

## WHERE HAS THE SURPLUS GONE?

California has been blessed by unusually strong revenue growth during the first two years of the Davis administration. General Fund revenues increased by nearly \$17 billion (30 percent) between the 1998-99 and 2000-01 fiscal years, primarily due to strong growth in personal income tax collections. General Fund spending, in turn, has increased by 38 percent over the same period. Where exactly have the increased funds gone? In this article, the California Budget Project (CBP) examines the growth in General Fund spending by agency and across major program areas to identify the winners and losers in the first two Davis budgets.

*And the Winners are...* While K-12 Education and Health and Human Services received the largest *dollar* increases, the largest *percentage* increases in spending between 1998-99 and 2000-01 were enjoyed by Business, Transportation, and Housing and General Government (620 percent and 160 percent, respectively). Funding increased for every agency, with the exception of the Trade and Commerce Agency, whose budget spiked in 1999-00 due to a one-time allocation for the state's Infrastructure Bank, then went back down to its 1998-99 level in 2000-01.

*But Who are the REAL Winners?* Looking at agency budgets as a percentage of total General Fund spending provides a different perspective. Although K-12 Education and Health and Human Services constitute the largest shares of the General Fund, and have received the largest dollar increases over the past two

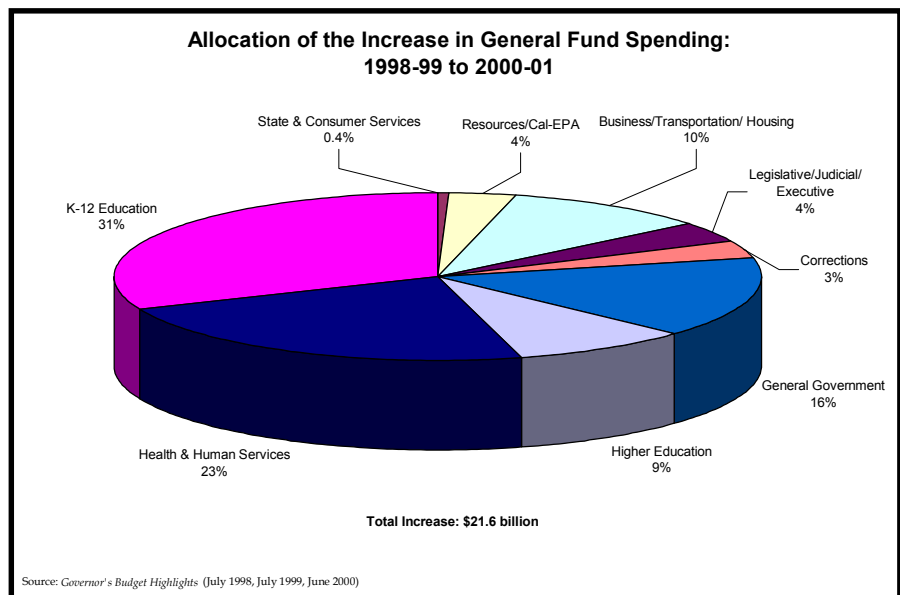
budgets, both have lost ground relative to other programs. Higher Education, Corrections, Trade and Commerce, and State and Consumer Services have all fallen as a share of General Fund spending.

The two big winners, again, are Business, Transportation, and Housing and General Government, which each increased by three percentage points as a share of total General Fund spending. Legislative, Judicial, and Executive programs, and Resources and Cal-EPA, also rose slightly as shares of General Fund expenditures.

### Where Did the Money Go?

The increased revenues supported spending increases tied to caseload growth, as well as a number of new initiatives. Notable augmentations include:

**Business, Transportation, and Housing.** The General Fund budget for the Business, Transport-



**General Fund Spending by Agency, 1998-99 to 2000-01**  
(In Millions)

	Dollar Change	Percentage Change
Trade & Commerce	\$ -	0%
Youth & Adult Corrections	\$736	17%
State & Consumer Services	\$95	22%
Higher Education	\$1,884	25%
K-12 Education	\$6,756	28%
Health & Human Services	\$4,941	32%
<b>TOTAL GENERAL FUND SPENDING</b>	<b>\$21,554</b>	<b>38%</b>
Legislative/Judicial/Executive	\$808	45%
Resources/Cal-EPA	\$755	60%
General Government	\$3,352	160%
Business/Transportation/Housing	\$2,227	620%

Source: CBP calculations based on Governor's Budget Highlights (1998, 1999, 2000).

tation, and Housing Agency increased dramatically this year. A significant portion of this increase is attributable to the Governor's new Traffic Congestion Relief Plan (\$1.5 billion). Housing spending also increased significantly, however, with the Department of Housing and Community Development's General Fund budget rising from only \$20.9 million in 1999-00 to \$560 million in 2000-01.

