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Balancing Budgets and Need during Recessions

California's Safety Net Programs

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California's economic picture is unusually bright now. Unemployment is at multiyear lows and the state's fiscal health is at historically high levels. But history tells us good times will not last forever. Sometime—and according to many forecasters, sometime soon—the nation and the state will go through a recession.

This report considers what a recession would mean for certain key programs within California's social safety net—a vital set of programs that aim to protect the health and wellbeing of the state's most vulnerable residents. Even in the best of times, millions of Californians depend on these programs. When the economy turns down, the need for assistance rises, sometimes substantially. Past downturns have hit state finances hard, forcing painful spending cuts. How then will California be able to balance its budget, as the state constitution requires, while maintaining support for those who need it?

It is helpful to look at the recent past in order to calibrate the difficulties that the state will likely face. California's most recent downturn was the Great Recession of a decade ago, which came on the heels of the nation's worst financial crisis since the Great Depression. During the Great Recession, the share of Californians who were poor grew from 12.2 percent to 16.6 percent, putting pressure on the state's safety net. All told, the three large safety net programs registered $1.9 billion in cuts annually from 2008 to 2012, representing 15 percent of all cuts in state General Fund spending.

This history serves as a guide to what may lie ahead for the state's safety net.

- Using past experience to project trends in the next recession, 500,000 to 1.2 million Californians could fall into poverty during a mild or moderate recession.
- Poverty rates remained elevated for several years after state revenue began to recover, underscoring the necessity of planning for the entire economic cycle, not just the period when the economy is contracting.
- Medi-Cal, the state's Medicaid program and its single largest expenditure when all funds are considered, has expanded dramatically in recent years and now provides health care coverage for millions of low-income families and individuals. Ensuring that it continues to play this critical role while managing increasing health care costs will be a challenge.

It is inevitable that program cuts will have to be considered in a moderate-to-severe recession. Two principles can help to frame spending decisions: (1) Prioritize protecting the most vulnerable Californians—those who are harmed most in economic downturns and depend on multiple safety net programs for basic necessities. (2) Recognize the staggered timing of recessions, revenue shortfalls, and poverty, and aim to restore cuts when revenue is recovering but poverty is still high.

California has one tool in its kitbag that was not there a decade ago—more than $20 billion in reserves set aside to provide a cushion in a budget crisis. These reserves could make safety net cuts insignificant in a mild recession and soften the blow in a severe one.

One important unknown will be the role of the federal government in the next recession. Federal support protected California from far-larger safety net spending reductions during the Great Recession. Today, a contentious national political climate and a soaring federal budget deficit raise questions about the amount of help California will be able to count on when the economy turns down.

Introduction

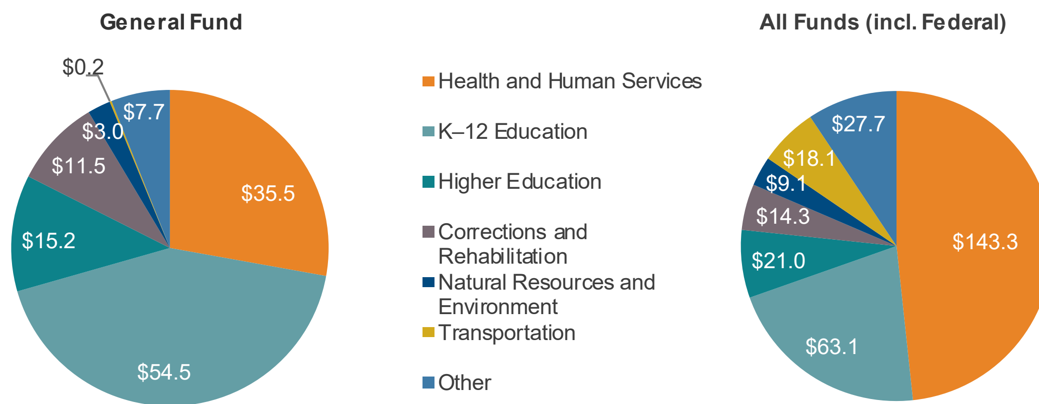
Despite a record period of sustained economic growth, it is reasonable to expect that the US economy will slip into recession in the near future. When that happens, California will see economic activity fall and unemployment rise. State tax revenue will drop and more Californians will turn to the state's safety net programs. The combination of declining revenue and increasing demand for services will put pressure on the state budget, leading to difficult choices.

In an earlier report, PPIC examined the impact different types of recessions may have on the overall state fiscal picture. That report concluded that the state has positioned itself to withstand a mild recession, but a moderate-to-severe recession would represent a considerable challenge (Murphy, Paluch, and Mehlotra, 2019).

This report focuses on four key state safety net programs that rely partly or wholly on state dollars: Medi-Cal; California Work Opportunity and Responsibility to Kids (CalWORKs); Supplemental Security Income/State Supplementary Payment (SSI/SSP), and a relatively new state commitment, the California Earned Income Tax Credit (CalEITC). While these programs differ in terms of their size and the levers available to state policymakers to manage costs, all are aimed at assisting low-income individuals and families.

Two factors motivate a special focus on these programs. First, health and social services account for nearly half of all expenditures (General Fund, special funds, and federal funds combined) and 28 percent of General Fund expenditures (Figure 1). Consequently, when policymakers face a large budget deficit, these programs are likely candidates for cuts. Second, safety net programs tend to be countercyclical—increasing during economic downturns at the same time that money coming into the state treasury is dwindling. Managing lower revenue while continuing to provide essential services to vulnerable populations is challenging.[1]

FIGURE 1
2018-19 budget expenditures (billions of dollars)



SOURCE: Governor's 2018-19 Enacted Budget, June 2018.

NOTES: General Fund expenditures totaled $127 billion. All Fund expenditures, which include special fund, bond fund, and federal dollars, totaled $298 billion.

[1] Keynesian macroeconomic argument holds that pumping money into the economy through safety net programs is appropriate. For the federal government, deficit spending has often been employed as a stimulus in response to recessions. But for a state like California with a balanced budget requirement, deficit spending technically isn't an option.

California's health and social safety net comprises a collection of programs that help low-income individuals and families meet basic needs. These programs move millions of Californians out of poverty according to the California Poverty Measure (Danielson, Thorman, and Bohn 2019). Although the state's contribution to these programs represents a considerable share of General Fund spending, federal and other monies also support them. At the same time, a set of legal and regulatory provisions often restrict the choices policymakers can make in response to a budget crunch.

To clarify the policy dilemma posed by a recession, this report considers the budgetary impact of four programs and analyzes how the need for these services might change in during the next downturn. The report begins by outlining the fiscal scale and scope of these programs, and examines the role that cuts in them played in balancing the state's budget during the Great Recession. We then describe how the increase in poverty the state experienced during that recession raised the need for the programs. Next, we identify two principles for cutting program costs grounded in both the timing of revenue changes and rising poverty and discuss each of the four programs in turn from the perspective of these principles. The report ends by highlighting two major factors in the budget equation that have changed since the last recession: state reserves and the role of the federal government.

Safety Net Programs and Budget Crises

At their core, budgets are a reflection of values and priorities. Recessions represent a tremendous test of those values.

Past Decisions Involved Cuts, but also Other Measures

Although recessions depress state revenues over several years, balancing the budget in a single fiscal year is the first order of business. Therefore, it is important to understand how decisions are made annually to solve immediate budget problems. Consider the annual budget solutions reported by the Legislative Analyst's Office (LAO) from 2008 to 2012, the years that the Great Recession had its biggest impact on state revenue. In absolute terms, spending cuts typically represented under half of the response to budget deficits. Raising additional revenue, securing federal funds, borrowing, and a grab bag of smaller measures made up over half the measures taken to balance the budget in all years except 2009 (Table 1).[2]

[2] In each fiscal year, the LAO reported the revenue, spending, and other actions taken to address the budget deficit. These lists of budget solutions were published as part of the final version of the California Spending Plan, published each fall. The dollars associated with each measure represent the amount that was scored relative to the size of the deficit. In other words, it represented an estimate or agreed-upon value for the measure when the budget was passed.

TABLE 1

Measures taken to address projected budget shortfalls during the Great Recession

	2008	2009	2010	2011	2012
Spending cuts	$10.30 (43%)	$32.67 (55%)	$3.80 (24%)	$10.00 (37%)	$6.22 (38%)
Revenue	3.82 (16%)	12.50 (21%)	3.60 (23%)	13.30 (49%)	5.87 (36%)
Federal	–	8.50 (14%)	6.00 (38%)	–	–
Borrowing	5.01 (21%)	2.40 (4%)	1.90 (12%)	2.80 (10%)	2.18 (13%)
Other measures	4.85 (20%)	3.50 (6%)	0.60 (4%)	1.20 (4%)	2.14 (13%)

SOURCES: LAO California Spending Plan, multiple years, 2008-12.

NOTES: Dollar amounts are in billions and are as reported as they were scored at the time of the passage of that year's budget. The column for 2009 includes changes made to the current year's budget in February as well as the next year's budget passed in June.

On average, the state cut spending to solve about two-fifths of the budget problem in any given year.[3] Raising additional revenues represented 29 percent on average. In 2009 and 2010, federal government assistance accounted for one-quarter of the budget solutions. However, over the entire 2008–12 period, federal dollars accounted for 10 percent of the solutions. Borrowing made up an average of 12 percent annually, and other measures made up 9 percent.

