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Mike Genest
Director, California Department of Finance
State Capitol
Sacramento, CA 95814

March 16, 2009

Re: SB 3X 16 (Ducheny) Determination of Sufficiency of Federal Stimulus Funds

Dear Treasurer Lockyer and Director Genest,

The Western Center on Law and Poverty represents California's poor in policy debates, legislation and litigation related to housing, health and public assistance. Western Center is writing related to the determination that the Treasurer and Department of Finance (DOF) must make in Government Code Section 99030. This section requires a public hearing by the two entities prior to April 1, 2009 and if the Treasurer and DOF determine that there are sufficient federal funds will avoid severe cuts to social service programs set to go into effect on July 1, 2009. A 1.25 percent income tax surcharge that goes into effect on April 1, 2009 would also be "triggered off."

WCLP has reviewed the estimates by the DOF and the Legislative Analyst Office (LAO), examined the budget bill language and control sections, conferred with national experts and believes that sufficient federal funds will be available to the state to offset \$10 billion in General Fund (GF). We urge the Treasurer and DOF to make the determination that sufficient federal funds exist to trigger off the cuts and tax increase prior to April 1, 2009 or, failing that, agree to an extension so that further information can be developed.

It is important that the Treasurer and DOF consider carefully the implications of this determination. The outcome of this decision literally impacts millions of the poorest and neediest Californians in the state and whether they can eat and access health benefits, dashes the hopes of those hoping to go to college and further slows the wheels of justice.

The unprecedented amount of federal funds that California is receiving from Congress and the Obama Administration is meant to help Americans survive the deepest recession in 70 years. They

are meant to help stabilize state government programs and services. For California to be cutting \$947 million from the very programs for which they are receiving in excess of \$18 billion in federal assistance is not only immoral, but sends a signal to Washington that we can not be trusted to spend the money to help the economy as intended. As our state is not yet out of the recession or its deep budget hole, we should be careful about creating an environment which precludes additional federal assistance.

At the outset we must note that the statute and control sections do not provide any definitions of what key terms mean. There were no public hearings for legislators and the public to ask questions and determine intent. The actual language in SB 3X 16 and SB 3X 1 was not available to the public until the day after the vote was taken. At the end of this letter we discuss some of terms that are of concern.

Additionally, the time frame for determination is so brief that it is impossible to provide an accurate assessment of what will be available from hundreds of federal programs. To compound the short time frame for decision, DOF and LAO have yet to provide crucial data and assumptions used for their estimates. Without this we are unable to advise you appropriately and worry that the determination may be made in haste without due consideration of all the options.

Will Sufficient Federal Funds Be Made Available to Offset \$10 Billion in General Fund?

Yes. As the LAO notes, the state is receiving \$31 billion in direct federal assistance just from ARRA and is eligible for billions more in competitive grants that could offset GF. There is additional state funding in the recently passed \$410 billion Omnibus Budget Act. By our count at least \$18 billion is directly available as General Fund offset. It is within the discretion of the state to have available at least \$10 billion of these funds by June 30, 2010 if the state has the will to do so. Given the Obama Administration's substantial interest in ending the recession, it is likely they would work with the state to insure that the state can maintain state spending and employment. Furthermore, the state's deteriorating 2009-10 fiscal condition makes it increasingly likely that the state will use most or all possible federal funds to offset General Fund gaps.

Specifically, we believe the following sources of funding would be sufficient to meet Section 99030:

State Fiscal Stabilization Funds (SFSF)

California is eligible to receive a total of \$4.9 billion in SFSF. According to the LAO, up to \$3.3 billion can be used to offset General Fund expenditures in 2009-10. At a Senate Budget Committee hearing on Thursday, March 12, 2009, DOF told the committee that they would apply for the SFSF funds by March 31, 2009 meaning they will be available under Section 99030.

