INTRODUCTION

This paper discusses the fiscal and political challenges facing California’s budget legislation in 2007. Based on public documents and media reports, Republican opposition to the budget has been more intense and resistant than in past years. In addition, the feasibility of relying on borrowing to manage the state’s expenditures is waning. While the governor’s proposed mandatory health plan is being debated in the press, it is anticipated that the core concern this fiscal year will be efforts to raise sufficient revenue.

THE DEMOGRAPHICS AND ECONOMICS OF CALIFORNIA

California has a population of 37.3 million people and grows by about 1.3% annually (Department of Finance, Demographic Research Unit). One person in 12 in the U.S. is a Californian. However, the growth by age categories in the population is uneven.

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Change in Thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-4</td>
<td>178</td>
</tr>
<tr>
<td>5-17</td>
<td>6</td>
</tr>
<tr>
<td>18-24</td>
<td>389</td>
</tr>
<tr>
<td>25-44</td>
<td>135</td>
</tr>
<tr>
<td>45-64</td>
<td>1386</td>
</tr>
<tr>
<td>65 and older</td>
<td>1740</td>
</tr>
</tbody>
</table>

There is an anticipated decline in the growth of school-aged children and a relatively larger increase among college-aged residents. However, the fastest growing sector is the 65 and older age group. The pressure on public schools and policing is likely to decline while the demand for health services, recreation and transit is apt to rise. See Figure 1 above for distribution by age groups (Kelley 2005).

The current estimated unemployment rate for the state is 4.8% which is slightly higher than the national average of 4.5% (Employment Development Department, 2006).
Unemployment rates for California overall have declined in recent years but the state’s poverty rate has soared from 15th to 3rd place after adjusting for the regional cost of living (COLA). Based solely on federal standards, California’s poverty level is 13.3% while the national average is 12.7%. When adjusting for regional COLAs, the differential widens to 16.2%. Only Washington D. C. and New York have higher rates of poverty (Public Policy Institute of California 2006).

A major contributor to being employed and in poverty in California is the slow growth in income and rapid rise in the cost of housing. Non farm income rose by 1.1% to 1.3%; California’s population grows steadily but housing construction lags. Consequently nearly every year there is a greater than 10% increase in the median cost of single family homes. California’s homeownership rate is the lowest in the U.S. at 59.7% (national average is 69%). The single family housing situation spills over into multi-family rental units. In order to afford an average two-bedroom apartment a worker would need to earn $22.86 per hour or about $46,000 a year. This amount is out of range for over 50% of wage earners. Today, 40% of renters are spending at least 30% of their income for housing. The fair market value (FMR) for housing exceeds the grasp of persons earning the minimum wage, CalWORKS, Social Security Income or State Supplemental Payment (SSI/SSP) programs (California Department of Housing and Community Development 2007).

The median cost of homes reached a record high at $576,000 statewide. The greatest jump in housing costs from 2001-2006 occurred in Riverside and San Bernardino counties with median costs approaching $400,000. The highest median housing costs are in San Francisco and Orange counties at around $700,000. The effect of population growth, stagnant income and unprecedented housing costs (now 150% higher than the national average) is soaring debt held by Californians. Last year more than a fifth of buyers took out mortgages with no down payment and a growing number needed to pool more than one mortgage to purchase a home (Kottle 2007). By late August the housing market in Los Angeles dropped by 7.3% as inventories rose just as credit conditions worsened. The market is not affected uniformly throughout the state. Beverly Hills and Malibu, with housing cost over $700,000, are unscathed while less affluent areas with homes in the mid-price range (Riverside and San Bernardino) were deeply affected. The bifurcation in the housing market mirrors the bifurcation in incomes (Haddad 2007).

In an economic environment of stagnant wages, rising costs and personal and public deepening debt, no new taxes or fees becomes a central concern of voters. In 2004 Californians elected to borrow their way out their economic troubles with Proposition 57 for “economic recovery” (Korey 2005). Last November voters approved an additional five propositions thereby enlarging the state’s debt by $42.55 billion. As the state approaches the new fiscal year both the voters and their government are deeply in debt and counting on strong economic growth to enable them to cover expenditures.
THE GOVERNOR’S BUDGET

Governor Schwarzenegger’s budget for 2007-08 projected the following:

- Current revenues of $101.3 billion based on rising personal income tax revenue and better than expected corporate revenues.
- Projected expenditures of $103.1 billion with notable increases in education, criminal monitoring, SSI/SSP cost of living increases, technology and health care.
- A gap ($2 billion+) between anticipated costs and revenue that is to be filled by a number of budget solutions.

The solutions include reallocating gasoline taxes to cover busing costs for school children and the disabled, cutting coverage of CalWORKS recipients who are not employed or in job training, anticipated revenues from amended Indian gaming compacts, the elimination of the Teacher Tax credit, use of recently approved bond measures for improving the state’s infrastructure and a dozen other proposals that will collectively enable the state to balance its budget (Schwarzenegger 2007; Genest 2007).

The initial critique of the proposed budget is provided by the Legislative Analyst’s Office (LAO) headed by Elizabeth Hill. The LAO’s preliminary critique suggests that:

- Projected revenue figures are more optimistic than recent trends indicate.
- $3.4 billion in budget solutions are based on assumptions that are speculative. The LAO’s key concerns include the legality of shifting gasoline tax revenues from the Public Transportation Account (PTA) to cover operating costs and the governor’s estimate of revenues from amended Indian gaming compacts.
- The resolution of the Guillen\(^1\) case regarding CalWORKS payments is uncertain.
- The state’s ability to manage its growing debt depends on volatile revenue sources that suggest greater caution be exercised in using debt as a means for sustaining the state’s financial equilibrium (LAO 2007).

While there are concerns by the LAO on both the revenue and expenditure sides of the proposed budget, Hill has emphasized her concerns regarding revenue projections. The budget season in California begins on January 10 with the governor’s message but doesn’t conclude until July. In the interim the governor and the LAO get to amend and revise their initial estimates of the health of California’s economy, projected revenue and appropriate expenditures. The budget message and review represents only the first month of what is hoped to be a six month process, January to June.

