Policy Brief
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LAO

An Overview of the 1990-91 Governor's Budget

In order to provide the Legislature with a perspective on the state's budget dilemma for 1990-91, we have prepared this brief overview. Our detailed analysis of state revenues and expenditures will be released on February 21.

Introduction

The *1990-91 Governor's Budget* reflects the two main constraints under which it was developed. First, the state's economy is expected to grow at a moderate pace, limiting the resources available to fund state spending requirements. Second, past state policy choices put in place by legislation and initiatives dictate to a large extent the allocation of available resources among state programs.

As it has in past years, the Governor's Budget offers as a starting point for negotiations a set of policy choices that only partially accepts these dual constraints. While the budget recognizes the need to restrain state expenditure growth to the level of available resources, it proposes changes in existing policies as to how those resources are allocated. In part, this reflects the administration's preferences as to how the state's money should be spent. Over the next six months, the Legislature and the administration will attempt to reconcile their preferences in developing a state budget for 1990-91. However, changes in the economy and in the state's past policy choices also may influence the budget that is ultimately signed into law.

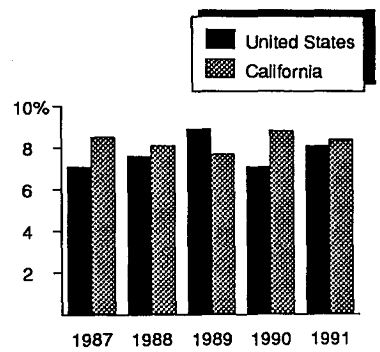
The Budget's Forecast for Revenues

The *1990-91 Governor's Budget* assumes that the state's economy will continue to expand at a moderate pace during 1990 and 1991. This assumption reflects both the weakness that has developed in the national economy over the last several months, and the expectation of a moderate rebound in the pace of economic activity by the end of 1990. As shown in Figure 1, the budget forecasts that California will see stronger economic and personal income growth over the next year than will the nation as a whole. The administration acknowledges, however, that its forecast is somewhat more optimistic than is the consensus forecast of other economists for California.

Figure 1

Percent Growth in Personal Income, United States and California

1987 through 1991



Source: 1990-91 Governor's Budget.

With respect to the current fiscal year, the new economic forecast produces considerably less revenue than had been anticipated by the administration last July. Specifically, General Fund revenues for the current fiscal year are approximately $875 million *lower* than previously forecast

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(excluding revenues attributable to the temporary sales tax enacted to fund earthquake relief efforts and other transfers proposed in the budget). The lower level of revenue, partially offset by other changes, reduces the balance in the state's reserve fund from the $1.1 billion anticipated by the administration last July to only $512 million by June 30, 1990.

For the budget year, the administration is projecting General Fund revenue growth of 8.4 percent, which represents approximately $3.3 billion in additional revenue. Taking into account the distorting effect of earthquake-related tax revenues transferred to the General Fund, the increase in revenue actually amounts to almost $3.5 billion. The first $300 million of these new revenues must be used to fund the *existing* level of state expenditures. This is because current-year expenditures are expected to exceed current-year revenues, and are being financed in 1989-90 by drawing down the state's reserve fund. In addition, the budget proposes that $489 million be used to restore the state's reserve fund in 1990-91. This amount would bring the state's reserve to $1 billion, or about 2.3 percent of proposed General Fund expenditures. These allocations leave about $2.7 billion (equivalent to an increase of 6.8 percent in revenues) available to fund increases in state programs. Thus, almost one-quarter of the increased revenues is not available to fund state spending in the budget year.

The State's Budget Dilemma for 1990-91

As noted earlier, the budget is influenced by a number of already established priorities and spending requirements. While new priorities may be established, one way to gain perspective on the state's budget dilemma is to examine what would be required to maintain current service levels in existing programs, comply with existing statutory requirements for the expansion of certain programs, and restore the state's reserve to the 3-percent-of-expenditures level. We estimate that approximately $4.6 billion in additional resources would be needed for these purposes in 1990-91. Figure 2 summarizes these budget-year funding requirements.

As the amount of General Fund revenues available for new spending in the budget year is estimated to be only $2.7 billion, the state is left with a $1.9 billion "funding gap" relative to the amount of resources that would be needed to maintain current service levels.

Figure 2

General Fund Current Service Level Funding Requirements

1990-91
(dollars in millions)

Program	Amount
Workload changes	$1,760
Proposition 98	1,270
COLAs:	
Statutory	480
Other	530[a]
Special Fund for Economic Uncertainties (SFEU)	380[b]
Increased federal requirements	210
Total	$4,630

[a] Includes funding for salary increase commitments.
[b] Amount required to bring SFEU balance to 3 percent of General Fund expenditures (in addition to amount proposed in Governor's Budget).

What Factors Contribute to the Funding Gap?

As the above data indicate, the forecast for available revenues will not allow the state to maintain its current levels of service. This situation reflects a structural problem in the state's budget. Although the state continues to experience at least moderate economic growth, the level of expected revenues is not adequate to fund anticipated growth in the state's existing programs. The higher growth rate for state expenditures stems from a variety of statutory and constitutional provisions and from past policy decisions which require growth in an increasing portion of the state's budget. For example:

Corrections. The state's prison inmate population has been increasing rapidly, in large part as a result of tougher statutory sentencing requirements but also due to increased numbers of parole violations. This has led to a dramatic increase in corrections-related expenditure requirements to accommodate the additional inmates. State expenditures for corrections have been growing significantly faster than the rate of increase in revenues.

