

AN OVERVIEW OF THE 1995-96 ANALYSIS OF THE BUDGET BILL



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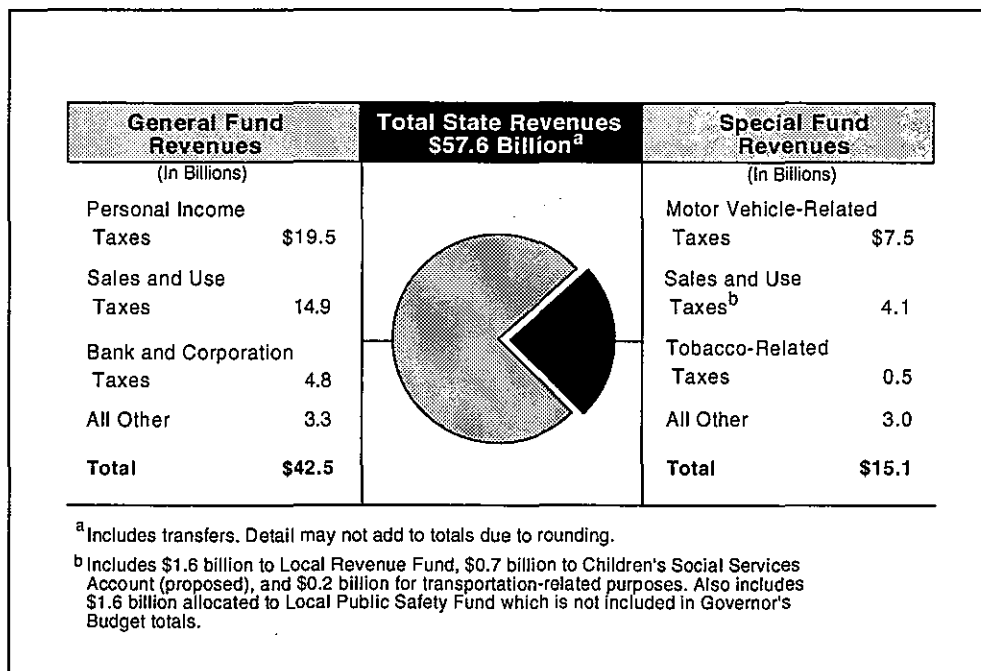
Presented to:
The Assembly Budget Committee

March 1, 1995

LEGISLATIVE ANALYST'S OFFICE



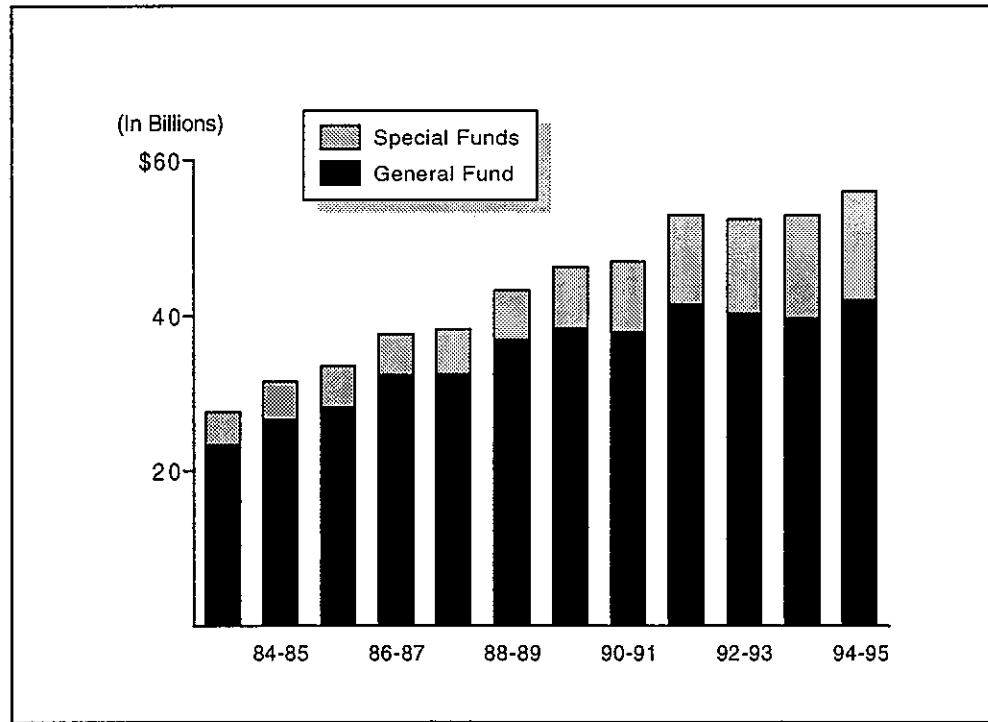
State Revenues in 1995-96



- General Fund revenues account for nearly three-fourths of total revenues.**
- Personal income taxes are the largest individual revenue source—over one-third of total revenues and 46 percent of General Fund revenues.**
- Special funds are usually earmarked for specific purposes, such as transportation funding. Motor vehicle-related levies account for half of all special fund revenues.**



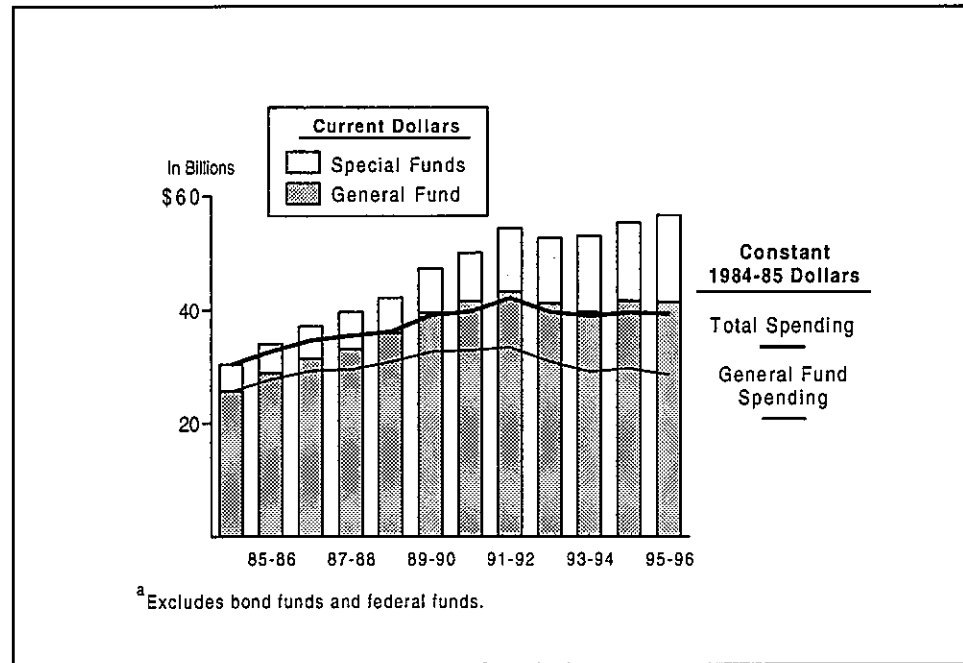
State Revenues Excluding Transfers 1983-84 Through 1994-95



- ✓ Total state revenues have experienced little overall growth over the past four years.
- ✓ During the past 12 years, however, total revenue growth has averaged 6.6 percent.
- ✓ Average growth since 1983-84 has been faster for special fund revenues than for General Fund revenues—over 11 percent versus 5.5 percent.



