201

1991-92 GOVERNOR'S BUDGET

PRESENTATION CHARTS

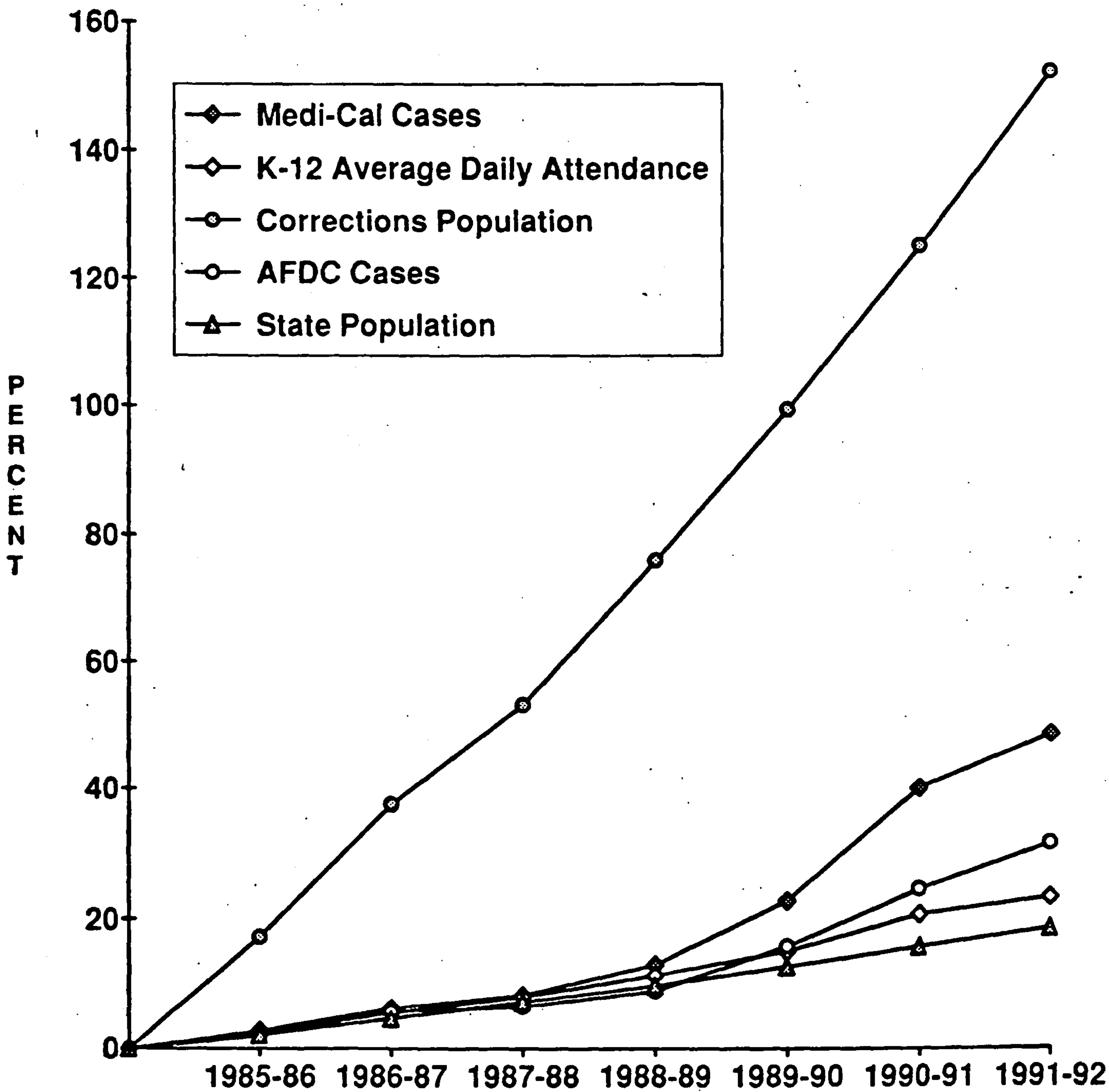
January 10, 1991
Chart 1

1991-92 GOVERNOR'S BUDGET

- Balanced
- Prudent Reserve
- No General Tax Increase
- No COLA's
- Enrollment, Caseload, Population Fully Funded
- Initiatives Funded
- Substantial Program Funding Reductions
- Long Term Budget Reform

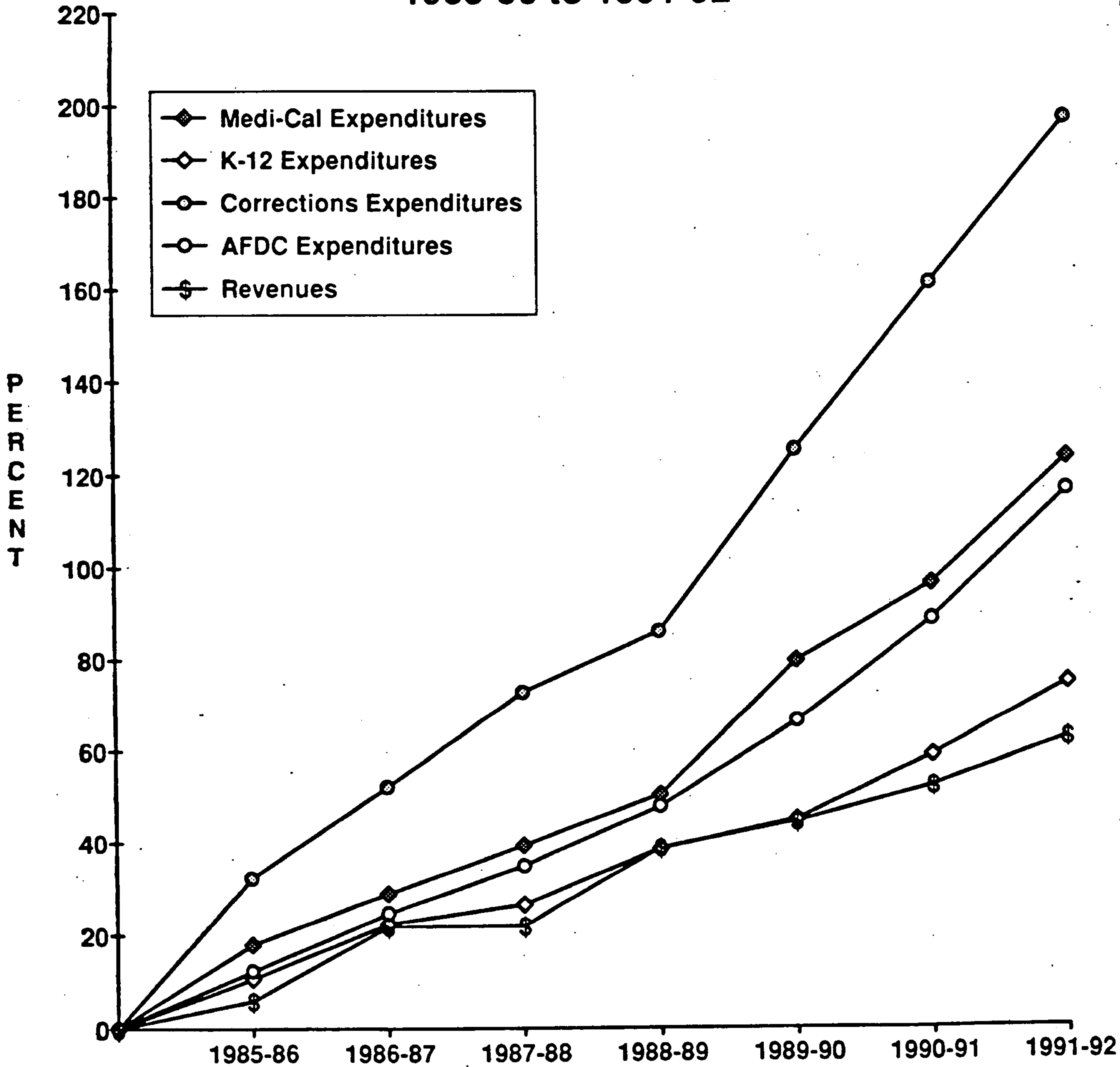
January 10, 1991
Chart 2

KEY GENERAL FUND BUDGET INDICATORS
CASELOAD vs POPULATION
1985-86 to 1991-92



January 10, 1991
Chart 3

KEY GENERAL FUND BUDGET INDICATORS
EXPENDITURES vs REVENUES
1985-86 to 1991-92

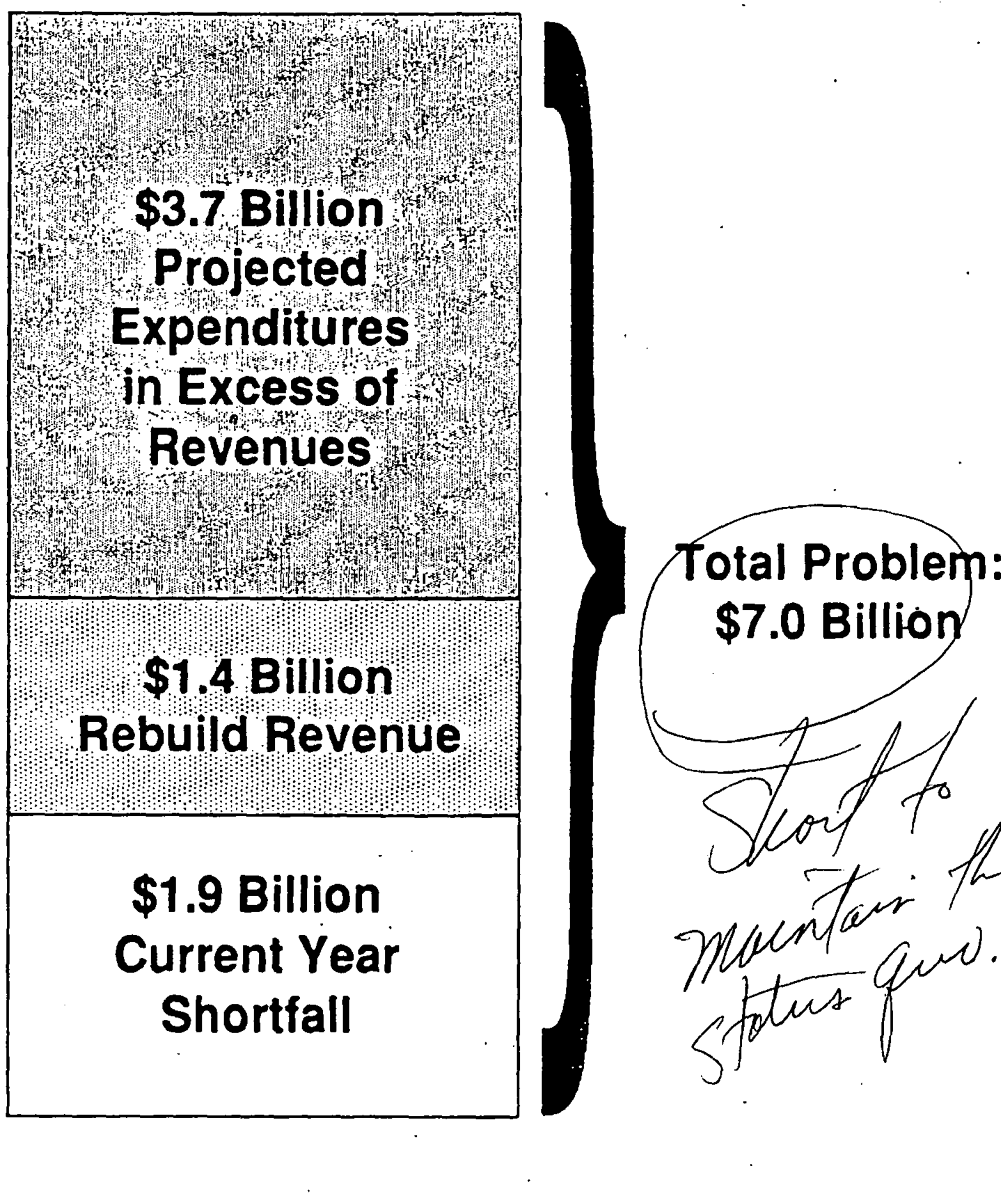


January 10, 1991
Chart 4

Budget Gap

Assumptions
1. growth
2. no war
3. Sales taxes
4. Recession over by now.

