

California Community Colleges State Budget Workshop

California's Economic Outlook and Proposition 98



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2008-09 Budget – Storm Begins

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- **California economy collapses, revenues decline leading to the latest State Budget in history – three months after the constitutional deadline**
 - ◆ **Revenues continue to decline**
 - ◆ **Budget is out of balance before the ink is even dry**
 - ◆ **Governor calls multiple special sessions as legislators struggle to bring the Budget back into balance**
 - ◆ **Five months later, in February 2009, lawmakers and the Governor cobble together a combination of tax increases, borrowing, and cuts**
- **As revenues decline, so does the Proposition 98 minimum funding guarantee**
- **Legislators and the Governor cut Proposition 98 down to the minimum . . . chasing the rock rolling downhill**

2009-10 Budget Storm Continues

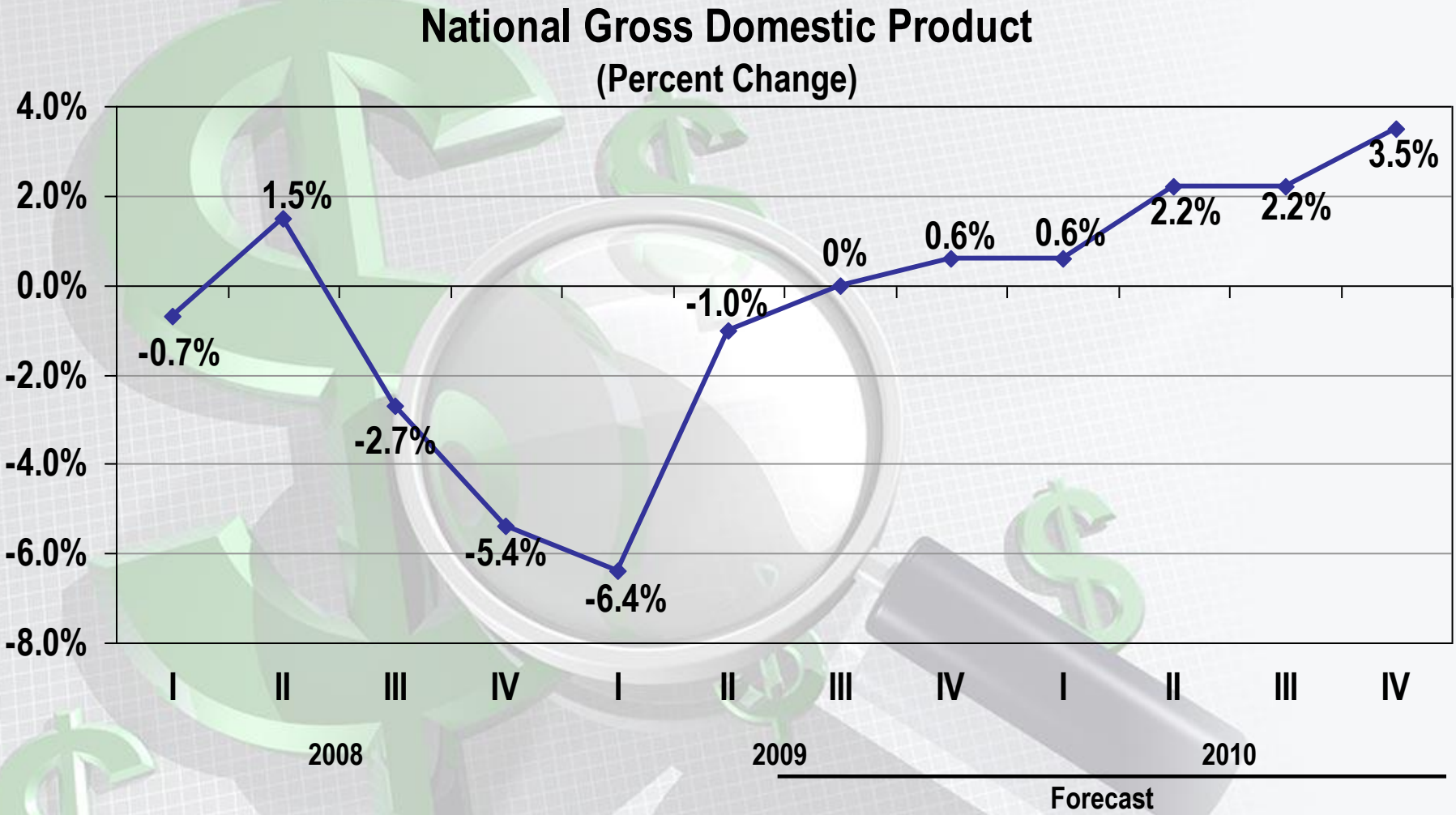
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- State lawmakers, in conjunction with revisions to the 2008-09 Budget, passed the 2009-10 Budget five months early – the earliest Budget in state history
- Voters reject special election propositions that would have helped to balance the Budget
- Revenues continue to fall
 - ◆ Budget is immediately out of balance
 - ◆ Governor calls a special session
- Republican legislators pay a price for supporting new taxes and refuse to consider more to stop the fiscal bleeding
 - ◆ Minority leadership in both houses changes
- Budget imbalance is solved by cuts and borrowing
- Legislators and the Governor cut Proposition 98 to the continually eroding minimum level and they continue to chase the rock rolling downhill

