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Budget Flexibility and Restrictions

LEGISLATIVE ANALYST'S OFFICE

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Budget Restrictions

- ☑ There are many types of restrictions on the Legislature's budget flexibility:
  - Ballot measures.
  - Federal restrictions.
  - Lawsuits and court rulings.
  - Spending commitments that take years to change.

- ☑ Despite these restrictions, the Legislature maintains considerable control over the state budget—particularly over the longer term.

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Ballot Measures Dedicate Tax Revenues

- Over the past two decades, some propositions have dedicated new tax revenues to specific purposes.
- In doing so, the ballot measures restrict the Legislature's ability to prioritize spending among programs in any particular year.
- Propositions 1D and 1E—defeated at the May 19 special election—would have allowed the redirection of some of these revenues (from Propositions 10 and 63) to help the General Fund for a limited number of years.

Date	Measure	Description
Dedicated Tax Revenues		
November 1988	Proposition 99	Provides a 25 cent per pack tax on cigarettes and dedicates the $300 million annually to tobacco education and health care services for low-income persons.
November 1993	Proposition 172	Raises the statewide sales tax rate by one-half cent and dedicates the almost $3 billion in annual funds to local public safety purposes.
November 1998	Proposition 10	Provides a 50 cent per pack tax on cigarettes and dedicates the roughly $600 million annually to early childhood development programs.
November 2004	Proposition 63	Enacts a state personal income tax surcharge of 1 percent that applies to taxpayers with annual taxable incomes of more than $1 million. The proceeds of the tax surcharge (about $1 billion annually) are earmarked to finance an expansion of community mental health programs.

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Ballot Measures Also Lock in State Spending

- ☑ Other ballot measures guarantee that a portion of General Fund spending be dedicated to a specific purpose.
- ☑ These measures restrict the Legislature from altering the relative shares of General Fund spending in any given year.
- ☑ Such measures often contain the ability for the Legislature to suspend their provisions during fiscal emergencies. For instance in July, the Legislature borrowed $1.9 billion in local government property taxes as allowed under Proposition 1A (2004).

Date	Measure	Description
Locked in State Spending		
November 1988	Proposition 98	Provides for a minimum level of total spending (General Fund and local property taxes combined) on K-14 education in any given year. The required General Fund contribution is roughly 40 percent of the state's budget.
March 2002	Proposition 42	Directs $1.4 billion in sales taxes on gasoline to transportation purposes. (Reflected as General Fund spending.)
November 2002	Proposition 49	Requires that the state spend a certain amount (currently $550 million) on after-school programs.
November 2004	Proposition 1A	Restricts the Legislature from altering local government revenues in many cases. In prior years, the state took such actions which helped the state's General Fund. Allows the borrowing of property taxes in limited circumstances.
November 2006	Proposition 1A	Restricts the circumstances in which the Legislature could suspend the Proposition 42 transfer for transportation.

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Federal Stimulus Brings New Restrictions

- ☑ The acceptance of federal stimulus dollars by the state helped provide billions of dollars in General Fund budget solutions this year.

- ☑ However, the funds also came with a number of strings attached. Generally, the federal requirements will constrain the state's budget-balancing options through 2010-11. (Attached is a short summary of program-by-program restrictions.)

- ☑ The two major restrictions are (1) creating maintenance-of-effort requirements in education (for both K-12 and higher education) and (2) restricting the ability to make eligibility changes in Medi-Cal. Consequently, as the state looks to adopt additional budget solutions, savings in these areas will be extremely limited.

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Lawsuits and Court Rulings

- ☑ Over the years, the state has lost some flexibility in its budgeting decisions as a result of a number of lawsuits and court rulings.
- ☑ Examples include the prohibition of borrowing from state retirement funds, restrictions on imposing reductions to health provider rates, and new spending requirements for health care for prison inmates.
- ☑ Some of these restrictions could be lifted through state constitutional amendments. Others are based on federal law or the U.S. Constitution and cannot be changed by the Legislature or California voters.

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Some Programs Take Decades to Change

- ☑ For some programs, the Legislature has considerable flexibility to affect costs but it would take many years to implement such changes.

- ☑ For instance, the Legislature has the ability to make major changes in the state's retirement programs, but generally only for *new* state employees. Consequently, any changes would take decades to fully implement a new retirement program for all employees and retirees.

- ☑ Similarly, when the state issues debt for the construction of buildings or other capital outlay purposes, it is committing the state budget for up to three decades of costs. The total amount that the state spends on debt-service payments can be reduced, but only by decisions over a number of years to reduce debt issuances.

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Increasing Budget Flexibility

- ☑ We have consistently recommended "unlocking" the state budget to the extent possible in order to provide each Legislature with the maximum flexibility to spend money on *its* priorities, not priorities from the past.

