

**CALIFORNIA STATE UNIVERSITY, LONG BEACH
2004-05 RESOURCE PLANNING PROCESS**

BUDGET OUTLOOK

PURPOSE

This Budget Outlook summarizes the fiscal assessment of the State, CSU System, and campus for 2004-05, 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

Generally, there is significant momentum for the U.S. and California economies. For nearly two years following the 2001 downturn, the U.S. economy expanded at a slow and uneven pace. The recovery was concentrated in consumer-durable purchases and home construction boosted by historically low interest rates and federal tax cuts. Business investment joined the expansion in the second half of 2003 and is expected to continue throughout 2004-05. The one major exception to these positive trends is employment growth, which continues to lag. This delay has not held back the total recovery thus far, but if it continues into the budget year it could undermine consumer and business confidence and spending which are key elements to the overall economic expansion.

California's economy also is on the rise. California's home markets remain strong, with sales and price levels at all-time highs. Permits for new construction totaled 193,000 units in 2003, which was the highest level since 1989. Most California regions reported rising consumer confidence, as well as being more optimistic about the future. The current rebound in computer and software spending is benefiting California-based high tech companies, many of which have been reporting major increases in sales and profits in late 2003 and early 2004. These improvements boost the firms' stock prices, which will

eventually result in renewed California income from stock options granted in previous years. Exports are of particular importance to California manufacturers, since a significant share of their products is sold in foreign markets. But foremost among the positive signs is an improvement in state personal income growth, which has increased more rapidly than in the nation. The main factors behind this acceleration are renewed job growth, moderate wage increases, and the increase in stock-option income. The forecast assumed that interest rates and inflation would rise some, but remain low by historical standards.

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 U.S. Gross Domestic Product (GDP) is projected to increase 2.9% in 2003 and 4.2% in 2004. State personal income is projected to increase by an estimated 5.6% in 2004 before mildly accelerating to a 5.9% pace in 2005. It is expected that California's economic recovery will continue to strengthen in 2004, with growth in employment, personal income, and taxable sales accelerating from 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, but will more than likely remain close to 6.5%. Since the release of the Governor's Budget in January, positive signs in the economy have continued to increase and troubling ones have grown fewer.

Table 1			
Summary of the Budget's Economic Outlook			
	<u>Actual</u>	<u>Forecast</u>	
	2003	2004	2005
United States Forecast			
Percent Change in:			
Real GDP	2.9%	4.2%	3.6%
Personal Income	3.2	5.1	5.8
Wage and Salary Employment	-0.2	1.3	2.1
Consumer Price Index (CPI)	2.3	2.0	2.3
Unemployment rate (%)	6.0	6.0	5.8
Housing Starts (000)	1,790	1,720	1,630
California Forecast			
Percent Change in:			
Personal Income	3.8%	5.6%	5.9%
Consumer Price Index (CPI)	2.4%	1.9%	2.7%
Unemployment rate (%)	6.7	6.7	6.5
New Housing permits (000)	194	192	198

Source: California Legislative Analyst's Office – February, 2004

GOVERNOR'S PROPOSED BUDGET – JANUARY 2004

When the 2004-05 Governor's Budget was presented to the Legislature on January 9th, the projected General Fund budget gap was slightly over \$17 billion, most of which represented an ongoing structural imbalance between current law revenues and expenditures in 2004-05 and beyond. The Governor's proposed solution plan is a combination of major and wide-ranging spending reductions, additional borrowing, and a diversion of local property taxes for the benefit of the State. The Governor's plan does not include new taxes as part of the solution. It is important to note that the plan only partially addresses the underlying structural budget problem projected beyond the budget year.

A key element of the Governor's plan was the assumed approval of a \$15 billion economic recovery bond on the March 2004 statewide ballot to pay off the accumulated 2002-03 budget deficit and help address the remaining budget shortfall. In March, the voters did approve Proposition 57—The Economic Recovery Bond Act that refinanced a portion of the inherited debt, as well as Proposition 58—a constitutional amendment to require balance budgets in the future.

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

- *Revenues.* For the current year (2003-04), revenues are projected to grow from \$74.6 billion (exclusive of any economic recovery bond proceeds) to \$76.4 billion in 2004-05 – an increase of 2.4%.
- *Expenditures.* For the current year (2003-04), expenditures are projected to decline from \$78 billion to \$76.1 billion in 2004-05.
- *Operating surplus (revenues in excess of expenditures).* The cumulative year-end reserve is projected to be \$635 million.

