



Revised June 14, 2005

GOVERNOR RELEASES MAY REVISION TO THE BUDGET

The Governor released his May Revision to the Proposed 2005-06 Budget on Friday, May 13, 2005. The following update provides a “quick and dirty” summary of key provisions of the May Revision. As additional details become known, the California Budget Project (CBP) will update this document. Please check the CBP website (www.cbp.org) for corrections and additions to this analysis as additional information becomes available. Budget documents are available on the Department of Finance’s website at www.dof.ca.gov.

The May Revision makes relatively few changes to the Governor’s January Budget. Most notably, the May Revision reflects an assumption that the General Fund will have an additional \$3.9 billion in revenues related to a tax amnesty program that concluded earlier this year. Importantly, nearly all of this money represents revenues the state would have received in the absence of the amnesty. The amnesty, and related penalty provisions, resulted in taxpayers paying these funds earlier than they otherwise would have. Corporate and personal income tax revenue collections, other than those related to the amnesty, are also above the January forecast for 2004-05.

“Big ticket” changes announced by the Governor include:

- Dropping his proposal to issue \$1.7 billion in deficit financing bonds;
- Shifting \$1.3 billion in sales tax revenues from the General Fund to transportation;
- Adding \$191.4 million in 2005-06 and \$19.7 million in 2004-05 spending for the Department of Corrections, largely related to previously assumed savings that are no longer anticipated; and
- Early repayment of \$593.4 million of the Vehicle License Fee (VLF) gap loan owed to counties and cities. The Governor’s proposal would pay off approximately half of the state’s outstanding debt a year early.

The May Revision continues the Governor’s January proposals to:

- Fund K – 14 education spending at a level that is approximately \$3.1 billion below the target assumed in the 2004-05 budget agreement for each of current and budget years combined;
- Shift \$469 million in teacher pension costs from the state to local school districts, reducing the funds available for classroom education;
- Reduce CalWORKs grants by 6.5 percent and eliminate the cost-of-living-adjustment (COLA);
- Withhold the federal COLA for the federal government’s share of SSI/SSP grants and use the federal funds to offset state costs for the program;

- Reduce the state's share of cost for wages paid to In-Home Supportive Services workers to the state's minimum wage of \$6.75 per hour. Under current law the state shares in costs of up to \$10.10 per hour in 2004-05 and \$11.10 per hour in 2005-06.

The Good News: Revenues Are Up

The good news in the May Revision is that state revenue collections are up. Accounting for the increased revenues, however, is complicated by the receipt of a large volume of revenues related to this year's tax amnesty program. The amnesty program affected two groups of taxpayers. The first is non-filers and others outside of the regular tax filing system that paid their taxes under the incentives provided by the amnesty. The second, and much larger, group is large corporations that paid taxes they likely would have paid in the future who paid early to avoid the stiff penalties imposed after the close of the amnesty. Most of this money is simply an acceleration of revenues that would have been received in future years. The May Revision assumes that approximately 5 percent (\$200 million) of these so-called "protective claim" revenues represent "new money" - funds the state would not have otherwise received.

The May Revision reflects a \$2.2 billion increase in 2004-05 revenues and a \$4.4 billion increase in 2005-06 revenues, for a total of \$6.6 billion. The May Revision assumes that \$900 million of this amount will eventually be returned to taxpayers that filed protective claims and that approximately \$3.9 billion represents one-time funds - funds presumably attributable to the amnesty that the state would have otherwise received, but at a later date. The remainder reflects revenues attributable to stronger personal and corporate income tax collections than assumed in the January budget. Sales tax collections, on the other hand, are weaker than previously forecast.

Additional details will be needed to determine how the additional revenues affect the calculation of the Proposition 98 guarantee and to understand how much of the recent bump in revenue collections will translate into ongoing gains to the state's coffers.

The Bottom Line

The May Revision reduces estimated 2004-05 spending by \$302 million and increases proposed 2005-06 spending by \$2.787 billion. As noted elsewhere, the largest increases in spending will go to transportation (\$1.3 billion) and the pre-payment of the VLF backfill loan (\$593.4 million). Over the two year period (2004-05 and 2005-06), Health and Human Services spending would fall by \$407 million relative to the Governor's January proposal and K - 12 Education spending would increase relative to the two-year January levels by \$340 million.

