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Assembly
California Legislature



ASSEMBLY COMMITTEE ON
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TUESDAY, SEPTEMBER 29, 2020
1:00 PM, STATE CAPITOL – ROOM 4202

STATE EXPENDITURES

Background

Hearing Focus

This will be a “big picture” discussion that will be the first in a series of hearings throughout next year focusing on state spending and opportunities for efficiencies as budget adjustments are needed. The Legislative Analyst’s Office (LAO) will provide an overview of state spending, share ideas for possible reductions, and answer Member questions.

Budget Summary

The pandemic has had severe impacts on the state budget and California’s economy. As a result of the pandemic and subsequent business sector lockdowns, Legislators and the Governor confronted a \$54.3 billion budget deficit.

Prior to the pandemic, the State enjoyed record budget reserves, but they were not enough to close the gap between expected revenues and expenditures once the pandemic hit. The final budget package, which was signed on June 29, 2020, reconciled the gap using the following approaches and their respective percentages of the overall budget solution (as calculated by the LAO):

- Adjusted K-14 education spending, 27%
- Made baseline adjustments and assumptions (ie, revenues and caseloads), 19%
- Used reserves, 15%
- Reduced spending, 15%
- Shifted costs and borrowing, 10%
- Increased revenues, 8%
- Used federal funds, 5%

Given that the budget was developed during a time of uncertainty, and economic challenges will likely continue during the course of the pandemic, these revenues and expenditure approaches will likely need to be reexamined during the current fiscal year.

Recent Budget and Economic Figures

According to the Department of Finance (DOF) September Bulletin, General Fund cash receipts for the first two months (July and August) of Fiscal Year 2020-21 were \$4.5 billion greater than forecasted in the Budget act.

- This represents a 12.8% improvement from the forecast;
- According to the bulletin, revenues from two of the state's three greatest revenue sources exceeded the forecast by double digits while one lagged by single digits:
 - Personal Income Tax exceeded the forecast by 14%
 - Sales and Use Tax exceeded the forecast by 34.9%
 - Corporation Tax fell short of the forecast by 3.5%

The DOF bulletin also noted the following economic trends about the state workforce:

- California's civilian unemployment rate fell to 11.4% in August from 13.5% in July.
- The state gained 101,900 nonfarm payroll jobs last month, and has recovered roughly a third of the 2.6 million jobs lost in March and April.

Federal Funding Uncertainty

The overall budget relies, in some part, on federal funding – the extent of which is unknown and subject to the decisions of Congress and the President. The state budget included \$11.1 billion in reductions and deferrals that will be restored if at least \$14 billion in federal funds materialize by October 15, 2020.

- If the state receives a lesser federal amount between \$2 billion and \$14 billion, the reductions and deferrals will be partially restored.
- The trigger breakdown, per the budget, includes:
 - \$6.6 billion in deferred spending on schools
 - \$2.8 billion for state employee compensation
 - \$970 million in funding for the University of California and the California State University
 - \$250 million for county programs to backfill revenue losses
 - \$150 million for various programs, including courts, child support administration, teacher training, moderate-income housing, and infrastructure to support infill housing.

State Workforce and the Budget:

The 2020-21 Budget reduced state employee compensation costs by up to 10 percent to achieve savings of \$2.8 billion (\$1.5 billion from the General Fund). The Administration sought to achieve these savings through the collective bargaining process. Accordingly, the Legislature ratified agreements to reduce employee compensation costs in the fiscal year with all 21 of the state's bargaining units. The Budget assumes that state employee compensation is reduced by an amount equivalent to a two-day-per-month furlough, a 9.23 percent reduction in compensation.

While furloughing state employees reduces costs in the budget year, the LAO suggests this approach works most appropriately as a short-term solution because there are added costs to the state associated with employees' increased leave balances. If budget problems persist beyond 2021-22 that require reductions to employee compensation, the LAO recommends the Legislature direct the Administration to identify staffing reductions in the future.

Potential Savings and Revenue Generating Strategies

The following approaches are potential strategies for identifying savings and/or generating revenue:

- Evaluating growth of agency spending over a prior ten-year period.
 - Focus on reducing overhead costs, called “administration expenses” at many state departments
 - This approach could limit impacts to programs by focusing on positions that do not directly staff programs.
 - Part of the savings could be realized by not filling open executive management positions.
 - This approach could potentially yield greater savings, but the extent of that is unknown as many departments do not clearly break out overhead costs in the budget.
 - Additional vetting would be needed, as definitions of “administration expenses” are not standardized across departments.

- Accelerating the sale of state surplus property.
 - In addition to the funds realized through the sale of these properties, there would also likely be savings related to no longer maintaining them.
 - While many properties have already been authorized for sale, additional legislation would be needed to authorize the sale of others.
 - As some of these properties are unique and require additional assessments before their sales, it is unknown how quickly sales could be accelerated.

- Reviewing projects and programs that do not represent core functions of state government amidst ongoing economic uncertainty.
 - This approach could include, for example, the State's High Speed Rail project.

- To date, the Legislature has appropriated \$5.5 billion of the total \$9.95 billion from Proposition 1A (the 2008 voter-approved bonds for the project), and about \$4 billion has been spent.
- In its review of the High-Speed Rail Authority's (HSRA) draft 2020 business plan, the LAO notes that if the HSRA moves forward with its plans in the coming months to enter into a contract for constructing track and electrification with a 30-year maintenance commitment, this could significantly limit the state's flexibility to change its approach to the project in the future.
- Given the very large potential commitments of state funds that are at stake, the LAO suggests that action by the Legislature would be needed soon to set the project on a path that is consistent with legislative priorities.
- To that end, House Resolution 97 introduced by Assemblymember Frazier on June 3, 2020, directs HSRA to defer awarding the contract until the Legislature reviews the plan and appropriates the remaining \$4 billion in Prop 1A funds.
- While the resolution does not have the force of law, it does bring attention to the responsibility that government officials have to ensure that the project is a sound investment that delivers a reliable and cost-effective high-speed rail system.