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SENATE REPUBLICANS' PROPOSAL TO BALANCE THE BUDGET RAISES QUESTIONS

On February 26, 2003, the Senate Republican Caucus released a proposal to eliminate the state's General Fund deficit by 2004-05.[1] The Senate Republicans' plan, unlike Governor Davis' proposal, does not bridge the sizable budget gap in 2003-04, but rather carries forward a deficit of $3.0 billion from 2003-04 to 2004-05. The proposal also rejects the use of new taxes and fees to address the deficit.

This analysis compares the Senate Republicans' proposal for bridging the gap to Governor Davis' January Budget proposal. The Senate Republicans' plan accepts most of the Governor's proposed spending reductions. In addition, the plan includes an unallocated reduction of 7 percent in 2003-04 and a "hard" spending cap of $67.8 billion for at least 2004-05 and 2005-06. The Senate Republicans' plan also rejects the Governor's proposal to shift $8.2 billion in funding responsibilities for health and social services programs to counties, along with the tax increases proposed by the Governor to fund the proposed "realignment." This increases General Fund program obligations in 2003-04 and subsequent years as compared with the Governor's proposal. The Senate Republicans' proposal increases current year spending above the Governor's Proposed Budget by $1.8 billion and 2003-04 spending by $4.7 billion.

The Senate Republicans' plan also rejects several spending reductions proposed by the Governor, including the elimination of the backfill of Vehicle License Fee (VLF) revenues to local governments and the shift of local redevelopment funds to the state General Fund and to schools. The plan also rejects the Governor's assumption that the state will collect $1.5 billion in revenues from Native American gaming activities. The plan balances higher costs and lower revenues in 2003-04 with a spending freeze after 2003-04, even though program obligations will continue to increase. The following analysis assesses the impact of the Senate Republicans' proposal and identifies areas for further consideration.

Issues Raised by the Senate Republicans' Proposal

- ***The Senate Republicans' proposal increases ongoing program obligations in 2003-04 over the Governor's Proposed Budget by $4.7 billion without increasing revenues.*** The Governor's proposal, in contrast, raises $8.3 billion in revenues to help bridge the $18 billion structural gap between revenues and program costs.

- ***The Senate Republicans' proposal does not identify how the 7 percent ($5.1 billion) across-the-board reduction will be accomplished.*** Many program expenditures, such as K-12 Education and California Community Colleges, are subject to constitutional spending guarantees, state or federal provisions entitling services to all who meet eligibility criteria, or federal spending requirements. The plan does not specify whether constitutional protections should be suspended, and, if they are not, where the additional cuts should be made to make up for unrealized savings.

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- ***The Senate Republicans' proposal fails to recognize the impact of rising program costs in 2004-05 and beyond.*** The Legislative Analyst's Office (LAO) estimates that expenditures will increase by $9.4 billion (14.8 percent) from 2003-04 to 2004-05 based on the Governor's proposal, reflecting both policy decisions and growing costs of providing services. The increase includes, for example, the cost of the Governor's proposal to restructure payments to the state's pension systems and the restructuring of the state's debt in 2002-03. In addition, many of the state's programs are driven by enrollment (K-12 and Higher Education) or caseload (Medi-Cal and In-Home Support Services), which often increase faster than population growth. Population growth and inflation alone would add an estimated $3.0 billion in program costs in 2004-05. The spending freeze would likely mean that the Legislature would have to make additional substantial program reductions in 2004-05, perhaps greater than those made in 2003-04.

- ***The Senate Republicans' plan accepts, and expands, the Governor's proposal to save $1.5 billion by restructuring payments to the state's pension systems.*** The Senate Republicans' plan increases the restructuring proposal to $2.5 billion by including $1 billion in payments to the pension systems that are ordinarily made from special funds.[2] The special funds payments would be deposited into the General Fund instead of into the retirement systems. If the restructuring takes the form of pension obligation bonds, the Senate Republicans' proposal to include special funds would increase debt payments in future years over the Governor's proposal. The LAO rejects the pension restructuring proposals, arguing that using debt to fund current spending is unwise fiscal policy.[3]

- ***The Senate Republicans' proposal to defer $1.1 billion in K-12 Education spending from 2003-04 to 2004-05 would reduce Proposition 98 expenditures below the minimum guarantee, which would require suspension of the guarantee in 2003-04.***[4] Suspension of the Proposition 98 guarantee requires a two-thirds vote of both houses of the Legislature and approval by the Governor.

