



May 14, 2010

Governor Releases May Revision With, As Promised, “Absolutely Terrible Cuts,” No Tax Increases

Governor Arnold Schwarzenegger released the May Revision to his 2010-11 Proposed Budget on May 14. The May Revision updates policy proposals, revenue projections, and estimated expenditures for both the current and upcoming budget years. As promised, the May Revision contains “absolutely terrible cuts,” including the elimination of CalWORKs, the state’s welfare-to-work program, and state-supported child care. The May Revision addresses a \$17.9 billion shortfall and outlines \$19.1 billion in “solutions,” leaving the state with a \$1.2 billion reserve. Proposed “solutions” include \$12.4 billion of spending reductions, \$3.4 billion of federal funds, \$1.3 billion of “alternative funding,” and \$2.1 billion of fund shifts and other revenues. The Governor did not propose any measures that would increase state taxes, but the May Revision would increase student fees in both the California State University (CSU) and University of California (UC) systems and require Medi-Cal recipients to pay more for many services.

Most of the “solutions” proposed in the May Revision are carried forward from the Governor’s January budget. Some, such as the elimination of the CalWORKs Program, were originally on the so-called “trigger list” – cuts that would only occur if the state did not receive a specified level of federal funds. Others, such as reductions to In-Home Supportive Services and Medi-Cal, have been modified since January.

The following update provides a “quick and dirty” summary of key provisions of the Governor’s May Revision. As additional details become available, the California Budget Project (CBP) will update this document. The CBP also will prepare analyses of major proposals contained in the May Revision over the upcoming days and weeks. Please check the CBP website (www.cbp.org) for corrections and additions to this analysis as additional information becomes available. The Governor’s budget documents are available online at <http://www.ebudget.ca.gov/>.

The Governor’s Definition of the Problem

The Governor’s January budget release identified \$19.9 billion in proposed “solutions.” The May Revision subtracts from that amount \$1.4 billion in “solutions” enacted during the special legislative session convened to address the shortfall earlier this year and \$700 million in federal funds received to date. It then subtracts – thereby widening the gap – \$600 million due to weaker than previously forecast revenue collections, \$500 million in cost increases, and \$200 million to increase the size of the budget reserve. The May Revision also notes that \$2.8 billion of the current gap is attributable to “delays in the adoption of budgetary solutions.”

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The May Revision assumes that the state receives an additional \$3.4 billion in federal funds, including \$1.7 billion from an extension of the enhanced federal match rate – FMAP – for the Medicaid Program (Medi-Cal in California), \$125 million from the extension of other enhanced federal rates originally contained in the American Recovery and Reinvestment Act of 2009 (ARRA), and \$1.6 billion in other federal funds for health and human services programs and corrections.

What Happened to the Revenues?

The state entered the month of April with revenue collections \$2.7 billion above levels forecast in the Governor's January budget. Weak April tax collections, however, more than reversed the gain, coming in \$3.1 billion below anticipated levels. The May Revision anticipates that combined 2009-10 and 2010-11 revenues will be \$567 million above the level forecast in January. It is worth noting, however, that both the January and May forecasts include \$892 million based on an assumption that the "pick up" tax – a provision in the federal Estate Tax – is reinstated beginning January 1, 2011. Federal policy experts doubt that this will occur.

Governor's Economic Outlook Is Somewhat More Optimistic, But Remains Cautious

California and the nation are experiencing what some have called a statistical recovery, but a human recession. Most economists believe that the Great Recession technically ended last year when the US economy resumed growth. Yet for many workers and their families the economy appears to be in recession because the job market remains weak.

The Governor's revised economic outlook is somewhat more optimistic than his January forecast, reflecting the fact that several indicators have improved since then. However, the updated forecast acknowledges that the recovery remains fragile and "employment remains the biggest source of concern" going forward. The Governor's projections suggest that recovery from the recession will be "moderate and prolonged," with recovery in California generally trailing that in the nation as a whole.

