



GOVERNOR'S BUDGET

# May Revision

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## OVERVIEW

The May Revision to the Governor's Budget seeks to protect education and other critical government services, while building consensus with the Legislature.

The Governor's January budget proposal, as described by the Legislative Analyst, was credible, balanced, and addressed the State's structural deficit. While it is still the preferred approach, that proposal required early and comprehensive action by the Legislature.

The May Revision responds to \$6.5 billion in additional pressure from May adjustments (\$3.6 billion) and previously proposed savings that can no longer be realized (\$2.9 billion). It is credible and balanced. It also requires that the Legislature continue its budget work on structural issues after the Budget is passed and signed into law.

Over the past five months, the Governor has met with hundreds of Californians from all walks of life and, as a result, is more determined than ever to protect the progress that has been made in our schools. In Sacramento, the Governor has already met with legislative leaders 19 times in order to make progress toward solving the State's budget problem.

The Legislature has passed and the Governor has signed two important budget packages aimed at reducing the size of the deficit.

The May Revision reflects these actions, as well as the ideas and values gleaned from the Governor's meetings, and the imperative that the Budget be passed on time.

Many, including members of the Legislature, have expressed a preference for addressing the structural budget shortfall over more than one budget cycle. The May Revision incorporates this preference by dividing the problem into three parts.



1. The current year deficit is financed over a multi-year period in a fiscally prudent and legally credible way.
2. The budget year is balanced through a combination of cuts and a slimmed down realignment package.
3. The Legislature is asked to spend the balance of the legislative session to address the structural issues that, if left unresolved, will put future budgets out of balance and threaten the future prosperity of our State's citizens.

**The May Revision to the Governor's Budget prioritizes education and public safety while protecting critical health and environmental programs.**

The May Revision is anchored by the commitment to protect the progress that has been made in our schools. The Proposition 98 Guarantee is met. Schools will have \$700 million more to spend in State and local funds than was contemplated in the Governor's Budget.

Critical classroom priorities, including class size reduction, accountability, and special education are fully funded. This budget will fund schools sufficiently to keep teachers in our classrooms.

Higher education is protected from further cuts. Community colleges will receive \$304 million in funding above the January proposal, and the size of the previously proposed fee increase is reduced to \$18 per unit.

The threat of terrorism makes this no time to compromise on public safety. Local police, sheriff, and fire departments are protected by the operation of existing law governing vehicle license fees, and the budget preserves funding for critical, targeted law enforcement programs.

The State's environmental programs, while impacted by the January cuts, will remain the strongest in the nation secured by special fund support. In addition, recent voter-approved general obligation bonds are aimed at protecting California's natural resources for future generations.

The first priority for the State's health and social services programs is to protect the most vulnerable among us: children, the elderly, and the disabled. Consistent with this principle, the May Revision restores the proposed cut in SSI/SSP, while continuing to ask that state-only cost of living increases be suspended. This means that seniors and the disabled will get a small increase in payments.



The May Revision also includes the legislative recommendation to preserve health care benefits for lower-wage parents and retains the January proposal to fund health care costs for children.

The May Revision continues to depend upon significant cuts in State government operations and programs. State spending will decrease by \$7.6 billion dollars (9.8 percent). This is the largest decrease in State spending since 1945. The deficit financing approach allows the Legislature to balance this year's budget and debate further cuts, tax increases, or reforms through the balance of the legislative session for implementation in the following budget year.

The adjusted Budget Gap is \$38.2 billion. This gap would have been larger, but for higher receipts in the last two weeks, which brought current year revenues closer to the January forecast. The gap is closed with a total of \$18.9 billion in cuts and savings, \$6.9 billion in fund shifts, transfers, and loans, \$1.7 billion in program re-alignments to local government, and \$10.7 billion in deficit financing.

In addition to the presumed operation of existing law with respect to local government's vehicle license fees (\$4.2 billion), the Budget requires the passage of \$1.8 billion in cigarette and income taxes for local government to operate realigned programs, and a temporary one-half cent sales tax (\$2.3 billion) to pay for the deficit financing plan.

Finally, the revised plan relies upon a lower estimate of revenues from Indian Gaming and will not rely on the plan to sell tobacco revenue bonds. These bonds have become significantly more expensive to sell and utilization of deficit financing requires a more conservative assessment of other borrowing options.

**California was among the first States in the Union to accurately forecast the impact of the deteriorating national economy on State revenues.**

In almost every state of the Union, Governors and Legislatures are struggling with the necessity to cut programs and raise taxes. Most states have been forced to make late downward adjustments in their revenue estimates. The choices are not pleasant ones.

California got a head start on confronting its problems by accurately identifying the impact of the nation's economic tailspin on State revenues. Ironically, at the time, many were skeptical about the accuracy of, and motivations behind, what have now proven to be reliable forecasts.

Despite the lost opportunities generated by that skepticism, California can still meet its fiscal challenges if decision-makers accept the reality of the size of the problem and the limited options still available for solutions.



**California must have a timely Budget to deal with its cash flow needs.**

The stress on the State's cash flow led the State Controller to request the authority to issue an unprecedented \$11 billion in Revenue Anticipation Warrants in June. The Governor approved this request with appropriate conditions.

This offering will provide enough cash for the State to meet its obligations for a limited time. Thereafter, it will be necessary for the State to have a signed Budget in place in order to issue Revenue Anticipation Notes.

The Governor's Budget required a series of early actions by the Legislature including cuts in the current year and a sweeping realignment proposal financed by an \$8.3 billion local government tax package.

It is still a preferred and prudent approach to solving the budget puzzle. However, as the Legislative Analyst noted, the January budget plan only worked given timely action by the Legislature. While the Legislature took significant action on portions of the plan, other portions were not acted upon. The options are now more limited.

**The January plan required comprehensive early action. The May Revision recognizes the best options still available for an on-time budget solution.**

In an effort to respond to the views of the Legislature and to recognize the need for a timely Budget (while not losing sight of the need to confront the structural deficit), the May Revision includes significant changes in the approach to closing the budget shortfall as well as suggestions made by members of all four legislative caucuses.

There are three reasons for this decision.

First, the complete January realignment proposal requires more study. Discussions regarding some portions of the realignment proposal have reached a degree of consensus. Those portions are retained in the May Revision. Legislators, local governments, and service providers have expressed a need to have more time to fully consider other options. These portions are reserved for implementation in the following budget year.

Second, many legislators and business and community leaders have indicated both publicly and informally a preference for closing the structural deficit over more than one budget year.

Third, spreading the deficit across multiple budget years is the best remaining option to avoid unacceptable levels of cuts or tax increases.

The Department of Finance, its bond counsel, and the Attorney General have analyzed many proposals to determine the legal and financial practicality of the



deficit financing options that have been discussed by members of the Legislature and others.

The May Revision accepts the proposal to finance the current year deficit on three conditions, all of which are critical to the credibility of the Budget. First, any deficit-financing plan must be paid for with an independent new revenue source. Second, the Legislature must pass the Budget on time. Third, the Legislature must continue its work on the structural deficit through the balance of the legislative session.

**The May Revision proposal will balance the 2003-04 Budget, finance the current year deficit in a prudent and credible way, and close a substantial portion of the structural deficit. But it will require that the Legislature continue work on structural issues after the budget is passed.**

In January, the Governor called upon the Legislature to produce a structural reform package as part of its budget solution. The May Revision balances the budget year, but defers a significant portion of the structural problem to the following budget year.

The Legislature must commit the balance of the legislative session to reaching agreement on realignment, structural reform, and other proposals to address structural problems. This may include the possibility of placing proposals before the voters.

The Governor has directed his Cabinet and all areas of State government to cooperate in this effort including a directive to identify ways to more efficiently meet California's needs.

Forthright and timely action can protect the promise of the future.



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# BRIDGING THE GAP

Recognizing the effect of the delay in the national and California economic recoveries on the State's revenue, the Administration and the Legislature, for the second consecutive year, took early and decisive actions.

- ◆ On November 26, 2002, the Governor issued Executive Order D-64-02, directing departments to freeze spending where possible and to begin implementing current year reductions in non-essential functions.
- ◆ On December 6, 2002, the Administration advanced mid-year reduction proposals totaling \$10.2 billion. The Governor called the Legislature into a special legislative session in December to address the Budget shortfall.
- ◆ In March and April of 2003, the Legislature approved reductions of \$6.9 billion (\$3.3 billion in March and \$3.6 billion in April).

When the 2003-04 Governor's Budget was presented to the Legislature on January 10, 2003, the projected General Fund budget gap was \$34.6 billion. While the Legislative Analyst's projection of the budget gap was \$26 billion, the major difference was largely attributable to methodological differences. Most of those differences are now subsumed in the May Revision adjustments.

Since the release of the Governor's Budget, the State economy and General Fund revenues have generally followed the January forecast. However, expenditures (primarily caseloads and Proposition 98) and the cancellation of the sale of the second installment of the tobacco securitization bond (\$2.0 billion) have increased the budget gap from \$34.6 billion to \$38.2 billion.

## REVISED GENERAL FUND BUDGET GAP

	(in billions)
<b>Budget Gap at Governor's Budget</b>	<b>-\$34.6</b>
Caseload and Estimate Increases	-1.5
Increased Proposition 98 Expenditures	-0.7
Cancel Tobacco Securitization Bond Sale	-2.0
Tobacco Settlement Fund Backfill of GF	0.2
Estimated Net Revenue Decrease 2002-03	-0.4
Estimated Net Revenue Increase 2003-04	0.7
Past/prior Year Adjustment Gain	0.1
Total Changes in Budget Gap	-\$3.6
<b>Revised Budget Gap at May Revision</b>	<b>-\$38.2</b>



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**STRATEGIES TO ADDRESS THE ADDITIONAL PRESSURE**

The May Revision to the Governor's Budget proposes the following strategy to address the additional pressure:

		(Dollars in billions)
<b>Reserve as of Governor's Budget</b>		<b>\$0.5</b>
<b>Additional Pressure from May Adjustments</b>		
Total Changes in Budget Gap	-\$3.6	
Current Year Solutions rejected by the Legislature	- 2.2	
Erosion of Solutions (no early adoption)	- 0.7	
<b>Total Additional Pressure</b>		<b>-\$6.5</b>
<b>Strategies:</b>		
Reduced Realignment Package	-\$6.4	
Reduced Indian Gaming Revenues	- 0.8	
Restorations/Changes	- 1.2	
Pension Obligation Bond, net changes	0.4	
VLF Offset Suspension	1.2	
Medi-Cal Accounting shift to Cash Basis	0.9	
Deficit Financing Bond	10.7	
Other Reductions	1.7	
<b>Total Strategies</b>		<b>\$6.5</b>
<b>Reserve as of May Revision</b>		<b>\$0.5</b>

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**ADDRESSING THE OVERALL \$38.2 BILLION GAP**

The proposed changes in solutions are summarized in the following table:

(Dollars in millions)

	<b>Jan 10</b>	<b>May Revision</b>	<b>Percentage at May Revision</b>
Cuts/Savings	\$20,728.3	\$18,875.4	49.4%
Realignments	8,154.0	1,732.4	4.5%
Fund Shifts	1,902.7	2,076.3	5.5%
Transfers	2,114.3	1,912.6	5.0%
Loans/Borrowing	1,683.3	2,901.5	7.6%
Deficit Financing		10,700.0	28.0%
<b>Totals</b>	<b>\$34,582.7</b>	<b>\$38,198.2</b>	<b>100%</b>

Note: Numbers may not add due to rounding.





# THE ECONOMY

The national economy made little progress on the road to recovery in the first quarter of 2003. Economic output grew only slightly for the second quarter in a row, as bad weather, the war with Iraq, fear of terrorist attacks, and concerns about severe acute respiratory syndrome (SARS) weighed on the economy. Consumers remained cautious, and businesses cut back on capital spending. Manufacturing slowed further. The war and SARS especially hurt air travel and tourism. On the positive side, residential construction increased, and housing markets remained strong. Net exports became less negative, and corporate profits continued to improve. In total, though, there was not enough demand in the economy to keep labor markets from deteriorating.

California fared much the same. War, fears of terrorism, and SARS hurt the state's tourism industry, which has not yet fully recovered from the September 11<sup>th</sup> terrorist attacks. Employment continued to decline in manufacturing, and high-tech companies announced new layoff plans. Layoffs were also expected in school districts, local government, and health care. However, overall employment rose in the state in the first three months of 2003 while it fell in the nation, but the gain was small and did not keep up with the state's growing labor force. The annual revision of the state employment statistics showed that the recession was even worse than previously thought in the San Francisco Bay/Santa Clara Area. On the positive side, personal income tax withholding and sales taxes were up from a year ago in the first four months of 2003. Residential building strengthened considerably in the last few months of 2002 and in the first quarter of 2003. Housing markets remained active and price appreciation was substantial in certain price levels. Despite a pickup in consumer confidence in April, most of the evidence suggests that the California and national economies will grow only modestly during the rest of 2003. Better things are in store for 2004.

## The Nation

The U.S. economy experienced its first full year of growth in 2002 after the mild recession of 2001. However, the mild recession led to a weak recovery with growth only half the rate of the average for post-World War II recoveries. Possibly as a result of war jitters, the economy slowed at the end of 2002, and the first quarter of 2003 was little better as inflation-adjusted Gross Domestic Product (GDP) increased by only 1.6 percent.

Personal consumption expenditures increased by only 1.4 percent in the first quarter, marking a slowdown from the already weak fourth quarter growth rate of 1.7 percent.



Consumers became more cautious as the threat of war with Iraq neared. The slowdown in consumption growth mirrored a decline in consumer sentiment, which reached a ten-year low in March before bouncing back strongly in April.

Business investment was disappointing in the first quarter. After growing for four consecutive quarters, it reversed course and declined. Investment in producers' durable equipment and software was very weak—declining by 4.4 percent. The decline was concentrated in transportation equipment, particularly motor vehicles and civilian aircraft. Investment in information equipment, on the other hand, soared. Spending on commercial structures dropped again, but the pace of decline was the slowest in six quarters. Housing construction, however, continued to increase. And business inventories expanded but at a slower pace.

Government spending grew modestly in the first quarter, posting its smallest gain since the third quarter of 2001. Although the public has focused on national security spending following the September 11<sup>th</sup> terrorist attacks, growth in government spending has actually been quite broad-based since then. This pattern was broken in the first quarter. While federal nondefense spending grew by 10.5 percent, defense spending declined by 1.5 percent, and State and local spending fell by 0.1 percent. The decline in State and local spending was expected with most State governments facing large budget shortfalls.

Net exports (exports minus imports) increased in the first quarter, as imports fell more quickly than exports. The depreciation in the dollar might have finally improved the trade balance. However, the work slowdown and eventual lockout at West Coast ports last fall could have distorted the results of the last three quarters.

Monthly statistics since the beginning of 2003 reflect the weak growth experienced in the first quarter and point to more weakness in the second. The Institute for Supply Management's survey of national manufacturing showed that manufacturing contracted in March after expanding the three previous months. Additionally, the Federal Reserve Bank's industrial production index fell in March—the sixth decline in the last eight months. The service sector also slowed in March with the ISM's non-manufacturing index falling for the first time since January 2002. Also, the University of Michigan's Consumer Sentiment Index declined throughout the first quarter before bouncing back in April. Falling gasoline and natural gas prices and the successful conclusion of hostilities in Iraq likely account for much of the rebound.

Consumers have become increasingly concerned about job prospects, however. Employers remain cautious about taking on more workers. And even though layoff announcements have trended downward in the last six months, suggesting that some improvement in job prospects may lie ahead, initial claims for unemployment insurance benefits have trended upward, indicating that a growing number of workers are losing their jobs. Consistent with this, the monthly establishment survey



shows that nonfarm payroll employment slid by 322,000 jobs from December 2002 to April 2003. The national unemployment rate, which has shown little trend in the last year and a half, would seem to paint a different picture. But, declining labor force participation in the last three years, caused in part by an increase in the number of discouraged workers, has held down the unemployment rate. (Discouraged workers are persons who would like to work and are available for work but are neither working nor looking for work because of job market-related reasons.)

The economy should pick up in the second half of 2003. Faster economic growth will, at last, translate into job gains since firms will have exhausted opportunities to increase productivity at the phenomenal rates experienced during 2002. Some of the fuel for faster growth will come from reduced uncertainty on the outlook for the Middle East, significant improvements in corporate profitability, and from additional tax cuts that will kick in by the fourth quarter of 2003. Moreover, the economy will continue to be buoyed by low interest rates. Construction, however, will not be adding to economic growth until 2005. International trade will not contribute much in 2004 either, but federal spending will be a key contributor.

A wildcard in the outlook is SARS. Asia was the star performer in the world economy in 2002. Recent reports suggest that the impact of SARS on the economies of mainland China, Hong Kong, and Singapore, especially their tourism industries, could be substantial. If SARS continues to sap the strength of Asia's economies, its trading partners, including the U.S., could experience a significant slowdown in exports. Additionally, the bottom line of major California high tech companies with significant ties to, or investments in, Asia could also be sorely impacted.

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## California

The California economy has tracked the national economy quite closely in the last year. Both economies have been sluggish. From March 2002 to March 2003, nonfarm payroll employment grew by 0.2 percent in the state while falling 0.2 percent in the nation—essentially unchanged. Over that year, state unemployment varied narrowly, never exceeding 6.9 percent nor falling below 6.6 percent. The national unemployment rate also was steady but averaged about 0.9 percentage points below the state rate. In addition, homebuilding was strong in both the state and the nation, as were housing markets.

The annual revision to the state's employment statistics revealed that the California recession was even more of a high-tech, Bay Area recession than previously thought. While nonfarm payroll employment fell by 290,000 jobs, or 2.0 percent, in the state between March 2001 and January 2002, it fell by about 105,000 jobs, or 10 percent, in the San Jose metropolitan area and 75,000 jobs, or 7 percent, in the San Francisco metropolitan area. Thus, the total job loss in the two metropolitan areas was greater than 60 percent of the net job loss in the entire state. Making



matters worse, these two areas got a month or two head start in losing jobs, and they continued to lose jobs a year after employment hit bottom in the state as a whole. In fact, as recently as April 2003, it was not clear whether the two metropolitan areas had stopped losing jobs, although the rate of loss had slowed considerably. The San Jose metropolitan area lost an astounding 16.5 percent of its jobs from March 2001 to March 2003, and the San Francisco metropolitan area, 11.1 percent (Figure ECON-1). These percentage losses exceed what Los Angeles County lost in the long and deep early-1990s California recession. Moreover, most of the jobs lost in the San Jose and San Francisco metropolitan areas were in high-paying industries, making the resulting losses in total wages and salaries and tax revenues in the state larger than would have otherwise been the case. The San Jose metropolitan area accounted for a hugely disproportionate \$3.1 billion of the \$9.5 billion decline in personal income tax assessments in the state in 2001.

The state's travel and tourism industry was recently set back by the war in Iraq and the SARS epidemic. The already-struggling air travel industry was particularly hit hard as travelers worried about being infected by SARS or being a victim of a terrorist attack on an airplane. San Francisco's tourism industry, with its heavy reliance on Asian visitors, was especially affected. Small businesses in California's Asian communities may also have suffered. With military operations winding down in Iraq and signs that the SARS epidemic is ebbing in most of the world, with the major exceptions of mainland China and Taiwan, California's travel and tourism industry might get some relief in the coming months.

Low mortgage rates and doubts about the stock market kept residential real estate markets strong in the first quarter of 2003. The median price of existing homes sold in the state hit a new record high of \$352,780 in March, up more than 15 percent from a year earlier. Sales were off a bit—down 3.2 percent in March and 3.5 percent for the entire first quarter—but still at high levels. Some of the real estate markets with very high prices—Santa Barbara, Santa Clara, and Santa Cruz Counties and the San Francisco metropolitan area—saw sharp drops in sales in March from year-earlier levels.

**The Forecast**—With the war in Iraq having gone as well as could be hoped, the recent capture of another high-level Al Qaeda leader, and signs that the SARS epidemic might be running its course, consumers and businesses should be feeling better about the outlook for the economy. At the very least, uncertainty about the near-term future has been reduced considerably, and that appears to account for much of the improvement in consumer confidence measures in April. What remains to be seen is how long that feeling of relief will last.

The nation's loss of 48,000 jobs in April brought the total job loss since March 2001 to 2,112,000. Over that time, unemployment rose from 4.2 percent to 6.0 percent. To be sure, few of those jobs—only 332,000—were lost in the last 12 months;



labor markets appear to have bottomed out. But consumers react to how long job markets have been down as well as the depth to which they have gone. So, while it is positive for the outlook that labor markets will likely not deteriorate much further, it doesn't do much for consumer confidence. Weak labor markets were the top concern of Americans before the buildup to the war in Iraq and will soon be again.

Judging from business confidence surveys, business leaders are even more skeptical than consumers about predictions of an improving economy. Here again, however, progress has been made. Many major businesses have aggressively cut costs (i.e. layoffs) in the last year or two and are now showing profits. When demand picks up in the economy, profits should grow quickly, and that should lead to more capital spending.

