

CHAPTER 5

GOVERNMENT APPROPRIATIONS LIMIT: ARTICLE XIII B OF THE CALIFORNIA CONSTITUTION

HIGHLIGHTS

- What is the Appropriations Limit
 - Expenditures Versus Appropriations
 - How the Appropriations Limit Works
 - History of the State's Limit
 - Relationship Between State and Local Limits
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1. IN BRIEF: WHAT IS THE APPROPRIATIONS LIMIT?

Proposition 4 approved by the voters in November 1979 added California Constitution, Article XIII B. Article XIII B limits the level of most appropriations from tax sources that the state and most local government entities are permitted to make in any given year. The limit for each year is equal to the limit for the prior year, adjusted for changes in the cost-of-living and population. Various other adjustments are also required. The first year in which appropriations limits applied to state and local governments in California was fiscal year (FY) 1980-81.

Article XIII B also requires state and local governments to return to taxpayers (or in certain cases, K-14 education programs) any tax revenues in excess of the amount that can be appropriated in any given FY.

This constitutional provision also contains requirements that the state reimburse local governments and school districts for the costs of complying with state mandates, and requires the Legislature to establish a prudent state reserve fund.

Article XIII B was significantly modified by two initiative constitutional amendments approved by the state's voters in November 1988, Propositions 98 and 99. Proposition 111, approved by the voters in June 1990, made several additional significant revisions in the appropriations limit. Changes made by these propositions are noted in the following sections.

2. EXPENDITURES VERSUS APPROPRIATIONS

The terms "appropriations limit" and "spending limit" or "expenditure limit" are often used interchangeably, and there is some confusion about the difference between appropriations and expenditures.

An appropriation is an action by the Legislature to set aside an amount of money for a specified purpose. In short, an appropriation authorizes money to be spent. Appropriations are made in the annual Budget Bill, or in individual bills providing for specific governmental programs.

The actual expenditure of money occurs later, and is implemented by the State Controller. Writing checks is a ministerial function of the Controller. The Controller has no authority to expend money that has not been appropriated by the Legislature.

The amount of an expenditure on a program may not equal the appropriation for that program. For example, if the number of clients for a particular government service is actually less than anticipated, the appropriation may be larger than the amount actually spent.

Article XIII B sets forth a limit on the amounts that may be appropriated from government proceeds of taxes. In the remainder of this chapter, Article XIII B will be referred to as an appropriations limit, although in casual conversation and popular press it is often called a spending limit.

3. HOW THE APPROPRIATIONS LIMIT WORKS

Most of the operative provisions of Article XIII B are provided in the Constitution. Some features required statutory implementation, which was accomplished by legislation enacted in 1980, and again in 1990 for changes made by Proposition 111.

The paragraphs below describe how the appropriations limit works, based on both constitutional and statutory provisions. Opinions provided by the Legislative Counsel and the Attorney General have contributed to our interpretation of the provisions of Article XIII B.

Which Governmental Agencies Have Limits. Article XIII B applies to the state and to most units of local government -- cities, counties, K-12 school districts, community college districts, and special districts. Each governmental entity has its own appropriations limit. The few local governmental entities that are not subject to an appropriations limit are:

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- Special districts in existence on January 1, 1987 that did not levy a property tax rate in excess of 12.5% in FY 1977-78; and
- New special districts formed since that time by a vote of the people that are not funded from proceeds of taxes.

Which Revenues Are Subject to Limit. Article XIII B places a limit on appropriations from most, but not all, government revenue sources. The limit applies to appropriations from proceeds of taxes from both the general fund and special funds of government entities. Proceeds of taxes include tax revenues, interest earnings on invested tax revenues, and any revenues collected by a regulatory license fee or user charge in excess of the amount needed to cover the cost of providing the regulation, product, or service.

Appropriations from non-tax revenues are excluded from the limit. Examples of non-tax proceeds include lottery proceeds, tidelands oil revenues, federal funds, proceeds from the sale of government property, revenues from regulatory license fees or user charges equal to the amount needed to cover the cost of providing the function, gifts, and borrowed funds.

Proposition 111 excluded appropriations from the following revenue sources from the limit:

- Gas and diesel tax revenues above nine cents per gallon;
- Sales and use taxes collected on gas and diesel taxes above nine cents per gallon; and
- Truck weight fees that exceed those in effect on January 1, 1990.

Which Appropriations Are Subject to Limit. Appropriations for almost all government functions are subject to limitation under Article XIII B. However, there are some important exceptions.

