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

**January 13, 2011**
**SENATE REPUBLICAN FISCAL OFFICE**

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# Budget Briefs
SENATE REPUBLICAN FISCAL OFFICE

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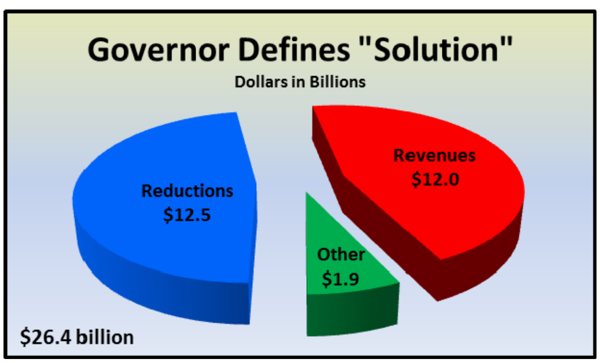
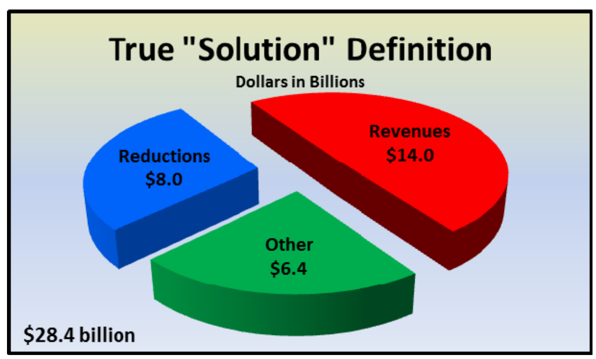
## Executive Summary

The Governor has projected a General Fund budget deficit of ***$25.4 billion*** ($8.2 billion in 2010-11 and $17.2 billion in 2011-12). This is the same as the Legislative Analyst's November 2010 estimate of $25.4 billion (a $6.1 billion projected deficit for 2010-11 and a $19.3 billion gap between projected revenues and spending in 2011-12) though it is arrived at through a different methodology.

Governor Brown proposes $26.4 billion in solutions ($25.4 billion problem plus $1 billion reserve) that include $12.5 billion of ***Expenditure Reductions***, $12 billion in ***Revenues***, and $1.9 billion of ***Other*** (primarily one-time special fund loans and transfers). However, it appears that *about $4.6 billion of "Expenditure Reductions" are actually from "Fund Shifts"* such as redirecting Redevelopment Agency funds ($1.7 billion), Proposition 10 and 63 revenues ($1.9 billion), and Transportation Weight Fees ($1.0 billion). In addition, the "Revenues" are actually $14 billion ($13.8 billion of tax increases), but cleverly offset by a negative $2 billion adjustment to reflect Proposition 98 interaction (i.e., the Proposition 98 share of new tax revenue).




An honest accounting would reflect $28.4 billion of solutions ($27.4 billion problem plus $1 billion reserve) with $8 billion of ***Expenditure Reductions***, $14 billion of ***Revenue***, and $6.4 billion of ***Other*** – not quite the "balanced" approach promoted by the Governor. (see chart above)

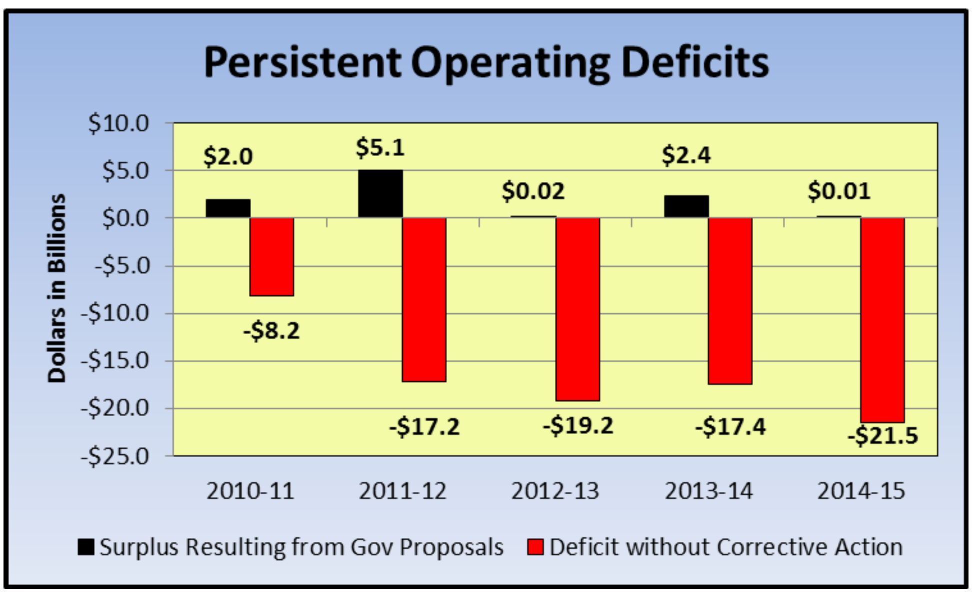
**<u>Key Points:</u>**

**Taxes.** The Governor's budget assumes $13.8 billion of tax increases with $11.1 billion of that amount proposed for placement on the June 2011 ballot. It is unclear why the changes to single sales factor and enterprise zones – a $2.3 billion tax increase – are not proposed for the ballot, but presumably it is intended to avoid opposition from business interests. Furthermore, the Governor has failed to propose solutions to replace the $11.1 billion if the tax increases fail on the ballot. (*see Taxes & Revenues on page 9*)

**Lower Vote Requirement for Tax Increases.** The Governor is proposing to phase out the current funding mechanism for redevelopment agencies, eliminate Enterprise Zone tax incentives, and establish a new funding mechanism for economic development (new Constitutional Amendment to provide for 55 percent voter approval for tax increases to secure new bonds for development projects). In November 2010, voters approved Proposition 26, which strengthened the requirement for a two-thirds vote for the imposition of state levies and charges (taxes and fees). Now, less than two months following that election, **the Administration is proposing to reduce the vote threshold for certain special taxes from two-thirds to 55 percent**.

**Realignment.** The Governor's budget includes a plan to move $5.9 billion in state programs to the counties and fund the shift by extending the current one percent sales tax and 0.50 percent Vehicle License Fee that are set to expire in 2011. The Realignment concept has some appeal as it could reduce state administrative costs and increase local control, transparency, and accountability. However, since the Administration is unable to provide details regarding how the Realignment would be implemented we cannot yet evaluate it. In their defense, it is a very complex and difficult technical task. Nonetheless, it does not seem reasonable to expect adoption of a placeholder proposal of this magnitude by March just so tax increases can be put on the ballot by June 2011. *(see Realignment on Page 13)*

**Structural Operating Deficit.** Absent "corrective action" the Administration projects continuing deficits in the range of $17 billion to $21.5 billion annually, which is also very similar to the LAO projections of annual $20 billion deficits. The Governor's budget, with proposed solutions, projects that operating deficits would be eliminated over the next four fiscal years.

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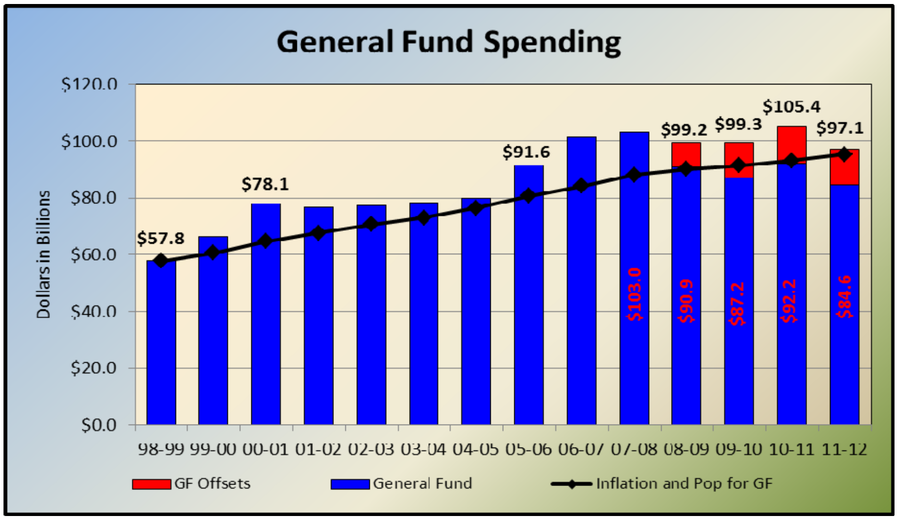
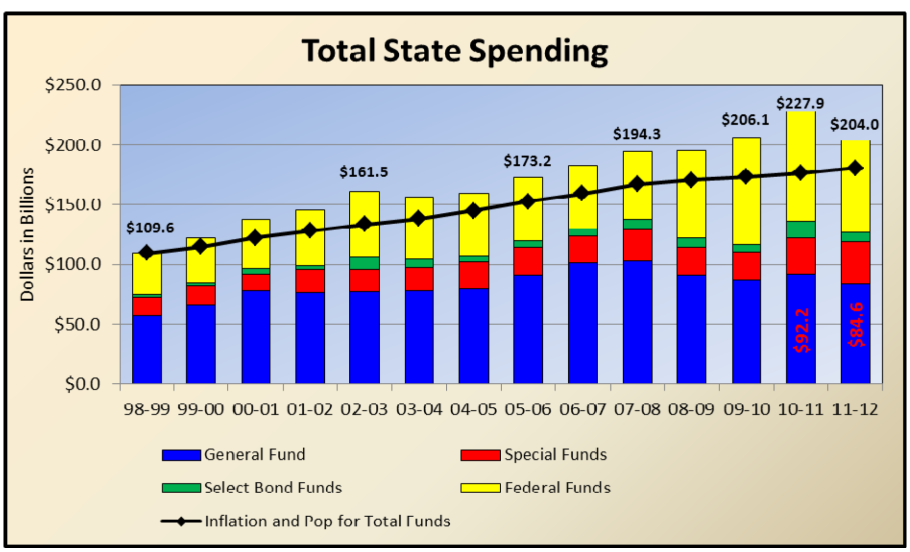
**General Fund Spending.** Fiscal year 2011-12 will be the fourth year in a row that California faces actual year-over-year reductions to General Fund spending, following peak General Fund expenditures of $103 billion in 2007-08. The 2011-12 Governor's budget proposes to spend $84.6 billion from the General Fund in 2011-12. This amount is approximately $16.1 billion less than what the budget would have been ($100.7 billion) absent the Governor's proposed solutions. In addition to General Fund resources, the Governor's budget proposes approximately $12.5 billion of "offsets" to General Fund costs including fund shifts of $4.6 billion (RDA sources, Proposition 63, Proposition 10, and the revised transportation funds), the realignment of various state programs to the local level ($5.9 billion), and the deferral of Proposition 98 funds from 2011-12 to 2012-13 ($2.2 billion). As noted in the chart below, the "true" underlying General Fund expenditure level (red bar), which recognizes the above "offsets," shows that actual General Fund-like spending is still hovering near the $100 billion mark and is in line with population and inflation growth.




**Total State Spending.** Though General Fund spending is always the focus of state budget conversations, it is just one component of total state spending. As the chart below demonstrates, 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 by more than $23 billion ($180.7 billion vs. $204.0 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.



**Conclusion**

The proposed budget plan contains many supportable elements, including major spending reductions of a permanent nature. However, it also contains some major flaws in that 1) it assumes support for $13.8 billion of tax increases and *provides no solutions in the event the $11.1 billion of tax increases on the ballot are rejected by voters* – it would be irresponsible to put the question to the voters without an understanding of the trade-offs they are being asked to make; and 2) the Realignment proposal lacks sufficient information to adequately assess it, and likely will not be complete within the desired timeframe (i.e., March 2011).

Furthermore, the Governor's plan *does not include any proposals to improve the economy and create jobs*. In fact, the proposed tax increases would likely result in further suppressing any burgeoning economic recovery.

This budget *maintains government's monopoly on providing services to the citizens* because it fails to include any reforms to state government programs or civil service rules to allow the type of innovation and efficiency that comes from the competitive approach typified by the private sector. Requiring state programs and employees to compete with the private sector, when done properly, can significantly reduce costs and improve quality.

Broadly stated, it is an incomplete plan that lacks many important details and **will likely result in a $11.1 billion budget deficit come June 2011** when the taxes fail on the ballot. Despite reaching for "vast and historic" changes, this budget plan fails to fully embrace the opportunities to reform state government provided by the current budget crisis.

# Expenditures

The 2010 Budget Act included total General Fund expenditures of $86.6 billion for 2010-11. However, General Fund expenditures for 2009-10 have increased by about $5.7 billion (to $92.2 billion) since the passage of the 2010 Budget Act (approximately 6.5 percent). Based on actions proposed in the Governor's budget, General Fund expenditures would then decrease to $84.6 billion (approximately 8.2 percent) for 2011-12. The following table compares the Governor's newly proposed budget to the budgets of the previous three fiscal years.

**General Fund Expenditures By Agency**
(dollars in millions)

| Agency | Actual 2008-09 | Actual 2009-10 | Revised 2010-11 | Proposed 2011-12 |
|---|---|---|---|---|
| Legislative, Judicial, Executive | $3,719 | $3,149 | $3,167 | $2,507 |
| State and Consumer Services | $534 | $598 | $586 | $597 |
| Bus, Trans, and Housing | $1,679 | $905 | $507 | $691 |
| Resources | $1,773 | $2,108 | $2,032 | $2,066 |
| Environmental Protection | $76 | $77 | $75 | $63 |
| Health and Human Services | $28,278 | $26,346 | $26,961 | $21,175 |
| Corrections and Rehabilitation | $9,705 | $8,931 | $9,257 | $9,165 |
| K-12 Education | $34,092 | $36,079 | $36,353 | $36,211 |
| Higher Education | $10,099 | $11,490 | $11,651 | $9,814 |
| Labor and Workforce Development | $95 | $58 | $42 | $414 |
| General Government | $1,045 | $1,120 | $1,524 | $1,544 |
| Other* | -$156 | -$4,309 | $54 | $367 |
| **Total, General Fund Expenditures** | **$90,939** | **$86,552** | **$92,209** | **$84,614** |
| Year-Over-Year Change | | -$4,387 | $5,657 | -$7,595 |
| - As a Percentage | | -4.8% | 6.5% | -8.2% |

General Fund expenditures for each of the four fiscal years listed above range from $10.8 billion to $18.4 billion less than expenditures recorded for 2007-08 ($103 billion) prior to the beginning of the "Great Recession." This significant decrease in General Fund expenditures over the past four years 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 on the following page 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** | **$92.2** | **$84.6** |
| "Offsets" to Maintain General Fund Program Levels* | -- | $8.2 | $11.4 | $7.3 | $12.5 |
| **Total, General Fund Program Expenditures** | **$103.0** | **$99.1** | **$98.0** | **$99.5** | **$97.1** |

* 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 Propositions 10 and 63 funds to support existing programs.

It is clear that while General Fund spending has technically been reduced by $10.8 billion to $18.4 billion over the past four years, total spending for General Fund programs has remained relatively constant over that same time period (an average of 4.5 percent below 2007-08 levels).

# Taxes & Revenues Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- The Governor's tax increase proposal would be limited to five years, as opposed to permanent, and subject to voter approval.

**Negative Aspects of Governor's Budget Proposal:**

The Governor's budget proposes $14.0 billion of new General Fund revenue over 2010-11 and 2011-12 ($2 billion of which is obligated to the Proposition 98 guarantee), subject to approval by the voters in June 2011. Specific revenue proposals include:

- $5.2 billion related to extending for five years the existing 0.25 percent personal income tax bracket increase ($1.2 billion in 2010-11 and $2.1 billion in 2011-12) and the suspended dependent tax credit ($725 million in 2010-11 and $1.2 billion in 2011-12) that were enacted as part of the February 2009 budget deal. This would go to the voters in June 2011.
- $5.9 billion in 2011-12 related to extending for five years the existing 1.0 percent Sales and Use Tax (SUT) increase ($4.5 billion) and the 0.5 percent vehicle license fee (VLF) increase ($1.4 billion) that were enacted as part of the February 2009 budget deal – to fund the Governor's realignment plan. This would go to the voters in June 2011.
- $1.4 billion ($468 million in 2010-11 and $942 million in 2011-12) related to requiring all businesses to use "single sales factor" (mandatory Single Sales Factor) to source the California share of income for corporate income taxes.
- $924 million ($343 million in 2010-11 and $581 million in 2011-12) related to eliminating state tax benefits currently provided in Enterprise Zones (i.e., no hiring credit, no SUT credit, etc.).
- $515 million (over the two fiscal years) related to a variety of other smaller revenue proposals, including another amnesty program, the Financial Institutions Records Match, extending the hospital fee for Medi-Cal, and continuing Managed Care Organization taxes.

**Comments/Bottom Line:**

Republicans have consistently stated that taxes should not be part of the budget solution. Voters were clear in the past two elections, rejecting the extension of the February 2009 tax increases and the car tax to fund state parks. In addition, Californians voted in November 2010 to make it harder to raise taxes.

Furthermore, the Governor's budget does not include a plan to address the $11.1 billion budget hole that could emerge if/when voters reject the tax increases on the June 2011 ballot.