**Corrections.** While corrections spending increased modestly compared to other program areas, the percentage increases in General Fund spending for the Department of Corrections (CDC) and California Youth Authority (CYA) outstripped the growth in the inmate population. The inmate population increased by 1.3 percent in the CDC, but declined by 3.9 percent in the CYA between 1998-99 and 2000-01.

**General Government.** Tax cuts account for the largest share of the General Government increase in General Fund spending. In particular, this category includes the allocation to cities and counties to backfill for revenues lost as a result

of reductions in the Vehicle License Fee (VLF) tax rate and increases in the Senior Citizens Property Tax Assistance Program.

**Health and Human Services.** Health and Human Services spending rose 14 percent between 1999-00 and 2000-01, but only 3.6 percent between 1998-99 and 1999-00. Increased support in 2000-01 is mainly targeted to caseload growth, program changes, and provider rate increases, while 1999-00 increases were attributable primarily to program changes, including expansions in Medi-Cal and Healthy Families eligibility.

**K-12 Education.** General Fund spending under Proposition 98 has increased by nearly a quarter since 1998-99, while Proposition 98 per pupil spending has increased by 17 percent.

**Legislative, Judicial, and Executive.** Trial court funding makes up a significant portion of the General Fund increase in Legislative, Judicial, and Executive spending. State support for trial courts has increased by 77 percent since 1998-99. This is due to legislation adopted in 1997 and 1998 increasing the state's financial responsibility

**Agency Budgets as a Share of General Fund Spending**

	1998-99	1999-00	2000-01	Change 1998-99 to 2000-01
<b>General Government</b>	3.7%	4.1%	6.9%	3.3%
<b>Business/Transportation/Housing</b>	0.6%	0.6%	3.3%	2.7%
<b>Resources/Cal-EPA</b>	2.2%	2.3%	2.6%	0.4%
<b>Legislative/Judicial/Executive</b>	3.2%	3.4%	3.3%	0.2%
<b>Trade &amp; Commerce</b>	0.2%	0.8%	0.1%	-0.1%
<b>State &amp; Consumer Services</b>	0.8%	0.8%	0.7%	-0.1%
<b>Health &amp; Human Services</b>	26.8%	26.6%	25.7%	-1.1%
<b>Youth &amp; Adult Corrections</b>	7.8%	7.4%	6.6%	-1.2%
<b>Higher Education</b>	13.2%	12.6%	12.0%	-1.2%
<b>K-12 Education</b>	41.6%	41.5%	38.8%	-2.8%

Source: CBP calculations based on Governor's Budget Highlights (1998, 1999, 2000).

for trial court operations, while capping and reducing county costs.

An upcoming report by the CBP will explore these issues in more detail, analyzing major General Fund spending increases across the 1998-99, 1999-00, and 2000-01 budgets. This report will compare agency level spending increases in the Davis budgets as compared to the final Wilson budget, break down key program and departmental increases, and discuss spending changes in broad issue areas such as child care, housing, tax relief, and local government.

Major Components of 1998-99 to 2000-01 Spending Increases	
Agency	Additional Spending Primarily Attributable To:
<b>Business/Transportation/Housing</b>	Traffic Congestion Relief Plan, Housing Programs
<b>Corrections</b>	Employee Compensation, Parole/Treatment Services
<b>General Government</b>	Backfill for Vehicle License Fee (VLF) Reductions
<b>Health &amp; Human Services</b>	Provider Rate Increases, Caseload Growth
<b>Higher Education</b>	Enrollment Increases, Employee Compensation, Summer Class Fee Reductions
<b>K-12 Education</b>	Revenue Limit Deficit Reduction, Teacher Recruitment and Retention Incentives, Inflation and Enrollment adjustments
<b>Legislative/Judicial/Executive</b>	Trial Court Funding
<b>Resources/Cal-EPA</b>	CALFED, Habitat Restoration/Preservation, Emissions Reduction/ Enforcement
<b>Trade &amp; Commerce</b>	Infrastructure Development Bank

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## WILL CALIFORNIA SOON ADDRESS THE ISSUE OF THE ADEQUACY OF FUNDING FOR EDUCATION?

