
# Highlights and Analysis of the Governor's 2011-12 May Revision

**May 20, 2011**
**SENATE REPUBLICAN FISCAL OFFICE**

# Table of Contents

# Budget Briefs

SENATE REPUBLICAN FISCAL OFFICE

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## Executive Summary

In January, the Governor's Budget identified a General Fund budget deficit of $25.4 billion. That deficit grew to $26.6 billion when the Governor cancelled the $1.2 billion sale of state buildings approved by Governor Schwarzenegger. In March the Legislature enacted a package of bills that provided about $13.4 billion of "solutions" that included about $7 billion in spending reductions and $6.4 billion of fund shifts, loans, transfers, and increased revenues (but no new taxes).

The Governor's May Revision now estimates a General Fund budget deficit of $9.6 billion ($4.8 billion carry-in deficit from 2010-11 and $4.8 billion operating shortfall in 2011-12). According to the Administration, this new deficit accounts for the $11 billion of solutions already adopted by the legislature and another $2.4 billion awaiting the Governor's signature. It also reflects $6.6 billion of higher than anticipated revenues and $3 billion of higher spending (includes backfill for $1 billion of Proposition 10 currently subject to litigation).

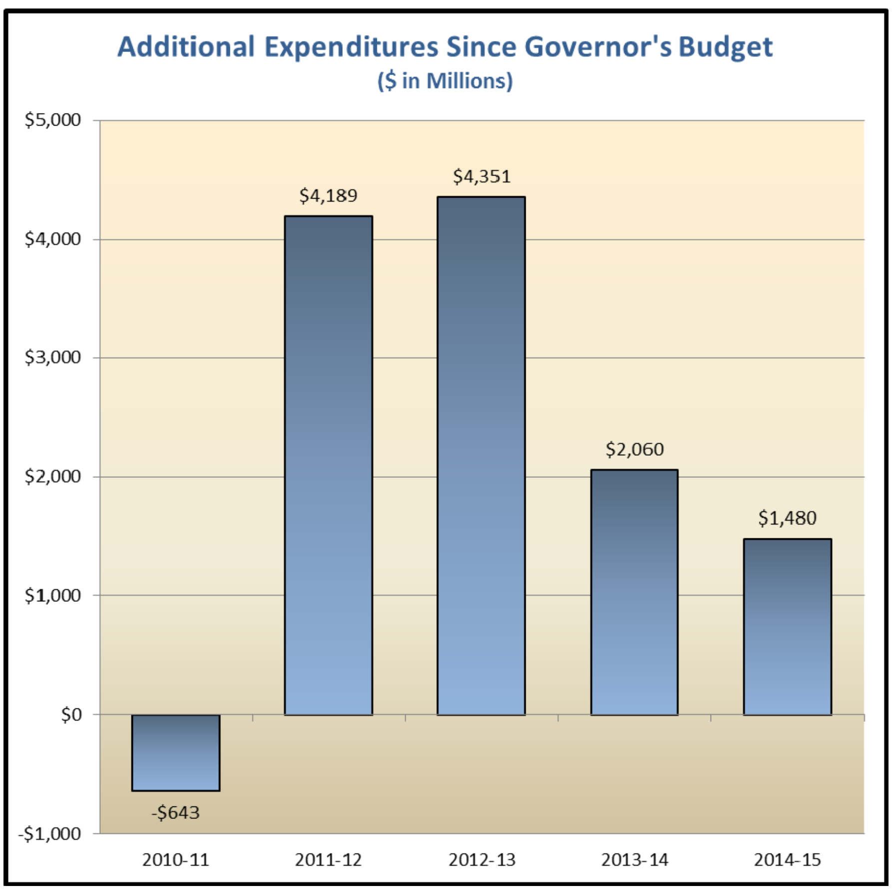
| Governor's View of Budget Problem (in billions) | |
|---|---|
| **Original Problem Statement** | **$26.6** |
| Solutions Already Enacted | -$11.0 |
| Higher Revenues | -$6.6 |
| Higher Spending | $2.0 |
| Proposition 10 Litigation | $1.0 |
| **Deficit Under Current Law** | **$12.0** |
| Solutions Adopted by Legislature - Pending Legislation | -$2.4 |
| **Remaining May Revision Problem** | **$9.6** |
| Build Reserve | $1.2 |
| **May Revision Solutions Needed** | **$10.8** |

It should be noted that the Governor's revised budget problem ($9.6 billion) actually includes a $2.2 billion General Fund spending increase for K-14 education and an additional $1.3 billion of General Fund spending to backfill spending reductions and fund shifts that have not materialized (about $300 million of health and human services reductions; and $1 billion because Democrats tried to go around the voters to take Proposition 10 funds). Instead of using the $6.6 billion revenue windfall to increase spending and unwind previously adopted reductions, it seems reasonable that all the new funds would go towards reducing the budget deficit – thus, an argument can be made that the **problem should only be about $6.1 billion.**

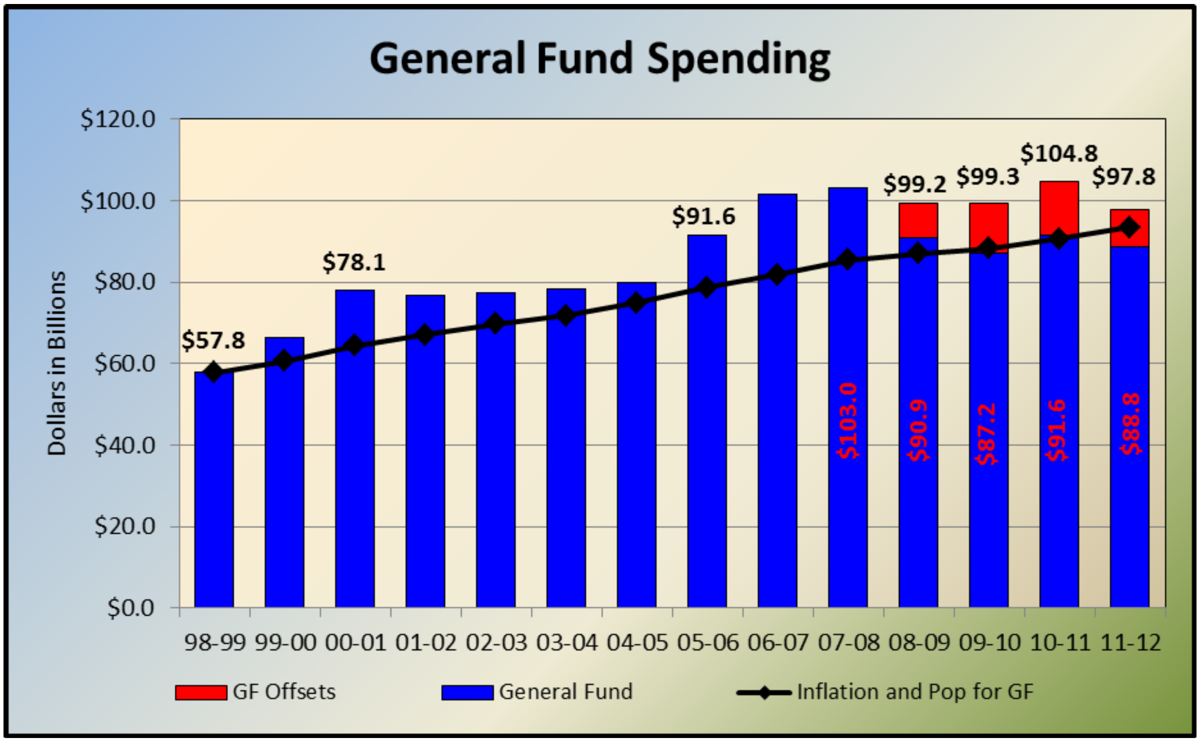
**Key Points:**

**New Revenue Not Enough to Satisfy Governor.** Despite an unanticipated revenue windfall of $6.6 billion ($2.8 billion in 2010-11 and $3.8 billion projected for 2011-12) the Governor's May Revision still proposes $11 billion of tax increases to immediately balance his budget plan, and a total of nearly **$58 billion of tax increases over five years.** Of this amount $51.2 billion would be subject to voter approval. These taxes are used to grow government spending by $24 billion (27 percent) in just three years.

**More Spending Growth.** The Governor's May Revision proposes to increase General Fund spending by $11.4 billion relative to his January budget plan over the five-year projection period. For the budget year (2011-12) **spending is actually $4.2 billion higher than it was in his January plan.** Just as Republicans have feared, it appears that the Governor is already spending the unanticipated revenues and negating the spending reductions already adopted. Also, as noted above, state General Fund spending would grow by $24 billion (27 percent) in the next three years. This serves to further demonstrate the need for a hard spending limit to prevent this type of irresponsible spending growth.



**True General Fund Program Spending.** The Governor's 2011-12 May Revision proposes to spend $88.8 billion from the General Fund in 2011-12. This is about $8.1 billion less than what the budget would have been ($96.9 billion) absent the savings enacted from January and the proposed May Revision solutions. In addition to General Fund resources, the May Revision continues to propose approximately $9.0 billion of "offsets" to General Fund costs, including fund shifts of $3.4 billion (RDA sources, Proposition 63, and the revised transportation funds), and the realignment of various state programs to the local level ($5.6 billion). As noted in the chart below, the "true" underlying General Fund program level (red bar), which recognizes these "offsets," is still hovering near the $100 billion mark and is slightly above population and inflation growth.

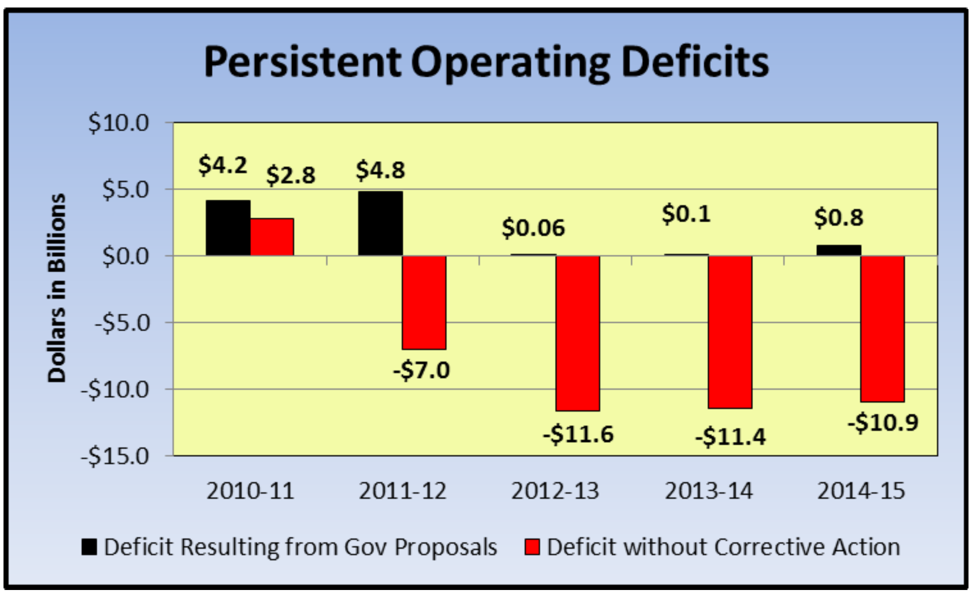



**Paying Off Debt.** The Governor noted that budgetary borrowing over the past decade is about $35 billion (i.e., the "wall of debt"), but only about $14 billion of this debt is borrowing that requires interest payments. The rest of this "debt" consists of deferred payments and other gimmicks that resulted in one-time savings but did not address the structural budget problem. The Governor's May Revision proposes to spend an additional $2.2 billion General Fund for K-14 education, but uses those funds to reverse Proposition 98 payment deferrals. The Governor also proposes to rescind $744 million of special fund borrowing. However, there is no plan to actually pay down the identified wall of debt. On the other hand, **Senate Republicans proposed a specific plan to pay off budgetary debt** that included a new state spending limit.

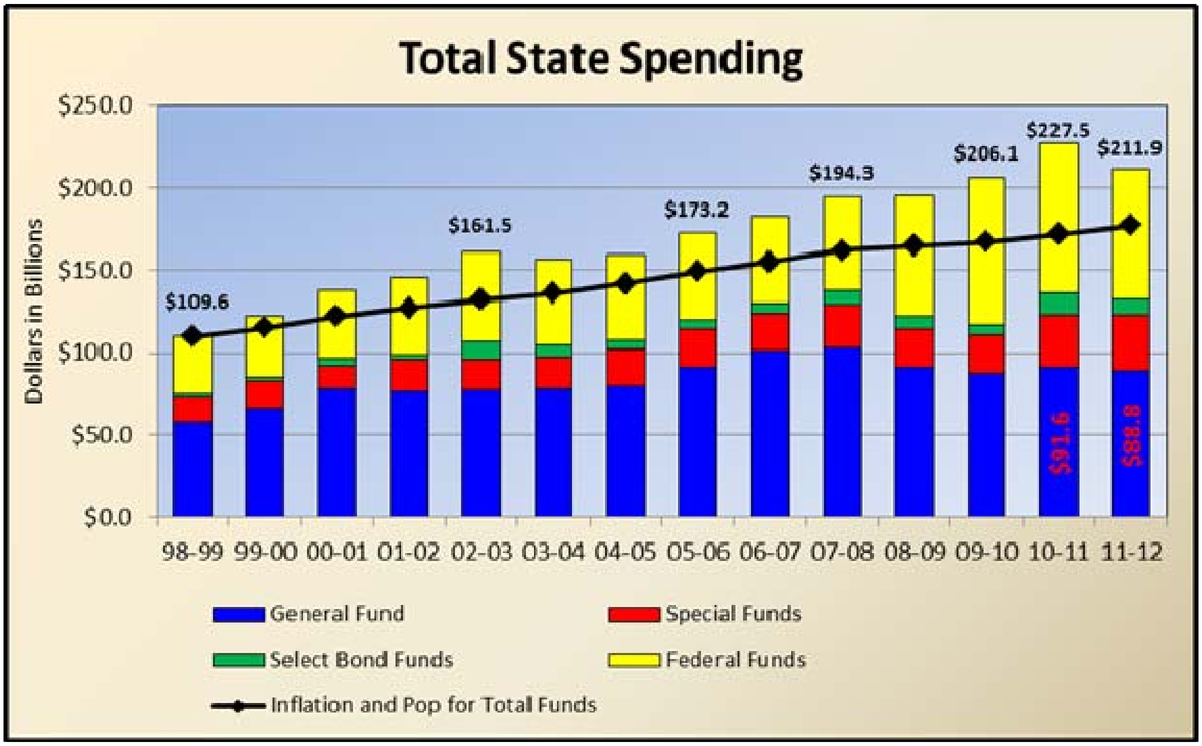
**Hints at Reforms.** The Governor does not propose any specific pension reforms or a new state spending limit in the May Revision. However, there are references to "working with the Legislature" to devise a mechanism that uses revenue above what is needed for current programs to pay off budgetary debt, and adopting comprehensive and fair pension reforms. This appears to be a transparent attempt to incorporate concepts that Senate Republicans have repeatedly proposed as necessary to fix California's chronic budget problems. Of course, the devil is always in the details and the Governor did not include any regulatory relief for business, education reforms, or civil service reforms to allow for cost savings and higher quality services through contracting with private sector businesses.

**Little Economic Stimulus.** In response to Republican criticism that the Governor's Budget in January did not focus on economic stimulus and job creation, the Governor is now proposing two initiatives that could help California's economy. The May Revision proposes a Sales and Use Tax exemption for purchases of manufacturing equipment (five percent for start-ups and one percent for all other firms); a modest proposal that is far short of SB 395 (Dutton/2011), which would authorize a sales and use tax exemption on equipment used in manufacturing and research and development. The May Revision also proposes to expand the existing jobs credit to provide $4,000 per new employee (instead of $3,000) and extend the credit to businesses that employ 50 or fewer employees (up from 20 or fewer), similar to SB 156 (Emmerson/2011). While potentially helpful, these two programs do not go far enough to help California businesses and are explicitly tied to implementing a mandatory single sales factor that is essentially a $1.4 billion tax increase.

