

RESEARCH REPORT

Fiscal Democracy in the States

How Much Spending is on Autopilot?

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Contents

Acknowledgments	iv
Executive Summary	v
Introduction and Background	1
Research Approach	5
Major Findings	8
Identifying and Describing State Budget Restrictions	8
States Are Subject to Numerous Budget Restrictions	8
Identifying Binding Restrictions Is Complex	11
Measuring State Budget Restrictions	14
Each State Has a Range of Potentially Restricted Spending	14
A Sizable Share of State Spending Is Restricted	21
Reflecting on State Budget Restrictions	21
States' Restricted Spending Is Growing	22
Some Spending Is Getting Squeezed	23
Everything Is a Policy Choice	26
State Findings	27
California	27
Florida	40
Illinois	50
New York	62
Texas	74
Virginia	87
Conclusion	100
Notes	102
References	121
About the Authors	136
Statement of Independence	138

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Executive Summary

Governors, lawmakers, and journalists often decry constitutional and statutory formulas, federal grant requirements, and court rulings they think excessively limit state budget decisions.

Some observers estimate as much as 70 percent of state spending is “on autopilot,” meaning it is determined before governors propose or lawmakers negotiate a budget.¹ Echoing critics of the federal budget process, they worry that past commitments are driving current policies, ultimately wresting control from voters and threatening “fiscal democracy” (Steuerle 2014).

But measuring predetermined state budget commitments is far from straightforward. At the federal level, the Congressional Budget and Impoundment Control Act of 1974 defines “tax expenditures” as revenues forgone because of special provisions in federal law and defines “mandatory spending” as programs not subject to annual appropriations. These definitions are enforced through the annual budget process. In contrast, few states regularly engage in a rigorous and transparent assessment of tax breaks or spending programs that are either fixed in size or will grow without policy changes.

In this report, we analyze how much spending was restricted or partially restricted in California, Florida, Illinois, New York, Texas, and Virginia from 2000 to 2015.² We define “restricted spending” as spending that requires policymakers to clear identifiable hurdles, beyond the normal appropriations process, to reduce obligations or pare their growth. This definition includes spending subject to formal legal requirements, as well as spending driven by inflexible or increasing caseloads, rising costs, or perceived political constraints.

We rely on a mix of qualitative and quantitative methods that allows us to explore state- and program-specific sources of restriction beyond well documented categories such as pensions, other postemployment benefits, debt service, and Medicaid. Further, whereas existing research tends to focus on future burdens arising from underfunded pensions and other deferred obligations, we examine the consequences for spending areas that may already be squeezed today.

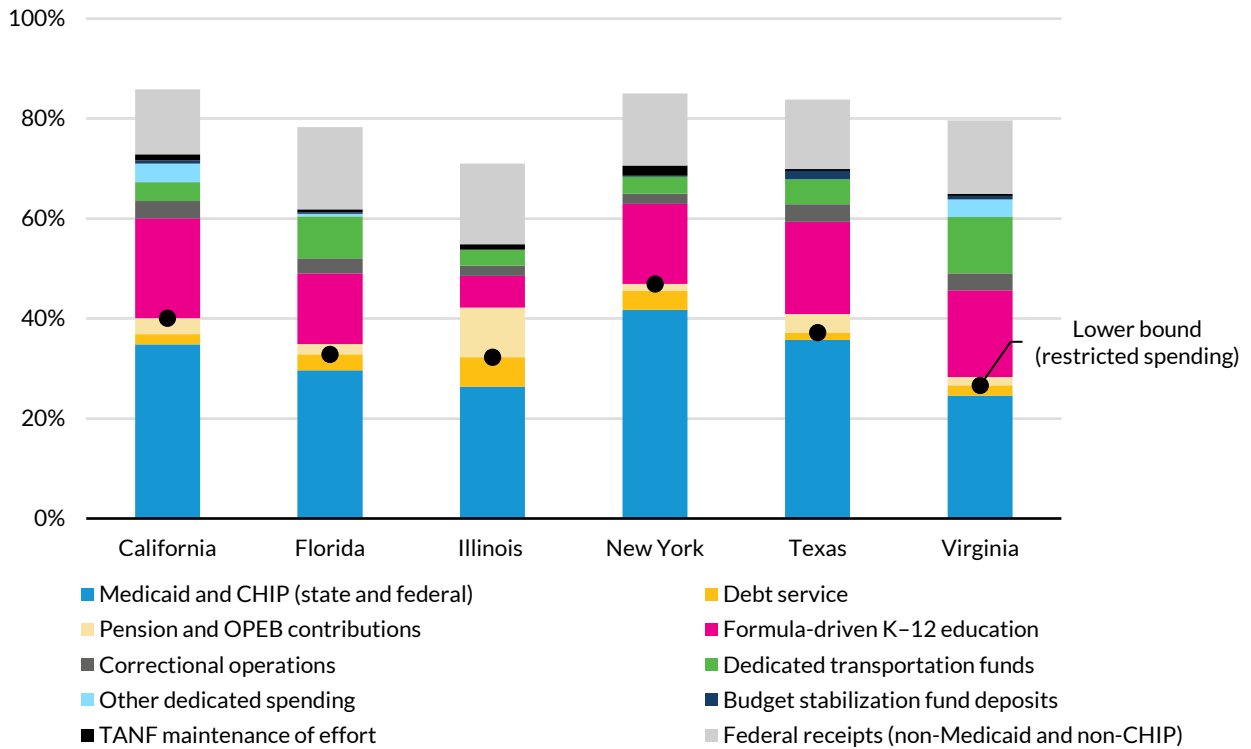
Because state restricted spending can have many different meanings and effects across states and over time, it cannot easily be classified into a single category (as the federal Congressional Budget Office does with its definition of federal “mandatory” spending). So, we present all quantitative estimates in ranges, as discussed in our findings that follow.

As much as 70 to 90 percent or as little as 25 to 50 percent of total state spending (including federal funds) was restricted in 2015. At the high end of our estimates, 71 percent of Illinois’s and 86 percent of California’s spending was at least partially restricted in fiscal year 2015 (figure ES.1). At the low end, 27 percent of Virginia’s and 47 percent of New York’s spending was restricted in that year.

FIGURE ES.1

Restricted Spending in Six States, Share of Total Annual Spending, FY 2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors’ analysis of state Comprehensive Annual Financial Reports, governors’ proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = Children’s Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. “Total annual spending” includes spending from all revenue sources, including federal funds. “Medicaid and CHIP” includes federally financed spending. Federal receipts include all non-Medicaid and non-CHIP federal receipts. In California, “Formula-driven K-12 education” includes the K-14 minimum funding guarantee related to Proposition 98 (1988). Data on OPEBs were unavailable for Illinois, New York, and Virginia. Values in this figure may not sum to those in table ES.1 because of rounding.

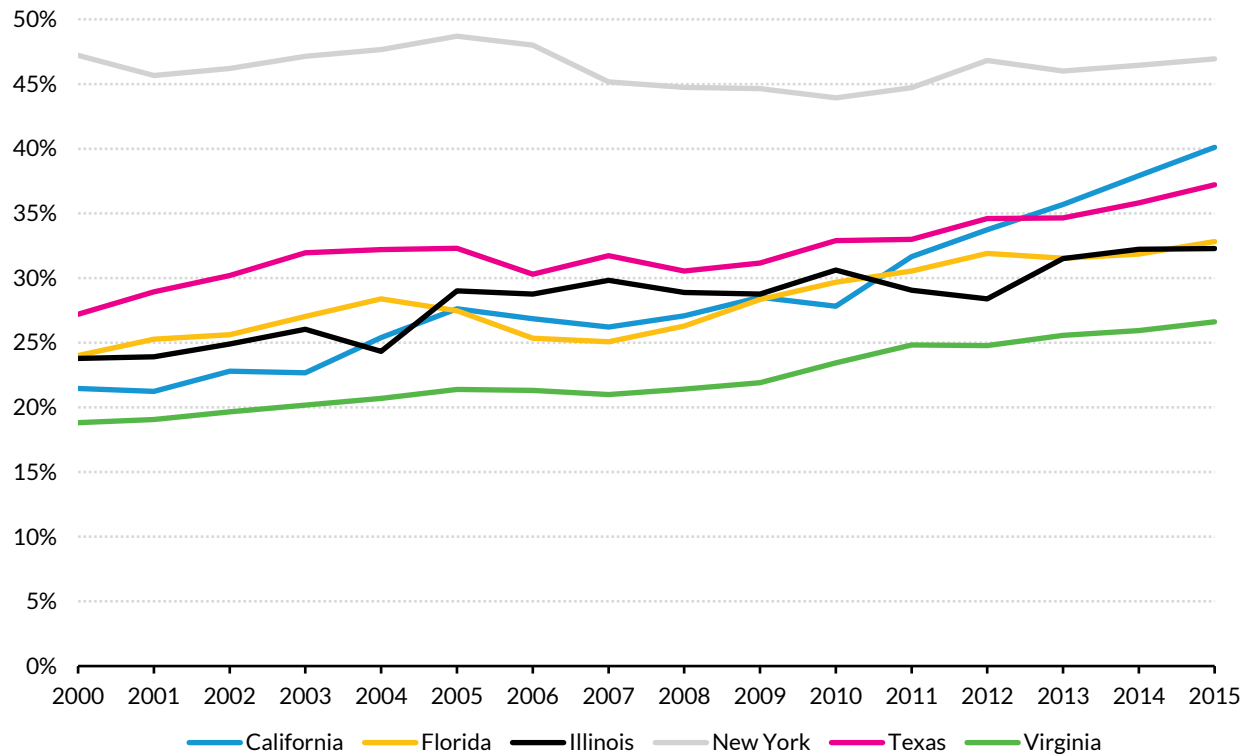
State budgets appear to be growing more restricted over time. At the low end of our estimates, the share of total spending subject to restrictions grew roughly 8 to 19 percentage points in all but one of our study states from 2000 to 2015 (figure ES.2). New York was the exception, although its restricted spending was already elevated at the start of our study period. Moreover, aging populations

in most states, tied with significant historical underfunding of pension plans and growing health care costs, could cause state budgets to become even more restricted in the future.

FIGURE ES.2

Minimum Restricted Spending in Six States, Share of Total Annual Spending, FY 2000–2015

Estimated lower bound of state restricted spending



Source: Authors’ analysis of state Comprehensive Annual Financial Reports, governors’ proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

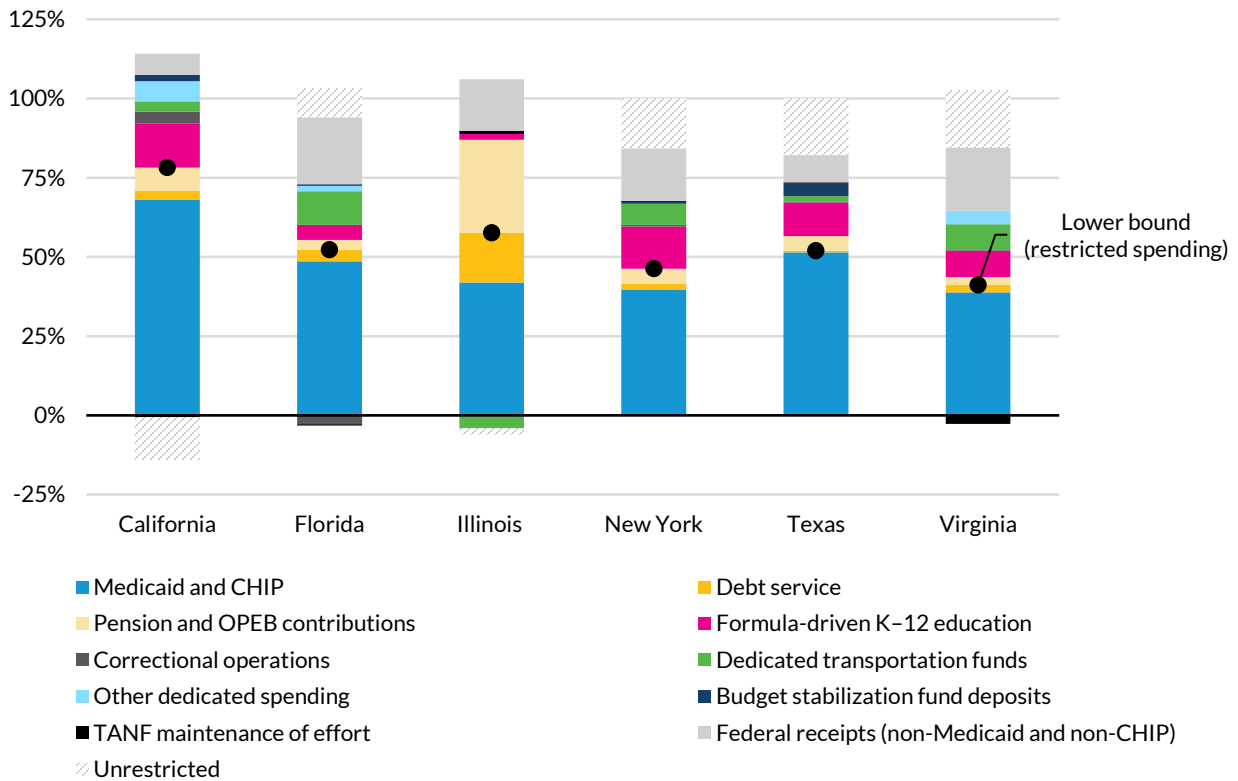
Notes: FY = fiscal year. “Total annual spending” includes spending from all revenue sources, including federal funds. Per our estimates, the lower bound of restricted state spending includes all Medicaid and Children’s Health Insurance Program spending (federally and non-federally financed), and the state’s annual debt service payments. In New York, the lower bound also includes annual state pension contributions, and in California annual state pension and other postemployment benefit contributions. Values in this figure may not sum to those in table ES.1 because of rounding.

Restricted or partially restricted categories consumed nearly all or, in some cases, more than all real state spending growth from 2000 to 2015 (figure ES.3). Medicaid (including federal funds) accounted for about half of real growth in total US state spending over this 15-year period,³ although other federal grants, formula-driven K–12 education spending, pensions, and debt service were also important contributors.

FIGURE ES.3

Restricted Spending in Six States, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors' analysis of state Comprehensive Annual Financial Reports, governors' proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = Children's Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. "Total real spending growth" reflects inflation-adjusted growth in spending from all revenue sources, including federal funds, between 2000 and 2015. "Medicaid and CHIP" includes federally financed spending. Federal receipts include all non-Medicaid and non-CHIP federal receipts. In California, "Formula-driven K-12 education" includes the K-14 minimum funding guarantee related to Proposition 98 (1988). Data on OPEBs were unavailable for Illinois, New York and Virginia. Values in this figure may not sum to those in table ES.1 because of rounding.

Comparing spending growth by category to spending growth overall, we find that cash assistance, higher education, and corrections bore much of the squeeze on spending. States may also have opted not to undertake new options or initiatives, such as expanding pre-K education, as a result of this squeeze.

However, many respondents reported that everything was flexible, especially in a crisis such as a recession. Because of the inherent subjectivity in defining budget restrictions, we provide detailed results and an accompanying data appendix so that readers can make their own determinations about states' levels of budget restriction (table ES.1) (Boddupalli and Randall 2019).

In all, we discovered that governors and legislators must weave their way through a multifaceted and complex maze of restrictions, not just to adopt a budget and make appropriations, but also to set new priorities. Having a substantial share of the state budget precommitted may in turn encourage advocates to push for locking in or earmarking revenues for their choice programs, further reducing spending flexibility.

TABLE ES.1

Restricted State Spending: Defining Upper and Lower Bounds

Lower (L) and upper bound (U) as share of total spending (FY 2015) and real spending growth (FY 2000–2015) Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions

		CA	FL	IL	NY	TX	V A
Total spending FY 2015^a	(billions \$)	250	75	69	140	104	35
	(L % restricted)	40	33	32	47	37	27
	(U % restricted)	86	78	71	85	84	80
Total real spending growth FY 2000–2015^b	(billions \$)	82	23	17	40	42	12
	(L % restricted)	78	52	58	46	52	41
	(U % restricted)	114	91	102	84	82	82
Restricted spending	Medicaid and CHIP (state and federal) ^c	L	L	L	L	L	L
	Debt service	L	L	L	L	L	L
	Pension and OPEB contributions ^d	L	U	U	L	U	U
	Formula-driven K–12 education ^e	U	U	U	U	U	U
	Correctional operations	U	U	U	U	U	U
	Dedicated transportation	U	U	U	U	U	U
	TANF maintenance of effort	U	U	U	U	U	U
	Federal receipts (non-Medicaid)	U	U	U	U	U	U
	Budget Stabilization Fund deposits ^f	U	U		U	U	U
Other state programs ^g	U	U				U	

Sources: Authors’ analysis of state Comprehensive Annual Financial Reports, governors’ proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = Children’s Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families.

^a “Total spending” includes spending from all revenue sources, including federal funds.

^b Real spending growth reflects inflation-adjusted growth in total spending between 2000 and 2015.

^c Includes federal and non-federal funds. The state share may also include local contributions toward the state’s nonfederal match requirement.

^d We combined pension and OPEB contribution data because data were only available as a combined total in some states and years. For Illinois, New York, and Virginia, we were unable to obtain separate state OPEB contributions and therefore excluded OPEBs from our analysis in those states, although they are a part of the states’ restricted spending landscape.

^e In California, this includes the K–14 minimum funding guarantee related to Proposition 98 (1988).

^f Illinois does not have a binding Budget Stabilization Fund.

^g In California, this includes state-local realignment funds; in Florida, the Voluntary Prekindergarten Education Program; and, in Virginia, the Personal Property Tax Relief Act of 1998 and Department of Justice behavioral health settlement (2011). We did not quantify other state programs for Illinois, New York, or Texas.

Conversely, some costs are seen as inflexible in the short term because of fixed caseloads or labor costs but more flexible in the long term. For example, we found that states can and did relax sentencing policies to reduce their incarcerated populations or retirement benefits for new employees, but these changes take time to affect spending.

We conclude by recommending how states can better examine, report on, and address budget restrictions. Showing how much spending growth is caused by past constraints (including federal requirements) versus by proposed or newly enacted legislation would be a significant improvement over current practices in many states. States should also prepare and present estimates of the cost to maintain existing service levels given projected caseloads and cost increases or proposed program changes (i.e., a current services budget). Although state budget offices and agencies routinely assemble this information for internal purposes, only a few states prepare and release comprehensive, multiyear projections (McNichol and Grundman 2011; McNichol, Lav, and Leachman 2015).

Why is grappling with state budget restrictions so important? Considered in isolation, each tax or spending restriction may have some merit by locking in important commitments. But together, they create a block of preexisting priorities against which residual options, those that lack such protections, must compete. Only by examining these commitments consistently over time can governors, legislators, and voters determine how well their fiscal constitutions and procedures help them meet short- and long-term priorities, set reasonable planning expectations for citizens over time, and retain the flexibility necessary to progress as new challenges and opportunities arise.

Introduction and Background

In November 2004, California Governor Arnold Schwarzenegger was eager to kick off a “year of reform” (Mathews 2006). His first year in office (after the second successful gubernatorial recall in US history) had produced many political wins, including securing voter approval for a plan to help California recover from a multi-billion-dollar budget hole (LAO 2003). However, the governor was feeling hemmed in by long-standing features of California governance, especially what he called “automatic pilot” spending.⁴

Governor Schwarzenegger was especially vexed by California’s constitutional formula for calculating state funding for K–14 education (elementary and secondary public schools, county education offices, and community college districts). At the height of the budget crisis, he had struck a deal with the California Teachers’ Association to suspend the formula, known as Proposition 98 (its originating ballot measure, adopted in 1988). However, that suspension was about to expire, and the state’s improving economy and finances meant the state was now on the hook for another \$3 billion in K–14 funding over seven years (LAO 2004, 2007).

The problem went beyond Proposition 98, according to Governor Schwarzenegger’s budget team. They projected that a growing economy would increase state revenues by \$5 billion in the next year, but various commitments and formulas would cause spending to grow by \$10 billion unless the governor or legislature altered these obligations (Schwarzenegger 2005). Governor Schwarzenegger concluded: “the way the formulas now work, we will never catch up. No matter how well we do, the current system is programmed to spend even more” (Schwarzenegger 2005).⁵

Governors, lawmakers, and many observers outside of government have long decried the constitutional and statutory formulas, federal grant requirements, court decisions, and political constraints they think overly restrict annual or biennial state budget decisions.⁶ Like critics of the federal budget process, they worry that past commitments are driving current policies, and taking decisionmaking authority out of the hands of governors, legislators, and ultimately voters. Steuerle (2014) has called this a loss of “fiscal democracy.”

At the federal level, this trend is due in part to growth in so-called mandatory spending. Mandatory spending includes programs such as Medicare, Medicaid, and Social Security, where the law requires the federal government to pay benefits to individuals meeting eligibility criteria even if per capita benefits and the eligible population are growing over time (CBO 2018). Further, interest payments and many federal tax exemptions, exclusions, and deductions escape annual budget review.

BOX 1

Budget Basics: What Do States Do?

State governments spent \$2.2 trillion in fiscal year 2016.^a They spent \$1.4 trillion directly on general government services,^b roughly two-thirds of which went toward programs in education, health, and public welfare (a broad functional category that includes the majority of Medicaid as well as Temporary Assistance for Needy Families (TANF) and other cash assistance and services for low-income residents).

States allocate much of their own and federal funds to local governments. In 2016, state transfers to counties, cities, school districts, and other special-purpose governments (such as sewer and water authorities) constituted about a quarter of all state spending. Most state aid to local governments (about two-thirds) goes to support programs in education.

States get roughly half of their general revenue from taxes, another third from federal grants (mostly Medicaid),^c and the remaining fifth from charges (including public college and university tuition, public hospital payments, and highway tolls) and other sources.^d Sales taxes, including business gross receipts taxes and separate taxes on motor fuel, cigarettes, and alcohol, are the single largest source of state tax revenue (about a quarter of the total), followed by individual income taxes (18 percent).

State finances have drawn scrutiny in recent years. The Great Recession made clear how much states rely on unstable revenue sources that rise and fall with the economy despite paying for functions for which demand remains constant or increases during an economic downturn. Further, many analysts have called attention to potential budget pressures from rising health costs and aging populations (GAO 2018; State Budget Crisis Task Force 2014).

Source: US Census Bureau, Annual Survey of State and Local Government Finances and Census of Governments, 2000–15, accessed via “Data Query System,” Urban-Brookings Tax Policy Center (TPC), July 2, 2019, <https://slfdqs.taxpolicycenter.org>.

Notes:

^a Total direct and intergovernmental expenditures.

^b Excludes intergovernmental transfers, spending from insurance trusts, such as employee retirement systems, as well as spending on utilities and government-run liquor stores (US Census 2006).

^c See “What Types of Federal Grants Are Made to State and Local Governments and How Do They Work?” TPC Briefing Book, accessed June 27, 2019, <https://www.taxpolicycenter.org/briefing-book/what-types-federal-grants-are-made-state-and-local-governments-and-how-do-they-work>.

^d Excludes revenue from insurance trusts, such as employee retirement systems, as well as utilities and government-run liquor stores (US Census 2006). See “What Are the Sources of Revenue for State Governments?” TPC Briefing Book, accessed June 27, 2019, <https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-state-governments>.

It is tempting to assert that, as at the federal level, state fiscal democracy is waning. Unlike the federal government, states are subject to balanced-budget requirements, which in theory further restrict states’ ability to juggle existing spending commitments with new priorities. But measuring state fiscal democracy is far from straightforward. States do not have “mandatory spending” defined by law

and reinforced by annual budget processes.⁷ Although many states report on tax expenditures, they do not do so in a manner comparable across states and over time (Pew 2017a).

More broadly, states occupy a different role than the federal government in the US public sector (box 1). Whereas the federal government collects most tax revenue, states (and local governments) provide most domestic public goods and services and employ most public-sector workers.⁸ In addition to legal restrictions, such as balanced-budget requirements (box 2 and table 1), governors and lawmakers face political imperatives to provide a certain level of services even if wage growth, demographic change, or new technologies make it more expensive to do so.

BOX 2

Budget Basics: What Institutions Govern State Budgeting?

Unlike the federal government, nearly all states have balanced-budget requirements. However, the stringency of these measures varies considerably. Some rules require only that governors submit, or legislatures enact, a balanced budget; other more stringent rules prohibit states and localities from carrying over a deficit from year to year (Rueben, Randall, and Boddupalli 2018).

Constitutional balanced-budget requirements are more difficult to override and are hence generally viewed as stricter than statutory requirements (Randall and Rueben 2017). But even strict balanced-budget requirements usually exclude capital and federal funds in addition to funds earmarked for specific purposes, such as transportation. Illinois, for example, has frequently circumvented its balanced-budget requirement, and has had a cash-based accounting deficit year-over-year since 2001 (Schuster 2018). Creditors' willingness to lend is the ultimate deterrence against an unbalanced state budget. In general, bond markets tend to frown on debt used to cover operating expenses.

Additionally, in 2015, 34 states had some kind of tax or expenditure limit, restricting revenues, expenditures, or both, to a fixed-dollar amount or tying them to an increase in population, inflation, personal income, or some combination of those factors.^a Similar to balanced-budget requirements, tax and expenditure limits are considered more binding if they require a legislative supermajority or popular vote to override.

Notes:

^aCount includes states requiring a supermajority vote of the legislature to raise new taxes or revenues. See "What Are Tax and Expenditure Limits?" Urban-Brookings Tax Policy Center Briefing Book, accessed June 27, 2019, <https://www.taxpolicycenter.org/briefing-book/what-are-tax-and-expenditure-limits>.

TABLE 1

Budget, Tax, and Spending Rules in Six States, FY 2015

Institution	Description	CA	FL	IL	NY	TX	VA
Balanced-budget requirement	Legislature must pass ^a	✓	✓	✓	✓	✓	
	Governor must sign	✓					
	Deficit carryover prohibited					✓	✓
	Other binding provision ^b	✓	✓	✓		✓	
Tax or expenditure limit	Binding state expenditure limit	✓					
	Binding state revenue limit		✓				
	Legislative supermajority to raise revenues ^c	✓	✓				

Source: Rueben, Randall, and Boddupalli (2018).

Notes: FY = fiscal year.

^a In New York, the governor is required to submit a balanced budget and has significant influence over budget negotiations, resulting in a practical, if not formal, requirement for the legislature to pass a balanced budget.

^b “Other binding” balanced-budget requirements include requiring the legislature to pass a balanced budget in conjunction with additional provisions requiring the state to implement a balanced budget mid-year.

^c Florida’s supermajority requirement applied only to corporate income tax until 2018, when voters passed a constitutional amendment applying the supermajority requirement to all new taxes and fees. See Fla. Const. art. VII, § 19.

Because of these data and conceptual issues, no one really knows how much state spending is predetermined. Academic papers have examined “budget spillovers,” meaning instances when pressure to spend in one area reduces spending in another (e.g., Baicker 2001; Baicker and Gordon 2006). For example, researchers have documented a persistent negative relationship between state higher education appropriations and Medicaid spending (e.g., Kane, Orszag, and Apostolov 2005; Webber 2018). In more applied work, credit analysts have assessed state fiscal stress arising from the fixed costs of state government. Fixed costs usually include some combination of debt service, pensions, other postemployment benefits, and Medicaid (e.g., Cembalest 2018; Petek et al. 2018; White, Metcalfe, and Crane 2018). Some of these reports note sources of unconventional budget flexibility, such as the ability to make interfund transfers, defer certain payments, and shift costs to lower government levels, as factors weighing in states’ favor.

Meanwhile, media commentators have raised concerns that pensions, other retirement costs, and Medicaid will increasingly crowd out vital investments in education and infrastructure, leading to a service insolvency.⁹ To our knowledge, however, no previous work has examined how state-specific budgeting constraints (including formal constitutional or statutory requirements as well as informal caseloads, costs, and political pressures) may already be crowding out other spending choices. The remainder of this report is as follows. After a brief description of data sources, we summarize major findings. We then present detailed results for each of our six states (California, Florida, Illinois, New York, Texas, and Virginia) from 2000 to 2015. We conclude with observations on how states could improve transparency and accountability about potential sources of budget restriction.

Research Approach

To track how states and localities get and spend money, researchers typically rely on data from the US Census of Governments. The US Census Bureau conducts a full census every five years of the nation's 50 states and more than 90,000 local governments.¹⁰ It also performs an annual survey of all states and a sample of localities. For both products, Census Bureau personnel sift through numerous government budgets and financial statements to assemble the most consistent, reliable, and comprehensive data set available. However, the Census Bureau achieves this standardization by aggregating budget and financial information up to functional categories (e.g., public welfare) that are too broad for much of our analysis.

The National Association of State Budget Officers (NASBO) collects and provides more fine-grain data by program (e.g., Medicaid) and fund type (i.e., general, other, federal, and bond funds). It makes these data available to researchers going back to 1991. However, although NASBO also provides detailed information on state fiscal institutions (e.g., rainy-day funds), it does not match spending data to institutions or infer how much spending in a year was required by a given institution or other restriction.

We therefore created our own dataset based on state Comprehensive Annual Financial Reports; proposed and enacted budgets; and other state documents, such as bond offering statements and independent legislative analyst reports.¹¹ We also relied, where appropriate, on federal data, including Centers for Medicare & Medicaid Services state expenditure reports on Medicaid and Children's Health Insurance Program (CHIP) and data from the Census of Governments and Annual Survey of State and Local Government Finances, referenced above.

We examine the five most populous states (California, Florida, Illinois, New York, and Texas) and Virginia, partly because of better information and reporting in those states. For example, the Texas Legislative Budget Board (LBB) produces a biennial *Fiscal Size-Up* report that includes a detailed accounting of "restricted appropriations" (LBB 2018), and the California Legislative Analyst's Office prepared briefings on budget flexibility and restrictions as the state confronted fiscal effects of the Great Recession (LAO 2009).

We included Virginia to bring additional geographic, population, and political diversity to our case studies and because Virginia was prominently featured in the State Budget Crisis Task Force (2012c) analysis. The task force identified areas Virginia could improve but also praised Virginia's sound

financial management practices. We desired to capture this perspective in our analysis and to benefit from the additional national information already available on Virginia.

Focusing on these states allowed us to delve deeply into each state’s budgeting and fiscal practices and have our states represent about 40 percent of the US population (table 2). Although we were interested in identifying long-term trends and spending restrictions may be long-standing, data constraints required us to restrict our attention to fiscal years 2000 to 2015.¹² We chose 2015 as the terminal year to allow comparisons to the most recent US Census Bureau and NASBO data at the time of our study.

TABLE 2
Study State Characteristics, 2015
Population, expenditures, and GDP

	US state total	CA	FL	IL	NY	TX	VA
Population (millions)	321.0	39.0	20.2	12.9	19.7	27.5	8.4
Total expenditures (\$ billions)	1,872.4	258.6	77.1	71.5	143.9	114.6	47.1
State-financed expenditures (\$ billions)	1,277.3	165.1	51.6	53.6	98.1	71.1	37.3
GDP (\$ billions)	18,842.0	2,644.5	925.6	818.7	1,539.1	1,622.3	501.3

Sources: Authors’ analysis of data obtained by request from the National Association of State Budget Officers (NASBO); as well as US Census Bureau, “Resident Population” by state, and US Bureau of Economic Analysis, “Total Gross Domestic Product” by state, retrieved from “FRED,” Federal Reserve Bank of St. Louis, accessed April 23, 2019, <https://fred.stlouisfed.org>.

Notes: GDP = gross domestic product. State-financed expenditures includes the general fund, other state funds, and bond funds; federal funds are excluded.

To inform our data collection and analysis, we conducted structured information-gathering interviews with key informants in each of our study states. The interviews followed a script of open-response questions, detailed in Boddupalli and Randall (2019). In each of our study states, we sought to confer with at least one respondent who is (a) currently or formerly in a governor’s budget office, (b) on legislative committee staff, (c) an independent fiscal analyst, and (d) in an advocacy group (Boddupalli and Randall 2019). In some cases, we were unsuccessful securing participants in those formal roles. However, we often found others willing to speak with us on background. Key informants also consulted in subsequent informal communications on questions about data sources and specific restrictions.

We provide a range of estimates for potentially restricted spending in each of our study states. We estimate potentially restricted spending for 2015, breaking out each potentially restricted category as a share of total spending annually back to 2000 and as a share of total real spending growth from 2000 through 2015.

In all states, our measure of total spending (the denominator) includes spending financed by state own-source revenues, bonds, and federal receipts.¹³ Although many policymakers take a keen interest in state own-source revenues and how those are spent, federal revenues and grants provide significant incentives as well as requirements for states.¹⁴ Excluding them from our analysis would obscure an important element of policymakers' fiscal decisionmaking process and a possible limitation on states' flexibility.

Except for Medicaid, CHIP, and federal receipts, each category of restricted spending (the numerator) reflects only the state-financed portion of spending on that item (e.g., pension contributions refer to state-financed contributions, excluding local employer and employee contributions; and K-12 spending includes only state funding and excludes any local or federal K-12 financing). Medicaid and CHIP include both federally and nonfederally financed contributions; federal receipts include all other (i.e., non-Medicaid and CHIP) federal funds.

In all states, our total spending measure excludes tuition and fees for higher education, which flow into separate proprietary or enterprise funds outside the scope of our research. Higher education analyses routinely separate tuition and fees from public appropriations to accurately estimate public investment in higher education.¹⁵ Our measure does include general fund spending that goes toward the higher education system (capturing public investment in higher education).

For detailed data and technical documentation, key informant interview methods, as well as citations and documentation for our case study states, please see *Fiscal Democracy in the States: Data Appendix* (Boddupalli and Randall 2019).

Major Findings

In some ways, our results validate complaints from governors and state legislators that they have little flexibility to adapt or shift priorities, even in response to an electoral mandate. Our analysis also places bounds on that discussion by quantifying degrees of spending restriction and illustrating where budget preparers may have room to maneuver (even if they can only do so temporarily and at the cost of squeezing other budget categories or reducing long-term flexibility). We present major findings in this section and provide detailed profiles of individual states in the sections that follow.

Identifying and Describing State Budget Restrictions

Below, we introduce a comprehensive conceptual framework for evaluating state budget restrictions. By “restricted” spending, we mean spending that faces identifiable hurdles for being pared (or its growth being pared) beyond the normal appropriations process. This definition includes spending subject to formal legal requirements, relatively inflexible or increasing caseloads and costs, and perceived political constraints (meaning the public has come to view the spending as especially obligatory).

States Are Subject to Numerous Budget Restrictions

Unlike the federal government, states do not use concepts of “mandatory” and “discretionary” spending in preparing, negotiating, implementing, and evaluating their budgets. But annual or biennial spending decisions may be constrained in many ways. Our review of the literature and state budget practices, as well as conversations with state informants, led us to identify seven distinct categories of potential spending restrictions (table 3). Although previous literature has looked at particular programmatic buckets (e.g., pensions or Medicaid spending) as a proxy for states’ levels of obligated spending,¹⁶ our research pointed to many complex and interacting restrictions that we enumerate below.

TABLE 3

A Framework for State Budget Restrictions

Type	Description
Long-term obligations	Debt service and pension programs, as well as other postemployment benefits, as in the California Public Employees' Retirement System or the Florida Retirement System.
Programmatic	<p>Provisions that require the state to (1) spend a certain amount on a particular area or program (e.g., state funding formulas in K-12 education); (2) earmark all or part of a specific revenue source for particular functions or funds (e.g., motor fuel taxes for highway construction); or (3) spend a certain amount to comply with federal program participation requirements (e.g., the nonfederal matching share of Medicaid or Temporary Assistance for Needy Families maintenance of effort). Also includes costs incurred from required state administration of federal programs such as the Community Development Block Grant, Supplemental Security Income, and the Supplemental Nutrition Assistance Program; or federal laws or regulations that amount to unfunded spending mandates for state governments.</p> <p>California's mandatory guaranteed funding for K-14 education under Proposition 98 (1988) falls into this category, as does the state share of spending on Medicaid and the Children's Health Insurance Program, and smaller state programs, such as Florida's Voluntary Prekindergarten Education Program.</p>
Institutional	Fiscal institutions that restrict spending or revenues. These provisions may require the state to deposit a portion of revenue or spending into a Budget Stabilization Fund or limit flexibility indirectly by restricting overall expenditures or revenues, as in the case of a strict tax or expenditure limit (box 2 and table 1). California and Florida have strict Budget Stabilization Fund deposit rules, for example.
Local aid	Required revenue sharing with local governments or obligations to provide general support for local government services. California provides required funding to local governments to cover the realignment of state services to local governments.
Federal	Federal receipts that are dedicated to particular programs or functional spending areas, including for example the federal share of Medicaid spending, transportation spending, or federal receipts flowing toward other programmatic areas not in our analysis. All federal receipts are assumed to be dedicated to a specific purpose, although state flexibility on use of these funds varies by program.
Judicial	Court interpretations of state constitutional or statutory requirements that create new spending requirements. Such interpretations may be found in court decisions, consent decrees, or other legally binding documents. For example, many states must comply with requirements related to <i>Olmstead v. L.C.</i> , a 1999 US Supreme Court case establishing community-based living requirements for individuals with disabilities. In another example, New York must invest resources to comply with a 2014 settlement on indigent legal services (<i>Kimberly Hurrell-Harring v. State of New York</i>).
Indirect	<p>Tax policy decisions that lead to forgone revenue restrain fiscal flexibility by restricting revenue availability. A permanent tax cut in one session may affect future lawmakers' ability to raise sufficient revenues, producing a spending squeeze. Economic development tax credits, such as film tax credit programs in many states, may fall into this category if they result in forgone revenue from projects that would have gone forward without the credit.</p> <p>Other factors place pressure on state budgets in a more diffuse or indirect way that is difficult to quantify, including for example minimum wage increases for public employees or local revenue caps that put additional pressure on the state to fund services.</p>

Sources: Authors' analysis based on literature review, data analysis, and key informant interviews. Categories are not mutually exclusive and may overlap. For additional detail on state examples referenced, see Boddupalli and Randall (2019).

Although lawmakers could technically loosen almost any restriction, doing so would involve clearing hurdles beyond the normal appropriations process and overcoming significant political and practical challenges. For example, some state officials at least rhetorically contemplated opting out of the federal-state Medicaid program (box 3) during the Great Recession because they could not come up with state dollars to draw federal matching funds. However, leaving Medicaid would not only increase the uninsured population, it would also lead to less federal funding for public hospitals and other undesirable budget consequences.¹⁷

BOX 3

Budget Basics: Medicaid and the Children’s Health Insurance Program

Medicaid is states’ single largest spending category when including federal funds, and it is their second largest when considering state funds alone.^a Medicaid and CHIP are joint federal-state programs that provide health insurance to low-income children, seniors, pregnant adults, and adults with dependent children or a qualifying disability. By 2019, 37 states and the District of Columbia had also expanded their program to include low-income adults without children, as permitted under the 2010 federal Affordable Care Act (ACA).^b

The federal government matches state Medicaid spending dollar for dollar at minimum; higher-need states receive a higher match.^c Higher matches may also apply to select services or populations. For example, the federal government initially paid 100 percent of the ACA expansion cost, with the rate declining incrementally until it reaches 90 percent in 2020.

To qualify for federal Medicaid and CHIP dollars, states must cover certain populations at minimum income thresholds. They may choose to extend eligibility to additional groups, apply more generous income thresholds, or operate under waivers that further expand state control over eligibility criteria (MACPAC 2017a).

States must also cover a mandatory suite of services, such as hospital and physician services, for all enrollees. Other services, such as prescription drugs or in-home supportive services for seniors, are technically optional (Artiga et al. 2017; MACPAC 2018a). In practice, however, all states provide some prescription drug coverage to ensure continuity of care, and states often provide home- and community-based services to avoid legal challenges.^d

Notes:

^a Authors’ analysis of data from the National Association of State Budget Officers, obtained by special request. See table 8.

^b See “Status of State Medicaid Expansion Decisions: Interactive Map,” Henry J. Kaiser Family Foundation (KFF), May 13, 2019, <https://www.kff.org/medicaid/issue-brief/status-of-state-medicaid-expansion-decisions-interactive-map/>.

^c State per capita income relative to the national average determines need. See “Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier,” State Health Facts, KFF, accessed June 27, 2019, <https://www.kff.org/medicaid/state-indicator/federal-matching-rate-and-multiplier/>; and Mitchell (2018).

^d In 1999, the US Supreme Court ruled in *Olmstead v. L.C.* that institutionalizing a person with a disability who can benefit from living in the community is illegal discrimination under the Americans with Disabilities Act. See Artiga et al. (2017).

Identifying Binding Restrictions Is Complex

State informants cautioned us against applying a rigid, quasi-federal definition of “mandatory spending” to states, observing that the issue is “not black and white”¹⁸ and can depend on factors such as overall economic and fiscal conditions (e.g., whether the governor and legislature are trying to close a budget gap), federal action (e.g., interpretations of regulations), and risk tolerance (e.g., willingness to invite legal challenges). We identified three factors that can illuminate how relatively flexible or binding a state’s budget restrictions are:

- **What is legally required?** Some restrictions are legal: they are built into state constitutions, statutes, or case law. Among our study states, all six have minimum funding requirements for K–12 education borne out of court cases or legislative action. Additionally, all have revenues dedicated to specific purposes, such as transportation. In another example, all US states have contractual requirements to pay debt service, and many reinforce this repayment pledge through statutory and constitutional debt provisions.¹⁹ As discussed in this section, however, legislatures can override, amend, or interpret laws to maintain flexibility, at least in the short term.
- **What is growing?** State budget preparers may be prevented from reducing spending or spending growth because of relatively inflexible caseloads and costs that grow with program enrollment or inflation. For example, informants in California, Florida, Illinois, Texas, and Virginia identified corrections expenses as restricted. Although states could change sentencing policies to reduce prison populations, budget flexibility would take years to materialize because of people already in the system.²⁰
- **What gets cut?** Another way to determine what spending is relatively fixed is to look instead at what spending gets cut, particularly when revenues are down following a recession. Interview respondents consistently reported that public colleges and universities have borne the brunt of budget shortfalls.²¹ To make ends meet, states have also offloaded service responsibilities to local governments or cut local aid (box 4). But in some states (e.g., California) these cuts have been met with political opposition and led to local government protections that further restrict future state budget choices. Informants in Florida, New York, and Virginia also observed that lawmakers can “starve” programs by holding allocations constant and not adjusting for inflation.²²

K–12 education offers an example of how spending restrictions can interact and bend when necessary. All of our study states have some legal obligation to fund K–12 education, but many states

override minimum funding requirements. In California, for example, the state constitution imposes a strict minimum funding guarantee for K–14 education (i.e., a legal funding floor).²³ However, the state can legally override this minimum (in the short term) with a supermajority vote of the legislature under specific circumstances and has done so twice since 1988 (LAO 2017a).²⁴ In the long term, however, the state is required to make up any deferred payments.

Conventional wisdom holds that public education is politically popular and therefore hard to cut.²⁵ State informants reported that governors and legislatures face strong pressure to maintain K–12 education funding, even during a recession. However, because K–12 education constitutes such a large share of state spending (19 percent in 2015),²⁶ states have difficulty balancing their budgets during a fiscal crisis without touching public education (Reschovsky 2004).²⁷ Most states implemented cuts to K–12 education during the Great Recession (Leachman, Masterson, and Figueroa 2017), including our study states. However, these cuts were partially offset by assistance from the federal government and a greater reliance on local governments to make up lost funds (box 4).

During the Great Recession, our study states employed a variety of mechanisms to reduce funding requirements when revenues were tight. The Florida legislature, for example, adjusted its statutory formula inputs, such as cost factors and the base per student allotment.²⁸ The Virginia General Assembly, meanwhile, modified its adequacy definition and statutory formula inputs to reduce the state’s funding obligation (Duncombe and Cassidy 2016). Still, as a bottom line, only a few states, and none of our study states, have fully restored their per pupil K–12 funding to prerecession levels in real terms (Leachman, Masterson, and Figueroa 2017). This also means that K–12 funding has been among the categories squeezed when its spending is measured per recipient and relative to growing real state income.

In prior crises (e.g., the 2002–04 recession), K–12 education also felt the squeeze, albeit less conspicuously. Then, states failed to allocate the additional funding necessary for forecasted enrollment and cost increases (Reschovsky 2004). Nominal increases in funding during this period masked real cuts relative to the funding required to maintain current service levels. The complexity of states’ K–12 funding requirements—including how they apply in the short versus long term, during times of expansion versus recession, and in a legal versus current services-driven framework—illustrates the difficulty of assigning a clear label of “binding” or “flexible” to any single restriction.

