



California Budget Project
Email Update
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BUDGET OVERVIEW

On September 5, Governor Gray Davis signed the \$98.9 billion 2002-03 Budget, which the Legislature had approved in the early hours of September 1. The Budget was signed into law 63 days into the new fiscal year and three days later than in 1992. The Budget assumes \$79.2 billion in 2002-03 General Fund revenues and transfers, a 7.1 percent increase over 2001-02, and provides for a \$1.035 billion reserve, which represents 1.3 percent of budgeted General Fund expenditures. The Budget, along with mid-year spending reductions in 2001-02, addresses a \$23.6 billion gap between revenues and expenditures. This gap is primarily attributable to a significant decline in revenues related to stock options and capital gains income in 2001-02 and the current year.

Gap-closing actions include:

- \$7.5 billion in program reductions;
- \$4.5 billion from borrowing against the state's future tobacco settlement funds;
- \$2.0 billion in loans;
- \$1.7 billion in education spending deferrals and reductions;
- \$2.9 billion in fund shifts, accelerations, and transfers;
- \$2.4 billion in additional revenues from the temporary suspension of the teacher tax credit and a temporary suspension of businesses' net operating loss deductions, as well as other tax changes;
- \$1.1 billion in assumed increases in federal funding; and
- \$1.1 billion from restructuring state debt.

The Budget provides \$76.7 billion in General Fund expenditures, a 0.2 percent decrease from 2001-02. The Governor vetoed \$235 million from General Fund and special fund appropriations approved by the Legislature, the largest share (75.3 percent) of which comes from \$177 million in spending reductions in Health and Human Service programs. AB 593 stated that the Governor may veto up to \$750 million in state operations appropriations, but the Governor's vetoes included only minimal reductions to state operations.

The following provides a more detailed overview of the governor's vetoes and policy changes in the 2002-03 Budget. Budget documents can be downloaded from the Department of Finance's web site at http://www.dof.ca.gov/HTML/BUD_DOCS/Bud_link.htm.

TAX CHANGES

The final revenue agreement did not include a permanent tax increase and was substantially smaller than the package assumed when the Senate passed the budget in late June. The final tax package, contained in AB 2065 (Oropeza):

- Suspends businesses' net operating loss deductions for 2002 and 2003, but increases the percentage of losses that businesses can carry forward and deduct in 2004 and beyond. Over the long term, the revenue loss from the increased deductions will exceed the revenues raised by the suspension. This provision will raise an estimated \$1.2 billion in 2002-03 and \$800 million in 2003-04, but cost \$400 million in 2004-05 and increasing amounts thereafter.
- Suspends the teacher tax credit in 2002, raising an estimated \$170 million.
- Increases withholding requirements for certain real estate transactions and on stock options. These provisions do not increase the amount of taxes owed, but rather accelerate the state's collection of taxes. These provisions will accelerate collection of an estimated \$625 million into 2002-03 that would otherwise have been paid in later years.
- Provides the Franchise Tax Board and Board of Equalization with enhanced authority to forgive penalties, interest, and fees in order to boost collection of certain "high risk" accounts. Estimates suggest that these provisions result in the collection of an estimated \$145 million in amounts currently owed.
- Requires large banks to deduct bad debts only when they actually become worthless, in conformity with federal law. Prior law allowed banks to claim tax deductions for contributions to reserves for bad debts. However, the new law forgives half of banks' previous deductions for contributions to reserves. This provision will raise an estimated \$285 million in 2002-03.

AB 2065 will raise an estimated \$2.425 billion in 2002-03. In contrast, the tax package approved by the Senate in June would have raised an estimated \$3.897 billion, including a \$650 million permanent increase in the state's cigarette tax and a \$1.3 billion increase in Vehicle License Fees in 2002-03 and 2003-04.

