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WHAT WOULD PROPOSITION 76 MEAN FOR HEALTH AND HEALTH-RELATED PROGRAMS?

Governor Schwarzenegger's California Recovery Team, a business-backed coalition, has placed an initiative on the November special election ballot that would dramatically change the rules governing the state's budget process.[1] This *Brief* analyzes the provisions of Proposition 76 that would affect state health and health-related programs, including those administered by local governments. This *Brief* finds that Proposition 76:

- Could reduce spending for health and health-related programs in years when the proposed spending cap limits state spending.
- Would cap spending from voter-approved taxes, such as tobacco taxes that support early childhood and health programs and the tax on high-income earners that supports mental health programs, when total state revenues exceed allowable spending. The cap would also apply to dedicated taxes for health, mental health, and human service programs transferred from the state to counties as part of realignment.
- Would allow the governor to cut spending for health and health-related programs during a fiscal emergency. Cuts to "entitlement" programs, such as Medi-Cal, could result in an "all or nothing" situation whereby programs continue to operate fully until available funding runs out and then cease to provide state-supported benefits entirely.
- Could shift costs for health and health-related programs to local governments, primarily counties. Counties and community clinics also could experience increased costs if state funding cuts result in more people turning to county programs for health services.

How Might The New Spending Cap Affect Health Programs?

Proposition 76 establishes a new limit on state spending that would be in addition to, not a substitute for, the existing State Appropriations Limit (SAL). Proponents argue that the new cap is designed to "smooth" state spending by limiting the growth in spending to the average change in state revenues for the three prior years. Analysis of historical spending and revenue data suggest that Proposition 76 would, in fact, substantially reduce spending over time.

The California Budget Project (CBP) examined historic revenue and spending data to assess how the proposed limit would have affected state spending if it had been enacted in 1987, 1990, or 1995.[2] This analysis found that allowable 2005-06 spending would have been significantly below that provided by the budget signed into law by the Governor under all three scenarios (Table 1). If Proposition 76 had been enacted in 1990, for example, allowable 2005-06 spending would be $12.6 billion below the level in the budget signed into law by Governor Schwarzenegger and $7.8 billion below anticipated 2005-06 revenues. Reductions equal to 11.1 percent of 2005-06 spending would be required to reach the cap under the 1987 and 1990 scenarios, while reductions equal to 5.2 percent

of 2005-06 spending would be needed to reach the cap under the 1995 base year scenario. Assuming that reductions were made on an across-the-board basis this would translate, for example, into a $1.6 billion reduction in Department of Health Services spending - which includes payments for Medi-Cal benefits - under the 1987 and 1990 scenarios or a $735 million reduction under the 1995 base year scenario.

Under each of the three scenarios examined, the cap was below actual spending for a majority of years. Moreover, the cap was also below actual revenue collections in a majority of the years examined in each scenario.

The New Spending Cap Would Apply to Voter-Approved Taxes

The new limit would apply to spending from special funds, as well as the state's General Fund. The cap would apply "proportionately" to the General Fund and special funds in years when revenues exceed the cap. Special fund revenues in excess of the cap would be held in a reserve in each special fund. Funds held in reserves could be spent in years when revenues are below the cap.[3] The new cap would apply to expenditures from voter-approved taxes, such as Proposition 10's tobacco tax which supports early childhood programs, Proposition 99's tobacco tax dedicated to health programs, and Proposition 63's tax on high-income earners which supports mental health programs.[4]

The impact of the cap could be particularly problematic in the case of revenue sources that grow slowly or decline over time, such as the tobacco tax, particularly if these revenues are earmarked for specific programs.[5] Tobacco tax revenues, for example, have declined over time due to falling consumption of tobacco products. The revenue raised by each $0.10 per pack of the tobacco tax declined by one-third between 1995 and 2005. Voters have approved two dedicated tobacco tax rates to support specific programs. Proposition 76's spending cap would reduce funds available for tax-supported programs including those authorized by:

- Proposition 99 of 1988, which supports a specific set of programs, including indigent health and tobacco prevention education.
- Proposition 10 of 1998, which provides funds for programs aimed at children from birth to age 5. County commissions receive 80 percent of Proposition 10 funds. A number of county commissions use Proposition 10 funds to support children's health initiatives, which provide access to low-cost health coverage, and other health-related programs. County commissions would receive less than the full amount of revenues raised by the tax in years when the cap applied.

The CBP's analysis of historical spending and revenue data suggest that the new spending cap could apply more frequently than not. If the cap applied for a number of consecutive years, large reserves could accumulate in funds supported by voter-approved taxes. These amounts would accumulate until there was room under the cap to allow expenditure of funds from the reserves.

