

**CALIFORNIA STATE UNIVERSITY, LONG BEACH
2003-04 RESOURCE PLANNING PROCESS**

BUDGET OUTLOOK

PURPOSE

This Budget Outlook summarizes the fiscal assessment of the State, CSU System, and campus for 2003-04, which formed the context and basis of the RPP Task Force's planning and recommendations to the President. The Outlook attempts to be comprehensive and takes into consideration a wide range of information and activities evolving over an eight-month period. In spite of best efforts, the external factors influencing the outcome are often difficult to predict and the final allocation may differ from projections.

INTRODUCTION

The sources for this budget outlook include the Governor's Budget, the Legislative Analyst's Office, the Department of Finance, the CSU Board of Trustees, the Chancellor's Office, and enrollment and financial projections about our own campus. These sources tend to fall into four categories: the Executive Branch of State Government; the Legislative Branch of State Government; the CSU system, and the campus.

THE EXECUTIVE BRANCH OF STATE GOVERNMENT

STATE ECONOMIC FORECAST

Although there have been some positive developments, overall economic growth in most areas of the U.S. and California economies have been struggling. California's economy has taken longer than expected to recover from the recession, and the stock market has lost a considerable amount of ground in the later half of 2002. This has resulted in a significant decline in State revenues over previous years. The Department of Finance reports the decline as the most dramatic loss of revenues California has experienced since World War II. The delay in the recovery of the national and state economies and a state tax structure heavily reliant on volatile revenues have resulted in a projected budget shortfall in the current year and the budget year totaling \$38.2 billion.

The national economy has made little progress on the road to recovery in the first quarter of 2003. Economic output grew only slightly for the second quarter in a row, and the war with Iraq, fear of terrorist attacks, and concerns about severe acute respiratory syndrome (SARS) have been heavy weights on the economy. On the positive side, residential construction increased and the housing markets remained strong. Net exports and corporate profits continued to show signs of improvement. In total, though, there has not been enough demand in the economy of keep labor markets from deteriorating in the U.S. Overall employment rose in California during the first quarter of 2003 while it fell in the

nation as a whole. But the gain was small and did not keep up with the state's growing labor force. State employment statistics show that the recession was even worse than previously thought in the San Francisco Bay area. Despite an increase in consumer confidence in April, most of the evidence suggests that the California and national economies will grow only modestly during the rest of 2003, with further improvement expected for 2004.

The Governor's original budget forecast in January assumed that both the U.S. and California economies would expand at a slow pace throughout most of 2003, before modestly increasing in 2004. As shown in Table 1, real Gross Domestic Product (GDP) is projected to increase 2.5% in 2003 and 3.5% in 2004. State personal income is projected to increase by an estimated 3.3% in 2003 before mildly accelerating to a 5.3% pace in 2004. The forecast assumed that interest rates and inflation would rise some, but remain low by historical standards.

Table 1			
Summary of Budget's Economic Outlook			
	<u>Actual</u> 2002	<u>Forecast</u> 2003 2004	
United States Forecast			
Percent Change in:			
Real GDP	2.31%	2.5%	3.5%
Personal Income	3.0	4.1	5.4
Wage and Salary Employment	-0.8	0.9	2.1
Consumer Price Index (CPI)	1.6	2.5	2.4
Unemployment rate (%)	5.8	6.0	5.5
Housing Starts (000)	1,691	1,570	1,660
California Forecast			
Percent Change in:			
Personal Income	0.9%	3.3%	5.3%
Wage and Salary Employment	-0.7	0.7	2.1
Taxable Sales	-2.2	3.4	5.6
Consumer Price Index (CPI)	2.5	2.8	3.2
Unemployment rate (%)	6.4	6.5	6.2
New Housing permits (000)	159	157	162

Source: California Legislative Analyst's Office – February 2003

It is expected that California's economic recovery will continue to parallel the nation's. By the fourth quarter of 2003, The Department of Finance projects that jobs will be growing, employment growth will increase, and growth in total state personal income will improve, clearly putting the economy back on track. The unemployment rate, a lagging indicator, will continue to improve some, but will more than likely remain close to 6%.

