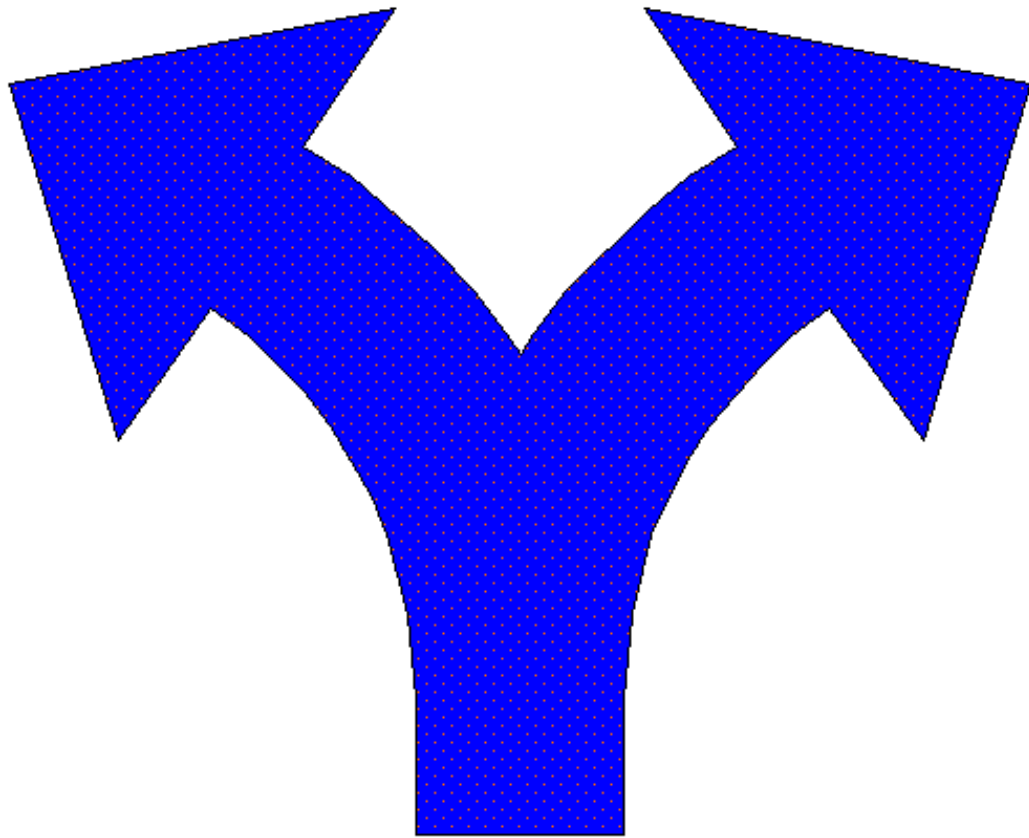


Critical Choices for California:

The 1999-00 State Budget



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, Charles Stewart Mott, Friedman Family, and California Wellness Foundations and the California Endowment and individual donations and subscriptions.

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Critical Choices for California: The 1999-00 State Budget

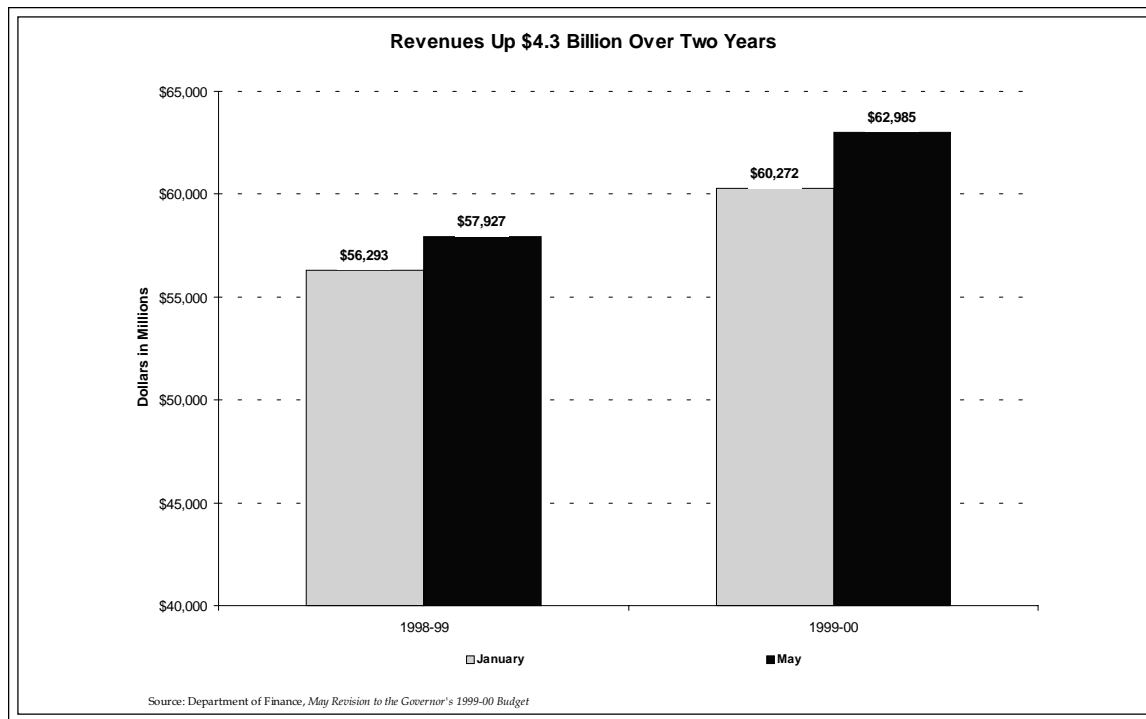
Release of the May Revision to the Governor's Budget marks the start of serious negotiations over the state's budget for the upcoming fiscal year. For the fourth consecutive year, the *May Revision* contains good news for California's fiscal future — between the current and upcoming budget years, the state will receive an estimated \$4.3 billion more in revenues than was forecast in January. *Critical Choices for California: The 1999-00 Budget* makes three key findings. First, as proposed, the 1999-00 budget spends more than it raises in revenues. This could leave the state vulnerable in the event of a slowdown in the economy or unforeseen expenditures. Second, there are a number of risks to the budget as proposed, including costs related to litigation and federal aid that is unlikely to materialize. Finally, the budget defers action on several of the most pressing issues confronting California, including creation of a long-range plan to address the state's infrastructure needs and reforming the fiscal relationship between the state and local governments.

