

CALIFORNIA BUDGET PROJECT

Back to the Future:

The Social and Economic Context of the Governor's Proposed 2011-12 Budget

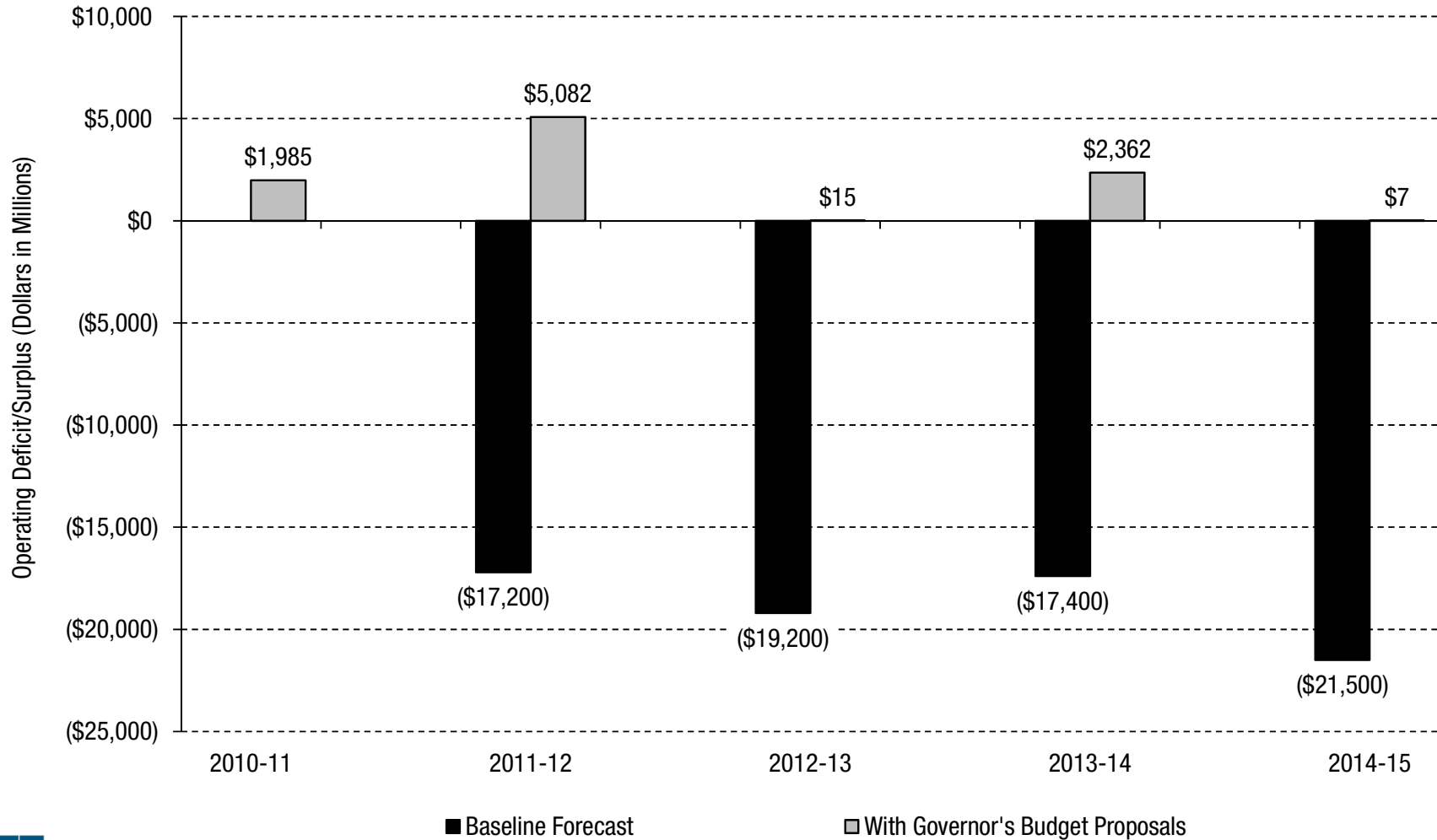
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A PRESENTATION BY
THE CALIFORNIA BUDGET PROJECT
February 2011

The Top Lines

- The Governor's Proposed 2011-12 Budget balances roughly equal levels of spending reductions and revenue increases and minimizes reliance on temporary measures, such as those used to address recent years' shortfalls.
- If enacted, the Governor's proposals would bring the state's budget into balance for the period of the temporary tax extensions. The state would, however, face significant shortfalls after the expiration of the temporary taxes.
- The Governor's proposed "realignment" of responsibility between the state and county governments is promising, however, the devil will be in the details.

