



Overview of the 2000-01 Governor's Budget

Introduction

On January 10, 2000, the Governor released his proposed \$85 billion 2000-01 state budget. This report provides a brief review of the Governor's plan and our preliminary reactions to it.

LAO Findings

- ❖ The Governor's initial budget proposal for 2000-01 focuses primarily on education, and contains relatively few new ongoing initiatives elsewhere. The budget is fiscally prudent and contains a mix of one-time and ongoing commitments.
- ❖ In K-12 education, the budget proposes significant increases for initiatives aimed at student achievement; teacher recruitment, retention and training; and new technology.
- ❖ The new proposal recognizes major improvements in the economic and revenue outlook since the 1999-00 budget was enacted last summer, and its assumptions are slightly more optimistic than our November report.
- ❖ However, recent economic and revenue trends have continued to far surpass expectations. These positive trends are likely to result in revenues exceeding the budget forecast by \$3 billion in the current year and budget year combined.
- ❖ In reviewing the Governor's budget plan, the Legislature will have the opportunity to both (1) evaluate the Governor's spending and tax initiatives to determine if they meet its own priorities, and (2) set legislative priorities for allocating \$3 billion in additional funds which are not recognized in the budget.
- ❖ Regarding the additional revenues, we believe that the current-year portion of the additional revenue increase—about \$1.5 billion—should be devoted to one-time purposes, such as further building up the reserve. The estimated increase for the budget year—also about \$1.5 billion—could be available for ongoing commitments, whether for new spending or tax relief.

Legislative Considerations

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OVERVIEW OF THE GOVERNOR'S BUDGET

THE BUDGET TOTALS

The Governor's 2000-01 budget proposes total state spending of \$85.1 billion (excluding expenditures of federal funds and selected bond funds), an increase of 3.7 percent from the current year. About 80 percent of this total is from the General Fund and 20 percent is from special funds.

As shown in Figure 1, the budget assumes that General Fund revenues will total \$68.2 billion in 2000-01, a 4.7 percent increase from the current year. General Fund expenditures are proposed to be \$68.8 billion, an increase of 4.5 percent. After accounting for various set-asides, the year-end reserve is estimated to be \$1.2 billion, or about 1.8 percent of total 2000-01 General Fund revenues.

MAIN FEATURES OF PROPOSAL

Figure 2 summarizes the key elements of the Governor's 2000-01 budget plan.

Focus Is on Education. As was the case last year, the Governor's budget proposal for 2000-01 focuses on education. It uses both Proposition 98 and non-Proposition 98 funds to support various K-12 initiatives directed at student

achievement; teacher recruitment, retention and training; and technology. It also includes substantial funding increases for higher education, partly to cover a new partnership agreement with the California State University (CSU) and University of California (UC) systems, expanded financial aid, and acceleration of the opening of the new UC Merced campus.

Modest Changes in Other Areas. Outside of education, the new proposal is largely a workload budget, which funds existing programs and makes adjustments for workload and most cost-of-living increases. It contains modest new spending initiatives and a tax credit relating to long-term

Figure 1
Governor's Budget General Fund Condition
1998-99 Through 2000-01 (In Millions)

	1998-99	1999-00	2000-01
Prior-year fund balance	\$2,920	\$3,708	\$3,012
Revenues and transfers	58,615	65,160	68,236
Total resources available	\$61,535	\$68,868	\$71,249
Expenditures	\$57,827	\$65,856	\$68,819
Ending fund balance	\$3,708	\$3,012	\$2,430
Encumbrances	\$592	\$592	\$592
Set-aside for legal contingencies	—	—	500
Set-aside for legislation	—	—	100
Reserve	\$3,116	\$2,420	\$1,238

Detail may not total due to rounding.