For the fourth year in a row, California received an April surprise — a significant increase in revenues above the level forecast in the Governor's January Budget. The additional resources will close the gap identified in the proposed 1999-00 spending plan and offer the Legislature the opportunity to consider budget augmentations. This report examines the Governor's Proposed 1999-00 Budget as modified by the May Revision and concludes by highlighting several of the key issues confronting policymakers as they craft a final spending plan. While certainly not an exhaustive list, the outcome of debate on these and other issues will affect the future of California for years to come.

The 1999-00 budget offers lawmakers a unique opportunity to plan for the future. The economy remains strong and public support for investment in services critical to the future of the social and economic well-being of California is widespread. The budget represents the most important expression of our values and vision for our state and its future. A healthy economy and strong revenue growth provides the opportunity to invest in a better future for all Californians.

THE CALIFORNIA ECONOMY

California's "April Surprise" is the direct result of a stronger state, national, and world economy. Unemployment rates have edged lower and revised employment counts disclosed that 1998 job growth was much stronger than originally believed. Despite a generally positive picture, there are reasons for concern. Employment in key state industries — notably high technology — remains soft and rising interest rates could dampen growth in construction and related industries. Moreover, the benefits of a strong economy have been slow to reach the majority of Californians. While incomes continue to surge for the wealthiest Californians — led by capital gains and other non-wage income — 1998 hourly wages were lower than those of 1989 for most California workers. Hourly wages for workers at the 20th percentile were 7.5 percent lower in 1998 than in 1989, after adjusting for inflation, and the 1998 median hourly wage stood 1.3 percent below where it was in 1989.



How MUCH MONEY IS THERE?

The May Revision assumes approximately \$4.3 billion in revenues over a two-year period above the forecast contained in the Governor's January Budget. Stronger than previously anticipated economic growth resulted in a \$1.97 billion year-to-date increase in 1998-99 personal income tax revenues above the level forecast in the January 1999-00 Budget. Based on current revenue trends, the May Revision estimates that 1998-99 revenues will exceed prior forecasts by \$1.6 billion. Recent economic forecasts indicate continued growth and suggest that the increase in 1998-99 revenues will carry over into 1999-00. Based on the latest forecast, the May Revision anticipates that 1999-00 revenues will be \$2.76 billion over the estimates in the January budget. The Legislative Analyst projects slightly stronger revenue growth. The Analyst's forecast exceeds that of the Governor by \$137 million in 1998-99 and \$223 million in 1999-00.

The \$4.3 billion increase in revenues forecast in the May Revision does **not** translate into a \$4.3 billion surplus. The \$4.3 billion figure represents revenues in excess of the amount forecast in the January budget. Specifically, it represents an increase of approximately \$1.6 billion in the current year (1998-99) and \$2.7 in the budget year (1999-00). The difference is significant for several reasons:

