STATE SPENDING PLAN FOR 1994-95

The 1994 Budget Act and Related Legislation

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Overview

This report summarizes the fiscal effect of the 1994 Budget Act (Ch 139/94, SB 2120), and the effects of major legislation that was enacted as part of the overall state spending plan for 1994-95. The report begins with a review of the 1994-95 budget problem, which involved a $4.5 billion funding gap. It then describes the actions taken by the Legislature and the Governor to resolve the budget gap over a two-year period, including the key assumptions that are included in the budget. The report then discusses the cash management and borrowing plan that has been implemented to finance the budget, as well as the standby "trigger" mechanism that is intended to keep the two-year budget plan on track. Next, we present the state's total spending plan from all funds and for the various individual program areas and we discuss recent spending trends. Finally, the report describes the major budget actions within each program area.

Our review indicates that the recently enacted two-year budget plan faces many risks. Some of these risks are inherent in any budget plan. Others, however, involve the specific assumptions that underlie this plan, the most important of which is that the federal government will provide $3.6 billion for immigrant-related state costs. Given these risks and the existence of the trigger mechanism, it is important that the Legislature address problems with the budget plan as they emerge.

Chapter 1

THE 1994-95 BUDGET PACKAGE

In this chapter, we discuss the budget problem that the Legislature and the Governor faced for 1994-95 and how the 1994-95 budget package addresses that problem.

THE 1994-95 BUDGET PROBLEM

The budget plan adopted last year to return the state's budget to balance unraveled, due primarily to the continued poor performance of the California economy. The 1993-94 budget plan sought to pay off a $2.8 billion General Fund deficit from prior years over a two-year period. That plan called for $2.3 billion of the carryover deficit to be paid off in 1993-94, when the state was expected to begin its economic recovery. The remainder of the deficit was to have been paid off in 1994-95, when the state would achieve a balanced budget. However, the state's economy continued to perform poorly. By January 1994, estimated revenue over the two-year period had declined by $2.7 billion. Furthermore, estimated spending over the period had increased by $2.3 billion, primarily because some of the savings assumed in the 1993-94 budget plan failed to materialize. The largest spending increases were caused by shortfalls in the amount of local property taxes shifted to schools by the 1993-94 budget package (requiring increased state funds to make up a loss of $600 million) and by the failure of the federal government to provide $480 million assumed in the budget plan for the health costs of undocumented immigrants. The unraveling of the 1993-94 budget plan meant that enacting a 1994-95 budget required the Legislature and the Governor once again to address essentially the same problems that the 1993-94 budget plan had attempted to resolve: a significant carryover deficit and a large projected 1994-95 operating shortfall.

Following the release of the *1994-95 Governor's Budget* in January 1994, we projected that the state faced a 1994-95 General Fund budget funding gap of $4.9 billion (please see *The 1994-95 Budget: Perspectives and Issues*, Part I). To put the size of the gap into perspective, it was equivalent to one-eighth of the total amount of General Fund spending in 1993-94. This funding gap represented the amount of savings, increased revenues, or other resources needed to offset:

- A projected 1993-94 year-end deficit of **$2.5 billion.**
- A projected 1994-95 operating shortfall of **$2.4 billion,** which was the difference between our estimate of 1994-95 "baseline" spending and available revenues under existing law.

By mid-June, when the Governor released his final deficit elimination plan, the budget gap had declined to $4.5 billion, primarily due to slightly better revenue performance and a modest slowing of growth in health caseloads and school enrollment. Two other major gap changes roughly offset each other. Disaster assistance costs for the Northridge earthquake increased the size of the gap, while a favorable court decision in the *Barclays* tax case provided a roughly offsetting revenue increase that reduced the size of the gap. Our estimated budget gap did not include any funds to establish a prudent reserve.

THE GOVERNOR'S BUDGET PROPOSALS

Figure 1 outlines the Governor's original January proposal to address the 1994-95 budget gap (as estimated at that time) and compares it with his June budget plan. Generally, the statutorily required May budget revision updates the January budget estimates and presents any new policy proposals of the Governor. However, the May revision for the 1994-95 budget provided only a technical update of budget estimates, pending a reassessment of the likelihood of receiving federal funds assumed in the budget. After making that reassessment, the Administration presented its major budget changes to the Legislature in mid-June.

Figure 1

Governor's Proposals to Address The 1994-95 Spending Gap[a] January Budget and June Budget Plan

(In Billions)

	January Budget	June Plan	Change
Cost shifts			
To federal government	$3.1	$0.8	-$2.3
To local governments	0.4	0.8	0.4
Subtotals	**$3.5**	**$1.6**	**-$1.9**
Program reductions			
Reduce General Fund Programs	$0.9	$1.0	$0.1
Shift special fund monies to General Fund	0.1	0.1	—
Subtotals	**$1.0**	**$1.1**	**$0.1**
Cost Deferrals and Revenue Accelerations			
1994-95 carryover deficit	—	$1.0	$1.0
Borrow to finance Northridge earthquake cost	—	0.5	0.5
Other	$0.1	0.4	0.3
Subtotals	**$0.1**	**$1.9**	**$1.8**
Increased revenues			
Assume victory in *Barclays* case	$0.6	—[b]	-$0.6
Other	-0.1	—	0.1
Subtotals	**$0.5**	—	**-$0.5**
Total Budget Solutions	**$5.2**	**$4.5**	**-$0.7**
Budget gap	$4.9	$4.5	-$0.4
General Fund reserve	$0.3	—	-$0.3

[a] Details do not add to totals due to rounding. Figures include both 1993-94 and 1994-95 effects.
[b] For the June Plan, revenue from the *Barclays* court decision is treated as a reduction in the budget gap, rather than a budget solution, because the case had been resolved by that time.

The January Proposal

The Governor's January budget proposal attempted to resolve the entire 1994-95 funding gap and create a small General Fund reserve of $260 million. The budget proposed to address more than 70 percent of the gap by shifting $3.5 billion of costs to other levels of government — primarily to the federal government. The January budget assumed that the federal government would provide a total of $3.1 billion of new funding to offset state costs in 1994-95. Of this amount, $2.3 billion reflected an assumption that the federal government would reimburse California for costs related to undocumented immigrants ($1.7 billion for K-12 education costs and a total of $600 million for Medi-Cal health services and for incarceration of undocumented immigrant felons). The budget also included about $600 million of savings from assumed federal legislation to increase the federal share of cost for the state's major health and welfare programs. The other significant federal funding increase assumed in January was full federal coverage of up to 36 months of benefits to refugees, for a savings of $111 million. Virtually all of the $3.1 billion of new federal funds assumed in the January budget required changes in federal law or budget policy, none of which were being considered in legislation by Congress at the time.

The largest budget savings proposal affecting local governments was a "correction" of a technical problem in 1993 legislation that had resulted in a shortfall of $400 million (over two years) in the intended $2.6 billion property tax shift from local governments to schools that was adopted in the 1993-94 budget. The shortfall increased the state's liabilities for K-12 school funding. (This $400 million accounts for most of the total $600 million property tax shortfall noted earlier.)

Program funding reductions accounted for $1 billion of savings, the largest components of which were grant reductions under Aid to Families with Dependent Children (AFDC) and related welfare reform proposals.. The budget also proposed substantial savings from the elimination of certain Medi-Cal optional benefits (benefits not required by federal law) and the elimination of funding for prenatal services for undocumented immigrant women. The January budget also included $600 million of additional revenue by assuming a favorable U.S. Supreme Court decision in the *Barclays* case involving disputed corporate taxes, which was partly offset by a revenue loss of $95 million for a new tax credit for low- and moderate-income taxpayers.

State/County Restructuring Proposal. The budget proposed to shift a total of $3.2 billion of state costs for health and welfare programs to counties. In return counties would receive an equivalent amount of state resources in the form of an increased share of state sales tax revenue, additional funding for local trial courts, and a shift of property tax revenues from schools back to counties (with the state backfilling the school losses). The proposal was not intended as a budget solution since it was designed to be fiscally neutral. Instead, it sought to increase county financial incentives to make program investments and operating decisions in ways that would improve program performance and reduce costs.

June Budget Plan
Proposed Two-Year Budget

The Governor's June budget plan recognized that no action had occurred to provide most of the new federal funds that the January budget proposal had assumed would be available to the state in 1994-95. Consequently, the June plan reduced the amount of these assumed federal funds by $2.3 billion in 1994-95. In place of these federal funds, the June plan proposed $1 billion of additional spending cuts, cost deferrals and revenue enhancements; eliminated the reserve that had been budgeted in January; and proposed to end 1994-95 with a budget deficit of $1 billion, to be financed by borrowing that would be paid off in 1995-96. However, the plan still relied on a total of $3.6 billion of new federal funds over the two-year period.

Federal Funds Remained Crucial in the June Plan. The June plan reduced the amount of assumed new federal funds in 1994-95 from $3.1 billion to $763 million. Specifically, the June plan continued to assume federal funds for Medi-Cal and incarceration costs for undocumented immigrants and for refugee costs. However, the June plan no longer assumed that the state would receive federal reimbursements of $1.7 billion in 1994-95 for the education costs of undocumented immigrant children or that the federal government would increase its funding match for health and welfare programs. Starting in 1995-96, however, the June plan assumed that the federal government would provide the state with a total of $2.8 billion for the cost of educating undocumented immigrant children and to continue the funding assumed in 1994-95 (adjusted for growth).

More Cost Shifts to Local Governments. The June plan proposed to shift an additional $285 million of federal reimbursements for health care services to the state in 1994-95, primarily from county hospitals and health programs.

Welfare and Health Cuts. The plan maintained the January proposals to reduce welfare grants and eliminate some Medi-Cal benefits. It also added savings from assumed federal legislation to restrict certain benefits available to legal immigrants.

Plan Included Some Legislative Budget Actions. The June plan included $427 million of additional savings actions that had been adopted by the budget conference committee. These actions included revenue from increasing tax audits and collections activities, special fund transfers to the General Fund, and savings from negotiating lower hospital rates and drug prices for Medi-Cal.

State/County Restructuring Proposal Withdrawn. The June plan withdrew the January proposal to restructure state and county program responsibilities and funding arrangements, which the Legislature had rejected in its subcommittee actions.

Borrowing for Earthquake Disaster Relief. The June plan proposed financing the General Fund share of disaster assistance costs for the Northridge earthquake using loans from the federal government and local governments to be repaid over the next several years. In part, these loans were to substitute for the state bond issue in Proposition 1A, which the voters rejected at the June 7 primary election.

Tax Expenditures. The June plan withdrew the January proposal for a tax credit for low- and moderate- income persons. Instead it proposed two new business tax incentives for headquarters retention and small business expensing (total annual revenue loss of $75 million starting in 1994-95). The June plan also proposed eliminating the renters' tax credit, which was temporarily suspended through 1994, for a savings of $390 million in 1995-96. (In the June 7 primary election, the voters had rejected Proposition 175, which would have established the renters' credit in the state Constitution.)

Barclays Decision. The U.S. Supreme Court decision in the *Barclays* case was handed down in June and affirmed the state's position. However, the June plan revised the estimated revenue gain from the decision downward to $410 million in 1994-95 and $100 million in 1995-96. In the context of the June plan, the *Barclays* revenues reduced the size of the budget gap. (Previously, these revenues were treated as a budget solution.)

SUMMARY OF ACTIONS TAKEN TO CLOSE THE BUDGET GAP

The budget package adopted by the Legislature incorporated most of the major features of the Governor's June plan. In particular, the budget package adopted the Governor's proposal for a two-year budget, with a $1 billion deficit in 1994-95 to be paid off in 1995-96. Paying off the deficit relies on the Governor's assumption that the state will receive a total of $3.6 billion of new immigrant-related federal funds over the two-year period—$763 million in 1994-95 and $2.8 billion in 1995-96. The most significant departure from the Governor's June plan was the rejection of most of the proposed cuts in AFDC grants and of the elimination of certain Medi-Cal optional services and prenatal services for undocumented women.