The May Revision estimates that 2004-05 spending will exceed revenues by \$2.7 billion and proposed 2005-06 spending will exceed projected revenues by \$4.9 billion. The Governor proposes to modestly reduce the amount of debt used to address the state's budget problems, but does not bring the budget into balance on an annual basis.

Health

The May Revision:

- Announces no changes to the Governor's plan to restructure the Medi-Cal Program. The plan includes proposals to impose monthly premiums on more than 500,000 beneficiaries, including children and people with disabilities; establish an annual cap of \$1,000 for some dental services for adults; increase the number of Medi-Cal beneficiaries in managed care plans by more than 800,000; and restructure the current safety-net hospital financing system. A new CBP analysis of the proposed Medi-Cal restructuring plan is available at www.cbp.org.
- Provides \$16.6 million (\$14.0 million General Fund) to fund outreach and training activities to assist the approximately one million Medi-Cal beneficiaries who will receive prescription drugs through the new Medicare Part D program starting January 1, 2006.
- Provides an additional \$7.8 million to implement a new discount prescription drug program (California Rx) for certain low-income families and individuals. In January, the Governor proposed to negotiate discounts with drug manufacturers. However, participation by drug manufacturers would be voluntary.
- Estimates that enrollment in the Healthy Families Program will increase from 740,835 at the end of 2004-05 to 867,418 at the end of 2005-06, a 17.1 percent increase. The May Revision attributes this enrollment growth to several factors, including earlier implementation of the Certified Application Assistance Program to help eligible children enroll in Healthy Families.

CalWORKs

The May Revision:

- Rescinds the Governor's January proposal to reduce the amount of earnings that CalWORKs families may exclude from their income when determining continuing eligibility and grant levels. This proposal would have reduced grants for all working recipients and caused more than 8,000 CalWORKs families to lose cash assistance.
- Maintains the Governor's January proposals to eliminate the statutory COLA and to reduce grant levels by 6.5 percent, but shifts the implementation date of the grant reduction to October 1, 2005. These proposals would reduce the maximum monthly grant for a family of three from \$723 to \$676 in high-cost counties and from \$689 to \$644 in low-cost counties.
- Rescinds the Governor's January proposal to enact a new sanctions policy for CalWORKs recipients who do not comply with program rules. The May Revision states that the Administration lacked sufficient information to develop a proposal due to the contractor's delay in providing a sanctions study to the state.
- Revises the Governor's "pay-for-performance" proposal. The Governor proposes to set aside \$30 million in Temporary Assistance for Needy Families (TANF) block grant funds for distribution in 2006-07 to counties that achieve specific CalWORKs Program outcomes.
- Estimates an average monthly CalWORKs caseload of 483,500 in 2005-06, a 1.7 percent decrease from the estimated 2004-05 caseload of 491,700.

Programs for Seniors and People with Disabilities

The May Revision:

- Estimates increased 2005-06 General Fund savings of \$12 million from the Governor's proposal to withhold the federal COLA for SSI/SSP grants and use those federal funds to offset state costs for the program. The increased state savings is due to a higher federal COLA factor. The May Revision also maintains the January proposal to suspend the state COLA for SSI/SSP grants. Under current law, the monthly grant would increase to \$849 for an individual and \$1,503 for couples in January 2006. The Governor's proposal would maintain monthly grant levels at \$812 for individuals and \$1,437 for couples and would affect some of California's poorest residents, reducing their ability to meet basic needs such as food and housing. The state has suspended SSI/SSP COLAs, delayed SSI/SSP COLAs, and/or reduced SSI/SSP grants in 11 out of the past 16 years.
- Maintains the Governor's January proposal to reduce state support for In-Home Supportive Services (IHSS) providers by only sharing in the cost of wages at the state's minimum wage of \$6.75 per hour. Currently, the state pays a share of cost for IHSS provider wages and benefits up to \$10.10 per hour and up to the Maximum Allowable Contract Rates for IHSS contract providers. Under current law, the state would pay a share of cost for wages up to \$11.10 per hour in 2005-06.
- Rescinds the Governor's proposals to eliminate the Senior Citizens' Property Tax Assistance Program and roll back income eligibility for the Senior Citizens' Renters' Tax Assistance Program for increased General Fund costs of \$136.6 million in 2005-06.