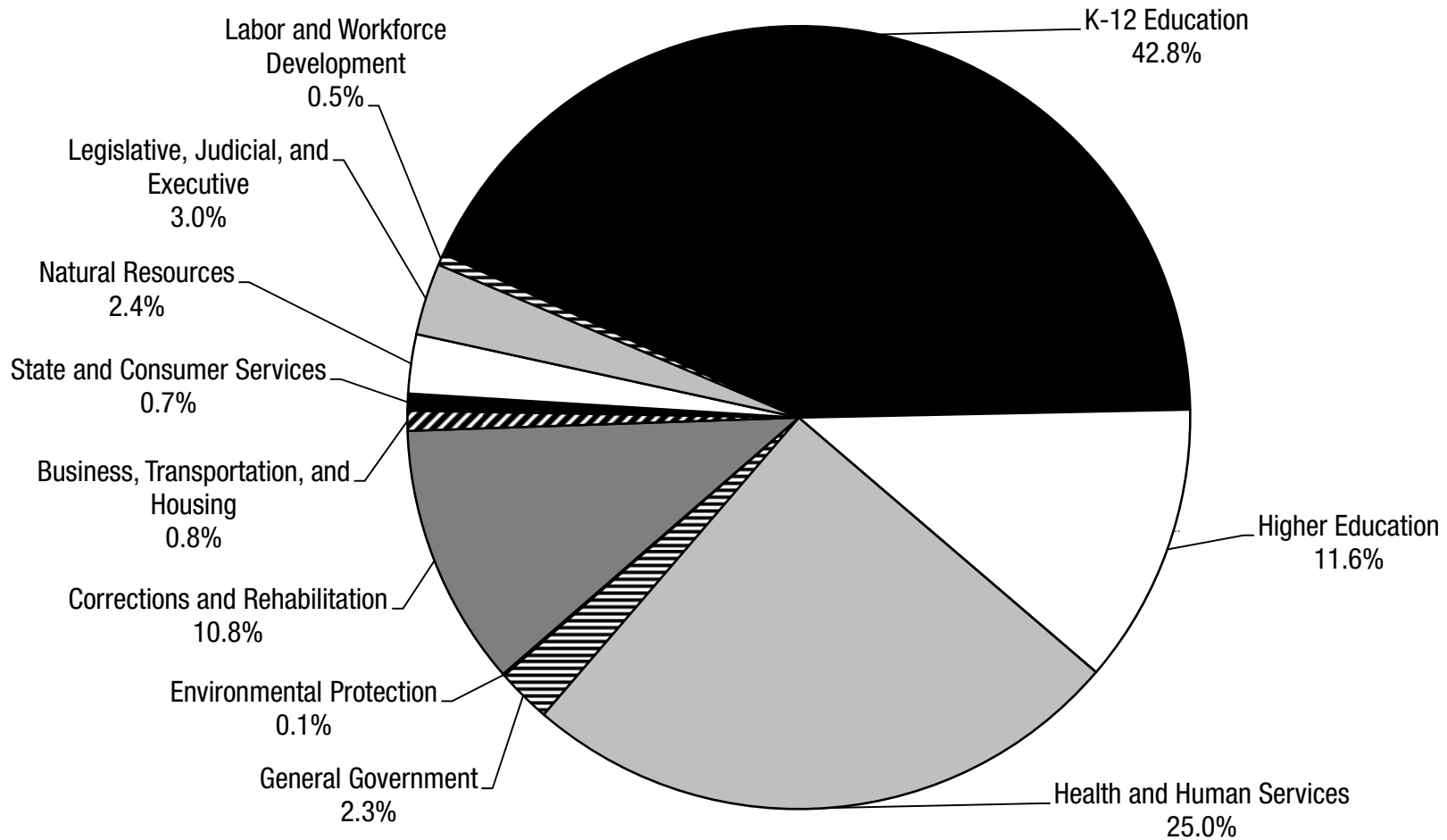
If Fully Implemented, the Governor's Proposals Would Eliminate Projected Operating Shortfalls Through 2014-15 Gaps Would Emerge When Temporary Taxes Expire