- Revenues continue to come in below projections leading to possible midyear cuts for 2009-10
 - ◆ The economy continues to cause concern
- There is no warning when the economy slips into recession
 - ◆ California was in a recession for a year before economists officially made the designation
- We do, however, get advance warning of economic recovery as jobs are created and increased tax revenue begins flowing into the Treasury
- We are not seeing a likely increase in revenue in the near future
- Will California's economy turn around in 2010?
- Will Proposition 98 funding stabilize?
- Or will legislators and the Governor cut education further and continue chasing the rock rolling downhill?

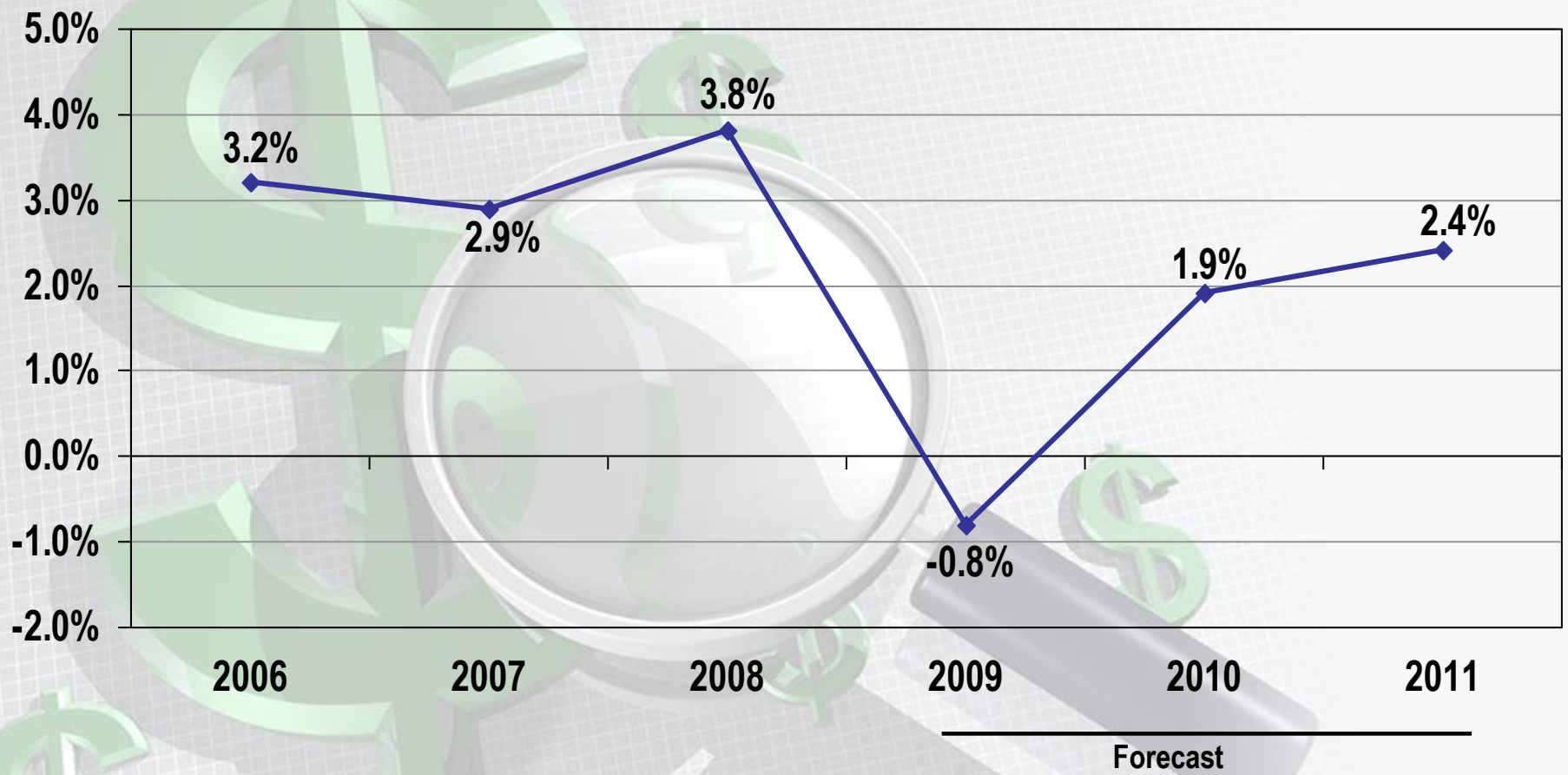
- The national recession began in December 2007 and is now 21 months old
 - ◆ It is the longest downturn since the Great Depression of the 1930s
- There are some signs that the economy has hit bottom
 - ◆ The stock market is up about 40% since its March 2009 bottom of 6,600 on the Dow Jones Industrial Average
 - ◆ The rate of job loss has slowed and the unemployment rate fell slightly to 9.4% in June
 - ◆ Gross Domestic Product is no longer in freefall
It was essentially flat in the second quarter of 2009

