- Council Member Land stated that he received an e-mail from Dustin Maple commenting that there is nothing for teenagers to do in Lodi. In response, Mr. Land reported that the City is considering a new skatepark and BMX bike area. Activities offered at Hutchins Street Square include classes in art, photography, dancing, piano, kayaking, scuba diving, water safety, lifeguard certification, first aide, etc. He also mentioned that the Lodi Energy Fair will be held on June 2 and encouraged everyone to attend.

- Council Member Hitchcock expressed concern that housing allocations will be considered in September and the Development Impact Fees still have not been updated.

  Deputy City Manager Keeter reported that the Public Works Department has been working diligently on this and has had several meetings with developers. Questions resulted from public workshops, which have delayed the matter coming to Council until they are resolved.

L. COMMENTS BY THE CITY MANAGER ON NON-AGENDA ITEMS

- City Manager Flynn pointed out that the first Wednesday in July falls on the 4th of July Holiday.

  Following discussion, Council concurred with canceling the Shirtsleeve Session of July 3, the Regular meeting of July 5, and scheduling a Special meeting on July 10, if needed.

  Mr. Flynn distributed copies of the May Governor's Budget Revision for 2001-02 (filed) and noted that the Education Reinvestment Augmentation Fund (ERAF) reduction for Lodi is approximately $125,000.

M. ADJOURNMENT

There being no further business to come before the City Council, the meeting was adjourned at 11:00 p.m.

ATTEST:

Susan J. Blackston
City Clerk

Legislative Analyst's Office, May 16, 2001

An LAO Report

Overview of the 2001-02 May Revision

LAO Findings

- The May Revision reports a $5.7 billion deterioration in the state's fiscal condition that reflects a $4.2 billion downward revision to revenues, about $900 million in added budget costs in non-Proposition 98 programs, and $600 million in added Proposition 98 spending--mostly related to prior-year adjustments.
- The Governor's revenue forecast assumes a much sharper slowdown in California's economy than did the January projection. The administration's revenue estimate is about $650 million below our updated forecast for the current year and budget year combined.
- A critical assumption underlying the plan is that the General Fund will be reimbursed from revenue bonds for the $7 billion plus it has committed for purchasing electricity.
- The revised budget proposal addresses the imbalance by deferring the transfer of General Fund monies for transportation, eliminating or reducing many of the one-time expenditures proposed in the January budget, scaling back funding for other programs, transferring certain special fund balances into the General Fund, and reducing the reserve.
- Although some of the budgetary solutions are ongoing in nature, the vast majority are one time. Thus, while the Governor's plan would result in a balanced budget in 2001-02, we estimate that the state would likely face a further shortfall of roughly $4 billion in 2002-03.

Legislative Considerations

- Aside from determining the extent to which the May Revision matches its own budget priorities, the Legislature needs to decide whether to adopt deeper ongoing budget reductions this year in order to address the large ongoing imbalance between revenues and expenditures in the future.

Introduction

In striking contrast to the past several years, the 2001-02 May Revision reflects a sharp deterioration in the state's fiscal picture. As we reported to the Legislature last week, slower near-term economic growth and recent weakness in the stock market have led to a sharp decline in the revenue outlook. This, coupled with added costs in a variety of budget areas, has necessitated significant changes to the Governor's January budget proposal. This report discusses the administration's new fiscal projections, the ways it proposes to address the state's multibillion dollar budgetary imbalance, and considerations for the Legislature as it evaluates the Governor's new plan.

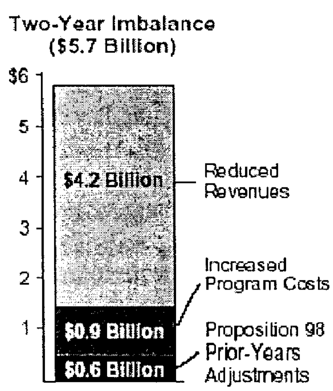
The May Revision Overview

The administration estimates that its January budget plan has fallen out of balance by $5.7 billion. As shown in Figure 1, this is due to the combination of a net two-year *reduction* of $4.2 billion in revenues and a net two-year *increase* of $1.5 billion in the January plan's spending requirements. The expenditure increases are due to higher retirement costs, legal settlements, energy costs, and prior-year Proposition 98 requirements.

