Federal Funds are Important:
Why Colorado Needs Support Now More Than Ever

www.bellpolicy.org

Before the COVID-19 pandemic struck, Colorado was just beginning to make headway on shortfalls in public investments created during the Great Recession. For example, Colorado increased its higher education budget by more than any other state in percentage growth. Although a major step in the right direction, Colorado remains 45th in the country in spending on higher education.

Now, as Colorado faces the economic pause brought on by the pandemic, investments in our public programs will shape how Coloradans and our economy will rebound. Without crucial public investments, Colorado risks an unequal recovery that threatens the state's long-term prosperity. Colorado and most other states across the country cannot deficit spend, meaning they cannot take out debt to help weather current revenue shortfalls. As such, states and local governments will depend upon federal aid, or other unique solutions, to maintain needed investments in our communities.

The extent of the pandemic's economic consequences may not be known for several years. As we await a new revenue forecasts from the Legislative Council and governor's office on May 12, we know one thing for certain: Without direct aid from the federal government, Colorado's progress in providing the infrastructure needed for a strong economy could be lost.

State and local government budgets will be strained in three major ways moving forward:

1. The direct costs related to treating the health and economic effects of COVID-19
2. The expanded need for public programs
3. The lost revenue that will occur over several years

While the true costs across these areas is unknown, some federal funding has been provided to state and local governments for the first two areas.

Four large bills have already passed Congress and were signed into law. However, fiscal relief to state and local governments remains inadequate, with no funding going directly to aid state and local governments for revenue shortfalls due to the pandemic. Thus far, partisan politics in Congress have ruled the day on this necessary need for states across the country.

Major Federal Legislation to Date:

Coronavirus Preparedness and Response Supplemental Appropriations Act (March 6th)

- $8 billion to help fight virus including money for vaccine development and medical supplies

Families First Coronavirus Response Act (March 18th)

- $100 billion for testing and increased Medicaid funding for states
- Requirements for emergency paid leave, temporary expansion of family and medical leave, increased unemployment insurance, and dollars for increased supplemental nutrition assistance program

Coronavirus Aid, Relief, and Economic Security (CARES) Act (March 27th)

- About $2 trillion for various forms of relief
- $150 billion in aid to state and local governments to only be used for expenses related to the pandemic

Paycheck Protection Program and Health Care Enhancement Act (April 24th)

- $250 billion for the Paycheck Protection Program, including $60 billion for banks with less than $50 billion in assets, $75 billion for hospitals, and $25 billion for testing.

Possible Revenue Shortfalls Caused by the Pandemic

Other than transfers from other governments, state and local governments get revenue primarily from property tax, income tax, and sales/use tax. In Colorado, the state is barred by the TABOR amendment from administering a property tax, thus only generating revenue from income and sales and use taxes. At the local level, governments are barred by the TABOR amendment from enacting income taxes and thus generate revenue from property and sales and use taxes. Fees are also used at both the state and local level to deliver specific services, but these fees are not a part of general revenue.

The economic consequences of COVID-19 will likely be seen quickest and most severely within sales/use taxes and income taxes. As opposed to property taxes, these sources of revenue will most immediately be impacted by a major reduction in local economic activity and unemployment. Because property taxes are typically based upon property assessments made a year or two in the past, they are less likely to rise and fall as fast and relentlessly. This difference in time and scale of revenue effects will produce uneven consequences across the state.

General Fund Projections

The Center for Budget and Policy Priorities estimates state budgets could see shortfalls of about 10 percent in the current fiscal year and as much as 25 percent in the coming fiscal year. A 25 percent shortfall would be close to $3.5 billion for Colorado.

The most recent Legislative Council economic forecast from March estimates a less severe reduction in the hundreds of millions, but those calculations were produced just as the pandemic hit Colorado. A more recent study from the University of Colorado estimates revenue will fall by $2.4 billion in the next fiscal year. Additional estimates from the Office of State Planning and Budgeting (OSPB) released on March 30 estimate revenue shortfalls could be over $3 billion in the coming year.

