

California's Fiscal Outlook



Presented to:

California County Superintendents

November 18, 2022

Legislative Analyst's Office

Update on State Economy and Budget

The Economic Picture

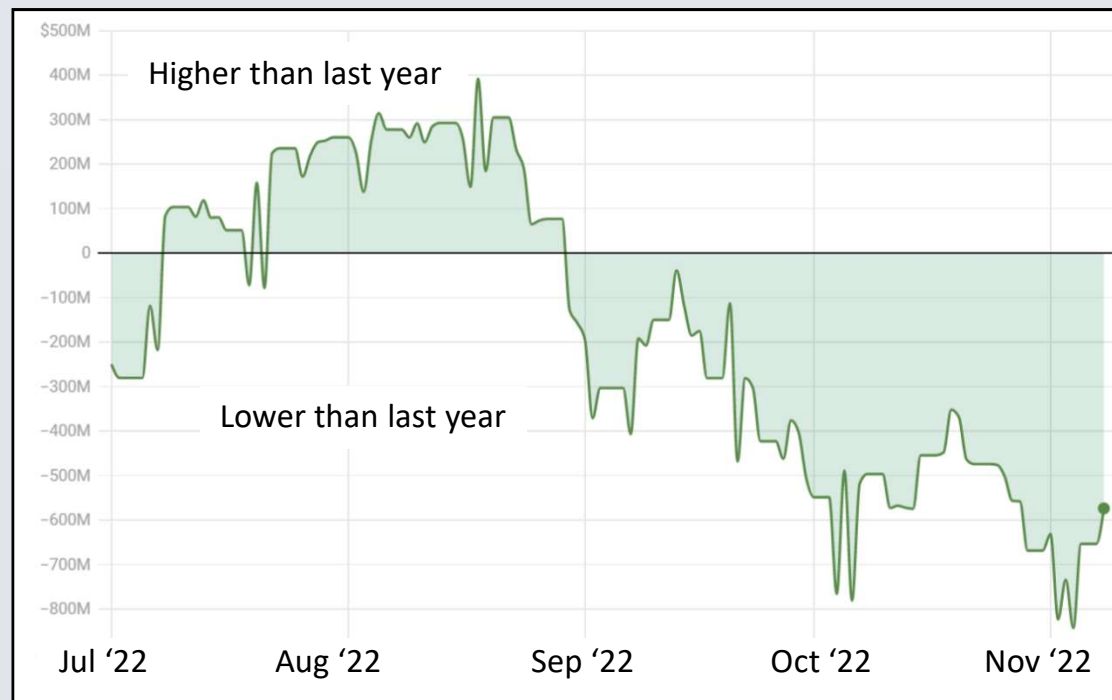
- **Federal Stimulus Spurred Economic Boom in Summer 2020**
- **Current Economic Expansion Appears Unsustainable**
- **Inflation Has Been Surging**
 - Global supply chain challenges and tight labor market.
 - Business unable to meet consumer demand.
 - Consumer prices up 8 percent compared over the past year.
- **In Response to Inflation, the Federal Reserve Has Been Raising Interest Rates Significantly**

Interest Rate Hikes Increasing the Risk of an Economic Downturn

- **Higher Borrowing Costs for Businesses and Consumers**
- **Notable Weakness in Several Areas of the Economy:**
 - The housing market is cooling.
 - Financial markets (e.g., stock market) are down.
 - Car sales are at their lowest level in more than a decade.
 - Funding for business startups in California is down.
 - Initial Public Offerings (IPOs) have dropped dramatically.
- **The Longer High Inflation and Interest Rate Hikes Persist,
the Greater the Risk to the Economy**

State Income Tax Withholding to Date Is Down Compared With Last Year

Cumulative Income Tax Withholding for 2022-23



Our Revenue Estimates Are Down Compared With Budget Estimates

- **Most State Revenue Comes From the “Big Three”—Personal Income, Sales, and Corporation Taxes**
- **We Estimate “Big Three” Taxes Are Down \$42.4 Billion**

