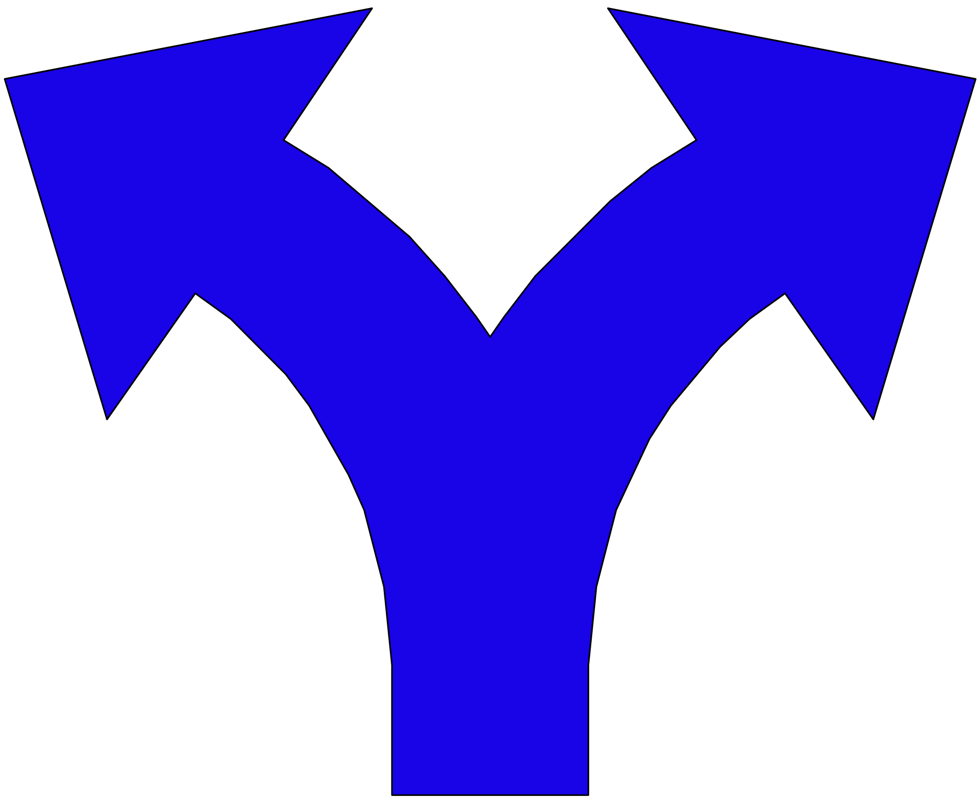
Critical Choices for California:

The 1996-97 State Budget



California Budget Project

The California Budget Project (CBP) is a nonpartisan, nonprofit organization whose goal is to promote a better understanding of state fiscal issues in order to promote a healthy public sector based on a fair and equitable tax system. General support for the CBP is provided by the James Irvine, Ford, and Annie E. Casey Foundations and individual donations and subscriptions. Support for the analysis of federal block grant and welfare reform proposals is provided by a grant from the Stuart Foundation.

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Critical Choices for California: The 1996-97 State Budget

Executive Summary

The annual state budget reflects the priorities and values of the Governor and the Legislature for the upcoming year. While California's economic recovery produced revenue growth exceeding previous expectations, $1.2 billion in budget actions -- spending reductions and tax increases -- are needed to produce a balanced spending plan. Funding the Governor's proposed tax cuts would require an additional $572 million in spending reductions.

Critical Choices for California: The 1996-97 State Budget reviews significant policy choices confronting the Legislature and the Governor as they enter the final month of budget negotiations. This report makes four key findings:

- The Governor's proposed 15% reduction in personal and corporate income taxes will reduce revenues below the level needed to maintain current service levels and will limit the state's ability to fund education and infrastructure development.

- The class size reduction proposal contained in the *May Revision* provides inadequate funding for schools to meet the threshold required to obtain state funds. On average, the Governor's proposal would fund less than half the cost of reducing classes from the current average of 28.5 to the proposed standard of 20.

- Programs addressing the needs of low-income families and children are targeted for a disproportionate share of the reductions necessary to achieve a balanced spending plan. While the Aid to Families with Dependent Children (AFDC) program accounts for approximately 4.6% of budgeted General Fund spending, it is targeted for 14.0% of the savings needed to balance the budget. SSI/SSP, which accounts for approximately 3.5% of budgeted General Fund spending, is targeted for 25.9% of the savings necessary to balance the budget. The one tax increase proposed in the *May Revision* and Assembly spending plan, elimination of the Renters tax credit, provides three-quarters of its benefits to families earning less than $30,000 per year.

- Over two-thirds of the actions proposed in the Governor's *May Revision* to balance the budget ($1.2 billion) require federal action in the form of law changes, waivers of federal laws, or appropriations. In making these assumptions, lawmakers should realize that the state has realized only a small fraction of the savings associated with federal actions included in recent years' budgets.

The 1996-97 budget offers policymakers the opportunity to plan for the future. Revenue growth, the product of the state's long awaited economic recovery, appears strong. Successive budget crises at both the state and local level have reduced investment in education, physical infrastructure, and human services, reducing the quality of life in many local communities. The apparent strength of the state's recovery provides the opportunity for policymakers to invest in California's future and create a strong fiscal foundation.