**Structural Operating Deficit.** Absent "corrective action" the Administration projects continuing deficits in the range of $7 billion to $11.6 billion annually. These annual deficit numbers have been reduced by about half (when compared to the January Governor's Budget) as a result of actions taken by the Legislature in March and the unanticipated revenue growth. The Governor's May Revision, with proposed solutions, projects that operating deficits would be eliminated over the next four fiscal years. However, the Legislative Analyst's revenue forecast suggests that deficits of at least $2 to $3 billion would continue in future years under the Governor's plan.



**Total State Spending.** General Fund spending is always the focus of state budget conversations. However, it is just one component of total state spending, as demonstrated in the chart below. Total state spending from all fund sources has continued to increase each year. Even with the decrease from 2010-11 to 2011-12, the proposed 2011-12 spending level still exceeds population and inflation growth since 1998-99 by $34.8 billion ($177.1 billion vs. $211.9 billion). Disregarding this data leads many people to assume that state spending has been *drastically* reduced in the wake of the "great recession," but the truth is that California continues to spend significantly more than it did before the recent economic downturn. Also keep in mind that in January, the Governor's Budget projected total state spending to be $204 billion, reflecting that total spending in the Governor's May Revision has grown by nearly $8 billion.




## Conclusion

The Governor's May Revision budget plan is an improvement relative to his January budget proposal because it reflects a desire to achieve some Republican priorities such as reducing budgetary debt and adopting tax policies that assist rather than hinder the economic recovery and create jobs. However, it still includes a $58 billion tax scheme that increases General Fund spending by $24 billion over the next three years. The May Revision's inclusion of $6.6 billion of unanticipated state General Fund revenues demonstrates just how unpredictable revenue growth can be. Given this uncertainty, the Governor's five-year tax and spend plan is an irresponsible and unacceptable abuse of California's hard-working families.

Not only does the May Revise include a tax plan that would likely suppress the burgeoning economic recovery, it also still fails to address Senate Republican requests for meaningful reforms. Republicans have called for real pension reform, a tighter state spending limit, and regulatory relief for California businesses to help reduce unemployment. Despite some steps in the right direction, the May Revision is too heavy on new tax revenue and spending increases and too light on the reforms needed to lay the groundwork for a strong economic recovery and ensure the state's budget is balanced now and into the future.

# Expenditures

The 2010 Budget Act included total General Fund expenditures of $86.6 billion for 2010-11. However, General Fund expenditures for 2010-11 have increased by about $5.0 billion (to $91.6 billion) since the passage of the 2010 Budget Act (approximately 5.7 percent). Most of this increase in costs was recognized as part of the Governor's Budget, and the May Revision actually scales back spending by $643 million.

The Governor's May Revision reflects nearly $4.2 billion of increased General Fund spending as compared to the January Governor's Budget. These revised estimates reflect a year-over-year decrease of General Fund spending ($2.8 billion), but it also shows how quickly the Administration will increase spending as new revenues come in rather than reduce taxes. The Governor's May Revision proposes General Fund spending of $88.8 billion for 2011-12. The following table compares expenditures proposed in the Governor's Budget to those proposed at the May Revision:

**General Fund Expenditures By Agency**

(dollars in millions)

| Agency | 2010-11 @ Governor's Budget | 2010-11 @ May Revision | | 2011-12 @ Governor's Budget | 2011-12 @ May Revision |
|---|---|---|---|---|---|
| Legislative, Judicial, Executive | $3,167 | $3,145 | | $2,507 | $2,546 |
| State and Consumer Services | $586 | $583 | | $597 | $626 |
| Bus, Trans, and Housing | $507 | $417 | | $691 | $603 |
| Resources | $2,032 | $2,004 | | $2,066 | $2,009 |
| Environmental Protection | $75 | $75 | | $63 | $62 |
| Health and Human Services | $26,961 | $26,557 | | $21,175 | $21,937 |
| Corrections and Rehabilitation | $9,257 | $9,623 | | $9,165 | $9,768 |
| K-12 Education | $36,353 | $35,849 | | $36,211 | $38,252 |
| Higher Education | $11,651 | $11,608 | | $9,814 | $10,737 |
| Labor and Workforce Development | $42 | $42 | | $414 | $371 |
| General Government | $1,524 | $1,519 | | $1,544 | $1,494 |
| Other* | $54 | $144 | | $367 | $398 |
| **Total, General Fund Expenditures** | **$92,209** | **$91,566** | | **$84,614** | **$88,803** |
| Year-Over-Year Change | | -$643 | | | $4,189 |
| - As a Percentage | | **-0.7%** | | | **5.0%** |

* Offsets in this table include additional federal funds for various health and human services programs, UC and CSU and Judicial and Criminal Justice services, Proposition 1A borrowing from local governments, fund shifts from redevelopment agencies to schools, payment deferrals for Proposition 98 and state worker pay, and using 63 funds to support existing programs.

General Fund expenditures continue to fall short of those recorded for 2007-08, when they peaked at $103 billion…prior to the beginning of the "Great Recession." Ongoing expenditures in the range of high-$80 to low-$90 billions of dollars has led to many claims that the state has already "cut to the bone." It is important to note, however, that while General Fund resources have been reduced, other fund sources have backfilled those reductions.

A review of federal funds, deferrals, borrowing, and other tools that the state has used to reduce General Fund spending and maintain programmatic funding levels provides a more accurate view of “Underlying General Fund Program Spending.” The table below reflects the impact of “offsets” that have been used to maintain General Fund programs.

**Underlying General Fund Program Spending**

(dollars in billions)

| | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 |
|---|---|---|---|---|---|
| **Schedule 9 Expenditures** | **$103.0** | **$90.9** | **$86.6** | **$91.6** | **$88.8** |
| "Offsets" to Maintain General Fund Program Levels* | -- | $8.2 | $11.4 | $7.3 | $9.0 |
| **Total, General Fund Program Expenditures** | **$103.0** | **$99.1** | **$98.0** | **$98.9** | **$97.8** |

It is clear that while General Fund spending has technically been reduced significantly for each of the past four years, total spending for General Fund programs has remained relatively constant (nearly $100 billion) over that same time period (an average of only 4.4 percent below 2007-08 levels).

# Taxes & Revenues

The May Revision proposes General Fund revenues of $95.7 billion for 2010-11 and $93.6 billion for 2011-12, including approximately $5.3 billion of General Fund tax increases over the two year period. These amounts do not include $5.6 billion of increased tax revenue related to providing a 0.4 percent Vehicle License Fee (VLF) increase and a one percent Sales and Use Tax (SUT) increase that are a part of the Governor's realignment proposal.

In January, the Governor proposed $14 billion of tax increases, $11 billion of which would be submitted to the voters for approval. Over the next five years, the January tax increases would cost taxpayers nearly $61.3 billion. The May Revision proposes the same mix of tax increases, but they are valued at $11.1 billion ($9.4 billion to be submitted to the voters). Over the next five years, the May Revision tax increases would cost taxpayers more than $57.8 billion.

The following table identifies where revenues are projected to increase and decrease, and compares them to estimates prepared in January for the 2011-12 Governor's Budget.

**General Fund Revenue Projections**

(dollars in millions)

| 2009-10 Revenue Source | Governor's Budget Revenues | Unexpected Windfall | May Revision Base Rev | Adjusted May Revenues | Change from Governor's Budget |
|---|---|---|---|---|---|
| Personal Income Tax | $44,848 | $4 | $44,852 | $44,852 | $0 |
| Sales & Use Tax | $26,741 | $0 | $26,741 | $26,741 | $0 |
| Corporation Tax | $9,115 | $0 | $9,115 | $9,115 | $0 |
| Insurance Tax | $2,002 | $0 | $2,002 | $2,002 | $0 |
| Other Revenues&Transfers | $4,335 | -$1,899 | $2,436 | $2,436 | $0 |
| **Total Revenue** | **$87,041** | **-$1,895** | **$85,146** | **$85,146** | **$0** |
| **2010-11 Revenue Source** | **Governor's Budget Revenues** | **Unexpected Windfall** | **May Revision Base Rev** | **Adjusted May Revenues** | **Change from Governor's Budget** |
| Personal Income Tax | $47,784 | $3,721 | $51,505 | $51,945 | $4,161 |
| Sales & Use Tax | $26,709 | $31 | $26,740 | $26,740 | $31 |
| Corporation Tax | $11,509 | -$1,042 | $10,467 | $9,408 | -$2,101 |
| Insurance Tax | $1,838 | $178 | $2,016 | $2,016 | $178 |
| Other Revenues&Transfers | $6,354 | $889 | $7,243 | $5,631 | -$723 |
| **Total Revenue** | **$94,194** | **$3,777** | **$97,971** | **$95,740** | **$1,546** |
| **2011-12 Revenue Source** | **Governor's Budget Revenues** | **Unexpected Windfall** | **May Revision Base Rev** | **Adjusted May Revenues** | **Change from Governor's Budget** |
| Personal Income Tax | $49,741 | $4,449 | $54,190 | $54,329 | $4,588 |
| Sales & Use Tax | $24,050 | -$135 | $23,915 | $23,915 | -$135 |
| Corporation Tax | $10,966 | -$701 | $10,265 | $10,160 | -$806 |
| Insurance Tax | $1,974 | -$81 | $1,893 | $1,893 | -$81 |
| Other Revenues&Transfers | $2,965 | $1,222 | $4,187 | $3,326 | $361 |
| **Total Revenue** | **$89,696** | **$4,754** | **$94,450** | **$93,623** | **$3,927** |
| **Three-Year Total** | | **$6,636** | | | **$5,473** |

The table on the previous page provides a significant amount of information that is not readily understood. Note the following main points:

- In the four months since the release of the January Governor's Budget, baseline General Fund revenue has increased by more than $6.6 billion. Of particular interest is the fact that this $6.6 billion increase offsets adjustments made in the January budget that recognized a $5.5 billion decrease in baseline General Fund revenues. In reality, General Fund revenues are about $1.1 billion higher than projected when the Governor signed the budget last October. One thing is for certain, there is consistent uncertainty related to revenue projections.
- ***As noted previously, $5.6 billion of tax increases related to the Governor's realignment proposal are not included in this table.***
- Total General Fund revenues and transfers over the three year period are about $5.5 billion higher than what was included in the January Governor's Budget. This amount is $1.1 billion less than what would be expected based solely on "natural growth" ($6.6 billion). This difference is primarily the result of changes made by the Governor to his January tax increase proposals, as well as accounting methodology changes.

**Governor's Tax Increase Proposals**

The Governor's May Revision continues to pursue many of the tax increases proposed in the Governor's Budget, but takes baby steps toward providing incentives for business growth in California. Taxes included in the Governor's Budget and May Revision can be understood in three parts: (1) Tax increases for voter approval; and (2) Tax increases not proposed for voter approval; and (3) new tax incentives. Changes since the Governor's Budget, proposed in the May Revision, are seen in *italics*.

**1) Tax Increases: <u>Subject to Voter Approval</u>**

- **Personal Income Tax (PIT) Rate Surcharge:** Re-establish the 0.25-percentage point surcharge for each PIT tax rate and the Alternative Minimum Tax (AMT) rate. The Governor's Budget proposed to reinstate the surcharge beginning January 1, 2011 through December 31, 2015. *The Governor's May Revision now proposes to impose the surcharge for only four years beginning January 1, 2012 through December 31, 2015. This revised proposal is projected to generate $1.3 billion of General Fund revenue in 2011-12.*
- **PIT Dependent Exemption Credit:** Re-establish the reduced dependent exemption credit in effect in 2009 and 2010, through 2015 while allowing for annual indexing. This aligns the dependent exemption credit with the amount of the personal exemption credit. For the 2010 tax year, the personal exemption credit is $99, as was the dependent exemption credit. This proposal is expected to generate revenues of $799 million in 2010-11 and $1.4 billion in 2011-12. This tax increase from 2009 expired on December 31, 2010, so this change would not be extending an existing tax*. No change to Governor's Budget proposal.*
- **Sales and Use Tax Increase (SUT):** Effective July 1, 2011, the additional one percent that was originally enacted in 2009 would continue for an additional five years, but would be redirected as local purpose revenues to fund the Governor's realignment proposal. As such, they are not reflected in the General Fund revenues shown above. This proposal is expected to generate revenues of $4.5 billion in 2011-12. *No change to Governor's Budget proposal.*
- **Vehicle License Fee (VLF) Increase:** Effective July 1, 2011, the additional 0.5 percent that was originally enacted in 2009 would continue for an additional five years, but would be redirected as local purpose revenues to fund the Governor's realignment proposal. As such, they are not reflected in the General Fund revenues shown above. This proposal is expected to generate additional revenues of $1.4 billion in 2011-12. *The Governor's May Revision now*

*proposes to deposit 0.1 percent ($270 million) into the General Fund, while continuing to use 0.4 percent ($1.1 billion) to fund the realignment proposal.*

**2) Tax Increases: <u>NOT Proposed for Voter Approval</u>**

- **Eliminate Enterprise Zone Tax Incentives:** The Governor's budget proposed to eliminate all enterprise zone (EZ) tax incentives and similar tax incentives for specific areas for tax years beginning on or after January 1, 2011. Local agencies would be authorized to retain any local incentives. This ***tax increase*** was expected to generate additional revenues of $343 million in 2010-11 and $581 million in 2011-12. *The Governor's May Revision now proposes to rescind the Governor's Budget proposal to eliminate EZs, and instead proposes to "reform" them. The details of the reform are included in the next section. "Reforming" EZs is projected to generate revenues of $23 million in 2010-11 and $70 million in 2011-12, growing to $300 million in 2015-16.*
- **Enact Mandatory Single Sales Factor (SSF) Apportionment:** As part of the 2009 Budget Act, the Legislature adopted an optional single sales factor apportionment (SSF) method, and required all corporations to follow the "market rule" for apportioning the sales of intangible personal property. The legislation provided for an election, effectively allowing corporations annually to choose the lower of two tax rates. The Governor's budget now proposes to require all corporations (except those corporations engaged in qualified agricultural, extractive, or banking activities) to use SSF. This ***tax increase*** is expected to generate additional revenues of $470 million in 2010-11 and $950 million in 2011-12. *No change to Governor's Budget proposal.*

**3) New Tax Incentives (not included in the January Governor's Budget).** In response to Republican criticism that the Governor's Budget in January did not focus on economic stimulus and job creation, the Governor is now proposing two initiatives that could help California's economy:

- **Expand the Current Jobs Credit:** The Governor's May Revision proposes to expand the existing jobs credit to (1) provide $4,000 per new employee, and (2) offer the credit to companies with fewer than 50 employees. Under existing law, the current jobs credit provides only $3,000 per new employees and is available only to companies with fewer than 20 employees. This bill is similar to Senator Emmerson's bill, SB 156, which would offer the credit to companies with fewer than 50 employees. This proposal would sunset the credit at the end of 2012, as opposed to existing law that allows the credit to continue until $400 million of credits have been issued.
- **Sales and Use Tax (SUT) Exemption for Purchases of Manufacturing Equipment:** The Governor's May Revision proposes a modest exemption from the General Fund share of the SUT for the purchase of manufacturing equipment. Start-up firms would be eligible for a five-percent exemption, while all other firms would be eligible for a one-percent exemption. The exemption would be effective only in years when the SUT rate is six percent (beginning in 2012-13 - for four years if voters approve the SUT tax increase). This proposal is a step in the right direction, but falls far short of Senator Dutton's bill, SB 395, that would authorize a broader five percent SUT exemption on all equipment that is used in manufacturing and research and development process. While potentially helpful, this exemption does not go far enough to help California businesses, and is explicitly tied to a mandatory SSF (a $1.4 billion tax increase).

# Local Economic Development

In the Governor's May Revision, the Governor continues to propose the elimination of Redevelopment Agencies (RDA), but has backed away from eliminating Enterprise Zones (EZs)…opting to "reform" them as opposed to repeal.

