2000-01

Meeting Our Obligations

The Governor's Budget is a financial plan based on estimates of existing law revenues and expenditures, and proposed changes to either or both. There are at least two big challenges in crafting a financial plan—one is setting budget priorities for all the competing needs of the people of California. The other challenge is estimating the level of revenues that will be available to support the budget spending.

Estimating Is An Art

Estimating revenues and expenditures is as much an art as a science. The amount of revenues for the support of the State is in constant flux from the initial projections to actual collections, which are not known until two years later. Similarly, major caseload-driven costs can vary widely over this period of time. Given the State's $68.8 billion General Fund Budget, a mere 1 percent increase in spending or a reduction in revenues would put the Budget out of balance by more than $680 million.

For the past few years, a significant share of the revenue increases has resulted from exceptional growth in the stock market. Fueled by the surging market, taxpayers—realization of capital gains has risen in excess of 20 percent per year for the last four years. In addition, income from stock options has become an increasing portion of employee compensation packages, income from retirement investment vehicles has been boosted, and consumption of taxable goods has soared, in part due to the "wealth effect" investors have experienced.

The portion of the State's revenues that is dependent on this highly volatile source has risen rapidly and now constitutes a very significant portion of the State's discretionary income. Forecasting market performance is notoriously difficult if not impossible. Therefore, expectations of market performance must be treated as an assumption, rather than a forecast. Similarly, the revenues dependent on this assumption are subject to a great deal of uncertainty. For this reason, fiscal prudence demands that a portion of current revenues be viewed as essentially one-time, rather than ongoing, and a reasonable reserve be established for future budgetary needs.

Even more fundamentally, a significant portion of the additional revenues available for programming in the Budget are due to revised estimates of the economy's performance for years *prior* to the budget year. Treating these revenues the same as budget year revenues for budgeting purposes would overstate the General Fund's ability to support ongoing spending commitments. Additional prior-year revenues are by definition one-time in nature and should be programmed as such.

Allocating One-Time Vs. Ongoing Revenues

In recognition of the fact that about $2.9 billion in additional revenues compared to earlier estimates is from better performance of the economy for years prior to the budget year, the

Budget proposes $2.9 billion in one-time spending and set-asides. Utilizing these funds for one-time purposes recognizes that these revenues are not part of current income in the budget year.

Major new one-time items include:

- Over $700 million to address lawsuits that have been resolved, including the smog impact fee litigation.
- $358 million to increase the General Fund Reserve.
- $121 million for transit projects and equipment.
- $100 million for technology grants for local law enforcement.
- $100 million for the Natural Heritage Preservation tax credit.
- $100 million for teachers-down payment assistance and school bus replacement.
- $500 million set-aside for legal contingencies.
- $100 million set-aside for one-time legislative initiatives.

Accounting for Past Budget Actions

One of the major pressures facing this Administration is dealing with the many lawsuits relating to past budget actions. Over the past few years, the State has been ordered by courts to pay hundreds of millions of dollars for settlements of lawsuits dealing with the budget balancing actions of the early 1990s.

The most notable of these lawsuits include:

California Public Employees Retirement System v. Wilson et al.—$1.5 billion General Fund

California Teachers Association v. Gould (State share)—$1.2 billion General Fund

Jordan v. Department of Motor Vehicles (Smog Impact Fee) —$665 million All Funds

Consolidated settlement for Malibu v. Brown and Abramovitz v. Wilson (Special Fund transfers)—$138.6 million General Fund

Hathaway v. Wilson (Special Fund transfer)—$21.4 million General Fund

Of these lawsuits, the 2000-01 Budget includes (1) $350.0 million for the next-to-last loan repayment under the CTA v. Gould settlement, (2) $665 million ($562 million from current year General Fund) to respond to the recent court findings in the Jordan v. DMV case, (3) $26.7 million General Fund for the final payment in the Malibu v. Brown and Abramovitz v. Wilson lawsuits, and (4) $21.4 million General Fund for the Hathaway v. Wilson lawsuit.

Providing Prudent Reserves

Because estimates of current revenues are subject to a great deal of uncertainty, prudence dictates that a reasonable reserve be established for future budgetary needs. We must not take actions today that will cause future funding problems, should there be a leveling or decline of revenues or a significant increase in the cost of entitlement programs. Part of the solution is to ensure that the State has adequate reserves.

The 2000-01 Budget proposes a General Fund Reserve of $1.2 billon.