22% short of all the general fund $ in the state



Short to maintain the status quo.

MAJOR REVENUE PROPOSALS
($ In Millions)

Rate Increase for Local Government	
Vehicle License Fee	$781
Alcoholic Beverage Tax	190
Tax Compliance	
Withholding for Independent Contractors	290
Withholding on Bonuses	80
Withholding on Estates and Trusts	42
Tax Equity	
Candy and Snack Foods	270
Newspapers and Periodicals	114
	$1,767

January 10, 1991
Chart 5

BRIDGING THE GAP
($ in Billions)

	Amount
Trigger Reductions	$0.8
Program Funding Reductions	1.4
Suspend Proposition 98 in 1991-92	1.4
Recalculate the Proposition 98 Guarantee for 1990-91	0.5
Realignment of State/Local Programs	0.9
Tax Compliance — TAX IS A TAX IS A TAX	0.4
Tax Equity — Cowdy	0.3
Medi-Cal Capitation/Accrual of Revenues	0.8
Other Resources and Transfers to the General Fund	0.5
	$7.0

January 10, 1991
Chart 7

GOVERNOR'S INITIATIVES

PREVENTATIVE MEASURES

- Expand Preventive Health Care Programs for Children and Families
- Integrate the Public Schools and Supportive Services for Children

STRUCTURAL REFORM MEASURES

- Realign State and Local Responsibilities
- Expand Enrollment in Medi-Cal Prepaid Plans
- Restructure Public Assistance Programs
- Allow Local Voters to Fund Crime and Drug Programs
- Allow Local Voters to Approve School and Jail Facilities

50%
1 cent for Ed

2.1

37/38

Governor's Budget Summary

1991–92

Submitted by

Pete Wilson

Governor

State of California

to the

California Legislature

1991–92 Regular Session

California's Fiscal Challenges

As the State of California enters the final decade of the 20th century, it faces unprecedented fiscal challenges. The continuing budget problems which have been the focus of efforts by the state's political leaders and fiscal experts remain largely unresolved. The widening gap between program commitments and available resources must be addressed immediately.

Budget Outlook. In the 1990–91 fiscal year, weak revenue growth, combined with unusually rapid expenditure increases in public assistance, education, corrections, and other programs will deplete the Reserve for Economic Uncertainties.

In the 1991–92 fiscal year, the General Fund workload budget exceeds expected revenues by $3.7 billion. This problem coupled with the current year shortfall and the need for a prudent reserve means that the state must close a funding gap by an amount exceeding $7 billion by June 30, 1992.

Structural Problem. Fundamentally, the state suffers from a *structural budget problem*. The growth in demand for public services—especially public assistance, health, K–12 education and corrections—is exceeding the growth in the state's economy and revenue structure. Some of this problem is associated with demographic factors. California is experiencing rapid population growth, due in large part to high levels of immigration. The state's population also is experiencing significant change in its ethnic and age composition. These demographic factors are having a substantial impact on public school enrollments, public assistance caseloads, and on other programs.

Figure 1-A

Key General Fund Budget Indicators
Caseload
1985-86 to 1991-92

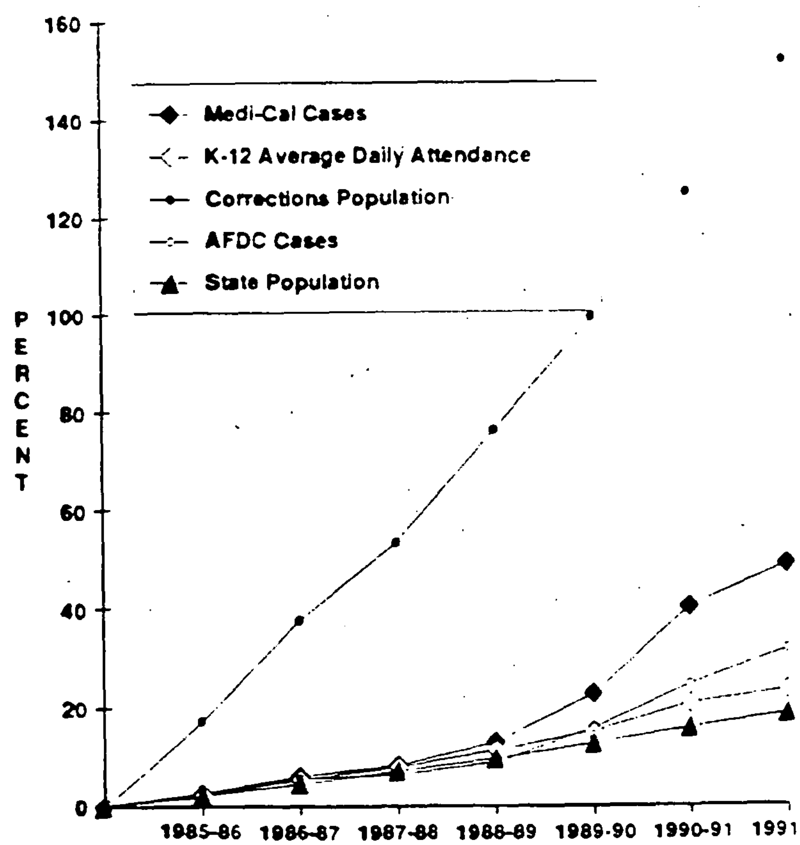
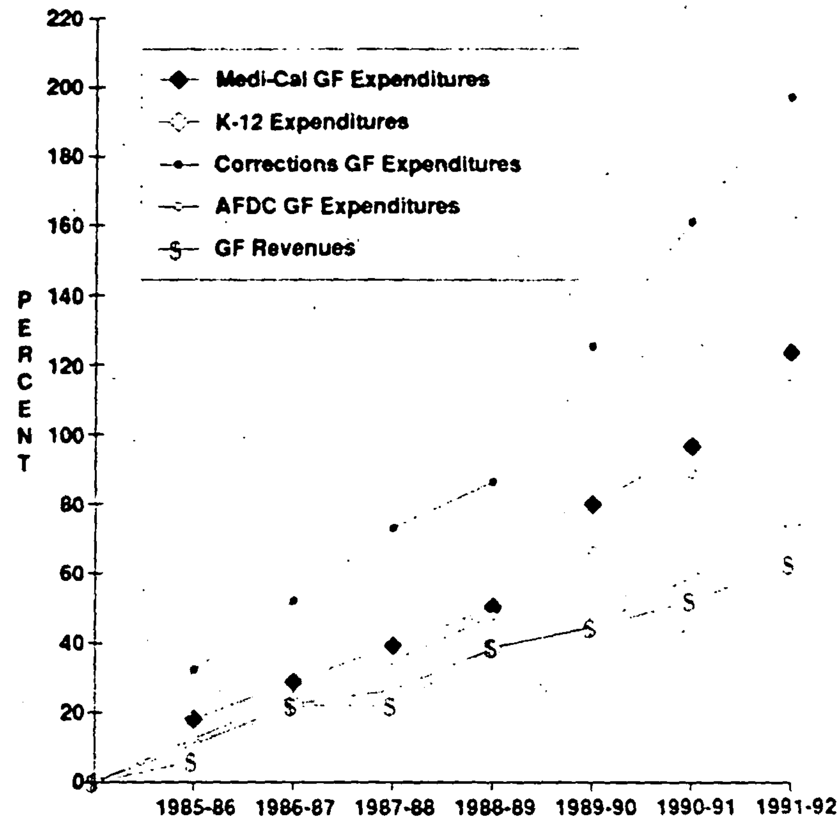


Figure 1-A compares the growth in caseload indicators for several large programs with the growth in the state's population since 1984–85. Public school enrollments have increased nearly 25 percent. In the past two fiscal years, school enrollment has grown over 70 percent faster than the growth rate of the general population. Caseload in the Aid for Families with Dependent Children (AFDC) program has increased by over 30 percent. The prison population has increased over 150 percent.

Figure 1B compares the growth in expenditures of these programs with the growth in General Fund revenues since 1984–85. The 1991–92 expenditures reflect the demands of the natural growth of these programs. K–12 expenditures, which have increased nearly 75 percent, have grown because of unusually rapid enrollment growth, statutory Cost-of-Living Adjustments (COLAs), and the impact of new policies, such as the education reforms enacted in 1983 and the constitutional funding guarantee contained in Proposition 98. Spending for AFDC has grown over 115 percent, due to caseload growth, increased placement of children in foster care, and the impact of statutory cost-of-living adjustments. Medi-Cal spending has grown over 120 percent, due most notably to federally mandated expansions in program eligibility. Corrections expenditures have increased nearly 200 percent, primarily from the rapid growth in the number of dangerous felons incarcerated in state prison facilities. Other programs not shown in the figure also have grown rapidly, most notably debt service and social services programs.

Figure 1-B

Key General Fund Budget Indicators Expenditures 1985-86 to 1991-92



General Fund revenues have grown slightly over 60 percent during this same period. It is clear that normal growth in General Fund revenues can no longer sustain these growth rates. A long-term strategy to address the structural budget problem must reduce the rate of growth in state spending.

Cyclical Problem. A second component of the budget problem is *cyclical*. The state has entered an economic recession of uncertain magnitude and duration. Revenue collections have fallen short of previous forecasts and caseloads for public service programs have increased sharply. The cyclical component of the budget problem is having dramatic effects on both revenues and spending, but will diminish as the economy recovers and program expenditures stabilize. This effect, and the fact that replenishing the Reserve for Economic Uncertainties is a one-time expenditure, means that a strategy for addressing the cyclical budget problem can appropriately include a limited number of one-time adjustments.

Limited Flexibility. Finally, the budget process suffers from a *lack of flexibility* in addressing the budget gap, because of a variety of state statutes, voter-approved initiatives, court decisions and federal laws. As much as 90 percent of the state's budget is governed by these laws. The remaining 10 percent lacks similar preferred treatment, but includes such vital services as mental health and fire protection.

The most important restrictions on the annual budget process are a number of constitutional restrictions. The most prominent is Proposition 98, which guarantees minimum state funding levels for K–14 education programs, and limits the ability of the state to use tax policy to address budget shortfalls. Other constitutional provisions require state spending for debt service, state-mandated local programs, and the homeowner's exemption.

A number of statutory entitlements guarantees that persons meeting eligibility requirements may receive specific benefits. Among these are entitlements for AFDC, SSI/SSP, Medi-Cal, and various tax relief programs. A number of these programs provide for automatic cost-of-living adjustments, which further erodes the flexibility of elected officials to set priorities through the budget process.

In recent years, federal policies have added greatly to the state's fiscal burden. Federal immigration and refugee policies in particular have greatly increased the number of legalized and undocumented noncitizens who are entitled to state-funded public assistance, medical and public education services. At the same time, the federal government has reduced its commitment to provide the state with fiscal relief for these obligations through reduced funding for the State Legalization Impact Assistance Grant (SLIAG) program and the Refugee Cash Assistance program.

Finally, the courts have greatly expanded their own role in setting the state's budget priorities. For example, the state has created a number of new public assistance programs in recent years solely to comply with court orders. In addition, the state's flexibility to administer its correctional facilities is also limited by a number of court orders affecting prison overcrowding. Finally, a number of important court decisions have weakened the state's revenue base.

These laws limit the ability of the state's elected officials to set priorities among competing demands for public services. The Administration will actively encourage a thorough review of factors which restrict the state's elected officials from discharging their constitutional obligations to develop an annual budget plan and oversee its implementation.

Primary Features of the Governor's Budget for 1991–92

The Governor's Budget for 1991–92 is an 18-month reform plan beginning in January 1991 to restore the fiscal health of the State of California and to assure the long-term integrity of the state and local agencies on which our 30 million residents depend. Toward these ends, the Budget has the following primary features:

- It is balanced.
- It provides a prudent reserve of $1.4 billion.
- It contains no general increases in the personal income tax, bank and corporations tax, or sales and use tax.
- It raises additional revenues that are needed to finance administration initiatives and to preserve funding for vital government services. Those revenues are raised on the basis of sound tax policy and will not adversely affect the state's business environment or economic growth.
- It funds all population, enrollment and caseload growth for all programs.
- It provides no funding for statutory or discretionary cost-of-living adjustments.
- It makes substantial reductions in state operations and local assistance budgets, in part from the application of the "trigger" mechanism enacted in the 1990 legislative session.
- It is equitable. The extraordinary circumstances facing the state require enacting controversial measures, including program reductions and new revenues. No program or constituency, however, is singled out for drastic cutbacks.
- It contains long-term budget reform.

