

CALIFORNIA BUDGET PROJECT

Back on Track?

The Social and Economic Context of the Governor's Proposed 2013-14 Budget

1107 9th Street,
Suite 310
Sacramento,
California 95814
(916) 444-0500
www.cbp.org
cbp@cbp.org

A PRESENTATION BY
THE CALIFORNIA BUDGET PROJECT
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Overview

- California is poised to turn the corner on years of severe budget shortfalls.
- New revenues approved by voters in November (Propositions 30 and 39) boost state spending for schools, while resulting in a state budget that is roughly in balance.
- Even with the increased revenues, the Governor's proposed spending for 2013-14 would be below the pre-recession level.
 - K-12 Proposition 98 spending per student remains below the 2007-08 level.
 - Other critical areas of spending remain below 2007-08 levels.
- The Governor's proposed budget also would expand Medi-Cal and make changes to the state's school funding formula.

Overview (continued)

- Many Californians are still hurting in the wake of the Great Recession.
 - California's poverty rate is at its highest point since the mid-1990s.
 - Long-term unemployment statewide remains near a record high.
- Budget choices are about priorities and values.
 - California has experienced widening income inequality over the past generation.
 - State policymakers cut spending on the child care credit, while spending on ineffective Enterprise Zone credits continued to rise.
- With California getting back on track, policymakers should look to rebuild public services and systems essential to economic growth and broadly shared prosperity.

Outline

- Our State Budget: The Big Picture
- The Social and Economic Context
- The Governor's Proposed 2013-14 Budget
 - Spending Realities
 - Key Areas of the Budget
- Policy Considerations and Choices
- Q&A/Discussion

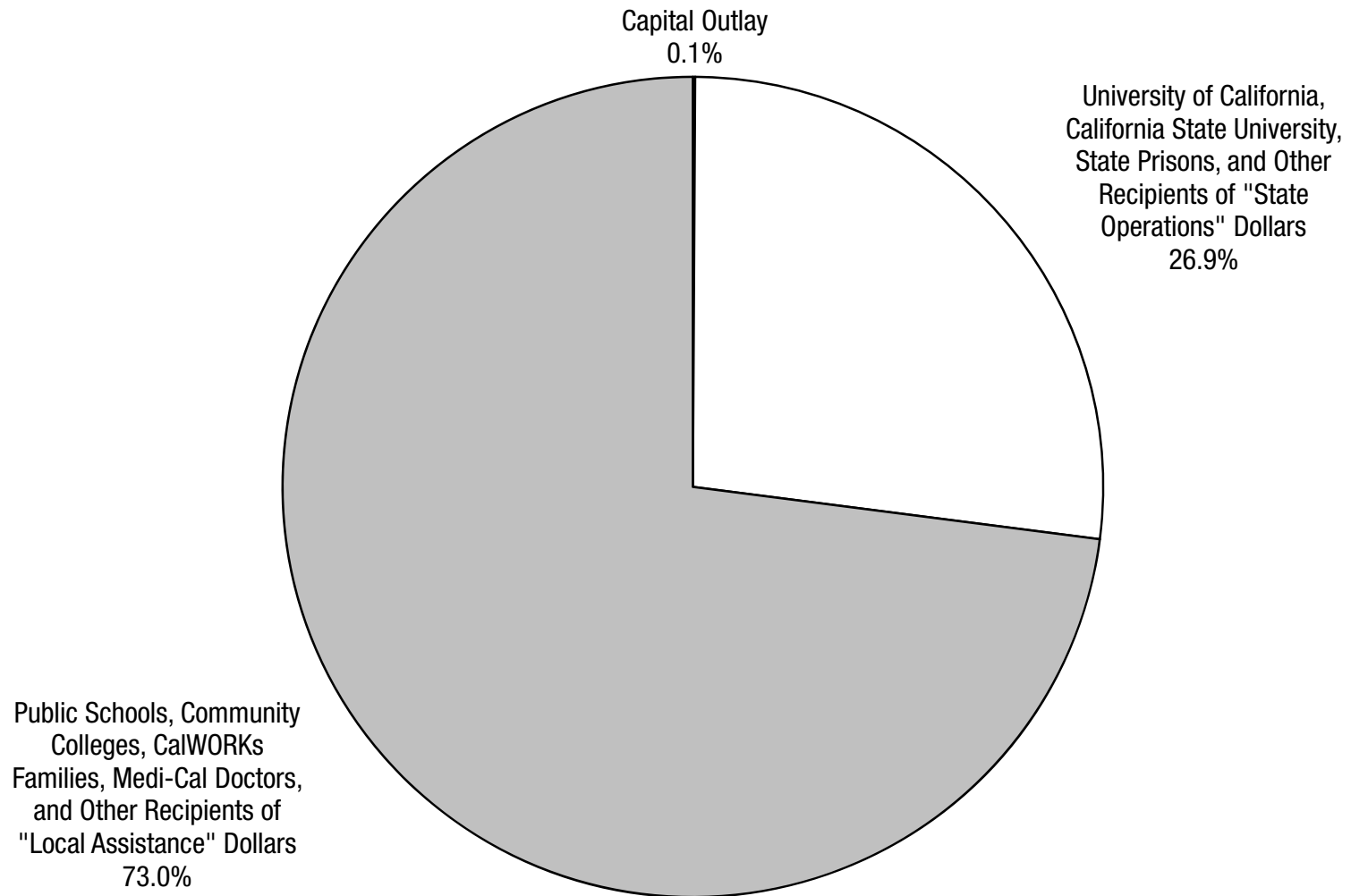
The Challenge: Recovering From the Great Recession

- State revenues were hit hard by the Great Recession, as Californians lost jobs and saw their incomes decline.
- General Fund revenues plunged by about \$20 billion in a single year, between 2007-08 and 2008-09.

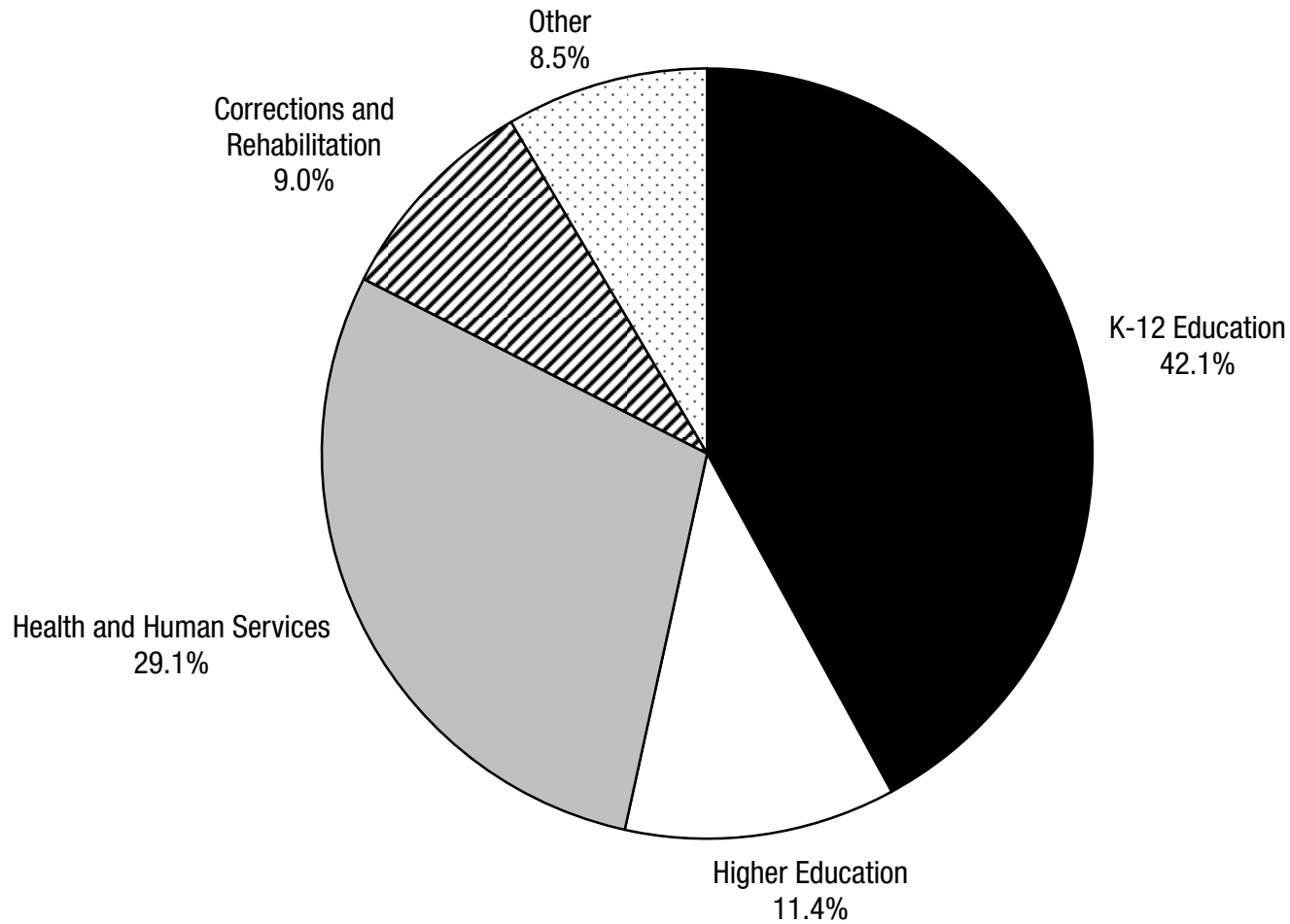


Our State Budget: The Big Picture

Most State Dollars Go to Local Communities and Individuals Proposed 2013-14 General Fund Spending

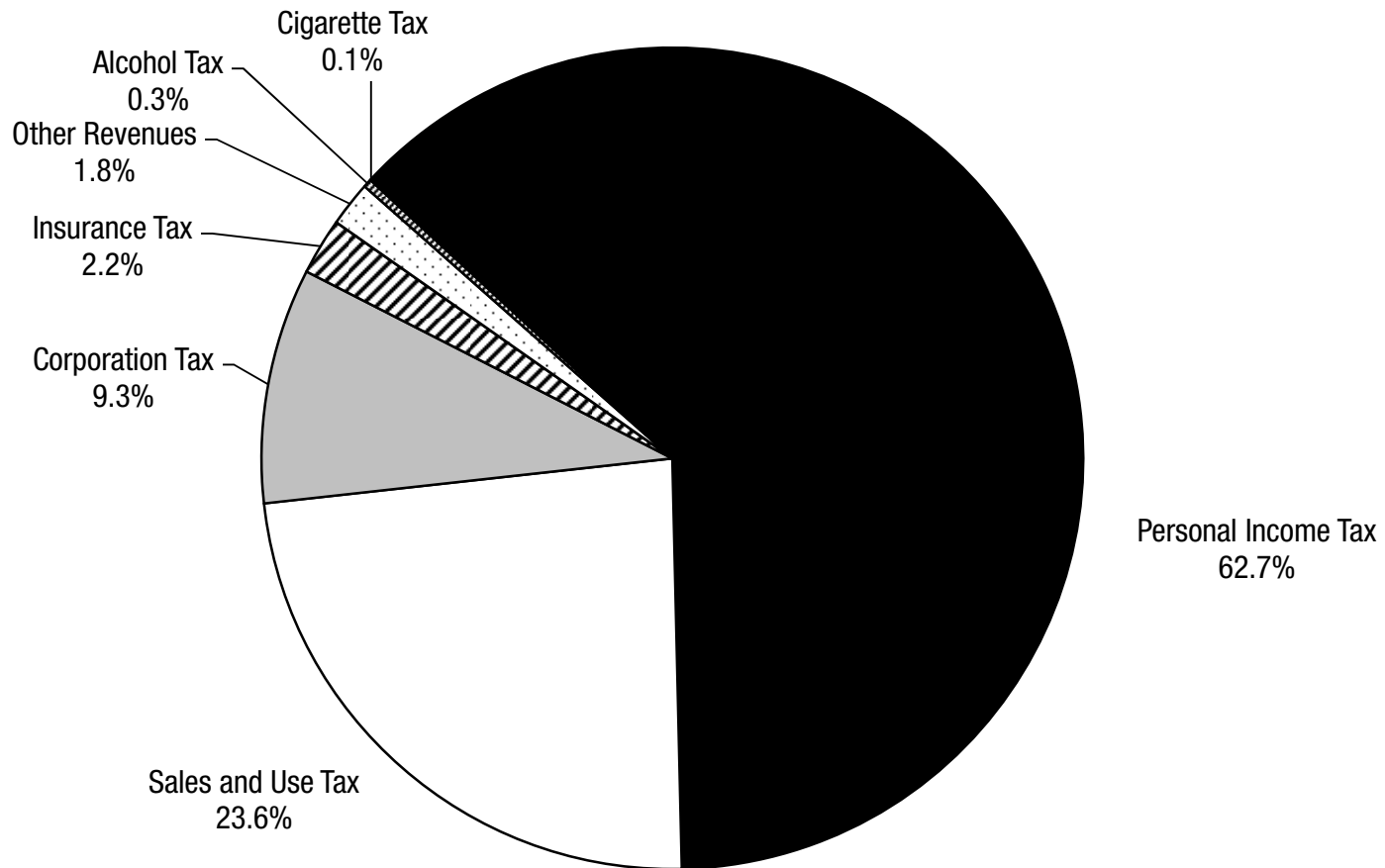


More Than Four Out of Five State General Fund Dollars Support Education or Health and Human Services



Proposed 2013-14 General Fund Expenditures = \$97.7 Billion

The Personal Income Tax Provides the Largest Share of General Fund Revenues



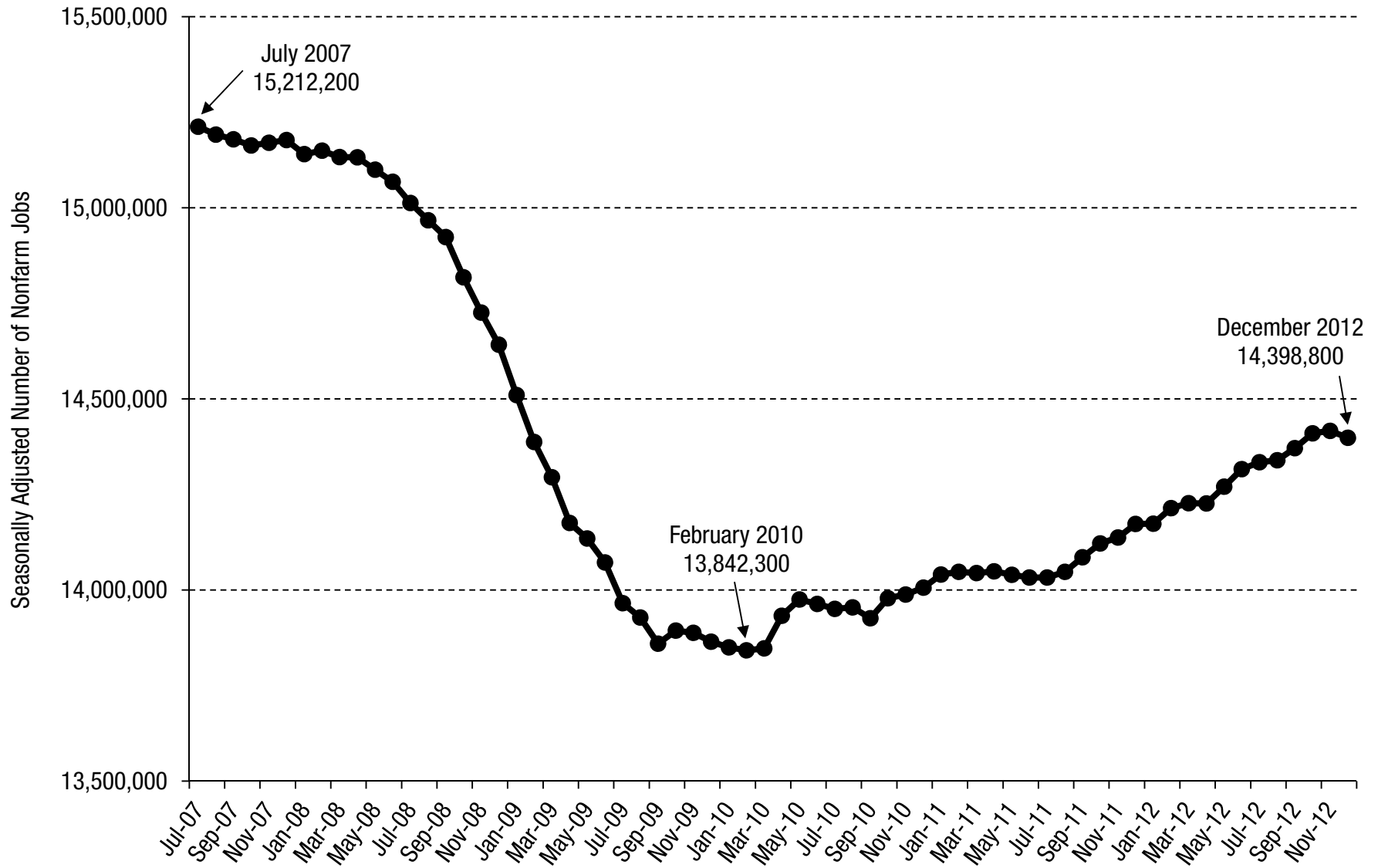
Proposed 2013-14 General Fund Revenues and Transfers = \$98.5 Billion

Source: Department of Finance

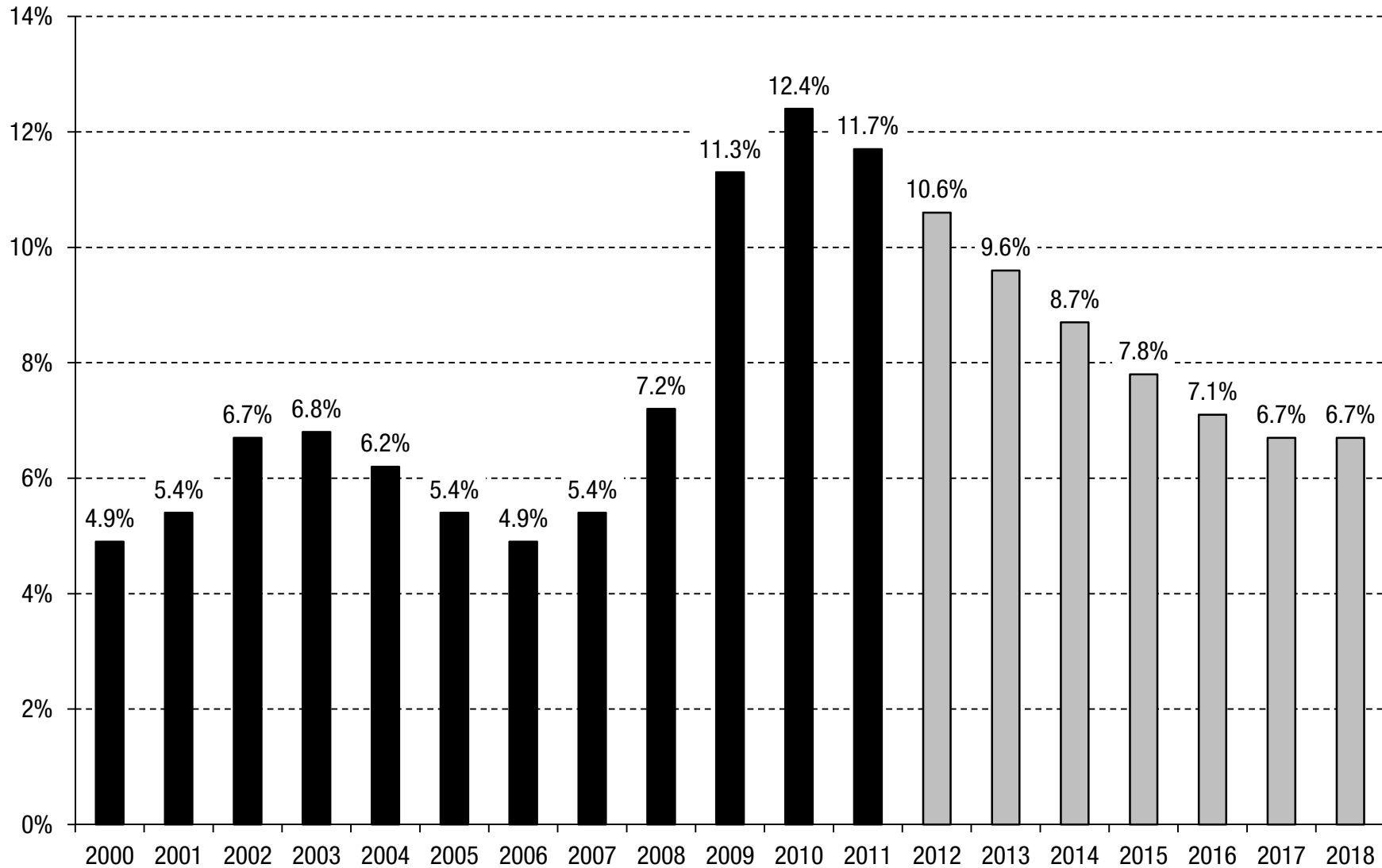


The Social and Economic Context: Many Californians are still hurting in the aftermath of the Great Recession.

