CALIFORNIA BUDGET PROJECT

BUDGET WATCH

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MAY REVISION CUTS FALL HEAVILY ON POOR

Governor Davis released his May Revision to the 2002-03 Budget on May 14. In order to bridge an estimated gap of $23.6 billion between revenues and expenditures for 2001-02 and 2002-03, the Governor proposed a series of spending reductions, tax increases, loans, and deferrals. The Governor proposes spending reductions of $7.6 billion, $2.4 billion more than in January. The new reductions take a disproportionate toll on programs affecting low-income and other vulnerable Californians.

The California Budget Project estimates that well over half (57.3 percent) of the new spending reductions proposed in the May Revision target programs that assist low-income and other vulnerable Californians. Over half (53.6 percent) would affect programs that have income eligibility guidelines or otherwise are aimed at low-income Californians. Over a third (34.3 percent) of the total cuts proposed in the Governor's January and May budget plans would affect low-income families.

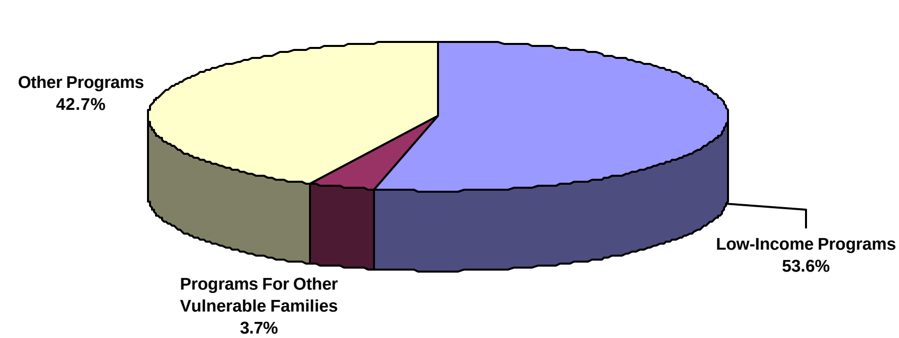
The impact of many of the proposed reductions would be magnified by a loss of federal funds. For example, the May Revision's proposed reduction for county administration of the Medi-Cal program would save the state $87.9 million, but the state would also forgo the same amount in federal funds. Taken together with the Governor's January proposal, the May Revision reduces General Fund spending for programs directed at low-income families by $2.6 billion, and by $4.3 billion when lost federal funds are taken into account.

Health programs received the majority (56.5 percent) of proposed spending reductions to programs for low-income families. These include postponing expansion of the Healthy Families Program to adults; rescinding the expansion of Medi-Cal for low-income, two-parent families; reducing optional benefits in the Medi-Cal program; charging copayments for Medi-Cal services; reducing Medi-Cal provider payments; postponing implementation of "express lane" eligibility for enrollees in the Food Stamp and National School Lunch Programs; and re-introducing quarterly reporting for Medi-Cal recipients. In addition, mental health programs, such as the Adult and Children's Systems of Care programs, would be reduced or eliminated.

Social service programs would sustain over a third (36.3 percent) of the proposed reductions to programs that target low-income families. These include suspension of cost-of-living adjustments (COLAs) for CalWORKs and SSI / SSP recipients.

May Budget Reductions Disproportionately Affect Programs for Low-Income and Other Vulnerable Families

Percentage Of New Spending Reductions Proposed In Governor's May Revision, By Type of Program



The Governor proposes to reduce federal and state funding for county welfare departments to administer Medi-Cal and social service programs by more than $800 million. This represents a reduction of 20 percent or more of proposed spending for many programs.

Other reductions affecting vulnerable families and children include funding for housing programs that target low-income households and aid to schools with high percentages of low-income students.

How Did The Gap Get So Big?

