

Comments on Budget Reserves

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Testimony to Senate Budget and Fiscal Review
Committee

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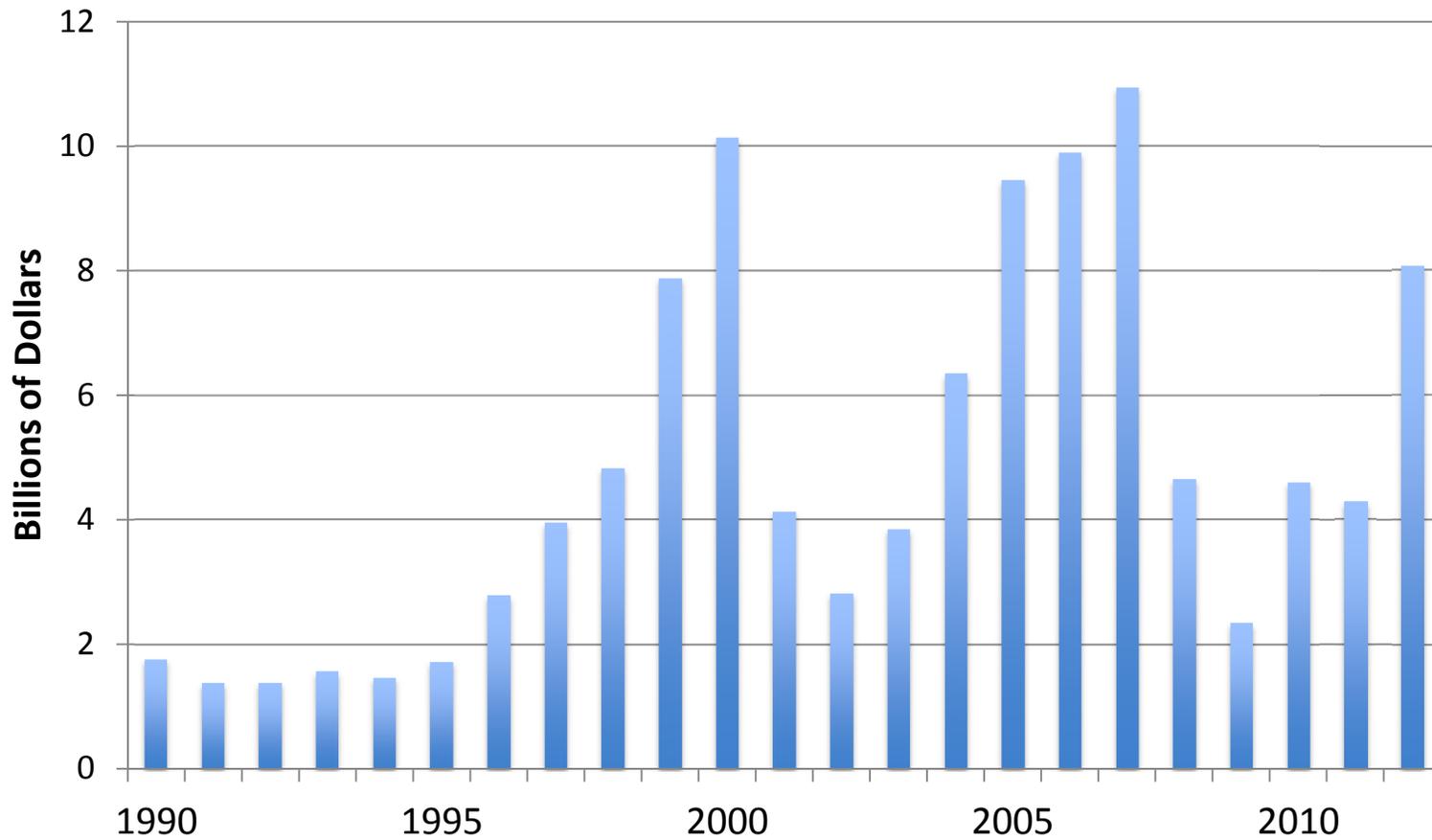
General Comments

- Goals of the reserve proposal are laudable
 - Stabilize program funding.
 - Avoid over-commitment of non-recurring revenues.
- Provisions in Governor's proposal to create a Prop 98 reserve and pay down budget debt make sense.
 - Multiple approaches needed
- But all reserve/restraint proposals come with challenges
 - Will formulas fit changing circumstances?
 - Will what makes sense in theory work in practice?

