

Major Features of California's 2010-11 Budget

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OVERVIEW

Addressing an \$18 Billion Budget Problem.

The *2010-11 Budget Bill* was passed by the Legislature and signed by the Governor on October 8, 2010. The plan attempts to address one of the most vexing state budget shortfalls in California's history—the product of a continuing structural imbalance between state revenues and expenditures and a slow recovery from a severe recession that began in 2007 and ended in 2009.

In May 2010, the administration estimated that there would be a gap of \$17.9 billion between General Fund resources and expenditures in 2010-11 under then-existing laws and policies. To address this projected gap, the Legislature and Governor opted for a package of budget actions summarized in Figure 1 (see next page). That package (including vetoes) includes the following actions (based on our office's categorization):

- \$7.8 billion of expenditure-related solutions (including ongoing and temporary cost or service reductions).
- \$5.4 billion of new federal funding (most of it not yet approved by Congress).

- \$3.3 billion of revenue actions (including \$1.4 billion in higher assumed baseline state revenues consistent with our May 2010 state revenue forecast).
- \$2.7 billion of largely one-time loans, transfers, and funding shifts.

The package does not include the Governor's proposed elimination of the California Work Opportunity and Responsibility to Kids (CalWORKs) and subsidized childcare, and it does not include reductions in social services grant levels.

If all of the assumptions are met in the package, the state would be left with a \$1.3 billion General Fund reserve at the end of 2010-11, as shown in Figure 2 (see page 3).

Longer-Term Budget and Pension Changes.

The budget package includes legislation proposed by the Governor to decrease pension benefits for state employees hired in the future. The package also places a measure on a future state ballot that is intended to stabilize state finances in the future by increasing amounts deposited to the state's rainy-day fund in certain years. While these changes would help the state's longer-term

fiscal situation, they would have little effect in the shorter term. We estimate that well over two-thirds of the 2010-11 budget solutions are one-time or temporary in nature. This means that California will continue to face sizable annual budget problems in 2011-12 and beyond.

Governor's Vetoes. When signing the budget, the Governor vetoed \$963 million in General Fund spending that had been approved by the Legislature. In doing so, the anticipated year-end reserve increased from \$364 million to \$1.3 billion. The vetoes included:

Figure 1
General Fund Budget Solutions in the 2010-11 Budget Plan

(In Billions)

	Reduced Costs or Increased Revenues
Expenditure-Related Solutions	
Reduce Proposition 98 costs ^a	\$3.4
Reflect savings in state employee payroll, benefit, and related costs	1.6
Reduce budget for prison medical care	0.8
Assume accelerated receipt of federal TANF funds ^a	0.4
Defer or suspend local government mandates ^a	0.4
Achieve IHSS savings through various actions	0.3
Reflect reductions in adult prison population	0.2
Offset UC and CSU General Fund costs with federal economic stimulus funding	0.2
Require managed care enrollment for certain Medi-Cal recipients	0.2
Adjust other spending (net reduction) ^a	0.3
Subtotal ^a	(\$7.8)
Federal Funding and Flexibility Solutions	
Assume enhanced federal funding and/or additional cost flexibility	\$4.1
Score savings from recent congressional action to extend FMAP support	1.3
Subtotal	(\$5.4)
Revenue-Related Solutions	
Adopt LAO's May 2010 revenue forecast	\$1.4
Suspend for two years the ability of businesses to deduct net operating losses	1.2
Score additional revenues from previously authorized sale leaseback of state office buildings	0.9
Adopt other compliance actions and reductions in business taxes (net reduction)	-0.1
Subtotal	(\$3.3)
Loans, Loan Extensions, Transfers, and Funding Shifts	
Borrow from special funds	\$1.3
Extend due dates for repayment of existing loans from the General Fund to special funds	0.5
Fund courts from previously authorized shift from redevelopment agencies	0.4
Use hospital fees to support Medi-Cal children's coverage	0.2
Transfer special fund monies to the General Fund	0.1
Use Student Loan Operating Fund monies for Cal Grant costs	0.1
Adopt other funding shifts	0.1
Subtotal	(\$2.7)
Total, All Budget Solutions^a	\$19.3

TANF=Temporary Assistance for Needy Families; IHSS = In-Home Supportive Services; FMAP = Federal Medical Assistance Percentage; LAO = Legislative Analyst's Office.

^aAmount listed includes Governor's vetoes.

- The elimination of CalWORKs Stage 3 child care (\$256 million), effective November 1, 2010. This will mean the loss of subsidized child care for approximately 55,000 children from low-income families who formerly received cash aid through the CalWORKs program.
- The assumed accelerated receipt of future federal Temporary Assistance for Needy Families funds, allowing a like reduction (\$366 million) in state CalWORKs General Fund spending.
- The rejection of various legislative augmentations to health and social services programs. The Governor vetoed similar amounts as part of last year's budget.

