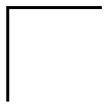
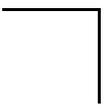
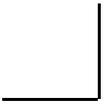


IV

Perspectives on State Expenditures





Perspectives on State Expenditures



AN OVERVIEW OF STATE EXPENDITURES

PROPOSED SPENDING IN THE CURRENT YEAR AND IN 1997-98

The *1997-98 Governor's Budget* proposes spending a total of \$64.6 billion from the General Fund and state special funds in 1997-98, as shown in Figure 1 (see next page). This expenditure level is about \$2.6 billion, or 4.2 percent, more than estimated current-year spending of \$62 billion.

Proposed General Fund spending is \$50.3 billion in 1997-98, or 78 percent of total spending. This is \$1.9 billion, or 3.8 percent, above estimated current-year General Fund spending.

Proposed spending for state special funds, as shown in the budget, is \$14.3 billion in 1997-98, a growth of \$751 million, or 5.5 percent.

Adjustment for Local Public Safety Fund—\$1.8 Billion. The budget does not include in its totals for state special funds any expenditures from the Local Public Safety Fund (LPSF). As in past years, we include these amounts in our spending totals. Our rationale is that LPSF revenues are state tax receipts expended for public purposes. This treatment is consistent with how the budget treats other dedicated state funds, such as the Motor Vehicle License Fee Account (which, like the LPSF, is also constitutionally dedicated to local governments) and the Cigarettes and Tobacco Products Surtax Fund (Proposition 99), both of which the budget *does* include in its spending totals.

As Figure 1 indicates, including this LPSF adjustment adds approximately \$1.7 billion to the budget spending totals in 1996-97 and \$1.8 billion in 1997-98, raising them to \$63.7 billion and \$66.4 billion, respectively. We use these adjusted figures in our discussions which follow.

Figure 1				
Governor's Budget Proposed and Adjusted Spending 1996-97 and 1997-98				
<i>(Dollars in Millions)</i>				
	1996-97	1997-98	Change From 1996-97	
			Amount	Percent
Budgeted Spending				
General Fund	\$48,443	\$50,301	\$1,858	3.8%
Special funds	13,593	14,343	751	5.5
Totals shown in budget	\$62,036	\$64,644	\$2,608	4.2%
Adjustments				
Add Local Public Safety Fund	\$1,678	\$1,769	\$91	5.4%
Adjusted totals	\$63,713	\$66,413	\$2,700	4.2%
Detail may not add to totals due to rounding.				

Spending From Federal Funds and Bond Proceeds

In addition to the \$66.4 billion of proposed spending from the General Fund and state special funds discussed above, the budget proposes a total of \$35 billion of combined spending from federal funds and the proceeds of bonds.

Federal Funds

The budget proposes to spend a total of \$32.6 billion of federal funds in 1997-98. Most of these federal funds are for federal contributions to health and welfare (\$21.6 billion), education (\$7.3 billion), and transportation (\$1.8 billion). Compared with the current year, total proposed spending from federal funds increases by \$605 million (1.9 percent) in 1997-98. This includes a total of \$216 million in new federal reimbursements,

which the Governor's budget assumes the state will receive to cover a portion of the state's costs of providing illegal immigrants with emergency Medi-Cal health care services. These amounts were not included in the President's federal budget proposal for the 1997-98 fiscal year, which was released in early February. Whether or not these monies will be included in the final federal budget will depend on actions taken by Congress.

Bond Proceeds

Debt service on general obligation bonds and lease-payment bonds is included in spending from the General Fund and special funds for the appropriate programmatic areas, as are direct "pay-as-you-go" expenditures on capital outlay projects. Spending from bond proceeds has *not* been included in the expenditures shown in Figure 1, however, because the spending of bond proceeds does not represent a *current* state cost. Instead, the expenditure costs of bond programs are reflected at the time when the debt-service payments are made. The budget proposes total spending of \$2.3 billion from bond proceeds in 1997-98—primarily relating to educational facilities, correctional facilities, and transportation projects.

