



# **Initial Comments On The 1995-96 Governor's Budget**

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## Overview



### **Economic Picture Finally Brightens**

- After four years of declining employment levels, state now experiencing modest economic expansion, including employment gains, declining unemployment, and increasing personal income.
- Budget assumes moderate personal income growth of 6.6 percent in 1995 and 6 percent in 1996 driven by continued improvement in such areas as job growth and housing activity.
- There are a variety of uncertainties and unknowns facing the state in the remainder of 1995 and 1996, however, which could affect economic performance. These include federal monetary policies and decisions regarding the future of California's military bases.



### **1995-96 Budget Has Certain Similarities to Last Year's . . .**

- Significant reductions in health and welfare programs.
- Restructuring of state-local relationship.
- Full funding of corrections.
- Full funding of K-12 schools.



### **. . . But Also Important Differences**

- Assumes much lower federal funds for immigration costs.
- Proposes major income tax reductions.



## The Budget's Proposed Solutions



### **Baseline Expenditures Exceed Revenues by Roughly \$2 Billion**

- This budget "gap," while still large, is much smaller than in previous years.



### **Major Budget Solutions Include:**

- \$833 million in assumed federal funding for refugees and undocumented immigrant costs.
- \$688 million in savings from welfare grant reductions.
- \$241 million savings (net) from realignment.
- \$143 million savings (net) from elimination of Medi-Cal optional benefits.



## Major Proposals



### Federal Funds for Refugees and Undocumented Immigrants

- Budget assumes state will receive about \$800 million in new federal monies.



### Welfare Grant Reductions

- AFDC grants cut by 7.7 percent and 15 percent (after six months).
- SSP grants reduced by 8 percent (individuals) and 10 percent (couples).



### Health Program Changes

- Eliminates nine optional services.
- Expands health coverage to certain children.



### Education System Changes

- Overhaul of the Education Code.
- Elimination of tenure.



### Transportation Position Reductions

- Major reduction in positions.
- Stretching out the STIP delivery.



### State-Local Restructuring

- Focuses on child welfare, AFDC and trial courts.
- Counties at risk for net cost increases.



## Governor's Income Tax Reduction Proposal



### The Proposal

- Extends the 10 percent and 11 percent personal income tax rates (under current law, they would have expired at the end of 1995).
- Provides permanent across-the-board rate reductions of 5 percent for three years, beginning in 1996.
- Reductions apply to both personal income and corporate income tax rates.



### Fiscal Impact

- Proposal will reduce state revenues by \$225 million in 1995-96 (a partial-year effect) and increasing amounts thereafter.
- Effect will rise to \$1.1 billion in 1996-97, \$2.6 billion in 1997-98 and \$3.6 billion in 1998-99.



### Effect on Individual Taxpayers

- For a married couple with \$50,000 income and two children, the proposal will result in reduced taxes of \$39 in 1996, \$72 in 1997, and \$102 in 1998.
- Comparable savings for an income level of \$100,000 would be \$196 in 1996, \$378 in 1997, and \$548 in 1998.
- In 1996, taxpayers at all income levels will pay less taxes except those with incomes well over half-a-million dollars.
- A significant share of any reduction in state income taxes will be retained by the federal government, due to the deductibility of state income taxes on federal tax returns.

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## Governor's Income Tax Reduction Proposal



### How Do California's Taxes Compare with Other States?

- California's marginal tax rates are relatively high compared to other states, California's state taxes per \$100 of personal income are about 10 percent above the average.
- However, California is near or below the average in certain other respects. For example, its total state and local tax burden is only 1 percent above the average, its local tax burden is 12 percent below the average, and its combined state-local burden for taxes, fees and charges is less than 2 percent above the average.
- Whether California's tax burden is "excessive" depends on how businesses and individuals value the services that taxes finance.



### Impact On the State Budget

- Over the next four years, the tax cut will absorb well over one-third of all new revenues that would have been realized under current law.
- The budget's definition of "discretionary spending" includes such items as the constitutionally mandated homeowners' exemption, debt service on lease-payment bonds, health and welfare entitlement programs, and corrections.



## Challenges for the Legislature



### **Balancing the Budget in a Way that Ensures the State's Fiscal House Is In Order**

- Proposed budget is precariously balanced, and much of the proposed budget solution is dependent on federal action.
- In addition, there are several lawsuits (related to PERS, Proposition 98, Medi-Cal and welfare) that could impose major costs on the state.
- Legislature will have to make its own choices for program reductions.



### **Considering Tax Changes**

- Can the state pay for essential services and provide tax relief at this time?
- What is the longer term outlook for revenues and expenditures?



### **Restructuring the State-Local Relationship**

- One of the most important issues for the Legislature to tackle.
- There are, however, many paths to restructuring, with the budget offering just one alternative.



### **Rethinking Provision of Many Governmental Services**

- Governor has proposed significant changes in many key areas (welfare, education, tort law, insurance, regulatory process).



### **Meeting the State's Infrastructure Needs**

- The state has multi-billion dollar needs (\$30 billion over five years) for prisons, education, and other facilities development/renovation.
- Most general obligation bonds have been allocated. Lease-payment (lease-revenue) bonds are another financing option, albeit more costly than general obligation bonds.