

CALIFORNIA STATE BUDGET FY 2008-09

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Context

Subprime mortgage failures and rising energy prices
 Economic Outlook: Slow Growth in 2008, Improved 2009-10
 California Unemployment Rate: 5.4%¹
 Inflation Rate: 4%²

2008 Population Estimate: 38,199,000

- 1.2% growth
- 67% from births; 34% from net migration
- Largest growth among retirees 65+ (12.7%) from 2007-2012

Projected Growth in State Revenues – Modest Growth: 2.8% in 2008-09 (\$102.9 billion)

- 7.2% revenue growth in 2007
- LAO Comparison: 3.5% in 2008-09
- Total General Fund Expenditures 2008-09: \$101 billion

Health and Human Services Expenditures: \$79.5 billion in state and federal funds, down 1.3%

- Total General Fund Expenditures: \$29.3 billion after budget-balancing reductions
 - 0.9% less than 2007-08
 - 29% of total proposed General Fund expenditures; second highest after K-12 Education
 - 34% increase (4.3% yearly average) since 2001-02 – but adjusted for inflation, spending shows a 1% decline
- Total budget-balancing reductions: \$2.7 billion General Fund (\$4.5 billion total) and 367.5 positions
- Most of HHS spending is on Medi-Cal

Governor Schwarzenegger's Estimation of the State Deficit

- 2007-2008: \$3.3 billion
- 2008-2009: \$14.5 billion
 - Including a change from a projected \$4.1 billion reserve to a negative \$3.3 billion reserve, with revenues \$4.8 billion less than predicted - estimated to total \$99.1 billion with no policy changes or \$101.2 billion in the current year and \$102.9 billion in the budget year with his proposed changes

Proposals to Balance the Budget As Required by Proposition 58

Expenditure Reductions:

¹ Seasonally adjusted average in 2007 from <http://www.bls.gov/>.

² This represents the six-month average from values estimated for February through July 2008 from <http://www.forecasts.org/inflation.htm>.



- Gain \$9.132 billion: 10% cuts across the board to most General Fund programs^{3,4}
 - Impacted programs in Health and Human Services include: Child welfare services allocations to counties (\$83.7 million), food stamps administration (\$14.4 million), IHSS administration (\$10.2 million), public health (\$31.7 million), the mental health managed care program (\$23.8 million), developmental services programs (\$22.5 million) and alcohol and drug programs (\$6.2 million)
- Gain \$400 million: Reduce Prop 98 overappropriation

Delayed Expenditures:

- Suspend 2008-09 prepayments for Economic Recovery Bonds
- Gain \$1.509 billion: Suspend Prop 58 transfer to Budget Stabilization Account

Increased Revenue:⁵

- Gain \$3.313 billion: Sell additional Economic Recovery Bonds, selling \$3.3 billion more of allowed \$15 billion
- Gain \$2.001 billion: Accrue June Personal Income Tax and Corporate Tax
- Gain \$4.918 billion: Delay disbursement to various programs
- Gain \$329 million: Increased tax collection and enforcement⁶

Policy Changes:

- Budget Stabilization Act: Constitutional Amendment to reform budget process to prevent over-budgeting based on extraordinary revenue gains and to give the state tools to quickly reduce spending when necessary to avoid a deficit
 - Deposit revenues above a long-term average rate of growth into the Revenue Stabilization Fund and transfer back out to General Fund in no more than the amount of a shortfall in years where revenue grows at less than the long-term average, unless the fund exceeds 10% of the General Fund, in which case the excess will be used for one-time spending for schools, tax rebates, infrastructure projects, or paying off debt

³ Major programs exempt because of constitutional restrictions or difficulty in implementation: Debt service/lease payments; homeowners exemption; health and dental benefits for retirees; Proposition 42; contributions to public employees, judges, and teachers retirement systems; Medi-Cal rates for LTC facilities; state hospitals; major revenue-generating departments (Franchise Tax Board and Board of Equalization); CalGrant high school and community college entitlement grants; juvenile justice programs; health care for inmates; Prop 58 budget stabilization account transfer; capital outlay; undistributed employee compensation; and non-Prop 98 mandates.

⁴ The largest reductions are within Health and Human Services (\$2.66 billion), K-12 education (\$4.36 billion) and higher education (\$1.13 billion), representing 89% of the cuts.

⁵ Sources of revenue to consider for formula changes: personal income tax (55% of General Fund revenues and transfers in 2008-09), sales and use taxes (28%), corporation tax (12%), all other (5%).

⁶ For example, in lieu of a \$22 million (10%) cut for the Board of Equalization, \$7.5 million will be added, leading to 2008-09 revenue of \$38 million, net \$8.5 million to the general fund.



- Automatic prorated reductions in spending based on General Fund balance three times per year (1% deficit = 2% appropriations reduction; >1% = 5% appropriations reduction; excludes debt service and other constitutionally protected appropriations)
- Revenue transfers considered twice per year based on General Fund balance
- Strategic Growth Plan: Create a Strategic Growth Council to coordinate the activities of the state agencies to coordinate investment in state-owned and state-funded infrastructure combined with the creation of a Performance Based Infrastructure to ensure innovation and efficiency by promoting environmental sustainability, economic prosperity, and quality of life through public-private partnerships
 - Plans to invest \$38.3 billion of new general obligation bonds in 2008 in education (K-12: \$6.4 billion; higher education:⁷ \$7.7 billion), water (\$11.9 billion, high speed rail (\$10 billion), judiciary (\$2 billion), and other public service infrastructure (\$300 million)

Some Expenditure Expansions:

- Wildland Firefighting Initiative: \$100 million through 1.25% surcharge on all residential and commercial property insurance
- Tax collection: \$2.122 million from the DOI's Insurance Fund to the General Fund
- Franchise Tax Board: \$16.3 million – estimated to generate \$93 million for the General Fund in 2008-09
- Board of Equalization: \$9 million to address tax compliance issues – estimated to generate \$20 million; \$1.7 million to expand E-Services Program for online filing of certain taxes

General LAO Analysis and Recommendations

Drawbacks of the Governor's Proposal:

- Lower revenues and higher costs than Governor projects
 - Taxable sales in California and U.S. GDP grow more slowly than personal income
 - Taxable Sales: 3.6% in 2008, 3.8% in 2009
 - U.S. GDP: 1.9% in 2008, 2.9% 2009
 - Personal Income: 4.8% in 2008, 5.2% in 2009
 - Weak corporate profits
- Structural budget shortfall after 2008-09
 - Shortfall of nearly \$4 billion in 2009-10, decreasing gradually to less than \$1 billion in 2012-13
- Failure to set priorities

Recommendations to Legislature:

- Targeted spending reductions: Maintain core services, eliminate/modify ineffective

⁷ Money for higher education would fund Proposition 1D beyond its two years, which includes funding the University of California Telemedicine program aimed at improving health care delivery to underserved populations and regions using videoconferencing in combination with expanded medical student enrollment.



- programs, use other funding sources, give enhanced administrative flexibility to local governments
- Including shifting some federal funds from hospital payments to other health care programs, rejecting proposed Medi-Cal provider reimbursement reductions, implementing P4P programs in Medi-Cal, and considering allocating the minimum guarantee to Prop 98⁸
 - Expand revenues: Reduce dependent credit, limit Research and Development credit, limit net operating loss carryforwards, have no broad-based tax rate increases
 - Balance through 2012-13
 - Rethink state responsibilities and budgetary formulas, no additional borrowing/debt

⁸ Proposition 98, which requires that a minimum percentage of the General Fund be used for K-14 education, accounts for about 40% of the state's General Fund spending.