

California State Senate

Committee
on
Budget and Fiscal Review

Room 5019, State Capitol
Sacramento, California 95814-4900

**SENATOR
WESLEY CHESBRO**
Chair

The Governor's Budget Proposal January 10, 2003

At noon today, the Governor proposed his 2003-04 budget. Spending from all funds (General Fund, special fund and bond funds) total \$96.4 billion. General Fund spending is \$62.8 billion, an amount which is \$13 billion less (17 percent) than current-year spending.

Staff of the Senate Budget and Fiscal Review Committee prepared the attached briefing, which includes a summary of the Governor's budget proposal. The summary provides:

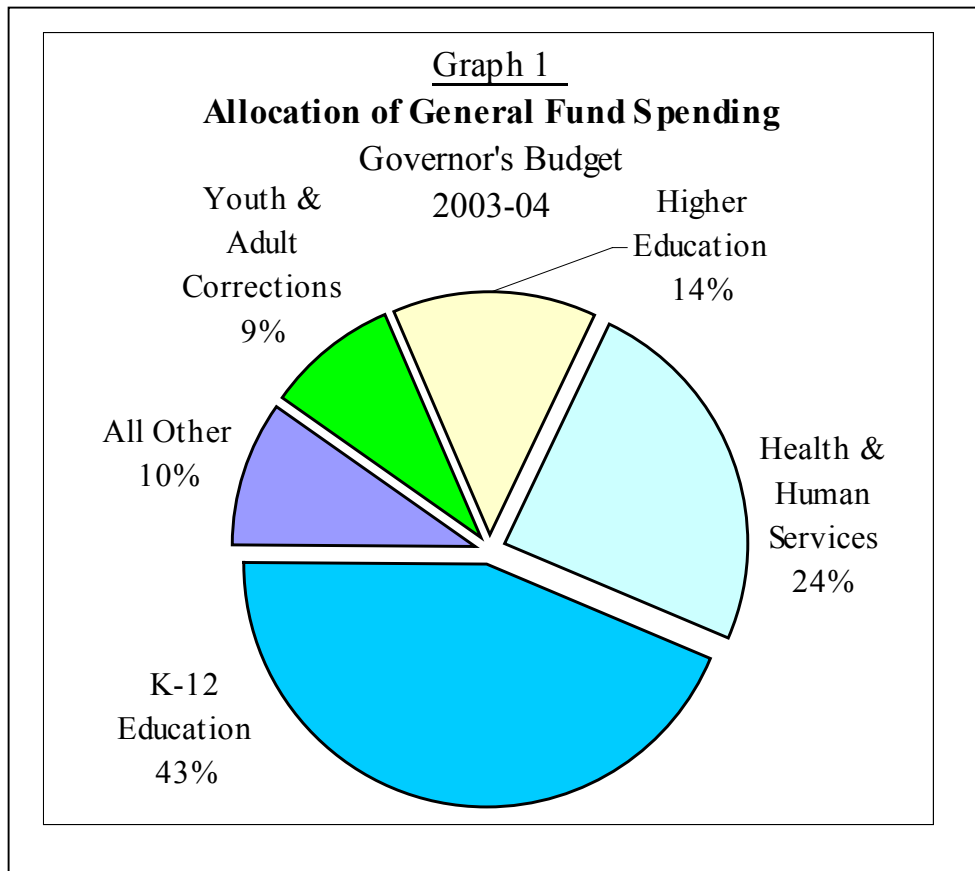
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Staff are preparing a more detailed review of the budget, to be released in early February. At the end of this brief is a full timeline for the committee's review of the budget. If you have questions, a list of the committee staff and assignments is provided on the last page. The committee's phone number is (916) 445-5202.

Overview of the Governor's Budget Proposal

General Fund Spending Concentrated in Four Areas. Four policy areas account for 90 percent of General Fund spending contained in the Governor's Budget. Graph 1 identifies the relative spending in these areas. Specifically, in the 2003-04 budget:

- K-12 Education receives \$27 billion, accounting for 43 percent of the General Fund spending,
- Health and Human Services receives \$15.1 billion, accounting for 24 percent of the total,
- Higher Education receives \$8.5 billion, account for 14 percent of the total, and
- Youth and Adult Corrections receives \$5.6 billion, accounting for 9 percent of the total.