State Spending^a Current and Constant Dollars 1984-85 Through 1995-96



- ✓ After adjusting for inflation, spending grew at an annual rate of 4.8 percent between 1984-85 and 1991-92—more than twice the rate of population growth.
- ✓ Spending fell in 1992-93 and remained essentially flat in 1993-94.
- ✓ Spending increases in 1994-95 (4.6 percent) and proposed for 1995-96 (2.4 percent) will be roughly the amounts needed to offset the effects of inflation.



1995-96 Budget Gap

(In Billions)

Pay off deficit from 1994-95		\$0.7
1995-96 baseline spending	\$45.0	
1995-96 baseline revenue ^a	-43.8	
Operating shortfall		\$1.2
Budget Gap^b		\$2.0

^a Based on administration's revenue forecast.

^b Excludes Governor's Budget proposals. Detail does not add to total due to rounding.

- ✓ The General Fund will end 1994-95 with a deficit of \$740 million (which is less than the \$1.0 billion year-end deficit projected in July).
- ✓ However, a shortfall in federal immigrant funds results in an operating shortfall of \$1.2 billion between baseline spending and estimated revenues in 1995-96.
- ✓ The combined effect of the carryover deficit from 1994-95 and the 1995-96 baseline operating shortfall results in a 1995-96 year-end budget deficit of \$2 billion if no corrective action is taken.
- ✓ The gap represents the minimum amount of savings and/or revenue from changes to existing laws and policies that is needed in order to achieve a balanced budget in 1995-96.



July Two-Year Budget Plan Out of Balance

(In Billions)

	General Fund Impact ^a
Reduced 1993-94 carryover deficit	\$0.5
1994-95	
Improved revenues	\$0.8
Spending increases	-0.4
1995-96	
Improved revenues	\$0.6
Spending increases	-0.3
Reduced encumbrance obligations	\$0.1
Underlying Improvement	\$1.3
Federal immigrant funds^b	
1994-95	-\$0.7
1995-96	-2.6
Federal funds shortfall	-\$3.3
Budget Gap	-\$2.0

^a Measures change between July 1994 and January 1995 budget estimates. Excludes Governor's proposed budget solutions and proposals, including realignment and tax reduction.

^b Based on current federal appropriations and authorizations.

- The budget plan adopted in July sought to pay-off an estimated \$2 billion 1993-94 year-end budget deficit by the end of 1995-96.
- The current budget gap exists because of a \$3.3 billion shortfall in federal funds assumed in the two-year plan.
- This large shortfall more than offsets a \$1.3 billion improvement due largely to stronger revenue trends.



Governor's Proposed Resolution Of the 1995-96 Budget Gap^a

(In Billions)

Program reductions/savings	
Welfare	
AFDC grant reductions and reforms	\$0.4
SSI/SSP grant reductions	0.4
Restrict eligibility	0.1
Medi-Cal	
Eliminate optional benefits and prenatal services for undocumented persons	0.2
Various cost containment measures	0.1
Proposition 98—tax cut reduces school funding guarantee	0.1
Other reductions/savings	0.2
Augment funding for disasters and emergencies	-0.1
Other augmentations, including REACH and AIM	-0.1
Subtotal	\$1.4
Shifts to other levels of government	
Federal Government	
Additional reimbursements for illegal immigrant costs	\$0.5
Increased refugee funding	0.1
Eliminate SSI/SSP administrative charge	0.1
Counties—unfunded realignment costs	\$0.2
Subtotal	\$0.9
Taxes	
Tax reduction proposal	-\$0.2
Total solutions	\$2.1
Establish 1995-96 General Fund reserve	\$0.1

^a Detail does not add to totals due to rounding.



Governor's Proposed Resolution Of The 1995-96 Budget Gap (continued)

- ✓ Program reductions and savings fill most of the budget gap (\$1.4 billion). The bulk of the proposed reductions are in health and welfare programs.
- ✓ Another \$0.9 billion of the gap is closed by shifting costs to the federal government (\$0.7 billion) and localities (\$0.2 billion).
- ✓ Budgeted revenues reflect a proposed reduction of \$225 million in 1995-96 due to the first year of a phased three-year reduction in income taxes.
- ✓ Approximately half of this revenue loss is offset by a reduction in education funding due to the resulting reduction in the Proposition 98 minimum funding guarantee.



1995-96 Governor's Budget Solutions Requiring Federal Action

(In Millions)

Costs for Immigrants

Pay full cost of Medi-Cal services to undocumented persons	\$310
Reimburse state for incarceration of undocumented felons	177 ^a
Fund 36 months of health and welfare benefits for refugees	101
Subtotal	\$588

Other Proposals

Federal legislation needed

Eliminate federal administrative charge for SSI/SSP program	\$50
SSI/SSP grant reductions	434
Bar sponsored immigrants from receiving Medi-Cal and AFDC benefits	64
Eliminate drug/alcohol abuse disability category for SSI/SSP program	52
Reduce Medi-Cal rates for "distinct part" nursing facilities	26

Waiver needed

AFDC grant reductions	254
Subtotal	\$880

Total	\$1,468
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^a Amount budgeted in excess of estimated \$245 million from existing authorizations and appropriations.



1995-96 Governor's Budget Solutions Requiring Federal Action (continued)

- In order to achieve \$1.5 billion of the new savings proposals in the budget, the state needs various federal actions to provide new funds or to change laws or waive existing program requirements.
- The budget assumes savings of almost \$590 million in 1995-96 from additional federal funds to offset the state costs of services to illegal immigrants and to refugees.
- A total of \$880 million of new savings proposals depend on the enactment of federal legislation or the approval of administrative waivers.



