



THE GOVERNOR'S MAY REVISION TO THE 2003-04 BUDGET

On May 14, Governor Gray Davis released the May Revision to the 2003-04 Budget. The so-called May Revision outlined proposals for bridging a budget gap that is \$3.6 billion larger than was anticipated in January. The widening gap stems from increased caseload costs (\$1.5 billion), increased Proposition 98 school spending (\$0.7 billion), cancellation of \$2.0 billion of planned bond sales that would be repaid from the state's share of tobacco settlement proceeds, a net increase in anticipated revenue collections (\$0.3 billion), and other minor factors. Major features of the May Revision include:

- A proposal to borrow \$10.7 billion, to be repaid through a temporary half-cent sales tax increase;
- A substantial reduction, from \$8.3 billion to \$1.7 billion, in the scope and dollar value of programs that would be shifted from the state to local governments under a proposed realignment of financial responsibility;
- A commensurate reduction in the size of the tax increase originally proposed to support realignment;
- An assumption that the state will not issue the final \$2 billion in tobacco settlement bonds authorized as part of the current year's budget agreement. Cancellation of the remaining bond issue will free up approximately \$200 million in annual settlement payments that otherwise would have gone to repay the debt, but results in a \$2 billion shortfall in the current year;
- A net reduction of \$1.853 billion in the share of the budget gap that would be filled through program reductions and savings; and
- A rejection by the Legislature of \$2.2 billion in current year "solutions" and an "erosion" of the value of "solutions" by \$0.7 billion.

If adopted in their entirety, the Governor's proposals would leave the state facing a \$7.9 billion structural deficit in 2004-05 and beyond. The structural gap represents the difference between the ongoing cost of programs and services as outlined by the Governor's proposals and the amount raised by the state's revenue system. The May Revision assumes that the state will end 2003-04 with a \$509 million reserve.

A copy of the May Revision can be downloaded from the Department of Finance's web site at www.dof.ca.gov.

TAXES AND REVENUES

The May Revision substantially scales back the tax increase that would support a realignment of program responsibilities to counties, imposes a temporary half-cent sales tax to repay bonds issued to retire the deficit, and assumes that the Vehicle License Fee (VLF) "trigger" will be pulled. Specifically, the May Revision:

- Drops a proposal to impose 10 percent and 11 percent rates on wealthy personal income taxpayers and replaces it with a proposal to institute a 10.3 percent rate. The January proposal raised an estimated \$2.6 billion in 2003-04, while the new proposal would raise \$1.6 billion. The proceeds would remain earmarked for realignment.
- Drops a proposed one-cent permanent increase in the state's sales tax rate originally dedicated to realignment and replaces it with a temporary half-cent rate earmarked for deficit bond repayment. The January proposal would have raised an estimated \$4.6 billion in 2003-04 with an effective date of July 1, 2003. The new proposal raises an estimated \$1.7 billion based on an October 1, 2003 effective date.
- Reduces the proposed \$1.10 per pack cigarette tax increase to \$0.23 per pack in 2003-04 and \$0.40 per pack in 2004-05. The January proposal would have raised an estimated \$1.17 billion, while the May proposal raises an estimated \$267 million in 2003-04 and \$678 million in 2004-05.
- Reduces the estimate of revenues that would be contributed from tribal gaming activities from \$1.5 billion to \$680 million.
- Suspends the Teacher Tax Credit for an additional year, raising an estimated \$175 million.
- Assumes that the VLF trigger is pulled. On an annual basis, this will restore \$2.97 billion in general purpose revenues to cities and counties and frees up \$987 million that otherwise would have gone to support programs shifted to counties as part of the 1991 realignment and to Orange County to pay outstanding debt.

REALIGNMENT

The Governor scales back the \$8.3 billion shift in responsibility for state services to counties proposed in January. While stating that "realignment remains a crucial component of structural reform," the Governor defers much of his original proposal until 2004-05. Instead, the Governor proposes to increase the county cost-sharing ratios for seven mental health and social services programs, for General Fund savings of \$1.7 billion, in exchange for new, dedicated revenue sources. Programs slated for realignment include Children's System of Care (CSOC); Integrated Services for Homeless; Child Abuse Prevention, Intervention, and Treatment (CAPIT); Foster Care grants and administration; Child Welfare Services; Adult Protective Services (APS); and CalWORKs grants, employment services, and administration. Counties would have 100 percent of the non-federal financial responsibility for CSOC, Integrated Services for Homeless, CAPIT, and APS.