Table 2 separates the spending cuts by program or budget category. Taken together, Medi-Cal, CalWORKs, and SSI/SSP accounted for about 15 percent of total annual spending cuts during the Great Recession. In comparison, reductions in the Proposition 98 guarantee affecting K–12 education and the state's community colleges equaled about one-quarter of spending cuts in a given year.[4]

[3] The figures in Table 1 represent decisions made in a given year. Because California sets budgets annually, the size of the budget problem was estimated before the start of the year and a package of solutions was identified to close the gap. Some solutions might have had implications for subsequent years that are not factored in here. For example, increasing income taxes in 2009 was credited with decreasing the budget problem by $3.7 billion that year. Keeping that increase in place led to increased revenue in subsequent years, thereby reducing the budget deficit. For the purposes here, the budget solution's impact is scored only in the year when the policy was put in place. It is, therefore, not an accounting of the total impact of these choices. It does, however, represent the relative magnitude of the solutions in the year when the budget decision was made.

[4] Proposition 98 determines the minimum level of K–12 funding each year, with projected state revenues playing a major role in the calculations. Generally, when state revenue drops, K–12 expenditures also fall. Of course, as revenue has steadily rebounded during the recovery, K–12 dollars have risen too.

TABLE 2

Magnitude of General Fund spending cuts (dollars in billions)

	2008	2009	2010	2011	2012
HHS					
Medi-Cal	$0.51	$1.92	$0.20	$2.00	$1.19
CalWORKs	0.16	0.78	–	0.80	0.76
SSI/SSP	0.29	0.76	–	0.20	–
IHSS	–	0.42	0.30	0.40	0.05
Other HHS	–	1.10	–	–	–
K–12 education	4.55	14.50	–	0.90	1.89
Higher education	0.37	2.90	–	1.60	0.11
Corrections	0.52	1.40	1.00	0.40	–
Redevelopment	–	1.70	–	–	1.48
Transportation	–	1.60	–	1.10	–
Judiciary	0.19	–	–	0.70	–
Other	3.71	5.60	2.30	1.90	0.74
Total	10.30	32.67	3.80	10.00	6.22

SOURCES: LAO California Spending Plan, multiple years.

NOTES: Dollar amounts are as reported as being scored at the time of the passage of that year's budget. The column for 2009 includes changes made to the current year's budget in February as well as the next year's budget passed in June. Programs in **bold** are discussed in greater detail below.

Relatively smaller cuts to safety net programs are in part due to the large role of federal support. For example, the temporary increase in the Federal Medical Assistance Percentage (FMAP) rate from 50 percent to 61.59 percent starting in July 2009 gave California a higher match rate for Medi-Cal program costs and for administrative costs in several other programs. An influx of federal dollars allowed the state to free general funds for other purposes. But to qualify for the higher match rate, the state could not restrict Medi-Cal eligibility.

Safety Net Program Cuts Would Have Been Larger without Federal Funds

State budget planners typically expect spending to increase continuously even in the absence of policy changes because program costs generally rise. At the same time, revenue is expected to increase as the economy grows. Recessions are a special problem in states like California that are constitutionally required to balance the General Fund budget. When revenue falls, policymakers must make changes to balance the budget.

Not surprisingly, safety net programs make up a substantial part of California's budget-balancing discussions. As Figure 1 indicates, absolute dollar amounts in the state's safety net programs are large, with health and human services programs accounting for $35.5 billion of the General Fund.[5] Nonetheless, safety net spending cuts have historically contributed less to closing budget gaps than this share suggests.

During the Great Recession, state expenditures experienced their greatest year-over-year drop in absolute terms from FY 2007–08 to FY 2008–09. General Fund expenditures fell $12 billion, from $103 billion to $91 billion. Although Health and Human Services made up more than 30 percent of total General Fund expenditures that year,

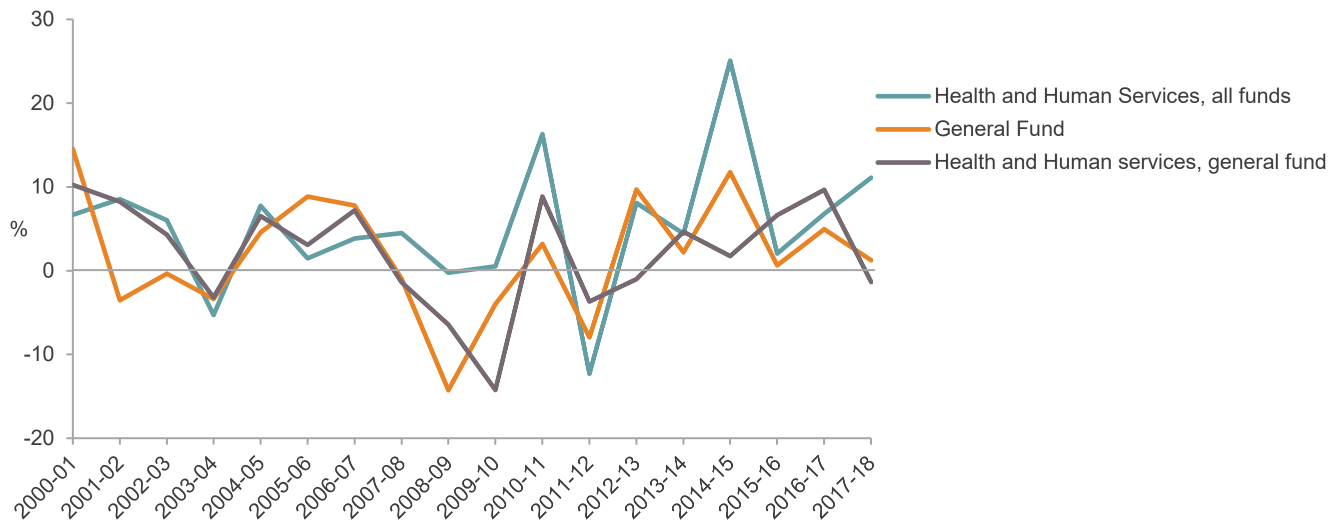
[5]Since the challenge facing policymakers during a recession is to balance the General Fund budget, we do not closely examine the role of special funds. They can be significant for some safety net programs and not others, however.

those programs accounted for only 9 percent of the overall net decline in spending, or $1 billion out of $12 billion. In Health and Human Services, the decline was concentrated in Medi-Cal, which fell $1.4 billion from the previous year. Spending for CalWORKs and other programs within the Department of Social Services rose $0.4 billion—reflecting increased program applications.

Figure 2 shows that an influx of federal funds to health and human services allowed aggregate spending in this area to remain unchanged or increase in most years. Particularly during the Great Recession, when year-over-year changes in both General Fund spending and General Fund spending on health and human services programs were negative, year-over-year changes in health and human services program expenditures from all funds (shown in green) did not fall below zero.

FIGURE 2

Federal funds and requirements protected HHS programs to some extent



SOURCE: California Legislative Analyst Office, California Spending Plan pivot tables, 2017.

NOTES: Year-to-year percentage changes shown in real terms.

The Complex State, County, and Federal Government Partnership

As we have seen, the relationship between safety net programs and the budget goes beyond the General Fund. As Table 3 shows, Medi-Cal expenditures totaled over $100 billion in 2018-19, but the General Fund accounted for only 22 percent of that amount. Federal dollars made up 64 percent and other funds 14 percent. Although the scale of the CalWORKs and SSI/SSP programs is much smaller, the situation is similar. Federal funds are subject to a variety of restrictions limiting how money can be used, or obligating the state to maintain certain funding levels. We discuss these differing constraints as they relate to managing General Fund spending below.

TABLE 3

Safety net programs appropriations by funding source, fiscal year 2018-19 (billions of dollars)

	Federal Funds	State General Funds	County Funds	Other	Total Funds
Medi-Cal	$67.30	$22.97	–	$14.14	$104.40
	(64%)	(22%)		(14%)	(100%)
CalWORKs	$3.12	$0.53	$2.60	$0.25	$6.24
	(50%)	(8%)	(42%)	(<1%)	(100%)
SSI/SSP	$7.14	$2.79	–	–	$9.93
	(72%)	(28%)			(100%)

SOURCES: California Department of Social Services, 2019-20 Local Assistance Estimate; California Department of Health Care Services, May 2019 Medi-Cal Local Assistance Estimate.

NOTE: To facilitate comparison of appropriations across government levels, the figures here draw upon multiple sources and include the appropriation for fiscal year 2018-19. Revised estimates of actual spending may vary. Other category for Medi-Cal includes funds from local government transfers and provider fees. CalWORKs appropriations includes the transfer for Cal Grants. County funds for CalWORKs are mainly state funds directed to counties pursuant to 1991 realignment and SB 85.

Beyond the challenges that come from federal requirements, the Medi-Cal and CalWORKs programs also have complex state and local financing arrangements that further complicate decision-making when programs are considered for cuts. In past budget crises, the state shifted program and fiscal responsibilities for aspects of these programs to counties while providing dedicated revenue streams (sales tax and vehicle license fees) to cover costs (California Legislative Analyst 2018c). Because realigned revenues must remain local funds, this can limit future options to address budget challenges.[6]

Other Safety Net Programs

Several of the largest social safety net programs are funded primarily from federal funds or other sources. These include Unemployment Insurance (UI), the federal Earned Income Tax Credit (EITC), and the Supplemental Nutrition Assistance Program (SNAP), known as CalFresh in California (Danielson 2019). In absolute terms, some of these programs are larger than the three that are the focus of this report and contribute more to keeping Californians out of poverty, according to the California Poverty Measure. However, because the state is responsible for very little or no funding for these programs, we do not consider them here.

Safety net program changes were important in solving annual budget problems during the last recession. However, they did not represent as large a part of the solution as might have been expected given their share of the total budget. In part this was because the need for these programs rises in a recession at the same time that budget cuts may be necessary. The next section examines how the need for safety net services changed during the last economic downturn.

