



California Spending Plan 2002-03

The Budget Act and Related Legislation

September 2002
Elizabeth G. Hill, Legislative Analyst

Legislative Analyst's Office

Legislative Analyst

Elizabeth G. Hill 445-4656

Deputy Legislative Analysts

Hadley Johnson, Jr. 319-8303

Mac Taylor 319-8301

Capital Outlay/Local Government

Director: Mac Taylor 319-8301

Criminal Justice and State Administration

Director: Greg Jolivette 319-8340

Economics, Taxation, and Fiscal Forecasting

Director: Jon David Vasché 319-8305

Education, Higher

Director: Steve Boilard 319-8331

Education, K-12

Director: Robert Manwaring 319-8330

Health

Director: Daniel C. Carson 319-8350

Resources

Director: Mark Newton 319-8323

Social Services

Director: Todd R. Bland 319-8353

State Administration

Director: Michael Cohen 319-8310

Transportation

Director: Chi-Ming Dana Curry 319-8320

Acknowledgments

The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.



LAO Publications

To request publications call (916) 445-4656.

This report and others, as well as an E-mail subscription service, are available on the LAO's Internet site at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.

Contents

Index of Figures iii

Chapter 1

2002-03 Budget Act—The Challenge and The Solution

Scope of the Problem 1
Factors Underlying the Budget Shortfall 1
How the Shortfall Was Addressed 4

Chapter 2

Key Features of the Budget Act and Related Legislation

The Budget Totals 7
Evolution of the Budget 9
Major Features of the Final Budget 16
State Appropriations Limit 18
Budget-Related Legislation 18

Chapter 3

Revenue-Related Provision

Chapter 4

Expenditure Highlights

K-12 Education 27
Higher Education 35
Health 39
Social Services 49
Judiciary and Criminal Justice 55
Transportation 58
Resources 61
Environmental Protection 65
Capital Outlay 66
Other Major Provisions 69

Figures

Chapter 1

The 2002-03 Budget Act—The Challenge and the Solution

1	How the Huge Budget Shortfall Developed	2
2	Capital Gain and Stock Option Related Revenues Plunge in 2001-02	3
3	Major Actions Taken to Close the Budget Funding Gap	4

Chapter 2

Key Features of the Budget Act and Related Legislation

1	The 2002-03 Budget Package, Total State Expenditures	7
2	The 2002-03 Budget Package, Estimated General Fund Condition	8
3	The 2002-03 Budget Package, General Fund Spending by Major Program Area	9
4	General Fund Expenditures Over Time	10
5	Mid-Year Savings for 2001-02 Adopted by the Legislature ...	11
6	Evolution of 2002-03 General Fund Budget Solutions	12
7	2002-03 Budget-Related Legislation	19

Chapter 3

Revenue-Related Provisions

1	2002-03 Budget Tax-Related Provisions	22
2	2002-03 General Fund Loans and Transfers	25

Chapter 4

Expenditure Highlights

1	Proposition 98 Budget Summary	27
2	K-12 Proposition 98 Spending Per Pupil, Adjusted for Funding Deferrals Between Years	28
3	Proposition 98 Funding Per Student	29
4	Proposition 98 Funding for 2001-02	30
5	How Was 2002-03 Growth in Proposition 98 Allocated?	31
6	Major K-12 Proposition 98 Funding Reductions	32

7	Funded Enrollment Growth Compared With Growth in College Age Population	36
8	Higher Education Budget Summary, General Fund and Local Property Tax Revenue	37
9	Major Health Services Programs, General Fund Spending ..	40
10	Major General Fund Reductions in State Health Programs ..	41
11	Tobacco Settlement Fund, 2002-03 Expenditures	45
12	Social Services Programs, General Fund Spending	50
13	Major Changes—Social Services Programs General Fund and Federal TANF Block Grant Funds	51
14	Cost-of-Living Adjustments Delayed Until June 2003	52
15	Judicial and Criminal Justice Budget Summary General Fund	56
16	Transportation Loans and Repayments	59
17	Motor Vehicle Account Revenue Increases	61
18	CALFED Bay-Delta Program, 2002-03 Expenditures	62
19	Proposition 40 Bond 2002-03 Expenditures	63
20	2002-03 Capital Outlay Programs, Budget Act	68

Chapter 1

2002-03 Budget Act— The Challenge and The Solution

SCOPE OF THE PROBLEM

The Governor signed the *2002-03 Budget Act* on September 5, 2002, a record 67 days into the new fiscal year. In enacting the \$99 billion budget, the Legislature was faced with the unprecedented and formidable task of addressing a \$23.6 billion shortfall. It did this through adopting a variety of program savings, borrowings and loans, transfers, deferrals, and revenue augmentations. The budget also includes a modest year-end General Fund reserve of \$1 billion. In terms of the budget's growth, both current-dollar and real per capita spending in 2002-03 are down modestly from their prior-year levels.

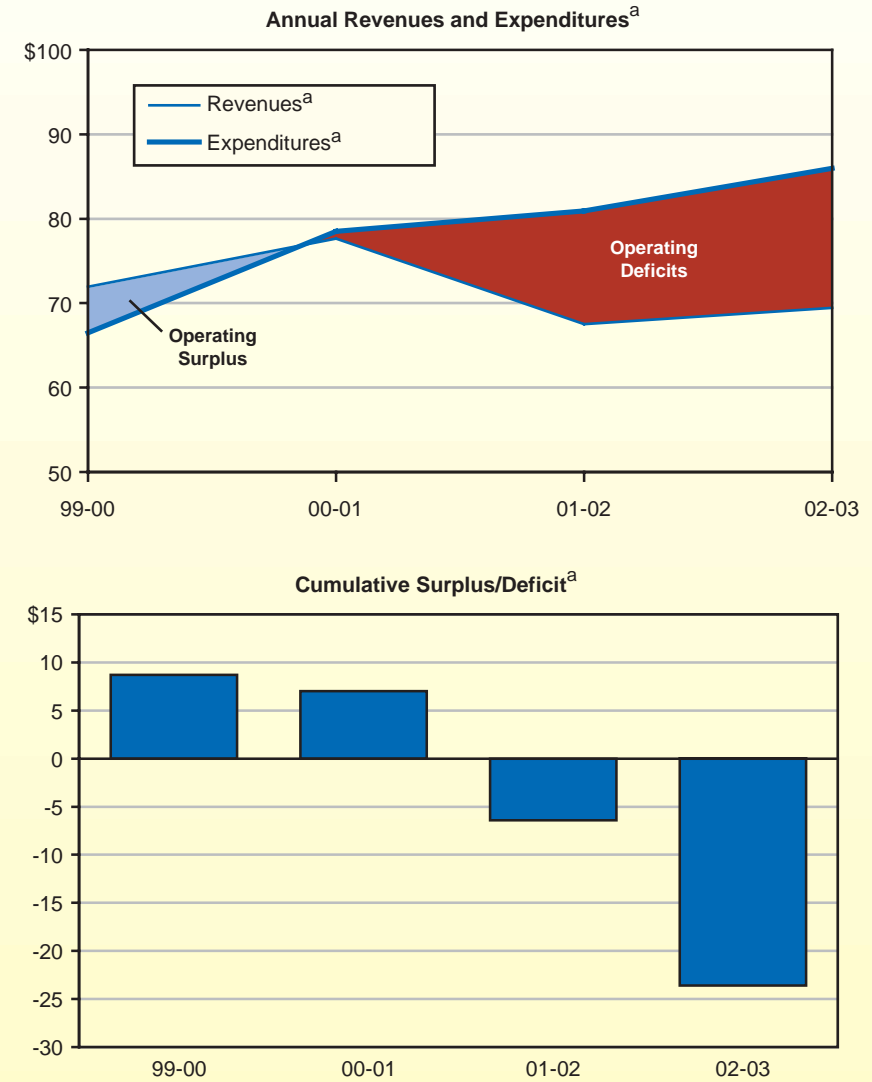
In this chapter, we first discuss the factors underlying the major fiscal challenge facing the Governor and Legislature as they approached the 2002-03 budget, and then describe the key actions taken to address the shortfall. In subsequent chapters, we provide additional details about the adopted budget package, including its main features, its development, and its revenue and expenditure detail.

FACTORS UNDERLYING THE BUDGET SHORTFALL

The \$23.6 billion budget gap facing the Governor and Legislature in 2002-03 reflected the cumulative impact of an unprecedented decline in General Fund revenues in 2001-02 and 2002-03, along with projected continued growth in General Fund expenditures during the two years. The budgetary impact of these trends is depicted in Figure 1 (see page 2), which shows what revenues and expenditures would have been in 2000-01 through 2002-03 had there been no budget-balancing actions taken following the 2001-02 budget's enactment. (These figures have also been adjusted to exclude the \$6.2 billion electricity loans in 2000-01 and their assumed repayments in 2001-02.) The figure shows that:

Figure 1
How the Huge Budget Shortfall Developed

Amounts in Billions



^aEstimates of what revenues, expenditures, and year-end surpluses/deficits would have been absent any budget-balancing actions following the adoption of the 2001-02 budget. Figures also exclude the impact of the electricity loan and its assumed repayment.

- In 2000-01, revenues and expenditures were roughly in balance, with each totaling about \$78 billion. At the conclusion of that year, the state had a reserve balance of about \$7 billion, which had been built up during the revenue boom of the late 1990s.

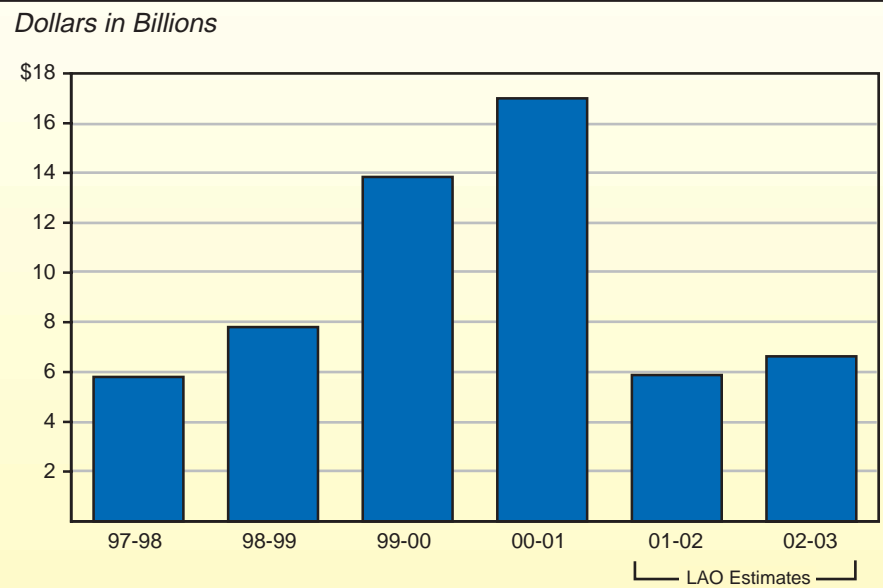
- Then, in 2001-02, revenues fell by over \$10 billion while expenditures grew by roughly \$3 billion, resulting in an operating shortfall of \$13 billion. The above-noted \$7 billion reserve balance from 2000-01 was available to cover part of this operating deficit, leaving a 2001-02 year-end deficit of \$6 billion. This compares to the positive reserve of \$2.6 billion anticipated when the 2001-02 budget was enacted.
- In 2002-03, expenditures would have continued to increase under current law, reaching \$86 billion. This would have been nearly \$17 billion more than the \$69 billion in revenues projected for that year. This, combined with the \$6 billion carry-in deficit, would have left the state with a year-end shortfall of \$23 billion absent corrective action. Adding to this the \$500 million reserve sought by the Governor, resulted in the estimated \$23.6 billion shortfall noted previously.

What Caused the Revenue Decline?

As indicated above, the large revenue decline was the main factor behind the budget shortfall. This decline was the largest in any single year since the Great Depression. While the national and state economic downturns beginning in 2001 played a significant role, the main factor behind the revenue plunge was the sharp drop in stock market-related revenues. As shown in Figure 2, we estimate that total personal income tax receipts related to stock options

Figure 2

Capital Gain and Stock Option Related Revenues Plunge in 2001-02



and capital gains fell from \$17 billion in 2000-01 to roughly \$6 billion in both 2001-02 and 2002-03. Even with an assumed sustained recovery in overall economic activity in 2002, the loss of stock market-related revenues reduced the ongoing amount of annual state revenues by well over \$10 billion relative to pre-2001-02 levels.

HOW THE SHORTFALL WAS ADDRESSED

As indicated above, based on the provisions and assumptions incorporated in the 2002-03 budget package, all of the \$23.6 billion budget gap would be eliminated by the close of the budget year. Figure 3 shows the various budget-related solutions that were adopted (based on the administration's methodology for categorizing the savings). These include:

- Program Cost Savings (\$7.5 Billion).** These savings—which account for about one-third of the overall budgetary solutions adopted—primarily involve the deferral or elimination of previously enacted program expansions, and the elimination of workload and cost-of-living adjustments throughout the budget. While all major program areas are affected, the largest dollar savings are in education, health, social services, and state operations. The programmatic details of these savings are discussed in “Chapter 4”. The \$7.5 billion total also includes \$750 million in unallocated reductions to state operations, \$285 million in savings from an early retirement program, and \$75 million from the elimination of vacant positions.

Figure 3
Major Actions Taken to Close the Budget Funding Gap

(In Billions)

Estimated Funding Gap	2001-02	2002-03	Total
Program cost savings	\$1.8 ^a	\$5.6	\$7.5
Increased borrowing	0.2	5.4	5.6
Inter-fund loans, funding shifts, and transfers	1.4 ^b	3.5	4.8
Revenue increases	—	2.9	2.9
Deferral of certain education disbursements	1.0 ^c	0.7	1.7 ^c
Assumed increased federal funds	0.1	1.0	1.1
Total Actions	\$4.6	\$19.0	\$23.6

^a Includes \$0.2 billion in 2000-02 savings

^b Includes \$0.3 billion in 2000-01 funding shifts.

^c Represents funds deferred in Chapter 101, Statutes of 2002 (AB 3011, Committee on Budget). Does not include \$77 million in school performance award payments deferred in the 2002-03 Budget Act. Detail may not total due to rounding.

- **Increased Borrowing (\$5.6 Billion).** This includes \$4.5 billion from the securitization of future tobacco settlement receipts. This will occur through the sale of revenue bonds whose repayments will be secured by future state receipts of tobacco settlement payments. The other \$1.1 billion is related to the State Treasurer's plan to restructure state debt, including the deferral of certain principal payments due in 2002 through mid-2004.
- **Interfund Loans, Funding Shifts, and Transfers (\$4.8 Billion).** This category includes \$2 billion in loans, of which about \$1.2 billion is from transportation-related funds. The balance is from a variety of sources detailed in Chapter 3, including certain resources-related funds.
- **Revenue Increases (\$2.9 Billion).** These include a two-year suspension of the net operating loss carry-forward deduction (\$1.2 billion), withholding increases on stock options and certain real estate sales (\$625 million), a one-year suspension of the teacher tax credit (\$170 million), and various tax compliance measures.
- **Deferral of Certain Education Disbursements (\$1.7 Billion).** This includes the deferral of \$1 billion from June to July of 2002, and another \$681 million from late 2002-03 into July 2003. These deferrals are not intended to materially affect the functioning of the programs involved.
- **Increased Federal Funding Assumptions (\$1.1 Billion).** This includes \$400 million related to increased federal contributions for Medi-Cal funding, \$350 million related to security and bioterrorism funding, \$91 million for child support system penalty relief, \$50 million for undocumented felon reimbursements, and \$56 million for various health and social services programs.

One Time Versus Ongoing Solutions

Although the above actions addressed the budget problem for 2002-03, they did not eliminate the multibillion dollar underlying imbalance that currently exists between General Fund revenues and expenditures. This is because most of the adopted budget solutions are either one-time or limited-term in nature. In fact, some of the actions—such as the special fund loans, borrowing, and net operating loss suspension—will result in additional budgetary obligations in later years. Because of the relatively limited amount of ongoing savings incorporated in the 2002-03 budget package, the state will continue to face large multibillion shortfalls in 2003-04 and beyond, absent corrective actions.



Chapter 2

Key Features of the Budget Act and Related Legislation

THE BUDGET TOTALS

Total State Spending

The state spending plan enacted for 2002-03 authorizes total state spending from all funds of \$98.9 billion. As indicated in Figure 1, this total includes budgetary spending of \$96.1 billion, reflecting \$76.7 billion from the General Fund and \$19.4 billion from special funds. In addition, spending from selected bond funds totals \$2.8 billion. These bond-fund expenditures reflect the use of bond proceeds on capital outlay projects in a given year. The General Fund costs of these outlays, however, involve the ongoing principal and interest payment until the bonds are retired.