BOX 4

The State-Local Relationship

Local governments perform many critical public functions and carry a significant share of total direct general spending (i.e., total spending excluding grants to other governments). In 2016, for example, 99 percent of total state and local direct spending on elementary and secondary education, and more than half of total direct spending on police and corrections, occurred at the local level (figure 1).

The split between state and local governments can also vary by state. For example, in West Virginia, local governments were responsible for 7 percent of total direct state and local spending on highways and roads, while in Wisconsin their share was 69 percent.

When state spending declines in a specific area, such as K–12 education, local governments often step in to fill the gaps. Local governments may do so in response to pressure from residents to maintain public service quality or as a result of unfunded mandates and implicit cost-shifting from the state (Reschovsky 2003). A decline in state spending in one area, therefore, does not necessitate a decline in total government spending in that area.

For example, in 2017, Connecticut cut state education aid to local governments, requiring districts to make up the difference in order to meet the state-imposed “Minimum Budget Requirement.”^a On a number of occasions, California has realigned social services, requiring local governments to take on additional mental health and correctional services, for example.^b Nonetheless, the state has since been required to provide additional funding for local governments to provide these services.

Sources: “State and Local Backgrounders,” Urban Institute, accessed July 2, 2019, <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders>; US Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2000-2015), accessed via “Data Query System,” Urban-Brookings Tax Policy Center, accessed July 2, 2019, <https://slfdqs taxpolicycenter.org>.

Notes:

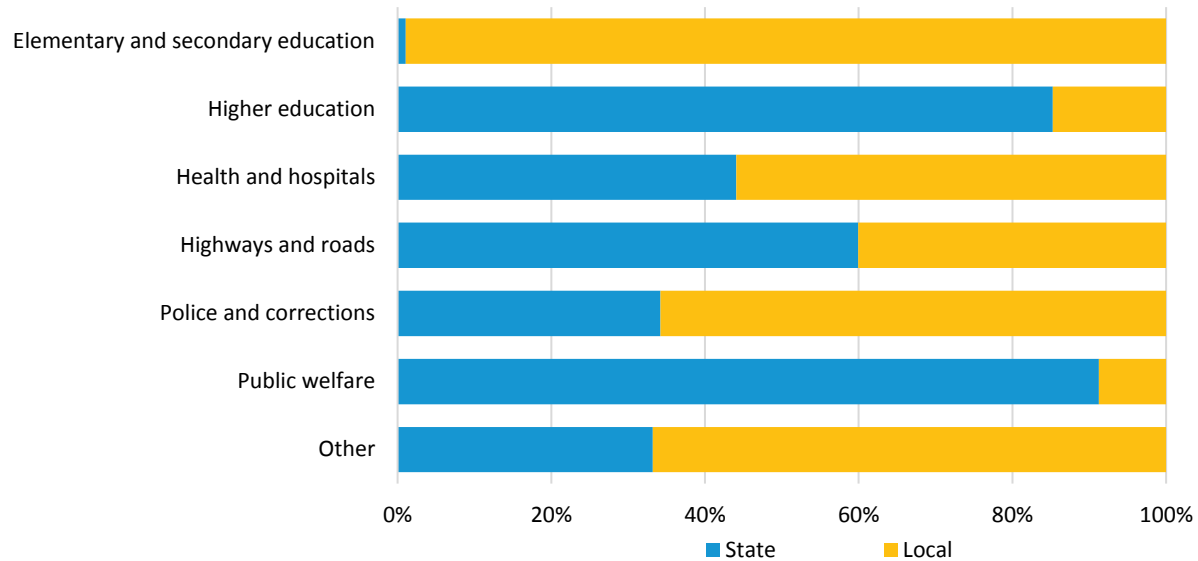
^a See Connecticut School Finance Project (2019); and Jacqueline Rabe Thomas, “Towns Told to Make up for State Education Cuts,” *Connecticut Mirror*, March 21, 2018. <https://ctmirror.org/2018/03/21/towns-told-make-state-education-cuts/>.

^b See the discussion of “Local Aid” in the California state supplement in Boddupalli and Randall (2019).

FIGURE 1

State Versus Local Expenditures, FY 2016

Percentage of total direct general expenditures from state and local governments, by functional category



Source: US Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2000-2015), accessed via “Data Query System,” Urban-Brookings Tax Policy Center, accessed July 2, 2019, <https://sfdqs.taxpolicycenter.org>.

Note: FY = fiscal year. Excludes spending on government-run liquor stores, utilities, and insurance trusts. Medicaid spending is divided between the public welfare and health and hospitals functional categories, with the majority allocated to the former.

Measuring State Budget Restrictions

Applying the above framework, we estimate the share of total state spending that is potentially restricted in each of our study states in 2015 and over time. Because, unlike federal mandatory spending, state spending restrictions can have many different meanings and different effects across states and over time, we present all quantitative estimates in ranges. We also provide detailed state profiles (in the following sections) and an accompanying data appendix (Boddupalli and Randall 2019).

Each State Has a Range of Potentially Restricted Spending

Based on our informant interviews in addition to our readings of state constitutions, statutes, case law, and history, we identified upper and lower bounds for restricted spending in each state (table 4).

TABLE 4

Restricted State Spending: Defining Upper and Lower Bounds*Lower (L) and upper bound (U) as share of total spending (FY 2015) and real spending growth (FY 2000–2015)**Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions*

		CA	FL	IL	NY	TX	VA
Total spending FY 2015 ^a	(billions \$)	250	75	69	140	104	35
	(L % restricted)	40	33	32	47	37	27
	(U % restricted)	86	78	71	85	84	80
Total real spending growth FY 2000–2015 ^b	(billions \$)	82	23	17	40	42	12
	(L % restricted)	78	52	58	46	52	41
	(U % restricted)	114	91	102	84	82	82
Restricted spending	Medicaid and CHIP (state and federal) ^c	L	L	L	L	L	L
	Debt service	L	L	L	L	L	L
	Pension and OPEB contributions ^d	L	U	U	L	U	U
	Formula-driven K–12 education ^e	U	U	U	U	U	U
	Correctional operations	U	U	U	U	U	U
	Dedicated transportation	U	U	U	U	U	U
	TANF maintenance of effort	U	U	U	U	U	U
	Federal receipts (non-Medicaid and non-CHIP)	U	U	U	U	U	U
	Budget Stabilization Fund deposits ^f	U	U		U	U	U
	Other state programs ^g	U	U				U

Sources: Authors' analysis of state Comprehensive Annual Financial Reports, governors' proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = the Children's Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families.

^a "Total spending" includes spending from all revenue sources, including federal, general, special, and bond funds.

^b Real spending growth reflects inflation-adjusted growth in total spending between 2000 and 2015.

^c Includes state and federal funds. The state share may also include local contributions toward the state's nonfederal match requirement.

^d We combined state pension and OPEB contributions because data were only available as a combined total in some states and years. For Illinois, New York, and Virginia, we were unable to obtain separate state OPEB contribution data before 2008 and therefore excluded OPEBs from our analysis in those states, although they are a part of the states' restricted spending landscape.

^e In California, this includes the K–14 minimum funding guarantee related to Proposition 98 (1988).

^f Illinois does not have a binding Budget Stabilization Fund.

^g In California, this includes state-local realignment funds; in Florida, the Voluntary Prekindergarten Education Program; and, in Virginia, the Personal Property Tax Relief Act of 1998 and Department of Justice behavioral health settlement (2011). We did not quantify other state programs for Illinois, New York, or Texas.

DEFINING THE UPPER BOUND

The estimated upper bound includes all spending restrictions that we could quantify in a state, including state- and program-specific spending restrictions. For example, all six of our study states have a legal mechanism requiring minimum payments to public schools, and our estimate reflects the entirety of that formula-based obligation. Some set a minimum funding total (e.g., California); others set funding per pupil and then determine how much the state owes (e.g., Florida).

Other sources of potential budget restriction in our upper bound include spending from funds earmarked for transportation, relatively inflexible correctional operational expenses, the state's maintenance-of-effort requirement for TANF, and mandatory deposits to Budget Stabilization Funds. Federal grants are captured under Medicaid and CHIP and their own restricted category (for non-Medicaid and non-CHIP grants) because of conditions the federal government puts on the receipt of those funds (box 5). We include spending from state and federal funds in Medicaid and CHIP, although the accompanying data appendix also presents state-financed expenditures (Boddupalli and Randall 2019). Where we could not quantify specific restrictions, we nevertheless discuss them in state profiles and in the data appendix (Boddupalli and Randall 2019).

BOX 5

Budget Basics: Federal Revenues and Grants

Our analysis treats federal grants as restricted to a specific purpose or function. But research and experience suggest that may not always be the case. For example, the American Recovery and Reinvestment Act of 2009 substantially enhanced Medicaid payments to states, but money is often fungible so, as in previous recessions, these funds were effectively used for general fiscal relief.

More generally, although federal grants often include provisions requiring recipients to continue their previous spending levels (maintenance-of-effort rules), states may substitute federal dollars for their own spending if they were already spending beyond the mandated level. Alternatively, states may save rather than spend federal dollars or, conversely, spend more than the grant amount.

Further, states often have flexibility in their interpretation of federal rules. For example, states have broad authority on how to spend federal TANF funds if they meet one of four program goals: (1) provide assistance to needy families so that children may be cared for in their own homes or in the homes of relatives; (2) promote job preparation, work, and marriage among needy parents; (3) prevent and reduce the incidence of out-of-wedlock pregnancies; and (4) encourage the formation and maintenance of two-parent families. Many states have used this discretion to reduce the share of TANF benefits spent on cash assistance to the lowest-income recipients.

Sources: Bitler and Hoynes (2016); Chernick (1979); Gordon (2018); Gramlich and Galper (1973); Knight (2002).

DEFINING THE LOWER BOUND

For all states, our estimated lower bound of restricted spending includes Medicaid and debt service. As evidenced during the Great Recession, state officials are often wary of cutting Medicaid and losing federal matching funds. We found this to be true in states with both spare and generous programs: states offering fewer optional benefits (i.e., Florida, Texas, and Virginia) reported less room to cut, and

states with more generous programs (i.e., California, Illinois, and New York) find cuts too politically difficult.

In general, Medicaid expenses are driven by factors often beyond states' control, such as medical care inflation and the availability of new drugs and procedures as well as demographics and federally determined categorical eligibility requirements.²⁹ States wishing to reduce Medicaid spending can limit eligibility or benefits, cut provider reimbursement rates, or increase their reliance on alternative health care delivery systems and revenues (such as local government and provider contributions).³⁰ However, many states already use these strategies (table 5). Further expanding them is often difficult because of administrative, legal, and political constraints.

TABLE 5
Medicaid Characteristics in Six States, FY 2015
Financing, services, and administration

		CA	FL	IL	NY	TX	VA
Financing	Federal medical assistance percentage ^a (%)	50	59.7	50.8	50	58.1	50
	Local government and provider contribution (% of nonfederal share, FY 2012) ^b	41	34	31	36	13	1
Service delivery and administration	Managed care (% of total enrollment) ^c	74	79	89	76	83	69
	Local eligibility determination ^d	✓					✓
Optional eligibility and services	Affordable Care Act (ACA) expansion ^e	✓		✓	✓		
	Spending on mandatory enrollment and services (% of total spending, FY 2013) ^f	48	61	38	32	67	45

Notes: FY = fiscal year.

^a The federal medical assistance percentage determines the federal government's share of Medicaid spending in each state. It is inversely related to state per capita personal income and subject to a 50 percent lower bound. See "Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier," State Health Facts, Henry J. Kaiser Family Foundation (KFF), accessed June 27, 2019, <https://www.kff.org/medicaid/state-indicator/federal-matching-rate-and-multiplier/> and Mitchell (2018).

^b Most recent data are from FY 2012 (GAO 2014).

^c Data reflect calendar year enrollment. See "Total Medicaid Managed Care Enrollment," State Health Facts, KFF, <https://www.kff.org/medicaid/state-indicator/total-medicare-mc-enrollment/>.

^d Data from authors' review of state Medicaid programs. In 2012, New York transferred responsibility from local entities to the state. See JLARC (2015a), Kelch (2015), NYSDOH (2015), and Schneider and Wachino (2002).

^e CA, IL, and NY implemented the ACA Medicaid expansion when it became available January 1, 2014. Virginia expanded coverage in 2019. See "Status of State Medicaid Expansion Decisions: Interactive Map," KFF, May 13, 2019, <https://www.kff.org/medicaid/issue-brief/status-of-state-medicare-expansion-decisions-interactive-map/>.

^f Optional services and eligibility data reflect FY 2013 conditions, before the ACA Medicaid expansion (MACPAC 2017b).

Cutting health care provider payments in a fee-for-service delivery system is often more politically feasible than cutting benefits or limiting eligibility.³¹ But federal law limits how much states can cut. And although many states have transferred a significant portion of Medicaid enrollees and costs to managed

care,³² an actuarial board often determines reimbursement rates, removing some state flexibility.³³ Transition to a managed care model may thus provide a trade-off in flexibility, as it can reduce costs but remove the state's ability to modify provider rates as a cost-lever.³⁴

Debt service is also in the lower bound of our estimates for all states. Consistent with previous credit analyst studies, our informants identified debt service as a contractual obligation that is often guaranteed in state constitutions and unlikely to be breached, although payments could be refinanced.³⁵ Even in Illinois, which has circumvented or failed to meet a variety of obligations in recent years, state law requires a continual appropriation to the General Obligation Bond Retirement and Interest Fund, which cannot be used for any purpose other than paying debt service.³⁶

Pension obligations are more complex. Following the literature and recommendations from our key informants, we classified pension contributions as relatively binding commitments where states had constitutional or statutory contribution requirements linked to an actuarial standard (table 6). Thus, state pension fund contributions are included in the lower bound for both California and New York but not for the remaining states (where pensions are included in the upper bound only, along with other potentially restricted areas of spending).³⁷

TABLE 6
Pension Contribution and Benefit Requirements in Six States, FY 2015

Requirements		CA	FL	IL	NY	TX	VA
State contributions	Constitutional (C) or statutory (S) ^a	C	S	S	S	C	S
	Based on actuarial estimate ^b	✓			✓		
Employee benefits	Legal protections: ^c Constitutional (C), contractual (CT), or other(O)	CT	CT	C	C	O	CT

Source: Authors' analysis of state legislative and constitutional language, discussion with key informants and staff in state budget offices, and other sources discussed in state profiles as well as Boddupalli and Randall (2019). For further reading, see "State Info," National Association of State Retirement Administrators (NASRA), accessed June 27, 2019, <https://www.nasra.org/states>; and Monahan (2014).

Notes: FY = fiscal year.

^a See Cal. Const. art. XVI, § 17; Fla. Stat. § 121.71; 40 Ill. Comp. Stat. 5/ and 15/; N.Y. Retire. & Soc. Sec. Law § 23; Tex. Const. art. XVI, § 67; and Va. Code § 51.1-137.

^b For example, required contributions to the California Public Employees' Retirement System are set by an independent actuarial board. In comparison, the Texas Constitution requires the state to contribute at a rate from 6 to 10 percent of compensation, which is not based on actuarial estimates of contribution rates necessary to reduce future or accrued liability. Since 2012, the Virginia General Assembly has been required to contribute a minimum share of the actuarially recommended amount, working up to the full amount.

^c Texas follows a "gratuity approach" for state-administered plans, wherein benefits are perceived as a "free benefit" for state employment and can be changed by the state. Pension protections based on specific constitutional provisions or a contractual approach are more difficult to modify. In addition, states vary in whether only past, or both past and future, accruals are covered. In California Illinois, and New York, courts have interpreted contractual and constitutional provisions as applying to past and future accruals, whereas in Florida and Virginia they apply only to past accruals. See "Litigation," NASRA, accessed July 5, 2019, <https://www.nasra.org/litigation>; Aubrey and Crawford (2017); and Munnell and Quinby (2012).

However, even states with constitutional or statutory requirements to fund their pensions have not always done so (Monahan 2014). And other states may be prevented from doing so by ceilings or caps (Shnitser 2015). Even where state law requires pensions to be funded on an “actuarially sound” basis, courts have declined to enforce that standard because of uncertainty about what it means, who may sue, and what remedies are available (Monahan 2014). However, the ability to potentially forgo pension system contributions in any given year can lead to increasing restrictions later on when, for example, funds are needed to pay retirees, or, as in the case of Illinois, pension contributions are funded with debt, which must be repaid.

TABLE 7

Pension Funding Status in Six States, 2016

Funding ratio estimates, share contributed, and net amortization

	US state total	CA	FL	IL	NY	TX	VA
Funded ratio (%)^a							
Pew	66	69	79	36	91	73	72
BEA	48	51	58	25	60	51	52
Share contributed (%)^b	88	82	101	75	152	71	101
Net amortization (millions \$)^c	-13.2	-2.9	0.0	-2.6	1.8	-1.6	0.0

Sources: Pew (2018); and US Census Bureau and BEA, “Financial Accounts of the United States,” accessed via “State and Local Government Pension Funding Ratios, 2002 – 2016,” Board of Governors of the Federal Reserve System, October 4, 2018, https://www.federalreserve.gov/releases/z1/dataviz/pension/funding_ratio/map/.

Notes: BEA = US Bureau of Economic Analysis; Pew = Pew Charitable Trusts.

^a“Funded ratio” is actuarial assets divided by actuarial accrued liabilities; differences between Pew and BEA estimates are based on the discount rates used in calculations.

^b“Share contributed” is actual employer payments (state or other) toward current benefits plus unfunded liabilities divided by the recommended payment for the current year (i.e., the actuarially determined contribution) (Pew 2018).

^c“Net amortization” is all contributions (employer, employee, and other, with interest) minus the net service cost and interest on the prior year’s debt. Plans with negative net amortization can expect to see their funding gap increase (Pew 2018).

Importantly, our estimates reflect what states currently spend on pension and OPEB contributions and not what they will eventually need to spend to address past underfunding (box 6).³⁸ Because most states face strong legal barriers to altering pension commitments (table 6), these costs may be substantial.

BOX 6

Budget Basics: State Pension Liabilities

States reported unfunded pension liabilities of \$1.4 trillion in 2016 (Pew 2018). However, the US Bureau of Economic Analysis (BEA) and other analysts have calculated figures that are much higher.^a Funded ratios (assets as a share of liabilities) are therefore likely to be lower than is often estimated.

The main difference in funding estimates is the discount rate, or the rate at which future liabilities are converted into current dollars. A high discount rate implies current dollars are worth much more than future dollars; a low rate treats the two as nearly equivalent.^b Previous accounting standards allowed governments and public pension plans to discount future liabilities based on past investment returns. However, this approach failed to recognize the certainty of promised benefits.

Accounting standards that took effect in fiscal years 2014 and 2015 (GASB Statements 67 and 68) require a “blended” discount rate based on the projected date (if any) at which plan assets are no longer sufficient to cover obligations.^c Although lower than the 7.6 average discount rate used in 2016, the blended rate (7.36 percent) was still much higher than the 4.5 percent rate favored by the BEA (based on yields for high-grade corporate bonds) or 2.9 percent rate advocated by some economists (based on yields for US Treasuries).

Beyond the discount rate, various modeling assumptions can lead to payments insufficient to cover incremental costs for current employees plus interest on unfunded liabilities, resulting in so-called negative net amortization. GASB Statements 67 and 68 eliminate some of these practices but leave others unchanged. As with prior standards, the new rules apply only to financial reporting and not to funding.

In sum, our estimates of restricted funding based on actual spending likely understate future restrictions because states increasingly will be called upon to make up for past funding shortfalls.

Sources: Aubry, Crawford, and Wandrei (2018), Boyd and Yin (2016), GFOA (2013), Hoops, Smith, and Stefanescu (2016), Moody's (2017), Pew (2018), and Rauh (2017).

Notes: GASB = the Governmental Accounting Standards Board.

^a See US Census Bureau and BEA, “Financial Accounts of the United States,” accessed via “State and Local Government Pension Funding Ratios, 2002 – 2016,” Board of Governors of the Federal Reserve System, October 4, 2018, https://www.federalreserve.gov/releases/z1/dataviz/pension/funding_ratio/map/

^b The formula for converting future liabilities into present values is $PV = FV/(1 + i)^n$ where PV is present value, FV is future value, n is the number of years in the future, and i is the discount rate.

^c GASB is a private, nonprofit organization that sets generally accepted accounting principles (GAAP) for public pension plans and state and local governments. Although GASB has no enforcement authority, auditors and municipal bond investors prefer financial statements that comply with GAAP (GASB 2012a, 2012b).

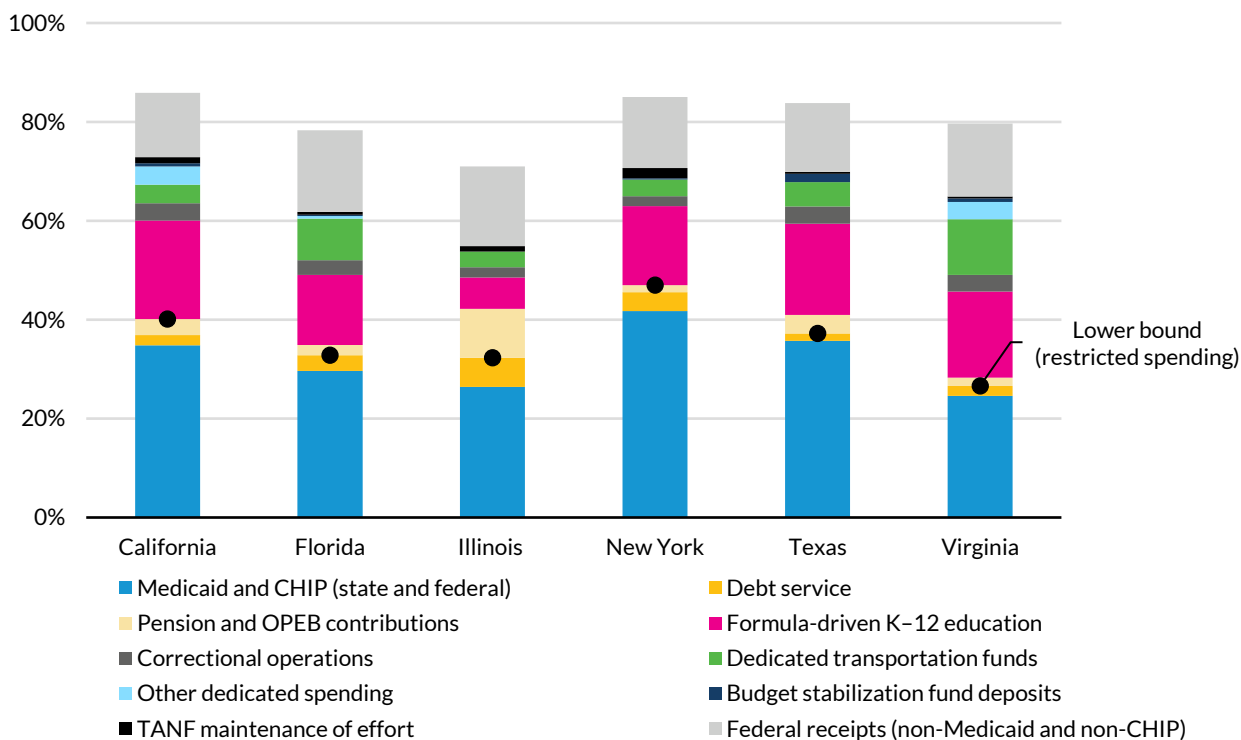
A Sizable Share of State Spending Is Restricted

Applying these upper and lower bounds to our study states, at the high end of our estimates, 70 to 90 percent of total state spending was potentially restricted in 2015. At the low end, restricted spending ranged from about a quarter to half of total spending in our study states (figure 2).

FIGURE 2

Restricted Spending in Six States, Share of Total Annual Spending, FY 2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors' analysis of state Comprehensive Annual Financial Reports, governors' proposed budgets, and other sources. For more detailed source and data documentation, see table 4 notes and Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = the Children's Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. "Total annual spending" includes spending from all revenue sources, including federal funds. "Medicaid and CHIP" includes federally and non-federally financed spending. Federal receipts include all non-Medicaid and non-CHIP federal receipts. In California, "Formula-driven K-12 education" includes the K-14 minimum funding guarantee related to Proposition 98. Data on OPEBs were unavailable for Illinois, New York, and Virginia. Values in this figure may not sum to those in table 4 because of rounding.

Reflecting on State Budget Restrictions

Whereas existing research tends to focus on future burdens arising from underfunded pensions and other deferred obligations, we examine what spending areas may already be getting squeezed today

and over the past 15 years. We use our framework to estimate potentially restricted spending in our study states annually from 2000 to 2015 as a share of total spending (including federal funds). We also identify the areas of potentially restricted spending consuming the largest share of state spending growth over time.

In all, we find that legislators and governors must weave their way through a multifaceted and complex maze not just to adopt a budget and make appropriations but to set new priorities. Policymakers and budget staff often have short-term flexibility to make room for new programs or balance a budget during a crisis. But today's choice to use flexibility can mean even further restrictions on tomorrow's spending options, squeezing the share of state resources, and likely total spending, available for competing priorities.

States' Restricted Spending Is Growing

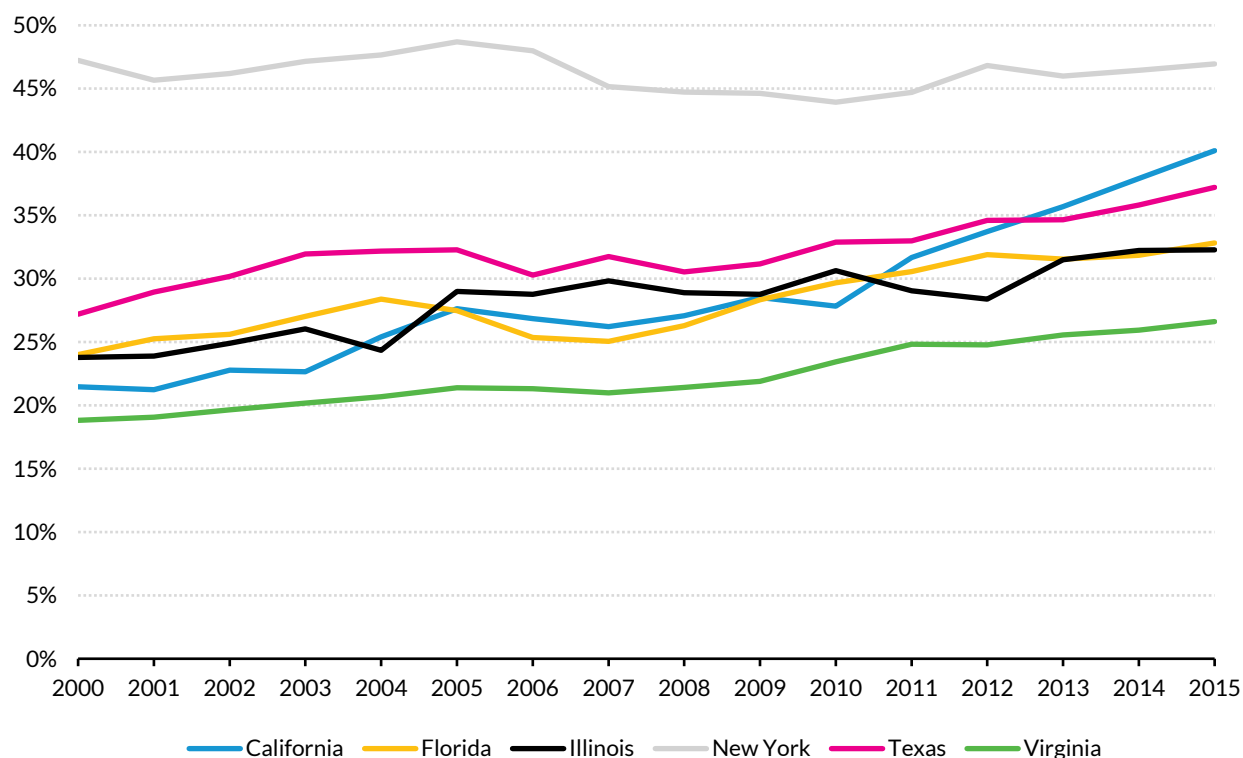
At the low end, our estimates suggest the share of state spending potentially subject to restriction has been growing over time, largely due to growing Medicaid obligations. The one exception is New York, where restricted spending was already elevated at the start of our study period (figure 3).

Many sources of budget restriction predate our study period, so any growth in restricted spending that occurred before 2000 will not be illustrated in our analysis. Other restrictions, conversely, were adopted or made stronger during our study period. For example, California adopted more stringent rainy-day fund deposit requirements in 2014 and Florida adopted its constitutional Voluntary Prekindergarten Education Program in 2002. Because of data and conceptual limitations, our time series analysis does not reflect any fluctuation in the stringency of specific provisions over time, although such changes may be evident in the share of spending going to an area. For example, the Affordable Care Act expanded spending on health care is included in our binding limits. We discuss any relevant changes qualitatively in the state profiles and Boddupalli and Randall (2019).

FIGURE 3

Minimum Restricted Spending in Six States, Share of Total Annual Spending, FY 2000–2015

Estimated lower bound of restricted spending



Source: Authors’ analysis of state Comprehensive Annual Financial Reports, governors’ proposed budgets, and other sources. For more detailed source and data documentation, see Boddupalli and Randall (2019).

Notes: FY = fiscal year. “Total annual spending” includes spending from all revenue sources, including federal funds. Per our estimates, the lower bound of restricted state spending includes all Medicaid and Children’s Health Insurance Program spending (federally and non-federally financed), and the state’s annual debt service payments. In New York, the lower bound also includes annual state pension contributions, and in California annual state pension and other postemployment benefit contributions. Values in this figure may not sum to those in table 4 because of rounding.

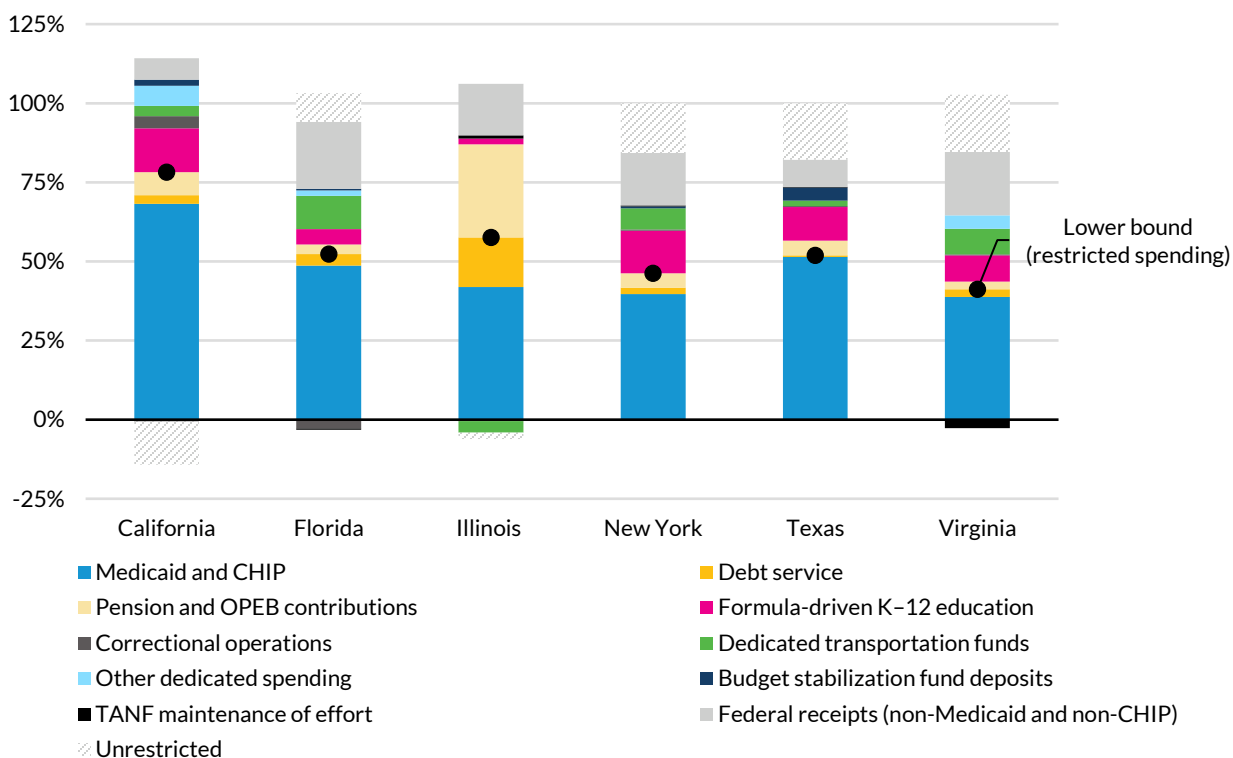
Some Spending Is Getting Squeezed

One way to understand the consequences of state budget restriction is to compare spending growth in restricted categories with spending growth overall, as Steuerle and Quakenbush (2016) did for the federal government. Our estimates suggest that, taken together, restricted and partially restricted categories consumed nearly all or, in some cases, more than all real state spending growth from 2000 to 2015 (figure 4). Where restricted spending grew by more than total spending, unrestricted spending areas experienced negative growth or cuts, similar to federal nondefense discretionary spending in recent years.

FIGURE 4

Restricted Spending in Six States, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors’ analysis of state Comprehensive Annual Financial Reports, governors’ proposed budgets, and other sources. For more detailed source and data documentation, see table 4 notes and Boddupalli and Randall (2019).

Notes: FY = fiscal year. CHIP = the Children’s Health Insurance Program; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. “Unrestricted” includes the remainder of total spending not classified as restricted. “Total real spending growth” reflects inflation-adjusted growth in spending from all revenue sources, including federal funds, between 2000 and 2015. “Medicaid and CHIP” includes federally and non-federally financed spending. Federal receipts include all non-Medicaid and non-CHIP federal receipts. In California, “Formula-driven K-12 education” includes the K-14 minimum funding guarantee related to Proposition 98. Data on OPEBs were unavailable for Illinois, New York and Virginia. Negative values indicate that an area experienced a spending cut over the time period in question. Figure includes only potentially restricted, quantifiable spending for which data were available. Values in this figure may not sum to those in table 4 because of rounding.

To get a better sense of which budget categories might be getting squeezed, we perform a similar analysis with data from the National Association of State Budget Officers. As a reference, table 8 shows spending by major program area from state funds and all funds (general, other, federal, and bond funds) in 2000 and 2015. Table 9 compares the growth of spending in each program area to spending growth overall from 2000 to 2015. Importantly, these comparisons do not provide insight into *why* spending grew from 2000 to 2015. Beyond budget precommitment, caseloads, costs, and program changes all affect spending growth.

TABLE 8

Spending by Major Functional Category, FY 2000–2015

Share of total expenditures

	US state total		CA		FL		IL		NY		TX		VA	
	2000	2015	2000	2015	2000	2015	2000	2015	2000	2015	2000	2015	2000	2015
Total spending (%)														
K–12 education	22	19	26	21	20	17	21	14	21	19	29	25	18	16
Medicaid	19	27	16	29	16	31	21	25	26	32	22	33	12	18
Higher education	11	10	12	7	9	9	7	4	7	7	14	14	14	15
Corrections	4	3	4	5	3	4	4	2	4	2	6	3	4	3
Transportation	9	8	6	5	12	13	9	9	6	7	9	8	13	12
Cash assistance	2	1	7	3	1	0	1	0	5	3	2	0	1	0
Other	33	31	29	31	39	26	36	47	31	30	17	16	37	36
State-financed spending (%)														
K–12 education	26	24	33	28	22	22	22	13	26	24	36	33	20	17
Medicaid	10	15	10	14	9	19	14	14	13	17	13	22	7	11
Higher education	13	13	11	8	11	13	9	4	10	11	20	18	15	16
Corrections	5	4	6	7	4	5	5	3	5	3	9	5	5	4
Transportation	9	8	6	4	13	15	11	11	6	8	8	9	13	12
Cash assistance	2	1	6	2	1	0	0	0	5	1	1	0	0	0
Other	35	35	28	37	40	25	38	54	35	36	14	13	39	40

Sources: Authors' analysis of data from the National Association of State Budget Officers (NASBO), obtained by special request.

Notes: FY = fiscal year. "State-financed spending" includes state general funds, other state funds, and bonds; federal funds are excluded. Functional spending categories are used as defined by NASBO. Higher education tuition and fees are fully excluded from California and Illinois higher education spending data, partially excluded for Florida, and included for New York, Texas, and Virginia (NASBO 2018).

However, it is notable that cash assistance spending was flat or declining in all of our study states from 2000 to 2015. Higher education and corrections also experienced negative growth by one metric (total spending growth) in some states. On the other hand, programs corresponding to our restricted categories (such as Medicaid and transportation) consumed larger shares of spending growth. Notably, Medicaid consumed half of all US state spending growth from 2000 to 2015 and an even greater share in some of our study states. This means that other areas grew more slowly or were cut.

TABLE 9

Spending Growth by Major Functional Category FY 2000–2015

Share of total expenditure growth in constant dollars

	US state total	CA	FL	IL	NY	TX	VA
Total spending (%)							
K–12 education	12	10	2	-2	15	18	11
Medicaid	49	53	116	31	45	49	28
Higher education	8	-2	10	-4	9	15	17
Corrections	1	6	4	-1	-2	-2	0

	US state total	CA	FL	IL	NY	TX	VA
Transportation	5	3	20	7	8	7	11
Cash assistance	-1	-5	-1	-1	-3	-2	0
Other	26	36	-51	70	29	15	34
State-financed spending (%)							
K-12 education	21	22	22	3	23	30	14
Medicaid	20	18	44	14	21	30	15
Higher education	14	5	19	-1	12	17	17
Corrections	4	9	7	1	1	1	2
Transportation	7	2	22	11	10	10	11
Cash assistance	0	-2	-1	0	-3	-1	0
Other	35	46	-13	71	37	13	41

Sources: Authors' analysis of data obtained by request from the National Association of State Budget Officers (NASBO).

Notes: FY = fiscal year. "State-financed spending" includes state general funds, other state funds, and bonds; federal funds are excluded. Functional spending categories are used as defined by NASBO. Higher education tuition and fees are fully excluded from California and Illinois higher education spending data, partially excluded for Florida, and included for New York, Texas, and Virginia (NASBO 2018).

Everything Is a Policy Choice

A consistent theme in our structured interviews was that everything is flexible in some way, especially in a crisis. During the Great Recession, many states cut own-source spending on typically inflexible programs, such as Medicaid and K-12 education. However, many of these cuts were made up temporarily through enhanced federal funding. When federal stimulus funds expired, states faced strong demands to restore prerecession K-12 funding levels despite an uncertain revenue future. Perhaps paradoxically, spending restrictions may be most binding when the economy is growing, especially immediately following a downturn.

Policymakers face limits in how they can slice and dice the resource pie; they also face limits on the size of the pie because of direct revenue limits, requirements for a legislative supermajority to approve tax increases, or simple tax cuts. Fiscal democracy is limited because of both restrictions on spending and an unwillingness to raise revenues to pay for unrestricted spending, including new programs. However, states can and do alter fiscal institutions. California, for example, recently lowered its legislative vote requirement to enact a new budget.

States also face trade-offs between short- and long-term flexibility. Illinois famously underfunded its pensions for many years through loose and inadequate statutory contribution requirements. But, pensions now constitute a large and growing share of state spending as the state strives to pay down its unfunded liability.³⁹ Taking advantage of short-term statutory flexibility may thus reduce flexibility in the long term.

State Findings

Although individual state analyses contributed to the major themes outlined in the previous section, each state has its own mechanisms and dynamics. The following sections discuss prominent findings that emerged in each state.

California

Although California is currently in excellent fiscal health,⁴⁰ the state has struggled in the past with multi-billion-dollar revenue shortfalls and chronically late budgets. Critics of California’s budget process point to the state’s voter initiative and referendum process as the main culprit and suggest that “ballot box budgeting” hemmed in public officials and prevented sound tax and spending policies.⁴¹ Although not denying those pressures, key informants noted that many perceived barriers to effective governance, including those passed by initiative and referendum, can be circumvented, especially in a crisis.⁴²

It’s rarely an “all or nothing” proposition, or matter of saying definitively, “This is on autopilot,” or nondiscretionary.

—Jason Sisney, California Legislative Analyst’s Office

Consistent with previous national studies (e.g., Petek et al. 2018; White, Metcalfe, and Crane 2018), California key informants identified state pension contributions and debt service as legally inflexible (table 10). Informants noted that debt service was a contractual obligation unlikely to be breached, although payments could be refinanced. Pension and other retirement benefits are often tied to collective bargaining agreements in California, and the state constitution prohibits the state from impairing these contractual obligations.⁴³ For the state’s largest public employee pension system, an independent board determines the state’s annual required contribution based on its long-term obligations, and the state is constitutionally required to meet that commitment.⁴⁴ Informants noted that California Medicaid and CHIP (together known as Medi-Cal in California) are generous compared with those programs in other states, but they are also difficult to cut because of administrative, political, and legal challenges we describe later.

Informants conceded that many well-known California ballot measures make it more difficult for the state to raise revenues (e.g., Proposition 13) or repurpose state transfers to local governments (e.g., Proposition 1A). However, apart from California's 1988 voter-approved education funding measure (Proposition 98, discussed in box 7), and some subsequent education (e.g., 1990's Proposition 111) and transportation (e.g., 2018's Proposition 69) measures, few initiatives obligate the state to spend on specific functions. Further, even within the total education budget, Proposition 98 protects some parts of the system but not others (early childhood and higher education beyond the first two years), which has long-term as well as short-term impacts.

BOX 7

California's Proposition 98

In 1988, California voters passed Proposition 98,^a establishing a minimum constitutional funding guarantee for school districts, county offices of education, and community college districts (collectively known as "K-14 education"). Subsequent major legislation, various lawsuits, and so-called poison pills have since produced a complex system of interacting formulas; now nearly a dozen inputs are required to fully determine state and local governments' required contribution under Proposition 98.^b The full minimum guarantee is funded from a combination of state general fund and local property tax revenue, though our analysis focuses on the state's share. Each year, one of three tests determines the minimum funding guarantee:

- **Test 1** sets the guarantee only when higher than the other tests and earmarks a minimum share of state revenue for K-14 education. It requires the state to contribute the same share of general fund revenue as it did in 1986-87 (41 percent). However, the legislature has at times adjusted its general fund share to account for shifts in K-14 property tax revenue. The share is now closer to 38 percent.
- **Test 2** requires that school districts, county offices of education, and community college districts receive, at minimum, the same full level of funding as in the previous year, adjusted for changes in average daily attendance and per capita personal income. Under this test, the state's obligation is the full minimum guarantee minus K-14 property tax revenue.
- **Test 3** is similar to Test 2 but adjusts for changes in state general fund revenue instead of per capita personal income, allowing the state to provide less than the Test 2-level amount in years of slow revenue growth. This creates a "maintenance factor" obligation, and the state is eventually required to restore funds that would have been appropriated under Test 2.

The "maintenance factor" is the difference between the funding actually provided and the level required by Test 2 or Test 1, whichever is higher. Maintenance factor obligations grow over time with average daily attendance and per capita personal income. When general fund revenue growth improves, the state must make maintenance factor payments, ensuring the state compensates the K-14 education

system for lower funding levels provided under Test 3 in prior years. The state also incurs a maintenance factor obligation when it elects to suspend the minimum funding requirement altogether in a given year; doing so requires a two-thirds vote of each house of the legislature.

“True-ups” are changes in the minimum guarantee caused by revised data on formula inputs (such as average daily attendance) that only become available after the state budget has been adopted; these can be substantial. Between 1988 and 2015, final Proposition 98 funding levels have been higher than the enacted budget level in 15 years and lower in 12 years; differences have been as large as 2008–09’s \$8.9 billion. In some cases, the state has delayed these adjustments. But since the passage of Proposition 2 in 2014, the state constitution requires regular “settle-up payments” to pay down this liability (LAO 2016).

Multiple litigation and legislative actions have affected Proposition 98 calculations. The state has been sued five times over Proposition 98 issues; four of those cases led to published court rulings, of which the state won two cases and reached a settlement in the other two.

