

California's Budget Woes: How Is Our Fiscal Health?



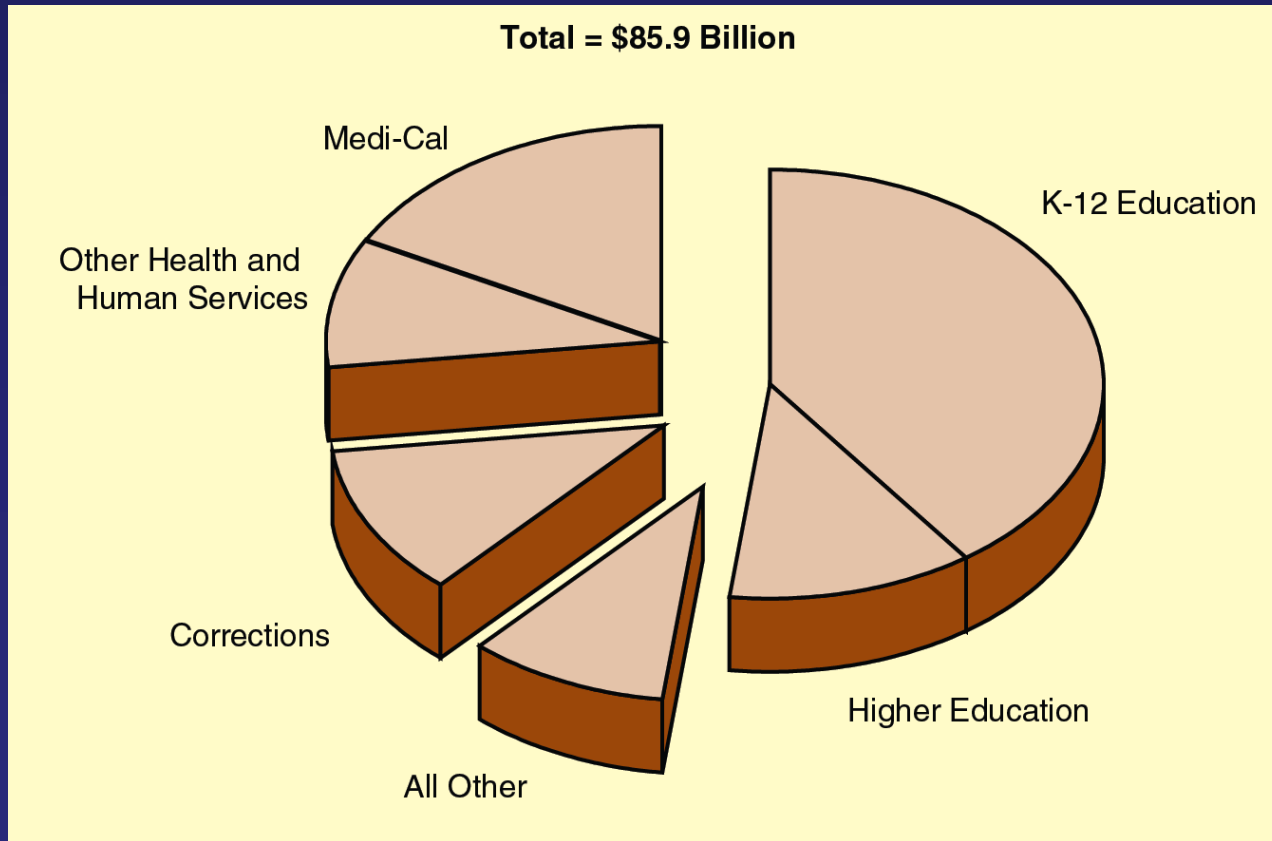
Legislative Analyst's Office

Randall Lewis Seminar Series
University of California, Riverside
October 27, 2011