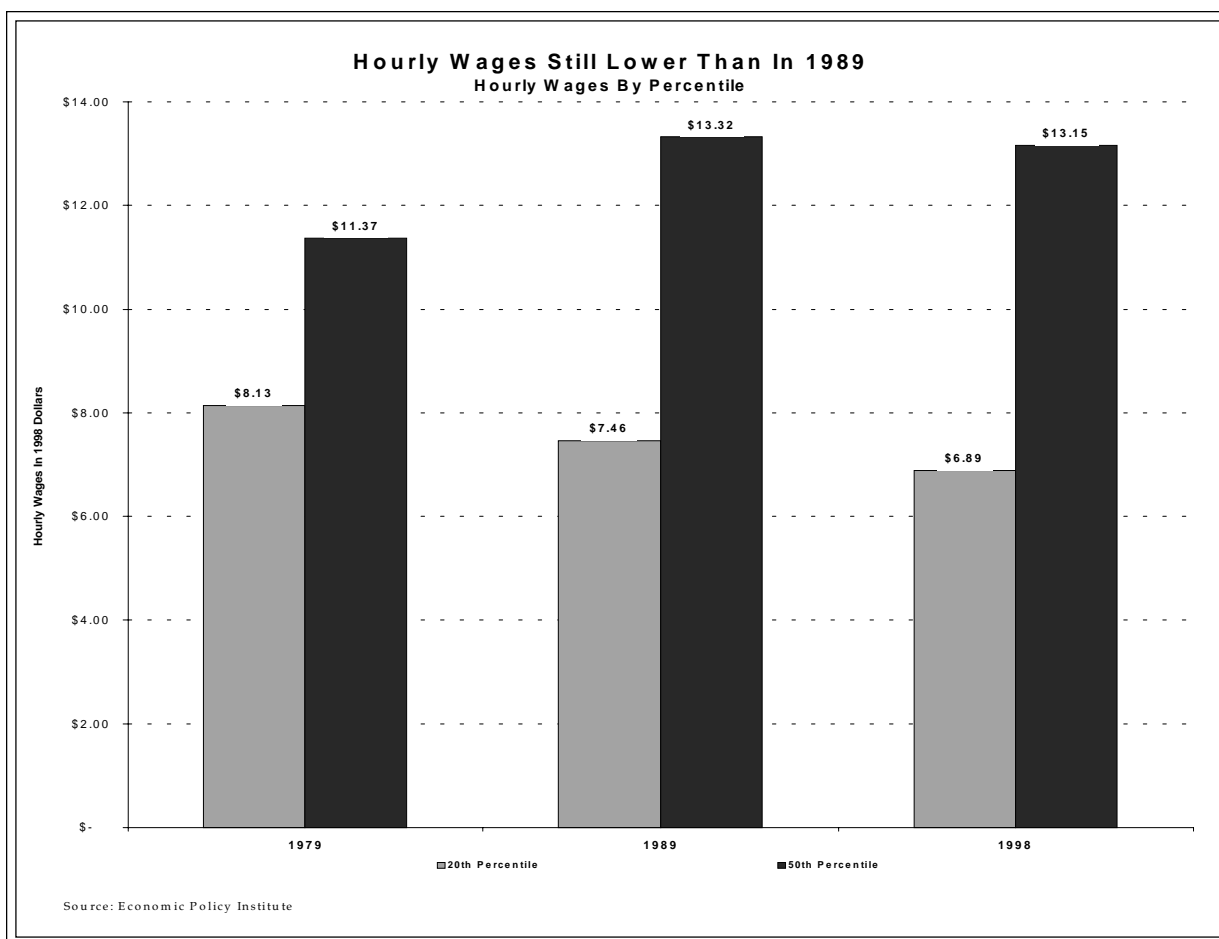
- As introduced, the Governor's 1999-00 budget assumed a \$2.3 billion gap between available resources and proposed expenditures. A portion of the additional moneys will be needed to backfill for some of the gap-filling measures assumed in the Governor's January Budget that are unlikely to materialize.
- Demands on the budget have also increased since January. Fulfilling these demands will require a significant fraction of the additional revenues. The most significant of these in changes is a 92,000 student increase in K - 12 enrollment in 1999-00 projected by the Governor's spending plan.

- Finally, the portion of the increase attributable to 1998-99 represents cash in the bank. However, the remainder, the increase in projected 1999-00 revenues, assumes continued economic growth. While the forecast is reasonable based on the state of the California economy, it is, like all estimates, subject to some degree of uncertainty.

WHY ARE THE FORECASTS SO DIFFERENT?

The structure of the state's tax system and turmoil in the world economy combine to make revenue estimating more difficult than in prior years. Reasons for the significant shift in the state's fiscal fortunes include the following:

- The Governor's January Budget forecast was based on economic data from the 3rd quarter of 1998. At that point, it appeared that the Asian financial crises would worsen, spread to other parts of the world, and have a more severe impact on the California economy. Since last fall, world economic conditions have somewhat stabilized and economists have upgraded the forecasts for near-term economic conditions.
- California receives a significant share of General Fund revenues from taxpayers whose incomes disproportionately include capital gains, dividends, bonuses, and other forms of non-wage income. This income is not subject to withholding and depends on the performance of the stock market and other investments, making it difficult to accurately estimate until tax returns are filed and revenues counted. California's pattern of unanticipated growth in personal income tax collections is consistent with the experiences of other states that rely on a relatively



progressive personal income tax.

- Changes in state and national tax laws make forecasting more difficult. Major changes have been enacted in both state and federal tax laws during the past several years. In 1997, Congress reduced the federal tax rate on capital gains. Capital gains tax cuts traditionally increase sales of appreciated assets, causing a one-time spike in tax collections attributable to the realization of capital gains.
- While large in dollar terms, the difference between the January and revised forecast is actually small in percentage terms. A \$2.7 billion increase in 1999-00 revenues corresponds to a 4.5 percent increase over the January forecast.

Reserves Used To Balance The Budget			
	Revenues	Expenditures	Operating Deficit
1998-99	\$ 57,927	\$ 58,631	\$ (704)
1999-00	\$ 62,985	\$ 63,223	\$ (238)

Source: May Revision to the Governor's 1999-00 Budget

BUDGETED EXPENDITURES EXCEED REVENUES IN BOTH 1998-99 AND 1999-00

This year's spending plan, like others in recent years, spends more than it raises on an annual basis. Under the Governor's proposal, both the 1998-99 and 1999-00 spending plans run operating deficits. That is, expenditures exceed revenues. In the current (1998-99) year, proposed expenditures exceed revenues by \$704 million. Budgeted 1999-00 expenditures exceed revenues by \$238 million. While the budgeted reserve of \$985 million, along with the \$248 million set aside to cover the potential 2000-01 impact of a trigger reduction in Vehicle License Fees, offer some protection against a downturn in the economy or unforeseen expenditures, the cushion is relatively modest in light of the risks to the budget described below.