The Governor's revised forecast projects stronger growth in the national economy and a somewhat larger drop in the nation's jobless rate than forecast in January. The Governor projects that inflation-adjusted gross domestic product (GDP) – the value of all goods and services produced in the US – will increase by 3.0 percent in 2010, a much greater rise than the 2.2 percent growth originally forecast. In addition, the Governor projects that the nation's unemployment rate will peak at 9.6 percent in 2010 – four-tenths of a percentage point lower than originally expected – and then fall to 9.0 percent in 2011.

The Governor's updated outlook for California's job market is little changed for 2010, while the 2011 outlook is more optimistic. The revised forecast projects that in 2010 California will lose approximately 100,000 nonfarm jobs – a 0.7 percent decline, the same as the January projection. The state's jobless rate is expected to peak at 11.9 percent, just one-tenth of a percentage point lower than originally forecast. In 2011, the Governor's projections expect somewhat stronger nonfarm job growth and a larger drop in California's jobless rate than forecast in January. The unemployment rate is expected to fall to 10.7 percent in 2011 – one-half of a percentage point lower than originally projected. The revised forecast also expects stronger growth in California personal income in 2010 and 2011.

Federal Health Reform

As a result of the new federal health reform law, the May Revision does not include a number of the Governor's January health care proposals that were aimed at reducing eligibility and enrollment in both the Medi-Cal Program and the Healthy Families Program (HFP). The Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 require states to maintain eligibility standards for their Medicaid Program and

Children's Health Insurance Program (CHIP) or lose all federal funds for both programs. Specifically, the May Revision withdraws a proposal that would have limited eligibility for the HFP to children in families with incomes up to 200 percent of the poverty line. The May Revision also drops proposals to eliminate the HFP and reduce Medi-Cal eligibility to the minimum required by federal law, both of which would have been triggered if the state did not receive the additional federal funds assumed in the Governor's January budget proposal.

The new federal requirement to maintain existing eligibility standards mirrors provisions included in the ARRA, which limited states' ability to impose eligibility policies more restrictive than those in effect as of July 1, 2008. This limitation also restricts states' ability to increase premiums for enrollees. The May Revision, however, maintains and expands the Governor's January proposal to increase premiums for some children in the HFP, potentially in violation of the federal restriction.

Medi-Cal

The May Revision maintains the Governor's January proposals that would eliminate Medi-Cal coverage for Adult Day Health Care services, reduce Medi-Cal payments for family planning services, and reduce services provided to certain immigrants, including legal immigrants who have resided in the US for less than five years. The May Revision also maintains the Governor's January proposal to significantly cut spending in the Medi-Cal Program by limiting services and increasing what Medi-Cal recipients must pay for medical services. Specifically, the Governor proposes to:

- Eliminate coverage for over-the-counter drugs, establish maximum benefit dollar caps on medical supplies and durable medical equipment, limit visits to physicians or clinics to 10 per year, and limit prescription drugs to six per month, except for life-saving drugs, for state savings of \$90.2 million.
- Impose copayments for medical services for state savings of \$118.2 million. Medi-Cal recipients would be required to pay \$5 for physician, clinic, dental, and certain pharmacy services. The Governor proposes to charge a copayment of \$3 for lower-cost drugs.
- Impose a \$50 copayment for emergency room visits for state savings of \$41.5 million.
- Impose a \$100 per day copayment, up to a maximum of \$200, for hospital stays, resulting in state savings of \$59.1 million.

In addition, the May Revision:

- Requires seniors and persons with disabilities to enroll in managed care for state savings of \$137.3 million.
- Reduces payments to radiologists to 80 percent of Medicare rates for state savings of \$10.5 million.
- Freezes payments to hospitals at the current level for state savings of \$64.9 million.
- Ceases to pay Medicare Part B premiums for recipients whose incomes exceed the Medi-Cal eligibility threshold by less than \$500 per month for savings of \$1.0 million.