## Major Aspects Affecting Local Economic Development

- Phases out RDAs, providing a one-time $1.7 billion offset in 2011-12 to General Fund costs in Medi-Cal ($840 million) and trial courts ($860 million), and $210 million to cities, counties and special districts. This is the same as in the January proposal, and we assume it still includes the intent to pursue a 55 percent voter approval for limited tax increases and bonding against local revenues for development projects.
- Rescinds the Governor's January proposal to repeal EZs, which was projected to generate $924 million of revenues ($343 million in 2010-11 and $581 million in 2011-12.
- Proposes to "reform"EZ by (1) limiting hiring credits to firms that actually increase their level of employment (but only if they are claimed on a taxpayer's original return), (2) prohibiting vouchers from being granted for tax years prior to 2011, as specified, and (3) limiting credits earned in an EZ to a five-year carry-forward period. This reform proposal is estimated to generate revenues of $23 million in 2010-11, $70 million in 2011-12, and growing to $300 million annually by 2015-16.

## Positive Aspects of the Governor's May Revision:

- Eliminates RDAs, many of which have been called out on instances of corruption, questionable spending, and poor accountability (including RDAs in Los Angeles County, and the cities of Industry, Banning, Riverbank, King, Rosemead, etc.).
- Returns billions of property tax revenues from RDAs to schools, cities, and counties to help sustain core functions such as law enforcement, fire protection, and education.

## Negative Aspects of the Governor's May Revision:

- The Governor's May Revision proposed a new financing mechanism for economic development, including a Constitutional amendment to provide for 55 percent voter approval for limited tax increases and bonding against local revenues for development projects (similar to the current RDA process). Under existing law, local tax increases for "specific purposes" require 2/3 vote of the people. This proposal would lower the threshold for tax increases from 2/3 to 55 percent.
- Eliminates an existing tool (RDAs) that have been used successfully by some local communities to revitalize the business climate and to rehabilitate and provide low-income housing (i.e., Pasadena's Old Town, Stockton's water front plaza, and San Diego's Gaslamp Quarter).
- Reforming EZs (as proposed by the Governor) would effectively eliminate the program's benefits, and burden businesses by replacing the existing program with another hoop-laden program that does nothing to benefit the budget, the economy, workers, businesses or communities.

While support and opposition for RDAs and EZs has been mixed among Republican members (depending on the performance of these entities within respective geographical areas), Republicans have consistently opposed attempts to reduce the vote threshold for increasing taxes. Notwithstanding the potential benefits of modifying these economic development strategies, reducing the vote threshold for enactment of local tax increases is a "poison pill."

# K-14 Education

The Governor's May Revision proposal fully funds the Proposition 98 guarantee for K-14 education at $52.4 billion in 2011-12, up $3 billion from his January proposal and still contingent on voter approval of new taxes. The growth in the guarantee is driven mostly by baseline General Fund revenue growth ($1.44 billion), an accrual adjustment ($470 million), and two adjustments to 'rebench' it upward – one to hold it harmless from the reduction naturally resulting from the fuel tax swap enacted in Chapter 6, Statutes of 2011 ($630 million) and a second to reflect the shift of responsibility for special education mental health services from counties to schools ($220 million, discussed further below).[1] The chart below displays the Proposition 98 funding levels proposed by the Governor's May Revision.

**Proposition 98 Funding**

*Source: Legislative Analyst's Office*

($ in millions)

| | 2007-08 | 2008-09 | 2009-10 | January 2010-11 | May 2010-11 | January 2011-12 | May 2011-12 |
|---|---|---|---|---|---|---|---|
| **K-12 education** | | | | | | | |
| **General Fund** | $37,752 | $30,075 | $31,732 | $32,239 | $31,722 | $32,401 | $34,430 |
| **Local property tax revenue** | $12,592 | $12,969 | $12,328 | $11,557 | $12,147 | $11,406 | $12,123 |
| **K-12 subtotal** | $50,344 | $43,044 | $44,060 | $43,796 | $43,868 | $43,807 | $46,553 |
| **California Community Colleges** | | | | | | | |
| **General Fund** | $4,142 | $3,918 | $3,721 | $3,885 | $3,885 | $3,542 | $3,807 |
| **Local property tax revenue** | $1,971 | $2,029 | $2,000 | $1,892 | $1,949 | $1,873 | $1,949 |
| **CCC subtotal** | $6,112 | $5,947 | $5,721 | $5,777 | $5,834 | $5,415 | $5,756 |
| **Other Agencies** | $121 | $105 | $93 | $85 | $85 | $78 | $85 |
| **Total Proposition 98 1/** | $56,577 | $49,096 | $49,874 | $49,658 | $49,787 | $49,300 | $52,394 |
| **General Fund** | $42,015 | $34,098 | $35,546 | $36,209 | $35,691 | $36,021 | $38,322 |
| **Local property tax revenue** | $14,563 | $14,997 | $14,327 | $13,449 | $14,096 | $13,279 | $14,072 |
| **Prop 98 per-pupil funding (K-12)** | $8,464 | $7,226 | $7,425 | $7,358 | $7,369 | $7,344 | $7,802 |
| **Programmatic funding 2/** | $8,235 | $8,415 | $7,933 | $7,820 | $7,830 | $7,693 | $7,733 |

1/ reflects 10-11 Governor's vetoes

2/ reflects LAO estimates of funds spent in each year from K-12 ongoing funding, deferrals, settle-up, Public Transportation Account, freed-up restricted reserves, and federal stimulus and education jobs funding.

Although the January Proposition 98 budget proposal appeared roughly flat from 2010-11 to 2011-12, base spending reductions of roughly $3 billion would have been necessary to offset the backfill of one-time solutions in 2010-11 and to 'make room' for various increasing costs within the guarantee (e.g., growth in average daily attendance). Accordingly, it proposed $2.2 billion in additional K-14 deferrals (as an alternative to outright reductions), $500 million net reduction in child care funding, and a $360 million net reduction in California Community College (CCC) funding. The Governor's May Revision would spend the majority of its $3 billion increase in Proposition 98 spending to avoid new deferrals and begin unwinding old ones. This would halt the state's recent practice of deferring more school payments each year, which forces schools to borrow funds to bridge the deferral period, or make outright program cuts if they lack borrowing capacity.

**Reimbursable state mandates.** The Governor's May Revision proposes to suspend several K-12 mandates for savings of $32.3 million, and to streamline future funding of K-14 mandates through a new categorical block grant approach, as the LAO has recommended.

[1] The Legislative Counsel has opined that rebenching is unconstitutional.

**New charter schools.** The Governor's May Revision proposes $19.5 million for charter school growth and $8 million for in-lieu categorical funding of new schools, most of which are charters.

**AB 3632 mental health services for special education students.** As noted above, the Governor's May Revision would repeal the state-level AB 3632 mandate, deferring to the requirements of a similar federal mandate, thus shifting responsibility for federally-mandated mental health services for students with disabilities from counties to schools. In addition to about $222 million in Proposition 98 funding, schools would get $69 million in federal special education funds for this purpose, and county mental health agencies would get about $99 million in one-time Proposition 63 funds during the transition period.

**Data systems.** The Governor's May Revision proposes to eliminate funding for CalPADS and CalTIDES, the state's longitudinal data systems for students and teachers, respectively. The Administration feels that the focus on data is distracting from the focus on instruction, and that the state is inappropriately micromanaging schools' collection and use of data. Scaling back the state's student data collection agenda might be a good idea, but we need to retain sufficient data capacity to meet requirements for federal funding. Restoration of the CalPADS funding should be approved only if it comes with language making the funds contingent on resolution of outstanding issues (e.g., resolution of contractor default issues, successful "knowledge transfer" from the contractor to CDE, correction of known software defects, demonstration of system reliability, etc.

**"Green" education.** The Governor's May Revision proposes $3.2 million in Proposition 98 funding for a new "Clean Technology and Renewable Energy Job Training, Career Technical Education, and Dropout Prevention Program" enacted through SB X1 1 (Chapter 2/2011, Steinberg), which received *no support* from Senate Republicans. **It makes no sense to launch a new categorical program** while simultaneously continuing reductions to schools' existing general purpose and categorical program funding.

**Child care.** The Governor's January budget proposal included substantial reforms to state-subsidized child care programs, many of which were adopted or modified by the Legislature for savings of almost $500 million. *The Governor's May Revision assumes that all of the child care reforms approved to date will continue.* It makes a variety of technical (caseload) adjustments, and anticipates that caseload may grow by $56 million in 2010-11 and $33.6 million in 2011-12, but does not appropriate funds for that potential growth.

**Community Colleges.** In March, the Legislature approved a Community College budget that included a $400 million funding reduction. The Governor's May Revision would make several changes to that budget, most notably to:

- Reduce CCC deferrals by $350 million, from $961 million to $611 million
- Reduce General Fund support by $58 million in 2010-11 and $75 million in 2011-12, backfilling the reductions with expected increases in local property tax revenues
- Reduce CCC mandates funding by $5.9 million, consistent with the mandate reform (block grant) proposal for K-12 education
- Remove $5.5 million in expenditure authority for Vocational Education to conform with the elimination of federal Tech Prep program funding

The colleges would still get their full statutory share of Proposition 98 funding (roughly 11 percent, or about $5.75 billion, up from the $5.4 billion proposed by the Governor in January and adopted by the Legislature). Student fees would be $36 per credit unit, per action already taken by the Legislature to raise them by $10 per credit unit effective July 1, 2011, but **would still be the lowest in the nation**. Students from families with incomes of up to $65,000 would continue to receive fee waivers, and those from families with incomes of up to $160,000 could get fee refunds through federal tax credits, thus effectively increasing the percentage of California tax dollars flowing back to the state.

**Missed Opportunities.** The Governor does *not* propose to bring **Proposition 49** before- and after-school programs back 'on-budget' so as to make that $550 million in Proposition 98 funding available for higher priority uses. Nor does he propose to repeal the restrictions on schools' authority to **contract out** for non-instructional services originally enacted in SB 1419 (Ch. 894/2002), which could free up several hundred million dollars each year for higher priority uses, nor to make **other needed reforms** relative to seniority-driven layoffs, substitute pay, layoff notice deadlines, or employee dismissal for cause.

## Higher Education (non-Proposition 98)

**UC and CSU.** The Governor's budget proposal, approved by the Legislature in March, imposed ongoing General Fund reductions of $500 million each at UC and CSU, offset by a $107 million augmentation to each segment to backfill the loss of one-time federal stimulus funds, as shown in the chart below. The Governor's May Revision leaves these appropriations unchanged, and it proposes no further student fee increases beyond those already adopted, but it does propose two notable adjustments for CSU:

- Reduce General Fund support for CSU CalPERS retirement contributions budgeted through Control Section 3.60 by up to $69 million, to offset previous overpayments, should such overpayments be confirmed
- Eliminate duplicative CSU audits to achieve efficiencies, which would enable CSU to save an estimated $1.6 million annually, similar to the proposal pending in SB 736 (Cannella)

**UC & CSU Funding**

(Selected core funds, in millions)

| | Fund | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 |
|---|---|---|---|---|---|---|
| **UC** | **General Fund** | **$3,257** | **$2,418** | **$2,596** | **$2,912** | **$2,524** |
| | **Fees** [1/] | **$1,593** | **$1,677** | **$2,001** | **$2,566** | **$2,749** |
| | **ARRA** [2/] | **$0** | **$717** | **$0** | **$107** | **$0** |
| | **Lottery** | **$25** | **$25** | **$28** | **$30** | **$30** |
| | **Total UC** | **$4,876** | **$4,837** | **$4,625** | **$5,614** | **$5,303** |
| **CSU** | **General Fund** [3/] | **$2,971** | **$2,155** | **$2,350** | **$2,683** | **$2,291** |
| | **Fees** [1/] | **$1,176** | **$1,406** | **$1,593** | **$1,718** | **$1,940** |
| | **ARRA** [2/] | **$0** | **$717** | **$0** | **$107** | **$0** |
| | **Lottery** | **$58** | **$42** | **$46** | **$46** | **$46** |
| | **Total CSU** | **$4,205** | **$4,320** | **$3,990** | **$4,553** | **$4,277** |
| | **Total** | **$9,081** | **$9,156** | **$8,615** | **$10,168** | **$9,580** |

[1/] Includes amounts diverted to financial aid controlled by UC and CSU

[2/] Federal American Recovery and Reinvestment Act ('stimulus') funding for 2008-09 w as received in the 2009 calendar year

[3/] 2011-12 funding could be reduced by up to $69 million if it is determined that previous overpayments w ere made

*Source: Legislative Analyst's Office*

**Student Fees.** The Governor's May Revision proposal assumes no changes to the 2011-12 annual undergraduate fees already approved by the UC Regents and CSU Trustees of $11,124 and $4,884 respectively.

**Student Financial Aid.** The Governor's May Revision proposes several significant adjustments to the budget of the California Student Aid Commission already approved by the Legislature in SB 69 (and still pending transmittal to the Governor), most notably:

- An increase of about $33 million in 2010-11, in addition to the $147 million augmentation already made pursuant to budget bill language, and $16 million in 2011-12 for growth in the estimated cost of the CalGrant student financial aid entitlement program
- A General Fund increase of about $113 million to backfill an identical reduction in federal TANF funds supporting CalGrants. The TANF funds would be used instead to backfill the erosion of CalWORKS (welfare) savings
- A reduction in the estimate of savings expected from the imposition of a limit on the maximum student loan default rates allowable for institutions participating in the CalGrant program, from $19 million to $5.7 million
- A one-time backfill of $12.25 million General Fund with Student Loan Operating Fund, for General Fund savings of the same amount

**California Postsecondary Education Commission.** The Governor's May Revision proposes to eliminate CPEC, for half-year savings of $927,000 in 2011-12 and twice that amount in subsequent years. The federally-funded "Improving Teacher Quality" grant program currently administered by CPEC would be moved to the California Department of Education. CPEC's contribution to education policy analysis has been negligible, and it has publicly called for higher taxes as its preferred budget solution.

# Health & Human Services

## HEALTH

**Department of Health Care Services (DHCS) – Medi-Cal**

**Overview.** The Governor's May Revision provides $14.7 billion General Fund ($46.3 billion total funds) for the Medi-Cal Program in 2011-12, which represents a net increase of $886 million General Fund from the Governor's January budget proposal. This net increase reflects a variety of counteracting factors, including (1) the deletion of $1 billion in savings from the Proposition 10 fund shift, (2) the erosion of $172 million in savings due to late enactment of January solutions, and (3) new savings proposals totaling $450 million (mainly from revising the hospital quality assurance fee) that were not included in the Governor's January proposal. The most significant changes and new proposals are discussed in more detail below.

**Consolidation of the Healthy Families Program (HFP) into Medi-Cal.** The Governor's May Revision proposes net savings of $31.2 million General Fund in 2011-12 to shift Healthy Families children into the Medi-Cal Program. Children now enrolled in HFP would shift to Medi-Cal over a six-month period beginning January 1, 2012. The new Medi-Cal costs to care for these children would be more than offset by savings in the HFP budget. The Administration estimates that the bulk of these savings would result because the state pays health plans lower rates to treat children in Medi-Cal than in HFP, even for the 43 percent of children that would actually remain in the same health plan after switching to Medi-Cal. In other words, most of the estimated savings results from a rate reduction of over 30 percent to health plans for most HFP children. The Administration indicates that this proposed shift is intended in part to implement federal health reform early. Despite the savings projected by the Administration, this proposal raises several concerns:

- *Cost Estimates Uncertain.* It is not yet clear that DHCS has accurately estimated what costs will be for benefits and administration for the transferring of HFP enrollees. Part of the Administration's proposal is a complicated arrangement of sharing enrollment responsibilities between counties and the current HFP vendor (currently MAXIMUS). The vendor would still collect family income information and monthly premiums for HFP enrollees in families with incomes higher than 150 percent of the federal poverty level, but would send enrollee files electronically to county welfare offices for final eligibility determinations. The Administration has not yet determined what the administration costs will be for this arrangement. County costs to process Medi-Cal applications have typically been much higher than the HFP vendor's costs, although a comparison is difficult due to more complex eligibility rules in Medi-Cal. Nonetheless, until all the administrative costs are identified, it is not clear that this proposal will actually generate savings.
- *Reduced Health Care Access.* Roughly 892,000 kids now enrolled in HFP would switch to Medi-Cal in 2011-12, and over 500,000 would either need to switch health plans or would need to use the Medi-Cal fee-for-service (FFS) provider network. Changing health plans would likely be a manageable change for most families, but the Medi-Cal FFS system offers inferior access to doctors and some specialists in many areas of the state.
- *HFP Board Criticism.* The Managed Risk Medical Insurance Board (MRMIB), a quasi-independent board that manages Healthy Families, issued a rare, strongly worded public letter criticizing the Governor's proposal. In the letter, MRMIB raises concerns about health care quality in Medi-Cal, questions the validity of the savings assumptions, and cites the lack of transparency and accountability associated with Medi-Cal compared with HFP.
- *Expanding an Entitlement Program.* The Medi-Cal Program is an open-ended entitlement program under federal law, meaning that the state generally must pay the costs of any person who meets the eligibility criteria, regardless of the overall costs. The HFP, on the other hand, is currently not an

entitlement, meaning that the state has some options to manage the program within a given budget. Given the state's current fiscal crisis, shifting beneficiaries from a capped program into an entitlement program is imprudent.

