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BILL SIMON'S PROPOSAL TO BALANCE THE BUDGET RAISES MORE QUESTIONS THAN IT ANSWERS

During the March 2002 Republican primary campaign, gubernatorial candidate Bill Simon presented his plan for bridging the state's budget gap. Estimates of the budget shortfall for the current and budget year have range from the Governor's forecast of \$12.5 billion in January to the Legislative Analyst's Office (LAO) \$17.5 billion estimate in February.

This analysis compares candidate Simon's proposals for bridging the gap to Governor Davis' January Budget proposals. Simon's proposal would reduce current and budget year spending below the Governor's Proposed Budget by an additional \$5.0 billion in 2001-02 and \$2.9 billion in 2002-03, equivalent to reductions of 6.3 percent and 3.7 percent respectively. The Simon plan provides a broad blueprint - for instance, stating that he would reduce funding for programs under the Health and Human Services (HHS) Agency by \$1.7 billion below the Governor's Budget in 2002-03 - but does not identify specific reductions. In contrast, the Governor's Budget identifies specific cuts within the HHS Agency, such as his proposal to reduce Medi-Cal provider reimbursement rates to achieve \$77.6 million in General Fund savings.

Despite the lack of details, Simon has created an opportunity to compare his proposal to the Governor's Budget, make some general observations about his priorities, and raise questions for further discussion. Included in this review of Simon's proposal are highlights, a comparison between the two spending plans by program area (Appendix A), and a comparison of Simon's and the Governor's proposals to close the budget gap (Appendix B).

Issues Raised By The Simon Budget Proposal

- Simon would cut Higher Education by \$923 million below the level in the Governor's Proposed Budget, equivalent to a 9.3 percent reduction, in 2001-02, and by \$936 million, or a 9.4 percent reduction, in 2002-03. Simon is silent on whether he would increase student fees to make up the difference, reduce enrollment, or scale back financial aid.
- Simon would cut K-12 Education below the level in the Governor's Proposed Budget by \$1.2 billion (3.7 percent) in 2001-02, and by \$237 million (0.8 percent) in 2002-03. Simon provides no specifics on the reductions, but at the same time presents "10 Commitments" for public education that include ensuring every child can read by the third grade, building needed school facilities and updating existing facilities, and providing remedial work for failing students at every school. The Simon budget does not address how these proposals would be funded or how he would reallocate existing resources to achieve these goals.
- Simon proposes to establish child care programs at every school in the state. However, his budget plan makes no provision for funding this expansion. Since state funding for child

care primarily comes from HHS Agency-supported programs and K-12 Education, expanding services will likely mean that non-child care programs will bear a disproportionate share of Simon's proposed reductions to these program areas.

- The Simon proposal substantially underfunds the Proposition 98 guarantee. The Legislative Analyst's Office estimates that the 2002-03 General Fund share of the Proposition 98 guarantee will be \$825 million above the level assumed by the Governor. Simon's proposed spending level for K-12 education is \$237 million below the Governor's proposal. The Simon plan would require suspension of the Proposition 98 guarantee or approximately \$1.1 billion in additional reductions in programs outside the guarantee in order to generate resources to avoid suspension.
- Simon would cut spending for Health and Human Services (HHS) Agency programs by \$1.2 billion (5.4 percent) below the level in the Governor's Proposed Budget in 2001-02, and to \$1.7 billion (7.5 percent) below the Governor's Proposed Budget level in 2002-03. The campaign does not specify the reductions that would be made within the agency. HHS funds programs that provide services and protection for many of the state's most vulnerable residents. These programs include Medi-Cal, mental health services, CalWORKs, foster care, and child services. The largest share of HHS General Fund spending goes to Medi-Cal (\$10.1 billion of the \$22.4 billion proposed for 2002-03). Medi-Cal provides health coverage for low-income families, children, seniors, and the disabled. Health services for the elderly and the disabled account for almost two-thirds of Medi-Cal in 2001-02.

Many HHS programs are governed by federal maintenance of effort (MOE) requirements or receive federal matching funds, and cannot be reduced without forfeiting federal funds. For example, the state already spends the minimum allowed by federal law on welfare programs. In order to maintain federal funding levels, it would be necessary to concentrate the spending reductions in programs without MOE requirements, such as In Home Support Services (IHSS) or state-supported programs providing food stamps and aid to elderly and disabled legal immigrants.

- Simon would cut Technology, Trade, and Commerce (TTC) Agency spending to \$49 million (71.0 percent) below the level in the Governor's Proposed Budget in 2001-02, and to \$10 million (13.9 percent) below the level in the Governor's Proposed Budget in 2002-03. TTC funds programs designed to promote economic development and job creation in the state, including programs to promote California's film industry, support and expand small businesses, and stimulate the growth of manufacturing. The campaign does not specify which programs would be cut.
- Simon's budget plan includes an economic stimulus package of tax cuts and reductions in state regulatory oversight that he claims would generate \$1.5 billion in General Fund revenues in 2002-03. His proposal consists primarily of reducing the capital gains tax rate from 9.3 percent to 5 percent. However, the state's dynamic revenue estimating model, which is designed to estimate the amount by which a tax decrease results in increased revenues due to greater economic activity, finds a one percent "feedback" effect from personal income tax reductions such as Simon's proposed capital gains tax cut. In other words, a \$1.0 billion tax cut would generate \$10 million in revenues, for a net loss to the

state of \$990 million. The minimal impact of a tax reduction on the economy stems from the fact that state income taxes are deductible for federal income tax purposes, and state taxes represent a very small share of the state's total economic activity.

