

June 4, 2010

# Overview of the May Revision, Assembly, and Senate Budget Plans

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L E G I S L A T I V E   A N A L Y S T ' S   O F F I C E

Presented to:  
The Conference Committee on the Budget



## Key Features of the Three Budget Plans

(2010-11)

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	Governor's May Revision	Assembly	Senate
<b>Revenues</b>	\$91.5 billion	\$93.6 billion <sup>a</sup>	\$96.8 billion <sup>a</sup>
<b>Key Revenue Differences</b>	<ul style="list-style-type: none"> <li>Limited additional revenues.</li> </ul>	<ul style="list-style-type: none"> <li>Suspends previously approved corporate tax reductions.</li> <li>Imposes oil severance tax<sup>b</sup> and decreases state sales tax by 1/4 cent.</li> </ul>	<ul style="list-style-type: none"> <li>Suspends or changes previously approved corporate tax reductions.</li> <li>Extends temporary income tax increases scheduled to expire in 2010-11, increases vehicle license fee, and raises alcohol taxes.</li> </ul>
<b>Expenditures</b>	\$83.4 billion	\$86.1 billion <sup>c</sup>	\$93.1 billion
<b>Federal Funds</b>	<ul style="list-style-type: none"> <li>\$3.4 billion in additional federal funding assumed, as well as federal program flexibility, to contain health and social services costs.</li> </ul>	<ul style="list-style-type: none"> <li>Approved Governor's approach.<sup>e</sup></li> </ul>	<ul style="list-style-type: none"> <li>Approved Governor's approach.<sup>e</sup></li> </ul>
<b>Key Expenditure Differences</b>	<ul style="list-style-type: none"> <li>Elimination of CalWORKs and child care. Sharp reductions in other health and social services programs.</li> </ul>	<ul style="list-style-type: none"> <li>Generally preserves existing health and social services programs.</li> <li>Beverage container recycling borrowing reduces expenditures by nearly \$8 billion.</li> </ul>	<ul style="list-style-type: none"> <li>Generally preserves existing health and social services programs.</li> </ul>

(Continued)

## Key Features of the Three Budget Plans

(Continued)

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	Governor's May Revision	Assembly	Senate
<b>Proposition 98 Spending<sup>f</sup></b>	\$48.9 billion	\$54.0 billion	\$51.2 billion
<b>Budgeted Reserve</b>	\$1.2 billion	\$1.2 billion	-\$2.1 billion <sup>d</sup>
<b>LAO Estimated Operating Deficit in 2011-12</b>	\$5 billion	\$16 billion	\$12 billion <sup>d</sup>
<p><sup>a</sup> Based on LAO's May revenue estimates (which were \$1 billion over the Governor's estimates in 2010-11), plus revenue actions of the respective houses.</p> <p><sup>b</sup> Proceeds would be transferred to proposed Jobs and Economic Security Fund as part of a \$9 billion Beverage Container Recycling Fund borrowing.</p> <p><sup>c</sup> The Assembly plan reflects reduced General Fund expenditures of nearly \$8 billion due to a proposed beverage container recycling fund borrowing.</p> <p><sup>d</sup> Senate plan requires identification of more budget solutions to meet requirements for a balanced state budget in 2010-11. These solutions could reduce the 2011-12 operating deficit that is shown.</p> <p><sup>e</sup> Benefit of assumed federal relief is slightly larger than the May Revision due to higher spending on health and social services.</p> <p><sup>f</sup> Includes both one-time and ongoing funds. Total spending includes local property tax revenues.</p>			

