

# The Latest Economic Forecasts And the Future of Proposition 98

## Association of Chief Business Officials

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Presented By:

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October 24, 2018



- **Near-term Economic Outlook and State Revenues**
  - UCLA's forecast
  - State revenues to date
- **30 Years of Proposition 98: Has school funding really improved?**
  - Enrollment and inflation
  - Comparison to other states
  - State voters and outlook for the future
- **The Changing Political Environment: A new Governor and Legislature**
  - Education policies and priorities

# Near-Term Economic and State Revenue Outlook

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- **Consistent with their prior forecast, UCLA economists continue to see a “3-2-1” economy**
  - **3% Gross Domestic Product (GDP) growth in 2018**
  - **2% GDP growth in 2019**
  - **1% GDP growth in 2020**
- **However, as the economy slows, the chances of a recession increase**
  - **One-sixth chance of a recession in 2019**
  - **One-third chance of a recession in 2020**



- **The economy is expected to slow because at full employment further increases in growth cannot be sustained**
  - **Federal deficit spending is stimulating the economy today, pulling demand from 2020 into 2018**
  - **As the effects of the federal stimulus wane, the economy will slow**
  - **Job growth will slow from an average of 200,000 jobs per month to 50,000 jobs per month**
- **“In 2020 Wile E. Coyote is going to go off the cliff, and he’s going to look down, and that (stimulus) will be withdrawn at that point.” – Ben Bernanke, (former chairman of the Federal Reserve), Business Insider, June 8, 2018**

- **The *UCLA Forecast* indicates that federal fiscal policy will increase the deficit from \$400 billion in 2015 to \$1.4 trillion by 2022 and will continue “as far as the eye can see”**
  - **This is “completely unprecedented” in peacetime**
  - **The U.S. is already at a full employment economy and does not need stimulus to promote job growth**
  - **The Federal Reserve is expected to raise interest rates in December 2018 and four more times in 2019**

- The *UCLA Forecast* estimates that if tariffs are imposed on all Chinese imports – a total value of \$537 billion – the effect on the U.S. economy would be similar to an \$80 billion tax hike
- However, the tariffs will not have the intended effect of stemming the trade imbalance
  - Instead, while the trade deficit with China will fall, it will increase with other nations which produce similar export goods (i.e., Vietnam, Thailand, and South Korea)
  - The trade deficit is projected to rise from \$580 billion in 2014 to \$1.1 trillion by 2020
- Since the release of the *UCLA Forecast*, the U.S. has struck trade deals with Mexico and Canada, which has relieved some anxiety about a successor to NAFTA

- California has enjoyed strong economic growth during the economic expansion
  - Among the major states, California ranked fifth in terms of state GDP growth from July 2017 to July 2018
    - 3.5% growth for California vs. 2.5% growth for the U.S.
  - The state added three million jobs (21%) since the bottom of the recession
- However, rising interest rates could threaten the expansion
- UCLA economists simulated the effects of a recession on state tax revenues
  - “Garden variety” recession: \$36 billion loss over two years
  - Mild recession: \$31 billion loss over two years
  - Rainy Day Fund: \$14 billion total





