

Association of California Community College Administrators  
Association of Chief Business Officials  
2016-17 Budget Workshop

Economic and State  
Budget Outlook



Presented by:  
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January 20, 2016



- **The Governor's Budget assumes modest growth in 2016-17**
- **For the current year, revenues are revised up by \$2.5 billion**
  - **This is consistent with prior years in which the May Revision presented a conservative revenue forecast**
- **For 2016-17, the Governor's Budget did not increase revenues commensurate with the current year upward revision**
  - **At May Revision, 2016-17 revenues were assumed to grow 4.5%**
  - **At the January Budget release, 2016-17 revenues are now assumed to grow 2.6%, or about \$3 billion**

- **In his press conference, the Governor warned of the impact of the next recession**
  - ❑ **He did not predict when it would occur, but guaranteed that it would come nevertheless**
  - ❑ **The Governor's Budget outlines a scenario of a loss of \$55 billion by 2019 if the downturn begins in 2017**
  - ❑ **To guard against state cuts during a recession, the Governor proposes \$10.2 billion for the state reserve in 2016-17, \$2 billion more than required by Proposition 2**
- **The Legislative Analyst's Office (LAO) also emphasizes that value of building the reserve, stating that it is "the key to weathering the next recession"**

- **Neither the Department of Finance (DOF) nor the LAO is forecasting a recession in 2016-17**
  - ❑ **Employment continues to grow**
  - ❑ **Gross Domestic Product (GDP) is increasing modestly**
  - ❑ **Wages may turn up as labor markets tighten**
- **However, a falling stock market has profound implications for California's General Fund**
  - ❑ **The Dow Jones is off 1,500 points, or about 8.5%, since mid-December when the DOF staff built the Governor's Budget; most of this decline has taken place in the last two weeks**

- **About two-thirds of state General Fund revenues come from the personal income tax**
- **The top 1% of tax payers account for about half of the personal income tax**
  - ❑ **They therefore account for about one-third of General Fund revenues**
  - ❑ **Most of their income is derived from capital gains**
    - **The Governor's Budget assumes that 10% of General Fund revenues will be from capital gains**
  - ❑ **Taxpayer behavior is very difficult to predict**
- **A falling stock market could significantly reduce capital gains income and therefore total General Fund revenues**

- **Stock prices reflect expectations of future earnings**
- **Earnings expectations could be lower due to a number of factors**
  - ❑ **Rising interest rates as the Federal Reserve unwinds its zero interest rate policy**
  - ❑ **The slowdown in China and weak economies in the European Union and Japan lessen their appetite for imports**
  - ❑ **The strong U.S. dollar makes U.S. exports more expensive worldwide**



- **According to the Governor's Budget, Proposition 98 – the minimum funding guarantee for K-12 education and community colleges – will be based on Test 3 in 2016-17**
  - **Test 3 is equal to the change in per capita General Fund revenues, plus 0.5%, estimated at 2.88%**
  - **The Governor's Budget provides \$2.4 billion in new Proposition 98 funds in 2016-17**
- **The May Revision could reduce Test 3 if the stock market remains weak or falls further**
  - **Current year revenues could rise slightly in May while the budget year forecast is lowered, resulting in a downward revision to Test 3**

- **Generally, we carefully monitor General Fund revenue collections as reported by the DOF in their monthly *Finance Bulletin* to provide a clue as to the likely direction of the May Revision**
- **This year it may be more important to follow the performance of the Dow Jones and the S&P 500, given the recent market selloff**
- **A recession may not be needed to bring about a drop in state revenues in 2016-17**
  - ❑ **Highly progressive tax rates, especially following Proposition 30, amplify the importance of high income taxpayers on total collections**
  - ❑ **The interactions with Proposition 98 may result in an unanticipated drop in 2016-17**





# Thank you



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