Table 2			
Overall Summary of the Governor's Budget			
General Fund			
<i>(Dollars in Billions)</i>			
	02-03	03-04	Proposed 04-05
Prior-year fund balance	- \$1.5	\$1.6	\$1.2
Revenues and transfers	71.3	74.6	76.4
Bond Proceeds	9.2	3.0	
Total resources available	\$79.1	\$79.2	\$77.6
Expenditures	\$77.4	\$78.0	\$76.1
Ending fund balance	\$1.6	\$1.2	\$1.6
Encumbrances	0.9	0.9	0.9
Reserve	\$0.7	\$0.3	\$0.6

Source: California Legislative Analyst's Office, Feb 2004

REVENUES (Table 3):

A key determinant of California's current budget outlook is the strength of state revenues. The budget reflects an overall increase in General Fund revenues for the past and current years combined, as well as a projected increase for 2004-05. After four consecutive quarters of negative growth, the California economy began showing signs of improvement in late 2002. During 2003, personal income tax withholding also began to show year-over-year growth, after declining nearly every month since mid-2001. Finally, personal income tax estimated payments are expected to recover, after 11 consecutive quarters of negative growth.

Table 3			
Summary of the Governor's Budget			
General Fund Revenue Forecast			
<i>(Dollars in Billions)</i>			
	Actual	Proposed	
	02-03	03-04	04-05
Revenue Source			
Personal Income Tax	\$32.7	\$35.1	\$38.0
Sales and Use Tax	22.4	23.7	25.0
Corporation Tax	6.8	7.5	7.6
Other Taxes	2.9	2.8	2.6
Other Rev, Transfers, Loans	6.5	5.5	3.2
Totals	\$71.3	\$74.6	\$76.4
Annual Percent Change	-1.3%	4.6%	2.4%

Source: Governor's Proposed Budget, January 2004

For 2004-05, the Governor's budget forecasts that General Fund revenues and transfers will be \$76.4 billion in the budget year, a \$1.8 billion or 2.4% increase from 2003-04. Major taxes are forecasted to increase about 6%, roughly in line with the growth in statewide personal income. In contrast, non-tax revenues and transfers are projected to fall by roughly 44% due to smaller amounts of one-time loans and transfers from special funds.

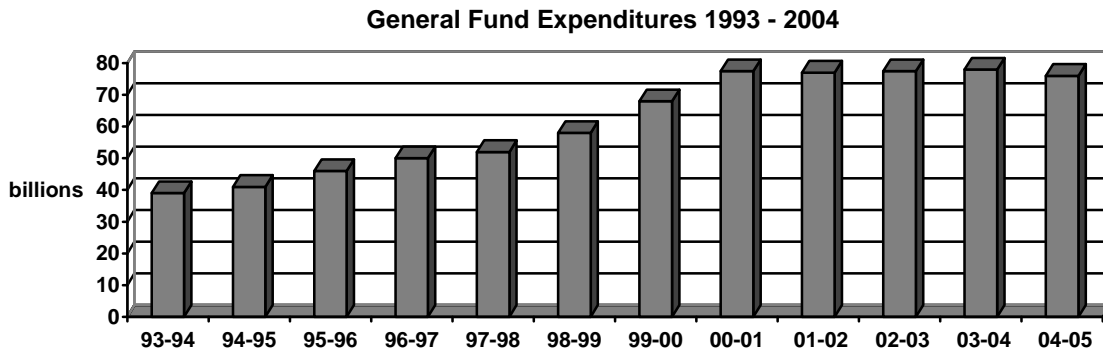
- ③ California's personal income tax, the single most important determinant of state revenues, is expected to contribute about 50% of all General Fund revenues in 2004-05. Current projections estimate revenues will increase by 7.4% in 2003-04, and then increase again in 2004-05 by another 8.3%.
- Sales 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 \$22.4 billion in 2002-03 to \$23.7 billion in the 2003-04 year. About 70% of the tax is remitted by retailers, while the remaining 30% is directly paid by businesses who themselves consume or use the products being taxed. With the passage of Proposition 57, \$15 billion of Economic Recovery Bonds will be sold to fund the accumulated State budget deficit. To repay these bonds, a new one-quarter cent sales tax is to become effective on

July 1, 2004. This sales tax will automatically cease as soon as the bonds are repaid. Because the local portion of the sales tax decreases on July 1, 2004, the total base statewide sales tax will remain at 7.25%.

