Colorado lawmakers are looking at how to close a $3 billion budget shortfall. Here’s the roadmap.

The Joint Budget Committee will begin reviewing recommendations for spending cuts this week to rewrite the $30 billion state budget.

The impact of the coronavirus pandemic on the $30 billion-plus state budget begins to take shape this week as lawmakers consider massive spending cuts.

How much tax revenue Colorado will lose to the paralyzed economy remains uncertain, but the governor’s budget office is projecting $3 billion in lost revenue for the current fiscal year and the next.

The General Assembly’s budget writers on Monday will start reviewing recommendations from legislative analysts for potential spending cuts across all government agencies. The documents are expected to include scenarios for slashing budgets as much as 20% and force legislators to make hard choices that will impact most Colorado families, according to drafts reviewed by The Colorado Sun.
“It’s a new paradigm, and it’s going to be very, very different than anything we’ve done,” said Sen. Paul Lundeen, a Monument Republican focused on education spending.

Even before lawmakers return, Gov. Jared Polis’ administration has begun to trim the current budget. The governor’s budget office asked state agencies to find more than $43.2 million in spending cuts for the final three months of the fiscal year, which ends June 30.

The savings will come from not filling new or vacant positions and by delaying the implementation of existing laws and programs, according to a memo. “The state must prepare for a possible prolonged period of economic disruption,” wrote Lauren Larson, the governor’s budget director.

None of the spending cuts affect the emergency response to the COVID-19 outbreak. The cost to combat the virus’ spread is not known, the state’s incident commander said, but the governor issued an executive order in early April that set aside at least $68 million from the state’s disaster emergency fund.

The road the governor and lawmakers can take to address the looming budget shortfall is paved with the decisions made in the past two recessions. But the tools available are limited by the fiscal restraints on spending in Colorado, such as the Taxpayer’s Bill of Rights, or TABOR.
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And even though the state’s budget reserve is larger this time, other budget-balancing options to find additional revenue, such as different cash accounts, were not fully restored after the prior recession. “A lot of the one-time tools that helped the state through the past two recessions are no longer available to us because we didn’t pay back those one-time funds,” Larson told lawmakers in a briefing earlier this year for lawmakers.

The challenge facing lawmakers is amplified by the fact that the coronavirus is expected to impact tax revenues for many years to come. The Great Recession in 2008 put such a dent in the state budget that it took 11 years for general fund revenues to recover to pre-recession levels, when adjusted for inflation and population, according to a legislative analysis.
Henry Sobanet, who served as a top budget official for Gov. Bill Owens during the 2001 recession and Gov. John Hickenlooper in the aftermath of the Great Recession, said the economic hit related to the coronavirus “is way worse.”

If federal stimulus funds can’t help backfill lost state revenues, he said, “this is going to make ‘01–‘02 (recession) and the Great Recession look very manageable in hindsight.”

And back then, Sobanet added: “Those were traumatic experiences in terms of budget cuts and decisions we had to make.”

The Joint Budget Committee will begin meeting May 4 to make decisions on how to cut billions of dollars in state’s spending, but a series of interviews with lawmakers and a review of legislative documents indicates it won’t be easy.

“We need to understand the loss in revenue, and potential new revenue, and put this whole big puzzle piece together,” said House Speaker KC Becker, D-Boulder.

Here’s a look at the options on the table.

**The federal stimulus is a lifeline, but it comes with caveats**

Colorado expects to receive as much as $2.5 billion in federal aid from the stimulus package, according to estimates from the Polis administration, and the state’s share is $1.7 billion. The CARES Act earmarks additional money for various programs, such as health care or education, but how much Colorado will receive for each remains unclear, a recent legislative analysis explained.
The stimulus dollars come with a major asterisk. The federal aid is only allowed to cover unexpected expenses related to COVID-19 — and not broader revenue losses from economic disruption. Colorado lawmakers are pushing for more flexibility, but received little help from federal officials.