Critical Choices for California: The 1996-97 State Budget

Release of the *May Revision* to the Governor's Budget marks the start of serious negotiations over the state's budget for the upcoming fiscal year. For the first time this decade, the *May Revision* contains good news for California's fiscal future -- between the current and upcoming budget years, the state will receive an estimated $2.6 billion more in revenues than was forecast in January. Despite this revenue windfall, many Californians will not share in the state's economic and fiscal recovery. Low-income children, families, the elderly, and the disabled face deep reductions in programs providing basic cash support. While K - 12 education will benefit substantially from the rise in state revenues, California's per pupil spending still falls far below the national average. Finally, the Governor's continued advocacy of a 15% reduction in personal and corporate income tax rates endangers the state's ability to invest in the services and infrastructure needed to restore California's economic competitiveness after years of neglect.

Critical Choices for California: The 1996-97 Budget highlights policy choices confronting the Legislature and the Governor as budget negotiations draw to a close. This report makes four key findings. First, California still confronts an imbalance between revenues and program demands. Implementation of the Governor's proposed tax cut would reduce state revenues below the level needed to keep pace with demands for services. Second, despite the worthiness of reducing class size as a policy goal, the Governor's proposal fails to provide adequate funding for most schools to reduce classes to the level necessary to receive funds. As a result, many districts will be unable to redeem the promised funds. The *May Revision* continues to balance the budget on the backs of the poor. Virtually all of the spending reductions used to close the budget gap come from programs addressing the needs of low-income families. These programs have suffered repetitive reductions over the past six years, pushing millions of Californians deeper into poverty. Finally, actions requiring federal approval or appropriations account for approximately 70% of the dollars used to balance the 1996-97 budget. Many of the assumptions on which these savings are based are tenuous, at best. The state has realized a small fraction of the savings attributable to federal actions and increases in federal aid attributable to federal actions assumed in previous years' budgets.

This report focuses on the impact of policies and spending reductions proposed in the budget on the local level. Since changes in state budget and policy priorities affect Californians most directly in their local communities, this report estimates the financial impact of the policies contained in the *May Revision* at the county level. These findings illustrate the magnitude of the effects of proposed tax and human service policy changes on California's children and local communities.

Significant differences and policy priorities are expressed in the budget proposals offered by the Governor and each house of the Legislature. These priorities reflect different visions of California's future and the role of public priorities in shaping that future. The choices made by policymakers over the coming weeks will determine whether the opportunities presented by California's economic recovery are used to build a sound fiscal future for all Californians or whether the state will continue to muddle through from one year to the next.

State To End 1995-96 With A Deficit, Minimal Surplus Anticipated in 1996-97

After accounting for adjustments made to the 1995-96 budget as a result of the *May Revision*, the Legislative Analyst estimates that the state will enter the next budget year with a $71 million deficit. The May spending plan provides K - 12 education $583 million in additional funding. This reflects the minimum amount required under Proposition 98's school funding guarantee. Specific proposals for allocating additional education dollars are detailed below.

Other adjustments to 1995-96 spending include a slight decrease ($29.9 million) for the Department of Corrections due to lower than anticipated inmate populations and a significant increase ($264.7 million) for the Department of Social Services. The latter reflects the absence of savings the Governor anticipated in his January budget based on the assumption that welfare reform would be enacted at the federal level. He further assumed that federal welfare reform would allow the state to implement grant reductions and other changes previously approved by the Legislature in the AFDC and SSI/SSP programs.

The Governor's spending plan provides a budget reserve of $516 million in 1996-97. This amount, equivalent to 1.1% of budgeted General Fund expenditures, is far below the 3% typically considered prudent. The proposed reserve is minimal in light of the risks to the budget, including the prospect of reduced federal aid or the failure to realize anticipated savings that require federal action.

Economic Growth Boosts Corporate Profits, High Income Earners

The Governor's *May Revision* notes that personal income tax revenues are much higher than anticipated in large part because bonus payments for high wage employees appear to have been exceptionally strong. Economic growth has also been strong in high wage industries including electronics, computer software, and motion pictures. In addition, over the past year average wages have increased faster than inflation, resulting in higher tax collections. Bank and corporation tax revenues are higher due to growth in taxable profits.

At the same time, analysts note the growth in income inequality and the widening of the gap between high and low income earners. Recent reports by the Bureau of the Census document increasing income inequality. The share of income received by the highest fifth of the US population was 49.1% in 1994, but only 43.0% in 1969. The bottom fifth of US residents received 3.6% of all income in 1994, down from 4.1% in 1969.[1] California's income inequality in the period from 1990-94 has ranged from the worst to the sixth worst in the nation.[2] Further, the gap between high wage and low wage jobs in the California economy continues to grow. The California economy has seen job growth at the lower end of the wage scale, while jobs with wages ranging from $30,000 to $80,000 have declined.[3]

Corporate profits also rose substantially in 1995. Between the 4th quarter of 1994 and 1995, US corporate profits rose 10%, substantially above the 2.9% rise in inflation. Fortune 500 companies, which enjoyed an average of 13% growth profits, while employing essentially the

