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GOVERNOR'S MAY REVISION BORROWS AGAINST FUTURE LOTTERY REVENUES, MAKES DEEP CUTS TO HEALTH AND HUMAN SERVICES

Governor Arnold Schwarzenegger released the May Revision to his 2008-09 Proposed Budget on May 14. The May Revision updates policy proposals, revenue projections, and estimated expenditures for both the current and upcoming budget years. Relative to the Governor's January Proposed Budget, the May Revision projects a widening of the budget gap. The May Revision assumes a shortfall of \$15.2 billion, up from the approximately \$8 billion gap remaining after the mid-year actions approved by the Legislature in February. The Governor outlines \$17.2 billion of "solutions," leaving the state with a \$2 billion reserve. With the exception of relatively modest fee proposals, the May Revision continues the Governor's "all cuts" approach to balancing the budget.

The following update provides a "quick and dirty" summary of key provisions of the Governor's May Revision. As additional details become available, the California Budget Project (CBP) will update this document. The CBP also will prepare analyses of major proposals contained in the May Revision over the upcoming days and weeks. Please check the CBP website (www.cbp.org) for corrections and additions to this analysis as additional information becomes available. The Governor's budget documents are available online at <http://www.ebudget.ca.gov/>.

May Revision Assumes Big Drop in 2008-09 Revenues

The May Revision assumes that 2007-08 and 2008-09 combined tax collections will be \$5.4 billion lower than was forecast by the Governor's January budget. The drop is attributable to the continued weakness in the state and national economies. The magnitude of the reduction, however, is somewhat significant. As of the end of April, year-to-date collections were \$738 million above the January forecast, according to reports issued by the State Controller's Office. While year-to-date sales and corporate income tax receipts lag amounts projected in January, stronger than anticipated personal income tax collections have more than made up the difference.

Other major revenue proposals include changes to the lottery (see below) and postponement of the sale of EdFund, which guarantees student loans, until 2009-10. The 2007-08 Budget assumed that the state would receive \$1 billion from the privatization of EdFund. The Governor proposes establishing a Tax Modernization Commission via executive order to "make recommendations to assist the state in becoming less susceptible to revenue swings in the future." The Legislature and the Governor would appoint commission members. New Assembly Speaker Karen Bass has also announced that she plans to appoint a commission to review the state's tax system.

The Governor also borrows from a number of special funds – funds that are earmarked for specific programs and purposes – to help fill the state’s General Fund shortfall. Significant loans include \$238 million in loans from transportation funds; \$126.4 million from a variety of regulatory boards and bureaus under the State and Consumer Services Agency; \$50 million from the Restitution Fund, which provides assistance to crime victims; \$17.6 million from several housing-related funds; \$30.4 million from four funds in the Resources Agency; and \$25.7 million from funds in the Health and Human Services Agency, including the Hospital Building Fund.

Governor Proposes Deep Human Services and Health Cuts, Borrowing Against Future Lottery Proceeds

The May Revision includes a number of major policy proposals, most aimed at generating savings to close the budget gap. One exception is the Governor’s withdrawal of his proposed early release program that would have released 22,000 “low-risk” inmates prior to the completion of their prison terms. The Governor’s January budget scored \$256.4 million in 2008-09 savings from this proposal. The May Revision proposes to:

- Make deep cuts in health and human services programs, including the In-Home Supportive Services (IHSS) Program, eliminating cash assistance and health benefits for certain legal immigrants, and limiting health coverage for low-income working parents. The additional reductions, which would total \$627 million, are in addition to the cuts proposed by the Governor in January. Of the \$11.4 billion in 2008-09 cuts proposed by the Governor, \$2.9 billion would come from health and human service programs.
- “Modernize” the lottery and provide it with “operational flexibility” as part of a proposal to borrow \$15 billion using bonds that would be repaid from future lottery sales. The Governor proposes to use bond proceeds to allocate \$1.2 billion per year to education, rather than the 34 percent of lottery sales guaranteed under current law; \$5.1 billion to help close the 2008-09 budget gap; and the remainder to a new reserve. The Governor would ask the voters to approve his proposed changes to lottery operations and the allocation of lottery proceeds in a measure that would appear on the November 2008 ballot. In the event voters reject the proposed change or the state is otherwise unable to issue bonds backed by lottery proceeds, the Governor proposes to trigger a one-cent sales tax increase. The sales tax increase would remain in effect for three years or until the balance in a new reserve reached a specified level.
- Restore \$1.1 billion of the Governor’s proposed \$4.8 billion January reduction to K-14 education programs covered by the Proposition 98 guarantee. Under the Governor’s May Revision proposal, 2008-09 funding for K-14 education would be cut by \$3.9 billion. However, the revised funding level would meet the minimum required by the Proposition 98 guarantee.

