Chapter 1

BUDGET OVERVIEW

I. CALIFORNIA ECONOMIC TRENDS AND DEMOGRAPHICS

California's gross state product—now at $1.34 trillion—is the largest of the fifty states; if California were a separate nation, it would rank fifth in the world, behind just the United States, Japan, Germany, and the United Kingdom.[1] The state's economy pulled up strongly from the of 1991–94 to 2001, when a contraction began, exacerbated by the events of September 11. Unemployment rose during 2001, particularly in the San Francisco Bay Area, but substantial employment recovery statewide is anticipated before the end of 2002 As of July 1, 2002, personal income rose 1.2% in 2001, is projected at 2.8% in 2002 and 7.6% in 2003,[2] reaching a record $1.225 trillion in 2002–03. (See Table 1-A.) In May 2002, the Governor estimates the state's inflation to be 2.5% for 2000–01, 3.1% for 2001–02, and 2.4% in 2002–03.[3] According to the most recent data (May 2002), state unemployment rose to 6% in 2000–01, increasing to 6.4% in 2001–02, and dropping back to 5.7% in 2002–03.[4]

In terms of wealth and income distribution, the gap between the rich and the poor continues to widen. Nationally in 1999, the top 1% earners received as much after-tax income as the bottom 38% combined.[5] California's division between rich and poor is even more pronounced—among the most extreme in the nation, and continues to grow. In 1996, California's wealthiest 20% was eleven times richer than her poorest 20%.[6] The share of total adjusted gross income attributable to the top 20% of taxpayers has consistently increased, going from 41.7% in 1975 to 56.7% by 1998. During this same period, the share of income at the very top end of the income distribution—for taxpayers with incomes exceeding 99% of the taxpayer population—nearly tripled, going from 7% to almost 20%.[7] The share of income attributable to each of the four remaining quintiles has fallen, with the share attributable to the bottom quintile declining by half—*i.e.*, the bottom 20% accounted for only 7.2% of the state's income in 1975, and fell further to 3.5% by 1998).[8]

Other recent studies confirm the severity and continuing trend, and document that

- inequality is increasing mostly because of the precipitous drop in income for families at the mid-to-bottom income levels;[9]
- over the last decade, income inequality has increased more in California than in 48 other states;[10]
- industry wage data from 1989 through 1998 indicates that wages in the top 25% of industries (ranked in terms of their average wages at the beginning of the period) have grown three times as fast as wages for the bottom 25% of industries during this period;[11] and

- the decline in income at the middle to lower end of the economic spectrum is affected by both immigration of low income workers, and most markedly by the collapse in jobs and pay for those without high school and increasingly without vocational or other higher education.[12]

The trend in wealth and income distribution is dividing the state into three groups: a top 5% enjoying unprecedented wealth, a middle class declining from 80% of the population to 60%, and an underclass increasing from 15% of the population to 35%. The latter projection is based on the current percentage of California children in families at or near the poverty line—substantially below income for family self-sufficiency. Since 1989, safety net reductions, tax changes, employment opportunities, and educational investment have been increasingly responsive to wealthy and upper middle class interests. The size of the underclass, its degree of poverty, and the barriers it confronts for upward mobility are at unprecedented levels since the 1950s.

The new underclass is predominantly young. The percentage of children born into families with incomes below the federal poverty line grew from 21.6% in 1989 to 28.2% in 1994–96, falling to a still high 24.7% in the current year and project up slightly to 24.9% in 2002–03.[13] In 2000, almost one-half of California's young children lived at below 185% of the poverty rate, a level below self-sufficiency.[14] Youth unemployment is almost four times working-age adult levels,[15] and the child poverty rate is close to three times the level of senior citizen poverty (see detailed discussion in Chapter 2).

	1979-80	1989-90	2000-01	2001-02	2002-03
Population (1,000s)	23,257	29,142	34,088	34,758	35,385
State Employees per 1,000 Pop.	9.5	8.7	9.1	9.4	9.2
Personal Income (Billions)	$252.2	$606.7	$1,099.5	$1,158.4	$1,229.7
Expenditures per $100 of Personal Income:					
General Fund	**$7.35**	**$6.50**	**$7.13**	**$7.06**	**$6.92**

Sources: Governor's Budget Summary, 2002–03.; May Revise 2002–03.

TABLE 1-A. California Population, Personal Information Data, 1979–2002

In addition to age, rural location correlates with poverty and unemployment. The state has the greatest rural versus urban disparity in the nation in terms of unemployment, employment growth, and earnings. Home prices are now beginning to rise again, from a base already substantially above the national average. These high costs constitute an important barrier to upward mobility for poor and young residents; California ranks 48th among the 50 states in home ownership rates (behind only Hawaii and New York).[16] Only 58.2% of Californians owned their homes in 2001, compared to a national average of 67.8%.[17]

Since 1990, the state's overall population has grown by 13.4%. There is a bolus of additional children aged ten to eighteen now moving through middle and high school and who require unprecedented higher education expansion in order to secure productive employment in the evolving international economy. As discussed in Chapter 7, that capacity expansion is not occurring. A 1999 national study of juvenile population found that from 1995–2015, California will increase her juvenile population more than any other state in the nation, the 0–17 group will increase by 34% (with a national average increase of 8%) and the 18–24 group will increase 57% (with a 22% national average growth).[18] School enrollment growth has already reflected these new numbers, with K–12 enrollment currently 28.7% higher than in 1989–90.[19]

Table 1-B presents population data relevant to children, including numbers from 1989 by age and poverty status. The number of children living in poverty has increased substantially faster than has the child population. As of February 2002, the federal poverty line for the benchmark family of three is an annual income of $15,020.[20] In 1980, 15.2% of California's children lived below the poverty line. In 1989, the state's child poverty percentage reached 21.6%. By 1994–95, the level reached a record high 28.2%. The number of impoverished children increased from 1.87 million in 1989 to 2.8 million in 1997–98, a 51% increase. The percentage of children in poverty has declined somewhat as the state

continues to pull out of its recession. However, the gains from the economic upturn are disproportionately enjoyed by the upper middle class and wealthy populations, and the number of children living in poverty is currently over 2.6 million—still close to it historical high. Although currently comprising 30% of the population, children make up 59% of Californians living in poverty (see Table 1-B).

	Budget Year								
	1989-90	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03
State Population	29,142,279	31,711,000	31,962,000	32,452,000	32,862,000	33,477,000	34,088,000	34,758,000	35,385,000
Child Population (0–19)	8,643,846	9,774,045	9,933,186	10,062,428	10,175,372	10,305,644	10,428,157	10,551,154	10,687,342
Young Children (0–4)	2,425,480	2,753,496	2,712,417	2,689,023	2,677,063	2,678,091	2,677,735	2,687,847	2,708,578
Children share of population	29.7%	30.8%	30.1%	31.0%	31.0%	30.8%	30.6%	30.4%	30.2%
K-12 Enrollment	4,771,978	5,467,224	5,612,965	5,727,303	5,844,111	5,951,612	6,050,895	6,142,264	6,207,986
Overall Poverty Rate	12.9%	16.7%	16.9%	16.6%	15.4%	13.8%	12.8%	12.6%	12.7%
Poverty population	3,759,354	5,295,737	5,401,578	5,387,032	5,060,748	4,611,549	4,363,264	4,379,508	4,493,895
Child Poverty Rate	21.6%	28.2%	27.1%	28.0%	26.0%	25.5%	25.0%	24.7%	24.9%
Child poverty population	1,867,071	2,756,281	2,691,893	2,817,480	2,645,597	2,627,939	2,607,039	2,606,135	2,661,148
Child share of poverty pop'n	49.7%	52.0%	49.8%	52.3%	52.3%	57.0%	59.7%	59.5%	59.2%

Sources: Governor's Budget Summaries and Appendix A.

TABLE 1-B. California Child Population, Poverty Rates

Family demographics have changed as poverty levels have increased. As discussed in Chapter 2, the most dramatic and damaging change has been the growth in the number of single-parent households; almost one-third of the state's children are born to unwed mothers. At present, only a minority of children now being born will spend most of their childhood in homes with their biological fathers. Notwithstanding recent increases, less than 30% of the 2.4 million absent biological fathers tracked by district attorney family support divisions contribute anything financially for their children. About 50% of children living with mothers as the single head of their households live below the poverty line.[21]

Related to economic barriers are serious language obstacles for many. In 1984, 483,000 California school children were identified as "limited English proficient" (LEP); the number was 1.5 million in 2000–01—25% of California's total K–12 population, and over one-third of all students in kindergarten through third grade, both record highs.[22]

California leads the nation as a home to immigrants, with 25% of the state's residents foreign born. The largest concentration in the nation (20%) reside in Los Angeles, Orange and Riverside Counties. About one-half are from Latin America and one-fourth are from Asia.[23] These arrivals account for some of the growing income disparity between the wealthy and impoverished, with the most recent study attributing about one-third of the income disparity growth to international immigration, and finding "the bulk of the growth" in inequality to be "the rising value of skills such as schooling and labor market experience," underlining adequate K–12 graduation and higher education capacity as critical.[24]

A. Public Revenue and Spending Trends

Total state spending, including bond interest and federal contribution, adjusted for inflation and population ("adjusted"), has increased by 34% from 1989–90 to the current year. However, adjusted general fund spending, where child-related spending is concentrated, has increased only 25%.

California has reduced the number of state employees from 9.9 per 1,000 population in 1977–78 to 9.4 in the current year and 9.2 as proposed for 2002–03 (see Table 1-A). The state has among the lowest level of state employees/population in the nation—notwithstanding a 37% increase in employees engaged in public safety (primarily incarceration-related).[25]

Figure 1-A below presents the major sources of state funds for the current 2001–02 fiscal year. Except for a few programs (such as federal Head Start), almost all federal money for children is channeled through state accounts and is spent by state, county, or school district officials. Similarly,

most local taxes generated for children are from local property taxes collected for schools, and are included in the state education accounts discussed in Chapter 7.

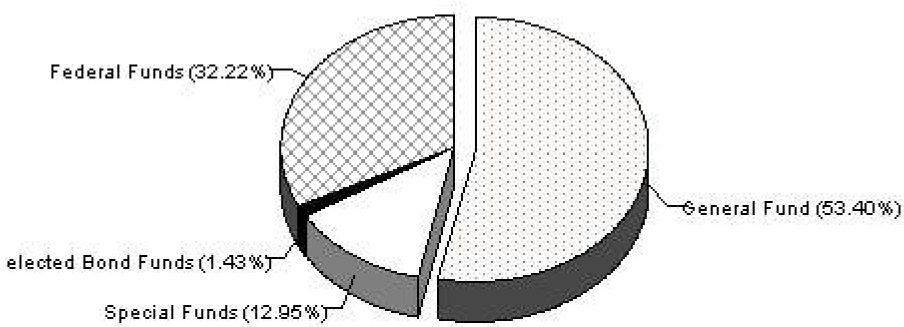

FIGURE 1-A. State Budget by Source of Funds, 2002–03

In general, federal funds are allocated within specific program categories, bonds are expended for enumerated capital projects (*e.g.,* prisons or university buildings), and special funds are committed by law to a particular use (*e.g.,* highway construction or regulatory agencies). Special fund spending, currently at $16.3 billion, has doubled over the past ten years. The three tobacco tax funds (Proposition 99, tobacco settlement fund monies, and Proposition 10 revenues) total 9.2% of the special fund total. All of the Proposition 10 portion and about 2/3 of the other two funds will benefit children.[26] But aside from this 6% to 7% share of special funds, child investment primarily comes from general fund spending, often with federal match augmentation.

	Budget Year				Estimated	Proposed	Percent Change	
	1989-90	1998-99	1999-2000	2000-01	2001-02	2002-03	'89-'01	Proposed
General Fund	$39,455,870	$57,827,075	$66,494,042	$78,052,949	$78,379,889	$78,805,549	98.7%	0.5%
Special Funds	$7,872,449	$14,735,897	$15,787,110	$13,971,535	$19,940,567	$19,112,549	153.3%	– 4.2%
Gov't Costs Totals	*$47,328,319*	*$72,562,972*	*$82,281,152*	*$92,024,484*	*$98,320,456*	*$97,918,098*	*107.7%*	*– 0.4%*
Selected Bond Funds	$1,265,897	$2,697,279	$2,582,955	$4,357,076	$4,588,710	$2,113,387	262.5%	– 53.9%
Gov't Cost/ Bond Funds Total	*$48,594,216*	*$75,260,251*	*$84,864,107*	*$96,381,560*	*$102,909,166*	*$100,031,485*	*111.8%*	*– 2.8%*
Federal Funds	$18,658,467	$34,375,067	$37,303,266	$41,272,772	$46,516,299	$47,557,516	149.3%	2.2%
Total State/Federal	$67,253,000	$109,635,318	$122,167,373	$137,654,332	$149,425,465	$147,589,001	122.2%	– 1.2%
Adjusted Total	$106,458,233	$121,968,070	$132,060,000	$142,611,980	$149,425,465	$142,135,133	40.4%	– 4.9%
Adj. General Fund	$62,456,726	$64,331,977	$71,878,464	$80,864,042	$78,379,889	$75,893,441	25.5%	–3.2%

Dollar amounts are in $1,000s. Sources: Governor's Budgets.
Adjusted to California population and deflator (2001–02=1.00). Adjustments by Children's Advocacy Institute

TABLE 1-C. California State Spending Plan (Excluding Nongovernmental Cost Funds)

Figure 1-B tracks the three major sources of state funds from 1989–90 in properly adjusted numbers, with the total spending figure represented by the line above the bars. The relative changes indicate increases in special funds, and especially in federal funds from 1989–90 to 1994–95 when the federal share of spending reached 36.6%. Since 1994, adjusted federal contribution has declined steadily to 31.1% in the current year.

