



California Budget Project
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GOVERNOR RELEASES MAY REVISION: BUDGET GAP NOW \$23.6 BILLION

The Governor released his May Revision to the 2002-03 Budget on Tuesday May 14. The May Revision outlines a marked deterioration in the state's fiscal condition since January. The following summary describes major proposals and assumptions contained in the May Revision. This report is preliminary. For updates please check the California Budget Project's web site at <http://www.cbp.org>.

WHAT CHANGED BETWEEN JANUARY AND MAY?

The May Revision reflects a budget gap that is nearly twice as large as that assumed by the Governor's Proposed 2002-03 Budget released in January. The May Revision attempts to bridge a \$23.6 billion gap between revenues and expenditures in the 2001-02 and 2002-03 fiscal years. The deterioration in the state's fiscal condition reflects a \$9.5 billion drop in revenues and \$1.6 billion in additional costs.

In January, the Governor outlined a plan for bridging a \$12.5 billion gap between revenues and expenditures. The May Revision addresses a \$23.6 billion gap. The Governor proposes to bridge the additional gap with program reductions (\$2.4 billion); securitizing a larger portion of the state's tobacco settlement payments (\$2.1 billion); loans (\$478 million); deferring certain payments to schools (\$1.1 billion); restructuring state debt payments (\$1.1 billion); tax conformity and compliance initiatives (\$760 million); accelerations, transfers, and shifts (\$233 million); and tax increases including a deferral of net operating loss carryforwards (\$1.2 billion), a \$0.50 per pack increase in cigarette taxes (\$475 million), and a temporary increase in Vehicle License Fees (\$1.276 billion).

While K-12 Education shows the largest dollar reduction in spending, most of the drop is attributable to deferring spending from the current year to the beginning of the upcoming budget year. The May Revision includes \$1.126 billion in General Fund reductions to Health and Human Service programs. The dollar impact on many programs is much larger due to the loss of federal matching funds. The \$3.8 billion in additional 2001-02 and 2002-03 spending reductions includes \$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 Governor's tax 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 operating loss (NOLs) carryforwards mirrors a provision contained in the 1991-92 Budget signed into law by then-Governor Pete Wilson. The Governor 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 revenue forecast used as the basis of the May Revision assumes that revenues will increase by 6.5 percent between 2001-02 and 2002-03. Of the \$4.8 billion in anticipated revenue growth in 2002-03, approximately half is attributable to growth and half to policy proposals contained in the May Revision. The forecast predicts continued weakness in personal income tax collections, driven by the drop in taxes paid on stock options and capital gains, but substantial growth in corporate income tax collections. The projected strength in corporate tax collections may be optimistic, since receipts from this tax lagged the January forecast by \$230 million (7.1 percent) as of the end of March.

The May Revision assumes that the state will receive \$1.081 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.

HEALTH PROGRAMS CUT SUBSTANTIALLY

The May Revision proposes an additional \$1.1 billion (\$758.3 million General Fund) reduction in Medi-Cal expenditures from the Governor's January 2002-03 Budget. Reductions include:

- Rolling back the expansion of the 1931(b) Medi-Cal program to two-parent working families with incomes up to 100 percent of the federal poverty level, for a savings of \$184.2 million (\$92.1 million General Fund). The Governor's January Budget projected that approximately 92,000 additional individuals would receive coverage under the expansion during 2002-03.
- Eliminating selected optional Medi-Cal benefits for a savings of \$526 million (\$263 million General Fund). These benefits include dental, chiropractic, podiatry, acupuncture, occupational therapy, psychological, rehabilitation, and certain medical supplies.
- Reinstating Medi-Cal quarterly status reporting, for a savings of \$310.8 million (\$155.4 million General Fund).
- A 20 percent reduction in Medi-Cal county administration funding, for a savings of \$175.9 million (\$87.9 million General Fund).
- A \$94 million (\$47 million General Fund) reduction in Medi-Cal provider payments.
- A delay in implementing "express lane" Medi-Cal eligibility for enrollees in the National School Lunch and Food Stamp programs until July 2005, for a savings of \$51.6 million (\$25.8 million General Fund).
- 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.
- Eliminating of the Medi-Cal/Healthy Families Program media outreach budget, for savings of \$18.6 million (\$7.2 million General Fund).

In addition, the May Revision:

- Continues to postpone the expansion of the Healthy Families Program (HFP) to cover parents until July 2003.
- Retains the Child Health and Disability Prevention (CHDP) program as a gateway program for Medi-Cal or the HFP. The May Revision also eliminates \$17.5 million in Tobacco Settlement Funds (TSF) for the Expanded Access to Primary Care (EAPC) program, which were provided when the Governor proposed eliminating the CHDP program in January.
- Eliminates the Adult and Children's Systems of Care mental health programs (\$42.6 million).
- Requires counties to fund a 10 percent share-of-cost for growth in the Early and Periodic Screening,

Diagnosis, and Treatment (EPSDT) and Therapeutic Behavioral Services (TBS) programs (\$35 million).