Adding Up the Numbers

The May Revision identifies a \$22.3 billion gap between revenues and expenditures in the current (2007-08) and budget (2008-09) years. The Governor increases the identified shortfall by \$2 billion in order provide a modest budget reserve and proposes \$24.3 billion of “solutions” to fill the gap. The Governor proposes to cut spending by \$12.6 billion and proposes \$11.7 billion in other solutions, including \$3.3 billion from the sale of additional deficit financing bonds, \$1.9 billion from an accounting shift, \$5.1 billion from the sale of bonds backed by lottery proceeds, and \$1.4 billion from “other initiatives.”

Governor Reiterates Support for Budget Measure That Would Limit Spending, Shift Power to Future Governors

The May Revision reiterates the Governor’s support for a proposal that would significantly limit the state’s ability to spend available revenues and give future governors sweeping power to cut spending in years when estimated spending lags estimated revenues. A portion of the proceeds of bonds backed by lottery revenues would be deposited in the new reserve created by the Governor’s proposal. A CBP analysis of past revenue and expenditure data shows

that, if the proposal had been in effect prior to the recent budget crisis, it would have significantly limited the state's ability to spend available resources in years of above average revenue growth and would have left the state facing substantial shortfalls in the early years of this decade. This analysis, which will be updated as additional details become available, is on the CBP's website at www.cbp.org.

Medi-Cal

The May Revision makes deep cuts to the Medi-Cal Program in addition to the Governor's January proposals, including substantial cuts in eligibility and services. Specifically, the May Revision:

- Maintains the Governor's January proposals to require enrollees to submit paperwork four times annually to retain eligibility for Medi-Cal services, eliminate dental and other benefits for adult Medi-Cal beneficiaries, and reduce payments to most Medi-Cal providers by 10 percent. The Administration estimated in January that half a million Californians would lose coverage if the paperwork proposal were fully implemented.
- Substantially restricts Medi-Cal eligibility for low-income parents with children, which would decrease the number of parents covered by Medi-Cal by approximately 430,000 by August 2011. The May Revision reduces the maximum income level for parents applying for Medi-Cal coverage to 61 percent of the poverty line (\$10,736 for a family of three in 2008). In addition, the Governor would make it more difficult for two-parent families to enroll in and retain Medi-Cal coverage by reinstating a rule that required the family's principal wage earner to work less than 100 hours per month. Because the proposal to reduce the maximum income level affects only those applying for Medi-Cal coverage, and not those already enrolled in the program, the number of parents affected would grow over time. As a result, estimated state savings would increase from \$31.2 million in 2008-09 to \$342.5 million in 2011-12.
- Reduces the services provided to certain legal immigrants – such as those who have been in the US for five years or less – for state savings of \$86.7 million. These immigrants would be eligible for emergency, pregnancy-related, and breast and cervical cancer treatment services, but would not be eligible for preventive services and routine doctors' visits.
- Restricts access to health care services for unauthorized immigrants by requiring them to reapply for Medi-Cal monthly to receive emergency services. The proposal assumes state savings of \$42 million in 2008-09 by reducing the number of immigrants covered by Medi-Cal by 11,000 in 2008-09. The proposal would not apply to pregnant women.
- Delays implementation of SB 437 (Chapter 328, Statutes of 2006), which would take several steps to make it easier to enroll individuals in Medi-Cal and Healthy Families. These steps include "express lane" eligibility for women in the Women, Infants, and Children program and a pilot program allowing families to self-certify their incomes.
- Increases payments to Medi-Cal managed care plans by \$169.8 million in order to comply with minimum federal requirements.
- Decreases payments to certain hospitals that treat Medi-Cal patients for state savings of \$11.3 million. This reduction builds on the Governor's January proposal to cut payments by 10 percent to hospitals that do not negotiate their reimbursement levels with the California Medical Assistance Commission (CMAC). The May Revision would further reduce payments for some of these hospitals to a level that is 5 percent below CMAC payments to other hospitals in the region.
- Proposes to contract, on a pay-for-performance basis, with a vendor to attempt to reduce spending on durable medical equipment, such as wheelchairs.

