
CALIFORNIA BUDGET REPORT

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COMING SOON TO THE STATE CAPITOL...

TERMINATOR 4: BATTLE OF THE UNIVERSE

Governor Arnold Schwarzenegger released his proposed 2005-2006 budget today with an optimism that appeared to deny the enormous political forces that will soon rise up against his various proposals. Though last week's "State of the State" speech served notice, interest groups from all over the political universe—state employees, teachers, the disabled, etc.—will be girding for fierce battle now that more details are public.

Sacramento Bee columnist Dan Weintraub has wondered in print whether Schwarzenegger would take bold steps in 2005, and here's his answer. While it remains to be seen whether the Governor will compromise away his budget proposals as he did with his spending cap proposal last year, the Governor's budget will anger some of the most powerful groups in the state. Even his friends in the business community are likely to be unhappy about the transfer of funds from the sales tax on gasoline to cover the General Fund shortfall.

The Governor's budget attempts to confront the estimated \$8.4 billion gap in the so-called workload budget while providing for a \$500 million General Fund Reserve, meaning a need of some \$9 billion in "cuts" and other mechanisms. Cuts, of course, is a relative term; when we speak of cuts, we mean reductions in spending that would otherwise occur given the laws and regulations on the books. Overall state spending will actually increase by more than 4 percent across the board. The Governor's "cuts" usually restrain growth in certain programs to achieve "savings."

As the Governor and Finance Director Tom Campbell freely admit, they propose to close much of the budget gap with strategies we've all seen before: bonded indebtedness, borrowing from other revenue sources and, frankly, stealing money designated for other purposes. While some folks will call this cowardly in that the Governor has avoided taxes or long-term structural changes, others will have to admit that by taking on public employees, teachers, the disabled and the Democrats (don't forget his redistricting proposal) *in the same year*, and threatening to go to the ballot with his proposals, the Governor is being a bit daring, to say the least, and will need to fight off the loud and bitter opposition from all sides with supernatural action hero powers.

Here's how the closure of the budget gap breaks down, in terms of the major pieces:

Proposition 98 Suspension:	\$2.284 billion
Proposition 42 Transfer:	\$1.3 billion
Economic Recovery Bonds:	\$1.683 billion
CalWORKS Grant Reduction:	\$ 449 million
Medi-Cal Fund Shifts, etc.:	\$ 260 million
SSI/SSP COLA Suspension:	\$ 259 million
IHSS Wage/Benefit Rollback:	\$ 195 million
General Government Cuts	\$ 928 million
Education Program Cuts:	\$ 543 million
Resources	\$ 475 million
Youth & Adult Correctional	\$ 272 million
Miscellaneous	\$ 20 million
Revenue Issues	\$ 409 million
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	\$9.092 billion

Nearly 60 percent of the gap is closed by the first three items, the most controversial being the Proposition 98 move, which the education community will decry as betrayal and treason. Of the remaining policy changes, several will impact the disabled and the poor, including the SSI/SSP and IHSS cuts, a \$1,000 annual limit on Medi-Cal dental benefits and the imposition of monthly premiums for certain individuals in the Medi-Cal program. Expect to see Johnny Burton back in the building. The advocates for those Medi-Cal beneficiaries affected are also likely to oppose the Administration's effort to move the aged, blind and disabled into managed care, a proposal that has been circulating some time because of its potential to reap big savings.

In addition, public employees will be out marching. Embedded in the "cuts" are savings expected not only from the proposal to reform state employee pensions but also savings of \$469 million by shifting responsibility, from the state to local school districts and their employees, for contributions to the California State Teachers' Retirement System defined benefit program. That's not all: There is a proposal to allow the Governor to authorize a five-day furlough for all state employees (except public safety of other certain areas) to save up to \$109 million, a change in the calculation of leave time, changes in the way health benefits are funded, and the elimination of two paid holidays.

The budget also unveiled more detail about the Governor's proposal to "reform the budget system" as he put it in his state-of-the-state speech. Called the Governor's Budget Control Proposal, this set of reforms would, according to budget documents, effectively amend last year's Proposition 58 to do the following:

- *Require* (instead of merely permit) the Governor to call a special session whenever the Director of Finance informs the Governor that state spending is likely to exceed available revenue.
- Provide that if the Legislature fails to send the Governor a budget by June 15, the appropriation levels in the prior year's budget would remain in effect until a new budget is enacted.

