

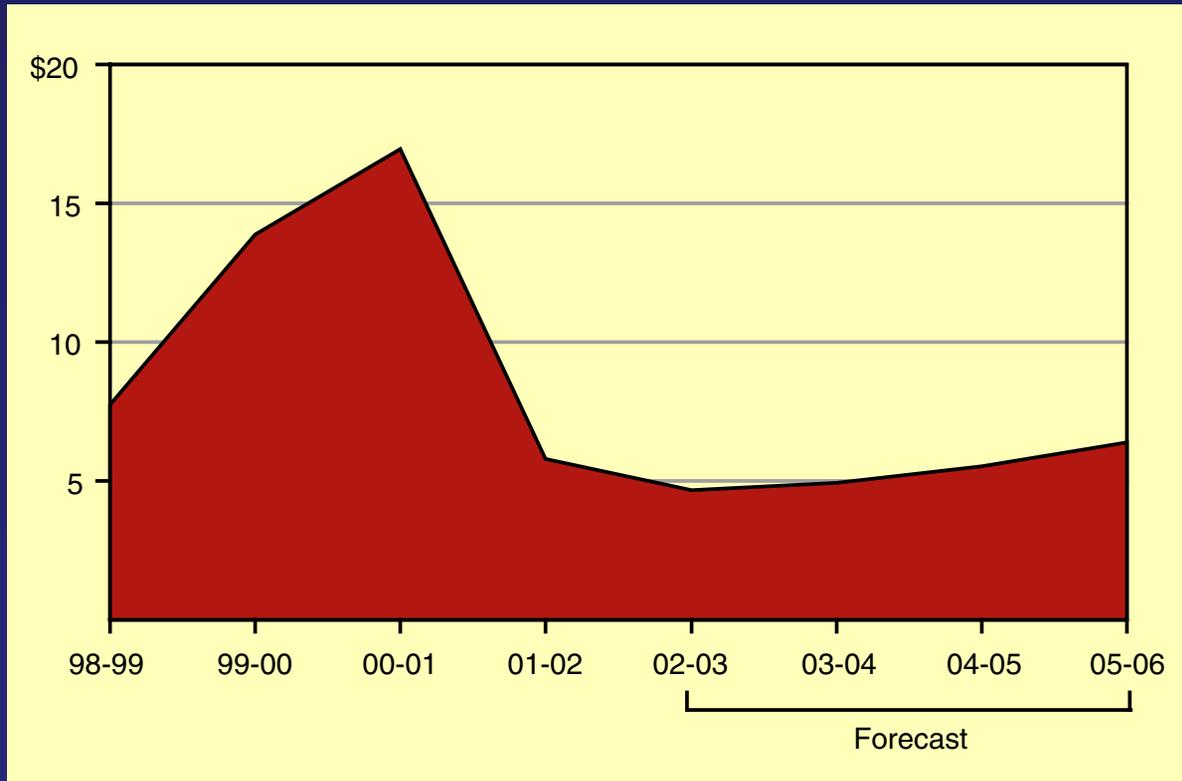
# The State's Budget Situation



Legislative Analyst's Office

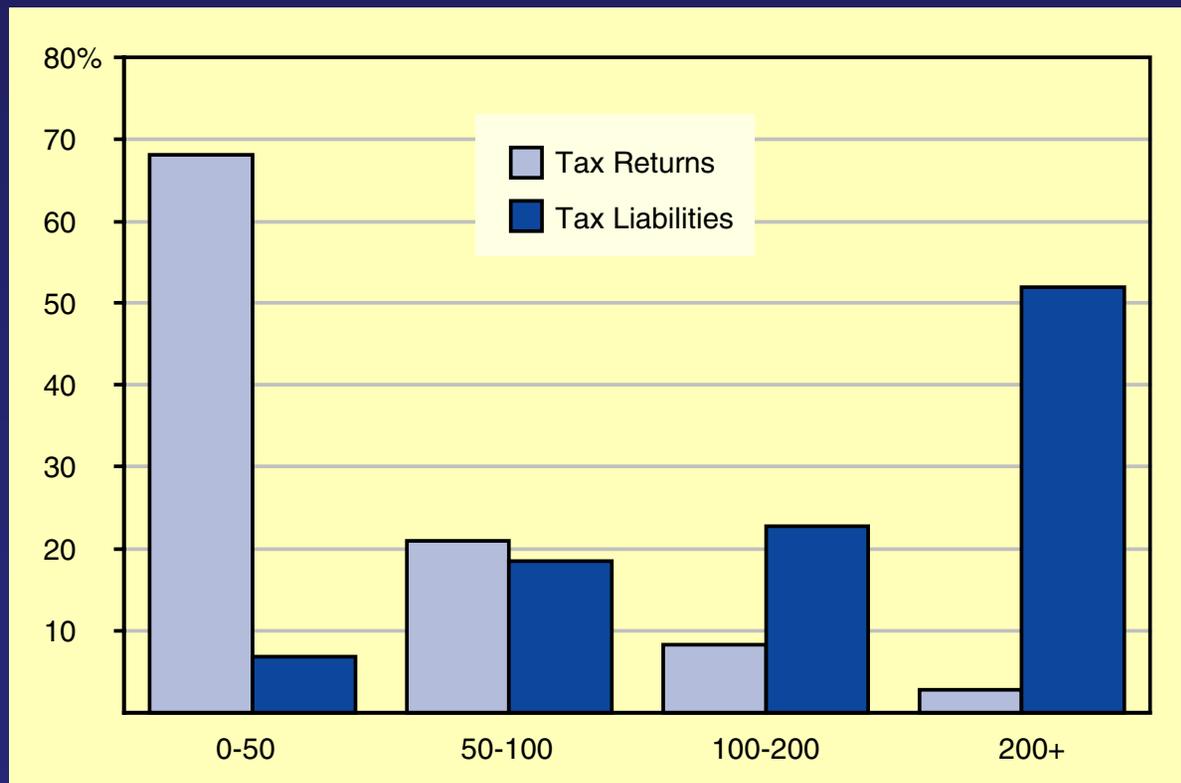
# The Capital Gains and Stock Options “Bubble”

(In Billions)



