California Spending Plan 1997-98

The Budget Act and Related Legislation

October 1997
Elizabeth G. Hill, Legislative Analyst

Contents

Table of Contents

Figures

Chapter 1
1997-98 Budget Package

Chapter 2
Perspectives on State Expenditures

Chapter 3
Major Features of the 1997-98 Budget Plan

Table of Figures

Summary

The 1997-98 budget, signed into law by Governor Wilson on August 18, 1997, authorizes total state spending of $67.2 billion, including $52.8 billion from the General Fund and $14.4 billion from special funds. Reflecting continued healthy economic and revenue growth in California, the budget contains major increases in Proposition 98 education spending. It also includes significant increases in higher education spending and a major reform to the state's welfare system.

The 1997-98 spending totals also reflect a $1.2 billion one-time payment of deferred obligations to the state's Public Employees' Retirement System, made following a Supreme Court ruling in late May. This large payment removed virtually all of the discretionary funds which had been available for noneducation purposes. For this reason, noneducation related spending in 1997-98 is relatively tight, with limited augmentations for state programs and local fiscal relief.

Following the enactment of the budget, the Governor and Legislature reached agreement on a number of major issues. These included tax reductions, possible employee compensation increases, a restructuring of the trial court funding system, and expansion of health care coverage for low-income children. The initial fiscal impact of these measures on the General Fund will occur primarily in 1998-99. (The income tax reductions have some impact in the current year.)

Chapter 1

The 1997-98 Budget Package

INTRODUCTION AND OVERVIEW

The *1997-98 Budget Act* signed by the Governor on August 18, 1997, together with related implementing legislation ("trailer bills"), comprise a 1997-98 budget package that authorizes state spending of $67.2 billion. This spending total includes $52.8 billion from the General Fund and $14.4 billion from special funds.

The estimated General Fund condition under the new spending plan is shown in Figure 1. It indicates that revenues and transfers are projected to total $52.5 billion in 1997-98, a 6.8 percent increase from the prior year. Expenditures are projected to total $52.8 billion, an 8 percent increase from the prior year. The spending totals for 1997-98 include a one-time $1.2 billion payment of deferred contributions to the state's Public Employees' Retirement System (PERS), made pursuant to a court ruling in late May. As enacted, the budget shows a modest reserve of $112 million (0.2 percent) in 1997-98, down from the 1996-97 reserve of $408 million.

Fund Condition Does Not Reflect Post-Budget Developments. It should be noted that Figure 1 reflects the budget as enacted, and does not include the impacts of several significant agreements reached between the Governor and Legislature in September. These agreements involved a state income tax reduction, trial court restructuring, an expansion of health care coverage for low-income children, and various other program augmentations (see discussions below and in Chapter 3). The effect of these agreements is to reduce or eliminate the reserve shown in Figure 1. We will be updating our estimates of the state's fiscal condition to reflect these and other factors affecting the budget—including revenue-related cash flow developments, the potential effects of recent federal tax law changes on state capital gains revenues and caseload trends—in our forthcoming November fiscal outlook report.

Figure 1

1997-98 Budget Plan[a]

(Dollars in Millions)

	1996-97	1997-98	Percent Change
Prior-year balance	$564	$859	
Revenues and transfers	49,205	52,531	6.8%
Total resources available	**$49,769**	**$53,390**	
Expenditures	$48,910	$51,599[b]	5.5%
PERS repayment	—	1,228	
Total expenditures	**$48,910**	**$52,827[b]**	**8.0%**
Ending fund balance	$859	$563	
Other obligations	451	451	
Reserve	**$408**	**$112**	

a Detail may not add to totals due to rounding. Data are on a budgetary accounting basis as reported by the Department of Finance, and do not incorporate post-budget legislation.

b Includes $197 million in General Fund expenditures vetoed and "set aside" by the Governor pending enactment of legislation involving mandatory statewide educational testing.

Budget Highlights

Figure 2 summarizes major features of the *1997-98 Budget Act*. The budget provides for major increases in K-12 education funding (including an expansion of the class-size reduction program), significant growth in higher education funding, and a major reform to the state's welfare system. Funding increases for other state programs is limited, however, due to the PERS-related court ruling and the decision to immediately repay PERS the entire $1.2 billion in deferred state contributions.

Figure 2

Major Features of the *1997-98 Budget Act*

- Major increase in K-12 education funding.
- Welfare reform.
- $1.2 billion payment of deferred obligation to PERS.
- Prison funding that covers caseload increases, but no funding for new prisons.
- Significant increase in higher education funding, and no student fee increases.
- Renters' credit suspension for an additional year.
- Modest increases in other programs.

In the remainder of this chapter, we first discuss current revenue performance and the outlook on which the budget is based. We then (1) discuss the development of the 1997-98 spending plan, (2) provide a brief overview of the major provisions in the enacted budget, and (3) provide an overview of the key post-budget actions adopted by the Legislature in September. Chapter 2 provides additional detail on the expenditure totals and a longer-term perspective on state expenditure trends, while Chapter 3 discusses in more detail the major features of the new budget and subsequent legislation.

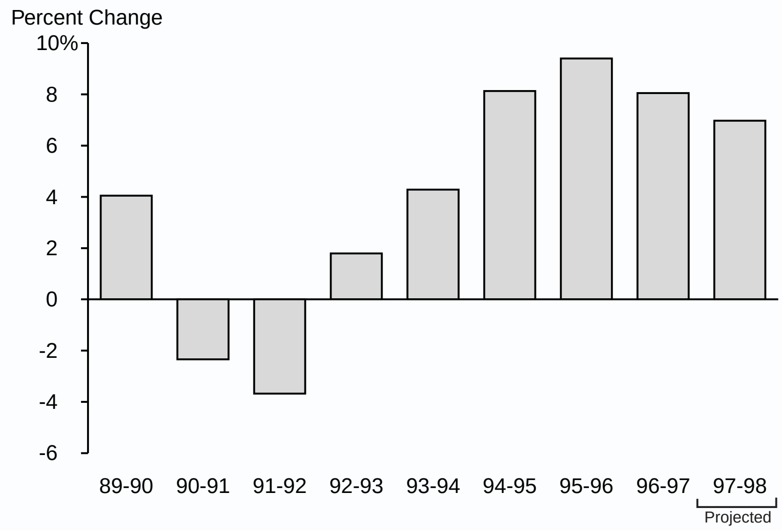
MODERATE STATE REVENUE GROWTH CONTINUES

The state budget continues to benefit from healthy growth in California's economy and the associated moderate growth it has produced in state revenues. As shown in Figure 3, General Fund revenues (adjusted to eliminate the effects of revenue-related law changes) fell sharply during the early 1990 recession, but have rebounded in line with the state's economy in recent years. Healthy revenue growth is expected to continue in 1997-98, with underlying revenues projected to increase by 7 percent. These anticipated revenue gains enabled the budget to provide for *significant* overall program funding increases and tax reductions, while at the same time eliminating the large cumulative deficit built up during the early 1990s' recessionary period.

Figure 3

Underlying General Fund Revenue Growth[a]

1989-90 Through 1997-98



[a] General Fund revenues excluding transfers and the effects of revenue-related legislation enacted in the 1990s.

DEVELOPMENT OF THE 1997-98 BUDGET

The 1997-98 spending plan evolved substantially between the time the Governor introduced his initial proposal in early January and when it was finally enacted in mid-August. In this section, we provide a brief chronology of the development of the 1997-98 budget.

The Governor's January Proposal

The Governor's original budgetary proposal for 1997-98, introduced on January 9, 1997, included $50.3 billion in General Fund spending.

Program Areas. The proposal contained significant new funding for K-12 education, including an expansion of the class-size reduction initiative started last year. In the areas of health and welfare, the budget proposed to make permanent certain previously enacted temporary welfare grant reductions, and it included the Governor's proposal to reform the state's welfare system. The budget also proposed elimination of state-only prenatal Medi-Cal services for undocumented persons.

In the area of higher education, the January proposal included a 4 percent increase in basic funding for the University of California and California State University systems, and it provided additional funding to avoid student fee increases. With regard to local government finance, the budget proposed a trial court realignment program (similar to the prior year's proposal), and it included $100 million for the second year of the Citizen's Option For Public Safety (COPS) program. The budget proposal also included full funding for the youth and adult corrections budgets, including monies for design and development costs for six new prisons. The budget proposed elimination of the renters' credit (which has been suspended since 1993). Finally, the budget contained no funds for state employees salary increases.

Taxes. The budget proposed a phase-in of a 10 percent reduction in the bank and corporation tax rate (in addition to the 5 percent corporate tax reduction adopted last year), as well as selected conformity to federal tax laws. The combined effect of these proposals was a projected revenue reduction of $90 million in 1997-98, growing to more than $600 million by 2000-01.

The May Revision

For the second year in a row, the May Revision reflected major improvements in the state's fiscal picture. Relative to the January budget proposal, it included a two-year increase in General Fund resources of $3.4 billion. This reflected two factors. First, revenues were $2.3 billion higher, including nearly $1 billion for 1996-97 and

$1.3 billion for 1997-98 (see Figure 4). Second, there were $1.1 billion in expenditure savings related to lower program caseloads and debt-service costs.

About $2.2 billion of the additional resources were allocated to Proposition 98 spending ($1.2 billion to 1997-98 spending and the remainder attributable to prior-year spending). This was due primarily to the impact of higher revenues on the minimum funding guarantee, as well as revisions to population and school attendance figures.

Figure 4

Changes in Projected Revenues During 1997-98

(In Millions)

	Department of Finance Projected Revenues	
	1996-97	**1997-98**
January budget	$48,405	$50,657
May Revision	49,365	51,960
Change from January budget	**$960**	**$1,303**
Final budget	$49,205	$52,531
Change from May	**-$160**	**$571**[a]

[a] This amount is due primarily to three factors: (1) rejection of the Governor's trial court funding proposal (for an increase in both revenues and expenditures of $315 million), (2) the rejection of the corporation tax cut proposal (for a revenue gain of $130 million), and (3) a compromise $100 million increase in the underlying revenue projection.

The May Revision also proposed a $1.2 billion increase in non-Proposition 98 spending, including new expenditures for childcare services related to the Governor's welfare reform proposal, new funding for local government fiscal relief (including a property tax shift back to local governments totaling $100 million in 1997-98), and new Supplemental Security Income/State Supplementary Program (SSI/SSP) funding to cover certain legal noncitizens.

Legislative Action on the Budget

The versions of the budget passed by the Assembly and Senate contained some similarities to, but also many differences from, the Governor's proposal.

Similarities. Areas where the legislative versions were similar to the Governor's proposal included K-12 education (where both houses adopted the class-size reduction proposal), higher education (where both houses adopted spending more or less consistent with the administration's plan), and local government fiscal relief (where both houses provided funds for the property tax shift).

Differences. Areas where the Senate and Assembly differed from the Governor's plan included health and welfare, taxes, corrections spending, and employee compensation. Specifically, both houses rejected the Governor's plan for welfare reform and adopted alternative proposals. The legislative versions also provided continued funding for prenatal services for undocumented persons. In the area of criminal justice, both houses reduced corrections funding, and lowered or eliminated funding for new prisons. Both houses rejected the corporate tax rate reduction. Finally, both houses provided funding for employee compensation in an amount equivalent to an average 5 percent increase.

Conference Committee. The Assembly and Senate versions of the budget were sent to Conference Committee for reconciliation in early June. Negotiations continued—both in Conference Committee and among the Legislature's leadership and the Governor—through June and into early July. Although the two houses of the Legislature and the Governor reached agreement on a compromise package for welfare reform and some other issues, they were not able to reach agreement on other key issues, such as taxes and state employee compensation. In mid-July the Governor proposed a personal income tax reduction effective in 1998, and linked it to employee pay increases. However, no agreement was reached, and negotiations reached an impasse that lasted until late July.

Final Budget

PERS Court Case. In late May, the California Supreme Court refused to hear an appeal of lower court rulings which had declared unconstitutional the General Fund's deferral of state contributions to the retirement fund in the early 1990s. As a result, the state was ordered to repay $1.2 billion in principal to PERS. (The lower courts had also agreed that the state owed PERS interest on the delayed payments—estimated to be approximately $300 million—but did not order immediate payment of these funds.) Following the Supreme Court decision, it became clear that it would be difficult to both fund various legislative and executive augmentations to the budget and make the PERS repayment, unless the latter could be spread over several years.

Budget Resolution. In late July, the Governor directed that the entire $1.2 billion principal amount be immediately repaid to PERS. The PERS transfer effectively required the Conference Committee to eliminate most of the spending augmentations being considered in the budget, including funds for employee compensation, local government fiscal relief, and tax reductions. Following these actions, the budget was passed by the Legislature and sent to the Governor on August 12, 1997.

MAJOR FEATURES OF THE 1997-98 BUDGET

Spending by Program Area

K-12 Education. Healthy revenue growth, coupled with other factors affecting Proposition 98 spending, led to major increases in K-12 education funding in both 1996-97 and 1997-98. The budget uses these funding gains to expand the class-size reduction program to fourth grade and significantly increases local revenue limit funding.