The amount of 2002-03 budget spending compared to 2001-02 represents a decline of \$782 million (0.8 percent)—\$141 million (0.2 percent) for the General Fund and \$641 million (3.2 percent) for special funds.

Figure 1
The 2002-03 Budget Package
Total State Expenditures

(Dollars in Millions)

Fund	Actual 2000-01	Estimated 2001-02	Enacted 2002-03	Change From 2001-02	
				Amount	Percent
General Fund	\$78,053	\$76,863	\$76,722	-\$141	-0.2%
Special funds	13,972	19,995	19,354	-641	-3.2
Budget totals	\$92,024	\$96,858	\$96,076	-\$782	-0.8%
Selected bond funds	4,357	4,456	2,812	-1,644	-36.9
Totals	\$96,382	\$101,314	\$98,888	-\$2,426	-2.4%

Detail may not total due to rounding.

The General Fund Condition

Figure 2 summarizes the estimated General Fund condition for 2001-02 and 2002-03 that results from the adopted spending plan and related legislation.

Figure 2

The 2002-03 Budget Package Estimated General Fund Condition

(Dollars in Millions)

	2001-02	2002-03	Percent Change
Prior-year fund balance	\$3,037	\$72	
Revenues and transfers	73,898	79,158	7.1%
Total resources available	\$76,935	\$79,230	
Expenditures	\$76,863	\$76,722	-0.2%
Ending fund balances	\$72	\$2,508	
Encumbrances	\$1,473	\$1,473	
Reserve	-\$1,401	\$1,035	

Detail may not total due to rounding.

2001-02. In the prior year, estimated revenues and transfers totaled \$73.9 billion (a growth of 3.5 percent from 2000-01) while expenditures were \$76.9 billion (a 1.5 percent decline). This resulted in a negative operating balance (that is, expenditures in excess of revenues) of about \$3 billion. This was offset by a carry-in balance of about \$3 billion from 2000-01. However, because encumbrances totaled \$1.5 billion, a year-end budget deficit of roughly \$1.4 billion occurred. (These figures include the \$6.2 billion electricity loan from the General Fund in 2000-01 and its assumed repayment in 2001-02.)

2002-03. Figure 2 shows that, under the adopted budget agreement, the current year is projected to end with a positive reserve balance of slightly over \$1 billion. This reflects estimated revenues and transfers totaling \$79.2 billion (7.1 percent growth) and estimated expenditures of \$76.7 billion (a 0.2 percent decline). This, in turn, results in an operating surplus of \$2.4 billion.

Programmatic Spending in 2002-03

General Fund spending in 2002-03 is summarized in Figure 3, by major program area. As discussed in greater detail in “Chapter Four”, budgetary growth varies considerably by program area. For example, K-12 education and social services programs collectively experience modest percentage gains, whereas health and corrections experience moderate reductions. Similarly, the University of California experiences a moderate reduction, California State Uni-

versity has a modest decline, and funding for the California Community Colleges sees moderate growth.

Figure 3
The 2002-03 Budget Package
General Fund Spending by Major Program Area

(Dollars in Millions)

Program	Actual 2000-01	Estimated 2001-02	Enacted 2002-03	Change From 2001-02	
				Amount	Percent
K-12 Education ^a	\$29,746	\$29,939	\$30,769	\$830	2.8%
Higher Education					
CCC ^a	2,808	2,854	3,016	162	5.7
UC	3,201	3,458	3,224	-234	-6.8
CSU	2,442	2,713	2,681	-32	-1.2
Other	697	753	838	84	11.2
Health	12,245	13,675	13,022	-653	-4.8
Social Services	7,564	8,419	8,611	192	2.9
Corrections	5,298	5,544	5,285	-259	-4.7
All other	14,050	9,508	9,276	-232	-2.4
Totals	\$78,053	\$76,863	\$76,722	-\$141	-0.2%

Detail may not total due to rounding.

^a Includes expenditures from prior-year Proposition 98 appropriations.

General Fund Spending over Time

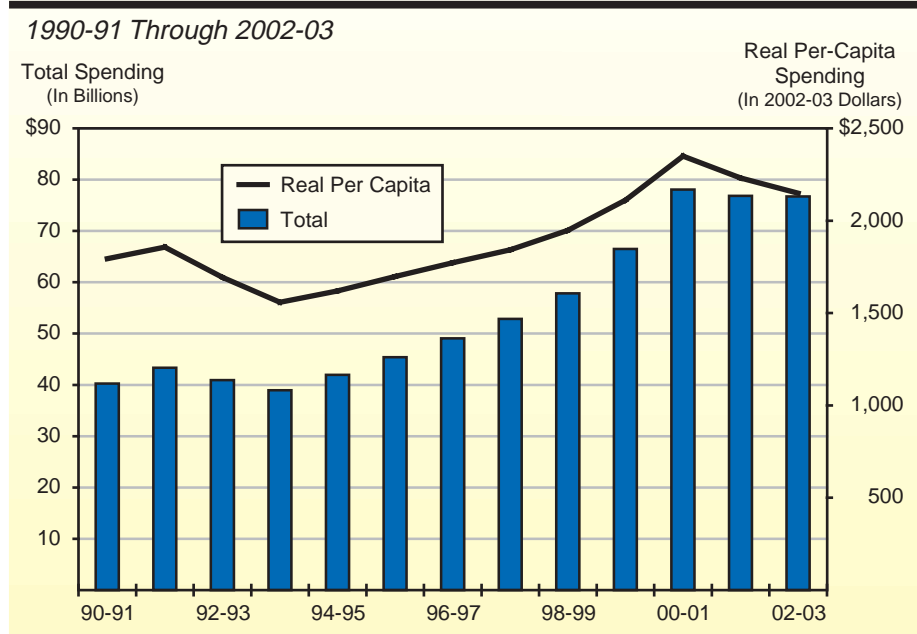
Figure 4 (see page 10) shows General Fund expenditures from 1990-91 through 2002-03, both in current dollars (shaded bars) and as adjusted for population growth and inflation (that is, in real per capita terms, displayed using the line).

The figure indicates that, based on the approved spending plan, General Fund spending in 2002-03 will decline for the second year in a row after having peaked in 2000-01. Likewise, real per capita spending will fall for the second consecutive year in 2002-03, which will leave it roughly 9 percent below its 2000-01 peak. This reduced percapita spending level will still be about 16 percent above its peak prior to the early 1990s' recession, and nearly 40 percent above its 1990s' recession low.

EVOLUTION OF THE BUDGET

In this section, we highlight the key developments in the evolution of the 2002-03 budget, beginning with the November 2001 executive order freezing

Figure 4
General Fund Expenditures Over Time



certain state expenditures and concluding with the Governor’s signing of the budget on September 5, 2002.

November Revisions

In the months immediately following the adoption of the 2001-02 budget in July 2001, the economy and state revenues both fell sharply below forecasted levels. The downturn accelerated following the September 11, 2001 terrorist attacks. By the fall, it was clear that the 2001-02 budget was falling seriously out of balance, and that the 2002-03 budget faced a major shortfall. In our November 2001 release of *California’s Fiscal Outlook*, we estimated that the state faced a cumulative shortfall of over \$12 billion in 2002-03, absent corrective actions.

In response to the emerging budget problem, the Governor issued an executive order in November freezing certain state expenditures. He also requested that the Legislature convene an extraordinary session to consider various current-year adjustments to help address the situation. These savings were included as part of the *2002-03 Governor’s Budget* released in January. On January 29, 2002, the Legislature adopted SB 1xxx (Chapter 1xxx, Peace), which included many of the Governor’s proposals. The measure included savings of \$2.2 billion in 2001-02 and \$589 million in 2002-03. As shown in Figure 5:

- About \$857 million of the 2001-02 savings were in education, including \$250 million from a rescission of funds for energy costs. Other education-related savings included funding deferrals for certain teacher incentives, as well as reductions in various categorical programs.
- About \$600 million in savings were in General Government. These included across-the-board cuts in state operating expenses, a reduction in funds provided for various energy-related costs and initiatives, and a reversion of funds that had been earmarked for Smog Impact Fee refunds (reflecting a reduction in the estimate of the likely amount of refunds needed to be paid).
- The balance of savings came from a variety of other areas, including a delay in the planned expansion of the Healthy Families program and the reversion of funds that had been approved for various program expansions and resources capital projects.

Figure 5
Mid-Year Savings for 2001-02
Adopted by Legislature

(In Millions)

K-12 Education	\$857
General Government	605
Resources	187
Transportation	138
Social Services	116
Local Government	109
Health Services	89
Higher Education	56
Criminal Justice	6
Total	\$2,163

Governor's January Proposal for 2002-03

The scope of the 2002-03 budget problem grew substantially between when the Governor released his original proposal in January and when the budget was approved in early September. The budget shortfall, along with the distribution of budget savings by major category, are shown in Figure 6 (see page 12) for the January proposal, the May Revision, and the *2002-03 Budget Act*.

In January, the Governor proposed a 2002-03 General Fund budget, which incorporated his proposed 2001-02 mid-year savings discussed above, as well as numerous other actions to cover an estimated \$12.5 billion budget shortfall. Specifically, the budget included:

Figure 6
Evolution of 2002-03 General Fund Budget Solutions

(In Billions)

Type of Solution	January 2002 Governor's Budget	2002 May Revision	September 2002 Budget Act
Program cost savings	\$5.2	\$7.6	\$7.5
Deferral of education disbursements	—	1.1	1.7
Tobacco settlement securitization	2.4	4.5	4.5
Debt restructuring	—	1.1	1.1
Funding shifts, loans, and transfers	3.6	4.3	4.9
Revenue increases and accelerations	0.2	3.9	2.9
Federal funding increases	1.1	1.1	1.1
Total Solution	\$12.5	\$23.6	\$23.6

- About \$5.2 billion in major program cost savings, including \$2.4 billion from his November proposal, and an additional \$2.6 billion from suspension of cost-of-living adjustments, postponements of some health care expansions, reduced inflationary adjustments for higher education, and various other funding delays. Overall, these reductions were largely from cutbacks in planned spending increases—either to cover workload, inflation, or previously approved program expansions. Relatively few of the savings were from cuts to existing ongoing programs.
- About \$2.4 billion from the securitization of future tobacco settlement receipts. Under this plan, the state would sell its future rights to about 45 percent of the present value of roughly 25 years of its annual tobacco settlement receipts for up-front cash. This would be achieved through the sale of a revenue bond whose repayment would be secured by a portion of future tobacco settlement payments beginning in 2003-04. Under legislation passed in conjunction with the 2001-02 budget, these tobacco settlement receipts had been earmarked for a variety of health care expansions.
- About \$3.6 billion in funding shifts, special fund loans, and deferrals. This category included about \$900 million in savings from the deferral of annual contributions to the state's public employees' and teachers'

retirement funds (in return for additional benefits in the future). It also included a \$672 million loan from transportation funds to the General Fund.

- About \$1.1 billion in additional funds from the federal government. These funds were earmarked to offset state costs for Medi-Cal, undocumented felon incarceration, and security activities. The budget also assumed elimination of federal child support penalties.

May Revision

During the months following the release of the January budget, the state's revenue picture continued to deteriorate sharply. In April alone, final payments were below the budget forecast by over \$2.5 billion. In response to these developments, the May Revision included a major downward revision to its revenue forecast. Specifically, the administration reduced its revenue forecast by \$3.8 billion for 2001-02 and \$5.8 billion for 2002-03, or a two-year total of \$9.5 billion.

In addition to the revenue reduction, the administration raised its estimate of expenditures by \$1.6 billion for 2001-02 and 2002-03 combined, primarily due to a significant upward revision to the 2002-03 Proposition 98 minimum funding guarantee. The combination of the two-year revenue decline and the two-year expenditure increase caused the estimated overall budget shortfall to almost double between January and May—from \$12.5 billion to \$23.6 billion.

The Governor's May Revision budget proposed to deal with the worsening fiscal outlook through a wide range of new program cost savings, significant tax increases, sharply expanded borrowing, new funding shifts, and additional interfund loans.

New Program Cost Savings. As shown in Figure 6, the May Revision included program cost savings totaling \$7.6 billion, about \$2.4 billion more than in January. The additional cuts were mostly in the areas of health, social services, and local government. In contrast to January—which focused mainly on elimination of previously approved program *expansions*—many of the cuts proposed in May involved reductions or elimination of *existing* programs. Examples include the proposed elimination of certain optional benefits in Medi-Cal, significant cuts to county administration funding for health and social services programs, and reduced higher education funding for research, equipment, and K-12 outreach and staff development.

The May Revision also proposed reduced funding for local programs, including law enforcement grants, open space subventions, high technology law

enforcement, and booking fee reimbursements. It also included the deferral of funding for various mandates. The May Revision eliminated 4,000 positions and required unallocated reductions in operating expenses for most state departmental budgets.

New Tax Increases. The May Revision included \$3.9 billion in tax increases and revenue accelerations. These included a one-year increase in vehicle license fees (VLF), a two-year suspension of net operating loss carryforward deductions for businesses, an ongoing 50-cent increase in the excise tax on cigarettes, and a variety of tax compliance and auditing-related measures.

Expanded Savings in Other Areas. In the May Revision, the administration proposed to sell the full stream of the state's future tobacco settlement receipts over the next approximately 25 years for \$4.5 billion in cash. This was up from the \$2.4 billion in tobacco securitization bonds proposed in January. The May Revision also proposed increases in loans from transportation funds to over \$1.2 billion in total, and contained a variety of other funding redirections to cover the additional shortfall. It also deferred \$1.1 billion of K-12 education expenditures from June 2002 to July 2002, thereby achieving one-time savings in 2001-02 while at the same time meeting the increased Proposition 98 guarantee in 2002-03.

Finally, the revised plan replaced the proposed deferral of retirement contributions with the Treasurer's plan to restructure state debt. The restructuring plan reduces debt service payments by \$223 million in 2001-02 and \$860 million in 2003-04—primarily by delaying principal repayments on certain debt maturing during the two-year period and instead borrowing to pay them over time.

Legislative Versions of the Budget

Assembly and Senate Versions. The budgets adopted by the Senate and Assembly in late May assumed most of the administration's May Revision budget proposals involving tax increases, the securitization of tobacco settlement receipts, special fund loans and transfers, and various other funding redirections. However, both houses rejected many of the May Revision's proposed spending reductions in the areas of health and social services. They also, to varying degrees, restored the May Revision's proposed reductions to local government programs. Both houses included unspecified savings (\$900 million for the Senate and \$1 billion in the Assembly) to offset the additional spending in each of the budgets.

Conference Committee Actions. The Assembly and Senate versions of the budget were sent to the Conference Committee for reconciliation in early June. In addition to the normal reconciliation of the Assembly and Senate budgets, the committee considered a wide variety of other actions, including various alternative spending reductions, tax increases, as well as additional loans and transfers from special funds.

The budget that emerged from the Conference Committee was similar to the earlier legislative versions, in that it restored many of the May Revision budget cuts in health, social services, and local governments. It compensated for the additional spending by: (1) deferring \$481 million in K-12 education programs from 2002-03 into early 2003-04, (2) raising the amount of targeted savings in state operations through the elimination of up to 6,000 vacant positions, and (3) further increasing one-time loans and transfers from special funds. The conference committee also adopted additional revenue and spending actions proposed by the administration in mid-June.

Subsequent Legislative Actions. The Conference version, with some modifications, was passed by the Senate on June 29, 2002. However, the budget failed to garner a two-thirds majority in the Assembly. Despite negotiations involving both alternative spending cuts and the substitution of higher cigarette taxes for the proposed VLF increase, a budget impasse ensued which lasted through July and most of August.

On the final night of the 2001-02 legislative session, the Assembly reached a compromise on the budget. The main provisions of the compromise were the elimination of the VLF and cigarette tax increases that had been approved by the Senate. These tax provisions were replaced with withholding increases on stock options and capital gains, an additional \$200 million in K-12 spending deferrals from 2002-03 into 2003-04, an up-to-5 percent unallocated cut to state operations, and assumed savings from a retirement incentive program. Other elements of the agreement included:

- The placement of ACA 11 on the 2004 ballot. This measure would dedicate annual amounts (starting at 1 percent in 2006-07 and potentially rising to 3 percent in future years) of General Fund revenues to infrastructure spending at the state and local levels.
- The dedication of approximately \$400 million of 2003-04 Proposition 98 funding for school district equalization.
- A requirement that spending not exceed revenues in 2003-04.

- The elimination of an additional 1,000 positions in 2003-04, beyond the 6,000 eliminated in 2002-03.

Both houses passed the revised budget and sent it to the Governor for signature.