Figure 1

Budgetary Imbalance and Proposed Solutions

2000-01 and 2001-02, General Fund



Proposed Solutions	
Reduced reserves	$1.4
Transportation funding shift	1.3
Reduced one-time spending proposals	1.3
Other special fund transfers	0.5
Reduced Proposition 98 ongoing spending	0.3
All other[a]	0.9

[a] Includes current-year adjustments.

As indicated in the figure, the Governor proposes to solve the budgetary imbalance through a variety of measures, including:

- Reduction in the budgetary and litigation reserves by a combined total of $1.4 billion.
- Redirection of monies from transportation funds into the General Fund, saving $1.3 billion in 2001-02 and $1.2 billion in 2002-03. These savings are achieved through a two-year postponement in the transfer of sales taxes on gasoline to transportation programs.
- Reduction or elimination of $1.3 billion in one-time spending proposals in the areas of local fiscal relief, housing, clean beaches, and flood control. Also, there is a shift of

$370 million in nontransportation capital outlay project funding from direct General Fund appropriations to debt financing.
- Transfer of about $500 million in non-transportation special funds to the General Fund in 2001-02.
- Reduction in ongoing Proposition 98 spending of about $255 million from January's proposed level.
- Other reductions in the current year and budget year totaling $900 million.

The administration's proposal assumes that the General Fund outlays for the purchase of electricity will be reimbursed by the sale of the revenue bonds authorized by Chapter 4x, Statutes of 2001 (AB 1x, Keeley) and Chapter 9x, Statutes of 2001 (SB 31x, Burton).

General Fund Condition

Figure 2 shows the Governor's projections for the General Fund condition taking account of the above factors. It indicates that under his revised projections and proposed actions for dealing with the budgetary imbalance, the General Fund would end 2000-01 with a positive reserve balance of $5.9 billion and 2001-02 with a positive reserve of $1 billion--the latter being 1.4 percent of revenues. Both revenues and expenditures are anticipated to decline between the current year and budget year.

Figure 2

Governor's May Revision General Fund Condition

2000-01 Through 2001-02
(In Millions)

	2000-01	2001-02
Prior-year fund balance	$8,848	$6,645
Revenues and transfers	78,043	74,842
Total resources available	$86,891	$81,487
Expenditures	$80,246	$79,676
Ending fund balance	$6,645	$1,811
Encumbrances	701	701
Set-aside for legal contingencies	7	100
Reserve	**$5,937**	**$1,010**

Detail may not total due to rounding.

We now turn to a more detailed look at the May Revision's economic and revenue projections, spending proposals, and proposals to address the budgetary imbalance.

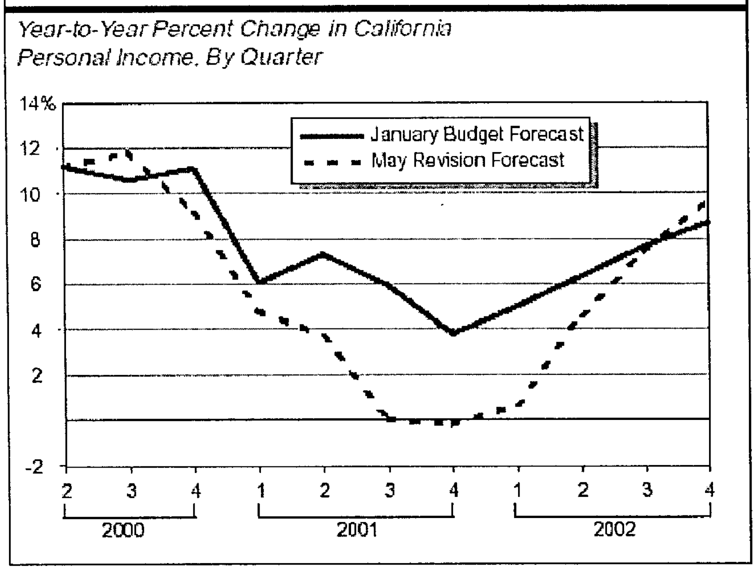
Economic and Revenue Assumptions

Economic Outlook

The administration's updated economic outlook assumes a much sharper slowdown in California's economy than it did in its January projections. As shown in Figure 3, year-over-year increases in California's personal income are forecast to slow from nearly 12 percent in early 2000 to around zero percent in late 2001, before partly rebounding in 2002. A similar sharp slowdown in taxable sales is also projected for 2001. The decline in personal income partly reflects the general slowdown in employment anticipated for 2001. However, a major factor is also the expected sharp decline in stock option-related income this year.