Child Care

The May Revision maintains the Governor's January child care proposals, including proposals to:

- Impose a time limit on CalWORKs Stage 3 child care, which would require working, former CalWORKs families to join already overcrowded waiting lists for subsidized child care.
- Reduce reimbursement rates for license-exempt child care providers. In January, the Administration estimated that this proposal would result in General Fund savings of \$140 million in 2005-06.
- Base income eligibility for the state's subsidized child care programs on the federal poverty level (FPL), rather than on state median income (SMI). Over time, this change could reduce the number of families who qualify for subsidized child care, since the FPL tends to increase more slowly than SMI.

K-12 Education

The May Revision:

- Maintains the Governor's January proposal to fund Proposition 98 at a level based on the 2004-05 Budget Act, rather than the target specified in the budget agreement, a difference of \$3.1 billion.

- Reduces the estimated 2004-05 Proposition 98 guarantee by \$141.9 million, mostly due to lower than previously estimated average daily attendance (ADA) growth.
- Reflects no change in total Proposition 98 funding for 2005-06 relative to the Governor's proposal.
- Reflects a change in the formula used to calculate the 2005-06 Proposition 98 guarantee. The May Revision assumes that the guarantee will be determined by Test 3, rather than Test 2, as was previously proposed in the Governor's January proposal. This results in a \$509.3 million decrease in the minimum required for the Proposition 98 guarantee for 2005-06. However, the May Revision does not reduce appropriations to reflect the lower minimum guarantee.
- Reflects an increase of \$28 in 2005-06 Proposition 98 per pupil spending relative to the Governor's January proposal, from \$7,374 to \$7,402. The May Revision also increases 2004-05 per pupil spending by \$11, from \$7,012 to \$7,023. After adjusting for inflation, this reflects an increase of \$194 in Proposition 98 per pupil spending between 2004-05 and 2005-06.
- Provides \$251.8 million toward prior year Proposition 98 settle-up obligations for the 1995-96 and 1996-97 fiscal years. The May Revision earmarks this one-time funding as follows: \$52.4 million to expand the class size reduction program to low-performing schools, \$49.5 million to recruit and retain teachers in low-performing schools, \$30 million to expand the Teacher Credentialing Block Grant to provide additional services for teachers, and \$57.5 million to provide additional support for students at risk of failing the High School Exit Exam. The May Revision also allocates \$123 million in ongoing funding for the class size reduction program described above.
- Proposes to increase school districts' ability to transfer funding between categorical programs and block grants. School districts would be allowed to transfer up to 50 percent of funding for former mega-item programs to other specified programs; transfers-in could not exceed 150 percent of the amount of state funding allocated for that program in the fiscal year.
- Includes \$190 million for special education mental health services, an increase of \$90 million over the Governor's January proposal. The Administration proposes to repeal the mandate for county mental health agencies (CMHs) to provide mental health services related to individualized education plans. Instead, districts providing special education services, known as SELPAs (Special Education Local Plan Areas), would be allowed to contract with CMHs to provide these services.
- Proposes to increase funding for schools participating in the High Priority Schools Grant Program (HPSGP) by \$15 million, from \$45 million to \$60 million relative to the Governor's January proposal. Approximately \$10 million would fund undefined sanctions for schools that fail to meet improvement targets.
- Provides \$28.5 million for charter school facilities to reimburse schools for costs incurred in 2004-05 and to provide additional funding for 2005-06.

Community Colleges

The May Revision:

- Proposes an augmentation of \$10 million in one-time funding in 2004-05 to create at least

1,800 new slots for nursing students. The expansion of nursing programs at the community colleges is part of the Governor's broader Nursing Initiative and is funded out of Proposition 98 settle-up monies.

