CITIZENS'
Budget
2003–05

A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities

Reason

The Performance Institute

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Part 8

Implement Health and Social Welfare Reforms

"With no one in charge, the foster care system fumbles forward, and often backwards, and costs children and families their happiness, their prosperity and even their lives. It is imperative that the Governor and Legislature clarify who is responsible for the children and families in the foster care system. Without that clarity, millions of dollars and millions of hours will continue to be wasted."

—Little Hoover Commission, 2002

Summary of Citizen Budget Recommendations in This Section:

1. Implement **Recovery Auditing and Fraud Reduction** efforts to reduce erroneous payments in the state health and social service programs.
2. Expand **Realignment of Health and Social Service Programs** to encourage cost savings, better service and local flexibility.
3. Implement **Competitive Sourcing and Performance-based Contracts** for all health and social services to eliminate cost-reimburse arrangements that encourage over-spending.
4. Improve **Child Support Enforcement** to reduce state compensating for parents unwilling to support their own children.
5. Follow the Wisconsin Works model for Long-term welfare reform by **Strengthening Work Requirements for Beneficiaries** and increasing the use of private vendors for program administration.
6. Consider participation in the **Independence Plus Demonstration Program** offered by the U.S. Department of Health and Human Services to reduce costs.

California Budget FACTS:



$1.3 billion
Estimated federal fines the state will accumulate by 2006 for the poor performance of its child support system

$115.8 million
Amount of federal fines California was assessed last year for operating "the most error-plagued food stamp program in the nation"

$3 billion
Amount spent on a foster care system that even the Secretary of the Health and Human Services Agency admits is broken

3
Number of people who participated in the $62 million department of Consumer Affairs Low-Income Repair Assistance Program

Second only to education, the state spends billions each year on a myriad of health and social service programs. Funding these programs and ensuring they deliver high performance is crucial to safeguarding California's quality of life. There are currently about 6.5 million people, just over one in five Californians, who qualify for Medi-Cal in any given month. While California has one of the most generous entitlement and welfare programs in the nation, the performance of many of our health and social services has been dismal.

Two-thirds of the states are cutting Medicaid benefits, increasing co-payments, restricting eligibility or removing poor people from the rolls.[123] Governor Davis plans on eliminating some optional services like hospice care, optometry, physical therapy, prosthetics and hearing aids. (It should be noted that nationwide, about 70 percent of all Medicaid spending is optional, covering either beneficiaries that do not have to be covered, or services that do not have to be covered, or both.[124] Since the average state currently spends 19.6 percent of its budget on Medicaid,[125] almost 14 percent of Medicaid spending could be saved in an average state by eliminating optional people and optional services.[126])

Yet, drastic cuts might not have to equate to the elimination of key services. Indeed, health and social service programs provide numerous opportunities for fundamental reforms. As such, the Citizens' Budget provides recommendations for reforming health and social services to achieve the reductions proposed by the Governor without cutting any services.

Realignment to Appropriate Level of Government

The current fiscal climate shares many similarities that Gov. Pete Wilson faced during his 1991 inaugural year. He inherited a $14 billion deficit and had to implement a plan immediately. His plan called for devolving 12 percent of state programs down to the control of local authorities where they could be managed better. Faced with a similar situation, Gov. Davis has taken a page from Wilson's playbook. He is asking counties to take over court security and realigning the mental and physical health programs administration from the state to the auspices of the county.

The concept is a great one, i.e., most actually argue for more local control over programs and expenditures. Davis's realignment resembles Wilson's plan, but his methods and internal motives are different. For example, while ceding responsibility for many social services including health care to counties, Davis and his administration will still determine the rules of the game the counties have to play by. The 58 counties are fighting realignment because there is little discretion and ultimately there is no accountability or guarantees that the money will flow.

Davis's plan also calls for the money to go straight to the local authorities. Of the $8.2 billion in new tax revenue, $7.9 billion has been slotted by Davis to go to the counties, $300 million will go to the courts for security and $100 million will generally compensate municipalities for lost sales tax. However, Davis' plan does not avoid Proposition 98 requirements, meaning that 50 percent of all tax revenues would have to be allocated for K-12education.

Still, the largest difference between Wilson's and Davis's plan is the term of the tax increases. Wilson did ask for some tax increases, but they were minor and short term. Davis is using realignment not to improve efficiency or improve programmatic results but rather as a mechanism to raise tax revenues. Furthermore, in order for realignment to work, the local governments (i.e., counties) need authority over the programs—they cannot simply function as administrators of state programs. Counties need the flexibility and ability to control the programs and administer them as they see fit.