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Recent debates over school funding have centered on the gap between California’s per pupil spending and the national average. The CBP estimates that California should reach the national average by 2001-02 due, in part, to the 11 percent increase in per pupil spending between the budgets enacted in June of 1999 and June of 2000. The last issue of *Budget Watch* introduced the concept of education funding adequacy, which is the idea that school funding levels should be based on the cost of achieving desired educational outcomes. This issue examines different methods of determining what constitutes “adequate.”

### What is Driving the “Adequacy” Discussion?

Several recently filed lawsuits attempt to move beyond the issue of equity and questions the adequacy of funding for the state’s public schools. On May 17, 2000, the American Civil Liberties Union filed a statewide class action suit in the San Francisco Superior Court on behalf of Cali-

fornia public school children charging the state with failing to fulfill its constitutional obligation to provide at least the bare essentials necessary for educating its students. Other suits address the availability of advanced placement courses in California’s high schools and the distribution of state bond funds for school facilities.

Other factors contributing to the shift toward an adequacy-based school funding approach include the implementation of the Public Schools Accountability Act. California’s new performance standards and the requirement that students must pass a high school exit exam in 2003-04 in order to graduate put pressure on the state to ensure that its schools have the basic tools necessary to prepare students to meet the new standards.

### How is “Adequate” Determined?

Traditionally, school funding equity was largely an accounting issue that determined whether districts received the same amount of funding per student. However, designing a school finance system based on “adequacy” requires a process of consensus building. To create an “adequate” finance system, the state would not only need to determine what an “adequate” funding level would be, but also whether changes need to be made to existing governance

Methods Used To Determine Adequate School Funding Levels	
<b>Professional Judgement</b>	Panel of educational "experts" come to consensus on necessary inputs of a quality education
<b>Economic cost function</b>	Statistical analysis that correlates levels of academic performance with levels of spending based on extensive data
<b>High Performance School Design</b>	Determine the cost of implementing a popular school improvement program, like the Modern Red Schoolhouse, in the state's schools
<b>Empirical Method</b>	Select the schools in the state that meet performance standards and use their average spending level as the foundation spending level

Source: Guthrie, James W. and Richard Rothstein, "Enabling Adequacy to Achieve Reality: Translating Adequacy into State School Finance Distribution Arrangements," (1999).

structures to ensure that resources will be used effectively. An adequacy-based system also takes into account the fact that different students and different school districts have different needs, which may require higher spending on some students and in some school districts to produce equal outcomes.

The first step in designing a school finance system based on adequacy is to define the specific skills the students will be required to achieve. Next, the stakeholders must assess the resources needed to meet the standards and their associated costs. Finally, the state would need to adopt a means of measuring success. While there may not be universal agreement on the standards set by the Public Schools Accountability Act, California has adopted an expected level of academic performance and a testing system to evaluate student outcomes. The last remaining step in determining an "adequate" funding level is an assessment of the tools that the schools need to meet the standards and their costs. "Adequate" school finance formulas generally provide a base, or foundation, level of funding for all students and then additional funding for students with special needs.

While some states, including Wyoming and Ohio, have been forced by the courts to develop new school finance formulas based on "adequacy," other states have developed "adequate" finance systems in an attempt to preempt court interference. Through these efforts,

as well as through academic research, four models for calculating "adequate" school spending levels have been developed. All of these methods have advantages and disadvantages but they provide a starting point for California in addressing the issue of school funding "adequacy."

The governance structure needed to successfully implement an educational "adequacy" system must provide accountability, while allowing individual schools the necessary flexibility to meet the standards given their particular situations. Governance structure also needs to provide a balance between motivating schools to adapt to the new system without the imposing of unnecessary regulations.

## Conclusion

Recent research and litigation have raised questions about whether California is providing all of its students with equal and adequate educational opportunities. Transforming the current equity-based system that strives to equalize funding across districts to an adequacy-based system that seeks to provide equal and adequate educational opportunities to all students will not be easy. There is a shortage of data on successful and transferable programs that would help schools meet the new standards and the costs associated with such programs. However, political pressure for quick fixes may preclude necessary data gathering and research, including the implementation and evaluation of pilot programs. Change generally faces resistance from the stakeholders in the current system. This may be especially true if an adequacy-based system would require changes to current school governance structures. While the process would be difficult, it could produce a school finance system that is derived rationally from an examination of what resources are needed to provide California's children with an adequate education.