March Legislative Council Forecast		University of Colorado Study		OSPB
FY 2019-20	FY 2020-21	FY 2019-20	FY 2020-21	FY 2020-21
$4.3 million	**-$247.7 million**	**-$451 million**	**-$2.4 billion**	**-$3.2 billion**

For perspective, a $3 billion revenue lost would be the equivalent of losing 75 percent of all state funding for education, the largest portion of the state budget. Without federal support or increased revenue to fill these shortfalls, the state General Fund could be crippled.

Local Government Revenue Reductions

Based on information from the Department of Revenue, 79 percent counties and 82 percent of municipalities have sales and use tax. Forecasters are constantly updating their projections about the economy and other states have started to estimate sales/use taxes may decrease by about 5 percent in mild scenarios and closer to 12 or more percent in severe scenarios.

Using 2017 municipal and county data from the Colorado Department of Local Affairs (DOLA), we are able to estimate what those scenarios might mean for total county and municipal sales/use taxes. Colorado cities and counties could lose over $522 million over the next year if there is a 10 percent reduction.

Mild Reduction (5%)	Medium Reduction (10%)	Severe Reduction (20%)
-$261 million	**-$522 million**	**-$1.04 billion**

Source: Bell Analysis of 2017 data from the Department of Local Affairs adjusted for inflation using CPI-U

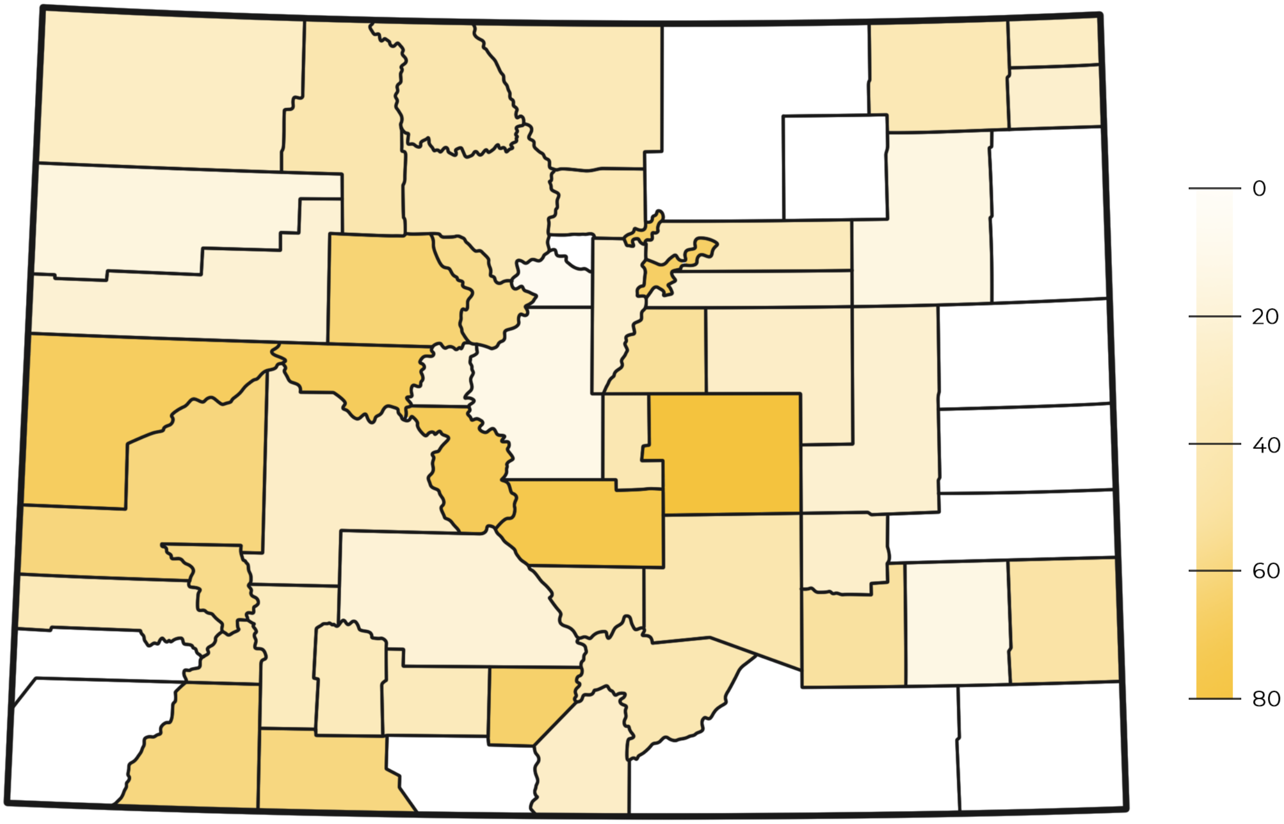
While sales/use taxes are not the only source of revenue for many communities, these estimates paint a dark picture of revenue shortfalls that are likely to come.

