 50 percent of this reserve. If the Governor reduces General Fund expenditures by at least 1 percent of all General Fund appropriations for the fiscal year in order to meet this requirement, the Governor is also authorized to transfer moneys from the Capital Construction Fund into the General Fund.⁷

Current law also specifies actions that the Governor may take in the event the General Assembly declares a fiscal emergency.⁸ In this event, the Governor is authorized to reduce state personnel costs by any of the following actions:

The Governor's Tools

The Governor may reduce spending by suspending or discontinuing state services under an **executive order**. Executive orders are valid for up to three months, and may be extended by three months at a time.

The Governor may also convene a special session of the legislature to address a specific purpose by issuing a **proclamation**.

The General Assembly's Tools

The General Assembly may address budget shortfalls through its **powers to enact legislation**. The General Assembly may convene a special session by written request of a two-thirds majority of each house.

By passing a **joint resolution**, the General Assembly may formally declare a fiscal emergency, which expands the purposes for which Amendment 35 tobacco tax moneys may be used.

³Colo. Const., art. V, § 7.

⁴Section 24-2-102 (4), C.R.S.

⁵Colo. Const., art. IV, § 9.

⁶Section 24-75-201.1 (1)(d), C.R.S.

⁷Section 24-75-201.5, C.R.S.

⁸Section 24-50-109.5, C.R.S.

- separating employees from state service;
- conducting voluntary and mandatory furloughs of employees;
- suspending pay and benefit increases;
- implementing a hiring freeze;
- requiring job-sharing; and
- reallocating vacant positions.

Each of the last two major economic downturns has resulted in the Governor invoking spending reductions by executive order. In 2002 and 2003, Governor Bill Owens issued five executive orders that implemented a hiring freeze and suspended or reduced state services.⁹ Similarly, in 2009 and 2010, Governor Bill Ritter issued seven executive orders that implemented a hiring freeze, required furloughs for executive branch employees, and suspended or reduced state services.¹⁰

During these budget shortfalls, the Governor has also been authorized in statute to transfer money from certain cash funds to the General Fund.¹¹ Such authorizations have usually been limited to a specifically identified number of cash funds and a single fiscal year.

Legislative Strategies for Responding to a Budget Shortfall

The General Assembly, in coordination with the executive branch, has a variety of strategies available for responding to a budget shortfall, all of which involve enacting legislation. These strategies include the following:

- 1) reduce state spending on a time-limited or permanent basis;
- 2) spend down savings by reducing reserves or spending from “rainy day” funds;
- 3) enact “revenue enhancements,” including fund transfers, voter-approved tax increases, tax policy changes, and increasing fees or other charges;
- 4) refinance expenditures with other sources, including federal funds or cash funds, if such moneys are available;¹² and
- 5) in limited instances, use accounting measures to defer expenses or accelerate revenue.

The General Assembly may pursue these strategies during a regular session or during a special session, called by proclamation of the Governor¹³ or by written request by a two-thirds majority of members from each house of the General Assembly.¹⁴

This section details each of these strategies and provides examples of how they have been used in recent years to address General Fund budget shortfalls.

⁹Executive Orders D 004 02, D 018 02, D 024 02, D 031 02, and D 007 03.

¹⁰Executive Orders D 015 29, D 017 09, D 024 09, D 026 09, D 2010-001, D 2010-003, and D 2010-008.

¹¹Section 25-75-201.5, C.R.S.

¹²Certain cash fund revenue streams are constitutionally reserved for certain purposes. For example, revenue credited to the Unemployment Insurance Trust Fund and transportation-related revenue, including the motor fuel tax and vehicle registration fees, are constitutionally required to fund the state unemployment insurance program and transportation projects, respectively. Federal funds also generally come with specific requirements for use.

¹³Colo. Const., art IV §9.

¹⁴Colo. Const., art. V, §7.

1) Reduce State Spending

Spending reductions are a common strategy employed by the General Assembly in response to a budget shortfall. To implement either statewide or department-specific reductions, the Governor, in coordination with the Joint Budget Committee, proposes a budget package, which includes what is known as the Long Bill and any special bills needed to suspend or discontinue statutorily required functions. These reductions may be permanent or time-limited.