General Obligation Bonds. General obligation bonds pledge the full faith and credit of the state and must be approved by voters. Proceeds of general obligation bonds are the major source of financing for state capital outlay and infrastructure programs, other than transportation. The budget proposes appropriating a total of \$2 billion from general obligation bond proceeds in 1997-98—about half for transportation-related purposes and roughly one-quarter for construction or renovation of educational facilities. (The actual level of spending for 1997-98 will differ from the amount appropriated because the spending of bond proceeds in any year includes amounts appropriated in both the current year and prior years.) Expenditures of bond proceeds in 1996-97 are an estimated \$2.2 billion.

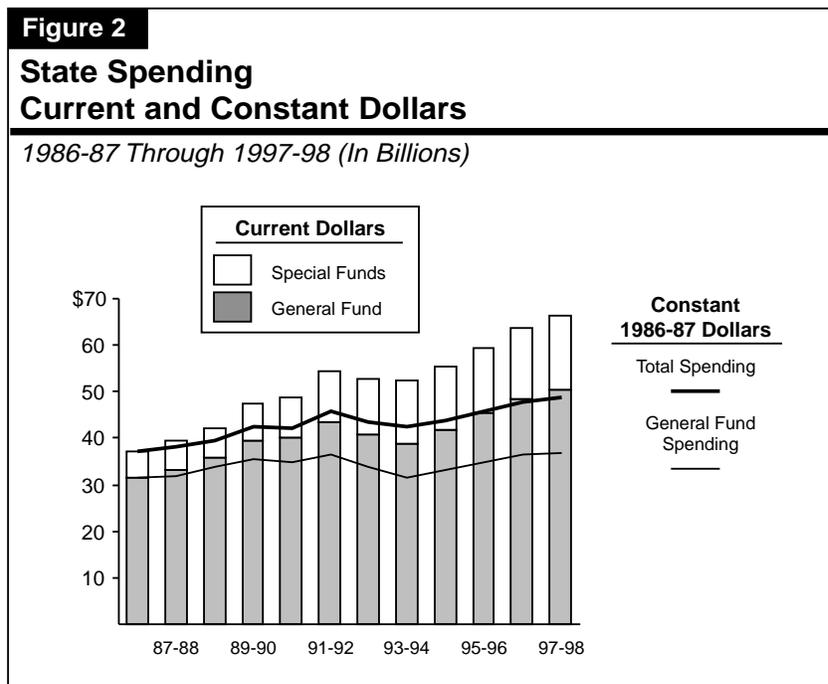
Lease-Payment Bonds. In addition to general obligation bonds, the state also uses lease-payment bonds (supported almost entirely from the General Fund) to finance the construction and renovation of facilities. Lease-payment bonds do not require voter approval. They are backed by annual appropriations for lease payments to the departments using the facilities constructed with the bond proceeds. These monies are, in turn, used to pay the debt-service to the investors who bought the bonds.

For 1997-98, the budget proposes appropriating \$343 million in proceeds from lease-payment bonds. Most of this amount is for prison con-

struction and other previously authorized projects of the Department of Corrections.

TRENDS IN STATE SPENDING

Figure 2 illustrates the trend in state General Fund and special funds expenditures from 1986-87 through 1997-98 (as proposed in the budget). The figure shows expenditures in both “current dollars” (nominal dollars, as appearing in the budget) and “constant dollars” (current dollars adjusted to remove the effects of inflation). Using constant dollars allows comparisons of the purchasing power of state spending over time.



The figure indicates that, since 1986-87, total spending has grown at an average annual rate of 5.4 percent in current dollars and 2.5 percent in constant dollars. Over this same period, the state’s population has grown at an average annual rate of 1.9 percent. Consequently, spending measured in terms of constant dollars per capita in both the current year and budget year is slightly higher than it was in 1986-87. (For 1997-98, the budget’s constant dollar spending per capita remains unchanged from

1996-97.) However, as Figure 2 shows, the pace of spending growth has varied considerably from year-to-year within this period.

Spending Grew Sharply Through 1991-92. Spending grew relatively rapidly from 1986-87 through 1991-92, when it reached \$54.5 billion. Total spending grew at an average annual rate of 8 percent during this period. Even after adjusting for the effects of inflation, annual spending growth averaged 4.3 percent. During this period, dollar spending from special funds grew more than twice as rapidly as General Fund spending (15 percent versus 7 percent annually), which reflected increases in earmarked special funds revenues and the creation of new programs with their own funding sources. Two major contributors to this trend were the approval of Proposition 99 in 1988 (which increased cigarette taxes and earmarked the associated revenues primarily to augment health programs) and Proposition 111 in 1990 (which authorized increases in the gasoline tax and various other transportation-related revenues).