The Governor bases the May Revision on an estimated budget gap of $23.6 billion, nearly twice the gap assumed in January. The state's widening budget gap reflects a $9.5 billion drop in revenues and $1.6 billion in additional costs. The deterioration in state revenue collections stems primarily from a drop in income taxes paid on stock options and capital gains. As compared to 2000-01, current and budget year personal income tax collections are down by $18.3 billion. Stock options and capital gains accounted for 24.7 percent of 2000-01 General Fund revenues; they are expected to drop to 11.1 percent in 2001-02 and 9.2 percent 2002-03. The primary expenditure increase, $848.4 million in funding for programs under the Proposition 98 guarantee, is driven by an increase in the required spending level due to higher than previously estimated enrollment and inflation adjustments.

How Does The Governor Propose To Bridge The Gap?

The Governor proposes to bridge the additional gap with program reductions; securitizing a larger portion of the state's tobacco settlement payments; loans; deferring certain payments to schools; restructuring state debt payments; tax conformity and compliance initiatives; accelerations, transfers, and shifts; and tax increases, including a deferral of net operating loss carryforwards, a $0.50 per pack increase in cigarette taxes, and a temporary increase in Vehicle License Fees (Table 1).

Combined 2001-02 and 2002-03 spending in the May Revision is $3.8 billion lower than what the Governor proposed in January. Spending reductions include $1.126 billion in General Fund reductions to Health and Human Services; $189 million in Business, Transportation, and Housing; $11 million in Environmental Protection; $858 million in General Government; $421 million in Higher Education; $1.243 billion in K-12 Education; $104 million in Legislative, Judicial, and Executive; $41 million in Resources; $42 million in State and Consumer Services; and $13 million in Technology, Trade, and Commerce programs. The May Revision includes a $1.4 billion reduction to K-12 Education spending in 2001-02 and a $137.8 million increase in 2002-03. The impact on programs is much larger in many instances, as discussed above, due to the loss of federal and local matching funds.

The Governor's revenue raising proposals include a partial rollback of the Vehicle License Fee (VLF) reduction approved in 1998. The Governor's proposal would leave the VLF rate 25 percent lower than in 1998, and corresponds to an $87 increase in the amount paid by the owner of the average automobile. The deferral of net

Table 1:
Additional Gap Filling Measures Include Spending Cuts, Taxes, and Borrowing
(in Millions)

	Governor's January Budget	May Revision	Difference
Program Reductions	$5,226	$7,597	$2,371
Tobacco Settlement Securitization	$2,400	$4,500	$2,100
Loans	$1,251	$1,729	$478
Temporary VLF Increase		$1,276	$1,276
NOL Deferral		$1,200	$1,200
Deferral of Education Disbursements		$1,149	$1,149
Debt Restructuring		$1,083	$1,083
Federal Funding Increases	$1,066	$1,081	$15
Federal Tax Conformity/Tax Compliance	$178	$938	$760
Acclerations, Transfers, and Shfits	$2,381	$2,614	$233
Cigarette Tax Increase		$475	$475
	$12,502	**$23,642**	**$11,140**

operating loss (NOL) carryforwards mirrors a provision contained in the 1991-92 Budget signed into law by Governor Pete Wilson. Governor Davis also proposes conforming state corporate income tax law to federal law with respect to the bad debt reserves of large banks, raising $255 million. Other proposals include waiving interest and penalties on delinquent tax accounts ($145 million) and increasing tax collection activities ($361 million).

The May Revision assumes that the state will receive $1.1 billion in additional federal aid. Changes since January include an increase in the penalties the state will pay for failure to have a statewide automated child support collection system, a partial restoration of funds for the California Food Assistance Program due to the phase-in of limited federal food stamp eligibility, and a delay in the receipt of additional federal funds for Medi-Cal until 2002-03.

The May Revision included a $516 million reserve. However, the LAO's analysis notes that $600 million of the prior year's revenues were double counted, leaving the budget $84 million in the red.