## Common Components of the Three Plans

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- Substantial Federal Funding Assumed.** The plans assume increased federal funding or program flexibility for California totaling \$3.4 billion in health and social services programs.
- Borrowing and Transfers From Special Funds.** The two houses' plans generally mirror the Governor's May Revision proposals for \$1.6 billion of loans, transfers, and loan extensions from special funds.
- Reductions in Prison Costs.** The plans each include an \$811 million reduction in the prison medical care receivership budget and a \$244 million reduction associated with placing certain offenders in county jail, instead of state prisons.
- Universities.** The plans all restore \$610 million in current-year cuts and provide funding for enrollment growth.
- Sale of State Buildings.** Each plan assumes that the state will sell and then lease back state office buildings. The plans assume \$600 million in revenues, but this amount would be hundreds of millions of dollars higher if the sale is approved.
- Vacant Positions.** The plans require General Fund departments (especially prisons) to hold thousands of positions vacant or reduce staffing to generate \$450 million of savings. Moreover, Department of Motor Vehicles and California Highway Patrol would have to reduce personnel and services to facilitate a special fund loan to the General Fund.

## Assembly and Senate Plans Reject Most of the Governor's Cuts

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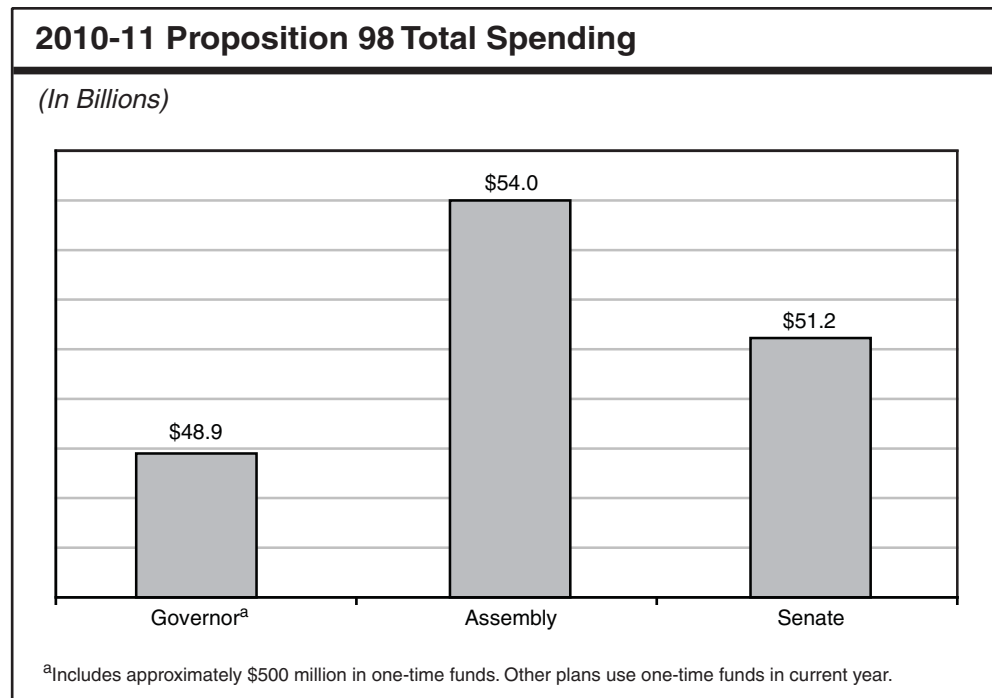


The Assembly and Senate plans basically avoid the sharp program reductions proposed by the Governor.

- **Proposition 98 and Child Care.** The legislative plans reject the Governor's K-14 funding approach. These plans provide over substantially more in Proposition 98 funding from state and local sources and reject the Governor's proposal to eliminate child care funding.
- **Social Services.** The legislative plans reject over \$2 billion of the Governor's proposed social services reductions, including the proposed elimination of CalWORKs and reductions in IHSS and SSI/SSP, and restore child welfare funds that were vetoed by the Governor in 2009-10.
- **Health.** The two houses' plans reject over \$1.5 billion of the Governor's proposed health spending reductions, including cost-containment actions in Medi-Cal, the proposed 60 percent reduction in county mental health realignment funds, and the elimination of Drug Medi-Cal.
- **State Employee Compensation.** The legislative plans reject \$1.5 billion of General Fund state personnel cost reductions proposed by the Governor.