General Fund spending also grew significantly from 1986-87 through 1991-92. In part, this reflected rapid growth in caseloads and costs in health and welfare programs. A strong economy facilitated this spending growth through healthy revenue performance until 1990-91, when the recession caused a drop in General Fund revenues. In response, the Legislature cut spending relative to current-law requirements. However, anticipating that the recession would not be prolonged, the state continued to fund spending growth for most programs through 1991-92. The recession proved far deeper and more prolonged than expected, and a large budget deficit resulted despite the funding actions, and the tax increases and other revenue enhancements.

Spending Fell During the Recession. From 1991-92 through 1993-94, revenues were essentially unchanged, and a portion of those revenues was used to reduce the accumulated budget deficit. As a result, total spending declined at an annual rate of 1.9 percent during this period (or 3.8 percent in real terms). The decline in General Fund spending was greater, averaging 5.2 percent annually (6.9 percent in real terms). However, a variety of cost deferrals and accounting adjustments that occurred over this period exaggerate this decline somewhat. Meanwhile, spending from special funds continued to grow, offsetting a portion of the General Fund decline. This difference in spending growth partly resulted from property tax shifts from localities to schools (see discussion on page 87), and the associated creation of the LPSF (a special fund) in 1993-94 to assist these localities.

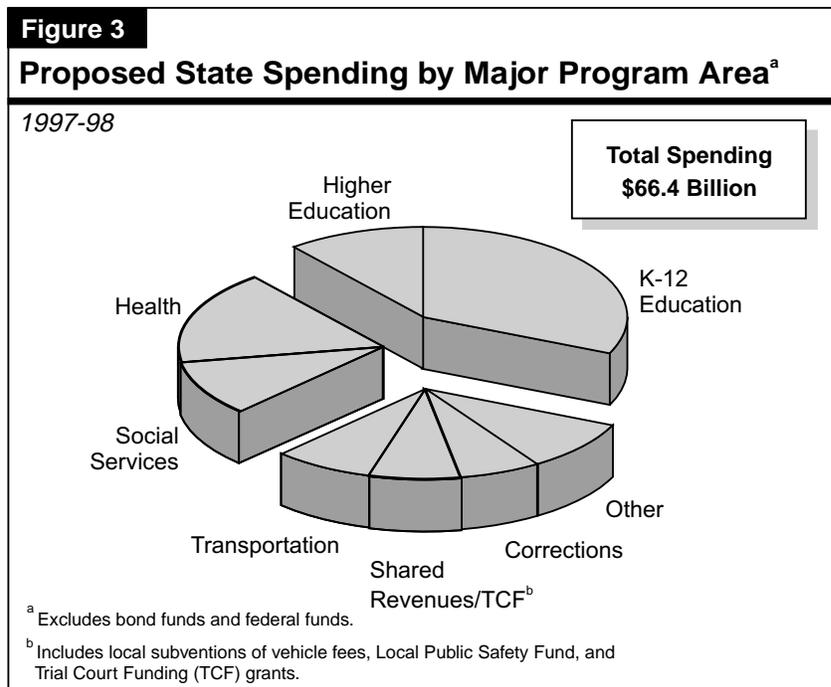
Spending Growth Returned With the Recovery. With the resumption of economic growth in California following the recession, spending growth has resumed, although at a slower pace than in the pre-recession

period. Between 1993-94 and the current year, total spending will have grown at an annual rate of 6.7 percent (4 percent in real terms), based on the budget's spending estimates. Nevertheless, General Fund spending in the current year remains slightly beneath the level of spending in 1991-92 after removing the effects of inflation.

As noted previously, proposed total spending increases by 4.2 percent during 1997-98; however, because of inflation and population growth, 1997-98 spending per capita in constant dollars will remain unchanged from the current year under the budget proposal. General Fund spending in 1997-98 is slightly above 1991-92 in real terms, but still below in real per capita terms.