Other Health Programs

The May Revision:

- Maintains the Governor's January proposals to reduce state support for the Healthy Families Program by reducing payments to the managed care plans that enroll Healthy Families children, placing a \$1,000 annual limit on dental services, increasing the family contributions for certain children, and increasing copayments for non-preventive services from \$5 per visit to \$7.50 per visit for families with incomes above 150 percent of the poverty line.
- Maintains the Governor's January proposals to reduce state support for a variety of health-related programs, including Regional Centers, which purchase and coordinate services for people with developmental disabilities; the Early and Periodic Screening, Diagnosis, and Treatment Program, which provides periodic health exams, screening, and treatment to certain children; and substance abuse treatment services for nonviolent offenders eligible under Proposition 36, the Substance Abuse and Crime Prevention Act.

California Work Opportunity and Responsibility to Kids (CalWORKs) Program

The May Revision maintains the Governor's January budget proposals to eliminate cash grants for nearly 200,000 children in the CalWORKs Program. In addition, the May Revision:

- Cuts CalWORKs grants by 5 percent for savings of \$108.2 million in 2008-09. This change would reduce the maximum monthly grant for a family of three in high-cost counties by \$36, from \$723 to \$687. The state last reduced CalWORKs grants in 1997-98.
- Suspends the October 2008 cost-of-living adjustment (COLA) for CalWORKs cash assistance payments, for savings of \$111 million in 2008-09. In February, the Governor signed legislation delaying the July 2008 COLA to October 2008.
- Requires CalWORKs recipients who are not meeting work participation requirements to meet with a county worker every six months in order to assess what services could help increase their participation. The Administration assumes that this proposal would generate savings of \$59.7 million because recipients who fail to attend the meeting without good cause would be dropped from the program.
- Implements a four-month, "pre-CalWORKs" program to provide job services to certain individuals who are eligible for CalWORKs, but who are not employed sufficient hours to meet federal work participation requirements for CalWORKs recipients. The Administration suggests that this approach could help to improve California's work participation rate.
- Uses federal Temporary Assistance for Needy Families (TANF) block grant funds in place of state funds for the following programs: student financial aid through the Cal Grant Program (\$223 million), the Juvenile Probation Program (\$151.8 million), and Emergency Assistance Foster Care (\$50.4 million). The May Revision also increases the transfer of TANF funds to the Department of Developmental Services by \$22.2 million, which replaces an equivalent amount of state dollars. The Administration states that these changes are needed in order to meet the state's maintenance-of-effort (MOE) spending requirement "without increasing overall state General Fund expenditures."
- Uses \$5 million in TANF dollars to fund the California Alliance of Boys and Girls Clubs (CABGC), which would allow the state to count an estimated \$88 million in CABGC expenditures toward the state's MOE spending requirement. This change would increase the likelihood that California would receive a federal credit for "excess MOE" expenditures – those above the minimum threshold required by the federal government – that would lower the state's required work participation rate for CalWORKs recipients.
- Eliminates \$40 million in "Pay for Performance" incentive funds for counties in 2008-09.

- Estimates that the CalWORKs caseload would drop from 460,119 in 2007-08 to 386,871 in 2008-09 (15.9 percent) if the Governor's proposed changes are enacted.

Supplemental Security Income/State Supplementary Payment (SSI/SSP) Program

The May Revision maintains the Governor's January budget proposals to suspend state COLAs for SSI/SSP grants in 2008 and 2009. In February, the Governor signed legislation delaying the June 2008 state COLA to October 2008; however, this measure maintained the state COLAs in 2008 and 2009. SSI/SSP grants help 1.3 million low-income seniors and people with disabilities meet basic living expenses. In addition, the May Revision:

- Does not "pass through" to SSI/SSP recipients the January 2009 federal SSI COLA for savings of \$108.8 million in 2008-09.
- Eliminates the Cash Assistance Program for Immigrants (CAPI) for savings of \$111.2 million in 2008-09. CAPI provides state-funded cash assistance to approximately 10,000 elderly and/or disabled legal immigrants who are not eligible for SSI/SSP payments due to their immigration status.

