CALIFORNIA BUDGET PROJECT

# BUDGET WATCH

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## REVENUES UP $12.3 BILLION OVER JANUARY FORECAST; EDUCATION, TRANSPORTATION BIG WINNERS

On May 15, Governor Gray Davis released the May Revision to his 2000-01 Budget. The May Revision includes a striking upward increase in projected revenues of $5.764 billion in the current (1999-00) and $6.555 billion in the budget (2000-01) years, for a total of $12.319 billion. The Governor's proposals spend $7.2 billion on one-time expenditures, with the largest amounts going toward transportation ($1.96 billion), tax relief ($1.9 billion), and K-14 education ($1.5 billion). The Governor allocates $5.1 billion to ongoing spending, including K-14 education ($2.4 billion), health and human service programs ($1.1 billion), and tax relief ($0.6 billion).

The significant share of resources dedicated to one-time spending reflects concern over the state's fiscal future. Two major concerns include the large share of additional revenues attributable to non-wage income (such as capital gains and stock options), which is relatively volatile; and the need to save room in the budget for additional Vehicle License Fee reductions scheduled to take effect beginning in 2001-02. The Governor's May proposal includes a $1.8 billion reserve and set-asides for legal contingencies ($500 million) and legislative initiatives ($200 million).

**How Does the Governor Allocate the Additional Revenues?** (Dollars in Billions)

| | One-Time | Ongoing | Total |
|---|---|---|---|
| K-14 Education | $1.5 | $2.4 | $3.9 |
| Tax Relief | 1.9 | 0.6 | 2.5 |
| Transportation | 1.5 | 0.4 | 1.9 |
| Health & Human Services | 0.1 | 1.1 | 1.2 |
| Reserve & Set-asides | 0.6 | | 0.6 |
| Housing | 0.5 | 0.1 | 0.6 |
| All Other | 1.1 | 0.5 | 1.6 |
| TOTAL | $7.2 | $5.1 | $12.3 |

Source: Legislative Analyst's Office

### Spending Limit Exceeded for 1999-00

The additional revenue growth makes it very likely that in 1999-00 the state will exceed the spending limit established in 1979 for only the second time. (For more information on the state spending limit, see *Will California Hit the "Gann" Limit?* on the CBP web site at www.cbp.org/qhits/index1.html.) If the state exceeds the State Appropriations Limit (SAL) in two consecutive years, amounts in excess of the limit must be divided evenly between education and tax reductions or rebates. The significant amount of spending for purposes excluded from the SAL in the May Revision, specifically capital outlay expenditures and the one-time tax rebates, lessens the likelihood that the state will exceed the limit in 2000-01.

### Proposed Rebate Gives Nothing to 40 Percent of the State's Families

The Governor proposes to give one-time rebates of up to $150 for single taxpayers and $300 for married couples. The Governor's proposal will cost $1.76 billion in 2000-01. Due to the fact that only families that paid personal income taxes in 1999 would be eligible for the rebate, a significant fraction of the state's families would not benefit from the Governor's proposal:

- Four out of ten (41 percent) California families will not receive the Governor's proposed rebate, an estimated 5.6 million families and individuals.

- Half of California's families with children will not receive the Governor's proposed rebate, an estimated 2.36 million families.
- While virtually all of the state's wealthiest households would receive a rebate, only 59 percent of middle income families would receive a rebate and only 26 percent of middle income families with children would receive a rebate.
- None of the state's poorest families with children would receive a rebate. Only one percent of families with children in the second poorest fifth of families would receive a rebate.
- Poor families are excluded from the rebate despite the fact that the poorest fifth of California households pay the largest share of their income in state and local taxes.

The Senate Budget includes a $1.4 billion sales tax rebate of a yet to be determined amount that would go to taxpayers regardless of whether they have an income tax liability. Unlike the Governor's proposal, the Senate proposal would be permanent. The Assembly Budget assumes $2.6 billion in unspecified tax relief and a $100 million increase in the Low Income Housing Tax Credit.

The Governor's other major tax proposal, a permanent exclusion of teachers' earnings from the state personal income tax, met with significant bipartisan criticism. Critics note that the Governor's proposal would provide vastly disparate benefits to teachers earning the same salary based on whether they are married, the earnings of their spouse, and whether they itemize their deductions. The Governor's proposal could lead to greater revenue losses if police, firefighters, and other groups of workers press for similar treatment.