Sources: See LAO (2017a); Rose et al. (2003); and Boddupalli and Randall (2019) for additional citations and state detail.

Notes:

^a Amending article XVI, section 8 of the California Constitution.

^b Major legislation included Proposition 11 (1991) and Proposition 2 (2014). “Poison pills” are legislative provisions that threaten to suspend the funding guarantee should the state’s Proposition 98 allocations be challenged in court.

Like all states, California is subject to restrictions on how federal revenues may be spent and must meet maintenance-of-effort requirements as a condition of receiving federal funds (e.g., for TANF). Respondents also identified state-specific institutional requirements (e.g., rainy-day funds) and court-imposed obligations (e.g., court orders to reduce prison overcrowding).

But for many perceived restrictions, including Proposition 98, the threat of lawsuits or political repercussions was often cited as more binding than the rules themselves. As one informant noted, California’s budget is “multifaceted and complicated,” and “in theory, the governor and legislature have a fair amount of flexibility, but politically they might not.”⁴⁵

TABLE 10
California's Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> ■ State contributions to public employee pension and other postemployment benefit trust funds ■ Debt service payments
Programmatic	

Category	Description
Major programs	<ul style="list-style-type: none"> Medicaid and Children's Health Insurance Program (Medi-Cal) spending Minimum required funding level for schools and community colleges (Proposition 98, 1988) Spending from earmarked or special transportation funds, such as the Motor Vehicle Account and the State Highway Account within the State Transportation Fund
Other programs	<ul style="list-style-type: none"> Correctional spending on inmate populations, including medical care and other services Spending from other smaller special funds, such as the Greenhouse Gas Reduction Fund State maintenance of effort for Temporary Assistance for Needy Families Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, and other federally financed programs
Institutional	Budget Stabilization Account deposits, as well as payments toward debt service and other unfunded pension or education liabilities (Proposition 2, 2014)
Local aid	State-local realignment spending
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Court orders	<p><i>Olmstead v. L.C.</i>–related court orders. Various cases requiring the state to invest resources in, or improve activities related to, transitioning people from institutions into community-based mental health care. Resultant court rulings in California included</p> <ul style="list-style-type: none"> <i>Cota v. Maxwell-Jolly</i> (2010), <i>Brantley v. Maxwell-Jolly</i> (2009), and <i>V.L. v. Wagner</i> (2009). <p><i>Brown v. Plata</i> (2011). A US Supreme Court case establishing a population limit in state prisons to protect inmates' constitutional rights and to ensure the quality of medical and mental health for incarcerated persons. This decision resolved the following previous cases:</p> <ul style="list-style-type: none"> <i>Plata v. Brown</i> (2002) (previously <i>v. Schwarzenegger</i>) <i>Coleman v. Brown</i> (1995) (previously <i>v. Wilson and v. Schwarzenegger</i>)
Consent decrees and settlements	<p><i>Olmstead v. L.C.</i>–related settlements and consent decrees, establishing case management and community living requirements and standards:</p> <ul style="list-style-type: none"> <i>Davis v. California Health and Human Services Agency</i> (2004) <i>Capitol People First v. California Department of Developmental Services</i> (2009)
Indirect	
Revenue-related	<ul style="list-style-type: none"> Proposition 13 (1978), limiting the tax rate on real property Proposition 1A (2004), prohibiting most statewide use of local government revenues
Other institutional	<ul style="list-style-type: none"> Gann Limit (Proposition 4, 1979), limiting state and local governments appropriations Constitutional supermajority requirement, requiring a legislative supermajority to pass tax increases

Source: Authors' analysis based on literature review, state reports, key informant interviews, and communication with the California Legislative Analyst's Office. See Boddupalli and Randall (2019) for citations and state detail.

Notes: Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried. See box 8 for further reading on California, the correctional system, and the courts.

How Much of California’s Spending May Be Restricted?

Depending on the actual flexibility of budget restrictions, we estimate California’s restricted spending was between 40 and 86 percent of total spending (including from federal receipts) in 2015 (table 11).⁴⁶ The lower bound of this range reflects pension and other postemployment benefit (OPEB) contributions, debt service payments, and Medi-Cal; the upper bound includes all potentially restricted spending that we were able to quantify (table 11 and figure 5).⁴⁷

TABLE 11

Restricted Spending in California: Upper and Lower Bounds

Categories (except for Medi-Cal and federal receipts) reflect only state contributions

		Total spending fiscal year 2015 ^a (billions \$)	250
		Lower bound	40%
		Upper bound	86%
Restricted spending	Medi-Cal (state and federal) ^b		L
	Debt service		L
	Pension and OPEB contributions ^c		L
	Minimum guaranteed K-14 education funding ^d		U
	Correctional operations		U
	Dedicated transportation spending ^e		U
	TANF maintenance of effort		U
	Federal receipts (non-Medi-Cal) ^f		U
	Budget Stabilization Account deposits		U
	Other state-specific programs: State-local realignment funding ^g		U

Sources: Authors’ analysis based on literature review, financial reports, historical data from the California Legislative Analyst’s Office (LAO), key informant interviews, and communications with LAO. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. K-14 education includes school districts, county offices of education, and community college districts.

^a Total annual spending includes general, special, and federal funds from California Legislative Analyst’s Office (LAO), “State of California Expenditures, 1984-85 to 2017-18.”

^b Includes both state-financed (\$33.6 billion) and federally financed (\$53.6 billion) spending. The state share may also include local contributions toward the state’s nonfederal match requirement.

^c Pension and OPEB contribution data are only available as a combined total for some years and states in our study period. Includes state contributions to the California Public Employees’ Retirement System, California State Teachers’ Retirement System, and other pension and postemployment benefit systems. Excludes employee and local contributions.

^d Includes state contribution determined by Proposition 98 (1988). Excludes local and federal K-14 education funding.

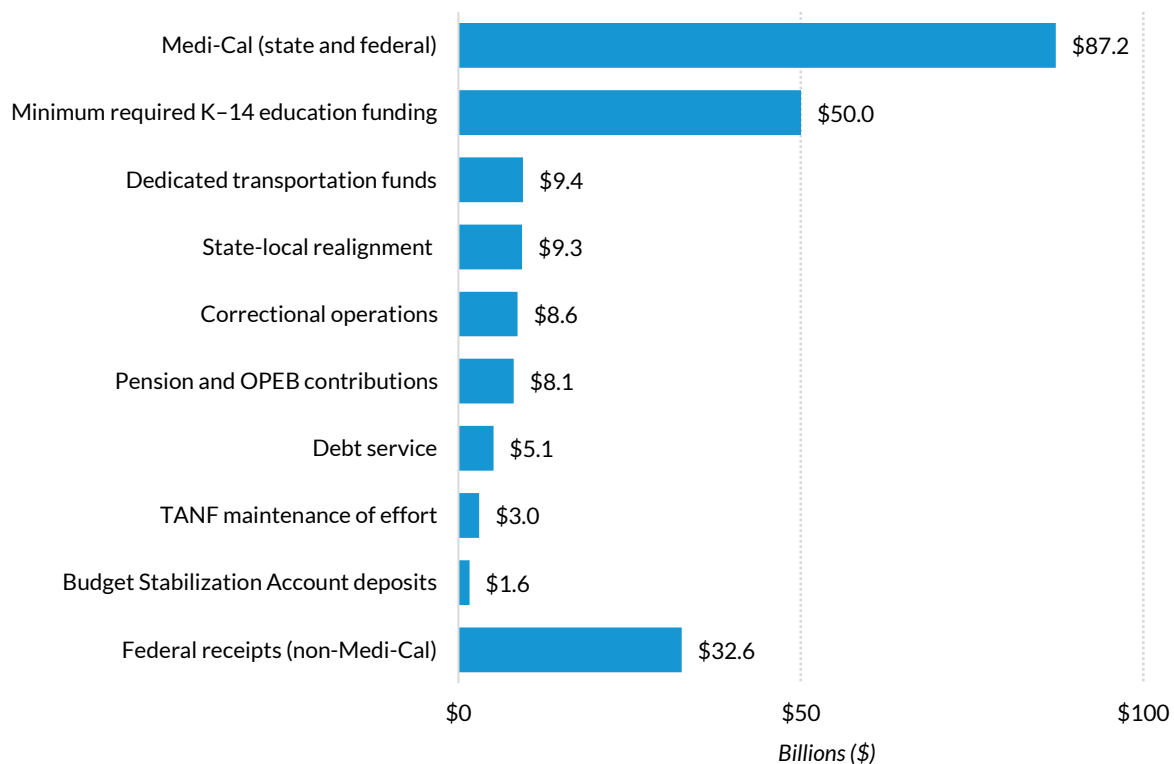
^e Includes transportation-related spending from special, general, and bond funds for the Department of Transportation, as reported in LAO historical data, excluding federal funds and debt service (which are counted under federal receipts and debt service, respectively). See Boddupalli and Randall (2019) for alternative approximation using state Comprehensive Annual Financial Report data.

^f Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and the Children’s Health Insurance Program, which are reflected under the Medi-Cal category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K-14 education) as well as dedications to other programs not displayed here.

⁸ State-local realignment spending includes required state payments to local governments for provision of formerly state-administered services, as required by Proposition 30 (2012).

We identify debt service (\$5.1 billion in fiscal year 2015) as more-or-less fixed because of contractual obligations and the necessity of maintaining access to credit markets (figure 5). In theory, states can opt out of Medi-Cal, but in practice this would impose significant fiscal, administrative, and political costs. In fiscal year 2015, California spent \$87.2 billion on Medi-Cal (figure 5), which included \$53.6 billion in federally financed spending.⁴⁸ The state adopted the largely federally funded Affordable Care Act Medicaid expansion in 2014. Further, the state constitution requires California to contribute to one of its largest public pension systems, the California Public Employees’ Retirement System (CalPERS), based on actuarial estimates.⁴⁹

FIGURE 5
California’s Restricted Spending, FY 2015
Categories (except for Medi-Cal and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, historical data from the California Legislative Analyst’s Office (LAO), key informant interviews, and communications with LAO. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. Includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 11 and accompanying notes for detail. Values in this figure may not sum to those in table 11 because of rounding.

California's uppermost restricted spending bound includes all categories illustrated in figure 5. After Medi-Cal, the minimum guaranteed funding for K–14 education (i.e., Proposition 98) constitutes the largest share of state spending, followed by dedicated transportation fund spending. The state's upper bound also includes transfers to local governments to cover state-local realignment of services, correctional operations, maintenance of effort for TANF, deposits to the Budget Stabilization Account, and federal receipts. Some state restrictions detailed in table 11 are not readily quantifiable and are therefore excluded from the quantitative portion of our analysis in figure 5. For more information on these and other less quantifiable restrictions, please see California's profile, as well as data and technical documentation, in the accompanying data appendix (Boddupalli and Randall 2019).

How Binding Are California's Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility and are subject to interpretation, our data and key informant interviews suggest a few points.

California's Medi-Cal program is large, growing, and difficult to cut or curtail. At 35 percent of total state spending, Medi-Cal is large in California, and it is restrictive. Consistent with our other study states, California informants reported that, in terms of its growing share of state spending, Medicaid is one of the most difficult programs to cut or contain. Restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state's fiscal incentive to obtain the federal match, as well as growth in caseloads, price inflation, and increasing supply of new goods and services such as new drugs and procedures in the health care sector.⁵⁰ Medicaid is a much larger source of pressure than CHIP, since children's health care costs are a small share of total Medicaid spending.⁵¹

Like all states, California is not required under federal law to participate in the Medicaid program. But if it does, it must meet certain requirements to receive federal matching funds. Informants noted that it is not realistic politically or fiscally for the state to opt out of the program, though it is theoretically possible.⁵²

Moreover, not all Medi-Cal spending is completely restricted. The state has enacted a variety of optional services and eligibility pathways.⁵³ Most recently, the state expanded Medicaid eligibility to low-income, childless adults as part of the Affordable Care Act in 2014, which was largely federally funded.⁵⁴ The state can also cut optional benefits when it encounters budget difficulties. However, many of these cuts have delivered limited savings and been short-lived.⁵⁵

Following a national trend, the state has attempted to control spending growth by implementing service delivery reforms. As in many states, most Medi-Cal beneficiaries are now enrolled in a managed care program (LAO 2015).⁵⁶ Although the state has in the past attempted to mitigate costs by reducing provider reimbursement rates, its reimbursement rates are already well below national averages.⁵⁷ Attempts to further reduce provider reimbursements would be legally challenging because federal rules prevent states from paying providers so little that enrollees lose access to medical care.⁵⁸ Any changes to managed-care reimbursements must be approved by an actuarial entity,⁵⁹ which one key informant said was a significant hurdle. California also already relies on alternative revenue sources, such as health care–related taxes and fees on providers, although provider taxes must meet several regulatory hurdles (LAO 2019).

California’s pensions are legally binding and treated as off-limits for a reason. CalPERS is one of the least flexible parts of the budget because an independent entity (the CalPERS board) determines state contributions, and the state is constitutionally required to meet that commitment.⁶⁰ Moreover, current case law suggests the state cannot make changes to prospective benefits (i.e., the “California Rule”),⁶¹ even though this could lead to unequal pay for equal work by providing higher compensation to those “grandfathered” in through earlier initial dates of employment.⁶² California’s other major pension program, the California State Teachers’ Retirement System (CalSTRS), provides benefits to full- and part-time educators in the California public school system. Annual state CalSTRS contributions are more flexible than CalPERS contributions because the former’s amount is set by statute.⁶³

Despite recent reductions in long-term unfunded liability as well as strong investment returns and plan reforms,⁶⁴ both CalPERS and the CalSTRS are underfunded, even more so when adjusting for actuarial and investment assumptions.⁶⁵ Further, when strong investment returns come from unusual price increases, future returns on that wealth base are unlikely to match that one-time surge. Recent reforms, such as reducing the assumed return rate on investments, will improve the plans’ ability to fund their obligations, but these work by pushing higher annual contributions from the state to current years (e.g., State of California 2019).

Like many states, California has generally followed a “pay as you go” strategy for funding OPEBs. In 2015, however, the administration adopted a strategy to eliminate unfunded liabilities by increasing prefunding (State of California 2019). As with pensions, this reform to OPEBs will improve their funding but will also tie up a greater proportion of the state budget in the near future. As with other efforts to reduce debt, gains (and lower costs) will only be recognized down the road. Moreover, Proposition 2 in 2014 made a variety of state unfunded pension and OPEB liabilities eligible for constitutionally required debt repayments (LAO 2016).⁶⁶

Proposition 98 establishes a legal floor and a political ceiling for K–14 education funding. California’s constitutionally mandated minimum K–14 funding level is at once flexible and binding. Although the state annually incurs Proposition 98-related funding obligations, it also has the ability to suspend and modify these requirements each year. In fiscal years 2005 and 2011, for example, the state unconditionally suspended Proposition 98. These suspensions provided immediate general fund savings but required the state to make larger future maintenance factor payments (box 7). As one informant noted, although some Proposition 98 work-arounds allow the state some flexibility in the short-term, “ultimately you have to pay the piper.”⁶⁷

Although it is impossible to determine what California’s K–14 education appropriations would look like absent Proposition 98 and subsequent measures, the state’s school funding levels have tracked enrollment growth and inflation since 1988 (LAO 2017a). K–12 operating expenditures per student have remained close to the national average both before and after 1988 and have grown at the same pace as K–12 expenditures nationally. Analysts have questioned whether the state would have spent the same amount, more, or less on K–14 education with the minimum spending that Proposition 98 imposes (Matsusaka 2010). Moreover, one informant noted that although the requirement establishes a legal funding floor, others have pointed to its ability to establish an informal ceiling, allowing lawmakers to justify funding K–14 education at the minimum funding level and no higher.⁶⁸ The requirement establishes a minimum funding level, but that funding level should not be conflated with a proper adequacy measure.

Caseload-driven growth is an issue for some services, such as those provided to people in correctional facilities. Several key informants reported that corrections spending was relatively inflexible in the short term. They cited ongoing court oversight because the state was found to be in violation of constitutional standards regarding prison overcrowding the provision of inmate medical and mental health care (box 8).

BOX 8

California’s Correctional System, Spending, and Courts

State and local policies governing law enforcement investigations, arrests, prosecutions, detention, and supervision determine the size of a state’s incarcerated population and therefore its correctional spending. California’s Three Strikes sentencing law enacted in 1994, for example, significantly increased sentencing time for felony convictions for people with prior infractions, which had direct implications for the state’s prison population and indirect effects on state correctional spending.^a More recently, voters have acted to reduce prison sentences.^b In 2011, the state legislature shifted responsibility for

lower-level offenses from state prisons to county jails. Federal court rulings have also influenced California's correctional spending:

- **Armstrong v. Brown (1996–2002).** In a series of class action cases, the court ruled that the California Department of Corrections and Rehabilitation (CDCR) had violated the Americans with Disabilities Act and ordered CDCR to provide equal access to services for incarcerated people and parolees with disabilities.^c
- **Coleman v. Brown (1995).** The court ruled the state was in violation of US constitutional standards for inmate mental health care. It instituted a “special master” outside of the CDCR's administration to oversee remedial efforts and ensure constitutional compliance.^d
- **Plata v. Brown (2002).** The court found the state did not provide adequate medical care. In 2005, at order of the court, the state appointed a receiver (effective 2006) to take over control of direct management and operations of the state's inmate health care program from CDCR.^e
- **Brown v. Plata (2011).** In 2009, a three-judge panel consolidated, and resolved state appeals related to, *Coleman* and *Plata*.^f The panel determined that prison overcrowding was the primary reason for inadequate inmate health care and ordered the state to reduce its prison population to a specified benchmark by constructing additional facilities and increasing credit eligibility for reduced terms. Upon appeal, the US Supreme Court upheld the lower court's order to reduce overcrowding.^g

The state is responsible for ongoing costs related to remedial activities required by the courts. These costs are incorporated into agency budgets. For example, the federal receiver has executive authority over CDCR until the state demonstrates a sufficiently high level of medical care for incarcerated people.

Sources: See “Prison Population Forecaster,” Urban Institute, September 6, 2018, <http://urbn.is/ppf>; LAO (2005, 2013, and 2017b); and Pfaff (2012).

Notes:

^a Proposition 184 (1994) increased the normal prison sentence for any new felony conviction with one prior serious or violent felony conviction and implemented life sentences in prison for any new felony conviction with two prior serious or violent felony convictions.

^b Proposition 36 (2012), Proposition 47 (2014), and Proposition 57 (2016) narrowed offenses subject to “three strikes” sentencing, reduced penalties for nonviolent crimes, and expanded eligibility for parole. See LAO (2017c).

^c See a history of *Armstrong v. Brown*, 4:94-cv-02307-CW (N.D. Cal.) and related cases at “Case Profile: *Armstrong v. Brown*,” University of Michigan Law School, Civil Rights Litigation Clearinghouse, accessed July 17, 2019, <https://www.clearinghouse.net/detail.php?id=572>.

^d See *Coleman v. Wilson*, 912 F. Supp. 1282 (E.D. Cal. 1995); and “Case Profile: *Coleman v. Brown*,” University of Michigan Law School, Civil Rights Litigation Clearinghouse, accessed July 17, 2019, <https://www.clearinghouse.net/detail.php?id=573>.

^e See *Plata v. Brown*, 3:01-cv-01351-TEH (N.D. Cal.); and “Case Profile: *Plata v. Brown*,” University of Michigan Law School, Civil Rights Litigation Clearinghouse, accessed July 17, 2019, <https://www.clearinghouse.net/detail.php?id=589>.

^f See *Coleman v. Schwarzenegger/Plata v. Schwarzenegger*, Nos. 2:90-cv00520 LKK JFM P, C01-1351 TEH (E.D. Cal./N.D. Cal. Aug. 4, 2009); and “Case Profile: *Plata v. Brown / Coleman v. Brown Three-Judge Court*,” University of Michigan Law School, Civil Rights Litigation Clearinghouse, accessed July 17, 2019, <https://www.clearinghouse.net/detail.php?id=12280>.

^g See *Brown v. Plata*, 131 S. Ct. 1910, 1923 (2011); and “Case Profile: *Plata v. Brown / Coleman v. Brown Three-Judge Court*.” For further reading on prison overcrowding, see LAO (2011).

More generally, however, changes to the size of the incarcerated population take time because of the need to adjust both the rate of entry into the system and the average length of stay.⁶⁹ As one informant shared, “Modifying sentences in the short term is not a solution—you can’t change sentences after the fact.”⁷⁰

To a degree, higher education has a similar problem because the average student is enrolled for several years. But the state can and has shifted higher education costs to students and the federal government through higher tuition (Baum et al. 2018).

Even when caseloads decline, program savings may not always follow. For example, California has seen its prison inmate population decline by roughly one-fifth since 2011 after several major policy changes (LAO 2017b). Between 2000 and 2015, however, state-financed expenditures toward correctional operations more than doubled from \$4.0 to \$8.6 billion.⁷¹ This trend is expected to continue because of employee salary and health benefit cost growth (LAO 2017d). It was also reported to us that the high, and increasing, costs of providing inmate medical care are largely out of the state’s control and have contributed to rising correctional spending obligations.⁷²

Earmarked funds and fiscal institutions also matter. As in other states, informants reported that earmarking of funds (such as for transportation and other issues) is also responsible for declining flexibility. Informants noted the significance of constitutional amendments such as Proposition 2 (2014), which requires the state to deposit annual payments toward the state’s rainy-day fund and to reduce eligible state debts related to special fund loans, Proposition 98, and unfunded pension liability (LAO 2016).

*The difficulty of increasing taxes imposes a very important constraint on overall spending.
—Jason Sisney, California Legislative Analyst’s Office*

Moreover, California’s fiscal institutions restrict the state’s flexibility to raise revenue. The state imposes a two-third majority requirement in both legislative chambers to raise taxes and fees. As one informant noted, “The difficulty of increasing taxes imposes a very important constraint on overall spending.”⁷³ Accordingly, it imposes a one-way mechanism that reduces flexibility: “Taxes can be cut, and tax expenditures introduced, by simple majority,” but tax increases must achieve a two-thirds vote.⁷⁴

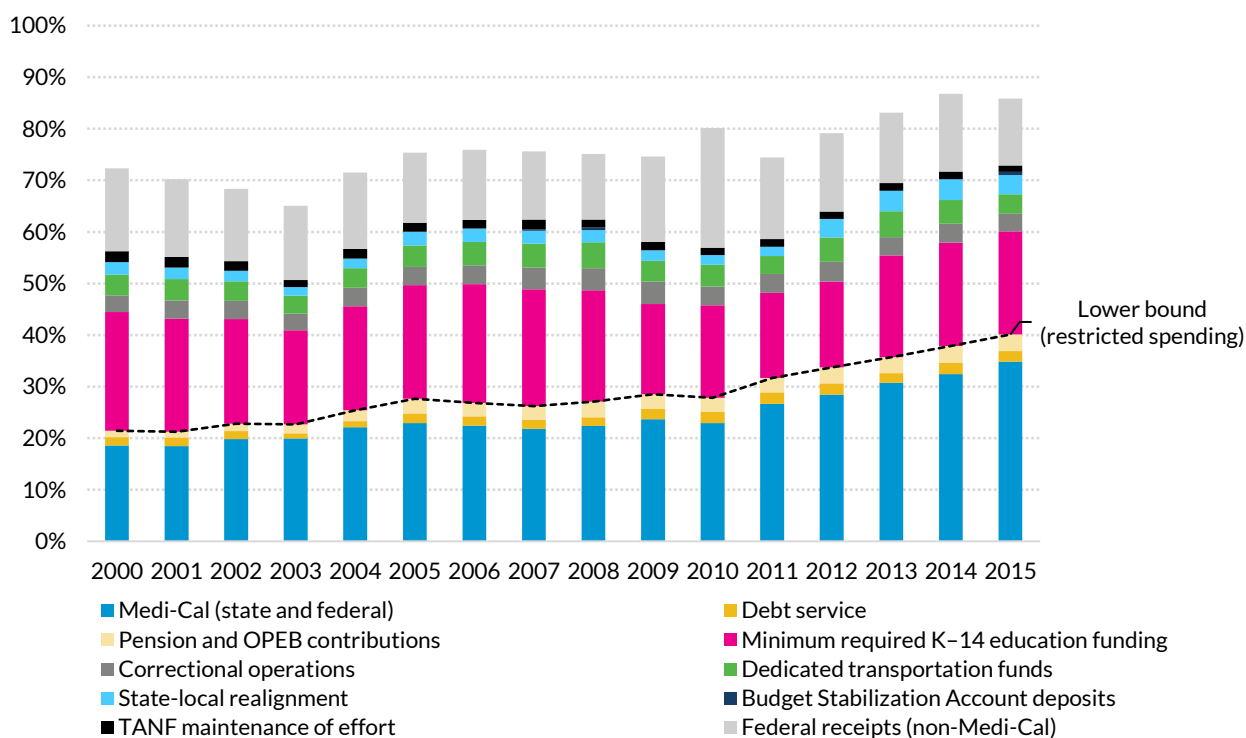
How Has Restricted Spending Changed in California over Time?

At the maximum of our range of estimates, California’s restricted spending (as defined in sections above) has increased since 2000 as a share of total spending (which consists of general fund, special funds, and federal funds; see figure 6).⁷⁵ Most of this increase over time stems from the growth of Medi-Cal spending, including for example California’s decision to expand the program in 2014. This trend is also evident when we consider the share of total spending growth that has gone to restricted categories over the same period (figure 7). About two-thirds of all real, inflation-adjusted spending growth between 2000 and 2015 went toward Medi-Cal spending, although this was in large part financed by the federal government (45 percent) and less so by state-financed spending (23 percent).

FIGURE 6

California’s Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medi-Cal and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, historical data from the California Legislative Analyst’s Office (LAO), key informant interviews, and communications with LAO. See Boddupalli and Randall (2019) for technical documentation and state detail.

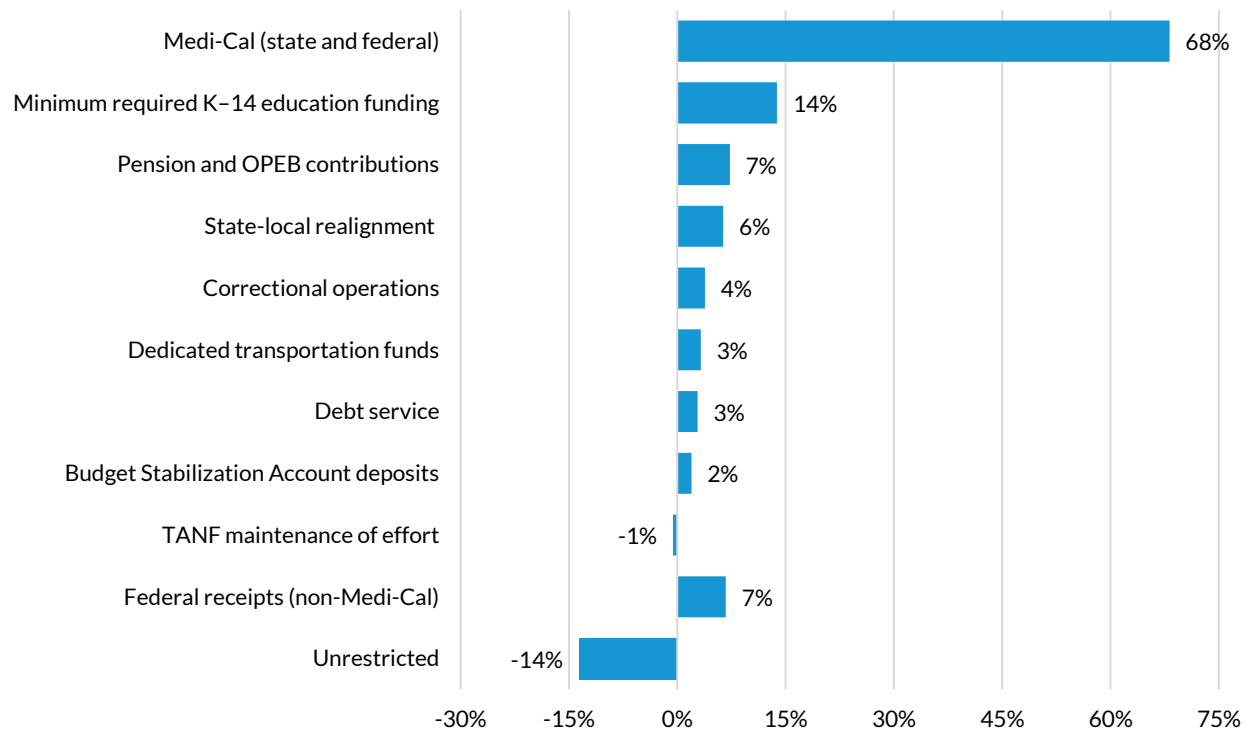
Notes: FY = fiscal year; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. Total spending includes general, special, and federal funds from LAO historical spending data. Figure includes only potentially restricted, quantifiable spending for which data were available. Medi-Cal includes spending on the Children’s Health Insurance Program, which the state operated as a separate program (i.e., the Healthy Families Program) until 2014, when it transferred eligible children into Medi-Cal. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. The black line reflects the estimated lower bound of restricted spending. See table 11 and accompanying notes for detail. Values in this figure may not sum to those in table 11 because of rounding.

Pensions and OPEB contributions, local aid (related to Proposition 30), and correctional spending also increased as a share of annual total spending since 2000. Although K–14 educational spending (the portion dictated by Proposition 98) declined from 23 to 20 percent of total annual spending between 2000 and 2015, it still exerts pressure on the budget: it constituted 14 percent of total spending growth since 2000 (figure 7).

How Much of California’s Spending Growth Has Gone toward Restricted Items?

Considering only Medi-Cal, pension contributions, and debt service, we find that, at the lower bound, 78 percent of all real (inflation-adjusted) spending growth since 2000 has gone to restricted categories. At the upper bound, considering all spending obligations (and offsetting for those restricted funds that have decreased over time and constitute a negative share of growth), California’s restricted spending consumed the entirety of state spending growth between 2000 and 2015 (figure 7).

FIGURE 7
California’s Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015
Restricted categories (except for Medi-Cal and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, historical data from the California Legislative Analyst’s Office (LAO), key informant interviews, and communications with LAO. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year; OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families. Total real spending growth includes inflation-adjusted growth in spending from general, special, and federal funds from LAO historical spending data. Unrestricted includes the remainder of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Medi-Cal includes spending on the Children’s Health Insurance Program, which the state operated as a separate program (i.e., the Healthy Families Program) until 2014, when it transferred eligible children into Medi-Cal. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 11 and accompanying notes for detail. Values in this figure may not sum to those in table 11 because of rounding.

Florida

Florida is known for its sound budgeting, reserve, and forecasting practices.⁷⁶ It is a relatively low-tax, low-spending state and, along with Texas, is one of our two study states (and seven states nationally) that does not have an income tax. Some have praised the state for its conservative budgeting practices.⁷⁷

In 2016, however, facing down a budget deficit, state officials debated how to best resolve a “structural imbalance” arising from a combination of spending pressures and tax cuts.⁷⁸ And in more recent years, they have debated how to spend unexpected budget surpluses to fund competing demands for public education, school safety, higher education, hurricane relief, and environmental measures.⁷⁹

Key informants provided different perspectives on how much mandatory or predetermined spending significantly curtails Florida’s fiscal flexibility. One informant, for example, reported that Florida is “incredibly constrained by required spending,” in large part from Medicaid, K–12 education, pension, and prison funding obligations.⁸⁰ But another suggested that mandatory and discretionary spending are not mutually exclusive in Florida, and there are nuances to each spending obligation.⁸¹

Although a large share of Florida’s spending may be characterized as either fully or partially restricted (figure 8), the legislature exercises enough flexibility to create a balanced budget each year (with few exceptions), though changing the long-term direction of the budget is another matter. Florida informants identified long-term obligations, major spending programs (especially Medicaid and K–12 education), Budget Stabilization Fund deposits; and various federal receipts, court decisions, and tax and fiscal institutions as potential fiscal restrictions (table 12).

TABLE 12

Florida's Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> State contributions to public employee pension and OPEB trust funds (Florida Retirement System defined-benefit pension plans and other pension and OPEB plans) Debt service payments
Programmatic	
Major programs	<ul style="list-style-type: none"> Medicaid and Children's Health Insurance Program (KidCare) spending Formula-driven K–12 education spending (Florida Education Finance Program) Spending from dedicated transportation funds Correctional spending on inmate populations, including medical care and other services
Other programs	<ul style="list-style-type: none"> Constitutional Voluntary Prekindergarten Education Program (universal pre-K) Constitutional tobacco education and prevention program (funded by dedicated revenue following a 1998 settlement in <i>Florida v. American Tobacco Company</i>) Spending from other earmarked or special funds, such as the Land Acquisition Trust Fund State maintenance of effort for Temporary Assistance for Needy Families Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, or other federally financed programs
Institutional	Budget Stabilization Fund deposits
Local aid	Required revenue sharing, such as the Local Government Half-Cent Sales Tax Program
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Court orders	<i>Department of Agriculture and Consumer Services v. Bogorff</i> (2010). Required state payments to property owners to compensate for destruction of private property in Florida's citrus canker eradication program.
Consent decrees and settlements	<i>Florida v. American Tobacco Co.</i> (1997). Established payments from private tobacco companies into the Tobacco Settlement Trust Fund.
Indirect	
Revenue-related	<ul style="list-style-type: none"> Quick Action Closing Fund for “deal-closing” grants for companies pitted against out-of-state sites Capital Investment Tax Credit to attract and grow capital-intensive industries
Other institutional	<ul style="list-style-type: none"> Constitutional limit on growth in revenues within growth rate of personal income Two-thirds vote of each chamber in the legislature required to pass any tax increases^b

Source: Authors' analysis based on literature review, state financial reports, key informant interviews, and communications with the Florida Office of Economic & Demographic Research and Florida Department of Education. See Boddupalli and Randall (2019) for citations and state detail.

Note: OPEB = other postemployment benefit. Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried.

^b Florida passed this requirement as a constitutional amendment in 2018. As such, it was not in effect during our study period but may affect future revenue and budgeting flexibility.

How Much of Florida’s Spending May Be Restricted?

Drawing on provisions identified by state informants, original state materials, and available data, we estimate 33 to 78 percent of Florida’s spending (including from federal receipts) was potentially restricted in 2015 (table 13).⁸² The lower bound of this range reflects debt service payments, as well as spending on Medicaid and the Children’s Health Insurance Program (known as KidCare in Florida). The upper bound includes all potentially restricted spending that we were able to quantify.

TABLE 13

Restricted Spending in Florida: Upper and Lower Bounds

Categories (except for Medicaid, KidCare, and federal receipts) reflect only state contributions

		Total spending fiscal year 2015 ^a	(billions \$)	75
		Lower bound	(L %)	33%
		Upper bound	(U %)	78%
Restricted spending	Medicaid and KidCare (state and federal) ^b			L
	Debt service			L
	Pension and OPEB contributions ^c			U
	Florida Education Finance Program ^d			U
	Correctional operations			U
	State Transportation Trust Fund ^e			U
	TANF maintenance of effort			U
	Federal receipts (non-Medicaid and non-KidCare) ^f			U
	Budget Stabilization Fund deposits			U
	Other state-specific programs: Voluntary Prekindergarten Education Program			U

Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with Florida Office of Economic & Demographic Research and the Florida Department of Education. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: OPEB = other postemployment benefit; TANF = Temporary Assistance for Needy Families.

^a Total annual spending includes total governmental fund spending as reported in the state annual Comprehensive Annual Financial Report.

^b Includes both state-financed (\$8.8 billion) and federally financed (\$13.5 billion) components. The state share may also include local contributions toward the state’s nonfederal match requirement.

^c Includes state contributions to the Florida Retirement System and retirement and OPEB systems. Excludes employee and local government contributions.

^d State contribution to formula-driven K–12 education. Excludes local and federal contributions.

^e State spending from the State Transportation Trust Fund (i.e., dedicated transportation fund), excluding federal funds and debt service, which are counted under federal receipts and debt service, respectively.

^f Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and the Children’s Health Insurance Program which are reflected under the Medicaid and KidCare category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K–12 education) as well as dedications to programs not displayed here.

We identify debt service (\$2.4 billion in fiscal year 2015) as more-or-less fixed because of contractual obligations and the necessity of maintaining access to credit markets (figure 8). In theory, states can opt out of Medicaid, but in practice this would impose significant fiscal, administrative, and

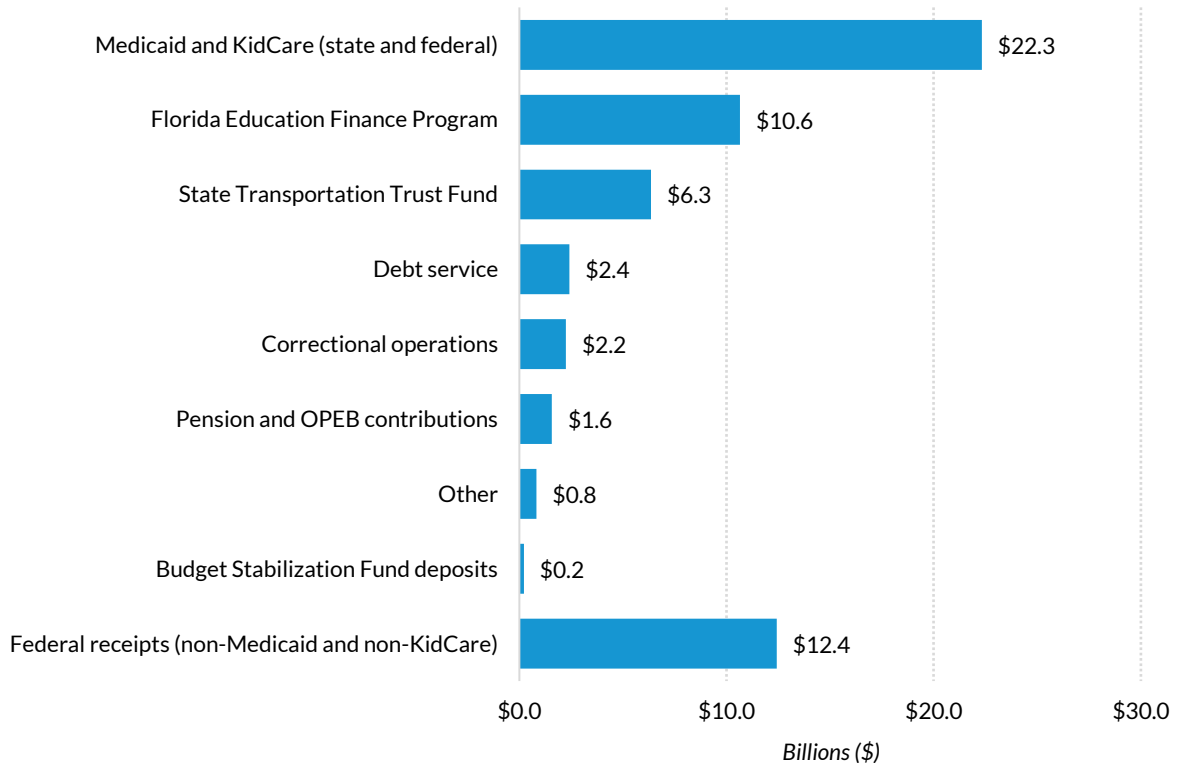
political costs. In fiscal year 2015, Florida spent \$22.3 billion on Medicaid and KidCare (figure 8), which included \$13.5 billion in federally financed spending.⁸³ Although it receives significant federal funding for the Medicaid program, Florida opted out of the largely federally funded Affordable Care Act Medicaid expansion in 2014.

Although the state’s pension systems are in good health, and informants reported that Florida treats pension contributions as a fixed obligation, the state has no formal requirement to contribute to its pension or other postemployment benefit (OPEB) systems at an actuarially determined level. As such, we did not include pension contributions in the lower bound of restricted spending.

FIGURE 8

Florida’s Restricted Spending, FY 2015

Categories (except for Medicaid, KidCare, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with Florida Office of Economic & Demographic Research and the Florida Department of Education. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year; OPEB = other postemployment benefit. “Other” includes state spending on its Temporary Assistance for Needy Families maintenance of effort requirement and the Voluntary Prekindergarten Education Program, which each comprise one percent or less of total spending. Includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 13 and accompanying notes for detail. Values in this figure may not sum to those in table 13 because of rounding.

Florida's uppermost restricted spending bound includes all categories illustrated in figure 8. After Medicaid and KidCare, formula-driven K–12 education (i.e., the Florida Education Finance Program, or FEFP) constitutes the largest share of state spending, followed by dedicated spending from the State Transportation Trust Fund. The state's upper bound also includes correctional operations, pension and OPEB contributions, maintenance of effort for TANF, Budget Stabilization Fund deposits, federal receipts, and spending on the constitutional Voluntary Prekindergarten Education Program, which is specific to Florida (classified as “other” in figure 8; see box 9 for more detail). Some state restrictions detailed in table 12 are not readily quantifiable and are therefore excluded from the quantitative portion of our analysis in figure 8. For more information on these and other less quantifiable restrictions, please see Florida's state profile, as well as data and technical documentation in the accompanying data appendix (Boddupalli and Randall 2019).

BOX 9

Florida's Voluntary Prekindergarten Education Program

In 2002, Florida adopted a constitutional requirement to establish a voluntary, free, high-quality prekindergarten program that would be available to every four-year-old Florida child.^a To meet this requirement, in 2005, the state established Florida's Voluntary Prekindergarten Education Program (VPK), funded from both state and local revenue.^b

Florida's VPK is an excellent example of a state-specific, semirestrictive program. Like K–12 education, the program's cost is driven significantly by caseload and enrollment changes, formula-funding requirements, and the state constitutional requirement. In fiscal year 2016, for example, the state estimates that enrollment changes will cost \$2.9 million, based on a projected increase of 1,563 full-time students (JLBC 2014).

Although the program constituted only 1 percent of state spending in 2015 (\$384 million),^c the requirement is strict, and informants reported that the program has placed a squeeze on other discretionary areas of the budget.

Notes:

^a See Fla. Const. amend. 8

^b The legislature passed the law in 2004, and it was signed by Governor Jeb Bush in 2005, creating sections 1002.51–1002.79 of the Florida Statutes.

^c Authors' analysis based on literature review, financial reports, key informant interviews, and communications with Florida Office of Economic and Demographic Research and the Florida Department of Education. See Boddupalli and Randall (2019) for technical documentation and state detail.

How Binding Are Florida’s Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility and are subject to interpretation, our data and key informant findings suggest a few points.

Florida Medicaid is among the state’s largest and least flexible obligations. As in all study states, Medicaid imposes significant pressure on Florida’s budget, both in terms of size and stringency of the obligation. The state classifies both Medicaid and KidCare as “critical needs” cost drivers in the state’s long-term financial outlook (box 10).⁸⁴

Informants reported that the state legislature does not have much control over Medicaid program design or spending.⁸⁵ At 30 percent of total spending in fiscal year 2015 (figure 9), Medicaid and KidCare are large and restrictive. Restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state’s fiscal incentive to obtain the federal match. They also manifest through growth in caseloads, price inflation, and increasing supply of new goods and services such as new drugs and procedures in the health care sector. Medicaid is a much larger source of pressure than KidCare because children’s health care costs are a small share of total Medicaid spending.⁸⁶ Florida has a spare program, leaving little room to cut optional services.⁸⁷

BOX 10

Florida’s Approach: Critical Needs and the *Long-Range Financial Outlook*

Each year, Florida prepares a *Long-Range Financial Outlook* report that forecasts three-year spending for the state’s most critical budget drivers.^a The report classifies drivers as either “critical needs” (i.e., mandatory, absent legal or structural changes) or “other high-priority needs” (i.e., items that have received funding historically) (JLBC 2014). The report’s 17 critical needs “represent the minimum cost to fund the budget without significant programmatic changes” (JLBC 2014).

The long-range outlook report informed our measure of restricted spending, but the two also differ in important ways. Medicaid, KidCare, the Florida Education Finance Program, and the Voluntary Prekindergarten Education Program are included in both our measure and the outlook report. The outlook report, however, estimates current services costs for other programs, such as for higher education, which we classify as largely discretionary. It excludes much of the spending from dedicated transportation funds that we include in our measure. While Florida attempts to estimate future spending pressure, we analyze current and past spending.

Note:

^a The state has produced this report since 2007.