## HOUSEHOLD INCOMES UP IN 1999, BUT STILL LOWER THAN A DECADE BEFORE

Despite the recent economic boom, California's median household income still lags behind its pre-recession levels of a decade ago. New data from the Census Bureau shows that the 1999 median income for California households rose 4.6 percent between 1998 and 1999 to \$43,744, still 1.4 percent below the inflation-adjusted 1989 level of \$44,349. Nationally, 1999 median household income was \$40,816, a 2.7 percent increase over the 1998 level of \$39,744. The new data also shows that while the nation's poverty rate has returned to pre-recession levels, California's rate remains seven percent higher than it was in 1989.

Although the 1999 figures for California mirror the national trend of rising income and declining poverty rates, it is clear that the state lags the nation. While California's median income is higher than the nation overall, 13.8 percent of Californians remain mired in poverty compared to 11.8 percent nationwide. In addition, 20.3 percent of Californians lack health coverage, which is higher than the national rate of 15.5 percent.

California's relatively poor performance stems from a number of factors. First, California experienced a longer and deeper recession than the rest of the nation during the early 1990s. Not only did California have more ground to make up than the nation as a whole, but its economic recovery began two years later. A second factor is the large number of immigrants to California with relatively low levels of education. A third factor is the growth in low wage employment described CBP's April report *Will Work Pay?: Job Creation*

in the *New California Economy*. CBP's Labor Day report, *Falling Behind: California Workers in the New Economy* explores wage and income trends in greater detail ([www.cbp.org/reports/index1.html](http://www.cbp.org/reports/index1.html)).

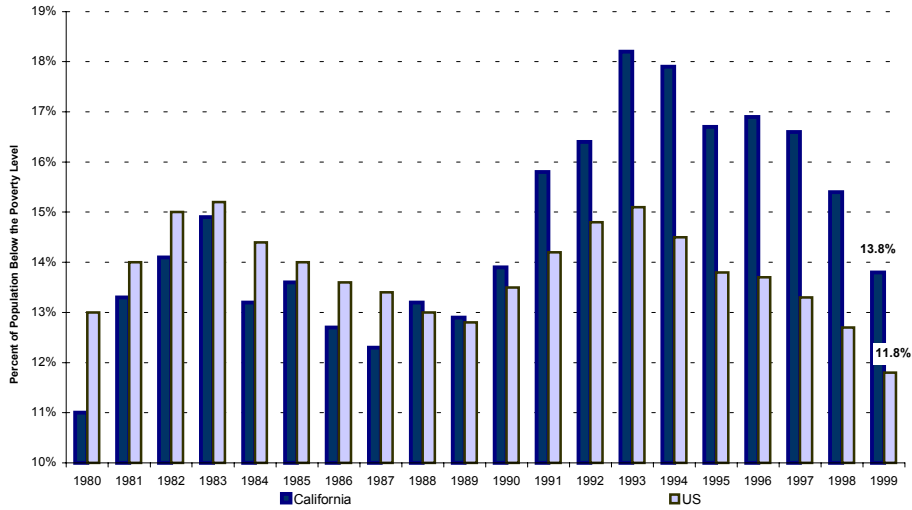
## CALIFORNIA'S TAX BURDEN HOLDS STEADY

The Census Bureau's latest tally of state tax revenues shows that California remains a moderate tax state. Measured as a share of personal income, which reflects the relative wealth of states as well as their level of taxation, California ranked 14<sup>th</sup> with respect to total state tax burden in 1998-99, the most recent year for which data is available. California's relatively high income tax burden - the state ranked 10 among the fifty states - was balanced by relatively low rankings for motor fuel (43<sup>rd</sup>), tobacco (32<sup>nd</sup>), and alcoholic beverage (37<sup>th</sup>) taxes. The state's general sales tax burden ranked 20<sup>th</sup> among the states. While California ranks 9<sup>th</sup> in corporate tax collections as a percent of personal income, it ranked 7<sup>th</sup> the year before. Corporate tax collections as a share of personal income dropped 9.2 percent between 1997-98 and 1998-99. Recent data is not available for the combined state and local tax burden. However, California typically