Thus, the national economy is better positioned to get back on track than it was last year at this time. In addition, the anticipated federal tax cut will give it a boost in the second half of the year. But it may well be close to the end of the year before progress is clearly evident. There are still quite a few industries with too much capacity, which would dampen the prospects for a strong recovery. Moreover, if productivity continues to grow as quickly as in the last year, improvement in the labor markets will likely come first in the form of fewer layoff announcements and longer workweeks for employed workers. Actual employment gains will trail behind, and declines in the unemployment rate will come even later. Reductions in layoffs and longer workweeks are less visible forms of improvement and not as desirable as outright hiring, especially to unemployed workers.

California will continue to track the national economy. By the fourth quarter of 2003, jobs will be growing at an annualized rate of about 1.6 percent on a quarter-to-quarter basis. Because job gains will be meager in the first half of 2003, employment will be up only 0.6 percent for 2003 as a whole, on an annual-average basis (Figure ECON-3). Employment growth will increase to 2.1 percent in 2004, on an annual-average basis. Growth in total state personal income will improve from 3.1 percent in 2003 to 4.9 percent in 2004, clearly putting the economy back on track.



FIGURE ECON-1

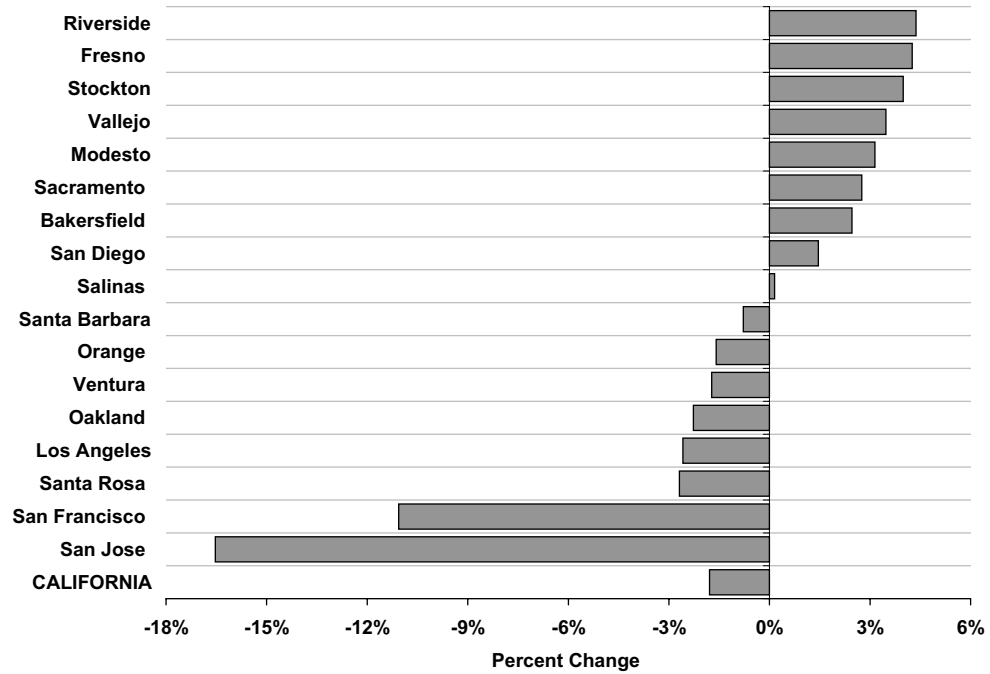
**Metro Area Employment Growth  
March 2001-2003**

FIGURE ECON-2

## Selected U.S. Economic Indicators

	2002	Forecast	
		2003	2004
Real gross domestic product, (1996 dollar) (Percent change)	2.4	2.4	3.5
Personal consumption expenditures	3.1	2.1	3.3
Gross private domestic investment	1.0	2.0	6.7
Government purchases of goods and services	4.4	3.7	1.0
GDP deflator (1996=100) (Percent change)	1.1	1.6	1.7
GDP, (Current dollar) (Percent change)	3.6	4.1	5.3
Federal funds rate (Percent)	1.67	1.28	2.24
Personal income (Percent change)	2.8	3.7	4.4
Corporate profits before taxes (Percent change)	-0.7	15.5	20.9
Nonfarm wage and salary employment (Millions)	130.8	130.8	132.7
(Percent change)	-0.9	0.1	1.4
Unemployment rate (Percent)	5.8	6.0	6.0
Housing starts (Millions)	1.71	1.62	1.52
(Percent change)	6.7	-5.1	-6.5
New car and light truck sales (Millions)	16.8	16.2	16.5
(Percent change)	-2.0	-3.7	1.9
Consumer price index (1982-84=100)	179.8	184.0	188.1
(Percent change)	1.6	2.3	2.2

Forecast based on data available as of April 2003.

Percent changes calculated from unrounded data.

FIGURE ECON-3

## Selected California Economic Indicators

	2002	Percent change	Forecast			
			2003	Percent change	2004	Percent change
Personal income (\$ billions)	\$1,138.7	0.9%	\$1,173.7	3.1%	\$1,231.5	4.9%
Nonfarm W&S employment (thousands)	14,523	-0.7%	14,608	0.6%	14,922	2.1%
Mining	22	-8.6%	21	-4.1%	20	-5.0%
Construction	757	-0.7%	765	1.0%	787	2.9%
Manufacturing	1,738	-7.8%	1,690	-2.7%	1,702	0.7%
High technology	442	-12.4%	422	-4.4%	433	2.5%
Transportation/utilities	705	-5.2%	706	0.1%	722	2.2%
Wholesale & retail trade	3,348	0.7%	3,419	2.1%	3,539	3.5%
Finance group	858	1.7%	862	0.5%	877	1.8%
Services	4,646	-0.2%	4,672	0.6%	4,802	2.8%
Government	2,450	2.8%	2,473	0.9%	2,473	0.0%
Unemployment rate	6.7%		6.6%		6.4%	
Housing permits (thousands of units)	166	11.5%	179	7.8%	174	-3.2%
Consumer price index (1982-84=100)	186.1	2.4%	191.5	2.9%	196.1	2.4%

Forecast based on data available as of April 2003.



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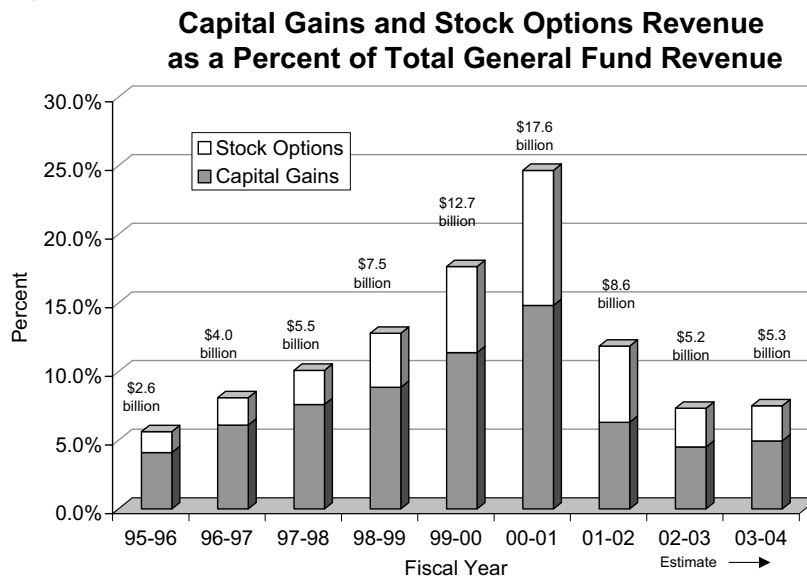


# REVENUE ESTIMATES

General Fund revenues are expected to be below the Governor's January Budget by \$2.4 billion in 2002-03 and above the Governor's Budget by \$1.8 billion in 2003-04. Over the two years, the reduction is approximately \$0.6 billion. The main difference between the two years is that the second tobacco securitization bond sale in 2002-03 has been cancelled, while transfers to the General Fund in 2003-04 have increased due to the sale of Pension Obligation Bonds.

For the major taxes only, the May Revision forecast is little changed from the Governor's Budget in total—down \$303 million in 2002-03 and up \$982 million in 2003-04, for a two-year change of \$679 million. The most significant change was in the personal income tax. Weaker final payments in April suggest that capital gains income was somewhat lower than expected. However, market-related income such as capital gains and stock options appear to have bottomed-out, and the May Revision estimate assumes modest growth in these components in 2003-04. This can be seen in Figure REV-1. Lower expectations for income tax revenues were largely offset by positive expectations for corporate receipts. Based on recent cash experience and the outlook for improved corporate profits, corporate tax revenues appear to be recovering and good growth is expected through the forecast period.

FIGURE REV-1



Note: An assumed tax rate of 9 percent was used to calculate the tax revenue from capital gains and stock options.



Anticipated revenues from Indian gaming in the budget year have been reduced from the goal of \$1.5 billion to \$680 million. The State's negotiators are taking the time necessary to consider the complex and competing factors involved, including the essential environmental and other concerns of the local communities, the state's interests, and the tribes' interests. The time must be taken to be sure this is done right and with respect for the sovereignty of the tribes. In addition, any new compacts must be approved by the Legislature and the Secretary of the Interior. Thus, this revision anticipates that the process will not, in this budget year, reach the goal contained in the January Budget.

The forecast also includes the effect of the May Revision proposals to address the budget problems that the State is experiencing. These proposals include the following:

- ◆ Continuation of the suspension of the teacher retention tax credit, which is expected to increase General Fund revenues by \$175 million.
- ◆ Maintaining the base level of transfers to the Public Transportation Account (PTA), but specify that any excess sales tax revenues on gasoline, which would otherwise be designated as PTA spillover, be credited to the General Fund. The May Revision proposes a partial Proposition 42 suspension and that the General Fund repay the Transportation Investment Fund (TIF) by June 30, 2009, for any funds not transferred in 2003-04 due to the suspension (see Transportation section). The \$87 million increase in General Fund sales tax revenue in 2003-04 due to the PTA spillover revenue is not included in the General Fund repayment, because it would not otherwise be considered TIF revenue.
- ◆ One-year suspension of the Natural Heritage Preservation Tax Credit and participation of the Employment Development Department in the Treasury Offset Program. These proposals are expected to increase revenues by \$15 million in 2003-04.
- ◆ To provide more time for legislative consideration, the majority of the Administration's January realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05. For 2003-04, the realignment proposal is reduced from \$8.3 billion to \$1.8 billion, which is proposed to be funded by the following tax proposals: adding a 10.3 percent personal income tax bracket at \$150,000 for single filers and \$300,000 for joint filers (\$1.56 billion in 2003-04), increasing the tobacco excise tax by \$0.23 per pack of cigarettes (\$267 million in 2003-04), and increasing the tobacco excise tax by an additional \$0.40 per pack in 2004-05 (\$678 million total tobacco excise tax in 2004-05).



- ◆ Deficit financing bond. The May Revision proposes a temporary one-half cent sales tax increase to provide an efficient, equitable, and economical means of funding the accumulated budget deficit, thereby providing fiscal relief to the state. This sales tax rate will automatically cease as soon as the bond is repaid. The sales tax increase is expected to become effective on October 1, 2003, and to raise approximately \$1.7 billion in 2003-04, and \$2.3 billion each year thereafter, until the bonds are fully repaid.

<b>Major Tax Proposals for Legislative Action (\$ in millions)</b>	<b>2003-04</b>	<b>2004-05</b>
Temporary Sales Tax: Additional 0.50 cent for deficit financing bond.	\$1,742	\$2,436
Personal Income Tax: New 10.3 percent rate for realignment to local government.	1,560	1,250
Tobacco Excise Tax: \$0.23 increase per pack for realignment to local government in 2003-04, \$0.40 increase in 2004-05.	267	678
<b>Total</b>	<b>\$3,569</b>	<b>\$4,364</b>

## Personal Income Tax

The personal income tax forecast has been reduced by \$780 million in 2002-03 and by \$154 million in 2003-04. The budget year estimate includes the effect of the Administration's proposals identified above.

Cash receipts associated with the 2002 tax year were lower than expected and this accounts for the downward revision in 2002-03. This weakness is assumed to be primarily due to a sharper decline in capital gains than previously estimated. The lower level of capital gains in 2002 carries forward to 2003, which suppresses 2003-04 revenues. Based on cash receipts through April, capital gains for the 2002 tax year are estimated to have decreased by 30 percent, to about \$35 billion, and are projected to recover with a 10 percent increase in 2003.

Partially offsetting the negative effect of lower capital gains is the growth in withholding receipts that has been experienced in 2003. The average monthly growth rate from January through April was 4.6 percent. Since withholding is based on current wages, it is a good indicator of current activity and this forecast assumes that the recent strength is real and ongoing.



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## Sales and Use Tax

The sales and use tax forecast has been increased by \$96 million in the current year and \$297 million in the budget year.

Through April, sales tax receipts are \$65 million above the 2003-04 Governor's Budget forecast, which reflects healthy vehicle sales and home sales. This slightly stronger growth is expected to continue as the economy begins to improve. For calendar year 2003, taxable sales are expected to grow by 3.1 percent, while 5.3 percent growth is expected for calendar year 2004.

The sales and use tax forecast includes \$87 million in 2003-04 due to specifying that any excess sales tax revenues on gasoline are credited to the General Fund, rather than transferred to the Public Transportation Account (PTA). This proposal maintains the base level of transfers to the PTA.

As noted above, the May Revision proposes a temporary one-half cent sales tax increase to repay the deficit financing bond, which will only be effective until the bond is repaid. The sales tax increase is expected to become effective on October 1, 2003, and to raise approximately \$1.7 billion in 2003-04.

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## Corporation Tax

The corporation tax forecast has increased by \$212 million in 2002-03 and \$713 million in 2003-04. This improvement is attributable to recent cash experience and a more positive outlook for corporate profits. Through April, net cash receipts from the corporation tax are above the January Governor's Budget estimate by approximately \$200 million. The forecast anticipates continued improvement in corporate profits after three years of flat or negative growth.



FIGURE REV-2

**GENERAL FUND REVENUE FORECAST**  
**Reconciliation with Governor's Budget**  
**(Dollars in millions)**

Source	Governor's Budget	May Revision	Change Between Forecasts	
<b>Fiscal 01-02</b>				
Personal Income Tax	\$33,047	\$33,047	\$0	0.0%
Sales & Use Tax	21,355	21,355	0	0.0%
Corporation Tax	5,333	5,333	0	0.0%
Insurance Tax	1,596	1,596	0	0.0%
Other Revenues	3,254	3,278	24	0.7%
Transfers	7,654	7,654	0	0.0%
<b>Total</b>	<b>\$72,239</b>	<b>\$72,263</b>	<b>\$24</b>	<b>0.0%</b>
<b>Fiscal 02-03</b>				
Personal Income Tax	\$32,880	\$32,100	-\$780	-2.4%
Sales & Use Tax	22,349	22,445	96	0.4%
Corporation Tax	6,452	6,664	212	3.3%
Insurance Tax	1,742	1,863	121	6.9%
Other Revenues	6,723	4,727	-1,996	-29.7%
Transfers	2,998	2,952	-46	-1.5%
<b>Total</b>	<b>\$73,144</b>	<b>\$70,751</b>	<b>-\$2,393</b>	<b>-3.3%</b>
Change from Fiscal 01-02	\$905	-\$1,512		
% Change from Fiscal 01-02	1.3%	-2.1%		
<b>Fiscal 03-04</b>				
Personal Income Tax	\$33,610	\$33,456	-\$154	-0.5%
Sales & Use Tax	23,210	23,507	297	1.3%
Corporation Tax	6,361	7,074	713	11.2%
Insurance Tax	1,830	1,918	88	4.8%
Other Revenues	3,789	3,250	-539	-14.2%
Transfers	353	1,729	1,376	389.8%
<b>Total</b>	<b>\$69,153</b>	<b>\$70,934</b>	<b>\$1,781</b>	<b>2.6%</b>
Change from Fiscal 02-03	-\$3,991	\$183		
% Change from Fiscal 02-03	-5.5%	0.3%		



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# EDUCATION

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## Preserving Education

Recognizing that the education of the state's students is the most important underpinning of the economy and the long run hope for increased prosperity, the May Revision maintains education as the Administration's highest priority by providing full funding of the Proposition 98 guarantee; funding growth for apportionments at 1.34 percent in 2003-04; increasing funding for the California Community Colleges by \$305 million and making limited reductions in higher education programs. K-12 Proposition 98 per pupil spending is increased by \$231 over the 2002-03 fiscal year as estimated in the May Revision and hits a new high of \$6,869 in 2003-04. The May Revision provides \$708 million more for Proposition 98, above the \$803 million needed to fund child care within the guarantee.

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## Responding to Priorities

The Administration has listened to the voices of the education community and the Legislature, and has engaged in a dialogue about priorities and ways to manage with a level of education funding lower than that which all parties, including the Administration, wish were possible. In the current fiscal situation, funding at the Proposition 98 guarantee is a significant accomplishment, requiring sacrifices throughout the rest of the budget.

The January Governor's Budget reflected an approach to reductions that spread the impact over as many programs as possible to minimize the impact on each, while preserving as much funding as possible for classroom instruction. The May Revision continues the priority of preserving flexible funding for classroom instruction by lowering the cut to revenue limit funding from \$612 million to \$350 million, now only a 1.2 percent reduction compared to 2.15 percent proposed in January. To help pay for this, the May Revision reduces or eliminates lower priority categorical programs, with the hope that some of the more effective programs can gradually be restored as future funding permits.

The Administration understands that the block grant for categorical aid proposed in January, while providing significant flexibility for local priority setting, was not considered the best approach for providing the remaining funding. The May Revision does not propose a specific alternative. The Administration is ready to work with all parties to craft a mechanism for school funding that helps schools to adapt to the funding changes in the 2003-04 Budget. The Administration is open to block grant type funding or other mechanisms to provide increased local choice while protecting the neediest students and preserving the State's accountability programs and high student achievement goals. The Administration proposes that districts be allowed to use reserves more flexibly, while encouraging fiscal responsibility.



### Priority Programs Fully Funded

- ◆ Class Size Reduction
- ◆ Special Education
- ◆ Accountability
- ◆ Child Nutrition
- ◆ School Safety

Class Size Reduction funding is fully restored with a \$180 million increase. Special Education is fully funded with an increase of \$28 million in Proposition 98 General Fund, and an increase of \$69 million in federal funding is proposed to fund mental health services. Programs to assist underperforming schools as part of the school accountability system are fully funded to meet the needs of current participants, with an increase of over \$60 million from the Governor's Budget level. Nutrition programs are fully funded. School safety programs are funded at the 2002-03 level.

### Proposition 98 Guarantee

<b>2002-03</b>	<b>–\$60.3 million</b>
<b>2003-04</b>	<b>\$1,502.9 million</b>

Combining the years 2002-03 and 2003-04, Proposition 98 funding is \$1.5 billion higher than the mid-year revision level established by Chapters 4 and 10, Statutes of 2003, First Extraordinary Session (SB 18X and SB 28X), a 1.8 percent change from the Governor's Budget level.

In the Governor's Budget, the minimum funding level for the budget year was established by Test 3, which adjusts the prior guarantee level for growth in attendance and the change in per capita General Fund revenues. A 0.34 percent increase in average daily attendance (ADA), an increase in General Fund revenues, and increases in the prior year base for the Proposition 98 calculation, results in an increase of \$1.511 billion to the guarantee.

The May Revision proposes to fully fund the guarantee under Test 2. The General Fund share of the guarantee increases by \$1.503 billion. An \$879 million adjustment is made to the guarantee to reflect the restoration of the child care program to Proposition 98. The local revenue share of the guarantee increases \$7.9 million after adjusting for a revision to the excess tax proposal.





### Funding the Guarantee

In order to fund the General Fund share of the guarantee, \$1.82 billion in undisbursed 2002-03 General Fund appropriations have been deferred until 2003-04 through current year special legislation, Chapters 4 and 10, Statutes of 2003, First Extraordinary Session (SB 18X and SB 28X). These appropriations will be counted toward the 2003-04 guarantee. The Administration proposes to defer \$1.16 billion in appropriations to 2004-05 but does not propose making this practice permanent.

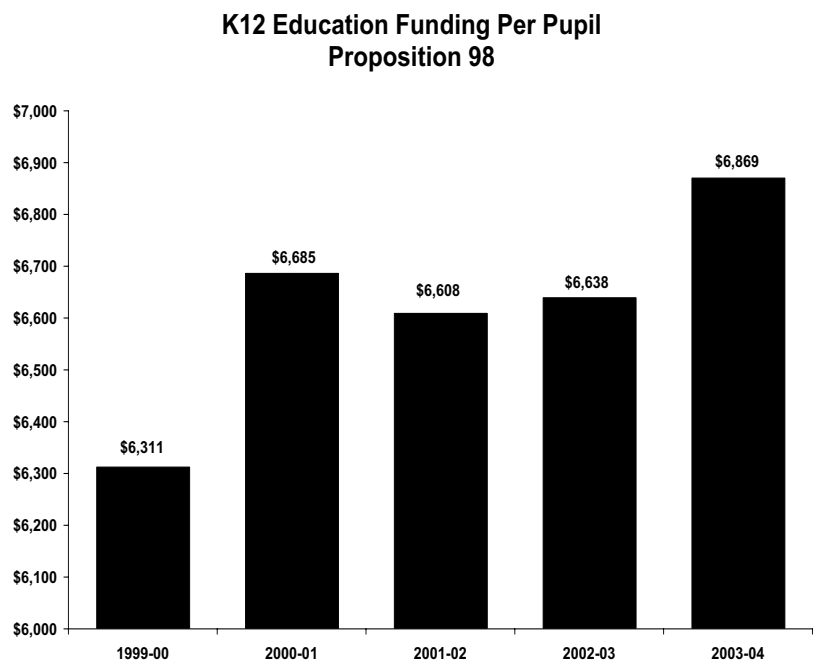
The reductions in Proposition 98 appropriations from the 2002 Budget Act level totaling \$2.53 billion still leave the total appropriations at \$122.3 million above the Test 2 guarantee level in the current year.