**According to the Department of Finance, the average family of four would pay an additional $1,040 per year in increased taxes as a result of the Governor's tax increase proposal.**

# Taxes & Revenues

The 2010 Governor's budget proposes General Fund revenues of $94.2 billion for 2010-11 and $89.7 billion for 2011-12, including approximately $9.6 billion of new revenues from tax increases, tax administration proposals, and transfers to the General Fund. These amounts do not include $5.9 billion of increased tax revenue related to extending the Vehicle License Fee (VLF) and the one percent Sales and Use Tax (SUT) increases that are a part of the Governor's realignment proposal. The following table identifies where revenues are projected to increase and decrease, and compares them to estimates prepared for the 2010 Budget Act.

**General Fund Revenue Projections**

(dollars in millions)

| 2009-10 Revenue Source | At Budget Act | Revised Baseline Revenues | Forecast Change | %△ | Governor's Budget Revenues | | |
|---|---|---|---|---|---|---|---|
| Personal Income Tax | $44,820 | $44,848 | $28 | 0.1% | $44,848 | | |
| Sales & Use Tax | $26,618 | $26,741 | $123 | 0.5% | $26,741 | | |
| Corporation Tax | $9,275 | $9,115 | -$160 | -1.7% | $9,115 | | |
| Insurance Tax | $2,029 | $2,002 | -$27 | -1.3% | $2,002 | | |
| Other Revenues | $3,731 | $3,859 | $128 | 3.4% | $3,859 | | |
| Transfers | $447 | $476 | $29 | 6.5% | $476 | | |
| **Total Revenue** | **$86,920** | **$87,041** | **$121** | **0.1%** | **$87,041** | | |
| | | | | | | | |
| **2010-11 Revenue Source** | **At Budget Act** | **Revised Baseline Revenues** | **Forecast Change** | **%△** | **Governor's Budget Revenues** | **Change** | **%△ to base** |
| Personal Income Tax | $47,127 | $45,470 | -$1,657 | -3.5% | $47,784 | $2,314 | 5.1% |
| Sales & Use Tax | $27,044 | $26,709 | -$335 | -1.2% | $26,709 | $0 | 0.0% |
| Corporation Tax | $10,897 | $10,820 | -$77 | -0.7% | $11,509 | $689 | 6.4% |
| Insurance Tax | $2,072 | $1,838 | -$234 | -11.3% | $1,838 | $0 | 0.0% |
| Other Revenues | $5,691 | $4,932 | -$759 | -13.3% | $4,934 | $2 | 0.0% |
| Transfers | $1,399 | $956 | -$443 | -31.7% | $1,420 | $464 | 48.5% |
| **Total Revenue** | **$94,230** | **$90,725** | **-$3,505** | **-3.7%** | **$94,194** | **$3,469** | **3.8%** |
| | | | | | | | |
| **2011-12 Revenue Source** | **At Budget Act** | **Revised Baseline Revenues** | **Forecast Change** | **%△** | **Governor's Budget Revenues** | **Change** | **%△ to base** |
| Personal Income Tax | $45,281 | $46,154 | $873 | 1.9% | $49,741 | $3,587 | 7.8% |
| Sales & Use Tax | $25,026 | $24,050 | -$976 | -3.9% | $24,050 | $0 | 0.0% |
| Corporation Tax | $10,239 | $9,725 | -$514 | -5.0% | $10,966 | $1,241 | 12.8% |
| Insurance Tax | $1,871 | $1,974 | $103 | 5.5% | $1,974 | $0 | 0.0% |
| Other Revenues | $4,354 | $2,410 | -$1,944 | -44.6% | $2,511 | $101 | 4.2% |
| Transfers | -$1,067 | -$767 | $300 | -28.1% | $454 | $1,221 | -- |
| **Total Revenue** | **$85,704** | **$83,546** | **-$2,158** | **-2.5%** | **$89,696** | **$6,150** | **7.4%** |
| | | | | | | | |
| **Three-Year Total** | | | **-$5,542** | | | **$9,619** | |

This table provides a significant amount of information. Note the following main points:

- In the two months since the 2010 Budget Act was enacted, General Fund revenue estimates have deteriorated by about $5.5 billion over the three year period.
- About $2 billion of that decrease is because California will not receive the "state pick-up tax" under the federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

- ***As noted above, $5.9 billion of tax increases related to the Governor's realignment proposal are not included in this table.***
- General Fund revenues and transfers over the two year period (2010-11 and 2011-12) are approximately $9.6 billion higher than the Governor's revised baseline revenue estimates. This amount includes $7.6 billion of tax increases, about $258 million of administrative revenue enhancements, and $1.8 billion of transfers to the General Fund.

**Governor's Tax Increase Proposals**

The Governor's budget plan to increase revenue consists of three parts: (1) Place four tax increases on the ballot for voter approval (each would be for a term of five years); and (2) Make changes to two categories of tax incentives; and (3) Provide the Franchise Tax Board (FTB) with two additional tools to collect taxes owed.

**1) Tax Increases (for five years): <u>Subject to Voter Approval on June 2011 ballot</u>**

- **Personal Income Tax (PIT) Rate Surcharge:** Effective for tax years beginning on or after January 1, 2011 but before January 1, 2016, re-establish the 0.25-percentage point surcharge for each PIT tax rate and the Alternative Minimum Tax (AMT) rate. The Administration estimates that this proposal would generate revenues of $1.2 billion in 2010-11 and $2.1 billion in 2011-12. *This tax increase from 2009 expired on December 31, 2010, so this change would not be extending an existing tax.*
- **PIT Dependent Exemption Credit:** Reestablish 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 $725 million in 2010-11 and $1.2 billion in 2011-12. *This tax increase from 2009 expired on December 31, 2010, so this change would not be extending an existing tax.*
- **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 $4.6 billion in 2011-12.
- **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.

**2) Changes to Tax Incentives: <u>Tax Increases NOT on June 2011 ballot</u>**

- **Eliminate Enterprise Zone Tax Incentives:** The Governor's budget proposes 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. These areas include EZs, Targeted Tax Areas, Manufacturing Enhancement Areas, and Local Agency Military Base Recovery Areas. The tax benefits provided for most of these areas include; a hiring credit, a credit for sales tax paid, a credit for employees who earn wages within the area, and a deduction for interest received from businesses in an area. This proposal would eliminate these tax benefits, both for newly earned credits and deductions and for credits that had been earned in prior years, but had not yet been used. Local agencies that want to keep any local incentives could continue to do so. This ***tax increase*** is expected to generate additional revenues of $343 million in 2010-11 and $581 million in 2011-12.

- **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. 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 $468 million in 2010-11 and $942 million in 2011-12.

**3) FTB Administrative Tools.**

- **Tax Amnesty Proposal:** The Budget proposes to allow the FTB to provide an amnesty for taxpayers who utilized an abusive tax-avoidance transaction. Abusive Tax Avoidance Transactions (ATATs) serve no purpose other than reducing tax. This proposal would authorize the FTB to provide a narrow tax amnesty for taxpayers that utilized an ATAT. This proposal would also provide an amnesty for the underreporting of California income resulting from offshore financial arrangements. This proposal, which is similar to that proposed in AB 2498 (Skinner/2009), is expected to generate additional revenues of $270 million in 2010-11 and to decrease revenues by $50 million in 2011-12.

  In the past, Republicans have been opposed to this proposal. The primary argument in opposition was that the language proposed would not provide for appeals, other than a chief counsel ruling at the Franchise Tax Board (FTB). The business community would request an appeals process other than a simple FTB chief counsel ruling. Republicans have also opposed a second voluntary compliance initiative so soon following the one that was implemented in 2005. Establishing another amnesty program so close to the previous one may encourage non-compliance as taxpayers delay filing and/or payment of taxes waiting for yet other amnesty programs in later years.

- **Financial Institutions Record Match:** The Budget proposes to require financial institutions to participate in a record match process between financial institution customer records and FTB debtor records. FTB would use the match information to collect delinquent state income tax debts using existing laws and collection methods. This proposal would help close the tax gap, collect additional revenue from taxpayers who have not paid their legally required share of taxes, and reduce collection process inefficiencies. This proposal is expected to generate additional revenues of $10 million in 2010-11 and $30 million in 2011-12.

# Realignment Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- The Governor's realignment proposal could reduce the size of state government and allow the locals to better structure programs based on local needs.

- Program flexibility and accountability could be improved and local governments could better serve their unique populations.

**Negative Aspects of Governor's Budget Proposal:**

- Proposal is predicated on a five year extension of taxes ($5.9 billion in 2011-12, growing to $7.2 billion in 2014-15) namely the VLF and sales tax increases implemented in 2009 and set to expire this year. The proposal would seek a five year extension of the taxes but the program realignment would be ongoing, resulting in either a push to further extend the taxes after five years or provide a General Fund backfill. Details on the realignment proposal, including the funding structure and who would determine program priorities for the funding, are not available.

- It is unclear if statewide standards would still be required for the various programs or if local government would truly have flexibility to run their programs.

**Comments/Bottom Line:**

The concept of realignment, moving programs down to the local level where they can better serve the individual needs of the community, is consistent with the Republican belief that government closest to the people governs best. Unfortunately, the Governor's realignment proposal relies on additional taxes and includes no specifics on how the realignment would be structured and what standards would still be required, leaving open the question of whether or not it really would be good for government at all. In all likelihood, this concept will end up being little more than a fig leaf for increasing taxes to protect health and welfare programs.

# Realignment

The Governor's budget includes a major proposal to realign many core functions of government from the state level to the local level, ostensibly to reduce the size of state government, conserve scarce General Fund resources, and place the management and delivery of governmental services closer to the people. Republicans have long argued for this type of reform, provided of course that any shift in responsibilities represents a true shift toward increased local control and flexibility and is accompanied by the funding necessary to ensure the ongoing viability of core governmental services. However, the Governor's proposal lacks implementation detail, including the funding structure and who would determine program priorities for the funding, which would allow for a comprehensive evaluation based on the aforementioned criteria.

The proposal is predicated on a five-year extension of taxes ($5.9 billion in 2011-12, growing to $7.2 billion in 2014-15), namely the Vehicle License Fee (VLF) and sales tax increases set to expire at the end of 2010-11, and a Legislative repurposing of existing Mental Health Services Act (Proposition 63) revenues to fund three existing state mental health programs. Revenues from these sources would be dedicated to local governments to fund various aspects of the realignment. Although the tax extensions would be temporary, the program realignment would be ongoing, resulting in either a push to further extend the taxes after five years or provide a General Fund backfill. Moreover, it is unclear if statewide standards would still be required for the various programs or if local governments would truly have flexibility to run their programs. In all likelihood, this concept will end up being little more than a fig leaf for increasing taxes to protect health and welfare programs. In addition, it is a proverbial "gun to the head" of local public safety.

Underlying the identified funding sources are two risky assumptions – first, that the voters approve the tax extensions on the June ballot, which is a tenuous position given that voters rejected two proposed tax increases and made it more difficult for the Legislature to raise taxes as recently as November 2010, and second, that the Legislature can legally repurpose Proposition 63 funds. The latter is highly likely to face significant legal challenges by stakeholder groups.

The Governor's proposal would be implemented in two phases.

**Phase I**

The plan would realign approximately $5.9 billion in General Fund-supported programs, as follows:

***Public Safety***

- *Low-level offenders and parole violators.* Parole violators and low-level offenders with short prison terms would become the responsibility of local jurisdictions.
- *Adult parole*. Local agencies would assume responsibility for all adult parolees.
- *Division of Juvenile Justice (DJJ)*. The remaining wards under the jurisdiction of DJJ would be shifted to county responsibility.
- *Local public safety programs*. Funding for state-supported local law enforcement programs would continue to be funded from 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. *(For additional information, please refer to the table on page 41, entitled 'Local Public Safety Funding*')

- *Court security*. Local governments would be responsible for providing security for courthouses within their respective jurisdictions.

- *Fire and emergency response activities*. Populated state responsibility areas will have fire protection and medical emergency response activities transferred to local government.

***Health and Human Services***

- *Community Mental Health Services.* The Governor's proposal would, beginning in 2012-13, shift responsibility for three state-funded community mental health programs from the Department of Mental Health to local governments. The three programs to be shifted 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). In 2011-12, the Governor proposes to shift $861 million in *funding only* for these programs from the General Fund to Proposition 63 funds, while retaining the current program administration structure. (*See discussion of the Department of Mental Health's budget on page 31 for additional discussion of the funding shift.*) However, 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.

- *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, Adoptions, 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 ($55 million General Fund) to the counties.

See the next page for Phase I Realignment Funding Information.

| Phase One Realignment Funding (Dollars in Millions) | | | |
|---|---|---|---|
| **Program** | | **2011-12** | **2014-15** |
| Fire and Emergency Response Activities | | $250.0 | $250.0 |
| Court Security | | 530.0 | 530.0 |
| Vehicle License Fee Public Safety Programs | | 506.4 | 506.4 |
| Local Jurisdiction for Lower-level Offenders and Parole Violators | | | |
| | Local Costs | 298.4 | 908.1 [1/] |
| | Reimbursement of State Costs | 1,503.6 [2/] | - |
| Realign Adult Parole to the Counties | | | |
| | Local Costs | 113.4 | 409.9 [1/] |
| | Reimbursement of State Costs | 627.7 [2/] | - |
| Realign Remaining Juvenile Justice Programs | | | |
| | Local Costs | 78.0 | 242.0 [1/] |
| | Reimbursement of State Costs | 179.6 [2/] | - |
| Mental Health Services | | | |
| | The Early and Periodic Screening, Diagnosis and Treatment Program | - | 579.0 |
| | Mental Health Managed Care | - | 183.6 |
| | AB 3632 Services | - | 104.0 |
| | Existing Community Mental Health Services | - | 1,077.0 |
| Substance Abuse Treatment | | 184.0 | 184.0 |
| Foster Care and Child Welfare Services | | 1,604.9 | 1,604.9 |
| Adult Protective Services | | 55.0 | 55.0 |
| Unallocated Revenue Growth | | - | 621.1 |
| **Total** | | **$5,931.0** | **$7,255.0** |
| 1% Sales Tax | | 4,549.0 | 5,567.0 |
| 0.5% VLF | | 1,382.0 | 1,688.0 |
| **Total Revenues** | | **$5,931.0** | **$7,255.0** |

[1/] The allocation in 2014-15 is different than the amount allocated in 2011-12 due to a phased-in implementation.

[2/] During the transition, estimated state costs will be reimbursed from realignment revenues.

**Phase II**

Implementation of national health care reform is linked with Phase II of the realignment proposal. Phase II assumes that the state will become responsible for costs associated with health care programs (except public health programs which will remain at the local level), including California Children's Services and In-Home Supportive Services, while the counties would assume responsibility for CalWORKs, food stamp administration, child support, and child care programs. The counties currently operate these programs for the state. There is no timing specified for when implementation of Phase II will begin, nor is any programmatic detail available. It is unclear if the Administration would seek additional taxes or a General Fund backfill to provide funding for these programs.

# Local Economic Development Snapshot

**Major Aspects Affecting Local Economic Development:**

- Phases out the current funding mechanism for redevelopment agencies (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. Beginning in 2012-13, amounts remaining after paying off RDA debts and contracts would be distributed to cities, counties, special districts and schools based on their proportionate share of base property tax (estimated at $1 billion for schools, $290 million for counties, $490 million for cities, and $100 million for non-enterprise special districts).
- Eliminates all Enterprise Zone (EZ) tax incentives, including hiring credits, sales and use tax credits, employee wage credits, and interest deductions (increased General Fund revenues of $343 million in 2011-12 and $581 million in 2012-13).

**Positive Aspects of Governor's Budget Proposal:**

- 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.
- Brings an end to eminent domain in the state as California's RDAs are virtually the only agency authorized with the power to seize private property for redevelopment.

**Negative Aspects of Governor's Budget Proposal:**

- Proposes 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 two-thirds vote of the people. This proposal would lower the threshold for tax increases from two-thirds to 55 percent.
- Eliminates an existing tool (RDAs) that has 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).
- Eliminating EZ tax incentives equates to a tax increase for those businesses operating within specified zones.

**Comments/Bottom Line:**

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."

# Local Economic Development

The Governor is proposing to phase out the current funding mechanism for RDAs, eliminate Enterprise Zone tax incentives, and establish a new funding mechanism for economic development (new Constitutional Amendment to provide for 55 percent voter approval for tax increases to secure new bonds for development projects). Property tax revenues currently collected by RDAs would be reallocated, as follows:

**2011-12 (estimated $5.2 billion)**

- $2.2 billion (first) to retire RDA debts and contractual obligations in accordance with existing payment schedules.
- $1.1 billion would be provided as pass-through payments that otherwise would be received (schools, special districts, etc).
- $1.7 billion as a one-time offset of General Fund costs for Medi-Cal ($840 million) and trial courts ($860 million).
- $210 million as one-time allocation to cities, counties, and special districts (assuming all SDs) proportionate to current share of countywide property tax.

**2012-13 and ongoing (estimated)**

- First - Amounts necessary to pay off pre-existing RDA debts and contractual obligations (estimated $2.2 billion).
- Remaining property tax amounts will be distributed to cities ($490 million), counties ($290 million), non-enterprise special districts ($100 million), and K-14 schools ($1 billion).
- **One exception** -- $50 million that would otherwise be distributed to enterprise special districts (mainly water and waste disposal districts) will instead be provided to counties. Reason: "Enterprise special districts are mainly fee-supported."

