



## ***2011-12 May Budget Revision Analysis***

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On Monday Governor Brown released the 2011-12 May Budget Revision. The governor addressed his plan to close the remainder of the state's \$25 billion budget deficit estimated to be approximately \$12 billion. The governor continued with a similar theme initiated in the January Budget Proposal; a budget proposal balanced with expenditure reductions and revenues while prioritizing public education and public safety. The following is ACSA's analysis of the May Revision and the next steps necessary for the Legislature to pass a balanced budget.

### **What is the May Revision?**

Historically, the May Revision is an update to the Governor's January Budget Proposal. The document is an annual event that marks the "real" start of the budget development process because it contains up-to-date revenue projections that include April tax receipts. The Legislature will use the proposal as a benchmark for determining how to balance the 2011-12 budget and would "kick start" the budget deliberation process in an effort to enact a budget by the June 30 deadline. The governor initially wanted to finalize the budget in 60-days or by March in order to place a tax extension measure before the voters in June. The failure of the Legislature to pass the governor's January plan has forced the governor to conduct a more traditional budget process through the May Revision.

The governor's revision stays true to his January theme of solving the current budget deficit with a combination of programs cuts and tax revenues. Further, he continues to mention the importance of prioritizing public education and public safety. In addition, the governor is focused on placing some initiatives before the voters to ratify an extension of tax revenues. While many capitol insiders have stated that there is a "deal" it is unclear what or when that "deal" will be finalized. Even with a majority vote threshold to pass the budget, it is unclear whether the state will adopt a budget by the constitutional deadline. Advocacy for K-adult education funding will be paramount as the budget negotiations heat up and the constitutional deadline quickly approaches.

## **May Revision Overview**

In January the state was projected to have a budget deficit of \$25.4 billion. However, in March, the Legislature adopted and the governor signed various budget measures which included \$13.4 billion in solutions. These solutions included \$11 Billion in program cuts, and \$2.4 billion in other solutions such as changes to the State Supplementary Program, reducing CalWORKs grants, decreasing inmate populations, closing state parks, reducing state employee payroll and eliminating the Adult Day Health Care program. All of these solutions helped close the deficit from \$25 billion down to \$12 billion.

California's economy is showing some signs of recovery from the most recent recession. This is represented by higher than expected revenues. The revenues have increased beyond estimates by \$6.6 billion over a two year period. There is an increase in the current year (2010-11) of \$2.8 billion and therefore a higher estimated level of revenues in the budget year (2011-12) of \$3.5 billion.

The combination of the solutions acted on in March, higher than expected revenues and updated spending projections have shrunk the state deficit to \$9.6 billion. This includes \$4.8 billion in the current year and \$4.8 billion in the budget year. The governor wants to provide a budget reserve of \$1.2 billion which pushes the deficit to \$10.8 billion. However, the May Revision notes that even with the solutions from March, the state budget still contains an ongoing structural deficit of \$10 billion.

## **Proposition 98**

Consistent with the governor's honest and transparent budgeting, the May Revision provides additional funding for Proposition 98 due to the increase in state revenues and the governor's proposal to extend the temporary revenues for five years. The increase in revenues increases the minimum guarantee by \$3 billion. The Proposition 98 minimum guarantee increases from \$49.4 billion that was adopted in March to \$52.4 billion. The administration acknowledges that this brings the guarantee to a level that is the highest it has been since 2007-08 and believes that this effort will begin to restore the disproportionate budget reductions schools and community colleges have endured the past several years.

The May Revision also makes adjustments for the 2010-11 fiscal year by increasing the guarantee \$100 million. This increases the Proposition 98 funding from \$49.7 billion to \$49.8 billion. Note that Proposition 98 was suspended in the 2010 Budget Act. In addition, the guarantee for 2009-10 is calculated to be \$51.1 billion; however, the funding amount is \$49.9 billion. The difference between the funding amount and the budgeted amount will create a settle-up obligation owed to schools in future years.