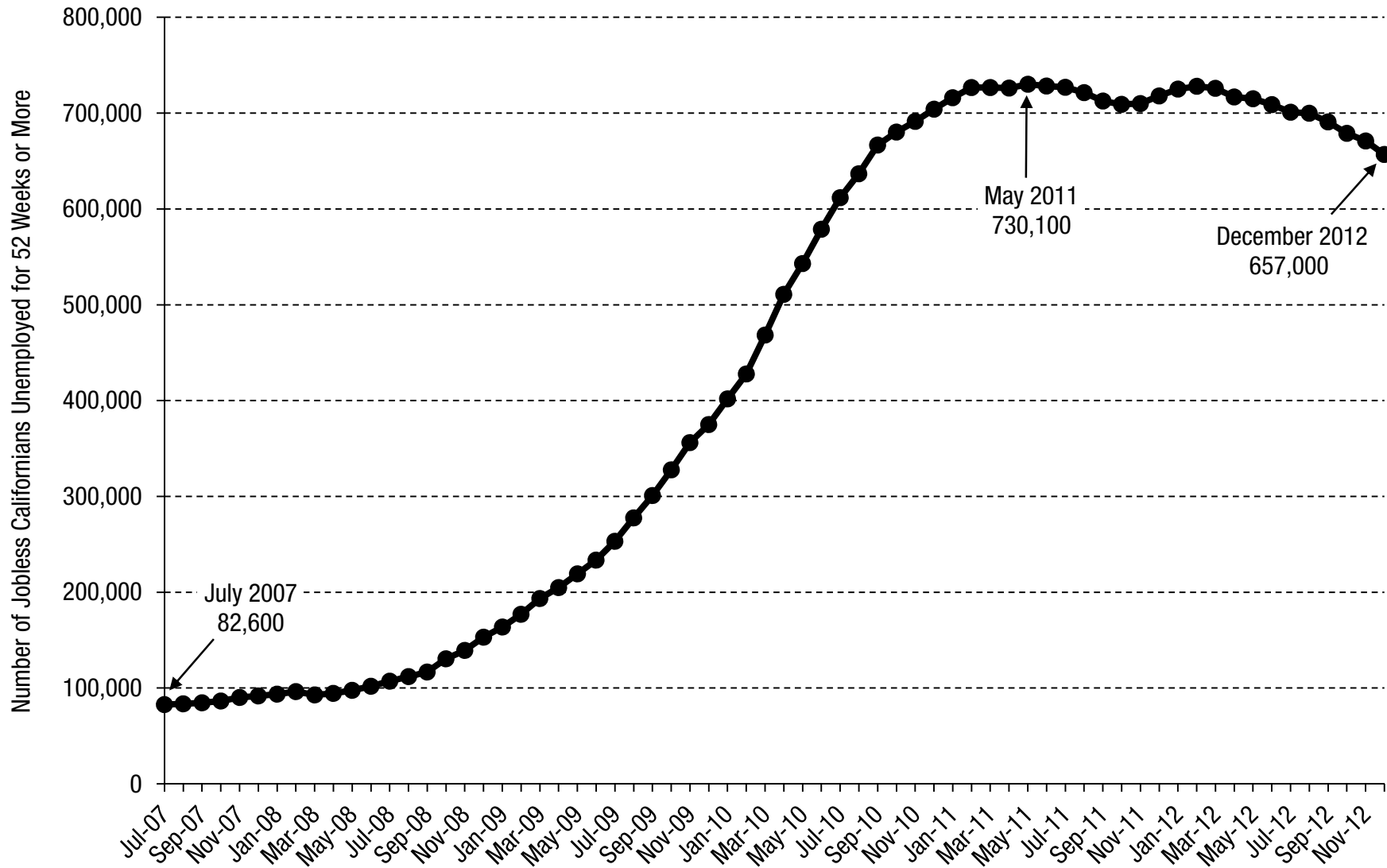
California Still Has a Deep Hole in Its Job Market



California's Annual Jobless Rate Is Projected to Drop Below 10 Percent in 2013

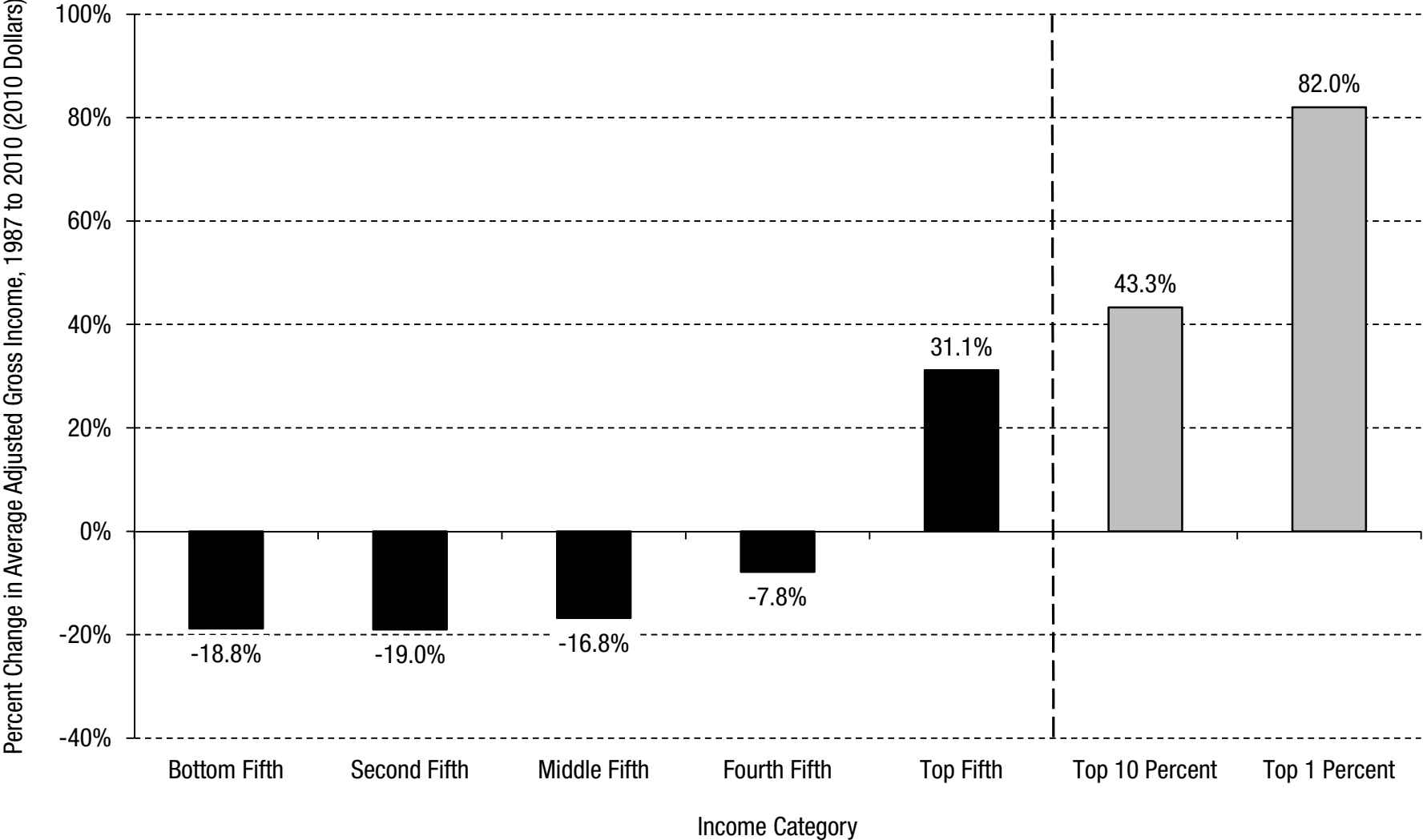


Long-Term Unemployment in California Remains Near a Record High

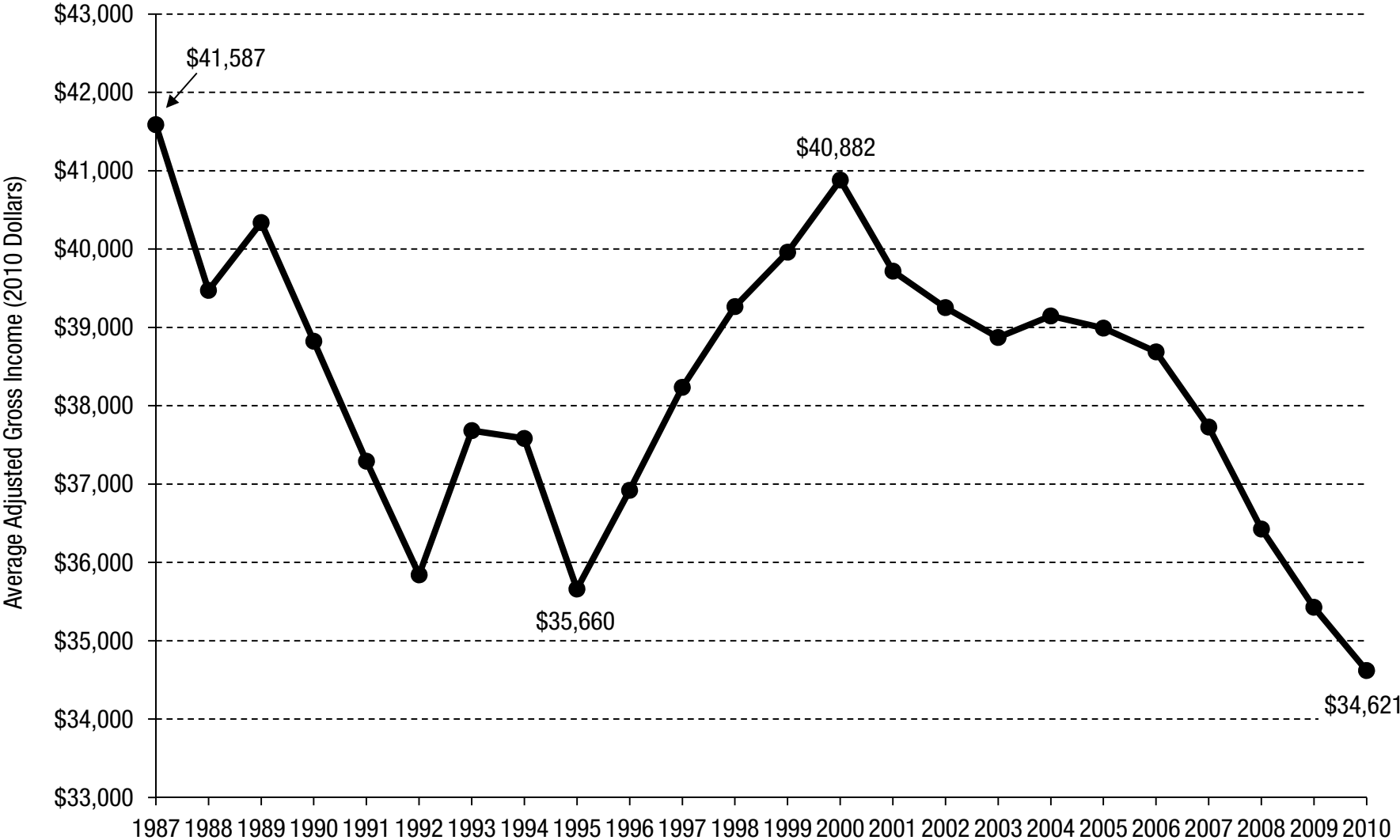


Note: Data reflect 12-month averages ending in the month displayed.
Source: Employment Development Department

The Average Income of the Wealthy Increased Significantly During the Past Two Decades, While Declining Among All Other Californians

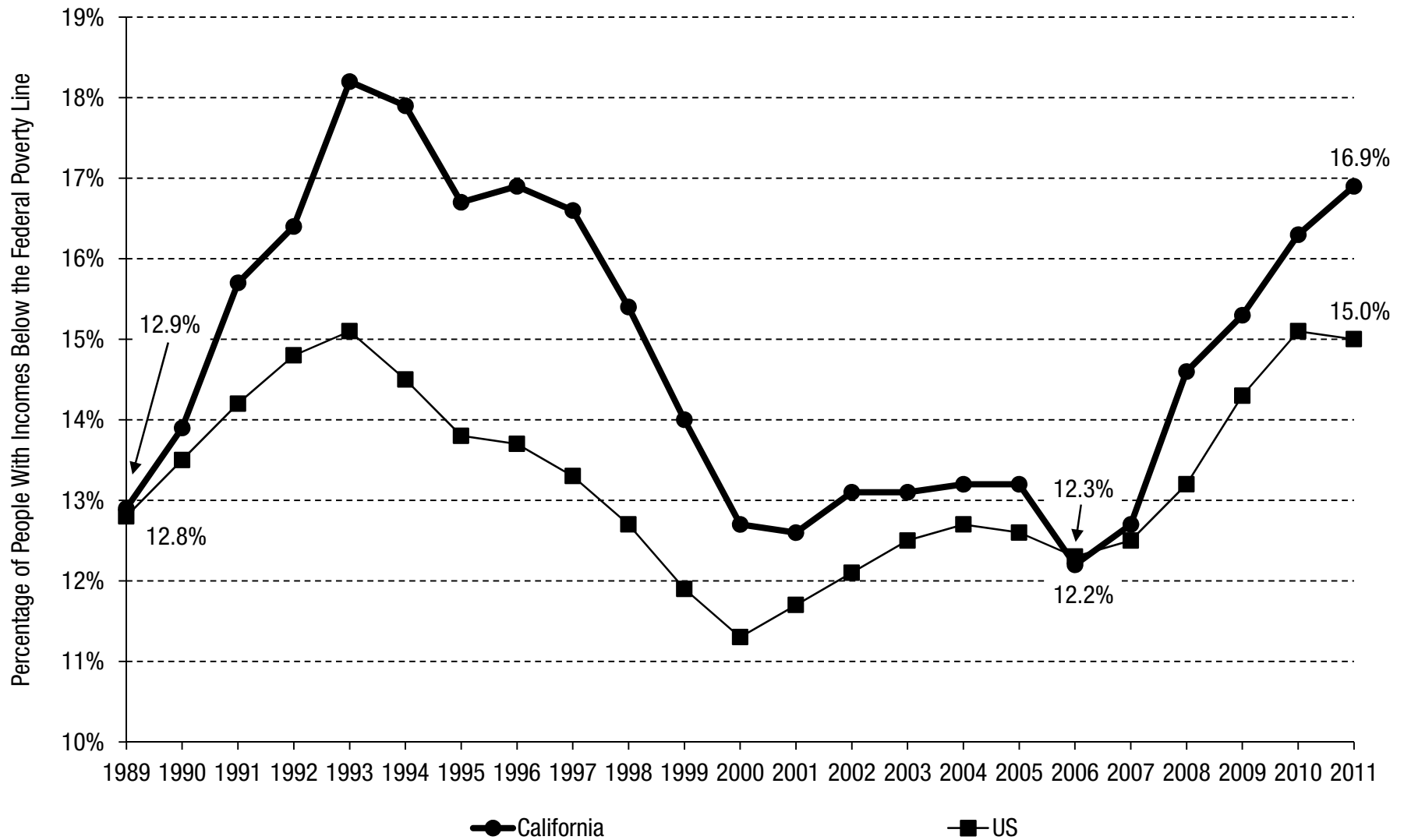


The Average Adjusted Gross Income of Middle-Income Californians Fell to a More-Than-Two-Decade Low in 2010



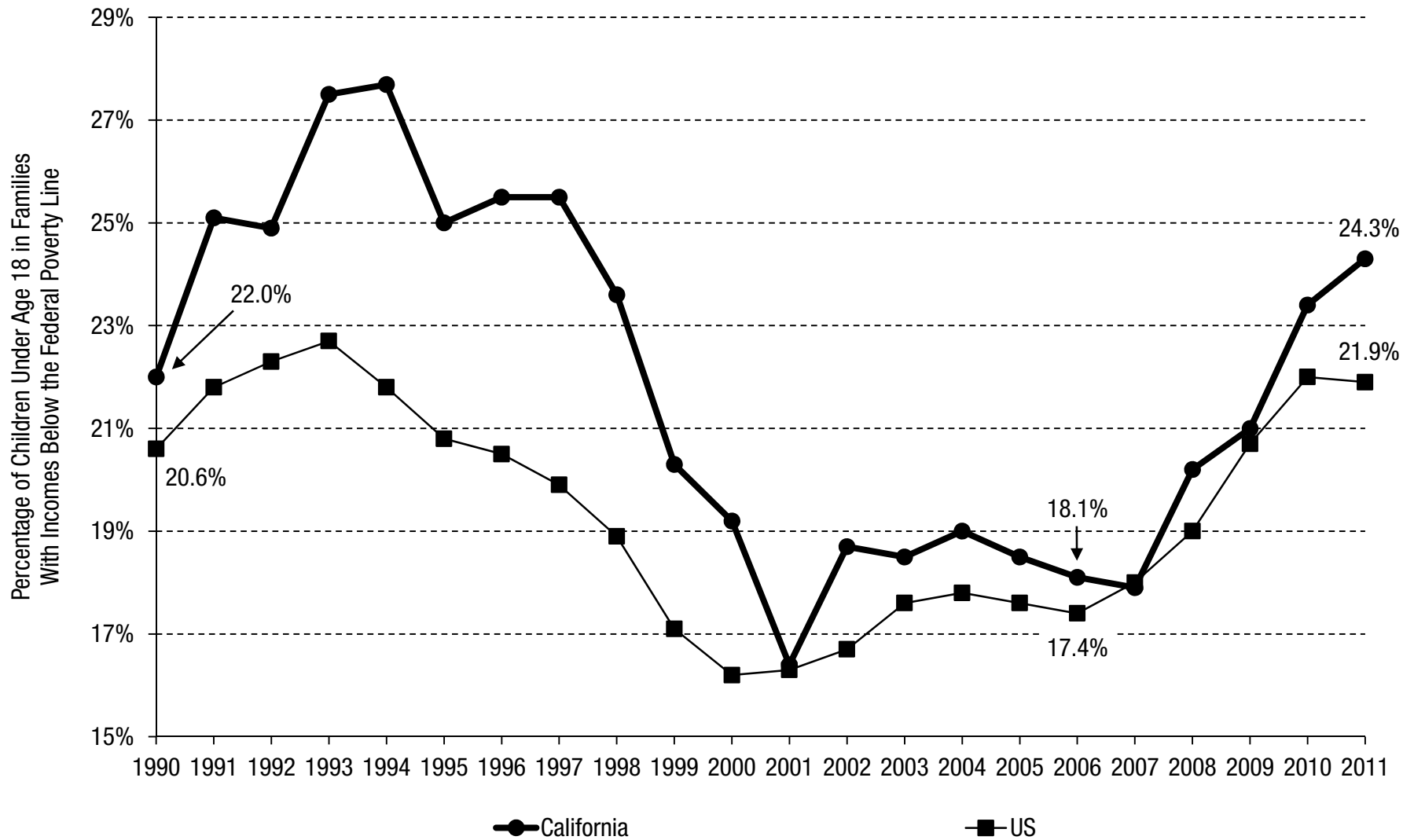
One Out of Six Californians Were Living in Poverty in 2011

Poverty Rate Has Increased by More Than One-Third Since the Year Before Recession Began



Nearly One Out of Four California Children Were Living in Poverty in 2011

Child Poverty Rate Has Increased by More Than One-Third Since the Year Before Recession Began





The Governor's Proposed 2013-14 Budget:
New revenues, investments in education,
expanded health care coverage, and
paying down budgetary debt.