The Information Gap

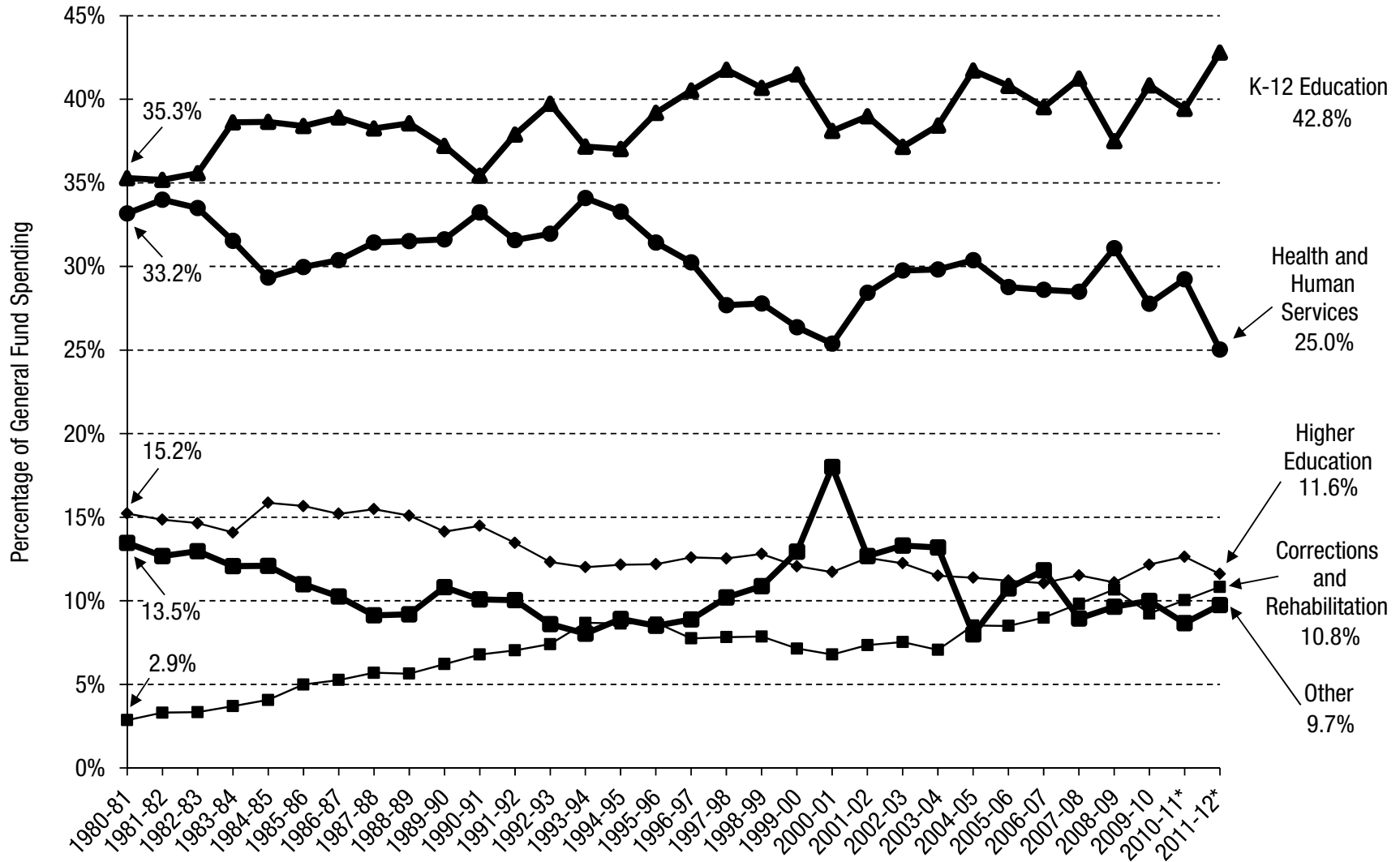
- A January 2011 poll by the Public Policy Institute of California found that:
 - Only 16 percent of adults and 22 percent of likely voters correctly identified K-12 education as accounting for the largest share of the state budget. Nearly half (45 percent) of adults and 41 percent of likely voters believe corrections represents the largest share of the budget.
 - Only 29 percent of adults and 33 percent of likely voters correctly identified the personal income tax as the largest state revenue source.
 - Just over one out of 20 adults (6 percent) and only 9 percent of likely voters answered both questions correctly.

Education Accounts for the Largest Share of Proposed 2011-12 Spending General Fund Spending by Agency



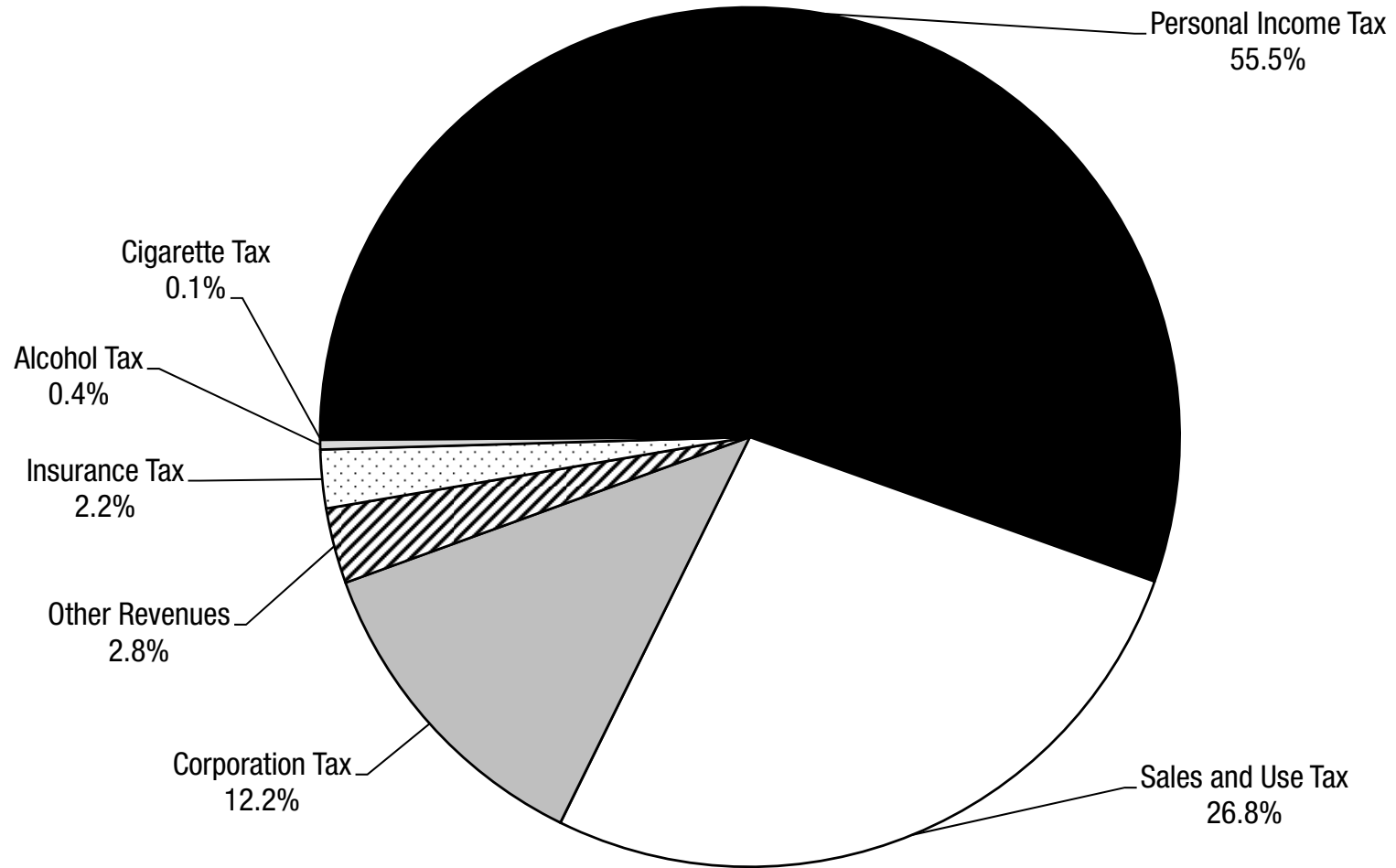
2011-12 Proposed General Fund Expenditures = \$84.6 Billion