## Comparison of Proposition 98 Plans

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- Funding decisions depend on amount of General Fund revenues and assumptions about constitutional interpretation of “maintenance factor.”
- Key question will be how much can the state afford given its other budget pressures. Meeting the minimum guarantee may not be possible—requiring suspension in 2009-10 and/or 2010-11.

## The Two Houses' Plans Include Additional Tax Revenues

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- ☑ **Legislative Plans Include New Tax Revenues.** While the Governor's budget plan largely avoided new revenues, both the Assembly and Senate plans include more tax revenues for 2010-11 and later years.
  
- ☑ **Senate Revenue Actions.** The Senate plan:
  - Suspends/changes previously approved corporate tax reductions (\$2 billion in 2010-11).
  - Extends temporary income tax provisions scheduled to expire in 2010-11 (\$1.3 billion).
  - Extends temporary vehicle license fee (VLF) increases and raises the VLF an additional 0.35 percent through 2012-13 (\$673 million).
  - Increases the excise tax on alcohol in line with inflation (\$214 million).
  
- ☑ **Assembly Revenue Actions.** The Assembly plan:
  - Suspends corporate tax reductions (\$2 billion).
  - Approves Governor's insurance surcharge proposal to fund emergency response activities (\$76 million in General Fund benefit).
  - Imposes a new oil severance tax, a key part of the Assembly plan to borrow over \$9 billion for various purposes in 2010-11, and decreases state sales tax by 1/4 cent (no net change in state tax revenues).
  - Allow local sales tax to increase by 1/4 cent (resulting in \$900 million of Proposition 98 savings).

## Assembly Plan Relies on Borrowing Proposal

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- Proposed Securitization of Beverage Container Revenues.** The Assembly plan authorizes nearly \$9 billion of borrowing through a securitization of future Beverage Container Recycling Fund (BCRF) revenues, as well as a \$500 million loan from the Disability Insurance Fund.
  
- Proceeds Would Benefit the General Fund.** The bulk of the borrowing proceeds would help balance the 2010-11 General Fund budget by:
  - Paying for \$5.3 billion of budgeted Proposition 98 expenditures.
  - Paying \$1.8 billion of CalWORKs costs.
  - Restoring \$610 million of current-year cuts to the universities, which the Governor's proposal would have paid from the General Fund.
  
- Other Uses of Borrowing Proceeds.** Other proceeds would be used to fund jobs measures, mandate payments to local governments, a reduction of previously planned university fee increases, and other programs.
  
- Repayment Over Next 20 Years.** The Assembly proposal would utilize BCRF revenues to repay securitization bondholders. To fund continued recycling services, oil severance taxes would be dedicated to the BCRF.

## Major General Fund Budget Proposals Affecting Local Government

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Program	Governor	Senate	Assembly
<b>Social Services</b>			
CalWORKs and Cash Assistance Program for Immigrants	Eliminates programs, increasing county general assistance costs potentially by more than \$1 billion annually.	Rejected proposals.	Rejected proposals.
Various programs	Redirects county savings created from proposed program reductions and one-time federal ARRA funds to offset state costs. (State General Fund savings of \$360 million).	Rejected proposal.	Rejected proposal.
<b>Health</b>			
Mental Health Realignment Funding	Shifts \$602 million of county mental health realignment funds to backfill state's share of child welfare and food stamps administration.	Rejected proposal.	Rejected proposal.
<b>Mandates</b>			
AB 3632 Mental Health Program	Suspends county mandate (shifting program responsibilities to schools). Defers payment of outstanding post-2003 county claims (\$133 million) to an unspecified future date.	Rejected proposal. Provides \$52 million (under DMH) and \$132 million (under mandate item).	Rejected proposal. Provides \$52 million (under DMH) and \$79 million (under mandate item).
Payment of pre-2004 claim backlog	Defers scheduled payment of \$95 million to local governments (primarily counties).	Approved as budgeted.	Provides \$931 million from Jobs Fund.
<b>Criminal Justice</b>			
Department of Corrections and Rehabilitation	Shifts to counties responsibility for certain offenders sentenced to three years or less in state prison. Provides county mitigation funds in future years.	Approved savings, but modified TBL.	Approved.

