



Major Features of the 2007 California Budget

ELIZABETH G. HILL • LEGISLATIVE ANALYST

On August 24, 2007, the Governor signed the 2007-08 Budget Act. In this report we highlight the major features of the budget package.

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Acknowledgments

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BUDGET OVERVIEW

On August 21, 2007, the Legislature passed the *2007-08 Budget Bill*, along with implementing legislation. The Governor signed the budget on August 24, after using his line item veto authority to reduce General Fund appropriations by \$703 million. The budget package authorizes total General Fund spending of \$102.3 billion.

General Fund Condition

The budget assumes the state ended the 2006-07 fiscal year with a reserve of \$4.1 billion. As shown in Figure 1, it projects \$102.3 billion in budget-year revenues, an increase of 6.5 percent from 2006-07. The budget authorizes expenditures of an equal amount, an increase of 0.6 percent from 2006-07. Thus, the plan leaves the General Fund with a year-end reserve of \$4.1 billion. This reserve is made up of two components:

- \$2.6 billion in the state’s traditional reserve—known as the Special Fund for Economic Uncertainties.
- \$1.5 billion in the Budget Stabilization Account, which was established when voters approved Proposition 58 in March of 2004.

The budget act provides authority for the administration to transfer these funds to the General Fund during the fiscal year if needed.

Operating Shortfalls. As noted above, 2007-08 budget expenditures do not exceed revenues. By comparison, state spending exceeded revenues by more than \$5 billion in 2006-07. Based on the 2007-08 budget plan’s policies, however, the state would once again face operating shortfalls of more than \$5 billion in both 2008-09 and 2009-10. This is because, as described below, many of the solutions enacted in the budget plan are of a one-time nature. We will be updating our fiscal projections in November 2007, when we release our *California Fiscal Outlook*.

Figure 1
2007-08 Budget General Fund Condition

(In Millions)

| | 2006-07 | 2007-08 |
|-------------------------------------|------------------|------------------|
| Prior-year fund balance | \$10,454 | \$4,811 |
| Revenues and transfers ^a | 96,013 | 102,262 |
| Total resources available | \$106,467 | \$107,073 |
| Expenditures | \$101,656 | \$102,258 |
| Ending fund balance | \$4,811 | \$4,815 |
| Encumbrances | 745 | 745 |
| Reserve^b | \$4,066 | \$4,070 |
| Budget Stabilization Account (BSA) | \$472 | \$1,494 |
| Reserve for economic uncertainties | \$3,594 | \$2,575 |

^a 2006-07 amount includes \$472 million and 2007-08 amount includes \$1.023 billion in General Fund revenues transferred to BSA, which the administration excludes from its revenue totals. These different treatments do not affect the bottom-line reserve shown.

^b Under the budget’s revenue assumptions, the state would need to appropriate from the reserve roughly \$400 million more each in 2006-07 and 2007-08 for Proposition 98 spending.

Key Features

In order to address the state's operating shortfall, the budget includes the following major solutions:

- **Proposition 98.** The Governor's May Revision revenue forecast (assumed by the Legislature in enacting its budget) results in a higher Proposition 98 guarantee for 2006-07 than included in the *2006-07 Budget Act*. Due to uncertainty regarding this revenue projection (particularly as it relates to final 2006-07 revenues), the budget does not provide \$411 million in 2006-07 Proposition 98 "settle-up" funds. As a result, the budget also assumes the 2007-08 minimum guarantee will be lower by \$427 million, generating additional General Fund savings. If the May Revision revenue forecast proves accurate, therefore, the state would owe more than \$800 million in additional funds to education under the Proposition 98 minimum guarantee. These funds would come from the budget's reserve.
 - **Transportation.** The budget uses almost \$1.3 billion in Public Transportation Account funds to reduce General Fund expenditures. The budget plan assumes \$596 million in General Fund benefit for 2008-09.
 - **Revenue Assumptions.** The budget package assumes \$1 billion in one-time revenues from the sale of EdFund, the state's nonprofit student loan guaranty agency.
- The budget also assumes \$293 million in new General Fund revenues from amended tribal gambling compacts. The budget package accelerates the transfer of \$600 million in tobacco securitization funds to the General Fund. These tobacco funds were originally scheduled to be transferred in 2008-09 and 2009-10.
- **Social Services Savings.** The budget achieves ongoing savings of about \$247 million from suspending a California Work Opportunity and Responsibility to Kids cost-of-living adjustment (COLA) for one year and permanently delaying the state Supplemental Security Income/State Supplementary Program COLA for five months.
 - **Governor's Vetoes.** The Governor vetoed \$703 million in General Fund expenditures from the budget passed by the Legislature. The largest veto was a \$332 million reduction to the state's Medi-Cal Program based on the administration's assertion that earlier estimates were too high. The second largest veto was a \$72 million reduction in the amount provided for higher state employee compensation costs. The administration expects departments to pay for these higher costs from existing funds.
- Figure 2 lists the budget bill and accompanying "trailer bills" which implement the budget package's solutions.

*Prepared by the State Administration Section—
(916) 319-8310*

Figure 2**2007-08 Budget and Budget-Related Legislation**

| Bill Number | Chapter | Author | Subject |
|-------------|---------|---------------------------------------|--------------------------------------|
| SB 77 | 171 | Ducheny | Budget bill (conference report) |
| SB 78 | 172 | Ducheny | Budget bill revisions |
| SB 79 | 173 | Committee on Budget and Fiscal Review | Transportation |
| SB 80 | 174 | Committee on Budget and Fiscal Review | Education |
| SB 81 | 175 | Committee on Budget and Fiscal Review | Corrections |
| SB 82 | 176 | Committee on Budget and Fiscal Review | Justice |
| SB 84 | 177 | Committee on Budget and Fiscal Review | Human services |
| SB 85 | 178 | Committee on Budget and Fiscal Review | Resources |
| SB 86 | 179 | Committee on Budget and Fiscal Review | General government |
| SB 87 | 180 | Committee on Budget and Fiscal Review | Taxation |
| SB 88 | 181 | Committee on Budget and Fiscal Review | Proposition 1B |
| SB 89 | 182 | Committee on Budget and Fiscal Review | EdFund |
| SB 90 | 183 | Committee on Budget and Fiscal Review | Information technology |
| SB 91 | 184 | Committee on Budget and Fiscal Review | EdFund |
| SB 97 | 185 | Dutton | California Environmental Quality Act |
| AB 199 | 186 | Budget Committee | General government revisions |
| AB 201 | 187 | Budget Committee | Proposition 1B revisions |
| AB 203 | 188 | Budget Committee | Health |



PROPOSITION 98

Figure 1 summarizes the Proposition 98 budget for K-12 schools and community colleges. As shown, the budget for 2007-08 includes \$57.1 billion in total ongoing Proposition 98 spending. This reflects an increase of \$2.1 billion, or 3.8 percent, over the prior year. Whereas General Fund support covers about one-third of this increase, additional local property tax revenue covers the remainder. Of the total increase, K-12 education funding grows by \$1.8 billion,

or 3.7 percent, and community college funding grows by \$289 million, or 4.9 percent.

Revenue Fluctuations Affect Proposition 98 Decision Making. Estimates of state revenues fluctuated notably throughout 2006-07, which, in turn, affected estimates of the 2006-07 Proposition 98 minimum guarantee. At the time of the May Revision, the Proposition 98 minimum guarantee for 2006-07 was believed to have increased by roughly \$400 million—generating

Figure 1
Ongoing Proposition 98 Budget Summary

| | 2006-07 Revised | 2007-08 Budget | Change | |
|---|--------------------|-------------------|-------------------------|----------------------|
| | | | Amount | Percent |
| Proposition 98 Funding (Dollars in Millions) | | | | |
| K-12 Education: | | | | |
| General Fund | \$36,637 | \$37,198 | \$560 | 1.5% |
| Local property tax revenue | 12,346 | 13,594 | 1,248 | 10.1 |
| Subtotals | (\$48,983) | (\$50,792) | (\$1,808 ^a) | (3.7% ^a) |
| California Community Colleges (CCC): | | | | |
| General Fund | \$4,030 | \$4,124 | \$94 | 2.3% |
| Local property tax revenue | 1,857 | 2,052 | 195 | 10.5 |
| Subtotals | (\$5,886) | (\$6,176) | (\$289) | (4.9%) |
| Other | \$114 | \$119 | \$5 | 4.3% |
| Totals | \$54,984 | \$57,087 | \$2,103 | 3.8% |
| Per Pupil Funding | | | | |
| K-12 (Average Daily Attendance) | \$8,218 | \$8,563 | \$345 ^b | 4.2% ^b |
| CCC (Full-Time Equivalent Student) | 5,164 | 5,260 | 96 ^c | 1.9 ^c |

^a Including one-time and special fund monies used for ongoing purposes, the year-to-year increase is \$2.2 billion (4.6 percent).

