Winners and Losers:
Where Has the Money Gone?

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Executive Summary

During his first two years in office, Governor Gray Davis has been blessed with a strong economy and exceptionally strong growth in state revenues. Unlike his predecessor, who confronted a series of deep deficits upon assuming office, Governor Davis has seen revenues exceed expectations in each of the past two years. The unanticipated revenue growth and continued economic expansion have given lawmakers resources to increase state spending while substantially reducing taxes.

Most of the new dollars have gone to K-12 Education, Health and Human Services programs (primarily Medi-Cal), and tax cuts. While the dollar increase in spending for a particular program area is one measure of the priority placed on that issue by lawmakers, perhaps a better measure is a program's performance relative to spending as a whole. In other words, whether spending for a particular program has increased by a greater or lesser percentage than the budget as a whole. This report compares revenue and spending growth in the first two Davis budgets with that of the final budget signed into law by former Governor Pete Wilson. Since the budget typically provides the blueprint and resources necessary to implement a governor's policy agenda, this analysis tries to shed light on the priorities of the Davis administration during its first two years in office and to identify areas that have fared well in recent years, as well as those that have fallen behind.

Key Findings

• General Fund revenues rose by 29.6 percent ($16.9 billion) between 1998-99 and 2000-01 due to extraordinary growth in personal income tax collections. The rise in personal income tax collections was led by taxes paid on stock options and capital gains primarily by the wealthiest Californians. Revenues are likely to significantly exceed the forecast adopted as the basis of the 2000-01 budget. The Legislative Analyst projects that 2000-01 revenues will be $4.1 billion above the budgeted levels, and actual cash-in-hand collections were $1.4 billion above the Governor's May 2000 forecast after the first five months of the fiscal year.

• A portion of the growth in General Fund revenues comes from payments made pursuant to a national settlement agreement between the tobacco industry and states' attorneys general. While many states have earmarked these funds for health or tobacco-education programs, California deposits settlement payments into the General Fund.

• State General Fund expenditures rose by 37.6 percent between 1998-99 and 2000-01 ($21.6 billion). The growth in expenditures exceeded revenue growth due to the large fund balances carried forward into subsequent fiscal years. A significant fraction of the increased spending is for one-time initiatives with no implied commitment for future funding.

• K-12 Education and Health and Human Services programs received the largest dollar increases, $6.8 billion and $4.9 billion respectively. However, K-12 Education dropped from 41.6 percent to 38.8 percent of General Fund expenditures, while Health and Human Services programs fell from 26.8 percent to 25.7 percent of General Fund expenditures between 1998-99 and 2000-01.

• A substantial fraction of the growth in revenues went to tax cuts. New and expanded tax cuts enacted in 1999 and 2000 reduced state revenue collections by $6.2 billion. Reductions in Vehicle License Fees (VLF) account for the bulk of the new reductions.

• Measured as a share of General Fund spending, the biggest winners were General Government and Business, Transportation, and Housing. The increase in General Government expenditures is attributable to the reductions in Vehicle License Fees (VLF) and the corresponding reimbursement of local governments for revenues lost, as well as an increase in the Senior Citizens Homeowners and Renters Tax Assistance Program. Thus, what appears to be a significant increase in ***spending*** is actually a reduction in taxes.

• Most of the increase in Health and Human Services represents caseload growth and cost-of-living adjustments. Approximately one-third of the $2.4 billion increase in Medi-Cal spending went toward new policy initiatives, primarily increases in payments to providers, rather than expanded eligibility or improvements in the Medi-Cal benefits package.

• Most of the increase in spending on housing programs represents a one-time allocation, rather than an ongoing commitment to higher funding levels. Similarly, the major infusion of funds for transportation is limited in duration. While both augmentations are substantial relative to historical state spending trends, they are modest relative to overall need. Over a six-year period, the Traffic Congestion Relief Program will spend $7.2 billion. In contrast, a report by the Business Roundtable identified $15 billion to $25 billion in unfunded transportation infrastructure needs. The Governor estimates that the new funding for multifamily housing will assist in the development of 5,200 to 7,200 units. In comparison, CBP's May report, *Locked Out: California's Affordable Housing Crisis*, identified a 684,000 gap between the number of low-cost housing units and low income renters.

• The magnitude of recent reserves triggered a provision enacted in 1991 that reduces the state's sales tax rate by one-quarter cent for a calendar year when the state's budget hits specified targets. This so-called trigger reduction will reduce General Fund revenues by an estimated $1.2 billion in 2000-01 and 2001-02.

• While 2000-01 revenue collections are above the level assumed in this year's budget, the state remains vulnerable to a downturn in the economy due to an increased reliance on income tax payments attributable to investment earnings (capital gains and stock options). The substantial amount of one-time spending will provide a cushion against slower revenue growth.