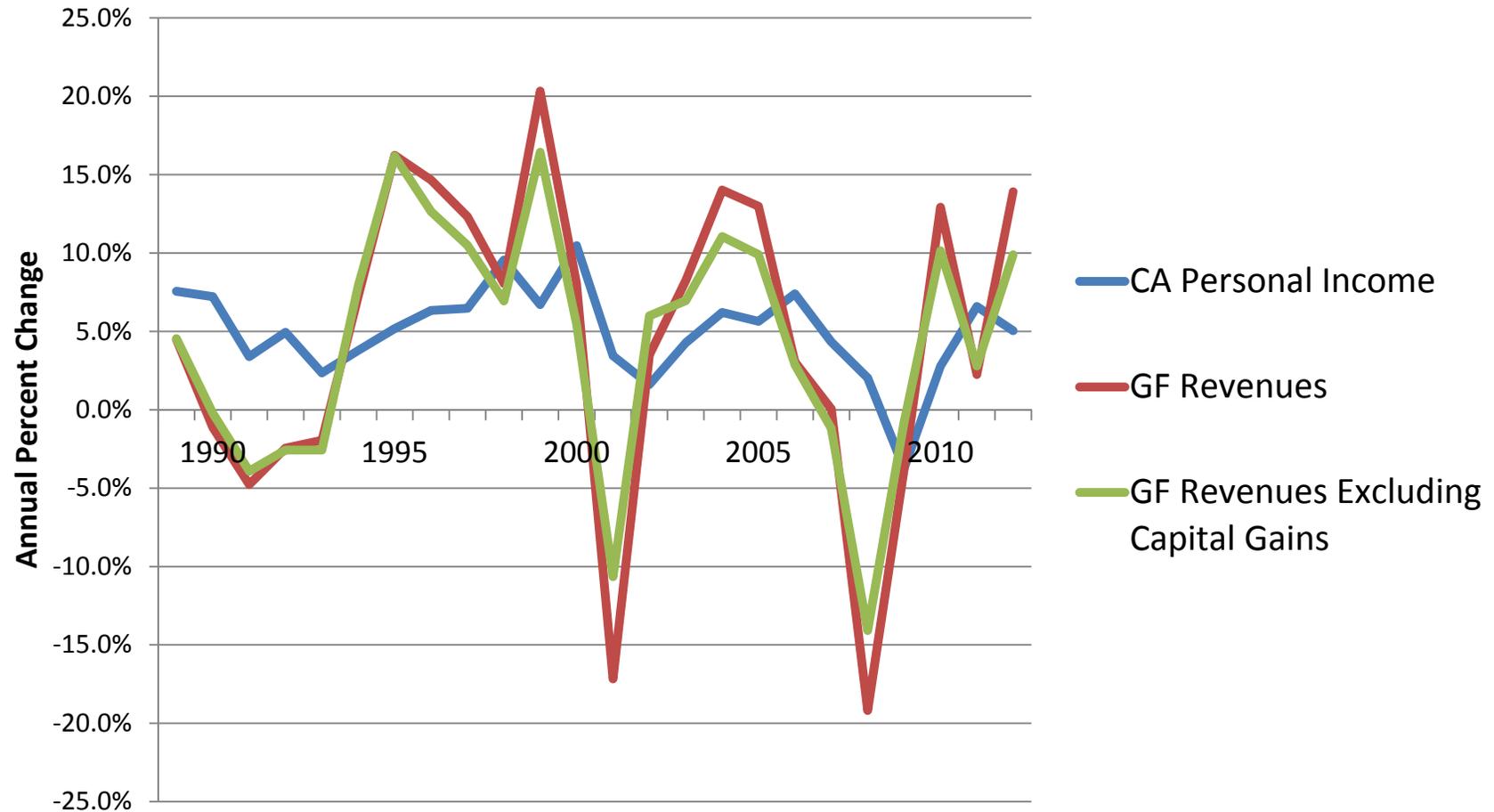
Specific Comments on the Capital Gains Proposal

- Capital gains is a major source of California's extraordinary revenue volatility.
- But it is not the only source
- Using it as a benchmark for reserve contributions has practical challenges:
 - Actual capital gains not known for 2 years after the fact.
 - This has led to major differences in capital gains estimates between LAO and DOF
 - It also raises the question of who would be responsible for determining whether gains are above or below the threshold.