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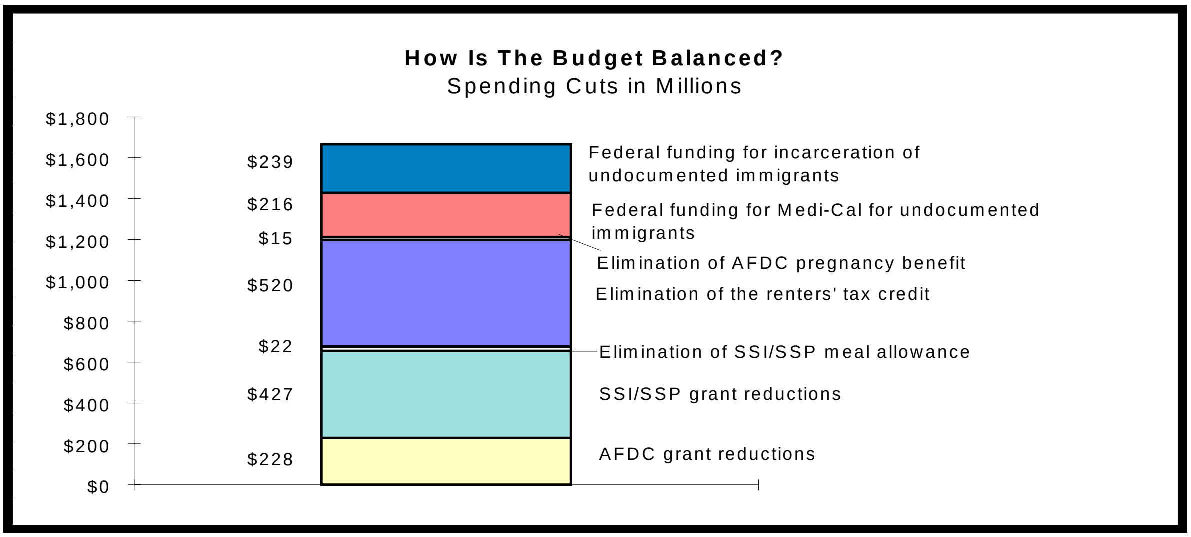
1 *Income and Poverty Estimates* (US Bureau of the Census, on-line data).
2 *New York: The State of the State Social Indicators Report Card* (Fiscal Policy Institute, 1995).
3 *Controller's Quarterly* (California State Controller, May 1996).

same number of workers.[4] Compensation for corporate CEOs jumped 23% in 1995.[5] The stark contrast between gains for high wage workers and industries, and growing income inequality, is heightened by the Governor's proposal to reduce support for low-income Californians in a year when the most well-off Californians will receive a tax decrease due to the expiration of the top rates on the personal income tax.

Tax Cut Will Limit California's Ability To Make Needed Investments

In order to balance the budget, the *May Revision* contains $692 million in spending reductions to programs for the poor, an assumption that the state will receive $455 million in federal aid for services provided to undocumented immigrants and a $520 million tax increase on predominantly low-income renters. The spending reductions assumed in the budget are larger than needed to achieve a balanced spending plan, since the Governor continues to advocate a 15% reduction in personal and corporate income taxes along with a number of smaller tax cuts. These proposals reduce General Fund revenues by $572 million in 1996-97, with the cost rising to $4.7 billion in 1999-00.



Source: Legislative Analyst's Office, May Revision to the Governor's Budget

The winners and losers in the proposed budget stand in stark contrast. Over half of the benefits of the 15% tax cut accrue to the wealthiest 9% of Californians. In contrast, the spending reductions associated with policy changes in the budget almost exclusively target low-income children, families, the elderly and the disabled. While some taxpayers would see their taxes decrease, the 5.7 million families that rent, rather than own their own homes, are slated for a tax increase under the Governor's proposal to eliminate the Renters' tax credit.

4 "Fortune 500 Profits Are Up As Payrolls Stay Steady," *Sacramento Bee*, April 9, 1996.
5 "CEO Compensation Soars 23 Percent," *Sacramento Bee*, March 6, 1996.

Tax Expenditures Continue Unchecked

Included in the Governor's tax proposals are ten additional tax breaks ranging from enhancements in the state's research and development tax credit to rate reductions for insurance companies that sell certain annuities to special credits for aircraft manufacturers located in enterprise zones. At full implementation, these provisions would cost the state General Fund $192 million in foregone revenues. While the likelihood the legislature will approve a 15% tax cut is fading, there appears to be some level of bipartisan interest in a tax reduction package of some magnitude as part of the budget agreement.

Analysts refer to tax credits, deductions, exclusions, and exemptions as tax expenditures. The term tax expenditures reflects the use of tax policies as a tool for achieving broader social and economic policy goals and to highlight that tax policies have similar policy functions to spending programs and policies. Growth in this type of spending through the tax code continued through the depths of the state's budget crises. While the 1991-92 budget included significant tax increases, many have since been repealed. The top rates on the personal income tax sunset at the end of 1995, costing the state $325 million in 1995-96, rising to $815 million in 1996-97. Voters threw out the "snack tax" in 1992, while the Legislature repealed the sales tax exemptions for bunker fuel, free newspapers, and subscription magazines enacted as part of the 1991 budget package.

Between 1989-90 and 1995-96, state spending through the tax code increased by 12.1% or $2.97 billion. During the same period, state General Fund spending increased by only $6.2 billion.[6] Over the past five years the legislature has enacted a number of corporate tax relief provisions costing the state over $1.5 billion in lost revenues. At the same time, safety net programs for low-income Californians, local government, and higher education suffered deep reductions.

Policies implemented through the tax code receive virtually no oversight or review. As a result, policymakers have no means to tell whether these provisions are a cost-effective means of achieving desired policy goals. At the same time, six consecutive budget gaps have forced lawmakers to carefully examine every dollar spent through the budget. The failure to subject tax expenditures to the same level of scrutiny as on-budget spending limits the effectiveness of state policy tools and provides uneven oversight of the different tools used to achieve state policy goals.