MEDI-CAL

The May Revision:

- Eliminates the January proposal to reduce eligibility for low-income parents in the 1931(b) Medi-Cal category to 61 percent of the Federal Poverty Level (FPL). Parents in families with incomes of up to 100 percent of FPL would continue to qualify for Medi-Cal under the revised proposal.
- Shifts Medi-Cal accounting from an accrual basis to a cash basis for one-time General Fund savings of \$930 million.
- Increases efforts to investigate and prevent Medi-Cal fraud for estimated savings of \$20.1 million (\$12.3 million General Fund) in 2003-04.

- Maintains the January proposals to reinstate Medi-Cal quarterly status reports, reduce Medi-Cal provider rates by 15 percent, eliminate certain Medi-Cal benefits not required by federal law, and rescind the expansion of no-cost Medi-Cal to aged and disabled individuals with incomes up to 133 percent of FPL.

OTHER HEALTH CARE PROPOSALS

The May Revision:

- Reduces the copayments for the AIDS Drug Assistance Program (ADAP), which were proposed in the Governor's January Budget to between \$5 and \$15 per prescription, rather than between \$30 and \$50 per prescription.
- Appropriates \$90.3 million (\$3.9 million General Fund) and creates 96.0 positions for a new Public Health Response Team to address the bioterrorism threat, SARS, and other public health threats.
- Reduces funding for the Expanded Access to Primary Care Program by \$2.4 million and reduces funding for the Adolescent Family Life Program by \$1.6 million. Both programs are excluded from the Governor's revised realignment proposal.
- Reverses the January proposal to consolidate the Emergency Medical Services Authority (EMSA) into the Department of Health Services and restores \$10.8 million in General Fund support.

CALWORKS

The May Revision:

- Rescinds the Governor's January proposal to reduce CalWORKs cash grants by 6.2 percent on July 1, 2003.
- Maintains the January proposal to suspend the June 2003 and October 2003 statutory cost-of-living adjustments (COLAs). Maximum monthly grant levels for 2003-04 would be frozen at \$679 for a family of three in high-cost counties and \$647 in low-cost counties. Grant levels have not been adjusted for inflation since October 2001.
- Estimates that the average monthly CalWORKs caseload will decline from 481,779 in 2002-03 to 471,106 in 2003-04.
- Estimates that a monthly average of 51,161 adults will reach the CalWORKs 60-month time limit in 2003-04, slightly more than half of the January estimate of 100,590.
- Decreases a one-time augmentation for CalWORKs employment services in 2003-04 by \$84.6 million as compared to the January Budget.
- Counts an additional \$57.0 million (General Fund) in child care spending toward the state's required \$2.7 billion maintenance of effort (MOE) for the Temporary Assistance for Needy Families (TANF) block grant.
- Creates a \$270.0 million TANF reserve, citing the need to respond to unanticipated program costs.

In addition, the Governor proposes to use federal Temporary Assistance for Needy Families (TANF) block grant funds to offset General Fund spending in other areas of the budget. The May Revision:

- Uses a total of \$53.0 million in TANF funds to offset an equivalent amount of General Fund spending on Child Welfare Services.
- Uses \$101.0 million in one-time TANF funds to offset Proposition 98 General Fund child care expenditures.

OTHER SOCIAL SERVICE PROGRAMS

The May Revision:

- Rescinds the January proposal to reduce Supplemental Security Income/State Supplemental Payment (SSI/SSP) grants by more than 6 percent on July 1, 2003.
- Maintains the proposal to suspend the June 2003 and January 2004 state COLAs. However, a federal COLA estimated at 2.1 percent would be passed through to SSI/SSP recipients starting in January 2004. The current maximum monthly grant is \$757 for individuals and \$1,344 for couples.
- Increases General Fund spending for Foster Care by \$53.6 million in 2002-03 in order to compensate for a reduction in federal funding due to federal concerns that some relatives who are Foster Care providers do not meet health and safety standards.
- Restores \$1.3 million to the Naturalization Services Program that had been slated in January for reversion to the General Fund.