K-12 Education Accounts for the Largest Share of State General Fund Spending



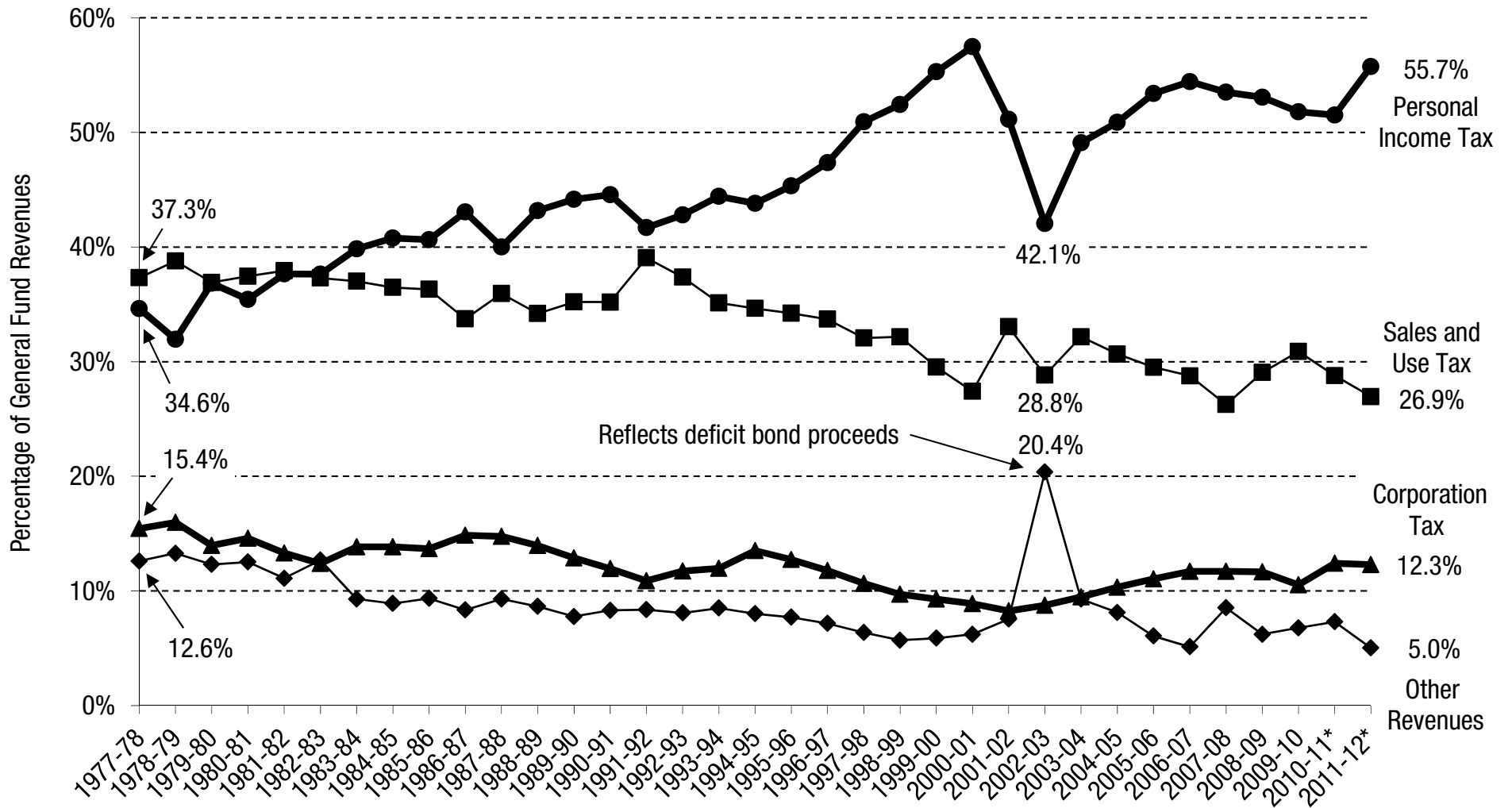
* 2010-11 estimated and 2011-12 proposed.
Source: Department of Finance

The Personal Income Tax Is Projected To Provide More Than Half of 2011-12 General Fund Revenues