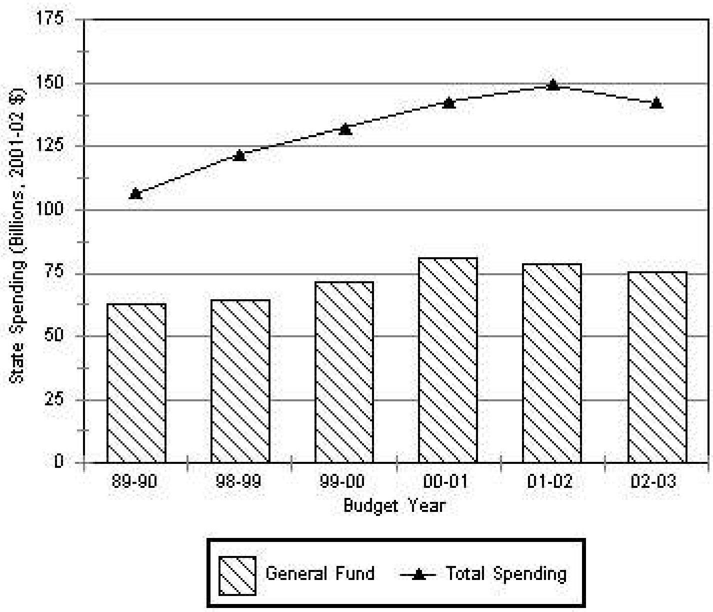

FIGURE 1-B. California State Spending, 1989–2002 (Adjusted to 2001–02 $)

B. Federal/State/Local Balance

1. Federal to State Delegation: "Devolution"

The state budget channels almost all federal funds received to the local level through state budgetary accounts. Hence, reliance on federal funds extends to local assistance spending for children; the federal share of local spending increased from 28% in 1989–90 to 40% in 1993–94, and has since declined with federal diminution generally to 31%.[27]

The June 13, 1996 congressional budget resolution (H.R. Cong. Res. 178) implemented substantial reductions extending to 2003. Most of this decline focuses on child-related spending, and largely takes the form of a five-year freeze in absolute spending through a block grant format, allowing per capita cuts to take place as population, need, and inflation reduce benefits per child over time. The block grant ceilings failure to compensate for population and inflation builds in an automatic 3% to 5% annual cut in constant dollar resources, accumulating to more than a 30% adjusted reduction in this funding after eight years—budget year 2002–03. That diminution in these funds has been compensated for by an economic upturn that helped to relieve states of millions of TANF recipients and other poverty/unemployment related costs. However, the underlying resource has moved from entitlement spending based on need, to a capped entitlement, with the cap constricting year to year—all other things being equal and assuming inflation and population change in the normal course. Given an economic downturn, or merely a flattening, will then make the underlying 30% reduction in resources to 2002–03 apparent and felt.

Considering those programs most relevant to children—child support enforcement, Medicaid, job training, school meals, food stamps, substance abuse prevention and treatment, special education, local agency education grants, the social services block grant, Head Start, and TANF, reductions to California *vis-a-vis* previous per/child constant dollar spending levels will total $17.248 billion from 1997 through 2002.[28]

Federal Reductions: 1997	Federal Reductions: 2002	Total Federal Reductions 1997–2002
$676.1 million	$5.515 billion	$17.248 billion

The 1996 congressional budget resolution was then followed by the Balanced Budget Act of 1997. Although providing substantial funds to allow states to expand child health coverage, the measure imposed huge cuts in less visible support for the medical infrastructure supporting uninsured children—some of whom will not be reached by the expansion funding (see, *e.g.*, Chapter 4's discussion of reductions to clinics serving impoverished populations). Nationally, net reductions will total $36.9 billion over ten years in Medicaid-related cuts.[29] Hence, although California was to receive $859 million/annum in federal grant funds to expand child health care each year until 2003, the state will suffer cuts averaging $1.34 billion in its proportionate share of Medicaid, giving it an annual loss averaging $480 million each year over the next ten. That reduction is scheduled to hit with a vengeance in 2002–03, with a $400 to $700 million Medicaid subtraction. The overall federal disinvestment is underlined further by four related concerns:

a. Failure to Capture Federal Money, or to Use it for Child Benefit

California's plans to implement child health coverage expansion have been and are being further delayed, and are likely to sacrifice substantial available federal money. First, the original amount for California of $855 million per year for SCHIP from 1998 mentioned above (and justifying deeper Medicaid cuts made at the time)—would have brought $7.7 billion to 2006. Failure of the state to enroll children and use the funds led to Congressional retraction to much lower SCHIP appropriations after 1999—reducing the potential $7.7 billion over nine years by $1.5 billion (to $6.23 billion from 1998–2006). Given the state's now proposed delay to implement that expansion, the state will lose hundreds of millions of unspent federal SCHIP funds unless the Congress allows additional time for rollover.

Most important, the state will leave almost 20% of the state's children uncovered despite monies available to accomplish it—refusing to follow an eligibility" path that could accomplish a simplified, efficient system, ending 17 fragmented programs, assure federal funds use, and assure coverage of all of the state's children (see Chapter 4).

b. Post-2002 Reauthorization Amounts and Restrictions

The various federal grants run out in 2003, and the re-authorization debate involves impractical and mean spirited minimum 40 hour/week work requirements on TANF parents, cut-offs even for those working 20 to 30 hours a week, and an increase in state work participation targets to unrealistic levels —particularly without aggressive economic expansion. The post 2002 grant sums are likely to be only symbolically higher for politically popular child care, but insufficient to allow training and employment of more than 10% to 20% of those required to work to meet federal targets. The result of target miss is federal cut-off or sanctions.

c. Supplantation/Diversion of Federal Monies

Much federal money is being diverted from Congressional intent to general fund reduction. For example, virtually the entire No Child Left Behind Act $738 million will not supplement California education spending, but will supplant current general fund spending to allow its reduction (see Chapter

7). Another example is the federal increase in special education funding for 2002–03—all of the $112 million is proposed for offset of previous and planned general fund contribution (see Chapter 5).[30]

d. Federal Tax Breaks and Future Capacity for Devolution Investment

Future devolution depends upon general fund monies available to invest in children. New tax deductions, credits and other expenditures deplete such funds. Such tax breaks continue unless affirmative ended, and unlike the devolution "block grants," are not static sums, but have their own built in population and inflation adjusters. They increase each year in foregone monies available for public investment.

In 1997, the Congress granted tax relief to wealthy, middle class and elderly taxpayers in a heavy "back-end benefit" pattern—with the tax expenditures growing as time passes. California's *pro rata* share of this tax spending—unavailable for children needing public investment—amounted to $2 billion per year by 2000, and will grow to $4 billion per year after 2002. More important, critical tax relief Congress added in 2001 (discussed below) will add a daunting $27.3 billion average annual reduction in potential revenue to that sum. California's proportionate share each year would finance all of the recommendations of this California Children's Budget, with room for substantial taxpayer relief.

If the approved tax breaks to 2011 are renewed for another decade, this average annual sum will then double to over $50 billion per annum to 2021. Many of these changes trigger additional California matching changes, as discussed below, new California "tax relief" from 1997 through 2001 reducing state revenues by $5.9 billion in 2002–03, to increase thereafter.[31]

2. State to Local Government: "Devolution" and "Realignment"

In addition to federal reductions passed through to counties, the state has started its own devolution of funding to counties and school districts with both state and federal funds. Traditionally state functions generally devolved to local discretion have included juvenile justice and most of the child protection systems (child abuse and dependency court). Starting in 1991–92, former Governor Wilson added to devolution three major areas, terming them "realigned" to local jurisdictions. The realignment scheme was divided into three block grants, one for mental health, one for health (some Medi-Cal functions), and one for social services. Counties were primarily given jurisdiction over these funds and expected to exercise local discretion in their administration.

In addition to these three funds and locally "realigned" services, local jurisdictions (cities and counties) needed additional state financing help. That help was needed both because of the cumulative effect of Proposition 13 property tax limitations (which do not allow revenue increase commensurate with population growth and public service demands). It was also driven by the increasing pattern of state legislative directives to local governments without a funding source ("unfunded mandates"). But most important, it was stimulated by the 1992–93 general fund shortage—not unlike the current dilemma facing the state budget. One measure of Governor Wilson to deal with his deficit was to require local governments to transfer approximately $3.75 billion in annual property tax revenue to the state for public education spending by school districts.[32] This transfer removed approximately one-third of this primary revenue source for counties and cities. In fact, the money did not add to education spending, but supplanted state general fund spending—in the same way the current administration is supplanting funds for general fund relief on an even larger scale.

In order to provide some funding for the newly realigned functions and to make-up for the $3.75 billion removal of local revenue, two major revenue sources were dedicated for local jurisdiction use: a portion of sales tax revenue and the Vehicle License fees. As to sales taxes, a 0.5% allocation of the state sales tax was reserved for local jurisdiction use. In addition, a local jurisdiction may assess up to 1.5% in additional funding—called "local add-on rates."[33] Increases within these limits must be proposed by the Board of Supervisors and approved by a two-thirds vote of the local electorate. This "Realigned Sales Tax Revenue" amounted to $2.29 billion in 2000–01, $2.20 billion in 2001–02, and is projected at $2.30 billion for 2002–03.[34] All of this money is allocated to the three realigned funds arrayed below. Adjusted for population and inflation, this revenue to local jurisdictions has declined 7.2% over this two-year period.[35]

The second source of revenue comes from Vehicle License Fees on every operating vehicle in the state. The fee is assessed in lieu of a personal property tax, and is based on 2% of the market value of the vehicle (the cost to the purchaser—adjusted by subsequent depreciation). As part of Realignment in 1991, the revenue from these fees was also dedicated to local governments—about one-fourth of it going to the three realigned accounts of Table 1-D below, and the other three-fourths designated for general county and city use and intended to compensate local jurisdictions for the $3.75 billion property tax revenue subtraction of 1991–93.

These three realigned funds are funded as follows from locally directed sales taxes and one-fourth of the VLF:

	2000–01	2001–02	2002–03
Mental Health	$1,064	$1,050	$1,112
Health	$1,415	$1,431	$1,517
Social Services	$1,043	$1,006	$1,015
Total:	**$3,523**	**$3,487**	**$3,644**

Dollars in millions.

TABLE 1-D. Realigned Funds

The VLF portion of total realigned funds was $1.235 billion in 2000–01, $1,289 billion in current 2001–02, and is projected at $1,344 for 2002–03. As noted, about three times this sum is goes to counties and cities as unrestricted funds. Note that the 2% of value VLF annual fee collects in total about four times these sums. The other three-fourths is also allocated to cities and counties—but as general purpose revenues to use as they see fit and was intended to compensate local jurisdictions for the taking of local property tax revenue in the early 1990s.

As with the federal block grants, the state to local devolution has also failed to adjust for population and inflation over time. As to the three realigned accounts in Table 1-D above, the small raw number increase of $3.52 billion to $3.64 billion over two years falls 4% below population growth and inflation over that period. In allocating these programs to the local level, state public officials provide a defined funding stream which may or may not match population/inflation or other factors relevant to need. However, the delegation of responsibility and financing allows state officials to avoid making visible, statewide decisions to increase—or to reduce spending.

The unrestricted VLF portion allocated to counties and cities has suffered a more prominent shortfall over time. Conservatively adjusted for statewide population and the CPI, the 1991–92 $3.75 billion should not total $5.29 billion. It is currently static in the $3.6 to $3.8 billion range.

The VLF fee has one anomaly—it has been "offset"—or reduced. In January 1999, a permanent "offset" of 25% of the calculated Fee was enacted. In year 2000 the "offset" (fee reduction) was increased to 35% from 2000 to June 30, 2001. Another add-on to the offset of 32.5% was appended for 2001—which was returned to taxpayers through a more noticeable separate rebate check. Beginning on July 1, 2001, the VLF was then reduced by this 67.5% total amount. However, local governments did not lose the revenue from lower VLF collections because the state guarantees full recompense of all offset amounts to cities and counties. It is as if the state is "picking up the tab" for two-thirds of this fee and sending its portion to local jurisdiction beneficiaries. Politically, this allows the state to (a) take continuing credit for "picking up the tab," and (b) maintain at least symbolic control as funds go to cities and counties not directly, but through state offices.

Local governments (primarily counties and school districts) also receive numerous other defined funds from the state for defined purposes. Some of these grants have a "block grant" flavor in that they cover a broad subject area and give counties wide discretion in how funds are to be spent. This latitude exists in particular for education spending to school districts, and even more so for CalWORKs spending by county departments of social services. Even trial court funding, taken over by the state as a funding source, gives grants to counties and to a great degree allows local courts to allocate those funds.

Counties and school districts spending on these and other child-related programs administered locally may be substantially below these facial levels. For the devolved programs, California has been removing "state mandates," similar to the 1996 federal removal of "entitlement" status for AFDC (TANF). Hence, local governments may choose to cut substantially beyond the reductions in the overall fund. Such local "off-state-budget" cuts have not been monitored or examined systematically.

In addition, the state has essentially devolved major Medi-Cal administration to counties over the past five years. Counties are experimenting with their own varying plans, the most common the "two-plan" model (one plan controlled by local officials). In each case, there is substantial county discretion as to how each works, with rate, service, and consumer protection variations.