- ***The Senate Republicans' proposal may require suspension of Proposition 98 in 2004-05.*** The LAO estimates that the General Fund share of the Proposition 98 minimum guarantee will increase by approximately $1.1 billion in 2004-05.[5] Therefore, to remain within the Senate Republicans' proposed spending cap in 2004-05, it would be necessary to either suspend the Proposition 98 guarantee again or cut non-Proposition 98 programs by up to an additional $4.1 billion.[6] This amount would result from freezing Proposition 98 General Fund spending at the 2003-04 level proposed by the Senate Republicans, which is $3.0 billion below the LAO's estimate of the General Fund share of the minimum guarantee, and not funding the $1.1 billion in growth to the Proposition 98 guarantee.[7]

- ***The Senate Republicans' proposal includes a switch in the accounting system for Medi-Cal expenditures.*** This shift from accrual to cash accounting would result in one-time savings of $1.1 billion by shifting expenditures from 2003-04 to 2004-05. The accounting shift does not change the actual amount that would be paid to Medi-Cal providers but, by moving expenditures from 2003-04 to 2004-05, it would effectively increase 2004-05 expenditures by $1.1 billion as compared to 2003-04 spending. However, the Senate Republicans' proposal freezes Medi-Cal spending at the artificially low 2003-04 level in 2004-05. Thus, in order to keep General Fund spending frozen in 2004-05, the Legislature would need to find an additional $1.1 billion in reductions in Medi-Cal or other programs.

What Would a 7 Percent Across-the-Board Reduction Mean?

The proposal includes a 7 percent across-the-board reduction for a savings of $5.1 billion. However, the state cannot reduce spending in many programs because they are required by the state constitution or are necessary to fulfill federal spending requirements.[8] In other spending areas, reductions may be limited due to the impact of voter-approved initiatives. For example, California's "Three Strikes" law could limit the ability to cut Corrections. Exempting a small number of expenditures that are strictly mandatory from the proposed across-the-board cuts would require a 9.0 percent reduction in remaining programs, including Corrections, K-12 Education and the California Community Colleges, and Medi-Cal. If the Legislature opts not to suspend the Proposition 98 guarantee, spending in other programs would have to be reduced by 18.6 percent. Examples of the impact of a 7 percent across-the-board cut include:

Education

- A 7 percent reduction to Proposition 98 would result in an additional reduction of $1.8 billion in K-12 Education spending in 2003-04. In combination with the proposed deferral of $1.1 billion, this reduction would lower per-pupil spending by approximately $487. This is in addition to the Governor's proposed $2.2 billion reduction in K-12 Education funding in 2002-03.

Health Programs

- A 7 percent reduction in state spending for the Healthy Families Program means that approximately 50,000 children would lose health coverage.

- The Senate Republicans' plan accepts the Governor's proposal to make sweeping reductions in Medi-Cal eligibility, benefits, and provider rates. The Governor proposes eliminating 18 Medi-Cal benefits, reducing provider reimbursement rates by 15 percent, and reducing eligibility for certain groups not required by federal law. Further reductions would require the Legislature to eliminate other benefits for adults not required by federal law, such as prescription drugs. Medi-Cal spending could also be reduced by eliminating eligibility for pregnant women and infants between 133 and 200 percent of the federal poverty level (FPL), further restricting eligibility for the aged and disabled, or rescinding continuous eligibility for children. Alternatively, the Legislature could reduce provider reimbursement rates beyond the 15 percent cut proposed by the Governor.

Social Services Programs

- A 7 percent reduction in state spending on the Supplemental Security Income / State Supplementary Payment (SSI / SSP) program is equivalent to $162 million. However, California cannot reduce spending in this program because the Governor's proposal lowers SSP payments to the federal minimum. Thus, offsetting reductions of $162 million would have to be made to other programs to meet the Senate Republicans' across-the-board reduction.

- California cannot spend less on the CalWORKs program without being subject to federal penalties.[9] If the state meets its full CalWORKs maintenance-of-effort obligation in 2003-04, approximately $187 million in offsetting reductions would have to be made to other programs to fulfill the proposed 7 percent across-the-board reduction.

- Reductions to Child Welfare Services, food stamps administration, and Medi-Cal administration may put California at risk of penalties for not meeting federal accountability standards. California failed a federal performance review of state Child Welfare Services and foster care programs in 2002 and received a federal penalty because of its high error rate in calculating food stamp eligibility. Cuts to these programs would potentially subject the state to further penalties.

- California is federally required to serve a portion of the In-Home Supportive Services (IHSS) recipients (Personal Care Services Program recipients) with federal Medicaid services. It is unclear how much the state can reduce IHSS and continue to meet federal requirements.

- California could eliminate $110 million in General Fund support for state-only food and cash assistance programs for low-income legal immigrants to offset the inability to cut other social service programs. This would eliminate cash assistance to 11,000 elderly and disabled immigrants and food stamps for 12,000 low-income immigrants.

Local Government

- The state currently backfills the loss of VLF revenues to local governments due to the 1998 reduction of the fee. A portion of the backfill reimburses local governments for programs shifted to counties as part of the 1991 realignment. The Senate Republicans' plan rejects the Governor's proposal to eliminate the non-realignment share of the VLF backfill to local governments. The realignment portion of the VLF backfill cannot be reduced without triggering potential mandate claims. Thus, a 7 percent reduction to the backfill would cost local governments $272 million in general purpose funds in 2003-04. In addition, the LAO estimates the cost of the VLF subvention to be $4.1 billion in 2004-05, of which approximately $1 billion is dedicated to realignment. If the VLF subvention is frozen at the 2003-04 level to remain within the proposed spending cap, local governments would lose approximately $455 million in general purpose funds in 2004-05. Alternatively, the same amount could be cut from other programs to remain within the spending cap.