How Does California Compare? (Revenues as a percentage of personal income)			
	CA Rank	CA	US
Total State & Local Own Source (1995-96)	25	16.34%	16.20%
Total State & Local Taxes (1995-96)	24	11.34%	11.30%
State Tax Revenues (1998-99)	14	7.83%	6.77%
Total Local Tax Revenues (1995-96)	33	3.74%	4.44%
Total State & Local Sales Tax (1995-96)	24	4.06%	4.08%
Total State & Local Property Tax (1995-96)	32	3.00%	3.43%
State General Sales Tax (1998-99)	20	2.45%	2.24%
Motor Fuels Tax (1998-99)	43	0.33%	0.40%
Tobacco Taxes (1998-99)	32	0.10%	0.11%
Alcoholic Beverage Taxes (1998-99)	37	0.03%	0.05%
Individual Income Taxes (1998-99)	10	3.33%	2.33%
Corporate Income Tax (1998-99)	9	0.59%	0.42%

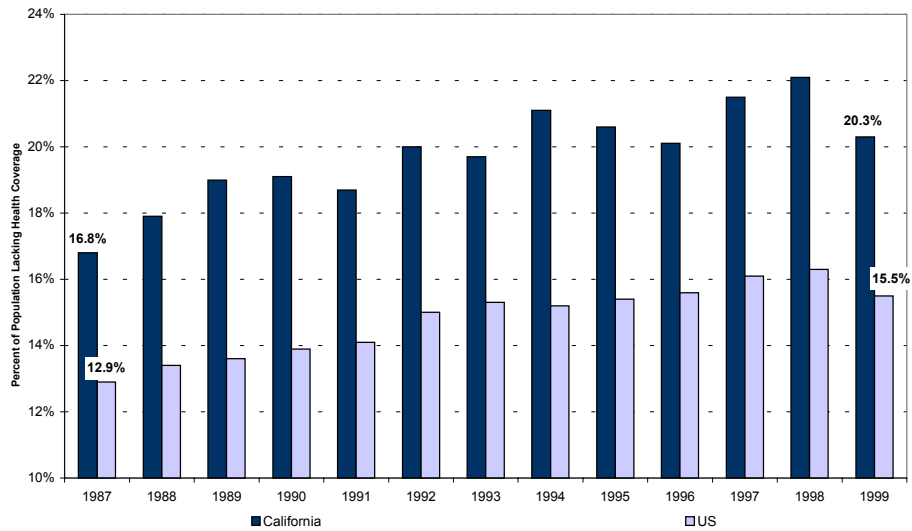
Source: U.S. Bureau of the Census and Bureau of Economic Analysis. All rankings exclude the District of Columbia.

### Poverty Higher in California



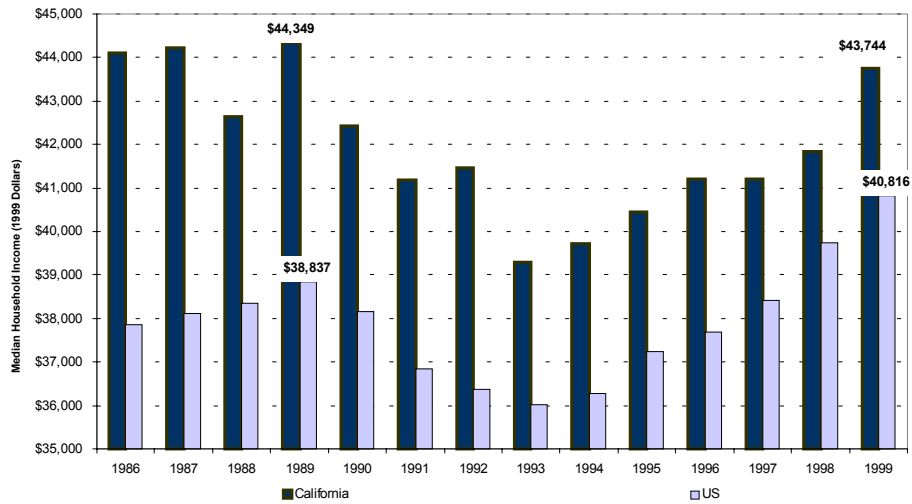
Source: US Census Bureau

### Californians are More Likely to Lack Health Coverage



Source: U.S. Census Bureau

### California's Median Household Income was Lower in 1999 than in 1989 After Adjusting for Inflation



Source: U.S. Census Bureau

ranks lower on this measure due to the state's low property tax rates. In 1995-96, California ranked 25<sup>th</sup> among the states in total state and local own source revenue collections, a measure that takes into account all revenues raised by state and local governments.