# Distribution of California Income Tax Returns And Liabilities by Adjusted Gross Income

In Thousands



# Stock-Price Index for Major California High-Tech Firms

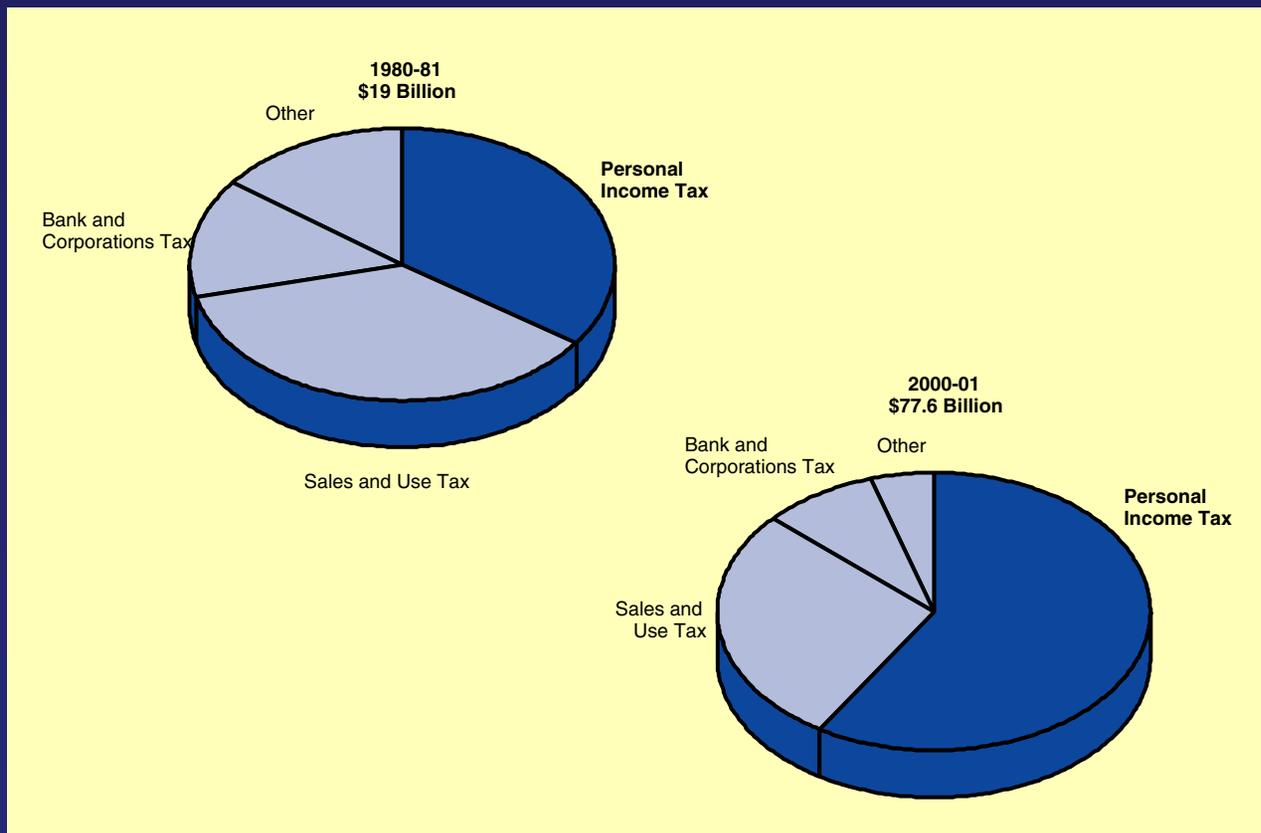
Percent of January 1999 level



# The PIT Has Become California's Dominant Revenue Source

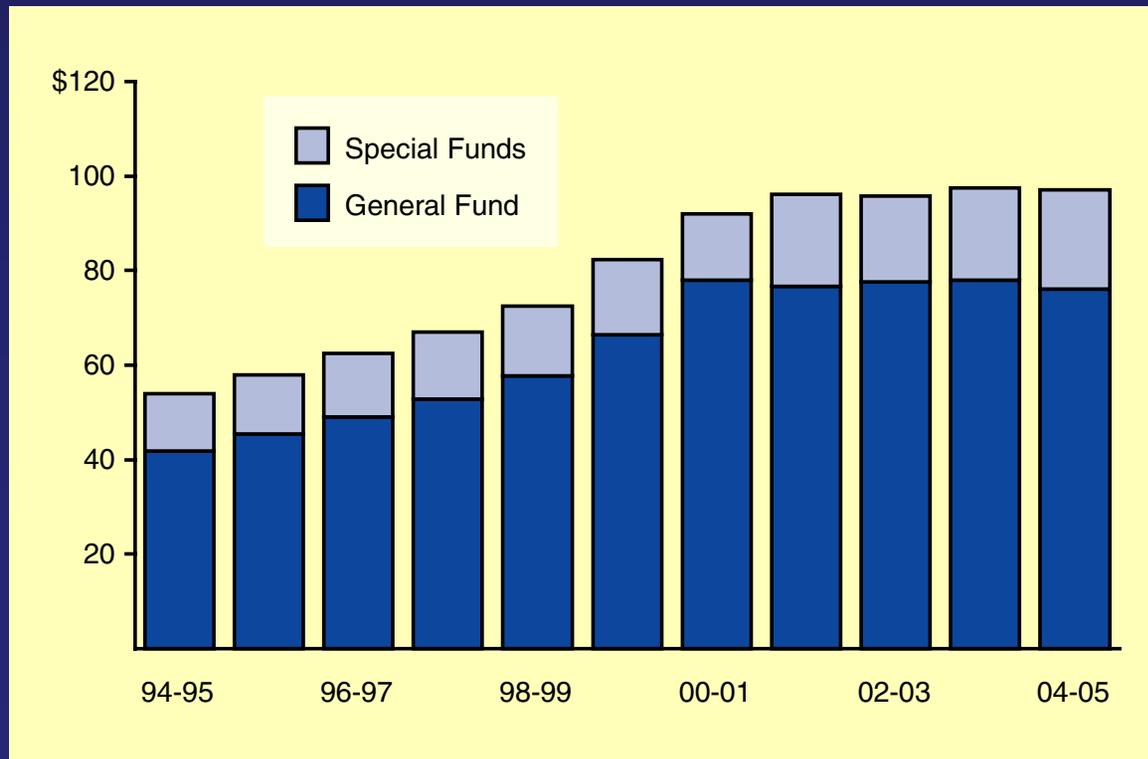
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## Total General Fund Revenues



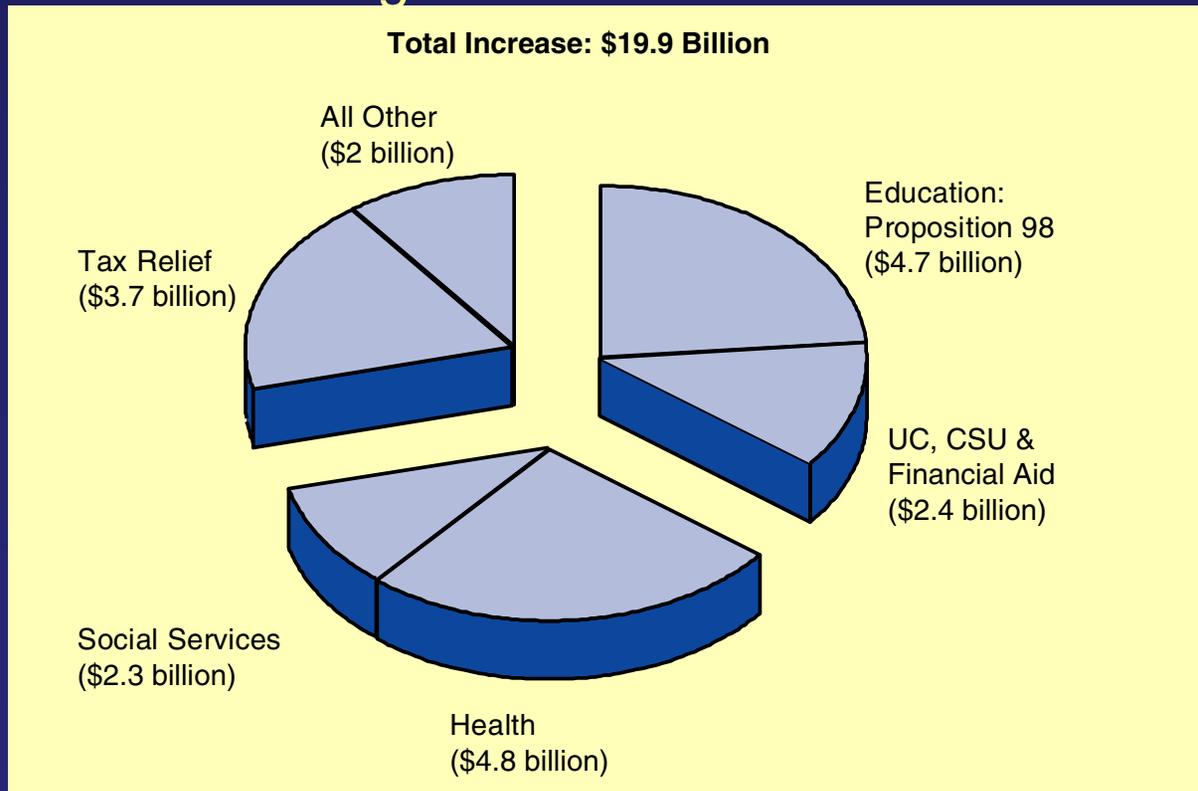
# Total State Spending Over Time

1994-95 Through 2004-05  
(In Billions)



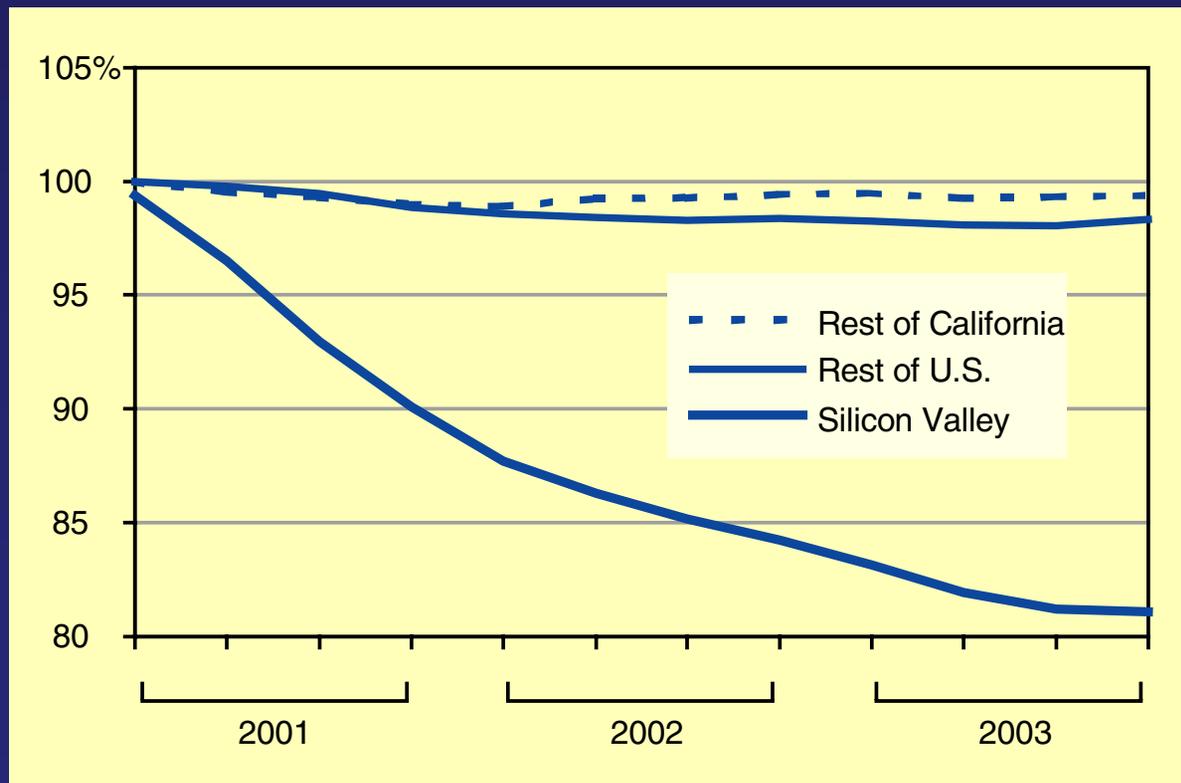
# Where Did The Money Go In The Good Times?