Republicans have historically supported HFP's approach because it supports working families, relies heavily on the private market for health care and administration, and incorporates shared responsibility through family premiums and copayments. This proposal is contrary to that approach because it shifts most administration over to a large state bureaucracy and county welfare offices, and eliminates premiums for some enrollees.

**Loss of Proposition 10 Fund Shift.** The Governor's May Revision reflects a loss of $1 billion in savings from redirecting Proposition 10 (First 5) reserves, which the Governor and legislative Democrats agreed to approve on a one-time basis without seeking voter approval. Senate Republicans voiced concerns in budget hearings regarding the legality of such an approach, and advocated sending the fund shift back to the voters. Since then, seven county First 5 commissions have sued to block the fund shift, claiming that only the voters have the authority to amend Proposition 10. The Administration indicates it will defend the current action in court, even though it is no longer assuming the savings. A more advisable approach would be for the Legislature to submit the redirection of First 5 funds to the voters for approval, including some ongoing First 5 revenue in addition to the $1 billion shift, as Governor Brown originally proposed in January.

**Savings Erosions.** Savings actions adopted by the Legislature in March were originally estimated to save nearly $1.6 billion in Medi-Cal. However, due primarily to the one month delay in taking action at that time, the overall savings have eroded by $172 million.

**Other Program Savings.** The Governor's May Revision reflects new savings items totaling $450 million General Fund, as well as "workload" adjustments totaling $115 million, including the following:

- *Hospital Quality Assurance Fee.* Savings of $320 million related to extending a revised version of the hospital "quality assurance fee" that was recently extended to June 30, 2011. Chapter 19, Statutes of 2011 (SB 90/Steinberg) authorized these savings but conditioned them upon approval of subsequent policy legislation that would establish the specifics of the fee. Although many Republicans supported SB 90, the follow-up legislation (SB 335/Steinberg, Hernandez) warrants careful evaluation because the fee could have detrimental effects on a significant number of individual hospitals or hospital chains. SB 90 also amended other Medi-Cal savings actions that are reflected in the Governor's May Revision, most notably lifting the inpatient hospital rate freeze imposed for 2010-11, repealing rate reductions for non-contract hospitals, and reducing disproportionate share payments for private hospitals.
- *Public Hospital Reimbursements.* $94 million in General Fund savings resulting from new reimbursements provided to Medi-Cal by designated public hospitals that receive federal funds under the hospital waiver. These new reimbursements are intended to reflect the designated public hospital component of the mandatory enrollment of Medi-Cal seniors and disabled persons into managed care plans.
- *Adult Day Health Center (ADHC) Transition.* The Governor's January budget plan proposed to eliminate the ADHC benefit for savings of $177 million General Fund. Legislative Democrats approved the elimination but also provided $85 million General Fund for a scaled-down replacement program to be implemented through subsequent legislation. The Governor's May Revision would reject that $85 million augmentation and instead provide $25 million General Fund

($50 million total funds) for a transition program to help ADHC users find alternative Medi-Cal services.

- *Intergovernmental Transfer Fee.* Savings of $34 million by imposing a fee of 20 percent on voluntary intergovernmental transfers (IGTs) that some county-operated managed care plans use to obtain additional federal funds. Counties are projected to provide $171 million in IGTs to Medi-Cal in exchange for higher federal reimbursement. Since the arrangement is entirely voluntary and provides a significant benefit to the participating counties, this proposal appears reasonable given the state's fiscal crisis.
- *Maddy Fund Sweep Removed.* During the March budget deliberations, Democrats sought $55 million in General Fund savings by sweeping a portion of local emergency services funds ("Maddy funds"). These savings were not part of the Governor's January budget proposal, and the Governor's May Revision now proposes to remove this action from the budget.

**Department of Public Health (DPH)**

**Overview.** The Governor's May Revision proposes $226 million General Fund ($3.1 billion total funds) for DPH in 2011-12, an increase of $40 million General Fund or 22 percent from the revised 2010-11 spending level. Notable individual programs and proposals are discussed below.

**AIDS Drug Assistance Program (ADAP).** The Governor's May Revision provides $83 million General Fund ($515 million total funds) for ADAP, an increase of $28 million General Fund or 51 percent compared with the revised 2010-11 spending level. Total funding for ADAP is now projected to increase by 11 percent in 2011-12 over the revised current year level. ADAP spending also reflects federal funds of $74 million in 2011-12 received through the recently enacted federal Bridge to Reform waiver. These funds help to offset additional General Fund costs that would otherwise result. In addition, DPH indicates that it will begin paying premiums for ADAP clients who voluntarily enroll in the recently implemented federal high-risk pool known as the Pre-Existing Condition Insurance Plan, which is administered by MRMIB. DPH estimates that this proposal will save a net of $5.7 million in the budget year.

**Immunization Funding Increase.** The Governor's May Revision proposes an increase of $7.3 million General Fund to restore DPH's immunization program funding. These funds are used to purchase influenza vaccines for distribution to local health districts. The 2010 Budget Act eliminated funding for this program due to the availability of one-time federal funds for the same purpose. The vaccines are intended primarily for seniors, pregnant women, and other high-risk individuals.

**Managed Risk Medical Insurance Board (MRMIB)**

**Healthy Families Program.** The Governor's revised budget includes $177 million General Fund ($838 million total funds) for HFP in 2011-12, which reflects a decrease of $95 million General Fund (35 percent) from January. The revised budget reflects the gradual shift of HFP enrollees to Medi-Cal, as discussed under the Medi-Cal section above.

**Access for Infants and Mothers (AIM).** The AIM Program provides prenatal and other health services to pregnant women with incomes between 200 percent and 300 percent of the federal poverty limit (roughly $44,000 for a single mother with a child). The program receives no General Fund support, but rather is funded primarily by tobacco tax proceeds and federal funds. The Governor's May Revision proposes that, effective October 1, 2011, all new AIM enrollees would receive services through the Medi-Cal fee-for-service system. No savings are associated with this proposal. Similar to concerns raised about the shift of HFP children to Medi-Cal, this proposed shift could result in diminished health care access to AIM enrollees, who now receive services through managed care plans.

**Elimination of MRMIB.** The Governor's May Revision proposes to eliminate MRMIB by July 1, 2012, and have its executive director report to the Secretary of Health and Human Services. This is consistent with the proposals to shift HFP and AIM to DHCS during 2011-12. The other programs administered by MRMIB would transition to DHCS during 2012-13. These include two high-risk pools and the County Children's Health Initiative Program. While Republicans generally support streamlining government operations, MRMIB has generally shown itself to be an efficient operation that uses a small number of state staff and operates a significant portion of its programs through contracts with private vendors such as managed care plans. This elimination proposal would fold programs from this largely effective entity into the enormous bureaucracy of DHCS.

**Department of Developmental Services (DDS)**

**Overview.** The Governor's May Revision provides $2.6 billion General Fund ($4.6 billion total funds) for DDS, which represents an increase of $213 million compared with the Governor's January budget package. This increase primarily reflects the Legislature's rejection of $224 million in savings the Governor proposed in January. The revised General Fund total is $171 million or seven percent higher than the revised estimate for 2010-11. The significant adjustments and new policies are discussed below.

**Earlier Reduction Target Detailed.** The March budget package approved savings of $591 million General Fund for DDS, including an unspecified $174 million reduction target for which the department was to develop proposals in conjunction with stakeholders. The Governor's May Revision indicates that the department will only be able to achieve $146 million of these savings in 2011-12 due to implementation lags, but that lower-than-expected caseload in the current year has provided sufficient savings to make up the difference. DDS projects that its thirteen proposals will achieve the full $174 million savings in the out years. Individual proposals of particular note include:

- *Reduced caseload and utilization*—$56 million savings from a baseline downturn in program costs. This is not actually a policy proposal, but the Administration is nonetheless offering it as part of the savings target.
- *Reduction and Efficiency in Regional Center Operations*--$14 million through several actions, most notably an unallocated reduction of $5.4 million and the elimination of $3 million for office relocation and modification. This is consistent with Republican priorities and comments made in budget hearings that DDS look to reduce overhead and administration before actual services.
- *Transfer Prevention Program Funds*. $7.5 million in 2011-12 and $10 million annually to reduce funding for the Prevention Program and transfer its responsibilities to the nonprofit Family Resource Centers. Remaining funding would be $4.5 million in 2011-12 and $2 million thereafter. Republicans have argued that the Prevention Program has been overfunded relative to the children it serves, and this proposal appears to better match the funding to the actual need.
- *Annual Program Fee*. $3.6 million in 2011-12 and $7.2 million annually to charge an annual fee for families with incomes greater than 400 percent of the federal poverty level ($89,400 for a family of four) who use particular services. Families above 400 percent would pay $150, and families above 800 percent would pay $200 annually. DDS estimates that about 42,000 families would pay a fee. Some fees already exist for certain DDS services, but families that pay the current fees would be exempt from this new fee. Expanding the use of family fees makes sense given the high value of the services provided by DDS. It would also be reasonable to assess fees beyond the level in the May Revision by incorporating a sliding fee scale, in which higher income families would pay a higher fee, and including families with lower incomes as well.

## Department of Mental Health

**Overview.** The Governor's budget proposes $1.3 billion General Fund ($4.5 billion total funds) for DMH programs, which is nearly identical to the level proposed in January. At this level, General Fund spending would be lower by $540 million or 29 percent than the updated estimate for spending in 2010-11. Current year spending is now estimated to be higher than the level appropriated for DMH, resulting in a deficiency request of up to $50 million. Following up on the Governor's January realignment package, the Governor's May Revision proposes to eliminate DMH and replace it with a department responsible for managing the state mental hospitals. These and other significant proposals are discussed further in the following paragraphs.

**Mental Health Deficiency.** The Administration indicates it will seek a supplemental appropriation bill in the current year to fund a deficiency of up to $50 million related to state mental hospital operations. However, the Administration is not yet able to identify definitively the specific causes of this deficiency, although DMH speculates that it is likely due to a combination of increases in overtime needed to maintain staff-to-patient ratios, extra security staffing, and higher patient admissions. In the absence of additional information regarding the cause of this deficiency, or any significant attempts to control costs prior to seeking additional funding, it is difficult to justify providing an overall funding increase in the state's current fiscal condition.

**Department Elimination and Creation.** The Governor's realignment package proposes to shift DMH's current community mental health services to counties, who already manage sizable mental health programs. Following such a shift, DMH's remaining responsibilities would consist almost entirely of managing the state mental hospitals. The Governor's May Revision proposes a new Department of State Hospitals that would administer these facilities with a renewed emphasis on managing the largely forensic (i.e., criminal) patients that now reside in state hospitals. Savings associated with the elimination have not yet been specified. The Governor's May Revision indicates that state operations related to public safety realignment in general will be reduced by 25 percent, although position reductions would not be fully implemented until July 2013.

**Additional Proposals.** The DMH May Revision also includes the following significant items:

- *Safety at State Hospitals.* Proposes an increase of 78 positions and $9.5 million to increase safety and security at the Napa, Metropolitan, and Patton state hospitals. The funding would include $4.0 million for personal alarms for staff at Napa State Hospital. The DMH indicates that it will seek an exemption from the usual technology procurement requirements, such as a feasibility study report, for the new alarm system. This proposal follows a year in which a patient fatally attacked a staff person at Napa State Hospital and four other staff members at various hospitals were hospitalized in separate incidents.
- *Special Education Mandate.* Amends the Governor's January realignment package with respect to special education mental health services (so-called AB 3632 mandate services). The January realignment proposal sought to shift these services directly to counties, who now provide the services and seek reimbursement from the state under standard mandate procedures. The amended proposal would instead shift responsibility for AB 3632 services to school districts beginning in 2012-13. This is a welcome change in direction that should address current confusion and misalignment of responsibility between counties and schools.

- *Proposition 63 Realignment Staffing.* Requests $2.3 million in Proposition 63 funds (Mental Health Services Act funds) to plan for the shift of greater MHSA responsibility from DMH to counties, as required by AB 100 in March. (Note that this is separate from the Governor's broader realignment proposal.)

## HUMAN SERVICES

The Governor's May Revision does not include any additional reductions within the state's human services programs for 2011-12. The Legislature took actions in March 2011 that will reduce General Fund expenditures in the long run and help address the structural budget deficit (See Recently Adopted Solutions below). Unfortunately, many of those policy changes did not go as far as the Governor had proposed in January, nor will they dramatically change the state's structural fiscal balance in subsequent years. Many of the In-Home Supportive Services actions are not program changes at all, but merely fund shifts and gimmicks that will likely result in a General Fund deficiency.

### Department of Social Services

### Recently Adopted Solutions

- $412.6 million General Fund-Reduced the counties' CalWORKs administration funding (also known as the single allocation). Expands exemptions within the welfare-to-work program to include those families with a child under the age of three in order to reduce the need for child care services as a way to manage the funding reduction at the county level.
- $314.3 million General Fund-Reduced CalWORKs grants by eight percent effective June 1, 2011.
- $178.4 million General Fund-Reduced monthly SSI/SSP grants for individuals to the federally required minimum level.
- $102.6 million General Fund-Reduced an adult's time on CalWORKs from 60 months to 48 months, effective June 1, 2011.
- $140 million General Fund-Proposed implementation of a medication dispensing pilot project for Medi-Cal beneficiaries. An unknown and untested program that will probably not achieve any savings.
- $67.4 million General Fund-Implemented a requirement that all IHSS applicants and recipients must have a physician certification of need prior to receipt of services.
- $128 million General Fund-Proposed implementation of the Community First Choice Option within the IHSS program. Although it appears this proposal may have merit and could result in the receipt of additional federal funds, it is highly unlikely that any savings would be achieved in 2011-12, creating yet another General Fund deficiency within an entitlement program.
- $83.3 million General Fund-Revised the earned income disregard within the CalWORKs program. Trailer bill language would revise the earned income disregard to be the first $112 of relevant income and then 50 percent of all other earnings, effective June 1, 2011.
- $86.3 million General Fund-Reduced grants to cases without an aided adult after a certain period of time (60, 72, and 84 months would each equate to a five percent grant reduction).
- $69 million General Fund-Eliminated Stage 1 child care for 11 and 12 year olds and reduced the reimbursement rate for licensed-exempt providers to 60 percent of the regional market rate.

**New Reductions Proposed for May Revision**

**Suspension of IT Projects the Only Proposed Reductions.** The Governor's May Revision proposes to indefinitely suspend the CWS/Web project and the Leader Replacement project, for savings of $29.3 million in 2011-12. The Child Welfare Services/Case Management System web project is in the planning and procurement phase, moving to design and implementation in 2012-13. The federal Administration for Children and Families may be revising requirements for the statewide automated child welfare information system and the Administration proposes a halt to the project until further clarification from the federal government.