^b Including one-time and special fund monies used for ongoing K-12 costs in 2007-08 raises per pupil spending to \$8,635, an increase of \$417, or 5.1 percent.

^c Year-to-year change is artificially depressed because the 2006-07 amount does not reflect the reversion of \$80 million in unused enrollment funds. Adjusting for this reversion, the 2006-07 amount would be \$5,093 and the corresponding year-to-year increase would be \$167, or 3.3 percent.

Detail may not add due to rounding.

a settle-up obligation of that amount. Since the release of the May Revision, state General Fund revenues appear to be down such that no settle-up obligation is owed. The budget, therefore, contains no additional Proposition 98 funding for 2006-07. (If finalized revenue figures for 2006-07 come in higher, the state will automatically owe a settle-up payment and need to provide it through subsequent budget action. Alternatively, if finalized revenue figures come in lower than projections, the state will have spent more than the Proposition 98 minimum guarantee.) The Proposition 98 spending level for 2007-08 builds off the 2006-07 spending level assuming no settle-up payment is needed—meaning the 2007-08 funding level is about \$430 million less than the May Revision level.

Budget Relies Heavily on Non-Proposition 98 Monies, Contains Large Ongoing K-12 Shortfall. Year-to-year growth in the Proposition 98 minimum guarantee is insufficient to cover all 2007-08 K-14 baseline costs. In response, the Legislature made adjustments to the Proposition 98 budget—all relating to K-12 education. In particular, the budget package uses a considerable amount of one-time and special fund monies (\$567 million) to support baseline K-12 costs. The state, therefore, will enter 2008-09 with a large ongoing shortfall for K-12 education.

Notable Increases in Per Pupil Spending. Several factors complicate year-to-year per pupil spending comparisons. For K-12 education, the comparisons are complicated by the substantial reliance on one-time and special fund monies. If these monies are not included, ongoing Proposition 98 K-12 spending is \$8,563 per pupil in 2007-08—an increase of \$345, or 4.2 percent, over the current year (see Figure 1). If the one-time and special fund monies are included, per

pupil spending rises to \$8,635—an increase of \$417, or 5.1 percent. For community colleges, the rebenching of district apportionments resulting from enrollment declines complicates year-to-year comparisons. Without the rebenching, ongoing spending per community college full-time equivalent student increases by \$96, or 1.9 percent, over the current year. Adjusting for the rebenching, the increase would be \$167, or 3.3 percent. As shown in Figure 1, community college per pupil spending rises to \$5,260 in 2007-08.

Ongoing Proposition 98 Funding

Figure 2 (next page) displays changes in ongoing K-14 spending from the revised 2006-07 budget. Below, we highlight the major changes.

- ***COLAs.*** For both K-12 education and the community colleges, the bulk of new spending (\$2.4 billion) is for a 4.53 percent COLA.
- ***Growth.*** Whereas K-12 education achieves savings from a projected 0.48 percent decline in average daily attendance, the budget includes \$114 million to fund 2 percent enrollment growth at the community colleges.
- ***Child Care Shift.*** The budget increases the Proposition 98 share of child care funding by \$269 million, thereby achieving a like amount of General Fund savings.
- ***School Meals.*** The budget provides \$29 million to increase the school meals reimbursement rate from 15 cents to 21 cents per meal. (Technically, the budget provides \$4.3 million to increase the rate from 15 cents to 16 cents, consistent

Figure 2
Ongoing Changes for K-14 Education

2007-08 (In Millions)

| Compared to 2006-07 Revised Budget | Amount |
|---|------------------|
| K-12 Education | |
| Cost-of-living adjustment (COLA) | \$2,122.8 |
| Child care funding shift | 269.0 |
| School meals | 24.9 |
| State median income adjustment ^a | 6.8 |
| Early Mental Health Initiative | 5.0 |
| Other | 7.5 |
| Ongoing shortfall ^b | -566.6 |
| Growth/baseline adjustments | -61.0 |
| Subtotal | (\$1,808.4) |
| California Community Colleges (CCC) | |
| COLA | \$263.3 |
| Growth/baseline adjustments | 136.2 |
| Textbook Assistance Program | 1.9 |
| FCMAT audits | 0.6 |
| Foster care/kinship | 0.5 |
| Rebenching apportionments | -80.0 |
| Basic skills base reduction | -33.1 |
| Subtotal | (\$289.4) |
| Other Agencies | \$4.9 |
| Grand Total | \$2,102.7 |

^a Increases the income ceiling for child care programs to 75 percent of the 2007-08 state median income (\$50,250 for a family of four).

^b Reflects existing ongoing costs funded with one-time and special fund monies.

with a 4.53 percent COLA, and an additional \$24.9 million to further increase the rate to 21 cents, consistent with statutory directive.)

One-Time Proposition 98 Funding

In addition to the \$2.1 billion increase in ongoing Proposition 98 monies, the budget provides \$703 million one-time Proposition 98 and special fund monies for K-14 education. Figure 3 shows how these monies are to be spent. As shown, \$567 million is for ongoing K-12 transportation, maintenance, and district/

school intervention costs. (This amount reflects the ongoing shortfall discussed above.) In addition, \$100 million is provided for the K-12 Emergency Repair Program, \$15 million is provided for various other one-time K-12 initiatives, and \$21 million is provided for several one-time community college initiatives.

Governor’s Vetoes

The Governor vetoed \$52 million in ongoing Proposition 98 spending. Of this amount, the Governor vetoed \$5 million for wrap-around child care and \$47 million for several community college initiatives. The largest community college veto was a \$33 million

reduction in base funding for the basic skills program. (The Governor, however, expressed willingness to restore this funding via legislation that enhanced program accountability and student outcomes.) The Governor also vetoed a \$14 million legislative augmentation to increase the funding rate for certain noncredit community college courses. Two legislative augmentations using one-time funds were also vetoed: \$4 million for the part-time faculty health insurance program and \$1.5 million in grants for construction training programs.

In addition to reducing Proposition 98 spending, the Governor reduced General Fund (\$253,000) and federal spending (\$12 million) for K-12 education. These vetoes affect various legislative priorities—including elimination of several initiatives involving low-performing schools, alternative schools, English Learners, and special education.

*Prepared by the
K-12 Education Section—
(916) 319-8332*

Figure 3
One-Time and Special Fund Monies

(In Millions)

| | Amount |
|---|-------------------------|
| One-Time/Special Fund Monies Used for Ongoing K-12 Purposes: | |
| Home-to-School backfill | \$250.0 ^a |
| Deferred maintenance backfill | 115.5 |
| High Priority School Grant Program backfill | 102.0 |
| Home-to-School backfill | <u>99.1^b</u> |
| Total—Ongoing Purposes | \$566.6 |
| One-Time Monies Used for One-Time Purposes: | |
| K-12 Education | |
| Emergency Repair Program | \$100.0 |
| Teacher Credentialing Block Grant | 8.8 |
| Community Day School deficiency | 4.1 |
| High-Speed Network technology refresh | 1.9 |
| FCMAT audits | <u>0.4</u> |
| Subtotal | (\$115.2) |
| Community Colleges | |
| Maintenance and special repairs ^c | \$8.1 |
| Nursing/allied health equipment | 8.1 |
| New nursing programs | 4.0 |
| Cal-PASS faculty councils | <u>1.0</u> |
| Subtotal | (\$21.2) |
| Total—One-Time Purposes | \$136.4 |
| Grand Total—One-Time/Special Fund Spending | \$703.0 |

^a Reflects amount shifted from the Emergency Repair Account back to the Proposition 98 Reversion Account.
^b Reflects monies from the Public Transportation Account.
^c Funds may be used for scheduled maintenance, special repairs, and various other purposes.