GOVERNOR'S PROPOSED BUDGET – JANUARY 2003

When the 2003-04 Governor's Budget was presented to the Legislature on January 10, 2003, the projected General Fund budget gap was \$34.6 billion. The Governor proposed a plan for addressing the budget gap between General Fund revenues and expenditures. It does this through a variety of actions, including spending reductions, State-Local realignment, fund shifts, and loans/borrowing.

Table 2 reflects the General Fund's condition under the budget's original assumptions and proposals.

- *Revenues.* For the current year (2002-03), revenues are projected to fall from \$73.1 billion to \$69.2 billion in 2003-04, a decline of 5.5%. This decline is due to weak underlying growth in revenues from major taxes, and the large amount of one-time receipts in the current year from tobacco securitization and loans from special funds.
- *Expenditures.* For the current year (2002-03). Expenditures are projected to decline from \$75.5 billion to \$62.8 billion in 2003-04, a decline of 16.8%. The decline reflects both major program reductions and the realignment to local governments.
- *Operating surplus (revenues in excess of expenditures).* The large decline in expenditures results in an operating surplus in 2003-04. This causes the cumulative year-end reserve to improve from a negative \$5.9 billion in 2002-03 to a positive \$531 million in 2003-04.

Table 2			
Overall Summary of the Governor's Budget			
General Fund			
<i>(Dollars in Billions)</i>			
	01-02	02-03	Proposed 03-04
Prior-year fund balance	\$2.4	-\$2.1	-\$4.5
Revenues and transfers	72.2	73.1	69.2
Total resources available	\$74.6	\$71.0	\$64.7
Expenditures	\$76.7	\$75.5	\$62.8
Ending fund balance	-\$2.1	-\$4.5	\$1.9
Encumbrances	1.4	1.4	1.4
Reserve	-\$3.5	-\$5.8	\$0.5

Source: California Legislative Analyst's Office, Feb 2003

REVENUES (Table 3):

The precipitating factor behind the enormous fiscal imbalance currently facing California is the record postwar deterioration in state revenues that recently occurred. The budget's revenue forecast reflects the budget estimates General Fund revenues will decline from \$72.2 billion 2001-02, to \$69.1 billion in 2003-04. In previous years, the State's remarkable revenue growth was driven by stock market related gains. Since enactment of the 2002 Budget Act, the General Fund revenue forecast for major taxes and licenses has decreased by \$7.7 billion for the past and current years combined. In addition, a decline of \$4 billion is expected for 2003-04.

The tax-related changes enacted with the 2002-03 budget will raise revenues by \$2.1 billion in the current year, and \$769 million in 2003-04. The main provisions include: (1) increased withholding on income associated with stock options, bonuses, and real estate sales; (2) a two-year suspension of net operating loss carry forward deductions; and (3) a change in the treatment of bad debt reserves maintained by banks.

For 2003-04, the Governor's budget proposed General Fund revenue-change increases totaling about \$1.6 billion. The major contributor is related to an assumed \$1.5 billion increase in tribal gaming revenues. The budget also proposes other legislation that would have revenue impacts in 2004-05 and beyond.