Reduce General Fund spending. During the period of declared fiscal emergency that followed the Great Recession (FY 2009-10 through FY 2011-12), the General Assembly took several actions to reduce General Fund appropriations. For example, the General Assembly:

- changed the P-12 school funding formula by introducing the Budget Stabilization or “Negative” Factor, saving \$381 million in FY 2010-11 and \$774 million in FY 2011-12;¹⁵
- suspended the senior homestead property tax exemption, saving \$88 million in FY 2009-10, \$92 million in FY 2010-11, and \$95 million in FY 2011-12;¹⁶
- required state employees who were active members of the Public Employees Retirement Association (PERA) to temporarily contribute an additional 2.5 percent of their salary to replace a portion of the state's contribution, saving \$58.3 million in FY 2011-12;¹⁷
- postponed scheduled payments to local governments for fire and police pension programs, saving \$25 million in FY 2009-10 and FY 2010-11 and \$20 million in FY 2011-12;¹⁸ and
- decided not to open the newly constructed Colorado State Penitentiary II and closed the Colorado Women’s Correctional Facility, saving \$21.9 million in FY 2009-10 and beyond.

Reduce transfers from the General Fund for cash fund spending. In addition to reducing General Fund appropriations for state programs, the General Assembly may also reduce transfers from the General Fund to cash funds in order to use those funds for General Fund spending. Such actions reduce the funding available for and spending on cash fund programs. Historically, the General Assembly has enacted General Fund transfers to transportation, capital construction, and education funds (shown in Figure 4) based on amounts or formulas set in statute. During periods of budget shortfall, these transfers have been reduced or repealed. For example, following the Great Recession, Senate Bill 09-228 repealed infrastructure diversions and transfers under Senate Bill 97-1 and House Bill 02-1310 and enacted a set formula for transfers triggered by strong growth in Colorado personal income.

2) Reduce Reserves or Spend From Rainy Day Funds

A second strategy is to use state savings from reserves or “rainy day” funds to support state expenditures. Under current law, Colorado has a statutory General Fund reserve requirement, as well as a constitutionally required Taxpayer’s Bill of Rights (TABOR) emergency reserve that may only be used in noneconomic emergencies. Colorado does not currently have a rainy day fund.

¹⁵House Bill 10-1369 and Senate Bill 11-230.

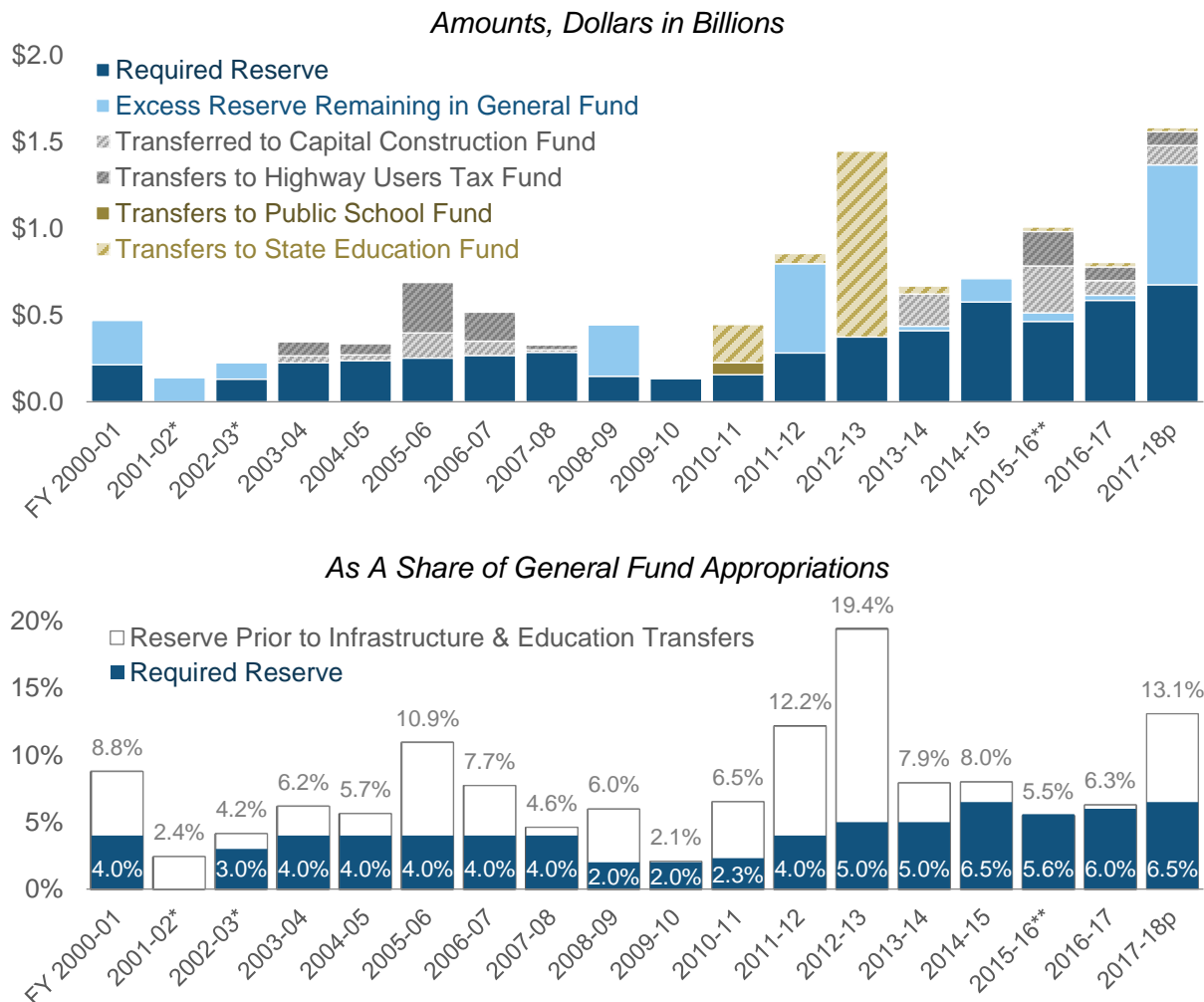
¹⁶Senate Bill 09-276 and Senate Bill 10-190.

