

REMARKS TO THE ORANGE COUNTY CHAMBER OF COMMERCE

APRIL 3, 1984

LEGISLATIVE ANALYST

STATE OF CALIFORNIA

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REMARKS TO THE ORANGE COUNTY CHAMBER OF COMMERCE
MANSION INN, SACRAMENTO, CALIFORNIA

I. INTRODUCTION

A. TOPIC

1. LETTER OF INVITATION ASKED ME TO SPEAK ON "THE STATE BUDGET IN TODAY'S ECONOMY".
2. I AM HAPPY TO DO SO.
3. I'M AFRAID, HOWEVER, THAT IF I CONFINE MYSELF TO THIS TOPIC, YOU'LL LEAVE SACRAMENTO WITH A VERY INCOMPLETE PICTURE OF THE BUDGET CHOICES FACING OUR LEGISLATORS IN 1984.
4. HERE'S A CASE WHERE A BROAD FIELD OF VISION IS ESSENTIAL -- WHERE YOU'VE GOT TO TAKE ACCOUNT OF WHAT'S ON EITHER SIDE OF YOU.
5. IT'S NOT UNLIKE THE SITUATION TWO OF MY FRATERNITY BROTHERS AT DARTMOUTH FOUND THEMSELVES IN ONE SUMMER WHEN THEY WERE DRIVING ACROSS COUNTRY.
 - a. THEY GOT INTO KANSAS CITY LATE ONE EVENING, HAD A FEW BEERS -- PERHAPS MORE THAN A FEW -- AND THEN HEADED OUT OF TOWN LOOKING FOR A PLACE TO UNFOLD THEIR SLEEPING BAGS.
 - b. THEY FOUND WHAT THEY THOUGHT WAS A NICE WOODED AREA WITH SOFT GRASS.
 - c. IT WASN'T UNTIL ABOUT 7:00 THE NEXT MORNING THAT THEY DISCOVERED THEIR CAMPSITE WAS ON THE MEDIAN STRIP OF INTERSTATE 70.

6. CONSEQUENTLY, WITH YOUR PERMISSION, I'M GOING TO EXPAND THE TOPIC GIVEN ME BY MARY-EVELYN AND TALK ABOUT "THE STATE BUDGET IN TODAY'S ECONOMY, TAKING INTO ACCOUNT YESTERDAY'S ECONOMY AND TOMORROW'S ECONOMY AS WELL".

B. TRANSITION

II. THE FISCAL OUTLOOK FOR 1984-85

A. FISCAL YEAR 1984-85 IS SHAPING UP AS A VERY GOOD YEAR.

B. MANIFESTATIONS

1. THE GOVERNOR'S BUDGET REPORTS THAT REVENUES WILL RISE 10½ PERCENT IN THE UPCOMING FISCAL YEAR.
2. IF YOU ADJUST FOR SOME ONE-TIME REVENUES THAT THE LEGISLATURE BUILT INTO THIS YEAR'S BUDGET, THE UNDERLYING INCREASE IS EVEN MORE IMPRESSIVE -- UP NEARLY 15 PERCENT.
3. A BETTER WAY OF MAKING THE POINT, PERHAPS, IS TO COMPARE THE AMOUNTS WE EXPECT TO TAKE IN NEXT YEAR WITH THE AMOUNTS WE WOULD NEED TO CONTINUE THIS YEAR'S LEVEL OF SERVICES.
 - a. THIS TAKES ACCOUNT OF RISING DEMANDS FOR SERVICES UNDER THE VARIOUS ENTITLEMENT PROGRAMS, PLUS
 - b. THE AMOUNTS NEEDED TO OFFSET THE EFFECTS OF INFLATION ON PURCHASING POWER.
 - c. WHEN WE MAKE THIS COMPARISON, WE FIND THAT THE STATE WILL HAVE ABOUT \$1.25 BILLION MORE THAN IT WOULD NEED TO MAINTAIN CURRENT SERVICE LEVELS.

- d. THIS \$1.25 BILLION, THEN, WOULD BE AVAILABLE FOR (1) EXPANDING EXISTING PROGRAMS, (2) LAUNCHING NEW PROGRAMS, OR (3) CUTTING TAXES.

