Colorado
Legislative
Council
Staff

Room 029 State Capitol, Denver, CO 80203-1784
(303) 866-3521 FAX: 866-3855 TDD: 866-3472

MEMORANDUM

July 6, 2009

TO: Long-Term Fiscal Stability Commission

FROM: Natalie Mullis, Chief Economist, (303) 866-4778

SUBJECT: The Framework for General Fund Expenditures

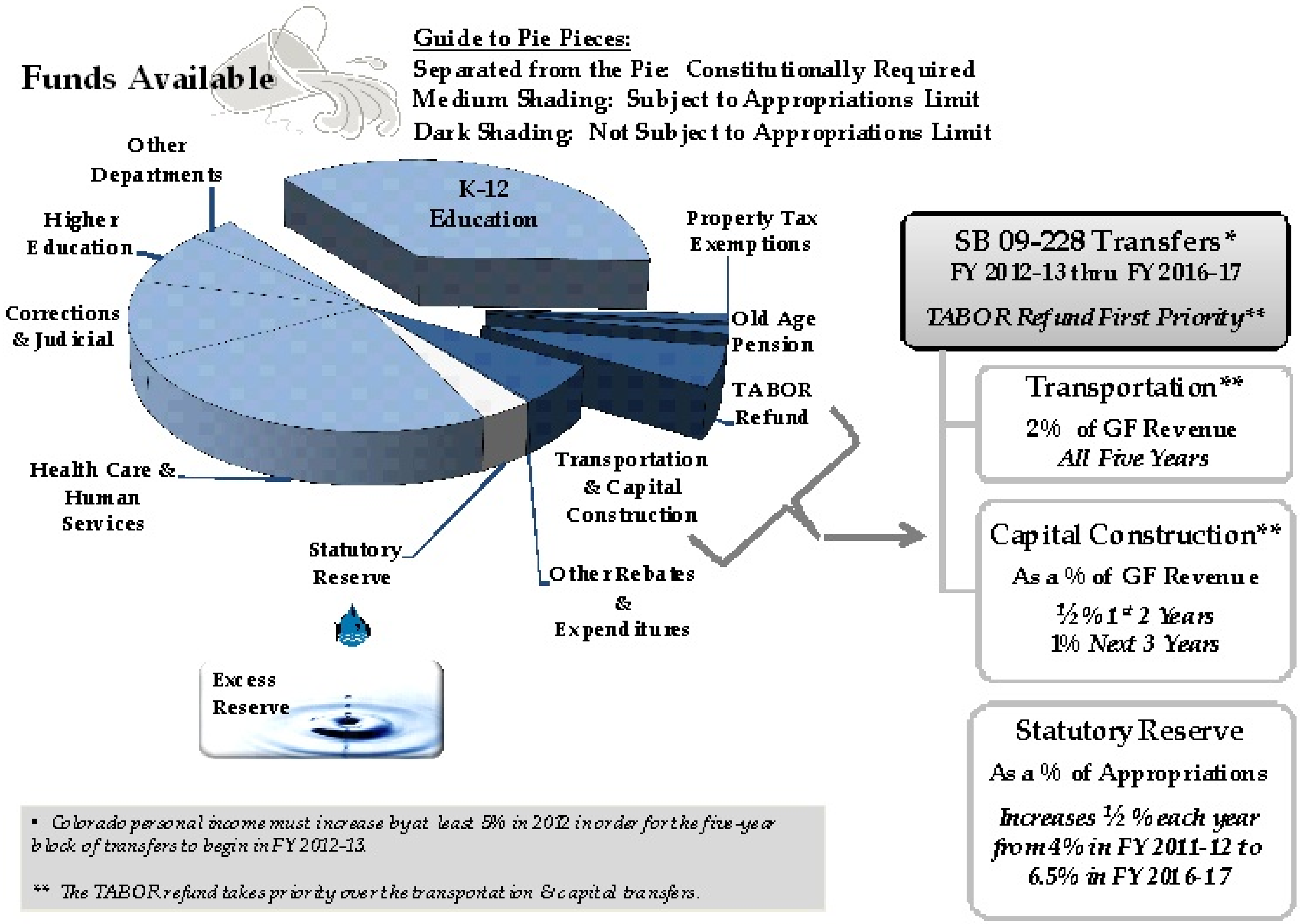
Figure 1 illustrates the statutory and constitutional framework for General Fund expenditures. The majority of money available for expenditure in the General Fund is spent on the operating expenses of the state's core programs, which include education, health care, human services, prisons, and the court system. The State Legislature has also chosen to use General Fund revenue to fund transportation, and General Fund revenue is the only major state revenue source available to fund other obligations, including (but not limited to) capital construction projects, the senior and veteran property tax exemptions, and the TABOR refund. Money must also be set aside to fund the statutorily-required reserve. Dollar amounts are not provided in Figure 1 and relative sizes of each pie piece should not be interpreted to remain constant over time, as the figure is intended to illustrate, in general, the framework for expenditures each year from FY 2009-10 into the future.

