



# **2008-09 STATE BUDGET ACT**

## ***UPDATED* FINAL COMPROMISE FLOOR REPORT**

**UPDATED SEPTEMBER 19, 2008**

***John Laird, Chair***

***Assembly Budget Committee***

## SUMMARY

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*Important Note: Since the budget package passed the Legislature on September 15, the following changes have been made:*

1. **Revenues:** *The Governor's suggested income tax "withholding" proposal and the Governor's August Revise Tax Amnesty Proposal – which together total about \$1.9 billion in revenues – has been replaced with penalty increase to 20 percent for corporations that understate their taxes by more than \$1 million – which generates \$1.5 billion.*
2. **Reform.** *Additional restrictions added to the Budget Reform to limit the circumstances when funds can be transferred out of the Budget Stabilization Fund.*

*This report has been updated to reflect these two changes.*

On July 8, 2008, the Conference Committee completed its work on the budget for 2008-09, and this work product, the Conference Report, is reflected in AB 1781. Despite being a responsible and balanced budget plan, the Conference Version of the budget did not receive the required 2/3 support in the Legislature.

Since the close of the Conference Committee, various attempts at compromise have been made including: a variation of the Conference Version voted on in the Assembly, a new "August Revise" put forth by the Governor, a variation of the August Revise voted on in the Senate, and a proposal put forth by the Legislative Republicans.

Until now, no alternative to the Conference Version has garnered the necessary support for final passage. And after the passage of the budget package on September 15, additional changes have been made to ensure the Governor's signature. This report outlines the updated Final Compromise for the Budget Act of 2008.

In total, the updated Final Compromise contains \$106.0 billion in available General Fund resources, \$104.3 billion in General Fund expenditures, and a reserve of \$.8 billion.

### **Key Changes from the Conference Version:**

- ◆ **Additional Proposition 98 Reductions.** Reduces Proposition 98 funding by about \$800 million below the Conference Version. However, this level of funding is about \$1.3 billion more than proposed by the Governor in the May Revision and about \$2.1 billion more than proposed by Legislative Republicans.

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- ◆ **Alternative Revenue Package.** Replaces the Conference Revenue package in accordance with the following:
  - Eliminates the upper income tax increase, the corporate tax increase, the dependant credit reductions, and the income tax indexing freeze (reduces revenues by about \$7.1 billion).
  - Eliminates the Conference Amnesty proposal, and does not include the modest Amnesty proposal proposed in the Governor's August Revise (reduces revenues from the Conference Version by \$1.5 billion).
  - Adds the Governor's Accrual proposal that was in the May Revision, but not adopted by the Conference Committee (adds about \$1.9 billion).
  - Increase penalties to 20 percent for corporations that understate their taxes by more than \$1 million (adds \$1.5 billion).
  - Expands the NOL suspension proposal to also limit various incentive credits for two years (adds about \$900 million).
  - Makes various other revenue accelerations to corporations and the wealthy (adds about \$2.3 billion).
  
- ◆ **Deeper Cuts.** Makes deeper cuts in public transit (\$217 million), delays the Medi-Cal Rate restoration to March 1, 2009 (\$210 million), shifts additional funds from Redevelopment Agencies (\$350 million), defers the Proposition 98 "Settle-up" payment (\$150 million), and makes modest reductions to county administration support (\$34 million).
  
- ◆ **Increased Spending.** Spends more than the Conference Version by restoring: over \$400 million to Corrections, \$105 million for local law enforcement programs, \$221 million for Medi-Cal as a result of the lawsuit, \$51 million to backfill the loss of Emergency Response Initiative (ERI) funds, and \$98 million as a result of increased fire costs.
  
- ◆ **No Emergency Response Initiative (ERI).** Rejects the Governor's proposal for an insurance surcharge to generate revenues to fight forest fires, floods, earthquakes and other emergencies. This results in increased General Fund spending to partially backfill the loss of the ERI funds, but also results in less emergency services being available.
  
- ◆ **Budget Reform.** Includes budget reform similar to that proposed by the Legislative Analyst by increasing the size of the Budget Stabilization Account and restricting all so-called "April Surprise" revenue. In addition, the budget provides expanded statutory mid-year powers to the Governor.

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- ◆ **Lottery Securitization.** Includes a lottery securitization proposal that will generate \$5 billion in debt relief in 2009-10 and likely more in the following year.

**Key Highlights of the Final Compromise:**

**Reserve**

- ◆ Contains a reserve of \$826 in 2008-09, and a modest out year projected shortfall of likely less than \$1.5 billion.

**Revenues**

- ◆ Includes \$8.9 billion in revenue solutions, including the following major revenue solutions:
  - \$1.9 billion from suspending the NOL and limiting other incentive credits for two years.
  - \$1.5 billion by increasing penalties to 20 percent for corporations that understate their taxes by \$1 million or more.
  - \$855 million in various Special Fund loans and transfers to the General Fund.
  - \$1.9 billion from accrual accounting changes.
  - \$360 million from the LLC acceleration.
  - \$2.3 billion from various accelerations from corporations and wealthy taxpayers.