1995-96 Governor's Budget Major Budget Risks

(In Billions)

	Potential Deterioration By End of 1995-96
Federal Actions	
Welfare grant reductions and other savings	\$0.9
Additional immigrant/refugee funding	0.6
Medicaid administrative/case-management funds	0.4
Local Actions	
AFDC savings to state from realignment	0.1
Pending Litigation	
<i>CTA v. Gould</i> —invalidates Proposition 98 loans	3.0
<i>PERS v. Wilson</i> —requires payment of deferred retirement contributions	1.0
<i>Parr v. California</i> —penalizes state for paying employees with IOUs	0.5
<i>Welch v. Anderson</i> —challenges 1994-95 AFDC welfare grant reductions	0.1

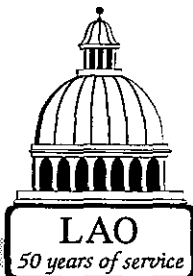
- The state faces budget risks with a maximum exposure totaling billions of dollars in 1995-96.
- Approximately \$1.9 billion of budget savings depend on federal actions.
- Pending litigation poses budget threats totaling billions of dollars.



Initiative Measures Limit Governments' Fiscal Flexibility

Initiatives Limiting Fiscal Flexibility

Measure/ Election	Major Provisions
Proposition 13/ June 1978	<ul style="list-style-type: none"> Limits general property tax rate to 1 percent and limits increases in assessed value after a property is bought or constructed. Makes Legislature responsible for dividing property tax among local entities. Requires two-thirds vote for Legislature to increase taxes. Requires two-thirds voter approval of new local special taxes.
Proposition 4/ November 1979	<ul style="list-style-type: none"> Generally limits spending of "proceeds of taxes" by the state and local entities to prior-year amount, adjusted for population growth and inflation (now per capita personal income growth). Requires state to reimburse local entities for mandated costs.
Proposition 6/ June 1982	<ul style="list-style-type: none"> Prohibits state gift and inheritance taxes, except for "pickup" tax qualifying for federal tax credit.
Proposition 7/ June 1982	<ul style="list-style-type: none"> Requires indexing of state personal income tax brackets for inflation.
Proposition 37/ November 1984	<ul style="list-style-type: none"> Establishes state lottery and dedicates revenue to education. Places prohibition of casino gambling in State Constitution.
Proposition 62/ November 1986	<ul style="list-style-type: none"> Requires approval of new local general taxes by two-thirds of the governing body and a majority of local voters. <p>Note: the courts have largely invalidated this measure.</p>



Initiative Measures Limit Governments' Fiscal Flexibility (continued)

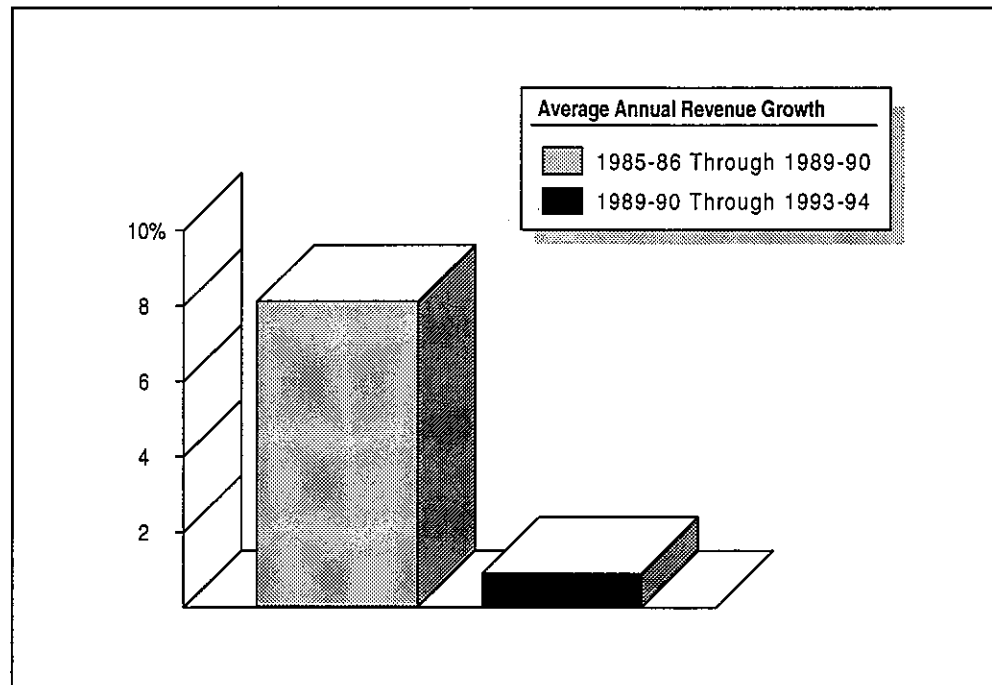
Measure/ Election	Major Provisions
Proposition 98/ November 1988	<ul style="list-style-type: none"> Establishes minimum state funding guarantee for K-12 schools and community colleges. Requires distribution to schools and community colleges of half of any state tax revenues in excess of the appropriations limit.
Proposition 99/ November 1988	<ul style="list-style-type: none"> Imposes surtax on cigarettes and tobacco products. Limits use of surtax revenue, primarily to augment health-related programs.
Proposition 162/ November 1992	<ul style="list-style-type: none"> Limits the Legislature's authority over PERS and other public retirement systems, including their administrative costs and actuarial assumptions.
Proposition 163/ November 1992	<ul style="list-style-type: none"> Repealed "snack tax" and prohibits any future sales tax on food items, including candy, snacks, and bottled water.

- Initiatives covering a wide range of subject areas have been enacted having significant fiscal implications for California's state and local governments.

- Initiatives can limit the Legislature's ability to modify the fiscal environment, and also restrict localities' flexibility. This lack of flexibility sometimes can cause "second best" alternative actions to be considered in order to address fiscal and policy issues.



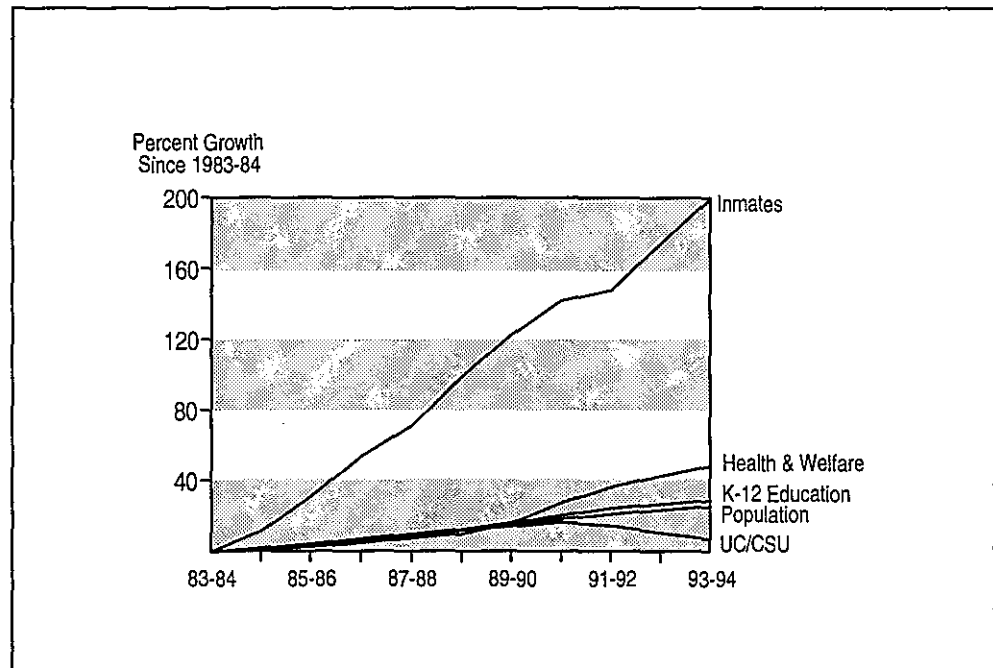
Revenue Growth Dramatically Slowed During the Recession