The Governor's realignment plan begs the question: given that local control is such a great thing because it means local accountability and allows decisions to be made based on the needs and resources of each community (the counties, in this case), why then must the money be funneled through Sacramento? This only serves to whittle down resources by unnecessarily passing funds through another layer of bureaucracy

at the state level and making appropriations subject to political pressures and interest groups. If local control truly is the goal—as it should be—then the counties should be allowed to both raise and spend money for such "realigned" programs locally. The state government would still have regulatory oversight of these programs, but such an arrangement would provide genuine local control without the state's strings attached.

The Citizens' Budget plan strongly endorses the realignment of the services proposed by the Governor through block grant to local government. While funding would still be provided through the General Fund, services should improve and cost efficiencies realized. However, the Citizens' Budget does not count on these cost savings to achieve a balanced budget—choosing to reinvest them into the programs instead as an "efficiency dividend."

Reduce Fraud through Recovery Auditing

The state of California is losing billions each year in erroneous and fraudulent claims in our health and social service programs. To boot, the federal government has cited California's fraud and error problems through millions in fines levied on the state!

Medi-Cal

The General Accounting Office estimates that fraud and abuse may be a high as 10 percent of Medicaid spending.[127] Likewise, at the state level, Medi-Cal fraud costs the state in excess of $1 billion annually. Several programs provide no-cost Medi-Cal to people who are not eligible. The Accelerated Enrollment Program will cost in excess of $10 million as a result of ineligible persons receiving benefits while the CHDP Gateway to Medi-Cal will cost in excess of $137 million to provide two months of Medi-Cal eligibility to people who have not even submitted a Medi-Cal application. If fraud can be eliminated in these two areas a $147 million will be saved. If an additional 10 percent of fraud is eliminated, that is another $100 million, for a total savings of $247 million. While savings cannot be guaranteed, it is important to highlight nonetheless.

Food Stamps

Another program that has been susceptible to federal fines is California's administration of the federal food stamp program. Last year, the state was reprimanded to the tune of a $115.8-million fine for operating "the most error-plagued food stamp program in the nation."[128] California's 17.4 percent error rate was over twice the national average of 8.66 percent. The fine was the largest ever imposed by the program, which dates back to the 1960s.

According to Eric Bost, U.S. Agriculture Department undersecretary for nutrition programs, negotiations between the state and the federal government would reduce the fine, but California would still end up paying at least 40 percent, or $46 million, of the fine.[129] The penalty comes on top of a $47.4-million fine, which was later reduced to $11.8 million, imposed for the state's second-worst-in-the-nation performance for the previous fiscal year.

So how can California tackle its fraud and error rates in these and other programs? As outlined in a previous chapter, recovery auditing can substantially address the problem of payment errors and fraud—not only

collecting overpayments but improving internal controls to prevent them in the future. In addition, the Citizens' Budget strongly endorses outsourcing of fraud and error detection efforts. Oftentimes, state employees (who created the problem in the first place) are too close the problem to improve the situation. Moreover, contracts should be performance-based, using the "Share-in-Savings" model where the contractor only gets paid by identifying and correcting fraud and errors.

Improve Child Support Enforcement

One area where fraud and payment obstacles must be addressed is at the new Department of Child Support Services, which was created to administer the child support collection program in an attempt to improve upon a child support collection rate that was for years the worst in the nation. During its first full year in operation in 2001, the new program collected and delivered $1.1 billion in monthly payments, a collection rate of 40 percent. That rate is actually 1 percent below the rate for 1999.[130]

In addition, the state has been racking up federal fines since 1998-99 because it has not complied with the federal Family Support Act of 1988, which required the states to develop a statewide automated system to track and collect court-ordered child support payments and to locate nonpaying parents. A December 2002 Bureau of State Audits report estimates that accumulated federal fines could total as high as $1.3 billion by 2006.[131] The state tried to build such a system beginning in 1992, but in 1997, after spending $111 million designing, developing, piloting, and implementing the system, the project was declared a failure.[132]

This collection rate forces many children to survive on welfare benefits and causes an unnecessarily increased social safety net cost for California taxpayers.

- The state should enable counties to form better partnerships and yield improved outcomes with child support enforcement.
- The state should allow for competitive service delivery, using highly experienced, state-of-the-art private companies to perform specialized child support enforcement services. For example, Montana has partnered with a private entity to perform the state's customer service function, allowing Montana's child support staff to devote more time to increasing collections. The private entity provides the key education function, interviews custodial parents to support paternity establishment, and verifies the identity of non-custodial parents.[133]
- The state should examine successful child support enforcement models, including competitive service delivery, in other states.