Figure 2 (next page) identifies the major actions taken to close the state's $4.5 billion budget funding gap, together with the Administration's estimates of the fiscal effect of each of these actions. As the figure shows, almost three-fourths of the gap was addressed by funding shifts to other levels of government, and by cost deferrals and revenue accelerations (including the planned 1994-95 deficit). This approach is very similar to strategy adopted in the 1993-94 budget package, which also relied on funding shifts to other government levels and on cost deferrals and revenue accelerations (including a planned carry-over deficit).

In brief, the major actions taken to close the 1994-95 budget gap consisted of the following:

Figure 2

Summary of Actions Taken To Close the 1994-95 Budget Gap

(In Billions)

Shifts to other levels of government	**$1.4**
Local government:	
Revise prior property tax shift	0.3
State Medi-Cal program share of federal reimbursements to counties	0.3
Subtotal	**($0.6)**
Federal government:	
Immigrant health and welfare costs	0.4
Incarceration of undocmented felons	0.4
Subtotal	**($0.8)**
Cost deferrals and revenue accelerations	**$1.9**
1994-95 carryover deficit	1.0
Use loans for Northridge Earthquake costs	0.5
Defer funding for flood control projects	0.1
Defer borrowing costs	0.2
Extend tax settlement authority	0.1
Program reductions	**$0.9**
Shift special fund monies to General Fund programs	0.4
Welfare grant reductions	0.1
Various Medi-Cal savings	0.2
Reductions to state agencies	0.2
Capture K-12 retirement savings	0.1
Other General Fund reductions	0.2
Community Colleges: backfill property tax shortfalls	-0.1
Other General Fund augmentations	-0.2
Increased resources	**$0.2**
Expand tax compliance activities	0.1
Increased higher education fees	0.1
Total	**$4.5**

[a] Figures reflect both 1993-94 and 1994-95 effects. Detail does not add to total due to rounding.

Shifts to Other Levels of Government—$1.4 Billion. These cost shifts address almost one-third of the total budget funding gap. A majority of the savings result from the adoption of the June plan's assumed increase in federal funding for immigrant-related state costs. Budget actions affecting counties, primarily the "correction" of last year's property tax shift from counties to schools and state actions to share in the proceeds of certain federal health-related disbursements to counties (SB 855 and SB 910 funds) account for the other savings in this category.

Cost Deferrals and Revenue Accelerations—$1.9 Billion. The largest item in this category is the $1 billion "roll-over" of the state's budget deficit from 1994-95 to 1995-96. Borrowing to cover earthquake disaster costs is the second largest deferral. A shift of costs for short-term borrowing expenses to 1995-96 and accelerated tax settlements account for most of the remainder.

Program Reductions—$900 million. A wide variety of individual actions contribute to the total General Fund savings from program reductions. The largest savings result from shifts of special fund monies to General Fund programs. Other major savings come from reductions in Aid to Families with Dependent Children (AFDC) and Supplemental Security Income/State Supplementary Program (SSI/SSP) welfare grants, actions to reduce the cost of providing services in the Medi-Cal program, and reductions in the operating budgets of state agencies.

Increased Resources—$200 Million. Improved tax compliance and collection efforts account for more than half of the additional resources in the budget. Fee increases for higher education students account for most of the remainder. The budget package did not include the Governor's proposed business tax incentives. The budget package continues the suspension of the renters tax credit through 1995 for a savings of $390 million in 1995-96 (not shown in Figure 2, which only identifies savings through 1994-95).

Chapter 3 of this report more fully discusses the significant elements of the budget package. Figure 3 (next pages) lists the major legislation that was enacted to carry out the budget agreement.

General Fund Condition At the Time of Budget Passage

Figure 4 shows the General Fund condition for 1993-94 through 1995-96, based on the 1994-95 budget package and presented according to the state's traditional budgetary accounting practices. The General Fund ended 1993-94 with an estimated deficit of

Figure 3

1994-95 Budget
Major Implementing Legislation

Measure	Description
AB 113 Andal (Ch 145/94)	• Recovery of incarceration and medical costs from prison inmates. • Prison medical contracts.
AB 167 B. Friedman (Ch 140/94)	• Domestic violence shelters; vertical prosecution.
AB 473 Brulte and Snyder (Ch 196/94)	• AFDC maximum family grants.
AB 816 Isenberg (Ch 195/94)	• Proposition 99 reauthorization.
AB 836 Pringle and Goldsmith (Ch 148/94)	• AFDC and SSI/SSP grant reductions (2.3 percent).
AB 860 Pringle (Ch 155/94)	• County property tax adjustments.
AB 973 Bornstein (Ch 142/94)	• 1993-94 community college property tax backfill.
AB 2377 Hannigan (Ch 147/94)	• Increase state portion of federal disproportionate share payments to hospitals and county Medi-Cal administrative claim monies. • Prescription drug savings.
AB 2383 Assembly Ways and Means (Ch 151/94)	• Authorization of loans to pay non-federal share of Northridge earthquake costs.
AB 2384 Assembly Ways and Means (Ch 150/94)	• Performance budgeting at Consumer Affairs.

Figure 3 CONTINUED

1994-95 Budget
Major Implementing Legislation

Measure	Description
AB 2385 Assembly Ways and Means (vetoed)	• Increase in judges' retirement contribution rate.
AB 2388 Assembly Ways and Means (Ch 149/94)	• Establishes regulatory fees (guide dogs).
AB 2389 Assembly Ways and Means (Ch 144/94)	• Extends suspension of renters' tax credit through 1995.
AB 2395 Assembly Ways and Means (Ch 152/94)	• Fee funding for workers' compensation managed care programs.
AB 2480 Vasconcellos (Ch 153/94)	• Education provisions (K-12 and higher education).
AB 3308 Takasugi (Ch 138/94)	• Extend tax settlement authority.
SB 141 Alquist (Ch 154/94)	• Oil settlement funds.
SB 1230 Senate Budget and Fiscal Review (Ch 135/94)	• "Trigger" provisions for 1994-95 and 1995-96 automatic spending cuts.
SB 2123 Senate Budget and Fiscal Review (Ch 136/94)	• Establishes cash borrowing mechanism needed to finance budget.

$2 billion, of which $1 billion will be paid off in 1994-95 and the remaining $1 billion will be carried over into 1995-96, when it is anticipated to be paid off. Total budgeted spending from the General Fund for 1994-95 is $40.9 billion—an increase of 5.2 percent from 1993-94. The spending amount shown for 1993-94, however, does not include $596 million (a net amount) provided as off-budget loans to schools and community colleges against their future state funding entitlements. Taking these 1993-94 loan expenditures into account reduces budgeted spending growth in 1994-95 to 2.6 percent.

Projections for 1995-96 incorporate budget package actions and assumptions. As discussed above, the 1994-95 budget that was approved by the Legislature and the Governor pays off the $2 billion 1993-94 General Fund deficit over two years. Consequently, the 1994-95 budget represents the first year of a two-year budget plan (as did the 1993-94 budget at the time of its enactment). Accordingly, the Department of Finance developed projections of 1995-96 revenues and expenditures in order to determine the effects of 1994-95 budget decisions on the 1995-96 budget balance. Figure 4 includes the Administration's 1995-96 budget projections, based on the

Figure 4

1994-95 Budget Package
Estimated General Fund Condition[a]
1993-94 through 1995-96

(In Millions)

	1993-94	1994-95	Percent Change	1995-96	Percent Change
Prior-year balance	-$2,141	-$1,619		-$667	
Revenues and transfers	39,821	41,892	5.2%	45,442	8.5%
Total resources available	$37,680	$40,273		$44,775	
Expenditures	$39,299	$40,940	4.2%	$44,394	8.4%
Fund Balance	-$1,619	-$667		$381	
Reserve	-$1,971	-$1,019		$29	
Other obligations	$352	$352		$352	

[a] Details do not add to totals due to rounding.

adopted 1994-95 budget plan. As the figure shows, the Administration's plan projects a balanced budget in 1995-96, but with only a very small General Fund reserve of $29 million.

The Department of Finance based its 1995-96 revenue projection on its economic outlook for California and on existing tax law. The department's economic outlook calls for the state's economy to gain some momentum over the next two years. For example, the department projects 1995 California personal income growth of 6.1 percent and employment growth of 1.6 percent, compared to increases of 3.6 percent and 0.1 percent, respectively, in 1994. The revenue projections also recognize the expiration of the temporary 10 percent and 11 percent personal income tax brackets for high- income taxpayers at the end of 1995. The department's spending projection for 1995-96 essentially represents a baseline estimate. It funds estimated growth in program caseloads and school enrollments. It also incorporates adjustments for one-time savings or spending and for changes in costs required by existing law or contracts, such as debt service on state bonds. Most importantly, the department's 1995-96 budget projections include savings that were adopted or assumed for 1995-96 as part of the 1994-95 budget plan (in addition to continuation of most of the savings that begin in 1994-95). For example, the projections: (1) assume receipt of $2.6 billion of new federal immigrant funding in 1995-96; (2) include a savings of $390 million due to legislation that continues the suspension of the renters' tax credit; and (3) assume an $85 million revenue gain from federal legislation to allow the IRS to offset state tax liabilities against federal income tax refunds.

The department's projection indicates that General Fund spending will grow by 8.4 percent ($3.5 billion) in 1995-96. More than half of this spending increase is required to meet the state's funding obligation to schools and community colleges under Proposition 98, and to fund caseload and cost increases anticipated for health and welfare programs and the operation of correctional facilities. Other factors that contribute to increased spending in 1995-96 are the need to pay certain costs deferred in

1994-95, such as interest on cash borrowing, and the exhaustion of one-time funds used to temporarily reduce the state's employee retirement contributions.

Budget Plan Depends on $3.6 Billion Of Assumed Federal Funds

The two-year budget plan faces many risks. Some of these risks are inherent in any budget plan—for example the risk of lower revenues due to poorer economic performance than anticipated or the risk of additional costs to deal with natural disasters. The plan also depends on many specific savings assumptions in individual program areas, some of which may turn out to be overly optimistic due to court challenges, implementation delays, or estimating errors, for example. The risks in the budget plan are particularly significant due to the lack of any meaningful reserve. By far the most significant and riskiest assumption in the budget plan, however, is that the federal government will provide the state with a total of $3.6 billion of new federal funds for immigrant-related costs over the two-year period. At the time that this report was written, Congressional appropriations would provide less than $100 million of that amount.

CASH BORROWING PLAN TO FINANCE THE BUDGET

The state's General Fund ended 1993-94 with a cash deficit of about $5.2 billion. This cash deficit is $3.2 billion larger than the 1993-94 budget deficit of $2 billion. During the past four years of budget crises, a number of budget-balancing actions have worsened the state's cash position relative to its budget position. These actions include off-budget spending for loans to schools and budget accounting changes to accrue more revenues and fewer expenditures. Because the cash deficit has grown larger than the state's internal borrowing capacity (the amount that the General Fund can borrow from special funds), the state must borrow additional money from investors. In order to help finance the 1993-94 year-end cash deficit, for example, the state sold $3.2 billion of revenue anticipation warrants (RAWs) to investors last February to be repaid by December 1994.

Based on the adopted budget plan, cash-flow projections developed by the Department of Finance and the State Controller indicated a need for substantial external borrowing in order to finance state spending through 1995-96. The mechanisms for the borrowing plan that was developed to finance the budget plan were authorized by Ch 136/94 (SB 2123). The borrowing plan includes the following elements:

- *External borrowing.* The state sold a total of $7 billion of warrants and notes in July 1994. Of this amount, $4 billion was raised by selling RAWs that extend into 1995-96 (repayment due in April 1996). The remaining $3 billion was raised by selling revenue anticipation notes (RANs) for temporary cash needs within the 1994-95 fiscal year (repayment due in June 1995). The plan also calls for the sale of $3 billion of RANs in August 1995 to finance temporary cash needs within the 1995-96 fiscal year (repayment due in June 1996).