Other Health Programs

The May Revision maintains the Governor's January proposal to eliminate vision services for children in the HFP. The May Revision also:

- Increases premiums from \$24 per child to \$42 per child – an increase of 75 percent – for families with incomes between 200 percent and 250 percent of the federal poverty line effective September 1, 2010. The maximum premium charged to a family would rise from \$72 to \$126. This proposal would result in state savings of \$13.3 million. This proposal is in addition to the Governor's January proposal to increase premiums for children in families with incomes between 150 percent and 200 percent of the poverty line. As noted above, the new federal

health reform law requires states to maintain existing eligibility standards for both their Medicaid and CHIP programs. This limitation, as applied to the Medicaid Program under ARRA, restricts states' ability to impose or increase premiums charged to enrollees. The US Centers for Medicare and Medicaid Services is expected to give guidance on whether the same restriction would also apply to state CHIP-funded programs.

- Increases HFP copayments for emergency room visits from \$15 to \$50 and adds a copayment of \$100 per day with a \$200 maximum for hospital inpatient services for state savings of \$3.2 million.

Proposition Fund Shifts

The May Revision modifies the Governor's January proposal to shift funds from programs funded by Proposition 99 to Medi-Cal. The proposal now uses funds from two programs rather than five programs as originally proposed for state savings of \$11.3 million. Proposition 99 of 1988 imposed a 25-cent-per-pack tax on cigarettes to support various health programs. The May Revision drops the Governor's January proposal to divert \$452.3 million in Proposition 63 revenues to fund existing mental health services in 2010-11. This proposal would have required voter approval. Proposition 63 of 2004 imposed a 1 percent tax on the portion of individuals' taxable incomes that exceeds \$1 million.

California Work Opportunity and Responsibility to Kids (CalWORKs) Program

The May Revision eliminates the CalWORKs Program effective October 1, 2010 for net state savings of \$1.6 billion in 2010-11. Eliminating CalWORKs would terminate cash assistance and a range of services for more than 1.4 million Californians, including 1.1 million children. In addition, the state would lose three-quarters (\$2.8 billion) of the state's federal Temporary Assistance for Needy Families (TANF) block grant in 2010-11 and the state's entire annual \$3.7 billion TANF block grant every year thereafter. California also could lose more than \$500 million in additional federal funds to help offset state expenditures for CalWORKs in 2010-11 if Congress extends the Emergency Contingency Fund, which was included in the ARRA and currently expires in September 2010.

May Revision documents outline alternative proposals should the Legislature choose not to eliminate CalWORKs. Specifically, the Administration estimates state savings of \$488 million in 2010-11 from reducing CalWORKs grants by 15.7 percent, eliminating CalWORKs eligibility for recent legal immigrants, and cutting reimbursement rates for CalWORKs child care providers, assuming an October 1, 2010 implementation date. All three of these proposals were included in the Governor's Proposed 2010-11 Budget released in January.

In-Home Supportive Services (IHSS) Program

The May Revision proposes to "develop specific IHSS cost-containment measures in time for legislative enactment by July 1" to achieve state savings of \$637.1 million in 2010-11, with annual savings increasing to an estimated \$750 million beginning in 2011-12. The CBP estimates that the 2010-11 reduction is approximately 42 percent of the state's projected share of total IHSS Program costs of \$1.5 billion in 2010-11. The Administration states that this proposal would be developed "in consultation with stakeholders" and would be "in lieu of" the Governor's January proposals to reduce the state's share of IHSS workers' wages and benefits to \$8.60 per hour and eliminate all services for IHSS recipients with "functional index" scores below 4.0. The Administration notes that it continues to challenge federal court rulings that have prevented California from implementing reductions to IHSS included in the February and July 2009 budget agreements.

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

The May Revision maintains the Governor's January budget proposals to:

- Reduce the maximum monthly SSI/SSP grant for individual recipients from \$845 to \$830. Implementation would be delayed to October 1, 2010 for state savings of \$132.8 million in 2010-11.
- Eliminate the Cash Assistance Program for Immigrants (CAPI). Implementation would be delayed to October 1, 2010 for state savings of \$73.6 million in 2010-11. CAPI provides state-funded cash assistance to elderly and disabled legal immigrants who are not eligible for SSI/SSP grants solely due to their immigration status.

