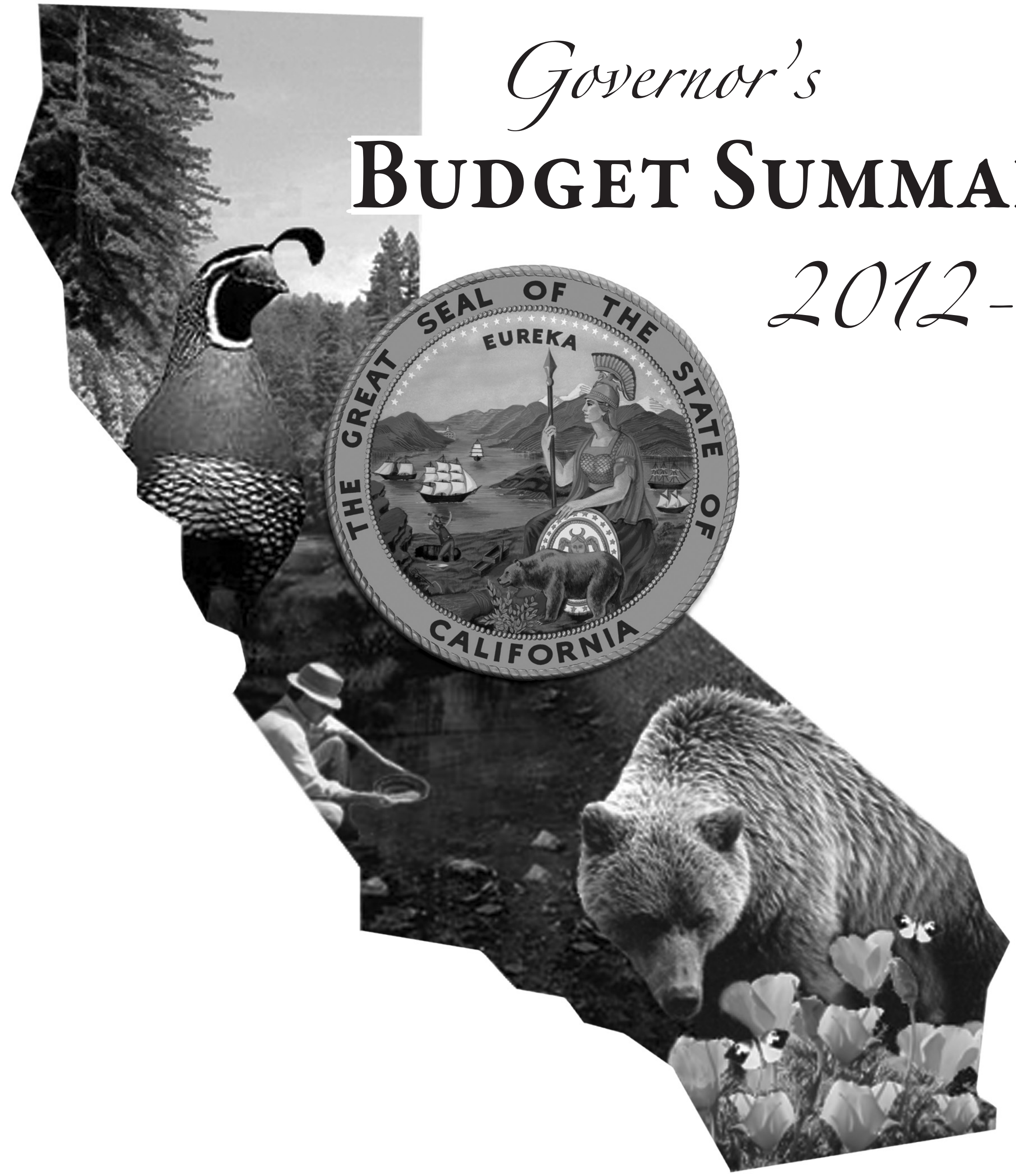
Governor's
BUDGET SUMMARY
2012-13



EDMUND G. BROWN JR.
GOVERNOR

To the California Legislature
Regular Session 2011-12

State of California

Governor
Edmund G. Brown Jr.

January 10, 2012

To the Senate and the Assembly of the California Legislature:

I hereby submit to you my proposed Budget for 2012-13.

When I came into office, California was facing an immediate $26.6 billion budget gap and future budget deficits of $20 billion a year.

In January of 2011, I proposed a budget that combined deep cuts with a temporary extension of some existing taxes. It was a balanced approach that would have finally closed our budget gap. In the end, the taxes were not extended and massive cuts — totalling $16 billion — were enacted.

The 2011 budget did, however, lay the foundation for fiscal stability. It cut the annual budget shortfall by three-quarters — from $20 billion to $5 billion or less. It shrunk state government, reduced our borrowing costs and gave local governments more authority to make decisions.

The budget that I am submitting today keeps the cuts made last year and adds new ones. The stark truth is that without some new taxes, damaging cuts to schools, universities, public safety and our courts will only increase.

That is why I will ask the voters to approve a temporary tax increase on the wealthy, a modest and temporary increase in the sales tax and to guarantee that the new revenues be spent only on education. I am also asking that the voters guarantee ongoing funding for local public safety programs. This ballot measure will not solve all of our fiscal problems, but it will stop further cuts to education and public safety and halt the trend of double-digit tuition increases.

My budget plan also includes important reforms. It improves government efficiency and pays down debt. It reorganizes state government to make it more efficient and saves tax dollars by consolidating or eliminating functions. It restructures social service programs to better support working families. It gives substantially more flexibility and decision-making to local school districts. The plan also calls for bold investments in our future: to assure a reliable water supply, build high speed rail and reduce greenhouse gas emissions.

As California's economy continues to slowly recover — and recover it will — our plan will provide fiscal stability and make California government more transparent and responsive to the people.

I look forward to working with you in the coming year.

Sincerely

Edmund G. Brown Jr.

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Introduction

California's fiscal condition is improving. A year ago, the state faced an immediate $26.6 billion shortfall and future estimated annual budget gaps of $20 billion. This year, the state faces a $9.2 billion budget problem and future annual budget gaps of $5 billion or less.

The on-time 2011 Budget Act balanced the budget by cutting billions of dollars in spending and realigning state programs. This year, the Governor's Budget proposes a balanced solution by cutting more deeply into spending while also increasing revenues. The Governor will ask voters in November to approve a Constitutional Amendment to prevent deep cuts to education and guarantee funding for public safety at the local level.

The Budget builds on last year's progress by continuing to move government closer to the people, protect education and public safety programs from the worst of the cuts, improve government efficiency, and pay down debt. The balanced budget will provide fiscal stability, make California more attractive for business and investment, and accelerate the state's economic recovery.

Substantial Progress Has Been Made

The enacted 2011 Budget made substantial progress in stabilizing California's finances. It rejected the past approach of over-relying on one-time solutions and instead substantially shrank the ongoing deficit.

The accomplishments of the 2011 Budget include:

- Passing an on-time budget that avoided the gimmicks of prior budgets.
- Closing three-quarters of the state's chronic structural budget gap. A year ago, the gap stood at about $20 billion and is now $5 billion or less.
- Adopting an historic realignment of public safety that brings government closer to the people.
- Protecting education, public safety, and other core state services to the extent possible, absent adoption of the proposed tax extensions.
- Eliminating redevelopment agencies to increase funding for schools, police, fire, and other core local services.
- Reducing the state's cash-flow borrowing from $10 billion to $5.4 billion and saving hundreds of millions of dollars in short and long-term borrowing costs.
- Improving management of the state's infrastructure projects by committing available cash to shovel-ready projects and avoiding unnecessary debt.
- Shrinking state government and making it more efficient by reducing the state workforce by more than 15,000 positions and eliminating 20 boards, commissions, task forces, offices, and departments.

Maintaining a Balanced Budget Is an Ongoing Challenge

While the passage of the 2011 Budget made substantial progress in restoring fiscal stability to the state, major challenges and threats remain. Achieving savings and controlling costs, especially in the areas of health and human services and corrections, are particularly challenging.

Last year, the Governor and the Legislature agreed to about $5 billion in cuts to health and human services programs. Many of these cuts—such as reducing CalWORKs grants to below their 1987 level—have already been implemented. Other cuts, however, have been blocked by the courts. For example, a portion of the Medi-Cal provider rate reductions has been enjoined. In other instances, the federal government has rejected or delayed timely implementation—both copayment requirements for Medi-Cal beneficiaries and expanding the sales tax to personal care services have yet to be approved. Each cut that cannot go into effect further strains the state's budget and requires deeper cuts.

In corrections, federal courts control many aspects of spending, including medical, mental health, and dental care, as well as disability access. The Administration continues to work to demonstrate compliance with legal requirements and return control to the state. 2011 Realignment is the cornerstone of achieving compliance with a U.S. Supreme Court decision ordering California to reduce state prison overcrowding. It will help end the costly revolving door of lower-level offenders and parole violators through the state's prisons. This reform will reduce the Department of Corrections and Rehabilitation's budget by 18 percent—$1.1 billion in 2012-13—and yield higher savings in the future. To achieve the budget target, Corrections will need to stay on track with its savings plan and overcome legal and other impediments as they materialize.

The State's Budget Problem

Slow Economic Recovery Continues

At the time of the 2011 May Revision, the state's economy was picking up steam, reflected in rising revenue collections. Since then, two events have slowed that progress—the federal debt limit debate and the European fiscal crisis. Consequently, the Budget forecasts that the economic recovery from the recession will continue at a slow pace.

The employment bounceback from this very severe recession has been so weak that the state's job level will not reach its pre-recession level until 2016. This slow jobs recovery, due in part to a housing market that remains mired in a slump, continues to take its toll on state revenues.

Baseline General Fund revenues are projected to total $89 billion in 2012-13. Five years after the recession, state revenues are below their peak and tens of billions of dollars below the level expected prior to the recession. General Fund revenues are not projected to return to their 2007-08 level until 2014-15.

Uncertainty and Significant Risks Remain

Risks to the Budget remain. The state faces a "wall of debt," pension liabilities, other increasing annual obligations, and potential cost increases associated with the federal deficit.

While budget estimates are always subject to some change, accurately forecasting revenues and expenditures is particularly challenging now, given the level of economic uncertainty. In particular, forecasting income for high income tax payers is difficult. During the economic recovery, income among top earners has grown at a much faster rate than income among all other groups. In 1980, the top one percent of taxpayers had about 10.5 percent of total income. This percentage has ebbed and flowed over time, but the trend has been upward. For 2010, data suggest that this group had over 22 percent of total state income. The Budget forecasts that income for top earners will continue to recover and grow at a faster rate than the income of all other earners. Differences in projections for wage growth are one reason why the Legislative Analyst's Office forecasts revenues $3 billion lower in 2012-13 than the budget estimate.

Actions at the federal level and demographic trends threaten to increase costs. Efforts to close the federal budget deficit will likely increase state costs and may reduce revenues. The population over the age of 65 is growing at approximately three times the rate of growth of the working population and seven times the rate of growth of the school and college-age group. At the same time, the income and assets of retirees and those nearing retirement are declining and becoming more uncertain. Reduced income levels of seniors will further increase the demand for government services—particularly health and human services programs.

Defining the Budget Gap

At the time Governor Brown signed the 2011 Budget, it was expected that the state would face a budget problem of less than $5 billion in 2012-13. A major contributor to this budget gap was the reduction in sales tax and vehicle license fee rates that went into effect on July 1, 2011.

The Budget projects a 2012-13 budget problem of $9.2 billion. This is the result of several developments:

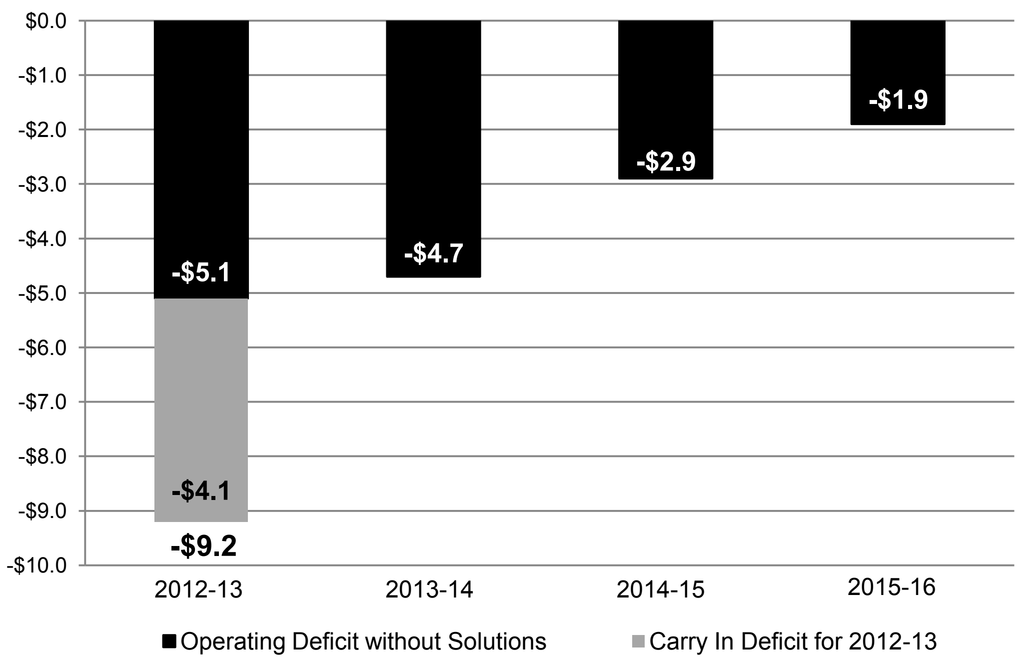
- The problem left over from the prior year is $1.9 billion worse than expected in June of 2011.

- Court orders and delayed federal approval related to several budget-balancing cuts in the health and human services area have increased costs by nearly $2 billion.
- National and international economic developments have pulled state revenues downward for 2011-12. This revenue loss is partially offset by lower costs for Proposition 98 and the implementation of "trigger" spending reductions in the current year.
- The elimination of redevelopment agencies, recently validated by the California Supreme Court, results in less General Fund savings in 2011-12 but significantly greater savings going forward, beginning in 2012-13.

The Budget projects that the state will end 2011-12 with a deficit of $4.1 billion. Absent corrective actions, it is projected that the state would spend $5.1 billion more than it takes in during 2012-13. Combined, the state faces a $9.2 billion budget problem.

The 2011 Budget was primarily comprised of ongoing solutions. Consequently, the size of the state's structural budget deficit has been reduced significantly, from roughly $20 billion annually to $5 billion or less each year. Figure INT-01 shows the current size of the budget problem through 2015-16.

Figure INT-01
Structural Budget Deficit
Dollars in Billions



Closing the Budget Gap

The Budget proposes a total of $10.3 billion in cuts and revenues to balance and to rebuild a $1.1 billion reserve. These proposals, summarized in Figure INT-02, are estimated to eliminate future budget problems throughout the forecast period under current projections.

Figure INT-02

Budget Balancing Proposals

(Dollars in Millions)

Expenditure Reductions	
Health and Human Services	
CalWORKs	$946.2
Medi-Cal	842.3
In-Home Supportive Services	163.8
Other Health and Human Services Programs	86.9
Education	
Proposition 98	544.4
Child Care	446.9
Cal Grant Program	301.7
Other Education	28.0
All Other Reductions	
State Mandates	828.3
Other Reductions	27.3
Total Expenditure Reductions	**$4,215.8**
Revenues	
General Fund Revenues	
Temporary Taxes	$4,400.8
Other General Fund Revenues	88.8
Special Fund Revenues	
Gross Premiums Insurance Tax on Medi-Cal Managed Care Plans	161.8
Total Revenues	**$4,651.4**
Other	
Loan Repayment Extensions	$630.5
Unemployment Insurance Interest Payment	417.0
Additional Weight Fee Revenues	349.5
Suspend County Share of Child Support Collections	34.5
Total Other	**$1,431.5**
Total Solutions	**$10,298.7**

Additional Difficult Spending Cuts

The 2011 Budget cut General Fund spending as a share of the economy to its lowest level since 1972-73. State Supplementary Payment grants were reduced to the level in effect in 1983. CalWORKs grants were reduced to below the level in effect in 1987. State support for its universities and courts was cut by about 25 percent and 20 percent, respectively. The Adult Day Health Care program, redevelopment agencies, Williamson Act subventions, Home-to-School Transportation, and the refundable child care and dependent tax credit were all eliminated. The Department of Corrections and Rehabilitation's expenditures will be reduced by approximately 18 percent once realignment is fully implemented. K-14 education funding remains $9 billion below the funding level in 2007-08.

The Governor is seeking additional tax revenues to mitigate the need for the deepest of cuts. However, these revenues will not be sufficient to close the entire budget gap. Among the difficult actions necessary to balance the Budget are:

- Refocusing CalWORKs and subsidized child care by increasing income support to working families and reducing assistance to families who are not meeting work requirements. (Savings of $1.4 billion)
- Merging service delivery for those who are eligible for both Medi-Cal and Medicare. This will reduce costs and improve the coordination of services. Additional savings will be achieved by other changes. (Savings of $842 million)
- Eliminating domestic and related In-Home Supportive Services for recipients in shared living arrangements. (Savings of $164 million)
- Eliminating supplemental funding for schools associated with the elimination of the sales tax on gasoline and making other Proposition 98 adjustments. (Savings of $544 million)
- Reducing grant amounts for students who attend private institutions and making other reductions to the Cal Grant program. (Savings of $302 million)
- Repealing, making permissive, or suspending many state mandates on local governments that are unnecessary and burdensome. (Savings of $828 million)
- Expanding the alternative custody program for female inmates. This will allow the state to further reduce its prison population and focus more dollars on services. (Savings of millions of dollars in future years)

Implementing many of these proposals will require months of lead time to generate budget savings. If they were adopted on July 1, less than a full year of savings would be generated in 2012-13, and additional cuts would be needed. Similar to last year, the Budget assumes that a portion of its proposals will be adopted by the Legislature by March 1, 2012.

Other budget proposals include the continuation of the use of weight fees to offset future General Fund costs connected with transportation expenses (savings of $350 million). In addition, funds will be borrowed from the Unemployment Compensation Disability Fund to pay the federal government for interest costs on the outstanding Unemployment Insurance loan. In future years, these interest costs will be paid from a proposed surcharge on employers.

Temporary Taxes to Protect Education and Public Safety

The Budget assumes the passage of the Governor's proposed initiative at the November election. This measure temporarily increases the personal income tax on the state's wealthiest taxpayers and temporarily increases the sales tax by one-half percent. The measure guarantees these new revenues to schools and constitutionally protects the 2011 Realignment funds for local public safety. It will generate an estimated $6.9 billion through 2012-13. After accounting for the increased Proposition 98 minimum guarantee, it will provide $4.4 billion in net benefit to the General Fund budget. The measure will prevent deeper cuts to schools, protect local public safety funding, and assist in balancing the budget. The revenues will allow the state to invest in higher education and to pay off the $33 billion in outstanding budgetary borrowing and deferrals by 2015-16.

Alternative to Taxes Is Even Deeper Cuts

The California Constitution requires that the annual state budget be balanced. To pay the state's bills on time, the budget must be credible and financeable. The Budget proposes a backup plan if the ballot measure is not approved. The plan specifies $5.4 billion in cuts affecting education and public safety — the areas protected by the Governor's initiative. These ballot trigger cuts, summarized in Figure INT-03, would go into effect on January 1, 2013:

- Funding for schools and community colleges would be reduced by $4.8 billion. A reduction of this magnitude would result in a funding decrease equivalent to more than the cost of three weeks of instruction. It would also continue to provide

20 percent of program funds a year in arrears. The savings would be achieved through the reduction in the Proposition 98 minimum guarantee that would result from the loss of the revenues. The costs of general obligation bond debt service for K-14 facilities would be shifted into the guarantee, thereby reducing other General Fund costs.

- The University of California and California State University would each be reduced by $200 million.
- The courts would be reduced by $125 million, the equivalent of court closures of three days per month.
- The number of the state's public safety officers in the departments of Parks and Recreation (park rangers) and Fish and Game (wardens) would be reduced, and the state would no longer staff its beaches with lifeguards.
- The Department of Forestry and Fire Protection's firefighting capabilities would be reduced substantially. The emergency air response program would be reduced, and fire stations would be closed.
- Flood control programs in the Department of Water Resources would be cut, which would reduce channel and levee maintenance and floodplain mapping.
- The Department of Justice's law enforcement programs would be reduced.

Figure INT-03

Ballot Trigger Reductions
Effective January 1, 2013
(Dollars in Millions)

	2012-13
Expenditure Reductions	
Proposition 98	$4,836.9
University of California[1/]	200.0
California State University[1/]	200.0
Courts	125.0
Department of Forestry and Fire Protection	15.0
Flood Control	6.6
Fish and Game: Non-Warden Programs	2.5
Fish and Game: Wardens	1.0
Park Rangers	1.0
Park Lifeguards	1.0
Department of Justice	1.0
Total Ballot Trigger Reductions	**$5,390.0**

1/ This level of savings may be offset by Cal Grant increases if the universities raise tuition.

Moving Government Closer to the People

The 2011 Realignment shifted various public safety programs closer to the people and provided an ongoing funding source for these programs. Because counties can better serve lower-level offenders at a lesser cost, the state has begun a major reduction in the size of the state prison system. In 2012-13, state correctional costs will be reduced by $1.1 billion to reflect the smaller prison population. Further reductions will occur in future years. The Budget proposes a permanent structure and revenue allocation mechanism for realignment.

The Budget provides local schools with enhanced flexibility to manage their finances and gives greater control to local decision-makers. Specifically, for K-12 schools, almost all funding (excluding federally-required programs, such as special education) would be allocated on a single formula that takes into account a school's number of students and the concentration of English learners and pupils eligible for free and reduced-price lunches. This funding approach will give school districts a significant new tool to target limited resources without being hampered by numerous rules and regulations. This flexibility, coupled with local accountability measures, will enhance transparency and support improved educational outcomes.

Several proposals in the Budget lay the foundation for further realignment. For example, the CalWORKs and child care restructuring emphasizes support for those individuals who meet federal work requirements. Counties will be the leaders in implementing these changes. As the state implements federal health care reform, there will be a natural shift of health care costs from the county indigent health system to Medi-Cal. In the future, it will make sense for the state to assume more responsibility for health care funding, while shifting other programs to the local level.

Meeting Long-Term Challenges

In addition to balancing the Budget, the Governor's plan sets forth a path to meet California's long-term fiscal challenges.

Reforming Pensions

Retirement costs for state and local government employees and retirees threaten the long-term viability of government finances. Specifically, the state faces unfunded pension obligations of $45.2 billion and unfunded retiree health obligations of $59.9 billion. In October, the Governor unveiled a 12-point pension reform plan to put the state on a more sustainable path to providing public retirement benefits. When fully implemented, these reforms will cut roughly in half the cost to taxpayers for providing pension benefits to state employees. It will also dramatically reduce the risk for future pension debts.

Shrinking State Government

The 2011 Budget eliminated 20 entities as a first step in making state government smaller, more efficient, and more focused on core activities. The Budget reflects the Governor's continuing efforts in this area by proposing the elimination and consolidation of 48 boards, commissions, programs, and departments. In addition, the Budget proposes a major reorganization of remaining entities. By making government's organization more sensible, the state can better provide services to the public.

Paying Down the Wall of Debt

The state's current budget problem is exacerbated by an unprecedented level of debts, deferrals, and budgetary obligations. At the time of the 2011 May Revision, a total of $34.7 billion in budgetary borrowing was identified. By the end of 2011-12, this amount will total $33 billion, as shown in Figure INT-04. The state also has large outstanding bond balances.

Figure INT-04

Outstanding Budgetary Borrowing

(Dollars in Billions)

Deferred payments to schools and community colleges	$10.4
Economic Recovery Bonds	6.3
Loans from special funds	3.4
Unpaid costs to local governments, schools, and community colleges for state mandates	4.5
Underfunding of Proposition 98	3.4
Borrowing from local government (Proposition 1A)	2.1
Deferred Medi-Cal costs	1.3
Deferral of state payroll costs from June to July	0.8
Deferred payments to CalPERS	0.5
Borrowing from transportation funds (Proposition 42)	0.3
Total	**$33.0**

In addition, the state faces major payment obligations that will eventually increase state spending annually by $13 billion. The largest such obligation — the Proposition 98 maintenance factor — will ensure that school funding over time returns to its pre-recession level. Debt service on authorized but unissued bonds will eventually add $3 billion in annual budget costs.

Under the Budget and current projections, for the first time in the past decade, the budget would be balanced on an ongoing basis. To restore fiscal order and support the state's economic recovery, the Budget proposes to pay off the $33 billion in outstanding budgetary borrowing and deferrals by 2015-16.

Changing the Budget Process

In December, the Governor issued an executive order that will alter state budgeting processes to make better use of existing tools—such as zero-based budgeting, performance measures, strategic planning, audits, cost-benefit analyses, and program reviews—to focus on achieving performance goals and increasing efficiency. That order requires the Department of Finance to develop a plan by early March. The Budget begins the type of evaluations and reviews envisioned under the executive order. The departments of Corrections and Rehabilitation, General Services, Mental Health, Technology, and Transportation have completed or will undertake comprehensive reviews of their operations to reduce costs.

Containing Health Care Costs

Actions proposed to reduce the federal budget deficit could drive higher costs. For example, the federal government has been exploring options to shift health care costs to states. These would be in addition to the future costs California will incur under federal health care reform.

The current Medicaid funding formula encourages spending and does not promote efficiency or cost containment. In addition, California receives relatively low Medicaid funding, as the federal formula fails to recognize the large number of Californians living in poverty. In conjunction with other states, California will pursue changes to the way the federal government funds health care programs to reward efficiency and to allow states to keep a portion of savings generated through cost-effective management. This reform will reduce the federal deficit without increasing costs to states. The changes could help contain overall health care costs and assist states in the implementation of health care reform.

Investing in California's Future

The Budget lays the foundation for critical investments in California's future.

Stabilizing Funding for Education

From its peak of $56.6 billion in 2007-08, Proposition 98 funding for K-14 education fell by $9 billion, or 16 percent, to $47.6 billion in 2011-12. The Governor is pursuing new tax revenues to prevent deeper cuts in school funding. Under the Budget, Proposition 98 funding will increase to $52.5 billion. This funding will be provided with fewer rules and regulations but greater accountability. The Budget eliminates school funding associated with the gas tax swap and applies a consistent approach to accounting for the various Proposition 98 programmatic adjustments that have been made.

Investing in Our Universities

The higher education system is critical to the state's long-term economic growth, but General Fund spending on higher education has dropped substantially. The Governor's proposed initiative protects higher education from further reductions. Given concerns about growing student debt and to halt the trend of double-digit tuition increases, the Budget provides at least 4-percent annual General Fund growth beginning in 2013-14.

Supporting Job Creation

The resulting stability from a balanced budget will give businesses the certainty and the reassurance they need to invest in California. In addition, the Administration will propose legislation to reform the enterprise zone program and move to a mandatory single sales factor for apportioning multistate business income. Such changes will allow the state to afford investments in manufacturing, business incentives, and other tax relief.

Reducing Greenhouse Gas Emissions

California has been an international leader in the effort to reduce air pollution and develop clean energy. The Budget reflects the first year of implementation of the AB 32 cap and trade program. Through a market approach, the program will create fiscal incentives for businesses to reduce their greenhouse gas emissions. The proceeds generated from the program, potentially $1 billion in the first year, will be used to invest in clean energy, low-carbon transportation, natural resource protection, and sustainable infrastructure.

Building High-Speed Rail

High-speed rail will be an important asset of the state's infrastructure. It will meet Californians' future travel needs in an efficient manner and reduce greenhouse gas emissions. The Budget includes funding requests to continue the basic functions of the High-Speed Rail Authority. The Authority's funding plan is under review by the Department of Finance. After the review, the Administration will propose a plan for the initial train segment.

Meeting Water Needs

Balancing the state's water needs with environmental protection remains a long-term challenge. The Delta Habitat Conservation and Conveyance Program is currently developing a plan to promote the recovery of endangered, threatened, and sensitive fish and wildlife and their habitats in the Sacramento-San Joaquin Delta in a manner that will also ensure water supply reliability. When completed, the plan will provide the basis for issuing permits for the operation of state and federal water projects. The Budget proposes $25 million and 135 positions to complete preliminary engineering work. Future funding requests to address the state's water needs will be necessary.

Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2012-13 Governor's Budget
General Fund Budget Summary
Problem Definition

(Dollars in Millions)

	2011-12	2012-13
Prior Year Balance	-$3,079	-$3,416
Revenues and Transfers	$86,309	$89,221
Total Resources Available	**$83,230**	**$85,805**
Non-Proposition 98 Expenditures	$53,846	$58,905
Proposition 98 Expenditures	$32,800	$35,348
Total Expenditures	**$86,646**	**$94,253**
Fund Balance	**-3,416**	**-8,448**
Reserve for Liquidation of Encumbrances	$719	$719
Special Fund for Economic Uncertainties	-$4,135	-$9,167
Budget Stabilization Account	**-**	**-**
Total Available Reserve	**-$4,135**	**-$9,167**

Figure SUM-02

2012-13 Governor's Budget
General Fund Budget Summary
Balanced Budget

(Dollars in Millions)

	2011-12	2012-13
Prior Year Balance	-$3,079	-$985
Revenues and Transfers	$88,606	$95,389
Total Resources Available	**$85,527**	**$94,404**
Non-Proposition 98 Expenditures	$53,883	$55,035
Proposition 98 Expenditures	$32,629	$37,518
Total Expenditures	**$86,512**	**$92,553**
Fund Balance	**-985**	**1,851**
Reserve for Liquidation of Encumbrances	$719	$719
Special Fund for Economic Uncertainties	-$1,704	$1,132
Budget Stabilization Account	**-**	**-**
Total Available Reserve	**-$1,704**	**$1,132**

Figure SUM-03

General Fund Revenue Sources

(Dollars in Millions)

	2011-12	2012-13	Change from 2011-12 Dollar Change	Percent Change
Personal Income Tax	$54,186	$59,552	$5,366	9.9%
Sales and Use Tax	18,777	20,769	1,992	10.6%
Corporation Tax	9,479	9,342	-137	-1.4%
Motor Vehicle Fees	103	30	-73	-70.9%
Insurance Tax	2,042	2,179	137	6.7%
Estate Taxes	-	45	45	-
Liquor Tax	323	329	6	1.9%
Tobacco Taxes	93	90	-3	-3.2%
Other	3,603	3,053	-550	-15.3%
Total	**$88,606**	**$95,389**	**$6,783**	**7.7%**

Note: Numbers may not add due to rounding.

Figure SUM-04

General Fund Expenditures by Agency

(Dollars in Millions)

	2011-12	2012-13	Change from 2011-12 Dollar Change	Percent Change
Legislative, Judicial, Executive	$2,540	$2,600	$60	2.4%
State and Consumer Services	619	689	70	11.3%
Business, Transportation & Housing	679	558	-121	-17.8%
Natural Resources	1,935	1,896	-39	-2.0%
Environmental Protection	51	47	-4	-7.8%
Health and Human Services	26,668	26,414	-254	-1.0%
Corrections and Rehabilitation	7,849	8,744	895	11.4%
K-12 Education	34,162	38,179	4,017	11.8%
Higher Education	9,821	9,377	-444	-4.5%
Labor and Workforce Development	354	448	94	26.6%
General Government:				
Non-Agency Departments	450	514	64	14.2%
Tax Relief/Local Government	544	2,534	1,990	365.8%
Statewide Expenditures	840	553	-287	-34.2%
Total	**$86,512**	**$92,553**	**$6,041**	**7.0%**

Note: Numbers may not add due to rounding.

Figure SUM-05
2012-13
Total Revenues and Transfers
(Dollars in Millions)

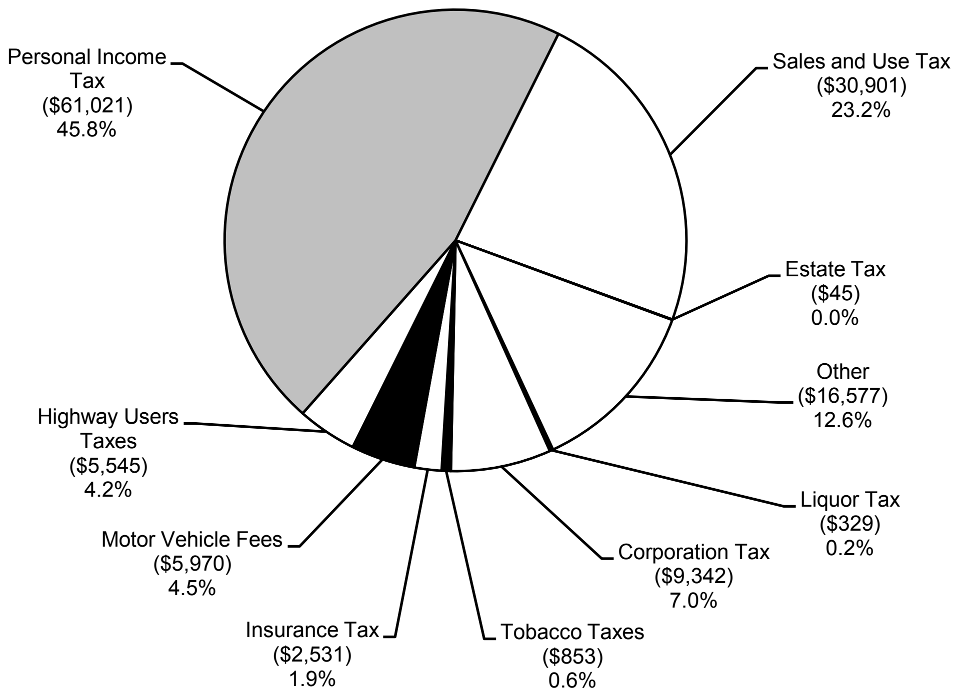


Figure SUM-06

2012-13

Total Expenditures

(Including Selected Bond Funds)

(Dollars in Millions)

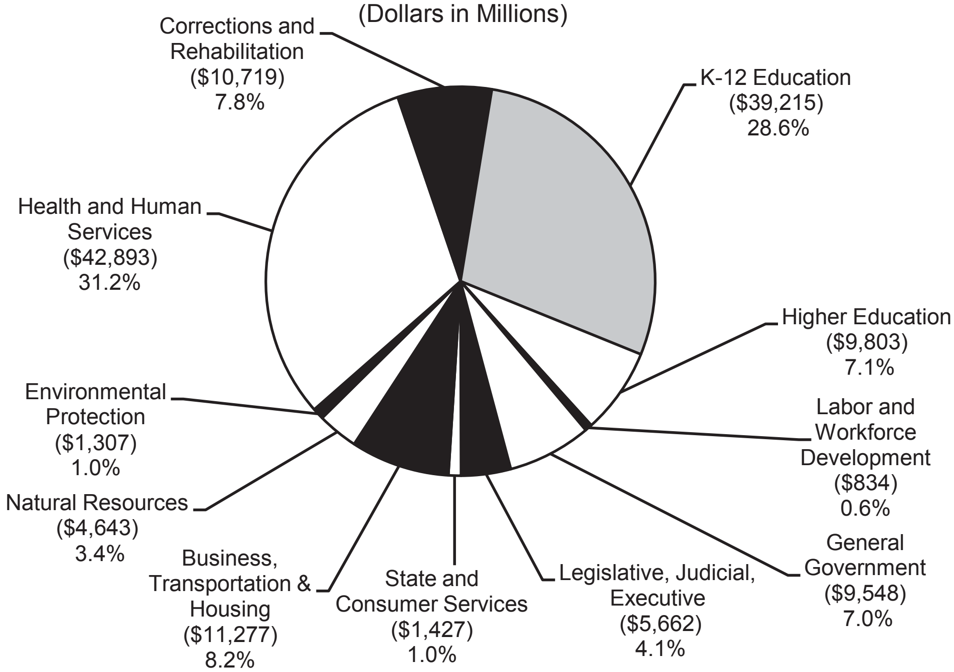


Figure SUM-07

2012-13

General Fund Revenues and Transfers

(Dollars in Millions)

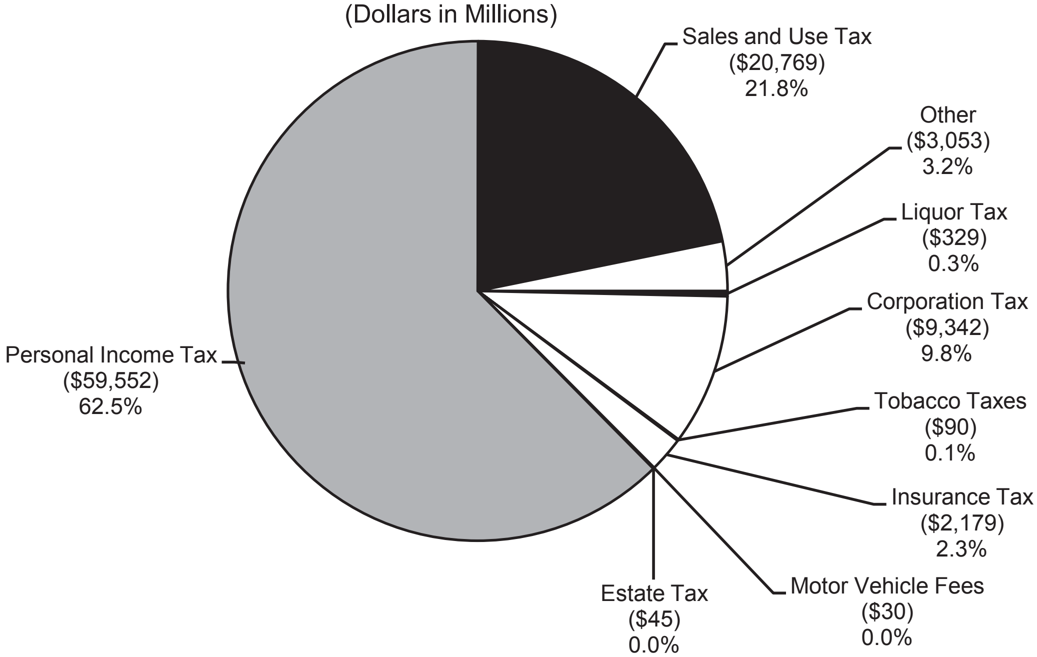


Figure SUM-08

2012-13 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2011-12
Personal Income Tax	$59,552	$1,469	$61,021	$5,684
Sales and Use Tax	20,769	10,132	30,901	2,455
Corporation Tax	9,342	-	9,342	-137
Highway Users Taxes	-	5,545	5,545	-64
Motor Vehicle Fees	30	5,940	5,970	-104
Insurance Tax	2,179	352	2,531	255
Estate Tax	45	-	45	45
Liquor Tax	329	-	329	6
Tobacco Taxes	90	763	853	-26
Other	3,053	13,524	16,577	1,721
Total	**$95,389**	**$37,725**	**$133,114**	**$9,835**

Note: Numbers may not add due to rounding.