The Los Angeles Eligibility, Automated Determination, Evaluation and Reporting Replacement (Leader Replacement) system is in the planning and procurement phase, with design and implementation set to begin sometime after 2012-13. The federal government has expressed concern with the current automation system (still in place) as it has been a sole source bid contract for many years. However, the state currently has other welfare automation systems in other counties that could be modified to meet the needs of Los Angeles, and utilizing a current system would save the state millions of dollars. The state should begin to look at what resources would be needed to migrate the Leader system into one of the other state welfare systems.

**Child Welfare Services**

**Foster Care Rates Increase.** The Governor's May Revision includes a proposal to increase foster family home rates as well as prospective Adoption Assistance Payment, Kinship Guardianship Assistance Payment, and Non-Related Legal Guardian payment rates pursuant to the *Foster Parent Association, et al vs. John A. Wagner, et al* court case. The budget includes additional funding of $12.3 million in 2011-12, a 31 percent increase in rates for foster family homes. In conjunction with the rate increases, the Governor's May Revision proposes to eliminate the supplemental clothing allowance for foster family homes, resulting in savings of $1.6 million in 2011-12.

**Funding Shift for Residential Care for Seriously Emotionally Disturbed Pupils.** The Governor's May Revision includes a reduction of $68 million in 2011-12 within DSS to reflect a shift in responsibility for Seriously Emotionally Disturbed placements from DSS to schools and a decrease in county administrative costs for this program. The budget proposes to include $66.6 million Proposition 98 General Fund on an ongoing basis to support this program.

## Department of Alcohol and Drug Programs

The Governor's May Revision continues to reflect the realignment for alcohol and drug programs from the state to the counties. As a result of this redirection of workload, the Governor's May Revision proposes to eliminate the Department of Alcohol and Drug Programs, shifting responsibility for Drug Medi-Cal to the Department of Health Care Services. For the federal block grant programs, licensing and certification activities, and all other non-Drug Medi-Cal programs (such as the Office of Problem Gambling), the Administration intends to identify which state department will provide oversight during the development of the 2012-13 budget.

# Public Safety & Judiciary

## Department of Corrections and Rehabilitation

***Baseline Adjustment.*** The Governor's May Revision includes deficiency funding of $414.9 million General Fund for the Department of Corrections and Rehabilitation (CDCR) to address various structural and operational shortfalls in the 2010-11 fiscal year, as well as a continuation of the baseline augmentation proposed in the Governor's Budget of $379.6 million to correct the structural shortfall on an ongoing basis. The original baseline augmentation proposal was for $395.2 million. However, it was later discovered that one element of the structural shortfall had been miscalculated, resulting in the funding need being overestimated by $15.6 million. The Administration continues to assert that providing this augmentation will true up CDCR's baseline funding, preventing the recurrence of funding shortfalls in the future.

***Population Changes.*** Relative to January projections, the adult institutional average daily population (ADP) is not projected to change much, while adult parolee ADP is projected to increase slightly. Juvenile institutional and parolee ADPs are both projected to decrease significantly. The net result of these changes is a General Fund decrease of $6.5 million in 2010-11 and an increase of $342,000 in 2011-12.

Projected institutional and parole populations are as follows:

- *Adult Institutions.* Institutional ADP is projected to be 163,634 for 2010-11 (decrease of 165 compared to January projections), and to decrease to 163,152 in 2011-12 (no change compared to January).
- *Adult Parole.* Parole ADP is projected to be 114,168 for 2010-11 (increase of 478 compared to January projections) and to decrease to 107,354 in 2011-12 (increase of 352 compared to January).
- *Juvenile Institutions.* ADP is projected to be 1,270 in 2010-11 (decrease of 34 relative to January projections) and to decrease to 1,165 in 2011-12 (decrease of 104 compared to January).
- *Juvenile Parole.* ADP is projected to be 1,520 in 2010-11 (decrease of 34 compared to January projections) and to decrease to 1,178 in 2011-12 (decrease of 286 compared to January).

Population funding projections reflect changes that are expected to occur on the natural (due to fluctuations in the rate of new commitments, implementation of court mandates, recent changes in the law, etc.) and do not consider population changes that would occur if the Governor's realignment proposal is enacted.

***Changes Related to Realignment.*** The Governor's May Revision includes the following changes to CDCR's budget related to realignment:

- Technical adjustment, reflected as a $240.6 million General Fund augmentation, to restore realignment savings scored in January and instead reflect them in the statewide realignment budget item.
- Technical adjustment shifting $393.6 million from CDCR's main budget item to two separate budget items. This separates baseline funding for in-state and out-of-state contract beds from the rest of CDCR's budget. The adjustment would facilitate any reduction or elimination

of contract beds that might come as a part of realignment. CDCR's bed contracts generally require a long-term commitment by the state. However, they contain clauses allowing for the reduction or termination of contracts in the event the budget fails to appropriate funds for contract beds. To the extent these provisions are exercised in connection with realignment, it would make it more difficult for CDCR to contract for bed space in the future.

- General Fund decrease of $36.1 million for the Board of Parole Hearings to reflect realignment of the parole revocation process to the courts *(see related item under Realignment-Related Parole Revocation Workload on page 28).*
- Increase of $275,000 General Fund to allow the Corrections Standards Authority to continue the review and approval process for county juvenile justice plans. As a result of the realignment of local public safety funding, this workload will no longer be funded through the Supplemental Law Enforcement Services Fund and will instead be funded by the General Fund.
- Increase of $97 million General Fund to reflect a recalculation of the Department's workforce cap reduction target. The recalculation accounts for changes to CDCR's operations that will result from realignment.

***Community Corrections Performance Incentive Grant Program.*** The Governor's Budget included $59.2 million General Fund for the Community Corrections Performance Incentive Grant Program that was established by Chapter 608, Statutes of 2009 (SB 678, Leno and Benoit). SB 678 established a system of performance-based funding that shares state General Fund savings with county probation departments when they demonstrate success in reducing the number of adult felony probationers sent to state prison for committing new crimes or violating their terms of probation. The Governor’s May Revision includes an additional $30 million for payment to counties, based on final calculations of the state’s cost avoidances.

***Abandoning Construction of the San Quentin Condemned Inmate Complex.*** The Governor recently announced his decision to abandon the ongoing project to construct a new condemned inmate housing unit and related facilities at San Quentin State Prison. The project is necessary to modernize the state's condemned inmate housing capacity and to correct existing deficiencies that threaten the health and safety of San Quentin correctional officers and inmates and the nearby public. Funding was first authorized for this purpose in the Budget Act of 2003, and the project has finally reached the construction phase. As a result of the Governor's decision to abandon the project, the health and safety of inmates, correctional officers, and the public will continue to be at risk. The Governor’s May Revision includes a one-time General Fund augmentation of $19.2 million in 2011-12 to repay a project loan made from the Pooled Money Investment Account and language to forgive a $1.3 million General Fund project loan.

**Department of Justice**

***Forensic Laboratory Funding Shortfall.*** As part of a comprehensive package of budget solutions, the 2010 budget increased the state's DNA Penalty Assessment, which is imposed on criminal and traffic-related convictions, from $1 to $3 and shifted roughly $30 million in support for Department of Justice’s (DOJ) forensic laboratories from the General Fund to the DNA Identification Fund (DNA ID Fund). Revenues from the increased penalty assessment have not come in as projected, resulting in a structural shortfall in the DNA ID Fund. The Governor’s May Revision includes several measures to address the problem, as follows:

- A $10.0 million General Fund transfer to the DNA ID Fund.

- A shift of $4.1 million in annual forensic laboratory lease-revenue bond debt service payments from the DNA ID Fund to the General Fund.
- A proposal to exempt the recent penalty assessment increase from a provision of law placing these revenues in a lower payment priority.

Absent these measures, it is likely that DOJ would have to scale back its forensic laboratory work significantly, which would negatively impact local law enforcement agencies statewide.

**California Emergency Management Agency**

***Fire Engine Replacement.*** The California Emergency Management Agency (Cal EMA) operates a program that provides fire engines for local fire departments throughout the state to use. The local departments maintain the engines and man them during emergency response and mutual aid calls. As part of this program, Cal EMA maintains a replacement cycle designed to rotate engines out of service when they have exceeded their useful life. The Governor's May Revision includes a proposal to reduce General Fund support for the replacement of fire engines by $1.8 million, instead using federal funds that are available for this purpose on a one-time basis. Given the magnitude of the state's remaining budget shortfall, this prudent use of an alternative funding source will provide temporary General Fund relief.

***Golden Guardian and State Agency Training.*** The Governor's May Revision includes an ongoing General Fund reduction of $779,000 reflecting a proposal to eliminate General Fund support for the annual Golden Guardian Exercise ($200,000) and state agency training ($579,000). The Golden Guardian Exercise is a federally-sponsored annual disaster response exercise involving multiple state and local agencies. Cal EMA also has a State Agency Direct Support Unit that provides disaster response training for state agency personnel. This unit is supported by federal funds that require a 100 percent state match. Cal EMA will continue to conduct the Golden Guardian Exercise using only federal funds and will offer state agency training on a reimbursement basis, which would theoretically allow the Agency to meet its state matching funds requirement.

***Disaster Assistance Act Baseline Reduction.*** The Governor's May Revision would reduce baseline funding that supports local governments' disaster recovery efforts by $20 million. According to the Department of Finance, Cal EMA has reviewed outstanding Disaster Assistance Act claims and has indicated that it can achieve the funding reduction without impeding the payment of existing claims. However, just one wildfire in a Southern California wildland-urban interface area could easily wipe out any savings achieved through this reduction. Thus, the savings likely will not be achieved.

## Local Public Safety Funding

The Governor's May Revision continues to fund state-supported local public safety programs with realignment tax revenues, restoring funding for various local public safety subventions to 2008-09 levels, as detailed in the table below. On the surface, this seems appealing. However, since the funding restoration is part of the realignment plan, it is also predicated on a $5.9 billion temporary (five-year) tax increase. As such, it holds local public safety programs (COPS, JJCPA, Small and Rural Sheriffs, etc.) hostage to the tax increase and fails to provide permanent funding for local public safety subventions. When the tax increase sunsets, the likely result would be pressure on the General Fund to backfill the lost tax revenue, pressure on the Legislature to raise taxes again, or both.

**Local Public Safety Funding**
**(Dollars in Thousands)**

| Progs. within Local Gov't. Funding | Gov.'s Budget | May Revise |
|---|---|---|
| COPS | $107,100 | $107,100 |
| JJCPA | $107,100 | $107,100 |
| Booking Fees | $35,000 | $35,000 |
| Small and Rural Sheriffs | $18,500 | $18,500 |
| **Total Local Gov't. Funding** | **$267,700** | **$267,700** |
| **Programs within CDCR** | | |
| Juvenile Probation Funding | $151,842 | $151,842 |
| Juvenile Camps Funding | $29,430 | $29,430 |
| **Total CDCR Programs** | **$181,272** | **$181,272** |
| **Programs within Cal EMA*** | | |
| Cal-MMET | $19,500 | $19,445 |
| Vertical Prosecution Block Grants | $14,558 | $14,517 |
| Evidentiary Medical Training | $583 | $0 |
| Public Prosecutors and Public Defenders | $7 | $0 |
| California Gang Violence Suppression Program | $1,607 | $1,603 |
| CALGANG | $270 | $0 |
| Multi-Agency Gang Enforcement Consortium | $84 | $84 |
| Rural Crime Prevention | $3,729 | $3,719 |
| Sexual Assault Felony Enforcement | $5,130 | $5,116 |
| High Technology Theft Apprehension and Prosecution Program | $11,970 | $10,978 |
| **Total Cal EMA Programs** | **$57,438** | **$55,462** |
| **Total** | **$506,410** | **$504,434** |

*The May Revision does not propose the use of realignment tax revenues to fund state operations or grants that go to entities other than local public safety agencies. This change is reflected in the table above by the difference in program funding between the Governor's Budget and the May Revision. The General Fund will continue to cover state-level costs of these programs with the exception of the Public Prosecutors and Public Defenders Training Program, which will be supported by the Local Public Prosecutors and Public Defenders Training Fund.

## Judicial Branch

***Court Security.*** The Governor's May Revision includes a $10.7 million General Fund augmentation to provide inflation growth for the court security budget and to correctly align programmatic costs in anticipation of realignment. This adjustment would help to ensure that the appropriate level of funding for court security would be allocated to local sheriffs under realignment.

***Realignment-Related Parole Revocation Workload.*** To address parole revocation hearing workload the courts will be assuming as a result of Chapter 15, Statutes of 2011 (AB 109), the criminal justice realignment bill, the Governor's May Revision includes an augmentation to the trial courts' budget of $41.8 million General Fund in 2011-12, which drops to $18 million annually thereafter.

# Transportation

**Capital Outlay Support Staffing.** The Governor's May Revision proposes to increase the capital outlay support program and workload by a net $60.4 million. This includes:

- No increase in state staff.
- No increase in cash overtime.
- No increase in other operating expenses.
- Increase of 122 contract positions and $59.1 million.
- Increase of $1.3 million in one-time operating expenses.

The Administration indicates that the new funding levels are approximately the same as 2010-11 and one percent higher than the 2011-12 Governor's budget. The Governor's May Revision proposes to temporarily increase contract staff for the California Department of Transportation (Caltrans) Capital Outlay Support Program (COS) by 122 positions to address a one year shortfall in the number of projects for which design work has been completed for projects ready to be funded from ARRA and bid savings from completed projects. Furthermore, the Administration includes trailer bill language for these 122 contract positions that would require the department to only hire contract staff if the costs are no greater than the costs for state staff. This cost per contract staff would be limited to $209,000 which is the amount that Caltrans charges for its staff work for which it receives reimbursements. This cost information can be misleading because it's not always an apples to apples comparison of all overhead related expenses. However, the most in depth analysis to date was conducted by William Hamm of LECG Corporation. The study, "Cost to the Taxpayers of Obtaining Architectural and Engineering Services: State Employees vs. Private Consulting Firms, April 9, 2007, concludes that, for fiscal year 2006-2007: "The amount that the State must pay to utilize an in-house engineer ranges from $173,434 to $209,212, while the amount paid for an outside engineer averages $193,000.

Although this is a step in the right direction, the proposal does not go far enough. Overall, the 10,756 proposed staffing level consists of 88.5 percent state staff and only 11.5 percent contract staff for the entire capital outlay support and bond-related activities. Proposition 35, passed by the voters in 2000, allows for the state to contract out for Architectural and Engineering (A&E) services in all situations for public works projects rather than only under certain conditions. Since the passage of Prop 35, only ten percent of A&E services have been contracted out in the department. By using contract staff, the state could prevent the build-up of staffing that can take time to reduce once workload declines and could result in projects being completed quicker to the benefit of all Californian motorists.

**Public Private Partnerships.** The Governor's May Revision proposes to increase Caltrans' reimbursement authority by $1.6 million from project sponsors to contract with financial advisors to review, analyze, and evaluate three projects for Public Private Partnership (P3) procurement. Caltrans made a request to the Joint Legislative Budget Committee in the current year for P3 funding from the State Highway Account and was denied because project costs would have been spent over multiple years due to contract specifications. This request would allow for three contracts with reimbursement authority of $534,000 per year for the department to do review work. It remains to be seen if the Democrat controlled Legislature will approve this latest request or kill the P3 program slowly by requiring the department to again submit a request through the Joint Legislative Budget Committee.

**Proposition 1B.** Includes an additional $1 billion in Proposition 1B bond funds for project construction costs including $594 for corridor mobility, $192 million for trade corridors, $123 million for public transit modernization, $48 million for major highway rehabilitation, $135 million for State Route 99, and a decrease of $36 million for state-local partnerships and $8 million for local bridge seismic safety. The reduction in funding is due to fewer local projects being ready to start in 2011-12. The total Prop 1B bond proposal for 2011-12 is $3.3 billion including the $2.3 billion proposed in the Governor's January budget. Although the Administration indicates that it is holding $2.7 million in Prop 1B bond cash, that money has been allocated to specific projects and the state or local entity responsible for the project has not requested the funding yet. This request for 2011-12 bond funds is for additional projects that Caltrans indicates are ready to move forward. It seems that an analysis of the existing $2.7 million of bond cash needs to be done to determine if any of those funds could be released to new projects that are ready to move forward.

