

## An Overview of the 1997-98 Governor's Budget

### SUMMARY

On January 9, the Governor released his proposed 1997-98 state budget. This brief discusses the proposal's major features and some of the key issues and considerations that the Legislature will face in reviewing it. Our initial findings are that:

- ❖ The proposed budget is balanced with a modest reserve, reflecting continued economic expansion and moderate expenditure and revenue growth. However, the reserve depends on a variety of federal actions, and the budget does not provide funding for current or future disasters.
- ❖ Significant funding increases are proposed for education and adult corrections. Significant funding reductions are proposed for welfare (primarily by making permanent past grant reductions). The plan also includes a new corporate tax cut and elimination of the renters' credit.
- ❖ Major programmatic initiatives are concentrated in K-12 education and welfare, and include proposals for additional class size reduction and welfare reform. There are relatively few major initiatives proposed in other areas such as higher education, youth and adult corrections, and Medi-Cal.
- ❖ Some of the most significant issues facing the Legislature involve evaluating (1) whether the welfare reform proposal effectively addresses such issues as support for children, work incentives, and employment-related services, and (2) the proposed use of new Proposition 98 funds, including the extent to which funds should be used for state-determined versus locally determined purposes.

We will be providing our complete analysis of the budget proposal and our own updated budget-related projections on February 19 in our **Analysis and Perspectives and Issues** publications.

## THE BUDGET PROPOSAL IN A NUTSHELL

On January 9, the Governor released his 1997-98 state budget proposal. California's continued economic recovery combined with a variety of other factors have enabled the Governor to submit a balanced budget with a modest reserve, moderate expenditure growth including

significant increases for education, and a corporate tax reduction.

### Total Spending

As summarized in Figure 1, the budget proposes total state spending of \$64.6 billion (excluding the expenditure of federal funds and selected bond funds). This total includes \$50.3 billion in General Fund spending and \$14.3 billion in special funds spending. In terms of expenditure growth, the budget proposes increases in 1997-98 of 3.8 percent (\$1.9 billion) in General Fund spending and 5.5 percent (\$0.7 billion) in special funds spending, or 4.2 percent (\$2.6 billion) in total spending.

**Types of Spending.** Figure 2 shows how spending from the state's General Fund is distributed across major

**Figure 1**

### Total Proposed Budgetary Spending

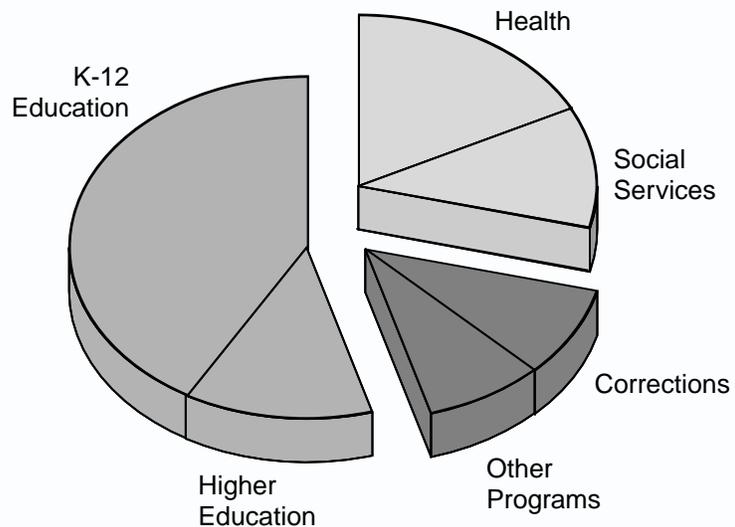
(Dollars in Billions)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	
			Amount	Percent Change
General Fund	\$45.4	\$48.4	\$50.3	3.8%
Special funds	12.5	13.6	14.3	5.5
<b>Totals</b>	<b>\$57.9</b>	<b>\$62.0</b>	<b>\$64.6</b>	<b>4.2%</b>

**Figure 2**

### Education, Health and Social Services Account for Four-Fifths of Spending

General Fund by Program 1997-98



program areas. It indicates that over four-fifths of this spending is for education-related and health and social services purposes. The remainder is spent for criminal justice, resources, tax relief, and general government.

## Key Features of the Budget Proposal

Figure 3 summarizes the key features of the Governor's budget proposal.