“Big Three” Tax Estimates <i>In Billions</i>			Change	
	June Budget	LAO Estimate	Amount	Percent
2021-22	\$215.6	\$214.3	-\$1.3	-0.6%
2022-23	210.0	195.5	-14.5	-7.4
2023-24	220.9	194.3	-26.6	-13.7
Three-Year Totals	\$646.5	\$604.1	\$42.4	-7.0%

State Faces \$25 Billion Deficit in 2023-24

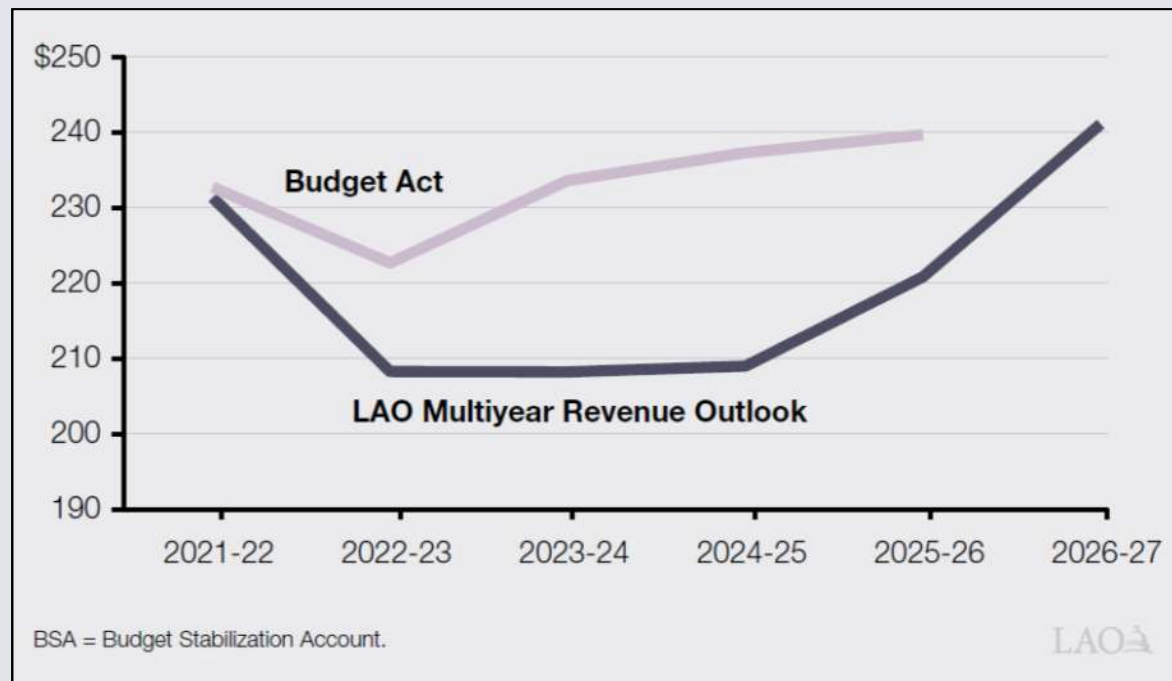
General Fund Budget Estimates Under LAO Outlook

(In Millions)			
	2021-22	2022-23	2023-24
Prior-year fund balance	\$38,334	\$19,385	-\$2,416
Revenues and transfers	224,089	208,280	208,252
Expenditures	243,039	230,081	226,486
Ending Fund Balance	\$19,385	-\$2,416	-\$20,650
Encumbrances	\$4,276	\$4,276	\$4,276
SFEU Balance	\$15,109	-\$6,692	-\$24,926
Reserves			
BSA balance	\$21,925	\$21,925	\$21,925
Safety Net Reserve	900	900	900
SFEU = Special Fund for Economic Uncertainties.			

