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California's Budget: "The 4-Legged Stool" In Detail

By Michael Martinez

After months of meetings and recent days of long negotiations, the 2009-2010 California state budget was passed by the California Legislature and has been signed into law by Governor Schwarzenegger today. What seemed like a daily soap opera unfolded to get us to this point including a Senate Republican Caucus coup ousting its leader, state worker furloughs battled in court, the single longest Senate floor session in California history (45.5 hours), and warnings of 20,000 state worker layoffs.

In the early morning of Thursday, February 19, three Republican Senators joined all Democrats in the Senate to support the budget package, while seven Republican Assembly Members joined all Democrats in the Assembly to pass the budget, with the required 2/3rds majority.

The total shortfall projected in the Governor's January budget is \$39.56 billion (\$41.7 billion assuming a \$2.1 billion reserve). With a combination of deep expenditure reductions and new revenues, it is believed that this 17-month budget will help solve California's \$39.56 billion fiscal shortfall.

The \$39.56 billion gap is bridged through the following solutions:

- \$14.9 billion in expenditure reductions.
- \$12.5 billion in multiyear General Fund tax increases.
- \$7.8 billion of federal stimulus revenue that is a conservatively estimated base amount for the current and budget year.
- \$5.4 billion in borrowing.
- \$1.024 billion final budget reserve.

Since this weekend, the changes to the February 14 budget "deal" include:

- Addition of a Constitutional provision calling for an open primary;
- Addition of a Constitutional provision that prohibits legislative pay from increasing in the event that the state budget has a projected deficit;
- Elimination of the 12-cent additional excise tax on gasoline;
- Change to the Personal Income Tax proposal from surtax to a surcharge;
- Removal of \$1 million from the State Controller's Office (SCO) budget and prohibition of state funding in the SCO budget from being used for modular furniture;
- Provision of \$100 million homebuyer tax credit for newly constructed homes;
- Provision of \$32 million General Fund per year for fairs and expositions in lieu of fees charged to

horse tracks;

Inclusion of a conservative assumption of \$7.8 billion in federal stimulus revenue; and

No longer proposes Reimbursement Warrants as a budget solution.

The budget package includes \$12.9 billion in temporary General Fund tax increases over the 17-month period it covers, namely:

\$5.8 billion from a 1-cent increase to the State Sales and Use Tax, effective April 1, 2009 (\$1.2 billion in 2008-09 and \$4.6 billion in 2009-10).

\$3.7 billion from a 0.25 percent rate surcharge on Personal Income Tax brackets, effective starting in tax year 2009.

\$1.4 billion from reducing the dependent credit allowed against the Personal Income Tax to the amount of the personal credit beginning in the 2009 tax year.

\$1.7 billion from increasing the Vehicle License Fee from the current rate of 0.65 percent to 1.15 percent, except for heavy vehicles.

As stated above, the budget package includes seven provisions that will require voter approval to be enacted. It is expected that most of these provisions will appear on a statewide ballot in May 2009, with a couple being on the primary election ballot in June 2010 (e.g., the open primary will be 2010).

These provisions are:

Spending Cap. ACA 1 places a Constitutional provision on the ballot to cap spending by limiting the amount of revenue that can be appropriated for General Fund purposes. The provision requires that each year the state Department of Finance forecast a revenue amount for the fiscal year that is derived from the last 10 years of revenue growth amounts. Any revenue that exceeds this forecasted amount must be deposited in a new fund, the Budget Stabilization Fund, with the exception of revenue that is required for Proposition 98 (protecting primary education funding) purposes that exceed revenue growth. The Budget Stabilization Fund can be used when state revenues are insufficient to cover prior-year expenditures, adjusted for inflation and population. The funding in the Budget Stabilization Fund is to be used in cases of a declared emergency. Revenue accumulates in the fund until it equals 12.5 percent of General Fund revenue, at which point excess funding can be used for onetime expenditures. Up to \$5 billion of the amount deposited in this fund would be dedicated to retiring Deficit Recovery Bonds over time. In addition, ACA 1 / SCA 1 requires that annually 1.5 percent of State General Fund revenue be deposited in the Budget Stabilization Fund and as of October 2011 1.5 percent of revenue be deposited in the Supplemental Education Payment Account, which pays for the Proposition 98 obligations outlined in ACA 2 / SCA 2.

Proposition 98 Maintenance Factor Clarification. ACA 2 places a Constitutional provision on the ballot that would require the state to increase annual school funding by \$9.3 billion in future years in lieu of any maintenance factors that could be required by Proposition 98. This additional funding would build up over several years, beginning in FY 2011-12. Funding for this provision would come from the Supplemental Education Payment Account specified in ACA 1 / SCA 1. Funding provided by this provision would be allocated to school districts in the same manner as the revenue limit per unit of average daily attendance. Two hundred million dollars would be appropriated in FY 2011-12 for equalization funding.

Proposition 63 – Mental Health Services Act (MHSA). Subject to approval by the voters at a statewide election, utilizes MHSA funds in the amount of \$226.7 million in 2009-10 and up to \$234 million in 2010-11, if caseload adjustments require this marginal increase, to support the Early and Periodic Screening, Diagnosis, and Treatment Program as administered by the State Department of Mental Health. Additional statutory changes are made in the Health Omnibus Trailer bill to improve the use and effectiveness of MHSA funds, consistent with the recommendations of recent audit reports.

Proposition 10 – California Children and Families Act of 1998. Subject to approval by the voters at a statewide election, expands use of Proposition 10 funds for health and human services through state programs for children up to five years of age. Transfers Proposition 10 reserve funds of \$340 million on a onetime basis for these state program purposes, and additionally transfers \$268 million annually for five fiscal years starting with 2009-10 to be appropriated by the Legislature as part of the annual budget process. Further directs the use of Proposition 10 funds to provide direct healthcare services, human services, including services for at-risk families who are involved in the child welfare system, and direct early education services, including preschool and child care.

California State Lottery. Makes changes to clarify education appropriations, clarify the lottery director's authority relative to state employees, and require that lottery audits be posted on the Internet. These changes

would be placed before the voters, along with various sections of Chapter 764, Statutes of 2008 (AB 1654), the lottery modernization trailer bill for the Budget Act of 2008.

Open Primary. SCA 4 would require primaries to be open to voters from all party registrations for Congressional and state-elected offices.

State Legislative/Constitutional Officer Salary Increases. SCA 8 would not allow legislative or Constitutional officer salaries to be increased in years when the state faces a projected fiscal deficit.

Finally, in order to secure the vote of moderate Republican Senator Abel Maldonado to achieve a 2/3rds majority in the state Senate, an additional \$600 million in gubernatorial line-item vetoes was agreed to by the Democrats in both houses. The Department of Finance released a summary of the agencies impacted by the line item vetoes just as this article went to print. They are available on the Department's website and, unfortunately, could not be included in this article and still have it sent out during the business day.

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