- *Credit enhancement for RAWs.* Since it reflects the budget plan, the cash management plan also depends on the assumption that the state will receive $3.6 billion of new federal funds. The riskiness of this assumption required the state to obtain a repayment guarantee from a syndicate of banks in order to enhance the marketability of the $4 billion of RAWs sold in July. The guarantee cost the state $31 million.

THE TRIGGER MECHANISM

An important feature of the 1994-95 budget plan is the adoption of a standby "trigger" mechanism that is intended to ensure that the two-year budget plan stays on track. Figure 5 (next pages) outlines the trigger process and also shows how that process coordinates with the borrowing plan. The trigger provisions are contained in Ch 135/94 (SB 1230). In essence, the trigger mechanism requires

Figure 5

General Fund "Trigger" Process Established by Ch 135/94 (SB 1230)

1994-95 Actions

Trigger Process	Borrowing Plan
July	
✧ 1994-95 budget enacted. ✧ Budget estimate of 1994-95 year-end cash deficit established by the State Controller for the RAW sale.	✦ State sold $4 billion of revenue anticipation warrants (RAWs) guaranteed by bank syndicate. Repayment due April 1996. ✦ State sold $3 billion of revenue anticipation notes (RANs). Repayment due June 1995.
November 15	
✧ **1994-95 Trigger:** State Controller reestimates year-end cash balance. Legislative Analyst provides input and reviews Controller's estimate. An increase of more than $430 million in the cash deficit over July budget estimate (additional cash shortfall) triggers subsequent actions.	
January 10	
✧ Governor presents 1995-96 budget and must propose legislation for spending cuts/revenue increases to eliminate any additional 1994-95 cash shortfall identified by the Controller in November.	
February 15	
✧ Deadline to enact legislation to eliminate any additional 1994-95 cash shortfall.	
February 20	
✧ **1994-95 Automatic Spending Cuts:** If legislation not enacted, Director of Finance makes automatic spending cuts to eliminate any additional 1994-95 cash shortfall.	
May—June	
✧ Governor updates 1995-96 budget proposal and cash projections. Controller reviews budget projections and identifies any 1995-96 cash shortfall (the amount by which the 1995-96 cash deficit exceeds borrowable funds.) ✧ Governor must propose legislation/budget changes to eliminate any 1995-96 cash shortfall.	
June	
✧ Enact 1995-96 budget. Budget must not result in any year-end cash shortfall.	✦ Repay 1994-95 RANs.

Figure 5 CONTINUED

General Fund "Trigger" Process Established by Ch 135/94 (SB 1230)

1995-96 Actions

	Trigger Process	Borrowing Plan
August		✦ Sell $3 billion of RANs due June 1996.
October 15	✧ **1995-96 Trigger:** Controller estimates 1995-96 General Fund cash condition with input and review by Legislative Analyst. A 1995-96 cash shortfall triggers subsequent actions.	
October 31	✧ Governor must propose legislation for spending cuts/ revenue increases to eliminate any 1995-96 cash shortfall identified by the Controller.	
December 1	✧ Deadline to enact legislation to eliminate any 1995-96 cash shortfall.	
December 5	✧ **1995-96 Automatic Spending Cuts:** If legislation not enacted, Director of Finance implements automatic spending cuts to eliminate 1995-96 cash shortfall.	
April		✦ Repay RAWs.
June		✦ Repay 1995-96 RANs.

automatic spending cuts to be implemented—absent corrective action by the Legislature and the Governor—if the state's anticipated year-end cash position worsens by more than $430 million in 1994-95, or if available cash projected for the end of 1995-96 falls short of the amount needed to repay external borrowing due at that time. These automatic spending cuts would be applied "across-the-board" to all General Fund spending programs except those protected by the state Constitution or federal law (primarily K-14 school funding). The trigger mechanism could be activated in either 1994-95 or 1995-96 if the state's cash position deteriorates and action to correct the problem does not occur by specific dates.

The assumption that the state will receive $3.6 billion of new federal funds presents the most significant risk in the budget plan. If, for example, the state does not receive these funds and there are no other changes to the budget plan, then—absent action to resolve the problem by the Legislature and the Governor—the 1994-95 trigger would require $333 million of spending cuts and the 1995-96 trigger would require additional spending cuts exceeding $1 billion.

Should the trigger be "pulled" in the current year (based on the Controller's November cash flow estimate), the Legislature will have until February 15, 1995, to take actions to avoid the imposition of automatic spending cuts this year. At the same time, the Legislature will be starting deliberations on the 1995-96 budget. Those budget deliberations will be the crucial period for the Legislature to address any estimated imbalances in next year's budget in order to keep the state's two-year borrowing plan on track and to avoid significant automatic cuts in 1995-96.

Chapter 2

State Expenditures

In this chapter, we discuss total state spending from all funds under the 1994-95 budget plan and year-to-year changes in these spending amounts. We show how total spending is divided among the major program areas in 1994-95 and discuss 1994-95 spending in the context of spending trends over the past ten years.

TOTAL STATE SPENDING

Figure 1 (next page) shows the total amount of state expenditures under the adopted budget plan in 1994-95 and compares it to total state spending in the previous two years. The figure includes spending from the General Fund, special funds, and selected bond funds. We have added two adjustments to the spending amounts shown in the Administration's budget summary documents. These adjustments better reflect actual state spending levels and make spending amounts more comparable from year to year. The first adjustment adds to General Fund expenditures the net spending for off-budget Proposition 98 loans to schools and community colleges. The second adjustment adds to the special fund spending totals the amount of spending from the Local Public Safety Fund (supported by the half-cent state sales tax allocated to local governments under Proposition 172). The administration excludes these allocations from its budget spending totals, but they are proceeds of state taxes and similar to other dedicated special funds that are shown in the budget totals. We therefore use these adjusted figures in our discussions below.

State Expenditures

Figure 1

The 1994 Budget Act
Total State Expenditures

(In Millions)

Fund	Actual 1992-93	Estimated 1993-94	Enacted 1994-95	Change from 1993-94 Amount	Change from 1993-94 Percent
General Fund					
Budgeted spending	$40,923	$39,299	$40,940		
Add net Proposition 98 loans	80	596	—		
Adjusted spending	$41,003	$39,895	$40,940	$1,045	2.6%
Special funds					
Budgeted spending	$11,652	$12,965	$12,296		
Local Public SafetyFund	—	689	1,480		
Adjusted spending	$11,652	$13,654	$13,776	$122	0.9%
Selected bond funds	$3,880	$2,028	$2,899	$871	42.9%
Total state expenditures	$56,535	$55,577	$57,615	$2,038	3.7%

Total 1994-95 budgeted state spending amounts to $57.6 billion, an increase of $2 billion (3.7 percent) over total spending in 1993-94. General Fund spending increases by $1.0 billion (2.6 percent) compared with 1993-94, and special fund spending increases by $122 million (0.9 percent). Slow growth of special fund expenditures reflects slow growth in special fund revenues sources, as well as transfers of some special fund revenues to the General Fund that were adopted in the budget plan. Spending from selected bond funds increases sharply, by $871 million (43 percent), due to the planned expenditure of funds for local school facilities from a new bond act that requires legislative authorization and voter approval in November.

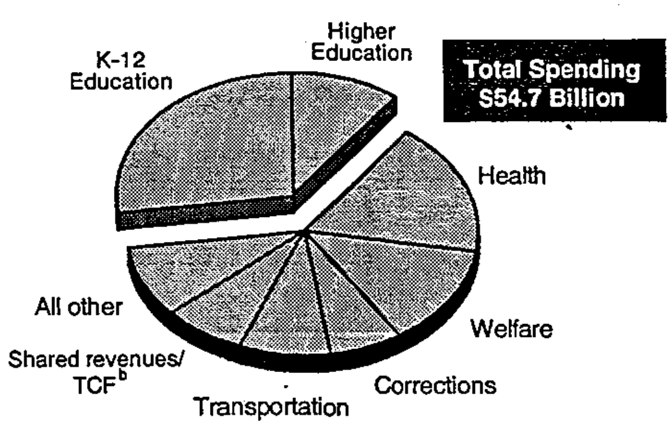
Most of the state's expenditures are from the General Fund. In 1994-95, General Fund expenditures will amount to $40.9 billion, 71 percent of total state expenditures.

MAJOR EXPENDITURES BY PROGRAM AREA

Budgeted state spending from the General Fund and special funds totals $54.7 billion in 1994-95. Figure 2 shows how this total spending is divided among the major program areas. As the figure shows, the largest share of state spending is for education programs (37 percent of total state spending). Health and welfare programs account for the next largest share of total spending (31 percent). Transportation programs and youth and adult correctional programs are the other major state spending program areas, with 8.4 percent and 6.8 percent of total spending, respectively. As shown in the figure, shared revenues and other general aid to local governments accounts for 7.4 percent of total state spending.

Figure 2

1994 Budget Act
Total State Spending by Major Program[a]



[a] Excludes bond funds and federal funds.
[b] Includes local subventions of vehicle license fees, Local Public Safety Fund and Trial Court Funding grants.

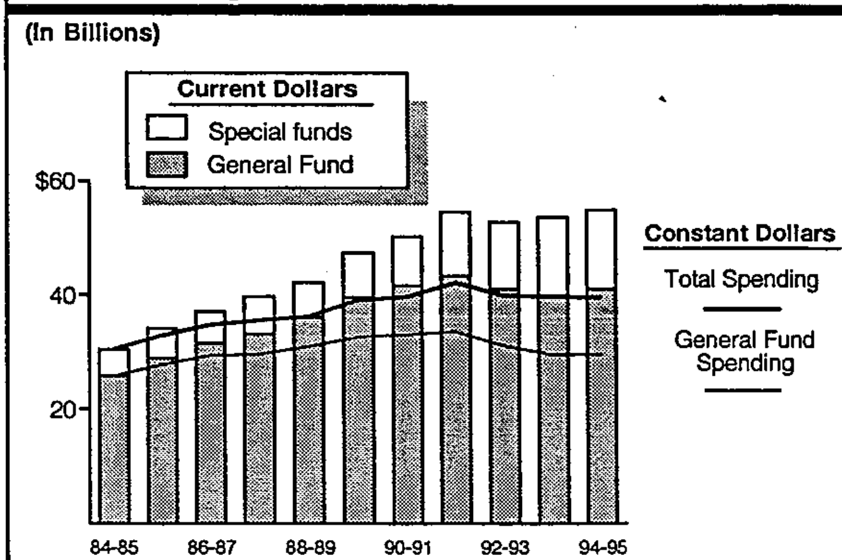
STATE SPENDING TRENDS SINCE 1984-85

To put this year's budget into perspective, Figure 3 shows state spending trends since 1984-85. The figure includes state expenditures from the General Fund and special funds in both "current dollars" (amounts as they appear in the budget) and "constant dollars" (current dollars adjusted for the effects of inflation). The use of constant dollars allows comparisons of the "purchasing power" of state spending over time.

As Figure 3 shows, total spending grew rapidly from 1984-85 to 1991-92, when the annual spending growth rate averaged 8.7 percent, and 4.8 percent after adjusting for inflation. Since 1991-92, however, total spending in current dollars has hardly grown, in large part due to the state's economic problems that have constrained revenues. After adjusting for inflation, total spending will decline by about 6 percent in 1994-95 compared with 1991-92.

Figure 3

State Spending[a]
Current and Constant Dollars
1984-85 Through 1994-95



[a] Excludes bond funds and federal funds.