State Spending Significantly Reduced from Current Year. The Governor proposes to reduce General Fund expenditures in the budget year, reducing expenditures from \$75 billion to \$63 billion, which represents a 17 percent reduction. The Department of Finance (DOF) estimates that revenues and transfers will fall from \$71 billion to about \$65 billion (a five percent drop). See Table 1 for a comparison of the current- and budget-year spending.

Table 1
 Comparison of General Fund Spending
 2002-03 and 2003-04
 Dollars in Millions

	<u>2002-03</u>	<u>2003-04</u>	<u>Change</u>
K-12 Education	\$ 29,067	\$ 27,390	-6%
Higher Education	9,447	8,509	-10%
Health & Human Services	23,029	15,149	-34%
Youth & Adult Corrections	5,674	5,639	-1%
All Other	<u>8,244</u>	<u>6,082</u>	-26%
Totals	\$ 75,461	\$ 62,769	-17%

- *Health and Human Services receives the largest reduction, falling from \$23.0 billion to \$15.1, dropping by over one-third. The entire reduction for this policy area--\$8 billion--is nearly equal to the amount of program spending the Governor shifts from a state responsibility to a local responsibility. This shift, referred to as “realignment,” is accomplished by eliminating state administrative control and earmarking new revenue streams for use by local governments to finance the responsibilities. The Governor realigns nearly \$8 billion of health and human services responsibilities, reducing state responsibilities and adding local responsibilities.*

The proposed realignment consists of several components: “Healthy Communities”, Long-Term Care, Mental Health and Substance Abuse, and Children and Youth. These are discussed further below.

- *K-12 Education spending falls from \$29.1 billion to \$27.4 billion, a six percent reduction. This reduction reflects the reduced minimum guarantee level for both the current and budget years. Approximately \$1 billion of this amount is*

attributed to the Governor's proposal to realign responsibility for child care services from the state to the local level. Under this proposal, the Department of Education would retain administration of the State Preschool and Before/After School Programs.

- *The Higher Education segments* receive \$850 million less, nearly a ten percent reduction. The reductions are associated base budget reductions of \$373 million at the University of California and \$326 million at the California State University which will reduce funding for student outreach, research, academic and instructional support, student services, and public service. The Governor proposes to eliminate the California Subject Matter Projects, the CalTeach program and the Bilingual Teacher Recruitment Program; increase the student-to-faculty ratio and assumes that the UC Regents and the CSU Board of Trustees will further increase student fees above the increases adopted in December 2002.

The Governor proposes to fully-fund enrollment growth at the UC and CSU by providing an additional \$268 million to support over 24,000 new students (including students for whom the universities did not receive funding in the current year).

The Governor proposes to further reduce funding for the California Community Colleges above the \$177 million reduction proposed as part of the Governor's December Revision. Additional reductions include \$60.3 million for an across-the-board 7.46 percent reduction to all community college categorical programs and \$211.5 million for reductions targeted at: the Partnership for Excellence; Student Outreach; EOP services; Matriculations; Part-Time Faculty Office Hours; Economic Development; Building Maintenance and Repairs; Instructional Equipment and Library Materials.

The Governor proposes to fund three percent enrollment growth and increase student fees from \$11 per unit to \$24 per unit.

The Cal Grant A and B programs remain funded, with a proposed decrease of nine percent to the amount paid to students attending private colleges and universities.

- *Youth and Adult Corrections* receives roughly the same amount of funding as it did in the current year.

State Ends 2003-04 with a Surplus. Although the state starts the budget year with a carry-over *deficit of nearly \$5 billion*, the entire deficit would be eliminated by the end of the fiscal year (June 30, 2004) under the Governor’s proposal. Indeed, DOF expects to end the budget year with a surplus over \$500 million. That is, after making the reductions summarized in Table 1, the state balances its budget.

See Table 2 for a comparison of the current- and budget-year General Fund condition.

