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60 YEARS OF SERVICE

March 25, 2003

2003-04 Budget Overview

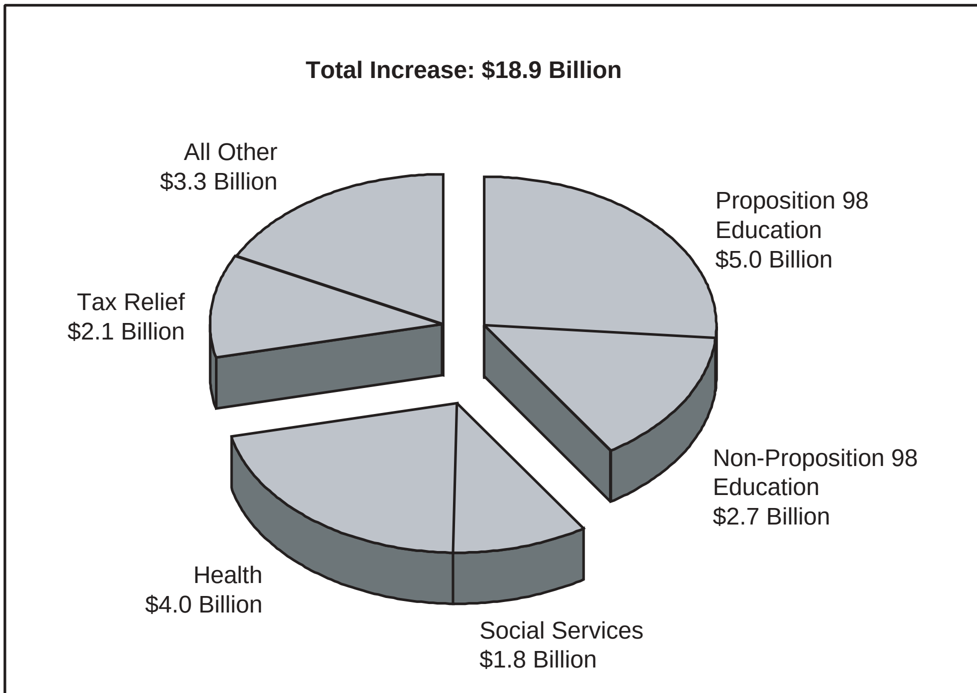
LEGISLATIVE ANALYST'S OFFICE

Presented To:

Senate Budget and Fiscal Review

Sources of General Fund Spending Growth

1998-99 Through 2001-02



☑ Total General Fund spending rose from $57.8 billion in 1998-99 to $76.8 billion in 2001-02, an increase of $18.9 billion, or 33 percent.

- About 60 percent of the growth was attributable to general inflation and population increases.
- The remaining 40 percent represents such factors as: new or expanded programs; increased levels of services; and, in some instances, caseload growth in excess of population and/or cost increases above general inflation.

☑ Of the total $18.9 billion increase, slightly over 70 percent ($13.5 billion) was for education, health, and social services. Another 11 percent involved expenditures for tax relief granted through the budget.

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Increases Related to Education, Health, and Social Services

☑ **Total Education Funding Increased by 25 Percent ($7.7 Billion)**

- *In K-12 education,* new funds were provided for general purpose funding (deficit reduction), lengthened school years, teacher recruitment and retention, testing, summer school, and after-school programs.
- *In higher education*, funds were provided for increased base support, enrollment growth funding above adult population growth, outreach to K-12 students, professional development for K-12 teachers, and buyout of student fee increases.
- *Financial aid* was increased through legislation that created entitlements for Cal Grant awards for recent high school graduates.

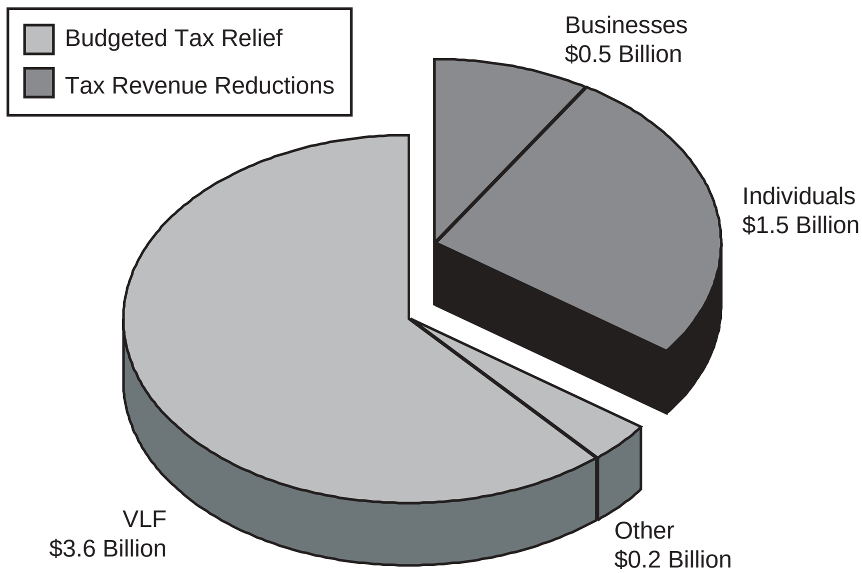
☑ **Total Health and Social Services Spending Grew By 36 Percent ($5.8 Billion)**