PROPOSED CONSTITUTIONAL AMENDMENT

For the second year in a row, lawmakers approved a constitutional amendment earmarking a portion of General Fund revenues to specific infrastructure-related purposes. Last year, the Legislature approved ACA 4, which dedicated sales taxes paid on fuel sales to transportation. Voters approved this measure in the form of Proposition 42 in March. Proposition 42 will divert \$1.4 billion from the General Fund to transportation programs when fully implemented.

This year's measure, ACA 11, would allocate increasing shares of the General Fund, up to 3 percent, to state and local infrastructure. ACA 11 will appear on the 2004 statewide primary ballot. Estimates suggest that in 2006-07, ACA 11 will redirect approximately \$950 million from the General Fund, increasing to about \$4.4 billion in 2015-16. If the voters approve Proposition 51 on the November ballot (see the California Budget Project's *Proposition 51: Should California Earmark the Sales Tax on Motor Vehicles?*), the ACA 11 transfer will be reduced by the amount redirected pursuant to Proposition 51. ACA 11 also includes various other triggers that reduce the infrastructure set-aside under certain conditions.

HEALTH

The Governor reduced spending for health and human services programs by \$177 million, which represents 75.3 percent of the \$235 million that the Governor cut from the Budget. With respect to health and related programs, the Governor's vetoes:

- Delete \$143.3 million (\$52.4 million state funds) to expand the Healthy Families Program to include parents of eligible children.
- Reduce funding for Medi-Cal county administration by \$58.0 million (\$29 million General Fund), a reduction of approximately 6 percent. The Governor proposed a 20 percent reduction in the May Revision.
- Eliminate \$12 million (\$6 million General Fund) to fund "express lane" Medi-Cal eligibility for children enrolled in the National School Lunch Program.
- Delete \$22.1 million (\$7.7 million General Fund) to fund a two-month coverage "bridge" for children transitioning from Medi-Cal to the Healthy Families Program. The Budget maintains funding for a one-month bridge.
- Delete \$5.4 million by shifting a 10 percent share of cost for growth in the Early and Periodic Screening, Diagnosis, and Treatment Program to counties. Although the Legislature rejected this proposal, the Governor intends to implement this policy change administratively and suggests that a match requirement would "give counties an incentive to control costs." It is not clear whether the Governor has the authority to require a county share of cost absent statutory authority.
- Reduce funding for trauma system providers by \$5 million, leaving a \$20 million appropriation.

MENTAL HEALTH

The Governor's vetoes:

- Reduce state funding for mental health services through the Children's System of Care (CSOC) by \$13.8 million. The Governor suggests the CSOC has not been able to provide outcome data for all children served by the program or to adequately document cost savings. He will direct the Department of Mental Health to restructure the CSOC "to provide better accountability and documented cost savings."
- Delete \$2 million by eliminating state funding for Adult Systems of Care mental health services.
- Reduce funding for the Integrated Services for Homeless Adults program by \$10 million.

DEVELOPMENTAL SERVICES

- The Governor deleted a \$5.6 million legislative augmentation for one-time grants to develop community resources for the developmentally disabled.

CALWORKS

- The Governor reduced funding for adult education services for CalWORKs participants by \$23 million General Fund. This leaves \$9.9 million in Temporary Assistance for Needy Families (TANF) funds for adult education to CalWORKs recipients.

- The Governor reduced funding for supportive services for CalWORKs community college students by \$9 million.

OTHER SOCIAL SERVICES

- The Governor reduced funding for county administration for the Food Stamp Program by 4.2 percent, or \$16.5 million (\$6.8 million General Fund). However, the final Budget assumes that counties will pay \$104.2 million of a \$115.8 million federal penalty for food stamp errors in 2001.
- The Governor reduced funding for Child Welfare Services by 2.7 percent or \$49.5 million (\$28 million General Fund) and Adoptions Programs by 6.4 percent or \$5.2 million (\$3 million General Fund).

UNEMPLOYMENT INSURANCE

- The Governor vetoed \$140.2 million in federal Reed Act funds for improvements to the Unemployment Insurance (UI) system, including expansion of UI eligibility for recent entrants into the labor force, implementation of a trigger mechanism for UI extended benefits, and an upgrade of UI call centers.