\(^1\) Guillen v. Schwarzenegger challenges the denial of cost of living adjustments to CalWORKS recipients in 2003. Lower court held for plaintiff (Guillen) and ordered the state to pay retroactive COLAs. The state is currently appealing the case. Guillen v. Schwarzenegger. 147 Cal. App. 4th 929, [2007].
BUDGET PROCESS AND POLITICS

On paper, California’s budget process is as follows:

- Department agencies develop budget proposals and specific requests for funding during the summer and submit requests by September 15th to the Department of Finance.
- The governor and Department of Finance Director evaluate and utilize agency information in the development of the proposed budget that is presented to the legislature on January 10th.
- The Legislative Analysts Office (LAO) typically sees an early draft of the governor’s proposed budget and begins the task of analyzing the assumptions and projections. The LAO’s public response to the budget proposal comes within days of the governor’s budget message. In 2007 the LAO’s first response was on January 12th. Additional data and analysis is provided throughout the budget process but is most extensive in January before the budget is divided up and sent to legislative committees.
- The subject areas of the budget are sent to subcommittees of the Assembly and Senate for consideration and revisions by March.
- Subcommittee reports are sent to their chamber’s budget committee and the budget committees develop a revised budget bill for consideration and discussion, typically by the end of April.
- The governor’s revisions to his January budget, based on up-to-date data on the state of the State’s economy and revenues, are provided in May. The update, like the January budget message, is reviewed, analyzed and presented to the legislature by the LAO.
- Differences between the Assembly and Senate versions are worked out in a conference committee comprised of three members of each chamber. They produce a single version of the budget that is voted on by the legislature before being sent to the governor by June 15th. Each chamber must approve the budget with a two thirds majority, which means not less than 54 votes in the Assembly and 27 votes in the Senate.
- Failing passage of a conference budget bill, the “BIG 5” meets to work out compromises that will enable the legislature to garner the votes necessary for passage. The BIG 5 are the governor, Speaker, Speaker Pro Tempore and minority leaders of both chambers. Their version of the budget is sent for approval by each chamber in June.
- The governor has until July 1st to sign the budget bill and begin the new fiscal year.

The six month budget cycle in 2008 took 8 months as Senate Republicans mobilized their efforts to force the governor to yield on key provisions of his proposed budget.

Politics

The executive branch dominates the budget process because it sets the budget agenda in January; serves as one of the BIG 5 when the legislature is at odds with itself and exercises the
line-item veto power when the budget is approved in July. Even when the governor has had a particularly disappointing year at the polls, as in 2005, he had considerable influence on the budget process and outcome (Korey, 2005). By comparison, the election cycle of 2006 was a banner year for the governor. He secured re-election with a 55% majority against the Democratic challenger and former State Treasurer, Phil Angelides. More importantly, from a budgetary perspective, he received significant support from voters on statewide ballot measures he endorsed in 2006.

Voters were presented with 13 statewide ballot measures in November and rejected six. Among the successful initiatives were five bond/loan measures. These initiatives are summarized below. See Table 1.

Table 1 Successful Statewide Ballot Measures of November 2006

<table>
<thead>
<tr>
<th>Number</th>
<th>Ballot Title</th>
<th>Fund (billions)</th>
<th>Interest (billions)</th>
<th>Voters in Favor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1A</td>
<td>Transportation Funding Protection*</td>
<td>n.a.</td>
<td>n.a.</td>
<td>77.0%</td>
</tr>
<tr>
<td>1B</td>
<td>Highway Safety, Traffic Reduction, Air Quality and Port Security Bond</td>
<td>$19.90</td>
<td>$19.0</td>
<td>61.0%</td>
</tr>
<tr>
<td>1C</td>
<td>Housing and Emergency Shelter Trust Fund</td>
<td>$2.85</td>
<td>$3.3</td>
<td>57.8%</td>
</tr>
<tr>
<td>1D</td>
<td>Kindergarten – University Public Education Facilities</td>
<td>$10.40</td>
<td>$9.9</td>
<td>56.9%</td>
</tr>
<tr>
<td>1E</td>
<td>Disaster Preparedness and Flood Prevention</td>
<td>$4.00</td>
<td>$3.9</td>
<td>64.2%</td>
</tr>
<tr>
<td>84</td>
<td>Water Quality, Safety and Supply, Flood Control, Natural Resource Protection and Park Improvements</td>
<td>$5.40</td>
<td>$5.1</td>
<td>53.8%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>Summary of all bond/loan measures</td>
<td>$42.55</td>
<td>$41.2</td>
<td></td>
</tr>
</tbody>
</table>

n.a. Not applicable
* No new funds raised by measure. Restricts gas taxes to be spent on transportation. Also limits transportation loans to a ten year period.
Source: California Secretary of State Election Results

Generally speaking the ballot measures had strong public support, with only initiative 84 getting a smaller plurality than the governor’s margin of victory. The interest costs (Table 1 above) did not appear to deter voters, who may see the $83.75 billion cost (principal + interest) over the life of the bonds as less onerous than other immediate alternatives for improving the state’s infrastructure. The governor appeared to have reestablished his relationship with voters.

The 2007-08 proposed budget provided for additional funding in education, including Proposition 98 which requires cost of living adjustments (COLA) for K-12 and community colleges. While the proposed budget provides additional funding for the University of California (UC) and California State University (CSU) systems, it also proposes 7% and 10% hikes (respectively) in student fees. However, there are a number of items that may appeal to legislative Democrats. These include the funding for technical education, COLAs for SSI and
SSP recipients, $32 million for greenhouse gas reductions, funding for alternative energy studies and the expansion of health care coverage through the state’s Medi-Cal and Healthy Families programs.

This rather liberal agenda has lead to speculation in the media regarding the governor’s true purpose. Popular theories include:

- He learned a valuable political lesson in 2005 when his ballot measures went down in defeat. “I rushed it (2005 special election). If I would have nurtured it, it would have been different”, Schwarzenegger has said (Miller and Beeman, 2006; Mathews, 2006; Ehrenhalt, 2006).

- He has come under the influence of Democrats, specifically Speaker Fabian Nuñez, Los Angeles Mayor Antonio Villaraigosa and President Pro Tempore Don Perata, who has been a champion of broad based health care statewide. In addition there is newly hired chief of staff, Susan Kennedy, a former staffer to Gray Davis who has taken a leadership role inside the governor’s administration (Mathews, 2006; Frommer, 2006; Nicholas 2006, Nov. 8).

- He has discovered his “inner Pat Brown”. This reference is to the very popular California governor of the 1960s who was responsible for an extensive building effort that resulted in the UC and CSU system the state has today (Economist 2007; Cahn, Schockman and Shafie).

- He is not ideological but practical in his political dealings. The apparent shift to the left is to effectively neutralize opposition forces (teachers, Indian tribes, prison guards) that have proven successful against him in the past (Mathews, 2006; Ehrenhalt, 2006; Nicholas, 2007).

Also in the latest budget are issues close to the Republican agenda including the funding of the Sex Offender Management Plan otherwise know as “Jessica’s Law”, funds for additional prisons and no overt hint of new taxes. In balance, the proposed budget is skewed to the left. This makes the inevitable political confrontation over the budget this summer a complex affair.

