

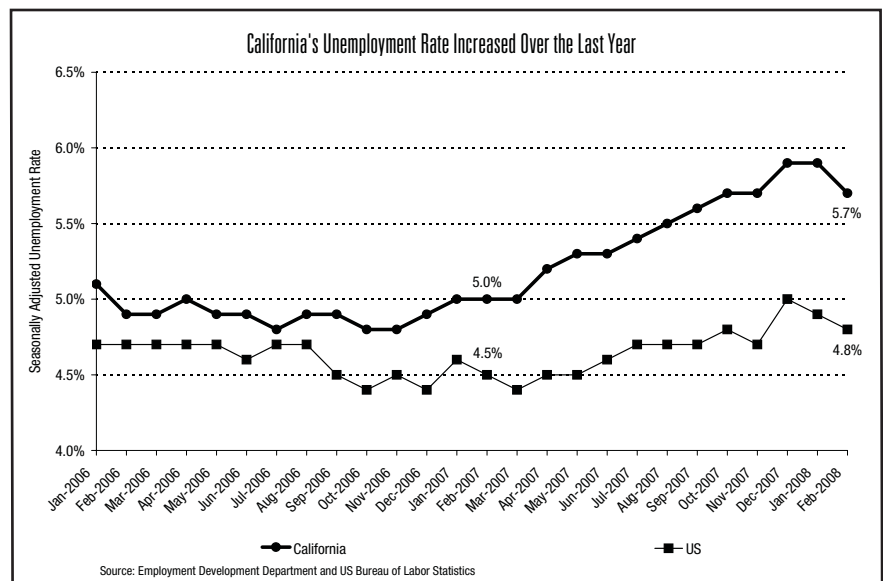
CONGRESS COULD HELP EASE CALIFORNIA'S FISCAL WOES

California faces a budget deficit of daunting proportions. To bridge the gap, the Governor has proposed – and the Legislature is considering – deep budget cuts that would reduce support for a broad array of public services at a time when more workers and their families will need public services due to the lagging economy. This *Policy Points* reviews how federal assistance could help California avoid deep budget cuts and support the state's economy.

K E Y F A C T S

■ California's economy is hurting.

California's economy is suffering from a weak housing market: home foreclosures have skyrocketed and the state has lost tens of thousands of housing-related jobs. However, the slowdown is much broader than the housing sector; the state's jobless rate has increased steadily for about a year and consumer spending has slowed. The number of jobless Californians increased by more than 140,000 between February 2007 and February 2008.¹ Although California's unemployment rate declined between January 2008 and February 2008, the drop is not good news, either, because the decline reflects discouraged workers giving up their job search and leaving the labor force.²



- **The weak economy has widened the state's deficit, and the Governor has proposed massive cuts.**

The lagging economy has caused state revenues to fall dramatically, leading to a deficit estimated to be \$16 billion. In response, the Governor has proposed \$9.3 billion in spending reductions. As a first step, the Legislature approved, and the Governor signed, a series of midyear cuts in February. These cuts include reducing reimbursement rates for physicians and other health care providers who treat Medi-Cal patients, cutting funding to public schools, and delaying cost-of-living adjustments for cash assistance grants that help low-income families, seniors, and persons with disabilities meet basic needs. The Legislature is considering billions of dollars in additional cuts as it develops a spending plan for 2008-09.

- **Spending cuts could further exacerbate the slowdown.**

The key to promoting the state's economic growth during a slowdown is to encourage spending on goods and services.³ However, state spending reductions have the opposite effect: each dollar less that the state spends often reduces consumption by the same amount.⁴ This dollar-for-dollar reduction in consumption tends to occur because state spending cuts disproportionately impact lower-income Californians, who typically spend all of their incomes. For example, every dollar of cash payments to low-income families that the state cuts would reduce the money that these families have to spend on rent, groceries, and other goods and services by an equal amount.

- **Hard economic times increase the need for public services.**

A slowing economy hurts workers and their families and increases the need for public services. Recessions typically result in job losses, declining incomes, and rising poverty.⁵ When workers lose their jobs, state programs such as Medi-Cal and CalWORKs often help families with health coverage and cash assistance to meet their basic needs. Cutting public services when job losses rise would be a "double whammy" for many California families.

- **Federal relief could help California avoid some of the cuts.**

Federal support would help California's families in two ways. First, increased federal assistance could help limit reductions in important public services. Second, federal relief could support the state's economy, which may shorten or lessen the severity of the slowdown. Federal assistance to states is a natural extension of the "countercyclical" role that the federal budget plays; federal spending helps sustain the economy during weak times and support families who lose their jobs by automatically increasing resources for health care, food assistance, and other programs. In contrast, most states must balance their budgets every year, even when the need for public services increases and revenues are down.

Although the economic stimulus package that Congress passed in February did not include assistance to help states with their fiscal crises, Congress should include state fiscal relief in any subsequent stimulus package it passes. Such relief could take different forms, such as state block grants and/or increased federal support for state Medicaid programs. California received \$1.2 billion in federal relief to cope with the last recession, which helped California avoid deeper cuts to health care and other critical services.

- **Congress can direct federal relief to states most in need.**

California is one of the states hardest hit by the economic slowdown. California has the largest state budget deficit in dollar terms, and the second largest in percentage terms.⁶ However, some states do not currently face budget deficits. In order to direct federal assistance to states most in need, Congress could target dollars to specific states based on key economic indicators such as decreases in employment, increases in foreclosures, and increases in participation in the Food Stamp Program – a measure of short-term increases in poverty.⁷

David Carroll prepared this Policy Points. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

- ¹ Employment Development Department.
- ² California's labor force declined by more than 40,000 between January 2008 and February 2008.
- ³ See Peter Orszag and Joseph E. Stiglitz, *Biting the Budget Bullet Why Raising Taxes is the Least Painful Way out of the State's Fiscal Crisis* (Tax Policy Center: April 27, 2003).
- ⁴ See Peter Orszag and Joseph Stiglitz, *Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive Than the Other During a Recession?* (Center on Budget and Policy Priorities: Revised November 6, 2001).
- ⁵ California Budget Project, *The Economic Slowdown Is Bad News for California's Workers and Their Families* (March 2008).
- ⁶ Elizabeth C. McNichol and Iris J. Lav, *22 States Face Total Budget Shortfall of at Least \$39 Billion in 2009; 6 Others Expect Budget Problems* (Center on Budget and Policy Priorities: Revised March 14, 2008).
- ⁷ Iris J. Lav, Jason Levitis, and Liz McNichol, *Economic Data Can Be Used to Target State Fiscal Relief Effectively* (Center on Budget and Policy Priorities: March 3, 2008).