General Fund Spending Growth:  
1998-99 Through 2002-03



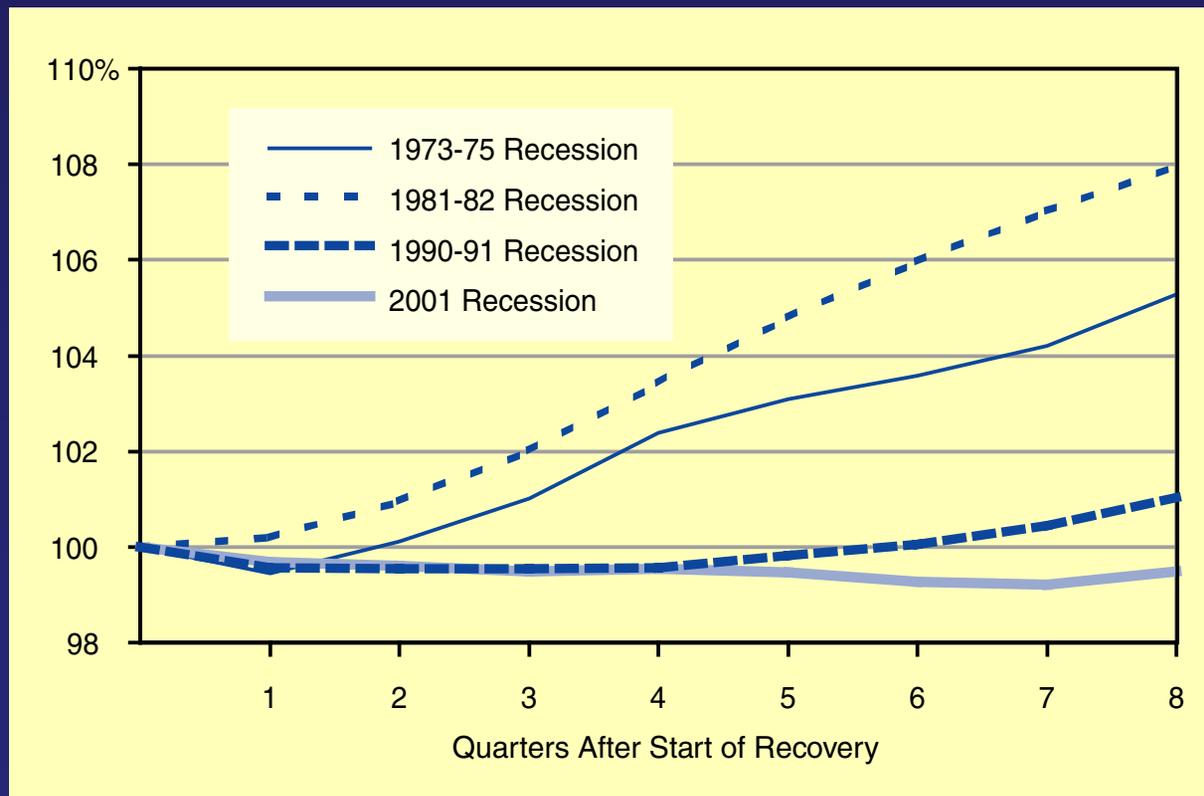
# California's Recent Employment Woes Concentrated in Silicon Valley

Wage and Salary Jobs, Percent of Prerecession Peak



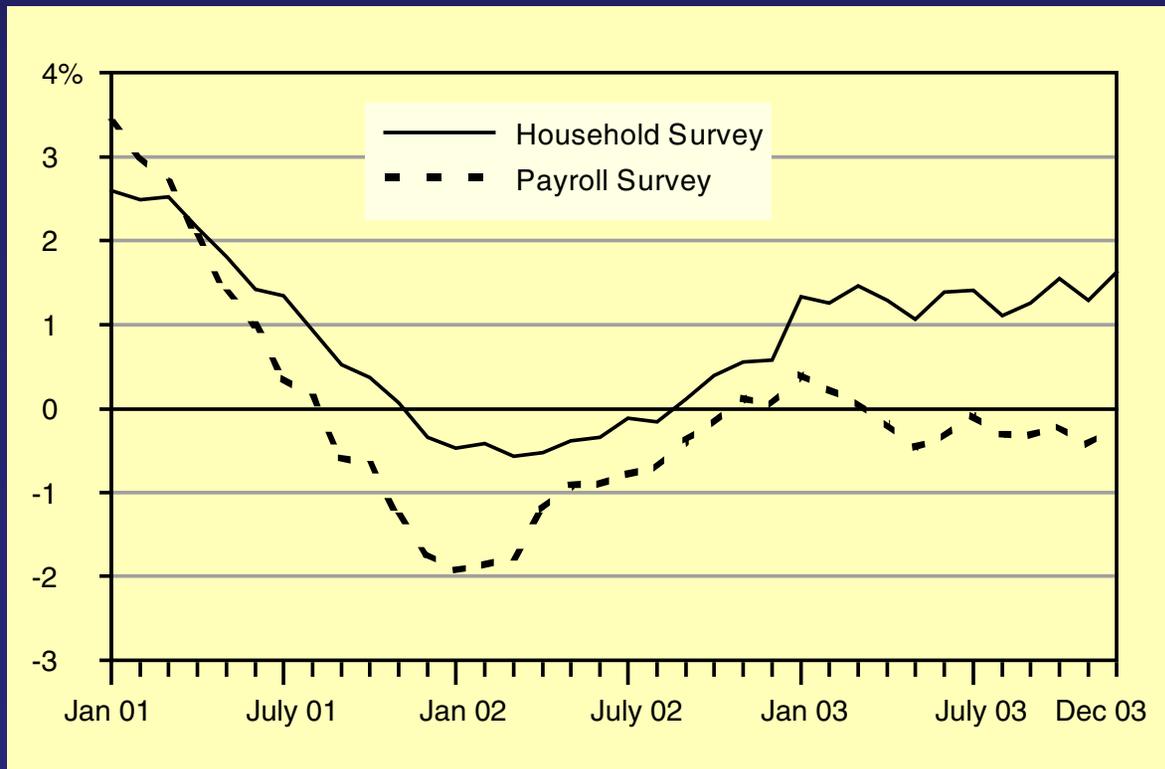
# U.S. Job Growth Lagging In Current Recovery