The New Spending Cap Would Apply to Funds That Support Realignment

The new cap would also limit spending from the Local Revenue Fund, a fund supported by a ½ cent sales tax rate and a portion of Vehicle License Fee (VLF) revenues. This fund supports programs shifted from the state to counties as part of the 1991 transaction referred to as "realignment." Under realignment, the state shifted increased responsibility for a variety of health, human service, and mental health programs to counties along with a dedicated revenue source. In years when the spending cap applies, counties would not receive all of the funds raised by the realignment revenue sources, but would be left with full responsibility for realigned programs and services.

The impact of the cap on realignment could be substantial. Under the 1987 and 1990 base year scenarios examined by the CBP, $194 million in realignment sales tax revenues would have been placed in a reserve in 2005-06. Under the 1995 base year scenario, $32.3 million would have been placed in a reserve.

Table 1: Allocation to Reserve in 2005-06 Under Base Year Scenarios (Dollars in Thousands)

	1987	1990	1995
Realignment Sales Tax	$193,553	$193,553	$32,327
Proposition 10 Revenues	$43,104	$43,104	$7,199
Proposition 99 Revenues	$21,552	$21,552	$3,600

Some county officials argue that capping funding for realigned programs is inconsistent with the legislative intent of realignment and could, in fact, violate realignment statutes. Counties argue that the withholding of funds could trigger a claim for reimbursement under the state's mandate provisions that could, in turn, jeopardize the revenues that support realigned programs and services.[6]

The Governor Would Gain Broad Power To Cut Spending

Proposition 76 allows the governor to declare a fiscal emergency if the Department of Finance estimates that General Fund revenues will fall 1.5 percent or more below forecast levels or if the balance in the state's Budget Stabilization Account is anticipated to fall by more than half during a fiscal year. If a bill or bills are not enacted to address the emergency, the governor could "reduce items of appropriation on an equally proportionate

basis, or disproportionately, at his or her discretion." The governor could cut any appropriation except for those required for debt service, to comply with federal laws and regulations, or those that would result in the violation of a contract to which the state is a party. However, the governor could cut appropriations supporting contracts signed after the effective date of Proposition 76.

The governor would have similar authority to reduce spending if the Legislature failed to enact a budget by July 1. If a budget were not enacted by July 1, spending would continue at the level provided in the prior year's budget. If a shortfall exists, the governor would have unilateral authority to cut spending if the Legislature failed to take action within 30 days.

Federal Law May Not Protect Spending for Key Health Programs

Proposition 76 states that the governor could not cut spending required by federal law or regulations. However, it is unclear whether this exclusion would protect a number of health and health-related programs. Federal law, for example, establishes minimum standards and guidelines for states that participate in the Medicaid program (Medi-Cal in California). Federal law does not, however, require states to participate in Medicaid. Similarly, federal law does not require states to participate in the State Child Health Insurance Programs, the federal program that provides funds for the Healthy Families Program. Federal law simply provides matching funds for qualifying expenses for states that do.

The impact of Proposition 76's exclusion on programs that receive state and federal funds would likely depend on how broadly courts construe the term "federal regulations."

Proposition 76 May Require "All or Nothing" Funding for Entitlement Programs

The Legislative Analyst has opined that Proposition 76 does not allow a governor to make statutory changes in order to implement reductions to state programs.[7] Under this interpretation, a governor could cut funding for the individual line items within the Medi-Cal budget, for example, but could not alter statutes that define eligibility for the program or the scope of benefits offered to Medi-Cal beneficiaries. Thus, if the governor reduced funding for Medi-Cal by 8.3 percent (one-twelfth), the Legislative Analyst argues that the program would operate as though fully funded for 11 months, and then provide no services at all during the final month of the fiscal year.[8]

The Legislative Analyst's interpretation of Proposition 76 raises a number of significant issues for beneficiaries and service providers in programs such as Medi-Cal and Healthy Families. The lack of funding could have serious financial consequences for providers and could make it difficult for enrollees to receive urgently needed services. Nursing homes, for example, might not be reimbursed for caring for Medi-Cal beneficiaries for a portion of the year and might evict individuals for periods during which they would not be paid. Hospitals might not receive payment for providing emergency care or obstetrical services for a portion of the year.

To the extent that these concerns discourage a governor from reducing spending for health and health-related spending, deeper cuts would be required in other areas of the budget. The impact could be significant, since Medi-Cal alone accounts for 14.4 percent of budgeted 2005-06 General Fund spending.[9]

Cuts to Programs Other Than Entitlements Would Reduce Services

For programs where the amount of available funds determines the level of services delivered, reductions in funding would limit access to services. Reductions in funding for Healthy Families outreach would simply reduce the amount of outreach that occurs. Similarly, cuts to programs that provide a fixed dollar amount of services, such as the program that supports treatment for prostate cancer, would reduce the number of people who receive services.

