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Economic Impact of Human Services Budget Reductions

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Human Services Committee

Hon. Carol Liu, Chair

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General Impact of Budget Solutions

- ☑ ***Most Budget Solutions Dampen Economic Growth.*** Regardless of program area, budget cuts reduce spending which then reduces demand in the overall economy for labor, goods, and/or services. Tax increases take money from the private sector and may create disincentives to expand or maintain business activity. Spending reductions and tax increases result in some level of economic contraction.

- ☑ ***State Budget Small in Comparison to California's Economy.*** The state General Fund is approximately $86 billion for 2009-10. This is about 5.4 percent of the entire California economy. When special and federal funds are considered, the total state budget represents about 14 percent of the California economy.

- ☑ ***Constitution Requires Balanced Budget.*** Because the budget must be balanced, the Legislature is forced to make difficult decisions when comparing potential budget solutions. These decisions often involve which solutions would be the least detrimental. Generally, the Legislature should focus on the primary effects that a solution has on service levels and/or benefits. Potential secondary effects, such as impacts on the economy, should usually be subordinate to the evaluation of the primary effects.

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Economic Impact of Social Services Reductions

- ***$2.7 Billion in Social Services Solutions.*** For the special session, the Governor proposed $1.5 billion in expenditure reductions and $1.2 billion in fund shifts affecting social services programs.

- ***Reductions in Social Services Present Certain Economic Issues.*** Like any budget reduction, a social services cut reduces demand and works against economic growth. However, social services reductions have characteristics that in part distinguish them from other types of reductions. These are (1) the potential loss of federal funds and (2) the high propensity of low-income families to spend.

- ***Substantial Loss of Federal Funds.*** If adopted, the Governor's proposals would result in the loss of $2.9 billion in federal funds during 2010-11. The federal fund losses are from reducing services in In-Home Supportive Services (IHSS) ($2.4 billion) and the 15.7 percent grant reduction ($0.5 billion) in the California Work Opportunity and Responsibility to Kids (CalWORKs) program.

- ***Low-Income Families Have a High Propensity to Spend.*** Most social services programs are targeted toward low-income families or individuals. Moreover, the providers of IHSS services tend to be low-income as well. Low-income families tend to spend almost all their income, potentially resulting in greater effects from their spending. Reducing income maintenance payments, such as a CalWORKs grant reduction, reduces aggregate demand.

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Revenue Impacts

- ☑ ***Direct Sales Tax Impact.*** Research suggests that low-income families spend about 45 percent of their income on taxable goods. The state portion of the sales tax is temporarily 6 percent but will return to 5 percent in July 2011. Given this taxable expenditure pattern, every $100 in benefit payments (such as a CalWORKs or Supplemental Security Income/State Supplementary Payment grant) in the future will result on average in $2.25 in sales tax revenue.

- ☑ ***Example: Direct Revenue Loss From CalWORKs Grant Reduction.*** For 2010-11, the Governor's proposed grant reduction saves about $600 million, mostly in federal funds due to the 80 percent Emergency Contingency Fund match available pursuant to the American Recovery and Reinvestment Act. Recipient expenditures of these funds would result in about $16 million in sales tax revenues.

- ☑ ***Potential Indirect Economic Effects.*** Beyond the sales tax revenues, there could be additional revenues associated with secondary effects from the initial spending. For example, grant recipients spend these funds with area merchants. This could increase merchant profits and/or lead to expansion of the merchant's business. Such economic activity could lead to additional state revenues.

- ☑ ***Attempting to Quantify Indirect Revenue Effects.*** Historically, about every $100 in personal income in California is associated with about $5 in General Fund revenue. The secondary economic effects of grant payments could increase the total revenue impact from 2.25 percent to as much as 5 percent. Such revenues would lag the direct sales tax revenues and might not accrue until a subsequent fiscal year.

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Employment Effect From Certain Social Services Reductions Proposals

- ☑ ***Reduction in Aggregate Employment.*** Most spending reductions result in some level of reduced employment. For example, a reduction in education support reduces demand for teachers, aides, and other school employees. However, not all of the reduction would occur in staff. There would also be reductions in demand for equipment, textbooks, and training.

- ☑ ***IHSS Is Labor-Intensive.*** The average IHSS worker makes about $10 per hour. There are about 360,000 IHSS workers. Of the $5.4 billion in total expenditures for the program, about 85 percent is paid out in wages.

- ☑ ***Proposed IHSS Reduction.*** The Governor's budget proposes to restrict eligibility to the most severely impaired, resulting in an 87 percent reduction in the caseload.

- ☑ ***310,000 Jobs at Stake.*** If adopted, the Governor's proposal would directly result in the loss of over 310,000 jobs of IHSS workers.

- ☑ ***IHSS Workers Entitled to Unemployment Insurance (UI) Benefits.*** About 60 percent of affected IHSS workers have no other employment and would have had a sufficient history of earnings to qualify for UI benefits. This would further stress the state's already insolvent UI fund.

- ☑ ***Effect on State Unemployment Rate.*** The Governor's budget forecasts that the unemployment rate will be 12 percent during 2010. If adopted, this proposal would increase the unemployment rate to as high as 13.2 percent.

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Issues for Legislative Consideration

Overarching Issues

- The economic impact of a proposed budget solution may be significant and it is worthy of consideration by the Legislature.
- However, we recommend that, in evaluating proposed budget solutions, the Legislature focus on the primary fiscal effects and the likelihood of achieving savings from those actions.
- Economic effects should be considered as secondary.
- Other secondary effects that should be considered by the Legislature include (1) the potential for cost shifts to other state programs, (2) cost shifts to other levels of government, and (3) the effect of the proposed actions on the state's receipt of federal funds.

IHSS as Case Study

- The economic impacts of the IHSS reduction proposed by the administration are significant, but we recommend against this proposal for other reasons.
- As we have explained in our January report, *Considering the State Costs and Benefits: In-Home Supportive Services*, the complete elimination of IHSS (or the dramatic reduction in eligibility proposed in the Governor's budget plan) would likely lead to offsetting costs that more than outweigh the savings from its elimination. Given the magnitude of this proposed reduction, we find that it would likely result in costs in developmental services and skilled nursing facilities that would more than offset the savings in IHSS.
- The administration's IHSS proposal has substantial legal risks.
- The IHSS proposal results in the loss of about $2.4 billion in federal funds while achieving General Fund savings of about $650 million.