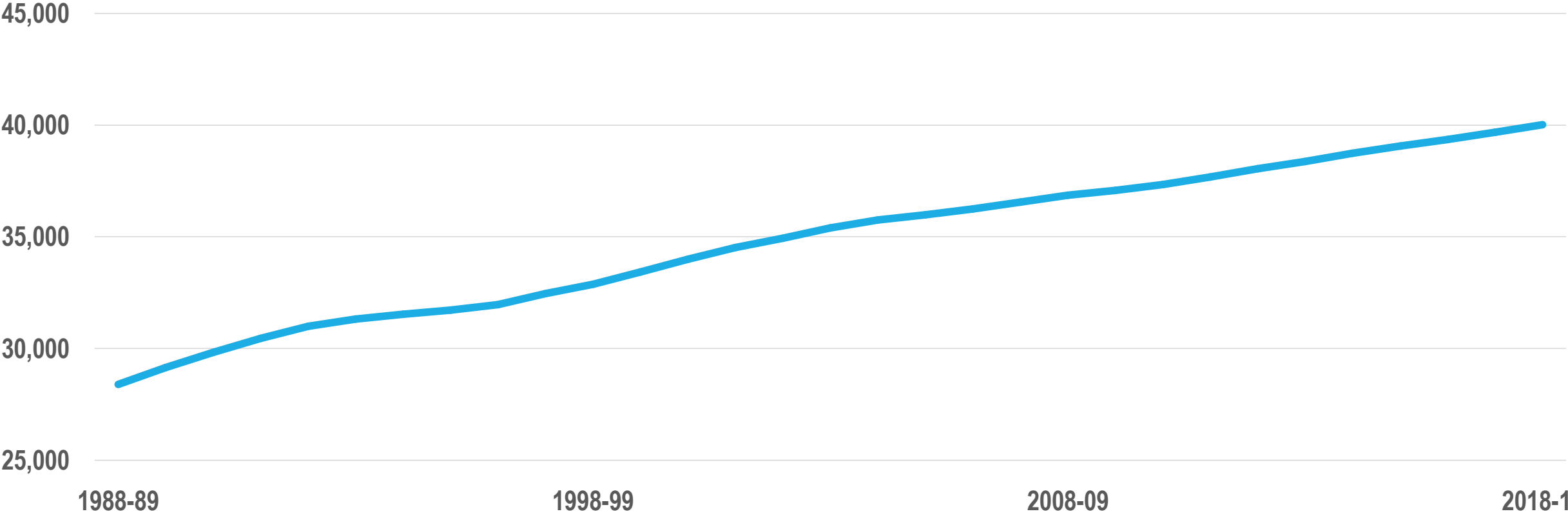
- **Department of Finance (DOF) report – through the first three months of the new fiscal year, state revenues are up \$1.032 billion (about 3.8%) from the May Revision forecast**
  - **September collections beat the forecast by \$1.6 million or 1.4%**
- **California's job market also remains strong**
  - **The state added 46,700 jobs in July and 44,800 jobs in August, more than three times the level needed to absorb population-related increases**
  - **The California unemployment rate has remained at a record low of 4.2% for five months through August; the U.S. unemployment rate dropped to 3.7% in September, the lowest rate since 1969**

# 30 Years of Proposition 98

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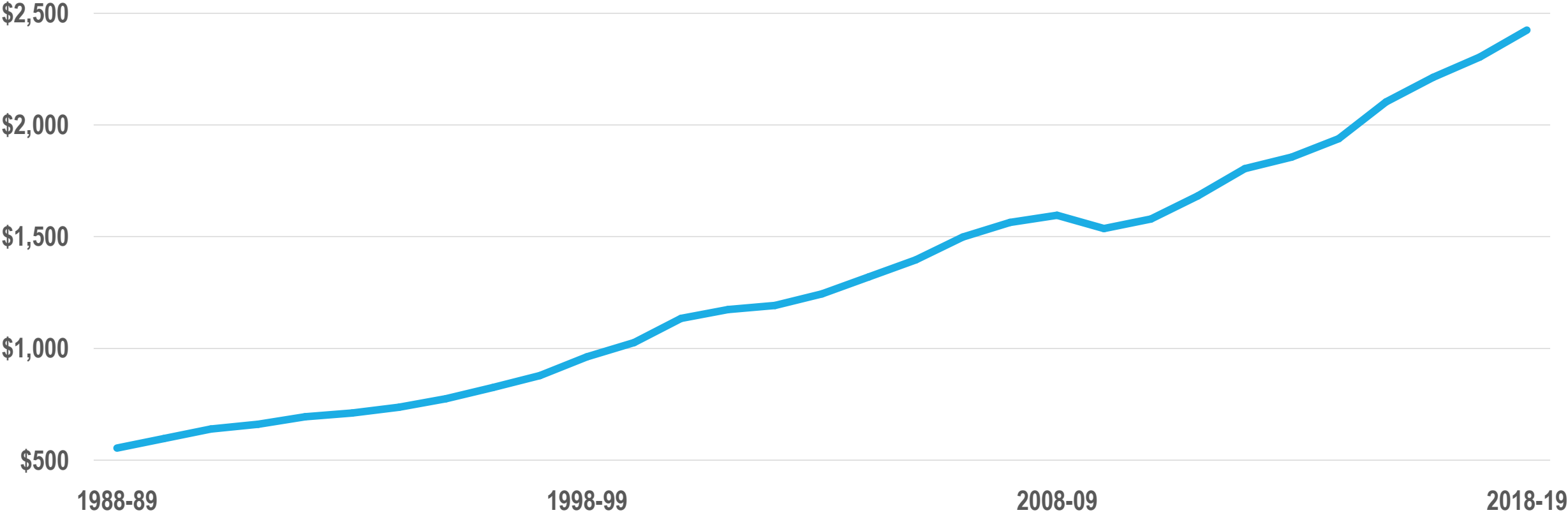
- Proposition 98, the state's minimum funding guarantee, was enacted in 1988, 30 years ago
- During this period, the state's population has increased 41%, from 28.4 million in 1988-89 to just over 40 million today
  - This is an average annual increase of 1.2%
  - However, population growth has slowed over this period
    - In the late 1980s, the annual growth rate was about 2.5%
    - The growth rate has been below 1% since 2005-06
- Personal income has increased almost 340%, from \$555 billion in 1988-89 to \$2.4 trillion today
  - This is equal to an average annual gain of 5% not adjusted for inflation
  - Per capita personal income has increased 3.8% annually

