



September 17, 2008

Legislature Passes, Governor Announces He Will Veto, 2008-09 Spending Plan

On September 15, after the longest budget stalemate in California's history, lawmakers approved a 2008-09 spending plan. On September 16, the Governor held a press conference announcing that he will veto the budget, sending lawmakers back to the drawing board. This summary is based on media reports, legislation passed as part of the budget package, and a summary prepared by the Assembly Budget Committee. The CBP will prepare a more detailed analysis of the budget agreement when a final spending plan becomes law. The following summary notes key differences between the approved spending plan and the plan approved by the Budget Conference Committee in July. Details on the Conference Committee's plan are outlined in the CBP's *How Do the Budgets Compare?* available at http://www.cbp.org/documents/080613_BudgetComparisonSide-by-Side.pdf.

The final agreement includes:

- Deep cuts to public education, health, human service, and other programs. The final spending level for programs covered by the Proposition 98 guarantee is \$800 million below the Conference Committee's budget and \$2.9 billion below the "workload" budget level.
- No permanent revenue increases. The budget agreement includes limits on businesses' use of loss deductions and tax credits in exchange for massive future tax breaks (see below) and a variety of measures that accelerate revenues from future years into the budget year.
- Changes to the budget process that would substantially increase the size of the state's reserve and limit the use of future revenues that exceed anticipated levels. The agreement also would give governors vast new power to unilaterally reduce spending midway through the budget year.
- Assumes that the state will issue bonds backed by lottery proceeds in 2009-10.

Revenue Package Includes Large Future Tax Cuts

The final budget agreement includes \$9.3 billion in what the Assembly Budget Committee describes as "revenue solutions." The agreement would:

- Suspend businesses' ability to claim net operating loss deductions in 2008 and 2009, increasing revenues by \$1.1 billion in 2008-09 and \$600 million in 2009-10, and then extend the carry forward period for loss deductions and allow businesses to "carry back" losses earned beginning in 2011. The expansion of net operating loss deductions would result in revenue losses of \$320 million in 2010-11, \$600 million in 2011-12, and \$485 million in 2012-13 and similar amounts thereafter.

- Limit businesses' use of tax credits in 2008 and 2009 for a revenue increase of approximately \$900 million in 2008-09 and somewhat less in 2009-10 and then allow corporations that are part of a "unitary group" for tax purposes to share tax credits thereafter. The sharing of tax credits marks a significant and costly change in tax policy that would result in substantial annual revenue losses. Sources report that this change would cost from \$300 million to potentially more than \$1 billion per year beginning in 2010-11.
- Loan or transfer \$855 million from various state special funds to the General Fund.
- Accelerate \$6.5 billion into 2008-09 using a number of accounting changes, modifications to personal income tax withholding schedules, changes to estimated income tax payment requirements, and other provisions. These provisions would not change the amount of revenues the state collects, but only the year in which revenues are scored for accounting purposes.

Reserve on Steroids

The final budget agreement includes a constitutional amendment, SCA 13, that would make a number of changes to state budget practices. If approved by the voters, SCA 13 would:

- Require the state to contribute an amount equal to 3 percent of General Fund revenues to a Budget Stabilization Fund (BSF). Transfers would be required until the balance in the BSF reached 12.5 percent of estimated General Fund revenues for the fiscal year. Transfers out of the BSF could only be made in a bill that contains no unrelated provisions.
- Limit the Governor's ability to suspend transfers into the BSF. In brief, transfers would be required annually unless, beginning in 2010-11, General Fund revenues are less than the prior year's General Fund expenditures, adjusted for population growth and inflation, as measured by the change in per capita personal income.
- Limit the use of so-called "April Surprise" revenues. At the end of May of each year, the Director of Finance would be required to estimate revenues for the current fiscal year and compare this estimate to the estimate contained in the budget bill for the same fiscal year. The use of any amounts estimated in May to exceed 105 percent of the budget act estimate would be limited to payment of Proposition 98 obligations that exceed amounts previously appropriated for that fiscal year if the outstanding obligation exceeds 5 percent of General Fund revenues for the year. Any remaining amount would be transferred to the BSF. After the balance in the BSF reached 12.5 percent of General Fund revenues for the year, the excess could be used for specified one-time purposes, including payment of "settle up" or maintenance factor obligations pursuant to the Proposition 98 spending guarantee; repayment of loans from transportation funds authorized by Proposition 1A of 2006; repayment of amounts owed to local governments for property tax shifts pursuant to Proposition 1A of 2004; repayment of outstanding deficit financing bonds authorized by Proposition 57 of 2004; and unfunded retiree health benefit obligations. After fulfillment of these obligations, any balances in the BSF in excess of 12.5 percent of General Fund revenues could be used for one-time infrastructure expenditures, bond debt repayment, or for a one-time tax cut.

