



*Revised May 18, 2004*

## **GOVERNOR RELEASES MAY REVISION TO THE BUDGET**

On May 13, Governor Arnold Schwarzenegger released his May Revision to the 2004-05 Budget. The May Revision provides updated revenue and expenditure estimates, as well as modifications to the Governor's budget and policy proposals. This summary reflects a "quick and dirty" examination of proposals contained in the Governor's May Revision. It is based on the May Revision packet issued by the Administration and various documents and summaries prepared by local government and higher education organizations. Please check the California Budget Project's website for updates and/or corrections as they become available.

The Governor's May Revision largely relies on borrowing and temporary measures to bring the budget into balance. Many of the deepest cuts to human services, higher education, local government, and other programs proposed in January remain on the table. In recent days, the Governor has announced agreements with the University of California and California State University systems and local governments that would sustain 2004-05 reductions similar to those proposed in January, while increasing funding in future years. The Administration also announced that it would not include the specifics of a proposed "redesign" of the Medi-Cal program as part of the 2004-05 Budget. Instead, a package will be presented to the Legislature when it returns from its summer recess.

Relative to the Governor's January Proposed Budget, the May Revision increases spending for K-14 Education, Health and Human Services (primarily due to the rejection of a proposal to reduce Medi-Cal provider reimbursement rates by 15 percent), and Corrections. The May Revision would spend \$11.3 billion of the \$15 billion in deficit bond proceeds authorized by Proposition 57, reserving \$3.7 billion to help close the anticipated 2005-06 budget gap.

### **REVENUES MODESTLY HIGHER, SIGNIFICANT INCREASE ATTRIBUTABLE TO ABUSIVE TAX SHELTER VOLUNTARY COMPLIANCE INITIATIVE**

The May Revision projects that General Fund revenues will increase by a total of \$1.256 billion in the current and budget years. In addition, the May Revision treats as adjustments to prior years' revenues \$1.225 billion received through a Voluntary Compliance Initiative (VCI) for taxpayers that participated in abusive tax shelters, \$185 million from a proposed tax "amnesty" proposal, and the loss of \$465 million in corporate tax revenues due to a final decision in the Farmers Brothers Company lawsuit. Taken together, these three issues result in a net increase in General Fund resources of \$945 million. The additional revenues would be partially offset by reduced transfers, for a total improvement in General Fund revenues of \$1.19 billion in 2003-04 and 2004-05, combined.

The May Revision forecast may prove overly optimistic. The Administration estimates, for example, that 2003-04 personal income tax collections will be \$949 million above the January budget estimate, excluding the proceeds of the VCI. However, as of the end of April, receipts were just \$285 million above the January forecast (excluding VCI proceeds).

The May Revision assumes enactment of a tax amnesty program, which would generate \$185 million in additional revenues. The amnesty program would waive penalties for taxpayers that voluntarily remit back taxes and interest owed between February 1, 2005 and March 31, 2005. Penalties and interest on back taxes would increase after the close of the amnesty to encourage taxpayer compliance. The Franchise Tax Board estimates that the amnesty would reduce 2005-06 revenues by \$15 million and increase revenues by small amounts thereafter. Assemblymember Judy Chu's AB 2203 authorizes a tax amnesty.

#### PUNITIVE DAMAGE PAYMENT AWARDS DIVERTED TO THE GENERAL FUND

The May Revision assumes that the state will receive \$450 million by amending state law governing the payment of punitive damages in lawsuits. Under the Governor's proposal, 75 percent of punitive damage awards would be deposited in a state "Public Benefit Trust Fund" to be used "for State programs and purposes consistent with the punitive nature of the award." According to the May Revision, eight states currently have statutes that allocate a portion of damage awards to the state.