Over 400,000 Could Lose Health Coverage

The May Revision proposes an additional $1.1 billion in Medi-Cal reductions, including:

- Rolling back the maximum family income for the 1931(b) Medi-Cal program for working families from 100 to 67 percent of the federal poverty level (FPL). Estimates show that this proposal would prevent 146,190 parents, mainly new applicants, from receiving coverage. This rollback also prevents California from expanding the Healthy Families Program to low-income parents.
- Eliminating selected optional Medi-Cal benefits, including dental, chiropractic, podiatry, acupuncture, occupational therapy, psychological, and rehabilitation services, and certain medical supplies.
- Requiring adults on Medi-Cal to file quarterly, rather than annual, reports. An estimated 246,667 persons would lose health coverage if quarterly reporting is reinstated.
- Reversing Medi-Cal provider reimbursement rate increases implemented since 1999. This would depress rates back to 1986 levels.
- Delaying implementation of "express lane" Medi-Cal eligibility determinations for enrollees in the National School Lunch and Food Stamp Programs until July 2005. This will prevent approximately 35,000 persons from receiving coverage in 2002-03.
- A $31 million General Fund increase in the fee the state charges public and University of California hospitals for the Disproportionate Share Hospital (DSH) program. This results in a total fee increase of $86.2 million when combined with the $55.2 million General Fund increase included in the Governor's Budget.
- Sharply reducing the outreach budgets for Medi-Cal and the Healthy Families Program.

The May Revision maintains the Child Health Disability Prevention (CHDP) program, which the Governor proposed to eliminate in January. The CHDP will also serve as a gateway for the Medi-Cal and Healthy Families Program, which provide full-scale health coverage under the new proposal.

County Social Service Funding Slashed

Among the deepest reductions proposed in the May Revision are 20 percent reductions in state support for county administration of many health and social service programs. The May Revision reduces funding for administration of the Medi-Cal, CalWORKs, Foster Care, Food Stamp, In-Home Supportive Services (IHSS), and adult and children's services programs by $500 million or more in combined federal, state, and county funds ($196 million General Fund).

The May Revision makes few substantial changes to the CalWORKs program. Changes include restoration of $20 million of the $58.4 million that was cut from the California Community College (CCC) CalWORKs program in January, which the CCC would be expected to match on a one-to-one basis. This program provides job placement services, work-study, and education-related work experience to CalWORKs participants. The May Revision also sustains the suspension of the cost-of-living adjustment (COLA) for CalWORKs recipients and does not pass through the federal COLA for Supplemental Security Income (SSI) recipients. The May Revision also uses $120 million in one-time performance incentive funds previously paid to counties to fund CalWORKs employment services costs, and reinstates "deeming" requirements for parents of minor parents (known as "senior parents") who live at home. This provision would count senior parents' income for purposes of determining the eligibility of the grandchild for cash assistance, saving an estimated $12.1 million. The May Revision also increases state funding for the California Food Assistance Program (CFAP) by $92 million to reflect the phased-in restoration of federal food stamp eligibility for legal immigrants.

Governor Suspends Earlier Child Care Proposal

As part of the January Budget, the Governor proposed far-reaching changes to the state's child care and development system for low-income and at-risk children, including lowering the income eligibility ceiling, increasing child care fees, lowering caps on maximum market-rate child care payments, and phasing-out the Stage 3 child care program, among other changes. The Governor dropped these changes in the May Revision. Restored funds include full funding for CalWORKs Stage 3 child care in 2002-03.

K-12 Education

Proposition 98 provides a constitutionally guaranteed level of state and local funding for K-12 Education, California Community Colleges, and child care programs. The May Revision reduces General Fund spending subject to the Proposition 98 guarantee by $1.912 billion in 2001-02 by deferring $1.15 billion in current year spending to the budget year; shifting the funding source for $503 million from the General Fund to the Proposition 98 Reversion Account; assuming a $193 million increase in local property tax revenues; and assuming $66 million in other savings.