**Legislative Relations**

Passage of the 2007-08 budget requires a two thirds majority in both chambers: 27 in the Senate and 54 in the Assembly. The Democrats, with 25 votes in the Senate, are two votes shy of the minimum. In the Assembly they are 6 votes shy, with just 48 seats. The constitutional requirement shifts political clout from the Democrats to the Republicans, if Republicans can sustain party discipline.

Historically, party identification is a key factor in winning and keeping a legislative seat. The Democratic Party registration plurality and creative drawing of Senate and Assembly seats by the Democratic-controlled legislature translates into a continuing majority in the California legislature (Field 2007). Since Schwarzenegger’s October 2003 recall victory he has had to share
power with a Democratic controlled legislature. In the budget process the leadership of the legislature is an important factor in resolving differences.

The Assembly is headed by Speaker Fabian Nuñez (D-46th District) who represents a heavily Latino community in downtown Los Angeles. Nuñez is young (40) and was elected as Speaker during his first term in Sacramento. For the past two budget cycles he has been influential in budget negotiations and is favorably compared to Jesse Unruh, the legendary Speaker of the 1960s who was renowned for getting things done. Since Nuñez was elected in his second year in the Assembly, he can potentially serve as Speaker through 2008. His meteoric rise was based on his combative and self-assured personality that fellow Democrats saw as essential in negotiating with the Schwarzenegger administration. He is not reluctant to use his position to discipline fellow Democrats that stray far from the party’s majority caucus (Gurwitt, 2006).

Nuñez’ policy preferences have much in common with the budget proposal for 2007-08. He supports the prescription drug program, a statewide health plan initiative and is an advocate for reduced greenhouse gas legislation which he successfully negotiated through the legislature in 2006. He is for increased funding of education at all levels and for cost of living increases to those on SSI and SSP. While less than enthusiastic about the state’s growing debt and intractable deficit, his public statements and official web page do not emphasize these issues.

In the Senate, the Democratic leader is President Pro Tempore Don Perata (D- Oakland) who at 62 has been a two-term Alameda County Supervisor and was elected Oakland’s Assembly representative in 1996. In 1998 he was elected to the Senate and by 2004 selected by fellow Democrats to serve as President Pro Tempore. He supports financial aid and service support for the state’s most vulnerable citizens: the elderly and mentally ill. The COLAs for SSI and SSP are consistent with his agenda. Like Nuñez, Perata has won legislative support in key areas of the 2007-08 budget; for example, his 2005 bill to repair and improve California’s infrastructure. This idea was embraced and expanded on by Schwarzenegger and became incorporated into Proposition 1B and 1C. Another policy innovation of Perata’s was a health plan system for all working Californians. His plan expands Medi-Cal coverage to the poor and mandates health insurance coverage by employers with ten or more employees. Perata’s December 2006 announcement was not far from the governor’s proposal in January 2007.

On the Republican side of budget negotiations is Senate Minority Leader Dick Ackerman (R-Tustin). Tustin is an area deep inside conservative Orange County. He is 65 and served on Fullerton’s city council, as the 72nd Assembly District’s representative for three terms and as its State Senator since 2000. During his first year in the Senate he was Vice Chair of the Senate’s Budget and Fiscal Review Committee. Ackerman is a fiscal conservative opposed to tax and debt increases but in favor of infrastructure projects and expanded court facilities. Publicly he has limited his strongest opposition to the governor’s health plan.

However, unlike Nuñez and Perata, Ackerman’s leadership in the Senate came under fire in 2006 when he was nearly ousted by Jim Battin (R-La Quinta). The apparent bone of contention was the ease with which Ackerman threw his support behind the governor’s 2006 budget that included expanded funding to education and extensive borrowing. Ackerman’s ability to remain in power may be due to a single vote by Abel Maldonado (R-Santa Maria) and
the efforts of Don Perata on his behalf. However, while Ackerman justified his support of the 2006 budget as an “election year” and “status quo affair”, he has vowed to take a much harder stand on the 2007-08 plan (Capitol Week staff, 2006).

Less fortunate was the fate of George Plescia (R- San Diego), Minority Leader of the Assembly in 2006, who was successfully challenged by Michael Villines (R- Clovis). Villines won unanimous support from fellow Republicans because Plescia was seen as weak against both legislative Democrats and Schwarzenegger. In March of 2006 the governor pushed to have his Economic Stimulus Package (Propositions 1A-1E) voted on in the Assembly but Republicans wanted 48 hours for review before placing the measure on the floor for a vote. Legislative votes are needed to place bond measures on the ballot. Plescia relented to the governor’s wishes for immediate consideration, which appears to have been the tipping point for Assembly Republicans.

The hostility of legislative Republicans toward their own 2006 leadership is undeniable. In a legislature where the Democrats comprise 61% of the members, Republican influence is nil. The only arena for them to exercise their collective will is the budget. To date Republicans have indicated they are prepared to take on both the Democrat majority and their party’s governor. As the tide of opposition inside the Republican Party rises, Schwarzenegger presents himself as a centralist (Vogel, November 2006; Vogel, January 2007; Kutzman 2007).

The middle can be a very empty place in California politics. While the voters may cluster around the center, the legislature does not. An examination of voting behavior in the California legislature indicates its voting record is bimodal. On the right most Republican representatives receive a 90 to 100% approval rating from conservative monitors. Most Democrats garner 0-10 scores. The middle (in and around 50) is empty for both the Senate and Assembly. See Figure 2.
While logrolling, horse trading and consensus are traditions in California’s legislature, getting to an agreement can be perilous. Such appears to be the evolving political concern regarding the 2007-08 budget. Party cohesion does not necessarily evolve into a solid legislative plurality. Majority standing may encourage members to strike out and forge their own agendas.

Figure 2 Senate and Assembly²

² Conservative Index is based on American Conservative Union and related self declared conservative interests groups that monitor legislative votes on key bills and rate legislators from 0 (never in accord with conservative position) to 100 for always in accord with groups’ interests, per ACU website.
Party cohesion may be more likely in the absence of a plurality as in the case of California. Here individualism, cooperation and compromise are reprimanded, as in the case of Ackerman and Plescia. Ideological polarization and hardened positions leave little room for negotiating (Davidson and Oleszek, 2006). This does not bode well for the self proclaimed centralist, Governor Schwarzenegger. California’s last self- proclaimed centralist was Gray Davis.

51 DAY BUDGET CRISIS

On July 21st the Assembly passed a 2007-08 budget and recessed for the summer. The compromise among Democrats and Republicans in the lower house diverted $1 billion in gasoline taxes from mass transit projects, primarily in Los Angeles county, to repay part of the state’s multibillion dollar deficit. The diversion of state gasoline taxes and a $124 million dollar cut in welfare aid for the elderly and disabled along with cuts in drug treatment programs for prisoners, ended the three week stalemate in the Assembly. The Assembly compromise rejected the governor’s cuts to Cal WORKS and to mental health programs for the homeless.