¹⁷Senate Bill 10-146.

¹⁸Senate Bill 09-227.

Reduce the required General Fund reserve. Current law requires a General Fund reserve equal to a set percentage of General Fund appropriations at the end of each fiscal year.¹⁹ Figure 4 provides a history of the General Fund reserve, including the required reserve, transfers from the General fund for capital construction, transportation, and education, and the remaining fund balance (or “excess reserve”). Figure 4 illustrates the amount of reserves, as well as reserves as a share of General Fund appropriations.

Figure 4
History of the General Fund Reserve and Selected Transfers From the General Fund



Source: Colorado State Controller's Office. p = Preliminary.

*The required reserve was set to 0.0 percent in FY 2001-02 and 3.0 percent, less \$31.2 million in FY 2002-03.

**Senate Bill 16-218 reduced the required 5.6 percent reserve by \$56.8 million, the amount of General Fund used to pay severance tax refunds following the Colorado Supreme Court decision regarding BP Amer. v. CO Dept. of Revenue.

The reduction of the General Fund reserve requirement is a strategy that has frequently been used by the General Assembly during a recession. For example, the reserve requirement was reduced to between 0.0 percent and 3.0 percent in FY 2001-02, FY 2002-03, and FY 2008-09 through FY 2010-11. In FY 2015-16, the reserve was used to address an unforeseen expense, when the General Assembly

¹⁹Section 24-75-201.1, C.R.S.

needed to provide unexpectedly large severance tax refunds following the Colorado Supreme Court decision in *BP America v. Colorado Department of Revenue*.²⁰

The Governor has certain statutory responsibilities regarding the reserve during budget shortfalls. If the General Assembly is not in session and the Office of State Planning and Budgeting forecasts the reserve at below half of the required amount for the current fiscal year, the Governor must implement a plan before the end of the fiscal year to reduce expenditures such that the actual reserve is at least half of the required reserve amount.²¹

Reduce the TABOR reserve during noneconomic emergencies. The TABOR Amendment, passed by voters in 1992, contains a provision that requires at least 3 percent of state fiscal year spending be kept in the TABOR emergency reserve.²² This reserve can only be used to pay for noneconomic emergencies, such as a natural disaster, war, or epidemic. The TABOR emergency reserve must be replenished in the fiscal year after money is withdrawn. The assets that constitute the reserve are designated by bill each year.²³ Historically, these assets have included both liquid assets (cash funds) and equity assets (state buildings).

The General Assembly may declare a state emergency by joint resolution approved by a two-thirds vote of each chamber, and approved by the Governor. The Governor may also expend money from the emergency reserve by declaring a disaster emergency by executive order or proclamation. Transfers from the emergency reserve have varied by year, ranging from a low of \$0 in about half of the years since the passage of TABOR to a high of \$53.4 million in FY 2013-14 in response to several fires and floods impacting multiple areas of the state.²⁴

Create and draw from a rainy day fund. One strategy that Colorado has not used is the creation of a budget stabilization, or “rainy day,” fund (RDF). RDFs have been established and maintained in 46 other states for use only when revenues decline or expenditures increase unexpectedly as a result of economic downturns, natural disasters, or other events. These funds may be established as either a restriction on a portion of the General Fund or as a separate cash fund. In Colorado, unless an RDF were created in the state constitution, it is questionable whether it would effectively serve its purpose, because any statutory transfer to an RDF could always be changed by a future General Assembly.