Tax Proposals Endanger California's Ability To Fund Education And Infrastructure

The rising cost of the Governor's tax proposals threaten the state's ability to adequately fund the state's schools and make needed capital investments. Due to the interaction between Proposition 98's school funding guarantee and General Fund revenues, upwards of 60% of the revenues lost due to the tax cut come out of funding for K - 12 education and Community Colleges.[7] Taken together the Governor's tax proposals would reduce per pupil spending by

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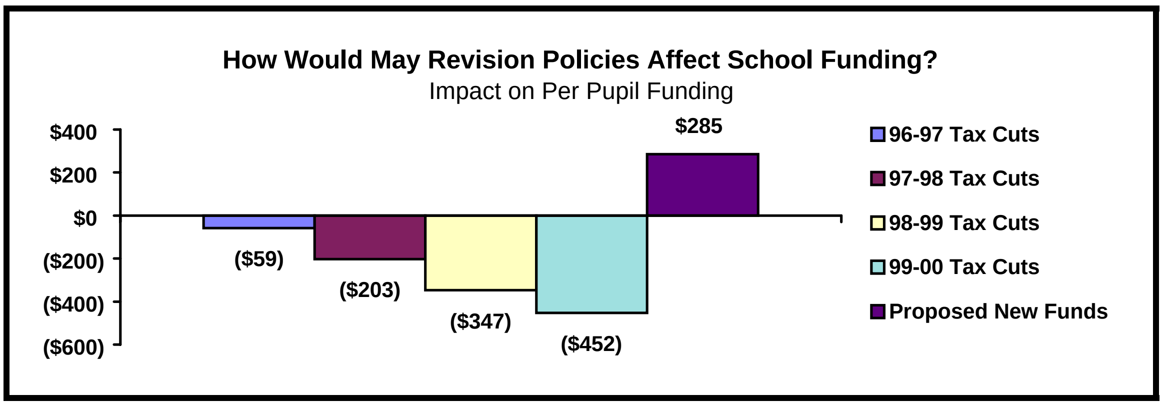
6 The growth in tax expenditures is understated, since the Department of Finance does not report most sales tax exemptions as tax expenditures. For example, this figure does not include the value of sales tax exemptions for food (including snack foods), fuel, or periodicals.

7 Tax cuts of the magnitude proposed by the Governor's proposal would place the state on "test 3" of the Proposition 98 guarantee that applies in years with relatively low revenue growth. Under test 3, the inflation factor used for determining school funding is

$452 in 1999-00. In contrast, the additional funding required by Proposition 98 in 1995-96 and 1996-97 totals $285 per pupil.

In addition to the impact on education, the reduction in revenues attributable to the tax cut will severely hamper the state's ability to invest in infrastructure. The Legislative Analyst recently identified $24.8 billion in capital outlay investments needed over the next five years.[8] Based on generally accepted levels of debt burden, the Analyst estimates that the state's ability to issue debt to fund capital investments would be reduced by as much as 24% ($5 billion) if the tax cut is enacted. The tax cut reduces the state's debt capacity by more than the projected need for investment in correctional facilities or half of the identified need for K - 12 schools.



Source: State Department of Education, May Revision to the Governor's 1996-97 Budget

School Funding Increased To Meet Requirements of the Prop 98 Guarantee

K - 12 education is the apparent winner in the *May Revision* to the budget. The additional funding for education contained in the Revision meets, but does not exceed, the level required under Proposition 98's school funding guarantee. Thus, lawmakers have discretion over how the additional funds are distributed to schools, but not the amount of funding that must be provided for programs counted as part of the Proposition 98 guarantee.

While the Governor should be applauded for addressing California's dismal performance in the area of class size -- California ranks next to last in the nation in average class size -- many, if not most, districts will find it difficult to utilize the benefits of the Governor's proposal. The *May Revision* offers $500 per student incentive payments to schools that achieve a 20 to 1 teacher to student ratio in first through third grades. Funding provided by the new initiative covers less than half the cost of moving from the current average class size to the twenty students necessary to receive the additional funds.

Take, for example, a hypothetical school with two second grade classes of 30 students each, just above the current average of 28.5 and typical in many districts. In order to receive the funds offered in the Governor's proposal, this school must add a third second grade class, for a total of three classes, each with twenty students. The Governor's proposal provides an additional

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based on growth in per capita General Fund revenues plus 0.5%. According to the State Department of Education, in a test 3 situation the school funding guarantee is reduced by approximately 60 cents for each dollar lost due to a tax cut.
8 *Bond Debt Update* (Legislative Analyst's Office, May 20, 1996).

$30,000 in funds ($500 for each of the sixty students) to schools that ***add*** classes to meet the target (schools that use teaching aides or other methods to reduce class size would qualify for a $250/student bonus).

How far would this additional $30,000 go toward meeting the cost of reducing class size? Staffing and operating a classroom for a year costs $71,280, according to the State Department of Education. In other words, the proposed incentive payments would, in this example, cover 42% of the cost of achieving the targeted goals.[9] Presumably, local districts are expected to pay the remainder of the cost out of local funds. For most districts, this represents a best case scenario. Schools that must construct additional classrooms in order to increase their number of classes confront additional costs. For these schools, the cost goes up an additional $77,760 -- the average cost of building an additional classroom, excluding the cost of land.