The FEFP is the state's next-largest spending obligation and is relatively inflexible, though options do exist to curtail it. K-12 educational spending is largely decided by formulas in the FEFP, originally adopted in 1973 (Florida House of Representatives n.d.). FEFP spending was \$10.6 billion (14 percent of total spending) in 2015 (figures 8 and 9). FEFP spending is large and restrictive largely because of state constitutional adequacy and classroom size requirements,⁸⁸ statutory funding formulas, caseload and enrollment trends, and strong public support for school funding. But the legislature exercises flexibility (and can implicitly reduce costs) by defining the basic per student funding allocation that undergirds all formula calculations. It was reported, both by informants and additional state sources, that the legislature often “backs into” the minimum allotment based on available resources (FSBA 2017). Moreover, at times, such as during the Great Recession, the state has implemented cuts. In inflation-adjusted terms, Florida's 2015 K-12 education spending was still below 2008 spending levels.⁸⁹

State contributions to the Florida Retirement System and other retirement and postemployment benefits are treated as binding, despite lack of formal requirements. Debt service is binding and constitutionally guaranteed. Pensions, OPEBs, and debt service are considered relatively fixed for actuarial or contractual reasons. Unlike other states, Florida does not have any formal requirement (constitutional or otherwise) to fund its pension at an actuarially determined contribution level. Rather, according to the Florida Statutes, all employers (including the state) are required to contribute a certain uniform rate based on employee payroll.⁹⁰ Despite lacking a formal actuarial requirement, Florida regularly meets its pension obligation requirements; the state is motivated by a strong desire to maintain a good bond rating and a fiscal culture that considers the actuarially defined pension contribution requirements “hard numbers.”⁹¹ Pension and OPEB contributions constituted 2 percent of total spending and debt service constituted 3 percent in 2015.

Both correctional operations and State Transportation Trust Fund spending are inflexible in the short term in Florida, though transportation constitutes the larger share of state spending. Key informants reported that after Medicaid and K-12 education, prisons were least vulnerable to cuts in Florida, in part because the state has little control over its prison population in the short term. Historical minimum sentencing laws and other policies in place today influence prison admissions and lengths of stay. Correctional operations constituted 3 percent of total spending in 2015 (\$2.2 billion). Projected increases in the state prison population are part of Florida's “critical needs” assessment in its financial outlook, although the correction population was declining during the latter years of our analysis.

Although correctional costs may be difficult to control in the short run, our analysis shows that operational expenditures declined in inflation-adjusted terms between 2000 and 2015, in part because of new sentencing guidelines leading to lower prison admission rates (Kang-Brown et al. 2018).

Interestingly, dedicated transportation spending constitutes a larger share of state total state spending (8 percent in 2015, or \$6.3 billion). Florida dedicates its motor fuel taxes and highway safety fees to the State Transportation Trust Fund (JLBC 2014). Although the state is not required to spend all dedicated revenue flowing into the fund in a given year, and the fund receives revenues from other sources, informants noted that those revenues are essentially off limits and, once in the trust fund, restricted to dedicated transportation purposes.

Informants reported that dedicated trust funds, such as the State Transportation Trust Fund and Land Acquisition Trust Fund, are less vulnerable to cuts than general revenue-funded discretionary programs. However, the state has at times reallocated trust fund balances to other general spending priorities.⁹² Informants reported that when revenues are tight, higher education, as well as environmental programs not funded by the Land Acquisition Trust Fund, are vulnerable to swift cuts, as are economic development, housing, and discretionary health and human services programs. State operations and cost-of-living adjustments for state employees may also be cut or held constant in nominal terms at the previous year's level.⁹³ Informants also noted that Florida's fiscal culture acts as a short-term disciplining force, as evidenced by the state's regular pension contributions and its commitment to retaining a \$1 billion surplus in the general revenue fund in each budget cycle.⁹⁴

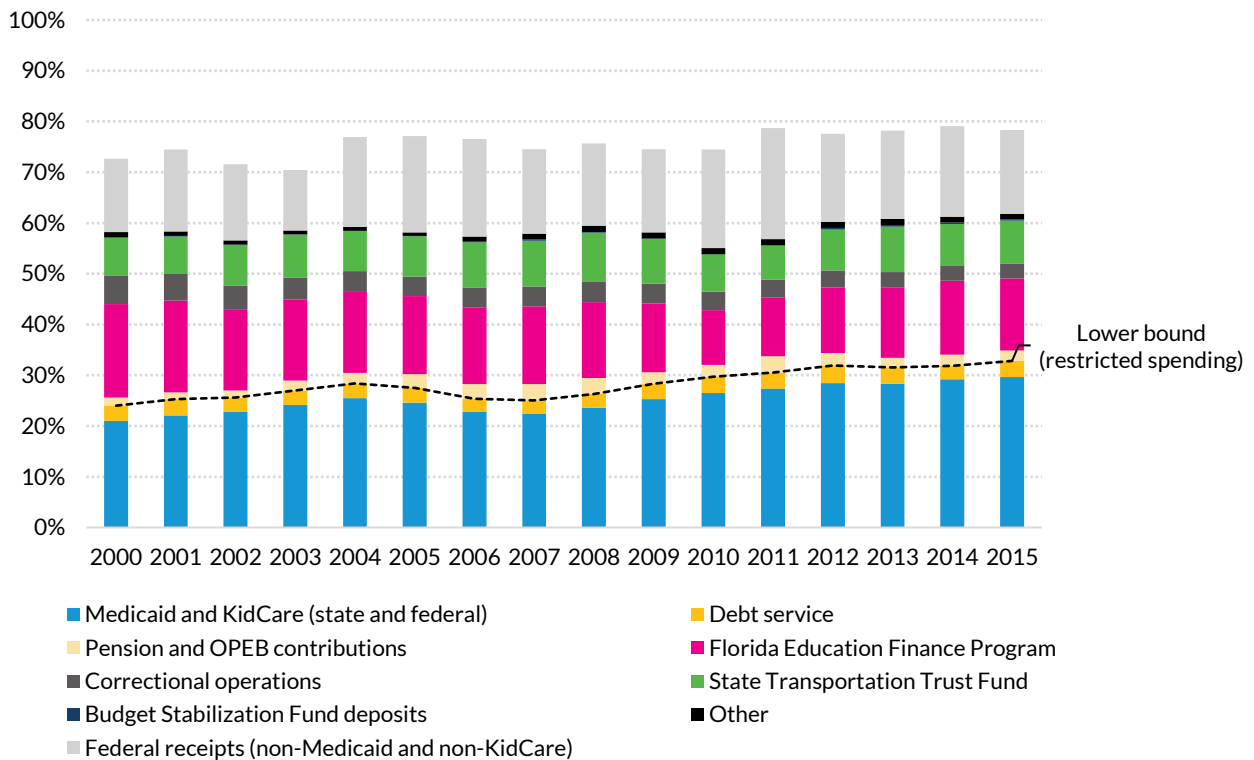
How Has Restricted Spending Changed in Florida over Time?

At its upper bound, our measure places Florida's restricted portion of spending in a range between approximately 70 and 80 percent of total governmental spending annually between 2000 and 2015. This share has remained stable over time (figure 9). Notably, however, Medicaid and KidCare have grown significantly as a share of total spending, from 21 percent in 2000 to 30 percent in 2015. In large part, this increase has largely been financed by the federal government: state-financed Medicaid and KidCare spending has grown from 9 percent to 12 percent of total governmental fund spending, but federally financed spending on those programs has grown from 12 percent to 18 percent. Long-term obligations and State Transportation Fund expenditures have largely remained steady, while state K-12 education declined from 18 to 14 percent of total governmental fund spending and corrections declined from 6 to 3 percent.

FIGURE 9

Florida's Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medicaid, KidCare, and federal receipts) reflect only state contributions



Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the Florida Office of Economic & Demographic Research and the Florida Department of Education. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year; OPEB = other postemployment benefit. Total spending includes spending from governmental funds, as reported in the state Comprehensive Annual Financial Report. "Other" includes state spending on its Temporary Assistance for Needy Families maintenance of effort requirement and the Voluntary Prekindergarten Education Program, which each comprise one percent or less of state spending. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 13 and accompanying notes for detail. Values in this figure do not sum to those table 13 because of rounding.

How Much of Florida's Spending Growth Has Gone toward Restricted Items?

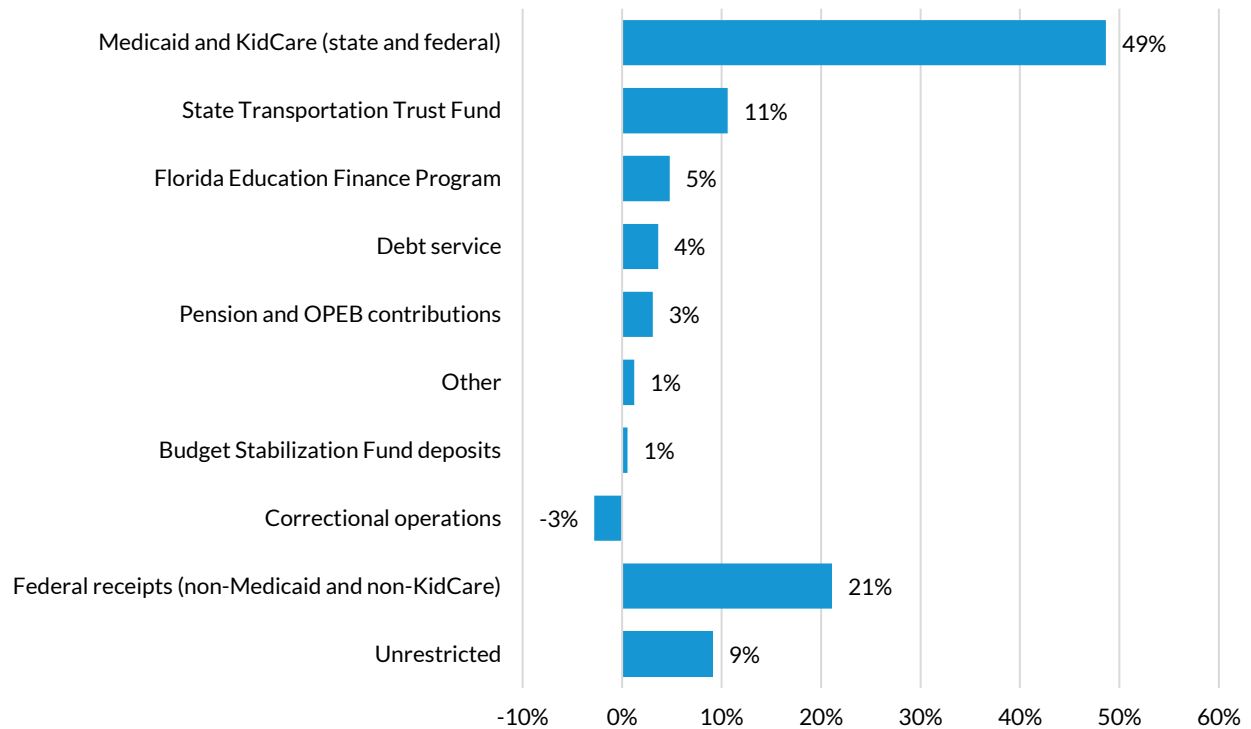
According to our analysis, at the lower bound, considering only Medicaid, KidCare, and debt service, 52 percent of all real (inflation-adjusted) spending growth since 2000 has gone to restricted categories.⁹⁵ At the upper bound, considering all spending obligations (and offsetting for those restricted funds that have decreased over time and constitute a negative share of growth), Florida's restricted spending consumed 91 percent of state spending growth between 2000 and 2015 (figure 10).

Nearly half of that growth went to Medicaid and KidCare (17 percent in non-federally financed and 31 percent in federally financed spending). Spending from the State Transportation Trust Fund made up the next largest portion of growth at 11 percent, followed by spending on the FEFP at 5 percent. The remaining categories comprised four percent or less of growth each, except for corrections spending, which has declined and constituted a negative share of spending growth.

FIGURE 10

Florida’s Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, KidCare, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the Florida Office of Economic & Demographic Research and the Florida Department of Education. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year; OPEB = other postemployment benefit. Total real spending growth includes inflation-adjusted spending growth from governmental funds, as reported in the state Comprehensive Annual Financial Report, between FY 2000 and 2015. “Other” includes state spending on its Temporary Assistance for Needy Families maintenance of effort requirement and the Voluntary Prekindergarten Education Program, which each comprise less than one percent of state spending. Unrestricted includes the remainder of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 13 and accompanying notes for detail. See table 13 and accompanying notes for detail. Values in this figure may not sum to those in table 13 because of rounding.

Illinois

From 2015 to 2017, Illinois functioned without a budget despite its constitutional obligation to pass a budget each year (State of Illinois Comptroller 2018b). It did this largely by relying on “continuing appropriations,” or funding that is guaranteed each year even absent a formal budget (box 11), and through federal court orders.⁹⁶

Illinois stands out among our study states for its regular circumvention of requirements and lack of formal commitments for what must be in the next year’s budget. Informants reported that Illinois’s statutory and constitutional language often appears binding, but it is not treated so in practice, and that state budget officers and lawmakers figure out “how to get around requirements.”⁹⁷

A lot of the state’s financial challenges come from language that sounds like a mandatory funding requirement, but in practice is something less than that.

—Laurence Msall, The Civic Federation

Although past behavior conferred some short-term budgeting flexibility, the state has in many ways only further constrained itself through those actions. The state’s long-term flexibility is declining as it incurs substantial current and future commitments to make up for prior funding postponements. Thus, despite few formal obligations, today’s legislature arguably has less flexibility than past legislatures for spending commitments.⁹⁸ As illustrated by the 2015–17 experience, important areas of the budget are either under continuing appropriations, subject to political spending pressure, or governed by a combination of court cases and consent decrees that require the state to conform more strictly to existing commitments. Fiscal pressure to reduce Illinois’s unfunded pension liability has also been strong.

Illinois informants identified long-term obligations; major programs such as Medicaid and K–12 education; local aid; and various federal receipts, court orders, and consent decrees as potential fiscal restrictions (table 14). A large share of Illinois’s spending may be therefore characterized as potentially restricted (figure 11).⁹⁹ With a few exceptions, however, the legislature has and exercises flexibility. Moreover, many of Illinois’s more binding restrictions, such as requirements related to Medicaid, have been imposed recently by courts.

BOX 11

Illinois's 2015–17 Budget Standoff

Illinois made national headlines between 2015 and 2017 when it went 736 days without a tax and spending plan.^a State spending continued, however, thanks to a variety of idiosyncratic rules and practices.

In Illinois, some obligations are automatically funded at the amount required by state statute even without an enacted line-item appropriation (GOMB 2018). These “continuing appropriations” cover a few categories, namely debt service (to assure bond holders that the state will make its required payments) and state pension fund contributions. The automatic funding also extends to legislative and judicial operations and a variety of special and tax-related funds.^b

The state also continued to fund other obligations for political reasons or under court orders. Until 2002, General State Aid (GSA) to school districts was under continuing appropriation (Illinois Economic and Fiscal Commission 2000). Since then, GSA has required an appropriation. The state considers K–12 education among its core priorities, however, and the legislature appropriated funds for it during the impasse.^c The state also paid for expenses necessary to comply with at least a dozen judicial consent decrees.^d

As one informant shared, the 2015–17 budget standoff offers “a good, concrete case to observe the things that continued to get paid in Illinois, and things that didn’t.”^e Informants reported that when revenues are tight, higher education, human services lacking a court order, and optional Medicaid programs have been cut, postponed or, during the budget impasse, not paid at all. State financing for other social services contracted out to private and nonprofit providers has also been vulnerable to cuts.^f

Notes:

^a See Julie Bosman and Monica Davey, “Illinois Lawmakers Override Budget Veto, Ending Two-Year Stalemate,” *New York Times*, July 6, 2017, <https://www.nytimes.com/2017/07/06/us/illinois-budget-shutdown-states-rauner.html>.

^b For a list of items under continuing appropriation, see “Exhibit A” in the agreed interim order for People of the State of Illinois v. Leslie Geissler Munger, 15 CH 10243 (2015), http://www.illinoisattorneygeneral.gov/pressroom/2015_07/People_v_Munger_Agreed%20Interim%20Order_July7_2015.pdf.

^c The state adopted a “b ridge” appropriations bill in 2016 that included funding for elementary and secondary education; see Public Act 099-0524, 99th Gen. Assemb., Reg. Sess. (Ill. 2016). In 2017, the state comptroller called K–12 education a core obligation in an affidavit filed and cited in *Memisovski et al. v. Maram, et al.*, No. 92 C 1982 (N.D. Ill. 2017); and *Beeks et al. v. Bradley et al.*, No. 92 C 4204, (N.D. Ill. 2017).

^d See “Exhibit C” in *Munger*.

^e Ginger Ostro (Advance Illinois), phone interview with authors, October 2017.

^f In 2012, Illinois ranked fourth in the country for number of nonprofits with government contracts and grants (behind California, New York, and Pennsylvania), second in problems with late payments (behind Rhode Island), and third in problems with government payments not covering the cost of services (behind New Jersey and Rhode Island) (Pettijohn, Boris, and Farrell 2014).

TABLE 14

Illinois's Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> ▪ State contributions to public employee pension and other postemployment benefit trust funds (Illinois State Employees' Retirement System and other pension and postemployment benefit plans) ▪ Debt service payments
Programmatic	
Major programs	<ul style="list-style-type: none"> ▪ Medicaid and Children's Health Insurance Program (All Kids) ▪ Formula-driven K–12 education spending (General State Aid to school districts) ▪ Spending from dedicated transportation funds, including the Road Fund, Motor Fuel Tax Fund, and state construction account ▪ Correctional spending on inmate populations, including medical care and other services
Other programs	<ul style="list-style-type: none"> ▪ Spending from other earmarked or special funds, such as the Tourism Promotion Fund, Supplemental Low Income Energy Assistance Fund, and Illinois Affordable Housing Trust Fund ▪ State maintenance of effort for Temporary Assistance for Needy Families ▪ Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, or other federally financed programs
Institutional	None applicable
Local aid	<ul style="list-style-type: none"> ▪ Local Government Tax Fund ▪ Local Government Distributive Fund ▪ Personal Property Tax Replacement Fund
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Court orders	<p><i>Memisovski v. Maram</i> and <i>Beeks v. Bradley</i> (2017). Required the state to make monthly payments to Medicaid providers to pay down its existing provider payment backlog.</p> <p><i>Doris Heaton v. Pat Quinn</i> (2015). Required the state to fulfill its existing pension benefit agreements between current and future retirees without benefit reductions.</p>
Consent decrees and settlements	<p><i>Olmstead v. L.C.</i>-related cases. Various cases requiring the state to invest resources in, or improve activities related to, transitioning people from institutions into community-based mental health care:</p> <ul style="list-style-type: none"> ▪ <i>Williams v. Quinn</i> (2010) ▪ <i>Ligas v. Hamos</i> (2011) ▪ <i>Colbert v. Quinn</i> (2012) <p><i>R.J. v. Mueller</i> (2012). Required additional resources for juvenile justice programs.</p> <p>Cases that required child welfare services improvements:</p> <ul style="list-style-type: none"> ▪ "B.H." consent decree (1991) ▪ <i>Norman v. Suter</i> (1991)
Indirect	None applicable

Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the State of Illinois Comptroller. See Boddupalli and Randall (2019) for citations and state detail.

Note: Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried. See box 12 for more information on Illinois and the courts.

How Much of Illinois’s Spending May Be Restricted?

Drawing on provisions identified by state informants, original state materials, and available data, we estimate 32 to 71 percent of Illinois’s total state spending (including from federal receipts) was potentially restricted in 2015 (table 15).¹⁰⁰

TABLE 15

Restricted Spending in Illinois: Upper and Lower Bounds

Categories (except for Medicaid, All Kids, and federal receipts) reflect only state contributions

		Total spending fiscal year 2015 ^a	(billions \$)	69
		Lower bound	(L %)	32%
		Upper bound	(U %)	71%
Restricted spending	Medicaid and All Kids (state and federal) ^b			L
	Debt service			L
	Pension contributions ^c			U
	General State Aid to school districts ^d			U
	Correctional operations			U
	Dedicated transportation spending ^e			U
	TANF maintenance of effort			U
	Federal receipts (non-Medicaid and All Kids) ^f			U
	Budget Stabilization Fund deposits ^g			
	Other state-specific programs			

Notes: Except for Medicaid and All Kids and federal receipts, restricted categories reflect state contributions.

^a Total annual spending includes total governmental fund spending as reported in the state annual Comprehensive Annual Financial Report.

^b Includes both state-financed (\$7.6 billion) and federally financed (\$10.8 billion) components. The state share may also include local contributions toward the state’s nonfederal match requirement.

^c Includes state contributions to the Illinois State Employees Retirement System and other employee retirement systems, including teacher and university employee pensions. It excludes other postemployment benefits because data are unavailable before 2008. Excludes employee and local contributions.

^d Formula-driven state contributions to K–12 education. Excludes local and federal contributions.

^e Includes spending from the Road Fund, Motor Fuel Tax Fund, and State Construction Account, excluding federal funds and debt service which are counted under federal receipts and debt service, respectively.

^f Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and the Children’s Health Insurance Program, which are reflected under the Medicaid and All Kids category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K–12 education) as well as dedications to other programs not displayed here.

^g Illinois has a Budget Stabilization Fund with formal deposit and withdrawal rules, but informants and outside sources concur that the fund exists as a working cashflow fund, and NASBO (2015) indicates that the state has not made a deposit since 2004.

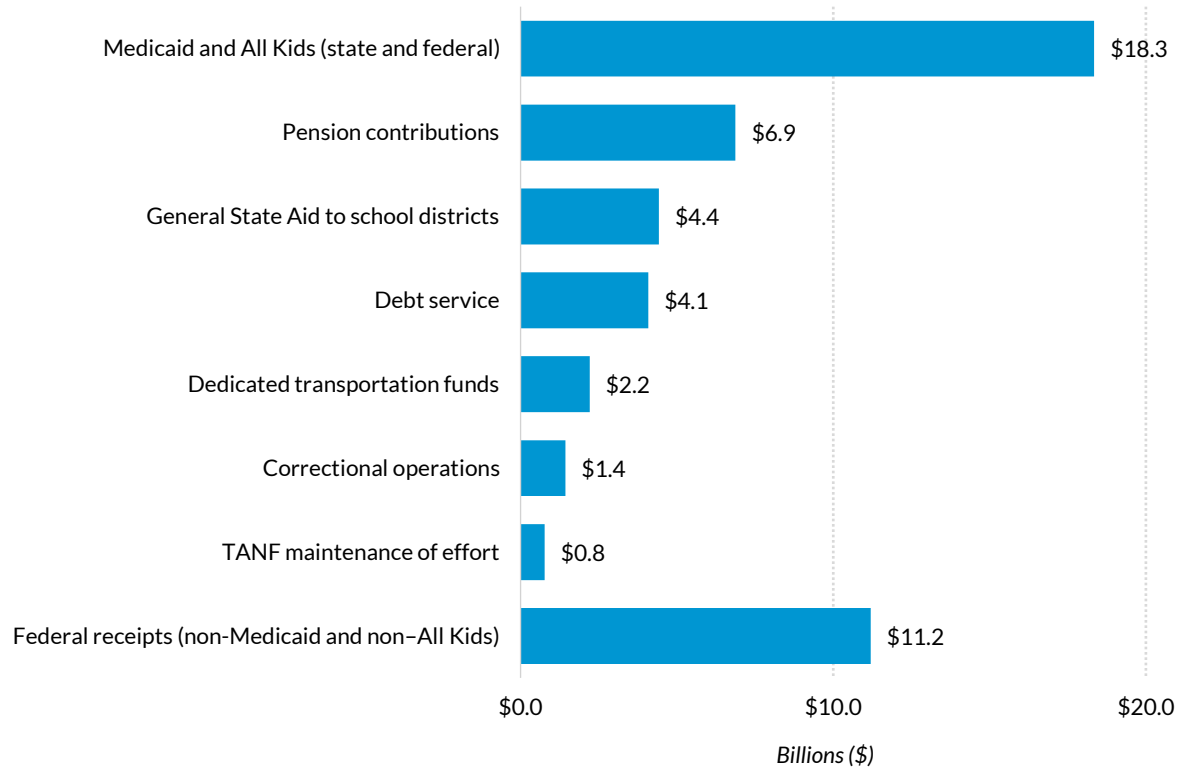
At its lower bound, this includes debt service, Medicaid, and the Children’s Health Insurance Program (known as All Kids in Illinois) spending. We identify debt service (\$4.1 billion in fiscal year 2015) as more-or-less fixed because of contractual obligations and the necessity of maintaining access to credit markets. In theory, states can opt out of Medicaid, but in practice this would impose significant fiscal, administrative, and political costs. In fiscal year 2015, Illinois spent \$18.3 billion on Medicaid and

All Kids (figure 11), which included \$7.6 and \$10.8 billion in state and federal spending, respectively. The state adopted the largely federally-funded Affordable Care Act Medicaid expansion in 2014.

FIGURE 11

Illinois's Restricted Spending, FY 2015

Categories (except for Medicaid, All Kids, and federal receipts) reflect only state contributions



Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the State of Illinois Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 15 and accompanying notes for detail. Values in this figure may not sum to those in table 15 because of rounding.

Illinois's upper bound of restricted spending includes all categories illustrated in figure 11. After Medicaid and All Kids, state pension contributions constitute the largest restricted share of state spending. We include pension contributions in the upper, but not lower, bound of potentially restricted spending in Illinois. Pension contribution obligations have historically been flexible, as evidenced by the state's unfunded accrued liabilities. Moreover, while the state has a statutory pension funding requirement in place, the requirement is not based on an actuarially determined estimate (table 6).

The next largest share goes toward GSA to school districts. Compared with other states, Illinois has fewer legal or court restrictions on reducing spending on K–12 education, though it’s not clear that the longer-term pressures in that arena are less than in other states. The state’s upper bound also includes spending from dedicated transportation funds, correctional operations, and the state maintenance of effort for TANF. Some state restrictions detailed in table 14 are not readily quantifiable, and as such are excluded from the quantitative portion of our analysis in figure 11. For more information on these restrictions, as well as others we were unable to quantify, please see Illinois’s state profile, as well as additional data and technical documentation, in the accompanying data appendix (Boddupalli and Randall 2019).

How Binding Are Illinois’s Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility and are subject to interpretation, and that relief from pressures is different in the long term than in the short term, our Illinois data and key informant findings suggest a few points.

Although Medicaid is a large share of spending and is relatively inflexible, the state has only recently (under court order) been required to fully fund program costs. Medicaid and All Kids constituted a quarter of total state spending (including from federal receipts) in 2015 (figure 12) and has consumed a large share of state spending growth over the last 15 years (figure 13). As in all study states, restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state’s fiscal incentive to obtain the federal match, as well as growth in caseloads and health care costs.

Although flexibility is limited when it comes to required services and eligibility groups, in the past the state has exercised temporary flexibility by adjusting the timing of its Medicaid payments. An Illinois statute previously allowed the state to defer Medicaid bills with the promise of paying them from future appropriations (State of Illinois Comptroller 2008).¹⁰¹ The state has thus paid its bills but has “played games” by under-appropriating for program costs and “kicked expenses down the road for years,” said one person we spoke with.¹⁰² When the state lacked a budget, for example, it deferred payments to Medicaid providers.

Exercising options for short-term flexibility in this manner, however, has obligated future state revenues for past expenses and reduced long-term flexibility. The state is required to pay interest penalties on its late payments, and in the past two and a half years has accrued more late interest penalties than it paid in the last 18 years combined (State of Illinois Comptroller 2018a). The majority of

late interest penalties are owed on medical bills for state employee health insurance and Medicaid (State of Illinois Comptroller 2018a). In 2017, courts required the state to reimburse Medicaid providers, even absent a budget.¹⁰³ This order immediately followed a previous court order that found the state had violated federal consent decrees and that subsequently required the state to increase payments to its managed-care organizations.¹⁰⁴

GSA to school districts, although not constitutionally guaranteed, is reportedly difficult to cut and was the only item to receive appropriations during the budget impasse. Until 2002, GSA to school districts (i.e., Illinois's formula-driven K–12 education funding system) was subject to continuing appropriations. Although this meant that funding for schools was guaranteed, even absent a formal state budget, school districts still experienced uncertainty in their expected level of state aid because of the complex interaction between property values, enrollment, and the state aid formulas (Illinois Economic and Fiscal Commission 2000).¹⁰⁵ Today, it is generally accepted that without a legislative appropriation, schools will not receive funding.

Despite the lack of a binding technical requirement to fund schools at a certain level, the state has identified K–12 education as among its core priorities,¹⁰⁶ and education was one of the only items to receive an appropriation during the 2015–17 budget impasse.¹⁰⁷ Key informants also reported that pressure to fund education at or above prior-year levels is in large part because of the political support for elementary and secondary education funding.¹⁰⁸ Further, property tax caps faced in some local school districts have encouraged the state to make up limited local funding with GSA dollars.¹⁰⁹

The state recently overhauled its school finance formula to apply both increases and reductions in school funding more equitably.¹¹⁰ In adopting the new funding formula, the state promised that each school district would continue to receive funding at its prior year's level or greater, and additional dollars would be distributed more equitably across districts (ISBE 2017a).¹¹¹ Thus, informants expect continued pressure on the state to maintain or increase current funding levels. Meanwhile, pressure from constituents may continue to push spending beyond that minimum, even absent formal requirements.

Flexible pension funding requirements have led to a large unfunded pension liability that now places significant fiscal pressure on the budget. Key Illinois informants reported that pensions are now one of Illinois's most binding constraints, although that has not always been the case. Past underfunding has led to large unfunded liabilities, which the state has only recently begun to address.

Although pension plan contributions have been subject to continuing appropriations in Illinois since 1993,¹¹² pensions were not always treated as a binding requirement in the short term. The statutory

contributions requirement is not actuarially sound and has often been below the actuarially determined contribution,¹¹³ leading to decades of structural underfunding.¹¹⁴ Moreover, the legislature can act to change or skip contributions. In 2005, for example, the state reduced its statutorily required contribution.¹¹⁵ In several years, the state financed its statutory pension contribution requirement out of bond proceeds, a financial maneuver that can save states money if investment returns exceed the cost of debt service payments but can also push financial risk to future generations.¹¹⁶ Such decisions shift a portion of that future liability from the pension bucket into debt service payments.

In addition, taking advantage of short-term flexibility in pension funding requirements may lead to a long-term loss of flexibility as other obligations are squeezed. In 2015, pension contributions were 10 percent of state spending in Illinois compared with only 3 percent in 2000 (figure 12). Illinois's pension challenges are now so difficult that the Pew Charitable Trusts ranks it 48th among underfunded states, or the third most underfunded state in the nation,¹¹⁷ and the Urban Institute has assigned the state grades of D and F for its fulfillment of required contributions and its funding ratio, respectively.¹¹⁸

The state distinguishes between general revenue funds, which reportedly receive a high level of scrutiny, and other state funds, which reportedly receive less scrutiny and are often funded through special revenue sources (e.g., fees from hunting licenses). Other state funds constitute a large share of the budget and include, for example, pension contributions, debt service, statutory “transfers out” to local governments, and Medicaid. Interest groups often exert some control over the use of these special funds even if there is no legislative constraint.¹¹⁹ So, although the state can legally access those funds, it can be politically challenging to do so, as one informant responded.¹²⁰ However, she also reported that because of the reduced scrutiny these special funds receive, some “game-playing” can occur between funds.¹²¹ Indeed, Illinois has accessed special revenue sources to meet general fund needs.¹²² In 2011, Illinois passed legislation requiring any interfund transfers to be paid back within 18 months, although it repealed this requirement in 2015.¹²³

Closing prisons or mental health facilities has also posed a political challenge, historically, even though they are not formally protected.¹²⁴ One informant reported that Illinois has cut its social service infrastructure significantly and finding additional savings in the current budget is difficult given the extent of previous cuts.¹²⁵

“It is challenging because I don’t think folks understand how limited you are in what you can cut. Everything that you can cut, we already have.”

—Illinois State Senator Heather Steans

Informants also reported that court cases are an additional, sometimes significant source of fiscal restriction in Illinois (box 12). As one informant humorously remarked, “The nice thing about Illinois is that we try to keep a continuous relationship with the federal courts.”¹²⁶ Though fiscal impacts from these cases are often difficult to quantify and separate from other pressures arising in the same programs, our informants noted that consequences of court decisions can be far-reaching and, during the most recent budget impasse especially, shifted lawmakers' perception toward spending being on “autopilot.”

BOX 12

The Courts and Restricted Spending in Illinois

In 2016, the state spent \$12.4 billion to comply with court orders and consent decrees, approximately \$6 billion of which went to Medicaid-related costs and \$3 billion to state employee salaries and related costs.^a Significant court decisions and consent decrees have required the state to fund the following:

- **Community-based care for individuals with mental illness or intellectual disabilities.** This mainly requires additional spending and compliance from the Department of Human Services, stemming from cases related to *Olmstead v. L.C.* (commonly known as Olmstead-related cases): *Williams v. Quinn* (2010);^b *Ligas v. Quinn* (2011);^c and *Colbert v. Quinn* (2012).^d
- **Higher juvenile justice staffing ratios.** These include other enhanced operations and services and mainly require additional efforts from the Department of Juvenile Justice: *R.J. v. Mueller* (2012);^e and *M.H. v. Montreal* (2014).^f
- **More stringent caseload standards in the state foster care program.** These include other enhanced operations and services for families and children in foster care and primarily require additional efforts from the Department of Children and Family Services: B.H. consent decree (1991);^g and *Norman v. Suter* (1991).^h
- **Medicaid provider payments.** A US judge ordered the state to pay \$586 million a month to Medicaid providers and to pay down the existing \$3.1 billion backlog of unpaid bills; this concluded a slew of lawsuits that challenged the state's noncompliance with multiple federal consent decrees since 1992: *Memisovski v. Maram* and *Beeks v. Bradley* (2017).ⁱ

- **State employee pensions and group health insurance.** This case required the state to fulfill pension benefit agreements with current and future retirees, as promised, without reductions in promised benefits to anyone hired when a previous plan was in place: *Heaton v. Quinn* (2015).^j

A previous case required the state to make payments toward group health insurance for state employees and retirees and fund the backlog (the state issued bonds in 2017 to pay this backlog): *Kanerva v. Weems* (2014).^k

- **State employee pay.** During the budget 2015-17 budget impasse, the state became involved in a series of court cases that requested the state pay public employee salaries in the absence of a budget. Competing court decisions from Cook County and St. Clair County judges left the case unresolved and with the appellate courts: *AFSCME v. Munger* (2015) (Bakala 2017).^l

A related case recently required the state to honor pay increases for state employees, as decided in union agreements, during union negotiations: *AFSCME et al. v. Illinois Labor Relations Board* (2017).^m

Notes: AFSCME = American Federation of State, County, and Municipal Employees

^a For a description of costs associated with court orders and consent decrees, see GOMB (2018, 54).

^b See *Williams v. Quinn*, 748 F. Supp. 2d 892 (N.D. Ill. 2010).

^c See *Ligas v. Hamos* (formerly v. Maram and ongoing as v. Norwood), No. 05-C-4331, (N.D. Ill. 2011).

^d See *Colbert v. Quinn*, No. 07-C-04737 (N.D. Ill. 2012).

^e See *R.J., et al. v. Mueller* (formerly v. Bishop), case no. 12-cv-07289 (N.D. Ill. December 6, 2012).

^f Requires higher standards for parole services and procedures for juvenile parolees, also affecting the Illinois Prisoner Review Board. See *M.H. v. Monreal*, No. 1:12-cv-08523 (N.D. Ill. 2014).

^g See *B.H., et al. v. Suter* (subsequently v. McDonald (1996), v. Sheldon (2015), among other names, and ongoing as v. Smith), No. 88-cv-05599 (N.D. Ill. 1991) For more information, see “B.H. v. Smith,” ACLU of Illinois, accessed June 28, 2019, <https://www.aclu-il.org/en/cases/bh-v-sheldon>; and Fuller et al. (2018).

^h See *Norman v. Suter*, No. 89-C-01624, (N.D. Ill. 1991).

ⁱ See *Memisovski et al. v. Maram, et al.*, No. 92 C 1982 (N.D. Ill. 2017); and *Beeks et al. v. Bradley et al.*, No. 92 C 4204, (N.D. Ill. 2017).

^j See *Heaton v. Quinn*, 32 N.E.3d 1 (Ill. 2015).

^k See *Kanerva v. Weems*, No. 115811 (Ill. 2014); and “Court Ruling on Health Insurance Could Add to State of Illinois Budget Woes,” Civic Federation, July 9, 2014, <https://www.civicfed.org/iifs/blog/court-ruling-health-insurance-could-add-state-illinois-budget-woes>.

^l See *AFSCME, et al. v. Munger*, No. 5-15-0277, (Ill. App. Ct. 5 2015), http://www.illinoiscourts.gov/r23_orders/AppellateCourt/2015/5thDistrict/5150277_R23.pdf. Also see John O’Connor, “2 Courts, 2 Takes on State Employee Pay – No Budget,” *State Journal-Register*, July 10, 2015, <https://www.sj-r.com/article/20150710/NEWS/150719915>; Rachel Droze, “Decision to Pay State Employees During Budget Impasse Back in Court,” *Fox Illinois*, June 13, 2017, <http://foxillinois.com/news/local/decision-to-pay-state-employees-during-budget-impasse-back-in-court-06-14-2017>; and Doug Finke, “Should State Employees Get Paid When There’s No Budget? Illinois Supreme Court Won’t Decide,” *Governing*, March 21, 2017, <https://www.governing.com/topics/mgmt/tns-illinois-state-employee-pay.html>.

^m See *AFSCME et al. v. Illinois Labor Relations Board*, State Panel, 2017 IL App (5th) 160229; and Doug Finke, “Illinois Supreme Court Won’t Take up Rauner’s Appeal of Step Pay Case,” *State Journal-Register*, March 22, 2018, <https://www.sj-r.com/news/20180322/illinois-supreme-court-wont-take-up-rauners-appeal-of-step-pay-case>.

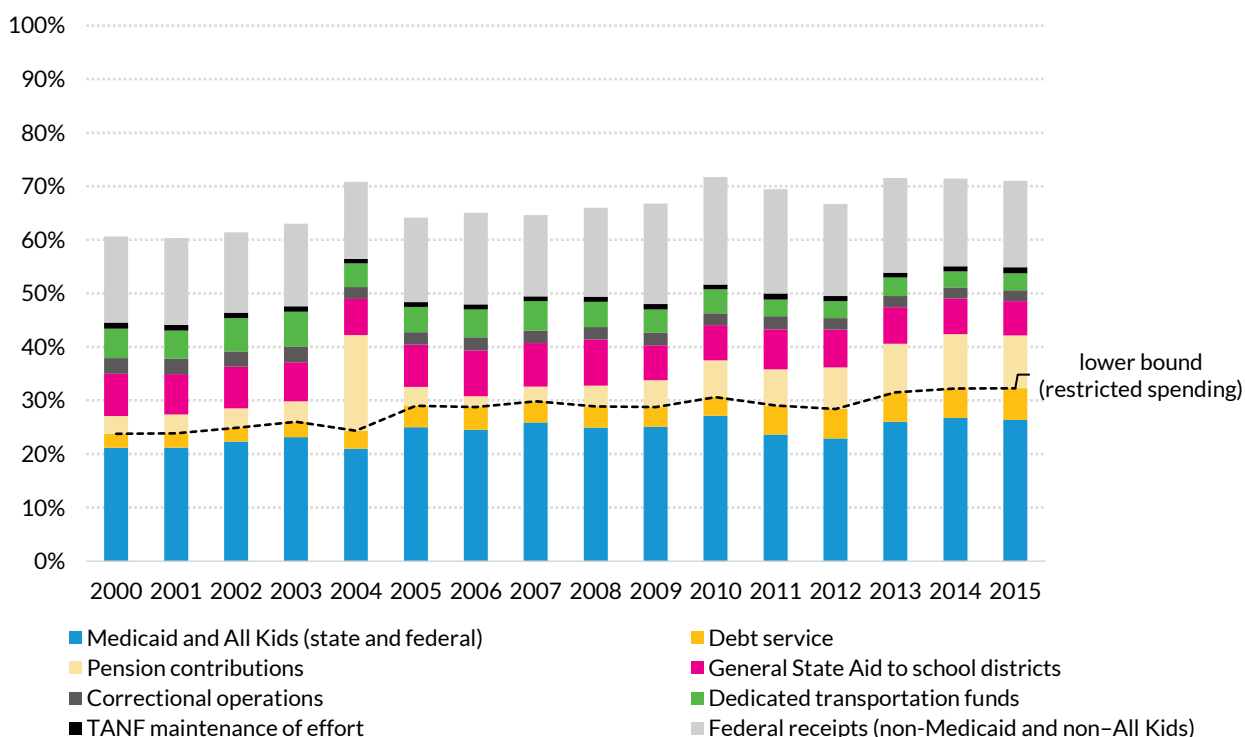
How Has Restricted Spending Changed in Illinois over Time?

At its upper bound, our measure places Illinois’s portion of restricted spending in a range between approximately 61 and 71 percent of total governmental spending annually between 2000 and 2015 (figure 12). This share has steadily increased over time, in large part because of growing pension fund contributions. One notable spike in state pension contributions occurred in 2004 (pension contributions rose from 4 percent to 18 percent of total state spending between 2003 and 2004, falling to 4 percent in 2005). This is attributable to bond funding the state procured to fund its pension systems in 2003. Over time, state pension fund contributions have grown from 3 percent of total spending in 2000 to 10 percent in 2015, largely reflecting the increasing pressure to address its large unfunded liability and recent changes to the pension funding system toward that end. The state still has a long way to go, however, until its pension liability is brought to a recommended level.

FIGURE 12

Illinois’s Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medicaid, All Kids, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the State of Illinois Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total spending includes spending from governmental funds, as reported in the state Comprehensive Annual Financial Report. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. The black line reflects the estimated lower bound of restricted spending. See table 15 and accompanying notes for detail. Values in this figure may not sum to those in table 15 because of rounding.

Medicaid and All Kids have also grown from 21 to 26 percent of total spending between 2000 and 2015. However, this increase is almost entirely attributable to increases in federally financed spending. State-financed Medicaid increased from 10 to 11 percent of state spending between 2000 and 2015, while federally financed portions grew from 11 to 16 percent. As described, the state deferred Medicaid payments for many years and was only required to make Medicaid provider payments in line with its accrued obligations in 2017. Formula-driven K–12 education, dedicated transportation fund spending, and correctional operations have all declined as a share of total spending.

How Much of Illinois’s Spending Growth Has Gone toward Restricted Items?

According to our analysis, at the lower bound considering only Medicaid, All Kids, and debt service, 58 percent of all real (inflation-adjusted) spending growth since 2000 has gone to restricted categories. At the upper bound, considering all spending obligations (and offsetting for those restricted funds that have decreased over time and constitute a negative share of growth), Illinois’s restricted spending consumed the entirety of state spending growth between 2000 and 2015 (figure 13).

