Policy Brief
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LAO

The State's Fiscal Problem

In order to provide the Legislature with a perspective on the State's short-term and long-term fiscal problems, we have prepared this brief overview.

INTRODUCTION

Just five months ago, the Legislature and the administration acted to resolve a $14.3 billion budget gap in adopting the 1991-92 budget. The budget package included $7.2 billion of additional tax revenue, spending reductions totaling $3.4 billion, as well as a variety of fee increases, cost shifts, and deferrals. That budget, however, was based on the assumption that the recession that began in 1990-91 had ended, giving way to modest but steady economic growth, thereby enabling the state to end 1991-92 with a reserve of $1.2 billion. It is clear that the state's economy has not yet begun to recover from the recession. Instead, the economic situation has generated a significant revenue shortfall while simultaneously increasing the demand for state services.

This policy brief presents a review of the three components of the budget problem facing the Legislature:

- *Current Year.* Our estimate is that revenues are likely to fall short of budget estimates by $2.5 billion, and spending is likely to exceed estimates by $850 million. Without corrective action, the state will end the year with no reserve and a deficit of $2.2 billion.
- *Budget Year.* In 1992-93, the state faces another multibillion-dollar gap between revenues and spending. This gap primarily is due to the cumulative effect of the recession on the state's revenue base. It also reflects the scheduled expiration of one-time revenue measures that were used to help balance the 1991-92 budget.
- *Beyond the Budget Year.* Assuming moderate economic growth, the state still faces increasing multibillion-dollar budget gaps after 1992-93. This is due to the basic structural imbalance between the growth of revenues and expenditures. The expiration of temporary revenue and expenditure adjustments enacted in 1991 compounds the problem.

In acting on the 1991-92 budget, the Legislature made many very difficult decisions. Many of these decisions were targeted at resolving the structural portion of the budget problem. However, the expectation of an imminent economic recovery led the Legislature to also rely on short-term strategies to maintain programs until economic growth caused revenues to catch up. The failure of the recovery to materialize undermined these strategies, and leads us to the conclusion that the 1992-93 budget will require additional ongoing solutions. To assist the Legislature in identifying these solutions, this policy brief presents a set of fiscal principles that we believe should guide budget decision-making under the current circumstances, and a framework of strategies for establishing budget priorities and using available funding more effectively.

THE CURRENT-YEAR FISCAL PROBLEM

"A $2.2 billion deficit now appears likely in the current year, absent any corrective action."

In the five months since adoption of the 1991-92 budget, the state's fiscal outlook has worsened considerably. A $2.2 billion deficit now appears likely in the current year, absent any corrective action.

Revenues are Down

Cumulative General Fund revenues through November were about $600 million less than the Department of Finance's 1991-92 budget estimate. This revenue shortfall is due to the continued economic weakness in the nation and California, which has affected all three of the state's major taxes: the Personal Income Tax, the Sales and Use Tax, and the Bank and Corporation Tax. Even with the tax increases enacted as part of the 1991-92 budget package, receipts from the "big three" taxes lag behind those of last year at this time.

Although the shortfall currently amounts to only 1.3 percent of the total $46.3 billion in General Fund revenues and transfers estimated in the budget for 1991-92, it portends a much larger problem for the remainder of the year. There are primarily two reasons for this. First, the majority of the state's 1991-92 receipts from its largest revenue source -- the Personal Income Tax (and, to a lesser extent, from the Bank and Corporation Tax) -- depend on income and earnings during the 1991 calendar year. Even if the state's economy begins to recover in early 1992, it will be too late to have a large effect on revenues for the remainder of 1991-92. Second, there are no signs at present that a strong economic recovery is imminent. Job losses continue, consumer confidence is low, and interest rate reductions by the Federal Reserve have had little effect in spurring increased economic activity. Consequently, most forecasters predict no more than a slow recovery for California, beginning in the middle of 1992. The budget's revenue estimate, however, assumed an economic recovery beginning at the start of the current fiscal year, with modest growth in the economy and revenues continuing throughout the year. As a result, the relative shortfall between actual revenues and the budget estimate is likely to grow in the second half of 1991-92.

Based on the current revenue trends and economic outlook, we project that General Fund revenues in 1991-92 will be roughly $43.8 billion, or $2.5 billion short of the final budget estimate. This estimate assumes that California's economy remains flat and does not resume growth until mid-1992. Alternatively, a further economic downturn during the remainder of the fiscal year could produce a revenue shortfall of up to $1 billion larger.