National Economy – End of the Recession?



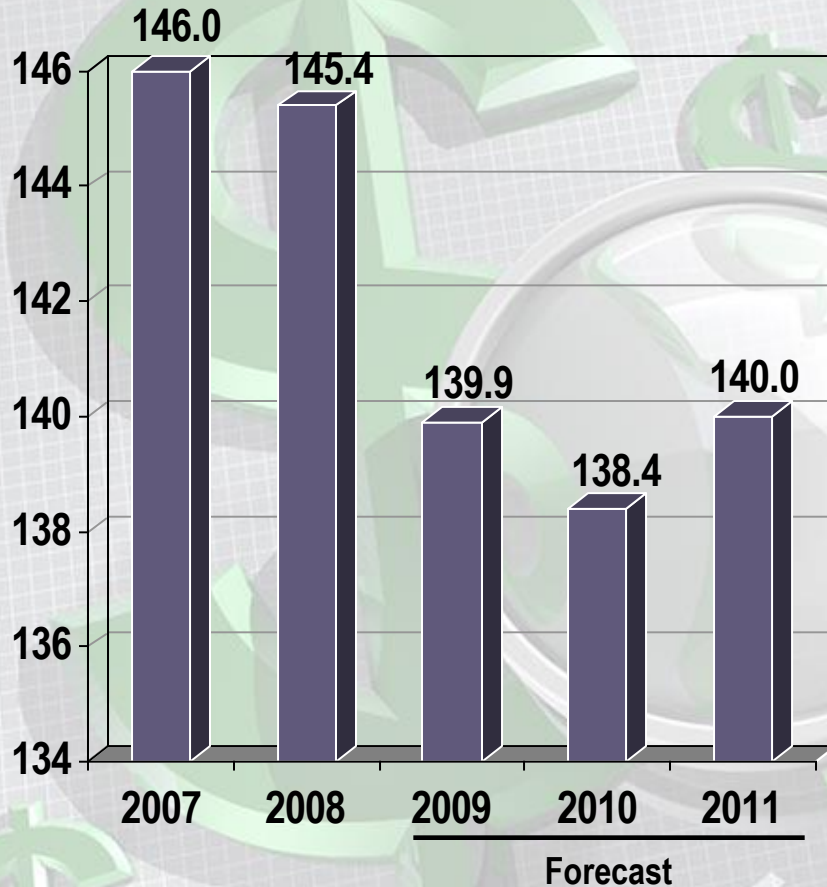
Source: National Bureau of Economic Analysis, July 31, 2009; UCLA Anderson Forecast, June 2009