Table 2
 General Fund Condition
 Comparison of General Fund Resources and Expenditures
 Dollars in Millions

	<u>2002-03</u>	<u>2003-04</u>	<u>Change</u>
Prior-Year Balance	-\$2,133	-\$4,451	109%
Revenues and Transfers	<u>73,144</u>	<u>69,153</u>	-5%
Total Resources Available	\$71,011	\$64,702	-9%
Expenditures	\$75,462	\$62,749	-17%
<i>Resources-Expenditures</i>	-4,451	1,953	
<i>Encumbrances</i>	1,402	1,402	
<i>Reserve</i>	-\$5,853	\$551	

How Does the Governor Close the Deficit?

The Governor estimates that the state has a \$35 billion difference between revenues and expenditures for the 18-month period ending on June 30, 2004. In eliminating the deficit, the Governor relied on three primary strategies:

- Realign administrative responsibilities from the state to local governments. This strategy requires the Legislature to raise revenues to finance the new local responsibilities. This contributes nearly 25 percent of the entire budget solution.
- Reduce K-12 Education by over \$6 billion.
- Reduce Local Government assistance by over \$6 billion.

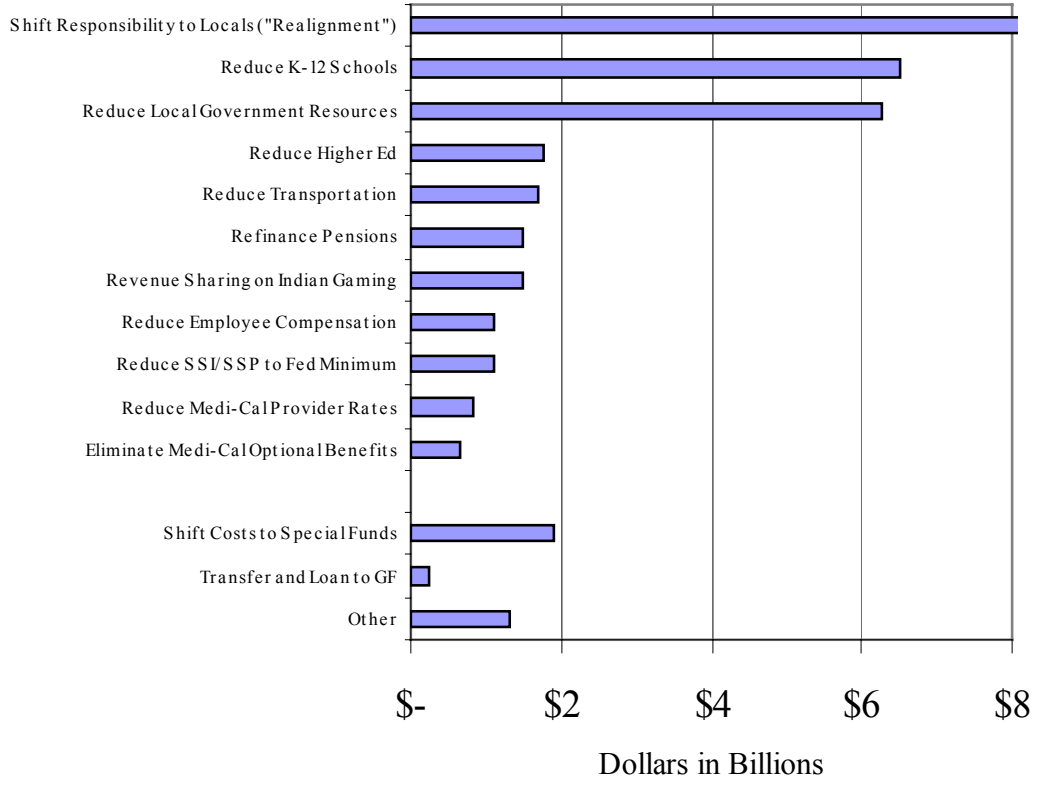
Taken together, these three strategies account for over half the solution.