**Figure 3**

### Key Features of the Governor's 1997-98 Budget Proposal

-  **General Fund Condition.** Balanced budget with \$553 million reserve.
-  **Economy and Revenues.** Assumes moderate economic and revenue growth.
-  **Taxes and Fees.** Phased 10 percent corporate tax rate reduction. Additional federal tax conformity. No renters' credit. Increase in drivers license fees.
-  **Welfare.** Welfare reform proposal includes various time limits for recipients and block grant funds for counties (beginning 1998-99). Makes permanent previously enacted welfare grant reductions. Additional federal block grant funds result in net savings that are used for other General Fund purposes.
-  **Medi-Cal.** Assumes elimination of prenatal care for illegal immigrants. Continues Medi-Cal (and certain welfare benefits) for legal immigrants already in country. Eliminates nonemergency benefits for new legal immigrants.
-  **K-12 Education.** Allocates increased Proposition 98 funds for enrollment growth, class size reduction, and other initiatives. Proposes \$2 billion in new bonds for school facilities.
-  **Higher Education.** Continues the Governor's "compact," which includes a basic 4 percent budget increase. Additional funding to avoid student fee increases.
-  **Criminal Justice.** Fully funds youth and adult corrections budgets. Assumes federal funds to offset a portion of design and development costs for six new prisons. Allocates federal welfare block grant funds to counties to cover juvenile probation costs. Renews proposal to restructure trial court funding program.
-  **Local Government.** Continues Citizen's Option For Public Safety program. Trial court realignment and welfare reform proposals could significantly affect counties.
-  **Other.** No funds for general salary increases or disaster relief for current or future incidents.

**Budget Is Balanced.** As noted in Figure 3 and detailed in Figure 4, the proposed General Fund budget is balanced with reserves of \$197 million in 1996-97 and \$553 million in 1997-98. These modest reserves are a significant improvement over the budget deficits experienced throughout the first half of the 1990s, and it is notable that proposed budget-year revenues exceed expenditures. Nevertheless, even the half-billion dollar budget-year reserve is relatively small compared to the size of the budget (only 1.1 percent), and building a larger reserve should remain a key budgetary priority.

This is especially true given the various risks inherent in the budget proposal (see below), and the fact that the proposed 1997-98 reserve is in part due to upward revisions to carry-in balances from prior years. Without these revisions, the proposed 1997-98 reserve would be considerably smaller.

**Tax Cut.** The budget proposes a 10 percent bank and corporation tax rate cut phased in during 1998 and 1999. This cut would be on top of the 5 percent cut adopted last year. The budget-year cost of this proposal is \$88 million; however, its annual cost would rise to \$647 million in 2000-01 when the proposal is fully phased in.

**Expenditure Proposals.** As Figure 3 shows, the budget includes a variety of proposals in various individual program areas. One of the most significant is a welfare reform proposal involving time limits and block grants to counties (beginning in 1998-99). Another key proposal involves the allocation of Proposition 98 funds for additional class size reductions in K-12 education. The other major proposals are summarized in the figure and discussed later in this brief.

### Budgetary Savings Dependent On Federal Actions

As in recent years, the budget assumes a significant amount of savings which are dependent on future federal actions. As shown in Figure 5, these assumed savings total \$647 million. They include \$279 million from reductions in Supplemental Security Income/State Supplementary Program (SSI/SSP) grant levels which require federal legislation to eliminate current federal maintenance-of-effort requirements. Similar savings were assumed in the

**Figure 4**

**Governor's Budget General Fund Condition 1996-97 and 1997-98**

(Dollars in Millions)

	1996-97	1997-98	Percent Change
Prior-year balance	\$685	\$648	
Revenues and transfers	48,405	50,657	4.7%
<b>Total resources available</b>	<b>\$49,091</b>	<b>\$51,275</b>	
Expenditures	\$48,443	\$50,301	3.8%
<b>Ending fund balance</b>	<b>\$648</b>	<b>\$1,004</b>	
Other obligations	\$451	\$451	
<b>Reserve</b>	<b>\$197</b>	<b>\$553</b>	

Detail may not total due to rounding.

**Figure 5****1997-98 Budget Savings  
Dependent on Federal  
Actions****(In Millions)**

Source	1997-98 Amount
SSI/SSP <sup>a</sup> grant reductions	\$279
Emergency medical services to undocumented persons	216
Higher federal reimbursements for undocumented felons	67
IRS <sup>b</sup> tax offset program	85
<b>Total</b>	<b>\$647</b>

<sup>a</sup> Supplemental Security Income/State Supplementary Program.

<sup>b</sup> Internal Revenue Service.

1996-97 Budget Act but the required federal actions did not occur.

The budget also assumes that \$216 million in new federal funds will become available to California for the

reimbursement of state costs for providing emergency Medi-Cal services to undocumented immigrants. These funds were authorized in 1996 federal legislation but require appropriation in the 1998 federal budget.