Figure 3

Sharp Economic Slowdown Expected



Revenue Outlook

Consistent with the steeper slowdown in the California economy, and stock-market-related options and capital gains income, the administration forecasts that revenues for the current year and budget year combined will fall by about $4.2 billion relative to its January projection. This two-year revision reflects a $1.1 billion increase in 2000-01 revenues--due mostly to higher personal income tax payments attributable to 2000 liabilities--but a $5.3 billion decrease in 2001-02. The single largest source of the budget-year decline is the personal income tax, which is being adversely affected by falling stock options and capital gains. However, the administration's forecasts for sales and corporation taxes are also down sharply, reflecting much lower levels of personal spending, business outlays, and corporate profits during the next 12 months.

Comparison to LAO's Forecast. After adjusting for such factors as transfers, fees, and tax-law changes assumed in the May Revision, the administration's forecast is below the estimate we provided to the Legislature last week by about $276 million in the current year and $373 million in the budget year, or about $650 million total. Over the two years combined, the administration assumes higher personal income tax receipts, but lower revenues from sales and corporation taxes.

Spending by Major Program Area

Under the proposed May Revision, General Fund spending would fall 0.7 percent in 2001-

02. Underlying this modest decline in aggregate spending are sharply diverging trends among major program areas. As shown in Figure 4, spending in the single largest budget area--K-12 education--is proposed to increase by over 7 percent, while the spending areas of resources, transportation, housing, and the "all other" category are proposed to decline significantly, reflecting a sharply lower level of one-time budget-year spending. The Governor's funding proposals for two major areas are discussed below.

Figure 4

Summary of May Revision Spending Proposal General Fund

(Dollars in Millions)

		2001-02	
Program/Agency	**2000-01 Amount**	**Amount**	**Percent Change**
Education Programs			
K-12-Proposition 98	$27,246	$29,229	7.3%
Community Colleges--Proposition 98	2,680	2,865	6.9
UC/CSU	5,824	6,138	5.4
Health and Social Services	20,128	21,852	8.6
Youth and Adult Corrections	5,199	5,300	1.9
Business/Transportation/Housing	2,579	746	-71.1
Resources/Environmental Protection	2,950	1,756	-40.5
All Other	13,640	11,790	-13.6
Totals	**$80,246**	**$79,676**	**-0.7%**

Transportation

The May Revision proposes to modify the financing of the Traffic Congestion Relief Program (TCRP) in order to free up a total of $2.5 billion for General Fund expenditures over the budget year and 2002-03. In 2000, the Legislature and administration enacted the TCRP, which provided $2 billion in General Fund monies to the Traffic Congestion Relief Fund (TCRF) in 2000-01. Additionally, the program transfers gasoline sales tax revenues that previously were deposited in the General Fund to transportation purposes for 2001-02 through 2005-06. Of the amount transferred annually, $678 million is deposited in the TCRF to fund 141 designated transportation projects, while the remainder of gasoline sales tax revenues is deposited in the Transportation Investment Fund (TIF) and distributed 40 percent to the State Transportation Improvement Program (STIP), 40 percent to local street and road repairs, and 20 percent to the Public Transportation Account (PTA). The proposal:

- Postpones the transfer of $2.3 billion in General Fund revenues for transportation purposes, including $1.1 billion in 2001-02 and $1.2 billion in 2002-03. Transfers would begin in 2003-04.
- Provides a $238 million loan to the General Fund from TCRF to be repaid beginning in 2004-05.
- Extends the program for two years--until 2007-08--providing an estimated $517 million

above the estimated program total under current law to compensate for the postponement of the transfer of funds.

Proposal Intends to Meet Projects' Cash-Flow Needs. With regard to the 141 designated projects, the proposal is designed to meet their cash-flow and schedule needs by borrowing from other transportation funds--specifically the State Highway Account (SHA) and the PTA. These loans would then be repaid beginning in 2006-07. The proposal also anticipates an additional loan of $100 million from the Motor Vehicle Account in 2004-05.

Local Streets and Roads Held Harmless; PTA and STIP Take Short-Term Hit. The proposal affects the remainder of the TCRP as follows:

- Maintains local street and road funding at amounts specified in current law, but uses the SHA instead of TIF for 2001-02 and 2002-03.
- Eliminates the TIF transfer to PTA in 2001-02 and 2002-03 ($77 million and $100 million, respectively). As a result, the State Transit Assistance program, which funds transit operators, would receive $38 million less than under current law in 2001-02.
- Eliminates TIF transfer to STIP for 2001-02 and 2002-03 (a cumulative total of $354 million).