Spending Is Up

While revenues are falling short of budget estimates, a number of factors will tend to increase General Fund spending beyond the 1991-92 budget estimates, as shown in Figure 1. Part of this spending increase is attributable to the fact that caseloads in the state's two largest entitlement programs -- Medi-Cal and Aid to Families with Dependent Children (AFDC) -- have risen faster than anticipated. In addition, increased federal reimbursements expected for various programs are not forthcoming. These and other spending increases will increase current-year spending by at least $850 million, to a total of $44.3 billion (as compared to a Budget Act spending plan of $43.4 billion). Other budget threats could increase this total by as much as $800 million. The largest threat at this time is the pending *Claypool v. PERS* lawsuit, which would prohibit the state from using excess retirement fund earnings to offset any of its current retirement contributions. An adverse decision could increase General Fund costs by $390 million in 1991-92.

Figure 1

Unbudgeted General Fund Costs 1991-92

(in millions)	
Shortfalls in budgeted federal funding	$260
Medi-Cal caseload, dental rates and other costs	198
Delay in implementing IDDA/EPDA retirement savings	160
AFDC caseload increases	150
Shortfall in tidelands oil revenues transferred to the General Fund	60
Interest cost for increased state bond sales	50
Failure to enact fee legislation	44
Cost of legislation not included in budget	35
Savings from slower growth in prison inmate population	-50
Other net changes	-54
Total	**$853**

Current-Year Deficit

With anticipated revenues declining by $2.5 billion and spending requirements increasing by at least $850 million, Figure 2 indicates that the General Fund's condition at the end of 1991-92 will be at least $3.4 billion less favorable than estimated by the administration when the budget was enacted. After taking the budget reserve of $1.2 billion into account, the General Fund will end the year with a deficit of about $2.2 billion in the Special Fund for Economic Uncertainties if no corrective action is taken. This estimate does not include the effect of potential adjustments to the General Fund's 1990-91 ending balance. The State Controller has not yet completed the final accrual adjustments for 1990-91, but preliminary information indicates that the 1990-91 deficit may have been larger than estimated. If so, this would increase the current-year budget shortfall.

A BUDGET-YEAR FUNDING GAP IS INEVITABLE

The Legislature and the Governor will be required to resolve another multibillion-dollar funding gap in order to craft a balanced 1992-93 budget. Our estimates of revenues and expenditures for the budget year, in combination with the current-year deficit discussed above, indicate that the funding gap could be $6.6 billion.

Revenues Flat in 1992-93

Although most economic forecasters now anticipate that California's economy will begin to expand by the middle of 1992, economic growth is expected to be sluggish for the remainder of that year, and to continue at a much slower pace than has occurred after previous recessions. Under this economic scenario, we estimate that the General Fund's ongoing revenue base will grow by about 5 percent in the budget

Figure 2

Estimated 1991-92 General Fund Reserve Balance

(in billions)	June 1992
Estimated, July 1991	**$1.2**
Changes since July 1991:	
• Decrease in estimated current-year revenues	-2.5
• Increase in estimated current-year expenditures	-0.9
Estimated, December 1991	**-$2.2**

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year. However, the loss of one-time revenues included in the 1991-92 budget (accrual accounting and special fund transfers) will offset this growth. The combined effect of slow growth and the loss of one-time revenues results in estimated revenue of $43.8 billion in 1992-93, or approximately the same amount of revenues as we now estimate for the current year.

Baseline Spending Projection

In order to illustrate the potential size of the 1992-93 budget gap, we have developed a "baseline" spending projection. This projection incorporates individual cost estimates for the state's major education, health, welfare, and correctional programs, as well as for tax relief, debt service, and trial court funding. Generally, to construct this estimate, we increased spending to maintain the current level of service. Current-year costs for each program were increased to reflect growth in anticipated demand (number of students, caseload, beneficiaries, or inmates) and to fund inflationary increases. Unallocated "trigger" reductions and employee compensation savings that were included in the 1991-92 budget were not restored. Our baseline projections for three particular programs are based on the following:

