



Budget Briefs

SENATE REPUBLICAN FISCAL OFFICE

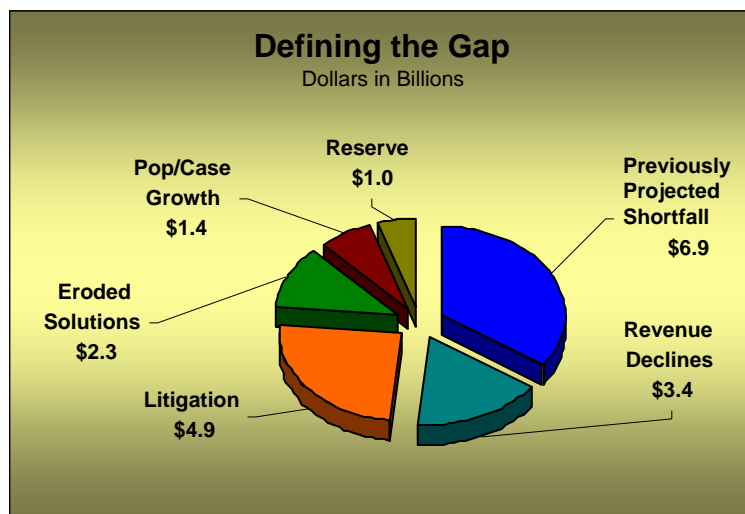
Highlights & Analysis of the Governor's Budget

January 12, 2010

Executive Summary

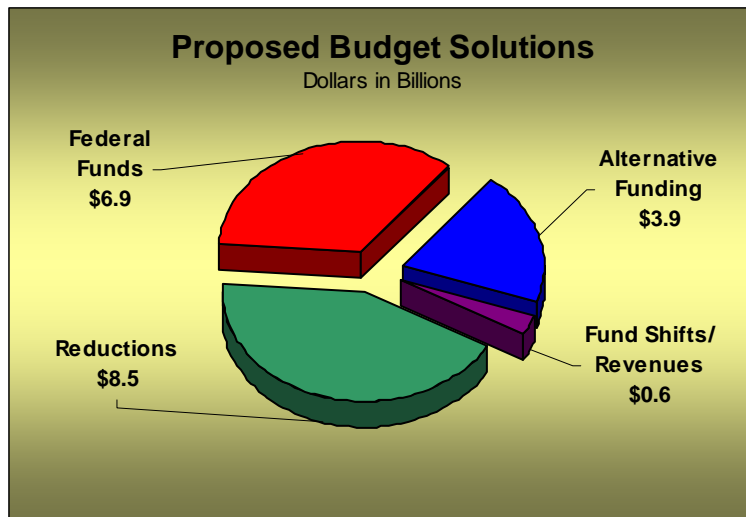
When the Governor signed the revised 2009 Budget Act in July 2009, the anticipated budget deficit for 2010-11 was \$6.9 billion. However, largely as a result of continued economic weakness and because many of the budget solutions failed to deliver the anticipated savings, the budget gap has grown to \$19.9 billion (\$6.6 billion in 2009-10 and \$12.3 billion in 2010-11) including \$1 billion for a reserve.

The Governor indicates that *\$4.9 billion* of solutions have been lost as a result of federal and state court decisions (e.g., In-Home Support Services program changes, sale of State Compensation Insurance Fund, and use of certain transportation funds to offset General Fund expenditures) – though there are several billion dollars more at-risk in other lawsuits that have not yet been acknowledged in this budget (i.e., state worker furloughs, use of Redevelopment Agency funds, several tax cases and Medi-Cal provider rate cases.) In addition, increased population/caseload driven costs (*\$1.4 billion*) and the “erosion” or failure to achieve some of the enacted solutions (*\$2.3 billion*) such as the state prison and Medi-Cal savings have contributed to the increased budget gap. Lower than anticipated revenues account for another *\$3.4 billion* of the identified budget deficit.



In order to generate immediate action and focus on the state budget, the Governor proclaimed a “fiscal emergency” pursuant to his Proposition 58 (2004) authority. The Proposition 58 special session requires the Legislature to send the Governor a bill addressing the fiscal emergency within 45 days or it cannot act on any other bills. The Governor has proposed about \$1.2 billion of “special session” solutions for 2009-10 that grow to nearly \$7.7 billion in 2010-11 (totaling \$8.9 billion). If the legislature waits until July 1, the savings would be reduced by over \$2.4 billion – that is the cost of delay.