Higher Education. The budget includes significant funding increases for the University of California, California State University, and California Community Colleges, with no student fee increases.

Welfare Reform. The budget funds a major welfare reform program—CalWORKs (California Work Opportunity and Responsibility to Kids program). It includes time limits on aid for adults, participation requirements for adults, expanded child care and job training services, and various county fiscal incentives.

Other Health and Welfare Provisions. The budget rejects the Governor's proposal to make permanent the 4.9 percent SSI/SSP statewide grant reduction, and instead restores the grant on November 1, 1997. The budget extends the previously enacted 4.9 percent Aid to Families with Dependent Children (AFDC) grant reduction through October 1998, and suspends both AFDC and SSI/SSP cost-of-living adjustments for an additional year.

Regarding Medi-Cal, the budget funds prenatal services for illegal immigrants until October 1, 1997. The Governor vetoed budget language to continue the program. Under proposed administration regulations, the program is projected to terminate in December 1997.

Corrections. The budget essentially funds inmate caseload, contains no money for new prisons, and provides for few new initiatives. In addition, the budget assumes $94 million more in federal funds than the amount included in the Governor's budget to offset the state's costs of supervising undocumented felons.

Local Government. The budget continues the COPS program ($100 million). It also reduces the state's “take-out” from the disproportionate share hospital payments, thereby increasing county resources by $75 million. Following the PERS repayment, the Legislature eliminated the shift of property taxes from the state back to local governments (proposed at $100 million by the Governor and the Senate, and at $280 million by the Assembly). It also eliminated $50 million that had been proposed by the Governor to capitalize the infrastructure bank.

Other Spending Programs. The budget extends the suspension of the renters' tax credit for one additional year (the Governor had proposed permanent elimination of the credit). The budget contains no general state employee salary increase. However, subsequent to the budget's enactment, the Governor committed to negotiate in good faith with employee organizations for a pay raise.

Tax Reductions

The Legislature rejected the 10 percent phased reduction to corporate tax rates included in the Governor's original budget proposal, as well his July proposal for a phased 10 percent reduction in personal income tax rates. (As noted later, subsequent to the enactment of the budget, the Governor and Legislature agreed on a package of tax reductions, including an increase in the personal income tax dependent exemption credit.)

THE BUDGET "TRAILER BILLS"

In addition to the *1997-98 Budget Act*, the 1997-98 budget package includes several related measures enacted to implement and carry out the budget's provisions. Figure 5 lists these budget "trailer bills."

Figure 5

1997-98 Budget
Major Implementing Legislation

Bill	Author	Subject
AB 64	Baca	Education: Technology grants to high schools.
AB 67	Escutia	Social Services: Various (SSI/SSP COLA, IHSS eligibility, foster care, group home rates).
AB 751	Escutia	Education: Class size reduction.
AB 1086	Mazzoni	Education: Second-year of GOALS 2000 program.
AB 1576	Bustamante	Social Services: Food stamps for legal immigrants.
AB 1578	Migden	Education: Various (K-12, community colleges). Proposition 98 “settle-up” appropriations.
AB 1579	Strom-Martin	Education: Staff development buyout, longer school year.
AB 1582	Bowen	Resources: Various (Department of Parks and Recreation, California Conservation Corps, Harbors and Watercraft, Stanford Mansion, Governor’s Residence).
AB 1584	Prenter	Citizen’s Option for Public Safety (COPS) program.
AB 1586	Wright, R.	General Government: Various (Department of General Services, Consumer Affairs, Veterans memorial, Health Plan Fees, California Science Center).
AB 1589	Pringle	Local Government: Library and fire ERAF.
AB 1591	House	Motor Vehicles: Vehicle registration and title transfer fees.
AB 1592	Leonard	Renters’ tax credit: Suspension in 1997.
AB 1593	Machado	Water resources: American River flood protection.
SB 271	Thompson	Resources: Tidelands oil revenues; coastal salmon, steel head, and trout restoration.
SB 391	Solis	Health: Public health, Medi-Cal, disproportionate share hospital, mental health, Proposition 99, and developmental disabilities.
SB 804	O’Connell	Education: Expansion of class size reduction.
SB 959	Kopp	Emergency services: Reorganization of claims processing.
SB 1095	Lockyer	Education: Special services to high-risk students.
SB 1320	Sher	Environmental protection: Peer review at CalEPA boards and departments.

GOVERNOR'S VETOES

Before signing the budget, the Governor used his line-item veto authority to eliminate $314 million from the spending plan, including $298 million from the General Fund and $16 million from special and federal funds.

About $203 million of the vetoes involved funds "set aside" by the Governor for restoration upon enactment of legislation which satisfied his requirements for a mandatory testing program in K-12 education. Virtually all of these funds were restored once agreement on statewide testing was reached in September.

The majority of the remaining vetoes were in health and welfare and community colleges. Specifically:

- ❖ The Governor vetoed $68 million from health and welfare. This included $30 million in legislative augmentations for indigent health care programs, $5 million for citizenship services to legal immigrants, $17 million in SSI/SSP state-only benefits for aged legal noncitizens who are not covered by federal law, and $8 million in SSI/SSP state-only benefits for certain children.

- ❖ About $23 million in vetoes involved funding for community colleges, including $9 million for apportionments and $5 million for economic development.

POST-BUDGET ACTIONS

The 1997 budget session was somewhat unusual in that the Legislature and Governor reached agreements on several major budget-related issues in late summer, several weeks after adoption of the budget bill. The main post-budget actions, which generally affect years after 1997-98, are highlighted in Figure 6 and discussed below.

Figure 6

Major Post-Budget Actions

- Tax reduction package.
- Employee compensation increase agreement.
- Trial court restructuring.
- Health coverage expansion for low-income children.

Tax Cuts. The Legislature adopted a tax package which includes significant reductions in personal income taxes. Its main provision is an increase in the dependent exemption credit of $52 in 1998 and an additional $102 in 1999. Other provisions include conformity to federal laws involving capital gains exemptions on principal residences sold after May 7, 1997, an increase in and indexing of the exemption from the alternative minimum tax, and an increase in the amount of research and development (R&D) expenditures that certain companies can claim in determining their R&D credits. The tax package will reduce state tax revenues by an estimated $166 million in 1997-98, $683 million in 1998-99, and $931 million in 1999-00.

Employee Compensation Increase. The Governor and legislative leaders agreed that state employees would receive a compensation increase depending on collective bargaining and availability of revenues. No funding for compensation increases is included in the state's spending plan, however.

Trial Court Funding. Under the Trial Court Consolidation Plan, the state will assume $274 million of trial court costs currently supported by counties, beginning in 1998-99. County costs will be capped, and the state will be responsible for funding future growth in the program. In addition, beginning in 1998-99, the state will assume full costs of courts in the 20 smallest counties (additional state cost of $10.7 million), and cities will able to keep all fine and penalty revenues collected within their jurisdictions (currently, some are remitted to the state). This plan will have no net impact on the state's General Fund in 1997-98, but it will result in a net increase in General Fund costs of at least $350 million in 1998-99.

Expanded Child Health Care Coverage. This year's federal budget agreement provides federal matching funds to states for the purpose of expanding health care coverage for children in low-income families who do not otherwise qualify for Medicaid (Medi-Cal in California). In response to these federal changes, the Legislature established the Healthy Families Program, which will enable qualifying families to purchase low-cost health coverage for their children, including vision, dental, and mental health coverage. In addition, legislation was passed which broadens and simplifies Medi-Cal eligibility for certain poor children. General Fund costs are expected to be limited in the current year—probably less than $20 million—but are estimated to rise to $188 million in 1998-99, when the program becomes fully operational.

We will incorporate the fiscal impacts of those measures signed into law in our November fiscal outlook report projections. This report will project revenues and expenditures through 1999-00.

Chapter 2

Perspectives on State Expenditures

In this chapter, we provide aggregate expenditure information relating to the 1997-98 spending plan. Specifically, the chapter discusses (1) current state expenditures by fund, (2) the programmatic distribution of state spending, and (3) General Fund and special funds expenditures over the past decade.

TOTAL STATE SPENDING

Figure 1 (see next page) shows total state expenditures from all funds from 1995-96 through 1997-98. As noted in the figure, our numbers include certain adjustments to the administration's spending amounts in order to make them more comparable from year to year, and to better reflect actual state spending levels.

The figure shows that under the enacted budget plan, total state spending from all sources grows from $66.2 billion in 1996-97 to $70.9 billion in 1997-98, an increase of $4.8 billion, or 7.2 percent. This is slightly less than the 7.6 percent gain experienced in 1996-97. Excluding spending from selected bond funds, budget-related expenditures from General Fund and special funds are up 7.5 percent. Figure 1 also shows that the majority of total state spending is from the General Fund, which in 1997-98 accounts for about 74 percent of the total. In addition, the figure indicates that:

Figure 1

**The 1997-98 Budget Plan
Total State Expenditures**

(Dollars in Millions)

Fund Type	Actual 1995-96	Estimated 1996-97	Enacted 1997-98	Change from 1996-97	
				Amount	Percent
General Fund[a]	$45,404	$48,760	$52,627	$3,867	7.9%
Special funds[b]	14,143	15,273	16,191	918	6.0
Budget totals	**$59,547**	**$64,034**	**$68,818**	**$4,784**	**7.5%**
Selected bond funds	$1,937	$2,122	$2,130	$8	0.4%
Totals	**$61,484**	**$66,156**	**$70,948**	**$4,792**	**7.2%**

Detail may not add to totals due to rounding.

[a] Budget data have been adjusted to exclude Proposition 98 loan repayments ($100 million in 1995-96, $150 million in 1996-97, and $200 million in 1997-98).

[b] Budget data have been adjusted to include Local Public Safety Fund expenditures ($1.6 billion in 1995-96, $1.7 billion in 1996-97, and $1.8 billion in 1997-98).

- Spending from the *General Fund* is estimated to be $52.6 billion, an increase of 7.9 percent from 1996-97 and a two-year 16 percent increase from 1995-96. The significant two-year growth rate includes a major increase in the General Fund contributions to Proposition 98 funding, which grew by slightly more than $4 billion (23 percent) between 1995-96 and 1997-98.

- Expenditures from *special funds* in 1997-98 are estimated to be $16.2 billion, up 6 percent from 1996-97. This reflects increases in several program areas, including business; transportation and housing; environmental protection; health and welfare; and resources.

- Expenditures from *bond funds* will be almost level this year. Spending is expected to be $2.1 billion, up just 0.4 percent from 1996-97. About four-fifths of the total expenditures from bond funds are for education and transportation-related purposes.

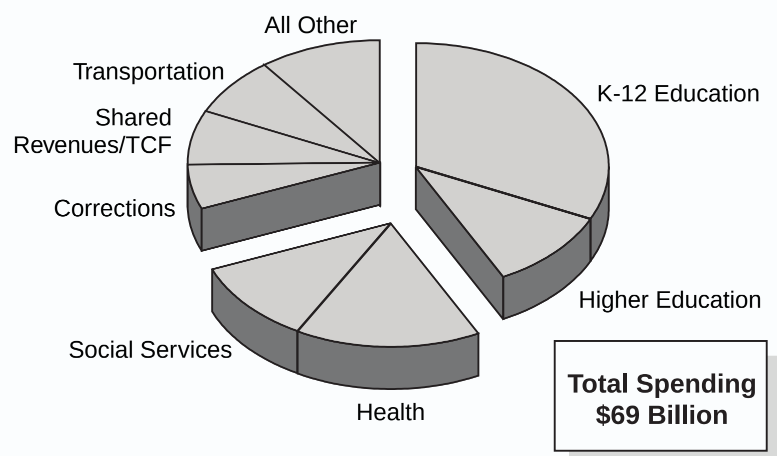
SPENDING BY MAJOR PROGRAM AREA

Figure 2 shows the distribution of total state spending from the General Fund and special funds combined. It shows that education is the largest category of state spending, accounting for over 42 percent of the total. The next largest categories are health and social services, which together account for 26 percent of the total. Other key categories are corrections, shared revenues, and transportation, which together make up 21 percent of total state spending.

Figure 2

Distribution of Total State Spending By Major Program[a]

1997-98



[a] Includes Local Public Safety Fund expenditures, and excludes Proposition 98 loan repayments, bond funds, and federal funds.

Figure 3 (see next page) provides programmatic detail of General Fund spending in 1995-96, 1996-97, and 1997-98. It shows that K-12 education is both the largest and fastest growing major program area, increasing by 9.9 percent in 1997-98. Higher education spending is up 6.9 percent, reflecting the impact of rising Proposition 98 funding on community colleges. The major increase in "all other" spending is primarily due to the one-time $1.2 billion payment to the Public Employees' Retirement System.

Figure 3 also shows that spending on health is up just 2.5 percent in 1997-98, reflecting slowing (or in some cases, declining) caseloads and slowing cost increases in the Medi-Cal Program. Social services spending is down from the prior year due to major caseload declines in the state's Aid to Families with Dependent Children / Temporary Assistance for Needy Families (AFDC / TANF) programs.