Spending from special funds has grown more than twice as fast as General Fund spending during the period covered in Figure 3. In 1984-85, spending from special funds equaled about 18 percent of General Fund expenditures. In 1994-95, however, spending from special funds will equal 34 percent of General Fund expenditures, according to the budget plan.

The reasons for the growth in the share of state spending financed from special funds fall into two general categories. First, a variety of actions have increased existing special fund revenues and created new special programs with dedicated funding sources. For example, Proposition 111 authorized increased gasoline tax rates to fund transportation programs, and Proposition 99 added a surtax on cigarettes and tobacco products dedicated primarily to health programs. Also, many new fee-supported programs have been established in recent years (for example, the beverage container recycling program). The second major explanation for the growth in the special fund share of state spending is that recent actions have shifted—either directly or indirectly—traditional General Fund costs to special funds. The 1991-92 budget package added a half-cent to the state sales tax and dedicated the revenue to local governments in order to finance certain health and welfare costs shifted from the state to them. The 1993-94 budget package and Proposition 172 dedicated an additional half cent of the state sales tax to the Local Public Safety Fund, in large part to mitigate a shift of property taxes from local governments to schools in order to offset state school funding.

In contrast with recent trends, however, the 1994-95 budget plan does not include any significant expansion of special fund financing. On the contrary, spending from special funds will grow more slowly than General Fund spending under the 1994-95 budget plan (0.9 percent versus 2.6 percent).

Chapter 3

Major Features Of the 1994 Budget Plan

This chapter provides a description of the major features of the 1994 budget plan. It includes individual discussions of the budget actions within each of the major program areas, as well as discussions of the budget actions that affect local governments and special fund programs.

PROPOSITION 98 EDUCATION

In this section, we describe the major features of the budget package as they relate to the Proposition 98 minimum funding guarantee and K-12 schools. Most of the package's education provisions are contained in the education trailer bill—Ch 153/94 (AB 2480, Vasconcellos).

Proposition 98 Provisions

Proposition 98 provides K-12 schools and community colleges a guaranteed minimum level of state funding. The Proposition 98 portion of the budget package:

- Provides overall K-12 funding of $4,199 per pupil in 1994-95. The effective level of funding, however, is $4,217—the same level funded in the 1993 budget package—due to a reduction in school district costs for employee retirement benefits.

- Fully funds enrollment growth for K-12 general purposes in 1994-95 and 1995-96, and provides a cost-of-living adjustment (COLA) in 1995-96 if funds are available.

- Increases Proposition 98 funding for the community colleges by $115 million.

The major elements of the budget package are discussed below.

Proposition 98 Funding. The budget provides $24.9 billion ($14.4 billion General Fund) in Proposition 98 funding for K-14 programs in 1994-95. This exceeds the amount provided in 1993-94—$24.3 billion ($13.8 billion General Fund)—by $532 million. General Fund spending (excluding loan funds) for Proposition 98 programs exceeded the Proposition 98 minimum funding guarantee by $483 million in 1993-94. However, General Fund Proposition 98 funding for 1994-95 essentially equals the minimum funding guarantee (the amount is $6 million over the minimum guarantee).

Figure 1 summarizes, for 1993-94 and 1994-95, the effect of the budget package on the three major recipients of Proposition 98 funding—schools, community colleges, and other educational agencies. As the figure shows, on a cash basis, the funding level for K-12 schools was $4,225 per pupil in 1993-94, slightly more than the $4,217 level provided in the 1993 budget package. (This resulted from a lower-than-expected number of K-12 students statewide.) The 1994-95 funding level for K-12 schools is $4,199 per pupil. The 1994-95 budget, however, effectively provides the same level of funding for classroom needs—$4,217 per pupil. This is because school employers will experience reductions in their contributions for employee retirement benefits that offset the funding reduction.

The 1994 Budget Act provides the community colleges $115 million more from Proposition 98 sources than the colleges received during 1993-94. We discuss budgetary actions affecting the community colleges in the higher education section of this chapter.

Figure 1

Proposition 98 Programs 1994 Budget Act and Education Trailer Bill

(Funding In Millions)

	1993-94	1994-95
K-12 programs		
State appropriations	$12,827	$13,178
Local taxes	8,415	8,892
Recapture	-190	—
Loan	609	—
Adjusted cash totals	*$21,660*	*$22,069*
Average daily attendance	5,127,018	5,256,627
Amount per pupil	$4,225	$4,217[a]
Community colleges		
State appropriations	$936	$1,104
Local taxes	1,293	1,416
Loan	178	—
Fees	195	197
Adjusted cash totals	*$2,602*	*$2,717*
Other agencies	$77	$84
Total Proposition 98		
State appropriations	$13,840	$14,366
Local taxes	9,708	10,308
Recapture	-190	—
Loan	787	—
Fees	195	197
Adjusted cash totals	*$24,338*	*$24,870*
Change from January budget		**-$284**
Change from 1993-94		**$532**

[a] Effective level after adjusting for retirement savings.

Property Tax Shifts. Chapter 155, Statutes of 1994 (AB 860, Pringle), requires county auditors to increase the amount of property taxes transferred from local governments to school and community college districts. By increasing the amount of property taxes allocated to schools and community colleges, this action reduces the amount that must be provided from the state General Fund under Proposition 98. Technical problems in the 1993 legislation that increased the property tax shifts had resulted in a smaller-than-expected transfer to schools and community colleges, and consequently required the state to provide additional funds in order to achieve the desired level of K-14 spending. The 1994 legislation corrects the problem by increasing the transfer for 1994-95 and subsequent years, and recaptures the additional 1993-94 revenues from counties over a two-year period.

K-12 Program Impacts

Apportionments. The budget provides a total of $8.3 billion from the General Fund for general-purpose apportionments (known as revenue limits) to school districts and county offices of education. Adding property tax revenues available to these entities, the budget provides a total of $16.9 billion in general-purpose funding. This represents a reduction of $23 per pupil from the amount provided in 1993-94. Despite this reduction in overall funding, the budget provides substantially the same level of support for classroom needs. Again, this is because school employers will experience reductions in retirement-related costs. The cost reductions for employee retirement benefits—a savings of $100 million statewide—are due to a 1994-95 reduction in Public Employees' Retirement System (PERS) employer contribution rates. About three-quarters of the rate reduction is one-time in nature. The education trailer bill includes a provision that increases state school funding in 1995-96 to offset the anticipated restoration of PERS rates to a higher level.

The trailer bill also specifies that state K-12 apportionments shall receive funding for enrollment growth and a COLA in 1995-96. However, the trailer bill expresses legislative intent to reduce the COLA, if granting a full COLA would (1) increase K-14 spending above the 1995-96 Proposition 98 minimum guarantee or (2) leave insufficient "room" within the minimum guarantee to maintain categorical program funding at least at the 1994-95 level. Under current budgetary assumptions, the COLA could be up to $270 million (about 1 percent).

Categorical Programs. The Legislature made a number of relatively minor changes to the categorical program budget for 1994-95. The budget continues the use of a single appropriation (the "mega-item") to fund most categorical programs. Funding for special education programs was removed from this item, however, and separately appropriated. With this change, the mega-item contains $3 billion for 38 individual programs.

The budget expands local flexibility over the use of mega-item funds. Specifically, it authorizes schools to redirect up to 10 percent of funds allocated to any specific program to other categorical programs funded under the mega-item, provided that no program may be increased by more than 15 percent. For comparison, the 1993 Budget Act authorized schools to redirect up to 5 percent of funds provided to a specific program, provided that no program could be increased above its 1991-92 funding level. The 1994-95 budget also permits schools or districts to use this flexibility to initiate a Healthy Start program or a conflict resolution program using mega-item funds.

The budget continues categorical program funding levels at about the same level as provided in 1993-94. Only three programs received significant additional funds. The largest increase went to special education programs ($53.4 million, or 3.3 percent) to recognize growth in the number of special education pupils. Growth funding also was provided to the Economic Impact Aid program ($29.9 million, or 10 percent), which funds services for limited-English-proficient pupils and for disadvantaged pupils who need additional instructional time or services to succeed in school. Finally, the budget contains a $9.1 million (8.8 percent) increase in funding for instructional materials in grades kindergarten through eight.

The only program experiencing a reduction in funding is the state assessment program, renamed the California Comprehensive Testing Program. Although the Legislature included $27.6 million in the budget for the program, the Governor vetoed these funds. In his veto message, the Governor indicated his intention to approve funding in subsequent legislation. At the time this analysis was prepared, no such legislation had been enacted.

The Two-Year Budget Outlook

Under current budgetary assumptions, the Proposition 98 guarantee for 1995-96 will exceed the amount necessary to fund enrollment growth in K-14 programs by about $540 million. Existing law provides that half of this amount be counted towards repayment of a total of $1.8 billion of off-budget Proposition 98 loans made to schools and community colleges in 1992-93 and 1993-94. (Please see *State Spending Plan for 1993-94*, p. 37, for a discussion of these loans.) Schools and community colleges would receive the remaining $270 million, which would be sufficient to fund about a 1 percent cost-of-living increase for K-14 programs.

This projection for 1995-96 assumes that the state will appeal and obtain a reversal of a superior court judgment in the *CTA v. Gould* lawsuit. That decision would: (1) nullify requirements that the schools and community colleges repay the state for the 1992-93 and 1993-94 Proposition 98 loans and (2) require the loan funds to be counted in the funding base that is used to calculate the Proposition 98 minimum funding guarantee. If the state is unsuccessful in its appeal:

- ❖ The state could be required to provide about $600 million more than the amount budgeted for K-14 programs in 1994-95.

- ❖ In 1995-96 the state could be required to budget about $600 million more for K-14 programs than would be necessary under current assumptions. The amount the state would actually provide to K-14 programs on a cash basis, however, could increase by $870 million over current assumptions ($600 million increase in Proposition 98 spending plus $270 million no longer retained by the state as a loan repayment).

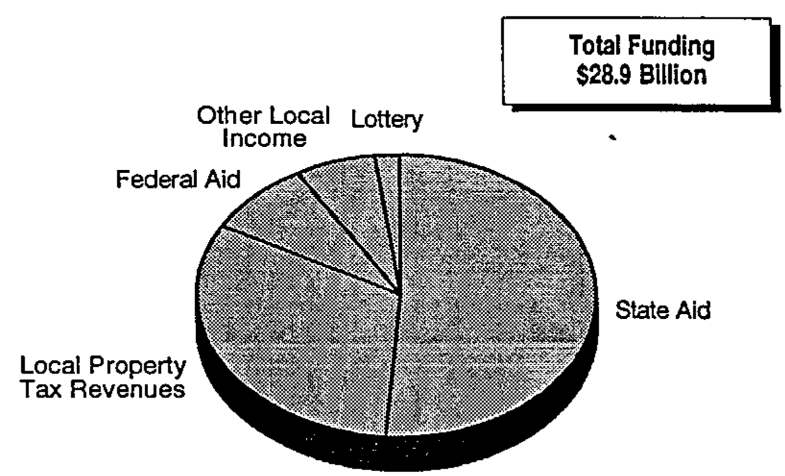
- ❖ The 1994-95 General Fund deficit would increase by about $1.8 billion on a budgetary basis to recognize the prior loan expenditures. However, this would have no effect on the state's cash situation, and would not increase the amount of borrowing assumed in the budget.

K-12 Funding From All Sources

In 1994-95, funding available for expenditure on K-12 education from all sources—including both Proposition 98 and non-Proposition 98 funding—will total $28.9 billion (see Figure 2). This amount represents an increase of $890 million, or 3.2 percent, over what was available in 1993-94. Of the $28.9 billion in total funding, 90 percent is from state and local sources, including 76 percent provided under Proposition 98 and 14 percent from non-Proposition 98 sources. Non-Proposition 98 funding from state and local sources includes primarily (1) state General Fund payments to the State Teachers' Retirement System and for debt service on school construction bonds and (2) local revenues from such sources as developer fees, sales of equipment and supplies, cafeteria revenues, and interest income.