HIGHER EDUCATION

The budget provides a total of \$11.3 billion in General Fund support for higher education in 2007-08 (see Figure 1). This reflects an increase of \$375 million, or 3.4 percent, above the amount provided in 2006-07. As shown in the figure, the budget provides the University of California (UC) with \$3.3 billion in General Fund support, which is \$191 million, or 6.2 percent, more than the 2006-07 level. For the California State University (CSU), the budget provides \$3 billion in General Fund support, which is an increase of \$176 million, or 6.2 percent.

The budget provides the California Community Colleges (CCC) with \$4.2 billion in General Fund support for 2007-08, which is \$61 million less than 2006-07. (All but about \$30 million of this amount counts toward Proposition 98.)

However, as explained in the prior section on K-14 Proposition 98 support, CCC also receives more than \$2 billion in local property tax revenue that is interchangeable with General Fund support for program purposes. When General Fund and local property tax support are combined, CCC's Proposition 98 funding increases by \$289 million, or 4.9 percent, from the prior

year. These figures reflect gubernatorial vetoes of \$47 million in CCC Proposition 98 ongoing funding, due to a base reduction in the basic skills program (\$33 million) and the veto of a legislative augmentation for certain noncredit courses (\$14 million).

The budget also provides \$873 million in General Fund support to the California Student Aid Commission (CSAC). This funding, which supports the state's Cal Grant and other financial aid programs, is \$70 million, or 8.7 percent, above the 2006-07 level.

Intersegmental Issues

Base Increases. All three higher education segments received substantial General Fund base augmentations to address salaries and other cost

Figure 1

Higher Education General Fund Support

(Dollars in Millions)

| | 2006-07 | 2007-08 | Change | |
|---|-------------------|-------------------|----------------|-------------|
| | | | Amount | Percent |
| University of California | \$3,083.4 | \$3,273.9 | \$190.6 | 6.2% |
| California State University | 2,810.4 | 2,985.9 | 175.5 | 6.2 |
| California Community Colleges ^a | 4,215.6 | 4,154.2 | -61.4 | -1.5 |
| Student Aid Commission | 802.9 | 873.0 | 70.0 | 8.7 |
| Hastings College of the Law | 10.7 | 10.6 | — ^b | — |
| California Postsecondary Education Commission | 2.2 | 2.2 | — ^b | — |
| Totals | \$10,925.1 | \$11,299.8 | \$374.7 | 3.4% |

^a Excludes more than \$2 billion in local property tax revenue under Proposition 98. See previous section for more information on community college funding.

^b Less than \$50,000.

increases. These include \$117 million (4 percent) for UC, \$109 million (4 percent) for CSU, and \$263 million (4.5 percent) for CCC. The CCC's base increase follows the same statutory formula used to calculate the K-12 cost-of-living adjustment.

Enrollment Growth. The three higher education segments received augmentations to fully fund all anticipated enrollment growth. The budget provides a total of \$117 million for 2.5 percent growth at both UC and CSU. This funds an additional 5,000 full-time equivalent (FTE) students at UC and 8,355 FTE students at CSU. Funding for these students is determined using a methodology adopted by the Legislature in 2006-07 for determining the marginal cost of serving each additional student. For the second year in a row, the Legislature rejected a different methodology proposed by the Governor.

The budget provides CCC with \$114 million to fund enrollment growth of 2 percent, or about 22,000 FTE students. The budget also reverts \$80 million associated with enrollment slots that were unfilled in 2006-07. Even after this reversion, however, CCC retains additional unused enrollment funding. When this existing enrollment capacity is combined with the funded growth, CCC could accommodate a total of 34,000 ad-

ditional FTE students in 2007-08.

Student Fees. The budget assumes UC and CSU will receive additional revenue as a result of fee increases of 7 percent and 10 percent, respectively. These fee increases are expected to provide UC with an additional \$105 million and CSU with an additional \$98 million. Fees at the community colleges would remain unchanged at \$20 per unit.

Student Academic Preparation (Outreach). The Legislature rejected the Governor's proposal to eliminate General Fund support for student academic preparation programs at UC and CSU. Instead, the budget provides General Fund support of \$19.3 million to UC and \$7 million to CSU for these programs.

Proposed Sale of EdFund

The budget package assumes the sale of EdFund, which is a nonprofit public benefit corporation that acts on behalf of CSAC to administer federal loan guarantee programs. The budget assumes that the sale would provide \$980 million in net one-time revenue to the state. With the sale of EdFund, CSAC would relinquish its status as California's federally designated guarantor for the Federal Family Education Loan program.

*Prepared by the Higher Education Section—
(916) 319-8331*

IV

HEALTH

The 2007-08 budget plan provides about \$20.3 billion from the General Fund for health programs, which is an increase of about \$734 million, or 3.8 percent, compared to the revised prior-year level of spending. Several key aspects of the budget package are discussed below and summarized in Figure 1.

Medi-Cal

The 2007-08 enacted budget provides about \$14.3 billion from the General Fund (\$37 billion all funds) for Medi-Cal local assistance expenditures. This amounts to about a \$642 million, or

5 percent, increase in General Fund support for Medi-Cal local assistance. This increase would have been greater except for combined Governor’s vetoes of \$416 million General Fund from the budget. In his veto messages, the Governor indicated that \$332 million of this reduction is based on historical data showing that on average, over the last three fiscal years, Medi-Cal expenditures have fallen short of estimated levels. However, if expenditures exceed the revised level, the Legislature would have to pass a supplemental appropriations bill.

Figure 1

Major Changes—State Health Programs 2007-08 General Fund Effect

(In Millions)

Medi-Cal

| | |
|---|--------|
| Governor's veto to reduce program spending | -\$332 |
| Increase rates for managed care plans | 54 |
| Governor's veto to eliminate “hold harmless” for certain managed care plans | -53 |
| Reduce reimbursement rates for drug ingredients | -39 |
| Increase funding for county administration to comply with new federal eligibility law | 25 |
| Exempt certain minors from new federal eligibility law | 20 |

Public Health

| | |
|--|-----|
| Expand efforts to investigate occurrences of foodborne illnesses | \$1 |
|--|-----|

Department of Developmental Services

| | |
|---|--------|
| Use Public Transportation Account funds for regional center transportation services | -\$129 |
|---|--------|

Department of Mental Health

| | |
|--|-------|
| Governor's veto of funding for Integrated Services for Homeless Mentally Ill Program | -\$55 |
| Address prior-year deficiency in Early and Periodic Screening, Diagnosis and Treatment program | 87 |
| Implement Proposition 83 (Jessica's Law) and SB 1128 (Alquist) | 32 |

Department of Alcohol and Drug Programs

| | |
|---|-------|
| Reduce spending on Proposition 36 drug programs | -\$25 |
|---|-------|

Major Cost Factors. The net increase in expenditures primarily reflects: (1) increases in managed care provider rates, (2) lower drug costs, (3) increases in county administration costs due to changes in federal law, and (4) ongoing growth in base costs and caseloads. Specifically, the Medi-Cal Program is assumed to grow by about 50,000 cases, or 0.8 percent, in 2007-08 to a total of 6.6 million average monthly users.

Changes in Medi-Cal Managed Care Provider Rates. The budget plan includes \$54 million General Fund for rate adjustments to Medi-Cal managed care plans as determined by a new rate setting methodology which will be applied to rates established beginning August 1, 2007. The Governor vetoed \$53 million in General Fund approved by the Legislature to “hold harmless” certain managed care plans that would have otherwise received a rate reduction under the new rate setting methodology.

Drug Cost Savings. The budget plan includes savings of almost \$39 million General Fund due to reductions in the amount Medi-Cal will reimburse pharmacies for certain drug ingredients. It is anticipated that the reduction in drug ingredient payments will bring them more in line with the actual cost of drug ingredients to pharmacies. The change in reimbursements to pharmacies is consistent with recent changes in federal law and regulations. In order to help ensure that pharmacies continue to participate in Medi-Cal after their reimbursements for certain drug ingredients are reduced, the Legislature adopted statutory language to allow for a one-time adjustment in the dispensing fee paid to pharmacies.

County Administration. The budget plan includes increased funding for county administration costs due mainly to program growth, and adjustments to account for increased costs.

The budget plan also includes about \$25 million General Fund for one-time and ongoing costs for implementation of the federal Deficit Reduction Act citizenship verification requirements.