**Reform**

- ◆ Includes budget reform that is based on the ideas first put forth by the LAO.
  - Increases the size of the Budget Stabilization Fund (BSF)—the Prop. 58 “rainy day” fund—from 5% to 12.5% of General Fund revenues.
  - Captures current year “April Surprise” revenues not needed for Proposition 98 and deposits them into the BSF and other one-time purposes. April Surprise revenues are defined as revenues that come in higher than 105 percent in a fiscal than projected for that fiscal year at the time the budget for that fiscal year was enacted.
  - Makes transfers out of the BSF more restrictive by requiring a stand alone statute and limiting the ability to transfer funds out of the BSF only when

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General Fund revenues are not sufficient to support spending at the prior year level (adjusted by population and inflation).

- Also provides additional statutory powers to the Governor to make mid-year reductions.

**Education**

- ◆ Increases school funding by about \$1.3 billion above the May Revision. This results in about \$3.0 billion in cuts below the workload budget level. The following chart illustrates the Final Compromise funding for Proposition 98 compared with the other Proposition 98 Proposals.

○ Workload Level	\$61.1 billion
○ Conference Version	\$58.9 billion
○ <b>Final Compromise</b>	<b>\$58.1 billion</b>
○ August Revise Level	\$57.8 billion
○ May Revise Level	\$56.8 billion
○ Legislative Republican	\$56.0 billion

- ◆ Funds the UC and CSU at the level proposed in the May Revision, which includes a \$100 million increase for each above the January proposal.
- ◆ Restores full funding for Cal Grants, including \$57 million for competitive Cal Grants that the Governor proposed cutting.

**Health**

- ◆ Restores the most difficult cuts proposed by the May Revision, including:
  - Restoring nearly all of the 10 percent Medi-Cal rate cut adopted in the Special Session for most providers (doctors, nurses, dentists, home health providers, etc.), and half of the rate cut for pharmacy, managed care and long-term care facilities that do not pay the quality assurance fee (most nursing homes pay the fee and will receive a cost-based rate increase). These rate restorations will take effect on March 1, 2009 and will result in a total General Fund cost of \$110 million.
  - Restoring the Medi-Cal optional benefits. Of the restoration of \$85.5 million, the adult dental restoration is \$73.8 million.
  - Restoring almost all cuts to Medi-Cal eligibility, by: rejecting the rollbacks in eligibility for poor families that penalize work and marriage, rejecting restrictions on services to legal immigrants and imposing monthly eligibility hurdles to emergency care for the undocumented, and rejecting the imposition of quarterly status reports for children and parents and instead

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adopting semi-annual status reporting for children, which is the current reporting requirement for parents.

- Rejecting the co-pay increase and reducing premium increases by half or more for children in the Healthy Families Program.

**Human Services**

- ◆ Makes tough cuts to human service programs, including cuts to SSI/SSP, CalWORKs, and other critical safety net programs.
- ◆ Restores other draconian cuts proposed by the Governor for the social safety net, including rejecting cuts to: children's services and foster care, CalWORKs kids eligibility, grant reductions, Federal SSI COLA, and IHSS.
- ◆ Makes cuts to county administration not included in the Conference Version.

**Transportation**

- ◆ Provides full funding of Proposition 42, which provides \$1.4 billion for highway construction, local road maintenance, and public transit.
- ◆ Funds public transit at \$100 million above the May Revision level, which is \$217 million below the Conference Version.
- ◆ Provides funding for various Proposition 1B programs, including local transit, State and Local Partnership, and the Trade Corridor Improvement Fund.
- ◆ Includes the Governor's proposed \$11 car registration fee increase to support the California Highway Patrol.

**Natural Resources and Environmental Protection**

- ◆ Provides funds for AB 32 to continue implementation of strategies to reduce greenhouse gas emissions in California.

**Public Safety**

- ◆ Achieves \$14 million in savings from Corrections reforms.
- ◆ Restores cuts to COPS/Juvenile Justice program that are included in the Conference Version.
- ◆ Funds Booking Fees and Rural Sheriffs programs at the May Revision level.

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**Lottery Securitization**

- ◆ Provides for the securitization of State Lottery revenues for debt relief purposes beginning in 2009-10.
  - Generates an estimated \$5 billion in 2009-10 and \$5 billion in 2010-11, but are not expected to generate revenues or provide any budget relief in 2008-09.
  - Deposits proceeds from the securitization into a new Debt Retirement Fund that could be used for repaying: budgetary borrowing (like transportation, education, and local government debts), bonded indebtedness, and payments to the BSF.
  - Provides only modest changes to the lottery such as increasing prize payouts, but proposes no new games or technology.
  - Protects education, unlike the Governor's original proposal, from experiencing any financial loss.

