

Viewpoints: January revenue projections are just the opening budget act

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Californians recently learned that this January the state received \$4 billion more income tax revenue than it had projected.

There is no consensus as to why projections were so far off. Was it capital gains accelerated into 2012 to escape 2013's higher capital gains taxes? Or receipt of the many dividends companies accelerated into 2012 to avoid 2013's higher dividend tax? Did taxpayers pay their taxes early?

Whatever the driver of the excess revenue, this news illustrates a fact too rarely discussed: The state's actual revenues usually diverge widely from its projections, and now almost always rely on rosy projections that don't come through.

Mandated by law, the governor must present a proposed budget every January, just as Gov. Jerry Brown did a few weeks ago. The proposed budget always includes [revenue projections](#) for the coming fiscal year, which doesn't begin for six more months, on July 1.

Those [revenue projections](#) are the basis for how the state crafts its budget, sets its spending and handles its debt. Therefore, one would think that accurately estimating incoming revenue would be the most crucial aspect of the early budget formation process.

But instead of providing a reasonable [spending plan](#) for the year ahead, January's proposed budget annually ushers in a round of political acrobatics based on wildly inaccurate [revenue projections](#), resulting in discourse far removed from reality.

California Common Sense recently found that since 1997-98, actual revenues have been within 2 percent of January's projected revenues only two times, and within 10 percent of projected revenues only nine times.

Considering the state's nearly \$100 billion general fund budget, missing the mark is a big deal. Even being just 2 percent off is a \$2 billion error – an amount almost equal to what the state spends on the entire 23-campus California State University system.

Certainly, whether the state overestimates or underestimates revenues does matter. Whereas revenue excesses generate questions about how to most effectively use those revenues, revenue shortfalls force immediate cuts to already budgeted spending.

The state has underestimated incoming revenues more frequently than it has overestimated them, though overestimates have become more common in recent years. Shortfalls have averaged \$10.1 billion and been as large as \$20.1 billion (2008-09). On the other hand, excesses have averaged \$5 billion and peaked at \$11.7 billion (1999-00).

When the state has underestimated revenues, it has failed to establish an effective reserve for when its estimates come up short in future years. Lacking a reserve when it has overestimated revenues, the state has scrambled to correct for the shortfalls by making cuts to programs and services.

Over-optimism has dominated [revenue projections](#) in the governor's proposed budget for the last five years. The opposite was true during the preceding decade. From 1997-98 to 2001-02, the governor's proposed budget underestimated actual revenues by an average 5.9 percent, and from 2002-03 to 2006-07, underestimated them by an average 7.1 percent. But from 2007-08 to 2011-12, the proposed budget overestimated actual revenues by an average 5.5 percent.

The final July 1 budget has adjusted revenues downward four of the last five years. During the entire preceding decade, the final budget adjusted revenue estimates downward only two times.

The final budget's revenue estimates have not been perfect over the last 15 years, but they have been three times as accurate as January estimates. Whereas the January budget has maintained a median error of 4.7 percent, the final budget's median error has been 1.6 percent.

That the final [budget projections](#) outperform January's early projections is not surprising. By July 1, the state has more information about what the coming year will look like.

But the state will never have perfect information about the future. The current confusion surrounding higher-than-expected revenues this month illustrates that point. Still, there is something to be said for policymakers showing restraint when they know their information is likely inaccurate.

Rather than jockey for media attention and capitalize on that inaccuracy for short-term political gain in January, they ought to prepare for the high likelihood that revised projections will illustrate a more sober fiscal picture in May and June.

They ought to inject reality into the early budgeting process by crafting an agile plan that takes into account the high likelihood the estimates won't be met. Furthermore, establishing a sufficient reserve using excess revenues would help the state respond to revenue shortfalls without sudden cuts.

What we see now is political theater. While championing inaccurate [revenue projections](#) may make for a good show, it misdirects the [budget process](#). Ultimately, it is Californians who buy the ticket but leave sorely disappointed.

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