#### MEDI-CAL

The May Revision:

- Reaffirms the Governor's commitment to seek a federal waiver to restructure the Medi-Cal Program. The proposal could include higher cost sharing for Medi-Cal enrollees, moving more enrollees into managed care, eligibility simplification, and changes designed to stabilize financing for the state's public hospitals. The Administration plans to seek further public input and submit a proposal to the Legislature on August 2, 2004. However, the Administration indicates that if the Legislature does not approve the waiver proposal by the end of the session, it will work with the federal government to develop a waiver and seek the Legislature's concurrence in January 2005. Any changes to Medi-Cal would not take effect until at least 2005-06.
- Rescinds the Governor's proposal to reduce Medi-Cal provider rates by 10 percent in 2003-04 and 2004-05 and eliminates the 5 percent provider rate reduction that was included in the 2003-04 Budget, but which was blocked by a federal court, for additional General Fund costs totaling \$947 million in 2003-04 and 2004-05.
- Proposes to lower drug cost reimbursements for pharmacies to the "average wholesale price" minus 20 percent and to raise the dispensing fee from an average of \$3.59 to \$8.30, for General Fund savings of \$79.3 million in 2004-05.
- Assumes one-time General Fund savings of \$143 million reflecting a one-week delay in check issuance for Medi-Cal provider payments from the last week of 2004-05 into the next fiscal year.

## HEALTHY FAMILIES

### The May Revision:

- Rescinds the proposal to implement a two-tiered benefit package, but retains the proposal to increase premiums for children in families with incomes greater than 200 percent of the federal poverty level (FPL), effective July 1, 2005. Healthy Families monthly premiums would increase from \$9 to \$15 per child and from \$27 to \$45 for three or more children.

## OTHER HEALTH POLICY PROPOSALS

### The May Revision:

- Transfers \$20 million in Temporary Assistance for Needy Families (TANF) block grant funds to the Department of Health Services to fund the Community Challenge Grant Program to promote responsible parenting and reduce teenage and unwanted pregnancies.
- Increases counties' share of costs for the Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) Program from 10 percent to 20 percent for General Fund savings of \$12.6 million. This proposal excludes small counties.

## CALWORKS

### The May Revision:

- Maintains the Governor's major January CalWORKs proposals, including requiring CalWORKs participants to work at least 20 hours per week in "core" work activities within 60 days of the receipt of aid, and reducing child-only cash grants by 25 percent for CalWORKs families who are in sanction status for more than one month or who have reached the state's 60-month time limit and in which the adult does not work. In January, the Administration estimated that its CalWORKs proposals would result in \$167.0 million in grant savings, partially offset by \$136.5 million in additional child care and automation costs, for net CalWORKs savings of \$30.6 million (TANF block grant, General Fund, and county funds).
- Estimates a CalWORKs caseload of 465,400 in 2004-05, a 1.8 percent decrease from the 2003-04 projection of 473,900.

## CHILD CARE

### The May Revision:

- Amends the Governor's January proposal to limit the amount of time that former CalWORKs families may spend in Stage 3 child care. CalWORKs families would be able to place their names on waiting lists for General Child Care programs once they have earned income. Families in Stages 1 and 2 child care who are still receiving cash assistance as of June 30, 2004 would be able to receive services in Stage 3 for one year

once they enter Stage 3. Families in Stage 3 on June 30, 2004 would be shifted to the non-time-limited Alternative Payment (AP) child care program, with no loss of funding or services. Families in Stages 1 and 2 who are not receiving cash assistance as of June 30, 2004 would be eligible to receive services in Stage 3 for up to two years, instead of one year, once they enter Stage 3. To support these changes, \$249 million in Child Care and Development Block Grant funds would be shifted from Stage 3 to the AP child care program.

- Maintains the Governor's January proposals to reduce the income threshold at which families begin to pay child care fees, establish a three-tiered income eligibility structure for General Child Care programs, and implement a sliding scale to reimburse child care providers, with higher reimbursement reserved for accredited, licensed providers that integrate early childhood development principles.
- Reflects an increase of \$13 million from TANF block grant funds, primarily due to a revised number of 11- and 12-year-olds for whom after-school programs would be available.

