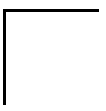
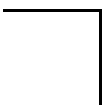
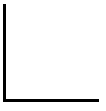
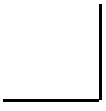




I
State
Fiscal Picture



State Fiscal Picture



California's fiscal outlook remains generally positive. Continued economic expansion and revenue growth, coupled with slowing caseload demands and other factors, will enable California to end 1996-97 with a balanced budget and modest positive reserve for the second year in a row. Revenue growth in 1997-98 is projected to be sufficient to permit moderate expenditure increases for the year and maintain a modest reserve.

Within this generally positive fiscal environment, the Legislature will face two particularly important challenges as it develops California's 1997-98 state budget. The first involves the question of how to best utilize the \$1.9 billion in increased funds available for schools under the Proposition 98 minimum funding guarantee—whether, for example, new funds should be allocated primarily for state-determined or locally determined purposes.

The second major challenge involves the state's response to federal welfare reform. In this area, the Legislature will be faced with developing an approach which balances the competing objectives of welfare reform—to move program recipients into the workforce, to provide a "safety net" for children, and to control public costs.

It is also important to note that while the budget picture is generally positive, the state will *not* have sufficient revenues to fund *all* of the requirements of current law, including the restoration of both the renters' tax credit and previously enacted welfare grant reductions. For this reason, *any* budget plan for 1997-98 will involve significant tradeoffs.

In this part, we discuss the Governor's 1997-98 budget proposal, provide our own perspective on the budget outlook, and discuss some of the key budget-related issues and considerations facing the Legislature.

OVERVIEW OF THE GOVERNOR'S BUDGET

The budget proposes total spending of \$64.6 billion in 1997-98 (this amount excludes \$35 billion in combined spending from federal funds and the proceeds of selected bond funds). As shown in Figure 1, the budget proposes \$50.3 billion in General Fund expenditures, which are allocated through the budget process for such programs as education, health and welfare, and criminal justice. About \$14.3 billion is from special funds, which are earmarked for specific purposes, such as highways, targeted health programs, and local governments. In terms of spending growth, the budget proposes a 3.8 percent increase in General Fund spending and a 5.5 percent increase in spending from special funds, for a combined increase in total state budget spending of 4.2 percent.

Figure 1				
Total Proposed Budgetary Spending 1995-96 Through 1997-98				
<i>(Dollars in Billions)</i>				
	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	
			Amount	Percent Change
General Fund	\$45.4	\$48.4	\$50.3	3.8%
Special funds ^a	12.5	13.6	14.3	5.5
Totals	\$57.9	\$62.0	\$64.6	4.2%

^a Excludes Local Public Safety Fund expenditures.

Two Perspectives on General Fund Spending

Figures 2 and 3 provide two different perspectives on how the budget proposes to allocate General Fund expenditures in 1997-98.

How Total Spending Is Allocated. Figure 2 shows that over one-half of proposed General Fund spending goes for education-related purposes, including \$20.9 billion for K-12 education, \$1.9 billion for community colleges, and \$4.5 billion for higher education. Slightly less than one-third is for health and social services' programs. The remainder is spent on criminal justice, resources, tax relief, and general government programs.