U.S. Consumer Price Index

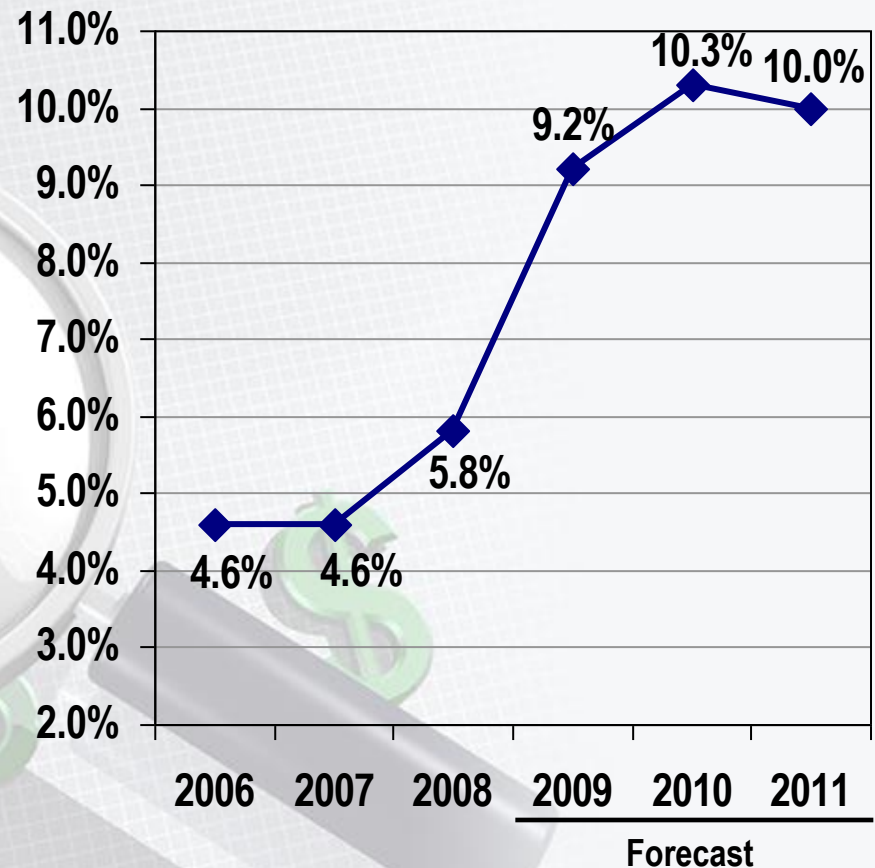


Source: UCLA Anderson Forecast, June 2009

U.S. Jobs (in millions)



National Unemployment Rate



Source: UCLA Anderson Forecast, June 2009

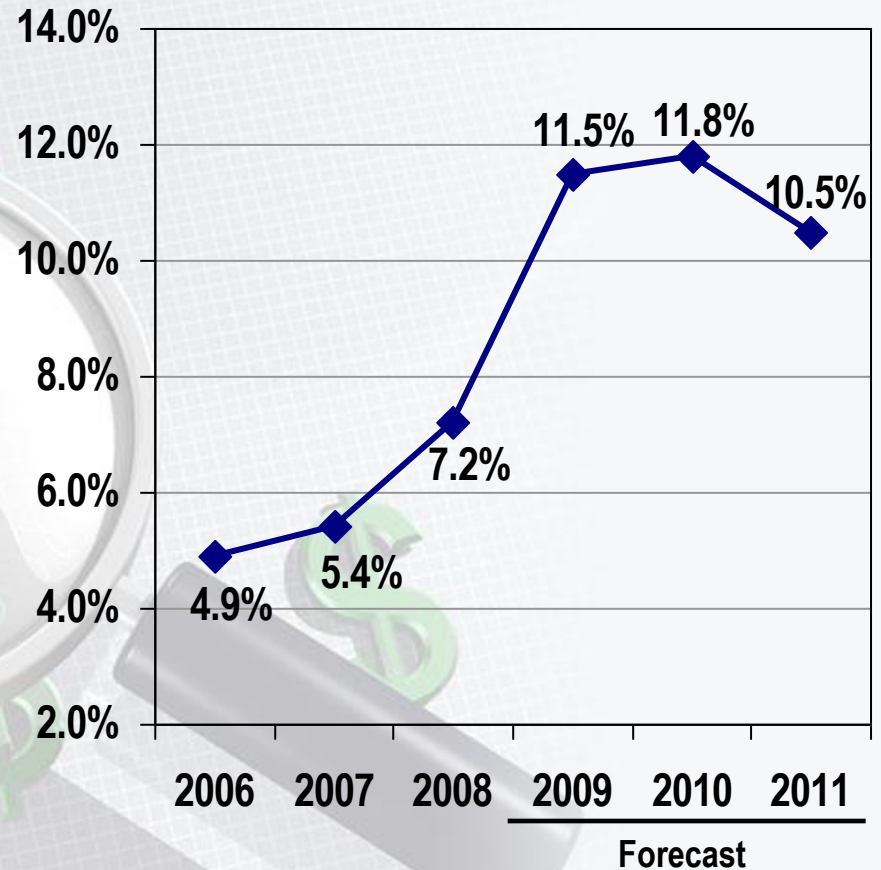
- California has suffered more than the nation as a whole
 - ◆ The state's unemployment rate reached 11.5% in May compared to the national rate of 9.5%
 - ◆ California has experienced a greater drop in its median home price, but also enjoyed a greater run up in prices before the fall
 - ◆ Its Budget deficit is among the worst of the 50 states
- It may take longer for the state's economy to turnaround
 - ◆ California was the epicenter of the collapse of the subprime mortgage market