The Assembly’s bipartisan budget did not prompt the California Senate to do likewise. Led by Minority Leader Dick Ackerman and Senator Jim Battin (R- Irvine) the Republican caucus agreed that no Republican would vote with the Democratic majority until the entire Republican caucus had agreed. This solved the 2006 dilemma of moderate Republican members striking out on their own. Since the Democrats need two Republican supporters out of 15, the unanimity rule effectively cut the Democrats off. For the next four weeks the Democratic leadership sought to work out a deal with the Republicans only to come up shy by two votes in successive balloting. Party discipline among Republican senators held. On August 9th, Senator Abel Maldonado (R-Santa Maria) broke ranks and sided with the Democratic majority (Skelton 2007). But the crisis continued.

The governor, unable to persuade fellow Republicans; left the senators to work out a deal on their own. This proved to be a counterproductive strategy as the Republicans in the Senate were more interested in exerting pressure on the governor than on Democratic senators. In mid-August the governor took trips to Republican districts to urge voters to contact their representatives to support the bipartisan budget passed by the Assembly. A lack of a budget, the governor argued, meant private contracts would stop doing business with the state and fire fighting efforts could be curtailed. The impact on the Republican senators is unknown. Instead, the governor agreed to back $703 million in budget cuts advocated by Senate Republicans in exchange for budget votes.

On August 22, the Senate passed a budget that was virtually identical to the budget package passed by the Assembly on July 21st. On August 24th the governor exercised his line item budget veto on $703 million of cuts. The crisis was officially over (Halper and McGreevy 2007).

The budget crisis, like the budget itself, was hardest on those with the least resources. Large institutions, such as counties or educational institutions, are able to get bridge loans to hold them until a budget is passed. Once a budget is in place, past payments are repaid in full by
the state and the institutions need to pay back the short term interest from savings in the coming year. However, child care providers, health care clinics, and nursing homes don’t have the financial clout to get short term bank loans and faced bankruptcy trying to serve clients while the legislature stalled on the budget. The budget battle is disproportionately harder on the poor, old, sick and weak than on more robust Californians.

ECONOMIC ISSUES AND CONSIDERATIONS

Revenue

The more controversial aspects of the governor’s budget are assumptions and projections regarding revenue. Five areas comprise the revenue picture:

1. Income taxes
2. Sales taxes
3. Corporation taxes
4. Other taxes (insurance, tobacco, liquor and miscellaneous) and
5. “Solutions”

Most state revenue is from income tax, which comprises 55 cents of every dollar. California’s tax is progressive, ranging from 1% rate to just over 10%. The personal income tax is also volatile and rises and falls significantly from year to year. Table 2 shows the rise and fall of income revenue for the past eight years:

Table 2 Changes in Income Revenue 1999-00 to 2007

<table>
<thead>
<tr>
<th></th>
<th>1999/00</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue ($ billions)</td>
<td>39.6</td>
<td>44.6</td>
<td>33.05</td>
<td>32.7</td>
<td>36.4</td>
<td>42.7</td>
<td>49.87</td>
<td>52.04*</td>
</tr>
<tr>
<td>% of Change</td>
<td>--</td>
<td>12.7</td>
<td>-26</td>
<td>-1</td>
<td>11</td>
<td>17</td>
<td>16.7</td>
<td>4</td>
</tr>
</tbody>
</table>

*California’s 2000 revenue of $44.6 is the equivalent in 2007 of $53.22.

The volatility is tied to a relatively small portion of the population contributing the lion’s share of the revenue. California taxpayers earning from $20,000 to $50,000 — roughly half of all taxpayers — contribute 6% of the total income tax revenue. Those earning from $50,000 to $100,000, or about 20% of taxpayers, contribute another 14% and the balance (80%) is contributed by persons earning over $100,000. However, it is the persons at the very top of the income pyramid earning more than $1 million a year (32,000+ people) who collectively pay taxes in excess of $10 billion. This means that one fourth of 1% of taxpayers pay a third of all income taxes. Any significant change to their economic welfare makes a considerable dent in the state’s revenues. This situation arose in 2001-02 and 2002-03. Five years later in 2007, California has barely recovered the buying power of its 2000-01 budget. See Table 2 above (Schwarzenegger, 2007 Governor’s Budget Summary 2007-08; Weintraub, 2002). Over the past seven years, the state’s economic boom was eclipsed by a slow recovery.
The disparity between the top and bottom is growing. Among the job market’s 12 fastest growing sectors, only four categories (finance/insurance, professional/technical services, wholesale trade and public administration) paid more on average than the seven declining employment areas which include manufacturing and management of companies and enterprises. If the 2000-2005 trend continues, future budgets may depend on a smaller and smaller percentage of top income earners to sustain revenues (California Budget Project, 2007). This leads some analysts to be concerned with both the health and stability of long term revenue projections.

Sales revenues and corporate taxes in the recent past have been steadier than income tax and recovered quickly from the 2001 economic downturn. In the projected 2007-08 budget, sales comprises 29 cents of each revenue dollar, corporate taxes represent 11 cents and all other revenues about 5 cents. See Table 3 below for revenue history. The LAO suggests that the proposed estimates are more optimistic than recent economic indicators suggest. However, the paucity of data and information on fourth quarter receipts for 2006 means that the differences between Finance Director Genest and LAO Director Hill are largely differences of opinion.

Table 3 Sales, Corporate and Other taxes

<table>
<thead>
<tr>
<th>Revenue in Billions</th>
<th>1999/00</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>SALES</td>
<td>21.1</td>
<td>21.3</td>
<td>21.35</td>
<td>22.4</td>
<td>23.8</td>
<td>25.7</td>
<td>7.6</td>
<td>27.8</td>
</tr>
<tr>
<td>% Change</td>
<td>--</td>
<td>.095</td>
<td>.023</td>
<td>4.9</td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>.07</td>
</tr>
<tr>
<td>CORPORATE</td>
<td>6.6</td>
<td>6.9/</td>
<td>5.3</td>
<td>6.8</td>
<td>7</td>
<td>8.6</td>
<td>10.32</td>
<td>10.31</td>
</tr>
<tr>
<td>% Change</td>
<td>--</td>
<td>.045</td>
<td>-.23</td>
<td>.28</td>
<td>.029</td>
<td>.23</td>
<td>.2</td>
<td>.000097</td>
</tr>
<tr>
<td>All Other Revenue**</td>
<td>4.2</td>
<td>4.8</td>
<td>4.93</td>
<td>15.6</td>
<td>8.9</td>
<td>4.9</td>
<td>5.6</td>
<td>4.96</td>
</tr>
<tr>
<td>% Change</td>
<td>--</td>
<td>14.3</td>
<td>2.7</td>
<td>--*</td>
<td>--*</td>
<td>--</td>
<td>14</td>
<td>-11</td>
</tr>
</tbody>
</table>

*Single year distorts rate of change for revenue.
** Does not include transfers, loans and adjustments.
1/5 $6.9 in 2000 would equal $8.3 in 2007.