SFSF funds can be used to both restore K-12 and higher education funds that have been reduced or to fill any shortfall in funding. But both the LAO and DOF have stated that because of the budget situation it is prudent to wait before committing these funds to one use or the other. Thus they are not "available" as a GF offset.

While this may be prudent from a budgetary standpoint it is irrelevant in the context of the language of Section 99030. The statute does not require the Treasurer and DOF to make a determination of whether it is wise to spend the funds in a certain way, it merely requires a

determination that they “may be available.” As the LAO notes, if the state GF forecast is below projections (LAO reported on March 13 that the state revenue was \$8 billion below the recently passed forecast), then the Legislature may choose to reduce the Prop 98 guarantee or may reduce its GF commitment to UC or CSU. The SFSF funds are available for that purpose and thus the Treasurer and DOF should add \$3.3 billion to DOF’s preliminary estimate.

There is no dispute that the funds are available to be used to offset GF costs because the Governor already obligated \$510 million of SFSF to backfill \$510 million in GF appropriations for UC and CSU in the 2009-10 state budget. Because this act occurred as a result of a Governor blue pencil and because it offset General Fund for the 2009-10 budget, the \$510 million must be included as federal funds available towards the \$10 billion.

Increased FMAP Funds

The federal stimulus bill includes an increased FMAP for California of 11.6%. The Department of Finance (DOF) estimates that a total of \$7.8 billion of increased FMAP will flow into the state for fiscal years 2008-09 and 2009-10: \$6.4 billion of which they estimate will be used to offset General Fund dollars and \$1.4 billion in local savings. By contrast the General Accounting Office estimates that for these two fiscal years California will receive a total of \$8.7 billion (which will offset both state and local Medi-Cal expenditures). Without seeing their methodologies we can not evaluate this billion dollar difference nor understand how the local savings were calculated. We also cannot analyze what level of caseload growth is calculated. Some counties are seeing double-digit increases in Medi-Cal enrollment. In Sacramento County, for example, enrollment in Medi-Cal in January 2009 was up 12% over last year.

Individuals with Disabilities Education Act (IDEA)

The LAO estimates that California is eligible for \$1.3 billion in IDEA funds for supplemental services for special education students. Of this amount, the LAO identifies \$144 million which can be used to offset GF expenditures for state special schools and residential placements. The LAO recommends that the remainder be used to pay retroactive special education mandate claims. The funds do not have to be used in this way, but if they were the portion paid in 2009-10 would also count toward the trigger calculation. The DOF identifies \$53.2 million which could replace GF currently spent on the Early Start program. As with other areas, we need additional information about the methodologies to analyze these assumptions.

Children’s Health Insurance Program (CHIP)

The CHIP Reauthorization Act includes funds for states for lawfully residing children enrolled in Medi-Cal and Healthy Families regardless of their date of entry. California has been paying for these legal immigrant children with state-only dollars, but will now be able to draw down federal matching funds. To our knowledge these funds have not been included in the DOF’s estimates even though ABx3 16 is clear that all “federal funds that may be used to offset . . . General Fund expenditures” count toward the trigger analysis.

Competitive Grants

ARRA and the Omnibus Budget Act contain tens of billions in competitive grants in a wide variety of program areas. The breadth and complexity of the competitive grants and their potential for GF offset is undeterminable at this time. But California will certainly apply for and receive some portion of the competitive grants. Yet the preliminary DOF document scores no revenue

from the competitive grants. Given the potential for significant GF offsets from competitive grants, the Treasurer and DOF should do a thorough analysis of the availability of GF offsets from competitive grants. If this requires an extension of the April 1, 2009 deadline for completing the determination the parties should request an extension to get this correct.