## IN-HOME SUPPORTIVE SERVICES (IHSS)

The May Revision:

- Rescinds the proposal to eliminate the IHSS Residual Program, which uses state and county funds to cover services that are not eligible for federal funding. The Administration will seek a waiver from the federal government to obtain federal funds for the Residual Program caseload, which includes low-income blind, disabled, and elderly individuals. The federal share would be an estimated \$264 million, and the General Fund share would be an estimated \$135.2 million, in 2004-05. Eliminating the Residual Program could have resulted in about 75,000 low-income individuals, or 20.9 percent of the total IHSS caseload, losing services that help them to live safely in their own homes.
- Maintains the Governor's proposal to reduce the state's share of costs for IHSS provider wages and benefits from \$10.10 per hour to the state minimum wage of \$6.75 per hour, for savings of \$416.2 million (\$156.4 million General Fund) in 2004-05.

## FOOD STAMP PROGRAM

- The Administration announced that the federal government will reduce total federal penalties assessed on California as a result of the state's food stamp error rate from \$186.9 million to \$12.0 million.
- The May Revision rescinds the Governor's January proposal to repeal recent changes to California's food stamp eligibility rules that were designed to enroll more low-income households in the Food Stamp Program. The Governor had proposed to repeal the Transitional Food Stamps Program, which provides five months of continuous food stamp eligibility for families who leave CalWORKs cash assistance, as well as AB 231 (Steinberg, Chapter 743 of 2003), which excludes the value of an applicant's vehicle when determining food stamp eligibility and allows for the elimination of face-to-face interviews as an application requirement. Repealing these provisions would have saved about \$3.5 million General Fund in 2004-05, but would have resulted in the loss of \$203

million in federally-funded food stamp benefits to support about 81,000 low-income households.

#### OTHER HUMAN SERVICES PROGRAMS

The May Revision:

- Anticipates General Fund savings of \$32.5 million in 2004-05 due to proposed and ongoing “reforms” in the Foster Care Program. Proposed changes include providing stronger incentives for relatives to adopt foster children and reducing foster care eligibility verification from every six months to annually.
- Requires counties to pay a 30 percent share-of-cost for the nonfederal portion of the Child Welfare Services Program augmentation, which provides for additional county social workers in recognition of staffing needs.

#### ENROLLMENT CAPS IN HEALTH AND HUMAN SERVICES PROGRAMS

The May Revision:

- Indicates that the Administration will withdraw its proposal to implement “Enrollment Caps and Co-Payments for Various Health and Human Services Programs,” including the Healthy Families Program and the AIDS Drug Assistance Program.

#### IMMIGRANT PROGRAMS BLOCK GRANT PROPOSAL

The May Revision:

- Rescinds the proposal to consolidate funding for certain programs that serve documented immigrants into a block grant to be provided to counties. The programs proposed for consolidation were the Healthy Families Program for legal immigrants and three human services programs: CalWORKs for legal immigrants, the California Food Assistance Program, and the Cash Assistance Program for Immigrants. Rescinding this proposal results in increased General Fund spending of approximately \$6.7 million in 2004-05.

#### LOCAL GOVERNMENT

In January, the Governor proposed to shift approximately \$1.3 billion in property tax revenues from local governments to the Educational Revenue Augmentation Fund (ERAF) on an annual ongoing basis in order to decrease the state’s General Fund obligation under Proposition 98. The May Revision includes a new proposal, negotiated with local government leaders in recent weeks, which would provide \$1.3 billion in General Fund savings in each of 2004-05 and 2005-06. The agreement:

- Eliminates the Vehicle License Fee (VLF) backfill to local governments and cuts the VLF rate from two percent to 0.65 percent of the value of the vehicle. An equivalent amount of property taxes would be shifted from schools to counties and cities.

- In both 2004-05 and 2005-06, reduces property taxes allocated to counties and cities by \$700 million (\$350 million from counties and \$350 million from cities). In each of these two years, \$350 million in property taxes would be shifted from special districts and \$250 million would be shifted from redevelopment agencies to schools. Beginning in 2006-07, local governments would receive the full amount of property taxes, plus growth (the shift proposed in January was annual and ongoing and hit counties significantly harder than other local governments).
- Commits that the state would begin to pay existing debts to local governments for state-mandated local programs over a five-year period beginning in 2006-07. The mandate process will be modified to provide for repeal of unfunded mandates.
- Commits to placing a constitutional amendment on the November ballot, pursuant to legislative approval, to protect local governments' property, sales, and VLF revenues. Local government leaders have committed to support the new constitutional amendment and drop support of the initiative for which they have already filed signatures, the Local Taxpayer and Public Safety Protection Act.