[6] For example, when Medi-Cal expansion resulted in much lower responsibility for county indigent care, the state had to swap between realignment funds to cover other safety net programs such as CalWORKs. In addition, the 2011 public safety realignment contained funding elements that constrain how Medi-Cal pays for specialty mental health.

The Need for Safety Net Programs in the Last Recession

During the Great Recession, poverty in California increased considerably, and continued to grow during the recovery before it began to fall. Examining these trends can help the state assess the need for safety net programs during and after the next recession. Some Californians are chronically poor, but for most people, poverty is cyclical. From time to time, they may fall below the poverty line, but then they bounce back (Huff Stevens 2019). Because earnings are a critical source of economic resources for Californians across the income spectrum, the state of the economy is key in determining whether people are poor. Not surprisingly, when the economy turns down, lost earnings push more families below safety net eligibility thresholds.

The safety net programs considered in this report, as well as the broader set of programs that include nutrition and housing assistance, provide cash benefits and other important resources to eligible low-income families that help them meet basic needs. Because they target people in need, one of the main criteria for receiving benefits is to fall below specified income thresholds, typically measured in terms of the federal poverty level (FPL).[7] Some programs have other eligibility criteria such as the presence of dependent children or a disability—but these factors change little or not at all in recessions.

Even as Revenues Began to Recover, Poverty Kept Rising

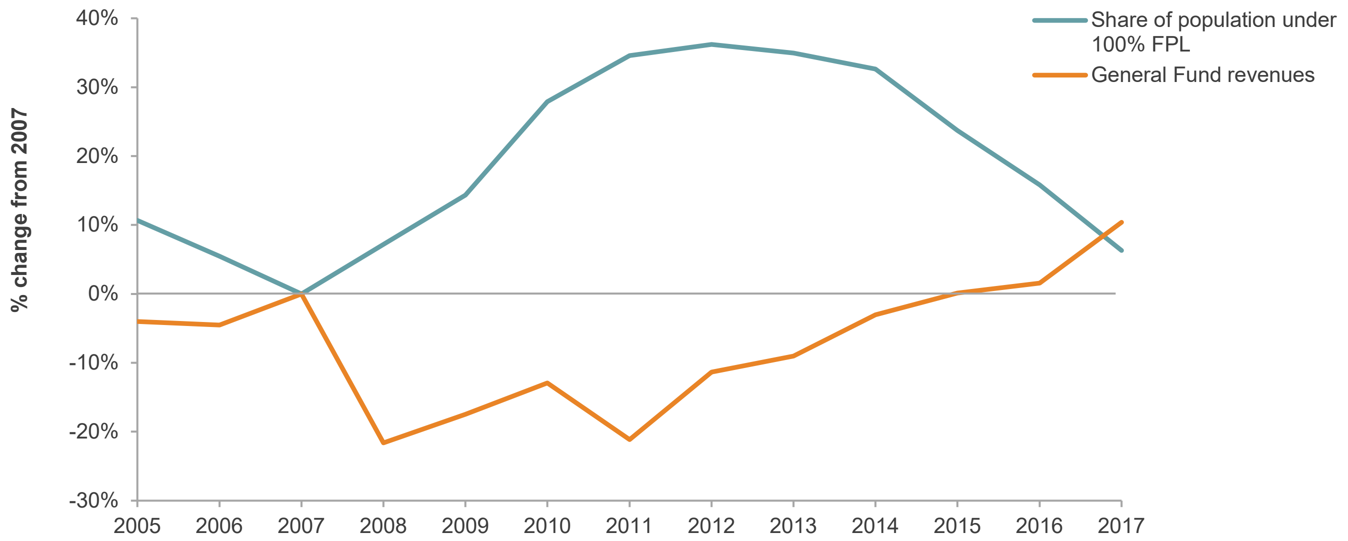
Figure 3 plots changes in General Fund revenue and official poverty rates using 2007 as the base year. State revenues posted their largest year-to-year drop of the past 20 years in 2008—the year the Great Recession started. From 2007 to 2008, General Fund revenue plunged more than 20 percent.

State revenues did not fully recover to pre-recession levels until 2015, but were clearly on an upswing starting in 2012—the same year official poverty rates peaked. Although the state economy was recovering, poverty rates remained above pre-recession levels for several years. This is consistent with the statewide pattern that incomes of families in the bottom 20 percent of the distribution declined the most in recent recessions and took the longest to recover (Bohn and Danielson 2016). It is also consistent with the national trend that involuntary unemployment and underemployment did not return to their prerecession lows until 2018 (Boushey et al. 2019).

[7] Efforts to improve measurement of poverty include the Census Bureau's Supplemental Poverty Measure (SPM) and PPIC's California Poverty Measure produced in collaboration with the Stanford Center on Poverty and Inequality (Bohn, Danielson, and Thorman 2019). These measures consider social safety resources and the cost of housing in family budgets. Because this report focuses on program eligibility—which hinges on the FPL, not the cost-adjusted poverty threshold—we focus on official poverty statistics.

FIGURE 3

The share of Californians falling below the official poverty line remained elevated several years after state revenues recovered



SOURCES: American Community Survey, 1 year PUMS, 2005–17; LAO historical revenue tables 1950–2017.

NOTE: Figure shows percent change from 2007 for the official poverty rate at 100 percent FPL and the inflation-adjusted General Fund revenue.

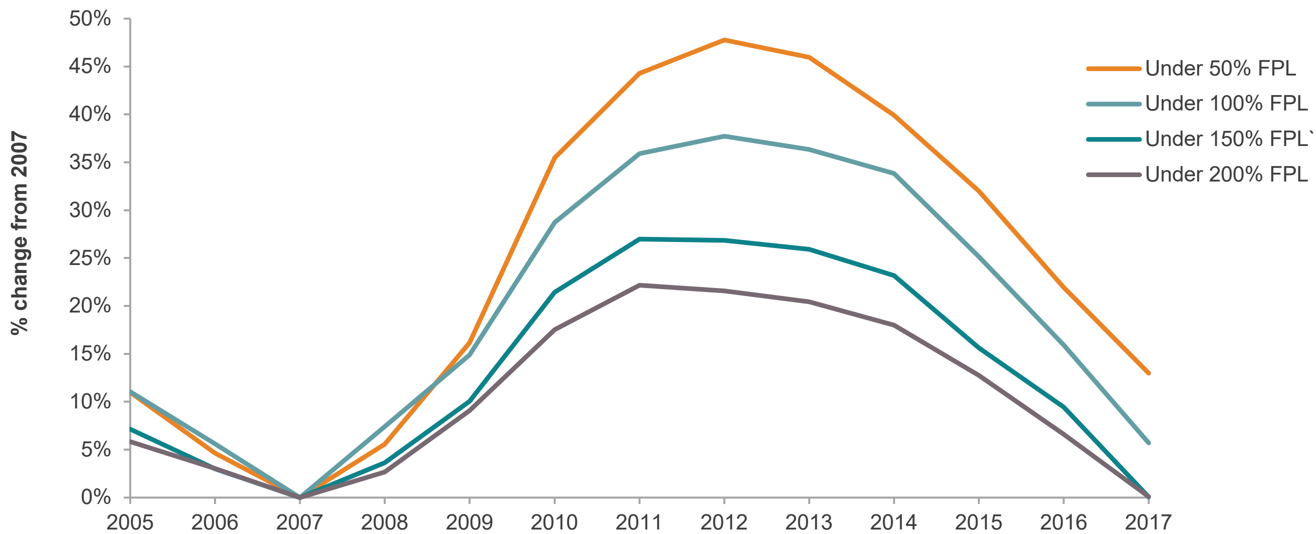
During the Great Recession, those in deep poverty, under 50 percent of FPL, experienced larger increases in official poverty rates than people at somewhat higher income levels (Figure 4). Poverty rates under 50 percent of FPL rose from a low of about 5 percent in 2007 to a high of 7.3 percent in 2012. Overall poverty rates (under 100 percent of FPL) increased from 12.2 percent to 16.6 percent. Official poverty rates for those at slightly higher income levels peaked in 2011 when state General Fund revenue fell again after increasing the previous two years.[8] The share of Californians falling below the near-poor threshold, under 150 percent of FPL, or low income, under 200 percent, increased from 21.8 percent to 27.2 percent and 30.8 percent to 36.9 percent respectively.

In the wake of the Great Recession, deep poverty was the most cyclical category, growing 45 percent while the share of Californians under 100 percent FPL rose 36 percent. At somewhat higher poverty levels, the increases were smaller, between 20 percent and 25 percent. This suggests recovery from economic downturns may be more prolonged for those at the lower end of the income spectrum—which is important when considering how safety net programs should respond during downturns.

[8] This 2011 dip in General Fund revenue was not driven by a reduction in personal income tax receipts, but by lower sales tax and corporate taxes.

FIGURE 4

Californians at lower income levels experienced larger increases in poverty rates during the Great Recession



SOURCE: American Community Survey, 1 year PUMS, 2005–2017 (Ruggles et al. 2019).

NOTE: Figure shows percent change from 2007 for the official poverty rate at various cut-points.