In addition, the Governor:

- Reduces higher education and transportation by nearly \$2 billion each.
- Refinances pensions for an 18-month savings of about \$1.5 billion.
- Assumes revenue sharing with the Indian tribes, for an increase in General Fund resources of about \$1.5 billion.
- Assumes that the Administration will negotiate—and the Legislature ratify—a contract change to reduce labor costs for a savings of \$500 million.
- Reduces SSI/SSP costs by reducing benefits to the federal minimum for a savings of \$662 million,
- Reduces Medi-Cal by eliminating 18 optional benefits for a savings of \$361.8 million.

For the balance, the Governor shifts General Fund costs to special funds for about \$1.9 billion, transfers and loans special fund money to the General Fund for \$260 million and takes other actions for about \$1.3 billion. See Graph 2.

Graph 2
Financing the General Fund Deficit
Governor's Budget



Highlights of the Governor's Budget

Social Service Programs

Reduction of CalWORKs grants. The Governor proposes to reduce CalWORKs grant levels by 6 percent to generate \$65.7 million in TANF fund savings that he proposes to transfer to offset general fund costs to the Department of Developmental Services. Under the Governor's proposal the monthly cash grant for a family of three would be \$637 in Region I and \$607 in Region II.

Reductions of SSI/SSP grants. The federal Supplemental Security Income, which is supplemented by the State Supplementary Payment, provides a monthly cash benefit to eligible aged, blind and disabled persons who meet specified income and resource requirements. The Governor proposes to reduce these SSI/SSP grants to the federally required level. This would result in a reduction from \$757 to \$708 for individuals and \$1344 to \$1225 for couples. The Governor does propose to continue the pass through of the federal SSI COLA in January 2004.

Increase in CalWORKs Employment Services. The Governor proposes to increase by \$241.5 million funding available to counties for the delivery of employment services to CalWORKs recipients.

County Share of the Penalty for Delayed Implementation of the Child Support Automated System. The federal government has levied approximately \$200 million in penalties due to California's delay in implementing a single statewide automated system for the collection of child support. The Governor proposes to require a 25 percent county share of this federal penalty.

Medi-Cal Program Proposals

- Shifts responsibility for 100 percent of the non-federal share of In-Home Supportive Services to the counties, as well as 100 percent of the non-federal share of Medi-Cal long-term care costs. This will result in proposed savings of \$2.571 billion (General Fund).
- Shifts responsibility for 15 percent and 50 percent share-of-cost for Medi-Cal and CalWORKs-related programs for proposed savings of \$2.671 billion

(General Fund). Of this amount, \$1.4 billion pertains to long-term care funding.

- Eliminates 18 Optional Benefits, including adult dental, medical supplies, outpatient drugs, durable medical equipment, non-emergency transportation, optometry, hospice care, speech and physical therapies and several others.
- Reduces the Aged, Blind and Disabled eligibility income limit to the Supplemental Security Income/State Supplementary Payment (SSI/SSP) benefit level for savings of \$63.8 million (General Fund). This would shift former eligibles to the Medi-Cal share-of-cost program.
- Reduces Medi-Cal rates by another 5 percent, for a total proposed reduction of 15 percent overall. Proposed savings on this 15 percent is \$721 million (General Fund) for 2003-04.

Public Health Proposals

- Transfers a series of programs to the counties under the title of “Healthy Communities” realignment. These programs include the Expanded Access to Primary Care Clinics and all other clinic programs, Adolescent Family Life Program, Indian Health Program, Black Infant Health Program, the California Healthcare for the Indigent Program, Public Health Subvention and the local Maternal and Child Health Program. In addition, several social services programs are transferred under this initiative as well.
- Provides an increase of \$8.3 million (General Fund) for the AIDS Drug Assistance Program (ADAP) and imposes a drug co-payment on ADAP participants with incomes between 200 percent and 400 percent of the federal poverty level.
- Transfers the existing Office of Criminal Justice Planning domestic violence shelter program funding to the Department of Health Services to consolidate the two programs. Total expenditures of \$32.5 million (\$22.5 million General Fund) would be available for domestic violence shelters.
- Proposes to eliminate state-funded cancer research as existing research contracts expire.