- Requires the State Controller to implement an across-the-board reduction in all state payments (except for debt service and other cuts that would violate the federal constitution) if the Legislature fails to act within the 45-day period specified for special sessions under Proposition 58.

The Budget Control Proposal would also, interestingly enough, include the following:

- Proposition 98 reform. That reform would, ironically, eliminate the ability to suspend Proposition 98, but also tinker with Proposition 98 funding levels.
- Proposition 42 reform, which would allow the state to suspend Proposition 42 for two more years, through 2006-2007, but then remove from the Constitution the ability to suspend Proposition 42 in future years. And all of the transfers that are suspended will be treated as loans.
- Special funds reform, in which borrowing from special funds to solve budget gaps will be prohibited.

The Budget Control Proposal is fascinating not only because the Governor is proposing to prohibit the very budget strategies he is employing this year and last, but also because he has, at the same time, decried a “budget system” that puts state spending on autopilot and turns the Legislature into “clerks.” If he succeeds in prohibiting these assorted fund thefts—whoops, we mean shifts—and other borrowing, the Governor will have permitted more “autopilot,” limited his flexibility to respond to crises and possibly painted himself into a corner where taxes are the only way out.

Of course all of this will meet with tremendous resistance and criticism in the Legislature, making for a tumultuous and uncertain year if the Governor fails to achieve his biggest budget strategies without going to the ballot. Without any other options that would garner the necessary two-thirds vote of the Legislature, we may see a budget stalemate until after an ugly campaign and popular vote.

Lost in the raucous combat of this legislative session will be the fact that the state does have to get serious about its finances. Very serious. Tom Campbell is a serious guy; there are some serious ideas here. At the same time, we wonder what Assemblymen Keith Richman and Joe Canciamilla will do in response to this budget and its likely political fallout. Now that both free-thinking legislators have fewer committee assignments, they have oodles more time to toy with the budget and other big questions of public policy. One can only wait.

Before we go, we have summarized for you the Medi-Cal redesign program, which is one of the elements of the budget that has significant policy interest for certain folks. We’d like to hear your reactions to the various proposals and the outcome you predict.....

Medi-Cal Redesign

Shelved last year, the long-awaited Medi-Cal redesign plan looks a lot like what was initially set forth by the Administration. The key elements, to be phased in over 18 months, are as follows:

- Moving 262,000 parents and children into Medi-Cal managed care plans in 13 additional counties, a move that the managed care plans will applaud and that might not draw as much opposition from the beneficiary advocates as in years past.
- Enroll 554,000 aged, blind and disabled into managed care plans in all counties in which managed care is available (currently eight counties already, available in another 14 currently, and another 13 after the redesign changes). This proposal will likely be strongly opposed by the disability community. Without some accommodations, it may not get out of the Legislature.
- Implement Acute and Long-Term Care integration projects in three counties.
- Limit Medi-Cal Dental Care to \$1,000 in benefits annually. The fees paid in the program, however, are so low that \$1,000 goes a long way.
- Impose a \$4 premium for each child under 21 and \$10 per month for adults, up to \$27 monthly per family, for beneficiaries in certain income categories.

It is likely, however, that the managed care pieces—in particular the aged, blind and disabled component—are contingent upon the state negotiating a new five-year hospital financing waiver, which has been in the works for some time. Last year’s shelving of the redesign was, rumor has it, largely caused by the fact that more than \$1 billion in federal funds to hospitals was at risk if the aged, blind and disabled were placed in managed care plans. Federal law provides for certain funding streams to hospitals for Medi-Cal patients, but does not provide those monies when the patients are managed care patients. The state has indicated that this waiver is in the works; whether the state succeeds at protecting those vital federal dollars will be critical to whether redesign proceeds as planned.

The redesign, however, is scored at only \$12 million in savings for the 2005-2006 budget year, which is not surprising given the implementation timeframe. But when fully implemented, the Administration estimates that the redesign will save \$287 million annually (\$145 million General Fund).

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