Assessing the Need for Safety Net Programs in the Next Recession

National research finds clear relationships between poverty on the one hand and economic cycles in unemployment rates on the other (Bitler and Hoynes 2016; Meyer et al. 2011). To estimate how many people could become eligible for safety net programs in California during the next recession, we used similar methods as national studies and examined how changes in local unemployment rates affect the share of the population falling below certain poverty thresholds. To assess changes in poverty, we consider solely private sources of income, including wages and salaries, self-employment, investments, and retirement income excluding Social Security (See Technical Appendix B for details).[9] While these poverty thresholds do not directly align with the eligibility limits for particular safety net programs, they are useful approximations.[10]

Our results indicate that poverty rates are quite cyclical in that there is a strong relationship with unemployment rates. A one-percentage-point increase in a county's unemployment rate is associated with a 0.88-percentage-point rise in the share of residents falling below 100 percent of FPL. Increases in unemployment rates lead to smaller percentage-point changes in poverty rates calculated at other poverty cut points, but are similar overall.[11] Figure 5 translates these results into estimates of the potential increase in the number of nonelderly Californians who could fall below these poverty thresholds during a future a mild or moderate recession.

During the Great Recession, the number of Californians who fell below 100 percent of FPL grew by more than 2 million between 2007 and 2011.[12] Fortunately, recessions are not generally so severe. Still, even in a mild

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[9] In contrast, the official poverty metric includes publicly provided cash assistance in family resources, principally Temporary Assistance for Needy Families, SSI, and Social Security. Because we are interested in how eligibility for means-tested programs may change, we excluded those income sources.

[10] Each safety net program has different income eligibility levels and rules for determining how income is counted. FPL ratios serve as rough proxies for income eligibility limits. The deep poverty threshold can be considered a proxy for CalWORKs eligibility, 100 percent FPL as a proxy for SSI/SSP eligibility for adults, 150 percent for Medi-Cal eligibility for adults, and 200 percent of FPL for children's eligibility for SSI/SSP and Medi-Cal.

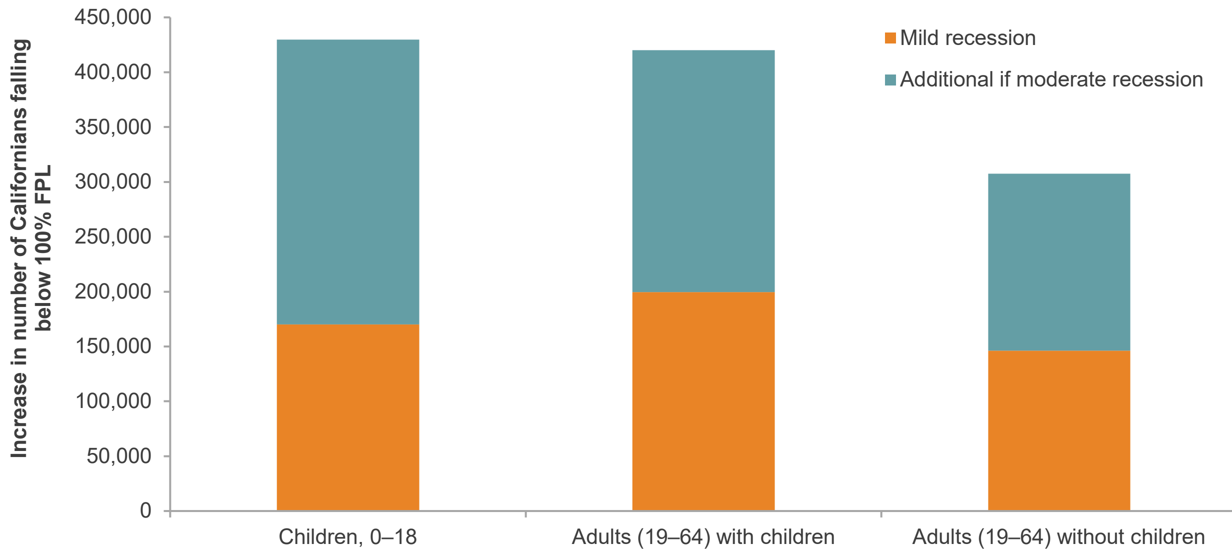
[11] These results use state poverty and local area unemployment rates and are similar to national results, which cover a longer period and capture other recessions. However, we find lower effects of unemployment rates for the share of the population falling below 200 percent of FPL. (See Technical Appendix B.)

[12] Recall we are using a slightly different construct for income than is used for official poverty statistics. According to official poverty measures, the number of Californians falling below 100 percent FPL between 2007 and 2011 was about 1.6 million.

recession, more than 500,000 people— about 170,000 children, 200,000 adults with children in their household, and another 145,000 adults with no children— could drop below 100 percent of FPL (Figure 5). A moderate recession (similar to the early 1990s downturn) could result in an additional 260,000 children, 220,000 adults with children, and 160,000 adults without children falling into poverty.

FIGURE 5

Even a mild recession could translate into hundreds of thousands of additional Californians falling into poverty



SOURCE: American Community Survey, 1 year PUMS, 2005-2017; Federal Reserve Bank of Cleveland, state unemployment rates over time.

NOTES: The figure shows the estimated increase in Californians falling below 100 percent of FPL based on county panel fixed effects regressions under different recession scenarios (from Table B1). The moderate recession scenario is based on the early 1990s recession and uses a 4 percentage point unemployment rate increase to estimate the number of additional people relative to the 2017 population who may fall below 100 percent FPL. The mild scenario is based on the early 2000 dot-com recession and uses an unemployment rate increase of 1.9 percentage points to estimate the number of additional people falling into poverty. See Technical Appendix B for additional details.

These numbers should be viewed as upper-bound estimates of potential increases in the need for safety net programs. Not all people who become income-eligible will enroll. In addition, some people may not qualify because of other eligibility criteria. Only families with dependent children qualify for CalWORKs, many SSI/SSP applicants must demonstrate they have a qualifying disability, and people with other sources of health insurance may not need Medi-Cal coverage.

Scheduled increases in the state minimum wage are another consideration. Medi-Cal estimates for the 2019-20 fiscal year include expected caseload reductions resulting from the January 2020 $13-an-hour state minimum wage increase.[13] However, it is unclear how minimum wage increases will affect labor market demand in future recessions (Bohn and Danielson 2017). Higher wages may keep people from falling below program eligibility levels. But it is also possible that increases could generate more cyclical poverty if employers disproportionately lay off minimum-wage and near-minimum-wage workers when the economy weakens.

[13] While the Department of Health Care Services' estimate of potential Medi-Cal caseload reductions attributable to increased minimum wages is less than 0.5 percent, the absolute number of 45,000 is sizeable relative to the Figure 5 estimates of increases in people falling below poverty thresholds.

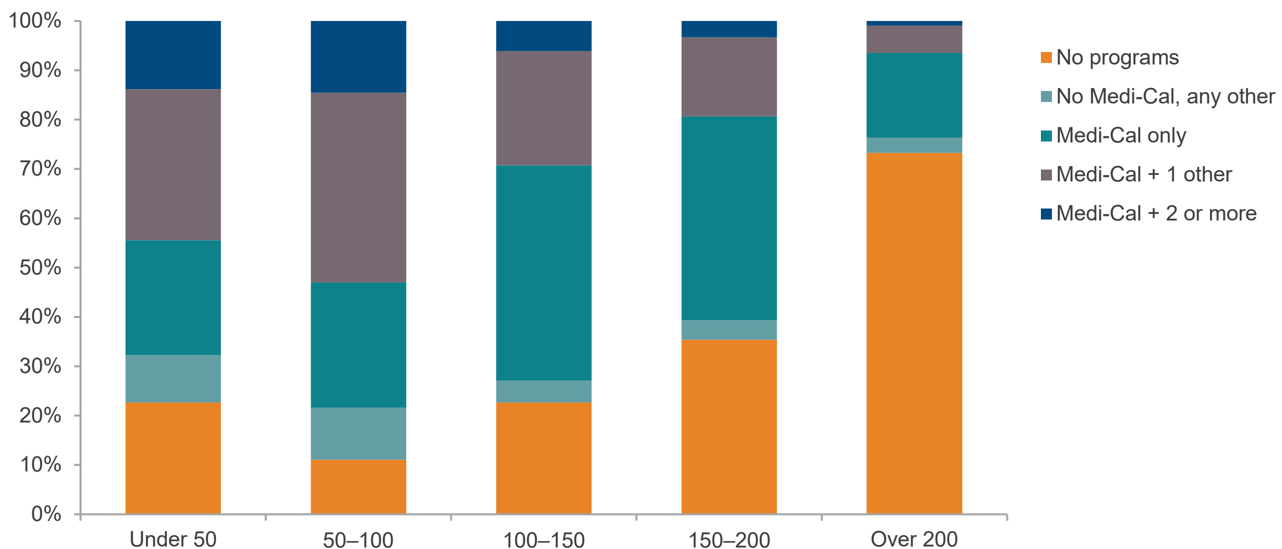
Many Californians Rely on Multiple Safety Net Programs

Many low-income Californians qualify for multiple safety net programs, especially since Medi-Cal expanded under the Affordable Care Act (ACA), dramatically boosting adult eligibility for the program. When cuts are made to safety net programs in budget crises, some people will take more than one hit if multiple programs are cut.

Figure 6 shows family use of Medi-Cal, CalWORKs, SSI/SSP, and the CalEITC.[14] We calculate access at the family level on the assumption that family members share resources. In general, higher shares of lower-income Californians use one or more safety net program, though those in deep poverty use these programs at lower rates that those in the 50–100 percent FPL group, at least partly because the deep-poverty group includes many more people ineligible for key safety net programs. For example, nearly three in ten in deep poverty are single adults not living with children, compared with one in ten in the 50–100 percent group.

FIGURE 6

About half of Californians with very low incomes use Medi-Cal and at least one other key state safety net program



SOURCE: Author calculations from the 2017 American Community Survey augmented for the 2017 California Poverty Measure (CPM).