Competitive Sourcing and Performance-based Contracting

A host of other health and social services would benefit dramatically from competitive sourcing and performance-based contracting (described in detail in a previous chapter.) As such, commercial activities in health and social services such as benefit reviews, processing of claims, and most treatment should be performed by contractors under the supervision of the state. Of course, no services should be provided on a "cost-reimburse" basis—instead, the state should use fixed-price, performance-based contracts. A few examples of opportunities for the state to consider:

- The state should contract with hospitals the way private insurers do, choosing hospitals that charge the lowest price for a given level of quality.
- The state should stop paying for empty nursing home beds and instead pay for services rendered, not costs incurred.
- The state should substantially increase the number of beneficiaries enrolled in managed care plans, particularly beneficiaries with disabilities where managed care programs can meet their special needs.
- The state should employ techniques to detect and eliminate unnecessary or questionable procedures being authorized or performed by contractors.

Strengthen Work Requirements for Welfare Benefits

Since January 1993, 38 states have seen welfare caseloads decline by more than 50 percent. Nationwide, the welfare rolls have fallen by almost 60 percent, from 14.1 million to 5.8 million. Unfortunately, California does not have much to celebrate. Despite some progress in reducing the state's caseload, California is near the bottom.[134]

The state should follow the Wisconsin Works model for Long-term welfare reform. For starters, a work requirement is universal—"financial penalties for non-participation in work are strict and substantial."[135] More importantly, 80 percent of the program is administered by private vendors, both profit and non-profit. Results from a Wisconsin Legislative Audit Bureau indicate that the private vendors spent considerably less money than the government-run counterparts.[136] Additionally, the quality of services was comparable i.e., at least as good if not better.[137]

Enroll California in the Independence Plus Program

In 2001, the federal Department of Health and Human Services launched the New Freedom Initiative, a "comprehensive plan to reduce barriers to full community integration for people with disabilities."[138] The initiative "allows participants to live in their family residence or their own home and have control over the planning and purchase of Long-term supports and services by way of a cash allowance."[139]

The New Freedom Initiative consists of a demonstration program known as Independence Plus, which caters to Medicaid-eligible populations consisting of frail elders, adults with physical disabilities, adults with developmental disabilities, and children with developmental disabilities in participating states. According to a program in Florida, the first state to adopt the Independence Plus template,

> *Personal care services are provided to consumers enrolled in the treatment group by providers of their choosing. Treatment group consumers determine the services they need, and from whom to receive them. The consumers pay their workers from accounts set-up for them through the State, which contains the amount of funds the Medicaid program would have spent on their personal care services.*[140]

The U.S. Department of Health and Human Services describes the goals of the Independence Plus templates as follows:

Independence Plus:
A Demonstration Program for Family or Individual Directed Community Services



This initiative expedites the ability of states to offer families with a member who requires long-term supports and services, or individuals who require long-term supports and services, greater opportunities to take charge of their own health and direct their own services. Families and individuals will exercise greater choice, control and responsibility for their services within cost neutral standards. Two template versions will be available to enable states to tailor the program to their preferences; the §1115 Demonstration Template and the 1915(c) Waiver Template. These templates further the interests of the administration, states and beneficiaries. The program builds on the experience and research from a number of pioneer states that have pre-tested these concepts.

The Goals of the Templates

1. The templates will assist states to develop programs that will permit individuals needing long-term supports and services to obtain assistance while living with their family or in their own home. This will be accomplished by:
   - Recognizing the essential role of the family or individual in the planning and purchasing of health care supports and services by providing family or individual control over an agreed resource amount.
   - Increasing family and individual satisfaction through the promotion of personal control and choice - a major theme expressed during the *New Freedom Initiative* - National Listening Session.
   - Encouraging cost effective decision-making in the purchase of supports and services. Allowing eligible families and individuals to receive a cash allowance (in the §1115 Demonstration) or individual budget (in the 1915(c) Waiver) to obtain personal assistant services and related supports.
   - Promoting solutions to the problem of worker availability.
   - Providing fiscal/employer agent and supports brokerage services to support and sustain families or individuals as they direct their own services.
   - Delaying or avoiding institutional or other high cost out-of-home placement by strengthening supports to families or individuals.
2. The templates will provide states the tools, resources and guidance to create effective programs and continue the CMS commitment to create a "culture of responsiveness" by:
   - Assisting states with meeting their legal obligations under the Americans with Disabilities Act (ADA) and the Supreme Court *Olmstead* decision.
   - Providing flexibility for states seeking to increase the opportunities afforded families and individuals in deciding how best to enlist or sustain home and community services.
   - Incorporating the essential elements of self direction such as person-centered planning, individual budgets, participant protections and quality assurance and improvements.
   - Providing states with streamlined and standardized application formats to reduce the administrative burden for preparing proposal submissions and to reduce the Federal review period.

Features of the Templates

Electronic format for easier submission.
Database platform to enable electronic tracking, sorting, querying and analyzing.
Structured series of check boxes to facilitate completion.
Pop-up instructions imbedded in the check boxes offering completion instructions.
Technical Guide for developing the 1915(c) Waiver or the §1115 Demonstration applications.