Other Human Services Programs

The May Revision maintains the Governor's January proposals to:

- Eliminate the California Food Assistance Program (CFAP) effective October 1, 2010 for state savings of \$42.8 million in 2010-11. CFAP provides solely state-funded nutritional benefits to qualified legal immigrants who are ineligible for federal food stamp benefits.
- Use county savings that would result from the proposed cuts to the CalWORKs and IHSS programs and the assumed extension of federal ARRA funds to pay for a \$359.5 million increase in counties' costs for a range of human services programs in 2010-11.

In addition, the May Revision drops the Governor's January proposal to:

- Divert Proposition 10 revenues to the General Fund each year through 2014-15 to reduce state costs for various programs that serve children. This proposal would have required voter approval. Proposition 10 of 1998 imposed a 50-cent-per-pack tax on cigarettes to support First 5 programs for children from birth to age 5.

Child Care and Development Programs

The May Revision eliminates all state funding for child care assistance for savings of nearly \$1.2 billion in 2010-11. This proposal would end child care assistance for approximately 142,000 children, but would not affect the State Preschool Program or state-funded after-school programs. The Administration states that "approximately \$594 million in federal funds would remain available for approximately 78,000 slots for the neediest of families under a revised program." The Administration also notes that it will attempt to identify alternative funds that could be used to provide the state match required by the federal Child Care and Development Fund. Alternative funds would be necessary in order to draw down federal funding to support even the reduced level of child care assistance proposed by the Administration.

In addition, the May Revision:

- Shifts CalWORKs Stage 2 and 3 child care funding to the "capped" Alternative Payment Program (APP). Children currently served by Stages 2 and 3 would be enrolled in the APP "based on income eligibility and to the extent of funds availability." This proposal is consistent with the Governor's proposal to eliminate the CalWORKs Program effective October 1, 2010.
- Reduces the income limit for child care assistance from 75 percent of the state median income (SMI) to 60 percent of the SMI in 2010-11. The State Preschool Program income eligibility limit would remain unchanged.
- Proposes to implement "more aggressive actions to minimize waste and seek collection of overpayments in child care programs." This proposal would require APP providers "to prevent and correct errors and collect

overpayments from families that benefit from the errors.” The Administration does not estimate costs or savings associated with this proposal, which would apply to state-funded child care centers, family child care homes, and other providers.

- Maintains the Governor’s January budget proposal to reduce reimbursement rate limits in voucher-based child care programs from the 85th percentile to the 75th percentile, based on the 2005 Regional Market Rate survey. This proposal also would reduce the reimbursement rate limits for license-exempt providers from 90 percent to 70 percent of the limits for licensed family child care homes.

Proposition 98

The May Revision would provide \$49.9 billion in 2009-10 and \$48.4 billion in 2010-11 for K-14 programs covered by the Proposition 98 guarantee, a reduction of \$1.3 billion in 2009-10 and \$4.2 billion 2010-11 compared to the minimum level required by bills signed by the Governor as part of the July 2009 budget agreement. The lower proposed funding level reflects the Governor’s assumption that provisions enacted as part of the July 2009 budget agreement do not apply to the 2009-10 or 2010-11 budgets. The 2009 budget agreement statutorily required the state to make payments to schools equivalent to those that would be required under the constitutional “maintenance factor” provisions of the Proposition 98 guarantee. A “maintenance factor” requires the state to restore school spending in future years to where it would have been absent the lower funding level allowed when the funding guarantee is suspended or when “test 3” of the guarantee applies in a bad budget year.

The May Revision would also adjust, or “rebench,” the 2010-11 Proposition 98 guarantee downward by \$1.4 billion to reflect the proposed elimination of child care programs administered through the California Department of Education.

