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TICKING TIME BOMBS: ACA 4 AND AB 426 WILL LIMIT THE STATE'S ABILITY TO MEET FUTURE OBLIGATIONS

Several measures passed as part of the Senate's budget package would severely limit the state's ability to respond to an economic downturn:

- If approved by the voters, **ACA 4** would dedicate the sales tax on gasoline to transportation beginning in 2003-04. The ability to transfer these revenues back to the General Fund averted \$1.3 billion in spending reductions in this year's budget.
- **AB 426** would change the formula used for the sales tax trigger beginning in 2002. AB 426 reduces the minimum reserve needed to trigger a sales tax reduction from 4 percent of General Fund revenues in two successive years to 3 percent of revenues in a single year. It would also exclude revenues from a ¼ cent sales tax rate from the revenues used to calculate whether the trigger threshold has been met, thus further reducing the size of the reserve needed to pull the trigger (3 percent of a smaller number translates into a smaller reserve).

These provisions would take effect at the same time that the state must cope with the loss of over \$1.1 billion in revenues from changes made by the recent federal tax bill (primarily the loss of estate tax revenues due to the elimination of the state's portion of the estate tax in 2005). The state also "prepaid" \$1.2 billion of its 2001-02 VLF backfill obligation in 2000-01. Beginning in 2002-03, the state must reimburse local governments for the full amount of the VLF revenue loss – a \$1.2 billion obligation that is not in the 2001-02 base.

- If AB 426 were in effect today, the sales tax trigger would most likely be pulled in 2002, reducing 2001-02 revenues by approximately \$600 million and 2002-03 revenues by \$1.2 billion (assuming the Governor's line item vetoes bring the 2001-02 reserve to \$2.5 billion), ***even though there is widespread agreement that the proposed reserve is at the bare minimum level needed to prepare for the tight fiscal conditions expected in 2002-03.*** The state is likely to face similarly tough conditions in the future due to its reliance on the increasingly volatile personal income tax for over half of all General Fund revenues.
- Taken together, the factors discussed above will constitute a \$3.0 billion "hit" on the 2003-04 budget relative to 2001-02 (\$1.2 billion to make up for the transfer of the sales tax gasoline to a special fund, \$570 million in revenues lost due to the federal estate tax phase out, and \$1.2 billion in added VLF backfill costs). AB 426's trigger provision changes make it impossible for the state to build a reserve to pay for anticipated future costs.
- AB 426 would prevent the state from ***ever*** reaching the 3 percent to 5 percent reserve level state finance experts consider prudent.