Table 1: How Are Additional Education Dollars Allocated in the May Revision?

1995-96	
$50,000 per school block grant	*$387 million*
Block grant augmentation	*$100 million*
Deferred maintenance augmentation	*$51.5 million*
Reading Improvement Initiative	*$67 million*
Instructional material and library resources	*$83.4 million*
School safety grants	*$10 million*
Academic mentor program	*$5 million*
CA Student Information Systems (CSIS)	*$10 million*
Mandate reserve	*$50 million*
TOTAL	***$763.9 million***
1996-97	
K - 3 Class size reduction	*$459.6 million*
Categorical block grant augmentation	*$135.7 million*
Categorical program COLA	*$160.7 million*
Revenue limit equalization	*$147.1 million*
County office of education equalization	*$13.9 million*
Preschool & child care program expansion	*$30 million*
TOTAL	***$947 million***

Source: May Revision to the Governor's 1996-97 Budget

Block Grants Will Benefit Small Schools At The Expense Of Large

Most of the additional funds owed schools in 1995-96 would be allocated as a $50,000 per school "block grant" for a total of $387 million. The block grant provides the same amount of funds to a rural school with 50 students as to an urban high school with 3,000 to 4,000 students. Schools could not use these funds for salaries and benefits, but would otherwise be free to determine how the moneys would be spent at the school site level. Other significant increases provided in the current year include additional funds for reading improvement, an augmentation to the block grant proposed in the January budget, and additional funding for deferred maintenance. Proposed augmentations for the block grant and deferred maintenance are consistent with the recommendations of the Legislative Analyst, while the Analyst recommended deleting funding for the Governor's reading improvement initiative.

9 The Governor's plan provides 47% of the funding need in order to reduce class size from the actual current average of 28.5 to 20.

Most of the additional funding required due to increased revenue collections is dedicated to a number of specific initiatives (see Table 1). By recommending that most of the additional aid to education be distributed to schools for a designated purpose, the Governor provides schools with little flexibility to address local needs or priorities. Funds over which local districts do have discretion include the block grant augmentation ($135.7 million) and revenue limit augmentation funding ($147.1 million).

In their review of the Governor's January budget proposals, the Legislative Analyst's Office recommended that the state move toward long-term certainty in school funding in a way that "increases funding for all districts and makes progress toward equalizing the amount provided to all districts."[10] To this end, the Analyst recommended that half of any new funds that become available should be used to reduce class size with the remainder used to support critical reform efforts. However, the Analyst specifically rejected a number of the reform proposals contained in the Governor's budget, including sex-segregated schools.

Tax Cut Erases The Gains Of Additional Funding

By 1998-99, the Governor's tax package cut would erase the gains made in per pupil funding. The new funds made available by this year's strong revenue growth add $285 per pupil to school spending, while in 1998-99, the tax package would reduce funding by $347 per student.[11]

In 1994-95, California trailed the national average in terms of per pupil spending by $1,170 per student, ranking 42nd in the nation.[12] While this year's increase in school funding makes significant headway toward reversing California's downward slide, approximately $5 billion in additional investments are needed to simply bring the state up to the average level of spending for elementary and secondary education.

Poor Asked To Make Greater Sacrifices, Cuts Bring California's Spending Below Levels Required In Proposed Federal Welfare Reform Legislation

While most state programs and services will receive the funding necessary to maintain current levels of services, cash assistance for low-income families, children, the elderly, and the disabled is slated for deep reductions. The *May Revision* includes the grant reductions proposed in the January Budget and adds a 3.4% reduction in SSI/SSP grants to the elderly and the disabled. For families who rely on AFDC, the average monthly grant for a family of three would fall to $514 in "low-cost" counties and $540 in high cost of living areas, while monthly SSI/SSP grants would drop to $576 for individuals and $1,030 for couples in high cost areas and $548 and $980 in low cost areas for individuals and couples, respectively.

As a share of proposed budget cuts, the proposed reductions in both AFDC and SSI/SSP far exceed these programs' share of total state expenditures. The *May Revision's* proposed reductions in AFDC comprise 14% of the savings needed to balance the budget. In contrast,

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10 *Analysis of the 1996-97 Budget Bill* (Legislative Analyst's Office, February 1996).
11 This figure includes both the 15% rate reduction and the additional provisions contained in the Governor's budget. The 15% rate reduction alone would reduce per pupil spending by $308 in 1998-99.
12 *California's Rankings, 1994-95* (EdSource, February 1996).

AFDC accounts for approximately 4.6% of budgeted General Fund spending. SSI/SSP, which accounts for approximately 3.5% of budgeted General Fund spending, is targeted for 25.9% of the savings necessary to balance the budget.

A number of the grant reductions proposed in the *May Revision* are extensions of prior legislation that has not yet taken effect. In order to reduce AFDC grants, the state must obtain a waiver of federal law, while a change in federal law is needed in order for the state to reduce SSI/SSP grants.