### California Population (in Millions)



Source: Department of Finance, Governor's Budget 2018-19, Schedule 6

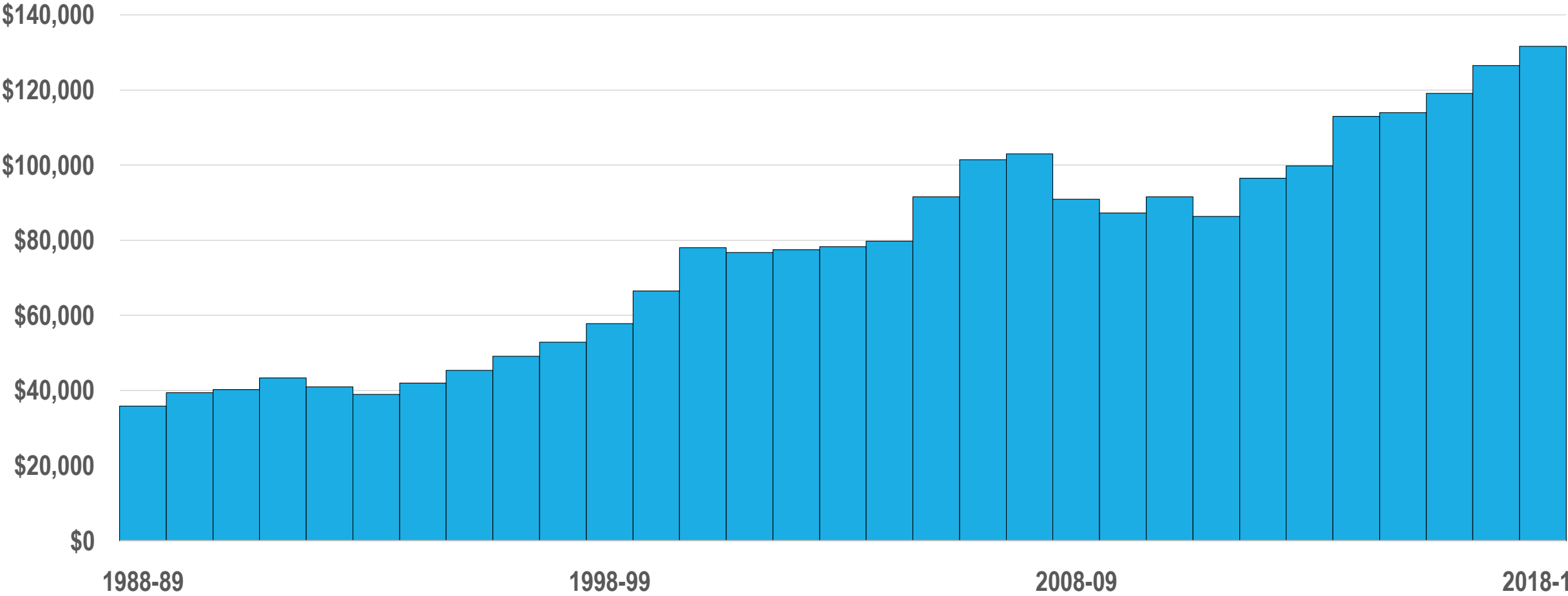
### California Personal Income (\$ in Billions)