Figure 2

Education, Health, and Social Services Account for Four-Fifths of Spending

*General Fund Spending by Program
1997-98*

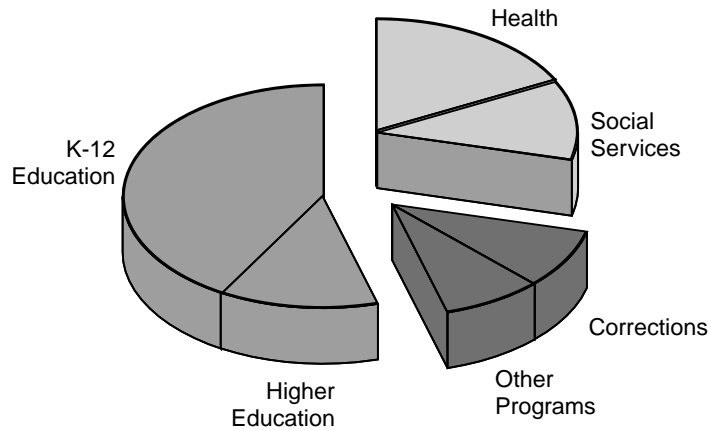
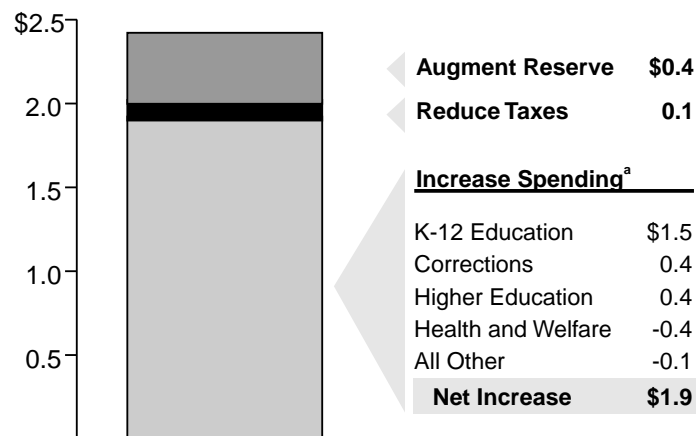


Figure 3

How Governor Proposes To Allocate 1997-98 Revenue Growth

General Fund (In Billions)



^a Detail do not total due to rounding.

How Revenue Growth Is Allocated. Figure 3 shows that General Fund revenues are projected to increase by \$2.3 billion between 1996-97 and 1997-98, or \$2.4 billion absent the Governor's tax cut proposal. Of this total, \$0.4 billion would be used to increase the reserve, and \$1.9 billion would be devoted to spending increases.

The figure shows that most of the \$1.9 billion in spending increases are allocated to education. Specifically, spending for K-12 education grows by \$1.5 billion (consistent with Proposition 98 funding requirements), while spending for higher education increases by \$0.4 billion. Corrections funding also increases by \$0.4 billion, while health and welfare spending falls by \$0.4 billion in the budget year. Finally, the budget would allocate \$0.1 billion for the bank and corporation tax reduction.

Key Features of the Budget Proposal

Figure 4 summarizes the key features of the Governor's budget proposal.

Budget Is Balanced. As noted in Figure 4 and detailed in Figure 5 (see page 8), the proposed General Fund budget is balanced in both the current and budget years, with reserves of \$197 million in 1996-97 and \$553 million in 1997-98. These modest reserves are a significant improvement over the budget deficits experienced throughout the first half of the 1990s. It also is notable that proposed budget-year revenues exceed expenditures; in other words, there is a projected "operating surplus." Nevertheless, even the half-billion dollar budget-year reserve is relatively small compared to the size of the budget (only 1.1 percent), and building a larger reserve should remain a key budgetary priority.

This is especially true given the ever-present risks inherent in budget projections, and the fact that the proposed 1997-98 reserve is in part due to upward revisions to carry-in balances from prior years. Without these revisions, the proposed 1997-98 reserve would be considerably smaller.

Expenditure Proposals. As Figure 4 shows, the budget's main programmatic initiatives are concentrated in K-12 education and welfare. Specifically, the Governor proposes significant funds for additional class size reductions in K-12 education. In the area of welfare, the budget includes a welfare reform proposal effective January 1, 1998, which involves various time limits for recipients and block grants to counties (beginning in 1998-99). It also proposes to make permanent previously-enacted welfare grant reductions. There are relatively few major initiatives proposed in other areas such as higher education and youth and adult corrections.