Principles of Balanced Long-Term Budget Reform

Prevention vs. Crisis Management. The social problems which are driving the state's fiscal problems—crime, mental illness, child abuse, illiteracy, premature births—are largely preventable. State government must establish new priorities for the prevention of these problems, rather than provide solely for their mitigation. In spite of the state's fiscal situation, this budget exercises leadership for the long-term benefit of our residents and taxpayers.

Economic Development. The state's diverse and growing economy is the basic source of resources for support of public services. A long-term strategy for budget reform includes tax, regulatory, public assistance, education, infrastructure and trade policies that promote the development of the state's workers and businesses.

If California is to compete effectively in the national and international marketplace of the 21st century, we cannot limit our ability to attract business and jobs to the state. Our economic development future is closely linked to a tax and regulatory environment that encourages entrepreneurial efforts. The state's tax policies should also be as fair and as simple as possible.

Balancing Services and Tax Effort. California ranks 25th among the states in total tax revenues per $100 of personal income. Yet in many programs, particularly public assistance, California's services are among the richest offered by any state. Simply put, the state's revenue structure cannot sustain the level of public service commitments that have been made.

Beyond the immediate problem, state spending is growing at a rate that cannot be sustained by growth in the state's economy. Although increased revenues alone cannot address the widening gap between expenditure growth and revenue growth, this budget includes new, ongoing revenues to fund administration initiatives and other vital services.

This budget includes substantial, comprehensive and permanent budget reforms which will realign expenditures with available revenues and which will reduce the rate of growth in state spending to a level which can be sustained by the growth in the state's economy.

Efficiency and Innovation. Efforts to balance the budget should not rely exclusively on reducing services and increasing taxes. Long-term budget reform means finding new and innovative ways to deliver existing services more efficiently.

Investing In Children. Children are our state's most important resource. Unfortunately, a variety of pressures in our society has resulted in unacceptable levels of perinatal health problems, childhood illness, substance abuse, crime and poor educational achievement. These problems have contributed directly to the state's fiscal difficulties. Long-term budget reform requires taking steps to assure that vital services to children are funded, in order to avoid future expenditures for acute medical care, drug rehabilitation, public assistance and incarceration.

Public Safety. State spending on corrections has grown rapidly over the past several years. The Administration will operate the state's correctional facilities in the most efficient manner possible, always maintaining as a first priority the protection of the lives and property of our residents.

New Directions: Long-Term Budget Reforms and Initiatives

Realigning State and Local Program and Financial Responsibilities. The current relationship between the state and the 58 counties includes a number of arbitrary and inefficient divisions of administrative and fiscal responsibilities. Counties have been forced to dedicate increasing portions of their general purpose revenues to support state programs, without having the flexibility to reduce service levels or manage programs more efficiently. The result has been a growing fiscal crisis in many counties, inefficient program administration, and a growing lack of accountability. To address these problems, the budget proposes:

- Returning administrative and fiscal responsibility for the AB 8 program, the local Public Health Services program and most local mental health services programs to counties. Counties would be provided adequate and growing new local revenues from the Vehicle License Fee and an Alcoholic Beverage Surtax to fund these services.
- Repealing a variety of state-mandated programs and giving counties greater flexibility to administer existing programs.
- Exploring with counties, cities, and redevelopment agencies options for improving land-use decision-making and preventing unnecessary erosion of local revenues.
- Allowing counties, with voter approval, to increase local sales and use taxes by up to ½ cent to fund drug interdiction, treatment, and education, and for crime suppression efforts.

In addition, the Administration proposes allowing local agencies to issue general obligation bonds for construction of county jail and school facilities with a majority vote of local electors. This proposal is intended to provide local agencies with a new revenue source for public facilities and to relieve the state of the fiscal burden of financing local infrastructure projects.

Investing in Children and Families: Health. Preventing childhood illness and substance abuse among children is a central focus of the Administration's efforts to avoid future costs for public assistance, drug treatment and incarceration. To address these issues, the budget proposes:

- Expanding eligibility for perinatal and well-baby care at a cost of $52.7 million. This will provide services to an additional 9,000 infants and 17,000 women in 1991–92.
- Increasing funding for family planning services by $10 million, and targeting those services at unmarried teens and substance-abusing women.
- Expanding funding for residential and day treatment for substance-abusing parenting women by $25 million.
- Expanding the Drug-Free School Zones program to four new sites.

Investing in Children and Families: Public Education. The Administration is committed to developing public schools as the primary focus for the integration of education and other supportive services for children. Toward that end, the Administration proposes:

- Establishing a new cabinet-level Secretary for Child Development and Education.
- Expanding funding for preschool services by $50 million, plus expected new federal Head Start and child development funding, as the first phase of a five-year commitment to provide preschool services for every low-income four-year-old who needs services. The Administration also proposes to modify the existing state program to serve more children and to more closely match Head Start standards.

- Funding a new Healthy Start program at $20 million to assist school districts to arrange for local coordination and integration of health and social services for children.
- Providing $10 million to provide mental health counseling in elementary schools to detect and prevent emotional or psychological problems.
- Providing $5 million to train volunteers to act as mentors for school-aged children who lack a caring adult in their lives.
- Providing $10 million to develop a new test instrument to assess individual student performance and progress through school.
- Expanding funding for the Early Intervention for School Success program by $1 million.
- Expanding funding for drug education in junior and senior high schools by $4 million.

Restructuring Public Assistance Programs. The Administration is proposing restructuring the state's public assistance programs with the objective of reducing AFDC caseload growth, reducing welfare dependence, improving work incentives and opportunities for AFDC recipients and improving access for medical services. Towards these ends, the budget proposes:

- Reducing AFDC grants to the minimum level permitted by federal law. At this level, California's grants will be third highest in the nation.
- Separating the AFDC aid payment from the need standard to allow recipients to retain more earned income, and studying the potential benefits of making other changes in work rules and in the grant structure.
- Expanding fraud prevention activities through elimination of the Homeless Assistance Program, reauthorization of the Fraud Early Detection Program and new efforts to discourage intentional program violators.
- Restructuring the GAIN program to provide a greater focus on work programs.

Financial Accounting and Medi-Cal Capitation. The administration is proposing moving the State of California substantially toward compliance with accounting standards recommended by the Governmental Accounting Standards Board. Beginning in 1991–92, the state will reflect as revenues those tax obligations which exist but would not be collected until 1992–93. This change will increase General Fund revenues on a one-time basis by an estimated $1,676 million. Offsetting this accrual of revenues will be a one-time expenditure of $876 million in the Medi-Cal program, reflecting services provided in 1991–92 but for which payment would not be made until 1992–93.

The accrual of both revenues and expenditures is sound accounting practice. It also provides the state with a unique opportunity to advance a significant reform of the Medi-Cal program by expanding enrollment of beneficiaries in prepaid management care systems, such as organized county health systems and primary care case management programs. The cash method of accounting has significantly impeded the state's ability to increase enrollments in prepaid plans, because of their significant "pipeline" costs. Returning Medi-Cal to accrual accounting eliminates these "pipeline" expenditures, and greatly facilitates the ability of the state to increase enrollments in prepaid plans, which have proven to be cost-effective in delivering high-quality medical care.

Strategy for the Future

California is facing unprecedented fiscal challenges. How effectively we meet these challenges will largely determine how well-prepared California will be to enter the next century. If we are to be competitive and prosperous, we must begin now to reshape the fiscal foundations of government. This 1991–92 Governor's Budget sets the framework for implementing this strategy.

Bridging the Gap

During the decade of the 1980s, various factors have combined to erode the ability of the Governor and the Legislature to allocate the resources needed to serve California's citizens within available resources as indicated in the California's Fiscal Challenges Section. These restrictions have been caused by federal actions, court decisions and voter approved initiatives; statutory entitlements and cost-of-living increases (COLAs); and rapid program caseload growth.

These pressures, when combined with the current year shortfall, and the need to restore the Special Fund for Economic Uncertainties have resulted in an 18 month budget gap of $7 billion. Specifically, the General Fund workload budget for 1991-92 is $46.8 billion. The reve-

Table 2-1
Bridging the Gap
(Dollars in Billions)

	Amount
Trigger Reductions. Exercise the "trigger" reduction to all non-exempted state programs	$0.8
Program Funding Reductions. Reduce expenditures by $1.4 billion by providing no COLAs, instituting or increasing co-payment requirements in various programs, increasing fees at the Universities, State Universities and Community Colleges, reducing AFDC grants and various other specific program reductions	1.4
Suspend Proposition 98 in 1991-92. Fully fund enrollment but provide no cost-of-living adjustments.	1.4
Recalculate the Proposition 98 Guarantee for 1990-91. Consistent with Proposition 111, the Proposition 98 guarantee has been reduced to reflect the shortfall in General Fund revenues	0.5
Realignment of State/Local Programs. Return administrative and fiscal responsibility for the local Public Health Services program and most local mental health programs to counties. Provide adequate and growing new local revenues from the Vehicle License fee and an Alcoholic Beverage Surtax	0.9
Tax Compliance. Require withholding for independent contractors, individuals receiving lump sum payments, and estates and trusts	0.4
Tax Equity. Eliminate Sales Tax exemption on candy, snack foods, newspapers and periodicals.	0.3
Medi-Cal Capitation/Accrual of Revenues. Continue to move the method of accounting for tax revenues and Medi-Cal expenditures from a cash basis to an accrual basis. These changes will allow the state to expand enrollment in prepaid health care systems. They will result in a one-time net increase of the General Fund available resources.	0.8
Other Resources and Transfers to the General Fund. Primarily Tideland Oil Revenues in the current year, delay implementation of tax credits for small employers who provide health insurance for their employees, recovery of federal social services funds and various other miscellaneous revenues	0.5
Total	$7.0

nue and transfer estimate is $43.1 billion prior to any policy decisions to close the gap. This workload budget exceeds the 1991–92 revenues by $3.7 billion. This problem, coupled with the $1.9 billion 1990–91 shortfall and the need to rebuild the reserve to $1.4 billion creates the $7 billion gap. The actions proposed to close this gap are summarized in Table 2-1.

1991–92 Workload Budget

A workload budget is defined in statute as the budget year cost of currently authorized programs, adjusted for changes in:

- Enrollment, caseload and population
- Statutory COLAs
- Chaptered legislation
- One-time and/or full year costs
- Federal and court mandates
- Merit salary adjustments (MSA) and price increase for operating expenses and equipment
- Constitutional program costs

Trigger Reductions. This structural problem in the budget was partially addressed as part of the 1990–91 Budget Agreement. A mechanism was adopted to automatically reduce General Fund appropriations in future years in the event of a gap between revenues and expenditures. Dubbed the "trigger", this mechanism provides a process to close the gap between automatic budget increases that grow at a faster rate than revenues. It is California's version of the federal government's Gramm-Rudman Law.

As required by statute, the "trigger" mechanism is in effect for 1991–92 and is reflected in this Budget because the gap between the growth in expenditures (10.4 percent) and revenues (7 percent) exceeds one half of one percent. Table 2-2 displays principal growth factors resulting in $4.4 billion growth from the current year to the 1991–92 workload budget.

After exempting costs for those items protected by the California Constitution (Proposition 98, General Obligation Bond Debt Service and Homeowners' Tax Exemption), application of the "trigger" resulted in an $838 million reduction, or 1.7 percent, in the $46.8 billion workload budget. Table 2-3 reflects the 1991–92 General Fund workload costs and the associated "trigger" reductions.

Of the $807 million in "trigger" reductions, $243 million is attributable to reducing COLAs, $210 million represents MSA, price adjustments and other specified reductions. The remaining $354 million in "trigger" reductions were applied as unallocated reductions, to be determined by the individual departments.

The reason that the "trigger" captures only 1.7 percent of the estimated total cost of the General Fund workload budget is because of the exemptions authorized by the enabling legislation. Two major exemptions are Proposition 98 ($18.4 billion) and General Obligation Bond debt service ($1.3 billion). Together, their costs represent 42 percent of the workload budget.