Figure 2

**The 1994 Budget Act
Sources of K-12 Education Funding[a]**



[a] Excludes funding for library programs and the proceeds of state general obligation bond issues for school facilities aid. Includes, however, General Fund payments for debt service on these bonds.

Other major sources of funding are:

- Federal aid—$2.4 billion (8.3 percent of total funding).
- Lottery revenues—$541 million (1.9 percent of total funding).

Figures 3 and 4 show total K-12 funding per unit of average daily attendance (ADA)—in both current and "constant" (inflation-adjusted) dollars—for the years 1985-86 through 1994-95. They show that per-ADA funding in inflation-adjusted dollars has decreased by 0.5 percent during the ten-year period.

Figure 3

K-12 Education Funding Per ADA Current and Constant Dollars 1985-86 Through 1994-95

(In Thousands)

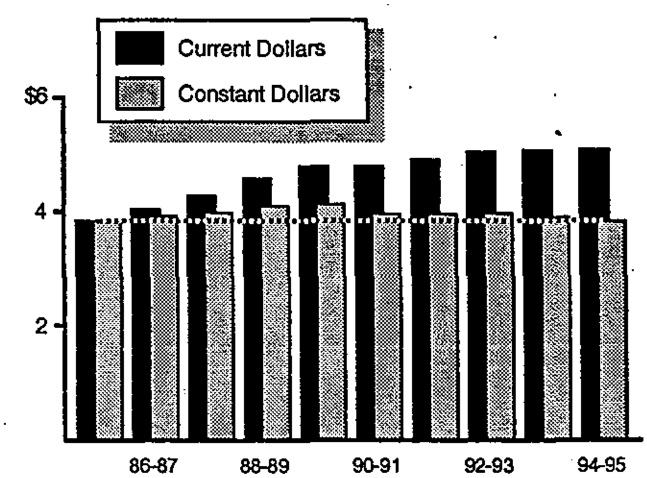


Figure 4

K-12 Education Funding
By Funding Source and Per ADA
Current and Constant Dollars
1985-86 Through 1994-95

	Funding (Millions)								
	State Aid	Local Property Tax Levies	Federal Aid	Other Local Income	Lottery	Total Funding	ADA (in thousands)	Current Dollars Per ADA	Constant Dollars Per ADA
1985-86	$10,805	$3,596	$1,126	$1,003	$556	$17,085	4,470	$3,822	$3,822
1986-87	12,174	3,804	1,167	979	411	18,535	4,612	4,019	3,892
1987-88	12,486	4,108	1,345	1,592	590	20,121	4,723	4,260	3,960
1988-89	13,568	4,466	1,517	1,767	911	22,229	4,872	4,563	4,070
1989-90	15,013	4,797	1,634	1,943	781	24,168	5,060	4,777	4,103
1990-91	15,770	5,252	1,770	1,770	602	25,164	5,273	4,772	3,932
1991-92	16,510	5,642	2,041	1,845	432	26,470	5,416	4,887	3,934
1992-93	16,255	6,841	2,257	1,786	479	27,618	5,495	5,026	3,946
1993-94 (Estimated)	14,382	8,930	2,375	1,800	541	28,028	5,558	5,043	3,873
1994-95 (Budgeted)	14,714	9,470	2,395	1,800	541	28,920	5,702	5,072	3,803
Cumulative Change									
Amount	$3,909	$5,875	$1,269	$797	-$15	$11,835	1,232	$1,250	-$19
Percent	36.2%	163.4%	112.7%	79.5%	-2.7%	69.3%	27.6%	32.7%	-0.5%

HIGHER EDUCATION

Figure 5 (next page) shows funding for each segment of higher education for 1993-94 and 1994-95 from selected fund sources. The figure shows that the budget increases for the higher education segments range from about 3 to 9 percent. Of the three major segments, the California State University experienced the largest increase (6.3 percent). Funding support for the University of California increased by 4.3 percent, while community college support increased by 2.9 percent.

Figure 5

Higher Education Budget Summary
Selected Funding Sources
1993-94 and 1994-95

(Dollars in Millions)

	Estimated 1993-94	Budget 1994-95	Change From 1993-94 Amount	Change From 1993-94 Percent
University of California				
General Fund	$1,793.2	$1,831.7	$38.5	2.1%
Student fee offset[a]	—	37.9	37.9	—[b]
Totals	**$1,793.2**	**$1,869.6**	**$76.4**	**4.3%**
California State University				
General Fund	$1,488.3	$1,553.2	$64.9	4.4%
Student fee offset[a]	—	29.5	29.5	—[b]
Totals	**$1,488.3**	**$1,582.7**	**$94.4**	**6.3%**
California Community Colleges[c]				
General Fund (Proposition 98)	$936.0	$1,104.1	$168.1	18.0%
General Fund (Non-Proposition 98)	41.3	3.0	-38.3	-92.7
Property taxes	1,292.9	1,416.0	123.1	9.5
Loan	178.0	—	-178.0	-100.0
Student fee revenues	194.8	196.8	2.0	1.0
Totals	**$2,643.0**	**$2,719.9**	**$76.9**	**2.9%**
Hastings College of the Law				
General Fund	$11.5	$11.8	$0.3	2.7%
Student fee offset[a]	—	0.8	0.8	—[b]
Totals	**$11.5**	**$12.6**	**1.1**	**9.4%**
California Maritime Academy				
General Fund	$6.4	$6.8	$0.4	6.0%
Student fee offset[a]	—	—[d]	—[d]	—[b]
Totals	**$6.4**	**$6.8**	**$0.4**	**6.7%**
Student Aid Commission (Cal Grants)				
General Fund	$207.6	$226.2	$18.6	9.0%

[a] The offset amount is the net increase in student fee revenues from 1993-94 to 1994-95, after allowance for financial aid for needy students.
[b] Not a meaningful figure.
[c] Local assistance only.
[d] Less than $50,000.

Figure 6 shows student fee levels for each segment from 1992-93 through 1994-95. Below, we highlight the significant budget actions in each of the segments of higher education.

The University of California (UC)

The 1994 Budget Act provides an increase of $38.5 million (2.1 percent) in General Fund support for the UC in 1994-95 compared to 1993-94. As part of its budget plan for the UC, the Legislature approved (1) a general student fee increase of $345 (10 percent) in 1994-95 and (2) an additional fee increase of $600 (17 percent) for students enrolled in professional programs (medicine, dentistry, veterinary medicine, law, and business). (The UC Regents had proposed a general fee increase of $620, or 18 percent, and an additional fee increase of $2,000 for new students in professional programs.) Including funds available as a result of the fee increases, the UC received an increase in 1994-95 of $76.4 million, or 4.3 percent, above 1993-94.

Figure 6

Higher Education Student Fees 1992-93 Through 1994-95

	Annual Fee Per Full Time Student			Change From 1993-94	
	1992-93	1993-94	1994-95	Amount	Percent
University of California					
Undergraduate/graduate	$2,824	$3,454	$3,799	$345	10%
Graduate professional[a]	2,824	3,454	4,399	945	27
Medicine/law	3,200	3,830	4,775	945	25
California State University	1,308	1,440	1,584	144	10
California Community Colleges[b]	300	390	390	—	—
Hastings College of the Law	3,200	3,830	4,775	945	25
California Maritime Academy	1,370	1,507	1,658	151	10

[a] Dentistry, veterinary medicine, and business.
[b] Excludes BA degree holders, who are charged $50 per credit unit. Fees for 1992-93 are as of January 1, 1993.

Major Features of the 1994 Budget Plan

In its plan, the Legislature provided (1) a 3 percent cost-of-living increase for faculty and staff beginning on October 1, 1994; (2) merit salary increases for faculty and staff; and (3) $25 million financed from new lease-payment bonds for priority-one deferred maintenance projects. The Legislature also (1) redirected $18 million from teaching hospital revenues to fund critical campus needs (instructional equipment replacement, deferred maintenance, and library books) and (2) reduced to $4 million the amount provided from Proposition 99 cigarette and tobacco taxes for health-related research projects (compared with 1993-94 funding of $26.3 million).

We anticipate that UC student enrollment will decline slightly in 1994-95 to match slight declines in the Master Plan eligible student population. The Legislature expressed its intent in the *Supplemental Report of the 1994 Budget Act* for the UC to continue to accept all applicants who are fully eligible under the Master Plan in 1994-95 and 1995-96.

The Legislature also expressed its intent in the supplemental report that the UC:

- Increase its budgeted student/faculty ratio from 17.6 to 18.7 by 1995-96.

- Establish "four-year degree pledge" programs at all campuses by 1995-96. In these programs, a campus pledges to provide specialized advice to students and guarantees that participating students will be able to take courses needed to graduate in four years. The students, in turn, agree to meet with their advisors and to follow the agreed upon courses of study.

- Increase fees for students enrolled in professional programs over the next six years to the average of fees charged by comparable public universities.

- ❖ Achieve specific objectives with respect to increasing the proportion of medical residents enrolled in primary care and family practice programs.

- ❖ Limit salary increases for UC executives in 1994-95 to an average of no more than one-quarter of the total percentage increase granted for faculty and staff. The report acknowledges the UC's commitment to the Legislature that the UC will not provide any salary or merit increases to its top 22 executives in 1994-95.

The California State University (CSU)

The 1994 Budget Act provides an increase of $64.9 million (4.4 percent) in General Fund support for the CSU in 1994-95 compared to 1993-94. As part of its budget plan for the CSU, the Legislature adopted a student fee increase of $144 (10 percent) in 1994-95. (The CSU Trustees had proposed a fee increase of $342, or 24 percent, for the budget year.) Including funds available as a result of the fee increase, the CSU will experience an increase of $94.4 million, or 6.3 percent, above 1993-94 funding.

The Legislature's budget plan for CSU also provides (1) $11.3 million for an enrollment increase of 2,500 full-time-equivalent (FTE) students, for a total budgeted enrollment level of 250,000 FTE students (this increase partially offsets recent significant enrollment declines); (2) an augmentation of $9.3 million for CSU's proposed new campus at Fort Ord in Monterey County; (3) funding for quality improvements ($6 million); and (4) $17 million financed from new lease-payment bonds for priority-one deferred maintenance projects.

The Legislature also expressed its intent in the *Supplemental Report of the 1994 Budget Act* that the CSU:

- ❖ Establish four-year degree pledge programs on all campuses by 1995-96.

- ❖ Provide no salary increases for executives who received an increase in 1993-94 and limit the salary increases for the remaining executives.

- Speed up enrollment growth to achieve economies of scale at the Fort Ord campus to reduce the projected higher cost per student at that campus and to reduce the need to build facilities at existing campuses.

- Fund from existing resources and with no related reduction in enrollments or increases in student fees, the future full-year annualization cost of any employee compensation increases granted for a portion of 1994-95.

California Community Colleges

The 1994 budget package increases funding for community colleges local assistance by $76.9 million (2.9 percent) compared to the amount actually received in 1993-94. The effect of this increase essentially is to restore in 1994-95 the intended level of funding for 1993-94. Specifically, in 1993-94, the community colleges received $71.5 million less than the total amount anticipated in the 1993-94 budget plan, primarily due to property tax and fee revenue shortfalls. Thus, the 1994-95 budget represents a $5.4 million, or 0.2 percent, increase compared to the 1993-94 budgeted level.

The Legislature maintained community college fees at the 1993-94 level of $390 per full-time student, or $13 per credit unit. The Governor had proposed a fee increase of $7 per credit unit (54 percent). The Legislature approved the administration's proposed reduction of $15.2 million related to declines in the enrollment of BA degree holders. The Legislature also recognized $14.5 million in savings to the community colleges due to a reduction in their contribution rates to the PERS for employee retirement benefits. The PERS savings were used to reduce General Fund costs ($9.1 million) and to augment basic skills and instructional equipment funds ($5.4 million). The Legislature provided $18.5 million to partially backfill the 1993-94 property tax shortfall.