Figure 3

Total General Fund Spending by Major Program Area 1995-96 Through 1997-98

(Dollars in Millions)

Major Program	Actual 1995-96	Estimated 1996-97	Enacted 1997-98	Change From 1996-97	
				Amount	Percent
K-12 Education	$17,902	$19,988	$21,963	$1,975	9.9%
Higher Education	5,531	6,180	6,610	430	6.9
CCC	1,600	1,854	2,063	209	11.3
UC	1,918	2,060	2,183	123	5.9
CSU	1,630	1,825	1,889	64	3.5
Other	383	442	476	34	7.6
Health	7,172	7,941	8,138	197	2.5
Social Services	7,091	6,820	6,719	-101	-1.5
Corrections	3,946	3,834	4,032	198	5.2
Shared Revenues/ Trial Court Funding	554	694	683	-11	-1.6
Transportation	172	201	217	16	8.0
All other[a]	3,136	3,253	4,466	1,213	37.3
Totals	**$45,504**	**$48,910**	**$52,827**	**$3,917**	**8.0%**

[a] "All Other" category includes $1.2 billion PERS repayment.

STATE SPENDING OVER THE PAST DECADE

State expenditures have experienced significant changes over the past decade, both in terms of overall spending and in terms of the relative growth or declines among major individual program areas.

Changes in Overall Spending

To put the amount of spending in this year's budget into perspective, Figure 4 (see next page) shows state spending trends over the past ten years since 1987-88. Total state spending grew relatively rapidly until 1991-92, but experienced little overall growth between 1991-92 and 1994-95. The latter occurred due to the impact of the recession. After removing the effects of inflation, "real" spending declined significantly during this period.

Spending growth rebounded sharply in 1995-96 and 1996-97, and will continue to grow in 1997-98. Even after these increases, however, inflation-adjusted spending is only modestly higher than it was at the beginning of the 1990s. The modest increase over the past seven years occurred at the same time the state experienced steady growth in school children, prison inmates, health and welfare recipients, and the state's general population.

Growth in General Versus Special Fund Spending. Over the past decade, spending from special funds has grown faster than spending from the General Fund due primarily to two factors:

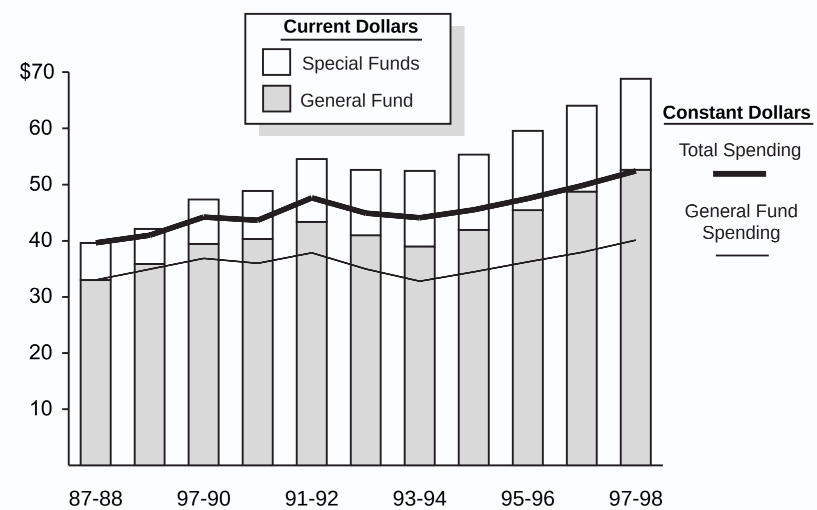
- ❖ First, legislation and voter initiatives have established new programs financed by fees or dedicated tax revenues (such as Proposition 99 tobacco-related taxes). Voters have also approved gasoline tax increases for the purpose of financing increased transportation spending.

❖ Second, in recent years the Legislature has shifted some traditional General Fund costs and revenues to special funds. For example, in 1991-92, a one-half cent increase in the state sales tax was enacted, and the associated revenues were placed in a special fund to cover the costs of certain health and welfare programs that the state transferred to the counties.

Figure 4

State Spending[a]
Current and Constant Dollars

1987-88 Through 1997-98



[a] Includes Local Public Safety Fund expenditures. Excludes Proposition 98 loan repayments, bond funds, and federal funds.

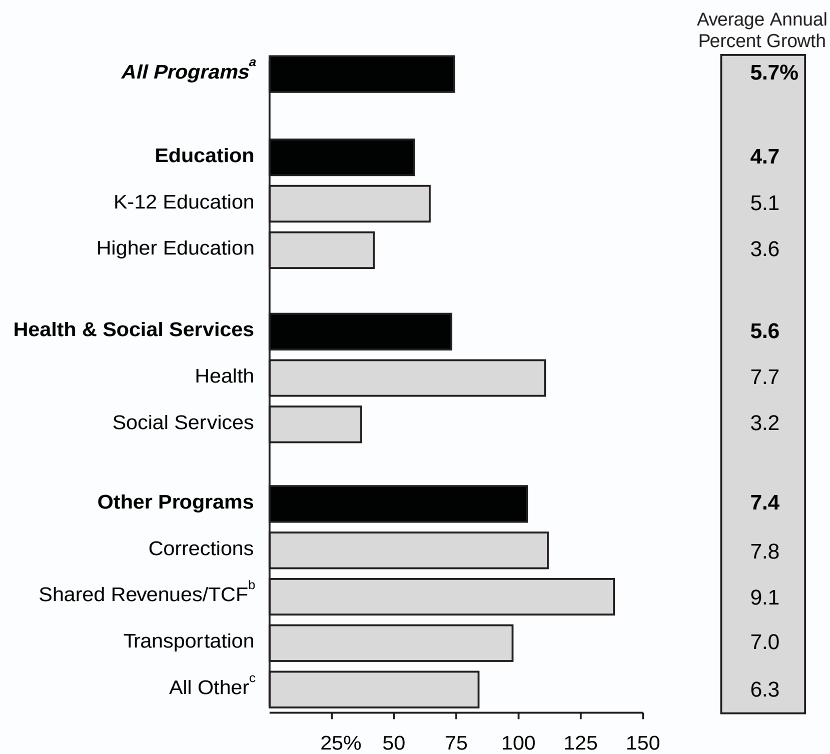
Changes in Spending by Programmatic Area

Figure 5 (see next page) shows how spending on different programs has changed over the past decade. It shows that total spending has increased at an average annual rate of 5.7 percent, with some programs growing significantly faster and some growing significantly slower than the average. Program areas experiencing above-average growth include health, corrections, shared revenues, and transportation. Program areas experiencing below-average growth in state funding include K-12 education, higher education, and social services.

Figure 5

Percent Change in Total State Spending By Major Program

1987-88 to 1997-98



[a] "Excludes bond funds and federal funds.
[b] Includes local subventions, Local Public Safety Fund expenditures, and Trial Court Funding (TCF) expenditures.
[c] Includes one-time PERS payment in 1997-98.

Faster-Growing Programs. Regarding those program areas with above-average growth over the past decade:

- ***Health.*** The above-average increase in health-related spending largely reflects the combined impacts of caseload and inflation, which resulted in particularly large increases in the Medi-Cal Program during the late 1980s and early 1990s.

- ***Corrections***. The growth in corrections-related spending reflects a major rise in inmate populations—partly due to expanded prison sentencing—and the increasing costs of financing and operating prisons.

- ***Shared Revenues/Trial Court Funding***. The increase in "shared revenues" partly reflects legislation passed in 1991 which allocated a new one-half cent increase in state sales tax revenues to counties to cover health and welfare programs transferred to local governments. It also reflects state allocation of a new one-half cent increase in sales tax to counties for public safety beginning in 1993.

- ***Transportation***. The increase in transportation spending partly reflects voter approval of Proposition 111 in 1990, which raised fuel related taxes and provided additional money for transportation spending.

Slower-Growing Programs. Regarding the slower-growth program areas:

- ***Education***. The lower-than-average increase in state education spending is primarily due to the replacement of state support for K-14 education with property tax revenues shifted from local governments to schools and community colleges. Since total school spending was unaffected by these shifts, the reported General Fund spending growth *understates* the increase in total funding for K-12 education. (This property tax shift, which took place in two stages in 1992-93 and 1993-94, was done to partly offset the major budget shortfalls facing state government in the early 1990s. The property tax shift was partly mitigated by a one-half cent increase in the sales tax, noted above, which is distributed to localities to support public safety.)

- ***Higher Education***. The lower-than-average growth rate for higher education also understates the total resources available to the segments. This is because fees were increased significantly during this period to make up in part for lower General Fund support.

- ***Social Services***. The comparatively low growth rate in social services spending reflects significant grant reductions and eligibility restrictions enacted in the AFDC and Supplemental Security Income/State Supplementary Program during recent years. It also reflects the recent declines in AFDC caseloads, which began in 1994-95, and have accelerated in 1996-97 and 1997-98.

Chapter 3

Major Features of the 1997-98 Budget Plan

PROPOSITION 98 EDUCATION

In this section, we describe the major features of the budget package as it relates to the Proposition 98 minimum funding guarantee and K-12 schools. Resources available for Proposition 98 increased significantly in 1997-98, which allowed the state to fully fund enrollment growth and inflation cost increases, expand the class size reduction program, and increase school district revenue limits.

K-12 Proposition 98 Provisions

The K-12 portion of the Proposition 98 budget package includes:

- ***Prior-Year—1996-97.*** Provides overall K-12 funding of $4,904 per pupil for 1996-97, or $131 more per pupil than anticipated in the *1996-97 Budget Act*.

- ***Budget Year—1997-98.*** Overall K-12 funding of $5,144 per pupil in 1997-98, which represents an increase of $371, or 7.8 percent, above the *1996-97 Budget Act*. (These figures assume enactment of legislation to appropriate funds that were vetoed by the Governor.)

Figure 1 (see next page) summarizes for 1996-97 and 1997-98 the effect of the budget package on K-12 schools, community colleges, and other specified agencies. Proposition 98 funding for K-12 schools totals

$28.9 billion in 1997-98. Figure 2 displays K-12 per-pupil funding amounts from 1991-92 through 1997-98. After adjusting for the effects of inflation, per-pupil funding has increased $277, or 5.7 percent, since 1991-92.

Figure 1

**K-12 Education Budget Summary
1996-97 and 1997-98**

(In Billions)

	1996-97 Budget	1996-97 Revised	1997-98 Budget
K-12 Proposition 98			
General Fund	$17.2	$18.1	$19.9
Local property taxes	8.6	8.7	9.0
Totals, K-12	**$25.9**	**$26.8**	**$28.9**
Average Daily Attendance (ADA)	*5,418,707*	*5,473,882*	*5,611,327*
Amount per ADA	*$4,773*	*$4,904*	*$5,144*
California Community Colleges			
General Fund	$1.6	$1.7	$1.9
Local property taxes	1.4	1.4	1.4
Totals, Community Colleges	**$3.0**	**$3.1**	**$3.3**
Other agencies	$0.1	$0.1	$0.1
Loan repayment	$0.2	$0.2	$0.2
Grand Totals, Proposition 98	**$29.1**	**$30.2**	**$32.5**
General Fund	$19.1	$20.1	$22.1
Local property taxes	10.0	10.1	10.4

K-12 Program Impacts

1996-97 and Prior Years' Settle-Up Funding. Proposition 98 minimum funding levels are determined by one of four specified formulas, each using a set of specified factors. Because the factors change during the year, the minimum funding guarantee under Proposition 98 also changes. Any additional amount needed to satisfy the guarantee is referred to as Proposition 98 "settle-up" funding.

The budget contains approximately $1.2 billion in settle-up funds. Figure 3 displays the major allocations of these monies. Pursuant to

Figure 2

Proposition 98 Funding Per Student

Current and Constant Dollars

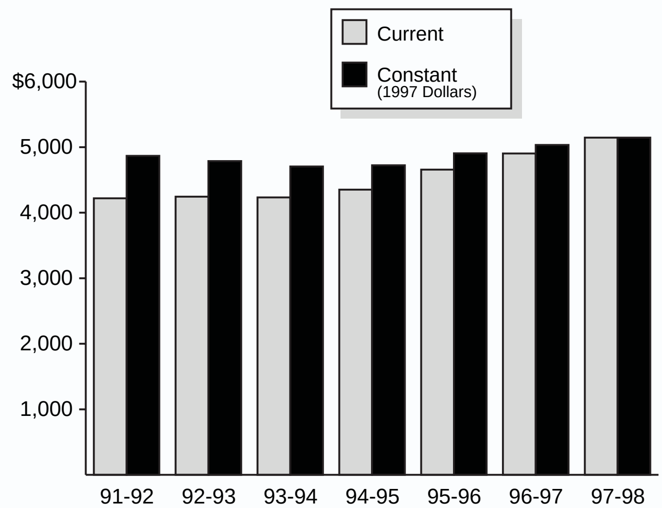


Figure 3

**K-12 Education
Major Actions Regarding Prior-Year Funds**

(In Millions)

Purpose	Amount
Revenue limit—equalization and deficit reduction	$522.0
Facilities for class size reduction	159.0
Mandates	158.6
Deferred maintenance	100.0
Special education deficiency	59.0
Digital high school	50.0
Child care facilities	25.0
Adult education—welfare reform	25.0

Chapter 203, Statutes of 1996 (AB 3497, Richter), the budget provides $522 million for revenue limit equalization and deficit reduction, with half the funds going to each purpose. The remaining funds are allocated for a variety of one-time purposes. For example, $159 million is allocated for facilities for class size reduction. These funds will pay for facilities requested for the 1996-97 school year that were not previously funded. The budget also provides one-time funds for deferred maintenance, educational technology (digital high school), and creation of new child care facilities.