Figure SUM-09

2012-13

General Fund Expenditures

(Dollars in Millions)

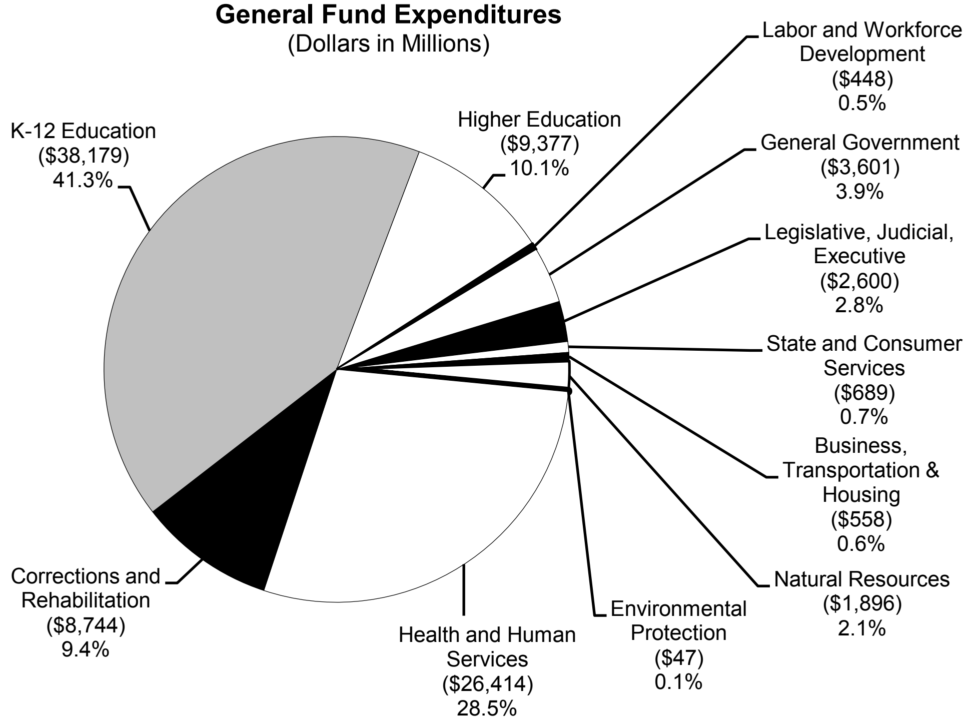


Figure SUM-10
2012-13 Total Expenditures by Agency
(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$2,600	$2,842	$220	$5,662
State and Consumer Services	689	723	15	1,427
Business, Transportation & Housing	558	8,003	2,716	11,277
Natural Resources	1,896	2,458	289	4,643
Environmental Protection	47	1,047	213	1,307
Health and Human Services	26,414	16,320	159	42,893
Corrections and Rehabilitation	8,744	1,974	1	10,719
K-12 Education	38,179	87	949	39,215
Higher Education	9,377	41	385	9,803
Labor and Workforce Development	448	386	-	834
General Government				0
Non-Agency Departments	514	1,612	3	2,129
Tax Relief/Local Government	2,534	1,715	-	4,249
Statewide Expenditures	553	2,617	-	3,170
Total	**$92,553**	**$39,825**	**$4,950**	**$137,328**

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Making Government More Efficient

Building off of last year's measures to reduce waste and make the state more efficient, the Governor is proposing a comprehensive package of additional efficiencies. These include reorganizing state government to eliminate and consolidate agencies, departments, and programs; eliminating unnecessary boards, commissions, and advisory groups; changing the budget process to increase efficiency and focus on accomplishing program goals; permanently eliminating surplus positions; and implementing additional efficiencies.

Reorganizing State Government

The state's current organizational structure lacks sense and cohesion. Agencies lack focus by having multiple missions, similar functions are scattered throughout several agencies, and some departments and programs are duplicative. The Budget makes government less costly and more efficient, more sensible, and easier to manage effectively. Among other changes, the proposal reduces the number of agencies from 12 to 10, eliminates 39 state entities, and eliminates 9 programs.

Restructuring Agencies

The proposal reduces the number of agencies from 12 to 10. It eliminates the California Volunteer Agency, and its programs will be subsumed into the Office of Planning and Research. It eliminates the California Emergency Management Agency and makes it an office reporting directly to the Governor. It eliminates the California Technology Agency and makes it a department under the new Government Operations Agency. To better focus the missions of the agencies, it restructures the State and Consumer Services Agency and the Business, Transportation, and Housing Agency as follows:

The Business and Consumer Services Agency

Government entities that license or regulate industries or business activities are spread throughout state government. Consolidating entities will improve efficiency in shared areas such as automated licensing systems, investigation practices, regulatory and legal processes, licensing, and consumer complaints. Placing consumer protection entities under one agency will also help the public more easily access consumer protection programs. This new agency will include the departments of Consumer Affairs, Housing and Community Development, Fair Employment and Housing, Alcoholic Beverage Control, and the newly restructured Department of Business Oversight.

The Government Operations Agency

Major components of state administration, including procurement, information technology, and human resources, are currently dispersed among different agencies. Combining these and other functions that assist in the general operation of state government into one agency will make state government more manageable and efficient. This new agency will include the departments of General Services, Human Resources, Technology, the Office of Administrative Law, the Public Employees' Retirement System, the State Teachers' Retirement System, and the newly restructured Department of Revenue. It also will include the State Personnel Board and the Government Claims Board.

The Transportation Agency

The state will benefit by focusing and consolidating transportation functions in one agency given their size, complexity, and importance. This new agency will include the Department of Transportation (Caltrans), the Department of Motor Vehicles, the High-Speed Rail Authority, the Highway Patrol, the California Transportation Commission, and the Board of Pilot Commissioners.

Eliminating and Consolidating Departments, Boards, Commissions, and Programs

- **Consolidate Revenue Functions —** The Employment Development Department and the Franchise Tax Board both collect taxes. To improve revenue collection and better enforce tax laws, this proposal consolidates the Employment Development Department's tax collection functions (mainly personal income tax withholding and payroll tax administration) with the Franchise Tax Board in a new Department of Revenue.

- **Consolidate Oversight of Financial Businesses into a Single Department —** The Department of Corporations regulates a variety of entities involved in the financial industry including securities brokers and dealers, mortgage lenders that are not affiliated with banks, and financial planners. The Department of Financial Institutions regulates state-chartered banks, credit unions, and money transmitters. This proposal eliminates the Department of Financial Institutions and the Department of Corporations and consolidates their functions into a new Department of Business Oversight because both of these departments perform the same fundamental mission (i.e. the licensing and regulation of business entities). The new Department will be part of the Business and Consumer Services Agency.

- **Consolidate Business Programs into the Governor's Office of Business and Economic Development —** Chapter 475, Statutes of 2011, created the Governor's Office of Business and Economic Development to better coordinate and promote business development and foster job growth and private-sector investment in California. The proposal transfers the Infrastructure Bank, the Film and Tourism Commissions, the Small Business Centers, and the Small Business Guarantee Loan Program to the Governor's Office of Business and Economic Development.

- **Transfer Housing Finance Agency into Department of Housing and Community Development —** The Department of Housing and Community Development and the California Housing Finance Agency (CalHFA) both assist in the development and financing of affordable housing for Californians. While CalHFA is unique in making low-interest loans through the sale of tax-exempt bonds, both departments administer general obligation bond programs. By moving the CalHFA functions into the Department of Housing and Community Development, the state will continue to serve the housing needs of the state while achieving administrative efficiencies.

- **Eliminate the Office of Traffic Safety —** The Office distributes federal grants to state and local entities. This proposal eliminates the Office and transfers the functions to the Department of Motor Vehicles to achieve efficiencies and reduce administrative costs.

- **Eliminate the State 9-1-1 Advisory Board —** The Board is responsible for advising on the policy and procedures of the 9-1-1 Emergency Communications Office within the California Technology Agency. This proposal eliminates the Board, and policies and procedures will be revised as necessary through the state administrative process.

- **Eliminate the Technology Services Board —** The Board is responsible for the oversight and approval of the Office of Technology Services budget and rates. This proposal eliminates the Board because its function duplicates other budgetary oversight roles. The Department of Finance will continue to review rate proposals.

- **Eliminate the Electronic Funds Transfer Task Force —** The Task Force is responsible for providing a plan on the development and implementation of a new payment dispersal system using electronic funds transfer technology. The Task Force is no longer needed because the plan was completed in 2008.

- **Eliminate the Unemployment Insurance Appeals Board and Consolidate Functions —** This proposal eliminates the seven full-time board members who review second-level appeal decisions. The proposal will streamline and consolidate the functions currently performed by the Board with the Employment Development Department.

- **Consolidate Professional Licensing Functions within the Department of Consumer Affairs —** The Department of Real Estate and the Office of Real Estate Appraisers license and oversee professionals, which is the core function of most of the bureaus in the Department of Consumer Affairs (DCA). This proposal eliminates the Department of Real Estate and the Office of Real Estate Appraisers and places them as bureaus under the DCA in order to achieve administrative savings and efficiencies. Similarly, the Structural Pest Control Board and the Board of Chiropractic Examiners will be placed under the DCA.

- **Eliminate the Fair Employment and Housing Commission and Transfer its Functions to the Department of Fair Employment and Housing —** This proposal transfers the Commission's adjudicatory and regulatory functions to the Department of Fair Employment and Housing. Adjudication of employment and housing discrimination cases will be handled by a separate and distinct division within the Department of Fair Employment and Housing.

- **Eliminate the Commission on the Status of Women —** This proposal eliminates the Commission, which advises the Governor and the Legislature on public policy issues affecting women. Numerous alternative and effective forums address these important issues.

- **Eliminate the Occupational Safety and Health Standards Board and Transfer its Functions into the Department of Industrial Relations —** The Board is responsible for the adoption, amendment, and repeal of the occupational safety and health standards and public safety standards enforced by the Department of Industrial Relations (DIR). This proposal eliminates the Board and transfers responsibility to the Division of Occupational Safety and Health within DIR.
- **Eliminate the Office of Privacy Protection —** The Office provides consumers with information on identity theft and other privacy issues and recommends policies and practices that protect individual privacy rights. Many other state, federal, and business resources exist that promote and protect the privacy rights of consumers.
- **Consolidate the California Law Revision Commission and the Commission on Uniform State Laws within the Legislative Counsel Bureau —** The California Law Revision Commission is responsible for reviewing California statutory and decisional law and recommending legislative revisions. The Commission on Uniform State Laws recommends to the Legislature uniform laws recommended by the National Conference of Commissioners on Uniform State Laws. Prior to the 2010 Budget Act, these Commissions were funded from their own General Fund appropriations. Since then, these Commissions have been funded by the Legislative Counsel Bureau.
- **Eliminate the Governor's Emergency Operations Executive Council —** The Council provides coordination between state agencies and departments with a nexus to emergency response and recovery. This proposal eliminates the Council, but the Governor will retain the ability to convene this group on an as-needed basis.
- **Eliminate the Public Safety Radio Strategic Planning Committee —** Created in 2002, the Committee is tasked with developing and implementing a statewide integrated public safety radio communication system and ensuring interoperability between state agencies. This proposal eliminates the Committee because it is duplicative of functions currently being performed by the California Technology Agency.
- **Eliminate Division of Labor Statistics and Research and Transfer its Functions to the Division of Occupational Safety and Health —** This proposal eliminates the Division of Labor Statistics and Research within the Department of Industrial

Relations and transfers the Division's functions related to maintaining job safety records, reports, and statistics to the Division of Occupational Safety and Health. The proposal also transfers functions related to prevailing wage rate determination for public works projects to the Division of Labor Standards Enforcement.

- **Eliminate the Governor's Mentorship Program —** This program is operated by California Volunteers. This proposal would eliminate the program because there are other community programs that provide similar services.
- **Consolidate Certain Gambling Activities —** There are currently many legal and operational inefficiencies stemming from the bifurcated system of gambling control, which separates the policy functions of the Gambling Control Commission from the licensing, investigation, compliance, and enforcement functions of the Department of Justice. Consolidating support, investigatory, and compliance functions within the Department of Justice will promote a more effective and efficient regulation of legalized gambling.
- **Consolidate the California State Summer School for the Arts with the California Arts Council —** The California Summer School for the Arts annually provides a number of California high school students engaged in the visual, literary, performing, and media arts with an intensive learning experience. This proposal consolidates the California State Summer School for the Arts with the California Arts Council to streamline administrative operations while continuing to provide students with access to intensive summer arts education.
- **Eliminate Vocational Education Supplemental Leadership Programs —** This program supports leadership development programs for vocational student officers, instructional materials for vocational teacher advisors, and training and preparation for new vocational education teachers. This program is being eliminated because these types of activities can be funded from existing Proposition 98 resources at local discretion.
- **Eliminate Non-Proposition 98 General Fund for Indian Education Centers —** This program provides funding to support local educational resource centers for American Indian students, parents, and public schools in American Indian communities. The funding is being eliminated because these Non-Proposition 98 resources are duplicative of funds already provided within Proposition 98 to support local Indian Education Centers.

- **Eliminate the Department of Mental Health and the Department of Alcohol and Drug Programs —** This proposal reorganizes behavioral health programs. With the elimination of the Department of Mental Health and the Department of Alcohol and Drug Programs, major community mental health programs and remaining non-Drug Medi-Cal programs and associated funding will be shifted as follows:
    - The Department of Health Care Services will assume responsibility for the administration of various Mental Health Services Act programs, financial oversight of Mental Health Services Act funds, administration of federal Substance Abuse and Mental Health Services Administration discretionary and block grants, Projects for Assistance in Transition from Homelessness grants, Substance Abuse Prevention and Treatment block grants, the Parolee Services Network, veterans mental health programs, and the mental health components of the California Health Interview Survey.
    - The Department of Public Health will assume the duties of the Office of Multicultural Services, the administration of counselor certification, narcotic treatment, driving under the influence, and problem gambling functions.
    - The Department of Social Services will be responsible for licensing and quality improvement functions.
    - The California Department of Education will administer the Early Mental Health Initiative grants.
    - The Office of Statewide Health Planning and Development will now include the Mental Health Workforce Education and Training program.
    - The Mental Health Services Oversight and Accountability Commission will be responsible for Mental Health Services Act training, technical assistance, and program evaluation.
- **Eliminate the Managed Risk Medical Insurance Board and Transfer its Function to the Department of Health Care Services —** The Board administers programs that provide health coverage through various health plans to certain individuals who do not have health coverage including children of low-income families, pregnant women, and individuals with pre-existing medical conditions. This proposal eliminates the Board and transfers its programs and responsibilities to the Department of Health Care Services (DHCS) in preparation for California's implementation of federal health care reform. Specifically, the Healthy Families

Program will transition to DHCS as part of the broader Medi-Cal program beginning in October 2012. Remaining programs, including the County Children's Health Initiative Program, Access for Infants and Mothers, Major Risk Medical Insurance Program (MRMIP), and Pre-Existing Conditions Insurance Plan (PCIP) will transfer to DHCS effective July 1, 2013. The two stand-alone programs that provide insurance to individuals with pre-existing conditions, MRMIP and PCIP, will be eliminated in January 2014 because these individuals will be able to purchase health insurance through the California Health Benefits Exchange as part of federal health care reform implementation.

- **Eliminate the Rehabilitation Appeals Board —** The Board hears appeals by applicants and consumers of Department of Rehabilitation services who wish to contest a denial of eligibility or are not satisfied with the services being provided to them. This proposal will shift the Board's duties to independent hearing officers, who will require less travel than multiple board members, and will have legal and evidentiary expertise. This proposal will result in a more effective and timely appeal process for consumers.
- **Consolidate Five Specialty Health Functions into the Office of Health Equity —** This proposal consolidates the Department of Health Care Services' Office of Women's Health, the Department of Public Health's (DPH's) Office of Multicultural Health, Health in All Policies Task Force, the Health Places Team, and the Department of Mental Health's Office of Multicultural Services into the new Office of Health Equity (OHE) within the DPH. Creation of the OHE will enable the state to better identify and ameliorate health disparities for disadvantaged and underserved communities by examining these issues through a more integrated approach to public health, behavioral health, and health care issues. California's demographics and a variety of socio-economic trends call for a different and more comprehensive approach to addressing the issues of health disparities across the entire health care continuum within the state.
- **Transfer the Department of Resources, Recycling and Recovery (CalRecycle) to the California Environmental Protection Agency —** Hazardous waste, electronic waste, used oil, used tires, and landfill permits are typically not considered "natural resources" but wastes that should be regulated under the California Environmental Protection Agency, not the Natural Resources Agency.
- **Eliminate the Department of Boating and Waterways and Transfer the Functions into the Department of Parks and Recreation —** The Department of Parks and Recreation currently partners with Boating and Waterways in

facilities construction projects. Boating and Waterways funds operations at all of Parks' reservoirs. This proposal will transfer the functions of the Department of Boating and Waterways to a division of the Department of Parks and Recreation, similar to the Off-Highway Vehicle Recreation Division. Because the Department of Boating and Waterways is being transferred to the Department of Parks and Recreation, the California Boating and Waterways Commission will be eliminated. The Commission advises the Department of Boating and Waterways on matters within its jurisdiction and consents to all boating facilities loans and grants. The duties performed by the Commission will be absorbed by the Department of Parks and Recreation.

- **Reduce Number of Regional Water Boards —** This proposal realigns the regional water board boundaries to create eight regional water boards, merging two of the smaller existing regional water boards (the Colorado River Basin Water Board) into neighboring regions with the boundaries continuing to follow watersheds. The proposal brings more consistency in the size of the regions. It also reduces the number of members on the boards from nine to seven.

- **Consolidate Colorado River Board within the Natural Resources Agency —** The Board is responsible for developing a plan to maintain an adequate water supply from the Colorado River. The proposal eliminates the Board and transfers these responsibilities to the Natural Resources Agency. This proposal will ensure that all statewide water supply issues, such as water supply reliability, Delta sustainability, and Colorado River water issues are addressed in a comprehensive and coordinated manner.

- **Eliminate the State Geology and Mining Board and Transfer its Responsibilities —** The Board serves as a regulatory, policy, and appeals body representing the state's interest in geology, geologic and seismologic hazards, conservation of mineral resources, and reclamation of lands following surface mining activities. Eliminating the Board will streamline functions by moving the appeals process to the Office of Administrative Hearings, and the balance of the Board's responsibilities to the Office of Mine Reclamation within the Department of Conservation.

- **Eliminate Various Entities within the Department of Fish and Game —**

    - The Salton Sea Restoration Council

    - The California Advisory Committee on Salmon and Steelhead Trout

- The Commercial Salmon Review Board
- The State Interagency Oil Spill Committee
- The State Interagency Oil Spill Review Subcommittee
- The Abalone Advisory Committee

These advisory groups provide public input and guidance to the Department in various program areas. The information provided by these entities is either no longer useful or can be provided through other means.

- **Eliminate Underutilized Programs Within the Department of Toxic Substances Control —** The following programs are proposed for elimination because they have outlived their purposes, are underutilized, or have been superseded by other programs:
  - Expedited Remedial Action Program
  - Private Site Management Program
  - California Land Environmental Restoration and Reuse Act Program
  - Hazardous Waste and Border Zone Property Designations
  - Abandoned Site Assessment Program
  - Registered Environmental Assessor Program
- **Eliminate the Watershed Coordinator Initiative Program —** This program was created to prepare Watershed Management Initiative Plans in each region, which were completed in 2007. The Water Board now maintains the Plans, and Plan concepts have been incorporated into various Water Board programs.

Saving Money and Improving Efficiency through the Budget Process

Building on last year's effort to make the budget more efficient, the Budget proposes cutting special fund budgets, zero-basing department budgets, and eliminating positions.

Cut the Budgets of Special Fund Programs

Government programs should be efficient and cost-effective regardless of their fund source. While the budgets of special fund departments have been cut in the past, the level of these cuts has been less than the cuts imposed on General Fund departments. Non-General Fund departments and programs will submit to the Department of Finance budgetary reduction plans targeted to reduce administration and program support, with the goal of reducing fees and shifting resources to programs. These plans will be reviewed as part of the spring budget process.

The Budget includes specific budgetary goals for the California Technology Agency and the Department of General Services that will result in reduced rates charged to other state agencies. This will result in more efficient government by making these services less expensive for both General Fund and special fund departments.

Improve the Budget Process through Zero-Basing and Other Tools

In Executive Order B-13-11, the Governor ordered the Director of Finance to create a plan by March 2012 for modifying the budget process to increase efficiency and focus on accomplishing program goals. Some departments, including Caltrans and the Department of Consumer Affairs, will be directed to perform a detailed review and analysis of all of their programs to evaluate whether the functions need to exist and the level of resources needed to accomplish them. This will begin recasting the current process that "focuses on incremental changes to the prior year's funding, rather than a deeper review of a department or program" as noted in Executive Order B-13-11.

Permanently Eliminate Positions

As a result of budget reductions, more than 15,000 positions were eliminated in 2011-12 compared to the prior year. The Department of Finance will conduct a department-by-department review to identify additional positions for elimination and permanently reduce positions to reflect the smaller size of state government.

Economic Outlook

California, like the nation, is in the midst of an uneven economic recovery. Some sectors of the economy, including high technology and export markets, are doing well. Despite these areas of strength, economic conditions are still hamstrung by weak real estate markets, consumer confidence lingers at recessionary levels, and volatility in equity markets remains high.

Global and national events have created economic uncertainty and had an impact on the recovery. Most recently, congressional gridlock on budgetary issues, including the debt ceiling, has added to economic uncertainty and stock market volatility. Further, the European debt, banking, and budgetary crisis has adversely affected the California and national economies.

The Nation — Slow Economic Recovery Underway

A variety of fundamental economic indicators suggests that the national economy has experienced a slow, steady economic expansion over the past year, including a recovery from midyear weakness. In October 2011, the Index of Leading Indicators posted the largest monthly increase since November 2010, which suggests that the economy should continue to experience at least moderate growth well into 2012. After slowing sharply during May and June, nonfarm employment gains rebounded to over 100,000 jobs per month beginning in July. The unemployment rate dropped from 9.2 percent in June to 8.6 percent in November.

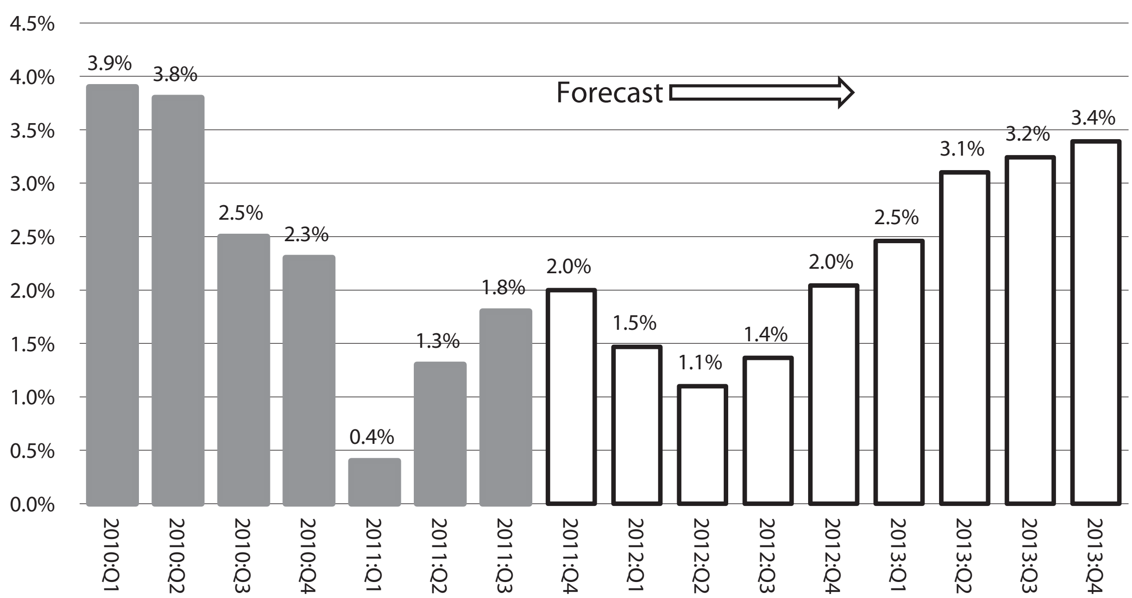
Consumer confidence also has improved steadily. The Conference Board Consumer Confidence Index rose in November, posting its largest monthly increase since April 2003. Even though indicators remain at recessionary levels, the improved confidence level has led to increased spending. Overall consumer spending in October was up 4.7 percent from a year earlier, led by a surge in motor vehicle sales, which in November reached their best level since June 2008 (excluding the August 2009 one-time Cash-for-Clunkers surge).

Businesses have remained cautious but boosted spending on equipment and software. Corporations with healthy profits invested in replacement needs neglected during the recession. Inventories remain low, which bodes well for future production growth.

After losing ground in August and September, industrial production accelerated in October and has continued to grow modestly. Construction spending also grew moderately in October, the third consecutive monthly gain.

In September, U.S. exports were up 16 percent over the year, led by industrial supplies and consumer goods. During the first three quarters of 2011, exports added 0.69 percentage point to Gross Domestic Product growth, trailing only the growth rates for household expenditures on services and business investment in equipment and software. (Figure ECO-01)

Figure ECO-01
U.S. Real Gross Domestic Product
Quarter-to-Quarter growth, annualized



Source: U.S. Bureau of Economic Analysis; CA Department of Finance Governor's Budget Forecast

Despite these indications that the economy was improving at the close of 2011, a number of factors will dampen economic growth in 2012.

Since spending growth outpaced income gains, the boost from consumers may slow again. Much of the additional spending was financed by the greater use of credit and reduced savings. While the consumer debt-to-income ratio has declined steadily over the past six years as households reduced their debt loads, this trend bottomed out in May 2011 and debt ratios have increased since then. Outstanding non-revolving credit grew sharply in September and October, largely to finance motor vehicle sales. In October, the personal savings rate was down almost 2 percentage points from a year earlier.

Businesses also have been reluctant to expand payrolls too quickly and national economic growth has been extraordinarily dependent on exports, and thus more sensitive to global economic developments.

The failure of Congress to address the federal deficit leaves considerable uncertainty. One example of this is extending the 2-percent payroll tax cut and emergency unemployment insurance benefits only through February 2012.

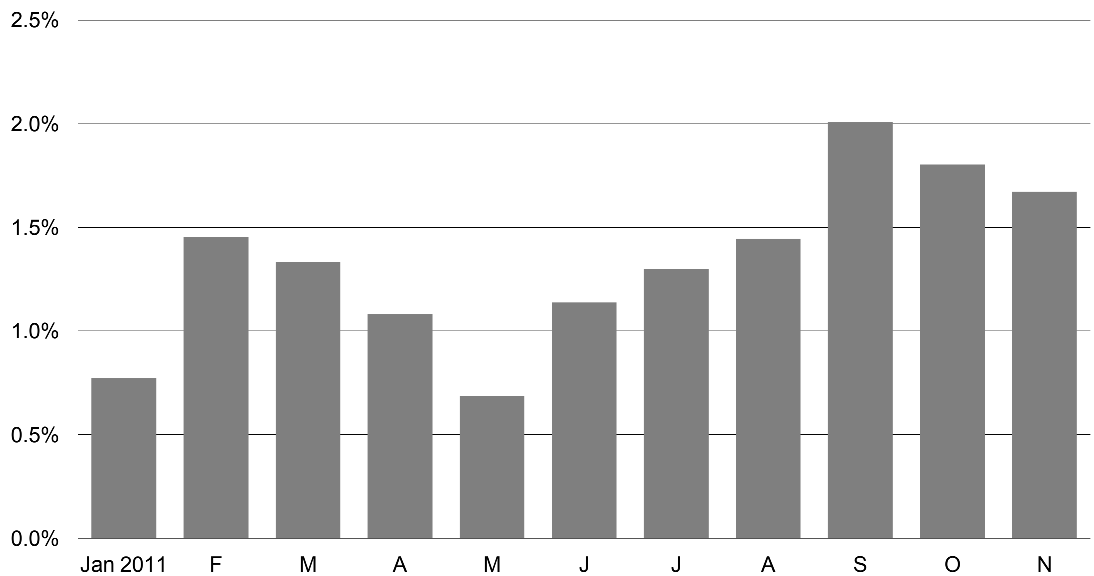
The European debt, banking and budgetary crisis also creates uncertainty and the lack of a solution could lead to a recession in Europe, thereby weakening the demand for U.S. exports, reducing corporate earnings, and strengthening the dollar. A full-blown financial collapse of the euro zone (those countries that use the euro as their currency) could drag the U.S. economy into recession.

California — An Uneven Recovery

Most of the indicators that affect the nation, both positive and negative, also affect California. In addition, California is affected by other positive and negative factors ranging from a robust high-technology sector to being one of the states hardest hit by the collapse of the housing market.

The state added 102,000 industry jobs in January and February, but only gained 4,700 jobs from March through July after the Japanese earthquake. The unemployment rate rose four-tenths of a percentage point between May and August. Nonfarm employment accelerated substantially from August through November and the unemployment rate dropped to 11.3 percent in November, the lowest rate since May 2009. Comparing November 2011 with a year earlier, 233,100 new jobs were created. (Figure ECO-02)

Figure ECO-02
California Nonfarm Employment
Year-Over-Year Percent Change



Source: California Employment Development Department

California wages also made substantial gains at the end of 2010 that continued into 2011. In the fourth quarter of 2010, California wages made their strongest quarter-to-quarter jump since the middle of 2000—the height of the dot-com bubble. Seven high-paying industries accounted for two-thirds of the overall wage gains in the fourth quarter of 2010, including computer and electronic manufacturing, finance and insurance, professional, scientific and technical services, mining, information (which includes motion pictures), management of companies, and health care and social assistance. In 2011, California personal income grew nearly $100 billion, the largest gain since 2006.

A disproportionately large share of the wage gain was driven by the state's high-technology and professional service sectors and by robust global demand for California exports. The surge reflected growing high-tech exports, booming Silicon Valley investment activity, strong stock market gains, and high oil prices. If these trends continue, it is expected that these sectors will expand their workforces.

Strong growth and rising profits among Silicon Valley companies and by booming investment activity likely led to wage gains in electronics manufacturing. In 2010, the

150 largest Silicon Valley corporations had their most profitable year in history. By the end of the first quarter of 2011, their combined stock market value rose over 11 percent from 2010.

2010 was a banner year for California-made exports with the total value rising 19 percent from 2009. This boom was dominated by computers, electronics, and electronic machinery, which combined accounted for over 60 percent of California's 2010 export growth.

Similar to the nation, consumption spending in California rebounded in 2011 with growing vehicle sales playing a significant role. Taxable retail sales during the first three quarters of 2011 grew 8.5 percent from the same period in 2010. New motor vehicle registrations during the first nine months of 2011 were up over 11 percent from the same months of 2010.

California industries that are not connected to high technology and export markets, however, have not fared as well. In particular, the state's housing market, still burdened by high foreclosure rates, weakened considerably during the midyear slowdown. Existing home sales during the first 11 months of 2011 were up slightly from the same months of 2010. However, this came at the expense of falling prices. These trends are likely to continue into 2012 because more foreclosure actions are anticipated.

In contrast to the healthy wage gains noted above, wage rate growth in other industries, such as agriculture, construction, retail trade, and accommodation and food services, did not even keep pace with inflation. These sectors employ nearly half of the state's private sector workforce.

The Forecast

The prospects for the national and California economies are guardedly positive. The national recovery has regained momentum in the closing months of 2011. While disappointing, labor markets have improved slowly. Exports are making solid improvements over 2010. Manufacturing activity was growing, albeit sluggishly.

Another recession is not in the forecast. The forecast assumes the federal government will not add any more stimulus funding, that future federal budget actions will not result in a severe fiscal contraction, and that some combination of spending cuts and tax increases will most likely be phased in beginning in 2013. The outlook also assumes that the 2-percent payroll tax holiday and emergency unemployment insurance benefits will be extended though 2012 and that the temporary tax decreases implemented during the Bush Administration will continue beyond the January 1, 2013 expiration date.

The prospect of a European financial crisis is the biggest known risk at this point. It is still too early to know if protective measures of sufficient strength will be approved to minimize the economic fallout. At the very least, economic growth in Europe will slow in 2012, which will adversely affect U.S. exports.

As indicated in Figure ECO-03, it will be several years before the nation and the state return to a healthy, balanced economic growth. The national economy, slowed by weaker global demand, will expand at a slower pace in 2012. Barring a severe European recession, U.S. economic growth will accelerate to a more sustainable pace in 2013 and 2014.

