



COMMITTEE ON BUDGET & FISCAL REVIEW
Room 5019, State Capitol
Sacramento, CA 95814

SENATOR MARK LENO, CHAIR

MAJOR ACTION REPORT

June 8, 2011

The purpose of this Major Action Report is to provide a review of the budget actions adopted by the Senate Budget and Fiscal Review Committee subsequent to the release of the Governor's 2011 May Revision.

If you have additional questions, please contact the Committee at (916) 651-4103.

2011-12 Budget Package

Senate Moves Balanced Budget Framework Forward

On May 16, the Governor released his May Revision for budget year 2011-12. The Governor indicates the remaining and adjusted General Fund (GF) deficit is \$10.8 billion for the two-year period ending June 30, 2012. This includes a \$1.2 billion reserve.

In January, the estimated GF shortfall was \$27.6 billion – including a \$1.0 billion reserve and including the cancellation of the sales-leaseback transaction. In March, the Legislature passed \$14 billion in solutions, primarily spending reductions.

The Senate has adopted most of the Governor's May Revision which maintains the Governor's overall budget framework from January, including the public safety realignment. Given the updated revenues and expenditures, the May Revision scales back the revenue proposals to ease the tax burden on households and to better-focus tax incentives to job creation. Other new revenue is directed to K-12 schools and to reduce the state's debt owed to schools.

Below is a high level summary of the budget framework adopted by the Senate, including both budget actions adopted in March and new actions:

Expenditure Cuts*:	\$11.1 billion
Revenues:	\$ 9.8 billion
<u>Other Solutions:</u>	<u>\$ 2.2 billion</u>
Total Solutions:	\$23.1 billion

**Excludes the \$1 billion attributed to the reduction of local Proposition 10 funds to pay for direct children's health care services in the Medi-Cal program. This action is the subject of a current legal challenge.*

The Senate has adopted the vast majority of the Governor's proposed expenditure reductions and the package would produce a reserve of about \$1.0 billion similar to the Governor's May Revision. The major changes to the Governor's May Revision include the following:

- Replacing the Governor's proposal to repay special fund debt with the repayment of \$745 million in Proposition 98 K-14 settle-up debt owed to

schools and community colleges. This payment would be used to further pay down the deferrals in the budget year.

- Restoring approximately \$200 million in child care cuts within Proposition 98 and approximately \$140 million in CalWORKs.

Based on preliminary scoring, the Senate Budget includes 2011-12 General Fund expenditures of \$89.1 billion, down from revised 2010-11 expenditure of \$91.5 billion

Major Expenditure Reductions

Overall, the Senate version of the budget prioritizes K-12 education and public safety. Significant reductions were made in the Health and Human Services areas, but in many cases, alternative cuts were found that mitigate the harshest of these reductions. Most areas of the budget saw significant expenditure reductions.

K-12 Education. Adopted the Governor's Proposition 98 funding framework, which includes approximately \$ 2 billion in expenditures attributable to the Governor's tax package. Overall, the Proposition 98 funding level with the Governor's tax package would be \$52.4 billion, which is about \$3 billion higher than the 2010-11 level. Major proposals included in the Senate package include the following:

- **Settle-Up Payment:** Provides \$745 million in settle-up payments to start repayment of settle-up debt. This debt repayment is directed to buy-down of the inter-year payment deferrals in K-12 education and community colleges.
- **Deferrals:** Buys-down the inter-year K-12 payment deferrals by approximately \$3 billion, consistent with the Governor's proposal.
- **Student Mental Health Services:** Approves Governor's budget proposal to rebench the Proposition 98 guarantee by \$222 million to fund mental health related services for students with disabilities (previously provided by counties per the AB 3632 mandate). Also augmented 2010-11 funding by \$80 million to partially backfill for a funding shortfall created when Governor Schwarzenegger vetoed funding for the AB 3632 mandate.
- **Class Size Reduction:** Approved a one-year extension of the continuous appropriation for the class size reduction categorical program.
- **Categorical Flexibility:** Approved the Governor's proposal to extend various flexibility options to school districts for an additional two years.
- **Secretary of Education Elimination:** Approved the Governor's proposal to eliminate the Office of the Secretary of Education.