Priority of Expenditure. *Constitutionally-required expenditures*, shown as separated pie peices in Figure 1, are prioritized over other expenditures. The large majority, though not all, of expenditures on K-12 education are required by Amendment 23. In addition, the constitution requires that:

- money be set aside to refund money in excess of the TABOR limit;
- the Old Age Pension Fund be fully funded based on constitutional requirements; and
- local governments are reimbursed for the senior and veteran property tax exemptions (the constitution allows the State Legislature to adjust the cost of the exemptions).

Although it's not illustrated in Figure 1, *federal and legal restraints* also require certain expenditures out of the General Fund. For example, the federal government requires certain Medicaid expenses if a state opts to participate in the Medicaid program.

Figure 1. General Fund Budget Framework



* *Colorado personal income must increase by at least 5% in 2012 in order for the five-year block of transfers to begin in FY 2012-13.*

** *The TABOR refund takes priority over the transportation & capital transfers.*

Arveschoug-Bird Appropriations Limit. From FY 1991-92 through FY 2008-09, General Fund appropriations were limited to the lesser of a 6 percent increase from the previous year's appropriation level or 5 percent of Colorado personal income. SB 09-228 set the limit equal to 5 percent of Colorado personal income. Figure 1 shows expenditures subject to the limit in medium shading and those excluded or exempt from the limit in dark shading. The statutory reserve is also not subject to the limit.

Figure 2 shows the six percent appropriations limit, 5 percent of personal income as it is calculated for the appropriations limit, and a history of actual appropriations since FY 1991-92. During the first half of the 1990s, appropriations were only slightly lower than 5 percent of personal income. Actual appropriations began to fall behind, however, as Colorado personal income increased quickly during the boom years of the late 1990s. Income tax and sales tax revenue, which make up about 95 percent of General Fund revenue, is substantially more volatile than Colorado personal income. As a result, this gap was further widened during the budget shortfalls of FY 2001-02 through FY 2003-04 and in FY 2008-09, when revenue was not sufficient to allow appropriations to increase at the same rate as personal income or at the then-allowable growth rate of 6 percent.

Figure 2. General Fund Appropriations Since 1991-92
June 2009 LCS Forecast; Billions of Dollars

