

The logo features the word "CALIFORNIA" in a large, serif font, with a stylized map of the state of California behind it. Below "CALIFORNIA" is a black rectangular box containing the words "BUDGET PROJECT" in white, sans-serif, all-caps font, flanked by small white dots on either side.

CALIFORNIA • BUDGET PROJECT •

August 6, 2003

2003-04 Budget Signed Into Law

On Saturday August 2, 2003, Governor Davis signed a 2003-04 spending plan into law. The budget bill (AB 1765) and accompanying legislation was passed by the State Senate on July 27, with minimal debate, by a vote of 27 – 10. Republican Senators Ashburn, Brulte, Johnson, Knight, and McPherson voted for the bill. Democratic Senators Alarcon and Soto abstained and Senator Vasconcellos was absent. The remaining Democrats voted for the bill, while the remaining Republicans voted no.

After a record setting overnight session, the Assembly passed a 2003-04 spending plan on Tuesday, July 29 by a vote of 56-22. Two Democrats, Assemblymembers Canciamilla and Dutra, voted no. Eleven Republicans voted aye (Assemblymembers Aghazarian, Benoit, Cogdill, Cox, Daucher, Dutton, Harman, Shirley Horton, Houston, Leslie, and Maze). The Assembly spending plan included approximately \$300 million in additional spending, through a combination of augmentations and reductions to the Senate-passed plan, in order to achieve the required two-thirds vote needed to pass a spending plan.

The budget gap was bridged through a combination of spending reductions, borrowing, fund shifts, and revenue assumptions. Major gap filling measures include:

- \$13.7 billion in spending reductions and savings. Major reductions are described below.
- \$3.9 billion in savings from the elimination of the VLF backfill to local governments. \$2.9 billion of this amount will be made up by the restoration in the VLF rate to its 1998 level.
- \$10.7 billion in deficit financing financed through the issuance of bonds that will be repaid through a three part shift of revenues between cities and counties, schools, and the state referred to as the “triple flip.”
- \$4.5 billion in other revenues, including \$2.2 billion in federal funds received from the state fiscal relief provisions of the recent federal tax bill. The budget also assumes that the state will receive \$680 million from tribal gaming activities.
- \$4.4 billion from internal borrowing and fund shifts.
- \$2.3 billion from other borrowing activities, including the sale of bonds backed by the state’s payments from the national settlement between states and the tobacco industry and pension obligation bonds.

As enacted, the budget provides a reserve of \$1.4 billion. The Legislative Analyst estimates that the state will face a roughly \$8 billion shortfall in 2004-05, largely due to the reliance of this year’s spending plan on one-time measures.

The budget agreement:

- **Taxes.** Did not include any taxes that must be approved by the Legislature. It does assume the increase in Vehicle License Fees (VLF) previously enacted through the trigger mechanism contained in the original VLF reduction bill and assumes that the Manufacturers' Investment Tax Credit will be allowed to sunset (for additional information see the CBP's *Unkept Promises: California's Manufacturers' Investment Tax Credit*, April 2003 at www.cbp.org).

- **Deficit Bonds.** Assumed that the state will issue \$10.7 billion in deficit retirement bonds to be repaid out of existing resources. The bonds will be repaid through a complex transaction insiders call the "triple flip." This transaction shifts ½ cent of local governments' sales tax rate (the "Bradley-Burns" rate) to the state; shifts property taxes from K – 14 education to cities and counties to replace lost sales tax revenues on a dollar for dollar basis; and reimburses schools for lost property tax moneys out of the state's General Fund. Contrary to some reports, the "triple flip" does not attempt to address the so-called fiscalization of land use – the preference of some local governments for sales tax generating land uses. Cities and counties will be reimbursed with property tax dollars based on the amount of sales tax they would have received under current law. The triple flip will be reversed once the deficit bonds are retired.

- **Assumed Federal and Other Funds.** Used the \$2.2 billion the state received in fiscal relief from the federal government to cover costs in 2002-03 and 2003-04. The budget assumes that the state will receive \$680 million in 2003-04 and thereafter in contributions from tribes that engage in gaming activities. The budget also assumes revenues from previously authorized pension obligation bonds and the sale of additional bonds backed by the state's payments from the national settlement between the tobacco industry and the states.