Multiyear Budget Condition

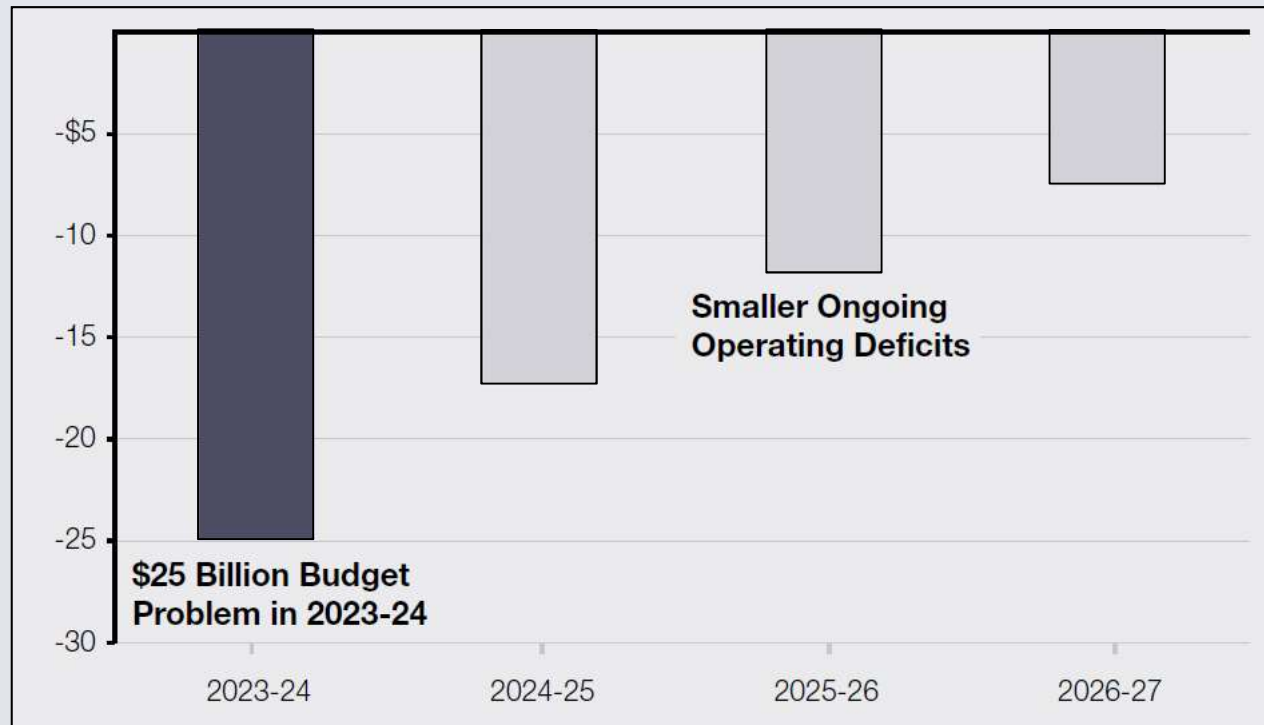
General Fund Revenues Decline, Stabilize, Then Grow

General Fund Revenue Estimates (In Billions)



