



December 11, 2001

GOVERNOR PROPOSES \$2.2 BILLION IN 2001-02 SPENDING REDUCTIONS

In mid-November, the Legislative Analyst's Office (LAO) released their annual long-term budget forecast. The LAO's analysis estimates that current (2001-02) revenues will be \$6.8 billion below the Budget Act forecast. The revised estimate represents a 12.1 percent decline from \$77.7 billion in total revenues in 2000-01, and is primarily attributable to the weak economy and significantly lower capital gains and stock option-related revenues. Revenues are projected to remain below their 2000-01 level until 2003-04, despite the expectation that the economic recovery will begin in the spring. The result is a projected \$4.5 billion deficit in the current year, and a deficit of \$12.4 billion in 2002-03.

THE ECONOMY AND THE BUDGET

The US and California economies slowed during early 2001, and economists now believe that the September 11th terrorist attacks will prolong the downturn. California's economic decline was primarily due to a decrease in business investment in high tech goods and services and reduced wealth and income related to lower stock values. However, since September 11th, the state has also suffered losses in tourism, the entertainment industry, retail sales, and real estate.

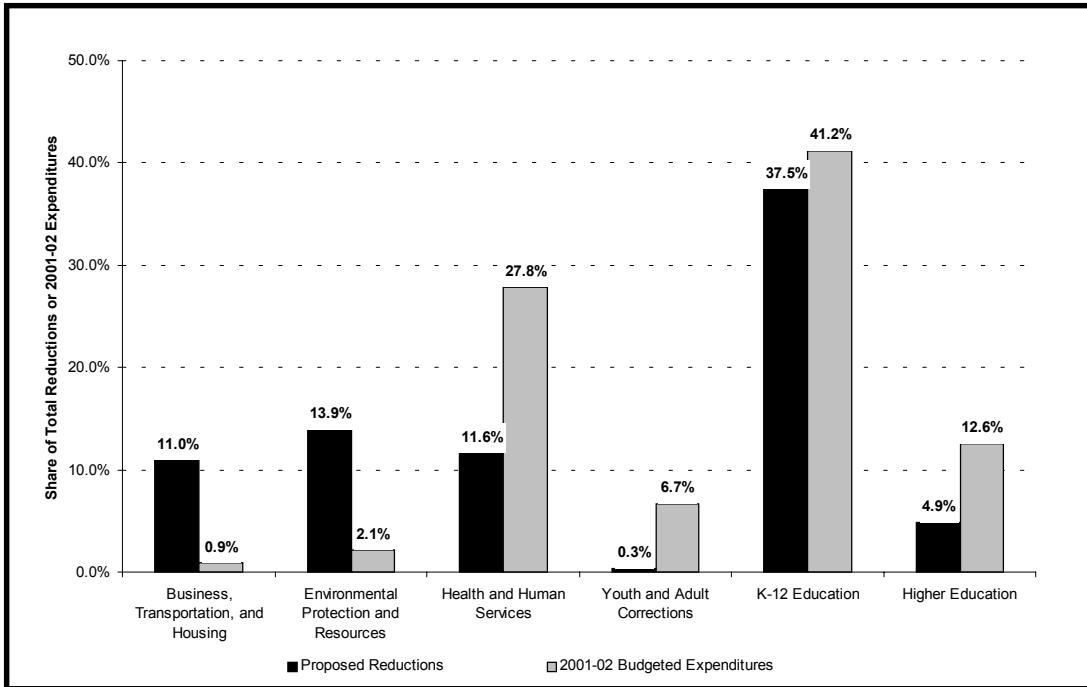
While economists expect the current downturn to be short-lived, it has and will have a substantial impact on state revenues. In May, the Department of Finance estimated that 23.1 percent of 2000-01 General Fund revenues came from taxes paid on stock options and capital gains. The LAO estimates that tax revenues attributable to these two sources will fall from \$17 billion in 2000-01 to \$7 billion in 2001-02. General Fund revenues for October were \$220 million below the 2001-02 Budget Act forecast, which brings the year-to-date total to \$827 million below projections.