- ✓ Revenue growth averaged over 8 percent during the latter half of the 1980s.
- ✓ In contrast, revenue growth averaged less than 1 percent during the early 1990s.
- ✓ Cumulative revenues over the past five years would have been about \$9 billion (5 percent) lower absent various budget balancing actions and law changes since the late 1980s.



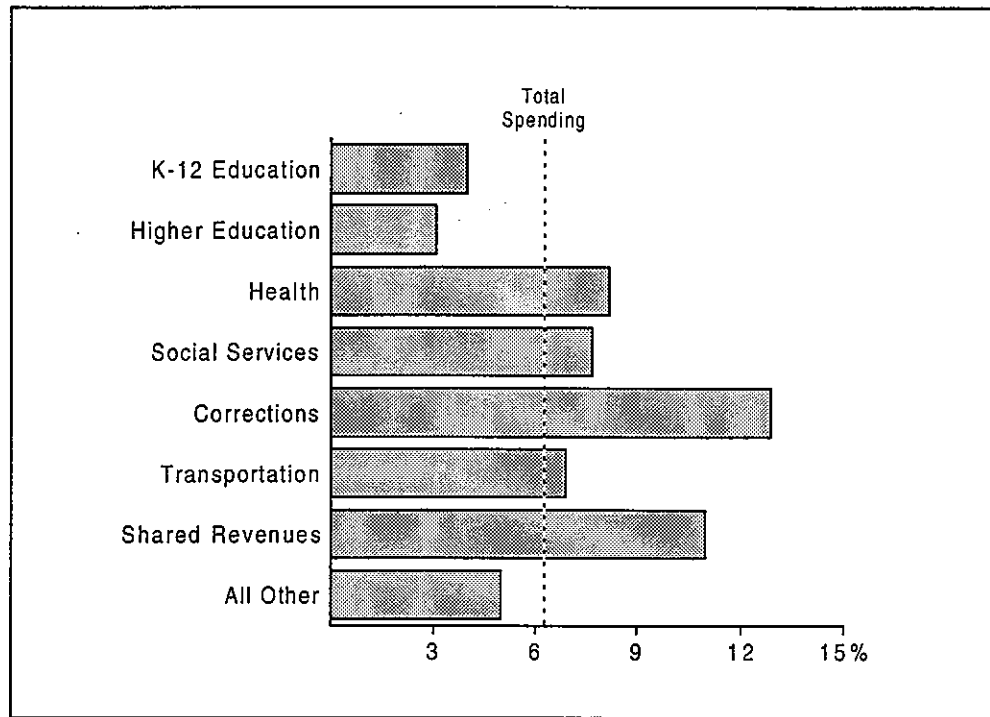
Prison Population Has Grown Much Faster Than Other Caseloads



- ✓ The number of prison inmates has been growing much more rapidly than any other group, in part due to mandatory and longer sentences.
- ✓ A rapid rise in the number of health and welfare beneficiaries began in 1989-90 due to the growth in welfare caseloads and additional federally mandated Medi-Cal eligibility categories.
- ✓ Enrollment at UC and CSU has declined.



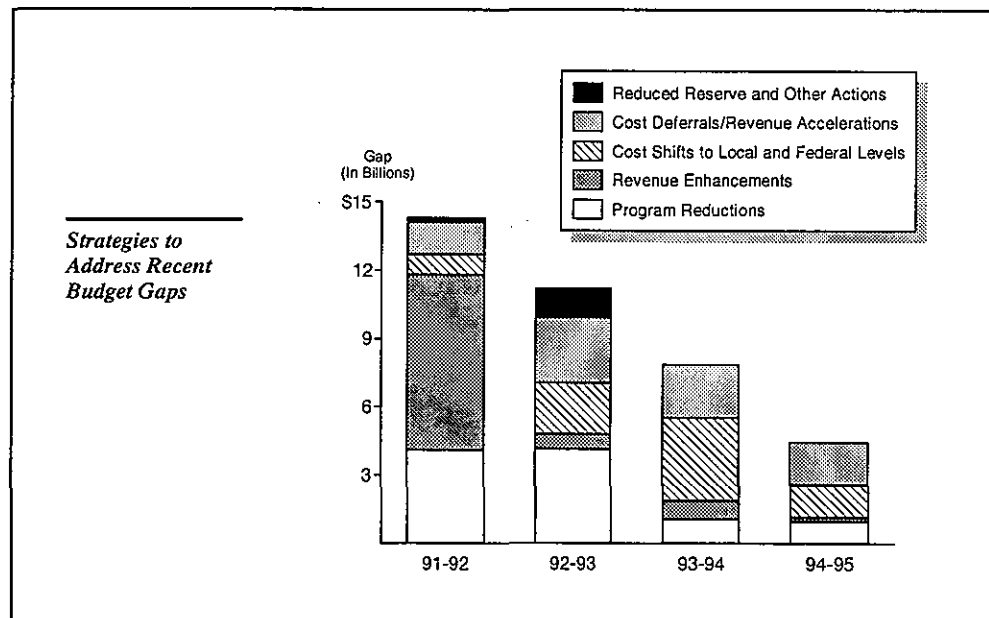
Spending Growth Varies Considerably By Program Area (Average Annual Rate 1983-84—1994-95)



- ✓ **K-12 state spending has grown slower than overall spending. Taking all funding sources into account, however, support for K-12 schools has grown at an annual rate of 7 percent since 1983-84.**
- ✓ **Shared revenues have grown rapidly due to funding to offset the shift of property tax revenues from local governments to schools, and trial court funding for localities.**