- ***K-14 Education.*** The projection assumes that state funding under Proposition 98 for public schools and community colleges will be the amount computed under the maintenance-of-effort, or "Test 2" formula. In 1992-93, this formula provides for growth in average daily attendance (ADA), but not for inflation, because growth in per capita personal income, the Test 2 cost factor, is projected to be slightly negative.
- ***AFDC and SSI/SSP.*** The baseline projection reflects only caseload increases for these welfare assistance programs, consistent with legislation that was part of the 1991-92 budget package -- Ch 97/91 (SB 724, Maddy) -- which suspended state cost-of-living increases for these programs through 1995-96.
- ***Trial Court Funding.*** The projection includes an increase in the state's share of trial court costs from 50 percent in 1991-92 to 55 percent in 1992-93. This carries out the legislative intent expressed in Ch 90/91 (AB 1297, Isenberg) to increase the state's share by 5 percent annually, until the state's share reaches 70 percent in 1995-96.

Using the methodology and assumptions described above, we estimate that 1992-93 baseline General Fund spending will total $46.9 billion. This amount represents an increase of $2.5 billion, or 5.7 percent, over our current estimate of 1991-92 spending.

1992-93 Budget Gap

Figure 3 shows that the state faces a potential $6.6 billion budget gap in 1992-93:

- $2.2 billion carryover of the 1991-92 deficit.
- $3.1 billion 1992-93 operating shortfall.
- $1.3 billion to restore the Special Fund for Economic Uncertainties (which would provide a 2.7 percent reserve, the same as in the current year).

What are the Uncertainties?

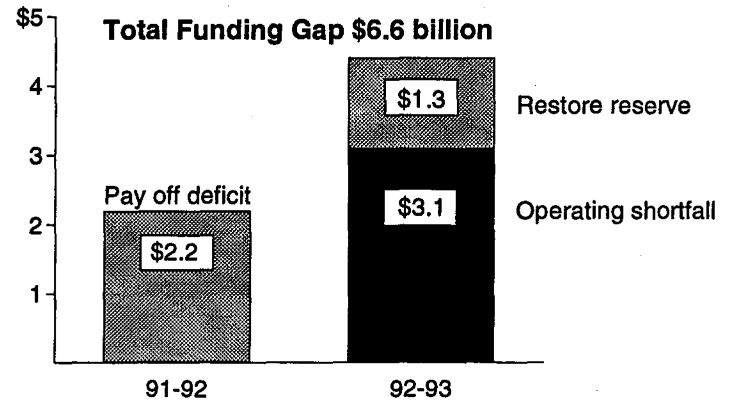
Of course, the economy is a major uncertainty. Depending on the timing and strength of the state's economic recovery, 1992-93 revenues could vary from our estimate by up to several billion dollars. The timing and pace of recovery also are factors that will affect the rate of welfare and Medi-Cal caseload growth. Other major uncertainties include the following:

- *Court Decisions.* The counties of Los Angeles, San Bernardino, and San Diego are suing the state for reimbursement of their costs of providing indigent health care. An adverse decision could cost the state up to $3 billion. The cumulative General Fund cost of retirement contributions that could be required as a result of the pending *Claypool v. PERS* suit could be close to $1 billion in 1992-93. In addition, potentially large costs could result from several other pending suits seeking damages from the state or invalidation of challenged taxes.
- *Federal Actions.* Changes in federal requirements for, or financial participation in, health and welfare programs, such as Medi-Cal, AFDC, and SSI, can affect state costs for these programs. Other federal actions, such as defense cutbacks, immigration changes, or additional funding for transportation projects can have significant, although less direct, effects on the state's General Fund budget.
- *State and Local Program Realignment.* The 1991-92 budget package shifted about $2.2 billion of state costs for health and welfare programs to the counties, along with dedicated sales tax revenues and vehicle license fees that were estimated to be sufficient to fully offset these costs. Estimated revenue shortfalls in these sources of up to $200 million in the current year may result in the counties seeking additional state funds for 1992-93.

Figure 3

Budget -Year Funding Gap

(in billions)



THE LONGER-TERM OUTLOOK: A GROWING PROBLEM

Is the 1992-93 budget gap a temporary problem that will disappear with the return of economic growth? Figure 4 shows that, to the contrary, the annual operating shortfall becomes progressively larger after 1992-93. This projection is based on an extrapolation of our baseline spending estimates and our estimate of the revenues that would be generated by sustained moderate economic growth through 1995-96. By the end of the five-year period, the operating shortfall has increased to more than $9.5 billion.