Governor's Vetoes

Before signing the budget, the Governor used his line item veto authority to “blue pencil” \$236 million in appropriations from the budget, including \$220 million from the General Fund. Of the total General Fund reduction, \$177 million was in health and social services programs, where the Governor deleted legislative augmentations for the Healthy Families program, child welfare services, and mental health. Of the remaining General Fund vetoes, about \$29 million was related to trial court funding. The Governor also vetoed a variety of legislative augmentations for K-12 Proposition 98 spending. However, these vetoes reduced the 2002-03 spending levels below the minimum funding guarantee. Thus, the Governor’s spending totals include a Proposition 98 reserve of \$143 million, which can be appropriated later in the year for any K-14 purpose.

MAJOR FEATURES OF THE FINAL BUDGET

K-12 Education. The budget includes \$41.6 billion in funding (state and local sources) for K-12 Proposition 98 funding, an 8.6 percent increase from 2001-02. Per-pupil funding will grow to \$7,067 during the year, representing an increase of 6.9 percent from 2001-02. After adjusting for the various spending deferrals in both 2001-02 and 2002-03, the underlying spending increases are more modest, with adjusted per-pupil funding growing by 3.4 percent. The budget includes \$1.5 billion to cover enrollment growth and inflation adjustments for most programs. Most of the remaining discretionary funds are earmarked for the High Priority School Grants Program. The budget includes funding reductions for certain previously enacted teacher incentive programs, digital high school, libraries, as well as funds that had previously been planned for school district equalization in 2002-03. It also defers spending for the scholarshare program.

Higher Education. The budget includes a 6.8 percent increase in community college funding, and declines of 3.2 percent for the University of California and 1 percent for California State University. The year-to-year changes for all three segments are affected by spending deferrals and one-time expenditures in 2001-02. Ongoing funding for higher education covers the Cal Grant entitlement programs, avoids any increases in resident student fees, more than fully funds student population increases, and provides funds (to varying degrees) for price increases. In order to make room for some of these increases,

the budgets contain some reductions in noninstructional funding for such purposes as research and K-12 teacher training.

Health. General Fund spending for health programs decreases by about 5 percent from the 2001-02 level. The reduction is partly related to an assumed \$400 million increase in federal funds for Medi-Cal payments. The budget generally funds caseload and cost increases. However, it contains specified reductions for such items as prescription drugs and medical supplies, and it assumes \$245 million in additional savings from antifraud activities. The budget also postpones the scheduled expansion of health care coverage to parents under the Healthy Families Program, imposes an unallocated reduction in the Regional Center budget, and reduces various community mental health grants. Finally, the budget increases the state's "takeout" of federal funding for hospitals that serve a disproportionate share of Medi-Cal and uninsured patients.

Social Services. General Fund spending for social services programs increases by about 2.5 percent in 2002-03, reflecting growth in the Supplemental Security Income/State Supplementary Program (SSI/SSP) and In-Home Supportive Services (IHSS) program, but declines in other areas.

The budget achieves savings by delaying cost-of-living increases for the CalWORKs and SSI/SSP programs until June 2003, eliminating discretionary cost-of-living-adjustments for Foster Care and related programs, and redirecting unspent county performance incentives to the core CalWORKs program. It also assumes suspension of state participation in the IHSS \$1 wage increase, and reduces adult education and community college support for CalWORKs recipients. Finally, the budget assumes enactment of federal legislation that will relieve the state of penalties associated with the delay in implementation of its child support computer automation.

Judicial and Criminal Justice. The budget reduces funding for certain adult and youth parole services, as well as contract medical services. It provides funds to continue the Citizens' Option for Public Safety (COPS) and Juvenile Justice grants at their 2001-02 levels, and provides funding for the High Technology Grant Program at about one-half its 2001-02 level.

Local Government. The budget does not include any major reductions in local government subventions. As discussed above, the budget maintains funding for the COPS and juvenile justice programs. However, it defers payments to local governments for state-mandated local programs, thereby avoiding budget-year costs. It also contains a one-time shift of \$75 million in property taxes from redevelopment agencies to school districts (and reduces General

Fund support by a like amount). Finally, it reduces state funding for the administration of health and social services programs.

STATE APPROPRIATIONS LIMIT

Background. Article XIII B of the State Constitution places limits on the appropriation of taxes for the state and each of its local entities. Certain appropriations, however, such as capital outlay and subventions to local governments, are specifically exempted from the state's limit. As modified by Proposition 111 in 1990, Article XIII B requires that any revenues in excess of the limit that are received over a two-year period be split evenly between taxpayer rebates and increased school spending.

State's Position Relative to Its Limit. After exceeding its limit by \$975 million in 1999-00, state appropriations fell below the state appropriations limit (SAL) in both 2000-01 and 2001-02.

For 2000-01, appropriations were more than \$1.8 billion below the SAL, due largely to a substantial volume of spending related to exempt appropriations. As a result, appropriations subject to the limit grew only marginally from the 1999-00 level, while the SAL itself rose by \$3.4 billion. The large volume of exempt 2000-01 appropriations related largely to VLF reimbursements, school district apportionments, local subventions, and capital outlay.

Then, in 2001-02, the gap dramatically expanded further—to \$16.5 billion. This occurred as appropriations subject to the limit dropped significantly, by \$8.8 billion, while the limit itself rose by over \$5.2 billion. This widening gap reflected the combination of declining General Fund appropriations necessitated by the budget imbalance, along with a rapid increase in the per capita personal income factor used to adjust the SAL during the year. (The rapid increase occurred between the fourth quarter of 1999 and the fourth quarter of 2000, prior to the economic and revenue downturn.)

For 2002-03, appropriations are expected to continue to remain well below the SAL, although the gap will drop to \$10.6 billion. This is because the SAL is expected to grow only marginally, reflecting the impact of the downturn on the per capita income factor, while appropriations subject to the limit are expected to grow by several billion dollars.

BUDGET-RELATED LEGISLATION

In addition to the *2002-03 Budget Act*, the budget package includes a number of related measures enacted to implement and carry out the budget's provisions. Figure 7 lists these bills and their status as of September 19, 2002.

Figure 7

2002-03 Budget-Related Legislation

Chaptered			
Bill Number	Author	Chapter #	Subject
ACA 11	Richman	185	Infrastructure financing
AB 2065	Oropeza	488	Tax-related suspensions, withholding, and administration
AB 2360	Dutra	578	Transportation: freeway service patrols
AB 2785	Oropeza	444	Education (current-year clean up)
AB 3008	Budget Committee	99	Education (current-year deferral)
AB 3011	Budget Committee	101	Education (current-year deferral)
SB 192	O'Connell	582	Federal education technology
SB 1831	Peace	414	Tobacco securitization
SB 1834	Budget and Fiscal Review	445	Transportation loans

Enrolled		
Bill Number	Author	Subject
AB 65	Strom-Martin	Federal Reading First
AB 312	Diaz	School sanctions and interventions
AB 442	Budget Committee	Omnibus health bill
AB 444	Budget Committee	Omnibus social services bill
AB 593	Oropeza	Unallocated reductions, golden handshake
AB 692	Aroner	Social services
AB 1100	Simitian	Charter schools
AB 1768	Oropeza	General government
AB 2781	Oropeza	Education finance and equalization
AB 2996	Budget Committee	Transportation
AB 2997	Budget Committee	Resources
AB 2998	Budget Committee	Charter schools
AB 3000	Budget Committee	General government omnibus bill
AB 3002	Budget Committee	Local government omnibus bill
AB 3004	Budget Committee	City of Millbrae disaster loan repayment
AB 3005	Budget Committee	Education mandates
AB 3006	Budget Committee	Medi-Cal provider rates
AB 3009	Budget Committee	Energy surcharge and natural heritage tax deferral
AB 3010	Budget Committee	Unemployment insurance
SB 1453	Alpert	Federal student data collection
SB 2083	Polanco	Federal education English learners
HR 96	Wesson	Commission on budgeting



Revenue-Related Provisions

In enacting the *2002-03 Budget Act*, the Legislature adopted a number of provisions to significantly augment General Fund resources. These provisions will result in estimated additional General Fund resources in 2002-03 of approximately \$10 billion. This total includes \$4.5 billion from tobacco securitization, \$2.9 billion from tax-related changes, and \$2.6 billion from loans and transfers.

Tobacco Securitization

The single largest action taken to increase 2002-03 revenues (\$4.5 billion) involves selling to investors the state's rights to its flow of tobacco settlement revenues (TSRs) over roughly the next 25 years. Under the provisions of the 1998 Master Settlement Agreement between certain large tobacco companies and various states, California will receive TSRs annually in perpetuity, including an estimated \$10-plus billion during this 25-year period. The budget plan essentially converts this future TSR stream into an upfront payment in the current year. In return, those investors who pay the \$4.5 billion will be repaid over time, with interest, from the TSRs when they are actually received. According to current estimates this will take roughly 25 years. The tobacco securitization program is the largest form of borrowing in the 2002-03 budget package.

Tax-Related Provisions

The \$2.9 billion in tax-related changes include the suspension of various personal income tax (PIT) and corporation tax (CT) deductions and credits, various revenue accelerations, conformity to the federal tax treatment of certain items, and certain tax compliance and enforcement measures. These measures are summarized in Figure 1 (see page 22) and discussed in detail below.

No Major Tax Increases Were Adopted

As noted in "Chapters 1 and 2", the Legislature and Governor considered but eventually did not adopt various proposals for major tax increases as a means of helping to address the budget problem. These proposals included: (1) increased income tax rates for high-income taxpayers, (2) cigarette and other tobacco-related tax rate increases, and (3) increasing the vehicle license fee.

Tax-Related Suspensions

The single largest tax-related provision involves suspending the net operating loss (NOL) deduction for businesses for a two-year period. In addition, the budget suspends the teacher tax credit for one year and the natural heritage tax credit for one year. Specifically, with respect to the largest two provisions:

NOL Suspension. Prior to the budget agreement, businesses were allowed to deduct from their income in a given year a specified portion of their NOLs incurred in earlier years under both the personal and corporate income taxes. Specifically, the law provided that the percentage of NOLs that could be used as an offset when calculating taxable income in future years was 60 percent in 2002 and 2003, and 65 percent in 2004 and thereafter. In contrast, the budget agreement suspends the use of these NOLs as an income offset during tax years 2002 and 2003. This will result in additional General Fund revenues of \$1.2 billion in 2002-03 and \$800 million in 2003-04. In exchange, the agreement also extends the maximum NOL carry-forward period for an additional two years, so that taxpayers affected by the suspension will have the same number of total years as formerly to use their NOLs. In addition, beginning with tax year 2004, businesses will be allowed to carry forward 100 percent (instead of only 65 percent) of their NOLs for a ten-year period (with this 100 percent provision thus first affecting NOLs incurred in 2004 and claimed in 2005 or

Figure 1
2002-03 Budget
Tax-Related Provisions

(In Millions)

	Revenue Gains
Deduction and Credit Suspensions	
Net operating losses	\$1,200
Teacher tax credit	170
Other	3
Subtotal	(\$1,373)
Accelerations	
Stock-option and bonus withholding	\$400
Real estate sales withholding	225
Subtotal	(\$625)
Federal Conformity	
Bank bad debt	\$285
Retirement and other ^a	188
Subtotal	(\$473)
Compliance, Enforcement, and Administration	
Waiver of penalties and interest	\$145
Settlement, audit, and protest activities	212
Administrative and other	24
Subtotal	(\$381)
Total	\$2,852

^a Includes revenue declines due to retirement conformity and revenue gains due to increased withholding requirements.

thereafter). These changes will result in significant annual General Fund revenue losses beginning in 2004-05 in the low hundreds of millions of dollars.

Teacher Tax Credit. Current law provides credentialed teachers with an annual tax credit against their PIT liabilities ranging from \$250 to \$1,500, depending upon their years of teaching service. The credit is limited to 50 percent of teaching-related income. The budget agreement suspends this credit for the 2002 tax year, resulting in additional revenues for 2002-03 of \$170 million.

Tax-Related Revenue Accelerations

The budget provides for increased withholding on bonus and stock-option income, and expanded withholding on real estate sales. The main effect of these changes will be to accelerate revenues, although some increase in compliance also will likely result.

- **Withholding on Stock Options and Bonus Income.** Currently, withholding on stock options and bonus income occurs at the rate of 6 percent. The budget agreement increases this rate of withholding to 9.3 percent, resulting in a one-time revenue acceleration of \$400 million in 2002-03.
- **Withholding on Real Estate Sales.** Under current law, *nonresidents* of the state are required to withhold for tax purposes 3.5 percent of the purchase price of commercial property. The budget agreement would expand the withholding requirement on commercial sales to state *residents*, resulting in a one-time revenue of \$225 million for 2002-03.

Federal Tax Conformity

Measures adopted to conform state tax law to federal tax law involving income tax treatment include those relating to bank bad debt. They also include a number of proposals contained in the Governor's January budget proposal and later adopted by the Legislature as part of the retirement conformity package (the bills involved are Chapter 35, Statutes of 2002 [AB 1122, Corbett] and Chapter 34, Statutes of 2002 [SB 657, Scott]. Specifically:

- **Bank Bad Debt.** Prior to the budget agreement, the law allowed large banks, when computing their taxable income, to deduct amounts set aside as reserves against losses from bad loans. The budget agreement would alter that treatment to conform to existing federal law and allow the bad loan income deduction only if and when loans become nonperforming. In addition, under the agreement, 50 percent of existing bank loss reserves are to be declared as income during the 2002 tax year. This measure will result in one-time revenues of \$285 million in 2002-03.

- **Retirement Programs and Other Conformity.** The Legislature previously approved legislation that conforms California law to federal tax law regarding pension plans, individual retirement accounts (IRAs), and 401k plans. Although these retirement provisions result in annual revenue losses, other conformity items incorporated in the bills (the largest item being the increase in required estimated tax payments from 80 percent to 90 percent of the final tax liability) would result in revenue increases. The net effect of these bills accounts for the vast majority of the \$188 million increase in 2002-03 revenues.

Tax Compliance, Enforcement, and Administration

The budget agreement approved numerous proposals to increase tax compliance, adopted certain tax enforcement-related provisions, and adjusted downward the interest rate the state pays on tax overpayments. The most significant of these measures are:

- **Waiver of Penalties and Interest.** The largest single revenue source among these measures is the authority to waive penalties and interest on certain delinquent accounts. The waiver would provide an incentive for the payment of these accounts, which would be expected to result in additional PIT, CT, and sales and use tax revenues in 2002-03 of \$145 million.
- **Settlement, Audit, and Protest Activities.** Enhancing the settlement program used to resolve tax disputes, increased auditing capabilities, and addressing protest program priorities is estimated to result in additional 2002-03 revenues of \$212 million.

Loans and Transfers

As summarized in Figure 2, the budget package includes \$2.6 billion of loans and transfers from special funds to help address the General Fund imbalance.

The single largest component involves a \$1 billion transportation-related loan from the Traffic Congestion Relief Account. Other significant components of at least \$100 million include a transfer from the Public Utilities Commission's High-Cost Fund B (related to telephone service), and loans from the Beverage Container Recycling Fund, Renewable Resources Trust Fund, and Vehicle Inspection and Repair Fund.

The various loans and transfers shown in Figure 2, while contributors to addressing the 2002-03 budget shortfall, will impose costs in future years to the extent that they have to be repaid. Their repayment requirements vary de-

pending on the specific loan or transfer involved. For example, repayment to the Traffic Congestion Relief Account is scheduled to be \$500 million in 2003-04 and \$650 million in 2004-05. In addition, because these loans and transfers are largely one-time in nature, they will not be available as solutions for addressing the anticipated 2003-04 budget imbalance.

Figure 2
2002-03 General Fund Loans and Transfers

(In Millions)

	Budget Package
Selected Loans	
Traffic Congestion Relief Account	\$1,045
Beverage Container Recycling Fund	218
Renewable Resource Trust Fund	157
Vehicle Inspection and Repair Fund	100
Public School Planning, Design, and Construction Review Revolving Fund	35
Occupancy Compliance Monitoring Account	35
Tax Credit Allocation Fee Account	27
Pollution Control Financing Authority Fund	25
Housing Rehabilitation Loan Fund	21
Agricultural Fund	15
Selected Transfers	
High-Cost Fund B	\$251
Trial Court Improvement Fund	43
High-Cost Fund A	27
Colorado River Management Account	22
State Parks and Recreation Fund	20
All other loans and transfers	\$529
Total Loans and Transfers	\$2,570



Chapter 4

Expenditure Highlights

K-12 EDUCATION

Total Proposition 98 Spending

The budget package includes \$46.5 billion in Proposition 98 spending in 2002-03 for K-14 education. This represents an increase of \$3.3 billion, or 7.6 percent, from spending in 2001-02 as revised by the Third Extraordinary Session and budget trailer bills. Figure 1 summarizes the budget, by funding source, for K-12 schools, community colleges, and other agencies in 2001-02 and 2002-03.