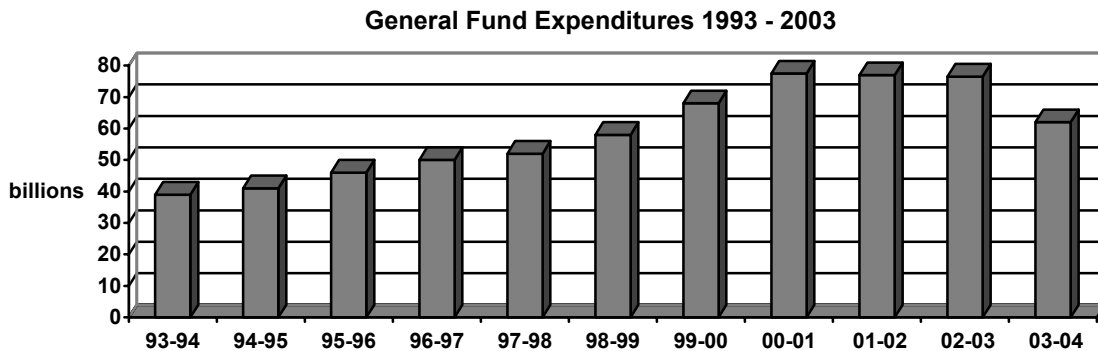
- California's personal income tax, the single most important determinant of state revenues, is expected to contribute about 49% of all General Fund revenues in 2003-04. While forecasted to decline by 0.5 % in 2002-03, decline by 13.8% for 2001-02 and then increase by 10.8% for 2003-04.
- Sales and use tax, the General Fund's second largest revenue source accounting for about one-third of the revenue total, is expected to increase from \$21.4 billion in 2001-02 to \$22.6 billion in the current year. About one-half of the year-to-year projected increase is related to the assumption of a slow improvement in taxable sales. The other half is related to the fact the State Use Tax rate had been reduced by one-quarter % during the first half of 2001-02 due to a previously adopted "trigger" provision.
- Corporation Tax (CT) revenues are expected to contribute about 9.2% of all General Fund revenues in 2003-04. The franchise tax and the corporate income tax are levied at a general tax rate of 8.84% on profits. Banks and other financial institutions subject to the CT pay an additional 2 % tax on their net income. The key determinant of CT receipts is the strength of corporate profits reported on California tax returns by businesses. While these profits have been hit hard by the economic downturn, it appears that the worst is over, and that profits will expand significantly once economic growth picks up.

Table 3			
Summary of the Governor's Budget			
General Fund Revenue Forecast			
<i>(Dollars in Billions)</i>			
	Actual	Proposed	
	01-02	02-03	03-04
Revenue Source			
Personal Income Tax	\$33.0	\$32.7	\$33.6
Sales and Use Tax	21.4	22.4	23.2
Corporation Tax	5.3	6.5	6.4
Other Taxes	2.9	2.8	2.7
Other Rev, Transfers, Loans	9.6	8.7	3.3
Totals	\$72.2	\$73.1	\$69.2
Annual Percent Change	1.1%	1.3%	-5.5%

Source: Governor's Proposed Budget, January 2003

EXPENDITURES

The General Fund is the main source of support for state programs. But, before examining the programmatic details of the Governor's spending plan for 2003-04, it is useful to provide some perspective on the historical expenditure trends. The table below shows that total general fund spending increased moderately between 1993-94 and 1998-99, then jumped by nearly 33% between 1998-99 and 2001-02. In contrast, it is projected to decline 1.6% in the current year, and by a steeper 5.7% in 2003-04. Over the full ten-year period, total spending is up an estimated \$37.6 billion (73%), an average annual rate growth of 5.6%.



The Governor's 2003-04 budget proposal laid out a comprehensive strategy for dealing with both California's near term budget shortfall and the State's longer-term structural budgetary imbalance. The Governor's proposed solutions are distributed over several major categories. Roughly 60% is related to program cuts, slightly less than one-fourth is related to realignment; one-sixth is related to a shift of local government resources to the state, and the remaining one-fifth is split between fund shifts, loans/borrowing.

For the second year in a row, the Governor proposed significant mid-year budget actions to help close the budget gap. In December 2002, the Governor released his current year plan for partially addressing the \$34.6 billion budget shortfall, proposing \$10.2 billion in spending reductions over the 2002-03 and 2003-04 years and a special session of the Legislature to facilitate prompt action on these proposals. To close the balance of the projected shortfall, the Governor's January budget plan proposed additional budget measures totaling \$24.4 billion. In March, the Legislature enacted about \$3.3 billion in current year savings, primarily related to Proposition 98 deferrals, as well a variety of reversions, cuts and redirections in other programs.

Addressing the Overall \$34.6 billion Gap				
<i>(Dollars in Millions)</i>	December 2002 Revision	Add'l Measures For 2003-04	Two-Year Total	Percent Of Total
Program Cuts / Savings	\$8,966.4	\$11,761.9	\$20,728.3	59.9%
State-Local Realignment	191.6	7,962.4	8,154.0	23.6%
Funding Shifts	815.6	1,087.1	1,902.7	5.5%
Transfers/Other Revenue	199.7	1,914.6	2,114.3	6.1%
Loans/Borrowing	25.4	1,657.9	1,683.3	4.9%
Totals	\$10,198.7	\$24,383.9	\$34,582.6	100.0%

Source : Governor's January Budget, January 2003

Program Cuts/Savings. The budget contains approximately \$21 billion in program reductions. Most programmatic areas of the budget are affected.

