

STATE BUDGET OUTLOOK

The state budget outlook has improved significantly in the past year. Beginning with the 1990-91 fiscal year, the state experienced three years of serious financial problems in its key funds -- the general fund-general purpose, the budget stabilization fund and the school aid fund (see **Council Comments No. 1016, February 1993**). As recently as February 1993, the state faced an estimated \$321.2 million combined 1992-93 deficit in its general and school aid funds. Fortright action on the part of state officials including the adoption of an \$84 million executive order budget reduction and a \$159 million appropriation reduction, accompanied by growth in state revenues, not only eliminated the deficit but resulted in a \$326.6 million surplus at the end of the 1992-93 fiscal year (see **Table 1**).

Improved economic conditions beginning in 1993 resulted in substantial increases in general and school aid fund continuing revenues for both 1992-93 and 1993-94. While 1992-93 general and school aid fund revenues were increased because of the use of one-time, non-recurring revenues, and some one-time revenues are continued in fiscal 1993-94 and 1994-95, the use of one-time revenues to balance the budget has decreased significantly. The accelerated economic growth not only enhanced the revenue outlook for the 1992-93 and 1993-94 state fiscal years, but provides a healthy economic base for the 1994-95 fiscal year.

However, there are long term reasons for concern including:

- By 1994-95, the state will be three years into an economic recovery that will not continue indefinitely;
- The precise effect the new school finance system, which becomes fully effective in fiscal 1994-95, will have on the state budget situation is unknown;
- The state has assumed major new financial responsibility for K-12 education, which will put pressure on state finances;
- Additional general fund monies are earmarked to the school aid fund limiting the ability of the state to meet other needs;
- By 1995-96, there may be a structural problem in financing the school aid system; and,
- The increase in state taxes to finance state school aid combined with the growth in revenues from the improved economy will leave the state little, if any, margin under the constitutional state revenue limit.

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Fiscal Years 1992-93, 1993-94 and 1994-95

The combined general fund and school aid fund surplus for 1992-93 is \$326.6 million (\$308.6 million general fund and \$18 million school aid fund). With respect to the general fund surplus, \$26 million was carried forward to 1993-94 as a general fund balance and \$282.6 million was transferred to the budget stabilization fund.

The adoption of Proposal A on March 15, 1994, radically changes the school finance system and the projected year-end 1993-94 balances in the general and school aid funds. **Table 1** presents information on the financial situation of the two funds under two scenarios: one, if school finance reform had not occurred, and the other reflects the adoption of school finance reform. Without reform, the estimated balance for the two funds would be \$193.3 million. Although the new school finance system becomes effective October 1, 1994, the additional state revenue stream begins May 1, 1994, and will be in effect for the last five months of fiscal 1993-94. Thus, there is a substantial estimated school aid fund surplus, \$1.02 billion as of September 30, 1994. The estimated combined balance for the two funds is \$1.11 billion; thus, the state financial position is sound for 1994-95.

Table I
General Fund-General Purpose and School Aid Fund
1992-93, 1993-94 and 1994-95
(in millions)

	1992-93 (act.)	1993--94 [est.]		1994-95** (est.)
		Reform	Post-Reform	
General Fund Revenue				
Beginning Balance	\$ 0	\$ 26.0	\$ 26.0	\$ 0***
Revenues	<u>7,993.0</u>	<u>8,037.8</u>	<u>7,931.1</u>	<u>8,072.0</u>
Total	\$ 7,993.0	8,063.8	7,957.1	8,072.0
School Aid Fund Revenue				
Beginning Balance	\$1.0	\$18.0	18.0	\$1,022.5
Dedicated Revenue	<u>2,439.5</u>	<u>2,722.2</u>	<u>4,188.2</u>	<u>7,004.1</u>
Total	\$ 2,440.5	\$2,740.2	4,204.2	8,028.8
Total Revenue	\$10,433.5	\$10,804.0	\$12,161.3	\$15,098.8
General Fund Expenditures/Appropriations	\$ 7,884.4	\$ 7,870.5	\$ 7,870.5	\$8,091.1
School Aid Fund Expenditures/Appropriations	2,422.5	2,740.2	3,181.7	7,807.7
Total Expenditures/Appropriations	\$10,106.9	\$10,810.7	\$11,052.2	\$15,898.8
General Fund/School Aid Fund Balance	\$ 326.6*	\$ 193.3	\$ 1,109.1	\$199.8

Source: 1993 Comprehensive Annual Financial Report; Senate Fiscal Agency; CRC calculations.

*\$282.6 million transferred to the budget stabilization fund.