Conceptually, the trigger represents a major step on the road to budget reform and a solution to the structural problems facing the state. It fundamentally alters the presumption for increased spending on programs and COLAs in that it requires legislative action in order to provide those increases rather than having them occur automatically.

In 1991–92 the "trigger" represents a significant reduction in the cost of the workload budget. In practice, however, it must be recognized that it is only the first step in closing the gap. The remaining gap after implementing the Trigger represent a major fiscal challenge that required careful deliberation to arrive at a budget that fits within projected revenues and yet meets the demand for essential public services.

Ultimately, true long-term budget reform will be accomplished when the state realigns expenditures with available revenues and reduce the rate of growth in state spending to a level which can be sustained by the growth in the state's economy.

Proposition 98. Passed by the voters in November 1988, Proposition 98 restructured state school finances by providing a guaranteed minimum level of funding for K–14 education. Specifically, school and community college districts are guaranteed either the same percentage of state General Fund tax revenues received in 1986–87 (40.317 percent), or the prior year funding level adjusted for enrollment and cost-of-living, whichever amount is greater.

The voters amended this funding guarantee in June 1990. Proposition 111 provides that if the growth in state General Fund tax revenue does not keep up with the rise in the cost-of-living, the guarantee would be adjusted for enrollment and growth in state General Fund tax revenues rather than the cost-of-living.

In 1989–90, $15.7 billion was appropriated for schools and community colleges pursuant to Proposition 98. In 1990–91, $16.6 billion has been under the provisions of Proposition 111.

For the 1991–92 budget year, the Administration proposes to suspend the guaranteed minimum level of funding in accordance with the provisions of Proposition 98. Proposition 98 contained provisions allowing for the suspension of its guarantee in the event of a fiscal crisis. This proposed suspension will provide for an equitable balance in funding of state programs. As detailed in Table 4-4, the Governor's Budget provides $16.8 billion for schools and community colleges, an increase of 1.4 percent over 1990–91. In addition, schools and community colleges will receive $6.4 billion in local property taxes, which represents a 9.6 percent increase. In compination, $23.2 billion will be provided, a 3.6 percent increase consistent with growth in other state programs.

Other K-14 Funding. Not all General Fund appropriations for elementary, secondary and community college education are covered by the provisions of Proposition 98. Additional appropriations are made for debt service payments made by the state in the school building and community college capital outlay programs, contributions made by the state to the Teachers' Retirement System, and for support costs of the Department of Education and the Chancellor's Office of the California Community Colleges. These non-Proposition 98 K-14 General Fund expenditures total $711 million in 1990-91 and $1.3 billion in 1991-92. (A detailed listing of all expenditures may be found in Schedule 9 and all Proposition 98 appropriations are shown in Schedule 9A.)

Table 2-2

1991–92
Workload Budget
General Fund

(Dollars in Millions)

1990–91 Budget, July 1990	$42.032
Enrollment, Caseload, Population	1.904
Statutory COLA's	383
Financial Legislation	46
One-time or full year costs	1.282
Merit Salary Adjustments and Price increase for operating expenses	211
Constitutional Programs	1.386
CSU fees to special funds	−358
All Other	−87
1991–92 Workload Budget	$46.799

Table 2-3

1991–92
General Fund
Workload Costs
and Trigger Reductions

(Dollars in Millions)

	1991–92	Trigger Reduction	
Agency	*Workload*	*Amount*	*Percent*
Legislative, Judicial and Executive	$1.487	−$42	2.8
State and Consumer Services	296	−12	4.0
Business, Transportation, and Housing	194	−3	1.5
Resources	821	−19	[illegible]
Health and Welfare	14,879	−410	2.8
Youth and Adult Correctional Agency	3.345	−115	3.5
K–12	17.502	−1	0.9
Higher Education	6.534	−172	3.6
General Government	1.741	−33	1.9
TOTAL	$46.799	−$807	1.7

Table 2-4

Proposition 98 Guarantee Appropriations

(Dollars in Thousands)

	1989–90	*1990–91*	***1991–92***
K–12 Schools			
School Districts and County Offices of Education	$13,843,715	$14,664,651	**$14,816,656**
School Facilities Aid Program	54,465	77,069	**90,090**
State Mandated Local Costs	126,634	119,872	**186,406**
Office of Criminal Justice Planning	16,700	26,470	**26,470**
K–12 Claims Legislation	1,250	–	**–**
Total	$14,042,866	$14,886,532	**$15,119,622**
Community Colleges			
Community College Districts	$1,584,557	$1,645,507	**$1,657,233**
State Mandated Local Costs	15,073	15,496	**7,850**
Total	$1,608,663	$1,661,003	**$1,665,083**
State Agencies			
Department of Developmental Services	$13,670	$16,746	**$18,544**
Department of the Youth Authority	26,136	29,551	**32,020**
State Special Schools	13,890	15,431	**15,765**
Employee Compensation	–	–	**400**
Indian Education Centers	1,530	1,530	**1,516**
Total	$55,226	$63,258	**$68,245**
Total Proposition 98 Guarantee	$15,706,755	$16,610,793	**$16,852,950**

Table 2-5

1991-92 Fund Sources

(Dollars in Millions)

Source	*General Fund*	*Special Funds*
Personal Income Tax	$20,034	$3
Sales Tax	16,780	183
Bank and Corporation Taxes	5,535	25
Highway Users Taxes	--	4,042
Motor Vehicle License Fees	--	3,225
Insurance Tax	1,325	--
Tobacco Tax	158	644
Liquor Tax	135	190
Estate Taxes	487	--
Horse Racing Fees	113	32
Other	1,204	2,982
Total	$45,771	$11,326

Table 2-6

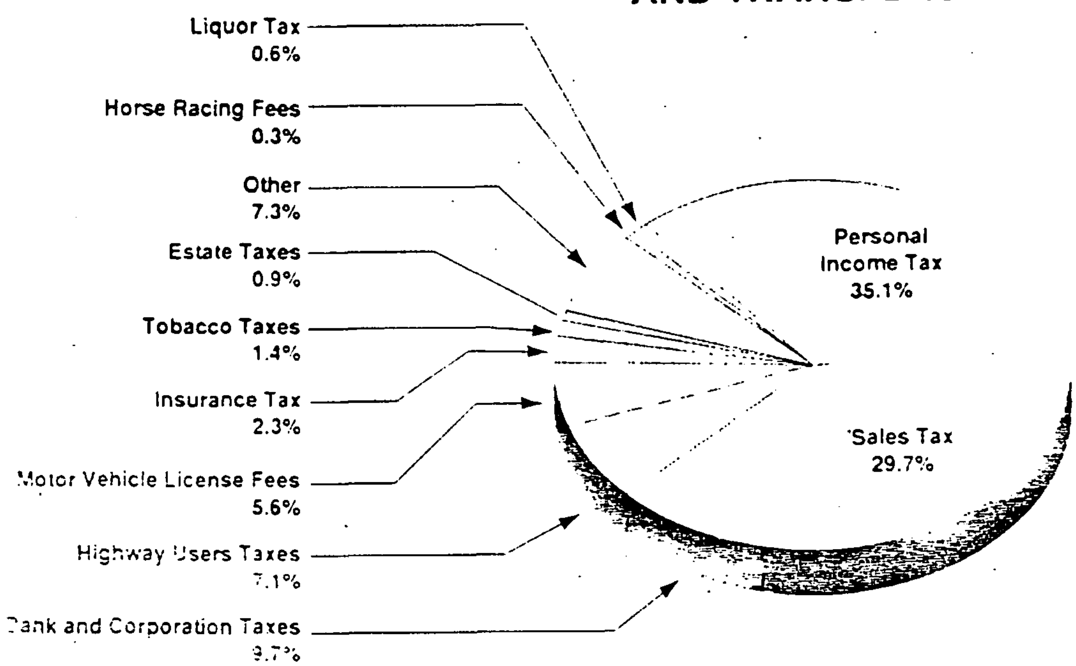
1991-92 Expenditures By Fund

(Dollars in Millions)

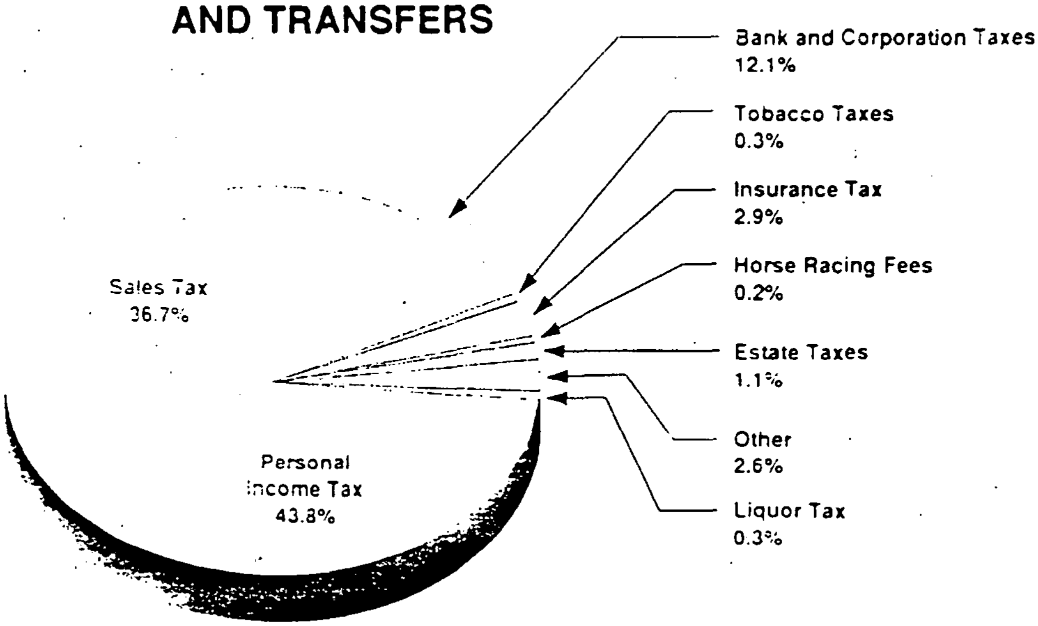
Function	*General Fund*	*Special Funds*	*Bond Funds*	*Total*
Education (K-12)	$16.259	$55	--	$16.314
Health and Welfare	13,964	754	--	14.718
Higher Education	5,890	458	$58	6.406
Business, Transportation and Housing	192	3,547	502	4.241
Tax Relief	716	--	--	716
Local Government Subventions	40	4,193	--	4.233
Youth and Adult Corrections	3.230	16	723	3.969
Resources	799	998	311	2,108
State and Consumer Services	289	335	--	624
Other	1.903	468	6	2.377
Total	$43.282	$10,824	$1.600	$55.706

REVENUES
1991-92 FISCAL YEAR

TOTAL REVENUES AND TRANSFERS



GENERAL FUND REVENUES AND TRANSFERS



State and Local Fiscal Relationship

As a result of the passage of Proposition 13 and various economic adjustments since that time, many local governments have found it increasingly difficult to finance burgeoning service demands with limited resources. At the same time, there has been a growing trend of fiscal power being concentrated in Sacramento. While certain programs were established in the 1980s to assist local government, e.g., Trial Court Funding and County Revenue Stabilization, much remains to be done in returning financial capacity and programmatic flexibility to local government. Consistent with this philosophy, the 1991-92 Budget proposes several important changes:

- Returning programmatic and financial responsibility for two social programs to local government and providing a source of revenue equivalent to the cost of those programs.
- Changing the California Constitution to allow local bond measures for educational and criminal justice facilities to be approved by a majority rather than two-thirds of the voters.
- Providing for a more equitable distribution of sales tax revenues among local jurisdictions.
- Providing local agencies with the authority to increase the sales tax by up to ½ of one percent for drug enforcement and crime prevention purposes.

In addition, the Administration is committed to preventing the further legislative erosion of local finances by vetoing any bill which would impose unfunded state-mandated costs on local entities.

