



May 20, 2010

## Moving California Forward . . . Or Backwards?

The Legislature is currently reviewing a set of recommendations, sponsored by the organization California Forward, that make a number of significant changes to the budget process. Some would be made in the state constitution, and thus could only be changed by the voters; others would be made in statute and could be changed by the Legislature. Some are “hard” changes, while others appear to impose certain requirements, but contain significant loopholes that would significantly limit the impact of various provisions.

This analysis is based on the text of ACA 4 (Feuer, Perez, and Bass) as amended May 10, 2010 and AB 2591 (Feuer and Perez) as amended May 10, 2010. These measures are designed to implement the recommendations of California Forward. Note that provisions contained in the constitutional amendment could only be changed by a subsequent vote of the people. Changes made to the statutory measures passed as part of the package could be changed by a vote of the Legislature. If the voters approve ACA 4, both measures would take effect January 1, 2011.

### By Way of Background

The California Forward package would change a number of the rules that govern the budget and budget process. In order to understand what these changes would mean, it is useful to review some key features of existing law:

- The Budget Act and any other bill that appropriates money from the General Fund for a purpose other than “public schools” must be approved by a two-thirds vote of the Legislature.
- The Budget Act is a bill that appropriates money and that remains in effect for a single year. The Budget Act does **not** include any policy changes needed to implement the budget and does not include tax policy changes needed to generate the funds needed to provide adequate resources to support the budget. Tax and fee changes needed to implement a budget agreement must be made in separate legislation.
- Bills, other than certain tax law changes, that take effect immediately require an “urgency clause” and must be approved by a two-thirds vote of the Legislature. Many budget “trailer bills” require urgency clauses in order to implement a budget agreement on a timely basis.
- Proposition 58 of 2004 requires the state to establish a Budget Stabilization Account (BSA) and to make deposits into the BSA until the balance reaches the greater of \$8.0 billion or 5 percent of General Fund revenues for a given year. The Governor can suspend or reduce a transfer into the

- BSA by executive order and funds can be transferred out of the BSA in a bill passed by a majority of the Legislature and signed by the Governor.

## What Does the California Forward Package Do?

### Change the vote requirement for passage of the budget and budget implementation bills

ACA 4 changes the vote requirement for legislative approval of the budget and “budget implementation” bills that take effect immediately from two-thirds to a majority. The vote requirement for measures that increase state tax revenues would stay two-thirds.

A “budget bill” is defined as a bill that makes appropriations for the support of the government of the State for an entire fiscal year, including “a bill that contains only provisions amending or augmenting an enacted bill that made appropriations for the support of the government of the State for an entire fiscal year.” A “budget implementation bill” is defined as a measure that only contains changes in law necessary to implement a specific provision of the budget bill.<sup>1</sup>

**Comments and concerns:** The vote requirement for any measure that increases state taxes would remain two-thirds. Changing the vote on the budget, but not tax increases, could lead to even more “all cuts” budgets, particularly in combination with the change in vote requirements for fees described below. Signatures placing a measure on the ballot changing the vote requirement for the budget and bills implementing the budget to a simple majority were filed with the Secretary of State on May 7, 2010. If the Secretary of State determines that sufficient signatures have been filed, this measure will go on the November 2, 2010 ballot.<sup>2</sup>

### Change the vote requirement for fees to two-thirds

ACA 4 requires a two-thirds vote to impose any fee “if revenue from the fee would be used to fund a specific program, service, or activity that was previously funded by revenue from a tax that is repealed or reduced in the same fiscal year or in the immediately preceding fiscal year.”

**Comments and concerns:** As drafted, this would change the vote requirement for virtually all fee increases from a majority to two-thirds, thus further limiting the Legislature’s ability to raise revenues to help balance the budget. The limitation would potentially apply to a fee supporting any program that receives any money out of the state’s General Fund, since there are reductions, sometimes large, sometimes small, in General Fund taxes every year.<sup>3</sup> ACA 4 does not establish a minimum threshold for a tax cut that would trigger the conversion of the vote requirement for a fee from a majority to two-thirds, thus, any tax cut no matter how small would shift the vote requirement for fees to two-thirds.