Figure 4**Key Features of the Governor's
1997-98 Budget Proposal**

- General Fund Condition.** Balanced budget with \$553 million reserve.
- Economy and Revenues.** Assumes moderate economic and revenue growth.
- Taxes and Fees.** Phased in 10 percent corporate tax rate reduction. Additional federal tax conformity. No renters' credit. Unspecified fee increases for Motor Vehicle Account.
- Welfare.** Welfare reform proposal includes various time limits for recipients and block grant funds for counties (beginning 1998-99). Makes permanent previously enacted welfare grant reductions. Additional federal block grant funds result in net savings that are used for other General Fund purposes.
- Medi-Cal.** Assumes elimination of prenatal care for illegal immigrants. Continues Medi-Cal (and certain welfare benefits) for legal immigrants already in country. Eliminates nonemergency benefits for new legal immigrants.
- K-12 Education.** Allocates increased Proposition 98 funds for enrollment growth, class size reduction, and other initiatives. Proposes \$2 billion in new bonds for school facilities.
- Higher Education.** Continues the Governor's "compact," which includes a basic 4 percent budget increase. Also provides additional funding to avoid student fee increases and to fund other initiatives.
- Criminal Justice.** Fully funds youth and adult corrections budgets. Assumes federal funds to offset a portion of design and development costs for six new prisons. Allocates federal welfare block grant funds to counties to cover juvenile probation costs. Renews proposal to restructure trial court funding program.
- Local Government.** Continues Citizen's Option For Public Safety program. Trial court realignment and welfare reform proposals could significantly affect counties.
- Other.** No funds for general salary increases or disaster relief for current or future incidents.

Figure 5**Governor's Budget General Fund Condition
1996-97 and 1997-98***(Dollars in Millions)*

	1996-97	1997-98	Percent Change
Prior-year balance	\$685	\$648	—
Revenues and transfers	48,405	50,657	4.7%
Total resources available	\$49,091	\$51,275	—
Expenditures	\$48,443	\$50,301	3.8%
Ending fund balance	\$648	\$1,004	—
Other obligations	\$451	\$451	—
Reserve	\$197	\$553	—

Detail may not total due to rounding.

Budgetary Savings Dependent on Federal Actions

As in recent years, the budget assumes a significant amount of savings which are dependent on future federal actions. As shown in Figure 6, these assumed savings total \$636 million. They include \$268 million from reductions in Supplemental Security Income/State Supplementary Program (SSI/SSP) grant levels, which require federal legislation to modify current federal maintenance-of-effort requirements. Similar savings were assumed in the *1996-97 Budget Act*, but the required federal actions did not occur.

The budget also assumes that \$216 million in new federal funds will become available to California for the reimbursement of state costs for providing emergency Medi-Cal services to undocumented immigrants. These funds were authorized in 1996 federal legislation. However, these monies were *not* included in the President's 1997-98 budget request (presented in early February), and the outlook for these funds now depends on future actions by Congress.

The remaining assumed budgetary savings relate to reimbursements for immigrant felons beyond current federal allocations, and the federal adoption of an Internal Revenue Service (IRS) tax offset program. Under the latter, the IRS would collect delinquent state tax liabilities out of refunds owed to Californians on their federal income tax returns. These

savings also were assumed in the past two years, but the requisite federal legislation was not enacted.

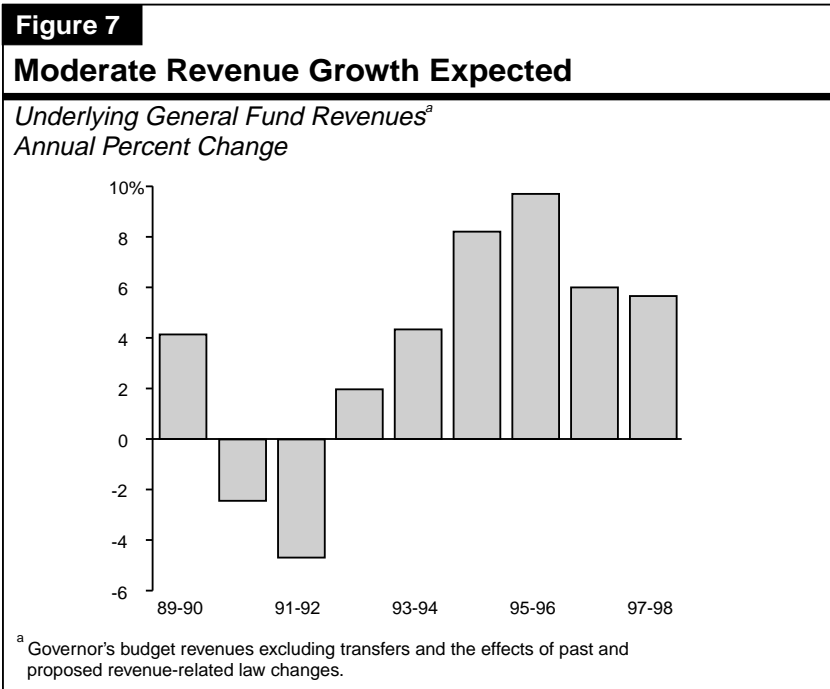
Figure 6	
1997-98 Budget Savings Dependent on Federal Actions	
<i>(In Millions)</i>	
Source	1997-98 Amount
SSI/SSP ^a grant reductions	\$268
Emergency medical services to undocumented persons	216
Higher federal reimbursements for undocumented felons	67
IRS ^b tax offset program	85
Total	\$636
^a Supplemental Security Income/State Supplementary Program.	
^b Internal Revenue Service.	