Figure 1

Proposition 98 Budget Summary

2001-02 and 2002-03
(Dollars in Billions)

	2001-02 Budget Package		2002-03
	As Enacted	Revised	
K-12 Proposition 98			
General Fund	\$28.8	\$26.4	\$28.6
Local property taxes	11.7	11.9	12.9
Subtotals, K-12	(\$40.5)	(\$38.3)	(\$41.6)
<i>Average Daily Attendance (ADA)</i>	5,780,737	5,800,896	5,880,576
<i>Amount per ADA</i>	\$7,002	\$6,610	\$7,067
California Community Colleges			
General Fund	\$2.7	\$2.6	\$2.8
Local property taxes	1.8	1.8	2.0
Subtotals, Community Colleges	(\$4.5)	(\$4.4)	(\$4.8)
Other			
Other agencies	\$0.1	\$0.1	\$0.1
Loan repayment	0.4	0.4	—
Totals, Proposition 98	\$45.4	\$43.2	\$46.5
General Fund	\$31.9	\$29.5	\$31.6
Local property taxes	13.5	13.8	14.9

Proposition 98 spending for 2001-02 was reduced by a total of \$2.2 billion as a result of actions taken in the Third Extraordinary Session, Chapter 99, Statutes of 2002 (AB 3008, Committee on Budget), and Chapter 101, Statutes of 2002 (AB 3011, Committee on Budget). Even after the reductions, Proposition 98 spending for 2001-02 exceeded the minimum guarantee by \$5.5 billion. For 2002-03 the Proposition 98 commitments are just above the minimum guarantee.

Per-Pupil Funding

The revised 2001-02 budget yields a K-12 per-pupil funding level of \$6,610. The 2002-03 budget results in per-pupil funding of \$7,067, an increase of \$457, or 6.9 percent, above the 2001-02 level. The level of growth in Proposition 98 spending per pupil, however, is distorted because expenses were deferred from one fiscal year to another (discussed in detail below). Figure 2 displays the impact that the deferrals have on the growth of per-pupil spending. Adjusting for the deferrals, per-pupil spending increased by \$227, or 3.4 percent, over the 2001-02 level.

Figure 2

K-12 Proposition 98 Spending Per Pupil Adjusted for Funding Deferrals Between Years

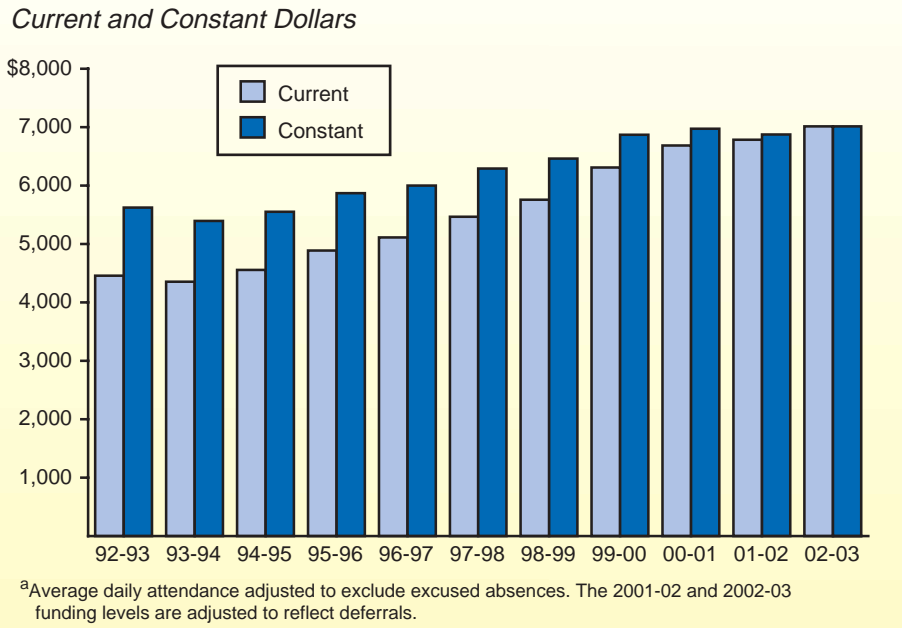
2000-01 Through 2002-03

	2000-01 Actual	2001-02 Revised	2002-03
Budgeted Funding			
Dollar per ADA	\$6,685	\$6,610	\$7,067
Percent Growth	—	-1.1%	6.9%
Programmatic Funding			
Dollar per ADA	\$6,685	\$6,784	\$7,011
Percent Growth	—	1.5%	3.4%

^a To adjust for the deferrals, we counted funds toward the fiscal year in which school districts had programmatically committed the resources. The deferrals meant, however, that districts technically did not receive the funds until the beginning of the next fiscal year.

Figure 3 displays K-12 per-pupil funding amounts from 1992-93 through 2002-03. After adjusting for deferrals, the effects of inflation, and changes in attendance accounting, per-pupil funding increased \$1,390 or 25 percent over the period.

Figure 3
Proposition 98 Funding Per Student^a

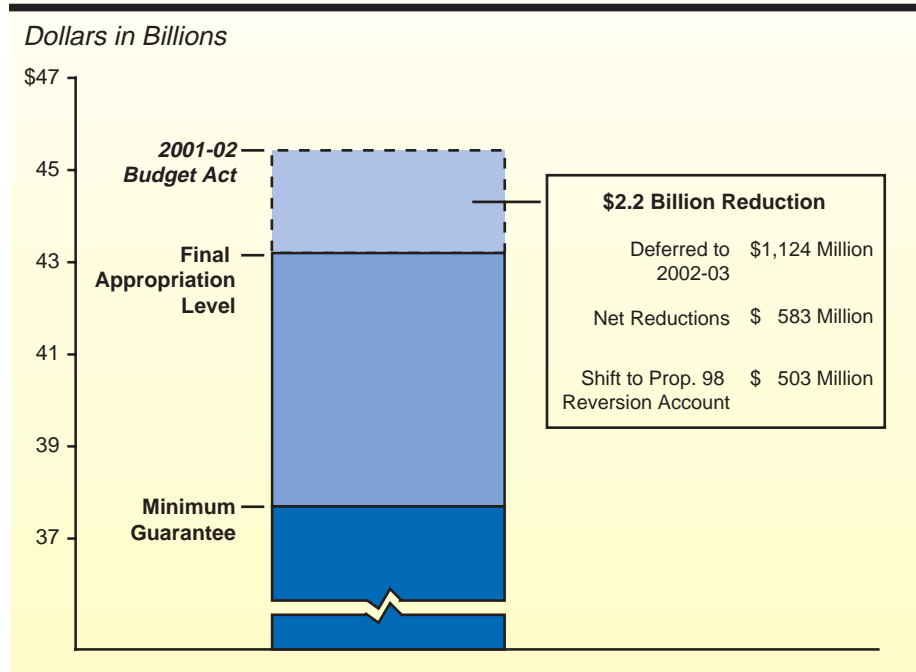


2001-02 Major Adjustments

In the *2001-02 Budget Act*, the Legislature appropriated over the minimum guarantee by about \$4 billion. The level of the appropriation over the minimum guarantee increased an additional \$3.7 billion during 2001-02 because actual General Fund revenues were less than predicted due to the worsening economy. Given the over-appropriation, the Legislature was able to achieve budgetary savings by reducing 2001-02 funding for K-12 schools and the community colleges in the Third Extraordinary Session and the trailer bills accompanying the *2002-03 Budget Act*. Figure 4 (see page 30) details the major changes in Proposition 98 funding from the *2001-02 Budget Act* to the revised 2001-02 appropriation level. In total, the Legislature reduced Proposition 98 funding for 2001-02 by \$2.2 billion, as described below.

Proposition 98 Deferrals From 2001-02 to 2002-03. Through a series of actions, the Legislature deferred \$1.1 billion of Proposition 98 spending from 2001-02 to 2002-03. Instead of receiving \$1.1 billion in categorical funding in the late spring of 2002, schools received the funding in summer 2002. The deferral had no programmatic impact on school districts, although some districts may have experienced cash-flow and accounting difficulties as a result of the delay. The deferral, however, allowed the state to achieve one-time General Fund savings of \$1.1 billion in 2001-02.

Figure 4
Proposition 98 Funding for 2001-02



Third Extraordinary Session and Trailer Bill Reduce Proposition 98 Spending. In addition to the deferral, the Legislature made a net reduction of \$583 million to Proposition 98 funding for 2001-02—with reductions made during the Third Extraordinary Session and cuts made in education trailer bills. Chapter 1xxx, Statutes of 2002 (SB 1xxx, Peace) reduced Proposition 98 funding for 2001-02 by \$457 million. Major reductions included delaying the High Priority School Grant program (\$162 million), delaying funding for the Teaching as a Priority Block Grant (\$119 million), and suspending the Certificated Staff Performance Awards (\$100 million). In addition, Chapter 1xxx eliminated funding for energy costs (\$250 million) that were originally appropriated to meet a Proposition 98 “settle-up” obligation for 1995-96 and 1996-97. In Chapter 99, the Legislature made additional 2001-02 reductions totaling \$169 million for various categorical programs. The cuts included CalSafe (\$44 million), 9th Grade Class Size Reduction (\$25 million), and Healthy Start (\$25 million).

Proposition 98 Reversion Account Fund Shift. In Chapter 99, the Legislature also reduced Proposition 98 General Fund support for adult education in 2001-02 by \$503 million. The Legislature then provided \$503 million from the Proposition 98 reversion account to fund adult education. This generated \$503 million in one-time General Fund savings.

2002-03 Baseline Changes

Compared to revised 2001-02 Proposition 98 spending, the 2002-03 budget includes a combination of baseline increases and reductions for various education programs that result in a net increase of \$3.3 billion. Figure 5 details the major changes in Proposition 98 funding from the final 2001-02 appropriation level to the 2002-03 appropriation level.

Figure 5

How Was 2002-03 Growth in Proposition 98 Allocated?

Purpose	Amount
K-12 growth and COLA	\$1,544
Program payment deferred from 2001-02	1,124
CCC growth and COLA	201
High Priority Schools Grant Program	199
Proposition 98 reserve	143
Other changes	56
Total growth	\$3,267

Major Increases. The budget allocates over \$1.5 billion to provide inflation and growth adjustments to K-12 education. Specifically, the budget includes \$731 million to accommodate a 1.37 percent increase in the student population and \$789 million for a 2 percent cost-of-living adjustment (COLA). This COLA applies to most programs and is higher than the 1.66 percent required under current law. The budget directs the remaining funds for other purposes, including \$199 million to begin implementation of the High Priority Schools Grant Program.

Spending Reductions. Figure 6 (see page 32) shows the major spending reductions (including Governor’s vetoes). The Legislature used additional 2000-01 and 2001-02 savings to restore several of its key education priorities. The Governor vetoed most of these restorations and augmentations (a total of \$143 million). The largest reductions and vetoes are discussed below:

- **Reward Programs Suspended (\$207 Million).** The budget includes the Governor’s proposals to suspend funding for the Governor’s Performance Awards (\$157 million) and Certificated Staff Performance Awards (\$50 million) for the 2002-03 school year. These programs provide financial awards to schools and certificated staff based on improvements in Academic Performance Index scores. The budget, however, does provide \$77 million to fund performance awards that schools earned in 2001-02.

Figure 6

Major K-12 Proposition 98 Funding Reductions

2002-03
(Dollars in Millions)

Program	Amount
Governor's Performance Awards	\$157 ^a
School Libraries	135 ^b
Digital High School	61 ^c
Certificated Staff Performance Awards	50
Equalization	42
Public Employees' Retirement System Offset	36
Teaching as a Priority	30
K-4 Classroom Libraries	25
9 th Grade Class Size Reduction	25

^a The Budget Act provides \$77 million as part of the deferral package for awards earned in the 2001-02 school year.

^b The budget contains \$9.5 million from the Proposition 98 Reversion Account for this purpose.

^c The Legislature adopted intent language to fund this program in 2003-04.

- **School and Classroom Libraries Cut (\$160 Million).** The budget reduces \$135 million from K-12 libraries and eliminates the K-4 Classroom Libraries program (\$25 million). The budget, however, retains a total of \$400 million for instructional materials.
- **Digital High School Program Suspended (\$61 Million).** The budget eliminates funding on a one-time basis for the Digital High School program, but includes intent language stating that funding will be provided in 2003-04 fiscal.
- **Revenue Limit Equalization (\$42 Million—Vetoed).** The Governor vetoed the \$42 million the Legislature provided as a partial payment toward equalizing school districts' revenue limit funding. This funding would have continued the equalization effort the Legislature began in 2001-02 on a one-time basis. (See below with regard to future legislative commitments to equalization.)
- **Public Employees' Retirement System (PERS) Offset (\$36 Million—Vetoed).** The Governor vetoed the \$36 million in general purpose funds the Legislature provided to school districts and county offices of education to continue the 2001-02 reduction for the PERS offset. The PERS offset is a series of complex calculations that allowed the state to "capture" savings from falling PERS contribution costs in the 1980s.

- **Other Program Restorations (\$40 Million—Vetoed).** The Governor vetoed a total of \$40 million associated with two other legislative restorations. Specifically, the Governor vetoed \$23 million (the entire restoration) for adult education for CalWORKs pupils, and \$17 million for the Healthy Start program (leaving \$2 million).

Governor Creates Proposition 98 Reserve. The Legislature passed a budget that appropriated Proposition 98 funding only slightly (\$6 million) above the minimum guarantee. The Governor's vetoes, therefore, move the appropriation level below the minimum guarantee. The state has, in effect, set aside \$143 million in Proposition 98 set-aside to be appropriated later in the fiscal year for any K-14 purpose.

State Mandates Eliminated, Suspended, or Deferred. The Legislature suspended three mandates in K-12 education—School Bus Safety, School Bus Safety II, and School Crime Reporting II. The Legislature also required the Commission on State Mandates to amend the parameters and guidelines for School Bus Safety II, which should reduce the cost of outstanding mandate claims from prior years. The one-year suspension in the School Crime Reporting II mandate will allow the State Department of Education to develop a new methodology for collecting school crime data consistent with new federal requirements. The Legislature eliminated three mandates related to absentee ballots for school elections, school site discipline notification, and inter-district transfer. In addition, the Legislature deferred an additional \$27.8 million for several state mandate claims. The Legislature will be required to pay these costs in future years with interest.

Federal Funds

The budget includes an increase in federal funds of over \$740 million. Most of the additional funds are from the federal *No Child Left Behind Act of 2001*, which imposes significant new federal requirements on teacher quality, student assessments, and school accountability. The Legislature appropriated the new federal funding and adopted language governing the appropriation and expressing legislative intent. In many instances, the Governor vetoed the budget bill language, but not the appropriation. Major federal fund items include:

- **Title I, Grants to Local Education Agencies (\$1.5 Billion).** Title I provides school districts with economically disadvantaged students resources to assist low-performing students. The 2002-03 funding level is a \$291 million increase over 2001-02. The additional funds will be distributed to school districts based on a revised federal formula. The Governor vetoed budget bill language that would have helped protect

the state against potential state mandates related to new data collection requirements imposed by Title I.

- **Reading First (\$132 Million).** This new program will provide grants to school districts to improve the quality of reading education. AB 65 (Strom-Martin) provides implementing legislation controlling how the funding can be used.
- **Improving Teacher Quality Grants (\$332 Million).** Through budget bill language, the Legislature directed the bulk of these new federal funds for (1) mitigating the costs of K-3 class size reduction (CSR), (2) expanding CSR in kindergarten and grades 1 to 12, and (3) funding teacher recruitment, retention, and standards-aligned professional development. The Governor vetoed this language, thereby allowing the State Board of Education to specify how the funds may be used.
- **Language Acquisition State Grants (\$109 Million).** This new program provides funding to school districts based on the number of English language learners the district serves. The Legislature appropriated these funds pending enactment of legislation designating the specific uses of the funds and related accountability provisions.
- **21st Century Community Learning Centers (\$41 Million).** The Legislature appropriated these funds generally to complement the state's Before and After School Learning and Safe Neighborhood Partnerships program.
- **Special Education (\$871 Million).** This is \$135 million more than the 2001-02 level. The Legislature approved the Governor's proposal to use \$112 million of the new federal funds to offset the General Fund cost of growth and COLA for special education.