PROPOSED SPENDING BY PROGRAM AREA

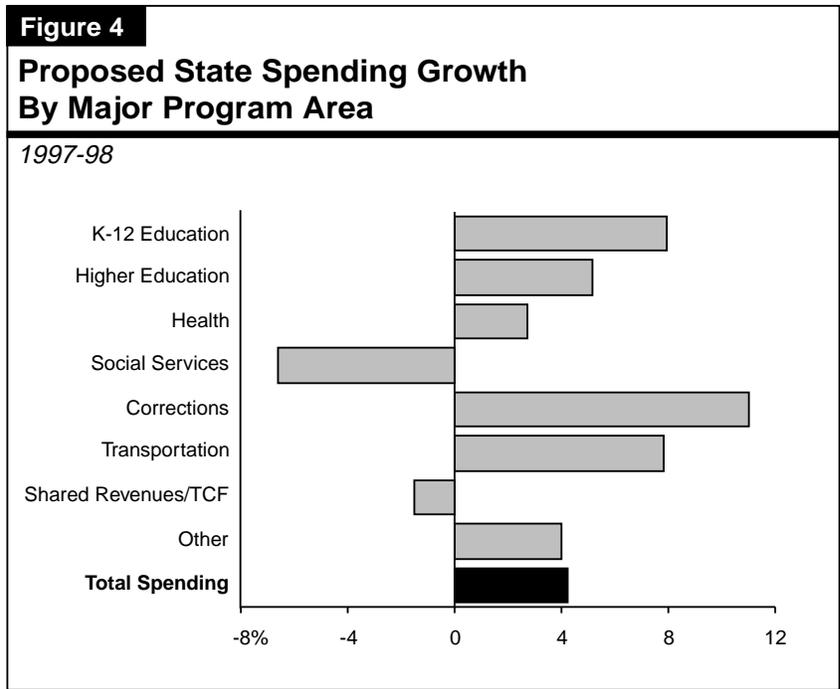
Figure 3 shows the distribution of the budget's proposed \$66.4 billion of total spending in 1997-98 among the major state program areas. The figure includes both General Fund and special funds expenditures in order to provide a meaningful comparison of program areas that have different mixes of General Fund and special funds support.



As Figure 3 shows, education receives the largest single share of proposed state spending—a total of 43 percent (32 percent for K-12 education and 11 percent for higher education). Education’s share of General Fund spending is considerably greater than its share of total spending—55 percent. Health and social services programs account for another 27 percent of proposed total spending. Thus, on a combined basis, more than two-thirds of proposed total state budget spending is for these three program areas alone. Their combined share is even higher of General Fund spending—over four-fifths.

Spending Changes by Program Area

Figure 4 shows the percentage changes in funding support levels by program area for 1997-98. Proposed spending growth varies widely by program. The budget proposes the largest spending increase for corrections-related programs—11 percent. This growth primarily reflects the costs associated with a projected 6 percent growth in the prison inmate and parolee populations, as well as a decline in federal funds available to offset state costs of incarcerating illegal immigrant felons. In contrast, proposed spending for social services programs declines by 7 percent in