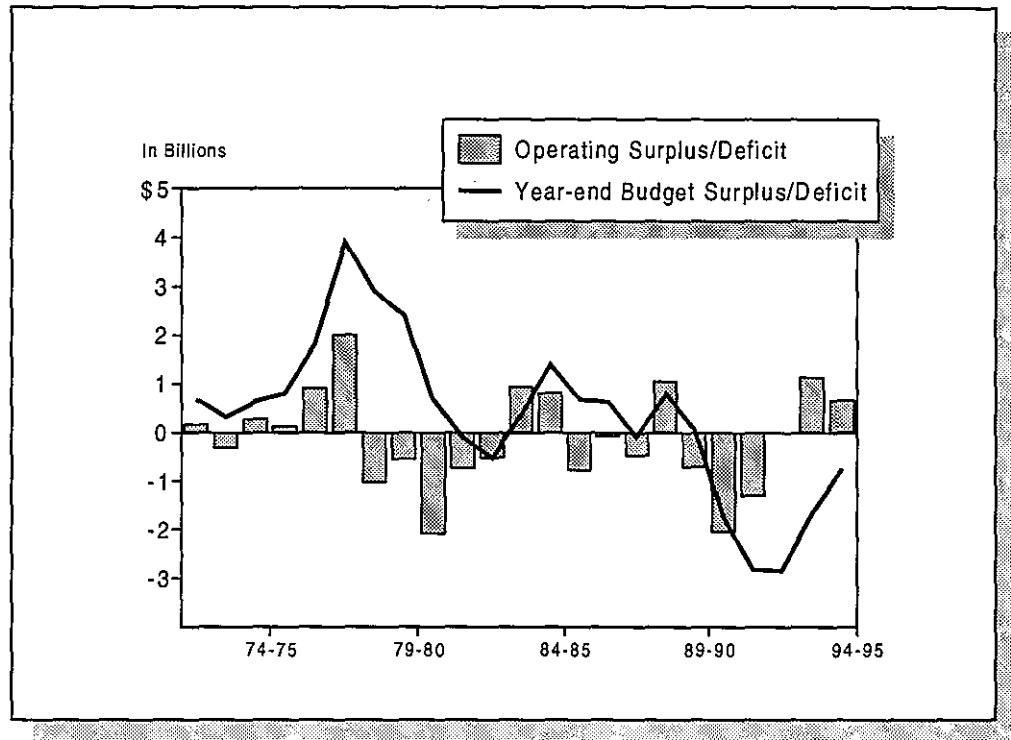
Strategies to Address Budget Gaps Have Varied



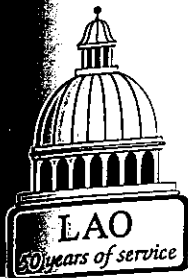
- ✓ Over the last four years, the state has faced large gaps between anticipated revenues and the amount of spending needed to fund programs at a "baseline" level.
- ✓ Different mixes of strategies have been used in different years to address budget gaps.
- ✓ In 1991-92 revenue increases played a major role. More recently, cost shifts and deferrals have been the largest categories of budget "solutions."



Past Operating Shortfalls Have Resulted in Budget Deficits



- ✓ Adding any carryover surplus or deficit from the prior year to the current operating balance yields the year-end budget balance (commonly referred to as the budget surplus/deficit).
- ✓ State General Fund spending has exceeded revenues in 11 of the 16 years since adoption of Proposition 13.



General Fund Operating Surplus/Deficit Budgeted v. Adjusted 1992-93 Through 1994-95

(In Millions)

	Actual 1992-93	Actual 1993-94	Estimated 1994-95
Amounts shown in budget			
Revenues	\$40,946	\$40,095	\$42,353
Expenditures	40,948	38,958	41,693
Budget operating surplus/deficit	-\$2	\$1,137	\$660
Adjustments			
Net off-budget spending for Proposition 98 loans	-\$80	-\$596	\$135 ^a
Deferral of PERS retirement contributions	-489	-467	-302
One-time accounting switch for bond interest	—	-248	—
Totals, adjustments	-\$569	-\$1,311	-\$167
Adjusted operating surplus/deficit	-\$571	-\$174	\$493

^a Adjustment *improves* 1994-95 surplus since budgeted loan repayment represents past, rather than current, spending.

- ✓ The budget shows General Fund operating surpluses of \$660 million in the current year and \$1.1 billion in 1993-94, and a roughly balanced operating budget in 1992-93.
- ✓ However, adjustments to exclude "paper" savings and deferrals result in operating deficits in 1992-93 and 1993-94 and reduce the 1994-95 operating surplus to \$493 million.



State Revenue Effects of the Tax Reduction Proposal 1995-96 Through 1998-99

(In Billions)

State Revenue Effects	1995-96	1996-97	1997-98	1998-99	Four-Year Total
Personal Income Tax					
Continuation of high-income tax brackets after 1995	\$0.3	\$0.8	\$0.9	\$1.0	\$3.0
Phase-in of 15 percent tax cut	-0.4	-1.5	-2.7	-3.6	-8.3
Net effect	(-\$0.1)	(-\$0.7)	(-\$1.9)	(-\$2.7)	(-\$5.3)
Bank and Corporation Tax					
Phase-in of 15 percent tax cut	-\$0.1	-\$0.4	-\$0.7	-\$1.0	-\$2.3
Total State Revenue Effect	-\$0.2	-\$1.1	-\$2.6	-\$3.6	-\$7.6

Source: Department of Finance. Detail may not add to totals due to rounding.

- The tax proposal has two parts:**
 - Extension of the 10 percent and 11 percent personal income tax brackets that are scheduled to expire after 1995.
 - A 15 percent phased-in income tax reduction for individuals and businesses.

- The budget estimates a total net cost of \$225 million for 1995-96 and \$7.6 billion through 1998-99.**



Savings From Tax Reduction Proposal 1996 Through 1998

Effects on Individuals, by Income Level ^a						
Adjusted Gross Income	1996		1997		1998	
	State Tax Savings	Net Tax Savings	State Tax Savings	Net Tax Savings	State Tax Savings	Net Tax Savings
\$20,000	\$0	\$0	\$0	\$0	\$0	\$0
40,000	34	29	66	56	96	82
60,000	74	63	142	121	206	175
80,000	130	94	252	181	365	263
100,000	210	151	407	293	593	427
150,000	410	283	807	557	1,193	823
200,000	628	402	1,244	858	1,849	1,276
250,000	826	529	1,639	1,049	2,441	1,563
500,000	384	232	2,562	1,547	4,666	2,818
1,000,000	-5,078	-3,067	-175	-106	4,896	2,957

^a Data are for a married couple filing jointly, with two children and average itemized deductions for their income level. Negative amounts reflect tax increases. Net savings equals state savings adjusted for related increases in federal income taxes (resulting from lower itemized deductions).

- ✓ Net tax savings will be less than total state tax savings, because federal tax liabilities will rise.
- ✓ A married couple with 2 children and income under \$20,000 would receive no benefits.
- ✓ A similar household with income of \$1 million would pay more taxes in both 1996 and 1997, but have savings in 1998.