Wage and Salary Jobs, Percent of Level at Start of Recovery



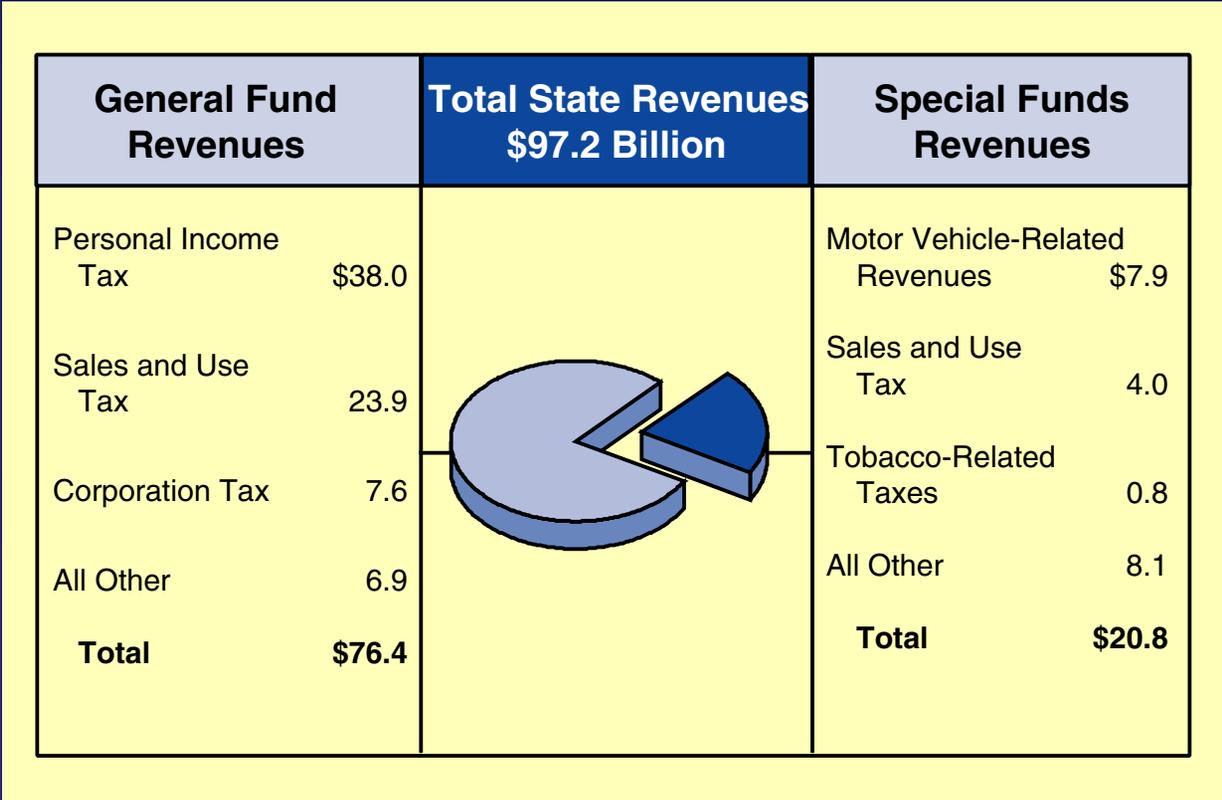
# Household Survey Is Showing More Growth Than Payroll Survey

Year-Over-Year Percent Change in California Employment, By Month



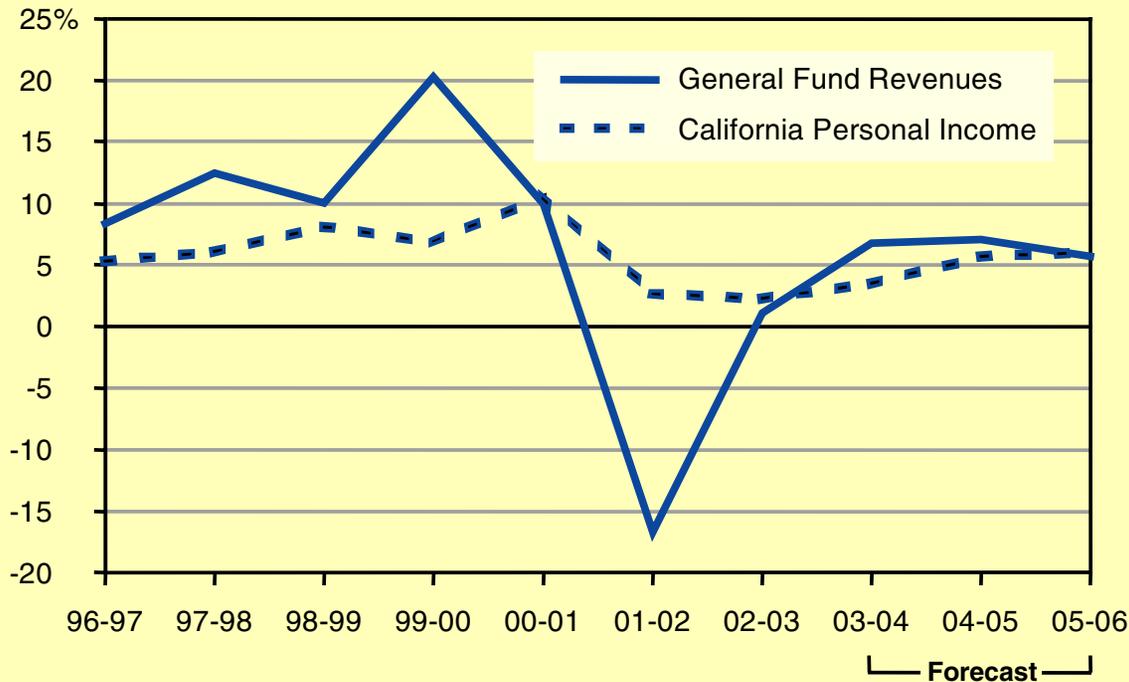
# State Revenues in 2004-05

(In Billions)



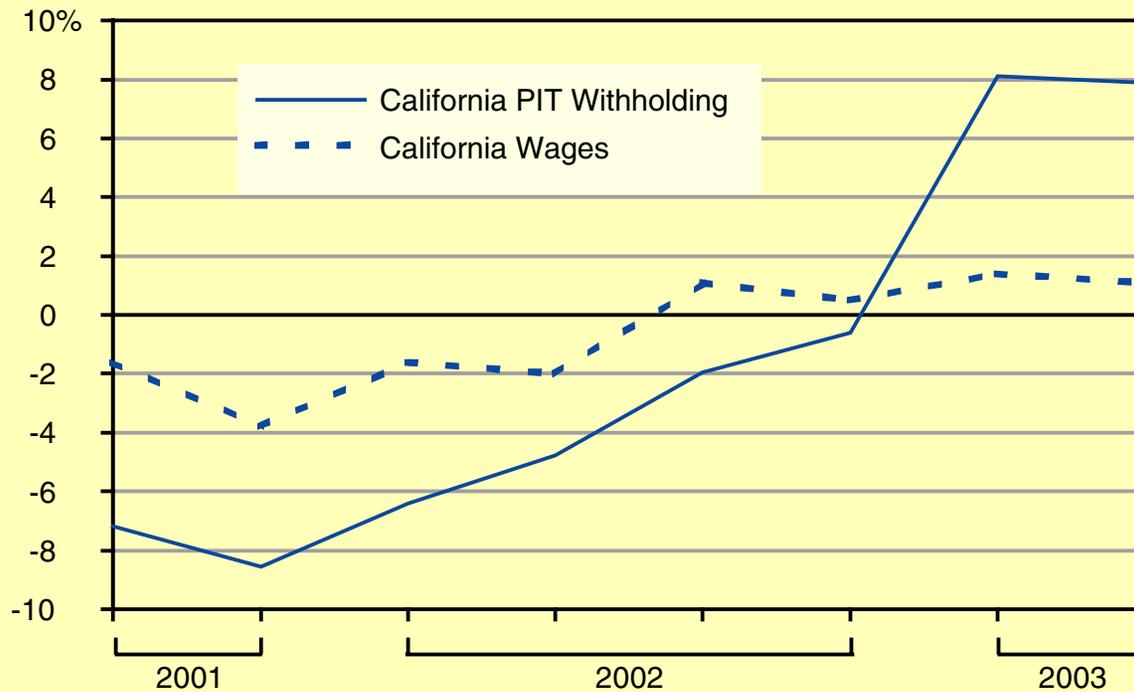
# After Dramatic Swings, Underlying Revenues to Expand Moderately