- The largest increase was in Medi-Cal, reflecting increases in the cost and utilization of medical services and expansion of eligibility (for example, 1931(b) expansion and eligibility simplification).
- The major social services cash assistance programs—SSI/SSP and CalWORKs—experienced a moderate combined increase (4 percent annually) but disparate individual growth. Total growth for SSI/SSP was 25 percent, primarily due to COLAs and caseload, partially offset by a slight decline in CalWORKs.
- Spending for other health and social services programs increased due to: (1) expansions in the Healthy Families program, mental health, and child welfare services; (2) wage increases for certain IHSS providers; and (3) caseload and cost growth in the Department of Developmental Services.

Fiscal Effects of Recently Enacted Tax Relief

2001-02

Total Relief: $5.9 Billion



Detail do not total due to rounding.

- ☑ Tax relief in 2001-02 from measures adopted over the previous five years totaled $5.9 billion. This includes (1) $3.8 billion appropriated for expenditure in the budget and (2) $2 billion in revenue reductions granted through the tax code.

- ☑ The main tax relief granted through the budget was the 67.5 percent reduction in the vehicle license fee (VLF) rate, which resulted in tax reductions to vehicle owners of approximately $3.6 billion in 2001-02.

- ☑ Tax relief through the tax code included increases in the dependent credit exemption, expansion of the research and development credit, and elimination of the minimum tax for new corporations.

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Overview:
LAO Analysis of Governor's Budget

- ☑ Forecasting Differences: $1.5 Billion

- ☑ Balance Only Achieved if Dramatic Actions Taken

- ☑ Realignment Worth Considering

- ☑ Education Credit Card Maxed Out

- ☑ General Fund Relief Threatens Transportation Projects

- ☑ Higher Education Alternative—Enrollment, Fees, and Financial Aid

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Key Elements of Senate Republican Plan

☑ Accepts Most of Governor's Proposed Savings

- Key exceptions are reductions affecting local governments—namely, elimination of VLF backfill, Williamson Act subventions, and redevelopment funding shifts.
- Savings foregone in the above areas partly replaced with a $500 million annual local contribution for three years beginning in 2002-03.

☑ Rejects Tax and Fee Increases

- Excludes $8.2 billion in new realignment taxes, $1.5 billion in new tribal gaming revenues, and about $600 million in proposed fees. The latter is related to community colleges, workers' compensation administration, trial courts, and certain other activities.

☑ Includes Additional 2003-04 Savings

- *One-time* savings assumed from Medi-Cal accounting change ($1.1 billion), 2003-04 deferral of education outlays ($1.1 billion), and added borrowing to cover special fund pension contributions ($1 billion).
- *Ongoing* 7 percent across-the-board reduction assumed ($5.1 billion), beyond the roughly 10 percent in program reductions included in the Governor's budget proposal.

☑ Assumes "Hard Freeze" on Expenditures in 2004-05 and 2005-06

- Total spending would remain at $67.8 billion (the plan's reduced 2003-04 level) through the subsequent two fiscal years, requiring major reductions to program spending levels.

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Effects of Senate Republican Plan on 2003-04 Expenditures

- ☑ Relative to the Governor's proposal, the Senate Republican plan would have a *lesser* adverse impact on local governments, but would result in *deeper* cuts in other state-funded programs.

- ☑ The 7 percent across-the-board reduction would be *in addition to* the roughly 10 percent program reductions included in the Governor's proposal and accepted in the Senate Republican plan.

- ☑ If applied proportionally, the 7 percent across-the-board reduction would imply:

  - A further $2 billion reduction in Proposition 98 education.
  - Roughly a $1.5 billion reduction in combined health and social services programs.
  - About a $400 million reduction in combined funding for UC and CSU.
  - An approximate $350 million reduction in the Department of Corrections.

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Effects of Senate Republican Plan on 2003-04 Expenditures *(Continued)*

☑ However, about $9.6 billion in General Fund spending is in areas (detailed below) that cannot be reduced beyond what the Governor's budget proposes for 2003-04.

General Fund Expenditures That Cannot Be Reduced Beyond the 2003-04 Governor's Budget

(Dollars in Millions)

	Amount
SSI/SSP (federal minimum)	$2,317
General obligation bond debt service	1,870
CalWORKs (federal minimum)	1,605
CalWORKs (proposed for realignment)	887
Health benefits for retired annuitants	661
Lease revenue bond debt service	539
Cal Grants (current recipients)	486
Homeowners' exemption	420
Child support penalties	207
General Fund interest on loans/borrowings	191
Judges retirement	129
Proposition 36	120
Retirement systems (PERS/STRS)	55
Lawsuits (*Brown v. HHS*)	48
Constitutional officers' salaries	34
Total	**$9,569**

☑ As a result, the proportional reduction in the remaining programs would be greater than 7 percent—namely, about 8 percent.