A separate conference committee will be convened to consider budget-related tax issues.

## May Revision Details

***Education.*** The May Revision includes $3.7 billion in funding for K-12 education above the Governor's January Budget proposal. Significant increases include repayment of cost-of-living increases deferred in the early 1990s ("deficit reduction," $1.84 billion), one-time technology grants ($402 million), and teacher performance bonuses ($500 million). The May Revision also includes an increase of $230 million in funding for California Community Colleges. Both the Senate and Assembly allocate significantly more funding to K-12 education and community colleges. The May Revision continues a reserve for litigation costs, but includes no provision for settling outstanding litigation between the state and local schools districts over funding for special education costs. The Commission on State Mandates is likely to rule on school districts' claims in the near future, barring a negotiated settlement.

***Child care.*** Contrary to expectations, the May

**Who Would Benefit from the Governor's Proposed Tax Rebate?**

| 1999 Income Group | All | Lowest 20% | Second 20% | Middle 20% | Fourth 20% | Next 15% | Next 4% | Top 1% |
|---|---|---|---|---|---|---|---|---|
| Income Range | | Less Than $15,000 | $15,000 - $26,000 | $26,000 - $42,000 | $42,000 - $70,000 | $70,000 - $145,000 | $145,000 - $514,000 | $514,000 or More |
| Average Income in Group | $57,600 | $9,000 | $20,300 | $33,600 | $54,400 | $96,600 | $209,300 | $975,600 |
| Percentage of All Families & Individuals Receiving Tax Cut | 59% | 16% | 43% | 59% | 86% | 97% | 98% | 100% |
| Percentage of Families with Children Receiving Tax Cut | 50% | 0% | 1% | 26% | 78% | 96% | 99% | 100% |

Source: Institute on Taxation and Economic Policy, May 15, 2000. Based on non-refundable rebate of $150 for single filers and $300 for married taxpayers and heads of households.

Revision does not include a major child care policy initiative. As part of his January Budget, the Governor initiated a review of the state's subsidized child care system aimed at developing a set of policy recommendations for inclusion in the 2000-01 budget. The Governor announced that the absence of a proposal was due to "a lack of data needed to model policy options." The Governor's comment highlights ongoing problems with the lack of basic information regarding state child care programs. Several child care issues remain to be resolved by Assembly and Senate Budget conferees, including:

- Allocation of funds between the CalWORKs child care reserve and Stage 2. The Senate and Assembly allocate more funding to Stage 2, while the Governor's May Revision shifts $69 million from Stage 2 to the reserve.
- Funding for general state child care programs. The Senate and Assembly each augment the Governor's proposed spending levels, although by differing amounts.
- Restoration of the cost-of-living allowances for center-based programs to compensate for several years in which cost-of-living adjustments (COLAs) were not provided. Neither the Assembly nor Governor provides funding to restore the COLAs.
- Funding for child care salaries. The Assembly allocates $6 million to establish a child care salary and retention incentive program. Neither the Senate nor Governor provides additional funds.

***Health care.*** The May Revision includes several significant augmentations to health programs, including $59.2 million for coverage of all children eligible for the Healthy Families Program, $115 million to reflect higher caseloads attributable to elimination of quarterly eligibility reporting for families receiving Medi-Cal, and $0.8 million to extend Medi-Cal coverage to youths formerly in foster care. The Governor increases the income eligibility standard for "no cost" Medi-Cal for elderly, blind, and disabled individuals to 100 percent of the federal poverty threshold, while both the Senate and Assembly increase the limit to 133 percent of the poverty threshold.