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## 2000 LEGISLATIVE WRAP UP: HEALTH AND HUMAN SERVICES

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Health and Human Services legislation met with mixed success during the 2000 legislative session. While several important measures were enacted, others fell prey to the Governor's veto pen or failed to win support during budget negotiations.

**CalWORKs.** After vetoing a similar provision last year, Governor Davis signed AB 1233 (Aroner), which enables counties to pay wages to community service participants by clarifying that these wages will not be considered "earned income" for the purposes of calculating grant checks. Without this change, participants in wage-based community service would earn more than those who continued to receive a traditional grant and the grant would be higher than the legal maximum aid payment in some instances (A forthcoming CBP Welfare Reform Update examines the implementation of community service programs under CalWORKs in greater detail). The Governor also signed SB 962 (Escutia), requiring counties to provide direct deposit banking for CalWORKs recipients if they offer it to county employees.

Continued efforts to allow CalWORKs recipients in Self-Initiated Programs (SIPs) to count study time toward the work requirement and to exempt the value of one automobile from the CalWORKs resource limit were unsuccessful. The Budget Committees of both houses approved both provisions. However, neither provision was sent to the Governor. Another set of unsuccessful bills, SB 1984 (C. Wright) and AB 1255 (R. Wright) would have permitted individuals convicted of certain drug offenses to receive some CalWORKs and Food Stamp benefits if they met conditions including enrollment in a treatment program and drug testing.

**Food Stamps.** The Governor signed into law a \$3 million allocation for Food Stamp outreach as part of the 2000-01 budget and SB 1013 (Senate Committee on Health and Human Services), which requires the simplification of Food Stamp application forms. The 2000-01 budget also included another one-year extension of eligibility, to September 30, 2001, for both the California Food Assistance Program (CFAP) and Cash Assistance Program for Immigrants (CAPI) for immigrants who entered the U.S. on or after August 22, 1996.

**Child Care.** The most significant child care legislation signed by the Governor was SB 1703 (Escutia), which provides \$42 million for child care facilities repair and expansion as well as equipment and instructional materials for subsidized child care providers. As reported in the last issue of *Budget Watch*, the 2000-01 budget agreement included additional support for child care and created a refundable child care tax credit.

**Medi-Cal.** The Governor signed four bills designed to maintain and expand Medi-Cal and Healthy Families eligibility. SB 87 (Escutia) enacts a streamlined procedure to help families leaving CalWORKs maintain Medi-Cal eligibility. AB 2415 (Migden) allows qualified immigrant children to enroll in Healthy Families regardless of date of entry. AB 1015 (Gallegos) instructs the state to seek federal approval to use federal State Children's Health Insurance Program funds (SCHIP, the funding source used for California's Healthy Families Program) to provide coverage to parents as allowed under a recent federal directive. AB 2900 (Gallegos) extends 12 month continuous Medi-Cal eligibility for children 19 and under. The Governor vetoed SB 147 (Alpert), which would have continued Medi-Cal eligibility for adolescents in foster care who turn 19; AB 1722 (Gallegos), which would have eliminated the Medi-Cal assets test; and AB 93 (Cedillo) which would have eliminated the requirement that families file quarterly reports in order to maintain eligibility for Medi-Cal.

*A more detailed summary of 2000-01 legislative actions can be found on the web site of the Western Center on Law and Poverty at <http://www.wclp.org/advocates/welfare/legupdate.html>.*

**RETURN SERVICE REQUESTED**

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## **REVENUE PICTURE LOOKS STRONG**

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While recent turmoil in the stock markets and rising energy costs have caused some economists to caution that the economy could be headed for a slow down, California's revenue collections are exceeding expectations. At the close of the first quarter of the 2000-01 fiscal year, year-to-date state General Fund revenue collections were \$897 million ahead of the forecast used as the basis of the 2000-01 budget. Revenue collections for all of the state's major taxes were above forecast levels at the end of September. The strength of recent revenue collections, coupled with the significant amount of one-time spending in the 2000-01 budget, bodes well for the Governor's upcoming 2001-02 spending plan.

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## **BUDGET WATCH**

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Regular readers may have noticed that we have switched from a bimonthly to quarterly publication schedule. CBP is currently reviewing our "product line" of publications with the goal of improving our efforts to communicate useful information in a timely way. We welcome your suggestions as to what works best for you. In the meantime, we plan to publish *Budget Watch* less frequently and to expand our use of email and the Internet to distribute time sensitive information. If you are not currently on our email list, you can subscribe via our web site at [www.cbp.org](http://www.cbp.org).

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*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.*

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