Annual Percent Change



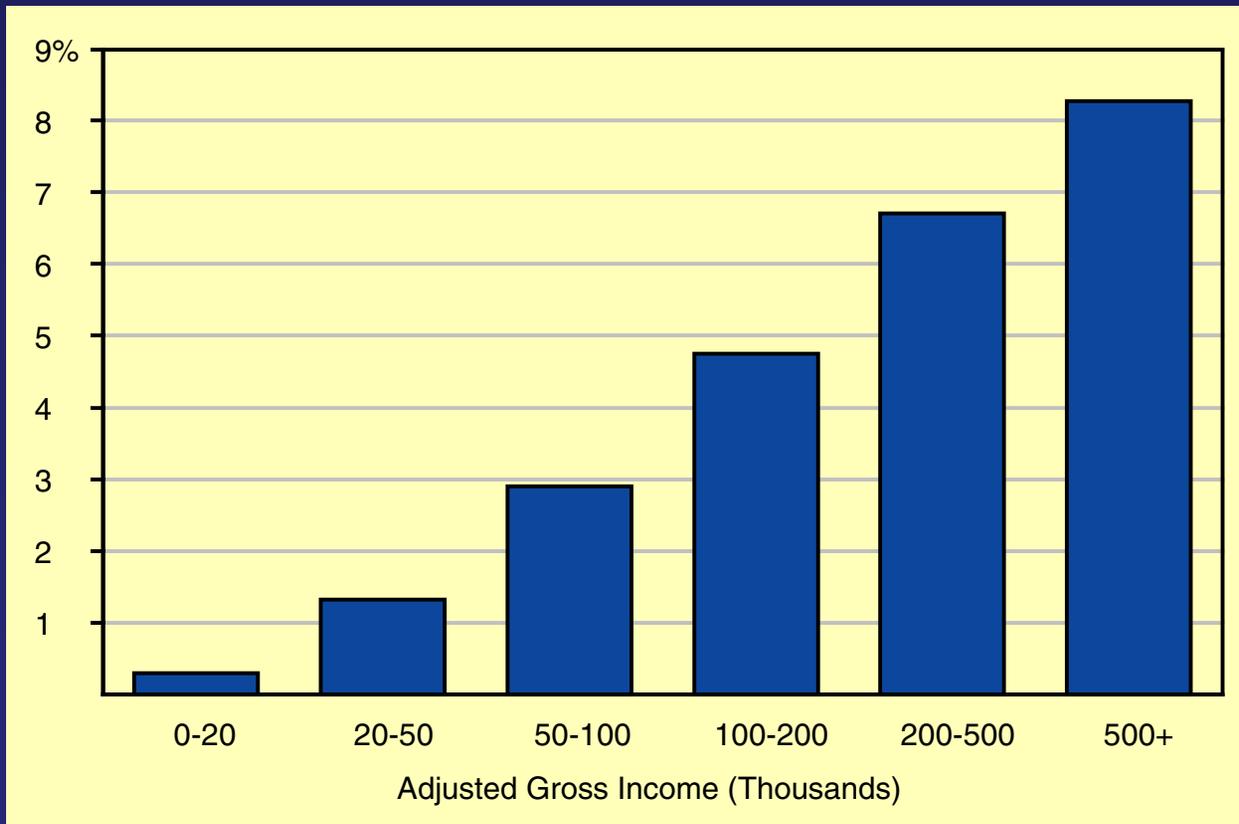
# PIT Withholding Growth Far Outpaced Wages in 2003

Year-to-Year Percent Change, by Quarter



# Percentage of California Income Paid to Personal Income Taxes

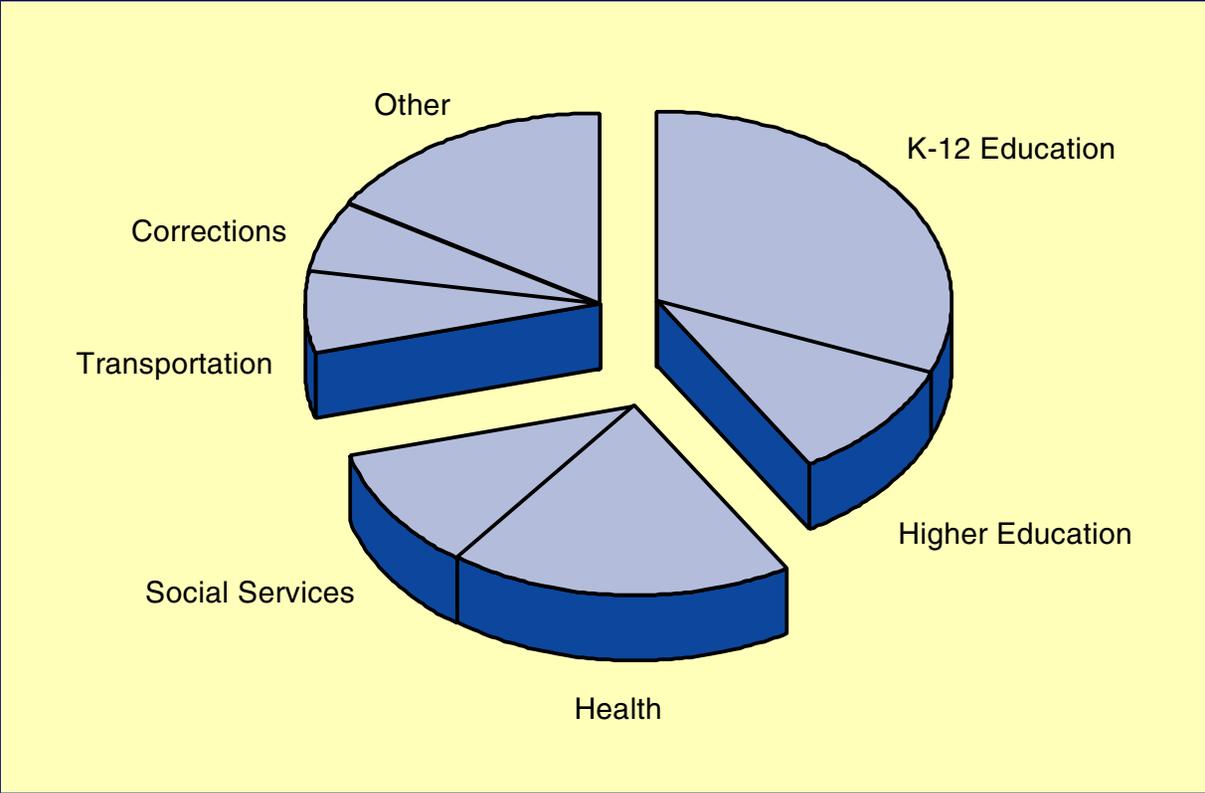
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# Proposed Total State Spending By Major Program Area

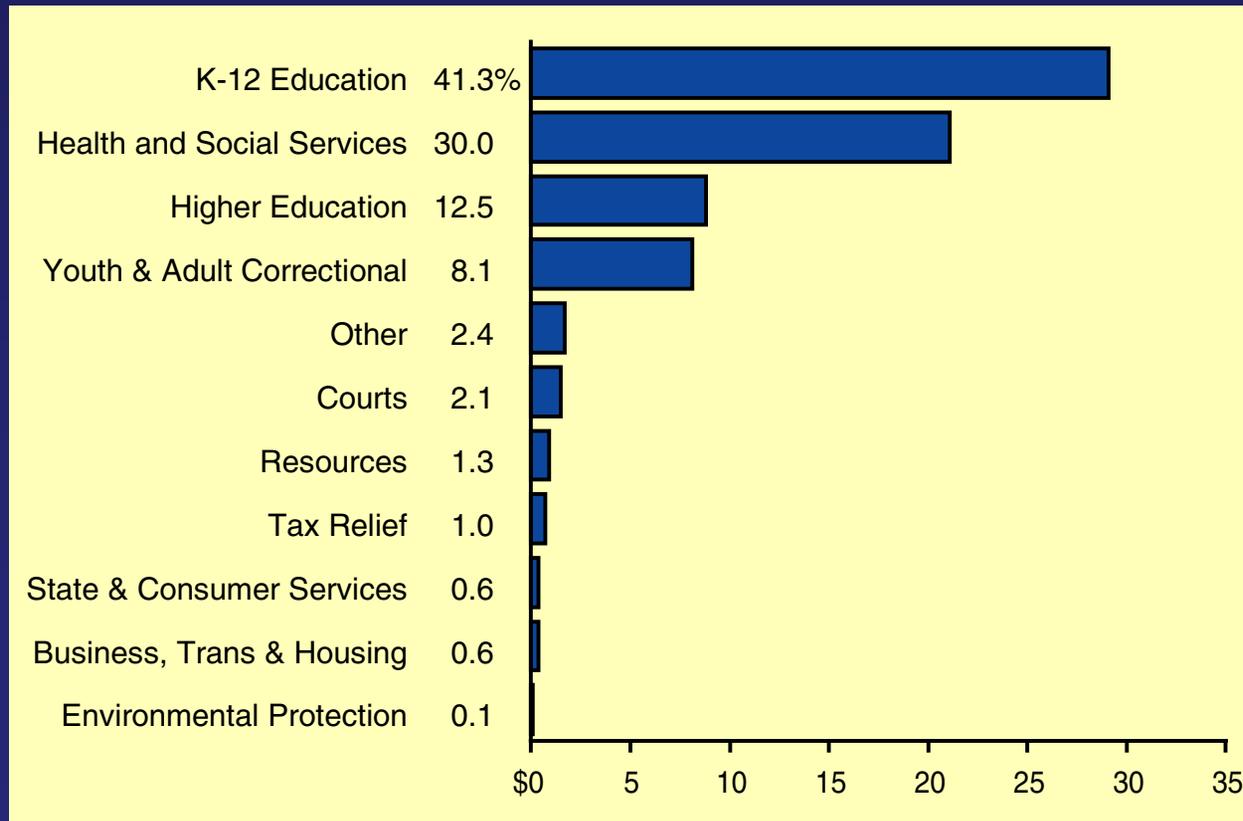
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2004-05