- ☑ The *2009-10 Budget Act* eliminates automatic spending increases for cost-of-living in most areas of the budget. This is one step to allowing greater annual flexibility.

- ☑ Other steps might include revisiting past propositions and determining whether they are still high priorities. Similarly, the Legislature could revisit retirement and debt policies.

Ability to Reduce General Fund Spending			
Program	**Percent of Revenues**	**Comments on the Short-Term (2009-10 and Under ARRA)**	**Comments on Future Years (Post-2009-10 and ARRA)**
Proposition 98 K-14 education	39%	**Considerable.** Unless suspended, Proposition 98 requires a minimum funding amount each year. Under the federal stabilization rules of the American Recovery and Reinvestment Act (ARRA), state General Fund spending must remain above a maintenance-of-effort (MOE) level tied to 2005-06 spending. Using the revised 2009-10 budget, the state is funded at the Proposition 98 minimum guarantee and slightly above the federal MOE. Funding at this level gave the state more than $6 billion in General Fund savings as part of the July budget package.	**Partial.** After the end of ARRA, the Proposition 98 minimum guarantee would govern annual minimum allocations to K-14 education unless it were suspended by a two-third vote. Absent suspension, the amount of flexibility varies year by year depending on the state's economy and revenue outlook.
University of California and California State University	6%	**Considerable.** Under ARRA, General Fund spending must remain an MOE tied to 2005-06 spending. Under the July budget package, university spending was reduced by $2 billion to the MOE levels in 2008-09 and 2009-10 combined.	**Considerable.** No significant restrictions on flexibility.
Medi-Cal	12%	**Very Limited.** Under ARRA, eligibility cannot be constrained beyond its July 1, 2008 level. However, optional benefits can be eliminated. Reductions to provider rates have generally been restricted by the courts. The administration intends to seek federal approval for program flexibility in order to reduce spending. The enacted budget counts almost $1.3 billion in 2009-10 General Fund savings, though most would depend on federal approval.	**Partial.** After the end of ARRA, the state would be able to reduce eligibility. Reductions to provider rates have generally been restricted by the courts.
Department of Developmental Services	3%	**Considerable.** The state can limit services, provider rates, and eligibility.	**Considerable.** The state can limit services, provider rates, and eligibility.

Program	Percent of Revenues	Comments on the Short-Term (2009-10 and Under ARRA)	Comments on Future Years (Post-2009-10 and ARRA)
Department of Mental Health	2%	**Partial.** Staffing ratios have been enhanced in response to a consent decree issued as a result of a federal investigation. The state hospitals are under the supervision of a court-appointed monitor. Community mental health programs are subject to an MOE imposed by Proposition 63.	**Partial.** Staffing ratios have been enhanced in response to a consent decree issued as a result of a federal investigation. The state hospitals are under the supervision of a court-appointed monitor. Community mental health programs are subject to an MOE imposed by Proposition 63.
CalWORKs	2%	**Partial.** Federal law requires a state MOE. The state is currently at the MOE, though there remains the ability to reduce some costs. Grant reductions result in state savings of 20 cents for every $1 reduction through September 2010 under ARRA.	**Considerable.** Federal law requires a state MOE. The state is currently at the MOE, though there remain options for redirecting federal block grant savings to offset General Fund costs.
SSI/SSP	3%	**Partial.** Federal law requires a state MOE, but the state is currently above it by $182 million.	**Partial.** Federal law requires a state MOE, but the state is currently above it.
In-Home Supportive Services	1%	**Considerable.** The state can limit services, provider rates, and eligibility. Reductions result in savings of 25 cents for every $1 reduction under ARRA.	**Considerable.** The state can limit services, provider rates, and eligibility.
Corrections and Rehabilitation	8%	**Partial.** The ability to reduce spending for medical care under the federal Receiver ($1.6 billion) is limited, though possible in some circumstances. Many other reductions take time to fully implement.	**Considerable.** The ability to implement longer-term changes in the prison system is more widespread, though constrained by the courts in some cases.
Judiciary	2%	**Considerable.** No significant restrictions on flexibility.	**Considerable.** No significant restrictions on flexibility.
Proposition 42 transfer	2%	**Partial.** If transfer is suspended, the funds must be repaid within three years, with interest.	**Partial.** If transfer is suspended, the funds must be repaid within three years, with interest. Transfer can be suspended only up to two times every ten years, and only after first suspension is fully repaid.
Retirement pension and health contributions	5%	**Very Limited.** Ability to reduce payments is extremely limited by retirement case law.	**Partial.** Retirement programs generally can be amended for newly hired employees. Any savings, therefore, accrue over many years.
General obligation bond debt service	7%	**Very Limited.** Contractual obligations to bond holders require that payments be made. At times, however, state payments have been legally refinanced.	**Partial.** Over time, debt-service costs can be controlled by limiting the amount of bonds authorized and improving the state's bond rating.