

NOVEMBER 2019

The 2020-21 Budget: Fiscal Outlook Overview



LEGISLATIVE ANALYST'S OFFICE

Purpose of the LAO *Fiscal Outlook*

▶ **Does the State Have Enough Resources to Pay for Next Year’s Commitments?**

First, the outlook aims to address whether there is a surplus or a deficit *for the upcoming fiscal year*. A surplus is the amount of money that is expected to be available in 2020-21 for new budget commitments, like program expansions or tax reductions. (A deficit in the outlook means we expect the state needs more money to pay for existing commitments in the budget year.)

▶ **Does the State Have Capacity to Take on New, Ongoing Commitments?**

Second, the outlook aims to address whether there is a surplus or deficit *over the longer-term*. This is called an operating surplus or operating deficit. An operating surplus is the amount of money that is available over time for new budget commitments. (An operating deficit means the state needs more money to pay for existing commitments over time.)

▶ **If a Recession Begins, Does the State Have Enough Reserves to Cover Revenue Shortfalls?**

Third, we estimate whether the state has enough savings—or budget reserves—to cover revenue shortfalls in a recession. In a recession, operating deficits emerge. If the state has enough reserves to cover operating deficits, the Legislature would not need to make difficult choices (like reducing spending or increasing taxes) to balance the budget.



Overview of the 2020-21 *Fiscal Outlook*

▶ Does the State Have Enough Resources to Pay for Next Year's Commitments?

Yes. We estimate the state has a surplus of \$7 billion for 2020-21. A portion of this \$7 billion would be available for one-time commitments and a portion for new, ongoing commitments. (The surplus is \$4 billion if the managed care organization [MCO] tax is not approved by the federal government.)

▶ Does the State Have Capacity to Take on New, Ongoing Commitments?

Assuming the economy continues to grow, yes. The extent of the capacity depends on how the Legislature views various risks. We estimate the ongoing surplus is:

\$3 Billion Under Baseline Expenditure Scenario. This assumes current laws and policies stay in place.

Less Than \$1 Billion Under an Alternative Expenditure Scenario. This assumes current laws and policies stay in place and:

- The federal government does not approve MCO tax and delays a cut to hospitals serving higher shares of Medi-Cal patients.
- There is at least one major wildfire season within the next few years.
- The voters approve the education facilities bond in 2020.

▶ If a Recession Begins, Does the State Have Enough Reserves to Cover Revenue Shortfalls?

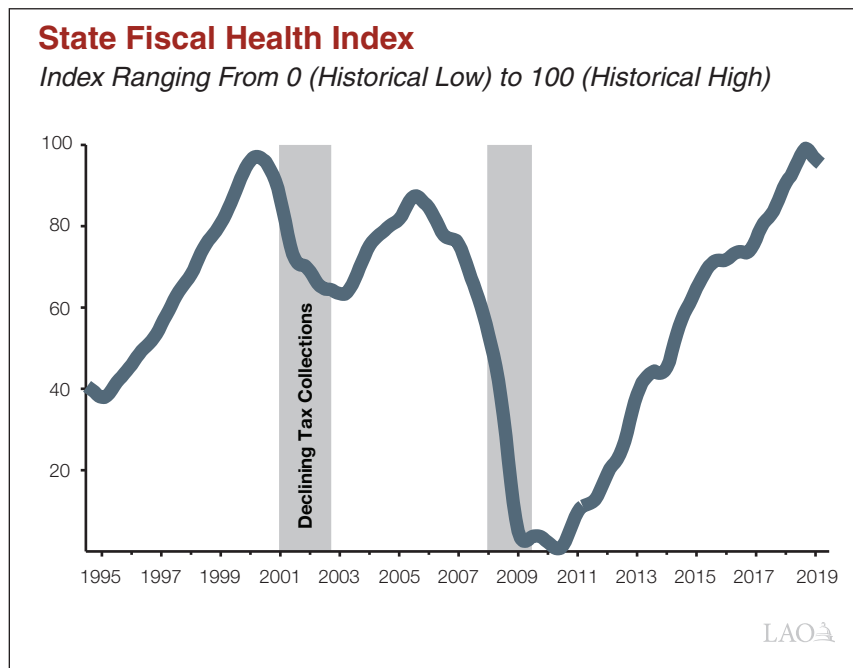
We find that the state is in good shape to weather a recession typical of the post-World War II era. This does not mean, however, that the state is prepared to weather any possible recession.



Economic and Revenue Outlook for 2020-21

► Economic Outlook for 2020-21

The consensus among professional economists is that the U.S. economy will continue to grow, but at a slower pace than in recent years. However, we think the risk to this year's economic outlook has increased compared to recent years. Specifically, weakening can be seen in data on housing markets, trade activity, new car sales, and business startup funding.



► Revenue Trends

We are projecting revenues to continue to grow from 2019-20 to 2020-21 at a rate of 3.5 percent. This is still positive, but slower than recent years.



Key Programmatic Trends

► Spending on K-14 Education

Our estimate of the minimum guarantee in 2020-21 is \$84.3 billion, an increase of \$3.4 billion (4.2 percent) over the revised 2019-20 level. Under our estimates, the General Fund share grows by 3.5 percent (consistent with General Fund revenue growth) and local property tax revenue grows by 5.7 percent.

► Other Spending Growth

Projected costs for many state programs have declined in recent years. For example, our projections of annual growth in Medi-Cal have declined to 5.5 percent, bond debt service cost growth has slowed as interest rates have declined, and pension cost growth is projected to be slower as the state has fully phased in changes to assumptions and made supplemental payments to both pension systems, resulting in state savings.



Comments and Recommendations

Budget Is in Good Condition. With an estimated surplus of \$7 billion, California's budget continues to be in a good position. The state also has made significant progress in preparing for a downturn. This good position reflects more than a decade of economic expansion, coupled with deliberate legislative action to put the budget on better footing.

Economic Risks Are Higher This Year. Uncertainty is inherent to every economic forecast, but there likely is greater risk in the economic outlook for 2020-21 than in previous budget cycles.

Suggest Caution in Allocating Available Surplus. From the \$7 billion surplus, we recommend the Legislature dedicate:

- No more than \$1 billion to ongoing purposes.
- A significant share toward building reserves and paying down debt.
- The remainder toward one-time flexible commitments that can be changed midyear if needed.