State-Local Realignment. The budget would raise a net of \$8.2 billion in new taxes to fund the shift of a like amount of primarily health and social services responsibilities to local government. The tax increases consist of (1) a 1% increase in the sales and use tax, (2) the imposition of 10% and 11% personal income tax marginal rates on the earnings of high-income tax payers, and (3) a \$1.10 per-pack increase in the state cigarette tax rate.

Funding Shifts. These total roughly \$2 billion and include (1) student fee increases in all three of the higher education segments, (2) other fee increases for trial courts and various resource programs, and (3) use of federal funds to support some child care costs.

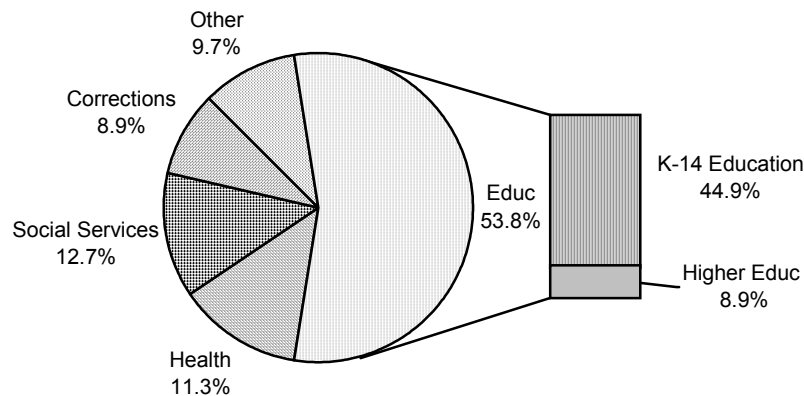
Transfers and Other Revenues. These account for \$2.1 billion in revenues. The major component is \$1.5 billion in new revenues associated with tribal gaming pacts.

Loans/Borrowing. The largest components of this category are the deferral of local government and education mandates, and the deferral of contributions to pension funds.

Table 4 summarizes the Governor's proposals for 2003-04 General Fund spending by major program area. The spending plan reflects a decline of \$12.7 billion or 16.8% from the current year's level. Over one-half (57%) of the expenditures is dedicated to education, with K-14 Proposition 98 education accounting for nearly 45% the total budget plan and Higher Education receiving about 9%. Combined, health and social services programs account for slightly more than one-fourth, while spending on youth and adult corrections accounts for about 9% of the total.

Table 4		General Fund Spending by Major Program Area			
<i>(Dollars in Millions)</i>		<u>Proposed 2003-04</u>			
	Actual 2001-02	Estimated 2002-03	Amount	Percent Change	
Education Programs					
K-12 Education	\$26,755	\$26,373	\$26,320	-0.2%	
Community Colleges } Proposition 98	2,577	2,525	1,906	-24.5%	
Higher Education (CSU and UC)	6,058	5,894	5,622	-4.6%	
Other (e.g. Hastings College)	4,178	3,721	2,052	-44.9%	
Health and Welfare Programs					
Medi-Cal	\$10,005	\$10,844	\$7,147	-34.1%	
CalWORKS	2,016	2,082	1,604	-23.0%	
SSI/SSP	2,793	3,013	2,317	-23.1%	
Other	7,006	7,090	4,079	-42.5%	
Youth and Adult Corrections	\$5,641	\$5,674	\$5,639	-0.6%	
All Other	\$9,722	\$8,246	\$6,085	-26.2%	
Totals	\$76,752	\$75,461	\$62,769	-16.8%	

Source : California Legislative Analyst's Office, February 2003



HIGHER EDUCATION OUTLOOK

The 2003-04 Budget proposes combined general fund support for CSU and UC of \$5.6 billion, which represents a 4.5% decrease compared to the current year. Prior to last year, the Administration has supported a budget agreement or "partnership" with higher education. The partnership as originally defined includes an annual increase of 4%, plus additional funding for enrollment growth and long term budget needs, capital outlay and selected high priority initiatives. In return, the CSU agreed to certain accountability goals. Regretfully, as a result of the slowing in the State's economy, the funding agreement was not being fully funded by the Governor for 2003-04 and both the UC and the CSU have had to share in the budget reductions necessitated by decline State revenues. The budget reductions are offset with revenue generated by increased student fees. The budget includes no funding for COLAs, nor does it include any major new initiatives. However, it does fund enrollment growth of about 7% at UC and CSU. The budget assumes that resident student fees at UC and CSU would increase 25% in the budget year and significantly expands various financial aid programs operated by the Student Aid Commission, UC, and the CSU.