According to UCLA, residential building permits are off 77% from the 2004 high of 213,000 units

California Jobs (in millions)

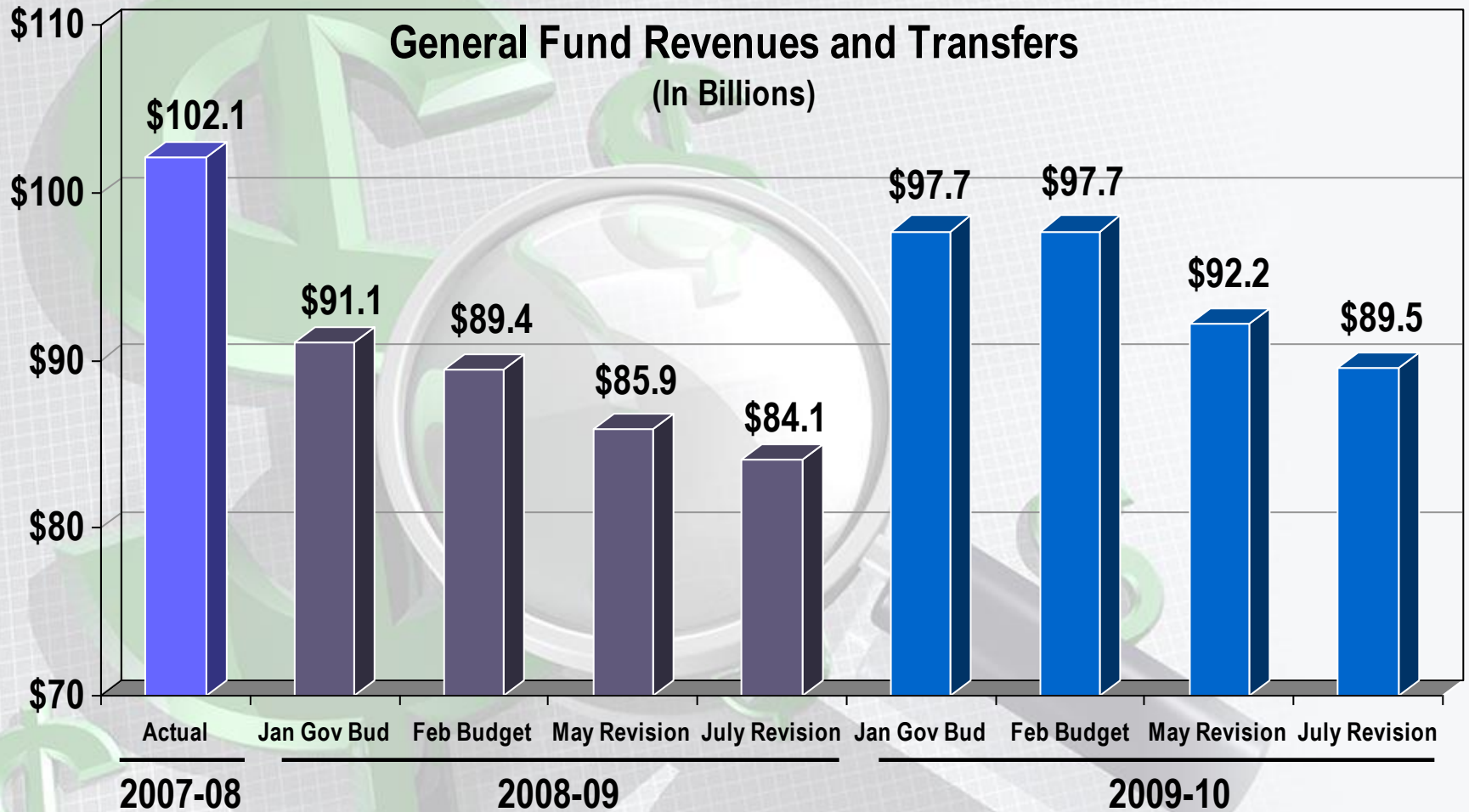


California Unemployment Rate



Source: UCLA Anderson Forecast, June 2009

General Fund Revenue Trends



Source: Legislative Analyst's Office

General Fund Budget Summary

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	(Dollars in Millions)	
	2008-09	2009-10
Prior-Year Balance	\$4,071	-\$3,379
Revenues and Transfers	\$84,097	\$89,541
Total Resources	\$88,168	\$86,162
Total Expenditures	\$91,547	\$84,583
Fund Balance	-\$3,379	\$1,579
Budget Reserve:		
Reserve for Encumbrance	\$1,079	\$1,079
Reserve for Economic Uncertainties	-\$4,458	\$500
Budget Stabilization Account	\$0	\$0
Total Available Reserve	-\$4,458	\$500

- The \$500 million reserve was created by the Governor's vetoes, which are being challenged in court
- Expenditures fall 7.6% in 2009-10, but this reflects one-time solutions, accounting gimmicks, and tenuous assumptions
- Revenues and transfers in 2009-10 are reduced \$3 billion from the May Revision

- The 2009 Budget reflects a \$500 million reserve – 0.56% of expected revenues and transfers
- There is a very great risk that the current-year Budget will fall out of balance
 - ◆ The state economy remains weak and revenue collections are already short \$862 million from the budgeted level through July
 - ◆ Major Budget solutions are being challenged in the courts
 - \$500 million in Governor's vetoes
 - \$1.7 billion in redevelopment agency (RDA) fund shifts
 - ◆ Numerous Budget assumptions may not materialize
 - \$1 billion in savings in corrections
 - \$1 billion from the sale of the State Compensation Insurance Fund
- There is no significant upside potential to offset the downside risks

- The Proposition 98 guarantee has plummeted more than 13% in less than one year
 - ◆ In September 2008, the Budget Act for 2008-09 placed the guarantee at \$58.1 billion
 - ◆ The Budget revision enacted last month set the 2009-10 guarantee at \$50.4 billion
- The fall in the Proposition 98 guarantee created a \$1.6 billion “overappropriation” in 2008-09
 - ◆ The Legislature and the Governor enacted a convoluted funding scheme to avoid the 2008-09 “overappropriation” and suspension of the guarantee in 2009-10
- Unless the economy rebounds, further reductions in the Proposition 98 guarantee may occur
 - ◆ Remember, however, cutting appropriations that count toward the guarantee would require a two-thirds vote of both the Assembly and the Senate