Governor Gains Mid-Year Cut Authority

AB 1389 gives the Governor authority to make mid-year reductions to state spending in years when "the Director of Finance determines that General Fund total available resources for the fiscal year will decline substantially below the estimate of General Fund total resources available upon which the Budget Act was based or that General Fund expenditures will increase substantially above that estimate of General Fund total resources available." The Governor would be allowed to reduce state operations appropriations – moneys that support state government, including the California State University and University of California systems – by up to 7 percent. Certain appropriations, including those for debt service, the Legislature, and the Governor's office could not be reduced.

The Governor, acting through his or her Director of Finance, could also suspend cost-of-living adjustments (COLAs) and rate increases provided in the Budget Act if “the Director of Finance determines that suspension by up to 120 days of the effective date of a cost-of-living adjustment is necessary to mitigate conditions that would authorize the issuance of a proclamation declaring a fiscal emergency.” During that period, the COLA or rate increase would not take effect. COLAs and rate increases also would be suspended if the governor issued a proclamation declaring a fiscal emergency until the Legislature passed a bill that addressed the fiscal emergency. COLAs for general purposes appropriations for public schools – revenue limits – could not be suspended. Beginning in 2009-10, the Budget Act would be required to include a list of COLAs and rate increases that could be suspended under the new provision.

Lottery

The budget agreement:

- Proposes to sell bonds that would be repaid from future lottery proceeds. The Assembly Budget Committee estimates that bond sales would raise \$5 billion in 2009-10 and \$5 billion in 2010-11. The budget agreement would establish a Debt Retirement Fund (DRF) into which bond proceeds would be deposited. The DRF could be used by the Legislature for any General Fund budgetary obligation.
- Proposes to modify the lottery by submitting a ballot measure to voters. The measure would replace annual payments from lottery revenues to K-12 and higher education with allocations from the General Fund, beginning in 2009-10. General Fund allocations to K-12 and higher education would be based on the amount of lottery revenues received in 2008-09, adjusted for inflation and changes in attendance. The measure would make several changes to the lottery, including authorizing an increase in prizes as a share of lottery revenues.

K-12 Education

The budget agreement:

- Assumes \$58.1 billion in Proposition 98 funds for 2008-09. The Assembly Budget Committee reports the spending level for programs covered by the Proposition 98 guarantee is roughly \$3.0 billion below the 2008-09 “workload” budget level.
- Provides a 0.68 percent COLA to fund revenue limits for school districts and county offices of education, which is below the 2.12 percent COLA proposed by the Conference Committee. The budget agreement does not provide a COLA for categorical programs, such as class size reduction and instructional materials.
- Does not provide any Proposition 98 “settle-up” funds needed to meet prior-year Proposition 98 obligations.
- Proposes to modify Proposition 49, the After School Education and Safety Program Act (ASES), by submitting a ballot measure to voters in November 2008. The measure would remove Proposition 49’s minimum appropriation level of \$550 million and would allow annual ASES budgeting decisions to be made by the Legislature.