Consistent with this trend, starting with 1998–99, the state added to this mix grants to counties to implement welfare reform. California's county CalWORKs grants consist of a defined grant of sums pursuant to federal welfare reform. As discussed in Chapter 2, the counties are given substantial discretion as to how the money is to be allocated between forms of assistance, child care, training, job placement and public employment, *et al.* The state has allowed counties to keep 75% of the savings from welfare roll and assistance reductions. The state's grant of these "incentive payments" to counties has resulted in a $1.2 billion surplus of unspent funds at the county level—a fund that has been terminated, and has been partly expropriated by the state (see Chapter 2).

The devolution pattern described above now presents problems relevant to child investment, as follows:

a. Local Sales Tax Revenue Routed Away from Lower Income Jurisdictions

Locally allocated sales tax revenues go to the jurisdiction from which they are collected. Hence, wealthier jurisdictions with upper-end commerce generate substantial revenues returned to the same neighborhoods generating the funds. While certain user fees are properly directed to the benefit of the payer, taxation rests on a different concept—that of police power collection and distribution based on need and merit, and conscious of the equality of opportunity obligations of the state. The return of money paid by the wealthy back to the wealthy—based on neighborhood/special district/city/county or school district location undermines those egalitarian principles (see discussion of *Serrano* case in Chapter 7 holding the distribution of property taxes for K–12 education based on neighborhood contribution to violate equal protection concepts).

b. Counties Child Service Reduction to "Free Ride"

State to local devolution, without state minimums, can also implicate equal protection principles. And it can reduce some important social services down to a "lowest common denominator." For example, counties may not invest heavily in job training or education for its TANF recipients, hoping they will leave for other jurisdictions. This "free ride" incentive may not lead to egregious abuses, but it is likely to discourage heavy investment in impoverished children where a local disparity vis-a-vis a nearby county may attract movement of such persons needing services. This concern is not merely theoretical. For example, the county by county survey of county spending of the CalWORKs block grant from the state reveals only 14% expended for job training, education, job search, *et al.*, and only 19% for child care provision (see Chapter 2). Devolution to local jurisdictions and the granting of broad discretion as to the "how" does not preclude state minimums as to outcomes. State grants to locals do not often include such minimums, and the alternative of incentive payments based on outcomes is rarely used intra-state. CalWORKs has been one grant which has included such an incentive based on at least one outcome measure, but its incentive payments were ended before the current 2001–02 fiscal year.

This problem has been manifest in many state to local delegated functions. One example is special education, where a conscientious school district may find itself attracting more students in need to the advantage of less responsible districts who avoid investment (see Chapter 5).

.

c. Across-the-Board 20% Cut of Funds for Local Service Administration

Devolution requires a local infrastructure able to deliver devolved services. Part of local funding for that purpose includes "local assistance" accounts for the hiring of social workers and administrators locally. The Governor's May 2002 Revise cuts that infrastructure by a profound 20%. Including the January cuts for these purposes, the proposed budget removes $977 million and would require the lay-off of 4,909 local workers administering social service programs—most of them relied upon by children in need. The staff reductions include: Adoptions—126; Child Welfare Services (child abuse protection)—420; foster care for abused children—221; food stamps—976; TANF/CalWORKs safety net (70% children beneficiaries)—863; Medi-Cal 1,846.[36]

Each of these positions to be eliminated is currently filled. The problem is then exacerbated because of the state hiring freeze now imposed until at least June 2003. That freeze means that state workers are unlikely to be able to fill in even if disproportionate personnel losses hit a particular needed service or locale. The state finds its own agencies understaffed based on the happenstance of attrition and regardless of small size requiring a critical mass of workers.

d. The State is Imposing Numerous Indirect Infrastructure Cuts

Where the state retracts Medi-Cal reimbursement rate increases, it saves funds from a state account, but imposes difficulties on local jurisdictions responsible for providing services. Those services require a supply of providers, which state compensation reductions may hinder—of particular concern as to physicians who treat children. The Governor's May Revise proposes $249 million in such reductions (see Chapter 4).

Another example is the imposition of additional co-pays to reduce state general fund costs (as with the tripling of doctor visit co-pays for 2002–03. Such a policy change may reduce timely treatment of children and add to belated and expensive emergency room visits.

e. State Capture of Local Funds .

The current proposed 2002–03 budget has found many ways to capture local funds for state general fund relief. It has ended CalWORKs incentive payments to counties, and now proposes to expropriate $600 million in unspent performance incentives from the counties, of which $169 million will be allocated "to maintain CalWORKs (state) funding."[37]

The Governor's 2002 May Revise includes a "one time augmentation to CalWORKs employment services of a substantial $120 million. However, it is merely simply the redirection of other county incentive payments taken from the counties and then given back to them— reduced by one-third. It does not represent net increased investment in education, or job training of CalWORKs parents.

The retraction of funding to counties for CalWORKs comes at a regrettable time for involved children. The previous county rolled-over surpluses are now gone. They were the product of an economic boom in the late 1990s (and perhaps welfare reform with increased job investment). But those savings gone and the accrued incentive payments will be soon exhausted or are to be taken by the state. Meanwhile, the economy has flattened, one million children remain on the rolls, substantial numbers of those who have left are in dire straits (living in extreme poverty), and over one half million children face cut-off of federal monies over the next three years at the 5 year mark of TANF receipt. The budget anticipates at least 20,000 such children so cut in 2002–03, and the following year will bring a substantial increase. The burden of last resort general assistance falls on counties, overburdened child welfare agencies, or local charity—if available. Where are the funds for theoretically required public employment (and child care) for 300,000 TANF parents? Where is the funding to provide "state only" funding of the "child's portion" of TANF that California states it will provide—when the 20,000 children subject to federal cut-off becomes 50,000? 200,000? How will the state provide counties with funding after pending TANF reauthorization raises the work minimum requirement to 40 hours, and work participation targets for full federal funding to impractical levels? (See Chapter 2.)

f. Program Assignment without Funding

Throughout the Children's Budget are examples of program general fund termination, often with the instruction that funding is to be picked up by similar programs in pre-existing accounts. See, *e.g.*, the use of Proposition 98 locked funds for such purposes discussed in Chapters 5, 6, and 7, *passim.*

g. Limited Local Funding Alternatives .

Complicating reliance on a limited sales tax and vehicle license fees as a source of revenue is that neither are responsive to need. As noted above, sales taxes are highly responsive to the economy, and decline just when impoverished children most need assistance. Further, as noted above, they are directed at jurisdictions in direct proportion to wealth and economic activity, short changing locales where the need is the greatest. Vehicle license fees are not likely to vary consistent with the merits of mental health needs which become tied to their sum total.

Where this funding does not match need, the local jurisdiction is without viable options for revenue. As noted above, assignable state sales taxes are limited in amount and require local two-thirds vote. The traditional revenue source for local government is the property tax. But under Proposition 13, real estate property taxes have been limited to 1% of assessed valuation as of 1975. The valuation may be increased no more than 2% per year unless a property is sold or is substantially improved.[38] Hence, property tax revenues generally do not match inflation and population gain, requiring continuous service reduction or development of alternative sources of revenue.[39] Property taxes feeding local government and school financing amounted to five times state income tax collection in 1977; they are now at approximately the same amount.

The passage of Proposition 218 in 1996 further limits local government resources and options by restricting "assessment districts," created to allow property owner financing of local improvements. Proponents contended that some districts were financing general services; the measure requires that, by July 1997, property owners pay through taxes only the share of "special benefit" conferred by the district. Property owners must directly approve any increase or enactment of assessments by a two-thirds vote—historically difficult to obtain. The unwinding of existing districts and revenue demands on existing local general fund resources may be significant in smaller and newer jurisdictions.[40]

h. State–Local Realignment and Public Official Accountability

A democracy works on the theory that public officials serve and are accountable to the citizenry. That accountability is enhanced where those who are responsible for making decisions have the authority to effectuate desired results. The mass delegation of responsibility to local officials without commensurate funding allows state officials to point locally for a failure of performance, while local officials point to the state for denying resources.

Critics of "realignment" restructuring of state accounts to counties contend that the result during economic flattening will be: (1) more local authority to decide what will be reduced, but by officials lacking the capacity to adjust revenue to need; (2) lower actual spending, as child-related programs compete with more powerful local interests; and (3) fragmentation of spending cuts into 58 county and

1,100 school district venues, where choices and revenue options are limited. Child advocates argue that outcomes are attributed to local decisions, but state officials who have made the underlying budgetary decisions may escape accountability for the consequences.

It is the state that is the sovereign, has generic power to tax, and to specify criminal offenses and civil liability. Local jurisdictions lack the practical ability to generate resources in California's current constitutional setting. It is the state budget that defines the values and priorities of state officials— which no facial delegation to others should obscure.

C. State Tax Sources and Burdens

1. Tax Sources

Most state revenue comes from three sources, as follows:

	1998–99	1999–00	2000–01	2001-02 (estimated)	2002-03 (proposed)
Personal income tax	$34.5	$39.6	$44.8	$42.1	$37.1
Sales and use tax	$19.0	$21.2	$21.5	$22.0	$23.0
Bank and corporate tax	$5.7	$6.6	$6.6	$5.9	$7.3

Source: Governor's May Revisions (numbers in billions).

TABLE 1-E. California Sources of Revenue

Personal income tax is the largest source of state-generated revenues and, together with sales taxes, make up over 70% of state-generated revenues. Sales and use tax, once substantially above income tax, has declined to 62% of its level as estimated for 2002–03. Bank/corporation and insurance tax revenues have increased only one-half as much as has income tax over the past two decades. Major other revenue sources include vehicle fees, where increases since 1977 matched personal income collection increases until 1998–99, when they were reduced as described above. Estate, inheritance, and gift taxes were reduced substantially in 1984 and have increased less than one-fifth as much as has income tax collection. Although alcohol taxes were increased in 1992, tax revenues have increased at less than one-third the rate of personal income tax gain, and substantially below sales tax collection increases for other products. Tobacco taxes were similarly below other taxation rates until the increases recently imposed by Proposition 10; total tobacco tax revenue is estimated to be $1.136 billion in 2001–02 and projected to be $1.119 billion in 2002–03.[41] Additionally, the state received $386.4 million in 2000–01 from the tobacco litigation master settlement agreement, and expects to receive $475 million and $474.4 million from this source in the current and budget years, respectively.[42]

Property tax revenues are considered local funds and finance county, city and special district spending on police, fire, and other services.[43] However, about one-half of these taxes is expended on child-related education and, because of the *Serrano* case[44] requiring a roughly equal base of spending for public education among schools, is allocated through the state budget in a separate account (discussed in Chapter 7). Total property tax revenue was estimated at $20.4 billion in 1998–99.[45] Property taxes proposed for K–12 public education amount to $12.7 billion in 2002–03, ranking as the second major source by amount in state controlled revenues (see Chapter 7).

Personal income tax revenues have borne an increasing proportion of the state tax burden, projected at $37 billion (47%) of state general fund revenues in proposed 2002–03.[46] Corporate sources of revenues have declined substantially in relative terms, particularly the taxation of alcohol. Although sales tax rates have increased, revenue increase has been somewhat moderated by the shift of the economy from goods toward services,[47] and may decline further as Internet sales commonly avoid taxation. Since 1989–90, state public spending has relied on increasing federal spending, taxes on personal income, and motor vehicle registration fees; the state realizes declining relative revenue from banks and corporations, real estate property owners, inheritance/estates, and alcohol.[48]

2. Tax Expenditures

In addition to annual spending, California's tax system expended over $24 billion in 2000–01 in foregone revenues from particularized deductions and credits.[49] These "tax expenditures" amount to about one-third of all state general fund spending. There are now 268 tax expenditure programs (197 at the state level and 71 local). In 1985, the Legislature required the Legislative Analyst to review tax expenditures every two years, but those reports were suspended with the 1990 passage of Proposition 140 (which imposed term limits and reduced the Legislature's budget), and were not resumed until February 1999. As noted above, newly-enacted tax relief measures from 1997 through 2001 cost the state $5.9 billion in reduced taxes annually by proposed 2002–03. The state has added on another $146 million in 2002–03, mostly for the middle class and elderly in pension fund deductions.[50]

	Amount Expended (billions)	As % of Total Tax Collected
State:		
Personal Income Tax	$17.8	62.5%
Bank and Corporation Tax	$3.2	53.6%
Sales and Use Tax	$6.0	26.4%
State Controlled Local:		
Property Tax	$3.7	18.0%
Sales and Use Tax	$1.9	26.4%

TABLE 1-F. Tax Expenditure [Revenue Reductions] 1998–99[51]

Each of the state's tax expenditures continues unless it is ended affirmatively by legislative act. Further, since ending a tax benefit is a form of "tax increase," each requires a two-thirds vote of the Legislature under California's current rules. Accordingly, tax breaks achieved by Sacramento lobbyists are a special prize, a locked-in benefit that will continue indefinitely independent of justification.

3. Tax Burdens

As Table 1-A above indicates, the personal incomes of Californians have increased above inflation since 1989. In raw numbers, total personal income has increased from $606.7 billion in 1989 to $1.1 trillion in 2000–01, an estimated $1.158 trillion in 2001–02, and a projected $1.23 trillion in 2002–03. (See Table 1-A.)

State general fund spending is the discretionary source of funding for most child-related accounts. General fund spending has increased 25% from 1989–90 to the current year adjusted for general population and general inflation, however there has been virtually no increase in relation to child population growth.[52] Table 1-A presents California state general fund spending in relation to the personal income of its residents. General fund spending has fallen from $7.35 per $100 in personal income in 1979–80 to $7.06 in current 2001–02 and would drop to $6.92 as the May 2002 Revise proposes for 2002–03.