The particularly rapid widening of the annual shortfall in 1992-93 and 1993-94 has two causes. First, several major revenue enhancements adopted to resolve the 1991-92 budget gap are either one-time or temporary in nature. Figure 5 (next page) shows the declining fiscal effect of these revenue enhancements. For example, as noted earlier, 1992-93 ongoing revenue growth is offset by the loss of one-time accrual accounting and special fund transfer revenues. In 1993-94, revenue growth is offset because the 1/2-cent temporary sales tax rate increase has terminated, and because business deductions for net operating losses become available again after being suspended in 1991 and 1992. A total of $4 billion of revenue growth would be necessary just to offset the loss of one-time and temporary revenues by 1993-94.

The second reason for the rapidly growing shortfall is that baseline spending increases sharply in 1993-94. One reason for this is that growth in per capita personal income begins to push up the K-14 funding requirement under Proposition 98. In addition, the state must resume making General Fund retirement contributions in 1993-94, because the excess earnings used to offset retirement contributions in 1991-92 and 1992-93 will be exhausted by then.

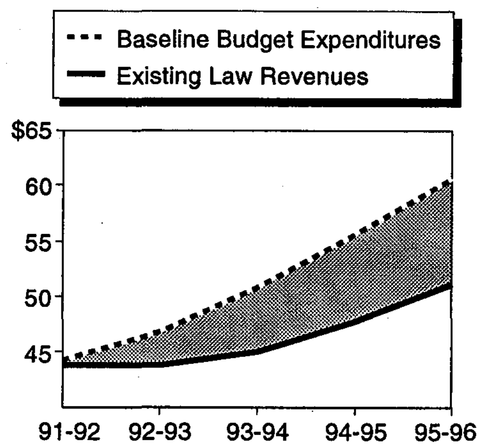
"Assuming moderate economic growth, the state still faces increasing multibillion-dollar budget gaps after 1992-93."

Figure 4 shows that, after 1993-94, the operating shortfall continues to widen, but not as rapidly as before. This is due to the ongoing disparity between the rate of annual baseline spending growth and the rate of revenue growth (about 9 percent for spending, versus our estimated 7-percent revenue growth rate). Our revenue projections anticipate that economic and revenue growth in the 1990s will be somewhat slower than in the 1980s. Spending, however, grows more rapidly than revenues. Projected Medi-Cal spending, for example, grows by more than 9 percent annually because of caseload growth and high inflation in medical costs. Another example is education funding, which is projected to grow by 8 percent to 9 percent annually primarily because of enrollment growth.

Figure 4

Baseline Budget Funding Gap 1991-92 through 1995-96

(in billions)



Even with Some Spending Restraint, Budget Problem Still Persists

In order to provide some additional perspective on the long-term fiscal imbalance, we have prepared an alternative projection that relaxes certain of the assumptions used in our baseline spending projection. First, this projection assumes that additional ongoing across-the-board "trigger" cuts are made each year, as authorized by Ch 458/90 (AB 2348, Willie Brown). Second, this projection assumes that funding to schools and community colleges is provided at the minimum amount required by Proposition 98 in times of slow revenue growth. Third, the projection assumes that the state's share of Trial Court Funding is maintained at 50 percent instead of increased to 70 percent, as existing law intends. Finally, with certain exceptions, no provision is made for cost-of-living and other inflation adjustments needed to maintain the purchasing power of state programs. As shown in Figure 6 (next page), even under this alternative projection, the state would still face a significant long-term budget problem. Under this scenario, we forecast multibillion-dollar operating shortfalls every year, growing to $5.5 billion in 1995-96.