Realignment of State/Local Fiscal Relationships

In an effort to increase county fiscal capacity and flexibility, the Administration is proposing a realignment of the state/local fiscal relationship as it pertains to two major health and welfare programs and the funding for those programs. It is proposed that funding and primary programmatic responsibility be shifted to counties for mental health and county health services programs. State funding for these two programs would be largely eliminated for a reduction in state General Fund costs of $942 million. To replace this lost state revenue, counties would receive the increased revenue that will result from a proposed change in the structure of the Vehicle License Fee (VLF) and an adjustment to the alcoholic beverages tax.

It is proposed that the depreciation schedule used to calculate the VLF annually paid by motorists be revised. This adjustment will produce approximately $781 million. Increases in this revenue source in future years will accrue to counties to handle future increases in the cost of providing the mental health and public health programs. In addition to the revenue that will result from changing the VLF depreciation schedule, counties also will receive most of the increase from a new surcharge that will be placed on alcoholic beverages. That surcharge will produce approximately $190 million. After using $17 million of this increase to fund an Administration initiative to educate women on the dangers of alcohol and drug abuse during pregnancy, the remainder of the surcharge revenue will flow to counties.

For more details on this initiative, see the Health and Welfare and the Revenue sections of this document.

Local Bonded Indebtedness Voting Requirements

Currently, the ability of local governments to fund needed educational and criminal justice facilities is constitutionally constrained; i.e., general obligation bonds must be approved by two-thirds of the voters. Based on the inherent difficulty of securing this approval, infrastructure needs are often neglected even though a majority of voters in a given community might support and be willing to pay for the construction of new facilities. Many local governments are finding it difficult to provide the level of service desired by their constituents, partly because of the overly restrictive voting approval requirements. This difficulty has placed a greater burden on the state to finance local infrastructure, especially school and jail facilities.

This Administration wishes to forge a new relationship with local governments and provide them the means and flexibility to tailor local program service levels to a revenue base deemed appropriate by a majority of the voters. One step toward accomplishing this objective would be the elimination of barriers to the approval of bond measurers for critical infrastructure needs. Accordingly, the Administration proposes a change in the California Constitution which would authorize the majority of voters in a local jurisdiction to approve bonds for educational and criminal justice infrastructure purposes.

Land Use Decisions

Unfortunately, local government land use decisions often hinge primarily upon the revenue generating potential of a proposed zoning, annexation or incorporation proposal. Often, the revenue impact overshadows other land use policy matters and may lead to overdevelopment, undesirable growth and loss of prime agricultural land or open space. In addition, it may lead to destructive competition between local governmental entities for existing revenue-generating developments (e.g., shopping centers).

There are several facets to this problem, but one of the more prominent ones is the existing situs basis of allocating sales tax revenue. The situs allocation method provides a strong incentive for annexation and incorporation drives that take revenue from one jurisdiction for the benefit of another with little or no other significant rationale for doing so except enhancing the fiscal condition of one jurisdiction at the cost of the other. The result usually is to adversely affect the distribution of resources among local governments, creating or exacerbating disparities in the ability of those governments to carry out their duties and serve their citizens.

Land use decisions based purely on finances have the dual negative result of discouraging sound land use actions and adversely affecting the equitable distribution of revenue among local jurisdictions. Recognizing this, the Administration would be supportive of efforts to ameliorate the conditions that lead to land use decisions based largely on fiscal matters. In particular, the Administration encourages legislation that would change the current method for distribution of sales tax revenue from situs to per capita for a county and all cities within the county. Although the immediate redistribution of sales tax revenue which cities and counties currently have within their base revenues may create unacceptable fiscal dislocation, it does seem reasonable to explore the possibility of changing the allocation method for *growth* in the sales tax revenue. The Administration will work with local government representatives to determine the best means of achieving this end.

State-Mandated Programs

The original statutory requirement which directed the state to reimburse local governments for costs of any state-mandated program was established in 1972 (SB 90). That requirement was elevated to a constitutional requirement in 1979 and in 1984 the five-member Commission on State Mandates (COSM) was created to determine whether local entities are entitled to reimbursement by the state for costs which may have been incurred as a result of new state-mandated local programs. If reimbursement is not initially provided in the mandating legislation or executive regulation, the local entities are authorized to file claims with the COSM alleging entitlement for reimbursement. The membership of the COSM, as prescribed by statute, includes the Treasurer, the Controller, the Director of Finance, the Director of the Office of Planning and Research, and a public member appointed by the Governor.

The 1991–92 Governor's Budget proposes to appropriate $236.1 million to fund all mandate programs funded in the 1990 Budget Act and in the most recently enacted COSM claims bill. In addition, the Governor's Budget proposes to set aside $76.4 million for costs which are anticipated to be funded in the next COSM claims bill. This brings the total budgeted level for mandate reimbursement to $312.5 million. This compares to a total of $2.9 million appropriated in fiscal year 1973–74, the first full year of reimbursement to local entities.

A new policy was established in the 1990 Budget changing several mandated programs to optional programs. This was done by eliminating the state funding formerly provided to reimburse local governments for nineteen mandates and relieving local governments from compliance with those mandates by adding specific language to that effect in the Government Code. In addition to eliminating many state-imposed requirements on local government, implementation of this policy reduced state costs in the current year by $31 million. The Governor's Budget for 1991–92 proposes to continue that policy. In addition, as part of its commitment to work with local governments and to prevent any unnecessary fiscal constraints, the Administration is pledging to veto any legislation mandating a new requirement on local entities which does not contain a corresponding appropriation to cover the cost of the mandate.

State-Required Programs

The Administration recognizes and appreciates the fact that, like the state, local governments (especially counties) are facing formidable challenges in allocating scarce financial resources to meet many important needs. Also like the state, local governments face structural budget problems of *required* expenditures that cannot be funded within their existing revenue system. These required expenditures limit flexibility and exacerbate the already difficult resource allocation problem.

Table 5-1

Summary of Payments to Local Government for State Mandates

(Dollars in Thousands)

Fiscal Year	*Mandate Legislation*	*Budget Acts*	*Claims Bills*	*Totals*
1973–74	$3,538	–	–	$3,538
1974–75	2,655	$14,943	–	17,598
1975–76	1,376	17,963	–	19,339
1976–77	20,226	18,356	$523	39,105
1977–78	4,007	52,623	–	56,630
1978–79	21,443	54,434	1,203	77,080
1979–80	12,013	75,565	12,202	99,780
1980–81	9,947	105,377	7,572	122,896
1981–82	–	101,942	33,980	135,922
1982–83	610	92,886	24,183	117,679
1983–84	10,000	74,671	22,208	106,879
1984–85	4,937	76,070	1,366	82,373
1985–86	44,741	109,842	6,884	161,467
1986–87	75	144,525	5,928	150,528
1987–88	–	87,754	48,700	136,454
1988–89	500	114,248	26,051	140,799
1989–90	–	198,159	47,998	246,157
1990–91	–	194,841	11,445	206,286
1991–92	**–**	**236,139***	**76,432***	**312,571***
TOTALS	$136,068	$1,770,338	$326,675	$2,233,081

*Estimated

There are at least three types of required expenditures—constitutional, court-imposed and statutory (including regulations promulgated pursuant to statutory authority). Counties, as political subdivisions and agents of the state, are required to administer various programs prescribed by state statute. Proposition 4 of 1979 defines as "state-mandated programs" whose costs must be borne by the state, those mandatory programs that were created or enhanced by state actions taken in 1975 and subsequent years. The processes for ensuring that the state fulfills its responsibility to fund state-mandated programs is for the most part functioning satisfactorily (see discussion of state-mandated programs above).

In addition to these reimbursable state-mandated programs, however, there are a host of state programs which do not fall within the purview of Proposition 4, but which nevertheless call for the expenditure of local resources. To distinguish those programs from the reimbursable state-mandated programs covered by Proposition 4, these programs are categorized as "state-required" programs. They include programs such as welfare (both AFDC and General Assistance), health services, mental health and criminal justice, which predate the benchmark year of 1975 in Proposition 4.

Some of the state-required programs involve joint state and local funding, but the amount of local fiscal match and the service level are mandatory, thus eliminating local discretion. Other state-required programs do not involve a state/local fiscal relationship, but do limit how local governments are permitted to carry out their functions.

The Administration recognizes that the statutory constraints which accompany these "state-required" programs limit local decisions about the allocation of resources. Consequently, the Administration will be receptive to proposals for elimination or amendment of "state-required" programs which are no longer effective or which can be demonstrated to unreasonably limit local government decision making. The Administration looks forward to working cooperatively with local governments to free them of unnecessary constraints and nondiscretionary demands for the expenditure of local revenue.

Trial Court Funding Program

The Trial Court Funding Program is a major state program for assisting local government while at the same time bolstering the administration of justice. This program provides a quarterly block grant to counties for each judicial position, as defined by statute. In return, the county must agree to maintain a specified level of court funding and to forgo reimbursement of court-related, state-mandated local programs. While participation in the program is optional, all 58 counties are currently participating in the program and are expected to continue to participate in 1991–92.

The Trial Court Funding Program became operative in the second half of the 1988–89 fiscal year. It replaced an earlier version that had been enacted in 1985, but which never became operative. The major difference between the two programs is that the original program provided for a larger block grant, but required counties to remit their court-generated fine, fee and forfeiture revenue to the state. The existing program provides for a different block grant and the retention of court-generated revenue at the local level.

In 1990, the basic block grant was reduced by ten percent, on an ongoing basis, and the automatic block grant adjustment was suspended for one year because of the serious fiscal constraints faced by the state. The 1991–92 Governor's Budget includes $399 million for support of the Trial Court Funding Program. This amount reflects an increase of $18 million for cost of living and a reduction of $16.6 million related to the "trigger".

County Revenue Stabilization Program

The County Revenue Stabilization Program was first proposed in the 1986–87 Governor's Budget. Local officials had expressed concerns that their revenue base was being eroded because they were required by state law to provide increased amounts as a match to certain state programs. Since they believed the amount of the match to be essentially outside of their control, they saw this as an unfair imposition on already limited general purpose revenues.

A 1987 law addressed this problem. The fraction of each county's general purpose revenue needed to meet specified requirements for matching funds is compared to the fraction of general purpose revenue needed for those same match requirements in the 1981–82 fiscal year. If the fraction of a county's general purpose revenue needed to meet match requirements has increased, the state is authorized to provide additional funding to that county up to an amount sufficient to reduce the fraction to the 1981–82 level. These payments are limited to the amount appropriated annually for this purpose. The 1991–92 Stabilization Program is proposed to be funded at $14.4 million, a four percent decrease from the prior year funding level due to the "trigger" adjustment.

Redevelopment Agencies

There are approximately 350 redevelopment agencies (RDAs) in the state. These agencies have a combined revenue from all sources in excess of $1.6 billion. RDAs have many sources of revenue, including payments under the Special Supplemental Subvention program. This program provides subventions to RDAs and to multi-county special districts for revenue lost as a result of the elimination of the former personal property tax subvention programs. Legislation in 1990 reduced the 1990–91 subvention by approximately 25 percent and established semiannual payment dates of July 1 and December 31. The 1991–92 Governor's Budget includes $9.6 million for the Special Supplemental Subvention program, which would be approximately 0.6 percent of total RDA revenues. Since RDAs have other substantial sources of revenue (primarily tax increment revenue and interest income) which are continuing to expand, the need for state subventions is diminished. Therefore, the reduced subvention level is expected to have a minimal effect on statewide RDA operations. The $9.6 million proposed for Special Supplemental Subventions in 1991–92 is to be allocated to those relatively few RDAs that have disproportionately relied on this subvention program for revenue to support bond debt, and to those RDAs in which Special Supplemental Subventions historically have provided more than ten percent of an RDA's revenues. This amount will be apportioned to such RDAs with the intent of minimizing fiscal dislocation as this program is eventually phased out completely.

Subventions for Open Space

In 1965, the Legislature passed the California Land Conservation Act, known as the Williamson Act, to preserve open space and agricultural land. The Williamson Act permits local governments to enter into contracts with landowners which restrict land use in exchange for reduced property tax assessments.

California's Open Space Subvention Program was enacted in 1972 to provide local governments with the means to adopt land use policies which are consistent with the provisions of the Williamson Act. State reimbursements are provided to local governments to assist them in financing the revenues lost because of the placement of land under open space contracts. Subvention amounts are based on the type and amount of urban prime, other prime and nonprime land under contract.