The Top Lines

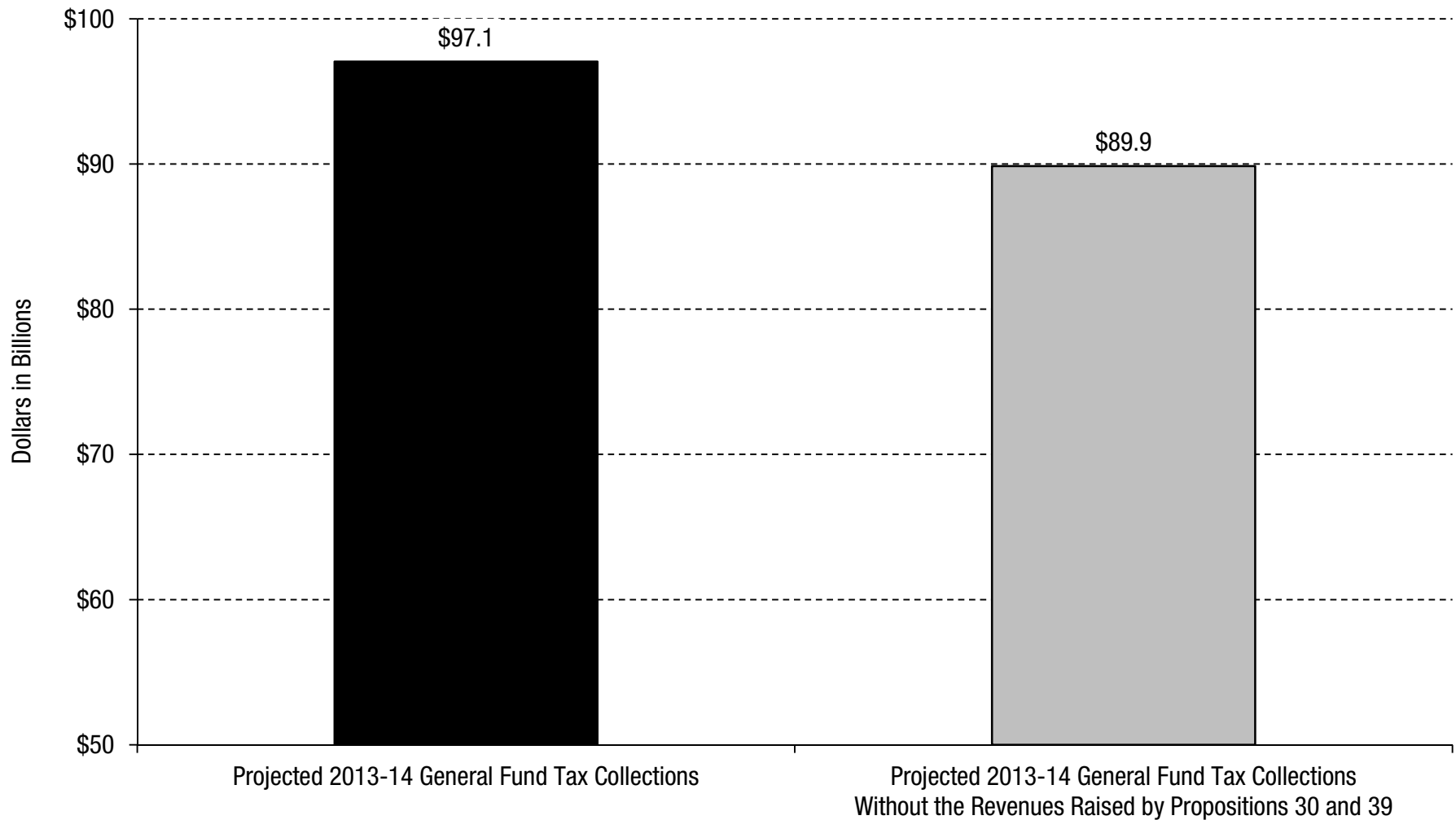
The Governor's proposed 2013-14 budget:

- Increases General Fund spending by 5 percent, from \$93 billion in 2012-13 to \$98 billion in 2013-14.
- Increases funding levels for K-12 schools and higher education.
- Expands Medi-Cal, the state's health care program for low-income Californians, as authorized by federal health care reform.
- Generally maintains last year's funding levels for most parts of the budget, including child care and other areas that have been cut deeply in recent years.
- Pays down \$4.2 billion in budgetary debt.
- Includes a \$1 billion reserve.

New Revenues Approved by California Voters

- The Governor's budget projects \$7.2 billion in increased General Fund revenues in 2013-14 resulting from voter approval of Propositions 30 and 39 in November.
- Proposition 30 temporarily imposes three new tax rates on very-high-income Californians – married taxpayers earning \$500,000 or above – and increases the state's sales tax rate by one-quarter cent.
 - The higher income tax rates apply to 2012 through 2018; the higher sales tax rate applies to 2013 through 2016.
- Proposition 39 requires multistate corporations to use the “single sales factor” method in calculating their taxable income.

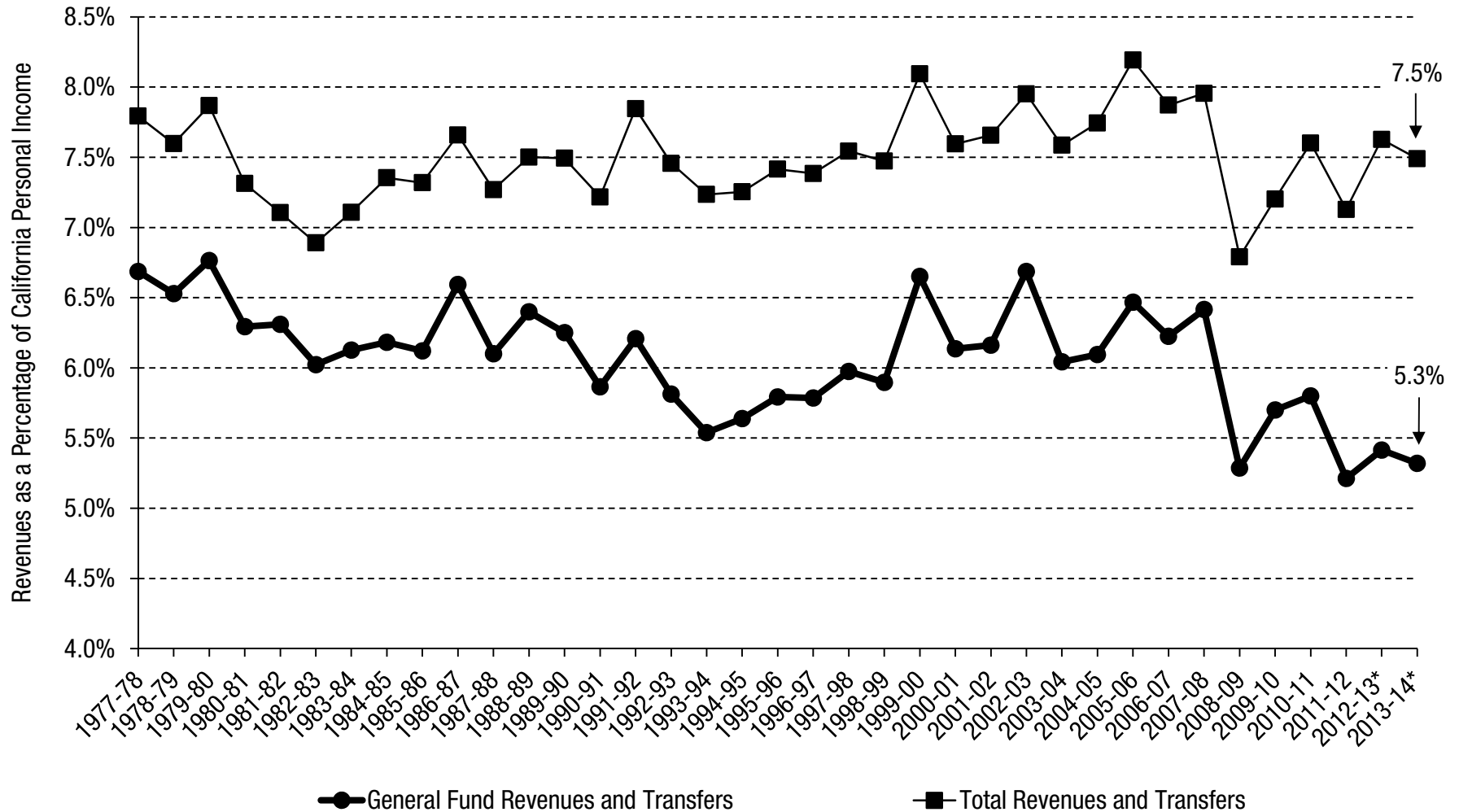
General Fund Tax Collections Would Be More Than \$7 Billion Lower in 2013-14 Had Voters Rejected Propositions 30 and 39



Note: Tax collections include revenues from major taxes and licenses and exclude minor revenues as well as transfers and loans.

Source: Department of Finance

Even With the New Dollars Raised by Propositions 30 and 39, Revenues as a Share of the State's Economy Are Projected to Be Lower Than in the Late 1970s

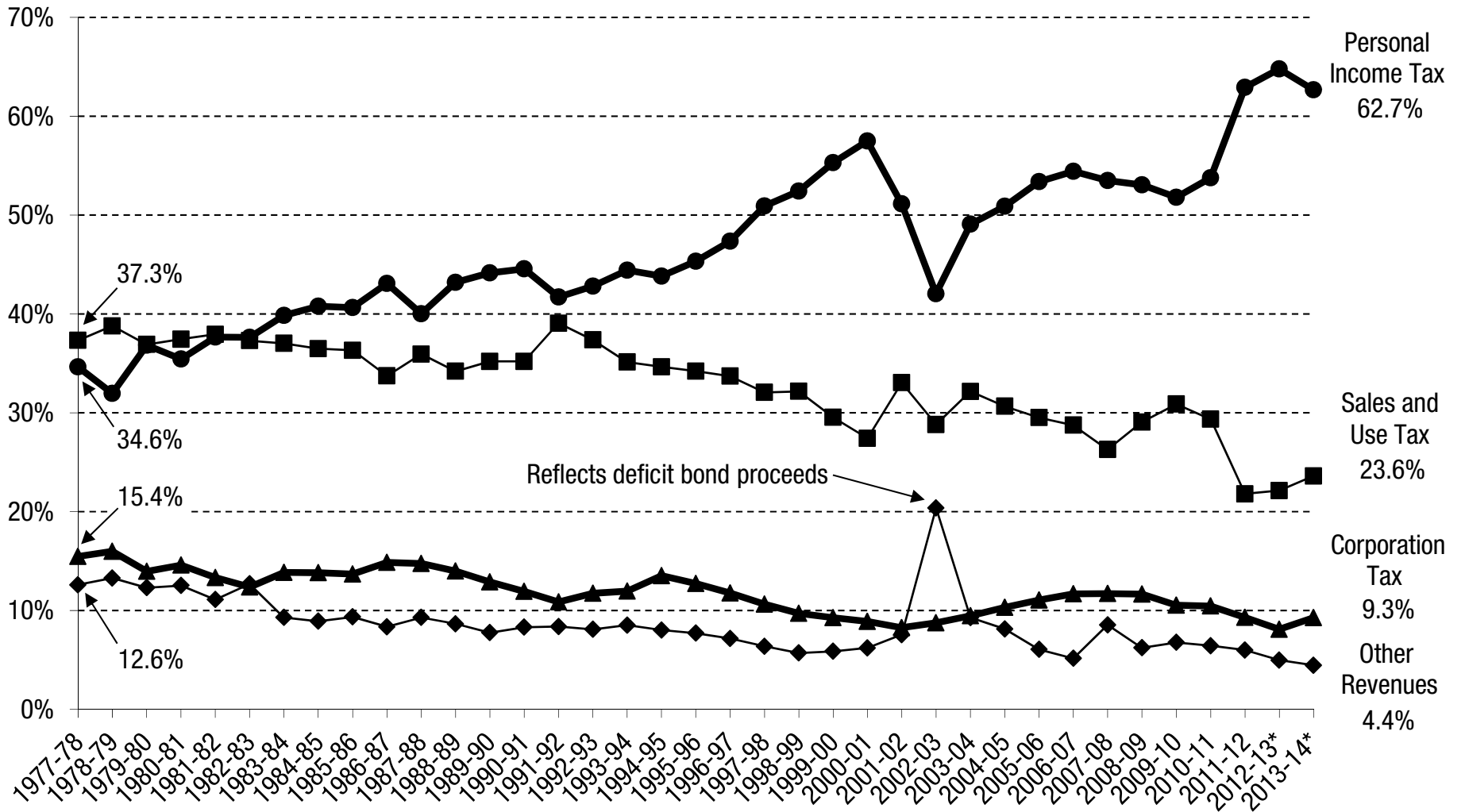


* 2012-13 estimated and 2013-14 projected.

Note: Total revenues include both General Fund and special fund dollars.

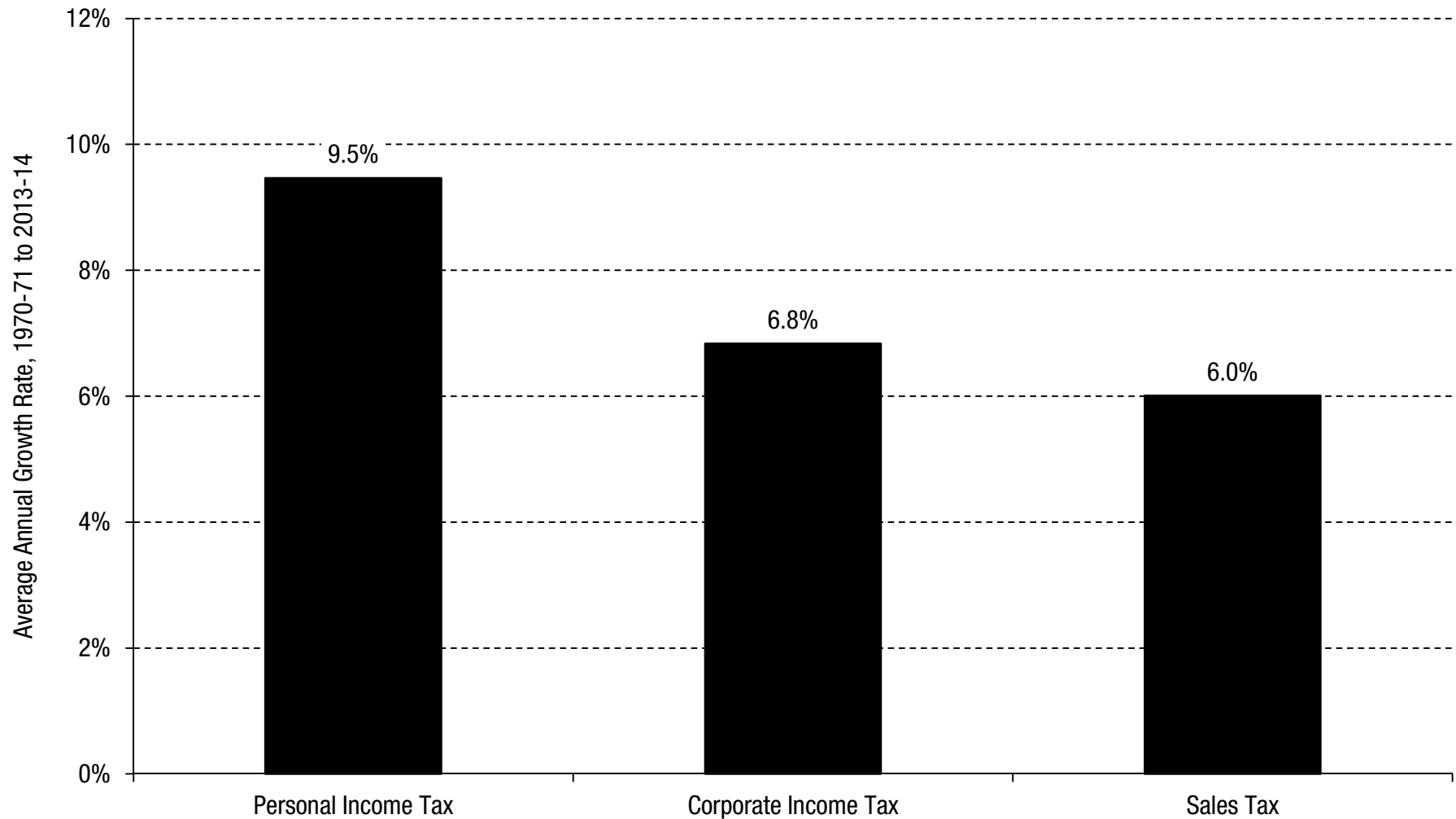
Source: CBP analysis of Department of Finance and US Bureau of Economic Analysis data