Background

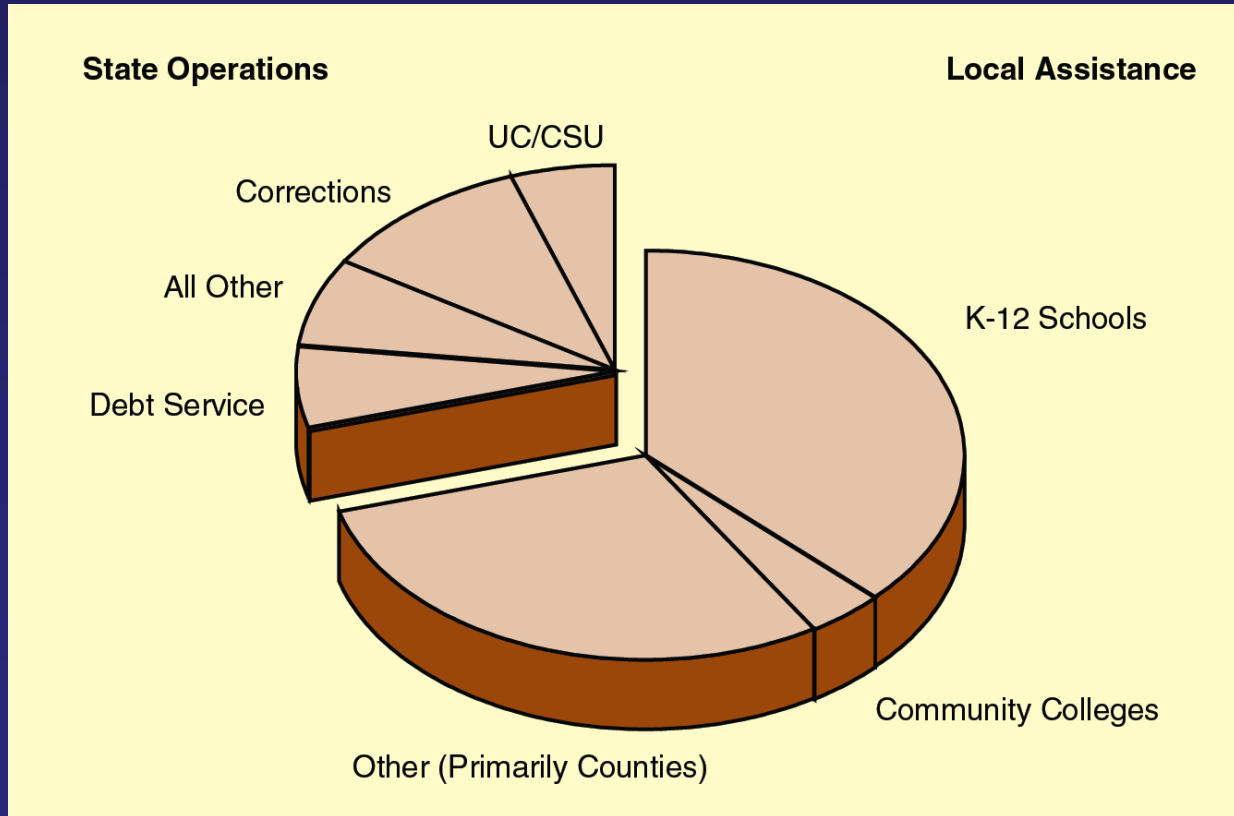
General Fund Spending By Program

2011-12



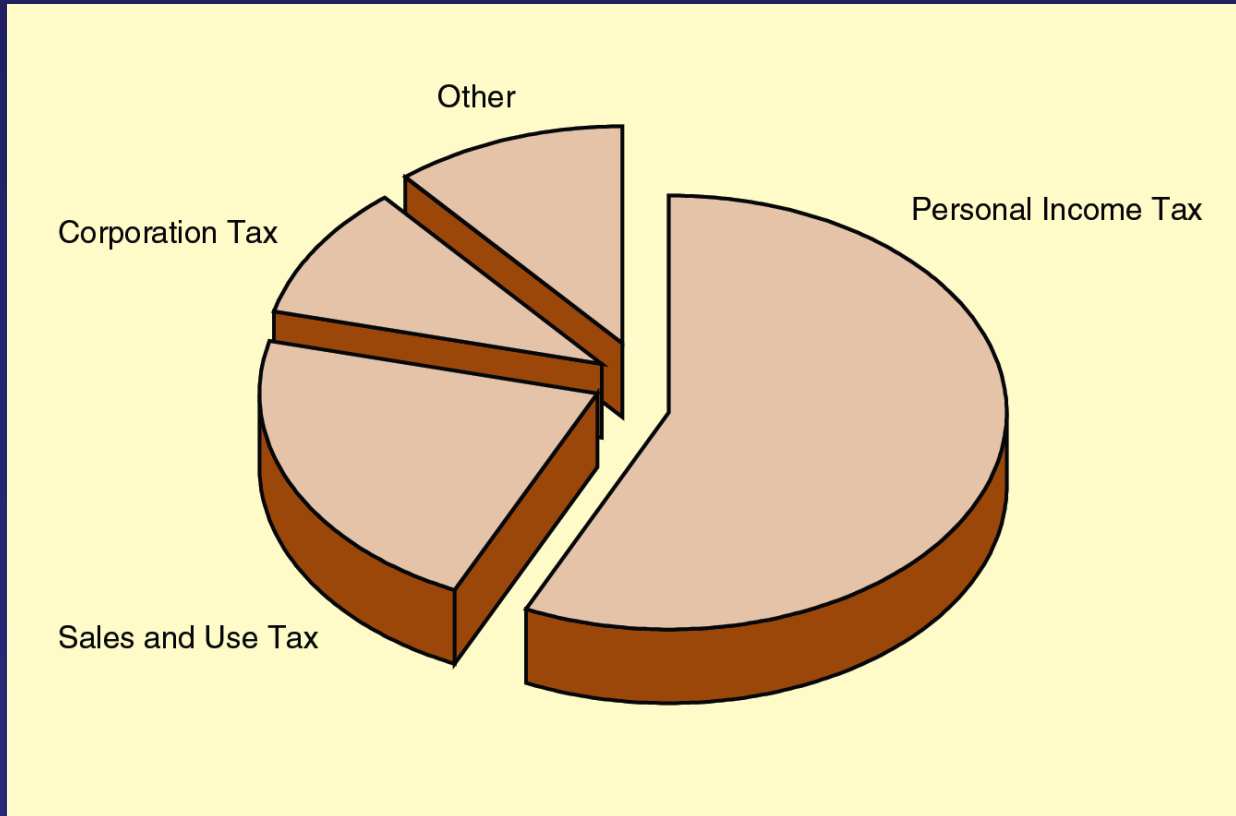
General Fund Spending By Object

2011-12



General Fund Revenues

2011-12



The Change in Our General Fund Revenue Structure

	Percent of Total	
	1969-70	2011-12
Personal Income Tax	27%	57%
Sales and Use Tax	40	22
Corporation Tax	14	10
Other	19	11
	100%	100%