Solutions

Even assuming an optimistic scenario, there are not sufficient revenues to cover costs; the governor’s budget has proposed “solutions” to fill the gap. These included:

- General obligation debt to pay for transportation expenses for school and regional centers
- Repeal of the Teacher Tax Credit
- Increased revenue from amended Indian gaming compacts
- Cuts in CalWORKS COLAs and the disqualification of those who are not employed or in job training
- Substitution of bond funds for General Fund programs regarding flood control
- Elimination of the probation monitoring of non-violent offenders, 90-day diagnostic evaluations, etc.
- Budget savings from government operation—to be identified later by the administration
- Elimination of services for the homeless who are mentally ill
- Lower MediCal drug costs due to using the average manufacturer’s cost (cost of production) rather than the average wholesale price standard and so on

The budget message provided 15 policy changes, called budget solutions, to reduce the deficit. The single largest portion of the overall package is the $1.1 billion that relies on reducing general fund costs by paying for transportation expenses from revenue raised for roads and public transit. In this case, the proposal moves some money for transportation projects from one bond measure to another. However, $771 million of the $1.1 billion fund is to cover current year operating costs for transportation in public schools and the state’s centers that serve the developmentally disabled. Using capital improvement and transit funds to cover operating costs obfuscates the fact that the operating budget is out of balance by at least $771 million based on the administration’s own proposal. Setting aside the legal question as to whether or not Proposition 42 gas taxes for transportation infrastructure can be used to transport children and the disabled, this solution suggests the administration’s projected surplus of $2 billion is either closer to $1 billion or the LAO’s estimate of a $2.4 billion deficit is a more accurate estimate.

Other major revenue enhancements proposed are projected fees from newly amended Indian gaming-compacts and the repeal of Teacher Tax Credit. Little support or criticism of the elimination of the tax credit is found in the documents of the Department of Finance, the LAO or the media. State revenues are projected to rise by $165 million when the teacher’s tax credit is eliminated. The more contentious issue is the expected revenue from recently revised Indian gaming compacts that require legislative approval.

**Indian Gaming**

The federal Indian Gaming Regulatory Act (IGRA) requires states to enter into compacts when Indian controlled land is used for gaming purposes. In California, tribes build Nevada-style casinos that employ slot machines, electronic games and card tables, e.g. blackjack. In 2000, passage of Proposition 1A amended the Constitution to enable the governor to negotiate compacts subject to legislative ratification. In 2004 and in 2006, the legislature ratified new amendments to these compacts.

Today the state has 66 compacts in which 53 tribes are operating 54 casinos. In 1999 the compacts limited a tribe to 2,000 slot machines for a total of 61,957 statewide. In 2004 the amendments allowed an unlimited number of slots and gaming devices but in 2006 the legislature set a new limit of 5,000 to 7,500 machines per tribe. California takes a percentage of the revenue generated from each machine. In 1999 the maximum payment per machine was
$4,350, in 2004 the rate rose to $8,000-$25,000 per machine and in 2006 the rates were 15% of revenue from tribes operating 2,001-5,000 machines and 25% of revenues from operation of 5,001 to 7,500 machines. Indian gaming is a growth industry and a revenue rich source for state and local governments (LAO February 2007; Marshall 1998; Eadington 1999).

There were about 20,000 slot machines in 1999 and over 58,000 (about 94% of 1999 limits) machines today. If all pending compacts are ratified by the legislature in 2007, then 32,600 new machines will be authorized for a total of 90,600 machines, an increase of 56%. In 2006, compact revenue amounted to $33 million. The governor’s 2007 budget projects about the same ($32.8 million) from existing compacts and $506 million for nine new compacts. The LAO estimates the new compact will bring in $200 million. The stark difference in estimates is due to disparities about:

- How quickly the legislature authorizes amending Indian compacts
- How quickly new machines are installed and producing revenue. Among the nine pending compacts, six are for 5,000 or fewer machines and three are for 7,500—the maximum allowed.
- How sensitive gambling activities may be to broader market circumstances.

The California legislature, with its deep aversion to tax increases and growing concerns about rising debt, is not likely to withhold or delay compact authorizations. However, the speed with which tribes implement compact options may be less timely. In theory the state has had a capacity for 108 compacts and 61,957 machines since 1999 but today has compacts with about 60% of its tribes and has reached 94% of the slot machines permitted in 1999. This less than optimal implementation occurred during a period (2004-2006) when there were no regulation limits on adding machines.

Economic forces play a role in determining how and when to expand operations. Most household gaming expenditures go to public and private lotteries. Casino/slot machines comprise less than 20%. In addition, the market for Indian gaming may be defined by competition from Nevada and visa versa. When California Indian gaming was first introduced, Las Vegas was concerned it would lose a quarter of its customer base that came from California. While California gaming did not impinge on the Vegas market that houses the Mandalay Bay, the Venetian, the Bellagio, etc., it made inroads into Nevada markets such as Laughlin, Stateline, Sparks and Reno. Building casinos and/or providing more machines did not expand the number of customers interested in gaming but pulled from a common customer base selecting one site over another based on travel time, gas costs, casino odds and amenities (Randazzo 2006; Economist 1998; Eadington 1999). Consequently, budget projections of $506 million based on the proposed number of machines rather than market share are apt to be overstated.

Revenue Solutions: CalWORKS and Others

Another major budget solution is the $465 million reduction in California’s Work and Responsibility to Kids (CalWORKS) program. CalWORKS is the state’s name for the federally funded Temporary Assistance to Needy Families (TANF). The proposed cuts impact over 78,000 of the state’s children who comprise 75% of the welfare population. The parents of these
children do not meet CalWORKS employment and/or job training requirements. The federally funded TANF program requires that states have 50% of welfare adults in the work force. In California, 24% of adult recipients meet the national requirement. Consequently, in an effort to boost revenue and avoid a $150 million federal fine for being out of compliance, the budget proposes that parents (and their children) who have been on CalWORKS for five years and are not in job training or employed 30 hours a week or more be dropped (along with their children) from CalWORKS. Forty thousand families will lose benefits based on the work/training requirement alone and another 38,000 children (who are citizens, but of immigrant parents unable to legally work), will be dropped because of the failure of their parents to meet the work requirement. This generates a savings of $324 million. In addition, the budget proposal calls for the suspension of COLA adjustments to the remaining CalWORKS households for an additional savings of $140 million.

