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Overview of Proposition 2 in 2018-19 Budget

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Budget and Fiscal Review Subcommittee No. 4

On State Administration and General Government

Hon. Richard D. Roth, Chair





Overview

- ☑ Proposition 2 requires the state to make minimum annual:
 - Debt payments.
 - Reserve deposits into the state's rainy day fund.

- ☑ Under the Governor's estimates for 2018-19, these requirements are each \$1.5 billion.

- ☑ The Governor also proposes depositing an additional \$3.5 billion into the rainy day fund in 2018-19, bringing the fund to its constitutional maximum level.



Debt Payments in 2018-19

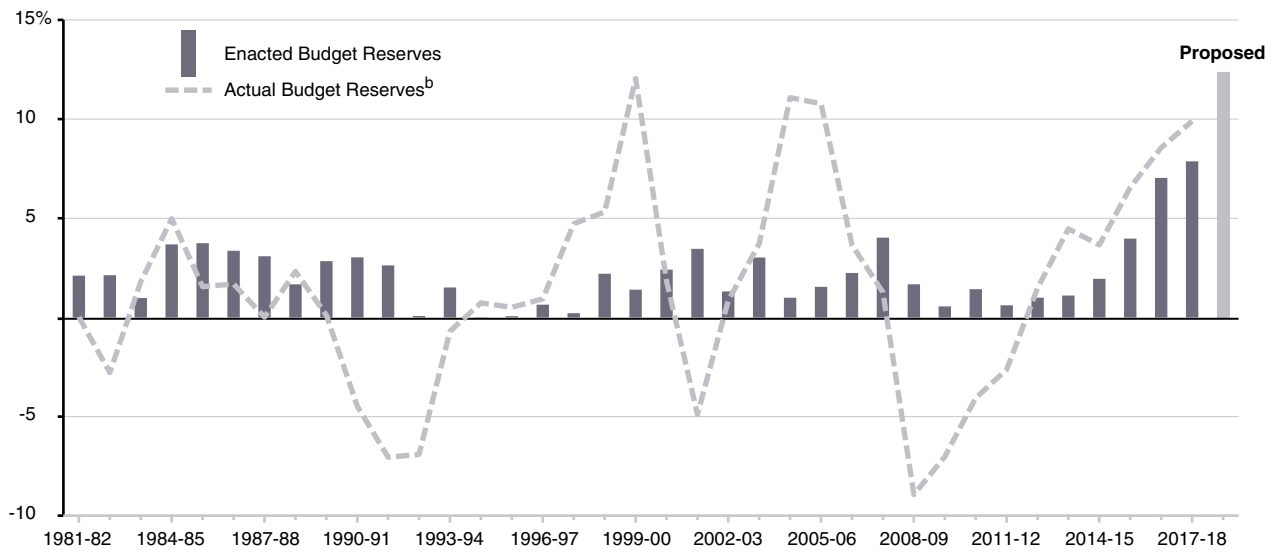
Administration's Proposition 2 Debt Proposal for 2018-19	
<i>(In Millions)</i>	
Transportation-related loans	\$560
CalPERS supplemental payment	475
Other special fund loans	205
State and CSU employee retiree health	195
Proposition 98 settle up	100
Total	\$1,535



Governor's \$16 Billion Reserve Proposal

Governor Reserve Proposal Is Historic . . .

Reserves as a Percent of Revenues and Transfers



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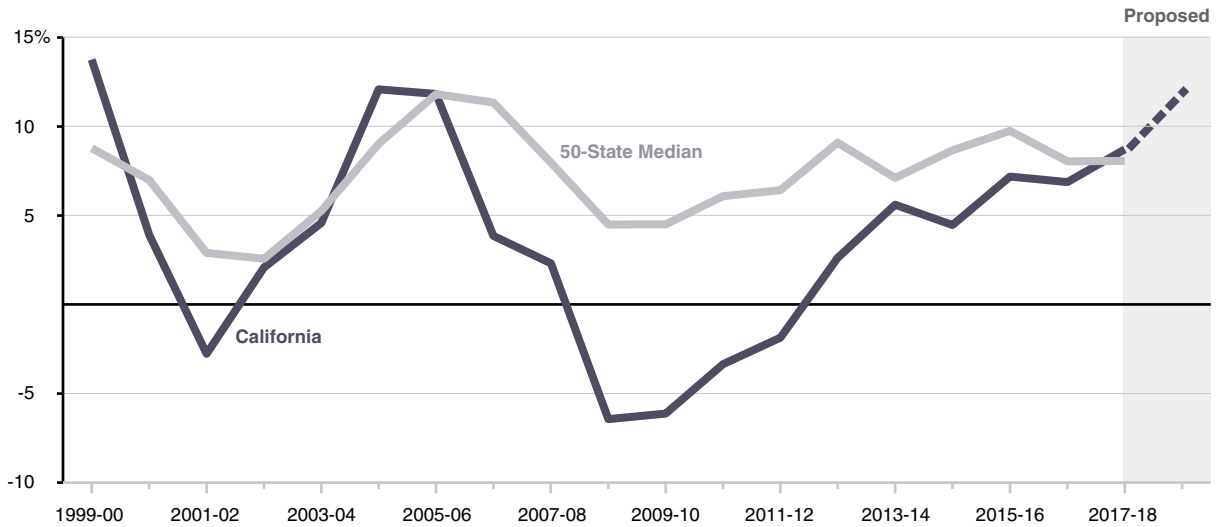


