

AN OVERVIEW OF THE GOVERNOR'S 1998-99 BUDGET PROPOSAL

On Friday, January 9th, Governor Wilson unveiled his spending plan for the 1998-99 fiscal year---his eighth and final state budget.

The budget is now the property of the Legislature to review, analyze, debate, revise, and return to the Governor. Assembly Bill 1656 (Ducheny) and Senate Bill 1391 (Thompson) will serve as the budget bills for the Assembly and the Senate, respectively. Multiple "Trailer Bills" will also be introduced in both houses as vehicles for policy changes necessary to implement the final budget agreement.

The Governor's 1998-99 budget proposal reflects the continued moderate growth in the California economy and a corresponding steady---and welcome---improvement in the state's fiscal condition.

Steady Economic Growth: California's economy continues its modest rebound from the near-Depression days earlier this decade.

Jobs are being created at a steady pace while unemployment continues to drop. As the national unemployment rate hit a 24-year low of 4.6 percent recently, California lead the way with the creation of nearly 400,000 new jobs this fiscal year. Today, California's unemployment rate is at a seven-year low of 5.8 percent.

Manufacturing and business services industries, including computer and related industries, continue to grow and add significant numbers of jobs to the State's economy. Nonfarm employment is projected to outpace the nation over the long run.

Housing markets remain active and new home construction is maintaining recent gains. The California Association of Realtors also reported large increases in the sales and prices of single-family homes in California in November 1997. Median home prices have risen 10.4 percent over last year.

More than 50,000 new businesses started up in California last year. Overall, incorporations statewide increased 6.2 percent in 1997. The Central Valley lead the way with a 15.8 percent jump in new businesses while the San Francisco Bay Area saw an increase of 6.5 percent and Southern California five percent.

Inflation is still low, hovering at 2.2 percent, and there are few indications of any sudden change. Personal income is steadily climbing, up 6.8 percent over last year, and wages are up significantly, approximately 7.5 percent over a year ago. Consumption remains on the rise.

Budget Outlook: According to the Legislative Analyst, State revenues are expected to continue growing by nearly five percent per year and public assistance caseloads,

namely Medi-Cal and CalWORKS, are projected to continue to decrease over the next couple of years.

This continued expansion of California's economy, coupled with higher than anticipated revenues resulting from the federal cut in capital gains taxes, is expected to increase current year General Fund revenues by nearly \$650 million over what was anticipated when the budget was enacted last August.

All this rosy economic news, however, does not necessarily translate into major new opportunities to create and fund large, new programs. Current statutory commitments mean that there will be only limited room for major new initiatives. At the end of the 1997 Legislative Session, the Governor and Legislature agreed on a number of issues that impact the budgets of future years:

- The tax package reduces State spending in the current year by \$189 million in the current year and \$593 million in 1998-99;
- The Healthy Families Program costs the State nearly \$5 million in the current year and another \$65 million in the budget year;
- The Trial Court Consolidation Plan will cost the State an additional \$450 million beginning in 1998-99;
- There were no funds set aside for a state employee pay raise in the current year, however the Governor has set aside \$280 million in the budget year, which would provide slightly less than a three percent raise;
- The agreement to roll back student fees by five percent for students attending the University of California and the California State University, to avoid any further fee increase in the 1998-99 academic year, will cost the State nearly \$112.8 million in the budget year; and,
- There also are a number of other smaller agreements and new statutory requirements, such as health-related research programs costing \$25 million, that were required to be built into the 1998-99 budget.

As expected, the Governor's budget proposal reflects these major agreements, makes no new tax proposals, and contains only a few new programmatic initiatives. Where the Governor does offer new budgetary initiatives, he largely draws on legislatively-sponsored proposals he has either vetoed or outright rejected in the past, such as in the areas of education and Adult Protective Services.