GOVERNOR'S PROPOSAL FOR THE CSU, JANUARY 2003

Overall, the Governor's budget plan proposed that the CSU's general fund budget be reduced by \$326 million, including a \$59.6 million reduction that was imposed at mid-year. The Governor also announced that the \$43 million reduction to the CSU originally set as a one-time cut would now be permanent and that no new funding will be provided for system-wide mandatory costs of \$78.6 million. The total net general fund impact for the CSU will be \$447.7 million, a 17% decrease in resources from the level originally approved for 2002-03.

The Governor's Budget also included a proposal to increase the State University Fee by 25% for undergraduate students, and 20% for graduate students in addition to the 10%/15% adopted for spring 2003. System-wide, this proposed fee increase would become effective in fall 2003 and generate revenues of about \$200 million, net of financial aid, or about 7%, mitigating the net budget reduction impact to roughly 10%. The Governor's budget also recommends \$150 million for enrollment growth.

MAY REVISION TO THE GOVERNOR'S BUDGET

Each year, the Department of Finance re-exams and revises its projection of revenues after the tax period has closed. This forecast, known as "the May Revision", provides updated economic and revenue forecasts, as well as the latest caseload, enrollment and population information for programs in the health and welfare, education and public safety areas. The May Revision has traditionally been considered to be an important milestone in the budget process and it is usually the benchmark for the final budget. This year, however, the May Revision represents the new point of departure for the Legislature and the Governor.

The May Revision reflects a \$3.6 billion increase in the budget shortfall, largely due to a projected increase in caseloads and cost factors including Medi-Cal, developmental services, and corrections. Table 5 reflects the comparison of the Governor's budget plan in January as compared to the May Revision. The most significant factor is the Governor's revised budget plan reflected a major change in how the administration proposes to deal with the State's budget shortfall. The Governor's revised plan adopts a multiyear approach to addressing the budget problem, relying more on borrowing and less on near-term spending reductions than the January proposal. Adoption of the plan would likely result in a balanced 2003-04 budget, but would leave the State with the continued problem of structural imbalance between ongoing revenues and expenditures in the future.

Table 5				
Governor's Proposed Budget Solutions				
General Fund				
<i>(Dollars in Billions)</i>				
Type of Solution	January 2003 Governor's Budget Plan	Changes Included in The May Revision	Total Solutions	
			Amount	% of Solution
Spending Reductions	\$20.7	-\$1.8	\$18.9	49.5%
Realignments	\$8.2	-\$6.5	\$1.7	4.4%
Fund Shifts	\$1.9	\$0.2	\$2.1	5.5%
Transfers/Loans/Borrowing	\$3.8	\$1.0	\$4.8	12.6%
Debt Financing		\$10.7	\$10.7	28.0%
Total Proposed Solutions	\$34.6	\$ 3.6	\$38.2	100.0%

Source : California Legislative Analyst's Office, May 2003

The May Revision would, if adopted and its assumptions realized, result in a large General Fund operating deficit in 2004-05 of \$7.9 billion. This operating deficit would persist over time and grow modestly, absent corrective actions.

THE LEGISLATIVE BRANCH OF STATE GOVERNMENT

Upon issuance of the Governor's proposed budget, the budget committee of each house of the Legislature assigns a subcommittee to analyze and develop independent recommendations regarding the budget. The parent committees adopt the subcommittee's recommendations, which are then sent to the floor of the respective house for action. After the Assembly and Senate have adopted budget plans, a Joint Conference Committee comprised of members from both houses is assembled to resolve differences between the two versions of the budget.

Once a compromise budget plan has been developed and ratified by both the Assembly and Senate, it is presented to the Governor for signature. As of this writing, the legislature remains in session and it is too early to predict the outcome and timing of the final budget.

