

# Comments on Budget Reserves

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Testimony to Senate Budget and Fiscal Review  
Committee

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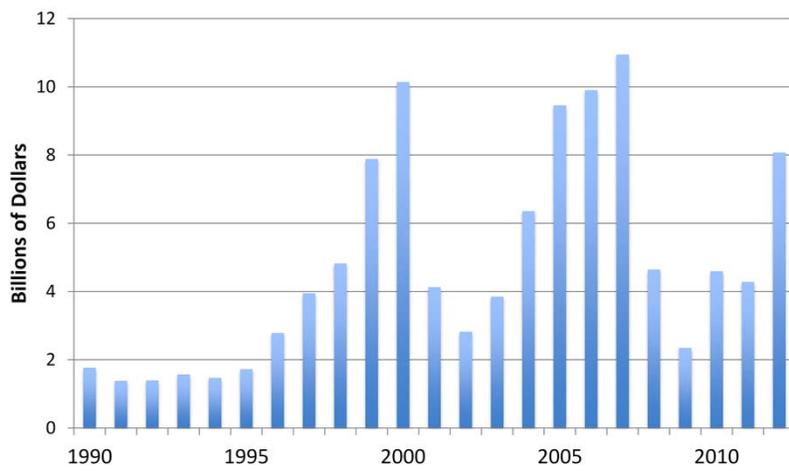
## General Comments

- 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?

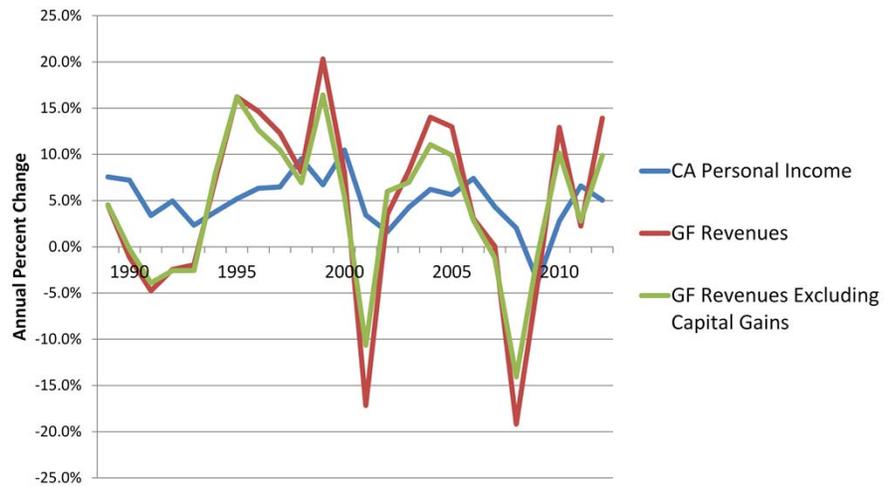
## Specific Comments on the Capital Gains Proposal

- 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



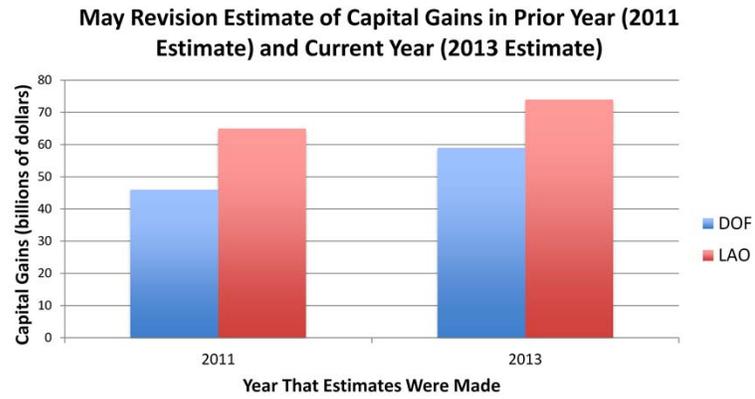
## Comparison Of Volatility With and Without Taxation of Capital Gains



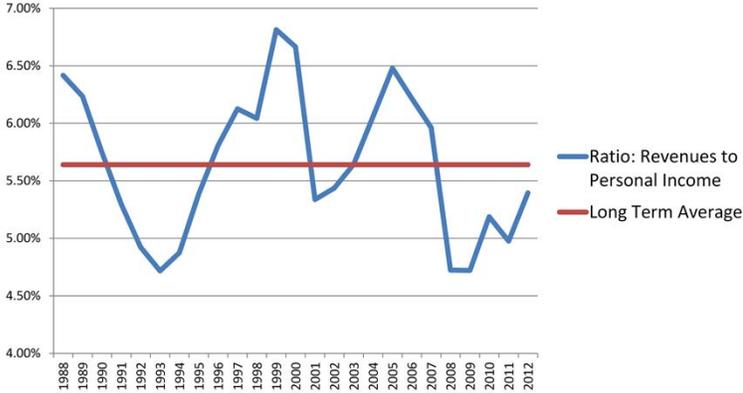
## Other Sources of Volatile Revenues

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

## Even Estimates of Prior- and Current-Year Capital Gains Can Differ Dramatically



# Ratio of Revenues to Personal Income May Be Better Measure For Determining Reserve Contribution Threshold



## 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 currently-available 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.