Projected 2011-12 General Fund Revenues = \$89.7 Billion

The Personal Income Tax Provides the Largest Share of General Fund Revenues



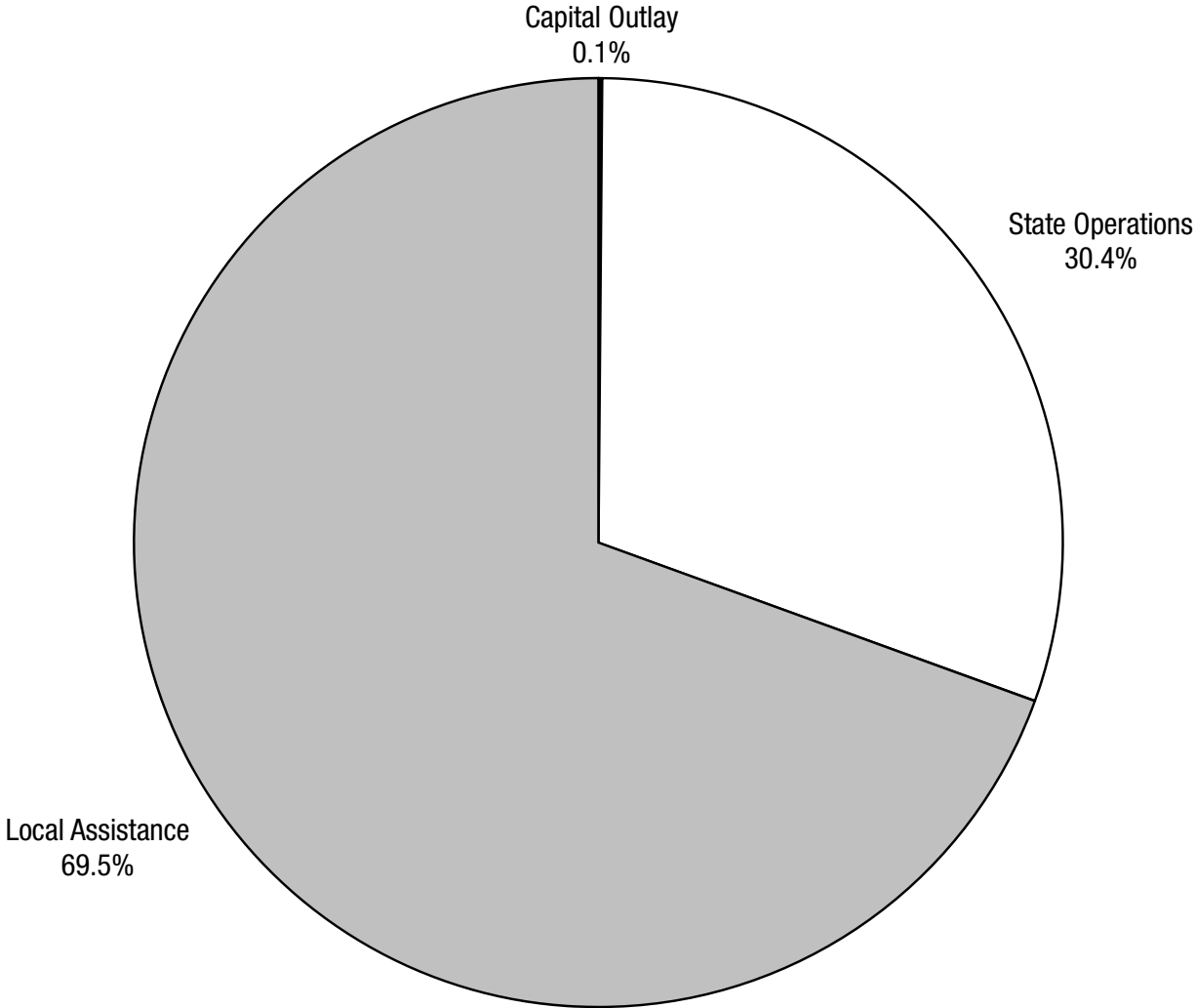
* 2010-11 estimated and 2011-12 projected.
Source: Department of Finance and Legislative Analyst's Office

The State Budget Is a Local Budget

- Nearly 70 cents out of every dollar spent through the state's General Fund is “local assistance” and goes to:
 - Schools and community colleges;
 - Counties for health and human services programs and public safety;
 - Health care providers through the Medi-Cal Program; and
 - Individuals as SSI/SSP and CalWORKs assistance.
- The largest share of “state operations” consists of higher education and corrections.