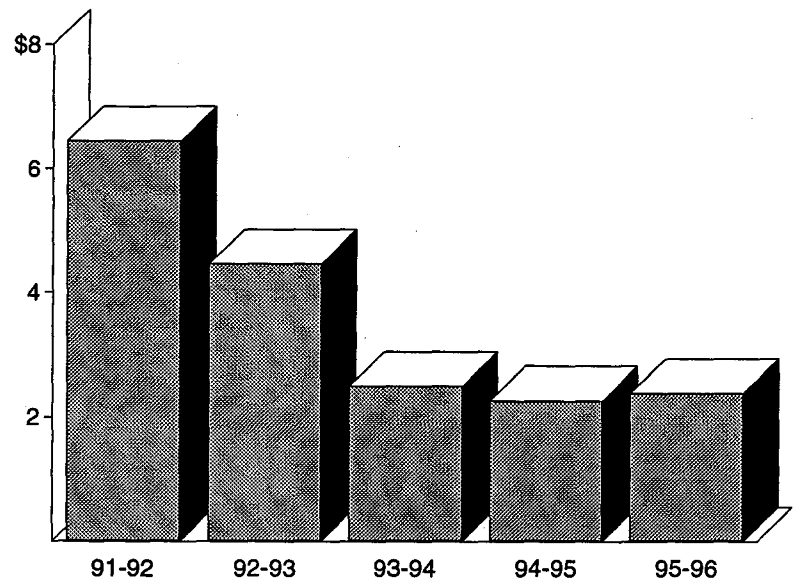
Solving the Longer-Term Budget Problem

Although the specific five-year spending and revenue projections in Figures 4 and 6 are subject to considerable uncertainty, they clearly illustrate that the following two types of budget actions will be necessary to solve the state's longer-term budget imbalance:

Figure 5

Fiscal Impact of Major 1991 Revenue Enhancements 1991-92 through 1995-96

(in billions)



- *Base Adjustments.* Program cuts, funding shifts, and/or tax increases will be needed to quickly bring the overall levels of spending and revenue into balance in order to avoid increasing annual shortfalls that will rapidly accumulate into deficits of major proportions in 1992-93 and 1993-94.
- *Balance the Ongoing Growth Rates of Spending and Revenue.* Adjustments that only reduce the base expenditures provide just a temporary solution if spending continues to grow at a faster pace than revenues. In order to reduce ongoing spending growth, program revisions and restructurings are required. In order to increase the rate of growth of revenues, actions to facilitate economic growth will be needed. In addition, revisions in the tax system to make it more responsive to economic growth should be examined.

WHAT PRINCIPLES SHOULD GUIDE BUDGET DECISIONS?

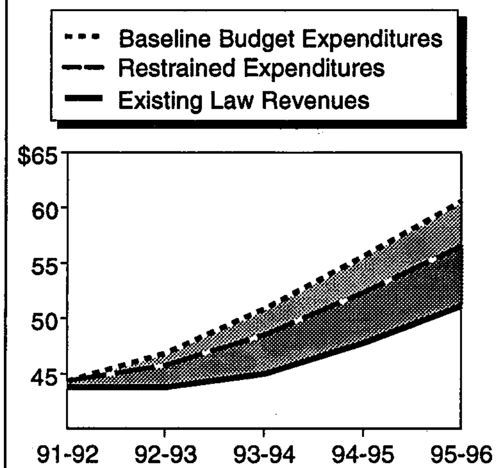
The Legislature faces a huge task in resolving the fiscal problems that face the state. We recommend that steps be taken to minimize the current-year deficit, and that the Legislature begin devising solutions that can be implemented for the 1992-93 fiscal year and beyond. The nature of the long-term budget problem itself suggests the following principles for decision-making.

Make Significant Reductions in Major Programs. There is no other way to achieve savings of the size required. Furthermore, the savings must be ongoing in order to address the ongoing budget imbalance. The programs that will have to provide the bulk of these savings are education (K-12 and higher education), Medi-Cal, welfare (AFDC and SSI/SSP), and corrections. Since more than 80 percent of the state's budget is spent

Figure 6

Budget Funding Gap
Effect of Spending Restraints
1991-92 through 1995-96

(in billions)



on these programs, there is no way to achieve multibillion-dollar savings without affecting them.

Restructure Programs. Significant changes in the organization, delivery, and financing of government services will be necessary to enable reduced levels of spending to more effectively address basic program objectives in the major program areas. Programs also will require restructuring and reform in order to reduce their ongoing rate of spending growth.

Make Choices Rather Than "Across-the-Board" Cuts. Successive years of tight budgets and unallocated cuts generally have pared "fat and frills" that could be cut without reducing public services or program effectiveness. Additional across-the-board cuts will further erode service levels and the effectiveness of many programs. By making specific choices, the Legislature can provide adequate funding to the programs with the highest priority.

Use One-time Solutions Appropriately. The use of one-time solutions can be justified in certain circumstances -- for example, addressing a portion of the 1992-93 budget problem. Specifically, paying off any deficit carried over from 1991-92 and restoring the reserve are not ongoing expenses and can be appropriately funded from one-time actions. One-time actions can also buy implementation time. For example, major program reforms often take time to achieve, and they may require some up-front investment in order to achieve long-term savings. In such a situation, one-time solutions can provide a means to "get from here to there," but only if used in conjunction with necessary structural changes.