## Risks Abound in Each Budget Plan

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- Borrowing Risks.*** The Assembly borrowing plan involves considerable implementation and legal risks. Even if ultimately found to be lawful by the courts, the borrowing could be delayed by lawsuits. These lawsuits, in turn, could delay the state's normal cash flow borrowing for months.
- Federal Government Risks.*** The \$3.4 billion federal funds assumption advanced by the Governor and the assumption that Congress will allow the state to collect about \$800 million in estate taxes appear increasingly uncertain. (The Governor's plan also relies on the federal government granting increased flexibility for the state to cut health program costs.)
- Prison Savings Risks.*** The prison medical system is unlikely to achieve \$811 million of savings in 2010-11. The prisons also are unlikely to achieve targeted workforce cap savings without more sentencing, operational, or collective bargaining changes.
- Retirement Cost Risks.*** Mandatory pension and retiree health costs may end up \$300 million above amounts assumed in the three budget plans.

## Sensitive Cash Situation

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- Cash Situation Sensitive to Budget Timing.** The normal annual state cash flow borrowing—a revenue anticipation note (RAN)—probably cannot proceed until a state budget is passed.
- Controller Must Act Weeks Before Cash Is Depleted.** Cash flow projections suggest the state could pay its bills through September without a budget. The October cash flow projections, however, are so dire that the Controller may have to begin unscheduled payment delays or IOU issuance weeks before then without a budget in place.
- June Cash Receipts Are Critical.** With recent accelerations in the timing of estimated income tax payments, June—not April—is now the state’s largest month for revenue collections. If June receipts are exceptionally weak, unscheduled payment delays or IOUs may be needed earlier.
- Additional Cash Management Measures.** Depending on the content of the final budget deal, additional cash management measures—revenue accelerations or scheduled payment delays—may be needed to keep the state’s borrowing to a manageable size. In our view, however, many school and community college districts cannot manage more payment delays.

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- Preserve Core Programs, but Reduce Spending in All Areas.*** Throughout this year's budget process, we have advised the Legislature to avoid elimination of core programs that provide services to some of the state's neediest populations, such as CalWORKs and child care. Nevertheless, significant spending reductions will be required in all program areas, including programs the Governor spares—such as universities, trial courts, and public safety local assistance programs.
  
- Decide What Level of K-14 Spending Is Affordable.*** For Proposition 98, the Legislature will need to determine what level of school spending is affordable. Suspending the minimum guarantee will, in our view, likely be necessary. Additional flexibility measures for districts would be helpful to districts in any case.
  
- Revenues Should Be Included in the Mix of Solutions.*** The Governor presents Californians with a clear vision of the severe program reductions necessary if the budget is balanced without additional revenues. Alternatively, some of the most severe cuts can be avoided by adopting selected revenue increases—from fees and other non-tax revenues, changes to tax expenditure programs, delays in previously scheduled tax reductions or expirations, and targeted tax increases.

## Addressing the Out-Year Problem

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- Adopting Ongoing Solutions.*** Any budget solution will involve some one-time measures. Balancing the budget *predominantly* with borrowing, however, would be poor fiscal policy and risk the need for larger cuts or tax increases later. We advise the Legislature to aim for at least one-half of its budget solutions to be ongoing or multiyear in nature.
  
- Act Now for Future Savings.*** The state needs to adopt actions now—such as delaying the kindergarten start date and modifying retirement programs—to achieve out-year savings.