

Governor's Budget-Related Reforms

LEGISLATIVE ANALYST'S OFFICE

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Main Budget Reform Proposals

Proposition 98
<ul style="list-style-type: none"> • Eliminates ability to suspend minimum guarantee. • Eliminates "Test 3" and maintenance factor. • Overappropriations not counted in Proposition 98 base.
Budget Process
<ul style="list-style-type: none"> • Late budget. <ul style="list-style-type: none"> — Prior year's appropriations continued. • Across-the-board cuts following Governor's proclamation of shortfall. <ul style="list-style-type: none"> — Late budget—if no legislative solution within 30 days. — Midyear—if no legislative solution within 45 days.
Proposition 42 Transportation Funding
<ul style="list-style-type: none"> • Eliminates ability to suspend transfer after 2006-07.
Special Funds
<ul style="list-style-type: none"> • No borrowing from special funds after 2006-07.
Consolidation and Repayment of Obligations Within 15 Years
<ul style="list-style-type: none"> • Existing Proposition 98 settle up and maintenance factor. • Proposition 42 suspended amounts (no less than one-fifteenth per year). • Mandate claim balances. • Loan balances from special funds.



Major Concerns Raised by Governor's Proposal

- ✓ **Proposition 98 Changes Would Seriously Limit Legislative Flexibility**
 - Suspension and Test 3 have been effective tools.
 - Their elimination would leave 45 percent of the budget off limits.
 - The limited flexibility could drive the state to across-the-board reductions.

- ✓ **Across-the-Board Reductions—A Blunt Tool**
 - Result in unpredictable and uneven impacts on programs.
 - Represent major delegation of legislative powers.
 - Fail to distinguish between high- and low-priority programs.



Considerations for Legislature

- Main challenge for lawmakers: managing budgets through times of volatile revenues and rapidly changing fiscal circumstances.

- Reforms should enhance—rather than limit—tools and flexibility lawmakers have at their disposal for managing budgets.

- Specific options:
 - Build on existing provisions of Proposition 58.
 - Unlock budget by modifying or eliminating existing provisions that earmark General Fund dollars.



Examples of Formula-Driven Spending

- ✓ Statutory cost-of-living adjustments
 - Trial court funding.
 - CalWORKs and SSI/SSP.
 - K-12 revenue limits.
- ✓ Voter approved propositions
 - Proposition 98 (K-14 school funding).
 - Proposition 49 (after school funding).
 - Proposition 42 (transportation funding).
- ✓ Multiyear collective bargaining agreements
- ✓ Higher education compacts



What Have Been the Operative Tests?

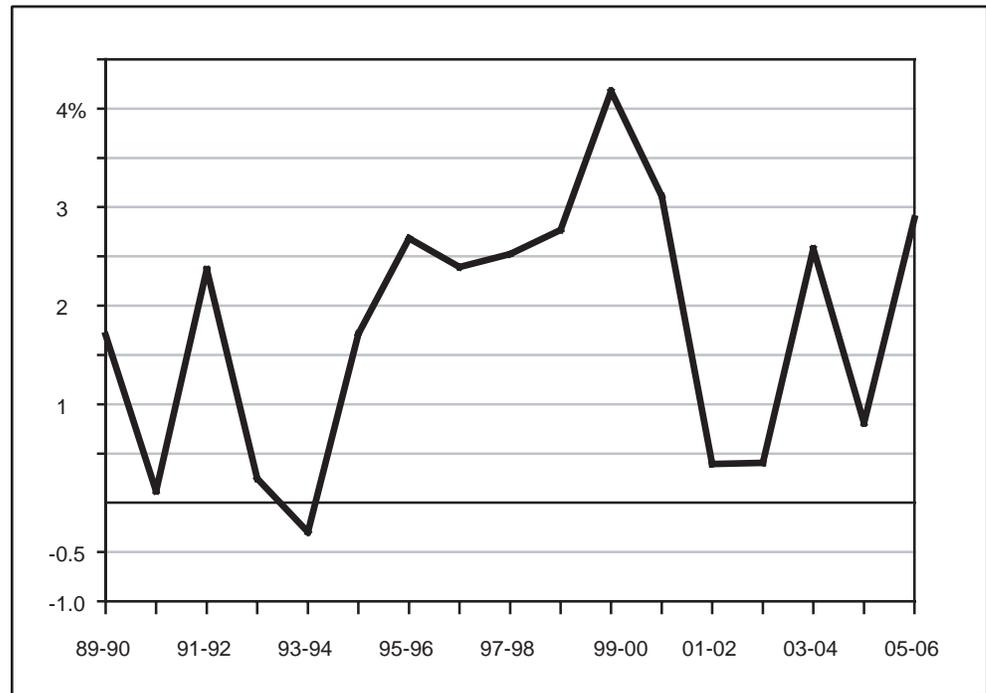
Year	Operative Test	Growth Factor Per Capita	
		Personal Income	General Fund
1998-89	1	3.9%	— ^a
1989-90	2	5.0	— ^a
1990-91	3	4.2	-4.0%
1991-92	2	4.1	8.0
1992-93	3	-0.6	-4.4
1993-94	3	2.7	-3.4
1994-95	2	0.7	6.6
1995-96	2	3.4	8.1
1996-97	2	4.7	5.6
1997-98	2	4.7	10.7
1998-99	2	4.2	6.5
1999-00	2	4.5	18.3
2000-01	2	4.9	6.9
2001-02	3	7.8	-18.6
2002-03	2	-1.3	1.0
2003-04	2	2.3	5.9
2004-05	Suspended	3.3	7.2
2005-06 ^b	2	4.5	5.7