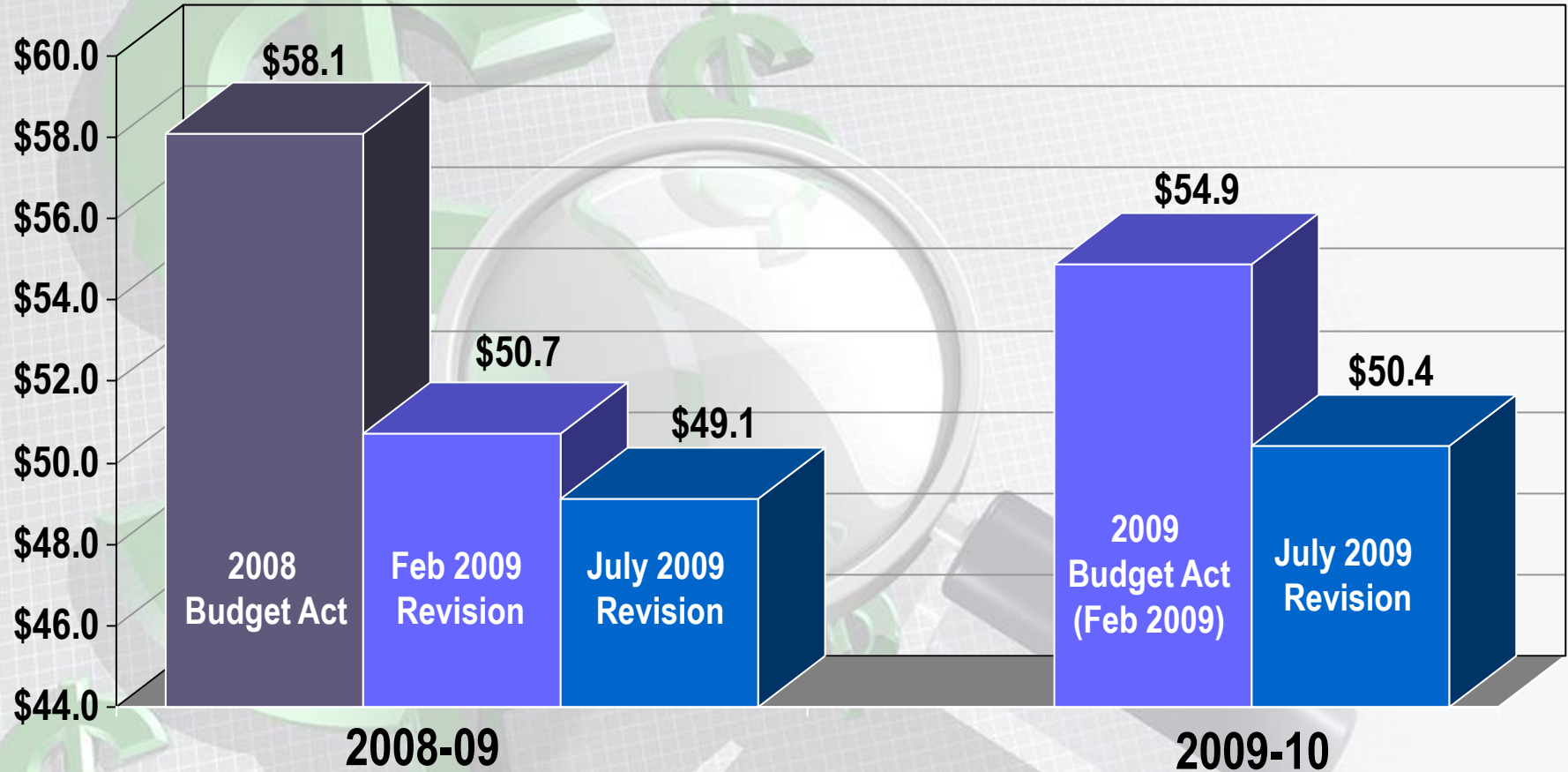
- **The Governor's May Revision indicated that the 2008-09 minimum guarantee had fallen, creating a \$1.6 billion "overappropriation"**
- **The Legislature did not reduce 2008-09 funding prior to the close of the 2008-09 fiscal year, which appeared to foreclose the opportunity to recapture the \$1.6 billion "overappropriation"**
- **However, the Legislature and the Governor ultimately agreed on a scheme that:**
 - ◆ **Swept \$1.6 billion in unallocated categorical funds and reverted this sum to the state's General Fund**
 - ◆ **Restored the same amount, less funding for High Priority School Grants, to every school district in 2009-10, making these funds available to cover 2008-09 expenses**
 - ◆ **Cut \$250 (est.) per 2008-09 Second Principal Apportionment (P-2) ADA from each local educational agency's (LEA's) revenue limit entitlement in 2009-10**

- The triple-bank-shot solution allowed the Legislature to avoid voting to suspend Proposition 98 in 2009-10
 - ◆ However, it also may have set a precedent by allowing the state essentially to cut appropriations subject to the Proposition 98 guarantee after the close of the fiscal year

This approach could be used in future years to cut Proposition 98 funding, regardless of the state's Budget condition

- The flat-rate reduction of \$250 per ADA is inequitable
 - ◆ Low revenue limit districts incur a relatively larger reduction than high revenue limit districts
 - ◆ Elementary districts are hit harder than high school districts for the same reason