Funding per pupil under Proposition 98 continues to increase. Appropriations for 2002-03 will provide a funding level of \$6,638 per pupil. Per pupil funding of \$6,869 in 2003-04 represents an increase of 3.5 percent over the current year. Funding per pupil grows more than \$200 for 2003-04 from the Governor's Budget.

FIGURE EDU-1

Proposition 98 January vs. May Revision (Dollars in thousands)			
2002-03	Mid-Year Revision	May Revision	Change
General Fund	\$29,397,125	\$29,336,823	-\$60,302
Local Revenue	14,513,835	14,612,403	\$98,568
<b>Total Guarantee</b>	<b>\$43,910,960</b>	<b>\$43,949,226</b>	<b>\$38,266</b>
2003-04	January Proposal	May Revision	Change
General Fund	\$28,225,485	\$29,728,383	1,502,898
Local Revenue	15,867,659	15,875,526	7,867
<b>Total Guarantee</b>	<b>\$44,093,144</b>	<b>\$45,603,909</b>	<b>\$1,510,765</b>
<b>Total Two-Year Funding</b>	<b>\$88,004,104</b>	<b>\$89,553,135</b>	<b>\$1,549,031</b>

FIGURE EDU-2



## K-12 Education

2002-03	–\$29.8 million
2003-04	\$1,672.2 million

The May Revision increases funds for K-12 education by \$1,642.4 million over two years in General Fund resources compared to totals enacted in mid-year legislation. Proposition 98 General Fund increased by \$1,174.6 million, contributions to the State Teachers' Retirement System (STRS) increased \$450.9 million because the proposal to defer or bond 2003-04 payments has been rescinded, and bond debt service increased \$70.4 million. Total General Fund allocations of \$29.1 billion for K-12 education now represent 41.2 percent of the General Fund budget.

## Total K-12 Funding

Funds available to K-12 education from all sources are increasing from \$54.5 billion in 2002-03 to \$55.5 billion in 2003-04, a 1.8 percent increase. General Fund declined \$536.7 million, while local property taxes grew by \$1.1 billion and federal funds grew by \$450.2 million. Major General Fund changes include:

- ◆ A reduction of \$465.7 million for STRS payments
- ◆ An increase of \$803.9 million to Proposition 98 General Fund
- ◆ A decrease of \$93.4 million for Scholarshare funding
- ◆ A decline of \$779.6 million in the use of Proposition 98 Reversion Account General Fund

## Attendance Changes

### Current Year

The May Revision includes estimated K-12 ADA growth of 1.75 percent, up from 1.48 percent in the Governor's Budget. General Fund costs for school district and county office of education revenue limits decrease by \$29.9 million, resulting primarily from significant increases in local property taxes that are partially offset by increased estimates of ADA, and other miscellaneous adjustments.

### Budget Year

In the budget year, the revised ADA growth is up slightly, from 1.00 percent to 1.34 percent (about 36,000 ADA higher than the January estimate). The total number of ADA is estimated to be 5,911,519 in 2002-03 and 5,990,495 in 2003-04.



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### **Growth Adjustments**

The May Revision provides over \$272 million in new funds to provide an increase in the estimated Proposition 98 ADA growth rate from 1.00 percent to 1.34 percent in budget year. Major adjustments include increases of \$183.4 million for K-12 school district apportionments, \$12.8 million for special education, and a decrease of \$0.5 million for county office of education apportionments. Other major adjustments include significant costs to pay for reductions in Public Employees' Retirement System (PERS) offset funding of \$51.7 million and an increase in unemployment insurance costs of \$25.2 million. The PERS and unemployment insurance adjustments reflect estimated rate increases to 10.42 percent and 0.30 percent, respectively, of projected salaries.

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### **Revenue Limits**

Revenue limit funding constitutes the basic funding source for classroom instruction. The May Revision provides a net increase of nearly \$262.4 million to revenue limits, after restoring current year across-the-board reductions totaling \$612.4 million and then reducing revenue limits by approximately 1.2 percent, or \$350.0 million.

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### **Basic Aid District Excess Taxes**

The May Revision modifies the Governor's Budget proposal to offset the General Fund with \$126.2 million in basic aid excess taxes by reducing the offset to \$20 million. Further, the proposal is modified to offset only State categorical funding that would otherwise be provided to excess tax districts. The revised proposal would limit the impact on basic aid districts—together with the previously proposed elimination of the \$120 per pupil basic aid payment—to a reduction of approximately 4.5 percent, consistent with the overall level of reduction to non-basic-aid districts.

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### **Class Size Reduction**

The May Revision proposes to increase funding for the K-3 Class Size Reduction Program by \$179.7 million to rescind the across-the-board reductions proposed for the program. This increase fully restores the program's base funding level for 2003-04.

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### **Accountability**

The May Revision provides an additional \$65.3 million for accountability programs to fund schools participating in Immediate Intervention/Underperforming Schools Program (II/USP) (\$44.4 million) and the High Priority Schools Grant Program



(HPSGP) (\$20.9 million) at \$200 per pupil and \$400 per pupil, respectively, less a 20 percent deferral. The augmentation to HPSGP allows an additional 86 schools to participate in HPSGP so that these schools in the first decile of the Academic Performance Index with an application for participation that has been approved by the Department of Education (SDE) would be funded at \$400 per pupil, less a 20 percent deferral, beginning in 2002-03. The May Revision contains a balance of \$4 million for HPSGP that will be available to expand the HPSGP subject to the enactment of legislation for this purpose.

The increase in funding is comprised of the restoration of the across-the-board cuts to these programs (\$41.8 million) and payment of the 20 percent deferral of 2002-03 funding contained in SB 18X (\$81.6 million). These increases are offset by continuing the 20 percent deferral established by SB 18X (–\$66.0 million). Additionally, the May Revision proposes to reduce Proposition 98 funding for these programs by \$23 million, which is offset by an increase of \$30.8 million from the Proposition 98 Reversion Account for II/USP; this last action also removes the last of the II/USP shortfall in the 2003-04 Governor's Budget.

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### Statewide Assessments

The May Revision continues the Administration's efforts to reduce testing time and streamline the State's system of assessments. Funding for the Golden State Examinations (GSEs) are eliminated and the English Language Arts and Mathematics GSEs are integrated into the Standardized Testing and Reporting (STAR) Program to be used in a pilot program by the California State University for the purposes of placement and remediation. This action provides not only a savings of approximately \$11.7 million from the 2002 Budget Act level, it also eliminates 11 examinations and links standards and assessments between the secondary level and higher education that has not previously existed. Further, the May Revision includes an unallocated reduction of \$13 million in the Testing Programs. The Administration notes the Legislature's concerns regarding testing volume and time and will work with the Legislature to determine how the \$13 million reduction will be allocated.

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### Special Education

The May Revision provides a net General Fund increase of \$27.8 million and also includes an additional \$35.6 million in federal funding over amounts proposed in the Governor's Budget. These increases allow for full funding of growth and maintain the year over year State aid funding commitment. In addition to growth funding, \$138,000 in additional federal funds is allocated to schools as a permanent increase to the base funding level for the Special Education program. Further, the May Revision provides \$4.9 million in funding from the Proposition 98 Reversion Account to fund prior year costs resulting from growth-related increases.



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**Individuals with Disabilities Education Act-Required Mental Health Services**

The May Revision provides \$69 million in federal funds to provide mental health services for children with exceptional needs, as required by the Federal Individuals with Disabilities Education Act. These funds will offset reimbursable mandate activities for services provided to children with exceptional needs as part of the pupil's individualized education plan (IEP). The Administration plans to work with the Legislature and interested parties to develop trailer bill language and Budget Bill language to ensure these services are provided.

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**Equalization**

The May Revision proposes to eliminate \$250 million previously proposed for 2003-04, including \$203 million appropriated by Chapter 1167, Statutes of 2002, and \$47 million in additional funding proposed in the Governor's Budget.

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**PERS Offset Mitigation**

The May Revision proposes \$35 million to mitigate the PERS offset to revenue limits. This represents a restoration of a proposed reduction in the Governor's Budget.

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**Fiscal Crisis and Management Assistance Team Restoration**

The May Revision proposes \$912,000 to ensure that core school district budget management and fiscal services provided by the County Office Fiscal Crisis and Management Assistance Team (FCMAT) will be provided during these difficult fiscal times.

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**Categorical Funding Adjustments**

In the Governor's Budget, \$854 million in categorical program reductions were proposed on an across the board basis. Of these, \$835 million are proposed to be restored in the May Revision, while \$19 million are retained because they reflect natural savings. To replace these reductions and increase funding for apportionments, specific program reductions are proposed. These reductions reflect the Administration's discussions with the education community and members of the Legislature. The table below lists the most significant reductions.



Categorical Program	Reduction (in millions)
Equalization	\$250
Deferred Maintenance	129
Summer School	85
Defer Mandates	125
Teaching as a Priority	89
Instructional Materials	76
Elementary Intensive Reading	31
Peer Assistance and Review	25
Miller-Unruh Reading	29
School Improvement	42
Supplemental Grants	80

### Child Care

**Defer Realignment Proposal**—Child care, originally a part of the \$8.2 billion realignment proposal, is proposed to be reinstated in the 2003-04 Budget. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05.

The Administration believes child care realignment continues to be a viable way to resolve a number of policy and fiscal concerns that have plagued the State's subsidized programs. By giving counties both responsibility to administer child care services in conjunction with other social services for the same families and a financial stake in child care expenditures, it was expected that the proposal would create more equitable access and improve coordination of services for the neediest families, enhance accountability, decrease fraud, and facilitate integration of local priorities and funding sources. Moreover, the Administration had proposed a revenue stream that would have provided a growing revenue source including over \$1 billion from new revenues. Unfortunately, the State's fiscal problem has not improved so cost reductions are necessary as the program is restored to state operations.

The Administration continues to be concerned with growth in CalWORKs Stage 3. While the May Revision restores the child care programs in their current form, the Administration will work with stakeholders, implementing agencies, and the Legislature to address these problems.

**Reforms, Cost Reductions, and One-Time Fund Shifts**—In order to restore child care to State administration and meet competing priority needs in Proposition 98 education programs, the Administration has carefully reviewed restructuring options included in the 2002-03 Governor's Budget comprehensive restructuring proposal. Based on that effort and combined with the availability of one-time Temporary



Assistance for Needy Families (TANF), the Administration proposes a series of reasonable reforms that are aimed at preserving existing programs, preserving access for current subsidized populations and striking a balance with other K-14 funding needs for 2003-04.

Overall, the Administration proposes a total funding level of \$1.867 billion for the restored programs. However, this funding level continues reliance on one-time funding solutions which will create additional problems in the future, absent realignment. Specific solutions produce a total of \$384 million in Proposition 98 General Fund cost savings as follows:

### **Reforms—\$216 Million Cost Reduction**

- ◆ \$4 million caseload savings by limiting child care services to children 12 years of age and under. No other state offers subsidies to 13 year old children.
- ◆ \$12 million savings by eliminating child care services to “grandfathered” families who earn above the current income limits for subsidized care. No other state offers subsidies for incomes at the level California currently provides.
- ◆ \$123 million savings by implementing Regional Market Rate (RMR) regulations, consistent with legislative intent expressed in the 2002 Budget Act that: (1) lowers providers’ rate limits if those providers do not participate in the market by serving only non-subsidized families; (2) prohibits payment of an hourly rate for full-time care; and (3) limits the evening/weekend premium rate to licensed providers.
- ◆ \$44 million savings by reducing the RMR ceiling for licensed providers to the 80th percentile of the regional market. No other state offers reimbursement to this level.
- ◆ \$33 million savings by implementing a modified family fee schedule. Families would begin contributing a share of child care costs when family income reaches 40 percent of the current income level index used for determining eligibility. Fees would increase on a sliding scale with family income, but would be capped at 10 percent of the family’s income at the highest income level, consistent with federal guidelines. Families still on cash aid would pay no fees.

### **Other Cost Reductions, Savings, and Fund Shifts—\$168 Million Savings:**

- ◆ \$39 million caseload savings, including (a) \$35 million reduction in Stage 3 caseload costs from the January estimate; and (b) \$4 million State Preschool participation savings.





- ◆ \$13 million reduction to non-direct care services including: (a) teacher retention bonuses, which is offset by recent implementation of a \$24 million Proposition 10 Commission initiative; and (b) \$3 million reduction to Resource and Referral programs (\$17 million remains for the most essential supportive services).
- ◆ \$15 million Proposition 98 General Fund reduction by utilizing one-time federal funds and unliquidated CalWORKs carryover funds that are available.
- ◆ \$101 million in one-time TANF funds to offset Proposition 98 General Fund.

### **Caseload Changes and Adjustments for Stage 2 and 3**

**Stage 2**—Based on April revised estimates, the average monthly caseload for Stage 2 has increased from the Governor's Budget estimate of 101,800 to 102,500 children due to adjustments in the calculations of the number of families affected by the federal five-year CalWORKs time limit. The \$48.3 million of additional cost for the caseload is funded through TANF transfers to the Child Development Block Grant.

**Current Year Stage 3**—As mentioned previously, Stage 3 caseload decreased for a savings of \$35 million, reflecting a caseload drop from 70,400 to 64,200. Additionally, savings of \$12 million in Proposition 98 for the revised current year estimate are proposed for reversion to the Proposition 98 Reversion Account.

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### **After School Safety and Education Programs**

The May Revision proposes to rescind the across-the-board reductions proposed for the After School Safety and Education Program in the amount of \$14.3 million. This action fully restores the program's base funding level of \$121.6 million and will help increase opportunities for school age children, including 13 year olds who may be displaced due to the child care reform proposal.

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### **Principal Training Program**

The May Revision reduces funding for this Administration initiative that provides 15,000 principals and vice-principals with training in instructional standards and effective school management techniques by \$22.5 million. This reduction will delay completion of this program into 2004-05. The Administration remains committed to this program and has reached an agreement with the Gates Foundation to continue providing 25 percent (\$1,000) of the \$4,000 per participant cost through 2004-05.





### Longitudinal Pupil Database

The May Revision continues \$12 million in federal funding for the assignment of student identifiers and for the development of the database, which is necessary to comply with the data reporting requirements of the federal No Child Left Behind Act. In addition, the May Revision contains an additional \$9.7 million in federal Title VI funds that could also be used for the development of the database, if necessary. The SDE is scheduled to complete a feasibility study report for the development of the database in 2003-04.

### California State Library

<b>2002-03</b>	<b>—</b>
<b>2003-04</b>	<b>–\$0.6 million</b>

Due to current fiscal constraints, the May Revision proposes the following budget adjustments:

- ◆ \$12,145,000 General Fund increase to rescind the prior proposal to shift funding for Transaction Based Reimbursements to local fees. The State Library advises that this program is a high priority, relative to other local assistance programs. This proposal will ensure that cost-effective resource-sharing infrastructure remains intact and that California continues to receive federal funds for one-time projects and system enhancements.
- ◆ \$2,000,000 General Fund increase to offset a lower, more achievable level of user fees (\$1,000,000) for supporting State Library services.
- ◆ \$14,766,000 reduction for the Public Library Foundation to offset the restoration of Transaction Based Reimbursements and contribute to the overall budget solution. Remaining foundation resources would be provided for the libraries most in need on a fiscal basis.



# HIGHER EDUCATION

## California Community Colleges

2002-03	–\$ 30.5 million
2003-04	\$ 304.1 million

### Current Year

Current year Proposition 98 General Fund expenditures for the California Community Colleges (CCC), subsequent to Chapter 4, Statutes of 2003, First Extraordinary Session (SB 18X), are reduced by \$30.5 million. SB 18X augmented CCC funding by \$38 million to backfill a projected decline in local property tax revenues below the level projected in the January Governor's Budget. The most recent data indicates the shortfall is only \$7.5 million below the January level. Therefore, the current year budget will be reduced by \$30.5 million to reflect the most recent data and capture the excess funding provided.

### Budget Year

The May Revision proposes a \$305 million Proposition 98 General Fund increase for local assistance, which is offset by increased Lease Purchase Payment reimbursements in the amount of \$909,000, for a net increase of \$304.1 million. This funding would significantly augment or fully restore various community college programs and services from the levels proposed in the Governor's Budget. Major adjustments include:

- ◆ \$154.7 million to reflect a reduction in the proposed student fee increase from \$13/unit to \$7/unit for a total fee of \$18/unit. This change will restore approximately 25,000 credit full-time equivalent (FTE) students for budget year, significantly reducing the expected levels of attrition projected in the Governor's Budget.
- ◆ \$66.6 million to restore proposed budget year across-the-board reductions to apportionments. Additionally, growth funds are increased \$4.4 million as a result of the higher current year apportionment base resulting from SB 18X.
- ◆ \$55 million to reflect a reduction in the amount proposed to be eliminated due to illegal concurrent enrollment practices. This augmentation will restore approximately 15,000 FTE students in the budget year, or approximately 70 percent of the projected concurrent enrollment FTE students loss assumed in the Governor's Budget.



- ◆ Significant restorations to critical categorical programs including both Extended Opportunity Programs and Services and Disabled Students Programs and Services. These programs are restored to within 99 percent of the 2002 Budget Act levels.

### University of California

2002-03	—
2003-04	\$1.5 million

The May Revision proposes to increase the University of California's (UC) General Fund by \$1.5 million to backfill student fee revenue losses pursuant to the anticipated enactment of legislation in the 2003-04 Regular Session that would offer fee waivers for California National Guard members.

### California State University

2002-03	—
2003-04	–\$5.0 million

The May Revision proposes reducing the California State University's (CSU) General Fund by a net \$5.0 million from the level proposed in the 2003-04 Governor's Budget, for the following:

A \$7.5 million reduction to eliminate a ProRata assessment that was inadvertently charged against the General Fund.

An augmentation of \$1.5 million to backfill student fee revenue losses pursuant to the anticipated enactment of legislation in the 2003-04 Regular Session that would offer fee waivers for California National Guard members.

### California Postsecondary Education Commission

2002-03	—
2003-04	–\$695,000

The May Revision proposes to consolidate the California Postsecondary Education Commission's (CPEC) activities with the California Student Aid Commission (CSAC), pursuant to legislation anticipated to be enacted in the 2003-04 Regular Session. Accordingly, the \$695,000 General Fund proposed in the Governor's Budget would be shifted to CSAC. Additionally, \$5.0 million in federal local assistance is shifted from CPEC to CSAC. This consolidation will provide administrative savings over the



longer term, allowing the CPEC to focus limited resources on their highest priority functions.

### California Student Aid Commission

2002-03	–\$20 million
2003-04	–\$29.2 million

#### Current Year

The May Revision proposes a \$20 million reduction in local assistance associated with revised estimates of the number of Cal Grant Entitlement awards that will be issued in 2003-04.

#### Budget Year

The May Revision proposes net General Fund reductions of \$29.2 million from the level proposed in the 2003-04 Governor's Budget, as noted below.

#### Increases include:

\$695,000 in state operations funds that will be shifted from CPEC to CSAC for state operations, pursuant to the consolidation of activities proposed for these organizations described previously. Additionally, \$5 million in federal local assistance is shifted from CPEC to CSAC.

\$800,000 for one-time implementation costs associated with the consolidation of CPEC to CSAC. This funding would help facilitate the transition to the reduced CPEC staffing level that was proposed for the 2003-04 fiscal year.

#### Decreases include:

\$20 million in local assistance associated with revised estimates of the number of Cal Grant awards that will be issued in 2003-04.

\$7.7 million in CSAC state operations costs are shifted to the Student Loan Operating Fund (SLOF). This is in accordance with federal regulations, which allow SLOF to be used for financial aid-related activities that benefit students, as selected by the guaranty agency.

\$3.0 million one-time local assistance cost savings by eliminating the Cal Grant T program and authorizing 700 additional Assumption Program of Loans for Education (APLE) loan assumption warrants be issued. This corresponds to the number of Cal Grant T awards that CSAC estimated would be issued in 2003-04. One-time savings would be offset as loan assumptions are paid in the future.



The May Revision would also prohibit the issuance of new Graduate APLE loan assumption warrants which will create savings beginning in 2004-05. Trailer bill legislation is proposed to effect this change.

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### **Scholarshare Investment Board**

<b>2002-03</b>	<b>—</b>
<b>2003-04</b>	<b>–\$16.8 million</b>

The May Revision proposes reducing the Scholarshare Investment Board's (SIB) General Fund by \$16.8 million, to reflect revised estimates of the number of Governor's Scholars Awards and Distinguished Math and Science Awards that will be issued in 2003-04. This reduction is consistent with statutory changes adopted in Chapter 4, Statutes of 2003, First Extraordinary Session (SB 18X), which authorized the deferral of funding for 9<sup>th</sup> and 10<sup>th</sup> grade students who qualify for awards until those students reach the 12<sup>th</sup> grade. This reduction is also consistent with the State Board of Education's adopted changes to criteria governing which California Standardized Test mathematics examinations a student may take to qualify for a Governor's Scholars Award.