Additional features of the §1115 Demonstration include simplified/streamlined budget neutrality model and sample terms and conditions.

Source: U.S. Department of Health and Human Services, http://cms.hhs.gov/independenceplus/summary.pdf

Participation in such a program would not only reduce costs, but also allow beneficiaries to achieve more freedom of choice in their health care coverage and improved quality of life. California should, therefore, strongly consider the merits of joining the Independence Plus program.

The Foster Care System:
One Example of California's Failure to Provide Effective Health and Social Services to its Citizens

The Little Hoover Commission reported in its 2001-2002 Biennial Report that the state spends over $3 billion each year on a foster care system that even the Secretary of the Health and Human Services Agency admits is broken.[1] The Commission recently released a follow-up report showing that little has changed since then. The new report summarized its findings as follows:

With no one in charge, the foster care system fumbles forward, and often backward, and costs children and families their happiness, their prosperity and even their lives.

It is imperative that the Governor and legislature clarify who is responsible for the children and families in the foster care system. Without that clarity, millions of dollars and millions of hours will continue to be wasted. In the last three years alone:

- *The legislature and Governor have considered over 100 bills intended to address deficiencies in the child welfare system. But legislative action has not dramatically improved the foster care system.*
- *The Department of Social Services has launched a $3 million planning process, but the proposed reforms do not address fundamental concerns about state and local responsibilities.*
- *State agencies spent over $8 million on research related to child and family welfare, to assess unmet needs and to explore options for reform. But some of that research has been disregarded, and many of the findings have not been publicly released or presented to the legislature.*
- *State and county officials have spent hundreds of thousands of dollars on consultants, staff time and travel to meet, explore options, debate reforms, champion legislation, defeat legislation and lament the lack of progress. But these actions have not yielded the direction or leadership that would give anyone confidence that real reform is underway.*

All of this is on top of the billions that taxpayers have spent to serve children in foster care over the last three years. The 2002-03 budget for foster care services is $2.2 billion. Yet despite this enormous price tag, we continue to fail these children. In many cases the system fails to meet formal standards of care. In some extreme but intolerable cases, the level of care is no better than the abusive homes from which those children were rescued.

During the last three years:

- *An additional 100,000 children have experienced abuse or neglect that is so severe as to warrant their removal from their homes.*
- *An estimated 25 percent of the children in foster care have not received timely medical care and 50 percent have not received appropriate mental health services.*
- *While the failure of the educational system to meet the needs of these children is well documented, officials have not even agreed on who is in charge of this issue,*
- *Unemployment rates for emancipated youth are still estimated at 50 percent.*
- *Most appalling, an estimated 2,800 children have emancipated from the foster care system only to become homeless.*
- *Los Angeles County alone has spent over $12 million to address lawsuits involving children who were neglected, harmed or killed while in foster care.*[1]

A Contrast to California's Failed Foster Care System: State of Kansas — Competitive Contracting

In 1996-97, Kansas became the first state in the nation to fully privatize its adoption, foster care, and family preservation services.

Kansas's Department of Social and Rehabilitation Services (SRS), previously the state's largest provider of adoption and foster care services, now is strictly a purchaser of services and contract monitor with respect to child welfare services.

In all three areas — family preservation, foster care, and adoption — the private contractors are paid a one-time, lump-sum rate per child. As with managed health care plans, the rate is "capitated." Previously, providers were paid on a fee-for-service basis. This provided little incentive to move a child quickly out of foster care, because the contractor would be out the monthly state payments for that child. The result was "foster care drift": kids floated through the system because there were no structural incentives to move them out of it.

In contrast, each contractor's fiscal soundness will now be linked directly to preventing such drift. For example, Lutheran Social Services, the lead adoption agency in a 13-agency private consortium, receives $13,500 for each child. Out of the $13,500 lump-sum payment, the agency must pay for foster care and counseling services for as long as the child remains in foster care. Thus, if the agency fails to place the child in less than one year, it will lose money. If the new adoptive home fails, the consortium must place her again—but with no additional state money.

All the contracts also are outcome-based. For adoption, the contractor must meet five key outcome measures in order to have the contract renewed. One is shortening the length of time between foster care and adoption. Previously, the state was placing only one-fourth of the children in homes within six months of being freed for adoption. State officials want the private consortium to increase this rate to 70 percent within 180 days and 90 percent within a year.

While a major challenge, the non-profits are confident that over time they will vastly improve on the state's performance. "In the future, the kids who need to be adopted will be younger, will have spent less time in out-of-home care and will have fewer problems as a result," Joan Wagnon, the director of Kansas Families for Kids, told the Kansas City Star.

Early results are encouraging. Inquiries from potential adoptive parents have tripled in five months while the number of adoptions has risen by one-third.

