California State Budget 2014-15

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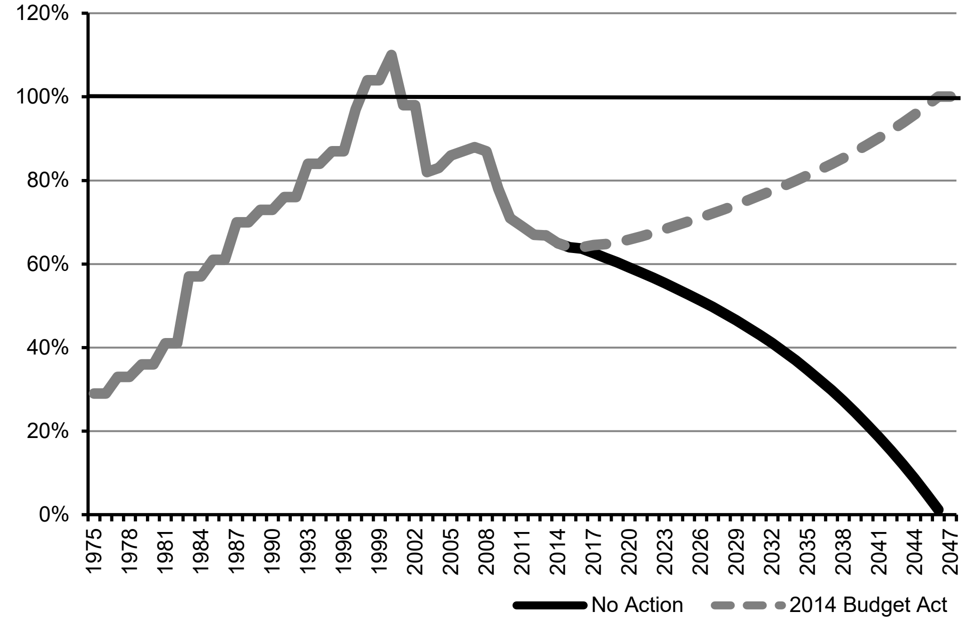
Introduction

The 2014 Budget Act advances a multiyear plan that is balanced, pays down budgetary debt from past years, saves for a rainy day, and shores up the teacher pension system. In addition, it increases spending for education, the environment, public safety, the judiciary, public works, health care, CalWORKs, In-Home Supportive Services, and affordable housing.

Shoring Up Teacher Pensions

In its 101-year history, the California State Teachers' Retirement System (CalSTRS) has rarely been adequately funded—meaning that expected contributions and investment returns have not been equal to expected pension payouts. As shown in Figure INT-01, the system was only 29 percent funded as recently as 1975. The system did reach full funding (100 percent) for a few years around 2000 because of exceptional investment returns and higher contributions in the preceding years. Yet, reduced contributions, benefit enhancements and stock market crashes have reduced the system's funding status to its current 67 percent and set it on a consistent downward trajectory. Barring state action, the system would run out of money in 33 years.

Figure INT-01
2014 Budget Shores Up Teacher Pensions



To counteract this dire prospect, the Budget sets forth a plan of shared responsibility among the state, school districts and teachers to shore up the teacher pension system. The first year's contributions from all three entities are modest, totaling about $275 million. The contributions will increase in subsequent years, reaching more than $5 billion annually. Total contributions today equal 19.3 percent of teacher payroll and will rise to 35.7 percent. This is projected to eliminate the unfunded liability by 2046.

Paying Down Debts and Liabilities

The state's fiscal challenges have been exacerbated by the Wall of Debt—an unprecedented level of debts, deferrals, and budgetary obligations accumulated over the prior decade. The Budget reduces more than $10 billion of the Wall of Debt by paying down the deferral of payments to schools by $5 billion, paying off the Economic Recovery Bonds, repaying various special fund loans and funding $100 million in mandate claims that have been owed to local governments since at least 2004.

If state revenues rise higher than anticipated in the Budget, the first call on additional funds will be for further debt payments—eliminating the remaining school deferrals ($1 billion from Proposition 98) and local government mandate claims ($800 million). As shown in Figure INT-02, the Budget plan would completely eliminate the Wall of Debt by 2017-18.