- Increases the community colleges' share of Proposition 98 funding from 10.35 percent in the Governor's January proposal to 10.46 percent.
- Provides \$40 million in Proposition 98 funds to equalize disparities among community colleges in the amount of funding they receive for each full-time equivalent student (FTES) enrollment. The 2004-05 Budget provided \$80 million for equalization and the community colleges had requested \$80 million annually for three years to achieve that goal.
- Restores \$31.4 million in Proposition 98 funding and provides an additional \$417,000 based on an agreement by the community colleges to adopt a new accountability framework. The funding is contingent on the passage of legislation to implement the accountability framework.
- Provides \$37.4 million for the Governor's proposed Career-Technical Education Initiative, an increase of \$17.4 million over the amount included in the Governor's January Budget for this new program.
- Provides increases of \$14.1 million for apportionments and \$830,000 for selected categorical programs, reflecting an increase in the COLA factor. The May Revision also decreases Proposition 98 funding by \$359,000 for selected categorical programs to reflect a decrease in the statutory growth rate.

Higher Education

The May Revision includes \$1 million to launch a Science and Math Teacher Initiative to be jointly implemented by the University of California (UC) and the California State University (CSU) systems. The UC would receive \$750,000 to establish at least six Science and Math Resource Centers. The CSU would receive \$250,000 to work with the UC on the initiative.

California Student Aid Commission

The May Revision proposes a net General Fund increase of \$6.9 million over the Governor's January Budget, including:

- An increase in the number of Cal Grant awards (\$15.7 million) and a restoration of the maximum award for students attending private universities and colleges (\$7.5 million).
- A shift of \$16 million from the Commission's Student Loan Operating Fund (SLOF) to the General Fund to cover a portion of the costs of the Cal Grant program. This is in addition to the \$35 million that the Governor's January Budget proposed to shift from the SLOF to the General Fund.
- Authorization of up to 350 Assumption Program of Loans for Education (APLE) warrants for students who participate in the Science and Math Teacher initiative. The Governor proposes legislation to establish this new APLE program. In general, the APLE assumes partial payment of student loans for teachers who agree to teach in areas where there is a critical teacher shortage in California.

Youth and Adult Corrections

The May Revision:

- Increases funding for the Department of Corrections (CDC) by \$19.7 million in 2004-05 year and by \$191.4 million in 2005-06. This level of funding reflects unrealized savings from parole reforms that failed to result in parole population decreases, as was assumed by the Governor in January.
- Restores \$51.2 million General Fund for Inmate and Parolee Programs, which had been slated for a reduction of \$95.3 million by the Governor in January. This leaves a net reduction of \$44.1 million General Fund.
- Augments funding for programs aimed at reducing recidivism by \$15 million. These funds will not be expended until the CDC submits program plans to the Legislature.
- Proposes an increase of \$17.3 million for improvements in the inmate dental program in order to discourage a lawsuit.
- Increases the CDC budget by \$5.2 million for the mental health service delivery system at the California State Prison-Corcoran and to fund mental health staffing needs at 12 institutions in order to comply with the *Coleman* lawsuit.
- Reflects savings of \$10.6 million General Fund for inmate medical services due to decreased costs stemming from the *Plata* lawsuit.
- Increases the budget of the Department of the Youth Authority (CYA) by \$18.8 million in 2004-05 and by \$13.5 million in 2005-06 due to a decrease in county reimbursements and errors in the way the CYA budgeted prior year institution closures. This also reflects the delayed closure of three fire camps.
- Includes \$6.8 million to implement remedial plans in the CYA's mental health, sex offender treatment, and disabilities programs to comply with the *Farrell v. Allen* lawsuit.
- Increases funding for the Department of Justice by \$6.7 million (\$2 million General Fund) for increased workload resulting from the collection of DNA required by the passage of Proposition 69. This is in addition to \$11.2 million included in the January budget.
- Augments the budget of the Office of Emergency Services by \$35 million General Fund for estimated costs of response and recovery efforts resulting from the Southern California winter storms.
- Proposes \$4.1 million General Fund for the Office of the Inspector General to meet federal court and statutory demands for additional oversight in the operation of the CDC and the CYA.