The May Revision also proposes that the Governor's Scholarship Programs be restored. The Administration intends to submit trailer bill legislation, to accompany the Budget Bill, that will reinstate the statutory authorization. This program was established as part of the agreement to create the Cal Grants entitlement and competitive programs for low income students. As such, the abolishment of the programs in Chapter 10, Statutes of 2003, First Extraordinary Session (SB 28X) abrogates that agreement and would deprive thousands of students the opportunity to be recognized for academic excellence.



## JUDICIAL BRANCH

### Judiciary

2002-03	—
2003-04	—

**Unallocated Reduction**—Due to current economic conditions and the State's fiscal constraints, the Governor's Budget included a \$17.7 million General Fund unallocated reduction to the Judiciary. The Judicial Council has submitted a plan to allocate these reductions among their various programs and items of appropriation.

The following details the allocation of the reductions to state operations:

- ◆ A reduction of \$2 million to the Supreme Court.
- ◆ A reduction of \$9.3 million to the Courts of Appeal.
- ◆ A reduction of \$2 million to the Judicial Council.
- ◆ A reduction of \$275,000 to the Habeas Corpus Resource Center.

The following details the allocation of the reductions to local assistance:

- ◆ A reduction of \$1 million to the California Drug Court Projects.
- ◆ A reduction of \$192,000 to the Court Appointed Special Advocate (CASA) Program.
- ◆ A reduction of \$83,000 to the Model Self-Help Program.
- ◆ A reduction of \$2.8 million to the Equal Access Fund.
- ◆ A reduction of \$30,000 to the Family Law Information Centers.

### State Trial Court Funding

2002-03	—
2003-04	\$17.6 million

**Trial Court Staff Retirement**—An increase of \$5.5 million General Fund is proposed for increased retirement costs for the trial courts throughout the State.



**Trial Court Workers' Compensation**—An increase of \$5.5 million General Fund is included to fund the increased costs of workers' compensation for the trial courts.

**Court Security**—An increase of \$3.6 million General Fund for increased costs associated with providing security at trial court facilities.

**Service of Process Fees**—An increase of \$3 million General Fund is proposed to fund the costs of Chapter 1009, Statutes of 2002, which requires the courts to provide free service of process of a protective order, restraining order, or injunction if the service of process is a result of domestic violence, stalking, or a threat of sexual assault. Chapter 1009 also requires local law enforcement agencies to bill the superior court for payment of the fees related to the service of process.

**Court Facilities Construction Fund Loan**—In order to achieve General Fund savings, a transfer of \$80 million from the State Court Facilities Construction Fund to the Trial Court Trust Fund is proposed as a loan repayable by the General Fund. An associated reduction of \$80 million to the General Fund transfer to the Trial Court Trust Fund is also proposed. This level of revenue from the State Court Facilities Construction Fund is not planned to be used for construction projects until fiscal year 2004-05 at the earliest.

**Court Security Realignment**—Court security, originally a part of the realignment proposal, is proposed to be reinstated in the Budget. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05. Therefore, an increase of \$300 million General Fund is proposed for court security. This amount includes \$266,954,000 for the base funding for court security and \$32,594,000 to fund the proposed increased court security costs included in the Governor's Budget.

**Unallocated Reduction**—Due to current economic conditions and the State's fiscal constraints, the Governor's Budget included a \$116 million unallocated General Fund reduction to the State Trial Court Funding budget. The Judicial Council has submitted a plan to allocate these reductions among their various programs and items of appropriation.

The following details the allocation of the reduction to State Trial Court Funding programs:

- ◆ A reduction of \$87 million to the Support for the Operation of the Trial Courts.
- ◆ A reduction of \$10 million to the Compensation of Superior Court Judges.
- ◆ A reduction of \$1.9 million to the Assigned Judges.



- ◆ A reduction of \$5.1 million in General Fund resources transferred to the Judicial Administration and Modernization Fund.
- ◆ A transfer of \$12 million from the Trial Court Improvement Fund to the General Fund.

## PUBLIC SAFETY

### Department of Justice

2002-03	\$0.8 million
2003-04	\$10.7 million

#### Current Year

The May Revision includes \$750,000 for unanticipated legal expert costs to continue litigation in the Stringfellow toxic dump site matter as a result of new toxic findings at the site.

#### Budget Year

**Appeals, Writs, and Trials Workload**—An increase of \$3.7 million and 30 positions is proposed for increased criminal case workload in the Appeals, Writs, and Trials Section of the Criminal Law Division.

**Forensic Services Lab Costs**—An augmentation of \$3.5 million, with a corresponding decrease in reimbursement authority, is proposed to fund the costs of forensic services provided to local agencies. The Governor's Budget included a proposal to assess local agencies a portion of the costs of processing and analyzing physical evidence. This funding would support those costs, eliminating the need to charge locals for these services.

**Spousal Abuse Prosecution Program**—An increase of \$3.2 million is proposed to restore funds for program staffing and local assistance grants to counties to assist with the prosecution of domestic violence cases.

**"Do Not Call" Program**—An augmentation of \$261,000 and 3 positions is included to provide State-level resources to assist with complaint monitoring, enforcement, and database management for the federal "Do Not Call" program which restricts telephone solicitors from contacting subscribers participating in the program.





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## Department of Corrections

2002-03	\$115.4 million
2003-04	\$23.9 million

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## Inmate/Parolee Population/Caseload Changes

### Current Year

Based upon the Department of Corrections' (CDC) spring estimates, the May Revision reflects an estimated June 30, 2003, population of 160,532 inmates. This is 129 fewer inmates than projected in the 2003-04 Governor's Budget. The revised population estimate represents an increase of 2,553 inmates (1.6 percent) from the June 30, 2002, population level.

The projected June 30, 2003, parolee population is 116,549. This is a decrease of 684 parolees from the number projected in the 2003-04 Governor's Budget. The revised parolee population estimate represents a decrease of 3,787 parolees (3.1 percent) from the June 30, 2002, level.

While the changes in population are relatively minor, the CDC has incurred costs to realign its bed availability with the type and level of inmates it houses. The net effect of the population changes listed above, as well as other adjustments, and estimated current year savings that did not materialize, is a cost to the General Fund of \$46 million, and a savings to the Inmate Welfare Fund of \$459,000.

The May Revision also reflects an additional \$69.4 million to cover unbudgeted costs in overtime, temporary help, and workers' compensation.

### Budget Year

Based upon the CDC spring estimates, the May Revision reflects a June 30, 2004, population of 161,287 inmates, which is 248 inmates more than projected in the 2003-04 Governor's Budget. The revised inmate population estimate reflects an increase of 755 inmates (0.4 percent) from the revised June 30, 2003 population estimate.

The spring population estimate for parolees as of June 30, 2004, is 115,467, which is 80 more parolees than projected in the 2003-04 Governor's Budget. The revised parolee population level projected for the budget year represents a decrease of 1,082 parolees (0.9 percent) from the revised population estimate for June 30, 2003.

As noted above, while the changes in population are relatively minor, the CDC will incur costs to realign its bed availability with the type and level of inmates it houses. The net effect of the population changes listed above, as well as other adjustments, and the budget year component of estimated savings that did not materialize in



2002-03, is a cost to the General Fund of \$59 million, and a savings to the Inmate Welfare Fund of \$520,000.

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### **Budget Reductions**

Due to the lower level of resources available for 2003-04, the May Revision proposes a reduction of \$34.7 million for the CDC, which would result in a total reduction of \$86.6 million, when the January reductions are included. These reductions take careful consideration of the need to make cuts in expenditures, while preserving public safety:

**Delay of 500 Substance Abuse Treatment Beds**—\$5.4 million savings associated with a delay of the activation of 500 substance abuse treatment beds for 12 months.

**Regional Administrators' Office Positions**—\$625,000 savings associated with a reduction at the Regional Administrators' Offices.

**Internal Affairs**—\$956,000 savings resulting from the closure of the Office of Investigative Services, Internal Affairs-Southern Region Office.

**Elimination of 7k Correctional Sergeants**—\$2.3 million savings due to the elimination of Correctional Sergeants associated with the 7k training program.

**Management Positions**—\$2.3 million savings associated with the reduction of management positions.

**Delay Implementation of Delano II**—\$8.8 million savings as a result of the delayed activation of Delano II until March 2005.

**Span of Control for Parole Administrators**—\$1.3 million savings as a result of increasing the span of control of Parole Administrators from five parole units to eight parole units.

**Various Health Care Services Program Reductions**—\$13 million savings resulting from improved pharmacy prescription protocols, reduced referrals to outside emergency/urgent care facilities, and reduced disease category requests for service.

It is anticipated that the cost savings identified above will increase as the CDC implements strict utilization management policies and procedures, and as more institutions implement the provisions of the Plata settlement which requires that inmates be provided the same standard of health care as provided in the community.

In addition, the CDC will aggressively pursue the implementation of a managed care model to further reduce health care program expenditures statewide and explore the best practices of managed care that can be implemented in a correctional setting. Some of the areas to be examined will include: increased use of preventive care to



reduce expenditures on specialty and emergency services; managing services for inmates with chronic conditions (e.g., HIV, diabetes) to reduce the amount spent for costly private hospitals, transportation, and security; and cost-effective drug formularies that restrict unnecessary use of high cost drugs.

**Salinas Valley Psychiatric Program Activation Delay**—\$1 million savings to reflect the revised activation schedule for the Salinas Valley Psychiatric Program.

## Department Of Corrections

### Capital Outlay

2002-03	—
2003-04	–\$2.8 million

The May Revision proposes to switch funding for three capital outlay projects from General Fund to existing general obligation bond funds. The projects, Duel Vocational Institution—Infirmary Heating, Ventilation and Cooling (\$1.0 million), California Institution for Men (CIM) Chino—Cell Security Lighting (\$1.3 million), and CIM—Chino East Electrified Fence (\$0.5 million), are all continuation of critical health and life safety projects.

## Department of the Youth Authority

2002-03	\$10.3 million
2003-04	\$6.5 million

## Ward/Parolee Population/Caseload Changes

### Current Year

For 2002-03, the May Revision estimate for the year-end institution population is 5,120, a decrease of 220 from the projection included in the Governor's Budget. This population decline, offset by a significant decline in the level of county reimbursements, will result in a General Fund increase of \$3.8 million. In addition, the Youth Authority projects a year-end parole population of 4,025, a decrease of 15 from the projection included in the Governor's Budget, which is offset by an increase in specialized caseloads, resulting in a General Fund increase of \$173,000.

The May Revision also reflects an additional \$3.5 million due to increased costs for worker's compensation.



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**Budget Year**

For 2003-04, the year-end institution population is projected to be 4,555, which is 540 fewer than anticipated in the Governor's Budget. The combined effect of declining population and a significant decrease in the level of county reimbursements will result in a General Fund increase of \$3.8 million. The Youth Authority projects a year-end parole population of 4,040, an increase of 210 from the level assumed in the Governor's Budget, resulting in a General Fund increase of \$468,000.

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**Budget Augmentations**

The May Revision proposes the following augmentations for the Department of the Youth Authority:

**Consolidate and Restructure the Youthful Offender Parole Board**—\$1.5 million to carry out the mandates of Chapter 4, Statutes of 2003, which consolidates the functions of the Youthful Offender Parole Board into the Department of the Youth Authority, effective January 1, 2004.

**Senior Youth Correctional Counselor/Sergeant Relief**—\$425,000 in 2002-03 and \$1.5 million in 2003-04 to provide regular day off relief coverage for Youth Correctional Counselors on open dorm living units are required by the Memorandum of Understanding between the State of California and the California Correctional Peace Officers' Association.

**Sick Leave Relief**—\$1.1 million in 2002-03 and 2003-04 to cover costs associated with the increased cost of sick leave coverage of posted positions.

**Physicians Call-Back Costs**—\$73,000 to cover physician call-back costs to enable seven-day a week on-call coverage for physicians.

**Northern California Youth Correctional Center Laundry Costs**—\$24,000 to cover the increased cost of providing laundry services at the closest Prison Industry Authority facility.

**Adjustment to Sliding Scale Reimbursements**—\$1.1 million to reflect additional General Fund costs due to lower reimbursements from the counties as a result of revised population projections.

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**Budget Reductions**

Due to a lower level of General Fund resources available for 2003-04, the May Revision proposes the following reduction for the Youth Authority:

**Consolidation Plan**—\$3 million reduction associated with the closure of the Karl Holton Youth Correctional Facility at the Department's Stockton complex



to accommodate the continuing decline in the Department's juvenile offender population.

### **Youthful Offender Parole Board**

2002-03	—
2003-04	–\$1.6 million

**Consolidate and Restructure the Youthful Offender Parole Board**—The May Revision proposes a reduction of \$1.6 million to reflect half-year funding for the Youthful Offender Parole Board (YOPB), associated with the implementation of legislation which eliminates the functions of the YOPB and instead consolidates the function of the Board within the Youth Authority, effective January 1, 2004.

### **Board of Corrections**

2002-03	—
2003-04	—

**Corrections Training Fund Transfer to the General Fund**—The May Revision reflects a \$558,000 reduction in the amount proposed for transfer to the General Fund from the Corrections Training Fund (CTF) due to lower revenue estimates for the CTF.

### **Board of Prison Terms**

2002-03	–\$0.5 million
2003-04	–\$3.5 million

**Hearing Workload Adjustment**—The May Revision proposes reductions of \$519,000 in 2002-03 and \$3.5 million in 2003-04 due to revised workload estimates associated with the projected number of parole considerations and parole revocation hearings.

### **Commission on Peace Officers' Standards and Training**

2002-03	—
2003-04	\$25.5 million



**Training Reimbursement Costs**—An augmentation of \$25.5 million Peace Officers’ Training Fund is proposed in the May Revision to restore funding to reimburse local law enforcement agencies for costs related to peace officer training.

**Department of California Highway Patrol**

2002-03	—
2003-04	—

**Fund Shifts**

The May Revision includes the following fund shifts:

**Motor Vehicle Account**—A fund shift of \$32.5 million from the Motor Vehicle Account to the Public Safety Surcharge Fund (PSSF) for CHP’s Homeland Security tactical alerts. This fund shift reflects the first year of a two-year proposal to shift all Homeland Security and non-transportation security activities of the CHP to the PSSF. This fund shift is intended to consolidate funding for security activities of the CHP into a singular fund source by 2004-05.



# HEALTH AND HUMAN SERVICES

## Preserving Critical Programs—Realignment

The Governor's Budget proposed to preserve critical programs by not reducing their funding levels, but instead either transferring responsibility for the programs to local governments or changing the State-local cost-sharing ratios, and dedicating a revenue stream to support the additional local financial obligations. The costs of the programs proposed to be realigned and the dedicated revenue stream totaled approximately \$8.3 billion. The programs proposed for realignment included Child Care, Mental Health, Alcohol and Substance Abuse, Public Health, Medi-Cal, Social Services, and Court Security programs. The revenue stream consisted of a 1 cent sales tax, 10 percent and 11 percent personal income tax brackets, and a \$1.10 excise tax on cigarettes and other tobacco products.

After discussions with representatives from the Legislature, the counties, and other parties, the Administration is narrowing the focus of its Realignment proposal for 2003-04. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January Realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05.

The costs of the programs proposed for realignment in 2003-04 and the dedicated revenue stream now total approximately \$1.8 billion. The revenue stream will consist of the following:

	2003-04	2004-05
◆ Additional 10.3 percent personal income tax bracket	\$1.5 billion	\$1.2 billion
◆ Increase excise tax on cigarettes and other tobacco products by 23 cents in 2003-04 and an additional 40 cents in 2004-05	0.3 billion	0.7 billion
	<b>\$1.8 billion</b>	<b>\$1.9 billion</b>

These realignment revenues are new revenues dedicated to the proposed Enhanced State-Local Realignment Fund and do not affect the General Fund. Therefore, these new revenues would not increase the Proposition 98 guarantee. Similarly, revenues dedicated to the 1991-92 Realignment also are not included in the Proposition 98 guarantee calculation. In addition, the Attorney General, in an April 29, 2003, legal opinion titled *Realignment Plan: Proposed New Revenues and Proposition 98*,



has concluded that “the Realignment Plan’s new revenue streams, if dedicated and restricted as proposed, would be excluded from General Fund revenues considered in calculating minimum funding levels under Proposition 98.”

See Figure HHS-1 for the programs proposed for Realignment.

FIGURE HHS-1

## State-Local Realignment

(\$ in Millions)

	Current County Share-of-Cost (Percent)	New County Share-of-Cost (Percent)	Realigned Costs
<b>Mental Health</b>			
Children's System of Care	0	100	\$20
Integrated Services for Homeless	0	100	55
<b>Children and Youth</b>			
Child Abuse Prevention, Intervention, and Treatment	0	100	12
Foster Care Grants	60	80	237
Foster Care Administration	30	50	11
Child Welfare Services	30	50	197
<b>Social Services</b>			
Adult Protective Services	MOE <sup>1/</sup>	100	61
CalWORKs Grants	2.5	30	782
CalWORKs Employment Services and Administration	MOE	30	359
			<b>\$1,734</b>

<sup>1/</sup>Maintenance-of-Effort (MOE) Requirements

Counties are currently administering these programs and thus should assume these program responsibilities. To the extent feasible, counties will be given additional discretion in the administration of these programs.

The Administration will continue to work collaboratively with the Legislature to resolve issues relating to revenue allocation, meeting State and federal requirements, allowing counties to shift funds among programs, and the scope of continuing State oversight of the realigned programs. The Administration will also work with the Legislature to draft the necessary trailer bill legislation to implement this Realignment proposal effective July 1, 2003.

Refer to individual departmental sections for discussion of modifications to the original Realignment proposal contained in the 2003-04 Governor’s Budget.





## Department of Health Services

### Medi-Cal

2002-03	\$288.2 million
2003-04	\$2.8 billion (Reflects deferral of realignment proposal)

### Current Year

The May Revision includes total Medi-Cal expenditures of \$29.8 billion (\$10.9 billion General Fund), an increase of \$621.2 million above the Governor's Budget. General Fund expenditures for Medi-Cal have increased by \$288.2 million, or 2.6 percent.

The number of persons projected to be eligible for Medi-Cal in 2002-03 is expected to decrease by 52,500 to 6,424,800 eligibles. This represents a decrease of about 0.8 percent below the level projected in the Governor's Budget. The revised caseload is 8.7 percent above 2001-02 caseload.

The net General Fund increase includes the following significant adjustments:

- ◆ \$164.9 million increase due to erosions of the mid-year spending reduction proposals.
- ◆ \$50.2 million increase in the cost of inpatient services.
- ◆ \$49.7 million increase due to unrealized savings for drug benefits and medical supplies.
- ◆ \$8.6 million increase for higher county administrative costs.
- ◆ \$6.3 million increase due to the *Craig v. Bontá* lawsuit, which requires that Medi-Cal benefits be continued until a redetermination can be done.
- ◆ \$16.3 million decrease for lower fiscal intermediary costs.
- ◆ \$24.8 million increase due to a variety of other increases and decreases affecting the Medi-Cal program.

### Budget Year

The May Revision includes total Medi-Cal expenditures of \$27.2 billion (\$9.8 billion General Fund), a net total funds decrease of \$500.0 million, including a \$2.8 billion General Fund increase, from the Governor's Budget.



The average monthly Medi-Cal caseload is expected to increase by 144,600 beneficiaries to 6,412,800 eligibles. This represents an increase of 2.3 percent above the Governor's Budget.

The budget year includes the following significant General Fund adjustments:

- ◆ \$3.0 billion increase to reflect deferral of realignment.
- ◆ \$930 million decrease to reflect an accounting change from accrual to cash.
- ◆ \$112.5 million increase to fund a rate increase of approximately 3 percent for Medi-Cal Managed Care Plans.
- ◆ \$66.2 million increase in the cost of inpatient services.
- ◆ \$60.8 million increase due to implementation of the *Craig v. Bontá* lawsuit.
- ◆ \$59.8 million in increased costs to provide a long-term care rate increase of approximately 3.8 percent.
- ◆ \$53.7 million increase to reflect restoration of the 1931(b) Medi-Cal Program.
- ◆ \$35.6 million increase for higher county administrative costs.
- ◆ \$341.4 million net increase due to a variety of other increases and decreases affecting the Medi-Cal program.

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## Maintaining Health Care Access

The May Revision also maintains the Administration's commitment to provide health care coverage to California's low-income children and adults.

- ◆ **Continuous Eligibility for Children**—Chapter 945, Statutes of 2000 (AB 2900, Gallegos), provides 12-month continuing Medi-Cal eligibility to children under 19 years of age. This expansion reduces the number of uninsured children in California and ensures continuity of medical care. The May Revision includes a total of \$486.6 million (\$243.3 million General Fund) to provide continuous Medi-Cal eligibility for an estimated 471,500 children. Since 2000-01, the Administration has provided a total of \$1.3 billion (\$638.9 million General Fund) to support this expansion.
- ◆ **1931(b) Medi-Cal Program**—The May Revision proposes to restore 1931(b) Medi-Cal program eligibility to 100 percent of the Federal Poverty Level. The income standard for this program would be reinstated to the level established in



March 2000. The May Revision provides \$107.4 million (\$53.7 million General Fund) in 2003-04 for this restoration.