Figure ECO-03

Selected Economic Data

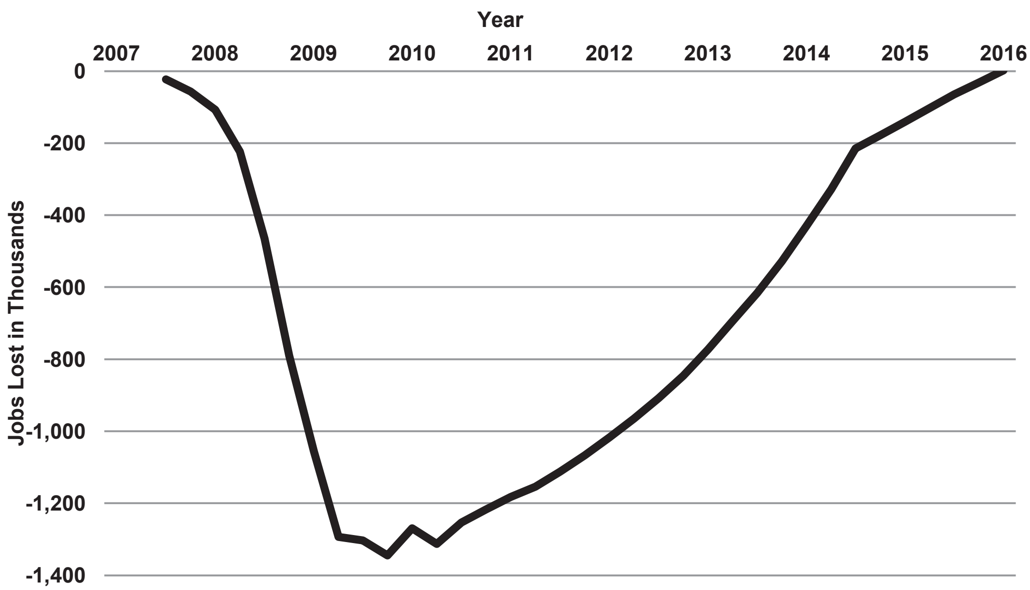
		Projected				
	2011	**2012**	**2013**	**2014**	**2015**	**2016**
U.S. real gross domestic product (percent change)	1.8	1.7	2.5	3.5	3.1	2.7
California unemployment rate (percent)	12.0	12.0	11.7	10.9	9.9	9.3
California nonfarm wage & salary employment (thousands)	14,029.9	14,206.5	14,463.8	14,820.6	15,074.2	15,215.5
(percent change)	0.9	1.3	1.8	2.5	1.7	0.9
California personal income (billions)	1,681.6	1,746.2	1,818.0	1,916.0	2,013.6	2,107.2
(percent change)	5.7	3.8	4.1	5.4	5.1	4.6
California total taxable sales (billions)	519.4	537.9	572.9	619.7	660.4	693.3
(percent change)	8.7	3.6	6.5	8.2	6.6	5.0

Note: Percentage changes calculated from unrounded data.

For California, job growth will improve through 2014. The state is forecast to recover the nonfarm jobs lost during the Great Recession in the second quarter of 2016, or approximately 84 months after the end of the recession. (Figure ECO-04) During the previous six recessions, full job recovery was achieved between 4 and 56 months.

Figure ECO-04

Jobs Lost During Recession Not Recovered Until 2016



The projection for wages and salaries in 2011 was boosted by upwardly revised historical information and better-than-expected growth at the end of 2010 and first half of 2011. Compared to the economic forecast developed for the May Revision, this outlook projects more restrained growth in 2012 due to a weaker national economic forecast and a lack of meaningful improvements in the state's real estate conditions.

Home construction also continued to slow during the last three quarters of 2011, rather than achieving the modest acceleration projected in the May Revision. Thus, employment and construction are weaker in the current forecast.

In contrast, new personal income data showed that California wages and salaries grew more strongly than originally indicated. Revised wage estimates for the first three quarters of 2010 (the latest data available at the time of the earlier forecast) raised the year-over-year growth in state wage income from 0.4 percent to 1.3 percent. In the fourth quarter of 2010, wages and salaries grew much stronger than forecast in the May Revision — 4.5 percent versus 1.9 percent. Wage growth during the first half of 2011 was also stronger than forecast in the May Revision. Overall, this boosted the outlook for 2011 personal income growth from 4.4 percent to 5.7 percent. On the other hand, the more subdued national outlook led to a more restrained projection for 2012—year-over-year wage growth dropped from 4.5 percent to 3.8 percent.

See Figure ECO-05 for highlights of the national and California forecasts.

Figure ECO-05

Selected Economic Data

United States	2011 (Est.)	2012 (Projected)	2013 (Projected)
Real gross domestic product (percent change)	1.8	1.7	2.5
Personal consumption expenditures	2.3	2.1	1.9
Gross private domestic investment	4.3	5.4	8.0
Government purchases of goods and services	-2.0	-2.7	-2.0
GDP deflator (percent change)	2.1	1.4	1.2
GDP (current dollar, percent change)	3.9	3.0	3.7
Federal funds rate (percent)	0.1	0.1	0.1
Personal income (percent change)	5.0	3.1	3.5
Corporate profits before taxes (percent change)	10.1	2.1	3.6
Nonfarm wage and salary employment (millions)	131.1	132.2	134.0
(percent change)	1.0	0.9	1.4
Unemployment rate (percent)	9.1	9.2	9.0
Housing starts (millions)	0.6	0.7	1.0
(percent change)	2.0	11.1	43.6
New car sales (millions)	6.2	6.9	7.9
(percent change)	7.9	12.2	13.5
Consumer price index (1982-84=100)	225.0	228.9	233.6
(percent change)	3.2	1.7	2.0
California			
Civilian labor force (thousands)	18,060.5	18,155.9	18,364.6
(percent change)	-0.6	0.5	1.1
Civilian employment (thousands)	15,893.8	15,975.8	16,207.0
(percent change)	-0.1	0.5	1.4
Unemployment (thousands)	2,166.7	2,180.0	2,157.7
(percent change)	-4.0	0.6	-1.0
Unemployment rate (percent)	12.0	12.0	11.7
Nonfarm wage and salary employment (thousands)	14,029.9	14,206.5	14,463.8
(percent change)	0.9	1.3	1.8
Personal income (billions)	1,681.6	1,746.2	1,818.0
(percent change)	5.7	3.8	4.1
Housing units authorized (thousands)	46.4	52.2	79.9
(percent change)	4.1	12.5	53.0
Corporate profits before taxes (billions)	165.0	170.6	179.7
(percent change)	7.7	3.4	5.3
New auto registrations (thousands)	1,221.8	1,364.3	1,431.4
(percent change)	4.1	11.7	4.9
Total taxable sales (billions)	519.4	537.9	572.9
(percent change)	8.7	3.6	6.5
Consumer price index (1982-84=100)	233.0	237.3	242.3
(percent change)	2.7	1.8	2.1

Note: Percentage changes calculated from unrounded data.

Revenue Estimates

It is projected that the California economy will continue to grow, albeit at a modest rate, through the period covered by the Budget. The modest growth in the economy is augmented by very rapid projected growth in certain segments of the economy —particularly corporate profits and income for high-income taxpayers. This strong growth in narrow segments of the economy tends to cause healthy growth in revenues.

Beyond the natural economic growth, a shift in revenue is expected into 2012-13 from 2013-14, resulting from the sunset of the lower federal tax rates on regular and capital gains income that is scheduled for the end of 2012. The scheduled higher rates in 2013 are expected to cause some taxpayers to shift some of their capital gains, dividend, and wage income from 2013 into 2012.

Figure REV-01 shows the impact of the recession on General Fund revenues. The black line shows the 2007-08 Governor's Budget long-term revenue forecast, prior to the recession. The dashed line shows actual General Fund revenue through fiscal year 2010-11 and projections for revenue through fiscal year 2013-14. The dotted line shows the effect of the Governor's proposed revenue solutions. Between 2007-08 and 2011-12, the major changes have been:

- The lingering effects of the Great Recession. For 2011-12, General Fund revenues remain tens of billions of dollars lower than the amount projected in the 2007-08 Governor's Budget.

- The 2011 Realignment lowered the state General Fund sales tax rate by 1.0625 percent and dedicated an equivalent special fund sales tax rate to local public safety programs.

Figure REV-01
General Fund Revenues

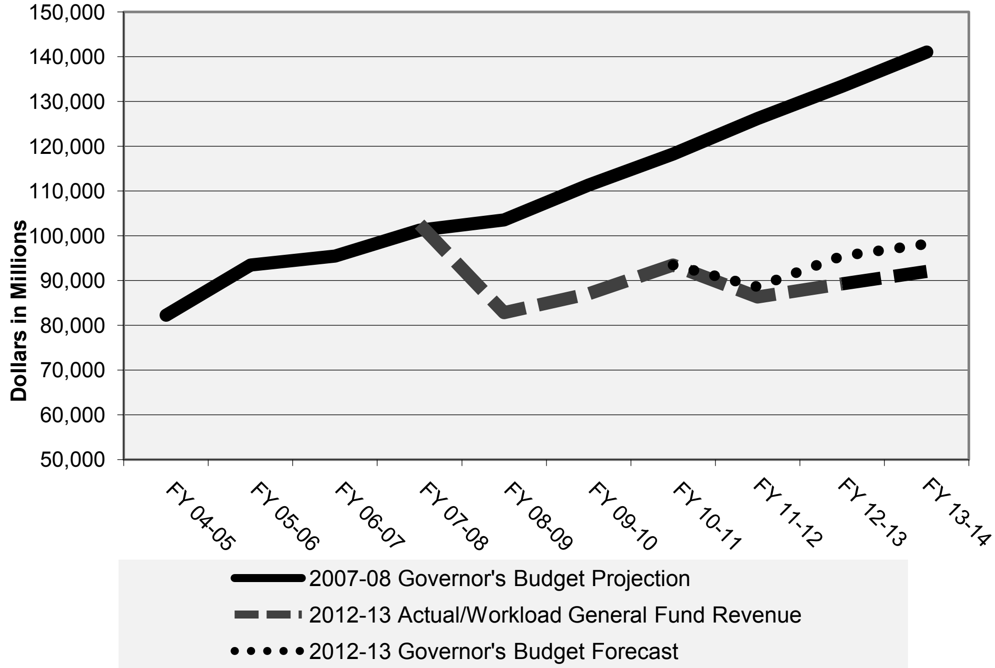


Figure REV-02 displays the forecast changes between the 2011 Budget Act, the 2012 budget baseline (current law) forecast, and the Budget with proposed policy changes. The Budget includes a total of $8.4 billion in revenue solutions within the 2012-13 budget window. Revenue is expected to be $88.6 billion in 2011-12 and $95.4 billion in 2012-13. The drop-off in revenue from 2010-11 to 2011-12 is a result of the reduction in Personal Income Tax, Sales Tax, and Vehicle License Fee rates, and the increase in the dependent exemption credit, following the expiration of temporary increases, as well as the reduction of 1.0625 percent of the Sales and Use Tax associated with 2011 realignment. These changes are projected to reduce General Fund revenues by $7 billion and $5 billion, respectively.

The Budget forecast was prepared in early December, before individuals and corporations made final withholding and estimated payments for the 2011 tax year, and before

Figure REV-02

2012-13 Governor's Budget
General Fund Revenue Forecast
Summary Table
Reconciliation with the 2011-12 Budget Act

(Dollars in Millions)

Source	2011 Budget Act	Governor's Budget Baseline	Change From Budget Act		Proposed	Change From Baseline
Fiscal 10-11						
Personal Income Tax	$50,027	$49,491	-$536	-1.1%	$49,491	$0
Sales & Use Tax	27,140	26,983	-157	-0.6%	26,983	0
Corporation Tax	9,963	9,614	-349	-3.5%	9,614	0
Insurance Tax	2,016	2,077	61	3.0%	2,077	0
Vehicle License Fees	1,360	1,330	-30	-2.2%	1,330	0
Alcoholic Beverage	318	334	16	5.0%	334	0
Cigarette	93	96	3	3.2%	96	0
Other revenues	1,967	2,076	109	5.6%	2,076	0
Transfers	1,897	1,488	-409	-21.6%	1,488	0
Total	**$94,781**	**$93,489**	**-1,292**	**-1.4%**	**$93,489**	**0**
Fiscal 11-12						
Personal Income Tax	$50,408	$51,937	$1,529	3.0%	$54,186	$2,249
Sales & Use Tax (a)	19,009	18,777	-232	-1.2%	18,777	0
Corporation Tax	9,012	9,479	467	5.2%	9,479	0
Insurance Tax	1,893	2,042	149	7.9%	2,042	0
Vehicle License Fees	150	80	-70	-46.7%	80	0
Alcoholic Beverage	326	323	-3	-0.9%	323	0
Cigarette	91	93	2	2.2%	93	0
Other revenues	2,102	2,192	90	4.3%	2,213	21
Transfers	1,465	1,386	-79	-5.4%	1,413	27
Unallocated Revenue Increase	4,000	0	-4,000	-100.0%	0	0
Total	**$88,453**	**$86,309**	**-$2,144**	**-2.4%**	**$88,606**	**$2,297**
Change from Fiscal 10-11	-$6,328	-$7,180			-$4,883	
% Change from Fiscal 10-11	-6.7%	-7.7%			-5.2%	
Fiscal 12-13						
Personal Income Tax	$55,030	$56,025	$995	1.8%	$59,552	$3,527
Sales & Use Tax	20,887	19,595	-1,292	-6.2%	20,769	1,174
Corporation Tax	9,426	9,342	-84	-0.9%	9,342	0
Insurance Tax	2,040	2,179	139	6.8%	2,179	0
Vehicle License Fees	0	5	5	N/A	5	0
Estate Tax (b)	830	45	-785	-94.6%	45	0
Alcoholic Beverage	334	329	-5	-1.5%	329	0
Cigarette	87	90	3	3.4%	90	0
Other revenues	2,125	2,240	115	5.4%	2,237	-3
Transfers	-1,036	-529	507	-48.9%	841	1,370
Total	**$89,723**	**$89,321**	**-$402**	**-0.4%**	**$95,389**	**6,068**
Change from Fiscal 11-12	$1,270	$3,013			$6,784	
% Change from Fiscal 11-12	1.4%	3.5%			7.7%	
Three-Year Total			**-$3,837**			**$8,365**

(a) The Sales and Use Tax revenue for 2011-12 is not directly comparable to the Sales and Use Tax revenue for 2010-11 because of two law changes that took effect on July 1, 2011.

(b) For 2011 and 2012, federal estate tax law is structured such that California will receive none of the "state pick-up" estate tax for those years. However, under current law, starting in January 1, 2013, the federal estate tax will return to its pre-2011 structure and California will, again, begin to receive estate tax payments for estates for which the death occurred on or after January 1, 2013.

Note: Revenues from the Governor's Initiative are not General Fund revenues, and are only available to fund education. As the initiative requires that they are treated as General Fund revenues for the purposes of calculating Proposition 98, they are treated as such.

consumers completed their December purchases. These critical December and January receipts can have a large impact on state revenues. Therefore, this forecast will be revised in early May when these data and April income tax receipts are available.

Temporary Tax Increase

The Budget is based on the assumed passage of the Governor's Constitutional Amendment on the November 2012 ballot. The proposal temporarily increases tax rates on the highest income Californians, and temporarily increases the Sales and Use Tax rate by 0.5 percent. These two provisions result in a revenue increase of $6.9 billion. The proposal will provide revenues to replace some of the revenues lost in the recession as the state's economy slowly recovers.

Figure REV-03 shows the tax brackets and tax rates contained in the Governor's tax initiative. These brackets will be indexed for inflation for the 2013 through 2016

Figure REV-03

Temporary Tax Increase Proposal

Filing Status	Income Subject to Higher Rate	Additional Rate
Single	Between $250,000 and $300,000	1 percent
	Between $300,001 and $500,000	1.5 percent
	Over $500,000	2 percent
Joint	Between $500,000 and $600,000	1 percent
	Between $600,001 and $1,000,000	1.5 percent
	Over $1,000,000	2 percent
Head of Household	Between $340,000 and $408,000	1 percent
	Between $408,001 and $680,000	1.5 percent
	Over $680,000	2 percent

tax years.

A portion of the revenues collected under the measure will be attributable to income earned in 2011-12. Therefore, a portion of the revenue attributed to the personal income tax rate increase for the 2012 tax year is accrued to the 2011-12 fiscal year.

Revenue Proposals

The Budget proposes the following policy changes that will affect General Fund revenue:

- Financial Institution Records Match. The Budget proposes to expand Financial Institutions Record Match to the Employment Development Department (EDD) and the Board of Equalization (BOE) beginning in January 2013. The EDD match program would primarily collect unpaid wage withholding debts, while the BOE match program would primarily collect unpaid sales and use tax debts. This program is expected to generate $4 million General Fund revenue in 2011-12 and $11 million General Fund revenue in 2012-13. In addition, this program is expected to generate local revenue and special fund revenue.
- The Budget proposes to improve the State Controller's Office management of the unclaimed property program. This improvement is expected to generate $21 million in 2011-12 and $57 million in 2012-13.
- The Budget reflects the transfer of an additional $349.5 million in weight fee revenues to the General Fund to be used to offset future debt service costs on transportation bonds.
- The Budget proposes to continue the 2011-12 practice of paying the interest on the loan from the federal government for unemployment insurance payments from the Unemployment Compensation Disability Fund, for revenues of $417 million for 2012-13.
- The Budget proposes to suspend the county share of child support collections in 2012-13 for a revenue gain of $34.5 million.

Figure REV-04 shows the total impact of the changes in revenues, policy decisions, and associated spending on the Budget.

Figure REV-04

Changes in Revenues

(Benefit to General Fund - Dollars in Millions)

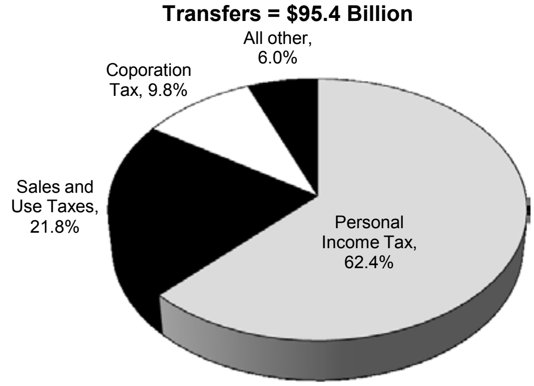
	2011-12	2012-13
Direct General Fund Impact		
Governor's Tax Initiative		
Temporary Additional Rates for High-Income Taxpayers	$2,245	$3,519
Temporary Sales Tax Rate of 0.5 percent	0	1,171
Revenue Driven Increase in Propostion 98 Expenditures		-2,534
Net Impact of Governor's Tax Initiative	$2,245	$2,156
Other Revenue Solutions		
Financial Institutions Records Match (FIRM)	$4	$11
Offsetting Costs Associated with FIRM		-9
Other Revenues	21	98
Fees and Loans	27	1,370
General Fund Revenue Solutions	$2,297	$3,626
Other Special Fund Revenues That Offset General Fund Costs		
Permanently Extend the Managed Care Organization Taxes for Medi-Cal and Healthy Families		$352
Total	$2,297	$3,978

General Fund Revenue

In 2012-13, General Fund revenues and transfers represent 71.7 percent of total revenues reported in the Budget. Figure REV-05 shows the breakdown of General Fund revenues by taxation type. The remaining 28.3 percent consists of special fund revenues dedicated to specific programs. The revenue estimates noted in the following discussion include the impact of the various proposals noted previously in "Revenue Proposals."

Figure REV-05

2012-13 General Fund Revenues and Transfers = $95.4 Billion



Personal Income Tax

The Personal Income Tax (PIT) is the state's largest single revenue source, accounting for 62.4 percent of all General Fund revenues and transfers in 2012-13. These revenue estimates include $2.3 billion in 2011-12 and $3.5 billion in 2012-13 from the assumed addition of three tax brackets for taxable incomes beginning at $250,000 ($500,000 joint) with rates of 10.3 percent, 10.8 percent, and 11.3 percent for five years.

Modeled closely on the federal income tax law, California's PIT is imposed on net taxable income—gross income less exclusions and deductions. The tax rate structure is steeply progressive over much of the income spectrum, with rates ranging from 1 percent to 9.3 percent. For the 2009 and 2010 tax years, the marginal rates ranged from 1.25 percent to 9.55 percent.

Income ranges for all tax rates are adjusted annually by the change in the California Consumer Price Index. This prevents taxpayers from moving into higher tax brackets because of inflation without an increase in real income. For the 2011 tax year, this adjustment increased 2.7 percent, reflecting rising prices for a second consecutive year following a decline in 2009. For the 2012 tax year, the adjustment is projected to be an increase of 1.6 percent. The largest income source for the PIT is wages and salaries. In 2009, taxes attributable to wages and salaries accounted for over 67 percent of PIT revenues. Based on the economic forecast, wages and salaries are expected to rise by an average of 4.8 percent in 2011, followed by 4.9 percent growth in 2012, and 2.3 percent in 2013.

The highest income Californians pay for a disproportionate share of the state's PIT taxes. Changes in the income of a relatively small group of taxpayers can have a significant impact on state revenues. 2009 tax return data reveal that taxpayers with adjusted gross income (AGI) above $200,000 represented only 3.8 percent of total returns for that year, but accounted for 31.4 percent of total AGI. This group accounted for 54.6 percent of 2009 total tax liability. Historically, this income group has also had wage growth rates that differ from those in the AGI group below $200,000. This differential can be exaggerated during periods of economic growth. In 2004 for example, wages for those in the over $200,000 AGI group grew at 24.4 percent. For all others, wages grew at 3.9 percent. Even several years into a recovery period, the growth differential can still be significant. For the 2007 tax year, the above-$200,000 AGI group had wage growth of 12.1 percent, while all others saw 6.3-percent growth. The PIT revenue forecast reflects this historical pattern of differential wage growth rates for different segments of the income distribution.

Another aspect of the PIT system is the significant role played by capital gains. In the period from 2003 to 2007, capital gains realizations saw tremendous growth from $45.6 billion to $132 billion. It dropped sharply in 2008 and again in 2009, when it stood at $28.8 billion. In 2009, this component accounted for 6 percent of the PIT. Gains from that low point are estimated to have increased 90 percent in 2010. Capital gains are expected to see continued growth of 15 percent in 2011, followed by 53 percent in 2012.

Capital gains income, while smaller than wage income, is concentrated in the above-$200,000 AGI group. The concentration of wages and capital gain income among high income earners, coupled with our progressive tax system, results in higher PIT revenue than the aggregate growth in total AGI would suggest.

Consistent with current law, the Budget reflects the potential behavioral impacts of federal tax law changes. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 reduced taxes for dividend income, capital gains, and other income. These tax reductions were set to expire after 2010. However, late in 2010 they were extended through 2012. In addition, a 3.8-percent surtax on specified unearned income will go into effect on January 1, 2013. Similar to what happened in 2010, the Budget estimates assume that in 2012 some taxpayers will respond to the potential rate changes by accelerating 20 percent of 2013 capital gains to 2012. It is also assumed that 10 percent of 2013 dividends and 1.1 percent of wages will be accelerated to 2012. These changes are projected to increase 2012-13 revenues by $1.5 billion and to reduce 2013-14 revenues by a similar amount.

Figure REV-06 shows the portion of General Fund revenues from capital gains. In addition to wages and salaries and capital gains, other major components of AGI include net business and proprietor income.

Figure REV-06

Capital Gains
As a Percent of General Fund Revenues

(Dollars in Billions)

	2002	2003	2004	2005	2006	2007	2008	2009	2010 [p]	2011 [e]	2012 [e]
Capital Gains Income	$33.4	$45.6	$75.5	$112.4	$117.9	$132.0	$56.3	$28.8	$54.7	$62.9	$96.0
Capital Gains Tax	$3.0	$4.1	$6.8	$10.1	$10.6	$11.9	$5.1	$2.6	$4.9	$5.7	$8.6
	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13
Total General Fund Revenues and Transfers	$71.3	$74.9	$82.2	$93.5	$95.5	$99.2	$82.8	$87.0	$93.5	$88.6	$95.4
Capital Gains Tax as Percent of General Fund Revenues & Transfers	4.2%	5.5%	8.3%	10.8%	11.1%	12.0%	6.1%	3.0%	5.3%	6.4%	9.1%

[p] Preliminary
[e] Estimated

Note: Totals may not add due to rounding
2002-03 revenues do not include $9.242 billion in economic recovery bonds.
2003-04 revenues do not include $2.012 billion in economic recovery bonds.
2007-08 revenues do not include $3.313 billion in economic recovery bonds.

A portion of PIT revenue is for dedicated purposes and deposited into a special fund instead of the General Fund. Proposition 63, passed in November 2004, imposes a surcharge of 1 percent on taxable income over $1 million in addition to the 9.3-percent General Fund rate (9.55 percent for tax years 2009 and 2010). Revenue from the surcharge is transferred to the Mental Health Services Fund and used to fund mental health service programs. Revenues of $1 billion are estimated for the 2010-11 fiscal year. Annual revenues of $1.2 billion for 2011-12, and $1.5 billion for 2012-13 are projected. The General Fund and the Mental Health Services Fund shares of PIT revenues for 2010-11 through 2012-13 are shown in Figure REV-07.

Figure REV-07

Personal Income Tax Revenue

(Dollars in Thousands)

	2010-11 Preliminary	**2011-12 Forecast**	**2012-13 Forecast**
General Fund	$49,491,070	$54,186,000	$59,552,000
Mental Health Services Fund	1,017,371	1,151,000	1,469,000
Total	**$50,508,441**	**$55,337,000**	**$61,021,000**

Sales and Use Tax

Since the end of 2010-11, the Sales and Use Tax has been adjusted as follows:

- Reduction of the temporary 1-percent General Fund rate in effect from April 1, 2009, to June 30, 2011, with an annual revenue loss of about $5 billion.
- The General Fund sales tax rate was further lowered from 5 percent to 3.9375 percent to fund 2011 Realignment.
- A Realignment rate of 1.0625 percent was permanently established to fund public safety programs through the Local Revenue Fund 2011.
- The Budget assumes the passage of a Constitutional Amendment that increases the sales tax rate by 0.5 percent from January 1, 2013, to December 31, 2016.

The sales tax is expected to generate General Fund revenues of $18.8 billion in 2011-12 and $20.8 billion in 2012-13. Figure REV-08 displays Sales and Use Tax revenues for the General Fund, as well as special funds, for 2010-11 through 2012-13.

Figure REV-08

Sales Tax Revenue

(Dollars in Thousands)

	2010-11 Preliminary	2011-12 Forecast	2012-13 Forecast
General Fund	$26,983,000	$18,777,000	$20,769,000
Sales and Use Tax-Realignment	2,469,129	2,661,201	2,774,986
Sales and Use Tax-2011 Realignment	0	5,107,000	5,320,000
Public Transportation Account	327,602	589,419	643,393
Economic Recovery Fund	1,216,641	1,311,000	1,394,000
Total	**$30,996,372**	**$28,445,620**	**$30,901,379**

Through the first three quarters of calendar year 2010, the largest contributors to the sales tax base were wholesale trade at 11.3 percent, food services and establishments serving alcoholic beverages at 11.0 percent, and motor vehicle and parts dealers at 10.1 percent. Other significant contributors to the sales tax base include sales by general merchandise stores at 9.1 percent and gasoline stations at 9.6 percent.

Taxable sales, including gas, decreased by 4.4 percent in 2009-10. Based on preliminary data, it is estimated that taxable sales have increased by 7.5 percent in 2010-11. Growth is expected to continue at 6.8 percent in 2011-12 followed by 4 percent in 2012-13.

General Fund revenues beginning in 2010-11 do not include any sales taxes collected from the sale of gasoline because of the fuel tax swap implemented on July 1, 2010, which exempted fuel sales from the General Fund portion of the sales tax (see the section on the Motor Vehicles Fuel Tax).

Approximately two-thirds of the sales tax is related to consumer spending and paid by households. Such purchases are influenced by employment trends and interest rates. Given that much of the sales tax base is comprised of nonessential purchases that can be postponed or cancelled, consumer confidence can have a significant impact on sales tax revenues. The remaining approximately one-third of the sales tax is paid on purchases by businesses. This component, too, is governed by businesses' perceptions of economic conditions and the need for additional equipment acquisitions and other capital purchases. Sales and Use Tax revenues are forecast by relating taxable sales to economic factors such as income, employment, housing starts, new vehicle sales, and inflation.

Receipts from Sales and Use Taxes, the state's second largest revenue source, are expected to contribute 21.8 percent of all General Fund revenues and transfers in 2012-13.

Figure REV-09 displays the individual elements of the state and local sales tax rates. Figure REV-10 shows combined state and local tax rates for each county.

Figure REV-09

2011-12 State and Local Sales and Use Tax Rates

State Rates		
General Fund	3.94%	Pursuant to Sections 6051.3 and 6051.4 of the Revenue and Taxation Code, this rate is 3.94% but may be temporarily reduced by 0.25% if General Fund reserves exceed specified levels.
Local Revenue Fund 2011	1.06%	Pursuant to Sections 6051.15 and 6201.15 of the Revenue and Taxation Code, beginning on July 1, 2011, revenues attributable to a rate of 1.0625 percent collected pursuant to Section 6051 shall be allocated to the Local Revenue Fund 2011.
Local Revenue Fund	0.50%	Dedicated to local governments to fund health and social services programs transferred to counties as part of 1991 state-local realignment.
Economic Recovery Fund	0.25%	Beginning on July 1, 2004, a new temporary 0.25% state sales tax rate was imposed, with a corresponding decrease in the Bradley-Burns rate. These revenues are dedicated to repayment of Economic Recovery Bonds. Once these bonds are repaid, this tax will sunset and the Bradley-Burns rate will return to 1%.
Local Uniform Rates[1]		
Bradley-Burns	0.75%[2]	Imposed by city and county ordinance for general purpose use.[3]
Transportation Rate	0.25%	Dedicated for county transportation purposes.
Local Public Safety Fund	0.50%	Dedicated to cities and counties for public safety purposes. This rate was imposed temporarily by statute in 1993 and made permanent by the voters later that year through passage of Proposition 172.
Local Add-on Rates[4]		
Transactions and Use Taxes	up to 2.00%	May be levied in 0.125% or 0.25% increments[5] up to a combined maximum of 2.00% in any county.[6] Any ordinance authorizing a transactions and use tax requires approval by the local governing board and local voters.

[1] These locally-imposed taxes are collected by the state for each county and city and are not included in the state's revenue totals.

[2] The 1 percent rate was temporarily decreased by 0.25 percent on July 1, 2004, and a new temporary 0.25 percent tax imposed to repay Economic Recovery Bonds. Cities and counties will receive additional property tax revenues equal to the 0.25 percent local sales tax reduction.

[3] The city tax constitutes a credit against the county tax. The combined rate is never more than 1 percent in any area (or 0.75 percent during the period when Economic Recovery Bonds are being repaid).

[4] These taxes may be imposed by voters in cities, counties, or special districts. The revenues are collected by the state for each jurisdiction and are not included in the state's revenue totals.

[5] Increments imposed at 0.125 percent are only allowed when revenues are dedicated for library purposes.

[6] An exception to the 2 percent maximum is Los Angeles County, which may impose up to 2.5 percent.

Figure REV-10

Combined State and Local Sales and Use Tax Rates by County

(Rates in Effect on October 1, 2011)

County	Tax Rate	County	Tax Rate	County	Tax Rate
Alameda [1/]	8.75%	Madera	7.75%	San Joaquin [23/]	7.75%
Alpine	7.25%	Marin [11/]	8.00%	San Luis Obispo [24/]	7.25%
Amador	7.75%	Mariposa	7.75%	San Mateo [25/]	8.25%
Butte	7.25%	Mendocino [12/]	7.25%	Santa Barbara	8.75%
Calaveras	7.25%	Merced [13/]	7.25%	Santa Clara [26/]	8.25%
Colusa [2/]	7.25%	Modoc	7.25%	Santa Cruz [27/]	8.00%
Contra Costa [3/]	8.25%	Mono [14/]	7.25%	Shasta	7.25%
Del Norte	7.25%	Monterey [15/]	7.25%	Sierra	7.25%
El Dorado [4/]	7.25%	Napa	7.75%	Siskiyou [28/]	7.25%
Fresno [5/]	7.975%	Nevada [16/]	7.375%	Solano	7.375%
Glenn	7.25%	Orange [17/]	7.75%	Sonoma [29/]	8.00%
Humboldt [6/]	7.25%	Placer	7.25%	Stanislaus [30/]	7.375%
Imperial [7/]	7.75%	Plumas	7.25%	Sutter	7.25%
Inyo	7.75%	Riverside [18/]	7.75%	Tehama	7.25%
Kern [8/]	7.25%	Sacramento [19/]	7.75%	Trinity	7.25%
Kings	7.25%	San Benito [20/]	7.25%	Tulare [31/]	7.75%
Lake [9/]	7.25%	San Bernardino [21/]	7.75%	Tuolumne [32/]	7.25%
Lassen	7.25%	San Diego [22/]	7.75%	Ventura [33/]	7.25%
Los Angeles [10/]	8.75%	San Francisco	8.50%	Yolo [34/]	7.25%
				Yuba [35/]	7.25%

[1/] 9.00% for sales in the City of San Leandro and 9.25% for sales in the City of Union City.
[2/] 7.75% for sales in the City of Williams.
[3/] 8.75% for sales in the Cities of Richmond, Pinole, and Concord and 9.25% in the City of El Cerrito.
[4/] 7.75% for sales in the Cities of Placerville and South Lake Tahoe.
[5/] 8.475% for sales in the Cities of Reedley and Selma and 8.725% for sales in the City of Sanger.
[6/] 8.00% for sales in the Cities of Eureka, Arcata and Trinidad.
[7/] 8.25% for sales in the City of Calexico.
[8/] 8.25% for sales in the Cities of Arvin and Delano.
[9/] 7.75% for sales in the City of Clearlake and the City of Lakeport.
[10/] 9.25% for sales in the Cities of Avalon, El Monte, Inglewood, Santa Monica, and South El Monte and 9.75% for sales in Pico Rivera and South Gate.
[11/] 8.50% for sales in the Cities of Novato and San Rafael.
[12/] 7.75% for sales in the Cities of Fort Bragg, Point Arena, Ukiah, and Willits.
[13/] 7.75% for sales in the Cities of Merced, Los Banos, and Gustine.
[14/] 7.75% for sales in the City of Mammoth Lakes.
[15/] 7.75% for sales in the Cities of Salinas and Sand City and 8.25% in the Cities of Del Rey Oaks, Marina, Pacific Grove, and Seaside.
[16/] 7.875% for sales in the Cities of Truckee and Nevada City.
[17/] 8.25% for sales in the City of La Habra.
[18/] 8.75% for sales in the City of Cathedral City.
[19/] 8.25% for sales in the City of Galt.
[20/] 8.00% for sales in the City of San Juan Bautista and 8.25% for sales in the City of Hollister.
[21/] 8.00% for sales in the City of Montclair and the City of San Bernardino.
[22/] 8.25% for sales in the City of Vista, 8.5% for the City of La Mesa, and 8.75% for sales in the Cities of El Cajon and National City.
[23/] 8.00% for sales in the City of Stockton and 8.25% for sales in the Cities of Manteca and Tracy.
[24/] 7.75% for sales in the Cities of Arroyo Grande, Morro Bay, Grover Beach, San Luis Obispo, and Pismo Beach.
[25/] 8.50% for sales in the Cities of Hillsdale and San Mateo.
[26/] 8.50% for sales in the City of Campbell.
[27/] 8.25% for sales in the Cities of Watsonville and Capitola and 8.50% for sales in the City of Santa Cruz.
[28/] 7.50% for sales in the City of Mount Shasta.
[29/] 8.25% for sales in the City of Sebastopol and 8.50% for Cotati, Rohnert Park, and Santa Rosa.
[30/] 7.875% for sales in the City of Ceres.
[31/] 8.00% for sales in the City of Visalia. 8.25% for sales in the Cities of Farmersville, Porterville, and Tulare. 8.50% for sales in the City of Dinuba.
[32/] 7.75% for sales in the City of Sonora.
[33/] 7.75% for sales in the Cities of Oxnard and Port Huememe.
[34/] 7.75% for sales in the Cities of West Sacramentoand Davis and 8.00% for sales in the City of Woodland.
[35/] 7.75% for sales in the City of Wheatland.