The May Revision increased the estimate of the 2002-03 Proposition 98 guarantee by $1.2 billion over the January Budget due to a 0.3 percent increase in projected enrollment growth and an estimate of the decline in per capita personal income that is 1.74 percent smaller than the estimate used in the January Budget. The General Fund share of this increase is offset by a $335 million increase in local revenues. The May Revision results in a 2002-03 per pupil spending level of $7,186, up from the $6,618 provided by the proposed 2001-02 spending level in the May Revision.

Local Government

Major cuts to local government total $1.1 billion. Of these, $483.6 million in reductions to counties primarily reduce health and human services programs, particularly county administration of those programs. Additional local government reductions of $661.5 million hit counties harder than cities. Of these, the single largest reduction is the suspension of state payments to local governments for reimbursable state mandate claims ($246.1 million); roughly the same amount is cut from public safety programs.

The Republican Response

The Assembly Republican Caucus objected to the revenue raising provisions contained in the May Revision, but proposed no spending reductions as an alternative to the Governor's proposals (see http://republican.assembly.ca.gov). The Senate Republican Caucus similarly objected to the use of strategies such as securitizing tobacco settlement revenues, but proposed no alternatives to Governor's proposals (see http://republican.sen.ca.gov). Gubernatorial candidate Bill Simon criticized elements of the May Revision, calling for additional spending reductions. Simon has not, however, proposed specific reductions that he believes should be made to balance the budget. A recent CBP paper, *Bill Simon's Proposal To Balance The Budget Raises More Questions Than It Answers*, compares candidate Simon's January plan to that of the Governor.

Senate, Assembly Restore Many Reductions

Both the Senate and Assembly Budget Subcommittees restored funding for:

- Medi-Cal 1931(b) coverage for two-parent working families;
- Rejecting the proposal to reinstitute quarterly status reports for parents coverage by Medi-Cal;
- County administration of Medi-Cal and most social service programs (see above).

In some instances, actions differed between the two houses, leaving the final action up to the Budget Conference Committee. These include:

- Partial restoration of cost-of-living adjustments for CalWORKs and Supplemental Security Income recipients;
- A reduction in funding for county administration of the CalWORKs program;
- Expansion of the Healthy Families Program to low-income parents;
- Requiring copayments for Medi-Cal recipients;
- Elimination of Medi-Cal benefits that are not required by federal law;
- Restoration of funding for juvenile crime prevention programs;
- The state "administrative fee" for the Disproportionate Share Hospital program; and
- Eliminating the property tax shifts for multi-county special districts.

What Would This Mean For The Future?

The magnitude of the current gap, coupled with the reliance on one-time measures to bridge the gap, is likely to result in substantial deficits in future years. Earlier this year, the Legislative Analyst's Office (LAO) estimated that the state could face an operating deficit in the range of $7 billion based on the Governor's January proposal. In reviewing the May Revision, the LAO noted that, "the state still has an underlying budget problem that will have to be dealt with in the following year. The exact size of this problem is difficult to accurately predict at this time, given that it will significantly depend on how strongly the state's economy and revenues perform over the next year. However, we believe that the magnitude of this imbalance could be much larger than what we estimated in February."

Where Do Things Go From Here?

The Senate and Assembly are slated to take the actions needed to move the budget to conference during the last week of May. The Budget Conference Committee should begin meeting at the beginning of June. Members of this year's Conference Committee have not yet been announced, but will include Assemblymember Jenny Oropeza, Chair of the Assembly Budget Committee, and Senator Steve Peace, Chair of the Senate Budget and Fiscal Review Committee.

CBP Reviews Budget Proposals

A series of California Budget Project (CBP) papers review policy proposals under consideration as part of this year's budget debate. Recent releases include:

- *Borrowing Against the Future: Is Securitizing California's Tobacco Settlement Revenues The Best Way To Close The Budget Gap?*
- *Governor Davis' Proposed Labor Agency Reorganization Plan*
- *Shifting the Burden on Subsidized Child Care: Will Families Be Able To Afford The Governor's Plan?* (Note: The Governor dropped his child care restructuring proposal as part of the May Revision.)
- *The Civil Service Vacancy Game: Abusive Practices or Underlying Structural Problems?*
- *Governor's Budget Proposes Suspending CalWORKs COLAs.*

These papers are available at www.cbp.org or can be ordered from the CBP.