"Blowing Up Boxes"

The May Revision proposes to eliminate 13 state boards and commissions. Funding for some of these entities had already been eliminated. In January, the Governor introduced a plan to eliminate 88 state boards and commissions. The Governor withdrew the proposal in mid-February after two Little Hoover Commission hearings, stating, "this proposal will benefit from further review."

The May Revision provides \$3.4 million to the Youth and Adult Correctional Agency (YACA) for additional workload relating to the YACA reorganization, and \$3.1 million for

“implementation of a major reform of juvenile justice programs.” In January, the Governor introduced a proposal to reorganize the YACA under a newly created Department of Corrections and Rehabilitation. On May 10, the Governor signed a compromise agreement negotiated with the Legislature, SB 737 (Romero, Chapter 10 of 2005), which will become effective July 1.

Several other reorganization proposals are pending:

- On March 31, the Governor introduced a proposal to create a new Department of Technology Services, consolidating the Stephen P. Teale Data Center, the Health and Human Services Agency Data Center, and some functions of the Telecommunications Division of the Department of General Services. The Little Hoover Commission is currently reviewing the proposal.
- On May 12, the Governor submitted a fourth reorganization plan to the Little Hoover Commission for review. This proposal would create a new Department of Energy, consolidating the California Energy Commission, the Electricity Oversight Board, and some functions of the California Public Utilities Commission and Department of Water Resources.
- The Administration has at least temporarily dropped a reorganization proposal for the California Environmental Protection Agency (Cal-EPA). This plan would have abolished the independent boards that establish rules and standards for air quality, waste management, and water, moving these functions to agencies that report directly to the Governor.

Housing

The May Revision proposes a “Governor’s Chronic Homelessness Initiative,” which provides funding to the Health and Human Services Agency and the Business, Transportation, and Housing Agency. Specifically, the Initiative:

- Allocates \$750,000 to the Department of Housing and Community Development (HCD) to create shelters and services for chronically homeless individuals;
- Redirects approximately \$40 million of unused Proposition 46 funds to loans to developers of housing for the mentally ill;
- Redirects \$2.4 million of Proposition 63 funds to rent subsidies and local homeless shelter projects, and encourages local governments to contribute their Proposition 63 funds for corresponding services (Proposition 63, approved by voters in November 2004, imposed an additional 1 percent tax rate on individuals’ taxable income over \$1 million to provide dedicated funding to expand mental health services);
- Allocates \$250,000 for interagency coordination of homeless services; and
- Indicates that the HCD and the California Housing Finance Agency (CalHFA) will provide, from existing resources, 400 to 500 units of permanent housing with services for chronically homeless populations.

Local Government

The May Revision:

- Repays cities and counties \$593.4 million, about half, of the Vehicle License Fees (VLF) lost in 2003-04 due to the elimination of the VLF backfill. This “gap loan” is due to be repaid in full by 2006-07.
- Restores \$2.5 million of the \$5.7 million reduction in grants to counties for property tax administration proposed in January.
- Reverses the January proposal to eliminate the Small and Rural Sheriffs’ Program (\$18.5 million).
- Restores the Juvenile Justice Crime Prevention Program (JJCPP), which was effectively eliminated in the Governor’s January proposal.

Transportation

The May Revision drops the proposal to suspend the \$1.3 billion Proposition 42 transfer from the General Fund to transportation programs, allocating the funding to the Traffic Congestion Relief Fund (\$678 million), the Transportation Investment Fund (\$254 million), the Public Transportation Account (\$127 million), and local streets and roads (\$254 million). The May Revision proposes to tie the availability of Proposition 42 funds to the passage of the Governor’s “GoCalifornia” bill package; the Governor has limited ability, however, to allocate Proposition 42 funds. Proposition 42, approved by voters in March 2002, required an annual transfer from the General Fund to the Traffic Congestion Relief Program of sales taxes paid on gasoline sales to fund state and local transportation projects. The Proposition 42 transfer was suspended partially in 2003-04 with repayment by June 2009 and fully suspended in 2004-05 with repayment by June 2008.