Figure 2

Key General Fund Budget Proposals

- K-12 Education.** Includes \$900 million for new initiatives targeting student achievement; teacher recruitment, retention and training; and new technology. Almost two-thirds of the total counts toward Proposition 98 purposes, and the remainder is from non-Proposition 98 funds.
- Higher Education.** Provides significant funding increases for a new partnership agreement, acceleration of the opening of UC Merced, increases in Cal Grant awards, and teacher preparation initiatives.
- Long-Term Care Initiative.** Contains \$93 million in spending and \$47 million in tax credits for initiatives to improve senior care.
- CalWORKs.** Prohibits counties from earning new incentive payments in the budget year resulting in savings of \$496 million.
- Tax Relief.** Contains \$167 million in tax relief in 2000-01 (including the long-term care credit). Proposes increases in net operating loss deductions, expansion of the research and development credit, and a one-time tax credit for land donations.
- Transportation.** Incorporates one-time General Fund expenditures for various rail projects. Also includes proposals to accelerate existing special funds and federal funds revenues for various transportation projects.
- One-Time Commitments.** Contains about \$2.9 billion in one-time commitments and set-asides, including \$1.1 billion for litigation.

care (the “Aging With Dignity” initiative), but no major new ongoing commitments elsewhere.

Includes Large Amount of One-Time Commitments. The budget contains about \$2.9 billion in one-time commitments and set-aides in the current year and budget year combined. Key one-time commitments are shown in Figure 3.

Figure 3

Key One-Time Commitments Proposed in Governor’s Budget

(In Millions)

Purpose	Amount
Smog impact fee rebate	\$562
Set-aside for legal contingencies	500
Direct appropriations for capital outlay	400
Increase in budgetary reserve	358
Rail projects	121
Tax credit for land donations	100
Set-aside for legislative initiatives	100
Grants for local law enforcement	100
School bus replacement	50
Down-payment assistance for teachers	50



BUDGET'S ECONOMIC AND REVENUE OUTLOOK

The Economy

The budget's forecast for both the nation and California has improved markedly since the 1999-00 budget was enacted last summer. The budget's outlook is slightly more optimistic than our November projections, and generally consistent with other forecasts made near the end of 1999. It assumes that after a very strong year in 1999, economic growth at both the national and state levels will slow some over the next 18 months, but still remain healthy. For example, the budget forecasts that after increasing by 6.6 percent in 1999, personal income will grow a further 6.5 percent in 2000 and 5.7 percent in 2001.

Revenues

The administration forecasts that General Fund revenues and transfers will increase from \$58.6 billion in 1998-99 to \$65.2 billion in 1999-00, an 11.2 percent growth rate. The updated forecast for the prior and current years is up by a combined total of \$2.9 billion, reflecting the improved economic outlook and healthy cash receipts from the state's major revenue sources. The budget forecasts that revenue growth will slow to 4.7 percent next year, bringing revenues to \$68.2 billion in 2000-01. This modest gain partly reflects the impact of proposed tax reductions that total \$167 million. It is also based on the assumption that capital gains will fall by 5 percent in 2000 and remain flat in 2001, after having climbed by 22 percent in 1999.

The LAO's Initial Assessment. The budget's updated revenue forecast reflects a major upward revision since last summer, and is up slightly from

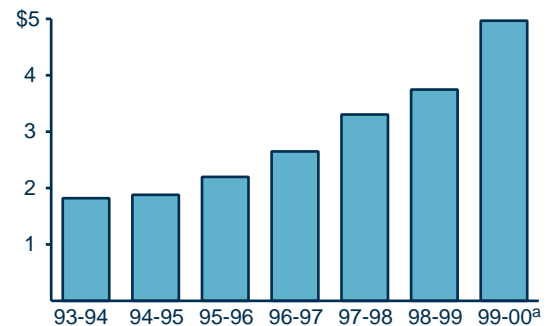
our November projections. However, it does not fully reflect the extraordinarily positive revenue developments that occurred late last year (mostly after the budget forecast was prepared). For example, personal income tax withholding, which is a key measure of current wage and employment trends, increased dramatically late in the year—by over 25 percent in November and 15 percent in December relative to the same months of the prior year—suggesting considerable strength in wages, bonuses, and stock options in late 1999.

Equally important, year-end estimated tax payments were up by 32 percent from the prior year (see Figure 4). This dramatic growth indicates that capital gains once again experienced a major increase in 1999. In past years, strong year-end payments have been followed by equally strong final payments on tax returns the following April.

Figure 4

Booming Year-End Income Tax Receipts Indicate Another Strong Year

December and January Estimated Tax Payments
(In Billions)



^a Data for last half of January 2000 are estimated, based on historical intramonth cash patterns.