The Legislature expressed its intent in the *Supplemental Report of the 1994 Budget Act* that:

- The budget provides for a state-funded FTE student enrollment of 869,590.

- The state-funded enrollment level shall not be reduced to reflect the lack of a cost-of-living adjustment.

- The Chancellor's Office shall conduct annual program reviews of categorical programs.

Hastings College of the Law

The budget provides $1.1 million (9.4 percent) more in overall support for Hastings in 1994-95 than in 1993-94. Fees at Hastings are set at the same level as those charged to law students at the UC. Enrollment at Hastings will be approximately 1,220 students in 1994-95, which is about the same number as in 1993-94.

California Maritime Academy (CMA)

The budget provides $431,000 (6.7 percent) more in overall support for the CMA in 1994-95 than in 1993-94. Enrollment at the CMA will be approximately 475 students in 1994-95, which is about the same level as 1993-94.

Student Aid Commission (SAC)

Figure 5 shows an increase of $18.6 million (9 percent) in Cal Grant funding, consisting of $10.2 million to offset the impact of the 10 percent undergraduate fee increases at the UC and CSU, and $8.4 million to reflect higher costs related to increased student retention and other factors. The Legislature expressed its intent in the *Supplemental Report of the 1994 Budget Act* for the SAC to report on its plans for addressing issues related to (1) the commission's changing role in light of significant federal financial aid changes and (2) serious and fundamental concerns about the long-term viability of the automated Financial Aid Processing System.

HEALTH AND WELFARE

In this section, we describe the major features of the health and welfare funding in the budget package. The 1994-95 budget for health and welfare programs includes $14 billion from the General Fund. This represents an increase of $445 million, or 3.3 percent, over estimated General Fund spending for these programs in 1993-94.

Anticipated health and welfare caseloads will grow more rapidly—in the range of 4 percent to 6 percent—than General Fund spending. However, the cost of caseload increases is partially offset by additional federal funds, a variety of savings actions adopted as part of the 1994-95 budget plan, and the realization of full-year savings in 1994-95 from actions approved in 1993-94.

Figure 7 shows the major General Fund savings in these programs that were adopted in the 1994-95 budget.

Medi-Cal Program

The California Medical Assistance (Medi-Cal) Program provides health care services to public assistance recipients and other qualified persons who cannot afford to pay for these services. The federal government provides over $9 billion for the program, and the budget appropriates $6 billion in matching funds from the state General Fund in 1994-95. This represents an increase of 4 percent over General Fund expenditures in 1993-94.

Services to Undocumented Persons. The budget assumes action by Congress to increase federal funding to *fully* offset the state's share of costs for emergency health services provided to undocumented persons, rather than the 50 percent funding California receives under current law. The budget assumes that the state will receive $296.2 million as a result of such action in 1994-95. At the time that this report was prepared, none of these additional funds had been requested by the President or included in pending federal budget legislation.

Federal Funds for County Administration and Case Management. The budget assumes a substantial increase in federal funds to

Figure 7

**Health and Welfare Programs
Major General Fund Savings
1994-95 Budget**

(In Millions)

Program/Issue	Savings
Medi-Cal	
Assume federal funds for services to undocumented persons	$296.2
Adopt state share of federal case management/county administration funds	200.0
Increase state share of disproportionate share hospital payments	85.0
Reduce drug costs	62.1
Assume federal funds for refugee services	45.9
Assume no net increase in hospital inpatient reimbursement rates	45.0
Bar sponsored aliens from eligibility	22.0
Reduce prepaid health plan rates	18.0
AFDC	
Reduce grants 2.3 percent	56.3
Assume federal funds for refugee services	44.7
Fund GAIN from Employment Training Fund	20.0
Bar sponsored aliens from eligibility	18.1
SSI/SSP	
Reduce grants 2.3 percent	41.6
Assume federal funds for refugee services	22.2
Obtain Medicaid match for personal care services	15.0
DDS—Regional Centers	
Unallocated reduction	20.0

reimburse counties for administrative and case management services (including activities such as outreach and application assistance) provided to Medi-Cal beneficiaries. Under this program, Medi-Cal uses funds transferred from counties and matching federal revenues to make supplemental payments to counties for these services, based on claims submitted by counties. The budget estimates that the amount of county claims, and therefore the supplemental payments, will increase from an estimated $169 million in 1992-93 to a two-year total of about $1.3 billion in 1993-94 and 1994-95. The budget provides for the state to retain a portion of these revenues to offset General Fund support for the Medi-Cal Program. Although the actual amount of supplemental payments is subject to federal review and approval, the budget fixes the state share at $200 million for 1994-95, regardless of the amount of supplemental payments ultimately provided to counties.

Federal Funds for Disproportionate Share Hospitals. Under the disproportionate share program, the state uses funds transferred from counties, special districts, and the University of California—together with matching federal revenues—to make supplemental payments to hospitals to offset the burden of uncompensated medical care (for non-Medi-Cal patients). Most of the payments are made to county-operated facilities. The state retains a portion of the county funds to help finance the regular Medi-Cal Program, and the budget increases this state share, resulting in General Fund savings of $85 million for 1994-95. This action results in a corresponding reduction in the net proceeds of the disproportionate share program for counties, special districts, and University of California hospitals.

Hospital Payment Reductions. The California Medical Assistance Commission negotiates reimbursement rates for hospital inpatient services provided to Medi-Cal beneficiaries. The budget assumes that there will be no net increase in the negotiated reimbursement rates for 1994-95, for a savings of $45 million.

Prescription Drug Program Savings. The budget makes a number of changes to the Medi-Cal prescription drug program. Currently, the Department of Health Services negotiates with pharmaceutical manufacturers for rebates on their products. The budget requires all manufacturers to provide a minimum 10 percent rebate for a savings of $42.8 million annually. In addition, the budget limits the number of prescriptions that may be provided to Medi-Cal beneficiaries to six per month ($13 million savings), and reduces the amount Medi-Cal reimburses pharmacists by 50 cents per prescription ($6.3 million savings).

Managed Care. The budget reduces reimbursement rates to privately operated health insurance plans that provide "managed care" services to Medi-Cal beneficiaries. The budget requires that the plans be reimbursed at no more than 97 percent of the amount Medi-Cal would otherwise pay to provide health care to these beneficiaries through the traditional "fee-for-service" system. This action is estimated to result in savings of $18 million in 1994-95. In addition, the budget implements contracting for dental services beginning in 1995-96, which is anticipated to result in future savings of $80 million annually.

Other Medi-Cal Actions. In addition to the actions described above, the 1994-95 budget package:

- Retains prenatal benefits for undocumented women and retains optional benefits, such as adult dental care. The Governor proposed to eliminate these benefits.

- Includes an "asset waiver." Specifically, implementing budget legislation expands Medi-Cal by allowing pregnant women with incomes of up to 200 percent of the federal poverty level to receive Medi-Cal services even if they have savings or other assets in excess of the usual Medi-Cal limit.

- Expands funding for tuberculosis prevention and treatment.

- Expands efforts to identify individuals entering the U.S. at the Mexican border who have fraudulently received Medi-Cal benefits.

Refugees and Sponsored Aliens

The budget reflects savings in various health and welfare programs as a result of assumed federal action regarding refugees and "sponsored aliens."

Refugees. The budget assumes a total of $113 million in additional federal funds to fully offset the state costs of providing services to refugees through the Medi-Cal, Aid to Families with Dependent Children (AFDC), and Supplemental Security Income/State Supplementary (SSI/SSP) programs for the first three years of residence. Currently, California receives funding to fully offset the cost of services provided to certain refugees for approximately 8 months, and 50 percent federal funding for the cost of services provided to other refugees, irrespective of their length of residency. At the time that this report was prepared, none of these additional funds had been requested by the President or included in pending federal budget legislation.

Sponsored Aliens. The budget assumes passage of federal legislation that will prevent individuals who legally enter this country under "sponsorship" by a U.S. citizen from receiving Medi-Cal or AFDC benefits for five years. Such legislation would result in annual savings of $22 million in the Medi-Cal Program and $18 million for the AFDC Program. The President's welfare reform proposal (currently before Congress) would partially achieve these savings by: (1) extending from three to five years the period during which the sponsors' income would be counted when determining eligibility and grant levels in the AFDC Program, and (2) conforming Medicaid eligibility for certain immigrants to the more restrictive criteria in the Food Stamps Program.

Proposition 99 Funding Reauthorized

Chapter 195, Statutes of 1994 (AB 816, Isenberg), reauthorizes for two additional years the expenditure of tobacco tax revenues received under Proposition 99—the Tobacco Tax and Health Protection Act of 1988. Chapter 195, the Budget Act, and other legislation appropriate a total of $450 million of these revenues for various health, education, and natural resources programs in 1994-95. The reauthorization act also provides that $169 million in

Proposition 99 funding for the following programs shall be protected from any reductions in the event that revenues fall short of the projected amounts: Medi-Cal perinatal services, the County Medical Services Program, the Child Health and Disability Prevention Program, the Access for Infants and Mothers Program, the Major Risk Medical Insurance Program, and the health education media campaign.

Battered Women Protection Act

The Budget Act appropriates $11.5 million to the Department of Health Services (DHS) and $3.5 million to the Department of Justice to establish a new domestic violence program. Pursuant to Ch 140/94 (AB 167, B. Friedman), the DHS will disseminate grants to existing shelters for battered women and to establish new shelters. That legislation stated the Legislature's intent to continue the same level of funding for these programs in 1995-96.

Aid to Families with Dependent Children (AFDC) Program

The AFDC Family Group (FG) and Unemployed Parent (U) Programs provide cash grants to low-income families and children. The AFDC Foster Care Program provides grants to pay for the care of children placed in foster care family homes or group homes. The Budget Act appropriates $3.1 billion from the General Fund for the AFDC Program in 1994-95, which is an increase of less than 1 percent over estimated 1993-94 expenditures.

Governor's Welfare Reform Proposals. The enacted budget substantially scaled back the Governor's welfare reduction and reform proposals. Specifically, the budget:

- Reduced the AFDC (FG and U components) maximum grants by 2.3 percent, beginning September 1, 1994, for a General Fund savings of $56 million. As Figure 8 (next page) shows, this reduces the maximum monthly grant for a family of three persons by $13—from $607 to $594. (The Governor proposed a 10 percent reduction, followed by an additional reduction of 15 percent after six months on aid.)

Figure 8

AFDC and SSI/SSP Reductions in Monthly Maximum Aid Payments—1994-95 Budget

	Maximum Payment		
	1993-94	1994-95	Reduction
AFDC			
Family of three	$607	$594	$13
SSI/SSP			
Aged or disabled individual	603	602	1
Blind individual	670	657	13
Aged or disabled couple	1,109	1,083	26
Blind couple	1,297	1,267	30

- Reduced from $70 to $47 the monthly special needs payment that pregnant women on AFDC receive, for a General Fund savings of $3 million in 1994-95. (The Governor proposed elimination of the special needs payment and elimination of the "state-only" program, in which AFDC grants are provided to pregnant women without other children during the first six months of pregnancy.)

Chapter 196, Statutes of 1994 (AB 473, Brulte) enacted a version of the Governor's proposed Maximum Family Grant Program. Chapter 196 requires the Department of Social Services (DSS) to seek federal approval to prohibit increases in any family's AFDC grant due to children conceived while on aid, except in cases of rape, incest, or failure of certain contraceptives. This provision is effective January 1, 1995 but will not have a fiscal impact until 1995-96 (estimated 1995-96 General Fund savings of $24 million).