The original Proposition 4 provided that the following appropriations are not limited, even if made from proceeds of taxes:

- Subventions from the state to local governments and schools, the use of which is unrestricted (these subventions are not subject to the state's limit, but instead are counted as subject to the local entity's limit);
- Appropriations to pay for costs of complying with federal laws and court mandates;

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- Payments for interest and redemption charges on pre-existing (i.e., pre-Proposition 4) or voter-approved bonded indebtedness;
- Withdrawals from previously appropriated reserve funds; and
- Refunds of taxes.

Proposition 99, adopted by the voters in November 1988, created another major category of appropriations not subject to the limit. These are appropriations of new tax moneys from cigarette and tobacco products resulting from tax increases imposed by Proposition 99. Under that statutory initiative, beginning in FY 1988-89, state revenues from those new or increased cigarette and tobacco taxes are set aside in special accounts for expenditure on treatment or research of tobacco-related diseases, tobacco health education programs, and wildlife preservation and related programs. All such appropriations are exempt from limitation under Article XIII B.

Proposition 111 excluded capital outlay from the appropriations limit. This change reflects the fact that while capital outlay appropriations are made during a single budget year, they reflect long-term investments that are utilized over a number of years.

Appropriations directly related to an emergency, such as a fire, earthquake, or other natural disaster, were also excluded from the limit by Proposition 111. No reduction in future limits is required for appropriations made for these emergency purposes.

The "Base Year" Limit. The first year that limits were in effect was FY 1980-81. The base year for determining the appropriations limit in FY 1980-81 was FY 1978-79. Actual appropriations in the FY 1978-79 fiscal year that had been financed by the proceeds of taxes were the starting point. Appropriations not subject to limitation (see above) were subtracted from that figure and this became the "base year" level of appropriations for computing all subsequent years' limits.

Proposition 111 updated the base year for calculating the limit for each government entity to FY 1986-87. For fiscal years beginning with FY 1990-91, the limit for each entity is the FY 1986-87 limit adjusted annually as specified by Article XIII B as amended by Proposition 111.

Base year appropriations limits for new local government entities incorporated after the enactment of Article XIII B are to be established by local agency formation commissions or county formation review commissions, and approved by the voters of the incorporation or formation elections.

Annual Adjustments to the Limit. The appropriations limit for each year since FY 1980-81 is calculated by adjusting the base year limit for changes in the cost-of-living

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and population. Proposition 111, passed by the voters in June 1990, revised each of the adjustment factors. Specifically, annual adjustments to limits, either upward or downward, are made as follows:

◦ Cost-of-Living.

State and schools. Governments' limits are adjusted by the change in California per capita personal income.

Local agencies (except schools). Limits are adjusted by the change in California per capita personal income or the change in the local property tax roll due to the addition of new nonresidential construction.

◦ Population.

State. The population factor is calculated by adding: (a) the change in the state's total population weighted by the percent of the budget spent on non-educational programs, and (b) the change in average daily attendance (ADA) for K-14 education weighted by the percentage of the budget spent on K-14 education.

Local agencies. The population factor is the percentage change in the jurisdiction or in the county in which the jurisdiction is located. Special districts located in two or more counties may use the change in the county in which the district has the highest assessed valuation.

Counties. The population change for counties can be calculated by using one of three methods: (a) the percentage change in population within the county; (b) the percentage change in population for both the county itself and contiguous counties; or (c) the percentage change in population within the incorporated portion of the county.

K-14 Schools. The change in population is the percentage change in average daily attendance.

◦ Program Transfers. Limits of governmental entities are modified to reflect transfers of financial responsibility from one level of government to another.

The limit of the new service provider is increased by the amount the former service provider's limit is reduced.

◦ Funding Transfers. Adjustments either upward or downward are made to account for transfers of program funding sources, for example from tax revenues (subject to limit) to fees (not subject to limit).

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The level of appropriations actually made by a government entity in any year does not have any bearing on the calculation of the appropriations limit for the subsequent years. Each year's limit is computed based on the prior year's limit, not the prior year's appropriations.

If the governing body actually appropriates less money than what would be permitted by the limit, it has "room" under its limit, and the limit will be further adjusted the following year for cost-of-living and population changes. A government entity does not "lose" room under its limit for the future by appropriating less than the maximum permitted in any year.

