

MARCH ON THE CAPITOL

FEBRUARY 28, 1984

LEGISLATIVE ANALYST

STATE OF CALIFORNIA

925 L STREET, SUITE 650

SACRAMENTO, CALIFORNIA 95814

LEAGUE OF CALIFORNIA CITIES

"March on the Capitol"  
Sacramento Convention Center

I. INTRODUCTION

A. ICE BREAKER

B. PURPOSE OF MY REMARKS

1. LAY OUT THE FISCAL PARAMETERS WITHIN WHICH THE LEGISLATURE WILL BE OPERATING AS IT ATTEMPTS TO:
  - a. PUT TOGETHER A BUDGET FOR 1984-85
  - b. RATIONALIZE THE WAY IN WHICH STATE POLICIES AFFECT LOCAL GOVERNMENT BUDGETS
2. I WON'T TRY TO TELL YOU WHERE THE LEGISLATURE WILL BE COMING OUT WITHIN THESE PARAMETERS, FOR TWO REASONS:
  - a. FIRST, IT'S WAY TOO EARLY TO BEGIN SPECULATING ON THESE MATTERS; AND
  - b. SECOND, AND MORE IMPORTANTLY, YOU'RE GOING TO BE SPENDING THE AFTERNOON WITH A GROUP OF INDIVIDUALS WHO ARE IN A MUCH BETTER POSITION THAN I AM TO MAKE SUCH PREDICTIONS.

C. OVERVIEW

1. BEFORE GETTING STARTED, LET ME SAY THAT THOSE OF YOU WHO CAME HOPING FOR GOOD NEWS REGARDING THE NEAR-TERM OUTLOOK FOR STATE REVENUES ARE NOT GOING TO BE DISAPPOINTED.
2. LET ME ALSO SAY THAT THOSE OF YOU WHO WOULD BE OVERCOME BY SURPRISE IF THE LEGISLATIVE ANALYST, FOR A CHANGE, CAME OUT WITH A TOTALLY UPBEAT FORECAST, NEED NOT BE CONCERNED EITHER.



II. A LITTLE HISTORY

A. TOUGH TIMES FOR THE STATE'S TREASURY

1. AS I KNOW YOU ARE ALL AWARE, THE STATE'S TREASURY HAS BEEN THROUGH SOME DIFFICULT TIMES IN THE LAST SEVERAL YEARS.
2. TO APPRECIATE JUST HOW DIFFICULT THESE TIMES HAVE BEEN, WE NEED TO STEP BACK TO MAY 1981.
  - a. IN THAT MONTH, THE CONFERENCE COMMITTEE ON THE BUDGET WAS ADVISED BY THE DEPARTMENT OF FINANCE THAT THE STATE'S GENERAL FUND COULD EXPECT TO RECEIVE \$23.9 BILLION IN FISCAL YEAR 1982-83 (THE COMMISSION ON STATE FINANCE'S NUMBER WAS EVEN HIGHER).
  - b. HAD NO CHANGES BEEN MADE IN THE STATE'S TAX LAWS, THE ACTUAL AMOUNT OF GENERAL FUND REVENUE IN THAT YEAR WOULD HAVE BEEN AN EVEN \$20 BILLION -- \$3.9 BILLION LESS THAN THE INITIAL FORECAST.
  - c. WHY THE SHORTFALL? CLEARLY, IT WAS DUE TO THE SEVERE RECESSION THAT HIT CALIFORNIA IN 1982.
  - d. LOOKING BACK, THIS WAS TRULY AN EXTRAORDINARY CHANGE IN THE STATE'S FORTUNES.
  - e. THE RESULT OF THIS CHANGE WAS THREE YEARS IN A ROW OF REDUCED STATE EXPENDITURES IN REAL TERMS (THAT IS, EXPENDITURES ADJUSTED FOR INFLATION), BEGINNING WITH FISCAL YEAR 1981-82.