- **VLF.** Eliminated the VLF backfill payments to counties and cities. This payment will be made up with revenues from the restored VLF rates paid by car owners. However, there is a gap of approximately 60 days between the end of backfill payments and the point when car owners will begin to pay higher fees. The budget ensures that county realignment programs will be fully funded and treats the so-called gap payment to cities and counties as a loan that would be repaid in 2006-07.

- **K - 12 Education.** Funded K – 12 education at a level \$288 million below that provided in the 2002-03 Budget Act as enacted last September. This reduction translates into a \$180 per pupil drop in funding from \$7,067 to \$6,887. The budget funds enrollment growth in revenue limits, the basic allocation school districts receive from the state, but does not fund enrollment growth in categorical programs or cost-of-living adjustments in either revenue limits or categorical programs. The budget delays \$1.2 billion in K – 12 payments for programs operated in 2003-04 until July 2004. In addition, the Assembly plan appropriates \$50 million for so-called equalization of school funding and reduces funding for the Math and Reading Professional Development Program (\$14.2 million); Deferred Maintenance of school facilities (\$18.5 million); Educational Technology (\$14.8 million); and the Principal Training Program (\$2.5 million). SB 1046 contains these changes, which must be approved by the Senate when it returns later this month.

- **Child Care.** Achieved \$384 million in savings from child care programs by reducing funding for after school programs (\$7 million), reducing provider regional market rates (\$82 million), assuming lower enrollment in CalWORKs' Stage 3 (\$57 million), using federal TANF dollars for Stage 2 (\$119 million), reducing the age limit so that subsidies are only available to children under the age of 13 (\$16 million), reducing the Alternative Payment Provider administrative rate by 1 percent (\$12 million), and eliminating Quality Improvement Technical Assistance spending (\$5 million), among other changes.

- **UC/CSU.** Made unallocated reductions of \$293 million to the University of California (UC) and \$204 million to the California State University (CSU). According to the Legislative Analyst's Office, all but \$114 million of this cut will be restored through student fee increases of approximately 30 percent. The budget reduces funding for UC and CSU outreach programs by \$37.7 million (51 percent) and \$12.6 million (19 percent), respectively.

- **Community Colleges.** Reduced Community College funding by a net of \$81.8 million. The budget increases student fees from \$11 per unit to \$18 per unit (the Governor had proposed an increase to \$24 per unit in January), defers \$200 million in 2003-04 apportionment and Partnership for Excellence payments into 2004-05, and cuts \$86 million from apportionments and categorical programs.

- **Health Care.** Made a number of changes to health care programs, including a 5 percent reduction in Medi-Cal provider reimbursement rates that excludes long-term care and hospital inpatient and outpatient services; rejected the elimination of so-called Medi-Cal optional benefits, but included cost containment efforts in the area of dental, hearing aids, and durable medical equipment; shifted the accounting treatment of Medi-Cal expenditures from accrual to cash to reflect a reduction in 2003-04 expenditures of \$930 million; and included \$46 million to fund the Supplemental Wage Rate Adjustment program that provides supplemental payments to nursing homes in 2002-03 and 2003-04 (this program had been previously eliminated in bills enacting mid-year reductions). The budget assumes that the cost-of-living adjustment for long-term care facilities will be suspended in 2004-05. The budget agreement imposes a new "quality improvement assessment fee" that will be imposed on Medi-Cal managed care plans and Intermediate Care Facilities for the Developmentally Disabled. Proceeds of the fee will be used to draw down federal funds and will be returned to health care providers in the form of higher reimbursement rates.

- **Social Services.** Retained June 2003 cost-of-living adjustments (COLAs) for the SSI/SSP and CalWORKs programs, but suspends 2003-04 COLAs. The budget does not reduce current grant levels. Other social service changes include shifting \$11 million of federal TANF dollars from CalWORKs to Child Welfare Services; authorizing state participation in the federal transitional food stamp program (this change is expected to provide Californians with \$70 million in food stamps at an estimated state cost of \$2.5 million). The budget shifts a total of \$56 million from the Employment Training Panel to support CalWORKs' employment services costs.

- **Public Safety.** Imposed new and increased court filing fees to result in \$150 million in General Fund savings for trial court funding. The budget also eliminates the Office of Criminal Justice Planning (OCJP) and makes a number of reductions in corrections spending totaling approximately \$110 million.