GOVERNOR ANNOUNCES CURRENT YEAR FREEZE

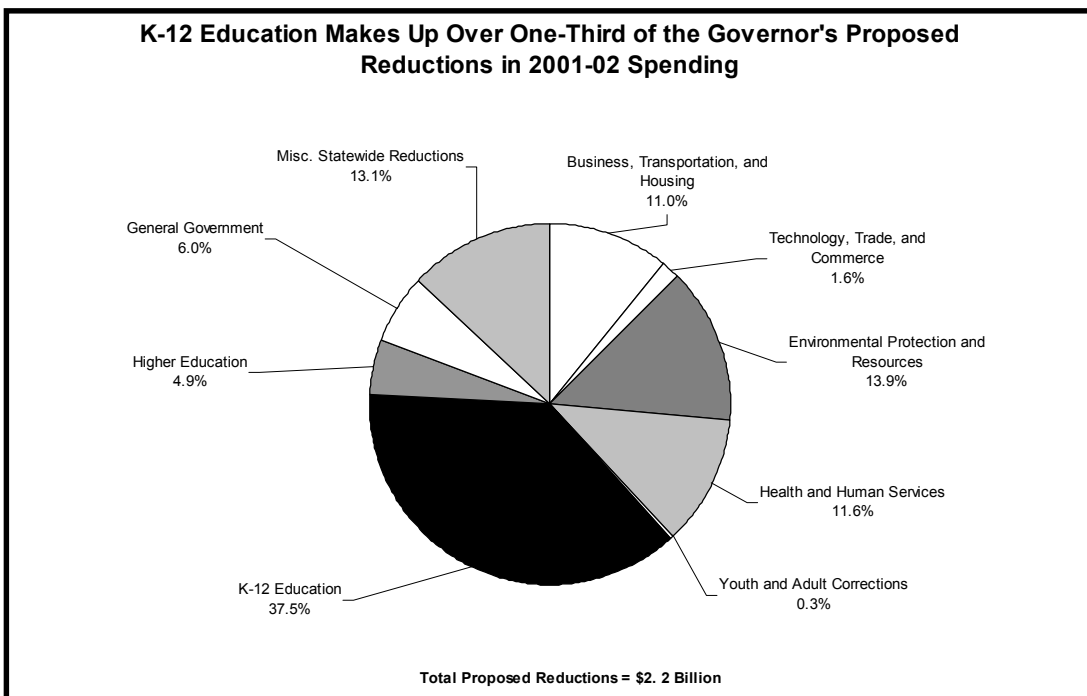
In response to the anticipated deficit, the Governor has proposed \$2.248 billion in current year spending cuts. These include the administration's direction to agencies to freeze hiring and cut current year operating expenses by \$150 million. The proposed reductions represent delays in program expansions and implementation, purchase deferrals, and the reversion of unspent funds. The Governor will ask the Legislature to make the statutory changes needed to implement his proposed reductions during a special session of the Legislature in January.

While the reductions affect all areas of state spending, the largest reductions are in K-12 Education with \$843.5 million in proposed cuts. This represents 37.5 percent of the total reductions, slightly below K-12 education's share of budgeted 2001-02 General Fund spending (41.2 percent). However, the Governor's proposals disproportionately reduce some categories of spending. These include Environmental Protection and Resources which represent only 2.1 percent of 2001-02 General Fund spending but comprised 13.9 percent of the proposed reductions and Business, Transportation, and Housing which suffered 11.0 percent of the reductions while making up only 0.9 percent of spending.

On the other hand, Youth and Adult Corrections, which accounted for 6.7 percent of budgeted 2001-02



General Fund expenditures, received only 0.3 percent of the proposed reductions. Health and Human Services' (HHS) share of the proposed reductions, 11.6 percent, is also less than its share of current year expenditures, 27.8 percent. This, in part, reflects that some HHS programs, such as CalWORKs, have maintenance of effort requirements tied to their federal funding, and many programs are caseload driven.



EDUCATION CUTS AFFECT AT-RISK STUDENTS

While K-12 Education's share of the total proposed reductions may be proportionate to its share of spending, the specific cuts are concentrated in programs that serve the state's most vulnerable children.

Proposed education reductions include:

- \$197 million for the High Priority Schools Grant program, which would provide assistance to the state's lowest performing schools. It should be noted that the Governor could have better targeted resources to those students with the greatest need and saved approximately the same amount by eliminating the \$157 million budgeted for the Governor's Performance Award and further reducing the controversial Certificated Staff Performance Awards by an additional \$50 million instead.
- \$38 million for new Healthy Start sites.
- \$29.7 million for the expansion of the Before and After School Learning and Safe Neighborhoods Partnership program.
- \$50 million for the Certificated Staff Performance Awards program, which provides staff bonuses in low performing schools with the greatest improvement in their academic performance.

The Governor also proposed \$260.8 million in reductions in Health and Human Service programs. The largest single reduction, \$54.3 million from the Tobacco Settlement Fund in 2001-02 and \$160.5 million in 2002-03, comes from delaying the expansion of the Healthy Families program to cover parents in families with incomes up to 250 percent of the federal poverty level. California receives approximately two federal dollars for each state dollar spent on the Healthy Families program. The state stands to permanently lose a portion of its federal allocation due to the delayed implementation of the parent expansion.

Other reductions include \$53.7 million for the Low Income Home Energy Assistance Program; \$40.5 million in unspent funds for local child support administration incentives; \$30 million for local trauma center support and trauma system planning; \$19 million in unspent 2000-01 Child Welfare Services funding; a \$10 million cut in the Expanded Access to Primary Care program, leaving the program at its 2000-01 funding level; and \$9.8 million for Foster Care Transitional programs.

CONCLUSION

The current downturn is severe, although the anticipated deficit is proportionately much smaller than those of the early 1990s. The state closed spending gaps of the early 1990s through a combination of spending cuts, tax increases, cost shifting to local governments, and borrowing. Factors influencing the debate over how to balance the budget across programs include fiscal constraints imposed by Proposition 98, which sets the spending level for K-14 education, and the supermajority vote required in the legislature for tax increases. These, in conjunction with the political support for education, corrections, and lower taxes, resulted in health and social services programs bearing a disproportionate share of the budget-balancing burden. These factors will still be relevant in the upcoming budget debate.

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. Support for the CBP comes from foundation grants, publications and individual contributions. Delaine McCullough prepared this paper. Please visit the CBP's web site at www.cbp.org.