RDFs have specific rules governing their size, use, and times when funds must be deposited or may be withdrawn. Colorado’s required General Fund reserve is not considered to be a RDF because it lacks most of these characteristics. The following summarizes common rules related to the RDFs established in other states.

- **Deposit rules.** States have different rules for contributions to RDFs. The most common rule, used in more than half of the states with a RDF, is that a portion of the state’s year-end surplus (or excess reserve) may be placed in the RDF. Six states use formulas based on growth in taxes or

²⁰*BP Am. Prod. Co. v. Colo. Dep’t of Revenue*, 2016 CO 23.

²¹Section 24-75-201.5, C.R.S.

²²Colo. Const., art. X, § 20 (5). Fiscal year spending is a legal term used to denote the amount of revenue TABOR allows the state to keep and either spend or save. The 3 percent calculation is based on fiscal year spending, excluding bonded debt service.

²³Section 24-77-104 (2), C.R.S.

²⁴Emergency reserve transfers in FY 2013-14 occurred under Executive Orders D 2014-001, D 2014-002, D 2014-006, D 2014-009, and D 2014-019 through D 2014-022.

personal income to ensure that RDF contributions occur only under positive fiscal conditions. Another six states require annual contributions to their RDF without regard to the state's fiscal condition.

- **Withdrawal rules.** Most states limit the withdrawal of money from their RDFs to cover budget shortfalls. In 18 states, withdrawals from RDFs can occur only through a vote by a supermajority of the legislature. Additionally, 11 states have limits on the amount of the RDF that can be withdrawn at any one time.
- **Replenishment rules.** Twelve states require that withdrawals from RDFs be replenished. In three states, replenishment may occur over five years or more, while six others require replenishment in three years or less. Three other states do not have set replenishment periods, but require that the RDF be fully repaid after a withdrawal is made.
- **Fund size rules.** Forty-one states have caps on the size of their RDFs. In 19 states, the caps are at least 10 percent of the state budget. In eight states, caps range between 5 and 10 percent of the budget, and in 14 states, caps are equal to 5 percent of the budget or less.

3) Revenue Enhancements

A third strategy employed by the General Assembly during General Fund budget shortfalls is to enhance revenue to the General Fund. Such enhancements are achieved through: 1) the transfer of cash fund revenue to the General Fund; 2) tax increases; 3) tax policy changes resulting in a revenue gain; and 4) fee increases that increase cash fund revenue, thereby freeing up General Fund revenue for other purposes. Each of these revenue enhancement options are described in greater detail below.

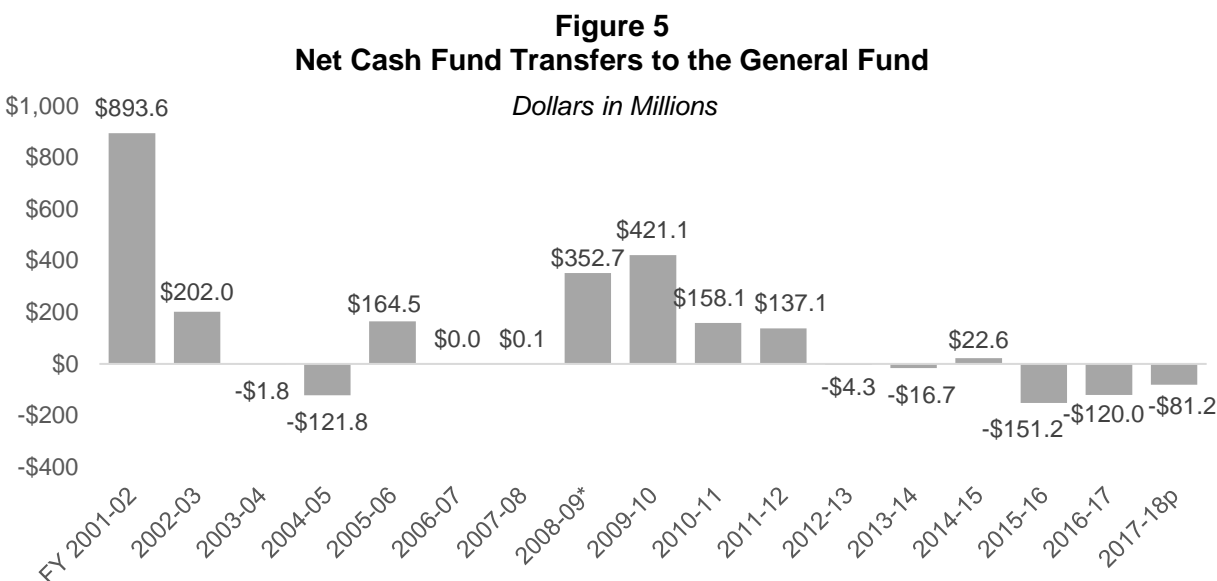
Cash fund transfers to the General Fund. One of the most common ways the General Assembly has enhanced General Fund revenue is through the transfer of money from one or more cash funds to the General Fund.²⁵ Cash funds are established for a specific purpose or program and receive revenue from fines, designated fees, or taxes. Some revenue streams, such as motor fuel taxes and vehicle registration fees, are constitutionally required to be spent for certain purposes. These constitutional requirements limit the General Assembly's ability to transfer these cash funds.