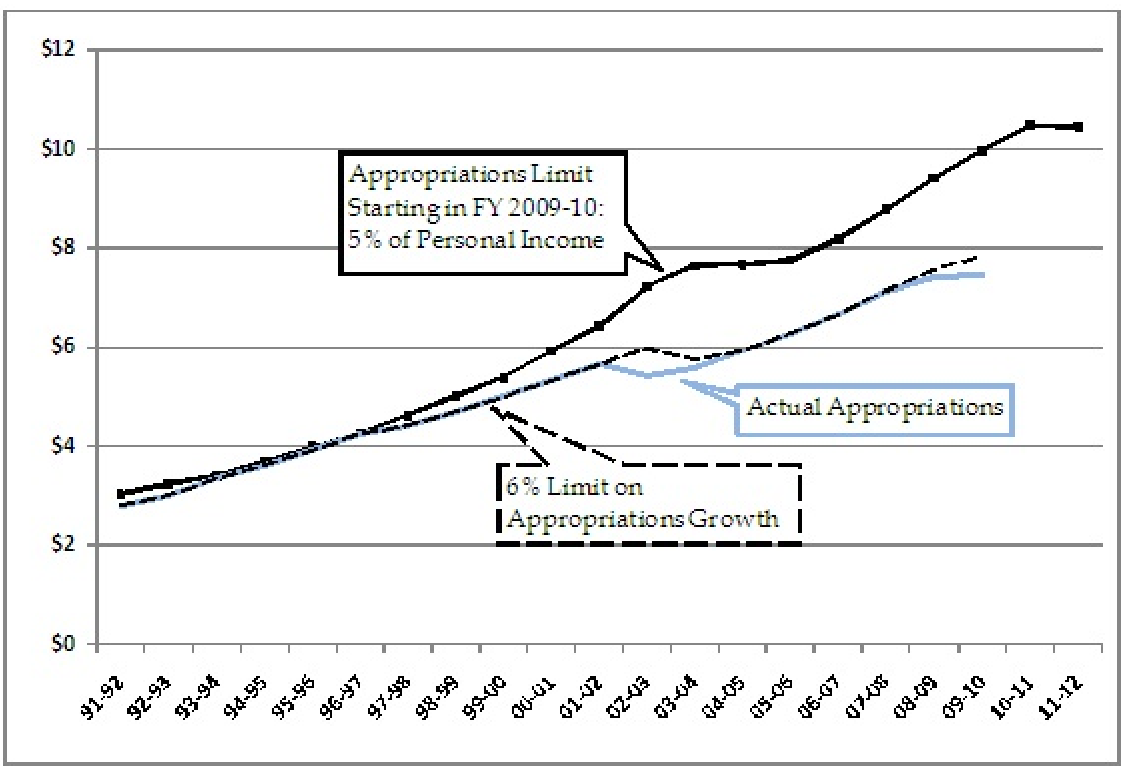


Figure 2 also illustrates that the gap between appropriations and 5 percent of personal income closed somewhat in FY 2005-06 and FY 2006-07. For purposes of calculating the appropriations limit, section 24-75-201.1 (1) (a) (VII) (A), C.R.S. defines personal income as that "for the calendar year preceding the calendar year immediately preceding a given fiscal year." For example, personal income growth for calendar year 2007 is used to determine the limit for FY 2009-10. Thus, there is a two-year lag between current economic events and a reduced growth rate in what would have been the 5 percent of personal income appropriations limit at the time. This lag is the reason for the slight closure of the gap in FY 2005-06 and FY 2006-07. Since personal income is expected to decrease slightly in calendar year 2009, it is also the reason for the slight decrease in FY 2011-12.

Exemptions from the limit. Certain appropriations, shown in dark shading in Figure 1, are exempt from the limit. They include spending on:

- property tax reappraisals;
- new programs or increased service levels required by federal law or final state or federal court order;
- Medicaid overexpenditures;
- programs funded by voter-approved tax or fee increases; and
- appropriations for a state fiscal emergency.

Exclusions from the limit. General Fund transfers for transportation or capital construction and certain rebates and expenditures are excluded from the appropriations limit. These are shown in dark shading in Figure 1. Rebates and expenditures excluded from the limit include:

- the TABOR refund (constitutional);
- the expenditure of sales and use taxes on the Old Age Pension program (constitutional);
- the senior and veteran property tax exemptions (constitutional);
- distributions of cigarette tax revenue to local governments (statutory);
- grants to the elderly to assist with property tax and heat/fuel expenses (statutory); and
- state contributions to the Fire and Police Pension Association (statutory).

The Statutory General Fund Reserve and Fiscal Emergencies. Colorado does not have a budget stabilization fund, or "rainy-day fund," but by law it does maintain a General Fund reserve equal to a set percentage of appropriations. Section 24-75-201.1, C.R.S., requires a certain percent of General Fund fiscal year appropriations be set aside in case revenue is insufficient to meet the state's General Fund obligations. This percent is equal to 4 percent in FY 2010-11 and FY 2011-12. Assuming the applicable trigger is met (see the discussion below about SB 09-228 transfers), this requirement will begin increasing by a half a percentage point in FY 2012-13 until it reaches 6.5 percent in FY 2016-17. Unless otherwise specified by special legislation, this statutory reserve must be replenished to the appropriate level each year as part of the budget process.

For FYs 2008-09 and 2009-10, the General Assembly reduced the reserve to 2 percent to free up money for appropriations, and gave the Governor authority to reduce it to zero in FY 2008-09 if revenue fell below the budgeted amount. However, money from the statutory reserve provided only a small portion of the amount needed to cover state expenditures. The legislature passed many other budget reduction measures and found additional revenue sources to balance the budget. The statutory reserve was also reduced during the recession in the first part of this decade and in the early 1990s.

