



Senate Budget and Fiscal Review Committee
Senator Denise Moreno Ducheny, Chair
State Capitol, Room 5019
651-4103

SUMMARY OVERVIEW

DECEMBER 2008 SPECIAL SESSION PACKAGE

On December 18, the Legislature passed numerous measures to begin the process of addressing a significant budget shortfall estimated at approximately \$40 billion by the end of fiscal year 2009-10. In total, the package of measures addresses approximately 44 percent of the identified problem making substantial progress toward resolving the shortfall and providing critical cash relief needed to free up resources for infrastructure investments. The package of measures consists of \$7.3 billion in spending reductions, \$9.3 billion in revenue increases, and approximately \$1.5 billion in other solutions, such as fund shifts.

On December 1, 2008 the Governor called a "Proposition 58" Special Session to address the current year drop in revenues, which saw General Fund revenue projections drop by almost \$14.5 billion for 2008-09 and \$16.3 billion for 2009-10. The Pro Tem of the Senate took the unprecedented step of appointing all 40 members of the Senate to the Budget and Fiscal Review Committee to immediately begin hearing recommendations and assessing areas of consensus in closing the widening budget gap -- proposals by the administration, Legislative Analyst, and both caucuses of the Senate were considered and deliberated. In addition, a joint session of the Legislature was held to hear from the State Treasurer, State Controller, LAO, and DOF on the implications, on the State, of not acting in a timely manner. [Under a Proposition 58 special session, the

Governor must include solutions to address the fiscal emergency and the Legislature has 45 days to act in addressing the emergency.]

Both the Governor and LAO have made clear the following:

- The Legislature must act to both raise revenues and to cut expenditures.
- The Legislature must act quickly.

The December Special Session Package passed by the Legislature meets these requirements: The package consists of \$7.3 billion in spending cuts, \$9.3 billion in tax increases, and about \$1.5 billion of other solutions, such as fund shifts. There is no borrowing; there are no gimmicks – only real, ongoing solutions that make real progress toward resolving what is now a \$40 billion shortfall.

The following chart summarizes the approximately \$18 billion of solutions:

(in billions)

Type of Solution:	2008-09	2009-10	Total
Budget Cuts	\$3.519	\$3.745	\$7.264
Revenue Increases	\$1.510	\$7.806	\$9.316
Other Solutions	\$.725	\$.754	\$1.479
Total Solutions	\$5.754	\$12.305	\$18.059

While more work needs to be done, this package is an important first step. The following provides a summary of the key areas of the Special Session Package.

Revenue Increases:

- **¼ Cent Local Sales Tax (Single Flip).** Ends the temporary reduction of the local "Bradley Burns" sales tax, which results in more property tax funds going to schools, which in turn saves the General Fund approximately \$95 million in the current year and \$1.3 billion in the budget year.

This action is referred to as the "Single Flip" because it is part of the "Triple Flip" mechanism used to repay the Economic Recovery Bonds (ERBs). The Triple Flip consists of the following:

- ¼ cent State Sales Tax increase dedicated to repay the ERBs.

- Temporary ¼ cent local sales tax decrease.
- Temporary property tax shift from schools to local governments to replace the lost sales tax revenues. This shift then results in increased General Fund spending on schools to replace the lost property tax revenues.

The Single Flip ends the temporary ¼ cent local sales tax reduction and returns the property tax revenues to the schools, which results in the General Fund savings. (While the Single Flip is thought of as a revenue increase, from the General Fund perspective, the budget solution actually results from less General Fund spending for schools.)

- **Independent Contractor Withholding.** Establishes a three percent withholding requirement for independent contractors for payments in excess of \$600 per year made by businesses to all independent contractors. Payments by households to contractors, for lawn service, painters, cleaning services, etc. would not be subject to withholding. This will result in \$2 billion in additional revenues for 2009-10. In addition, this proposal will bring in approximately \$150 million on an ongoing basis as a result of increased tax compliance.
- **Oil Severance.** Imposes an oil severance tax of 9.9 percent of gross value of oil produced in California, effective July 1, 2009. Low-value stripper oil would be exempt, as would oil owned or produced by the state or local governments. This generates \$855 million in 2009-10.
- **2.5 percent Personal Income Tax Surcharge.** Establishes a 2.5 percent surcharge on Personal Income Tax liabilities beginning for the 2009 tax year. This generates \$150 million in the current year and \$1.5 billion in the budget year.
- **½ cent State Sales Tax Increase.** Increases the State Sales and Use Tax by ½ cent effective February 1. The Governor proposed a 1-½ cent sales tax increase; this is just a portion of that proposal and will generate \$955 million in the current year and \$2.3 billion in the budget year.

Education Solutions:

- **Current Year Reductions.** Reduces Proposition 98 spending in the current year by \$2.5 billion. However, this package of reductions does not follow the Governor's proposal to cut school district revenue limits, and instead targets specific programs that mitigate direct impacts on classroom instruction.
- **Settle-Up Solutions.** Adopts a variation of the LAO's proposal to count a portion of current year spending as "settle-up" dollars rather than Proposition 98 dollars. This does not reduce current year education spending, but does provide additional Proposition 98 flexibility in the budget year.
- **CSU and UC Reductions.** Adopts the Governor's proposal to cut \$132 million from the UC and the CSU.