***CalWORKs.*** The May Revision reflects a continued decline in CalWORKs caseloads and a lower than previously estimated COLA due to lower than previously forecast inflation. These factors combine to reduce proposed spending for cash assistance by $170.5 million in 2000-01. Total spending for programs subject to the federal Temporary Assistance for Needy Families (TANF) maintenance of effort (MOE) requirement will meet, but not exceed, the minimum federal requirement. Significant policy issues pending in the budget include:

- The treatment of performance incentive funds previously earned by counties. The Governor places these funds in a reserve, while both the Senate and Assembly appropriate a portion of the incentives earned to date directly to counties.
- Whether to expand the definition of "needy families." Federal regulations allow TANF and maintenance of effort funds to be spent for families with incomes higher than current CalWORKs limits. The Senate and Assembly Budgets give counties the flexibility to use performance incentive funds to provide services to the working poor, while the Governor's proposal adopts a more restrictive standard.
- The Senate and Assembly Budgets exempt wages paid to participants in wage-based community service programs from the current earned income disregard and establishes, instead, a $50 per month work allowance for families participating in community service. This proposal is designed to remedy a conflict in existing law that resulted in higher grant payments for community service participants than for individuals in unsubsidized work with comparable earnings.

***Other Social Service issues.*** As part of his "Aging with Dignity" initiative, the Governor allocates $100 million for the first phase of a multi-year program to provide increased wages and benefits for In Home Supportive Services (IHSS) workers. The Governor's proposal increases wages for homecare workers to $11.50 per hour over five years and allocates $34 million to purchase health coverage. The IHSS program provides in-home care to low income elderly and disabled individuals.

The May Revision does not extend eligibility for the California Food Assistance Program (CFAP) or the Cash Assistance for Immigrants Program (CAPI) for immigrants who entered the U.S. after August 22, 1996. The CFAP and CAPI programs are state-funded programs that replace benefits lost to legal immigrants as a result of federal welfare reform. Both the Senate and Assembly Budgets extend CFAP and CAPI eligibility.

***Housing.*** The May Revision includes $300 million in budget year funds for housing and $200 million to provide grants to local governments that increase the number of building permits issued. Of this amount, $39.4 million is intended for ongoing program enhancements. Increases include $150 million for programs designed to boost homeownership; $97.4 million for multifamily rental housing programs; $10 million for farmworker housing; and $42.6 million for housing for "special needs" populations, including $17 million for homeless shelter development and operations and $20 million for supportive housing construction. Both the Senate and Assembly Budgets include significantly higher funding levels for housing, particularly multifamily housing.

***Local Government.*** The Governor's May Revision includes $250 million in one-time funds for cities and counties. The Assembly Budget includes the Governor's proposal, while the Senate Budget provides $650 million. All three proposals allocate half the available funds on a per capita basis and half based on jurisdictions' property tax loss during the early 1990s. Other major proposals include a $55 million reduction in the administrative fee paid by public hospitals as part of the Disproportionate Share Hospital program, $400 million in one-time funds for deferred maintenance of local roads and streets, and $125 million for cleanup and development of urban brownfields.

A legislative conference committee began meeting in May to consider proposals to reform the fiscal relationship between the state and local governments. The conference committee, co-chaired by Assemblymember Dion Aroner and Senator Steve Peace, is considering proposals ranging from the constitutional protection of local revenues to revising the system used to assess commercial property to a state assumption of costs for county "safety net" programs. The conference committee is not expected to complete its deliberations prior to passage of the budget and may hold hearings around the state during the month of July.

***Mental Health.*** The May Revision includes an additional $101 million in state funds for mental health programs, including $35.6 million to expand the Integrated Services for Homeless Adults program, $50 million for the Adult Mentally Ill Offender Crime Reduction Program, and $15 million for one-time Supportive Housing Grants. Both the Senate and Assembly include larger augmentations for mental health programs. A conference committee co-chaired by Senator Wes Chesbro and Assemblymember Helen Thomson has been meeting to consider both funding and policy issues related to mental health.

***Transportation.*** The Governor replaces his January Budget proposal with a new five-year, $5.3 billion Traffic Congestion Relief Plan funded on a pay-as-you-go basis. The proposal includes $1.5 billion in additional General Fund support for transportation, diversion of $440 million in revenues from the sales tax on gasoline to support transportation programs, a statement that the Governor plans to allocate $1.6 billion over the next four years to complete the proposed plan, $500 million to fund deferred maintenance, and funding to boost CalTrans staffing to accommodate the increased workload expected from the proposed plan.

The Legislative Analyst has raised a number of concerns with the Governor's transportation proposal, including the lack of a plan to meet the state's ongoing needs, its failure to identify a source for required local matching funds, and the lack of objective criteria for selecting projects proposed for funding. A conference committee is currently meeting to review the Governor's proposal, as well as other measures designed to address the state's transportation funding needs.