Proposed Spending Level Below That Required Under Congressional Reform Proposals

In order to insure that states maintain a minimum level of funding for poor children and families, Congressional welfare reform proposals included a "maintenance of effort" requirement -- a provision requiring states to keep funding at 75% of 1994 levels -- in order to receive their full allotment of federal dollars. Many critics argued that this floor was too low and would allow deep reductions in support for vulnerable children and families. The depth of the spending reductions contained in the Governor's proposed spending plan is illustrated by the fact that spending for cash assistance alone would not comply with the maintenance of effort requirement in the most recently proposed or the previously vetoed welfare reform bill. As currently proposed, 1996-97 AFDC spending would be $2,040 million, $28 million below 75% of 1994 levels.[13]

Budget and Policy Priorities Will Result in Significant Losses To Local Communities

Budget and policy priorities have a direct impact on local communities. Recipients of public assistance spend their grants in local communities. Funds go to landlords, grocery stores, clothing stores, and other local businesses. Tax reductions reduce the amount local schools receive under Proposition 98's funding guarantee. Many policy choices which appear abstract taken at the statewide level are much easier to grasp at the local level. Appendix 1 illustrates the magnitude of the annual impact of the spending reductions and tax cuts at the local level.

Due to the funding formula used for the AFDC program, for each dollar of state savings, recipients and local communities lose $2.11. The brunt of the impact of the proposed reductions falls on California's children. Over one out of every five children in California relies on AFDC.[14] In six counties, over one in three children relies on AFDC.

On average, the proposals contained in the *May Revision* will reduce the amount received by each individual receiving AFDC by $244 per year, or $732 for a parent and two children. On the county level, reductions in AFDC translate into annual losses to local communities ranging from $180.8 million in Los Angeles County to $36,567 in Sierra County.[15]

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[13] The proposed maintenance of effort requirement is based on combined spending for cash assistance, work programs, and child care. This calculation only includes cash assistance.
14 Unpublished data, UC DATA, University of California at Berkeley.
15 The impacts shown in Appendix 1 are calculated on an annual basis and do not directly correspond to the 1996-97 savings assumed in the *May Revision*. The *May Revision* assumes that AFDC grant reductions will be implemented October 1, 1996 and SSI/SSP grant reductions will be implemented November 1, 1996. SSI/SSP caseload figures shown in Appendix 1 reflect December 1995 caseloads as reported by the Social Security Administration.

Since the federal government matches each dollar of state and county funds for AFDC, the impact of grant reductions on local communities is doubled.[16] Proposed General Fund AFDC savings of $228 million translate into a $481 million loss to local communities. For neighborhoods and communities with large numbers of families who depend on public assistance, the impact is likely to be substantial. Local merchants that lose business are even less likely to be able to provide job opportunities to families hoping to move off welfare and into the workforce.

Proposed reductions in SSI/SSP will also reduce support to low-income communities. On an annual basis, the changes to SSI/SSP grant levels would reduce the amount received by beneficiaries by $530 million. The number of individuals affected by these reductions ranges from 337,069 in Los Angeles County, corresponding to a $151.6 million annual loss, to 107 persons in Mono County, who will lose $71,025 under the Governor's proposal.

Grant reductions thus have a double impact on local communities. First, reduced grant payments mean less money circulating through local economies. Second, demand for locally provided services is likely to increase as grant reductions push families and individuals deeper into poverty.

The third major policy proposal that will directly affect local communities is the Governor's proposed 15% reduction in individual and corporate income taxes. The reduction in General Fund revenues due to the tax cut will lower Proposition 98's school spending guarantee. On a per pupil basis, the tax cut will reduce school funding by $422 in 1999-00.[17] Using local enrollments, the impact of the tax cut at the local level can be calculated. At full implementation, the State Department of Education estimates that the school funding guarantee would be reduced by $2.207 billion. At the county level, losses range from $609 million in Los Angeles County to $68,475 in Alpine County.

Optimistic Projections of Federal Assistance Close What Would Otherwise Be A Budget Gap

The *May Revision* anticipates receipt of federal funds for incarceration and provision of emergency medical services to undocumented immigrants. As in previous years, the state assumes that federal funds will fill the remaining budget gap. Last year's budget assumed California would receive $449 million in federal funds for services provided to undocumented immigrants, with $45 million actually appropriated. While this year's estimates are somewhat more modest, there is still cause for concern. Further, as discussed above, the Governor predicates budget savings in the AFDC and SSI/SSP programs upon changes in federal welfare regulations that may or may not occur.

Prison Dollar Expectations Reasonable, Medi-Cal Less So

16 The cost of the AFDC programs is shared by the federal government (50%), the state (47.5%), and counties (2.5%).
17 This figure includes the 15% tax rate reduction and the annuity tax rate reduction as contained in AB 2033 (Brulte). The dollar impact shown in Appendix 1 reflects the loss to schools when the tax cut, which is phased in over three years, is fully implemented in 1999-00.

Congressional staffers and other Washington budget watchers believe that California's chances of receiving $239 million for incarceration of undocumented immigrants from the federal government are reasonably good. Funds for medical care for undocumented immigrants appear less realistic, leaving a gap in the 1996-97 spending plan of $216 million. Coupled with the assumption that federal action will allow AFDC and SSI/SSP grant reductions to be implemented without a waiver, there is strong reason to believe that some level of shortfall will occur. For over a full year, analysts have been predicting that welfare reform is imminent. Yet, as the November election comes closer, action grows less, rather than more, likely to occur.