Economic and Revenue Assumptions—Moderate Growth

A critical element of the budget proposal is its underlying economic and revenue assumptions. The budget's economic forecast assumes ongoing national economic expansion and continued, though tapering, moderate economic growth with low inflation in California. California personal income, the single most important determinant of state revenues, is expected to grow moderately by 6.6 percent in 1997 and 5.9 percent in 1998.

The budget also forecasts moderate growth in General Fund revenues in both the current and budget years. Specifically, the budget projects that General Fund revenues will reach \$48.4 billion in 1996-97 and \$50.7 billion in 1997-98. As Figure 7 (see next page) indicates, these projections reflect moderate growth in the underlying revenue trend (defined as revenues excluding the effects of law changes) consistent with the economic forecast.

We discuss the administration's forecasts in more detail, and provide our own assessment of the economic and revenue outlook, in Parts II and III of this document.



Revenue-Related Proposals. The revenue projections incorporate the Governor's proposal to reduce the bank and corporation tax rate by 5 percent in 1998 and another 5 percent in 1999, and to partially conform state law to recent federal changes involving Subchapter S corporations. The budget's estimated revenue cost of these proposals is \$93 million in 1997-98, rising to \$654 million by 2000-01 when fully phased in.

In addition, the budget's revenue projection for 1997-98 assumes implementation of the Governor's trial court funding proposal, including redirecting \$290 million in court fines and penalties from the General Fund to a trial court trust fund. Also assumed is \$85 million from federal adoption of the IRS tax offset program.

THE GOVERNOR'S BUDGET PROPOSAL BY PROGRAM AREA

The key proposals and assumptions contained in the proposed budget, along with their fiscal effects, are highlighted in Figure 8 and discussed below.

Figure 8	
Major 1997-98 Budget Proposals and Assumptions	
<i>(In Millions)</i>	
Expenditure-Related Proposals and Assumptions	Effect on Expenditures
Welfare	
Grant reductions/state cost-of-living adjustment suspensions	
Aid to Families with Dependent Children	-\$245
Supplemental Security Income/State Supplementary Program	-212
Governor's welfare reform proposal	
New grant structure and paternity establishment requirements	-176
Employment services and county administration	172
Infant Health Protection Initiative	22
Medi-Cal	
New federal funds for emergency services to undocumented persons	-\$216
Elimination of state-only prenatal care for undocumented persons	-80
K-12 Education	
Additional class size reduction (excluding COLA)	\$457
Community Colleges	
Welfare reform-related initiatives	\$53
Higher Education (CSU and UC^a)	
"Buy out" of student fee increase	\$67
Other initiatives	15
Local Government	
Allocation of federal welfare block grant to counties for juvenile probation costs	\$141
Other	
Eliminate renters' credit	-\$525
Tax-Related Proposals and Assumptions	Effect on Revenues
Bank and corporation rate reduction and federal conformity	-\$93
Federal Internal Revenue Service tax offset program	85
^a California State University and University of California.	

