LAO

October 9, 2017

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional initiative that would amend the Constitution to allow and facilitate future, but unknown, legislative actions that could substantially increase state healthcare spending and associated tax revenues (A.G. File No. 17-0019).

BACKGROUND

California's Healthcare Landscape

Californians Obtain Healthcare Coverage From a Variety of Sources. In 2017, around 93 percent of California's approximately 40 million residents are expected to have health insurance coverage. The largest source of coverage for state residents is commercial health insurance provided through employers. The next largest source is Medi-Cal, the state's Medicaid program for low-income residents; followed by Medicare, the federal program that provides healthcare coverage to the elderly. The final major source of coverage is the individual health insurance market, through which individuals who do not receive health insurance through their employers or other public programs purchase commercial health insurance either through a health benefits exchange such as the California Health Benefit Exchange ("Covered California") or directly from a health insurance company. The federal government pays a portion of the health insurance costs for low-income individuals who purchase health insurance through Covered California.

Between 2 Million and 3 Million Uninsured Californians. Around 7 percent of the state's population is uninsured. Over half of the state's uninsured residents are undocumented immigrants. The remainder of the uninsured are legal residents who have elected not to sign up for healthcare coverage. A significant portion of uninsured legal residents are likely currently eligible for public financial assistance to obtain healthcare coverage either through Medi-Cal or through Covered California.

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Nearly $400 Billion in Estimated Healthcare Expenditures in California in 2017. Over half of total healthcare spending in the state is expected to come from *public* as opposed to *private* sources. Spending by the federal government is expected to account for around three-fourths of estimated public expenditures, or about two-fifths of overall estimated healthcare spending in California. The federal government funds Medicare, a significant portion of Medi-Cal, and a significant portion of the premium, copay, and deductible costs for eligible individuals who purchase commercial health insurance coverage through Covered California. The state and counties account for the remainder of California's projected public healthcare expenditures. Private healthcare expenditures primarily comprise payments made by individuals, as well as their employers, on commercial health insurance and healthcare.

Healthcare Expenditures Account for Nearly 30 Percent of State Budget. This year, total state spending for all purposes is expected to be about $180 billion. Of this total, about $50 billion (roughly 30 percent) reflects spending on healthcare. Around 80 percent of state healthcare spending is expected to come from the General Fund, the state's main operating account (which receives revenue from a broad variety of taxes and may be used to fund any public purpose). The remaining 20 percent is expected to come from special funds, which are state accounts that have their own revenue sources and are dedicated to specific purposes.

Potential Healthcare Policy Changes

Recently, policy proposals have received consideration at the state and federal levels that could dramatically change healthcare coverage and public healthcare expenditures in California.

Some State Policymakers Considering Single-Payer Healthcare Proposal. In 2017, state legislators introduced Senate Bill (SB) 562, which aims to eliminate commercial health insurance and replace the existing healthcare system with a government-administered single-payer healthcare program. In addition to replacing commercial health insurance with publicly provided coverage, the bill would consolidate existing public healthcare programs—such as Medi-Cal and Medicare—under the single-payer program. A single-payer program similar to that envisioned in SB 562 could cost around $400 billion annually and require new state tax revenues in the low hundreds of billions of dollars. (Existing public healthcare expenditures could potentially be redirected to pay for a portion of a single-payer program, reducing the amount of new revenues that would need to be raised.)

Some State Policymakers Considering Other More Targeted Approaches to Expanding Healthcare Coverage. Certain state policymakers are considering ways in addition to single-payer healthcare to expand healthcare coverage to the remaining 2 million to 3 million uninsured state residents. One approach, for example, is to extend full Medi-Cal coverage to undocumented immigrants who would qualify for Medi-Cal if not for their undocumented status. This approach was partially implemented in 2016 when Medi-Cal coverage was extended to otherwise qualifying undocumented immigrants under 19 years of age. Extending Medi-Cal coverage to all qualifying undocumented immigrant adults would, for example, likely have state costs in the billions of dollars annually.

Potential Changes to Federal Health Policy and Budgeting Priorities Could Reduce Federal Funding of Healthcare in California. Federal lawmakers have recently deliberated

over changes to federal law that, if enacted, could result in the loss of tens of billions of dollars in annual federal healthcare funding in California. Should federal lawmakers enact legislation that significantly reduces federal funding for healthcare in California, state policymakers might decide to replace the lost federal funding with state funding, which could require new state tax revenues in the tens of billions of dollars.

Constitutional Constraints

Two-Thirds Legislative Majority Required to Pass State Tax Increases. In addition to other changes, Proposition 13 (1978) amended the State Constitution to require a two-thirds vote of each house of the Legislature to pass bills that increase taxes. This increased the vote threshold from a "simple majority" (50 percent plus one vote), which applies to most bills.

Constitution Limits State and Local Government Spending; State Nearing Its Spending Limit. Proposition 4 (1979) amended the State Constitution to impose spending limits (technically, appropriations limits) on the state and most local governments. The measure limits spending from tax revenue (such as the sales tax) but not from fee revenue (such as drivers' license fees). A few categories of spending are exempt from the limit—including spending to pay down bond debt, spending on infrastructure like buildings and roads (capital outlay), and in the case of the state, certain transfers of tax revenue to local governments. Current estimates indicate that the state has $6 billion of "room" under its spending limit. In other words, state spending from tax revenues could rise $6 billion before the state would have to take actions to manage its spending limit.