Minor Consent. The budget plan includes \$20 million General Fund to backfill a loss of federal funds. California will not require minors who independently seek certain health care services to show proof of citizenship and personal identification. As such, the state will not receive its usual federal share of funding for services provided to these beneficiaries.

Establishment of the Department of Public Health

Effective July 1, 2007, Chapter 241, Statutes of 2006 (SB 162, Ortiz), created the new Department of Public Health (DPH) and the Department of Health Care Services (DHCS) from the existing Department of Health Services (DHS). The DPH will administer a broad range of public and environmental health programs to prevent illness in, and promote the health of, the public at large. In contrast, DHCS will deliver health care services to eligible individuals, through the state’s Medicaid program (known as Medi-Cal in California) and through other programs, such as the Genetically Handicapped Persons Program and the California Children’s Services Program. As intended by Chapter 241, the creation of the two new departments did not result in increased expenditures for state operations in 2007-08.

Public Health Programs

The 2007-08 enacted budget provides about \$390 million from the General Fund (\$3.1 billion all funds) for support of public health programs. The Legislature adopted statutory language requiring more accountability in budgeting for the

new DPH in order to ensure that it will be able to better exercise fiscal oversight in the future. Specifically, the amounts budgeted for each branch within DPH have to be identified by the administration in budget documents starting in 2008-09.

Foodborne Illness. The budget plan provides almost \$1 million for DPH to expand its existing efforts to investigate foodborne illnesses and to provide additional emergency outbreak investigation capacity. These additional resources should increase DPH's capability to investigate foodborne illnesses, obtain and review food processors' records, review growing and harvesting practices on farms, and embargo contaminated products.

Healthy Families Program

The 2007-08 enacted budget provides about \$399 million from the General Fund (\$1.1 billion all funds) for local assistance under the Healthy Families Program. This reflects an increase of about \$94 million all funds (\$36.5 million General Fund), or almost 10 percent, in annual spending for the program. This growth is primarily due to increases in caseload and provider rates.

Department of Developmental Services

The budget provides \$2.6 billion from the General Fund (\$4.4 billion all funds) for services to individuals with developmental disabilities in developmental centers (DCs) and regional centers (RCs). This amounts to an increase of about \$96 million, or 3.7 percent, in General Fund support over the revised prior-year level of spending.

Community Programs. The 2007-08 budget includes a total of \$2.2 billion from the General Fund (\$3.6 billion all funds) for community services for the developmentally disabled, an

increase in General Fund resources of about \$108 million over the revised prior-year level of spending. The growth in community programs is due mainly to increases in caseload, costs, and utilization of RC services. The budget continues several, mostly temporary, actions to hold down community program costs.

The budget plan includes an allocation of \$129 million from the Public Transportation Account (PTA) in lieu of General Fund to provide certain transportation services to RC clients. If this allocation from the PTA had not been included in the budget, General Fund expenditures for community services for 2007-08 would have grown by about \$237 million above the prior-year spending level.

Agnews Developmental Center Closure. The budget continues to support plans to close Agnews DC and place many of its clients in community programs by June 2008.

Department of Mental Health

The budget provides about \$1.9 billion from the General Fund (\$4.8 billion all funds) for mental health services provided in state hospitals and in various community programs. This is an increase of about \$49 million from the General Fund compared to the revised prior-year level of spending.

Community Programs. The 2007-08 budget includes about \$777 million from the General Fund (\$3.5 billion all funds) for local assistance for the mentally ill, a decrease of about \$73 million in General Fund support compared to the revised prior-year level of spending.

Integrated Services for Homeless Mentally Ill Program. The Governor vetoed almost \$55 million General Fund for Integrated Services for Homeless Mentally Ill, effectively eliminating

all funding for the program. In his veto message the Governor indicated that counties could choose to restructure the program to meet the needs of the counties' homeless population using other county funding sources, such as federal funds, realignment funds, or Proposition 63 funds.

Early and Periodic Screening Diagnosis and Treatment (EPSDT). The budget provides about \$454 million General Fund for support of EPSDT, an increase over the prior-year adjusted spending level of almost \$48 million or 12 percent. This increase is due mainly to increases in caseload and utilization of services. The increase also reflects modifications to the estimating methodology to eliminate adjustments that generally caused estimates to understate costs in prior years. The modifications to the estimating methodology were recommended by the Department of Finance's Office of State Audits and Evaluations which reviewed the Department of Mental Health's (DMH's) estimating methodology in light of significant prior-year deficiencies.

The budget provides about \$87 million General Fund as the first of three annual payments to reimburse counties for costs from prior years for EPSDT. The prior-year deficiency for the fiscal years 2003-04 through 2005-06, totaling about \$260 million, is attributed to several factors including misestimating of EPSDT claims and different accounting methodologies employed by DMH and DHS in conjunction with a technical fund shift that occurred in 2006-07.

SB 1128 and Proposition 83 (Jessica's Law). Recent legislation, Chapter 337, Statutes of 2006 (SB 1128, Alquist), and the passage in November of 2006 of Proposition 83, also known as Jessica's Law, increased the DMH workload related to screening, evaluating, and housing sexually

violent predators (SVPs). The budget provides about \$27 million for clinical evaluations of sex offenders and court costs mostly related to SVP commitment proceedings. The budget also provides \$4.8 million to address increased administrative workload related to implementation of Chapter 337 and Proposition 83.

State Hospitals. The budget provides about \$1.1 billion from the General Fund for state hospital operations. The \$110 million increase in General Fund resources over the prior-year funding level is due to several factors including caseload that is anticipated to increase from about 5,590 in the prior year to almost 6,100, or by about 9 percent. Almost one-half of the year-over-year increase in projected caseload is from anticipated growth in the number of SVPs that will receive civil commitments.

Salary Increases for DMH Hospital Staff. A federal court, under the *Coleman v. Schwarzenegger* case, ordered pay increases for certain classifications of mental health care positions within the California Department of Corrections and Rehabilitation (CDCR) to address the shortage of these workers within CDCR institutions. This created a wage differential between mental health care workers in CDCR facilities and DMH hospitals. The budget plan provides funding for various salary increases in order to provide an incentive to DMH staff to remain at state hospitals instead of transferring to CDCR facilities to obtain higher salaries ordered by the federal court in the *Coleman* and other cases.

Department of Alcohol and Drug Programs

The budget provides about \$294 million from the General Fund (\$679 million all funds) for community programs operated by the De-

partment of Alcohol and Drug Programs. This is about a \$2.1 million, or 1 percent decrease, in General Fund support compared to the revised prior-year level of spending for alcohol and drug programs.

Proposition 36. The budget provides \$100 million in funding for the Substance Abuse and Crime Prevention Act (also known as Propo-

sition 36), a reduction of \$20 million, or about 17 percent from the prior-year funding level. In addition, the budget provides \$20 million General Fund for Proposition 36 substance abuse treatment services that are provided through the Substance Abuse Offender Treatment Program, a reduction of \$5 million from the prior-year funding level.

*Prepared by the Health Section—
(916) 319-8362*



SOCIAL SERVICES

General Fund support for social services programs in 2007-08 totals \$9.5 billion, a decrease of about \$400 million (4.1 percent) since the prior year. Most of this decrease is due to savings from using Proposition 98 funds for California Work Opportunities and Responsibility to Kids (CalWORKs) child care, replacing General Fund support for CalWORKs grants with federal Temporary Assistance for Needy Families (TANF) funds, and avoiding federal child support automation penalties by seeking certification for an “alternative” system. These savings are partially offset by increased caseload costs in various social services programs and augmentations for programs for children. The adopted budget rejects the Governor’s proposals to (1) establish new sanctions and time limits for CalWORKs children and (2) freeze state participation in In-Home Supportive Services provider wages at current levels. The

2007-08 Budget Act and related legislation make various changes to current law and the fiscal impacts of these changes are summarized in Figure 1.