REVENUES

State General Fund revenues are projected to grow by 4.7 percent over the revised current year, for total 1998-99 revenues of \$55.4 billion. Table 1 delineates the

estimated revenues for 1998-99 by source and Table 2 shows the change in estimated revenues by major source.

Table 1

1998-99 Revenue Sources (Dollars in millions)		
	General Fund	Special Fund
Personal Income Tax	\$27,640	----
Sales Tax	18,290	\$2,066
Bank and Corporation Tax	6,175	----
Highway Users Taxes	----	2,994
Motor Vehicle Fees	36	5,622
Insurance Tax	1,281	----
Estate taxes	762	----
Liquor Tax	268	----
Tobacco Taxes	162	479
Horseracing Fees	42	36
Other	727	3,523
Total	\$55,383	\$14,720

Table 2

Governor's Budget Revenue Forecast Comparison Between 1997-98 and 1998-99 (Dollars in billions)			
	Projected		Percent Change
	1997-98	1998-99	
Revenue Source			
Personal income tax	\$26.0	\$27.6	6.2
Sales and use tax	17.6	18.3	4.6
Bank and corporation tax	5.8	6.2	6.9
All other	3.5	3.3	-5.7
Totals	\$52.9	\$55.4	4.7

However, revenues are understated by nearly half a billion dollars over the current and budget years, according to recent projections by the Legislative Analyst, when

incorporating figures which became available during final preparation of the Governor's budget.

Once again, the budget assumes the federal government will adopt a Reciprocal Tax policy that will generate an additional \$85 million in revenue. And, the Governor's budget contains no tax proposals to stimulate small business growth and development, such as reducing the Minimum Franchise Tax. Nor does the budget propose any additional federal tax conformity.

EXPENDITURES

The Governor proposes a total 1998-99 State Budget of \$73.8 billion, a 6.3 percent increase over the estimated current year budget. State General Fund spending is projected to be \$55.4 billion, or 4.5 percent over the current year. The budget proposal also projects Special Fund spending to be \$15.2 billion and bond funding to be \$3.2 billion.

In Table 3, the Governor's 1998-99 spending plan is displayed by major expenditure area and funding source---General Fund, Special Funds and Bond funds.

Table 3

1998-99 EXPENDITURES BY FUND (Dollars in Millions)				
Function	General Fund	Special Funds	Bond Funds	Total
Education (K-12)	\$23,522	\$59	\$1,957	\$25,538
Health and Welfare	15,070	3,460	--	18,530
Higher Education	7,191	655	460	8,306
Business, Transportation and Housing	338	4,445	538	5,321
Trade and Commerce	103	13	--	116
Courts	964	42	--	1,006
Tax Relief	465	--	--	465
Local Government Subventions	113	3,749	--	3,862
Youth and Adult Corrections	4,399	10	17	4,426
Resources	750	994	106	1,850
Environmental Protection	118	513	83	714
State and Consumer Services	408	477	61	946
Other	1,975	733	1	2,709
Total	\$55,416	\$15,150	\$3,223	\$73,789

Table 4 displays the Governor's overall estimate of the condition of the state General Fund at the end of both the current and budget years. As can be seen, the Governor's budget proposes a Reserve for Economic Uncertainty of a mere \$296 million, approximately .53 percent of the General Fund budget.

Table 4

1998-99 GOVERNOR'S BUDGET GENERAL FUND BUDGET SUMMARY (Dollars in Millions)		
	1997-98	1998-99
Prior Year Balance	\$906	\$774
Revenues and Transfers	52,890	55,383
Total Resources Available	\$53,796	\$56,157
Expenditures	53,022	55,416
Fund Balance	\$774	\$741
Budget Reserves:		
Special Fund for Economic Uncertainties	329	296
Reserve for Liquidation of Encumbrances	445	445

Major Issues

Reciprocal Tax Payment: Once again, the budget assumes the U.S. Congress will act to establish a program under which the Internal Revenue Service and the U.S. Treasury Department may offset or withhold a federal tax refund to satisfy legally enforceable, past due state income tax obligations.