Issues for Legislative Consideration. Our preliminary review of the TCRP financing proposal raises the following issues:

- The proposal could negatively impact delivery of the STIP or the State Highway Operation and Protection Program in the next few years because SHA and PTA funds will be used to meet TCRP needs.
- There would be no uncommitted PTA funds available for new transit capital projects for 2001-02 and 2002-03. Earlier estimates projected an uncommitted PTA balance of $264 million in the budget year.

Proposition 98--K-12 Education

The May Revision proposes a complicated set of adjustments to General Fund spending for Proposition 98 programs. For the current year, the May Revision proposes a net General Fund increase of $54 million, primarily to (1) offset a downward revision in estimated property tax allocations to local education agencies and (2) cover an average daily attendance (ADA) increase of about 12,000 pupils. For the budget year, the May Revision proposes a net General Fund decrease of $255 million. This change includes increases for higher ADA growth (about 30,000 more pupils than estimated in January) and a new block grant proposal for low-performing schools ($220 million). It also includes numerous other augmentations and reductions, the most significant of which are listed in Figure 5.

Figure 5
May Revision Changes in K-12 Proposition 98 Spending--Ongoing Funds
2001-02 (In Millions)

	Augmentation	Reduction
High priority students block grant	$220	--
Property tax backfill	108	--
Attendance increase	102	--
Immediate intervention/underperforming schools	49	--
Math and reading professional development	--	$175
Caseload decreases (voluntary programs)	--	162
Shifts to one-time funds	--	140
Governor's performance awards	--	123
High school exit exam	--	46
Longer middle school year	--	35

In addition to the above changes to current-year and budget-year Proposition 98 appropriations, the May Revision proposes a one-time General Fund allocation of $541 million for energy conservation investments and energy costs at K-12 schools. This allocation is needed to meet Proposition 98 minimum funding requirements for 1995-96 through 1997-98 that have been revised as a result of new census data. Because these funds would be distributed to school districts in the budget year, the Governor counts these funds as part of his Proposition 98 per-pupil estimate of $7,168 in 2001-02. If the $541 million is counted on an appropriations basis rather than a cash-flow basis, the May Revision Proposition 98 amount is $7,075 per pupil. This is $99 less than the $7,174 proposed in the January budget and $397 (5.9 percent) more than the $6,678 revised per-pupil amount for the current year.

Considerations for the 2002-03 Fiscal Year. The Governor's revised spending proposal for Proposition 98 programs raises potential concerns for the 2002-03 fiscal year. Our preliminary analysis indicates that the minimum amount (General Fund and local property tax) that will be required for allocation under Proposition 98 in 2002-03 will be approximately $2.4 billion higher than the amount proposed for expenditure in 2001-02 by the May Revision. We estimate that *at least* this amount will be needed in 2002-03 to fund (1) enrollment growth and cost-of-living adjustments, (2) planned increases in the Longer Middle School Year program and the Math and Reading Professional Development Program, and (3) program requirements being met in the budget year by one-time monies. Thus, the Governor's revised spending plan leaves essentially no room for error or for new programs or program expansions in K-12 education, unless the Legislature modifies the budget year spending plan or "over-appropriates" the Proposition 98 guarantee in 2002-03.

One-Time Expenditures

The May Revision eliminates or reduces many of the one-time spending proposals included in January, for a savings of roughly $1.3 billion. Key proposals affected include housing incentives ($200 million), local fiscal relief ($250 million), Clean Beaches ($90 million), and River Parkway initiatives ($35 million). The plan also reduces direct appropriations for capital outlay by about $460 million, by deferring some projects and shifting support for others to bond proceeds.

The Outlook Beyond the Budget Year

While the May Revision proposal would eliminate the estimated 2001-02 shortfall, it is not a comprehensive solution to the budget problem that has emerged. This is because the May Revision relies most heavily on *one-time* solutions, even though the revenue shortfall in the budget year is *ongoing* in nature. Specifically, even if the economy and state revenues rebound in 2002, revenues in 2002-03 would likely fall below expenditures by roughly $4 billion. This implies that the Governor and Legislature would need to make substantial budgetary reductions in future years. Thus, in considering the May Revision the Legislature will need to decide not only whether it agrees with the Governor's basic spending priorities, but also whether it agrees with the Governor's proposed mix of one-time versus ongoing budgetary solutions.