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## SUMMARY OF CHARTS

**May Revise / Conf. Version / August Revise / Est. Final Compromise  
General Fund Summary  
(in billions)**

	May Revision	Conference Version	August Revise	Est. Final Compromise
<b>Prior-year balance</b>	\$1.7	\$3.3	\$3.9	\$3.9
Revenues and Transfers	\$103.0	\$104.4	\$101.5	\$102.1
<b>Total Resources Available</b>	<b>\$104.7</b>	<b>\$107.7</b>	<b>\$105.4</b>	<b>\$106.0</b>
<b>Total Expenditures</b>	<b>\$101.8</b>	<b>\$105.3</b>	<b>\$103.5</b>	<b>\$104.3</b>
<b>Fund Balance</b>	<b>\$2.9</b>	<b>\$2.4</b>	<b>\$1.9</b>	<b>\$1.7</b>
<b>Budget Reserves:</b>				
(Liquidation of Encumbrances)	(\$.9)	(\$.9)	(\$.9)	(\$.9)
<b>Final Reserve</b>	<b>\$2.0</b>	<b>\$1.5</b>	<b>\$1.1</b>	<b>\$ .8</b>

### Key Budget Cuts Included in Final Compromise

K-12 and Community College Prop 98 Cuts	\$3.0 billion
University of California Cuts	\$233 million
California State University Cuts	\$215 million
Suspension of State SSI/SSP COLAs	\$302 million
Suspension of CalWORKs COLA	\$131 million
Medi-Cal Rate Cuts	\$307 million
Medi-Cal Semi-Annual Reporting for Children	\$25 million
Corrections Reforms	\$14 million
Public Transit	\$1.0 billion



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**Comparison of Solutions for the \$15.2 Billion General Fund Shortfall**  
**May Revision / Conf. Version / August Revise / Final Compromise**  
(in billions)

	May Revision	Conference Version	August Revise	Final Compromise
<b>Starting Problem</b>	<b>-\$15.2</b>	<b>-\$15.2</b>	<b>-\$15.2</b>	<b>-\$15.2</b>
<b>Expenditure Solutions</b>				
Non-98 Budget Balancing Reduc. & Misc.	\$2.8	\$1.7	\$1.8	\$1.0
Prop 98 Reductions	4.3	2.1	3.3	3.0
LAO Property Tax estimate	0.0	0.6	0.6	0.6
RDA Pass-through	0.0	0.0	0.0	0.4
Transit Cuts	0.8	0.5	1.1	1.0
CCPOA Last, best, and final	0.4	0.5	0.5	0.5
HHS cuts not part of BBR	0.6	0.3	0.4	0.4
PERS/STRS savings issues	0.1	0.2	0.2	0.2
Cal Grant Cuts	0.1	0.0	0.0	0.0
Delay local Mandates	0.1	0.1	0.1	0.1
<b>Total Expenditure Solutions</b>	<b>\$9.1</b>	<b>\$6.0</b>	<b>\$7.9</b>	<b>\$7.1</b>
<b>Revenue Solutions</b>				
Tax Increases:	\$0.0	\$8.2	\$5.1	\$1.9
<b>subtotal</b>	<b>\$0.0</b>	<b>\$8.2</b>	<b>\$5.1</b>	<b>\$1.9</b>
Borrowing:				
Lottery Securitization Revenues	\$5.1	\$0.0	\$0.0	\$0.0
Special Fund Loans/Transfers	0.7	0.7	0.9	0.9
<b>subtotal</b>	<b>\$5.8</b>	<b>\$0.7</b>	<b>\$0.9</b>	<b>\$0.9</b>
Other Revenues:				
LLC Acceleration	\$0.4	\$0.4	\$0.0	\$0.4
Amnesty	0.0	1.5	0.4	0.0
Tax Accrual	1.9	0.0	1.9	1.9
20% Underreporting Corp. Penalty	0.0	0.0	0.0	1.5
Estimated Payments Accelerations	0.0	0.0	0.0	2.3
Misc.	0.1	0.1	0.1	0.1
<b>subtotal</b>	<b>\$2.3</b>	<b>\$1.9</b>	<b>\$2.4</b>	<b>\$6.1</b>
<b>Total Revenue Solutions</b>	<b>\$8.1</b>	<b>\$10.8</b>	<b>\$8.4</b>	<b>\$8.9</b>
<b>Grand Total, Solutions</b>	<b>\$17.2</b>	<b>\$16.8</b>	<b>\$16.3</b>	<b>\$16.0</b>
<b>Final Reserve</b>	<b>\$2.0</b>	<b>\$1.5</b>	<b>\$1.1</b>	<b>\$0.8</b>

(totals may not add due to rounding)