Most Vulnerable Counties

The economic effects of COVID-19 will be their harshest for local governments that are more reliant upon sales and use taxes. Those include counties throughout the state:

Most Vulnerable Counties: Reliance on Sales/Use Taxes

Percent of County Revenue from Sales/Use Tax



Counties where employment is more dependent upon industries more likely to be shut down by needed health actions — such as retail, entertainment, hospitality, leisure, and food services — may have even more immediate revenue reductions. These counties tend to be outside of the Denver metro area.

Most Vulnerable Counties: Combined Reliance on Sales/Use Taxes & Employment in Vulnerable Industries		
County	**% Revenue from Sales/Use Taxes**	**% Employment from Vulnerable Industries**
Chaffee	56%	52%
Pitkin	55%	61%
San Juan	30%	29%
El Paso	65%	34%
Fremont	60%	31%
Mesa	54%	77%
Archuleta	43%	22%
Eagle	47%	22%
Grand	26%	51%
Summit	38%	51%

Most Vulnerable Municipalities

The economic effects of COVID-19 will be their harshest for municipalities that are more reliant upon sales and use taxes. Those include municipalities throughout every part of the state.

Most Vulnerable Cities: Reliance on Sales/Use Taxes			
Cities Population 50,000+		Cities Population 10,000 to 50,000	
City	**% Revenue from Sales/Use Taxes**	**City**	**% Employment from Vulnerable Industries**
Castle Rock	94%	Montrose	91%
Colorado Springs	91%	Lone Tree	91%
Commerce City	90%	Brighton	90%
Arvada	88%	Federal Heights	89%
Westminster	87%	Durango	88%
Parker	85%	Steamboat Springs	88%
Thornton	84%	Glenwood Springs	87%
Fort Collins	83%	Evans	87%
Greeley	82%	Canon City	84%
Lakewood	81%	Wheat Ridge	83%

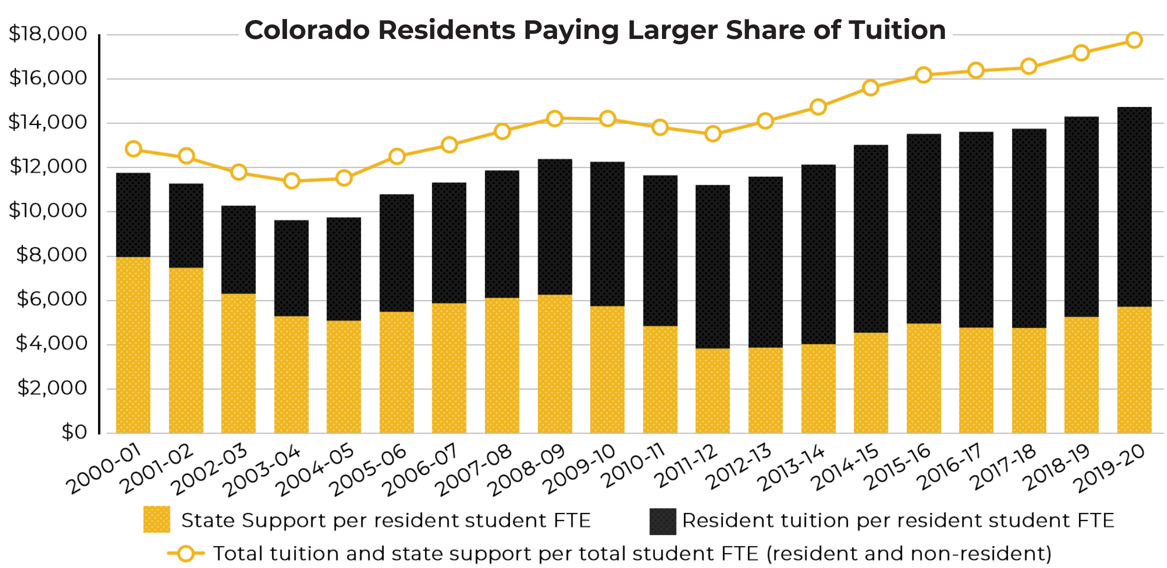
Source: Bell Analysis of data from the Department of Local Affairs