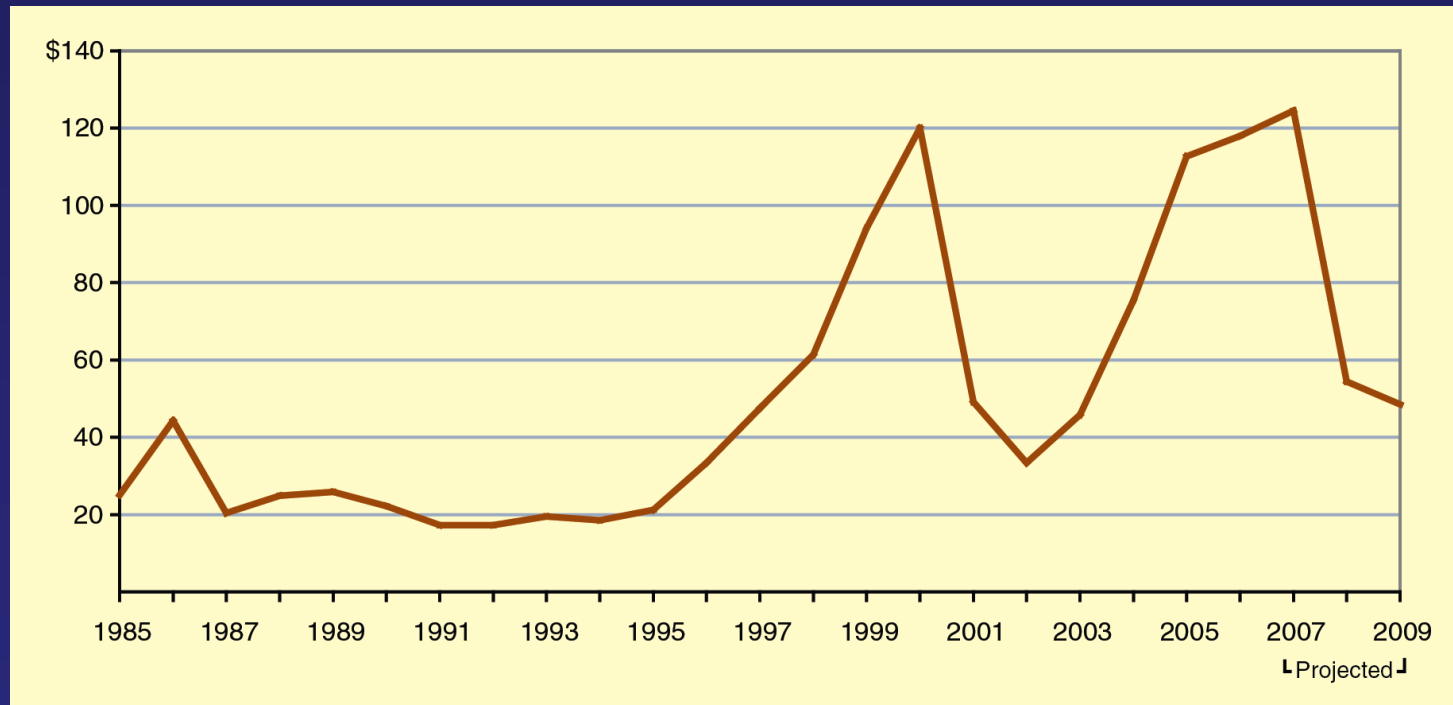
The Origins of Our Situation

Increasing Revenue Volatility

- **What Is Volatility?**
 - State revenues change more dramatically than the economy.
- **From 1979-80 Through 2003-04, Revenues Were *Twice* as Volatile as the Economy**
- **From 1991-92 Through 2003-04, Revenues Were *3 ½ Times* as Volatile**

The Capital Gains Roller Coaster

Net Capital Gains Income in California (In Billions)



Poor Budgeting Practices

- **Failure to Build Up Reserves During the Good Times**
- **Boom in Revenues Used for Ongoing Spending Commitments and Tax Relief**
 - Did do some one-time spending (capital outlay).

Use of Debt to Finance Operating Shortfalls

- **2003-04: \$10.7 Billion Deficit Financing Bond**
- **March 2004: Voters Approved \$15 Billion “Replacement” Bond Measure**