Figure 1
Major Changes—Social Services Programs
2007-08 General Fund

(Dollars in Millions)

| Programs | Change |
|--|-----------------|
| SSI/SSP | |
| Permanently reschedule January COLA to June | -\$123.0 |
| Establish interim assistance for naturalizing noncitizens | — |
| CalWORKs | |
| Use Proposition 98 funds for stage 2 child care | -\$269.0 |
| Suspend July 2007 COLA (3.7 percent) | -124.0 |
| Use TANF reserve to offset General Fund costs | -84.0 |
| Replace General Fund with Employment Training Fund | -25.0 |
| Child Welfare Services, Foster Care, Adoptions | |
| Increase for transitional housing for foster youth | \$20.2 |
| Establish single rate for "dual agency" foster children receiving regional center services | 15.2 |
| Increase most foster care rates by 5 percent | 9.6 |
| Increase private adoption reimbursement rate | 2.0 |
| Establish single rate for dual agency foster children receiving regional center services | 15.2 |
| Community Care Licensing | |
| Increase random inspection visits | \$2.3 |
| Department of Child Support Services | |
| Backfill for reduced federal incentive funds | \$ 23.0 |
| Mandatory federal fee | 1.8 |
| Automation penalty held in abeyance | -220.0 |
| Employment Development Department | |
| Reduce support for job services | -\$12.1 |
| Total | -\$783.0 |

TANF = Temporary Assistance for Needy Families.

SSI/SSP

COLA Delayed. Trailer bill legislation permanently reschedules from January to June the annual state Supplemental Security Income/State Supplementary Program (SSI/SSP) cost-of-living adjustment (COLA). This results in a five-month savings of \$123 million in 2007-08, compared to prior law. Recipients will continue to receive their federal COLA each January.

Interim Assistance for Naturalizing Noncitizens. The Cash Assistance Program for Immigrants (CAPI) provides state-only funded benefits to legal noncitizens who are ineligible for federal SSI/SSP benefits due solely to their immigration status. Trailer bill legislation establishes an interim assistance program for CAPI recipients who naturalize and apply for federal benefits. Once CAPI recipients are granted SSI, the federal Social Security Administration will reimburse the state for the interim assistance that was provided by the state. Providing CAPI interim assistance is expected to be cost neutral, with a possibility of savings, because it removes a barrier for current CAPI recipients to naturalize, potentially reducing the caseload for this state-only funded program.

CalWORKs

Proposition 98 Funding for Stage 2 Child Care. The budget uses \$269 million in Proposition 98 funds to replace an identical amount of TANF funding for Stage 2 child care. The freed-up TANF funds are then used to offset grant costs in CalWORKs, resulting in a General Fund savings of \$269 million.

COLA Suspended. Trailer bill legislation suspends the statutory July 2007 COLA, resulting in a savings of \$124 million.

Use TANF Reserve Funds to Offset General Fund Costs. The budget uses \$84 million from

the TANF reserve to replace General Fund support for CalWORKs grants.

Employment Training Fund Shift. The budget shifts an additional \$25 million (to a total of \$45 million) in Employment Training Funds to offset General Fund costs for CalWORKs welfare-to-work services.

**Child Welfare Services,
Foster Care, and Adoptions**

Transitional Housing for Foster Youth. The budget provides \$35.7 million (\$20.2 million above the Governor's May Revision) for county-operated housing assistance programs for emancipating foster youth. This level of funding will allow additional counties to begin providing these services and makes \$10.5 million available to reimburse counties for costs incurred during 2006-07.

Modifying Foster Care Payments for Developmentally Disabled Children. Trailer bill legislation prospectively stabilizes the foster care grants for developmentally disabled children, sometimes referred to as "dual agency" children. Currently, some developmentally disabled children receive the standard foster care rates of \$1,067 (for children age three and over) and \$495 (for children under age three) while other developmentally disabled children receive a rate of \$5,159 per month, which corresponds to the Department of Developmental Services' regional center community care facility rates. Trailer bill legislation prospectively establishes a rate of \$2,006 per month for children age three and over and \$898 per month for those under the age of three. Foster children receiving less than \$2,006 (or \$898) will have their rates increased, while children already at higher rates (\$5,159 for example) would continue at that rate. There would be no change in other services provided by the regional centers for these children. In

addition, certain severely disabled children will be eligible for an additional \$1,000 per month if they meet specified criteria. This change results in additional costs to bring current rates up to \$898 and \$2,006 (\$22.3 million), and prospective savings from preventing future cases from receiving the previous rate of up to \$5,159 (-\$7.1 million), for a net cost of \$15.2 million in 2007-08. In future years, this change will result in ongoing estimated annual savings of \$46 million.

Foster Care Rate Increase. Effective January 1, 2008, trailer bill legislation increases reimbursement rates for foster family homes and group homes by 5 percent. Rates for foster family agency homes remain unchanged. Parents adopting foster children after January 1, 2008 will be entitled to a corresponding 5 percent increase in their adoptions assistance payment. These changes result in costs of \$9.6 million in 2007-08, rising to about \$20 million in 2008-09.

Private Adoption Agency Reimbursement Payments. Effective February 1, 2008, trailer bill legislation increases the adoption reimbursement rate for private agencies which place special needs foster children in adoptive homes from \$5,000 to \$10,000 per adoption. This results in General Fund costs of \$2 million in 2007-08, rising to \$10 million in 2008-09. To the extent this increase in reimbursement rates results in more adoptions, there will be future savings in Medi-Cal and child welfare services.

Adult Protective Services (APS)

APS Augmentation. The Legislature provided an additional \$12 million General Fund for the APS Program. However, the Governor vetoed this augmentation.

Community Care Licensing

Increased Inspections. Currently the state conducts random inspections at 20 percent of child

care and other residential facilities. The budget includes \$2.3 million additional funding to increase the rate of random inspections to 30 percent.

Department of Child Support Services

Backfill Lost Federal Incentive Funds. Previously, states could reinvest federal incentive funds in order to draw down additional federal matching funds. The Deficit Reduction Act (DRA) of 2005 eliminated this matching opportunity. The budget provides \$23 million General Fund to backfill for the loss of federal matching funds due to DRA.

Mandatory Federal Fee. Pursuant to DRA, effective January 1, 2008, California must pay a fee of \$25 for each never-assisted child support case for which \$500 or more is collected, resulting in a cost of \$1.8 million. Although the state has the option of recouping the cost of this fee from the noncustodial or custodial parents, the budget pays the fee with General Fund monies.

Federal Penalty Held in Abeyance. Since 1998, the state has paid a total of nearly \$1.2 billion in penalties for failing to have a single state-wide automation system. In September 2006, the department applied for federal certification of its automated system. While the federal government reviews California's request for alternative certification, penalties are held in abeyance, resulting in savings of \$220 million.

Employment Development Department

The Governor's budget proposed to eliminate state support for the job services program, resulting in a General Fund savings of \$27.1 million. Although the Legislature restored all of this funding, the Governor vetoed \$12.1 million.

*Prepared by the Social Services, Labor, and
Information Technology Section—
(916) 319-8353*

VI

JUDICIARY & CRIMINAL JUSTICE

The 2007-08 budget plan contains almost \$13 billion from the General Fund for judicial and criminal justice programs, including support of ongoing programs and capital outlay projects. This is an increase of \$770 million, or 6.3 percent, above the revised level of General Fund expenditures for 2006-07. Figure 1 shows the changes in General Fund expenditures in some of the major judicial and criminal justice budgets. Below, we highlight the major changes in these budgets.

Judicial Branch

The budget includes \$3.8 billion for support of the judicial branch. This amount includes \$2.2 billion from the General Fund and \$499 million transferred from the counties to the state, with most of the remaining balance of about \$1 billion derived from fine, penalty, and court fee revenues. The General Fund amount is \$211 million or almost 11 percent greater than the revised 2006-07 amount.

Court Operations.

Funding for trial court operations is the single largest component of the judicial branch budget, accounting for about 86 percent of total judi-

cial branch spending. The 2007-08 budget provides for growth in trial court operations funding based on the annual change in the state appropriations limit (\$127 million) and partial-year funding for 100 new superior court judgeships (\$25 million). It also includes \$36 million from the State Court Facilities Construction Fund for acquisition (\$31 million) and working drawings (\$4.7 million) related to 12 courthouse construction projects.

Corrections and Rehabilitation

The budget contains about \$9.7 billion from the General Fund for support of the California Department of Corrections and Rehabilitation (CDCR), an increase of \$529 million, or 5.7 percent, above the revised 2006-07 level.