The Governor's Authority in Fiscal Emergencies. When the revenue estimate from the Governor's Office of State Planning and Budgeting for the fiscal year indicates that General Fund expenditures will result in the use of one-half or more of the required General Fund reserve, the Governor must reduce General Fund expenditures so that the reserve will be at least one-half of the required amount. The Governor is required to use the procedures set forth in Section 24-2-102 (4), C.R.S., Section 24-50-109.5, C.R.S., or any other lawful means to reduce expenditures. The Governor must notify the legislature of the plan to accomplish the reductions. The Governor may also consider recommendations for reducing General Fund expenditures at institutions of higher education submitted by the Colorado Commission on Higher Education, after consultation with their governing boards (Section 24-75-201.5 (2), C.R.S.).

Section 24-2-102 (4), C.R.S, grants the Governor authority to issue an executive order to suspend or discontinue the functions or services of any department, board, bureau, or agency of the state government for up to three months when there are not sufficient revenues available to carry on the functions of the state government. The Governor may extend the executive order if necessary.

Section 24-50-109.5, C.R.S., requires the Governor to reduce state personnel expenditures in the event of a fiscal emergency, defined as a significant General Fund revenue shortfall or significant reductions in cash or federal funds received by the state, which threatens the orderly operation of state government and the health, safety, or welfare of the citizens of the state. The fiscal emergency must be declared by joint resolution adopted by the General Assembly and approved by the Governor.

Actions that may be undertaken to reduce state personnel expenditures include separations, voluntary and mandatory furloughs, suspension of salary and fringe benefit survey increases, suspension of performance awards or merit increases, job-sharing, hiring freezes, or forced reallocation of vacant positions. The head of each department and the governing board of each institution of higher education are required to order measures in accordance with the actions taken by the Governor to reduce the personnel expenditures of their departments.

TABOR Emergency Reserve. TABOR requires that at least 3 percent of state fiscal year spending, excluding bonded debt service, be kept in an emergency reserve. The TABOR emergency reserve cannot be used to offset revenue shortfalls; it can only be utilized to pay for non-fiscal emergencies, such as natural disasters. It must be repaid in the following fiscal year. The reserve is currently in several funds and includes nonfinancial assets.

Senate Bill 09-228 Transfers. SB 09-228 requires transfers from the General Fund to *transportation, capital construction, and the General Fund statutory reserve* in the amounts and during the years shown in Table 1. Once the five-year period of transfers is complete, the General Fund statutory reserve will equal 6.5 percent of General Fund appropriations. These transfers are also illustrated in Figure 1.

Trigger on all SB 09-228 transfers. The five-year block of transfers is subject to a trigger on personal income growth. If Colorado personal income increases by less than 5 percent in 2012, the entire five-year block of transfers is postponed until the first fiscal year in which personal income increases by at least 5 percent during the calendar year in which the fiscal year originated. For example, if 2014 were the first year in which personal income increased by at least 5 percent, the five-year block of transfers would begin in FY 2014-15. Once the first transfer occurs, they continue to occur without pause even if personal income growth were to later fall below 5 percent during the five-year period.

Table 1. Required General Fund Transfers
Subject to Applicable Triggers

	Transportation	**Capital Construction**	**Reserve**
FY	**% of GF Revenue**		**% of GF Appropriations**
2012-13	**2%**	**0.5%**	**0.5%**
2013-14	**2%**	**0.5%**	**0.5%**
2014-15	**2%**	**1%**	**0.5%**
2015-16	**2%**	**1%**	**0.5%**
2016-17	**2%**	**1%**	**0.5%**

Schedule for and triggers on transportation and capital construction transfers. During FY 2012-13 (or the first year of the transfers), 80 percent of the transportation and capital construction transfers are scheduled to occur on April 15th, 2013 (or on the applicable April 15th of a future fiscal year). The remaining 20 percent will be transferred when the state controller's office closes the books for that fiscal year, usually in December. During the remaining four fiscal years, 80 percent will be transferred in equal installments on a quarterly basis, with the remaining 20 percent transferred when the books are closed for that fiscal year.

Each individual transportation and capital construction transfer is subject to a trigger based on the size of future TABOR refunds. If a TABOR refund equal to between 1 percent and 3 percent of General Fund revenue is expected to occur, transfers will be reduced by 50 percent. If the TABOR refund is equal to more than 3 percent of General Fund revenue, the transfer will not occur. In FY 2011-12, 1 percent is equal to about $80 million and 3 percent is equal to about $240 million.