



CALIFORNIA

• BUDGET PROJECT •

California Budget Project
Email Update
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The Legislature approved a final spending plan for 2002-03 early Sunday, September 1, 11 weeks after the Constitutional deadline and two months after the beginning of the fiscal year. The final agreement included:

- Passage of AB 425, the Budget Bill approved by the Senate on June 29, and associated trailer bills;
- Passage of ACA 11, a constitutional amendment earmarking a portion of the state's General Fund revenues for infrastructure beginning in 2006-07;
- Deferral of \$681 million in education expenditures from 2002-03 into 2003-04. The deferral reflects, in part, a reduction in the Proposition 98 guarantee resulting from a reduction in the magnitude of the revenue package;
- A measure stating that the Governor *may* (emphasis added) veto up to \$750 million in state operations; and
- Capping 2003-04 expenditures at 2003-04 revenue levels.

The following summarizes key elements of the agreement that changed over the weekend. The CBP will publish a comprehensive summary after the Governor's line item vetoes are released.

WHAT BROKE THE LOGJAM?

The final agreement dropped most of the tax increases contained in the budget agreement passed by the Senate on June 29. Assembly Republicans had opposed the Senate tax package, as well as the Assembly Democrats' substitute plan, the latter of which included a \$2.13 per pack cigarette tax increase. The final agreement also included passage of ACA 11, which when fully implemented would allocate 3 percent of General Fund revenues for infrastructure. Sources cite inclusion of ACA 11 in the budget deal as a critical factor for securing Assemblyman Keith Richman's (R-Northridge) support for the budget.

The agreement also allows businesses to carry forward and deduct 100 percent of their net operating losses (NOLs) after a two-year suspension of the deduction. Under current law, businesses can carry forward 60 percent of their NOLs (current law increases the carry forward provision to 65 percent in 2004). The Senate package increased the allowable percentage to 80 percent. The last minute change provides businesses with a larger tax break beginning in 2004.

The final tax package will increase 2002-03 revenues by \$2.4 billion. In contrast, the Senate's June tax package raised \$3.9 billion. In addition to the NOL provisions described above, which are estimated to raise \$1.2 billion, the final tax bill (AB 2065) conforms the state's treatment of banks' bad debts to federal law (\$285 million), suspends the teacher tax credit (\$170 million), increases withholding on stock options and real estate transactions (\$625 million), and provides enhanced flexibility for the state to collect taxes owed by "high risk" accounts (\$145 million).

The provisions increasing withholding accelerate, but do not increase, the total amount of revenues the state receives.

On the expenditure side, the final agreement defers \$681 million in education appropriations from the current fiscal year to 2003-04. The same measure allocates \$406 million for equalization of school districts' revenue limits in 2003-04.

The final package does not include additional spending reductions, but it does allow that appropriations for state operations "may be reduced by up to 5 percent" or \$750 million. The 5 percent reduction is not, however, a required reduction. Even in the absence of this language, the Governor has the authority to line item veto part or all of any appropriation contained in the Budget. AB 593 also contains a spending cap and eliminates 1,000 vacant state positions (see below).

THE BOTTOM LINE

The final budget agreement will exacerbate, rather than mitigate, future years' projected deficits. The Legislative Analyst had estimated that the state would face operating deficits in the range of \$9 to \$12 billion in the years 2003-04 through 2007-08 under the spending plan adopted by the state Senate in June. The final agreement will deepen these deficits by at least \$650 million annually by not including the permanent tobacco tax increase contained in the Senate's previous plans. The impact will be substantially greater in 2003-04, due to the deferral of education spending and the elimination of the Senate's prior Vehicle License Fee (VLF) increase that would have raised \$1.3 billion in 2003-04. Moreover, if approved by the voters, ACA 11 will limit the ability of future legislatures to balance the budget by constitutionally dedicating a portion of the state's General Fund to infrastructure.

The Budget has been sent to the Governor, who is expected to sign it on Thursday, September 5. California's governors have broad constitutional line item veto powers and can reduce or eliminate any appropriation contained in the budget. Vetoes can be overridden by a two-thirds vote of the Legislature. Most observers expect that the Governor will make substantial reductions using his veto power.

THE VACANCY GAME, PART TWO

Currently, the so-called "six-month rule" provides for the elimination of any civil service position that is vacant for six consecutive months during a single fiscal year. The Department of Finance may reinstate positions eliminated due to late enactment of the state Budget, or due to recruitment problems for "hard-to-fill" positions.

The 2002-03 budget agreement includes several provisions related to vacant positions. AB 425 eliminates a minimum of 6,000 vacant civil service positions. These are to be chosen by the Department of Finance from positions that were vacant on June 30, 2002, regardless of how long the position had been vacant. Public safety and 24-hour care positions are exempted from this provision, as well as positions in entities including the University of California, California State University, Legislature, Judiciary, and lottery system.

AB 593 requires the Department of Finance to eliminate at least 1,000 civil service positions by June 30, 2004. (It is implied, but not specified, that these are in addition to the 6,000 positions eliminated by AB 425). The legislation gives priority to vacant positions and exempts positions that “provide 24-hour care, public safety, and critical services to the state.” AB 593 also provides for a “golden handshake” to encourage early retirement for specified state employees; presumably, the positions thus left vacant would be eliminated.

AB 3000 specifies that, beginning July 1, 2002, the six-month rule applies to any consecutive six-month period, not just to a single fiscal year. Public safety and health positions are exempted. This legislation also adds hiring freezes to the circumstances under which the Department of Finance may reinstate positions lost under the six-month rule.

For more information on state law regarding vacant civil service positions, see CBP’s Budget Brief, “The Civil Service Vacancy Game: Abusive Practices Or Underlying Structural Problems?” (May 2002)

THE BUDGET PACKAGE

To the best of our knowledge, the bills constituting the budget agreement include:

AB 425 – Budget Bill

HR 96 – Establishes a commission on “Structural Challenges to Budgeting in California”

ACA 11 – Infrastructure constitutional amendment

SB 1831 – Tobacco settlement securitization

SB 1834 – Transportation loans

AB 442 – Health

AB 444 – Human services

AB 523 – Medi-Cal pharmacy reimbursement increase

AB 593 – Spending cap, vacant position elimination

AB 692 – Human services clean-up

AB 1100 – Education

AB 1768 – General government

AB 2065 – Tax and revenue

AB 2781 – Education deferral and equalization allocation

AB 2785 – Education

AB 2996 – Transportation

AB 2997 – Resources

AB 2998 – Education

AB 3000 – General government

AB 3004 – Millbrae loan deferral

AB 3006 – Medi-Cal provider rates

AB 3009 – Natural Heritage Tax Credit/Energy Surcharge

AB 3010 – Unemployment insurance (alternative base period)