Corporation Tax

Corporation Tax revenues are expected to contribute 9.8 percent of all General Fund revenues and transfers in 2012-13. Corporation Tax revenues were $9.6 billion in 2010-11 and are expected to decline by 1.4 percent to $9.5 billion in 2011-12. In 2012-13, they are expected to decline another 1.5 percent to $9.3 billion. This is in part a function of recent policy changes discussed below. Corporation Tax revenues are driven by corporate profits, which generally track the overall business cycle. Further, Corporation Tax revenue over the next several years will be diminished by the recent legislative actions taken in prior budget acts. In particular, the following provisions will tend to weaken the growth of corporation tax revenue:

- The ability of taxpayers to elect single sales factor apportionment, which is operative for tax years beginning on or after January 1, 2011.
- The ability of unitary taxpayers to share tax credits among members of the unitary group, which is operative for tax years beginning on or after January 1, 2010.
- The ability for taxpayers to carry back net operating losses to prior years, which is operative for tax years beginning on or after January 1, 2012.
- The expiration of the temporary limitation of credits to offset no more than 50 percent of pre-credit tax liability, which were operative for tax years beginning after January 1, 2008, but before January 1, 2010.
- The end of the temporary suspension of net operating losses, which is operative for tax years beginning on or after January 1, 2008, but before January 1, 2012.

From 1943 through 1985, Corporation Tax liability as a percentage of profits closely tracked the corporation tax rate. Since 1986, increasing S-corporation activity and use of credits have been contributing to a divergence between profit and tax liability growth. Businesses that elect to form as S-corporations pay a reduced corporate rate, with the income and tax liability on that income passed through to owners and thus shifted to the personal income tax.

Insurance Tax

Most insurance policies written in California are subject to a 2.35-percent gross premiums tax. This premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. In general, the basis of the tax is the amount of "gross premiums" received, less return premiums.

To provide interim funding for the Healthy Families and Medi-Cal programs, Chapter 11, Statutes of 2011, expanded the 2.35-percent gross premiums tax to the Medi-Cal managed care plans through June 30, 2012. The Budget proposes to permanently extend this tax on Medi-Cal managed care plans. All tax receipts collected from this proposed extension would remain in the budget of the Department of Health Care Services.

Figure REV-11 displays the distribution of total Insurance Tax revenues from 2010-11 through 2012-13.

Figure REV-11

Insurance Tax Revenue

(Dollars in Millions)

	2010-11 Preliminary	2011-12 Forecast	2012-13 Forecast
General Fund	$2,076.9	$2,042.0	$2,179.0
Children's Health and Human Services Special Fund	230.1	234.2	352.4
Total	**$2,307.0**	**$2,276.2**	**$2,531.4**

The Department of Finance conducts an annual survey to project insurance premium growth. Responses were received this year from a sample representing about 42 percent of the dollar value of premiums written in California.

In 2010, $114.4 billion in taxable premiums were reported, representing a decrease of 0.1 percent from 2009. The most recent survey indicates that total premiums will increase by 6.5 percent and 3.8 percent in 2011 and 2012, respectively. The estimated yearly growth rates in taxable premiums from workers' compensation insurance are mixed: survey respondents reported a decline of 1.3 percent in 2011 and an increase of 3.8 percent in 2012. The primary reason for the decline in the Insurance Tax revenue estimate from 2010-11 to 2011-12 is refunds that are expected to be paid pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case. These refunds are also expected to dampen 2012-13 revenue. The California Department of Insurance estimates that the refunds resulting from to this decision are as follows: $2 million in 2010-11, $239 million in 2011-12, and $149 million in 2012-13.

Alcoholic Beverage Taxes

In addition to the sales tax paid by retail purchasers, California levies an excise tax on distributors of beer, wine, and distilled spirits. The tax rates per gallon are applied as follows: (1) $0.20 for beer, dry wine, and sweet wine, (2) $0.30 for sparkling wine, and (3) $3.30 for distilled spirits.

Alcoholic beverage revenue estimates are based on projections of total and per capita consumption for each type of beverage. Consumption of alcoholic beverages is expected to decline by about 3 percent in 2011-12 before returning to a 2-percent increase in 2012-13. Revenues from this tax were $334 million in 2010-11 and are forecasted to be $323 million in 2011-12 and $329 million in 2012-13.

Cigarette Tax

The state imposes an excise tax of 87 cents per pack of 20 cigarettes on distributors selling cigarettes in California. An excise tax is also imposed on the distribution of other tobacco products such as cigars, chewing tobacco, pipe tobacco, and snuff. The rate on other tobacco products is calculated annually by the Board of Equalization based on the wholesale price of cigarettes and the excise tax on cigarettes.

Revenues from the tax on cigarettes and other tobacco products are distributed as follows:

- Ten cents of the per-pack tax is allocated to the General Fund.
- Fifty cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, goes to the California Children and Families First Trust Fund for distribution according to the provisions of Proposition 10 of 1998.
- Twenty-five cents of the per-pack tax, and an equivalent rate levied on non-cigarette tobacco products, is allocated to the Cigarette and Tobacco Products Surtax Fund for distribution as determined by Proposition 99 of 1988.
- Two cents of the per-pack tax is deposited into the Breast Cancer Fund.

Projections of Cigarette Tax revenues are based on projected per capita consumption of cigarettes and population growth, while revenue estimates for other tobacco products also rely on wholesale price data. The cumulative effect of product price increases, the increasingly restrictive environments for smokers, state anti-smoking campaigns funded by Proposition 99 Tobacco Tax and Health Protection Act revenues and revenues from the Master Tobacco Settlement, and the 2009 federal cigarette tax rate increase have reduced cigarette consumption considerably.

Annual per capita consumption (based on population ages 18-64) declined from 123 packs in 1989-90 to 84 packs in 1997-98 and 41 packs in 2010-11. This forecast assumes an annual decline in total consumption of approximately 3 percent.

Figure REV-12 shows the distribution of tax revenues for the General Fund and various special funds for 2010-11 through 2012-13.

Figure REV-12

Tobacco Tax Revenue

(Dollars in Millions)

	2010-11 Preliminary	2011-12 Forecast	2012-13 Forecast
General Fund	$96.1	$93.0	$90.0
Cigarette and Tobacco Products Surtax Fund	285.0	277.0	269.0
Breast Cancer Fund	19.2	19.0	18.0
California Children and Families First Trust Fund	505.0	490.0	476.0
Total	**$905.3**	**$879.0**	**$853.0**

Property Taxes

Although the property tax is a local revenue source, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools generally offset General Fund expenditures.

Assessed value growth is estimated based on twice-yearly surveys of county assessors and evaluation of real estate trends. Sales volumes and prices of new and used homes and condominiums declined moderately from 2010 to 2011 (with activity in the 2011 calendar year driving fiscal year 2012-13 property tax revenues). These declines were less than in some prior years, however, and will be offset somewhat by reductions in the number of foreclosures and notices of default. Property tax revenues are estimated to increase 0.5 percent from 2010-11 to 2011-12, and increase 0.7 percent from 2011-12 to 2012-13.

Estate/Inheritance/Gift Taxes

Proposition 6, adopted in June 1982, repealed the inheritance and gift taxes and imposed a tax known as "the pick-up tax," because it was designed to pick up the maximum state credit allowed against the federal estate tax without increasing total taxes paid by the estate. The pick-up tax is computed based on the federal "taxable estate," with tax rates ranging from 0.8 percent to 16 percent.

The federal Economic Growth and Tax Relief Reconciliation Act of 2001 phased out the federal estate tax by 2010. This Act reduced the state pick-up tax by 25 percent in 2002, 50 percent in 2003, 75 percent in 2004, and eliminated it beginning in 2005. The state "pick-up tax" was scheduled to resume in 2011. However, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 made changes to the federal estate tax for 2011 and 2012. One of those changes was an extension of the elimination of the state estate tax credit for 2011 and 2012. This extension effectively eliminates the California estate tax through 2012. Assuming no changes to current federal or state law, California will begin to collect its portion of the federal estate tax on deaths occurring after January 1, 2013. As a result, no revenues are expected from estate tax in 2010-11 and 2011-12. Because of the lag between death and resolution of an estate, the forecasted revenue from estate tax in 2012-13 is $45 million. The estate tax remains an issue of significant interest to both political parties, and there is only a narrow range of federal law under which California would receive any revenue from an estate pick-up tax. Therefore, there is substantial uncertainty as to whether the federal estate tax law will remain or be modified to eliminate or substantially reduce the state pick-up tax.

Other Revenues

Unclaimed Property

The Budget reflects receipts of $254 million in 2010-11, $268 million in 2011-12, and $324 million in 2012-13 from unclaimed property. The 2011-12 amount includes $21 million from audits performed on insurance companies. The 2012-13 amount includes $48.7 million from audits performed on insurance companies and $7.9 million from the Unclaimed Property Fraudulent Claims Prevention and Detection Program.

Indian Gaming

The Budget reflects General Fund revenues from tribal gaming of $360 million annually in 2010-11 through 2012-13. Additionally, since 2009-10, about $100 million has been transferred annually from a special deposit fund to the General Fund for certain transportation programs that would otherwise be funded with revenues from a bond sale yet to occur. Absent a bond sale, the Administration proposes to continue this funding arrangement through 2015-16.

Loans and Transfers from Special Funds

The Budget proposes the following repayments for certain loans previously made from various special funds to the General Fund be deferred until future years, resulting in temporary savings to the General Fund:

- $27 million in 2011-12
- $605.5 million in 2012-13

Special Fund Revenue

The California Constitution and state statutes specify into which funds certain revenues must be deposited and how they are to be spent.

Total special fund revenues are estimated to be $38.6 billion in 2012-13. Taxes and fees related to motor vehicles are expected to comprise about 30 percent of all special fund revenue in 2012-13. The principal sources are motor vehicle fees (registration, weight, and vehicle license fees) and motor vehicle fuel taxes. During 2012-13, it is expected that about $12 billion in revenues will be derived from the ownership or operation of motor vehicles. About 27 percent of all motor vehicle taxes and fees will be allocated to local governments, and the remaining portion will be used for state transportation programs.

Motor Vehicle Fees

Motor vehicle fees and taxes consist of vehicle license, registration, weight, driver's license, and other charges related to vehicle operation. Figure REV-13 displays revenue from these sources from 2010-11 through 2012-13.

Figure REV-13

Motor Vehicle Fees Special Fund Revenue

(Dollars in Thousands)

	2010-11 Preliminary	2011-12 Forecast	2012-13 Forecast
Vehicle License Fees	$1,838,597	$2,049,577	$2,091,129
Registration, Weight, and Other Fees	3,359,359	3,918,191	3,846,459
Total	**$5,197,956**	**$5,967,768**	**$5,937,588**

The Vehicle License Fee (VLF) is imposed on vehicles that travel on public highways in California. This tax is imposed in lieu of a local personal property tax on automobiles and is administered by the Department of Motor Vehicles. Revenues from the 0.65-percent base VLF rate, other than administrative costs and fees on trailer coaches and mobile homes, are constitutionally dedicated to local governments.

The VLF is calculated on the vehicle's "market value," adjusted for depreciation. The motor vehicle schedule is based on an 11-year depreciation period; for trailer coaches, it is an 18-year period. A 0.65-percent rate is applied to the depreciated value to determine the fee.

Chapter 87, Statutes of 1991 revised the VLF depreciation schedule and required the Department of Motor Vehicles to reclassify used vehicles based on their actual purchase price each time ownership is transferred. Revenue from this base change is transferred to the Local Revenue Fund for state-local program realignment.

Chapter 322, Statutes of 1998 established a program to offset a portion of the VLF paid by vehicle owners at the 2-percent rate. The state paid or "offset" a portion of the amount due and taxpayers paid the balance. This General Fund offset gave taxpayers significant tax relief and compensated local governments. A permanent offset of 25 percent of the amount of the VLF owed became operative in 1999. Chapter 74, Statutes of 1999 increased the offset to 35 percent on a one-time basis for the 2000 calendar year. Chapters 106 and 107, Statutes of 2000, and Chapter 5, Statutes of 2001, extended the 35-percent offset through June 30, 2001, and provided an additional 32.5-percent VLF reduction, which was returned to taxpayers in the form of a rebate. Beginning July 1, 2001, the VLF was reduced by 67.5 percent. As the amount paid by taxpayers decreased, the amount backfilled by the General Fund increased.

The VLF reduction was suspended for a 141-day period beginning July 1, 2003. Executive Order S-1-03, issued November 17, 2003, rescinded the offset suspension and directed the Department of Motor Vehicles to reinstate the offset as soon as administratively feasible.

Chapter 211, Statutes of 2004 eliminated the VLF offset and reduced the VLF tax rate to 0.65 percent. Local governments now receive property tax revenues to compensate them for the loss of VLF revenue. In 2004-05 and 2005-06, that replacement revenue was reduced by $1.3 billion to assist the state. In 2012-13, the estimated value of the VLF backfill to local governments is $6 billion. The value of the tax reduction from 2 percent to 0.65 percent is $4.3 billion.

In February 2009, the VLF rate was increased to 1.15 percent from May 19, 2009, through June 30, 2011. Out of the 0.5-percent increase, all of which was deposited into the General Fund, 0.15 percent went towards funding local law enforcement and the remaining 0.35 percent went to the General Fund. It is estimated that an additional $80 million in revenue associated with the 0.5-percent VLF increase will be collected in 2011-12 from customers making late payments. As a result, in 2011-12, local law enforcement is expected to receive an additional $24 million, and the General Fund is expected to receive an additional $56 million. Effective July 1, 2011, the VLF returned to the 0.65-percent rate.

The number of vehicles in the state, the ages of those vehicles, and their most recent sales price affect the amount of VLF collected. The total number of vehicles in California—autos, trucks, trailers, and motorcycles including vehicles registered in multiple states—is estimated to be 29,643,974 in 2011-12 and is expected to decline to 28,483,919 in 2012-13. Consistent with expected increases in national new vehicle sales due to the availability of consumer credit, an improving employment picture, and projected increases to after-tax income, the forecast projects that there will be 1,483,000 new vehicles registered in 2011-12, and this will increase to 1,644,000 new vehicles in 2012-13.

The Department of Motor Vehicles administers the VLF for trailer coaches that are not installed on permanent foundations. Those that are installed on permanent foundations (mobile homes) are subject to either local property taxes or the VLF. Generally, mobile homes purchased new prior to July 1, 1980, are subject to the VLF. All trailer coach license fees are deposited in the General Fund.

In addition to the VLF, commercial truck owners pay a fee based on vehicle weight. Due partly to the expected increase in truck sales reflecting an improving business climate, weight fee revenues are expected to increase by about 2.0 percent in 2011-12 and 2012-13.

Motor Vehicle Fuel Taxes

The Motor Vehicle Fuel Tax, Diesel Fuel Tax, and the Use Fuel Tax are the major sources of funds for maintaining, replacing, and constructing state highway and transportation facilities. Just over one-third of these revenues are apportioned to local jurisdictions for street and highway use.

Gasoline consumption was down 0.5 percent in 2010-11 when compared to the prior fiscal year. Gasoline consumption is expected to decrease 0.6 percent in 2011-12 and then increase 1.9 percent in 2012-13.

Because most diesel fuel is consumed by the commercial trucking industry, consumption is affected most significantly by general economic conditions. Diesel fuel consumption fell 1 percent in 2010-11. However, a recovering economy is expected to contribute to growth of 3.8 percent in diesel consumption in 2011-12 followed by 3-percent growth in 2012-13.

Motor Vehicle Fuel Tax collections are shown in Figure REV-14.

Figure REV-14

Motor Vehicle Fuel Tax Revenue

(Dollars in Thousands)

	2010-11 Preliminary	**2011-12 Forecast**	**2012-13 Forecast**
Gasoline [1]	$5,231,599	$5,230,507	$5,222,580
Diesel	473,928	378,427	322,436
Total	**$5,705,527**	**$5,608,934**	**$5,545,016**

[1] Does not include jet fuel.

The Motor Vehicle Fuel Tax (gas tax) is collected from distributors when fuel is loaded into ground transportation for transport to retail stations. This fuel is taxed at a rate of 35.7 cents per gallon under current law. Fuels subject to the gas tax include gasoline, natural gas, and blends of gasoline and alcohol sold for use on public streets and highways.

Distributors pay the Diesel Fuel Tax, which applies to both pure diesel fuel and blends, at the fuel terminal. Diesel fuel for highway use is taxed at a rate of 13 cents per gallon in 2011-12. Dyed diesel fuel, which is used for off-highway purposes such as farm equipment, is not taxed.

Beginning in 2010-11, the fuel tax swap eliminated the General Fund portion of the sales tax on gasoline and replaced it with an excise tax of 17.3 cents per gallon. This tax swap is intended to be revenue-neutral. To maintain revenue neutrality, the excise tax rate is adjusted each year. For 2011-12, the rate is set at 35.7 cents per gallon. The Budget forecasts that the excise tax on gasoline will be 35 cents per gallon in 2012-13.

Beginning in 2011-12, the fuel tax swap increased the sales tax on diesel fuel by 1.87 percent, while decreasing the excise tax to maintain revenue neutrality. For 2011-12, the excise tax rate was reduced by 5 cents and is set at 13 cents per gallon. The Budget forecasts that the excise tax on diesel fuel will be set at 10.5 cents per gallon in 2012-13, and the sales tax rate will be increased by 2.17 percent in the same year.

The Use Fuel Tax is levied on sales of kerosene, liquefied petroleum gas (LPG), liquid natural gas (LNG), compressed natural gas (CNG), and alcohol fuel (ethanol and methanol containing 15 percent or less gasoline and diesel fuel). These fuels are taxed only when they are dispensed into motor vehicles used on the highways. Current Use Fuel Tax rates are 18 cents per gallon for kerosene, 6 cents per gallon for LPG and LNG, 7 cents per 100 cubic feet for CNG, and 9 cents per gallon for alcohol fuel. Users of LPG, LNG, or CNG may elect to pay a flat rate of tax based on vehicle weight instead of the per-gallon tax.

An excise tax of 2 cents per gallon is levied on aircraft jet fuel sold at the retail level. This tax does not apply to commercial air carriers, aircraft manufacturers and repairers, and the U.S. armed forces.

Local transit systems, school and community college districts, and certain common carriers pay 1 cent per gallon on the fuel they use instead of the tax rates described above.

Summary of State Tax System

The state's tax system is outlined at the end of this section in Figure REV-15. Tax collections per capita and per $100 of personal income are displayed in Schedule 2 in the Appendix. The revenue generated from each state tax from 1970-71 through 2011-12 is displayed in Schedule 3 in the Appendix.

Figure REV-15
Outline of State Tax System as of January 1, 2012

Major Taxes and Fees	Base or Measure	Rate	Administering Agency	Fund
Alcoholic Beverage Excise Taxes:				
Beer	Gallon	$0.20	Equalization	General
Distilled Spirits	Gallon	$3.30	Equalization	General
Dry Wine/Sweet Wine	Gallon	$0.20	Equalization	General
Sparkling Wine	Gallon	$0.30	Equalization	General
Hard Cider	Gallon	$0.20	Equalization	General
Corporation:				
General Corporation	Net income	8.84% [1]	Franchise	General
Bank and Financial Corp.	Net income	10.84%	Franchise	General
Alternative Minimum Tax	Alt. Taxable Income	6.65%	Franchise	General
Tobacco:				
Cigarette	Package	$0.87 [2]	Equalization	See below [2]
Other Tobacco Products	Wholesale cost	31.73% [3]	Equalization	See below [3]
Estate	Taxable Fed. Estate	0% [4]	Controller	General
Insurance				
Insurers	Gross Premiums	2.35% [5]	Insurance Dept.	General
Medi-Cal managed care plans	Gross Premiums	2.35%	Health Care Services	See below [6]
Liquor License Fees	Type of license	Various	Alc. Bev. Control	General
Motor Vehicle:				
Vehicle License Fees (VLF)	Market value	0.65%	DMV	Motor VLF, Local Revenue [7]
Fuel—Gasoline	Gallon	$0.357 [8]	Equalization	Motor Vehicle Fuel [9]
Fuel—Diesel	Gallon	$0.13 [10]	Equalization	Motor Vehicle Fuel
Registration Fees	Vehicle	$69.00	DMV	Motor Vehicle [11]
Weight Fees	Gross Vehicle Wt.	Various	DMV	State Highway
Personal Income	Taxable income	1.0-9.3% [12]	Franchise	General
Proposition 63 Surcharge	Taxable income > $1 million	1.0%	Franchise	Mental Health Services
Alternative Minimum Tax	Alt. Taxable Income	7.0%	Franchise	General
Retail Sales and Use	Sales or lease of taxable items	7.25% [13]	Equalization	See below [13]

[1] Minimum Tax is $800 per year for existing corporations. New corporations are exempt for the first two years.

[2] This tax is levied at the combined rate of 10 cents/pack of 20 cigarettes for the General Fund, 25 cents/pack for the Cigarette and Tobacco Products Surtax Fund, 2 cents/pack for the Breast Cancer Fund, and 50 cents/pack for the California Children and Families First Trust Fund.

[3] The surtax rate is determined annually by the BOE and is equivalent to the combined rate of tax applied to cigarettes, with funding for the Cigarette and Tobacco Products Surtax Fund and California Children and Families First Trust Fund. Effective July 1, 2011, through June 30, 2012, the rate is 31.73 percent of the wholesale cost.

[4] Since 2005 and through the end of 2012, federal estate tax law is structured such that California will receive none of the "state pick-up" estate tax for those years. However, under current law, starting in January 1, 2013, the federal estate tax will return to its pre-2011 structure and California will, again, begin to receive estate tax payments for estates for which the death occurred on or after January 1, 2013.

[5] Ocean marine insurance is taxed at the rate of 5 percent of underwriting profit attributable to California business. Special rates also apply to certain pension and profit sharing plans, surplus lines, and nonadmitted insurance.

[6] Insurance tax on Medi-Cal managed care plans through June 30, 2012, pursuant to Chapter 11, Statutes of 2011 (X1 AB 21), to provide interim funding for the Healthy Families and Medi-Cal programs.

[7] For return to cities and counties. Trailer coach license fees are deposited in the General Fund.

[8] As part of the fuel tax swap implemented beginning July 1, 2010, this rate was increased from 18 cents and will be adjusted each year to maintain revenue neutrality with the elimination of the General Fund portion of the sales tax on gasoline.

[9] For administrative expenses and apportionment to State, counties and cities for highways, airports, and small craft harbors.

[10] As part of the fuel tax swap, this rate will be decreased by an estimated 4.8 cents on July 1, 2011, and will be adjusted each year thereafter to maintain revenue neutrality with the 1.75% increase in sales tax on diesel beginning July 1, 2011.

[11] For support of State Department of Motor Vehicles, California Highway Patrol, other agencies, and motor vehicle related programs.

[12] The Budget assumes passage of the Governor's proposal for a Constitutional Amendment on the November 2012 ballot which would temporarily add three tax brackets for taxable incomes beginning at $250,000 ($500,000 joint) with rates of 10.3 percent, 10.8 percent, and 11.3 percent.

[13] The 7.25 percent rate includes the rates for General Fund, Special Funds, and uniform local rates. Additionally, cities and counties may generally assess up to an additional 2.00 percent to the statewide rate. The Budget assumes passage of the Governor's proposal for a Constitutional Amendment on the November 2012 ballot which would temporarily increase the Sales and Use Tax rate by 0.5 percent.

Demographic Information

Results from the 2010 Census, initially released on December 21, 2010, have now been incorporated into current population estimates. In addition to being used for budget planning, state-produced demographic data are used by local officials to calculate their annual appropriations limits and by state officials to calculate state subvention funds distributed on a per capita basis.

There was a 1.25 million discrepancy between the census count for California and the estimate produced by the Department of Finance. Although discrepancies between estimates and censuses occur every decade, this discrepancy was larger than expected and likely resulted from the depth of the recession late in the decade that caused net domestic migration to other states. The reduced base population from the 2010 census will affect population projections, especially in the short term. The Department will be developing ways to better incorporate information about California's economic conditions into population projections.

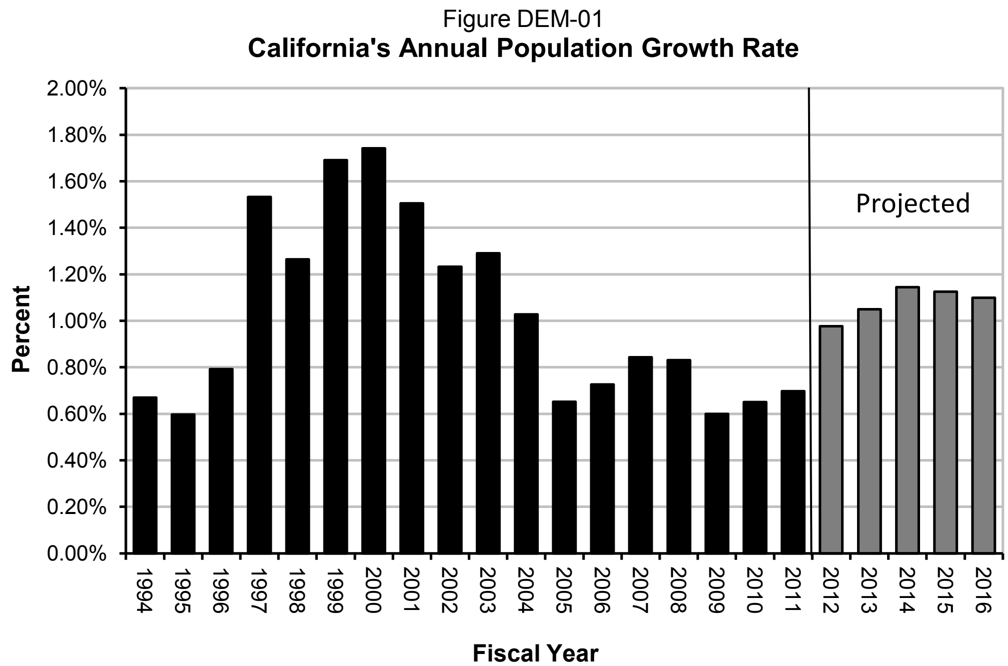
Population Overview

The Budget assumes a population estimate of more than 37.5 million people residing in California as of mid-2011. California continues to experience moderate growth, growing by only 0.7 percent in the last fiscal year, which is slightly higher than each of the previous two years.

- The estimate of the population on July 1, 2011 is 37,579,000.

- The population is forecast to be 37,946,000 by July of 2012 and 38,344,000 by July of 2013, reflecting a short-term annual growth rate of 1.01 percent.

Figure DEM-01 displays the projected annual growth rates through 2016.

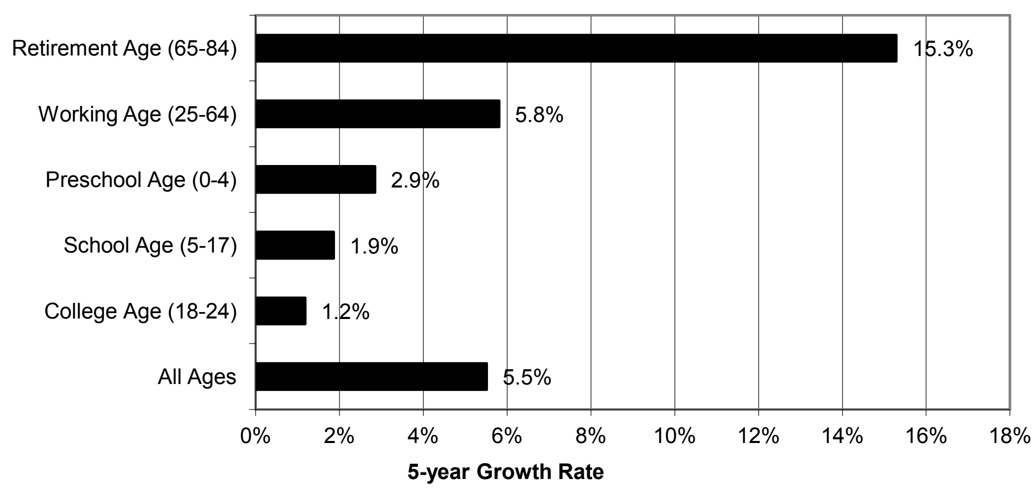


Through the next five years, the state will start to grow at a higher rate, averaging 414,000 additional residents each year. Natural increase (more children being born than people dying) will account for two-thirds of the growth, while net migration (people moving to California from other states and other countries, less those moving out) accounts for the remaining third. By July 2016, California will have added almost 2.1 million people and have a population of over 39.6 million, a five-year growth rate of 5.5 percent. If California continues to grow at this pace, the state population will not exceed 50 million before 2040.

Population growth rates vary significantly by age group. The state's projected total five-year population growth of 5.5 percent is almost double the anticipated 2.9-percent growth in the preschool-age group, as births declined for calendar years 2009 and 2010. Both the school-age group and the college-age group will grow even more slowly, with growth rates of 1.9 percent and 1.2 percent respectively. The working-age population will grow by 1.2 million or 5.8 percent. The population of the retirement-age group, those over age 65, will continue to soar, with a five-year growth rate of more than 15 percent.

Figure DEM-02 shows the projected cumulative growth rates by age group through 2016.

Figure DEM-02
Projected California Population Growth Rate by Age Group (2012-2016)



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Realignment

The finances of the state and local governments have been closely linked since the passage of Proposition 13 in 1978. Counties have been heavily dependent on state budget decisions regarding programs in which they share the cost and programs they administer for the state.

Government is most effective at the local level, where locally elected officials can tailor programs to local needs and priorities. In a state as diverse as California, it is difficult to establish programs that are equally effective and make sense in both large urban and small rural areas.

Over the past three decades, there have been attempts to clarify and simplify which level of government pays for what services. These efforts include the 1991 Realignment program, in which counties assumed responsibility for community mental health and indigent health funding, and the 1997 state assumption of trial court funding designed to bolster equal access to justice for citizens across the state.

2011 Public Safety Realignment

The 2011 Budget includes a major realignment of public safety programs from the state to local governments. The realignment moves program and fiscal responsibility to the level of government that can best provide the service, eliminating duplication of effort, generating savings, and increasing flexibility. The implementation of the Community

Corrections Grant Program authorized by AB 109 will end the costly revolving door of lower-level offenders and parole violators through the state's prisons.

The goals of realignment are to:

- Protect California's essential public services.
- Create a government structure that meets public needs in the most effective and efficient manner.
- Have government focus on core functions.
- Assign program and fiscal responsibility to the level of government that can best provide the service.
- Have interconnected services provided at a single level of government.
- Provide dedicated revenues to fund these programs.
- Provide as much flexibility as possible to the level of government providing the service.
- Reduce duplication and minimize overhead costs.
- Focus the state's role on appropriate oversight, technical assistance, and monitoring of outcomes.

With resources and program responsibility at the local level, each county Board of Supervisors can integrate programs across the spectrum of health and human services and law enforcement to best meet the needs of its citizens, limit program cost increases, and achieve better outcomes.

Constitutional Protection

The Governor is sponsoring an initiative to provide Constitutional protection for the revenue dedicated to 2011 Realignment. This initiative will also protect local government against future costs imposed upon them, as well as provide mandate protection for the state.

Realigned Programs

2011 Realignment gives counties the funding responsibility for:

- Substance Abuse Treatment programs

- Adult Protective Services
- Foster Care
- Child Welfare Services
- Adoptions and Adoption Assistance
- Child Abuse Prevention
- Mental Health Managed Care
- Early Periodic Screening, Diagnosis, and Treatment (EPSDT) Program
- Court Security
- Local Law Enforcement Programs (which include allocations for cities)
- Community Corrections Programs (Lower-Level Offenders, Parole, and Parole Violators)
- Juvenile Justice Programs

In addition, community mental health programs previously funded in 1991 Realignment are now funded by revenue dedicated for 2011 Realignment. The 1991 Realignment funding previously dedicated to mental health programs is allocated to a new Maintenance of Effort Subaccount in 1991 Realignment to cover costs of cash assistance grants to low-income families.

Funding Model for Lower-Level Offenders, Parole, and Parole Violators

As part of the implementation of AB 109, the Department of Finance developed a funding model based on assumptions about costs of activities for these offenders at the local level. For each category (parole violators, parolees, and local jurisdiction for lower-level offenders), an Average Daily Population was determined along with assumptions about average length of jail stays, program and treatment costs, and probation monitoring costs, as well as administrative costs. The California Department of Corrections and Rehabilitation developed month-by-month projections of persons on post-release community supervision and numbers of lower-level offenders in order to assist counties in planning for program needs.

The 2011-12 county funding allocation for this program was developed by the California State Association of Counties, working with county executive officers, using three factors—the estimates of the number of offenders who would be under the jurisdiction of each county, each county's population between the ages of 18 to 64, and a county's success under the felony probation program initiated under Chapter 608, Statutes of 2009 (SB 678).

The allocation for the community corrections programs was for 2011-12 only in order to gain more program experience before determination of a permanent allocation.

Local Implementation of Community Corrections Programs

Each county is required to have a Community Corrections Partnership, which is charged with developing an implementation plan to deal with the population serving their sentence at the local level. Most counties have completed their plans and offer a wide range of intermediate sanctions, supervision, and treatment options in addition to appropriate jail time. For example, counties can utilize Pre-Trial Release Programs with enhanced supervision, Day Reporting Centers, and flash incarceration in addition to providing behavioral health assessments and treatment, housing, and employment services. These intermediate sanctions and treatment services can help prevent the revolving door of the corrections system.

With only three months of information available, it is difficult to gauge exactly how numbers to date are tracking to 2011 Budget Act estimates on a county-by-county basis. The Administration will continue to work closely with counties to monitor and analyze the information to see if adjustments are necessary. This information will be useful in developing future allocations.

2011 Realignment Funding

The 2011 Realignment is funded through two sources – a state special fund sales tax of 1.0625 percent totaling $5.1 billion and $462.1 million in Vehicle License Fees (VLF).

Figure REA-01 identifies the programs and funding for 2011 Realignment.

At the time of the final Budget, the estimate for 2011-12 sales tax was $5,105.7 million. This estimate has been revised to $5,107 million. The 2011-12 VLF estimate at the time of budget enactment was $453.4 million. This estimate has been revised upward to $462.1 million. Pursuant to Chapter 40, Statutes of 2011, these funds are deposited into

Figure REA-01

2011 Realignment Funding

(Dollars in Millions)

Program	2011-12	2012-13	2013-14	2014-15
Court Security	$496.4	$496.4	$496.4	$496.4
Local Public Safety Programs	489.9	489.9	489.9	489.9
Local Jurisdiction for Lower-level Offenders and Parole Violators				
Local Costs	239.9	581.1	759.0	762.2
Reimbursement of State Costs	957.0	-	-	-
Realign Adult Parole				
Local Costs	127.1	276.4	257.0	187.7
Reimbursement of State Costs	262.6	-	-	-
Mental Health Services				
Early and Periodic Screening Diagnosis and Treatment	-	544.0	544.0	544.0
Mental Health Managed Care	-	188.8	188.8	188.8
Existing Community Mental Health Programs	1,104.8	1,164.4	1,164.4	1,164.4
Substance Abuse Treatment	179.7	179.7	179.7	179.7
Foster Care and Child Welfare Services	1,562.1	1,562.1	1,562.1	1,562.1
Adult Protective Services	54.6	54.6	54.6	54.6
Existing Juvenile Justice Realignment	95.0	98.8	100.4	101.3
Program Cost Growth	-	180.1	443.6	988.8
Total	**$5,569.1**	**$5,816.3**	**$6,239.9**	**$6,719.9**
Vehicle License Fee Funds	462.1	496.3	491.9	491.9
1.0625% Sales Tax	5,107.0	5,320.0	5,748.0	6,228.0
Total Revenues	**$5,569.1**	**$5,816.3**	**$6,239.9**	**$6,719.9**

the Local Revenue Fund 2011 on an ongoing basis for allocation to the counties and are available only for the purposes of 2011 Realignment.