Childcare. Approved \$300 million in ongoing savings to childcare programs. This is approximately \$200 million less than was previously eliminated in March due to the following actions:

- **Standard Reimbursement Rate Reduction:** Restored 10 percent rate cut to the Title V contracts.
- **Contract Reduction:** Reduced contracts, or slots, including preschool, by 11 percent instead of 15 percent.
- **11 and 12-Year Olds:** Continued funding childcare services for 11 and 12-year olds.
- **Family Fees:** Rejected earlier proposal to increase sharply the family fees paid by low-income individuals for childcare services.

Higher Education. Adopted the Governor's Higher Education budget proposals including a \$500 million reduction to the University of California, a \$500 million reduction to the California State University, and a \$400 million reduction to the California Community Colleges. Some of these cuts in each segment will be offset with student fees.

Health and Human Services. Achieved total expenditure cuts of around \$5.0 billion in the Health and Human Services area. This total does not include \$1.0 billion in savings related to using Proposition 10 funds one-time to offset GF costs in Medi-Cal consistent with the Governor's May Revision. The transfer of these funds is currently subject to active litigation. The Senate version of the budget also adopts the following additional proposals included in the May Revision for an additional \$500 million in savings:

- **Transition Healthy Families Program to Medi-Cal:** Approved Governor's proposal to transition all children in the Healthy Families Program to the Medi-Cal Program, but adopted a slower phase-in of the transition for a slightly lower savings level of approximately \$22 million in the budget year. A comprehensive transition plan with benchmarks is required to ensure a smooth transition.
- **Hospital Fee:** Assumes \$320 million in savings from extending the hospital fee for one year as enacted in SB 90 (Steinberg) chaptered in April of this year.
- **Maximizing Federal Funds:** Approved Governor's proposals to technically modify the use of certified public expenditures to enable

California to maximize federal funds and obtain offset of General Fund expenditures.

- **CalWORKS:** Restores approximately \$90 million related to additional grant cuts for safety net and child-only cases that exceed 60 months. Also restores \$50 million of the single allocation, which is the funding used by counties to provide welfare-to-work services.
- **Getting Ready for Health Care Reform:** The Senate version of the budget also approved the Governor's proposal to transfer administration of Medi-Cal community mental health programs and the Drug Medi-Cal program to the Department of Health Care Services. This will enable the state to be better positioned for the implementation of health care reform, which will provide greater parity for behavioral health issues.

Corrections: Approved expenditure reductions of about \$1.0 billion in Corrections mainly due to the realignment proposal. However, the Senate has also approved the Governor's workforce cap proposal for an additional \$195 million and significant reductions to the Board of Parole Hearings operations. Furthermore, the Senate has restored nearly \$50 million in community-based rehabilitation contracts that will be needed as the State implements realignment.

Courts: Approved the Governor's proposal to reduce the courts funding by \$200 million. However, also augmented the courts budget by \$42 million for additional workload related to realignment and new workload related to parole revocation activities.

Transportation: Approved the Governor's proposal to use truck weight fees to pay about \$1.0 billion in transportation-related general obligation bond debt. Approved re-enactment of the 2010 Tax Fuel Swap to conform to the requirements of Proposition 26.

Redevelopment: The Senate's budget package includes a solution from redevelopment agencies (RDAs) that provides a \$1.7 billion General Fund benefit in 2011-12.

Local Government: Approved the Governor's proposal to suspend the Williamson Act / Open Space Subvention for a two-year savings of \$20

million. Rejected the Governor's proposal to suspend the Brown Act / Open Meeting mandate.

Natural Resources and Energy: Approved a cut of \$155 million in energy efficiency programs funded by the Gas Consumption Surcharge Tax. Approved cuts of \$11 million to State Parks and \$10 million to Off-Highway Vehicle Parks.

Government Efficiency and Employee Compensation: Approved expenditure cuts of about \$700 million in areas such as: employee compensation (\$308 million); employee healthcare (\$80 million); and other state operations-related governmental efficiencies (\$250 million) (discussed further in Page 10 of this document).