As noted above, the state general fund comes primarily from personal income taxes and state sales taxes. Unlike most of the spending accounts affecting children, state income taxes are now "indexed" to inflation; as inflation occurs, the tax schedules are reduced so that increased taxes are paid only where there is actual "spending power" increase. In addition, the tax expenditures automatically adjust to inflation, and have been arranged to increase substantially beyond inflation during 2000 to 2010 ("out year" growth).

California has reduced the personal income tax rate for the highest bracket from 11% to 9.3% (by failing to extend the sunset date of a previous increase). Those earning more than $100,000 in adjusted income gain over $1 billion in the current and proposed years. SB 1255 (Burton), now pending before the legislature, would reinstate somewhat higher tax rates for the highest tax bracket.

Notwithstanding this decline in progressivity, the state personal income tax remains more progressive than other state taxes, which are generally regressive (costing the poor a higher percentage of their income). In particular, sales and excise taxes are regressive. Viewing all state and local taxes together, the lowest one-fifth of households with average income of $15,300 per year pay the highest tax rate, at 12.1%.[53] The total tax burden as a percentage of income lessens by quintile to the top 1%, earning over $434,000 per year, and who contribute an average of 7.8%.[54] Over the last fifteen years, generally progressive inheritance, estate, corporate, and property taxes have declined substantially in relation to personal income and other revenue sources. Regressivity has been increasing since at least 1985.[55]

California's personal income tax system has three features favorable to impoverished children. (1) It does not begin taxation until just above the poverty line, unlike the federal system which withholds and taxes at below the line. (2) The state has added two tax benefits over the last three years: restoring part of the renters' tax credit, and (3) California enacted in 2000 a child care tax credit. However, the previous renter's credit (meant to give the poor a counterpart to the large mortgage interest deduction of homeowners) was "refundable." Hence, it was not merely an offset to taxes, but could benefit the working poor who did not pay high personal income taxes. The reenacted renter's tax credit was "non-refundable," benefitted the poor with expenditures only one-third its previous level as a refundable credit, and had no benefit to those earning near or below the poverty line. The child care tax credit is refundable, and enjoys a small increase in 2002–03, but remains limited to less than 15% of existing child care costs. If a low income working family cannot afford the remaining 85% cost they must privately provide—than they are unable to obtain any benefit from the credit. Hence, very little of either of these two tax changes will reach the population of children most in need (see discussion in Chapters 2 and 6, respectively).

While these tax cuts were occurring, impoverished children—subject to food stamps and TANF as their basic safety net—have had assistance cut from close to the poverty line to 89% of the line in 1989 to 70% of the line currently. Between 2003 and 2005, over one million California children face federal TANF cut-off, with possible state fill-in of the "child's share" reducing families to under 50% of the poverty line in TANF plus food stamp safety net assurance.

4. The Problem of Revenue Volatility

The state has many continuing obligations to its children, including education, safety net, child abuse protection, and health. As noted above, it lacks the ability of the federal government to borrow funds en masse or to engage in direct deficit spending. Accordingly, volatility, particularly sudden revenue drops threaten its ability to meet its continuing obligations. California's single largest revenue source is the personal income tax, and major stock market movement can produce major and quick stock option and capital gains income changes. Capital gains and stock option revenue normally averages from $3 to $9 billion, but jumped to $12.7 billion in 1999–00 and then to $17.7 billion in 2000–01, only to fall back to $8.2 billion in the current year and $7.2 billion estimated for 2002–03. The loss of $9 billion to $10 billion in a single year dislocates state planning and forces disruptive budget changes. It often correlates with other income trends, and with corporation tax revenues, exacerbating the volatility.

The optimum approach to such volatility is for the state to engage in a kind of "income averaging," establishing a baseline of historically reliable minimums for volatile revenue sources, and reserving a substantial percentage for a running reserve account to even out variations (see Recommendations below).

II. The Federal Surplus and Adult Priorities

The national economic recovery over the last half decade, combined with an end to the cold war, created a projected budget surplus for the federal government to allocate during 2001 to 2011. Those monies could be returned to taxpayers, or invested in societal assets, such as the environment, service infrastructure, education, children. The national tax and spend decisions made in 2001 form the reality of our priorities. What is important to us? How much to we invest or return and for whom? Experts examining the $1.35 trillion eleven-year tax reduction final plan contend:

- The eleven-year cost of the plan is $1.9 trillion, not $1.35 trillion. The lower level was advertised to give tax cut opponents a public relations victory by artificially "sunsetting" many of the cuts before the 11th year (so they would not be counted in the total), with the practical arrangement that they would in fact continue.[56]

- The revenue reduction will require increased interest payments on the debt, which brings the total cost to $2.3 trillion.

- In the following 2012–21 ten-year period, the cost will rise to $4.3 trillion, excluding substantially increased interest payments.[57]

The sums which have been cut substantially exceed actual projected surpluses. The optimistic projection of $2 trillion in surpluses over ten years itself assumes continued positive growth. Tax cuts above that level are imprudent, and remove any cushion should funds be needed. Moreover, the tax cuts assume current spending levels, and ignore prospective new funding, including social security support and medicare assistance, including prescription drug coverage for seniors. Both are backed by the politically potent elderly, and both have been promised. Experts advise the reservation of at least $500 billion for the former alone.[58]

As currently enacted, the tax cut will reduce non-defense spending by 2011 to the lowest percentage of gross domestic product since the data was collected in 1962.[59] Such a reduction mandates a further spiraling down of public investment in children as a percentage of our personal income.

The distribution of the new tax forbearance excludes impoverished children. In terms of wealth distribution, the one percent at the income top receive about 40% of the tax benefits, the bottom 80% would receive 29% and the bottom 20% would receive a negligible amount. An estimated 12.2 million low and moderate-income families with children, 31.5% of all families with children, would not receive any tax reduction. The cuts excludes benefit to the working poor and lower middle class families covering 33.5% of the nation's children.[60]

The exclusion is not the result of simply "those who pay the most in taxes get a greater break with a tax reduction." The issue is which taxes are reduced and how. For example, payroll taxes, which the working poor pay deducted off the top from the first paycheck they receive yield no reductions. Such taxes for a family of two parents and two children earning $25,000 currently amounts to at least $3,825. In contrast, the inheritance/estate tax is phased out entirely (after having already exempted the first $1 million from taxes in 2000). Half of all estate taxes are currently paid by the 2,400 largest estates, and the elimination of this tax confers on that number a tax expenditure averaging $3.5 million each. The defenders of the abolition claim that family owned businesses or farms are lost to family succession, but only 3% of taxed estates have substantial family owned farm or business assets, and these paid less than one-half of one percent of existing estate taxes.[61] As discussed in Chapter 2, African-American children inherit less than one-fifth the average amount of white American children. Some child advocates argue that equality of opportunity principles require society to avoid giving one group of children millions of dollars in resources based on nothing more than the circumstances of their birth. Whatever the merits of allowing inheritance to compromise equality of opportunity, the new tax policy takes the extreme position of foreclosing the partial sharing of such inherited advantage with children not fortunate enough to be born to wealthy parents.

The distribution of benefits to exclude working poor parents and families occurs in the context of record income disparities between the top and the bottom. Nationally, income disparities are at their widest point since World War II, and as indicated above, California incomes are among the most disparate. From 1977 to 1995 *after tax* income of the bottom fifth of the population fell 14% in constant dollars. The after-tax income of the top fifth of households rose 27%, while the after-tax income of the top 1% increased 87%. These widening after-tax disparities form the context for the tax changes enacted by the Congress in 2001.

Other elements of the tax package favor corporate interests and the elderly. For example, substantial new tax benefits are implemented for private pension subsidies. And spending plans are now being formulated to commit millions for prescription drug coverage for the elderly and to bolster MediCare generally. In addition, social security general fund cross subsidies are likely given the now-projected shortfall. The only alternative is likely to be payroll tax adjustments which will increase burdens on the working poor. Much of these expenditures will come on top of the $2.3 trillion in tax expenditures discussed above. Finally, the likelihood of deficit re-inflation is great with even a small economic downturn. That deficit will constitute a debt to be paid by children for benefits received by a current generation of adults.

Some of the elements of the 2001 federal tax plan have benefits for children and families, chiefly the doubling of the dependent tax credit from $500 to $1,000, but as with other administration's tax proposals, it is a non-refundable credit. It does not benefit those who pay payroll and property taxes but earn below the personal income tax line. Moreover, such dependent credits start to phase out as income rises above $110,000, but the 2001 tax system raises that ceiling to $200,000—assuring full benefit to the latter level. Hence, for a substantial share of families above $100,000, the credit will mean a new (previously unavailable) tax reduction of $1,000 per child.

It is not just the poverty line working poor who are excluded, while the plan reduces marginal tax rates generally, they are not reduced at all for working families with children earning from $13,000 to $20,000. For each additional dollar these families earn, they lose up to 21 cents in Earned Income Tax Credit phase-out, 15.3 cents in payroll taxes, 24 to 36 cents in lost food stamp benefits and child care credits.[62] As Chapter 2 discusses in detail, tax and social benefit policies establish a barrier near and just above the poverty line inhibiting working parents from reaching self-sufficiency and their children from reaching into the middle class.

The federal government has initiated a limited number of major spending initiatives for children, as outlined in Chapters 2–9 which follow. The two largest are SCHIP (State Child Health Insurance Program) and education accountability/investment. As discussed in Chapter 4, Congress has responded to the failure to use its funds to cover children by reducing the original $855 million/annum for California by a total of $1.5 billion through 2006. Rather than covering children effectively, the state is maintaining a "sign-up/enroll/qualify" system with premium payments required of parents living just above the poverty line. Some new enrollments are accomplished, but close to 20% of the state's children will remain uncovered and much of the federal money may not be used at all, or may be used to cover additional parents while large numbers of inexpensively insured children remain uncovered.

Only 5.7% of the state's children lack private coverage and are ineligible for public coverage (undocumented—ineligible immigrants or whose parents lack dependent coverage but earn over 250% of the poverty line. Rather than covering all children and billing parents of this group *post hoc* where substantial medical services are rendered and a parent earns over that limit, the state continues on a course of individual sign-ups, required premiums (in addition to co-payments) and seventeen separate, confusing programs for possible qualification, run by seven different, largely uncoordinated agencies. Although well intentioned, this federal investment has not been implemented effectively to date in California.

The education investment in children formed a substantial basis of President Bush's presidential campaign. As described in Chapter 7, his spending plan includes accountability requirements (similar to those already taking effect in California), but it does not add substantial new resources. Rather, actual spending increase is 2.9%, less than the average annual increases over the previous five years.

The actual $2.3 trillion in new money to be expended or returned in 2001 through 2011 averages $218 billion per annum. California's share is approximately $27.3 billion a year. Apart from this, major new spending in social security and medicare are planned for the elderly. Impoverished children received none of those resources. The two major new federal spending initiatives will bring approximately $500 million in expended child health insurance provision, and $140 million in additional education investment. That $640 million in federal additional annual commitment to children represents 2.3% of the $27.3 billion in federal allocation of the surplus. Very little of the latter is expended for children, and none of it for impoverished children.

Of additional concern, these sums represented the allocation of an anticipated surplus of $5.6 trillion over fiscal 2002 to 2011. However, the Congressional Budget Office now anticipates the surplus to be only $1.6 trillion.[63] The huge surplus is dissipating, and maintaining these already committed tax expenditures will now require substantial affirmative spending cuts. Those cuts are likely to disproportionately affect children. It is unlikely that they will affect defense spending, now proposed at a record $390 billion per year. The next nearest defense budget in Russia's at $60 billion. U.S. military spending now totals approximately the same amount as is spent cumulatively by all 47 nations with substantial armed forces in the world.[64]

III. THE ENERGY CRISIS AND INVESTMENT IN CHILDREN

In 1996, the California legislature enacted AB 1890 (Brulte) (Chapter 854, Statutes of 1996). Effective March 1, 1998, the statute authorized creation of an "Independent System Operator" (ISO), which assumed control of the power grid that transmits electricity statewide between the respective utilities controlling local delivery; further, a second agency, the Power Exchange (PX), functions like a stock exchange, enabling sellers and buyers to bargain for the best price for electricity.[65]

The ensuing deregulation debacle has affected the state budget and is relevant to children. Wholesale power had been in the $33 a megawatt hour in 1999 climbed to an average of $346 on the spot market in 2000, with prices spiking up to $1,900. The parallel would be a charge of $120 for a loaf of bread, with all other bread on the shelves immediately reverting to that price and no substitute product available. And with consumers billed for the product after they have consumed it.

The Federal Energy Regulatory Commission (FERC) did not intervene to stop the excessive pricing, although evidence surfacing in 2002 indicates conscious "gaming" by out-of-state energy companies to subvert free market pricing. The state was also slow to act and overcharges continued and escalated. The price increases reached through 2001 over $35 billion in charges over normally competitive levels.

The state undertook: (1) a bidding process to establish long term contracts at specified prices to undercut the impact spot price excesses; (2) the use of the state's Department of Water Resources to purchase about half the power in the demand gap area subject to then extant spot market excessive prices;[66] (3) the purchase of substantial power at highly inflated prices using more than $5 billion of the 2000–01 surplus funds, (4) the planned issuance of $13.4 billion in revenue bonds to finance further purchases allegedly to repay the general fund; (5) the enactment of legislation to create additional generator capacity with authority for an additional $5 billion in bond financing; (6) an offer to "purchase the transmission lines of Southern California Edison" for $2.76 billion (2.3 times book value) with a possible additional $6 billion to purchase the lines from SDG&E and Pacific Gas & Electric—as compensation to the state for public payment to the utilities of energy costs so they may avoid bankruptcy; (7) a $1 billion set aside ($850 million appropriated) to stimulate conservation and an offer of a discount to consumers who cut energy use by more than 20% from the previous year.