In-Home Supportive Services (IHSS) Program

The May Revision withdraws the Governor's January budget proposal to reduce the number of hours provided for certain non-medical domestic services – including meal preparation, laundry, and errands – by 18 percent in 2008-09. Instead, the May Revision:

- Eliminates domestic and related services for IHSS recipients with less severe impairments, for savings of \$52 million in 2008-09. This change would cut the hours of IHSS services provided to approximately 84,000 IHSS recipients – 20 percent of all recipients – from 73.8 hours per month to 52.2 hours per month.
- Caps the state's contribution toward the wages of IHSS workers at the state's minimum wage – currently \$8.00 per hour – plus \$0.60 per hour for benefits, for savings of \$186.6 million in 2008-09. Currently, the state shares – with the federal and county governments – in combined wage and benefit levels of up to \$12.10 per hour for IHSS workers. Counties could continue to provide wages and benefits above the proposed level, but would have to use their own dollars to make up for lost state funding.
- Requires IHSS recipients with less severe impairments to begin paying their own Medi-Cal "share of cost," for savings of \$27.7 million in 2008-09. The state has paid these individuals' share of cost since 2004. Approximately 7,100 low-income IHSS recipients would be required to pay an average of \$427 per month under this proposal.

Other Human Services

The May Revision maintains the Governor's proposed across-the-board reductions for a number of programs that assist children and families, including the Child Welfare Services Program, the Foster Care Program, the Adoption Assistance Program, and the California Food Assistance Program. In addition, the May Revision includes an increase of \$9.4 million to pay a federal penalty for the state's failure to meet a performance measure related to the stability of children placed in foster care.

Child Care and Development Programs

The May Revision maintains the Governor's January budget proposals to reduce state funding for child care and development programs in 2008-09. In addition, the May Revision reduces the maximum amount that certain child care

providers could be paid by lowering the Regional Market Rate (RMR) reimbursement “ceiling” from the 85th percentile to the 75th percentile, beginning January 1, 2009. The Administration also proposes to delay the 2008 RMR survey to January 2009 and conduct the survey every two years, rather than annually.

Proposition 98

The May Revision restores \$1.1 billion of the Governor’s proposed \$4.8 billion January reduction to K-14 education programs covered by the Proposition 98 guarantee. Under the Governor’s May Revision proposal, 2008-09 funding for K-14 education would be cut by \$3.9 billion. However, the revised funding level would meet the minimum required by the Proposition 98 guarantee. The May Revision funding level would not require suspending the Proposition 98 guarantee due to the additional funding proposed by the Governor and the fact that the minimum guarantee is anticipated to be lower than was projected in January.

K-12 Education

The May Revision:

- Reflects an increase in 2008-09 spending covered by the Proposition 98 guarantee relative to 2007-08, from \$56.6 billion to \$56.8 billion. This results in a \$101 increase in 2008-09 Proposition 98 K-12 per pupil spending, from \$8,509 to \$8,610.
- Reflects a net increase in 2008-09 revenue limit funding of \$85.3 million due to an increase in projected enrollment above the Governor’s January budget estimate. The May Revision also increases 2007-08 revenue limit funding by \$50.5 million due to an increase in estimated enrollment relative to the Governor’s January budget. Revenue limits provide general purpose funds for schools.
- Reflects a decrease in local property tax revenues. The May Revision increases funding for revenue limits and special education apportionments by \$179.1 million in 2007-08 and \$521.3 million in 2008-09 to backfill for the loss of local revenues.
- Maintains the Governor’s January budget proposal to eliminate 2008-09 COLAs for school districts and county offices of education. The May Revision also maintains the Governor’s proposal to change the formula used to calculate COLAs for K-12 education programs.
- Maintains the Governor’s January budget proposal to reduce funding for a number of categorical programs. In order to achieve these savings, the Governor proposes to eliminate COLAs and reduce rate allocations. Categorical programs include class size reduction, instructional materials, home-to-school transportation, and various career technical education programs.
- Proposes to use Public Transportation Account dollars to pay for up to \$592.9 million in 2008-09 home-to-school transportation costs.
- Reduces deferred maintenance funds by \$222.6 million and eliminates the local matching requirement for the deferred maintenance program in 2008-09. School districts are required to develop a maintenance plan and allocate local funds to receive matching funds from the state.
- Restores \$234.1 million of the reduction in special education funding proposed in the Governor’s January budget. The revised funding level would meet the federal maintenance-of-effort requirement for special education programs.
- Provides \$100 million to fund school facility emergency repairs as required by the settlement agreement in *Williams vs. California*.
- Modifies the Governor’s January budget proposal that reduces the state’s contribution to the State Teachers’ Retirement System (STRS) for retiree purchasing power protection. In January, the Governor proposed reducing the state’s contribution from 2.5 percent to 2.2 percent of payroll. The May Revision modifies the proposed state contribution to 2.25 percent