- The plan includes a $500 million local government "contribution" to the budget solution, which would exacerbate the impact of reductions in state funding for health and social service programs administered by counties. Local governments would be required either to reduce service levels in these programs or cut other locally funded programs such as law enforcement.

Environmental Protection / Resources

- The Senate Republicans' plan rejects the Governor's proposal to replace $58.1 million in General Fund spending with increased fees for programs administered by the Department of Parks and Recreation, the Department of Fish and Game, the Department of Pesticide Regulation, the State Water Resources Control Board, and the Air Resources Board. However, a 7 percent reduction to the Resources and California Environmental Protection Agencies translates into a 20 percent reduction for these agencies from 2002-03.

Public Safety

- While the Governor's Proposed Budget left public safety relatively untouched, the Senate Republicans' proposed 7 percent reduction would translate into reductions of $360.6 million from the Department of Corrections, $21.1 million from the Department of Justice, $4.5 million from the Office of Criminal Justice Planning, and $3 million from the Military Department.

SENATE REPUBLICAN PLAN INCREASES COSTS IN 2004-05

Certain proposals in the Senate Republicans' plan would increase or defer costs in 2004-05 and subsequent years.

- ***Proposition 42:*** The Governor proposes to *suspend* a General Fund transfer of $1.1 billion in 2003-04 to transportation funds as required by Proposition 42. The Senate Republicans' proposal *defers* the transfer, meaning that the state would be required to make the transfer at a later date. The Senate Republicans' plan, absent suspension or deferral in 2004-05, would require the 2003-04 and the 2004-05 transfers to occur in 2004-05. Thus, in order to remain within the proposed spending cap, $1.1 billion, in addition to the amount required by Proposition 42 to be transferred in 2004-05, would have to be reduced from other programs in 2004-05.

- ***State Mandates:*** The plan proposes to *eliminate* state-mandated programs that have costs for local governments. Conversely, the Governor's proposal *defers* payment for these programs without eliminating the mandates. While the elimination of the mandates would eliminate future state costs related to these programs, it would not reduce the state's more than $1.2 billion obligation to reimburse local governments for past mandate claims for programs already implemented by local governments. The Senate Republicans' plan also defers these payments in 2003-04 but does not change the obligation to pay them in the future. If these payments were made in 2004-05, more than $1.2 billion would have to be reduced in other programs in order to remain within the spending cap.

David Carroll and Delaine McCullough prepared this Budget Brief. *The California Budget Project (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 California Budget Project is provided by foundation grants, individual donations, and subscriptions.* *Please visit the CBP's web site at www.cbp.org.*

ENDNOTES

[1] Estimates of the budget shortfall for the current and budget years range from the Legislative Analyst's Office (LAO) projection of $28 billion to the Governor's forecast of $34.6 billion.

[2] The Public Employees' Retirement and the State Teachers' Retirement Systems.

[3] Legislative Analyst's Office, *Analysis of the 2003-04 Budget Bill* (February 2003), p. F-16.

[4] If the guarantee is suspended as proposed in the Senate Republicans' plan, the Proposition 98 "maintenance factor" would increase above its current level of $3.5 billion. A "maintenance factor" occurs in years when the funding provided for Proposition 98 is below the level that would have been required under the "Test 2" calculation, which is the funding level in years with average General Fund revenue growth. In order to avoid an ongoing reduction in the guarantee level, the maintenance factor, which is equal to the difference between the Test 2 level and the actual funding level, is restored over time. The level of funding required to restore some or all of an existing maintenance factor is determined, in part, by the growth in General Fund revenues. Under the revenue estimates used as the basis of the Senate Republicans' proposal, increasing the maintenance factor would not increase the level of restoration required in 2004-05, but it would extend the obligation to restore the Proposition 98 guarantee further into the future.

[5] The LAO estimate is based on the assumption that the Legislature reduce 2002-03 Proposition 98 spending to the LAO estimate of the minimum guarantee of $43.8 billion.

[6] The Proposition 98 guarantee is funded with a combination of state General Fund and local property tax revenues. Therefore, the level of non-Proposition 98 General Fund reductions that may be required under the Senate Republicans' plan could be higher or lower depending on the actual amount of local property tax revenues.

[7] The $3.0 billion difference is due to the $1.1 billion deferral to 2004-05 and the 7 percent, or $1.9 billion, reduction in 2003-04 Proposition 98 General Fund spending.

[8] These programs include state contributions to state employees' retirement plans; debt service; health and dental benefits for state retirees; Court and Federal Mandates; Temporary Assistance for Needy Families (TANF) maintenance-of-effort spending; the federal minimum spending on State Supplementary Payment recipients; special education expenditures required to meet federal requirements; and reimbursement to local governments for property taxes lost as a result of the homeowners' exemption.

[9] California's TANF block grant would be reduced by the percentage by which it does not meet its MOE requirement of $2.7 billion. It would also have to repay the amount by which it does not meet its MOE in the following year.