



CALIFORNIA BUDGET PROJECT

March 17, 2009

The Honorable Bill Lockyer  
California State Treasurer  
915 Capitol Mall, Suite 110  
Sacramento, CA 95814

Michael C. Genest  
Director  
California Department of Finance  
State Capitol, Room 1145  
Sacramento, CA 95814

Subject: AB 16xxx (Evans, Chapter 5 of 2009)

Dear Treasurer Lockyer and Mr. Genest:

AB 16xxx charges you with determining, by April 1, whether the federal government has enacted legislation "that will make available, by June 30, 2010, additional federal funds that may be used to offset not less than" \$10 billion in General Fund expenditures. If you certify that the state will reach this threshold, then a \$1.8 billion personal income tax increase and \$948 million in cuts – primarily targeting health and human services programs and higher education – will be eliminated, or "triggered off." In contrast, if you do not certify that the state has met this self-imposed threshold, then the cuts and the tax increase will take effect. The California Budget Project (CBP) is deeply concerned that the tax increase and the cuts, particularly reductions in cash payments for low-income families and individuals and the wage cut for IHSS workers, will weaken the impact of the American Recovery and Reinvestment Act (ARRA), endangering efforts to "jump start" the California and national economies. We offer the following comments with the goal of eliminating the need for these reductions, which would have a severe impact on critical services affecting the health and well-being of low-income Californians.

### **Department of Finance's Approach Is Unnecessarily Narrow**

The California Budget Project (CBP) believes that the approach taken by the Department of Finance (DOF) regarding the question of whether the \$10 billion threshold will be met is unnecessarily narrow and is inconsistent with the requirements of AB 16xxx. The DOF's preliminary analysis suggests that the state will receive only \$8 billion in ARRA funds that will offset state General Fund spending by June 30,

1107 9th Street, Suite 310  
Sacramento, California 95814  
P: (916) 444-0500  
F: (916) 444-0172  
cbp@cbp.org  
www.cbp.org

2010. However, the DOF's methodology excludes ARRA funds that will support programs and services that suffered deep reductions in the 2008-09 and/or 2009-10 budgets. In many instances, these same programs and services have experienced significant cuts repeatedly in recent years. The CBP believes that the calculation of federal funds that may be counted toward the \$10 billion threshold should include ARRA funds that will support programs and services that received funding reductions in the 2008-09 or 2009-10 budgets and/or that are experiencing higher costs due to the economic downturn – costs that would, in the absence of federal funds, fall on the state's General Fund.

The DOF's approach is inconsistent with AB 16xxx, which simply states that California must receive at least \$10 billion in federal funds that "may be used" to offset General Fund spending. Instead, we argue that more than \$17 billion in ARRA funding can – and likely will – be used to help cover the costs of programs and services that, in better budget times, would be paid from the General Fund. For example, the 2009-10 budget agreement cut funding for K-14 education programs covered by the Proposition 98 guarantee by \$7.4 billion (12.7 percent), compared to the level assumed in the 2008-09 budget. In addition, the budget agreement reduced 2009-10 funding for K-14 education by \$3.7 billion (6.3 percent) below the level that would have been required absent mid-year reductions to 2008-09 Proposition 98 spending.

A portion of these K-14 reductions can – and will – be offset with ARRA funds for California, including the education portion of the State Fiscal Stabilization Fund (SFSF – \$4.9 billion), increased Title I funding (\$1.5 billion), and increased funding for Individuals with Disabilities Education Act (IDEA) activities (\$1.3 billion). In essence, federal ARRA funds will partially backfill the significant cuts to General Fund spending for K-14 programs included in the 2009-10 budget agreement. Absent these funds, California's schools would experience extreme fiscal distress, and the quality of the education provided to the state's students would be further diminished. Consequently, we believe it is appropriate to count these federal funds toward the \$10 billion threshold. Moreover, this same reasoning applies to the ARRA's increased funding for higher education and for Supplemental Nutrition Assistance Program (SNAP) administration, which will partially offset reductions the state has made to these areas of the budget in recent years, including in the 2009-10 budget agreement.

## **Additional Concerns**

In addition to our concern with the DOF's narrow approach, the CBP is troubled by:

- **The DOF's lack of transparency, which has led to confusion about how it reached its estimates.** The DOF has not responded to requests – including those by the CBP – for information about its methodology and other aspects of its analysis. This has led to confusion about its estimates. For example, the DOF estimates California will receive \$6.4 billion in federal Medicaid funds that can offset General Fund spending by June 30, 2010. However, an analysis by the Government Accountability Office (GAO) suggests that the state could receive well over \$7 billion in General Fund relief during the same period – even after accounting for savings that will accrue to local governments. This difference is far from trivial, but it cannot be understood until the DOF allows independent analysts to evaluate its methodology.
- **The DOF's failure to count any SFSF funding toward the \$10 billion threshold.** The Governor vetoed a total of \$510 million from the CSU and UC budgets and indicated that this cut would be backfilled with ARRA funds from the education portion of the SFSF. Specifically, the Governor stated that, these "additional reductions will be offset by funding intended for restoration from the State Fiscal Stabilization Fund under the Federal American Recovery and Reinvestment Act of 2009."<sup>1</sup> However, the DOF's analysis inexplicably fails to count any SFSF funding toward the \$10 billion threshold.

---

<sup>1</sup> Department of Finance, *California 2009 Budget Act* (no date), p. 5.

- **The DOF's failure to consider other potential federal funding sources that could help the state meet the threshold.** AB 16xxx does not limit the scope of analysis to federal funds provided by the ARRA. Therefore, the CBP believes that any determination as to whether the state will receive federal funds that could offset General Fund spending must consider additional federal funding sources. For example, the recent reauthorization of the Children's Health Insurance Program will provide California with substantial additional federal funding, some of which will offset General Fund spending. The recently signed omnibus appropriations bill also may provide opportunities to identify federal funding that could be used to offset state spending by June 30, 2010. There may be other potential federal funding sources as well. Furthermore, much of the funding included in the ARRA will be distributed through a competitive grant process. California is likely to receive a significant share of this funding, much of which could offset General Fund spending. Yet, the DOF does not attempt to estimate the extent to which ARRA competitive grant funding could help the state meet the \$10 billion threshold.
- **An inconsistency in the DOF's approach to potential revenue increases.** The DOF scores \$7 million in General Fund relief due to the increase in federal SNAP benefits provided by the ARRA. This benefit increase is estimated to boost state sales tax revenues as SNAP households shift a larger share of their incomes from food – which is largely exempt from the state sales tax – to taxable goods. However, the DOF does not apply the same reasoning to other ARRA provisions that will increase Californians' incomes, potentially boosting General Fund revenues above projected levels. UI benefits have increased by \$25 per week, for example, and many UI recipients will receive benefit extensions during 2009 and 2010 that will be fully paid for with federal funds. In addition, more than 5 million Californians who receive Social Security, SSI, and/or other benefits will receive a one-time \$250 federal payment. Furthermore, the ARRA increased funding for federal tax credits for low- and moderate-income families and created a new Making Work Pay credit, all of which will boost Californians' incomes. As a result, these measures could increase General Fund revenues and, therefore, should be included in the analysis under the DOF's approach to this issue.

If you have any questions or comments, please do not hesitate to contact Senior Policy Analyst Scott Graves or me at (916) 444-0500.

Sincerely,

Jean Ross  
Executive Director

cc: John Decker, executive director  
California Debt and Investment Advisory Commission