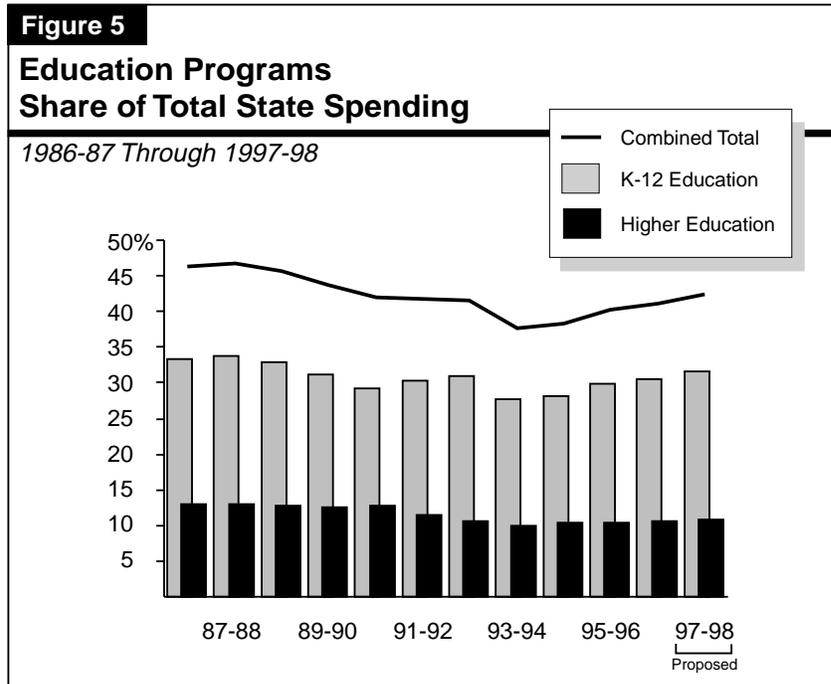


1997-98. This decline reflects grant reductions and federal welfare reform provisions (primarily General Fund savings due to the Temporary Assistance for Needy Families (TANF) block grant and elimination of Supplemental Security Income/State Supplementary Program (SSI/SSP) eligibility for noncitizens).

During the past decade, there have been significant changes in the shares of the budget devoted to different major program areas. Below we briefly discuss these past shifts in order to provide a context for viewing the proposed 1997-98 spending changes.

Education's Share of Spending Continues to Rise

Education programs consistently have received the largest share of state spending. However, their share of state spending had been declining until recently, as shown in Figure 5. Ten years ago, for example, almost 47 percent of total state spending was devoted to either K-12 or higher education programs. By 1993-94, however, education's percentage of total state spending had fallen to 38 percent.



Property Tax Shifts—An Important Factor. Property tax shifts enacted in 1992-93 and 1993-94 contributed significantly to this decline in education's share of total spending. These shifts replaced a portion of the state's education funding with an equivalent amount of local property tax revenues that were shifted from local governments to schools and community colleges. Consequently, the abrupt drop in education's share of the state budget that Figure 5 shows occurred in 1993-94 primarily reflected a restructuring of school funding, instead of a significant reallocation of total resources away from education.

Higher Education Funding Dropped During the Recession. Higher education's share of spending fell from 13 percent in 1986-87 to 10 percent in 1993-94. Much of the decline in General Fund spending was offset by increased student fees.

Education's overall share of the budget stayed more or less constant during the recession (excluding the impact of the property tax shifts). This is because the decline in higher education's share was offset by an increase in the K-12 share of spending, which was driven by rising school enrollments and the funding requirements of Proposition 98.

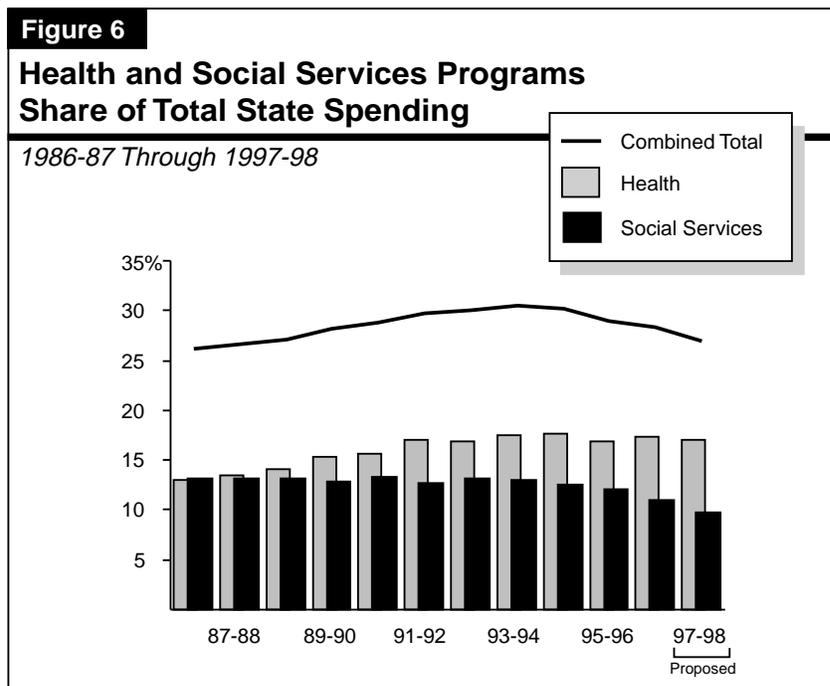
Budget Continues Recent Trend of Increased Funding for Education. Since 1993-94, Figure 5 shows that education's share of the budget has grown and would exceed 42 percent of total spending in 1997-98 under the Governor's budget proposal. As shown in Figure 4, the budget proposes spending increases for K-12 education and higher education of 7.9 percent and 5.2 percent, respectively, in 1997-98. These growth rates both exceed the proposed overall spending increase of 4.2 percent in the budget. The following two factors are primarily responsible for the growth in education's share of total state spending.