- ◆ **Accelerated Enrollment: Single Point-of-Entry**—The Accelerated Enrollment Program, implemented July 1, 2002, enables the Department of Health Services to temporarily enroll children under the age of 19 into the Medi-Cal program. Approximately 3,078 children will receive Medi-Cal benefits through the Accelerated Enrollment program in 2003-04. As a result of the presumptive eligibility mechanism, expenditures are projected to reach \$8.3 million (\$4.1 million General Fund) for 2003-04.
- ◆ **Child Health and Disability Prevention Program Gateway to Medi-Cal**—The May Revision maintains funding of \$74.5 million (\$35.8 million General Fund) for the Child Health and Disability Prevention Gateway, which streamlines enrollment into Medi-Cal and the HFP.

In addition, the Administration continues to demonstrate its commitment to maximizing health care coverage for California's uninsured children by implementing two expansions that will greatly facilitate their enrollment into Medi-Cal. This streamlining of enrollment, referred to as Express Lane eligibility, will link Medi-Cal eligibility with that of other public programs that serve low-income individuals. The expansion programs are as follows:

- ◆ **Eligibility to Children Receiving Free School Lunches**—Chapter 894, Statutes of 2001 (AB 59), will facilitate enrollment into Medi-Cal for uninsured school children by linking Medi-Cal eligibility with free school lunch eligibility. It is estimated that this expansion will result in 3,905 additional children receiving Medi-Cal coverage in 2003-04. The May Revision provides \$3.5 million (\$1.7 million General Fund) to support this expansion.
- ◆ **Facilitating Medi-Cal Enrollment and Eligibility for Persons Receiving Food Stamps**—Chapter 897, Statutes of 2001 (SB 493), will facilitate the enrollment of low-income, uninsured families into the Medi-Cal program by linking Medi-Cal eligibility with the Food Stamp Program. It is expected that this linkage of food stamp eligibility with the Medi-Cal program will result in an additional 5,967



parents and children receiving Medi-Cal coverage in 2003-04. The May Revision provides \$7.7 million (\$3.9 million General Fund) to support this expansion.

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## General Fund Adjustments

General Fund revenue receipts have been below expectations since the release of the Governor's Budget. Additionally, expenditures required for enrollment, caseload, and population changes have increased. Furthermore, the mid-year reductions proposed in January have not been fully enacted. These three factors necessitate further adjustments to reduce or eliminate various programs included in the Governor's Budget. Accordingly, the Administration is proposing the following adjustments that will result in net General Fund savings in the Medi-Cal program:

- ◆ **Medi-Cal Accounting Change**—The May Revision includes one-time General Fund savings of \$930 million reflecting a change in the Department of Health Services' (DHS) accounting for the Medi-Cal program from an accrual basis to a cash basis.
- ◆ **Medi-Cal Anti-Fraud Initiative**—The May Revision significantly expands efforts by the Department of Health Services (DHS) to prevent, identify, and investigate fraud in the Medi-Cal program. Successful existing anti-fraud strategies would be expanded, including the Medi-Cal Beneficiary Identification Card replacement project. New strategies would also be implemented, including random claim sampling, data mining, and the creation of a one-year provisional status for all new providers. This proposal is anticipated to result in \$20.1 million (\$12.3 million General Fund) net savings in 2003-04 and \$188.9 million (\$95.3 million General Fund) net savings in 2004-05. Beginning in 2005-06, annualized savings are expected to be somewhat higher. To achieve these savings, the May Revision proposes to establish 315.0 new positions in the DHS at a cost of \$27 million (\$10.7 million General Fund).
- ◆ **Drug Expenditure Reduction through Therapeutic Category Reviews and the Resolution of Aged Rebate Disputes**—\$29.5 million (\$15.1 million General Fund) to reduce Medi-Cal drug expenditures through therapeutic category reviews and the processing of aged rebate disputes. Therapeutic category reviews ensure that only the most cost-effective drugs are included on the Medi-Cal formulary while maintaining appropriate beneficiary access. These savings assume that the entire backlog of aged rebate disputes will be resolved in 2003-04. Included in this proposal are increased costs of \$1.4 million (\$342,000 General Fund) for 14 positions to conduct the Therapeutic Category Reviews and resolve the aged rebate disputes.



- ◆ **Impose a Moratorium on Adult Day Health Care (ADHC) Centers and Amend Rates**—\$18.8 million (\$9.6 million General Fund) to impose a one-year moratorium on the certification of new ADHC centers, which will slow the rapid growth of this provider type. In addition, the ADHC reimbursement rate would be lowered to reflect the removal of therapies (speech, physical, and occupational) and transportation from the bundled daily rate. These services would then be billed separately when they are actually provided.
- ◆ **Impose a Cap on Medi-Cal Laboratory Services**—\$8.2 million (\$4.5 million General Fund) to place a per-beneficiary limit on selected laboratory services. Additional, medically necessary services could still be approved through prior authorization.
- ◆ **Change Reimbursement Methodology for Durable Medical Equipment**—\$3.1 million (\$1.6 million General Fund) to reduce the reimbursement for durable medical equipment by removing the current reimbursement methodology from regulatory control, which will allow the DHS to react quickly to changing market factors and ensure that Medi-Cal pays a cost-effective rate.
- ◆ **Change Reimbursement Methodology for Anti-Hemophiliac Blood Factors**—\$2.5 million (\$1.2 million General Fund) to change the reimbursement methodology for anti-hemophiliac blood factors, which will allow for electronic claims processing and enhanced rebate collection.
- ◆ **Pharmacy Cost Savings through Provider Education**—\$1.4 million (\$756,000 General Fund) to reduce pharmacy expenditures through provider education, which will ensure that the most cost-effective prescribing habits are utilized.
- ◆ **Convert Contract Nurse Positions to State Positions**—\$694,000 (\$164,000 General Fund) to convert contract nurse positions to State civil service positions. These contract positions were included in the 2002 Budget Act to review treatment authorization requests and expand medical case management activities. Because of the higher cost of contract positions, this conversion results in a net savings.
- ◆ **Include HIV/AIDS Drugs in Medi-Cal Managed Care Capitation Rates**—\$218,000 (\$109,000 General Fund) as a result of including and capitating HIV/AIDS drugs within the Medi-Cal Managed Care program.
- ◆ **Encourage Enrollment of Aged, Blind, and Disabled into Medi-Cal Managed Care**—\$1.3 million (\$630,000 General Fund) increase in 2003-04 for informational material to encourage voluntary enrollment of aged, blind, and



disabled individuals into Medi-Cal Managed Care. This proposal is expected to result in savings of \$4.8 million (\$2.4 million General Fund) in 2004-05.

- ◆ **Implement a Disease Management Program in Medi-Cal**—\$756,000 (\$279,000 General Fund) increase in 2003-04 to implement a Disease Management Program for Medi-Cal beneficiaries. This program is expected to achieve savings in future years by reducing health care costs for patients with chronic conditions and result in improved health outcomes.
- ◆ **Personal Injury Recovery Program**—\$358,000 (\$90,000 General Fund) increase in 2003-04 to expand personal injury cost recovery activities, which ensure that Medi-Cal funds are recovered when a third-party is liable for the costs. This proposal is expected to result in annual General Fund savings of \$1.4 million beginning in 2005-06.
- ◆ **Medi-Cal Managed Care Administrative Costs**—Redirection of three positions in 2003-04 to conduct initial health plan financial reviews and rate calculations for managed care contractors. This proposal is estimated to result in savings of \$39 million (\$19.5 million General Fund) in 2004-05.

## Public Health

2002-03	\$10.9 million
2003-04	\$114.4 million

## Caseload Programs

### Current Year

The May Revision includes an increase of \$10.9 million General Fund, or 7.6 percent, above the \$143.9 million provided in the Governor's Budget, due to an increase in caseload and health care costs in the California Children's Services (CCS), Child Health and Disability Prevention, and Genetically Handicapped Persons programs.

### Budget Year

The May Revision includes an increase of \$59.9 million General Fund, or 58.8 percent, above the \$84.7 million provided in the Governor's Budget, due to an increase in caseload and health care costs in the CCS and the Genetically Handicapped Persons programs.



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## Realignment

Public health programs, originally a part of realignment, are proposed to be reinstated in the budget and are no longer being considered by the Administration for realignment in 2003-04. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05. Therefore, the May Revision proposes to restore \$146.7 million (\$68.5 million General Fund) and 49.3 positions (46.9 personnel years) to the following programs:

- ◆ Adolescent Family Life
- ◆ Black Infant Health Program
- ◆ Local Maternal and Child Health
- ◆ Expanded Access to Primary Care
- ◆ Clinic Grants-In-Aid
- ◆ Indian Health Program
- ◆ Rural Health Services Development Program
- ◆ Seasonal Agricultural and Migratory Workers
- ◆ Managed Care Counties
- ◆ California Health Care for Indigents
- ◆ Rural Health Services
- ◆ Public Health Subvention

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## AIDS Drug Assistance Program (ADAP)

The May Revision increases the ADAP in 2003-04 by \$8.2 million total funding due to additional reimbursements and federal funds, and adjustments to the co-payment proposal included in the Governor's Budget. To align ADAP co-payments with private insurance rates, the May Revision proposes to reduce co-payments from \$30, \$45, and \$50 per prescription to \$5, \$10, and \$15 respectively based on a sliding income scale tied to federal poverty levels. Total funding for the ADAP is \$195 million, an increase of \$75.2 million, or 62.8 percent since the 1999-00 Governor's Budget.

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## Cigarette and Tobacco Products Surtax Fund—Proposition 99

Proposition 99 resources in the budget year are projected to be higher than estimated in the Governor's Budget, primarily due to a one-time augmentation





(\$10.4 million) under Proposition 99 in 2002-03 that has not been expended and will be carried over into the budget year. This augmentation, combined with other adjustments, provided nearly \$15.1 million in available resources. These increases result in additional resources in the Health Education Account (\$8.4 million), Research Account (\$4.4 million), and Unallocated Account (\$2.3 million).

To reflect these increases, the May Revision proposes to restore, at least partially, programs that were previously reduced due to the decline of Proposition 99 revenues: Competitive Grants (\$1.5 million), Local Lead Agencies (\$4.5 million), Media (\$2.4 million), and the California Healthcare for Indigents Program (\$2.3 million). In addition, the University of California will receive an additional \$4.4 million to conduct tobacco-related research.

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### **Tobacco Settlement Securitization**

The Governor's Budget proposed to securitize \$4.5 billion in bonds backed with tobacco settlement revenues. The May Revision reflects that only \$2.5 billion in tobacco-securitized bonds were sold in 2002-03. Due to market conditions and a large number of states securitizing their own tobacco settlement moneys, the Administration determined that California should not seek to sell additional securitized bonds, but rather should budget annual tobacco settlement moneys. For 2003-04, \$173 million in tobacco settlement payments are projected. The May Revision proposes to use this funding to offset General Fund expenditures in the Managed Risk Medical Insurance Board's Healthy Families Program.

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### **Public Health Preparedness and Response**

California is faced with an onslaught of new pathogens and diseases, as well as the ongoing threat of a bioterrorist attack. Severe Acute Respiratory Syndrome (SARS), West Nile Virus, and Hepatitis C are but a few of the public health crises that have made front-page news recently. Responding to each of these new threats as a separate problem, requiring new resources and a support infrastructure, is inefficient and expensive. To counter these threats and to form a core preparedness and response team for unknown pathogens and sudden disease outbreaks or events, the Administration, with the assistance of the federal government, is developing a long-term comprehensive strategy. The May Revision includes \$90.3 million (\$3.9 million General Fund) in new funding and 96.0 positions (91.1 personnel years) to combat these threats. The proposed Public Health Response Team will immediately address the following priorities:

- ◆ The Emergence of SARS (\$950,000 General Fund)
- ◆ West Nile Virus Early Detection (\$923,000 General Fund)
- ◆ Hepatitis C Prevention (\$2 million General Fund)





- ◆ Anti-Bioterrorism (\$82.8 million federal funds)
- ◆ Botulism Immune Globulin Production (\$3.6 million federal funds)

While initially working on two specific disease threats, the SARS and West Nile Virus, program staff will form the core of a preparedness and response team to deal with future unknown pathogens and sudden disease outbreaks or events. The team's primary responsibilities include detection and monitoring trends of unusual or new infectious disease, and development of initial response plans in consultation with local public and environmental health departments, vector and animal control agencies, physicians, health care providers, and veterinarians. The long-term goal of the initiative is to develop a comprehensive prevention and control program designed to combat new pathogens and diseases that uses all available public health assets, local and State, in an effective and efficient manner.

## General Fund Reductions

General Fund revenue receipts have been below expectations since the release of the January Governor's Budget. Additionally, expenditures required for enrollment, caseload, and population changes have increased. Furthermore, the mid-year reductions proposed in January have not been fully enacted. These three factors necessitate further adjustments to reduce or eliminate various programs included in the January Governor's Budget. Accordingly, the Administration is proposing reductions as follows:

- ◆ **Expanded Access to Primary Care**—\$2,350,000 to reflect a reduction to the program in lieu of realignment.
- ◆ **Adolescent Family Life Program**—\$1,621,000 to reflect a reduction to the program in lieu of realignment.

## Managed Risk Medical Insurance Board

2002-03	–\$2.7 million
2003-04	–\$182.1 million

### Current Year

The May Revision includes an overall expenditure decrease of \$5.5 million (\$2.9 million General Fund). This expenditure decrease is due primarily to lower than anticipated caseload growth in State-only funded children. The Healthy Families Program (HFP) is expected to serve a total of 668,000 children by June 30, 2003, which is consistent with the caseload anticipated in the Governor's Budget.



### Budget Year

The May Revision projects overall expenditures to decrease by \$15.2 million (\$182.7 million General Fund) below the level anticipated in the Governor's Budget. The securitization of the remaining Tobacco Settlement Fund revenues has been deferred, which results in an increase of \$173.4 million Tobacco Settlement Fund revenues and a corresponding decrease of \$173.4 million General Fund. Also, there is a lower rate of caseload growth in the program. The HFP is expected to serve a total of 727,000 children by June 30, 2004, which is 42,000 children less than the caseload projected in the Governor's Budget.

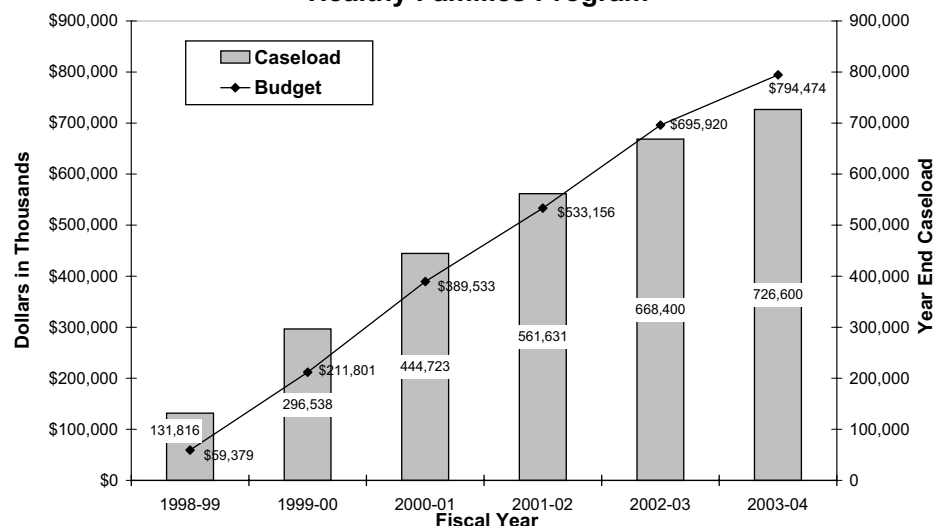
Since the beginning of this Administration, children's caseload within the HFP has grown from 50,000 to an expected 727,000 children by the end of June 30, 2004, for an increase of 677,000 children, or 1,354 percent. Additionally, expenditures for the program have grown from a total of \$59.4 million (\$15.6 million General Fund) in fiscal year 1998-99 to an expected \$794.5 million (\$294.3 million State Funds) in fiscal year 2003-04, or 1,786 percent.

### Healthy Families Program

Providing health care coverage to uninsured children remains a high priority for this Administration. A total of 668,000 children are expected to be enrolled in the Healthy Families Program (HFP) by the end of June 2003. It is expected that by June 30, 2004, a total of 727,000 children will be provided low-cost, comprehensive health care coverage through the HFP. See Figure HHS-2.

FIGURE HHS-2

#### Managed Risk Medical Insurance Board Healthy Families Program



The May Revision continues funding to facilitate the enrollment and eligibility of uninsured children into the HFP, as follows:

- ◆ \$3.7 million (\$1.3 million State Funds) to fund two-months of HFP eligibility to ensure coverage during the transition to Medi-Cal.
- ◆ \$3.1 million (\$1.3 million State Funds) for additional caseload resulting from implementation of the Child Health and Disability Prevention Gateway Program.

## Access For Infants And Mothers Program

### Current Year

Average monthly enrollment in the Access for Infants and Mothers program is expected to reach 10,606 women and infants, compared to 10,213 as originally estimated in January. This represents a 3.8 percent increase. Current year General Fund expenditures are expected to increase by \$182,000, due to higher than anticipated enrollment of children in the program. However, net expenditures are expected to decrease by \$243,000, due to lower than anticipated enrollment of mothers in the program.

### Budget Year

Average monthly enrollment is expected to reach 13,119 women and infants, compared to 12,314 as originally estimated in January. This represents an increase of 6.5 percent. Budget year expenditures will be increased by \$1,516,000 (\$647,000 General Fund) due to greater than anticipated enrollment of infants in the program and an increase in the average monthly capitation rates.

The budget for this program has increased from \$41.7 million (\$37.5 million Perinatal Insurance Fund) in 1998-99 to \$119 million (\$97 million Perinatal Insurance Fund) in 2003-04 for a total increase of \$77.3 million, or 185 percent. Since 1998-99, average monthly enrollment has grown from 6,549 women and infants to an expected 13,119 women and infants in 2003-04, or an increase of 100 percent.

## Department of Developmental Services

2002-03	\$89.3 million
2003-04	\$219.1 million



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## Developmental Centers

### Current Year

The May Revision includes a net reduction of \$7.4 million General Fund as the result of the following:

- ◆ **Developmental Center Caseload**—A \$2.4 million General Fund decrease resulting from a decrease of 78 consumers in the estimated caseload.
- ◆ **Bay Area Project**—\$5 million General Fund one-time savings which will be reappropriated for the Bay Area Project in 2003-04 to facilitate the transition of consumers from Agnews Developmental Center to new settings.

### Budget Year

The May Revision includes an increase of \$25.3 million (\$10.7 million General Fund) primarily as the result of the following:

- ◆ **Intermediate Care Facility for the Developmentally Disabled (ICF-DD) Quality Assurance Fee**—A \$29.7 million (\$17.4 million General Fund) increase reflecting the impact of the ICF-DD Quality Assurance Fee proposal.
- ◆ **Elimination of Optional Medi-Cal benefits**—\$7.2 million General Fund increase and an equivalent decrease in reimbursements reflecting the impact of the proposal to eliminate Medi-Cal optional benefits.
- ◆ **Medi-Cal Base Funding Adjustment**—A \$10.4 million General Fund reduction and an equivalent increase in reimbursements as a result of the annual adjustment of the Medi-Cal base funding.
- ◆ **Developmental Center Caseload**—\$5.7 million (\$3.7 million General Fund) decrease resulting from a decrease of 70 consumers in the estimated caseload.
- ◆ ***In Re Hop* hearings**—A \$323,000 increase to fund 5.0 limited-term positions related to workload required under the *In Re Hop* decision.
- ◆ **Life Services Alternative Project**—A \$1 million increase in Reimbursements from Regional Centers (RC) to provide up to six months of temporary help in order to train community providers in the specific needs of consumers transitioned from Agnews Developmental Center.



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## Regional Centers

### Current Year

The May Revision includes a net increase of \$45.4 million (\$98.3 million General Fund) primarily as a result of the following:

- ◆ **RC Caseload**—A decrease of \$1.6 million General Fund for an estimated decrease of 1,440 consumers.
- ◆ **Increased Purchase of Services** —A \$46.5 million General Fund increase based on increased utilization and an inability to effectuate the \$52 million unallocated General Fund reduction authorized by the Legislature for 2002-03.
- ◆ **Enhancing Federal Financial Participation II**—A decrease of \$11.3 million in federal funds, and corresponding increase in General Fund, due to an inability to retroactively bill for Targeted Case Management at a recalculated rate.
- ◆ **Decrease in Reimbursements**—A \$42 million decrease in reimbursements, and corresponding increase in General Fund, due to South Central Los Angeles Regional Center's inability to qualify for federal funds, and a decrease in the amount of additional Title XX that can be transferred from the Department of Social Services (DSS).

