

Overview of the May Revision

INTRODUCTION

On May 20th, the Administration issued the May Revision of the 1993-94 Governor's Budget. As originally presented in January, the budget proposal addressed a budget gap that we estimated at \$8.6 billion (please see The 1993-94 Budget: Perspectives and Issues, Part I). Since the introduction of the original budget proposal, this gap has declined slightly. In contrast, the amount of savings that could be achieved from the original budget proposals has decreased by a much larger amount. While the May Revision does propose some additional spending reductions to partially replace these lost savings, the Administration proposes to roll over a deficit of \$667 million into 1994-95. A major solution component continues to be a \$2.6 billion local property tax shift. We conclude that, as currently structured, this property tax shift proposal is unworkable. It significantly reduces local (especially county) resources without a corresponding change in local responsibilities or a practical way to find

*replacement
revenue in 1993-
94.*

**BUDGET GAP DECLINES
TO \$8.0 BILLION**

Based on changes in the state's spending and revenue trends identified in the May Revision, we estimate that the 1993-94 budget gap has declined from \$8.6 billion to \$8.0

billion. Figure 1 shows that the gap reduction is due primarily to slower growth in health and welfare caseloads, and an increase in estimated revenues.

**VALUE OF BUDGET
SOLUTIONS DECLINES
BY \$1.9 BILLION**

The January budget proposal included \$8.6 billion of budget "solutions" in order to bridge the January budget gap. Figure 2 illustrates, however, that the May Revision has reduced the estimated value of those budget solutions by \$1.9 billion. At the same time, the size of the budget gap has declined by \$0.6 billion, so that the May Revision requires a net amount of \$1.3 billion in new budget solutions.

Figure 1

**1993-94 Budget Gap^a
May Revision Changes**

(In Billions)

	January	May	Change
Pay off deficit from 1992-93	\$3.4	\$2.9	-\$0.4
1993-94 baseline spending	\$44.7	\$44.8	\$0.1
Less 1993-94 revenue ^b	-39.4	-39.7	-0.2
1993-94 Operating shortfall	\$5.2	\$5.1	-\$0.2
Budget Gap	\$8.6	\$8.0	-\$0.6

^a Excludes Governor's proposed budget solutions. Details do not add to totals due to rounding.

^b Based on Administration's revenue forecasts.

Major May Revision Changes in the Budget Gap^c

(In Millions)

Slower growth in health and welfare caseloads	-\$483
Increased revenue estimates	-326
Proposition 98—1993-94 property tax shortfalls and enrollment increase	283
Required COLA for Medi-Cal long-term care providers	75
Prior-year spending revisions	-52
Increase in prison inmate and parole populations	50
Reduced estimate of Renters' Tax Credit claims	-50
Other changes (net)	-111
Total	-\$614

^c Amounts show combined effects in 1992-93 and 1993-94.

The \$1.9 billion decline in January budget solutions includes lost savings of:

- \$873 million in federal immigration funding.
- \$450 million related to the 1992 renter's credit.
- \$329 million in proposed changes in welfare and Medi-Cal benefits.
- \$168 million in Proposition 98, due to declines in school property tax revenues and a slight increase in enrollment in 1992-93.

**MAY REVISION RESULTS
IN DEFICIT OF \$667
MILLION**

Figure 3 shows the May Revision changes to the Governor's January budget proposal for 1993-94, presented in accordance with the state's traditional budgetary accounting practices. Spending increases by \$879 million compared with the January budget, while available

Figure 2**1993-94 Governor's Budget—May Revision^a
January Budget Solutions Decline by \$1.9 Billion.**

(In Billions)	Spending Gap Solutions	
	Spending Gap	Solutions
January Governor's Budget	\$8.6	\$8.6
Changes recognized in May Revision	-0.6	-1.9
Revised amounts	\$8.0	\$6.7
Additional May Revision solutions needed ..	\$1.3	

^a Details do not add to totals due to rounding

resources increase by \$181 million in 1993-94. As a result, while the January budget contemplated a \$31 million reserve at year-end, Figure 3 shows that the General Fund will now end 1993-94 with a deficit of \$667 million. This will be carried over into 1994-95.

Administration's "Reserve" Is Borrowed Funds. The ending deficit of \$667 million in Figure 3 contrasts with a 1993-94 ending reserve of \$457 million shown in the Administration's May Revision package. The difference—\$1.125 billion—represents borrowing that the Administration intends to use to finance the deficit and provide its stated "reserve." The proposed borrowing is a means of *financing* the deficit, not a means of *eliminating* it.