K-12 Education

The May Revision maintains the Governor’s January budget proposal to reduce 2010-11 revenue limit funding by \$1.5 billion. Revenue limits provide general-purpose funding for schools. The May Revision also maintains the Governor’s January budget proposal to reduce 2010-11 funding for the K-3 Class Size Reduction Program by \$550 million and to reduce revenue limit and categorical funding for school districts and county offices of education (COE) by \$206.3 million due to lower cost-of-living adjustments (COLAs). The May Revision continues to suspend most K-12 education mandates except for \$65 million for mandated behavioral assessment plans, \$7.7 million for mandated costs related to interdistrict and intradistrict transfers, and \$6.8 million for costs related to the California High School Exit Exam.

In addition, the May Revision:

- Reflects a decrease in local property tax revenues. The May Revision increases funding for school district and COE revenue limits by \$1.1 billion in 2009-10 and \$447.5 million in 2010-11 to backfill for the loss of local revenues.
- Withdraws the January budget proposal that required \$300 million of the proposed \$1.5 billion reduction to 2010-11 revenue limits be achieved by contracting out administrative functions to the private sector.
- Increases funding for school district and COE revenue limits by \$31.8 million in 2009-10 and \$71.7 million in 2010-11 as a result of increased unemployment insurance and CalPERS costs.
- Reduces funding by \$78.5 million to reflect anticipated savings in special education, Economic Impact Aid, Child Nutrition, and Charter School Categorical Block Grant programs.
- Reduces 2010-11 funding for COE administration by \$28.2 million, instead of \$45 million as proposed in the January budget. The May Revision also withdraws the January budget proposal to require COEs to consolidate services and functions.
- Reduces one-time funding for new school categorical programs by \$9 million in 2009-10.

- Restores the writing component of the 4th grade English language arts California Standards Test.

Higher Education

The May Revision proposes no additional reductions in funding for the UC, the CSU, or student aid programs and rescinds the Governor's January budget proposals that would have:

- Suspended awards in the Cal Grant Competitive Program for savings of \$45.5 million and reduced Cal Grant awards by freezing the income eligibility limit for assistance for savings of \$79 million.
- Eliminated funding for enrollment growth in the CSU and UC systems for savings of \$111.8 million.

In addition, the May Revision:

- Shifts a portion of Cal Grant costs to the Student Loan Operating Fund on a one-time basis for savings of \$75 million.
- Reduces Student Aid Commission (CSAC) funding by \$10.3 million as a result of a series of changes related to the Governor's proposal to eliminate the CalWORKs program. In his January budget, the Governor proposed to use federal TANF funds to support CSAC costs.
- Provides a total of \$21.7 million to the CSAC to reflect workload adjustments in both 2009-10 and 2010-11 since the release of the January budget for the Cal Grant Program and loan assumption programs such as the Assumption Program of Loans for Education (APLE).

Corrections

The May Revision:

- Maintains the Governor's January budget proposal to reduce per-inmate medical care costs to a level comparable to that of New York for savings of \$811 million in 2010-11. In February, the Legislature passed a bill – AB X8 2 – intended to implement this reduction in 2010-11. However, the Governor vetoed the measure, arguing that the bill did "not actually implement spending reductions and make progress to close our budget gap."
- Proposes to require non-violent, non-serious, non-sex felony offenders convicted with sentences of three years or less to serve their sentence in local jails. The state would provide counties with approximately \$11,500 per offender to support "programs and services such as probation programming, drug courts, and alternative custody," according to the Administration. This proposal, which is similar to one the Governor made in January, would result in savings of \$243.8 million in 2010-11.
- Shifts supervision of juvenile parolees to county probation departments for state savings of \$4.6 million in 2010-11. The state would provide counties with \$15,000 per juvenile parolee per year to fund this new responsibility.
- Provides a continuous General Fund appropriation of \$502.9 million each year beginning in 2011-12 to support various local law enforcement programs that are currently supported with a portion of the temporary Vehicle License Fee increase that expires June 30, 2011.
- Modifies the Governor's January budget proposal that would reduce the number of juvenile offenders through a number of statutory changes. Specifically, the Administration has dropped a prior proposal to reduce the Division of Juvenile Justice's age of jurisdiction to 21, reducing estimated state savings from this package of changes to \$5.6 million and \$0.4 million Proposition 98 General Fund in 2010-11.