The feasibility of these options hinges on the Guillen court case currently before the California Supreme Court. Guillen is a case that the state lost in the lower courts and requires retroactive COLAs for CalWORKS recipients. The difference between the governor’s $465 million savings and the LAO’s $553 million deficit is the difference in anticipating if the state’s position will prevail or will be rejected by the highest court. Since the cuts are tied to the federally funded TANF, a loss in the state’s Supreme Court may delay, but not resolve, the issue. However, given this uncertainty, the Democratic legislature may not need to advocate on behalf of these welfare recipients but leave the final determination to the courts.

A number of the remaining solutions are about shifting funds from one place to another or shifting priorities. A summary of options is noted below in Table 4.

THE REVENUE PICTURE AT THE END OF THE BUDGET BATTLE

Between the presentation of the governor’s budget in January and the passage of the budget in August 2007, the revenue picture for 2007-08 was modified downward as was the budget of 2006-07. $411 million in backfill funds anticipated to be owed to local school districts to comply with Proposition 98 was deleted from the 2007-08 budget when the 2006-07 year’s revenue came in below projections. The difference between the January and August anticipated revenue is summarized below on Table 5. Please note that the final figures for California’s 2006-07 year will not be available from the Legislative Analyst Office until November 2007, thus these are estimates.
## Table 4- Other Budget Solutions

<table>
<thead>
<tr>
<th>FROM</th>
<th>TO</th>
<th>Reduction to State Budget Costs by--</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Transportation Account (PTA) and Local Property Tax Growth*</td>
<td>Home-to-school transportation expenses; regional center transportation and transportation bond debt.</td>
<td>- $627 million</td>
</tr>
<tr>
<td>Proposition 98 funding for K-14</td>
<td>Stage 2 Child Care payments to CalWORKS parents</td>
<td>- $269 million</td>
</tr>
<tr>
<td>Proposition 1E Bond (Approved in 2006)</td>
<td>Flood protection and levee repair</td>
<td>- $200 million</td>
</tr>
<tr>
<td>Parolee program for non violent offenders, 90-day diagnostic</td>
<td>Sex Offender Management Plan a.k.a. Jessica’s Law</td>
<td>- $100 million</td>
</tr>
<tr>
<td>evaluations, state incarceration of juvenile offenders and community</td>
<td>reentry grants for released felons</td>
<td></td>
</tr>
<tr>
<td>reentry grants for released felons</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unspecified savings ***</td>
<td></td>
<td>- $ 100 million</td>
</tr>
<tr>
<td>State Teacher’s Retirement System Supplemental Benefits</td>
<td>Purchasing power protection program</td>
<td>- $ 75 million</td>
</tr>
<tr>
<td>Restructuring payments to intermediate care facilities for disabled</td>
<td>Day care program and transportation for disabled</td>
<td>- $ 44 million</td>
</tr>
<tr>
<td>Payments for Medi-Cal drugs based on Wholesale price</td>
<td>Payments to Medi-Cal drug based on Average Manufacturing Costs.</td>
<td>- $ 44 million</td>
</tr>
<tr>
<td>Other cuts and adjustments**</td>
<td>Reallocation</td>
<td>- $ 115 million</td>
</tr>
</tbody>
</table>

- $ 1.6 billion

* Based on recent jump in cost of housing. See Demographics and Economics discussion above.

** Includes $55 million cut in aid to homeless with serious mental illnesses, $35 million in use tax of vessels, vehicles, etc., brought into the state within one year of purchase and $25 million shifts in spending on substance abuse treatment.

*** Post budget approval the Director of Finance and state agencies are to identify $100 million in reductions. This $100 million is a deficit unmet by any current revenue. The $100 to-be-determined adjustment is reminiscent of David Stockman’s “magic asterisk” that plagued the Reagan administration’s efforts to balance the federal budget in the 1980s.
Table 5: Evolving Picture of Revenues for 2007-08

<table>
<thead>
<tr>
<th>Revenue</th>
<th>January 2007</th>
<th>August 2007</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income</td>
<td>55,598</td>
<td>55,236</td>
<td>-362</td>
</tr>
<tr>
<td>Sales Tax</td>
<td>29,347</td>
<td>28,820</td>
<td>-527</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>10,816</td>
<td>11,055</td>
<td>239</td>
</tr>
<tr>
<td>Highway Users Tax</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Motor Vehicles Fees</td>
<td>26</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2,354</td>
<td>2,181</td>
<td>-173</td>
</tr>
<tr>
<td>Liquor Tax</td>
<td>325</td>
<td>324</td>
<td>-1</td>
</tr>
<tr>
<td>Tobacco</td>
<td>122</td>
<td>120</td>
<td>-2</td>
</tr>
<tr>
<td>Other</td>
<td>2,716</td>
<td>3,477</td>
<td>761</td>
</tr>
<tr>
<td>Totals</td>
<td>101,304</td>
<td>101,239</td>
<td>-65</td>
</tr>
</tbody>
</table>

The $826 million adjustment was based on a decline in personal income and sales tax. The downward estimates look less severe on paper than in practice due to an increase in “other” money. The legislature authorized the sale of Edfund, the state’s nonprofit student loan guaranty agency, for an estimated $1 billion, making the net difference $65 million dollars rather than $826 million.

At the end of the state’s budget battle, LAO data indicated the state would have nearly a billion dollars less than anticipated. To fill this gap all the governor’s budget initial solutions (minus budget saving from unspecified operations) were passed by the legislature or were part of the governor’s line item budget veto action of August 24th. In addition to the original list of “solutions” the legislature added the sale of Edfund. The budget appears balanced between revenues and projected expenditures. However, as noted in the LAO report of August 31st the solutions do not address the chronic $5 billion shortfall the state has seen in past years nor does it resolve whether the slashing of Cal WORKS or transfer of PTA money will be upheld in the courts.

THE REVENUE OVERALL

Overall the revenue picture for California is mixed. Steady sources of revenue (corporate tax.) made gains in the prior year but continue to comprise a small percentage of total revenue. Volatile sources (income tax) began to weaken and remains unreliable. The budget for 2007-08 is either $2 billion in the black or $2.4 billion in the red. Whatever the revenue picture is, it is out of balance. The evidence is the list of “solutions” which include:

- Covering operating costs with gasoline sales taxes earmarked for roads and public transit
- Selling Edfund to make up nearly $1 billion in revenue

In sum, public school funding has been sustained and nonviolent offenders have been freed of parole requirements, but public transit, school teachers and poor children and poor elderly bear much of the costs (LAO 2007, Department of Finance 2007, Halper and Warren 2007).
EXPENDITURES AND THE DISAPPEARANCE OF DISCRETION

The governor’s budget calls for expenditures of $103.1 billion or roughly $2 billion more than projected revenues. The balance will be made up from reserves from prior years. A comparison of 2006-07 with the proposed 2007-08 is provided below in Table 6. Most changes in expenditures are modest, with about a 10% difference from the prior budget year. There are some exceptions. Most prominent is the controversial use of gasoline taxes to cover K-12 transportation. Prop 98 requires about 40% of the total California budget be spent on education for K-12. In order to meet Proposition 98 obligations in 2007-08, the governor’s proposal is to appropriate increased revenue from gasoline taxes designated for streets, roads and public transit be used to transport school children and the disabled with buses. The designated money from gasoline sales taxes is called PTA funds and the legality of this use of PTA is in question.