Source: Department of Finance, Governor's Budget 2018-19, Schedule 6

- The state General Fund supports many programs, including Medi-Cal, CalWorks, the University of California and California State University, State Parks, Corrections and Rehabilitation, as well as K-12 education and the community colleges under Proposition 98
- General Fund spending has increased almost 270% over this 30-year period, from \$35.9 billion to \$131.7 billion under the Governor's proposed Budget
  - This is an average annual increase of 4.4%
  - Unlike population and personal income, General Fund spending is volatile, rising and falling with tax receipts
    - Spending plummeted in 2001-02 and remained flat for four years
    - The Great Recession saw General Fund spending drop from \$103 billion in 2007-08 and not exceed that level until 2014-15

# State General Fund Expenditures

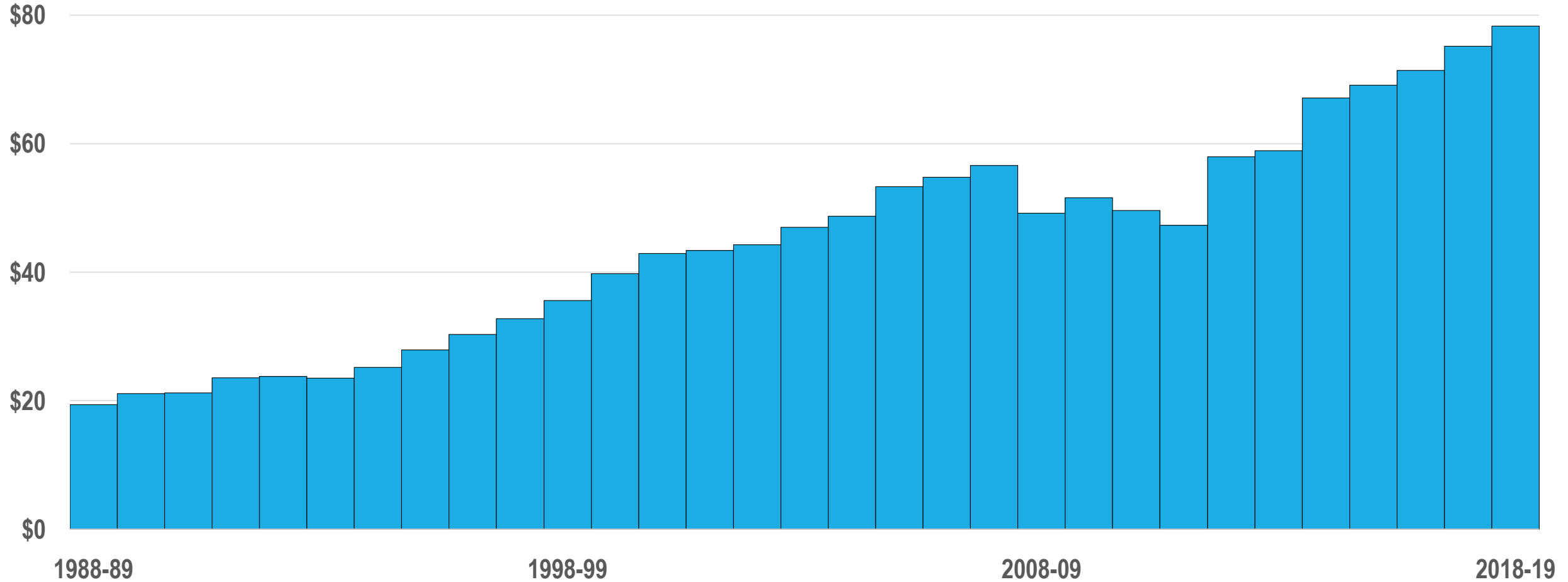


Source: Department of Finance, Governor's Budget 2018-19, Schedule 6

- **Enacted by state voters in November 1988, Proposition 98 amended the state constitution to establish a minimum funding guarantee for K-12 education and the community colleges**
  - **The formulas take into consideration changes in workload as measured by ADA and inflation as measured by (1) the change in per capita personal income or (2) the change in General Fund revenues**
  - **Proponents argued that Proposition 98 would take politics out of school finance**
- **According to a report by the Legislative Analyst's Office (LAO), over the period during which Proposition 98 has been in effect, "There is no evidence that school funding is higher as a result of the formulas"**
  - **The formulas fail to address "real world" developments and there is no evidence that school funding decisions are any less political**