Transfers provide only a short-term solution to addressing General Fund revenue shortfalls, as they represent a one-time funding source and not an ongoing General Fund revenue stream. In addition, such transfers mean less funding is available for the purposes for which the money was originally intended.

Figure 5 presents a history of cash fund transfers to the General Fund over the past two business cycles. It excludes the General Fund transfers to infrastructure and education shown in Figure 4. As Figure 5 demonstrates, the General Assembly increased net cash fund transfers to the General Fund during budget shortfalls. The cash funds most affected by the transfers between FY 2001-02 and FY 2011-12 include funds related to major medical insurance, the tobacco litigation settlement, and

²⁵The Colorado Supreme Court authorized this method in *Barber v. Ritter*, 196 P.3d 238 (Colo. 2008). The Court held that \$42 million in transfers from cash funds to the general fund were not a tax policy change, new tax, or tax rate increase requiring voter approval under TABOR, and the transfers did not create unconstitutional debt.

severance taxes. For example, about \$286 million in severance tax revenue was transferred to the General Fund between FY 2001-02 and FY 2011-12, representing 13 percent of total net transfers during this period.



Source: State Controller's Office, State Treasurer's Office, and Joint Budget Committee Staff.

Note: Excludes the transfers to transportation, capital construction, and education included in Figure 4.

*Excludes \$458.1 million of one-day transfers authorized by Executive Order D 013 09 to occur on June 30, 2009.

Tax increases. The General Assembly can only modify existing tax policies in certain limited ways to increase General Fund revenue. Prior to the passage of TABOR in 1992, the General Assembly had the authority to increase tax rates. In 1983, for example, the General Assembly temporarily increased the state sales and use tax rate from 3.0 percent to 3.5 percent for eight months, raising approximately \$24.0 million in additional tax revenue.

Generally, the General Assembly may increase tax rates, but only with voter approval. However, if the state experiences an emergency (such as a war, natural disaster, or epidemic) that is not fiscal in nature, the General Assembly may enact emergency taxes (excluding property taxes) without voter approval but only after emergency reserves are first depleted and after two separate votes: 1) a two-thirds vote on a resolution declaring an emergency; and 2) a two-thirds vote on a bill imposing the emergency tax.²⁶

Tax policy changes resulting in a revenue gain. In addition to tax increases, certain tax policy changes can enhance revenue to the General Fund and cash funds. During the 2009 through 2011 legislative sessions, the General Assembly passed several laws removing or reducing existing tax exemptions and incentives. Most of these changes affected sales and income taxes, thereby increasing General Fund revenue. Table 1 summarizes these laws and their estimated General Fund revenue impacts.

²⁶Colo. Const., art. X, § 20 (4)(a).

Table 1
Legislation Augmenting General Fund Revenue, 2009 through 2011
Dollars in Millions