POTENTIAL RISKS TO THE BUDGET

While economic indicators point to continued growth, a number of factors could impact the state's fiscal condition. One-time expenditures proposed in the May Revision, particularly the \$1 billion designated for infrastructure, will provide a cushion in future years. In crafting a final spending plan, the Legislature should carefully consider how to address the potential risks to both the budget and future years.

- *Some of the assumed savings are unlikely to materialize.* The January budget assumed that increased federal aid would reduce state expenditures. The Governor assumes, for example, that the federal government will pay a larger share of costs for the Medi-Cal program (generating \$210 million in state savings) and increase funding for the incarceration of undocumented immigrants by \$100 million. To date, there is little evidence that the federal government will allocate additional funds.
- *Outstanding lawsuits could boost state costs.* Several high profile court cases could have a significant impact on the budget. This summer, the Commission on State Mandates is expected to act on a claim stemming from litigation that could require the state to reimburse school districts for \$1.6 billion in special education costs. The second suit involves Medi-Cal

reimbursement rates for health care providers that could result of payments of \$300 million to \$1 billion. Other pending cases stem from the diversion of revenues from the Proposition 99 account and State Highway Account in the early 1990s. The potential impact of these cases could be in the billions of dollars and includes both retroactive and prospective costs. The May Revision includes a \$300 million set-aside to cover state employee salary increases and pending litigation. The Revision also includes a \$40.6 million one-time payment for special education-related mandate costs and a \$110 million set-aside to cover Medi-Cal provider rate increases, expansion of health coverage, and other purposes. The set-asides are modest in comparison to the state's potential liability.

- ***Continued revenue growth could trigger additional VLF cut.*** The measure enacting last year's VLF reduction included a complex set of "triggers" that reduce the VLF tax rate if General Fund revenues exceed specified targets. If revenues increase by approximately 4.4 percent between 1999-00 and 2000-01, a relatively modest increase, a \$500 million reduction would be triggered. The Revision sets aside \$248 million to reflect the half-year impact on the 2000-01 budget of backfilling local governments for the reduction in VLF revenues.
- ***World economic conditions are still uncertain.*** Rapid change has become a distinguishing feature of the world economy. The US economy is well into its longest peacetime expansion and unemployment is below the rate historically thought to constitute full employment. Several key indicators suggest a slight weakening in the state's economy in recent months. Unemployment rose slightly in March and job growth slowed, with manufacturing employment actually falling. Many observers expect the Federal Reserve Bank to increase interest rates. Such a move would likely have a dampening effect, particularly in areas like construction that have been hot spots in the state economy.
- ***Child support penalty could increase.*** California is subject to \$90 million in federal penalties for failing to implement a single statewide child support system. The Governor's budget avoids a direct impact to the state by allocating the full cost of the penalties to county governments. However, recent reports suggest that the federal government may impose much stiffer penalties. Federal law allows penalties of up to a state's full Temporary Assistance to Needy Families block grant, approximately \$3.7 billion for California. At a minimum, the need to implement an acceptable system that insures that families receive the support they are owed will result in added costs to the state and local governments.
- ***Federal discretionary funds vulnerable.*** In order to increase defense spending and make room for tax cuts, the House and Senate budget allocations for federal fiscal year (FFY) 2000 make significant reductions in the program areas that provide aid to the states. FFY 2000 budget allocations for Agriculture, Labor, Health and Human Services, Education, Veterans Affairs, and Housing and Urban Development are all lower than FFY 1999 levels. While federal budget negotiations are still in their early stages, the budget allocations suggest that California could receive fewer, rather than more, federal dollars in the upcoming year. Making up for any shortfall could place new demands on state resources.

WHERE DOES THE NEW MONEY GO?