Avoid Short-Term Savings That Increase Long-Term Costs. The budget imbalance is a long-term one; thus, shifting costs to the future will only make subsequent budget problems worse.

Examine Tax Base and Coverage. General tax increases are difficult to impose during poor economic conditions, especially after the significant tax increases adopted last summer; but, other types of tax actions should not be ignored. The coverage and structure of the state's tax system should be reevaluated to determine whether it can be made more responsive to economic growth in all sectors of the state's economy. Furthermore, tax expenditures (special exemptions, deductions, credits, and so forth) should be reexamined with the same rigor as regular spending.

STRATEGIES TO ACHIEVE LONG-TERM FISCAL BALANCE

The magnitude and persistence of the fiscal problems facing the state require more than a "business-as-usual" approach to budgeting. Better ways must be found to use available funds to accomplish the state's most important objectives. Less critical functions will have to be cut back or eliminated. In this section we discuss four strategies for addressing the state's long-term fiscal problems.

Deciding What Programs are Most Important

Budgeting expresses priorities in dollars. Clearly established priorities, therefore, are a fundamental prerequisite for effective budgeting. In setting the state's priorities, four steps are important.

Identify the State's "Core" Objectives. Clearly, the state has fundamental interests and responsibilities in a broad range of program areas, so that priority setting must be much more specific than simply saying, for example, that schools should be a higher priority than transportation. To be useful in budgeting, priorities must be established within each of the program areas, and this requires identifying the objectives that are at the core of each program. Programs that are most effective in achieving these core objectives should receive the highest priority for funding. In Medi-Cal, for example, the state spends about $2 billion annually to provide optional services not required by the federal government, or to serve clients who are not required to be served under federal law. These optional program components should be examined to determine how well they serve the state's core goal of providing basic health protection to the poor, including the potential impact for increasing health costs over the long run if they are eliminated.

Redefine Objectives. In some cases, it may be necessary to scale back program objectives in order to operate effectively with limited funds. The Master Plan for Higher Education, for example, provides for the California State University (CSU) to admit the top one-third of high school graduates. Budget cuts in the current year, however, have limited students' opportunity to take needed classes. The Legislature might reconsider whether this objective -- along with other objectives set forth in the Master Plan -- can be met within current budget constraints.

Eliminate Low-Priority and Ineffective Programs. Some programs are ineffective or do not serve high-priority state objectives. Such programs should be eliminated. For example, the sales tax exemption for printed advertising materials originally was established to enable California printers to compete equally with those in other states who, it was thought, could not be taxed by California. A U. S. Supreme Court decision, however, has made it clear that states can tax those out-of-state printers, thereby eliminating the rationale for this tax exemption.

Remove Roadblocks to Priority-Setting. Special funds that earmark revenues or requirements for minimum program expenditure levels protect funding for some programs at the expense of others. They lock in spending, regardless of changing state fiscal conditions and program needs and priorities. Where there is not a legitimate requirement for these arrangements (such as for money held in trust or to comply with federal law), the Legislature should eliminate them, or propose constitutional amendments to do so.

> *"The magnitude and persistence of the fiscal problems facing the state require more than a 'business-as-usual' approach to budgeting."*

Doing the Important Things More Effectively

Within the state's high-priority programs, restructuring and reforms will be needed to enable them to achieve their objectives at lower costs, and to reduce the growth rate of spending.

Restructure Programs. Changing the way programs work can reduce costs and provide better service. For example, providing Medi-Cal services through contracts with managed care plans may provide beneficiaries with better access to service and with care that is more prevention-oriented, at a lower cost to the state compared with the traditional fee-for-service approach. Recent legislation, Ch 95/91 (AB 336, Hunter), will encourage the use of managed care plans by Medi-Cal beneficiaries.

Consolidate Organizations. Organiza-

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tions with similar or duplicative responsibilities can be consolidated to achieve greater effectiveness at lower cost. Examples of consolidation opportunities include combining the Franchise Tax Board and the State Board of Equalization into a Department of Revenue, and combining the existing separate energy forecasting groups in the Energy Commission and the Public Utilities Commission.