State Faces Deficits the Next Several Years

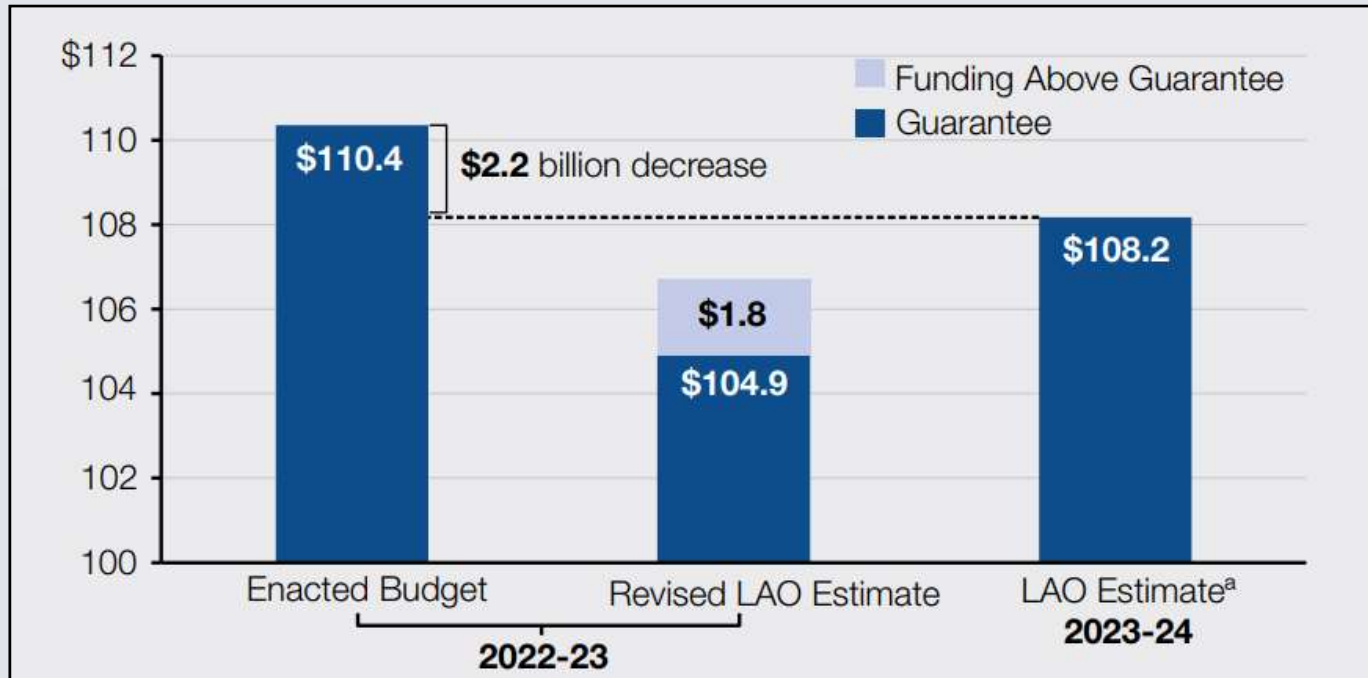
Operating Deficit (In Billions)



Near-Term Outlook for Schools

Proposition 98 Guarantee Below Previously Enacted Budget Level

In Billions



Three Key Adjustments Make Additional Funding Available in 2023-24

➤ **One-Time Allocations Expire**

- The 2022-23 budget allocated \$5.7 billion in ongoing Proposition 98 funds to one-time activities (including programs and reserve deposits).
- These allocations expire in 2023-24, freeing-up the underlying funds.