**As Debt is Paid Off**

"After 2010-11, the money available after payment of RDA debt would be distributed to schools, cities, counties, and non-enterprise special districts for general uses. Successor entities would continue to process the retirement of RDA debt, which is expected to take at least 20 years. As the RDA debt is retired, the monies formerly used for debt service payments will flow to local governments."

In addition to the complicated funding shifts (identified above), the Legislative Analyst's Office (LAO) indicates that this plan will require considerable work by the Legislature to sort through many legal, financial, and policy issues, as well as other concerns:

- In November 2010, voters approved Proposition 26, which strengthened the requirement for a two-thirds vote for the imposition of state levies and charges (taxes and fees). Now, less than two months following that election, **the Administration is proposing to reduce the vote threshold for certain special taxes from two-thirds to 55 percent**.
- Several other voter approved constitutional measures constrain the state's authority to redirect redevelopment funds (CA Redevelopment Law-Article XVI, Section 16 (b)), use property tax revenues to pay for state programs (Proposition 1A), or impose new costs on local agencies (SB 90/1972).
- Enterprise special districts, which would not receive the $50 million allocation, will likely raise concerns that, even though they have the authority to raise fees, the process for doing so is long and complex. And, why shouldn't they benefit from the $50 million allocation?

# Education Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- Maintains Proposition 98 funding at roughly the same level in 2011-12 ($49.3 billion) as in 2010-11 ($49.7 billion).
- Extends existing K-14 local funding flexibility provisions for two additional years.
- Makes child care reforms, including elimination of service to 11- and 12-year-olds and reductions in family income eligibility ceilings and subsidy levels, for net savings of about $500 million.
- Makes difficult but necessary funding reductions, including $500 million each to UC and CSU, to eliminate the structural budget problem.
- Reduces bureaucracy by eliminating the Office of the Secretary for Education, for net savings of $1.6 million.

**Negative Aspects of the Governor's Budget Proposal:**

- Predicates the continuation of existing Proposition 98 funding levels on a $4.8 billion tax increase.
- Borrows from the future by increasing K-14 education funding deferrals by $2.2 billion.
- Fails to repeal the contracting-out restrictions on non-instructional services originally enacted in SB 1419 (Ch. 894/2002), to enable reduced costs and improved quality of service.

**Bottom Line/Comments:**
The Governor's education budget proposal is generally supportable, with the exception of its reliance on new taxes.

On the up-side, it prioritizes K-14 education by holding Proposition 98 funding roughly flat. Its extension of existing local funding flexibility should help school districts remain solvent in this lean budget environment. Its child care reforms are consistent with those endorsed by Republicans in the past. Reductions to total UC and CSU funding are unfortunate but likely necessary to resolve the state's structural budget problem.

On the down-side, its maintenance of existing Proposition 98 funding **is predicated on the voters' willingness to support higher taxes**, and its $2.2 billion increase in K-14 deferrals will require that same amount of increased spending in the following year to avoid reductions to existing Proposition 98 programs.

# Education

## K-14 Education

In an effort to prioritize funding for K-14 education, the Governor's proposed budget fully funds the Proposition 98 guarantee for K-14 education at $49.3 billion in 2011-12, down slightly from $49.7 billion in 2010-11, contingent on voter approval of new taxes in June 2011.[1]

Proposition 98 per-pupil spending would fall slightly from $7,358 in 2010-11 to $7,344 in 2011-12. Total K-12 per-pupil spending would fall from $11,154 in 2010-11 to $10,703 in 2011-12, mostly due to a loss of federal funds.

**Proposition 98 Funding**

*Source: Legislative Analyst's Office*

($ in millions)

| | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | $ change | % change |
|---|---|---|---|---|---|---|---|
| **K-12 education** | | | | | | | |
| **General Fund** | **$37,752** | **$30,075** | **$31,732** | **$32,239** | **$32,401** | **$162** | **0.5%** |
| **Local property tax revenue** | **$12,592** | **$12,969** | **$12,328** | **$11,557** | **$11,406** | **-$152** | **-1.3%** |
| **K-12 subtotal** | **$50,344** | **$43,044** | **$44,060** | **$43,796** | **$43,807** | **$11** | **0.0%** |
| **California Community Colleges** | | | | | | | |
| **General Fund** | **$4,142** | **$3,918** | **$3,721** | **$3,885** | **$3,542** | **-$343** | **-8.8%** |
| **Local property tax revenue** | **$1,971** | **$2,029** | **$2,000** | **$1,892** | **$1,873** | **-$19** | **-1.0%** |
| **CCC subtotal** | **$6,112** | **$5,947** | **$5,721** | **$5,777** | **$5,415** | **-$361** | **-6.3%** |
| **Other Agencies** | **$121** | **$105** | **$93** | **$85** | **$78** | **-$7** | **-8.7%** |
| **Total Proposition 98** | **$56,577** | **$49,096** | **$49,874** | **$49,658** | **$49,300** | **-$358** | **-0.7%** |
| **General Fund** | **$42,015** | **$34,098** | **$35,546** | **$36,209** | **$36,021** | **-$188** | **-0.5%** |
| **Local property tax revenue** | **$14,563** | **$14,997** | **$14,327** | **$13,449** | **$13,279** | **-$170** | **-1.3%** |
| **Prop 98 per-pupil funding (K-12)** | **$8,464** | **$7,226** | **$7,425** | **$7,358** | **$7,344** | **-$14** | **-0.2%** |
| **Programmatic funding** | **$8,235** | **$8,415** | **$7,933** | **$7,820** | **$7,708** | **-$112** | **-1.4%** |
| **Total funding[2/]** | **$11,965** | **$11,392** | **$10,921** | **$11,154** | **$10,703** | **-$451** | **-4.0%** |

1/ LAO's 'programmatic funding' calculations are detailed on page 24 of its budget overview document: http://www.lao.ca.gov/reports/2011/bud/budget_overview/budget_overview_011211.pdf

2/ funds appropriated from state, local, and federal sources

Although the Proposition 98 budget appears roughly flat, base spending reductions of roughly $3 billion will be 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, the Governor's budget proposes:

- $2.2 billion additional K-14 deferrals (as an alternative to outright reductions),
- $500 million net reduction in child care funding, discussed further below, and
- $360 million net reduction in California Community College (CCC) funding.

**Deferrals.** The $2.2 billion funding deferral referenced above consists of $2.064 billion for K-12 and $129 million for the Community Colleges. It would enable schools and CCCs to spend at $2.2 billion above the minimum guarantee in 2011-12 and be reimbursed by the state in 2012-13, to the extent that they can borrow an equal amount of funds in the interim. The risk associated with a deferral is that it could require reductions to revenue limit or categorical program funding in the following year, unless the

[1] Absent his proposed taxes, the minimum guarantee would be about $2 billion lower.

guarantee naturally grows by at least the amount of the deferral. The Legislative Analyst has observed that the adoption of this latest deferral would increase total inter-year deferrals to over $10 billion per year, or roughly 20 percent of the 2011-12 Proposition 98 program, and has expressed concerns that the resulting cash-flow burden on schools could necessitate state emergency loans to avoid fiscal insolvencies.

**Child Care.** The Governor would substantially reform state-subsidized child care, for savings of about $750 million, but at the same time would add back about $250 million to restore Stage 3 child care funding vetoed in the fall of 2010, for net savings of about $500 million. The reforms would include:

- Eliminating subsidized care for 11- and 12-year-olds,
- Reducing family income eligibility ceilings from 75 percent to 60 percent of the state median income,
- Reducing state subsidies (provider payments) by about 35 percent, and
- Shifting family fee collection duties from state administrative agencies to child care providers.

An October 2010 report by the California Senate Office of Oversight and Outcomes (SOOO) detailed many examples of past child care fraud and revealed that little is being done to address the problem. The report declared that the current system "amounts to a merry-go-round of disincentives in which those who oversee the program would rather not know about fraud or feel powerless to address it", and made several recommendations, among which were the practice of random unannounced visits to child care providers and the funding of investigators dedicated to child care fraud. A January 2011 Associated Press report about a Riverside, California, woman whose apparent fraud continued for nine years and cost taxpayers $500,000, demonstrates that the problem continues to exist; however, the Governor's budget includes no proposals to address it.

**Community Colleges.** Funding for the CCCs would fall by a net of about $360 million, mostly associated with a revision to the method by which attendance is calculated for purposes of state funding.[2] The colleges would still get their full statutory share of Proposition 98 funding (roughly 11 percent, or about $5.4 billion). CCC student fees would rise from $26 to $36 per credit unit, generating about $110 million in new resources, 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.

**Flexibility.** All existing K-14 local flexibility provisions would be extended for two additional years (through 2014-15, with one exception):

- Categorical program funding flexibility,
- Routine maintenance contributions,
- Deferred maintenance matching requirements,
- Continued use of existing instructional materials,
- Relaxed school district budget reserve requirements, and
- Relaxed K-3 class size reduction penalties (through 2013-14).

**Other notable K-14 budget proposals** include:

- $90 million for K-14 reimbursable state mandates (same as 2010-11),
- $54 million for the Emergency Repair Program (Williams lawsuit settlement),

[2] Currently CCCs are paid based on the number of students in attendance during the third week of class, regardless of how many drop the class after that date.

- No funding for a 1.67 percent cost-of-living adjustment; instead, a ‘deficit factor’ would be created to reflect the intent to increase revenue limit funding by an equivalent amount when funds eventually become available, and
- Suspension of $6.5 million in federal funding for development of student and teacher data systems (CalPADS and CalTIDES), pending review by an interagency working group.

**Office of the Secretary for Education (OSE).** The Governor also proposes to eliminate the OSE to reduce bureaucracy, simplify education governance, and reduce spending. He would transfer $274,000 of its $1.9 million annual budget to the State Board of Education and capture the remaining $1.6 million as General Fund savings.

**Redevelopment Agencies.** The Governor’s proposal to eliminate redevelopment agencies (*see Local Economic Development on page 17*) would generate roughly $1 billion in ongoing school funding that would be in addition to the Proposition 98 guarantee, beginning in 2012-13.

**Libraries.** The education budget also includes funding for the California State Library (CSL) and for local libraries. The Governor’s budget proposal would eliminate state support for local libraries, for savings of $30.4 million, as follows:
- Public Library Foundation - $12.9 million
- California Library Services Act - $12.9 million
- California Library Literacy and English Acquisition Services Program - $4.6 million

**Missed Opportunities.** The Governor does *not* propose to bring **Proposition 49** before and after-school programs back ‘on-budget’ so as to make the associated $550 million in Proposition 98 funding available for higher priority uses. Neither 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.

### UC, CSU, & Student Financial Aid

The Governor’s budget proposal would impose 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 used to offset General Fund costs in 2010-11.

The chart below summarizes funding for UC and CSU:

**UC & CSU Funding**
(Selected core funds, in millions)

| | Fund | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | $ change | % change |
|---|---|---|---|---|---|---|---|---|
| UC | General Fund | $3,257 | $2,418 | $2,596 | $2,912 | $2,524 | -$388 | -13.3% |
| | Fees [1/] | $1,593 | $1,677 | $2,001 | $2,566 | $2,749 | $183 | 7.1% |
| | ARRA [2/] | $0 | $717 | $0 | $107 | $0 | -$107 | -100.0% |
| | Lottery | $25 | $25 | $28 | $30 | $30 | $0 | 0.0% |
| | Total UC | $4,876 | $4,837 | $4,625 | $5,614 | $5,303 | -$311 | -5.5% |
| CSU | General Fund | $2,971 | $2,155 | $2,350 | $2,683 | $2,291 | -$391 | -14.6% |
| | Fees [1/] | $1,176 | $1,406 | $1,593 | $1,718 | $1,940 | $222 | 12.9% |
| | ARRA [2/] | $0 | $717 | $0 | $107 | $0 | -$107 | -100.0% |
| | Lottery | $58 | $42 | $46 | $46 | $46 | $0 | 0.0% |
| | Total CSU | $4,205 | $4,320 | $3,990 | $4,553 | $4,277 | -$276 | -6.1% |
| | Total | $9,081 | $9,156 | $8,615 | $10,168 | $9,580 | -$587 | -5.8% |

[1/] Includes amounts diverted to financial aid controlled by UC and CSU
[2/] Federal American Recovery and Reinvestment Act ('stimulus') funding for 2008-09 was received in the 2009 calendar year

*Source: Legislative Analyst's Office*

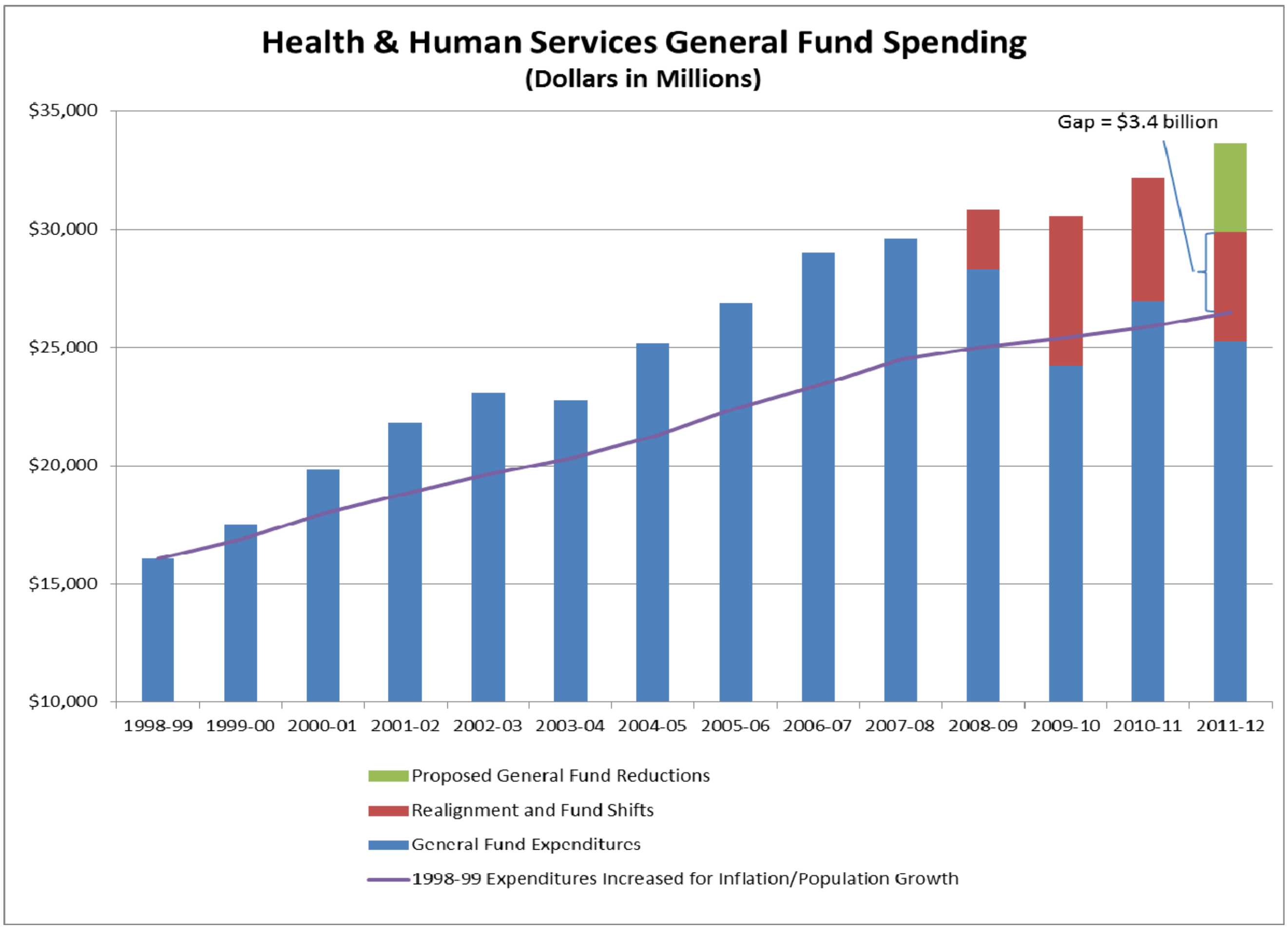
The Governor's budget proposal assumes 2011-12 annual undergraduate **student fees** already approved by the UC Regents and CSU Trustees of $11,124 and $4,884 respectively.

**Financial Aid.** Support of student financial aid programs, primarily the CalGrant entitlement program, would grow by more than $370 million, while General Fund costs would fall by about $1 billion through the replacement of state General Fund with federal Temporary Assistance for Needy Families (TANF) funds.

# Health & Human Services Overview

The 2011-12 Governor's budget includes total expenditures of $73.8 billion from all fund sources, including federal funds, for all Health and Human Services (HHS) Agency budgets. General Fund expenditures for HHS are projected to be $25.3 billion, which represents a decrease of $1.7 billion (6.3 percent) from the revised 2010-11 budget. The Governor's budget includes $6.8 billion in General Fund solutions for HHS through the end of 2011-12, including program reductions of $3.8 billion, fund shifts of $2.7 billion (not including realignment proposals), and revenue of $257 million. These solutions account for 26 percent of the $26.4 billion total solution package.