Bill Number	Bill Description	Revenue Impact by Fiscal Year					Future Impacts
		2008-09	2009-10	2010-11	2011-12	2012-13	
Sales Tax Revenue Impacts							
SB 09-212	Repeal Vendor Fee - Part 1	\$16.1	\$37.5	\$19.7	-	-	Temporary
SB 09-275	Repeal Vendor Fee - Part 2	-	\$25.5	\$46.6	-	-	Temporary
HB 09-1342	Repeal Cigarette Exemption	-	\$31.0	\$32.0	-	-	Temporary
HB 10-1189	Repeal Exemption for Direct Mail	-	\$0.1	\$0.3	\$0.3	\$0.3	Ongoing
HB 10-1190	Repeal Exemption for Industrial Energy Use	-	\$7.2	\$37.6	\$36.9	-	Temporary
HB 10-1191	Repeal Exemption for Candy and Soda	-	\$1.4	\$16.0	\$16.0	\$17.8	Ongoing
HB 10-1192	Repeal Software Regulation	-	\$4.6	\$18.9	\$20.2	-	Originally ongoing; Reinstated by HB 11-1293
HB 10-1193	Sales Taxes and Out-of-State Retailers	-	\$0.02	\$0.2	\$0.2	\$0.2	Ongoing but limited impact due to state and federal injunctions
HB 10-1194	Repeal Exemption for Food Containers	-	\$0.4	\$2.0	\$2.0	\$2.0	Ongoing
HB 10-1195	Repeal Exemption for Agricultural Products	-	\$0.9	\$3.4	-	-	Originally ongoing; exemption reinstated by HB 11-1005
SB 11-223	2.22% Vendor Fee until July 1, 2014	-	-	-	\$23.6	\$24.5	Temporary
HB 11-1296	Continue State Sales Tax on Cigarettes	-	-	-	\$27.6	\$26.3	Originally temporary; exemption repealed under HB 13-1144
Total Sales Tax Revenue Impact		\$16.1	\$108.6	\$176.7	\$126.8	\$71.1	
Income Tax Revenue Impacts							
HB 09-1331	Tax Incentives for Fuel Efficient Vehicles	-	\$1.8	\$5.2	\$1.9	-	Temporary
HB 09-1366	Capital Gains Deduction Modification	-	\$7.1	\$15.8	\$15.9	\$16.0	Temporary (January 1, 2015 repeal)
HB 10-1196	Tax Incentives for Fuel Efficient Vehicles	-	-	\$2.7	\$2.7	-	Temporary
HB 10-1197	Limit Conservation Easement Credits	-	-	\$18.5	\$37.0	\$37.0	Temporary; limited further by HB11-1300
HB 10-1199	Modify Deduction for Net Operating Loss	-	-	\$8.2	\$16.5	\$16.5	Temporary; offsetting revenue reductions in FY 2013-14 through FY 2015-16
HB 10-1200	Limit Enterprise Zone Investment Tax Credit	-	-	\$4.0	\$8.0	\$8.3	Temporary; offsetting revenue reductions in FY 2013-14 through FY 2014-15
Total Income Tax Revenue Impact		-	\$8.9	\$54.4	\$82.0	\$72.4	
Total General Fund Revenue Impact		\$16.1	\$117.5	\$231.1	\$208.8	\$143.5	

Source: Legislative Council Staff fiscal notes. Actual impacts may differ from the estimates shown.

TABOR limits the ability of the General Assembly to enact a "tax policy change directly causing a net tax revenue gain" to the state by requiring prior voter approval. While the Colorado Supreme Court has interpreted this phrase in such a way to allow some of these efforts to be enacted without voter approval as described above, that authority is most particularly limited to years when the state is not required to issue TABOR refunds.²⁷

Increase fees. Many state programs are supported by user fees, most of which are deposited into cash funds. Typically, state agencies are authorized to adjust fees to cover the administrative costs of the programs they support. Some fees, such as those charged for court proceedings and motor vehicle registrations, are set in statute, and legislation is required to adjust them. During a budget shortfall, however, the General Assembly may choose to create new fees or raise existing fees in order to relieve pressure on the General Fund. These actions increase program revenue over the long term unless fee increases are made temporary or repealed. Examples of legislation creating or modifying fees include:

- “FASTER” (Senate Bill 09-108), which increased vehicle rental fees, penalties for late vehicle registrations, a surcharge on all vehicle registrations, and fees for oversize vehicles. These fee changes increased revenue for statewide transportation improvements by an estimated \$250 million each year.
- Under House Bill 09-1293, the General Assembly created the hospital provider fee, which allowed the state to collect additional federal matching funds to support an increase in the number of people eligible for Medicaid and the associated reimbursements made to hospitals. This fee has since been repealed under Senate Bill 17-267.
- Under Senate Bill 17-267, the General Assembly created the Colorado Healthcare Affordability and Sustainability Enterprise and healthcare affordability and sustainability fee, which allows the state to collect federal matching funds to support the Medicaid eligibility expansion and associated reimbursements made to hospitals.
- Senate Bill 10-120 created a new fee on prepaid wireless telephones to fund enhanced local 911 services, estimated to generate \$7.6 million in revenue each year.
- House Bill 10-1379 increased the provider fee assessed on nursing facilities to help reduce General Fund costs for Medicaid. In FY 2010-11 only, the bill increased cash fund revenue by an estimated \$5.8 million and reduced General Fund expenditure by an estimated \$8.2 million.

4) Refinancing General Fund Expenditures

Refinancing is another tool used to address budget shortfalls in the General Fund. Refinancing in this context occurs when a program has some or all of its General Fund appropriations replaced with either federal money or another state funding source.