### Budget Year

The RC population is not projected to increase above the 193,100 clients estimated in the Governor's Budget. Although reduced, the Budget continues to assume savings will be achieved through the implementation of various cost saving measures as previously proposed. The Administration looks forward to working with the Legislature to accomplish savings in this area. The May Revision includes a net increase of \$74.5 million (\$204.1 million General Fund) primarily as the result of the following significant changes:

- ◆ **Increased Operations**—The May Revision proposes a net \$2.1 million increase in Regional Center Operations. Projected changes in the severity of the caseload, an augmentation for Community Placement Plan activities, and a technical correction to the estimated number of monthly intakes results in an increase of \$13 million. This increase is offset by a \$10.9 million reduction to be achieved through the restructuring of caseload ratios in a manner similar to that proposed by providers.
- ◆ **Increased Purchase of Services**—A net \$187.1 million General Fund increase primarily due to:



- ◇ \$30.7 million for the delayed implementation of Statewide Standards (The Administration will work collaboratively with the Legislature to achieve savings in the Regional Center System).
- ◇ \$47.9 million for increased base costs as adjusted for actual expenditures.
- ◇ \$47.7 million for the proposed elimination of optional Medi-Cal benefits.
- ◇ \$28.9 million for increased utilization of services.
- ◇ \$27.1 million for Increased Community Placement Plan costs.
- ◇ \$4.8 million primarily for increases in provider costs and new facility rates that are temporarily ineligible for federal financial participation until licensure is received.
- ◆ **Decreased Federal Reimbursements**—A \$107.7 million decrease in federal reimbursements and a commensurate General Fund increase due to the non-certification of South Central Los Angeles Regional Center, decrease in Targeted Case Management as a result of the proposed operations staffing reduction, and a decrease in the amount of additional Title XX that can be transferred from the DSS.
- ◆ **Habilitation Services Program (HSP) Transfer**—The Legislature passed and the Governor signed Chapter 7, Statutes of 2003, First Extraordinary Session (SB 24X), which transfers the HSP from the Department of Rehabilitation (DOR) to the Department of Developmental Services effective July 1, 2004. All of the resources requested in the Mid-Year Revision to transfer the program July 1, 2003, are reversed, including the \$114.7 million General Fund transferred from the DOR for local programs.
- ◆ **Parental Co-Payments**—The May Revision also assumes a decrease in the projected revenues for the proposed Parental Co-Payment. A \$14.7 million decrease in the General Fund revenues estimated in the Governor's Budget is assumed due to delayed implementation of the Co-Payment proposal.



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## Department of Rehabilitation

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2002-03	–\$6.4 million
2003-04	\$105.8 million

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### Current Year

The May Revision reflects a net General Fund savings of \$6.4 million. Significant adjustments include: (1) savings of \$839,000 in the Vocational Rehabilitation Program (VRP) resulting from an estimated decrease in caseload, (2) savings of \$7.1 million in the Habilitation Services Program (HSP) attributable to a projected decline in caseload, and (3) costs of \$1.5 million in the Work Activity Program and Supported Employment Program resulting from the erosion of savings from the proposed 5 percent provider rate reduction.

### Budget Year

The May Revision reflects a net General Fund increase of \$105.8 million in 2003-04, comprised of the following:

**Caseload Projections**—Revised projections for both the VRP and HSP reflect an increase in caseload. However, the VRP caseload reduction is offset by a higher cost to serve clients resulting in costs of \$556,000 General Fund. Additionally, savings in the HSP are greater because of an increase in the Home and Community-Based Waiver reimbursements for total General Fund savings of \$12.3 million. Further, \$594,000 of the projected General Fund savings from the proposed rate reduction will not materialize.

**Technical Adjustments to Implement HSP Transfer**—The 2003-04 Governor's Budget proposed to transfer the HSP to the Department of Developmental Services (DDS) effective July 1, 2003. The transfer would achieve administrative efficiencies and an estimated net reduction of 11 positions and net General Fund savings of \$1.5 million. Chapter 7, Statutes of 2003, First Extraordinary Session, delayed the HSP transfer by one year, making it effective July 1, 2004, but neither restored the positions or funding necessary to administer this program in the budget year, nor adjusted the departments' budgets accordingly. The May Revision proposes the restoration of the HSP funding within the DOR by: (1) adding 29.3 positions and \$2.2 million General Fund for support, and (2) \$114.7 million General Fund for local assistance. Conforming actions are being made in the DDS budget.



## Department of Mental Health

2002-03	–\$7.1 million
2003-04	–\$7.9 million

### Long-Term Care/State Hospitals

#### Current Year

The May Revision includes \$7.1 million in General Fund reductions in long-term care, primarily as the result of a new methodology for estimating state hospital population. The revised state hospital population estimate is based on additional data on the number of patients in the first nine months of 2002-03 that were not available in the fall. The General Fund reductions are comprised of the following:

- ◆ **State Hospital Population**—The May Revision projects a state hospital caseload reduction of 127 judicially-committed/Penal Code patients from the level in the Governor's Budget, resulting in a current year savings of \$8.2 million General Fund. Caseload is expected to decline from 4,552 patients to 4,425 patients. This decline in caseload will result in the elimination of 82.7 positions (78.6 personnel years).
- ◆ **Sexually Violent Predator (SVP) Evaluations**—A General Fund increase of \$1.1 million is proposed to fund additional evaluations of SVPs to be performed by private contractors.

#### Budget Year

Funding for long-term care and state hospitals is anticipated to decrease by \$9.5 million General Fund. This revised estimate is based on an additional nine months of data with which to estimate the number of patients and a new methodology to estimate operating expenses and equipment. Significant adjustments are as follows:

- ◆ **State Hospital Population**—A reduction of 213 positions (202.4 personnel years) and a savings of \$17.1 million (\$11.5 million General Fund savings) reflects a net reduction of 93 judicially-committed/Penal Code patients and 90 county-funded patients below the Governor's Budget. The budget year census is projected to decrease from 4,640 patients to 4,457 patients.
- ◆ **Delay Activation of Coalinga State Hospital**—A reduction of 33.3 positions (31.6 personnel years) and a savings of \$2 million General Fund reflects a four-month delay and a revised estimate of January 2005 for facility activation.





- ◆ **SVP Evaluations**—A General Fund increase of \$2 million is proposed to fund additional evaluations of SVPs. This increase will fund additional evaluations to be performed by private contractors, as well as additional costs for evaluator testimony.

The Administration will also request two pieces of trailer bill language to insure public safety and clarify the State's fiscal obligation to provide community treatment programs for SVP patients. First, proposed language will enhance the sentence for conviction of a felony committed by SVP patients while under supervision and treatment in a conditional release program. Second language proposed will restrict placement in a conditional release program to those SVP patients who do not require extraordinary measures of supervision and treatment to prevent further sexually violent behavior.

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## Community Mental Health Services

### Current Year

The May Revision includes no General Fund adjustments in 2002-03 for community mental health services. However, a technical change is proposed to the General Fund budgeted within the Department of Health Services for mental health services.

- ◆ **Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) Estimate Validation**—The May Revision includes a reduction of \$4.6 million (\$2.3 million General Fund savings within the Department of Health Services [DHS] budget) to reflect a technical correction in expenditures based on statistical validation of the estimating methodology. There is no reduction in services as a result of this change.

### Budget Year

- ◆ **Realignment**—The Governor's Budget proposed to preserve critical programs by transferring responsibility to counties and dedicating a revenue stream to support the additional local financial obligations. The revised Realignment proposal for the budget year continues to include the Children's System of Care (\$20 million) and Integrated Services for Homeless (\$55 million) programs because counties currently administer these programs and can easily assume program responsibilities. The Administration will continue to work collaboratively with the Legislature to resolve issues relating to revenue allocation, allowing counties to shift funds among programs, and the nature of continuing State oversight of the realigned programs.



The May Revision includes a \$1.6 million General Fund increase in 2003-04 for community mental health services compared to the January Governor's Budget, comprised primarily of the following significant adjustments:

- ◆ **EPSDT Accrual to Cash Accounting**—Funding for the EPSDT program is proposed to decrease by \$208.2 million (\$115.7 million General Fund within the DHS budget) to reflect the change from an accrual to cash accounting methodology for Medi-Cal services. There is no reduction in services as a result of this change.
- ◆ **EPSDT Estimate Validation**—The May Revision includes a reduction of \$11.6 million (\$5.5 million General Fund savings within the DHS budget) to reflect a technical correction in expenditures based on statistical validation of the estimating methodology. There is no reduction in services as a result of this change.
- ◆ **Managed Care Adjustment**—Funding for Mental Health Managed Care is proposed to increase by a net \$9.8 million (\$4.9 million General Fund) to reflect forgone savings from the proposed 10 percent across-the-board reduction in 2003-04 and a reduction in Medi-Cal beneficiaries. Department operations will also decrease by \$5 million (\$1.3 million General Fund) as a result of a revision to the federal regulations delaying the implementation of External Quality Reviews.
- ◆ **Community Services Activities**—General Fund savings of \$2 million is proposed to reflect the elimination of various community services activities, including funding for Sacramento County, rehabilitation services, and grants to community organizations.

## Department of Alcohol and Drug Programs

2002-03	\$4.8 million
2003-04	\$227.5 million

### Current Year

General Fund costs for the Department of Alcohol and Drug Programs (DADP) will increase by \$4.8 million, reflecting an increase of 1,009 in estimated Drug Medi-Cal caseload and higher rates paid for services.



- ◆ **Regular Drug Medi-Cal**—Caseload is expected to be 1.7 percent higher than projected in the Governor's Budget. Costs will increase by \$4.6 million General Fund, or 9.5 percent, above the Governor's Budget.
- ◆ **Perinatal Drug Medi-Cal**—Caseload is estimated to decrease by 15.8 percent, or 1,225 clients from the Governor's Budget. Costs, however, are expected to increase by \$178,000 General Fund, or 8.23 percent.

### Budget Year

General Fund costs are estimated to increase by \$239 million for the following reasons:

- ◆ **Defer Realignment**—The alcohol and drug programs, originally a part of realignment, are proposed to be reinstated in the budget and are no longer being considered for realignment in 2003-04. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05. Thus, funding was restored (\$230.3 million General Fund) for local alcohol and drug programs, drug court programs, and State operations to reflect the deferral of the original realignment proposal.
- ◆ **Regular Drug Medi-Cal**—The estimated caseload for Regular Drug Medi-Cal will increase by 8,128 clients, or 6.4 percent, above the Governor's Budget. Costs are expected to increase by \$5.6 million General Fund. The increase in expenditures reflects a technical correction in estimate methodology, which undercounted the General Fund cost of the minor consent program. Additionally, overall costs are also expected to increase due to higher average costs.
- ◆ **Perinatal Drug Medi-Cal**—Caseload is projected to increase 13.4 percent, or approximately 845 clients, above the Governor's Budget. Costs are expected to increase by \$111,000 General Fund, for updated population and an increase in the average cost of services.
- ◆ **Annualized Funding for Drug Court Partnership Program**—One-time savings in the Drug Court Partnership Program were captured for 2002-03, and restoration of the annual funding level was made contingent upon the courts demonstrating savings through avoidance of prison days. Outcome data for the restructured Drug Court Partnership Program revealed almost 80,000 prison days avoided, resulting in estimated General Fund savings of \$10.8 million. A \$3 million General Fund augmentation is requested to restore the annualized funding and maintain the prison savings.



## General Fund Reductions

Due to the State's fiscal outlook, the May Revision proposes to reduce discretionary alcohol and other drug services, excluding perinatal programs, by \$11.5 million General Fund, and fund the Department at the Substance Abuse Prevention and Treatment Block Grant Maintenance-of-Effort requirement.

## Department of Social Services

2002-03	\$40.9 million
2003-04	\$2.5 billion (Reflects deferral of realignment proposal)

## CalWORKs

The 2002-03 average monthly CalWORKs caseload of 482,000 represents a 3.9 percent decrease from 2001-02. For 2003-04, the caseload is expected to be 471,000, 46,000 below the Governor's Budget projection and a 2.2 percent decrease from the 2002-03 projection.

The May Revision continues to meet the federally-required combined State and county Temporary Assistance for Needy Families (TANF) maintenance-of-effort (MOE). For 2002-03 and 2003-04, the MOE will be met at \$2.7 billion. For 2002-03, total CalWORKs-related expenditures are estimated to be \$7.2 billion including the transfer to the Department of Education (SDE) for child care and county expenditures. For 2003-04, total CalWORKs related expenditures are anticipated to be \$7.0 billion.

Major General Fund and TANF Block Grant changes proposed for 2002-03 include:

- ◆ **Assistance Payments**—A \$307.3 million decrease due to lower than projected caseload, based on more current data reflecting that caseload has continued to decline, rather than flatten as originally projected. This is partially offset by a loss of time-limit savings attributable to fewer cases than previously estimated reaching the 60-month CalWORKs time limit.
- ◆ **Employment Services**—An \$83.3 million increase due to fewer cases than previously estimated reaching the 60-month CalWORKs time limit and an increase in county performance incentive funds carried over from prior years.
- ◆ **Child Care**—A \$73.3 million increase for CalWORKs child care due to a higher cost per child, fewer cases reaching the 60-month CalWORKs time limit, and a lower estimate of savings attributable to the discontinuance of retroactive child



care payments. Funding has already been transferred to Stage One from the Child Care Reserve to address the majority of this increase.

Major changes proposed for 2003-04 include:

- ◆ **Assistance Payments**—A \$940.1 million decrease as a result of assessing counties a 30 percent share of CalWORKs grant costs, as discussed in the Realignment section below, and a projected decrease in caseload, partially offset by a \$229.3 million increase to reflect the restoration of the grant reduction proposed in the Governor's Budget.
- ◆ **Employment Services**—An \$84.6 million decrease in the one-time augmentation to CalWORKs employment services proposed in the Governor's Budget, to make funds available to reverse the proposal to reduce CalWORKs grants, effective July 1, 2003.
- ◆ **Total TANF Block Grant Reserve**—A \$74.3 million increase in the Total TANF Block Grant reserve for contingencies, making the total reserve \$331.6 million. This funding will be available for unanticipated needs in any program for which TANF funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care, as well as litigation and changes in federal laws and regulations. The funding to increase this reserve has been redirected from decreases in expenditures due to the lower caseload estimate.

## CalWORKs Child Care

The May Revision reflects a decrease of \$27.4 million for CalWORKs Stage One child care administered by the Department of Social Services (DSS) in 2003-04. This decrease is due primarily to child care reforms, including a reduction in reimbursement rate ceilings for licensed providers, elimination of services for certain grandfathered families, and implementation of a modified fee schedule.

In addition, the May Revision reflects an increase of \$195.3 million for CalWORKs child care administered by the SDE. Of this amount, \$38.3 million is an increase in Stage 2 child care due to fewer child care cases than previously estimated reaching the 60-month CalWORKs time limit, and \$157 million to enable a like amount of Child Care and Development Block Grant funding to be used to augment Stage 3 child care.



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## **Supplemental Security Income/State Supplementary Payment (SSI/SSP) Program**

Total General Fund expenditures for the SSI/SSP program are \$3 billion in both 2002-03 and 2003-04, which represents increases of \$8.7 million in the current year and \$674.6 million in the budget year, compared to the Governor's Budget. Caseload for the SSI/SSP program is projected at 1,128,000 recipients in 2002-03, and 1,151,000 recipients in 2003-04. Significant General Fund adjustments include:

- ◆ An increase of \$441.6 million General Fund in 2003-04 to restore the grant reduction proposed in the Governor's Budget, while maintaining the proposal to suspend the State-only COLA.
- ◆ Increases of \$8.7 million General Fund in 2002-03 and \$12.2 million General Fund in 2003-04, due to higher than anticipated caseload growth and a higher average grant in the SSI/SSP program. The year-to-year caseload growth is projected at approximately 2 percent.

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## **In-Home Supportive Services (IHSS)**

General Fund expenditures for the IHSS program are above the levels reflected in the Governor's Budget by \$15.8 million in the current year and \$1.2 billion in the budget year. Caseload is projected to be 302,000 recipients in 2002-03 and 329,000 in 2003-04. Of the total increase, \$1.2 billion is to restore State funding for IHSS previously proposed for realignment in the 2003-04 Governor's Budget. Other significant General Fund adjustments include:

- ◆ Increases of \$29 million General Fund in the current year and \$46.7 million General Fund in the budget year due to the higher caseload estimate, higher wages for IHSS providers, and increased average number of service hours in Los Angeles County.
- ◆ A decrease of \$13.2 million in 2002-03 and \$19 million in 2003-04 due to the availability of increased federal Title XX funding to offset General Fund costs for eligible recipients.

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## **Foster Care**

General Fund expenditures will increase by \$64.5 million in the current year, due primarily to a \$53.6 million reduction in Title IV-E funds for relative Foster Care providers that were not approved in accordance with federal requirements. The remaining General Fund increase is due to net increases in caseload and average grant payments.



For the budget year, the May Revision reflects an increase of \$259.5 million, due primarily to the restoration of \$246.1 million in State funding as a result of the revised cost-sharing ratios for Foster Care included in the Administration's modified Realignment proposal for 2003-04. Included in the budget year increase is \$13.4 million due to an increase in grant costs for Group Homes, a decrease in federally eligible children in Foster Family Homes, and caseload growth.

## Realignment

State General Funds for a number of social services programs originally included in the Realignment proposal, are proposed to be reinstated or partially reinstated in the budget. Realignment remains a crucial component of structural reform. However, to provide more time for legislative consideration, the majority of the Administration's January Realignment proposal is being deferred to the remainder of this legislative session for implementation in 2004-05.

- ◆ **CalWORKs Assistance Payments**—A decrease of \$782.3 million reflects the inclusion of CalWORKs Assistance Payments in the Administration's modified Realignment proposal for 2003-04. This proposal increases the county share-of-cost for CalWORKs Assistance Payments from 2.5 percent to 30 percent.
- ◆ **CalWORKs Administration and Employment Services**—An increase of \$194.4 million is included to partially restore State funding for CalWORKs Administration and Employment Services proposed for realignment in the 2003-04 Governor's Budget. The modified Realignment proposal assumes a 30 percent county share-of-cost, while the Governor's Budget assumed a 50 percent county share.
- ◆ **Child Welfare Services (CWS)**—An increase of \$398.9 million is included to partially restore State funding for CWS proposed for realignment in the 2003-04 Governor's Budget. The modified Realignment proposal assumes a 50 percent county share-of-cost, while the Governor's Budget assumed a 100 percent county share.
- ◆ **Child Abuse Prevention, Intervention, and Treatment (CAPIT) Program**—An increase of \$1 million is included to partially restore State funding for the CAPIT program, which was proposed for realignment in the 2003-04 Governor's Budget. This amount reflects the statutorily-required appropriation to the State Children's Trust Fund to support innovative services contracts to develop child-centered approaches geared toward the prevention of child abuse and neglect.
- ◆ **Foster Care Grants**—An increase of \$222.8 million is included to partially restore State funding for Foster Care Grants proposed for realignment in the





2003-04 Governor's Budget. The modified Realignment proposal assumes an 80 percent county share-of-cost, while the Governor's Budget assumed a 100 percent county share.

- ◆ **Foster Care Administration**—An increase of \$23.2 million is included to partially restore State funding for Foster Care Administration proposed for realignment in the 2003-04 Governor's Budget. The modified Realignment proposal assumes a 50 percent county share-of-cost, while the Governor's Budget assumed a 100 percent county share.

The May Revision proposes to fully restore funding for the following programs originally proposed for realignment in the Governor's Budget.

- ◆ **Adoption Assistance Program**—An increase of \$217 million to restore State funding for the Adoption Assistance Program.
- ◆ **Kinship Guardianship Assistance Program (Kin-GAP)**—An increase of \$18.6 million to restore State funding for Kin-GAP.
- ◆ **California Food Assistance Program (CFAP)**—An increase of \$11.2 million to restore State funding for the CFAP.
- ◆ **Cash Assistance Program for Immigrants (CAPI)**—An increase of \$95.3 million to restore State funding for the CAPI.
- ◆ **IHSS**—An increase of \$1.2 billion to restore State funding for IHSS, including \$1.1 billion for IHSS and \$84.9 million for administration.
- ◆ **Food Stamp Administration**—An increase of \$268.1 million to restore State funding for Food Stamp Administration.

## General Fund Reductions

Expenditures required for enrollment, caseload, and population changes have increased. Furthermore, the mid-year reductions proposed in January have not been fully enacted. These factors necessitate further adjustments to reduce or eliminate various programs included in the January Governor's Budget. Accordingly, the Administration is proposing reductions as follows:

- ◆ **Count Additional Child Care Expenditures Toward the TANF MOE**—\$57 million General Fund resulting from counting a like amount of general subsidized child care expenditures toward the federally-required MOE. This results in a \$57 million increase in TANF expenditures in order to maintain CalWORKs program funding.





- ◆ **Offset CWS Costs with TANF Funds**—\$27 million General Fund in 2002-03 and \$26 million General Fund in 2003-04 resulting from offsetting costs in the CWS program achieved by transferring a like amount of TANF to the federal Title XX Block Grant.
- ◆ **Financing Adjustment for CWS/Case Management System (CMS)**  
**Computer Hardware**—A decrease of \$7 million to reflect the financing of a \$10.6 million hardware expenditure included in the Governor's Budget for the CWS/CMS. Under this proposal, the hardware will be financed over a period of three years. The revised 2003-04 Budget also includes a corresponding reduction in expenditure authority from the Heath and Human Services Data Center (HHSDC) Revolving Fund.
- ◆ **CWS/CMS Maintenance and Operations (M&O)**—A decrease of \$4.9 million to continue M&O activities for the CWS/CMS. This reflects the net changes for the renegotiated CWS/CMS contract extension, increased support to conduct competitive reprocurement for follow-on services, and the establishment of 8.0 State positions to support and improve statewide CWS/CMS training. The revised 2003-04 Budget also includes a corresponding reduction in HHSDC expenditure authority.
- ◆ **Remove FBI Fingerprinting Exemption**—A decrease of \$2.8 million to reflect the removal of the FBI fingerprinting exemption for small licensed child care providers (Fee-Exempt Live Scan). This proposal would create parity among large (non fee-exempt) and small (fee exempt) providers.