- (1) IN FACT, STATE EXPENDITURES IN THE CURRENT YEAR ARE ABOUT 12 PERCENT LESS THAN STATE EXPENDITURES IN 1980-81 -- WHICH WAS THE HIGH-WATER MARK IN TERMS OF PURCHASING POWER.
  - (2) IF YOU FURTHER ADJUST STATE EXPENDITURES TO DISREGARD LOCAL FISCAL RELIEF, THE STATE IS SPENDING IN 1983-84 ABOUT WHAT IT SPENT UNDER GOVERNOR REAGAN'S LAST BUDGET (1974-75), EVEN THOUGH THERE ARE ABOUT 20 PERCENT MORE CALIFORNIANS NOW THAN THERE WERE THEN.
3. PROBABLY THE LOW POINT IN THE STATE'S FISCAL FORTUNES OCCURRED ABOUT A YEAR AGO WHEN A \$1.6 BILLION DEFICIT IN THE GENERAL FUND BUDGET WAS PROJECTED FOR JUNE 30, 1983.
- B. SINCE LAST FEBRUARY, THERE HAS BEEN ANOTHER SHARP REVERSAL IN THE STATE'S FISCAL FORTUNES -- A REVERSAL THAT WAS FAR MORE WELCOME THAN THE ONE THAT PRECEDED IT.
1. THE DEFICIT ON JUNE 30, 1983 TURNED OUT TO BE ONLY \$521 MILLION, OR ABOUT \$1.1 BILLION LESS THAN WHAT WAS ANTICIPATED JUST FIVE MONTHS EARLIER.
  2. BY THE END OF THE CURRENT YEAR, EVEN THIS DEFICIT WILL HAVE BEEN PAID OFF.



III. OUTLOOK FOR 1984-85

A. REVENUES PROJECTED IN THE GOVERNOR'S BUDGET

1. TURNING NOW TO THE FISCAL YEAR THAT BEGINS NEXT JULY 1, WE FIND THAT THE GOVERNOR'S BUDGET PROJECTS A CONTINUATION OF THE ECONOMIC RECOVERY AT LEAST THROUGH 1985.

a. SPECIFICALLY, HE PROJECTS THAT GENERAL FUND REVENUES IN 1984-85 WILL BE ABOUT \$2.5 BILLION HIGHER THAN REVENUES IN THE CURRENT YEAR.

b. ADJUSTING FOR CERTAIN ONE-TIME FACTORS, THIS REPRESENTS ABOUT A 15 PERCENT INCREASE OVER THE CURRENT-YEAR LEVEL.

2. MY STAFF AND I SHARE THE GOVERNOR'S OPTIMISM FOR 1984-85, AND MY ADVICE TO THE LEGISLATURE IS TO ADOPT THE BUDGET'S REVENUE ESTIMATE AS THE BASIS FOR ITS FISCAL PLANNING.

B. WHAT DOES THIS IMPLY FOR THE BUDGET GENERALLY, AND FOR AID TO LOCAL GOVERNMENTS SPECIFICALLY?

1. FIRST, IT MEANS THAT FOR THE FIRST TIME IN THREE YEARS, THE CHOICE FACING THE LEGISLATURE IS NOT BETWEEN RAISING TAXES AND CUTTING SERVICES.

a. IN FACT, THE LEGISLATURE COULD CONTINUE THE EXISTING LEVEL OF SERVICES, ADJUSTED TO REFLECT THE EFFECTS OF INFLATION, CHANGES IN CASELOAD, AND NEWLY AUTHORIZED PROGRAMS, AND STILL HAVE \$1.1 BILLION AVAILABLE FOR OTHER PURPOSES (INCLUDING INSURANCE AGAINST UNFORESEEN CONTINGENCIES).