Federal Budget Reductions Approved And Specter Of Future Cuts Looms On The Horizon

Congress and the President finally reached accord on the final portions of the 1996 federal budget in April, six months into the federal fiscal year. Lawmakers continued to voice commitment to balancing the federal budget over the next seven years. While the 1996 budget package included no changes to the major entitlement programs -- AFDC and Medi-Cal -- that affect the state budget, deep cuts were made in a number of so-called discretionary programs that fund programs and services at the state and local level. Both houses of Congress passed legislation to limit undocumented immigrants' access to emergency health care, school lunches, disaster relief, and child nutrition and immunization. Proposals to scale back legal immigrants' eligibility for public services are also under consideration. Since California is home to the largest number of legal immigrants in the nation, any reduction in federal support would likely lead to an increase in state costs.

Significant Policy Differences Emerge Between Senate, Assembly, and the Governor

The spending blueprints passed by each house of the Legislature differ significantly. Neither of the budget bills passed by the Legislature fully conforms to the Governor's vision as expressed by the *May Revision*. Among the significant differences that will be addressed during the remaining deliberations include:

- *Should the state adopt a 15% reduction in personal and corporate income taxes? The Governor and Assembly say yes, the Senate says no.*
- *Should the Renters' tax credit be permanently eliminated? The Assembly and Governor say yes, the Senate says no.*
- *Should the Governor's proposed reductions in AFDC and SSI/SSP grant payments be enacted? The Senate rejects most of the reductions. The Assembly adopts the Governor's proposed AFDC cuts, but limits reductions in SSI/SSP.*
- *Should the state begin planning for six additional prisons? The Governor and Assembly say yes, while the Senate urges reform in sentencing laws as an alternative to prison construction.*
- *What level of support should the state provide to family planning programs and how should these funds be distributed? Significant differences exist between proposals contained in the budget bills passed by each house and the proposals made by the Governor in his January budget.*

Conclusions

California's economy and fiscal condition are getting stronger, but have a long way to go to make up for the effects of the recession and resulting public disinvestment of the early 1990s. The policy choices contained in the *May Revision* will push California's poorest and most vulnerable populations deeper into poverty, while providing tax cuts that endanger the state's ability to maintain public services.

The Governor's most significant policy initiative contained in the *May Revision* -- an ambitious class size reduction effort -- addresses one of the most important challenges confronting California. However, as currently structured, many schools will not be able to share in the proposed additional funding. Finally, California faces an uncertain future as efforts to balance the federal budget continue. As yet, it is too early to tell whether Congress and the President will reach agreement on a spending plan that balances the budget or legislation to reform the nation's welfare system. In light of this uncertainty, the Legislature should move cautiously when considering reject budget proposals that rely on unrealistic assumptions for federal action or aid.

In order for California's economy to remain competitive and build toward the next century, a renewed commitment to public investment is necessary. The 1996-97 budget provides lawmakers with the opportunity to address investment in California's schools, basic infrastructure, and the nature and quality of our public services. However, California will not be prepared to compete if the poorest and most vulnerable among us are pushed deeper and deeper into poverty. Balancing the demands for services with still limited resources presents policymakers with both challenges and opportunities.

Appendix 1: How Will The Tax And Budget Policies In The *May Revision* Affect California Communities?