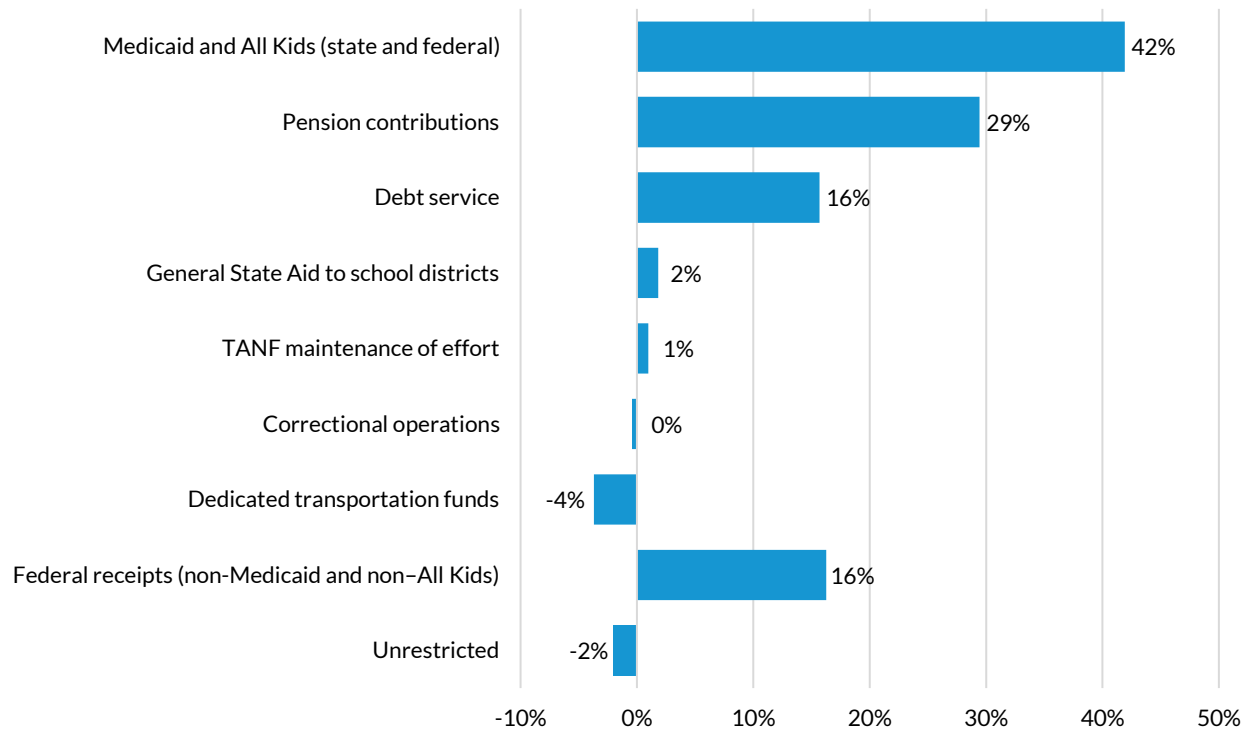
Forty-two percent of that spending growth went to Medicaid and All Kids (12 percent in state-financed and 30 percent in federally financed spending). Twenty-nine percent went to pension contributions and 16 percent to debt service payments. Thus, despite the fact that Illinois has greater short-term flexibility, or fewer strictly restricted program areas, than many other states, over the longer term it has now boxed itself in as one of the most restricted states.

As for formula-driven K–12 and other dedicated spending, restrictions over this period have generally maintained spending levels but not allowed them to share in spending growth. Of course, this means that over time, they received a reduced share of overall spending as well as of overall state resources.

FIGURE 13

Illinois's Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, All Kids, and federal receipts) reflect only state contributions



Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the State of Illinois Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total real spending growth includes inflation-adjusted spending growth from governmental funds, as reported in the state Comprehensive Annual Financial Report, between FY 2000 and 2015. Unrestricted includes the remainder of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 15 and accompanying notes for detail. Values in this figure may not sum to those in table 15 because of rounding.

New York

Despite following sound budget forecasting practices,¹²⁷ New York has faced unexpected revenue shortfalls in recent years. In February 2019, for example, the Office of the New York State Comptroller (OSC) reduced its estimate of state tax receipts by \$5.7 billion for the current and next fiscal year.¹²⁸ This prompted the governor to propose a series of budget amendments (1) cutting spending on major state programs (including Medicaid) (2) cutting aid to local governments and state agency operations and (3) taking advantage of one-time revenue sources to close the fiscal gap.¹²⁹ Although this revenue outlook improved because of higher-than-expected collections in March,¹³⁰ and several proposed cuts

were restored in the enacted budget,¹³¹ the estimated shortfalls drew attention to the state's fiscal position and spending obligations.¹³² Moreover, because of New York's strong executive budgeting process,¹³³ revenue shortfalls typically bring the executive branch's spending priorities into focus (box 13).

As in other study states, informants reported that New York's obligations exist along a continuum of flexibility and we were cautioned against applying a federal "mandatory spending" lens to the state's budget.¹³⁴

*We do not have obligations in the same sense that the federal government does. We don't have "mandatory spending."*¹³⁵

—Sandra Beattie, New York State Division of the Budget

It was reported to us that pension payments and debt service are the closest to being "on autopilot" in New York, although in recent years the state has reformed its pension system to reduce the future rate of growth.¹³⁶ The bulk of the budget, meanwhile, is dedicated to K-12 education and Medicaid. Although these large, relatively inflexible obligations place significant pressure on the budget, options exist to curtail spending or make cuts when revenues become tight.¹³⁷

BOX 13

The Governor, the Legislature, and the New York Budget

New York's governor wields significant influence in the state's budget process. As in many states, the governor is responsible for initially proposing a budget to the legislature. Unlike other states, however, the New York constitution prohibits the legislature from altering any appropriations in the governor's proposal except to either strike or reduce appropriations for specific items (ABSNY 2003; Mauro 2005).^a If the legislature wishes to include any additional appropriations, it must include them as separate, single, line-item amendments, and those amendments cannot repurpose the appropriations designated in the governor's proposal (*Pataki*). The governor, thereafter, is authorized to veto any line item and may therefore reject the legislature's additions while approving the remainder of the appropriations bill (Mauro 2005, 4).^b The legislature can also override the governor's line-item veto with a two-thirds supermajority in each house of the state legislature (DOB 2018a), though it has taken this step infrequently (Benjamin 2004).

These constitutional limitations make the governor extremely influential throughout the New York budget process and limit the legislature's control over the policies and purposes of fiscal legislation. The legislature has little bargaining power except arguably in its ability to delay the budget approval process and reject the governor's extender bills, encouraging the governor to negotiate to avoid threat of a shutdown.^c

These executive budgeting powers have been tested and affirmed in the courts. In *Silver v. Pataki* (2004), New York's legislature took then-governor Pataki to court over the governor's ability to veto legislative amendments that repurposed the governor's proposed appropriations. In *Pataki v. the New York State Assembly* (2004), the legislature challenged the governor's power to embed non-appropriations policy language in the appropriations bill (in this case education and health care policy language). In a joint decision, the New York Court of Appeals ruled that the governor's exercise of executive power was within constitutional limits in both cases.^d

Sources: For further reading, see Michael Gormley, "Cuomo Faces Aggressive New Legislature in Hard-Times Budget," *Newsday*, March 16, 2019, <https://www.newsday.com/news/region-state/state-legislature-cuomo-1.28560189>; and Zach Williams, "Think Lawmakers Have a Say in the State Budget? Think Again," *City & State New York*, January 23, 2019, <https://www.cityandstateny.com/articles/politics/new-york-state/lawmakers-say-in-state-budget.html>.

Notes:

^a See N.Y. Const. art. VII, § 4; and *Pataki v. State Assembly*, 4 N.Y.3d 75 (N.Y. 2004).

^b See N.Y. Const. art. VII, § 4.

^c See Jon Lentz, "Beating The Clock: The Downside to On-Time Budgets," *City & State New York*, February 26, 2014, <https://prod.cityandstateny.com/articles/politics/new-york-state-articles/beating-the-clock.html>.

^d The New York Court of Appeals suggested that there is likely a limit on the governor's ability to embed policy language in the appropriations bill, although the case before them did not go beyond that limit. They declined to clarify where future courts should consider drawing such a line. See Liz Benjamin, "Cuomo's Plan to Tilt Albany's Balance of Power," *Politico*, 2015, <https://www.politico.com/states/new-york/albany/story/2015/02/cuomos-plan-to-tilt-albanys-balance-of-power-087096>.

Although a large share of New York's spending is potentially restricted (figure 14), with few exceptions the legislature has, and can exercise, flexibility. New York informants identified long-term obligations, major programs such as Medicaid and K-12 education, rainy-day fund deposits, local aid, and various federal receipts and court orders as potential fiscal restrictions (table 16).

TABLE 16

New York's Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> ▪ State contributions to public employee pension and other postemployment benefit trust funds (New York State and Local Employees' Retirement System and other retirement trust funds) ▪ Debt service payments
Programmatic	
Major Programs	<ul style="list-style-type: none"> ▪ Medicaid and Children's Health Insurance Program (Child Health Plus) spending ▪ Formula-driven K-12 state expenditures as outlined by state school aid formulas ▪ Spending from dedicated transportation funds ▪ Correctional spending on inmate populations, including medical care and other services
Other Programs	<ul style="list-style-type: none"> ▪ Spending from other earmarked or special funds, such as the School Tax Relief program, the New York State Tuition Assistance Program, and taxes and fees from the New York State Health Care Reform Act of 1996 ▪ State maintenance of effort for Temporary Assistance for Needy Families ▪ Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, and other federally financed programs
Institutional	Tax stabilization and rainy-day deposits
Local aid	<ul style="list-style-type: none"> ▪ Aid and Incentives for Municipalities ▪ Local Government Efficiency Grant Program ▪ County-Wide Shared Services Initiative
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Court orders	Established funding requirements for the Indigent Legal Services Programs: <i>Hurrell-Harring v. State of New York</i> (2010).
Indirect	
Revenue-related	<ul style="list-style-type: none"> ▪ Empire State film production tax credit for film projects and film industry jobs in New York ▪ Excelsior Jobs Program for businesses expanding in and relocating to New York
Other institutional	Operating Budget Cap of 2 percent annual spending growth in state operating funds, informally executed by Governor Andrew Cuomo

Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the New York State Division of the Budget and Office of the New York State Comptroller. See Boddupalli and Randall (2019) for citations and state detail.

Note: Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried.

How Much of New York’s Spending May Be Restricted?

Drawing on provisions identified by state informants, original state materials, and available data, we estimate 47 to 85 percent of New York’s spending was potentially restricted in 2015 (table 17 and figure 14).¹³⁸

TABLE 17

Restricted Spending in New York: Upper and Lower Bounds

Categories (except for Medicaid, Child Health Plus, and federal receipts) reflect only state contributions

		Total spending fiscal year 15 ^a	(billions \$)	140
		Lower bound	(L %)	47
		Upper bound	(U %)	85
Restricted spending	Medicaid and Child Health Plus (state and federal) ^b			L
	Debt service			L
	Pension contributions ^c			L
	State School Aid ^d			U
	Correctional operations			U
	Dedicated transportation funds ^e			U
	TANF maintenance of effort			U
	Federal receipts (non-Medicaid/Child Health Plus) ^f			U
	Budget Stabilization Fund deposits			U
	Other state-specific programs			

Notes:

^a Total annual spending includes total governmental fund spending as reported in the state annual Comprehensive Annual Financial Report.

^b Includes both state-financed (\$26.9 billion) and federally financed (\$31.4 billion) components. The state share may also include local contributions toward the state’s nonfederal match requirement.

^c Includes state contributions to the New York State and Local Retirement System. Excludes employee and local government contributions. Data on New York’s other postemployment benefits contributions are unavailable, so they are excluded from this analysis.

^d New York State School Aid contributions to formula-driven K–12 education. Excludes local and federal contributions.

^e Includes spending from New York’s transit State Dedicated Fund, the Statewide Mass Transportation Operating Assistance fund, and the Metropolitan Transportation Authority Financial Assistance Fund.

^f Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and the Children’s Health Insurance Program, which are reflected under the Medicaid and Child Health Plus category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K–12 education) as well as dedications to programs not displayed here.

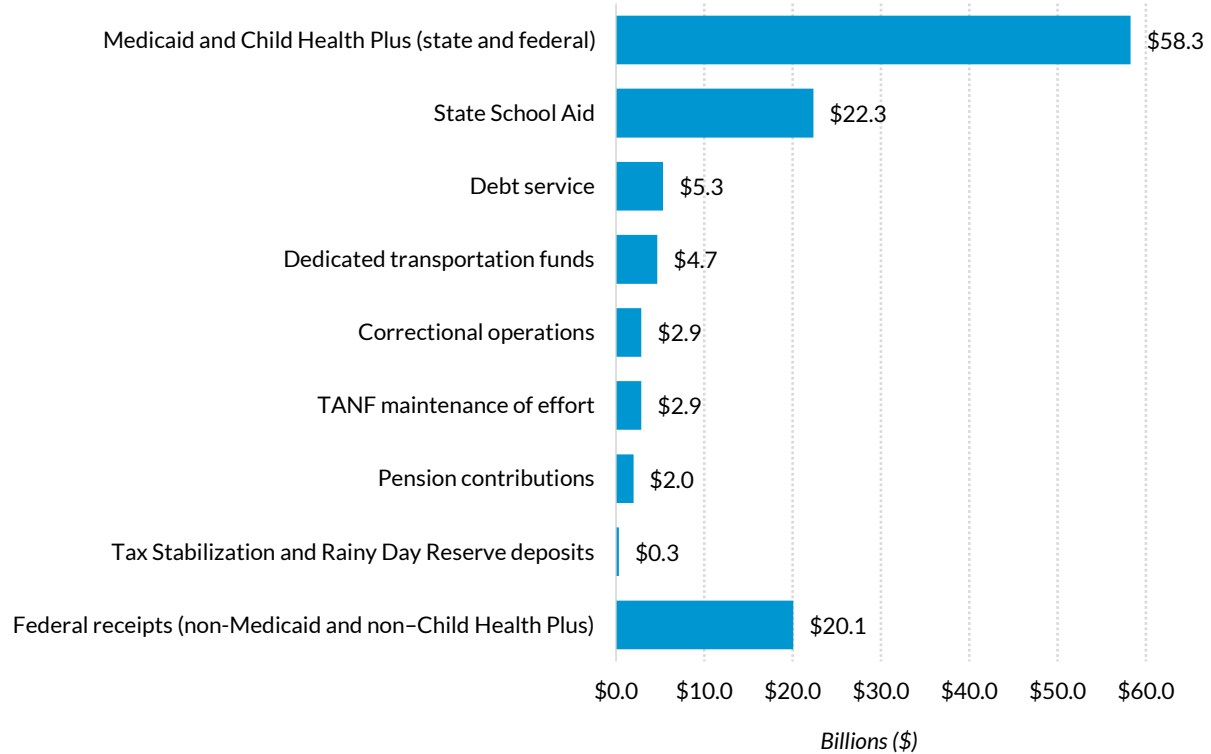
At its lower bound, this figure includes Medicaid, the Children's Health Insurance Program, or CHIP (known as Child Health Plus in New York), pension contributions, and debt service. Although New York has limited the rate of growth in Medicaid in recent years, large-scale reductions would impose significant fiscal, practical, and political costs. Debt service was identified as generally fixed because of contractual obligations and the necessity of maintaining access to credit markets. Further, the state constitution guarantees public-sector retirees their pensions, and statute requires the state to make contributions based on actuarial estimates.¹³⁹ For more information on these and other less quantifiable

restrictions, please see New York’s profile, as well as data and technical documentation, in the accompanying data appendix (Boddupalli and Randall 2019).

FIGURE 14

New York’s Restricted Spending, FY 2015

Categories (except for Medicaid, Child Health Plus, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the New York State Division of the Budget and the Office of the New York State Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 17 and accompanying notes for detail. Values in this figure may not sum to those in table 17 because of rounding.

How Binding Are New York’s Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility and are subject to interpretation, our New York data and key informant findings suggest a few points.

Medicaid is large and difficult to cut, but local governments pay a share, and New York caps state Medicaid spending growth. At 42 percent of total state spending, Medicaid and Child Health Plus are large in New York.¹⁴⁰ Key informants reported that Medicaid as a top driver of state spending.¹⁴¹

Restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state's fiscal incentive to obtain the federal match, as well as growth in caseloads, price inflation, and increasing supply of new goods and services such as new drugs and procedures in the health care sector.¹⁴² Medicaid is a much larger source of pressure than Child Health Plus, since children's health care costs are a small share of total Medicaid spending.¹⁴³

In theory, New York has a good amount of discretion when it comes to Medicaid, especially because it has enacted a variety of optional services and eligibility pathways.¹⁴⁴ Most recently, the state expanded Medicaid eligibility to low-income, childless adults as part of the Affordable Care Act in 2014, which was largely federally funded.¹⁴⁵ However, the political and policy implications of cutting Medicaid makes it an unlikely target for large reductions.¹⁴⁶

Following a national trend, the state has attempted to control spending growth by implementing service delivery reforms. Today, most of New York's Medicaid enrollees are in managed care programs.¹⁴⁷ Over the last eight years, the state has reduced the rate of growth in Medicaid, largely through system redesign choices but also by imposing some service restrictions (OSC 2015). In 2011, it enacted the Medicaid Global Spending Cap, limiting state Medicaid spending growth under the New York State Department of Health to the 10-year average rate of growth in the medical component of the Consumer Price Index (DOB 2011; NYSDOH 2012).¹⁴⁸ At the same time, the state began to adopt a mix of cost containment measures from the newly-formed Medicaid Redesign Team, including rate reductions, utilization controls, and systemic reforms (NYSDOH 2012). Since that enactment, the state has successfully managed spending within the statutory growth allowed under the Medicaid Global Spending Cap.¹⁴⁹ However, the cap does not apply to all state Medicaid spending, and the New York State Division of the Budget has projected a declining share of total state Medicaid spending subject to the cap (Hammond 2018).¹⁵⁰

Unlike most states, New York has historically shifted a sizable share of its non-federal match spending to its 57 counties and New York City (Orecki 2018). This placed less burden on the state to finance services. However, in recent years the state has moved to centralize Medicaid financing or at least reduce local governments' burden. In 2005, the state enacted a growth cap, making the state responsible for any growth in cost above that level (Orecki 2018).¹⁵¹ In 2012, Governor Cuomo and lawmakers passed a measure that froze local governments' contribution to their 2015 share (Hammond 2018; Orecki 2018). This is expected to place a larger burden on state Medicaid financing going forward.¹⁵²

State pensions contributions are statutorily binding and treated as fixed. In 2003, New York amended its minimum employer contribution funding requirement.¹⁵³ The new statute required state and local government employers to contribute the greater of either 4.5 percent of payroll or the actuarial contribution as determined by the OSC (NYSLRS 2018; Snell and Marks 2003).¹⁵⁴ The OSC is responsible for setting an actuarially determined contribution rate, and the state is directed to use that rate (NYSLRS 2018).¹⁵⁵ The comptroller thus requests a specific level of funding from the legislature, which is responsible for appropriating at that level. Public employers, including the state, cannot suspend these payments or defer to future years, as was the case prior to the enactment of the 2003 legislation (Snell and Marks 2003).

According to our conversations with informants, the legislature could, in theory, choose not to appropriate at the requested level, but this has not occurred, and the state treats its payments to the pension fund as a given.¹⁵⁶ In addition, courts have previously established that the legislature cannot override the independent judgment of the comptroller in establishing the actuarial cost method used to determine the actuarial pension rate (Bentley 2009).¹⁵⁷ Demonstrating this commitment, New York's pension system has received favorable evaluations for meeting its required contributions and maintaining a high ratio of funded to unfunded liability.¹⁵⁸

Employer contributions to the New York State and Local Retirement System have varied dramatically in response to financial crises and resultant unstable investment earnings. In 2010, attempting to mitigate employer contribution volatility that the state experienced when investment returns declined during the Great Recession, New York adopted legislation that allowed public employers to amortize their required pension contributions over time (DOB 2018b; Johnson, Haaga, and Southgate 2015, 2016).¹⁵⁹

K-12 education formulas are more flexible than fixed. According to our informants, education is a large expense and difficult to cut for political and practical reasons. Public education has strong public support in New York. Moreover, the state has adopted local property tax caps that have placed pressure on the state to finance a larger share of school aid (OSC 2011).¹⁶⁰

Today, New York's state school aid is determined in large part by the Foundation Aid program, which was established in 2007.¹⁶¹ In 2006, the Campaign for Fiscal Equity (CFE) successfully challenged the adequacy of state funding for New York City schools, requiring the state to provide additional funds for a "sound basic education," as required by the state constitution.¹⁶² Although the Foundation Aid program is not legally tied to the CFE settlement, it was adopted in response to some of the inadequacies highlighted by the case.¹⁶³

According to our informants, although New York has state school funding formulas in statute, the formulas are routinely changed to meet policy and fiscal priorities. The state has no binding requirement to appropriate a specific dollar amount. For example, although in 2007 the state pledged to dedicate a significant increase in state funding to schools through the Foundation Aid program, it held its promise for only two years before freezing state school aid when revenues became tight during the Great Recession (USNY 2013).

There are formulas in law that drive certain spending in certain areas. But it is routine to update formulas to respond to policy and fiscal considerations.

—Mary Beth Labate, Commission on Independent Colleges and Universities

The state has also taken steps to limit growth in state school aid spending. For example, in 2011 New York adopted a cap that limits growth in state aid to growth in personal income.¹⁶⁴ However, the cap is also flexible. The state has authorized increases to school aid above this growth rate annually since 2014 (DOB 2019c). The state also contributes indirectly to schools through its School Tax Relief program, which allows individual property owners to claim tax exemptions and which New York makes up to local districts affected by the exemptions (Baker 2014, 30).¹⁶⁵

The state generally complies with the governor’s 2 percent overall spending cap. New York is our only study state with a binding expenditure cap. Although many states have a formal spending limit in place, in other states (e.g., California, Florida, and Texas) the limit has historically not been binding because the threshold is set generously. In 2012, Governor Cuomo implemented a spending benchmark that stipulated annual growth in state operating funds cannot exceed 2 percent (DOB 2014). Although this policy is informal and self-imposed as part of the governor’s fiscal management approach, the governor’s significant influence in budgeting means that the cap is a regular consideration in the New York budgeting process.

Because it imposes limits on spending and forces trade-offs between spending priorities, the cap has been unpopular and garnered criticism from outside groups.¹⁶⁶ In addition, although the state has complied with the governor’s cap, it has exercised flexibility in defining State Operating Funds.¹⁶⁷ Some have criticized the administration for engaging in “budget gimmicks,” such as shifting spending out of SOF and into other special funds.¹⁶⁸

Although many areas of spending are not immediately flexible, New York has discretion over other parts of its budget, especially items that fall outside of K–12 education and health care. The state’s four-year public higher education systems have been largely immune from nominal spending reductions because the state adopted a maintenance of effort requirement in 2011.¹⁶⁹ However, the maintenance of effort requirement can be waived if the governor declares a fiscal emergency and, unlike with K–12 education, it does not tie funding to a formula based on need or adequacy.¹⁷⁰ The state’s newly adopted Excelsior Scholarship (i.e., “tuition-free college”) program is also limited in scope because it has strict eligibility guidelines and limited state funding for the program.¹⁷¹

Although the state follows some institutions stringently, such as the governor’s 2 percent spending cap, others operate with more discretion. Contributions to the two rainy-day funds are largely discretionary, and the state does not access its reserve funds frequently.¹⁷² Further, New York spreads budget cuts across agencies and programs to avoid disproportionate cuts to health care and educational services.¹⁷³ Every agency receives a target it must meet during budgeting season. As in other study states, the ultimate constraint may be political. For example, pressure from interest groups and stakeholders has resulted in a multiyear process for closing mental health facilities and correctional institutions.¹⁷⁴

BOX 14

Local Aid: New York’s Aid and Incentives for Municipalities

New York established the Aid and Incentives for Municipalities (AIM) program in 2005, consolidating what had previously been five separate local government aid programs (DOB 2005; OSC 2005).^a State disbursements to local governments under AIM totaled \$715 million in fiscal year 2015.^b AIM funding is typically disbursed to municipalities in the same amount each year. However, the state has the flexibility to modify those formulas and obligations at any time.

In 2007, the state adjusted its funding distribution to target fiscally distressed communities, with planned increases of \$200 million over four years, holding funding for New York City constant (DOB 2007b). Localities anticipated receiving different aid increases based on established criteria related to property values, revenue capacity, population loss, and poverty rates (OSC 2008).

In 2009, however, amidst recession-era revenue shortages, the state eliminated previously-scheduled increases in AIM funding (DOB 2009). In 2010, it eliminated New York City’s eligibility entirely, and instituted reductions in other localities of either two or five percent based on their reliance on AIM funding (DOB 2010).

Amidst a budget crunch in February 2019, Governor Cuomo proposed eliminating AIM funding for certain towns and villages entirely if AIM funds made up less than 2 percent of their total expenditures

(DOB 2019b).^c Although the legislature attempted to restore that funding in its version of the budget bill, the enacted budget kept the cuts (DOB 2019a).^d

Notes:

^a See N.Y. State Fin. Law § 54; and “Aid and Incentives for Municipalities (AIM) Program,” New York State Division of the Budget (DOB), accessed March 18, 2019, <https://www.budget.ny.gov/pubs/archive/fy0506archive/fy0506stateaid/fy0506aim.html>.

^b See “2014-15 Enacted Budget Aid and Incentives for Municipalities (AIM),” DOB, accessed June 7, 2019, https://www.budget.ny.gov/pubs/archive/fy1415archive/enacted1415/2014-15EnactedBudgetAIM_all.pdf.

^c See Chad Arnold, “Funding Cut to Towns, Villages to Get a ‘Second Look,’ Andrew Cuomo Says,” *Democrat & Chronicle*, February 11, 2019, <https://www.democratandchronicle.com/story/news/politics/albany/2019/02/11/andrew-cuomo-town-village-funding-cut/2837185002/>.

^d See Zach Williams, “Think Lawmakers Have a Say in the State Budget? Think Again,” *City & State New York*, January 23, 2019, <https://www.cityandstateny.com/articles/politics/new-york-state/lawmakers-say-in-state-budget.html>.

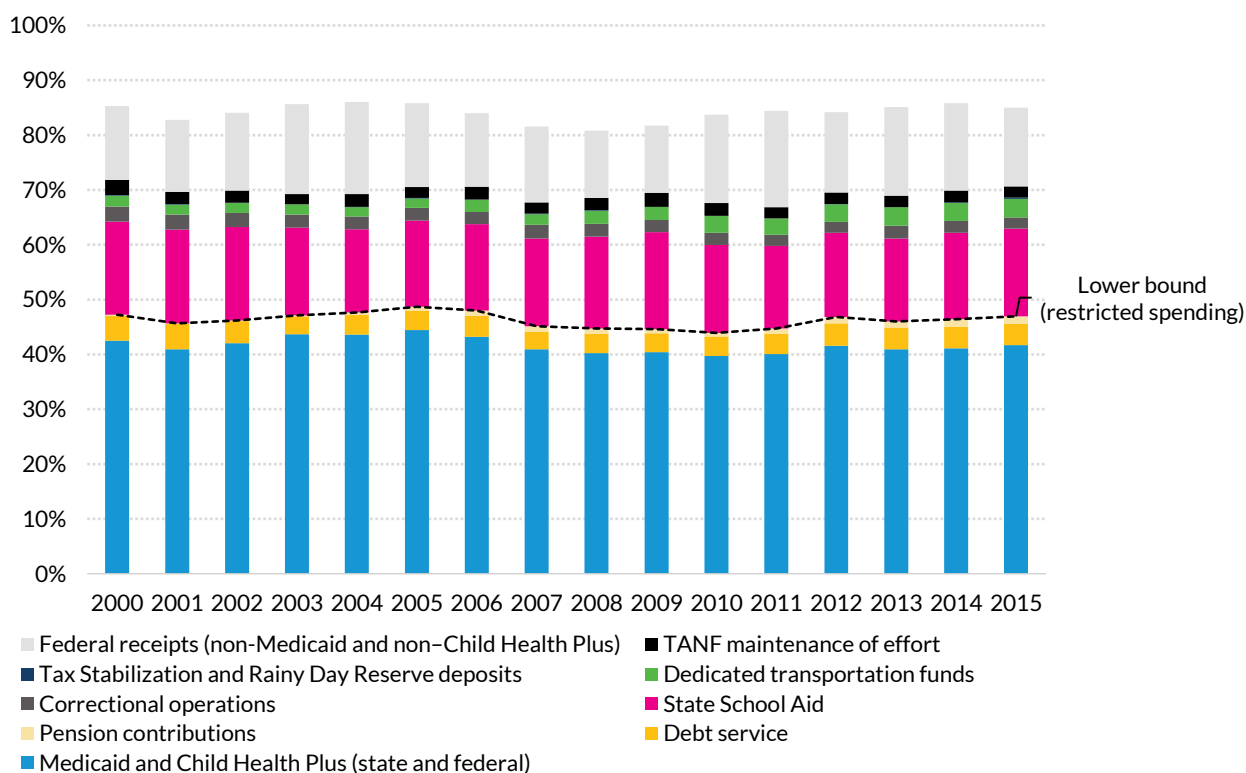
How Has Restricted Spending Changed in New York over Time?

We estimate that at the upper bound, New York’s portion of restricted spending is between approximately 80 and 85 percent of total governmental spending annually between 2000 and 2015. This share has remained stable over time (figure 15). Shares of spending going toward specific restricted categories have also remained relatively stable. Medicaid and Child Health Plus continue to constitute approximately 40 percent of total governmental fund spending. State-financed and federally financed shares of Medicaid and Child Health Plus spending have also remained at an approximately 50-50 split since 2000, with federal shares increasing between 2009 and 2011, because of enhanced federal funding during the Great Recession.

FIGURE 15

New York’s Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medicaid, Child Health Plus, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with New York State Division of the Budget and the Office of the New York State Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total spending includes spending from governmental funds, as reported in the state Comprehensive Annual Financial Report. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. The black line reflects the estimated lower bound of restricted spending. See table 17 and accompanying notes for detail. Values in this figure may not sum to those in table 17 because of rounding.

How Much of New York’s Spending Growth Has Gone toward Restricted Items?

Another facet of our analysis is to examine the share of growth in state spending that has been consumed by different spending obligations. New York governmental funds spending increased by \$39.8 billion from 2000 to 2015 (in real, inflation-adjusted 2015 dollars). Forty percent of that growth went toward Medicaid and Child Health Plus (15 percent in state-financed and 25 percent in federally financed spending).

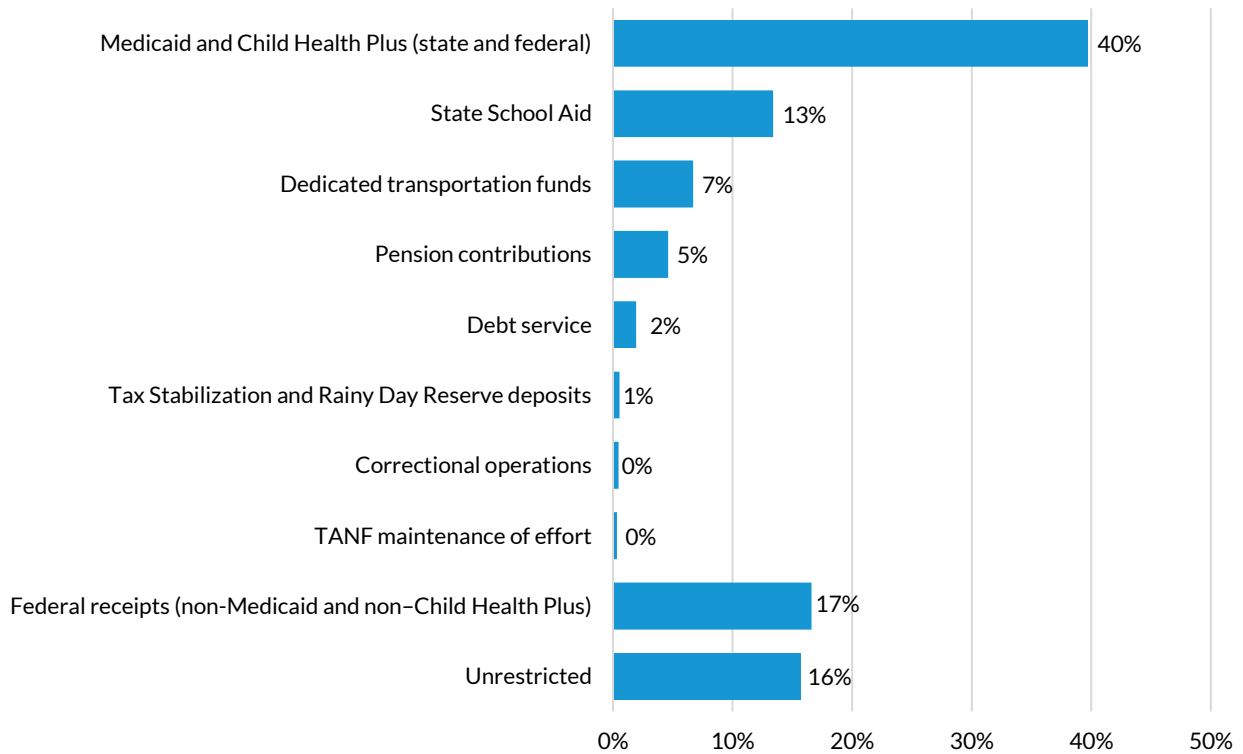
According to our analysis, at the lower bound considering only Medicaid, Child Health Plus, pensions, and debt service, 46 percent of growth has gone to restricted categories. At the upper bound,

considering all spending obligations, New York’s restricted spending consumed 84 percent of spending growth between 2000 and 2015.

FIGURE 16

New York’s Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, Child Health Plus, and federal receipts) reflect only state contributions



Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with New York State Division of the Budget and the Office of the New York State Comptroller. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total real spending growth includes inflation-adjusted spending growth from governmental funds, as reported in the state Comprehensive Annual Financial Report, between FY 2000 and 2015. Unrestricted includes the remainder of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 17 and accompanying notes for detail. Values in this figure may not sum to those in table 17 because of rounding.

Texas

Texas is known for consistently having one of the healthiest budget reserve funds in the nation, thanks in part to revenues derived from its oil and gas resources.¹⁷⁵ Texas is one of 20 states (including Virginia)

that budget every two years (NASBO 2015). In Texas, the governor is weaker than the legislature by constitutional design,¹⁷⁶ giving the legislature wider latitude to set fiscal priorities than legislatures in the states with strong governors (e.g., Illinois and New York).

In our interviews, key informants suggested that a large portion of Texas' spending is precommitted and that flexibility has declined over time. Texas informants identified state pension contributions and debt service; major programs such as Medicaid, K-12 education formulas, and transportation funds; the Economic Stabilization Fund, local aid, and various federal receipts, court orders, and consent decrees as potential fiscal restrictions (table 18). A large share of Texas' spending may therefore be characterized as potentially restricted (figure 17). With a few exceptions, however, the legislature has and exercises flexibility.

TABLE 18
Texas' Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> ▪ State contributions to public employee pension and other postemployment benefit (the Employees Retirement System and the Teacher Retirement System of Texas and other retirement and post-employment benefit funds) ▪ Debt service payments
Programmatic	
Major Programs	<ul style="list-style-type: none"> ▪ Medicaid and Children's Health Insurance Program spending ▪ Formula-driven K-12 state expenditures as outlined by the Foundation School Program and Available School Fund ▪ Spending from dedicated transportation funds (State Highway Fund and Transportation Infrastructure Fund) ▪ Correctional spending on inmate populations, including medical care and other services
Other Programs	<ul style="list-style-type: none"> ▪ Spending from other earmarked or special funds, such as the game, fish, and water safety account, system benefit fund, and the Texas Emissions Reduction Plan Account ▪ State maintenance of effort for Temporary Assistance for Needy Families ▪ Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, and other federally financed programs
Institutional	Economic Stabilization Fund deposits
Local aid	Grants to counties, such as in the Fair Defense Account, Task Force on Indigent Defense, and the Large County and Municipality Recreation and Parks Account
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Court orders	<i>American Multi-Cinema, Inc. v. Hegar</i> (2015). Required the state to refund \$1.2 million of taxes (plus interest and fees) in lawsuit over nontaxable cost of goods sold.
Consent decrees and settlements	<i>State of Texas v. The American Tobacco Co.</i> , (1997). Established the Tobacco Settlement Permanent Trust Fund.

Category	Description
Other revenue-related and indirect	
Tax expenditures	<ul style="list-style-type: none"> Economic development incentives (e.g., chapter 313 of the 2001 Texas Economic Development Act limiting the taxable value of firm property) Additional tax exemptions (e.g., expansion of homestead exemption on property taxes over time)
Other institutional	<ul style="list-style-type: none"> “Pay-As-You-Go” constitutional spending limit on appropriations Constitutional limit on state assistance to children and caretakers in need (i.e., not to exceed 1 percent of state budget)

Sources: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the Texas Comptroller of Public Accounts and Texas Legislative Budget Board. See Boddupalli and Randall (2019) for citations and state detail.

Notes: Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried.

How Much of Texas’ Spending May Be Restricted?

Drawing on provisions identified by state informants, original state materials (e.g., Texas’ *Fiscal Size-Up* report, discussed in box 15), and available data, we estimate 37 to 84 percent of Texas’ total spending was potentially restricted in 2015 (table 19).¹⁷⁷

TABLE 19

Restricted Spending in Texas: Upper and Lower Bounds

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions

		Total spending fiscal year 2015 ^a	(billions \$)	104
		Lower bound	(L %)	37
		Upper bound	(U %)	84
Restricted spending	Medicaid and CHIP (state and federal) ^b			L
	Debt service			L
	Pension and OPEB contributions ^c			U
	Formula-driven K-12 education ^d			U
	Correctional operations			U
	State Highway Fund			U
	TANF maintenance of effort			U
	Federal receipts (non-Medicaid and non-CHIP) ^e			U
	Economic Stabilization Fund deposits			U
	Other state-specific programs			

Notes: CHIP = the Children’s Health Insurance Program; OPEB = other postemployment benefit; TANF = temporary assistance for needy families.

^aTotal annual spending includes total governmental fund spending as reported in the state annual Comprehensive Annual Financial Report.

^bIncludes both state-financed (\$15.0 billion) and federally-financed (\$22.2 billion) components. The state share may also include local contributions toward the state’s nonfederal match requirement.

^c Includes state contributions to the Teacher Retirement System trust account, the Employees Retirement System trust account, the Law Enforcement and Custodial Officer Supplement Retirement Fund, the Judicial Retirement System – Plan Two Trust Fund, the Retired School Employees Group Insurance Trust, and the State Retiree Health Plan Trust.

^d Includes spending on the Foundation School Program (including Available School Fund per capita transfers) as well as Available School Fund textbook and technology fund allocations. Excludes local and federal contributions.

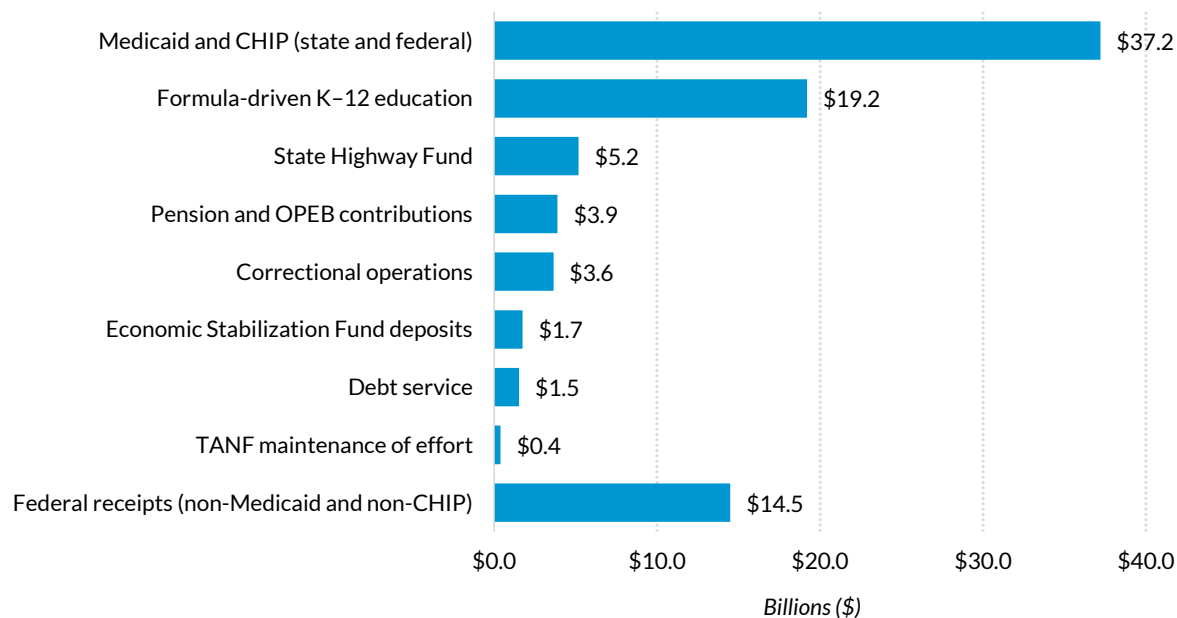
^e Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and CHIP which are reflected under the Medicaid and CHIP category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K-12 education) as well as dedications to programs not displayed here.

At its lower bound, this includes Medicaid, the Children’s Health Insurance Program (CHIP) and debt service. In theory, states can opt out of Medicaid, but in practice this would impose significant fiscal, administrative, and political costs. In fiscal year 2015, Texas spent \$37.2 billion on Medicaid and CHIP (figure 17), which included \$15.0 and \$22.2 billion in state and federal spending, respectively. Although the state receives significant federal funding for the Medicaid program, Texas has not opted into the largely federally funded Affordable Care Act Medicaid expansion. Debt service (\$1.5 billion in fiscal year 2015) was also identified as generally fixed because of contractual obligations and the necessity of maintaining access to credit markets.

FIGURE 17

Texas’s Restricted Spending, FY 2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



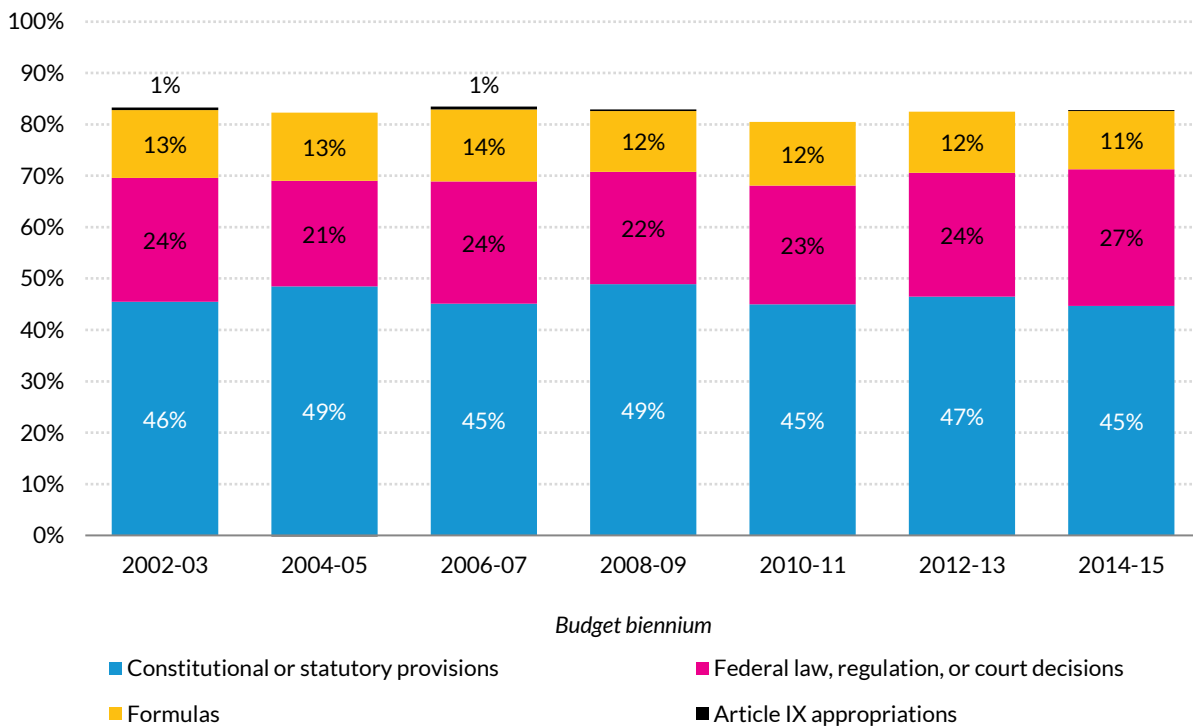
Source: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the Texas Comptroller of Public Accounts and Texas Legislative Budget Board. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 19 and accompanying notes for detail. Values in this figure may not sum to those in table 19 because of rounding.

We include pension contributions in the upper, but not lower, bound of potentially restricted spending in Texas because the legislature is not formally required to contribute to its pension system at an actuarially determined level (table 6).¹⁷⁸ Texas also has a formal cap on pension contributions, and although the state has not yet come up against the cap, informants reported it was of future concern as the state strives to increase its contributions to actuarially determined contribution levels.¹⁷⁹ Alternatively, one could interpret Texas' annual pension contributions as fixed despite its lack of a formal requirement. This would add \$3.9 billion to the state's lower bound of restricted spending in fiscal year 2015.