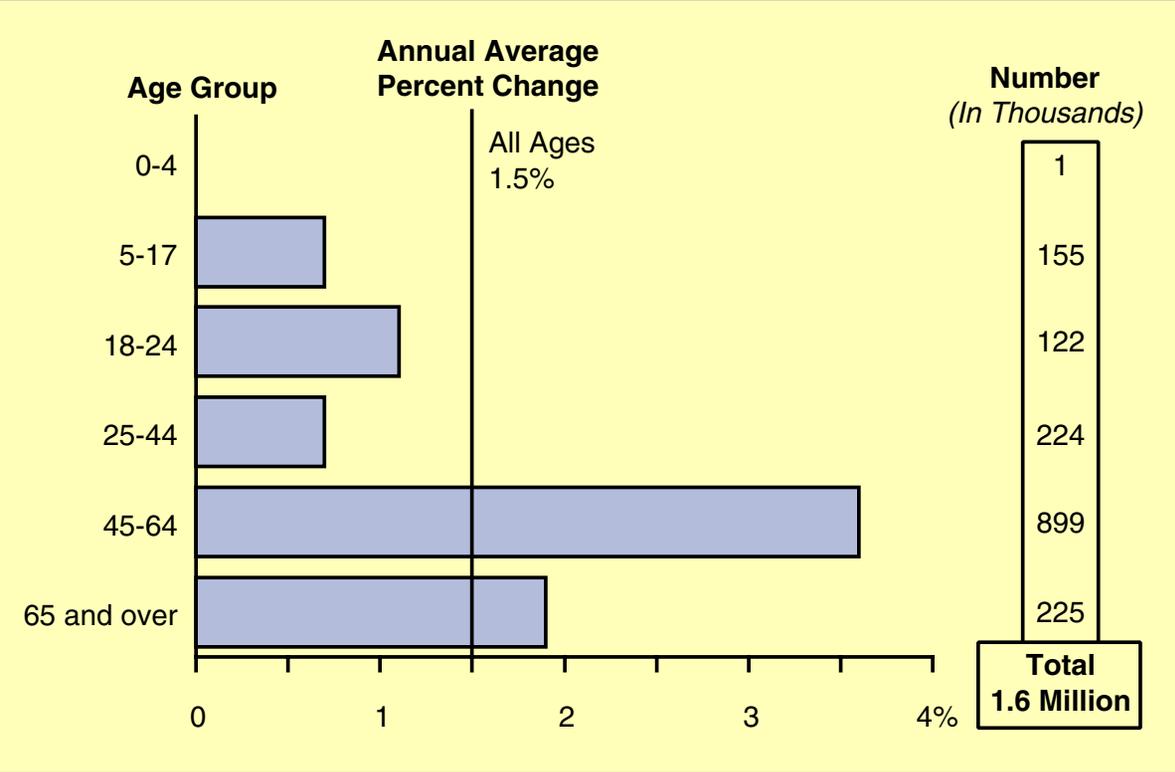
# What Makes Up State General Fund Spending?

(2003-04, Amounts In Billions)



# California's Population Outlook By Age Group

Population Change  
2003 Through 2006



# 2004-05 Shortfall Facing California

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- ▶ **Before Proposition 57—\$17 Billion**
- ▶ **After Proposition 57—\$12 Billion**
  - **New bond contributes \$5 billion to solution**
    - **\$3.7 billion from larger bond proceeds**
    - **\$1.3 billion from lower debt-service**

# Allocations of Governor's Proposed Budget Solutions

In Billions

|  | 2003-04<br>And Prior | 2004-05       | Two-Year<br>Total |
|--|----------------------|---------------|-------------------|
| Program reductions/savings               | \$0.8                | \$6.5         | \$7.3             |
| Economic Recovery Bond                   | 0.7                  | 4.3           | 5.0               |
| Other loans/borrowing                    | 1.6                  | 1.0           | 2.6               |
| Local government-related                 | —                    | 1.8           | 1.8               |
| Transfers/other revenues and fund shifts | 0.9                  | 0.8           | 1.6               |
| <b>Totals</b>                            | <b>\$4.0</b>         | <b>\$14.4</b> | <b>\$18.3</b>     |

# Budget Overview: Key Findings

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- ▶ **Budget Modestly Out of Balance  
In 2004-05**
- ▶ **Major Budget Threats Could  
Increase Shortfall**
- ▶ **\$7 Billion Operating Shortfall Projected  
For 2005-06**
- ▶ **Reform Proposals Still Under  
Development**

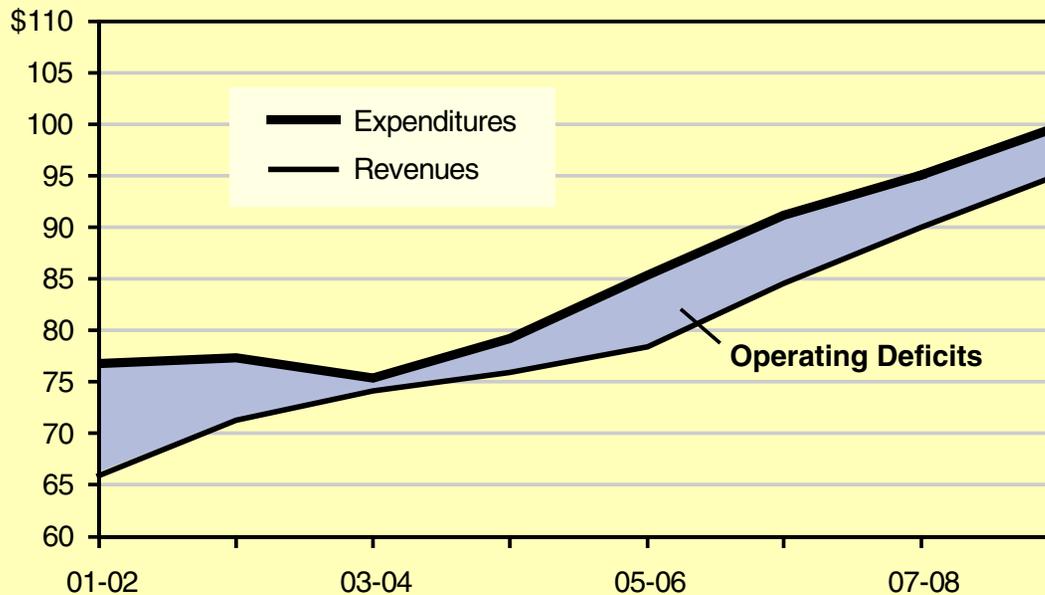
# Major Budget Threats

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- ▶ **Pension Obligation Bond**
- ▶ **Corporation Tax**
- ▶ **Medi-Cal Provider Rates**
- ▶ **Tribal Gaming**

# Large Operating Shortfalls to Persist Under Governor's Plan

General Fund  
(In Billions)



# Why Structural Shortfall Reemerges In 2005-06

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- ▶ **Expiration Of One-Time Savings After 2004-05**
  - Economic recovery bonds
  - Pension Bonds
  - Suspension of Proposition 42
- ▶ **Other Obligations In 2005-06**
  - Transportation loan repayment
  - Local mandates

# Legislative Considerations

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- ▶ **Hold Administration Accountable for Information**
- ▶ **Ongoing Solutions Critical**
- ▶ **Does the Budget Push Too Much Off Into the Future?**

# Proposition 57—Economic Recovery Bond

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- ▶ **Raises \$15 Billion To Cover Past And Projected Future Shortfalls**
- ▶ **Replaces Smaller (\$8.6 Billion) Statutory Bond**
- ▶ **Budget Proposes To Use:**
  - \$8.6 billion to eliminate 2002-03 deficit
  - \$3 billion to help with next year's shortfall
  - Remainder in 2005-06 or later

# Proposition 58

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- ▶ **Requires 3 Percent of Revenues Set-Aside Into Reserve**
- ▶ **Requires Budget That Is Passed Be Balanced**
- ▶ **Prohibits Most Forms Of Deficit Borrowing In Future**
- ▶ **Does Not Modify Existing Appropriations Limit**