- **Revenue Growth Increases the Proposition 98 Spending Guarantee.** Proposition 98's funding formula currently results in the state devoting about 60 percent of General Fund revenue growth to increased spending for K-12 schools and community colleges. Since Proposition 98 spending currently accounts for 40 percent of General Fund expenditures, adding 60 percent of revenue growth automatically increases the Proposition 98 share of the General Fund budget.
- **Governor's Compact With Higher Education.** The 1997-98 budget proposal implements the third year of this funding plan for the University of California and California State University. The compact calls for a 4 percent increase in state funding as well as additional amounts for growth in debt service and other contractual obligations. The Governor's budget also proposes \$67 million

additional funding to avoid any student fee increase in 1997-98. Thus, student fees would be held constant for the third consecutive year.

Social Services' Share of Spending Continues to Decline

Most state spending in the social services area is for (1) grants to low-income persons in families with children under the Aid to Families with Dependent Children (AFDC)/TANF program, and (2) grants to elderly, blind or disabled persons under the SSI/SSP. Caseloads in these welfare programs grew rapidly through the early 1990s. As a result, social services' share of total spending grew from just under 12 percent in 1986-87 to more than 13 percent in 1992-93, as shown in Figure 6.



Between 1991-92 and 1996-97, the state adopted a series of reductions in both AFDC and SSI/SSP grants levels. In addition, caseload growth (which had peaked at 11 percent for AFDC in the early 1990s) slowed substantially in the latter part of this period, due in part to the end of the recession and a variety of demographic, social, and policy-related factors. In the current year, AFDC caseloads are declining significantly, although SSI/SSP caseloads continue to experience moderate growth. The combination of grant reductions and slowing caseload growth now has reduced

social services' share of the budget from just over 13 percent in 1992-93 to just under 11 percent in the current year.

Under the budget proposal, state spending for social services programs in 1997-98 declines by \$460 million, or 7 percent, compared with estimated spending for the current year. Social services' share of total spending would decline to 9.8 percent. The budget proposes to make permanent the temporary statewide welfare grant reductions and cost-of-living-adjustment (COLA) suspensions.

Health Programs' Share of Spending Stays Relatively Constant

Rising welfare caseloads (welfare recipients automatically qualify for Medi-Cal, the state's major health care program) and rapid inflation in health care costs combined to increase health programs' share of state spending from 13 percent in 1986-87 to 17 percent in 1991-92, as illustrated in Figure 6. Since then, however, its share of the total budget has remained relatively stable. This is due to a slowdown in caseloads as well as a variety of cost containment measures that have been implemented in recent years. In contrast to the social services programs, which experienced grant reductions, the state has not significantly reduced the health services that it provides.

For 1997-98, the budget proposes to eliminate prenatal care for illegal immigrants (pursuant to federal welfare reform legislation). Moreover, the budget assumes that federal funds will be appropriated in the 1997-98 federal budget to offset some of the state costs of providing emergency care to illegal immigrants in the Medi-Cal program, resulting in a savings to the state of \$216 million. Proposed state spending for health care programs increases by 2.7 percent (\$118 million) in 1997-98, as indicated previously in Figure 4.

Spending Trends in Other Areas

Corrections Spending Continues to Rise. Under the budget proposal, youth and adult corrections will continue to experience the most rapid percentage growth of any of the major program areas. As noted previously, spending on youth and adult corrections would grow by 11 percent in 1997-98—slightly higher than the 9 percent average annual growth rate for such spending since 1986-87. Corrections' share of state spending has grown more-or-less steadily—from 4.6 percent in 1985-86 to 6 percent in the current year. In 1997-98, corrections' share of total state spending would increase to 6.4 percent.