Funding Structure for 2011 Realignment

Although the revenue stream for 2011 Realignment is ongoing, the program allocations were for the 2011-12 fiscal year only.

Following discussions with the California State Association of Counties, the Administration is proposing a permanent funding structure for 2011 Realignment for both base and growth funding. Figure REA-02 displays the proposed County Local Revenue Fund structure.

The funding structure is designed to provide local entities with a known, reliable, and stable funding source for these programs. Within each Subaccount, counties will have the flexibility to meet their highest priorities. Counties will be able to use their funds to draw down the maximum amount of federal funding for these programs. In those programs in which there are federal requirements, such as federal eligibility and statewideness, counties will be responsible for meeting those requirements and will be responsible for penalties if they fail to achieve them. The state is committed to assisting counties as appropriate if they need federal state plan amendments, waivers, or other flexibilities.

The following concepts were important in determining the components of the funding framework:

Base Funding – Providing Stable Funding

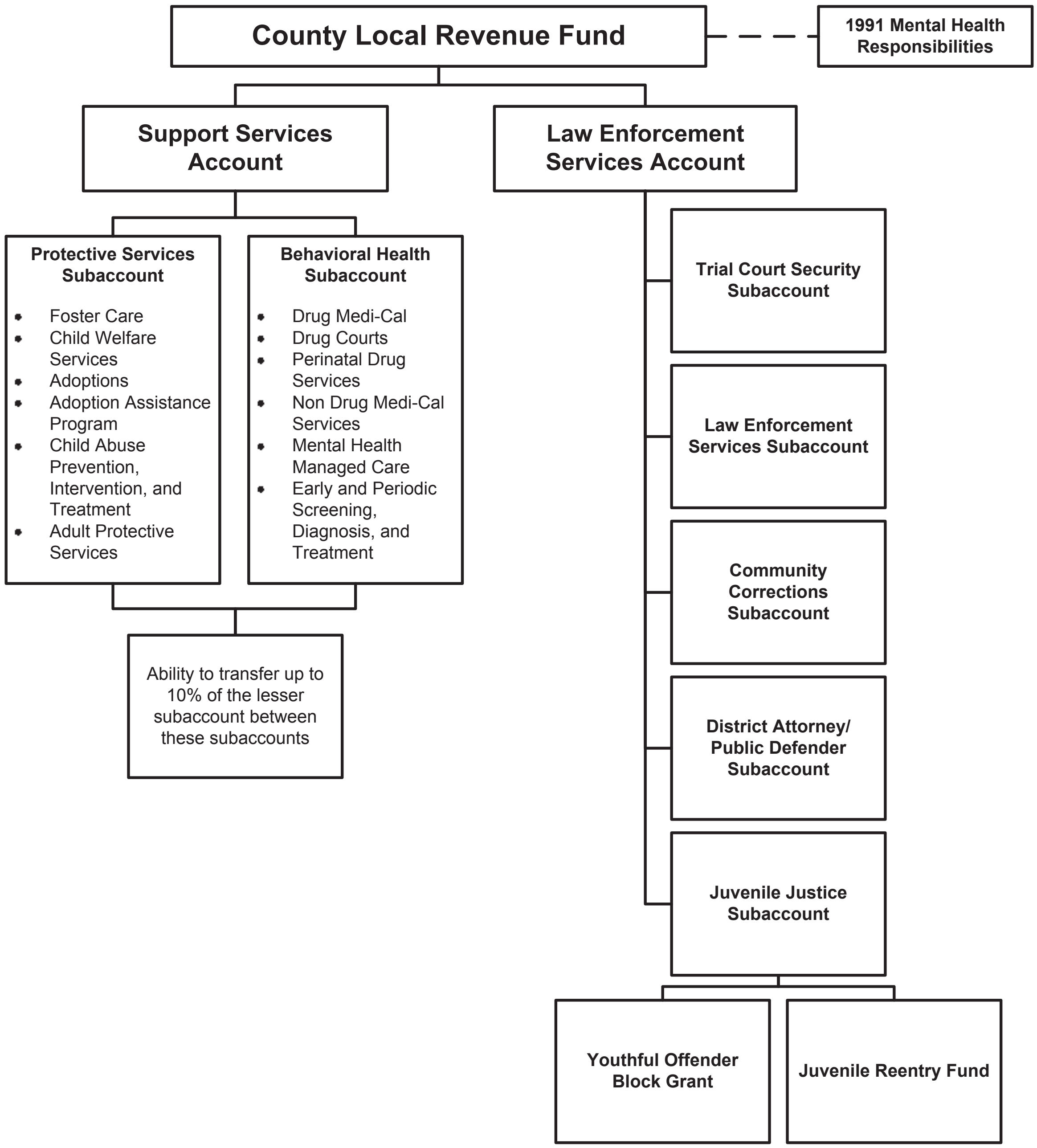
- The base in each Subaccount should not experience a year-over-year decrease. A statutory mechanism should be in place to deal with the possibility of a year's base being short due to significantly reduced revenues.
- The timing of the program's inclusion in 2011 Realignment and the implementation schedule should affect base funding for each program.
- The base should be a rolling base for each Subaccount; i.e., the base plus growth equals the subsequent year's base.
- The 1991 Mental Health program should continue to receive revenue based on its 1991 formula.

Growth Funding

- Funding for program growth should be distributed on a roughly proportional basis, first among Accounts, and then by Subaccounts.
- Within each Subaccount, federally required programs should receive priority for funding if warranted by caseload and costs.

Figure REA-02

2011 Realignment Funding Structure



- Growth funding for the Child Welfare Services (CWS) program is a priority once base programs have been established. Over time, CWS should receive an additional $200 million.

Transferability

- To provide flexibility, counties should have the ability to transfer a maximum of 10 percent of the lesser subaccount between the Subaccounts within the Support Services Account.
- Beginning in 2015-16, there should be a local option to transfer a portion of the growth among Subaccounts within the Law Enforcement Services Account.
- Transfers should be for one year only and not increase the base of any program.

Reserve Account

To provide some cushion for fluctuations in future revenue, a Reserve Account should be established when Sales and Use Tax revenues exceed a specified threshold.

Continuing the Work of Moving Government Closer to the People

Ongoing Implementation of 2011 Realignment

The Administration is committed to a continued partnership with county officials for the successful implementation of 2011 Realignment. These efforts include:

Refocus State Efforts. The Administration is committed to a 25-percent reduction in the state operations of program areas that have been realigned. Both the Departments of Alcohol and Drug Programs and Mental Health reduced their program components by that amount before transferring functions to the Department of Health Care Services (DHCS). The new Division of Mental Health and Substance Use Disorder Services within the DHCS will provide appropriate state oversight and assistance for programs realigned to the counties.

The Department of Social Services will develop its 25-percent reduction plan upon county decisions regarding workload within realigned programs and based on federal requirements.

County Flexibility. The Administration continues to support efforts to increase the flexibility of counties in administering programs.

Ongoing Training for AB 109. The Budget proposes $8.9 million for a second year of training efforts related to the implementation of AB 109 programs. Of this amount, $1 million is for statewide training efforts. The remainder is for allocation to each Community Corrections Partnership so the Partnerships have sufficient resources to review and amend plans based on the first year of program experience.

Other 2011 Realignment Efforts. As issues arise that appear to be systemic in implementation, the Administration will work with county officials to address them. For example, the Administration will work with counties to develop improved treatment and housing options for offenders who are incarcerated and suffer from mental illness, as necessary.

Increased Local Flexibility for Schools

Increasing local flexibility and local decision-making is not just associated with counties. Over the past 30 years, the state also has made more and more decisions for local schools. The Budget proposes a weighted pupil funding formula to be phased in over the next five years. This will reduce the complexity and administrative costs for school districts and provides significant additional flexibility to local districts by consolidating funding for the vast majority of categorical programs and revenue limits into a single source. Current accountability measures will be used, along with locally developed measures, as the basis for evaluating and rewarding school performance under this new finance model.

Juvenile Justice Reform

One of the more successful efforts over the past 15 years has been the change in jurisdiction of juvenile offenders from the state to counties. Over the last decade, the number of wards in state juvenile facilities has decreased from over 10,000 to approximately 1,100.

The Administration wants to build on this success and eventually have the counties manage all youthful offenders. This effort must be done thoughtfully and carefully to provide the best placement and treatment options for these youth. The Budget proposes to stop the intake of new juvenile offenders to the Division of Juvenile Justice (DJJ) effective January 1, 2013. The DJJ's population will gradually diminish through attrition.

The state is committed to providing the necessary resources and assistance to local governments for a successful transition. Recognizing that counties will need resources and support to secure appropriate placements and treatment options for additional offenders, many of whom need mental health and substance abuse treatment, the Budget proposes $10 million General Fund in 2011-12 for counties to begin planning for this population. To help with the transition and prevent the disinvestment of funds in juvenile justice at the local level, the state will delay collection of recently imposed additional fees for those wards housed in the DJJ.

Phase 2 Realignment

The implementation of Phase 2 of Realignment is linked to the ongoing discussion of how California will implement federal health care reform.

Under health care reform, counties will have a significant role in Medi-Cal eligibility determinations. The focus of the Phase 2 Realignment discussion with counties and others in the coming months will revolve around the appropriate relationships between the state and counties in the funding and delivery of health care as about two million additional people will shift from county indigent programs to the Medi-Cal caseload. Additional data are needed to inform decisions about implementation.

The discussion also will involve what additional programs the counties should be responsible for when the state assumes the majority of costs of healthcare.

Legislative, Judicial, and Executive

Governmental entities classified under the Legislative, Judicial, and Executive section of the Governor's Budget are either established as independent entities under the California Constitution or are departments that operate outside the agency structure. Constitutionally established bodies include the Legislature, the Judicial Branch, Governor's Office, and Constitutional Officers.

The Budget includes total funding of $8.5 billion ($2.6 billion General Fund and $5.9 billion other funds) in 2012-13 for all programs included in this area.

Judicial Branch

The Judicial Branch consists of the state-level judiciary which includes the Supreme Court, the Courts of Appeal, and the Administrative Office of the Courts. There are also 58 superior courts in the state.

Significant Adjustment:

- The Budget includes an augmentation of $50 million Trial Court Trust Fund in 2012-13 from proposed civil court fee increases in light of the General Fund budget reductions in recent years. The courts' General Fund budget has been reduced by 21 percent since 2007-08. These funds would be available to offset the ongoing impact of these cuts.

Ballot Trigger Reduction:

- The Judicial Branch would be reduced by $125 million in 2012-13 if the Governor's tax proposal is not approved in November. While the Branch would determine how to implement this reduction, it is the equivalent of court closures equal to three days per month.

Governor's Office of Business and Economic Development

Chapter 475, Statutes of 2011, created the Governor's Office of Business and Economic Development (GO-Biz) to serve as the lead state entity for economic strategy and marketing of California on issues relating to business development, private sector investment, and economic growth. The GO-Biz provides a single point of contact for economic development, business assistance and job creation efforts, and works with companies and organizations across the state to market the benefits of doing business in California.

Significant Adjustment:

- The Budget proposes $4.1 million General Fund to support the annual operations of the GO-Biz. The Governor's reorganization proposal would also consolidate the Infrastructure Bank, the Film and Tourism Commissions, the Small Business Centers, and the Small Business Guarantee Loan Program within the GO-Biz.

California Emergency Management Agency

The principal objective of the California Emergency Management Agency (Cal EMA) is to reduce vulnerability to hazards through emergency management. The Cal EMA coordinates emergency activities to save lives and reduce property loss during disasters and to expedite recovery from the effects of disasters. The Cal EMA provides leadership, assistance, and support to state and local agencies in planning and preparing for the most effective use of federal, state, local, and private sector resources in emergencies.

Significant Adjustment:

- Consistent with the Administration's continued efforts to streamline state government, the Budget proposes to relocate the California Specialized Training

Institute from San Luis Obispo to more populated locations in northern and southern California. The Institute offers specialized training that focuses on emergency management, criminal justice, and hazardous materials. The relocation will result in state savings of $1.5 million ($0.2 million General Fund and $1.3 million other funds) in 2012-13. In addition, local governments will save travel costs since the training will be available in central locations that are more easily accessible.

Governor's Office

The Office of the Governor provides the overall direction and executive administration of all state agencies and departments under its purview. The Governor's Office is funded from the General Fund and a special fund that supports centralized state administrative costs. In 2011-12, the Governor's Office reduced its budget by 25 percent, or $4.5 million. In recognition of the state's fiscal crisis, the budget for the Governor's Office remains at the level budgeted for 2011-12. The Governor is committed to ensuring that his office contains costs through being more efficient and continuing to do more with less.

Department of Justice

As the chief law officer of the state, the Attorney General has the responsibility to see that the laws of California are uniformly and adequately enforced through the programs administered by the Department of Justice (DOJ).

Proposal to Balance the Budget:

- The Budget proposes to shift support for the Armed Prohibited Persons System from the General Fund to the Dealers' Record of Sale Account. This results in a decrease of $4.9 million in General Fund expenditures beginning in 2012-13. Chapter 743, Statutes of 2011, expanded the allowable uses of the Dealers' Record of Sale Account to include regulatory and enforcement activities related to possession of firearms, thus permitting the shift in funding source for this program.

Other Significant Adjustment:

- The 2011 Budget Act eliminated $71.5 million in General Fund support for the Division of Law Enforcement. The Budget partially restores the Division of Law Enforcement and creates the California Bureau of Special Investigations through an augmentation of $11.8 million ($4.9 million General Fund and $6.9 million other funds) beginning in 2012-13. Specifically, this funding would allow the DOJ to continue special investigations, prosecute foreign crimes, and address a backlog in entries in the Armed Prohibited Persons System.

Ballot Trigger Reduction:

- The DOJ would be reduced by $1 million in 2012-13 if the Governor's tax proposal is not approved in November. By 2013-14, this would eliminate the $4.9 million General Fund resources proposed in the Budget for the Division of Law Enforcement.

Board of Equalization

The Board of Equalization (BOE) administers the collection of the sales and use tax, property taxes, and various special taxes, and exercises oversight of the property tax assessment practices of county assessors. The BOE also serves as the appellate body for contested property, income, and business tax assessments.

Significant Adjustments:

- State Responsibility Area Fire Prevention Fee—An increase of $6.4 million State Responsibility Area Fire Prevention Fund and 57 positions in 2012-13 to collect this fee in accordance with Chapter 8, Statutes of 2011. The fee is expected to generate General Fund savings of $88 million in 2012-13.
- Out-of-State Use Tax Collection—An increase of $2.1 million General Fund and 28 positions in 2012-13 to implement collection of use tax from out-of-state retailers in accordance with Chapter 313, Statutes of 2011. This is expected to generate $50 million in General Fund revenue in 2012-13.

State and Consumer Services

As currently structured, the State and Consumer Services Agency's mission is to help educate consumers and make government more efficient, effective, and accountable for all California taxpayers. Among its many responsibilities, the Agency licenses more than 2.7 million Californians in more than 250 different professions, procures more than $7.9 billion in goods and services, and oversees the Franchise Tax Board.

The Budget includes total funding of $36.3 billion ($689.1 million General Fund) for the Agency.

Department of General Services

The Department of General Services (DGS) provides centralized services and oversight activities to state agencies over a broad spectrum of areas, including: management of state-owned and leased real estate, maintenance of state-owned buildings, approval of architectural designs for local schools and other state-owned buildings, a quasi-judicial court that hears administrative disputes, publishing services, management of the state's fleet, and procurement of commodities, services, and equipment. These activities are largely funded through fees that are charged to the client departments.

Current Efficiency Efforts Underway

Since the economic downturn, expenditure reductions have limited departments' ability to pay for goods and services. Consequently, it is essential for service entities such as DGS to implement efficiencies to reduce client departments' costs. Efforts to identify efficiencies and better business practices are underway and should result in either cost avoidance or savings for departments. Efforts include:

- Renegotiating nearly 300 departmental leases to reduce lease costs.
- Reducing costs for servicing office equipment by initiating a new equipment maintenance and management insurance program that will replace the multiple service contracts currently used by individual departments.
- Reducing travel arrangement costs for state employees by renegotiating statewide travel services contracts.
- Negotiating with a major airline carrier in an effort to provide air transportation at a cost less than the current discounted rates that are available to employees traveling on state business.
- Examining warehouse utilization to determine opportunities for consolidation, eliminating unnecessary materials, and reducing warehouse space.
- Closing three state garages that are no longer cost effective in comparison to the negotiated commercial rental car company rates.

Proposal to Balance the Budget:

- State Capitol Repairs—A one-time decrease of $2.7 million in 2012-13 as a result of delaying less-critical repairs to the mechanical systems and other infrastructure repairs until future years.

Other Significant Adjustment:

- Unallocated Reduction—A decrease of $59.1 million as a result of budgetary savings and rate reductions that will occur as a result of operational efficiencies.

Business, Transportation, and Housing

As currently structured, the Business, Transportation, and Housing Agency includes programs that promote the state's business and economic climate, transportation infrastructure, and affordable housing. The Agency also includes public safety programs, including the Department of Motor Vehicles, the California Highway Patrol, and the Department of Alcoholic Beverage Control. Funding for all programs exceeds $17.2 billion, which is derived largely from special fund revenues, federal funds, and bond proceeds.

Department of Transportation

The Department of Transportation (Caltrans) has over 20,000 employees and a budget of $11.2 billion. Caltrans designs and oversees the construction of state highways, operates and maintains the highway system, funds three intercity passenger rail routes, and provides funding for local mass transit projects. Approximately 50,000 road and highway lane miles and 12,559 state bridges are maintained, and 812 public-use and special-use airports and heliports are inspected. The largest sources of funding for transportation projects are excise taxes paid on fuel consumption, federal funds also derived from fuel taxes, and weight fees on trucks. Bond funds currently provide more than 16 percent of the total funding available. It is expected that new bond appropriations will be proposed in the spring of 2012 after the Administration has more information regarding cash needs for projects.

Proposal to Balance the Budget:

- Weight Fee Revenue Transfer — A transfer of $349.5 million in weight fee revenues to the General Fund in 2012-13. The state collects a fee on commercial trucks based on the weight of the vehicle, which represents compensation for the wear and tear on the State's roads and highways. The Budget proposes to transfer existing weight fee revenue above the level needed to offset current debt service on specified general obligation transportation bonds to the General Fund. These funds will be used to offset debt service costs in the future.

Other Significant Adjustments:

- Amtrak Cost Increase — The Budget includes a $13.9 million increase (growing to $28 million in 2013-14) in payments to Amtrak for current intercity rail services provided in Southern California. These increases will reduce the amount of funding that otherwise would be available for future capital projects or increased service levels.
- Mass Transportation Program — The Budget includes a reduction of $3.7 million and 41.7 positions to reflect a zero-based analysis of ongoing staffing needs. With the significant reduction of Public Transportation Account funding for capital projects, the Budget proposes a reduction in project oversight positions to appropriate levels. The Budget also proposes to streamline planning and administrative workload.

High-Speed Rail

The High-Speed Rail Authority (Authority) is responsible for the development and construction of a high-speed passenger train service between San Francisco and Los Angeles/Anaheim (Phase I), with extensions to San Diego and Sacramento and points in-between (Phase II). Proposition 1A, enacted in November 2008, authorizes $9 billion in bond proceeds for the rail lines and equipment, and an additional $950 million for state and local feeder lines. The federal government also has awarded the Authority nearly $3.5 billion, most of which has been designated to fund portions of the project in the Central Valley.

In November 2011, the Authority approved a Funding Plan and a draft Business Plan for the High-Speed Rail project. The revised Business Plan includes updated ridership assumptions, revised cost estimates, and additional funding options. Proposition 1A provides a 90-day review period to evaluate the Authority's Funding Plan before capital funding can be proposed. The Department of Finance is conducting a comprehensive review of the Funding Plan. The Administration will propose a complete capital outlay and support funding plan early in 2012.

Significant Adjustment:

- Administrative Staffing and Support—The Budget proposes to fund $6.8 million for some of the contract activities and additional staff the Authority will need in 2012-13 to support legal analysis, accounting, personnel, procurement, grant administration, and information technology, as well as environmental planning, program management oversight, and financial consulting. The Budget proposes a total of $15.9 million for support of the Authority, which will be revised early in 2012. Regardless of the specifics of the capital proposal, these resources are necessary to enable the Authority to more effectively develop and manage the project.

Department of Motor Vehicles

The Department of Motor Vehicles (DMV) promotes driver safety by licensing drivers, and protects consumers and ownership security by issuing vehicle titles and regulating vehicle sales. The Budget proposes $967 million, all from non-General Fund sources, and 8,441 positions for support of the DMV.

Significant Adjustments:

- The Budget proposes $4.4 million to increase efficiencies in field offices. The DMV will modernize both its customer flow and appointment systems to minimize the amount of time customers wait. Technology improvements can encourage customers to use the field offices during non-peak times, and the automated written tests will reduce the amount of time it takes to administer knowledge tests. The automated test system will eventually result in a reduction in field office staff.
- The Budget proposes a $5 discount to customers who use the mail or internet for routine vehicle registration renewals, which will result in savings for the DMV by moving customers from more costly field offices to less expensive methods of renewing vehicle registrations. It is estimated that this will result in an annual savings to vehicle owners of approximately $100 million statewide.

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Natural Resources

As currently structured, the Natural Resources Agency consists of 27 departments, boards, commissions, and conservancies responsible for administering programs to conserve, protect, restore, and enhance the natural, historical, and cultural resources of California.

The Budget proposes total funding of $7.8 billion ($1.9 billion General Fund) and 19,762.8 positions for all programs included in this Agency.

Department of Forestry and Fire Protection

The Department provides resources management and wildland fire protection services covering over 31 million acres of the State. It operates 228 fire stations and, on average, responds to over 5,600 wildfires annually. The Department also performs the functions of a local fire department through reimbursement agreements with local governments. In six areas of the state, the State contracts with local entities to provide fire protection and prevention services. Other responsibilities include the development and enforcement of fire safety standards through the Office of the State Fire Marshal and the regulation and enforcement of timber harvesting operations. The Budget includes $1.2 billion and 6,569.4 positions for the Department.

Significant Adjustment:

- State Responsibility Area Fees—An increase of $9.3 million State Responsibility Area Fire Prevention Fund in 2012-13 and 28.5 positions as a result of Chapter 8, Statutes of 2011. This legislation established a fee not to exceed $150 on each structure on a parcel that is within a state responsibility area to pay for the fire prevention activities that benefit the owners of those structures. The Department will provide the Board of Equalization a list of structure owners and the amount of the fee to be assessed per structure, and is also developing a process where structure owners can have their questions answered and their appeals adjudicated. The Administration is continuing to evaluate the long-term structure of the fee, including supplementing the fee with a per-acre charge.

Department-Specific Efficiency Proposal:

- Timber Harvest Plan Reform—The Administration is committed to improving the health of California forests, continuing California's commitment to the environment, and supporting the state's climate and energy goals. The departments of Forestry, Conservation, and Fish and Game, and the State Water Resources Control Board will be seeking ways to improve the timber harvest plan process. The Administration will meet with stakeholders to receive input in developing a proposal.

Ballot Trigger Reduction:

- The Department's firefighting capabilities would be reduced by 10 percent, or approximately $60 million, if the Governor's tax proposal is not approved in November. This would require cuts to the Department's fire protection services, including the closure of fire stations and reductions to the emergency air response program.

Department of Parks and Recreation

The Department operates the state park system to preserve and protect the state's most valued natural, cultural and historical resources and to create opportunities for outdoor recreation. The 2011 Budget Act includes an $11 million General Fund reduction. The reduction will grow to $22 million, which will result in the closure of up to 70 state parks effective July 1, 2012. The Budget includes $517.8 million and 4,056.5 positions for the Department.

Significant Adjustment:

- Revenue Incentive Opportunities—An increase of $4.3 million State Parks and Recreation Fund in 2012-13 and a shift of $11 million from its base budget to a continuous appropriation to provide the Department additional flexibility to implement new projects and/or new programs that generate additional revenues and help keep parks open to the public. The Department has been pursuing concessions, operating agreements, and other arrangements with public, non-profit, and private entities to keep as many parks open as possible.

Ballot Trigger Reduction:

- All seasonal lifeguards and 20 percent of park rangers would be eliminated if the Governor's tax proposal is not approved in November. The reductions would result in savings of approximately $8.7 million when fully implemented. This would reduce the number of arrests and citations issued in state parks, and would impact natural and cultural resource protection efforts.

Department of Fish and Game

The Department manages California's diverse fish, wildlife, and plant resources, and the habitats upon which they depend, for their ecological values and for use and enjoyment by the public. The Department is also responsible for the diversified use of fish and wildlife including recreational, commercial, scientific, and educational uses. The Budget includes $390.9 million and 2,595.2 positions for the Department.

Significant Adjustments:

- Renewable Energy Projects Permitting—An increase of four positions to implement Chapters 10 and 311, Statutes of 2011. These bills require the Department to approve or reject an incidental take permit application from an owner or developer of an eligible renewable energy project within 60 days and expand the types of projects under consideration to include wind and geothermal projects. These changes are intended to facilitate the development of renewable energy projects in the Colorado and Mojave deserts.

- Oil Spill Response Program—An increase of $2.9 million Oil Spill Prevention and Administration Fund and 16 positions to fulfill the requirements of Chapter 583, Statutes of 2011, which requires the Department to develop a statewide monitoring program to ensure vessels loading other vessels with fuel and lubricants and vessels transferring oil as cargo are doing so in a safe manner and are compliant with state laws.

Ballot Trigger Reductions:

- Game wardens would be reduced by 20 percent, or approximately $5 million when fully implemented, if the Governor's tax proposal is not approved in November. This reduction would impact the Department's ability to conduct field operations, detect invasive species transportation, and conduct large boat operations.
- Certain non-warden programs like the Marine Life Protection Act, Marine Life Management Act, and the monitoring and management of fish and wildlife species would be reduced for savings of approximately $15 million when fully implemented. The core functions of the Department would be retained, including permitting and data collection and monitoring activities of sensitive endangered species.

State Lands Commission

The Commission manages and protects California's sovereign public trust lands and other lands. These lands total more than 4.5 million acres, plus 790,000 acres of reserved mineral interests. The Budget includes $31.3 million and 228 positions for the Commission.

Proposal to Balance the Budget:

- Royalty Recovery and Lease Compliance—An increase of $1 million General Fund and 9 positions for the Commission to increase financial audit activities related to management of oil, gas, and other mineral resources owned by the state, as well as to ensure compliance and prompt payment of rentals from surface leasing. These additional audits are expected to annually generate $6.6 million in General Fund revenues.

Other Significant Adjustment:

- Land Exchanges for Renewable Energy Projects—An increase of $686,000 School Land Bank Fund and 6 positions to execute land exchanges for renewable energy related projects as required by Chapter 485, Statutes of 2011. This legislation directs the Commission to negotiate land exchanges with the federal government to consolidate non-contiguous school parcels owned by the state to promote the development of large-scale renewable energy projects. Any revenues generated from leasing land for renewable energy projects would go to offset state General Fund costs statutorily owed to the State Teachers' Retirement Fund.

Department of Water Resources

The Department of Water Resources protects, conserves, develops, and manages California's water. The Department evaluates existing water resources, forecasts water needs, and explores potential solutions to meet growing needs for personal use, irrigation, industry, recreation, power generation, and fish and wildlife. The Department also works to prevent and minimize flood damage, ensure the safety of dams, and educate the public about the importance of water and its efficient use.

The Budget includes $2.5 billion and 3,584.4 positions for support of the Department. The Budget does not include any new major bond expenditures due to the anticipated release of the Five-Year Infrastructure Report in the spring.

Significant Adjustment:

- Delta Habitat Conservation and Conveyance Program—An increase of $25.4 million California Water Resources Development Bond Fund and 135 positions for preliminary engineering work to support the Delta Habitat Conservation and Conveyance Program. The program is a partnership between the Department and the U.S. Bureau of Reclamation to meet the dual goals of ecosystem restoration and water supply reliability identified by the Bay Delta Conservation Plan, including the preparation of the necessary Environmental Impact Report. The Plan is funded by a group of public water agencies that voluntarily signed an agreement with the Department to fund the program. The Plan, due in 2012, will promote the recovery of endangered, threatened and sensitive fish and wildlife species and their habitats in the Sacramento-San Joaquin Delta in a manner that will also ensure water supply reliability. When completed, the Plan will provide the basis for the issuance of permits for the operation of the state and federal water projects.

Ballot Trigger Reduction:

- The Department's flood control programs would be reduced by 20 percent, or approximately $6.6 million, if the Governor's tax proposal is not approved in November. These programs include floodplain mapping and risk awareness.

Department of Resources Recycling and Recovery

The Department of Resources Recycling and Recovery (CalRecycle) protects public health, safety, and the environment by regulating solid waste facilities and promoting recycling.

Significant Adjustments:

- Electronic Waste Fraud—A transfer of $588,000 Electronic Waste Recovery and Recycling Account and 5 positions from the Department of Toxic Substances Control to CalRecycle to consolidate and strengthen financial fraud investigation and enforcement activities in the Electronic Waste Program.
- Product Stewardship Programs—An increase of $255,000 Carpet Stewardship Account and $255,000 Architectural Paint Stewardship Account to implement two new programs. Under the Carpet Stewardship Program and the Architectural Paint Recovery Program, carpet and paint manufacturers and retailers will be responsible for collecting and managing used carpet and leftover paint.

Environmental Protection

The California Environmental Protection Agency works to restore, protect, and enhance environmental quality. The agency coordinates state environmental regulatory programs and ensures fair and consistent enforcement of the law.

The Budget proposes total funding of $1.54 billion ($43.1 million General Fund and $1.5 billion other funds) for all programs included in this Agency.

Air Resources Board

The Air Resources Board has primary responsibility for protecting air quality in California as well as implementation of the California Global Warming Solutions Act of 2006 (AB 32).

Investing in Greenhouse Gas Emission Reductions

For decades, California has been an international leader in efforts to reduce air pollution. The state has a variety of programs and policies that promote energy efficiency and renewable energy, low-carbon fuels and vehicles, and sustainable infrastructure development and planning. These programs and policies have delivered major environmental and economic benefits over the course of many decades and are responsible for billions of dollars in savings to consumers. The California Global Warming Solutions Act of 2006 (AB 32) further established California as a global leader in reducing greenhouse gas emissions.

The Cap and Trade program is a key element in the state climate plan. It sets a statewide limit on the sources of greenhouse gases (GHG) responsible for 85 percent of California GHG emissions. It establishes a financial incentive for long-term investments in cleaner fuels and more efficient energy use. By assessing a cost to emit GHG, investments in technological and scientific innovation will be encouraged. The program is designed to provide GHG emitters the flexibility to find and implement cost-effective options to reduce GHG emissions.

In 2012-13, through the Cap and Trade program, the Air Resources Board will begin auctioning GHG emission allowances as a market-based compliance mechanism authorized by AB 32. The auctions will generate substantial funds to support existing and new efforts to address the causes of GHG emissions. Fee proceeds from the Cap and Trade auctions are expected to be $1 billion in the first year of the program. In the coming years, the auctions will generate substantially more in fees as the program phases in other major GHG emitters.

The budget proposes a framework to invest proceeds from Cap and Trade fees to reduce greenhouse gases consistent with AB 32. These investments will create jobs and deliver public health, economic, and environmental benefits. Only activities that further the purposes of AB 32 are eligible for funding.

The budget proposal is designed to support the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions. This strategic investment plan is also designed to provide economic, environmental, and clean energy benefits, as well as to complement state efforts to improve air quality. It will support efforts to invest in local communities already affected by air pollution and communities disproportionately vulnerable to the effects of GHG emissions. Investments in the following areas will be proposed:

Clean and Efficient Energy:

Funding to reduce emissions through energy efficiency, clean and renewable distributed energy generation, and other related actions, including at public universities, state and local public buildings, and industrial and manufacturing facilities.

Low-Carbon Transportation:

Funding to reduce emissions through the development of state-of-the-art systems to move goods and freight, deploy advanced technology vehicles and vehicle infrastructure, advanced biofuels, and low-carbon and efficient public transportation.

Natural Resource Protection:

Funding to reduce emissions associated with water use and supply, land and natural resource conservation and management, and sustainable agriculture.

Sustainable Infrastructure Development:

Funding to reduce emissions through strategic planning and development of major infrastructure including transportation and housing.

The fees will be deposited in the Greenhouse Gas Reduction Account within the Air Pollution Control Fund. Because actual revenues cannot be certified until late in 2012-13, specific expenditures are not included in the budget. Instead the budget provides that an expenditure plan be jointly submitted by the Director of Finance and the Air Resources Board. The plan must outline specific expenditures and not be submitted fewer than 30 days prior to allocating funds.

Department of Pesticide Regulation

The Department of Pesticide Regulation protects public health and the environment by regulating all aspects of the sale and use of pesticides and by promoting reduced-risk pest management strategies. The Department ensures compliance with pesticide laws and regulations through oversight of County Agricultural Commissioners, who enforce pesticide laws at the local level.

Significant Adjustment:

- Research Grants for Fumigant Alternatives—An increase of $713,000 Department of Pesticide Regulation Fund and 2.0 positions to provide funding for applied research grants for fumigant alternatives research projects. These grants will encourage and support development of alternative techniques, procedures, and processes for pest control, reducing the need for high-risk pesticides use and ensuring compliance with Federal Clean Air Act requirements for specialty crop pesticide use.

State Water Resources Control Board

The State Water Resources Control Board and the nine Regional Water Quality Control Boards preserve and enhance the quality of California water resources and ensure proper allocation and effective use of state water.

Significant Adjustment:

- Water Quality Grants for Small Disadvantaged Communities—An increase of $11 million State Water Pollution Control Revolving Fund Small Community Grant Fund for grants to small and severely disadvantaged communities to address critical wastewater system needs.

Department of Toxic Substances Control

The Department of Toxic Substances Control protects California residents and the environment from the harmful effects of toxic substances through restoring contaminated resources, enforcement, regulation, and pollution prevention.

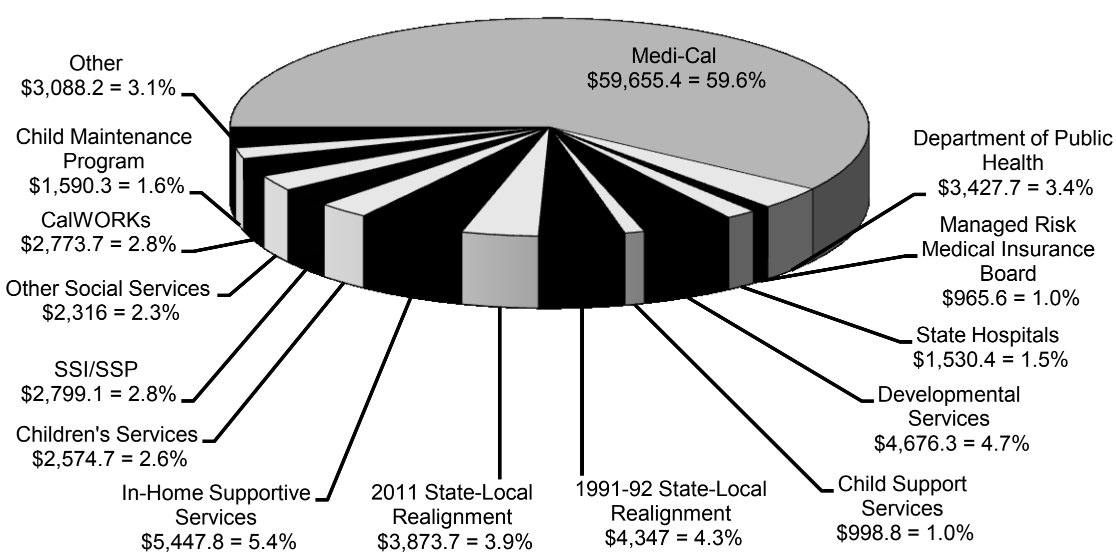
Significant Adjustment:

- Stringfellow Pre-Treatment Plant—An increase of $40.1 million in lease revenue bond authority for the construction phase of the New Stringfellow Pre-Treatment Plant. The plant will provide more effective, reliable methods to treat contaminated groundwater, satisfying the federal court-mandated restoration of the Stringfellow Site.