Revenues

Revenue Package. The Senate version of the budget includes the Governor's proposal to maintain 2010 tax rates for five years. However, because an election cannot be held until after the fiscal year has begun the Senate version of the budget will also include a one-year revenue "bridge". The revenue bridge would maintain the existing tax rates for one year and generate \$9.4 billion in revenues for the budget year. (This total does not include the net impact to the Proposition 98 guarantee, which is about \$1.6 billion.) This bridge will provide assurances for schools and local public safety in the budget year. Schools and local governments will need additional time in the budget year to make reductions if the constitutional amendment is ultimately defeated by the voters.

Consistent with the Governor's May Revision the Senate version does not propose to continue the personal income tax (PIT) surcharge (0.25 percent) in the 2011 tax years. The Senate version of the "bridge" financing would extend the following taxes:

- Maintaining the current vehicle license fee (VLF) rate of 1.15 percent until July 1, 2012.
- Maintaining the current sales tax rate of 6 percent until July 1, 2012.
- Maintaining the 2010 PIT dependent credit (\$99) for the 2011 and 2012 tax years.
- Reestablishing the 2010 PIT Surcharge (0.25 percent) for the 2012 tax year.

The constitutional amendment that is part of the Senate version is consistent with the Governor's proposal, but would effectively start after the bridge financing has expired. The constitutional amendment would need to be placed before the voters sometime in the next fiscal year before the bridge financing expires. The constitutional amendment would extend the taxes in the bridge for an additional four years. The VLF and the Sales and Use Tax would be in effect until July 1, 2016 and the PIT-related taxes would be effective through tax year 2015.

Also consistent with the Governor's proposal, the Senate version would dedicate the 1 percent of the sales tax and 0.4 percent of the vehicle license fee to local governments for public safety realignment. The PIT revenues would be dedicated to schools.

PUBLIC SAFETY REALIGNMENT

Senate Approves Major Public Safety Realignment

The Senate version of the budget package contains the Governor's revised public safety realignment plan. This plan has been made more essential in the last few weeks after the U.S. Supreme Court affirmed the lower court's decision to require the reduction of overcrowding in the state prison system. The State has two years to reduce the prison population by over 30,000 inmates. Realignment will allow the state to accomplish this reduction in a way that has significant potential benefits for public safety. Funded realignment will allow for funding to flow with the offender back to the community where it can be invested in support services, programs, and law enforcement that enhance the safety of communities.

The public safety realignment proposal takes a significant step towards bringing services closer to the people, allows for more integrated service delivery, and allows the services to be tailored to local situations and conditions. In total, the May Revision realignment proposal dedicates \$5.6 billion in revenues in 2011-12 to fund a menu of programs shifted from the State to the locals. However, because the Conference version reduced the number of low-level offenders that would be transferred to the counties, the March realignment package included funding the existing county mental health services (realigned in 1991) out of this revised realignment proposal. This frees up the 1991 realignment funds to cover an increased share of CalWORKs grants. This "swap" should have no programmatic impacts.

The table below shows the Governor's February 25 revised realignment proposal with an indication of the four programs dropped from realignment with the May Revision. If the May Revision package is adopted, there still needs to be significant follow-up legislation related to implementing the realignment.

As noted below, the realignment funding is expected to grow to \$7.0 billion by 2014-15.

Program	2011-12 Feb 25	2014-15 Feb 25	2011-12 May Rev	2014-15 May Rev
Fire and Emergency Response	\$52.0	\$52.0	\$52.0	\$52.0
Court Security	485.0	485.0	497.8	497.8
Vehicle License Fee Public Safety	506.4	506.4	504.4	504.4
Lower-level Offenders/Parole Violators	1,096.0	705.1	955.3	762.2
Realign Adult Parole	421.2	183.0	420.5	187.7
Realign Remaining Juvenile Justice	156.0	234.0	241.5	241.5
Mental Health Services:				
EPSDT	0.0	636.9	0.0	579.0
Mental Health Managed Care	0.0	190.7	0.0	183.7
AB 3632 Services	0.0	150.9	0.0	150.9
Existing Community Mental Health	1,077.0	1,077.0	1,077.0	1,077.0
Substance Abuse Treatment	184.0	184.0	183.6	183.6
Foster Care and Child Welfare Services	1,623.9	1,703.9	1,567.2	1,567.2
Adult Protective Services	55.0	55.0	55.0	55.0
State Penalty Funds to Locals	40.5	40.5	40.5	40.5
Existing Juvenile Justice Realignment	97.1	103.3	97.1	103.3
Funded Public Safety Mandates	50.9	50.9	50.9	50.9
Growth*	0.0	888.4	0.0	1,069.6
Total	\$5,931.0	\$7,255.0	\$5,599.4	\$7,012.0