Figure 2
2010-11 Budget Act
General Fund Condition

(In Millions)

	2009-10	2010-11	
		Amount	Percent Change
Prior-year balance	-\$5,375	-\$4,804	
Revenues and transfers	86,920	94,230	8.4%
Total resources available	\$81,545	\$89,426	
Total expenditures	\$86,349	\$86,552	0.2%
Fund balance	-\$4,804	\$2,874	
Encumbrances	\$1,537	\$1,537	
Reserve	-\$6,341	\$1,337	

Note: Department of Finance estimates.

Specifically, he vetoed \$80 million for child welfare services, \$52 million for HIV/AIDS programs, \$10 million for health clinics, and \$6 million for community-based programs in the Department of Aging.

- The deletion of \$133 million of funding for the AB 3632 mandate for students' mental health services. As part of the veto, the Governor declared his intent that the mandate be suspended for 2010-11.

2010-11 BUDGET SOLUTIONS

EXPENDITURE-RELATED SOLUTIONS

Proposition 98—K-14 Education

Proposition 98 Funds. Figure 3 (see next page) shows Proposition 98 funding levels under the budget plan. As shown, ongoing Proposition 98 funding is slightly higher in 2010-11 (\$49.7 billion) than the revised 2009-10 level (\$49.5 billion). To fund at this level, the Legislature suspended the Proposition 98 minimum

funding requirement (commonly known as the minimum guarantee) for 2010-11. Absent suspension, we estimate the minimum guarantee would require \$53.8 billion, which is \$4.1 billion higher than the amount appropriated for 2010-11. The state also is ending 2009-10 with a "settle-up obligation," meaning the state appropriated less in 2009-10 than the revised estimate of the minimum guarantee for that year. We estimate

the 2009-10 settle-up obligation is \$1.8 billion. The budget also spends \$242 million in 2010-11 using one-time Proposition 98 funds available from prior years.

Increased Spending for Community Colleges. The budget reflects a net increase of \$108 million in ongoing Proposition 98 funding for community colleges. This largely is the result of a 2.2 percent increase in budgeted enrollment.

Settle-Up Funds. In addition to Proposition 98 funds, the budget plan for 2010-11 provides \$300 million as a payment to begin to meet the state’s outstanding 2009-10 Proposition 98 settle-up obligation. Of these settle-up monies, \$90 million is provided for annual education mandate costs and \$210 million will be distributed on an equal per-student basis and applied to school districts’ and community colleges’ unpaid prior-year mandate claims.

Federal Funds. In addition to these state funds, related budget bills provide K-12 education with \$1.5 billion in special one-time federal funding. Of this amount, \$1.2 billion is from

recent federal grants provided specifically to help retain K-12 jobs, and \$272 million is from the last round of federal stabilization funding from the 2009 stimulus package.

Deferrals Significant Component of Budget Package. Though the state is providing slightly more ongoing funding in 2010-11 than 2009-10, the large reliance on one-time solutions last year resulted in the need for 2010-11 reductions. Under the budget plan, however, the reductions largely are treated as deferrals of payments rather than cuts. Specifically, the package defers \$1.9 billion in additional K-14 payments (\$1.7 billion for K-12 education and \$189 million for community colleges). Rather than being paid in the spring of 2011, these payments will be made in July 2011 (that is, the next fiscal year). Virtually all other K-12 reductions are technical adjustments designed to align appropriations with anticipated program costs, such as for the K-3 Class Size Reduction program. The package also makes some reductions in child care funding. Most notably, the package achieves child

Figure 3
Proposition 98 Spending Under Budget Package

(Dollars in Millions)

	2008-09 Final	2009-10 Revised	2010-11 Budgeted	Change From 2009-10	
				Amount	Percent
K-12 Education					
General Fund	\$30,075	\$31,662	\$32,249	\$588	1.9%
Local property tax revenue	12,969	12,105	11,529	-576	-4.8%
Subtotals	(\$43,044)	(\$43,767)	(\$43,778)	(\$11)	(—)
California Community Colleges					
General Fund	\$3,918	\$3,722	\$3,885	\$163	4.4%
Local property tax revenue	2,029	1,962	1,907	-55	-2.8
Subtotals	(\$5,947)	(\$5,683)	(\$5,792)	(\$108)	(1.9%)
Other Agencies	\$105	\$93	\$89	-\$4	-4.5%
Totals, Proposition 98	\$49,096	\$49,543	\$49,658^a	\$115	0.2%
General Fund	\$34,098	\$35,477	\$36,223	\$746	2.1%
Local property tax revenue	14,997	14,066	13,435	-631	-4.5

^aDue to the Governor’s veto of CalWORKs Stage 3 child care, the administration intends to create an additional \$256 million settle-up obligation, to be paid in the future.

care savings by drawing down some provider reserves, reducing the reimbursement rate for license-exempt providers (from 90 percent to 80 percent of the licensed-provider rate), and reducing the administrative allowance for certain providers (from 19 percent to 17.5 percent of total contract amounts). As described above, the Governor also vetoed \$256 million in funding for child care.

