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Legislature Sends 2006-07 Spending Plan to the Governor

The Legislature passed a 2006-07 spending plan and a number of bills to implement the budget on the evening of June 27. The Budget and related legislation:

- Increase spending for K-14 and higher education;
- Prepay approximately \$2.8 billion in outstanding budget-related debt;
- Reflect the timely pass through of federally-funded cost-of-living adjustments for individuals receiving cash assistance through the SSI/SSP Program and increase funding for foster care, child welfare services, and the CalWORKs Programs;
- Include funds for salary increases for state workers that have concluded contract negotiations; increased costs related to outstanding contracts would be paid for out of the budget reserve;
- Do not include either the Governor's or the Assembly's proposed funds to expand health coverage to children who are not currently eligible for coverage through the Healthy Families or Medi-Cal Programs; and
- Respond to changes in federal law requiring US citizens enrolled in or apply for Medi-Cal to document their citizenship and changes in the rules governing the federal Temporary Assistance for Needy Families (TANF) block grant.

The Big Picture

As passed by the Legislature, the budget spends \$7.0 billion more than the state expects to receive in revenues in 2006-07. After subtracting the \$2.8 billion prepayment of the budget-related debt, the 2006-07 operating deficit – the difference between revenues and expenditures – would be \$4.1 billion. The gap is filled with funds from the \$9.0 billion reserve carried forward from 2005-06 into the budget year. The Legislative Analyst's Office (LAO) notes that this reserve "reflects both past budgetary borrowing and stronger-than-expected revenues in prior and current years." The LAO also notes that based on current forecasts, "the state would continue to face multibillion dollar operating shortfalls in 2007-08 and 2008-09."

The Governor is expected to sign the budget later this week. Appropriations can be reduced or eliminated by the Governor using the line item veto, or "blue pencil," authority.

The Budget and related legislation can be found in:

AB 1801: 2006-07 Budget Bill

AB 1802: K-12 and higher education

AB 1803: Resources and environmental protection
AB 1805: State mandated local programs and local government
AB 1806: State operations
AB 1807: Health and developmental services
AB 1808: Human services
AB 1809: Taxes
AB 1810: Augmentations for contingencies and emergencies
AB 1811: Changes to appropriations made to reflect negotiations after the close of the budget conference committee
SB 1132: Transportation
SB 1137: Proposition 36/drug treatment

Tax Expenditure Reporting Will Improve; Taxes Up for Teachers, Boats, Planes, and RVs

Legislation passed as part of the budget agreement (AB 1809, Committee on Budget) imposes more detailed tax expenditure reporting requirements on the Department of Finance. This measure requires the Department to publish an annual report with a comprehensive list of tax expenditures resulting in an annual revenue loss of more than \$5 million; a description of the legislative intent and statutory authority for each expenditure; the sunset date, if any, of each expenditure; a description of the beneficiaries of each expenditure; a description of any comparable federal provision; and a description of any evaluation completed by a state agency for a tax expenditure. Additional reporting on the number of beneficiaries would be required for personal and corporate income tax expenditures.

The budget agreement also extends for one year a provision that requires Californians to pay sales taxes on vehicles, boats, and aircraft purchased out-of-state and brought into the state within 12 months of purchase and suspends the teacher tax credit for an additional year. Earlier this year, a report by the LAO found that requiring yachts and recreational vehicles to be kept out of the state for at least a year after purchase to avoid a California sales tax liability resulted in a sharp drop in the number of untaxed sales.

Health

The budget agreement:

- Does not include \$22.8 million to provide health coverage to nearly 24,000 children through county-based children's health initiatives. The Governor's May Revision and the conference report included this funding.
- Does not expand eligibility for the Healthy Families Program. The conference report expanded eligibility to all children with family incomes up to 275 percent of the federal poverty level (FPL) beginning July 1, 2007 and up to 300 percent of the FPL beginning July 1, 2008. Reports indicate that the Governor would support legislation that expands children's health coverage later this year.
- Requires Medi-Cal applicants and beneficiaries who are citizens to document their citizenship status. This requirement implements a provision of the federal Deficit Reduction Act of 2005. However, vulnerable citizens who are unable to document their citizenship status will not be eligible for the full range of Medi-Cal benefits, a step not required by the federal law.

CalWORKs

The budget agreement includes a package of CalWORKs policy and funding changes that respond to the recent reauthorization of the federal Temporary Assistance for Needy Families (TANF) block grant. Starting in October 2006, California must substantially increase the number of CalWORKs participants meeting federal work requirements or

face substantial penalties. The package provides \$100 million more for CalWORKs than was included in the Governor's May Revision. The package includes the following changes:

- Provides \$140 million to increase the funding that counties use to provide employment services and child care for CalWORKs participants.
- Provides \$90 million for counties to implement strategies to increase the number of CalWORKs participants meeting federal work requirements, including making home visits to families who are at risk of being sanctioned for not complying with program rules.
- Provides \$9 million to increase the number of work study positions available to CalWORKs participants enrolled in a community college.
- Provides \$5 million for an initiative to reduce homelessness among CalWORKs families.
- Shifts CalWORKs families who are exempt from participation requirements under state law into a non-TANF program in order to exclude these families from the state's work participation calculation.
- Modifies state law to allow individuals who have been sanctioned for not meeting program rules to come into compliance at any point, rather than having to remain sanctioned for a specified number of months.

Foster Care and Child Welfare Services

The budget agreement increases state funding for the Child Welfare Services and Foster Care programs by \$75 million as compared to the Governor's May Revision. The budget agreement includes initiatives to reduce social worker caseloads or implement early interventions to improve outcomes for families and children; increase the availability of transitional housing for emancipated foster youth; and increase financial aid for foster youth.