1997-98 Baseline Increases. Compared to the *1996-97 Budget Act*, K-12 Proposition 98 funding increased by $3 billion in 1997-98. Figure 4 displays the major K-12 Proposition 98 appropriations for 1997-98. The budget allocates $1.4 billion to provide inflation and growth adjustments. Specifically, the budget includes about $722 million to accommodate a projected 2.5 percent increase in the student population and $707 million for a cost-of-living adjustment (2.65 percent) for K-12 programs.

Figure 4

K-12 Education
Major Actions Regarding 1997-98 Funds

(In Millions)

Purpose	Amount
Growth in student attendance	$722.0
COLAs	707.0
Expand class size reduction	717.6
Equalization and deficit reduction	555.2
Special education reform	76.7
Child development expansion	64.0
Digital high school	50.0
Buyout of one staff development day	50.0

The budget directs the remaining $1.6 billion for other purposes, including new programs and existing K-12 categorical programs. The major discretionary increases approved in the budget are as follows:

- ***Class Size Reduction***. The budget dedicates about $718 million for expansion of the class size reduction program, bringing total funding for the program to $1.5 billion. The new funds are sufficient to increase per-pupil funding in the program from $650 to $800, and expand the program from three to four grades.

- ***Equalization and Deficit Reduction***. The budget continues the equalization and deficit reduction funds provided for the 1996-97 year in the base budget for 1997-98. Because these funds cannot be released until the accounting for the 1996-97 fiscal year is complete, districts will receive both the $522 million provided for 1996-97 and the continuation amount of $555 million in the 1997-98 budget year.

- ***Other 1997-98 Initiatives***. As Figure 4 illustrates, the budget contains a number of other program increases. The budget includes an additional $76.7 million for special education reform. The Legislature passed AB 602 (Davis and Poochigian) containing the proposed reforms. The budget also includes funds for other programs, including child care, educational technology, staff development, and assessment.

Federal Goals 2000 Funds. The budget includes the expenditure of $87.9 million in Goals 2000 funds. The budget spends these funds for a wide variety of purposes. Figure 5 (see next page) displays the largest Goals 2000 expenditures. As the figure shows, by far the largest Goals 2000 expenditure is $56 million for staff development in reading for teachers in grades kindergarten through eight.

Figure 5

**Federal Goals 2000
Budget Expenditures, 1997-98**

(In Millions)

K-8 staff development	$56.0
Local improvement plans	15.2
Student tutoring program	5.0
Donated Computer Program	4.7
Partnerships between districts and higher education	4.0
Program evaluation	1.7

Governor's Vetoes. The Governor vetoed $203 million in 1997-98 Proposition 98 funds and $14.9 million in settle-up funds. Of these funds, $189 million in 1997-98 funds and $10.2 million in settle-up funds were "set-aside" pending an agreement with the Legislature regarding student testing. In September, the Legislature passed legislation restoring these funds. Figure 6 lists the major restorations of ongoing funds in the 1997-98 budget. The Legislature also appropriated settle-up funds for several new programs, including $5.7 million for school libraries and $3.7 million for technology projects at several school districts. The Governor has not yet taken action on these budget restorations.

Figure 6

**Previously Vetoed Funds
Restored to the 1997-98 Budget[a]**

(In Millions)

Mega Item growth and COLA	$123.0
Pupil assessments	31.2
Adult Education COLA	12.2
ROC/P COLA	7.6

[a] Contained in AB 1188 (Lempert), AB 1571 (Ducheny), and AB 1587 (Committee on Budget).

HIGHER EDUCATION

Figure 7 shows the change in funding for each major segment of higher education for 1997-98 from selected fund sources. Figure 8 (see next page) shows for each segment spending per full-time-equivalent student over the past 25 years. (It includes expenditures from General Fund, local property tax, lottery fund, and student-fee revenues.) After adjusting for the effects of inflation, expenditures from these sources

Figure 7

**Higher Education Budget Summary
Selected Funding Sources
Change from 1996-97 to 1997-98**

(Dollars in Millions)

	1997-98[a] Budget	Change From 1996-97[b] Amount	Percent
University of California			
General Fund	$2,184.4	$124.0	6.0%
Student fees	629.8	11.8[c]	1.9
Totals	**$2,814.2**	**$135.8**	**5.1%**
California State University			
General Fund	$1,896.1	$115.7	6.5%
Student fees	609.4	5.7[c]	0.9
Totals	**$2,505.5**	**$121.4**	**5.1%**
California Community Colleges			
General Fund	$1,919.8	$310.1	19.3%
Property taxes	1,402.5	39.6	2.9
Student fees	176.4	5.1[c]	3.0
Totals	**$3,498.7**	**$354.8**	**11.3%**
Student Aid Commission			
General Fund	$295.3	$30.5	11.5%

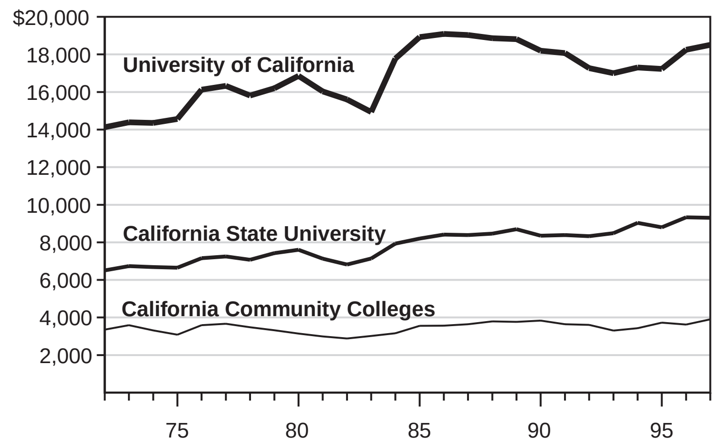
a Includes $2.8 million (UC), $7.5 million (CSU), and $22.7 million (CCC) in AB 1188 (Lempert) and AB 1571 (Ducheny), two bills that are before the Governor.
b Does not include one-time funds.
c Increase due to more students and/or an increase in certain professional program fees.

will be $4,377 more per student (31 percent) for the University of California (UC), $2,796 more per student (43 percent) for the California State University (CSU), and $544 more per student (16 percent) for the California community colleges (CCC) than in 1972-73.

Figure 8

California Public Higher Education Spending[a] Per Full-Time-Equivalent Student

Constant 1997 Dollars



[a] Includes expenditures from total General Fund, local tax, student fee, and lottery revenues.

University of California

The *1997-98 Budget Act* and related legislation provides $124 million (6 percent) more in General Fund support for the UC in 1997-98 compared to 1996-97. The budget assumes no general increase in undergraduate and graduate student fees, although growth in the number of UC students and the fourth year of a four-year planned increase in graduate professional program fees (including law, medicine, dentistry, and veterinary medicine) will generate an expected $11.8 million in increased revenues for the UC in 1997-98. (Assembly Bill 1318 [Ducheny], discussed in more detail later, would reduce undergraduate fees and freeze graduate / professional fees in 1998-99.)

The Legislature approved a budget plan for the UC that includes:

- ❖ $82 million in employee compensation to provide a 2 percent cost-of-living increase for all employees (effective October 1, 1997), an additional 3 percent "parity" salary increase for faculty (also effective October 1, 1997), and merit salary increases for eligible faculty and staff. An additional increase of $15 million will cover the annualized costs of salary increases from the prior year.

- ❖ $11.8 million to offset the impact of inflation on goods and services.

- ❖ $10.5 million to increase student enrollment by 1,500 (1 percent).

The California State University

The *1997-98 Budget Act* and related legislation provides $116 million (6.5 percent) more in General Fund support for the CSU in 1997-98 than in 1996-97. As with the UC, the budget assumes no general increase in student fees. (Assembly Bill 1318 [Ducheny], discussed in more detail later, would reduce student fees by 5 percent for the 1998-99 fiscal year.)

The Legislature approved a budget plan for the CSU that includes:

- ❖ $68 million to provide a 4 percent pool of funds for employee compensation increases. How these funds are used (for cost-of-living adjustments, merit increases, and parity adjustments) will be determined through collective bargaining.

- ❖ $14.4 million to increase enrollment by 2,500 students (1 percent).

Community Colleges

Because of the major increases in Proposition 98 funding in 1996-97 and 1997-98, the 1997 budget package contains major funding increases for community colleges. Specifically, General Fund spending for community colleges totals more than $1.9 billion in the budget year. This represents a $310 million, or 19 percent, increase above the funding level included in the *1996-97 Budget Act*. (The 1996-97 total in Figure 9 does not include $106 million of one-time funds made available to the colleges due to the recent upward revision of the Proposition 98 guarantee for that fiscal year.) The budget does not contain any increase in student fee levels. Fee revenues, however, will increase due to enrollment growth. (Assembly Bill 1318 [Ducheny], discussed in more detail later, would reduce student fees for the 1998-99 fiscal year.)

1997-98 Expenditures. Figure 9 illustrates the major program increases provided with the additional funds in 1997-98. The budget includes $89 million for colleges to increase enrollment by a statewide average of 3 percent. The budget also provides $65 million for various services for students on welfare, expands the economic development program (by $15 million), and starts a job development program ($5 million).

Settle-Up Expenditures. The budget includes $130 million in settle-up funding for 1996-97 and prior years for several one-time activities. Of this amount, the budget allocates $98 million for district block grants, which will be allocated on a per-student basis. The budget also provides $20 million for deferred maintenance and $10 million for child care facilities.

Figure 9

Major Community College Increases 1997-98 General Fund

(In Millions)

Purpose	Amount
COLA	$91.0
Enrollment growth	89.2
Welfare reform	65.0
Instructional equipment	29.0
Lease-purchase payments	20.9
Economic and job development	20.0

Vetoes. The Governor vetoed $24 million of 1997-98 appropriations for the community colleges. In his veto message, the Governor expressed his willingness to restore $10.6 million of this amount—$8.6 million for equalization and $2 million for office hours for part-time faculty—upon enactment of legislation meeting his criteria for statewide testing of pupils in grades 2 through 11. Assembly Bill 1188 (Lempert) restored these funds and awaits consideration by the Governor. The remaining vetoes included a $5 million reduction for faculty and staff development and a $5 million reduction in a new job development program. In AB 1571 (Ducheny), the Legislature restored $12.1 million for various other purposes. The bill also awaits consideration by the Governor.

Student Aid Commission

The budget appropriates $295 million from the General Fund for the Student Aid Commission in 1997-98, which is an increase of $31 million, or 12 percent. Of this amount, $26 million represents augmentations to the Cal-Grant program, which provides financial aid grants to higher education students in California. These augmentations include funds to increase the number of grants by 3,916 students and to increase the maximum grant amount for students attending private colleges and universities from $7,164 to $8,184.

Student Fees

The *1997-98 Budget Act* provides adequate funds to UC, CSU, and the CCC to permit systemwide, mandatory fees for California resident undergraduates to be held level for the third consecutive fiscal year. For 1997-98, the Legislature allocated a total of $67 million from the General Fund to UC and CSU to "buy out" potential fee increases of 10 percent.

In AB 1318 (Ducheny), now awaiting consideration by the Governor, the Legislature appropriated $42 million *for the 1998-99 fiscal year*, to compensate UC and CSU for resident undergraduate fee reductions of 5 percent for that fiscal year. This bill also would freeze fees for graduate and professional degree programs at UC for two years, beginning in 1998-99. To the extent UC and CSU would otherwise have raised fees to cover increased costs in 1998-99 and 1999-00, the measure would result in *additional* General Fund costs as a result of the "frozen" fees.

In addition, the bill reduced CCC fees from $13 per credit unit to $12 per credit unit for 1998-99, and stated its intent to compensate the CCC for any foregone fee revenue (about $14 million). Figure 10 shows how fees for full-time students would be affected if the bill is signed by the Governor.

Figure 10

Higher Education Fees Under AB 1318 (Ducheny)[a] 1997-98 through 1999-00

System	1997-98	1998-99	1999-00	Change From 1997-98
University of California	$3,799	$3,609	$3,609	-$190
California State University	1,584	1,505	1,505	-79
California Community Colleges	390	360	360	-30

[a] Mandatory systemwide fees for full-time undergraduate students (California residents).

