# Proposition 2
# Increases State's Rainy Day Fund. Legislative Constitutional Amendment.

## Background

### The State Budget

***How Does the State Spend Its Money?*** This year, the state plans to spend about $250 billion from the General Fund to pay for services to the public. The General Fund is the account the state uses to pay for most public services. About half of this spending is for schools, community colleges, and the state's public universities. (The State Constitution sets a minimum spending level for schools and community colleges.) About another one-third of state spending is for health and human services programs, mainly for the state's low-income health insurance program, Medi-Cal. The rest goes mostly to prisons, courts, and other state services.

***How Does the State Raise Revenue?*** The income tax is the state's largest tax. It pays for most spending from the General Fund. Other major taxes include the corporation tax and the sales tax. Much of the income tax is paid by high-income taxpayers, whose incomes often include gains from stocks and other investments.

***State Revenues Are Unpredictable.*** State revenues go up and down a lot from year to year. This is because revenues depend on how the economy and stock market are doing. When things are going well, revenues can grow quickly. When things are going badly, like during a recession or a stock market crash, revenues can decline by tens of billions of dollars. During a bad recession or market crash, total revenue declines over a few years can equal 50 percent or more of annual General Fund revenues.

***The State Must Meet Certain Budgeting Requirements Each Year.*** The State Constitution requires the Legislature to pass a balanced budget each year. This means the state cannot adopt a budget that spends more money than is available. In addition, the State Constitution limits how much tax revenue the state can spend. This limit is called the "state appropriations limit." Certain kinds of spending—like infrastructure—do not count toward the limit. All other spending, including money put into reserves, does count toward the limit.

## Reserves

***Reserves Allow the State to Maintain Spending When Revenues Decline.*** The state puts money into reserves when the economy is doing well. This means that money is saved instead of being spent on public programs during these periods of time. When the economy gets worse and revenues decline, the state uses reserves to help maintain spending on public programs. Reserves help the state avoid some spending cuts, tax increases, and borrowing to balance the budget. Currently, the state has about $20 billion in reserves that can be used for any public program.

***State Constitution Requires the State to Save Money in the "Rainy Day Fund."*** The State Constitution requires the state to deposit 0.75 percent of General Fund tax revenues in the state's main rainy day fund, which is called the Budget Stabilization Account, each year. Money in the rainy day fund can be used for any state program. In addition, the state must put more money into the rainy day fund in years when revenue from taxes on investment gains is higher than normal. During a budget emergency, the state can stop making deposits and/or take money out of the rainy day fund.

***Savings Are No Longer Required Once the Rainy Day Fund Reaches a Certain Level.*** Once money in the rainy day fund reaches 10 percent of General Fund taxes, the state is no longer required to make additional deposits. The money that would have gone into the rainy day fund instead must be spent on infrastructure (like highways and housing).

### Debt

***The State Has Different Kinds of Debts.*** The state has more than $250 billion in debts. These include debt for infrastructure and pension and retiree health benefits earned by state employees. The state also sometimes borrows money from other state funds to help pay General Fund costs. State debts are repaid over time, usually according to a schedule or plan. Each year, the state makes payments toward its debts.

***State Constitution Requires the State to Make Extra Debt Payments Toward Pension and Health Benefits.*** The State Constitution requires the state to make extra debt payments above those normally made each year. The amount of these extra debt payments is the same as the amount initially deposited into the rainy day fund each year. The state may only use these extra debt payments to pay down long-term pension and retiree health care debts. Making extra payments toward these debts saves the state money in the long run.

***Extra Debt Payments Optional After 2030.*** The requirement for extra debt payments ends in 2030. After that, the Legislature and the Governor could decide to deposit the money for extra debt payments into the rainy day fund instead. Or, the Legislature and the Governor could make smaller extra debt payments and put the rest of the money into the rainy day fund.

## PROPOSAL

***Save More in the Rainy Day Fund.*** Proposition 2 requires the state to make deposits into the rainy day fund until it reaches 20 percent of General Fund taxes (instead of 10 percent of General

Fund taxes). In addition, the state would make even larger deposits in years when revenues from taxes on investment gains are very high, like when the stock market is booming.

***Extend and Expand Extra Debt Payments.*** Proposition 2 also requires the state to make extra debt payments through 2040 (instead of through 2030). These debt payments would be the same as the amount initially deposited into the rainy day fund each year. In addition, the amount set aside for extra debt payments could be used for an expanded set of purposes. Specifically, these payments could be used to make required payments to schools and community colleges, repay borrowing from other state funds, and repay certain loans from the federal government.

***Change How Rainy Day Fund Deposits Count Toward the State Appropriations Limit.*** Deposits into the rainy day fund would not count toward the state appropriations limit. Instead, the money would count toward the limit when it is taken out.

***Change How Other Deposits Count Toward the State Appropriations Limit.*** The state has an account to set aside funds when revenues are surging. By setting these funds aside, the state can avoid overspending when revenue estimates are particularly uncertain. Under Proposition 2, deposits into this account also would not count toward the state appropriations limit. Instead, the money would count toward the limit when it is taken out. This exclusion could not be larger than 10 percent of General Fund taxes in each year.

## FISCAL EFFECTS

***Budget Reserves Would Be Higher.*** By continuing to require deposits into the rainy day fund until the balance reaches 20 percent of General Fund taxes, the state would save more over time. In addition, by depositing more money when revenues are surging, the state likely would save more in the rainy day fund in certain years. More reserves would make balancing the budget somewhat easier when revenues decline.

***Possibly More Debt Payments.*** By requiring the state to make extra debt payments through 2040, the state might make more debt payments than it would without Proposition 2.