Child Care

The budget agreement increases the income eligibility limit for subsidized child care, which has not been adjusted to reflect the increase in the cost of living since 2000. In addition, the budget agreement will require families to pay fees for child care assistance in 2006-07 when their incomes reach approximately 40 percent of the state median income (SMI) and will allow the state to assess fees of up to 10 percent of a family's income. Currently, families pay fees when their incomes reach 50 percent of the SMI and fees do not exceed 8.3 percent of a family's income for full-time, daily child care.

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

The budget agreement provides the federal cost-of-living adjustment (COLA) for SSI/SSP grants in January 2007, eliminating the three-month delay included in the 2005-06 budget agreement. SSI/SSP payments help low-income seniors and people with disabilities meet basic living expenses.

K-12 Education

The budget agreement:

- Assumes \$49.1 billion in K-12 Proposition 98 funds for 2006-07, approximately the same level proposed in the Governor's May Revision.
- Includes an increase in ongoing funds of \$350 million for Economic Impact Aid (EIA) above the Governor's May Revision. EIA provides funds to school districts with disproportionate numbers of low-income and English learner students. The budget package also includes \$350 million in ongoing funds to help equalize general

purpose school district revenues. This reflects an increase of \$50 million for both EIA and equalization above the Conference Committee's proposed spending level.

- Includes \$2.5 billion in one-time Proposition 98 funds for a variety of K-12 education purposes according to a report by the LAO. The Governor's May Revision proposed a similar level of one-time funding, but outlined a different plan for allocating these funds. The budget agreement includes \$534 million in one-time funds for a discretionary block grant that would be divided between school districts and school sites on a 25 percent/75 percent basis. The budget package specifies the purposes for which schools and school districts could use the funds, including instructional materials, education technology, deferred maintenance, and fiscal solvency.
- Maintains the Governor's May Revision proposal to provide \$50 million in ongoing funds to expand the state's preschool program, and \$50 million to renovate or expand preschool facilities.

Higher Education

The budget agreement:

- Adopts a methodology different from that proposed by the Governor to fund the cost of additional enrollment at both the California State University (CSU) and the University of California (UC). In effect, the budget package provides \$26 million for this per-pupil cost increase (\$9.3 million for UC and \$16.8 million for CSU).
- Includes \$26.3 million for academic preparation programs at UC and CSU, rejecting the Governor's proposal to eliminate these programs.

Transportation

The 2006-07 budget agreement:

- Retains the Governor's proposal to provide full funding (\$1.4 billion) for Proposition 42 in 2006-07.
- Distributes revenues from a portion of the sales tax on gasoline (so-called "spillover" revenues), estimated at \$668 million, to Proposition 42 loan repayment (\$200 million), the seismic retrofit of Bay Area bridges (\$125 million), farmworker transportation grants (\$20 million), high-speed rail development (\$13 million), and transit programs (\$310 million). The Legislature rejected the May Revision proposal to divert most spillover revenues to a new fund dedicated to paying a portion of the debt service on existing and new transportation bonds. Spillover revenues are customarily transferred to transit programs, but the 2005-06 budget agreement suspended the transfer for 2005-06 and specified that in 2006-07 the first \$200 million of spillover would be retained in the General Fund, the next \$125 million would go to the seismic retrofit of Bay Area bridges, and any remaining revenues would be transferred to transit programs.
- Prepays \$1.4 billion in outstanding Proposition 42 loans that are due in 2007-08 and 2008-09. The repayment will come from the General Fund (\$1.2 billion) and from spillover revenues (\$200 million). The Governor had proposed to prepay the \$920 million Proposition 42 loan that is due in 2007-08.

State Employees

The budget agreement:

- Provides \$567 million (\$361 million General Fund) for a state employee salary increase, of which \$30 million (\$15 million General Fund) is designated to address recruitment and retention issues. The budget agreement provides pay increases for only six of the state's 21 employee bargaining units; since most contracts have expired or will

expire in July, the state will face additional costs in the budget year. Salaries have not been increased for most state civil service employees since 2004-05.

Local Government

The budget agreement:

- Provides \$403 million for prior-year and budget-year non-education mandate claims. Proposition 1A, approved by voters in 2004, requires the Legislature to either fund or suspend most non-education mandates for local governments.
- Provides \$38 million for the Citizens' Option for Public Safety (COPS) and Juvenile Justice Prevention programs (total \$238 million).
- Provides \$35 million for booking fees, whereby the state reimburses cities and special districts for fees paid to counties for booking inmates into county jails. The Governor had proposed to eliminate booking fee reimbursements and redirect these funds to local detention facilities. The budget agreement authorizes an annual subvention of \$35 million, subject to budget appropriation, and prohibits counties and cities from charging general booking fees in any fiscal year when the subvention is fully funded.
- Provides \$500,000 to the Central Coast Rural Crime Program.

Public Safety

The budget agreement:

- Includes an additional \$7.3 million over the conference report to help support an 8.5 percent salary increase for judges beginning January 2007.
- Provides \$5.5 million, twice as much as included in the conference committee's proposed spending plan, to fund 50 new judgeships.

Proposition 36

The budget agreement:

- Modifies the Substance Abuse and Crime Prevention Act of 2000 (Proposition 36) to provide closer monitoring of substance abuse offenders and to allow for brief jail time for offenders with probation violations. The budget agreement also requires participants in Proposition 36-supported treatment programs to be tested for drug use. Proposition 36 funding is continued at the 2005-06 level of \$120 million.
- Creates the Substance Abuse Offender Treatment Program and provides up to \$25 million General Fund to match certain county expenditures for Proposition 36 offenders.