- Corporation Tax (CT) revenues are expected to contribute 10% of all General Fund revenues in 2004-05. The franchise tax and the corporate income tax are levied at an 8.84% rate 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 in recent years, it appears that profits will expand slightly over the current year.

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 2004-05, 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, spending has been relatively flat since 2001-02. Over the full ten-year period, total General Fund spending is up by roughly \$37 billion, an average annual rate growth of 5.4%.



The Governor’s 2004-05 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 proposed an economic recovery plan, that incorporated solutions are distributed over several major categories and several years. After refinancing the prior years’ debt, the ongoing/accumulative funding gap totaled some \$18.3 billion. The budget plan incorporates most of the Governor’s mid-year savings reductions made in late November 2003, and includes major new savings proposed in 2004-05. Roughly 40% is related to program cuts, and the remaining 60% is related to the economic recovery bonds, transfers, funding shifts, loans and borrowing.

Addressing the Overall \$18.3 Billion Shortfall				
<i>(Dollars in Billions)</i>	2003-04 and Prior	2004-05	Two-Year Total	Percent Of Total
Program Reductions / Savings	\$ 0.8	\$6.5	\$ 7.3	40.0%
Economic Recovery Bond:				
Proceed amounts	0.7	3.0	3.7	20.2%
Reduced debt service	--	1.3	1.3	7.1%
Transfers/Other Revenue	0.9	2.6	3.4	18.6%
Other Loans/Borrowing	1.6	1.0	2.6	14.2%
Totals	\$4.0	\$14.4	\$18.3	100.0%

Source: Governor's January Budget, January 2004

Program Cuts/Savings. The budget contains approximately \$7.3 billion in program reductions and related cost savings in the current and budget years combined. These include a \$2 billion reduction in Proposition 98 spending, a \$950 million reduction in transportation spending related to the suspension of Proposition 42 transfer, a \$1.4 billion reduction in social services, a \$1.1 billion reduction in Medi-Cal, and significant reductions in higher education, backfilled partly by student fee increases.

Economic Recovery Bond. This category accounts for about \$5 billion of total solutions, including about \$3.7 billion in net new borrowing and \$1.3 billion from debt-service savings.

Transfers and Other Revenues. These account for \$1.6 billion of the total solutions and include several one time shifts in revenue to the General Fund, and one-time proceeds from a land sale at the University of California at Riverside.

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 2004-05 General Fund spending by major program area. The spending plan reflects a decline of \$2 billion or 2.5% from the current year's level. Over one-half (51.3%) of the expenditures is dedicated to education, with K-14 Proposition 98 education accounting for nearly 39% of the total budget plan and Higher Education receiving about 7%. Combined, health and social services programs account for nearly one-third, while spending on youth and adult corrections accounts for about 7.5% of the total.

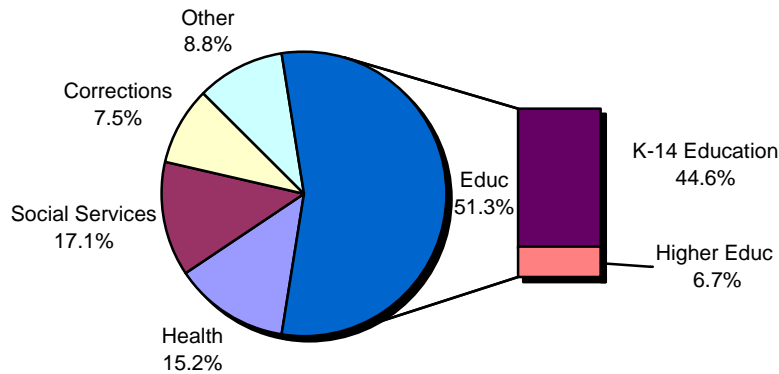
Table 4

General Fund Spending by Major Program Area

(Dollars in Millions)