Health and Welfare

As indicated in Figure 8, most of the budget's major savings proposals involve health and welfare programs, primarily reflecting grant reductions and suspension of state cost-of-living adjustments (COLAs) in the state's two major cash grant programs. The first program, Aid to Families with Dependent Children (AFDC), provides grants to low-income persons who are in families with dependent children. This program has been replaced by the Temporary Assistance for Needy Families (TANF) Program pursuant to federal welfare reform legislation. The second cash grant program is for persons who are elderly, blind, or disabled (SSI/SSP).

Budget Makes Permanent the Temporary Welfare Grant Reductions and COLA Suspension. The Governor's budget proposes to make permanent the AFDC and SSI/SSP 4.9 percent statewide grant reductions adopted in 1995-96. In addition, suspension of the COLAs would be made permanent. Under current law, the grant reductions and the AFDC COLA suspension are scheduled to be restored on November 1, 1997, with the state SSP COLA to be restored on January 1, 1998. The Governor's proposal would avoid increased General Fund costs of about \$457 million in the budget year.

Major Budgetary Impacts of Federal Welfare Reform. On August 22, 1996, the President signed into law H.R. 3734—The Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The budget estimates that federal welfare reform will result in net General Fund savings of \$274 million in 1996-97 and \$288 million in 1997-98 due to the federal TANF block grant. (This assumes that the state enacts all of the Governor's welfare reform initiatives and TANF spending proposals.) Federal welfare reform also makes most legal noncitizens ineligible for SSI/SSP, resulting in estimated General Fund savings of \$153 million in the budget year.

Governor's Proposal to Reform Welfare. The Governor proposes to fundamentally redesign the state's AFDC program, effective January 1, 1998. The Governor's proposal includes benefit reductions pursuant to specified time limits, changes in how grants are determined for recipients with income, work and training participation mandates, and expanded paternity establishment requirements.

The Governor's welfare reform proposal involves state savings of approximately \$176 million from changing the grant structure and paternity establishment. These savings are nearly offset by \$172 million in costs for employment services, automation improvements, and training

for county caseworkers. Thus, the net fiscal effect of these proposals is an approximate “wash.”

Medi-Cal. The budget proposes General Fund expenditures of \$6.9 billion for the Medi-Cal program, a 0.5 percent increase from the current year. The budget also recognizes a current-year deficiency of \$429 million, about one-half of which is due to the absence of a federal appropriation of funds for the state costs of emergency services to undocumented persons. The budget assumes that federal funds for this purpose will be appropriated in the 1997-98 federal budget, resulting in a \$216 million state savings in 1997-98. These funds, however, have not been included in the President’s recently released budget proposal.

The budget assumes elimination of state-only prenatal care benefits for undocumented persons, pursuant to federal welfare reform legislation, for a General Fund savings of \$80 million in 1997-98. The budget proposes to continue providing Medi-Cal (as well as AFDC/TANF) benefits to legal immigrants in the country prior to August 22, 1996. However, legal immigrants entering the country after that date would not be eligible for nonemergency services.

In contrast to proposals in recent years, this year’s budget does not propose to eliminate optional Medi-Cal benefits, and contains relatively few new initiatives.

Infant Health and Protection Initiative. The Governor proposes an initiative designed to protect children from substance-abusing parents, through early detection and intervention services focusing on newborns and their mothers. The program includes stronger requirements for hospitals to detect signs of substance abuse or substance exposure to babies, treatment services, and home visitations. The Governor proposes \$22 million from the General Fund for this program.

Education

K-12 Education. The budget proposes significant increases in K-12 education spending, consistent with Proposition 98 funding requirements. Specifically, total K-12 education expenditures are proposed to increase \$1.7 billion from current-year levels in 1997-98 (of which \$1.5 billion would come from the General Fund).

The Governor proposes to spend the majority of these funds for state-determined purposes. The largest share—\$629 million (38 percent)—would provide a 2.5 percent COLA for district and county office revenue limits as well as selected categorical programs. Providing general-purpose funding for the projected 2.3 percent growth in the student popula-

tion accounts for \$482 million (or 29 percent) of available funds. The Governor's class size reduction proposal accounts for another \$457 million (or 27 percent). The remaining \$110 million (or 6 percent) is dedicated in the budget proposal for special education reform (\$77 million) and various other categorical program increases.