HEALTH AND SOCIAL SERVICES

In this section, we describe the major features of the health and social services funding in the budget package. General Fund support for health and social services programs in 1997-98 totals $14.9 billion, an increase of slightly less than 1 percent over the prior year. Increases from workload-related activities and new or expanded programs such as welfare reform were offset by various savings, the largest resulting from caseload reductions in the Temporary Assistance for Needy Families (TANF) program.

Figure 11 describes the major General Fund changes (from prior law) enacted in the *1997-98 Budget Act* and related legislation. The major health trailer bill was SB 391 (Solis). The major social services trailer bill was AB 1153 (Escutia), which was vetoed and subsequently replaced by AB 67 (Escutia).

Medi-Cal Program

The California Medical Assistance (Medi-Cal) Program provides health care services to welfare recipients and to other qualified low-income persons (primarily families with children and the aged, blind, or disabled). The Department of Health Services (DHS) administers the program. The budget appropriates $7 billion from the General Fund to the department for Medi-Cal benefits in 1997-98, an increase of 2.1 percent over estimated General Fund spending in 1996-97. The DHS budget also includes $10.1 billion of federal Medicaid funds in 1997-98. These Medicaid funds match state General Fund spending for Medi-Cal benefits in the DHS budget, and they include additional federal funding to (1) provide supplemental payments to disproportionate share hospitals (DSH) and (2) match state funds budgeted in other departments for several related programs.

Reduced State "Takeout" From DSH Payments. The budget includes a $75 million General Fund augmentation in the Medi-Cal program to backfill for a reduction in the state "takeout" from DSH contributions made by public hospitals operated by counties, the University of California, and local hospital districts. The state obtains a federal match to these DSH contributions and allocates the combined funds (about $2.2 billion after the state takeout) to both public and private

Figure 11

Health and Welfare Programs
Major 1997-98 Policy Changes—General Fund

(In Millions)

Program/Issue	Change From Prior Law
Medi-Cal	
Disproportionate share hospitals	$75.0
Medicare/Medi-Cal crossover payment limit	-94.0
Prenatal services for illegal immigrants	-63.7[a]
Public Health	
Primary care programs	$5.0
Department of Developmental Services	
Community care facilities rate increase	$7.2
Regional center services	13.4
Department of Mental Health	
State hospital overhead costs	$11.9
Children's System of Care Program	6.0
AFDC/TANF[b]	
Welfare reform (CalWORKs[c] and related programs)	$217.1[d]
SSI/SSP	
Continue suspension of cost-of-living adjustment for one year	-$27.4
Reject continuation of statewide 4.9 percent grant reduction	—
State-only program for aged legal noncitizens	—[e]
Food Stamps	
State-only program for legal noncitizens—children and elderly	$35.6

a Budget includes about $21 million which would fund the program for the first three months of the fiscal year. Existing state law authorizes the program, but federal welfare reform legislation of 1996 requires a new state law to continue the program. The Governor vetoed budget language to continue the program.
b Aid to Families with Dependent Children/Temporary Assistance for Needy Families.
c California Work Opportunity and Responsibility to Kids program.
d Includes $111 million in Proposition 98 funds.
e The Governor vetoed $17 million provided by the Legislature.

hospitals that serve a disproportionate number of low-income persons. The budget action reduces the state takeout, which is used to offset a portion of the General Fund cost of the Medi-Cal program, from $229.8 million to $154.8 million in 1997-98. The budget, as passed by the Legislature, also expressed intent to reduce the state takeout by an additional $25 million in 1998-99. However, the Governor vetoed this language.

The budget action primarily benefits counties that operate county hospitals, which provide most of the DSH transfers. Absent the budget action, these counties would have had to increase their contributions by about $50 million to offset the loss of contributions from Fresno and several smaller counties that recently closed their county hospitals. The remaining benefit of about $25 million will enable counties to reduce their contributions or to receive more DSH funds.

Medicare/Medi-Cal "Crossover" Payment Limits. The recently enacted federal *Balanced Budget Act of 1997* allows California to reinstate crossover payment limits, for an estimated General Fund savings of $94 million in 1997-98. These payment limits apply to dual beneficiaries—low-income persons who are aged or disabled and qualify for benefits under both the Medi-Cal program and the federal Medicare program. For these dual beneficiaries, Medi-Cal pays the cost of premiums, deductibles, and copayments that normally are the responsibility of the Medicare beneficiary.

Currently, allowable Medicare charges for a service often exceed Medi-Cal rates. Under the crossover limits, however, Medi-Cal will only pay deductibles and copayments for Medicare-covered services to the extent necessary to meet the Medi-Cal payment rate, and Medicare providers must accept the Medi-Cal rates as payment in full. The federal courts overturned California's existing crossover limits in 1996. Federal budget legislation, however, enables the state to reinstate the limits.

Continuation of Prenatal Care for Illegal Immigrant Women. The budget, as passed by the Legislature, authorized the continuation of prenatal benefits for illegal immigrant women and provided

$23 million to partially fund those costs in 1997-98. (The 1996 federal welfare reform legislation requires states to enact new legislation in order to continue providing benefits to illegal immigrants.) The Governor vetoed the language authorizing continuation of the program and reduced funding by $1.7 million. Consequently, this leaves $21 million for the program, which would terminate December 1, 1997, under the proposed regulations.

Healthy Families—A New Program to Expand Health Coverage for Children

The federal *Balanced Budget Act of 1997* created the State Children's Health Insurance Program. For the program's first year (starting October 1, 1997), up to $885 million is available to California on approximately a 2-to-1 federal/state matching basis. These federal funds can be carried forward for up to two years. States may use the funds to provide health care coverage for children in families with incomes that are less than 200 percent of the federal poverty level (FPL)—$32,100 for a family of four—but are too high to qualify for Medicaid (Medi-Cal in California). Subsequent to enactment of the state budget, the Governor proposed a new state program to implement this federal program by July 1, 1998. The Legislature adopted, with some modifications, a package of three bills to implement the "Healthy Families Program."

Assembly Bill 1126 (Villaraigosa) Establishes the Healthy Families Program. The new program is based on an insurance model of providing health coverage. It will be administered by the Managed Risk Medical Insurance Board (MRMIB), which will help low-income families purchase health coverage for their children. The program has the following major features:

- ***Eligibility.*** Qualifying family income levels will be between 133 percent and 200 percent of FPL for children ages 1 through 5, and between 100 percent and 200 percent of FPL for children ages 6 through 18. Children at lower income levels (and infants up to 200 percent of FPL) are eligible for Medi-Cal coverage.

Generally children must not have been covered by employer-sponsored insurance for at least three months to qualify. Families will purchase health insurance coverage directly through MRMIB or receive purchasing credits from MRMIB to participate in employer-sponsored coverage, if available.

- ***Benefits.*** Health benefits will be equivalent to state employee health benefits, including vision, dental, and mental health coverage.

- ***Premiums and Copayments.*** Monthly premiums paid by families for the lowest-cost plan will be $7 per child (up to 150 percent of FPL) or $9 per child (up to 200 percent of FPL), with family maximums of $14 and $27, respectively. Families that choose higher-cost plans would pay the difference, and families that choose the plan with the greatest participation of traditional Medi-Cal and safety net providers would receive a $3-per-child premium discount. Copayments for most outpatient services will be $5, excluding preventive care, with an annual cap of $250.

Senate Bill 903 (Lee) Broadens and Simplifies Medi-Cal Eligibility for Poor Children. Children ages 14 through 18 in families up to 100 percent of FPL will be eligible for coverage now, rather than being phased in a year at a time. This measure also eliminates asset limits for Medi-Cal coverage of children and requires DHS to allow enrollment through a simplified mail-in form.

Assembly Bill 1572 (Villaraigosa) Provides Initial Funding. This measure appropriates $4.9 million ($1.8 million General Fund, $3.1 million federal funds) to MRMIB and DHS for startup costs and outreach efforts for the Healthy Families and Medi-Cal programs.

Because the new insurance program is not expected to operate until 1998-99, costs in 1997-98 will be modest—probably less than $20 million to the General Fund, depending on when the Medi-Cal eligibility changes are implemented. On a full-year basis, the administration estimates that the new insurance program will cost a total of $485 million ($315 million federal funds, $170 million General Fund) to cover all currently-eligible uninsured children plus an additional $43 million ($25 million federal funds, $18 million General Fund) for increased Medi-Cal costs.

Public Health

The DHS administers a broad range of public health programs including (1) programs that complement and support the activities of local health agencies controlling environmental hazards, preventing and controlling disease, and providing health services to populations with special needs; and (2) state-operated programs, such as those which license health facilities and certain types of technical personnel.

Primary Care Expansion. The budget, as passed by the Legislature, allocated $30 million from the General Fund to expand primary care services in three programs: the Early Access to Primary Care program ($7 million), the Rural Health Clinics grant program ($6.5 million), and the California Healthcare for Indigents Program ($16.5 million). In the budget deliberations, funds for these expansions were redirected from a reduction in the budget for Medi-Cal prenatal care services for illegal immigrants. Subsequently, the Governor vetoed these funds. The budget includes a $3 million General Fund augmentation for the Seasonal Agricultural and Migrant Worker Clinics grant program, and a $2 million General Fund augmentation for the Rural Health Clinics grant program.

Department of Developmental Services

The Department of Developmental Services administers services in local communities through regional centers and state developmental centers for persons with developmental disabilities. A developmental disability is defined as a disability, related to certain mental or neurological impairments originating before a person’s eighteenth birthday, that is expected to continue indefinitely and that constitutes a substantial handicap.

Community Care Facilities Rate Adjustment. The budget includes $11.4 million ($3 million General Fund and $8.4 million in reimbursements, which are 49 percent General Fund) to provide a 3 percent rate increase for community care facilities.

Regional Center Operations and Services. The budget includes $18.1 million ($8.9 million General Fund and $9.2 million in reimbursements, which are 49 percent General Fund) for the following activities to augment and improve regional centers' operations and services: $6.1 million to establish a clinical health team in each center; $5.6 million to add case managers in order to expand program monitoring; $0.6 million to provide enhanced case management for persons transferring from developmental centers to community programs; $1 million for start-up funding for Supportive Living Services, which will assist persons to live more independently in their communities; $2 million for infant mental health services; $1 million for "Wellness Initiative" projects to improve access to health care specialists and enhance health care; $1.3 million for research and analysis of persons moving from developmental centers to community living; $0.4 million to expand consumer rights advocacy services; and $0.2 million to contract with the Organization of Area Boards to conduct "Life Quality Assessments" of regional center clients.

Department of Mental Health

The Department of Mental Health directs and coordinates statewide efforts for the treatment of mental disabilities. The department's primary responsibilities are to (1) administer the Bronzan-McCorquodale and Lanterman-Petris-Short Acts, which provide for the delivery of mental health services through a state-county partnership and for involuntary treatment of the mentally disabled; (2) operate four state hospitals and the Acute Psychiatric Program at the California Medical Facility at Vacaville; and (3) administer community programs directed at specific populations.

State Hospital Overhead Costs. The budget includes a General Fund cost of $11.9 million to reflect an adjustment in the distribution of state hospital overhead costs between the state and the counties, due to an increase in the proportion of patients for whom the state is responsible.

Children's System of Care Program. The budget includes $6 million from the General Fund to expand the Children's System of Care Program, in which participating counties provide a coordinated delivery system for children's mental health services through local interagency collaboration. The additional funds will be awarded based on county proposals to the department.

Aid to Families with Dependent Children/ Temporary Assistance for Needy Families Program

The Aid to Families with Dependent Children / Temporary Assistance for Needy Families (AFDC / TANF) Family Group and Unemployed Parent Programs provide cash grants to low-income families with children. The AFDC Foster Care program provides grants to pay for the care of children placed in foster family homes or group homes. The budget plan provides $2.2 billion from the General Fund for the AFDC program in 1997-98. This represents a decrease of 18 percent from estimated 1996-97 expenditures, due primarily to caseload reductions.

Welfare Reform. Assembly Bill 1542 (Ducheny, Ashburn, Thompson, and Maddy) creates the California Work Opportunity and Responsibility to Kids (CalWORKs) program and creates and modifies other related programs. This act, in conjunction with budget legislation, results in a state cost of $218 million in 1997-98, compared to prior law. This includes $111 million from the Proposition 98 allocation for schools and community colleges. (We note, however, that because of declining caseloads, the budget appropriation for the AFDC / CalWORKs program is less than estimated expenditures for 1996-97.) Figure 12 (see pages 21 and 22) provides detail on this fiscal impact and Figure 13 (see pages 23 and 24) describes the major features of AB 1542.