CHILD CARE

The Governor's revised realignment proposal does not include child care programs. The May Revision:

- Restores funding for CalWORKs Stage 3 child care and revises funding for CalWORKs Stage 1 and Stage 2 based on updated caseload estimates.
- Makes 13 year olds ineligible for state subsidized child care.
- Eliminates child care subsidies for families with incomes above the current eligibility cap who were "grandfathered" in when the cap was reduced several years ago;
- Modifies reimbursement rates for providers in order to achieve \$167 million in savings by lowering rate limits for providers who do not participate in the market; prohibiting payment of an hourly rate for full-time care, limiting evening and weekend premium rates to licensed providers; and reducing the regional market rate ceiling for licensed providers to the 80th percentile.
- Imposes a modified family fee schedule in order to achieve \$33 million in savings.
- Restores full funding for After School Safety and Education Programs.
- Removes the fingerprinting exemption for small licensed child care providers.

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 fully funds the 2003-04 Proposition 98 guarantee at the Test 2 level of \$45.6 billion (\$29.7 billion General Fund). The 2003-04 Proposition 98 funding level is \$1.511 billion (\$1.503 billion General

Fund) higher than the January Budget estimate, in part due to the rejection of the proposal to remove \$879 million in child care funding from the guarantee. The May Revision proposes to:

- Decrease General Fund spending for K-12 Education in 2002-03 by \$29.8 million below the enacted mid-year reductions. The May Revision includes \$29.1 billion in General Fund K-12 spending in 2003-04, an increase of \$1.7 billion (6.2 percent) over the January Budget. The May Revision results in a per-pupil funding level of \$6,869, which is \$231 (3.5 percent) above the current year.
- Provide \$272 million to fund an increase in projected 2003-04 enrollment growth since the January estimate, and increase revenue limit funding by \$262 million. Revenue limits provide general purpose revenues to local school districts.
- Provide increases above the January Budget of \$179.7 million to fully fund Class Size Reduction, \$44.4 million for the Intermediate Intervention/Underperforming Schools Program, \$20.9 million for the High Priority Schools Grant program, \$63.4 million (\$27.8 million General Fund) to fully fund Special Education, and \$35 million to mitigate the PERS offset to revenue limits.
- Revise the January proposal to modify state funding for Basic Aid districts - districts with sufficient local property tax revenue to fully fund their general purpose allocations - resulting in \$37.8 million in anticipated General Fund savings. This amount is \$106.2 million lower than the savings proposed in January.
- Restore \$835 million in categorical program reductions proposed in January by eliminating \$250 million in equalization funding, \$129 million for deferred maintenance, \$125 million for deferred mandate reimbursements, \$114 million for teacher recruitment and retention programs, \$85 million for summer school, \$76 million for instructional materials, \$80 million for supplemental grants, \$42 million for the School Improvement Program, and \$60 million for reading programs.
- Reduce funding for the Principal Training program by \$22.5 million and for the California State Library by an additional \$0.6 million over the January Budget.

CALIFORNIA COMMUNITY COLLEGES

The May Revision proposes to:

- Reduce Proposition 98 funding for community colleges by \$30.5 million in 2002-03 below the mid-year adjusted spending level due to a revision in estimates of local property tax revenues.
- Increase 2003-04 Proposition 98 General Fund spending on community colleges by \$304.1 million above the January Budget. The May augmentation includes \$154.7 million to reflect higher enrollment due to a reduction in the proposed student fee increase from \$24 to \$18 per unit, \$66.6 million to restore proposed across-the-board reductions to apportionments, \$4.4 million for growth due to the mid-year adjustments, and \$55 million to reduce the proposed elimination of funds related to improper concurrent enrollment.