The Personal Income Tax Has Increased as a Share of General Fund Revenues Since the Late 1970s



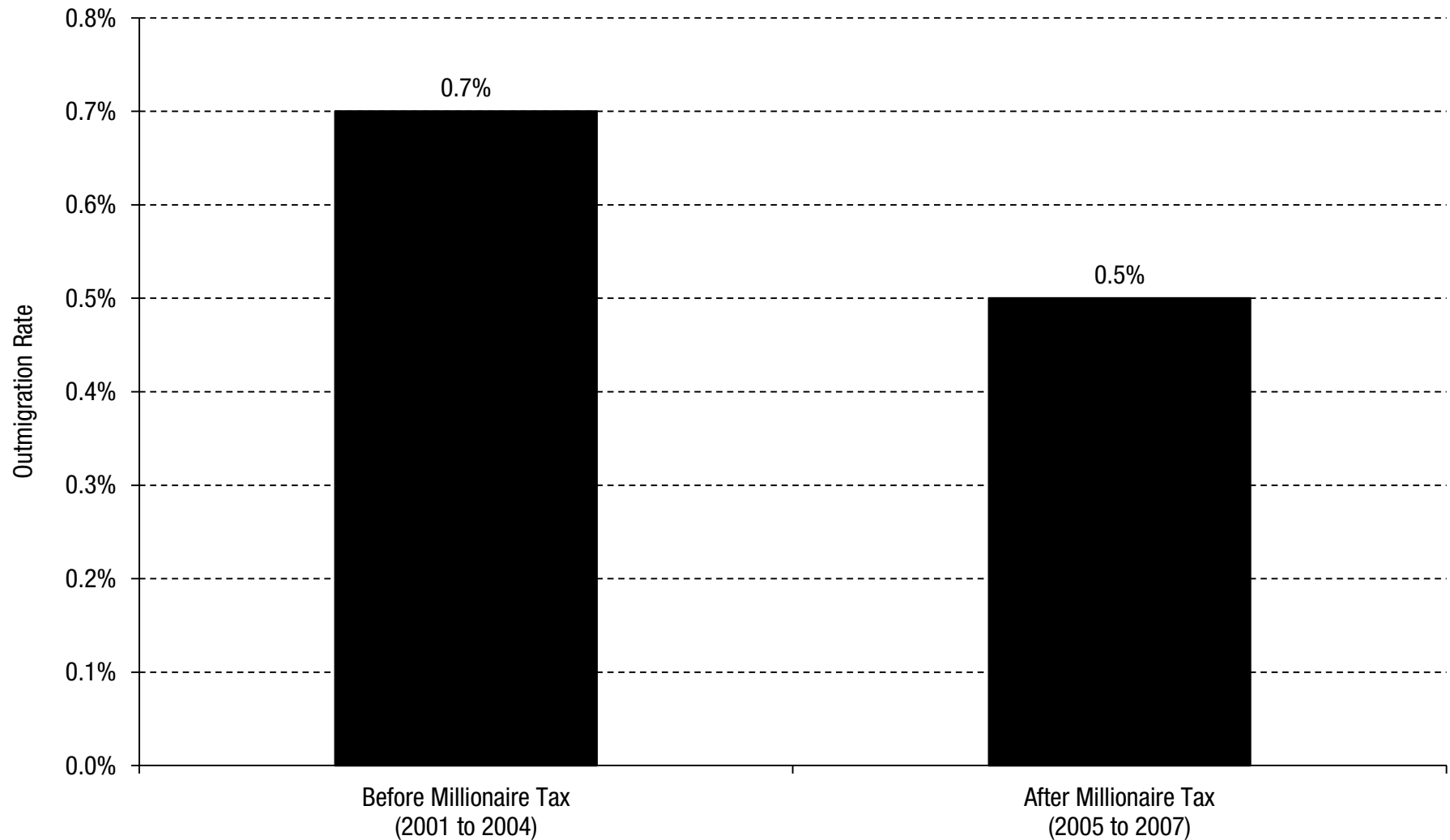
* 2012-13 estimated and 2013-14 proposed.
Source: Department of Finance and Legislative Analyst's Office

Of the Major Sources of State Revenues, the Personal Income Tax Posts the Highest Average Annual Growth Over Time



Note: 2012-13 estimated and 2013-14 projected.
Sales tax reflects sales tax revenues per 1 percent rate.
Source: Department of Finance and Legislative Analyst's Office

California's Millionaires Were Less Likely to Leave the State After Proposition 63's Tax Increase on Income Over \$1 Million



How Does California Compare? Revenues as a Percentage of Personal Income

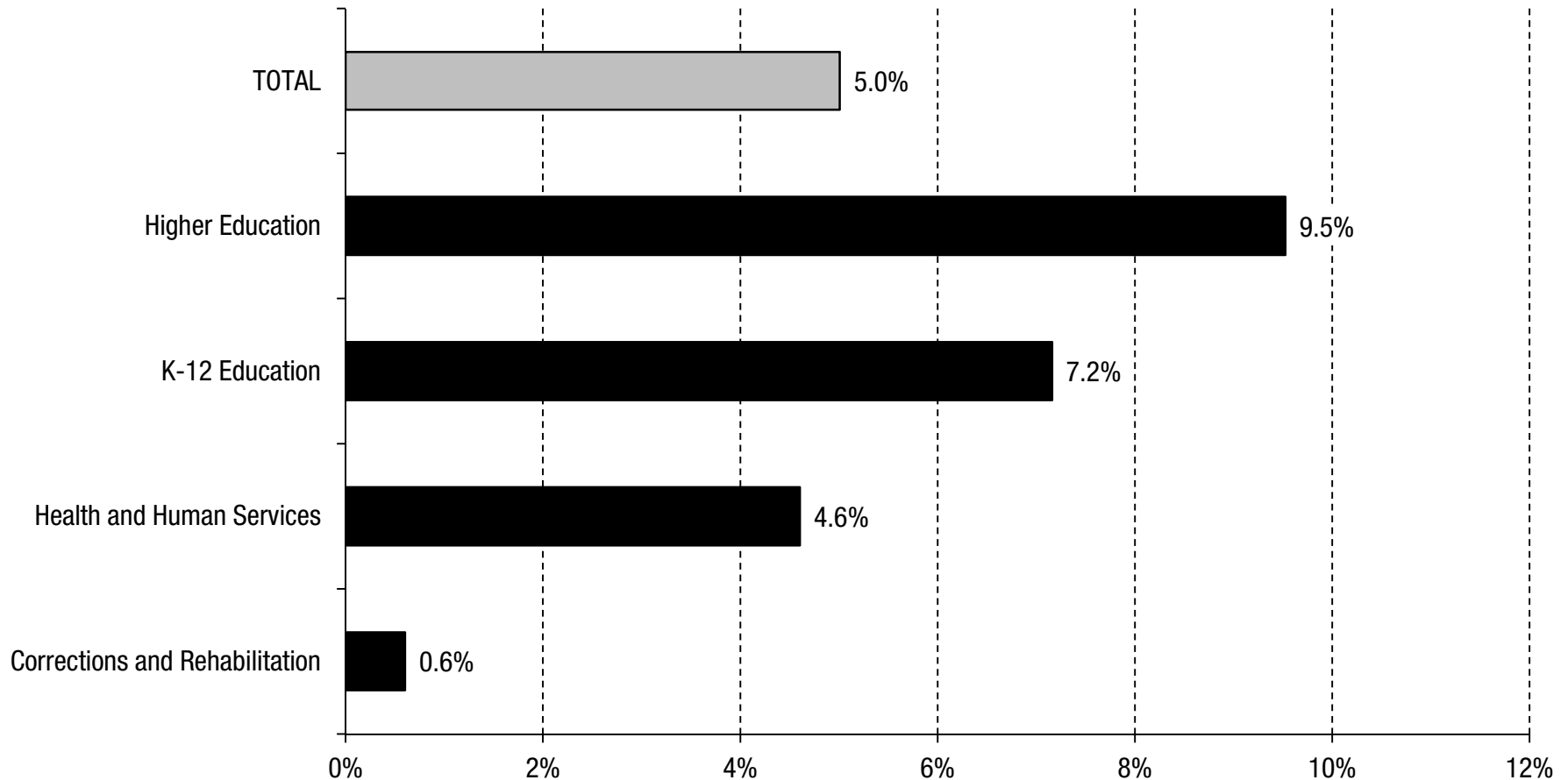
	California Rank	California	US
Total State and Local Own Source (2009-10)	15	16.51%	15.65%
Total State and Local Taxes (2009-10)	10	11.30%	10.57%
State Taxes (2010-11)	11	7.24%	6.00%
Local Taxes (2009-10)	23	4.44%	4.71%
State Individual Income Tax (2010-11)	6	3.13%	2.05%
State Corporate Income Tax (2010-11)	4	0.60%	0.32%
State and Local General Sales Taxes (2009-10)	19	2.61%	2.37%
State General Sales Tax (2010-11)	23	1.92%	1.86%
State and Local Property Tax (2009-10)	24	3.53%	3.68%
State Motor Fuels Taxes (2010-11)	22	0.35%	0.32%
State Tobacco Tax (2010-11)	46	0.06%	0.14%
State Alcoholic Beverage Sales Taxes (2010-11)	42	0.02%	0.05%

Note: US excludes the District of Columbia.
Source: US Bureau of Economic Analysis and US Census Bureau

Spending Realities

- While the Governor's proposal includes increased spending on K-12 schools and higher education, proposed state spending would remain below the 2007-08 level, after adjusting for inflation.
- California will end 2012-13 with an estimated \$27.8 billion in budgetary debt, including deferred payments to K-12 schools, unpaid costs to local governments, and loans from state special funds. The Governor proposes to pay down \$4.2 billion of this debt in 2013-14 and to repay a total of \$23.5 billion by the end of 2016-17.
 - While it is critical to address this debt in a timely manner, there may be opportunities for policymakers to adopt a more gradual repayment schedule, thereby freeing up funds that could be used to support other key budget priorities.

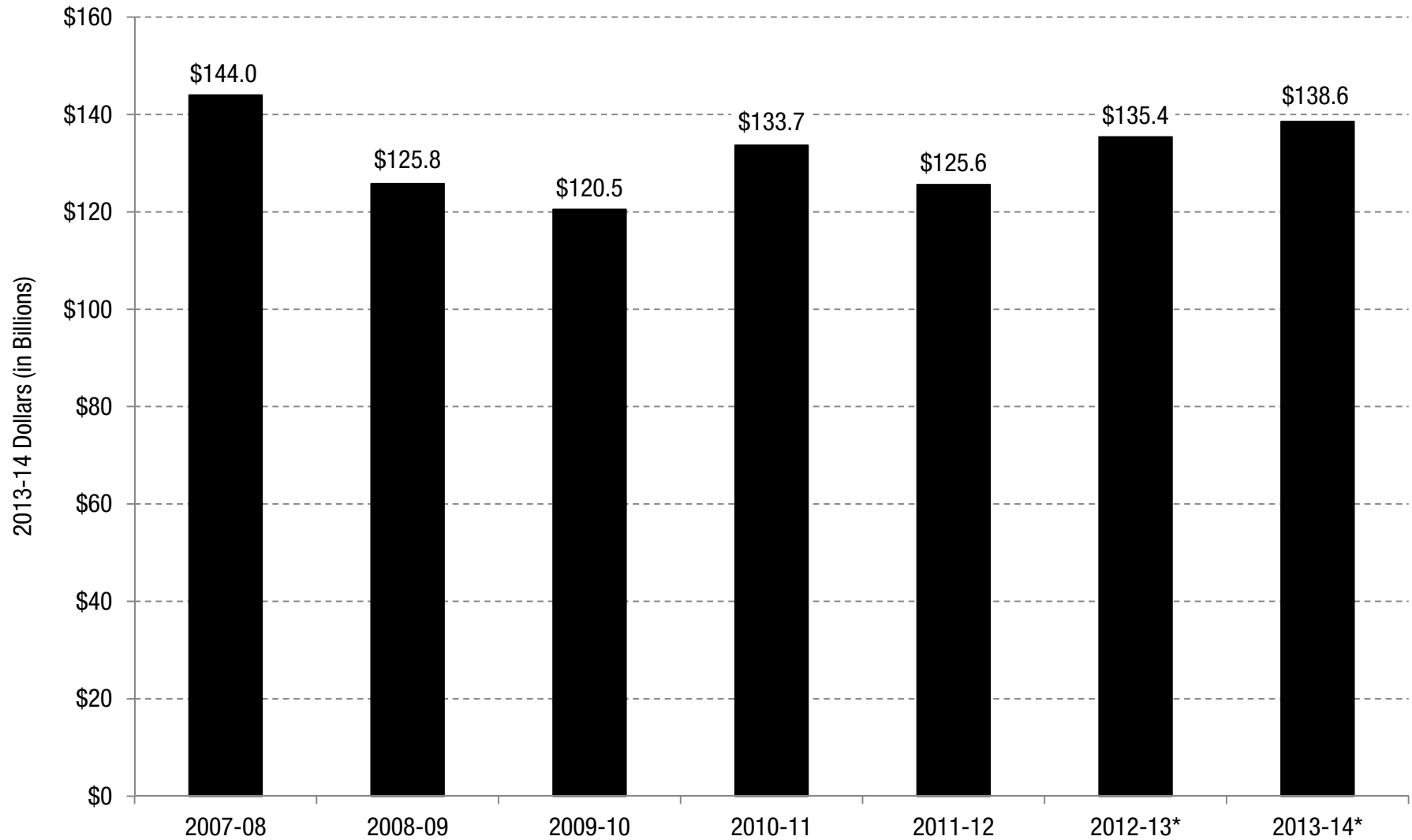
After Being Severely Cut in Recent Years, Education Spending Would Increase Under the Governor's Proposed 2013-14 Budget



Percent Change in General Fund Spending, 2012-13 Estimated to 2013-14 Proposed

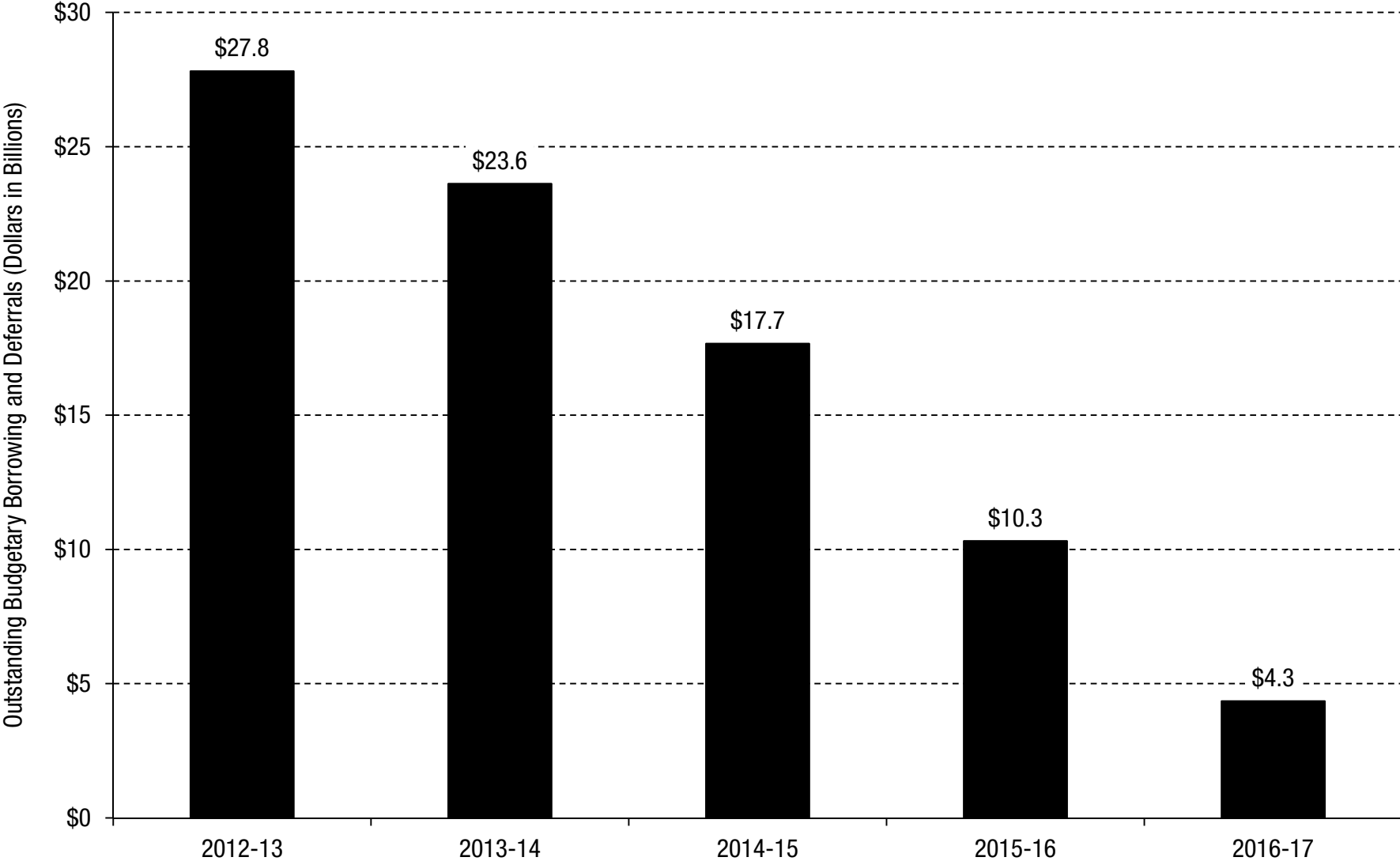
Note: The total change in General Fund spending indicated above reflects all state expenditures, including for agencies not displayed. Excluded agencies account for less than 9 percent of General Fund spending.
Source: Department of Finance

Proposed State Spending Would Be Nearly 4 Percent Below the 2007-08 Level, After Adjusting for Inflation



* 2012-13 estimated and 2013-14 proposed.
Note: Reflects General Fund and special fund expenditures.
Source: Department of Finance

The Governor's Proposal Prioritizes Paying Down the State's Budgetary Debt



Note: Data reflect debt remaining as of the end of each fiscal year.
Source: Department of Finance