In the first seven months of the family preservation privatization, 91 percent of families served have remained intact, meaning that children did not require an out-of-home placement. This is substantially higher than the 80 percent outcome goal.

In addition, since privatizing its child welfare services, Kansas has seen a 44 percent increase in adoptions finalized; private contractors have met or exceeded outcome goals related to child safety, minimizing placement moves, keeping siblings together, and keeping children near their home community; and contractors have exceeded goals for longevity of placements.

Virginia Rodman, a consultant with Lutheran Social Services, is convinced privatization represents the future of foster care and adoption in America. "The national trend is certainly in the direction of privatization," says Rodman. "It may be different models than in Kansas but some kind of privatization is definitely coming to child welfare."

Part 9

Adopt a Biennial Budget and Limit Constitutional Revenue and Spending

"The total annual appropriations subject to limitation of the State and of each local government shall not exceed the appropriations limit of the entity of government for the prior year adjusted for the change in the cost of living and the change in population, except as otherwise provided in this article."

– California Constitution, Article XIII-B, "Government Spending Limitation," Sec. 1.

Summary of Citizen Budget Recommendations in This Section:
1. Adopt a **Biennial Budget** (2-Year Budget) where state budget is approved in year one and oversight of state government occurs in year two.
2. Adopt a **Constitutional Revenue Limit (Taxpayer Bill of Rights)** that holds increases in state revenue growth to population and inflation increases.
3. Restore a **Modified Gann Spending Limit** that allows for carry-over reserve.
4. Adopt a **Balanced Budget Trigger** that automatically makes proportional spending reductions to discretionary programs should revenue forecasts not match actual revenue collections.

In Governor Davis's 2003 State of the State Address, he stated that he would not entertain any budget that does not contain "substantial structural reform." Unfortunately, other than calling for reform, the Governor did little to propose specific steps the state could take to prevent this crisis from happening again.

As a result, the first step in addressing the state's short-term and Long-term spending challenges is to enact a biennial budget and create real Constitutional revenue and spending limits. Both of these reforms

California Budget FACTS:



$87 Billion

Reserve Surplus today had California adopted Gann-like spending limit with Spending Ratchet method

$93.9 Billion

Surplus today had California adopted 10-year moving average Revenue-based limit with Growth Freeze method

$151.4 Billion

Surplus today had California adopted population plus California CPI (inflation) spending limit with Growth Freeze method

$166.4 Billion

Surplus today had California adopted population plus California CPI spending limit with Spending Ratchet method

enacted together can provide much-needed discipline to ensure California does not find itself victim to the same scenario of inflated revenue forecasts and over-spending. Moreover, it provides an impetus for the legislature to improve its oversight of state government, while limiting the growth of government.

Moving to a Biennial Budget

Biennial budgeting is the adoption of a two-year budget rather than a one-year budget. Currently, 23 states already have a biennial budget cycle, and one more is considering it.[141] Given the complexity of the federal government's budget process, there have been numerous suggestions over the years that the federal government move to a biennial budget.

The U.S. General Accounting Office surveyed of a number of states to discover the benefits and problems of switching budget cycles. According to the survey, switching from an annual cycle to a biennial cycle afforded states the following benefits:

- More time is available in the off-year for review of program issues through effective legislative oversight; and
- Biennial budgeting requires departments and programs to consider the long-range implications of their budget requests and their program operations.[142]

Opponents of biennial budgeting note that it is sometimes hard to forecast revenues for one year, let alone doing it for two years. While biennial budget spending and revenue forecasts are necessarily less reliable for the second year of the budget cycle, off-year corrections can be made easily. In addition, should the state follow the next recommendation and adopt a revenue limit, the need for 100 percent precision in revenue forecasts will not be as great. In the end, expanding the time horizon of the budget cycle forces legislators to place greater emphasis on planning and performance evaluation, leading to more sound budget priorities and financial management.

For the short term, adopting a biennial budget allows for California to address today's fiscal crisis in a way that requires less drastic cuts. Indeed, a biennial budget for the next two years would allow time for cost savings measures to be implemented as well as provide time for the economy to recover—resulting in greater revenues.

Adopting Real Constitutional Revenue and Spending Limits

Many states have attempted to curtail spending (or, more accurately, spending *growth*) with mixed success. In fact, 45 states currently maintain some sort of spending limit, combined with rainy day funds. The effectiveness of the spending restraints and the size of the rainy day funds vary greatly, however.[143]

In fact, California has a rich history of its own in reining in tax rates and state spending. In 1978, Californians passed Proposition 13. The measure amended the state's constitution to cap property taxes at 1 percent of fair market value and prohibit valuations from growing more than 2 percent per annum unless the property was sold, effectively reducing property taxes by 57 percent. Proposition 13 did not affect the state's power to spend, however, and the government's response was predictable: raise taxes from other sources. According to Michael New of the Cato Institute, "in the years following the passage of Proposition 13, California raised the income tax, the sales tax, and taxes on beer, wine, and cigarettes."[144]