HIGHER EDUCATION

The May Revision proposes to:

- Increase 2003-04 funding for the University of California (UC) by \$1.5 million to backfill student fee revenue losses pursuant to the anticipated passage of AB 307 (Maddox), which offers fee waivers to members of the California National Guard.
- Increase 2003-04 funding for the California State University (CSU) by \$1.5 million to backfill losses attributable to AB 307.
- Consolidate the California Postsecondary Education Commission (CPEC) into the Student Aid Commission (SAC) by shifting CPEC funding (\$0.7 million General Fund, \$5.0 million federal funds) to the SAC. AB 655 (Liu) proposes to create a new commission consolidating the SAC, CPEC, and Bureau for Private Postsecondary and Vocational Education.
- Reduce funding for the SAC by \$20.0 million in the current year and by \$29.2 million in 2003-04, primarily attributable to revised estimates of the number of Cal Grant awards.
- Reduce funding for the Scholarshare Investment Board by \$16.8 million to reflect revised estimates of the number of Governor's Scholars Awards and Distinguished Math and Science Awards that will be issued in 2003-04.
- Restore the Governor's Scholarship Program, which was eliminated by SB 28X effective January 1, 2004.

LABOR AND WORKFORCE DEVELOPMENT

The May Revision proposes the same level of General Fund spending for the Labor and Workforce Development Agency (\$90.0 million). However, funding reflects a reduction of \$88.9 million in anticipated federal Workforce Investment Act (WIA) support in 2003-04.

STATE MANDATES

The state constitution requires the state to reimburse local governments for certain program costs they incur. The current year's budget deferred payment of the state's obligation for a number of mandates, and the Governor's January Budget proposed an additional deferral in 2003-04. The May Revision proposes to suspend 34 mandates and repeal one mandate in 2003-04, reducing the annual obligation for non-education-related mandates by roughly \$32.9 million. These actions would reduce the state's estimated total obligation for 2003-04 to roughly \$876.3 million (of which \$162.6 million is incurred in 2003-04). The May Revision proposes to continue deferral of these mandate payments, and the Governor indicates that he will propose elimination of 27 mandates in the 2004-05 Budget.

STATE OPERATIONS

The January Budget proposed an \$855 million (\$470 million General Fund) reduction in state employee compensation, subject to collective bargaining with state employee unions. In April, the Department of Finance ordered all departments to submit a plan to reduce ongoing personnel budgets by at least 10 percent in anticipation of the possibility of failing to reach such an agreement. The May Revision includes an increase of \$1.5 million for the Department of Personnel Administration (DPA) to implement a state employee layoff plan. The May Revision

continues the January Budget assumption of a \$95.5 million (\$65.9 million General Fund) net reduction in departments' base budgets for employee expenses, but cautions that other actions may be necessary if these savings do not occur.

HOUSING

The May Revision reduces the Department of Housing and Community Development (HCD) by \$88.1 million by:

- Transferring \$19.6 million from the Self-Help Housing Fund to the General Fund (\$12.6 million of this amount is a fund shift from the Self-Help Housing Fund to Proposition 46 bond funds and resultant transfer to the General Fund).
- Loaning \$31.7 million, and transferring \$9.7 million, from the Housing Rehabilitation Loan Fund to the General Fund.
- Making a \$27.1 million fund shift from the Farmworker Housing Grant Fund to Proposition 46 bond funds and resultant transfer to the General Fund.

TRANSPORTATION

The 2002-03 Budget included a \$1.045 billion loan from the Traffic Congestion Relief Fund (TCRF) to the General Fund. The January 2003-04 Budget proposed a \$100 million transfer (no repayment required) from the TCRF to the General Fund, as well as a suspension of the scheduled transfer of sales tax revenue from the General Fund to the Transportation Investment Fund (TIF) for \$1.1 billion in savings in 2003-04. The May Revision proposes to transfer \$207 million from the General Fund to the TIF and to defer the remaining \$938 million that is owed by the General Fund to the TIF.

TECHNOLOGY, TRADE, AND COMMERCE AGENCY (TTCA)

The May Revision proposes a \$3.8 million increase for the TTCA over the January Budget, through partial restoration of funds to the Tourism Commission, Office of Military Base Reuse and Retention, California Main Street Program, and Manufacturing Technology Program.