- **Booking Fees.** The Senate budget plan eliminated state reimbursements to cities for booking fees paid to counties for booking inmates into county jails, as well as counties' authority to levy these fees, a cut of \$38 million, and defers or suspends state payment for most mandated programs. The Assembly plan, however, maintained the status quo with respect to booking fees. The Assembly did not take up AB 1749, which was part of the Senate budget package, that would have eliminated state payments to cities as reimbursement for fees paid to counties for booking inmates into county jails as well as counties' authority to levy booking fees.

- **Local Law Enforcement.** The Senate budget agreement eliminated high technology grants to local law enforcement (\$18.5 million) and Rural County Law Enforcement Grants (\$18.5 million), and reduces funding for COPS and Juvenile Justice Crime Prevention grants. The Assembly plan added \$16.1 million for training grants to local law enforcement agencies. SB 1042 makes this change, which must be approved by the Senate when it returns later this month. The Assembly plan also appropriated \$18.5 million for grants of \$500,000 each to 37 rural county sheriffs' departments. SB 1044 contains this change, which must also be approved by the Senate when it returns later this month.

- **Redevelopment.** The Senate budget plan included a one-time \$250 million transfer from Redevelopment Agencies (RDAs) to schools. RDAs would be prohibited from using low and moderate income housing funds to make the transfer and the parent cities or counties of RDAs are authorized to make the transfer in lieu of all or part of that required by a RDA. The Assembly plan reduced this shift from RDAs to schools from \$250 million to \$135 million. SB 1045 contains this change, which must be approved by the Senate when it returns later this month. This reduction will increase the level of state spending for K – 14 education required by Proposition 98.

- **Transportation.** Made a number of complex fund shifts and loans from transportation programs to the General Fund, including transferring \$856 million in Proposition 42 funds to the General Fund and deferring the repayment of a loan from the Transportation Congestion Relief Fund to the General Fund. The agreement also increased truck weight fees by about \$160 million to make up for a shortfall created by a prior measure that inadvertently resulted in a reduction in total fee revenues.

- **State Employee Compensation.** Assumed a total \$1.1 billion (\$585 million from the General Fund) in reductions in employee compensation costs, a reduction of approximately 10 percent. These savings would come through either layoffs or reductions in compensation.

- **Technology, Trade, and Commerce Agency.** Eliminated General Fund support for the Technology, Trade, and Commerce Agency. Programs funded with special or federal funds will be transferred to the Business, Transportation, and Housing Agency or other state departments. Transferred programs include the Small Business Expansion program, the Film Commission (although the Film California First program is eliminated for \$8 million in savings), Manufacturing Technology program, fee supported tourism programs, Underground Storage Tank program, and the Infrastructure Bank.

- **Resources/Environmental Protection.** Assumed that the Legislature will enact a variety of fees

to support resources, environmental, and energy programs. However, these bills were not included as part of the budget package and will, according to the Senate Republican Fiscal Consultants' Analysis, be considered in August. The fees would backfill reductions in general support and include air pollution permitting fees, waste water discharge permitting fees, pesticide permitting and licensing fees, dam safety fees, earthquake insurance policy fees, fishing and hunting license fee increases, park use fee increases, power plant siting and annual fee increases, and water rights fees. Other changes include eliminating General Fund support for the Secretaries of Resources (\$1.3 million) and CalEPA (\$879,000).

- **Arts Council.** Eliminated \$11 million in General Fund support for the Arts Council, leaving the Council with \$1 million.

- **Housing.** Achieved \$40 million in General Fund savings by reducing funding for various housing programs and shifting these programs to the proceeds of Proposition 46 bond funds, and restored \$1.3 million for Emergency Housing Grants proposed for reduction in the Governor's January budget.

The Assembly plan also:

- Rejects a proposed shift of \$4.8 million from the Aeronautics Account of the State Transportation Fund to the General Fund. As restored, this money will go to pay for security costs at rural airports. SB 1048 contains this change, which must be approved by the Senate when it returns later this month.

- Establishes an 11 percent minimum county share of local property tax revenues. This proposal would benefit Orange and Yolo Counties and will be amended into AB 1568 (Correa) and considered later this month.