Figure 12

CalWORKs[a] (AB 1542) and Related Programs Fiscal Summary—State Funds

(In Millions)	Change From Prior Law	
	Non-Proposition 98	Proposition 98
Department of Social Services (DSS)		
Eligibility		
Conform resource limits to Food Stamps	$8.8	—
Eliminate "look back" requirement for two-parent families	1.0	—
Modify treatment of lump sum income and recovery of overpayments	1.9	—
Services		
Welfare-to-Work services (GAIN)	$222.6	—
Mental health and substance abuse	23.5	
Child care	106.4	—
Child care capacity building	8.0	—
Child care capacity building (to Department of Education)	8.0	—
Microenterprise projects	—[b]	—
Job identification program	6.7	—
County Administration		
Retraining and retooling	$40.6	—
County fiscal incentives (county savings)	19.3	—
Other	7.0	—
Subtotals—DSS costs	**($453.8)**	**—**
Grants and County Administration		
Continue 4.9 percent grant reduction	-$135.2	—
Suspend cost-of-living adjustment	-71.0	—
Eliminate Beno case grant reduction exemptions	-35.0	—
$225 and 50 percent earned income disregard	-82.2	
Eliminate child care disregard	-20.4	—
Exits due to employment	-3.2	—
Increased earnings	-8.1	—
Failure to participate (sanctions)	-9.7	—
GAIN conciliation (county administration)	-9.9	—
Paternity establishment	-4.0	—
Subtotals—DSS savings	**(-$378.7)**	**—**
Net Impact—DSS	**$75.1**	**—**

Continued

(In Millions)	Change From Prior Law	
	Non-Proposition 98	Proposition 98
Community Colleges		
Work-study and child care	—	$49.5
Job placement/coordination/curriculum development	—	15.5
Job development	—	5.0[c]
Department of Education		
Adult education	—	$25.0
Child care	—	16.0
Employment Development Department		
Employment Training Panel Program	$20.0	—
Trade and Commerce Agency		
Job creation	$5.0[d]	—
Department of Housing and Community Development		
Child care loan funds	$7.0	—
Total (all departments)	**$107.1**	**$111.0**
Total (all state funds)	**$218.1**	

a California Work Opportunity and Responsibility to Kids program.

b The Governor vetoed $2.5 million provided by the Legislature. Subsequent legislation (AB 1571, Bustamante) provided $1 million in federal funds. Gubernatorial action still pending on this legislation.

c The Legislature appropriated $10 million. The Governor reduced this amount to $5 million.

d AB 1571 provided an additional $5 million. Gubernatorial action still pending on this legislation

Grants. Assembly Bill 1542 extended through October 1998 the (1) statewide 4.9 percent grant reduction enacted in 1995-96, and (2) suspension of the statutory cost-of-living adjustment (COLA). Figure 14 (see page 25) shows the AFDC/TANF grant levels for a family of three in both low-cost and high-cost counties.

Caseload Reduction. After reaching a peak of 921,000 cases in 1994-95, the AFDC/TANF caseload decreased by 2 percent in 1995-96 and 6.6 percent in 1996-97. For 1997-98, the caseload is projected to decline by just over 10 percent, resulting in savings of $542 million compared to 1996-97. Figure 15 (see page 25) shows the historical caseload trend and the projected caseload for 1997-98.

Figure 13

CalWORKs[a] Program (AB 1542) Major Features

Eligibility

- ☑ ***"Look Back" Provision.*** Eliminates the requirement that two-parent families applying for assistance have a prior connection to the labor force.
- ☑ ***Resource Limits.*** Conforms resource limits to the amounts permitted under federal law for the Food Stamps program. (This increases the asset limit for automobiles, as applied to applicants, from $1,500 to $4,650.)
- ☑ ***Diversion Program.*** Permits counties to provide eligible applicant families with up to three months of aid payments in the form of a lump sum for purposes of providing temporary assistance so that the family does not enter the program.

Grants

- ☑ ***Maximum Grants.*** Continues 4.9 percent statewide grant reduction and suspension of the statutory COLA through October 31, 1998.
- ☑ ***Beno Exemptions.*** Eliminates Beno court case grant reduction exemptions (applicable to certain recipients not able to work).
- ☑ ***Income Disregards***. Replaces the existing "fill the gap" and "$30 and one-third disregard" with a $225 plus 50 percent earned income disregard, whereby the first $225 of earnings plus 50 percent of each additional dollar of earnings are disregarded in determining the family's grant.

Services

- ☑ ***Welfare-to-Work Activities.*** Specifies the following sequence of services: job search; assessment; welfare-to-work activities (education and training); and community service employment.
- ☑ ***Child Care.*** Creates a new delivery system administered by county welfare departments and the State Department of Education.
- ☑ ***Employment Retention.*** Authorizes up to one year of case management and other job retention services for persons leaving aid due to employment.

Continued

Participation Requirements

- ✔ ***Weekly Hours.*** Adults in single parent families must participate in work or approved education or training activities for 20 hours per week effective January 1, 1998, 26 hours effective July 1, 1998, and 32 hours effective July 1, 1999 and thereafter. An adult recipient in a two-parent family must participate for 35 hours per week.
- ✔ ***Sanctions.*** The sanction for failure to participate in work activities or community service is removal of the adult portion of the grant.

Time Limits

- ✔ ***Welfare-to-Work Services.*** New applicants are limited to 18 months of job training/education services. Existing recipients are limited to 24 months. Counties may extend the 18 month limit by six months if the extension is likely to lead to nonsubsidized employment or if no jobs are available. Able-bodied adults must commence community service employment at the end of these time limits.
- ✔ ***Five-Year Time Limit/Safety Net.*** After five cumulative years on aid, the amount of the grant is reduced by the portion for the adult. Counties have the option of providing subsequent aid in the form of cash or vouchers. Certain recipients are exempt, including specified caretaker relatives and disabled persons.

County Administration

- ✔ ***County Training.*** Provides funding for county training and "retooling."
- ✔ ***County Fiscal Incentives.*** Provides 100 percent of certain grant savings to the counties. Specifically, allocates 75 percent of the state's grant savings resulting from (1) program exits due to employment lasting six months, (2) increased earnings due to employment, and (3) diversion of applicants from the program. The remaining 25 percent of such grant savings shall be allocated to counties that have not achieved savings but have performed in a manner "worthy of recognition." Counties must use these savings in the CalWORKs program unless expenditure of these funds is not needed to meet the federal TANF maintenance-of-effort requirement.
- ✔ ***Fraud Savings.*** Reallocates 25 percent of the state's savings from fraud detection activities to the counties.

[a] California Work Opportunity and Responsibility to Kids program.

Figure 14

Temporary Assistance for Needy Families (TANF) and SSI/SSP Maximum Monthly Grants[a] 1996-97 and 1997-98

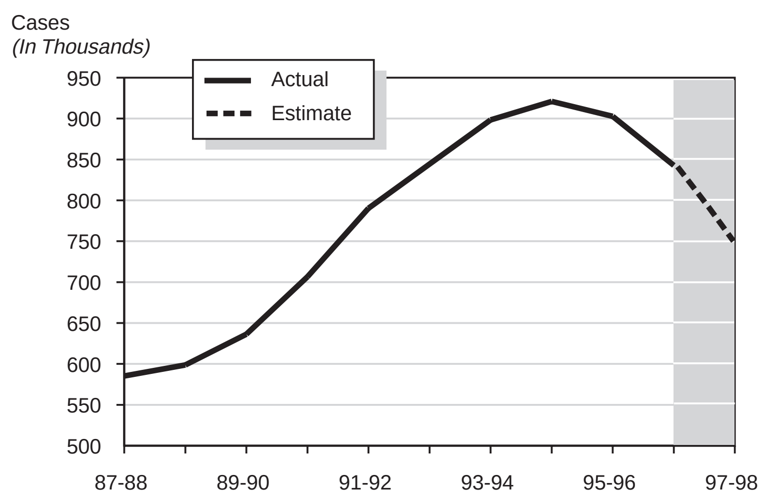
			Change	
	1996-97	1997-98	Amount	Percent
TANF[b]				
Low-cost counties	$538	$538	—	—
High-cost counties	565	565	—	—
SSI/SSP—Individuals[c]				
Low-cost counties	$640	$622[d]	-$18	-2.8%
High-cost counties	640	652	12	2
SSI/SSP—Couples[c]				
Low-cost counties	$ 1,122	$ 1,106[d]	-$16	-1.5%
High-cost counties	1,122	1,160	38	3

a Reflects inability to implement SSI/SSP grant reductions during 1996-97 and assumes implementation of regional SSI/SSP grant reduction in the low-cost counties in 1997-98.
b Amounts shown are for a family of three.
c Amounts shown are for aged or disabled persons. Includes "pass through" of federal SSI COLA ($12 per individual and $19 per couple) effective January 1, 1998.
d Requires elimination of federal maintenance-of-effort provision in order to reduce grants to this level.

Figure 15

AFDC/TANF Caseloads Declining

1987-88 Through 1997-98 (In Thousands)



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 appropriates $2 billion from the General Fund for the program in 1997-98, which is an increase of less than 1 percent over 1996-97.

Grant Payments. Pursuant to current law, the budget rejected the Governor's proposal to make permanent the 4.9 percent statewide grant reduction enacted in 1995. The budget legislation, however, extends the suspension of the statutory COLA for one year, resulting in General Fund savings of $27 million. (See Figure 14 for grant levels.)

October Grant Reduction Cannot Be Implemented. As discussed above, the Legislature did not extend the statewide 4.9 percent grant reduction beyond October 31, 1997. The budget assumes $25 million in savings from implementing this reduction, pursuant to current law, during the month of October 1997. This grant reduction, however, cannot be implemented due to the federal maintenance-of-effort requirement. Thus, the budgeted savings will not be achieved.

Elderly Noncitizens. Federal welfare reform, as amended by the *Balanced Budget Act of 1997*, makes elderly legal noncitizens, who were in the United States prior to August 22, 1996 but not yet receiving aid, ineligible for the SSI/SSP. The budget, as passed by the Legislature, provided state-only funded benefits for such legal noncitizens, resulting in a General Fund cost of $17 million in 1997-98. Subsequently, the Governor vetoed these funds.

Federal Administrative Fee Increase. The federal *Balanced Budget Act of 1997* increased the monthly federal administrative fee from $5 per case to $6.20 per case effective October 1, 1997. This fee increase is estimated to result in a General Fund cost of $11 million in 1997-98, which was not included in the budget. Thus, the cost represents a potential deficiency.

FOOD STAMPS PROGRAM

The Food Stamps Program provides food stamps to low-income persons. The cost of the food stamps coupons (over $2 billion) is borne entirely by the federal government, with the exception of the new state-only program, as discussed below.

State-Only Program for Children and Elderly Noncitizens. Federal welfare reform makes legal noncitizens (with certain exceptions) ineligible for food stamps benefits. The budget legislation (AB 1576, Bustamante) provides state-only funded food stamp benefits for noncitizens under the age of 18 or over the age of 64 who were residing in the United States prior to August 22, 1994. This temporary program commences on September 1, 1997 and sunsets on July 1, 2000.

JUDICIAL AND CRIMINAL JUSTICE

The 1997-98 budget for judicial and criminal justice programs totals $5.4 billion, including $4.7 billion from the General Fund and $663 million from state special funds. This is an increase of $308 million, or 6.1 percent, over 1996-97 expenditures. This increase is due to a number of factors, including increases in spending to accommodate the projected growth in the state's prison and parole populations, declining federal support (and thus increased state costs) to pay the costs of incarcerating undocumented felons in state prison, and increases in state support of the trial courts financed primarily by increases in court filing fees.

The amount is about $266 million below the Governor's proposed budget. The principal reasons for the change are legislative actions to use additional federal funds (instead of the General Fund) to pay the costs of incarcerating undocumented felons, downward revisions of estimates of the prison inmate population, and the Legislature's rejection of some policy initiatives and augmentations proposed by the Governor.

Trial Court Funding Restructuring

The budget act includes $1.6 billion for support of the trial courts in 1997-98. Of this amount, $890 million would be from funds transmitted by counties to the state which would, in turn, be allocated to the courts. This transaction would be part of a larger restructuring of the way the trial courts are supported.

In January, the Governor proposed a major consolidation of funding responsibility for the trial courts at the state level. In enacting the *1997-98 Budget Act,* the Legislature modified the Governor's plan substantially. The restructuring plan, which was adopted in AB 233 (Escutia and Pringle), will result in a major change in the way funding is provided to trial courts and represents the most significant fiscal relief provided to counties this year. Because many of the provisions of AB 233 will not take effect until 1998-99, its changes will have no General Fund impact in 1997-98, but will result in additional General Fund costs to the state of at least $350 million in 1998-99. The amount could be greater depending on (1) growth in operating costs of trial courts and (2) decisions by the Legislature and Governor with regard to how much money to provide to the Judicial Council for improvement and efficiencies in court operations.

The major elements of the plan are shown in Figure 16 and are described in more detail.

County Costs for Courts Capped. Under the new funding arrangement, county costs for support of the courts would be $890 million in 1997-98 (roughly equivalent to the amount they paid in 1994-95). The amount would be reduced to $605 million in 1998-99 and capped at that amount in future years. As a result, in 1998-99, counties will experience savings of $285 million. This amount includes savings resulting from the state increasing its share of every county's court costs to at least 58 percent ($274 million), and paying for all court costs of the 20 smallest counties ($10.7 million).