Most State Dollars Go to Local Communities and Individuals

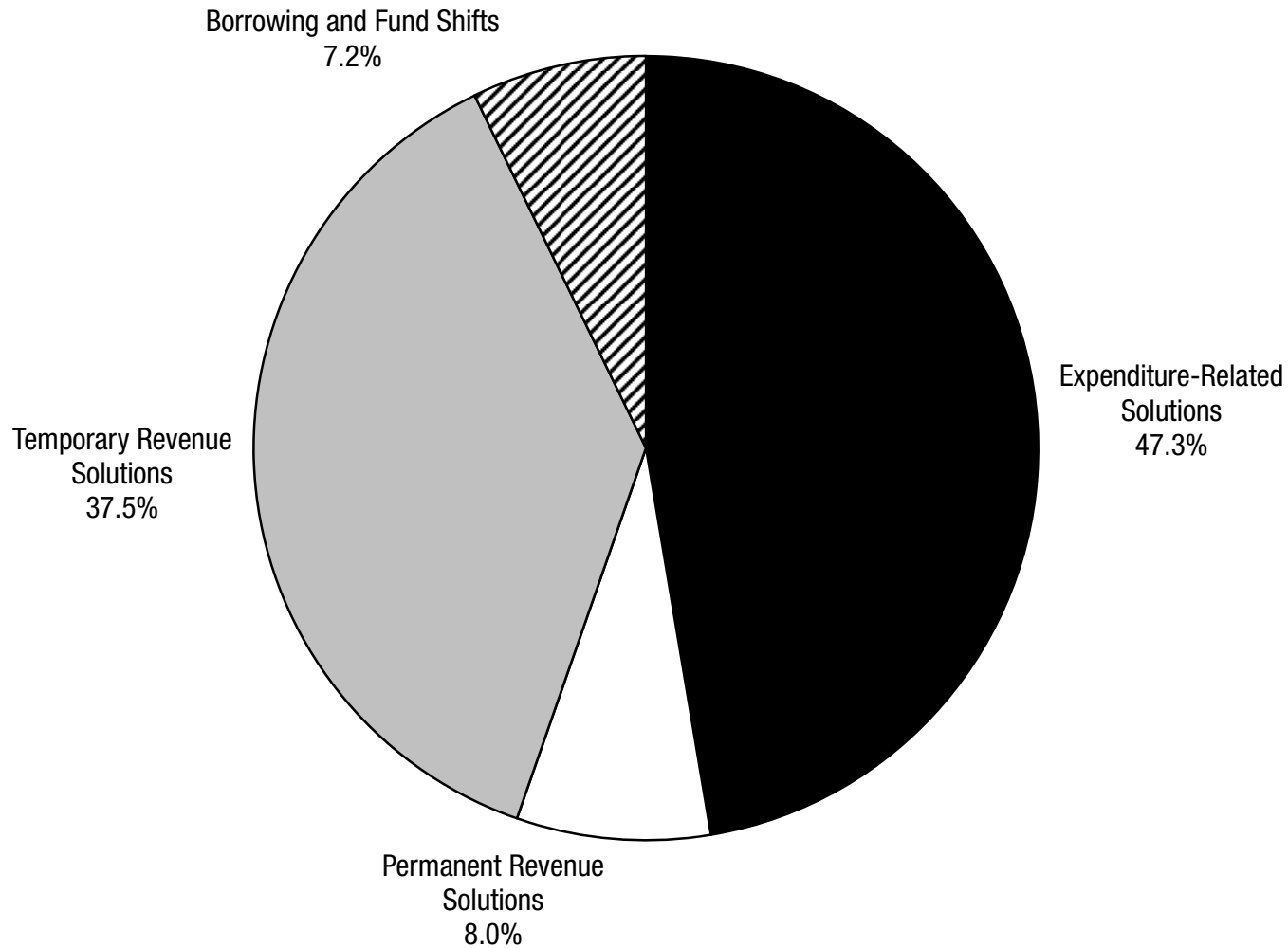
2011-12 Proposed General Fund Spending



How Is the Budget Balanced?

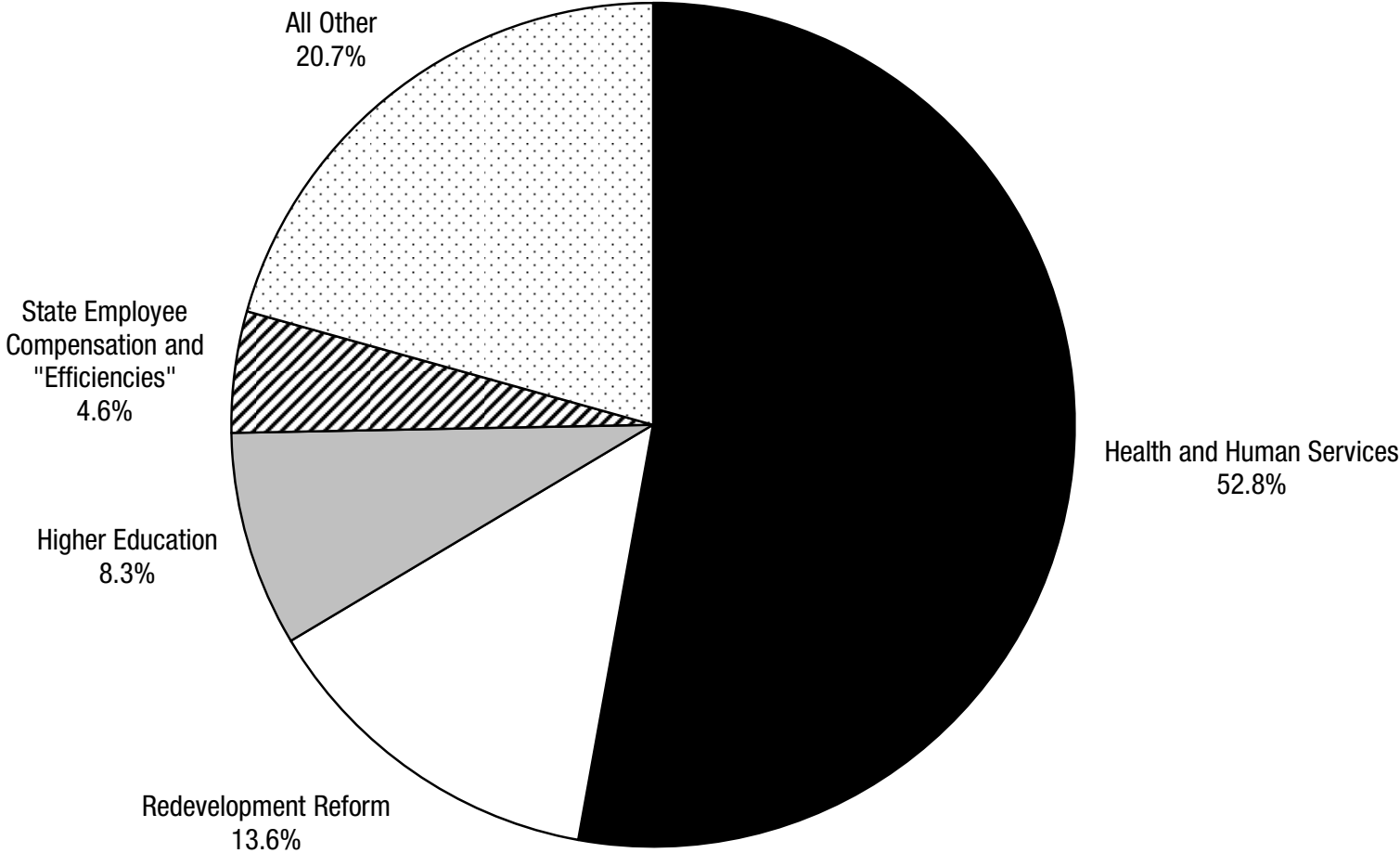
- \$12.5 billion in expenditure-related “solutions” including \$1.7 billion from the phase-out of redevelopment agencies, \$1.7 billion in Medi-Cal reductions, \$1.5 billion in cuts to the CalWORKs Program, \$1.0 billion in reductions to the University of California and California State University, and \$1.0 billion from the diversion of Proposition 10 funds.
- \$14.0 billion in “revenue solutions” including \$11.2 billion of temporary tax extensions (\$5.9 billion of which would support the proposed realignment), \$1.4 billion from modifying single sales factor apportionment, and \$0.9 billion from the elimination of Enterprise Zones. The Governor’s tax proposals would increase the state’s school spending guarantee by an estimated \$2.0 billion.
- \$1.9 billion in loans and transfers.