The 1991–92 Governor's Budget provides approximately $13.9 million for the Open Space Subvention Program, $600,000 less than the 1990–91 funding level due to the "trigger" reduction.

Disaster Assistance

The Loma Prieta earthquake on October 17, 1989 served as a grim reminder that California is prone to natural disasters. The magnitude of this earthquake can be put into perspective by the damage it caused relative to previous disasters: The combined damage of the preceding nine Presidentially declared disasters in California since 1983 is estimated at $1.5 billion; the Loma Prieta earthquake is estimated at more than $5 billion. Without government intervention, response to and recovery from these disasters would be unduly arduous. While the federal government is helpful, additional state aid is often necessary to minimize disruptions of essential services.

Through the Office of Emergency Services, the state provides substantial assistance to local governments to help them respond to and recover from natural disasters. Under the provisions of the state's Natural Disaster Assistance Act, the state provides on behalf of local governments 75–100 percent of the matching funds required in order to receive federal disaster aid through the Federal Emergency Management Agency following a major disaster. During the last decade, and including anticipated subventions resulting from the Loma Prieta earthquake, the state has provided local governments with roughly $832 million in aid.

This Administration is committed to prompt disaster response and relief sufficient to accommodate the needs of local governments and their citizens. Maintenance of $4 million in the various Natural Disaster Assistance Act accounts and a reasonable reserve for economic uncertainties is vital to ensure appropriate action during and after an emergency.

Tax Relief

The state provides substantial assistance to homeowners and renters through a variety of tax relief programs. Several of these programs are devoted to providing relief to senior citizens in the form of renters' tax assistance, property tax assistance, and property tax deferral. However, the majority of tax relief program costs are aimed at reducing the property tax burden of homeowners in general and at providing tax relief to all qualified renters. In 1990–91, the Renters' Tax Relief program will provide over one-half billion dollars in tax credits to California renters, making it the largest of the state's tax relief programs. The Homeowners' Property Tax Relief program will provide local governments with approximately $360 million to reduce homeowners' property tax bills.

The Homeowners' Property Tax Relief program is provided for in the California Constitution. It exempts from property taxes the first $7,000 of market value of a homeowner's principal residence. Under the one-percent property tax rate established by Proposition 13, this exemption equates to a reduction in the homeowner's property tax bill of about $70 per year. Well over five million homeowners receive this tax reduction each year.

The Renters' Tax Relief program, established in 1973, initially provided renters with credits ranging from $25 to $45, depending upon their adjusted gross income, with maximum relief at incomes of $8,000 or more. Since that time, credit amounts and various eligibility criteria have been changed on at least six occasions. For example, in 1976, the Legislature changed the relief amount to a uniform $37 for all renters regardless of income. Most recently, legislation reduced the maximum credit for married couples, heads of household and surviving spouses from $137 to $120.

The California Constitution delineates a relationship between the Homeowners' Property Tax Exemption and the Renters' Tax Credit. Since 1974, the homeowners' benefit has remained unchanged, yet the renters' benefit has increased nearly three-fold, resulting in benefit inequities. Therefore, to more closely align the benefit of the Renters' Tax Credit with that of the Homeowners' Property Tax Exemption, the Governor's Budget proposes to change the credit from $120 to $70 for married couples, heads of household and surviving spouses, and from $60 to $35 for singles. In addition to equalizing benefits between homeowners and renters, this proposal would provide significant savings to the General Fund (approximately $210 million) at a time when financial resources are unable to keep pace with increasing demands

Table 5-2

Local Assistance Expenditures
State General Fund

(Dollars in Thousands)

	1989–90	*1990–91*	*1991–92*
Assistance to Individuals			
Health and Welfare			
SSI/SSP Grants	$2,203,946	$2,298,805	**$2,286,200**
AFDC Grants	2,649,267	3,002,205	**2,952,145**
Special Adult Programs	3,000	2,955	**3,089**
Office of Statewide Health Planning	2,347	3,596	**2,765**
Totals	$4,858,560	$5,307,561	**$5,244,199**
Tax Relief			
Homeowners' Tax Relief	352,208	356,049	**360,000**
Senior Citizens' Property Tax Assistance	4,047	3,287	**2,893**
Senior Citizens' Property Tax Deferral	8,350	9,500	**10,500**
Senior Citizen Renters' Tax Assistance	20,070	16,220	**14,279**
Renters' Tax Relief	483,275	577,000	**328,000**
Totals	$ 867,950	$ 962,056	**$ 715,672**
Student Aid Commission	146,091	155,823	**162,794**
California Arts Council	12,852	13,118	**12,413**
Loma Prieta Earthquake Relief	30,000	-	**-**
Totals, Assistance to Individuals	$5,915,453	$6,438,558	**$6,135,078**
Payments to Service Providers			
Health and Welfare			
Department of Aging	33,075	31,068	**29,441**
Department of Alcohol and Drug Programs	73,089	74,435	**71,458**
Department of Health Services			
Public Health Services	85,700	85,860	**86,045**
Medi-Cal Assistance Program	3,339,209	3,810,934	**5,127,578**
Department of Developmental Services	491,644	554,506	**580,989**
Mental Health Services	593,825	545,761	**117,383**
Social Service Programs	760,285	790,939	**911,436**
Community Care Licensing	9,822	9,045	**8,797**
Department of Rehabilitation	69,852	80,314	**78,606**
Emergency Medical Services Authority	2,856	3,057	**2,935**
Totals, Payments to Service Providers	$5,459,357	$5,985,919	**$7,014,668**

[a] Beginning in 1989-90, this amount is budgeted in State Operations; previously it was budgeted in Local Assistance.

Table 5-2—Continued

Local Assistance Expenditures State General Fund

(Dollars in Thousands)

Payments to Local Government	*1989–90*	*1990–91*	***1991–92***
Restricted			
Legislative/Judicial/Executive	576,349	656,287	**562,956**
State and Consumer Services	1,750	1,750	**1,680**
Business/Transportation/Housing	86,710	48,181	**53,695**
Resources	14,520	1,779	**910**
Health and Welfare			
Department of Health Services			
Public Health Services for Local Agencies	1,072,389	899,392	**430,220**
County Administration	110,852	139,694	**181,351**
Department of Social Services			
County Administration	173,068	199,521	**235,231**
Corrections			
Department of Corrections	26,600	24,842	**25,829**
Youth Authority	73,851	40,905	**40,641**
Education			
K-12 Categoricals	3,868,551	4,225,882	**4,470,492**
State Library Assistance	34,890	29,579	**23,148**
Contribution to Teachers' Retirement Fund	446,316	53,000	**587,902**
Community College Categoricals	139,023	172,120	**173,115**
Student Aid Commission—CAL SOAP	577	577	**577**
School Facilities Aid	–1,839	21,100	**21,093**
Other Governmental Units	77,049	65,296	**63,830**
Loma Prieta Earthquake Relief			
Shared Revenues—Tidelands	459	300	**288**
Local Mandates	232,383	232,966	**311,061**
Totals—Restricted	$ 6,933,498	$ 6,813,171	**$ 7,184,019**
General Purpose			
Education			
K-12 Apportionments	10,017,630	10,674,748	**10,576,195**
Community College Apportionments	1,400,836	1,535,090	**1,484,118**
Other Governmental Units			
Aid to Local Governments	21,235	15,615	**14,400**
Tax Relief			
Open Space	19,416	14,500	**14,500**
Substandard Housing	278	293	**396**
Special Supplemental Subventions	39,596	11,700	**25,138**
Totals—General Purpose	$11,498,991	$12,251,946	**$12,114,747**
Totals, Payments to Local Government	$18,432,489	$19,065,117	**$19,298,766**
Unallocated Trigger Reduction	-	-	**–48,325**
Estimated Unidentifiable Savings	-	–75,000	**–115,000**
Totals, General Fund Local Assistance	$29,807,299	$31,414,594	**$32,285,187**

Table 5-3

Summary of Local Revenues

(Dollars in Millions)

Local Agencies	*1987–88*	*1988–89*	*1989–90*	*1990–91*	**1991–92**
Counties					
Property Taxes	$4,129.7	$4,500.4	$4,945.3	$5,512.7	**$6,039.1**
Sales Taxes	369.3	380.8	403.4	409.6	**442.8**
Vehicle License Fees	1,043.3	1,128.5	1,197.0	1,288.0	**2,324.2**
Other Revenues	1,284.2	1,616.1	1,978.0	2,178.8	**2,376.4**
Totals	$6,826.5	$7,625.8	$8,523.7	$9,389.1	**$11,182.5**
Less Mandated Health and Welfare Costs	−910.5	−955.5	−948.1	−1,060.1	**−677.9**
Adjusted Totals	$5,916.0	$6,670.3	$7,575.6	$8,329.0	**$10,504.6**
Cities					
Property Taxes	1,552.8	1,704.8	1,885.3	2,115.0	**2,331.7**
Sales Taxes	2,048.7	2,205.7	2,405.0	2,478.3	**2,720.0**
Vehicle License Fees	669.8	769.9	817.5	879.0	**943.5**
Other Revenues	2,706.3	3,047.3	3,325.5	3,562.9	**3,903.5**
Totals	$6,977.6	$7,727.7	$8,433.3	$9,035.2	**$9,898.7**
Special Districts					
Property Taxes	1,077.0	1,171.3	1,309.9	1,485.7	**1,655.7**
Education					
K–12 and County Offices					
Property Taxes	3,786.2	4,116.9	4,521.2	5,014.4	**5,495.9**
State Apportionment	8,734.8	9,590.3	10,043.9	10,696.6	**10,598.0**
Categorical Aid	3,161.1	3,485.5	3,964.4	4,331.4	**4,664.0**
Lottery	650.9	834.3	788.8	613.5	**613.5**
Totals	$16,333.0	$18,027.0	$19,318.3	$20,655.9	**$21,371.4**
ADA	4,595,352	4,735,816	4,894,607	5,130,520	**5,242,739**
Expenditures per ADA	3,554	3,807	3,947	4,026	**4,076**
Community Colleges					
Property Taxes	603.9	653.6	715.5	793.2	**865.8**
Fees	65.4	66.2	67.2	69.0	**84.7**
State Apportionments	1,168.4	1,302.4	1,403.4	1,538.9	**1,488.0**
Categorical Aid	168.5	171.5	167.0	200.2	**173.1**
Lottery	96.8	126.9	122.4	95.2	**95.2**
Totals	$2,103.0	$2,320.6	$2,475.5	$2,696.5	**$2,706.8**
ADA	679,234	702,502	720,623	738,291	**752,189**
Expenditures per ADA	3,096	3,303	3,435	3,652	**3,599**

Policy Brief
periodic analyses of issues before the Legislature

LAO

An Overview of the 1991-92 Governor's Budget

In order to provide the Legislature with a perspective on the 1991-92 Governor's Budget, we have prepared this brief overview. Our detailed analysis of the proposed budget will be released on February 27.

INTRODUCTION

Underlying structural budget problems and the onset of a national recession have combined to pose extremely difficult challenges for the 1991-92 state budget. The budget plan for the current year, adopted last summer, is now expected to leave the state with a large deficit on June 30, 1991. In addition, projected revenues for 1991-92 will fall far short of the level needed to both maintain current levels of services and restore the state's reserve fund.

The *1991-92 Governor's Budget* has as its most basic goal the resolution of the state's fiscal problems. It proposes increases in revenues to help fund state programs as well as reductions in existing state services in order to achieve this goal. It also contains a number of "prevention" proposals which are aimed at reducing the cost of existing services in future years.

The Governor's Budget provides a reasonable starting point for crafting a solution to the state's fiscal problems. However, whether the Governor's proposals are the best way to achieve this goal, versus other policy choices that will be considered in the coming months, is the key question facing state lawmakers in 1991.

This *Policy Brief* summarizes the nature of the state's budget gap in the absence of any corrective action, and the Governor's plan for bridging it. We also summarize the major proposals contained in the budget and provide our preliminary assessment of the extent to which the Governor's plan effectively addresses the budget gap for 1991-92 and in the longer term.