Schools and Community Colleges Receive a Minimum Share of State Revenue. Proposition 98 (1988) amended the Constitution to require the state to provide schools and community colleges a minimum level of funding each year. This minimum requirement—commonly referred to as the minimum guarantee—depends upon various formulas but typically ensures that schools and community colleges together receive at least 40 percent of all state General Fund revenue. The minimum guarantee tends to be sensitive to changes in state General Fund revenue, with the guarantee increasing as state revenue increases.

Constitution Requires Minimum Annual Debt Payments and Reserve Deposits. Proposition 2 (2014) requires the state to make minimum annual debt payments and reserve deposits using a formula specified in the State Constitution. Under this formula, the state must set aside: (1) 1.5 percent of General Fund revenues and (2) revenues from capital gains that exceed a certain threshold. The state combines these two amounts and then allocates half to pay down eligible debt obligations and half to increase the level of the state's rainy day reserve.

PROPOSAL

This measure amends the State Constitution to (1) create a new special fund whose purpose is to fund healthcare-related goods and services; (2) allow the Legislature to pass tax increases with a simple majority vote—rather than a two-thirds vote—as long as the revenues from the new taxes are dedicated to the new special fund; (3) exempt state revenues placed in the fund from any appropriations limit, revenue limit, or spending formula. We describe these changes in greater detail below. The measure, on its own, would *not* create any new healthcare programs,

establish any new taxes, increase existing taxes, or divert existing state revenues to the fund. Rather, the measure is designed to make it easier for the Legislature in the future to raise new state revenues or redirect existing state revenues to pay for state healthcare expenditures—such as, for example, on a single-payer healthcare program.

Creates a New Special Fund That May Be Used to Fund Healthcare-Related Goods and Services. The measure creates the Healthy California Trust Fund (HCTF) in the State Treasury and restricts expenditures from the HCTF to healthcare and healthcare-related goods and services. The measure would further prohibit the loaning of funds from the HCTF and limit the amount of unallocated reserves that can be held in the fund to 12.5 percent of annual deposits.

Allows State Legislature to Pass Tax Increases With a Majority Vote if Revenues Are Dedicated to the New Special Fund. This measure allows the Legislature to pass bills with tax increases with a simple majority vote from each house—rather than a two-thirds vote—as long as the new revenues are dedicated to the HCTF and spent on healthcare-related goods and services.

Exempts State Revenues Dedicated to the New Special Fund From Certain State Spending Rules. The measure exempts any new or existing state revenues that are placed in the HCTF from any appropriations limit, revenue limit, or spending formula:

- ***State Spending Limit.*** Any revenue deposited into the HCTF would be excluded from the state spending limit established by Proposition 4 (1979).
- ***Proposition 98.*** Under the measure, any revenue deposited into the HCTF would be excluded from the calculation of the minimum funding guarantee for schools and community colleges.
- ***Constitutionally Required Debt Payments and Reserve Deposits.*** Under the measure, any revenue deposited into the HCTF would be excluded from annual calculations of constitutionally required reserve deposits and debt payments.

FISCAL EFFECTS

Fiscal Effects Fully Contingent Upon Future Unknown Legislative Action. Because the measure does not, on its own, make any changes to existing healthcare programs, raise new tax revenues, or transfer existing tax revenues, the measure has no *direct* fiscal effects. Instead, the fiscal effects of the measure entirely depend upon whether the Legislature passed future healthcare-related legislation increasing state revenues or transferring existing revenues to the HCTF.

Makes Passage of Tax Increases Easier. By lowering the proportion of votes needed for the Legislature to pass tax increases whose revenues are placed in the HCTF, the measure makes it easier for the Legislature to pass tax increases as long as these new revenues are used to pay for healthcare-related goods and services. These monies could be used to fund new state healthcare programs or healthcare program expansions. The funds could also be used, however, to replace existing state funding for healthcare programs and create more room under the state's spending

limit. This would free up state funds that could then be spent on non-healthcare programs. The measure's exemption of these new revenues from various existing constitutional provisions would ensure that: (1) spending from these new resources would not be constrained by the state's existing spending limit and (2) the state would not have to dedicate a portion of the new revenues to education, debts, and reserves. The above constitutional changes would allow and facilitate potentially large increases in new tax revenues dedicated to healthcare spending.

Potential Redirection of Existing Tax Revenues. In addition to new taxes, the measure's provisions would apply to the redirection of *existing* state tax revenues to the HCTF. Such redirections could be done for various reasons and have a variety of fiscal effects. For example, the state could redirect funds to dedicate more money to healthcare or reduce current spending subject to the state's spending limit. Such redirections could also affect spending requirements related to education, debts, and reserves. For example, redirecting state tax revenue from the General Fund to the HCTF potentially could result in a lower minimum funding requirement for schools and community colleges.

Summary of Fiscal Effects

This measure would have the following impacts:

- No direct fiscal impact on state and local governments.
- Any future impact would be dependent on actions by the Legislature and Governor. The measure makes it easier to increase state tax revenues dedicated to healthcare spending. It could also have a variety of impacts on the state budget—including on the state's spending limit, and spending on healthcare, education, debts, and reserves.

Sincerely,

for Mac Taylor
Legislative Analyst

for Michael Cohen
Director of Finance