Health and Human Services

The Health and Human Services Agency oversees departments and other state entities, such as boards, commissions, councils, and offices that provide health and social services to California's vulnerable and at-risk residents. The Budget includes $100.1 billion ($26.4 billion General Fund and $73.7 billion other funds) for these programs. Figure HHS-01 displays expenditures for each major program area and Figure HHS-02 displays program caseload.

Figure HHS-01
Health and Human Services Proposed 2012-13 Funding[/1]
All Funds
(Dollars in Millions)



[/1] Totals $100,064.8 million for support, local assistance, and capital outlay. This figure includes reimbursements of $9,108.5 million and excludes county funds that do not flow through the state budget.

Figure HHS-02

Major Health and Human Services Program Caseloads

	2011-12 Revised	2012-13 Estimate	Change
Medi-Cal enrollees	7,735,200	8,347,800	612,600
Healthy Families Program [a]	877,711	420,119	-457,592
California Children's Services (CCS) [b]	46,213	47,068	855
CalWORKs [c]	587,365	324,283	-263,082
Non cash-assistance CalFresh households	1,463,321	1,794,464	331,143
SSI/SSP (support for aged, blind, and disabled)	1,274,656	1,294,868	20,212
Child Welfare Services [d]	138,490	137,176	-1,314
Foster Care	46,810	42,363	-4,447
Child Maintenance [c]	0	296,132	296,132
Adoption Assistance	84,453	85,964	1,511
In-Home Supportive Services	433,839	422,993	-10,846
Community services for persons with developmental disabilities			
Regional Centers	249,827	256,059	6,232
State Hospitals			
Mental health patients [e]	6,320	6,439	119
Persons with developmental disabilities [f]	1,759	1,533	-226
Alcohol and Drug Programs [g]	304,312	337,025	32,713
Vocational Rehabilitation	28,203	28,203	0

[a] Current year represents the year-end population. Budget year represents the remaining average monthly caseload not included in Medi-Cal.

[b] Represents unduplicated quarterly caseload in the CCS Program. Does not include Medi-Cal CCS clients.

[c] The Budget proposes a major restructuring of the CalWORKs program that, among other changes, limits the provision of employment services and child care to 24 months for families not fully meeting work participation requirements, and creates a separate Child Maintenance program to continue income support to children whose parents are not eligible for cash aid.

[d] Represents Emergency Response, Family Maintenance, Family Reunification, and Permanent Placement service areas on a monthly basis. Due to transfers between each service area, cases may be reflected in more than one services area.

[e] Represents the year-end population. Includes population at Vacaville and Salinas Valley Psychiatric Programs.

[f] Represents average in-center population.

[g] Represents Drug Medi-Cal Clients.

The Budget continues the efforts to streamline government operations to be more efficient and effective. The Budget provides the plan for completing the elimination of the Departments of Mental Health (DMH) and Alcohol and Drug Programs (DADP) and proposes several other reorganizations to improve efficiency and program delivery. Additionally, consistent with the Administration's goal of streamlining state operations as a result of 2011 Realignment, both DMH and DADP have reduced realigned program positions by at least 25 percent. The Department of Social Services (DSS) continues to develop its reduction plan associated with 2011 Realignment in concert with county actions relative to agency adoptions, how caseload growth will be addressed in the pending realignment superstructure, and what the role of the Department will be regarding federal reporting, monitoring, and oversight of the realigned programs.

Significant Adjustments:

- The Budget reorganizes behavioral health programs. With the elimination of DMH and DADP, major community mental health programs and remaining non-Drug Medi-Cal programs and associated funding will be shifted to the Department of Health Care Services (DHCS). Co-locating these key mental health and substance use disorder services with physical health programs is the first step toward integrating services in preparation for an effective continuum of care, consistent with federal health care reform implementation in 2014.
- The Budget transfers a number of DMH and DADP programs to other state departments to better align the program's mission with that of the department. These transfers include: licensing functions to the Department of Public Health (DPH) and DSS; mental health workforce development programs to the Office of Statewide Health Planning and Development; the Early Mental Health Initiative to the Department of Education; problem gambling, driving under the influence, and licensing of narcotic treatment programs to DPH; and Mental Health Services Act technical assistance and training to the Mental Health Services Oversight and Accountability Commission.
- Transfer of the following medical services programs from DPH to DHCS effective July 1, 2012: (1) Every Woman Counts, (2) Prostate Cancer Treatment, and (3) Family Planning Access Care and Treatment. The transfer of these programs is consistent with the Administration's goal of placing direct health care service programs with the DHCS to improve service delivery.
- Consistent with the Administration's direction at May Revision, the Budget proposes the creation of the Department of State Hospitals, which is discussed in more detail later in this chapter.
- In preparation for California's implementation of federal health care reform, the Budget proposes the elimination of the Managed Risk Medical Insurance Board, which is discussed in more detail later in this chapter.

Department of Health Care Services

Medi-Cal, California's Medicaid program, is administered by DHCS. Medi-Cal is a public health insurance program that provides comprehensive health care services at low cost for low-income individuals including families with children, seniors, persons with disabilities, children in foster care, and pregnant women. The federal government mandates basic services including, but not limited to, physician services, family nurse practitioner services, nursing facility services, hospital inpatient and outpatient services, laboratory and radiology services, family planning, and early and periodic screening, diagnosis, and treatment services for children. In addition to these mandatory services, the state provides optional benefits such as outpatient drugs, home- and community-based waiver services designed to avoid institutionalization, and medical equipment, which avoid more costly services.

Medi-Cal costs have grown about 6 percent annually since 2006-07 due to a combination of health care cost inflation and caseload growth. Medi-Cal spending is projected to decline from $15.4 billion General Fund in 2011-12 to $15.1 billion General Fund in 2012-13 because of enacted and proposed program savings options. Absent these savings options, costs would grow by approximately 3.4 percent to $15.9 billion General Fund.

Caseload will increase approximately 7.9 percent from 2011-12 to 2012-13 (from 7.7 million to 8.3 million), which is due primarily to shifting children in Healthy Families to Medi-Cal, which is discussed later in this chapter. Caseload growth would be 1.9 percent absent the proposal to shift children in Healthy Families to Medi-Cal.

Proposals to Balance the Budget:

Improved Care Coordination for Seniors and Disabled Beneficiaries. Within the Medi-Cal program, approximately 7 percent of beneficiaries account for 75 percent of program costs – mostly because of costly institutional services. These beneficiaries are typically seniors or persons with disabilities and they are frequently eligible for and enrolled in both the federal Medicare program and the Medi-Cal program. Approximately one-third of these individuals are also enrolled in the In-Home Supportive Services (IHSS) program. Individuals eligible for both Medi-Cal and Medicare are known as dual eligible beneficiaries. California has 1.2 million dual eligible beneficiaries, which represents 14.1 percent of the total Medi-Cal caseload. In addition, the majority of the 423,000 IHSS recipients (85 percent) are dual eligible beneficiaries. These dual eligible beneficiaries represent some of the most expensive and medically complicated health cases and the cost for their care is paid by public funds, including federal funds, state General Fund, and in some cases county funds.

Medicare is the primary insurance/payer for dual eligible beneficiaries and covers medically necessary acute health services such as physician services, hospital services, and skilled nursing. Medi-Cal is the secondary insurance/payer and typically covers Medicare cost sharing and services not covered by Medicare, as well as services delivered after Medicare benefits have been exhausted. Most long-term care costs for these beneficiaries are paid for by Medi-Cal, including longer nursing home stays and home and community-based services designed to prevent institutionalization. In addition, many of these beneficiaries are also eligible for IHSS, which is locally administered and includes a county share of cost. Consequently, the current system attempts to address the health care needs of the most chronically ill and vulnerable beneficiaries through a variety of providers that receive funding from multiple government sources. The system is riddled with incentives that encourage payers to shift costs to one another.

The fractured funding streams and administrative responsibilities make it difficult for dual eligible beneficiaries to navigate program benefits associated with this uncoordinated fee-for-service environment. As a result, these individuals will benefit the most from a care model that provides benefits in a more coordinated manner. Coordinating care for these beneficiaries generally means having the same health plan responsible for the delivery of all benefits. This will achieve significant efficiencies and improve care for beneficiaries. This also will help beneficiaries remain in the community and reduce costs from unnecessary hospital and nursing home admissions. In addition to aligning program responsibility and financial incentives, this proposal increases the number of individuals in managed care and broadens the scope of managed care services. This proposal works to:

- Promote Coordinated Care—Managed care done properly results in high-quality care. This initiative provides managed care plans with a blended payment consisting of federal, state, and county funds and responsibility for delivering the full array of health and social services to dual eligible beneficiaries. The proposal combines strong beneficiary protections with centralized responsibility for the broader continuum of care. This combination will promote accountability and coordination, align financial incentives and improve care continuity across medical services, long-term services, and behavioral health services.

- Enhance the Quality of Home and Community-Based Services—Within an expanded system of coordinated care, it is critical to better coordinate medical services with

> the full continuum of long-term services, including In-Home Supportive services, Community-Based Adult Services, and nursing home services. Merging long-term services into managed care will increase access to home and community-based medical and social services. Improving access to these services should help beneficiaries remain in their homes and out of institutions, and should improve their health outcomes. When necessary, care will also be coordinated with behavioral health services, which generally will be provided by counties. The Home and Community-Based Services Waiver for Persons with Developmental Disabilities will continue to be administered by the Department of Developmental Services.

The proposal to improve care coordination for dual eligible beneficiaries will be phased in over a three-year period starting January 1, 2013. The transition to managed care for Medi-Cal benefits will occur in the first year, with the benefits becoming a more integrated plan responsibility over the subsequent two years. The transition of Medicare benefits to managed care will occur over a three-year period starting first with eight to ten counties that already have the capacity to coordinate care for these individuals. Beneficiaries in counties in which Medi-Cal managed care plans may not yet have the capacity to take on additional beneficiaries will begin to transition six or twelve months later. The Budget separately proposes to expand Medi-Cal managed care statewide starting in June 2013. Beneficiaries in these managed care expansion counties will transition in 2014-15.

In year one, IHSS, other home and community-based services, and nursing home care funded by Medi-Cal will become managed care benefits. The IHSS program will essentially operate as it does today, except all authorized IHSS benefits will be included in managed care plan rates. Beneficiaries in the eight to ten selected counties will also receive their Medicare benefits and long-term services and supports through their Medi-Cal plan. This represents about 800,000 of the 1.2 million dual eligible beneficiaries currently in California. These changes will be phased-in over a 12-month period starting January 1, 2013. Over time, managed care plans will take on increasing responsibility for home and community-based services, including IHSS.

Delivering services through Medi-Cal managed care plans will make the state the single point of accountability for services to these beneficiaries. This will ensure access to the entire continuum of health care services for dual eligible beneficiaries through their Medi-Cal managed care plan. Delivering these services through Medi-Cal managed care plans, however, also raises important issues that will need to be considered in the program design including, but not limited to: (1) consumer protections for acute, long-term care, and home and community-based services within managed care; (2) development of a uniform assessment tool for home and community-based services; and (3) consumer choice and protection when selecting their IHSS provider. The Administration will consult consumers and other stakeholders in this effort.

This proposal also sets the foundation for the state to implement health care reform, which further impacts the health care delivery and financing structure by expanding Medi-Cal to include all adults below 138 percent of the federal poverty level. In addition, it establishes the state as the level of government primarily responsible for delivering health care services. Additional issues to consider related to the state-county relationship in financing and delivering services include determining the collective bargaining structure for IHSS providers, and the long-term county financial responsibility for IHSS and other health care programs. The Administration will work with counties and stakeholders to address these overarching issues through the development of legislation that will be necessary to implement this Budget proposal.

As beneficiaries transition from fee-for-service to coordinated managed care, the state will generate savings due to a reduction in hospital and nursing home costs. However, because Medi-Cal is budgeted on a cash basis, there is a delay in realizing these savings. To accelerate these savings into 2012-13, the Budget also proposes a payment deferral (one payment for all providers), and alignment of payment policies for all managed care counties. Together, this proposal will achieve savings of approximately $678.8 million General Fund in 2012-13 and $1 billion General Fund in 2013-14.

Medi-Cal: Operational Flexibilities. Medi-Cal is a major health care delivery system approaching an enrollment of 8.3 million Californians and is estimated to gain another 2 million beneficiaries when federal health care reform is implemented in January 2014. The Medi-Cal health care delivery system must have the capacity to respond to the rapidly changing field of health care and be able to change benefits, services, rate methodologies and payment policies faster than the current regulatory process allows. Examples of potential program changes include reducing laboratory rates, no longer funding avoidable hospital admissions, and no longer paying for services of limited value.

The Budget proposes a process that will incorporate stakeholder input and determine cost-effectiveness before implementing changes in benefit design, and includes a post-implementation assessment to ensure that changes achieve the intended results. Similarly, any changes in rate methodologies and payment policies driven by this process will comply with federal requirements to rigorously monitor the impact of rate changes on beneficiary access to services and to mitigate any problems as they arise. Under the proposed process, the Medi-Cal program will have the flexibility it needs to operate a health care delivery system that meets its obligations to use sound evidence, transparent processes, and monitoring mechanisms to ensure the program achieves its outcomes in the most efficient possible manner.

This proposal will achieve General Fund savings of approximately $75 million in 2012-13 and ongoing.

Federally Qualified Health Center Payment Reform. The Budget proposes to reform the payment methodology for federally qualified health centers (FQHCs) and rural health clinics (RHCs) funded under Medi-Cal to create a performance, risk-based payment model that will allow, and reward, these clinics to provide more efficient and better care. Under this proposal, payments made to FQHCs and RHCs participating in Medi-Cal managed care plan contracts will change from a cost and volume-based payment to a fixed payment to provide a broad range of services to its enrollees. A waiver of current operating restrictions will empower FQHCs to follow efficient best practices, such as group visits, telehealth, and telephonic disease management. The waiver will ensure that medical care is provided by the most appropriate and affordable medical professional and allow clinics to perform multiple services on the same day. The efficiencies will allow these community health centers to provide better and more efficient care, and to expand capacity. The proposal will achieve General Fund savings of $27.8 million in 2012-13 and $58.1 million in 2013-14.

Managed Care Expansion. Beginning in June 2012, the Budget proposes to expand managed care into rural counties that are now fee-for-service only. This expansion will provide beneficiaries throughout the state with care through an organized delivery system. This proposal will result in a General Fund savings of $2.7 million in 2012-13 and $8.8 million in 2013-14.

Annual Open Enrollment. Current law authorizes Medi-Cal beneficiaries to change plans once per month or up to 12 times in a year. The Budget proposes an annual open enrollment period for beneficiaries to select their Medi-Cal health plan and receive care through that health plan for the entire year. This open enrollment process will align Medi-Cal with industry best practice of other third-party health benefit payers including CalPERS and Healthy Families. By establishing an annual election process, plans will be accountable for providing beneficiaries with a medical home, care coordination, and case management over the entire year leading to better care and health outcomes. This proposal will achieve General Fund savings of $3.6 million in 2012-13 and $6 million in 2013-14.

Medical Therapy Program Eligibility. The Budget proposes to align income eligibility requirements for the Medical Therapy Program with the broader California Children's Services (CCS) Program. Currently, there is no financial test for eligibility. Under the proposed eligibility standards, families with annual income less than $40,000 or with annual CCS-related medical expenses exceeding 20 percent of their annual income will continue to be eligible for the Medical Therapy Program. This is consistent with the eligibility requirements already in place for all other CCS benefits and will result in savings of $9.1 million General Fund in 2012-13 and $10.9 million in 2013-14. In addition to state savings, counties will also realize savings.

Stabilization Funds. The Budget proposes a one-time redirection of private and non-designated public hospital stabilization funding that has not yet been paid for fiscal years 2005-06 through 2009-10 to provide General Fund savings and avoid direct service reductions. This proposal will achieve one-time savings of $42.9 million General Fund.

Gross Premium Tax. The Budget proposes to eliminate the sunset date of the Gross Premiums Tax on Medi-Cal managed care plans. Continuing the tax, coupled with increased managed care utilization, will generate General Fund savings of $161.8 million in 2012-13 and $259.1 million in 2013-14.

Other Significant Adjustments:

- Medi-Cal Base Benefit Costs—A decrease of $395.9 million General Fund in 2011-12 and an increase of $493.9 million General Fund in 2012-13 based on cost and utilization trends in the base program.
- Budget Savings Erosions—An increase of $778.2 million General Fund in 2011-12 and $235.3 million General Fund in 2012-13 because of delayed federal approval of budget savings proposals, litigation related to elimination of the Adult Day Health Care benefit, and a portion of the provider payment reductions not being approved by the federal government.
- Hospital Fee Extension—A savings of $255 million General Fund in 2011-12 and $472 million General Fund in 2012-13 as a result of extending the hospital fee.

The fee provides funds for supplemental payments to hospitals and also makes some funding available to offset the costs of health care coverage for children.

- Managed Care Rate Adjustment—An increase of $203.4 million General Fund in 2012-13 as a result of increasing managed care rates by 3.61 percent. Rate adjustments are based on the previous year's increase. The managed care rate adjustments for 2012-13 will be updated in May 2012.
- Nursing Home Fee Program—The Budget includes funding to restore the 10-percent provider rate reduction ($171.2 million General Fund) and also includes supplemental payments ($245.6 million General Fund). The Budget does not include the maximum 2.4-percent cumulative rate increase for 2011-12 and 2012-13 because preliminary fee revenues are insufficient to support such an increase. The Budget also proposes to permanently extend the rate methodology and nursing home fee initially established by Chapter 875, Statutes of 2004 (AB 1629). This extension is necessary to continue to fund the current payment methodology without a greater impact to the General Fund.
- Reserve for Litigation—The Budget includes a set-aside of $86.8 million General Fund in 2011-12 and $260.4 million General Fund in 2012-13 in the event litigation challenging recently approved provider rate reductions is successful.

Managed Risk Medical Insurance Board

The Managed Risk Medical Insurance Board (the Board) administers five programs that provide health coverage through commercial health plans, local initiatives and county organized health systems to certain persons who do not have health insurance. The five programs include:

- The Access for Infants and Mothers Program, which provides comprehensive health care to pregnant women.
- The Healthy Families Program, which provides comprehensive health, dental, and vision benefits through participating health plans for children who are not eligible for Medi-Cal.
- The County Health Initiative Matching Fund Program, which provides comprehensive benefits similar to the Healthy Families Program, but through county-sponsored insurance programs.

- The Major Risk Medical Insurance Program (MRMIP), a state-funded program, which provides health coverage to residents of the state who are unable to secure adequate coverage for themselves and their dependents because insurers consider them to be medically uninsurable or at high risk of needing costly care.
- The Pre-Existing Conditions Insurance Plan (PCIP) Program, a federally funded program which provides health coverage to medically uninsurable individuals with pre-existing conditions. The program is only available for individuals who did not have health coverage in the six months prior to applying.

The Budget includes $965.6 million ($136.2 million General Fund) for the Board, a decrease of $152.4 million General Fund from the Budget Act of 2011. This significant decrease is primarily due to the proposed Healthy Families rate reduction.

Proposal to Balance the Budget:

- Healthy Families Program Rate Reduction—The Budget proposes to reduce Healthy Families managed care rates by 25.7 percent effective October 1, 2012. This rate reduction will achieve General Fund savings of approximately $64.4 million in 2012-13 and $91.5 million in 2013-14.

Other Significant Adjustments:

- Transition of Children from the Healthy Families Program to Medi-Cal—The Budget proposes transferring approximately 875,000 Healthy Families Program beneficiaries to Medi-Cal over a nine-month period beginning in October 2012. This transition will create benefits for children, families, health plans, and providers, by: (1) simplifying eligibility and coverage for children and families; (2) improving coverage through retroactive benefits, increased access to vaccines, and expanded mental health coverage; and (3) eliminating premiums for lower-income beneficiaries.
- Transition of Other Programs—In preparation for California's implementation of federal health care reform, the Budget proposes to eliminate the Board by July 1, 2013. Therefore, the remaining programs administered by the Board will transition to the DHCS by July 1, 2013. These programs include the Access for Infants and Mothers, California Health Initiative Matching Fund Program, MRMIP, and PCIP programs. The two programs that provide insurance to individuals with pre-existing conditions, MRMIP and PCIP, will be eliminated in January 2014 because these individuals will be able to purchase health insurance through the California Health Benefits Exchange as part of federal health care reform implementation.

Department of Public Health

The DPH is charged with protecting and promoting the health status of Californians through programs and policies that use population-wide interventions. Funding for 2011-12 is $3.5 billion ($132.4 million General Fund), and proposed funding for 2012-13 is $3.4 billion ($124.8 million General Fund).

Proposal to Balance the Budget:

- Increase Client Share of Costs for the AIDS Drug Assistance Program (ADAP)—The Budget reflects a decrease of $14.5 million in 2012-13 as a result of increasing client share of cost in the ADAP to the maximum percentages allowable under federal law. Cost-sharing for ADAP clients with private insurance will be limited to a maximum cost-sharing of two percent. Implementing the federal share of cost maximum amounts for this client group will create a disincentive for many clients to continue ADAP participation because their cost-sharing obligation will exceed their private insurance out-of-pocket costs. This proposal will result in General Fund savings of $16.5 million, which will be offset by program administrative costs of $2 million for a net General Fund savings of $14.5 million. Average monthly copayments will range between $28 and $385, depending upon the client's income.

Department of Developmental Services

The Department of Developmental Services (DDS) serves approximately 256,000 individuals with developmental disabilities in the community and 1,500 individuals in state-operated facilities. Proposed funding for 2012-13 is $4.7 billion ($2.7 billion General Fund). Services are provided through the developmental centers, one community facility, and the regional center system. The Lanterman Developmental Disabilities Services Act established a statewide network of regional centers and related services to allow consumers to live independent and productive lives in the community.

Significant Adjustments:

- Program Reductions—A decrease of $200 million in 2012-13 as a result of the reductions related to lower-than-expected revenues assumed in the 2011 Budget Act. To achieve these savings, with the intent of minimizing the impact on consumer services, the DDS is considering extending the 4.25-percent provider and regional center operations payment reduction, reductions in the developmental center budget, and other potential savings options in the department's budget. DDS will be engaging stakeholders to discuss savings proposals.

- Developmental Centers—A decrease of $14.4 million General Fund ($724,000 Proposition 98 General Fund) in 2012-13 as a result of a revised population estimate.
- Reduced Costs—A decrease of $32 million General Fund in 2011-12 and a decrease of $2.9 million General Fund in 2012-13 as a result of changes and delayed implementation of Medi-Cal savings proposals regarding the Adult Day Health Care program, caps, and copayments, which will delay the need for regional centers to backfill these reductions.
- Regional Center Caseload Adjustment—An increase of $5.9 million General Fund in 2011-12 and an increase of $115.2 million General Fund in 2012-13 as a result of a revised population estimate.
- Expiration of Provider and Regional Center Operations Payment Reduction—An increase of $108.4 million General Fund in 2012-13 as a result of the 4.25-percent provider and regional center operations payment reduction expiring on June 30, 2012.
- Proposition 10—An increase of $50 million General Fund in 2012-13 to backfill for the one-time use of Proposition 10 funding for services to consumers age 0-5 years.

Department of State Hospitals

To create an efficient system of care focusing on effective treatment and increased worker and patient safety, the Budget establishes a new Department of State Hospitals (DSH). State hospitals operated by the DSH provide long-term care and services to individuals with mental illness. The state supports patients committed by the courts, including those committed for Penal Code violations and Sexually Violent Predators. Counties fund civil commitments. The Budget includes $1.3 billion General Fund in 2012-13 for support of the Department. The patient population is projected to reach a total of 6,439 in 2012-13. The Department will provide efficient and appropriate care and treatment for patients, a safer environment for individuals and fiscal responsibility and transparency.

Developing the new DSH resulted in a thorough evaluation of the state hospital system and its budget. The evaluation highlighted unfunded activities within the system, some of which were the result of federal court orders. In December 2011, a report was released that focused on the issues to be addressed by the DSH, and proposed a plan to address a current year funding shortfall of approximately $180 million. Through a combination of current year cost-saving measures, the shortfall was reduced to approximately $63 million. The Budget reflects ongoing savings of $193.1 million and 620 positions through staffing ratio changes, program flexibilities, and other efficiencies. Additional aspects of the plan include:

- Streamlined Services and Operational Efficiencies—Based on experience implementing the state hospital Enhancement Plan, DSH will modify the Plan to reduce documentation, implement flexible treatment models, and eliminate ineffective auxiliary services. This will allow level of care staff to return to providing treatment services, allow hospitals to make treatment decisions that are most appropriate for the individuals in their facilities, and reduce the need for additional staffing.
- Stronger Fiscal Accountability—The new DSH structure supports enhanced communication between hospital and headquarters staff, and consolidates fiscal operations to ensure consistent information sharing among budget, accounting, and operations staff.
- Staffing Ratio Adjustment—A decrease of $21.3 million General Fund in 2011-12 and a decrease of $68.7 million General Fund in 2012-13 as a result of changes to the staffing ratios of physicians and treatment teams and changes to the staffing mix of registered nurses and psychiatric technicians.
- Program Restructuring/Elimination—A decrease of $8.6 million General Fund in 2011-12 and a decrease of $24.4 million General Fund in 2012-13 as a result of modifications to services and treatments and elimination of less effective programs within the hospitals.
- Pharmaceuticals and Outside Medical Costs Adjustment—A decrease of $2 million General Fund in 2011-12 and $23 million General Fund in 2012-13 as a result of the availability of generic drugs and revisions to contract rates.
- County Bed Rate Adjustment—A decrease of $20 million General Fund in 2012-13 as a result of increased bed rates charged to counties for civil commitments to more accurately reflect actual patient cost of care.
- Staff Redirection Adjustment—A decrease of $8.4 million General Fund in 2011-12 and a decrease of $15.4 million General Fund in 2012-13 as a result of redirecting staff to higher priority assignments and reducing overtime and temporary help costs.

- Streamlined Documentation—A decrease of $6.9 million General Fund in 2011-12 and a decrease of $14 million General Fund in 2012-13 as a result of modifications to documentation processes.
- Elimination of Funding for Caregiver Resource Centers—A decrease of $2.9 million General Fund in 2012-13 as a result of eliminating contract funding for Caregiver Resource Centers, which provide services to individuals with acquired brain disorders.

In addition to changes related to the new DSH, the Budget reflects ongoing court-ordered commitments to treat CDCR inmates with mental health needs, including an increase of $39.4 million and 368.1 positions for *Coleman* court-ordered patient care and the activation of the new Stockton health care facility, as noted in the following adjusments.

Other Significant Adjustments:

- Reorganization—A decrease of $119.9 million ($15 million Proposition 98 General Fund and $593,000 General Fund) in 2012-13, and a corresponding increase in various department budgets as a result of the elimination of the DMH.
- Overtime and Temporary Help Adjustment—An increase of $102.4 million General Fund in 2011-12 and 2012-13 as a result of increased workload associated with enhanced patient observations, admissions assessments, and redirected staff to comply with the Civil Rights of Institutionalized Persons Act.
- Operating Expenses and Equipment—An increase of $45.1 million General Fund in 2011-12 and 2012-13 as a result of the increased cost of pharmaceuticals and outside medical care.
- Population Adjustment—An increase of $13.9 million General Fund in 2011-12 and $44.3 million General Fund in 2012-13 as a result of the anticipated population increase primarily related to the court-ordered increase in *Coleman* patient admissions.
- Safety and Security—An increase of $22.8 million General Fund in 2012-13 to fund new alarm systems at Patton and Metropolitan State Hospitals, pending the successful implementation of a similar system at Napa State Hospital. In addition, the DSH is piloting an Enhanced Treatment Unit at Atascadero State Hospital and working with the Division of Occupational Safety and Health to institute new safety policies and procedures throughout the state hospital system.
- California Health Care Facility—An increase of $11.4 million General Fund in 2012-13 as a result of the anticipated opening of the facility in July 2013.

Department of Social Services

The DSS administers programs that provide services and assistance payments to needy and vulnerable children and adults in ways that strengthen and preserve families, encourage personal responsibility, and foster independence.

The Budget includes $17.5 billion ($6.2 billion General Fund), a decrease of $2.3 billion General Fund from the Budget Act of 2011. This significant decrease primarily is due to reflecting savings associated with 2011 Realignment within the appropriate DSS programs. These savings were reflected in a statewide item in the 2011 Budget Act rather than in individual department budgets.

California Work Opportunity and Responsibility to Kids

The CalWORKs program is California's version of the federal Temporary Assistance for Needy Families (TANF) program. For low-income families with children, the program provides temporary cash assistance to meet basic needs and welfare-to-work services so that families may become self-sufficient. The program recognizes the different needs in each county and affords them flexibility in program design and funding.

After many consecutive years of decline in caseload, the CalWORKs program has experienced significant growth in recent years due to the severe economic downturn. Absent the program changes described below, the average monthly caseload in this program is estimated to be 597,000 families in 2012-13, a 0.5-percent increase from the 2011 Budget Act projection. This represents almost a 30-percent increase compared to the low point of 460,000 cases in 2006-07. The proposed changes to CalWORKs are estimated to reduce the 2012-13 caseload projection to 324,000 families, a 44.8-percent decrease from the 2011-12 estimate after accounting for cases transferred into the new Child Maintenance program.

Prior to CalWORKs, the state administered the Aid to Families with Dependent Children (AFDC) program, which provided cash assistance to needy families regardless of whether or not recipients were working. California's AFDC program caseload peaked at 921,000 cases in 1994-95. The state also operated the Greater Avenues to Independence employment program which, because of limited funding, only served a small portion of adults receiving aid. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 fundamentally reformed the nation's welfare system and included provisions to convert the AFDC entitlement program to TANF, a block grant program with work requirements and lifetime time limits.

Effective January 1, 1998, CalWORKs replaced the AFDC program. Consistent with the federal welfare reform law, CalWORKs contains time limits on the receipt of aid and linked eligibility for aided adults to work participation requirements. As part of CalWORKs, the state included a safety net program to provide monthly assistance payments to children whose parents are not eligible for aid. In 2005, the federal welfare reform was modified to further restrict countable work activities and to require states to have 50 percent of the program's caseload meeting federal work participation levels.

In the early years of CalWORKs, counties were successful in getting many of the most readily employable CalWORKs families to enter the labor market. This was evidenced by the substantial decline in the welfare caseload, which decreased from a high of 921,000 cases in 1994-95 to an all-time low of 460,000 cases in 2006-07. Subsequently, with the steep rise in national and state unemployment stemming from the recession, the caseload has increased and its composition has changed. A significant share of the caseload has not been subject to work participation requirements. This is in addition to the portion of caseload that is required to participate in work activities but is not doing so. Over time, the safety net and child only caseload has become larger than the caseload that is subject to work requirements. Additionally, because of severe budget constraints, recent grant and earned income disregard reductions, as well as cuts to employment and child care services described later, have further reduced the "work first/work pays" goals of the program. Major programmatic changes are necessary to refocus the work emphasis of the program in light of both the composition of the current CalWORKs caseload and the state's limited resources.

Absent any changes, General Fund costs in CalWORKs are projected to grow by more than half a billion dollars in 2012-13 compared to the 2011 Budget Act. The primary drivers of this increase are expiration of "short-term reforms" and an increased caseload projection. The short-term reforms, which have been included in the Budget on a one-time basis each year since 2009-10, have achieved savings through a significant reduction in the amount of funding made available to counties to provide employment services and child care to CalWORKs recipients. Families with a child between the ages of 12 and 23 months, or with two or more children under the age of six, have been exempt from work requirements. Over time, these short-term reforms have significantly eroded the work focus of the CalWORKs program, prevented assistance to needy clients on a path to success, and left the state more vulnerable to costly federal work participation penalties.

Proposal to Balance the Budget:

Redesigning and Refocusing the CalWORKs Program. The CalWORKs program is a "work first" program that encourages employment as the most direct method of achieving self-sufficiency. With the impacts of the Great Recession still lingering, the changes described below are necessary to refocus the CalWORKs program to prioritize resources on the families most likely to become employed and to manage the program within the state's available resources. The new strategy creates two subprograms within CalWORKs, each with differing grant structures, services arrays, and time limits:

- **CalWORKs Basic Program.** The CalWORKs Basic program will serve families moving toward self-sufficiency by providing up to 24 months of welfare-to-work services, including job search, employment training, child care, and barrier removal services (e.g., substance abuse, mental health, and domestic violence recovery assistance). Effective October 2012, clients not participating in sufficient hours of unsubsidized employment after an initial job search will be placed in the CalWORKs Basic program and will be required to participate in welfare-to-work activities. After the first 12 months, the adult will again participate in job search. If, during the second 12 months, the adult remains unable to find unsubsidized employment, the adult will continue to participate in welfare-to-work activities, including subsidized job placements. As in the current program, failure to meet welfare-to-work requirements will result in a sanction equal to the adult portion of the grant. Clients unable to meet federal work participation requirements after 24 months, or cases in sanction status for more than three months, will be disenrolled from CalWORKs.
- **CalWORKs Plus Program.** The CalWORKs Plus program will serve those clients working sufficient hours in unsubsidized employment to meet federal work participation requirements, generally 30 hours per week (20 hours per week for families with children under the age of six). Effective April 2013, this program will reward clients who meet federal work participation requirements with a higher grant level by allowing them to retain more of their earned income through a higher income disregard (first $200 earned and 50 percent of subsequent income disregarded for purposes of computing the monthly grant level). For a family of three, this equates to an average increase of $44 per month. These clients will also have full access to supportive services and child care. These benefits will continue for up to 48 months as long as clients continue to meet work participation requirements through unsubsidized employment. After 48 months, the adult will no

longer be aided, but the higher earned income disregard will remain available if the employment continues.

This new design will use incentives to encourage unsubsidized employment and focus available resources on early client engagement. State and federal rules regarding hours of required participation will be aligned. This, combined with eliminating current state rules regarding core and non-core work activities, will afford counties maximum flexibility under federal law. Sanction months will count toward the 48-month time limit, further emphasizing the importance of work. As a package, the proposal will save the CalWORKs program $1.1 billion in 2012-13.

Transition to Success. To assist families in obtaining employment sufficient to meet federal work participation requirements, all currently aided eligible adults will be eligible for up to six months of welfare-to-work services and child care following the October 2012 implementation of the CalWORKs Basic program. Prior to this transition, $35.6 million will be provided to counties to serve these families.

Providing Additional Work Supports. Consistent with the proposal to redesign and refocus the CalWORKs program, the Administration proposes to align eligibility and need criteria for low-income working family child care services with federal TANF rules for work participation requirements. Over time, the three-stage child care system for current and former CalWORKs recipients and programs serving low-income working parents will be replaced with a work-based child care system administered by county welfare departments. (Refer to "Reduce Child Care Costs and Restructure Administration of Child Care" in the K-12 Education chapter for more information.) In addition, the Administration proposes to create a state benefit to increase support for low-income working families. Beginning July 1, 2013, the state will provide working families receiving CalFresh benefits or child care, but who are not in the CalWORKs program, with a $50-per-month supplemental work bonus. Providing this additional benefit to working families will increase the state's work participation rate and help avoid federal TANF penalties.