THE 1991-92 BUDGET PROBLEM

As has been typical of recent years, the 1991-92 budget must address not only the need to balance revenues and expenditures for the budget year, but also the imbalance that has arisen in the current year. According to the *administration's* calculations, the magnitude of this two-year fiscal problem amounts to $7 billion. This includes $1.9 billion to pay off the 1990-91 deficit, $3.7 billion to fund current levels of services in the budget year, and $1.4 billion to replenish the state's reserve fund. Our preliminary analysis suggests, however, that these estimates significantly *understate* the magnitude of the problem.

Specifically, as shown in Figure 1, we estimate that the total budget gap is closer to *$9.9 billion*. This includes $2.1 billion to pay off the 1990-91 deficit, $6.4 billion to fund current levels of services in the budget year, and $1.4 billion to replenish the state's reserve fund.

Figure 1

General Fund Budget Gap: Preliminary LAO Estimates

(In billions)

1990-91 Budget Deficit		$2.1
1991-92:		
Base Expenditures	$48.1	
Base Revenues	41.7	
Difference		$6.4
Amount to Replenish Reserve		1.4
Two-Year Budget Gap		**$9.9**

Why Do Our Estimates Differ?

Our figures differ from those of the administration primarily for three reasons.

First, the administration's estimate of 1991-92 General Fund revenues includes a special $1.2 billion "economic recovery adjustment." This adjustment reflects the administration's view that it is appropriate to anticipate certain events which would justify a more optimistic revenue outlook than implied by its economic forecast. We have excluded this upward adjustment on the basis of its relatively low probability and the fact that *the department's standard economic forecast already assumes a recovery in line with the consensus view of economists.*

Second, the administration's estimate of workload budget expenditures, such as AFDC costs, does not reflect the most recent trends in caseloads and unemployment, which we estimate will increase costs above the budgeted level by $300 million.

Third, our estimate of current services includes an additional $1 billion related to discretionary COLAs, Proposition 98 funding, and certain other factors.

The Gap's Cyclical and Structural Components

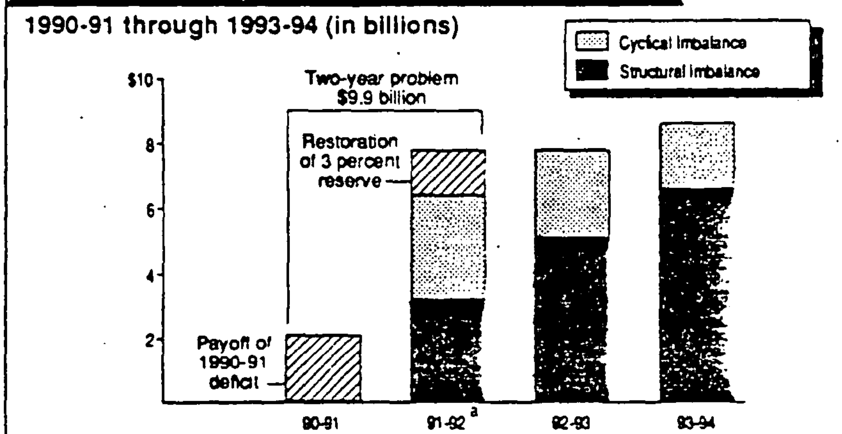
Our estimated $9.9 billion budget gap is the result of two fundamental factors. The first is the *current economic downturn*, which has the effect of depressing state revenue collections and increasing caseloads in state assistance programs. Because these effects should dissipate over time as the economy recovers, this part of the budget problem is *cyclical* in nature. The budget gap also reflects a substantial *structural* component, in that there is a significant imbalance between the levels of revenues and expenditures that would occur even in the absence of an economic downturn. Our estimates indicate that the $6.4 billion gap between revenues and expenditures for the 1991-92 fiscal year is almost equally attributable to these cyclical and structural factors.

Figure 2 shows our estimates of the budget gap, both for 1990-91 and 1991-92 as well as the following two years, including its cyclical and structural components. These estimates do not include any of the administration's budget proposals or any other corrective actions. They are based upon the budget's economic forecast for 1991 and 1992, our assumptions about economic performance in subsequent years, and our preliminary estimates of their associated revenue and expenditure levels. As this figure indi-

Figure 2

Components of the State Budget Problem

1990-91 through 1993-94 (in billions)



[a] 1991-92 data reflect the second year effects of 1990-91 budget actions. These actions reduced expenditures and augmented revenues, thereby making the 1991-92 projected budget imbalance less than it otherwise would have been.

cates, although the economy is assumed to strengthen by 1992 (see below), the *cyclical* imbalance still remains a factor in the out years. This is because of the time it takes to return to "normal" revenue levels, given the pace of economic recovery that most forecasters are assuming. *The structural component of the gap, however, is projected to increase substantially over time,* reflecting the continuing imbalance between annual revenues and expenditures. We now turn to an examination of these underlying trends.

The Economic Outlook

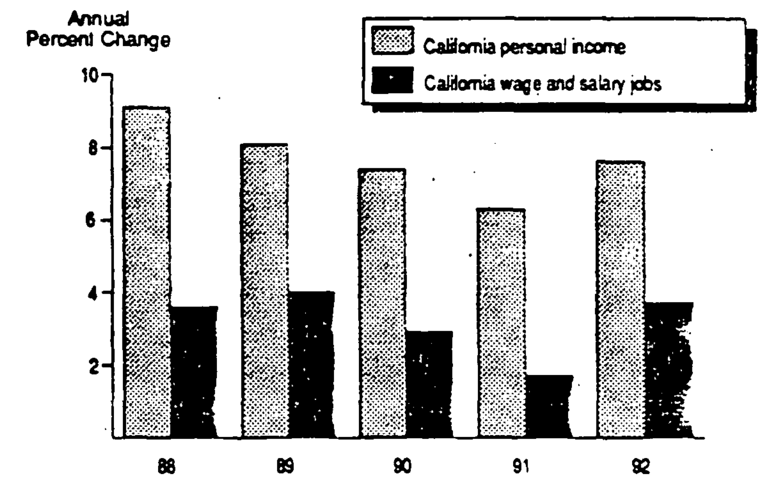
The Department of Finance's economic forecast assumes that the state will experience a brief and mild recession, with recovery beginning by the latter half of 1991. Figure 3 shows the projected growth rates in California personal income and employment which are reflected in this forecast. This forecast also assumes that a non-military resolution of the Persian Gulf crisis occurs by the spring of 1991, and that interest rates and oil prices will be declining through mid-1991. Beginning in 1992, it is assumed that the economy will return to a more normal pattern, with state personal income growth in the 8-percent range. This forecast is generally consistent with the consensus view of economists, although the situation in the Persian Gulf has obviously changed since the forecast was prepared.

The Revenue Forecast

As shown in Figure 4, the budget forecasts General Fund revenue growth in 1991-92 totaling $5.3 billion, or 13 percent. This large increase is due primarily to a variety of revenue enhancements proposed in the budget, along with the optimistic $1.2 billion economic recovery revenue adjustment discussed earlier. The underlying rate of growth in revenues in the budget forecast is only 4 percent when these special factors are excluded, however, reflecting the forecast for generally slow economic growth. Our estimates of revenues beyond the budget year reflect a return to more-normal rates of growth in economic activity and underlying tax liabilities. In addition, these figures reflect none of the revenue proposals contained in the budget.

Figure 3

The DOF Economic Forecast— Brief Recession Followed by Upturn



Source: 1991-92 Governor's Budget.

Figure 4

Components of General Fund Revenue Growth Anticipated in the 1991-92 Governor's Budget

(In billions)

Baseline Revenue Increase (Standard Economic Forecast)	$1.3
Additional Increase, Assuming Economic Recovery Adjustment	1.2
Accrual Accounting Proposal	1.7
Other Revenue Proposals*	0.8
Transfer Proposals	0.3
Total Revenue Growth	**$5.3**

* Includes $400 million in withholding payments and $400 million from elimination or delay of certain tax expenditures.

"The Governor's proposals fall significantly short of eliminating the funding gap."

Expenditure Growth Trends

Regarding expenditures, our estimates of the budget gap are based on calculations which attempt to measure the cost of providing 1990-91 levels of state services in 1991-92 and beyond. Thus, these calculations do not reflect the effect of the expenditure proposals contained in the Governor's Budget.

In the aggregate, we estimate that the cost of funding 1990-91 service levels amounts to $48.1 billion for 1991-92, an increase of 13 percent over 1990-91 expenditures (prior to the policy adjustments contained in the budget). Our estimates indicate that current services funding requirements will increase by 10 percent in both 1992-93 and 1993-94.

The Bottom Line

The state faces a multi-billion dollar funding gap in 1991-92 and beyond, *absent corrective action*. Although about half of the near-term funding gap may be ascribed to short-term cyclical factors, the underlying problem is predominantly structural. Dramatic action to either increase revenues and/or reduce expenditures on a continuing basis will be needed to permanently bring state revenues and expenditures into balance. In doing so, however, the consequences of both service reductions and tax increases need to be kept in mind.

WHAT DOES THE NEW BUDGET PROPOSE?

The *1991-92 Governor's Budget* contains a large number of major proposals to address the funding gap. Figure 5 shows that, in the aggregate, these proposals provide $5.4 billion in expenditure reductions and $3.1 billion in revenue enhancements. These proposals, combined with the added-on economic recovery revenue adjustment discussed earlier, total $9.7 billion. Thus, these proposals would have the effect of eliminating all but about $200 million of the $9.9 billion funding gap, and thus would leave the state budget in balance, but with a reserve slightly below the 3-percent target. Because the $1.2 billion economic recovery adjustment is unlikely to occur, however, the Governor's proposals fall significantly *short* of eliminating the funding gap. In fact, the state would be left with *no* reserve and a small *deficit* on June 30, 1992.

Specific Expenditure Proposals

The predominant themes of the *1991-92 Governor's Budget* have to do with correcting the budget's underlying structural problem and re-orienting certain state programs to focus on *prevention* of the social problems which in part are driving the state's fiscal problems. To these ends, the budget proposes the elimination or reduction of several specific state programs and the enhancement or creation of other programs thought to have preventive potential. In general, these program expansions are funded by redirecting resources from other existing programs. For example, the budget proposes to develop new public school programs to increase prevention-oriented services for children, and proposes that these efforts be funded by redirecting funds from other existing spending categories (primarily cost-of-living adjustments).

The budget's specific expenditure proposals to balance the budget are categorized in Figure 5 as follows:

Program Reductions. The budget proposes $5.0 billion in program funding reductions, including almost $700 million in current-year savings which are primarily due to reductions in Proposition 98-related education spending. Our estimate of budget-year Proposition 98 savings—$2.0 billion—is higher than the administration's $1.4 billion estimate. This is because our estimate of current service level requirements for 1991-92 is based on the amounts needed to fully fund Proposition 98—excluding the administration's proposal to reduce funding in 1990-91. The administration's estimate, in contrast, is based on the amount needed to fund the *reduced* current-year level of services in the budget year. Other major program reduction proposals include the suspension of cost-of-living adjustments ($0.4 billion), AFDC grant reductions ($0.2 billion), a reduction in the renters' tax credit ($0.2 billion), and reductions in support for higher education ($0.2 billion). The budget also achieves substantial savings by not funding normal cost increases (for example, price increases and merit salary adjustments) and through a variety of unallocated reductions in departmental budgets ($0.8 billion).

Funding Shifts. By shifting the responsibility for funding programs to other levels of government or to fees, the budget proposes to achieve savings of $1.2 billion in 1991-92. The major item in this area is the budget's "program realignment" proposal, which would shift existing state responsibilities for funding local mental health and public health programs to county governments. State taxes on alcoholic beverages and automobiles would be increased and dedicated to counties to assist them with these or other responsibilities. The budget also funds a portion of the increased costs of operating the University of California (UC), the California State University, and the Community Colleges by imposing a 20 percent student fee increase.

Cost Deferrals. The budget contains two proposals that would result in a deferral of $125 million of current costs to future years. The budget proposes that $55 million of 1991-92 UC expenditures be instead paid for in 1992-93, and that $70 million in current state costs for the Public Employee's Retirement System (PERS) be deferred by accelerating the recognition of investment earnings.

Partially offsetting these various expenditure reductions is an increase of about $900 million due to an accrual accounting change involving Medi-Cal expenditures.

