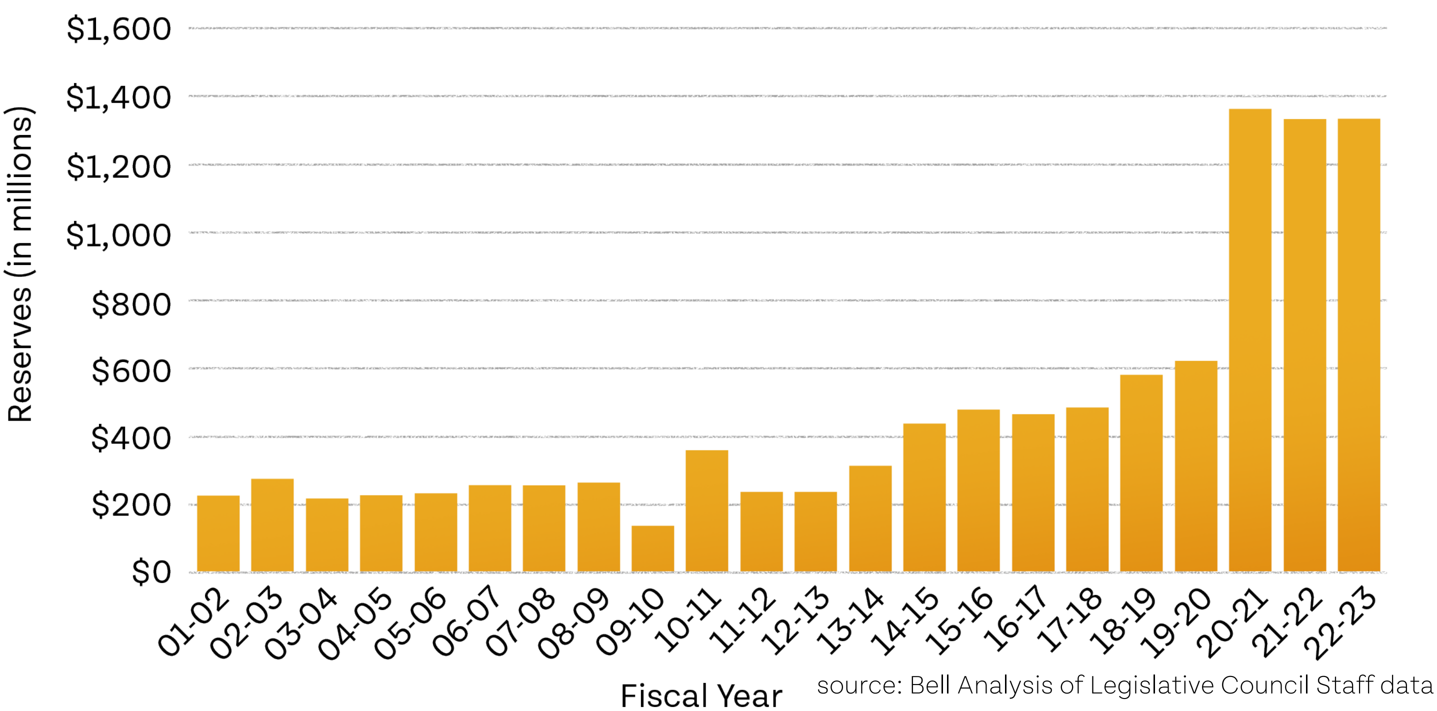
IN THE KNOW: STATE RESERVES

Unlike many other states, Colorado does not have a “rainy day fund." The state does have reserves that act as an emergency parachute in the case of an economic downturn. When the broader economy slows down, or goes into a recession, tax revenues decrease. That reduces the revenue in the budget to fund important governmental programs like education, health care, and transportation. Simultaneously, demand for services increases, as more families qualify for programs like Medicaid, child care support, and food assistance. In Colorado reserves have been an important backstop against cuts that would only make things worse in an economic downturn.

In recent years, Gov. Polis and members of the legislature’s Joint Budget Committee have committed to growing the state’s reserves so that we have a strong buffer if state revenues were to decline. While Colorado’s current reserves are larger than in any year since the turn of the century, many believe our reserves must be higher.