NOTES: Includes California residents under age 65 for whom poverty status is determined. These figures do not include CalFresh or the federal EITC; including these two programs would increase shares of low-income Californians enrolled in multiple programs.

Effects may be large for more-disadvantaged populations

Recessions may have more-pronounced effects on certain demographic groups. African Americans, Latinos, and Californians at lower education levels have higher unemployment rates and take longer to recover from recessions (Boushey et al. 2019). We examined patterns among racial and ethnic groups and across levels of education in California using statistical models to adjust for county differences and trends over time unrelated to employment. In most cases, this exercise did not show significant differences in sensitivity to increases in the unemployment rate. (See Technical Appendix B).

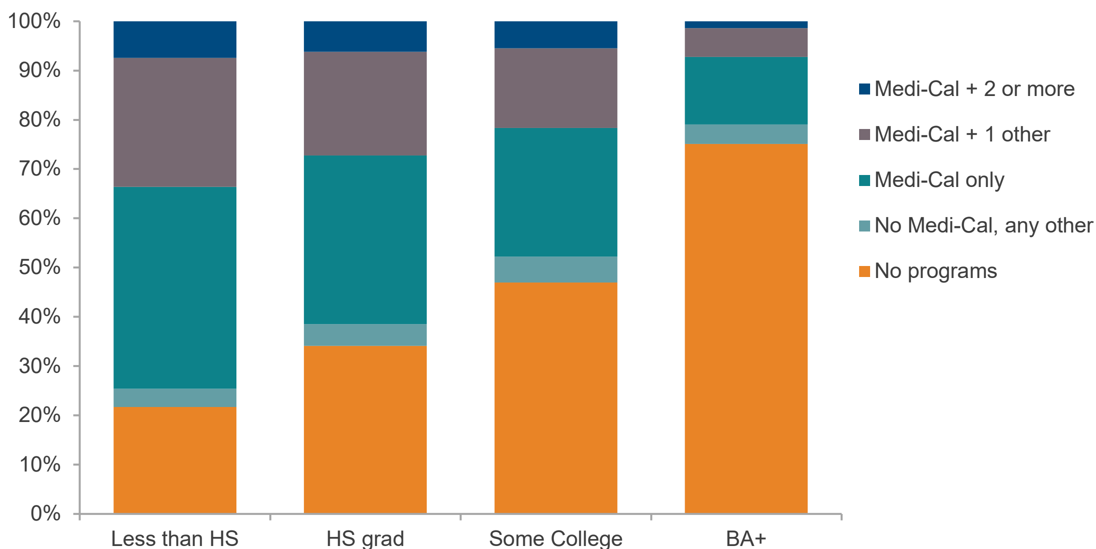
[14] Income categories are based only on private sources including wages, self-employment, and investments, and excludes certain types of cash assistance such as CalWORKs and SSI/SSP. In addition, usage of CalWORKs, SSI/SSP, and CalEITC are based on the California Poverty Measure, which adjusts safety net program participation in the survey data to more accurately reflect administrative program enrollments. Medi-Cal enrollment is not augmented.

Nonetheless, levels of poverty are higher among disadvantaged groups, and thus people of color and those without post-secondary education rely more on safety net programs than whites and those at higher education levels. In 2017, a majority of Californians with a high school education or less were enrolled in at least one of the safety net programs examined in this report. About a third of those with less than a high school degree and more than a quarter of those with a high school education used both Medi-Cal and at least one among SSI/SSP, CalWORKs, and CalEITC (Figure 7).

Similarly, higher shares of African Americans and Latinos relied on one or more safety net programs than whites and Asian Americans (see Technical Appendix B for details). There is also evidence that, during recessions, disadvantaged groups rely less on unemployment insurance as a buffer against poverty and more on safety net programs (Boushey et al. 2019). Thus, cuts to safety net programs affect Latinos, African Americans, and less-educated Californians more than other groups, potentially heightening existing disparities.

FIGURE 7

About a third of Californians with less than a high school education rely on Medi-Cal and at least one other program



SOURCE: Author calculations from the 2017 American Community Survey augmented for the 2017 California Poverty Measure (CPM).

NOTE: These figures do not include CalFresh or the federal EITC; including these two programs would increase shares of low-income Californians enrolled in multiple programs.

Balancing Need and Budgets

During recessions, it will be necessary to accomplish the two competing goals of balancing the budget while also addressing Californians' greater need for assistance. To do that, two principles can guide policy decisions affecting the four key safety net programs examined in this report:

- Protect the most vulnerable.
- Take advantage of the staggered timing of revenue and poverty cycles.

Protect the Most Vulnerable

In the Great Recession, deep poverty rose 45 percent, while levels of less-extreme poverty increased less. Those with less education may face larger increases in poverty during recessions, and they tend to rely on multiple safety net programs. Given that the most vulnerable are most adversely affected by recessions, how can lawmakers protect them?

First, basic grant levels can be buffered from cuts. Further, obstacles to applying and re-applying for programs should be kept low because it is probably harder for those in greatest need to navigate these application processes (Mullainathan and Shafir 2013). Families that cannot navigate the application process, or that drop off a program prematurely, face the complete loss of assistance. Barriers may include a reduced number of entry points, less outreach, or greater information requirements to demonstrate eligibility.

State agencies and departments should improve their understanding of families enrolled in multiple safety net programs in order to know who will be most greatly affected by cuts across programs. CalWORKs and SSI/SSP recipients are also enrolled in Medi-Cal through the application process, but there is currently little information on how many families qualifying for CalWORKs include SSI/SSP recipients and how many in these programs qualify for the CalEITC.

Consider Focusing Resources on Addressing Immediate Needs

One goal of several safety net programs is addressing immediate income needs. In a market economy, these programs act as social insurance, serving those who lack adequate savings, assets, or unemployment insurance benefits (Hacker 2006). While other, longer-range purposes are an important part of the rationale for spending public funds, during a recession the goal of filling family income gaps arguably becomes paramount. Certainly, a recession is a good time to invest in human capital and provide economic stimulus by subsidizing jobs with public funds. Nonetheless, ensuring a basic level of income during a downturn is essential for broader well-being (Duncan and Menestrel, eds. 2019).

Take Advantage of the Staggered Timing of Revenue and Poverty

The cyclicality of state revenues and the counter-cyclicality of poverty poses a major problem for state budgets. The timing and temporary nature of budgetary contraction in California stems in part from our heavy reliance on tax income from the highest earners and capital gains. But this cyclicality also offers opportunities for wise budget planning.

First, falling revenue serves as a warning signal that the state should prepare to address rising poverty and higher safety net program need. Second, when state revenues begin to climb again, poverty levels will still be elevated, but more resources will become available to fund programs. Therefore, when lawmakers consider program reductions necessary, temporary cuts or those that automatically sunset after several years should be considered instead of permanent reductions that require legislation to reverse.[15]

[15] Triggers and sunset provisions exist in reverse. For example, the automatic increases in the minimum wage can be suspended in a recession. The 2019–20 budget restored certain optional Medi-Cal benefits that sunset in 2022.

Safety Net Program Considerations

Policymakers used spending cuts to provide about 40 percent of the budget solutions enacted during the Great Recession. On average, CalWORKs, SSI/SSP, and Medi-Cal represented about 15 percent of those spending cuts. These programs differ in terms of who is served, how caseloads typically change during recessions, and options available for trimming costs.

Medi-Cal

Medi-Cal is the state's Medicaid program, providing comprehensive health insurance coverage to low-income Californians. It is by far the largest safety net program in number of people served and amount of state funding. Medicaid was established in 1965 under Title XIX of the Social Security Act as a joint federal-state program. The federal government sets minimum program standards and provides most funding. States administer the program and have broad flexibility in program design, including determining who is eligible, what benefits are offered, and how services are paid for and delivered. Total Medi-Cal costs in 2018–19 were more than $100 billion, making it the state's largest single program expenditure.

Who the Program Serves

ACA coverage expansions greatly increased the Medi-Cal caseload; program enrollment has increased more than 50 percent (McConville 2019). Families and children make up about half of total enrollment (Table 4). Adults without dependent children or a qualifying disability gained eligibility in 2014 under the ACA expansion and are now the second-largest group. Non-disabled adults and children represent about 80 percent of the total Medi-Cal caseload, though they account for only about 40 percent of program costs. Seniors and people with disabilities compose about 15 percent of the total caseload, but about 60 percent of program costs (Kaiser Family Foundation 2019). About 7 percent of Medi-Cal enrollees are undocumented and eligible only for limited emergency services. In recent years, the state has extended full Medi-Cal benefits to undocumented children. Starting in January 2020, young adults 19 to 25 will also be covered.

TABLE 4

Medi-Cal provides health insurance to over 12 million Californians

Eligibility Groups	Enrollment	State/Federal share
Seniors and disabled	2,009,920	50/50
Parent/caretaker and children	6,204,474	50/50
ACA Optional Adult Expansion	3,434,422	10/90
Undocumented children and young adults (full-scope)	218,801	80/20
Undocumented adults (limited-scope)	568,353	50/50
Other 'state-only' health programs	42,294	100/0*

SOURCES: DHCS Fast Facts, March 2019; SB 75 – Full Scope Medi-Cal for All Children Enrollment from CHHS open data portal; DHCS May 2019 Family Health Local Assistance Estimates; DOF 2019–20 budget summary

NOTE: Enrollment for the first four groups are from March 2019. Estimates of undocumented children and young adults are from SB 75 enrollment trends and the 2019–20 state budget summary, respectively. Other 'state-only' health program enrollment is from the DHCS Local Family Assistance Estimates for FY 18–19. State-federal share represents the standard cost-sharing for these groups. The federal share for certain segments could be higher because of waiver programs or other federal incentives. The state-federal split for full coverage for undocumented children and young adults is based on the budget estimate for undocumented young adults in the 2019–20 budget. The federal government only provides Medi-Cal funding for undocumented immigrants for limited-scope or emergency-only services. Other 'state-only' health programs include the California Children's Services (CCS) program, the Genetically Handicapped Persons Program (GHPP), and Every Woman Counts (EWC), and serve low-income children and adults with special health care needs who do not qualify for Medi-Cal.