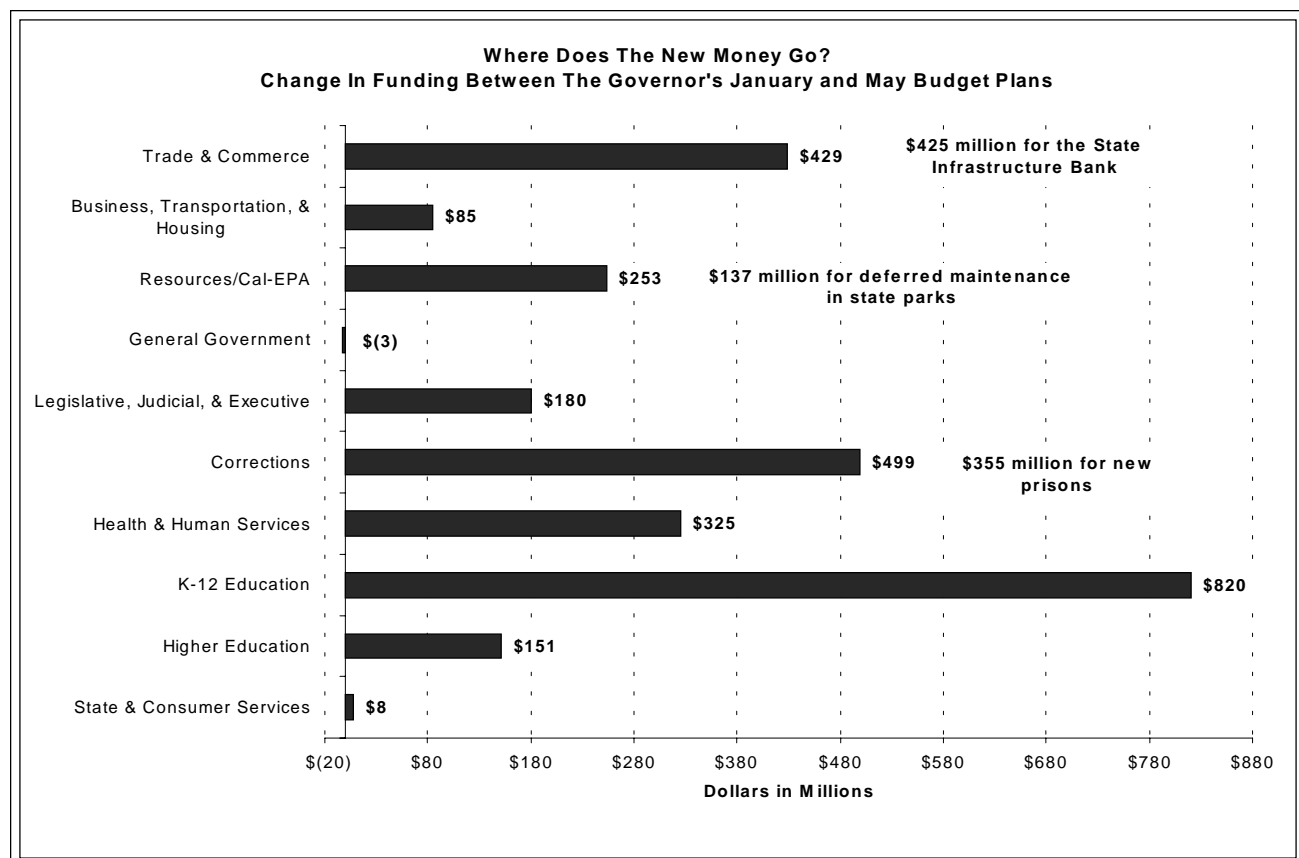
The May Revision proposes \$3.109 billion in new expenditures. Of this amount, \$360 million will augment current year spending, with the remaining \$2.748 billion designated for 1999-00 initiatives. The Governor also establishes two set-asides to be allocated through the budget process. Most of the additional 1999-00 spending will go toward K - 12 education, new prison construction,

infrastructure, and a larger reserve. Significant augmentations include:

- **K - 12 education.** The May Revision increases 1999-00 spending on K - 12 education by \$820 million. Most of the additional funds cover costs attributable to higher than previously estimated enrollment and a modest increase in the Proposition 98 guarantee due to new per capita personal income figures. The May Revision proposes to “overfund” the Proposition 98 guarantee by \$100 million.
- **The state Infrastructure Bank.** The May Revision adds \$425 million to the state Infrastructure Bank. In related policy proposals, the Governor expands the scope of the Bank’s operations. The Bank was capitalized with a \$50 million allocation in 1998.
- **New prison construction.** The May Revision allocates \$355 million to build a new prison in Kern County and begin design work on another prison in San Diego County.
- **A larger reserve.** The May Revision increases the state’s Special Fund for Economic Uncertainties to \$985 million, a \$570 million increase over the reserve proposed in January. At 1.6 percent of proposed expenditures, the reserve is modest and lower than the often recommended three to five percent of General Fund expenditures.

CRITICAL CHOICES FOR CALIFORNIA

The Governor’s May Revision to the 1999-00 Budget raises a number of important policy issues for consideration as lawmakers conclude work on a final spending plan. In its current form, the Governor’s spending plan takes modest steps to restore reductions made during the early parts of the decade. A number of important issues that will impact California not only this year, but in the



years to come, remain unresolved.

May Revision Moves Forward With Infrastructure Expenditures In The Absence Of A Coordinated Plan

Building and maintaining the physical infrastructure needed by the state over the next decade will cost upwards of \$100 billion. While there is disagreement over how best to address this need, there is nearly unanimous agreement that California needs a comprehensive and integrated plan for investing in transportation, schools and colleges, health facilities, and other public facilities. At the center of the Governor's May proposals is a nearly \$1 billion package of infrastructure expenditures. The Governor's proposals include a \$425 million augmentation to the state's Infrastructure Bank, \$355 million to build one prison and plan for another, \$137 million for deferred maintenance in state parks, and \$75 million for train and ferry service improvements in the Bay Area and San Joaquin Valley. While all of these proposals are essentially one-time in nature, and thus will have a limited impact on the state's long-term finances, lawmakers should question whether expenditures of this magnitude should be made in the absence of a comprehensive strategy.¹

The proposed augmentations raise both general and specific policy considerations. Lawmakers should consider how they wish to balance one-time expenditures and debt-financed projects and which of the state's unmet needs are of the highest priority or in need of immediate assistance. Lawmakers should also consider the role of the state's Infrastructure Bank. To date the Bank has not invested any of its initial \$50 million allocation and the Bank's primary activity has been the issuance of rate reduction bonds as part of the deregulation of the state's electric utility industry. In light of the magnitude of the Governor's proposed allocation, lawmakers should insure that mechanisms are in place to assure that projects funded through the Bank are consistent with overall state infrastructure priorities.