Higher Education (Non-Proposition 98)

Augmentations for Universities. The budget increases spending on higher education programs. The budget provides General Fund augmentations of \$250 million for the University of California and \$260 million for the California State University. These augmentations are each \$106 million lower than the amount proposed in the May Revision, reflecting that the universities recently each received a like amount of federal stimulus funding.

General Fund Reduction in Cal Grant Costs Offset by Other Funding. The budget includes a reduction of \$100 million for the state's Cal Grant financial aid programs, and backfills this reduction with \$100 million in excess revenue in the Student Loan Operating Fund (monies derived from the servicing of federal student loans).

Employee Compensation

General Fund Personnel Cost Reductions of \$1.6 Billion. The budget assumes that General Fund employee pay and benefits are reduced by \$896 million, which includes (1) savings from recent agreements with unions and (2) over \$600 million of additional reductions resulting from future union agreements or other administrative actions. (Comparable personnel savings are budgeted for state accounts outside of the General Fund.) The budget also reduces General

Fund departmental budgets by \$450 million—a roughly 5 percent decrease—to account for the administration's "workforce cap," which consists of reductions in hiring. An additional \$130 million of savings is assumed due to reduced departmental operating costs related to the workforce cap.

Health and Social Services

Changes to In-Home Supportive Services (IHSS) Program. The vast majority of the Legislature's budget actions in the social services area result from changes in the IHSS program (\$300 million). About \$190 million in savings is anticipated from applying the sales tax to IHSS providers and using the revenue to obtain additional federal funding. The providers subject to the tax will receive a supplementary payment. Legislation also reduces authorized service hours for IHSS recipients by 3.6 percent for an additional savings of \$35 million. Finally, the budget was adjusted to reflect lower-than-anticipated caseload for savings of \$75 million.

Medi-Cal Changes. The majority of the budget solutions in health come from the Medi-Cal Program. The budget reflects about \$187 million in savings in the Medi-Cal Program from the phase-in of mandatory enrollment of certain seniors and persons with disabilities into managed care in some counties. The budget also reflects approximately \$100 million in savings from rate freezes and rate reductions to specified Medi-Cal providers. About \$26 million in savings from Medi-Cal antifraud efforts are assumed in the budget plan.

Governor's Vetoes. In addition to these IHSS and Medi-Cal changes passed by the Legislature, the Governor vetoed several hundred million dollars of health and social services spending, as described earlier.

Judiciary and Criminal Justice

Cuts in Funding for Prisons, Including the Receiver. The budget package assumes a total of \$1.1 billion in General Fund savings within the California Department of Corrections and Rehabilitation. This amount includes an \$820 million unallocated reduction in the federal court-appointed Receiver's inmate medical services program. (This funding decrease is offset by \$532 million in various workload adjustments to support the Receiver's planned information technology projects and increased contract medical costs.) The Receiver intends to achieve the assumed savings by releasing certain infirm inmates early from prison and placing them on parole based on their medical status, as well as other unspecified operational and policy changes. The budget package also assumes \$219 million in General Fund savings from mostly unspecified adult correctional population changes.

General Fund Cuts for Courts Offset by Other Fund Sources. The budget package reduces General Fund support for the trial courts in 2010-11 by \$405 million. However, this reduction would largely be offset by a one-time shift of \$350 million in redevelopment funding to the courts, as well as a shift of \$30 million from reserves held by individual trial courts. In addition, the budget reflects increased court fees (such as civil filing fees and fees charged to offenders) and the redirection of various special funds to offset trial court costs.

Other Provisions

Local Mandate Securitization. The budget package includes a measure that allows cities, counties, and special districts to receive payments of up to \$1 billion for their outstanding state mandate reimbursement claims. Specifically, the budget package authorizes a joint powers authority to issue ten-year "local mandate claim

receivables" (backed by the state's repayment obligation) and use the proceeds to pay local agencies for their outstanding mandate claims. Under the plan, the state would pay interest on the receivables at a rate of 2 percent per year. Local agencies would pay any additional interest or debt-issuance costs.