^a Test 3 was added to Proposition 98 in 1990 by Proposition 111. Thus, per capita General Fund revenues were not part of the calculation in these years.

^b Based on 2005-06 Governor's Budget.



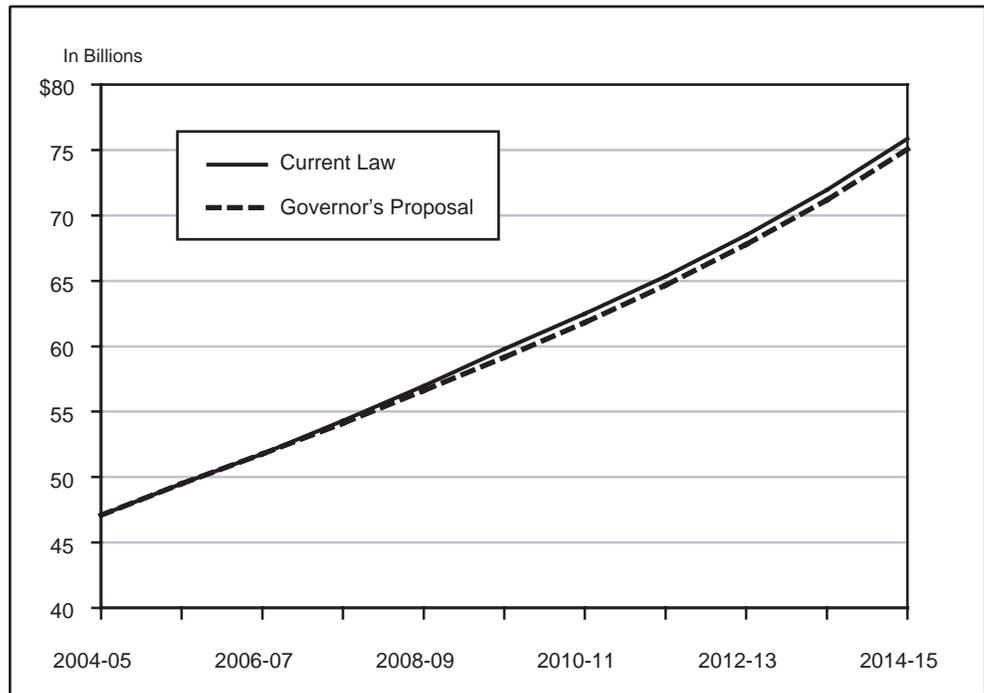
Year-to-Year Growth Proposition 98



- Year-to-year growth in Proposition 98 revenues is volatile. This volatility results from the dependence of Proposition 98 on General Fund revenues and the fact that General Fund revenues are volatile.