The Governor is also proposing a \$2 billion bond for school facilities to accommodate enrollment growth and class size reduction.

Community Colleges. The budget proposes a \$238 million increase in total community college funding (of which \$149 million would come from the General Fund). This funding increase covers growth in enrollment, full statutory cost-of-living increases, and a variety of other initiatives. Among these are about \$53 million in funds which would be allocated for purposes related to federal welfare reform. These include work-study and child care services for community college students who are welfare recipients.

University of California (UC) and California State University (CSU). The budget proposes increases to the UC and the CSU budgets totaling \$194 million in 1997-98. This amount includes funding to maintain the Governor's "compact" with higher education, which includes 4 percent annual budget increases for both segments. It also includes \$67 million to "buy out" the 10 percent fee increases provisionally approved by the Regents and Trustees of the two systems. Thus, student fees would be held constant for the third consecutive year. The budget also proposes \$15 million, for the two systems combined, for a variety of new initiatives.

Criminal Justice

Corrections. The budget includes an increase of \$251 million (7.3 percent) in General Fund support for the Department of Corrections, primarily to accommodate growing inmate populations. The prison inmate population is projected to grow by about 9,000 inmates in 1997-98 (or 5.9 percent). Although substantial, this rate of growth is less than the state has experienced over the past ten years (an average of about 9 percent).

In addition, the budget proposes funding, primarily from anticipated federal funds, for six prisons as follows: (1) design and construction of one new prison, (2) land acquisition and design of two additional prisons, and (3) environmental reviews for three more prisons.

Trial Court Funding Redirection. The budget proposes to consolidate and restructure the Trial Court Funding Program. The proposal, which is nearly identical to the Governor's 1996-97 proposal, would cap the

contribution counties make for support of the trial courts and make the state responsible for future growth in trial court costs. The proposal also calls for increases of about \$88 million in court-related fees to offset costs of the state, and requests about \$27 million to create 40 new trial court judgeships, enhance trial court security, and reimburse certain expenses of trial court jurors.

Local Government

Several of the Governor’s proposals have a significant impact on local governments (see Figure 9). For example, the trial court realignment and welfare reform proposals could significantly affect counties.

Figure 9	
Major New Budget Proposals Affecting Local Government 1997-98	
Proposal	Local Fiscal Impact
Public Safety/Criminal Justice	
Transfer trial court funding responsibility to the state.	Savings to counties of tens of millions of dollars in 1997-98, growing substantially thereafter.
Increase funding for juvenile probation.	\$141 million of the federal welfare block grant (Temporary Assistance for Needy Families) to be allocated to counties for probation.
Allocate 15 percent of federal crime bill funds for prison construction to local correctional facilities (maximum allowed by law).	\$15 million to local government for jail or juvenile hall construction, with additional amounts through 1999-00.
Welfare	
Counties relieved of obligation to provide General Assistance.	Potential county savings of up to hundreds of millions of dollars annually.
Counties to administer new program.	Counties to receive \$80 million (one-time) for training and implementation. Counties to share in future costs or savings. Unknown overall local fiscal impact.
Other Programs	
Infrastructure bank	\$200 million general obligation bond issue proposed for capitalization of an infrastructure bank.

In addition, funding for several previously enacted programs is continued in the budget year. These continuing programs include:

- The Citizen's Option for Public Safety (COPS) program, which provides \$100 million for local law enforcement;
- The property tax administration loan program, which provides up to \$60 million in forgivable loans to local assessors; and
- \$33 million in continued funding for county juvenile detention camps.

Other Programs

Renters' Tax Credit. This credit, which provides a refundable tax credit of \$60 to single renters and \$120 to married couples and heads of households, was suspended between 1993 and 1996, and was reinstated on January 1, 1997. The budget proposes to eliminate the credit, for a savings of \$525 million in 1997-98.