## Department of Child Support Services

2002-03	–\$2.7 million
2003-04	\$0.7 million

### Current Year

The May Revision includes a decrease of \$2.7 million General Fund compared to the Governor's Budget. This is primarily savings that results from additional federal incentives of \$3.2 million, which were partially offset by a \$1.4 million increase in the Alternative Federal Penalty. The increased incentives reflect improved performance on federal child support program performance measures.



### Budget Year

The May Revision includes a net increase of \$653,000 General Fund, comprised of the following major adjustments:

- ◆ \$1.8 million General Fund savings because of an anticipated increase in federal incentives.
- ◆ \$1.5 million General Fund increase resulting from an estimated increase in the Alternative Federal Penalty, based on estimated federal fiscal year (FFY) 2003 administrative expenditures. The Alternative Federal Penalty levied against the State each year is a percentage of the Child Support Program's administrative costs for the prior FFY.
- ◆ \$934,000 General Fund reappropriated from the Budget Act of 2002 because of delays in the procurement of a vendor for the conversion of current county consortia automation systems into a single statewide system. The systems are proposed for conversion to realize system efficiencies and reduce maintenance, operations, and system enhancement costs.

Child Support collections are projected to be \$2.3 billion in 2002-03 and \$2.4 billion in 2003-04. Collections are expected to increase by \$14.5 million, or 0.6 percent for 2002-03 and \$46.6 million, or 2 percent for 2003-04, over the level projected in the Governor's Budget.

## Emergency Medical Services Authority

2002-03	—
2003-04	\$10.8 million

### Budget Year

### Restoration of the Emergency Medical Services Authority (EMSA)

The 2003-04 Governor's Budget proposed the consolidation of the EMSA into the Department of Health Services (DHS) to improve the coordination of emergency medical services policy with overall State health policy, and increase organizational and administrative efficiency through the consolidation of similar functions under the DHS. The Administration has further evaluated EMSA's role in the development of State emergency medical services policy, particularly in the area of the State's medical response to terrorist events, and has determined that EMSA would be



more effective in the development and dissemination of such policy as a stand-alone entity. The May Revision proposes the restoration of the EMSA funding by adding 46.6 positions and \$10.8 million General Fund for state operations and local assistance. Conforming actions are proposed in the DHS budget.

### **Hospital Bioterrorism Preparedness Program**

Public safety continues to be a high priority for the Administration. The May Revision includes an increase of \$32.8 million in reimbursements to implement a federal grant to prepare California hospitals and other healthcare organizations for a bioterrorism attack. In the wake of the September 11<sup>th</sup> terrorist attacks and the subsequent anthrax incidents, hospitals and emergency medical services providers have expressed concern that California is unprepared for a bioterrorist event. This federal grant funding provides an invaluable opportunity for hospitals and healthcare providers to focus on bioterrorism and preparedness issues.

## **Department of Community Services and Development**

2002-03	\$1.3 million
2003-04	—

### **Restoration of Funding and Positions in the Department of Community Services and Development (DCSD)**

The May Revision includes an increase of \$77.6 million federal funds and reimbursements and 56.6 positions in the DCSD to restore 50 percent of funding and positions proposed for transfer to the Department of Social Services (DSS) as part of the Administration's Mid-Year Spending Reduction plan. The revised Budget for 2003-04 also includes a commensurate reduction in the DSS. This restoration is necessary due to the anticipated delay in the proposed consolidation from July 1, 2003, to January 1, 2004.

### **Restoration of Funding for Naturalization Services Program**

The Administration's Mid-Year Spending Reduction plan included a proposal to revert \$1.3 million in the Naturalization Services Program to the General Fund in 2002-03. As there was no legislative action to approve this reversion, the May Revision fully restores these funds.



# RESOURCES/ENVIRONMENT

## Energy Resources Conservation and Development Commission

2002-03	—
2003-04	—

The May Revision proposes the following reversions, loan, and transfers to the General Fund:

- ◆ Revert to the General Fund \$4.683 million appropriated in Chapter 8, Statutes of 2001, First Extraordinary Session, for energy conservation projects such as demand responsive building systems, classroom outreach, and equipment retrofit projects.
- ◆ Revert to the General Fund \$260,000 appropriated in Chapter 329, Statutes of 2000 for conservation and demand-side management programs.
- ◆ Loan \$20.0 million Public Interest Research, Development, and Demonstration Fund to the General Fund. The Public Interest Energy Research (PIER) program provides grants to public and private entities for energy research and development projects such as energy efficiency, renewable energy, and energy systems integration. Due to the long-term nature of the PIER research and development projects, the proposed loan will address the current General Fund shortfall without affecting the overall success of the PIER program. Therefore, PIER expenditures are proposed for reduction and the resources loaned to the General Fund.
- ◆ Transfer of \$1.288 million Energy Technologies Research, Development and Demonstration Account (ETAP) to the General Fund. Under ETAP, the California Energy Commission offers grants and loans to public and private entities for energy conservation and efficiency-related research and development projects. Today, ETAP programs are overshadowed by the Commission’s PIER program, which supports similar research and development activities but on a much larger scale (\$62.5 million per year). Therefore, ETAP expenditures are proposed to be reduced and fund reserves transferred to the General Fund to support other high priority programs.
- ◆ Transfer of \$1.014 million Local Government Geothermal Resources Development Account to the General Fund. The Geothermal Program offers



grants and loans to local jurisdictions and private entities for geothermal-related research and development projects. Federal geothermal royalty payments support the program, and the payments may be used for any purpose. Therefore, we are proposing that program expenditures be reduced and the funds transferred to the General Fund to support other high priority programs.

## Department of Conservation

2002-03	—
2003-04	—

## General Fund Loan

The May Revision reflects a net increase of \$44 million in combined current and budget year loans to the General Fund from various recycling funds. The current year budget authorizes a loan of \$218 million to the General Fund from the Beverage Container Recycling Fund. The Governor's Budget for 2003-04 also proposes an additional loan from that fund of \$80 million. Based on revised cash flow projections for the Beverage Container Recycling Fund, it is projected that the fund will have insufficient cash to achieve the full amount of these loans. Therefore, loan transfers to the General Fund will be down \$30 million in the current year and \$10 million in the budget year. However, there will be significant balances in both the Glass Processing Fee Account and the Plastic Processing Fee Account available in the budget year. After setting aside a prudent five percent reserve in each of these accounts, an additional loan to the General Fund of \$84 million is proposed in the May Revision for 2003-04.

## Department of Water Resources

2002-03	—
2003-04	–\$4.7 million

## Dam Safety Fees

The May Revision proposes to reduce General Fund support for the Dam Safety Program by \$4.7 million and replace these funds with fees. The Department of Water Resources' Dam Safety Program inspects and evaluates the structural integrity of dams throughout the state. The General Fund is currently responsible for funding approximately 70 percent of this program, with the remaining 30 percent funded from existing fees on dam owners. This proposal will increase dam safety fees to offset most of the General Fund expenditures for the Dam Safety Program,



resulting in \$4.7 million of General Fund savings. However, this fee increase will not apply to owners of smaller dams on farms and ranches.

**Public Utilities Commission**

2002-03	—
2003-04	—

The May Revision proposes a \$136.0 million loan from the California Teleconnect Fund Administrative Committee Fund to the General Fund. The California Teleconnect Fund Program offers discounts on telecommunications services, such as business lines and broadband services, to qualifying schools, libraries, hospitals, and community-based organizations. However, the program has been underutilized, due in part, to a competing federal program that offers similar discounts on telecommunications services. As a result, \$136.0 million can be loaned to the General Fund with no programmatic impact.

The May Revision also proposes an increase of \$1.92 million Public Utilities Commission (PUC) Utilities Reimbursement Account for expert witnesses to assist PUC with defense of the Pacific Gas & Electric (PG&E) v. Loretta Lynch et al lawsuit. If won by PG&E, this lawsuit could allow the utility to raise electricity rates to collect between \$3.0 billion and \$8.0 billion from ratepayers.

**GENERAL GOVERNMENT**

**Secretary of State**

2002-03	\$2.2 million
2003-04	—

The May Revision includes \$1.1 million for increased postage costs for the November ballot and the redesign and printing of Voter Registration Cards. In addition, \$1.1 million is proposed for payment of federal court-awarded attorney fees against the Secretary of State related to the decertification of specific punch-card voting systems.



## Department of Veterans Affairs

### Headquarters

2002-03	—
2003-04	\$1.9 million

The May Revision proposes an augmentation of \$1.9 million and 28 positions, including the transfer of \$1.7 million and 27 positions from the Yountville Home's budget to shift central service position authority and funding to Headquarters. The remaining position and \$161,000 will provide for a new Director of Medical Services to provide medical oversight for all three homes.

### Yountville Home

2002-03	\$4.4 million
2003-04	–\$1.8 million

#### Current Year

The May Revision includes \$4.4 million General Fund due to a shortfall in reimbursements in the current year for the Yountville Home.

#### Budget Year

The May Revision proposes a reduction of \$1.8 million General Fund, a reduction in Medicare/Medi-Cal reimbursement collections of \$3.2 million, an increase of \$980,000 federal funds, and a reduction of 60 positions. These changes are due to an increase in the United States Department of Veterans Affairs (USDVA) per diem rate and a reorganization of the Yountville Home, including the downsizing of Holderman Hospital, the transfer of 27 central services positions to Headquarters, the consolidation of the business office, and the realignment of both the urgent care and the ambulatory care clinics.

### Barstow Home

2002-03	\$1.1 million
2003-04	–\$1.8 million

#### Current Year

The May Revision includes \$1.1 million General Fund for current-year transportation, nursing registry, and security costs associated with closure of the Skilled Nursing Facility at the Barstow Home.



### Budget Year

The May Revision proposes a reduction of \$1.8 million General Fund, a reduction in reimbursement collections of \$3 million, and a reduction in federal funds of \$1.8 million due to the closure of the Skilled Nursing Facility at the Barstow Home.

### Chula Vista Home

2002-03	—
2003-04	\$22,000

The May Revision proposes a \$22,000 increase in General Fund, a \$1.3 million increase in reimbursements, and a \$1 million increase in federal funds. These changes are due to an increase in the USDVA per diem rate, an increase in the budgeted census level related to the closure of the Skilled Nursing Facility at the Barstow Home, and increased Medicare/Medi-Cal reimbursement and USDVA per diem rate collections resulting from the conversion of the Intermediate Care Facility to a Skilled Nursing Facility.

### Employment Development Department

2002-03	—
2003-04	—

The May Revision provides for several changes to Employment Development Department (EDD) programs that are primarily federally funded. Highlights of significant changes are described below.

### Unemployment and Disability Insurance

#### Current Year

The May Revision includes increased benefits of \$1.6 billion for the Unemployment Insurance (UI) and Disability Insurance (DI) programs. The projected increase in benefit payments is associated with statutory changes to the weekly benefit amounts in both programs. Additionally, the sluggish economy continues to impact employment levels, leading to increased claim activity in the UI program.

#### Budget Year

The May Revision includes a \$1.4 billion increase for UI and a \$66.2 million increase for DI benefits in 2003-04. The projected increases are due to a higher level of unemployment claims and increased claim duration in both programs. In addition to these benefit adjustments, the May Revision proposes the following augmentations:





- ◆ An increase of 103 personnel years and \$13.6 million to implement the Family Temporary Disability Insurance Program authorized by Chapter 901, Statutes of 2002 (SB 1661). This program will provide temporary financial assistance to individuals who take leave from work to care for a sick or injured family member or for the birth, adoption, or foster care placement of a new child.
- ◆ An increase of 43.7 personnel years and \$3 million to perform fraud prevention activities in the UI program.
- ◆ An augmentation of \$0.6 million for the Treasury Offset Program, which will generate \$14.3 million in new General Fund revenue from tax collections and transfers.

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### Workforce Investment Act Programs

#### Budget Year

The May Revision reflects a reduction of \$88.9 million in federal Workforce Investment Act funds. Of this amount, \$66.6 million will be reduced from local assistance programs for adult employment and training, youth activities, and dislocated workers. The state operations reduction of \$22.3 million will affect programs supported by 25 percent Rapid Response funds and 15 percent Governor's Discretionary funds.

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### Office of Emergency Services

2002-03	—
2003-04	\$663,000

The May Revision proposes to restore \$663,000 in local assistance General Fund for the Disaster Service Worker's Volunteer Program, which provides worker's compensation coverage to registered disaster service worker volunteers who are injured while performing disaster-related activities.

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### Department of Food and Agriculture

2002-03	—
2003-04	—

**Exotic Newcastle Disease**—An additional \$34.6 million in federal funds is proposed to detect, contain, and eradicate the Exotic Newcastle Disease which is



a highly contagious disease that affects poultry food production, infects most bird species, has the ability to spread rapidly, and has a high fatality rate.

### California Arts Council

2002-03	—
2003-04	–\$5.5 million

Due to the continuing deterioration of the State's fiscal outlook, the May Revision proposes reductions totaling \$5.5 million in General Fund for the California Arts Council, bringing total reductions to the Arts Council to \$14 million, including:

**State Operations**—\$532,000 and 18 positions for state operations. This reduction would retain \$317,000 for the Arts in Education Program, \$227,000 in the Performing Arts Program, and \$956,000 for the Organizational Support Grants Program.

**Local Assistance**—\$5 million for local assistance projects and grant programs. This reduction would retain \$1.6 million for the Arts in Education Program, \$1.6 million for the Organizational Support Grants Program, \$300,000 for the Performing Arts Program, and \$1.5 million for the Cultural Institutions Program.

### Reimbursable State Mandated Local Programs (Non-Education)

2002-03	—
2003-04	–\$5,000

The Budget Act of 2002 deferred payment for non-education mandate obligations from prior years as well as the 2002-03 costs of those mandates. The 2003-04 Governor's Budget proposed to continue the deferral of mandates payments, preserving the obligation of local governments to provide the mandated activities as well as the obligation of the State to reimburse those entities in the future, with interest.

The May Revision proposes the suspension of 34 mandates and the repeal of one mandate. The mandate proposed for repeal, related to the *Open Meetings Act* (Chapter 641, Statutes of 1986), requires local entities to post agendas regarding items to be considered at meetings, as well as the time and location of the meetings. This mandate requires local governments to perform activities that any responsible public agency should perform without being mandated to do so, and retaining it would continue the State's obligation to pay the cost. Mandates such as this result in additional General Fund costs without producing a significant benefit to the State.



This action would reduce the annual obligation for non-education mandates by approximately \$32.9 million. The State's total estimated obligation for non-education mandates through 2003-04 would be reduced to approximately \$876.3 million. The estimated deferred obligation in 2003-04 alone for non-education mandates would be reduced to approximately \$162.6 million.

It is the Administration's intention to draft the statutory changes necessary to repeal 27 of the 34 mandates proposed for suspension in this proposal during the development of the 2004-05 Governor's Budget.

## State Retirement Contributions

### Supplemental Benefits Maintenance Account

2002-03	—
2003-04	\$3.5 million

General Fund contributions to the State Teachers' Retirement System (STRS') Supplemental Benefits Maintenance Account (SBMA) for purchasing power protection will increase by \$3.5 million for 2003-04 (from \$55.4 million to \$58.9 million). This is due to a recalculation of 2001-02 fiscal year teacher payroll, which is the basis for the statutory formula. Normally, this would result in a total contribution of \$558.9 million, but for the 2003-04 fiscal year only, the contribution to the SBMA is reduced by \$500 million pursuant to the enactment of Chapter 6, Statutes of 2003, First Extraordinary Session (SB 20X). This results in no reduction to benefits for retired teachers.

### Judges' Retirement System

2002-03	—
2003-04	-\$10.3 million

The May Revision includes a decrease of approximately \$10.3 million General Fund (from \$97.7 million to \$87.4 million) to reduce the Judges' Retirement System I fund balance for benefit payments to retired judges from two months to one month.



## Department of Personnel Administration

### Staffing for Layoffs

2002-03	–\$1.4 million
2003-04	\$1.5 million

The Governor's Budget does not include funding for salary increases effective in 2003-04. In April, the Director of Finance and the Director of the Department of Personnel Administration jointly requested departments to prepare staff reduction plans to mitigate the effects of the unbudgeted salary increases.

The May Revision includes an increase to the 2003-04 Governor's Budget of \$1,477,000 to provide the Department of Personnel Administration with adequate staffing and funding to implement a layoff plan.

### Rural Health Care Equity Program

2002-03	\$11.5 million
2003-04	\$9.3 million

The May Revision includes an increase to the 2003-04 Governor's Budget of \$9,326,000 to continue funding for annuitants in the Rural Health Care Equity Program and to reflect new caseload estimates. In addition, the current year \$11.5 million reduction proposed in the Governor's Budget has been rescinded.

### Governor's Reorganization Plan for Data Centers

The Administration has requested the State Chief Information Officer to develop a Governor's Reorganization Plan to consolidate the Health and Human Services Agency Data Center and the Stephen P. Teale Data Center beginning in fiscal year 2004-05, with the objective of positioning the State to implement data center services more effectively. While no immediate operational savings will be derived, there should be other benefits including potential administrative savings and savings from consolidated purchasing.

## Department of Corporations

2002-03	—
2003-04	—



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## Fund Transfer

The May Revision includes the following transfer to the General Fund:

**State Corporations Fund**—A transfer of \$36 million from the State Corporations Fund to the General Fund. These funds are available due to a \$40 million settlement related to conflicts of interest in Wall Street analyst research.

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## Augmentation

**Statewide Outreach on Predatory Practices**—An increase of \$4 million in special funds in order to provide consumer education outreach on predatory investment, financing, and lending practices. These funds are available from the settlement related to conflicts of interest in Wall Street analyst research.

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## Department of Housing and Community Development

2002-03 —

2003-04 —

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## Fund Transfers and Loans

The May Revision includes the following transfers and loans to the General Fund:

**Self-Help Housing Fund**—A transfer of \$7 million from the Self-Help Housing Fund.

**Housing Rehabilitation Loan Fund**—A transfer of \$9.7 million and a loan of \$31.7 million from the Housing Rehabilitation Loan Fund.

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## Fund Shifts

The May Revision includes the following fund shifts to the Housing and Emergency Shelter Trust Fund Act of 2002 bond funds and resultant transfers to the General Fund:

**Self-Help Housing Fund**—A fund shift and transfer to the General Fund of \$12.6 million from the Self-Help Housing Fund.

**Farmworker Housing Grant Fund**—A fund shift and transfer to the General Fund of \$27.1 million from Farmworker Housing Grant Fund.



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### Special Transportation Programs

2002-03	—
2003-04	—

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### Budget Adjustment

The May Revision proposes to cap the revenues and expenditures for Special Transportation Programs at the \$100.4 million level specified in the 2003-04 Governor's Budget, resulting in a gain of \$87.4 million to the General Fund.

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### Department of Transportation

2002-03	—
2003-04	\$207 million

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### Budget Adjustments

The May Revision proposes the following adjustments:

**Transportation Investment Fund (TIF)**—The May Revision includes a modification of the Governor's Budget proposal to suspend the transfer of revenues from the sales tax on gasoline. In order to provide sufficient funds to meet the cash requirements of projects that received allocations prior to December 2002, the May Revision proposes to transfer \$207 million in revenues from the General Fund to the TIF pursuant to Article XIXB, Section 1 (d) of the Constitution. Of this amount, \$157.5 million is proposed for expenditure from the continuous appropriation of the Traffic Congestion Relief Fund for project expenditures. A budget act appropriation of \$49.5 million is proposed to support 283 positions/268.7 personnel years for project and program support workload. Budget trailer bill language is also proposed for a partial TIF suspension of \$938 million the amount over \$207 million, and to specify that the General Fund shall be obligated to repay the TIF for the amount of the transfer that is suspended in 2003-04.

**Project Delivery Workload**—An increase of \$98.4 million and 1,365 positions/1,296.5 personnel years relative to the Governor's Budget to reflect project delivery workload. This staffing level includes workload for the non-Traffic Congestion Relief Fund components of the Traffic Congestion Relief Program projects.



**High-Speed Rail Authority Consolidation**—A net decrease of \$1.6 million consisting of:

- ◆ A decrease of \$1.9 million to reflect the reversal of the consolidation of the High-Speed Rail Authority (Authority) within Caltrans as proposed in the Governor's Budget.
- ◆ An increase of \$312,000 in reimbursements for Caltrans to redirect three personnel years of support to assist the Authority, thereby incorporating Caltrans expertise into the Authority's environmental impact report and planning processes.

## High Speed Rail Authority

2002-03	—
2003-04	—

## Budget Adjustments

The May Revision proposes the following adjustments:

**Reversal of Consolidation Proposal**—An increase of \$3.8 million in special funds to reflect the reversal of the consolidation of the High-Speed Rail Authority within Caltrans as proposed in the Governor's Budget and the receipt of \$1.2 million in federal funds of which \$312,000 will be used to reimburse the Caltrans for assistance related to completion of the EIR.