Figure 16

Major Features of AB 233
Trial Court Funding Consolidation Plan

- ✓ Establishes a cap on county contribution for support of the trial courts:
  - $890 million in 1997-98 (roughly equivalent to amounts expended in 1994-95).
  - Reduced to $605 million in 1998-99.
  - Reduction in 1998-99 results in savings to counties of $274 million and corresponding costs to state.
- ✓ State pays 100 percent cost of the courts in 20 smallest counties, beginning in 1998-99 (cost to state: $10.7 million).
- ✓ State funds future cost increases (estimated annual cost: $30 million to $80 million).
- ✓ Counties transfer amount of fine and penalty revenues to the Trial Court Trust Fund (rather than the General Fund) equivalent to amount transferred in 1994-95; counties retain any growth in revenues.
- ✓ Cities keep all fine and penalty revenues (for citations issued within city limits) that are currently remitted to the state, beginning in 1998-99 (revenue gain to cities: $61.9 million). State General Fund would make up for the loss.
- ✓ State provides additional funds to five counties that currently remit more in revenue to the state than they receive for support of courts (state costs/county savings of $4.3 million in 1998-99).
- ✓ Increase court filing fees to generate additional revenues ($43.1 million in 1997-98 and $86.2 million in 1998-99).
- ✓ New Judicial Administration Efficiency and Modernization Fund to be expended to promote improvements and efficiencies in court operations. No appropriation to the fund in AB 233.

State Responsible for Future Cost Increases. Because the costs to counties is capped, the state will be responsible for all future growth in trial court costs, including costs resulting from workload increases, inflation adjustments, and new programs. Although the measure will result in no additional General Fund costs in 1997-98, based on historical experience, we estimate that the annual increases thereafter will probably be in the range of $30 million to $80 million.

Change in Fine and Penalty Remittances. Currently, counties and cities remit fines and penalties to the state General Fund to offset the state's cost of operating the trial courts. Beginning in 1998-99, counties will remit to the Trial Court Trust Fund (rather than the General Fund) an amount of fines and penalties equivalent to the amount they remitted in 1994-95. Thus, counties will be able to retain any growth in fine and penalty revenues.

In addition, beginning in 1998-99, cities will retain all of their fine and penalty revenues and the state will make up the revenue loss (about $61.9 million) from the General Fund.

"Donor County" Adjustments. Beginning in 1998-99, the state will ensure that no county submits more in fine and penalty revenues to the state than it receives from the state for trial court support. This will result in costs to the state of about $4.3 million, and savings to the affected counties (currently: Placer, Riverside, San Joaquin, San Mateo, and Ventura) of a like amount.

New Civil Court Filing Fees. The Legislature approved most of the Governor's proposal to increase court filing fees to generate additional revenue to support the courts through the Trial Court Trust Fund. The increase will result in additional revenues of about $43.1 million in 1997-98 and $86.2 million in 1998-99. The fee changes, which were included in AB 233, are shown in Figure 17.

Figure 17

**Trial Court Funding
Court Fee Changes in AB 233**

- ✔ **Increase civil filing fees** from $182 to $185 in superior court cases and from $80 to $90 in municipal court cases (annual revenue: $6.7 million).
- ✔ **Increase filing fee for any notice of motion,** or other paper requiring a hearing, or opposition to a motion or paper requiring a hearing, from $14 to $23 (annual revenue: $7.2 million).
- ✔ **Establish new fees for filing an amended complaint** or cross-complaint, or amendment to a complaint or cross-complaint, of $75 in superior court and $45 in municipal court (annual revenue: $11.1 million).
- ✔ **Increase small claims filing fees** to $20 for the first 12 filings per person per year and $35 for any additional filings (annual revenue: $2.2 million).
- ✔ **Retain jury fee deposits** if the proceeding is dismissed or the trial by jury is waived after deposit of the fees (annual revenue: $5 million).
- ✔ **Recover previously waived filing fees** when litigant receives a monetary settlement (annual revenue: $1 million).
- ✔ **Increase all miscellaneous clerk fees** by 50 percent (annual revenue: $52.6 million).
- ✔ **Increase fees for family conciliation court** from $15 to $20 (annual revenue: $430,000).
- ✔ **Total annual revenue:** $86.2 million.

New Fund to Initiate Court Improvements. The measure created a new Judicial Administration Efficiency and Modernization Fund. The fund, which would be administered by the Judicial Council, would be used to promote improved access, efficiency, and effectiveness in trial courts that have unified their operations to the fullest extent permitted by law. Assembly Bill 233 does not appropriate any money to the new fund for 1997-98. Presumably, funds would be appropriated and expended by the Judicial Council in 1998-99.

Studies of Possible Additional Changes in Funding Responsibility. Assembly Bill 233 establishes two task forces to examine and make recommendations to the Legislature on two significant areas regarding the change in state and local responsibility for funding the courts. First, the measure establishes a task force on trial court employees to recommend an appropriate personnel structure for employees, including examining whether personnel should be court employees, county employees, or state employees. Second, the measure establishes a task force on court facilities to make recommendations on funding court facility needs and improvements, and the specific responsibilities of each entity of government (under the restructuring plan, counties retain responsibility for court facilities).

New Trial Court Judgeships

In addition to the trial court funding realignment, the Legislature enacted the Governor's proposal to establish 40 new trial court judgeships. The judgeships, which were created in AB 420 (Baca), would be allocated to specific superior and municipal courts throughout the state based on findings in a report to be submitted by the Judicial Council in May 1998 that considers such factors as court workload and efforts to coordinate or unify court operations. The Governor could appoint the new judges in 1998-99 following an appropriation by the Legislature to pay for the judgeships. We estimate that the full-year costs of 40 new judgeships and associated staff would be about $16 million.

Legal Representation of Inmates on Death Row

The Legislature enacted legislation to make significant reforms in the way appeals of convictions are handled for indigent inmates on death row. These changes were designed to speed up the processing of death penalty appeals and to reduce the growing number of inmates on death row who do not have legal representation.

Specifically, the Legislature adopted SB 513 (Lockyer) which does the following:

- ❖ Creates a new California Habeas Resources Center within the Judicial branch of government to handle state and federal habeas corpus appeals for death penalty convictions and provide legal and investigative assistance to private attorneys who handle such appeals. The center could employ up to 30 attorneys.

- ❖ Provides for the State Public Defender to hire 15 additional attorneys and support staff necessary to handle automatic death penalty appeals to the California and U.S. Supreme Courts.

- ❖ Authorizes the California Supreme Court to increase from $98 per hour to $125 per hour, the rate paid to private defense attorneys who handle death penalty cases under contract with the state. In addition, the measure provides that the Supreme Court may increase from $12,000 to $25,000 the amount private counsel can spend for investigation and other expenses without providing special justification.

Assembly Bill 1571 (Ducheny) provides $5 million to begin implementing the reforms in 1997-98. The amount includes $2 million for support of the Habeas Resources Center, $1.5 million for the State Public Defender, and $1.5 million for the attorney rate increase.

Department of Corrections

The budget provides a total of $3.7 billion ($3.6 billion from the General Fund and $43.4 million from other funds) for support of the California Department of Corrections (CDC). This represents an increase of about 4.1 percent above the 1996-97 level and is primarily due to projected increases in inmate and parole populations.

The budget reflects a total General Fund reduction of about $90.1 million below the Governor's budget request for the CDC support budget. The most significant changes were a $31 million unallocated reduction in departmental programs, a $20.7 million reduction to reflect recent caseload trends, and a $16.2 million shift of bond payments from the General Fund to bonds no longer needed for prison construction.

The *1997-98 Budget Act* is based on the department's spring projections that the inmate population will grow by about 8,700 inmates during 1997-98 and will reach about 159,000 as of June 30, 1998. The budget act also assumes that the number of parolees under CDC supervision will increase by about 6,500 during 1997-98 and will total about 110,000 by the end of the fiscal year. Figure 18 shows the projected inmate and parole population growth through 2001-02.

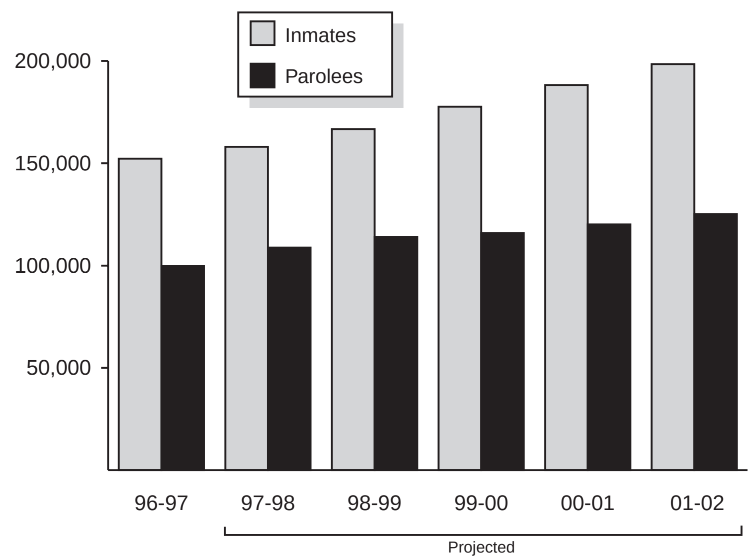
The budget act includes no funds for planning or construction of new state-operated prisons. However, it does provide funding to hold 1,400 state prison inmates in jail space leased from Los Angeles County as well as to activate beds for 2,000 medium-security inmates at four new privately operated facilities. In addition, the budget includes funding to significantly expand substance abuse treatment programs at several state prisons intended to help slow future growth in the prison population.

Federal Funds for Incarceration and Supervision

The budget assumes a total of $346 million in federal funds to offset the state's costs of supervising undocumented inmates and wards in

Figure 18

Prison Inmate and Parole Populations



state prison and the Department of the Youth Authority in 1997-98. This amount is $94 million more than the amount assumed in the Governor's budget. The increase results from two factors. First, the Legislature chose to shift $54 million in federal funds from prison construction to offset incarceration costs of undocumented felons, as permitted under federal law. Second, the budget assumes that the state will receive $40 million more in federal funds in 1997-98 than the Governor assumed, consistent with the amount contained in the federal appropriations bill approved by the U.S. House of Representatives. (At the time this report was prepared, the Congress had not made final decisions on these federal appropriations.)

Department of the Youth Authority

The budget provides $330 million ($323 million from the General Fund and $6.6 million from other funds) for support of the Youth Authority.

The most significant change to the Youth Authority's budget from the prior year was the shift of $32.7 million in state support for county probation camps and ranches from the General Fund to federal Temporary Assistance for Needy Families (TANF) funds.

Other Criminal Justice Programs

Assistance for Police, Sheriff, and Prosecution. The budget continues for a second year a program that provides $100 million to local police, sheriff, and prosecution programs (sometimes referred to as the Citizen's Option for Public Safety, or COPS, program). A budget trailer bill—Chapter 289, Statutes of 1997 (AB 1584, Prenter and Cardoza)—modifies local government reporting requirements for the program and specifies legislative intent that the program be funded again in 1998-99 and 1999-00.

In addition, the budget provides $54.6 million in federal prison construction funds to the Board of Corrections for allocation to local governments to construct, expand, or modify local adult and juvenile detention facilities. The Governor had proposed $14.9 million for this purpose in his January budget. The *1997-98 Budget Act* provides that at least $20 million of the amount appropriated be used to build new or modify existing juvenile detention facilities in counties with populations of 200,000 or less.

Initiatives and Augmentations. The Governor proposed a number of program initiatives, including a $20 million statewide program for "at-risk" juveniles and a $15 million Community Law Enforcement And Recovery (CLEAR) Demonstration Project in Los Angeles, that were not included in the enacted budget. Subsequently, however, the Legislature adopted SB 1050 (Alpert and Kopp), which appropriated $2 million for the program for "at-risk" juveniles in San Diego County only, and AB 853 (Hertzberg), which appropriated $1.2 million for the CLEAR Project.

Restitution Fund Loan. The budget includes a loan of $26 million of surplus funds from the Restitution Fund, which supports the Board of Control's Victims of Crime Program, to the General Fund. The budget act provides that the funds be repaid to the Restitution Fund by June 30, 1999.

TRANSPORTATION

Caltrans

The 1997 budget provides about $5 billion for the Department of Transportation (Caltrans). This amount does not include funds for seismic retrofit of state highway bridges and toll bridges. Seismic retrofit funds, including the toll bridge seismic retrofit funds described below, are not appropriated in the annual budget act. Thus, Caltrans' total funding for 1997-98 is actually larger than it appears to be in the budget.

Support and Capital Outlay. The 1997 budget provides about $1.8 billion for support of Caltrans, which reflects legislative decisions including:

- ❖ Substitution of state staff for 619 personnel-year equivalents of planned consulting engineer contracts, in response to a California Supreme Court decision.
- ❖ An increase of $16 million in engineering costs to repair road damage caused by heavy storms in December 1996 and January 1997.
- ❖ $1.5 million to expand service on the San Diegan intercity rail corridor.

The budget also provides $1.9 billion for construction of transportation capital outlay projects, which includes $157 million to repair road damage. In addition, the budget provides $1.5 million (as a separate item from Caltrans) to support the newly established High Speed Rail Authority (created by Chapter 796, Statutes of 1996).