**1994-95 figures are based on Governor's budget recommendation.

***Based on Governor's recommendation to appropriate any 1993-94 GF--GP balance to the budget stabilization fund.

Based on the appropriation level recommended by the Governor for 1994-95 and the consensus revenue estimate for 1994-95, the upcoming fiscal year will end with a surplus in the two funds. It is estimated that the combined general and school aid fund balance for the 1994-95 fiscal year will be \$200 million.

This does not include an estimated \$87 million general fund 1993-94 surplus recommended for transfer to the budget stabilization fund by the Governor.

The state financial outlook is enhanced by the projected condition of the budget stabilization fund. Based on a \$283 million payment into the fund at the close of the 1992-93 fiscal year, \$87 million from 1993-94, and an estimated \$99 million formula payment in 1994-95, plus interest earnings, the estimated balance at the end of the 1994-95 fiscal year will be in excess of \$500 million. This would be the largest year-end balance in the budget stabilization fund since it was established in 1977.

Long Range Outlook

However, there are reasons for state policymakers to be cautious concerning the state financial outlook. One concern is that the state revenue stream is cyclical in nature (see **Table 2**). After slow revenue growth or decline for fiscal years 1990, 1991 and 1992, the state is in the midst of a substantial economic recovery. The official consensus revenue estimates for fiscal 1994 and 1995 may be understated. Revenue collections for 11 major state taxes for the first six months of fiscal 1993-94 are up 9.3 percent, which compares with the consensus revenue growth rate for the full year of 3.8 percent. How much longer the current economic recovery will continue is uncertain.

Table 2
General Fund-General Purpose and School Aid Fund Baseline Revenue*
(in millions)

<u>Fiscal Year</u>	<u>Amount</u>	<u>Change</u>	<u>Percent</u>
1987	\$8,225	--	--
1988	8,762	\$537	6.5
1989	9,230	468	5.3
1990	9,340	110	1.2
1991	9,024	(316)	(3.4)
1992	9,262	238	2.6
1993	9,907	645	7.0
1994 (est.)	10,287	380	3.8
1995 (est.)	10,910	623	6.1

Source: Senate Fiscal Agency; CRC calculations.

*Excludes one-time revenues and additional state revenues relating to school finance reform

Estimated total revenues for the general and school aid funds will increase from \$10.4 billion in 1992-93 to \$16.1 billion in 1994-95. This increase reflects the state's increased responsibility for

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K-12 education and is supported by additional earmarked revenue to the school aid fund. This new earmarking includes a portion of the state income tax, estimated to be \$813 million in 1994-95, which is general fund revenue at the present time. This earmarking of current general fund revenue to the school aid fund will reduce the state's flexibility to meet public needs supported by the general fund.

Another concern is that the new school finance system puts greater pressure on the state budget, because a greater percentage of total school operating revenues will come from the state than occurs under the current system. Approximately 80 percent of total state and local operating revenues will come from the state, compared with 39 percent from the state under the current school finance system. There will be even greater pressure on the state to increase its absolute dollar commitment to K-12 education. The state has taken on a major new expenditure responsibility, and will not be able to fall back on the local property tax to sustain the growth of total K-12 revenues.

There may be a structural problem in the new school finance system. The estimated school aid fund surplus in 1993-94 of \$1.02 billion shrinks to \$219 million in 1994-95. While there are school aid transitional payments and onetime revenue items, there appears to be a \$600 million shortfall between continuing school aid fund revenues and expenditures in 1995-96. This estimated shortfall cannot be covered by growth in dedicated revenues in the school aid funds because the growth is earmarked to increase the base foundation grant.

Another structural problem is the state commitment to raise low per pupil spending districts to the base foundation grant, set at \$5,000 per pupil for 1994-95, by giving those districts below \$5,000 a greater dollar increase than those districts above the foundation level. Using the 1995-96 statutory formula and assuming a three percent per pupil increase, the estimated cost to the state is \$45 million in 1995-96 to accelerate bringing districts up to the base foundation level. This occurs because the base foundation grant increases by the increase in school aid revenue over the prior year and allocating additional resources above the increase in the basic foundation grant to low expenditure districts results in additional costs to the state.

The ability of the state to cope with any structural imbalance in the school aid fund or to fund other state services will be restricted by the overall state revenue limit imposed by Article 9, Section 26 of the state Constitution. While no official estimates have been made available as to state compliance with the overall state revenue limit, the combination of the increases in state tax revenues in 1994-95 to finance state school aid and the growth in state revenues resulting from the improved economy will leave the state with little, if any, margin under the state revenue limit.