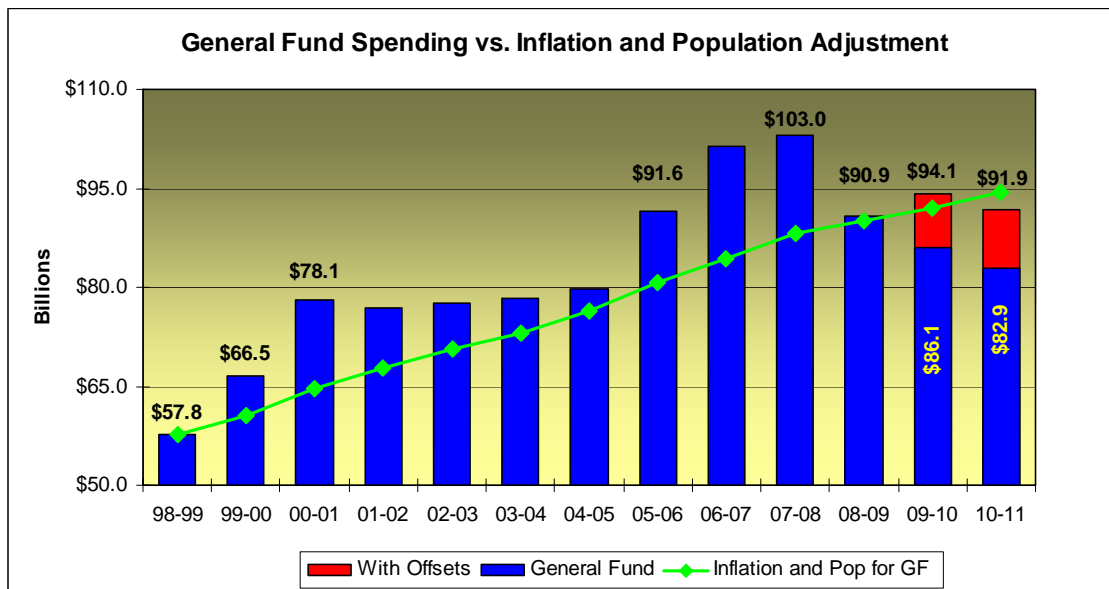
The Governor’s proposed 2010-11 Budget includes a combination of major spending reductions, some fund shifts and “other” revenue increases (e.g., sale of EdFund and sale-leaseback proposals), a new category called “alternative funding” that appears to be more new revenues and fund shifts (e.g., Proposition 10 and 63 funds, add speeding violations to red light cameras, Tranquillon Ridge, Emergency Response Initiative, etc.) and a considerable expectation for new federal funds– but **no new general taxes** – to make up the budgetary shortfall. The following charts reflect the current \$19.9 billion solution allocations:



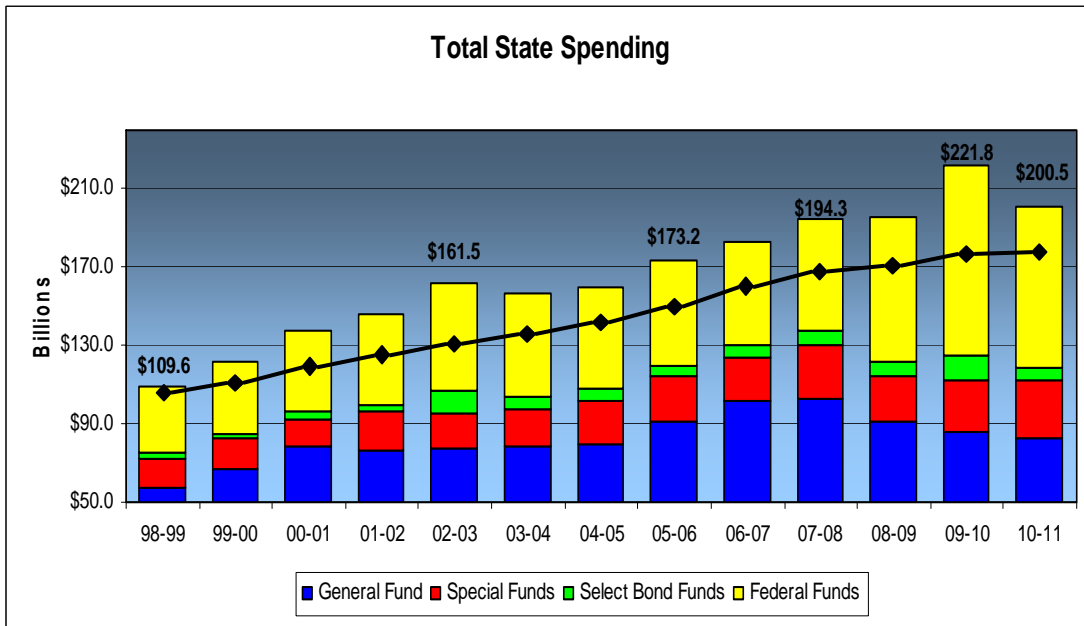
Key Points:

Major Expenditure Reductions. The revised budget plan reflects over \$8.5 billion in proposed expenditure reductions. A snapshot of these reductions shows about \$2.4 billion in Proposition 98 school funding (recognize lower 08-09 guarantee and delay Maintenance Factor repayment, etc); \$2.9 billion in Health and Human Services (primarily from IHSS and Medi-Cal); \$1.6 billion related to changes in employee compensation (five percent increase in employee retirement contributions, five percent decrease in employee salaries, and five percent reduction to state workforce in all departments except for revenue generating positions and constitutional officers); and \$1.2 billion to Corrections and Juvenile Justice (mainly from an unspecified plan to reduce prison health care costs and shifting some felons to local jails.)