The Davis administration requested and received "deficiency appropriations" of $500 million every ten days during early 2001 as the state slid into a $50 million dollar a day burden of energy purchases. Will the general fund be repaid? The PUC has authorized some rate increases for partial repayment, but full repayment is dubious. And in 2001, Republicans proposed substantial general fund payments to avoid further ratepayer hikes.

The current debacle has the following unavoidable consequences: (1) Excessive pricing has moderated in 2002, but the total amount claimed as due by out-of-state generators could substantially exceed $50 billion for 2000 and 2001—a figure greater than the state's entire K–14 education budget. (2) At least some of the long term contracts signed by the Governor apparently include an "escalator" clause allowing pass-through increases based on natural gas prices. Moreover, the contract prices are two to three times the current market (and cost of production) levels and are inexplicably locked in not for the one to three years necessary to resolve scarcity problems or stop gaming manipulation, but for 20 years and more. (3) Natural gas transmission has been deregulated by FERC in an environment of limited competition and initial prices paralleling the electricity excesses.

The Governor contends that the general fund will be held harmless by the energy problem. General fund monies used by DWR to purchase power will be repaid through the issuance of a public bond. Prices will fall. But the energy problem is so massive that it has important effects on the overall budget and on children. Short term, the heads of agency departments knew near the end of fiscal 2000-01 that any serious funding initiatives for children were "off the table" categorically for current 2001–02. Another immediate impact has been approval of utility rate increases. While "lifeline" rates softened the blow to low volume users and two programs offered some minor assistance to those below 175% of the poverty line, the scale of the increases overwhelmed these gestures. The subsidy for poor families is insubstantial in relation to rate increases, and although lower rates are charged up to a baseline, that line (300–1,000 KwHr) is a low threshold. Utility increases to impoverished families—particularly those living inland where rents are lower—require some relief from the substantial desert heat, particularly in the Southern California summer. Although the deregulation statute facially required a rate freeze, and a 20% roll-back at final deregulation implementation, families instead saw rate increase approvals to SDG&E of 30% in 2000, followed by 17% more, followed by 9% on January 4, 2001, followed by 12% in September of 2001, and with another increase pending in 2002. PG&E and SCE obtained rate hikes averaging 55% above previous levels during 2001—a rate increase involving almost $5 billion in annual additional revenue. Additional increases have since been requested, with PG&E seeking such monies through bankruptcy proceedings and SCE seeking to make a deal for major public buy-out.

These utility increases reach into impoverished families in the context of safety net contraction and record rent level increases. While utilities increase 55% in one year, the children of TANF parents are denied a 1.9% COLA increase.

A third impact involves the $12.5 billion in bonds necessary to repay the general fund. That new bond issuance must occur in the midst of major borrowing to make up the $23.6 billion in general fund shortfall by various borrowing arrangements—including tobacco settlement fund securitization bonds discussed below. State cash flow, now critical, is not assisted by the sudden and unbudgeted demand for over $8 billion in less than 12 months for DWR purchases. Moreover, the bond rating of the state could be affected (on April 24, 2001 was reduced by Standard & Poor's by two rating steps, from AA to A+) which then requires more interest to attract bond financing, further encumbering the state perhaps as to *all* of its revenue bonds, and perhaps as to its more considerable general obligation bonds financing school and prison construction, *et al.*

Another impact is on yet another source of general fund denial—the interest paid on these bonds, in order to obtain a favorable interest rate, is tax deductible. That means it generates tax forbearance that would otherwise go to the general fund, but is now lost in order to obtain an acceptable interest rate.

A final impact of high energy costs is increased operating costs for the public sector. Public hospitals, schools, agencies all pay utility bills, and incur costs at the premium high-user rates. The Governor provided a $500 million augmentation for increased school energy costs in 2000–01, it is not included in the 2002–03 budget, and must be borne by schools, day care centers, receiving homes, government offices, hospitals and clinics.

IV. The Proposed 2002–03 Budget

Chapters 2 through 9 below detail the present and proposed budgets, as well as trends from 1989, adjusted for population and inflation. In general, the 2002–03 budget is extraordinary. It reflects a shortfall in anticipated general fund revenue that produces a budget deficit of $23.642 billion, the largest such deficit ever faced by a state in the nation's history. Moreover, a state lacks the borrowing and deficit spending facility of the federal government—budgets must balance.

The Governor's May 2002 Revise publishes the following itemization of that needed sum:[67]

	Amount (billions)
Program Reductions	$7.6
Tobacco Settlement Securitization	4.5
Loans	1.7
Fund Shifts	1.3
Temporary VLF Offset Reduction	1.3
Net Operating Loss Deferral (2 year)	1.2
Deferral of Education Disbursements	1.1
Debt Restructuring	1.1
Federal Funding Increases	1.1
Federal Tax Conformity/Compliance	.9
Other Accelerations and Transfers	.7
Fund Transfers	.6
Cigarette Tax Increase	.5
Total	$23.6

Table 1-G. Governor's May 2002 Revise Proposal to Close Budget Gap

The Governor's May 2002 Revise budget includes three methods to fill the projected 2002–03 deficit of $23.6 billion: (1) social service cuts, (2) fund transfers and deferrals, and (3) new revenue. The Governor argues that the May 2002 Revise listing of Table 1-G above represents a balanced approach between reductions, deferral, and new revenue. However, a close examination of the proposal indicates that it is balanced against the interests of children *in extremis*, and is formulated with a paramount guiding imperative: do not raise revenue for fear of invoking the "tax and spend" label.

A. Social Service Cuts Total an Adjusted $11.6 Billion

The Department of Finance's listed $7.6 billion in social service cuts fails to include the population and inflation effects on social service spending. Using conservative adjusters to the $78.8 billion in general fund money primarily focused on children yields $2.9 billion is needed to maintain current spending. This sum is properly added to the raw number cuts used by the Department of Finance. Hence, the adjusted cuts to existing programs is $10.5 billion. In addition, the reduction amount ignores the administration's accounting trick of moving $1.1 billion in education money from the current to the proposed 2002–03 year by delaying payment of late fiscal year bills due in June to July 2002 (see "Deferral of Education Disbursements (1 month) entry above, and Chapter 7 discussion). This timing change does not add real money for social services, but is another subtraction of social service (education) money from 2001–02, and is properly included as a reduction of such spending to reach the

$23.6 billion figure. Accordingly, actual taking from social service/education spending is an adjusted $11.6 billion.

This count excludes substantial reduction impacts from proposed 2002–03 budget, including the hiring freeze in place until June 2003, and numerous opportunity costs—including the loss of over $1 billion in federal matching funds for child health and other purposes which these cuts compel. Nor does it include the diversion of No Child Left Behind Act and other federal monies by using it not for additive effect, but to supplant current general fund monies in similar existing accounts.

B. Reductions Are to Child Related Accounts

The accounts absorbing 90% of the proposed cuts focus on children—with special focus on impoverished children or those with special needs. Hence, education, health, child welfare services, and safety net programs bear the brunt of the budget's listed cuts (see Chapters 2–9 below). We estimate that 72% of the cuts can be fairly allocated to pregnant women, infants, children and youth still in school.[68] Accounts not experiencing serious reductions include the Department of Corrections, where the highly organized and politically active prison guards enjoyed extraordinary pay and benefit gains. As discussed above, substantial tax expenditures have accrued for organized interests, with 2002–03 adding new tax forbearance revenues for pension savings purposes.

C. Cost Transferral to Future Taxpayers—$11.1 Billion

After program reductions, the next largest source to make up the $23.6 billion shortfall is borrowing from future taxpayers. A quantum of such borrowing is prudent where volatile revenues threaten relied upon existing programs, and revenues are likely to increase in future years. Such transfers simply smooth out revenues to moderate displacement harm from short term revenue variation. But the Governor's proposed borrowing is in excess of such a rationale, and instead overburdens future taxpayers with high interest costs and obligations for many years—a generation-long obligation for much of it. This burden to be visited upon today's youth over the next two decades has one overriding purpose: Save existing taxpayers any additional revenue assessment for the single year of 2002–03.

To protect the "no new revenue burden on present adults" prime directive, the Governor's plan includes deferral of required payments to major public pension plans, including $412 million in 2002–03 and $440 million in 2003–04 to the State Teachers Retirement System. He would add to this deferral $371 million to CalPERS in 2002–03 and another $124 million in 2003–04.

He would transfer $97 million of what he terms "idle cash" out of nineteen funds.

The general fund would also receive $579 million borrowed from 15 special funds—which must be repaid under existing court precedent.

He would secure loans of $1.7 billion, and "shift" $1.3 billion temporarily. And carry a net operating loss deferral over two years of $1.2 billion.

The May 2002 Revise largest single deferral is $4.5 billion from "Tobacco Settlement Securitization." The Tobacco Settlement Fund collects monies paid by the tobacco industry pursuant to the Master Settlement Agreement of 1998 settling most public/state claims against the tobacco industry. The settlement requires the payment of sums for the benefit of those injured by the nicotine addiction deceit and manipulation and related unfair business practices of tobacco. The five California suits settled alleged violation of Section 17200 of the Business and Professions Code (the Unfair Competition Act). The remedy for its violation lies in equity and consists of injunctive relief (and civil penalties for public prosecutors). Funds paid pursuant to injunctive relief are "restitutionary" in nature—they are intended to restore victims to their status prior to the alleged wrong as a first priority.

The restitution sums payable to California amount to approximately $21 billion payable over twenty five years from 1999. The state receives 50% of the sum and local jurisdictions the other 50%. The state received $515 million in 1999–2000 and $386 million in 2000–01, and deposited both amounts improperly in the general fund—with none of it allocated for victims. In 2001 the state created the Tobacco Settlement Fund (TSF) and committed itself to spend the money for health related purposes. The Centers for Disease Control has issued guidelines on proper spending purposes. But it is clear that a first priority is rectifying the abuses complained of in the litigation. Hence, payment for past and future de-addiction services, and affirmative de-addiction promotion are high priority targets given the litigation's focus on addiction. Another high priority, given the youth targeting allegations, could be substantial public advertising and education to lessen juvenile smoking and addiction.

The TSF spending proposal for 2002–03 includes nothing for de-addiction, and only $35 million for youth anti-smoking education—which the May 2002 Revise then canceled. Much of the funds are now directed to health—not as additional resources, but to supplant current general fund monies in accounts such as Healthy Families.

The tobacco securitization proposal floats a bond for $4.5 billion, and then allocates future tobacco settlement revenues to pay-off the principle and interest over the following 22 years of revenue. The debt service will cost $116 million in 2002–03. It will increase to $356 million in 2003–04 and thereafter. The total cost over the 22 years will be $7.9 billion, assuming an optimistic low interest rate of 5%. The cost does not include lost revenues from the deduction of tax free interest on the bonds.

The payments will consume about 75% of the anticipated $10.56 billion tobacco settlement amount due the state to 2024. These substantial payments will be made each year for the next 22 to mitigate a deficit for 2002–03, and to avoid new revenue demand to present taxpayers.

D. Proposed New Taxes—$.48 Billion

The May 2002 Revise plan includes only one tax increase, a $0.50 per pack tax on cigarettes to generate $475 million. While child advocates generally support such a tax, it may not net the listed sum due to its likely effect in reducing sales and hence revenues already publicly received (*e.g.*, Propositions 99 and 10).

The proposal lists as additional tax revenue $1.276 billion from a "Temporary VLF Offset Reduction." The Vehicle License Fee is set by law at 2% of the value of a vehicle per annum. It has been imprudently "offset" over the last two years—so public officials could be identified as beneficent tax returners. The VLF offset hardly establishes a defined tax level—it has been moved up and down from 1999 to 2001 from 25% in January 1999, with a "temporary one year add-on" to 35% for 2000, then extended to June of 2001, and then increased 11 months ago to 67.5%. The May 2002 Revise simply adjusts the offset back to 25%. It does not reimpose the full fee, but the 1999 level cut 25% below full assessment. These adjustments up and down over a two year period—all below the long-standing 2% of valuation tax—are not fairly characterized as "new taxes."

While all of the tax breaks of the last four years, except the child care tax credit, could be rescinded (see proposal below), this declination to refund a longstanding tax raises the following ethical question: do you take the VLF and send it back to car owners with the largest amount going to the owners of the most expensive vehicles, or do you direct it to moderate a threatened $11.6 billion disinvestment in the future of California's children?

E. Gap Redress Balance:

Disinvestment in Children:	**$11.6 billion**	**(50%)**
Required of Future Taxpayers:	**$11.1 billion**	**(48%)**
New Revenue Sources	**$0.475 billion**	**(2%)**

The May 2002 Revise proposal to fill the $23.6 billion projected revenue gap for the budget year is not balanced. Ninety eight percent of the amount produced takes the form of either direct disinvestment in children, or in substantial payment burdens in future years—payments borne during years where those monies devoted to repayment will be unavailable for child investment, and because some of the obligations will last for twenty years, will directly burden today's youth. All of this deferral of $11.1 billion, plus substantial additional interest, over many years for some of the sources listed, is compelled to save general fund revenues in a single year.