County	Children Receiving AFDC [a]	Percent Of All Children In County Receiving AFDC [b]	Annual Impact If All AFDC Cuts Are Enacted [c]	Persons Receiving SSI/SSP [d]	Annual Impact If All SSI/SSP Cuts Are Enacted	Loss To County Schools If 15% Tax Cut Is Implemented (1999-00) [e]	Estimated Annual County Impact
Alameda	68,448	22.5%	$19,996,382	48,365	$22,302,759	$81,166,945	$123,466,085
Alpine	89	35.4%	$33,260	171	$189,914	$68,475	$291,649
Amador	707	10.7%	$286,085	540	$353,580	$1,996,150	$2,635,815
Butte	15,156	31.2%	$6,420,178	8,398	$5,422,584	$13,845,645	$25,688,407
Calaveras	1,589	17.2%	$678,699	897	$566,654	$2,768,465	$4,013,818
Colusa	829	13.4%	$319,506	506	$302,627	$1,647,550	$2,269,684
Contra Costa	30,716	14.9%	$8,848,920	21,249	$9,723,968	$57,944,790	$76,517,678
Del Norte	2,391	29.5%	$976,100	1,498	$969,642	$2,090,770	$4,036,512
El Dorado	3,683	9.8%	$1,476,500	2,452	$1,687,609	$11,560,655	$14,724,765
Fresno	84,881	37.2%	$31,102,433	37,168	$25,199,885	$68,838,540	$125,140,858
Glenn	1,792	24.7%	$666,433	901	$529,597	$2,509,920	$3,705,951
Humboldt	7,442	22.7%	$3,233,191	5,642	$3,782,839	$8,933,290	$15,949,320
Imperial	14,104	29.6%	$5,625,743	7,869	$4,349,493	$13,049,260	$23,024,497
Inyo	842	18.1%	$346,752	580	$322,699	$1,417,640	$2,087,091
Kern	51,945	24.3%	$20,628,023	25,140	$15,521,993	$54,627,280	$90,777,296
Kings	8,282	23.0%	$3,253,152	4,073	$2,484,322	$9,668,255	$15,405,728
Lake	4,705	35.4%	$2,055,175	3,099	$1,934,652	$4,068,245	$8,058,072
Lassen	1,696	23.2%	$745,199	1,024	$626,870	$2,221,495	$3,593,564
Los Angeles	615,864	26.2%	$180,847,994	337,069	$151,603,323	$609,107,950	$941,559,267
Madera	8,567	23.1%	$3,328,763	4,238	$2,609,387	$9,257,820	$15,195,970
Marin	2,625	6.5%	$779,256	3,591	$1,527,453	$11,149,805	$13,456,514
Mariposa	730	19.3%	$308,966	302	$171,386	$1,108,050	$1,588,402
Mendocino	5,068	22.2%	$2,209,292	3,527	$2,229,559	$6,376,475	$10,815,326
Merced	25,388	37.2%	$9,198,809	8,389	$5,502,873	$19,165,115	$33,866,797
Modoc	751	25.2%	$295,282	399	$239,322	$923,790	$1,458,394
Mono	207	9.2%	$83,576	107	$71,025	$750,320	$904,921
Monterey	17,473	15.6%	$4,312,119	8,446	$3,246,203	$25,587,240	$33,145,562
Napa	2,655	10.6%	$700,460	2,360	$916,472	$7,437,215	$9,054,146
Nevada	2,188	10.4%	$880,168	1,544	$980,450	$5,439,820	$7,300,438
Orange	77,140	12.4%	$21,399,172	48,604	$21,434,112	$172,310,905	$215,144,189
Placer	5,262	10.8%	$2,165,202	4,023	$2,492,042	$18,007,680	$22,664,924
Plumas	825	14.8%	$352,523	685	$410,708	$1,483,210	$2,246,441
Riverside	75,177	18.4%	$32,436,229	35,530	$22,060,901	$108,011,635	$162,508,765
Sacramento	98,365	32.8%	$40,943,573	45,742	$33,813,950	$79,364,600	$154,122,123
San Benito	1,841	14.6%	$681,214	876	$490,997	$3,836,675	$5,008,887
San Bernardino	128,232	26.6%	$54,940,183	46,112	$30,485,052	$134,657,955	$220,083,190
San Diego	127,758	20.3%	$35,723,637	72,426	$30,794,028	$177,985,615	$244,503,280
San Francisco	21,265	21.3%	$6,414,953	47,638	$22,667,786	$25,180,540	$54,263,279
San Joaquin	48,917	32.4%	$19,824,240	24,324	$17,362,460	$42,521,315	$79,708,015
San Luis Obispo	6,170	11.5%	$1,753,206	4,990	$1,949,088	$14,205,865	$17,908,159
San Mateo	11,359	8.0%	$3,203,687	13,758	$5,798,464	$36,561,085	$45,563,235
Santa Barbara	13,040	14.2%	$3,448,261	8,747	$3,506,797	$24,194,500	$31,149,557
Santa Clara	55,791	16.3%	$15,192,732	39,232	$17,949,763	$97,979,010	$131,121,505
Santa Cruz	7,164	13.0%	$1,992,972	5,717	$2,326,803	$15,326,780	$19,646,555
Shasta	11,554	24.8%	$4,954,918	7,606	$4,976,364	$12,234,615	$22,165,897
Sierra	91	13.8%	$36,567	116	$64,849	$358,145	$459,560
Siskiyou	3,166	27.3%	$1,326,535	2,184	$1,398,878	$3,446,575	$6,171,988
Solano	16,322	14.6%	$4,836,892	9,556	$4,176,338	$26,746,750	$35,759,980
Sonoma	11,732	11.4%	$3,180,420	9,854	$3,794,719	$27,788,815	$34,763,954
Stanislaus	32,603	25.1%	$13,308,542	17,816	$11,740,698	$36,239,045	$61,288,284
Sutter	3,772	18.7%	$1,545,330	2,850	$1,718,490	$6,018,745	$9,282,564
Tehama	3,709	24.6%	$1,544,515	2,177	$1,330,942	$4,449,215	$7,324,672
Trinity	831	23.9%	$335,750	568	$333,507	$1,040,820	$1,710,077
Tulare	38,241	34.2%	$14,289,628	16,246	$9,546,651	$33,263,495	$57,099,774
Tuolumne	2,288	17.9%	$992,496	1,383	$772,008	$3,390,135	$5,154,639
Ventura	19,920	10.4%	$4,948,552	14,096	$5,290,939	$50,290,945	$60,530,437
Yolo	8,375	23.8%	$3,404,284	4,371	$2,910,470	$10,051,300	$16,366,054
Yuba	7,893	38.3%	$3,023,698	3,678	$2,458,073	$5,416,165	$10,897,937
CA TOTAL	1,819,595	22.3%	$607,836,326	1,031,845	$530,138,479	$2,207,089,105	$3,475,813,536

Notes:

a) Source: State Department of Social Services, Health and Welfare Agency, Caseload Monthly Averages: January-March 1996 (includes Family Groups and Unemployed). The figures shown in this column are annual amounts. The May Revision assumes that AFDC grant reductions will take effect 10/1/96.

b) Source: University of California Data Archive and Technical Assistance, UC Berkeley (data as of January 1994).

c) The Legislature cut AFDC benefits in the 1995-96 budget based upon a regionalized formula: grants were cut 4.9% in "high-cost areas," and 9.8% in "low-cost areas." Because these reductions have not been approved by the federal government, the cuts to monthly benefits have not been implemented to date. The recently implemented 2.3% grant reduction was subtracted from the monthly averages before calculating totals.

d) Source: Social Security Administration, December 1995. This column shows the loss on an annual basis. The May Revision assumes grant reductions will take effect 11/1/96.

e) Source: California Department of Education, Fiscal Policy Office, April 1996.