**Program Initiation Documents.** The Administration has requested to increase state staffing by 78 positions and $8.6 million from the State Highway Account to fund Project Initiation Documents (PIDs) for work related to the State Highway Operations and Protection Program (SHOPP). The proposal would also eliminate 74 positions and $8 million funded from reimbursements for locally-funded projects on the state highway system. The Administration has trailer bill language that would eliminate any requirement that the department work on PIDs or Independent Quality Assurance work for locally-funded projects on the state-highway system unless a cooperative agreement providing reimbursement to the department is executed by the local agency that would be funding the project. The department would only develop PIDs for projects funded through the SHOPP and State Transportation Improvement Program.

**General Fund Relief from Loan Repayment Extensions.** The Governor's May Revision proposes to extend the repayment of loans made from weight fees indefinitely until these funds are needed for debt service payments. Trailer bill language would also permit those payments to be used for reimbursing the General Fund for costs of redeeming transportation bonds due in future years. This proposal benefits the General Fund by allowing weight fees and other loans from the Highway Users Tax Account (HUTA) and the Public Transportation Account to remain in the General Fund and offset other state program costs until needed for debt service or transportation projects. Since Prop 22 inadvertently eliminated the requirement to repay HUTA loans and weight fees within three years, the ability to align loans with debt service payments seems permissible. Furthermore, this proposal allows for additional loans in any given year to the General Fund from weight fees if those revenues are greater than debt service payments in that year. By allowing these funds to remain in the General Fund in future years, it would misrepresent the actual condition of the General Fund.

**High Speed Rail Authority (HSRA).** The Governor's May Revision proposes an increase in state operations of $3.9 million (from $12.6 million to $16.5 million) and a decrease of $46.2 million in capital outlay funding (from $179.3 to $133.1 million). The capital outlay work on Phase 1 is estimated at $180.5 million in 2011-12 and the additional $47.4 million will be funded from savings carried over from the current year.

The Legislative Analyst's Office (LAO) has identified concerns with HSR project in their report, High-Speed Rail Is at a Critical Juncture. In this report, the LAO recommends that Legislature direct the HSRA to renegotiate the terms of the federal funding awarded to the state by the Federal Rail Administration to allow for more flexibility, provide only $7 million in funding for state administration, reconsider where construction of the line should start, and for the Legislature to pass legislation that shifts the responsibility for the day-to-day and strategic development of the project from HSRA to Caltrans.

Although Republicans may not support all of these recommendations, there are valid concerns with the path the HSRA has taken with this project. To date, the HSRA has not provided an investment grade business plan, financing plan, or ridership model, yet it continues to ask for millions in Prop 1A bond funding.

# Resources, Environmental Protection, and Energy

**Department of Parks and Recreation.** The Governor's May Revision does not include any further reductions in General Fund for state parks beyond the $11 million in 2011-12 and $22 ongoing which were already approved in March (SB 69/Leno). Furthermore, the Legislature approved Administration requested language in SB 95 (Committee on Budget) of 2011 that would require the department to achieve the General Fund reductions through full or partially park closures, and service reductions. Recently, the Department of Parks and Recreation did a press release indicating that 70 parks would be closed by July 1, 2012. In releasing this information, the department stated that it would still retain 92 percent of today's attendance, 94 percent of existing revenues, and keep 208 parks open. Since the department has not released all of the details specifying how it achieved the savings, the reduction plan remains unclear. The department is now indicating that it will seek additional partnership agreements to keep as many parks open as possible. These partnerships should have been created prior to deciding to close state parks. It's been very clear since voters rejected Proposition 21 (VLF park fee) last year that the department would need a new operating plan. Republicans have offered alternatives to park closures over the past several years, but the department has ignored them. It seems the department is more interested in continuing its existing management practices rather than keeping parks open.

**Department of Water Resources.** This proposal shifts $16 million General Fund to Proposition 1E to support flood management activities. These funds are currently dedicated to levee maintenance, floodplain mapping, and Delta levees. Although the use of General Fund would prolong the availability of bond funds, given the General Fund condition this proposal seems prudent.

**Department of Toxic Substances Control.** A one-time decrease of $802,000 General Fund for the Clandestine Drug Lab Cleanup program. The proposal indicates that the department currently has sufficient Illegal Drug Lab Cleanup Account expenditure authority to cover these costs and is working on a proposal to develop a stable long-term funding source. The department has an additional proposal to use $731,000 from the Expedited Site Remediation Trust Fund to reimburse the City Santa Cruz and Santa Rosa for site remediation activities.

**Renewable Portfolio Standards.** The Governor proposes to increase funding by $646,000 for the California Energy Commission and $2.1 million for the California Public Utilities Commission (CPUC) from special funds to implement the 33 percent Renewable Portfolio Standards (RPS), SBX1 2 (Simitian) of 2011. Most Senate Republicans did not support this measure because a 33 percent RPS mandate is likely to drive up electricity prices during the deepest economic downturn since the Great Depression. Higher electricity rates will hurt the household budgets of millions of Californians, who already are heavily taxed and either unemployed or underemployed. Furthermore, the CPUC will be working on activities to reach a 40 percent RPS although this work is beyond existing law.

**Environmental Fee Increases.** The Governor's May Revision proposes the following fee increases:

> **Department of Conservation.** The Governor's May Revise proposes an increase of $4.7 million in fees on oil and gas operators to fund additional positions to address permitting workload and enhance the Department of Conservation's existing regulatory oversight of oil and gas development both onshore and offshore. Last year, the department received an increase of $3.1 million from fees on oil and gas operators for the underground injection program. To date, oil and gas well permits are still backlogged and industry hasn't seen much relief. It's unclear whether this new request would actually result in more permits being approved in a timely manner.

**Department of Water Resources.** Shift of $1.2 million from General Fund to Watermaster fees for the Department of Water Resources' Watermaster program. This action will eliminate all General Fund and make the program fully fee funded. SB 1107, Resources Trailer Bill, of 2004 was rejected by most Senate Republicans and included language to increase fees on water rights holders so that the Watermaster Service Program is funded 100 percent from user fees. However, General Fund has continued to be appropriated for this program. The primary purpose of the program is to ensure that water is allocated among the water rights holders consistent with various agreements and court orders. This includes the water rights for instream flows for fish and habitat purposes which is a public benefit that should be paid for with General Fund.

# Employee Compensation

**State Employees Protected and Rewarded.** The Governor's May Revision does not include any reductions in employee compensation expenditures. Currently, all bargaining units have approved contracts, including a one-day a month personal leave program, minimal increases in retirement contributions, and additional personal holidays. The agreements will result in increased state expenditures in the hundreds of millions of dollars, beginning in 2013-14 as a result of additional pay increases and higher state contribution levels for health care.

Since 2006-07, salary increases have added $1.9 billion ($694.8 million General Fund) in base employee compensation costs. Cumulatively since 2006-07, costs are $9.9 billion higher ($3.7 billion General Fund). And these numbers are just the salary increases. Merit salary adjustments, those increases in step pay that all employees not at the top step of their classification are eligible for, have resulted in additional base employee compensation expenditures of $602.3 million (approximately $300 million General Fund) in the past six years, cumulatively costing the state $2 billion (about $1 billion General Fund). Without civil service reform, the state will continue to give automatic salary increases regardless of job performance or fiscal circumstances. The state can no longer afford to do business this way, salary increases must be tied to performance, giving the state the flexibility to reward those that deserve it and send a message to those that believe an annual pay increase is an entitlement.

**Pension Reform- All Talk and No Plan.** The Governor's May Revision does not include a pension reform proposal as had been anticipated. Instead, the budget documents include a paragraph that references a pension framework released in March and states the Administration looks forward to "working with the Legislature to adopt comprehensive and fair reforms that reduce and stabilize taxpayer costs and curb abuses."

The Governor's 12-Point Pension plan included some proposals consistent with Senate Republican's pension reform recommendations. With similar recommendations for reform, such as eliminating the purchase of airtime and prohibiting pension holidays and retroactive pension benefit increases, there is a strong starting point. However, Senate Republicans called for a vote of the people on permanent pension reform, creating a mandatory hybrid pension system for new employees, requiring state employees to pay their fair share of unfunded pension liabilities, giving the state the flexibility to change benefits in the future and protecting the state from future pension giveaways. Unfortunately, the Governor refused to let the people vote on real pension reform.

**Paying CalPERS General Fund for Pension Advice.** The Governor's May Revise includes a proposal to give CalPERS $1.5 million General Fund to provide consultation and analysis to the administration and the Legislature for potential pension reform ideas.

# General Government

## California Department of Insurance

***Implementation of Obamacare.*** The Governor's May Revision includes an augmentation of $748,000 from the Insurance Fund for the Department of Insurance (CDI) to implement federal healthcare reforms related to the Patient Protection and Affordable Care Act (PPACA), otherwise known as Obamacare. Federal district court judge Roger Vinson ruled in January that the individual mandate contained within PPACA violates the Commerce Clause of the U.S. Constitution and that, because the individual mandate is not severable, the entire Act is void. Given that ruling and a similar one from a Judge in Virginia, plus vows from the majority leadership in the House of Representatives to defund Obamacare, now might not be the best time to invest a lot of resources in its implementation.

## Military Department

Before the California Military Department (CMD) joined PERS, it had its own retirement program, which still exists for pre-PERS retirees. As the population of retirees participating in the program ages, more members decease, reducing the program's funding needs. The level of retirement funding budgeted must be realigned periodically as a result. The Governor's May Revision includes a General Fund reduction of $1.5 million to the CMD's budget to correctly align funding for non-PERS military retirement benefits with the actual program costs.

## California Science Center

In March, the Legislature approved $1.7 million of the Governor's proposed $3.7 million unallocated reduction for support of the California Science Center in 2011-12, and deleted authorization for the Science Center to establish a nominal admission fee to offset this reduction. The Governor's May Revision continues to pursue the full $3.7 million General Fund reduction for the Science Center, as well as fee authorization. This is appropriate given that the Science Center is the only state-subsidized science museum in the state. Comparable entities, including the Exploratorium in San Francisco, serve primarily regional clientele and exist solely on foundation funding and fee revenues. The state should look into transitioning itself out of the science museum industry.

# Realignment

The Governor's May Revision continues to include the January proposal to realign many core functions of government from the state to the local level. The proposal is still predicated on a five-year extension of the VLF and sales tax increases implemented in 2009 that are set to expire this year. Tax revenues assumed to be available to fund realigned programs are projected to be $5.9 billion in 2011-12, growing to $7.4 billion in 2015-16. Notably, the realignment of programs contemplated by the Governor would be permanent, while the tax increase to support it would expire in five years. This would create pressure to make the tax increases permanent after five years. The realignment proposal still lacks implementation detail in the non-criminal justice areas, such as mental health, adoption, and transitional housing services. Chapter 15, Statutes of 2011 (AB 109, Committee on Budget) was the first of the realignment bills to be enacted. It provides some detail about the criminal justice aspects of realignment, but leaves many substantive questions unanswered, such as how funding allocations to each county will be determined, how funds earmarked for program growth will be allocated between programs, how the realignment of court security will work, etc.

With the enactment of AB 109, a major portion of realignment became law, including shifting certain "low-level" adult offenders and parolees to local supervision and realigning the few remaining juvenile offenders housed within the Division of Juvenile Justice (DJJ) to counties (with a provision allowing counties to contract with DJJ for bed space). AB 109 will not take effect until July 1, 2011 and its operability is contingent upon the creation of a "community corrections grant program," which has not yet taken place. That said, nothing would prevent the state from creating the grant program and funding it at a minimal level, making the bill operative July 1, yet providing inadequate funding for realignment. Thus, it could be said that AB 109 was enacted without guaranteed funding for its implementation, creating the proverbial "gun to the head" of local law enforcement agencies. They are essentially forced to support the realignment-related tax increases because if they do not, they could end up with full fiscal and operational responsibility for managing the realigned population of offenders and no money to pay for it.

The Governor's updated plan realigns approximately $5.9 billion in General Fund-supported programs, as follows:

***Public Safety***

- *Low-level offenders and parole violators.* All parole violators and "low-level" offenders will become the responsibility of local jurisdictions. Since January, the Administration has narrowed its definition of "low-level" offenders by excluding those convicted of certain crimes that local law enforcement agencies found too egregious. However, the updated list of crimes for which an offender will go to jail, rather than prison, still includes many offenses that most people would consider serious felonies. This change was already enacted via AB 109 (see discussion above). AB 109 also shifts responsibility for the parole revocation process to the courts, sets up a menu of alternative sanctions for parole violators, and specifies that violators will no longer be returned to state custody, but will instead be the responsibility of local law enforcement. Due to inadequate local funding, jail capacity, staffing, and program space, the timing of this shift spells disaster for public safety. The Administration projects General Fund spending reductions associated with this shift to be approximately $574 million in 2011-12, growing to $1.8 billion by 2014-15. The state savings reflect a shift of new tax dollars to local government to carry out the function.

- *Adult parole*. Local agencies will assume responsibility for all adult parolees, the costs of which will be paid by revenues from the tax increases, resulting in state General Fund spending reductions of approximately $110 million in 2011-12 that would grow to $170 million by 2014-15. Since January, the Administration has revealed some details of this part of realignment, too. AB 109 created a construct to replace parole, referred to as "postrelease community supervision," which essentially shifts responsibility for parolees to local probation departments. However, because these offenders will technically not be on parole, they will be able to vote, and in some relatively rare cases, specific sex offenders will not be tracked by GPS. While probation officers do a great job at the local level with the resources they are given, they are not equipped or funded to handle the number of inmates the state plans to transfer. In some cases they already have caseload ratios that exceed 1,000 probationers for every probation officer. Even if fully funded, it will take years to hire and train the thousands of agents that would be needed.

- *Division of Juvenile Justice (DJJ)*. AB 109 shifts the remaining wards under the jurisdiction of DJJ to county responsibility and includes a provision allowing counties to contract back with DJJ for bed space. Annual General Fund spending reductions associated with this shift are projected to be approximately $242 million, beginning in 2011-12. Again, state savings come from the tax increases that are shifted to local governments to pay for these offenders at the local level.

- *Prior juvenile realignments.* A February 2011 realignment update proposed to additionally fund the Youthful Offender Block Grant program and the costs of supporting juvenile parolees that were shifted to the counties in 2010 from the realignment tax revenues. The Governor's May Revision continues this plan.

- *Local public safety programs*. Funding for state-supported local law enforcement programs would continue to be funded from Vehicle License Fee (VLF) revenues, pushing the need for a General Fund backfill out another five years. Affected programs include the Citizens' Option for Public Safety (COPS) program, Juvenile Justice Crime Prevention Act (JJCPA) grants, "booking fees," funding for small and rural sheriffs, juvenile probation and camps, and various local public safety grant programs administered by the California Emergency Management Agency. No General Fund savings are associated with this portion of the realignment plan, as these programs are currently supported by the temporary 0.15 percent VLF increase set to expire on June 30, 2011, and the Governor proposes to extend the tax increase for five more years.

- *Court security*. Local governments would be responsible for providing security for courthouses within their respective jurisdictions. As with the January proposal, the Governor's May Revision fails to provide details on exactly how this would work. However, the Administration projects an annual General Fund spending reduction of approximately $485 million associated with this portion of realignment, as the new taxes would fund it at the local level.

- *Fire and emergency response activities*. The January realignment plan proposed to shift responsibility for providing fire protection services and emergency medical response in state responsibility areas from CAL FIRE to local jurisdictions. The Governor's May Revision instead leaves the responsibility with CAL FIRE, resulting in a level of General Fund spending that is approximately $250 million higher than the Governor's Budget.