Future Proposition 98 Spending

The 2002-03 budget package also includes several important provisions affecting Proposition 98 spending in 2003-04:

- **Proposition 98 Deferral from 2002-03 to 2003-04.** The Legislature deferred payment of \$681 million of expenditures from 2002-03 to 2003-04. As part of the deferral, the Legislature appropriated \$681 million in 2003-04 funds for four programs—Supplemental Grants (\$241.7 million), Targeted Instructional Improvement Grants (\$184.4), Home to School Transportation (\$139.6 million), and School Improve-

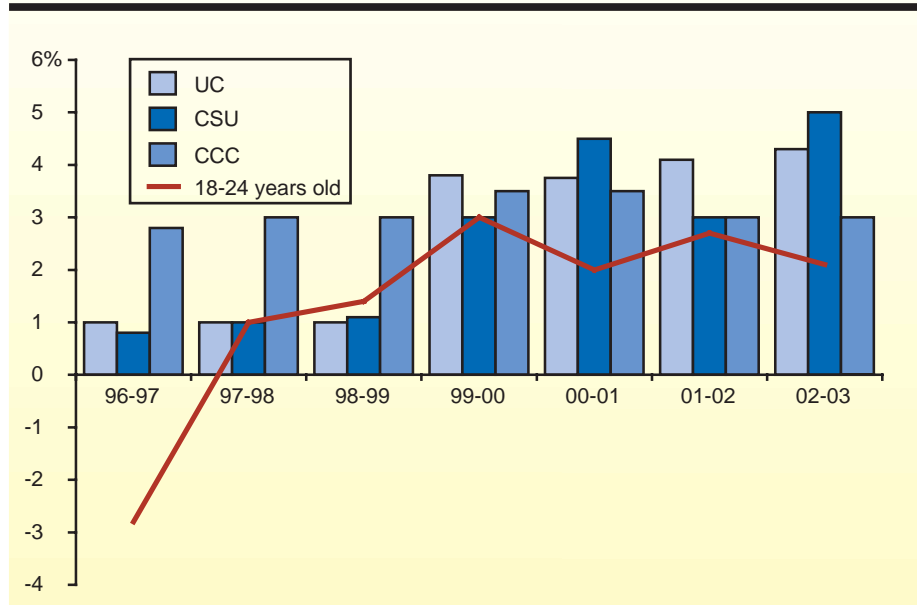
ment Program (\$115.3 million). These appropriations are to cover costs incurred by school districts administering these programs in the 2002-03 school year.

- **Revenue Limit Equalization.** The Legislature passed AB 2781 (Oropeza), which provides \$406 million in 2003-04 funding for revenue limit equalization. AB 2781 allocates half the money based on revenue limits adjusted for excused absences and half on unadjusted limits.
- **Commitment to Over-Appropriate Proposition 98.** In AB 2781, the Legislature committed to appropriate \$78.8 million over the Proposition 98 minimum funding guarantee in 2003-04. Of this amount, the Legislature committed to over-appropriate \$57.8 million in recognition of the impact to school districts and community colleges of the \$1.1 billion deferral from 2001-02 to 2002-03, and the \$503 million funding shift for adult education. Similarly, the Legislature committed to over-appropriate \$20.9 million in recognition of the impact of the \$681 million deferral from 2002-03 to 2003-04.
- **Outstanding State Mandate Claims Continue to Grow.** The budget defers payments to school districts and county offices of education for state-mandated programs. This deferral includes reimbursements for 2002-03 mandate claims, prior-year deficiencies, and newly identified mandate claims. We estimate that the state's one-time costs to pay these deferred claims totals about \$600 million. In addition, we estimate that the on-going annual costs of state mandates for K-12 education will exceed \$300 million in 2003-04.

HIGHER EDUCATION

The enacted budget includes \$11.6 billion in General Fund and local property tax support for higher education in 2002-03. This is \$284 million, or 2.5 percent, higher than the amount expended in 2001-02. In general, the budget fully funds the Cal Grant entitlement programs, avoids any increases in resident student fees, and increases base funding for faculty and staff compensation and enrollment growth. As shown in Figure 7 (see page 36), the budget continues a trend in prior budgets to fund enrollment growth at levels above the college age population growth. In order to accommodate these funding commitments, the budget includes a number of one-time and ongoing reductions to noninstructional programs. It also defers some community college funding from 2001-02 to 2002-03 as a way to save money (one-time) and help meet the Proposition 98 minimum guarantee in 2002-03.

Figure 7
Funded Enrollment Growth
Compared With Growth in College Age Population



Governor's Vetoes. The Governor vetoed a total of \$20.3 million from the higher education appropriations approved by the Legislature. This amount primarily includes the reduction of \$10 million from California Community Colleges' (CCC) matriculation programs, and \$9 million from CCC's California Work Opportunity and Responsibility to Kids (CalWORKs) services. (The budget's treatment of CalWORKs funding is discussed in the Social Services section of this report.)

The Governor vetoed budget bill language requiring the deferral of new spending by the California State University (CSU) on an information technology project until after a pending audit is completed. He also vetoed language that would have reappropriated up to \$20 million in unspent 2001-02 CCC funding. Total appropriations for the higher education segments are shown in Figure 8.

University of California

The 2002-03 budget provides \$3.2 billion in General Fund support for the University of California (UC). This is \$108 million, or 3.2 percent, less than provided in 2001-02. However, most (\$77.5 million) of this amount is due to one-time expenditures in 2001-02. Despite the net reduction in total General Fund support, the budget includes major augmentations for the following purposes:

Figure 8

**Higher Education Budget Summary
General Fund and Local Property Tax Revenue**

(Dollars in Millions)

Segment	2002-03 Budget	Change From 2001-02	
		Amount	Percent
University of California	\$3,223.9	-\$107.8	-3.2%
California State University	2,680.3	-27.2	-1.0
California Community Colleges	5,030.0	320.3	6.8
General Fund	(3,016.5)	(162.1)	5.7
Property taxes	(2,013.5)	(158.2)	8.5
Student Aid Commission	661.6	100.1	17.8
Hastings College of the Law	15.4	0.3	2.0
California Postsecondary Education Committee	2.2	-1.6	-42.9
Totals, Higher Education	\$11,613.3	\$284.1	2.5%

- \$69.2 million to serve approximately 7,700 additional full-time equivalent students (a 4.3 percent increase).
- \$47.6 million for a 1.5 percent increase in base support.
- \$16.8 million for increased costs of annuitant health and dental benefits.
- \$13.9 million to recruit faculty and for other startup costs at UC's new campus in Merced.

In order to fund these augmentations, the budget reduces several noninstructional programs from 2001-02 funding levels. Major reductions include:

- \$50.9 million to eliminate funding for grants to providers of training for K-12 teachers.
- \$32.1 million in research funding.
- \$29 million on a one-time basis for information technology, instructional equipment, library materials, and deferred maintenance.
- \$17 million for institutional financial aid programs.
- \$7.6 million for several outreach programs.

California State University

The 2002-03 budget provides \$2.7 billion in General Fund support for CSU. This is \$27.2 million, or 1 percent, less than provided in 2001-02. About two-thirds (\$18.9 million) of this amount is due to one-time expenditures in 2001-02. Despite the net reduction in total General Fund support, the budget includes major augmentations for the following purposes:

- \$97.6 million to serve approximately 15,000 additional full-time equivalent students (a 5 percent increase).
- \$37.7 million for a 1.5 percent increase in base support.

In order to fund these augmentations, the budget reduces several noninstructional programs from 2001-02 funding levels. Major reductions include:

- \$43 million on a one-time basis for information technology, library acquisitions, instructional equipment, and facility maintenance.
- \$21 million to suspend the Governor's Teaching Fellowship program, and issue loan forgiveness awards in place of the fellowship awards.
- \$14.5 million for institutional financial aid programs.
- \$12.5 million to defund the Education Technology Professional Development program.

California Community Colleges

The budget provides \$3 billion in General Fund support for CCC. All but \$157 million of this amount is Proposition 98 funding. After adding local property tax revenues, total funding for CCC in 2002-03 exceeds the 2001-02 amount by \$320.3 million, or 6.8 percent. This increase is primarily due to a May Revision proposal, approved by the Legislature, to defer \$115.6 million in Proposition 98 funding for apportionments from 2001-02 to 2002-03. Without this deferral, CCC's funding increase for 2002-03 would have been 1.8 percent.

Other major features of CCC's budget include:

- An increase of \$120.2 million to accommodate a 3 percent increase in enrollment.
- An increase of \$82.6 million to accommodate a 2 percent cost-of-living adjustment for apportionments and categorical programs.

- A reduction of \$104.9 million to various categorical programs.
- \$300 million to continue funding for the Partnership for Excellence program at the same level as 2001-02.

California Postsecondary Education Commission

The 2002-03 budget provides \$2.2 million in General Fund support for the California Postsecondary Education Commission (CPEC). Although the Governor proposed eliminating almost all General Fund funding for CPEC in the May Revision, the Legislature approved only a portion of that reduction. Specifically, the enacted budget reflects a reduction of \$1.6 million, or 43 percent, from the prior year. The reduction is primarily due to the elimination of 20.7 positions and a corresponding decrease in expenditures for operating expenses and equipment.

Student Aid Commission

The 2002-03 budget provides \$662 million in General Fund support for the Student Aid Commission. This represents a net increase of \$100 million, or 17.8 percent, above expenditures in the prior year. Major augmentations include:

- \$107 million for the Cal Grant A and Cal Grant B programs.
- \$10.6 million for the Assumption Program of Loans for Education.

Notable reductions include:

- \$8.6 million for the California Student Opportunity and Access Program, which will be sustained at the same level as 2001-02, but now funded entirely with federal funds.
- \$4 million for the Cal Grant T program.

HEALTH

General Fund support for health programs in 2002-03 totals \$13 billion, a decrease of more than \$650 million, or 4.8 percent, compared to 2001-02. This includes the impact of the Governor's vetoes of specific health program budget items that resulted in about \$139 million in General Fund savings. Figure 9 (see page 40) summarizes the changes in expenditures for major health programs. Figure 10 (see page 41) provides a summary of some of the most significant actions adopted in the budget plan to address the state's fiscal difficulties.

Figure 9
Major Health Services Programs
General Fund Spending

(Dollars in Millions)

	2001-02	2002-03	Change	
			Dollars	Percentage
Medi-Cal (local assistance only)	\$9,745	\$9,841	\$96	1.0%
Department of Developmental Services	1,778	1,815	38	2.1
Department of Mental Health	982	821	-161	-16.4
Department of Alcohol and Drug Programs	254	237	-17	-6.8
Healthy Families Program (local assistance only)	148	21	-127	-85.8
Emergency Medical Services Authority	36	28	-9	-23.6
Additional federal funds offsets	—	-425	-425	N/A
All other health services	732	684	-48	-23.6
Totals	\$13,675	\$13,022	-\$653	-4.8%

Medi-Cal Program

The budget provides about \$9.8 billion from the General Fund and \$224 million from the Tobacco Settlement Fund (almost \$27 billion all funds) for local assistance support of the Medi-Cal Program. The Medi-Cal General Fund budget increased almost \$100 million, or 1 percent, above the 2001-02 expenditure level. The spending plan accommodates changes in costs, utilization, and caseload and also includes other changes to reduce program expenditures. Below we discuss the major changes adopted by the Legislature, as well as proposals considered and rejected by the Legislature.

Assumed Federal Relief. The 2002-03 spending plan includes an adjustment which assumes that the state will be able to offset, on a one-time basis, \$400 million in Medi-Cal Program expenditures with special federal relief. The additional federal funds would be for the purpose of offsetting a projected decrease in the federal cost-sharing ratio (known as the Federal Medicaid Assistance Percentage or FMAP) for the state's Medicaid payments. The FMAP is based on per-capita income and is adjusted by the federal government each year. It remains uncertain whether Congress will appropriate the necessary federal funds to provide the FMAP relief that is assumed in the state budget.

Drug and Medical Supply Purchases. The Legislature largely accepted the Governor's proposal to reduce the Medi-Cal budget by about \$189 million

Figure 10
Major General Fund Reductions in State Health Programs

(In Millions)

	General Fund Savings
Medi-Cal	
Assumed federal relief to offset cost-sharing ratio increase	\$400
Assumed additional savings from antifraud activities	245
Changes in the purchase of drugs and medical supplies	189
Shift additional program support to Tobacco Settlement Fund	89
Reduction in provider rates ^a	71
Assumed receipt of additional rebates on drugs	66
Increase the state "takeout" from hospital funding	55
Reduction in county administration of eligibility	29
Assumed additional caseload savings	23
Postpone start of "express lane" eligibility for children	21
Public Health Programs	
Reductions in County Medical Services Program	\$24
Reduced transfers to the Cancer Research Fund	13
Managed Risk Medical Insurance Board	
Postpone expansion of Healthy Families coverage to parents	\$105
Department of Developmental Services	
Shift clients to home and community-based services	\$97
Shift program support to Title XX federal funds	71
Unallocated reduction in Regional Center budgets	52
Department of Mental Health	
Defer payments to counties for state-mandated programs	\$65
Reduce various community mental health grants	58
Establish county share of cost for EPSDT services ^b	35
Adjust caseload for recent trends in hospital population growth	15
Eliminate categorical program for special education pupils	12
Department of Alcohol and Drug Programs	
Reductions in various local grant programs	\$14

^a The administration is proposing to restore about \$22 million of this reduction through funding adjustments to be offered in January 2003.

^b Reduction shown in DMH budget is to reimbursements. Equivalent General Fund savings are reflected in the Department of Health Services Medi-Cal budget.

(General Fund) through various changes in the way the state purchases drugs and certain medical supplies and services. The budget plan further assumes an additional \$66 million in General Fund savings due to increased rebates

from pharmaceutical companies from the state's purchases of drugs for Medi-Cal beneficiaries.

Provider Rates and Copayments. The Legislature accepted the Governor's proposal to reduce Medi-Cal provider rates by about \$71 million from the General Fund—in effect, partially reversing rate increases granted to them two years ago. However, it rejected a May Revision proposal for an additional \$73 million in General Fund reductions. Moreover, the Governor indicated in his veto message his intention to exempt California Children's Services, nonemergency medical transportation, home health services, shift nursing, and family planning from the rate reduction accepted by the Legislature. The Governor indicated that the funding adjustments needed to allow this would be presented in January 2003. It is estimated that such action could add as much as \$22 million in state spending.

The Legislature did not accept a separate proposal to further reduce provider rates by an amount equivalent to proposed additional copayment charges for Medi-Cal beneficiaries that was intended to reduce General Fund costs by about \$31 million.

Changes in Eligibility Rules and Procedures. The Governor had proposed to slow down the growth in the Medi-Cal caseload and reduce expenditures primarily by reinstating parental quarterly status reporting requirements that were dropped as a result of 2000 legislation, and rescinding the 1931(b) expansion of Medi-Cal benefits to poor families that was enacted in 1999. These two actions in combination were projected by the administration to reduce the average number of Medi-Cal eligibles by almost 400,000. The reversal of the 1931(b) expansion would have saved \$92 million from the General Fund in 2002-03, while the reinstatement of quarterly status reports was estimated to result in about \$155 million in General Fund savings. However, both proposals were rejected by the Legislature.

The administration put on hold the implementation of recent legislation providing "Express Lane" eligibility for children participating in school lunch or food stamp programs in order to save \$12.1 million from the General Fund. The Legislature reinstated \$6 million from the General Fund to move ahead with the school-lunch component of the program, but the funds provided for this purpose in the budget bill were vetoed by the Governor.

Reductions in Medi-Cal Services. The Governor's proposal to reduce certain optional Medi-Cal services, such as dental care, for adult beneficiaries was not approved by the Legislature. The administration had estimated that the savings from the proposal in 2002-03 would have been \$263 million. How-

ever, the budget plan does limit dental cleanings and exams to one visit annually for adults in order to save an estimated \$4 million in General Fund resources.

County Administration. The Legislature rejected a proposal by the Governor to impose a 20 percent reduction in payments to counties for Medi-Cal eligibility activities to achieve a state General Fund savings of \$88 million. The Governor subsequently implemented about a 6 percent reduction in these payments by vetoing \$29 million (General Fund) from the spending plan.

Disproportionate Share Hospitals (DSH). The state funds the DSH program by combining local funding from public entities such as counties, the University of California, and hospital districts with federal dollars. Hospitals that serve a disproportionate share of Medi-Cal patients and the uninsured are eligible to receive this funding. The budget plan includes a \$55 million increase in the state's "takeout" of funding that is used to offset costs for the Medi-Cal Program that would otherwise be supported by the state General Fund. However, the Legislature rejected a May Revision proposal to save the state an additional \$31 million by increasing the DSH takeout even further.

Other Budget Adjustments. The Governor's budget plan assumed that the state would achieve an additional \$145 million in savings to the General Fund as a result of various efforts to crack down on Medi-Cal fraud. The Legislature revised the budget plan to assume an additional \$100 million in savings from these activities, in effect assuming that the total General Fund savings from antifraud efforts will be \$245 million above the level estimated for the prior fiscal year.

In addition, the Legislature assumed that Medi-Cal caseloads would run below the projected level, reducing General Fund costs by about \$23 million in the budget year. Finally, a larger portion of the Medi-Cal Program would be supported from the Tobacco Settlement Fund in order to achieve about \$89 million in General Fund savings.