The Simon proposal to cut the tax rate for capital gains would provide a tax cut to the wealthiest Californians. The wealthiest 5 percent of California households report 87 percent of income from capital gains. These taxpayers would receive an even greater share of the benefits from a capital gains tax reduction, since they are taxed at the state's highest marginal rate.

- Simon proposes making \$1.5 billion in additional 2002-03 spending reductions to build the state's reserve. This significant amount represents nearly 20 percent of Simon's proposed reductions for the budget year, but there are no details on what specific programs he would cut. These unallocated reductions exceed proposed 2002-03 spending for all programs under Business, Transportation, and Housing (BTH), TTC, and Environmental Protection combined. Alternatively, \$1.5 billion in savings could be achieved either by reducing state support for community colleges by 50 percent or by eliminating both the California Youth Authority, which incarcerates juvenile offenders, and state support for the IHSS program, which provides in-home care to the elderly and disabled.

APPENDIX A
The Effect On Agency Expenditures For The Simon And Davis Budget Proposals
(Dollars in Millions)

Program Area	Fiscal Year 2001-02					Fiscal Year 2002-03			
	2001 Budget Act	2001 Davis	Simon Proposal	Difference Between Simon and 2001 Davis	Percent Difference Between Simon and 2001 Davis	Davis Proposed Budget	Simon Proposal	Difference Between Simon and Davis	Percent Difference Between Simon and Davis
Legislative, Judicial, Executive	\$2,618	\$2,659	\$2,466	(\$193)	-7.3%	\$2,627	\$2,388	(\$239)	-9.1%
State and Consumer Services	\$580	\$715	\$650	(\$65)	-9.1%	\$513	\$629	\$116	22.6%
Business, Transportation, and Housing	\$696	\$678	\$303	(\$375)	-55.3%	\$378	\$468	\$90	23.8%
Technology, Trade, and Commerce	\$82	\$69	\$20	(\$49)	-71.0%	\$72	\$62	(\$10)	-13.9%
Resources	\$1,272	\$1,558	\$932	(\$626)	-40.2%	\$993	\$955	(\$38)	-3.8
Environmental Protection	\$411	\$423	\$352	(\$71)	-16.8%	\$203	\$314	\$111	54.7%
Health and Human Services	\$21,898	\$21,722	\$20,544	(\$1,178)	-5.4%	\$22,441	\$20,750	(\$1,691)	-7.5%
Youth and Adult Corrections	\$5,242	\$5,372	\$5,329	(\$43)	-0.8%	\$5,274	\$5,247	(\$27)	-0.5%
K-12 Education	\$32,437	\$31,046	\$29,891	(\$1,155)	-3.7%	\$31,316	\$31,079	(\$237)	-0.8%
Higher Education	\$9,901	\$9,934	\$9,011	(\$923)	-9.3%	\$9,985	\$9,049	(\$936)	-9.4%
General Government	\$606	\$1,125	\$851	(\$274)	-24.4%	\$580	\$520	(\$60)	-10.3%
Tax Relief	\$3,020	\$3,079	\$3,079	-	-	\$4,424	\$4,424	-	-
Total	\$78,763	\$78,380	\$73,428	(\$4,952)	-6.3%	\$78,806	\$75,885	(\$2,921)	-3.7%

*The 2001 Budget Act refers to the 2001-02 Budget enacted in August 2001, and the 2001 Davis Budget refers to the revised 2001-02 Budget as proposed by the 2002-03 Governor's Budget.

Sources: Andrew LaMar and Daniel Borenstein, *Hopefuls Take Aim on Deficit*, Contra Costa Times (February 17, 2002), and the Department of Finance, *Governor's Budget Highlights 2002-03* (January 2002) and *State Budget Summary 2001-02* (August 2001).

APPENDIX B
Simon And Davis Proposals To Bridge The Budget Gap
(Dollars in Millions)

The following is a side-by-side comparison of Bill Simon's and Governor Davis' proposals to eliminate the projected shortfall in the current and budget year. Simon's proposal was downloaded from www.simonforgovernor.com/issues/pr01112002-02.pdf on April 19, 2002, and the Governor's is from his 2002-03 Budget as proposed in January. An attempt was made to compare similar items between plans, although there are some items for which there is no comparable item in the other proposal. While the Governor's Budget provides detailed information on his proposals, the Simon campaign does not provide supporting documentation outlining the specifics of his proposals.