The sudden increase in general government expenditures is due to the state coming into compliance with the 2004 ballot’s Proposition 1A that forbids state government from taking local property tax unless there is a state of emergency. The measure, which won approval of the voters (86% to 14% opposed), was designed to restrict state authority over local finances. Cities and counties lost over a billion dollars when the state moved local property money into education in an effort to reduce the state’s Proposition 98 costs during the economic downturn early in 2000. The shuffling of funds was in theory a “loan” from local governments until the state’s economic picture improved and the money could be repaid. However, the boom in California’s economy in the 1990s, which went bust in early 2000, has been followed with a long recovery. The loan was not repaid and by 2004 frustration with the state’s inability to meet its obligations to local governments gave rise to the successful passage of Proposition 1A. In part, the 2007-08 increase in general government expenditures is a recognition that some repayment to local governments was past due.

Finally, the significant drop in the funding for resources and environmental protection does not reflect a significant change in support. During the prior budget period a number of one-time-only payments for water quality and improvement programs were provided. These 2006-07 expenditures for resource and environmental projects make the prior year look more significant than it was.
Table 6 2006-07 and 2007-08 Expenditures (General and Special Funds)

<table>
<thead>
<tr>
<th>Category</th>
<th>Revised 2006-07</th>
<th>Proposed 2007-2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dollars (billion)</td>
<td>% of Total</td>
</tr>
<tr>
<td>K-12 Education</td>
<td>40,016</td>
<td>39.2</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>29,820</td>
<td>29.1</td>
</tr>
<tr>
<td>Higher Education</td>
<td>11,368</td>
<td>11.2</td>
</tr>
<tr>
<td>Business, Transportation &amp; Housing</td>
<td>3,026</td>
<td>3.0</td>
</tr>
<tr>
<td>Corrections and Rehabilitation</td>
<td>9,236</td>
<td>9.0</td>
</tr>
<tr>
<td>General Government</td>
<td>2,206</td>
<td>2.2</td>
</tr>
<tr>
<td>Legislative, Judicial and Executive</td>
<td>3,505</td>
<td>3.4</td>
</tr>
<tr>
<td>Resources Environmental Protection</td>
<td>2,253</td>
<td>2.2</td>
</tr>
<tr>
<td>State and Consumer Services</td>
<td>602</td>
<td>.6</td>
</tr>
<tr>
<td>Labor and Workforce Development</td>
<td>105</td>
<td>.1</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td>102,137</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Governor Budget Summary 2007-08

Consequently the 2007-08 budget generally parallels the 2006-07 budget. Over the years California propositions have made it more and more difficult for a governor or legislature to exercise discretion over expenditures. Among the propositions that specify what the state can and cannot do are:

- Proposition 37 of 1984 that allocates lottery funds to education
- Proposition 98 of 1988 that guarantees minimum state funding of education K-12
- Proposition 172 of 1993 that mandates sales increase for public safety programs.
- Proposition 42 of 2002 that directs sales taxes on gasoline for transportation projects.
- Proposition 49 of 2002 that requires state funds for after school programs.
- Proposition 1A of 2004 that restricts the state’s ability to dip into local property, sales and vehicle license fees, and
- Proposition 63 of 2004 that imposes an additional tax on income to fund mental health. (LAO 2006 California Facts)

The current budget is no exception. Two priorities in the current budget are funding Proposition 98 ($58.8 billion) and the compacts with the UC and CSU ($346 million of the state’s $11.6 billion are for higher education expenditures). The full funding of Proposition 98 is unavoidable and support for the UC and CSU is the result of 3 years of intense negotiations between the governor and the education community (Miller and Beeman 2006). In addition, the $100 million to $150 million in funding to improve health care in the state’s correction and
rehabilitation facilities is unavoidable because it is required by a federal court decision. However, there are eight new agenda items. See Table 7.

**Table 7 2007-08 Spending Initiatives Proposals**

<table>
<thead>
<tr>
<th>Proposed Expenditure</th>
<th>Amount (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 SSI and SSP COLA for the aged, blind and disabled</td>
<td>$217</td>
</tr>
<tr>
<td>2 Comprehensive Sex Offender Management Plan program begun in 2006-07</td>
<td>$193</td>
</tr>
<tr>
<td>3 Strategic Research and Innovation Program: $30 million in lease revenue bonds for the HELIOS Project; $40 million for the Energy Biosciences Institute; $19.8 million for California Institutes for Science and Innovation and $5 million for the Petascale Supercomputer Project.*</td>
<td>$95</td>
</tr>
<tr>
<td>4 Career Technical Education for high school and community colleges</td>
<td>$52</td>
</tr>
<tr>
<td>5 Greenhouse Gas Reduction Program</td>
<td>$36</td>
</tr>
<tr>
<td>6 Expanded health care coverage through the state Medi-Cal program for self-certified persons at the poverty line and increased enrollment into state’s Healthy Families Program for self-certified low income households above the poverty line.</td>
<td>$36</td>
</tr>
<tr>
<td>7 Improving the state food-borne illness emergency response capability and a new environmental contaminant bio-monitoring program.</td>
<td>$3.5</td>
</tr>
<tr>
<td>8 Discount Prescription Drug Program to reduce consumer costs by 40 to 60% below retail prices by securing their drugs through the state’s California Rx Prescription Drug website.</td>
<td>**</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$632.5</td>
</tr>
</tbody>
</table>

* Indicate estimated costs
** No specific funding amount identified. State serves as broker for Californian’s buying prescription and generic drugs at wholesale rather than retail prices.

Most expenditures are set by constitutional and/or statutory propositions and court cases. There is little room to maneuver. Out of a $103.1 billion budget, the governor’s spending initiatives concern about $632.5 million or roughly six tenths of one percent (LAO 2005). Most of the initiatives are not controversial: monitoring sex offenders, cost of living increases for aged, blind, and disabled, research innovations, technical education and assuring food quality. The only problematic initiative is the governor’s health plan which is apt to be opposed by Democrats and Republican legislators for opposite reasons.
Republican legislators see the mandated health care coverage fees as new taxes and higher costs on small businesses. The governor’s proposal goes too far for Republicans; Democrats don’t believe the proposal goes far enough. The plan provides subsidies for families with income 250% above the federal poverty level. A family of four would be eligible if their income did not exceed $51,625. The coverage is for catastrophic care that would cost about $1,200 ($100 per person/month) and cover medical expenses that exceed $5,000. The net effect is that for the policy to pay out its first dollar of coverage the insured has to pay premiums of $1,200 and a co-pay of $5,000 -- 12% of his/her gross income.