Revenues. The Department of Finance's estimate for revenues in the current and budget years has risen slightly, largely due to better-than-anticipated personal income tax collections through April. Upward adjustments to the forecast for personal income taxes more than offset lowered expectations for other major sources of revenues. The forecast also incorporates a presumption that the existing tax settlement authority program will be extended for one year and reflects revenue losses associated with the Governor's proposal to extend and expand the research and development tax

Figure 3**Governor's Budget
1993-94 General Fund Condition^a
May Revision Changes**

(In Millions)	January	May	Change
Prior-year balance	-\$2,100	-\$2,229	-\$129
Revenues and transfers	39,875	40,184	309
Total resources available	\$37,774	\$37,955	\$181
Expenditures	\$37,333	\$38,212	\$879
Fund Balance	\$441	-\$257	-\$698
Reserve	\$31	-\$667^b	-\$698
Other obligations	\$410	\$410	—

^a Includes Governor's proposed budget solutions. Details may not add to totals due to rounding.

^b The May Revision proposes to finance this deficit with a loan to be repaid in 1994-95.

credit for business taxpayers. Over the two-year period, the revenue forecast has been raised by a net amount of \$391 million.

PROPOSALS IN THE MAY REVISION

The May Revision proposes \$596 million of new budget solutions, in addition to carrying over a deficit of \$667 million into 1994-95. Together, the new solutions and the

Figure 4

**New Budget Solutions
Proposed in the May Revision^a**

(In Millions)

New Solutions

Reduce SSI/SSP grants to the federal minimum	\$136
Reduce Medi-Cal hospital contract rates	87
Community Colleges: accelerate enrollment savings	84
Additional revenue from extension of tax settlement authority	80
Obtain federal reimbursement for perinatal services to undocumented persons	57
Medi-Cal: reduce SB 855 transfers to local governments	50
Shift health program costs to Proposition 99 funds	41
Suspend rate increase for foster care group homes	30
Increase 1993-94 Proposition 98 loan	24
Net value of other solutions	7
New solutions	\$596
Deficit financing	\$667

Total **\$1,263**

^a Amounts show combined effects in 1992-93 and 1993-94. Details may not add to totals due to rounding.

carryover deficit account for the \$1.3 billion of additional solutions needed to resolve the May Revision budget gap of \$8.0 billion. Most of the new solutions are in the health and welfare area. Figure 4 lists the major new solutions.

Local Government. The May Revision provides some additional information on the \$2.6 billion property tax shift originally proposed in the January Governor's Budget. The shift would reallocate \$2.6 billion of property tax revenue from local governments to schools in order to reduce the state's education funding requirement

under Proposition 98. The new proposal would allocate \$2.1 billion of the shift to county governments, and allow them to offset some portion of this reduction through retention of property taxes that would otherwise be allocated to special districts. City governments and redevelopment agencies would be required to transfer about \$288 million and \$65 million, respectively, to support schools.

The Administration indicates that "the state should repeal all mandates on local programs not directly related to public safety," in order to give local governments the flexibility to give

appropriate priority to public safety. However, the Administration has offered no specific proposals for eliminating such mandates.

LAO ASSESSMENT

The May Revision employs risky strategies of deficit financing and significant cost shifts to local government. The most problematic part of the budget plan is the proposed \$2.6 billion property tax shift from local governments to schools. The Administration proposes that the counties offset a portion of their \$2.1 billion loss by increasing local sales taxes, obtaining relief from state-mandated programs requirements, and using transferred special district property tax revenues. However, we believe that, as currently structured, these remedies provide little meaningful relief. This is because (1) the local sales taxes could not be operative until April 1994, (2) there are currently no Administration proposals for substantial mandate relief, and (3) much of the special district revenues will be needed to maintain fire protection and other local services. In order to accommodate their revenue losses, counties would have little alternative but to reduce their health, social services, and public safety programs; and those reductions would adversely affect the achievement of important public goals in these program areas. The budget proposal appears indifferent to the consequences of these reductions.

In finalizing a budget for 1993-94, the Administration and Legislature should adopt solutions that not only avoid increasing the dysfunctionality of our current state-local government system, but also make progress toward fundamental restructuring.

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