“The real tricky part for us now is how much the federal government money will offset any (budget shortfall),” said Sen. Bob Rankin, a Carbonale Republican on the budget committee. “It doesn’t look like we are going to get much flexibility.”

Senate Majority Leader Steve Fenberg, D-Boulder, said the current rules will mean the state will be “handing out out money for rental assistance to families who are not sure if their neighborhood school is going to be open.”

“It’s just pretty odd,” he added.

The main tool for lawmakers is spending cuts. But it means difficult decisions for education and PERA.

Given the limits on federal aid, lawmakers will focus most of their attention on spending cuts across most state agencies.

The figure-setting documents set for release this week will include recommendations from budget analysts on where to trim and serve as a guide for lawmakers.

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The budget committee essentially finalized the spending plan for fiscal year 2020–21 before the pandemic hit Colorado, but new revenue projections expected May 12 will force them to essentially start from scratch.

So far, legislative leaders are signaling no spending on new programs unrelated to the coronavirus response and the elimination of a 3% salary hike for state employees. In higher education — an agency frequently targeted for cuts in downturns — budget analysts are recommending cutting the 7% increase that the budget writers tentatively adopted earlier this year.

One other target is K–12 education. In the recession at the turn of the century, after the dot–com bubble popped, lawmakers created the so–called “negative factor” to reduce the required classroom spending increases mandated by Amendment 23. And in the Great Recession, the debt to school districts ballooned again as lawmakers reduced education spending by $774 million, according to legislative figures. This time, legislative leaders say they want to avoid that option — particularly because they’ve worked to pay down the debt in recent years — but it remains on the table.

Another big ticket item where lawmakers can reduce spending is the state pension, known as Colorado Public Employees’ Retirement Association, or PERA. The state and employees are required to increase contributions into the fund next fiscal year under a law designed to keep the pension solvent. But now lawmakers are considering hitting the pause button.

“We were trying to address the long–term solvency of PERA” with the increased contributions, said Sen. Dominick Moreno, a Commerce City Democrat and budget writer. “It’s not like the building is on fire the way the state budget could be.”

Regardless of what lawmakers do, the governor may need to act on his own to cut spending. In the last two recessions, the Republican Gov. Bill Owens and Democratic Gov. Bill Ritter both issued a series of executive orders put in place a state hiring freeze and reducing government services.
The reserve account is a go-to source. And so is the TABOR emergency fund.

Each year, the state is required to set aside 7.25% of the discretionary spending from the general fund into a reserve account. The current reserve amounts to $814 million. In addition, another $448 million remains unspent from the prior year, a legislative analysis shows. The extra money gives lawmakers a cushion for economic downturns, but it’s not enough to solve all the problems.

Right now, the Polis administration and legislative leaders are cautioning against immediately tapping the reserve because it will be needed as the economic downturn continues in future budget years. But lawmakers could pass a state law to lower the amount and spend the difference, which they did in the prior two recessions.

One more option available to lawmakers is the TABOR Emergency Reserve, which is available during declared emergencies, such as an epidemic. The reserve must contain 3% of fiscal year appropriations, and sat at $449.6 million at the start of the fiscal year. But not all of it is available to spend.

To allow for more spending in past economic declines, lawmakers reduced the cash in the emergency reserve and substituted capital assets, such as state buildings. The breakdown for this budget year is $271 million in cash and $179 million in capital assets, according to legislative analysis. The TABOR reserve is a temporary measure, however, because once the emergency declaration expires, lawmakers must replenish the fund.

The governor already tapped the money for the COVID-19 response in two executive orders transferring a total $27 million from the controlled maintenance trust fund, which is part of the TABOR reserve. Polis directed $3 million for short-term rental and mortgage assistance to low-income
households and $1 million to improve the state’s unemployment benefits system.

In another executive order, he directed $23 million to the existing disaster emergency fund for the pandemic response without providing specifics on how the money would be spent. The remainder he earmarked for COVID-19 response came from money in the disaster fund.