Governor's \$16 Billion Reserve Proposal

(Continued)

... But Not Particularly Remarkable by National Standards

Reserves as a Percent of Expenditures



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Recessions and Budget Problems

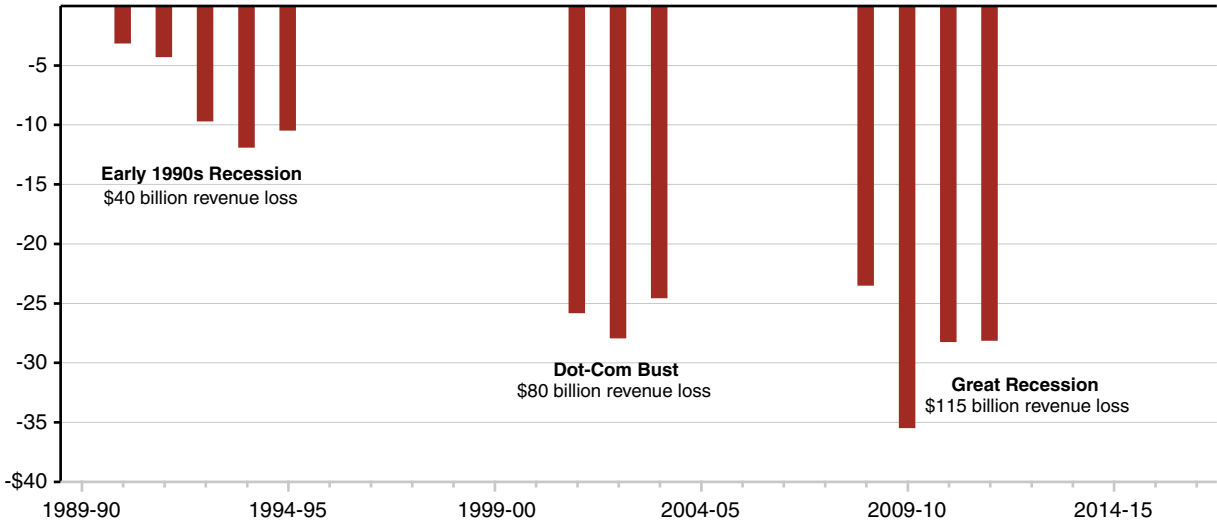


How a Recession Leads to a Budget Problem

- Revenues decline during a recession, but recessions also result in changes to spending.
- As a result of these changes, the budget problem is equal to about half of a revenue loss.

Annual Estimated Tax Revenue Losses by Recession

Inflation Adjusted, in 2017-18 Dollars (In Billions)



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Illustrative Budget Problems		
<i>(In Billions)</i>		
	Mild Recession	Moderate Recession
Hypothetical revenue loss	\$40	\$80
Formula-driven adjustments	20	40
Hypothetical budget problem	\$20	\$40



Planning for a Recession

(Continued)



Addressing the Budget Problem

- Reserves.
- One-time spending.
- Actions (spending reductions, revenue increases, cost shifts).

Hypothetical Budget Scenarios		
<i>(In Billions)</i>		
	Mild Recession	Moderate Recession
Anticipating the Recession and Budget Problem		
Hypothetical revenue loss	\$40	\$80
Formula-driven adjustments	20	40
Hypothetical budget problem	\$20	\$40
Addressing the Budget Problem		
Reserves	\$15	\$25
One-time spending	—	5
Actions	5	10
Totals, Actions and Tools	\$20	\$40



LAO Comments

- Recommend the Legislature set this year's reserve target at or above \$16 billion.
- Governor's proposal, counterintuitively, makes building more reserves more difficult.
- If the Legislature would like more reserves in the future than what the Governor now proposes, it has some alternatives:
 - Amend the statutory Special Fund for Economic Uncertainties rules.
 - Create a third reserve.
 - Prepay pension costs.