CONGRESS REAUTHORIZES FOOD STAMP PROGRAM

On May 13, the President signed into law the Farm Bill, which reauthorizes the Food Stamp Program for five years. The Farm Bill, HR 2646, earmarks $6.4 billion in additional investments for the Food Stamp and other nutrition programs. The Bill restores federal eligibility to certain immigrants, allows food stamp benefits to increase with inflation, allows for transitional benefits for families that leave welfare, and reforms the way state administration of the program is evaluated.

Immigrant benefit restoration: The act restores federal food stamp eligibility to certain legal immigrants, including adults who have lived in the US continuously for five years, and children and disabled immigrants, regardless of date of entry. California spends over $100 million in state funds for food stamp benefits for these and other immigrants not currently eligible for federal benefits.

Benefit adjustment: The act increases benefits for large families and allows benefits to rise over time by revising the way they are calculated. The standard deduction, the amount of a family's income that is excluded when determining benefit levels, will vary by household size and be adjusted annually for cost-of-living increases. Currently the standard deduction does not rise over time.

Transitional benefits for families leaving welfare: Under the new act, states may extend transitional food stamp benefits for up to five months to households when they lose TANF cash assistance. Benefits would be frozen at the amount received before leaving welfare, adjusted for the loss of TANF income. California has not yet implemented the current option to extend transitional benefits for up to three months.

Quality control system: The act revises the system that ensures that states correctly determine food stamp benefit levels. Current law imposes penalties each year a state's error rate is above the national average. Under the new law, only those states with high error rates for two consecutive years would face penalties. The federal government has levied a $116 million penalty this year due to high payment error rates.

The Farm Bill does not include increased benefits for childless, unemployed adults. Under current law they can receive benefits for three months out of any 36 months.

The ten-year total cost of HR 2646 is about $80 billion, most of which is for subsidies for agricultural commodities.

HOUSE PASSES TANF LEGISLATION

On May 16, the US House of Representatives approved HR 4737, which would implement the primary elements of President Bush's welfare plan, on a largely party-line vote of 229-197. The bill reauthorizes the Temporary Assistance for Needy Families (TANF) block grant, which expires September 30, and makes several major changes to federal welfare policy, including imposing tougher work requirements on welfare recipients. The bill provides $1 billion in mandatory child care funding over five years, but no additional funding for the TANF block grant. However, the additional child care funding is inadequate to implement the revised work requirements, which the Legislative Analyst's Office estimates would cost $2.8 billion over five years in California alone.

The bill also includes $200 million per year for states to promote married, two-parent families; a super-waiver provision that would allow states to better coordinate programs for the poor (while perhaps undermining federal eligibility guidelines and other protections); and an option for states to convert their food stamp programs into block grants.

The Senate will likely take up TANF reauthorization legislation in June. The leadership of the Finance Committee, which has jurisdiction over TANF in the Senate, has expressed interest in drafting bipartisan legislation. In that spirit, a "tripartisan" group of Finance Committee Senators, including Democrats, Republicans and an Independent, released a proposal in early May outlining basic principles. These include increasing the number of TANF recipients required to work, maintaining the current number of hours that recipients must work, increasing child care but not TANF funding, and restoring federal benefits for legal immigrants.

However, a group of Democrats have introduced their own bill, S 2524, which contains stricter work requirements than the tripartisan plan. On the other hand, more liberal Democrats sent a letter to the Finance Committee asking for increased TANF and child care funding while maintaining current work requirements so that states may better serve the hard-to-employ. After the Senate passes a bill, a conference committee will reconcile differences between the House and Senate versions.

A comparison of HR 4737 and other TANF reauthorization proposals is available on the CBP web site at http://www.cbp.org.