Based on these recent positive trends, our initial estimate is that revenues will exceed the budget forecast by roughly \$1.5 billion in both the current year and budget year, for a two-year total of \$3 billion. Our higher estimate assumes that California's economy avoids a serious slowdown during the next 18 months, and that the stock market avoids a steep and prolonged retrenchment, which could depress capital gains. We will provide a more complete and updated assessment of the revenue outlook next month in *The 2000-01 Budget: Perspectives and Issues*.

Proposition 98 Interaction. The added revenues we project will not have a direct impact on the Proposition 98 minimum funding guarantee. The improvement in California's overall economy could have some impact, through its effect on per-capita personal income reported for the fourth quarter of 1999. However, we believe that the effect will likely be smaller than the \$257 million over-appropriation of the 2000-01 guarantee proposed in the budget.

GOVERNOR'S BUDGET PROPOSALS BY PROGRAM AREA

Figure 5 shows General Fund spending by major program areas for fiscal years 1998-99 through 2000-01. It shows that the budget proposes a 12 percent increase for higher education; approximately 6 percent growth for K-12 education, community colleges, Medi-Cal, SSI/SSP and "other" health and social services programs; and slightly less than 4 percent growth for Youth and Adult Corrections. The budget reflects an increase for the California Work Opportunity and Responsibility to Kids

Figure 5

General Fund Spending by Major Program Area

(Dollars in Millions)

	Actual 1998-99	Estimated 1999-00	Proposed 2000-01	
			Amount	Percent Change
Education Programs				
K-12 Education	\$23,528	\$26,366	\$28,014	6.3%
Community Colleges	2,260	2,452	2,613	6.6
UC/CSU	4,632	4,912	5,506	12.1
Other Higher Education	510	581	656	12.9
Health and Welfare Programs				
Medi-Cal	\$7,471	\$8,209	\$8,749	6.6%
CalWORKs	2,022	1,994	2,072	3.9
SSI/SSP	2,242	2,483	2,620	5.5
Other	4,327	5,157	5,479	6.2
Youth and Adult Corrections	\$4,547	\$4,868	\$5,054	3.8%
All Other^a	\$6,287	\$8,835	\$8,055	-8.8%
Totals	\$57,827	\$65,856	\$68,819	4.5%

^a The 2000-01 decline is partly due to one-time spending in 1999-00.



(CalWORKs) program, but this is due to technical changes related to the child support programs. After adjusting for these changes, the budget would reflect a decrease of about 6 percent. Finally, the budget shows that combined spending on all other programs is proposed to decline by 8.8 percent in the budget year. This decline reflects the large number of one-time expenditures in the current year.

K-12 Education

The budget proposes a 6 percent increase in K-12 education spending from all funding sources. Proposition 98 allocations (which include local property tax revenues) to K-12 schools total \$35.8 billion in 2000-01. This represents an increase of over \$1.9 billion, or 5.7 percent, over the current-year estimate. Per pupil spending under Proposition 98 increases by \$268, or 4.4 percent, from \$6,045 per pupil to \$6,313 per pupil. The budget proposes Proposition 98 spending that exceeds the estimated minimum funding guarantee by \$257 million.

How Are the New Proposition 98 Monies Spent? Figure 6 displays the major proposed uses of the additional \$1.9 billion of Proposition 98 funds. The largest share—\$947 million (49 percent)—would provide a 2.84 percent cost-of-living adjustment (COLA) for district and county office apportionments (revenue limits) and categorical programs. General purpose and categorical program funding for the projected 1.26 percent growth in the student population accounts for \$428 million, or 22 percent, of new Proposition 98 funds. Providing full-year funding for programs that began in the current year and other

net adjustments account for \$98 million, or 5 percent of new funding.