Figure 1

Judicial and Criminal Justice Budget Summary General Fund

(Dollars in Millions)

| Program/Department | 2006-07 | 2007-08 | Change | |
|--|-----------------|-----------------|--------------|-------------|
| | | | Amount | Percent |
| Department of Corrections and Rehabilitation | \$9,210 | \$9,739 | \$529 | 5.7% |
| Judicial Branch | 2,010 | 2,221 | 211 | 10.5 |
| Department of Justice | 406 | 412 | 6 | 1.5 |
| Citizens' Option for Public Safety | 119 | 119 | — | — |
| Juvenile Justice Crime Prevention Act Grants | 119 | 119 | — | — |
| Other Criminal Justice Programs ^a | 290 | 314 | 24 | 8.3 |
| Totals | \$12,154 | \$12,924 | \$770 | 6.3% |

^a Includes debt service on general obligation bonds, the State Criminal Alien Assistance Program, Office of the Inspector General, the State Public Defender, and other programs.

Adult Corrections. Major new spending includes funding to implement Proposition 83 (Jessica’s Law) and other initiatives related to the management of sex offenders under parole supervision (\$106 million). The budget also includes funding to upgrade prison maintenance (\$36 million), develop information technology infrastructure at state prisons (\$32 million), and provide 111 new staff and contract resources to implement the recently approved prison construction program authorized in Chapter 7, Statutes of 2007 (AB 900, Solorio) (\$2 million General Fund and \$10 million reimbursements). As shown in Figure 2, the spending plan implements new and expanded programs to reduce recidivism among adult offenders (\$96 million, including base funding), as well as reduces revenues the state receives from fees charged on collect telephone calls made by inmates (\$7 million in the budget year, growing to \$26 million annually in 2010-11).

Adult Correctional Health Services. The budget plan funds new and continuing initiatives to carry out the remedial plans of the federal

Receiver and comply with court orders in the *Plata* case relating to inmate medical services (\$354 million in various funding allocations, plus a shift of \$66 million in funding within the corrections budget for medical guarding and transportation). Additional support funding is provided to comply with settlements in the *Perez* inmate dental care legal case (\$79 million) and the *Coleman* mental health case (\$81 million). The various support-spending items related to inmate health care are summarized in Figure 3 (next page). Also, the budget plan directs that a \$56 million 50-bed mental health crisis unit at California Men’s Colony (near San Luis Obispo) be designed and constructed using available lease-revenue bond funding if the *Coleman* court does not agree to fold the project into a larger mental health bed facility proposed for the same prison.

Juvenile Justice Programs. The 2007-08 budget plan enacts a major policy change under which nonviolent juvenile offenders would no longer be held at state juvenile facilities and new grant programs would be created to support programs for these offenders at the local

level. In approving this change, the Governor vetoed about \$15 million in one-time grants to assist with this transition. Also, \$100 million in bond funding would be provided to construct or renovate local juvenile facilities. (The fiscal impact of this policy change is a net savings of about \$12 million in 2007-08 that eventually reaches \$70 million in

Figure 2
Increased Funding for Recidivism Reduction Programs

(In Millions)

| | |
|--|-----------------|
| Base Funding Level 2006-07 | \$52.8 |
| Program Funding Increases | |
| Parole programs | \$24.1 |
| Inmate rehabilitation and treatment | 3.9 |
| Community partnerships | 3.6 |
| Inmate education | 1.1 |
| Other programs | 4.4 |
| Subtotal, funding increases | <u>(\$37.3)</u> |
| Total Funding 2007-08^a | \$90.1 |

^a Budget also includes reduced revenues (\$6.5 million) from phasing out fees charged on collect calls made by inmates.

Detail may not total due to rounding.

subsequent years.) The budget provides additional support and capital outlay funding to comply with the legal settlement of the *Farrell* lawsuit to remedy inadequate conditions for offenders held in institutions operated by the Division of Juvenile Facilities within CDCR. These projects include modular buildings to expand program space, telecommunication improvements, and renovation of existing buildings (\$10 million General Fund).

Anti-Gang Programs

The spending plan establishes an anti-gang coordinator position and three new gang prevention grant programs in the Office of Emergency Services (\$466,000 General Fund and \$9.5 million from the Restitution Fund). The grant programs target specific cities with heavy gang concentrations, provide competitive grants to cities as a whole, and support community-based organizations that provide services designed to reduce gang activity. The budget also provides \$820,000 General Fund to expand to additional juvenile institutions Project IMPACT, a program to deter offenders from gang participation.

Local Assistance Programs

The budget establishes two one-time proba-

tion pilot projects mainly to improve probation supervision and services to serve at-risk youth from age 18 to 25 (\$10 million General Fund). The programs would be administered by the Corrections Standards Authority (CSA) within CDCR. The spending plan also reduces funding (by \$15 million General Fund) for the Mentally Ill Offender Crime Reduction program (also now administered by CSA) aimed at reducing recidivism among adult and juvenile offenders.

*Prepared by the Criminal Justice Section—
(916) 319-8350*

Figure 3

**Adult Correctional Health Care Services Costs
General Fund**

(In Millions)

| Services | 2007-08 |
|--|--------------|
| Medical Services | |
| Receiver's reserve fund | \$125 |
| Receiver's request to augment CDCR medical item | 128 |
| Cost in 2007-08 of <i>Plata</i> actions initiated in 2006-07 | 70 |
| <i>Plata</i> salary enhancements | 31 |
| Shift of medical guarding and transportation ^a | — |
| Subtotal | (\$354) |
| Dental Services | |
| <i>Perez</i> salary enhancements | \$57 |
| Staffing adjustments for <i>Perez</i> | 21 |
| Increased dental staff at headquarters | 2 |
| Subtotal | (\$79) |
| Mental Health Services | |
| <i>Coleman</i> salary enhancements | \$50 |
| Cell modifications to reduce suicide risks | 18 |
| Activation of California Medical Facility crisis beds | 8 |
| Reception center mental health services | 5 |
| Subtotal | (\$81) |
| Total | \$514 |

^a No net cost. Transfer of \$66 million from CDCR custody to medical operations.
CDCR = California Department of Corrections and Rehabilitation.
Detail may not total due to rounding.

VII

TRANSPORTATION

Department of Transportation

The 2007-08 budget plan provides total expenditures of \$13.4 billion from various fund sources for the Department of Transportation (Caltrans). This level of expenditures is substantially higher than the expenditure level in 2006-07—by about \$2.2 billion (or 20 percent). The higher level reflects significantly higher expenditures in capital outlay and local assistance for transportation projects funded from bonds authorized by Proposition 1B, passed by voters in November 2006.

The 2007-08 budget provides approximately \$6 billion for transportation capital outlay, \$2.5 billion for local assistance, \$1.8 billion for capital outlay support, and about \$1.4 billion for highway operations and maintenance. The budget also provides \$1 billion for Caltrans' mass transportation and rail program and \$562 million for transportation planning and department administration.

Full Funding of Proposition 42. Consistent with the requirements of Proposition 42, the 2007-08 budget provides for the transfer of gasoline sales tax revenue from the General Fund to the Transportation Investment Fund (TIF) for transportation purposes. The total transfer is projected at \$1.48 billion. This amount is to be allocated as follows:

- \$602 million for the Traffic Congestion Relief Program to fund 141 state and local transportation projects.

- \$702 million for the State Transportation Improvement Program to fund state and local transportation projects.
- \$176 million to the Public Transportation Account (PTA) for mass transportation purposes.

Repayment of Past Proposition 42 Suspensions. Proposition 1A, passed by voters in November 2006, requires Proposition 42 suspensions that occurred in 2003-04 and 2004-05 to be repaid from the General Fund, with interest, no later than June 30, 2016, with the annual repayment being at least one-tenth the amount owed. The budget includes \$83 million from spillover revenue (discussed below) to repay one-ninth of the outstanding amount in 2007-08. Figure 1 (next page) shows the past Proposition 42 suspensions and the repayments to TIF in 2007-08 and subsequent years.

Tribal Compact Revenues to Repay Debt, Instead of Bonds. Under current law, \$1.2 billion in previous loans to the General Fund from the Traffic Congestion Relief Fund (TCRF) are to be repaid by tribal gaming revenue bonds. Due to pending lawsuits, the bonds will likely not be issued in 2007-08. Instead, the budget uses \$100 million in tribal compact revenue each in 2006-07 and 2007-08 to repay a portion of the loan, as reflected in Figure 1. The repayments will, in turn, be used to repay the State Highway Account for previous loans made to TCRF.