## STATE OPERATIONS

The May Revision proposes to include control sections in the budget bill that:

- Provide authority to implement recommendations from the California Performance Review (CPR). The January budget announced that the CPR would release its recommendations by April 30, 2004 to streamline government, and thereby achieve unspecified savings. However, no announcement has been made, and the CPR is not otherwise mentioned in the May Revision, although press reports state that the CPR may release recommendations by June 30.
- Give the Director of Finance authority to reduce appropriations in 2004-05 by \$150 million. The Director of Finance would work with Agency Secretaries to determine how this reduction would be allocated.
- Authorize the Director of Finance to reduce appropriations to the extent that savings are achieved through purchasing goods and services in bulk, for estimated General Fund savings of \$96 million.

The May Revision also proposes adoption of legislation to reform the state's processes for managing real property and selling surplus property, for an estimated \$50 million General Fund increase in 2004-05 and larger amounts in subsequent years. The Governor proposes to fund this reform through \$2.8 million from the Property Acquisition Law Account, existing department budgets, and "some one-time resources."

## STATE EMPLOYEE COMPENSATION

The May Revision proposes:

- A reduction of \$857.8 million (\$465.4 million General Fund) in state employee compensation in 2004-05, which would be achieved through collective bargaining agreements. (\$300 million of this is attributable to anticipated savings from

renegotiation of the existing agreement with correctional officers at the Department of Corrections).

- Control language to prohibit any increase to state employee compensation beyond the levels already approved for 2003-04.
- No change to the January proposal of nearly \$1 billion in pension obligation bonds to help fund current CalPERS obligations, despite the fact that a pension obligation bond proposal included in the 2003-04 Budget was initially rejected at the trial court level.

## PROPOSITION 98 GUARANTEE

The May Revision reflects an increase in the 2004-05 estimated Proposition 98 guarantee for K-14 Education to \$47.0 billion, an increase of \$275.2 million from the level in the Governor's January Proposed Budget. However, the May Revision maintains the January budget proposal to reduce 2004-05 Proposition 98 funding to \$2 billion below the estimated guarantee level. The state's contribution to the guaranteed funding level would increase by \$4.3 billion relative to the January Budget, while the local contribution would decrease by \$4.0 billion. This change largely reflects the local government budget agreement.

## K-12 EDUCATION

The May Revision:

- Increases Proposition 98 funding by \$230.4 million in 2003-04 and by \$145.3 million in 2004-05 relative to the January Proposed Budget. Proposed funding from all sources for K-12 Education would total \$58.9 billion in 2004-05, an increase of \$818.7 million from the Governor's January Budget level. State funding would increase by \$4.2 billion relative to 2003-04, while local property tax revenues would decline by \$2.4 billion. The increase in state funding reflects the agreement between the Administration and local governments.
- Increases 2004-05 per pupil funding to \$7,007, slightly less than the revised 2003-04 level of \$7,011, and an increase of \$62 per pupil from the Governor's January Budget level.
- Increases funding for the 22 categorical programs that would be shifted into school districts' general purpose allocations ("revenue limits") by \$36 million to reflect growth and cost-of-living adjustments.
- Reflects an increase of \$50.6 million in support for "revenue limits," the basic general purpose state funding provided to local school districts.
- Proposes to reduce categorical funding to basic aid districts by \$2.7 million, which would reduce General Fund support by an amount equivalent to a 0.3 percent revenue limit reduction.
- Provides \$100 million for the purchase of instructional materials conforming to the 1998 academic content standards adopted by the State Board of Education. The Governor's January Budget allocated \$188.0 million for this purpose.
- Funds 2004-05 revenue limit equalization at the \$110 million level proposed in January.