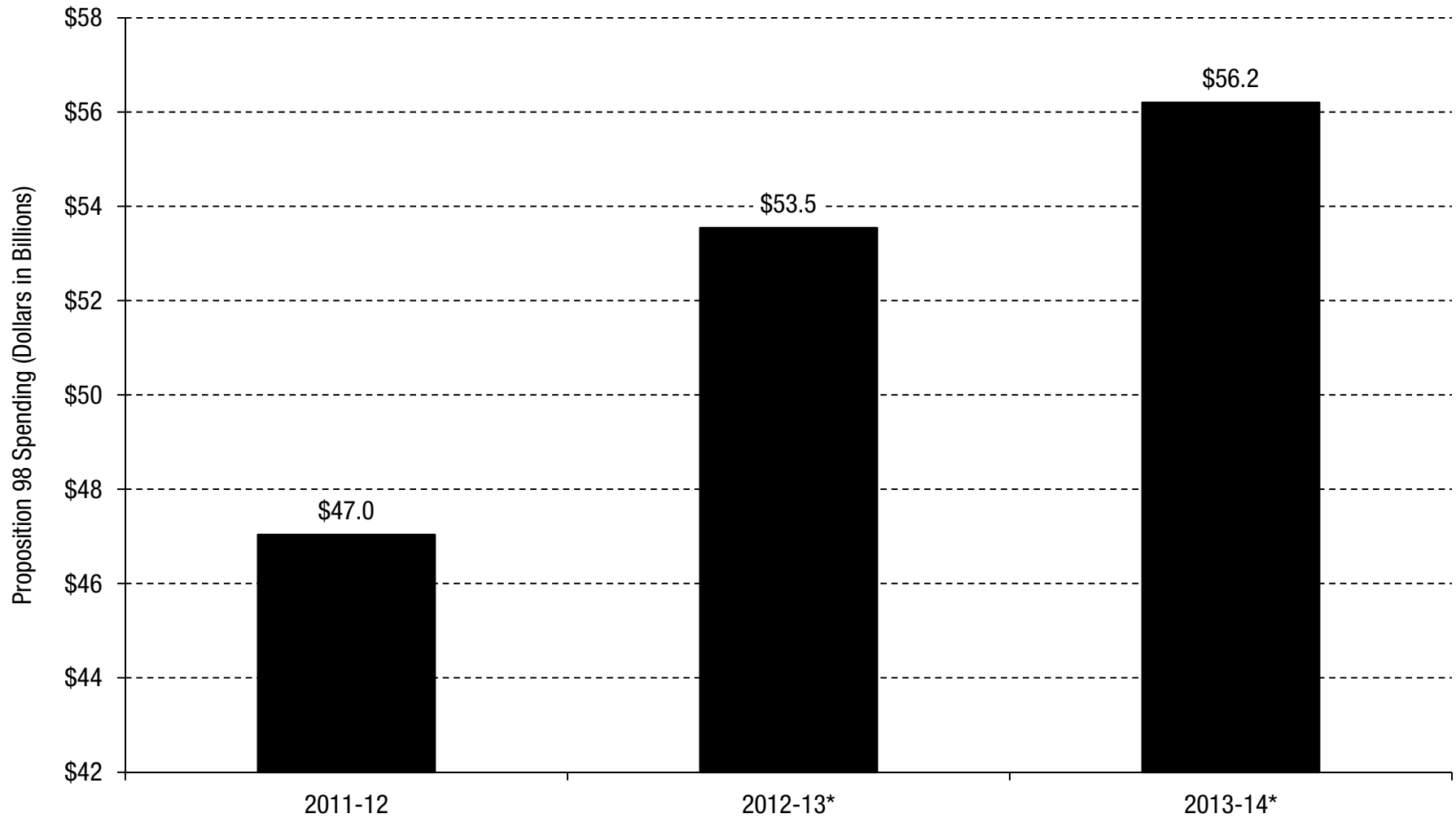


Key Areas of the Budget

Voter Approval of Propositions 30 and 39 Boosts State Spending for Schools

- The Governor estimates that Propositions 30 and 39 will increase state General Fund revenues by nearly \$6 billion in 2012-13 and by \$7.2 billion in 2013-14.
- Because increases in General Fund revenues tend to boost the state's Proposition 98 minimum funding guarantee for schools and community colleges, Proposition 98 spending would increase by nearly one-fifth (\$9.2 billion) between 2011-12 and 2013-14 under the Governor's proposal.

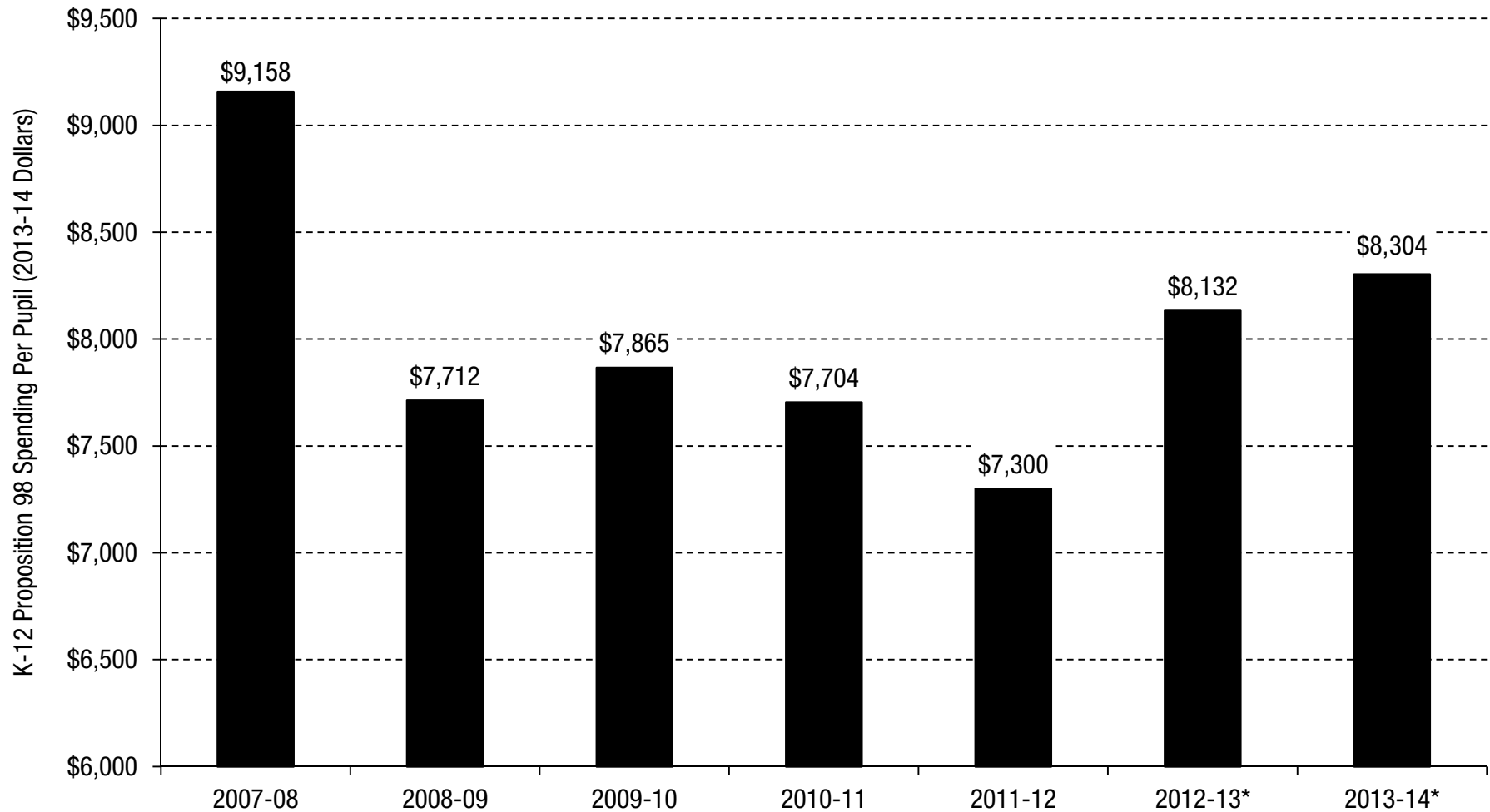
Proposition 98 Spending Would Increase by Nearly One-Fifth Between 2011-12 and 2013-14 Under the Governor's Proposal Due to Voter Approval of Propositions 30 and 39



Spending Per Student Rises Due to New Revenues, But Still Faces a Long Climb Back

- While K-12 Proposition 98 spending under the Governor's proposal would increase by \$1,000 per student between 2011-12 and 2013-14, it would remain more than \$850 below the 2007-08 level, after adjusting for inflation.
- The drop in General Fund revenues compared with six years ago helps explain why K-12 Proposition 98 spending per student in 2013-14 would remain so far below 2007-08.

Spending Per Student Would Increase in 2013-14 Under the Governor's Proposal, But Remain Significantly Lower Than the 2007-08 Spending Level, After Adjusting for Inflation



* 2012-13 estimated and 2013-14 proposed.
 Note: Excludes child care and includes preschool spending. Proposition 98 spending reflects both state General Fund and local property tax dollars.
 Source: Legislative Analyst's Office

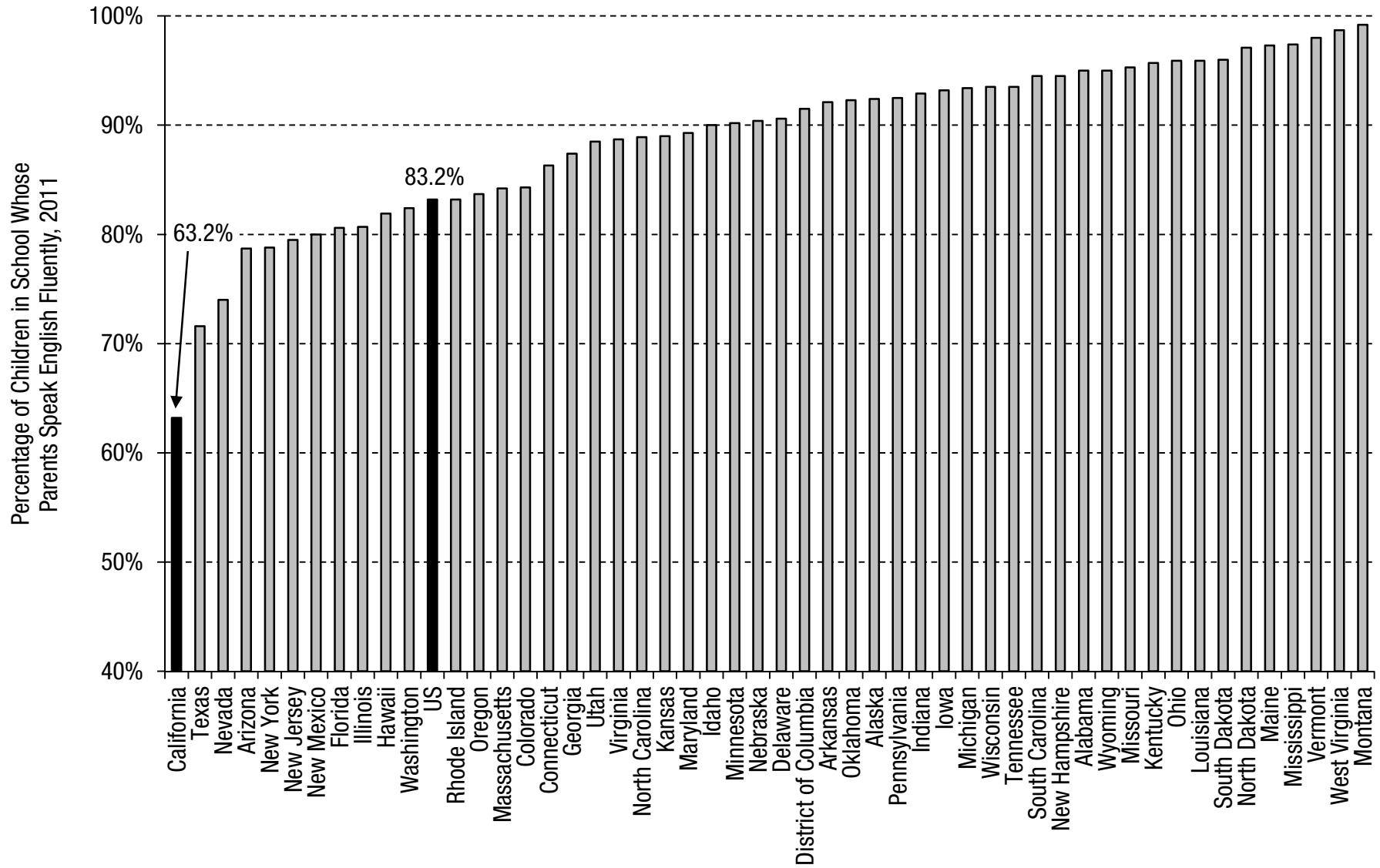
The Governor Proposes a School Funding Formula Based on the Cost of Educating Students

- The Governor proposes to eliminate nearly all programs earmarked for specific purposes (so-called “categorical” programs), consolidate funding with state general purpose revenues, and create a new “Local Control Funding Formula.”
- The new funding formula would provide school districts with a base grant per student, depending on a student’s grade level, and with supplemental and concentration grants based on each district’s proportion of English learners and economically disadvantaged students.
- The Governor proposes to implement the new funding formula during a seven-year period.

California's Schools Educate a Large and Diverse Student Population

- California's K-12 public schools enroll 6.2 million students in more than 1,000 school districts.
- A large share of California's students come from low-income families or have parents who do not speak English fluently.
- Research shows that to achieve the state's academic standards, English learners and economically disadvantaged students require additional resources.

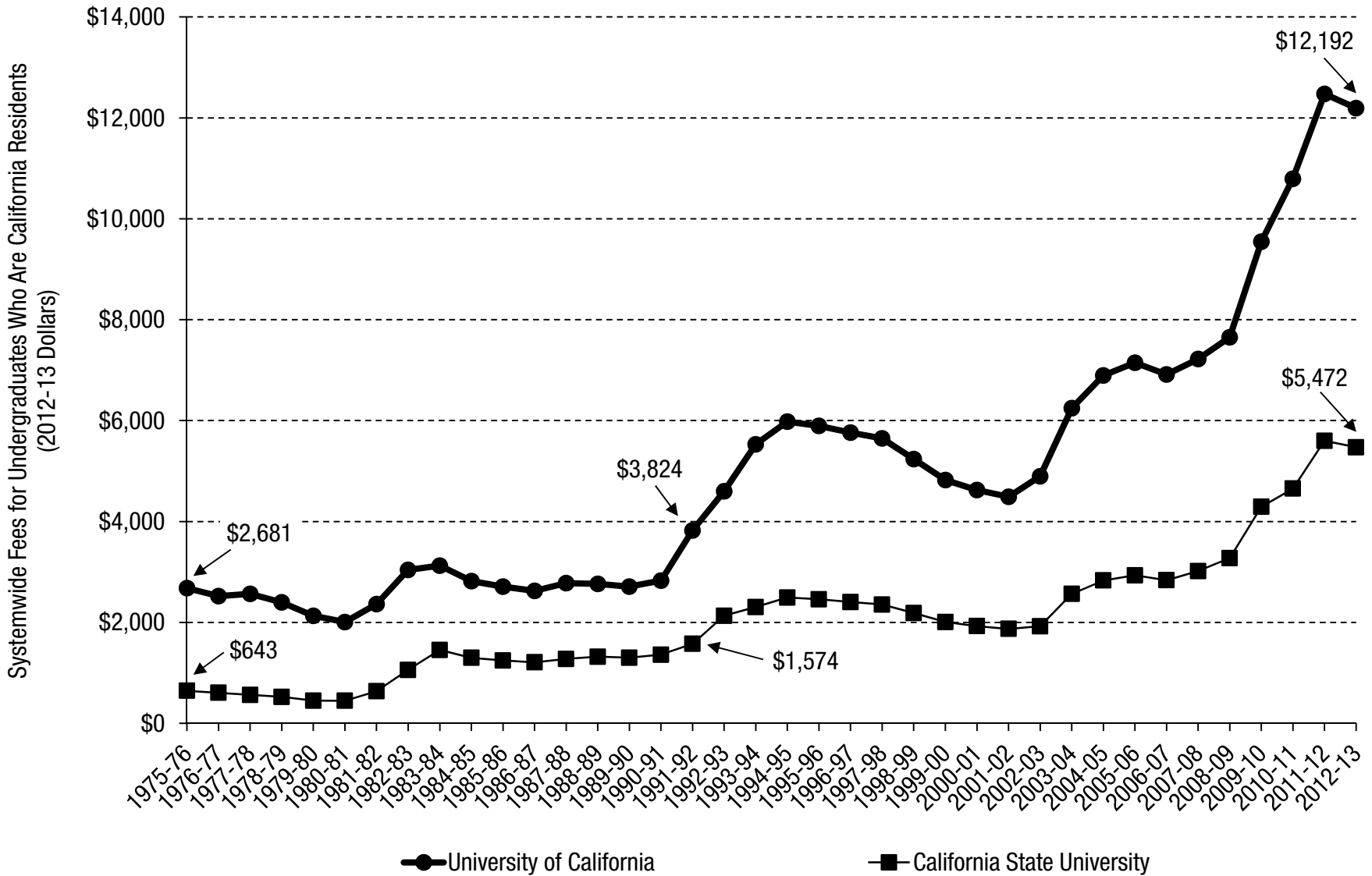
California Has the Lowest Share of Children in School With English-Speaking Parents



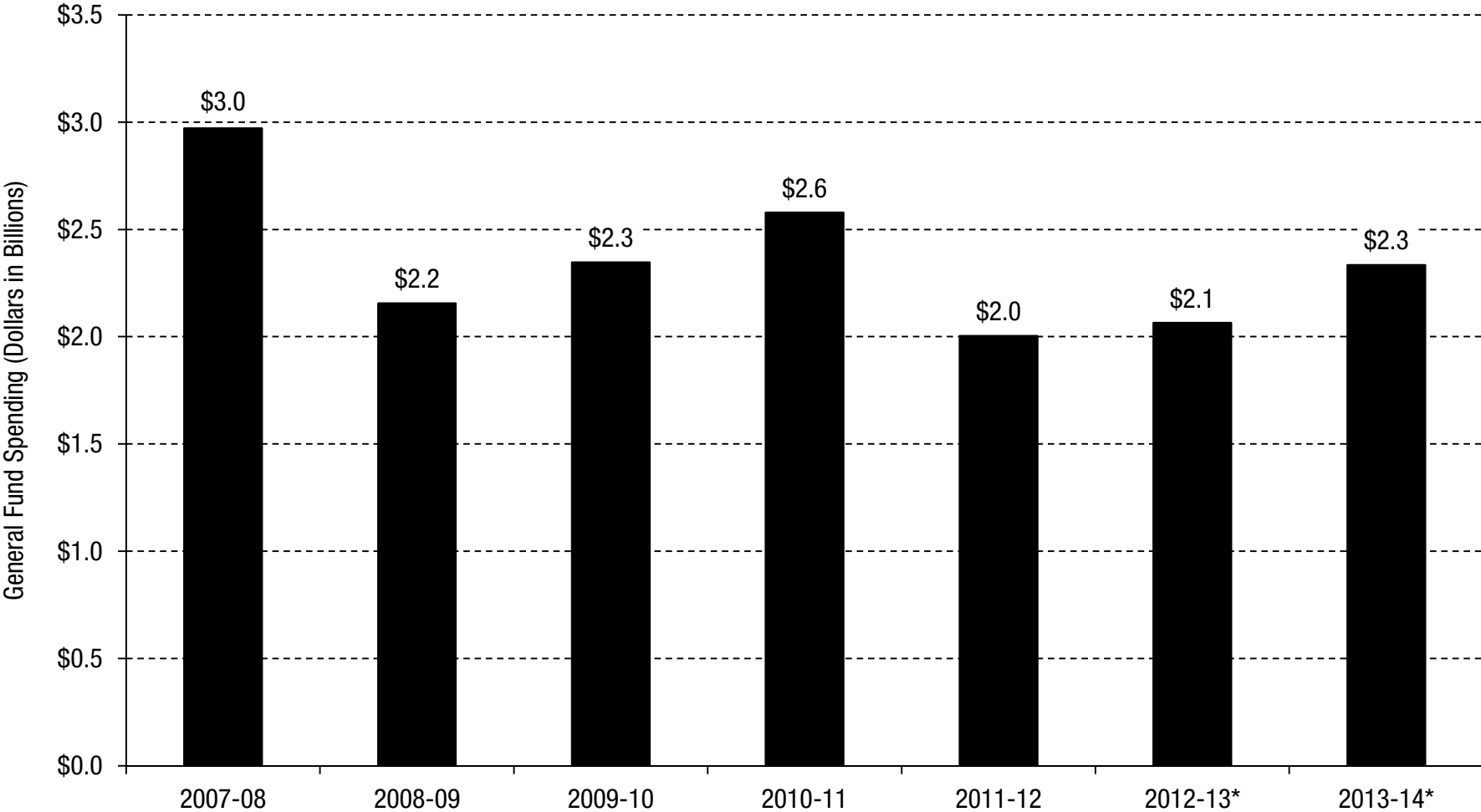
The Governor Proposes Increased Spending for Higher Education

- The Governor's proposed budget outlines a multiyear funding plan for higher education with the expectation that colleges and universities would not increase tuition and fees through 2016-17.
- While General Fund spending would increase by more than \$250 million each for the University of California and the California State University in 2013-14, state support would remain significantly below 2007-08 under the Governor's proposal.