THE CALIFORNIA STATE UNIVERSITY

Given the seriousness of the fiscal conditions, it was questionable if any elements of a budget request could be funded. Nonetheless, in October 2002, the CSU submitted its 2003-04 budget request to the Governor seeking \$408 million in increased resources: \$137.7 million for 5% enrollment growth, \$121 million for employee compensation, \$78.6 million in mandatory costs; \$35.6 million for Assembly Concurrent Resolution 73, \$26.5 million for technology/libraries/deferred maintenance, and \$10 million for other special CSU initiatives.

Enrollment was the largest component of the budget request, outlining the funding need for a 5% enrollment growth equaling 12,030 full-time equivalent students (FTES). For Long Beach, our 2003-04 enrollment target has been set at 28,650 FTES, which is a 2,029 FTES (7%) increase over the current year enrollment target and about 900 FTES over our actual enrollment in the current year.

PRELIMINARY CAMPUS ALLOCATION

The Chancellor's Office issued preliminary campus budget allocations in March 2003, reflecting a \$23 million general fund increase for Long Beach, together with unfunded mandatory costs, bringing the total impact to \$34 million. Revenues expected from the proposed fee increase (\$11 million), together with new enrollment growth funding (\$15 million) and advanced planning in the prior year, provide substantial solutions for the proposed base budget reduction. Subsequent to the system office releasing this preliminary allocation, the Governor released the May Revision. There were no substantive changes to the CSU budget. However, several alternative budget proposals in the Legislature call for additional cuts to the CSU system beyond those proposed in the Governor's January and May budgets and it is very likely that the CSU will experience additional cuts on top of the \$440 million from the January budget. In June 2003, the Legislative Conference Committee proposed an additional \$69.5 million reduction to the CSU. Should this occur, the Chancellor intends to request an additional 5% increase in the State University Fee, beyond that which is proposed in the Governor's January Budget to partially offset this additional cut. The revenue generated by this further increase is estimated to be \$25 million, net of financial aid, leaving a \$45 million shortfall that would be covered by "rolling back" the additional over-enrollment funding provided to the campuses as part of the January Budget.

Our campus' share of the additional \$69.5 million reduction is estimated to be \$7.2 million, represented by the \$2.5 million in additional revenues from the 5% proposed increase in student fees, and the loss of loss of \$4.7 million in enrollment funding.

LOCAL CAMPUS CONDITIONS

Early in the planning process, the campus' local budget planning process judged that there would be a high probability that the actual budget would be leaner. Therefore, it was important that the campus be prepared for reductions, which might include a base budget cut.

Given the considerable uncertainty about the economy and the politics associated with the State Budget, the RPP Task Force believed that it was necessary to develop a flexible budget plan that would be capable of responding to changing conditions. Therefore, the Task Force has recommended the campus plan for three different scenarios:

1. **4% Reduction Plan based on the Governor's January Budget.** Should the Governor's Budget be adopted, a 4% reduction to all non-instructional units will be imposed. The instructional program has been held harmless from this first phase of budget reductions. Under the 4% reduction plan, non-instructional units are expected to protect mission-critical services and avoid formal layoff of permanent/probationary faculty and staff. No new funding requests will be considered.
2. **7% Reduction Plan.** One-time, temporary savings from university-wide budgets and excess revenues have been reserved to offset an additional 3% reduction in the final budget. Both instruction and non-instructional units will be protected in 2003-04 from the additional budget reduction. However, since the reductions in our State operating budget are permanent, and this phase of our plan utilizes temporary savings not available in future years, the permanent solution must be finalized in the next budget cycle.
3. **10% Contingency Plan.** Should the final outcome require additional cuts beyond the 7% plan, all instruction and non-instructional units will participate in this next level of reduction. Planning would only be implemented to the level required to balance the budget.

CONCLUSION

It is very possible that the passage of the final budget could be delayed. The Chancellor and the Board of Trustees are working with the Legislature and the Governor's Administration to maintain funding for the system as close to the May Revision as possible. However, recent actions by the Legislature indicate that it is highly probable that the CSU will experience further reductions beyond that contained in the Governor's Budget, but still within the planning provided by the campus.