➤ **Attendance-Related Changes**

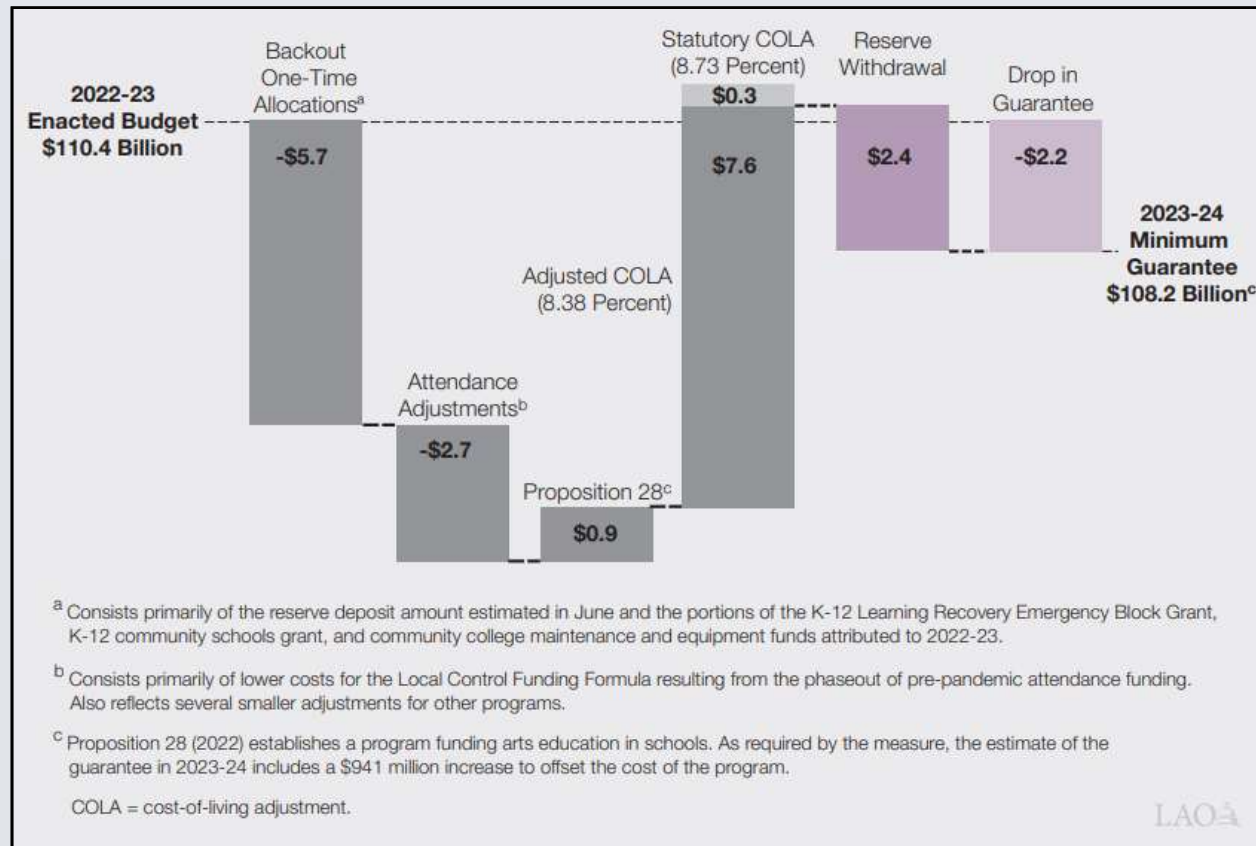
- District funding based on pre-pandemic attendance levels in 2021-22.
- Gradual ramp down (through the three-year rolling average calculation) generates \$2.7 billion in savings in 2023-24.

➤ **Proposition 98 Reserve Withdrawal**

- \$2.4 billion withdrawal required due to weakness in the guarantee.

\$7.6 Billion Available for Cost-of-Living Adjustment (COLA) in 2023-24

In Billions



Planning for COLA in 2023-24

➤ **Estimate of Statutory COLA in 2023-24 is 8.73 Percent**

- COLA rate is determined by a national price index for state and local governments and finalized in late April before the start of the year.
- Our estimate represents the highest statutory rate since 1979-80.
- Reflects price increases throughout the economy and an especially large surge in energy prices.

➤ **State Could Cover Up to 8.38 Percent COLA**

- State law provides COLA for programs automatically but reduces it to fit within the available funding under Proposition 98.
- Each 1 percentage point change in the rate equates to \$910 million.

School Outlook Through 2026-27

Estimates of Proposition 98 Guarantee Grow Faster Near the End of Period

Dollars in Billions

	2022-23	2023-24	2024-25	2025-26	2026-27
Proposition 98 Funding					
General Fund ^a	\$78,613 ^b	\$78,098	\$81,829	\$87,258	\$95,354
Local property tax	28,112	30,077	31,627	32,573	33,927
Totals	\$106,724	\$108,175	\$113,456	\$119,831	\$129,281
Change From Prior Year					
General Fund	-\$5,313	-\$515	\$3,732	\$5,429	\$8,096
Percent change	-6.3%	-0.7%	4.8%	6.6%	9.3%
Local property tax	\$1,385	\$1,965	\$1,550	\$946	\$1,354
Percent change	5.2%	7.0%	5.2%	3.0%	4.2%
Total funding	-\$3,929	\$1,451	\$5,281	\$6,375	\$9,450
Percent change	-3.6%	1.4%	4.9%	5.6%	7.9%

State Would Make Additional Proposition 98 Reserve Withdrawals

- **Withdrawals Required Due to Slower Growth in Guarantee**
 - Withdrawals would reduce the balance from \$8.3 billion to zero over the next few years. (State would make a small deposit in 2026-27.)
 - Reserve deposits and withdrawals are controlled by formulas and very sensitive to changes in revenues and other inputs.
 - Local district reserve cap operative until 2025-26.