Mental Health and Substance Abuse Realignment

- Proposes to transfer responsibility for the Integrated Services for Homeless Adults and the Children’s System of Care programs from the state to the

counties for savings of \$74.8 million (General Fund). Additionally, a shift of alcohol and drug programs to the counties is anticipated to save \$306 million (General Fund).

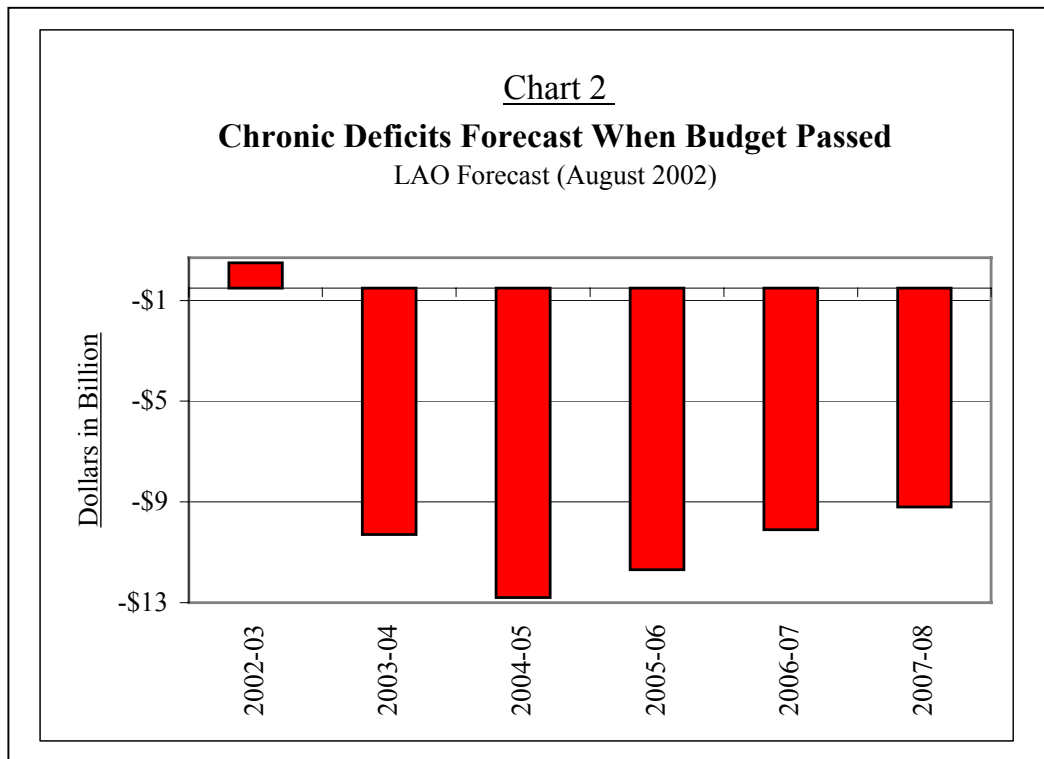
VLF Backfill Eliminated

The state constitution dedicates revenue derived from the tax on vehicles, the vehicle license fee (VLF), to cities and counties. When the Legislature reduced the VLF tax rate, it enacted statutory law requiring the state General Fund to “backfill” revenue loss sustained by cities and counties. The Governor proposes eliminating the back, beginning on February 1, 2003. Over the period ending June 30, 2004, the proposal saves the General Fund in excess of \$4 billion.

How Bad Is the Deficit?

The Problem. When the Legislature considered the budget last August, the Legislative Analyst estimated that the state would sustain a surplus of about \$1 billion in 2002-03. Starting in 2003-04, however, the state would run a General Fund operating deficit for each year of the forecast. As displayed in Chart 2, the LAO