Persons struggling to pay for a doctor’s visit at $120 a visit would not be better off. They would be paying $1,200 a year for healthcare that doesn’t cover health maintenance or non-catastrophic care such as prenatal care or a broken leg. Catastrophic medical expenses are allowed under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Consequently a $150,000 medical bill that would be covered in theory under the mandatory health care program would cost the citizen $6,200 while the same catastrophic medical costs under the revised bankruptcy laws (BAPCPA) would cost the consumer considerably less. The ability for the uninsured to secure medical coverage for basic medical care is not reduced by the governor’s Plan (Kurtzman 2007; Nicholas 2007; Rau 2007; Ronan 2006). The governor’s Health Care proposal is likely to be an early casualty of the budget battle of 2007. Given the pressure on Californians to meet basic needs for housing, utilities and gasoline, there is little likelihood for broad public support for this initial health care proposal. (See Demographic and Economic discussion)

FINAL EXPENDITURES

The governor’s proposed budget for 2007-08 included $103,140,601,000. The final approved budget – which includes the governor’s $703 million in line item vetoes, was for $102 billion. This would have meant that 2007-08 expenditures were roughly equal to last year’s budget but 2006-07 was adjusted downward to $101 billion making 2007-08 look as though it reflects a $1 billion increase. It is difficult to evaluate the 2007-08 budget compared to 2006-07. A comparison of the approved budget for 2007-08 to the prior year indicates increases in all areas except: Consumer Services, Business, Transportation and Housing, Resources, Labor and General Government. Table 8, below, compares the governor’s January budget with the final budget in August.
Table 8: The Evolved 2007-08 Budget from January to August

<table>
<thead>
<tr>
<th>State Agencies</th>
<th>Proposed Budget (000) January 2007</th>
<th>Final Budget (000) August 2007</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Education</td>
<td>40,512</td>
<td>41,371</td>
<td>859</td>
</tr>
<tr>
<td>Higher Education</td>
<td>12,003</td>
<td>11,980</td>
<td>-23</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>29,875</td>
<td>29,719</td>
<td>-156</td>
</tr>
<tr>
<td>Corrections and Rehabilitation</td>
<td>10,043</td>
<td>9,836</td>
<td>-207</td>
</tr>
<tr>
<td>Business, Transport. and Housing</td>
<td>1,588</td>
<td>1,567</td>
<td>-21</td>
</tr>
<tr>
<td>Resources</td>
<td>1,472</td>
<td>1,674</td>
<td>202</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>86</td>
<td>90</td>
<td>4</td>
</tr>
<tr>
<td>State and Consumer Services</td>
<td>575</td>
<td>577</td>
<td>2</td>
</tr>
<tr>
<td>Labor and Workforce Development</td>
<td>118</td>
<td>103</td>
<td>-15</td>
</tr>
<tr>
<td>General Government</td>
<td>3,077</td>
<td>1,579</td>
<td>-1498</td>
</tr>
<tr>
<td>Legislative, Judicial and Executive</td>
<td>3,793</td>
<td>3,792</td>
<td>-1</td>
</tr>
<tr>
<td>Totals</td>
<td>103,142*</td>
<td>102,288</td>
<td>-854</td>
</tr>
</tbody>
</table>

* When including special funds ($27,685 billion) and bond funds ($12,583 billion) with the overall General Fund allocations noted above, the total budget is $143,408,832,000.

Based on Table 8 it would appear that all areas were cut with the exception of K-12 education and resources. However, schools will not be getting $411 million in Prop.98 funds due to the weaker than expected revenues in 2006-07. The $859 million increase is functionally half that figure. Prop. 98 requires the state meet its obligation to public schools based on revenues raised, not based on costs districts incur. Higher education lost $23 million. These savings were achieved by setting aside basic skills training at community colleges. There was an increase in higher education for the UC and CSU system. The increase was from $11,331 million in 2006-07 to $11,980 million in 2007-08 (nearly 6%) which will be made up by charging 7% to 10% higher fees to students on these campuses.

The lion’s share of revenue cuts was achieved by health care cuts to the poor: $331.9 million to the Medi Cal program due to projected lower enrollments, $53.1 million in managed care support to Medi Cal recipients, $54.9 million for mental health services to the homeless, and so on. In all, $528.5 million in budget savings was derived from cutting health programs and services. $72 million was cut from state employee compensation which may represent planned staff projections rather than actual staffing costs. The balance was largely achieved by cutting child care, food banks, libraries and substance abuse services to nonviolent offenders (California Budget Project 2007).

The immediate consequences of the 2007-08 budget cycle will be felt by the poor and college students. In the long run commuters, who thought Public Transportation Account monies would be used to relieve congestion, will pay in longer commuting times and travel delays. Schools, higher education and prisons were not officially cut in this budget cycle but the big winners were those advocating privatization. In the breech between revenues and
expenditures, the sale of the EdFund became a viable option. As noted by LAO, this year’s budget solutions are one-time solutions and the chronic revenue shortfalls that have plagued the state in the past have yet to be addressed (LAO 2007).

CONCLUSIONS

Revenues, or the lack of them, dominated the budget discussion in 2007. The optimistic projections from the governor’s Office in January were not supported by revenue figures in July. The governor’s re-election and ballot support from voters in 2006 did not provide sufficient political capital to influence fellow Republicans in the Senate. Consequently, while the budget looks balanced, it is probably out of balance by at least $2-3 billion. The precarious state of the state’s revenues rests on budget solutions that are uncertain:

- The proposed $1 billion for the sale of Edfund
- The use of Public Transportation Account funds for general fund expenditures which may be rejected by the courts
- Cuts in Cal WORKS COLA that may be rejected in court
- Anticipated revenue from Indian gaming contracts that have not been implemented by the tribes

Consequently spending initiatives (see Table 7) dissolved. While the legislature passed some initiatives, the governor eliminated them using the line item veto which was the condition imposed by Senate Republicans for their budget support after a 51 day delay. The savings that cannot be challenged are those that cut health, education and welfare support to the old, poor, ill and youth.

The budget battle was particularly bitter in 2007. In part, the bitterness was due to significant ideological divisions between Senate Republicans versus the governor and the Democratic legislative majority. The other key factor was declining revenues. Both factors will likely define the budget process for years to come.
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