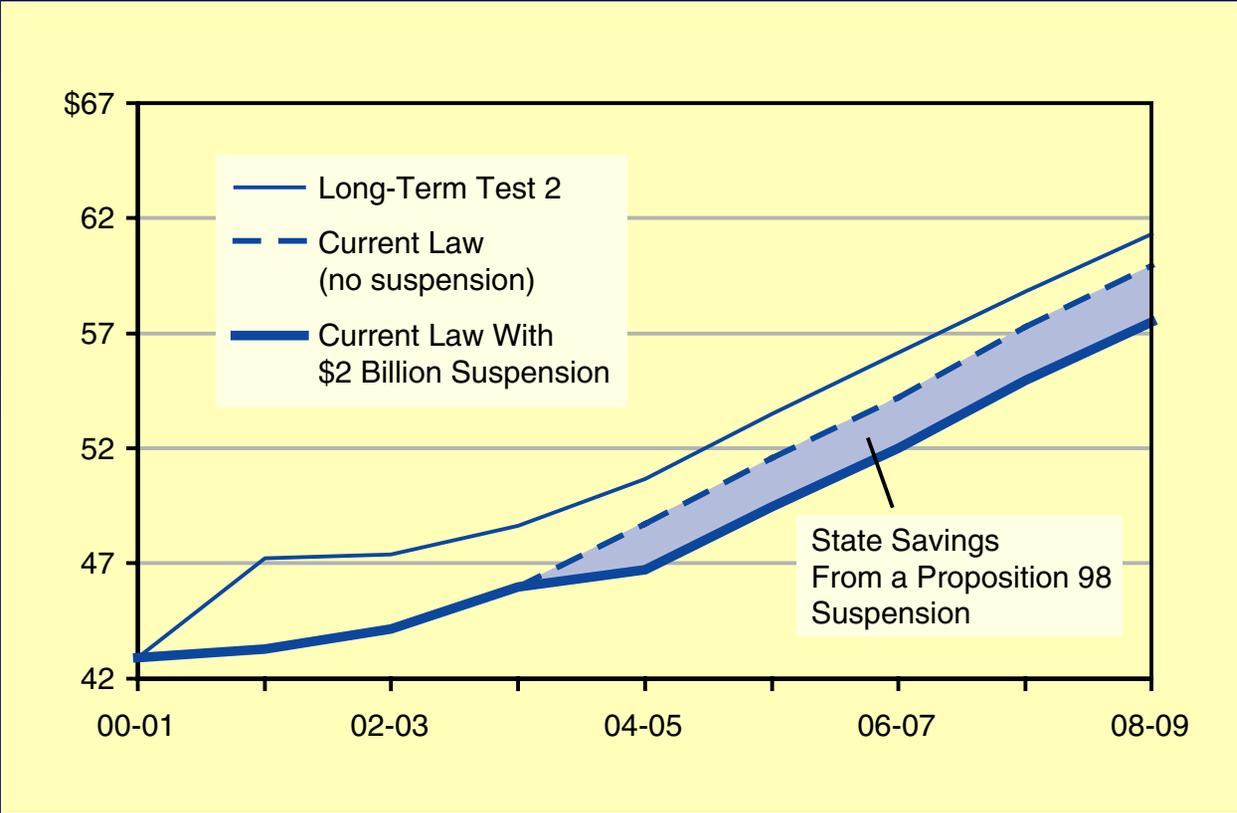
# Key K-12 Issues

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- ▶ **Suspend Prop. 98?**
  - If so, by how much?
  - Consider suspending in 2002-03 and 2004-05
- ▶ **Move Programs into Revenue Limits?**
- ▶ **Establish categorical block grants?**

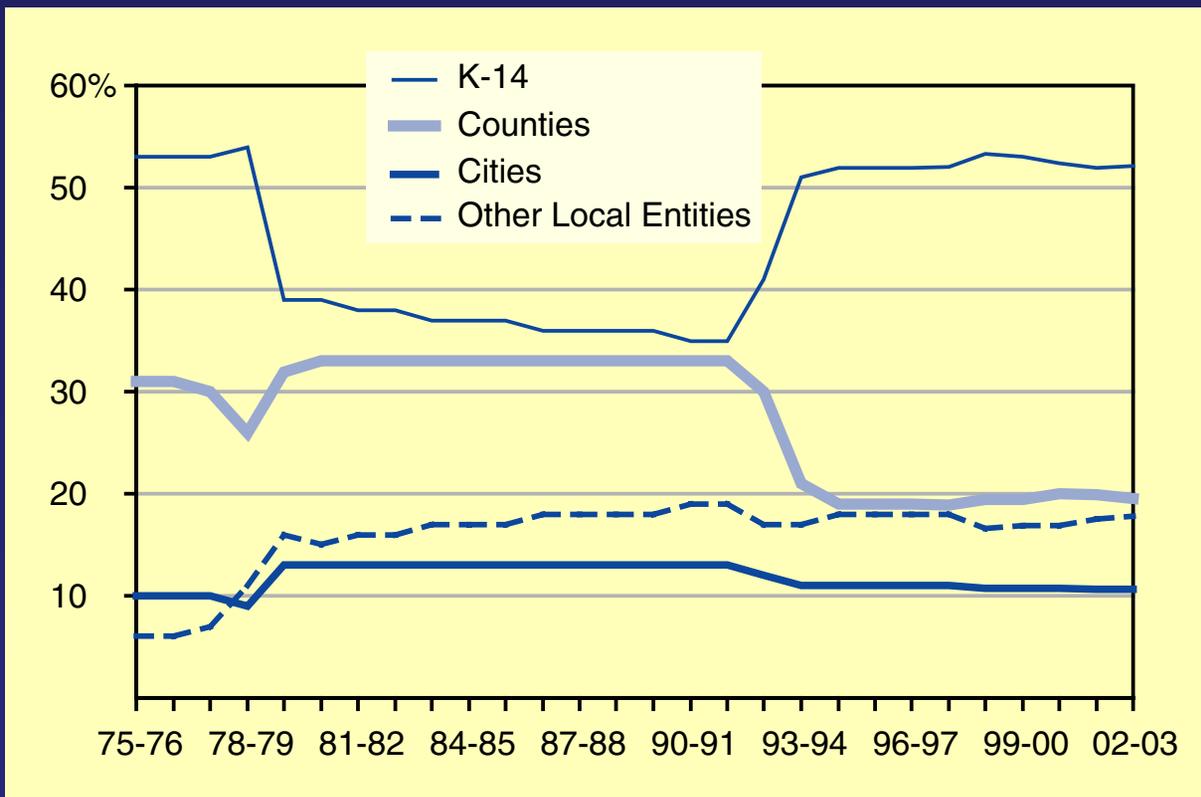
# Impact of Suspension on Proposition 98 Funding Over Time

(In Billions)



# Property Tax Allocation Over Time

Percent of Property Taxes Allocated to Local Agencies



# Key Local Government Issues

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- ▶ **Governor's proposed \$1.3 billion hit**
- ▶ **Mandate deferrals**
- ▶ **Booking fees**

# Guidelines to Consider in Reviewing Local Proposals

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- ▶ **Minimize Reductions to General Purpose Revenues**
- ▶ **Leave Past Formulas in the Past**
- ▶ **Allow Local Control**
- ▶ **Be Mindful of Effect on Land Use Incentives**
- ▶ **Consider Impact of Revenue Reductions**

# 2004-05 Local Gov't Proposals

(In Millions)

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|                     | Gov's Budget | LAO     |
|---------------------|--------------|---------|
| Counties            | \$909        | \$200   |
| Cities              | 188          | 200     |
| Redevelopment       | 135          | 320     |
| Special Districts   | 105          | 400     |
| Reduced Subventions | —            | 216     |
| Totals              | \$1,336      | \$1,336 |

# Mandate Reimbursements

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- ▶ **2004-05 Budget continues practice of deferring costs of most mandates**
  - State will owe locals (non-school) over \$1 billion by end of 2004-05
  - Does suspend additional mandates
- ▶ **Mandate process in need of reform**

# Local Government— Pending Initiative Measures

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## ▶ League/CSAC Measure

- Prohibit future revenue shifts
- Tighten mandate requirements

## ▶ Hertzberg Measure

- Comparable provisions to League/CSAC
- Also rearranges revenues:
  - Shifts sales tax (1/2 cent) and VLF to schools
  - Shifts property taxes to locals