K-12 EDUCATION

The Budget:

- Provides a total 2002-03 Proposition 98 funding level of \$41.6 billion (\$28.6 billion state funds) for K-12 education, a \$3.3 billion (8.6 percent) increase over 2001-02. This results in a Proposition 98 per pupil spending level of \$7,067, an increase of \$457 (6.9 percent) over 2001-02.
- Includes \$727 million for growth in attendance and \$817 million for a 2 percent cost-of-living adjustment (COLA) for revenue limits and categorical programs. This is higher than the 1.66 percent COLA required by statute.
- Reflects \$1.7 billion in deferred 2001-02 and 2003-03 education disbursements as part of the solution to the budget deficit. Of the total, \$681 million in 2002-03 expenditures will be deferred to 2003-04, including \$241.7 million for supplemental grants, \$184.4 million for Targeted Instructional Improvement grants, \$139.6 million for home-to-school transportation, and \$115.3 million for school improvement.
- Reflects vetoes totaling \$143.3 million in Proposition 98 spending. This amount, including \$42 million for revenue limit equalization; \$36 million for PERS offset mitigation; \$23 million for remedial education services for CalWORKs recipients; and \$17 million for expansion of Healthy Start Support Services, will be set aside to cover education funding adjustments that may arise during the fiscal year.

HOUSING

- The housing budget did not change in the final budget negotiations, but housing had already been cut significantly based on the anticipated passage of a \$2.1 billion housing bond (Proposition 46) in November.
- Supportive Housing, a program under the Department of Mental Health that assists

homeless mentally ill individuals, received no funding in the final Budget. This program is not funded in Proposition 46.

- The Governor reduced Farmworker Housing by \$3 million and deleted the provision triggering an additional \$8.5 million reduction if Proposition 46 passes. He did not delete a similar trigger that would reduce Self-Help Housing funding by \$5.6 million if Proposition 46 passes.

LOCAL GOVERNMENT

- The budget for major local government public safety programs did not change in the final budget negotiations and the Governor did not impose any significant vetoes.
- The Budget provides \$232.6 million for the Citizen's Options for Public Safety (COPS) and Juvenile Justice Crime Prevention programs (\$116.3 million each). Funding for Juvenile Justice Crime Prevention had been eliminated in the May Revise.
- Reimbursement of jail booking fees were restored to \$38.2 million, after being eliminated in the May Revise.

TECHNOLOGY, TRADE, AND COMMERCE AGENCY (TTCA)

- The Budget eliminates or suspends more than half a dozen TTCA programs; reduces most, if not all, remaining programs; and imposes a \$10 million unallocated reduction.
- The Governor's vetoes reduce the TTCA budget by an additional \$751,000. The final Budget provides \$42 million (General Fund) for the agency for 2002-03, a \$30 million reduction from the budget proposed in January.
- The Governor reduced funding for the Office of Military Base Reuse and Retention by \$100,000 and deleted a \$150,000 appropriation intended for the evaluation of foreign trade offices, leaving TTCA to accomplish this within existing funds.
- The Governor reduced the Economic Research and Strategic Initiatives Division budget by \$1,000 and deleted legislative intent language providing funding from this item for the Economic Strategy Panel.
- The Governor deleted \$500,000 intended for expansion of the Small Business Financial Development Corporation in southeast Los Angeles.

HIGHER EDUCATION

- The final Budget provides \$9.8 billion (General Fund) for higher education, down from \$10.0 billion provided in the January budget. The Budget includes no fee increases for resident students of the three higher education institutions.
- The Governor did not veto any funding for the University of California (UC).
- The Governor vetoed \$140,000 for the California State University (CSU) Export Delivery Study and \$50,000 for the CSU Centers for Excellence, stating the funding was "premature."
- The Governor vetoed \$10 million for matriculation services for the California Community Colleges, as well as \$1 million for faculty staff and development.
- The Governor reduced funding for the Student Aid Commission by \$98,000, primarily for administrative costs for a loan forgiveness program.