The remaining assumed savings relate to reimbursements for immigrant felons beyond current federal allocations, and the federal adoption of an Internal Revenue Service (IRS) tax offset program. Under the latter, the IRS would collect delinquent state tax liabilities out of refunds owed to Californians on their federal income tax returns. These savings also were assumed last year but the requisite federal legislation was not enacted.

**Figure 6****Summary of Budget's Economic Outlook**

	Actual 1996	Projected	
		1997	1998
<b>United States forecast</b>			
Real GDP (percent change)	2.3%	2.4%	2.5%
Pre-tax corporate profits (percent change)	4.8	2.4	8.1
Unemployment rate (%)	5.4	5.2	5.2
Federal funds interest rate (%)	5.3	5.1	5.0
<b>California forecast</b>			
Percent change in:			
Personal income	7.2%	6.6%	5.9%
Nonagricultural employment	2.7	2.6	1.9
Consumer prices	2.0	2.7	2.7
Taxable sales	6.8	5.0	4.3
Unemployment rate (%)	7.3	6.8	6.9
New housing permits (000)	94.0	110.0	121.0

## ECONOMIC AND REVENUE ASSUMPTIONS— MODERATE GROWTH

A critical element of the budget proposal is its underlying economic and revenue assumptions.

### Continued Economic Expansion

The budget's economic forecast assumes on-going national economic expansion and continued, though tapering, moderate economic growth with low inflation in California. Figure 6 summarizes the key elements of the outlook. It shows that California personal income, the single most important determinant of

revenues, is expected to grow moderately by 6.6 percent in 1997 and 5.9 percent in 1998.

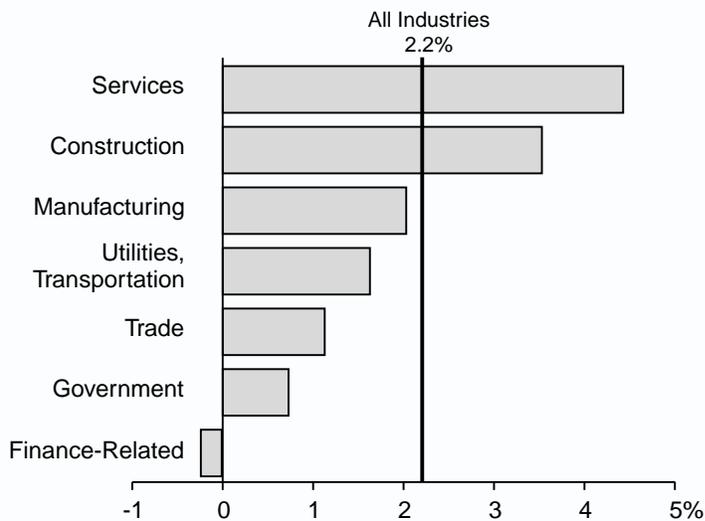
Figure 7 shows that broad-based growth is expected, with job gains in all industry sectors except the finance-

related one. Leading growth areas should include such high-wage service industries as motion pictures and computer software and design.

The budget forecast is generally consistent with recent projections made by other economists, although its state personal income forecast is slightly above the consensus.

**Figure 7**  
**Most Industry Sectors Projected to Grow**

*Average Annual Percent Change in California Jobs 1997 and 1998*



**Moderate Revenue Growth**

Figure 8 shows that General Fund revenues are projected to reach \$48.4 billion in 1996-97 and \$50.7 billion in 1997-98. As Figure 9 indicates, these projections reflect moderate growth in the underlying revenue trend (defined as revenues excluding law changes) consistent with the economic forecast. Moderate growth in sales and personal income taxes is assumed along with a slight decline in bank and corporation taxes, the latter reflecting both slowing profit growth and the impacts of recently enacted and proposed tax rate reductions.

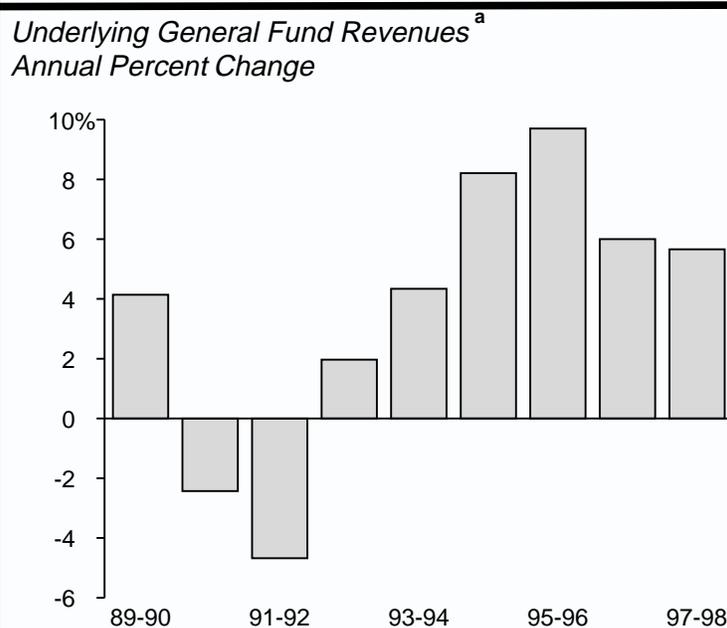
**Figure 8**  
**Governor's Budget Revenue Forecast**