Revenue Impacts

The preliminary DOF document does not account for revenues associated with the grant increases and infrastructure investments. Specifically:

- The federal stimulus package increases Unemployment Insurance by \$25 per week. Most – if not all of the aid – is spent and has an economic multiplier. There should be some portion of those funds that are spent on taxable goods and will benefit sales and use tax revenues.
- Similarly, the package includes a one-time emergency payment of \$250 to Supplemental Security Income (SSI) recipients, Social Security recipients, Railroad Retirement recipients, and veterans compensation or pension recipients. Californians would receive \$1.8 billion. Again, should be some portion of those funds will be spent on taxable goods and will benefit sales and use tax revenues.
- The federal stimulus package is intended to increase jobs associated with infrastructure and new technology. To the extent that currently unemployed individuals secure jobs related to federal stimulus, the personal income tax and sales and use tax revenues should increase. For example, a White House-released analysis conducted by two prominent economic advisors estimates that California stands to gain or save 369,000 jobs, many in the private sector and across various sectors of the economy, from the package.

Omnibus Spending Bill

Finally, the state may receive additional funds through the omnibus spending bill enacted this week by Congress and signed by President Obama. To the extent that these funds may offset state General Fund spending, either directly or indirectly through job creation and tax increases, these funds may also contributed to the overall calculation. The Treasurer and DOF should thoroughly examine this source of funds and if needed seek an extension of the April 1 deadline to complete the review.

Statute Is Ambiguous and Lacks Definitions

The statute that guides this proceeding is only two paragraphs long but it is full of ambiguous terms subject to interpretation. Among the phrases subject to interpretation are:

Government Code Section 99030 (a)

“Available, by June 30, 2010” – Does this mean all federal funds to which California is eligible or does this mean those funds that California seeks and obtains by that date? Are funds that are reimbursed by the federal government after we spend, such as TANF, “available” since the state knows it will receive those funds? WCLP believes any federal funding received or accrued prior to June 30, 2009 is available to offset GF.

“Federal Funds” – Section 99030 never refers to the federal stimulus package but mentions “federal legislation.” Because this phrase is inclusive we read this to mean any federal legislation

passed by April 1, 2009 including the Children’s Health Insurance Program Reauthorization Act, the American Recovery and Reinvestment Act (ARRA), the recently enacted Omnibus Budget Act and any other legislation in which California may be eligible for federal funding.

“May Be Used to Offset” – This inclusive phrase allows the Treasurer and DOF to include any federal funding available by June 30, 2010 that can be used to offset General Fund. It appears from our reading of the DOF and LAO estimate that they do not use a consistent standard for determining whether funds can be used to offset GF. They seem to impose an interpretation on some potential sources of funds, such as the State Fiscal Stabilization Funds (SFSF), that excludes it because it can be used on either GF offset or to augment state funding levels. Conversely with FMAP (Federal Medical Assistance Percentage), both DOF and LAO find that the funds may be used to offset GF even though they could likewise be used to augment state health programs. The same is also true for Temporary Assistance for Needy Families (TANF) Emergency Funds. WCLP believes the correct standard is *if* the funds can be used as GF offset then they may be used to offset under Section 99030.

“General Fund expenditures” – This phrase appears to require the Treasurer and DOF to determine by April 1, 2009 that there will be GF “expenditures” of \$10 billion that can be offset. As a practical matter this is impossible since determinations of expenditures can not be known before they occur. The Treasurer and DOF may wish to ask the Legislature what it meant by this phrase before making the determination called for in Section 99030.

Government Code Section 99030 (b)

“Sufficient federal funds” – This language suggests that the Treasurer and DOF do not have to determine that there is exactly \$10 billion in offsets but if they get close to it that it may be sufficient. If the Legislature wanted it to be no less than \$10 billion they would have written the language that way. Thus, the Treasurer and DOF may decide that if they determine that we are close to \$10 billion that that is sufficient. They may determine that the GF offsets are sufficient if short of \$10 billion because the state will receive additional sales and income taxes directly flowing from federal funds that put the state over \$10 billion.

WCLP urges the Treasurer and DOF to determine that sufficient federal funds are available to avoid cutting programs that are critical during these times and for which the state has received significant federal assistance.

Sincerely,

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Legislative Advocate

Elizabeth Landsberg
Legislative Advocate