- b. QUITE A DIFFERENCE FROM THIS TIME LAST YEAR, DON'T YOU THINK?
- 2. SECOND, THE REVENUE OUTLOOK MEANS THAT THE LEGISLATURE CAN PROVIDE THE FULL AMOUNT OF LOCAL FISCAL RELIEF CALLED FOR BY AB 8 WITHOUT HAVING TO REDUCE STATE PROGRAMS.
- C. WHAT THE REVENUE OUTLOOK DOES NOT IMPLY
  - 1. INTRODUCTION
    - a. IF I STOPPED HERE AND ENTERTAINED YOUR QUESTIONS, I SUSPECT YOU'D ALL GO HOME HAPPY.
    - b. THERE ARE A COUPLE OF OTHER CONSIDERATIONS, HOWEVER, THAT YOU NEED TO KEEP IN MIND IN ASSESSING THE PROSPECTS FOR 1984-85.
      - (1) ONE HAS TO DO WITH THE PENT-UP DEMANDS FOR SPENDING INCREASES THAT ARE A VERY REAL PART OF THIS YEAR'S BUDGET PICTURE.
      - (2) THE OTHER CONSIDERATION HAS TO DO WITH THE ECONOMIC OUTLOOK BEYOND THE BUDGET YEAR.
  - 2. PENT-UP DEMAND
    - a. SIMPLY COMPARING AVAILABLE RESOURCES TO CURRENT SERVICE REQUIREMENTS, AS I DID A FEW MOMENTS AGO, CAN GIVE A VERY INCOMPLETE PICTURE OF WHAT THE LEGISLATURE HAS TO WORK WITH IN THE SPRING OF 1984.

- b. THIS IS BECAUSE SUCH A COMPARISON IGNORES COMPLETELY THE COST OF THOSE SERVICES THAT WERE PROVIDED IN 1980-81 AND 1981-82 BUT ARE NOT BEING PROVIDED IN THE CURRENT YEAR BECAUSE OF BUDGET CUTBACKS.
  - c. ALTHOUGH THESE SERVICES ARE OVERLOOKED IN A "CURRENT SERVICES" COMPARISON, I GUARANTEE YOU THEY ARE NOT BEING OVERLOOKED BY THOSE WHO USED TO RECEIVE THEM.
  - d. AMONG THE AREAS WHERE PENT-UP DEMANDS ARE PARTICULARLY SIGNIFICANT ARE:
    - (1) PROVIDER RATE INCREASES UNDER MEDI-CAL;
    - (2) THE IN-HOME SUPPORTIVE SERVICES PROGRAMS;
    - (3) SALARY INCREASES FOR STATE EMPLOYEES;
    - (4) FUNDING FOR THE COUNTY-RUN MEDICALLY INDIGENT ADULT PROGRAM; AND
    - (5) COMMUNITY COLLEGES.
  - e. FOR THESE AND A LOT OF OTHER RECIPIENT GROUPS, THE GOVERNOR'S BUDGET PROVIDES ONLY THE LAUNCHING PLATFORM, NOT THE END OF THE RAINBOW.
3. THE LONG-TERM OUTLOOK
- a. AS I MENTIONED A FEW MOMENTS AGO, MY COLLEAGUES AND I GENERALLY SUBSCRIBE TO THE VIEW THAT 1984-85 WILL BE A GOOD YEAR FOR THE STATE'S ECONOMY . . . AND THEREFORE A GOOD YEAR FOR REVENUES.