- Deletes \$35 million in Tobacco Settlement Funds (TSF) for local youth tobacco prevention programs.
- Assumes the state will receive an additional \$400 million in federal funds to offset the state cost of Medi-Cal services in the budget year, rather than in the current year as was assumed in the Governor's January budget proposal.

FEW CHANGES TO CALWORKS PROGRAM

The May Revision makes few substantial changes to the CalWORKs program. The May Revision:

- Restores \$20 million of the \$58 million that was cut from the California Community College CalWORKs program in January. The CCC's CalWORKs program provides job placement services, work study, and other education-related work experience to CalWORKs participants.
- Uses \$120 million in one-time performance incentive funds previously paid to the counties to fund CalWORKs employment services costs.
- Reinstates "deeming" requirements for parents of minor parents (known as "senior parents") who live at home. Senior parents' income would be counted in determining eligibility of the grandchild for cash assistance, saving an estimated \$12.1 million.
- Increases the 2002-03 TANF block grant reserve to \$90 million by redirecting \$50 million from the child care reserve.

ADMINISTRATION OF SOCIAL SERVICES SLASHED

The May Revision:

- Reduces funding for county administration of the CalWORKs, Foster Care, Food Stamps, In-Home Supportive Services (IHSS), and children's services programs, by \$300 million or more in combined federal, state, and county funds (\$98 million General Fund). This is in addition to a reduction in funds for county administration of Medi-Cal and represents a 20 percent reduction in administrative funding for the Foster Care, Food Stamps, and IHSS programs.
- Suspends the pass through of the federal cost-of-living adjustment (COLA) for Supplemental Security Income/State Supplementary Payment (SSI/SSP) recipients. The Governor's January Budget suspended the state COLA but retained the 1.8 percent federal COLA. This will decrease monthly grant levels by \$9 for individuals and \$15 for couples as compared to the January Budget.
- 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.
- Includes \$11.6 million General Fund for the state's portion of the 2001 federal food stamp error rate penalty. The remaining \$104.2 million of the penalty will be assessed on counties whose error rates prompted the sanction.
- Includes \$557,000 to support a shift from a monthly to a quarterly reporting system for food stamp and CalWORKs beneficiaries in order to reduce quarterly administrative errors, resulting in annual savings of \$16.9 million beginning in 2003-04.
- Includes a \$44.9 million to pay an anticipated federal penalty of \$89.7 million due to the delay in implementing a statewide-automated child support collection system. The Governor assumes counties will pay the remainder of the penalty (\$44.8 million).

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. These included 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. (See CBP's April Budget Brief, "Shifting the Burden on Child Care: Will Families Be Able To Afford The Governor's Plan?" at <http://www.cbp.org>.)

In the May Revision, the Governor suspends his reform proposal and "restore(s) programs to baseline levels as adjusted for revised caseload projections, and extend services, through the budget year only, for all prior CalWORKs families who reach the time limits for transitional benefits." Restored funds include \$103.7 million to fully fund the "budget year Stage 3 cohort" until June 30, 2003, and a reduction of \$22.2 million due to savings from lower Stage 3 caseloads. The May Revision also reduces funding for CalWORKs Stage 2 by \$85.9 million, primarily due to an estimated enrollment decline of 21,400, "primarily due to families meeting their five-year federal time limit for CalWORKs." The Department of Social Services subsequently clarified that the only families losing services under this provision will be those currently receiving child care because they are required to work in community service, a requirement that ends when they reach their five-year time limit. The May Revision also shifts a portion (\$11.1 million) of the expansion in the Before and Afterschool Program, proposed in January, to newly received federal funds from the No Child Left Behind Act.

K-12 EDUCATION

- Proposition 98 provides a constitutionally guaranteed level of state and local funding for K-12 Education, the 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 increases 2002-03 General Fund Proposition 98 spending over the January Budget by \$848.4 million (2.7 percent), to \$32.2 billion. The 2002-03 Proposition 98 guarantee increases by \$1.184 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 \$335 million in higher local revenues, including \$115 million from a proposal to require redevelopment agencies and multi-county special districts to make allocations to the Education Revenue Augmentation Fund (ERAF).
- The May Revision reduces General Fund spending for K-12 Education in 2001-02 by \$1.38 billion below the January Budget, including the spending deferrals, shifts in funding source, and increases in local revenues mentioned above. General Fund K-12 spending in 2002-03 increases by \$137.8 million over the January Budget corresponding to a per pupil spending level of \$7,186. The budget year increase is due, in part, to higher estimates of enrollment growth (\$290 million).
- The May Revision provides \$107.6 million to fund a 2 percent cost of living adjustment (COLA) for general purpose apportionments for school districts and county offices of education and special education.
- The May Revision includes \$738 million in increased federal funds from the No Child Left Behind Act for programs to increase accountability and student achievement, including \$315 million for professional development; \$131.1 million for teacher training; \$206.7 million for K-3 class size reduction; and \$28.9 million for assessment improvements and data system development.

TOBACCO SETTLEMENT

The May Revision expands upon the January proposal to securitize a share of the state's tobacco settlement revenues to provide for an additional \$2.1 billion to help bridge the budget gap, for a total of \$4.5 billion in accelerated revenues in 2002-03. The May Revision also proposes to defer debt service payments on the securitization until 2003-04. The proposed increase in the securitization will result in reduced revenues for 23 years into the future.