**One option: Hit the red button and declare a fiscal emergency.**

The General Assembly has the authority to declare a “fiscal emergency” if it deems the decline in revenue “threatens the orderly operation of state government and the health, safety, or welfare of the citizens of the state.”

The move — which most recently took place in the Great Recession — triggers three distinct options.

First, it allows lawmakers to divert the cigarette and tobacco tax collections approved by voters in 2004 from its intended purpose under Amendment 35 toward broader health-related expenses. From fiscal year 2010 through 2012, lawmakers used the provision to redirect $247 million.

Second, it requires the governor to take action to reduce personnel costs through layoffs, furloughs, suspension of salary hikes and merit pay, hiring freezes and reallocating vacant positions.

The third consideration is one of the more controversial options. If lawmakers declare a fiscal emergency, TABOR allows for them to approve emergency taxes without prior voter approval.

There’s a caveat: The tax revenue can only be spent after the TABOR emergency reserve is depleted, so the state would need to restructure the
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reserve or sell off the buildings designated in the fund.

A potentially bigger obstacle: It requires approval of the tax by a two-thirds vote, meaning it would need Republican support. Voters would also need to approve the tax hike at the next election to keep it in place.

One of the easier options is moving money between accounts, but it comes with trade offs.

In each budget, revenue the state collects is transferred to various accounts, or cash funds, that are designated for specific purposes, such as building maintenance, transportation and education.

But in times of economic collapse, budget writers often keep that money to cover core operational expenses. In each of the prior two economic downturns, lawmakers transferred $1 billion from cash funds.

State Sen. Bob Rankin, a Carbondale Republican, speaks at a news conference March 28, 2019. He is a member of the Joint Budget Committee. (Jesse Paul, The Colorado Sun)
Part of the money came from severance taxes, the levy on oil and gas production. Rankin, the Republican budget writer, said he wants to protect severance tax collections, which go toward grants for local governments impacted by drilling. But he acknowledged that all options are on the table.

“The budget analysts are going through and looking at every cash fund, and talking about how much we might be able to sweep from cash funds but still leave them viable for the future,” Rankin said.

**To balance the budget, lawmakers may look toward new revenue through taxes and fees.**

Outside the Capitol, liberal interest groups want to put an alternative to budget cuts on the table: new revenue.

“We can’t cut our way out of this one,” said Carol Hedges at the Colorado Fiscal Institute. “Additional revenue is another option that we need to be thinking about.”

State lawmakers are considering whether to eliminate tax breaks or increase fees in certain areas to generate additional money. TABOR puts limits on the legislature’s authority, but both options became a key strategy in the prior decade.

“We have to make sure if tax expenditures are actually on the merits and policy of the proposal and not just a rush for additional funding,” said Moreno, the Democratic budget writer.

In three fiscal years starting in 2010, lawmakers suspended the senior homestead property tax exemption, saving nearly $100 million each time.

At the same time, the General Assembly removed existing tax breaks and reduced other incentives — part of what critics called “the dirty dozen” at
the time — to keep $718 million in state coffers, according to a legislative analysis.

Republican lawmakers have expressed objections about new revenue, and Democratic leaders are not sold on the idea.

“It’s in the mix, but I wouldn’t say it’s a main strategy,” said Fenberg, the Senate Democratic leader. “You can only increase fees so much. These cuts are so deep. You can increase some fees here or there, but it’s not going to solve the problem by any means.”

The Common Sense Policy Roundtable, a conservative-leaning think tank backed by major business leaders, issued a recent report that warned against shifting the burden to private industry in order to balance the budget.

“It’s also important to recognize ... businesses are facing the same challenge,” said Chris Brown, the report’s lead author. He cautioned against policies that “carry a disproportionately heavy burden on the private sector.”

One element of the report where all lawmakers agree: “Balancing the state budget, without causing undue harm to schools and other essential public services, will be extremely difficult.”

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