Health and Human Services Solutions:

- **SSI/SSP.** Reduces SSI/SSP grants in 2009 back to the 2008 level and suspends the budget year state COLA. Together these actions will save about \$117 million in the current year and about \$418 million in the budget year. However, this ultimately means that the state's neediest elderly and disabled individuals will lose more than \$700 per year (and couples more than \$1,300).
- **CalWORKS.** Suspends the budget year CalWORKS COLA to save about \$100 million.
- **Regional Centers.** Reduces, by three percent, certain payments for services delivered to individuals with developmental disabilities for the period from December 1, 2008 to June 30, 2010, as proposed by the Governor. This results in a reduction of \$24.1 million General Fund for 2008-09 and \$60.2 million in 2009-10.

Also reduces the Regional Center Operations' budget by \$4.6 million General Fund in 2008-09 and \$12.2 million in 2009-10 by suspending certain case management ratios and administrative requirements.

Local Government Solutions:

- **Local Public Safety Programs.** Approves the Governor's proposal to eliminate General Fund support for various local law enforcement programs which saves approximately \$189 million in the current year and \$500 million in the budget year. These cuts are mitigated by reallocating Vehicle License Fee revenues (\$92 million in the current year and \$359 million in the budget year) to support these local programs.
- **Williamson Act Local Backfill.** Approves the Governor's proposal to eliminate the \$34.7 million backfill to counties. This does not, however, make any changes to the underlying program to preserve agricultural land.

Transportation Solutions:

- **State Transit Assistance.** Reduces annual funding for the State Transit Assistance (STA) from \$306 million to \$150 million. The Governor had proposed to eliminate the program entirely.
- **Fund Shifts.** Achieves \$185 million in General Fund solutions by shifting eligible Motor Vehicle Account funds and Tribal Compact revenues to the General Fund.
- **Transportation Funding Enhancement and Protection.** Generates over \$3 billion for new transportation investments over the next 18 months, including \$600 million in the current year and \$2.4 billion in the budget year. Of this amount over \$750 million will go to local governments and over \$2.2 billion will be available for state transportation priorities.

The additional \$3 billion for transportation could translate into 45,000 jobs.

The additional revenues result from the establishment of a gas and diesel fee that replaces the stagnant excise tax and the vulnerable sales taxes on gas. The fee is preferable to the taxes for the following reasons:

1. The fee will have improved constitutional protection. Not only will the fee revenues be restricted to the constitutional limitations placed on fees (there must be a nexus), but the fee will also be subject to limitations of Article XIX. Therefore the revenues could not be borrowed, shifted,

suspended, or in any other way be transferred to the General Fund the way that the existing excise tax and sales tax revenues can.

2. The fee will protect vehicle drivers as gas prices increase because it will be set at a rate and stay there regardless of the price of gas. Under current law, the sales tax on gas increases as the price of gas goes up, so consumers get hit twice with the increased base price on gas and the increased sales tax. Under the fee, the same fee will be paid whether gas costs \$1.50 per gallon or \$3.00 per gallon.
3. The fee revenues will keep pace with the needs of the transportation system, because the fee will be adjusted every three years to keep pace with inflation.

Cities and counties will receive about \$2.2 billion from the fee, which is about \$600 million more than they receive combined from the existing excise and sales tax. In addition, they will continue to receive the funds based on the same formulas that were in place under the excise and sales taxes.

In addition, the State Transportation Improvement Program (STIP) will be guaranteed a greater level of funding than what was dedicated to the STIP under the sales tax.

- **G.O. Bond Payment.** Transfers \$378 million from the State Highway Account for Transportation-related General Obligation Bond payment. This results in GF savings of the same amount.

Various Other Solutions:

- **Judicial Branch Solutions.** Achieves \$96 million in solutions from the Judicial Branch with a reduction to the 2008-09 COLA for the trial courts and a one-time transfer from the Trial Court Improvement Fund to the General Fund.
- **Office of Emergency Services.** Eliminates \$54 million in funding for the gang initiative and various other local law enforcement programs.

- **Employee Compensation.** Reduces funding for employee compensation by \$240 million in the current year and \$417 million in the budget year, however, the savings is required to be negotiated through the collective bargaining process.
- **Corrections.** Implements policy proposals to bring state parole policies in line with best practices and other state policies. These policy changes will save \$500 million in the budget year. The parole period for non-violent, non-serious, non-sex offenders without any prior violent serious or sex offenses would be shortened by six months and more parole violators would be diverted to alternative sanctions instead of being returned to prison. Policy changes also include increasing prison credits for inmates that complete rehabilitation programs and expanding current day-for-day credits to prisoners that serve part of their sentence in county jail. Finally, certain property crime thresholds would be adjusted to reflect inflation since 1982, the last time many of these thresholds were adjusted.