In addition to funding a higher guarantee amount, the administration proposes two funding increases to the minimum guarantee. The first is a “rebenching” of Proposition 98 and an increase of \$629.6 million to ensure that education funding is held harmless in the shift in motor vehicle fuel revenues also known as the “gas tax swap.” The other increase is the shift of responsibilities under AB 3632 services. This results in an increase of \$221.8 million.

### **Program Changes**

AB 3632 Mental Health Services – The May Revision proposes to shift the responsibility of providing mental health services from county mental health agencies and county welfare agencies to school districts. This shift includes out-of-home residential services and removes mental health services from the governor’s realignment plan. As mentioned above, Proposition 98 is increased by \$221.8 million to pay for these services. In addition, the May Revision provides \$98.6 million in Proposition 63 funds (the Mental Health Services Act) to county mental health on a one-time basis in 2011-12. The administration notes that the existing system that reimburses counties for mental health services lacks accountability and the shift back to schools will provide greater cost containment and provide a better connection to mental health services and student educational outcomes.

Deferrals – The budget bills adopted in March included a deferral of \$2.1 billion. The May Revision proposes to eliminate this deferral and add an additional \$434 million to reduce other existing deferrals.

California Longitudinal Pupil Achievement Data System (CALPADs) and California Longitudinal Teacher Integrated Data Education System (CALTIDES) – The May Revision eliminates all funding from both CALPADs and CALTIDES. This equates to a reduction of approximately \$3.4 million in federal funding. The governor notes that he is proposing to reform the state’s testing, accountability, and data collection systems. The governor intends to engage school leaders, teachers, parents and scholars to look at how to reduce the amount of time devoted to testing, eliminate data collections that fail to provide useful information and restore power to school administrators, teachers and parents.

State Mandate – The May Revision proposes to eliminate some state mandates and implement some reforms proposed by a working group charged with mandate reform. This provides a savings of \$38.2 million. In addition, the administration proposes to streamline future mandate funding through a block grant approach.

Charter schools – An increase of \$19.5 million for Charter School Categorical Block Grant and Economic Impact Aid caseload growth

New Charter Schools – An increase of \$8 million to provide charter schools that commenced operations between 2008-09 and 2011-12 with supplemental categorical funding, in lieu of categorical funding they are no longer able to apply for under current categorical flexibility provisions.

Clean Technology and Renewable Energy Training – An increase of \$3.2 million to support the Clean Technology and Renewable Energy Job Training, Career Technical Education and Dropout Prevention Programs, which creates school business partnership that provide occupational training for at-risk students in areas such as conservation, renewable energy and pollution reduction.

County Offices of Education – An increase of \$14.6 million in 2010-11 and \$13.9 million in 2011-12 for updates to unemployment insurance, PERS, average daily attendance growth, and deficit factor adjustments.

Special Education – Funding caseload growth with an increase of \$399,000.

Proposition 10 – First 5 Reserves – The governor originally proposed to place on the ballot an initiative to allow the state to use First 5 reserves for other purposes. The governor's plan would use \$1 billion in Proposition 10 funds to fund Medi-Cal services for children through age five. The May Revision eliminates this proposal.

Child Care and Development – The May Revision decreases funding to child care and development programs by \$97.2 million to reflect adjustments based on caseload costs for CalWORKs stage 2 and stage 3 child care from March reductions and federal funding offsets. The administration is setting aside \$33.6 million pending the receipt of updated caseloads data from the Department of Education.

## **Revenues**

The May Revision proposes to maintain the current level of tax rates for Sales and Use tax and vehicle license fee for five years and the dependent exemption credit for five years. It also proposes to reinstate the Personal Income Tax surcharge adopted in 2009 for four years beginning in 2012. The governor still maintains that he will place any extension of revenues before voters to approve.

In addition to extending current tax rates, the administration proposes the following changes in the tax code to encourage job growth and economic development:

- The adoption of mandatory single sales factor apportionment, which was also in the governor's January budget proposal.
- Reform, rather than repeal, of the Enterprise Zone tax provision to make them more efficient in creating incentives for economic development.
- An expansion of the new jobs credit.
- Partial sales tax exclusion for purchase of manufacturing equipment.