Appropriations Permitted in Excess of the Limit. Article XIII B sets forth two circumstances under which governments may make appropriations in excess of their limits:

- Emergency. Appropriations for declared emergencies do not count towards and may be made in excess of the limit. Proposition 111 removed the requirement that the limits for future years must be reduced over a three-year period so that there would be no total increase in allowable appropriations.
- Voter Approval. Article XIII B permits voters of a jurisdiction to authorize an increase in the appropriations limit. However, no voter-approved increase may be in effect for more than four years. At the end of the four-year period, either the voters must approve another increase or the limit must return to the level it would otherwise have been.

When Revenues Exceed the Appropriations Limit. A government entity may receive revenues during a fiscal year that exceed its appropriations limit. Proposition 111 allows governments to average appropriations over a two year period before becoming subject to the excess revenue provisions of Article XIII B. In other words, a government entity can offset appropriations that exceeds its appropriations limit in one year of a two-year period by appropriating less than the limit in the other year. If, after taking this two year averaging into account, authority to appropriate is not provided by either an emergency declaration or voter approval, Article XIII B as amended by Propositions 98 and 111 sets forth a process for disposing of the excess state revenues:

- Education Programs. After the two-year averaging period, 50% of any excess revenues are transferred to the State School Fund for elementary, secondary and community college education. A portion of this excess revenue (25%) may effectively be built into the base used to calculate future funding required by Proposition 98 if the excess funds are used for a specified purpose. The transfer to education is not required if the state's average expenditure per student and average class size is equal to or exceeds that of the ten states with

the best performance in these areas.

- Return of Excess. The 50% of excess revenues remaining after the transfer to education must be returned to taxpayers within the following two years. The return can be made through a reduction in the tax rate or as a fee reduction.

4. HISTORY OF THE STATE'S LIMIT, FYS 1980-81 TO 2004-05

How the Limit is Administered. Under statute, the Governor must submit to the Legislature along with the budget an estimate of the state's appropriations limit for the budget year. The estimate is subject to the budget process, and the official limit is established in the annual Budget Bill. The Department of Finance and the Legislative Analyst's Office have developed the methodologies necessary to compute the limit annually.

Effect of the State's Limit FYS 1980-81 to 1986-87. For the first five years that Article XIII B was operative, it essentially had no constraining effect on state budgets. Changes in population and CPI outpaced the growth in state revenue in the early 1980s, so that actual revenues received were the constraint on the level of state spending until FY 1986-87.

During this period unused "room" under the state's appropriations limit peaked in FY 1982-83 at \$3.4 billion, and declined steadily after that. A decline in the rate of inflation after that time reduced the rate at which the limit was raised annually, while at the same time a robust economy brought steady growth in state revenues. In late 1986, analysts were predicting that by FY 1987-88, the Article XIII B appropriations limit would begin to function as a significant constraint on state spending.

However, an unanticipated surge in tax revenues in the spring of 1987 caught most observers by surprise. That revenue surge, caused primarily by taxpayer reaction to the federal Tax Reform Act of 1986, pushed the state substantially over its appropriations limit for the first time during the 1986-87 fiscal year. The state ended that fiscal year with \$1.1 billion in excess revenues.

FY 1986-87 Rebate of Excess Revenues. During FY 1986-87 Article XIII B required excess revenues to be returned by means of a tax rate reduction or fee reduction. The method selected to deal with the \$1.1 billion in excess state revenues for the 1986-87 FY was to send rebate checks to 11.1 million personal income taxpayers.

The Limit Today. Revisions to the limit calculation implemented by Proposition 111 have continued to result in room under the appropriations limit since 1986. For example, California is expected to be approximately \$9 billion under the appropriations cap in FY 2004-05.

5. RELATIONSHIP BETWEEN THE STATE'S AND LOCAL GOVERNMENTS' LIMITS

Subventions. As noted above, subventions from the state to local governments that are unrestricted as to the purposes for which they may be spent are not counted as state expenditures subject to limit, but rather are counted against the local limit.

With respect to K-12 school districts, a portion of a district's revenue limit apportionment from the state constitutes a subvention for purposes of Article XIII B. Subventions are defined as amounts necessary to fund the "foundation program," after taking into account local tax revenues. The "foundation program" represents a computed value that generally is less than the revenue limit amount. The balance of the regular apportionment, as well as apportionments for categorical programs, are not considered to be subventions. State subventions for community college districts are determined similarly.

Reporting Requirements. Legislation enacted in 1987 requires local entities to include information in their annual budget documents relating to their appropriations limits and their appropriations subject to the limit. Proposition 111 requires that the annual calculation of a local government entity's appropriations limit shall be part of that entity's annual financial audit.

6. CODE

California Constitution, Article XIII B

Government Code Sections 7900-7914

Education Code Sections 41203-41206