Healthy Families Program

Funding Level. The budget provides about \$21 million from the General Fund and \$235 million from the Tobacco Settlement Fund (about \$677 million all funds) for local assistance provided under the Healthy Families Program. This spending total for 2002-03 amounts to about a \$127 million, or 86 percent, decrease in General Fund support. However, this is due primarily to a shift in program support to the Tobacco Settlement Fund. Spending would actually increase more than 22 percent above the 2001-02 level of expenditures when all fund sources for the Healthy Families Program are taken into account.

That spending total reflects ongoing increases in the children's program caseload, including an assumption that the total number of enrolled children will grow by about 65,000 over the course of 2002-03. These spending totals include a reduced level of funding—about \$4.6 million all funds—for Rural Health Demonstration Projects, a component of the Healthy Families Program.

Parent Expansion Delayed. The 2001-02 state budget had included funding to expand the Healthy Families Program to parents commencing in October 2001, but the Legislature and Governor subsequently agreed to delay implementation to at least July 2002 because of the state's fiscal problems. Had the program actually begun operation on that date, the cost to the state during 2002-03 would have been as much as \$105 million to add 166,000 parents to Healthy Families enrollment. As the state's fiscal problems worsened, the Legislature subsequently proposed a further delay in the program that would allow implementation at lower state cost during 2002-03. It augmented the 2002-03 spending plan by about \$52 million from the General Fund (about \$143 million all funds) to start the program in October 2002. However, the Governor vetoed all funds for the program expansion, in effect delaying the expansion to parents to at least July 2003. He also vetoed a \$7.7 million appropriation from the General Fund within the Medi-Cal Program budget to establish transitional Medi-Cal coverage for parents that would have shifted over to Healthy Families.

Tobacco Settlement Fund

The budget plan assumes the state will have about \$546 million in resources from the settlement of tobacco-related litigation that will be deposited into a special fund, known as the Tobacco Settlement Fund, established last year. The budget plan appropriates all of the anticipated funds for recently enacted expansion of health care programs and does not provide for a reserve. The expenditure plan for these funds is summarized in Figure 11.

Under the adopted budget plan, the state's future revenue stream from the tobacco settlement is to be sold to provide cash needed to support state operations during 2002-03. Thus, little if any of these funds would be available in 2003-04 and subsequent years for the support of health programs. The tobacco securitization action is discussed further in "Chapter 3" of this report.

Child Health and Disability Prevention (CHDP) Program

Due to legislative opposition, the administration eventually withdrew an initial 2002-03 budget proposal to abolish the CHDP program for an estimated net savings of about \$52 million (after related augmentations to community clinic programs were taken into account).

Figure 11
Tobacco Settlement Fund
2002-03 Expenditures

(In Millions)

Revenues in 2002-03	\$474.4
Prior-year carryover	71.6
Total Resources	\$546.0
Expenditures:	
Healthy Families Program	\$229.9
Access for Infants and Mothers (AIM)	4.3
Medi-Cal Programs:	
Section 1931(b) expansion to poor families	213.5
Breast and Cervical Cancer Treatment	10.6
State-Only Breast and Cervical Cancer Treatment	11.1
Child Health and Disability Prevention Program	56.7
Prostate Cancer Treatment	20.0
Total Expenditures	\$546.0
Ending Balance	\$0

At the time of the May Revision, the administration proposed and the Legislature subsequently approved steps to make the CHDP immunization and screening program a more effective “gateway” to transition eligible children to more comprehensive health coverage under the Medi-Cal and Healthy Families Programs. The net fiscal impact on the budget of implementing the gateway plan, including the assumed shifts in caseloads, was about \$3.8 million General Fund (\$9.7 million all funds).

The Legislature further augmented the CHDP budget by \$2 million from the General Fund (\$4 million all funds) to update the schedule for children’s visits to the doctor under the program, but these augmentations were vetoed by the Governor.

Public Health Programs

Antitobacco Programs. The administration’s January 10 budget plan for 2002-03 proposed a \$35 million augmentation for youth antitobacco programs using resources from the Tobacco Settlement Fund. The May Revision spending proposal, which was accepted by the Legislature, withdrew this augmentation request. The budget plan also eliminates the proposed expendi-

ture of about \$24 million in Proposition 99 cigarette tax revenues to continue a media campaign to persuade the public to quit smoking.

Cancer Research. The administration had initially proposed to reduce transfers of General Fund resources to the Cancer Research Fund by \$25 million. But the budget plan that was finally adopted reflects a revised proposal by the Governor to restore \$12.5 million from the General Fund that is to be matched by an equal amount of private-sector contributions for continued cancer research efforts.

County Medical Services Program (CMSP). The Legislature accepted an administration proposal to suspend, on a one-year basis for the fourth year in a row, state General Fund support of the county-run CMSP, which provides care for indigent adults. This action comes at a time when the program continues to have a significant financial reserve. The Legislature also agreed to shift some of the state Department of Health Services' administrative support costs for the program to CMSP. Together these actions are expected to save about \$24 million for the state General Fund.

Expanded Access to Primary Care (EAPC) Program. The Governor's January 10 budget plan had proposed an augmentation of almost \$18 million to the EAPC Program, which gives grants to primary care clinics to provide care for uninsured persons. That proposed funding increase, which was tied to the proposal discussed above to abolish CHDP, was withdrawn.

Bioterrorism Preparedness. The budget plan includes about \$51 million in additional federal grant funding for programs administered by the state Department of Health Services and local public health departments to improve their ability to respond to the threat of bioterrorist attacks. The funding was allocated to upgrade the abilities of these governmental agencies to detect and investigate potential outbreaks of infectious diseases, to prepare hospital systems and providers to deal with large numbers of potential casualties, and to expand public health laboratory and communication systems.

Childhood Lead Prevention Program (CLPP). The budget reflects legislative approval of an administration plan to expand the CLPP, the primary program responsible for ensuring that children at an increased risk for lead poisoning are tested for the presence of lead in their blood. The budget would increase local assistance for lead poisoning prevention activities, provide for increased testing of blood for lead contamination, expand computer systems needed to better track the cases of children exposed to lead, and step up local and state enforcement of lead abatement laws. The spending plan (including changes proposed in the May Revision) increases the resources provided to

CLPP by about \$4.4 million when all funding sources are taken into account. General Fund support for CLPP would decrease by about \$2.1 million due to a shift in program support to fees assessed on past and present manufacturers of lead products.

Emergency Medical Services Authority

The Emergency Medical Services Authority budget provides about \$28 million from the General Fund (\$43 million all funds). The spending plan provides for a decline in General Fund support of about \$8.6 million and 24 percent below the 2001-02 level of spending. When all fund sources are taken into account, however, the overall spending level for the authority would actually increase slightly.

Some small General Fund-supported programs and administrative expenditures of the authority were reduced because of the state's fiscal difficulties. However, the budget plan provides the authority with an additional \$9.1 million in federal funds (reflected in the budget as reimbursements from the Department of Health Services) to help prepare the state's hospital system for the threat of a bioterrorism attack. Also, the Legislature augmented the authority's budget by \$25 million from the General Fund to continue a grant program to assist trauma care centers that was begun in 2001-02. The Governor vetoed \$5 million of this sum because of the state's fiscal problems, leaving \$20 million available in the current year to continue support for trauma care systems.

Department of Developmental Services

The budget provides \$1.8 billion from the General Fund (\$2.9 billion all funds) for services to individuals with developmental disabilities in developmental centers and Regional Centers.

Community Programs. The 2002-03 budget includes a total of \$1.5 billion from the General Fund (\$2.2 billion all funds) for community services for the developmentally disabled, an increase of \$59 million over the prior fiscal year. This increase is the net result of caseload and cost increases as well as some offsetting General Fund program reductions and funding shifts.

An additional \$110 million from the General Fund (\$138 million all funds) is provided in the budget to accommodate Regional Center caseload growth of 9,725 persons, or 5.6 percent, as well as cost increases for community-based services. A \$15.9 million increase from the General Fund (\$20.4 million all funds) was provided to help move or divert individuals from developmental centers to the community. However, the Governor vetoed a legislative aug-

mentation to provide an additional \$5.6 million in one-time grants to provide additional resources for community programs.

General Fund expenditures for community programs were reduced by \$97 million by shifting additional Regional Center consumers to the Medicaid home and community-based services waiver. An additional \$71 million was saved by shifting federal Title XX funds to the Regional Centers to further offset General Fund costs. While these funding shifts were not expected to affect community programs, the budget also reflects an unallocated reduction of \$52 million in General Fund resources for Regional Centers. Additional savings were to be achieved by suspending start-up of new community programs and temporarily extending the deadline for intake assessments at Regional Centers.

Developmental Centers. The budget provides a total of \$343 million from the General Fund for operations of the developmental centers (\$629 million all funds), about the same amount of funds as the prior fiscal year. While some operating costs increased, the budget also assumes a small decline in the developmental center population of 19 residents.

Department of Mental Health

The budget provides about \$821 million from the General Fund (\$2.1 billion all funds) for mental health services provided in state hospitals and in various community programs.

Community Programs. The 2002-03 budget includes a total of about \$320 million from the General Fund (about \$1.5 billion all funds) for local assistance for the mentally ill, a decrease of almost \$164 million, or 34 percent, in General Fund resources compared to the prior year. Reductions totaling \$58 million were made in various categorical grant programs, including the adult and children's systems of care, integrated services for the homeless, supportive housing grants, and dual diagnosis programs for mentally ill persons who are also addicted to illegal drugs.

The budget eliminated a \$12 million categorical program supporting mental health services for special education pupils, with the result that counties would henceforth seek reimbursement for these costs through the state claims process. However, the budget delays payments to counties for that and other state-mandated programs. The Legislature did adopt budget-related legislation providing potentially tens of millions of dollars in fiscal relief to county governments from cost-sharing requirements for providing such services to children.

General Fund support for special mental health services provided under the Early and Periodic Screening, Diagnosis and Treatment (EPSDT) program

(including therapeutic behavioral services) would increase by about \$44 million. However, the budget plan assumes that EPSDT expenditures will increase by \$35 million less than was otherwise projected because of anticipated state-county efforts to help control the 30 percent annual growth in the cost of the program. As part of this effort, counties were required to assume a 10 percent share of the nonfederal costs of the growth in the EPSDT program.

State Hospitals. The budget provides a total of \$451 million from the General Fund for state hospital operations (\$589 million all funds), about a 1.3 percent increase above the prior-year level of funding. The Governor's January 10 budget request for the state hospital budget was reduced by \$14.8 million from the General Fund to adjust for actual trends in patient population growth.

Department of Alcohol and Drug Programs

The budget provides about \$237 million from the General Fund (\$578 million all funds) for drug and alcohol programs, a decrease of about \$17 million, or 6.8 percent, below the prior fiscal year. The decrease in General Fund resources is primarily the result of caseload adjustments in the Drug Medi-Cal Program and reductions in state-local assistance programs. The Legislature restored funding for some programs that had been proposed for reduction, including drug courts, perinatal services, and technical assistance grants. This was achieved by a combination of actions, including the redirection of additional federal grant funds that became available to the state as well as restructuring the drug court program to focus on felons in order to generate additional state General Fund savings on prison operations.

Health Insurance Portability and Accountability Act (HIPAA)

The HIPAA is a federal law that, among other provisions, establishes national standards and requirements for the transmission, storage, and handling of certain electronic health care data. The budget plan postponed to 2002-03 a large part of the HIPAA compliance expenditures initially scheduled for 2001-02 due to the state's fiscal problems. Also, about \$4 million from the General Fund (\$6.1 million all funds) proposed for HIPAA remediation activities was deleted until state agencies complete an assessment of the steps they need to take to comply with the federal law. Overall, the budget plan provides an additional \$20.7 million General Fund (\$59.2 million all funds) to 13 state agencies for HIPAA compliance efforts.

SOCIAL SERVICES

General Fund support for social services programs in 2002-03 totals \$8.6 billion, an increase of 2.5 percent over the prior year. This increase results from

substantial additional combined costs of \$360 million in the Supplemental Security Income/State Supplementary Program (SSI/SSP) and In-Home Supportive Services (IHSS), partially offset by savings in almost all other social services programs (\$150 million). Figure 12 shows the changes in expenditures for social services programs.

Figure 12
Social Services Programs
General Fund Spending

(Dollars in Millions)

	2001-02	2002-03	Change	
			Amount	Percent
SSI/SSP	\$2,807	\$3,058	\$252	9.0%
CalWORKs	2,057	2,071	14	0.7
Foster Care/Children's Services/ Adoptions	1,246	1,276	30	2.4
IHSS	887	996	108	12.2
Child Support Services	426	376	-50	-11.7
County Administration of Food Stamps/ Foster Care	421	415	-6	-1.5
All other social services programs	556	419	-137	-24.6
Totals	\$8,401	\$8,611	\$210	2.5%

Although General Fund spending for social services programs increased by \$210 million compared to 2001-02, spending would have increased by about \$1 billion had the Legislature not made substantial program reductions in comparison to statutory requirements. Figure 13 lists \$840 million in major reductions to social services programs.

CalWORKs

The budget includes \$2.1 billion from the General Fund in the Department of Social Services (DSS) budget for the California Work Opportunity and Responsibility to Kids (CalWORKs) program in 2002-03, which is an increase of less than 1 percent compared to 2001-02.

CalWORKs Grants. Budget legislation delays the October 2002 statutory cost-of-living adjustment (COLA) until June 2003 resulting in an eight-month savings of \$99 million. Effective June 1, 2003, the maximum monthly grant for a family of three in high-cost counties will increase by \$25 (3.7 percent) to a

Figure 13

**Major Changes—Social Services Programs
General Fund and Federal TANF Block Grant Funds**

(In Millions)

Department/Program	Change From Prior Law
Department of Social Services (DSS)—CalWORKs	
Redirect unspent county performance incentives to core program	-\$317.2 ^a
Delay COLA by eight months until June 2003	-99.1 ^a
Reduce adult education and community colleges support	-56.0
Reduce administrative support	-47.4 ^a
Defer Welfare-to-Work match payment	-25.4
Reinstate senior parent deeming for teen parent cases	-12.1 ^a
Require quarterly rather than monthly financial reporting	16.8 ^a
DSS—Adult and Special Programs	
Delay SSI/SSP state COLA by five months until June 2003	-\$111.5
Suspend state participation in IHSS \$1 per hour wage increase	-25.9
Reduce adult protective services	-6.0
Provide no funding for special circumstances program	-5.0
DSS—Food Stamps	
Reduction in administrative funding	-\$6.8
Require quarterly rather than monthly financial reporting	-2.1
DSS—Children's Programs	
Child welfare services reductions	-\$28.1
No discretionary COLA for Foster Care and related programs	-23.0
Basic adoption funding replaced with federal adoption incentives	-11.4
Adoptions program reduction	-3.0
Department of Rehabilitation	
Suspend Work Activity Program rate adjustment	-\$10.8
Department of Child Support Services	
Assume enactment of federal penalty relief legislation	-\$57.0
Suspend certain incentive payments to counties	-4.3
Other Reductions	
Reduce naturalization assistance funding	-\$2.9
Eliminate job agent program	-2.7
Totals	-\$840.9

^a Combined General Fund and Temporary Assistance for Needy Families (TANF) funds.

total of \$704, and grants in low-cost counties will similarly increase to a total of \$671 (see Figure 14, page 52).

Figure 14
Cost-of-Living Adjustments Delayed Until June 2003

(Maximum Monthly Grants)

Program	2001-02	June 2003	Change	
			Amount	Percent
CalWORKs^a				
Low-cost counties	\$647	\$671	\$24	3.7%
High-cost counties	679	704	25	3.7
SSI/SSP				
Individuals	\$750	\$778	\$28	3.7%
Couples	1,332	1,382	50	3.8

^a Family of three.

County Performance Incentives. Since 2000-01, payments for county incentives are subject to annual budget appropriation. No additional incentives are provided in 2002-03 and the budget redirects \$317 million in *unspent* performance incentives (previously paid to the counties) to support core program activities (such as grants and child care).

Reductions in Adult Education and Community Colleges. The Governor's May Revision included reductions of \$26 million for adult education and \$30 million for community colleges services. (These education programs were designed to assist CalWORKs recipients.) The Legislature restored \$23 million for adult education and \$9 million for the community colleges. The Governor, however, vetoed these partial restorations.

Senior Parent Deeming. Budget legislation reinstates the senior parent "deeming" requirement, whereby the income of a grandparent is deemed to the grandchild for purposes of determining financial eligibility. This results in combined Temporary Assistant for Needy Families (TANF)/General Fund savings of \$12.1 million.

Reduction in Administration. The Governor's May Revision proposed a net reduction of \$71.9 million (TANF/General Fund) to the CalWORKs administration. The Governor sustained a partial legislative restoration of \$24.5 million. Thus, the net reduction to CalWORKs county administration is \$47.4 million (about 12 percent of estimated 2001-02 spending).

