CALIFORNIA
BUDGET PROJECT

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WILL CALIFORNIA HIT THE "GANN" LIMIT?

In 1979, voters approved Proposition 4, establishing an appropriations (or spending) limit for the state and every local government jurisdiction. The State Appropriations Limit is often referred to as the Gann Limit, after Paul Gann, the author of the measure placing the limit in the state constitution. In 1987, the state hit its Gann limit and rebated approximately $1.1 billion to taxpayers. During the late 1980s, the state hovered around the State Appropriations Limit (SAL). Changes made to the limit by Proposition 111 of 1990, coupled with the recession, made the SAL a "non-issue" during the 1990s. Due to strong revenue growth, coupled with relatively modest inflation, it now appears highly likely that the state will reach the SAL in the current year (1999-00). The state may also hit the SAL in 2000-01, depending upon the continued strength of the economy and expenditure choices made in the budget (see below).

How Does the State Appropriations Limit Work?

The current SAL consists of the framework established by Proposition 4 of 1979 as amended by Proposition 111 of 1990. Changes made by Proposition 111 include:

- Modifying the inflation factor used to adjust the limit;
- Requiring the state to reach the SAL in two consecutive years in order to trigger a return of excess revenues to the taxpayers; and
- Requiring, in the event the state exceeds its limit in two consecutive years, half of the surplus amount to be allocated to education and half returned to the taxpayers (Proposition 98 of 1988 also required that a portion of excess revenues be allocated to schools. However, these provisions were superceded by the formula contained in Proposition 111).

This paper describes how the provisions of Proposition 4 as amended by Proposition 111 apply to the state's budget. The State Appropriations Limit:

- Establishes a limit on appropriations from the proceeds of taxes for the state and every local government jurisdiction.
- Provides for an annual inflation adjustment based on the percentage increase in per capita personal income and change in population. The population growth factor is the percentage change in population multiplied by the percentage of the budget that goes to all programs other than K – 12 education plus the percentage change in K – 12 enrollment multiplied by the fraction of the budget that goes toward K – 12 education.
- Requires, in the event state revenues exceed the SAL in two consecutive years, amounts in excess of the SAL to be divided equally between K – 12 education and community colleges and tax reductions within the two subsequent fiscal years.
- Excludes certain types of expenditures from the SAL. Specifically, "appropriations subject to limit" does not include appropriations:
    - For debt service;

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- Required to comply with court or federal mandates;
- For qualified capital outlay projects; and
- From the proceeds of tobacco taxes imposed by Proposition 99 of 1988 and Proposition 10 of 1998 and the increase in the gas tax imposed by Proposition 111.

- Counts state aid to local governments toward the local jurisdiction's appropriations limit, rather than the state's, if the aid is provided in a form that is unrestricted by statute. Taxes collected by the state on behalf of local governments count toward local governments' limits. For example, Vehicle License Fees (VLF) collected by the state and allocated to local governments, and the state's reimbursement of revenues lost to local governments as a result of the VLF rate reduction, both count toward local limits.

How Close is the State to the Limit?

Under the revenue assumptions contained in the Governor's January Budget, the state was $3.777 billion away from its spending limit for 1999-00 and $3.975 billion away from the estimated limit for 2000-01. Higher than anticipated revenue collections during the first three months of 2000 brought the state to within $1.3 billion of its spending limit as of the end of March. The Legislative Analyst's Office (LAO) April *Update* concluded "if current strong trends continue through the end of the year, revenues in 1999-00 will exceed the administration's January budget forecast by more than $4 billion." If strong performance carries into the budget year, this means that the state could exceed the SAL in 1999-00, 2000-01, or both.

The State Appropriations Limit (SAL): How Close Are We? (Dollars in Billions)	
Room Under the 1999-00 Limit: Governor's January Budget Forecast	$3.777
Difference Between Actual and Forecast Revenue Collections through March	$2.477
Remaining "Room" Under the Limit	$1.300
Room Under the 2000-01 Limit: Governor's January Budget Forecast	$3.975

Source: Department of Finance

What Happens if the State Exceeds the Limit?

If the state exceeds the SAL in two consecutive years, the excess is divided evenly between K – 12 education, community colleges and tax reductions. Funds allocated to education must be divided among school and community college districts on the basis of enrollment. The portion that is allocated to tax reductions must be returned within the two subsequent fiscal years. In other words, if the state exceeded the SAL in 1999-00 and 2000-01, the state would be required to provide a rebate to taxpayers no later than 2002-03.

How Do Spending Choices Affect the SAL?

The SAL applies to ***appropriations*** subject to limit, not revenues per se. Not all appropriations count toward the SAL and there are special provisions that apply to subventions that flow from one level of government to another. Thus, whether the state reaches the SAL depends on the share of state expenditures that are made for purposes subject to the appropriations limit. The state constitution excludes certain appropriations from the limit calculation, including:

- Appropriations for debt service.
- Appropriations required to comply with federal or court mandates that increase the cost of providing services.
- Appropriations for capital outlay projects with a useful life of 10 or more years and a value of at least $100,000.

Furthermore, state aid provided to local governments would count against the limit of the local jurisdiction rather than the state. The implementing statutes for Proposition 4 specify that only unrestricted subventions are excluded from the state's SAL. For example, funds allocated to counties and cities to replace revenues lost during the property tax shifts of the early 1990s would count against the limits of the cities and counties receiving relief, not the state.

What Are the Outstanding Issues?

Decisions made as part of this year's budget deliberations will have a major impact on whether the state "hits" the SAL. Several factors will determine whether the state exceeds the SAL:

- Final 1999-00 tax collections and revenue growth in the budget year.
- Expenditure decisions made as part of the 2000-01 budget, specifically levels of capital outlay and local fiscal relief. Legislators could, for example, increase the share of the budget allocated to capital outlay and local government in recognition of the state's unmet infrastructure needs and the revenues lost to local government as a result of the property tax shifts of the early 1990s.
- Inflation and personal income growth. In particular, the revisions to the personal income data used as the basis of the SAL inflation factor could provide a modest amount of additional room under the limit in the budget year.

SAL Q&A:

How do contributions to and expenditures from a budget reserve interact with the SAL?
Contributions to the reserve count against the state's limit in the year they are made. Expenditures paid out of the reserve do not count toward the limit.

Are local governments in danger of exceeding their appropriations limits?
No. The revenues relied upon by local government have grown more slowly than the personal income tax, which provides over ½ of state General Fund revenues.

If the state exceeds the SAL in two consecutive years, does the portion that goes to education add to the Proposition 98 "base"?
No. The constitution specifically excludes the amount allocated to education from the calculation of the school spending guarantee in future years. Thus, amounts received by education in the event the state exceeds the SAL are, in essence, one-time moneys.

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