The May Revision also proposes to reduce the amount of anticipated tribal gaming revenues by \$222 million, since no new compacts have been signed, and proposes to delete the requirement that \$1.2 billion in outstanding Proposition 42 loans to the General Fund be repaid by June 2006. The 2004-05 Budget assumed that \$1.4 billion in transportation loans would be repaid through \$1.2 billion in bond proceeds from certain dedicated Indian gaming revenues as well as other sources.

State Employees

In January, the Governor proposed to negotiate with state employee unions to reduce the state’s annual contribution to the California Public Employees’ Retirement System (CalPERS) to half of the normal retirement cost and any unfunded liability in the pension fund. Currently, state employees pay approximately one-fourth of the state’s pension contribution costs. Although the Governor recently indicated that he has dropped support for a corresponding ballot initiative that was strongly opposed by public safety employee unions, the May Revision does not address the pension issue. The proposed pension obligation bond has been reduced from \$760 million to \$525 million.

The May Revision:

- Maintains the January assumption of \$408 million in employee compensation savings, which remains subject to collective bargaining.
- Assumes an additional General Fund savings of \$36.2 million for employee compensation.

- Includes an increase of \$8.4 million in 2004-05, and \$34.5 million in 2005-06, for health and dental benefits for retirees, to address current year enrollments that are higher than January estimates.

State Operations

The May Revision:

- Proposes \$2.3 million for a new Office of the State Inspector General, to be appointed by the Governor, subject to Senate confirmation, to “conduct audit, investigation and program review functions to provide increased accountability, integrity, and oversight of Executive Branch agencies and to deter illegality and waste.”
- Eliminates previously assumed savings in both 2004-05 (\$48 million) and 2005-06 (\$96 million) from a “Strategic Sourcing Initiative” that would reduce state procurement costs, citing an inability to accurately estimate savings due to “implementation delays and data collection difficulties.”

Economic Development

The May Revision proposes:

- \$500,000 to upgrade the state’s film location database, located in the Business, Transportation, and Housing Agency (BTH), to make it easier for filmmakers to find sites in California.
- \$224,000 and 2.0 positions for the Office of Administrative Law (OAL) to implement a 2003 Executive Order to enforce provisions of the Government Code restricting the issuance, utilization, or enforcement of “underground regulations” by state agencies.

Resources

The May Revision:

- Includes \$67 million for the first payment of the *Paterno* settlement in 2005-06. In *Paterno v. State of California*, the state was found responsible for a levee break that occurred in Yuba County in 1986. The Governor’s 2005-06 January Proposed Budget included a \$464 million “judgment bond” to pay the settlement. Instead, the plaintiffs have agreed to sell \$428 million of their claim to Merrill-Lynch, which will collect payments from the state over several years. The May Revision does not indicate whether the state’s total cost will be higher than under the January proposal.
- Proposes an increase of \$300,000 for the Resources Agency to support an independent review of the CALFED Bay-Delta Program and indicates that the Governor intends to request an additional \$40 million in federal funds for the program, for a total request of \$100 million.
- Includes a General Fund revenue loss of \$47.3 million in 2004-05 and \$48 million in 2005-06 from tidelands oil revenues. The revenues result from the sale of oil recovered from state tidelands; the major recovery site is in Long Beach. The City of Long Beach is setting aside

funds to pay for the eventual abandonment of this site. The state argued that the funds belonged to the state; however, the California Court of Appeal ruled that the city's actions are permissible.

- Includes an additional \$5 million for the Department of Forestry and Fire Protection (CDFF) to replace an additional 19 outmoded fire engines. The May Revision also provides an additional \$5 million General Fund to the Office of Emergency Services to purchase new fire engines.
- Restores a \$6.7 million unallocated reduction to the CDFF.

Environmental Protection

The May Revision proposes an additional \$12.5 million for the Air Pollution Control Fund for the Carl Moyer Program, which seeks to reduce diesel emissions.

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, individual donations, and subscriptions. Please visit the CBP's website at www.chp.org.