Figure 5

Budget's Proposed Resolution of the 1991-92 Spending Gap[a]

(In billions)

Program Reductions	$5.0	
Funding Shifts	1.2	
Cost Deferrals	0.1	
Cost Increases	-0.9	
Total, Expenditure Changes		$5.4
Revenue Enhancements	$3.1	
Economic Recovery Adjustment	1.2	
Total, Revenue Changes		$4.3
Total		**$9.7**

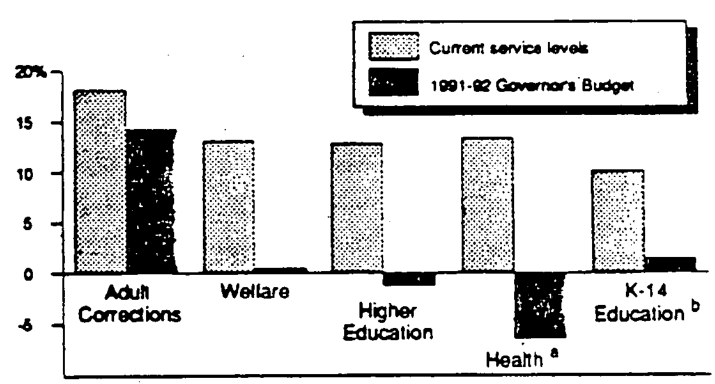
[a] Amounts reflect combined effect of 1990-91 and 1991-92 changes.

Proposed Changes By Program Area

Figure 6 shows generally how most major program areas fare under the Governor's Budget proposals, relative to current services funding requirements. As these data indicate, Adult Corrections programs are the most fully funded, while all other major program areas face significant reductions from current state-supported service levels. The level of funding for health programs is reduced dramatically, reflecting primarily the impact of the Governor's proposal to shift the state's existing local mental health and public health services funding responsibilities to county governments.

Figure 6

Expenditure Growth Rates by Program Area, Current Service Levels Versus Governor's Budget



[a] Reflects the Governor's program realignment proposal.
[b] *1991-92 Governor's Budget* figure reflects proposed reductions in funding levels for 1990-91 and 1991-92.

Revenue Enhancements

The $3.1 billion of revenue enhancements proposed by the budget include $2.8 billion in 1991-92. The major changes are summarized in Figure 7. As this figure shows:

- The bulk of this increased revenue ($1.7 billion) is attributable to a proposed change in state accounting practices, whereby revenue is to be recognized as it is *earned* instead of generally when cash is *received* by the state. Thus, this proposal does not result in an actual increase in the tax liabilities of state taxpayers, and it would have only a small impact in subsequent years.
- The budget also proposes that state income tax withholding requirements be extended to cover independent contractors, estates and trusts, and that withholding requirements be increased as they apply to certain "lump-sum" payments. These proposals would raise about $400 million in 1991-92, only part of which would be ongoing.
- The state sales tax would be applied to candy, snack foods, newspapers and periodicals to generate about $300 million in additional revenue. This gain would be ongoing.

Figure 7

Major Revenue Enhancement Proposals in the 1991-92 Governor's Budget

(In millions)

	1991-92 Amount
Accounting Practices	
Accrual Accounting	$1,702
Withholding Proposals	
Independent Contractors	290
Estates/Trusts	42
Lump-Sum Payments	80
Tax Expenditures	
Repeal Sales Tax Exemptions:	
Candy/Snack Foods	200
Newspapers/Periodicals	83
Delay Health Care Tax Credit	97
Total, Major Changes	**$2,494**

Figure 8 shows that, as was the case with the revenue changes adopted along with the 1990 Budget Act, the aggregate revenue impacts of the changes proposed in the budget would decline over time because of their one-time effects. In the case of the 1991 proposals, however, the one-time effects are particularly dominant. Thus, in effect, the budget relies on revenue changes primarily to address the *cyclical* (versus *structural*) portion of the budget problem, given that the long-term effect of these measures on state revenues is limited.

DOES THE BUDGET WORK?

The primary test of the desirability of the budget plan is the extent to which it can be relied upon to eliminate the budget funding gap, both in 1991-92 and for several years thereafter, while at the same time addressing the basic needs of Californians for public services.

Dealing With the Budget Gap

Figure 9 presents our estimates of the impact of the proposals contained in the budget on the budget funding gap from 1990-91 through 1993-94.

As noted earlier, *our analysis indicates that the proposed budget does not eliminate the budget funding gap for the 1990-91 fiscal year, and would leave the state with a small deficit and no reserve fund as of June 30, 1992.* This is primarily because we do not believe it is prudent to adopt the administration's optimistic premise that an additional $1.2 billion in revenue should be added to the revenue forecast. We also have identified several increased costs not addressed by the Governor's Budget, such as higher costs for public assistance stemming from the slowdown in the economy.

As Figure 9 indicates, the budget's proposals *do* make significant *headway* towards the elimination of the funding gap in the near term and reducing it in the longer term. It also indicates, however, that their effectiveness is expected to diminish over time, meaning that an underlying budget gap still will remain. In large part, this is attributable to the reduced level of ongoing revenue gains that result from the Governor's revenue proposals. However, it also reflects the budget's failure to deal fully with the underlying structural problems in the state budget. Although the budget makes some significant reductions in the levels of expenditures for state programs, these savings are not sufficient to permanently offset the increased costs of providing services to an ever-expanding population.

State Services

Another major consideration involved in assessing the budget's workability is whether its impact on state-supported services is acceptable. Among other things, the Legislature will need to evaluate the budget's proposal to substantially reduce funding for K-14 schools. Proposed levels of funding for both 1990-91 and 1991-92 are below the level of funding adopted in the 1990 Budget Act for the 1990-91 fiscal year. The Legislature will need to determine the impact that such reductions will have and whether they are acceptable. The same is true for such other major budget proposals as reductions in welfare grants, shifts of mental health and public health programs, reduced renters' credits, and funding for higher education.

Other Considerations

In assessing the budget's workability, the Legislature also must consider whether it provides adequate protection from economic and other types of uncertainties that could potentially affect state resources and spending requirements. In this regard, we note that the estimates of state revenues contained in the budget are subject to large dollar errors, even if the budget's economic forecast is basically correct. Given the substantial uncertainty over the course of events in the Middle East and the unknown duration and severity of the current economic downturn, these dollar error margins are considerably larger than normal.

Figure 8

Fiscal Impact of 1990 and 1991 Revenue Adjustments

1990-91 through 1993-94 (In billions)

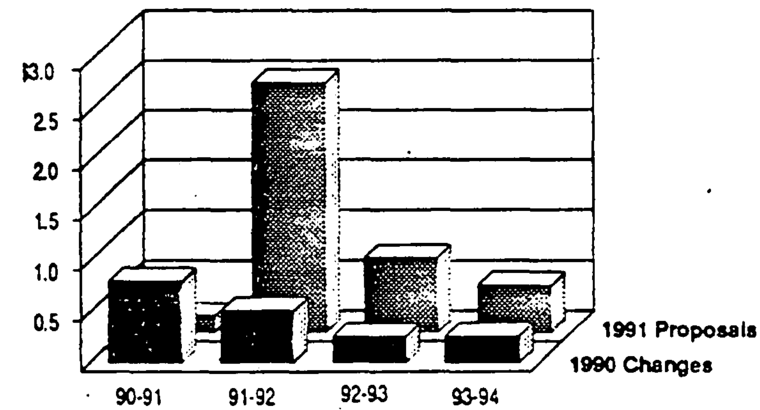
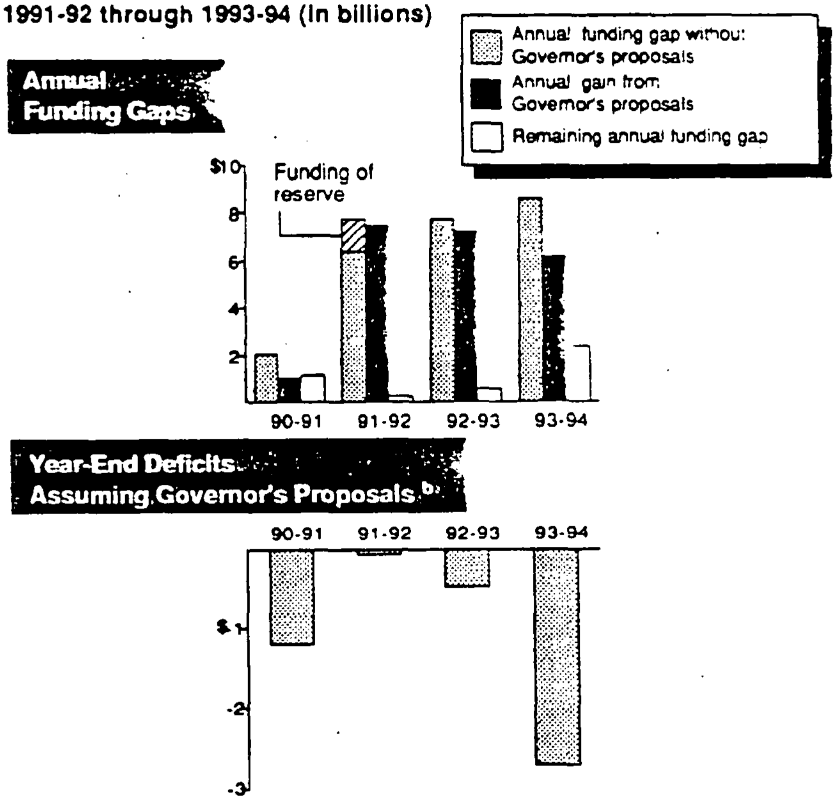


Figure 9

Impact of Governor's Budget Proposals on Budget Funding Gap[a]

1991-92 through 1993-94 (In billions)



[a] Assumes that the $1.2 billion in economic recovery adjustment revenues included in the budget does not materialize.

[b] All years shown end up with zero balance in the reserve fund.

"Ultimately, the Legislature must agree on a plan that balances the need for state services with the need to address the state's underlying structural budget problem."

State spending requirements also are subject to considerable uncertainty over the forecast period. Certainly, the budget's "prevention" proposals may result in savings beyond those reflected in our estimates, to the extent that they have a strong impact on the social problems they are intended to address. However, the budget also places great reliance on the use of unspecified reductions that may be restored as their impacts become apparent. Thus, there also is uncertainty as to whether these proposals can achieve the level of savings over the long-term that is reflected in our estimates of expenditures.

The other major source of uncertainty in our forecast is the potential impact of several outstanding lawsuits against the state in such areas as corporate taxation and indigent aid to counties. The combined impact of these lawsuits could exceed $7 billion initially, with substantial ongoing costs thereafter.

ARE THERE OTHER OPTIONS?

The plan proposed in the Governor's Budget is but one of a wide variety of alternative budget strategies available to the Legislature. For example, stategies could be developed that place a greater reliance on long-term revenue gains or a different set of reductions in state-supported services. All of these strategies, however, involve difficult decisions and impose burdens on those affected by them.

It is also important to note that the bulk of state spending is determined by existing federal, constitutional and statutory requirements. Thus, addressing the state's budget problems may necessitate modifying some of these requirements. Although the Legislature has only limited potential to change or limit the impact of federal requirements, it can seek voter approval of state constitutional changes and it can change existing statutory provisions where it believes such changes are necessary to effectively manage the budget.

The challenge for the Legislature in developing its budget strategy is to make the changes necessary for the state to best address the basic service needs of the population, while at the same time resolving the underlying budget gap.

CONCLUSION

The Governor's Budget offers *one approach* for addressing the budget problem and providing for the state's public service needs. This plan has within it much to commend, especially given the adverse fiscal situation facing the state budget. However, the Governor's plan also suffers from certain shortcomings that need to be addressed in order to make it workable. Most notable in this regard is its failure to fully address the budget funding gap. The budget also raises concerns regarding its impacts on health and welfare program users, schools, and other affected groups. As with the alternative strategies available to the Legislature, this plan will require the enactment of many pieces of legislation, and raises many important policy issues that will be difficult to resolve.

The Legislature faces an enormous task as it begins its deliberations on the 1991-92 Budget Bill. It must evaluate a wide range of potential budget strategies and determine their impacts on the achievement of state goals, as well as on the funding gap. Ultimately, it must agree upon a plan that balances the need for state services with the need to address the state's underlying structural budget problem. This problem, unless effectively addressed, will only become worse in the future. ♦

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