Proposition 98 Reserve Estimates

In Millions

	2022-23	2023-24	2024-25	2025-26	2026-27
Deposit (+) or withdrawal (-)	\$14	-\$2,351	-\$3,110	-\$2,830	\$510
Cumulative balance	8,292	5,941	2,830	—	510

COLA Estimates Beyond the Budget Year

➤ Outlook for Next Several Years

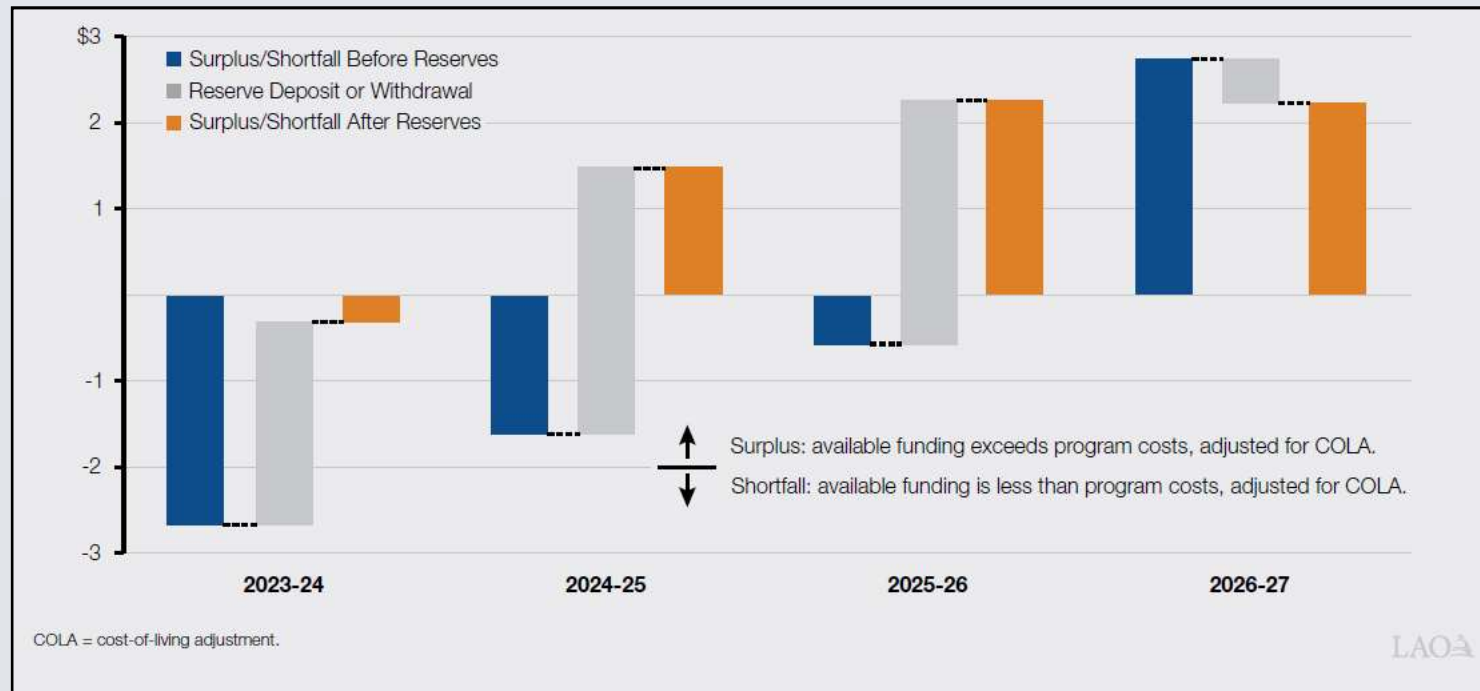
- Most forecasters expect inflation to moderate somewhat after 2022-23.
- Some evidence inflation could remain above the historical average for another couple years, but depends on Federal Reserve action.