## **Borrowing**

The governor has noted the need to extend revenues for several reasons. One reason is to preserve and prioritize public education and public safety. The other reason is to reduce the state's debt service. The governor characterizes debt in a variety of ways. This includes future annual payment obligations, outstanding budget borrowing and retirement liabilities.

Future annual payment obligations cost the state approximately \$13.6 billion. This obligation includes paying back the Proposition 98 maintenance factor and unemployment insurance debt to the federal government and debt service on general obligation bonds. The outstanding budget borrowing equates to \$34.7 billion and includes obligations such as education deferrals and settles up payments, deferred payments to CALPERS and payroll costs, borrowing from transportation funds and local government and economic recovery bonds. The debt owed from pension liabilities equals approximately \$181 billion. This includes liabilities for retiree health and the pension systems for state employees, teachers, University of California employees and judges.

In an effort to demonstrate the need to reduce the debt and borrowing structure of the state budget, the governor proposes to eliminate the deferral to schools and community colleges (\$2.2 billion) and \$2.9 billion in borrowing from special funds.

## **Alternative Budget**

The governor noted in the May Revision that a failure to follow a balanced approach to the budget will result in an all cuts budget or a continuation of gimmicks and cuts. He noted that public education, public safety and health and human services would take significant reductions. The governor acknowledged that K-12 and community colleges would need to take deep reductions requiring a suspension of the Proposition 98 minimum guarantee in the budget year and in subsequent years. In addition, it would likely be necessary to make a reduction of at least \$5 billion which equates to almost \$825 per ADA, eliminating 4 weeks of school, laying off thousands of school employees and increasing community college fees from \$36 to \$125 per unit.

An all cuts approach would cause several changes to the criminal justice system including eliminating supervision for non-serious, non-violent parolees and eliminating several programs administered by the Department of Justice. Further, an all cuts budget would eliminate several services for IHSS, capping Medi-Cal coverage and eliminating programs such as Adult Protective Services.

While the governor acknowledges that an all cuts approach is an alternative, he notes that this approach is damaging to California. The governor adds that it is more responsible to balance the budget with revenues and reductions while protecting public education and public safety.

## ACSA Perspective

The overall construct of the budget demonstrates that the governor is focused on the issues most important to the public: education and public safety. The governor throughout his tenure continues to speak about the importance of prioritizing public education and public safety. His May Revision reflects this philosophy. With that said, there are still some questions regarding his proposed changes outlined in the May Revision. For example, the shift of responsibility for AB 3632 mental health services from county mental health to school districts is a major shift that may take some time for implementation. Further, it is unclear what direction the governor wants to proceed as it relates to testing, accountability and the use of data. It is clear he wants reform, but it is not clear exactly what that reform would entail.

While the budget saves education from reductions, the budget is still built on the extension of revenues. Even though the state is receiving an uptick in General Fund revenues, there is still a need to extend tax revenues to close the deficit. Without the revenues, it is clear the governor is willing to move forward with an all cuts approach which would devastate public education. It is not clear whether there are the necessary votes available to pass a revenue extension. Further, it is not clear if the public believes an extension is necessary given the increase in General Fund revenues. This puts a possible ballot measure in jeopardy.

To add an additional wrinkle to the budget conversation, the Assembly Republican Caucus released a budget proposal to close the remaining deficit. The proposal relied on no tax increases but preserved funding for public education. The proposal went so far as to state that the Caucus will not vote for a suspension of Proposition 98. Expect to have the budget conversation heat up as summer approaches.

## What you can do

**School leaders must stay active and continue advocacy efforts to ensure that funding to public education is preserved.** Continue to meet with legislators, write letters to legislators and the governor, write letters to editors, and create media events to discuss your district's budget situation. It is important that school leaders demonstrate the devastating cuts that could result if the Legislature fails to extend the revenues or prioritize public education. It is important to share those stories of programs that help children succeed and, what has, and will be lost if the budget deficit is not solved with a revenue extension. An "all cuts" budget is unacceptable.