Acknowledgments	**LAO Publications**
This report was prepared by Brad Williams and Jon David Vasché, with contributions from others in the office. For questions, contact the authors at (916) 324-4942. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.	To request publications call (916) 445-2375. This report and others, as well as an E-mail subscription service, are available on the LAO's Internet site at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.

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Filed 5-16-01

May GOVERNOR'S BUDGET REVISION

OVERVIEW

The May Revision to Governor Davis' January Budget provides updated economic and revenue forecasts, as well as the latest caseload, enrollment, and population information for programs in the education, public safety, and health and human services areas.

Although California's economy remains strong, the rate of economic growth has slowed, and the stock market has experienced steep declines. Accordingly, anticipated tax revenues, particularly from capital gains and stock options, have been significantly reduced in this budget forecast. The May Revision projects that revenues in the current year will be above the January forecast by $1.144 billion in 2000-01 and below the January forecast by $4.592 billion in 2001-02, for a combined two-year reduction of $3.448 billion.

Consistent with this drop in revenues, the May Revision proposes to reduce General Fund spending by $3.177 billion compared with the January Budget, and proposes a year-over-year reduction of $570 million compared to the current fiscal year.

In spite of lower overall General Fund spending, the Governor's Budget continues to reflect a strong commitment to public education, with K-12 funding increased by $676 million above the January budget proposal.

New initiatives and proposed program expansions in a wide array of other program areas have been scaled back in order to bring the budget into balance and avoid more harmful cuts in programs vital to public safety and health.

The volatility of the stock market and the resulting impact on General Fund revenues underscore the importance of the Administration's emphasis on achieving the appropriate balance of one-time and ongoing spending.

On January 17, 2001, the Governor issued an emergency proclamation due to the financial insolvency of two of the State's investor-owned utilities and rolling black-outs. Subsequently, legislation was passed to authorize advances from the General Fund for the Department of Water Resources to purchase power. Revenue bonds have been authorized for the purpose of repaying the General Fund for the amounts advanced to purchase power. The May Revision assumes that these revenue bonds are sold in mid to late August, resulting in reimbursement of the General Fund at that point.

THE ECONOMY

U.S. economic growth has been slower than expected in recent months, and the national slowdown has begun to affect California. Despite a recent rally, stock prices—especially in the high-technology sector—are lower than projected in January. Additionally, while the energy crisis has not yet directly affected the national or California economy, rising wholesale energy costs are expected to have a ripple effect throughout the western United States. Reflecting these developments, forecasts of most economic indicators have been revised down from the Governor's Budget.

THE NATION

After four years of robust 4 percent growth, the nation's economy slowed markedly starting around the middle of 2000. Real, or inflation-adjusted, gross domestic product (GDP) growth averaged only 1.7 percent at an annual rate during the second half of 2000 and the first three months of 2001. The Blue Chip Consensus forecast for 2001 economic growth has fallen from 3 percent in December to only 1.8 percent in April.

While the initial 2 percent estimate of first quarter growth was better than most analysts had expected, employment declined during both March and April, and the April jobless rate jumped to 4.5 percent from 3.9 percent last November. Thus far, buoyant consumer spending has helped offset weakness in business investment—the main element in the recent slowdown. However, rising unemployment, coupled with unrestrained wholesale energy prices throughout the nation, might trigger a setback in household spending that could halt or even reverse economic growth.

Despite these concerns, most economists believe the U.S. economy is likely to avoid an outright downturn. First quarter GDP included a sharp contraction in business inventories, implying that many companies are preparing for a period of sluggish sales. In addition, the Federal Reserve has acted aggressively to offset developing weakness, cutting short-term interest rates by two full percentage points since the beginning of 2001, with the promise of more rate cuts to come. Lower interest rates have helped avert a slump in housing, which has been a prominent feature of every post-World War II recession.

The nation's large trade deficit is also cushioning the domestic economy from the effects of slower spending. For example, in the first quarter, the falloff in inventories and continued weakness in business equipment spending were offset by a sharp drop in imports. The resultant narrowing of the trade deficit was the main factor in the better-than-expected gain in first quarter GDP. Thus, it appears that declining imports—which boosts GDP growth—may offset some of the weakness in domestic spending.