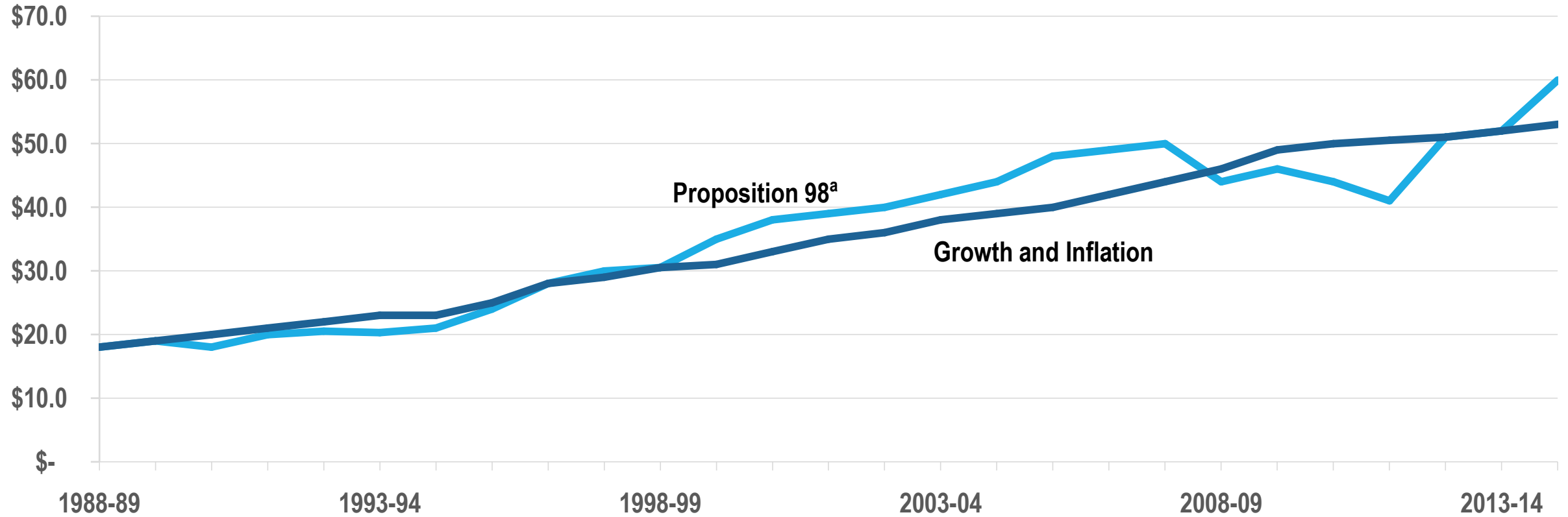


# Proposition 98 Funding



Source: LAO, *A Historical Review of Proposition 98*, page 13, January 2017

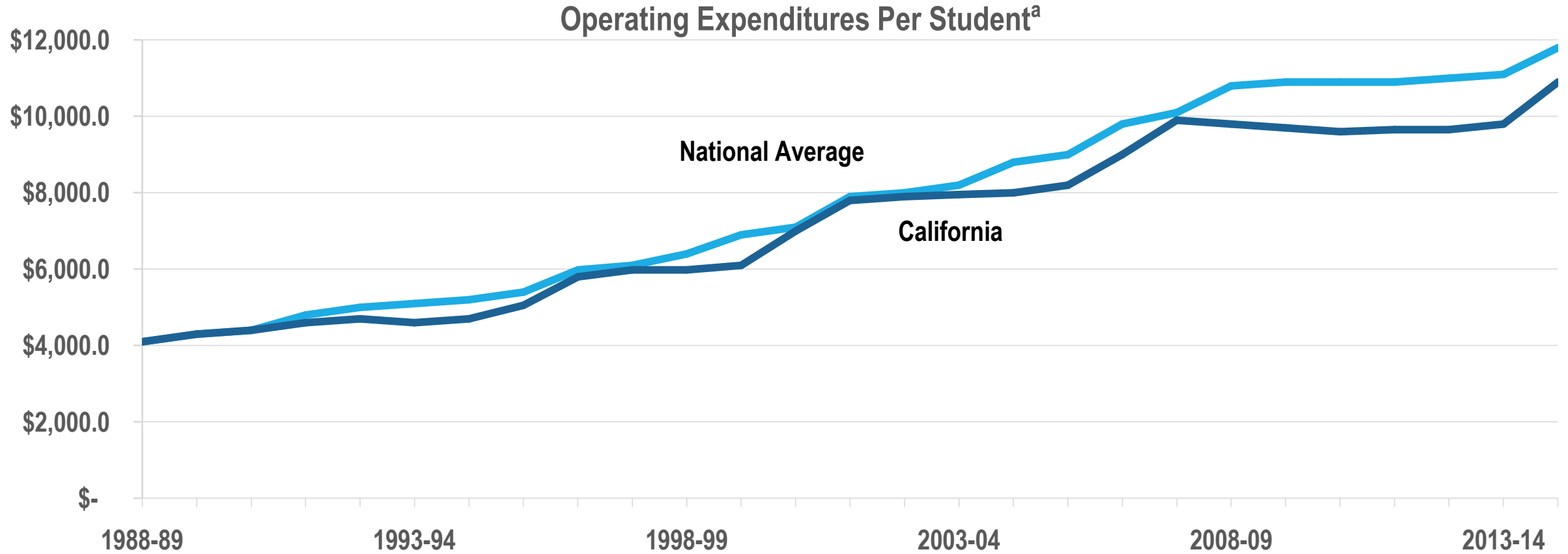
# Proposition 98 vs. Enrollment Growth and Inflation



<sup>a</sup>Includes all Proposition 98 funding except the amount going to the California Community Colleges

Source: LAO, *A Historical Review of Proposition 98*, page 25, January 2017

# California's Proposition 98 vs. the Rest of the Nation



<sup>a</sup>Reflects spending data reported by the U.S. Census Bureau. Amounts for 1988-89 to 1990-91 have been adjusted for comparability with subsequent years. Amounts shown for 2014-15 reflect an LAO estimate.

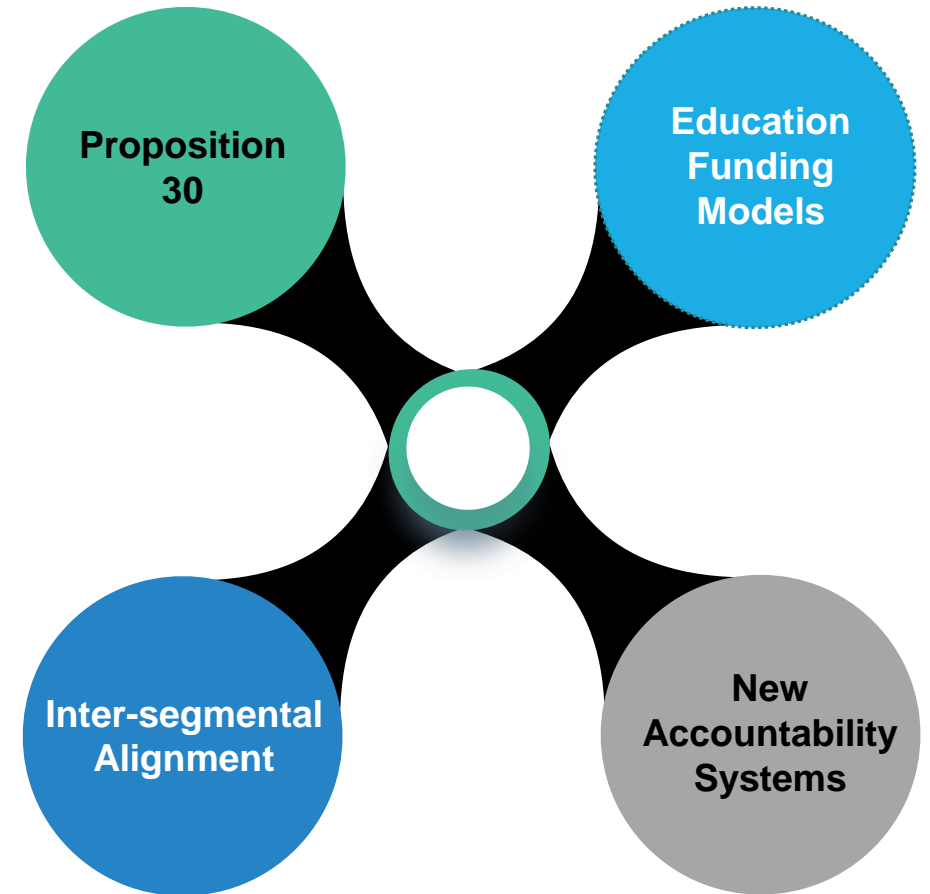
- **The state's economy will drive state tax revenues, with an increasing reliance on the high income earners**
  - **Greater volatility in state revenues should be expected**
- **The Legislature and Governor set the state's spending**
  - **State General Fund support for K-14 education has been weak because of flat or declining enrollment and consistently strong property tax growth**
    - **Most other state programs have seen larger increases in General Fund support**
    - **The Legislature rarely funds education above the Proposition 98 minimum guarantee**
  - **Policy discussion regarding the needs of K-14 education are rare; funding the Proposition 98 target substitutes for meaningful budget priority setting**