Californians followed up Proposition 13 with Proposition 4 in 1979. Proposition 4, commonly known as the Gann limit, established a state appropriations limit (SAL) that grows each year based on population and cost-of-living factors. Any tax proceeds that exceed the SAL limit over a two-year period are to be refunded to taxpayers in the form of tax rebates.[145]

Unfortunately, in 1990, the Gann limit was effectively gutted with the passage of Proposition 111. Proposition 111 altered how the Gann limit is calculated, adding K-12 public school enrollment rates in the population formula to correct a school funding inequity. Locals were provided the option of using California per capita personal income growth or the percentage of local assessed value attributable to non-residential new construction. It based cost-of-living adjustments solely on per capita income growth to recognize state economic growth and directed half of the excess revenues to be returned to taxpayers and half to go to schools. It also exempted certain state expenditures from the limit such as responding to natural disasters, "qualified" capital outlay projects (defined by the legislature) and projects funded by the gas tax and other fees. Finally, it declared the Gann limit refund would be triggered only if tax proceeds are in excess in two consecutive fiscal years.[146]

In addition, since the SAL has grown each year, even as the economic downturn has caused tax revenues and state spending to fall, the limit is presently so high that it is nowhere near binding on the state. The Legislative Analyst's Office reports that appropriations subject to the SAL will fall $14.5 billion short of the limit in FY 2001-02 and $6.3 billion below the limit in FY 2002-03.[147] In fact, the SAL has only resulted in one tax rebate, when tax revenues surged roughly 20 percent in 1987, resulting in $1.1 billion in rebates. The last time the limit was exceeded was FY 1999-00, by $702 million, although state appropriations fell well below the limit the following year and thus did not trigger a rebate due to the two-year surplus requirement.



"It's very reasonable to think that population increase and inflation should be your basis for increasing the budget. And during boom years, obviously you are going to have a surplus, (and) that surplus should not be touched, but should be put aside for rainy days."

– Esmael Adibi, author of Chapman University's semiannual economic forecast

An Alternate Solution: Colorado's Taxpayer Bill of Rights (The TABOR Model)

One of the most successful checks on government spending has been the Taxpayer Bill of Rights (TABOR), adopted by Colorado taxpayers in 1992. Although TABOR is often referred to as a spending limit, it is actually a limit on the *revenues* the state may collect, and thus serves as a *de facto* spending limit. (Although, given recent spending behavior by those in Sacramento, almost anything is possible in California!)

What It is and How It Works

TABOR caps the growth in state tax revenues at the combined growth rates of inflation and population. Any amount collected above this limit must be returned to the taxpayers through refunds, temporary tax credits, or any other "reasonable means." The state exceeded the revenue limit for the first time in FY 1997-98, and has exceeded it every year thereafter. Since 1997, Colorado has reduced taxes more

than any other state in the nation, returning over $3.2 billion to taxpayers.[148] While other states have been grappling with their financial woes, Colorado enjoyed a balanced budget and still managed to issue $927 million in tax refunds in fiscal 2001.

Increases above the tax revenue limit may only be obtained by approval of the voters in a referendum, giving the system a degree of flexibility. Since TABOR's inception, several such referenda have been offered to the voters. The only ones to pass thus far are Amendment 23, which allows for over $300 million per year to be exempted from the limit for increased public school funding, and Referendum A, which directed $44 million from the TABOR surplus toward property tax relief for qualified seniors. Both measures passed in the 2000 election.

In addition to the TABOR revenue limit, Colorado does have a spending limit as well. The Arveschoug-Bird limit, put in place in 1991, restricts General Fund appropriations growth to 6 percent per annum. Exceptions are made for federal mandates, court orders, Medicaid over-expenditures, and transfers to the state's Capital Construction Fund. According to State Treasurer Mike Coffman, "if the state collects tax revenues that exceed the Arveschoug-Bird limit but that are less than the total TABOR revenue limit … that money is normally spent on transportation and capital construction projects."[149]

Although the "6 percent limit" was merely a statute, a specific provision of TABOR prohibits the state (and local governments) from weakening any spending limitations that existed at the time of TABOR's inception, including Arveschoug-Bird. Thus, the 6 percent limit has become "constitutionalized."