In California, income eligibility criteria for several eligibility groups is above the federally required minimum, which means it includes optional components (Finnochio et al. 2019). Moreover, the ACA Medi-Cal expansion to adults is optional, though state costs are buffered during economic downturns because of the higher federal share. Expansion of full-scope Medi-Cal to undocumented children and young adults is also optional and the state receives less federal funding for these groups.[16] However, the estimated cost for these two groups is less than 0.5 percent of overall program expenditures. Other "state-only" programs serve individuals with specific, often-expensive medical conditions who do not qualify for Medi-Cal, likely due to immigration status.

How Caseloads Might Change in a Recession

Because of ACA-related policy changes, it is difficult to use historical trends to project caseloads in future recessions. On one hand, eligibility is much broader than in the past, so Medi-Cal might experience larger enrollment increases when the economy turns down. However, because of Medi-Cal's expansion, the program may already cover many people at the lower end of the income spectrum who could lose jobs or earnings in a recession.

Since peaking in 2016, Medi-Cal caseloads have declined primarily among families and children, consistent with historical trends for this group. A national study simulated how Medicaid enrollment would have changed during the Great Recession if the ACA had been in effect throughout the period between 2005 and 2014. It found that if all states had expanded their Medicaid programs, for every percentage point increase in the unemployment rate, Medicaid enrollment would have increased 0.77 percentage points (Jacobs et al. 2017).[17] This is in line with our estimates of changes in the poverty and near-poverty populations.

Other aspects of the ACA could potentially increase the take-up rate— the share of people who are eligible and choose to enroll in the program— in future recessions. These include the individual mandate, which was repealed by the federal government but reinstated at the state level, simplification of application and income determination, and less stigma as the result of extensive outreach and enrollment campaigns.

Coverage patterns among low-income and part-time workers—the groups most susceptible to insurance loss in economic downturns—have changed considerably in California (Holahan 2011). Since 2014, the share of working adults below 200 percent of FPL who are covered by Medi-Cal has risen to nearly 40 percent (Figure 8). The share of part-time or part-year employed adults on Medi-Cal has also increased.

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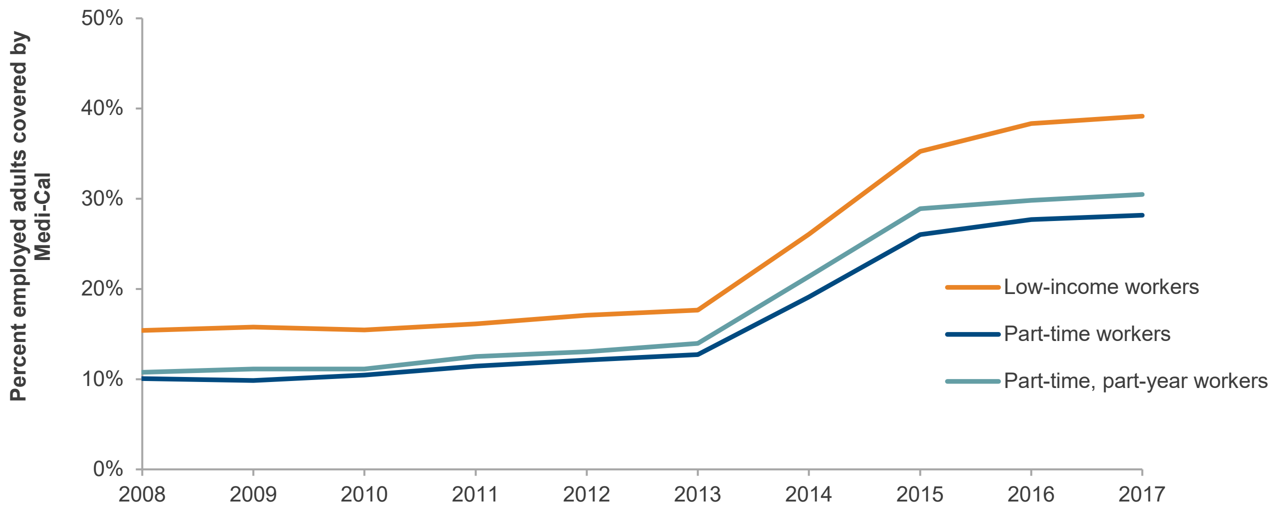
[16] Under federal Medicaid rules, undocumented immigrants are not eligible for federal match except for emergency services, often referred to as limited-scope or emergency-only Medi-Cal. Based on estimates for the state Medi-Cal expansion to undocumented young adults in the 2019–20 state budget, federal funds will make up just over 20 percent of funding to provide full-scope coverage to this group.

[17] This study indicates that, under 2009 rules, eligibility would have increased 1.6 percentage points from 2005–07 to 2010, roughly a third of the increase in the unemployment rate. In contrast, if all states had expanded Medicaid, eligibility rates would have increased 4.0 percentage points, about 77 percent of the increase in the unemployment rate.

FIGURE 8

The share of working Californians covered by Medi-Cal has increased since ACA Medicaid expansion



SOURCE: American Community Survey, 1 year PUMS, 2008 – 17.

NOTE: Figure shows the share of employed adults between 25 and 64 with Medi-Cal coverage.

Options for Reducing Program Costs

Three primary levers are available to reduce Medi-Cal expenditures: (1) reducing the number of people eligible for the program; (2) cutting program benefits; (3) lowering rates paid to service providers and managed care plans.

Reducing eligibility

Over the past 20 years, policymakers have generally not restricted Medi-Cal eligibility in response to budgetary crises (see Technical Appendix Table A1). There have been no direct changes in eligibility criteria in response to past recessionary periods, although there have been increases in reporting requirements, effectively reducing the number of people in the program.

Since the last recession, Medi-Cal eligibility has been extended as a result of the ACA optional adult expansion and the extension of full benefits to undocumented children and young adults. The ACA's expansion to adults is optional, and state costs have been growing for this group. However, since the federal government provides 90 percent of the funding, it shields California from increased program costs for this group. In addition, if the state reduced or eliminated adult eligibility, county indigent care costs would rise and require changes to the complicated state-local fiscal relationship for health programs.

Because the expansion of Medi-Cal to undocumented children and young adults is financed predominantly from the state General Fund, rolling back eligibility for this group will probably be considered if program cuts are required. State-only health programs are also largely funded by state dollars and these represent larger dollar amounts than Medi-Cal expansion to undocumented children and young adults.

However, under the principle of protecting the most vulnerable, the lens shifts from income to health needs, which argues against reducing eligibility for most state-only programs.[18] In addition, strong evidence indicates that expanding Medicaid coverage for children yields significant fiscal benefits, including higher tax payments

[18] The California Children's Services program and the Genetically Handicapped Persons Program serve people with serious health conditions and high medical expenses. The Every Woman Counts program provides breast cancer screening and connections to treatment if necessary.

and lower future reliance on safety net programs (Brown, Kowalski, and Lurie 2019). The young adult expansion could be considered differently in that this group is relatively healthy and may be adequately served by other safety net resources.

Reducing optional benefits

Federal Medicaid rules require state Medicaid programs to provide certain benefits, including physician services and inpatient and outpatient hospital care. Many other benefit categories are optional. California, like many states, provides a range of optional benefits, including outpatient drugs, dental services, and podiatry.

To reduce program costs in past recessions, California cut such optional benefits as adult dental services, chiropractic services, optometry/eyeglasses, speech therapy, and podiatry. The 2019–20 state budget completes the restoration of all optional Medi-Cal benefits pared back during the Great Recession, reauthorizing them for two years before they must be approved again. This illustrates that it often takes several years to restore benefits once they have been cut.

Reducing provider rates

The state sets the rates it pays providers and managed care plans for Medi-Cal services. In past recessions, reducing these payments has been one of the most common ways of cutting program costs. However, California's Medi-Cal reimbursement rates are low relative to other state Medicaid programs and Medicare and cutting them further could limit access to care for beneficiaries. This may be particularly salient because a lawsuit accuses the state of providing California's Latino population—which makes up a majority of Medi-Cal enrollees—inadequate access to care (MALDEF 2019).

Proposition 56 tobacco tax funding, which passed in 2017 and offers a new revenue source for Medi-Cal provider payments, could buffer Medi-Cal provider rates in future downturns. In the 2019–20 budget, the Newsom administration signaled it intends to use Prop 56 only to support provider rates. Tobacco taxes are a declining revenue source and do not represent a permanent way to buttress provider rates, but they might serve as a stopgap during a recession.

California Work Opportunity and Responsibility to Kids

CalWORKs assists some of the state's lowest-income families. Created in 1997 in the wake of the 1996 federal welfare reform legislation that established the Temporary Assistance for Needy Families (TANF) program, CalWORKs provides cash grants and job services to low-income families. CalWORKs is the largest income source for beneficiaries, accounting on average for nearly half of family income (Danielson 2012). At the same time, CalWORKs aims to increase parents' earning power.