C. INTERPRETATION

1. IF I WERE TO STOP HERE AND ASK IF THERE WERE ANY QUESTIONS, MANY OF YOU PROBABLY WOULD CONCLUDE THAT THE STATE'S GENERAL FUND IS ON EASY STREET, AND THAT MY BOSSES IN THE LEGISLATURE ARE FEELING NO FISCAL PRESSURE.
2. BOTH CONCLUSIONS WOULD BE WRONG BECAUSE THEY LOOK ONLY AT THE MEDIAN STRIP AND IGNORE THE CARS ROARING BY ON EITHER SIDE.

III. THE BUDGET IN CONTEXT

A. PERSPECTIVE

1. IN ORDER TO UNDERSTAND THIS YEAR'S BUDGET CONTEXT, WE HAVE TO TAKE ACCOUNT OF TWO THINGS THAT FALL OUTSIDE OF FISCAL YEAR 1984-85.
 - a. FIRST, WE NEED TO RECOGNIZE THE EXTENT TO WHICH STATE SPENDING HAS BEEN CURTAILED IN RECENT YEARS.
 - b. SECOND, WE NEED TO CONSIDER WHAT PATH THE ECONOMY IS LIKELY TO TAKE BEYOND THE BUDGET YEAR.
2. WHEN WE DO THIS, WE WILL FIND THAT THERE IS NOT QUITE AS MUCH SLACK IN THE FISCAL ROPE AS ONE MIGHT THINK.

B. RECENT TRENDS

1. AS EACH OF YOU KNOW, SIMPLY COMPARING THE AMOUNT SPENT IN ONE YEAR WITH THE AMOUNT SPENT IN ANOTHER YEAR DOES NOT

NECESSARILY TELL US ANYTHING ABOUT THE CHANGE IN THE QUANTITY OR QUALITY OF PUBLIC SERVICES BEING PROVIDED.

2. TO MAKE EXPENDITURE TOTALS MEANINGFUL, WE NEED TO ADJUST THEM FOR THE EROSION IN PURCHASING POWER THAT RESULTS FROM INFLATION.
3. SUCH AN ADJUSTMENT TO THE EXPENDITURE DATA FOR THE LAST 10 YEARS TURNS UP A VERY SURPRISING FACT:
 - a. EXCLUDING THE BAIL-OUT MONEY THAT THE STATE PROVIDES TO LOCAL GOVERNMENTS AS AN OFFSET TO PROPOSITION 13-INDUCED REVENUE LOSS, GENERAL FUND EXPENDITURES IN THE CURRENT FISCAL YEAR ARE ABOUT WHAT THEY WERE WHEN GOVERNOR REAGAN LEFT OFFICE AT THE END OF 1974.
 - b. THIS, IN TURN, SUGGESTS THAT THE LEVEL OF SERVICES BEING PROVIDED BY THE STATE THROUGH ITS GENERAL FUND, IN REAL TERMS, IS ABOUT WHAT IT WAS NINE YEARS AGO.
 - c. OVER THIS SAME NINE-YEAR PERIOD, THE NUMBER OF CALIFORNIANS HAS INCREASED BY 20 PERCENT.
4. PLEASE NOTE THAT I AM NOT WRINGING MY HANDS OVER THIS -- JUST POINTING OUT A FACT.
5. IT'S AN IMPORTANT FACT, HOWEVER, BECAUSE IT IS INDICATIVE OF THE PENT-UP DEMAND FOR SPENDING INCREASES THAT THE LEGISLATURE WILL HAVE TO DEAL WITH AS IT PUTS THIS YEAR'S BUDGET TOGETHER.
6. AFTER THREE YEARS OF RECESSION-INDUCED BUDGET CUTS THAT HAVE TRIMMED STATE EXPENDITURES (IN INFLATION-ADJUSTED DOLLARS) BY 12 PERCENT, THESE PENT-UP DEMANDS ARE ESPECIALLY STRONG.

7. THEY ARE MOST EVIDENT IN AREAS SUCH AS:
 - a. PUBLIC HEALTH, WHERE FUNDING LEVELS HAVE BEEN FROZEN FOR SEVERAL YEARS;
 - b. MEDI-CAL, WHERE PROVIDERS HAVE GOTTEN LITTLE OR NO INCREASES SINCE 1981;
 - c. STATE EMPLOYMENT, WHERE EMPLOYEES WENT TWO AND ONE-HALF YEARS WITH NO INCREASES;
 - d. COMMUNITY COLLEGES; AND
 - e. ELEMENTARY AND SECONDARY EDUCATION.
8. THUS, THE LEGACY OF THE LAST RECESSION IS A KEY FACTOR IN THE 1984-85 BUDGET PICTURE.