Why is State & Local Revenue So Important?

Colorado's General Fund — the funding lawmakers can allocate to various programs — is critical in maintaining programs we all depend on. Whether its money for K-12 education, community colleges, child care assistance, support for aging adults, judicial and law enforcement agencies, consumer protection, or many other uses, we all depend on General Fund revenues for maintaining the Colorado way of life. Public investments create jobs and sustain families.

Projections showing more than $3 billion in reductions in state money — due to loss of tax revenues — combined with the increased need for public programs like unemployment insurance and Medicaid to support people during the recession, means that without an infusion of money, we will have to cut many programs that are vital to a state's recovery. One only has to look back to the previous recession of 2009-2010 to see the true costs of budget cuts. Take for instance postsecondary education, K-12 education, and transportation:

- **Postsecondary education:** As a result of cuts during the Great Recession, the costs of postsecondary education shifted to students in the form of tuition increases and student debt. While Colorado has made significant strides the last two years to alleviate some of the burdens on students by investing during good economic times, those gains are in jeopardy of being reversed and worsened.



Source: Joint Budget Committee April 2020 Budget Balancing Documents

- **K-12 education:** The average statewide funding per pupil dropped 10 percent between fiscal year 2008 and fiscal year 2011 — from $7,225 per pupil to $6,468. Education funding became so dire during this time Colorado created the " budget stabilization factor number," or the amount of money the state owed to education in order to meet the constitutional commitments of Amendment 23, which required education funding grow at the size inflation plus 1 percent. The budget stabilization factor was instituted in 2009 and represented a $130 million deficit in education funding. In 2010 it grew to $381 million, then $724 million in 2011, and $1 billion in 2012. It wasn't until 2014 the state was able to start reducing this large IOU to education.
- **Transportation:** During strong economic years, the legislature has typically been able to dedicate funding for transportation projects. In 2006 and 2007, those transfers were over $400 million each year. During the Great Recession, the legislature was not able to dedicate any discretionary funding for transportation projects.

The lessons from the Great Recession show cuts can have severe consequences with extremely long tails unless there is federal support. While good economic times have helped recently to make progress in overcoming loses from the Great Recession, critical areas are still underfunded, including:

- A $500 million IOU on K-12 education (i.e. the budget stabilization factor)
- A $9 billion backlog on state transportation projects
- Only 8.9% of Colorado children under 5 who are eligible for child care assistance receive it
- We have only been able to slow tuition growth by 3 percent in the than last year, not reverse the long-term trend of overreliance on tuition.