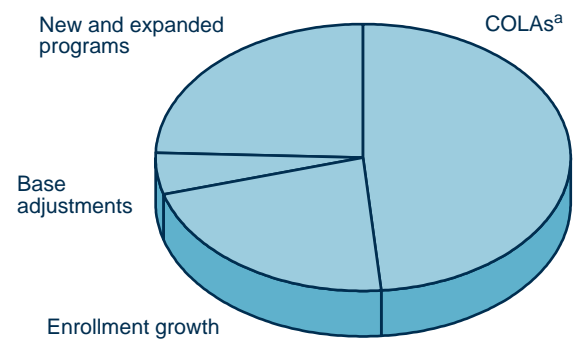
The budget allocates the remaining funds for a variety of new and expanded *categorical* spending programs, over which school districts would have minimal discretion. Several of these proposals, and a significant share of the monies, are directed at teacher training and recruitment and retention. Other major funding augmentations are proposed for education technology, and summer school/after school programs.

Spending Outside of Proposition 98. In addition, the budget proposes significant new expenditures that are directed at K-12 education, although the funding does not go to local educational agencies and is “outside” of Proposition 98. These include \$118 million for scholarship awards for high school students who score high on standardized tests, \$70 million for expansion of teacher training programs administered by UC, \$50 million

Figure 6

Proposed Use of New K-12 Proposition 98 Funds

2000-01



^aCost-of-living adjustments.

to replace polluting school buses, and \$50 million for a Teachers Home-Buyers Assistance Program (all General Fund amounts).

Higher Education

Community Colleges. The budget proposes a 6 percent increase in California Community Colleges funding. This increase includes funding for a 2.84 percent statutory COLA and 3 percent enrollment growth. The budget also proposes new funds for the Partnership for Excellence program, as well as initiatives aimed at improving access for low-income students.

The UC and CSU. The budget proposes increases of 14.8 percent for UC and 8.7 percent for CSU in 2000-01. The new funds support a 6 percent base increase for both segments, enrollment growth (budgeted at 3.6 percent for UC and 4.5 percent for CSU), the various teacher-training costs associated with the Governor's K-12 education initiatives, and other costs. The budget also proposes \$75 million to construct the California Institutes for Science and Innovation at three UC campuses, and provides \$25 million in one-time funds for UC teaching hospitals to purchase new equipment.

Other Programs

CalWORKs. The budget proposes \$2.1 billion in General Fund expenditures for the CalWORKs program in 2000-01, a 3.9 percent increase from the current year. The budget includes a 3.6 percent statutory COLA effective October 2000 and

fully funds the estimated need for child care and employment services for CalWORKs recipients. It assumes enactment of legislation prohibiting counties from earning new performance incentive payments until the estimated prior obligation of incentive payments owed to the counties (approximately \$364 million) has been satisfied. This policy change results in General Fund savings of \$496 million in 2000-01.

Medi-Cal. The budget proposes Medi-Cal spending of \$8.7 billion in 2000-01, a 6.6 percent increase from the current year. This amount includes funding for a reduction in the state "takeout" from disproportionate share hospital funding, a 5 percent increase in wages for nursing home workers (which is part of the Governor's Aging With Dignity initiative), and some modest proposed increases in Medi-Cal eligibility. The budget also includes funding to cover substantial increases in prescription drug costs.

Youth and Adult Corrections. The budget includes \$5 billion for Youth and Adult Corrections, representing a 3.8 percent increase from the current year. For the Department of Corrections, the budget includes funding to cover a modest 1.5 percent increase in the inmate population and a 2.6 percent increase in the parole population. The budget includes augmentations for substance abuse treatment program expansion, and increased parole supervision for selected parolees.



CONSIDERATIONS FOR THE LEGISLATURE

The *2000-01 Governor's Budget*, like last year's initial proposal, focuses primarily on education, and contains relatively few major ongoing initiatives elsewhere. The budget is fiscally prudent, in that it contains an increased reserve, sets aside significant funds for various contingencies, and reflects a mix of one-time versus ongoing commitments.

However, we believe that the budget seriously understates the amount of revenues that will be available in the current and budget years. Thus, in evaluating the Governor's plan, the Legislature will need to consider both the Governor's proposals

and its own priorities for allocating \$3 billion in *additional* funds which are not recognized in the budget.

In considering these additional resources, we believe that the current-year portion of the revenue increase—about \$1.5 billion—should be devoted to one-time purposes, such as further building up the reserve. In contrast, the increase estimated for the budget year—also about \$1.5 billion—could be available for ongoing commitments, involving either new or expanded spending or tax relief.

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