- b. BEYOND 1984-85, HOWEVER, I AM NOT NEARLY SO OPTIMISTIC -- NOT BECAUSE OF WHAT IS LIKELY TO HAPPEN IN SACRAMENTO, BUT BECAUSE OF WHAT IS LIKELY NOT TO HAPPEN IN WASHINGTON.
- c. TO BE OPTIMISTIC REGARDING THE PROSPECTS FOR 1985-86 AND 1986-87, YOU'VE EITHER GOT TO BELIEVE:
  - (1) THAT FEDERAL BUDGET DEFICITS IN THE \$200 - 300 BILLION RANGE WILL NOT JEOPARDIZE THE ECONOMY'S WELL-BEING, OR
  - (2) THAT THE PRESIDENT AND CONGRESS WILL ACT RESPONSIBLY TO BRING THE DEFICIT DOWN TO A SAFER LEVEL.
- d. I DON'T BELIEVE THE FORMER, AND I AM HAVING GREAT DIFFICULTY FINDING ANY REASON TO BELIEVE THE LATTER.
- e. CONSEQUENTLY, I SEE A VERY REAL POSSIBILITY THAT THE CURRENT ECONOMIC RECOVERY COULD ABORT IN MID-1985 OR 1986.
- f. WHAT THIS MEANS FOR THE 1984-85 BUDGET IS THAT THE STATE MUST SET ASIDE A SUBSTANTIAL AMOUNT AS A CONTINGENCY RESERVE . . . WHICH MEANS NOT SPENDING IT.
- g. THE GOVERNOR HAS TAKEN A LAUDABLE STEP IN THIS DIRECTION BY PROPOSING TO SET ASIDE \$950 MILLION FOR CONTINGENCIES.
- h. THIS IS A GOOD START, BUT IN MY JUDGMENT IT'S NOT ENOUGH.



(1) I HAVE RECOMMENDED THAT THE LEGISLATURE SHOOT FOR A RESERVE EQUAL TO 5 PERCENT OF GENERAL FUND EXPENDITURES, OR ABOUT ONE AND ONE-QUARTER BILLION DOLLARS.

(2) WHY 5 PERCENT?

(a) BECAUSE THIS IS WHAT THE STATE CAN EXPECT TO LOSE IN A MILD ECONOMIC DOWNTURN SUCH AS WE EXPERIENCED IN 1981-82.

(b) WHILE IT WILL NOT COVER THE REVENUE LOSSES THAT RESULT FROM A MORE SEVERE DOWNTURN, SUCH AS WE EXPERIENCED IN 1982-83, A RESERVE OF THIS SIZE WILL BUY ENOUGH TIME FOR THE GOVERNOR AND THE LEGISLATURE TO SEEK AND ADOPT ALTERNATIVES FOR AVOIDING A DEFICIT IN THE BUDGET.

- i. TO PUT IT AS BLUNTLY AS I CAN, IF WE CHOOSE NOT TO BUILD-UP A SIZABLE "RAINY DAY" FUND IN 1984-85, WHEN WE CAN AFFORD TO DO SO, WE PROBABLY WILL FIND OURSELVES IN 1985-86 OR 1986-87 IN MUCH THE SAME BIND WE WERE IN LAST YEAR AND THE YEAR BEFORE.
- j. AND WHEN LARGE CUTS HAVE TO BE MADE IN MID-YEAR, THE DAMAGE TO STATE AND LOCAL PROGRAMS GENERALLY IS CONSIDERABLY GREATER THAN IF THOSE CUTS CAN BE PLANNED AND IMPLEMENTED WITH MORE LEAD TIME.

D. SUMMARY

1. IN SUM, 1984-85 LOOKS LIKE A GOOD YEAR, AND THE THREAT TO THE CITIES' SHARE OF LOCAL FISCAL RELIEF FROM THE REVENUE SIDE OF THE BUDGET IS A LOT LESS THAN WHAT IT WAS IN RECENT YEARS.
2. BECAUSE THE YEARS PRECEDING AND FOLLOWING 1984-85 DO NOT LOOK QUITE AS GOOD IN TERMS OF RESOURCE AVAILABILITY, HOWEVER, THERE'S A LOT LESS ROOM IN THE 1984-85 BUDGET THAN APPEARS AT FIRST GLANCE.

IV. THE GOVERNOR'S PROPOSAL FOR FINANCING LOCAL GOVERNMENT

A. INTRODUCTION

1. BY NOW, YOU'RE ALL FAMILIAR WITH THE SPECIFIC FEATURES OF THE GOVERNOR'S PROPOSALS FOR REFORMING LOCAL GOVERNMENT FINANCING, SO I WON'T TAKE THE TIME TO REPEAT HERE.
2. LET ME SIMPLY GIVE YOU MY REACTION TO THE PROPOSAL AS IT IS LIKELY TO AFFECT CITIES.

