
CALIFORNIA BUDGET REPORT

Volume 6, Number 9

February 29, 2008

The Budget Nun Speaks

The budget committees of both houses met this week to hear Elizabeth Hill, the Legislative Analyst, explain her recent report on the Governor's budget and her alternative proposal. Below is a report on both hearings from Matthew Christy, the now-well-known Isenberg/O'Haren intern who is becoming the 2008 budget expert.

Senate Budget Committee

Tuesday afternoon, Legislative Analyst Elizabeth Hill testified before the Senate Budget Committee regarding her alternative budget proposal. Hill began her testimony by reviewing the key findings of her recent report on the Governor's 2008-09 budget proposal and the state of California's economy.

Our analysis of Hill's report can be accessed on our website at www.isenberg-oharen.com (click on the Publications link) or directly at

<http://www.isenberg-oharen.com/Upload/CA%20Budget%20Report%20Vol%206%20No%208.pdf>

Hill then reiterated a major theme of her report—that the Governor's across-the-board-cutting approach represented a failure to set priorities for the state.

After reviewing the report's major findings, Hill explained some of the key components of her alternative budget proposal. Unlike the Governor's budget, which relies almost exclusively on untargeted spending cuts to balance the state's budget, Hill's proposal relies on both targeted spending cuts and increased revenue. Several times during her testimony, Hill pointed out that during good times the state increased spending and cut taxes, so now, faced with a fiscal crisis, the state should both cut spending and increase revenue.

Under Hill's proposal, the state budget would remain balanced through fiscal year 2012-13.

Hill noted that one objective of her proposal was to preserve core services at current levels of service. Unlike the Governor's plan, her proposal does not include Medi-Cal provider rate cuts. In lieu of cuts to core services, Hill advocates modification, consolidation or elimination of ineffective state programs.

In order to raise revenue, Hill recommends the modification or elimination of about a dozen tax expenditures—those sneaky tax loopholes. Chief among them are the dependent credit, the research-and-development credit and the net-operating-loss credit. Of the tax expenditure solutions discussed, reduction of the dependent credit would generate the most revenue.

After Hill provided a basic explanation of her key proposals, she took questions from committee members.

The Republicans on the committee took issue with Hill's tax expenditure proposals. Senator Cogdill, the newly-elected Senate Minority Leader-elect, questioned Hill about the effects of the tax expenditure proposals on the state's corporate citizens. Hill conceded that certain companies would be hurt by these modifications. Hill noted that her modification of the R&D credit, however, would save \$305 million in 2008-09, and her modification of the NOL would save \$330 million.

Hill's proposal that the state assess a fire-protection fee upon the owners of structures within the State Responsibility Area also generated significant deliberation. Republicans suggested that the assessment would amount to double taxation because many owners were already paying a local government for local service. An LAO representative responded that the assessment would account for increased risk of fire to the affected structures. Hill then reiterated another theme of her testimony: in order to stamp out waste, it is imperative that the state conclusively determine which services are its responsibility and which are local governments' responsibility.

Hill's proposal to realign the state's parole system also prompted extended deliberation.

As the hearing was winding down, a Department of Finance representative advised that the Department had yet to analyze Hill's proposal because it lacked sufficient manpower, noting that the LAO had never produced its own budget before this year. This provoked Senator Steinberg, the Senate Pro Tem-elect, to demand the Department catch up and join the debate.

Assembly Budget Committee

The following day, Legislative Analyst Elizabeth Hill was back in the Capitol, testifying before the Assembly Budget Committee regarding her report on the status of California's economy, the Governor's budget proposal, and her budget proposal.

Just as she had yesterday when she presented before the Senate Budget Committee, Hill brought along a copy of the first-ever LAO report, which covered the biennial budget for 1945-47. Hill pointed out that that budget, which covered two years, totaled \$683 million, whereas the 2008-09 budget is projected to total around \$130 billion. Democratic Chairman John Laird joked that he could hear Senator Tom McClintock, a true budget nerd (we say that with admiration), calculating the increase in spending in the interim as they spoke.

Hill went on to provide the highlights of her report. She noted that California's economy continues to sag, the Governor's budget proposal fails to set priorities for the state, and her own budget proposal would maintain a balanced budget through 2012-13, unlike the Governor's.

Hill then proceeded to answer the committee members' questions.

Democratic Assemblyman Sandre Swanson asked why Hill hadn't proposed a significant increase in the Vehicle License Fee or an increase in the sales tax rate. Hill advised that she employed a surgical approach to raising revenue because she wanted to avoid impacting investment decisions.

Republican Assemblyman John Benoit asked why Hill hadn't included cuts to Medi-Cal optional benefits in her proposal. Hill responded that she tried to preserve funding for essential services to the greatest extent possible.

Democratic Assemblyman Gene Mullin asked why Hill had chosen to propose her own alternative budget this year, despite the LAO never having done so before. Correcting Mullin, Hill noted that the LAO had also produced an alternative budget in June of 1992. Hill then asserted that the Governor's failure to set priorities for the state and the need for both additional revenue and decreased spending to address structural shortfalls in the budget led to her decision to produce an alternative budget proposal this year.

Republican Vice Chair Roger Niello asked Hill why she had rolled back tax expenditures that were increased during good times, but not program expansions that occurred during those same good times. Hill advised that she had actually done both. She noted that her proposal cuts spending to the local criminal justice program and local assistance programs, which were expanded during the good times. Niello then asked her to look for other program expansions to cut, to which Hill responded: "We're always looking."

Niello proceeded to argue that the health of the state's economy should be the foremost focus of the Legislature and that any tax increases could hamper the economy's recovery. He particularly took issue with modifications to the Net Operating Loss and Research and Development tax credits. Hill explained that she shared some of his concerns, and that was the explanation for why she merely modified, rather than suspended, these tax expenditures.

Laird closed the hearing by pointing out that just as modification of tax expenditures could hurt the state's economy, so could cuts to education funding because the state will need educated workers to thrive in the future. He went on to note that, given the extent of this year's deficit, legislators will need to work together to account for both of these perspectives in fashioning the budget.

The California Budget Report is produced by Phil Isenberg and Maureen O'Haren of ISENBERG/O'HAREN. Questions, comments and requests to be added to the mailing list should be directed to Phil at phil@isenberg-oharen.com or Maureen at maureen@isenberg-oharen.com