Texas's upper bound for restricted spending includes all categories shown in figure 17. After Medicaid and CHIP, formula-driven K-12 education constitutes the largest share of state spending, followed by dedicated state spending from the State Highway Fund (SHF). For more information on these restrictions, as well as others we were unable to quantify, please see Texas's state profile, as well as additional data and technical documentation, in the accompanying data appendix (Boddupalli and Randall 2019).

FIGURE 18
Restricted Appropriations in the Texas Fiscal Size-Up 2002-03 to 2014-15 Biennia
As share of total General Revenue and General-Revenue Dedicated Funds



Source: Texas Legislative Budget Board, *Fiscal Size-Up*, 2002-03 to 2016-17 budget biennia, <http://www.lbb.state.tx.us/FSU.aspx>.
Notes: No detail or description available for individual categories of restriction prior to 2016-17, and no appropriations for Article IX reported in the *Fiscal Size-Up* for the 2012-13 biennium. The *Fiscal Size-up* is publicly available from 2002-03 to 2018-19.

BOX 15

Texas's Approach: Restricted Appropriations and the *Fiscal Size-Up* Report

Every two years, the Texas Legislative Budget Board (LBB) prepares a *Fiscal Size-Up* report that assesses “restricted appropriations” from the state’s general revenue (GR) and general revenue-dedicated (GR-D) funds.^a According to the LBB (2014), in the 2014–15 biennium, 83 percent of the state’s \$103 billion in appropriations from GR and GR-D funds were restricted—that is, influenced by state law, federal law or regulation, court decisions, or formulas (LBB 2014, 8-9). This share has remained fairly constant since the 2002–03 biennium (figure 18).

Although the *Fiscal Size-Up* estimates informed our measure of potentially restricted spending, the two differ in important ways. The LBB’s measure organizes restrictions by mechanism, such as state constitutional or statutory provisions, federal law, regulations, court decisions, and formulas. Our measure organizes restrictions by program, institution, or other area of spending. The LBB also groups categories together, such as federal law and court decisions, and does not provide the level of detail we uncovered in our key informant interviews and supplemental state materials.

Finally, the LBB includes only state GR and GR-D funds in its measure of total appropriations (excluding federal funds and other state funds, such as the State Highway Fund). In our analysis, we measure total spending as governmental funds, including federal and transportation fund spending. Despite the differences, the LBB analysis offers a valuable comparison and demonstrates the significant discretion involved in defining potentially restricted state spending.

Notes:

^a GR consists of taxes and fees that can be appropriated for any purpose, while GR-D revenue are statutorily established for a specific purpose and receive a dedicated source of revenue. GR-D revenue includes, for example, revenues collected by the parks and wildlife system to maintain the parks. Some GR-D funds are appropriated at the discretion of the state, and some are constitutional. Together, GR and GR-D represented roughly half of appropriations in the fiscal year 2014–15 biennium (LBB 2014).

How Binding Are Texas’ Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility, and are subject to interpretation, our data and key informant findings suggest a few points:

Texas Medicaid is among the state’s largest and least flexible obligations. At 36 percent of total state spending, Medicaid and CHIP are large and restrictive. Restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state’s fiscal incentive to obtain the federal match, as well as growth in caseloads, price inflation, and an increasing supply of new goods and services such as new drugs and procedures in the health care sector.¹⁸⁰ Medicaid is a much larger source of pressure than CHIP, because children’s health care costs are a small share of total

Medicaid spending.¹⁸¹ Texas has a spare program, so little room is available to cut optional services.¹⁸² Like Florida, Texas has not expanded Medicaid eligibility to childless adults under the Affordable Care Act.¹⁸³

Following a national trend, the state has attempted to control spending growth by implementing service delivery reforms. Today, most of Texas' Medicaid enrollees are in managed-care programs, and this has generated some cost-savings for the state.¹⁸⁴

The state has also pursued provider or pharmacy rate-reductions to contain costs. In all states, Medicaid provider rates often fluctuate with the economy (Smith, Gifford, et al. 2010). In 2010 and 2011, during the Great Recession, Texas reduced its Medicaid provider payments, implemented pharmacy cost control measures, and reduced long-term care services (Smith, Gifford, et al. 2010). The state also cut provider rates (as well as existing optional services) in response to the 2004–05 budget deficit (Hill 2004) and as recently as 2016 received criticism for cutting provider reimbursement rates for pediatric therapy services.¹⁸⁵

Texas's Foundation School Program (FSP) and Available School Fund allotments are the state's next-largest spending obligations. Although their formulas and cost drivers are relatively inflexible, options do exist to curtail spending. The Texas constitution requires the state to provide free K–12 education as well as funding for textbooks.¹⁸⁶ However, the state has flexibility in how it defines adequacy and formula requirements. The level of K–12 educational spending is largely decided by formulas in the FSP and Available School Fund textbook and technology allotments.¹⁸⁷ Spending on these required programs was \$19.2 billion (18 percent of total spending) in 2015.

The current school finance system was adopted in response to a series of court cases between the mid-1980s and early 1990s (Imazeki and Reschovsky 2004; Mudrazija et al. 2019). Courts, on several occasions during this period, ruled the state's school finance system unconstitutional, leading to repeated state attempts to retool the system. The last major overhaul occurred in 1993 and, despite numerous court challenges since then (the most recent concluding in 2016),¹⁸⁸ the system has remained largely unchanged (Imazeki and Reschovsky 2004; Mudrazija et al. 2019).¹⁸⁹ Although, in 2019, the state adopted school finance reform legislation that is expected to increase the state's share of public education funding from 38 to 45 percent.¹⁹⁰ The legislation also included a school property tax cut, leaving the state responsible for making up any resultant loss of property tax revenue to school districts.¹⁹¹

Informants reported that although the state can modify the FSP formula requirements, it has historically been reluctant to do so. Portions of the formula have remained unchanged since they were

adopted in the 1980s.¹⁹² Despite these apparent inflexibilities, the legislature has identified mechanisms to cut funding when revenues were tight. In 2011, during the Great Recession, the legislature cut formula funding for K-12 education by \$4 billion for the 2012-13 biennial budget (Villanueva 2013). Among its approaches to implementing these cuts, the state created a “regular program adjustment factor” that allowed it to fund only a portion of its formula obligation to districts (Villanueva 2013).

Texas’s nominal reductions in K-12 formula funding are even more pronounced when considering inflation and growth in school enrollment (Marder and Villanueva 2017). Before to the Great Recession (between 2006 and 2010, when funds from the American Recovery and Reinvestment Act of 2009 ran out) K-12 education spending in Texas grew sufficiently to keep up with enrollment and inflation (Marder and Villanueva 2017). This changed with the Great Recession. Texas did not restore funding to its prerecession levels, in inflation-adjusted terms, until 2016, and considering enrollment growth, the state had still not caught up to its per pupil prerecession levels of funding (Marder and Villanueva 2017).

In 2019, the Texas Comptroller of Public Accounts reported that the state’s formula requirements provided insufficient funding to meet rising costs and growing demographic pressure (CPA 2019). The formula, as the CPA reported, did not include even basic adjustments for inflation (CPA 2019). So, although in theory Texas’s formula funding system is predetermined, with its undergirding formulas and inputs subject to little change over time, the state can alter its funding obligation at will and indirectly curtail costs by failing to account for inflation and other cost drivers in its formulas and inputs.

Transportation funding has become more restricted over time, as the state has dedicated additional general fund revenues to the SHF. In recent years, Texas has dedicated larger portions of its discretionary revenue sources toward transportation. In November 2014, for example, the state amended its constitution to dedicate a portion of severance tax collections to the SHF,¹⁹³ and in 2015, dedicated additional sales tax revenue that formerly went to the general fund.¹⁹⁴

Informants observed that when revenues contract, these dedications place pressure on discretionary spending. During the 2017 legislative session, one informant reported that “the state is in a bad place right now because of dedications for transportation.”¹⁹⁵ That year, amidst tighter revenues than anticipated, the state delayed \$2 billion in promised payments to the SHF to free up funds for other uses.¹⁹⁶ Projected revenue growth relieved much of this pressure in the 2019 session.¹⁹⁷

However, informants expect that restrictions on discretionary revenue sources will continue to place pressure on the spending side of the budget in future sessions.¹⁹⁸ According to one informant, these dedications mean that, from time to time, “other parts of the budget have less and can’t plan.”¹⁹⁹

These changes were only implemented at the end of our study period, and our analysis does not show a significant portion of spending growth going toward transportation (figure 19). However, this may change as the state implements its new constitutional revenue dedication over time.

The advantage to these dedicated revenue sources is that the transportation department can plan. The downside is that other parts of budget have less and can't plan.

—John O'Brien, University of Texas at Austin

Debt service payments are treated as fixed. State pension fund contributions are subject to some requirements, but in practice they are relatively flexible. Constitutionally, state contributions to the Employees Retirement System and Teacher Retirement System of Texas must be from 6 to 10 percent of the aggregate compensation paid to participants in the systems, except when subject to governor-declared emergencies.²⁰⁰ Although the state must meet this requirement, the funding standard is not actuarially determined and therefore provides the state with a less stringent funding benchmark than states with a formal actuarial standard (e.g., California and New York).

The state's recent contributions have been deemed inadequate to fund the cost of future benefits and eliminate the unfunded liabilities over a finite period (CPA 2018).²⁰¹ Moreover, in recent years, the actuarially recommended state pension contributions have exceeded the state's constitutional limit, potentially limiting its ability adequately pay down its unfunded pension liability. The state comptroller has indicated that the constitution would have to be amended (or a fiscal emergency declared by the governor) to contribute at an actuarially determined amount (CPA 2017). The comptroller has further proposed retiring long-term obligations using a portion of the state's growing Economic Stabilization Fund (CPA 2018).

Informants shared that when revenues are tight, all services aside from Medicaid and K-12 education are vulnerable to cuts. Both Medicaid and K-12 education grow with demographic and enrollment trends and are also difficult to modify, which leaves the state with little spare room to reduce spending when revenues are tight and the state must balance its budget.²⁰² Spending on corrections, especially health care costs for incarcerated people in state correctional facilities, also places pressure on the budget, because inmate populations are relatively fixed in the short term and Texas has a high incarceration rate (Mitchell and Leachman 2014).

Informants also reported that the state limits its fiscal flexibility indirectly through tax cuts (box 16). The state also has numerous General Revenue-Dedicated (GR-D) accounts, which vary in their level of restriction. These funds, in theory, are more restricted than standard General Revenue (GR) funds because they are statutorily or constitutionally established for a specific purpose and receive a dedicated source of revenue (LBB 2014). This includes, for example, revenues collected by the parks and wildlife system. However, recently the state has made efforts to reduce the number GR-D funds. Cash balances in the GR-D accounts are included in the GR fund balance when determining and certifying the amount available for appropriation, calling into question whether these funds are treated as restricted in the budget process.²⁰³

Texas loves to provide tax cuts. Every time that's done, it limits flexibility in the budget. It's very difficult to reverse tax cuts.

—John O'Brien, University of Texas at Austin

Higher education, as in most states, is reportedly especially vulnerable to cuts because it does not have any dedicated source of funding (save user charges, such as tuition).²⁰⁴ Although Texas higher education is funded through formulas, similar to K-12 education, the formulas are easier to change in the appropriations bill if revenue is short.

BOX 16

Texas' Revenue-Related Restrictions

Although much of our analysis focuses on restrictions that apply to the spending side of the budget, state tax policy also affects fiscal flexibility by determining the revenues available for appropriation.

Along with Florida, Texas is one of two study states (and seven states nationally) without an individual income tax.^a In addition to this large revenue constraint, the state provides many tax incentives and individual property tax exemptions to firms as part of its economic development policy. For example, the 2001 Texas Economic Development Act established a tax abatement program that limits firms' local property tax liability in exchange for locating in Texas. Loss of local revenue from this program places additional funding pressure on the state school finance system, which makes school districts whole for any abatements they grant (LBB 2011). In another example, in the 2015 legislative

session, lawmakers increased the homestead exemption in school finance formulas at a cost of roughly \$1.4 billion over the 2016–17 biennium and reduced business tax rates at the cost of roughly \$2 billion.^b

In 2015, state tax exemptions totaled \$44.4 billion and school property tax exemptions \$9.8 billion (CPA 2015). With total fiscal year 2015 governmental fund expenditures of \$104 billion, tax exemptions thus constitute half the value of the state’s total expenditures.

A 2015 study on the fiscal capacity and needs of states found that Texas’ per capita revenue collections fell short of its actual revenue capacity by \$680 per capita, suggesting the state is collecting less revenue than it could if it adopted policies and rates closer to the national average across states.^c

Sources:

^aThe others being Alaska, Nevada, South Dakota, Washington, and Wyoming. See “Individual Income Taxes,” Urban Institute, accessed May 22, 2019, <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/individual-income-taxes>.

^bSee LBB (2016c); and Morgan Scarborough, “Texas Legislature Passes \$2.56 Billion Tax Cut Package,” Tax Foundation, June 1, 2015, <https://taxfoundation.org/texas-legislature-passes-256-billion-tax-cut-package/>.

^cUsing a representative revenues and expenditures approach. See Gordon, Auxier, and Iselin (2016).

How Has Restricted Spending Changed in Texas over Time?

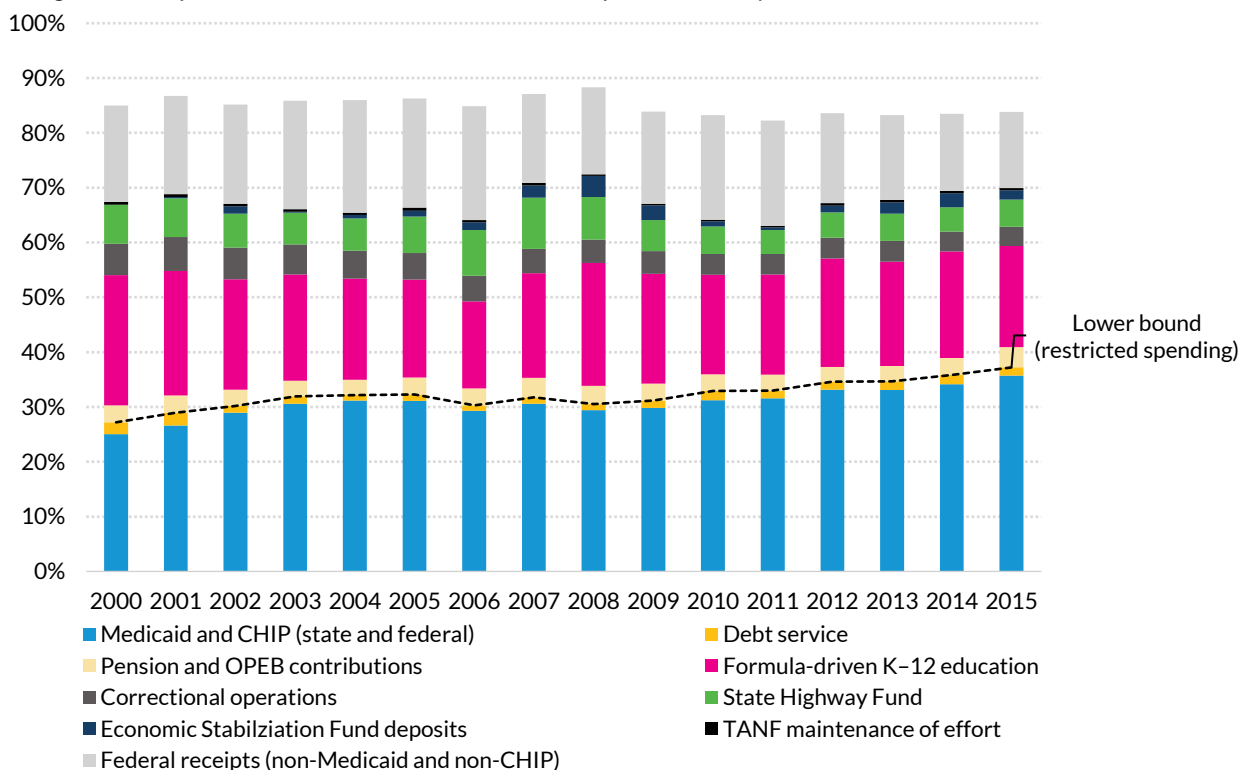
At the upper bound of our estimates, Texas’s potentially restricted spending has remained relatively stable as a share of total spending since 2000 (figure 19). At the lower bound, however, restricted spending has steadily increased over time (from 27 to 37 percent) thanks to growing Medicaid obligations. Total Medicaid and CHIP (state and federal spending) grew from 25 to 36 percent of total governmental fund spending during this period (figure 19). This increase has been financed by both the state and federal government: nonfederally financed Medicaid and CHIP spending grew from 10 to 14 percent of total spending, while the federally financed component grew from 15 to 21 percent. Debt service remained steady at between 1 and 2 percent of spending.

Formula funding for K–12 education declined notably from 24 to 18 percent of total governmental fund spending. Other categories of state restricted spending have remained mostly stable, with correctional operations, SHF, and TANF maintenance of effort spending declining as a share of total spending. Deposits to the Economic Stabilization Fund and pension and OPEB obligations increased slightly as a share of total spending over the period. Although formula K–12 education, corrections, SHF, and TANF maintenance of effort spending all increased in absolute terms, they did not grow as a share of all state spending.

FIGURE 19

Texas's Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the Texas Comptroller of Public Accounts and Texas Legislative Budget Board. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total spending includes spending from governmental funds, as reported in the state Comprehensive Annual Financial Report. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. The black line reflects the estimated lower bound of restricted spending. See table 19 and accompanying notes for detail. Values in this figure may not sum to those in table 19 because of rounding.

How Much of Texas' Spending Growth Has Gone toward Restricted Items?

According to our analysis, at the lower bound considering only Medicaid, the Children's Health Insurance Program (CHIP), and debt service, 52 percent of all real (inflation-adjusted) spending growth since 2000 has gone to restricted categories.²⁰⁵ At the upper bound, considering all spending obligations (and offsetting for those restricted funds that have decreased over time and constitute a negative share of growth), Texas' restricted spending consumed 82 percent of state spending growth between 2000 and 2015 (figure 20).

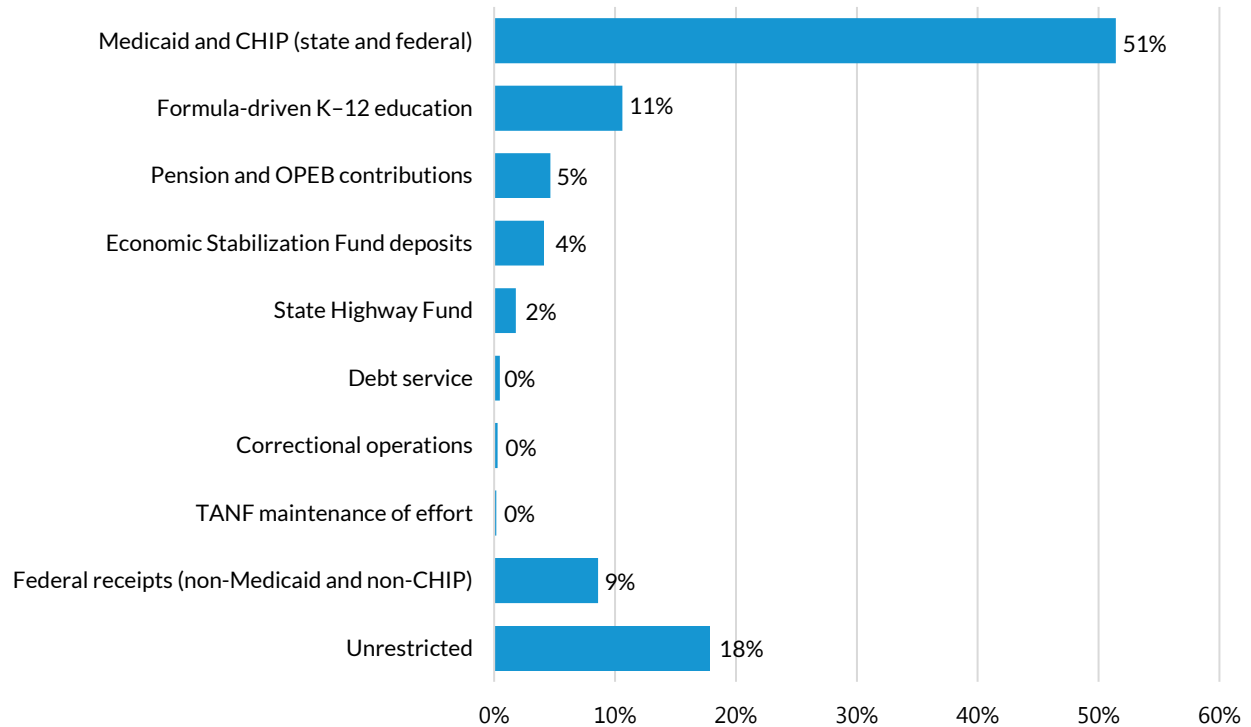
Fifty-one percent of that growth went to Medicaid and CHIP (21 percent in non-federally financed and 30 percent in federally financed spending; figure 20). Formula-driven spending on K-12 education was the next largest at 11 percent of growth, followed by the pension and OPEB contributions at 5 percent, Economic Stabilization Fund deposits at 4 percent, and the SHF at 2 percent. Debt service, correctional operations, and TANF maintenance of effort spending all constituted less than 1 percent of total spending growth.

Medicaid and CHIP have thus consumed much of Texas' spending growth since 2000. As for formula-driven K-12 and other dedicated spending, restrictions over this period generally have maintained spending levels but not allowed them to share significantly in spending growth. Of course, this means that over time, many areas, especially formula K-12 education, have received a reduced share of overall spending and of overall state resources.

FIGURE 20

Texas's Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Source: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the Texas Comptroller of Public Accounts and Texas Legislative Budget Board. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total real spending growth includes inflation-adjusted spending growth from governmental funds, as reported in the state Comprehensive Annual Financial Report, between FY 2000 and 2015. Unrestricted includes the remainder

of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 19 and accompanying notes for detail. Values in this figure may not sum to those in table 19 because of rounding.

Virginia

Virginia has a reputation for sound fiscal management, especially for its revenue forecasting and budget reserve practices.²⁰⁶ State revenue collections have grown in recent years. In 2018 and 2019, the state debated how to invest unexpected midyear revenue surpluses that were largely gained from changes in federal tax law.²⁰⁷ Like most states, however, Virginia must respond to unexpected shortfalls and expenses. In late 2018, for example, state lawmakers debated how they would respond to a projected \$500 million in unplanned expenses that resulted from higher-than-forecasted costs in the state's Medicaid program.²⁰⁸ The funding gap spurred calls for increased oversight of Medicaid forecasting practices (box 17).²⁰⁹

BOX 17

Forecasting Program Caseloads and Spending in Virginia

Virginia has periodically instructed its legislative research agency (the Joint Legislative Audit and Review Commission, or JLARC) to oversee state agency forecasting practices (e.g., JLARC 1985, 1996). In 1999, for example, the state directed JLARC to oversee expenditure forecasting for four of the state's critical, caseload-driven programs: adult corrections, higher education, K-12 public education, and Medicaid (JLARC 2000).

With the exception of higher education, JLARC described these as “entitlement programs...required by law to serve or provide funding for services for their target populations, regardless of the size of the population” (JLARC 2000). The state has thus periodically recognized the importance of forecasting spending for programs that, absent changes to current law, will grow or shrink with demographic changes, inflation, and other factors outside a state's control. Toward this end, in 2002, the state adopted legislation requiring the governor to produce a forward-looking, six-year financial plan every two years.^a The plan forecasts and outlines spending drivers for major state programs, including corrections, K-12 education, and Medicaid, among others (e.g., DPB 2016).

Each agency still forecasts its own spending to inform its request for appropriations each budget cycle, and the governor may take these estimates into account when producing the six-year financial plan. The Virginia Department of Medical Assistance Services (DMAS) forecasts enrollment and cost growth for Medicaid,^b the Secretary of Public Safety and Homeland Security forecasts the number of people in correctional facilities and other corrections programs (e.g., Virginia Office of the Secretary of Public Safety and Homeland Security 2017), and the Board of Education forecasts enrollment changes in its comprehensive plan (e.g., Virginia Board of Education). In 2019, DMAS enlisted an independent auditor to overhaul its enrollment, cost, rate, and spending forecasts.^c

Sources:

^a See Va. Code § 2.2-1503.1, <https://law.lis.virginia.gov/vacode/title2.2/chapter15/section2.2-1503.1/>

^b For an overview of its previous forecasting methods, see JLARC (1996).

^c See “Top-to-Bottom Review of Virginia Medicaid Agency to Be Conducted Over 60 Days,” DMAS, February 6, 2019, [http://www.dmas.virginia.gov/files/links/2625/Virginia%20Medicaid%20Agency%20Financial%20Review%20Announcement%20\(02.06.2019\).pdf](http://www.dmas.virginia.gov/files/links/2625/Virginia%20Medicaid%20Agency%20Financial%20Review%20Announcement%20(02.06.2019).pdf).

Virginia is one of 20 states (including Texas) that budget every two years (NASBO 2015) and is the only state with a single-term governor.²¹⁰ Governors’ limited time in office shifts the balance of power toward the Virginia General Assembly (GA),²¹¹ which has wider latitude to set fiscal priorities than legislatures in the states with strong governors (e.g., Illinois and New York).

Virginia key informants reported that there is no formal concept of mandatory or “autopilot” spending in the state. However, demographic, enrollment, and cost trends place pressure on spending in Medicaid and K–12 education programs, requiring significant resources and reducing the state’s fiscal flexibility.

In addition to Medicaid and K–12 spending obligations, the state is contractually required to make annual debt service payments. And although the state deferred required contributions to its pension system during the Great Recession, in 2012 it adopted a requirement for the GA to gradually move its pension contribution rate toward the actuarially required amount.²¹² This formalized the state’s annual contribution requirement while reducing long-term plan liability.²¹³

Although a large share of Virginia’s spending may be characterized as potentially restricted, the legislature can exercise flexibility with few exceptions. Virginia informants identified long-term obligations, major programs such as Medicaid and K–12 education, rainy-day fund deposits, local aid, and various federal receipts and court orders as potential fiscal restrictions (table 20).

“Despite the fact that core Medicaid spending is essentially on autopilot and continues to grow rapidly as a share of the budget, there is still a lot of flexibility for the governor and General Assembly to make policy changes in spending.”

—Jim Regimbal, Fiscal Analytics, Ltd.

TABLE 20

Virginia's Fiscal Restrictions

Category	Description
Long-term obligations	<ul style="list-style-type: none"> State contributions to contributions to public employee pension and other postemployment benefit trust funds (Virginia Retirement System and other retirement and post-employment benefit funds) Debt service payments
Programmatic	
Major Programs	<ul style="list-style-type: none"> Medicaid and Children's Health Insurance Program spending (Family Access to Medical Insurance Security) Formula-driven K-12 state expenditures as outlined by Standards of Quality constitutional requirements Spending from dedicated transportation funds (Commonwealth Transportation Fund) Correctional spending on inmate populations, including medical care and other services
Other Programs	<ul style="list-style-type: none"> Spending from other earmarked or special funds, such as the Water Quality Improvement Fund State maintenance of effort for Temporary Assistance for Needy Families Administration of the Supplemental Nutrition Assistance Program, Supplemental Security Income, and other federally financed programs
Institutional	Revenue Stabilization Fund deposits
Local aid	<ul style="list-style-type: none"> Personal Property Tax Relief Act of 1998 refunds (i.e., car tax relief program reimbursement), payable to localities assessing personal property taxes Statewide pool expenditures as required by the 1992 Children's Services Act
Federal	Transfers from the federal government for specified purposes
Judicial^a	
Consent decrees and settlements	<i>United States v. Commonwealth of Virginia</i> (2011). <i>Olstead</i> -related case requiring additional resources to comply with community-based living requirements.
Other revenue-related and indirect	<ul style="list-style-type: none"> Political and budget process factors, such as a one-term limit for governorship or the 1984 balanced-budget requirement limiting expenses to at-hand funds or revenues anticipated within two years and six months

Sources: Authors' analysis based on literature review, financial reports, key informant interviews, and communications with the Virginia Joint Legislative Audit and Review Commission and the Virginia Department of Planning and Budget. See Boddupalli and Randall (2019) for citations and state detail.

Notes: Excludes spending or institutional features not identified as restricted or mandatory in sources above.

^a Court cases and consent decrees are illustrative and do not provide an exhaustive inventory. We have identified cases with the most significant implications for state budgeting, but informants often suggested that judicial restrictions were numerous and not regularly quantified or inventoried.

How Much of Virginia's Spending Is Restricted?

Drawing on provisions identified by state informants, original state materials, and available data, we estimate 27 to 80 percent of Virginia's total spending was potentially restricted in 2015 (table 21).²¹⁴

TABLE 21

Restricted Spending in Virginia: Upper and Lower Bounds

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions

		Total spending fiscal year 2015 ^a	(billions \$)	35
		Lower bound	(L %)	27
		Upper bound	(U %)	80
Restricted spending	Medicaid and CHIP (state and federal) ^b			L
	Debt service			L
	Pension contributions ^c			U
	Standards of Quality (SOQ) for K-12 education ^d			U
	Correctional operations			U
	Commonwealth Transportation Fund			U
	TANF maintenance of effort			U
	Federal receipts (non-Medicaid and non-CHIP) ^e			U
	Revenue Stabilization Fund deposits			U
	Other state-specific programs:			U
	Personal Property Tax Relief Act ^f			
	Children's Services Act ^g			
	DOJ behavioral health settlement ^h			

Notes: CHIP = the Children's Health Insurance Program; DOJ = US Department of Justice FAMIS = Family Access to Medical Insurance Security.

^a Total annual spending includes total governmental fund spending as reported in the state's annual Comprehensive Annual Financial Report.

^b Includes both state-financed (\$4.1 billion) and federally financed (\$4.5 billion) components of Medicaid, FAMIS, and FAMIS Plus (i.e., CHIP) programs. The state share may also include local contributions toward the state's nonfederal match requirement.

^c Includes the Virginia Retirement System, State Police Officers' Retirement System, Judicial Retirement System, and others. Data on state other postemployment benefit contributions are unavailable before 2008, so they are excluded from this analysis.

^d State SOQ contributions to formula-driven K-12 education. Excludes local and federal contributions.

^e Federal receipts refer to intergovernmental transfers from the federal to state government, excluding for Medicaid and CHIP which are reflected under the Medicaid and CHIP category. These additional transfers include federal funding for restricted categories displayed above (e.g., transportation and K-12 education) as well as dedications to programs not included here.

^f Enacted in 1998.

^g Enacted in 1992.

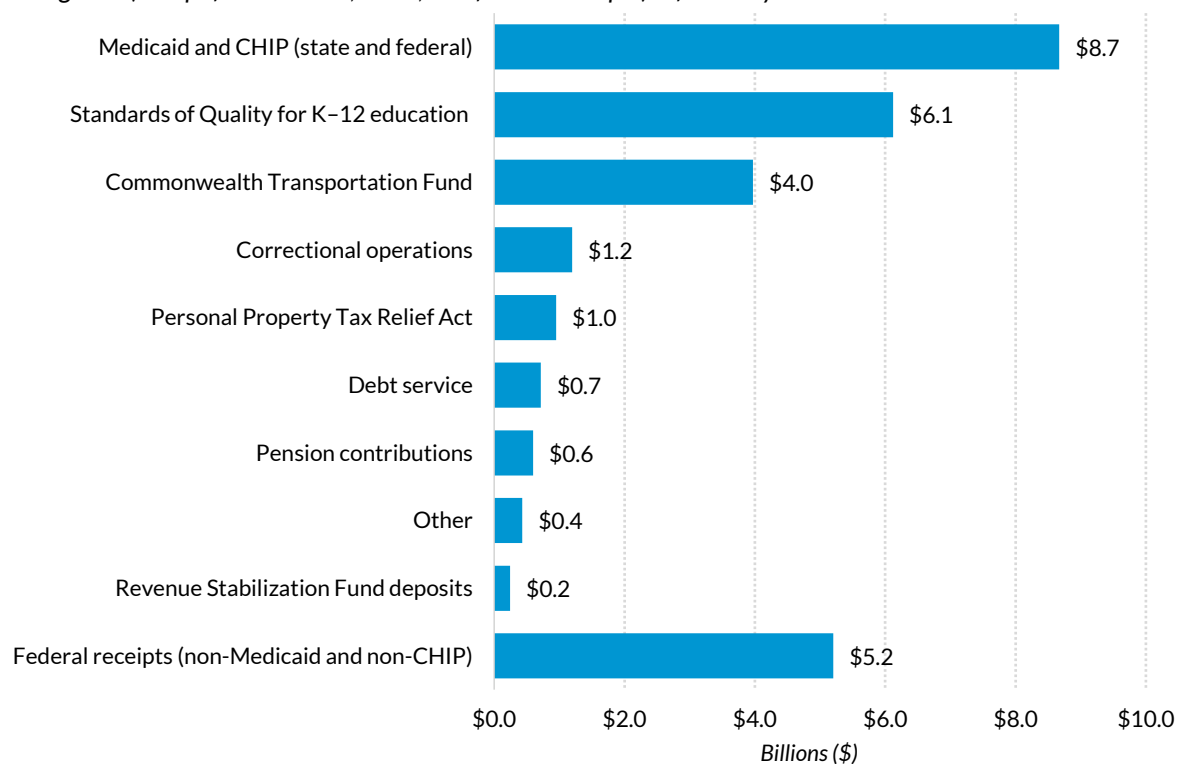
^h See "United States v. Commonwealth of Virginia," DOJ, August 8, 2016, <https://www.justice.gov/crt/united-states-v-commonwealth-virginia>.

At its lower bound, this includes Medicaid, the Children's Health Insurance Program (CHIP), and debt service. In theory, states can opt out of Medicaid, but in practice this would impose significant fiscal, administrative, and political costs. In fiscal year 2015, Virginia spent \$8.7 billion on Medicaid and CHIP (figure 21), which included \$4.1 and \$4.5 billion in state and federal spending, respectively. Although the state receives significant federal funding for the Medicaid program, Virginia did not opt into the largely federally funded Affordable Care Act Medicaid expansion until 2019.²¹⁵ Debt service (\$0.7 billion in fiscal year 15) was also identified as generally fixed because of contractual obligations and the necessity of maintaining access to credit markets.

FIGURE 21

Virginia’s Restricted Spending, FY 2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with Joint Legislative Audit and Review Commission and Department of Planning and Budget. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Includes only potentially restricted, quantifiable spending for which data were available. “Other” includes the state TANF maintenance of effort, spending to comply with the 1992 Children’s Services Act, and spending to comply with the US Department of Justice behavioral health settlement, which each comprise less than 1 percent of state spending in FY 2015. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 21 and accompanying notes for detail. Values in this figure may not sum to those in table 21 because of rounding.

We include pension contributions in the upper, but not lower, bound of potentially restricted spending in Virginia because the GA has only been required to contribute a share of its actuarially required amount in recent years (table 6).²¹⁶ Alternatively, one could interpret Virginia’s annual pension contributions as fixed despite annual underfunding as a share of its actuarially determined contribution. This would add \$0.6 billion to the state’s lower bound of restricted spending in fiscal year 2015.

Virginia’s uppermost restricted spending bound includes all categories illustrated in figure 21. After Medicaid and CHIP, state spending on Standards of Quality (SOQ) for K-12 education constitutes the largest share of state spending, followed by dedicated state spending from the Commonwealth Transportation Fund (CTF). The state’s upper bound also includes state spending to comply with the

1992 Children’s Services Act (CSA), which is specific to Virginia (classified as “other” in figure 21, see box 18 for more detail). Some state restrictions detailed in table 20 are not readily quantifiable and are therefore excluded from the quantitative portion of our analysis in figure 21. For more information on these restrictions, as well as others we were unable to quantify, please see Virginia’s state profile, as well as additional data and technical documentation, in the accompanying data appendix (Boddupalli and Randall 2019).

How Binding Are Virginia’s Restrictions?

Accepting that most state fiscal restrictions exist along a continuum of flexibility, and are subject to interpretation, our data and key informant findings suggest a few points:

Virginia Medicaid is among the state’s largest and least flexible obligations. At 25 percent of total spending, Medicaid and CHIP (FAMIS and FAMIS Plus) are large and restrictive. In 2017, Republican state delegate Jimmie Massie referred to Medicaid as “the Pac-Man” of the budget.²¹⁷ Restrictions largely come in the form of federal minimum service and eligibility requirements paired with the state’s fiscal incentive to obtain the federal match; restrictions also manifest through growth in caseloads, price inflation, and an increasing supply of new goods and services, such as new drugs and procedures in the health care sector.²¹⁸ Medicaid is a much larger source of pressure than FAMIS and FAMIS Plus because children’s health care costs are a small share of total Medicaid spending.²¹⁹ Virginia has a spare program, leaving little room to cut optional services.²²⁰

Following a national trend, the state has attempted to control spending growth by implementing service delivery reforms. Today, most of Virginia’s Medicaid enrollees are in managed-care programs, which have generated some long-term cost-savings partly because of their better health outcomes and administrative oversight.²²¹ Enrollees who are elderly or have disabilities are typically the costliest eligible population to serve, and the state’s recent decision to transition those enrollees to managed care was expected to produce some long-term savings. However, the recent forecasting errors for Medicaid long-term services spending show that anticipated cost savings may not always materialize as planned.²²²

Virginia’s SOQs establish required state K–12 education funding levels, but standards are ultimately determined by the legislature, which has the flexibility to adjust formulas and inputs. Virginia’s constitution requires the state to contribute sufficient funding to ensure a quality public education after accounting for local contributions and property tax capacity.²²³ The state Board of Education is constitutionally responsible for formulating these SOQs, but the GA ultimately approves or

revises the standards, determines the cost of meeting the SOQs, and apportions the estimated cost between the state and local governments.²²⁴

Virginia informants gave conflicting reports regarding the flexibility of the state's SOQ requirements. On the one hand, informants reported that the legislature has been reluctant to significantly alter the current funding scheme, which has been in place since 1988.²²⁵ At 17 percent of total spending in fiscal year 2015 (figure 22), it constitutes an important share of state spending. In 2015, the Joint Legislative Audit and Review Commission (JLARC) characterized SOQ payments as occurring "automatically," per constitutional mandate (JLARC 2015a), and informants reported that the state largely treats K-12 education as a fixed cost.²²⁶ Moreover, legally, it has been generally accepted that the GA cannot determine SOQ funding arbitrarily and that the SOQs must reasonably relate to the cost of providing a quality education in Virginia (JLARC 2002).

But other sources point out that the legislature has at times materially altered the SOQ definition and formula inputs to reduce the state's funding obligation.²²⁷ During the Great Recession, for example, the state capped support staff positions and eliminated support for select district expenditures; it also adopted other indirect cost-containment measures, such as only partially accounting for inflation increases (Duncombe and Cassidy 2016; Senate of Virginia Senate Finance Committee 2012, 15).²²⁸ Although the GA makes the final decision about the SOQs, informants reported that standards can be established by working backward from the amount of state funding available.²²⁹

Transportation funding is dedicated, but available in a crisis, and efforts to further restrict revenues have stalled. Virginia has historically dedicated a share of its revenue to the CTF, including revenue collected through motor fuel and gasoline taxes, motor vehicle license fees, motor vehicle sales and use taxes, and certain proceeds from the state retail sales and use tax (VDOT 2014). Dedicated revenues flow primarily into the CTF's two largest subfunds, the Highway Maintenance and Operating Fund and the Transportation Trust Fund (TTF).²³⁰

In recent years, the legislature has earmarked additional general revenue for the CTF, which informants said has reduced general revenue that the state can tap during a crisis and therefore hampered flexibility. In 2013, for example, the state raised its general sale and use tax and dedicated those revenues to transportation.²³¹ Before this, in 2007, the state had already dedicated two-thirds of any undesignated general fund balance to the TTF.²³²

Past governors have reportedly "raided" the TTF as a budget fix in 1991, 2002, 2003, and 2007.²³³ However, the scale of these one-time diversions—a proposed \$180 million for the fiscal year 2009 budget, for example (Conant 2010)—has been small compared with the dedication of general revenue to

transportation purposes over the years.²³⁴ In 2007, not only did the state dedicate two-thirds of its undesignated fund balance to transportation, it also dedicated one-third of its license tax on insurance companies and a portion of the recordation tax.²³⁵ Moreover, the proposed \$180 million fiscal year 2009 diversion was eventually restored.²³⁶

Some legislators and transportation advocates continue to encourage tighter restrictions on transportation revenue, however, and introduced a “Transportation Revenue Lockbox” amendment to the state constitution.²³⁷ The amendment would have significantly curtailed legislators’ ability to access dedicated transportation funds for other uses.²³⁸ Though the amendment was approved by the 2017 GA,²³⁹ an amended version was eventually rejected by the state senate in the 2018 and was therefore not on the November 2018 ballot as expected.²⁴⁰ Though these recent efforts to further restrict dedicated transportation revenues have stalled, future efforts to carve out transportation funds could further reduce state fiscal flexibility. And transportation advocates have criticized Virginia’s system of transportation as inadequate to meet future maintenance and construction needs (Chase 2011).

Debt service payments are treated as a given; state pension fund contributions are more flexible. As in all study states, Virginia informants reported that debt service payments are treated as fixed.²⁴¹ Others have reported that the state is financing more of its capital expenditures through debt, so debt service has grown and placed additional pressure on the budget over the past decade (JLARC 2015a).²⁴²

Pension obligations, however, are more complex and more flexible. Virginia’s public employee retirement system consists of approximately four separate pension systems, the largest of which is the Virginia Retirement System (VRS).²⁴³ Unlike some states (e.g., California), Virginia has not always been formally required to contribute to its pension system at an actuarially determined level. Key informants reported that although pension costs are fixed in the long term, they become flexible in the short term because the state can delay contributions, as it did during the Great Recession. Between 2006 and 2012, the state’s contribution to the VRS fell from 101 percent to 38 percent of its actuarially required or determined contribution.²⁴⁴

“I would term [pensions] mandatory—at some point. The benefits that you’ve promised are mandatory. At some point you have to fulfill benefits, but you have time to make up for underfunding because it is a long-term obligation.”

—Jim Regimbal, Fiscal Analytics, Ltd.

However, informants reported that in recent years, pension contributions have been treated as a fixed obligation in Virginia. In 2012, the state adopted a requirement for the GA to gradually move its pension contribution rate toward the actuarially required amount, formalizing the state's annual contribution requirement.²⁴⁵ This malleable commitment is reflected in the mixed-to-critical feedback Virginia has received from outside groups on its pension commitments. In 2014, the Urban Institute gave Virginia a D for "making required contributions" and "funding ratio,"²⁴⁶ while Pew ranked the state 20th among all states for its funding ratio in 2016.²⁴⁷

The car tax relief program, also known as the Personal Property Tax Relief Act (PPTRA) of 1998, is politically popular and treated as binding. In 1998, Virginia passed the PPTRA, which requires the state to assume financial responsibility for a portion of state-mandated reductions in local property tax rates (DOA 2015). State statute thus obligates Virginia to annually disburse funding to local governments, which then determine the amount of vehicle tax relief they can provide to taxpayers (hence the measure's informal designation as the car tax relief program).²⁴⁸ In 2004, after unanticipated growth in program costs, the state capped the total amount of reimbursements to localities at \$950 million annually for all tax years 2006 and thereafter.²⁴⁹ Informants noted that this requirement is treated as binding by the state and that changing it would be politically unpopular because it would involve an effective tax increase. As one informant noted, "Once you put tax cuts in place, it is difficult to go back."²⁵⁰

Informants also reported that the state limits its fiscal flexibility through tax cuts, which reduce the revenue available for other purposes. Tax expenditures, such as income tax deductions for elderly taxpayers, reduction of sales tax on food items, and repeal of the estate tax have restricted flexibility by reducing available revenue (Cassidy and Okos 2009),²⁵¹ and the amount of revenue that Virginia places into special funds rather than general funds has increased over time.²⁵² But fund restrictions vary in their stringency and, as evidenced by the debate over use of transportation funds, the state can pull funds from dedicated revenue sources when necessary.