The second largest component of the Governor's infrastructure package is the addition of new prison capacity. If approved by the Legislature, the Kern County facility would be the first in the state's history to be paid for with cash, rather than debt financing. Voters rejected the last three attempts to authorize General Obligation bonds for correctional facility construction, most recently in November of 1996.²

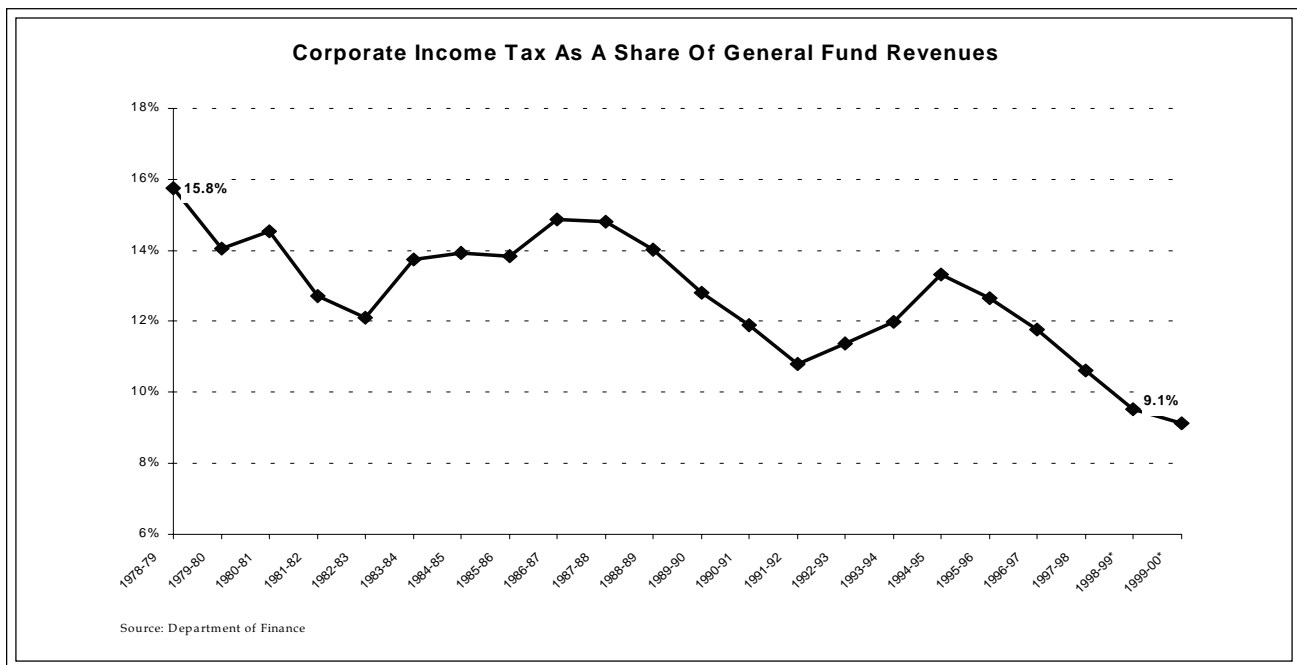
Education Dollars Increasingly Under State Control

Over the past two decades, the share of school district revenues under local control has declined significantly. General purpose funds constituted 92 percent of 1978 school revenues. By 1995, general purpose funds accounted for 71 percent of school revenues.³ A more recent analysis estimates that only 53 percent of 1999-00 school revenues are general purpose in nature.⁴ Continued earmarking of new school dollars limits the ability of districts to meet basic needs and address local priorities. In particular, the lack of discretionary dollars limits school districts' ability to attract and retain quality teachers by limiting funds available for teacher salaries. The lack of general purpose resources will be exacerbated by the May Revision's failure to augment funding for most so-called categorical programs to reflect the 92,000 additional students assumed by the Administration's forecasts. Absent additional funding, per student categorical funding will decline.⁵

Corporate Tax Receipts Stagnate

Over the past two decades, the share of General Fund revenues provided by the corporate income tax has declined by 42 percent. In 1978-79, the corporate income tax provided 15.6 percent of all

General Fund dollars. In 1999-00, the May Revision estimates that 9.1 percent of the General Fund will come from corporate income taxes. Over the past five years, corporate tax receipts have stagnated, with estimated 1999-00 receipts only \$100 million higher than 1994-95 collections. With the stock market and corporate profits at record levels, the issue does not appear to be one of profitability. In 1977, corporate income tax assessments equaled 15.4 percent of corporate income. In 1997, corporate taxes equaled 9.4 percent of income, a 42 percent decline. Much of this trend is due an increased number of credits, deductions, and other corporate tax preferences. According to the Legislative Analyst's recent report on state tax expenditures, the value of corporate tax expenditures rose from 32 to 54 percent of corporate income tax revenues between 1991-92 and 1998-99. In crafting a budget and related tax legislation, lawmakers should consider how they wish to balance the mix of taxes that fund public programs. The Governor's May proposals include a \$28 million reduction in the minimum franchise tax, increasing to \$60 million thereafter. The Legislature should consider whether a further reduction in corporate taxes is warranted in light of the



shift in the burden of funding public services from businesses to taxes paid primarily by consumers — the personal income and sales taxes.