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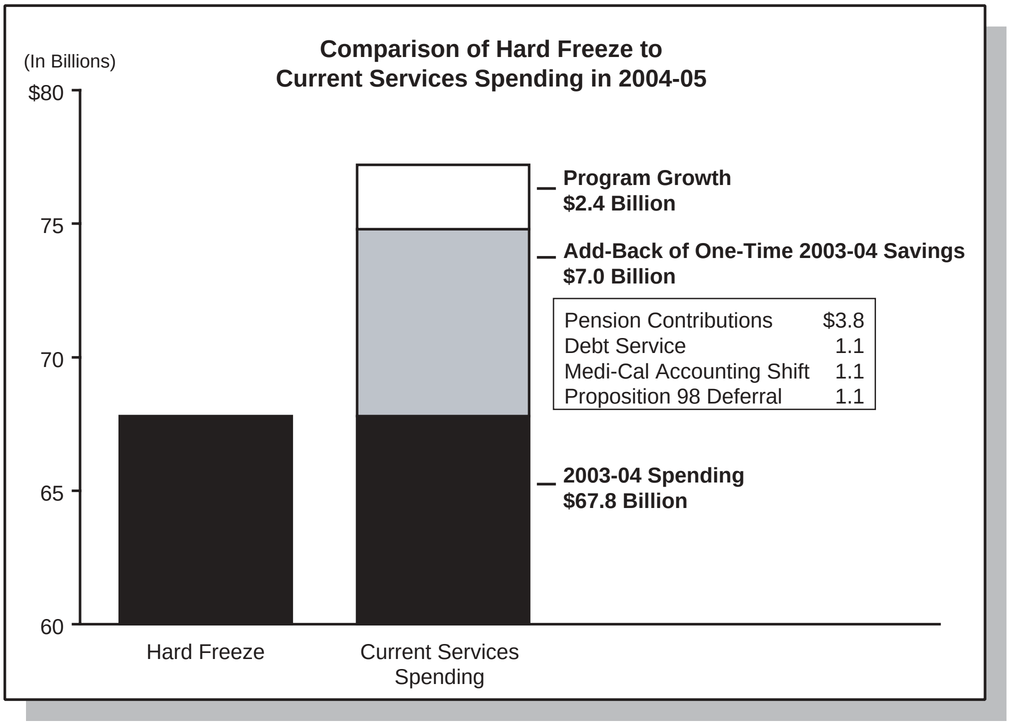
Effects of Senate Republican Plan on 2004-05 Expenditures



☑ General Fund current services spending requirements would jump from $67.8 billion in 2003-04 to $77.2 in 2004-05—an increase of $9.4 billion (close to 14 percent).

- Most of the increase would be for the restoration of spending that is reduced on a one-time basis in 2003-04.
- The remainder would be for caseload and inflation-related costs.

☑ Thus, in order to maintain a freeze, spending for General Fund programs would need to be reduced by an additional 12 percent from the plan's current services levels in 2004-05.

☑ This is in addition to the 7 percent across-the-board reduction in 2003-04, as well as on top of the ongoing effect of the Governor's proposed reductions incorporated in the plan.

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Effects of Senate Republican Plan on 2004-05 Expenditures *(Continued)*

☑ If these reductions were achieved (and assuming LAO February revenue estimates), the state would end 2004-05 with a modest reserve of $708 million.

- It would also have a large operating surplus in 2005-06 that would generate a $10.4 billion reserve at the end of that year.
- Thus, a considerable portion of the 2004-05 additional reductions ($9.4 billion) needed to achieve the hard freeze could be one-time as opposed to ongoing in nature.

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Impact on Proposition 98 Programs

- ☑ In the current year, the Senate Republican Plan would require $1.1 billion in K-14 program reductions to replace the $1.1 billion in funding deferrals adopted in Chapter 4x, Statutes of 2003 (SB 18x, Chesbro). In addition, the Legislature would have to reduce K-14 programs by an additional $151 million to lower Proposition 98 funding to the Governor's proposed 2002-03 guarantee level of $43.9 billion.

- ☑ In 2003-04, the proposal would reduce Proposition 98 funding by $3 billion, requiring suspension of the minimum guarantee.

  - A deferral of $1.1 billion of funding from 2003-04 to 2004-05.
  - A reduction of an additional $2 billion compared to the Governor's budget, if the 7 percent reduction applies to Proposition 98.

- ☑ Potential additional reductions in 2004-05 if Proposition 98 General Fund amount "frozen":

  - Funding would be roughly $1 billion less than required by Proposition 98, thereby requiring another suspension.
  - Because the $1.1 billion deferral was one-time, additional reductions of that amount would be necessary within the lower Proposition 98 spending level.