Historical Revenues From Capital Gains



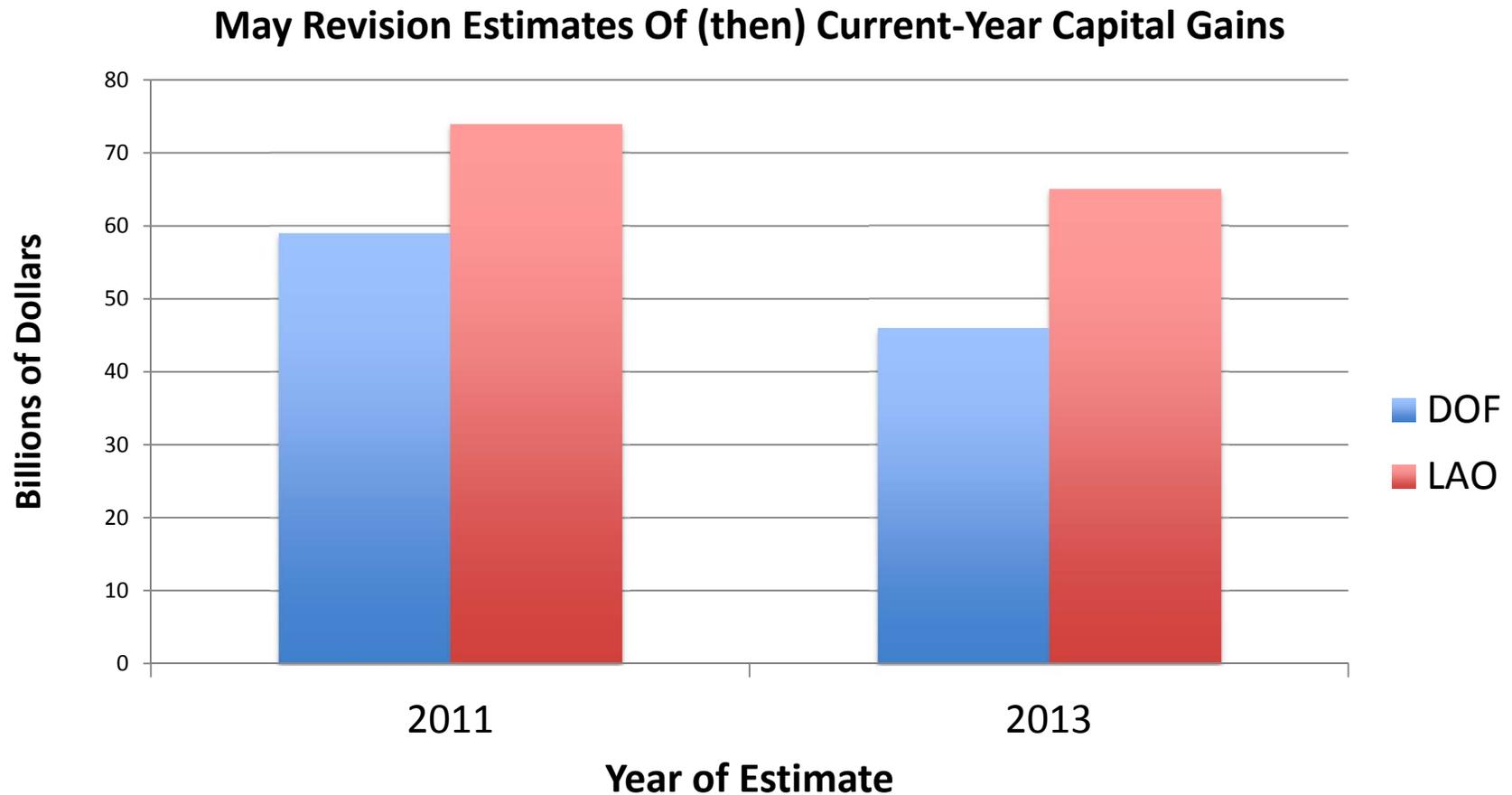
Comparison Of Volatility With and Without Taxation of Capital Gains



Other Sources of Volatile Revenues

- Stock options, bonuses and other non-recurring wage income
- Taxable sales of durable goods and building materials
- Business income

Practical Problem: What Is the Level of Capital Gains This Year?



Concluding Observations

- Annual contributions and meaningful controls on reserve withdrawals are core features of an effective reserve policy
 - Both key to building large reserves
 - Contribution amounts can be based on sliding scale
- Using a more current revenue measure makes sense for determining supplemental reserve contributions
 - For example, total revenues, or major tax revenues, as a percent of personal income
 - Monthly revenue collections by tax known immediately.
 - The exact source of revenues is not that important – many forms of revenues can be viewed as non-recurring under specific circumstances.