***Health and Human Services***

- *Community Mental Health Services.* The Governor's January realignment plan proposed shifting responsibility for three state-funded community mental health programs from the Department of Mental Health to local governments, beginning in 2012-13. The three programs are the Early and Periodic Screening, Diagnosis, and Treatment Program (EPSDT), mental health managed care, and state-mandated special education mental health services (known as AB 3632 services). Counties largely administer these three programs already. The state's current role is to provide funding and, in the case of EPSDT and mental health managed care, program oversight. The Governor's May Revision alters the January plan with respect to the shift of the AB 3632 services. The amended proposal would shift responsibility for these services to school districts, instead of counties, beginning in 2012-13. This is a welcome change in direction that should address current confusion and misalignment of responsibility between counties and schools. In every other state, schools are responsible for providing these services based on a mandate in federal law.

- *Substance Abuse Treatment.* The Department of Alcohol and Drug Programs (DADP) is responsible for administering prevention, treatment, and recovery services for alcohol and drug abuse. Under the Governor's realignment proposal, counties would receive funding ($184 million from additional taxes dedicated to the program) and responsibility for these services. DADP currently contracts with 57 counties to provide inpatient and outpatient alcohol and drug treatment services. The proposal would remove the state contractual process, allowing counties to prioritize funding, and would enable counties to continue to provide services that meet community needs.

- *Foster Care and Child Welfare Services.* The Child Welfare Services (CWS) system provides a continuum of services to children and their families through the CWS, Foster Care, and Child Abuse Prevention programs. CWS is currently administered by the counties and non-federal funding is shared between the state and counties at a split of 40 percent General Fund and 60 percent county funds. The proposal would transfer primary program responsibility for CWS to the counties. The proposal would offset $1.6 billion General Fund for the program with taxes directed to the counties to provide for these services.

- *Adult Protective Services.* The Adult Protective Services (APS) program provides services, without regard to income, to persons aged 65 and older who are functionally impaired, unable to meet their own needs, and who are victims of abuse, neglect, or exploitation. This program is currently administered by the 58 local APS agencies and the proposal would transfer this entire program ($50.1 million General Fund) to the counties, along with new tax revenue to fund it.

# Statewide Issues

**Restore Public Safety Mandates.** SB 69 (Leno/2011), the March budget bill, includes $51.7 million General Fund to fund two property tax administration mandates. The two mandates identified in SB 69 are only two of the 13 mandates proposed for funding in the 2011-12 Governor's Budget (the Legislature suspended the other 11 which were related to public safety, without Republican support). The Governor’s May Revision proposes to restore these 11 mandates to the budget bill, to be funded with the $51.7 million appropriation included in that bill. These mandates include those related to peace officer protections, domestic violence arrest policies, victim assistance and treatment services, child abduction and recovery services, and civil commitment procedures for sexually violent predators.

**Unallocated Capital Outlay Budget Package Funds.** The Governor’s May Revision continues to pursue a reduction of $500,000 in 2011-12 from capital outlay planning and study funds. The reduction is a result of fewer capital outlay project being funded because of limited General Fund resources and debt concerns. Consequently, fewer budget packages and infrastructure project studies are being requested.

**Budget Year Debt Service.** General Fund debt service expenditures will decrease by $130.9 million, to a total of $5.5 billion, including a decrease of $127 million for General Obligation debt service ($4.8 billion total) and a decrease of $3.9 million for lease revenue bonds ($617.5 million total). This decrease in General Obligation debt service reflects a workload reduction as a result of a lower projected need for a fall 2011 bond sale and associated interest savings.

The Governor’s May Revision is proposing to decrease the size of the fall bond sale, and instead use the balance of unspent bond proceeds available from previous bond sales (currently in excess of $11 billion). The Department of Finance will be working with departments, agencies, and the Treasurer’s office over the next several months to closely evaluate existing cash balances and report future bond cash needs. It is estimated that only a limited amount of new bonds will need to be issued in the fall. It is not clear why $11 billion of bonds were sold if projects were not ready…nor is it clear what processes will be changed to prevent such a buildup of excess cash in the future.

General Fund offsets from the Transportation Debt Service Fund remain unchanged ($777.5 million).

**Current Year Debt Service.** General Fund debt service for General Obligation bonds will decrease by $140.5 million to a total of $4.8 billion, to reflect lower than previously estimated interest costs and fees on variable rate bonds and commercial paper ($50.2 million) and increased General Fund offsets from the Transportation Debt Service Fund ($90.3 million).

# Reducing State Government

**Savings Through Efficiencies—Will They Be Achievable?**— In March the Legislature assumed savings of $250 million General Fund in 2011-12 to be achieved through the identification of efficiencies in state operations, including identification of agencies, departments, and programs that could be reorganized to eliminate duplication and unnecessary functions. The March 2011 budget included a control section that provides the Administration with authority to make reductions necessary to achieve the savings.

The Governor's May Revision proposes to reduce state operations by $82.7 million ($41.5 million General Fund) and 138.1 personnel years through a variety of eliminations, consolidations, reductions, and efficiencies, including: (1) the elimination of 32 boards, commissions, task forces, and offices; (2) the consolidation of the State Personnel Board and the Department of Personnel Administration; (3) several changes due to realignment, including the elimination of the Departments of Mental Health and Alcohol and Drug Programs and a 25 percent state operations reduction for realigned public safety programs; (4) various program reductions and efficiencies; and (5) a comprehensive state asset review resulting in the disposition of non-essential or under-utilized properties.

**Reduction Proposals Could Go Further.** While the Governor's proposed eliminations generally are warranted, and in many cases consistent with past Republican proposals, the Governor could have gone further in some places. Examples of state entities that could also be eliminated or consolidated include the following:

- *California Children and Families Commission*—This state commission receives 20 percent of the tobacco taxes authorized by Proposition 10 (First 5 funds). Although it has provided some funding to offset General Fund spending in the past few years, the commission's funding was approved by voters in a far superior fiscal climate. Eliminating this commission should be submitted to the voters along with a broader redirection of First 5 funds.

- *California Science Center*—In addition to the $3.7 million General Fund reduction proposed by the Administration, eliminating all General Fund resources for the Science Center would save an additional $16.7 million General Fund. This is appropriate given that the Science Center is the only state-subsidized science museum in the state. Comparable entities, including the Exploratorium in San Francisco, serve primarily regional clientele and exist solely on foundation funding and fee revenues. The state should get out of the science museum business.

- *California Arts Council*—The state could save nearly $1.1 million annually by eliminating General Fund support of the Arts Council. Not only would the Council continue to receive nearly $4.3 million in special and federal funds, but this action would remove General Fund tax dollars from an activity more appropriately conducted by the private or not-for-profit sectors.

The Governor's proposals are discussed in more detail below.

**Elimination of Boards, Commissions, Task Forces and Offices**

- **Accelerate End of American Recovery and Reinvestment Act Task Force**—Eliminate the American Recovery and Reinvestment Act of 2009 (ARRA) Task Force by January 1, 2012. This makes sense given the ramp down of ARRA funds in 2011.
- **Eliminate the California Privacy Security Advisory Board**—The Board develops and recommends privacy and security policies for California's Healthy Information Exchange. There are

14 board members, however there are also an advisory group, a committee, and task groups. The committee and task groups would be used to cover the work of the Board.

- **Eliminate the Health Care Quality Improvement and Cost Containment Commission**—The Commission's role is to research and recommend changes for promoting high quality care and containing health care costs. This commission is currently inactive.
- **Eliminate the Colorado River Board**—The Colorado River Board is responsible for developing a plan for using Colorado River water. Although these responsibilities are necessary to maintain an adequate water supply from the Colorado River, the eight members of the Board are all Southern California Colorado River water users and the Board is funded entirely by Southern California water districts. Although this appears appropriate given that the local water districts make up the entire membership and are providing the funding, it is unclear how this would affect working relationships with other states.
- **Eliminate the Salton Sea Council**—Chapter 303, Statutes of 2010 created the Salton Sea Restoration Council as a separate department under the Natural Resources Agency. The Council is required to evaluate Salton Sea restoration plans and, by June 30, 2013, report to the Governor and the Legislature with a recommended Salton Sea restoration plan. Senate Republicans were split on their support for SB 51 (Ducheny) of 2010. However, given that any alternative solution for restoration of the Salton Sea would cost billions of dollars with no dedicated funding source available at this time, the decision to eliminate the council seems appropriate.
- **Eliminate the State Mining and Geology Board**—The State Mining and Geology Board serves as a regulatory, policy, and appeals body representing the state's interests in geology, geologic and seismologic hazards, conservation of mineral resources, and reclamation of lands following surface mining activities. To streamline state government functions, this proposal will move the appeals process to the Office of Administrative Hearings, and the balance of the Board's responsibilities to the Office of Mine Reclamation within the Department of Conservation. This would provide efficiencies within the department but no General Fund savings would materialize.
- **Eliminate Nine Advisory Committees and Review Panels at the Department of Fish and Game**—This proposal will eliminate (1) the Commercial Salmon Fishing Review Board, (2) the Commercial Sea Urchin Advisory Committee, (3) the Dungeness Crab Review Panel, (4) the Recreational Abalone Advisory Committee, (5) the California Advisory Committee on Salmon and Steelhead Trout, (6) the State Interagency Oil Spill Committee Review Subcommittee, (7) the State Interagency Oil Spill Committee, (8) the Striped Bass Advisory Committee, and (9) the Abalone Advisory Committee. Since statutory requirements are completed for these committees and review panels, it seems reasonable to have the department meet with stakeholders as needed.
- **Eliminate the Commission on Emergency Medical Services**—The Commission's role is limited to providing advice to the Emergency Medical Services Authority and approving regulations when they are brought forward by EMSA.
- **Eliminate the California Health Policy and Data Advisory Commission**—The Commission was created in the late 1980s to advise the Office of Statewide Health Planning and Development (OSHPD) on its data collection and outcome reporting programs. The OSHPD can perform these functions without this commission.
- **Eliminate the Healthcare Workforce Policy Commission**—The functions performed by this commission can be performed by OSHPD with public input and informal advice.
- **Eliminate the Rural Health Policy Council**—This Council is made up of department directors in the Health and Human Services Agency. We are still reviewing the merits of this elimination.
- **Eliminate the Public Health Advisory Committee**—This committee provides advice and makes recommendations on the development of policies and programs that seek to prevent illness and promote the public's health. The committee will sunset in June 2011. We are still reviewing the merits of this elimination.

- **Eliminate the California Medical Assistance Commission (CMAC)**— This proposal would eliminate CMAC and have the CMAC Executive Director report to the Secretary of the California Health and Human Services Agency by July 1, 2012. CMAC's remaining responsibilities would be transferred to the Department of Health Care Services (DHCS) following implementation of a revised hospital payment structure DHCS is developing. There is no sound justification for CMAC commissioners to draw salaries that they currently receive for attending meetings twice a month to approve staff recommendations for hospital contracts.
- **Eliminate the Rehabilitation Appeals Board (RAB)**—Currently, Department of Rehabilitation (DOR) consumers who are dissatisfied with decisions made regarding their eligibility for services or the type of services they receive may appeal to the RAB, which consists of seven members appointed by the Governor. This proposal would eliminate the RAB and, instead, have appeals heard by hearing officers, resulting in a more efficient and timely appeal process for DOR consumers. This is an efficient use of state hearing offices and streamlines the oversight process.
- **Eliminate the Continuing Care Advisory Committee (CCAC)**—The CCAC is responsible for advising the Department of Social Services (DSS) concerning matters in the continuing care industry, and consists of 11 members. Republicans have argued for the elimination of this unnecessary committee for several years now and fully support its elimination.
- **Eliminate the Early Learning Advisory Committee (ELAC)**—The ELAC was established through an executive order in 2009 to make California eligible for a three-year $10.8 million planning grant to pilot a recommended quality rating improvement system and to develop a data tracking system for children ages 0-5, including preschool. The elimination of this advisory council will result in the loss of the remaining federal planning grant funds ($3.6 million), but the Governor believes that the ELAC's work represents a new initiative that the state cannot afford. This is true – the implementation of a quality rating system will create pressure to increase reimbursements to providers who earn a higher rating, and the establishment of a data tracking system for children from birth to age five will be a costly endeavor.
- **Eliminate the California Postsecondary Education Commission**—The California Postsecondary Education Commission (CPEC) is intended to be California's higher education coordinating and planning agency, providing policy analyses, advice and recommendations to the Legislature and the Governor on statewide policy and funding priorities for colleges, universities, and other postsecondary education institutions. However, CPEC's contribution to education policy analysis over the years has been negligible, and it has publicly called for higher taxes as the preferred budget solution.
- **Eliminate the Office of the Insurance Advisor (OIA) within the State and Consumer Services Agency**—The OIA provides the Governor's Office with independent policy advice on insurance matters and makes policy recommendations on legislation.
- **Eliminate the California Anti-Terrorism Information Center (CATIC)**—This program is operated by the Department of Justice (DOJ) through a $6.4 million grant provided by the California Emergency Management Agency (Cal EMA). Cal EMA operates the State Terrorism Threat Assessment Center (STTAC) using federal homeland security funding. The Administration indicates that most of the information gathered and processed by the CATIC eventually makes its way to the STTAC and/or the U.S. Department of Homeland Security irrespective of the efforts of the DOJ; therefore, the CATIC's function is largely redundant. Eliminating this redundant function is a step in the right direction.
- **Eliminate the Office of Gang and Youth Violence Prevention**—This office was created by Chapter 459, Statutes of 2007 and provides grants to various local governments to combat gang-related issues. Grants provide funding for various entities that employ evidence-based practices for reducing gang activity, including prevention, intervention, and suppression strategies. The grants will continue to be administered by staff of the California Emergency Management Agency. Streamlining this program in this way is good practice.

- **Eliminate the California Council on Criminal Justice (CCCJ)**—The CCCJ establishes funding priorities for federal criminal justice grants. In recent years, Democrats in the Legislature have taken a more active role in the allocation priorities for these grants, and have attempted to eliminate the CCCJ as recently as last year. Democrats would like nothing more than to squeeze out law enforcement community input on the allocation of federal criminal justice funding, placing much more control of these funds in the hands of community-based organizations focused on an education and treatment model of prevention. This elimination does not result in any General Fund savings, but could result in federal funds being siphoned away from law enforcement efforts and poured into social programs.
- **Eliminate Governor's Emergency Operations Executive Council (GEOEC)**—The GEOEC was established as a result of Governor's Executive Order S-04-06, which required the Directors of the Office of Homeland Security and Emergency Services to convene a coordinating body for emergency management and homeland security activities across California state government. In 2008, legislation created the California Emergency Management Agency (Cal EMA) by merging these two departments, rendering this body obsolete. Eliminating it would not have any measurable negative impact on the state's emergency preparedness.
- **Eliminate California Emergency Council (CEC)**—The CEC is responsible for recommending and approving orders, regulations, and emergency planning documents for the Governor. The members of this group can be convened as necessary, making it a good candidate for elimination.
- **Eliminate the Economic Strategy Panel**—The Panel reviews the economic base and industry sectors to guide policy decisions for economic growth. The Labor Agency indicates that this is "step 1" in removing this business-related function from the Agency, which could be a viable option. However, the Agency does not yet have a plan for where this function will be reconstituted.
- **Eliminate the Commission on the Status of Women**—The Commission advises the Governor and the Legislature on public policy issues impacting women. Funding lobbyist activities is not a core function of government and should not be prioritized for General Fund resources.
- **Eliminate the California Law Revision Commission**—The Commission is responsible for reviewing California law, recommending legislation to make needed reforms, and making recommendations to the Governor and the Legislature for revision of the law on major topics. Given the state's current fiscal climate and the abundance of other stakeholders who are constantly looking for ways to improve California's laws, elimination of the Commission is a reasonable way to save the state some money.
- **Eliminate the Commission on Uniform State Laws**—The Commission presents to the Legislature uniform laws recommended by the National Conference of Commissioners on Uniform State Laws and then promotes passage of these uniform acts. The Commission is primarily composed of appointees of the Senate Rules Committee, the Speaker of the Assembly, and the Governor. Given that all three entities are now controlled by Democrats, the Governor's plan to eliminate this body appears to have no down side.
- **Eliminate the Office of Privacy Protection within the State and Consumer Services Agency**—There are many other state, federal, and business resources that promote and protect the privacy rights of consumers, as well as legislation and a court system for resolving issues.
- **Eliminate the Unemployment Insurance Appeals Board**—The Administration indicates they will consult with stakeholders and evaluate options to phase out the full-time board. Eventually, this would result in the elimination of seven board members in 2012-13. The Labor Agency has indicated that the Governor's May Revision does not include any action to eliminate this board, only the intent to initiate a conversation regarding the issue.
- **Eliminate the Fair Employment and Housing Commission**—The Administration indicates they will consult with stakeholders and evaluate options to phase out the stand-alone commission that handles appeals of employment and housing discrimination cases by January 1, 2012. Republicans have argued for many years that the Commission should be eliminated as

discrimination cases could be appealed to the Department of Fair Employment and Housing, resulting in a consolidation of workload and saving the state General Fund monies.

