

# COMMUNITY COLLEGE UPDATE

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

## LAO: Revenue Shortfall to Grow by \$19 Billion

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On May 2, 2024, the Legislative Analyst’s Office (LAO) revised its “Big Three” revenue outlook for California, including April net tax receipts, forecasting that state revenues for the three-year budget window will be \$19 billion below Governor Gavin Newsom’s January estimates. On the same day, the LAO also reported that income tax withholding payments (payments made by employers on behalf of their employees) has rebounded from the trough in January 2023, and is now on track to beat the Governor’s projections, albeit modestly.

Revenue from personal income, corporation, and sales taxes make up the lion’s share of California’s budget resources at just under 95% of total state revenue, with personal income tax revenue comprising nearly 60%. Across all three taxes, receipts are currently performing below January estimates. Moreover, the LAO attributes the recent positive trend in income tax revenue to Wall Street’s recovery over the last six months—indicating that capital gains taxes are buoying what may otherwise be flat or slumping personal income in the wake of steady inflation and rising unemployment.

The 2023–24 fiscal year bears the brunt of the LAO’s \$19 billion additional shortfall across the three-year budget window, with total tax receipts for the current year projected to be \$11.2 billion below the Governor’s estimates.

LAO May “Big Three” Outlook Compared to Governor’s Budget  
(In billions)

	2022-23		2023-24		2024-25		
	Governor's Budget	LAO	Governor's Budget	LAO	Governor's Budget	LAO	Total Difference
<b>Personal Income Tax</b>	\$122.8	\$121.5	\$113.8	\$108.6	\$114.8	\$114.2	\$7.1
<b>Corporation Tax</b>	\$42.1	\$41.3	\$36.9	\$32.4	\$38.3	\$34.9	\$8.7
<b>Sales and Use Tax</b>	\$33.1	\$33.2	\$34.6	\$33.1	\$35.1	\$32.8	\$3.7
<b>Total</b>	\$198.0	\$196.0	\$185.3	\$174.1	\$188.2	\$181.9	<b>\$19.5</b>

### The Proposition 98 Problem

The implications for education funding are significant. Current state revenue trends are likely to keep Test 1 as the operative test that determines the Proposition 98 minimum guarantee for each of the three fiscal years, meaning funding levels will decrease by 40 cents for every dollar reduction in state General Fund revenues.

**Proposition 98 Revised Estimates**  
(In billions)

	<b>Governor's Budget</b>	<b>Impact of LAO May Estimate</b>	<b>Revised Estimate</b>
<b>2022-23</b>	\$98.3	(\$0.8)	\$97.5
<b>2023-24</b>	\$105.6	(\$4.5)	\$101.1
<b>2024-25</b>	\$109.1	(\$2.5)	\$106.5

Note: Annual estimate computed as 40% of General Fund revenue reduction, which will change with revised local property taxes

Given that spending within the Proposition 98 minimum guarantee was already outpacing revenues, the LAO's revised Big Three tax revenues suggest that the education deficit will worsen with the soon-to-be-released May Revision and 2024-25 Enacted Budget. The impact is exacerbated by the additional cost of a higher-than-expected cost-of-living adjustment (now at 1.07% compared to the Governor's January estimate of 0.76%), which increases spending pressures within the minimum guarantee by approximately \$250 million for the 2024-25 fiscal year.

Recall that Governor Newsom proposed to draw down \$722.1 million from the Proposition 98 reserve to maintain current-year funding levels and support the cost of funding the Student Centered Funding Formula for 2024-25. Reduced revenues and increased costs will complicate education budget decisions and negotiations in the next month-and-a-half and will likely require the Governor and the Legislature to adopt a suite of mitigating measures.