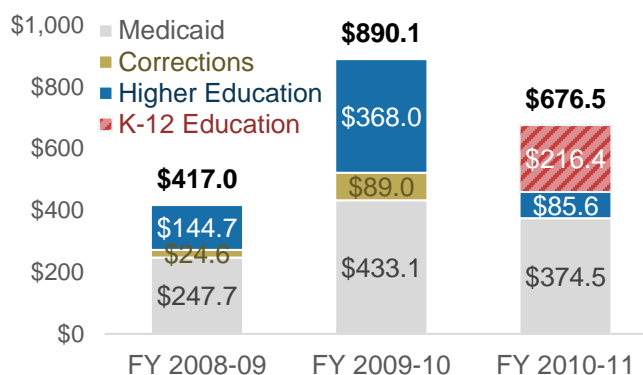
Refinance with federal funds. During economic downturns or unusual events, additional short-term federal moneys may be made available to states. For example, the federal American Recovery and

²⁷*Mesa County Bd. Of Comm'rs v. State*, 203 P.3d 519 (Colo. 2009). For more information about enacting tax policy changes, please see the Office of Legislative Legal Services.

Reinvestment Act (ARRA) was a federal economic stimulus bill enacted in February 2009 in response to the Great Recession. Moneys known as State Fiscal Stabilization (SFS) funds were provided to states to stabilize their budgets. ARRA also provided additional funding for other federal-state programs, such as Medicaid.

Figure 6 shows the amount of SFS funds that refinanced what had been General Fund appropriations to the departments of Higher Education, Corrections, and Education, as well as the additional funding provided to Medicaid. As a condition of accepting ARRA funds for higher education, state spending on higher education could not fall below FY 2005-06 levels. The state was thus required to spend at least \$555.3 million in General Fund moneys each year between FY 2008-09 and FY 2010-11 on higher education, although in FY 2009-10 Colorado met the criteria for a waiver from this requirement, allowing the state to spend less in FY 2009-10.

Figure 6. ARRA Funds Used to Refinance Selected General Fund Programs
Dollars in Millions



Source: Joint Budget Committee and Legislative Council Staff.

ARRA also increased the share of costs covered by the federal government for public health programs such as Medicaid.

Usually, the federal government pays about 50 percent of Colorado's Medicaid costs, with the state picking up the remainder. Under ARRA, the federal share was temporarily increased to 59.7 percent, allowing 19.4 percent of General Fund costs (or 9.7 percent of total Medicaid costs) to be refinanced with federal dollars. These moneys were not part of the SFS Fund distributions.

Refinance with cash fund moneys. Programs may also be refinanced with cash fund revenue. During the Great Recession, funding for several programs shifted from the General Fund to cash funds. Examples include:

- Senate Bill 09-293 permanently shifted the General Funding of the Division of Parks and Wildlife to the Operational Account of the Severance Tax Trust Fund beginning in FY 2009-10; and
- Senate Bill 09-274 temporarily shifted General Funding for the Division of Motor Vehicles, Driver and Vehicle Services to the Highway Users Tax Fund from FY 2008-09 through FY 2011-12.

Declare a state fiscal emergency to use Amendment 35 tobacco moneys for health-related purposes. The General Assembly may declare a fiscal emergency through passage of a joint resolution.²⁸ In periods of declared fiscal emergency, the state's constitution allows cash fund revenue generated by Amendment 35 to be used for any health-related purpose. During the recent period of declared fiscal

²⁸Section 24-50-109.5, C.R.S. Colorado statute defines a fiscal emergency as a "crisis concerning the fiscal condition of state government which is caused by a significant General Fund revenue shortfall or significant reductions in cash or federal funds... which threatens the orderly operation of state government and the health, safety, or welfare of citizens ...". In addition to greater flexibility in the use of Amendment 35 revenue, during the period for which a fiscal emergency is declared, the Governor, with the assistance of the heads of state agencies, may take actions to reduce personnel expenditures such that they operate within available revenue.

emergency in FY 2009-10, FY 2010-11, and FY 2011-12, the General Assembly dedicated \$102.4 million, \$92.4 million, and \$52.3 million, respectively, to health-related programs.

5) Accounting Adjustments

In limited instances, the General Assembly has used accounting measures to defer General Fund expenses or accelerate the receipt of revenue during a budget shortfall. These actions, unless reversed by subsequent legislation, serve as one-time relief for budgetary pressures.

Defer expenses with pay date shifts. Under Senate Bill 03-197, starting in FY 2002-03 the state shifted the last pay cycle for state employees from June to July, in order to defer a portion of personnel expenses from one fiscal year to the next. In FY 2002-03, this practice deferred \$89.4 million in General Fund expenses to the following year. This practice has continued to the present. However, to reverse this practice for part-time employees only, the General Assembly spent \$1.7 million in General Fund in FY 2011-12.