Other fiscal obligations include constitutionally required contributions to the state Revenue Stabilization Fund (RSF), miscellaneous dedications such as to the Water Quality Improvement Fund (which receives 10 percent of any budget or revenue surplus (Fiscal Analytics, Ltd. 2017b), court-imposed obligations such as a settlement the state has with the US Department of Justice that requires additional investments in community-based mental health services and spending toward the CSA (box 18). Informants reported that the RSF is a source of fiscal obligation due to the constitutional requirements governing contributions and withdrawals. They further noted that the formula for mandatory deposits can create a "ratcheting down" effect, since it is based on prior-years' revenue

collections, leading to the state's depositing funds to the RSF even if it cuts spending on other less restrictive fiscal obligations.

BOX 18

The Virginia Children's Services Act

In 1993, Virginia implemented the Comprehensive Services Act for At-Risk Youth and Families, now referred to as the Children's Services Act (CSA).^a The act sought to establish a system that would facilitate coordination across state and local child-serving agencies in Virginia seeking to meet the needs of at-risk youth and families (OCS 2019). Administered by the state's Office of Children's Services, the program provides technical assistance to local agencies and finances services for at-risk youth and their families. Local governing bodies are responsible for appointing Community Policy and Management Teams and Family Assessment and Planning Teams that manage the provision of services tailored to local needs; examples of eligible local spending include expansion of special education and foster care systems.

To finance this program, the General Assembly is statutorily obligated to annually appropriate funds to a statewide pool, from which funds are allocated based on target population needs and service costs (such as residential versus community treatments). The statewide pool also receives obligated matching funds from local governments based on locality-specific match rates that averaged 32 percent in 2015.^b Funds cannot be used for services that are already funded through Medicaid. In inflation-adjusted terms, state-financed CSA pool expenditures have grown from \$201 million in 2003 to \$236 million in 2015.^c Informants noted that CSA funding is considered mandatory by the state, despite some flexibility in adjusting the timing of payments to local administrators.

Sources:

^a Enacted in 1992, the legislation went into effect in 1993. See Va. Code § 2.2-5200-5214, <https://law.lis.virginia.gov/vacode/title2.2/chapter52/>.

^b Authors' calculation with "CSA Reports - FY15 Match Rate - Expenditure Report - By FIPS Status of 1-9," Virginia Office of Children's Services (OCS), May 6, 2019, http://www.ocs.csa.virginia.gov/publicstats/pool/poolreports/match_expenditure_report.cfm?fy=2015.

^c Authors' calculations with "CSA Pool Expenditure Reports," OCS, 2003-2015, http://www.ocs.csa.virginia.gov/publicstats/csa_pool.cfm.

Higher education is reportedly especially vulnerable to cuts,²⁵³ and tuition has been growing as a source of finance for higher education in response to declining state funding (JLARC 2014). Outside of the car tax relief program transfers, aid to local governments is also flexible, and the state has the option to push responsibility for services down to local governments. In fact, between 2009 and 2013, each year local governments remitted a portion of their state funding *back* to the state in a policy commonly referred to as "reversion."²⁵⁴ Although correctional spending is largely caseload driven and inmate

medical costs continue to rise (JLARC 2018), prison population growth has slowed in Virginia in recent decades, relieving some pressure on the state budget (Farrar-Owens 2015).

How Has Restricted Spending Changed in Virginia over Time?

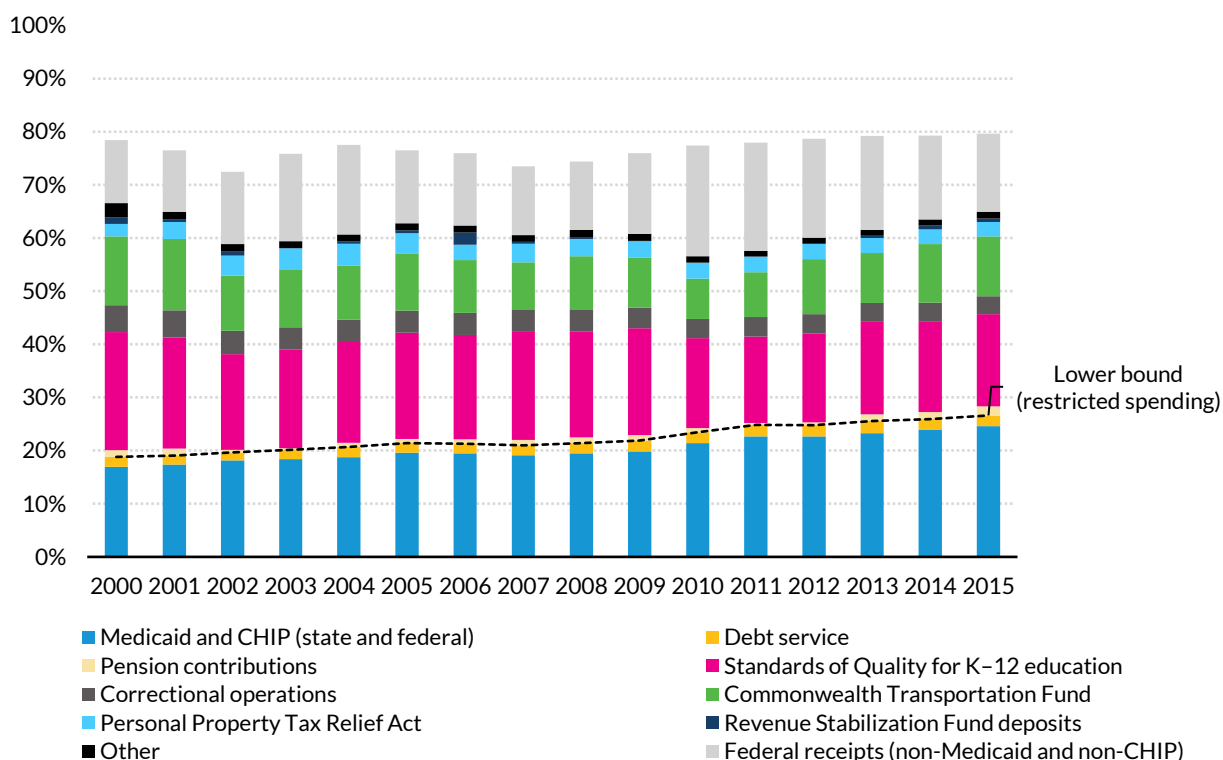
At the upper bound of our estimates, Virginia's restricted spending (as defined in sections above) has remained relatively stable as a share of total spending since 2000 (figure 22). At its lower bound, however, restricted spending has steadily increased over time (from 19 to 27 percent) thanks to growing Medicaid obligations. Total Medicaid and CHIP (state and federal spending) grew from 17 to 25 percent of total governmental fund spending during this period (figure 22). This increase has been financed by both the state and federal government: state-financed spending grew from 8 to 12 percent of total governmental fund spending, while federally financed spending grew from 9 to 13 percent. Debt service remained steady at 2 percent of spending.

SOQ spending toward K-12 education declined notably from 22 to 17 percent of total state governmental fund spending between 2000 and 2015. Other categories of state restricted spending have remained mostly stable, with correctional operations, CTF, and other dedicated spending declining slightly over the study period as a share of total spending. Corrections, CTF and SOQ spending have all increased in absolute terms but not as a share of all state spending. Pension contributions grew only slightly, from 1 to 2 percent of governmental fund spending, over the same period.

FIGURE 22

Virginia’s Restricted Spending, Share of Total Annual Spending, FY 2000–2015

Categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the Virginia Joint Legislative Audit and Review Commission and Virginia Department of Planning and Budget. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total spending includes spending from governmental funds, as reported in the state Comprehensive Annual Financial Report. “Other” includes the state TANF maintenance of effort, spending to comply with the 1992 Children’s Services Act, and spending to comply with the US Department of Justice behavioral health settlement from 2013–15, which each constituted 2 percent or less of state spending. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. The black line reflects the estimated lower bound of restricted spending. See table 21 and accompanying notes for detail. Values in this figure may not sum to those in table 21 because of rounding.

How Much of Virginia’s Spending Growth Has Gone toward Restricted Items?

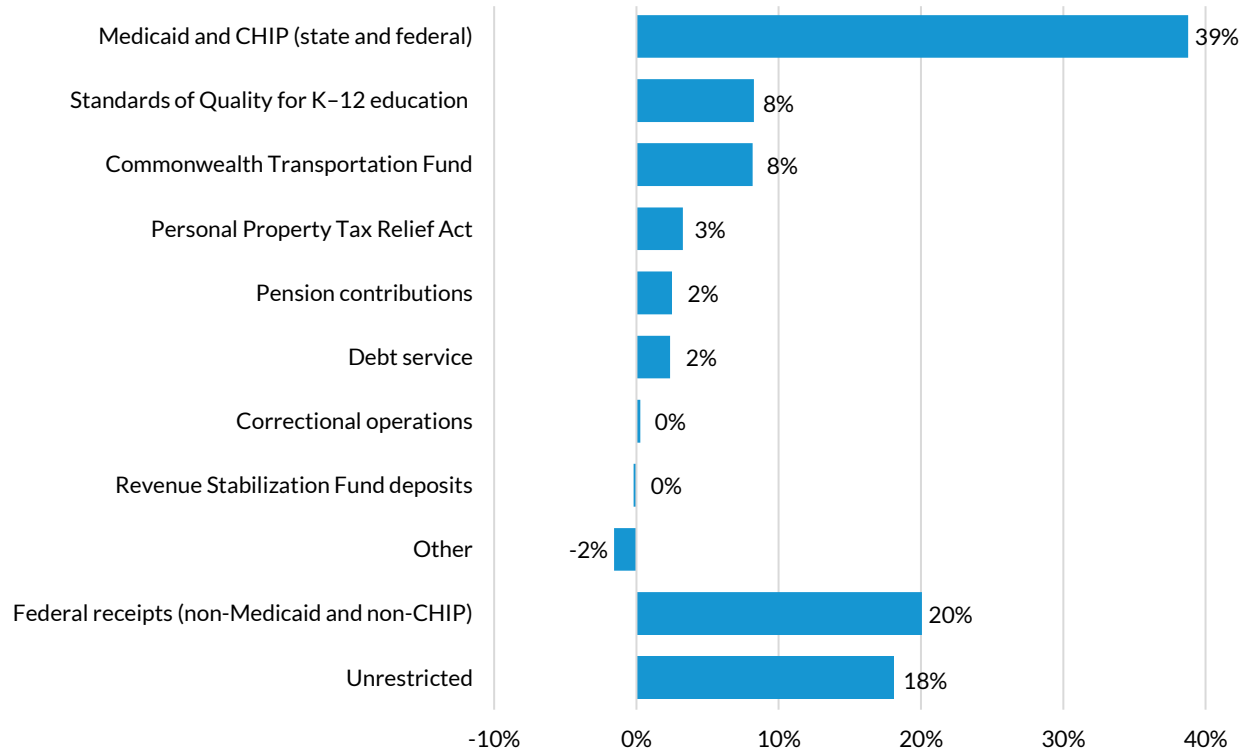
According to our analysis, at the lower bound considering only Medicaid, the Children’s Health Insurance Program (CHIP), and debt service, 41 percent of all real (inflation-adjusted) spending growth since 2000 has gone to restricted categories.²⁵⁵ At the upper bound, considering all spending obligations (and offsetting for those restricted funds that have decreased over time and constitute a negative share of growth), Virginia’s restricted spending consumed 82 percent of state spending growth between 2000 and 2015 (figure 23).

Thirty-nine percent of that growth went to Medicaid and CHIP (19 percent in non-federally financed and 20 percent in federally financed spending). Formula-driven SOQ spending for K-12 education and the CTF were next largest at 8 percent of growth, followed by the car tax relief program at 3 percent (although this should decline or remain stable in future years because the program was capped at \$950 million annually). Pension contributions and debt service each constituted 2 percent of total growth over the period. Correctional operations, RSF deposits, and other dedicated funding all constituted zero percent or less of growth.

FIGURE 23

Virginia’s Restricted Spending, Share of Total Real Spending Growth, FY 2000–2015

Restricted categories (except for Medicaid, CHIP, and federal receipts) reflect only state contributions



Sources: Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the Virginia Joint Legislative Audit and Review Commission and Virginia Department of Planning and Budget. See Boddupalli and Randall (2019) for technical documentation and state detail.

Notes: FY = fiscal year. Total real spending growth includes inflation-adjusted spending growth from governmental funds, as reported in the state Comprehensive Annual Financial Report, between FY 2000 and 2015. “Other” includes the state TANF maintenance of effort, spending to comply with the 1992 Children’s Services Act, and spending to comply with the US Department of Justice behavioral health settlement from 2013–15, which each comprised two percent or less of state spending. Unrestricted includes the remainder of total governmental fund expenditures not classified as restricted. Figure includes only potentially restricted, quantifiable spending for which data were available. Due to varying accounting bases, and inconsistent reporting over time, some overlap between categories is possible. See table 21 and accompanying notes for detail. Values in this figure may not sum to those in table 21 because of rounding.

Conclusion

To our knowledge, this study provides the most comprehensive assessment available of state spending that is relatively “fixed” or precommitted each year. Because these constraints almost always derive from past decisions and not from current voters or their elected representatives, we label such extraordinary constraints as limitations on fiscal democracy. Although fiscal democracy can have many meanings, we can safely assert that before any governor has proposed a budget or new legislature has begun meeting, they are forced to find ways to spend less or tax more to meet mandates they have inherited and not voted upon.

Broadly speaking, our results validate the complaints of governors and state legislators that they have limited flexibility to adapt or shift priorities, even in response to an electoral mandate. As much as 70 to 90 percent of state budgets are off limits in a given year. Depending on one’s interpretation of budget restrictions and other pressures a state may be under, however, that share could be as little as a quarter to a half.

Regardless of where states lie on the continuum, they could report better on past budget choices, how those choices become built into the current budget before it is voted upon, how flexibility is changing over time, and the share of new spending driven by those past choices and by new initiatives.

One option to do this, following Steuerle and Quakenbush (2016), is to distinguish between *real* spending and revenue growth that comes about automatically from levels and changes that are proposed in new legislation. More concretely, governors’ proposed budgets should present incremental revenue growth and highlight which programs garner greater and smaller shares of that growth.

Programs can then be ordered to reveal where most growth occurred. The years chosen for comparison serve different purposes. If assessing the past year or legislative session, the reports reveal changes that have occurred recently. If reviewed over a longer period (e.g., 10 years), they reveal the overall path that a state’s budget has been taking. That path often is hidden over shorter periods, especially when economic cycles cause fluctuations around an overall trend.

The same kind of analysis can look forward. However, these analyses require projections of spending and revenues. But only a handful of states prepare multiyear revenue and spending forecasts, and almost none project spending forward for 10 years like the CBO does for the federal government (McNichol, Lav, and Leachman 2015). Still, reporting this way on at least the one- or two-year changes implicit in every new budget would be informative.

Of course, there are other valuable ways to show shifts over time, such as a simple lineup of programs by growth rates. Again, however, the growth in real dollars, not nominal dollars, should be shown. Further, analysts should show growth in programs relative to aggregate state income or gross domestic product, and possibly highlight how growth is related to changing demographics.

In the budgetary process, states almost always prepare for the governor some estimate of current services or workload budgets. These are projections of what resources would be needed to maintain current services apart from those required to fund new legislative initiatives. In Medicaid, for instance, the budget office might assume that expenses will rise as new health care technologies are introduced or more people qualify for the program. Those projections could count any legislative expansion of eligibility groups as a policy change.

Current services budgets require making assumptions and judgement calls, and these will vary by state. A state, for instance, may assume that health care prices reflect some past trend or forecast. The state may project growing public-school employment and rising compensation costs based on projected student population growth and sought-after teacher-student ratios. It may or may not forecast salary increases, leaving that as a more discretionary policy choice.

Our aim is not to give specific guidance about how best to prepare a current services budget, although we do suggest consistency for common items such as inflation adjustments across program areas. Rather, we hope to clarify that current services plus new reforms (proposed cuts or increases) must add up to the total projected change in revenues and spending relative to the previous year or over the budget cycle. Divided and presented this way, readers can see more readily how much discretion has been left in the budget and how much its elected officials are changing relative to what would have occurred by simply continuing existing programs.

There's a saying that budgets are too important to be treated as mere accounting exercises. In any organization, budgets do much more than establish financial and managerial accountability and control. In government, they also create transparency about the collection and use of public resources. Government budgets are strategic planning documents, communication devices, and ultimately statements about values.

This report identifies in significant detail how constraints on state legislative action limit fiscal democracy. We do not suggest constraints are inherently problematic, but when combined they may greatly restrict a state's ability to make choices according to new needs, opportunities, and voter desires. At minimum, states should use this report to try to enumerate and measure those constraints as much as possible.

Notes

- ¹ See, for example, Bill Stall, “California’s fiscal straightjacket,” *Los Angeles Times*, January 14, 2006, <https://www.latimes.com/archives/la-xpm-2006-jan-14-oe-stall14-story.html>.
- ² All dates in this report reference the state fiscal year, unless explicitly stated otherwise. In 46 states, the fiscal year begins on July 1, with the remaining states starting on the first of April (New York), September (Texas), or October (Alabama and Michigan) (NASBO 2015). Fiscal years are referred to by their terminal year (i.e., 2014–15 is 2015, 2013–14 is 2014, and so forth).
- ³ Authors’ analysis of data from the National Association of State Budget Officers (NASBO), obtained by special request.
- ⁴ See budget transmittal letter to the legislature in DOF (2005).
- ⁵ He would later say: “You have to understand, it’s nothing personal with me...[previous governor] Gray Davis could not make it manage. No one could have made it manage under the political and budget system that we have. The system itself is dysfunctional” (Mathews 2006).
- ⁶ Thirty states budget on an annual basis and 20 (including two of our study states, Texas and Virginia) on a biennial basis (NASBO 2015).
- ⁷ The Congressional Budget and Impoundment Control Act of 1974 defines mandatory spending at the federal level as spending controlled by laws outside the annual appropriations act. Federal mandatory spending primarily consists of Social Security and Medicare obligations. See Levit, Austin, and Stupak (2015).
- ⁸ At the end of 2017, the federal government employed roughly 9 workers per 1,000 residents while the state and local sector employed about 60 (authors’ analysis using data from US Bureau of Labor Statistics, or BLS, Current Employment Statistics survey, 2017, accessed via “Databases, Tables & Calculators by Subject,” BLS, July 5, 2019, <https://www.bls.gov/data/>; and US Census Bureau, National Population Totals and Components of Change, 2010–18, accessed via “Population and Housing Unit Estimates,” US Census Bureau, July 5, 2019, <https://www.census.gov/programs-surveys/popest/data/data-sets.html>). In 2017, state and local government spending (from own resources and federal grants) represented 14.7 percent of gross domestic product, while federal domestic direct spending on public goods and services (excluding national defense and grants to states and localities) was 15.4 percent (authors’ analysis using data from US Bureau of Economic Analysis, or BEA, National Income and Product Accounts (2000–17), accessed via “GDP & Personal Income,” Interactive Data, BEA, https://apps.bea.gov/iTable/index_nipa.cfm). From 2000 to 2008, the state and local share was higher than the federal one (14.3 percent versus 12.7 percent in 2000). However, from 2009–17, that relationship switched, as the federal government ramped up spending in response to the Great Recession.
- ⁹ See, for example, Cezary Podkul and Heather Gillers, “Why Are States So Strapped for Cash? There Are Two Big Reasons,” *Wall Street Journal*, March 29, 2018, <https://www.wsj.com/articles/why-are-states-so-strapped-for-cash-there-are-two-big-reasons-1522255521>.
- ¹⁰ For more information, see “Annual Survey of State and Local Government Finances: About,” US Census Bureau, January 24, 2018, <https://www.census.gov/programs-surveys/gov-finances/about.html>.
- ¹¹ Comprehensive Annual Financial Reports (CAFRs) are prepared in accordance with generally accepted accounting principles (GAAP) developed by the Governmental Accounting Standards Board (GASB). No entity strictly enforces compliance with GASB standards, but auditors render opinions on financial statements based on GAAP conformity, states often require local governments or public pension plans to comply, and the municipal bond industry tends to penalize issuers that do not comply with GAAP (Marlowe 2007).
- ¹² All dates in this report reference the state fiscal year, unless explicitly stated otherwise. In 46 states, the fiscal year begins on July 1, with the remaining states starting on the first of April (New York), September (Texas), or

October (Alabama and Michigan) (NASBO 2015). Fiscal years are referred to by their terminal year (i.e., 2014–15 is 2015, 2013–14 is 2014, and so forth).

- ¹³ We selected our total spending measure based on data availability and guidance from state budget office staff in each state. For five states, we used total governmental fund spending as reported in the state’s annual CAFR. Governmental funds reflect a majority of states’ financial activity and exclude propriety and fiduciary funds, such as dedicated public university or pension funds, for example. In California, however, we used total spending from the California Legislative Analyst’s Office (LAO) historical data, including federal, special, general, and bond funds. See “State of California Expenditures, 1984–85 to 2017–18,” Historical Data, LAO, August 2017, <https://lao.ca.gov/PolicyAreas/state-budget/historical-data>.
- ¹⁴ For example, see Bitler and Hoynes (2016), Chernick (1979), Gramlich and Galper (1973), and Knight (2002).
- ¹⁵ For example, Baum and Johnson (2015) treat tuition and state appropriations separately as the two main sources of funding for higher education institutions.
- ¹⁶ See, for example, the estimates of state mandatory and discretionary spending, which use social benefits payments as a proxy for mandatory spending, in Campbell and Sances (2013).
- ¹⁷ As Doug Porter, Washington state Medicaid Director, told *Governing* magazine in 2010, “...while opting out might work on the acute-care piece of Medicaid, it’s a whole other set of problems with the developmentally disabled and long-term care parts of the program. Plus, the hospital industry benefits from disproportionate share payments in the tens of millions of dollars. It really isn’t economically feasible [to opt out].” As quoted in Penelope Lemov, “Cutting Medicaid,” *Governing*, December 16, 2010, <https://www.governing.com/topics/finance/cutting-medicaid.html>. See also Janet Adamy and Neil King Jr., “Some States Weigh Unthinkable Option: Ending Medicaid,” *Wall Street Journal*, November 22, 2010, <https://www.wsj.com/articles/SB10001424052748704444304575628603406482936>.
- ¹⁸ Tim Gage (Blue Sky Consulting Group), phone interview with authors, April 2017.
- ¹⁹ No legal bankruptcy process exists for states, complicating creditors’ claim on state resources in the event of default (Ergunor 2017; Johnson and Young 2012). However, state default is rare. States treat their debt payment obligations seriously and, if experiencing fiscal distress, are more likely to pursue alternative strategies, such as delaying payments or issuing IOUs to creditors (Johnson and Young 2012). Some states reinforce their contractual repayment requirements via a legal framework establishing a priority of payment for debt service. For an example of how credit analysts use this framework in rating criteria, see Prunty et al. (2011). In another example, in 2018, Moody’s affirmed California’s A1 rating on lease debt in part based on its “strong legal framework” that includes continuing appropriations of lease payments and a debt service reserve fund (Butler 2018).
- ²⁰ For more information and estimates of how specific policies and other factors influence state prison populations, see “Prison Population Forecaster,” Urban Institute, September 6, 2018, <http://urbi.is/ppf>. Because prison populations decline slowly in response to reforms, “as people with relatively longer prison sentences take time to clear the system,” some organizations have advocated for a broader range of measures to assess the immediate and likely future affect of sentencing and other criminal justice reforms (Kang-Brown et al, 2018, 20).
- ²¹ Data suggest that state higher education funding is still below prerecession levels (Mitchell et al. 2018; Pew 2019b).
- ²² At the federal level, there has been semantic and political debate about whether failing to keep funding on pace with inflation and enrollment trends qualifies as a “budget cut” (e.g., House Budget Committee Democratic Staff 2017). It is, nonetheless, generally understood that funding programs at a level below the accepted current services baseline will reduce levels of services (McNichol and Grundman 2011). Even for programs with some level of funding guarantee, like K–12 education, failing to keep up with the increasing costs of state-funded services or growing student enrollment can contribute to a decline in inflation-adjusted per pupil funding

(Leachman, Masterson, and Figueroa 2017). See, for example, a 2019 report which found that Utah's per pupil K-12 education funding had neither kept pace with inflation nor demographic changes affecting education spending (Kuntz and Weinstein 2019).

- ²³ Although some have concluded that it acts as a de facto ceiling, rather than floor. For more references to the “floor or ceiling” debate, see “Proposition 98,” Public Policy Institute of California, accessed June 28, 2019, <https://www.ppic.org/blog/tag/proposition-98/>; Angela Hart, “California Lawmakers Call for More State Funding as Teachers Strike in L.A.,” *Politico*, January 14, 2019, <https://politi.co/2FssSOD>; Kaplan (2014); and LAO (2017a).
- ²⁴ In addition, the state has adopted “poison pills” that suspended certain Proposition 98 conditions three times since 1988 (LAO 2017a).
- ²⁵ As Reschovsky (2004) notes: “Conventional wisdom suggests that state governments consider the funding of education to be one of their most important functions, and thus governors and legislators try very hard, even in difficult fiscal environments, to maintain (or expand) funding for public schools and (perhaps to a lesser degree) for core municipal services, such as public safety.” In 2017, Erica Williams, an analyst at the Center on Budget and Policy Priorities (CBPP), characterized prerecession state education funding as “a ‘bipartisan third rail,’ immune to significant reduction.” As quoted in Liz Farmer, “Nation’s Least-Funded Schools Get What They Pay For,” *Governing*, June 2017, <https://www.governing.com/topics/education/gov-oklahoma-states-education-funding.html>.
- ²⁶ Authors’ analysis of NASBO, *State Expenditure Report* data, 2000-2015, obtained by special request.
- ²⁷ See Farmer, “Nation’s Least-Funded Schools Get What They Pay For.”
- ²⁸ See Allison Graves, “Florida House Says Per-Student Bump of 47 Cents Is a Myth,” *PolitiFact*, May 30, 2018, <https://www.politifact.com/florida/statements/2018/may/30/florida-house-majority/did-florida-students-see-increase-47-cents-or-it-m/>; and William Mansell, “School Board Plans for ‘Devastating’ State Education Cuts,” *Patch*, February 16, 2011, <https://patch.com/florida/sarasota/school-board-plans-for-devastating-state-education-cuts>.
- ²⁹ For trends across states, see Rudowitz, Hinton, and Antonissee (2018), and for further information on trends in cost containment measures related to service delivery systems, pharmaceutical costs, eligibility limitations, and provider rates, among other factors, see Smith, Ramesh, et al. (2004); and Smith, Gifford, et al. (2014).
- ³⁰ Under federal law, up to 60 percent of state Medicaid spending may come from local governments or provider taxes and fees. Provider taxes must be “broad based and uniform,” meaning they must be levied against all non-governmental providers and not just those that participate in the Medicaid program. In addition, providers cannot be “held harmless” through a direct or indirect guarantee that they will be repaid for taxes they contribute (MACPAC 2012; McConville, Warren, and Danielson 2017).
- ³¹ Hoadley, Cunningham, and McHugh (2004), for example, found that Medicaid has a broad coalition of supporters that discourage states from severely limiting beneficiary access or services. Rather, states were more likely to implement administrative changes and provider payment reductions to mitigate costs during a budget shortfall.
- ³² In a traditional fee-for-service delivery system, health care providers receive payments for each medical service delivered. Under managed care, the state contracts with managed care plans to provide benefits in a health maintenance organization or through a provider network. Plans are reimbursed on a “capitated” basis, meaning they receive a fixed amount per member per month regardless of utilization.
- ³³ The Centers for Medicare and Medicaid Services (CMS) verify states’ compliance with federal requirements for actuarial soundness. See “Managed care rate setting,” Medicaid and CHIP Payment and Access Commission (MACPAC), 2019, <https://www.macpac.gov/subtopic/managed-care-rate-setting/>.

- ³⁴ State Medicaid costs may become more predictable under a managed care model, as the state locks in a capitated payment rate with each managed care organization. While states may in theory reduce costs by transferring some risk to participating health plans, such savings may not materialize in practice. See Jeff Goldsmith, David Mosley, and Anne Jacobs, “Medicaid Managed Care: Lots Of Unanswered Questions (Part 2).” *Health Affairs Blog* (blog), May 4, 2018, <https://www.healthaffairs.org/doi/10.1377/hblog20180430.510086/full/>.
- ³⁵ When 8 US states and one territory repudiated their debts between 1841 and 1843, those that ultimately resumed payment experienced 32 percent higher borrowing costs until they did so. Mississippi and the Florida Territory, which refused to reverse their repudiation, lacked access to financial markets for almost two decades. See English (1996).
- ³⁶ See “State Funding Payments” in State of Illinois (2010).
- ³⁷ In California, pension contributions are grouped with state other postemployment benefit (OPEB) contributions, so OPEB contributions are also included in the lower bound. Data on state OPEB contributions were not available for New York, so we excluded OPEBs from our New York analysis. We also excluded OPEB data from our analyses in Illinois and Virginia because data were unavailable prior to 2008 for those states. OPEB contributions are included, along with pensions, in the upper bound for Florida and Texas.
- ³⁸ In addition to contributing as employers, states often contribute as “non-employer contributing entities” to pension plans on behalf of local employees such as teachers (e.g., the California State Teachers' Retirement System) (CalSTRS). See Boddupalli and Randall (2019) for details.
- ³⁹ See a more detailed discussion of Illinois pension obligations in the “State Findings” section of this report.
- ⁴⁰ In 2018, the LAO stated that “it is difficult to overstate how good the budget’s condition is today” (LAO 2018b).
- ⁴¹ See, for example, “The Perils of Extreme Democracy,” *Economist*, April 20, 2011, <https://www.economist.com/leaders/2011/04/20/the-perils-of-extreme-democracy>.
- ⁴² It was noted that the range of spending subject to restriction could vary widely, depending on how one chose to define it. Jason Sisney shared that, while some budget adjustments were cleaner or quicker than others, “solutions rely on the creativity of policymakers and their staffs.” Ana Matosantos (independent budget and policy consultant), phone interview with authors, May 2017; and Jason Sisney (LAO), phone interview with authors, April 2017.
- ⁴³ See “A.G. File No. 2015-076,” LAO, November 24, 2015, <https://lao.ca.gov/BallotAnalysis/Initiative/2015-076>.
- ⁴⁴ Proposition 162 (1992) amended the state constitution to establish rules for the California Public Employees’ Retirement System (CalPERS).
- ⁴⁵ Gage (interview).
- ⁴⁶ Any reference to total spending in the California data discussion refers to spending from general, special, bond, and federal funds from LAO, “State of California Expenditures, 1984-85 to 2017-18.” See Boddupalli and Randall (2019) for data documentation.
- ⁴⁷ Informants noted that it is difficult to ascertain to what extent specific obligations are binding. Many of the state’s obligations are only partially restricted or restricted only under specific circumstances. Matosantos (interview); and Sisney (interview).
- ⁴⁸ Authors’ analysis using federal data from CMS. See Boddupalli and Randall (2019) for technical documentation and state detail.
- ⁴⁹ See Cal. Const. art. XVI, § 17.
- ⁵⁰ McConville, Warren, and Danielson (2017) find that enrollment growth is currently the primary driver of increases in Medi-Cal spending. See also California Healthcare Foundation (2006) for more information about

state trends. For trends across states, see Rudowitz, Hinton, and Antonisse (2018), and for further information on trends in cost containment measures related to service delivery systems, pharmaceutical costs, eligibility limitations, and provider rates, among other factors, see Smith, Ramesh, et al. (2004); and Smith, Gifford, et al. (2014).

⁵¹ See “Medicaid Spending by Enrollment Group,” State Health Facts, Henry J. Kaiser Family Foundation (KFF), accessed June 28, 2019, <https://www.kff.org/medicaid/state-indicator/medicaid-spending-by-enrollment-group/>.

⁵² Tim Gage, for example, shared, “It is not realistic politically for California to abandon Medicaid, but theoretically it could” (Gage interview).

⁵³ For data on optional state Medicaid services, eligibility thresholds, and expansion populations, see MACPAC (2017b, 2018a).

⁵⁴ See “Status of State Medicaid Expansion Decisions: Interactive Map,” KFF, May 13, 2019, <https://www.kff.org/medicaid/issue-brief/status-of-state-medicaid-expansion-decisions-interactive-map/>.

⁵⁵ For example, The state restored full adult dental benefits in its Medicaid program in 2017, after eliminating them in 2009. See “Restoration of Adult Dental Services,” DHCS, https://www.dhcs.ca.gov/services/Pages/Restoration_Adult_Dental.aspx.

⁵⁶ Also see “Total Medicaid Managed Care Enrollment,” State Health Facts, KFF, accessed June 28, 2019, <https://www.kff.org/medicaid/state-indicator/total-medicaid-mc-enrollment/>.

⁵⁷ For example, in 2014, physician visit reimbursements rates were roughly 81 percent of the national average under Medicaid and 41 percent of payments under Medicare, the country’s subsidized health insurance program for seniors and qualifying disabled persons, which itself pays less than private insurers (Zuckerman, Skopec, and McCormack 2014).

⁵⁸ In general, states must show that Medicaid recipients will continue to have access to the same health care services as the general population. However, recent developments have complicated this issue. According to MACPAC: “on March 31, 2015, the US Supreme Court precluded future lawsuits when it decided, in *Armstrong v. Exceptional Child Center, Inc.*, that Medicaid providers do not have the right to sue Medicaid agencies regarding payment rates under the Supremacy Clause of the Constitution or under 1902(a)(30)(A) of the Social Security Act.” MACPAC also points out, however, that “a January 2016 CMS regulation now requires states to consider input from providers, beneficiaries, and other stakeholders when evaluating the potential impacts of rate changes prior to instituting provider payment rate reductions or changes in the provider payment structure. States must also analyze the effect that rate changes may have on beneficiary access to care and then monitor the effects for at least three years after the changes are effective.” See “Provider Payment under Fee for Service,” MACPAC, accessed June 28, 2019, <https://www.macpac.gov/subtopic/provider-payment/>.

⁵⁹ DHCS sets the capitation rates, and Mercer (an actuarial contractor) has certified them as actuarially sound. The state’s rates are also subject to CMS review. For further reading, see CHCF (2018), and DHCS (2015).

⁶⁰ Proposition 162 (1992) amended Article XVI, section 17 of the California Constitution to establish rules for CalPERS.

⁶¹ However, recent California Supreme Court rulings have indicated that not all aspects of a pension plan are considered vested rights. See Ed Mendel, “New Pension-Cut Rulings Begin with Little Change,” *Calpensions* (blog), March 11, 2019, <https://calpensions.com/category/california-rule/>; and Pew (2019a).

⁶² For further reading, see Wayne Winegarden, “The Opportunity Created by California’s Overly-Generous Public Pensions,” *Forbes*, September 20, 2018, <https://www.forbes.com/sites/waynewinegarden/2018/09/20/the-opportunity-created-by-californias-overly-generous-public-pensions/>.

- ⁶³ CalSTRS is governed by the California Education Code sections 22000-25115 and 26000-28101. See “California,” National Association of State Retirement Administrators, 2019, <https://www.nasra.org/ca>; and CalSTRS (2018).
- ⁶⁴ For more detail on reform, see Brainard and Brown (2018), as well as the California state supplement in Boddupalli and Randall (2019).
- ⁶⁵ See “State Retirement Fiscal Health and Funding Discipline: California,” Pew Charitable Trusts (Pew), September 28, 2018, <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health-and-funding-discipline#/state-profiles/california?year=2016>; and the state’s breakdown table on “The State of Retirement: Grading America’s Public Pension Plans,” Urban Institute, 2014, <http://apps.urban.org/features/SLEPP/index.html>.
- ⁶⁶ Proposition 2 (2014) debt repayment requirements are strict, and the state cannot defer them as it can other obligations.
- ⁶⁷ Gage (interview). Additionally, see LAO (2016b) for more information on how the Proposition 2 (2014) debt repayment requirement applies to Proposition 98 settle-up payments.
- ⁶⁸ Matosantos (interview). For more references to the “floor or ceiling” debate, see “Proposition 98;” Angela Hart, “California Lawmakers Call for More State Funding as Teachers Strike in L.A.,” *Politico*, January 14, 2019, <https://politi.co/2FssSOD>; and Kaplan (2014).
- ⁶⁹ For more information and estimates of how specific policies and other factors influence state prison populations, see “Prison Population Forecaster.”
- ⁷⁰ Gage (interview).
- ⁷¹ In nominal dollars. They increased from \$5.5 billion in 2015, inflation-adjusted dollars. Data from US Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2000-2015), accessed via “Data Query System,” Urban-Brookings Tax Policy Center, accessed July 2, 2019, <https://sldqs.taxpolicycenter.org>.
- ⁷² Gage (interview). California spending on inmate healthcare is reportedly the highest in the nation (LAO 2018a; Pew 2017b).
- ⁷³ Sisney (interview).
- ⁷⁴ Sisney (interview).
- ⁷⁵ For California’s expenditures, we used LAO historical data, which provide a breakdown of state expenditures and revenues by functional category and agency. See LAO, “State of California Expenditures, 1984-85 to 2017-18.” For further information on specific variables, see Boddupalli and Randall (2019).
- ⁷⁶ The Volcker Alliance assigned Florida grades of either A or B for its budget forecasting, reserve fund and transparency practices, as well as its limited use of budget maneuvers (Volcker Alliance 2018).
- ⁷⁷ See, for example, Holcombe’s (2015) praise of Florida for following its balanced-budget requirements and keeping its spending, taxes, and government employment low; and quotations in Lloyd Dunkelberger, “\$223 Million Surplus Reflects Florida’s Sound ‘Conservative Financial Decisions,’” *Sunshine State News*, September 15, 2018, <http://www.sunshinestatenews.com/story/223-million-surplus-reflects-floridas-sound-conservative-financial-decisions>.
- ⁷⁸ See Randy Schultz, “If Florida Is Booming, Why Is Budget Busted?” *South Florida Sun Sentinel*, December 22, 2016, <https://www.sun-sentinel.com/opinion/fl-rsscol-florida-economy-20161220-story.html>.
- ⁷⁹ See John Haughey, “Florida Senate OKs \$90.3 Billion Budget; House Poised to Pass Its \$89.9B Plan,” *Florida Watchdog*, April 4, 2019, <https://www.watchdog.org/florida/florida-senate-oks-billion-budget-house-poised-to->

[pass-its/article_Odaba49a-56c6-11e9-9917-eb1cd55bcd4.html](https://www.reuters.com/article/us-usa-municipals-florida-education-idUSKCN1GR032); Laila Kearney, “Florida Education Budget Should Be Revised, Superintendents Say,” *Reuters*, March 14, 2018, <https://www.reuters.com/article/us-usa-municipals-florida-education-idUSKCN1GR032>; Scott Maxwell, “Florida Has an Extra \$842 Million. Here’s How We Should Use It,” *Orlando Sentinel*, December 28, 2018, <https://www.orlandosentinel.com/news/taking-names-scott-maxwell/os-ne-florida-budget-surplus-scott-maxwell-20181227-story.html>; and Jim Turner, “Florida House Budget Proposal Gives Governor the Environmental Money He Sought,” *South Florida Sun Sentinel*, March 19, 2019, <https://www.sun-sentinel.com/news/politics/fl-ne-nsf-house-budget-proposal-environment-20190319-story.html>.

⁸⁰ Gary VanLandingham (Florida State University), phone interview with authors, August 2017.

⁸¹ Amy Baker (Florida Office of Economic and Demographic Research), phone interview with authors, September 2017.

⁸² Any reference to total spending in the Florida data discussion refers to total spending from governmental funds spending as reported in the state CAFR from 2000–2015, including spending financed from general, federal, special, and bond revenues that flow into governmental funds. See Boddupalli and Randall (2019) for data documentation.

⁸³ Authors’ analysis using federal data from CMS. See Boddupalli and Randall (2019) for technical documentation and state detail.

⁸⁴ For 2015–16, the Medicaid program was the next largest cost driver in Florida after the Florida Education Finance Program, at roughly 38 percent of total “critical needs” (JLBC 2014).

⁸⁵ Baker (interview).

⁸⁶ See “Medicaid Spending by Enrollment Group.”

⁸⁷ For data on optional state Medicaid services, eligibility thresholds, and expansion populations, see MACPAC (2017b, 2018a).

⁸⁸ The Florida Constitution requires the state to provide an adequate and uniform system of free public education. The state also has a constitutional class-size requirement. In 2002, citizens approved an amendment to the Florida Constitution that set limits on the number of students in core classes in the state’s public schools. In 2003, the state adopted section 1003.03 of the Florida Statutes, which implemented the amendment by requiring the number of students in each classroom to be reduced by at least two students per year beginning in the 2003–04 school year, until the maximum number of students per classroom did not exceed the requirements in law. For fiscal year 2015–16, the Class Size Agreement budget was \$3.03 billion. See “Class Size,” Florida Department of Education, 2019, <http://www.fldoe.org/finance/budget/class-size/>.

⁸⁹ See Andrew Atterbury, “Florida Education Funding High; Schools Still Recovering from Recession Cuts,” *USA Today*, February 4, 2017, <https://www.news-press.com/story/news/local/2017/02/04/florida-education-funding-high-schools-still-recovering-recession-cuts/97507816/>; and Samantha Waxman, “Florida’s Supermajority Proposal Would Deepen K–12 Funding Crisis,” CBPP, June 20, 2018, <https://www.cbpp.org/blog/floridas-supermajority-proposal-would-deepen-k-12-funding-crisis>.

⁹⁰ See Fla. Stat. § 121.71.

⁹¹ As reported by key informants. According to Fitch Ratings, although Florida did not fully fund its actuarially determined contribution level in fiscal year 2012–13, it restored full funding for fiscal year 2013–14, 2014–15, 2015–16, and 2016–17. See Elizabeth Koh, “Moody’s Upgrades Florida to Its Highest Credit Rating,” *Miami Herald*, June 22, 2018, <https://www.miamiherald.com/news/politics-government/state-politics/article213648744.html>; Offerman, Porter, and Montgomery (2018).

⁹² Baker (interview). Also see “Editorial: Lawmakers Sweep Trust Funds Clean,” *Herald-Tribune*, September 2, 2015, <https://www.heraldtribune.com/opinion/20150902/editorial-lawmakers-sweep-trust-funds-clean>; and Mary

Ellen Klas, "Where Did \$1.3 Billion for Affordable Housing Go? Florida Legislature Took It," *Miami Herald*, April 4, 2017, <https://www.miamiherald.com/news/politics-government/state-politics/article142033109.html>.

⁹³ VanLandingham (interview).

⁹⁴ Baker (interview).

⁹⁵ Florida spending increased by \$23.4 billion in real, inflation-adjusted terms from 2000 to 2015 (authors' analysis using data from state CAFRs). See Boddupalli and Randall (2019) for technical documentation.

⁹⁶ Laurence Msall (Civic Federation), phone interview with authors, August 2017; and Ostro (interview). Also see "Illinois Spending Continues Without an FY2016 Budget," Civic Federation, August 20, 2015, <https://www.civicfed.org/iifs/blog/illinois-spending-continues-without-fy2016-budget>.

⁹⁷ Ostro (interview).

⁹⁸ Ostro (interview).

⁹⁹ An analysis by the Center for Tax and Budget Accountability (CTBA) estimated that 90 percent of Illinois's spending was on autopilot in 2016 (CTBA 2016). CTBA suggested that autopilot spending in Illinois included the K-12 education budget, debt service, transfers out, pension contributions, and expenditures required by court orders or administrative decisions.

¹⁰⁰ Any reference to total spending in the Illinois data discussion refers to total spending from governmental funds spending as reported in the state CAFR from 2000-2015, including spending financed from general, federal, special, and bond revenues that flow into governmental funds. See Boddupalli and Randall (2019) for data documentation.

¹⁰¹ See section 25 of the Illinois State Finance Act (30 Ill. Comp. Stat. 105/25). Also see "The Section 25 Exception: How Illinois Defers Medicaid Bills," Civic Federation, March 1, 2012, <https://www.civicfed.org/iifs/blog/section-25-exception-how-illinois-defers-medicaid-bills>.

¹⁰² Ostro (interview).

¹⁰³ See *Memisovski et al. v. Maram, et al.*, No. 92 C 1982 (N.D. Ill. 2017); and *Beeks et al. v. Bradley et al.*, No. 92 C 4204, (N.D. Ill. 2017), <https://legalcouncil.org/wp-content/uploads/2017/06/192-cv-01982-Documents-533-Filed-063017.pdf>. Also see "Medicaid;" and Karen Pierog and David McKinney, "Judge Orders Illinois to Boost Medicaid Bill Payments," *Reuters*, June 30, 2017, <https://www.reuters.com/article/us-illinois-budget-medicaid/judge-orders-illinois-to-boost-medicaid-bill-payments-idUSKBN19L310>.