UC and CSU Fees Have More Than Tripled Since 1991-1992, After Adjusting for Inflation



General Fund Support for the California State University Would Increase in 2013-14 Under the Governor's Proposal, But Remain More Than 20 Percent Below 2007-08



* 2012-13 estimated and 2013-14 proposed.
 Note: Excludes 2013-14 general obligation bond debt service payments included in the Governor's proposed budget.
 Source: Department of Finance

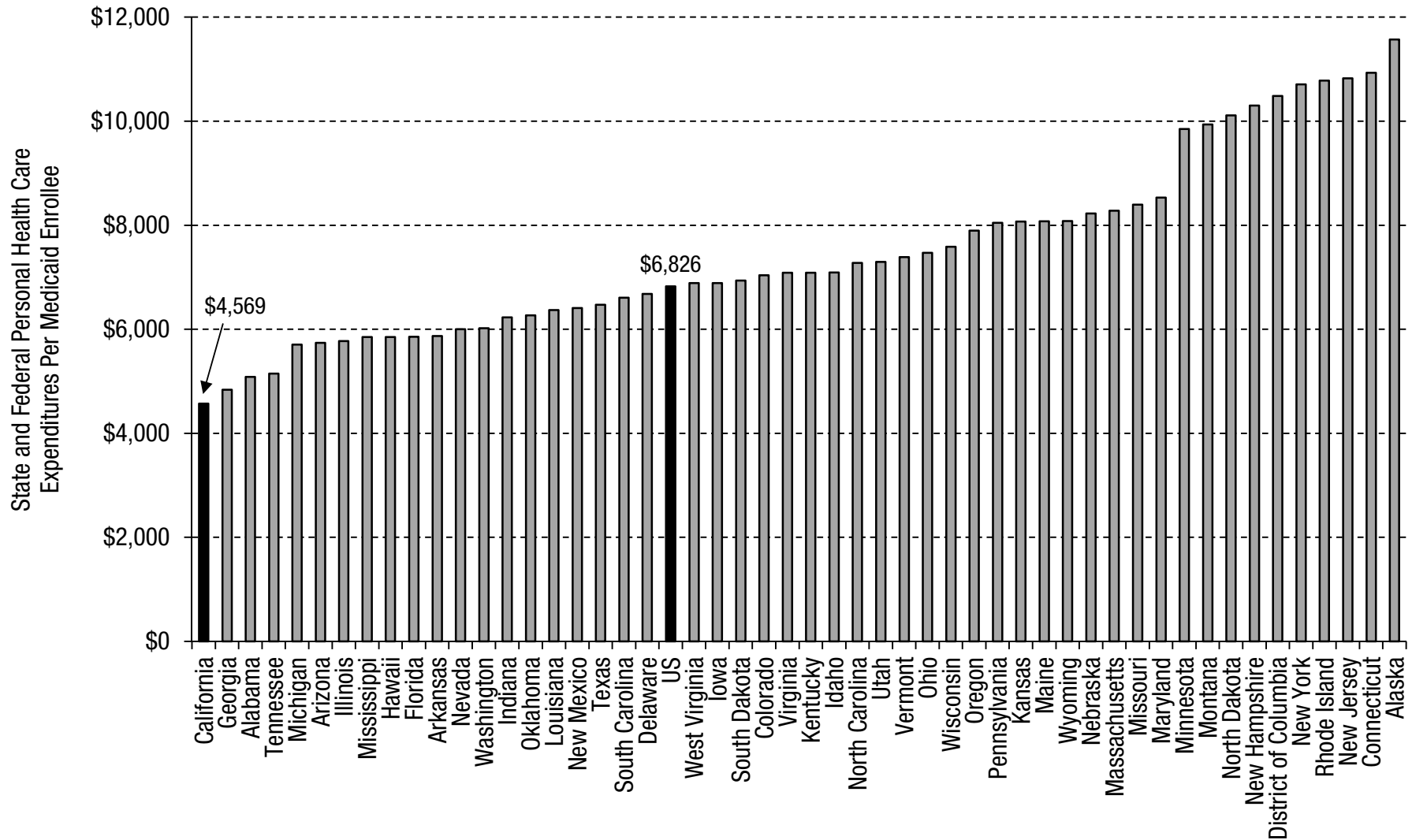
The Governor Proposes Increased Spending for Higher Education (continued)

- Voter approval of Propositions 30 and 39, with the resulting increase in the Proposition 98 minimum funding guarantee, boosts General Fund spending for community colleges by \$680 million in 2013-14 under the Governor's proposal.
- However, \$300 million of this increase would be allocated for a new adult education block grant that would centralize funding and administration within the community college system.
- The Governor's proposal would restrict the adult education block grant to core instructional areas such as vocational education, English as a Second Language, and elementary and secondary education.

Medi-Cal Spending Would Increase Modestly in 2013-14 Under the Governor's Proposal

- The Governor proposes \$15.6 billion in General Fund spending for the Medi-Cal Program in 2013-14 – an increase of 3.9 percent from 2012-13. In particular, the Governor's proposal:
 - Calls for renewing a fee and a tax that help support Medi-Cal.
 - Reflects the transfer to Medi-Cal of more than 870,000 children enrolled in Healthy Families, as required by 2012 legislation.
 - Assumes a federal court will allow the state to implement a 10 percent cut to Medi-Cal provider payments that was enacted in 2011. California's spending per Medicaid enrollee is the lowest in the US, in part due to already low provider payments.

California's Spending Per Medicaid Enrollee Was the Lowest in the Nation in 2009



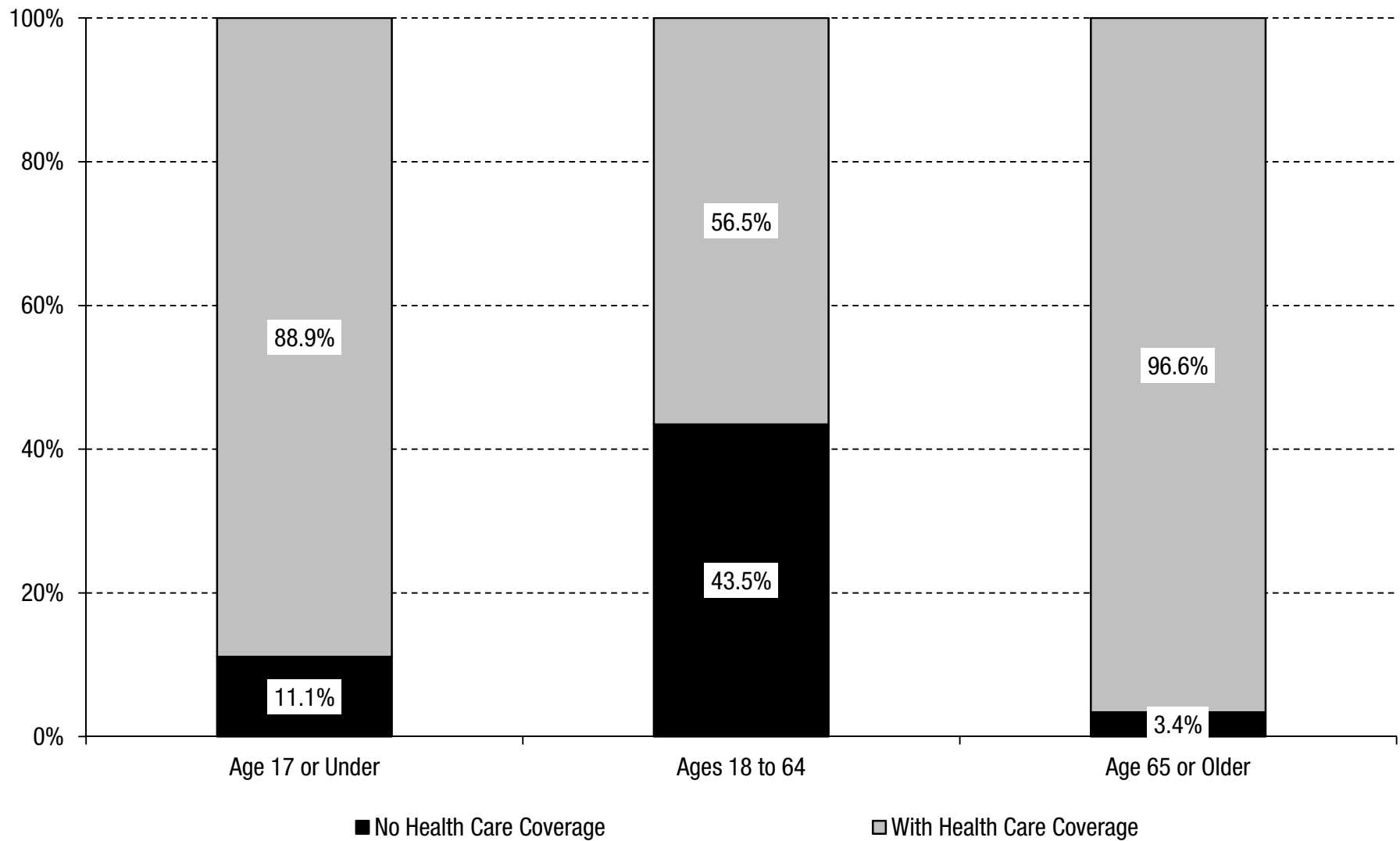
Note: Personal health care spending reflects the total amount spent to treat individuals with specific medical conditions.
Source: US Centers for Medicare & Medicaid Services

The Governor Proposes to Expand Medi-Cal in 2014

- Under the federal health care reform law, California may expand Medi-Cal in 2014 to previously ineligible adults with incomes up to 138 percent of the poverty line. More than 40 percent of Californians ages 18 to 64 with incomes below this level lack health coverage.
- The federal government will pay the entire cost of the expansion for the first three years, later phasing down to no less than 90 percent.
- The Governor proposes two options to expand Medi-Cal: directly enrolling newly eligible Californians in Medi-Cal (the “state-based approach”) or building on counties’ current health care systems.
- The Governor suggests that expanding Medi-Cal would substantially reduce counties’ costs for indigent health care. He proposes that the state “capture county savings” by shifting fiscal responsibility for one or more human services programs to the counties.

More Than Four Out of 10 Low-Income Californians Ages 18 to 64 Lack Health Care Coverage

Californians With Incomes Below 138 Percent of the Federal Poverty Line, 2011



The Governor Proposes to Renew a Fee and a Tax That Help Support Medi-Cal

- The Governor proposes to:
 - Extend the current fee on hospitals for three years, through December 31, 2016. Revenues would be matched with federal dollars in order to increase payments to hospitals. Revenues also would offset General Fund spending on Medi-Cal, for state savings of \$310 million in 2013-14.
 - Permanently reinstate a gross premiums tax on managed care plans, which expired July 1, 2012. Revenues would be matched with federal dollars in order to increase Medi-Cal managed care payments. Revenues also would offset General Fund spending on the Healthy Families and Medi-Cal programs.

The Governor's Proposal Assumes a Reduction in Authorized Hours for IHSS Participants

- In-Home Supportive Services (IHSS) helps more than 400,000 low-income seniors and people with disabilities live safely in their own homes, preventing the need for more costly out-of-home care.
- The Governor proposes to increase General Fund spending for IHSS by 6.5 percent over the 2012-13 level.
- However, the Governor also assumes the state will move ahead with a 20 percent across-the-board reduction in recipient hours.
- This reduction was originally scheduled to take effect in January 2012, but has been challenged in court. The Governor assumes the court's stay will be lifted and reductions will proceed this November, with exceptions for severely impaired IHSS participants.

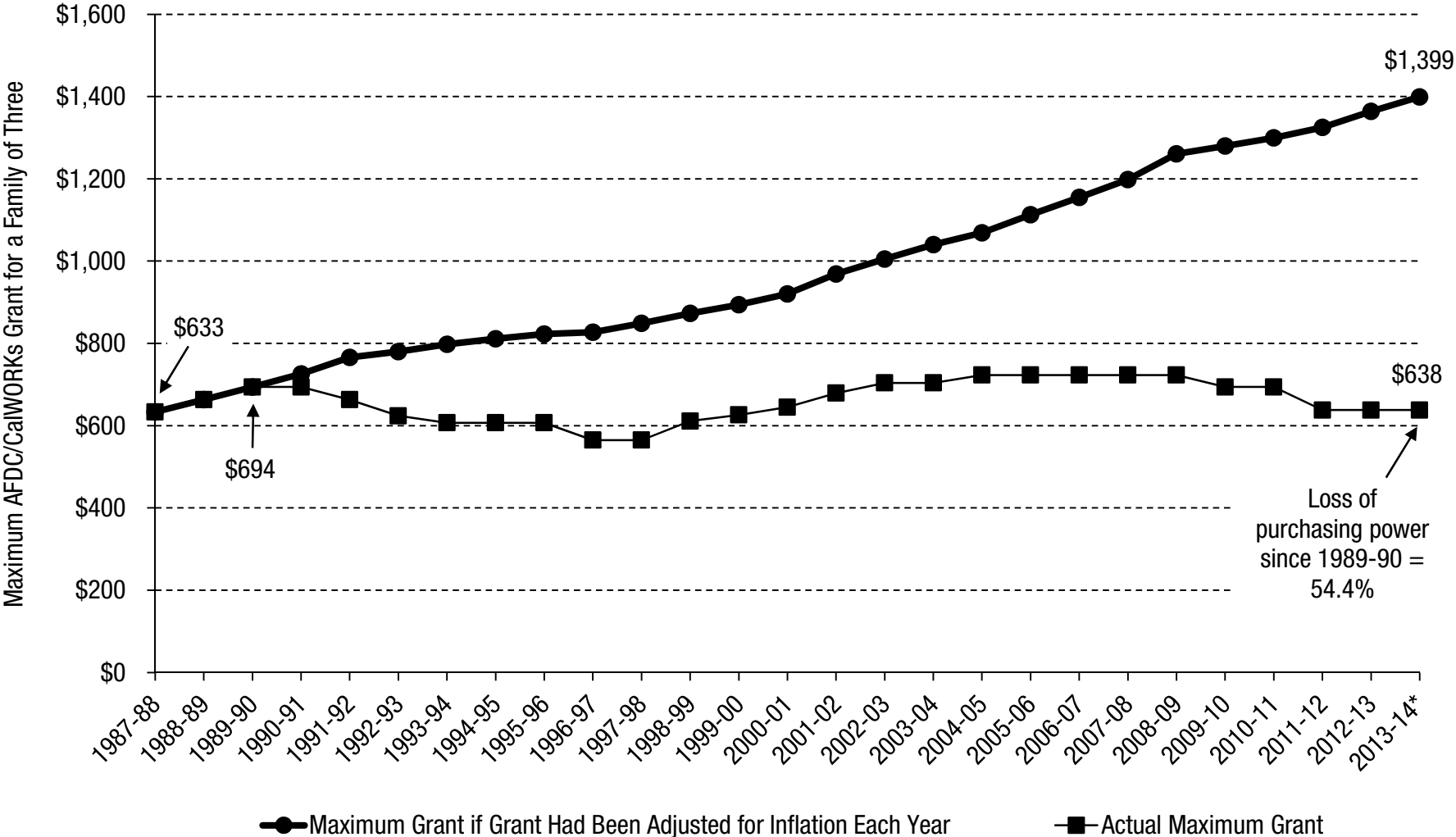
CalWORKs Is a Key Resource for Low-Income Families

- During the Great Recession and its aftermath, poverty increased dramatically. One in six Californians – and nearly one in four California children – are living in poverty.
- Californians continue to face a difficult job market, with long-term unemployment still near a record high. More than one-third of California's unemployed report that they have been searching for a job for at least a year.
- CalWORKs provides modest cash assistance while helping parents overcome barriers to employment and find jobs.
- Nearly four out of five Californians who receive CalWORKs cash assistance are children.

After Years of Cuts, the Governor's Proposed Budget Generally Maintains CalWORKs Funding

- In recent years, state policymakers have repeatedly made deep cuts to CalWORKs in order to help close budget gaps.
- Since 2008, the maximum CalWORKs grant has been reduced by 12 percent, or \$85 per month for a family of three.
- The purchasing power of the CalWORKs grant is less than half what it was nearly 25 years ago. Families lose cash assistance well before their incomes reach the federal poverty line.
- The Governor's proposed 2013-14 budget maintains the cuts and program changes adopted in prior years. Grants would remain at the 2012-13 level.