## COMMUNITY COLLEGES

The May Revision:

- Increases community college funding by \$30.8 million in General Fund monies in 2003-04 and by \$623.7 million in 2004-05. Most of the 2004-05 increase reflects \$492.6 million in additional state funding, offset by a reduction in local property tax revenues of the same amount. These changes reflect the proposed local government budget agreement.
- Includes an additional \$25.3 million to reflect an increase in the cost-of-living adjustment for both categorical programs and apportionments.
- Provides an increase of \$17.9 million to reflect a reduced estimate of revenues from student fees.

## HIGHER EDUCATION

The May Revision reflects an agreement reached between the Governor, the University of California (UC), and the California State University (CSU). The “Higher Education Compact” contained in the May Revision proposes:

- An increase of \$20.2 million in 2004-05 for the UC and \$623,000 in 2004-05 for the CSU relative to the Governor’s January Proposed Budget.
- A 14 percent increase in in-state undergraduate student fees at the UC and the CSU in 2004-05, up from 10 percent in the January Proposed Budget, and an increase of no more than 8 percent per year in 2005-06 and 2006-07. The average increase for the three years would be no more than 10 percent. Longer term, the Administration proposes that undergraduate student fee increases be linked to the growth in state per capita personal income.
- To increase 2004-05 CSU fees by 25 percent for all graduate students, except teacher credential candidates. Credential candidates’ fees would increase 20 percent.
- A 20 percent increase in 2004-05 UC graduate student fees. This is a significant reduction from the 40 percent 2004-05 graduate student fee increase included in the Governor’s January Proposed Budget. The May Revision also proposes fee increases for the UC and the CSU graduate students of not less than 10 percent in 2005-06 and 2006-07. Thereafter, graduate student fees would increase until graduate fees in both systems are 50 percent higher than undergraduate fees.
- That not less than 20 percent and no more than 33 percent of the revenue from student fee increases be used for financial aid.
- To reduce proposed 2004-05 UC enrollment by 5,000 full-time equivalent students (FTES) and to redirect another 3,200 FTES to community colleges. The CSU’s 2004-05 enrollment would be reduced by 13,000 FTES below planned levels and another 3,800 FTES would be redirected to community colleges. The Administration plans to establish a system of “dual enrollment,” whereby lower division students enroll in community colleges and then complete their upper division work at the UC or the CSU.
- To eliminate General Fund support for UC and CSU outreach activities, as in the Governor’s January Proposed Budget, but includes agreements from the UC and the CSU to allocate no less than \$12 million and \$45 million, respectively, to outreach.
- No increase in General Fund base funding for the UC and the CSU in 2004-05, but promises an increase of 3 percent to the prior year’s base in both 2005-06 and 2006-07, an increase of 4 percent in 2007-08, and increases of 5 percent from 2008-09 through 2010-11.

The May Revision reverses the Governor's January proposal to decouple Cal Grant awards from fee increases at the UC and the CSU, but reduces funding for the California Student Aid Commission (CSAC) by \$73.3 million in 2004-05. Of this, \$5.4 million is associated with a reduction in the number of Cal Grant Competitive awards CSAC is authorized to issue in 2004-05. A \$134 million one-time transfer from the Student Loan Operating Fund surplus would make up the 2004-05 shortfall.

#### YOUTH AND ADULT CORRECTIONS

The May Revision increases 2003-04 and 2004-05 funding for the Department of Corrections (CDC) by \$114.6 million and \$167.7 million, respectively, over the levels proposed in January, largely to reflect increased inmate populations. The May Revision also outlines the Governor's proposals for \$476.7 million in savings in the CDC budget, which include:

- \$36.6 million from "operational efficiencies" such as reducing energy expenditures, reducing the number of meals served to inmates on weekends and holidays, consolidating equipment purchases, and eliminating some headquarters positions.
- \$48.0 million in savings from a variety of proposals affecting medical treatment within the CDC system.
- \$85.4 million in savings attributable to reforms in the parole system.
- \$300 million in savings anticipated from renegotiating correctional officers' collective bargaining agreements. The document notes, "due to the nature of negotiations, there are no details available regarding how \$300 million of savings will be achieved."