Expenditures of Proposition 1B Bond Funds. Proposition 1B authorized the issuance of \$20 billion in general obligation bonds for state and local transportation improvements. All Proposition 1B funds are subject to appropriation by the Legislature. The 2007-08 budget appropriates a total of \$4.2 billion for various programs. Figure 2 shows the amount the budget provides to the individual programs. The funding will mainly be used for capital outlay and local assistance purposes. The Legislature also adopted trailer bill legislation that further defines and directs the implementation of Proposition 1B programs.

Delivery of Transportation Projects. The budget provides \$1.8 billion to Caltrans to fund 12,549 personnel-year equivalents (PYEs) in staff resources to design and engineer transportation projects. This is an increase of 527 PYEs over the 2006-07 level.

Figure 1
Transportation Loans and Repayments^a

(In Millions)

| Year | To General Fund ^b | | To TCRF ^c | |
|-------------------------|------------------------------|----------|----------------------|----------|
| | From TCRF ^d | From TIF | From SHA | From PTA |
| Balance through 2003-04 | \$1,383 | \$868 | \$463 | \$275 |
| 2004-05 | -183 | 1,258 | -20 | — |
| 2005-06 | -151 | — | -151 | — |
| 2006-07 | -100 | -1,373 | -100 | — |
| 2007-08 | -100 | -83 | -100 | — |
| 2008-09 | -100 | -83 | -92 | — |
| 2009-10 | -100 | -83 | — | — |
| Beyond 2009-10 | -649 | -504 | — | -275 |

SHA = State Highway Account; TCRF = Traffic Congestion Relief Fund; TIF = Transportation Investment Fund; PTA = Public Transportation Account.

^a Amounts do not include interest.

^b Positive numbers are amounts payable to the General Fund, negative numbers are amounts payable from the General Fund.

^c Positive numbers are amounts payable to TCRF, negative numbers are amounts payable from TCRF.

^d Funds shown from the General Fund as payment to the TCRF in 2005-06 and beyond come from tribal gaming revenues. Assumes no gaming bonds would be issued.

Figure 2
2007-08 Appropriations of Proposition 1B Funds

(In Millions)

| Program | Amount |
|---|------------------|
| Local Streets and Roads | \$950.0 |
| Public Transportation Modernization | 788.1 |
| State Transportation Improvement | 727.4 |
| Corridor Mobility Improvement | 608.3 |
| State Highway Operations and Protection | 402.8 |
| Air Quality | 250.0 |
| School Bus Retrofit | 193.0 |
| Railroad Crossing Safety | 123.1 |
| Transit Security | 101.5 |
| Port Security | 41.1 |
| Highway 99 Improvement | 14.3 |
| Local Bridge Seismic | 13.6 |
| Trade Corridor Improvement | 0.1 |
| Total | \$4,213.3 |

Special Transportation Programs

Substantial Public Transportation Funds Used to Help General Fund. The PTA derives its revenues from diesel sales tax and a portion of the gasoline sales tax, including a portion known as the “spillover.” The account also receives a portion of Proposition 42 gasoline sales tax revenue. Funds in the PTA are required statutorily to be used for mass transportation and planning purposes. Due to high gasoline prices, the budget projects that spillover revenues will total \$827 million in 2007-08. Due to the state’s fiscal condition, the budget allocates about \$1.3 billion in PTA funds, including spillover, to fund activities that have traditionally been paid from the General Fund. Specifically:

- **Transportation Bond Debt Service.** The budget uses \$948 million to pay for debt service of transportation bonds, including \$339 million for costs in 2007-08 and \$609 million to reimburse the General Fund for similar costs incurred in prior years.
- **Regional Center Transportation.** The budget provides \$129 million in PTA funds to pay for the cost of regional center transportation.
- **Home-to-School Transportation.** The budget provides \$99 million in PTA funds to cover a portion of the cost of home-to-school transportation in 2007-08.
- **Partial Repayment of Proposition 42 Loan.** As noted above, the budget provides \$83 million in spillover revenue to repay a portion of the outstanding Proposition 42 loan in 2007-08.

The Legislature also adopted trailer bill legislation to provide transportation funds on an ongoing basis to help the General Fund beyond 2007-08. Specifically, one-half of spillover revenue will be deposited in a newly created Mass Transportation Fund to be used to cover, on an ongoing basis, various costs which traditionally have been paid for with the General Fund. (For 2008-09, this amount is projected to be \$467 million.) The remaining spillover revenue will be split: two-thirds to the State Transit Assistance (STA) program and one-third to the PTA. Additionally, the PTA will fund the costs of regional center transportation on an ongoing basis.

State Transit Assistance. The 2007-08 budget provides \$316 million from PTA for the STA program. (The amount reflects the Governor’s action that reduced by \$100 million the funding level approved by the Legislature.) This program provides funds to assist local rail and bus transit operators in their operations. Under previous state law, the STA program receives one-half of annual PTA revenues, including spillover revenues. Trailer bill legislation amended the STA program funding formula. Specifically, beginning in 2008-09, the STA program will be allocated annually two-thirds of the remaining spillover revenue (after one-half of any spillover is deposited in the Mass Transportation Fund) and one-half of all other PTA revenues.

Funding for Local Transportation Capital Improvements. As Figure 2 shows, the 2007-08 budget appropriates significant amounts of Proposition 1B bond funds for local transportation improvements. These include \$950 million for local streets and road improvements, \$600 million for local transit capital projects, and \$100 million to improve local transit security.

**California Highway Patrol (CHP) and
Department of Motor Vehicles (DMV)**

The 2007-08 budget provides \$1.8 billion to fund CHP operations, an increase of \$135 million (8 percent) compared to the 2006-07 level. This increase mostly reflects the second-year cost of CHP's multiyear project to upgrade and replace its radio communications system (\$51 million), and support costs related to hiring additional patrol officers as well as other staff to work in the call centers and perform truck inspections (\$43 million). The budget also provides increases for inflationary growth on operating expenses and equipment, and administrative services provided to CHP by other agencies (\$35 million).

As regards the DMV, the budget provides approximately \$917 million for departmental operations, about \$44 million (5 percent) more than in 2006-07. This increase primarily reflects the cost of projects aimed at improving customer service. Most notably, the budget includes funding to (1) further implement DMV's technology modernization project related to its driver license and vehicle registration programs (\$24 million), and (2) cover the growing cost of debit and credit card processing fees for customers who use the Internet, telephone, or self-service terminals for DMV-related business (\$11 million).

About \$2.1 billion of the total funding for these departments will come from the Motor Vehicle Account.

*Prepared by the Transportation,
Business, and Housing Section—
(916) 319-8320*

VIII

RESOURCES AND ENVIRONMENTAL PROTECTION

Overview. The 2007-08 budget provides about \$5.7 billion for resources programs and \$2 billion for environmental protection programs.

Of the \$5.7 billion for resources programs, about \$2.1 billion is from special funds, \$1.8 billion is from bond funds, and \$1.7 billion is from the General Fund. The remaining \$160 million are federal funds. This total amount, while roughly the same as estimated 2006-07 expenditures, reflects a lower amount from the General Fund and higher amounts from special funds and bond funds than in the prior budget year. Higher bond fund expenditures reflect the infusion of new resources-related bond funds approved by the voters in November 2006, for various purposes including flood management and land conservation.

Of the \$2 billion for environmental protection programs, about \$1.1 billion is from special funds and \$700 million is from bond funds. The remaining funds—about \$265 million—are General Fund and federal funds. This total amount is an increase of about \$325 million from estimated 2006-07 expenditures, mainly due to the availability of new bond funds for both water quality and air quality projects.

Bond Fund Summary. The budget provides about \$2.5 billion from bond funds (mostly Propositions 50, 84, and 1E) for various resources and environmental protection programs. This amount includes \$250 million for air quality improvement projects along trade corridors, about \$785 million for flood control projects, about \$250 million for water quality programs, \$225 million for

integrated regional water management, \$193 million for replacing old and heavily polluting school buses, and \$49 million for the state park system.

Flood Management. The budget includes about \$900 million for flood management (mainly from bond funds) for statewide planning, levee repairs and improvement, and flood corridor improvements. The Governor vetoed a legislative augmentation of \$40 million to increase non-structural flood protection in floodway corridors. The budget also reverts \$168 million General Fund from the \$500 million appropriation for flood management in Chapter 34, Statutes of 2006 (AB 142, Núñez), replacing the reverted funds with bond funds.