Major Policy Decisions Left To Compete For Limited Funds

The May Revision defers some of the most critical decisions affecting programs addressing the needs of low income Californians. The Governor sets aside two pots of funds for allocation among competing programs. The first set-aside contains \$110 million earmarked for expansion of the Healthy Families Program, In-Home Supportive Service worker wage increases, nursing home reforms, and rate increases for Medi-Cal managed care providers. The cost of significant action in these areas exceeds the amount in the set-aside and both the Senate and Assembly budgets allocate more than the \$110 million provided by the Governor's budget.

The Governor also sets aside \$300 million for state employee compensation increases and to cover the cost of potential court settlements. If used exclusively for pay increases, the fund would cover an increase of approximately six percent for General Fund supported workers. Contracts signed earlier this year provided most state employees with a 5.5 percent raise, the first since January 1,

1995. Allocation of the entire \$300 million to pay increases would barely restore state workers' purchasing power to 1995 levels. As noted above, the state's potential liability for costs related to pending litigation is far in excess of the \$300 million set-aside in the budget.

How Should Tobacco Settlement Dollars Be Spent?

In November of 1998, state attorneys general and the tobacco industry reached agreement on a landmark settlement of litigation seeking to recover amounts spent by public programs to treat tobacco-related illness. Under the terms of the agreement, the tobacco industry will make annual payments to the state and local governments potentially exceeding \$25 billion. The funds will continue for at least twenty-five years and will be divided evenly between the state and local governments. The state is scheduled to receive a \$562 million first payment, covering 1998 and 2000, next spring.

Under the terms of the agreement, proceeds from the settlement come to the state with no strings attached. However, health advocates and others argue that the funds should be devoted to health care, since the lawsuits that led to the agreement sought to recover amounts spent by public programs for treatment of tobacco-related diseases. In particular, the tobacco settlement could be used to match federal funds available to expand health coverage to a portion of the seven million Californians currently lacking insurance. While the Governor's proposal sets aside funds for expanding the Healthy Families program, which subsidizes health coverage for children in families with incomes of up to 200 percent of the federal poverty level, it is silent on the issue of extending coverage to adults. California lags behind other states in utilizing the flexibility of federal law to extend coverage for adults in low income working families. Lawmakers should consider how they wish to use the funds the state will receive from the tobacco settlement and whether they wish to direct some or all of the amounts the state will receive to health-related programs.

How Should CalWORKs Dollars Be Spent?

The May Revision estimates that counties will leave \$612 million in 1998-99 funding for CalWORKs services unspent at the end of the fiscal year. The funds are part of the county block grant designated for employment services and child care. County officials report that utilization of funds varies significantly between counties. Some counties will spend their entire allotment, while others, including Los Angeles County, will leave substantial amounts unspent.

While federal law allows states to carry over unused Temporary Assistance for Needy Families (TANF) Block Grant funds (the federal funds used to support the state's CalWORKs program), the Legislature should examine why such a large share of the funds designated for employment and other services remains unspent.⁶ Are the savings attributable to falling caseloads; limited utilization of training, supportive services, and childcare; or some combination of the two? In considering this issue, lawmakers should consider expanding the range of CalWORKs services. The new federal regulations governing the use of TANF dollars allows federal funds to be used for child care, the refundable portion of a state Earned Income Tax Credit (EITC), contributions to Individual Development Accounts, transportation, and other services that "do not provide basic income support" to TANF eligible families without counting toward a family's lifetime limit on assistance.

A second area of controversy involves the allocation of funds within the new three stage CalWORKs child care system. The new system was intended to provide recipients with a "seamless" transition as they move from welfare to work. The first stage is administered by the Department of Social Services, with Stages 2 and 3 administered by the State Department of Education.

The May Revision shifts \$76 million of funds from Stage 3 to Stage 2 and increases funds available for Stage 1 to support expansion of services to children in two-parent families. The rationale for the shift of funds from Stage 3 to Stage 2 is unclear. Local child care groups report that many counties have exhausted their allotment of Stage 3 funds. Moreover, parents are limited to no more than two years of assistance through Stage 2, while Stage 3 services are available for as long as families meet applicable income tests. Over the long term, more accurate information on the supply and demand for CalWORKs child care is needed to insure that the allocation of funds parallels demand for services.

What Is The Appropriate Relationship Between The State And Local Government?

The ongoing impact of the property tax shifts of the early 1990s is one reason for the state's current strong financial position. Current state spending is \$1.3 billion lower than it would have been in the absence of the shifts after taking into account the 1/2 cent sales tax for public safety programs enacted by Proposition 172 of 1993, the \$350 million 1997 trial court funding reform package, and the Citizens Option for Public Safety (COPS) program, which provides aid to local law enforcement.⁷ While the May Revision restores some of the reductions in local assistance made in the January budget, it takes no steps to reverse the shifts of the early 1990s or otherwise reform the fiscal relationship between the state and local governments. The recent history of the fiscal relationship between the state and local government raises important policy considerations. Counties, cities, and special districts lost discretionary revenues under the property tax shift. However, most of the relief provided to local government in the wake of the shifts comes with strings attached. The \$1.8 billion of sales tax and the \$100 million for the COPS program, for example, must be used for public safety and thus are not comparable with unrestricted property taxes.