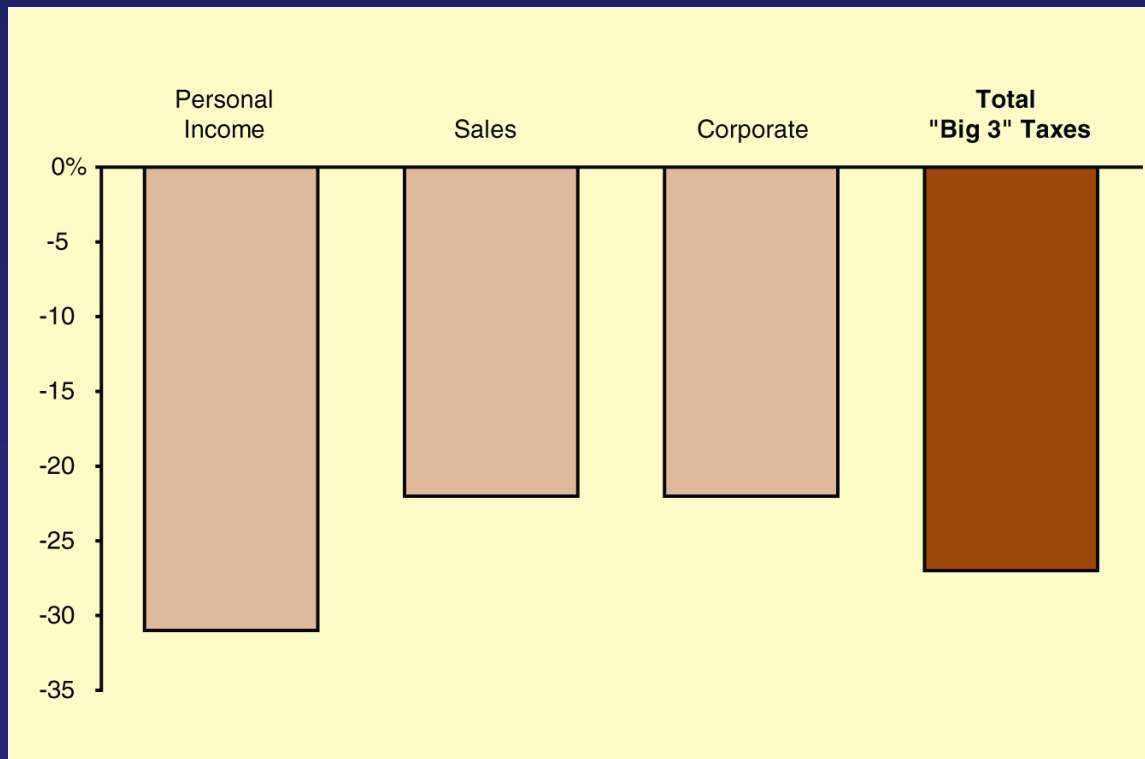
End Result—State Entered Recession in Poor Fiscal Shape

- **State Had an Underlying Out-Year Budget Problem in Excess of \$7 Billion**
- **No Budgetary Reserve to Cushion Blow of Recession**