Figure INT-02

Budget Plan Would Eliminate the Wall of Debt

(Dollars in Billions)

	End of 2010-11 [1/]	End of 2013-14 [2/]	End of 2014-15 [3/]	End of 2014-15 with triggers [4/]	End of 2017-18 [3/]
Deferred payments to schools and community colleges	$10.4	$6.1	$1.0	$0.0	$0.0
Economic Recovery Bonds	7.1	3.9	0.0	0.0	0.0
Loans from Special Funds	5.1	3.9	3.1	3.1	0.0
Unpaid costs to local governments, schools and community colleges for state mandates	4.3	6.7	6.2	5.4	0.0
Underfunding of Proposition 98	3.0	2.4	1.8	1.8	0.0
Borrowing from local governments (Proposition 1A)	1.9	0.0	0.0	0.0	0.0
Deferred Medi-Cal Costs	1.2	1.8	2.2	2.2	0.0
Deferral of state payroll costs from June to July	0.8	0.8	0.8	0.8	0.0
Deferred payments to CalPERS	0.5	0.4	0.4	0.4	0.0
Borrowing from transportation funds (Proposition 42)	0.4	0.2	0.1	0.1	0.0
Total	**$34.7**	**$26.2**	**$15.6**	**$13.8**	**$0.0**

[1/] As of 2011-12 May Revision

[2/] Based on 2013 Budget Act policies

[3/] As of 2014 Budget Act

[4/] Separate trigger mechanisms to accelerate repayments to schools and local governments

Beyond the Wall of Debt, the state faces more than $300 billion in retirement, deferred maintenance, and other long-term liabilities. As noted above, the Budget begins a multi-decade plan to eliminate the CalSTRS $74 billion unfunded liability. In addition, the Budget contains a $688 million package to reduce its deferred maintenance on critical infrastructure. If property taxes are higher than anticipated (and therefore offset state K-14 costs), up to an additional $200 million in deferred maintenance for state buildings, the University of California, and California State University will be provided.

Reinvesting in Education

The 2014 Budget continues a reinvestment in schools, providing more than $10 billion this year alone in new Proposition 98 funding. The Budget provides $1,954 more per K-12 student in 2014-15 than was provided in 2011-12. This funding will:

- Reduce the outstanding deferrals to school districts. As discussed above, as recently as 2011-12 these deferrals totaled $10 billion, and the Budget reduces this amount to $1 billion. The remaining deferrals will have the first call on funding if the Proposition 98 minimum funding guarantee rises this year due to higher revenues.
- Provide $4.7 billion for the second year of implementation of the Local Control Funding Formula to correct historical inequities in school district funding by committing most new funding to districts serving English language learners, students from low-income families, and youth in foster care.
- Increase community college programmatic funding by $594 million, concentrating on expanding student success programs, strengthening efforts to assist underrepresented students, reducing deferred maintenance, and increasing regional capacity for career technical education.
- Reduce outstanding school district and community college mandate claims by $450 million. It is expected that these funds will be used to continue implementation of the new Common Core standards.
- Fund a second round of the Career Technical Education Pathway program with $250 million for one-time capacity-building grants for programs focused on work-based learning.
- Expand the number of low-income preschool students served, increase the rates paid to providers, and provide grants to improve the quality of these programs ($155 million Proposition 98, $100 million General Fund).

In addition, the Budget increases funding for the University of California and California State University by 5 percent each and maintains tuition at its 2011-12 level.

Expanding Health Care

Last year, the state's adoption of the optional expansion of Medi-Cal under the Affordable Care Act represented a major new spending commitment in providing Californians with affordable health care coverage. Medi-Cal enrollment is expected to rise from 7.9 million before implementation to 11.5 million in 2014-15, covering about 30 percent of the state's population.

Although the federal government will pay the costs for the optional expansion for the next few years, approximately 800,000 individuals will receive Medi-Cal benefits under the mandatory expansion where the costs are shared on a 50/50 basis with the federal government. As a result, the Budget assumes General Fund Medi-Cal costs will rise by $2.4 billion over 2012-13.