As the chart below demonstrates, General Fund expenditures had increased far faster than inflation and population until 2009-10, when temporary fund shifts reduced General Fund spending below the trend line. The Governor's budget for 2011-12 proposes solutions that would bring HHS General Fund spending below the trend line by $1.2 billion. Absent the Governor's funding shift and realignment proposals, which do not reduce program activities, underlying program spending for HHS in 2011-12 would remain $3.4 billion above the trend line. As discussed further in the following sections, however, spending trends differ substantially by department. Spending for numerous Health programs such as Medi-Cal and In-Home Supportive Services has grown rapidly, offset somewhat by flat overall spending for Human Services programs such as CalWORKs.



# Health Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- ***Redirection of Voter-Approved Funding.*** Proposes to save almost $1.9 billion General Fund in 2011-12 by redirecting funding approved by the voters through Proposition 10 (the First Five Program) and Proposition 63 (the Mental Health Services Act). Revising Prop 10 would require voter approval and would free up $1 billion to offset General Fund spending for the Medi-Cal Program. The Governor's proposal to amend Prop 63 would provide $861 million in General Fund relief on a one-time basis in 2011-12 for several state-supported mental health programs. After 2011-12, these mental health programs would be part of the broader realignment shift. According to the Administration, the Prop 63 changes are consistent with the intent of that initiative and therefore can be enacted through approval by two-thirds of the Legislature.

- ***Health Program Savings.*** Reflects over $1.7 billion in savings from a variety of cost containment measures, including a 10 percent reduction to Medi-Cal provider rates ($709 million) and various benefit limitations and cost-sharing requirements for Medi-Cal, Healthy Families, and the AIDS Drug Assistance Program. These proposals assume that the state obtains necessary federal approvals.

- ***Developmental Services***. Proposes savings of $750 million from developmental services. As much as $533 million of this amount would result from setting standards for how regional centers administer benefits. The 21 regional centers are nonprofits that currently have significant discretion to influence rates and service delivery.

**Negative Aspects of Governor's Budget Proposal:**

- ***Permanent Managed Care Tax.*** The state enacted a temporary gross premiums tax on Medi-Cal managed care plans in order to leverage a short-term increase in federal matching funds. The state and managed care plans in general benefitted from the arrangement. This tax is currently scheduled to expire June 30, 2011 (along with the extra federal funds), but the Governor's budget proposes to make it permanent for General Fund relief of $97 million in 2011-12.

**Comments/Bottom Line:**

The Governor's health proposals generally move in the right direction by seeking to reduce spending and to revise budget restrictions that were established through "ballot box budgeting." However, it is uncertain whether the majority of the Governor's savings proposals can be achieved. The most significant savings components rely on approval from either the federal government or the voters, and courts have blocked past attempts to reduce some Medi-Cal provider rates and benefits. In addition, extending the managed care tax on a permanent basis is objectionable, although some Republicans supported the current temporary version. Nonetheless, most of the Governor's health proposals are consistent with Republican priorities.

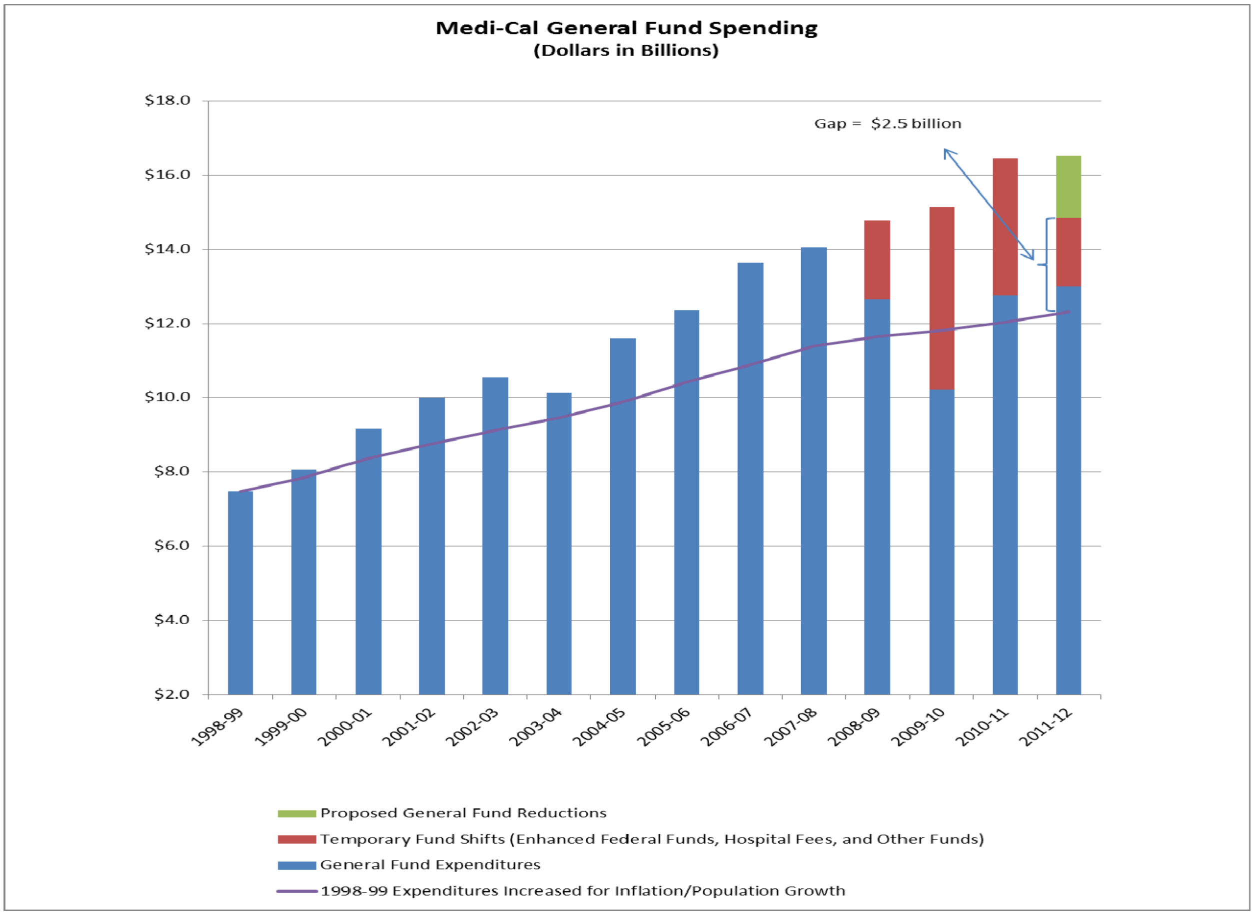
# Health

Health care proposals provide a substantial portion of the Governor's overall budget solution. Within the health area, the Governor's budget proposes General Fund savings of $175 million in 2010-11 and $5.3 billion in 2011-12. These solutions consist of (1) $2.7 billion in alternate funding sources such as Proposition 10, (2) $2.5 billion in expenditure reductions, and (3) $257 million in additional revenues. Key budget proposals for each department are discussed below.

## Department of Health Care Services (DHCS) - Medi-Cal

**Overview.** The Governor's budget provides $13 billion General Fund ($42 billion total funds) for the Medi-Cal Program in 2011-12, a net increase of $243 million General Fund or 1.9 percent from the revised 2010-11 budget estimate. This increase is the net result of several offsetting factors, most notably the budget's assumption that DHCS will obtain $1.8 billion in alternate fund sources to offset General Fund spending. The budget also proposes program reductions totaling nearly $1.7 billion. These changes offset most of the underlying program growth and expiration of short-term solutions that are no longer available. The most significant budget components are discussed in more detail below.

Despite the significant reductions proposed, Medi-Cal General Fund expenditures are projected to once again exceed what a growth rate equal to inflation and population combined would indicate (see chart below). Underlying program costs (which add back temporary fund shifts) would result in an excess of $2.5 billion above the trend line. Since most of the Governor's proposed cost savings rely on temporary fund shifts, substantial additional programmatic changes remain necessary in order to establish a program that the state can afford.



**Caseload Maintains Recent Substantial Growth.** The Governor's budget estimates that caseload will increase by approximately 132,000 enrollees (3.5 percent) to almost 7.7 million. This growth in caseload continues a recent trend of growth over the past few years in the number of children and families entering the program, which has generally coincided with the state's economic malaise. Prior to 2009-10, Medi-Cal enrollment had been roughly flat for several years.

**Alternate Funding Sources Would Provide Temporary Relief.** The temporary federal stimulus funds that provided General Fund relief for three years will not be available in 2011-12. The Governor is now proposing the following major fund shifts:

- *Prop 10 Shift.* $1 billion in a one-time transfer from First 5 Program reserves. Proposition 10 enacted the First 5 Program and implemented a 50 cent cigarette tax to fund it, and voter approval would be necessary to implement the proposed changes. In general, 80 percent of the funds are given to county First 5 commissions with the remainder available to a state commission. The $1 billion shift would consist of $766 million from the county commissions and $234 million from the state commission, and the funds would offset current General Fund spending for Medi-Cal enrollees under five years of age. The Governor also proposes to redirect 50 percent of future Prop 10 revenues to the state, which would provide over $200 million annually for state use. A redirection of Prop 10 funds to higher priorities has been sought by Republicans for several years, but voter approval is uncertain. In May 2009 the voters rejected Proposition 1D, which would have shifted $265 million in Prop 10 funds to offset General Fund costs for developmental services. While Proposition 1D arguably may have been a casualty of voters' disdain for the tax increases in Proposition 1A, which appeared on the same ballot, the prospects for voter approval of this funding shift remain uncertain.
- *Redevelopment Funds.* $840 million from redevelopment funds would be used on a one-time basis to offset Medi-Cal General Fund costs. *This shift is discussed further under Local Economic Development on page 17.*
- *Federal Waiver Funds.* $500 million in additional federal funds made available through California's recently approved "waiver." Last fall, the federal government approved a broad-ranging Medi-Cal waiver that, among other features, permits California to obtain new federal funds for programs that were previously entirely funded by the state or local governments, such as health care for inmates and health care workforce training. A portion of the state savings would be realized in other departmental budgets, such as the Department of Corrections, although the allocation of the savings is not yet available. These funds do not require additional federal approval.

**Program Reductions: What's Old Is New.** The Governor's budget proposes nearly $1.7 billion in various program reductions, some of which were put forward by the Schwarzenegger administration and rejected by the Democrats in the past two years. It is uncertain whether the majority of these savings could be achieved, though, because they are contingent on the state obtaining favorable court decisions or federal approval. Significant items include the following:

- *Provider Rate Reduction.* Savings of $709 million are proposed by implementing a 10 percent reduction to reimbursement rates for nursing facilities, physicians, pharmacies, clinics, medical transportation, home health, and certain hospitals. Past attempts to reduce Medi-Cal provider rates have been enjoined by the courts, but the Administration argues that these rulings stemmed from procedural violations the state committed in establishing those rate cuts. The state has appealed to the U.S. Supreme Court to overturn those appellate court rulings, and believes that a final decision will come by July 1, 2011. This proposal assumes that California prevails in its appeal.
- *Copayments for Medi-Cal Services*. Savings of $557 million in 2011-12 by requiring mandatory copayments for certain Medi-Cal services. The savings would be achieved by deterring utilization

and by reducing the rates the state pays to providers by the amount of the copayment (assuming the provider will collect that amount from the enrollee). The specific copayments would be:

- $5 for physician, clinic, dental, and pharmacy services ($3 for lower-cost preferred drugs).
- $50 for emergency room services.
- $100 per day for hospital services, up to a $200 maximum.

Copayments are currently authorized for Medi-Cal but virtually never collected because providers cannot refuse to provide service due to nonpayment of the copay. This proposal would seek a federal waiver to permit providers to deny services if the enrollee does not make the copayment. **Although these amounts might strike some as expensive for low-income families, data from the U.S. Bureau of Labor Statistics indicate that families with earnings below the 20th percentile spend on average over $1,500 per year on entertainment, alcohol, and tobacco.** This suggests that these copayments should be manageable even for low-income families. However, it is highly doubtful that the current federal administration would approve this proposal. In addition, providers are likely to believe that copayments will still not be collectible, and thus to view this policy as a rate reduction.

- *Limitations for Use of Services.* The budget proposes to implement caps on the use of certain Medi-Cal services for General Fund savings of $217 million General Fund. The caps would be set at the 90th percentile of current use. Doctor visits would be limited to 10 per year, and prescriptions would be limited to six per month (except for life-saving drugs). Maximum dollar limits would also be implemented for durable medical equipment, hearing aids, incontinence supplies, urological supplies, and wound care.
- *Elimination of the Adult Day Health Center (ADHC) Benefit.* This previously proposed policy would eliminate the ADHC benefit, which is optional under federal law, for General Fund savings of $177 million. Only nine states provide this benefit. More moderate attempts to reform the ADHC program, such as by tightening medical criteria, have been attempted in recent budgets but blocked through the courts.

**More Cost Containment Proposals Should Be Considered.** Although the Governor has proposed significant program reductions, more options to reduce structural program spending should be considered. For example, Medi-Cal's current eligibility levels were largely frozen in place by federal health reform, but the state can roll back eligibility for groups funded only by the state, such as immigrants that do not qualify for federal funding. Additionally, the state could press for the federal health reform eligibility restrictions to be repealed, allowing states greater flexibility to live within their means.

## Department of Public Health

**Overview.** The Governor's budget proposes $315 million General Fund ($3.5 billion total funds) in 2011-12 for DPH. The proposed General Fund spending represents an increase of $110 million or 54 percent from the revised 2010-11 estimated spending level. Of this increase, $92 million stems from funding changes for the AIDS Drug Assistance Program (ADAP), which include the following key components:

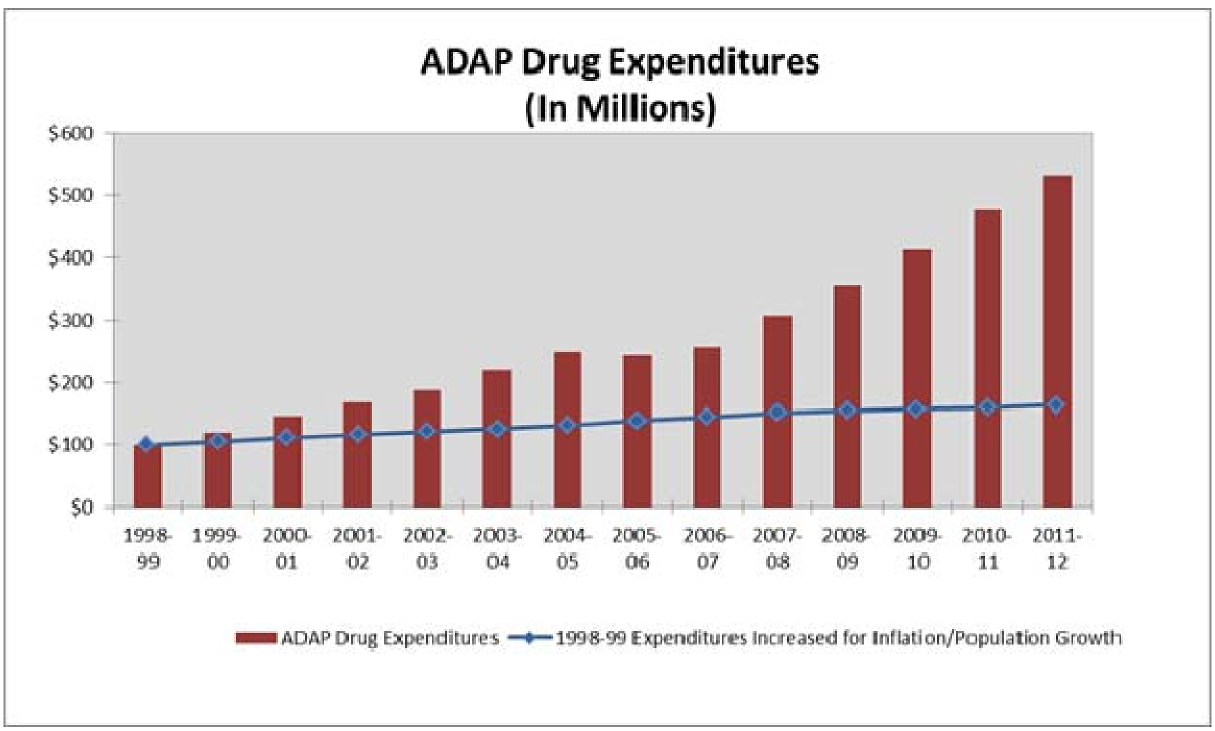
- A baseline program increase of $55 million to fund higher caseload and prescription drug costs.
- A fund shift of $76 million in 2010-11 from the General Fund to federal Safety Net Care Pool funds that were made available through an amendment to the recently ended Medi-Cal waiver. These funds will not be available in 2011-12, resulting in higher General Fund support for the program. It is unclear whether federal funds from the new Medi-Cal waiver will be allocated for ADAP.

➢ A proposal to save $16.8 million General Fund by increasing ADAP cost-sharing requirements to the maximum permitted under federal law. Cost-sharing for those clients with private insurance or Medicare Part D would be limited to a lower cost-sharing percentage than others. Specific cost-sharing requirements are proposed as follows:

  - o Income equal to or less than $10,830 (100 percent of the Federal Poverty Level (FPL)): No cost.
  - o Income up to $21,660 (200 percent FPL): share of cost equal to 5 percent of the individual's gross income.
  - o Income up to $32,490 (300 percent FPL): share of cost equal to 7 percent of the individual's gross income.
  - o Income above $32,490 (300 percent FPL): share of cost equal to 10 percent of the individual's gross income.