Addressing Our Budget During the Recession

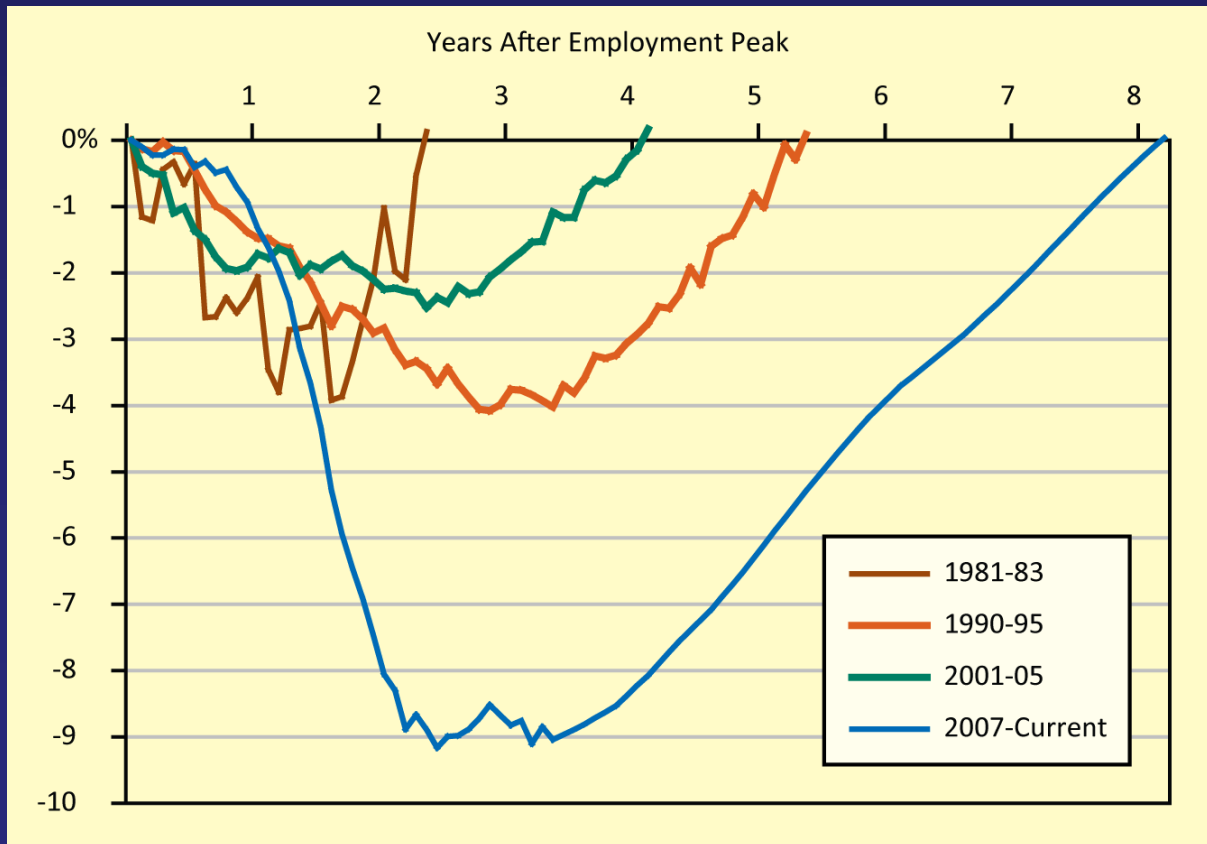
Recession Devastated State Revenues

Percent Reduction in Baseline Revenues
November 2010 Estimates Compared to January 2008 Estimates



Very Modest Recovery Forecast

Job Loss in Percent



How Big Have Our Budget Deficits Been?

(In Billions)

2008-09	\$24.3
2009-10	60.0
2010-11	19.3
2011-12	27.2

The 2011-12 Budget

Actions to Close the 2011-12 Budget Gap

Two-Year General Fund Benefit (In Billions)

Expenditure-Related Actions	\$11.1
Revenue-Related Actions	13.2
Borrowing and Transfers	2.9
Total	\$27.2

Major Expenditure-Related Actions

Two-Year General Fund Benefit (In Billions)

Medi-Cal	\$2.0
Redevelopment	1.7
UC and CSU	1.4
Fuel tax swap	1.1

Major Revenue-Related Actions

Two-Year General Fund Benefit (In Billions)

Score additional revenues	\$11.8
May Revision	(6.6)
Final budget—2010-11	(1.2)
Final budget—2011-12	(4.0)
Various other fee and revenue measures	1.1

Revenue-Related Proposals Not Included in the Budget

- **Extension of Tax Rate Increases Adopted in 2009**
 - Personal income tax (PIT), sales and use tax (SUT), vehicle license fee (VLF)
- **Tax Provisions**
 - Mandatory single sales factor.
 - Changes to enterprise zone credits.
 - Sales tax exemption for manufacturing equipment.