(Dollars in Billions)

Revenue source	Actual 1995-96	Projected	
		1996-97	1997-98
Personal income tax	\$20.9	\$22.7	\$24.2
Sales and use tax	15.8	16.5	17.3
Bank and corporation tax	5.9	5.8	5.9
All other	3.8	3.5	3.2
<b>Totals</b>	<b>\$46.3</b>	<b>\$48.4</b>	<b>\$50.7</b>
Percent change	8.4%	4.6%	4.7%

Detail may not total due to rounding.

**Revenue-Related Proposals.** The revenue projections incorporate the Governor's proposal to reduce the bank and corporation tax rate by 5 percent in 1998 and another 5 percent in 1999, and to partially conform state law to recent federal changes involving Sub-Chapter S corporations. The revenue cost of these proposals is \$93 million in 1997-98, rising to \$654 million by 2000-01 when fully phased in.

**Figure 9****Moderate Revenue Growth Expected**

<sup>a</sup> Governor's budget revenues excluding transfers and the effects of past and proposed revenue-related law changes.

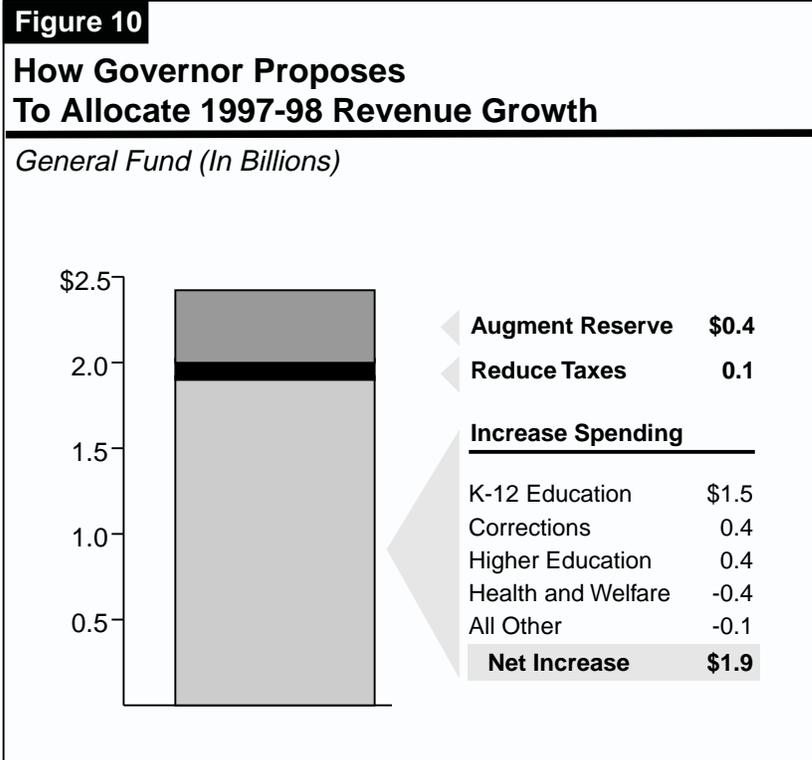
In addition, the projection for 1997-98 assumes implementation of the Governor's trial court funding proposal, including redirecting \$290 million in court fines and penalties from the General Fund to a trial court trust fund. Also assumed is \$85 million from federal adoption of a tax offset program as noted earlier.

***How Is Revenue Growth Allocated?***

The Governor's projections are that budget-year revenue growth will be \$2.3 billion (4.7 percent), or \$2.4 billion absent his tax cut proposal. Figure 10 (see next page) shows how the budget proposes to allocate this revenue growth—a net of \$1.9 billion for spending (most for K-12 education

under Proposition 98), \$0.4 billion for improving the budget reserve, and \$0.1 billion for the tax cut.

***Comparison to Legislative Analyst's Office.*** The budget assumes slightly stronger economic growth than our November forecast. Its revenue forecast, however, is lower than ours by \$266 million in 1996-97 and \$399 million in 1997-98, or \$665 million combined. Most of the difference is related to the budget's more conservative estimate of sales tax revenues.



