

Overview of the 1995-96 May Revision

SUMMARY

This Budget Brief reviews the changes contained in the May Revision of the 1995-96 Governor's Budget and presents the following findings:

- ▲ The broad outlines of the January Budget are essentially unchanged by the May Revision.
 - The economic and revenue forecasts differ little from the January forecasts.
 - The budget proposes to end 1995-96 in balance, with virtually no reserve.
 - The budget gap is addressed primarily through health and welfare program reductions requiring federal approvals.
 - The budget assumes enactment of the Governor's proposed tax reduction.
- ▲ However, some key details of the budget proposal are modified by the May Revision.
 - Federal funds for immigrant costs and Medi-Cal administrative claims are revised downward (\$677 million).
 - Welfare grant reductions are increased (\$260 million).
 - The state savings from the state-county realignment proposal are reduced to \$75 million.
- ▲ The budget remains precariously balanced and is heavily dependent on federal actions.

MAY REVISION: NO MAJOR CHANGES TO JANUARY BUDGET

Figure 1 shows the May Revision changes to the Governor's January budget proposal for 1995-96. Available resources in 1995-96 increase by \$41 million, but spending increases by \$74 million compared with the January budget. As a result, the year-end reserve decreases by \$34 million—to \$58 million.

BUDGET GAP DECLINES

Based on revenue and expenditure changes in the May Revision, we estimate that the 1995-96 budget gap has declined \$152 million from \$2.0 billion to \$1.8 billion. Figure 2 shows that the reduction in the budget gap primarily results from the net effect of:

- Increased requirements for Proposition 98 support.

- Increased Medi-Cal costs due to federal rejection of administrative claims.
- Reduced short-term and long-term borrowing costs.
- Slower growth in Medi-Cal, SSI/SSP, and Corrections caseloads.

Budget Solutions Decline. The January budget proposal for 1995-96 included \$2.1 billion of budget "solutions" in order to fill the budget gap of \$2.0 billion and to provide a small reserve of \$92 million. The May Revision has reduced the estimated value of those budget solutions by almost \$200 million. The most significant changes in budget solutions are:

- An increase in welfare grant reductions (\$260 million).
- A reduction in new federal funds for immigrant costs (\$317 million).

Figure 1

Governor's Budget 1995-96 General Fund Condition May Revision Changes^a

	1995-96		
	January	May	Change
(In Millions)			
Prior-year balance	-\$459	-\$566	-\$107
Revenues and transfers	42,538	42,685	146
Total resources available	\$42,078	\$42,119	\$41
Expenditures	\$41,726	\$41,800	\$74
Fund balance	\$352	\$319	-\$33
Reserve	\$92	\$58	-\$34
Other obligations	260	261	—

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

- A reduction in realignment savings to the state (\$166 million).

risk, however, that the state's economy could experience subpar performance in the rest of 1995 and in 1996.

THE ECONOMY AND REVENUES

Continued Economic Growth Forecast. The May Revision economic forecast is little changed from the January budget forecast, which anticipated the now-visible softening in the nation's economy. The department is predicting continued economic growth and modest inflation in California through 1996. Although its forecast for California is similar to the current consensus in many respects, it is more optimistic regarding employment growth in 1996.

California's economic performance in the first quarter of 1995 was weaker than expected. Most economists attribute this partly to severe weather conditions and are not predicting a recession or severe slowdown in the near term. There is a

Revenues Down Modestly

The May Revision revenue forecast is down \$64 million for the current and budget years combined. This reflects a reduction of \$210 million in 1994-95, partially offset by an increase of \$146 million for 1995-96.

Major Reporting Correction Made. Earlier this month, we reported that 1994-95 revenue collections were "on track," reflecting weaker-than-expected tax revenues offset by stronger-than-expected nontax revenues. The department now indicates that most of the nontax revenue gain was due to a reporting problem and will not materialize. This partly explains why the current-year projected revenue reduction has emerged.

Figure 2

Major Changes in the Budget Gap Two-Year Effects May Revision^a

(In Millions)

Proposition 98	
Backfill property tax shortfall	\$182
Increase in 1995-96 minimum guarantee	200
Medi-Cal	
Federal rejection of state administrative claims	360
Slower growth in caseload and costs	-399
SSI/SSP: slower growth in caseload and grant costs	-123
Corrections: slower inmate growth	-94
Lower borrowing costs	-305
Reduced revenue estimates	64
Other changes (net)	-37
Total	-\$152

^a Amounts show combined effects in 1994-95 and 1995-96.

Components of Two-Year Change. Although the two-year net revenue change is relatively small, it reflects significantly different revisions for individual revenue sources. As shown in Figure 3:

- Sales and use taxes are down \$407 million.
- Remaining revenues are up \$343 million, including bank and corporation taxes (up \$295 million).

Reasonableness of the Revenue Forecast. The department's revenue forecast is generally consistent with its economic outlook. Our own two-year forecast, revised downward due to developments since February and other factors, is about \$200 million more than the department's. This is a relatively small difference—less than one-half of one percent of the revenue base—and reflects somewhat different assumptions about certain economic variables, growth in tax bases, average effective tax rates, and cash-flow factors.

CONCLUSION

As indicated above, the May Revision does not change the broad outlines of the budget that was presented to the Legislature in January. While the Governor's revised plan reduces the estimate of federal funds for immigrant costs and Medi-Cal administrative claims, the budget is still heavily dependent upon federal actions to implement health and welfare reductions. Given that there is basically no planned reserve at the end of the budget year and the state is vulnerable to other risks, the budget remains precariously balanced.

In completing its work on the 1995-96 budget, the Legislature faces key decisions on:

- The type of program changes it will make (the administration's plan is heavily dependent on welfare reductions).
- The level of risk to assume by adopting proposals dependent on future federal action.
- The administration's proposed tax cut and state-local realignment proposals.



Figure 3

**May Revision Revenue Changes
1994-95 and 1995-96**

(In Millions)

Revenue Category	Two-Year Change from Budget Forecast
Personal Income Tax	\$20
Sales and use taxes	-407
Bank and corporation taxes	295
All other	28
Total	-\$64

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