	Actual 2002-03	Estimated 2003-04	Proposed 2004-05	
			Amount	Percent Change
Education Programs				
K-12 Education	\$26,106	\$27,846	\$27,233	-2.2%
Community Colleges } Proposition 98	2,642	2,244	2,414	7.6%
Higher Education (CSU and UC)	5,874	5,530	5,080	-8.1%
Other (e.g. Hastings College)	3,653	2,660	4,284	61.1%
Health and Welfare Programs				
Medi-Cal	\$10,554	\$9,765	\$11,569	18.5%
CalWORKS	2,078	2,060	1,995	-3.1%
SSI/SSP	3,004	3,144	3,346	6.4%
Other	7,423	7,821	7,689	-1.7%
Youth and Adult Corrections	\$5,837	\$5,326	\$5,732	7.6%
Vehicle License Fee Subventions	\$3,797	\$2,703	\$4,062	50.3%
Transfer to/From Deficit Recovery Fund	--	\$3,012	-\$3,012	--
All Other	\$6,512	\$5,918	\$5,669	-4.2%
Totals	\$77,482	\$78,028	\$76,062	-2.5%

Source : California Legislative Analyst's Office, February 2004



HIGHER EDUCATION (UC and CSU) OUTLOOK

The 2004-05 Budget proposes combined general fund support for CSU and UC of \$5.1 billion, which represents an 8.1% decline in state support as compared to the prior year. The reductions to the University of California totaled \$360 million in allocated and unallocated reductions, partially offset by a \$196 million increase in student fee revenue.

The California State University cuts totaled \$299 million in allocated and unallocated reductions, partially offset by a \$75 million increase in student fee revenue, net of financial aid. The budget includes no funding for COLAs, nor does it include any funding for mandatory costs.

In keeping with legislative intent expressed in the 2003-04 budget package, the Governor's proposal provides no new funding for enrollment growth at either the UC or the CSU. In fact, the Governor proposes to reduce new freshman enrollment at both segments by 10%, with the foregone enrollment begin redirected to the community colleges. In recognition of this diverted enrollment, the Governor's budget plan provides funding for enrollment growth of 3% at the community colleges, which is considerably higher than the statutory growth rate of 1.8%.

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.

The state's near-term fiscal picture brightened significantly in the May Revision, although an imposing structural budget problem still exists that will require further major actions in the future. The updated budget plan assumes a roughly \$3.6 billion increase in resources. It uses these increases to cover various added costs in the budget that have materialized, partly associated with the Governor's withdrawal of certain previously proposed spending cuts in health and social services programs. It also reduces the amount of Economic Recovery Bonds to be sold to cover the 2004-05 budget shortfall, thereby preserving these bond proceeds for use in future years. The updated spending plan also reflects significant new agreements involving local governments and higher education.

Economic developments in recent months have been generally consistent with the administration's January forecast, which called for accelerating income and job growth in California. 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 reflecting a 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. The May Revision would, if adopted and its assumptions realized, result in a balanced budget in 2004-05, and leave the state with enough Proposition 57 bond proceeds to temporarily cover much of the structural budget gap for 2005-06.

Table 5

Governor's Proposed Budget Solutions General Fund

<i>(Dollars in Billions)</i> Type of Solution	January 2004 Governor's Budget Plan	Changes Included in The May Revision	Total Solutions	
			Amount	% of Solution
Spending Reductions	\$7.3	-\$1.9	\$5.4	31.2%
Economic Recovery Bonds	\$5.0	-\$1.0	\$4.0	23.1%
Loans and Borrows	\$2.6	\$1.2	\$3.8	22.0%
Transfers/Other Revenue	\$3.4	-\$0.7	\$2.7	15.6%
Local governmental related	--	\$1.4	\$1.4	8.1%
Total Proposed Solutions	\$18.3	-\$ 1.0	\$17.3	100.0%

Source : California Legislative Analyst's Office, May 2004

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 committees had presented alternative proposals that would restore some funding to higher education, including access and outreach. However, resolution by the Joint Conference Committee was still pending.

THE CALIFORNIA STATE UNIVERSITY

Given the seriousness of the fiscal conditions, it was highly unlikely if any elements of a budget request could be funded. Nonetheless, in October 2003, the CSU submitted its 2004-05 budget request to the Governor seeking \$283 million in increased resources: \$182 million for partnership funding, and \$57 million for mandatory cost obligations.