Benefits of TABOR

There can be no denying the success of TABOR and its impact on the Colorado economy. In the words of University of Colorado economics professor Dr. Barry Poulson, "Colorado has achieved unprecedented growth over the past decade due to a favorable business climate."[150] By helping to keeping tax rates low and stable, TABOR has allowed taxpayers and business owners to invest more of their earnings into the economy, spurring further growth. Colorado's favorable business climate and economic growth are evidenced by the following:

- Colorado's 60 percent growth in per capita disposable income growth during the 1990s ranked first among all states.[151]
- During this period, Colorado's population grew an average of 2.3 percent per year—the third highest growth rate in the nation. The number of full-time jobs increased 43 percent, from 1,655,000 jobs in 1990 to 2,363,000 jobs in 2000. What is more, most of the jobs created during the economic expansion were not for low-skilled work, but rather for relatively high-paying positions.[152]
- Between 1995 and 2000, Colorado's 51 percent growth in gross state product was the second fastest in the nation.[153]

In addition, TABOR has made the budgeting process more transparent. This has allowed taxpayers to become more informed and have a stronger and more direct say as to what their tax dollars are buying. If taxpayers feel legislators are not adequately funding the programs that truly need funding, they can agree to set aside a special allotment for that purpose through the referendum process.
Since under the TABOR system, any funds for such a program will be taken from revenues collected over the limit—revenues that would otherwise be returned to the taxpayers—taxpayers can make the funding priority decisions that legislators are unable, or unwilling, to make. The crucial point is that, under TABOR,

excess tax collections are rightly recognized as property of the taxpayers, not the legislators. This implies that, when deciding whether or not spending (and thus, taxes) should be increased to pay for programs not covered under the TABOR limits, Colorado taxpayers can more easily factor in the costs of programs, and not simply focus on the benefits heralded by legislators or special interest groups, since the money to pay for such programs will be coming from their own tax refunds. Without such a check on the power of the purse, taxpayers might just as well kiss their tax dollars goodbye, knowing that they will all be spent, regardless of whether or not the state collected too much money in the first place.

In case the above benefits are not evidence enough of TABOR's success, its growing reputation as a model for other states should serve as proof. If, indeed, "imitation is the sincerest flattery," then TABOR has much to be proud of. Last year, State Representative Russell Pearce introduced a TABOR proposal for Arizona and Senator Curtis Person of Tennessee announced plans to sponsor a Tennessee Taxpayer Bill of Rights (TN TABOR), both built on the Colorado model.

Some Refinements Are Necessary

Despite its many attractive features, however, TABOR is not flawless. The main drawback is that Colorado lacks an effective "rainy-day fund" to resort to in times of economic hardship. While the state does maintain very limited emergency reserve funds, "it does not currently have a device in place to smooth government revenues and expenditures over the business cycle," according to Professor Poulson.[154] This is not so much a criticism of TABOR itself as it is the tax collection system as a whole, but it nonetheless deserves comment.

TABOR may be able to limit the amount that the state can collect, and thus spend, but it cannot prevent legislators from spending the maximum amount of tax dollars from the General Fund and dipping into reserves not subject to the TABOR limit. Thus, while the pot may be smaller to begin with, lack of fiscal discipline will still cause it to be depleted, leaving little or nothing in reserve for use in the event of an emergency. Indeed, this has proven to be the case in Colorado. In the words of State Treasurer Mike Coffman, "The problem is a legislature that spends to its legal limits in good times and is reluctant to set aside any of that money for the tough ones. What we need to do is ensure a balance that restrains government growth in prosperous times and permits the state to meet the needs of its citizens when times get tough."[155] To that end, Coffman has proposed the creation of a rainy-day fund.

In addition to the lack of a rainy-day fund, TABOR has been weakened by the practice of pre-spending the surplus. In 1998, legislation passed that allowed the state to recognize the TABOR surplus obligation in the year after the money is realized instead of in the year in which revenue comes in the door. Thus, the surplus is treated as an asset in the year it occurs and a liability the subsequent year. According to the Colorado Office of State Planning and Budgeting:

> *Beginning in 1998, the state did not restrict the TABOR surplus revenue in the year it occurred. Rather the legislature, through House Bill 98-1414, obligated the TABOR refund from the next year's revenues. This pre-spending of the TABOR revenues in FY 1998-99 allowed $468.3 million in spending for capital construction and highways. If the TABOR surplus had been restricted in the year it was realized, only $287 million would have been available for capital and highway expenditures in FY 1998-99.*[156]

This raises a potential cash flow problem if the TABOR surplus is less than that of the preceding year or if an economic downturn causes revenues to come in under projections. In addition, permanent tax relief in the full amount of the surplus is now much more difficult, as the prior year's TABOR surplus must be incurred in the current year. If a similar measure is to be employed in California, efforts must be made to avoid these dilutive effects and the accounting gimmicks that the legislature is so adept at using.

Alternate Models to TABOR

The TABOR model is certainly not the only means of addressing California's spending problem. Several types of spending limits have been proposed. Some of the most common include the following:

- **Gann-like.** Modeled after California's Gann limit, this measure would establish a spending limit equal to the combined growth in population and per capita personal income.
- **Revenue-based.** This method would prohibit spending from increasing more than the 10-year moving average increase in revenues, thus preventing spending splurges during short-term economic booms.
- **ACA 6.** This approach would limit spending increases to the growth in population plus the growth in the California Consumer Price Index (inflation). This proposal is similar to the Colorado TABOR model, but focuses on the spending side of the equation instead of the revenue side.