FEDERAL FUNDING AND FLEXIBILITY SOLUTIONS

Most Funds Have Yet to Be Approved by Congress. The budget plan assumes that the federal government will provide the state with the ability to reduce General Fund costs by \$5.4 billion in 2010-11. These savings could result either from increased federal funding to the state or federal approval for certain reductions in state costs or service levels. By approving extension of enhanced Federal Medical Assistance Percentage funding levels for Medi-Cal and related programs, Congress and the President have approved about \$1.3 billion of funding to date.

REVENUE-RELATED SOLUTIONS

Adopts Legislative Analyst's Office Revenue Estimates. The budget package adopts our office's May 2010 General Fund revenue forecast—\$1.4 billion higher than the administration's forecast for 2009-10 and 2010-11 combined. (As of the end of September, the state's personal income and corporation tax revenues to date are \$1.4 billion higher than those projected in the administration's monthly revenue estimates. Much of this difference, however, may be related to early receipt of taxes that had been expected later in the fiscal year.)

Two-Year Extension of Business Tax Increases and Other Changes. The budget package extends for two additional tax years—2010 and 2011—the previously enacted temporary suspension of businesses' abilities to use net operating

losses to reduce tax liabilities. This extension exempts small businesses with net income of under \$300,000 per year. The suspension is projected to increase state revenues by \$1.2 billion in 2010-11 and about \$400 million in 2011-12. In future years, these gains would be offset by revenue losses of a roughly similar amount. The budget package also includes (1) decreases in taxes for certain businesses that sell intangible products and services and (2) reductions in penalties for some businesses that are determined to have taxes higher than those reported on their tax returns. These two reductions are estimated to reduce 2010-11 revenues by around \$150 million.

Sale Leaseback of State Office Buildings.

The budget plan assumes \$1.2 billion in one-time revenue from the sale of 11 state office properties as authorized in last year's budget agreement. This amount reflects the net revenue from the sale after the state pays off the outstanding debt on the buildings and the transaction's expenses. The state would immediately lease back the office buildings in order to retain use of the

properties. Generally, the state's rent costs will increase in future years. (Because \$289 million was assumed from the sale by the administration in its workload budget, this solution contributes a net amount of \$911 million to closing the budget gap, as reflected in Figure 1.)

LOANS, TRANSFERS, AND FUNDING SHIFTS

\$2.7 Billion of Loans, Transfers, and Fund Shifts. The budget plan includes \$2.7 billion of loans, loan repayment extensions, transfers, and fund shifts from special funds, which generally are fee-supported funds that pay for specified state functions. A significant portion of these actions relate to the state's transportation accounts, including the Highway Users Tax Account (\$762 million loan), the Motor Vehicle Account (\$180 million loan and \$72 million transfer), and other special funds related to the Department of Transportation (\$231 million of loan repayment extensions).

STATE CASH MANAGEMENT

Measures to Reduce Chance of State IOUs Over Next Few Weeks. During the unprecedented three-month budget impasse, the state has not paid several billion dollars in bills due to a lack of available appropriations, and the state's regular annual cash-flow borrowing from investors (revenue anticipation notes [RANs]) has not been able to proceed. Without proceeds from the RANs, the state would have difficulty paying all October and November payments, as well as the

backlog in bills, over the next few weeks without resorting to registered warrants (also known as IOUs). To reduce the likelihood that IOUs will be needed during this period, the budget package includes legislation authorizing the Controller to delay specified school and community college payments, as well as other payments, in October by several days. The State Treasurer plans to market the RANs in November.

LONGER-TERM REFORMS

Proposed Constitutional Amendment to Build State Reserves. The budget package contains a proposed constitutional amendment—to go before voters at a future statewide election—intended to increase the state’s budgetary reserves and stabilize the state’s financial health over time. The measure would increase the maximum size of the existing Budget Stabilization Account (BSA) from 5 percent to 10 percent of annual General Fund revenues and provide new requirements for depositing state funds to that account. It also would restrict withdrawals from the BSA to certain situations.

Reductions in Pension Benefits for Future State Employees. The budget package includes a measure to reduce pension benefits for newly hired state employees. (Labor agreements recently ratified by the Legislature also reduce pension benefits for future employees in several bargaining units, and these reductions remain in effect.) In general, the measure sets benefit levels for future employees at levels that were in place for employees prior to 1999. In addition, all future state employees would have their pension benefits calculated based on their highest average annual pay over any consecutive three years of employment, not the one-year period applicable for some current state employees. These requirements would not affect pension benefits for current state employees and retirees.

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