The remainder of 2001 is expected to see a continuation of recent slow growth in the 0.5 to 2 percent range—well below the economy's estimated 3.5 to 4 percent potential growth rate. In these circumstances, job growth will also remain sluggish, and the unemployment rate is expected to rise to around 5.5 percent by early 2002. Business investment spending will continue to be a drag on growth, reflecting previous over-investment in communications equipment and rising commercial vacancy rates.

By early next year, as the stimulative effects of interest rate cuts begin to take hold, growth is expected to gradually improve to around 3 percent—closer to long-term potential—allowing the jobless rate to edge down.

FIGURE ECON-1

Selected U.S. Economic Indicators

		Forecast	
	2000	2001	2002
Real gross domestic product, (1996 dollar) (Percent change)	5.0	1.3	2.5
Personal consumption expenditures	5.3	2.6	2.8
Gross private domestic investment	10.2	(2.6)	2.2
Government purchases of goods and services	2.8	2.3	2.4
GDP deflator (1996=100) (Percent change)	2.0	2.7	2.0
GDP, (Current dollar) (Percent change)	7.1	4.0	4.5
Federal funds rate (Percent)	6.24	4.55	4.03
Personal income (Percent change)	6.3	4.7	4.4
Corporate profits before taxes (Percent change)	12.5	(6.9)	7.2
Nonfarm wage and salary employment (Millions)	131.4	132.0	132.2
(Percent change)	2.0	0.5	0.1
Unemployment rate (Percent)	4.0	4.8	5.5
Housing starts (Millions)	1.61	1.56	1.50
(Percent change)	(4.2)	(2.9)	(4.1)
New car sales (Millions)	8.9	8.3	8.2
(Percent change)	1.8	(6.5)	(1.2)
Consumer price index (1982-84=100)	172.2	178.0	182.0
(Percent change)	3.4	3.4	2.2

Forecast based on data available as of April 2001.
Percent changes calculated from unrounded data.

CALIFORNIA

The California economy avoided the national slowdown during the second half of 2000, entering 2001 with very strong momentum. The state accounted for more than two-thirds of all new jobs created in the nation on an April 2000-to-April 2001 comparison. Of particular note, manufacturing employment, down by 553,000 nationwide over the past year, actually posted a 12,000-job gain in California on a April-to-April comparison.

Although California's growth continues to outpace the nation by a wide margin, the state is clearly not immune to a nationwide slowdown in economic activity. The early months of 2001 revealed a significant moderation in the state's economic growth. Gains in nonfarm employment, which averaged more than 150,000 each quarter during 2000, slowed to only 41,500 during the first three months of 2001.

In addition, announcements by several of the state's major companies point to a softening in high-tech jobs in the months ahead. However, to an increasing degree, California companies specialize in the advanced stages of design, research, and development, rather than the actual manufacturing of finished goods and components. Because most technology-oriented firms are reluctant to cut future product development, the effects of the weakness in high-technology goods and services are likely to be somewhat muted in California.

The Forecast. Given the recent slowing of job growth, non-farm employment this year is likely to moderate to 2.3 percent growth, down from 3.8 percent in 2000. Even though some pickup is projected in 2002, year average growth is expected to be under 2 percent. The unemployment rate—a lagging indicator—is forecast to edge up to 5 percent this year from a 4.9 percent average in 2000, and rise further to 5.7 percent in 2002.

Construction trends are expected to be mixed. Low interest rates and a large backlog of unmet demand should encourage further gains in new residential construction, with 160,000 new units authorized by building permits in 2001, up from 150,000 in 2000. Next year, homebuilding is expected to reach 166,000 units.

Although California has avoided the commercial construction excesses of the 1980s, slower job growth, coupled with new supply already under construction, will result in rising commercial and retail vacancy rates, which in turn will discourage new construction starts. After several years of strong double-digit growth, nonresidential permit values (not adjusted for inflation) are expected to slow to 6.4 percent growth this year and 2.6 percent in 2002.

The Stock Market and Personal Income. Much of last year's extraordinary income growth reflected a surge in stock option incomes—counted in wages and salaries—reflecting the "bubble" in the technology-heavy NASDAQ index that more than doubled in value between mid-October 1999 and early March 2000. Of the $81 billion increase in wages and salaries last year, the Department of Finance estimates that $34 billion or 42 percent was attributable to the increase in the value of stock options exercised.