Shared Revenues/Trial Court Funding. For 1997-98, the budget proposes a small decline in spending for the shared revenues/trial court

funding portion of the budget. Modest growth in shared revenues would be offset by a reduction of \$290 million due to the proposed redirection of trial court fines and penalties to a trust fund.

Transportation. Support for transportation, including subventions for local streets and roads, has grown on average slightly faster than overall state spending for all programs during the last decade. Generally speaking, however, its share of total spending has been in the range of 7 to 8 percent. The budget proposes growth in transportation-related spending of 7.9 percent in 1997-98, which would correspond to a 7.4 percent share of total proposed state spending.

BUDGET PROPOSALS THAT REQUIRE LEGISLATIVE OR FEDERAL ACTION

Figure 7 lists the major budget proposals which require state legislation or federal action to implement, as well as the timing of the actions assumed by the budget. The figure includes both budget savings actions and proposed spending increases for new programs. The savings and costs shown in Figure 7 represent the amounts estimated in the budget as submitted. They also represent two-year totals in those cases where the budget proposal or assumption affects the current year as well as 1997-98.

Figure 7				
1997-98 Governor's Budget				
Requirements for Legislation or Federal Action				
<i>(In Millions)</i>				
Proposal/Assumption	State Legislation Required?	Federal Action Required?	Assumed Effective Date	Budget Savings
Implement Previous Budget Savings Actions^a				
SSI/SSP				
Regional 4.9 percent grant reduction	No	Yes	10/1/97	\$66
Statewide 4.9 percent (October 1997 only)	No	Yes	10/1/97	24
Make Temporary Savings Permanent				
SSI/SSP				
Statewide 4.9 percent grant reduction ^b	Yes	Yes	11/1/97	\$205
No statewide COLA	Yes	No	1/1/98	7

Continued

Proposal/Assumption	State Legislation Required?	Federal Action Required?	Assumed Effective Date	Budget Savings
AFDC/TANF				
Statewide 4.9 percent grant reduction	Yes	No	11/1/97	160
No COLA	Yes	No	11/1/97	85
Eliminate grant reduction exemptions	Yes	No	1/1/98	48
Eliminate renters' credit ^c	Yes	No	1997	525
Federal Assumptions				
Reimbursements for illegal immigrant incarceration costs ^d	No	Yes	—	\$299
Reimbursements for Medi-Cal costs of illegal immigrants	No	Yes	10/1/97	216
New Health and Welfare Proposals				
Reduce payments for drug ingredient costs	Yes	No	11/1/97	\$10
Impose spending limits for certain laboratory services and medical equipment and supplies	Yes	No	1/1/98	9
AFDC/TANF—eliminate \$50 child support disregard	Yes	No	1/1/98	21
Infant Health and Protection Initiative—augmentation	Yes	No	7/1/97	-22
CalTAP Welfare Reform Initiative				
Modify grant structure	Yes	No	1/1/98	\$156
Paternity establishment requirements	Yes	No	1/1/98	19
County training	Yes	No	1/1/98	-79
SAWS reprogramming	Yes	No	1/1/98	-13
Employment services (GAIN) augmentation	Yes	No	1/1/98	-80
Shifts to Special Funds				
GAIN—continue use of ETP funds	Yes	No	7/1/97	\$20
Revenue/Fee Proposals				
Increase court fees to support trial courts	Yes	No	7/1/97	-\$88
Motor Vehicle Account—unspecified fee increases	Yes	No	7/1/97	50
Governor's tax reduction program (net of Proposition 98 offset) ^c	Yes	No	—	-35
Offset delinquent state taxes against federal refunds ^e	No	Yes	1997	85
^a Part of current law. ^b \$16 million does not require federal action. ^c Assumes enactment in time to affect 1997 tax liabilities. ^d Assumes \$63 million from an existing federal appropriation and \$236 million from future federal funds. ^e Assumes enactment in time to provide 1997-98 revenue accrual.				