# Maintain Higher Education Access in Tough Fiscal Times

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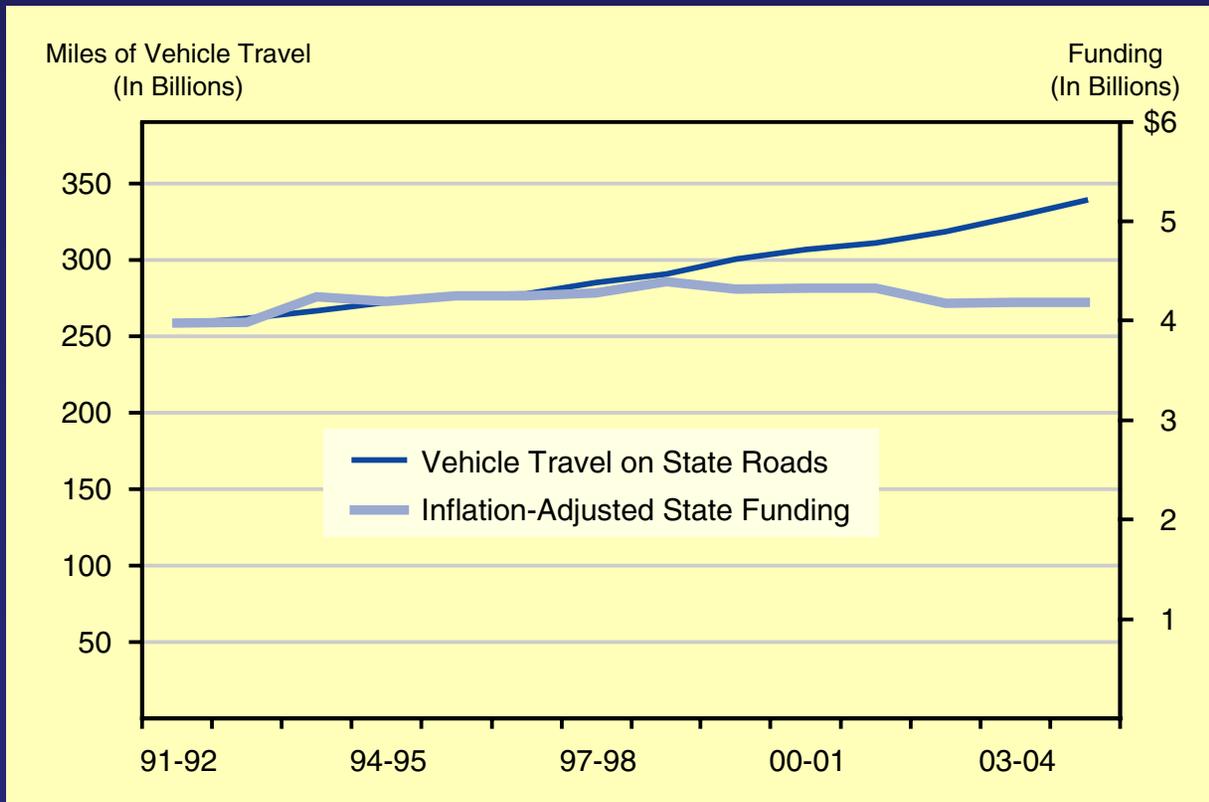
- ▶ **New College Preparation Block Grant**
- ▶ **Link Fees to Percent of Costs**
- ▶ **Link Cal Grants With Fee Levels**

# Transportation Project Delay Harms the Economy

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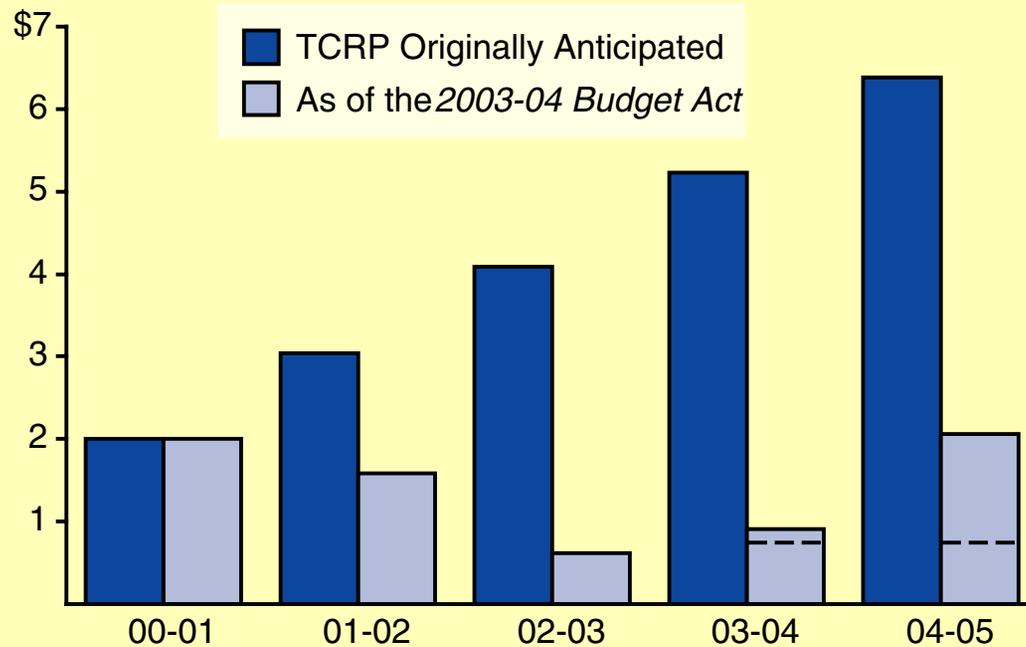
- ▶ **Congestion Costs Drivers More Than \$4.7 Billion a Year**
- ▶ **Transportation Funding Used to Help General Fund**
- ▶ **Transportation Funding Not Kept Pace With Road Use**

# State Transportation Funding Has Not Kept Pace With Road Use



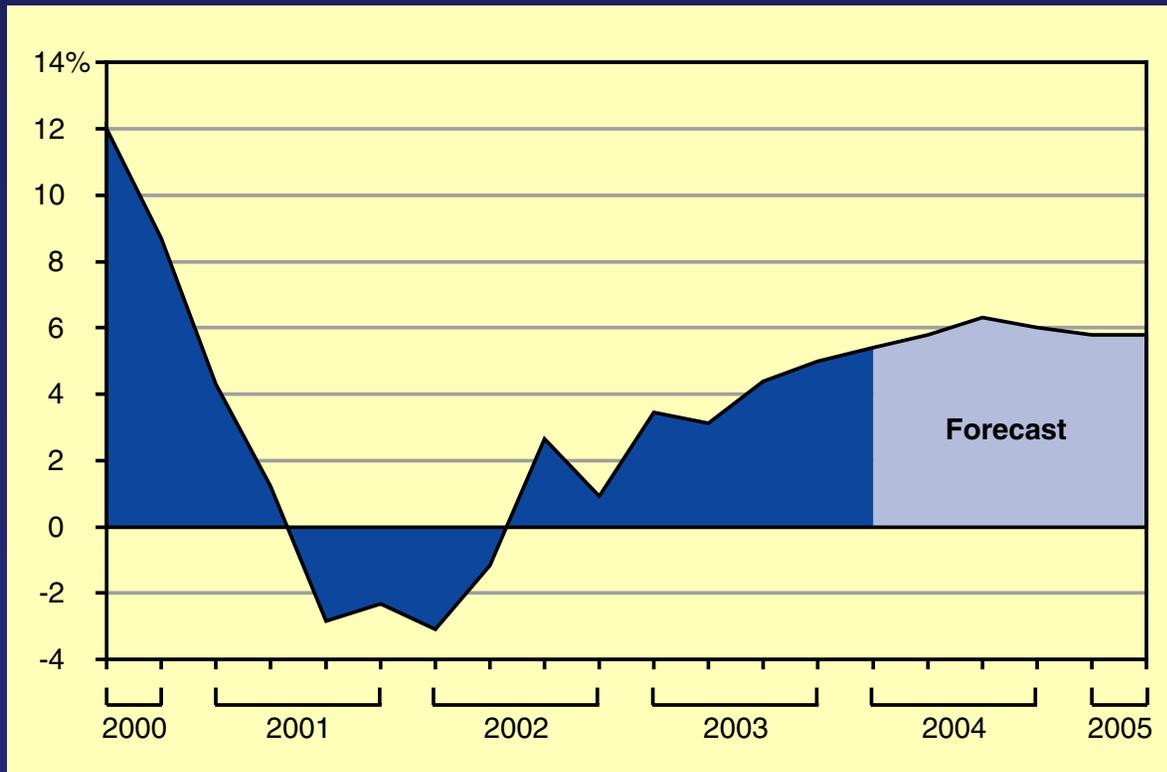
# Cumulative General Fund Money for Transportation

(In Billions)



# Taxable Sales Forecast— Continued Strengthening

Year-to-Year Percent Change, by Quarter



# For Your Reference

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▶ **LAO Web Site:**

- [www.lao.ca.gov](http://www.lao.ca.gov)

▶ ***See The Perspectives and Issues:***

- *Another Property Tax Shift? (p.119)*
- *Mandates: Mounting Liabilities and Need for Reform (p. 197)*