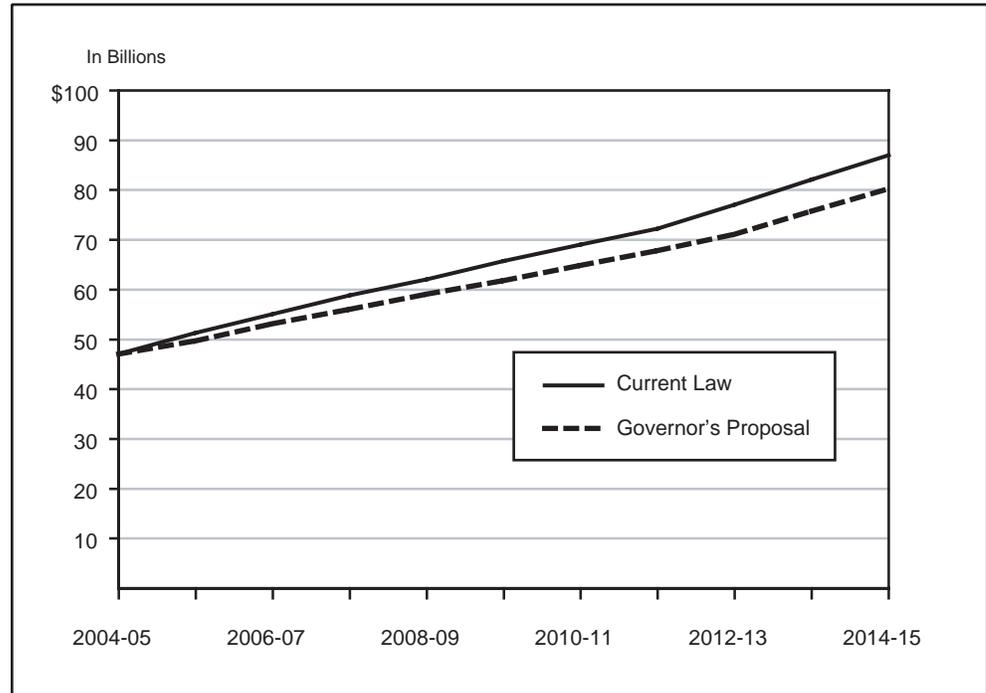
Impact of Governor's Proposal Under LAO Forecast



We forecast that both the economy and General Fund revenues will grow at a moderate pace throughout the forecast period. Under stable growth, the impact of the measure would be minimal.



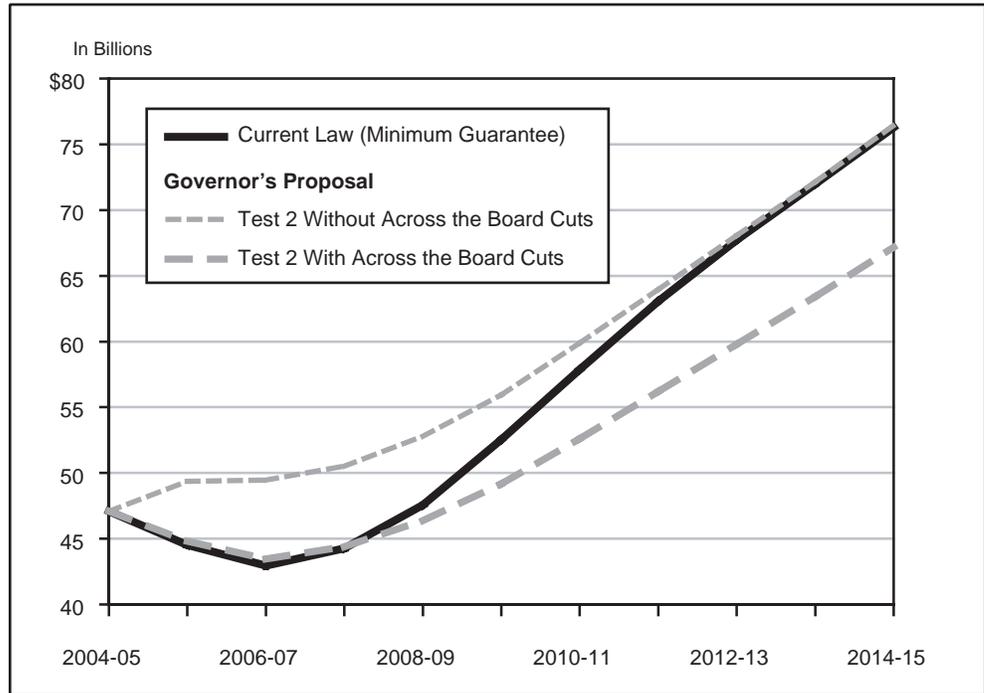
Impact of Governor's Proposal With Stronger Economic Growth