Counties run CalWORKs programs under state Department of Social Services (DSS) supervision. The program is funded mainly through a combination of California's federal TANF block grant and realignment funds. The state General Fund and county general funds provide additional support.[19]

Who the Program Serves

Just before the Great Recession, the program served approximately 900,000 children and 230,000 adults. During and after the recession it grew to over 1.1 million children and 335,000 adults. In 2018, the program had dropped

[19] To receive its annual TANF block grant, California must spend a maintenance-of-effort amount, currently $2.9 billion, from state and local funds.

to 820,000 children and 170,000 adults, equivalent to about 8 percent of children and under 1 percent of nonelderly adults in the state receiving CalWORKs on average in a month.

Key program components

CalWORKs is complex, including cash benefits to families, work services and support to adults, and special programs such as home visits and emergency housing. To remain eligible for cash grants, adults generally must be employed or participate in employment-related activities, and eligibility is limited to four years. During the first two years, parents can carry out a wide range of activities to prepare for employment. During the second two years, they are expected to be employed (Davis, Karoly et al. 2016). Parents can be exempt from employment-related requirements under some circumstances, such as caring for a young child. They can also get time-limit extensions. Regardless of parental status, children remain eligible, though family benefits generally decline if an adult becomes ineligible.[20]

How Caseloads Might Change in a Recession

Despite the rise in poverty and deep-poverty rates during recessions, not all of those who become poor will qualify for CalWORKs. Some may instead be eligible for unemployment insurance. In addition, some eligible individuals will have reached their CalWORKs time limit, or will simply not apply.

In the last recession, CalWORKs' caseload grew 41 percent among adults and 26 percent among children. The greater change for adults was probably because children remain eligible even when adults lose eligibility.[21] Chronically poor children can stay on CalWORKs throughout the economic cycle, but chronically poor adults eventually lose eligibility. Both cyclically poor children and adults can qualify for CalWORKs on a more equal basis.

The CalWORKs caseload peaked well after the Great Recession officially ended in June 2009. The number of adult and child beneficiaries did not drop below the pre-recession low until mid-2016 even though program changes had reduced access.

An analysis of how caseloads changed based on the timing and severity of the recession at the county level shows that enrollment rose as child poverty increased, but the size of the caseload increase was not commensurate with rising need for the program as measured by child poverty rates (see Technical Appendix C).[22] Still, CalWORKs responded more than similar cash assistance programs in other states (Bitler and Hoynes 2016).[23]

Options for reducing program costs

The $6.4 billion appropriated for CalWORKs in the 2018–19 budget included $2.8 billion for assistance payments, $1.3 billion for services excluding child care, $228 million for child care, and $672 million for county administration. In addition, since 2012–13, California has used federal TANF money partly to fund the Cal Grants program for low-income college students, amounting to $1.1 billion in 2018–19. This has the effect of freeing up General Fund dollars—that would have been devoted to Cal Grants—for other purposes.

In 2018–19, General Fund appropriations to CalWORKs were only $528 million, reflecting the use of realignment funds for cash grants and flexibility in spending federal TANF block grants. However, any program growth will put pressure on the General Fund because federal funds are capped (California Legislative Analyst 2019b).

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[20] Children can be eligible for CalWORKs grants even if parents or adult caregivers were never eligible, due to documentation status, for example.

[21] The main reasons adults become ineligible are failure to comply with CalWORKs' work requirements or reaching the 48-month time limit.

[22] We found clear evidence that the CalWORKs caseload rose and mixed evidence that program exits dropped as the unemployment rate increased. See Technical Appendix C.

[23] See Legislative Analyst (2019b) for estimates of future CalWORKs caseload increases under several scenarios.

During the last recession, CalWORKs was cut in a variety of ways, including cutting the base grant, foregoing cost of living adjustments, and tightening eligibility requirements (see Technical Appendix Table A2). Benefits were trimmed directly and by reducing the adults' allowed time on CalWORKs from 60 to 48 months, which had the effect of reducing some families' grants. This change disproportionately affected adults who were meeting work requirements, but not earning enough to work their way off of CalWORKs. The 48-month time limit remains in force. The state also exempted families with young children from work requirements for several years, saving funds transferred to counties to provide work services and work-related child care (Davis, Karoly et al. 2016). This exemption helped some parents to avoid sanctions for failing to meet work requirements, thus effectively boosting their families' grants.

These cuts followed in part the principle of addressing immediate need by exempting adults with more intensive family duties from work requirements. However, while the work exemptions were conceived as temporary—and work requirements were reinstated starting in January 2013—grant cuts were permanent, and only in the 2017-18 budget did recipients start to see grant increases. In the next recession, lawmakers might first modify work requirements and exempt smaller amounts of earned income before reducing grants.[24] For any cuts, sunset dates aligned with the expected recovery of state funds could be considered.

Supplemental Security Income/ State Supplementary Payment

SSI is a federal entitlement program established in 1972 for disabled, blind, and elderly low-income individuals with few assets. The federal government sets eligibility requirements, limitations, and disability definitions. California augments federal SSI grants with its SSP program.[25] Decades-old federal law requires states with such programs to maintain minimum supplemental payments or face loss of certain federal Medicaid funds. In 2018–19, General Fund SSP grant outlays totaled $2.8 billion.[26]

Who the Program Serves

In 2017, California had nearly 1.3 million SSI/SSP recipients, including 105,000 children, 576,000 adults between 18 and 64, and 581,000 65 or older. In California, 0.1 percent of children, 2.4 percent of nonelderly adults, and 10.6 percent of elderly adults get SSI/SSP assistance.

How Caseloads Might Change in a Recession

SSI's strict eligibility requirements make the program unavailable to most low-income Californians. However, in a recession, eligible individuals may be more likely to apply because fewer income alternatives are available. National research has found the SSI caseload to be sensitive to the economy in some, but not all, states (Sevak and Bruns 2018). A statistical analysis across California counties based on the dot-com bust and the Great Recession finds evidence that SSI/SSP adult caseloads, but not child caseloads, grew as the unemployment rate rose. (See Technical Appendix C).

Options for Reducing Program Costs

The magnitude of the General Fund commitment to SSP makes it an obvious target for budget cutting. However, if lawmakers want to protect the most vulnerable, across-the-board, permanent SSP cuts should be avoided.

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[24] Federal work rules are a potential constraint. During the last recession, California failed to meet work participation rate requirements for several years, but the state has been able to take steps to avoid most penalties.

[25] In California, when the Social Security Administration finds an individual eligible for SSI, that person is then also eligible for SSP and Medi-Cal.

[26] The federal portion totaled $7 billion.

Temporary cuts with specific sunset dates and raising the rate that SSP grants decline when other household income is available are better options.

During the last recession, savings were achieved by rescinding the statutory cost-of-living adjustment and reducing grants to the federally allowed minimum. SSP savings options are more limited now.[27] (See Table A3 in the technical appendix for additional details.) In 2019, SSP grants are less than 3 percent above the federally required minimum. Cutting them to the minimum would save the General Fund only about $70 million.

Starting in July 2019, SSP recipients became eligible for CalFresh food assistance, which could partly offset any future SSP reductions. That is because, for families not receiving the maximum CalFresh amount, program grants rise when income drops, making up some of the loss.[28]

California Earned Income Tax Credit

CalEITC is a refundable tax credit that boosts the incomes of Californians with low-to-moderate earnings, particularly families with children. Only those with earned income are eligible. Although many CalEITC claimants are also income-eligible for other safety net programs, CalEITC has no effect on those benefits because it is a tax refund instead of a grant. Since its introduction in 2015—well into the state's recovery from the Great Recession—the state has expanded both the eligible population and the total amount refunded. The state estimates the program will cost $1 billion in 2019–20, with about 40 percent coming from the newly added credit for young children (Montiel and Milam 2019).

Who the Program Serves

In 2017, 1.5 million Californians claimed the CalEITC, receiving an average $236 credit (Department of Community Services and Development 2019; Legislative Analyst 2019c). About half the 2017 claimants were adults without dependents, receiving average credits of $76. In previous years, 90 percent of CalEITC dollars went to adults with children. Expansions in 2018 and 2019 have probably further changed the claimant population (Danielson and Thorman 2018; California Legislative Analyst 2019d). The 2019–20 budget anticipates 3 million households will claim the credit in 2020.

Although Californians with earnings up to $30,000 are eligible for the CalEITC, families with the very lowest earnings are a key target population. Policymakers originally designed the CalEITC to complement the federal EITC so that people with earnings too low to qualify for the maximum federal credit could still receive nearly that amount by claiming the state credit. Both credits vary depending on family size. The largest credits are for adults with children and the smallest for single adults.

Between 2017 and 2018, the state made self-employed workers and adults 18 to 24 and over 65 eligible for the CalEITC.[29] As California's minimum wage increases, the state also raised the earnings ceiling to ensure that those collecting full-time, full-year minimum wages qualify. Lifting the CalEITC's earnings limit has expanded its eligible population without changing its focus because people with higher pay receive relatively smaller state credits.

For the 2019 tax year, the CalEITC will raise credits for low-to-moderate earners, with the largest increases going to families with children. California has also created an additional refundable young-child tax credit of up to

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[27] The federal requirement that SSI grants be adjusted annually for cost of living remains in place.

[28] Before 2019, California was the only state to exclude SSI recipients from eligibility for nutrition assistance. Instead, the state provided a $10 supplemental cash out payment to all SSI recipients. SSI/SSP recipients began to gain CalFresh eligibility on June 1, 2019.

[29] Filers with self-employment income are eligible for the federal EITC, but those under 25 or over 65 are not.

$1,000 for claimants with children under six. Because the share of earnings matched by the CalEITC determines the amount of this child credit, this expansion maintains CalEITC's overall focus.