### Require spending increases and tax cuts to be “paid for” – maybe

ACA 4 would require initiatives that increase state costs or decrease state revenues by more than \$25 million to provide for “additional revenues in an amount that meets or exceeds the net increase in costs.” This requirement

<sup>1</sup> Budget implementation bills “could not be used to create or abolish any office or change the salary, term, or duties of any office, or grant any franchise or special privilege, or create any vested right or interest.”

<sup>2</sup> See <http://www.endbudgetgridlock.com>.

<sup>3</sup> Some General Fund tax cuts are small, such as measures providing preferential treatment to individuals affected by natural disasters.

would not apply to costs attributable to the sale and repayment of bond debt. ACA 4 also requires legislative constitutional amendments and bills that result in a net increase in “qualified state costs” or a net decrease in revenues in excess of \$25 million to contain “provisions that would result in state program reductions, or additional state revenue, or both... in an amount that is equal to or greater than the net increase in qualified state costs or net decrease in revenues.” This requirement also excludes measures authorizing the sale of bonds. For initiatives, the Legislative Analyst and the Department of Finance would jointly make the determination of whether a measure meets the \$25 million threshold, which would be adjusted for inflation. For legislation, AB 2591 outlines a process by which legislation would be referred to the Legislative Analyst for review, but would leave the discretion of whether a measure would be reviewed up to the fiscal committees of each house of the Legislature. The Legislature could also, by a two-thirds vote, make a “finding” that a measure should be “deemed in compliance” with the pay-as-you-go requirement. AB 2591 also exempts restoration of prior years’ funding reductions from the pay-as-you-go requirements, but only to the extent that spending is increased to level at which it was at prior to the reductions.

The “pay-as-you-go” requirement would not apply to the budget act, budget implementation bills, appropriations that count toward the Proposition 98 guarantee, or “an emergency declared by the Governor.”<sup>4</sup> Note that there is no constitutional exemption for appropriations required by federal law. The “pay go” requirement would not apply to spending growth required by state or federal laws in effect as of the operative date of AB 2591 (but not spending growth required by federal laws passed after that date); increases related to workload and inflation; and increases related to state employee union contracts approved by the Legislature.

**Comments and concerns.** The exemptions are sufficiently broad so as to give the Legislature full discretion as to when to follow, and when to ignore, the pay-as-you-go requirement. Spending increases or tax cuts enacted as part of a budget agreement would not be subject to “pay go.” This would likely push even more decision-making out of the policy committee process and into budget agreements, where there is little opportunity for public comment or review. The “dark-of-night” tax deals that occurred in September 2008 and February 2009 would not have been subject to “pay-go,” since they were enacted in “budget implementation bills.” Measures that don’t impose a cost in the first or second year – but which have significant costs in future years – would also be exempt.

The exclusion for bond measures, including initiatives that authorize bonds, is also a major loophole. Bond debt service is one of the fastest growing areas of the budget and debt service payments as a share of the budget are now far beyond levels normally considered prudent. Since bonds impose a 20 to 30 year spending obligation on the budget they should, if anything, be subject to tougher not weaker restrictions.

### **Give governors unilateral authority to cut spending in the event of a mid-year shortfall**

ACA 4 gives governors the unilateral authority to reduce or eliminate any “unexpended appropriation” that is not required by the state constitution or federal law in the event the Legislature fails to send the Governor a bill addressing a fiscal emergency declared by the Governor within 45 days. The Governor could not reduce appropriations by more than the amount of the discrepancy between anticipated spending and revenues and a gubernatorial reduction could be overridden by a two-thirds vote of the Legislature.

**Comments and concerns.** This provision would give the Governor sweeping power to cut spending with only minimal limitations. While the Legislature can block the use of this power by passing a bill responding to the Governor’s declaration of a fiscal emergency regardless of whether the Governor signs that bill, ACA 4 would permanently change the state constitution. If, for example, the partisan composition of one house of the Legislature

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<sup>4</sup> There appears to be a drafting error in this section, presumably the exclusion should apply to appropriations made in response to an emergency declared by the Governor.

were to change, that house could block passage of a measure that satisfies the constitutional requirements and thereby allowed the Governor to make unilateral reductions. As drafted, ACA 4 does not exclude payments to local governments or amounts specified in contracts with state employees or vendors.