Average Tax Rates Decline Under the Governor's Proposal

Adjusted Gross Income	Current Tax Law	Proposed Tax Law	Percentage Decline
\$0-25,000	0.77%	0.60%	22.1%
25,000-50,000	2.44	2.02	17.2
50,000-75,000	3.67	3.10	15.5
75,000-100,000	4.78	4.09	14.4
100,000-200,000	6.33	5.43	14.2
200,000-500,000	8.13	7.15	12.1
500,000-1,000,000	8.80	8.16	7.3
1,000,000 and over	9.08	8.92	1.8
Totals	4.43%	3.87%	12.6%

^a Rates are for all filing statuses (California residents only).

- By 1998, average tax rates (tax as a percent of income) fall for all taxpayers under the proposal.
- The statewide average tax rate falls by nearly 13 percent.
- However, the percentage decline in average tax rates becomes less as income rises.
- This means that the personal income tax structure becomes more progressive under the proposal.

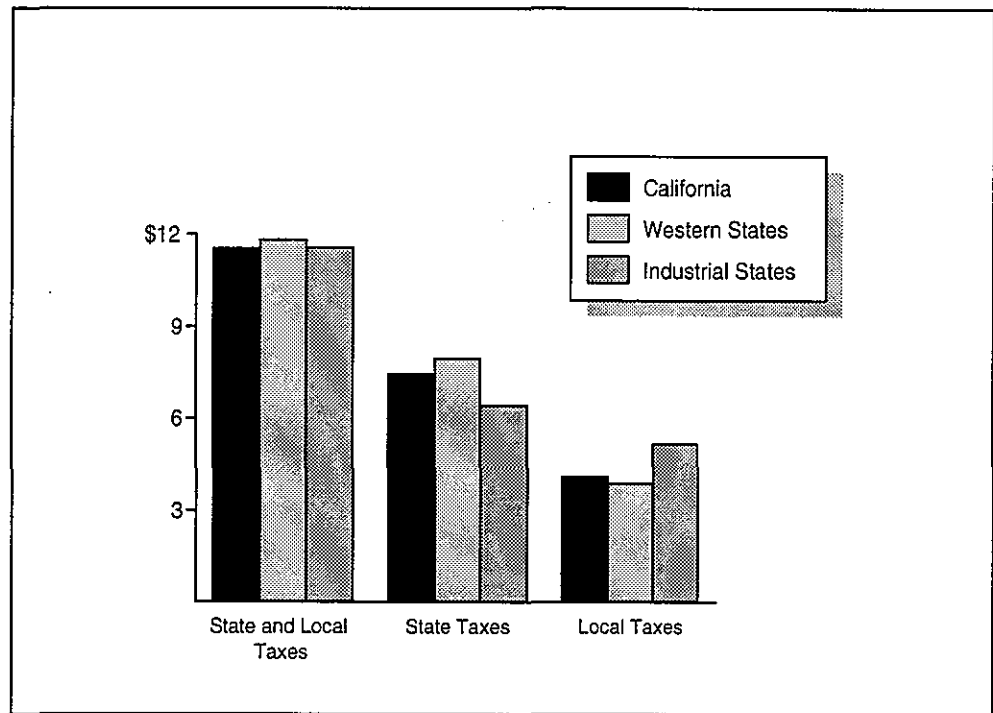


How California's Tax Rates Compare

- California has one of the most progressive tax structures among western and industrial states.
- California's marginal tax rates for low income individuals are among the lowest; however, high income Californians are taxed at one of the highest marginal rates among western and industrial states.
- California's corporate tax rate is comparable to many other major industrial states, but is one of the highest among neighboring western states.
- Tax rates are only one element of a tax structure. Other factors that should be considered when making interstate comparisons include deductions, exemptions, exclusions, and credits available.



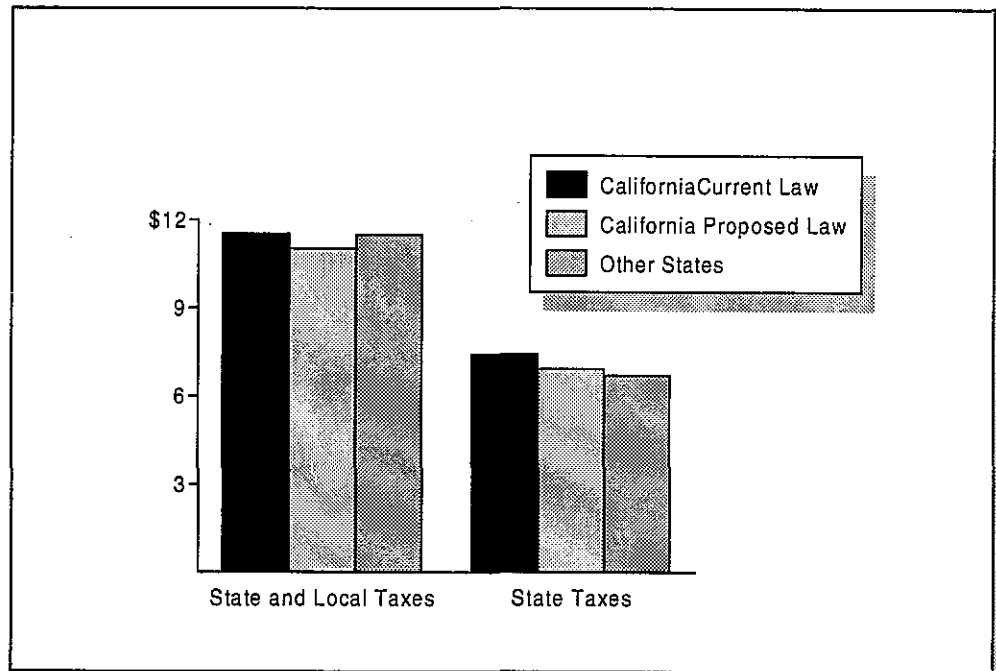
California Tax Revenues Per \$100 Personal Income Compared to Other Western and Industrial States—1991-92



- ✓ California's state-local taxes combined per \$100 personal income are below the average of other western and industrial states.
- ✓ California ranks between other western and industrial states in terms of both state taxes and local taxes.