If General Fund revenues grow rapidly throughout the forecast, then the state would restore the current \$3.9 billion outstanding maintenance factor. Under this scenario, the Governor's proposal could save roughly \$4 billion annually in the out-years by converting the maintenance factor to a one-time obligation.



Impact of Governor's Proposal Under a Bust-Boom Forecast



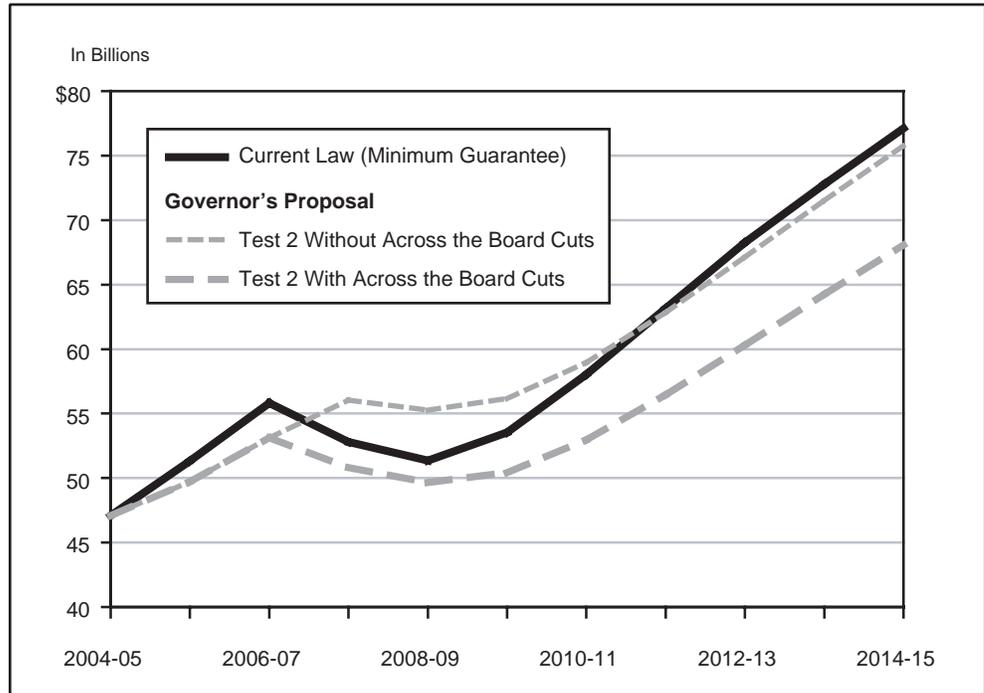
- If revenues fell dramatically in the near term, the Governor's proposal would provide higher Proposition 98 spending than current law. The difference would decline in the out-years as the economy recovered.

- If the state needed to use across-the-board reductions to balance the budget, then education's guaranteed share of the budget would be permanently reduced. The state could provide funds above the guarantee to maintain education's share of the budget.

- Without across-the-board reductions, the percentage reduction in non-Proposition 98 programs would have to be nearly double the fall in General Fund revenues.



Impact of Governor's Proposal Under a Boom-Bust Forecast



- The Governor's proposal would provide lower funding during the initial boom, but higher funding during the bust years.
- If across-the-board reductions were needed to balance the budget, then education's guaranteed share of the state budget would be permanently reduced.