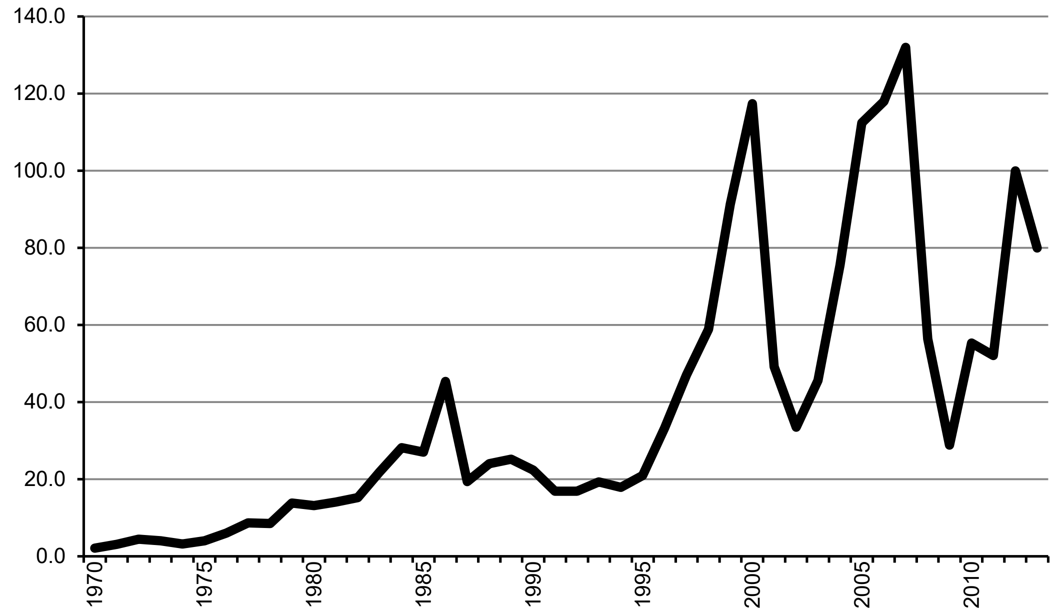
Addressing Climate Change

The California Global Warming Solutions Act of 2006 (AB 32) established California as a global leader in reducing greenhouse gas emissions. To advance this effort, the Budget spends $832 million of Cap and Trade auction proceeds to support existing and pilot programs that will reduce greenhouse gases, with a particular emphasis on assisting disadvantaged communities. An additional $40 million was appropriated in February for drought related activities. The full spending plan will reduce greenhouse gas emissions by modernizing the state's rail system, including high-speed rail and public transit; encourage local communities to develop in a sustainable manner with an emphasis on public transportation and affordable housing; increase energy, water, and agricultural efficiency; restore forests in both urban and rural settings; and create incentives for additional recycling. The Budget permanently allocates 60 percent of future auction proceeds to sustainable communities, public transit, and high-speed rail. The remaining proceeds will be allocated in future budgets.

Saving for a Rainy Day

The Budget is heavily dependent on the performance of the stock market and the resulting capital gains. Capital gains alone will provide 9.8 percent of General Fund revenues in 2014-15. In response to the volatility of these revenues (see Figure INT-03) and the resulting boom-and-bust budget cycles, the Legislature placed a constitutional amendment on the November ballot for a strong Rainy Day Fund that requires both paying down liabilities and saving for a rainy day. Upon voter approval, the Constitutional amendment would:

Figure INT-03
Unpredictable Capital Gains
(Dollars in Billions)



- Require deposits into the Rainy Day Fund whenever capital gains revenues rise to more than 8 percent of General Fund tax revenues. In addition, 1.5 percent of annual General Fund revenues will be set aside each year.
- Set the maximum size of the Rainy Day Fund at 10 percent of General Fund revenues.
- Require half of each year's deposit for the next 15 years be used for supplemental payments to the Wall of Debt or other long-term liabilities. After that time, at least half of each year's deposit would be saved, with the remainder used for supplemental debt payments or savings.
- Allow the withdrawal of funds only for a disaster or if spending remains at or below the highest level of spending from the past three years. The maximum amount that could be withdrawn in the first year of a recession would be limited to half of the Fund's balance.

- Require that the state provide a multiyear budget forecast to help better manage the state's longer term finances.
- Create a Proposition 98 reserve, whereby spikes in funding would be saved for future years. This would smooth school spending and thereby minimize future cuts. This reserve would make no changes to the Proposition 98 calculations, and it would not begin to operate until the existing maintenance factor is fully paid off.

Under current projections, the proposed Rainy Day Fund would result in over $3 billion in savings and $3 billion in additional debt payments in its first three years of operation. If capital gains surge above normal levels during that period, even more money would go into the Fund.

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