Child Maintenance Program

The Budget provides continued support to children from low-income families. Beginning in October 2012, the state will create a new Child Maintenance program to provide for child well-being through basic support to children whose parents are not eligible for aid under the restructured CalWORKs program. Income and resource eligibility criteria for the Child Maintenance program will be the same as for CalWORKs families, but the

Child Maintenance program grant will be less than the current amounts available for child-only cases. This will decrease the average monthly grant for child-only cases from $463 to $392. When combined with CalFresh benefits, the full monthly grant will be sufficient to keep families of three with CalFresh-eligible adults at approximately 64 percent of the federal poverty level. Children will be aided as long as they meet eligibility criteria, including a new requirement to participate in an annual well-child exam. There are estimated to be 296,000 Child Maintenance cases on average each month in 2012-13.

Because Child Maintenance cases are outside of the state's welfare-to-work program, they will have minimal case management and an annual reporting requirement. These cases can move to the CalWORKs Plus program anytime by obtaining unsubsidized employment sufficient to meet federal work participation requirements. Every six months, work-eligible adults who still have time remaining on the 48-month aid clock may ask for one month of child care to attend job search. If a sanctioned adult still has time remaining on the 48-month aid clock and the 24-month services clock, the family can transfer to the CalWORKs Basic program after complying with a welfare-to-work plan for at least two months. The cost of this program partially offsets the savings in CalWORKs, resulting in a net savings of $946.2 million.

In-Home Supportive Services

The In-Home Supportive Services (IHSS) program provides domestic services such as housework, transportation, and personal care services to eligible low-income aged, blind, and disabled persons. These services are provided to assist individuals to remain safely in their homes and prevent institutionalization.

The Budget proposes $1.4 billion General Fund for the IHSS program in 2012-13, a decrease of $292.3 million General Fund from the revised 2011-12 IHSS budget. General Fund costs are significantly higher in the revised current year projection than in the 2011 Budget Act primarily because of erosions to savings previously assumed. Specifically, General Fund costs of $231 million result from a six-month delay in extending the state sales tax to IHSS providers, a two-month delay in implementing the Community First Choice Option for enhanced federal funding, a two-month delay in eliminating services for recipients without health care certification, and from not implementing the medication dispensing machines proposal. Additionally, an increase of $130 million accounts for savings from program integrity efforts already being captured in the caseload projections. The average monthly caseload in this program is estimated to be 423,000 recipients in 2012-13, a 2.5-percent decrease from the 2011-12 projected level.

Proposals to Balance the Budget:

Eliminate Domestic and Related Services for Certain Recipients. Domestic and related services include housework, shopping for food, meal preparation and cleanup, laundry, and other shopping and errands. Currently, when an IHSS beneficiary resides in a shared living arrangement and his/her need for any domestic or related service is met by other household members, the authorized hours are pro-rated by county social workers based on the number of household members. Under this proposal, IHSS beneficiaries residing in a shared living arrangement will not be eligible for domestic and related services that can be met in common with other household members. In instances where the shared living arrangement consists entirely of IHSS recipients, domestic and related services will continue to be authorized. In addition, IHSS beneficiaries who have a need for domestic and/or related services that cannot be met in common because of a medically verified condition of other members of the shared living arrangement can be authorized hours for any of these services that meet the need assessment metrics. Similarly, when minor recipients are living with their parent(s), the need is being met in common; hence, the authorization of domestic and related service hours will no longer be allowed. Since minors would not be expected to be able to perform these services independently, the parent will be presumed available to perform these tasks unless the parent can provide medical verification of his/her inability to do so.

Eliminating domestic and related services for recipients in shared living arrangements and minor recipients living with an able and available parent is estimated to provide General Fund savings of $163.8 million in 2012-13 and is estimated to impact approximately 254,000 recipients beginning July 1, 2012.

Coordinated Care for Dual Eligible Beneficiaries. This proposal will better coordinate IHSS, other home and community-based services, and institutional long-term care. All individuals receiving both Medi-Cal and Medicare benefits (dual eligible beneficiaries) will be required to enroll in managed care health plans for their Medi-Cal benefits. The IHSS program will operate as it does today during 2012-13; all authorized IHSS benefits will be included in managed care plans. No IHSS savings are estimated to result from this proposal in 2012-13. Refer to “Improved Care Coordination for Seniors and Disabled Beneficiaries” within Department of Health Care Services for more information.

Other Significant Adjustments:

- 20-Percent Reduction in Service Hours—Because revised revenue projections have fallen short of previous estimates, pursuant to Chapter 41, Statutes of 2011, a 20-percent across-the-board reduction in IHSS hours was to be implemented January 1, 2012. Because of a court injunction, the state currently is prevented from implementing this reduction. However, the Budget assumes this reduction will be implemented April 1, 2012. To be prudent, the Budget also includes a set-aside to fully fund the IHSS program in the event of an adverse court ruling.

- Medication Dispensing Machine Pilot Project — Current law requires the state to implement a Home and Community Based Medication Dispensing Machine Pilot Project that utilizes an automated medication dispensing machine with associated telephonic reporting service for monitoring and assisting Medi-Cal recipients with taking prescribed medications. Current law also requires the DSS to implement an across-the-board reduction in authorized hours for IHSS recipients beginning October 1, 2012, to the extent the pilot project and/or alternative savings proposals enacted by the Legislature does not achieve a combined net annual General Fund savings of $140 million. Based on the assumed 20-percent reduction described above, the Budget assumes neither savings from the pilot project nor savings from the associated across-the-board reduction, and proposes to repeal the associated statutory requirements.

Department of Child Support Services

The Department of Child Support Services (DCSS) is designated as the single state agency responsible for administering the statewide child support program. The Budget includes $998.8 million ($313.2 million General Fund) for the DCSS, a decrease of $7.2 million General Fund from the revised 2011-12 Budget and a decrease of $8.4 million General Fund from the 2011 Budget Act.

Child Support Collections

The child support program establishes and enforces orders for child, spousal, and medical support from absent parents on behalf of dependent children and their caretakers. For display purposes, the Budget reflects the total collections received, including payments to families and collections made in California on behalf of other states. The General Fund share of assistance collections is included in statewide revenue projections. The General Fund portion of child support collections is estimated to be $253.7 million in 2011-12 and $263.6 million in 2012-13. The increased General Fund collections in 2012-13 primarily reflect the continued suspension of the county share of collections.

Proposal to Balance the Budget:

Suspend County Share of Collections. The Budget proposes to suspend the county share of child support collections in 2012-13. The county share of collections is estimated to be $34.5 million in 2012-13. Under this proposal, the entire non-federal portion of child support collections will benefit the General Fund on a one-time basis. This will not reduce the revenue stabilization funding of $18.7 million ($6.4 million General Fund) counties receive for caseworker staff in order to maintain child support collections.

Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation (CDCR) incarcerates the most serious and violent felons, supervises these felons after their release on parole, and provides rehabilitative strategies designed to successfully reintegrate offenders into communities. The CDCR provides safe and secure detention facilities and necessary support services to inmates, including food, clothing, academic and vocational training.

The Budget proposes $8.9 billion ($8.7 billion General Fund) for all state operations and local assistance programs included under this Agency in 2012-13.

Improving the Efficiency of the State Prison System

The Budget reflects the implementation of the 2011 Public Safety Realignment. Chapter 15, Statutes of 2011 (AB 109), shifted the responsibility for lower-level offenders and parole violators from state prisons to county jurisdictions. Counties are now responsible for the community supervision of lower-level offenders upon the completion of their prison sentence. Public Safety Realignment is the cornerstone of California's efforts to comply with a 2009 court order in the *Plata* and *Coleman* cases that required the State to reduce crowding levels in the prison system.

The ongoing successful implementation of the reform of the state's incarceration system is a key priority of the Administration. The effects of this reform included in the Budget are as follows:

- Population Declining as Expected—As a result of realignment, the total adult inmate population is expected to decline from 150,038 in the current year to 132,167 in the budget year, a 12-percent decrease. The adult inmate population is projected to decrease by 13,114, or 8 percent, in the current year and 30,985, or 19 percent, in the budget year. The current projections also reflect decreases in the estimated parolee population of 23,476 in 2011-12 and 51,898 in 2012-13, declining to a total parolee population of 84,862 in the current year and 56,440 in 2012-13. These population changes result in state savings of $453.3 million in the current year and $1.1 billion in the budget year.
- Operational Changes to Better Address Needs of Remaining Population—Realignment has significantly changed the population mix remaining in the care of the state, requiring substantial changes to the Department's operations. For example, the number of female inmates is declining by a greater proportion than male inmates, which necessitates the conversion of the Valley State Prison for Women to a male facility by July 2013. In addition, fewer reception beds are needed due to a significant decline in the intake and release of inmates within CDCR. The lower demand for reception beds is allowing the Department to convert existing reception center capacity throughout the state to house inmates on a longer-term basis. The mission of the reception centers is being aligned to better address the needs of the remaining population.
- Fewer Non-Traditional Beds Needed—Under realignment, the deactivation of non-traditional beds has increased significantly. CDCR deactivated 898 non-traditional beds in October 2011, 3,223 beds in November, and 844 beds in December. Currently, CDCR is down to 1,263 non-traditional beds. This equates to just 7 gymnasiums and 1 dayroom compared to the 72 gyms and 125 dayrooms in operation at the peak of crowding in August 2007.
- Rethinking the Prison Facilities Plans—Realignment fundamentally alters the State's future facility needs as funded under Chapter 7, Statutes of 2007 (AB 900). The primary purpose for the infill program is no longer present, since the state will no longer operate any non-traditional bed capacity. Although the major medical facility under construction in Stockton will proceed as scheduled due to the specialized capacity that it will provide, the Administration is reevaluating the need for other infill and reentry construction projects in light of the substantial population declines.

The Budget includes a reduction of $44.5 million to reflect the cancellation of the Estrella infill project. Additionally, the Budget reflects that the state is not currently proceeding with the construction and conversion of the DeWitt youth facility to an adult facility. It is anticipated that the state will avoid approximately $250 million in annual debt service costs as a result of the revised construction plan. The Budget also assumes savings of $125 million related to infrastructure projects authorized by AB 900 that are not needed as a result of realignment.

Alternative Custody for Women

Proposal to Balance the Budget:

- Approximately 70 percent of the current female inmate population is classified as non-violent offenders with convictions for property or drug-related crimes. Additionally, a majority of the women in state prison, including those with prior serious or violent convictions, are classified as low-risk. Increased participation by women in programs such as substance abuse counseling and vocational education will enhance prison safety and rehabilitation efforts and further reduce the state's adult inmate population. The Budget provides for the expansion of Alternative Custody for Women to include women who have a prior serious or violent conviction. This will allow CDCR to place these offenders in community-based treatment programs in an effort to achieve successful outcomes and reduce recidivism among this population. Savings resulting from the reduction in the female inmate population will be used to cover the cost of treatment programs in the community. The anticipated population decline in future years is expected to generate long-term savings of $2.5 million beginning in 2014-15 and $5 million annually thereafter. In addition, the state expects to avoid future incarceration costs related to this population due to the positive effects of rehabilitative and therapeutic programs provided through alternative custody.

Fiscal Accountability

The Budget continues the Department's focus on fiscal accountability. Previously, structural budgetary shortfalls in various programs led to the Department's inability to manage its budget within the funding provided. Consequenty, the 2011 Budget Act included an ongoing augmentation of $379.6 million to more accurately reflect the operational costs within the adult institutions' budgets. In addition, new and expanded program structures were implemented to allow for a more detailed level of fiscal tracking, improving fiscal oversight. The following provides an update on these efforts.

- Program Funding — A necessary component of ensuring sufficient funding is the semiannual population funding request to address CDCR's ongoing costs for serving the population remaining under its jurisdiction. The Budget includes an increase of $33.4 million General Fund in 2011-12 and $30.1 million in 2012-13 for costs primarily related to changes in the budgeted populations of adult mental health inmates. The Budget recognizes the cost to deliver mental health treatment to inmates and represents implementation of the Mental Health Staffing Ratios presented to the court in 2010 in response to the *Coleman v. Brown* lawsuit.

- Reporting Requirements — The Budget continues the reporting requirements that were included in the 2011 Budget Act to increase the fiscal accountability at adult institutions. In addition, the Budget requires CDCR to report at intervals on position reductions associated with the population decline.

- Zero-Based Budgeting of Division of Adult Parole Operations — The Department of Finance and CDCR are working together to zero-base the budget for the Division of Adult Parole Operations.

Juvenile Justice Realignment

The Division of Juvenile Justice currently houses approximately 1,100 offenders. The Budget proposes to expand on previous successful efforts to reform the state's juvenile justice system by eventually transferring the responsibility for managing all youthful offenders to local jurisdictions. The Budget proposes to stop intake of new juvenile offenders effective January 1, 2013, and also proposes $10 million General Fund in 2011-12 to support local governments in planning for this transition. The Administration is committed to working with local governments and stakeholders to ensure a successful transition, and to develop a funding model that provides an appropriate level of resources to house and treat juvenile offenders locally.

Board of State and Community Corrections

The Budget establishes and includes funding for the Board of State and Community Corrections (Board) through transfers from the Corrections Standards Authority (CSA) within CDCR and the California Emergency Management Agency.

Legislation associated with the 2011 Budget Act abolished the CSA and established the new Board as an independent entity, effective July 1, 2012. The Board will absorb the previous functions of the CSA as well as other public safety programs previously administered by the California Emergency Management Agency.

The Board will provide statewide leadership, coordination, and technical assistance to promote effective state and local efforts and partnerships in California's adult and juvenile criminal justice system. Particularly important in the next several years will be coordinating with and assisting local governments as they implement the realignment of many adult offenders to local government jurisdictions that began in 2011. The Board will guide statewide public safety policies and ensure that all available resources are maximized and directed to programs that are proven to reduce crime and recidivism among all offenders.

The Budget proposes $109.1 million ($16.9 million General Fund and $92.2 million other funds) for the state operations and local assistance programs included under this Board.

Incarceration of Undocumented Felons

An estimated 10.8 percent of inmates in the state prison system in 2011-12 will be undocumented persons. Approximately $936.4 million will be spent to incarcerate 16,250 offenders. However, the state is expected to receive only $65.8 million in federal State Criminal Alien Assistance Program funding for 2011-12 and 2012-13. At this level of funding, the state will be reimbursed for only 7 percent of the costs associated with the incarceration and related debt service associated with the undocumented felon population, with $870.6 million in costs in excess of the level of federal reimbursements.

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K thru 12 Education

Reinvesting in Education

The Budget begins to reverse the recent decline in funding for K-12 education programs. Since reaching an all-time high of $56.6 billion in 2007-08, Proposition 98 funding of K-12 schools and community colleges slipped to $47.6 billion for the 2011-12 year.

The Budget provides Proposition 98 funding of $52.5 billion for 2012-13, an increase of $4.9 billion compared to 2011-12. When accounting for all state, federal, and local property tax resources, total funding for K-12 education is projected to be $67.1 billion in 2012-13. This funding supports California's school districts, charter schools, and county offices of education that provide instruction and support services to more than six million students.

The Budget assumes passage of the Governor's proposed tax initiative which will provide $6.9 billion in additional revenue for education programs. In the event the initiative does not pass, the Budget includes a trigger reduction of $4.8 billion. A reduction of this magnitude would result in a funding decrease equivalent to more than the cost of three weeks of instruction. It will also continue to provide 20 percent of program funds a year in arrears.

In addition to assuming new revenues, the Budget includes a series of adjustments or "rebenchings" of the Proposition 98 guarantee. The most significant adjustment relates to the elimination of the sales tax on gasoline in 2010-11. These adjustments provide $373.2 million of General Fund savings. The Budget also includes a Proposition 98

General Fund reduction of $171.2 million to special education and community college apportionments in the current year to offset increased property taxes resulting from the elimination of redevelopment agencies (RDAs).

The Budget builds upon flexibility granted to schools in recent years and gives significant decision-making authority to local school districts. While local districts have enjoyed recent, temporary flexibility to use many categorical programs for any educational purpose, a significant number of programs remain cordoned off. The Budget dramatically increases flexibility and local control by consolidating the vast majority of categorical programs (excluding federally required programs such as special education) with revenue limit apportionments into a single stream of funding for schools on a permanent basis. In doing so, it will eliminate many of the inefficiencies and costs that plague the current system of school finance, while continuing to target funds to schools with large populations of disadvantaged pupils. This change will empower local school officials to determine the best uses of scarce resources. It will increase transparency and help to facilitate greater and more informed involvement of parents and community members in local school financial matters. As a result, parents and community members will be better able to access information on the performance of their local schools and hold schools accountable.

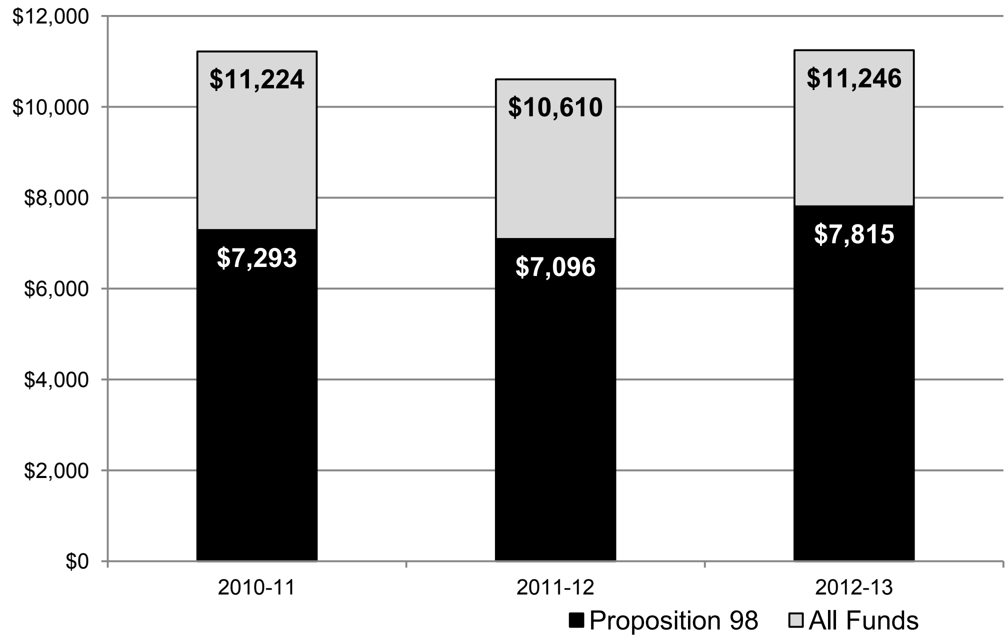
The Budget recognizes that this is a time for reinvestment and reform, not for program expansions. As such, it does not fund the new Transitional Kindergarten program created pursuant to Chapter 705, Statutes of 2010, for a cost avoidance of $223.7 million. These savings will be used to support existing education programs. The Budget also proposes an increase of more than $2.3 billion in Proposition 98 General Fund to reduce inter-year budgetary deferrals for schools and community colleges.

K-12 School Spending and Attendance

Per-Pupil Spending

Total per-pupil expenditures from all sources are projected to be $10,610 in 2011-12 and $11,246 in 2012-13, including funds provided for prior year settle-up obligations. K-12 Proposition 98 per-pupil expenditures in the Budget are $7,815 in 2012-13, up significantly from the $7,096 per-pupil provided in 2011-12. (See Figure K12-01). Figure K12-02 displays the revenue sources for schools.

Figure K12-01
K-12 Education Spending Per Pupil



How Schools Spend Their Money

Figure K12-03 displays FY 2009-10 expenditures reported by schools from their general funds, the various categories of expenditure and the share of total funding for each category.

Attendance

After several years of declining attendance from 2005 to 2010, attendance in public schools began increasing gradually in the 2010-11 fiscal year. Public school attendance is projected to continue increasing

Figure K12-02
Sources of Revenue for California's K-12 Schools
(As a Percent of Total)

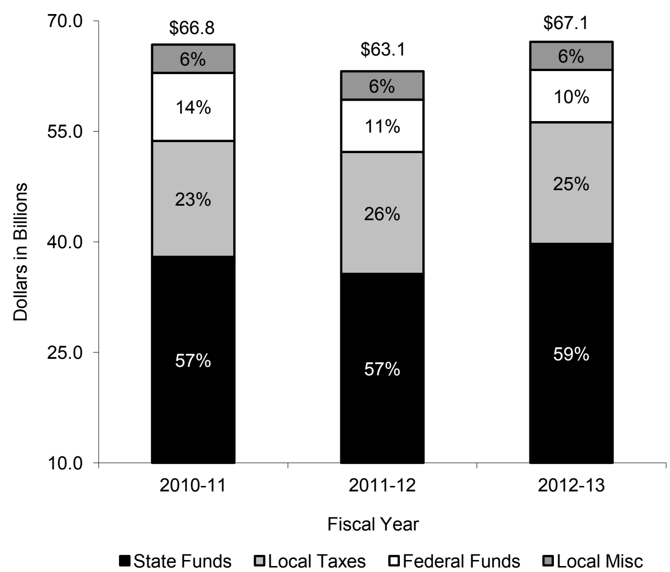
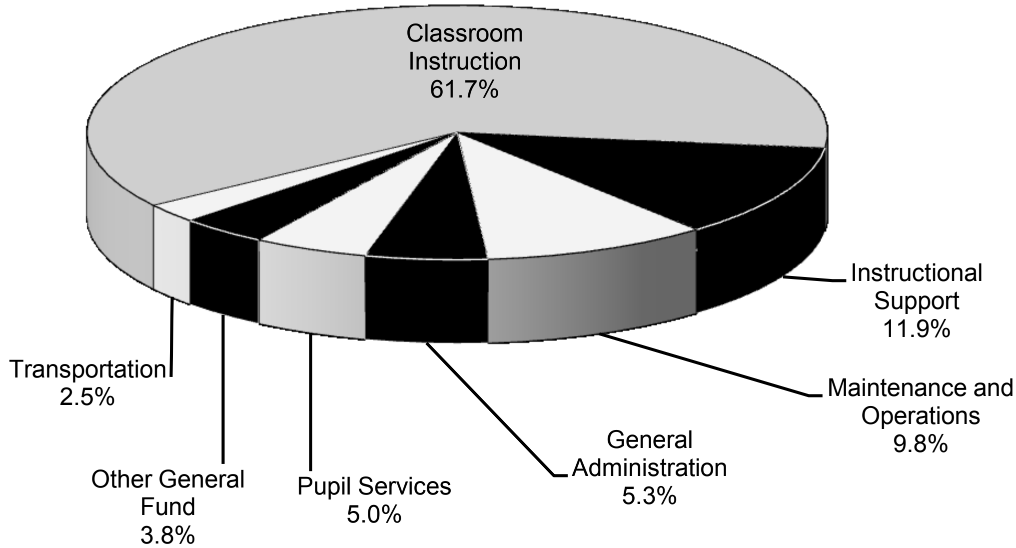


Figure K12-03
Where Schools Spend Their Money[1]



Classroom Instruction includes general education, special education, teacher compensation, and special projects.
General Administration includes superintendent and board, district and other administration and centralized electronic data processing.
Instructional Support includes instructional, school site, and special projects administration.
Maintenance and Operations includes utilities, janitorial and groundskeeping staff, and routine repair and maintenance.
Pupil Services includes counselors, school psychologists, nurses, child welfare, and attendance staff.
Other General Fund includes spending for ancillary services, contracts with other agencies, and transfers to and from other district funds.

[1] Based on 2009-10 expenditure data reported by schools for their general purpose funding.

during the 2011-12 and 2012-13 fiscal years. For 2011-12, K-12 average daily attendance (ADA) is estimated to be 5,950,041, an increase of 2,673 from the 2010-11 fiscal year. For 2012-13, the Budget estimates that K-12 ADA will increase by an additional 20,734 to 5,970,775.

Proposition 98 Guarantee

A voter-approved constitutional amendment, Proposition 98 guarantees minimum funding levels for K-12 schools and community colleges. The guarantee, which went into effect in the 1988-89 fiscal year, determines funding levels according to multiple factors including the level of funding in 1986-87, General Fund revenues, per capita personal income, and school attendance growth or decline.

Proposition 98 originally mandated funding at the greater of two calculations or Tests (Test 1 or Test 2). In 1990, Proposition 111 (SCA 1) was adopted to allow for a third funding test in low revenue years. As a result, three calculations or tests determine funding for school districts and community colleges (K-14). The calculation or test that is used depends on how the economy and General Fund revenues grow from year to year.

Proposition 98 Test Calculations

Test 1 — Percent of General Fund Revenues: Test 1 is based on a percentage or share of General Fund tax revenues. The base year for the Test 1 percentage is 1986-87, a year in which school districts and community colleges (K-14) received approximately 40 percent of General Fund tax revenues. As a result of the recent shifts in property taxes from K-14 schools to cities, counties, and special districts, the current rate is approximately 39 percent.

Test 2—Adjustments Based on Statewide Income: Test 2 is operative in years with normal to strong General Fund revenue growth. This calculation requires that school districts and community colleges receive at least the same amount of combined state aid and local property tax dollars as they received in the prior year, adjusted for enrollment growth and growth in per capita personal income.

Test 3—Adjustment Based on Available Revenues: Test 3 is used in low revenue years when General Fund revenues decline or grow slowly. During such years, the funding guarantee is adjusted according to available resources. A "low revenue year" is defined as one in which General Fund revenue growth per capita lags behind per capita personal income growth more than one-half percentage point. Test 3 was designed so that education is treated no worse in low revenue years than other segments of the state budget. In years following a Test 3 funding level, the state is required to provide funding to restore what was not allocated the previous year. This is often referred to as a "maintenance factor".

Assuming the passage of the Governor's tax proposal, for fiscal year 2011-12, the Proposition 98 guarantee will be $48.3 billion, of which the General Fund share is $32.6 billion, with local property taxes covering the balance. The 2011-12 Proposition 98 guarantee will be $661 million above the level of General Fund appropriated in 2011-12, and that amount will be appropriated in the future as "settle-up" payments. Proposition 98 funding in 2012-13 is proposed to be $52.5 billion. The General Fund share in 2012-13 is $37.5 billion, including $6.6 billion in assumed initiative revenues. In fiscal year 2012-13, it is estimated that the state will be in a Test 1 year.

The funding levels above reflect a $2.5 billion increase in the Proposition 98 minimum guarantee in 2012-13 assuming passage of the Governor's tax proposal and the revenues from the initiative are budgeted on an accrual basis.

In addition to proposing new revenues, the Budget includes a series of adjustments or "rebenchings" of the Proposition 98 guarantee. Two rebenchings of the Proposition 98 guarantee in 2011-12, for the inclusion of special education mental health services and the exclusion of most child care programs from within the guarantee, are adjusted based upon 1986-87 level costs for those programs. This 1986-87 level cost methodology was used for previous rebenchings and, therefore, the change provides a single and consistent methodology for all rebenching adjustments. An additional adjustment is made for special education mental health services in 2012-13 for costs funded in 2011-12 out of Proposition 63 funds, ensuring that the guarantee is fully adjusted for the program.

K-12 Budget Adjustments

Proposals to Balance the Budget:

- Proposition 98 Savings Adjustments—A combined reduction of $373.2 million to reflect: (1) elimination of the policy rebenching made to hold Proposition 98 harmless from the elimination of sales tax on gasoline, and (2) changes to two rebenchings of the Proposition 98 guarantee in 2011-12, for the inclusion of special education mental health services and the exclusion of most child care programs from within the guarantee, to conform them to the methodology used for previous rebenchings.
- Restructure Administration and Reduce Child Care Costs—A decrease of $446.9 million in Non-98 General Fund and $69.9 million in Proposition 98 General Fund to State Department of Education (SDE) child care programs to reflect changes to reimbursement rates, and to reflect the alignment of eligibility for low-income working family child care services with federal welfare-to-work work participation requirements. These changes are consistent with the Administration's proposal to restructure CalWORKs, which will focus limited state resources on low-income parents working a required number of hours (See the "Child Care" section for details.)
- Child Nutrition Program Subsidy for Private Entities—A decrease of $10.4 million Non-98 General Fund in 2012-13 to reflect the elimination of supplemental

reimbursement for free and reduced-price breakfast and lunch served at private schools and private child care centers.

- State Special Schools Unallocated Reduction—A decrease of $1.8 million Non-98 General Fund in 2012-13 to reflect a reduction in discretionary funding for the California Schools for the Deaf in Fremont and Riverside and the School for the Blind in Fremont.
- California State Library—A reduction of $1.1 million Non-98 General Fund to reflect a decrease in anticipated administrative workload resulting from 2011-12 trigger reductions that eliminated $15.9 million in local assistance programs.
- Special Education Property Tax Adjustment—A decrease of $24.3 million Proposition 98 General Fund for special education programs in 2011-12 to reflect increased property tax revenues from redevelopment agencies as a result of the ruling in *California Redevelopment Association v. Matosantos*.

Other Significant Adjustments:

- K-12 Deferrals—An increase of $2.2 billion Proposition 98 General Fund to reduce inter-year budgetary deferrals.
- Transitional Kindergarten—A decrease of $223.7 million Proposition 98 General Fund to reflect the elimination of the requirement that schools provide transitional kindergarten instruction beginning in the 2012-13 academic year. These savings will be used to support existing education programs.
- Charter Schools—An increase of $50.3 million Proposition 98 General Fund for charter school categorical programs due to charter school growth.
- Special Education—An increase of $12.3 million Proposition 98 General Fund for Special Education ADA growth.
- K-14 Mandates Funding—An increase of $110.1 million to support a new block grant program for K-12 and community college mandates as discussed further below.
- Cost-of-Living Adjustment Increases—The Budget does not provide a cost-of-living-adjustment (COLA) for any K-14 program in 2012-13. The projected 2012-13 COLA is 3.17 percent, which would have provided a $1.8 billion increase to the extent Proposition 98 resources were sufficient to provide that adjustment. A deficit factor will be established in 2012-13 for school district and county office of

education revenue limit apportionments to reflect the lack of a COLA, ensuring that funding in future years is used to restore this adjustment.

- Local Property Tax Adjustments—An increase of $196 million for school district and county office of education revenue limits in 2011-12 as a result of lower offsetting property tax revenues. An increase of $627 million for school district and county office of education revenue limits in 2012-13 as a result of reduced offsetting local property tax revenues.
- Redevelopment Agency Elimination—An increase of $1.1 billion in offsetting local property taxes for 2012-13 due to the elimination of redevelopment agencies.
- Average Daily Attendance (ADA)—A decrease of $694 million in 2011-12 for school district and county office of education revenue limits as a result of a decrease in projected ADA from the 2011 Budget Act. An increase of $158 million in 2012-13 for school district and county office of education revenue limits as a result of projected growth in ADA for 2012-13.
- Unemployment Insurance—An increase of $21.8 million in 2012-13 to fully fund the additional costs of unemployment insurance for local school districts and county offices of education.
- Child Nutrition Program—An increase of $37.2 million for 2012-13 in SDE federal local assistance funds to reflect growth of nutrition programs at schools and other participating agencies.
- Fresh Fruit and Vegetable Program—An increase of $2 million for 2012-13 in SDE federal local assistance funds for the Fresh Fruit and Vegetable Program, which provides an additional free fresh fruit or vegetable snack to students during the school day.
- Child Care—The significant workload adjustments for Child Care programs are as follows:
    - Stage 2—A decrease of $26.3 million non-Proposition 98 General Fund in 2012-13, reflecting primarily the decline in the number of eligible CalWORKs Stage 2 beneficiaries. Nearly 9,000 children whose families were determined eligible for diversion services as a result of the Stage 3 veto in 2010-11 will lose Stage 2 eligibility and re-enter Stage 3 in the budget year. Total base workload cost for Stage 2 is $416.2 million.

- Stage 3—A net increase of $4.5 million non-Proposition 98 General Fund in 2012-13 that reflects a relatively flat caseload. The anticipated transfer of nearly 9,000 children from Stage 2 to Stage 3 in the budget year is offset by the number of children who will be disenrolled in the current year due to the contract reduction included in the 2011 Budget Act. Total base workload cost for Stage 3 is $148.1 million.
- Capped Non-CalWORKs Programs—On a workload basis, the Budget provides an increase of $29.9 million in non-Proposition 98 General Fund to fund the statutory COLA of 3.17 percent for capped child care programs, and an increase of $11.7 million in Proposition 98 General Fund to fund the COLA for part-day preschool. However this COLA is eliminated as part of the child care reductions.
- Child Care and Development Funds (CCDF)—A net increase of $14.9 million federal funds in 2012-13 reflecting removal of one-time carryover funds available in 2011-12 ($3.5 million), an increase of $23.2 million in carryover funds, and a decrease of $4.8 million in available base grant funds.

Ballot Trigger Reduction:

- If new revenues are not achieved, the Proposition 98 guarantee will drop by $2.4 billion in 2012-13. In addition, Proposition 98 will be rebenched to shift K-14 General Obligation Bond debt service costs into Proposition 98, resulting in additional savings of $2.4 billion. As a result, total program funding for Proposition 98 will drop by $4.8 billion, which will eliminate the $2.2 billion repayment of inter-year budgetary deferrals proposed in the Budget for 2012-13. The remaining $2.6 billion reduced from Proposition 98 would equate to shortening the school year by more than three weeks. The Administration will work with school officials and stakeholders to develop legislation that protects education programs, but allows schools to develop and implement necessary contingency plans.

Significant Other General Fund Policy Issues:

- Greater Flexibility and Accountability—California's school finance system has become too complex, administratively costly and inequitable. There are many different funding streams, each with its own allocation formula and spending restrictions. Many program allocations have been frozen and no longer reflect demographic and other changes. Furthermore, the fiscal flexibility that has recently been provided to schools is time-limited and excludes some significant programs.

- To remedy this, the Budget proposes a weighted pupil funding formula that will provide significant and permanent additional flexibility to local districts by consolidating the vast majority of categorical programs (excluding federally required programs such as special education(and revenue limit funding into a single source of funding. The formula will distribute these combined resources to schools based on weighted factors that account for the variability in costs of educating specific student populations, thereby ensuring that fund will continue to be targeted to schools with large populations of disadvantaged pupils. The formula will be phased in over a period of five years.

- All of the programs that will be replaced by the formula will immediately be made completely flexible for use in supporting any locally determined educational purpose.

- This proposal will be coupled with a system of accountability measures that will be the basis for evaluating and rewarding school performance under this finance model. These measures will include the current quantitative, test-based accountability measures, along with locally developed assessments and qualitative measures of schools.

- Reform K-14 Mandates—The Budget provides a total of $200 million to fund a mandates block grant incentive program for K-12 schools and community colleges. Legislation will eliminate almost half of all current K-14 mandates and will create incentives for schools to continue to comply with remaining previously mandated activities. The significant shortcomings of existing mandates and the process for administering them compel this reform. Many existing mandates fail to serve a compelling purpose. The mandates determination process takes years. Reimbursement costs are very often higher than anticipated and can vary greatly district by district. Further, the reimbursement process rewards inefficiency.

    - Eliminate Unnecessary Mandates—The proposal will eliminate nearly half of all existing mandates, including Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. While the mandate to perform these activities will be eliminated, local districts may choose to continue these activities at local discretion.

- Preserve Core Programs and Functions—Mandates that are not eliminated will be made optional. However, the proposal creates a block grant to encourage schools to continue meeting these requirements. Receipt of funding from this block grant will be conditioned on schools complying with these provisions. The proposal will sustain core programs, including school and county office fiscal accountability reporting. It will also continue to support sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks. The mandates block grant provides an almost 340-percent increase in funding to encourage districts to perform these programs.

- Streamline and Expand Financial Support for Charter Schools—The Budget proposes to improve in general the operational and financial playing field for charter schools. Charter schools receive less per average daily attendance funding than traditional public schools and are not eligible for mandate reimbursements. They have limited options for borrowing funds at affordable interest rates and may not issue bonds. To address these issues, the Budget proposes the following changes:

  - Enhance Charter School Funding—(1) Fully fund non-classroom-based charter schools and continue to provide growth funding for all charter schools through the charter school categorical block grant, until a weighted student formula replaces this funding mechanism, (2) stabilize funding for the Charter School Revolving Loan Fund by providing additional access to proceeds available in the Charter School Security Fund, (3) facilitate timely processing of charter school deferral exemption requests by eliminating the requirement that requests be reviewed by the charter authorizer, and (4) provide additional borrowing opportunities to charter schools by specifying in statute that Local Educational Agencies (LEAs) may include charter schools in their issues of County Treasury Revenue Anticipation Notes (TRANs). LEAs issuing TRANs will be statutorily identified as senior creditors for the purposes of the repayment of TRANs issued on behalf of a charter school.