HOUSING

The May Revision reduces the Department of Housing and Community Development's (HCD) budget by \$27.9 million. The Governor attributes \$13.5 million of this to "transfers, loans, and fund shifts." The largest HCD cuts are to the Farmworker Housing Program (\$11.5 million), the Emergency Housing Assistance Program (\$6.0 million), and the Self-Help Housing Program (\$5.6 million). In addition, the Integrated Services for Homeless Adults Program under the Department of Mental Health is reduced by \$10 million.

LABOR AND WORKFORCE DEVELOPMENT AGENCY

The May Revision proposes redirecting \$1.8 million and 17 positions from the Employment Development Department (EDD), Department of Industrial Relations (DIR), and the Workforce Investment Board (WIB) to the proposed new Labor and Workforce Development Agency. The agency will also include the Agricultural Labor Relations Board.

TECHNOLOGY, TRADE, AND COMMERCE AGENCY (TTCA)

The May Revision proposes to reduce the TTCA's budget by \$17.4 million. The reductions come from program cuts (\$13.5 million) and eliminations (\$3.9 million). The May Revision also transfers or loans \$37.1 million from various special funds under the TTCA to the General Fund. Many reductions reflect recommendations made by the Legislative Analyst's Office earlier this year.

LOCAL GOVERNMENT

The Governor's May Revision:

- Eliminates \$38.2 million from cities and special districts for reimbursement of booking fees paid to counties and other cities.
- Eliminates \$39 million in subventions to local governments for property tax losses suffered due to Williamson Act contracts. The Williamson Act authorizes local governments to enter into contracts with private landowners to restrict land to agricultural or open space use; in return, landowners receive lower property tax assessments. The state has previously reimbursed local governments each year for the forgone property tax revenues.
- Proposes to require certain special districts and redevelopment agencies to pay into the Educational Revenue Augmentation Fund (ERAF), for a total of \$45 million and \$75 million, respectively.
- Maintains the backfill of local governments for the reduction in VLF revenues, although at a level reflecting the proposed increase in the VLF rate.
- Eliminates the Juvenile Crime Prevention Program, for a savings of \$111.3 million. Technology grants to local law enforcement are reduced by \$16.9 million from the January Budget. Reductions to the War on Methamphetamine Program (\$5 million) and the High Technology Theft Apprehension and Prosecution Program (\$4.2 million) leave \$10 million in each program.

- Proposes to substantially reduce funding for county administration of health and social service programs (see above).
- The May Revision proposes a reduction of \$246.1 million in the current and budget year by suspending state payments to local governments for reimbursable state mandate claims. When the Legislature or a state agency mandates a new program or a higher level of program services, the state is generally required to reimburse local governments for the increased costs. If a local government is not reimbursed for costs related to a claim that it believes is reimbursable, it can file a claim with the Commission on State Mandates.
- The May Revision proposes a \$49.6 million net reduction for trial court funding to local governments. This reflects a \$9.6 million increase to cover increased security costs and a \$59.2 million reduction in funding for trial court operations. It is unclear whether counties will be required to backfill this reduction.

HIGHER EDUCATION

The May Revision:

- Reduces the University of California's (UC) budget by a net of \$162.4 million, reflecting \$157 million in reductions, \$8.2 million in increases for enrollment growth and annuitant health and dental benefits, and \$13.8 million in savings.
- Proposes a \$50.4 million net reduction in state funding for the California State University (CSU) system, reflecting \$70 million in reductions, \$19.5 million in increases for enrollment growth and annuitant health and dental benefits, and a small augmentation for insurance costs.
- Proposes a net reduction of \$109.3 million in funding for the California Community Colleges (CCC) in the current year, including \$115.6 million in undisbursed allocations that is moved to the budget year. For the budget year, the Governor proposes a net increase of \$115 million, including a restoration of \$20 million to Special Services for CalWORKs.
- Reduces the budget for the Student Aid Commission, which administers the Cal Grant financial aid programs, by \$10 million in the current year and \$58 million for 2002-03, due to awards and eligible students coming in below estimates. The May Revision proposes an additional \$21 million in reductions for 2002-03.

CIVIL SERVICE VACANCIES

The May Revision proposes to eliminate 4,000 state government positions, primarily vacant positions that are not critical in providing public health and safety services. The Governor also proposes to amend state law to abolish positions that are continuously vacant for six months, regardless of fiscal year; currently the six-month rule only applies within a fiscal year. (See CBP's April Budget Brief, "The Civil Service Vacancy Game: Abusive Practices or Underlying Structural Problems?").

CORRECTIONS SPENDING INCREASES

The May Revision contains a \$185.9 million increase for the Department of Corrections. Most of the increase is attributable to workers compensation costs (\$42.1 million) and contract medical costs (\$115.5 million). The May Revision does not include the delay in funding for the planned Delano prison as adopted by the Budget Committees of the Legislature.

OTHER REDUCTIONS

The May Revision proposes reductions across nearly all of state government, including the Governor's Office and the budgets of other constitutional officers.