B. MY REACTION

1. I SEE THE PROPOSED CONSTITUTIONAL AMENDMENT TO RESTORE THE CITIES' ACCESS TO THE GENERAL OBLIGATION BOND MARKET AS A MAJOR VIRTUE WITHOUT QUALIFICATION.
  - a. AS YOU KNOW, THE LEGISLATIVE ANALYST'S OFFICE HAS BEEN RECOMMENDING SUCH AN AMENDMENT SINCE 1979.
  - b. IF APPROVED BY THE VOTERS, IT SHOULD PROVIDE CITIES WITH MUCH GREATER FISCAL FLEXIBILITY THAN THEY HAVE NOW.



- c. IT ALSO SHOULD PERMIT REDEVELOPMENT AGENCIES TO GET BACK TO REDEVELOPMENT AND STOP USING THEIR BROAD POWERS TO FINANCE THE OPERATION AND MAINTENANCE OF EXISTING MUNICIPAL FACILITIES.
2. I SEE THE PROPOSALS TO REPEAL THE AB 8 DEFLATOR AND GUARANTEE V.L.F. AND CIGARETTE TAX SUBVENTIONS:
  - a. AS PROVIDING CERTAIN TACTICAL ADVANTAGES TO CITIES, SINCE YOU WOULD NO LONGER HAVE TO DEFEND YOURSELVES AGAINST CUTS IN STATE AID USING THESE MECHANISMS.
  - b. I DO NOT BELIEVE, HOWEVER, THAT THESE FEATURES OF THE PROPOSAL WOULD PROVIDE ANY STRATEGIC ADVANTAGE TO CITIES, BECAUSE THERE WOULD STILL BE WAYS TO SHORE UP THE STATE'S BUDGET BY CUTTING REVENUE TO CITIES -- SUCH AS BY REALLOCATING THE LOCAL PROPERTY TAX.
3. THE PROPOSAL TO PROVIDE REIMBURSEMENTS FOR CERTAIN MANDATED COSTS THROUGH A BLOCK GRANT SHOULD SAVE BOTH CITIES AND THE STATE MONEY, AND I FIND MYSELF SYMPATHETIC TO THIS IDEA AS WELL.
4. FINALLY, I THINK THERE IS MERIT IN THE GOVERNOR'S PROPOSAL TO ABANDON THE BUSINESS INVENTORY SUBVENTION, SINCE THESE SUBVENTIONS HAVE LITTLE TO DO WITH REVENUE LOSSES FROM THE BUSINESS INVENTORY EXEMPTION.
  - a. ON THE OTHER HAND, I AM MINDFUL THAT THIS PROPOSAL WILL COST CITIES ABOUT \$70 MILLION IN 1985-86.

- b. WHETHER THIS CUT IN STATE AID TO CITIES IS APPROPRIATE OR NOT, I CAN'T SAY, SINCE THE LEVEL OF SUCH RELIEF IS ARBITRARY TO BEGIN WITH.
- 5. IN SUM, THE PROPOSAL WILL PROVIDE SOME BENEFITS TO CITIES AT THE MARGIN.
- 6. THE BENEFITS, HOWEVER, ARE NOT DRAMATIC AND MAY NOT BE WORTH WHAT THEY WOULD COST YOU IN TERMS OF REVENUE LOSSES.
- C. OUTLOOK
  - 1. WHETHER YOU AGREE WITH MY REACTION OR NOT (I SUSPECT THAT WITH RESPECT TO THE BUSINESS INVENTORY EXEMPTION YOU DO NOT), YOU CAN TAKE HEART THAT RATIONALIZING THE FRAMEWORK FOR STATE-CITY FISCAL RELATIONS HAS FOUND ITS WAY TO THE FOREFRONT.
  - 2. AT THIS POINT, THERE SEEMS TO BE GENERAL AGREEMENT THAT IMPROVEMENTS NEED TO BE MADE, AND THE ONLY QUESTION IS HOW TO DO IT.

THANK YOU.

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