Improve Intergovernmental Relationships

California state and local governments alike are increasingly affected by the actions of other government agencies, and their ability to respond to changing conditions is limited by past actions defining their power and duties. For example, the state's costs for health and welfare programs are, to a large extent, determined by federal law and regulations. Federal actions to increase benefits or expand eligibility, for instance, can impose major costs on the state; and inflexible federal requirements limit the state's ability to provide services in the most cost-effective manner. The federal government also imposes costs on California through other types of actions, such as changing immigration law, without providing the state with funds to offset those costs. Solving the state's long-term budget problem requires the cooperation of the federal government. The Legislature and the administration should work together to actively pursue federal law changes that will reduce unfunded federal mandates and allow more program flexibility.

Fiscal responsibilities and incentives also need to be revised between the state and local governments. Legislation enacted in 1991 to "realign" health and welfare program funding responsibilities between the state and the counties was a first step in this direction. However, additional changes in state and county program responsibilities are needed to achieve operational efficiencies and better control over program expenditures. For example, the consolidation of funding for various county-operated health and welfare programs could help to facilitate implementation of alternative human service delivery systems by counties and other providers. These systems could achieve savings through better coordination of service delivery, case management, and preventive activities.

Just as the state requires flexibility in carrying out federal programs, the state should provide local governments, especially counties, with greater flexibility. Local agencies also need greater access to discretionary revenue sources so they can better adjust service levels to meet local needs.

Making California's Economy More Productive

California will need a vital and expanding economy to provide employment and a high standard of living to the rapidly growing population of the state. A strong state economy also is essential to resolving the long-term budget problem, because it provides the revenues to finance state spending and because employment growth reduces the demand for assistance programs.

The most important and effective way for the state to support healthy economic growth is to do its own job well by providing a well-educated workforce, efficient transportation facilities, and adequate water supplies, for example. The quality of these basic government services is much more important to economic growth than any economic development program or business incentive.

The state must also examine how it carries out its responsibilities for coordinating the activities of government agencies and for regulating the activities of the private sector. To some extent, better coordination among government agencies and more effective regulatory programs can result in decreased business burdens and an improved climate for business. Specific changes that the Legislature might consider in this area include:

- *Local Planning and Development Approval Process.* The state needs to examine changes that would facilitate better coordination of local planning and development review efforts, and reduce the extent to which multiple agency approvals are required.
- *Environmental Regulation.* The important goal of environmental protection can be achieved at less burden to employers. For example, incentive-based regulation, in which businesses are charged according to the amount of pollution produced, would give businesses an economic incentive to reduce a given amount of pollution in the most cost-effective manner. Also, better coordination of inspections carried out by state and local agencies on businesses generating more than one type of pollution could help to minimize the disruption of business operations and increase the effectiveness of these programs.
- *Mandated Employee Benefit Programs.* The state requires employers to finance certain programs that help maintain workers' incomes when they are laid off or become injured. These programs are of tremendous importance to California workers, but also represent a large expense for business. Ensuring that the costs borne by businesses, for programs like workers' compensation, are not so large as to become a disincentive to job creation, and are not out of proportion to the benefits provided, should be a high priority.

THE DECISION PROCESS SHOULD BEGIN NOW

Action is needed on two fronts:

- Actions are needed to reduce the 1991-92 deficit while there is still time for those actions to affect a significant portion of the fiscal year. This will help to ensure that these steps are in place for 1992-93 as well.
- The Legislature should create task forces that will begin work to develop the basis for long-term budget and program decisions which will return the state to fiscal balance in 1992-93 and beyond. A task force should be established for each major program area that will do the following:
  - Identify core objectives and prioritize programs and services.
  - Identify opportunities to realize savings by restructuring, realigning, and consolidating programs.
  - Develop proposals to improve governmental relations at the federal, state, and local levels.
  - Evaluate changes in state programs and policies that are needed to ensure continued economic growth in California.

CONCLUSION

California faces a $2.2 billion deficit in the current year, which will grow to a $6.6 billion budget gap for 1992-93 if no corrective action is taken. Moreover, the gap between projected spending to maintain existing programs and the state's revenues under current law grows larger in subsequent years, even with a return of moderate economic growth. The first step in resolving these problems is to act now to reduce the size of the 1991-92 deficit. Balancing the 1992-93 budget will require setting priorities and making specific program reductions to bring the ongoing level of spending in balance with revenues on a permanent basis. Revenue options are limited after the substantial tax increases enacted this year, but the coverage and structure of the state's tax system deserves examination. In order to provide a basis for its budget decisions, the Legislature should establish program area task forces to begin work now.

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