Health and Welfare. The state also faces increasing costs for entitlement programs in the health and welfare areas. For example, existing laws require that funding be provided for cost-of-living and caseload increases in a number of these programs including AFDC, SSI/SSP and Medi-Cal. In addition, changes in federal requirements have expanded eligibility for some programs and shifted existing costs to the state. The costs for these programs have been increasing more rapidly than state revenues in the last several years.

K-14 Education. Finally, since the passage of Proposition 98 in November 1988, the state cannot reduce K-14 current service levels as a part of an overall budget-balancing strategy. Because of Proposition 98, schools are guaranteed an increase in funding each year equal to *at least* the total growth in General Fund tax revenues, and possibly more.

We estimate that in order to maintain current service levels, spending for most of the major General Fund programs in the state would have to increase faster than *available* revenues in 1990-91, as shown in Figure 3.

Figure 3

Growth Rates Required to Maintain Current Service Levels (CSL)

1990-91

Program	CSL Growth Rate
Youth and adult corrections	12.7%
Welfare	12.1
Higher education	8.8
Health	8.6
K-14 education (Proposition 98)	8.0
Resources	7.6
Growth in revenues available for expenditure	6.8%

Funding Priorities Reflected in the Governor's Budget

The Governor's Budget proposes that overall expenditure growth be restrained to the level of available revenue, while accepting higher growth rates in certain program areas. Thus, it recognizes certain existing priorities and spending requirements, and proposes that others be changed in order to make ends meet. In general, the administration proposes to provide the necessary funding increases for K-14 education required by Proposition 98, and to continue the expansion of the state's correctional system. In addition, the Governor's Budget reflects the administration's general policy decision to fund workload and new legislative requirements.

The administration's strategy for closing the funding gap and balancing the budget can be categorized as follows:

Deferrals of State Costs (-$98 million). The budget includes two proposals which would defer existing General Fund costs to 1991-92. Specifically, the administration proposes to defer the last Medi-Cal checkwrite of 1990-91 and the state's 1990-91 contribution to the University of California Retirement System.

Lower Reserve Funding (-$380 million). We estimate that an additional $380 million (above the amount provided in the budget) would be required to fund the state's reserve at the 3-percent-of-expenditures level used in recent years as the state's funding goal.

Reductions in Services (-$1.3 billion). The budget proposes to provide reduced levels of services in a variety of areas. It proposes suspension of statutory cost-of-living adjustments for specified programs (-$351 million), and reductions in funding for other programs. Some of the most significant reductions include: cutbacks in a variety of welfare programs (-$223 million) including GAIN and the In-Home Supportive Services program and the elimination of funding for a variety of state mandated local programs (-$127 million). Of the proposed reductions, approximately half ($510 million) would require legislation in order for the proposed savings to be realized.

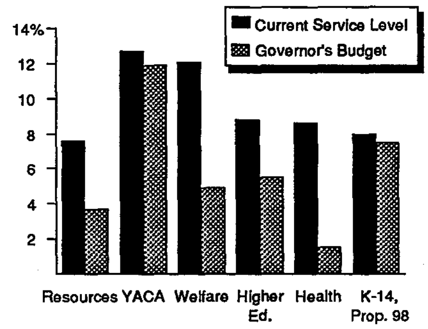
Shifting Costs to Counties (-$157 million). The budget includes two proposals which will, at least in part, result in a shift of program costs to county governments. These include a proposed reduction of $150 million in the AB 8 county health services program (which requires legislation) and a shift of state costs for property tax programs to local funding sources.

Figure 4 illustrates the priorities reflected in the budget by comparing the current

Figure 4

Growth Rates for Current Service Level versus Governor's Budget

1990-91



service growth rates to the rates of growth provided in the Governor's Budget for the major program areas. It shows that the only major programs for which the current level of services is nearly funded are K-14 education and Youth and Adult Corrections (YACA). The lower level of funding for K-14 education reflects the proposed diversion of Proposition 98 resources to other programs and certain technical factors. All other major program areas show significant shortfalls.

Conclusion

Given the context in which the budget must be developed, the Legislature must begin its work with the majority of its effort focused on how to trim the state's spending requirements to match its available resources. The state's appropriations limit precludes the Legislature from proposing any significant increase in revenues for the budget year, at least as it stands today. The Governor's Budget estimates that the state would have less than $150 million in room available under its appropriations limit to absorb additional tax revenues. Thus, if the context of the budget six months from now remains as it is today, the Legislature will be faced with adopting a budget that makes significant reductions in existing programs and does not provide the traditional level of protection against economic uncertainties.

The context for the 1990-91 budget, however, could easily change over the next six months. The May revision could find the economy growing faster than anticipated, and provide the Legislature with more revenue to allocate (as occurred in the current year). A constitutional amendment which has been placed on the June 1990 ballot (SCA 1) could provide in the range of $1 billion of increased room under the appropriations limit to absorb additional revenues, if approved by the voters. Under these circumstances, the Legislature would find its choices less difficult, but still not easy. On the other hand, the budget's economic forecast is already somewhat more optimistic than that of other forecasters, and the state's economy could grow more slowly than anticipated. This could increase the magnitude of the budget problem. ❖

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