Actual new revenue, not collected as taxes within the last three years, amounts to 2% of the shortfall solution. Regrettably, when the Governor proposed this "balance" of token taxes, substantial deferral and future burden, and $11.6 billion in cuts, the media in all four California major markets headlined the "gotcha" phrase: "Governor raises taxes." That approbation, given the reality confronting the state's children, suggests a seminal problem confronting those who care about children and the state's future: the current politico-cultural assumption that revenue advocacy is reprehensible. Disinvestment in children is of some concern, as are future burdens on the citizenry. But obtaining new revenue yields an almost universal "gotcha" headline. Public officials believe that is the value-judgment rendered by the media—and they accordingly treat new revenues—whatever the circumstances or justification or use, as political anathema.

While tax expenditures enacted since 1999 amounting to $5.9 billion per annum receive little coverage or discussion, a "tax increase" amounting to about 2% of the budget shortfall draws critical attention. Although California media has covered to some extent the social service cuts, comparative numbers and future implications of not investing commend a very different balance in public discussion. Given the political and financial weakness of children, and the critical role of the media as the champion of otherwise under-represented diffuse and future interests, that rebalance in coverage and subject-matter attention is a prerequisite to public policies favorable to children. Without such a re-balancing to put on the table— front and center—the difficult options and the consequences of revenue failure, the malaise of public officials—who would see the deprivation of much of a generation rather than risk a "tax and spend" adjectival reference—will not moderate.

The public official's fear of taxation advocacy is understandable. But the extent of that fear is extraordinary. Part of it may be ascribed to the increased taxes supported by former Governor Wilson to solve the serious general fund shortfall of the early 1990s. Some contend that this "betrayal" of Republican values undermined his credibility within his party and elsewhere. Wiser voices suggest that it was his response to criticism from the right, and the attempt to demonstrate his toughness—that led to his political decline, and to that of his Party. The electorate-at-large is not likely to condemn an act of generosity toward children in need—including one involving common sacrifice.

That the populace is well ahead of public officials and cultural assumptions is not a surprise to professional pollsters. Surveys of Californians over the past decade indicate a sophisticated understanding of taxation and the needs of children. They reflect consistent and surprisingly strong public support for additional investment in children—so long as they are convinced that the funds will be spent to effectively benefit children. The voting results in recent bond propositions attests to that sentiment. Most encouraging are consistent poll results showing not only support for increased revenue, but for higher taxes for themselves if it will be invested in children and afford them greater opportunity.

F. 2002–03 Major Budget Omissions

Apart from what the Governor's proposed 2002–03 does, there is much that it does not do but should. He continues a number of his valuable education proposals involving testing and school aid and Cal Grant expansion, but dilutes it considerably by expending over $100 million on bonuses to students who score high on tests and bonuses to teachers based on single year test improvement—rather than on a three- to five-year progression. And his cuts and failure to spend to scale, the largest class sizes in the nation, his diversion of virtually the entire additive effect of the federal No Child Left Behind Act, all subtract fro those efforts (see discussion in Chapter 7). At bottom the Governor's budget reflects as a central priority the protection of wealthy and corporate interests from taxation over his stated goal of education enhancement.

In general, the omission in the proposed 2002–03 budget are as important as the reductions and burdens imposed on future taxpayers. Those investment declinations include: (1) inattention to the developing underclass of impoverished children who need public investment, and (2) unwillingness to affirmatively add the $12.557 billion to the public revenue base to invest in children commensurate with past generations and adequately to assure their successful future, as proposed in Chapters 2–9 below.

More specifically, the proposed Governor's budget fails to:

- Resolve the flawed CalWORKs plan which requires "county provided employment" over a short period for up to 150,000 to 300,000 TANF parents at makework at a wage equivalent to TANF assistance and food stamps, only to fire them *en masse* three years later, followed by the cut-down of their kids to below half the poverty line in family income;

- Initiate the kinds of reforms which can give impoverished parents a chance to reach self-sufficiency, including both a seamless child care system which does not leave out help for the working poor and an earned income tax credit state augmentation;

- Provide the most realistic plan to give our children health coverage (true presumptive eligibility), despite $4 billion in federal money in front of us at a two to one match to provide it;

- Deal with the lack of parenting education to teach basics about children, particularly for males;

- Address the most serious underlying cause of child poverty—continuing adult irresponsibility in the creation of unintended children by single mothers (who are primarily *not* teens) and absent fathers;

- Reduce class sizes appreciably further, especially in grades 4 through 8, but will move California below its recent national ranking of 49th, and back into 50th place in overall class size;

- Expand higher education capacity; enhanced student aid is valuable but fails if there are inadequate enrollment opportunities necessary for youth future employment

- Assure adequate supply and quality of family foster care providers, realistic adoption opportunities, and resources so state-parented children who become 18 have a realistic chance at higher education as a responsible parent would provide.

V. A Children's Budget 2002–03

The *California Children's Budget 2002–03* would keep most of the spending for children proposed in the Governor's January budget, except for the accounts listed in VI below it would sacrifice to generate additional funding for the higher priority needs it identifies. The *Children's Budget* would reverse the child-related social service cuts of $11.6 billion, as noted above. The net cost of that reversal would be approximately $8.3 billion—because a restoration of $8.3 billion in general fund money for social services would generate additional federal matching funds and yield close to the $11.6 billion listed above to close the $23.642 billion shortfall to $12 billion. We would provide that $12 billion by (1) accepting the Governor's $1.3 billion VLF Offset Reduction, and the cigarette tax increase ($1.7 billion total), (2) accepting federal tax conformity/tax compliance ($0.9 billion), (3) anticipating one-half of his federal funding increases ($0.5 billion), (4) accepting $4.9 billion of the Governor's $11.1 billion in short-term borrowing, and (5) raising $4 billion in additional revenue (see below).

The short-term borrowing and other transfers we would accept up to $4.9 billion would include net operating loss deferral for two years ($1.2 billion), fund shifts ($1.3 billion), federal tax conformity/ compliance ($0.9 billion), and some of the $1.7 billion in loans ($1.5 billion). We would not accept any tobacco fund use, debt restructuring, fund transfers, other accelerations and transfers, or deferral of education disbursements. We would allow a modest evening out of revenue over the next three years—anticipating some upturn as has been predicted. But we would not burden taxpayers long-term because of an immediate need, and if the upturn predictions are incorrect, we would not engage in additional borrowing, but obtain additional revenue. The purpose is not to shift spending to future taxpayers and generations, but to allow an averaging over two to five years where there is volatility. As suggested in this Chapter, where that volatility turns to the positive (as in 1999–2000 with stock options/ capital gains), we would capture two-thirds of that excess for an extraordinary "averaging" surplus account. Were such an account in place, the state would not be confined to deferral for future payment, cuts, or new revenue as choices, but could use the banked surplus as a need fourth alternative.

We would accordingly close the budget deficit at a cost of $12.3 billion in required new revenue beyond the Governor's May 2002 Revise.

To this $12.3 billion, the *California Children's Budget 2002–03* would add a Child Advancement Fund of $12.557 billion. Thus, total additional state general fund revenues required would total $24.9 billion.

The Child Advancement Fund augmentations would include the following major elements:

- A substantial and continuing public education campaign on the right of a child to be intended by two adults prepared for his or her arrival;
- An assured safety net for children, with focused training for TANF employment;
- Inclusion of the children of all legal immigrants within that safety net;
- A substantial state Earned Income Tax Credit supplement to help pull children of working parents above the poverty line;
- Child care for the working poor in a seamless system, including substantial tax subsidies for space provision in the neighborhoods of the working poor;
- Investment in enhancing child care quality and wage enhancement;
- Assured medical coverage for all California children, with post hoc assessment of parents earning over 300% of the poverty line on a sliding scale, and a tax credit for employers who cover dependent children of employees below 300% of the poverty line;
- Classroom reduction for grades 4–8 (full funding for the first year of a required three-year effort);
- Truancy prevention increases and parenting education;
- The beginning of major capacity expansion of vocational schools and community colleges;
- The beginning of major capacity expansion of the university and state college systems; and
- Substantial adoption assistance funding and assistance to foster children who turn 18 years of age in both transition help, support, and vocational training/higher education up to the age of 23.

Each recommended augmentation is discussed in detail in Chapters 2–9 below, and a summary list is contained in the Executive Summary above. The Fund counts its tax credit allocations as general fund expenses; takes full advantage of available federal funding, including EITC available for public TANF workers and the SCHIP federal funding otherwise to remain substantially unused; and allows California to meet federal TANF targets and avoid substantial penalties which may otherwise be imposed in and after 2002–03.

Most important, the investments proposed herein will yield a long-term return in contributive taxpayers who will finance the future base. Assuring an adequate safety net for brain development, health coverage for a population which costs one-fifth the amount of adult coverage and can affect fifty years of future productivity, higher quality child care, education in smaller classrooms (which the 2001 STAR results tell us is working)—particularly where it is implemented with experienced teacher. And higher education investment for jobs and employment is a final, critical element our children and future require. The difference between the large, intractable underclass now evolving, and a large, employed middle class living at self-sufficiency levels is profound.

California had 19,000 adult prisoners in 1977; it now has 162,000, an eight-fold increase in a generation, as an annual cost of over $6 billion excluding capital costs, judicial expenses, local police, and the cost of crime itself. Most citizens who have moved into the middle class, or who believe they realistically can move into it, and with a track from school to career, is likely to becomes a contributor. That is the base which the state must build. It is a future revenue base, and it requires the expansion and adjustment of the cost/investment base necessary to accomplish that essential return.

As recommended below, spending policy should not be based on foreclosing future obligations. To the contrary, rather than spreading funds into fragmented “one time only” sudden influxes, or allocated into pilot project boutique programs at symbolic levels, investment should proceed with paced, planned investment increase where needed, consistent with a comprehensive vision and sensitive to the condition indicators discussed in Chapter 2–9 below. Each new program or major expenditure should be subject to independent measurement. Additions to the base should be driven by empirical success, and subtractions by failure. That evaluation should be based on a twenty year horizon, the time it takes to pass on to the next generation what our grandparents and parents provided for us.

To provide what is missing for children, the Children’s Advocacy Institute proposes a serious alternative for the Governor and Legislature to consider. It involves what polling has shown the people want: sensible and effective investment in our children and especially in their education.

VI. Monies for Child Protection and the Child Advancement Fund

Our parents of one generation ago taxed their $219.7 billion in total personal income for $16.25 billion in general fund monies, then as now—primarily for children. The same ratio of general fund investment in relation to the now projected personal income for 2002–03 would produce $91 billion in general fund revenue and spending.[69] The Governor’s tax and other revenue final 2002–03 proposal collects $78.6 billion, $12.4 billion less than the burden assumed by our parents—with lesser wealth and standard of living. This sum approximates the Child Advancement Fund proposed herein and would supply most of the $21.5 billion necessary to also hold children harmless from the proposed cuts and excessive future tax burdens implicit in the proposed 2002–03 budget.

One reason for the shortfall in general fund investment in children is a procedural anomaly in California law. The state requires a two-thirds legislative vote to appropriate monies for the general fund (California Constitution Article IV, §12d). And related to that requirement is the two-thirds supermajority necessary to *end* any tax deduction or credit. Hence, spending for children requires an annual two-thirds affirmative vote. But tax expenditures—which shred the revenue base for the general fund—continue unless affirmative ended, and the reduction of that form of spending takes a two-thirds supermajority to accomplish. To recapitulate: more investment in children requires a two-thirds vote, more tax expenditures require a majority vote, with a two-thirds vote then required to limit them.

The result of these twin inequities shreds the tax base over time. They exacerbate the already limited public resources locally available due to Proposition 13. Procedurally, California should conform the budget process to the rule in most states, which govern by majority vote. The obligation adults have to our state's children is paramount, and is not appropriate for super-majority barriers. Accordingly, a constitutional amendment should be proposed and voted upon to alter that anti-majoritarian obstacle to fulfilling our most important societal obligation. Tax expenditures should have automatic three-year sunset dates and similarly a require majority vote to continue. These two changes would allow public investment in children decisions to be considered fairly.

The generation of additional revenues is politically painful, but far more difficult sacrifices have been made over the last 200 years. Numerous options allow California to generate the proposed Child Advancement Fund, and moderate the cuts and future obligations now proposed for 2002–03, consistent with the stated goal of the Bush Administration that "No Child [Be] Left Behind."

The state's public officials view themselves as moderators orchestrating disputes among contending forces, reflected in the 1,050 full-time registered lobbyists now in Sacramento—9 *lobbyists* for each legislator. They commonly have two understandable priorities: win for their clients tax advantages which continue unless affirmatively terminated and prevent any new expense or tax from imposition. To the extent that the Governor and legislature continue the now ascendant philosophy that their function is to mediate disputes between contending interests so that none is unduly offended, the interests of diffuse and future interests will be sacrificed—children foremost. Although painful and certain to spawn opposition, numerous alternatives are available for the generation of the Child Advancement Fund proposed in the Children's Budget 2002–03. All resource and tax decisions involve priorities, what is comparatively more important—our legacy is the product of such decisions and the sacrifices they entail. How we characterize our priorities, or our stated sympathies, do not materially alter what matters—how much we effectively invest in our children. We suggest the following options capable of raising $35 billion without substantial hardship, substantially more than is required for the Child Advancement Fund, and for restoration of social service cuts and reduction in deferred obligations:

(1) Redistribute some unnecessary expenses in child-related areas: $1.5 billion. The granting of wholesale tax credits to teachers based on years in service is too unfocused a benefit to warrant inclusion vis-a-vis the other elements in the Children's Budget. Similarly, the $118 million to be expended annually on the "Governors' Merit Awards" to students who score high on standardized tests lacks a nexus to a socially defensible outcome. A large proportion of these beneficiaries do not need the reward as an incentive, and are not part of the impoverished population at risk.