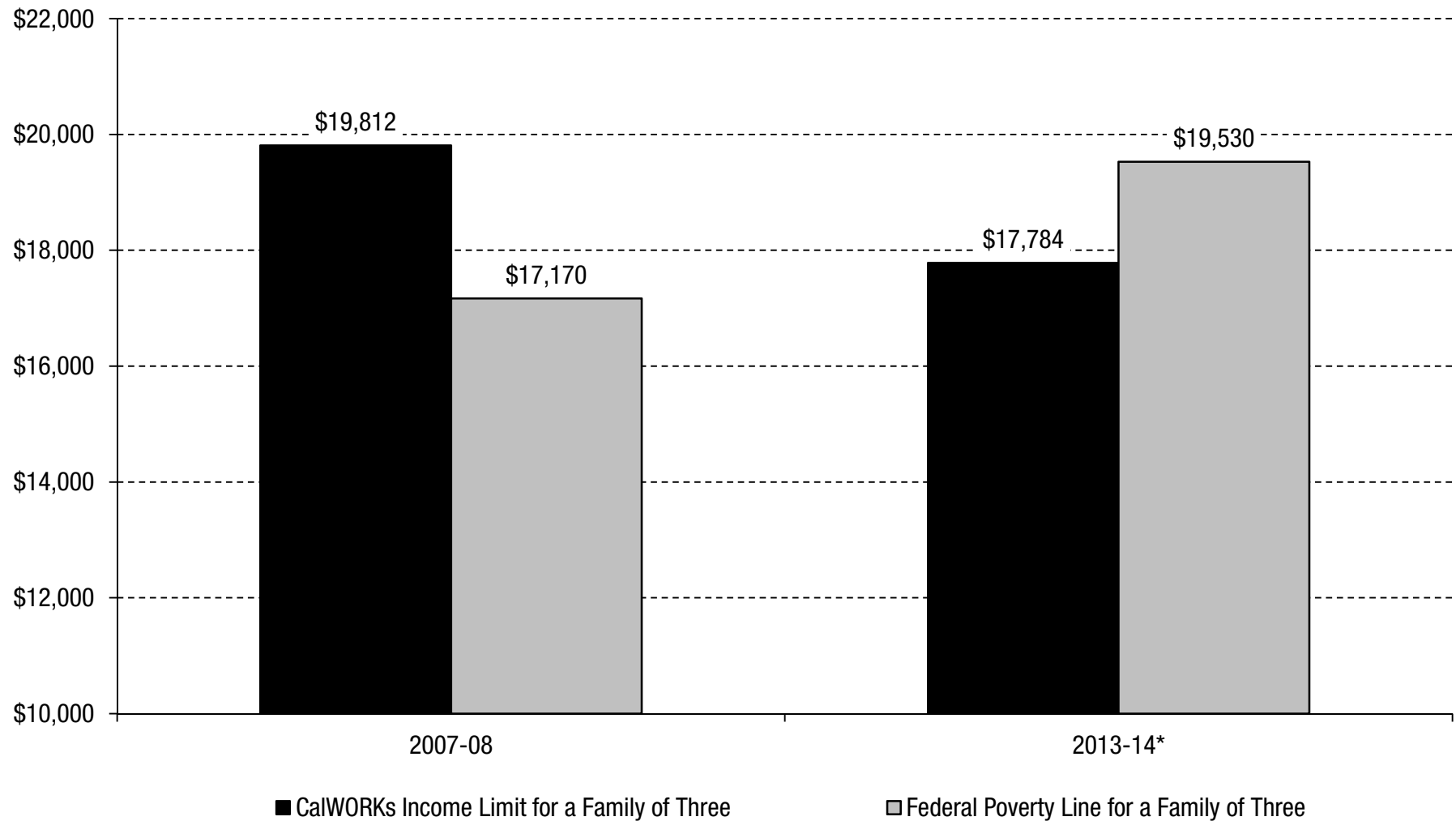
Purchasing Power of CalWORKs Grants Has Dropped by More Than Half Since 1989-90



* Maximum grant as of the Governor's proposed budget.
 Note: Maximum grants are for high-cost counties beginning in 1996-97.
 Previously, maximum grant levels did not vary by county.
 Source: CBP analysis of Department of Finance and Department of Social Services data

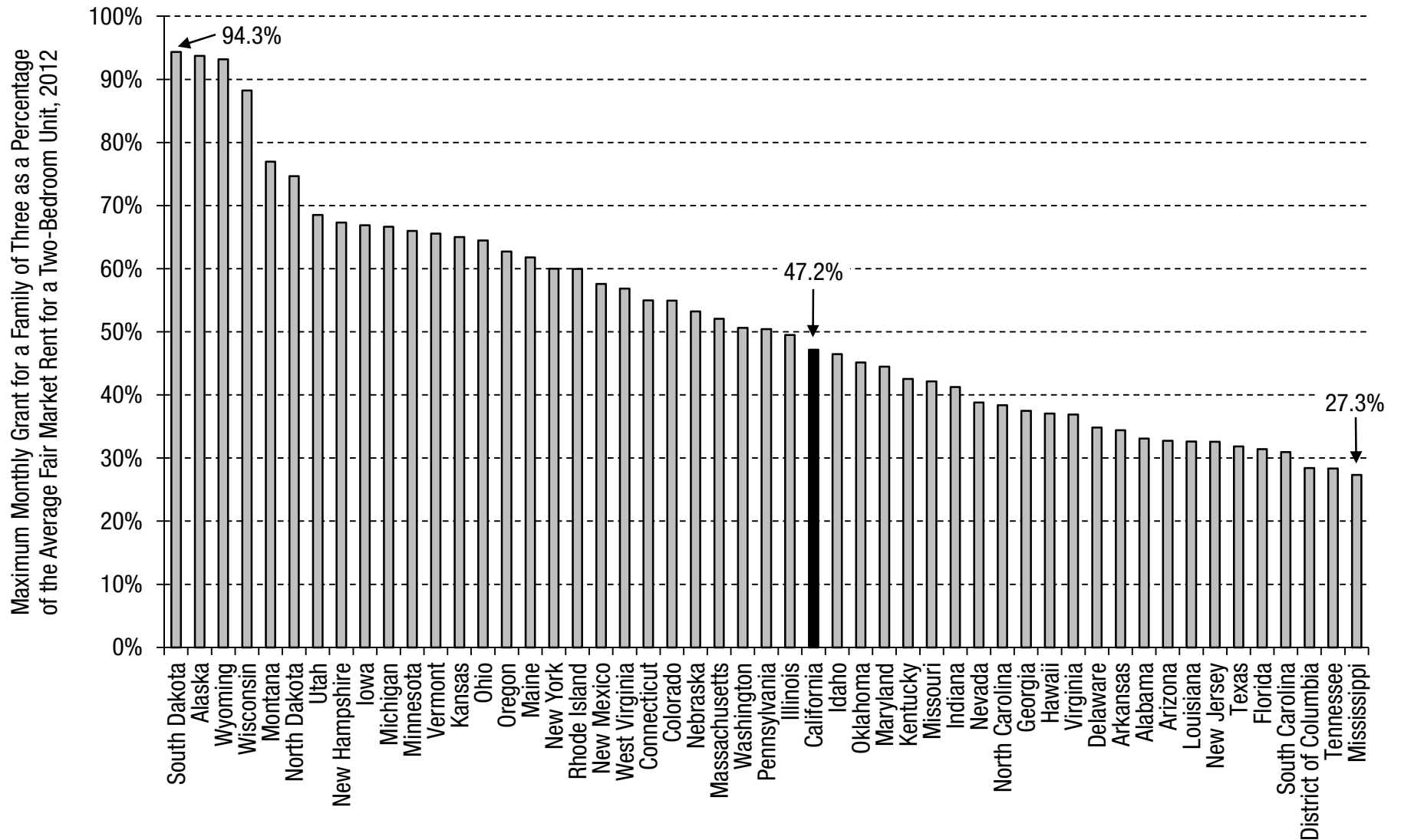
Families Lose CalWORKs Cash Assistance Well Before Their Incomes Reach the Poverty Line

Under the Governor's Proposal, the CalWORKs Income Limit Would Remain Below the Poverty Line for the Third Year in a Row



* Income limit based on the maximum CalWORKs grant in the Governor's proposed budget.
 Note: CalWORKs income limits are for high-cost counties.
 Source: Department of Social Services and US Department of Health and Human Services

The CalWORKs Grant Is Smaller Than TANF Grants in 27 States, When Compared to Housing Costs



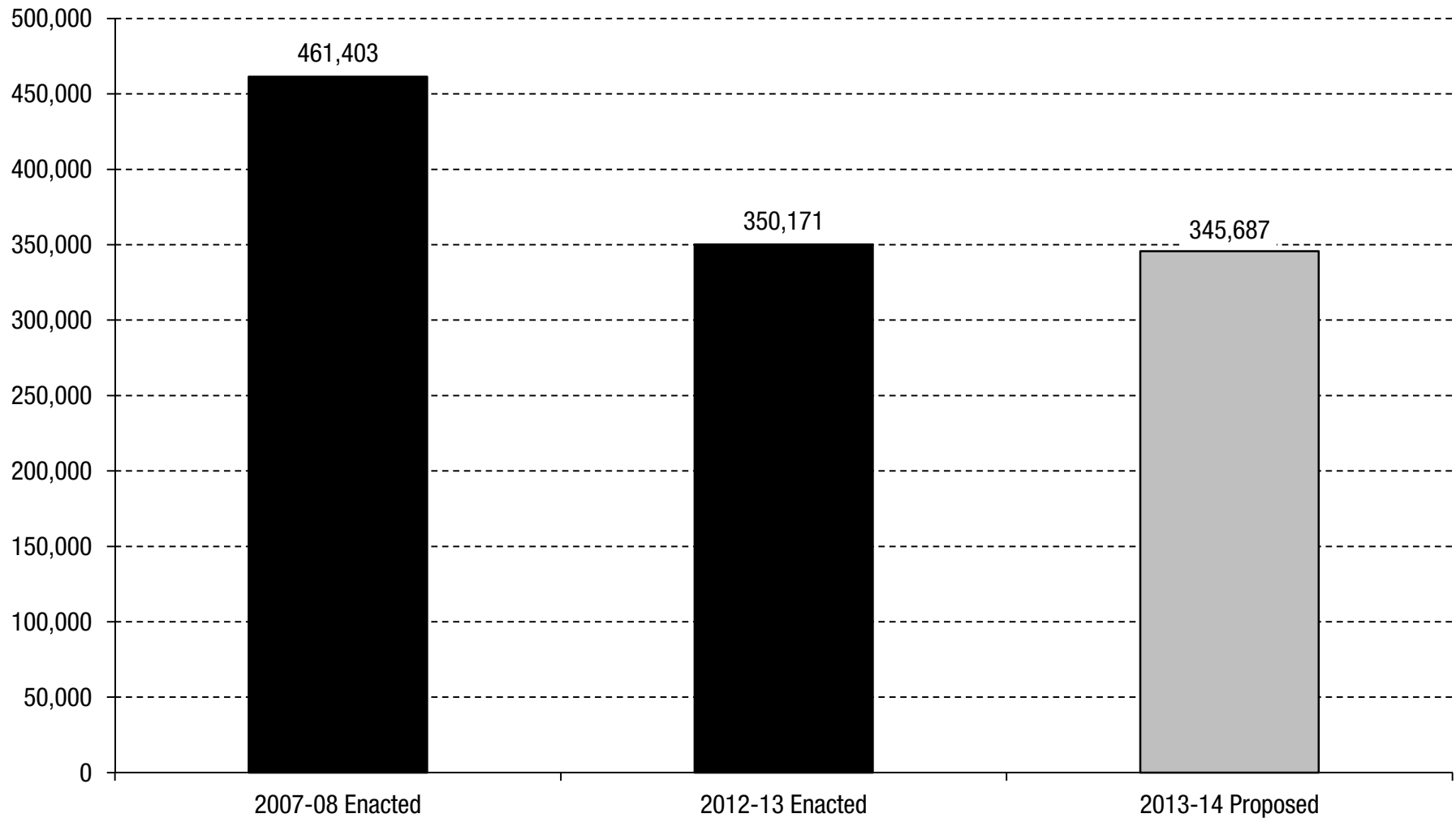
A Major CalWORKs Cutback Made Last Year Has Only Recently Taken Effect

- While the Governor's proposal does include a small funding increase for CalWORKs welfare-to-work services, county agencies would need to use the additional funds to implement a major programmatic change made to CalWORKs in the last round of budget cuts.
- This change – a reduction of the CalWORKs time limit for adults to 24 months – took effect January 1, 2013.
- Participants now face a challenging job market with very little time to access resources for securing long-term employment.

Child Care and Preschool Spending Would Drop Slightly in 2013-14 Under the Governor's Proposal

- The Governor proposes to spend \$2.1 billion (General Fund and federal dollars) for child care and state preschool in 2013-14 – a slight decrease (0.8 percent) from 2012-13. These dollars would support about 345,700 child care and preschool “slots,” down from about 350,200 slots in 2012-13.
- This reduction in 2013-14 would follow years of deep cuts to child care and preschool programs. Since 2007-08, state policymakers have reduced annual funding for these programs by more than \$900 million, resulting in the elimination of more than 110,000 child care and preschool slots.

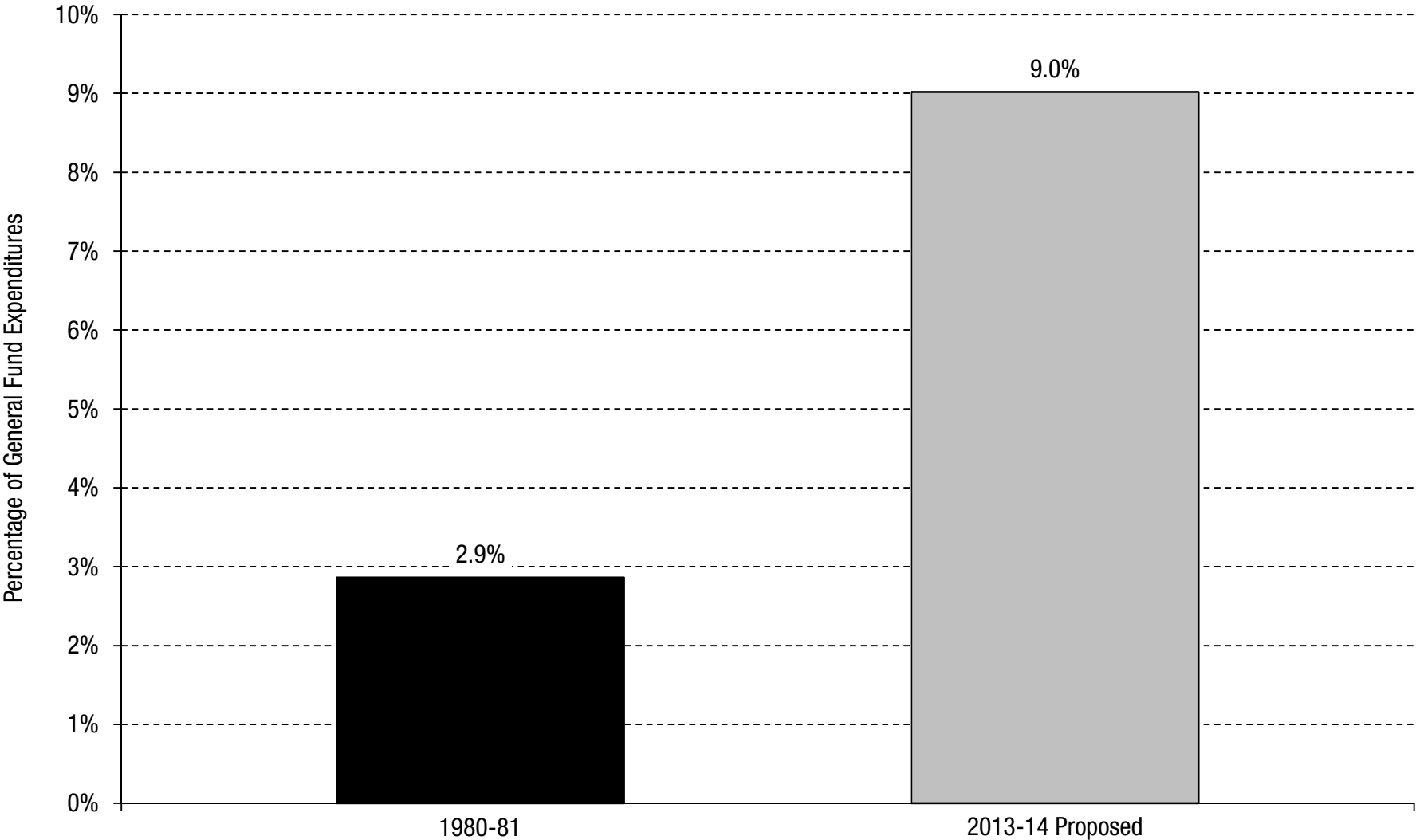
State Budget Cuts Have Reduced the Number of Child Care and State Preschool Slots by One-Quarter Since 2007-08



Corrections Spending Would Rise Slightly in 2013-14 Under the Governor's Proposal

- The Governor proposes \$8.8 billion in General Fund spending for prisons and parole in 2013-14 – a slight (0.6 percent) increase from 2012-13.
- State spending on corrections is down significantly from the 2007-08 peak of \$10.1 billion.
- However, corrections spending as a share of the state budget remains high compared to prior years. Under the Governor's proposal, 9 cents out of every General Fund dollar would support corrections in 2013-14 – more than three times higher than in 1980-81.

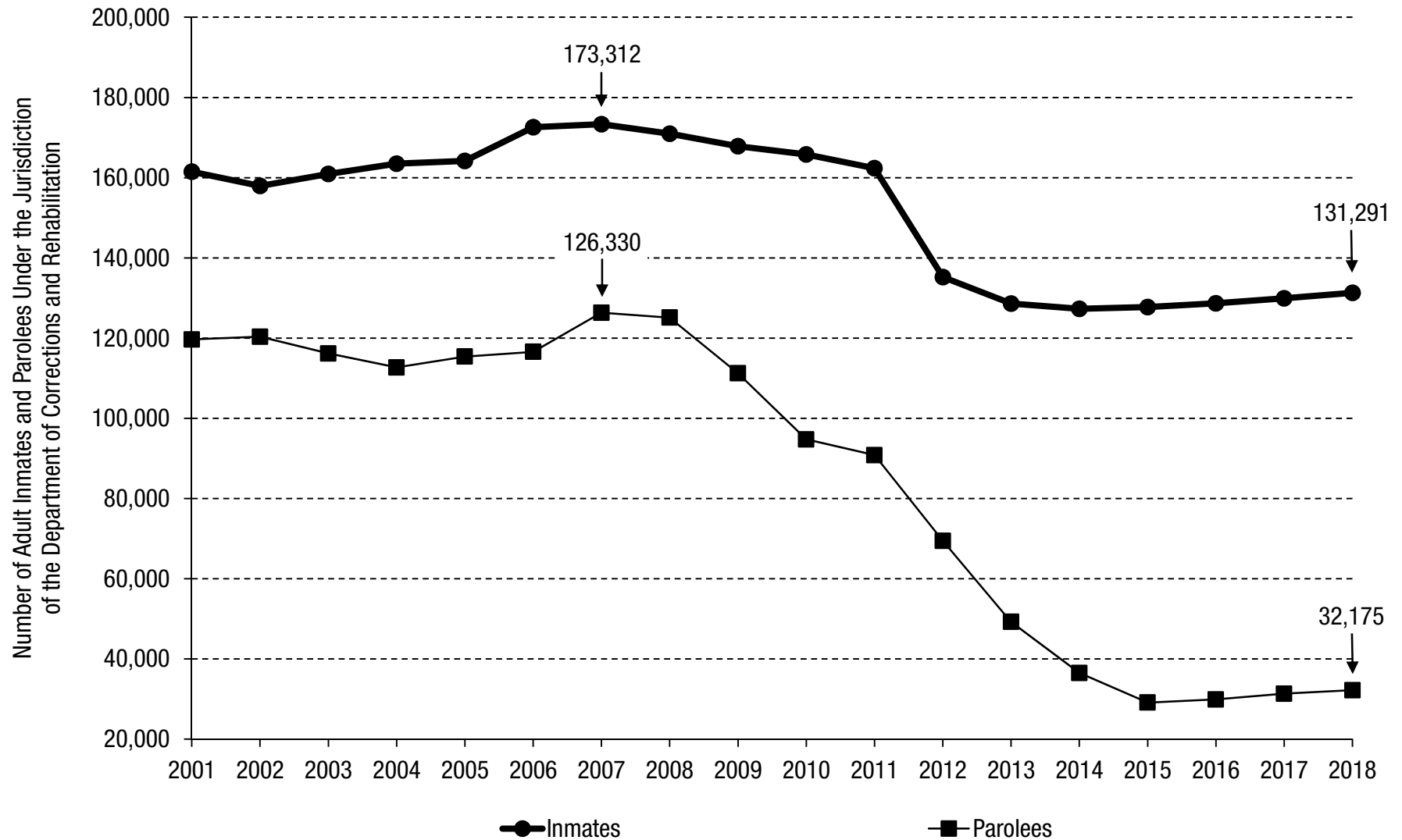
As a Share of General Fund Spending, Proposed Spending on Corrections
in 2013-14 Would Be More Than Three Times Greater Than in 1980-81



Number of Inmates and Parolees Continues to Drop

- The recent decline in state spending on corrections is largely due to the drop – since 2007 – in the number of inmates and parolees under the state’s jurisdiction.
- This trend accelerated in 2011 due to the transfer – or “realignment” – of responsibility for low-level offenders and parolees from the state to the counties that began on October 1, 2011. (The state also provided counties with a dedicated source of revenues to carry out their new duties.)
- Largely due to the 2011 realignment, the numbers of inmates and parolees are projected to remain below their 2007 peaks for the foreseeable future.