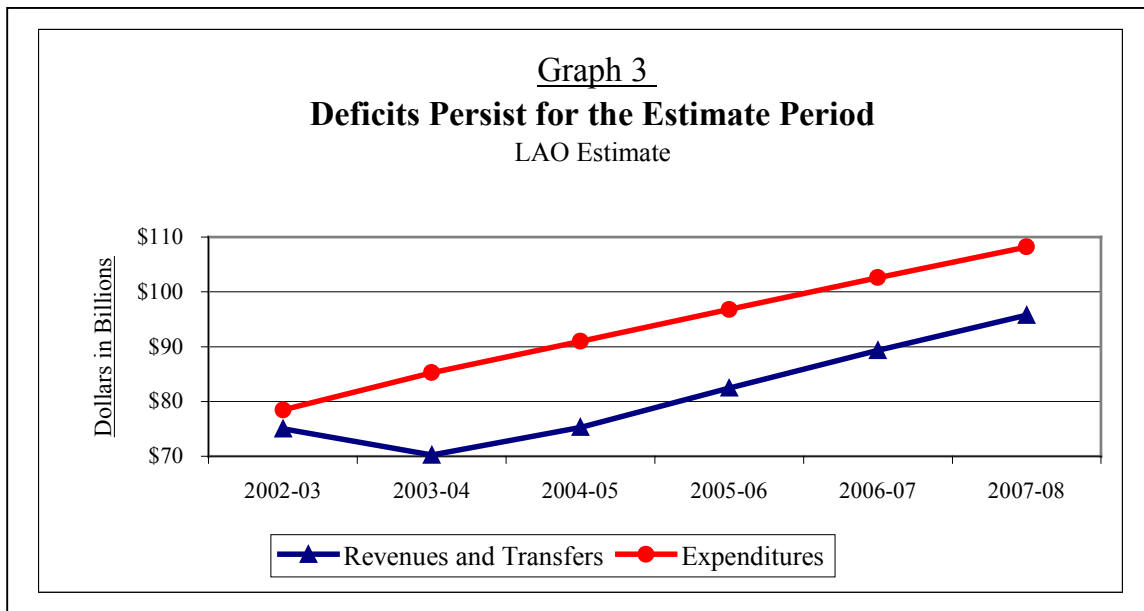
estimated that the state would run a deficit of about \$10 billion in 2003-04. The LAO estimated that the deficit would rise to nearly \$13 billion in the following year unless corrective actions were taken.



Changes Since August. Since August, estimates of the state’s fiscal condition have worsened for the current and budget years. In November, the Analyst estimated that the state’s *current-year deficit* would be about \$6.1 billion. Of this amount, \$4.1 billion is attributable to a loss in revenues and about \$2 billion is attributable to higher-than-anticipated expenditures in the period ending June 30, 2003. Absent action by the Legislature in the current year, this deficit must be financed entirely in the budget year.

At the same time, the LAO raised its estimate of the *budget-year deficit* from \$9.8 billion to \$15 billion. Taken together, the LAO’s estimates of the deficits have risen from a total of \$10 billion to a total of \$21 billion.

The deficits persist throughout the forecast period. As displayed in Graph 3, in each year through 2007-08, the state will run annual deficits of between \$12 billion and \$16 billion.



Problem Statement. As the Legislature considers the Governor’s December Revision, it must place the proposed reductions into the context of the \$21 billion deficit. It must:

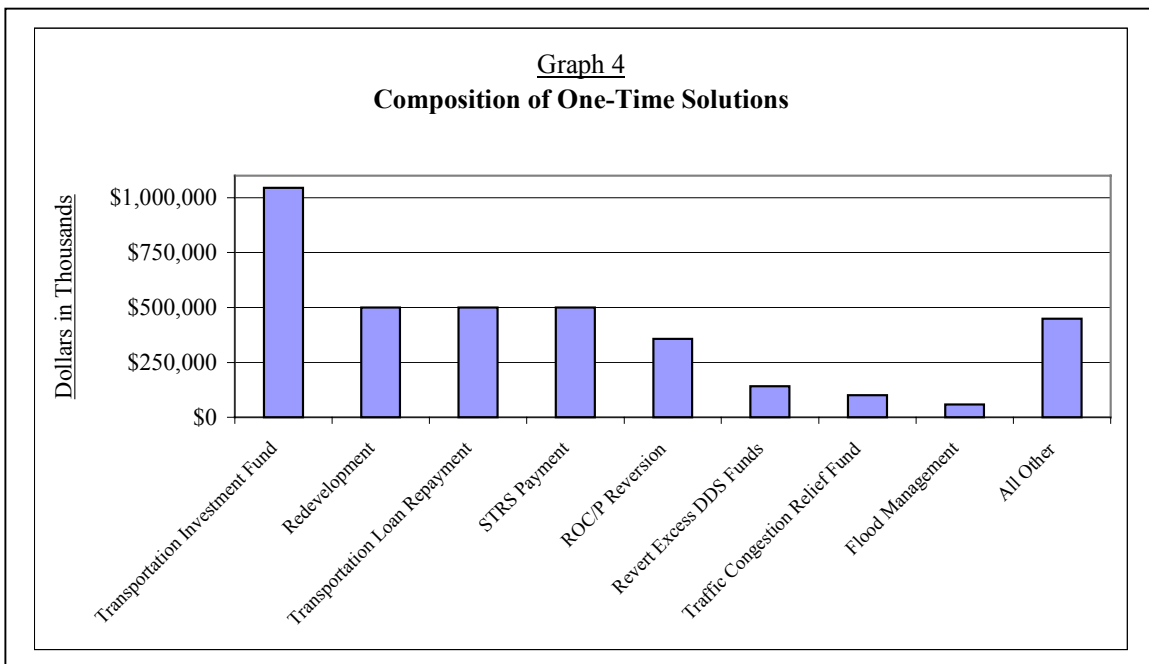
- *Determine How Quickly To Re-Balance the Budget.* The structural deficit is deep and profound. The Legislature’s incremental decisions about spending and tax policy—decisions made over several years and administrations—

contribute to the state's unprecedented fiscal problems in 2003-04. The Legislature must consider whether it is most prudent to eliminate the accumulated deficit during 2003-04 or reduce the deficit over several years.

- *Retire the Current-Year Deficit.* The state starts the new fiscal year with a carryover deficit of about \$6 billion. The carryover deficit can be addressed with either one-time budget cuts (such as reductions to capital outlay projects) or with on-going reductions.
- *Address the Chronic Deficit.* To address the chronic deficit averaging around \$15 billion, the Legislature must take action to reduce annual spending by \$15 billion, raise annual tax revenue by \$15 billion or use a combination of spending cuts and tax increases to close the gap between expenditures and revenues. The chronic deficit cannot be addressed with one-time solutions.

Legislature Must Take Action on the December Revision by January 30

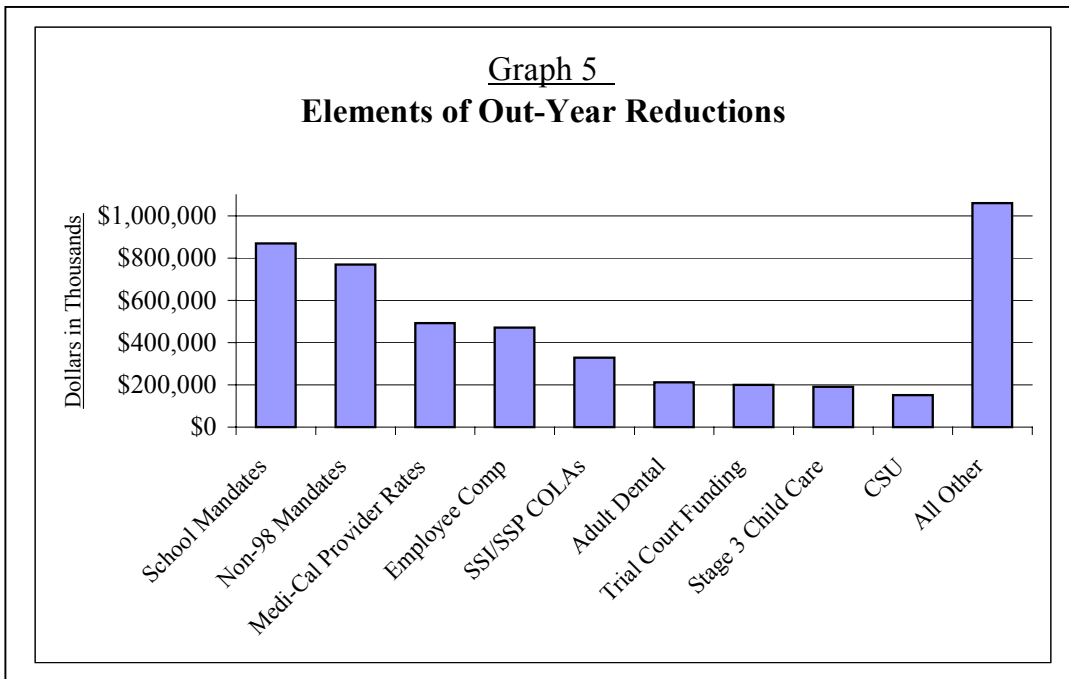
Summary of the December Revision. The December Revision addresses both the one-time and chronic budget deficits. According to the Department of Finance,