Greater Avenues for Independence (GAIN) Program. The GAIN Program provides basic education and job training for AFDC recipients. The budget and related legislation made the following changes in the GAIN program:

- The budget includes a one-time transfer of $20 million from the Employment Training Fund to support the nonfederal share of the GAIN Program, for a corresponding General Fund savings in 1994-95.

- Chapter 148/94 (AB 836, Goldsmith) requires adult recipients who have been on AFDC for two years and have completed the GAIN Program to work 100 hours per month in a long-term work preparation assignment (paid or unpaid job slots), unless the recipient is already working at least 15 hours per week. Participants who refuse an assignment would be subject to the current GAIN sanction (a reduction in the family's grant).

- The DSS will implement a performance demonstration project in the GAIN Program designed to increase AFDC grant savings. Under the demonstration project, the county would share in the state's savings if the county (1) operates its program at a high level of performance, or (2) improves its performance, as measured by increased AFDC grant savings. The statewide performance standard is one dollar of AFDC savings for one dollar of GAIN expenditure. The department indicates that the project will be implemented in 30 counties during 1994-95. Savings generated from improved performance will be used to fund incentive payments to successful counties. (The Governor vetoed a provision in the Budget Bill that would have required legislative approval of the project prior to its implementation.)

Court Decision Jeopardizes AFDC Grant Reductions. In recent years, the Legislature and the Governor have reduced the AFDC maximum grants several times. Specifically, Ch 722/92 (SB 485) reduced AFDC maximum grants by 4.5 percent to the federal maintenance-of-effort (MOE) level—based on 1988 grant levels. Chapter 722 also authorized the DSS to apply for federal waivers to implement an additional maximum grant reduction of 1.3 percent effective December 1992, thereby reducing the grant below the MOE. Chapter 69, Statutes of 1993 (SB 35) and Ch 148/94 provided for further grant reductions of 2.7 percent effective September 1993, and 2.3 percent effective September 1994, respectively. The Secretary of the U.S. Department of Health and Human Services (HHS) approved a federal waiver authorizing these reductions as part of a five-year project to study the work incentive produced by various program changes, including reductions in the maximum grants and allowing recipients to keep more of their earned income.

On July 13, 1994, a three-judge panel of the U.S. Ninth Circuit Court of Appeals directed the Secretary of the HHS to reconsider the waiver. In its decision (*Beno v. Shalala*), the panel cited an "extraordinarily sparse administrative record" providing any evidence that the state or the Secretary of HHS had taken the plaintiffs' issues into consideration. The plaintiffs argued that the state's waiver request for grant cuts below the federal MOE requirement failed to take into consideration the effect on child-only cases and certain other recipients who may be unable to work in order to replace the lost income.

The DSS is requesting a review of the decision by the Ninth Circuit Court. In addition, the Governor has directed the DSS to prepare an amended waiver request to HHS that addresses the concerns regarding the administrative record and exempts specified types of cases—including certain child-only cases and cases that have disabled adults—from AFDC grant reductions below the MOE. If approved, this would require restoration of grants to a portion of the AFDC caseload. The DSS estimates that the General Fund costs of the restoration of grants would be about $15 million annually.

In addition, a state superior court ruled in August 1994 (*Welch v. Anderson*) that the 2.3 percent grant reduction for 1994-95 cannot be implemented because it was based on the federal waiver that was invalidated in the *Beno* decision. The DSS indicates that it has filed an appeal of the superior court ruling. According to the department, the grant reduction will be implemented as scheduled in September 1994, pending disposition of the appeal.

Statewide Automated Welfare System (SAWS)

The SAWS is a major project of the DSS to establish a statewide computer-based system for administering various health and welfare programs. It will be the largest and most costly computer-based system ever undertaken by the state. The budget includes $30 million ($15 million General Fund) to begin implementing a specific SAWS design in 14 counties, and $10 million ($5 million General Fund) to conduct three demonstrations on the feasibility of running the SAWS software on different types of computer hardware. The budget also includes funds for the Bureau of State Audits to contract with an independent consultant to evaluate the state's current approach in implementing SAWS.

Supplemental Security Income/ State Supplementary Program

The Supplemental Security Income/State Supplementary Program (SSI/SSP) is a state- and federally-funded program that provides grants to low-income aged, blind, and disabled persons. The Budget Act appropriates $2.1 billion from the General Fund for the program in 1994-95, which is a decrease of less than 1 percent from estimated 1993-94 expenditures.

Reduction in Maximum Grants. The budget reduces the maximum grants for certain SSI/SSP eligibility categories by up to 2.3 percent, beginning September 1, 1994, for a General Fund savings of $42 million in 1994-95. As shown in Figure 8, the major effects are a reduction of $26 per month for aged and disabled couples, $30 for blind couples, and $13 for blind individuals.

Personal Care Services. The budget assumes the receipt of federal Medicaid funds to pay for a portion of personal care services provided by nonmedical out-of-home care facilities to SSI/SSP recipients who reside in these institutions. The budget includes General Fund savings of $15 million in 1994-95 from this provision.

Drug and Alcohol Addiction Clients. Under existing SSI/SSP federal eligibility criteria, an individual can receive aid if he or she is disabled due to drug addiction or alcoholism. The budget includes two General Fund savings actions related to these clients:

- A savings of $4.8 million from assumed enactment of federal legislation that will (1) deny retroactive SSI/SSP payments until a recipient who receives aid as the result of drug or alcohol addiction has entered treatment and (2) deny SSI/SSP benefits to any recipient who has been offered a treatment slot and refuses or does not complete treatment. Federal legislation limiting SSI/SSP eligibility for reasons of drug addiction and alcoholism and requiring that retroactive payments apply towards treatment is currently pending in Congress.

- A savings of $4 million from denying SSI/SSP benefits for two years to individuals who have been convicted of a felony related to the sale or possession of a controlled substance, and who at the time of conviction are receiving SSI/SSP due to a drug- or alcohol-related disability. This provision would only be effective if found to be consistent with federal law or authorized by a federal waiver of eligibility criteria. Individuals found to be disqualified from SSI/SSP under this provision would, under the budget legislation, also be ineligible to receive county general assistance payments for a period of two years following the date of the conviction.

Regional Centers for the Developmentally Disabled

Regional Centers are private nonprofit organizations—funded through the state Department of Developmental Services (DDS)—that provide services to developmentally disabled persons.

Unallocated Reductions. The budget includes an unallocated reduction of $20 million to the Regional Centers. This represents a reduction of 2.4 percent in total funding for the centers.

Juvenile Crime Initiative

The Budget Act appropriates $5 million from the General Fund to establish the Juvenile Crime Prevention Initiative. The appropriation will fund various pilot projects throughout the state to provide support and prevention services to high-risk families. The program will emphasize early identification, family support, community collaboration, and follow-up services. The Department of Social Services plans to evaluate the pilot projects, based on family functioning, school outcomes, and levels of crime.

JUDICIARY AND CRIMINAL JUSTICE

In this section, we describe the major features of the budget package as they relate to judiciary and criminal justice programs (courts, adult and youth corrections, and other justice-related programs). Generally, the amounts approved for the judiciary and criminal justice programs are very similar to the amounts proposed by the Governor and represent substantial increases above the prior-year funding levels. Budgets for correctional and law enforcement programs received substantial increases to provide full funding for caseload increases as well as for a number of new program initiatives.

The 1994-95 budget for judiciary and criminal justice programs includes $4.6 billion from the General Fund and $256 million from state special funds, for a total of $4.8 billion in state funds. The General Fund amount represents an increase of $351 million, or 8.3 percent, above estimated spending for these programs in 1993-94.

Figure 9 (next page) shows the major funding changes in judiciary and criminal justice programs provided by the 1994 Budget Act.

Judiciary

The 1994 Budget Act provides $151 million for support of the judiciary, which includes the California Supreme Court, the Courts of Appeal, Judicial Council, and the Commission on Judicial Performance. This represents an increase of $11.5 million, or 8.3 percent, above 1993-94 expenditures. The increase is primarily due to increases for computer information systems and court-appointed counsel services.

Trial Court Funding

In January, the Governor proposed an increase of about 65 percent from the 1993-94 expenditure level for the Trial Court Funding Program. This proposed increase would help to offset state costs shifted to counties as part of the Governor's state/county restructuring proposal. The Legislature rejected the Governor's restructuring proposal and deleted $388 million of funding related to that proposal. The Governor dropped the proposal in June. The enacted budget provides $624 million ($483 million from the General Fund and $141 million from special funds) for support of local trial courts in 1994-95, or about $7.0 million more than the amount provided in the prior year. As a result, the state will pay about 40 percent of statewide trial court expenses in 1994-95 and the counties will have to pay the balance. This amount of state support is substantially below the intended level of 65 percent that was previously expressed by the Legislature in Ch 90/91 (AB 1297, Isenberg).

Figure 9

Major General Fund Changes in Judiciary and Criminal Justice Programs 1994-95 Budget

(Dollars in Millions)

	Change from 1993-94	
	Amount	Percent
Judiciary	$11.5	8.3%
Trial Court Funding	7.0	1.5
Department of Corrections	245.9	9.0
Department of the Youth Authority	1.8	0.5
Department of Justice	24.3	15.4
Office of Criminal Justice Planning	-5.4	-17.0

Department of Corrections

The budget provides $3.1 billion ($3.0 billion from the General Fund) for support of the Department of Corrections (CDC) in 1994-95. This is an increase of about 9 percent above the 1993-94 level and is primarily due to projected increases in inmate and parole populations and to staff salary and price increases. The only significant reduction to the department's budget was an unallocated General Fund cut of $10 million (about 0.3 percent) below the amount proposed by the Governor.

Inmate and Parole Caseloads. Although the Legislature considered a number of changes that would have saved money by reducing the number or length of stay of offenders in prison and on parole, the final budget did not include any of these changes. The budget is based on the administration's projected inmate population of about 138,000 inmates by June 30, 1995, an increase of approximately 11 percent over 1993-94. The parole population is projected to reach about 97,000 parolees by June 30, 1995, an increase of 8.6 percent. The administration's caseload cost estimates include $5.6 million for the first-year impacts of the "Three Strikes and You're Out" legislation (Ch 12/94 [AB 971, Jones]), which became law in March 1994. In addition, the budget includes $10 million for the department to begin various planning efforts to accommodate the substantial future year increases in inmate population resulting from the "Three Strikes" law.

New Prisons. The budget includes $51 million in one-time costs to begin activation of a new prison in Madera County and to fully open a new prison in Fresno County. These facilities are designed to house about 2,000 female inmates and 2,200 male inmates, respectively.

Federal Funds for Incarceration and Supervision of Undocumented Felons. The budget assumes that the state will receive $356 million in federal funds for the incarceration of undocumented immigrant inmates and wards in state prison and the Department of the Youth Authority, as well as the supervision of undocumented immigrant parolees in communities. The budget treats these funds as General Fund revenues, rather than as offsets to the state costs of either the CDC or the Youth Authority. Consequently, any shortfall in these federal funds will reduce overall General Fund revenue but will not reduce the spending authority of the CDC or the Youth Authority.

At the time this report was prepared, it appeared that the state would receive substantially less than the $356 million assumed in the budget. The federal budget provides only $130 million *nationwide* for this purpose, and only one-third of this amount would be available to states in 1994-95.

Department of the Youth Authority

The budget provides $364 million ($360 million from the General Fund) for support of the Department of the Youth Authority. The General Fund amount is an increase of less than 1 percent over 1993-94 expenditures. The budget deleted $33 million in proposed General Fund support for juvenile detention camps and ranches in approximately 20 counties in anticipation that the counties will receive increased federal funds for their probation departments. However, the budget provides $14 million from the General Fund to Los Angeles County to fund salaries and overtime expenses previously deferred by the county for probation department staff.