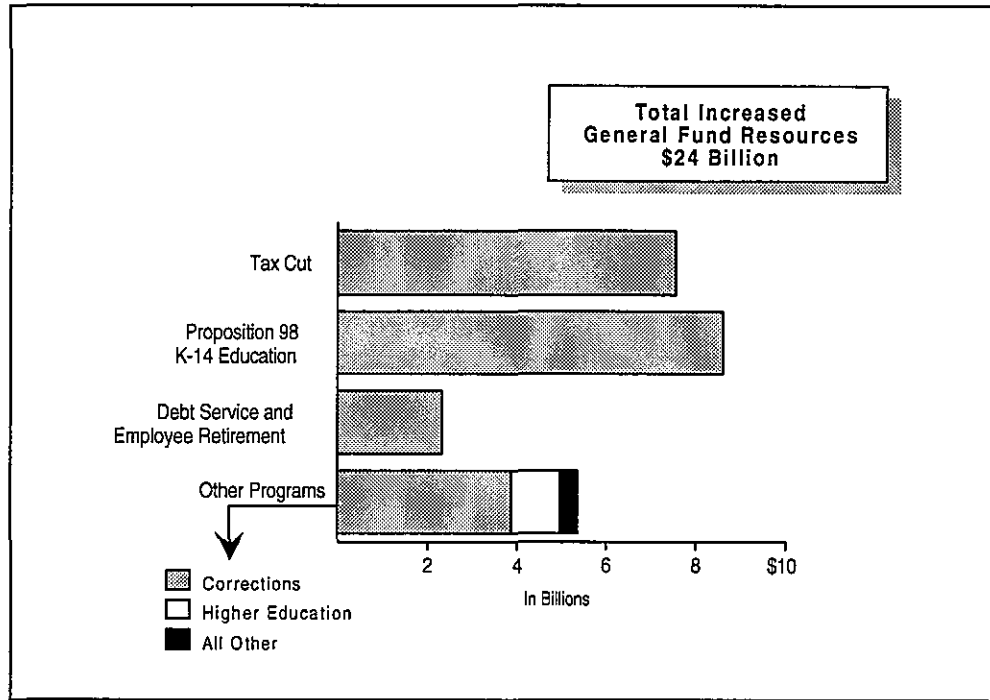
Illustrative Effect of Tax Proposal on Taxes Per \$100 Personal Income 1991-92



- ✓ Had the tax proposal been in effect in 1991-92, California state-local taxes would have switched from being slightly above (less than one-half of a percent) to somewhat below (4 percent) the average.



Use of Increased Resources 1995-96 Through 1998-99



- Assuming moderate economic and revenue growth, we estimate there will be \$24 billion of increased General Fund resources over the next four years compared to revenues staying constant at their 1994-95 level.
- The tax cut proposal would absorb nearly one-third of these new resources.
- Proposition 98 funding would decrease by \$3.9 billion as a result of the tax reduction.



Governor's State/County Realignment Plan^a 1991-96

(In Millions)

State Costs Shifted to Counties	
Increase county share of AFDC costs	\$1,157
Shift programs to counties	
Foster care	329
Child welfare and abuse prevention	298
Adoption	83
Total	\$1,868
State Resources Shifted to Counties	
Shift state sales tax revenues	\$710
Increase state trial court block grants	605
Return trial court fines and forfeiture revenues	311
Total	\$1,626
Net State Savings	\$241

^a Detail may not add to totals due to rounding.

- The budget proposes a significant shift of responsibility and funding from the state to counties for certain welfare and social services programs.
- The proposal shifts about \$1.9 billion of state costs to the counties, along with \$1.6 billion of state resources.
- The state would realize a net savings (and the counties a cost) of \$241 million in 1995-96 under the proposal.



Summary of Legislative Analyst's Recommendations

- Overall Assessment of Proposal**
 - Seriously flawed.
 - Exacerbates county budgetary pressures.
 - Gives counties few tools to control costs.
 - Children's services component has merit.

- Children's Services**

Adopt Governor's proposal to increase positive local incentives.

 - Include state-operated adoptions programs.
 - Increase Youth Authority placement fees.

- Sales Tax to Counties**

Adopt Governor's proposal to offset Children's Services costs.

- County Share of AFDC to 50%**

Reject Governor's proposal because share-of-cost is not commensurate with county control.

- State Share of TCF to 70%**

Legislature should consider in context of alternative realignment options.

- General Assistance and Other Mandate Relief**

Legislature should consider on policy merits outside of realignment debate.



Projected Five-Year Capital Outlay Needs For the State and K-12 Education 1995-96 Through 1999-00

(In Millions)

	Five-Year Total
Executive	\$50
State and Consumer Services	1,050
Transportation	14,721 ^a
Resources	719
Health and Welfare	403
Youth and Adult Corrections	7,036
K-12 Education	11,000 ^b
Higher Education	6,563
General Government	273
Total	\$41,815

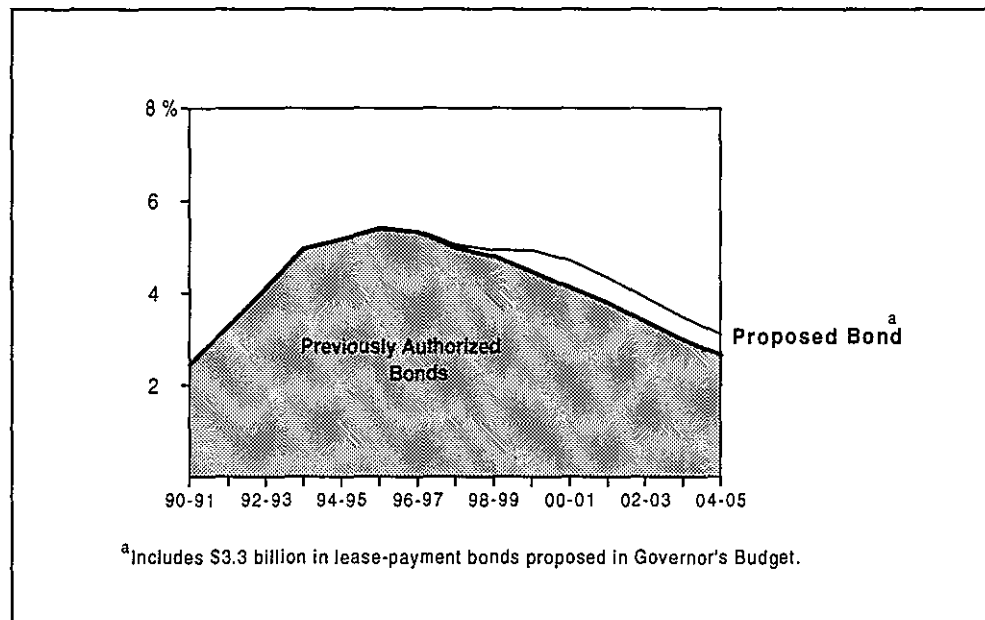
^a Includes \$14.5 billion to be funded from state and federal gasoline tax revenues, state truck weight fees, and state toll bridge revenues for the Department of Transportation (1992 STIP and seismic retrofit).

^b Estimate only. No statewide five-year plan.

- \$42 billion in project-specific needs have been identified over the next five years.
- Amounts listed above do not include programs for the state land conservancies or local government projects (such as jails and parks).
- Less than \$1.3 billion in general obligation bonds remain available for allocation to new projects. About \$800 million of this total are from Proposition 116 (rail bonds) and are designated for specific transit corridors.