In addition, the DPH budget proposes to increase funding for the Every Woman Counts Program by $7.7 million General Fund due to increasing caseload, and to re-appropriate $10.6 million for the program that wasn't spent in 2010-11 due to delays implementing program changes.

**AIDS Drug Assistance Program Continues Rapid Growth.** Nearly all ADAP program spending consists of drug costs, which are projected to rise by nearly 12 percent in 2011-12. This continues a prolific growth trend that by the end of 2011-12 will see costs rise by $434 million or 439 percent since 1998-99, as shown in the chart below. ADAP is funded through a mix of General Fund, federal funds, and rebates the state receives from drug manufacturers (the ADAP Rebate Fund). Program caseload is expected to rise to over 42,000 in 2011-12, an increase of 6.8 percent over 2010-11. By the end of the budget year, ADAP caseload will have grown by over 23,000 clients or 120 percent since 1998-99.




The Governor's proposal to increase cost-sharing for ADAP clients is a step in the right direction, although it provides only modest program savings. Cost-sharing in ADAP is now limited to individuals with federal adjusted gross income between 400 percent of FPL (about $43,300) and $50,000 per year, which is the income ceiling for the program. In contrast, 31 other states maintain ADAP eligibility ceilings of 337 percent FPL or less. In addition, a 2010 report from the Bureau of State Audits raised significant concerns about ADAP program integrity, including findings that some enrollment sites had no documentation of income eligibility in as many as 60 percent of the applications reviewed by auditors.

## Managed Risk Medical Insurance Board

**Overview.** The Governor's budget proposes $265 million General Fund ($1.0 billion total funds) for the Healthy Families Program (HFP) in 2011-12, which reflects an increase of $137 million General Fund (107 percent) from the revised 2010-11 spending level. This net increase primarily results from the loss of $259 million in alternate fund sources that provided General Fund relief in 2010-11, which would be offset partially by General Fund solution proposals of $136 million. Total funding for HFP is estimated to decline by $721 million (6.4 percent) from the revised 2010-11 level of $1.2 billion. Caseload is projected to increase from an revised estimate of 894,000 in 2010-11 to 916,000 by June 30, 2012, an increase of 22,000 enrolled children (2.4 percent).

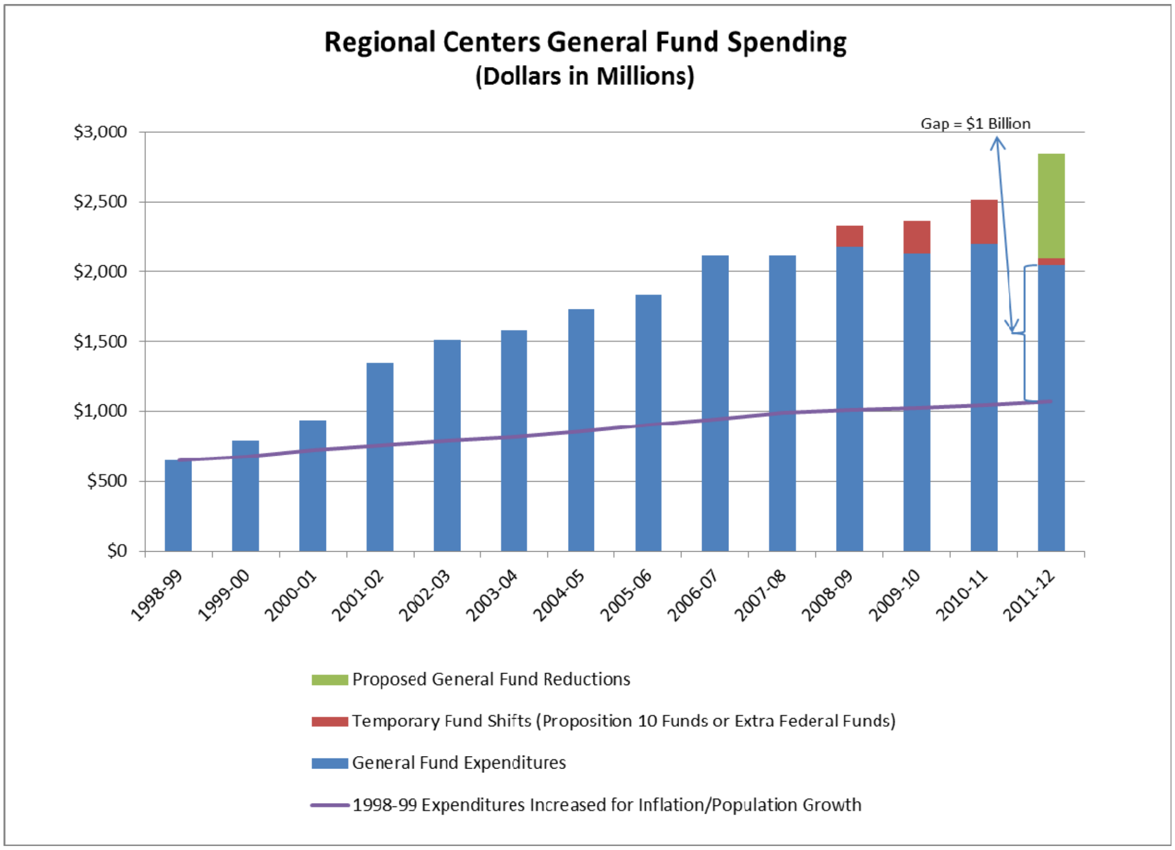
The Healthy Families budget reflects the following significant proposals:

- *Permanent Managed Care Tax.* Chapter 157, Statutes of 2009 (AB 1422, Bass), authorized a temporary expansion of the existing 2.35 percent gross premiums tax to include Medi-Cal managed care plans. The tax intended to help the state benefit from a temporary increase in federal matching funds, which are set to expire on June 30 this year. However, the Governor's budget now proposes to make this tax permanent. Proceeds of the tax are used to obtain new federal funds, increase Medi-Cal rates to managed care plans, and provide new funding for children's coverage. The managed care plans subject to AB 1422 supported the original legislation, which included a sunset of the tax as of January 1, 2011 (extended to June 30, 2011 in the 2010 Budget Act). The Governor's budget estimates that the tax will provide $115 million in current year savings, and the proposed extension would provide savings of $97 million. Federal approval is required to extend this tax, however, and it is not clear whether that approval will be granted.
- *Vision Elimination.* The Governor proposes to eliminate the vision benefit in HFP for savings of $11 million General Fund.
- *Premiums Increase.* Savings of $22 million in 2011-12 are proposed through an increase in monthly premiums for families with incomes above the federal poverty level (FPL). Families with incomes between 150 percent and 200 percent of FPL would pay an additional $14 per child per month, or $30 per child, with a family maximum of $90. Families with incomes up to 250 percent of FPL would pay an additional $18 per child per month, or $42 per child, with a family maximum of $126. The HFP also raised premiums twice in 2009, but only once (in 2005) in the history of the program before that.
- *Copayment Increase.* The Governor's budget proposes savings of $5.5 million in 2011-12 by increasing copayments for emergency room services from $15 to $50 and by establishing a copayment of $100 per day for inpatient services (up to a $200 maximum for inpatient stays). Copayments for these two services would then be consistent with the Governor's proposals for Medi-Cal copayments. Other existing HFP copayments would not be changed.

## Department of Developmental Services (DDS)

**Overview.** The Governor's budget provides $2.4 billion General Fund ($2.5 billion total funds) for DDS, a decrease of $110 million General Fund from the revised 2010-11 spending level. The 2011-12 budget includes $2.0 billion General Fund for regional centers and $324 million General Fund for developmental centers. The Governor's budget proposes a target of $750 million in General Fund solutions for regional centers

The underlying growth in DDS programs continues a trend seen over the past decade. As shown in the chart on the next page, spending for regional centers has been particularly strong, and regional center costs as proposed would be nearly $1 billion above what a growth rate equal to population and inflation would indicate.  Without the proposed spending reductions, the DDS General Fund budget would increase by 26 percent in 2011-12 compared with the prior year.




**Specific Savings Proposals.** The Governor's $750 million savings target includes only $217 million associated with a specific proposal.  Key specific savings components are the following:

- $91 million through an extension of the 4.25 percent reduction to regional center operations and provider rates.  A reduction of three percent was first enacted in 2008-09, then increased to 4.25 percent in the 2010 Budget Act with a sunset of June 30, 2011.
- $65 million through increased federal funds for "Money Follows the Person" grants and the expanded use of services associated with the current 1915(i) state plan amendment.
- $50 million through an extension of Prop 10 funding that the state First 5 Commission provided in 2010-11. (Note that this is separate from the $1 billion Prop 10 fund shift described in the Medi-Cal budget.)

**Regional Center Standardization.**  The Governor proposes to achieve the remainder of the $750 million savings target, or up to $533 million, through an unspecified plan to set standards for how regional centers administer benefits.  The 21 nonprofit regional centers that administer most DDS services currently have significant discretion to influence rates and service delivery.  The Administration states that it will obtain input from stakeholders and set benefit standards for every category of service provided by regional centers.

Reports by the Bureau of State Audits and the Legislative Analyst's Office in recent years have raised concerns about the lack of state oversight for regional center operations, and newspaper articles have shed light on questionable uses of state funds in which certain regional centers have awarded their staff bonuses or lavished funds on new headquarters buildings. Attempts by legislative staff to obtain information regarding regional center spending from DDS have met with responses that such information is not available. Thus, the regional center system is ripe for greater oversight and cost containment. Nevertheless, without a specific plan to achieve the Governor's proposed savings, it's unclear whether such savings can be realized.

## Department of Mental Health (DMH)

**Overview.** The Governor's budget proposes $1.3 billion General Fund ($4.5 billion total funds) for DMH programs in 2011-12, a decrease of $498 million General Fund (28 percent) from the revised 2010-11 spending level. This decline reflects savings from a proposed fund shift of $861 million in Proposition 63 funds, partially offset by baseline budget increases, rather than reductions in state programs or improvements in efficiency.

**Proposition 63 Redirection.** The Governor's proposal would shift $861 million from Proposition 63 reserves on a one-time basis in 2011-12 to pay for community mental health services that would otherwise be supported by state General Fund. (Prop 63 funds are provided by a one percent tax surcharge on personal incomes greater than $1 million.) According to the Administration, the Proposition 63 changes are consistent with the intent of that initiative and therefore can be enacted through approval by two-thirds of the Legislature. Following the one-time shift of these funds in 2012-13, the Governor proposes to include these mental health services in his overall realignment proposal, and funding for the newly shifted programs would be part of the broader revenue source to be developed as part of the overall realignment process. For the one-time 2011-12 shift, savings by program would be as follows:

- $579 million for the Early and Periodic Screening, Diagnosis, and Treatment Program (EPSDT), an entitlement program for Medi-Cal eligible children and young adults under age 21.
- $184 million for Mental Health Managed Care, which provides inpatient and outpatient services to Medi-Cal enrollees through county mental health plans.
- $99 million for mandated mental health services for special education students (AB 3632 services). These funds are for prior year costs incurred by counties.

Counties already administer most community mental health services, including the General Fund-supported programs listed here. The state's current role for these programs is to provide funding and oversight, or, for the AB 3632 mandate, primarily to fund the mandate. As such, giving counties direct funding and responsibility for these programs makes sense. However, with respect to the AB 3632 mandate, consideration should be given to simply repealing the state mandate. Schools are under a federal mandate to provide necessary services to special education students, and California is the only state to add a superseding mandate for mental health services that shifts responsibility from schools to county governments. Repealing the state mandate would allow this responsibility to shift back to schools.

# Human Services Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- Reduces expenditures in the human services programs by over $2.2 billion through significant program reductions within CalWORKs, In-Home Supportive Services (IHSS), SSI/SSP, Aging, and Child Support. Policy changes include reducing CalWORKs grants, limiting time on welfare aid, reducing county funding for administration, reducing IHSS service hours, eliminating domestic and related services for IHSS recipients living with their provider, requiring a written physician certification prior to receipt of IHSS services and eliminating the Multipurpose Senior Service Program.

- Makes strides in reversing the fiscal trend in human services programs, significantly reducing ongoing program expenditures with ongoing reform.

- Tightens up time on welfare aid and requires medical certification for IHSS, a strong step towards personal as well as program accountability.

**Negative Aspects of Governor's Budget Proposal:**

- While the Governor's budget includes program reductions of more than $2.2 billion within human services, the budget fails to eliminate cash grants for families that have maximized their time spent on aid and continues to provide grants to felons and illegal immigrants.

**Comments/Bottom Line:**

The Governor's proposed budget continues to fund programs for non-federally eligible immigrants (Food Stamps and SSI/SSP) as well as families that have maximized their time on aid within CalWORKs, continuing generous benefits the state can no longer afford. However, the Governor's budget does generally makes strides in reducing ongoing spending with the state's human services programs (over $2.2 billion General Fund in 2011-12), helping to align the state's revenue and expenditures in subsequent years. Additionally, the budget includes significant policy changes, especially within the IHSS program, where a written physician certification would now be required for entrance into the program, increasing program integrity and reducing fraud.

# Human Services

The Governor's proposed budget for 2011-12 contains over $2.2 billion in programmatic solutions within the state's human services programs. These reductions are significant and would help the state move towards fiscal solvency. On the negative side, the Governor proposes a number of human services programs for realignment (child welfare services, adult protective services, drug and alcohol programs, and foster care) that are contingent upon additional taxes. The concept of realignment, moving programs down to the local level where they can better serve the individual needs of the community, is consistent with Republican belief that government closest to the people governs best. Unfortunately, the Governor's realignment proposal relies on additional taxes and includes no specifics on how the realignment would be structured and what standards would still be required, leaving open the question of whether or not it really would be good for government at all.

## Department of Social Services

**Welfare-to-Work.** The Governor's budget includes $6.5 billion for California Work Opportunity and Responsibility to Kids (CalWORKs) programs, including $4.5 billion for programs within the Department of Social Services (DSS), $1.9 billion for other programs, and $69.4 million in county expenditures.

CalWORKs differs from welfare programs in other states, providing a much more generous cash grant (grant level is fourth highest in the nation, second highest of the ten largest states), as well as continuing to allow families to receive a cash grant even though the adult has maximized their allotted time in the program (one of only eight states that provide a "safety net" program). The Governor's budget proposes a number of significant policy changes that would result in major General Fund savings of $1.5 billion in 2011-12 and ongoing. Some of these savings are achieved as an offset for General Fund within the state's Cal Grant program ($946.8 million TANF). The proposals include the following:

1. Establish Time Limit of 48 Months. The proposal would eliminate monthly benefits for families that have received aid for 48 months or more, effective July 1, 2011. Benefits for families with children (those receiving aid for the children only) would continue beyond the 48 months if the family is fully meeting the work participation requirements. As of 2009, nine states have established shorter time limits for welfare aid, including three of the ten largest. This proposal would result in savings of $698.1 million in 2011-12. The Administration is also proposing to repeal long term CalWORKs reforms that were enacted with the passage of ABX4 8 as there may be inconsistencies with the newly established time limit of 48 months.

2. Reduce CalWORKs grants by 13 percent. The proposal would reduce the maximum monthly grant for a family of three from $694 to $604 effective June 1, 2011, for savings of $13.9 million in 2010-11 and $405 million in 2011-12. Even with this reduction, California grants would be the ninth highest of all states and remain second highest of the ten most populous states. The recipient's grant reduction would be partially offset with additional food stamp benefits.

3. Maintain County Reduction. The proposal would maintain the CalWORKs county single allocation funding at the reduced 2010-11 level (savings of $376.9 million in 2011-12). The single allocation provides funding for CalWORKs employment services, child care, and county administration. When the reduction was initially implemented in 2009-10 (implementation was for two years), statutory language was included that increased the number of exemptions recipients could meet and not have to participate in the program's work requirements (basically allowed mothers with young children to remain at home and not work while remaining compliant with program requirements). The Administration is not

proposing to extend these exemptions. Counties would need to prioritize funding as necessary at the local level.

4. Eliminate Child Care for 11 and 12 year olds. The proposal would eliminate child care for all 11 and 12 year olds, resulting in savings of $34 million from Stage 1 child care within the CalWORKs program.