Impacts on Local Government

Realignment—Major Shift in Services From State to Counties

- **Transfers Over \$6 Billion in Services**
 - Adult and juvenile offenders and parolees.
 - Mental health programs.
 - Foster care and child welfare services.
- **Provides Counties With Equivalent Ongoing Funding Sources**
 - Just over 1 percent of state sales tax.
 - Certain VLF revenues.

Realignment—Major Service Delivery Changes in Correctional Programs

- **Lower-Level Offenders, Parole Violators, and Parolees Will Now Be Served Locally**
- **Estimated to Reduce State Prison Population by 40,000 Inmates (About 25 Percent) by 2014**

Redevelopment Agencies

- **One Bill Eliminated All Redevelopment Agencies**
- **A Second Allows Existing Agencies to Continue if They Make Payments to Other Local Agencies**
- **State Savings of \$1.7 Billion in 2011-12 and \$400 Million Annually Thereafter**
- **Currently Challenged in Courts**

The Trigger

Mechanism Established to Address Revenue Shortfall

- **Given \$4 Billion Revenue Assumption, State Adopted Cuts to Go Into Effect Mid-Year if Monies Fail to Materialize**
- **Spending Reductions Would Cover About 60 Percent of Potential Shortfall**

Trigger Reductions Fall Into Two Tiers

- **Tier 1: Revenues Fall at Least \$1 Billion Short**
 - \$600 million in specific cuts (such as \$100 million to the University of California).
- **Tier 2: Revenues Fall More Than \$2 Billion Short**
 - Up to \$1,860 million in education cuts, primarily K-12.
 - K-12 cut prorated, based on revenue shortfall.

Key Challenges

Closing Our Remaining Budget Gap

- **The State Made Much Greater Progress in 2011-12 in Reducing Structural Budget Problem**
- **We Are Still Likely to Have a Significant Problem Next Year**
 - Revenues will be key.
- **Our Mid-November Fiscal Forecast Will Estimate Remaining Problem in 2012-13 and Out-Years**

Deciding on the Size of the Public Sector

- **Much of the Debate—at Both State and Federal Level—Comes Down to:**
 - What is the appropriate size of government?
- **Your Answer Determines Whether You Support New Revenues or Expenditure Reductions**
- **If Governor Has His Way, You Will Have a Chance to Vote on Revenue Increases This November**

Addressing Budget-Related Obligations

- **The State Has Accumulated a Variety of Deferred Expenses Over the Past Decade:**

	Billions
School shortfalls	\$10.4
Deficit-financing bonds	7.2
Special fund loans	6.4
Mandate claims	4.7

Addressing Public Employee Post-Retirement Obligations

- **The State Has Unfunded Liabilities—Pension and Retiree Health—Probably Well Over \$150 Billion**
- **Two Major Implications:**
 - Increased state costs to begin to address these obligations.
 - Continued pressure to modify benefits—primarily related to future employees.

Addressing Our State Unemployment Insurance Shortfall

- **The State Currently Owes Over \$9 Billion to the Federal Government Related to Our Unemployment Insurance Program**
- **We Will Need to Raise Employer Costs and/or Reduce Future Benefits to Bring Our Account Back to Balance**

Making Choices on Infrastructure

- **The State Has Huge Infrastructure Demands:**
 - Water, highways, universities, schools, etc.
- **Capital Outlay Spending Is Also One of the Only Ways for State to Contribute Immediately to Economic Growth**
- **The Tradeoff?**
 - Every \$5 billion in new bond spending generates \$350 million in debt service payments.

Achieving Budgetary Reform

- **Key Is Addressing Revenue Volatility By:**
 - Taking revenues off the table during good times.
 - Building up and maintaining reserves that will be there in bad times.
- **Many Other Possibilities**
 - Performance based budgeting.
 - Two-year budgeting.
 - Improved program reviews.

Considering Tax Reform

- **Incredibly Difficult Task With No Clear Consensus on What to Do**
- **Most Widely Discussed Topics**
 - PIT: reducing volatility.
 - SUT: broadening base and not taxing business-to-business transactions.

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