**Figure 11**  
**General Fund Spending by Major Program Area**

(Dollars in Millions)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	
			Amount	Percent Change
<b>Education Programs</b>				
K-12 education	\$17,791	\$19,427	\$20,936	7.8%
Community Colleges	1,600	1,783	1,932	8.4
UC/CSU <sup>a</sup> and other	3,931	4,328	4,562	5.4
<b>Health and Welfare Programs</b>				
Medi-Cal	6,253	6,908	6,943	0.5
AFDC <sup>b</sup>	2,712	2,229	1,966	-11.8
SSI/SSP <sup>c</sup>	2,051	2,070	1,660	-19.8
Other	3,248	3,685	3,968	7.7
<b>Youth and Adult Corrections</b>				
Youth and Adult Corrections	3,946	3,834	4,257	11.0
<b>All Other</b>				
All Other	3,861	4,179	4,077	-2.4
<b>Totals</b>	<b>\$45,393</b>	<b>\$48,443</b>	<b>\$50,301</b>	<b>3.8%</b>

<sup>a</sup> University of California/California State University.  
<sup>b</sup> Aid to Families with Dependent Children.  
<sup>c</sup> Supplemental Security Income/State Supplementary Program.

**THE GOVERNOR'S BUDGET PROPOSAL BY PROGRAM AREA**

Figure 11 shows General Fund spending by major program area for fiscal years 1995-96 through 1997-98. The figure shows that spending *increases* are proposed for all of the major education segments, as well as youth and adult corrections. Spending *declines* are proposed for welfare programs, as well as the "all other" category. The key proposals and assumptions contained in the proposed budget, along with their fiscal effects, are highlighted in Figure 12 and discussed below.

<b>Figure 12</b>	
<b>Major 1997-98 Budget Proposals and Assumptions</b>	
<b>(In Millions)</b>	
<b>Expenditure-Related Proposals and Assumptions</b>	<b>Effect on Expenditures</b>
<b>Welfare</b>	
Grant reductions state cost-of-living adjustment suspensions	
Aid to Families with Dependent Children	-\$245
Supplemental Security Income/State Supplementary Program	-196
Governor's welfare reform proposal	
New grant structure and paternity establishment requirements	-176
Employment services and county administration	172
Infant Health Protection Initiative	22
<b>Medi-Cal</b>	
New federal funds for emergency services to undocumented persons	-\$216
Elimination of state-only prenatal care for undocumented persons	-80
<b>K-12 Education</b>	
Additional class size reduction	\$457
<b>Community Colleges</b>	
Welfare reform-related initiatives	\$53
<b>Higher Education (CSU and UC<sup>a</sup>)</b>	
"Buy out" of student fee increase	\$67
Other initiatives	15
<b>Local Government</b>	
Allocation of federal welfare block grant to counties for juvenile probation costs	\$141
<b>Other</b>	
Eliminate renters' credit	-\$525
<b>Tax-Related Proposals and Assumptions</b>	<b>Effect on Revenues</b>
Bank and corporation rate reduction and federal conformity	-\$93
Federal Internal Revenue Service tax offset program	85
<sup>a</sup> California State University and University of California.	

## Health and Welfare

As indicated in Figure 12, most of the budget's major savings proposals affect health and welfare programs, primarily grant reductions and suspension of state cost-of-living adjustments (COLAs) in the state's two

major cash grant programs. The first program provides grants to low-income persons who are in families with dependant children. This program has been replaced by the Temporary Assistance for Needy Families (TANF) Program pursuant to federal welfare reform. The second cash grant

program is for persons who are elderly, blind, or disabled (SSI/SSP).

***Budget Makes Permanent the Temporary Welfare Grant Reductions and COLA Suspension.*** The Governor's budget proposes to make permanent the Aid to Families with Dependent Children (AFDC) and SSI/SSP 4.9 percent statewide grant reductions adopted in 1995-96. In addition, suspension of the COLAs would be made permanent. Under current law the grant reductions and the AFDC COLA suspension are scheduled to be restored on November 1, 1997, with the state SSP COLA to be restored on January 1, 1998. The Governor's proposal would avoid increased General Fund costs of about \$441 million in the budget year.

***Major Budget Impacts of Federal Welfare Reform.*** On August 22, 1996, the President signed into law H.R. 3734—The Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The budget estimates that federal welfare reform will result in net General Fund savings of \$274 million in 1996-97 and \$288 million in 1997-98 due to the federal TANF block grant. (This assumes that the state enacts all of the Governor's welfare reform initiatives and TANF spending proposals.) Federal welfare reform also makes most legal noncitizens ineligible for SSI/SSP, resulting in estimated General Fund savings of \$153 million in the budget year.