Local Assistance. The budget provides $1.3 billion for a variety of local assistance programs, primarily a pass-through of federal funds for highway and transit purposes and state funds for the State-Local Transportation Partnership Program (SLTPP). This amount also includes $32 million in federal funds to repair storm damage on local streets and roads. Local assistance to transit authorities includes $85 million for operating assistance (through the State Transit Assistance program) and $64 million for capital acquisition (through the Transit Capital Improvement [TCI] program).

Toll Bridge Seismic Retrofit. In addition, the Legislature enacted a funding package—Chapters 327 and 328, Statutes of 1997 (SB 60 and SB 226 [Kopp])—that provides a $2.5 billion multiyear funding commitment for toll bridge seismic retrofit. The package includes $790 million from the Seismic Retrofit Bond Act of 1996 (Proposition 192), $875 million from existing state transportation funds, and $875 million from bridge tolls. The funding package does not directly impact the 1997-98 budget, but will result in reductions to subsequent budgets for the SLTPP, TCI, and the Transportation Systems Management programs. This is because a portion of the funds otherwise used to support these programs has now been earmarked for seismic retrofit.

Motor Vehicle Account

To close a $129 million funding shortfall in the Motor Vehicle Account (MVA) and to provide for a $50 million reserve, the budget provides $179 million in new revenue, transfers, and expenditure reductions. The MVA is projected to receive $40 million in new revenue from a $1 increase in the vehicle registration fee and increases to other fees. The account will also receive $97 million in transfers from other funds—$67 million from the State Highway Account and $30 million from the Transportation Planning and Development Account. Finally, the Department of Motor Vehicles (DMV) and the California Highway Patrol (CHP) will reduce their expenditures from the MVA by a total of $42 million by deferring capital outlay projects, shifting some expenses to other accounts, and making unspecified administrative reductions.

Factors that may affect the MVA fund balance during the year include:

- Upcoming labor negotiations with CHP and DMV employees over salary and employee benefits.

- The impact on vehicle registration of Chapter 1126, Statutes of 1996, which requires proof of financial responsibility insurance.

RESOURCES

The 1997 budget provides a total of about $1.3 billion for resources programs, including about $1 billion for state operations of various resources agencies and conservancies and $265 million for local assistance and capital outlay. Significant features of the budget include:

- $368 million for fire protection by the California Department of Forestry and Fire Protection, including the continued support of fire hand crews at conservation camps operated in conjunction with the Department of Corrections, and a total of about $20 million for emergency firefighting purposes.

- $75 million from Proposition 204 bond funds for water supply and Bay-Delta restoration projects.

- $24 million from Proposition 204 bond funds for local flood control projects and delta levee improvements.

- $10 million for coastal programs including improving coastal access and acquiring coastal lands. Legislation—AB 241, Lempert (not yet signed by the Governor at the time of this report)—was also enacted creating a coastal wetlands mitigation bank and providing $6 million for wetlands restoration.

- $3 million for restoration of salmon and steelhead trout from tidelands oil revenues, pursuant to legislation—Chapter 293, Statutes of 1997 (SB 271 [Thompson])—that reallocated these revenues.

- $9 million to acquire land to implement the Natural Community Conservation Planning program.

In addition to the 1997 budget, legislation has been enacted to provide more funds for parks and resources projects, including flood repairs and response activities. Specifically, AB 1188 (Lempert) provides $3.4 million and AB 1571 (Ducheny) provides $16.5 million for these purposes. Furthermore, Chapters 1 and 2 of the First Extraordinary Session, Statutes of 1997 (SB 4x [Costa] and SB 11x [Maddy]), and AB 11x (Poochigian) provide a total of $21 million from the General Fund to implement recommendations of the Governor's Flood Emergency Action Team formed in response to the 1997 floods. (At the time this report was prepared, the Governor had not yet signed these measures.)

ENVIRONMENTAL PROTECTION

The 1997 budget provides about $808 million for environmental protection programs, including about $684 million for various environmental protection agencies and $124 million for local assistance. This amount is about $131 million (19 percent) more than 1996-97 expenditures. Two expenditure increases account for most of the total increase:

- ❖ A $90 million increase—to $212 million—in estimated reimbursements to tank owners for clean up of leaking underground tanks.

- ❖ A $34 million increase—to $79 million—in local assistance for wastewater treatment, water recycling, and other water quality projects. This increase reflects the availability of $225 million of Proposition 204 bond funds administered by the State Water Resources Control Board for local water quality projects.

The budget provides a substantial increase in General Fund appropriations, both to address various urgent public health risks and to restore core regulatory activities that had been reduced due to a lack of available funds in prior years. For example, $8 million from the General Fund is appropriated for the clean up of illegal drug labs and $6 million is allocated for direct site cleanup at the highest-risk hazardous waste sites in the state. Additionally, $6 million is provided to restore planning, monitoring, and enforcement activities of the State Water Resources Control Board that had been reduced due mainly to the depletion of bond funds for these purposes.

CAPITAL OUTLAY

The budget includes $754 million for capital outlay as shown in Figure 19 (see next page). About 85 percent of this total is from bonds ($639 million), with other funding from the General Fund ($40 million), various special funds ($48 million), and federal funds ($26 million). Future appropriations of $695 million will be needed to complete capital outlay projects funded in the budget. Almost two-thirds of total capital outlay funding is for the three segments of higher education. The budget includes no funding to design and construct new state prisons.

Figure 19

1997-98 Capital Outlay Programs

(In Millions)

	Budget Amount	Future Cost
Legislative/Executive/ Judicial	$19.8	—
State and Consumer Services	79.2	$13.3
Transportation[a]	3.5	3.0
Resources	90.3	5.4
Health and Welfare	18.8	146.4
Corrections	51.8	32.7
Higher Education	490.4	494.2
General Government	0.6	—
Totals	**$754.4**	**$695.0**

[a] Covers office buildings only. Highway and rail capital outlay is discussed under "Transportation."

Some of the major projects and programs funded in 1997-98 include:

- ❖ Department of Justice—$20 million for replacement of two crime laboratories.
- ❖ Department of General Services—$79 million for seismic safety retrofits of 28 state buildings.
- ❖ Department of Health Services—$3.9 million to prepare construction documents for a $108 million public health laboratory and office complex in Richmond.
- ❖ Department of Mental Health—$3.2 million to prepare construction documents for a $33 million addition to the Atascadero State Hospital.

- ❖ University of California—$172 million for 32 projects at nine campuses.

- ❖ California State University—$138 million for 35 major projects at 18 campuses, including $1 million to study the feasibility of converting the former Camarillo State Hospital into a new campus.

- ❖ Community Colleges—$158 million for 98 projects at 49 districts (65 campuses and off-campus centers), including initial funding for two new off-campus centers.

Other Legislation. In addition to the budget act appropriations for capital outlay, the Legislature passed SB 1270 (Johnston) authorizing $392 million in lease-payment bonds for the design and construction of state office buildings and parking structures in the Capital Area in Sacramento. The buildings will provide approximately 1.5 million gross square feet (gsf) of office space and the parking structures will total approximately 743,000 gsf. The Legislature designated the Departments of Education, Health Services, and General Services as the occupants of the new buildings.

OTHER EXPENDITURE PROGRAMS

State Employee Compensation

The budget provides no funding for increased compensation for state employees. Both houses had provided $500 million ($250 million General Fund)—an amount equivalent to an average 5 percent increase for 1997-98—but these funds were deleted later as one of several actions to balance the budget. Late in the legislative session, however, the Governor committed to negotiate in good faith with employee organizations for a pay raise.

Petroleum Violation Escrow Account

The Petroleum Violation Escrow Account (PVEA) receives revenue from negotiated settlements and judgments against oil companies from legal actions taken by the federal government to recover oil company overcharges during the period of price regulations (August 1973 to January 1981). The *1997-98 Governor's Budget* included $33.9 million of proposed appropriations from the PVEA. Consistent with actions of prior years, the Legislature deleted all PVEA proposals in the budget (except $1.6 million for the California Energy Commission) and placed PVEA proposals in separate legislation (SB 368, Peace). That measure appropriates $32,626,000 from the PVEA as follows:

- $18,233,000 to the California Energy Commission for 101 projects, ranging from $3,000 to the City of Pittsburg for insulation of city offices to $4 million for the commission's transportation, technology, and commercialization program.
- $9,751,000 to the California Conservation Corps for the Southern California Energy Center ($1,450,000), the Solano County energy conservation program ($301,000), and for energy audits and weatherization of low-income housing ($8 million).
- $4,662,000 to the Department of Transportation for 22 projects, ranging from $35,000 to the City of Moreno Valley for the Perris Boulevard interconnect and synchronization of traffic signals, to $2 million for the Bay Area Rapid Transit / San Francisco Airport extension.

Local Government

As described earlier in this report (see "Judiciary and Criminal Justice"), the Legislature enacted a trial court funding measure. By relieving counties of future court costs, the measure provides significant general fiscal relief to counties.

The Legislature also considered proposals to reverse a portion of the property taxes shifted from local governments to schools in 1992-93 and 1993-94 to address state budget shortfalls. Proposals for Educational Revenue Augmentation Fund (ERAF) relief of $100 million included in the May Revision and the Senate version, and augmented in the Assembly version to $280 million, were removed from the final version of the budget.

Funding for the Citizen's Option for Public Safety program was continued for a second year with the intent to guarantee future funding for at least two additional years.

Renters Credit

The Renters' Tax Credit provides a refundable tax credit of $60 to single renters and $120 to married couples and heads of households. The credit was suspended in 1993, 1994, 1995, and 1996. The credit was scheduled to be reinstated this year but was suspended for an additional year, saving $520 million.

TAX RELIEF PACKAGE OF 1997-98

As noted previously, the main tax-related measures passed by the Legislature were part of a tax relief package providing benefits to both individuals and businesses. Figure 20 (see next page) provides summary information regarding these measures, including a general description of their basic provisions.

Figure 20

1997-98 Tax Relief Package

- ✔ ***Dependent Tax Credit Increase (SB 1233, Lockyer, Bustamante, Pringle)***. Increases personal income tax dependent credit from $68 in 1997 to $120 in 1998, and to $222 in 1999.
- ✔ ***Capital Gains Conformity on Home Sales (SB 5, Lockyer, Lewis, Bustamante; SB 1233)***. Conforms state tax law to federal tax law by increasing the capital gains exclusion on sales of principal residences. Specifically, it allows a $250,000/$500,000 (single/married) exclusion on capital gains from homes sold in which a taxpayer has resided for at least 2 years. Effective for homes sold on or after May 7, 1997.
- ✔ ***Subchapter S Corporation Conformity (SB 5, SB 1233)***. Conforms state tax law to federal tax law relating to Subchapter S corporations. Among other things, allows Subchapter S corporations to have up to 75 shareholders (prior law allowed up to 35 shareholders).
- ✔ ***Research and Development Tax Credit Conformity (AB 1042, Wayne)***. Partially conforms state tax law to federal tax law relating to calculation of the research and development (R&D) tax credit. Specifically, provides an alternative formula for calculating the base percentage of R&D, allowing certain businesses that were disadvantaged under the original formula (such as rapidly growing companies) to claim a greater share of increased R&D expenditures. Also makes changes to accommodate certain types of start-up companies and expenses by research consortia.
- ✔ ***Alternative Minimum Tax (AMT) Exemption Increase and Indexing (SB 1233)***. Increases the AMT exemption amounts and income levels at which the exemptions phase out beginning in 1998 to account for inflation since 1987. Indexes these amounts for inflation annually thereafter.
- ✔ ***Individual Retirement Account Conformity (SB 1233***). Conforms state tax law to federal tax law relating to expansion of existing individual retirement account (IRA) tax benefits and the addition of two new IRA programs (the "Roth IRA" and "Education IRA").
- ✔ ***Omnibus Tax Conformity (SB 455, Alpert)***. Conforms aspects of over 40 state tax law provisions to federal law, including such tax areas as corporate estimated payment rules, treatment of pension funds, and various amortization rules.

Continued

- ✔ ***Bunker Fuel Sales Tax Exemption Extension (AB 366, Havice, et al.)***. Extends sales tax exemption for purchases of bunker fuel through January 1, 2003.
- ✔ ***Targeted Tax Area Credits (AB 1217, Bustamante)***. Provides tax incentives and tax credits (similar to enterprise zone tax incentives and credits) to businesses in a targeted area.

The estimated net impact of these tax-related provisions is a revenue reduction of $166 million in 1997-98, increasing to $683 million in 1998-99 and $931 million in 1999-00. The significant increase in the revenue effect during these years reflects the fact that many of the provisions do not take effect until on or after January 1, 1998, and thus there is a phasing in of the fiscal impact.

About two-thirds of the fiscal impact of the package, when fully phased in, is due to increases in the dependent tax credit claimable on personal income tax returns. Other provisions include reduced taxes on capital gains from sales of residences, reduced Alternative Minimum Tax liabilities, and increased credits for research and development expenditures by businesses.