### **Either creates a tough spending cap or does little at all to limit the use of “unanticipated revenues”**

ACA 4 requires the Director of Finance, no later than May 31 of each year, to estimate General Fund revenues for the current fiscal year, the current-year impact of any tax legislation enacted after the passage of the budget, and the balance in the state’s reserve as of the end of the current fiscal year. “Unanticipated revenues” are defined as the lesser of a) the estimate of General Fund revenues for the current year, as estimated by the Director of Finance on or before May 31, minus the estimate of General Fund revenues contained in the budget act at the time of its passage by the Legislature “augmented by” the revenue impact of any tax legislation approved during the fiscal year subsequent to the passage of the budget and which was not taken into account in the revenue estimate contained in the budget bill, or b) the estimated balance in the state reserve.

“Unanticipated revenues” must be used first to satisfy any Proposition 98 obligations related to the unanticipated revenues; any remainder would then be transferred to the Budget Stabilization Act up to the targets currently established in the constitution; and any remaining amounts could be used to retire outstanding “budgetary indebtedness.” ACA 4 defines budgetary indebtedness as unfunded prior-year obligations under Proposition 98; property taxes owed to local governments under the suspension provisions of Proposition 1A of 2004; repayment obligations related to the suspension of the transfer of sales taxes on gasoline to transportation programs pursuant to Proposition 1A of 2006 (note this transfer no longer occurs as a result of the gas tax swap approved earlier this year); repayment of outstanding economic recovery bonds; or specified one-time purposes including one-time tax cuts, repayment of general obligation bond debt, or capital outlay projects.

**Comments and concerns.** By limiting the use of funds in the reserve at the end of the fiscal year, ACA 4 would severely restrict the state’s ability to use revenues generated during periods of strong economic growth to restore spending reductions or fund new program initiatives. However, some would note that transferring funds into the BSA and then immediately transferring funds out, which can be done by majority vote, could circumvent this limitation. In circumstances where there is legislative agreement to spend these funds, the impact of limiting the use of “unanticipated revenues” may be minimal. However, there have been major battles over the use of funds in budget reserves in a number of states, including those that require a simple majority vote for appropriations. Under ACA 4, one house of the Legislature could block action on a measure transferring funds out of the BSA or the Governor could veto a bill that would transfer funds out of the reserve if he or she viewed maintaining the reserve to be a higher priority than any purpose for which the funds might be spent. As in past measures, such as Proposition 1A of 2009, this measure restricts the use of “unanticipated revenues” projects aimed at capital, rather than human, investment.

### **Prohibit payment of lawmakers’ salaries or expenses in the event of a late budget**

ACA 4 requires the Legislature to “consider” the budget bill and any bills implementing the budget and to refer them to a two-house conference committee no later than May 1. The conference committee would be required to report its commendations to the Legislature no later than June 20, and the Legislature would be required to pass a budget and budget implementation bills no later than June 25. If this does not occur, the Legislature would permanently forfeit its pay, per diem, and reimbursement for travel expenses until the budget is passed and sent to the Governor.

## **Requires all state agencies to use “performance based budgeting”**

AB 2591 mandates across-the-board use of “performance based budgeting methods” and outlines criteria that would be used, mandates a training process for executive branch employees, and outlines a process that would be used. Beginning in 2014-15, AB 2591 states that the “amount of each appropriation made in the Budget Act... shall be determined after considering performance-related data.”

**Comment:** No other state uses performance-based budgeting this broadly. Moreover, academics and other public budget experts are divided as to whether performance-based budgeting works and most argue that it should be used as “a” tool to assess whether programs and policies are effective, but not as “the” sole or primary basis for making funding decisions. The approach outlined in AB 2591 makes no provision for determining whether current funding levels are sufficient to achieve program goals and/or demands or the extent to which poor outcomes reflect lack of resources or factors that are beyond the control of program administrators. Finally, it is worth noting that the process required by AB 2591 makes no provision for input by stakeholders or the public.