#### ***Governor's Proposal to Reform***

***Welfare.*** The Governor proposes to fundamentally redesign the state's AFDC program, effective January 1, 1998. Figure 13 summarizes the major provisions of the Governor's welfare reform proposal. The Governor's proposal includes benefit reductions pursuant to specified time limits, changes in how grants are determined for recipients with income, work and training participation mandates, and expanded paternity establishment requirements.

The Governor's welfare reform proposal involves state savings of approximately \$176 million from changing the grant structure and paternity establishment. These savings are nearly offset by \$172 million in costs for employment services, automation improvements, and training for county caseworkers. Thus, the net fiscal effect of these proposals is an approximate "wash."

***Medi-Cal.*** The budget proposes General Fund expenditures of \$6.9 billion for the Medi-Cal program, a 0.5 percent increase from the current year. The budget also recognizes a current-year deficiency of \$429 million, about one half of which is due to the absence of a federal appropriation of funds for the state costs of emergency services to undocumented persons. The budget assumes that federal funds for this purpose will be appropriated in the 1998 federal budget, resulting in a \$216 million state savings in 1997-98.

**Figure 13****Governor's Proposal to Reform Welfare**

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**Grant Reduction After Six Months.** Beginning January 1, 1998, Temporary Assistance for Needy Families recipients on aid for more than six months will receive a grant reduction of 15 percent.
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**Time Limits:**
  - **For those on aid prior to January 1, 1998**, recipients are limited to two years of cash assistance in any three-year period. After the two years, benefits are reduced by roughly 15 percent (the portion of the grant for the adult) and this aid is provided in the form of non-cash benefits (state funded) such as vouchers.
  - **For those coming on aid as of January 1, 1998**, their cash assistance is limited to one year in any two-year period. After the one year, benefits are reduced as noted above.
  - **Recipients who go off aid for one year** would be eligible to return at the same level of cash benefits as new applicants.
  - **Lifetime receipt of cash assistance is limited to five years.** After this period, benefits are available, but limited to non-cash assistance as noted above.
- 
**Participation Mandate.** To receive assistance, recipients must participate for 32 hours per week (35 hours for two-parent families) in work or county-approved education or training activities.
- 
**Reduction in Income "Disregards."** Families with earnings will have lower grant payments (roughly 30 percent) than under current law as a result of reducing the amount of income that is excluded when calculating the grant.
- 
**Services.** Provides additional funding for automation, employment services, and training for county caseworkers.

The budget assumes elimination of state-only prenatal care benefits for undocumented persons, pursuant to federal welfare reform legislation, for a General Fund savings of \$80 million in 1997-98. The budget proposes to continue Medi-Cal (as well as AFDC/TANF) benefits to legal immigrants in the country prior to August 22, 1996. However, legal immigrants entering the country after that date would not be eligible for nonemergency services.

In contrast to proposals in recent years, this year's budget does not propose to eliminate optional Medi-Cal benefits, and contains relatively few new initiatives.

**Infant Health and Protection Initiative.** The Governor proposes an initiative designed to protect children from substance-abusing parents, through early detection and intervention services focusing on newborns and their mothers. The program

includes stronger requirements for hospitals to detect signs of substance abuse or substance exposure to babies, treatment services, and home visitations. The Governor proposes \$22 million from the General Fund for this program.

### Education

**K-12 Education.** The budget proposes significant increases in K-12 education spending, consistent with Proposition 98 funding requirements. Specifically, total K-12 education expenditures are proposed to increase \$1.7 billion from current-year levels in 1997-98 (of which \$1.5 billion would come the General Fund).

Figure 14 displays the major uses of these additional funds. The largest share—\$629 million, or