State Employees

The May Revision maintains the Governor's January proposals to cut state employees' compensation and benefits in 2010-11. The Governor implemented one of the proposals – a requirement that most state departments reduce personnel costs by 5 percent by July 1, 2010 – through an executive order issued in January.

In addition, the May Revision:

- Proposes to require all state civil service employees to take one unpaid leave day per month beginning July 1, 2010, for General Fund savings of \$445.7 million. According to press reports, employees' salaries would be reduced by 4.65 percent each month. In exchange, employees would accumulate one day per month of unpaid leave, which they would be required to use before taking any paid leave.
- Assumes the state will save \$200 million due to provisions in the new federal health reform law that could impact the cost of state retiree health benefits.

Local Government

The May Revision maintains the Governor's January proposals to suspend most local government mandates and defer payments for current mandate claims, as well as to use funds shifted from redevelopment agencies to offset the cost of local trial courts.

Transportation

The May Revision:

- Delays repayment of \$230 million in loans from the State Highway Account and other transportation funds to the General Fund from June 2011 to June 2012.
- Loans \$650 million in fuel tax revenues from the Highway Users Tax Account to the General Fund. This transfer is part of a recently enacted set of changes that eliminated the sales tax on gasoline and increased the gas excise tax. The funds would be repaid by June 2013.
- Loans up to \$250 million that would be generated by "the adoption of reductions in state staffing costs" from the Motor Vehicle Account to the General Fund.
- Assumes the transfer of \$72.2 million in proceeds from the sale of documents and miscellaneous services to the public from the Motor Vehicle Account to the General Fund.

Resources

The May Revision maintains the Governor's January proposal to impose a 4.8 percent statewide surcharge on all residential and commercial property insurance to support state and local fire protection and emergency response activities for state savings of \$76.0 million in 2010-11, assuming an implementation date of July 1, 2010.

In addition, the May Revision:

- Drops the Governor's January proposal to allow offshore oil drilling at Tranquillon Ridge and use the lease revenues to support state parks in lieu of state General Fund dollars. The May Revision proposes to fully restore funding for state parks in 2010-11.

- Cuts funding for multiple Department of Fish and Game (DFG) conservation and restoration programs by \$5.0 million in 2010-11, which is in addition to the Governor's January proposal to cut funding for DFG recreational hunting and fishing programs by \$5.0 million.
- Loans \$75.0 million from the Department of Resources Recycling and Recovery's Electronic Waste Recovery and Recycling Account to the General Fund in 2010-11.
- Delays repayment of \$35.0 million in loans from the Energy Resources Conservation and Development Commission's Renewable Resource Trust Fund to the General Fund 2010-11.
- Delays repayment of \$10.0 million in loans from the Department of Resources Recycling and Recovery's Tire Recycling Management Fund to the General Fund in 2010-11.

Legislative, Executive, and Judicial

The May Revision maintains the Governor's January proposals to:

- Delay the implementation of the Guardianship and Conservatorship Reform Act by one year for savings of \$17.4 million.
- Implement an automated speed enforcement program generating \$206.1 million in revenues that would be used to offset court costs in 2010-11.

In addition, the May Revision:

- Increases the amount of, and delays the repayment of, loans from the Tax Credit Allocation Committee to the General Fund, resulting in \$70.0 million of budget "solutions" in 2010-11.
- Assumes \$13.0 million in savings in 2010-11 from the use of electronic court reporting systems.
- Loans \$10.0 million from the Secretary of State's Victims of Corporate Fraud Compensation Fund to the General Fund in 2010-11.