Quarterly Reporting. Budget legislation reduces the frequency of required income reporting from monthly to quarterly for CalWORKs and food stamps recipients. This change results in net CalWORKs costs of about \$16.8 million

and Food Stamps administrative savings of about \$2 million. The primary benefit of this change is an expected reduction in the state's Food Stamps error rate, which should also result in lower federal Food Stamps penalties (currently exceeding \$100 million).

Defer Welfare-to-Work Match Payment. In order to receive federal Welfare-to-Work block grant funds, the state must provide a \$1 match for every \$2 in federal funds. California's matching funds are appropriated to county welfare departments as part of the CalWORKs program. In 2001-02, California provided \$25.4 million in matching funds. For 2002-03, the budget provides no matching funds, and the remaining match obligation of approximately \$60 million must be paid by July 2004.

SSI/SSP

The budget includes \$3.1 billion for the program in 2002-03, which is an increase of 9 percent compared to the prior year.

Grant Payments. Budget trailer bill legislation delays the January 2003 COLA for SSI/SSP until June 2003. The five-month SSI/SSP COLA delay results in savings of \$111.5 million. Effective June 2003, the maximum grant for aged and disabled individuals will increase by \$28 to a total of \$778 per month and the grant for couples will increase by \$50 to a total of \$1,382 per month (see Figure 14).

County Administration

The budget includes \$415 million from the General Fund for county administration of Food Stamps and Foster Care. This amount represents a decrease of 1.5 percent compared to 2001-02.

Rejection of Most Administrative Reductions. The Governor's May Revision proposed 20 percent reductions in county administration of Food Stamps and Foster Care as well as similar reductions to IHSS and Medi-Cal (please see the "Health" section of this chapter for a discussion of the Medi-Cal administration). The Legislature rejected these proposed reductions. Nevertheless, the Governor vetoed \$6.8 million in General Fund support for Food Stamps administration.

DSS Special Programs

The budget includes \$65.9 million from the General Fund for various special programs which serve the aged, disabled, and certain refugees. This funding level represents a reduction of 14 percent compared to 2001-02.

Special Circumstances. The budget provides no funding for the special services program, resulting in a savings of \$5 million compared to 2001-02.

Adult Protective Services (APS). The budget reduces General Fund support for APS by \$6 million (about 11 percent compared to 2001-02).

DSS Children's Programs

The budget provides a combined total of \$1.3 billion from the General Fund for Foster Care, Child Welfare Services, and Adoptions. This is an increase of \$30 million (2.4 percent) compared to 2001-02.

Child Welfare Services. The Legislature rejected the Governor's May Revision proposal to (1) eliminate the cost-of-doing-business inflationary adjustment (\$10.9 million General Fund) and (2) reduce the workload relief augmentation provided since 2000-01 by \$17.2 million General Fund. The Governor, however, vetoed these legislative restorations.

Adoptions. The Legislature adopted the Governor's January proposal to replace basic adoptions funding with federal funds resulting in a General Fund savings of \$11.4 million. Although the Legislature rejected an additional May Revision reduction of \$9.1 million, the Governor vetoed \$3 million in Adoptions funding.

Foster Care COLA. The budget provides no funding for discretionary COLAs for Foster Care and related programs. This results in General Fund savings of \$23 million.

In-Home Supportive Services

The budget provides \$1 billion from the General Fund for IHSS, an increase of 12 percent compared to 2001-02.

Suspension of Wage Increase. The budget assumes General Fund savings of \$25.9 million from suspending the statutory requirement to increase by \$1 per hour state participation in wage increases for IHSS providers working in "public authorities." Because legislation to suspend this requirement was not passed by the Legislature, the \$25.9 million in assumed savings could result in a deficiency in the IHSS program. The actual amount of such a deficiency would depend on the outcome of wage negotiations between counties and IHSS workers.

Department of Rehabilitation

The budget provides \$165 million from the General Fund for the Department of Rehabilitation. This is an increase of \$5 million (3.1 percent), compared to the prior year.

Rate Adjustment Suspension. The budget achieves savings of \$10.8 million by suspending the Work Activity Program rate adjustment.

Department of Child Support Services (DCSS)

The budget includes \$376 million in General Fund support for the DCSS, a decrease of \$50 million (12 percent) compared to 2001-02

Assumed Automation Penalty Relief. Because California has not completed its automated statewide child support collection system, it is subject to penalties that are collected in the form of reduced federal administrative support for child support enforcement. In 2001-02, the penalty was approximately \$157 million and is estimated to be \$180 million in 2002-03. The budget assumes enactment of federal legislation which would effectively reduce the penalty by 50 percent, resulting in savings of \$67 million compared to 2001-02. At the time this report was prepared, Congress had not passed any penalty relief legislation.

Incentive Payment Suspension. Budget bill legislation suspends \$4.3 million in incentive payments to counties that have been successful in collecting child support.

Other Changes

The budget eliminates the Job Agent program at the Employment Development Department, resulting in General Fund savings of \$2.7 million. Finally, the budget reduces funding for naturalization assistance at the Department of Community Services and Development by \$2.9 million.

JUDICIARY AND CRIMINAL JUSTICE

The 2002 budget for judicial and criminal justice programs totals about \$7.8 billion, including \$7.2 billion from the General Fund and \$519 million from federal and special funds. The total amount is a decrease of \$331 million, or 4.1 percent, from 2001-02 expenditures. The General Fund total represents a decrease of \$291 million, or 3.9 percent, relative to 2001-02 expenditures. This decrease in the General Fund amount is the result of (1) a projected decline in the inmate and ward populations, (2) a shift of funding for certain programs from the General Fund to special funds, and (3) one-time expenditures included in the 2001-02 budget that were not included in the 2002-03 budget.

Figure 15
Judicial and Criminal Justice Budget Summary
General Fund

(Dollars in Millions)

Program/Department	2001-02	2002-03	Change	
			Amount	Percent
Trial Court Funding	\$1,191	\$1,106	-\$85	-7.2%
Department of Corrections	4,883	4,800	-83	-1.7
Department of Youth Authority	368	336	-32	-8.7
Citizens' Option for Public Safety	116	116	—	—
Juvenile Justice Grants	116	116	—	—

Figure 15 shows the changes in expenditures in some of the major judicial and criminal justice budgets.

Trial Court Funding

The budget includes \$2.2 billion for support of the trial courts. This amount includes \$1.1 billion from the General Fund, \$475 million transferred from counties to the state, and \$589 million in special funds (fine, penalty, and court fee revenues). The General Fund amount is \$85 million, or 7.2 percent, less than the prior-year amount. This decrease primarily reflects a shift of funding for certain program costs from the General Fund to special funds.

Department of Corrections

The budget contains \$4.8 billion from the General Fund for the California Department of Corrections (CDC), a decrease of \$83 million, or 1.7 percent, from the 2001-02 expenditure level. The decrease is the result of several factors, including a projected decline in the inmate population, reductions in inmate substance abuse treatment and parole programs, and overtime expenditures included in the 2001-02 budget that were not included in the 2002-03 budget.

The budget provides full funding for the projected inmate and parole caseloads in 2002-03. Specifically, the budget assumes that the inmate population will be about 155,000 by the end of the current year. This represents a decrease of approximately 3,000 inmates from the prior year. According to CDC, this decline in the population is due primarily to the implementation of Proposition 36, which diverts certain drug offenders who would otherwise be sent to prison, into drug treatment programs. The budget also provides full funding

for a parole population of approximately 122,500. This represents an increase of approximately 1,200 parolees above the 2001-02 level.

Federal Funds for Incarceration and Supervision of Undocumented Felons.

The budget also assumes that the state will receive \$204 million in federal funds to offset the state's costs of supervising undocumented felons in CDC and the Department of the Youth Authority. This is about \$50 million more than received in 2001-02. The federal funds are counted as offsets to state expenditures and are not shown in the budgets of the CDC and the Youth Authority or in the budget act.

Department of the Youth Authority

The budget provides \$336 million from the General Fund for support of the Youth Authority, a decrease of \$32 million, or 8.7 percent, relative to the 2001-02 funding level. This decrease is largely due to the projected decline in the number of wards, and reductions in substance abuse treatment and parole services. The budget includes increased funding for mental health services (\$1 million) and litigation management (\$1.7 million) to address a recent class action lawsuit.

Assistance to Local Law Enforcement

Citizens' Option for Public Safety (COPS) Program. The budget includes \$116.3 million for support of the COPS program, which is the same level that was provided in 2001-02. The program provides discretionary funding on a per capita basis to local police departments and sheriffs for front-line law enforcement (with a minimum guarantee of \$100,000), to sheriffs for jail services, and to district attorneys for prosecution.

High Technology Crime Programs. The budget provides \$18.5 million for grants to local law enforcement agencies for technology equipment purchases, a reduction of \$16.9 million from the 2001-02 funding level. In addition, the budget provides \$10.8 million for the High Technology Theft, Apprehension, and Prosecution program; and \$3.3 million for the High Technology Identity Theft program, the same levels as provided in the prior year.

War on Methamphetamine. The budget includes \$15 million for local law enforcement in the Central Valley for antimethamphetamine activities.

Rural and Small County Law Enforcement Assistance Program. The budget continues funding of \$18.5 million for small and rural county sheriff departments to enhance law enforcement efforts in those counties.

Assistance for Local Juvenile Justice Programs

Juvenile Justice Grants. The budget maintains \$116.3 million to fund county juvenile justice programs, which is the same level as last year. The grants go to local juvenile justice coordinating councils who have identified program needs related to juvenile delinquency and crime. Chapter 495, Statutes of 2001 (SB 736, Poochigian), permanently established the Juvenile Justice Grants and COPS programs.

TRANSPORTATION

Department of Transportation

The 2002-03 budget provides a total of \$9 billion from special funds and federal funds for the Department of Transportation (Caltrans), a 15 percent increase over 2001-02. The increase is entirely the result of higher anticipated capital outlay expenditures funded from federal dollars. Of the total Caltrans budget, approximately \$7.4 billion will be for the highway program, including \$3.3 billion for capital outlay, \$1.3 billion for highway design and engineering, \$1.5 billion for local assistance, and \$814 million for highway maintenance. The budget provides about \$853 million for Caltrans' mass transportation program including the support of intercity rail service. The budget also provides \$686 million for all other programs, including administration, planning, and aviation.

In addition to the funding increases for the transportation program, the budget provides for a number of transportation loans to the General Fund, as shown in Figure 16. These loans are a part of the state's strategy for addressing the General Fund condition, and are described in greater detail below.

Transportation Loans to General Fund

The TCRF to Loan Money to General Fund, Backfilled by State Highway Account. The 2002-03 budget includes over \$1 billion in loans from the Traffic Congestion Relief Fund (TCRF) to the General Fund. This amount is in addition to the \$238 million loaned to the General Fund in 2001-02 as part of the refinancing of the Traffic Congestion Relief Program (TCRP). All of these loans must be repaid to TCRF by June 30, 2006.

In order that the TCRF loan would not negatively affect the delivery of transportation projects, the budget backfills part of this loan with a \$474 million loan from the State Highway Account (SHA) to TCRF. This loan is in addition to a \$60 million SHA loan to TCRF previously approved in the 2001-02 budget to be made in 2002-03, as part of the refinancing of TCRP. All these loans must be repaid to SHA by June 30, 2007.

Chapter 445, Statutes of 2002, (SB 1834 [Committee on Budget and Fiscal Review]), the trailer bill legislation to implement these loans, requires that the new \$474 million loan from SHA be repaid with interest, and that the interest be paid from the General Fund instead of TCRF. This is because TCRF currently does not retain any interest accrued to its fund balance; instead, any interest it earns is transferred to the General Fund.

The SHA to Loan Money Directly to General Fund. In addition to the loans described above, the budget provides a three-year loan of \$173 million from SHA to the General Fund in the 2001-02 fiscal year. This loan must be repaid in full by June 30, 2005. In addition, Chapter 445 requires that the General Fund repay this loan with interest.

Public Transportation Account Loan to TCRF Reduced. The Legislature reduced by \$5.1 million the Public Transportation Account (PTA) loan to TCRF for 2002-03, thereby providing a loan of \$94.5 million instead of the \$100 million approved as part of the refinancing of TCRP. In turn, the Legislature used the \$5.1 million to augment the State Transportation Assistance (STA) program for local transit operators, thus providing a total of \$103.1 million

Figure 16
Transportation Loans and Repayments^a

(In Millions)

Year	To General Fund ^b		To Traffic Congestion Relief Fund ^c	
	From State Highway Account	From Traffic Congestion Relief Fund (TCRF)	From State Highway Account	From Public Transportation Account
2000-01	—	—	\$9	—
2001-02	\$173	\$238	40	\$180
2002-03	—	1,045	534	95
2003-04	—	-500	-50	—
2004-05	-173	-650	-149	—
2005-06	—	-380	-275	—
2006-07	—	147	-109	—
2007-08	—	100	—	-275

^a Amounts do not include interest.

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

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

for STA. The amount is \$5.1 million more than the minimum amount called for by statutory formula.

The Governor vetoed the augmentation. The freed-up amount will remain in PTA, to be available for mass transit capital improvement projects.

California Highway Patrol

The budget provides a total of \$1.1 billion to support the California Highway Patrol (CHP), about \$100 million, or 9.7 percent, above the 2001-02 level. Virtually all of this support comes from the Motor Vehicle Account (MVA).

Antiterrorism Programs Funded. The budget includes \$93.4 million from MVA for CHP to carry out enhanced security antiterrorism activities in 2002-03. This amount would be repaid with any federal funds that the state receives for antiterrorism activities. Of the \$93.4 million, \$32.5 million will be available only for tactical alerts when security monitoring and patrol activities are increased. The remaining funding will support 322 new CHP positions, including 150 officers to inspect commercial vehicles and carriers of hazardous materials. Other new officers will serve on antiterrorism task forces and provide security for major bridges, the State Capitol and state office buildings, nuclear power plants, and state health laboratories. The budgeted amount also includes funding for five new helicopters and 24 pilots and flight officers to operate them.

Department of Motor Vehicles

The budget provides about \$660 million for the support of the Department of Motor Vehicles (DMV), about \$13 million less than the 2001-02 level. The amount includes \$346 million from MVA, \$265 million from vehicle license fees, and \$40 million from SHA.

Increased Fees and Penalties Boost MVA Funding. To address a projected funding shortfall in the MVA, the Legislature adopted the Governor's proposal to increase various fees and penalties and to impose new fees charged by DMV. These actions are expected to increase MVA revenue by \$76 million in 2002-03 and \$98 million annually thereafter, as shown in Figure 17. Specifically, the following penalties and fees will be increased:

- Higher penalties for late vehicle registration, including an increase from \$10 to \$17 for missing the registration deadline by less than ten days, and from \$165 to \$217 for missing the deadline by more than two years.

Figure 17

Motor Vehicle Account Revenue Increases

(In Millions)

Program	2002-03	Ongoing
Higher penalties for late registration	\$25	\$50
Doubled charges for sale of information	40	40
Merge Motor Carriers Permit fee with MVA	9	2
New driving test retake fee	—	2
DUI appeal and license reissuance fees	2	4
Totals	\$76	\$98

- Increased fees of \$4 per record, instead of \$2, for the purchase of driver information.
- A new \$5 fee for retaking a driving test, a new \$120 fee for second appeals of driving-under-the-influence (DUI) sanctions, and an increase from \$100 to \$125 in the fee for the reissuance of a license for former DUI offenders.

RESOURCES

The budget provides a total of about \$3.6 billion for resources programs, of which about \$1.1 billion is from the General Fund, \$1.3 billion is from special funds and federal funds, and about \$1.2 billion is from bond funds. Of the bond funds, about \$636 million is from Proposition 40 (the \$2.6 billion resources bond approved by the voters in March 2002).

The total funding for resources programs is a decrease of about \$1.4 billion below estimated 2001-02 expenditures. This decrease largely reflects an \$800 million reduction in bond fund expenditures for park and water projects. The decrease also reflects significant one-time General Fund expenditures that occurred in 2001-02, including funding for energy conservation and efficiency programs and for local flood control projects. In addition, 2001-02 resources expenditures reflect a particularly high level of expenditures for emergency fire suppression.

The overall budget solution includes a number of loans and transfers to the General Fund from resources-related special funds. These loans and transfers are highlighted in the “Revenue” chapter of this report.

Significant features of the resources budgets are discussed below.

CALFED Bay-Delta Program

The CALFED Bay-Delta Program is a consortium of 24 state and federal agencies created to address a number of interrelated water problems in the state's Bay-Delta region. These problems include inadequate water quality, declining fish and wildlife populations, deteriorating levees, and uncertain water supplies.

The budget provides a total of about \$532 million from various state and federal funds, including \$46 million from the General Fund, for the CALFED Bay-Delta Program. This budget total reflects a decrease of about \$79 million in state funds for CALFED from estimated 2001-02 expenditures.