Reserves are a pot of money set aside from the General Fund to protect against declining revenues and economic downturns. Dollars put in the reserve count as spending against the state’s TABOR limit. Historically, Colorado has had a hard enough time adequately funding all programs, and in many years reserves have been neglected as a part of the budgeting process. In fact, going into 2020 the highest the state’s reserves had been was slightly over 7.25 percent of General Fund revenues, less than half is what is recommended by experts. But with economic uncertainty swirling since the onset of the COVID-19 pandemic, it has made sense to put some money aside in case revenue is needed to plug budgetary holes that appear later.

Reserves, Inflation Adjusted



source: Bell Analysis of Legislative Council Staff data

While it would seem that Colorado has ballooned its reserves to reach 15 percent of General Fund revenue, nonpartisan experts believe that Colorado needs to bulk up its reserves even more to truly shield Colorado's budget from a recessionary shock. The Government Finance Officers Association recommends at least a 16.7 percent reserve (the equivalent of two months of General Fund revenues.) Moody's Analytics has stress-tested Colorado and in 2022 recommended at least 19 percent reserves would be needed to buffer state finances in a moderate recession scenario.

As the previous graph shows, Colorado had very low reserves going into the early-2000s recession and going into the Great Recession of 2008-09. There was very little ability to fill holes in the budget when General Fund revenues precipitously declined. For example, here is some of what happened to the budget during the Great Recession:

- Total education spending dropped by more than $300 million, or $256 per pupil.
- Colorado voters passed Amendment 35 in 2004 to fund health care programs through an increase in tobacco taxes. However, in FY 2010-11 the legislature redirected $12 million from a primary care program, established through Amendment 35, to cover other holes in the budget.
- Newly imposed fees on providers and patients were substituted for $89.7 million in General Fund revenue in the Department of Health Care Policy & Financing.
- Provider rates were cut significantly, impacting both patients and providers throughout the state. Provider rates for the Department of Human Services – including those servicing Medicaid developmental disability support, and the Division of Youth Services – were cut from 0.5 to 1 percent below FY 2007-08 levels. Also, there was a 1 percent rate cut for providers in the Medicaid medical program.

While setting aside 15 percent of reserves would not have prevented all of the budget cuts, the fact that reserves were only at 5 percent of General Fund revenue going into the Great Recession led to worse outcomes in terms of program funding.

The bottom line is that setting aside reserves in good economic times helps the state be able to continue to fund programs when revenue declines. This is immensely helpful to communities – especially many of those in rural areas that rely more heavily on help from the state government – which have fewer levers to raise revenue and also see revenue declines during recessions and downturns.

Key Facts

- For FY 2023-24, which started on July 1, 2023, Colorado set aside 15 percent of General Fund revenue for reserve, which is nearly $2.3 billion.
- Since FY 2020-21, the legislature has followed the statutory requirement of setting aside at least 15 percent of General Fund dollars for reserves.
- Reserves can carry over from year to year, so cutting into reserves in one year will reduce reserves into the future, unless they are replenished using more General Fund money. That, in turn, limits spending in other areas.
- The recessions of 2001 and the Great Recession both caused revenue drops of more than 16 percent from peak to trough, although the 2001 recession drop was in a calendar year, while the Great Recession was over a two-year time period.
- Nonpartisan Legislative Council Staff have found that 15 percent reserves would provide a necessary buffer for one year of a moderate recession, but would force deep cuts for the subsequent years when reserves would have been depleted.
- While the federal government has helped states manage economic declines in recent years, the actual package is not consistent for every downturn, and each state has a responsibility to ensure its own fiscal responsibility.
- Since the advent of the Taxpayer Bill of Rights, or TABOR, in 1993, the General Assembly has never reduced the General Fund reserves for any reason other than a projected decline in General Fund revenues.

What's the difference between our TABOR surplus and General Fund Reserve?

It's critical to understand that Colorado's General Fund reserves are different from Colorado's TABOR surplus. Reserves can carry over from year to year and are purposefully set aside to buffer the state from revenue declines. In contrast, the TABOR surplus starts over every year and is based on current tax collections. In an economic downturn, the TABOR surplus would be significantly reduced, or even eliminated, because tax revenues sharply decline when the economy contracts. In the case of a downturn, only reserves are available to be used to help minimize budget cuts. These distinctions are crucial to understanding how to be fiscally responsible when budgeting.