

December 10, 2010

Hon. Robert Dutton
Senator, 31st District
Room 305, State Capitol
Sacramento, California 95814

Dear Senator Dutton:

You asked our office to provide an analysis of “underlying” General Fund expenditures relative to the expenditures displayed in the budget act and other supporting documents. For purposes of this analysis, underlying expenditures represent the level of programmatic spending once federal funds, deferrals, and other tools the state has used to reduce General Fund spending and maintain program funding are removed.

Basis for Our Estimates

We have used as a starting point Department of Finance Schedule 9—the official scoring detail of General Fund expenditures—and made adjustments based upon our knowledge of funding shifts that took place in the three fiscal years from 2008-09 to 2010-11. It is important to note, however, that some information, such as the amount of federal funds used to fund a program, are estimates of the actual amounts, as final confirmation of funding often does not happen until several years later.

Base Year Taken as 2007-08. In discussions with your staff, we narrowed our focus to fiscal years 2008-09, 2009-10, and 2010-11. As such, any deferrals, accounting changes, or other shifts that were in place in 2007-08 are not reflected. The General Fund expenditure base in 2007-08 was \$103 billion.

Focus on Major Changes. The scale of the state’s recent fiscal problems has required the adoption of a long list of budget solutions, fund shifts, and deferrals. For the purposes of this analysis, we have focused on the major changes and as such, our list of adjustments is not exhaustive. We have captured, however, most changes that likely account for the vast majority of General Fund expenditure supplanted or delayed.

Only Temporary Shifts Captured. As you requested us to reflect where reported General Fund expenditure amounts do not reflect true, ongoing programmatic expenditures, we have not included any permanent shifts away from General Fund support, such as a permanent shift to a special fund source. For the most part, shifting General Fund expenditures to fund sources that align a beneficiary or service recipient with a fee or charge can sometimes be an appropriate budgetary action.

Caseload and Inflation Growth. In comparing 2007-08 expenditures with 2010-11 expenditures, it is important to consider the impacts of both caseload changes (demand for services such as California Work Opportunity and Responsibility to Kids [CalWORKs]) and inflation costs. For example, we show that in 2007-08 General Fund expenditures were \$103 billion. If the state were to spend \$103 billion in 2010-11, this may not represent a similar level of service provision due to the effects of increasing caseload and inflation. In recent years, programs such as CalWORKs and Medi-Cal have seen significant increases in the number of program participants due in part to the condition of the state's economy. Therefore, it is likely that a flat level of total funding for these programs translates to a reduced level of program service to an individual participant. Also, while the consumer price index and other inflation measures may have been low over the period, certain state expenses such as Medi-Cal have been subject to a higher rate of inflation.

Estimate of Underlying General Fund Expenditures

As shown in Figure 1, we estimate that the underlying level of General Fund expenditures has remained fairly constant at around \$99 billion after the initial cut of some \$4 billion between 2007-08 and 2008-09. There are four main categories of adjustments that we made:

- **Federal Funds.** California has received significant amounts of federal funds that have been used to supplant General Fund expenditures since 2008-09—mostly in the health and human services areas. We estimate that over the period 2008-09 to 2010-11, the state was able to replace around \$5 billion of General Fund expenditures annually with federal funds.
- **Local Government Funding Shifts.** The 2009-10 budget package redirected two sources of local government funds: (1) property taxes by borrowing funds under the provisions of Proposition 1A (2004) and (2) redevelopment dollars. In 2009-10 a total of \$3.6 billion of General Fund relief was provided between these two sources, and in 2010-11 an additional \$350 million of relief will be achieved. We discussed the mechanics of these funding shifts in our publication *The Budget Package: 2009-10 California Spending Plan*.
- **Deferrals.** In the last three years, the state has deferred payments to schools and to certain Medi-Cal providers across fiscal years to achieve budgetary savings. In addition, the 2009-10 budget package deferred state worker pay by one day from June 30, 2010 to July 1, 2010—again for budgetary savings. The Legislature also has enacted a number of deferrals to payments within years for cash purposes that we have not included in our analysis, as they do not affect the overall fiscal year expenditure.
- **Unachievable Budget Solutions.** As we described in our *2011-12 Budget: California's Fiscal Outlook*, there are a number of budget solutions contained in the most recent budget package that we estimate will not be achieved. For 2009-10 we estimate this amount to be around \$700 million and to be around \$6 billion in 2010-11.