Proposition 13 bond funds are the largest source of funding for the program, providing about \$189 million of the program's funding. The Legislature denied the Governor's proposal to use \$101 million of Proposition 40 bond funds for CALFED. The final budget instead replaces \$51 million of the funding denied from Proposition 40 with a like amount from Proposition 50—contingent upon water resources and coastal protection bond measure being approved by the voters at the November 2002 election. The CALFED expenditures are under seven state departments, including six departments in the Resources Agency. Figure 18 shows the allocation of the \$532 million for the program among the program's 11 components.

Figure 18

CALFED Bay-Delta Program 2002-03 Expenditures

(In Millions)

Expenditures by Program Element^a

Ecosystem restoration	\$147.8
Water storage	105.4
Water use efficiency	62.0
Water conveyance	41.3
CALFED program management	40.1
Drinking water quality	34.7
Science	33.4
Watershed management	33.1
Environmental Water Account	29.2
Levees	4.2
Water transfers	0.6

Total **\$531.8**

Expenditures by Fund Source

Proposition 13	\$188.7
Proposition 204	155.1
Federal reimbursements	55.0
Proposition 50 ^b	51.1
General Fund	46.1
State Water Project funds	32.7
Other state funds	3.1

Total **\$531.8**

^a Includes state funds and federal reimbursements.

^b To be voted on at the November 2002 election.

Proposition 40

Proposition 40 is a \$2.6 billion resources bond measure approved by the voters in March 2002. The measure provides funds to conserve natural resources (land, air, and water); acquire and improve state and local parks; and preserve historical and cultural resources. At budget hearings, the administration presented the Legislature with a plan to spend all of the Proposition 40 bond funds over the five-year period from 2002-03 through 2006-07.

The budget includes about \$636 million in expenditures from Proposition 40 in 2002-03. Figure 19 shows the breakdown of these expenditures by programmatic area.

The \$636 million expenditure amount for 2002-03 may be higher, however, depending on whether the Governor signs several bills currently awaiting his approval that would appropriate additional Proposition 40 funds. These bills include AB 2534 (Pavley)—which would appropriate \$223.4 million for water quality programs; AB 716 (Firebaugh)—which would appropriate \$219.8 million for historical and cultural projects and \$74.7 million for specified local park projects; and AB 52 (Wiggins) and SB 984 (Costa)—which together would appropriate \$28.8 million for agricultural and grazing land preservation.

Figure 19
Proposition 40 Bond
2002-03 Expenditures^a

(In Millions)

Program Area	Budgeted Expenditures
State conservancies—acquisition, development, restoration	\$215.5
Local parks	172.9
Wildlife Conservation Board—acquisition, development, restoration	81.0
State parks—acquisition, development, deferred maintenance	65.5
River parkways and urban streams	56.2
Air pollution reduction	24.5
Administration	8.8
Salmon and steelhead protection	8.0
Grants to local conservation corps	4.0
Total	\$636.4

^a Does not include statutory appropriations in pending legislation.

Natural Resources Management

- **Fire Suppression.** The budget provides \$75 million from the General Fund to the Department of Forestry and Fire Protection for emergency fire suppression and \$12 million from the General Fund to enhance the department's fire-fighting capabilities during the 2002 fire season.
- **Agricultural Land Conservation.** The budget includes \$11.7 million from Proposition 12 for a farmland conservancy program. The program provides grants to purchase the development rights on agricultural lands through voluntary conservation easements.
- **State Park Compliance With the Americans With Disabilities Act.** The budget provides \$9 million (\$8.1 million General Fund and \$900,000 special funds) to improve accessibility in state parks and achieve compliance with the Americans With Disabilities Act.
- **Operation and Maintenance of Selected New State Parks.** The budget includes \$3.1 million from the General Fund to provide security, maintenance, and support facilities for public use of recent property acquisitions within the metropolitan Los Angeles area.
- **California Environmental Quality Act Review.** The budget provides \$2.9 million to the Department of Fish and Game for environmental review of proposed projects under the California Environmental Quality Act. Of this amount, \$2.1 million is from the Environmental License Plate Fund, with the balance from various other funds.
- **Sudden Oak Death.** The budget provides \$2 million from the General Fund for research and tree removal related to Sudden Oak Death.

Energy

- **California Energy Commission (CEC).** Assembly Bill 3009 (Committee on Budget), which accompanies the *2002-03 Budget Act*, changes how the Energy Resources Program Account (ERPA) surcharge is set. The ERPA surcharge is the primary funding source for the CEC and is assessed on every kilowatt-hour (kWh) of electricity consumed in the state. This measure increases the cap on the surcharge by one-tenth of one mil (\$.0001) per kWh to three-tenths of one mil (\$0.0003) per kWh and would also allow the CEC to set the surcharge annually according to its budgetary needs.

- **California Energy Resources Scheduling (CERS) Program.** The budget includes \$28.2 million from the Department of Water Resources (DWR) Electric Power Fund for the administration of the CERS program within DWR. This program was established in early 2001 to purchase electricity for the customers of the state's three largest investor owned utilities (IOUs) after the wholesale price of electricity skyrocketed and left the IOUs nearly insolvent. The 2002-03 funding level for the administration of the CERS program is \$31.4 million below estimated 2001-02 expenditures. This is due to significant one-time expenditures on information technology projects in 2001-02, as well as the assumption that DWR will transfer the responsibility of making spot market power purchases back to the IOUs at the end of December 2002—halfway through the budget year.
- **California Public Utilities Commission (CPUC).** This budget includes \$1.3 billion (various special funds) to support the CPUC, including the regulation of the state's energy IOUs. This includes \$950,000 for ten new positions to analyze DWR's revenue requirements, \$5.8 million for consultants to support the CPUC's alternative bankruptcy plan for Pacific, Gas, & Electric, and \$1 million for bond counsel to support CPUC's role in DWR's electricity bond sale scheduled for this fall. In addition, the Legislature approved 19.5 new positions and \$2.1 million to fund a new program to monitor the performance of power plants and their outages.
- **California Power Authority (CPA).** The budget includes a \$4.4 million loan to the CPA. This represents the second installment of a \$10 million loan authorized in Chapter 10x, Statutes of 2001 (SB 6x, Burton) to help the CPA start up its operations. The budget switches the funding for this loan from the General Fund to CEC's Renewable Resource Trust Fund in an effort to reduce the pressure on the General Fund.

ENVIRONMENTAL PROTECTION

The budget includes about \$1.2 billion for environmental protection programs, including \$866 million for the support of various environmental protection agencies and \$293 million for local assistance. This total amount is a decrease of about \$656 million, or 36 percent, from estimated 2001-02 expenditures. This decrease largely reflects

(1) large one-time expenditures in 2001-02 (including \$115 million to settle hazardous waste-related litigation against the state) that will not occur in 2002-03 and (2) a decrease in bond-funded expenditures for local water quality and water recycling projects. Significant features of the budget include:

Water Quality

- **Bond-Funded Water Projects.** The budget includes about \$151 million from various bond funds for local water quality, water recycling, and watershed protection projects funded by the State Water Resources Control Board. Of this amount, \$30.5 million is from Proposition 50 to be considered by the voters in November 2002. In addition, as mentioned above, AB 2534 (currently before the Governor) would appropriate Proposition 40 funds for water quality programs that would be administered by the board.
- **Funding for Core Regulatory Program.** The budget includes about \$62 million from various fund sources (including \$16.3 million from the General Fund) for the board's core permitting, inspection, and enforcement program. Relative to past budgets, the budget reflects a higher proportion of this program being funded from fees. Specifically, the budget replaces \$15 million of previous General Fund support with funding from fees.

Air Quality

- **Program Reductions.** The budget proposes expenditures totaling \$144 million for the Air Resources Board in 2002-03—a reduction of about \$78 million (35 percent) from 2001-02 expenditures. While much of this reduction reflects the elimination of major one-time expenditures that occurred in 2001-02 (including \$20 million for zero-emission vehicle incentives), the reduction also reflects significant reductions to baseline funding. These reductions include a decrease of \$7.7 million from the General Fund for the board's stationary source program, \$5.5 million from the Motor Vehicle Account for the mobile source program, and \$5 million from the Motor Vehicle Account for local air district subventions.

CAPITAL OUTLAY

The budget package includes \$2.2 billion for capital outlay (excluding highways and transit), as shown in Figure 20 (see pages 68-69). About 94 percent of total funding is from bonds.

State Capital Outlay. Some of the major state capital outlay projects and programs funded in the budget package include:

- **Department of General Services**—\$175.9 million from bond funds to renovate four state office buildings and \$21.6 million from bond funds to design and construct ten seismic retrofit projects of state-owned facilities.

- **Department of Parks and Recreation**—\$35.7 million from the Proposition 12 (March 2000) bond measure, \$55.5 million from the Proposition 40 (March 2002) bond measure, and \$13 million from special funds for 42 capital outlay projects.
- **Coastal Conservancy**—\$160 million from Proposition 40 and \$12.4 million from Proposition 12 for coastal conservation and restoration projects.
- **Department of Health Services**—\$47.5 million from bond funds for construction of the Phase III office building at the Richmond Laboratory Campus.
- **Department of Corrections**—\$12.8 million from bond funds for construction of four projects (including \$8 million to replace aging inmate housing and \$4.8 million for two projects to construct new medical facilities) and \$6.5 million from the General Fund for design and construction of eight projects.
- **Department of the Youth Authority**—\$18.8 million from bond funds for construction of six projects (five projects to construct new medical facilities and one project to construct a new kitchen).
- **California Community Colleges**—\$317 million from bond funds for 73 projects at 56 campuses and eight off-campus centers.
- **California State University**—\$481 million from bond funds for 33 projects at 23 campuses.
- **University of California**—\$3 million special funds and \$379 million from bond funds for 33 projects at ten campuses.
- **Department of the Military**—\$7.3 million from the General Fund for design and construction of two new armories and one electrical infrastructure project.

Constitutional Amendment on Infrastructure Funding. As part of the budget package, the Legislature passed ACA 11 (Richman and Canciamilla), that would create the California Twenty-First Century Infrastructure Investment Fund. Beginning with the 2006-07 fiscal year, ACA 11 would annually direct a specified percentage of General Fund revenues to the fund. The measure specifies that the moneys in the fund be allocated by the Legislature for capital outlay purposes, of which 50 percent would be for state-owned infrastruc-

Figure 20
2002-03 Capital Outlay Programs
Budget Act

(In Thousands)

Department	Bonds	General	Special	Federal	Total
Legislative, Executive and Judicial					
Judicial Council	\$31,909	—	—	—	\$31,909
Justice	5,518	—	—	—	5,518
State and Consumer Affairs					
California Science Center	\$19,137	—	—	—	\$19,137
Franchise Tax Board	—	\$288	—	—	288
General Services (seismic retrofit)	21,572	—	—	—	21,572
General Services (other)	175,886	—	—	—	175,886
Business, Transportation and Housing					
Transportation	\$72,599	—	\$14,401	—	\$87,000
Highway Patrol	—	—	9,194	—	9,194
Motor Vehicles	—	—	21,167	—	21,167
Resources					
Conservation Corps	—	—	\$400	—	\$400
Tahoe Conservancy	\$14,278	—	1,195	—	15,473
Forestry and Fire Protection	68,577	\$485	—	—	69,062
Fish and Game	1,768	—	2,000	\$14	3,782
Wildlife Conservation Board	2,500	—	21,164	—	23,664
Boating and Waterways	—	—	9,792	—	9,792
Coastal Conservancy	172,391	—	5,000	2,000	179,391
Parks and Recreation	91,255	—	9,198	3,700	104,153
Santa Monica Mountains Conservancy	12,728	—	466	—	13,194
San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy	18,000	—	—	—	18,000
Baldwin Hills Conservancy	15,000	—	—	—	15,000
Coachella Valley Mountains Conservancy	8,000	—	—	—	8,000
Water Resources	1,000	7,181	—	—	8,181

Continued

ture and 50 percent would be for local government infrastructure, excluding school and community college facilities. The measure will be submitted to voters on the March 2004 ballot.

Department	Bonds	General	Special	Federal	Total
Health and Human Services					
Health Services	\$47,527	—	—	—	\$47,527
Mental Health	20,808	\$736	—	—	21,544
Youth and Adult Corrections					
Corrections	\$12,785	\$7,603	—	—	\$20,388
Youth Authority	18,747	550	—	—	19,297
Education^a					
State Library	\$10,487	—	—	—	\$10,487
University of California ^b	379,299	—	\$3,000	—	382,299
California State University	481,170	—	—	—	481,170
Community Colleges	316,716	—	—	—	316,716
General Government					
Food and Agriculture	\$11,203	—	\$4,043	—	\$15,246
Military	—	\$7,270	750	—	8,020
Veterans Home of California	—	273	1,901	\$3,527	5,701
Unallocated	—	1,500	—	—	1,500
Totals	\$2,030,860	\$25,886	\$103,671	\$9,241	\$2,161,658

^a Of the \$1.2 billion in spending from bonds, \$514 million is appropriated for higher education projects from Proposition 47 on the November 2002 ballot. The bond amount also includes \$651 million in lease-revenue bonds for higher education appropriated by Chapter 33, Statutes of 2002 (AB 16, Hertzberg).

^b Includes Hastings College of the Law.

OTHER MAJOR PROVISIONS

Local Government

The budget defers payments to local governments for state-mandated local programs. This deferral includes reimbursements for 2002-03 mandate claims, prior-year deficiencies, and newly identified mandate claims. We estimate that the state's costs to pay these deferred claims will total about \$800 million.

The budget package also shifts, on a one-time basis, \$75 million of property taxes from redevelopment agencies to K-14 districts. Increasing K-14 district property tax revenues offsets state education expenses on a dollar-for-dollar basis. This tax shift equates roughly to a 4 percent reduction in redevelopment agency property tax revenues in 2002-03.

Finally, as discussed elsewhere in this report, the budget package reduces state support for a variety of local and state-local programs including: Early and Periodic Screening, Diagnosis and Treatment (\$35 million); county drug and alcohol programs (\$14 million); public libraries (\$21.4 million); and the administration of a variety of health and social services programs.

Technology, Trade, and Commerce Agency

The budget includes a total of about \$224.5 million (including \$41.5 million from the General Fund) for the Technology, Trade, and Commerce Agency. This is about \$3 million, or 1.3 percent more, than 2001-02 expenditures. Offsetting factors account for the small net increase in the 2002-03 expenditures: (1) an increase of \$44 million from the special fund that supports Infrastructure Bank projects, (2) a \$33 million reduction in General Fund support for a number of agency programs, and (3) \$8 million in various special fund expenditure reductions.

The \$33 million, or 44 percent, reduction in General Fund support includes the following:

- Elimination of the agency's regional offices.
- Elimination of grant programs that promote small business-oriented software development, rural e-commerce, defense adjustment, and space industry development.
- Reductions in the support of foreign trade offices, military base retention and reuse program, consulting services provided to small manufacturers, and grants for biomass electricity production and for small businesses that develop technologically innovative products.
- An additional unallocated cut of \$10 million in the agency's programs.

Employee Compensation and Retirement

The budget includes \$299 million (including \$184 million General Fund) for employee compensation increases. The majority of this amount is for the state's two-thirds share of health insurance premium increases, as negotiated in collective bargaining. In addition, the budget includes a \$155 million (including \$76 million General Fund) increase in the state's contribution toward state employees' retirement. This higher cost is the result of the recent decline in the stock market.

The budget also includes \$577 million for the state portion of retirees' health and dental insurance premiums. This is a \$118 million increase over 2001-02 spending due largely to premium increases for health insurance. The contribution for health insurance is determined by the premium cost of the four state plans with the greatest enrollment of state employees and retirees.

Technology Oversight and Security Unit

The budget provides \$2 million General Fund for the Department of Finance's establishment of a new information technology (IT) oversight unit responsible for the assessment and oversight of high-risk IT projects and security risks in the state's IT systems. The new unit will fulfill some of the responsibilities of the former Department of Information Technology, whose authorization ended on June 30, 2002.

State Operations

The budget package reflects considerable savings as a result of the following actions affecting state operations:

Unallocated Reductions. Assembly Bill 593 (Oropeza) authorizes the Director of Finance to reduce state operation appropriations in the *2002-03 Budget Act* by up to \$750 million. The measure also requires the Director to report in January on the reductions taken and the effects of each reduction on program functions or services.

Golden Handshake. Assembly Bill 593 also provides an incentive for state employees to retire early by offering an additional two years of retirement service credit. This provision was scored as \$285 million in General Fund savings in the current year.

Vacant Positions. The budget act eliminates 6,000 vacant positions, resulting in savings of at least \$300 million (\$150 million General Fund). However, the budget also allows 50 percent of these savings (\$75 million General Fund) to be retained by the departments. Assembly Bill 593 requires the elimination of an additional 1,000 positions by the end of the 2003-04 fiscal year.