about \$3.5 billion of the reductions in the December Revision are one-time cuts.

The most significant one-time reductions are detailed in Graph 4. Transportation reductions account for \$1.7 billion of the one-time cuts. A reduction in redevelopment funds and a deferred payment to the teacher’s retirement system account for \$500 million each in one-time cuts.

As to the on-going reductions, according to the Department of Finance, the December Revision permanently reduces the state’s General Fund spending base by \$4.7 billion. Of this amount, the biggest share—nearly \$1.6 billion—is associated with “deferring” reimbursements for mandates at the schools and other local governments. The state is constitutionally required to make the payments, so it is not clear how these deferrals can be scored as an on-going reduction. Reductions in the Medi-Cal provider rates and reductions in employee compensation provide an additional \$500 million in annual savings. Suspension of the SSI/SSP COLA further reduces the annual spending base by over \$300 million. The state saves \$200 million each for eliminating adult dental services as an optional Medi-Cal benefit, reducing trial court funding and eliminating Stage 3 child care. Graph 5 summarizes these permanent reductions.



Process and Timing Issues. The December Revision assumes legislative action by February 1. A few reductions contained in the December Revision can be delayed. Specifically:

- Reduce General Fund support for transportation,
- Reduce trial court funding in the budget year,
- Reduce the Judiciary's budget in the budget year,
- Reduce regional centers by approving statewide standards, and
- Defer mandate reimbursements.

In addition, deferring the STRS payment can be delayed until June. The Legislature cannot take action on the reduction in employee compensation until the Administration completes collective bargaining with the state's bargaining units.

TENTATIVE TIMELINE FOR THE 2003-04 BUDGET BILL

Wednesday	January 8	Senator Burton releases <i>Review of the December Revision</i>
Friday	January 10	<ul style="list-style-type: none">• Governor submits State Budget to the Legislature.• Committee releases <i>Quick Summary of Governor's Proposed Budget</i>.
Wednesday through Friday	January 15 through 17	Committee conducts hearing on December Revision
Tuesday	January 21	Committee conducts overview hearing of the budget. Department of Finance presents budget and the Legislative Analyst provides initial review.
Wednesday	February 12	Committee releases <i>Overview of the 2003-04 Budget Bill</i> .
Wednesday	February 19	Legislative Analyst submits <i>Analysis of the 2003-04 Budget</i> to the Legislature.
Thursday	February 27	Committee conducts hearing on revenues.
Monday	March 1	Subcommittees begin hearings.
Thursday	April 10	Spring Recess begins.
Monday	April 21	Legislature reconvenes.
Thursday	May 1	Department of Finance submits final capital outlay revisions.
Wednesday	May 14	Governor delivers May Revision to the Legislature.
Friday	May 23	Subcommittees complete hearings.
Tuesday	May 28	Committee meets to adopt subcommittee reports. Committee releases <i>Major Action Report</i> .
Thursday	May 30	Senate votes on Senate budget bill.
Monday	June 4	Conference Committee may begin. Conference <i>Agenda</i> available from committee.
Sunday	June 8	Conference Committee completes work.
Friday	June 13	Senate and Assembly vote on budget bill and budget trailer bills.
Sunday	June 15	Legislature must pass budget to meet constitutional deadline for passage of the budget.

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