State Reductions Could Shift Costs to Local Programs

The governor's authority to reduce spending would apply "notwithstanding any other provisions of this Constitution." Some argue this provision would pre-empt the state's obligation to reimburse local governments for mandated programs and services. Proponents would disagree. The Legislative Analyst did not comment on the interrelationship between the so-called "mandate" provisions of the Constitution and Proposition 76 in their ballot pamphlet analysis. It is unclear whether reductions made by a governor due to a fiscal emergency would suspend local governments' requirement to provide a particular benefit or service or whether local governments would be required to continue to provide services with less than full state funding.

Reductions made in response to a fiscal emergency would shift costs to local governments, to the extent existing provisions requiring the state to reimburse local governments for so-called mandates did not apply. Counties, in particular, share financial responsibility for a number of health and social service programs. For programs where the legal responsibility to provide benefits or services rests with counties, counties could be required to pay the full costs of the program out of their own funds, once state funds ran out. This could shift the cost of programs such as In-Home Supportive Services, Foster Care, Adoptions Assistance, Adult Protective Services, and CalWORKs to counties.

County hospitals and clinics and community-based clinics could also experience increased costs if funding for state-supported health programs, such as Medi-Cal or Healthy Families, runs out due to reductions made by a governor. In this instance, individuals could turn to county health programs and counties would be required to provide health services under state law, which establishes counties as the "providers of last resort" for health services and cash assistance.[10]

Conclusion

Both Proposition 76's new spending cap and the governor's authority to unilaterally reduce spending during a fiscal emergency could affect health and health-related programs. In both instances, health programs may be disproportionately vulnerable to spending reductions for several reasons. First, health programs account for a substantial fraction of state spending. Second, health programs lack constitutional protection and, for the most part, dedicated funding. Third, Proposition 76 would eliminate the Legislature's authority to suspend the transfer of certain tax revenues to transportation programs during tough budget years and would eliminate the state's ability to borrow monies from special funds to close a General Fund budget gap. To the extent that the share of the budget that is "locked in" increases, programs that lack similar protections – including many health programs - would be more vulnerable to reductions.

Reductions to programs, such as Medi-Cal or Healthy Families, where federal dollars match each dollar of state spending, could also reduce the amount of federal funds received by the state. To the extent this occurs, the impact of state funding reductions would be magnified.

Jean Ross prepared this Budget Brief. The California Budget Project (CBP) neither supports nor opposes Proposition 76. This Budget Brief is designed to help voters reach an informed decision based on the merits of the issues. The CBP was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org..

ENDNOTES

[1] For a detailed examination of all of the provisions of Proposition 76, see California Budget Project, *Limiting the Future?: What Would the "Live Within Our Means Act" Mean for California?* (Revised June 17, 2005).

[2] The California Budget Project's *Proposition 76's New Spending Cap Could Require Substantial Spending Cuts* (September 2005) describes this analysis in detail.

[3] It is not clear whether Proposition 76 would allow the Legislature to reduce spending disproportionately in some funds in order to spend more from others in years when the cap applies.

[4] Revenues from the taxes imposed by Proposition 10 and Proposition 99 are exempt from the current SAL.

[5] The Legislative Analyst notes that Proposition 76 does not clearly state how the cap should be proportionately allocated and notes that the cap could be allocated based on each fund's contribution to revenues that exceed the cap. See Legislative Analyst's Office, *Proposition 76: Key Issues and Fiscal Effects* (September 30, 2005), p. 5. This interpretation would more significantly affect a fund that experienced substantial revenue growth.

[6] County Welfare Directors Association of California, *Talking Points for Human Services Directors California Live Within Our Means Act* (no date).

[7] Legislative Analyst's Office, *Proposition 76: Key Issues and Fiscal Effects* (September 30, 2005), pp. 7-8. See also Legislative Analyst's Office, *State Spending and School Funding Limits. Initiative Constitutional Amendment* downloaded from http://www.ss.ca.gov/elections/bp_nov05/voter_info_pdf/entire76.pdf on October 3, 2005. Typically, the state budget appropriates funding for state health programs; while state law outlines the criteria under which individuals qualify for benefits, the basis for reimbursing providers for services, and the scope of benefits that are offered by a program. Funding for Medi-Cal benefits, for example, is contained in a single line item for Benefits (Medical Care and Services). A separate line item appropriates funds to counties for determining eligibility for the Medi-Cal program and a third line item provides funding for fiscal intermediary management services that process payments to providers. The budget does not allocate funds for individual benefits, such as dental or hospital care, or funds to specific populations that are eligible for benefits, such as children or the aged.

[8] Unless the Legislature made, and the governor signed into law, statutory changes to the program providing an alternative mechanism for achieving the governor's reductions. See Legislative Analyst's Office, *Proposition 76: Key Issues and Fiscal Effects* (September 30, 2005), p. 8.

[9] This percentage refers only to the Local Assistance portion of Medi-Cal; the percentage of total state Medi-Cal spending would be larger.

[10] This requirement is in Section 17000 of the California Welfare and Institutions Code.