Simon Proposal				Davis Proposal			
	2001-02	2002-03	Comments		2001-02	2002-03	Comments
Select cuts from the Governor's \$2.25 billion November list	\$1,428	\$897		November Revision Reductions *	\$2,449		SB3X 1, signed on February 2, reduces spending in 2001-02 by \$2.2 billion and in 2002-03 by \$589 million. SB3X 1 provides a detailed description of the reductions.
Select cuts from the LAO's \$1.45 billion December list	\$1,149	\$533	Details on the specific cuts are not available, but may double count some from the Governor's January Proposed Budget.	Budget year reductions		\$2,677	Governor's 2002-03 Proposed Budget provides detailed description of reductions.
15 percent reduction in state operations, excluding Public Safety	\$1,460	\$2,004	Translates into nearly a \$1 billion reduction for higher education requiring increased fees or lower enrollment. Simon's estimates of savings appear to include costs that cannot be reduced, such as debt service and state contributions for employee pensions and retiree benefits, as well as cuts to Public Safety including the Judiciary, the Department of Justice, and the Military Department. Achieving the savings assumed in the Simon Plan would require a 23 percent reduction in spending exclusive of Public Safety and obligated expenses.				

Simon Proposal				Davis Proposal			
Institute hiring freeze	\$60	\$125	The Governor's October 23 hiring freeze will result in an estimated current year savings of \$13 million for 8 months of 2001-02 and \$20 million in 2002-03. The Simon plan may double-count savings scored under "eliminating phantom positions". Finally, the remaining savings are probably overestimated because funds are required to pay overtime, particularly for correctional officers and other custody staff in state hospitals.				
Eliminate "phantom" employees	\$400	\$400	There is no information available on how this amount was calculated. Simon's estimate exceeds most estimates of potential savings.				
Eliminate new programs	\$700	\$756	Details not available, but most likely double-counts savings scored under cuts from the Governor's November and January proposals.				
Additional cuts to build the reserve		\$1,500	Details not available on the nature of these proposed cuts.	Reduce reserve for litigation		\$100	
Eliminate "pork" projects	\$100	\$100	The Governor's Proposed Budget does not include funding for legislative initiatives, i.e. "pork", in 2002-03. The Governor's November revision reverted most "pork" projects funded in 2001-02.				
Transfers from the Governor's list and the LAO's list	\$158			Various transfers and loans		\$2,237	Loans must be repaid, thereby reducing resources available in future years.
				Payment deferral/benefit improvement for STRS		\$508	Same as for PERS proposal.
Savings from revised PERS payment		\$371	The cost of repaying the loan and funding the enhanced benefits would total an estimated \$9.7 billion over the next 30 years.	Payment deferral/benefit improvement for PERS		\$371	This has been replaced with a debt restructuring plan that will save the state \$223 million in 2001-02 and \$920 million in 2002-03.
Convert bonds to variable rates		\$30	The State Treasurer estimates that \$500 million in variable rate bonds issued in 2002-03 would result in no savings in 2002-03, and \$8 million in savings in 2003-04. The debt restructuring plan adopted by the Governor includes savings from shifting to variable rate debt.	Shift to lease-revenue bonds and General Obligation Bonds		\$167	

Simon Proposal				Davis Proposal			
Increased revenue from economic stimulus proposal including a capital gains tax rate reduction from 9.3 percent to 5 percent		\$1,500	There is no economic stimulus package that would result in a net gain in state revenues, particularly in the short run. The state's dynamic revenue estimating model finds a one percent "feedback" effect from personal income tax reductions, resulting in a long-term loss equal to 99 percent of the "static" revenue loss. In addition, the Simon proposal would substantially reduce the taxes paid by the wealthiest Californians. The wealthiest 5 percent of California households report 87 percent of income from capital gains. These taxpayers would receive an even greater share of the benefits from a capital gains tax reduction, since they are taxed at the highest marginal rate.				
				Securitize tobacco settlement revenues		\$2,400	This would reduce available resources by \$62 million in 2002-03 and \$190 million per year for 22 years thereafter based on estimates included in the Governor's Budget.
				Federal tax conformity		\$178	The Governor has dropped items that would initially increase state revenues but retained items that would reduce state revenues, resulting in revenue losses in the budget year and beyond.
				Other revenue accelerations		\$349	
				Assumed federal funds		\$1,066	This includes child support penalty relief; an expansion in the Food Stamp program to cover post-August 22, 1996 immigrants; and funding to offset security spending related to September 11 th . It is unlikely that the state will realize all of the assumed increases in federal funding. For example, the Governor includes an offset of \$400 million for Medi-Cal funding that the state will lose due to changes in the federal funding formula (FMAP) that was excluded from the federal economic stimulus package enacted in March.
Total	\$5,455	\$8,216		Total	\$2,449	\$10,053	
2-Year Total	\$13,671			2-Year Total	\$12,502		

*November Revision refers to reductions in current year spending proposed by the Governor in November 2001, which were amended by the Legislature through SB3X 1 and enacted in February 2002.