C. THE OUTLOOK BEYOND THE BUDGET YEAR.

1. AN EQUALLY IMPORTANT FACTOR IN UNDERSTANDING THE BUDGET PICTURE IS THE NEXT RECESSION -- THE RECESSION THAT I EXPECT TO BEGIN IN THE SECOND HALF OF 1985 UNLESS THE PARALYSIS OF THE POLITICAL SYSTEM AT THE FEDERAL LEVEL IS CURED.
2. YES, I'M AFRAID I'M ONE OF THOSE DEFICIT HYSTERICS THAT YOU'VE HEARD SO MUCH ABOUT.
3. MY LIMITED INSIGHTS INTO THE WORKINGS OF THE ECONOMY TELL ME THAT, WHILE WE MAY BE ABLE TO GET AWAY WITH A \$200 BILLION DEFICIT WHEN THE ECONOMY IS AT LOW EBB, WE CAN'T STAND SUCH DEFICITS AS THE ECONOMY BEGINS TO APPROACH FULL EMPLOYMENT.
4. I SAY THIS BECAUSE I DON'T SEE THE COMBINATION OF DOMESTIC SAVINGS AND FOREIGN INVESTMENT PROVIDING ENOUGH CREDIT TO SATISFY BOTH THE FEDERAL GOVERNMENT AND THE PRIVATE ECONOMY AT TODAY'S INTEREST RATES.

5. AND IT'S NOT HARD TO SEE WHO COMES OUT THE LOSER WHEN THESE DEMANDS COLLIDE.
 - a. IT CERTAINLY ISN'T GOING TO BE THE BORROWER WHOSE DEMANDS FOR CREDIT INCREASES AS INTEREST RATES INCREASE, AND WHO NEVER COMES UP EMPTY-HANDED.
 - b. NO, IT WILL BE THE HOMEBUYER, THE CAR BUYER, THE SMALL BUSINESSMAN THAT DOESN'T HAVE THE CASH FLOW TO SUPPORT HIS CAPITAL PURCHASES, AND EVERYBODY ELSE WHO CAN BE DRIVEN FROM THE MARKET BY HIGH INTEREST RATES.
6. WHEN THAT HAPPENS, WE WILL FIND THE STATE'S REVENUES ON THE "DOWN" ESCALATOR.
7. SO WHAT DOES ALL THAT HAVE TO DO WITH THE 1984-85 BUDGET?
8. JUST THIS:
 - a. IF WE HAVE LEARNED ANYTHING THESE LAST THREE YEARS, IT IS THAT THE STATE MUST HAVE A HEALTHY RESERVE TO CUSHION THE BUDGET WHEN REVENUES TAKE A TURN FOR THE WORSE.
 - b. NOT BECAUSE EVERYTHING IN THE BUDGET MUST BE PROTECTED FROM A DROP-OFF IN REVENUES; WHEN REVENUES DECLINE, EXPENDITURES SHOULD ALSO.
 - c. BUT IT TAKES TIME TO CUT BACK EXPENDITURES IN A SENSIBLE MANNER, AND A RAINY DAY FUND BUYS US THIS TIME.
9. THUS, I SEE THE STATE'S RAINY DAY FUND AS HAVING ONE OF THE PRIMARY CLAIMS ON 1984-85 REVENUES.
10. I'VE RECOMMENDED THAT BETWEEN \$950 MILLION AND \$1.25 BILLION BE SET ASIDE IN SUCH A FUND.

IV. CONCLUSION

- A. IN SUM, IF WE LOOK ONLY AT 1984-85, THE STATE'S GENERAL FUND BUDGET IS IN PRETTY GOOD SHAPE.
- B. WHAT'LL MAKE THE BUDGET DEBATE INTERESTING THIS YEAR IS THE COLLISION BETWEEN PENT-UP DEMANDS THAT HAVE BUILT UP DURING THE LAST RECESSION AND THE NEED TO REBUILD THE STATE'S RESERVE IN ORDER TO PREPARE FOR THE NEXT RECESSION.

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