LAO
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February 17, 2012

Hon. Bob Huff
Senate Minority Leader
Room 305, State Capitol
Sacramento, California 95814

Dear Senator Huff:

As requested by your staff, we are updating our December 10, 2010 letter to Senator Dutton concerning "underlying" General Fund expenditures. The updated analysis displays underlying spending estimates for 2008-09 through 2012-13.

Background. In 2010, Senator Dutton asked our office to provide an analysis of underlying General Fund expenditures relative to the expenditures displayed in the budget act and other supporting documents. For purposes of this analysis, we described underlying expenditures as "the level of programmatic spending once federal funds, deferrals, and other tools the state has used to reduce General Fund spending and maintain program funding are removed." As described below, we provide additional information concerning the basis for our estimates and the various adjustments we made to reported General Fund spending to arrive at an estimate of underlying expenditures.

Basis for Our Estimates

In both the December 2010 letter and this update, we use as a starting point Department of Finance Schedules 6 and 9—the official scoring detail of General Fund expenditures—and made adjustments based upon our knowledge of funding shifts that have taken place in the fiscal years since 2007-08.

Base Year Taken as 2007-08. Similar to the approach we adopted in the December 2010 letter, we narrowed our focus to fiscal years after 2007-08. As such, any deferrals, accounting changes, or other funding shifts that were already in place for 2007-08 are not reflected in these estimates. The General Fund expenditure base in 2007-08 was about $103 billion.

Focus on Major Changes. The scale of the state's recent budget problems has required adoption of a long list of budget solutions, fund shifts, and deferrals. For purposes of this analysis, we focus only on the major changes and, as such, omit some minor changes. We have captured, however, the changes that account for the vast majority of General Fund expenditures supplanted or delayed since 2007-08.

Focus on Temporary Shifts. The purpose of this analysis is to reflect where reported General Fund spending does not reflect ongoing General Fund programmatic expenditure commitments. Accordingly, we generally omit from our adjustments permanent shifts of programmatic funding from the General Fund to another existing or new source of funding outside the General Fund. For example, in recent years, much of the transportation-related debt service expenses of the General Fund have been shifted to such sources of funding in separate special funds. Accordingly, there is not the same sort of ongoing General Fund commitment for transportation debt service as there was in 2007-08, and we include no adjustment to General Fund spending for this factor in estimating underlying expenditures.

2011 Realignment. In calculating underlying spending, we do, however, make an adjustment to increase reported General Fund spending in 2011-12 and 2012-13 by the amount of funds being used to support the 2011 realignment package. The 2011 realignment package differs from the transportation debt service example mentioned above in that realignment was not transferred to a special fund with a preexisting or newly increased revenue source. Instead, the realignment package merely transferred existing General Fund revenues—already in place as of 2007-08—to the special fund that supports realignment. As such, this adjustment makes the year-to-year numbers more comparable. On the other hand, like the transportation debt service example, the realignment package does permanently shift a prior General Fund responsibility to another fund. Accordingly, there is an argument to omit the adjustment we make for 2011 realignment, which would reduce underlying spending below the levels we list by nearly $6 billion per year in 2011-12 and 2012-13.

Caseload and Inflation Growth. In comparing 2007-08 expenditures with expenditures in later years, it is important to consider the effects of both caseload changes (demand for services such as those in health and social services programs) and inflation (particularly notable in health programs). For example, in 2007-08, General Fund expenditures were $103 billion. If the state were to spend $103 billion in 2012-13, this would not represent a similar level of service provision due to the effects of increasing caseload and inflation. Therefore, a flat level of total funding for these programs over the entire period translates to a reduced level of program service to an individual participant.

2011 Redevelopment Legislation. During the period, the state has adopted several measures intended to shift redevelopment agency property tax revenues on a temporary basis to support General Fund expenditures, culminating in the two redevelopment bills passed in 2011. Given that the Supreme Court has determined that the 2011 redevelopment legislation results in the permanent elimination of redevelopment agencies, we omit adjustments to General Fund spending related to redevelopment funding of schools in 2011-12 and 2012-13. Revenues previously dedicated to redevelopment agencies now will provide a permanent source of funding to schools, offsetting General Fund expenditure requirements over time.

Estimate of Underlying General Fund Expenditures

As shown in Figure 1, we estimate that the underlying level of General Fund expenditures under the assumptions described above dropped from $103 billion in 2007-08 to around $98 billion or $99 billion over the next three fiscal years, primarily due to receipts of federal economic stimulus funding that offset General Fund spending requirements. In 2011-12, underlying General Fund spending dropped to around the $96 billion level, where it is estimated to remain in 2012-13 under the Governor's budget proposal. (For 2012-13, we rely entirely on the administration's estimates of spending if the Governor's budget proposal is adopted.)

Figure 1

LAO Estimates of Major Adjustments to General Fund Expenditures to Reflect Underlying Programmatic Expenditures

(In Billions)

	2007-08	2008-09	2009-10	2010-11	2011-12[a]	2012-13[b]
General Fund Expenditures[c]	$103.0	$90.9	$87.2	$91.5	$86.5	$92.6
Federal Funds Offsetting General Fund Spending[d]		3.8	5.5	4.6	1.1	0.5
Proposition 1A Securitization and Repayments		—	2.0	-0.1	-0.1	-2.1
Redevelopment/School Funding Shifts[e]		—	1.7	0.4	—	—
Use of cap-and-trade auction revenues to offset unspecified General Fund costs		—	—	—	—	0.5
Proposition 63 Support of Community Mental Health Programs		—	—	—	0.9	—
New Deferrals						
One-day deferral of June 2010 state worker pay		—	0.9	—	—	—
Proposition 98 inter-year deferrals		3.2	1.8	1.8	2.2	—
Proposed Medi-Cal deferral		—	—	—	—	0.8
Proposed Reversal of Proposition 98 Deferrals		—	—	—	—	-2.4
2011 Realignment		—	—	—	5.6	5.8
Subtotals, Adjustments		($7.1)	($11.9)	($6.7)	($9.6)	($3.2)
Adjusted General Fund Expenditures	**$103.0**	**$98.0**	**$99.1**	**$98.2**	**$96.1**	**$95.8**

[a] Governor's budget estimate.
[b] Governor's budget proposal.
[c] Derived from Schedule 6 of the *Governor's Budget Summary* for 2007-08 through 2009-10 and Schedule 9 for 2010-11 through 2012-13.
[d] Derived from Schedule 6 of the *Governor's Budget Summary* and Department of Finance data.
[e] The 2011-12 redevelopment shift—intended as a one-time budgetary offset—is omitted to reflect the Supreme Court's decision that redevelopment agencies will be terminated permanently.

School Deferrals. Similar to the method we used in the December 2010 letter, we make upward adjustments in General Fund spending in 2008-09, 2009-10, 2010-11, and 2011-12 due to the increases in each fiscal year in interyear payment deferrals to school and community college districts. In each of these years, the state committed to an annual level of programmatic funding to K-14 education, but it chose to defer payment of a portion of that annual funding to the subsequent fiscal year. By contrast, in 2012-13, reflecting the Governor's budget proposal, we reduce General Fund spending to reflect the effect of the proposed reductions in interyear K-14 deferrals. Conceptually, this means that a portion of the funds that would be provided to K-14 in 2012-13 would be retiring prior deferrals, rather than supporting educational services to be provided in 2012-13.

If you have any questions about this letter, please contact Jason Sisney at 319-8361 (Jason.Sisney@lao.ca.gov).

Sincerely,

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