As a result of the collapse of this bubble, the projected slowdown in personal income growth—from a 16-year high of 11.5 percent in 2000, to only 2 percent in 2001—is far greater than warranted by the moderation in job gains from 3.8 percent last year to 2.3 percent in 2001. With the NASDAQ having now given up all of the early 2000 gains and then some—in early May the index was down nearly 60 percent from the March 5, 2000, peak—it seems virtually certain that option-generated incomes will fall from last year's elevated levels. However, forecasting this increasingly important but extremely volatile element of income involves assumptions both about stock prices over the remainder of 2001 and about the behavior of option holders.

Lower stock prices reduce the value of each option exercised, especially since the strike price (the price at which the option holder actually "buys" the shares) rises over time. In addition, it seems likely that skyrocketing stock prices last year encouraged the exercise of more options than would have occurred under more ordinary circumstances. Thus, some of last year's options were accelerated from 2001 and future years.

This forecast assumes that option-related incomes drop back to near 1999-levels, representing a decline of about 37 percent, or $31 billion from 2000. This assumption allows for some further recovery in the NASDAQ, which averaged about 2800 in 1999, about 600 points higher than the early May trading range.

To illustrate the impact of this assumption on personal income, if stock option-related incomes were held constant, 2001 personal income growth in this forecast would be 7.6 percent rather than 2 percent. Because much of this option income is taxed at or near the top 9.3 percent personal income tax rate, the effect on General Fund revenues is even larger than implied by the effect on household incomes.

In addition to options, the stock market also affects personal income tax revenues through capital gains on the sale of stocks and the gains realized within mutual funds. These gains are excluded from the economic measure of personal income.

As discussed in the following section, in terms of General Fund revenues, the relatively modest dampening in economic activity as compared to the January Budget forecast is far overshadowed by the stock market assumption.

FIGURE ECON-2

NASDAQ and
California Stock Option Income

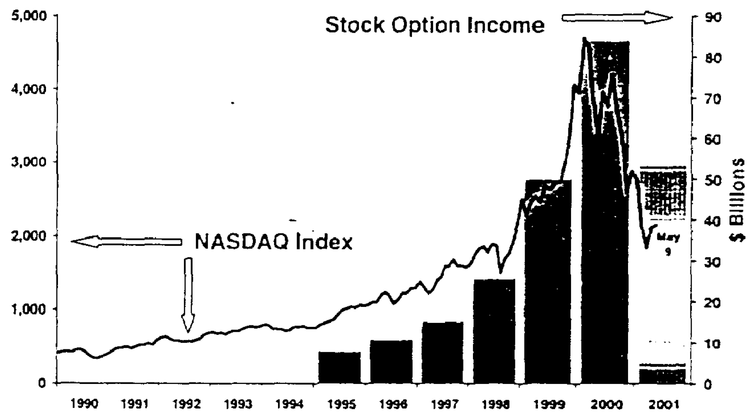

FIGURE ECON-3

Selected California Economic Indicators

	2000	Percent Change	2001 (Forecast)	Percent Change (Forecast)	2002 (Forecast)	Percent Change (Forecast)
Personal income ($ billions)	$1,105.7	11.5%	$1,128.2	2.0%	$1,191.0	5.6%
Nonfarm W&S employment (thousands)	14,525	3.8%	14,864	2.3%	15,116	1.7%
Mining	24	1.0%	24	3.3%	24	-1.9%
Construction	730	7.4%	776	6.2%	813	4.8%
Manufacturing	1,945	1.2%	1,949	0.2%	1,948	-0.1%
High technology	517	0.9%	517	0.0%	515	-0.4%
Transportation/utilities	742	3.1%	758	2.1%	769	1.5%
Whlse & retail trade	3,305	3.3%	3,372	2.0%	3,422	1.5%
Finance group	821	0.4%	831	1.3%	838	0.8%
Services	4,636	5.7%	4,795	3.4%	4,909	2.4%
Government	2,321	3.7%	2,359	1.6%	2,394	1.5%
Unemployment rate	4.9%		5.0%		5.7%	
Housing permits (thousands)	150.3	7.4%	160.4	6.7%	165.8	3.4%
Consumer price index	174.8	3.7%	182.6	4.5%	187.0	2.4%

Forecast based on data available as of April 20, 2001.
Percent changes calculated from unrounded data.