A recent analysis modeled how the above spending limits would have affected the state's fiscal situation, had they gone into effect in FY 1990-91, using historical data and Governor's Budget spending and revenue numbers.[157] Table 11 illustrates both General Fund and total budget spending, and denotes the cumulative deposits made into the rainy-day fund for each alternative. In addition, each option was analyzed using three different methods of spending limit implementation:

- **Continuous Accrual.** This approach allows spending limits to grow each year, even when actual spending falls below the limit.
- **Spending Ratchet.** This technique focuses on actual spending instead of prior spending limits by re-setting the base year at the previous year's spending level. Thus, spending limits can be reduced and, once reduced, must grow from the lower base level.
- **Growth Freeze.** This method is a combination of the two previous methods. It allows the spending limit to grow when actual spending for the previous year is restrained by the limit, but freezes the limit at the previous year's level during years in which spending falls short of the limit.

The analysis concluded that, had the above plans been put into effect beginning in FY 1990-91, all of them except for the revenue-based continuous accrual option would have resulted in significant rainy-day fund balances.[158] Moreover, these rainy-day funds would have been more than enough to balance the budget today *without tax increases or spending cuts*.

The analysis also noted that if the spending limits were allowed to accrue continuously, each would have resulted in significantly higher spending limits for 2003-04 than those proposed by the Governor's Budget, both for general funds and total funds. The spending ratchet and growth freeze methods would have resulted in much lower spending limits than proposed by the Governor's Budget. For all three methods, the revenue-based formula would have produced the highest spending limit and the ACA 6 option the lowest.[159]

Structuring California's Revenue and Spending Limits

While almost any serious revenue and spending limit would be helpful, the Citizens' Budget Plan proposes California adopt the following:

- **TABOR Revenue Limit:** California desperately needs a revenue-limit to serve as a de-facto discipline on spending, as well as on taxes.
- **Tax Rebate/Revenue Reserve Fund**: Critics of TABOR point out that should the state spend exactly to the revenue limit each year, it might be possible that a year of falling revenue would produce a deficit. As a result, we propose to modify TABOR to keep a running balance of up to 30 percent of the revenue over-collection accumulated during the previous five-year cycle. As a result, a maximum of 70 percent of over-collected revenues could be automatically rebated to the taxpayer, while provisions would be made for the retention of over-collections to meet the 30 percent reserve.
- **Restore Gann Limit, with Spending Ratchet**: California should restore its Gann spending limit and adopt the spending ratchet formula for setting the spending limit each year. While it is unlikely that Sacramento will resist spending right up to the Gann limit, a restored Gann limit along with the revenue limit outlined above will impose the right mix of restraint on Sacramento's ability to overspend.
- **"Balanced Budget Trigger":** California should adopt an Automatic Spending Reconciliation in Biennial Year Two—thus providing another way to correct for any intentional or accidental inflation of revenues. The "trigger" would adjust discretionary spending levels to achieve a balanced budget based on a program's proportion in the budget. This would make balancing the budget automatic and shield politicians from making the hard votes of reducing spending on popular programs. Now, should the legislature actually want to craft its own package of reductions and take a formal vote, it certainly could. However, to ensure gridlock doesn't prevent the balancing of the budget, an automatic "trigger" would be necessary.

Table 11: Comparison of Three Options for Spending Limits ($ in Millions)

	Continuous Accrual		Growth Freeze		Spending Ratchet	
	General Fund $	Total $	General Fund $	Total $	General Fund $	Total $
Option 1, Gann-like (Population and Per Capita Personal Income)						
▪ Spending	71,874	91,834	66,851	86,186	63,882	87,044
▪ Rainy-day Fund	11,242	59,682	57,148	109,011	83,906	98,968
Option 2, Revenue-based (10-year Moving Average Revenue Increase)						
▪ Spending	82,399	113,230	67,891	91,061	66,105	93,552
▪ Rainy-day Fund	(57,911)	(92,770)	64,857	93,899	85,372	76,398
Option 3, ACA 4 (Population and California CPI)						
▪ Spending	67,698	86,499	60,404	80,142	57,409	78,224
▪ Rainy-day Fund	38,911	92,036	108,842	151,421	134,395	166,433
For Comparison, the Governor's Budget Proposes:						
▪ General Fund Spending	$62,769 million					
▪ General Fund Reserve	$531 million					
▪ Total State Spending	$96,437 million					

Source: California State Senate Republican Caucus, "Options for Spending Limits and Rainy-Day Funds," January 15, 2003.