Climate Change. The budget includes about \$33 million, mainly from special funds, for actions at various departments to reduce greenhouse gas (GHG) emissions through implementing Chapter 488, Statutes of 2006 (AB 32, Núñez). These actions include evaluation of market-based compliance mechanisms and development of early action measures, source-specific measures, protocols for voluntary early-action credits, a GHG emissions inventory, and scientific and economic analyses.

Hydrogen Highway. The budget includes \$6 million (Motor Vehicle Account) for staff positions and matching funds for up to eight publicly accessible hydrogen fueling stations.

CALFED. The budget includes about \$477 million from various state funds for the CALFED Bay-Delta Program, including about

\$142 million of reappropriations. (These CAL-FED expenditures are under eight resources and environmental protection departments, plus the Department of Public Health.) The main funding sources for the program are Propositions 50 and 84 bond funds.

San Joaquin River Restoration. The budget provides about \$14 million (bond funds) for the restoration of the San Joaquin River to implement a lawsuit settlement between the federal government, water users, and environmental groups.

Salton Sea Restoration. The budget provides about \$26 million (various bond funds) for planning, monitoring, and various early actions relating to the restoration of the Salton Sea.

Lower-Emission School Buses. The budget provides \$193 million (Proposition 1B bond funds) for financial incentives for the replacement of the state's remaining oldest, most-polluting school buses and for the replacement or retrofit of other high-polluting school buses.

Goods Movement-Related Air Quality Improvements. The budget provides \$250 million (Proposition 1B bond funds) for financial incen-

tives to reduce emissions and improve air quality along California's principal trade corridors.

State Parks. The budget includes \$15 million (Proposition 84 bond funds) for the acquisition of parcels located within or adjacent to existing state parks. The Governor vetoed \$15 million of a \$25 million legislative augmentation for this purpose. The Governor also vetoed \$15 million (General Fund) on a one-time basis from the state parks maintenance budget, leaving about \$67 million for maintenance activities.

Canal Lining. The budget includes \$51 million (General Fund) from a prior appropriation for the lining of the All-American and Coachella canals. These projects when complete will save approximately 100,000 acre-feet of water and are related to the Colorado River "Quantification Settlement Agreement."

Paterno Lawsuit Financing. The budget provides \$65 million (General Fund) for the third year of payments related to the \$464 million *Paterno* lawsuit settlement, stemming from a flood in 1986. (Of the settlement amount, \$428 million is being financed over ten years, beginning in 2005-06.)

*Prepared by the Resources and
Environmental Protection Section—
(916) 319-8323*

IX

OTHER MAJOR PROVISIONS

STATEWIDE ISSUES

Employee Compensation. The budget provides approximately \$1.1 billion (\$600 million General Fund) to increase pay for state employees pursuant to (1) provisions of approved memoranda of understanding with state employee collective bargaining units; (2) the administration's compensation plan for nonrepresented personnel such as supervisors and managers; and (3) court-ordered or legislatively approved pay increases for medical personnel in state prison, mental health, developmental services, and veterans facilities. Most state employees receive a 3.4 percent pay increase under current labor agreements. The Governor vetoed \$72 million in General Fund spending that was budgeted for these costs. Instead, the administration expects departments to pay for these costs from existing resources. The budget also includes no funds to increase compensation levels for state correctional officers and attorneys. Accordingly, any pay increases for these groups would need to be paid from the reserve.

Retirement Benefits. The budget assumes that the state's payment obligations for pensions and retiree health benefits for state employees and pension benefits for teachers will total around \$5.2 billion (\$3.9 billion General Fund). This represents about an 8 percent increase in retirement costs from the current year. The budget package makes no changes to the purchasing power program for retired teachers—thus rejecting an administration proposal for modifications.

State government contributions to health benefits for state government and California State University retirees increase by \$120 million (up 12 percent from the current year). The budget funds \$63 million of the increased retiree health payment obligations by using federal subsidy funds received through the Medicare Part D Program in exchange for the state's providing prescription drug benefits for eligible retirees in calendar years 2006 and 2007.

Unallocated Reductions. The budget assumes \$258 million in General Fund savings from unallocated reductions to departmental budgets. It achieves \$86 million of this amount by not providing funds to cover the costs of inflation on operating expenses. The budget provides the administration with the authority to make an additional \$100 million in reductions during the fiscal year. As noted above, departments will also have to pay for an additional \$72 million in higher employee compensation costs from existing resources.

Tax Changes. The budget permanently eliminates the teacher retention tax credit (which has been suspended the past three years), resulting in annual General Fund revenues of \$165 million. The budget does not extend the use tax laws enacted in 2004 related to vessels, vehicles, and aircraft past their June 30, 2007 sunset date. (The Governor had proposed to make the 2004 change permanent, resulting in additional revenue of \$21 million in 2007-08.) In addition, the budget rejects the Governor's proposal to eliminate Williamson Act subventions for open space

preservation, which compensate local governments for reduced property tax revenues.

DEPARTMENT ISSUES

Financial Information System for California (FI\$Cal) Reduction. In January, the Governor proposed to expand a new statewide budgeting computer system project into the FI\$Cal project—at a proposed cost of \$38 million from the General Fund in 2007-08, with total project costs of approximately \$1.3 billion over nine years. The budget provides only \$6.6 million on a one-time basis for 2007-08. Budget act language requires that the administration evaluate four different project alternatives (including no action) by April 1, 2008. In addition, budget act language shifts some oversight responsibilities for the project from the Department of Finance (DOF) to the Bureau of State Audits.

Proposition 1B Security Funds. The budget appropriates a total of \$140 million in Proposition 1B (November 2006) bond funds for two new programs related to improving transportation security. Specifically, the budget provides \$100 million for mass transit security grants and \$40 million for port and harbor security grants. Both programs will be administered by the Office of Emergency Services.

Unclaimed Property. The budget package responds to a federal court preliminary injunction which freezes most aspects of the state's unclaimed property program. When financial institutions cannot locate the owner of property (such as cash, stocks, or safety deposit box contents), it transfers to the state. The budget provides the State Controller with an \$8 million General Fund augmentation for enhanced notifications to property owners, including notices by the state prior to when property transfers to the

state. The package assumes that these increased notifications will reduce annual General Fund revenues by almost \$80 million.

Human Resources Modernization Project.

The budget includes \$3 million for the Department of Personnel Administration and the State Personnel Board to further develop their proposed statewide human resources modernization project. The initial blueprint for the project—which would require up to eight years to be fully implemented—envisions major changes in state hiring processes, the civil service employee classification system, evaluations of employee performance, and processes for determining merit-based salary adjustments for state employees. The project implementation plan anticipates a budget request to the Legislature for 2008-09 to fund development of a new statewide information technology (IT) system to simplify the state's employee hiring process.

Tribal-State Compact Regulatory Activities.

Measures passed by the Legislature in June ratify amended compacts between the state and four Southern California Indian tribes and authorize those tribes to expand their casinos with up to 17,000 new slot machines on a combined basis. The compact amendments currently await federal approval. The budget package assumes receipt of \$293 million in new General Fund revenues from amended compacts. Chapter 42, Statutes of 2007 (AB 1738, Coto), approves memoranda of agreement (MOAs) between the state and the four tribes. The MOAs require the tribes to maintain minimum internal control standards (MICS) for financial accounting and reporting purposes and give the California Gambling Control Commission (CGCC) responsibilities for administering several enforcement and audit requirements. The budget appropriates \$1 million from the Indian

Gaming Special Distribution Fund (SDF) to allow CGCC to establish a MICS review and enforcement unit. The Governor vetoed \$30 million from SDF for grants to local governments to mitigate the effects of casinos—citing a recent audit which raised concerns with the grants.

Statewide IT Governance Structure. The budget establishes the Office of the Chief Information Officer (OCIO) with a budget of \$4.6 million. Budget legislation gives OCIO responsibility for (1) setting statewide IT policy and standards, (2) reviewing and approving IT projects, and (3)

oversight of IT projects. The IT project funding approval and fiscal oversight remains with DOF. The budget also establishes the Office of Information Security and Consumer Privacy Protection (OISCPP) within the State and Consumer Services Agency. Responsibility for data security is placed with this office. As part of this IT governance reorganization, the Office of Technology Review, Oversight and Security is transferred out of DOF effective January 1, 2008. Its oversight staff are reassigned to OCIO and security staff are reassigned to OISCPP.

*Prepared by the State Administration Section—
(916) 319-8310*