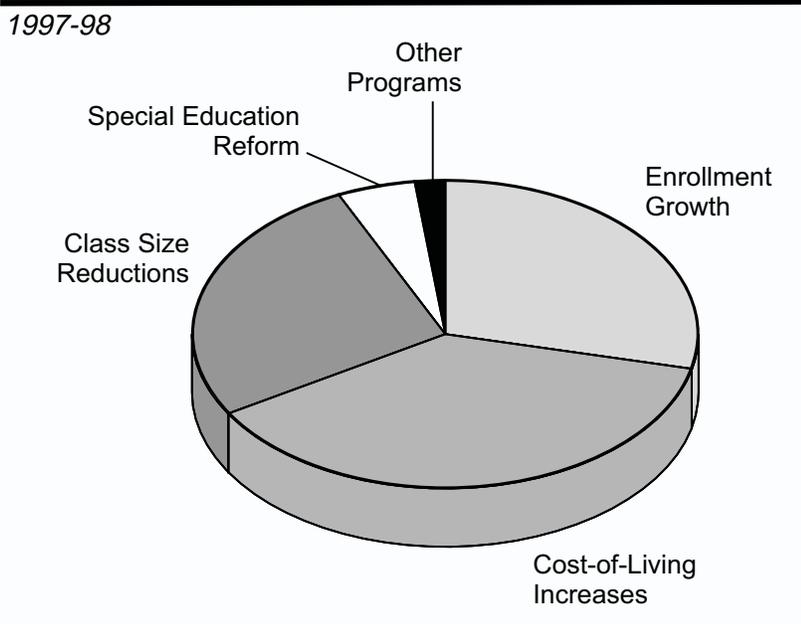
38 percent—would provide a 2.5 percent COLA for district and county office revenue limits as well as selected categorical programs. Providing general-purpose funding for the projected 2.3 percent growth in the student population accounts for \$482 million, or 29 percent, of available funds. The Governor's class size reduction proposal accounts for another \$457 million, or 27 percent. The remaining \$110 million, or 6 percent, is dedicated in the budget proposal for special education reform (\$77 million) and various other categorical program increases.

The emphasis on funding categorical program increases means that none of the new 1997-98 Proposition 98 monies would be available for locally determined priorities. The budget does not propose to use 1997-98 Proposition 98 funds to increase per-pupil local revenue limits above the statutorily required COLA. The COLA is designed to maintain the purchasing power of funding provided to schools, not afford an increased level of services. As a result, the budget would provide increases only in those targeted areas and not for needs identified by local school boards.

The Governor is also proposing a \$2 billion bond for school facilities to accommodate enrollment growth and class size reduction.

**Community Colleges.** The budget proposes a \$238 million increase in total community college funding (of

**Figure 14**  
**Proposed Use of New Proposition 98 Funds**  
**K-12 Education**



which \$149 million would come from the General Fund). This funding increase covers growth in enrollment, full statutory cost-of-living increases, and a variety of other initiatives. Among these are about \$53 million in funds which would be allocated for purposes related to federal welfare reform. These include work-study and child care services for community college students who are welfare recipients.

***University of California (UC) and California State University (CSU).***

The budget proposes increases to the UC and the CSU budgets totaling \$194 million in 1997-98. This increase includes funding to maintain the Governor's "compact" with higher education, which includes 4 percent annual budget increases for both segments. It also includes \$67 million to "buy out" the 10 percent fee increases provisionally approved by the Regents and Trustees of the two systems. Thus, student fees would be held constant for the third consecutive year. The budget also proposes \$15 million, for the two systems combined, for a variety of new initiatives.

**Criminal Justice**

***Corrections.*** The budget includes an increase of \$251 million (7.3 percent) in General Fund support for the Department of Corrections, primarily to accommodate growing inmate populations. The prison inmate population is projected to grow by about 9,000 inmates in

1997-98, or about 5.9 percent. Although substantial, the rate of growth is less than the state has experienced over the past ten years (an average of about 9 percent).

In addition, the budget proposes funding, primarily from anticipated federal funds, for six prisons as follows: (1) design and construction of one new prison, (2) land acquisition and design of two additional prisons, and (3) environmental reviews for three more prisons.

***Trial Court Funding Redirection.***

The budget proposes to consolidate and restructure the Trial Court Funding Program. The proposal, which is nearly identical to the Governor's 1996-97 proposal, would cap the contribution counties make for support of the trial courts and make the state responsible for growth in trial court costs. The proposal also calls for increases of about \$88 million in court-related fees to offset costs of the state and requests about \$27 million to create 40 new trial court judgeships, enhance trial court security, and reimburse certain expenses of trial court jurors.

**Local Government**

Several of the Governor's proposals have a significant impact on local government (see Figure 15, next page). For example, the trial court realignment and welfare reform proposals could significantly affect counties.

**Figure 15**

**Major New Budget Proposals Affecting Local Government 1997-98**

Proposal	Local Fiscal Impact
<b>Public Safety/Criminal Justice</b>	
Transfer trial court funding responsibility to the state.	Savings to counties of tens of millions of dollars in 1997-98, growing substantially thereafter.
Increase funding for juvenile probation.	\$141 million of the federal welfare block grant (Temporary Assistance for Needy Families) to be allocated to counties for probation.
Allocate 15 percent of federal crime bill funds for prison construction to local correctional facilities (maximum allowed by law).	\$15 million to local government for jail or juvenile hall construction, with additional amounts through 1999-00.
<b>Welfare</b>	
Counties relieved of obligation to provide General Assistance.	Potential county savings of up to hundreds of millions of dollars annually.
Counties to administer new program.	Counties to receive \$80 million (one-time) for training and implementation. Counties to share in future costs or savings. Unknown overall local fiscal impact.
<b>Other Programs</b>	
Infrastructure bank	\$200 million general obligation bond issue proposed for capitalization of an infrastructure bank.