The Numbers of Inmates and Parolees Are Projected to Remain Well Below Their 2007 Peaks



Note: 2013 through 2018 data are projected. Data are as of June 30 of each year.
Source: Department of Corrections and Rehabilitation

The Governor Seeks to End Judicial Oversight of Prisons

- The prison population, which excludes inmates housed in other California facilities or in other states, is about 119,000.
- A federal court order requires California to reduce the population of its 33 prisons to 109,805 inmates, or 137.5 percent of “design capacity.” The court recently extended the deadline for meeting this target to December 31, 2013. Realignment alone will not allow the state to reduce the prison population to this level.
- The Governor argues that further inmate reductions are unnecessary given recent state reforms and has asked the court to end judicial oversight of the state’s prison system.

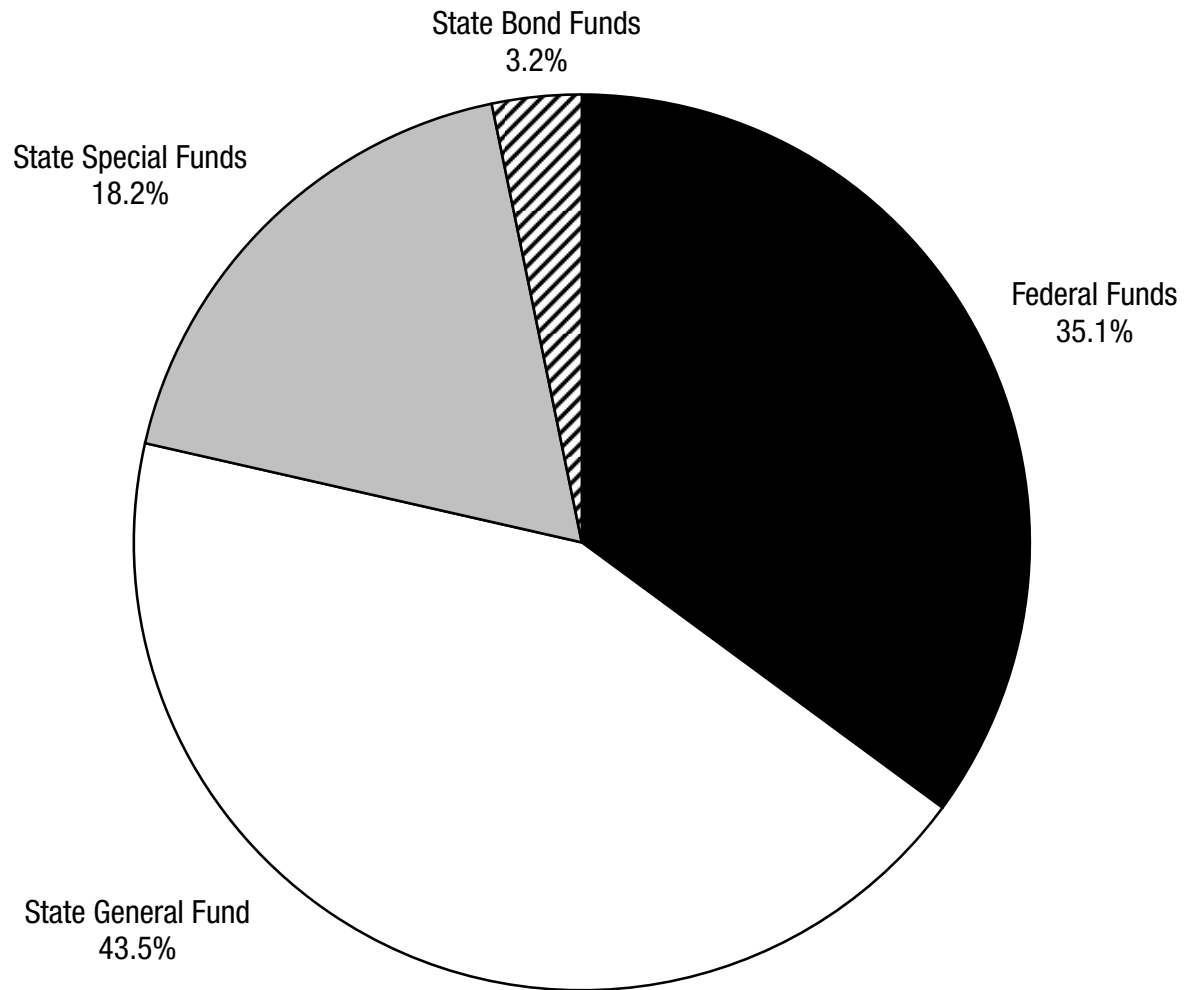


Policy Considerations and Choices: Staying on Track in 2013-14 and Beyond

Other Factors Contribute to Uncertainty

- Federal funds account for more than one-third of California's total state budget. Actions at the federal level, from “sequestration” to debt ceiling negotiations, will have implications for the state budget.
- “It’s the economy.” The Governor’s forecast estimates that the US gross domestic product (GDP) – the value of all goods and services produced – will increase at an average annual rate of 2.7 percent over the next five years, a “slightly slower rate than normal for an economic expansion.”

Federal Dollars Account for More Than One-Third of California's State Budget

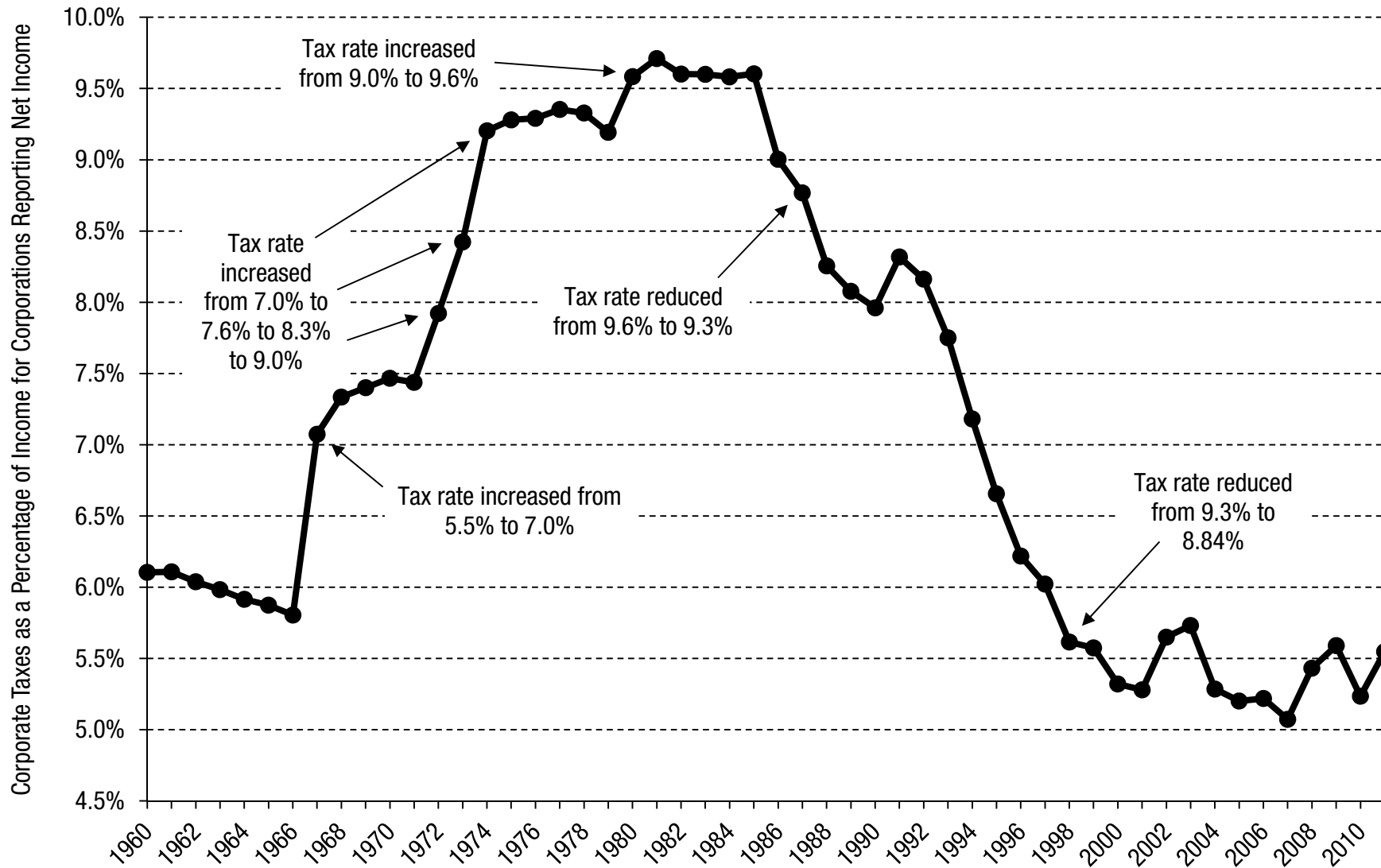


Proposed 2013-14 Expenditures = \$224.7 Billion

Budgets Are About Choices

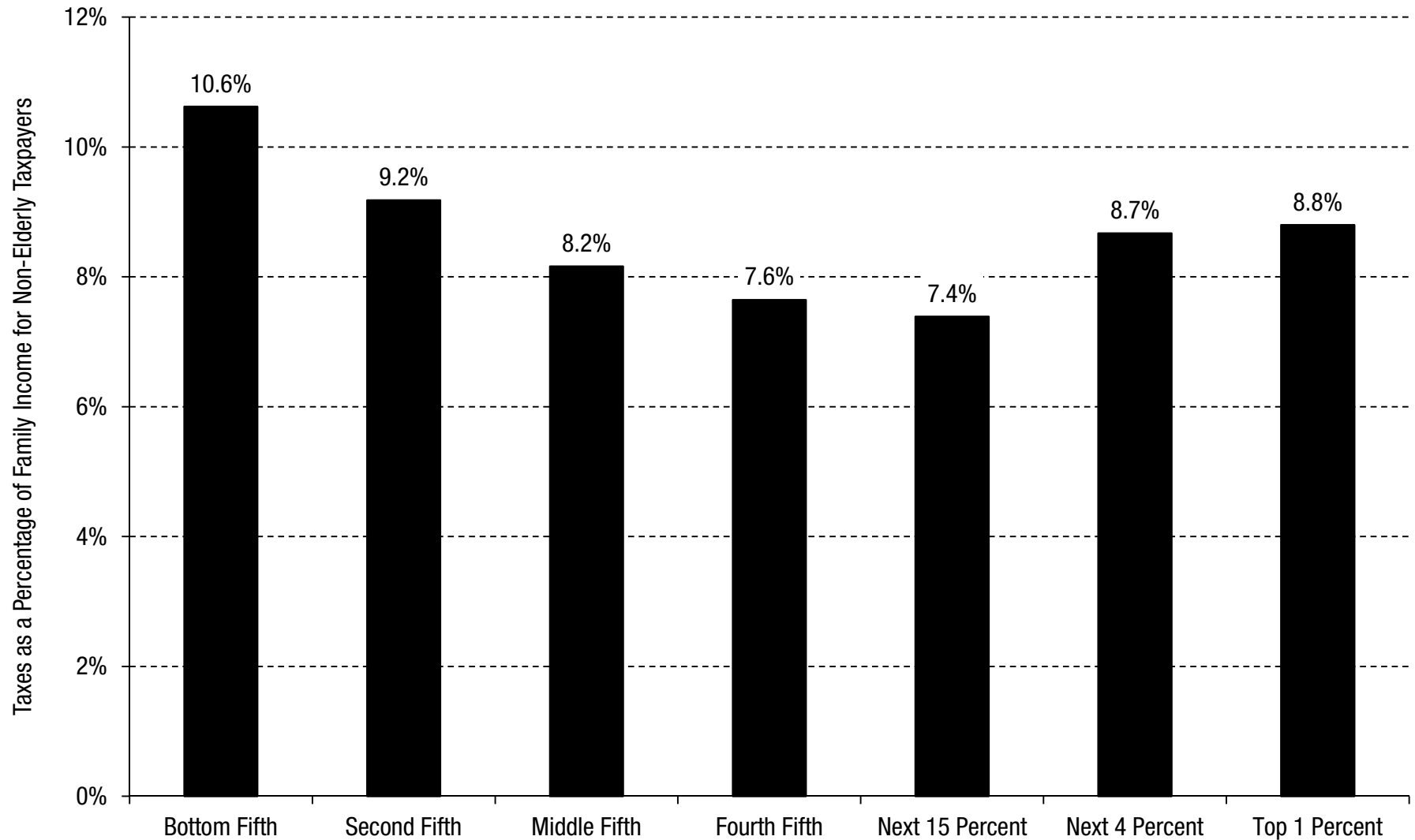
- California is a state with enormous wealth, diversity, and opportunity, but one challenged by widening inequality.
- Even amid 2013-14 budget constraints, policymakers have *choices*.

The Share of Corporate Income Paid in Taxes Fell by Nearly Half Between 1981 and 2011



Note: 2010 and 2011 data are preliminary.
Source: Franchise Tax Board

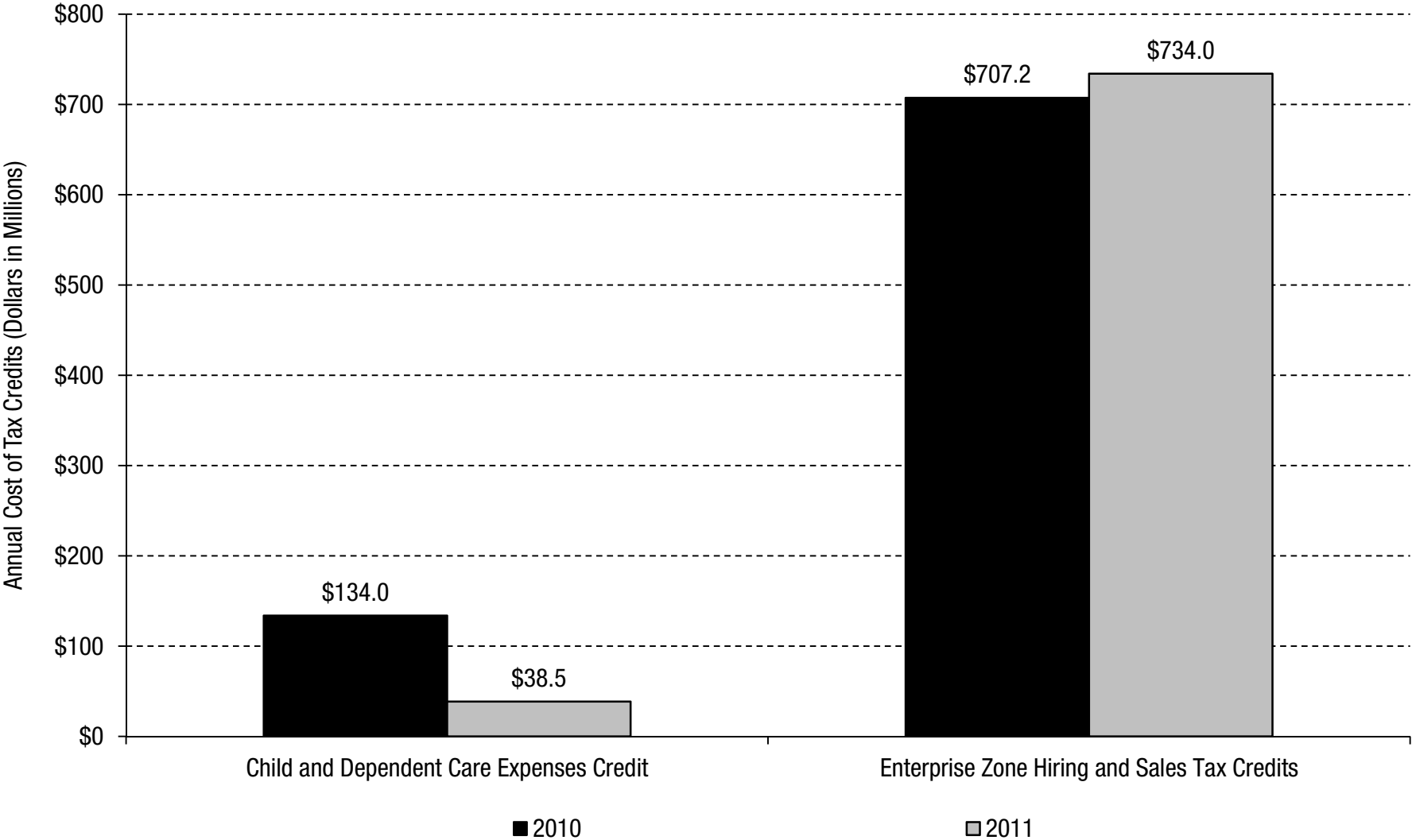
California's Lowest-Income Families Pay the Largest Share of Their Incomes in State and Local Taxes



Which Tax Credit?

- State policymakers in recent years significantly scaled back the Child and Dependent Care Expenses Credit, which provides a state tax credit to help working families defray child care costs.
- Meanwhile, a costly state program that is widely considered to be ineffective emerged unscathed from recent rounds of deep budget cuts. The Enterprise Zone Program provides multiple tax breaks to promote business development and job creation in economically distressed areas. This program costs the state more than \$700 million per year.

State Policymakers in 2011 Sharply Cut Spending on the Child and Dependent Care Expenses Credit, While Spending on Enterprise Zone Credits Continued to Rise





California is back on track after years of serious budget challenges. Our state leaders now have the opportunity to choose a fiscally responsible path, while reinvesting in vital public services that foster economic growth and contribute to broadly shared prosperity.