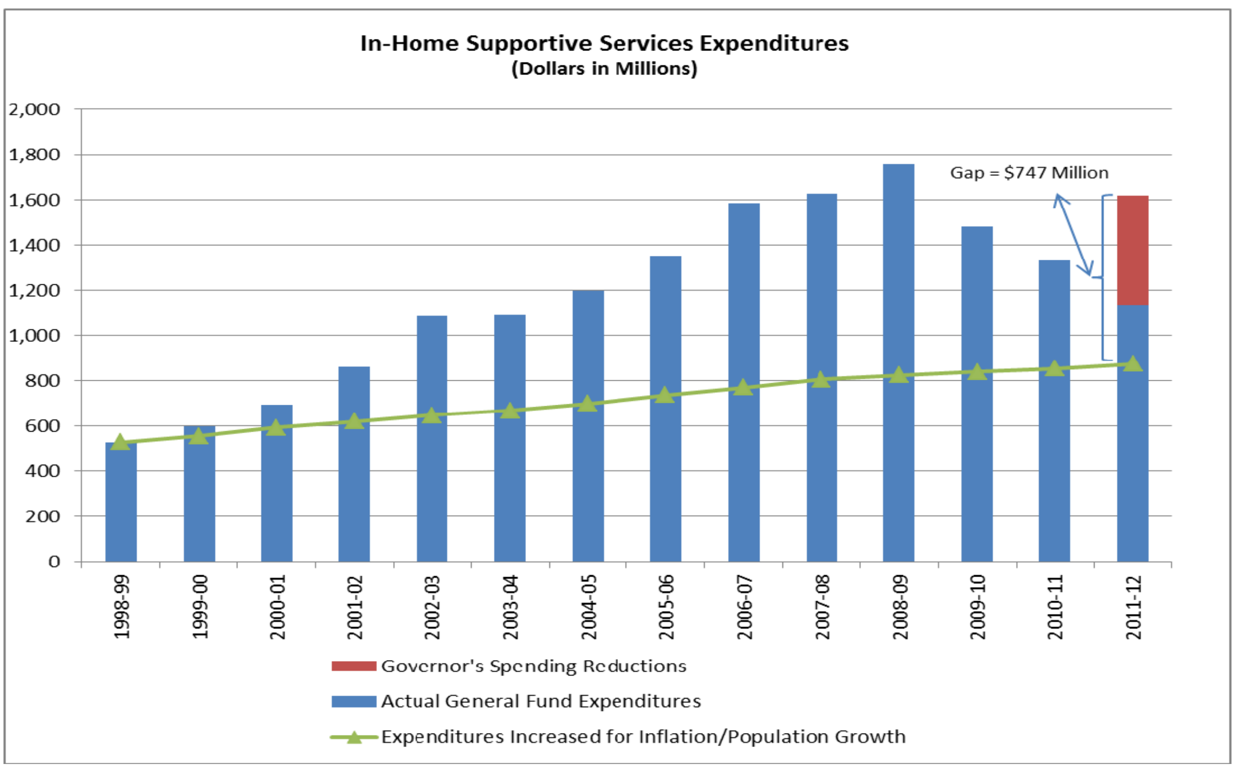
**Phase II Realignment Includes CalWORKs.** Although no details were included in the Governor's budget for Phase II of realignment, the proposal would move responsibility for the CalWORKs program to counties. Funding for the program at the local level has not been identified and it is unclear exactly how the program and funding would be structured. The lack of detail leaves one to question whether or not the Governor is **planning on additional taxes** to cover the cost of the program, or merely to provide a General Fund backfill (*See Realignment on page 13*).

**In-Home Supportive Services**

The Governor's budget includes $3.9 billion ($1.1 billion General Fund) for the In-Home Supportive Services (IHSS) program in 2011-12. Recent efforts to reform the program and reduce expenditures have met with resistance and immediate litigation from unions and other parties. A number of litigation issues remain unresolved at this point, and it is unclear when the state will see final resolution. The Governor's budget includes a number of significant policy changes, none of which are currently under litigation, which is a positive step. As costs and caseload have grown significantly in recent years, it will be important for the state to take steps to reduce program expenditures that are within federal program limits and that can withstand any legal challenge.

**Caseload and Cost Explosion**

The Governor's budget assumes caseload for IHSS to be approximately 456,400 recipients in 2011-12, a 3.4 percent increase over the 2010-11 projected level. The IHSS program has seen disproportionate growth over the past several years. During the times of revenue growth experienced by the state in recent years, program growth was more than twice the rate of inflation. Compared to population and inflation, the IHSS program costs, without the 2011-12 proposed reductions, are significantly higher than the trend for growth.



**Policy Changes a Move in the Right Direction.** The Governor's 2011-12 budget includes significant policy changes within the IHSS program that will reduce expenditures for the budget year as well as ongoing and will provide stronger program accountability in the ongoing battle to combat fraud. The policy changes, resulting in savings of $486.1 million General Fund in 2011-12, are as follows:

1. Reduction in Service Hours. The proposal would implement an 8.4 percent permanent reduction to service hours for all IHSS recipients, achieving savings of $127.5 million in 2011-12. Included in the 2010-11 budget is a 3.6 percent reduction in service hours for two years. For 2011-12, total reduction in hours would be 12 percent, although under the proposal, qualified recipients at risk of out-of-home care placement could appeal and apply for supplemental hours. The budget assumes approximately 21,000 recipients would receive full restoration of hours, and this impact is reflected in the savings assumed in the budget.

2. Eliminate Domestic and Related Services for Some Recipients. The proposal would eliminate domestic and related services for recipients either living with their provider, including parents being paid to take care of their children, or living with another person. Eliminating these services for recipients in a shared living environment is expected to impact more than 300,000 recipients and would result in savings of $236.6 million General Fund in 2011-12.

3. Physician Certification Required. The proposal would require the provision of IHSS services to be conditioned upon a physician's written certification that services are necessary to prevent out-of-home care. This proposal is consistent with the recommendation included in the Senate Office of Oversight and Outcome's June 2009 IHSS fraud report which recommended the program include a medical evaluation form that requires a doctor to specify a level of care needed, not just the diagnosis and prognosis. This new requirement would help in the state's fight against fraud and will provide an increased level of certainty that IHSS services are being provided to those most at-risk of institutionalization. The budget assumes 43,000 recipients (about ten percent) will fail to receive certification, resulting in savings of $120.5 million General Fund in 2011-12.

4. Eliminate State Funding for IHSS Advisory Committee. The proposal would eliminate the mandate for counties to establish advisory committees, resulting in General Fund savings of $1.6 million in 2011-12. Counties would continue to have the option to maintain advisory committees at their own expense.

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

The Governor's budget proposes $2.7 billion General Fund for the SSI/SSP program in 2010-11, a 3.8 percent decrease from the revised 2010-11 budget level of $2.9 billion General Fund. The budget estimates 1.3 million recipients in 2011-12, an increase of 0.8 percent over the 2010-11 level of 1.2 million recipients. The caseload consists of 70 percent disabled, 28 percent aged, and two percent blind persons.

The budget would reduce the SSI/SSP grants to the federal minimum for individuals. The 2009 Budget Act reduced grants to the federal minimum for couples ($1,407 per month) but only slightly reduced the grants of the individuals. This proposal would reduce the monthly grants from $845 per month to $830 per month for individuals. The budget includes savings of $14.7 million in 2010-11 and $177.3 million in 2011-12.

### Child Welfare Services

The Governor's budget proposes $4.2 billion ($1.7 billion General Fund) for services and out-of-home care for children who are either at risk of or have suffered abuse and neglect.  This is an increase of $23.2 million General Fund or 1.4 percent from the revised 2010-11 budget.

**Realign Foster Care and Child Welfare in Phase I.**  The Governor's realignment proposal includes transferring primary program responsibility for CWS to the counties. The proposal would make the realignment of these programs contingent upon voter approval of additional taxes. As with other realignment proposals, there are no details included as to what the funding distribution would be, what standards would be required, or how the program would be paid for on an ongoing basis, leaving it unclear as to how program flexibility and accountability would be enhanced at the local level.  (*See Realignment on page 13).*

**Reduce Transitional Housing Program-Plus.**  The Governor's budget includes a reduction of $19 million General Fund beginning in 2011-12. This reduction reflects the cost of transitional housing services for 18 and 19 year olds, who would now be eligible for continued placement via foster care. With the passage of Chapter 559, Statutes of 2010 (AB 12), foster care will expand to provide services up to 21 years of age. Beginning January 1, 2012, youth up to 19 years of age may remain in foster care and could choose a transitional housing placement as an optional foster care placement.  The $19 million would be shifted to foster care services, allowing the state to save General Fund as it reduces funding for the Transitional Housing Plus Program, a state-only program.

**Gifts with Fiscal Strings.**  The budget includes a proposal to accept an IT program as a gift from the John Burton Foundation. The participant tracking system was developed by the John Burton Foundation to accumulate data and track program participants within the Transitional Housing Plus Program.  Although the new system is being "gifted" to the state, the system will require modifications or will need to be recreated to adhere to departmental system designs, to the tune of $115,000 annually. It is unlikely this is a gift the state should be accepting if ongoing General Fund support is required.

## Department of Aging

The Governor's budget includes $182.2 million ($15.1 million General Fund) for programs within the Department of Aging, a decrease of $17.7 million General Fund from the revised 2010-11 budget.

**Eliminate the Multipurpose Senior Service Program.** The Governor's budget includes a reduction of $19.9 million General Fund in 2011-12 as a result of eliminating the Multipurpose Senior Service Program (MSSP).  The local MSSP sites (41 sites statewide serving approximately 12,000 clients per month) provide case management services for elderly clients who qualify for placement in a nursing facility but who wish to remain in the community.  In addition to case management services, funds are also used to provide adult day care, housing assistance, chore and personal care assistance, protective supervision, respite, transportation, meal services, social services, and communication services.

## Department of Child Support Services

The Governor's budget includes $1 billion ($328.3 million General Fund) for child support services, a decrease of $6.9 million General Fund from the revised 2010-11 budget. The budget proposes to suspend the county share of child support collections, directing the entire non-federal portion of collections to the General Fund, for savings of $24.4 million in 2011-12.  The Administration would include trailer bill to clarify that the state has no statutory requirement to provide counties with any of the collection funds.

# Public Safety & Judiciary Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- Recognizes that recent unallocated reductions to the Department of Corrections and Rehabilitation (CDCR) have been unattainable and, in some cases, counterproductive. Restores funding for many essential correctional functions.
- Requires the Judicial Branch to implement permanent spending reductions on par with those faced by virtually every other state agency over the past three years. Judicial Branch reductions, to date, have been almost entirely one time in nature.
- Provides transparency for litigation costs incurred by General Fund-supported state agencies by requiring the Department of Justice to bill them for legal services.

**Negative Aspects of Governor's Budget Proposal:**

- Jeopardizes public safety by shifting responsibility for a significant segment of the state's offender population to local agencies without first ensuring that adequate local capacity and resources exist (part of Realignment plan).
- Holds local public safety programs (COPS, JJCPA, etc.) hostage to the tax increase that is part of the realignment plan.
- Could result in reduced access to justice due to court closures that may be necessary to keep trial court expenditures in line with budgeted resources.

**Comments/Bottom Line:**
Overall, the Governor's budget plan represents a mixed bag with respect to public safety. The Governor's realignment plan shifts responsibility for housing and supervising many offenders to local law enforcement, but does not ensure permanent funding for this purpose, nor does it ensure adequate facilities and programmatic capacity to accommodate the significant offender population changes at the local level. And of course, the realignment plan is predicated on a $5.9 billion tax increase.

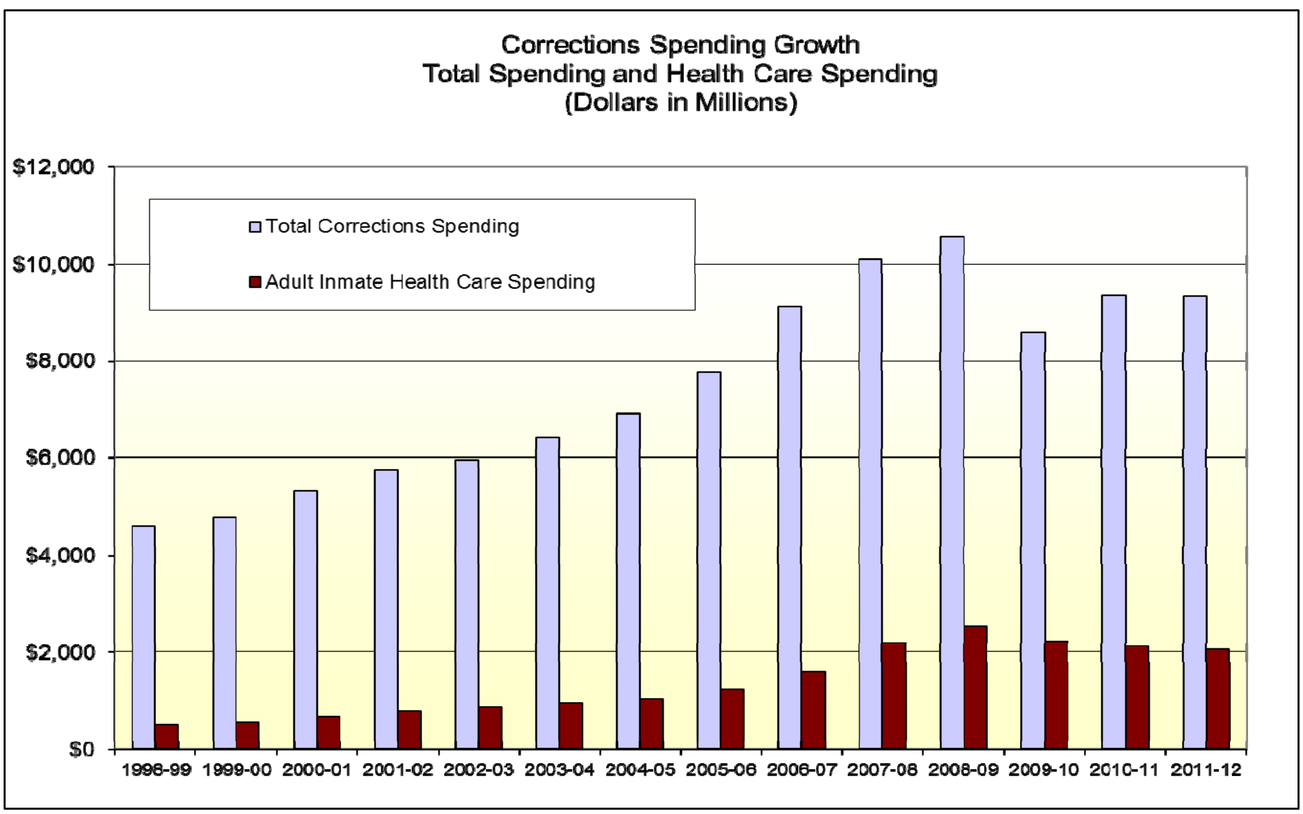
# Public Safety & Judiciary

**Department of Corrections and Rehabilitation**

***Baseline Adjustment.*** The Governor's budget includes a baseline increase of $395.2 million for the Department of Corrections and Rehabilitation (CDCR) to "correct previous budget shortfalls and more accurately reflect the operational costs within the adult institutions' budget." The Administration asserts that providing this augmentation will help to prevent the recurrence of funding redirections that have hurt inmate education and work programs, caused the freezing of purchasing and training activities, and resulted in increased equipment and physical plant costs due to deferred maintenance. Elements of this augmentation include:

- Closing a shortfall in the baseline budget for Correctional Officer salaries,
- Indexing the Department's overtime budget to account for inflationary factors, and
- Providing operational funding for a minimal level of swing space beds to streamline the logistics of inmate movement.

***Partial Elimination of Recent Unallocated Reductions.*** Recognizing that many of the recent unallocated reductions to CDCR's budget have been unattainable, and in some cases counterproductive, the Governor's budget proposes restoration of $843.4 million in 2010-11 and $762.8 million in 2011-12. This change eliminates the $200 million unallocated reduction for "population changes" and restores much of the $820 million reduction to the Receiver's budget for inmate medical care that were included in the 2010 Budget Act. The chart below provides some detail of the state's historical spending on corrections and inmate healthcare.



***Population Changes.*** Although adult and juvenile institutional average daily populations (ADP) and adult parolee ADP are projected to decrease, the proposed budget includes an increase of $161.3 million General Fund for population-related workload changes. The apparent discrepancy (decreasing populations and increasing population costs) is due mainly to:

- An $88.9 million augmentation to align baseline funding with program expenditures for reimbursing county jails the costs of housing parolees awaiting revocation hearings. Currently, this program carries costs forward each year due to chronic underfunding. This augmentation would true up the base and allow counties to be paid in a timely manner.
- Increases totaling $60.1 million to back out institutional savings from recently enacted reform measures. The effects of these reforms, including the associated population-related savings are being captured on the natural in the semi-annual population adjustments.
- A $43.3 million augmentation to fund a projected increase in a segment of the parolee population for which the supervision caseload was recently reduced from 70:1 to 48:1. While parole ADP is projected to decrease overall, this segment is projected to increase by approximately 17,867 parolees since the last adjustment.
- A $12.5 million increase for mental health workload driven by the new mental health staffing ratio that was implemented in 2010-11.

Projected institutional and parole populations are as follows:

- *Adult Institutions.* Institutional ADP is projected to decrease from 163,681 to 163,799 in 2010-11 (increase of 118 compared to May Revision projections), and to decrease to 163,152 in 2011-12.
- *Adult Parole.* Parole ADP is projected to decrease from 119,200 to 113,690 in 2010-11 (decrease of 5,510 compared to May Revision projections) and to further decrease to 107,002 in 2011-12.
- *Juvenile Institutions.* ADP is projected to decrease from 1,399 to 1,304 in 2010-11 (decrease of 95 compared to May Revision projections) and to decrease further to 1,269 in 2011-12.
- *Juvenile Parole.* ADP is projected to increase from 1,520 to 1,554 in 2010-11 (increase of 34 compared to May Revision projections) and to decrease to 1,464 in 2011-12 (decrease of 279 from the revised 2009-10 projections). *Note: This estimate does not reflect changes that will occur as a result of the juvenile parole reforms that were enacted with the 2010 Budget Act. These reforms shifted responsibility for the supervision of juvenile parolees to local probation departments, effective January 1, 2011. The Administration indicates these changes will be accounted for in the May Revision.*

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 2011-12 Realignment proposal is enacted. The details of that proposal as it relates to CDCR are discussed below.