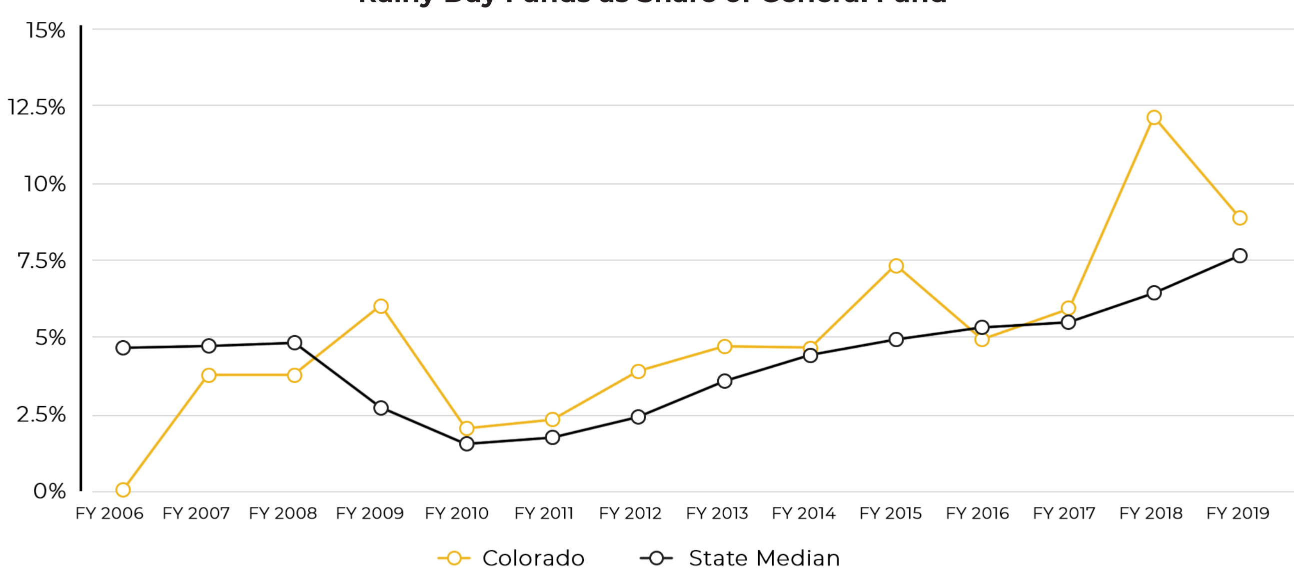
Cuts to state and local funding hurts our communities precisely at a time when most Coloradans need these resources. These cuts also have a disproportionate effect on racial inequalities, as many public investments are vital to promoting opportunity.

Colorado cannot continue to repeat the mistakes of the last recession and make the coming economic recovery longer and less equitable. We cannot cut our way to prosperity, especially as we see the significant problems that have long existed laid bare.

Why Federal Support is Needed

Since the Great Recession, Colorado has made great progress to build up its reserves. As the chart shows, Colorado has built up its "rainy day" fund above and beyond most states in the country. This is even in spite of the general fiscal restrictions and challenges unique to Colorado. But even with a robust reserve fund, no state is built to whether such an unprecedented event like a global pandemic. That is where the federal government comes in.

Rainy Day Funds as Share of General Fund



Source: Pew Charitable Trusts, Fiscal 50: State Trends and Analysis

The federal government is extremely important for state budgets in recessions. Colorado, like most states, has to balance it budgets and cannot deficit spend. The federal government does not have these obligations, meaning it can spend money to help states make up for lost revenue and maintain critical programs and investments.

So far during the COVID-19 pandemic, Congress has allocated a total of $150 billion for states through the end of the year, but the funding can only go needs that are a direct result of the pandemic, not lost revenue.

What Needs to Happen

Congress needs to act quickly to increase money to state and local governments. Most estimates, including those from the National Governor's Association and think tanks, have zeroed in on a total of $500 billion in aid to states and local governments. That should also include an increase to the Federal Medicaid Assistance Percentages (FMAP) — the formula used to determine the amount of Medicaid money that is the responsibility of the federal government.

Just as importantly, the time horizon of this aid should not be done by calendar or arbitrary deadlines. It should be tied to the economic recovery so that it does not just delay state economic pain. Tying economic aid to improved employment numbers will help ensure that states have recovered before pulling the rug from under them.

But the federal government is not the only avenue towards getting the Colorado state budget to adequate levels. Initiatives to raise money could be on the November ballot and if our federal officials do not step forward to help Colorado, then the residents of this state will need to make their voices heard at the ballot.