¹⁰⁴ On June 7, 2017, the judge gave the comptroller and plaintiffs until June 20, 2017, to reach a deal regarding Medicaid funding and concurred that the state had failed to comply with previous consent decrees (*Memisovski* and *Beeks*). Also see Amanda Vinicky, "Judge Rules on State Payments to Medicaid Providers," *WTTW News*, June 7, 2017, <https://news.wttw.com/2017/06/07/judge-rules-state-payments-medicaid-providers>.

¹⁰⁵ Ostro (interview).

¹⁰⁶ The state comptroller filed an affidavit in the 2017 court case addressing the state's deferred Medicaid provider payments. The affidavit justified deferred payments in light of the state's competing fiscal obligations and core spending priorities (*Memisovski* and *Beeks*). Also see Kim Geiger, "Federal Judge Weighing Whether Illinois Must Prioritize Paying Medicaid Bills," *Chicago Tribune*, June 6, 2017, <https://www.chicagotribune.com/news/local/politics/ct-medicaid-lawsuit-hearing-met-0607-20170606-story.html>.

¹⁰⁷ See Doug Finke, "Gov. Rauner Signs Education Funding Bill to Keep Schools Open," *State Journal-Register*, June 24, 2015, <https://www.sj-r.com/article/20150624/NEWS/150629728>.

- ¹⁰⁸ In 2019, for example, 71 percent of poll respondents in Illinois supported increased funding for public education, and 83 percent said that improving public schools is one of the most important issues facing Illinois. These results were from a poll of Illinois residents released by the Illinois Education Association. See Jackson, Leonard, and Deitz (2016); and Kristen Thometz, “Poll: Illinoisans Say Improving Schools Among Top Issues Facing State,” *WTTW News*, April 30, 2019, <https://news.wttw.com/2019/04/30/poll-illinoisans-say-improving-schools-among-top-issues-facing-state>.
- ¹⁰⁹ Illinois State Senator Heather Steans, phone interview with authors, September 2017. Illinois’s Property Tax Extension Limitation Law (PTELL) limits local property tax rates for some districts, and the state currently provides an adjustment to GSA for those districts to make up for reduced property tax revenue. For more information about how PTELL affects GSA and evidence-based school aid in Illinois school districts, see Augenblick, Palaich and Associates (2013); Dabrowski and Klingner (2017); IDOR (n.d.); ISBE (2017b); and Tax Increment Financing (TIF) Reform Task Force (2018).
- ¹¹⁰ See the Invest in Kids Act, also known as the Evidence-Based Funding for Student Success Act [35 Ill. Comp. Stat. 40/1 to 40/999 (2017)]; “Finance, Budgets & Funding: Evidence-Based Funding,” Illinois State Board of Education, accessed June 12, 2019, <https://www.isbe.net/Pages/EvidenceBasedFunding.aspx>; and Mary Ann Ahern and Shelby Bremer, “Illinois Senate Passes Education Funding Reform Deal,” *NBC Chicago*, August 29, 2017, <http://www.nbcchicago.com/blogs/ward-room/illinois-senate-education-funding-reform-442150953.html>.
- ¹¹¹ Ostro (interview).
- ¹¹² See the State Pension Funds Continuing Appropriation Act (40 Ill. Comp. Stat. 15/0.1 to 15/2). For more information, see Dierks (2018) and “Note 16” in State of Illinois Comptroller (2016).
- ¹¹³ See a 2013 settlement accepted by the Securities and Exchange Commission (SEC), which found that the state misled investors about the adequacy of its Statutory Funding Plan. See “Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1993, Making Findings, and Imposing a Cease-and-Desist Order,” SEC, 2013, <https://www.sec.gov/litigation/admin/2013/33-9389.pdf>.
- ¹¹⁴ The legislature passed Public Act (P.A.) 88-0593 in 1995, amending the Illinois Pension Code (40 Ill Comp. Stat. 5/1-101 to 5/24-109) to require the state to contribute based on a certain formula related to payroll. For more information, see Formas et al. (2015).
- ¹¹⁵ For more information about P.A. 94-0004, which amended many articles throughout the Illinois Pension Code (40 Ill Comp. Stat. 5/) to change the 1995 funding plan created by P.A. 88-0593, see the State of Illinois Comptroller (2016) and Formas et al. (2015).
- ¹¹⁶ See the State of Illinois Comptroller (2016) for details on Illinois’s pension obligation bonds. In 2018, the Commission on Government Forecasting & Accountability found that returns on Illinois’s 2003 pension obligation bonds had exceeded debt service costs (CGFA 2018a). For more detail on some of the risks of financing through pension obligation bonds in Illinois and other states, see “Pension Bonds: Lessons from the State of Illinois,” Civic Federation, August 31, 2018, <https://www.civiced.org/iifs/blog/pension-bonds-lessons-state-illinois>; Calabrese (2010); and Eric Schulzke, “Pension Obligation Bonds: Risky Gimmick or Smart Investment?” *Governing*, January 2013, <https://www.governing.com/topics/finance/gov-pension-obligation-bonds-risky-or-smart.html>.
- ¹¹⁷ See “State Retirement Fiscal Health and Funding Discipline: Illinois,” Pew, September 28, 2018, <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health-and-funding-discipline#/state-profiles/illinois?year=2016>.
- ¹¹⁸ See the state’s breakdown table on “The State of Retirement: Grading America’s Public Pension Plans.”
- ¹¹⁹ After Illinois accessed \$1.2 million from the Cycle Rider Safety Training Fund in 2003 and 2004, for example, a motorcycle advocacy group sued the state, arguing that that fees deposited into the fund were an “irrevocable

trust.” In 2011, however, the Illinois Supreme Court decided the dispute in favor of the state. See Monique Garcia, “Illinois Unions, Road Builders Pushing Transportation Lockbox Amendment,” *Chicago Tribune*, October 17, 2016, <https://www.chicagotribune.com/politics/ct-illinois-transportation-funding-amendment-met-20161014-story.html>; and Chris Wetterich, “Supreme Court OKs Fund ‘Sweeps’ to Balance State Budget,” *State Journal-Register*, November 1, 2011, <https://www.sj-r.com/article/20111101/NEWS/311019959>.

¹²⁰ Sen. Steans (interview).

¹²¹ Sen. Steans (interview). The State Budget Crisis Task Force (2012a) identified “fund-shift budgeting” as a major impediment to budget transparency in Illinois.

¹²² In the past, Illinois has swept special funds clean as a temporary fix to keep the government running. The State Budget Crisis Task Force (2012a) has identified and provided further detail about fund sweeps in Illinois. Also see “Illinois’s Budget Stand-off: Rauner v the Rest,” *Economist*, November 12, 2015, <https://www.economist.com/united-states/2015/11/12/rauner-v-the-rest>; Madeleine Doubek, “Rauner’s Budget-Balancing Claim Doesn’t Come Close to Adding Up,” *PolitiFact Illinois*, March 9, 2017, <https://www.politifact.com/illinois/statements/2017/mar/09/bruce-rauner/rauners-budget-balancing-claim-doesnt-add/>; and Monique Doubek, Kim Geiger, and Hal Dardick, “Rauner Signs Stopgap Budget, School Funding Bill – but Relief from Stalemate Proves Temporary,” *Chicago Tribune*, June 30, 2016, <https://www.chicagotribune.com/news/local/politics/ct-illinois-budget-impasse-madigan-rauner-met-0701-20160630-story.html>.

¹²³ Public Act 96-1500, adopted in 2011, amended many articles throughout the State Finance Act (30 Ill Comp. Stat. 105/) to extend interfund borrowing to 2011. See further discussion in CGFA (2013). In 2016 the state adopted Public Act 99-0523, which amended the State Finance Act to eliminate the requirement for funds to be paid back in 18 months (30 ILCS 105/5k). See discussion in CGFA (2018b).

¹²⁴ Ostro (interview); and Sen. Steans (interview). For examples related to mental health care and institutional closures, see “‘Devastating’ Closure of Mental Health Centers to Hit 10,000 Patients next Mont.,” *Chicago Sun-Times*, June 2016, <https://chicago.suntimes.com/politics/devastating-closure-of-mental-health-centers-to-hit-10000-patients-next-month/>; “Illinois Budget Impasse ‘Destroying’ State’s Mental Health Services, Providers Say,” National Alliance on Mental Illness Illinois, accessed June 28, 2019, <https://namiillinois.org/budget-impasse-destroying-mental-health-services/>; and Matt Egan, “Illinois Budget Crisis Puts Teens with Mental Health Problems at Risk,” *CNN Business*, July 14, 2017, <https://money.cnn.com/2017/07/14/news/economy/illinois-budget-crisis-mental-health-teens/index.html>. For an example related to prison closures, see Becky Schlickerman, “Rauner Prepares to Close State Museums, Shutter Some Prisons to Balance ‘Phony’ Democratic Budget,” *Chicago Sun-Times*, June 24, 2016, <https://chicago.suntimes.com/news/rauner-prepares-to-close-state-museums-shutter-some-prisons-to-balance-phony-democratic-budget/>.

¹²⁵ Sen. Steans (interview).

¹²⁶ Msall (interview).

¹²⁷ New York was one of ten that the Volcker Alliance awarded an A for its budget forecasting practices (Florida and Virginia were also among these states) (Volcker Alliance 2018).

¹²⁸ See “Message from the Comptroller” in OSC (2019a). Projected revenue shortfalls were, in part, due fluctuations in volatile “Wall Street” income and effects from federal TCJA. See also Rachel Silberstein, “Cuomo: State Facing \$2.3 Billion Shortfall,” *Times Union*, February 4, 2019, <https://www.timesunion.com/news/article/State-facing-unexpected-2-3-billion-shortfall-13587646.php>.

¹²⁹ The governor proposed (among other things) a \$632 million sweep from other programmatic funds, a roughly \$500 million reduction in local assistance payments, and \$177 million in cuts to state agency operations. The proposed cuts also included several prison facility closures, Medicaid provider reimbursement rate cuts, and

reduced aid to local governments. See David Lombardo, “Budget Amendments Seek to Close \$2.6 Billion Gap,” *Times Union*, February 15, 2019, <https://www.timesunion.com/news/article/Budget-amendments-propose-cuts-to-health-care-13619588.php>; and Jimmy Vielkind, “Tax Shortfalls Widen New York’s Revenue Gap,” *Wall Street Journal*, February 16, 2019, <https://www.wsj.com/articles/tax-shortfalls-widen-new-yorks-revenue-gap-11550329288>.

¹³⁰ See “Message from the Comptroller” in OSC (2019b).

¹³¹ For example, proposed Medicaid cuts were restored in the enacted budget (DOB 2019a). See also Tom Precious, “Analysis: More Money for Schools, Transit as NY Budget Ritual Nears End,” *Buffalo News*, March 30, 2019, <https://buffalonews.com/2019/03/30/analysis-more-money-for-schools-transit-as-ny-budget-ritual-nears-end/>. The governor’s proposal to cut Aid and Incentives for Municipalities (AIM) for some localities, and to replace that funding with new online sales tax revenue from the county, was included in the enacted budget. The New York State Division of the Budget (DOB) maintains that the increased county sales tax revenue will exceed what is necessary to restore AIM funding to those localities (DOB 2019a), although affected localities have protested that the state is replacing a stable transfer with a potentially volatile new revenue source and largely opposed the cut, as did counties (NYSAC 2019). See David Lombardo, “Hundreds of Localities Facing Direct State Aid Cut,” *Times Union*, January 17, 2019, <https://www.timesunion.com/news/article/Hundreds-of-localities-facing-direct-state-aid-cut-13541286.php>; and Marcus Wolf, “State Supplements AIM Funding Cut with Local Sales Tax Dollars,” *Watertown Daily Times*, April 7, 2019, <http://www.watertowndailytimes.com/article/20190407/NEWS03/190409043>.

¹³² The comptroller and others continue to encourage the state to make more robust deposits in its reserve funds in case of a future recession. See David Friedfel, “NYS Revenues in a Recession,” Citizens Budget Commission (CBC), March 19, 2019, <https://cbcny.org/research/nys-revenues-recession>; and “Message from the Comptroller” in OSC (2019b).

¹³³ For further reading on the strong executive budget model, see Rubin and Meyers (2014).

¹³⁴ Sandra Beattie (DOB), phone interview with authors, April 2017.

¹³⁵ In reference to the statutorily defined concept of federal “mandatory spending” established in the Congressional Budget and Impoundment Control Act of 1974, which defines federal mandatory spending as controlled by laws outside the annual appropriations act. See Levit, Austin, and Stupak (2015).

¹³⁶ Mary Beth Labate (Commission on Independent Colleges & Universities in New York), phone interview with authors, April 2017. See also Joan Gralla and Dan Burns, “New York Cuts Pension Benefits for Public Workers,” *Reuters*, March 15, 2012, <https://www.reuters.com/article/us-newyork-pensions-idUSBRE82E0OF20120315>.

¹³⁷ Beattie (interview); and Labate (interview).

¹³⁸ Any reference to total spending in the New York data discussion refers to total spending from governmental funds spending as reported in the state CAFR from 2000-2015, including spending financed from general, federal, special, and bond revenues that flow into governmental funds. See Boddupalli and Randall (2019) for data documentation.

¹³⁹ See N.Y. Const. art. V, § 7; and N.Y. Retire. & Soc. Sec. Law § 23.

¹⁴⁰ Data are from authors’ analysis. See figures 14 and 15.

¹⁴¹ In part due to enrollment growth; between 2000 and 2012, Medicaid enrollment grew by more than 80 percent in the state (IBO 2013).

¹⁴² For trends across states, see Rudowitz, Hinton, and Antonisse (2018), and for further information on trends in cost containment measures related to service delivery systems, pharmaceutical costs, eligibility limitations, and provider rates, among other factors, see Smith, Ramesh, et al. (2004); and Smith, Gifford, et al. (2014).

- ¹⁴³ See “Medicaid Spending by Enrollment Group.”
- ¹⁴⁴ For data on optional state Medicaid services, eligibility thresholds, and expansion populations, see MACPAC (2017b, 2018a).
- ¹⁴⁵ See “Status of State Medicaid Expansion Decisions: Interactive Map.”
- ¹⁴⁶ For further reading on the difficulties of cutting Medicaid in New York, see, “Medicaid and New York’s Budget,” *New York Times*, February 19, 2011, <https://www.nytimes.com/2011/02/19/opinion/19sat1.html>; and on Medicaid popularity, see Julie Rovner, “Memo To GOP: Cutting Medicaid Is Unpopular, Too,” *National Public Radio*, May 26, 2011, <https://www.npr.org/sections/health-shots/2011/05/26/136689308/memo-to-gop-cutting-medicaid-is-unpopular-too>.
- ¹⁴⁷ In 2015, 76 percent of state Medicaid enrollees were in managed care programs. See “Total Medicaid Managed Care Enrollment.”
- ¹⁴⁸ In 2017, the state also adopted a Medicaid drug spending cap (N.Y. Pub. Health Law § 280). For more information, see Coukell and Reynolds (2018).
- ¹⁴⁹ See the 2011–12 and 2018–19 Medicaid Global Spending Cap reports at “Monthly Global Cap Updates – Current State Fiscal Year (SFY) 2018-2019,” New York State Department of Health, March 2019, https://www.health.ny.gov/health_care/medicaid/regulations/global_cap/monthly/sfy_2018-2019/index.htm.
- ¹⁵⁰ In 2019, the DOB (2019c) forecasted that the total state share of Medicaid disbursements would grow to \$27.7 billion by 2023, while the Global Cap would grow to \$21.2 billion (or 76 percent of total state Medicaid disbursements). This is compared to total state share spending of \$23.3 billion in 2019, and an \$18.7 billion Medicaid Global Cap (roughly 81 percent).
- ¹⁵¹ See 2005 N.Y. Laws, ch 58. For more information, see “Medicaid Cap Update,” Office of the New York State Comptroller, November 2005, <https://www.osc.state.ny.us/localgov/pubs/releases/medicaidcap2.pdf>; and NYSDOH (2010).
- ¹⁵² Beattie (interview); and Labate (interview).
- ¹⁵³ See the N.Y. Retire. & Soc. Sec. Law § 23-a.
- ¹⁵⁴ See the N.Y. Retire. & Soc. Sec. Law § 23-a.
- ¹⁵⁵ See the N.Y. Retire. & Soc. Sec. Law § 23.
- ¹⁵⁶ Labate (interview).
- ¹⁵⁷ See *McDermott v. Regan*, 191 A.D.2d 47 (N.Y. App. Div. 1993).
- ¹⁵⁸ As of 2016, at a 91 percent funded ratio, Pew ranked New York fourth of the fifty states. See “State Retirement Fiscal Health and Funding Discipline: New York,” Pew, September 28, 2018, <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health-and-funding-discipline#/state-profiles/new-york?year=2016>. In 2014, the Urban Institute gave New York an A for “Making Required Contributions” and a B for “Funding Ratio.” See the state’s breakdown table on “The State of Retirement: Grading America’s Public Pension Plans.”
- ¹⁵⁹ See 2010 N.Y. Laws, ch 57; 2013 N.Y. Laws, ch 57; and NYSLRS (2018).
- ¹⁶⁰ See the N.Y. Gen. Mun. Law § 3-c (2011). For a summary of the local property tax cap legislation, see OSC (2011). The state made this cap permanent in the most recent budget. See “Governor Cuomo and Legislative Leaders Announce Agreement On FY 2020 Budget,” Governor’s Press Office, March 31, 2019, <https://www.governor.ny.gov/news/governor-cuomo-and-legislative-leaders-announce-agreement-fy-2020-budget>; and Associated Press, “Cuomo Doubles down on Permanent Property Tax Cap in Budget,” *Times Herald-*

Record, March 14, 2019, <https://www.recordonline.com/news/20190314/cuomo-doubles-down-on-permanent-property-tax-cap-in-budget>.

¹⁶¹ The so-called “Education Budget and Reform Act of 2007,” enacted in the 2007–08 budget, consolidated roughly 30 different aid programs under one funding formula. For further reading, see Friedfel (2016), OSC (2016), and USNY (2013).

¹⁶² Campaign for Fiscal Equity (CFE) refers to a trio of lawsuits brought before the New York Courts between 1995 and 2006. See *Campaign for Fiscal Equity, Inc. v. State*, 8 N.Y.3d 14 (N.Y. 2006).

¹⁶³ See “Ensuring Educational Excellence” in DOB (2007) for further discussion of CFE and its relationship to education reform. Most recently, in a 2017 school finance case, the New York courts determined that the court’s 2006 CFE decision “terminated that litigation” and that “no injunctive relief survives that termination,” clarifying that the state has already taken the actions necessary to satisfy the CFE decision. See *Aristy-Farer v. State*, No. 75 (N.Y. 2017).

¹⁶⁴ See N.Y. Educ. Law § 3602 (2011); and Baker (2011).

¹⁶⁵ See N.Y. Real Prop. Tax Law § 425.

¹⁶⁶ See “New York’s Self-Imposed 2% Spending Cap = Unforced Austerity,” Fiscal Policy Institute, n.d., <http://fiscalspolicy.org/wp-content/uploads/2016/02/Fact-Sheet-2-percent-spending-cap.pdf>; and Noah Kazis, “Is Cuomo’s Spending Cap the Real Threat to Transit Funding?” *Streetsblog NYC* (blog), November 12, 2010, <https://nyc.streetsblog.org/2010/11/12/is-cuomos-spending-cap-the-real-threat-to-transit-funding/>.

¹⁶⁷ See David Friedfel, “When 2 Percent Isn’t 2 Percent,” CBC, *State Budget* (blog), May 30, 2017, <https://cbcny.org/research/when-2-percent-isnt-2-percent>; and David Friedfel, “The State Budget Cap Has Lost Its Meaning,” CBC, *State Budget* (blog), May 29, 2018, <https://cbcny.org/research/state-budget-cap-has-lost-its-meaning>.

¹⁶⁸ See “Cuomo Quietly Breaks His Own Spending Cap,” *New York Post*, May 22, 2017, <https://nypost.com/2017/05/22/cuomo-quietly-breaks-his-own-spending-cap/>; and Friedfel, “The State Budget Cap Has Lost Its Meaning.”

¹⁶⁹ See N.Y. Educ. Law § 355.

¹⁷⁰ Recently, the state has debated whether to expand the scope of its maintenance of effort requirement, with stakeholders articulating that the education system continues to experience salary increases, costs at its public hospitals and health science centers, and the gap between student tuition rates and state financial aid. For further reading, see New York State Assembly Standing Committee on Higher Education (2018).

¹⁷¹ See Jillian Berman, “Report: Nearly 70% of Students Who Applied for New York’s Free College Program Were Rejected,” *MarketWatch*, August 16, 2018, <https://www.marketwatch.com/story/report-nearly-70-of-students-who-applied-for-new-yorks-free-college-program-were-rejected-2018-08-16>; and Melissa Korn, “Strong Demand Leads to Questions About New York Scholarship Program,” *Wall Street Journal*, July 26, 2017, <https://www.wsj.com/articles/demand-exceeds-supply-for-state-funded-suny-and-cuny-scholarships-1501025603>.

¹⁷² Labate (interview).

¹⁷³ Beattie (interview); and Labate (interview).

¹⁷⁴ Beattie (interview).

¹⁷⁵ It received a grade of A from the Volcker Alliance (2018) for its reserve funds. Also see State Budget Crisis Task Force (2012b).

- ¹⁷⁶ Although observers in the state have noted that Governor Rick Perry successfully developed and consolidated the powers of the governorship while in office in Texas between 2000 and 2015. See Ross Ramsey, “A Weak Governor System, With a Strong Governor,” *Texas Tribune*, July 8, 2013, <https://www.texastribune.org/2013/07/08/weak-governor-system-strong-governor/>; and Jonathan Weisman, “In Texas, a Weak Office Becomes Stronger,” *Wall Street Journal*, September 12, 2011, <https://www.wsj.com/articles/SB10001424053111903532804576564741924419026>.
- ¹⁷⁷ Any reference to total spending in the Texas data discussion refers to total spending from governmental funds spending as reported in the state CAFR from 2000-2015, including spending financed from general, federal, special, and bond revenues that flow into governmental funds. See Boddupalli and Randall (2019) for data documentation.
- ¹⁷⁸ Texas has a constitutional obligation to contribute between six and ten percent of payroll toward its pension system. See Tex. Const. art, XVI, § 67, <https://statutes.capitol.texas.gov/Docs/CN/htm/CN.16.htm>.
- ¹⁷⁹ In 2017, the Texas Comptroller of Public Accounts (CPA) reported that the state would have to amend its contribution cap in order to contribute at the state national average (CPA 2017), and in 2019 it reported that the state had already reached its 10 percent cap (Grubbs and Williams 2019).
- ¹⁸⁰ For more information on trends in Medicaid spending Texas, see HHSC (2015). For trends across states, see Rudowitz, Hinton, and Antonisse (2018), and for further information on trends in cost containment measures related to service delivery systems, pharmaceutical costs, eligibility limitations, and provider rates, among other factors, see Smith, Ramesh, et al. (2004); and Smith, Gifford, et al. (2014).
- ¹⁸¹ See “Medicaid Spending by Enrollment Group.”
- ¹⁸² For data on optional state Medicaid services, eligibility thresholds, and expansion populations, see MACPAC (2017b, 2018a).
- ¹⁸³ See “Status of State Medicaid Expansion Decisions: Interactive Map.”
- ¹⁸⁴ In 2015, 83 percent of state Medicaid enrollees were in managed care programs. In 2018, HHSC concluded that the state’s transition to managed care produced between \$5.3 and \$13.9 billion in savings between 2009 and 2017 (HHSC 2018). Also see “Total Medicaid Managed Care Enrollment.”
- ¹⁸⁵ See Elena Mejia Lutz and Edgar Walters, “Texas Moves Forward with Cuts of Therapy Services for Disabled Children,” *Texas Tribune*, November 28, 2016, <https://www.texastribune.org/2016/11/28/texas-quietly-moves-forward-cuts-therapy-services/>.
- ¹⁸⁶ See Tex. Const. art. VII, <https://statutes.capitol.texas.gov/Docs/CN/htm/CN.7.htm>.
- ¹⁸⁷ See Tex. Educ. Code §§ 42.001–42.460, <https://statutes.capitol.texas.gov/Docs/ED/htm/ED.42.htm>.
- ¹⁸⁸ See Kiah Collier, “Texas Supreme Court Rules School Funding System Is Constitutional,” *Texas Tribune*, May 13, 2016, <https://www.texastribune.org/2016/05/13/texas-supreme-court-issues-school-finance-ruling/>.
- ¹⁸⁹ The Texas school finance system is comprised of a series of complex, interacting formulas and inputs. Detailing all changes to these formulas over the course of the last several decades is beyond the scope of this report. While the major components of the Foundation School Program, especially Tier I formulas and adjustments, have remained largely unchanged (Mudrazija et al. 2019), some components have undergone important adjustments (such as in 2006 when the state agreed to compensate school districts for lost revenues as a result of 2006 tax reform. For further reading, see LBB (2016a), CPA (2019), and Villanueva (2013).
- ¹⁹⁰ See Julie Chang, “\$11.5B Texas School Finance Bill Signed into Law,” *Austin American-Statesman*, June 11, 2019, <https://www.statesman.com/news/20190611/115b-texas-school-finance-bill-signed-into-law>; and Aliyya Swaby, “Teacher Raises and All-Day Pre-K: Here’s What’s in the Texas Legislature’s Landmark School Finance

Bill,” *Texas Tribune*, May 24, 2019, <https://www.texastribune.org/2019/05/24/texas-school-finance-bill-here-are-details/>.

¹⁹¹ See Chang, “\$11.5B Texas School Finance Bill Signed into Law;” and Swaby, “Teacher Raises and All-Day Pre-K: Here’s What’s in the Texas Legislature’s Landmark School Finance Bill.”

¹⁹² See Texas Commission on Public School Finance (2018); and Shelly Conlon, “Price of Student Safety,” *Waco Tribune-Herald*, July 9, 2017, https://www.wacotrib.com/news/education/school-leaders-lament-s-funding-formula-as-bus-seat-belt/article_703bdd34-c4fc-5633-bff7-50f5d2fb3fc5.html.

¹⁹³ See Tex. Const. art. III, § 49-g(c), <https://statutes.capitol.texas.gov/Docs/CN/htm/CN.3.htm>; “Proposition 1 Funding,” Texas Department of Transportation (TxDOT), 2019, <https://www.txdot.gov/government/legislative/state-affairs/ballot-proposition.html>; and LBB (2016b).

¹⁹⁴ See Tex. Const. art. VIII, § 7-c, <https://statutes.capitol.texas.gov/Docs/CN/htm/CN.8.htm>; “Proposition 7 Funds,” TxDOT, 2019, <https://www.txdot.gov/government/legislative/state-affairs/ballot-proposition-7.html>; and LBB (2016b).

¹⁹⁵ John O’Brien (University of Texas at Austin), phone interview with authors, April 2017.

¹⁹⁶ See Brandon Formby and Jim Malewitz, “With Money Tight, Texas Budget Writers Eyeing Billions Approved by Voters for Roads,” *Texas Tribune*, February 13, 2017, <https://www.texastribune.org/2017/02/13/texas-lawmakers-prop-7-funding/>; and Edgar Walters, “Budget Compromise Taps Rainy Day Fund, Transportation Funding,” *Texas Tribune*, May 21, 2017, <https://www.texastribune.org/2017/05/21/budget-compromise-taps-rainy-day-fund-transportation-funding/>.

¹⁹⁷ See “Texas Comptroller Glenn Hegar Releases Biennial Revenue Estimate,” news release, CPA, January 7, 2019, <https://comptroller.texas.gov/about/media-center/news/2019/190107-bre.php>.

¹⁹⁸ Phillip Ashley and Rob Coleman (CPA), phone interview with authors, July 2017.

¹⁹⁹ O’Brien (interview).

²⁰⁰ See Tex. Const. art. XVI, § 67, <https://statutes.capitol.texas.gov/Docs/CN/htm/CN.16.htm>.

²⁰¹ The Volcker Alliance gave Texas a grade of D- for its legacy costs, and, in 2016, Pew (2018) ranked Texas’ funded ratio (73 percent) 19th of the 50 states. See “State Retirement Fiscal Health and Funding Discipline: Texas,” Pew, September 28, 2018, <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health-and-funding-discipline#/state-profiles/texas?year=2016>. The Urban Institute assigned the state a grade of C for its funding ratio, but a B for making required contributions. See the state’s breakdown table on “The State of Retirement: Grading America’s Public Pension Plans.” For an annual comparison of actual contributions compared to the actuarially recommended contributions, see the required “Schedule of Employer Contributions” in the Employees Retirement System of Texas (ERS) and Teacher Retirement System of Texas (TRS) CAFRs, accessible at “Reports ERS Operations and Overall Financial Management,” ERS, 2019, <https://ers.texas.gov/About-ERS/Reports-and-Studies/Reports-on-Overall-ERS-Operations-and-Financial-Management>; and “Comprehensive Annual Financial Report Archived Editions,” TRS, accessed May 21, 2019, https://www.trs.texas.gov/Pages/about_archive_cafr.aspx.

²⁰² Ashley and Coleman (interview).

²⁰³ Prior to 1991, most of the accounts that now compose General Revenue–Dedicated funds existed as separate special funds outside the General Revenue Fund. A fund consolidation process initiated in 1991 brought almost 200 special funds into the General Revenue Fund as General Revenue–Dedicated accounts. There is an important distinction between special funds and General Revenue–Dedicated accounts: cash balances in the General Revenue–Dedicated accounts are counted as part of the General Revenue Fund balance in determining the amount of cash available for certification of appropriations from the General Revenue Fund; special fund

account balances do not affect the amount of cash available for certification for the General Revenue Fund. See LBB (2014).

- ²⁰⁴ It has been reported that the state “backs into” a total higher education spending number, and then allocates those funds across public universities using a formula. See Kate McGee, “Looking at Higher Education Funding in Texas—and How We Got Here,” *Alcalde*, January 3, 2019, <https://alcalde.texasexes.org/2019/01/looking-at-higher-education-funding-in-texas-and-how-we-got-here/>; and Chris O’Connell, “TXEXplainer: Formula Funding,” *Alcalde*, March 23, 2015, <https://alcalde.texasexes.org/2015/03/txexplainer-formula-funding/>.
- ²⁰⁵ Texas total governmental funds spending increased by \$42.2 billion in real, inflation-adjusted terms between 2000 and 2015. Authors’ analysis based on literature review, financial reports, key informant interviews, and communications with the CPA and Texas Legislative Budget Board. See Boddupalli and Randall (2019) for technical documentation and state detail.
- ²⁰⁶ Along with Florida and New York, Virginia was one of 10 states that the Volcker Alliance awarded a grade of A for its budget forecasting practices (Volcker Alliance 2018). See also, for example, Stephen Fehr, “Virginia Knows How to Balance Its Budget,” *Trust Magazine (Pew)*, March 5, 2018, <http://magazine.pewtrusts.org/en/archive/winter-2018/virginia-knows-how-to-balance-its-budget>.
- ²⁰⁷ See Michael Martz, “Virginia Revenues up More than \$550 Million for Fiscal Year, Building Reserves,” *Richmond Times-Dispatch*, July 12, 2018, https://www.richmond.com/news/virginia/government-politics/general-assembly/virginia-revenues-up-more-than-million-for-fiscal-year-building/article_f1d09b5b-1c3f-53d9-bc73-d568d1b24400.html; and Laura Vozzella, “The \$1.2 Billion Question in Virginia: Just How Much Money Does the State Have to Spend?” *Washington Post*, December 24, 2018, https://www.washingtonpost.com/local/virginia-politics/the-12-billion-question-in-virginia-just-how-much-money-does-the-state-have-to-spend/2018/12/24/31007d06-046b-11e9-9122-82e98f91ee6f_story.html.
- ²⁰⁸ See Michael Martz, “Virginia’s Medicaid Costs Soar by \$462.5 Million - but Not Because of Expansion,” *Richmond Times-Dispatch*, November 1, 2018, https://www.richmond.com/news/virginia/government-politics/virginia-s-medicaid-costs-soar-by-million---but/article_7049a3bf-4a9a-5a06-965f-17bb74e0076e.html.
- ²⁰⁹ See Michael Martz, “‘We Need to Have More Time,’ Medicaid Director Says in Defense of Forecast,” *Richmond Times-Dispatch*, January 7, 2019, https://www.richmond.com/news/virginia/government-politics/general-assembly/we-need-to-have-more-time-medicaid-director-says-in/article_3a483c61-5772-53f7-9da8-fcf13dc02fc6.html.
- ²¹⁰ See Rob Gurwitt, “The Last One-Term Statehouse,” *Governing*, October 2005, <https://www.governing.com/topics/politics/Last-One-Statehouse.html>.
- ²¹¹ See Martin Auster Muhle, “Why Can Virginia Governors Only Serve One Term? And Should That Change?” *WAMU*, September 28, 2017, <https://wamu.org/story/17/09/28/single-virginia-governors-commonwealth-cant-stand-re-election-change/>; and Fiscal Analytics, Ltd. (n.d.).
- ²¹² Among several pension reforms that Virginia adopted in 2012, the Code of Virginia section 51.1-145 (K1) instructed the General Assembly (GA) to fund employer contribution rates as a share of what was determined by the state actuary. See Va. Code § 51.1-145 (K1), <https://law.lis.virginia.gov/vacode/title51.1/chapter1/section51.1-145/>; and the section on “Statutory Contribution Adjustment” in VRS (2015).
- ²¹³ The Virginia Retirement System (VRS) has reported that strong market returns and the movement toward fully funding its actuarially determined contribution have reduced unfunded liability and improved the plan’s funded status. See “Executive Summary” in VRS (2018a).
- ²¹⁴ Any reference to total spending in the Virginia data discussion refers to total spending from governmental funds spending as reported in the state CAFR from 2000-2015, including spending financed from general, federal,

special, and bond revenues that flow into governmental funds. See Boddupalli and Randall (2019) for data documentation.

²¹⁵ See Alan Suderman, “Medicaid Expansion in Virginia Is Set to Start in the New Year,” *WLSL*, December 31, 2018, <https://www.wsls.com/news/virginia/medicaid-expansion-in-virginia-is-set-to-start-in-the-new-year>.

²¹⁶ See Va. Code § 51.1-145 (K1), <https://law.lis.virginia.gov/vacode/title51.1/chapter1/section51.1-145/>; and the section on “Statutory Contribution Adjustment” in VRS (2015).

²¹⁷ See Michael Martz, “Medicaid Costs to Rise by \$671 Million, but Congress’ Inaction on Children’s Health Insurance Could Cost State Extra \$195 Million,” *Richmond Times-Dispatch*, November 6, 2017, https://www.richmond.com/news/virginia/government-politics/general-assembly/medicaid-costs-to-rise-by-million-but-congress-inaction-on/article_1eb19d97-dfa1-51e5-9c14-e279967c6527.html.

²¹⁸ For more information on trends in Medicaid eligibility determination and spending in Virginia, see JLARC (2015b, 2016). For trends across states, see Rudowitz, Hinton, and Antonisse (2018), and for further information on trends in cost containment measures related to service delivery systems, pharmaceutical costs, eligibility limitations, and provider rates, among other factors, see Smith, Ramesh, et al. (2004); and Smith, Gifford, et al. (2014).

²¹⁹ See “Medicaid Spending by Enrollment Group.”

²²⁰ For data on optional state Medicaid services, eligibility thresholds, and expansion populations, see MACPAC (2017b, 2018a).

²²¹ In 2015, 69 percent of state Medicaid enrollees were in managed care programs. In 2016, the Joint Legislative Audit and Review Commission (JLARC) concluded that the Virginia Department of Medical Assistance Services’ emphasis on managed care enrollment had produced better health outcomes and long-term cost-savings for Virginia, noting that future savings are also possible with improved financial oversight and contractual compliance from Managed Care Organizations (JLARC 2016). See “Total Medicaid Managed Care Enrollment.”

²²² See Martz, “Virginia’s Medicaid Costs Soar by \$462.5 Million - but Not Because of Expansion.”

²²³ See Va. Const. art. VIII, §§ 1-2, <https://law.lis.virginia.gov/constitutionexpand/article8/>.

²²⁴ See Va. Const. art. VIII, §2, <https://law.lis.virginia.gov/constitution/article8/section2/>; and Va. Code § 22.1-253.13, <https://law.lis.virginia.gov/vacode/title22.1/chapter13.2/>. For more information, see “Virginia Standards of Quality,” Virginia Department of Education, <http://www.doe.virginia.gov/boe/quality/>.

²²⁵ Ric Brown (Virginia Secretary of Finance), June Jennings (Virginia Deputy Secretary of Finance), and Dan Timberlake (DPB), phone interview with authors, April 2017. Also see Lou et al. (2018).

²²⁶ Brown, Jennings, and Timberlake (interview).

²²⁷ Jim Regimbal (Fiscal Analytics, Ltd.), phone interview with authors, March 2017. See “Recent Funding Actions” in Virginia Senate Finance Committee (2012, 15); Sean Gorman, “Kitty Boitnott Says Virginia Has Cut \$1.6 Billion from Minimum School Standards,” *Politifact Virginia*, February 7, 2012, <https://www.politifact.com/virginia/statements/2012/feb/07/kitty-boitnott/kitty-boitnott-says-virginia-has-cut-16-billion-mi/>; and Lou et al. (2018).

²²⁸ Also see “Recent Funding Actions” in Dickey (2013).

²²⁹ Regimbal (interview).

²³⁰ The Highway Maintenance and Operating Fund and the Transportation Trust Fund (TTF), the two largest funds within the Commonwealth Transportation Fund, receive state revenue from the sales tax on motor fuels, road tax, aviation fuels tax, state general sales and use tax, motor vehicle sales and use tax, retail sales and use tax, motor vehicle rental tax, license fees, Motor Vehicle Licenses, hybrid fee, International Registration Plan,

recordation tax, and other miscellaneous revenues. TTF revenues are distributed by formula, as defined by the Code of Virginia. See VDOT (2014).

²³¹ See Va. Code § 58.1-638.3, <https://law.lis.virginia.gov/vacode/title58.1/chapter6/section58.1-638.3/>; Bishop-Henchman (2013); and “State Revenue Sources” in Rall (2016).

²³² See Va. Code § 2.2-1514, <https://law.lis.virginia.gov/vacode/title2.2/chapter15/section2.2-1514/>.

²³³ See “Editorial: Put Trust Back in Transportation Trust Fund,” *Free Lance-Star*, March 14, 2018, https://www.fredericksburg.com/opinion/editorials/editorial-put-trust-back-in-transportation-trust-fund/article_eb30f878-a496-50bd-8c6f-813c1b2517a1.html.

²³⁴ Regimbal (interview).

²³⁵ See Va. Code § 58.1-2531, <https://law.lis.virginia.gov/vacode/58.1-2531/>; and Va. Code § 58.1-815.4, <https://law.lis.virginia.gov/vacode/58.1-815.4>.

²³⁶ In 2007, Governor Tim Kaine introduced a budget that diverted transportation funds in the first year of the 2008-2010 biennial budget but restored them in the second year (DPB 2007). Through the enacted budget, the legislature authorized \$180 million in transportation bonds in year two to replace the general funds diverted in year one (Virginia House Appropriations Committee and Senate Finance Committee 2008).

²³⁷ See “Virginia Needs a Lockbox for Transportation Dollars,” *News & Advance*, March 11, 2018, https://www.newsadvance.com/opinion/editorials/virginia-needs-a-lockbox-for-transportation-dollars/article_39dc4d00-23e4-11e8-9fbb-873edb6864ac.html.

²³⁸ The measure would have required that all dedicated revenues to the TTF, the Highway Maintenance and Operating Fund, and other smaller transportation funds be dedicated for specific transportation purposes, and any borrowing from these funds require a two-thirds vote of each legislative chamber accompanied by a four-year repayment schedule. See H.J. Res. 693, Gen. Assemb., Reg. Sess. (Va. 2017).

²³⁹ See H.J. Res. 693, Gen. Assemb., Reg. Sess. (Va. 2017).

²⁴⁰ Constitutional amendments must pass through the GA twice before going to voters for approval. Following the 2017 approval of the measure, the “Transportation Lockbox” bill was rejected by the Virginia Senate Finance Committee (though approved by the house) during the 2018 legislative session. See H.J. Res. 41, Gen. Assemb., Reg. Sess. (Va. 2018).

²⁴¹ Brown, Jennings, and Timberlake (interview).

²⁴² Regimbal (interview)

²⁴³ For further information, refer to the 2015 CAFR (VRS 2015). In 2015, state contributions to the VRS were 80 percent of total state pension system contributions [authors’ calculation from “Required Supplementary Schedule of Employer Contributions” in VRS (2018b)].

²⁴⁴ Authors’ calculations with data from the “Required Supplementary Schedule of Employer Contributions” in VRS (2018b, 119).

²⁴⁵ See Va. Code § 51.1-145 (K1), <https://law.lis.virginia.gov/vacode/title51.1/chapter1/section51.1-145/>. The state achieved 100 percent of its actuarially determined contribution in 2018 [authors’ calculations with data from the “Required Supplementary Schedule of Employer Contributions” in VRS (2018b)].

²⁴⁶ See the state’s breakdown table on “The State of Retirement: Grading America’s Public Pension Plans.”

²⁴⁷ See “State Retirement Fiscal Health and Funding Discipline: Virginia,” Pew, September 28, 2018, <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health->

and-funding-discipline#/state-profiles/virginia?year=2016. The Volcker Alliance awarded the state a D- and C in recent years for its legacy cost practices (Volcker Alliance 2018).

²⁴⁸ See “Personal Property Tax Relief Act (PPTRA) Summary,” Virginia Department of Motor Vehicles, accessed May 6, 2019, <https://www.dmv.virginia.gov/general/#pptr/summary.asp>.

²⁴⁹ See Va. Code § 58.1-3524, <https://law.lis.virginia.gov/vacodepopularnames/personal-property-tax-relief/>.

²⁵⁰ Regimbal (interview). Recent suggestions to eliminate the program have been met with political opposition. See Laura Vozzella, “GOP Claims That Va.’s Car-Tax Relief Is in Danger Are Wrong, McAuliffe’s Office Says,” *Washington Post*, December 12, 2014, https://www.washingtonpost.com/local/virginia-politics/gop-claims-that-vas-car-tax-relief-is-in-danger-are-wrong-mcauliffes-office-says/2014/12/12/8bb4ea94-820f-11e4-8882-03cf08410beb_story.html. JLARC has described the program as contributing to state spending growth (JLARC 2015a).

²⁵¹ Virginia does not conduct an annual tax expenditure study. For more information on Virginia tax expenditures, see “Sales and Use Tax Expenditure Study,” Virginia Tax, Virginia Department of Taxation, 2019, <https://tax.virginia.gov/sales-and-use-tax-expenditure-study/>; and Fiscal Analytics, Ltd. (2017a).

²⁵² In real, inflation-adjusted terms, nearly half of Virginia’s spending growth went toward special funds between 2000 and 2015. In 2015, Special Funds comprised nearly 40 percent of Virginia spending (authors’ analysis of NASBO, *State Expenditure Report* data, 2000-2015, obtained by special request).

²⁵³ Regimbal (interview). Conant (2010) notes that the 2008-2010 budget included percentage cuts to higher education, among other spending items, and according to Mitchell et al. (2018), Virginia’s 2018 higher education funding was 17 percent below its prerecession level.

²⁵⁴ See Travis Fain, “Tangled Web of Dollars Ties Virginia Localities Back to State,” *Daily Press*, April 21, 2015, <https://www.dailypress.com/news/politics/dp-nws-local-budgets-state-aid-20150421-story.html>. The state eliminated the Aid to Localities Reversion account in the 2014-16 budget (Virginia House Appropriations Committee and Senate Finance Committee 2015) amid encouragement from local governments. See, for example, “House and Senate Release Respective Budgets,” Virginia Association of Counties, February 9, 2015, <http://www.vaco.org/house-and-senate-release-respective-budgets/>.

²⁵⁵ Virginia total governmental funds spending increased by \$12.3 billion in real, inflation-adjusted terms between 2000 and 2015 (authors’ analysis using data from the Virginia Department of Accounts and state CAFRs from 2000-2015).

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