- **California voters have consistently identified public education as their top budget priority**
  - **The Lottery was sold to voters as benefitting education**
  - **Proposition 98 was approved by voters, notwithstanding the opposition of most state political leaders**
  - **Recently, voters approved Propositions 30 and 55, the temporary tax on high income earners**
    - **Voters were told this was a tax to save K-12 education from cuts; the reality is that these tax revenues benefit all General Fund programs**
  - **Voters approved Proposition 51, the K-14 education bond program**
- **A direct appeal to voters through the initiative process may be the only way to substantially improve funding for California's K-14 education system**

# **The Changing Political Environment: A New Governor and Legislature**

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- During his eight-year tenure, Governor Jerry Brown instituted bold and historic reforms, particularly with respect to public education
  - Proposition 30, and subsequently Proposition 55, generate \$6-\$11 billion annually
  - Unprecedented regional collaboration to deliver key educational programs
  - Reformed the community college and K-12 funding formulas
  - Accountability systems using multiple measures of institutional effectiveness and student success



California's next governor will want to distinguish himself, which can impact the future direction of education policy . . .



**Commitment to  
the local control and local  
decision making**



**Position on  
categorical  
programs**



**Position on education  
accountability**



**Strength of leadership &  
relationship with key  
education leaders**



- **The next Governor will take office on January 7, 2019 – three days shy of the constitutional deadline to introduce a state spending plan**
- **As we speak, Governor Brown’s DOF is beginning the framework of that spending plan**
  - **Plugging in revenue estimates**
  - **Estimating workload and statutorily required spending**
- **After Election Day, the current Administration and the next Administration will work together on the details of the 2019-20 Governor's State Budget so it will be ready on January 10**

- The next Governor will preside over a “fully funded” K-12 Local Control Funding Formula but a newly enacted allocation model for the community colleges
- In the event of economic downturn, how he prioritizes education will be critical for the success of our schools
  - Will Proposition 98 suspension be on the table or out of the question?
  - If K-14 education cuts are needed, how will they be implemented?
- A new Governor’s first budget is often driven by
  - The revenue outlook
  - The costs of continuing existing commitments
  - Unless they are clearly defined, the new Governor’s policy priorities take time to emerge

- **On the economy:** No recession on the horizon, but few economists warned us of the Great Recession before it began
- **On Proposition 98:**
  - The Legislature and Governor will provide enough to meet the minimum guarantee, but no more
  - The voters offer the best chance of increasing funding in the long run
- **On the political environment:**
  - Governor Brown had a clear view of the role of state government – local decision making should prevail in most cases
  - The Legislature has traditionally sought and secured a greater role in education policymaking

# Thank You!

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