Employee Compensation. The Governor's budget does not provide for any general pay or benefit increases for state employees. The UC and the

The State's Cash Position

In order to manage differences in the timing of its revenue inflows and expenditure outflows, the General Fund routinely borrows funds on a short-term basis. Even during years of balanced budgets, such short-term cash borrowing typically needs to occur. The state conducts its cash-management activities both by borrowing from temporarily idle balances in other state funds, and by borrowing funds on a short-term basis from outside investors. During the recession years of the early 1990s, the state's cash position was aggravated due to large budget deficits and Proposition 98 school loans, which necessitated additional short-term external borrowing. At one time, the amount of external borrowing reached \$7 billion.

Since that time, the state's cash position has improved markedly. The amount of external borrowing needed has declined significantly from the peak years, primarily because of the General Fund's improved budgetary position, partial repayment of Proposition 98 loans, and increased temporarily idle balances available in other funds. During 1997-98, the budget proposes \$3 billion in short-term external borrowing for cash-flow purposes, the same as in 1996-97.

CSU have indicated, however, that salary increases for their employees will be provided from “compact” funds. Based on 1997-98 salaries and wages for state employees (other than higher education), we estimate that it would cost nearly \$100 million per 1 percent general salary increase for these employees. About \$55 million of this cost would be General Fund and about \$45 million would come from special funds.

Capital Outlay. The budget proposes nearly \$1.2 billion for capital outlay other than highways and rail. The majority of this spending is for higher education facilities and new state prisons.

THE LAO’S BUDGET OUTLOOK

In this section, we provide our perspective on the General Fund budget outlook for 1997-98 and 1998-99. In making these projections, we have (1) used LAO projections for the economy, revenues, and expenditures; and (2) assumed the Governor’s proposed policy changes (such as the new corporate tax cut and the elimination of the renters’ credit). With regard to federal actions shown in Figure 6, we also have assessed the likelihood that congressional action will occur. We have prepared these estimates to assist the Legislature in evaluating the impact of the 1997-98 budget proposal, and to help the Legislature in shaping its own budget priorities. Key differences between our outlook and the administration’s are shown in Figure 10 (see next page).

Economy and Revenues. We share the administration’s view that the California economy will experience moderate economic growth over the next two years. However, we project that revenues will exceed the budget forecast by \$77 million in the current year and \$266 million in the budget year, for a two-year gain of \$343 million.

Proposition 98 Interaction. The increase in revenues implies modestly higher educational funding under Proposition 98. Specifically, we estimate that \$211 million of our total \$343 million two-year revenue increase would go for K-14 funding, while the remaining \$132 million would be available for general appropriation.

Caseload Savings. A second positive factor is that caseloads in key programs continue to be lower than the administration’s projections. The largest reduction is in the AFDC/TANF program, which is now experiencing significant caseload declines from the prior year. More modest declines relative to the budget estimate are occurring in Medi-Cal and the corrections programs. We estimate that these caseload reductions will translate into General Fund savings relative to the budget figures of

\$169 million in the current year and \$267 million in 1997-98, or a combined two-year total of \$436 million.

Figure 10**Key LAO Differences From Budget****Factors Increasing the 1997-98 Reserve**

- Higher revenues (\$343 million before Proposition 98 interaction)
 - Higher personal income and sales tax
 - Partly offset by lower bank and corporation taxes
- Caseload reductions (\$436 million expenditure reduction)
 - Medi-Cal
 - AFDC/TANF
 - Corrections

Factors Lowering the 1997-98 Reserve

- Savings dependent on federal action (\$335 million additional state costs)
 - SSI/SSP MOE relief
 - Reimbursements for illegal immigrant felons
- Other costs (\$125 million additional state expenditures) for expenses such as:
 - Disaster relief
 - Local property tax administration

Federal Assumptions. Partly offsetting these savings are \$335 million in increased costs associated with adjustments we have made to the budget's assumptions about federal actions (which were discussed earlier and shown in Figure 6). Specifically, our estimates do not include \$268 million in SSI/SSP savings that depend on maintenance-of-effort (MOE) relief from the federal government. We have made this adjustment because MOE relief was not included in the federal welfare reform program, and there is presently no provision in current federal law for such relief. We have also reduced by \$67 million the budget estimate of federal funds available in 1997-98 for the reimbursement for state costs of incarcerating

illegal immigrant felons. Our lower estimate is consistent with the level of federal funds included in the President's federal budget proposal for the 1997-98 fiscal year.