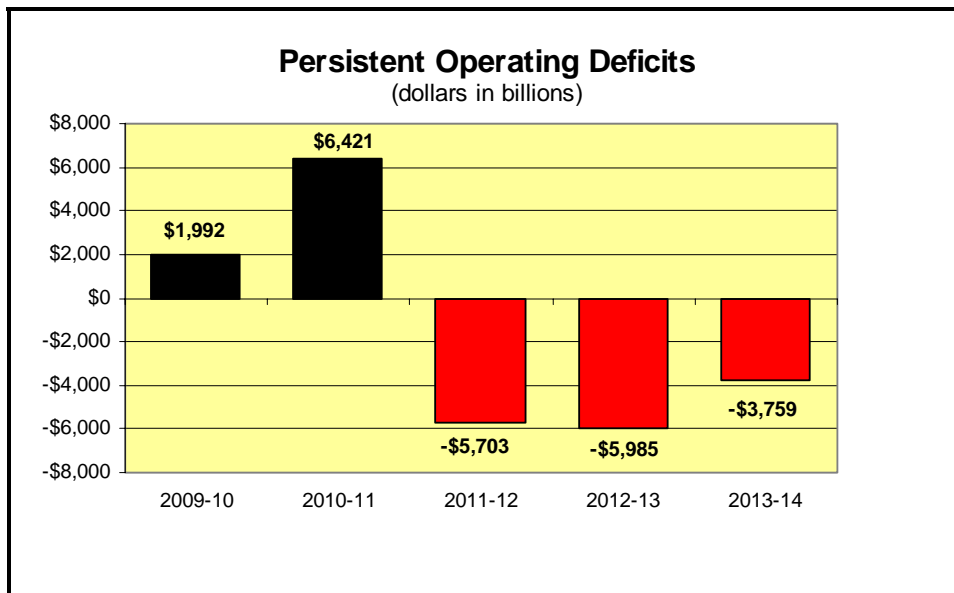
General Fund Spending. Fiscal year 2010-11 will be the third year in a row that California faces actual year-over-year reductions to General Fund spending, following peak General Fund expenditures of \$103 billion in 2007-08. Projected General Fund spending for 2010-11 is well below population and inflation adjusted revenues over the past 12 years (\$82.9 billion vs. \$94.5 billion). However, absent the Governor’s proposed \$8.5 billion of new expenditure reductions in 2010-11 General Fund spending would be at the second highest level in state history (\$100.4 billion). Additionally, the “true” underlying General Fund expenditure level, which recognizes federal funds and the General Fund offsets from borrowing local government property taxes pursuant to Proposition 1A and the shift of redevelopment agency funds in 2009-10 (\$8 billion) and 2010-11 (\$8.9 billion), moves the state more in line with population and inflation trends.



Total State Spending. Though General Fund spending is usually the focus of state budget conversations, it is just one component of total state spending. As the chart below demonstrates, total state spending from all fund sources has continued to increase each year over the past 12 years and the proposed 2010-11 spending level exceeds population and inflation growth by over \$21 billion (\$179.1 billion vs. \$200.5 billion). Absent this data, most people would assume that state spending has been drastically reduced in the wake of the “great recession,” but California continues to spend significantly more than it did before the recent economic downturn.



Operating Deficits Persist. Assuming the Legislature adopts all of the Governor’s budget solutions, the proposed plan is projected to achieve a \$1 billion reserve for 2010-11. However, even after implementing these difficult solutions, operating deficits would return the following year (2011-12). As shown in the chart below, following a positive year in 2010-11, expenditures will continue to outpace revenues each year through 2013-14, with operating deficits ranging between \$3.8 billion and \$6.0 billion. Cumulatively, these deficits will total over \$15 billion.



The “operating deficit” differs from the bottom line “reserve” in that it reflects only the difference between projected revenues and expenditures for that specific

year and does not include any surplus or deficits from the previous year in the calculation. The reserve includes the impact of prior year balances (for example: in 2010-11, the reserve is proposed to be only \$1 billion, but the operating surplus is \$6.4 billion because the prior year reserve balance was -\$5.4 billion.)