State Long-Term Debt Debt Service Ratios



- ✓ The state's debt service ratio has risen in recent years primarily due to increased bond sales, but also due to flat General Fund revenue growth.
- ✓ The current debt service ratio is about 5.2 percent of General Fund revenues.
- ✓ With no additional bond authorizations, the debt service ratio will peak at 5.4 percent in 1995-96 and decline thereafter.
- ✓ The Governor's proposed \$3.3 billion in new lease-payment bond authorizations will not increase the peak of 5.4 percent, but will raise the debt ratio in future years by about 0.5 percent.



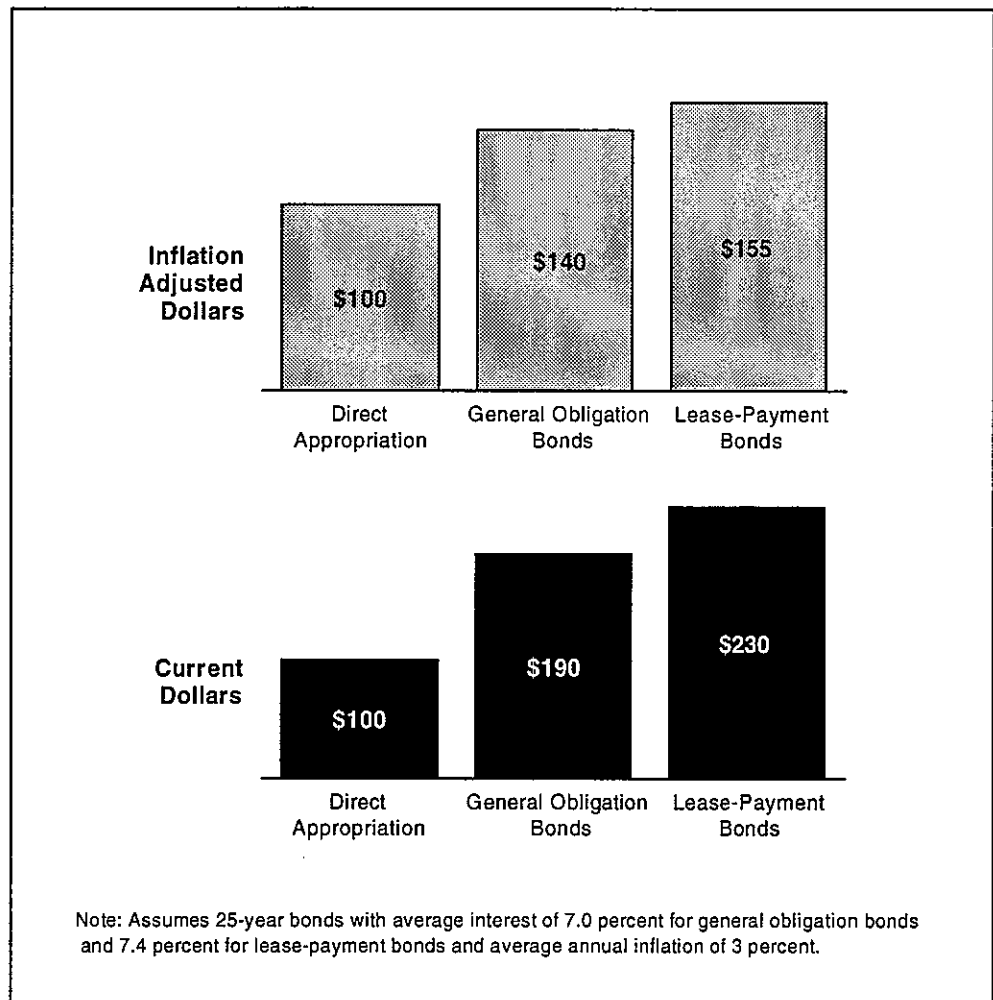
Lease-Payment Bonds Are Costlier to Issue

	General Obligation Bond	Lease-Payment Bond
Approval needed	Two-thirds of Legislature and Governor (except initiatives) <i>and</i> majority voter approval	Majority vote of Legislature and Governor
Amount authorized 1990-94	\$10 billion	\$4.1 billion
Limits on spending	Amount approved by voters (administrative augmentations and other costs must be within this amount)	Amount authorized by Legislature (plus any administrative augmentations and bond upsizing)
Pledged security to bondholders	Full faith and credit of the state (entire taxing power)	Annual debt-service appropriations required for "lease" payments
Interest rate on bonds	Lowest possible (actual sales at 4.8 percent to 7 percent between 1990-94)	Up to 0.5 percentage points above general obligation bond rate; average about 0.4 percent (actual sales at 5.1 percent to 7.3 percent between 1990-94)
Underwriting process	Competitive bidding required	Competitive bidding not required; sales to date have been negotiated
Need for reserve fund to effectively market bonds?	No	Yes
Need to purchase property and liability insurance?	No	Yes
Amount of bonds required	Based on project costs, plus less than 1 percent for issuance costs	Bond volume upsized to cover project costs <i>plus</i> such costs as underwriting fees, debt-service during construction period, issuance costs, insurance, and reserve fund
Additional debt service costs	—	15 to 20 percent higher than general obligation bonds over life of the bonds



Relative Costs of Financing A Capital Outlay Project

(In Millions)



- ✓ Lease-payment bonds are more costly, mainly because they must be upsized (more bonds must be sold for a given project) and they sell for somewhat higher interest rates (about 0.4 percent on average).



Major Issues/Proposals 1995 Capital Outlay Program



State Transportation Improvement Program (STIP)

- STIP Programs State and Federal Revenues and expenditures for highway and rail projects.
- STIP has a \$5.9 billion shortfall.
- Due to funding shortfall, projects scheduled in 1992 STIP will be delivered over a 11-year, rather than a 7-year period.



State Prisons

- Budget proposes \$146 million in lease-payment bonds and \$19 million from the General Fund to develop over 20,000 emergency housing beds.
- Governor also supports legislation—separate from the budget—to authorize \$2 billion in lease-payment bonds for six new prisons.
- Annual debt service for the proposed \$2.1 billion in lease-payment bonds would be about \$200 million.
- Need for new prison beds should be evaluated in relation to spring 1995 inmate population projections and any policy changes the Legislature may wish to adopt to reduce prison costs.



Higher Education

- Budget proposes \$327 million in lease-payment bonds and \$24 million in general obligation bonds for the three segments.
- Annual debt service costs for the lease-payment bonds will be about \$30 million.
- Due to Board of Governors' concerns of lease-payment debt service impact on support budgets, community colleges' program only funds equipment to complete previously funded construction projects.



State Office Buildings

- Governor supports legislation—separate from the budget bill—to authorize \$560 million in lease-payment bonds for five new state office buildings.
- Annual debt service costs for these buildings would be about \$52 million.