IMPORTANT POLICY DIFFERENCES EMERGE BETWEEN THE SENATE, ASSEMBLY, AND GOVERNOR

The spending blueprints offered by each house of the Legislature and the Governor differ in several key respects. Neither the Senate's nor Assembly's budget fully conforms to the Governor's vision as outlined in the May Revision. Among the key differences to be resolved in the remaining weeks of deliberations are the following:

- ***Should the state invest in infrastructure or cut taxes?*** The Governor's May Revision proposes two modest tax cuts, an elimination of the minimum franchise tax for new corporations and extension of the small business stock capital gains exclusion. The Senate and Assembly plans assume these changes. Both the Senate and Assembly Republican budget proposals assume significant tax cuts requiring reductions in other parts of the budget.
- ***Should the state provide local governments with fiscal relief? What form should it take?*** The Senate caps the growth on the property tax shift at a cost of \$234 million. The Assembly sets aside \$200 million for local government assistance to be allocated by future legislation and provides state funding for local road maintenance. The Governor restores some of the reductions made in his January budget, but makes no general proposals for local fiscal relief.
- ***Should the state spend \$355 million to build one prison and plan for another?*** The Senate and Assembly say no, the Governor says yes. The Governor's plan allocates a significant fraction of the year's infrastructure dollars to prison construction and makes no provision for the various bond proposals currently pending before the Legislature.
- ***How should additional funds for education be allocated?*** The Senate and Assembly assume that enrollment will be significantly lower than the 92,000 student increase projected by

the Governor. Other differences between spending plans include funding for textbooks and instructional materials, the level of discretionary funding, and funding for the Governor's proposed incentive plan for teachers in low-performing schools.

- *How much of the new money should go to health and human services?* The Senate and Assembly each propose a number of spending augmentations to health and human service programs above the levels offered by the Governor in his May Revision.
- *Should California extend health coverage to the working poor?* The Governor allocates \$2.0 million for a modest expansion of the Healthy Families program and sets aside a \$110 million fund to be divided between a number of health and social service programs. The Senate funds a number of specific changes to the Medi-Cal and Healthy Families programs, while the Assembly allocates \$310 million for a significant expansion of the Medi-Cal and Healthy Families programs.
- *Should the state make a long-term commitment to services for legal immigrants?* The Assembly deletes the June 30, 2000 sunset date on the Cash Assistance for Legal Immigrants (CALI) program and California Food Assistance Program (CFAP), which provide the equivalent of SSI/SSP and Food Stamp benefits, respectively, to legal immigrants denied federally funded assistance. The Senate deletes the CFAP sunset and extends the CALI sunset to June 30, 2005. The Governor is silent on both sunsets.

CONCLUSION

Continued economic growth and unanticipated revenues offer state lawmakers the opportunity to make significant investments in California's future. While the state's fiscal condition is strong, a number of risks loom on the horizon. Legal challenges to state spending practices could impose significant costs far in excess of available reserves. More importantly, the state confronts significant investment gaps in both the physical and human assets that are the state's greatest resources.

For at least two decades, California has failed to invest in the human and physical resources critical to a healthy economy. The state's school spending guarantee has become a ceiling as well as a floor. In a year that is widely heralded as that of education, the Governor's May Revision proposes a scant \$100 million more than the bare constitutional requirements. In contrast, raising state per pupil spending to the national average — a modest goal — would cost in excess of \$6 billion. Failure to maintain California's physical assets has resulted in \$100 billion of needed investments in schools, health facilities, transportation system, parks, and public buildings to meet the needs of a growing economy.

California confronts a number of challenges that will generate additional demand for public services. Despite falling unemployment, more Californians live in poverty than a decade ago. The incomes of low and middle income families remain below where they were a decade ago, after adjusting for inflation. More Californians lack health coverage. While welfare reform has helped many families transition into the work force, most struggle to make ends meet on earnings that are far below the basic costs of subsistence.

California is falling behind because Californians are spending less. As a share of personal income, state General Fund revenues are 12 percent lower than they were in 1977-78, immediately before the passage of Proposition 13. A renewed commitment to public investment is needed to restore the state's position as a national and world leader and, perhaps more importantly, as a place that offers boundless opportunity to all who live here. Under new leadership, lawmakers have the

choice between budget policies that maintain the status quo and those that move the state forward toward a new century.

ENDNOTES

¹ It should be noted that construction of new prisons would impose significant additional operating costs on future years' budgets.

² Department of Finance, *1999 Capital Outlay and Infrastructure Report* (no date), p. 66.

³ Michael Shires, *Patterns in California Government Revenues Since Proposition 13* (Public Policy Institute of California, 1999), p. 86.

⁴ EdSource, *Governor's Proposed Budget for 1999-2000* (February 1999), p. 3.

⁵ Categorical programs are special programs that receive allocations through the budget. Categorical programs include the Class Size Reduction, Dropout Prevention, and the Gifted and Talented programs.

⁶ In order for the state to fulfill the federal maintenance of effort requirement, counties must spend state and local dollars, but can rollover unspent federal dollars. These moneys can only be used, however, for purposes allowed under federal TANF law. Since state and local spending is at the minimum level required by federal law, the unspent dollars cannot be used to offset state spending.

⁷ California State Association of Counties.