Regretfully, the Governor was not able to support any of the CSU's budget request. The budget plan reduced the CSU's general fund budget by \$239 million and provided no new funding for some \$57 million in mandatory cost increases. The Governor proposed that a

portion of this reduction be offset through higher fees to be effective Fall 2004: 10% for undergraduates, 40% for graduates, and 20% for non-resident students. The CSU was concerned about the effect that the graduate fee increase will have on the teacher credential program and shared those concerns with the administration. Included in the May Revision, the Governor modified his original plan lowering the graduate student rate increase to 25%, and increasing undergraduate to 14%, which resulted in no overall change in revenue expectations.

A significant feature of the Governor's budget plan was a series of proposed line-item cuts to higher education, including increasing the student-faculty ratio, cuts to outreach programs, eliminating the state subsidy for excess course units, and a deferral in administrative systems implementation costs. Because several of these targeted reductions were either impractical or objectionable, the CSU's strategy was to seek budget flexibility and to inform the Governor and the Legislature about the number of students who could realistically be served with reduced resources. Consequently, the CSU proposed to reduce enrollment by 5%, which is 20,000 headcount or 16,700 full time equivalent students (FTES).

Subsequent to the system office releasing this preliminary allocation, the Governor released the May Revision, which had no changes to the CSU's budget. However, alternative budget proposals by the Legislature suggest some restoration of these cuts.

In conjunction with the May Revision, the Governor also announced a multi-year commitment to higher education, whereby the UC and the CSU would accept the budget cuts in 2004-05 in exchange for budget support in subsequent years. The budget compact is a very welcome development, as the 2005-06 budget year is worrisome due to the high reliance on one-time funding in 2004-05. The agreement, which begins in 2005-06 and continues through 2010-11, provides base funding increases of 3% for the first two years, 4% for 2007-08 and 5% thereafter. Further, enrollment growth funding of 2.5% annually is provided for the duration of the agreement. In return for these funding commitments, the CSU will provide comprehensive annual reports on a variety of student outcome-based performance measures, as well as measures of resource utilization and student data. The agreement also calls for student fee increases in each of the next three years, resulting in undergraduate fees increasing by an average of 10%. With respect to graduate student fees, the UC and the CSU would make progress toward setting the fees at a rate 50% higher than undergraduate rates to better reflect the higher cost of instruction and relative value of the graduate education to the students. Further, the student fee policy contained in the Compact assumes that the UC and the CSU will retain student fee revenue without a corresponding reduction in State funds which, together with State funds would provided each year, will be used to help meet their budgetary needs as well as help the segments recover from the current fiscal crisis. This level of added resources would be very welcome, but the ability of the State to fund the action is questionable.

LOCAL CAMPUS CONDITIONS

The Chancellor's Office issued preliminary campus budget allocations and enrollment targets in March 2004, reflecting a \$20 million decrease in state support for Long Beach, together with \$3.5 million in unfunded mandatory costs. Revenues expected from the proposed fee increase (\$9.6 million) resulted in a net reduction in state funding to \$14 million, which represents a 7.7% decline in state funding. A downward adjustment was made in our enrollment target by about 1800 head count or 1,387 FTES from the 2003-04 original target.

In response to the expected reductions in the campus budget for the coming year, the local planning process developed a plan that consisted of three components:

- A 8% base budget reduction plan total \$14 million that provides for the Governor's January Budget Plan,
- The application of \$6.3 million in division reserves that provides one-year, temporary budget relief, and
- The application of \$8 million in university contingency reserves that provides temporary funding for any further deterioration in our General Fund budget. Any portion of these funds not required for 2004-05, would be carried over to assist with budget planning for 2005-06.

Incorporating temporary solutions into the budget planning strategy minimizes the impact in 2004-05, while allowing time to phase in more permanent solutions for 2005-06. Hopefully, 2005-06 will be less problematic if the State is able to deliver on the terms of the new compact agreement with higher education, which will bring an end to the budget cuts, and the start of some modest budget increases.

CONCLUSION

Although there have been tremendous efforts on the part of the Governor and the Legislature to reach agreement on a final budget during the month of June, statutory deadlines have past and we are now into the new fiscal year without a budget. The Chancellor and the Board of Trustees are working with the Legislature and the Governor's Administration in hopes that the final budget will provide some improvement in funding from the May Revision.