PAYMENT OF INTEREST ON GENERAL FUND LOANS

The May Revision indicates that estimated interest costs on borrowing from internal sources in 2002-03 - primarily special fund loans to the General Fund - has increased by \$15 million over January estimates (to \$45 million), due to factors including the state's failure to sell tobacco settlement bonds in April. Estimated interest due on internal borrowing in 2003-04, however, is expected to be \$0.6 million below January estimates (\$30.6 million total). The May Revision also indicates that interest costs on borrowing from external sources in 2002-03 will increase by \$91.1 million over January estimates (to \$302.6 million), primarily attributable to the anticipated issuance of Revenue Anticipation Warrants in June 2003. Estimated interest due on external borrowing in 2003-04 is expected to increase by \$120.0 million (to \$280.0 million).

PENSION OBLIGATION BONDS

The May Revision reflects passage of SB 29X to increase the pension obligation bonds to include special fund and non-governmental cost fund contributions to the California Public Employees' Retirement System (CalPERS). The May Revision does not include the State Teachers' Retirement System (STRS) component from the January proposal. The May Revision projects the net proceeds from the bond to total \$1.9 billion, to be partially offset by the spring 2004 payment of \$28 million, for a net General Fund benefit of \$371 million as compared to the January proposal.

DEFICIT FINANCING BOND

The May Revision proposes the sale of \$10.7 billion in bonds to bridge the current-year General Fund budget gap. The bonds would be financed through a temporary half-cent sales tax increase. The Governor indicates that since the revenues would be dedicated to bond repayment and deposited in a special fund, they would not be included in the calculation of the Proposition 98 funding guarantee. The Governor indicates that the proposal depends on the creation of a new independent revenue source, passage of the budget on time by the Legislature, and a proposal by the Legislature by the end of this session to address the structural budget deficit.

LOCAL GOVERNMENT

The May Revision:

- Does not change funding levels proposed in January for local governments for technology grants to local law enforcement (\$18.5 million); grants to small and rural county sheriffs (\$18.5 million); the Citizens Option for Public Safety (COPS) Program (\$116.3 million); and the Juvenile Crime Prevention Program (\$116.3 million).
- Maintains the January proposal to transfer property tax revenue from redevelopment agencies (RDAs) to school districts. (In redevelopment project areas, property tax revenue generated from the growth in the assessed value of property goes to RDAs for revitalization projects.) This transfer would shift \$250 million in local property taxes from RDAs to schools in 2003-04, and increasing amounts thereafter, resulting in equivalent General Fund savings. The Legislature has indicated bipartisan opposition to this proposal.
- Rejects the Governor's December mid-year proposal to redirect \$500 million from RDAs' Low and Moderate Income Housing Funds to the General Fund.
- Restores \$40.2 million in funding to local governments to backfill property tax losses under Williamson Act contracts, which are intended to preserve agricultural land. The January Budget eliminated these subventions beginning in 2003-04.

PUBLIC SAFETY

The May Revision proposes to:

- Increase Department of Justice funding by \$10.7 million over the January Budget, including \$3.2 million for the Spousal Abuser Prosecution Program, which aids counties in prosecuting those charged with domestic violence.
- Increase Department of Corrections funding by \$23.9 million over the January Budget. This includes a \$59.0 million increase for costs due to higher caseload and \$34.7 million in reductions, including \$5.4 million from postponing the opening of 500 substance abuse treatment beds, \$8.8 million from delaying activation of the Delano II prison facility, and \$13.0 million in health care program reductions.
- Increase the Commission on Peace Officers' Standards and Training by \$25.5 million to compensate local law enforcement officer training efforts.
- Shift \$32.5 million in Motor Vehicle Account funds to the Public Safety Surcharge Fund (PSSF) in accordance with a two-year plan to move funding for the California Highway Patrol homeland security and non-transportation security activities to the PSSF.

RESOURCES AND ENVIRONMENTAL PROTECTION

The May Revision proposes to:

- Reduce General Fund support for the Dam Safety Program by \$4.7 million and offset this reduction with fees.
- Revert \$7.2 million from a variety of energy-related programs and accounts to the General Fund.
- Loan \$20.0 million from the Public Interest Research, Development, and Demonstration Fund to the General Fund.
- Loan \$136.0 million from the California Teleconnect Fund Administrative Committee Fund to the General Fund.
- Increase loans from several recycling-related funds to the General Fund by \$44 million.

5/20/2003