## Budget Moves to Conference Committee

A conference committee consisting of three Assemblymembers and three Senators began meeting to resolve differences between the Senate and Assembly versions of the budget on May 31. Both houses of the Legislature assumed slightly higher General Fund revenues ($517 million) than projected in the Governor's May Revision, based on forecasts prepared by the Legislative Analyst's Office, and both houses spent more than the amount proposed in the Governor's May Revision. The Assembly Budget assumes $1.8 billion in General Fund spending above the level proposed in the Governor's May proposal, while the Senate Budget assumes $2.8 billion in additional General Fund spending. In addition to the Budget Conference Committee, budget related policy issues will be considered by separate conference committees on mental health, transportation, taxes, and local government.

**Conference Committee on the 2000-01 Budget**

Assemblymembers:
- Denise Moreno Ducheny (D-National City) (co-chair)
- Carole Migden (D-San Francisco)
- George Runner (R-Lancaster)
- Tony Cardenas (D-Panorama City) (alternate)

Senators:
- Steve Peace (D-Chula Vista) (co-chair)
- Pat Johnston (D-Stockton)
- Jim Brulte (R-Rancho Cucamonga)

## Areas of Potential Controversy

While there are a number of differences between the Legislature and the Governor, and between the two houses, the significant amount of new money should result in an "on-time" budget. Areas of potential controversy include:

- The size and structure of the Governor's proposed tax rebates and the Governor's proposed tax exclusion for teachers' pay.
- The size and allocation of funding increases for a number of programs, including mental health, housing, and transportation. Advocates have pushed to dedicate a greater share of the new housing funds for multifamily housing. The Governor's transportation plan would result in funding shifts among regions and from roads to mass transit.

# How Much is Enough? Funding California's Public Schools

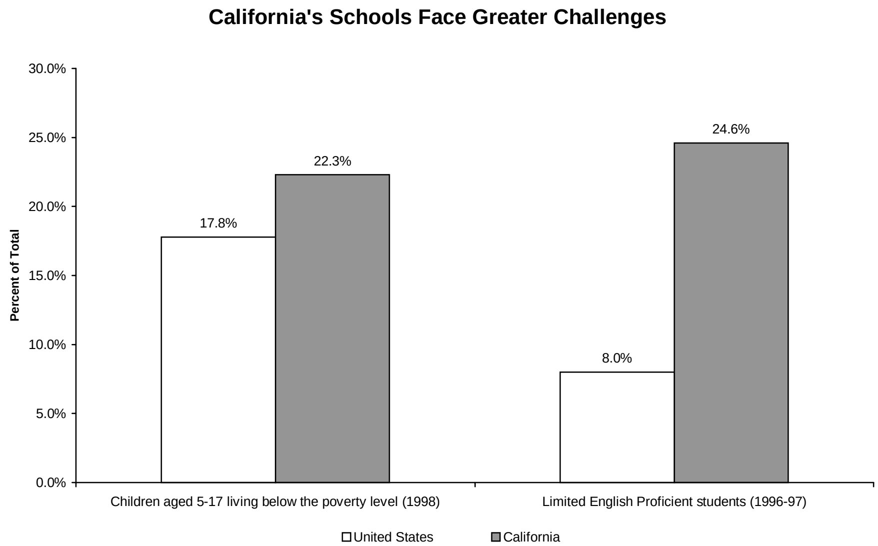
Since the 1980s, California's spending for K-12 public education relative to that of other states has steadily declined. According to the National Education Association's most recent calculations, California spends about $600 less per pupil than the national average.

Responding to calls for a dramatic increase in spending for schools, Governor Davis' May Revision contains $3.7 billion in funding for K-12 education above his January Budget proposal, including $1.84 billion in ongoing funds to fully fund cost-of-living adjustments that were not paid to schools during the recession of the early 1990s. CBP estimates that this $1.84 billion in additional K-12 funding alone will likely bring California to the national per pupil spending average within four years, based on projected growth in the Proposition 98 school funding guarantee. The state may reach the national average even sooner, as some portion of the additional school spending proposed by the Governor and the Legislature will count toward the per pupil spending calculation.