Health

The budget agreement reflects the major outlines of the Conference Committee’s budget, including rejecting the Governor’s proposed deep cuts to Medi-Cal services and eligibility. However, the budget agreement:

- Extends the current 10 percent reduction to payments for Medi-Cal and other health care providers through February 28, 2009. However, smaller cuts would take effect starting on March 1, 2009, with payments reduced by 1 percent for some providers and by 5 percent for others, including pharmacies and adult day health care centers. A recent court ruling raises questions about whether these cuts can be sustained. A federal district

court ordered the state to restore full payments to Medi-Cal providers starting on August 18, a ruling that the state has appealed.

In addition, consistent with the Conference Committee's budget, the budget agreement:

- Requires paperwork twice per year for children in the Medi-Cal Program. Currently, paperwork is required once per year for children.
- Increases Healthy Families Program premium contributions for families with incomes between 151 percent and 250 percent of the poverty line by \$2 to \$3 per child per month.
- Allows the Managed Risk Medical Insurance Board to cap – at a level as low as \$1,500 per child per year – the amount of dental coverage provided to children in the Healthy Families Program.

California Work Opportunity and Responsibility to Kids (CalWORKs) Program

The budget agreement reflects the major outlines of the Conference Committee's budget, including suspending the October 2008 COLA for CalWORKs grants and rejecting the Governor's proposals to drop more than 225,000 children from the CalWORKs Program.

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

The budget agreement suspends the October 2008 and June 2009 state COLAs for SSI/SSP grants, provisions that also were included in the Conference Committee's budget. The budget agreement rejects the Governor's proposal to divert the January 2009 federal COLA to the state's General Fund, rather than passing it through to recipients.

Other Human Services

The budget agreement reflects the major outlines of the Conference Committee's budget, including rejecting the Governor's proposed deep cuts to the Child Welfare Services Program and the Foster Care Program. However, the budget agreement makes additional modest reductions to funding for county administration of the Food Stamp and In-Home Supportive Services programs.

Child Care and Development

The budget agreement largely reflects the major outlines of the Conference Committee budget, including freezing the income eligibility limit for child care services at the 2007-08 level in 2008-09. However, the budget agreement does not provide a COLA for child care and development programs in 2008-09.

Higher Education

The budget agreement:

- Includes \$39.8 million to support a 0.68 percent COLA for California Community Colleges, which is below the 2.4 percent COLA proposed by the Conference Committee.
- Funds the University of California and the California State University at the level proposed in the May Revision.

Transportation

The budget agreement cuts \$1.0 billion in public transit funds to support programs usually funded by the General Fund. This reduction is \$0.5 billion higher than in the conference committee's spending plan. However, a portion of this amount is due to diversion of higher-than-anticipated growth in so-called "spillover" revenues due to the rise in gas prices.

Corrections

The budget agreement:

- Restores cuts to the Citizens' Option for Public Safety (COPS) and Juvenile Justice Crime Prevention Act programs that were included in the conference committee's proposed spending plan.
- Reimburses local governments for booking fees and funds the Small/Rural Sheriffs Grant program at the level proposed in the Governor's May Revision to the 2008-09 Budget.

The 2008-09 Budget and related legislation include:

AB 1781: 2008-09 Budget Bill

AB 10: Overtime compensation

ABX3 36: Tax withholding and estimated payment changes

AB 88: Changes to appropriations to reflect negotiations after the close of the budget conference committee

AB 158: Tribal gaming

AB 186: Rural crime prevention

AB 268: Transportation

AB 519: Education

AB 1183: Health

AB 1279: Human services

AB 1338: Resources

AB 1389: General government, including mid-year cut authority

AB 1452: Net operating loss, tax credit changes, and "yacht tax"

AB 1526: Proposition 49 after school programs

AB 1654: California State Lottery modifications

AB 1741: Lottery securitization authorization

AB 1805: Mental health services

AB 2026: State property

AB 2246: Charter schools

AB 2784: Medi-Cal hospital reimbursements

SCA 12: Constitutional changes related to Lottery securitization

SCA 13: Budget Stabilization Fund and related provisions