Families that include unauthorized immigrants are ineligible for the CalEITC. (This is also the case with the federal EITC.) In other words, if a parent lacks a valid Social Security number, federal and state EITCs cannot be claimed, even if a child is a US citizen.

How Caseloads Might Change in a Recession

During the Great Recession, the federal EITC was countercyclical for two-parent families, but not for single-parent families, which represent the majority of federal tax credit filers (Bitler, Hoynes, and Kuka 2017). It is unclear what this means for the CalEITC, which targets a lower income range than the federal credit. A two-parent family with both adults working might not become eligible for the CalEITC if a parent loses earnings even though the family might still claim the federal credit. A single adult who experiences a complete loss of earnings cannot get a CalEITC credit, so in a recession, CalEITC claims might drop among this group.

Recent expansions may mean that a high share of eligible people, particularly parents of young children, now claim the credit. If this is true, the change in the number of claimants in a recession would reflect the difference between the number of people whose earnings drop below the maximum and the number of current claimants who lose all earnings. However, if some eligible, very low-income people are not currently filing taxes, economic difficulties due to a recession could bring this group out of the woodwork.

Options for Reducing Program Costs

In the 2019–20 budget, the CalEITC grew to represent a substantial state commitment of an estimated $1 billion in the 2019 tax year.[30] There is no dedicated funding source for the program.[31]

The CalEITC falls into the category of tax expenditures, that is, foregone income tax revenue. However, the CalEITC is directed at low-income tax filers who typically owe no net taxes. Consequently, the General Fund bears the program's cost in the form of tax refunds. The CalEITC was initiated in 2015, well into the state's recovery from the Great Recession, which means there is no program history during a downturn to guide policymaking.

The CalEITC is funded by annual state budget decisions and is not subject to federal requirements. Lawmakers can restructure it any year by a majority vote. One option in a budget crisis would be to take an incremental approach. CalEITC expansions since 2015 demonstrate how costs might be trimmed by shrinking the eligible population. Originally, the CalEITC was available only to the lowest-earning families and it could return to that role in a recession. In addition, the federal EITC's age range could be adopted, or the young-child tax credit could be suspended, though the last option would especially hurt families with children.

Consistent with the principle of protecting the most vulnerable during recession by meeting immediate need, policymakers could consider balancing investments in the CalEITC with investments in programs, such as CalWORKs, whose benefits are not purely contingent on employment. The credit can play an important role in boosting disposable income for low-earning families during recessions and in encouraging work during recoveries. Nonetheless, the CalEITC does nothing to fill the income gap created by job loss.

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[30] The federal EITC is a much larger program. In the 2018 tax year, 2.8 million California tax filers received about $6.6 billion through the federal EITC. However, unlike the other safety net programs discussed in this report, the federal program operates parallel with the state program.

[31] The budget legislation cited changes made to the state's corporate tax law that conformed to earlier federal tax law modifications as the source of the offset for the expansion of the state EITC.

Managing the Safety Net in Future Recessions

Although we know a recession will hit the state at some point, much is unknown, which makes discussion of future policy decisions difficult. We do know that significant changes in California's budget situation position the state differently than before the Great Recession. Among the most substantial changes are (1) California's buildup of substantial reserves and (2) potential constraints stemming from federal fiscal policy.

Reserves

Proposition 2, approved in 2014, created the Budget Stabilization Account (BSA), also known as the rainy day fund, funded by setting aside both a portion of General Fund revenues as well as capital gains revenues above a certain threshold.[32] The account reached $19.6 billion in 2019. To withdraw funds from the BSA, the governor must declare a budget emergency (as defined by Proposition 2). In addition to the BSA, California also has other reserve funds to augment its preparation against deficits. As part of the 2018–19 Budget Act, the legislature created a new reserve with a CalWORKs and Medi-Cal subaccount, the Safety Net Reserve Fund.

In prior years, the question was not whether safety net programs would be cut, but how much. The presence of reserves introduces another dimension into budget deliberations, raising the question of what portion of reserves should be used to offset safety net cuts. During the Great Recession, reductions represented about 45 percent of budget solutions. Medi-Cal, CalWORKs, and SSI/SSP absorbed about 15 percent of total cuts, or $9.6 billion. The current level of reserves earmarked for social safety net services represents $900 million. That amount alone could offset some of the cuts made in the past, but it would be exhausted quickly in a moderate to severe recession. Following are hypothetical examples of policy choices for using the safety net reserve:

- The state portion of the SSI/SSP grant above the federal minimum totals $70 million. Reserves could easily be used over several years to avoid trimming to that level.
- The allocation for CalWORKs child care services is $228 million, and the 2019–20 budget included an increase to the base CalWORKs grant that is estimated to cost $442 million. The safety net reserve could either offset cuts to child care for more than three years or avoid rolling back the recent grant increase for two years.
- The recent decision to extend Medi-Cal coverage to undocumented adults up to age 26 is estimated to cost about $100 million ($75 million General Fund) in the first year. The safety net reserve could protect that extension from cuts during a recession. But if safety net reserves were used for that, they would not be available to cover other benefits restored in recent years, such as payments to providers and dental services, and other benefits the federal government considers optional.
- The most recent budget expanded eligibility for the CalEITC, adding an estimated $600 million to the estimated cost of the program. In a recession, the safety net reserve could temporarily maintain eligibility, but funds would not last for two full years.

Some portion of the rainy day fund ($19.6 billion in 2019) could also be drawn on to offset safety net program cuts. However, safety net programs would have to compete for scarce dollars with K–12 and higher education, corrections, and other programs. For example, earlier PPIC work estimated that the reduction to the K–12 funding guarantee would fall as much as $8–15 billion a year below projected levels during a moderate or severe recession, which would significantly strain reserves (Murphy, Paluch, and Mehlotra 2019).

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[32]Proposition 2 requires annual transfers into the BSA until it reaches a threshold of 10 percent of General Fund tax revenue. According to Proposition 2, any funds in excess of the 10 percent threshold must be spent on infrastructure (California Legislative Analyst 2019a). The proposition also includes a provision that makes it possible to set aside savings for future education spending. Higher-than-average capital gains tax receipts could fund the Public School System Stabilization Account (PSSSA), although the rules governing this are tied as well to both the Proposition 98 tests and the level of reserves held by local districts.

The safety net reserve and the rainy day fund represent important changes in California's finances. Nevertheless, policymakers will still face difficult choices. In a recession, the state will need to plan how to allocate those reserves over multiple years. Protecting reserve funds is critical and building them further is advisable.

Regardless of severity, any recession will depress state revenue for multiple years. Having a multi-year reserve use plan is sensible. Any plan must ensure the state will be able to support safety net programs late in the recession cycle, when state revenue has begun to recover, but when poverty remains relatively high. It is appropriate to view reserves as a way to mitigate the effects of cuts on the most vulnerable early in a recession and bridge the period between the downturn's initial impact and the beginning of recovery of state revenue.

The Federal Role

Perhaps the biggest dollar factor is the one the state controls the least—federal spending. Certainly the state must maintain certain spending levels in Medi-Cal, CalWORKs and SSI/SSP in order to trigger federal funds flowing to the state.

Beyond the baseline agreements, how much the federal government spends in a recession to help states support safety net programs is a choice made in Washington, DC, not Sacramento. During the Great Recession, the $14.5 billion in federal funds California received accounted for a significant share of state budget fixes. During the two years the federal government provided that support, the state cut health and human services programs by a total of $5.5 billion. Without federal money, the state would have had to go much further in reducing benefits for some Californians and eliminating them entirely for others.

Today, it is risky to depend on the federal government to step in. At the national level, the political and the fiscal pictures have changed dramatically, making it hard to predict what California might expect from Washington in the next recession.[33]

Conclusion

To support vulnerable Californians, the state has assembled a robust safety net providing a number of different payments and services. During recessions, these programs face great stress. Demand for assistance rises, driving up enrollment and expenditures at the same time falling revenue creates pressure to cut spending.

During the Great Recession, policymakers cut safety net programs significantly. If the next downturn is moderate or severe, cutbacks will undoubtedly be part of the package the state puts together to balance the budget. Our examination of specific programs reveals that each presents different options, often limited by federal restrictions or prior state-level decisions. Nonetheless, policymakers should bear in mind protecting access for the most needy within—and across—programs.

The arc of the recession cycle also matters. When employment is falling, state revenue falls and poverty rises. When economic growth picks up, revenue rebounds. However, our findings suggest that poverty levels lag the economic recovery. In other words, during the period when California's coffers begin to fill again, poverty levels

[33]Regardless of the outcome of the 2020 elections, the ratio of total federal debt to GDP has risen dramatically since the Great Recession. The 2017 tax cuts are projected to increase the debt load further. At this point in the economic cycle, the debt-to-GDP ratio would have been expected to fall. When the next recession hits, the federal government may not be in a position to increase deficit spending to the level that would provide substantial relief to the states.

remain relatively high. Budget policy should be tailored to this predictable cycle, using triggers and sunset provisions to sync with the state's shifting finances, balance the budget, and meet the needs of Californians.

Other elements of the budget balancing equation have changed since the last recession. The programs themselves have undergone a number of changes. Medi-Cal in particular has grown dramatically since 2014. Federal budgetary strains raise questions about Washington's ability to support states. At the same time, the state has amassed unprecedented reserves, which will help avoid some safety net cuts.

There are many uncertainties. We do not know when a recession will take place or how severe it will be. And we do not know what policies will emerge from the nation's capital. What we do know is that California will face hard choices in taking care of those in need. To make those choices easier, it is essential to plan ahead. The drawdown of reserve funds should be viewed from a multi-year perspective, acknowledging that the fall in the number of state residents living in poverty will lag the speed at which state revenues will rebound.

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