## Why Should California Meet the National Average?

Since the 1960s, discussions of school finance have addressed questions of equity: does the state's school finance system provide equal education opportunities for all of its children, regardless of race or socioeconomic status? In 1976, the California Supreme Court, in *Serrano v. Priest*, found the property tax-based system of school finance in the state violated constitutional "equal protection" rights of students who lived in areas with low property values. The ruling ushered in decades of court ordered and legislative efforts to equalize spending among districts. The result is the byzantine system of revenue limits, differential COLAs, deficit factors and equalization formulas that drive California's K-12 funding.

While comparisons of per pupil spending among school districts can be useful in tracking the success of equalization efforts in a state, comparisons among states are difficult due to the differences in costs of living, demographic breakdowns and educational costs in different states. If a state has to pay more for educational inputs (i.e., land for schools, salaries, etc.), or has a greater number of poor students or students with other challenges, then spending an amount equal to another state with lower costs and fewer challenges would actually provide an unequal educational opportunity.



Sources: U.S. Census Bureau, CPS March Supplement, 1999. National Clearinghouse for Bilingual Education, 1998.

California has both higher costs and a greater share of students with special needs than the national average. Research findings suggest that California should be spending more per pupil than most other states; instead the state's spending has been well below the national average every year since 1987-88.

## A Shift from "How Much are We Spending?" to "How Much Does it Cost?"

Questions of equity have historically focused on educational inputs and dollars spent rather than on educational outcomes, such as students' academic performance. This assumes that spending an equal amount of money on each student will provide an equal educational opportunity. However, that rationale ignores the fact that different students, different school districts and different states have different characteristics, all of which may require higher spending on some students and in some school districts to produce equal outcomes.

With more states adopting tough educational performance standards for their children, discussions about school finance in the courts and in state legislatures are switching from equity to adequacy. Education advocates, policymakers, and the public are becoming more concerned with whether their state's school finance system provides all of its children with an adequate education, as opposed to equal inputs.

While the *Serrano* decision was one of the first in the nation to address the question of equity in school funding, current court battles over the question of adequacy are being waged in other states, including Kentucky, New Jersey, Ohio, and Wyoming. The courts are forcing states to develop methods to determine adequate levels of school funding to ensure that all of their students have the opportunity to meet state-mandated performance standards. While a number of methods for determining an adequate funding level for a state have emerged, there is agreement among funding adequacy experts that, regardless of the method employed, the national average should be the absolute minimum level of funding adopted by a state.

## Conclusion

Although comparisons among states' spending on education may not provide precise evaluations of the quality of their education systems, school finance experts contend there is value to using the national per pupil spending average as a general measure of adequacy.

Given the high stakes that California students now face, the state must address the question of school funding adequacy. In light of the high cost of educational inputs, and the large share of the state's students facing particular educational challenges, it is likely that California will need to spend more than other states to educate its children. While developing a system of adequate funding, the state should move as quickly as possible to increase current per pupil spending to the national average.

## LOCKED OUT: CALIFORNIA'S AFFORDABLE HOUSING CRISIS

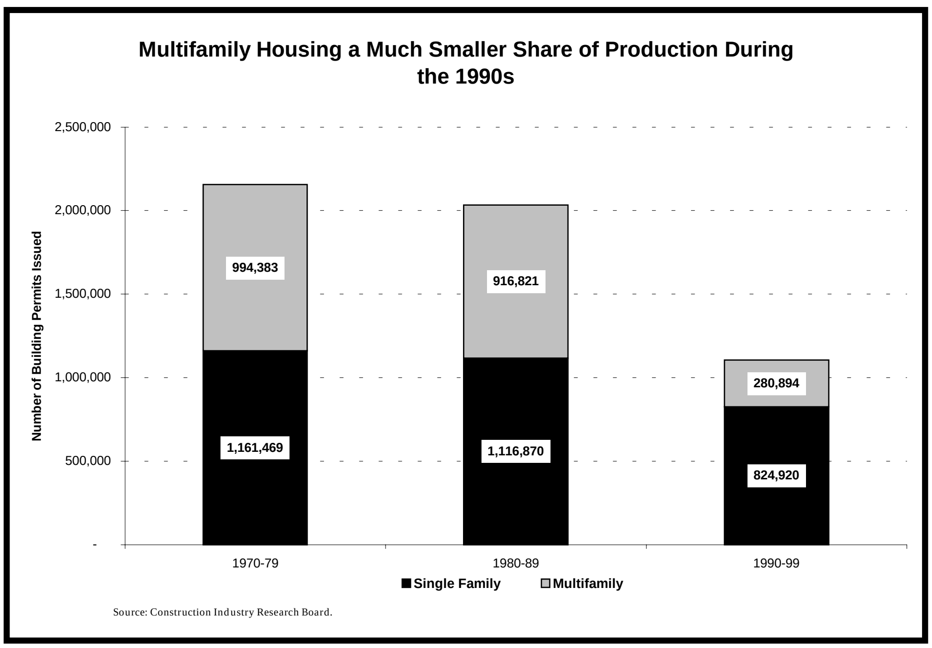
A new California Budget Project, *Locked Out: California's Affordable Housing Crisis,* profiles the state's housing problems, explores the roots of the crisis, and proposes a set of policy recommendations designed to address the crisis. Key findings made in the report include:

***Renters Bear the Brunt of the State's Affordable Housing Crisis***

- In 1997, nearly a quarter of the renter households in the state's metropolitan areas - one million out of 4.2 million - spent more than half of their incomes on rent and 43 percent spent more than the recommended 30 percent of their income on housing.
- Nearly two-thirds of low income renters in California's metropolitan areas paid more than half of their income for housing and 86 percent spent more than the recommended 30 percent of their income for housing in 1997.
- The number of Californians in need of affordable housing far outstrips the supply of low-cost units. In 1997, the number of low income renter households in the state's metropolitan areas exceeded low-cost rental units by more than 2-to-1, a gap of 684,000 units.

***Homeownership is Out of Reach for a Growing Number of California Families***

- California's homeownership rate is the second lowest in the nation. Only 56 percent of California households owned their own homes in 1999, compared to 67 percent for the nation as a whole.
- The median income renter household earned less than half the income needed to purchase the median priced home in 1998.
- The share of homeowner households headed by individuals in their twenties dropped by 40 percent between 1979 and 1999, and by 29 percent for households headed by individuals in their thirties. Ownership rates declined for all age groups except seniors between 1979 and 1999.
- While 62 percent of the state's white-headed households were homeowners in 1999, just 40 percent of African-American-headed households owned their own homes, along with 54 percent of Asian / Pacific Islander-headed households and 42 percent of Latino-headed households.




***Housing Production Declined Substantially During the 1990s***

- Between 1990 and 1999, building permits were issued for an average of 110,581 units of housing each year. In contrast, permits were issued for an average of 215,585 units per year during the 1970s and 203,369 units per year during the 1980s.

*(continued on back page)*

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921 11TH ST STE 502
SACRAMENTO CA 95814-2820



- Multifamily housing accounts for the majority of the housing production gap. During the 1980s, building permits were issued for an average of 91,682 units of multifamily housing per year, 45 percent of total permits. Between 1990 and 1999, building permits were issued for an average of 28,089 units per year of multifamily housing, just 25 percent of permits issued and a 69 percent drop from the levels of the 1980s.

***Public Support for Affordable Housing Has Failed to Keep Pace With Need***

- State housing spending dropped substantially during 1990s, from 0.7 percent of total spending in 1990-91 to 0.2 percent of total spending in 1999-00.
- Federal support for housing has dropped dramatically since the 1970s. Many federally assisted units are at risk of conversion to market rents. In the past three years, California has lost more than 15,000 affordable housing units to opt-outs and prepayments, a total of 11 percent of the state's federally assisted inventory; estimates suggest that more than 180,000 units are at risk of conversion over the next decade.

Copies of *Locked Out: California's Affordable Housing Crisis* are available from CBP for $4.31 (includes sales tax). A separate chart book is available for $2.16 (includes sales tax). The report and regional fact sheets are also available on CBP's web site at www.cbp.org.

*The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low and middle income Californians. General operating support for the California Budget Project is provided by foundation grants and individual donations and subscriptions.*

*The California Budget Project can be reached at 921 11th Street, Suite 502, Sacramento, CA 95814-2820, by phone at (916) 444-0500, by fax at (916) 444-0172, or by email at cbp@cbp.org. Budget Watch is published six times a year. Subscriptions are $20/year. Visit CBP's web site at www.cbp.org.*