PRESIDENT TAKES WRONG APPROACH ON WELFARE REAUTHORIZATION

Jean Ross, Executive Director, and Scott Graves, Policy Analyst, California Budget Project

The following op-ed appeared on May 15, 2002 in the San Diego Union-Tribune.

When Congress restructured the federal welfare system in 1996, it gave states substantial flexibility to craft programs aimed at moving welfare recipients into the workforce. California and other states created a diverse set of programs that have helped millions of people increase their skills and education, find jobs, and move off of welfare. Aided by the strong economy of the late 1990s and record low unemployment, the national caseload has declined 56 percent and the California caseload has fallen 46 percent since 1995. While low earnings and persistent poverty among former welfare recipients point to the need for additional work, the record indicates that states have succeeded in getting unprecedented numbers of people into the workforce.

Unfortunately, President Bush learned the wrong lesson from five years of welfare reform. As Congress prepares to reauthorize the Temporary Assistance for Needy Families (TANF) block grant, the President is pushing an inflexible set of work requirements that would limit California's ability to tailor welfare-to-work strategies to local economic conditions and the needs of recipients, including individuals with significant barriers to employment, such as drug addiction or limited English skills. The President's plan was incorporated, with some changes, into HR 4090, introduced in Congress on April 9 by Rep. Wally Herger (R-Chico).

HR 4090 would require California to steer almost all welfare recipients into a small number of work activities – including unsubsidized jobs, on-the-job training, or community service – or face stiff fiscal penalties. California would have to de-emphasize or even abandon a variety of successful education and training programs that prepare people for stable, well-paying jobs, because such programs will not help the state meet the proposed federal requirements.

There is no research or empirical evidence to support the President's view that a short-term, jobs-first approach is appropriate for everyone. In fact, studies show that welfare programs that use a mix of activities lead to higher earnings and lower welfare payments. The most successful programs allow some people to start with job search while others engage in work-focused education or training and then move into the workforce. Education is a key component of many successful strategies. In California, the median annual earnings of CalWORKs recipients who earned an associate degree with a vocational emphasis increased 100 percent one year after leaving college.

State and local officials are concerned about HR 4090. A recent survey by the National Governors Association found that 41 states, including California, would have to fundamentally restructure their welfare programs if HR 4090 becomes law. States also expressed concern about the proposal's costs. In areas where the private sector cannot absorb all welfare recipients who need a job, counties will have to administer costly "make-work" programs. Local officials will have to spend more time and money enforcing complex federal rules, leaving less time and resources to help people move into the workforce. And as more recipients engage full time in work activities, the need for subsidized child care will explode, along with the costs to states. The nonpartisan Legislative Analyst's Office estimates that the five-year cost to California of meeting the child care and employment services needs generated by the Bush plan would be $2.8 billion.

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While HR 4090 promises to drive up costs, it will not provide one additional penny beyond current funding levels to help states operate their welfare-to-work or child care programs through 2007. In California, the CalWORKs program already faces a deficit of several hundred million dollars in fiscal year 2002-03. To close the gap, Governor Davis has proposed limiting funds for employment services, freezing cash grants, and making painful cuts to child care and other services. By imposing costly new requirements while capping federal funding, HR 4090 will compel California to further scale back the very programs that show the greatest promise of success.

Helping people move toward self-sufficiency and improving child well-being is expensive. California needs more money and more flexibility to effectively work with the hard-to-employ and to help families that struggle after leaving welfare. Earnings are low, often less than $9 per hour, and many families live below the poverty line. Subsidized child care, employment services, and other supports are needed to help current and former recipients increase their skills, overcome barriers, and move toward self-sufficiency.

The Bush / Herger proposal moves welfare reform in the wrong direction. Rather than imposing an unworkable, one-size-fits-all approach, Congress should help states build on their successes, overcome ongoing challenges, and protect vulnerable children by expanding state flexibility and increasing TANF and child care funding.

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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