➤ Future COLA Estimates

- Our estimates of statutory rate are 5.3 percent in 2024-25, 4.5 percent in 2025-26, and 4.2 percent in 2026-27.
- By comparison, the COLA rate has averaged 2.8 percent over the past 20 years.
- Actual COLA rates have often varied significantly from forecasts.

Proposition 98 Reserve Compensates for Small Shortfalls Over the Next Few Years

In Billions



Key Takeaways from Multiyear Analysis

➤ **Not Much Room for New Ongoing Commitments**

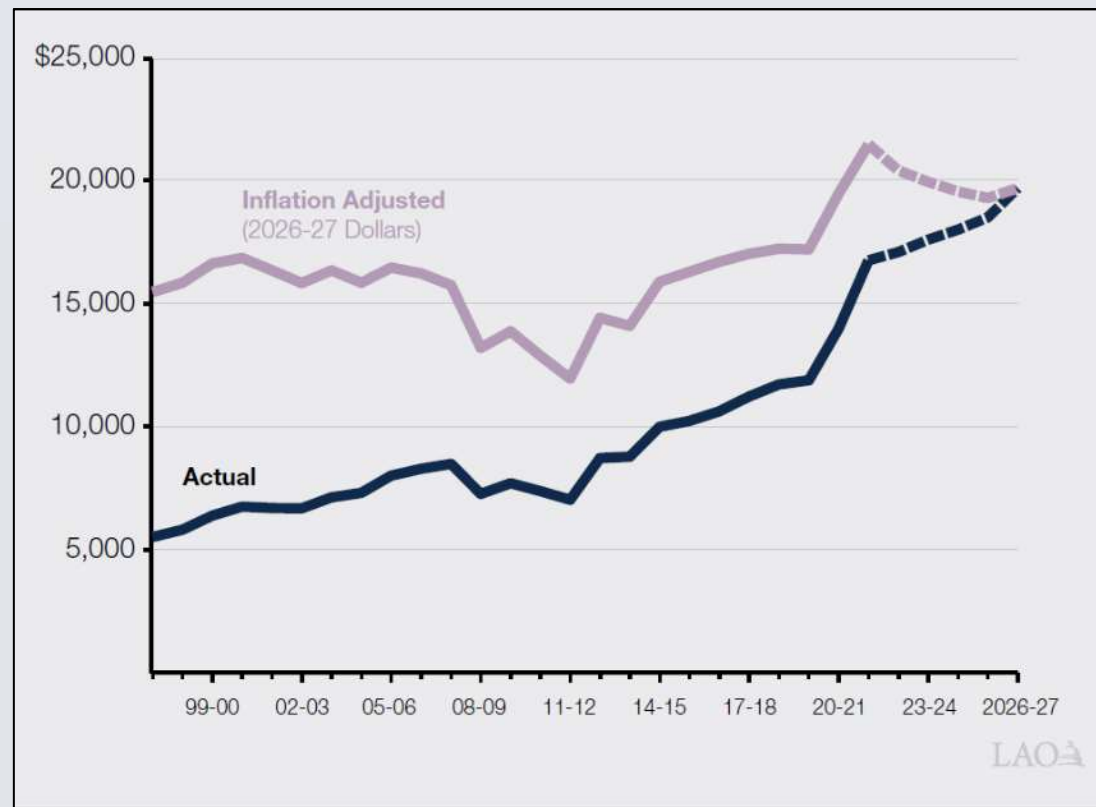
- In most years, growth in guarantee and reserve withdrawals are only slightly above the cost of existing programs and COLA.
- One-time funds potentially available in some years.

➤ **K-14 Budget Balance Is Relatively Precarious**

- Recession or further economic weakness poses risk to programs.
- Encourage the Legislature to think about building budget resiliency.
- One option could be revisiting the Expanded Learning Opportunities Program (ELOP)—the \$4 billion provided for the program seems high based on feedback from districts about student interest.

The Outlook in Context: Funding Would Remain High by Historical Standards

K-12 Proposition 98 Funding Per Student



lao.ca.gov