Proposition 98 Guarantee (In Billions)



- **Adopted by state voters in 1988, Proposition 98 was intended to set a minimum funding level for K-14 education**
- **Unfortunately, there have been many manipulations of Proposition 98 over the last 21 years, which distort this as a measure of school funding**
 - ◆ **Off-book loans during the Wilson Administration**
 - ◆ **Inclusion of child care and development as a Proposition 98 expenditure**
 - ◆ **Elimination of maintenance factor obligation proposed by the Governor (ultimately not enacted)**
 - ◆ **Substituting special funds for General Fund revenues to fund Home-to-School Transportation (ultimately not enacted)**
 - ◆ **Cutting appropriations after the close of the fiscal year**
 - ◆ **Cutting non-Proposition 98 funds (i.e., Quality Education Investment Act [QEIA]) that would have been allocated to schools**
- **The school community should consider developing a new measure other than Proposition 98 to gauge state support for public education**

- The maintenance factor tracks the amount the state owes to K-14 education when actual funding falls short of the long-term Test 2 target level (ADA and per-capita personal income change)
- In January 2009, the Administration asserted that no maintenance factor would be owed in 2008-09 and 2009-10 because funding was projected to be determined by Test 1 (fixed share of General Fund revenues)
 - ◆ \$9.2 billion was at stake
- The final Budget revision agreement (ABX4 3 [Chapter 3/2009]) specifies that the maintenance factor for 2009-10 is \$11.2 billion
 - ◆ Enactment of this measure settles this issue
 - ◆ This obligation will be paid over several years when healthy General Fund revenue growth resumes

- The engine for improvement in funding for education is a robust economy
- We get very little warning of a downturn, as we have seen over the past 18 months
- But when a recovery develops, we will be able to see it more clearly
 - ◆ First, consumer spending shows improvement
 - ◆ Then, business and production activities improve
 - ◆ Then, employment stabilizes and begins to recover
 - ◆ Then, sales and income taxes begin to improve
 - ◆ Finally, state revenues improve and Proposition 98 is pushed upward
- Typically, it takes about 18 months from the beginning of the recovery until we see more funding for education and other government services
- And the recovery has not yet begun

- Many of the solutions provided in the February enacted Budget and the recent revision are one time in nature
 - ◆ About half of the \$24 billion in solutions enacted in July are one time
 - ◆ The savings from these solutions will need to be readdressed each year until permanent solutions, such as cuts or new revenues, are adopted
- Increases in demand for government services will continue to outstrip the state's ability to provide them until the economy turns
- There are lot of shortfalls that will need to be addressed as a result of cuts made during this difficult time – education is not the only area falling behind; the others will need to be addressed as well
- The debt load for the state of California is tremendously high and, unless there is substantial improvement in the credit rating, the cost of servicing that debt will rise dramatically
- Federal funding plugs holes once, but is not ongoing

- Education funding from the state is the result of two major factors:
 - ◆ Proposition 98, which is driven by workload and inflation adjustments
 - ◆ Political will to fund Proposition 98
- This year, we have seen Proposition 98 crash as state revenues have collapsed
- Perhaps even more troubling, we have seen manipulations and reinterpretations of Proposition 98 through the political process that have rendered this measure almost meaningless
 - ◆ This may be the time for a new way to budget education funding

- **Is the economy turning around?**
 - ◆ Watch for sustained job growth, rather than a drop in the unemployment rate
 - ◆ Consumer confidence index will signal an improving consumer market
- **Is the Budget outlook improving?**
 - ◆ SSC will report on the state revenues hitting or falling short of the forecast
 - ◆ Are the Budget assumptions holding or are things falling apart?
 - ◆ Relations between the Legislature and Governor are also important
- **When will education funding turn around?**
 - ◆ The economy, state revenues, and State Budget must stabilize first, then improve

Education funding will follow

- In the midst of a chaotic year, we are optimistic
 - ◆ The long-term trend for the economies of California, the United States, and the world is upward
 - ◆ There will be significant setbacks from time to time, but it has been 75 years since the Great Depression of the early 1930s and the Great Recession of 2007 is the second-worst economy we have seen
 - ◆ So, as bad as it is, the price of long-term prosperity will be some significant short-term volatility from time to time
- The consolidation that occurs during a world economic collapse is the springboard for a return to prosperity
- We think now is the time for leaders to prepare for a brighter future