  - Invest in Charter School Facilities—(1) Allow non-classroom-based charter schools to participate in the Charter School Facility Grant Program (Grant Program), (2) facilitate the timely release of Grant Program funds by eliminating some of the up-front application processes and streamlining eligibility determinations, and (3) specify in statute that the state be identified as the senior creditor for Grant Program fund accountability purposes.

- Improve Charter School Working Capital — Authorize the California School Finance Authority to: (1) refinance existing working capital revenue bonds, (2) expand charter school payment intercepts to include categorical block grant funds, and (3) expand working capital financing to include charter management organizations.

School Revenue Limit Apportionments

K-12 revenue limits provide the primary form of general purpose funding assistance to California's public schools. These funds are discretionary and typically cover the cost of teacher and administrator salaries. Funding is distributed to schools based on ADA.

The average revenue limit per pupil in the current year is estimated to be $5,717 per ADA. A school district's revenue limit is funded from two sources — local property taxes and state General Fund. Local property taxes are allocated first and, if insufficient to fully fund a school's revenue limit apportionment, state General Fund pays the difference.

When state General Fund is insufficient to fully fund revenue limits statewide, a deficit factor is created to reduce funding to all schools by the same percentage. The deficit factor keeps track of reductions to school revenue limits which will be restored when sufficient funding is available in the future.

K-12 School Facilities

Since 1998, voters have approved approximately $35 billion in statewide general obligation bonds to construct or renovate public school classrooms used by the state's 6.3 million elementary, middle and high school students. In addition to general obligation bonds, school districts may utilize developer fees, local bonds, certificates of participation and Mello-Roos bonds to construct additional classrooms or renovate existing classrooms. The Budget proposes to shift existing School Facilities Program bond authority from the Overcrowding Relief Grant Program to the New Construction program and to regulate the allocation of new construction and modernization funds to ensure continued construction of new classrooms and modernization of existing classrooms. This action will delay local authority to impose a third level construction fee while continuing construction of new classrooms using bond proceeds, fee revenues and local funds.

Child Care

Background on the Existing Child Care System

Subsidized Child Care includes a variety of programs designed to support the gainful employment of low-income families. These programs are primarily administered by the SDE through non-Proposition 98 funding and the annual federal Child Care and Development Fund grant. Additionally, part-day preschool programs — funded through Proposition 98 — meet a child care need, but are also designed as an educational program to help ensure children develop the skills needed for success in school. All programs, with the exception of preschool, are means-tested and require that families receiving subsidies have a need for child care, which means all adults in the family must be working or seeking employment, or are in training that leads to employment. The part-day State Preschool program is an exception to the need-based requirement because it is primarily an education program. Most programs are capped, drawing eligible families from waiting lists, while those specifically limited to CalWORKs families or former CalWORKs families have been funded for all eligible recipients.

The major capped programs include General Child Care, State Preschool, Alternative Payment Program, and Migrant Child Care. CalWORKs programs include: Stage 1, administered by the Department of Social Services (DSS), is for families on cash assistance whose work activities have not stabilized; Stage 2, administered by the SDE, is for those CalWORKs families with stable work activities and for families who are transitioning off of aid, for up to two years; and Stage 3, also administered by the SDE, has been reserved for families who have successfully transitioned off of aid for more than two years and still have a child care need.

Total funding for SDE child care programs in 2011-12 is $2 billion, consisting of $1.1 billion in non-Proposition 98 General Fund, $373.7 million in Proposition 98 General Fund, and $543.1 million in federal funds. Stage 1 child care totals $428.3 million General Fund/TANF and is included in the DSS budget. Collectively, the SDE programs are estimated to serve 298,600 average monthly enrolled children and Stage 1 child care serves 44,300 children, for a current-year average monthly total of 342,900.

Reduce Child Care Costs and Restructure Administration of Child Care

Total funding proposed for SDE child care programs in 2012-13 is $1.5 billion, consisting of $585.3 million in non-Proposition 98 General Fund, $310.2 million in Proposition 98 General Fund, and $557.9 million in federal funds. The $1.5 billion total funding reflects a $446.9 million reduction to child care programs funded from non-Proposition 98 General Fund, and a reduction of $69.9 million in Proposition 98 General Fund for part-day preschool. Funding for cash-aided families who are currently enrolled in Stage 1 child care totals $442 million General Fund/TANF and is included in the DSS budget. Collectively, the SDE and DSS programs are estimated to serve 292,900 average monthly enrolled children in 2012-13. This figure reflects the elimination of 62,000 child care slots and other caseload changes.

The reductions to SDE child care programs reflect changes to reimbursement rates. They also reflect the alignment of eligibility and need criteria for low-income working family child care services with federal income eligibility rules and welfare-to-work participation requirements. These changes are consistent with the Administration's proposal to restructure CalWORKs, which will focus limited state resources on low-income families working a required number of hours (see Department of Social Services in the Health and Human Services section). Over time, the three-stage child care system for current and former CalWORKs recipients, and programs serving low-income working parents, will be replaced with a work-based child care system administered by county welfare departments.

By focusing the state's subsidized child care programs on supporting work, the state will be able to maximize the number of available child care slots within constrained resources. Using Proposition 10, federal and other local funds, local entities can invest in program quality improvement based on local needs and priorities.

The child care reductions consist of the following:

- A decrease of $293.6 million in non-Proposition 98 General Fund by requiring families to meet federal welfare-to-work participation requirements. This change will eliminate services for families who do not work a required number of hours. Part-day preschool programs will not be affected by this reduction, as these programs are not intended to meet the full-time needs of working parents. This reduction will eliminate about 46,300 child care slots.

- A decrease of $43.9 million in non-Proposition 98 General Fund and $24.1 million in Proposition 98 General Fund by reducing the income eligibility ceilings from 70 percent of the state median income to 200 percent of the federal poverty level. This level equates to 61.5 percent of the state median income for a family size of three, reflecting a reduction in the income ceiling from $42,216 to $37,060. This reduction will eliminate about 15,700 child care slots.

- A decrease of $29.9 million in non-Proposition 98 General Fund and $11.7 million in Proposition 98 General Fund by eliminating the statutory COLA for capped non-CalWORKs child care programs.

- A decrease of $11.8 million in non-Proposition 98 General Fund by reducing the reimbursement rate ceilings for voucher-based programs from the 85th percentile of the private pay market, based on 2005 market survey data, to the 50th percentile based on 2009 survey data. To preserve parental choice under lower reimbursement ceilings, rates for license-exempt providers will remain comparable to current levels, and these providers will be required to meet certain health and safety standards as a condition of receiving reimbursement. (A corresponding $5.3 million General Fund decrease is made to Stage 1 in the DSS budget.)

- A decrease of $67.8 million in non-Proposition 98 General Fund and $34.1 million in Proposition 98 General Fund by reducing the standard reimbursement rate for direct-contracted Title 5 centers by 10 percent.

Components of the administrative restructuring of child care consist of the following:

- Beginning in 2013-14, families meeting federal work requirements will receive a work bonus issued by the county welfare departments to better support working families.

- In the budget year, the SDE will continue to administer services payment contracts with alternative payment programs (which administer voucher-based programs) and Title 5 centers. Contracts with alternative payment programs for funding remaining after the reimbursement rate and eligibility reductions will be consolidated. Priority for voucher-based services will be given to families whose children are recipients of child protective services, or at risk of being abused, neglected, or exploited, and cash-aided families. Cash-aided families that are currently enrolled in Stage 1 will continue to receive child care services.

- Beginning in 2013-14, the eligibility and payment functions will shift from the alternative payment programs and Title 5 centers to the counties, though counties may contract with these agencies to perform the payment function. All eligible families, including those currently enrolled in Title 5 centers, will receive a voucher for payment to a provider of their own choice. This will shift responsibility for the administration of services for approximately 142,000 children from the SDE to the counties. The SDE will continue to administer part-day preschool programs.

- The Administration is also proposing legislation, effective in 2013-14, to require counties and alternative payment programs to identify and collect overpayments. The legislation also imposes sanctions on agencies that do not reduce the incidence of overpayments, and it also imposes sanctions on providers and families who commit intentional program violations. Any savings will be reinvested in child care slots.

California State Library

The 2011-12 Budget included the elimination of $15.9 million in General Fund support for the following discretionary programs administered by the California State Library: the Public Library Foundation ($3 million), the California Library Services Act ($8.5 million), the California English Acquisition and Literacy Program ($3.7 million), the California Civil Liberties Public Education Program ($450,000), and the California Newspaper Project ($216,000).

To conform to these local assistance reductions, the Budget proposes a reduction of $1.1 million Non-98 General Fund to reflect a decrease in associated administrative workload. Despite this reduction, the California State Library will continue to preserve California's history and cultural heritage, and share its collection of historic documents with the citizens of California.

Higher Education

Each year, millions of Californians pursue degrees and certificates and enroll in courses to improve their knowledge and skills at the state's higher education institutions. More are connected to the system as employees, contractors, patients, and community members.

From 2008-09 through 2011-12, the state reduced funding by $2.65 billion General Fund to the University of California, the California State University, the California Community Colleges, and the Hastings College of the Law. The most notable consequences have been significant student tuition and fee increases and declining course offerings, which have made it difficult for students to complete their certifications and degrees in a timely manner.

The Administration's long-term plan for higher education is rooted in the belief that higher education should be affordable and student success can be improved. The Administration proposes stable and increasing state funding to higher education and provides fiscal incentives to improve management of all costs. The significant components of the plan include the following:

- Affordability—The plan will curtail tuition and fee increases and will lessen the pressure for students to take out burdensome loans.
- Student Success—The plan will make annual General Fund augmentations contingent upon each institution achieving the Administration's priorities, including improvements in specific accountability metrics, such as graduation rates,

time to completion, transfer students enrolled, faculty teaching workload, and, for community colleges, successful credit and basic skills course completion.

- Stable Funding Source—The state will increase its General Fund contribution to each institution's prior year base by a minimum of four percent per year, from 2013-14 through 2015-16, contingent upon the passage of the Governor's tax initiative.
- Fiscal Incentives—The state currently budgets separately for, and adjusts annually, retirement program contributions and general obligation and lease revenue bond debt service for higher education capital improvement projects. The Budget proposes to shift these appropriations into each institution's budget (except retirement program and general obligation bond debt service for the California Community Colleges). This will encourage the institutions to factor these costs into their overall fiscal outlook and decision-making process.

For 2012-13, the Budget proposes total funding of $22.5 billion, reflecting an increase of $367.5 million above 2011-12, a 1.7-percent increase. As a subset of total funding, the Budget proposes funding of $11.6 billion in General Fund and Proposition 98 related-sources reflecting a decrease of $335.1 million below 2011-12. This decrease is due chiefly to the use of available federal Temporary Assistance for Needy Families funds in lieu of General Fund for the Cal Grant Program.

See Figure HED-01 for a summary comparison of individual institution funding totals reflecting the budget proposal and prior year appropriations.

University of California

Drawing from the top 12.5 percent of the state's high school graduates, the University of California (UC) educates approximately 237,800 undergraduate and graduate students at its ten campuses and is the primary institution authorized to independently award doctoral degrees and professional degrees in law, medicine, business, dentistry, veterinary medicine, and other programs. UC manages one U.S. Department of Energy national laboratory, partners with private industry to manage two others, and operates five medical centers that support the clinical teaching programs of the UC's medical and health sciences schools that handle more than 3.8 million patient visits each year.

Figure HED-01

Higher Education Expenditures

(Dollars in Millions)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Change from 2011-12 Dollar	Change from 2011-12 Percent
University of California [1/]								
Total Funds	$5,453.3	$5,453.4	$5,298.1	$5,948.2	$6,064.2	$6,362.7	$298.5	4.9%
General Fund	3,257.4	2,418.3	2,591.2	2,910.7	2,273.6	2,570.8	$297.2	13.1%
ARRA Reimbursement [2/]	-	716.5	-	106.6	-	-	-	-
California State University [1/]								
Total Funds	4,487.1	$4,616.9	$4,279.9	$4,674.5	$4,499.3	$4,697.1	$197.8	4.4%
General Fund	2,970.6	2,155.3	2,345.7	2,577.6	2,002.7	2,200.4	$197.7	9.9%
ARRA Reimbursement [2/]	-	716.5	-	106.6	-	-	-	-
Community Colleges								
Total Funds	9,081.6	$9,558.8	$9,965.7	$10,029.8	$9,500.7	$9,980.3	$479.6	5.0%
General Fund & P98 [3/]	6,425.6	6,332.6	6,117.5	6,297.7	5,729.4	6,210.2	$480.8	8.4%
ARRA Reimbursement [2/]	-	35.0	-	4.0	-	-	-	-
Student Aid Commission								
Total Funds	896.1	$924.7	$1,111.9	$1,398.1	$1,574.1	$1,364.0	-$210.1	-13.3%
General Fund	866.7	888.3	1,043.5	1,251.0	1,481.7	567.9	-$913.8	-61.7%
Other Higher Education [4/]								
Total Funds	384.3	$452.9	$547.4	$536.9	$454.2	$55.8	-$398.3	-87.7%
General Fund	354.7	419.3	508.2	489.1	405.8	8.8	-$397.0	-97.8%
Total Funds	**$20,302.3**	**$21,006.7**	**$21,203.0**	**$22,587.5**	**$22,092.5**	**$22,460.0**	**$367.5**	**1.7%**
General Fund	**$13,875.0**	**$12,213.7**	**$12,606.2**	**$13,526.1**	**$11,893.2**	**$11,558.1**	**-$335.1**	**-2.8%**

1/ For purposes of this table, expenditures for the UC and CSU have been adjusted to include the offsetting general purpose income, but exclude self-supporting functions such as auxiliary enterprises and extramural programs among others. This provides consistency in comparing magnitudes and growth among the various segments of education.

2/ All second round allocations of American Recovery and Reinvestment Act (ARRA) funding from the State Fiscal Stabilization Fund are shown in 2008-09 to more accurately reflect segmental expenditures between the two fiscal years and intent of federal law to backfill 2008-09 reductions.

3/ For purposes of comparing with UC and CSU General Fund, CCC includes property tax revenue as a component of the state's obligation under Proposition 98. CCC General Fund also includes general obligation (GO) bond debt service payments.

4/ The Other Higher Education amount includes Hastings College of the Law (HCL), the California Postsecondary Education Commission (CPEC), and GO bond debt service payments through 2011-12 for UC, CSU and HCL. GO bond debt service payments are included in UC, CSU, and Hastings General Fund figures for 2012-13.

Significant Adjustments:

- Eliminate Set-Asides in UC's Budget—The Budget proposes to remove various set-asides for specific programs and purposes, such as the Drew Medical Program, AIDS research, the Institutes for Science and Innovation, and the Summer School for Mathematics and Sciences. This provides UC with greater flexibility to manage its $750 million 2011-12 budget reduction.

- Operating Budget Needs—An ongoing increase of $90 million General Fund for base operating costs, which can be used to address costs related to retirement program contributions.

- Fiscal Incentives — It is the current practice that the state separately budgets, and annually adjusts, for general obligation and lease revenue debt service for UC capital improvement projects. The Budget proposes to shift these appropriations into UC's budget, which will require the University to factor these costs into UC's overall fiscal outlook and decision-making process.

Ballot Trigger Reduction:

- Unallocated Reduction — A decrease of $200 million in 2012-13 for an unallocated reduction. To the extent that UC chooses to increase tuition to backfill this reduction, the General Fund costs of providing Cal Grants to financially needy California students will increase and partially offset the General Fund savings of this proposal.

California State University

Drawing students from the top one-third of the state's high school graduates, as well as transfer students who have successfully completed specified college work, the California State University (CSU) provides undergraduate and graduate instruction through master's degrees and independently awards doctoral degrees in education, nursing practice, and physical therapy, or jointly with UC or private institutions in other fields of study. With 23 campuses and approximately 412,000 students, the CSU is the largest and most diverse university system in the country. It also is one of the most affordable. The CSU plays a critical role in preparing the workforce of California; it grants more than one-half of the state's bachelor's degrees and one-third of the state's master's degrees. The CSU prepares more graduates in business, engineering, agriculture, communications, health, and public administration than any other California institution of higher education. It also produces over 50 percent of California's teachers.

Significant Adjustment:

- Fiscal Incentives — It is the current practice that the state separately budgets, and annually adjusts, for general obligation and lease revenue debt service for CSU capital improvement projects. Additionally, the state currently budgets separately for, and adjusts annually, California Public Employees' Retirement System contributions for CSU employees. The Budget proposes to fold these appropriations into CSU's budget, which will require the University to factor these costs into CSU's overall fiscal outlook and decision-making process.

Ballot Trigger Reduction:

- Unallocated Reduction—A decrease of $200 million in 2012-13 for an unallocated reduction. To the extent that CSU chooses to increase tuition to backfill this reduction, the General Fund costs of providing Cal Grants to financially needy California students would increase and partially offset the General Fund savings of this proposal.

California Community Colleges

The California Community Colleges (CCC) are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.6 million students. The California Community College system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 71 educational centers. In addition to providing education, training, and services, the CCC contributes to continuous workforce improvement. The CCC also provides remedial instruction for hundreds of thousands of adults across the state through basic skills courses and adult non-credit instruction.

Significant Adjustments:

- Apportionments—An increase of $218.3 million in 2012-13 to partially restore funding that had been previously deferred, contingent upon the passage of the Governor's tax initiative. This restoration will reduce the debt burden of the state and is consistent with, and proportional to, the restoration of funding in K-12 education.
- Categorical Program Consolidations and Flexibility—Currently, colleges have many overlapping limitations on how they spend their funds and are not able to direct their scarce resources based on what is needed locally to achieve student success. They are limited as to the populations of students that they may serve and programs they may offer. The Budget proposes to consolidate nearly all categorical programs and provide flexibility to CCC to use "flexed" funds for any categorical program purpose. This proposal will improve student access and success and will provide the colleges with more local control, flexibility, and decision-making authority. The Administration will review the recommendations of the forthcoming Student Success Task Force report and explore other possibilities for expanding flexibility—including fee policy changes and loosening operational restrictions—for inclusion in the May Revision.

- Mandate Reform—The Budget proposes to preserve core mandatory programs and functions, to eliminate unnecessary mandates, and to create a mandates block grant incentive program. The details of this proposal are consistent with the K-12 Education mandate reform proposal discussed in the K-12 Education section.
- Redevelopment Agency Elimination—The Budget includes a current year Proposition 98 General Fund reduction of $146.9 million to CCC apportionments to reflect an identical increase in offsetting property taxes resulting from the elimination of redevelopment agencies.

California Student Aid Commission

The California Student Aid Commission (CSAC) administers state financial aid to students attending all institutions of public and private postsecondary education through a variety of programs including the Cal Grant High School and Community College Transfer Entitlement programs, the Competitive Cal Grant program, and the Assumption Program of Loans for Education. Over 91,000 students received new Cal Grant awards, and over 144,000 students received renewal awards, in 2010-11.

Prior to 2001, the program offered a capped number of awards to students and award amounts were specified in the Budget. The program is now an entitlement program and has been one of the fastest growing programs in the state. Costs for the program have increased dramatically due to an increased number of students participating in the program and UC and CSU tuition increases. Over an eight-year period, the number of participants in the program and costs have increased by 79,000 students and $915 million – from 177,000 students and $688 million in 2004-05 to an estimated 256,000 students and $1.6 billion in 2012-13.

Proposals to Balance the Budget:

- Change Cal Grant Award Amount for Private, For-Profit Colleges and Universities—A decrease of $59.1 million in 2012-13 by lowering the award amount for students attending private, for-profit schools to $4,000. This will affect approximately 14,900 students.
- Change Cal Grant Award Amount for Independent, Non-Profit Colleges and Universities—A decrease of $111.5 million in 2012-13 by lowering the award amount for students attending independent, non-profit schools to the CSU award amount. This will affect approximately 30,800 students.

- Raise Cal Grant Program Grade Point Average (GPA) Requirements—A decrease of $131.2 million in 2012-13 by raising the minimum GPA requirement for all applicants (e.g. Cal Grant A from 3.0 to 3.25, Cal Grant B from 2.0 to 2.75, and CCC Transfers from 2.4 to 2.75). This will focus limited financial aid resources on those students who are most likely to complete their degrees. This proposal will affect approximately 26,600 students.
- Phase Out Student Loan Assumption Programs for Teachers and Nurses—A decrease of $6.6 million in 2012-13 as a result of eliminating all new awards while continuing to fund remaining renewal awards through 2015-16. This will affect approximately 2,600 teachers and 70 nurses.
- Offset Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements—A decrease of $736.4 million in 2012-13 to reflect TANF funds available through an interagency agreement with the Department of Social Services.

Other Significant Adjustments:

- Restrict Cal Grant Program Participation for Independent, Non-Profit and Private, For-Profit Colleges and Universities—One indicator that institutions are effectively preparing their students is that their graduates consistently pay their student loans when they enter the workforce. The student loan default rate is the percentage of an institution's students who default on their student loan payments after graduation. Beginning in 2011-12, any institution that exceeds a 25-percent default rate is excluded from Cal Grant Program participation for one academic year. Under current law, this maximum default rate would have increased to 30 percent. The Administration proposes to maintain the maximum student loan default rate at 25 percent. This proposal is consistent with state and federal efforts to ensure non-profit and for-profit colleges and universities are effectively preparing students for entrance into the workforce.
- Restore Uninterrupted Enrollment Requirement for Transfer Entitlement Awards—Currently, a CCC student is eligible for a Transfer Entitlement Award at a four-year institution only if the student is enrolled in a CCC in one academic year and then transfers to and enrolls at a four-year institution the next academic year. Recently, the CSAC relaxed this requirement by allowing prolonged enrollment breaks between the CCC and the four-year institution. It is estimated that this decision will result in $70 million in new General Fund costs. The Administration proposes to maintain the uninterrupted CCC/four-year college enrollment requirement so as to avoid creating new costs at a time of limited General Fund resources.

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Labor and Workforce Development

The Labor and Workforce Development Agency addresses issues relating to California workers and their employers. The Agency is responsible for: labor law enforcement, workforce development, and benefit payment and adjudication. The Agency works to combat the underground economy and to help legitimate businesses and workers in California.

The Budget includes total funding of $14.8 billion ($448 million General Fund, $14.3 billion various other funds) for the Agency.

Employment Development Department

The Employment Development Department (EDD) administers the Unemployment Insurance (UI), Disability Insurance (DI), and Paid Family Leave programs and collects payroll taxes from employers, including the Personal Income Tax. The EDD connects job seekers with employers through job services programs and one-stop service centers and provides employment training programs through the Employment Training Panel and the Workforce Investment Act of 1998. To support the Department, the Budget includes $14.3 billion ($438.8 million General Fund), which reflects a decrease of $6.1 billion as compared to the revised 2011 Budget and is $11.6 billion less than the 2011 Budget Act. This decrease is primarily due to the end of the federal UI extensions.

Unemployment Insurance Program

The UI program is a federal-state program that provides weekly payments to eligible workers who lose their jobs through no fault of their own. Benefits range from $40 to $450 per week depending on the earnings during a 12-month base period. To be eligible, an applicant must have received enough wages during the base period to establish a claim, be totally or partially unemployed, be unemployed through no fault of his or her own, be physically able to work, be seeking work, be immediately available to accept work, and meet eligibility requirements for each week of benefits claimed.

Beginning in January 2009, the state's UI Fund was exhausted due to an imbalance between benefit payments and annual employer contributions. To continue to make UI benefit payments without interruption, the EDD began borrowing funds from the Federal Unemployment Account. The UI Fund deficit was $9.8 billion at the end of 2011 and is projected to be $11.7 billion at the end of 2012.

While annual interest payments were waived under the American Recovery and Reinvestment Act for 2010, interest of $303.5 million was paid in September 2011 and the interest payment for September 2012 is estimated to be $417 million. Interest will continue to accrue and be payable annually until the principal on the UI loan is repaid. The interest payment must come from state funds.

Proposals to Balance the Budget:

- Offset UI Interest Payment—A loan from the Unemployment Compensation Disability Fund to the General Fund to pay for the UI interest expense. This achieves a General Fund savings of $417 million in 2012-13. This is a continuation of the 2011-12 budget approach.
- Employer Surcharge to Fund UI Interest Payments—An increase in revenue of $472.6 million, Employment Training Fund, as a result of implementing a surcharge on employers effective January 1, 2013. The surcharge revenue will fund future interest payments for funds borrowed from the federal government to pay California's unemployment insurance benefits and repay the funds borrowed from the Unemployment Compensation Disability Fund.
- Eligibility Change—In conjunction with the employer surcharge, increase the minimum monetary eligibility requirements to qualify for UI benefits to account for increases in employee wages that have occurred since the requirements were last adjusted in 1992.

Other Significant Adjustments:

- October Revise—A decrease of $5.4 billion in 2011-12 and $11.7 billion in 2012-13, Unemployment Fund, as a result of the end of the federal UI extensions. With this adjustment, total benefit payments will be $13.2 billion in 2011-12 and $6.9 billion in 2012-13. The October Revise also includes an increase of $11.5 million in Disability Insurance benefit payments and a state operations increase of $11.6 million and 142.5 positions for administrative support for the Disability Insurance program.
- Workforce Investment Act (WIA) Funding—A decrease of $39.5 million federal funds for the Governor's discretionary WIA funding. This decrease reflects a reduction in the discretionary funds, from 15 percent to 5 percent, provided by the federal government.

Agricultural Labor Relations Board

The Agricultural Labor Relations Board investigates, prosecutes, and adjudicates unfair labor practice disputes and is responsible for conducting secret ballot elections so that farm workers in California may decide whether to have a union represent them in collective bargaining with their employer.

Significant Adjustment:

- Unfair Labor Practice Case Backlog—An increase of $500,000 Labor and Workforce Development Fund and 3.8 positions to reduce a backlog of unfair labor practice cases. The Agricultural Labor Relations Board will implement permanent process changes and efficiencies that will enable unfair labor practice cases to be processed more quickly.

Department of Industrial Relations

The Department works to improve working conditions, enforces laws relating to wages, hours, conditions of employment, and workers' compensation, and adjudicates workers' compensation claims. The Budget includes $425.1 million ($4.4 million General Fund) to support the Department.

Significant Adjustment:

- Expand Education and Outreach to Employees and Employers — An increase of $2.3 million Labor and Workforce Development Fund to expand education and outreach efforts to increase the effectiveness of labor compliance field staff.

General Government

The General Government Section includes multiple departments, commissions, and offices responsible for the operation of various government programs. The Budget includes total funding of $4.1 billion ($514.6 million General Fund and $3.5 billion various funds) for these entities.

California Department of Food and Agriculture

The California Department of Food and Agriculture (CDFA) protects and promotes California's agricultural industry and ensures that only safe and quality food reaches the consumer. The Budget proposes approximately $65 million General Fund for a number of programs, such as agricultural plant and animal health, pest prevention, and food safety services.

Significant Adjustment:

- Further Reduce General Fund Support—A permanent decrease to various department programs of $12 million in 2012-13, as part of a two-year effort to achieve $31 million in ongoing General Fund savings. The 2011 Budget Act reflected an initial decrease to the CDFA's budget of $19 million. This additional reduction primarily affects various programs relating to border control stations, pest prevention, and food safety activities. Some border station hours will likely be reduced. A portion of the General Fund reduction will be replaced by the Recycling Fund for new efforts the border stations will be making to mitigate recycling fraud, which occurs when recycling material is brought into California for illegal redemption. Funding to counties for performance of pest trapping and incoming shipment inspection activities will be reduced. Other reductions will be offset by increasing fees associated with the certification of nursery stock and milk and dairy food safety, as well as by implementing several departmental efficiencies.

Commission on State Mandates

The Commission on State Mandates is a quasi-judicial agency that hears test claims to determine whether local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The Constitution requires the Legislature to either fund or suspend specified mandates in the annual Budget Act.

Proposals to Balance the Budget:

- Suspend/Repeal State Mandates—The Budget proposes to suspend various mandates except for most mandates related to law enforcement or property taxes. Consistent with the Governor's focus on streamlining government and providing local flexibility, the Budget proposes to repeal dozens of the approximately 50 mandates that have been suspended for the past two years or more. Many of the activities required by these mandates have become common practice and should not be mandated by the state. This proposal will result in a decrease of $728.8 million General Fund in 2012-13.
- Redetermination of Mandate—Chapters 762 and 763, Statutes of 1995, created the Sexually Violent Predators reimbursable state mandate. However, in 2006, voters approved Jessica's Law (Proposition 83), which restated several of the provisions of the reimbursable mandate. Because mandates imposed by voter-approved initiatives are not reimbursable state mandates, the Administration will submit a request to the CSM to adopt a new test claim decision for the mandate to reflect this change.
- Delay of Program Participation Requirements for Specified Probationers—Chapter 219, Statutes of 2010, provided for enhanced sentencing of sex offenders. The Budget proposes to implement a two-year delay, from July 2012 to July 2014, of the requirement that probationers who are registered sex offenders participate in a sex offender management program. All the enhanced sentencing terms and parole lengths that were part of the bill, which basically required longer sentences for sex offenders and in some cases longer/lifetime parole, will remain in place. No sentencing changes will result from this proposed program delay.

In light of the public safety realignment, this delay will provide probation departments the opportunity to focus on the implementation of realignment. In addition, if this program were determined to be a reimbursable state mandate, this two-year delay could result in significant General Fund savings.

- Deferral of Pre-2004 Mandate Obligations—A decrease of $99.5 million in 2012-13 as a result of deferring the 2012-13 payment for mandate costs incurred prior to 2004-05.

California Department of Veterans Affairs

California owns and operates six veterans homes located in Yountville, Chula Vista, Barstow, Lancaster, Ventura, and West Los Angeles. Two additional homes in Redding and Fresno are under construction, scheduled to be completed in January 2012 and April 2012, respectively. These homes provide residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 62 or disabled.

Significant Adjustment:

- Further Delay the Opening of Veterans Homes in Redding and Fresno—The opening of the homes was delayed through 2011-12 and will continue to be delayed through 2012-13.

Oversight of Regulatory Programs

- Chapter 496, Statutes of 2011 (SB 617) provides for expanded economic analyses of new major regulations. The Administration has already begun the development of this program, which will provide standards for analysis and consideration of alternatives that are the least harmful to the economy.

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Tax Relief and Local Government

This part of the Budget contains state and federal funds used for tax relief and provided to local governments. The largest programs are the homeowners' property tax exemption ($439 million General Fund) and the apportionment of fuel taxes to local governments ($1.9 billion special fund).

Redevelopment Agencies

Chapter 5, Statutes of 2011 (ABx1 26), eliminated redevelopment agencies (RDAs) and replaced them with locally organized successor agencies tasked with retiring the RDAs' outstanding debts and other legal obligations. Chapter 6, Statutes of 2011 (ABx1 27), created a Voluntary Alternative Redevelopment Program through which an RDA could avoid termination pursuant to ABx1 26, if the city or county that established the RDA remitted payments to K-12 schools. These payments were expected to generate $1.7 billion in Proposition 98 General Fund savings in 2011-12.

The California Redevelopment Association and other entities challenged both bills before the California Supreme Court in the case *California Redevelopment Association et al. v. Matosantos et al.* In a ruling released on December 29, 2011, the Court upheld ABx1 26, but ruled that ABx1 27 was invalid. In accordance with the Court's order, RDAs will be dissolved on February 1, 2012. Revenues that would have been directed to the RDAs will be distributed to make "pass through" payments to local agencies that they would have received under prior law, and to successor agencies for retirement of the RDAs' debts and for limited administrative costs. The remaining revenues will be distributed as property taxes to cities, counties, school and community college districts, and special districts under existing law. The Budget reflects an estimate that approximately $1.05 billion in additional property tax revenue will be received by K-14 schools in 2011-12, which will offset the state's Proposition 98 General Fund obligation. Additional property tax revenues are estimated at $340 million for counties, $220 million for cities, and $170 million for special districts. These amounts are expected to grow as property values increase and debts are retired. Additional revenues will also be distributed in the next several years as RDA assets are monetized.

Statewide Expenditures

This chapter describes items in the Budget related to statewide expenditures.

Debt Service and Bond Authority

Debt Service—General Fund debt service expenditures will increase by a net of $24.6 million (0.46 percent), to a total of $5.4 billion, as compared to the revised current year estimate. This net increase is comprised of a decrease of $36.5 million for general obligation (GO) debt service ($4.6 billion total) and an increase of $61.1 million for lease revenue bonds ($745.5 million total). The change in GO debt service reflects estimated debt service costs for bonds issued in 2012 ($188.2 million). Program costs reflect a slight decrease compared to the current year because the Treasurer's Office has structured bond redemptions to accomodate the $1.9 billion Proposition 1A financing obligation due June of 2013. General Fund offsets from the Transportation Debt Service Fund increased slightly to $703.3 million.

While General Fund debt service is estimated to increase only slightly in the budget year, General Fund debt service has been a fast-growing area of the Budget. In 2002-03 General Fund debt service was $2.1 billion, or 2.9 percent of revenues, versus $5.4 billion, or 5.6 percent of estimated revenues, in 2012-13. This trend is expected to continue through the end of this decade, with debt service projected to peak at $7.5 billion in 2019-20. In large part, the increase in debt service is due to the issuance of new voter-approved bonds to fund the state's infrastructure needs, with over $100 billion of bonds authorized since 2000. Additionally, since December 2008, the state changed how it funds GO bond-funded projects due to the Pooled Money Investment Board's decision to suspend interim financing for GO bond-funded projects. This change required the state to issue bonds sooner than it previously would have, and at first in larger amounts.

One of the Administration's priorities has been to manage the "Wall of Debt", including the amount of General Fund resources dedicated to debt service. To this end, the Administration has been working with agencies to expedite the use of new and idle bond cash (as noted in the Infrastructure Investment section below) to fund needed projects and create jobs. The Administration continues to judiciously manage the GO bond program to ensure bonds are sold only when agencies can demonstrate an immediate need for additional proceeds. This limits the General Fund resources required for debt service. The state did not issue any additional bonds last spring because the amount of excess bond proceeds on hand was found sufficient to meet cash needs. The Administration has continued to work to identify alternative funding sources to offset General Fund debt service costs where applicable, such as weight fees to offset transportation debt service.

Extinguish Excess Bond Authority—Consistent with the Administration's ongoing efforts to make government more efficient, this proposal reduces up to nine GO bond acts authorized by the voters between 1976 and 1998 by up to $44 million. This remaining authority is no longer needed or cannot be legally issued for another purpose. Secondly, this proposal eliminates $250 million in lease revenue bond authority associated with two state office building projects that were authorized in 1993 and 1994 that were never pursued. The two state office buildings are the Riverside/San Bernardino Office Building ($150 million authority) and the Long Beach Office Building ($75 million authority).

Infrastructure Investment

The Administration has worked closely with state agencies to expedite the use of new and idle bond cash to create tens of thousands of jobs and bolster economic recovery efforts by funding major infrastructure projects throughout California. Bond cash balances that were in excess of $10 billion as of January 2011 are expected to be substantially expended by July 2012. This infusion of cash will begin hundreds of new projects to make much-needed infrastructure investments and jump-start the creation of new jobs. By using existing bond cash more efficiently, Caltrans was able to move forward with 120 new projects this year with a total construction cost of more than $5.4 billion, including an anticipated $3 billion in leveraged non-state funds. These projects created an equivalent of approximately 100,000 new jobs. Other significant areas of state infrastructure investments include over 450 new K-12 school construction projects and an average of about 125 new projects each month within the natural resources area, for such activities as flood control and water quality assurance. The Administration will be working to release the required Five-Year Infrastructure Report this spring and will be evaluating infrastructure priorities for the next five years.

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