Department of Justice

The budget provides $234 million ($182 million from the General Fund) for support of the Department of Justice (DOJ). The General Fund amount is an increase of about 15 percent over 1993-94 expenditures. The budgeted level includes increases in virtually all of the department's program areas. The most significant increases include workload increases in the Criminal Law ($10.1 million) and Civil Law ($5.4 million) Sections, as well as $3.8 million for a new Violence and Weapons Suppression Program.

The 1994-95 budget also includes an increase of $15 million for domestic violence programs. Of this amount, $3.5 million is for the DOJ to provide financial and technical assistance in the prosecution of domestic violence cases, and $11.5 million is for the Department of Health Services to provide grants for domestic violence shelters and services.

Among the budget trailer bills approved by the Legislature was Ch 140/94 (AB 167, B. Friedman), which specified the Legislature's intent to appropriate an additional $15 million for these programs in 1995-96.

Office of Criminal Justice Planning

The budget reduces General Fund support for the Office of Criminal Justice Planning (OCJP) by $5.4 million, or 17 percent, below 1993-94 expenditures. The reduction is primarily the result of ending one-time augmentations provided for victim assistance programs in 1993-94. Although the Legislature considered abolishing the OCJP and transferring its responsibilities to the DOJ, the Youth Authority, and a new Board of Victim Assistance, the final budget left the office intact.

GENERAL GOVERNMENT

Judges' Retirement System

The Judges' Retirement System (JRS) faces a growing annual shortfall in funds needed to make benefit payments to retired judges and their survivors. Each year the Legislature must approve additional General Fund transfers to bridge the gap. In 1994-95, the additional General Fund transfer totals approximately $33 million.

To reduce the size of the General Fund transfers in 1994-95 and future years, the Legislature enacted AB 2385 to raise the judges' contribution rates paid into the JRS from 8 percent to 11 percent of judges' salaries, effective January 1, 1995. This would have reduced General Fund costs by a total of $7 million in 1994-95 and 1995-96 combined. The Governor, however, vetoed the measure.

Employee Compensation

Under approved memoranda of understanding (MOUs), represented state employees (other than employees of the University of California and the California State University) will receive a 3 percent cost-of-living adjustment (COLA) on January 1, 1995. The Department of Personnel Administration has approved identical increases for nonrepresented state employees. This COLA will cost an estimated $133 million ($68 million General Fund) during the last six months of 1994-95. The 1994 Budget Act provides $66 million ($44 million General Fund) to cover a portion of these COLA costs. As proposed in the Governor's Budget, the Budget Act amount will be distributed to 14 departments to pay the COLA to employees who provide direct public safety or 24-hour care services or who are in major revenue-producing agencies. The amounts needed to pay the COLA to other state employees must be borne by departments and agencies from existing support funds. In effect, this imposes unallocated reductions totaling an estimated $67 million ($24 million General Fund).

Reduction in Manager and Supervisor Positions

The budget includes a savings of $150 million ($75 million General Fund) in 1994-95 based on the Administration's plan to reduce the number of managers and supervisors in state government by 10 percent. To begin implementing this plan, the Department of Personnel Administration (DPA) imposed a freeze on appointments to management and supervisor positions in civil service, and asked all departments to submit plans to reduce manager/supervisor positions by 5, 10, and 15 percent.

According to the DPA, there are currently about 28,500 supervisors and managers overseeing the work of 140,000 full-time and part-time civil service workers. Based on the average salaries and benefits of existing managers/supervisors, the administration would have to eliminate 10 percent of these positions for about 10.5 months in 1994-95 in order to realize the $150 million savings. Given the number of managers and supervisors that would be affected by this proposal, combined with the complexities of the civil service process, we believe it is highly unlikely that savings of this magnitude will be achieved in the budget year through staff reductions. Consequently, a large portion of the budgeted $150 million savings in 1994-95 either will not be realized or departments will be required to reduce costs in other ways.

TRANSPORTATION

The 1994-95 budget provides about $1.7 billion from various funds for the support of the Department of Transportation—about the same level as in 1993-94. The major changes to the department's support budget are as follows:

- A $65 million reduction in departmental support—including a $23 million reduction proposed in the Governor's Budget to reflect increased efficiencies, and legislative reductions of $14 million in departmental administration and an additional $28 million unallocated reduction.

- A reduction of $32 million for highway design and engineering—including a $5.6 million reduction proposed in the Governor's Budget to reflect lower workload, and an additional $26 million reduction taken by the Legislature.

In addition, the 1994-95 budget provides about $1.8 billion for state transportation capital outlay purposes and $970 million for local highway and mass transit purposes. The latter includes about $61.7 million for the State Transit Assistance program (transit operating subventions), reflecting about an $8 million increase from the 1993-94 level.

Transfers to the General Fund. The budget includes several transfers of transportation funds to the General Fund. The largest transfer shifts $154.3 million in State Highway Account funds to the General Fund in order to pay for debt service on state rail bonds in 1994-95. About $26 million of this transfer was achieved by deferring to future years some planned expenditures for the State-Local Transportation Partnership Program.

The budget also includes a separate $15.4 million transfer from the Motor Vehicle Account (MVA) to the General Fund which was accomplished by reducing funding for Transit Capital Improvements to $20 million, rather than the level proposed in the Governor's Budget. The 1994-95 budget also continues to transfer to the General Fund MVA revenues from the sale of documents and information ($32 million), which began in 1991-92.

RESOURCES AND ENVIRONMENT

Natural Resources

The budget provides about $1.2 billion (about $395 million General Fund) for natural resources programs in 1994-95. This amount includes about $833 million to support various state agencies and conservancies, and $318 million for local assistance and capital outlay. In particular, the 1994 budget includes:

- About $30 million to fund various wildlife habitat acquisition and improvements as required by Proposition 117.
- About $9 million, mostly from the California Water Fund, for a grant to the City of Los Angeles for a waste water reclamation project to replace water previously diverted from Mono Lake.
- A reallocation of $5 million for firefighter positions to enhance initial fire attack capability in the Department of Forestry and Fire Protection by reducing budgeted funding for emergency fire fighting operations by a similar amount (from $20 million to $15 million).
- A contingency loan of $7.6 million from the Oil Spill Response Trust Fund to the Department of Fish and Game to continue work related to the Cantara Spill on the upper Sacramento River.

Environmental Protection

The budget provides about $607 million ($45 million General Fund) for environmental protection programs in 1994-95. This amount is about $139 million (19 percent) less than in 1993-94—primarily reflecting the following changes:

- A reduction of about $125 million in grants and loans for local water reclamation, water quality, and pollution control activities, mainly due to the depletion of bond funds that have been used to provide a state match for federal funds.

- A $23 million reduction in staff support for the Department of Toxic Substances Control, due to declining revenues to the Hazardous Waste Control Account.

- A $20 million increase in discretionary grants for local collection and recycling activities for used motor oil in accordance with statutory requirements relating to the use of money in the California Used Oil Recycling Fund.

CAPITAL OUTLAY

As shown in Figure 10 (next page), the 1994-95 budget includes almost $800 million for capital outlay (excluding transportation and the State Water Project). This amount is $84 million more than proposed by the Governor. Major legislative changes to the Governor's budget proposal included the following:

- An appropriation of $61 million from lease-payment bonds to exercise a purchase option for the Department of Justice Building in Sacramento, which is currently under construction.

- A shift of $29 million of the cost for a new museum facility at the California Museum of Science and Industry from general obligation bonds (Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990) to lease-payment bonds. The balance of this $45 million museum project is still funded from the 1990 Bonds Act.

- A reduction of $4 million that was proposed for planning and design of facilities to increase capacity in the California Youth Authority by 950 beds.

Figure 10

1994-95 Capital Outlay Programs[a]

(In Millions)

Legislative/Judicial/Executive	$3.9
State and Consumer Services	107.9
Transportation	29.3
Resources	68.2
Health and Welfare	8.1
Corrections	52.2
Higher Education	504.5
General Government	9.1
Total	**$783.2**

[a] Excluding highways and the state water project.

Capital Outlay Program Dependent on Approval of New Bond Measures. More than half of the $800 million capital outlay program depends on action by the Legislature to place new bond measures on the upcoming November ballot and on voter approval of those bonds. About $470 million for higher education facilities and $46 million for the Departments of Corrections, Youth Authority, Forestry and Fire Protection, and the Office of Emergency Services are dependent on legislative and voter approval of new bond measures. When this report was written, the Legislature had not yet approved these bond measures for the November ballot.

Bond Debt Service

Current Debt Service Costs. We estimate that the state's General Fund debt service payments on long-term bonds (general obligation and lease-payment) will be almost $2.2 billion during 1994-95. This is about 5.3 percent of estimated General Fund revenues.

Future Debt Service Costs for Bond Appropriations in the 1994-95 Budget Act. The budget includes appropriations totaling about $1.06 billion from existing and new bond funds. This amount consists of $900 million from general obligation bonds and $160 million from lease-payment bonds. These bonds will be used for the following purposes:

- Capital outlay projects of state agencies and the community colleges ($690 million).

- Deferred maintence and capital planning costs of certain state agencies ($125 million).

- Local government capital projects ($245 million).

Assuming the new bond measures are submitted to and approved by the voters this November, the bonds needed to finance the projects in the 1994 Budget Act would be sold in 1994-95 and future years. The state's General Fund debt service costs for these bonds would begin after 1994-95 and would average about $80 million annually for about 25 years until the bonds are paid off.

Tidelands Oil Revenue

In January, the Governor's Budget proposed allocating the estimated $31 million in 1994-95 tidelands oil revenues for (1) support of the State Lands Commission ($9 million), (2) the California Housing Trust Fund ($2 million), and (3) transfer to the General Fund ($20 million). No allocation was proposed to the Special Account for Capital Outlay (SAFCO). In May, based on an estimated increase in tidelands oil revenue, the Governor's Budget was revised to reflect a $17 million increase in the transfer to the General Fund. The Legislature increased this General Fund transfer by $1.4 million by eliminating an estimated reserve in the SAFCO. The Governor vetoed the $1.4 million additional transfer.

LOCAL GOVERNMENT

In this section, we describe actions in the 1994-95 budget package that affect local government. In contrast to the major impacts that state budget actions imposed on local governments in 1992-93 and 1993-94, the state budget package for 1994-95 imposes relatively moderate impacts on local government.

Property Tax Shifts. Chapter 155, Statutes of 1994 (AB 860, Pringle), requires county auditors to increase the amount of property taxes transferred from cities, counties, and special districts to school and community college districts. By increasing the amount of property taxes allocated to schools and community colleges, this action reduces the amount that must be provided from the state General Fund under Proposition 98. Technical problems in the 1993 legislation requiring transfers of property taxes from local entities to schools and community colleges had resulted in a smaller-than-expected net transfer, which the state then had to backfill with additional General Fund expenditures for K-14 education. The 1994 legislation corrects the shortfall problem by (1) increasing the transfer for 1994-95 and subsequent years and (2) recapturing the additional 1993-94 revenues from counties over a two-year period.

State Retains More Federal Payments to Counties. The budget assumes that the state will retain a share of federal reimbursements and matching funds intended to (1) reimburse counties for administrative and case managment services provided to Medi-Cal beneficiaries and (2) make supplemental payments to hospitals to offset the cost of uncompensated medical care for non-Medi-Cal patients. The state will retain a share of these funds to finance the state's costs of the Medi-Cal program. These federal payments to counties are expected to increase substantially. The 1994-95 budget increases by $285 million the amount of these federal funds retained by the state to offset General Fund costs for support of the Medi-Cal program.

Restructuring the State/Local Relationship. In January, the Governor proposed a major restructuring of the relationship between the state and the counties. This proposal primarily focused on the areas of health, welfare, and trial courts. No actions, however, were included in the 1994-95 budget package to restructure the relationship between the state and local governments.

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