These kinds of proposals, particularly those from the first three years of the Davis Administration, are borne of a regrettable political instinct to distribute public largesse widely and ostentatiously for political advantage. For example, the vehicle registration fee reductions of the last two years could have easily been handled through fee amount reduction, especially given the annual nature of the charge. However, public officials chose the added expense of sending checks out to millions of Californians. The "gratitude generating" motivation of public figures is both transparent and insulting to the electorate.

In education, although bureaucratic barriers are hampering its delivery, the state has approved important Cal Grant expansion in 2000–01 and to proposed 2002–03. But why not raise tuition for graduate professional students? They are currently subsidized by the public general fund at over $20,000 per year each. These are persons easily able to obtain low interest loans, and about to enter careers at attorneys, physicians, and engineers. Why are we so extensively subsidizing all of them, regardless of need? Is it a defensible subsidy where those resources could fund additional enrollment in vocational school, community colleges, and universities for hundreds of thousands of current middle and high school students who will not find productive employment without it?

Not only are resources available through the elimination or redirection of some benefits, but also through the elimination of unnecessary government. For example, the creation of a single health insurance system for children as proposed in Chapter 4 would end over $300 million in red tape and bureaucracy necessary to carry and administer seventeen separate child related health programs, each with its own qualifications, benefits, paperwork and channeled though five separate (and uncoordinated) agencies. This entire construct is designed to filter out the 5.7% of California's children who are uncovered privately and are ineligible for public coverage (undocumented immigrant children and those in families over 250% of the poverty line).

These examples are illustrative of program elimination or redirection which could conservatively produce $1.5 billion in resources for the Child Advancement Fund.

(2) State Adjustment to Federal Disinvestment in Children: $13 billion. As discussed above, the current federal imbalance effectively restricts new child investment in the state from federal sources to under $1 billion, while affording California senior citizens, corporations, and wealthy residents about $27.3 billion per annum over the next ten years, a figure which will increase substantially thereafter. Is such a balance consistent with our values and the needs of California's children?

California is not barred from effectively adjusting the federal changes using California assessments consistent with the values of its citizenry. For example, where the Congress subtracts 2% from the personal income upper income bracket, California could add 1% of it back onto its rate (which would still leave it below recent levels) and produce about $1 billion. Similarly, it could increase the state estate tax to produce at least half the revenue foregone on the federal side.

The fairest option is to take the $27.3 billion, scheduled to benefit almost entirely senior citizens and the wealthy, and divide it in half. One-half as allocated by the Congress, and one-half for our impoverished children. Rather than replicating the federal tax changes at the state level and exacerbating the disinvestment in children, each federal alteration could yield a partial state tax response to the same population—to allow for a sharing of benefit between taxpayers and children who warrant investment.

(3) Tax Corporate Profits: $1 billion. California corporations paid $6.9 billion in corporate taxes to the state in 2000–01, with 2002–03 estimates at $5.9 billion. Although profits are down somewhat, the economy is recovering and some corporate tax diminishment is the result of the cumulative addition of tax deductions and credits as discussed above. The rescission or suspension of sufficient corporate tax expenditures, or a small rate increase of from the current 8.8% to 9.9% would generate close to $1 billion. Such a corporate contribution is warranted given the long term benefits term to business of a larger, more educated middle class, which the Child Advancement Fund is intended to engender.

(4) Tax Alcohol Equitably: $2 billion. California has one of the nation's lowest alcohol tax rates. That dispensation is not on the merits, but is rather the result of the industry's well known political influence. Beer and wine are taxed at 20 cents a gallon in California. The tax amounts to $.04 for a bottle of wine, less than 1%. The taxes on alcohol could be increased by a factor of 10 with very little impact on sales. A $2 charge per gallon translates to $0.40 for a bottle of wine. Hard liquor taxes are somewhat higher and should be doubled. These changes would likely generate an additional $2 billion over the current embarrassing revenue of $290 million from this source.

(5) Raise the personal income tax high bracket to 14%: $4.15 billion. The wealthy of California have prospered at record levels of income and wealth. Nevertheless, their total state and local tax contribution is less as a percentage of income than for the bottom quintile of taxpayers, as discussed above and in Chapter 2. The high tax bracket was recently at 11%, but was rolled back. A 14% assessment is not confiscatory, and would make the local/state tax balance less regressive and more equitable.

(6) Temporarily Suspend New Tax Expenditures Granted Since 1997: $5.85 billion. As discussed above, California has enacted numerous tax deductions/credits over the last four years. They will cost the general fund $5.9 billion in 2002–03.[70] Tax benefits enacted during 2002 (*e.g.*, allowing IRA pension contribution deductions up to $5,000 per annum, adds another $150 million for a $6.05 billion total. However, the refundable child care tax credit would be retained—currently at $200 million (see recommendation for its possible increase and discussion in Chapter 6).

(7) Roll Back Unjustified or Obsolete Tax Expenditures: $3.5 billion. Quite apart from the recently enacted tax expenditures are another $18 billion in older and long unexamined tax deductions, credits and exceptions. The state should review its tax expenditure budget in the same way it appropriates direct spending. No deduction or credit should last more than three years—all should sunset in staggered format to allow for their required re-enactment. A majority vote should govern both the creation and removal of a tax expenditure.

A critical review of the current tax expenditure budget should find at least 15% of existing subsidies appropriate for termination or further limitation. Even the sacrosanct mortgage interest deduction, originally intended to stimulate home ownership and home improvements now finances the transfer of non-deductible credit card debt onto second and third mortgages to obtain the tax deduction benefit—unrelated to the deduction's original purpose. A bright line limitation on that deduction alone would generate the $3.6 billion goal above.

(8) Leverage State Spending to Fully Use Available Federal Funds: $ 3 billion. Based on current projections and plans, the state stands to send over $400 million a year in State Child Health Insurance Program funds back to the federal government. As noted above, the Children's Budget includes a proposal to expend all $857 million per year. In addition, the state stands to lose substantial TANF funds, penalties for child support computer system failure, and other deductions as outlined in Chapters 2–9 below. Finally, the state is capable of leveraging additional federal funds in education, child abuse, and juvenile justice. Similarly, Proposition 10 spending can be leveraged to achieve federal matches, as can tobacco settlement funds.

(9) Impose an Excess Profits Energy Tax: $1 billion; Obtain Energy Excess Payment Refunds. California should impose an "excess profits" tax which would operate on a sliding scale as energy prices exceed 10% of 1999–2000 market levels. The tax should be levied at 100% of any revenue collected beyond a charge more than 30% above 1999–2000 levels. That tax should have an exception for unavoidable, pass-through, out-of-pocket costs to generators.

This technique essentially imposes an externally specified limit on the spot market, indirectly accomplishing a meaningful wholesale cap separate and apart from reliance on FERC.

The tax could be arranged to yield approximately $ 1 billion in revenue. Its more salient advantage is to impose a cap as it slides to 100%. That cap precludes spot market inflated price assessments beyond its line. Such a tax is not imposed directly on the energy producers, but on the utilities or any other purveyor of energy operating within the state and who are subject to California and PUC jurisdiction. But it is automatically passed on and effectively operates as a ceiling above which the California wholesale buyer cannot practically go. One result of such a ceiling could be a slightly larger risk of "rolling black-outs." However, the ceiling would be at a level allowing substantial profit, which the power generator would have to forego absent antitrust collusion or improper "gaming" of the market. Such an assured maximum would itself deprive generators of the excess profit for selected submarkets that facilitates such gaming.

In addition, the state should press aggressively for a full refund from FERC, or through litigation, of the excessive charges imposed by energy generators and dealers—including the $7 to $9 billion expended by the state through Department of Water Resources purchase. This sum is not a direct net revenue source, but will free the state from the onerous requirement of a general obligation revenue bond of substantial size and with indirect costs for other budget priorities (interest deductions lowering general fund contribution, limitation of revenue bond capacity, interest payment obligations over many years, *et al.)*

VII. SUMMARY AND RECOMMENDATIONS

In the area of budgetary process, the *California Children's Budget 2002–03* makes two recommendations:

Recommendation #1.* Create a Child Advancement Fund, *Estimated cost: $12.557 billion general fund

Sources of revenue available to provide for the Fund are discussed above. Chapters 2–9 below detail its proposed allocation.

Recommendation #2.* Pilot projects and initiatives should sunset in five years, and 2%–5% of monies allocated to each should be earmarked for independent performance audits. *Estimated cost: allocated among programs affected.

The past seven editions of the *California's Children's Budget*s have documented the willingness of former Governor Wilson and now the Davis administration to test new ideas. A survey of the last five Governor's Budgets reveals over 127 new programs relevant to children. They are almost always accompanied by catchy acronyms, a sensible-sounding theoretical basis, and high hopes. Some simply disappear—opposed by the Legislature for reasons unrelated to the merits. Often, they are not re-proposed the following year, whether designated as "once only" expenditures or not. Other ideas are proposed by the Legislature *de novo*.

In most cases, the new program starts as a pilot project, and then stabilizes in a single county or site, or often at three to seven locations. The survival of programs seems to relate to the creation of a constituency to advocate for its perpetuation. The budget offered by Governor Davis continues in the same spirit. But that open minded approach to new ideas should fit within a structure. Either an approach indicates enormous success, works but is outperformed by alternatives, could be an optimal approach if refined (*e.g.*, works for a certain profile or type of need), or is fatally flawed. Depending on which most applies, it should be altered, redirected to a different population, ended, or rolled out *en masse*. This critical process does not happen for California children's programs. Accordingly, every new program should start with a five-year sunset date. That will drive an evaluation. Each program should expend at 2%–5% of its funding (barring unusual circumstances) on an independent and scientifically valid evaluation of outcomes. Major programs should include two separate evaluations. Based on outcome, the state should either terminate, refine, redirect or generalize programs. Those which have clearly beneficial results deserve widespread state investment so all may benefit.

Proposition 140's budget reductions have limited the Legislature's available resources for monitoring and evaluation. Fewer independent studies are now available than during the 1970s or 1980s, although the number of new experiments under way—particularly affecting children—has grown. The Legislative Analyst, the State Auditor, and the Little Hoover Commission are able to perform important work on selected subjects. But the systematic generation of outcome measurement would give each of them material to work with to more completely inform the Legislature and public. They could take the data presented as to individual programs to give the state a "macro-look." For example, how do the many programs in the area of TANF parent job training compare to each other in job placement, income, and longevity? How do the child care programs for the working poor interact given outcome results as to each? How do the various health insurance coverage options compare to each other in cost, coverage, access, prevention, and services?

Ideally, the State Auditor would be assigned the task of organizing and administering these measurement elements to assure coordination. A percentage of the study funds should be allocated to the Bureau of State Audits for that purpose. The Little Hoover Commission and Legislative Analyst would be in a position to compare results with reported outcomes in other states and jurisdictions of related ideas.

Assuming that spending proposals are intended to have effect beyond titles, press releases, and some grateful local beneficiaries, such a sunset timeline and earmarked evaluation element makes it more likely that a program which does not work will end quickly, or suffer revision, and those which are succeeding will enjoy expansion. Government programs usually lack both a market check and a biological natural selection process—no predators exist to eliminate the weakest and strengthen the species, or to propagate the competent. We must perform that function consciously and optimally accomplish it short of the many millennia which nature requires.

Recommendation #3*: Address Revenue Volatility with an Income Averaging Approach [*Estimated Cost: Partial Assessment of Future Revenues]

As discussed above, the sudden growth of stock options and capital gains from 5% of general fund revenue to 25% in four years, followed by a $9 billion retraction has helped to produce the current budget shortfall. The result of that shortfall has been a drastic proposed budget, with profound long term consequences for children, as discussed above. Given the state's inability to accommodate volatility through deficit spending, it must avoid such disruption costs. It carrying of a $2 billion to $3 billion reserve is inadequate for that purpose, as present events demonstrate.

The state should identify its three most volatile large revenue sources, including stock options, capital gains, and possibly certain elements of corporation and sales taxation (sectors highly responsive to general economic change). It should establish a "baseline" for each such source based on the minimum collection generally obtained. In the case of stock options and capital gains, such a baseline would appear to be in the $4 to $6 billion range. Where revenue is above that baseline level in a given year, a substantial percentage of that overage (from 50% to 70%) should be banked in a separate "income averaging" account, and maintained at an appropriate level for general fund addition to cushion sudden drops. For example, if the baseline were $6 billion and the 67% the reserved amount, the overage of 1998–99 would produce $1 billion for the fund. The overage of 1999–00 would add $4.5 billion, and the overage of 2000–01 would add $7.8 billion. The fund would then have available $13.3 billion for use during a downturn requiring a cushion. California has no such safety net for 2002–03.

Chapter 1

ENDNOTES

1. California Technology, Trade and Commerce Agency, *The California Economy is the Fifth Largest in the World* (Sacramento, CA) (see http://commerce.ca.gov/ttca).

2. Office of Legislative Analyst, *The 2002–03 Budget Bill: Perspectives and Issues* (Sacramento, CA; June 2002) at Figure 6.

3. Office of the Governor, *Governor's May Revise, 2002–03* (Sacramento, CA; May 2002) at 8 (hereinafter *"Governor's May Revise, 2002–03*").

4. *Id*.

5. Center on Budget and Policy Priorities, *Gaps Between High-Income and Other Americans Will Reach Record Level in 1999, Analysis Finds* (Washington, D.C.; Sept. 1999) at 1.