Currently 31 states, including California, offset state income tax refunds to satisfy delinquent federal tax obligations under a cooperative arrangement between the state tax agency and the Internal Revenue Service. California has been participating in the state offset arrangement since January 1991, and annually collects nearly \$30 million for the federal government.

However, this assumption has been built into the Governor's budget in the past, but Congress has shown little interest in enacting a state reciprocal tax offset program.

Healthy Families: California is eligible for federal matching funds approximating \$855 million to implement the new State Children's Health Insurance Program enacted by Congress in 1997. In response to the new federal law, the Legislature enacted a package of bills creating the state Healthy Families program.

The Governor's budget proposes total funding of \$201 million to support the Healthy Families program, of which \$73 million from the General Fund will draw down \$158 million in federal funds. The budget assumes 54 percent of 580,000 eligible children in California will enroll in the program by the end of the 1998-99 fiscal year.

Grant Cuts & COLA Suspensions: The Governor's budget assumes continuation of the suspension of grant cuts and cost of living adjustments for certain social service program recipients scheduled for reinstatement next Fall. More specifically, the Governor proposes to continue a previously-approved 4.9 percent welfare grant for a savings of \$150.8 million (\$73.5 million General Fund), although the Governor apparently has abandoned repeated efforts to implement comparable grant cuts for SSI/SSP recipients. The Governor also proposes to deny a 3.2 percent cost of living adjustment for:

- People with disabilities and senior citizens receiving SSI/SSP, for a General Fund savings of \$51.7 million;
- CalWORKS participants, for a savings of \$71 million, of which \$34.6 million is from the General Fund; and,
- Foster care group home providers, for a \$7.9 million General Fund savings.

These cuts were made on a temporary basis during the deep recessionary years of the early 1990s.

Renter's Credit: For the fifth year in a row, the Governor's budget assumes the continued suspension or outright elimination of the highly-popular Renter's Tax Credit Program, for a General Fund savings of \$539 million.

Originally, the renter's credit was enacted to offset tax relief provided to real property owners. The renter's credit, the only tax relief offered renters, provides a refundable tax credit to Californians who rent their principal place of residence.

Under current law, and absent legislative action to the contrary during this budget process, renters will receive \$60 per individual and \$120 per couple for the 1998 tax year.

El Niño: There are no funds in the Governor's budget specifically set aside to cover the costs of preparing for or damage related to anticipated flooding as a result of El Niño weather conditions.

Fund Repayments: To balance the 1997 budget after the Governor repaid the Public Employees Retirement System obligation, the Legislature borrowed \$26 million from the Victim Restitution Fund and postponed repaying another \$30 million previously-borrowed from a variety of special funds. The Legislature may wish to expedite the repayment of these one-time loans, as SB 1311 (Lockyer) proposes for the Victim's Restitution Fund.

Infrastructure Investment: The Governor's budget proposes the sale of \$7 billion in General Obligation bonds over the next year to build and rebuild schools and college facilities, to build additional prison facilities and water projects, and to invest in local infrastructure needs and environmental protection. After more than a decade of infrastructure decay and neglect throughout state and local government, an infrastructure investment strategy will need to be carefully shaped.

Reserve: Considering the number of disasters California experienced this decade, the proposed Reserve for Economic Uncertainty is uncharacteristically low for the Wilson Administration. The reserve is estimated to be less than one percent (.53 percent) of total General Fund resources. A modest economic slowdown could adversely effect revenue projections, or a serious natural disaster could quickly drain the small reserve.

The state budget is the single most important tool available to the Legislature to direct policy in any given year.

As usual, the Legislature will analyze, revise, and negotiate the annual budget, before returning it to the Governor in June. This year, the Legislature is in the unique position of having an estimated \$500 million of additional revenue to invest at its discretion----above and beyond whatever proposals of the Governor the Legislature chooses to reject or redirect.