

Overview of Legislative Analyst November Budget Report

Current Budget Solutions Inadequate

On November 18, 2009, the Legislative Analyst's Office (LAO) released its annual state budget forecast. The forecast covers the LAO's projections for state budget revenues and expenditures over five fiscal years, from 2009-10 through 2014-15.

The LAO says that the state is facing a \$20.7 billion budget problem over the next 18 months (through June 2011). They attribute the problem to previously enacted budget solutions that will fail to produce the savings anticipated, and a persistent gap between obligations and state revenues.

In particular, the LAO cites the absence of projected savings from prison and Medi-Cal cuts, the loss of an anticipated \$1 billion in income from the sale of the State Compensation Insurance Fund, recent court rulings invalidating state cuts to transportation, in-home services, and some state furloughs, and, finally, the underestimation of the Proposition 98 guarantee to schools in 2009-10 – by about \$1 billion. Additionally, local government agencies have sued the state to stop the transfer of \$2 billion redevelopment funds to schools.

These failed budget solutions from the July version of the budget add up to over \$6.3 billion, and they carry over again into 2010-11. Add to that \$7 billion in the state's persistent structural budget problem and the LAO sees almost a \$21 billion gap that has to be either addressed in the final 2010-11 budget agreement.

The Good News For Schools

There were some positive news in the LAO report for school districts:

- **The state's economy is stabilizing** - After a "staggering drop-off in late 2008 and early 2009," the LAO is predicting a "sluggish" recovery in both 2010 and 2011. It appears the state has bottomed out in terms of revenues.
- **State revenues on track for 2009-10** - The state revenue assumptions utilized to develop the 2009-10 budget appear to be coming in very close to projections – only \$500 million below the projected target.
- **Prop 98 guarantee projected to rise in out-years** - In the last three years of the LAO's forecast period (2012-13, 2013-14, 2014-15), they are projecting consecutive years of increases in the Prop 98 minimum guarantee. The LAO estimates that by 2013-14, Prop 98 funding levels for K-14 will return to pre-recession levels and that the K-14 guarantee could reach as much as \$60 billion in the final year of the forecast (2014-15).
- **More money owed to K-14 in 2009-10** - Due to the complex nature of the Prop 98 formula, the 2009-10 guarantee for schools is now estimated to be about \$1 billion higher than assumed or provided in the 2009-10 budget. The question is how the state can increase funding to meet this increased guarantee.

- **Federal MOE protection for schools** - The LAO mentions the federal Maintenance of Effort (ROE) requirements under the American Recovery and Reinvestment Act (ARRA) will also help to protect education funding levels through 2010-11, although the actual MOE minimum is not specified.
- **State cannot afford to pay schools** - The state's larger revenue picture means that being owed an additional \$1 billion in the current year, or even some of the out-years, doesn't mean that the state can afford to meet that guarantee. As a result, for the current year, the LAO is suggesting the Legislature wait until May to deal with the issue of the increased 2009-10 funding owed to schools, so that a decision can be made with more information. They recommend the Legislature will then likely want to consider three potential options to deal with this funding requirement:
 1. *Pay schools the additional dollars owed in the current year, making greater reductions to other budget areas.* This is an unlikely scenario given cuts of that magnitude would have to come from the health and human services side of the budget – the one place this Legislature is loathe to go.
 2. *Create an out-year settle-up obligation with a multi-year payment plan.*
 3. *Suspend Prop 98, thus saving \$1 billion in 2009-10.* Under the constitutional provisions governing the Prop 98 suspension, the state would have to restore this funding in the future, but likely would not be required to do so within the near term.

Other Key Issues In LAO Report

- **Prop 98 down in 2010-11 and 2011-12** - The LAO projects that the Prop 98 minimum guarantee will decrease slightly in 2010-11 (from the new, higher estimation, but still above current-funded levels). It will then suffer a much larger decline of about \$2 billion for 2011-12, as a result of the temporary tax increases ending, reducing the overall Prop 98 funding level to \$49 billion in that year. (As noted above, the LAO does project an increase in the guarantee after that in 2012-2013, 2013-14, and 2014-15.)
- **Loss of federal stimulus dollars** - Prior reductions to education spending in 2008-09 and 2009-10 were tempered by the flow of \$6 billion in federal funding from the ARRA, which helped prevent additional reductions to school district budgets. Thus, if the state funds at the minimum level in 2010-11 and 2011-12 and does not “backfill” these ARRA funds, K–12 school districts and community colleges would face even more difficulty as they also are experiencing decreases in federal funding.
- **Unprecedented retirement and debt–service costs.** These combined make up about 12 percent of state General Fund revenues in 2009-10. During the LAO's forecast period, these costs grow to an unprecedented 15 percent and leave less General Fund resources for other state programs, like education, corrections, health, and social services.

LAO Budget Recommendation

Obviously, the next two years will be especially difficult budget years for all budget sectors, including education. The LAO says that next year (2010-11) will be particularly difficult and calls upon the Legislature to take the kinds of actions they have historically shown little interest in executing:

- Take early action
- Focus on long-lasting solutions
- Make hard decisions on priorities
- Include revenue options
- Seek new federal assistance
- Go back to the ballot (specifically, asking the voters to redirect to the General Fund dollars they put to other purposes under Propositions 10, 49, and 63)

To assist schools in dealing with reduced state funding and the loss of the one-time federal ARRA dollars, the LAO is recommending the Legislature consider providing additional local flexibility, eliminating certain state mandates, and looking for ways to “improve efficiencies in K-14 education.”

What Does This Data Mean

First, this report is very sobering. The shortfall in the current year are not based on a shortfall of revenue. It is based on solutions that have not happened or are being challenged. The projected shortfalls in future years are based on a revenue, in that the temporary taxes will end in the middle of the 2010-11 fiscal year. The LAO ahs noted that and ahs suggested that these taxes be extended if there is any hope of balancing the budget in 2010-11 and beyond. Additionally, the current solutions of the legislature and Governor have not been structural. In fact, the vast majority of them have been one-time in nature and have resulted in persistent shortfalls. While the budget cuts that have been made to date have been very difficult, the policymakers need to address the systemic problems that have led to this budget crisis – too much program spending and not enough stable revenue. Finally, it is great news that Proposition 98 spending may not be able to be reduced. However, it is troubling that a federal waiver is still possible. In the 2009-10 budget agreement, Prop 98 was approximately 40 percent of the budget and it took 60 percent of the aggregate cuts. It may not be politically possible for the legislative leaders and Governor to come to agreement on \$20 billion worth of cuts out of the \$50 billion in the non-Prop side of the budget. This realization could lead these leaders to appeal directly to the Obama administration for the needed ARRA waiver. If this is done, it would likely come well after the March 15 layoff notice date. So, while the news offered by the LAO seems to provide some protection for education, we must lose sight of the fact that we are still at risk of large cuts in future budget years.