Similarly, under Senate Bill 09-265, the Department of Health Care Policy and Financing delayed the last weekly health care providers' June reimbursement payment until after July 1 in order to defer a portion of their reimbursements until the next fiscal year. In FY 2009-10, this practice deferred approximately \$25.2 million in General Fund expenses for Medicaid. House Bill 10-1383 enacted changes that reversed the payment shift.

Accelerate revenue. In some circumstances, accounting methods may also be modified to accelerate the recognition of certain sources revenue. For example, under Senate Bill 09-269, \$65.0 million was transferred from the state's 2010 Tobacco Master Settlement Agreement (MSA) payment to the General Fund. This created an annual General Fund obligation for a bridge loan, or "accelerated payment," made to fund MSA programs between the date when the prior year's payment is exhausted and the date when the current year's payment arrives. Had the transfer not been made, this amount would have been used to fund programs for FY 2010-11; to compensate, \$65.0 million from the state's 2011 MSA payment was allocated to programs in the then current FY 2010-11. This measure created an ongoing obligation on the General Fund, and the accelerated payment has occurred in every year since.

To decrease the amount advanced annually from the General Fund, any unallocated amount remaining in the Tobacco Litigation Settlement Cash Fund after programs are funded is retained in the fund and used to reduce the following year's accelerated payment.²⁹

Fund Solvency Considerations

Related to state budget shortfalls is the solvency of state funds. The funds available for future state government benefits may decline during an economic downturn when revenue from traditional sources falls, and demand for services rises. Fund solvency may also come into question under lower than expected returns on investments. This is particularly relevant to funds for state retirement benefits. Fund insolvency may necessitate the refinancing of programs to ensure long-term viability

²⁹For more information on the current state of accelerated payments, see the most recent Legislative Council Staff Tobacco MSA forecast, available at: <http://leg.colorado.gov/agencies/legislative-council-staff/forecasting>.

of the state program. The following provides a brief overview of legislative actions taken to address solvency issues for Colorado's state retirement system and unemployment insurance system.

PERA. Colorado's state retirement system, the Public Employees' Retirement Association (PERA), provides retirement benefits to state and local government employees. Benefits are generally funded by state and employee contributions, though General Fund allocations have also been made to improve PERA fund solvency. PERA investments are adversely impacted by economic downturns, which can threaten the long-term solvency of PERA. Following the 2001 and 2007-09 recessions, several actions were taken by the General Assembly to strengthen PERA's fiscal condition, including increases in both state and employee contributions, and reductions in benefits.³⁰ More recently, the General Assembly enacted Senate Bill 18-200, which requires ongoing General Fund transfers to improve PERA's funded status. The bill also created new mechanisms to increase the employee contribution depending on the solvency of the fund.³¹

Unemployment insurance. The Colorado unemployment insurance (UI) program provides temporary and partial wage replacement to workers who have become unemployed through no fault of their own. The program operates under a federal-state partnership. UI benefits are paid from the Unemployment Insurance Trust Fund (UITF), which is funded through state UI premiums, surcharges, and federal taxes paid by Colorado employers. The amount of state UI premiums and surcharges an employer pays depends on the UITF fund balance. When the fund balance falls, employers pay more to improve the solvency of the fund.

Colorado job losses resulting from the 2007-09 recession shifted employer premium rates to a higher schedule beginning in 2010. However, the UITF still became insolvent in 2010 due to unprecedented UI benefit expenditures, shifting premiums to the highest rate schedule by 2011. To continue to meet UI benefits payment obligations, the state began borrowing from the federal Unemployment Trust Fund in mid-January 2010.

To address UITF insolvency, the General Assembly enacted House Bill 11-1288, which changed the way the state UI system is financed and created a new UI premium and solvency rate schedule. Additionally, the Colorado Department of Labor and Employment issued unemployment compensation bonds in June 2012. The bonds were repaid by a bond principal repayment surcharge on Colorado employers. By June 30, 2012, the UITF was solvent. The final bond principal payment was paid on May 2017, removing the principal repayment surcharge in 2018.

³⁰Including Senate Bill 03-098, Senate Bill 04-132, Senate Bill 04-257, Senate Bill 10-001, and Senate Bill 10-146.

³¹For more information, see the Legislative Council Staff Memorandum, "Overview of the Colorado Public Employees' Retirement Association and Changes Made by Senate Bill 18-200," available at: <http://leg.colorado.gov/publications/overview-colorado-public-employees-retirement-association-and-changes-made-senate-bill>