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LAO Releases Overview of the 2010-11 May Revision

The nonpartisan Legislative Analyst's Office (LAO) released its Overview of the May Revision on May 18, 2010, recommending that the Legislature suspend Proposition 98 if, as the LAO says is likely, the minimum guarantee is above the spending level the state can afford. According to the LAO, the state would need to provide $4.1 billion more than the Governor proposes in his May Revision to meet current-law requirements.

The LAO describes as questionable the Governor's legal interpretation of the obligation to pay a maintenance factor in a Test 1 year, and characterizes as legally uncertain the Governor's proposal to rebench Proposition 98 for the elimination of state-subsidized child care. Absent those legal interpretations, the LAO says that the Governor's proposed spending level would require suspension of the Proposition 98 minimum guarantee.

The LAO suggests a different approach to that proposed by the Governor. Under its approach, the Proposition 98 minimum guarantee would be suspended in the current year to the current spending level. (The Governor's May Revision would instead provide $503 million more than the estimated Proposition 98 guarantee for the current year.) If Proposition 98 were suspended, it would clarify that a maintenance factor does exist. The LAO says the Legislature would then have the option to fund the minimum guarantee in 2010-11 or to provide flat funding by suspending the Proposition 98 guarantee to the current funding level for a second year. Regardless, the LAO says, some reductions to K-14 education will be needed. The LAO has identified a number of targeted savings proposals, but in its Overview specifically cites reducing funding for physical education classes offered by community colleges as the only community college example. The LAO says that other cuts would likely be needed, and suggests that the Legislature could consider making reductions to K-12 revenue limits, community college apportionments, and the K-12 flexibility item (or a combination of these). The LAO recommends that additional flexibility accompany any further cuts.

The LAO advises the Legislature to reject the Governor's proposed elimination of the California Work Opportunities and Responsibility to Kids (CalWORKs) and state-subsidized child care, but suggests that the state could make some changes to the programs to reduce costs. In addition, the LAO opined that the Legislature should achieve more savings from the universities, trial courts, and public safety assistance programs.

The May Revision assumes that California will receive $3.4 billion in federal funds, a more reasonable level than the $6.9 billion that the Governor assumed in his January Budget Proposal; however, the LAO warns that receipt of even the lower level is uncertain.

The LAO also noted the May Revision's expectation that the Public Employees' Retirement System would obtain $200 million in reimbursements from the early retiree reinsurance program included in the recent federal health care reform legislation, and said it expected the final cost savings to PERS' state retiree health programs to be less than the $200 million.

The LAO forecasts slightly higher revenues for the final two months of the current year, and about 1% higher tax revenues than the Administration forecasts for 2010-11, but says the May Revision revenue forecast is reasonable and realistic.

The LAO suggests that more revenues could help avoid the most severe cuts, but discourages legislators from increasing the broad-based personal income tax, sales and use tax, and corporation tax, and instead recommends targeted tax increases, such as an increase in the alcohol tax. In reiterating revenue options previously presented to the Legislature, the LAO cited its recommended community college fee increase.

Even if all of the Governor's May Revision proposals were adopted, the state would still have an annual operating shortfall of $4 billion to $7 billion. The LAO recommends that the Legislature adopt some other changes to address that structural deficit, including a stronger "rainy day fund" and major changes in pension and retiree health benefits for future state and local employees.

—Deborah Harmon

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