Other Costs. In addition, we have increased expenditures by a two-year total of \$125 million for 1996-97 and 1997-98 to reflect potential emergency expenses, and the likely cost of the local property tax administration loan program in 1997-98.

Implications of LAO's Estimates for the General Fund

Taking into account all of the factors discussed above, we project that the General Fund would remain in fiscal balance through 1997-98 under the Governor's budget proposal (see Figure 11).

Figure 11			
LAO's General Fund Condition With Governor's Proposals 1996-97 Through 1998-99			
<i>(Dollars in Millions)</i>			
	1996-97	1997-98	1998-99
Prior-year balance	\$685	\$867	\$1,219
Revenues and transfers	48,482	50,923	53,562
Total resources available	\$49,167	\$51,790	\$54,781
Expenditures	\$48,300	\$50,572	\$53,634
Ending fund balance	\$867	\$1,219	\$1,147
Other obligations	\$451	\$451	\$451
Reserve	\$417	\$768	\$696
Detail may not total due to rounding.			

Current-Year Outlook. We estimate that 1996-97 will end with a reserve of \$417 million, up from the budget estimate of \$197 million. The improvement is primarily related to our lower caseload estimates and higher revenue projections for the current year.

Budget-Year Outlook. We estimate that 1997-98 revenues will increase by 5 percent and expenditures will grow by 4.7 percent, generating a year-end reserve of \$768 million. This is up about \$214 million from the budget estimate of \$553 million.

1998-99 Outlook. For 1998-99, the year following the budget year, we project that the General Fund budget would remain in balance with a slightly lower reserve than in 1997-98. We project that revenues would grow by 5.2 percent, while expenditures would increase by 6.1 percent, resulting in a 1998-99 year-end reserve of \$696 million.

Resources Would Be Inadequate to Fund All Current-Law Spending Requirements. While we estimate that the Governor's proposal would result in a balanced budget, it is important to remember that the proposal includes significant spending reductions, including the elimination of the renters' credit, the extension of previously enacted temporary welfare reductions, and the elimination of prenatal services to undocumented immigrants. Without these or alternative savings of a similar magnitude, the budget would be out of balance. Thus, any alternative to the Governor's budget proposal would likewise require some budgetary savings relative to current law.

Key Budget-Related Issues and Considerations Facing the Legislature

The January budget proposal reflects the *Governor's* budgetary priorities for 1997-98. However, the *Legislature's* own budgetary priorities may differ from the Governor's. In addition, there are various risks and other budget-related issues and considerations inherent in the Governor's proposal of which the Legislature needs to be aware as it prepares to evaluate and make decisions regarding the Governor's proposal over the coming months.

Some of the most significant budget-related issues and considerations facing the Legislature are highlighted in Figure 12. These and other issues are discussed elsewhere in the remainder of this document and throughout our *Analysis of the 1997-98 Budget Bill*.

Figure 12**Key Budget-Related Issues and Considerations Facing the Legislature**

- Proposition 98 Spending.** How should additional Proposition 98 funding be allocated by program and between state versus locally determined priorities?
- Welfare Reform.** How should welfare reform be implemented in order to move recipients from welfare-to-work, while maintaining a safety net for children?
- Corporate Tax Cut.** What will be its economic and fiscal effects, and are there other options that should be considered for providing tax relief?
- Corrections.** Are there appropriate alternatives to traditional incarceration for certain offenders?
- Transportation.** How should the Legislature deal with the large shortfall in funds needed for seismic retrofit of state-owned toll bridges?
- Local Government.** In state-local fiscal matters, how should responsibilities be divided, and how can proper fiscal incentives and local flexibility be achieved?
- Budgetary Reserve.** Should the state take advantage of the opportunity its expanding economy provides to further rebuild its budgetary reserve?