- **Eliminate the Occupational Safety and Health (OSH) Standards Board**—Proposal would eliminate the separate OSH Standards Board and transfer responsibility to the Division of Occupational Safety and Health within the Department of Industrial Relations. Republicans should not have a problem with this change.
- **Eliminate the Managed Risk Medical Insurance Board (MRMIB)**—Proposal would eliminate the Board and have MRMIB's Executive Director report to the Secretary of the California Health and Human Services Agency by July 1, 2012. In 2011-12, the Healthy Families Program and the Access for Infants and Mothers Program would transfer to the Department of Health Care Services. In 2012-13, the remaining MRMIB programs—high-risk pools (Pre-Existing Conditions Insurance Plan and Major Risk Medical Insurance Program) and the County Children's Health Initiative Program would transfer to DHCS. Republicans have significant concerns about this proposal, which are discussed further in the Health section under MRMIB *(see Health Section page 20).*

**Consolidations**

- **Consolidation of the State Personnel Board and the Department of Personnel Administration**—The Governor's May Revise proposes to consolidate the Board and DPA into a single California Department of Human Resources. The consolidation would save $2.2 million ($300,000 General Fund) and 24.2 personnel years in 2012-13, increasing to $4.3 million ($700,000 million General Fund) and 48.3 personnel years upon full implementation. Consolidating the two entities will streamline the appeals process, utilizing economies of scale to ensure efficient use of resources within DPA. Personnel functions are split between the two entities, causing confusion and duplication within state government. However, the SPB was constitutionally created in 1934 to administer the civil service system and ensure that state employment is based on merit and free of political patronage and it is unclear how the Administration's proposal to combine workload with DPA would meet and/or maintain that constitutional requirement.

- **Civil Service Reform Needed**—Although the Governor's May Revision proposes to consolidate SPB and DPA, creating a new state department in the process, the budget fails to address and include much needed civil service reforms such as streamlining the layoff process, ensuring merit salary adjustments are based on performance standards and enhancing the state's ability to contract out for core services. The Legislature should begin a fundamental rethinking, or reinvention, of the state civil service system in order to make it again serve the state, its employees, and the public. The potential savings associated with contracting out the management and operations of government service could be in the billions of dollars. Contracting out for state services would provide efficiencies and economies of scale, as well as competitive advantages that may be realized within the private sector. The importance of reforming the civil service system lies in not only achieving significant General Fund savings but also greater efficiencies and a stronger workforce for the state.

**Efficiencies Driven as a Result of Realignment of Programs to Counties**

The Governor's May Revision continues to reflect the realignment for alcohol and drug programs and the remaining community mental health programs from the state to the counties. With the adoption of the realignment proposal, it would no longer be necessary to maintain separate state departments and as such, the Governor's May Revision proposes to eliminate the Department of Mental Health and the Department of Alcohol and Drug Programs (DADP). Although DADP would still have responsibility for some federal block grants as well as licensing, prevention, and counselor and certification programs, these functions could be shifted to another department, utilizing the state's personnel to streamline processes and reduce expenditures through efficiencies within state operations.

**Create a Department of State Hospitals—**The Department of Mental Health (DMH) has had two primary functions, community mental health and state hospitals. The transfer of community mental health state responsibilities to counties and DHCS enables the state to change the oversight structure of the state hospitals. This proposal is discussed under the review of DMH's budget in the Health section. *(See discussion under Health section Page 21)*

**State Operations Reduction Related to Realignment—**The Governor's May Revision proposes to reduce state operations and positions by 25 percent for various departments that have programs proposed to be realigned to counties beginning in 2011-12. Considering the lengthy time constraints facing the state when attempting to implement layoffs (it can take six to twelve months for the layoff process to be completed), it is likely the position reductions would not be fully implemented until 2013-14.

**Program Reductions**

The Governor's May Revise proposes additional program reductions necessary to achieve efficiencies and expenditure reduction within state operations. These additional reductions include the following:

- **Office of the Inspector General Workload Reduction**—The Governor's May Revision proposes to eliminate all Office of the Inspector General (OIG) workload except performing use-of-force and employee discipline oversight for the California Department of Corrections and Rehabilitation (CDCR). Medical inspections currently performed by the OIG would be transferred to the Office of State Audits and Evaluations. Activities that would be eliminated as a result of this proposal include first-year warden audits, quadrennial reviews of each institution, accountability audits that follow up on the degree to which CDCR has implemented prior recommendations, and special reviews conducted on an ad hoc basis. The proposed workload reduction includes the elimination of the California Rehabilitation Oversight Board. A savings of $6.4 million General Fund and 45.6 personnel years in 2011-12 is projected. Concerns have been raised recently with respect to moving the medical inspection function out of the OIG. Given these concerns, it may be premature to support this proposal at this time.
- **Reduce the Labor and Workforce Development Agency**—The Governor's May Revision proposes to eliminate one position currently assigned to support the Economic Strategy Panel. The relocation from leased space to state-owned space will also result in rental savings of $210,000 other funds in 2011-12 within the Department of Industrial Relations. The budget includes a decrease of $677,000 reimbursements and 3.8 personnel years in 2011-12. Republicans should not be concerned with this change.
- **Eliminate General Fund Support of the State and Consumer Services Agency**—The Governor's May Revision includes a decrease of $965,000 ($548,000 General Fund) in 2011-12 as a result of eliminating General Fund support of the State and Consumer Services Agency and requiring departments under the Agency's purview to reimburse the Agency for operational expenses. Republicans should not be concerned with this change.
- **Decrease State Matching Funds for Tourism Office**—The Governor's May Revision includes a decrease of $734,000 General Fund in 2011-12. While the state would maintain an investment in the program, the tourism industry supports the marketing of California tourism through $50 million in industry self-assessed fees. Republicans should not be concerned with this change.
- **Federal Funding for Small Business Loan Guarantee Support**—The Governor's May Revision includes a decrease of $862,000 General Fund in 2011-12. Support for the program is being partially shifted to federal funds because the program expansion is funded by a federal grant. This

is consistent with the receipt of more than $84 million from the federal government to expand this program.

- **Eliminate Child Care Monitoring Support**—The Governor's May Revision includes a decrease of $10,000 General Fund in 2011-12 in the Department of Housing and Community Development (HCD) as the Community Development Block Grant programs no longer provide funding at the state level.
- **Eliminate Preservation Technical Assistance**—The Governor's May Revision includes a decrease of $35,000 General Fund in 2011-12 for HCD, which would eliminate funding to provide assistance in the prevention of subsidized housing converting to market rents upon the expiration of the subsidy period. Any assistance necessary to preserve low-income housing should come from non-profits or local communities that benefit from those programs.
- **Eliminate Redevelopment Housing Funds Oversight**—The Governor's May Revision includes a decrease of $123,000 General Fund and 1.4 personnel years in 2011-12 for HCD, which would eliminate funding for oversight of redevelopment agency low- and moderate- income housing funds and an annual report on housing funds and activities. As the budget includes a proposal to eliminate redevelopment agencies, these oversight funds would not be necessary, but if the Legislature rejects the proposal to eliminate Redevelopment Agencies, some level of state oversight of the program may need to be maintained.
- **Reduce Housing Policy Funding**—A decrease of $1.3 million General Fund and 8.5 personnel years in 2011-12 in the Division of Housing Policy Development in HCD. The program provides oversight for Redevelopment Agencies. The program still has $1.3 million remaining for housing element law administration and housing and transportation planning. A portion of this fund is currently used to produce an annual report on housing activities of redevelopment agencies. It is unclear what activities would no longer be continued with this funding reduction.
- **Eliminate General Fund Support for the Tahoe Conservancy**—The Governor's May Revision includes a decrease of $193,000 in 2011-12. The Tahoe Conservancy is primarily funded from special funds. This is an appropriate action given the condition of the General Fund.
- **Revert Unexpended General Fund from the Department of Parks and Recreation's Public Safety Modernization Project**—The Governor's May Revision includes a decrease of $4.5 million in 2010-11. As a result of unanticipated delays, funds provided in prior years for this information technology project have not yet been spent. The State Park and Recreation Fund (SPRF) will be used to backfill the General Fund reduction, so the project will have some level of support. An argument could be made to cancel the project given that state parks may be closed in the future due to a lack of funding and use the SPRF to fund essential park services. This technology project is an upgrade to the departments computer aided dispatch system to improve the coordination and monitoring of Park Ranger and Game Wardens.
- **Reduce General Fund Support for Department of Water Resources**—The Governor's May Revision includes a decrease of $1.8 million in 2011-12 for water data collection, support for the Central Valley Flood Board, and flood control activities. The Governor's May Revision will preserve $64 million General Fund for the Department of Water Resources to dedicate to high priority water management and flood control programs. This is an appropriate reduction given the condition of the General Fund and these program areas are also funded from Prop 1E and Prop 84.
- **Transfer Support of the Governor's Commission on Employment of People with Disabilities to the Department of Rehabilitation**—This Commission currently receives staff support from the Employment Development Department. The promotion of employment of people with disabilities is a core function of the Department of Rehabilitation and can be operated more efficiently within their department. The May Revision includes a decrease of $403,000 and 3.3 personnel years in 2011-12 as a result of this transfer.
- **Elimination of the Human Resources Modernization Project**—The Governor's May Revision includes a decrease of $5.5 million ($2.3 million General Fund) and 11.3 personnel years in 2011-

12. The key functions of the project will be absorbed within the proposed California Department of Human Resources (formerly DPA/SPB).

### Asset Management—A Plan with No Savings

The Governor's May Revision proposes to improve the state's asset management but does not include any savings in 2011-12 as a result of the improved level of oversight. Any savings that may or may not materialize could be included in the Governor's 2012-13 budget. The proposals include the following policy actions:

- **Review and Dispose of Properties with no State Programmatic Use**—The DGS will develop a proposal to sell properties that serve no state programmatic need. If there is a determination that these properties should remain in state ownership, DGS already has the statutory authority to pursue long-term lease agreements on these properties until there is a state need. Initial properties intended for sale include the Los Angeles Coliseum, properties owned and managed by the Capitol Area Development Authority in Sacramento, and the Ramirez Canyon property in Southern California. Additionally, the California Department of Transportation is currently in the process of selling its share of the Montclair golf course in Oakland.
- **Review and Dispose of Underutilized Properties**—There have been reviews of high-value state properties but there has been considerably less effort focused on lower value and underutilized state properties. To improve the management of assets and sell underutilized properties where possible, state agencies will be directed to review their holdings in an attempt to down-size or dispose of properties and submit a report to DGS.
- **Consolidation of Under-utilized Space**—In recent years, some state agencies have experienced a downsizing of staff and consequently may have excess general office space. Additionally, other agencies may have either leased or planned for excess space anticipating various programs would grow and more state employees would be needed. In the past, DGS has completed studies that indicate some agencies could be reorganized more efficiently into state-owned space and therefore some excess lease space could be eliminated. Further downsizing of space will be realized as departments fully implement reductions to state operations. To this end, DGS will undertake a thorough space analysis with the input of state agencies to determine opportunities to eliminate lease space as well as to utilize state-owned space more efficiently.
- **Develop a Comprehensive Policy for Fairgrounds**—Proposals to sell properties should be evaluated in the context of a statewide policy and a property by property review of fairgrounds. The Secretary of Food and Agriculture would develop a plan to be included in the Governor's 2012-13 Budget, addressing the future operation, maintenance, and oversight of the Network of California Fairs, including real and personal property and the feasibility to restructure the governance of the fairs within this network. This could result in future flexibility for local entities to run county fairs by eliminating onerous state requirements and controls.

### Additional Efficiencies Achieved Via Executive Action

Additional actions taken by the Governor to achieve state operations savings include the following:

- **Secretary of Education**—The Office of Secretary of Education has been eliminated.
- **Inspector General**—The Inspector General for the American Recovery and Reinvestment Act has been eliminated.
- **Governor's Office**—The Governor's Office budget has been reduced by 25 percent.
- **Ban on Non-Essential Travel**—No travel by state employees is permitted unless mission critical.

- **Statewide Building Rental Rate Reduction**—A decrease of $26.6 million ($5.4 million General Fund) in 2011-12 as a result of reduced building rental rate funding for various state agencies based on lower costs within the DGS to operate these buildings.
- **State Issued Cellular Phone Reduction**—A decrease of $20 million ($11 million General Fund) in 2011-12 would result from the reduction to state-provided cellular phones.
- **Statewide Vehicle Reductions**—Pursuant to Executive Order B-2-11, the DGS is conducting an analysis of the purpose of, and necessity for, all vehicles and equipment that comprise the state fleet. This review will culminate in the elimination of any vehicles that are non-essential or are cost ineffective.

# 2011-12 Governor's May Revision Fee List

## 2011-12 Governor's May Revision Fee List*

(Dollars in Thousands)

| | | | 2010-11 Fee Revenues | | 2011-12 Fee Revenues | |
|---|---|---|---|---|---|---|
| Dept | Issue Title | Leg or NA** | GF $ | OF $ | GF $ | OF $ |
| Conservation | Permitting and Enforcement staff Augmentation | NA | $0 | $0 | $0 | $4,686 |
| Department of Water Resources | Watermaster Program | NA | 0 | 0 | 0 | 1,234 |
| State Water Resources Control Board | National Pollutant Discharge Elimination System (NPDES) Fund Shift | NA | 0 | 0 | 0 | 1,373 |
| State Water Resources Control Board | Irrigated Land Regulatory Program (ILRP) Fund Shift | NA | 0 | 0 | 0 | 1,762 |
| State Water Resources Control Board | Basin Planning | LEG | 0 | 0 | 0 | 6,103 |
| State Water Resources Control Board | Water Rights Program Fund Shift and Enforcement Augmentation | NA | 0 | 0 | 0 | 3,570 |
| Department of Health Care Services | Extend the Existing Hospital Fee | LEG | 0 | 4,036,060 | 0 | 1,816,027 |
| Managed Risk Medical Insurance Board (MRMIB) | Increase Healthy Families Program Premiums | LEG | 0 | 0 | 0 | 0 |
| Developmental Services | Annual Family Program Fee | LEG | 0 | 0 | 0 | 3,600 |
| University of California | Mandatory Fee Increase | NA | 0 | 0 | 0 | 183,076 |
| Hastings College of the Law | Mandatory Fee Increase | NA | 0 | 0 | 0 | 1,775 |
| California State University | Mandatory Fee Increase | NA | 0 | 48,500 | 0 | 224,209 |
| California Community Colleges | Credit Unit Fee Increase of $10/Unit | LEG | 0 | 0 | 0 | 110,000 |
| California Department of Food and Agriculture | Division of Measurement Standards Fees | LEG | 0 | 0 | 0 | 1,327 |
| California Department of Food and Agriculture | Phytosanitary Fee | NA | 0 | 0 | 0 | 200 |
| California Department of Food and Agriculture | Animal Health Branch - Fee for Service | LEG | 0 | 0 | 0 | 25 |
| California Department of Food and Agriculture | Meat and Poultry Inspection Program | LEG | 0 | 0 | 0 | 200 |
| **Total as of 2011-12 May Revision** | | | **$0** | **$2,359,167** | **$0** | **$0** |

*** The Fee List excludes routine statutorily required fee issues.**

**** Leg--fee requires legislation to enact or change. NA--no legislation is required.**

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