## Technology, Trade, and Commerce Agency

2002-03	—
2003-04	\$3.8 million

The May Revision continues reductions from January totalling \$22.8 million General Fund and 156.4 positions, and proposes the following restorations:

**Manufacturing Technology Program**—\$2.1 million in reimbursements from the Employment Training Fund and 1.0 position for an interagency agreement with the Employment Training Panel to administer \$2 million in local assistance grant funds for the Manufacturing Technology Program.

**Tourism Commission Assessments**—\$929,000 in reimbursement authority to restore 7.5 positions to collect the industry assessments on behalf of the nonprofit Tourism Commission.



**Office of Military Base Reuse and Retention**—\$180,000 General Fund and 1.0 position to restore funding for the Office to continue to represent California's interests before the next Base Realignment and Closure Round in 2005.

**California Main Street Program**—\$126,000 General Fund to restore funding for 1.0 position for the California Main Street Program.

**Tourism Marketing Contract Funds**—\$2.5 million General Fund for tourism marketing in conjunction with the Tourism Commission.

## STATEWIDE ISSUES

### Savings on Contract Renegotiations

2002-03	—
2003-04	—

### Budget Year

The May Revision adds Control Section 5.50, which would authorize the Administration to develop and implement a plan to generate and capture savings of up to \$100 million (\$50 million General Fund) or more through operational efficiencies in areas such as contracting, leasing, and procuring goods and services. This control section authorizes the Department of General Services to develop the specific details of the plan, and the Department of Finance to approve and allocate the necessary reductions.

### Employee Compensation

#### Control Section 4.10

The Governor's Budget directed the Department of Personnel Administration (DPA) to negotiate through the collective bargaining process a reduction of \$855 million (\$470 million General Fund) in 2003-04 employee compensation expenditures. To achieve this reduction, the State is prepared to pursue deferring scheduled salary increases, lowering or freezing future salary or benefit expenditures, layoffs, furloughs, and other similar personnel actions.

In anticipation of changes, the Governor's Budget did not include any new funds for employee compensation increases and also assumed a net reduction of \$95.5 million (\$65.9 million General Fund) from departments' base budgets for employee expenses. While the May Revision continues these planned savings, the State must be prepared to implement other alternatives should the savings not be realized in a timely manner through the collective bargaining process.





On April 1, 2003, the Director of Finance and the Director of DPA required departments to submit reduction and layoff plans. Control Section 4.10 will allow the Director of Finance to implement these plans and other savings strategies necessary to keep the budget in balance, as necessary. To help preserve critical programs, the control section also permits the Director of Finance to rebalance between separate items of appropriation. This authority is restricted such that the net effect of all actions taken by this control section is to reduce appropriations by at least \$95.5 million (\$65.9 million General Fund), and actions taken pursuant to the section will be reported to the Legislature.

### Control Section 4.15

The Governor has proposed reforms to the Workers' Compensation System that should reduce workers' compensation costs to employers by 10 to 15 percent. The State should realize a savings of approximately \$50 million (\$30 million General Fund) as a result of these reforms. Control Section 4.15 allows the Department of Finance to reduce department budgets to capture these savings.

## 2003-04 State Appropriations Limit Calculation

Pursuant to Article XIII B of the California Constitution, the 2003-04 State Appropriations Limit (SAL) is estimated to be \$61.724 billion. The revised limit is the result of applying the growth factor of 3.79 percent. The revised 2003-04 limit is \$462 million above the \$61.262 billion estimated in January. This increase is due to changes in the following factors:

	<b>January Percentage</b>	<b>May Revision Percentage</b>
Per Capita Personal Income	1.51	2.31
State Civilian Population	1.58	1.69
K-14 Average Daily Attendance	1.31	1.03

For SAL purposes, per capita personal income is defined as calendar fourth quarter California personal income, as estimated by the US Bureau of Economic Analysis (BEA), divided by California civilian population, estimated by the California Department of Finance. Since BEA does not release its estimate until April, the Department of Finance uses its own estimate for the Governor's Budget. The May Revision reflects the BEA's estimate.

The SAL for 2002-03 does not change since it was statutorily established by Control Section 12.00 of the 2002 Budget Act.



## General Obligation Bonds and Commercial Paper Debt Service

2002-03	–\$7.8 million
2003-04	\$54.7 million

### Current Year

The Governor's Budget anticipated current year general obligation (GO) bond debt service expenditures of approximately \$1.693 billion. The May Revision proposes a reduction of \$7.8 million to reflect savings from Commercial Paper costs and accrued interest and premiums from bonds sales occurring in spring of the current year.

### Budget Year

The Governor's Budget anticipated budget year GO bond debt service expenditures of approximately \$1.870 billion. There will be a net increase of \$54.7 million in debt service funding in the budget year resulting primarily from an increase in the sales of fixed and variable rate bonds.

## Lease-Revenue Debt Costs

2002-03	–\$170,000
2003-04	–\$12.3 million

The May Revision includes \$11.4 million in General Fund savings and \$909,000 Proposition 98 savings in lease-revenue debt costs in budget year. These savings result from changes in bond sale schedules and increases in off-setting reimbursements. In addition, there is \$139,000 General Fund savings and \$31,000 special fund savings in current year as a result of updated insurance costs.

## Payment of Interest on General Fund Loans

2002-03	\$106.1 million
2003-04	\$119.4 million

### Current Year

The Governor's Budget anticipated the interest cost on internal borrowing to be \$30.0 million General Fund. However, due to unanticipated events, such as the loss of the tobacco securitization bond proceeds in April, the enactment of fewer current year reductions than proposed by the Administration, and the deterioration in revenues, the State's reliance on borrowing from internal sources to meet



cash obligations has increased. Actual interest costs through April are estimated at \$23.6 million. Interest costs for the month of April alone are estimated at \$7.5 million. Therefore, interest costs for the remaining months of 2002-03 are now estimated at \$15 million. For this reason, interest costs on internal borrowing are currently estimated at \$45 million, a \$15 million increase from the January estimate.

The Governor's Budget included \$211.5 million for the interest costs on external borrowing for 2002-03. The redemption of the 3<sup>rd</sup> installment of Revenue Anticipation Warrants (RAWs), issued in June 2002, in November rather than January resulted in \$10.5 million of interest cost savings. On the other hand, it is estimated that \$101.6 million of additional General Fund will be required in 2002-03 to cover additional costs related to the issuance of RAWs anticipated to occur in June 2003. This estimate includes the anticipated costs for credit enhancement for the RAWs. It was not anticipated at the time of the 2003-04 Governor's Budget that the State would need to issue RAWs before the end of the fiscal year; therefore, these costs were not budgeted at that time. The total cost of external borrowing in 2002-03 is now estimated at \$302.6 million, or an increase of \$91.1 million. The total 2002-03 General Fund increase is \$106.1 million.

### **Budget Year**

The Governor's Budget anticipated the interest costs on internal borrowing to be \$31.2 million General Fund. The May Revision estimates the interest costs on internal borrowing to be \$30.6 million. This reflects a \$554,000 reduction in the estimated interest due for budgeted loans scheduled to be repaid in 2003-04.

The Governor's Budget anticipated the interest costs on external borrowing to be \$160.0 million General Fund. This estimate was based upon the assumption that \$5.0 billion Revenue Anticipation Notes (RANs) would be issued in July 2003 and redeemed in June 2004.

The Administration, along with the State Controller's Office and the State Treasurer's Office, has been monitoring the State's cash condition closely since January. On February 27, 2003, the Governor approved the Controller's request to establish the General Cash Revolving Fund, the initial step necessary to issue RAWs. The Controller has indicated his intent to sell up to \$11 billion of RAWs in June 2003, and the Governor granted approval on May 1, 2003. The structure and maturity date(s) of RAWs and the sizing of RANs to be issued in 2003-04, if needed, have not yet been determined. Based upon the above, the revised estimate for external borrowing costs is \$280.0 million, or an increase of \$120.0 million. The estimate should be sufficient to cover the interest costs of RAWs and RANs, if needed, and any credit enhancement that may be required. The total 2003-04 General Fund increase is \$119.4 million.



The May Revision estimates are preliminary because the cash flow projections cannot be completed by the May 14 statutory deadline. An updated cash flow and related interest costs will be available soon after the formal release of the May Revision.

We note that these estimates are based on the assumption of enactment of a timely budget. The need for internal and/or external borrowing will ultimately be based on the cash flow projection for the Budget Act together with new information when available, rather than based on the May Revision or the Governor's Budget.

### Financial Assistance to Local Governments

Notwithstanding the change in the State's fiscal outlook, the May Revision continues to provide for the following:

- ◆ \$18.5 million for technology grants to local law enforcement.
- ◆ \$18.5 million for grants to small and rural county sheriffs.
- ◆ \$232.6 million total (\$116.3 million each) for the Citizens Option for Public Safety (COPS) and Juvenile Crime Prevention programs.

### Tax Relief to Local Governments

2002-03	—
2003-04	–\$947 million

Section 10754 of the Revenue and Taxation Code requires the Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD), as appropriate, to reduce the vehicle license fee (VLF) offsets and restore the VLF “during any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets.” Based on all available financial information, it is anticipated there will be insufficient moneys available to be transferred from the General Fund for the offsets, beginning with the payments scheduled for transfer in July 2003. Thus, this May Revision assumes that the State will not be obligated to make offset payments in 2003-04.

The May Revision also proposes to restore \$40.15 million in subventions to local governments for property tax losses incurred by enrolling agricultural land in Williamson Act contracts. The Governor's Budget had proposed to eliminate these subventions commencing in 2003-04.



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# FINANCIAL INSTRUMENTS

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## Revenue Anticipation Warrants/Revenue Anticipation Notes

At the time of the 2003-04 Governor's Budget, despite further deterioration in revenues, it was estimated that the State would have sufficient cash resources to repay the current year \$12.5 billion Revenue Anticipation Note (RANs) when due in June 2003. The State's cash position will not allow that payment, without additional borrowing.

In early spring, there were already indications that the State might not have sufficient cash to fund all critical programs for upcoming months. On February 27, 2003, the Governor approved the establishment of the General Cash Revolving Fund by the State Controller, a first step to prepare for the possible need to issue Revenue Anticipation Warrants (RAWs). On April 29, 2003, the Controller requested the Governor's approval to issue \$11 billion of RAWs to avoid the need to issue registered warrants. In light of the current cash position, the Governor approved the Controller's request on May 1, 2003.

General Fund cash and internal borrowable resources will be fully exhausted by mid to late June as a result of various events, including the rejection by the Legislature of \$2.2 billion of current year reductions and the cancellation of the \$2.0 billion (second) Tobacco Securitization bond sale. Furthermore, revenues have deteriorated by over \$300 million in the current year. The combination of these factors has resulted in the need for the State to again issue RAWs, in the amount of \$11 billion, to finance cash flow requirements for June and the early summer months. However, even the \$11 billion of RAWs will be exhausted during the summer. Therefore, a timely budget is still critical for the State to issue RANs to finance the normal cash flow needs for the remaining months of 2003-04.

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## Pension Obligation Bond

In the Governor's Budget, the Administration proposed to take advantage of favorable interest rates by pursuing legislation to authorize the sale of pension obligation bonds to fund the State's General Fund contribution to both the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS), which were estimated to total \$1,510 million in 2003-04. The Administration was also exploring a fixed-rate borrowing of \$1,510 million from either, or both, systems as an alternative to the pension obligation bonds.

Since the Governor's Budget was released in January, the Administration has refined its proposal. The Administration is no longer recommending that pension obligation bonds be used to pay contributions to STRS, and the Administration



now proposes to increase the pension obligation bonds to include special fund and non-governmental cost fund contributions to CalPERS. A transfer from these funds will be made to the General Fund, and the General Fund will be responsible for all future bond redemption costs. Finally, CalPERS has increased its estimate of contributions from the State in the budget year by \$31 million. The net proceeds from the bond are now projected to total \$1,908 million, which will be partially offset by the interest payment in spring, 2004 of \$28 million. These changes will result in a net benefit to the General Fund of \$371 million from using pension obligation bonds in the budget year.

The Legislature has concurred with this proposal by passing Chapter 11, Statutes of 2003, First Extraordinary Session (SB 29X), which was signed by the Governor on May 5, 2003. The Administration is working with the Treasurer and the Controller to effect this proposal in time to issue the bonds before the October 1, 2003, payment is due.

Issuance of this debt instrument is contingent on court validation of its legality.

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## Deficit Financing Bond

Since the January release of the Governor's Budget, the General Fund current year deficit is now estimated at \$10.7 billion.

The May Revision accepts the proposal to finance this deficit over multiple years on the following three conditions:

- ◆ The deficit must be financed with a new independent revenue source.
- ◆ The Legislature must pass the Budget on time.
- ◆ The Legislature must continue its work on the structural deficit after the passage of the Budget.

The deficit financing proposal requires the sale of \$10.7 billion in bonds that would be financed by a temporary one-half cent sales tax dedicated for the purpose of the repayment of the bonds. The revenues from the one-half cent sales tax would be deposited in a newly created special fund. These new revenues are not required to be included in the Proposition 98 calculation, as new revenues that are dedicated to a special fund are excluded from General Fund revenues for purposes of that calculation, similar to the realignment revenues. The debt service for these bonds would be subject to annual appropriation by the Legislature.



## Long Term Debt Financing

California and most other states have long used debt financing, as does private industry. Financial markets recognize it as a legitimate and appropriate funding technique, as long as it is employed prudently. Both the bond market and the bond rating agencies consider a number of factors when reaching a conclusion about the reasonableness of a State's debt position. The same level of debt may be considered either reasonable or imprudent depending upon the State's performance over a range of factors.

One common measure of a State's debt position is the ratio of its General Fund supported debt to its General Fund revenue. In January, the Governor's Budget proposal estimated that the State's debt ratio would peak at 6.53 percent in the year 2008-09. The May Revision results in that ratio peaking at 6.80 percent. The increase is attributable to a revision in the payment schedule for the Pension Obligation Bonds offset by a nominal increase in annual revenues over the next few years.

### Comparison of Debt Service Ratios

Year	Jan 10 Governor's Budget			May Revision		
	Revenues (\$ in Millions)	Total Annual Debt Service	Debt Service %	Revenues (\$ in Millions)	Total Annual Debt Service	Debt Service %
2003-04	\$69,153	\$2,621.1	3.79%	\$70,934	\$2,506.5	3.53%
2004-05	\$71,152	\$3,952.6	5.56%	\$71,318	\$4,177.7	5.86%
2005-06	\$75,651	\$4,533.7	5.99%	\$75,836	\$4,709.0	6.21%
2006-07	\$80,174	\$5,073.2	6.33%	\$80,313	\$5,179.3	6.45%
2007-08	\$85,004	\$5,543.2	6.52%	\$85,178	\$5,695.9	6.69%
2008-09	\$90,033	\$5,881.3	<b>6.53%</b>	\$90,208	\$6,132.2	<b>6.80%</b>
2009-10	\$95,406	\$6,231.1	6.53%	\$95,599	\$6,072.0	6.35%
2010-11	\$102,035	\$6,500.5	6.37%	\$102,412	\$6,332.3	6.18%
2011-12	\$109,223	\$6,204.0	5.68%	\$109,518	\$6,030.4	5.51%
2012-13	\$115,832	\$6,179.0	5.33%	\$116,190	\$6,005.0	5.17%

#### Standard Accounting Principles Followed

1. Debt service ratios include long term debt service costs as a percentage of General Fund revenues.
2. Short-term cash flow borrowing (RANs, RAWs) is not included in debt service ratio numbers, because it is not a long-term debt obligation.
3. Debt service ratios do not include debt funded by legally dedicated special funds (tobacco securitization bonds and deficit financing bonds secured by a dedicated new revenue source).



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# SUMMARY CHARTS

## 2003-04 Governor's Budget General Fund Budget Summary (Dollars in millions)

	2002-03	2003-04
Prior Year Balance	-\$1,985	\$1,410
Revenues and Transfers	\$70,751	\$70,934
Deficit Financing Bond	\$10,700	\$ -
<b>Total Resources Available</b>	<b>\$79,466</b>	<b>\$72,344</b>
Expenditures	<u>\$78,056</u>	<u>\$70,433</u>
<b>Fund Balance</b>	<b>\$1,410</b>	<b>\$1,911</b>
<b>Budget Reserves:</b>		
Reserve for Liquidation of Encumbrances	\$1,402	\$1,402
Special Fund for Economic Uncertainties	\$8	\$509



### 2003-04 Revenue Sources (Dollars in millions)

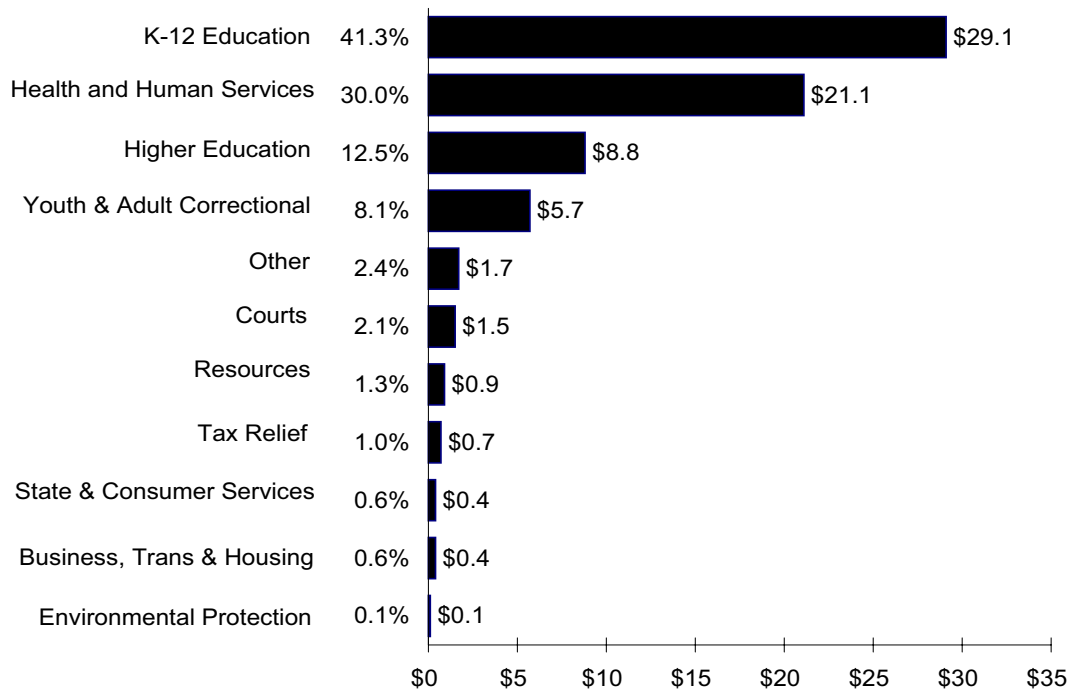
	<b>General Fund</b>	<b>Special Funds</b>
Personal Income Tax	\$33,456	\$1,560
Sales Tax	23,507	4,288
Corporation Tax	7,074	--
Highway Users Taxes	--	3,313
Motor Vehicle Fees	18	7,687
Insurance Tax	1,918	--
Estate Taxes	437	--
Liquor Tax	288	--
Tobacco Taxes	111	1,160
Other	<u>4,125</u>	<u>6,827</u>
<b>Total</b>	<b>\$70,934</b>	<b>\$24,835</b>

### 2003-04 General Fund Expenditures by Agency (Dollars in millions)

	<b>2002-03</b>	<b>2003-04</b>
Legislative, Judicial, Executive	\$2,484	\$2,428
State and Consumer Services	480	439
Business, Transportation & Housing	208	426
Technology, Trade, and Commerce	46	25
Resources	1,119	922
Environmental Protection	174	100
Health and Human Services	23,456	21,124
Youth and Adult Correctional	5,833	5,729
K-12 Education	29,548	29,080
Higher Education	9,543	8,837
Labor and Workforce Development	177	90
General Government	<u>4,988</u>	<u>1,233</u>
<b>Total</b>	<b>\$78,056</b>	<b>\$70,433</b>



### 2003-04 General Fund Expenditures (Dollars in Billions)



### Preliminary General Fund Projection for 2004-05 (Dollars in Billions)

	2002-03	2003-04	2004-05
<b>BEGINNING RESOURCES</b>	<b>-\$2.0</b>	<b>\$1.4</b>	<b>\$1.9</b>
<b>REVENUES AND TRANSFERS</b>	<b>\$70.8</b>	<b>\$70.9</b>	<b>\$71.3</b>
<b>DEFICIT FINANCING BOND</b>	<b>\$10.7</b>		
<b>TOTAL RESOURCES</b>	<b>\$79.5</b>	<b>\$72.3</b>	<b>\$73.2</b>
<b>EXPENDITURES</b>	<b>\$78.1</b>	<b>\$70.4</b>	<b>\$79.2</b>
<b>STRUCTURAL DEFICIT</b>			<b>\$7.9</b>
<b>FUND BALANCE</b>	<b>\$1.4</b>	<b>\$1.9</b>	<b>\$1.9</b>
Reserve for Liquidation of Encumbrances	1.4	1.4	1.4
Special Fund for Economic Uncertainties	0.0	0.5	0.5



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