The public safety realignment proposal outlined above would be funded by maintaining the Vehicle License Fee and sales tax at current levels for five years via a constitutional amendment. The related constitutional amendment would also provide that the State is responsible for funding this realignment after the five-year period has ended.

REDUCING STATE GOVERNMENT

Senate Streamlines Government and Eliminates 21 Boards & Commissions

The Senate version of the budget package eliminates 21 boards and commissions that were proposed for elimination in the Governor's May Revision. The Senate also adopted policy to put in motion a major reorganization and consolidation of various health care programs that when fully implemented may result in the further elimination of additional agencies. These actions will help the Governor achieve the \$250 million GF savings identified in March 2011 related to efficiencies in state government operations. The mechanism to achieve these savings is a budget control section that provides the Administration with the authority to make the required budgetary reductions to achieve the total savings.

The Administration has identified and in some cases already achieved, savings through a variety of executive actions, including eliminating the offices of the Secretary of Education and the American Recovery and Reinvestment Act Inspector General, banning non-essential travel, implementing a statewide building rental rate reduction, reducing the number of state-issued cellular phones, and reducing the statewide vehicle fleet, including the elimination of any non-essential vehicles and reducing the number of home-storage permits.

CREATING ECONOMIC INCENTIVES

Senate Creates Economic Incentives for California Businesses

The Senate version of the budget has proposed several changes to tax policy to provide economic incentives for business to invest in the State and create jobs. These proposals include the following:

- **Mandatory Single Sales Factor.** The Senate version of the budget proposes to make the multi-state corporate income apportionment method mandatory instead of elective. The revenue from this policy change in the budget year is \$1.4 billion, and approximately \$950 million ongoing. Current law gives tax advantages to companies that invest capital and workforce outside of California, thereby providing disincentive for investment in California.
- **Enterprise Zones.** The Senate version of the budget agreed with the Governor to withdraw the earlier proposal to eliminate all tax incentives for companies investing in designated enterprise zones. Even though there is limited evidence that enterprise zones result in overall economic growth to the State, these zones are perceived to provide benefits to certain economically depressed areas of the state.

Instead the Senate version of the budget package approves the Governor's May Revision, which includes several reforms to the enterprise zone program that will hopefully improve the overall effectiveness of the program in incentivizing new economic activity in economically depressed areas of the state. Specifically, the Senate version proposes to reform enterprise zone hiring credits so that the credits are only available to firms that actually increase their level of employment and would only be allowed if claimed on the taxpayer's original tax return. The Senate version also proposes to limit the use of new vouchers for tax years prior to 2011 and limit the carry-forward period for credits to five years.

- **Improve Existing Job Credit.** The Senate version of the budget package also adopts reforms to the 2009 jobs credit for small business to stimulate job creation by small businesses during this early part of the State's economic recovery. The Senate version reforms this

existing credit, which is capped at \$400 million, to provide a \$4,000 credit per job instead of \$3,000 per job and to target the credit to small businesses with 50 or fewer employees instead of small businesses with 20 or fewer employees.

- **Sales and Use Tax Exemption.** The Senate version of the budget package also includes the Governor's sales and use tax exemption for the purchases of manufacturing equipment. This exemption would start in 2012-13 and would be in effect during periods when the sales and use tax rate is at 6 percent. Under the Senate's version, manufacturing firms would be eligible for a 1 percent exemption from the General Fund Sales and Use Tax and a start-up firm would be eligible for a full 5 percent exemption. This sales and use tax exemption could help to stimulate investment and job growth in manufacturing in California.