Figure 1
LAO Estimates of Major Adjustments to General Fund Expenditures to Reflect Underlying Programmatic Expenditures
(In Billions)

	2007-08	2008-09	2009-10 ^a	2010-11 ^b
Schedule 9 General Fund Expenditures	\$103.0	\$90.9	\$86.3	\$86.6
Federal Funds ^c				
Health programs		2.4	4.0	3.5
Social services programs		0.8	0.8	0.4
CalWORKs TANF acceleration		—	—	0.4
UC and CSU		1.4	—	0.2
Judicial and Criminal Justice		0.7	0.4	—
Local government funding shifts		—	—	—
Proposition 1A		—	1.9	—
Redevelopment/schools funds shift		—	1.7	0.4
Deferrals		—	—	—
One-day deferral of June 2010 state worker pay		—	0.9	—
Proposition 98 inter-year deferrals ^d		2.9	1.7	1.8
Medical checkwrite delay ^e		—	—	0.3
LAO Estimates of Unachievable Budget Solutions ^f		—	0.7	6.0
Subtotals, Adjustments		(\$8.3)	(\$12.1)	(\$12.9)
Adjusted Schedule 9 General Fund	\$103.0	\$99.2	\$98.5	\$99.5

^a Estimated.
^b Enacted.
^c LAO estimates of federal funds used to supplant General Fund expenditures. Actual federal funds expenditure information often takes several years to be confirmed.
^d In 2001-02, the state deferred \$1.3 billion in K-14 education costs to the subsequent fiscal year. As these deferrals are included in the base for 2007-08 we have not adjusted for this deferral.
^e Since 2004-05, the last checkwrite in June of the fiscal year has been delayed until the start of the fiscal year. In addition, in the combined solutions for the 2007-08 and 2008-09 budget, an additional delay of a checkwrite for Medi-Cal was included. As these delays are included in the 2007-08 base, we have not adjusted for the delay. The delay shown for 2010-11 includes two new delays: one related to mandatory enrollment into managed care (\$187 million) and one related to payments for institutional providers (\$120 million).
^f Based on LAO November 2010 forecast and assumes that where General Fund savings (either program reductions or federal fund backfills) are not achieved, the General Fund will be the funding source. Also includes estimated impacts of Propositions 22 and 26 passed after the enactment of the budget.

UC = University of California; CSU = California State University; TANF = Temporary Assistance for Needy Families; CalWORKs = California Work Opportunity and Responsibility to Kids.

Implications for the 2011-12 Budget

As we described in our *2011-12 Budget: California's Fiscal Outlook*, we forecast that under current law and policies, the state will face an estimated deficit of \$25 billion in 2011-12 caused, in part, by the removal of the General Fund offsets described above. We characterized these changes as temporary in nature and therefore they did not address the underlying structural deficit in the California budget. As discussed in our *Fiscal Outlook*, we recommend that the Legislature consider a multiyear approach to reducing the ongoing deficit that combines a mix of permanent and temporary solutions. As such, some types of temporary shifts like those shown in

Hon. Robert Dutton

4

December 10, 2010

Figure 1 will likely still be needed in order for the Legislature to close the deficit, at least in the near-term.

If you have any questions about this letter, please contact me or Jason Sisney of my staff at 319-8361 (jason.sisney@lao.ca.gov).

Sincerely,

Mac Taylor
Legislative Analyst