In addition, funding for several previously enacted programs is continued in the budget year. These continuing programs include:

- The Citizen's Option for Public Safety program, which provides \$100 million for local law enforcement;
- The property tax administration loan program, which provides

up to \$60 million in forgivable loans to local assessors; and

- \$33 million in continued funding for county juvenile detention camps.

**Other Programs**

**Renters' Tax Credit.** This credit, which provides a refundable tax credit of \$60 to single renters and \$120 to married couples and heads of

households, has been suspended since 1993. Under existing law, the credit is scheduled to be reinstated in 1997. The budget proposes to eliminate the credit, for a savings of \$525 million in 1997-98.

**Employee Compensation.** The Governor's budget does not provide for any general pay or benefit increases for state employees. The UC and the CSU have indicated, however, that salary increases for their employees will be provided from "compact" funds. Based on 1997-98 salaries and wages for state employees (other than higher education), we estimate that it would cost nearly \$100 million per 1 percent general salary increase for these employees. About \$55 million of this cost would be General Fund and about \$45 million special funds.

**Capital Outlay.** The budget proposes nearly \$1.2 billion for capital outlay other than highways and rail. The majority of spending is for higher education facilities and new state prisons.

## KEY BUDGET-RELATED ISSUES AND CONSIDERATIONS FACING THE LEGISLATURE

The January budget proposal reflects the Governor's budgetary priorities for 1997-98. However, the Legislature's own budgetary priorities may differ from the Governor's. In addition, there are various risks, missed opportunities, and other issues inherent in the Governor's proposal that the Legislature needs to be aware of as it prepares to evaluate and make decisions regarding the Governor's proposal over the coming months. Some of the major issues and considerations regarding the Governor's budget proposal are identified in Figure 16 (see next page).

On February 19, we will release our *Analysis of the 1997-98 Budget Bill*, which will contain our detailed analysis and recommendations relating to the budget proposal. The *Analysis* will be accompanied by our *Perspectives and Issues*, in which we will evaluate the Governor's economic and fiscal projections and update our own previous projections that were published in *California's Fiscal Outlook: The LAO's Economic and Budget Projections for 1996-97 through 1998-99* (November 1996).

**Figure 16**

### **Key Budget-Related Issues and Considerations Facing the Legislature**

- Proposition 98 Spending.** The budget allocates most of the new Proposition 98 funds for state-determined purposes. In addition, those funds provided for expanded class size reduction permit little flexibility to school districts. In allocating 1997-98 Proposition 98 monies, the Legislature needs to address the question of how much funding and how much flexibility should be provided to local school districts.
- Corrections.** The budget includes no significant reforms. Are there proposals which should be considered, such as options to traditional incarceration for lower-level offenders?
- Welfare.** Any welfare reform proposal, whether the Governor's or someone else's, must address at least three competing goals: (1) provide support for children; (2) establish incentives for their parents to work ; and (3) control public costs. The Legislature should consider whether to:
  - provide a different safety net for children in welfare families than the one proposed by the administration;
  - provide other work incentives (including, different time limits) for welfare recipients;
  - invest additional funds in employment and training programs.
- Governor's Corporate Tax Cut Proposal.** Issues to consider in evaluating the proposal include the relative tax position of California to other states, the effects of the tax cut on California's interstate competitiveness, its longer term fiscal effects, and the lack of parity between individual and corporate taxpayers inherent in the proposal.
- Transportation.** The state faces a shortfall of up to \$1.5 billion in funds for completing the seismic retrofit of state-owned toll bridges. The budget does not include any proposal to fully fund the program.
- Local Government.** The budget contains proposals which would affect local government's operation of particular programs (such as trial courts and welfare). In considering these proposals—or more comprehensive ways to restructure the state local relationship—the Legislature should strive to (1) clearly define responsibilities, (2) provide proper fiscal incentives and capacity, and (3) maximize the level of local flexibility.
- Budgetary Reserve.** The budget proposes to build the reserve up to a modest level. This reserve would give the state some flexibility in dealing with unforeseen emergencies and certain fiscal problems. It would provide only partial protection, however, against more significant problems, such as a moderate economic slowdown. Ultimately, the size of the reserve is a legislative policy decision involving tradeoffs between current funding for state programs versus protecting against the risk of serious future fiscal disruptions.

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