***Impact of Realignment on CDCR.*** As part of his Realignment plan, the Governor proposes to shift responsibility for the housing and supervision of many offenders who are currently under the state's jurisdiction to local law enforcement agencies, providing new funding to the locals for this purpose via temporary tax increases (*see Realignment section beginning on page 13 for more details on funding*).

Unfortunately, details regarding implementation of this plan are sorely lacking. The level of CDCR-related Realignment savings assumed by the Administration is $3.4 billion. However, the Administration has not allocated all those savings to specific programs, and has in fact double counted about $50 million of the savings it has scored thus far.

The Administration has provided only a high-level description of the offender populations that would be shifted to the locals, as follows:

- Low-level adult inmates with no prior serious, violent, or sex offenses who have short prison terms,
- All juvenile wards still in state custody,
- All adult parolees, and
- All adult parole violators.

The proposal would allow for some juvenile offenders to remain in state custody, but assumes that local governments would reimburse the state for 100 percent of the costs of housing them (including all overhead). All juvenile parolees were shifted to local responsibility as part of the 2010-11 budget proposal.

Overall, the Governor's budget represents a mixed bag with respect to public safety. The Realignment plan could lead to efficiencies and enhanced public safety if local agencies prove better able to align offenders with programs that result in lower recidivism rates. However, the plan fails to ensure permanent funding for the new local costs, relying on temporary tax increases to fund permanent programmatic changes. When those tax increases expire, the result could be public safety disaster, pressure on the General Fund to backfill vanishing tax revenue, pressure on the Legislature to raise taxes again, or all of the above.

Furthermore, while the plan would provide some additional funding to bolster the ability of locals to manage the influx of offenders, no analysis has been done to determine whether existing local facilities and service providers would be able to mitigate the public safety impact of such a dramatic change, even with the additional funding. In fact, evidence is beginning to surface indicating that local agencies may already be strained beyond their ability to absorb any additional responsibilities. As reported in the *Sacramento Bee,* the Sacramento County Grand Jury recently released a report indicating that the Sacramento County Probation Department has lost nearly 40 percent of its staff over the past three years. A stunning 96 percent of the County's 27,000 probationers are unsupervised, with 80 percent of gang members and sex offenders lacking probation supervision.

**Department of Justice.** The Governor's budget proposes to convert the Department of Justice's (DOJ) General Fund clients (with the exception of the Coastal Commission, the State Lands Commission, and a handful of small departments) to a billable status. Under current practice, DOJ bills client departments that are supported by special funds for the costs of legal and investigatory services provided to them. In contrast, it does not generally bill its General Fund clients for services rendered. Instead, DOJ has a direct General Fund appropriation to pay these costs. The proposed budget deletes all General Fund from DOJ's litigation services budget, except for $3.1 million for the Coastal Commission and State Lands Commission and $1.5 million for the assorted small departments, and replaces it with a corresponding amount of reimbursement authority (Legal Services Revolving Fund). Each newly-billable client department is then allocated the rough equivalent of a pro-rated share of the General Fund deleted from DOJ's budget.

This revised billing arrangement would provide additional budgetary transparency by reflecting each department's legal costs within its respective budget. It would also force each department that overspends its legal services budget to come forward with a deficiency request on its own. For the past several years, CDCR has been guilty of consuming virtually the entire pot of "community funding," leaving smaller departments without funding for legal services. Under the Governor's proposal, the possibility of this scenario repeating itself would be limited to the handful of exempted departments mentioned above. Over time, the increased accountability and transparency would likely drive costs down by providing incentives for departments to manage their legal services budgets more effectively.

It is not clear why the Coastal Commission and the State Lands Commission should be exempted from this arrangement. Some might suggest that these entities want to preserve their anonymity and ability to sue landowners for various “public rights” purposes without public awareness of the associated costs. That said, should a request to augment DOJ’s remaining General Fund legal services budget come forward, the source of that request would be relatively unambiguous.

**Local Public Safety Funding.** As part of his Realignment plan, the Governor’s budget would restore 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 (5-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 | |
|---|---|
| **Progs. within Local Gov't. Funding** | |
| COPS | $107,100 |
| JJCPA | $107,100 |
| Booking Fees | $35,000 |
| Small and Rural Sheriffs | $18,500 |
| **Total Local Gov't. Funding** | **$267,700** |
| **Programs within CDCR** | |
| Juvenile Probation Funding | $151,842 |
| Juvenile Camps Funding | $29,430 |
| **Total CDCR Programs** | **$181,272** |
| **Programs within Cal EMA** | |
| Cal-MMET | $19,500 |
| Vertical Prosecution Block Grants | $14,558 |
| Evidentiary Medical Training | $583 |
| Public Prosecutors and Public Defenders | $7 |
| California Gang Violence Suppression Program | $1,607 |
| CALGANG | $270 |
| Multi-Agency Gang Enforcement Consortium | $84 |
| Rural Crime Prevention | $3,729 |
| Sexual Assault Felony Enforcement | $5,130 |
| High Technology Theft Apprehension and Prosecution Program | $11,970 |
| **Total Cal EMA Programs** | **$57,438** |
| **Total** | **$506,410** |

## Judicial Branch

***Unallocated Reduction.*** The budget includes a $200 million unallocated General Fund reduction to trial court funding and an indication that the Administration will try to work with the stakeholders to identify ways to implement the reduction while minimizing harm to the courts and preserving service levels to the public. This would essentially make permanent recent reductions to the trial courts that have been implemented several years running by employing a mix of one-time solutions.

***Repeal the Omnibus Conservatorship and Guardianship Reform Act of 2006.*** The Governor proposes repeal of the Omnibus Conservatorship and Guardianship Reform Act of 2006. This legislation established standards for the education, certification, and oversight of court-appointed conservators and guardians. However, funding for full implementation of the Act has been deferred several years in a row and the program has never been rolled out statewide. While this proposal would relieve courts of the duty to implement the Act, those courts that have successfully done so within available resources could continue their efforts.

# Transportation Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- The Administration proposes to reenact the fuel tax swap by a two-thirds vote trailer bill in response to the passage of Proposition 26. The new approach will save over $1 billion across two fiscal years (2010-11 and 2011-12). This would protect revenue sources for highways and transit while continuing the ongoing General Fund relief as proposed in the current fuel tax swap without violating Proposition 22 requirements.

- The budget proposes loans of $494 million in weight fee revenue to the General Fund in 2010-11 and $166.3 million in 2011-12 without violating Proposition 22 requirements.

- Includes $2.3 billion in Proposition 1B bond funds for capital funding of bond projects including $631.2 for corridor mobility, $972.3 million for trade corridors, $117 million for public transit modernization, $200 million for state-local partnership projects, $22 million for local bridge seismic safety, and $391.9 million for State Route 99.

**Negative Aspects of Governor's Budget Proposal:**

- At this time, it doesn't appear that the Administration has proposed any increases in the use of contract services.

- Use of $63 million in State Highway Account funds for vehicle replacements and retrofits instead of highway projects.

**Comments/Bottom Line:**
The Governor's budget plan is a step in the right direction to protect funding for transportation projects and continue General Fund relief related to transportation debt service payments. The budget also provides Prop 1B bond funding for capital projects to improve our transportation system and help jump start the economy by getting Californians back to work. It remains to be seen whether this Administration will include future proposals to contract out of more transportation services, a concept Republicans have supported for many years. Generally, this plan is a good starting place.

# Transportation

## Department of Transportation

**General Fund Backfill.** The Governor's budget proposes to transfer $262.4 million in 2010-11 and $700 million in 2011-12 in weight fee revenues from the State Highway Account to the General Fund for the payment of transportation-related debt service. In addition, $77.5 million in revenues not restricted by the California Constitution would be used to reimburse the General Fund for debt service payments made on Proposition 116 transit bonds. These transfers allow the state to continue funding transportation projects and programs at current levels while achieving the same level of General Fund relief provided for in the 2010 Budget Act without violating Proposition 22 requirements. The State Highway Account would be backfilled by the excise tax not directed to General Fund relief thus replacing the weight fee shift.

**Weight Fee Loans.** The budget proposes loans of $494 million in weight fees revenue to the General Fund in 2010-11 and $166.3 million in 2011-12 without violating Proposition 22 requirements.

**Fuel Tax Swap Reenactment.** The Administration also proposes to reenact the fuel tax swap by a two-thirds vote trailer bill in response to the passage of Proposition 26. This would protect revenue sources for highways and transit while continuing the ongoing General Fund relief as proposed in the current fuel tax swap. Although Republicans did not support ABX8 6 and ABX8 9 of 2009 (fuel tax swap), this was generally due to the fact that Republicans believed it was a violation of Proposition 13 because the measures were approved by a majority instead of a two-thirds vote. However, Republicans were largely supportive of the funding levels given to local streets and roads and the State Transportation Improvement Program under the fuel tax swap.

**Local Transit Assistance Funding.** The budget provides $330 million for transit operations by appropriating additional funds from the Public Transportation Account fund balance to ensure that local transit agencies continue to receive the equivalent of 75 percent of diesel sales tax revenues as well as funding that the local agencies were to have received from non-article XIX revenues as part of the 2010 fuel tax swap.

**Proposition 1B Bond Funds.** Includes $2.3 billion in Prop 1B bond funds for capital funding of bond projects including $631.2 for corridor mobility, $972.3 million for trade corridors, $117 million for public transit modernization, $200 million for state-local partnership projects, $22 million for local bridge seismic safety, and $391.9 million for State Route 99.

**Vehicle Replacement and Retrofits.** The budget proposes $63 million in State Highway Account funds to retrofit and replace the department's vehicles to meet the California Air Resources Board air quality mandates. At a time when the state has limited resources for highway improvement projects, investing in infrastructure seems more prudent than meeting the unreasonable requirements of another state agency.

**Tribal Gaming Funds.** This budget redirects $100.8 million in Tribal Gaming revenues to the General Fund instead of going to transportation special funds in repayment of transportation loans from 2001-02 and 2002-03.

**Transfer from Motor Vehicle Account to General Fund.** The Governor's plan would transfer $71.6 million from the Motor Vehicle Account (MVA) to the General Fund from revenues not covered by Article XIX of the California Constitution. Article XIX restricts the use of revenues from fees and taxes on motor vehicles to the enforcement of motor vehicle laws, including environmental regulations relating to the operation of motor vehicles, and to transportation infrastructure planning, improvements, construction, and maintenance. The $71.6 million figure represents revenues to the MVA from sources other than motor vehicle fees and taxes, such as funds received from the sale of documents and various other services to the public. Fund shift maneuvers like this do not help to solve the structural budget problem. In fact, they may perpetuate it.

**High Speed Rail Authority**

The budget proposes $192 million for the High Speed Rail project ($102.4 million in Proposition 1A bond funds and $89.7 million in federal funds). These funds are for continued project management, environmental and engineering work. No construction funds have been provided yet. The federal government has awarded the High Speed Rail Authority (Authority) $3.6 billion, of which most must be used to fund the Central Valley portion of the project. Total costs for Phase 1 are projected by the Authority to exceed $42.6 billion. There have been no financial commitments made from the private sector at this point since the plan does not have enough specifics to attract private investment. The prudent approach would be to allow private companies to bid on the project who have experience and financial capital to plan for and develop the system without relying on any more state funding.

# Resources & Environmental Protection Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- The Governor's budget proposal eliminates funding of $41.7 million General Fund in 2011-12 by eliminating CAL FIRE's fourth firefighter per engine and making reductions to the Department of Parks and Recreation.

**Negative Aspects of Governor's Budget Proposal:**

- Shift of $12.8 million in General Fund to Waste Discharge Permit fees and Water Rights fees. The budget also proposes statutory changes to authorize the State Water Resources Control Board to assess a fee for basin planning activities.
- Lack of regulatory reforms that would help California businesses such as streamlining the CEQA process and eliminating AB 32 fees.

**Comments/Bottom Line:**

The Governor's budget plan proposes some programmatic spending reductions that will benefit the General Fund but may be unpopular. The reductions to CAL FIRE will mean fewer firefighters but could bring more efficiencies. The reductions to state parks may mean partial or full closure of some state park units but Californians have spoken when they rejected additional funding through Proposition 21 to keep parks open. Unfortunately, the Governor has proposed similar environmental fees that were eliminated from the budget last year.

# Resources & Environmental Protection

## CAL FIRE

**Staffing Reduction.** The Governor's budget proposal eliminates funding for CAL FIRE's fourth firefighter for a decrease of $3.6 million in 2010-11 and $30.7 million in 2011-12 which would restore CAL FIRE's staffing to pre-2003 levels. According to the Administration, in 2003 staffing was increased from three to four firefighters per engine during peak fire season in the summer and early fall. However, these additional staffing levels did not significantly change the department's initial attack effectiveness. The wildfire containment rate of 92.2 percent (wildfires contained to less than 10 acres) remained similar to CAL FIRE's historic trends. The reductions to CAL FIRE will mean less firefighters but could bring more efficiencies.

**Fire Protection Services Realignment.** The budget also proposes to shift up to $250 million of state General Fund firefighting and medical emergency response responsibilities in populated wildland areas to local governments through the Board of Forestry's reclassification of state responsibility areas (SRA). The final amount of funding provided by the state to local governments will depend on the Board of Forestry's final determination of the SRA classification based on revised criteria and extensive field review of existing state responsibilities. CAL FIRE will continue to provide fire protection services until the Board of Forestry's reclassification process is finished. The Administration intends to provide funding to local governments for firefighting services on an ongoing basis, beyond the proposed five year tax extension. Therefore, this realignment would provide no General Fund savings to the state. (*See Realignment Section on page 13).*

## Department of Parks and Recreation

**Reduction to State Parks Budget.** This budget proposes to reduce General Fund spending by $11 million for the Department of Parks and Recreation in 2011-12 increasing to $22 million in future years. The reduction to state parks may mean the partial or full closing of some state park units. The department intends to develop a plan to minimize the impact on attendance by partially closing state parks during weekdays and off-peak seasons and closing other parks with the lowest attendance and revenue generation. The Administration indicates that the department will work with stakeholders and local communities to explore partnership opportunities.

## Other

**Proposition 65.** Increase of $1.1 million General Fund in 2011-12 increasing to $2.3 million in 2012-13 to continue the Proposition 65 program within the Office of Environmental Health Hazard Assessment due to the structural deficit of the Safe Drinking Water and Toxic Enforcement Fund that currently supports the program. Existing penalty revenues paid by businesses from enforcement cases are not enough to support the existing program. Given the current budget deficit, providing additional General Fund to this program does not seem prudent.

**Environmental Fee Increases.** The Governor's budget proposes the following fee increases that Republicans have opposed in the past and fought to eliminate in recent state budgets.

**State Water Resources Control Board**

**National Pollutant Discharge Elimination System Program.** Replace $1.4 million General Fund with Waste Discharge Permit Fund (WDPF). This would require NPDES permit costs to be raised.

**Irrigated Land Regulatory Program.** Replace $1.8 million General Fund with WDPF. This would increase fees on irrigated land owners for waste discharge requirements, conditional waivers, and NPDES permits.

**Water Rights Program.** Shift $3.6 million General Fund to the Water Rights Fund. This would require water rights holders to pay higher fees per acre foot of diverted water.

**Basin Planning Program.** This proposal would increase waste discharge permit fees by an estimated seven percent, increasing the average permit cost from $2,400 to $2,570. The WDPFs would be used to backfill $6.1 million of General Fund for basin plans and associated activities. In addition, $746,000 in reimbursement authority would be replaced with WDPF.

# Employee Compensation Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- Would achieve $308.4 million General Fund savings from reducing take home pay of six remaining bargaining units (BU's) that are currently without an agreement. Assumes a ten percent pay reduction beginning July 1, 2011. The six units remaining include BU's 2 (attorneys and hearing officers), 6 (CCPOA), 7 (public safety and protective services), 9, 10, and 13 (engineers).

**Negative Aspects of Governor's Budget Proposal:**

- No new pension reforms or other civil service reforms that will move the state closer to operating like the private sector.

**Comments/Bottom Line:**

The Governor's budget achieves savings of $308.4 million for compensation changes proposed for the six remaining BU's that are without an agreement. The proposal could be an incentive for units to come to an agreement on a new contract, but it is likely any agreement would result in less savings achieved as BU's with an agreement are only subject to a 4.6 percent pay decrease in 2011-12 (current personal leave program included in most contracts). Furthermore, the proposed budget would restore some level of pay compared to 2010-11 as these BU's are subject to three furlough days a month in 2010-11 and the proposed 2011-12 budget is basically two furlough days. However, it is likely that an agreement would include retirement changes that could reduce retirement costs in the long term. The proposal, while a step in the right direction, does not go nearly far enough in addressing employee compensation funding concerns. Given the magnitude of the budget deficit, it may be necessary to reduce salaries and benefits further for all bargaining units.

# Employee Compensation

**Compensation Reduced for Remaining Six Bargaining Units.** The labor agreements reached in 2010, covering 15 of the state's 21 collective bargaining units (BU's), included a number of concessions such as implementation of a personal leave program (PLP), which reduced state employees' take-home pay by 4.6 percent and granted them one personal leave day in exchange, and increased employee retirement contributions. The six BU's without a contract remain subject to the Governor's furlough program, with reduced pay equaling approximately 15 percent for three furlough days a month through June 30, 2011. The Governor's budget includes a reduction of ten percent in take-home pay from employees in the six remaining BU's, and assumes savings of $308.4 million General Fund in 2011-12. The savings would be achieved either through collective bargaining or other administrative actions, such as a Governor directed furlough program.