California Youth Authority (CYA) spending would increase by \$3.1 million in 2003-04 and \$9.8 million in 2004-05 relative to the Governor's January Budget proposal. Most of the increase is attributable to higher than anticipated inmate populations.

The May Revision also expands funding for the Office of the Inspector General to increase oversight of CDC and CYA operations.

#### DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

The May Revision makes no further changes to housing programs. The Governor does propose, however, to transfer \$8.0 million to the General Fund from the Child Care and Development Facilities Direct Loan Fund (\$0.6 million); Child Care and Development Facilities Loan Guaranty Fund (\$0.07 million); and School Facilities Fee Assistance Fund (\$7.3 million).

#### ECONOMIC DEVELOPMENT

The May Revision proposes to transfer \$1.1 million from the Film California First Fund (under the Business, Transportation, and Housing Agency) to the General Fund. Part of this amount would help fund a \$0.6 million increase for the California Film Commission to develop an online film permitting system.

## RESOURCES

### The Governor's May Revision:

- Is largely silent on the issue of when bond funds for Resources Agency programs will be appropriated and how they will be spent. The Governor's January Proposed Budget deferred the appropriation of bond funds, including Proposition 40 and Proposition 50 monies, "until the spring." Large proportions of state support for departments, boards, and commissions within the Resources Agency have come from bond funds in recent years.
- Indicates that 2004-05 state spending on the CALFED Bay-Delta program will be below 2003-04 levels. The May Revision provides \$381 million for the CALFED program in 2004-05. In contrast, state expenditures for the CALFED program were \$522.6 million in 2003-04. The May Revision also states that the Administration will support the enactment of a water user fee to help fund the program.
- Appears to support \$10 million in increased timber harvest plan (THP) review fees, in exchange for streamlining the state's "overly burdensome" timber harvest regulations. The 2003 Budget Act reduced the California Department of Forestry and Fire Protection budget by \$10 million General Fund in anticipation of new THP review fees, which were never enacted.

## TRANSPORTATION

- The Governor's Proposed January Budget proposed to suspend the Proposition 42 transfer from the General Fund to the Traffic Congestion Relief Program (TCRP), for savings of \$1.1 billion. Proposition 42, approved by voters in March 2002, provides for annual transfers of sales and use taxes paid on gasoline sales from the General Fund to the TCRP to fund state and local transportation projects. The Proposition 42 transfer was partially suspended in 2003-04. The May Revision proposes to both change this suspension to a loan and to accelerate repayment of outstanding General Fund obligations to the TCRP, due to an unspecified amount of "anticipated one-time tribal gaming revenues."
- The May Revision also drops two prior proposals, one that would have transferred \$189 million of TCRP funds to the General Fund and another that would have retained additional "spillover" sales tax revenue in the General Fund.
- The May Revision proposes that the Business, Transportation, and Housing Agency review TCRP projects based on specified criteria prior to the California Transportation Commission allocating funds for additional TCRP projects.

## TRIAL COURT FUNDING

The May Revision reflects an agreement negotiated between the Governor and the Judicial Branch on a plan for trial court funding and restructuring of the collective bargaining process to ensure state approval of local employee union negotiations in the future. The May Revision provides \$88.2 million in 2004-05 to meet the following increases attributable to local union negotiations:

- \$23.1 million to cover additional costs associated with retirement rate increases that take effect, but are not funded, in the current year.
- \$28.8 million to cover higher costs of court security contracts attributable to increased salaries and benefits negotiated by local sheriffs departments.
- \$8.1 million for increased costs attributable to negotiated salaries and benefits for judges.
- \$9.6 million to cover increased costs for scheduled salary and benefit increases pursuant to existing labor agreements.
- \$11.5 million to cover increased costs for benefit plan changes for court employees.
- \$1.5 million for 2004-05 increases in the amounts charged by counties to provide various services to courts.
- \$27.6 million for increased costs for the Judges Retirement System for 2004-05.

These increases would be offset by an \$11 million unallocated General Fund reduction, in addition to the \$59 million reduction proposed in January.

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