- Proposes to delay and reduce yearly payments toward the \$210 million in interest owed as a result of a 2007 court decision in the STRS lawsuit. The Governor's January budget allocated \$80 million in 2008-09 as the first of three payments toward interest owed. The May Revision allocates \$52.6 million in 2009-10 as the first of four equal payments. The court awarded STRS interest payments based on \$500 million the state withheld from the STRS inflation protection program in 2003-04.
- Proposes to reauthorize provisions adopted in 2003-04 that provide flexibility to school districts with regard to how they use their funds. These provisions include allowing school districts to reduce a variety of required reserves to allow districts to use more funds for general purposes.

Community Colleges

The May Revision:

- Increases 2008-09 Proposition 98 funding for California Community Colleges by \$167.2 million, including \$138.7 million to backfill for lower than previously anticipated local property tax revenues and \$35.5 million for growth in apportionments. The May Revision also provides \$69 million in 2007-08 funding to backfill an anticipated decline in local property tax revenues.
- Provides community colleges flexibility to transfer funds among categorical programs "to allow local priority needs to be better addressed."

Higher Education

The May Revision restores \$98.5 million in funding for the University of California (UC) and \$97.6 million for the California State University (CSU). The proposed augmentation would result in a \$233.4 million proposed 2008-09 reduction for the UC and a \$215.3 million proposed reduction for the CSU when combined with the cuts in the Governor's January budget.

Student Aid Commission

The May Revision uses \$223 million in federal TANF block grant funds to replace state funds to pay for financial aid for TANF-eligible students, resulting in an equal amount of state savings.

Resources

The May Revision reverses the Governor's January budget proposal to cut funding for the Department of Parks and Recreation by \$13.3 million, which would have resulted in the closure of 48 state parks and reduced the number of lifeguards at a number of state beaches. The May Revision includes an increase in state park fees that is projected to raise \$1.5 million to partially offset the lost savings.

Corrections

The May Revision:

- Drops the Governor's January budget proposal to release 22,159 non-violent inmates before their scheduled release dates. The Governor states that his early release proposal is no longer necessary due to approximately \$300 million in Department of Corrections and Rehabilitation savings attributable to a lower than previously

anticipated inmate population, “the effectiveness of parole reforms and rehabilitative efforts to date,” and other measures.

- Increases funding for medical care for inmates by \$8.6 million in order to comply with the *Plata* lawsuit, which challenged the quality of medical care in state correctional facilities. The Governor also proposes legislation that would allocate \$6 billion in lease revenue bond authority for projects proposed by the federal court-appointed receiver, including the construction of new medical facilities to serve up to 10,000 inmates, and provide \$100 million from the state’s General Fund and \$900 million in lease revenue bond authority to improve health care facilities at existing correctional facilities.
- Maintains the Governor’s January budget proposal to place certain inmates and parolees on “summary parole” for savings of \$173.6 million. Summary parolees would have no active supervision, but would be subject to searches and drug testing.
- Scores total savings of \$421 million in 2007-08 and 2008-09 because the Legislature has not approved key elements of the “last, best, and final” contract offer to correctional peace officers. The Administration indicates it would implement the offer once the Legislature approves the changes.

Transportation

The May Revision proposes to use \$828 million in public transportation funds to support \$593 million in K-12 home-to-school transportation costs and \$235 million in debt service on transportation bonds. Both of these costs traditionally have been paid from the state’s General Fund. These funds would come from increased “spillover” gas sales tax revenue, higher than anticipated diesel tax collections, and maintaining funding for the State Transit Assistance (STA) Program at 2007-08 levels. Spillover funds are generated when gas prices rise at a faster rate than prices for other goods. The Governor plans to seek legislation to maintain STA funding at its 2007-08 level.

Emergency Response Initiative

The May Revision continues the Governor’s January budget proposal to establish the Emergency Response Initiative, formerly named the Wildland Firefighting Initiative, to respond to emergencies and disasters. The Governor proposes to fund this initiative through a surcharge imposed on all residential and commercial property insurance policies based on the likelihood of risk due to earthquakes, fires, or floods. A 1.40 percent surcharge would be assessed on structures in high-risk areas and a 0.75 percent surcharge would be assessed on structures in low-risk areas. The May Revision projects fee receipts of \$69.3 million in 2008-09, \$35.6 million less than the savings assumed in the Governor’s January budget due to the delayed implementation of this proposal.