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

# Economic and State Budget Outlook



Presented by: Robert D. Miyashiro, Vice President January 20, 2016 Process

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- 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"

#### **Recession vs. Stock Market Decline**

- 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

## **Stock Market and Capital Gains Income**

- 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

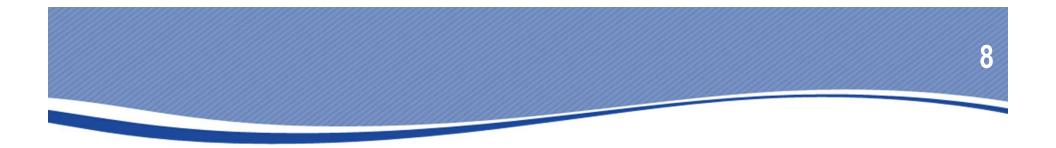


### **Proposition 98 Implications**

- 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





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# Thank you

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