6. John Sladkus, Jean Ross, Kate Breslin, and Scott Harding, California Budget Project, *Working, But Poor, in California* (Sacramento, CA; September 1996) at 25.

7. California Legislative Analyst's Office, *California's Changing Income Distribution* (Sacramento, CA; Aug. 2000) at 2.

8. *Id.*

9. Deborah Reed, Melissa Glenn Haber, Laura Mameesh, Public Policy Institute of California, *The Distribution of Income in California* (San Francisco, CA; July 1996) at vi.

10. *Id.* at 24. Only Michigan had a higher rate of inequality gain from 1969 to 1989.

11. California Legislative Analyst's Office, *California's Changing Income Distribution* (Sacramento, CA; Aug. 2000) at 8.

12. Deborah Reed, *Income Inequality in the Golden State: Why the Gap Has Widened Between Rich and Poor,* Research Brief Issue #17, Public Policy Institute of California (February 1999) at 1–2.

13. See *infra* Appendix A (Table App.-C).

14. Children Now, *California County Data Book 2001* (Oakland, CA; 2001).

15. See *infra* discussion and citations in Chapter 2 (Figure 2-A).

16. U.S. Census Bureau, *Housing Vacancies and Homeownership Annual Statistics: 2001* (Washington, D.C.; 2002) at Table 13.

17. *Id.*

18. See Bureau of the Census, *Residential Population Estimates by Age, Sex, and Race for the Years 1970–1996* and *Population Projections of the United States by Age, Sex, Race, and Hispanic Origin: 1995–2050* (Washington, D.C.; 1999), cited in *Juvenile Offenders and Victims: 1999 National Report* (Washington, D.C.; 1999) at Chapter 1.

19. See Appendix A (Table App.-B).

20. This figure is applicable to the 48 contiguous states and the District of Columbia. Note that there are two separate federal measures of poverty. The "poverty thresholds" for various family sizes were the original format developed by Mollie Orshanksy of the Social Security Administration. These thresholds are used for statistical purposes, *e.g.,* estimating the number of children in poverty each year.

    In contrast, the "poverty guidelines" are issued each year in the Federal Register by the U.S. Department of Health and Human Services (DHHS). They are a simplification of the more complex "thresholds" above for administrative purposes, including eligibility for income related programs. The guidelines below are in effect as of February 14, 2002 and are popularly referred to as the "federal poverty line." For the 48 contiguous states, they are:

Size of family unit	Poverty guideline
1	$8,860

2	11,940
3	15,020
4	18,100
5	21,180
6	24,260
7	27,340
8	30,420
additional members	add $3,080 each

Source: Federal Register, Vol. 67, No. 31 (Feb. 14, 2002) at 6931-6933; see also http://aspe.hhs.gov/poverty/02poverty.htm

21. See *infra* Chapter 2 at Table 2-A.

22. See California Department of Education, Educational Demographics Unit, *Number of English Learners in California Public Schools, by Language and Grade, Ranked by Total, 2000-01* (Sacramento, CA; 2002) and *Statewide Enrollment in California Public Schools by Grade, 2000-01* (Sacramento, CA; 2002).

23. See U.S. Census Bureau Report released October 4, 2000, summarized by Melissa Healy and Robert Rosenblatt, *State Leads as Home to Immigrants*, L.A. TIMES, October 5, 2000, at 1.

24. Mary C. Daly, Deborah Reed, and Heather N. Royer, *Population Mobility and Income Inequality in California*, Public Policy Institute of California, California Counts Vol. 2, No. 4 (May 2001) at 1-2.

25. See Office of the Governor, *Governor's Budget Summary 1998–99* (Sacramento, CA; January 1998) at Appendix 24 (Schedule 6). The employees per 1,000 population has increased from 8.0 in 1964-65 to 9.9 in 1977-78, to 9.1 currently and 9.0 as proposed in 2001-02 (see Office of the Governor, *Governor's Budget Summary 2001–02* (Sacramento, CA; January 2001) at Appendix 25 (hereinafter "*Governor's Budget Summary 2001–02*").

26. *See Governor's Budget Summary 2000–01, supra* note 25, at 31 (tobacco settlement estimate of $388 million), at 121 (Proposition 99 projection at $394 million), at 143 (Proposition 10 revenues estimated at $719 million). Note that total revenues from the tobacco tax, only a portion of which is applied to children, plus the direct child welfare funds, total approximately 4% of the special fund total. Although some special fund revenues, particularly a designated portion of vehicle registration fees, are now realigned to the counties for what should include child-related purposes; this assignment is in lieu of general fund moneys taken from previous local and state sources, and has been set at an adjusted amount lower than funds previously contributed by the state.

27. See *supra* Table 1-C.

28. See compilation of data by county presented by Tom Zembar, American Federation of State, County and Municipal Employees, *California Cuts in Federal Aid Under the Congressional Budget Resolution* (July 29, 1996) in implementation of H.R. Cong. Res. 178. Note that the calculation here adjusts for inflation for accounts subject to appropriation caps (*e.g.*, Head Start), and for inflation and population for those accounts historically subject to entitlement status (*e.g.*, AFDC). We have subtracted the major non-child account (highway planning and spending reductions) from the study's totals for projected federal reductions; these subtractions amount to $67.8 million for 1997, $68.8 million for 2002, and total $427.4 million for the 1997–2002 five-year period.

29. See Andy Schneider, Center on Budget and Policy Priorities, *Overview of Medicaid Provisions in the Balanced Budget Act of 1997, P.L. 105-33* (Washington, D.C.; September 8, 1997) at 8–10.

30. See Office of the Governor, *Governor's Budget Summary 2002–03* (Sacramento, CA; January 2002) at 8 (hereinafter "*Governor's Budget Summary 2002–03*").

31. Senate Committee on Budget and Fiscal Review, *Overview of the 2002–03 Budget Bill* (Sacramento, CA; January 2002) at 19 (hereinafter *"Overview of the 2002–03 Budget Bill*").

32. Property tax revenues contributed to education (school district accounts throughout the state budget) totaled $5.3 billion in 1991, $6.5 billion in 1992, and $8.2 billion in 1993.

33. Except note that the law makes three exceptions to the 1.5% permitted add-on: San Mateo may go to 2%, San Francisco to 1.75% and San Diego only to 1%.

34. *Governor's Budget Summary 2002–03, supra* note 30, REV -13 at 108.

35. This adjustment uses the conservative COLA and overall population, see Appendix at end of Budget, App.-A and App.-B, respectively.

36. Frank Mecca, *Estimated Staff Reductions Related to May Revision Cuts* (Sacramento, CA; May 15, 2002) Table 1 at 1.

37. See Office of the Governor, *Governor's Budget 2002–03* (Sacramento, CA; January 2002) at HHS 151.

38. In addition, Proposition 8 enacted in 1979 requires reassessments where property values decline, as occurred in 1991–1996. While market increases in value do not increase assessments, reductions in value can compel a reassessment reduction.

39. Total state-assessed value growth was held to 2.8% in 1993–94, 1.3% in 1994–95, 1.0% in 1995–96, 3.0% in 1997–98, and 5% for 1998–99; these increases are below inflation and population gain which average 5%–6% and create increasing financial pressure on counties. See Office of the Governor, *Governor's Budget Summary 1998–99* (Sacramento, CA; January 1998) at 80 (hereinafter "*Governor's Budget Summary 1998–98*").

40. See June Gin, *Legislative Analyst's Office and Local Government Reflect on Proposition 218's Impact,* CAPITOL WEEKLY (Jan. 6, 1997) at 1.

41. *Governor's Budget Summary 2002–03, supra* note 30, at 113.

42. *Id.*

43. The remainder goes to counties (22%), cities (11%), and special districts (16%), and pays for such things as police, fire protection, courts, and other local services outside of the state budget.

44. *Serrano v. Priest* (1971) 5 Cal. 3d 584.

45. *Governor's Budget Summary 1998–99, supra* note 39, at 80.

46. The Governor proposes to spend $78.6 billion general fund monies for 2002–03, as Revised in May 2002.

47. Office of the Governor, *Governor's Budget Summary 1996–97* (Sacramento, CA; January 1996) at 72–73.

48. The tax rates for alcohol and tobacco have increased somewhat from historical levels, *e.g.,* the passage of Proposition 99 (The Tobacco Tax and Health Protection Act of 1988). However, declining cigarette consumption has reduced tobacco tax revenue since 1989.

49. For one listing of such expenditures, see California Department of Finance, *Tax Expenditure Report, 2000–01* (Sacramento, CA; February 2002) at 1–12.

50. *Governor's Budget Summary 2002–03, supra* note 30, at 101; for $5.9 billion figure, see *Overview of the 2002–03 Budget Bill, supra* note 31, at 19.

51. Office of the Legislative Analyst, *California's Tax Expenditure Programs* (Sacramento, CA; February 1999) at 8 (see www.lao.ca.gov).

52. See Table 1-C. Note that special fund sources have increased substantially more than has population and inflation, while general fund spending has increased about 1% over general population increase.

53. California Budget Project, *Who Pays Taxes in California?* (Sacramento, CA; April 15, 2002) at 1.

54. *Id. See also* Citizens for Tax Justice, *A Far Cry From Fair* (Sacramento, CA; 1991) (hereinafter "*A Far Cry From Fair*"). The quintile comparisons measure average total tax burden for a four-person family.

55. *A Far Cry from Fair, supra* note 54.. The study found that since 1985, the poorest one-fifth of the population had its tax percentage of income increase by 19%, more than double that of any other quintile, while the tax percentage of the wealthiest one-fifth increased only 1%.

56. Joel Friedman, Richard Kogan, and Robert Greenstein, *Final Tax Bill Ultimately Costs as Much as Bush Plan*, Center for Budget and Policy Priorities (Washington, D.C.; May 29, 2001) at 1–3 (see www.cbpp.org).

57. *Id.*

58. Robert Greenstein and Richard Kogan, *What the New CBO Projections Mean*, Center on Budget and Policy Priorities (Washington, D.C.; January 31, 2001) at 1-4 (see www.cbpp.org).

59. *Id.*, at 4.

60. Center on Budget and Policy Priorities, *Overview Assessment of President Bush's Tax Proposal* (Washington, D.C.; February 15, 2001) at 1-2 (see www.bpp.org).

61. *Id.* A narrow exemption could be crafted to address such a concern (indeed, attorney-developed probate planning tactics, including incorporation and inter vivos trusts commonly loophole much current estate taxation).

62. Center on Budget and Policy Priorities, *Bush Tax Cut Tilts Toward Top* (Washington, D.C.; February 7, 2001) at 1 (see www.cbpp.org).

63. Kaiser Famiily Foundation, *The President's Fiscal Year 2003 Budget: An Overview of Health Programs* (March 8, 2002) Chart 3 at 8, citing CBO estimates of January 2002.

64. The United States will spend $396 billion for military purposes in fiscal 2003. The next largest military budget is Russia's at $60 billion. The 47 other major nations of the world combined spend $420.7 billion as of 2001. Christopher Hellman, *Last of the Big Time Spenders*, Center for Defense Information (2002) (see www.cdi.org/issues/wme/spendersFY03.html). Note that the $420.7 billion may be somewhat higher in the comparable year of 2003. However, the U.S. amount does not include $190 billion in indirect defense costs: military retirement pay, veterans' benefits, and interest attributable to past defense spending. See Center for Defense Information, *Military Almanac 2001–02* (2002) at 34 (see www.cdi.org).

65. For a description of PUC proceedings detailing the history of deregulation, see the *California Regulatory Law Reporter* (CRLR), a publication monitoring the PUC and other regulatory agencies, published by the Center for Public Interest Law, the parent organization to the Children's Advocacy Institute (see www.cpil.org). *See, e.g., 17:1 CRLR 170-175; 16:2 CRLR 140–44; 16:1 CRLR 158–62; 15:4 CRLR 234-37.*

66. The Department is not able to exercise the kind of buyer's monopsony power that could match a cartel-like pattern of sellers. Rather, DWR purchased "net short" power, essentially the market gap between demand and existing bilateral contracts and Qualifying Facility generated power, the area where the spot market excesses are centered.

67. *Governor's May Revise, 2002–03, supra* note 3, at 2.

68. Of the $78.8 billion in anticipated 2002–03 general fund expenditures, 53.8% goes to K–12 and higher education. The latter is included within the Children's Budget as a critical part of youth opportunity, even though its beneficiaries are over 18 years of age. Of the 7% general fund monies for corrections, about 1% is youth related. Of the 27.4% expended for Health and Human Services, we allocate 60% for children, or 16.4%. Children make up about 70% of TANF and food stamp beneficiaries, and the child only category is now expanding substantially. The child share of health spending is less, but remains substantial given the separation out of Medi-Care monies , and the inclusion of child welfare services, adoption, foster care, and the other accounts discussed in Chapters 2 through 8 below. Finally, a small portion of trial court funding is allocated to juvenile courts and bringing the percentage to 72%.

69. See *Governor's Budget Summary 2002–03, supra* note 31, Schedule 6 at Appendix 25. Note that the selection of 1978–79 may be fairly matched. In some other years special fund monies was included in the general fund total in the Schedule, but the 1978–79 total is roughly comparable to current general fund definition. For example, Proposition 13 and the *Serrano* decision sending some property tax funds to the state's general fund had both been implemented. The personal income numbers in Schedule 6 have been updated consistent with the most recent May Revise estimates of increase (see Table 1-A above). The formula 16.25/219.7 = X/1.123 yields a general fund total of $91 billion for 2002–03 at the same ratio of general fund collection/spending extant in 1978–79.

70. *Overview of the 2002–03 Budget Bill, supra* note 31, at 19.