**Core Health Plan Option.** The Governor's budget assumes savings of $72 million General Fund from the addition of a core health plan to the current benefit plan options. The core health plan would consist of basic coverage at a lower premium. The Governor proposes, through legislation, to direct CalPERS to negotiate and add a core health plan option to the existing portfolio and include a state representative in the health contract negotiations. The Governor's proposal would reduce the escalating cost of state employee and retiree health care, attempting to add another option to go along with the state's current "Cadillac" health plan. The proposal would allow for a more fundamental health plan option to be included in the health care plans, one that could meet the basic needs of state employees while resulting in reduced health care costs in subsequent years. It is critical that the state begin to recognize and minimize health care costs and adding a core health plan as an option for state employees will be a very good start down this path.

**Additional Reductions May Be Necessary.** The budget, while a step in the right direction, does not go nearly far enough in addressing employee compensation funding concerns. Given the magnitude of the budget deficit, it may be necessary to reduce salaries and benefits further for all bargaining units. The LAO has also suggested increasing the level of proposed savings associated with state employees.

**No Reforms for Civil Service or Pensions.** The budget does not include any changes in policy for either the state's pension program or civil service program. 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. Any savings that may be achieved would be relatively minor, there may be a small level of savings to the state as seniority priorities are adjusted, but the importance of reforming the civil service system lies in greater efficiencies and a stronger workforce for the state. The Little Hoover Commission hit the nail on the head in their April 1995 report, Too Many Agencies, Too Many Rules: Reforming California's Civil Service. In the report, they instruct the Legislature that "the state must abolish redundant, and therefore unneeded, civil service protections that make it difficult to recruit, promote and reward good workers and even harder to punish, demote and terminate bad ones. Minimum standards and a system of accounting must be established for management training, and training must be tied to performance evaluations and compensation. State managers also must have at their disposal the talents, energy and efficiency of the private sector. It is no longer appropriate for the civil service to have a monopoly on public work, and competition for that work is a proven way to stretch the resources of the State." Even fifteen years later, the Commission's recommendations and findings are highly relevant to today's civil service system, identifying changes that continue to be necessary for the state to move forward.

# Labor & Workforce Development

California suffered its worst job losses on record during the latter half of 2008 and the first six months of 2009 — losing nearly a million nonfarm jobs. These losses moderated during the second half of 2009 and switched to very modest gains in 2010. As with the nation, it will likely take a long time for employment to reach pre-recession levels. The national unemployment rate peaked at 10 percent in the last quarter of 2009 and declined sporadically through July 2010. The state's rate, in contrast, continued to trend up to 12.6 percent in March 2010, and then improved slightly thereafter. This continued unemployment rate has had a significantly negative impact on the state's unemployment system, resulting in insolvency for the Unemployment Insurance Fund (see below).

## Employment Development Department (EDD)

**Unemployment Insurance (UI) Fund Solvency.** The Governor's budget includes $18.4 billion for unemployment benefit payments (as opposed to estimated receipts of only $5.2 billion for 2011), financed by employers who pay state unemployment taxes, ranging between 1.5 and 6.2 percent, on the first $7,000 in wages paid to each employee in a calendar year.

Beginning in January 2009, the state exhausted its UI Fund as a result of the imbalance between benefit payments and annual employer contributions (noted above). To make UI benefit payments without interruption, EDD began borrowing funds from the Federal Unemployment Account to pay benefits to an increasing number of unemployed claimants. At the end of 2009, the UI Fund had a projected deficit of $6.2 billion. Based on EDD's October 2010 UI benefit estimate, this deficit is expected to increase to $10.3 billion by the end of 2010 and $13.4 billion by the end of 2011. ***The Governor's budget does not propose a solution to resolve the structural imbalance in the UI Fund.*** However, interest on this debt continues to accrue.

While annual interest payments were waived under the American Recovery and Reinvestment Act for 2010, interest totaling $362.3 million is due and payable in September 2011. According to federal law, this interest payment must come from state funds (and not the UI Fund). Interest will continue to accrue and be payable annually until the principal on the UI loan is repaid. The Governor's budget proposes to pay $362.3 million of interest costs ***using a loan*** from the state's Disability Insurance Fund, to be repaid over the next four years.

**Automated Collection Enhancement System (ACES).** The Budget includes $19.5 million General Fund to continue ACES. The ACES will improve EDD's ability to track, collect, and audit the payment of employer payroll taxes, including unemployment and personal income taxes. The ACES solution is anticipated to increase General fund revenue by $27 million in 2011-12 by improving collection capabilities for delinquent accounts.

# General Government Snapshot

**Positive Aspects of Governor's Budget Proposal:**

- Nothing significant noted yet.

**Negative Aspects of Governor's Budget Proposal:**

- The Governor's budget proposes to save $15 million General Fund in 2011-12 and $30 million ongoing from the Department of Food and Agriculture's programs.  Although the source of new funding is unknown at this time, it is likely to come from agricultural fees, local funds, and federal funds.
- SB X2 16 (Ch. 12/2009) eliminated $32 million of horse racing revenue that had previously helped to support the network of California fairs and backfilled that revenue with General Fund. The Governor's budget proposes to eliminate the General Fund backfill.
- The Governor's budget proposes to eliminate the annual $10 million for Williamson Act Open Space Subventions.  The administration indicates that additional property taxes related to eliminating RDAs could help counties continue this program on their own.

**Comments/Bottom Line:**
The Governor's budget could result in the elimination of some local fairs and increased fees on the agricultural community.

# General Government

**Department of Veterans Affairs.** The Governor's budget provides $253 million General Fund ($399 million total funds) for Veterans Affairs in 2012-13, an increase of $39 million (18 percent) General Fund over the revised 2010-11 spending estimate. The funding increase is primarily the net result of the following factors:

- A $39.8 million baseline increase for constructing previously approved veterans homes in Fresno and Redding and for phasing in staff and residents at the recently opened facilities in the greater Los Angeles area.
- A baseline increase of $9.3 million for higher lease revenue debt service related to the Greater Los Angeles-Ventura County facilities.
- A proposed reduction of $9.9 million General Fund to eliminate state support for county veterans services offices (CVSOs). This reduction would include $2.3 million to eliminate state staff that supports CVSOs and $7.6 million to eliminate state grants to CVSOs themselves. The CVSOs assist veterans in obtaining federal benefits available to them, among other services. This proposal marks a significant turnaround from the 2010 Budget Act, which increased General Fund grants to CVSOs by $4.2 million, bringing the total CVSO grant funding to nearly $8.5 million in 2010-11.

**California Science Center.** The Governor's budget includes a $3.7 million reduction beginning in 2011-12 for support of the California Science Center and would authorize the Science Center to establish a nominal admission fee to offset this reduction. 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.

**Franchise Tax Board (FTB).** The Governor's budget includes resources for the FTB to administer and implement the following revenue proposals:

- <u>Financial Institution Record Match (FIRM)</u>—An increase of $1.3 million and three positions to establish a quarterly records match process between their customer records and the FTB's records of delinquent taxpayers. The administration estimates that this initiative would result in increased General Fund revenues of $10 million accruable to 2010-11 and $30 million in 2011-12.
- <u>Amnesty – Abusive Tax Avoidance Transactions (ATAT)</u>—An increase of $500,000 and five positions to administer the Governor's proposal to reduce abusive tax shelters and other tax avoidance transactions. This initiative will result in General Fund revenues of $56 million accruable to 2010-11 and $40 million in 2011-12. In the past, Republicans have been opposed to this proposal. The primary argument in opposition was that the language proposed would not provide for appeals, other than a chief counsel ruling at the Franchise Tax Board (FTB). The business community would request an appeals process other than a simple FTB chief counsel ruling. Republicans have also opposed a second voluntary compliance initiate so soon following the one that was implemented in 2005. Establishing another amnesty program so close to the previous one may encourage non-compliance as taxpayers delay filing and/or payment of taxes waiting for yet other amnesty programs in later years.

The Governor's budget also includes an increase of $3.2 million and 34 positions for discretionary workload in the Audit Program, which is estimated to generate revenues of $6.5 million in 2011-12, increasing to $13 million in subsequent years.

**Department of Food and Agriculture**

- **Reduction of General Fund for Department of Food and Agriculture.** The Governor's budget proposes to save $15 million General Fund in 2011-12 and $30 million ongoing from the Department of Food and Agriculture's programs. These savings will be determined by a group of key agricultural and industry individuals convened by the Secretary of Food and Agriculture to look at the long-term viability of state programs and determine ways to limit General Fund resources. It is likely that new funds would come from fees, local funds, and federal funds. The due date to complete this work is February 1, 2011, which seems very unrealistic.

- **Elimination of General Fund for California Fairs.** The budget also proposes to eliminate $32 million General Fund support for the Network of California Fairs. Beginning in 2009-10, SB X2 16 (Chapter 12/2009) eliminated $32 million in horse racing revenue that had previously helped to support the fairs and backfilled that revenue with General Fund. This could result in the closure of some local fairs.

# Statewide Issues

**Mandates Deferral.** The Governor's budget includes $56.7 million ($53.7 million General Fund) to reimburse local agencies for state reimbursable mandate. This amount is net of (1) a one-time reduction of $227.8 million related to suspending most mandates not related to law enforcement and property taxes (consistent with suspensions included in the 2009 Budget Act), and (2) a one-time reduction of $94 million related to deferring the 2011-12 payment of the mandates obligation for costs incurred prior to 2004-05, which are statutorily required to be completely paid by 2020-21. This $95 million will be spread over the next nine years to complete the total payment. Though this reduction is labeled as "one-time," it follows similar deferrals that have occurred over the last three years.

In preparation for the 2012-13 Budget, the Administration is proposing to develop a process with the Legislature whereby all reimbursable mandates are reviewed. This review shall determine which statutes should be maintained, modified to reduce costs, repealed to eliminate the mandate entirely, or amended to make the activity permissive using best practices or guidelines.

**Williamson Act.** The Governor's budget eliminates funding in both the current and budget years ($10 million annually) for Williamson Act subventions. The Administration indicates that funding provided from the redevelopment agencies tax shift could help counties continue this program on their own as a local program.

Until 2009-10, the Budget Act annually appropriated approximately $35 million to partially offset the property tax revenues lost by local governments due to these lower assessments. Funding for these subvention payments was suspended in the 2009 Budget Act due to fiscal constraints. However, Chapter 722, Statutes of 2010 appropriated $10 million for an alternative form of Williamson Act subvention payments for 2010-11. The bill also made several technical changes to the Williamson Act.

**Debt Service.** General Fund debt service expenditures will increase by $59.3 million, or 1.0 percent, for a total of $5.6 billion, including an increase of $36.7 million for General Obligation debt service ($4.9 billion total) and an increase of $22.6 million for lease revenue bonds ($685 million total). This increase in General Obligation debt service reflects the proposed use of fees from weight fees imposed on trucks and certain other revenues to pay a portion of transportation debt service costs (see Transportation section on Page X) as well as a one-time pause in the issuance of new bonds in the current year. This pause will give time for the Administration to prioritize funds for the most effective activities.

**Efficiencies in State Government.** The Governor's budget includes $200 million in savings associated with identification of efficiencies in state operations. For example, identification of agencies, departments, and programs that can be reorganized to eliminate duplication and unnecessary functions; review of state peace officer and safety classifications; and reductions in other areas like contracting; fleet operations; and, cell phone use. Basically, this is an unallocated cut without a plan for implementation, which the Legislative Analyst's Office has hinted may be unachievable.

# State Employee Growth Chart

**Authorized Positions by Agency as of Budget Enactment**

| Agency | 2003-04 | 2004-05 | 2009-10 | 2010-11* | 2011-12 | Change in Positions 09-10 to 03-04 | Change in Positions 10-11 to 03-04 | Change in Positions 11-12 to 03-04 | Percentage Change 09-10 | Percentage Change 10-11 | Percentage Change 11-12 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Legislative, Judicial, and Executive | 14,772.9 | 15,365.7 | 16,607.60 | 18458.5 | 18526.5 | 1,834.7 | 3,685.6 | 3,160.8 | 12% | 25% | 21% |
| State and Consumer Services | 13,470.0 | 14,093.6 | 15,868.30 | 16084.1 | 15940.2 | 2,398.3 | 2,614.1 | 1,846.6 | 18% | 19% | 14% |
| Business, Transportation, and Housing | 41,674.4 | 42,625.3 | 40,589.90 | 42995.5 | 42715.5 | -1,084.5 | 1,321.1 | 90.2 | -3% | 3% | 0% |
| Technology, Trade, and Commerce | 21.2 [1/] | 0.0 | 0.00 | 0 | | -21.2 | -21.2 | 0.0 | -100% | -100% | 0% |
| Resources Includes Forestry and Fire | 18,470.0 | 18,423.1 | 17,671.60 | 17543.1 | 17724.6 | -798.4 | -926.9 | -698.5 | -4% | -5% | -4% |
| Environmental Protection | 4,260.7 | 4,288.5 | 4,551.00 | 4270.2 | 4270.2 | 290.3 | 9.5 | -18.3 | 7% | 0% | 0% |
| Health and Human Services | 30,089.6 | 30,619.1 | 29,829.50 | 31332.9 | 31741 | -260.1 | 1,243.3 | 1,121.9 | -1% | 4% | 4% |
| Youth and Adult Correctional | 50,937.4 | 54,818.8 | 59,400.90 | 65657.5 | 61915.4 | 8,463.5 | 14,720.1 | 7,096.6 | 17% | 29% | 14% |
| Education | 119,081.3 | 116,813.9 | 133,642.60 | 134,782 | 134,753 | 14,561.3 | 15,700.5 | 17,939.0 | 12% | 13% | 15% |
| Labor and Workforce Development | 12,368.1 | 12,288.0 | 13,833.50 | 13733.7 | 12987.6 | 1,465.4 | 1,365.6 | 699.6 | 12% | 11% | 6% |
| General Government | 17,978.9 [2/] | 18,464.8 | 13,782.5 | 12,668.6 [3/] | 12,506.6 | -4,196.4 | -5,310.3 | -5,958.2 | -23% | -30% | -33% |
| **Total** | **323,124.5** | **327,800.8** | **345,777.4** | **357,525.9** | **353,080.5** | **22,652.9** | **34,401.4** | **25,279.7** | **7%** | **11%** | **8%** |

*2003-04 and 2004-05 are actual positions filled

*2010-11 Projections as of Governor's Budget

[1/] Agency eliminated effective January 1, 2004

[2/] Various Org 9901 was carrying a lump sum unallocated cut of -16,000.0 positions.

[3/] Various Org 9901 is carrying an equivalent reduction of 8,915.7 positions to account for Governor's employee compensation changes. Actual Gen Govt position projected for 2010-11 equals 8,682.5 in Schedule 4.

State and Consumer Services includes PERS and STRS

BT&H includes CalHFA
Gen Govt includes BSA, and SCIF

Labor and Workforce includes EDD

Education includes UC's, CSU's, and Hastings

Resources include Forestry and Fire Protection

Each year reflects the authorized positions when that year was enacted.

The chart shows state employee growth for 2011-12 is approximately 4,400 personnel years less than 2010-11, but approximately 7,000 personnel years higher than 2009-10. Overall state employees have grown eight percent since 2003-04.

# 2011-12 Governor's Budget Fee List

| 2011-12 Governor's Budget Fee List* (Dollars in Thousands) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | 2010-11 Fee Revenues | | 2011-12 Fee Revenues | |
| **Org #** | **Dept** | **Issue Title** | **Leg or NA**** | **GF $** | **OF $** | **GF $** | **OF $** |
| 3940 | State Water Resources Control Board | National Pollutant Discharge Elimination System (NPDES) Fund Shift | NA | $0 | $0 | $0 | $1,373 |
| 3940 | State Water Resources Control Board | Irrigated Land Regulatory Program (ILRP) Fund Shift | NA | 0 | 0 | 0 | 1,762 |
| 3940 | State Water Resources Control Board | Basin Planning | LEG | 0 | 0 | 0 | 6,103 |
| 3940 | State Water Resources Control Board | Water Rights Program Fund Shift and Enforcement Augmentation | NA | 0 | 0 | 0 | 3,570 |
| 4260 | Department of Health Care Services | Extend the Existing Hospital Fee | LEG | 0 | 879,720 | 0 | 0 |
| 4280 | Managed Risk Medical Insurance Board (MRMIB) | Increase Healthy Families Program Premiums | LEG | 0 | 0 | 0 | 0 |
| 6440 | University of California | Mandatory Fee Increase | NA | 0 | 0 | 0 | 183,076 |
| 6600 | Hastings College of the Law | Mandatory Fee Increase | NA | 0 | 0 | 0 | 953 |
| 6610 | California State University | Mandatory Fee Increase | NA | 0 | 40,700 | 0 | 221,569 |
| 6870 | California Community Colleges | Credit Unit Fee Increase of $10/Unit | LEG | 0 | 0 | 0 | 110,000 |
| | **Total** | | | **$0** | **$920,420** | **$0** | **$528,406** |

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

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

# Senate Republican Fiscal Staff Assignments

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| Human Services, Public Employees Retirement | Chantele Denny |
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