How Does the Governor Propose To Balance the Budget?



Total 2010-11 and 2011-12 Solutions = \$26.4 Billion

Half of Proposed Spending Reductions Target Health and Human Services Programs

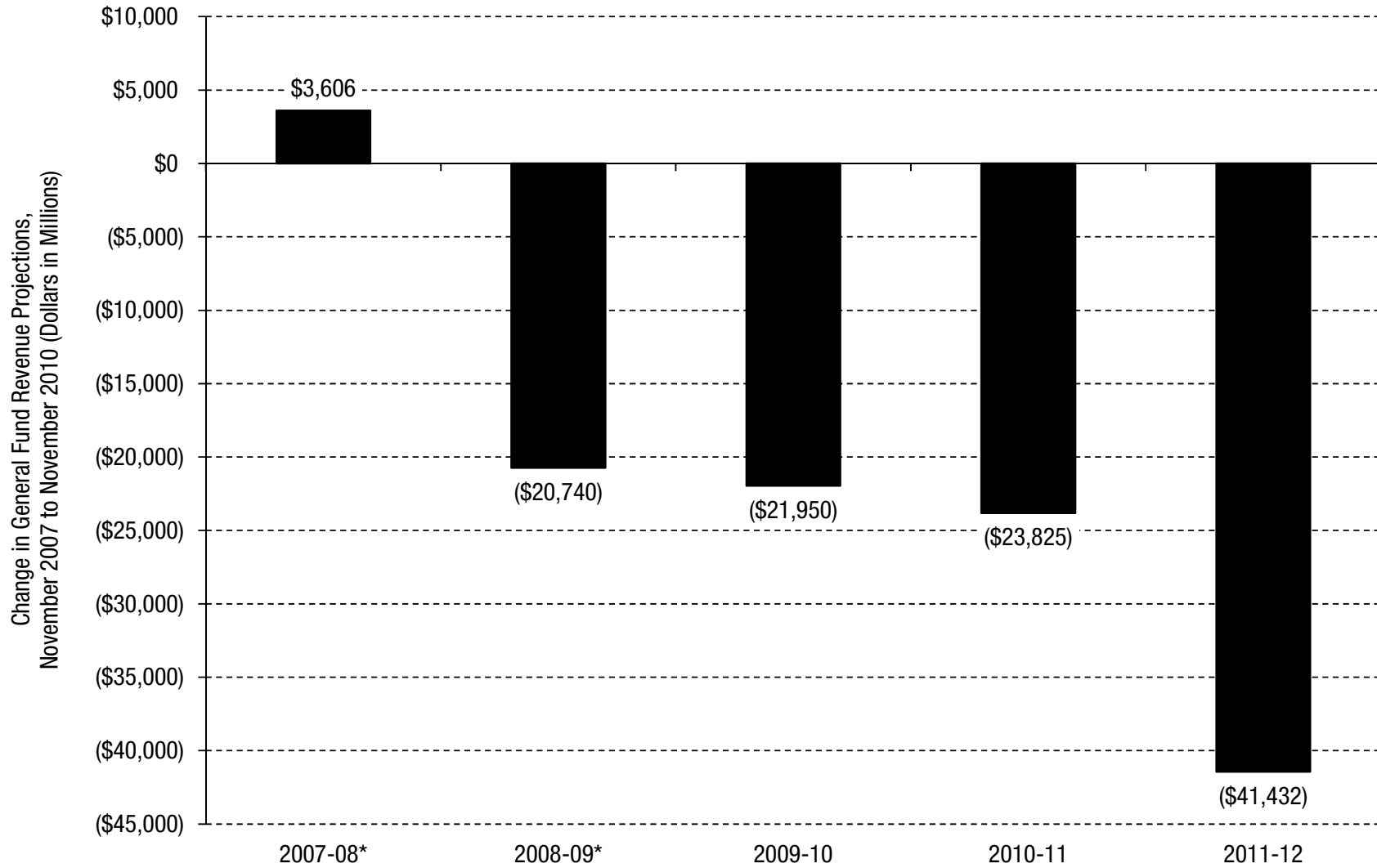


Combined 2010-11 and 2011-12 Spending Reductions = \$12.5 Billion

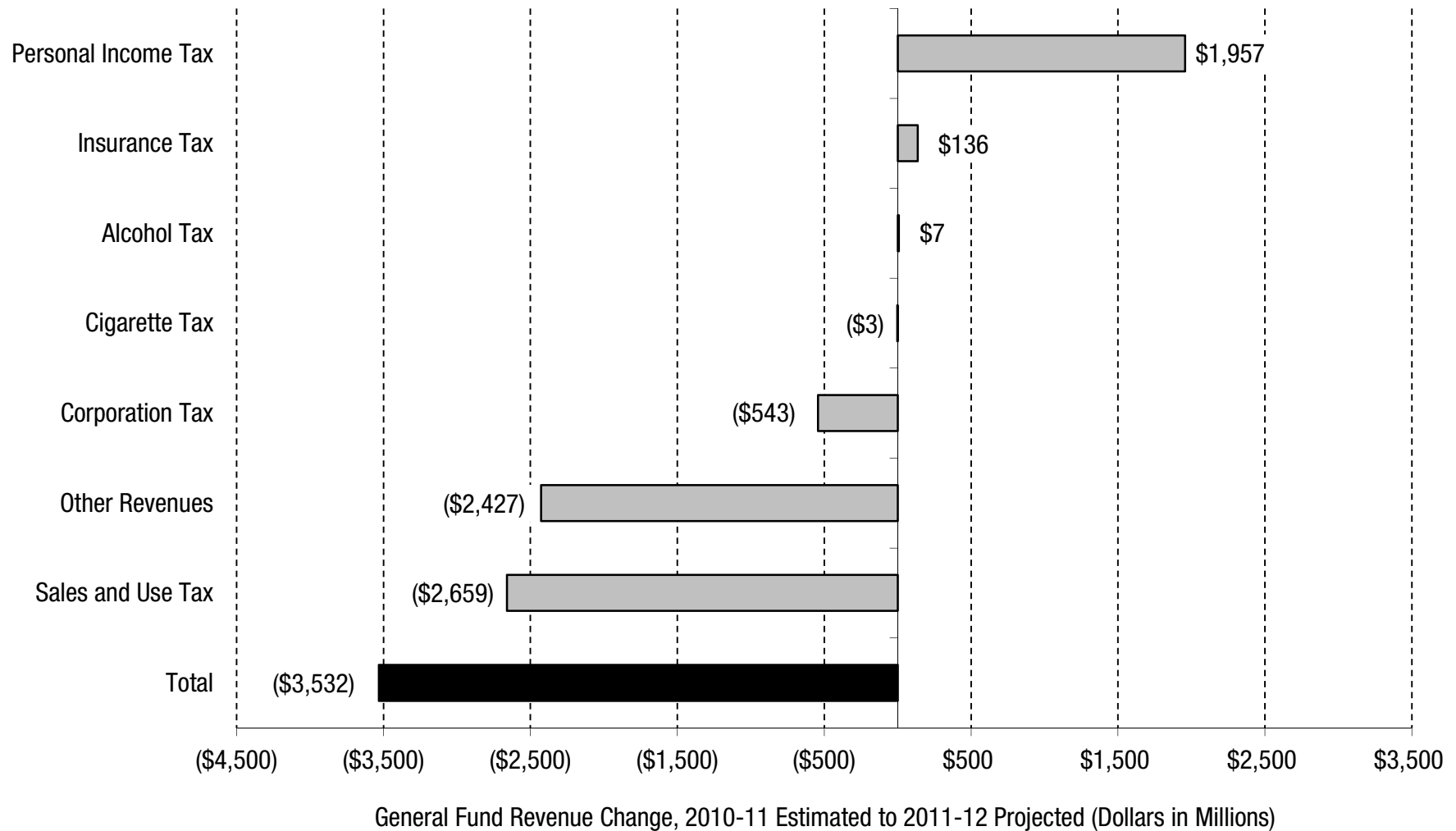
How Did We Get Here?

- **The economy.** Projected 2011-12 revenues are \$41.4 billion below the Legislative Analyst's 2007 forecast.
- **Tax cuts.** Tax cuts enacted since 1993 will cost the state more than \$13 billion in 2011-12. The Legislature continued to cut taxes through the worst of the state's budget crisis.
- **Demographic changes.** The state's population continues to grow and to age, placing demands on the budget.
- **Spending on corrections, debt service, and transportation has increased,** while spending on virtually all other parts of the budget has declined in recent years.
- **Temporary solutions.** A significant portion of recent years' budget gaps have been closed with temporary "solutions" and anticipated savings that didn't materialize.

Recent General Fund Revenue Projections Are Far Below November 2007 Levels

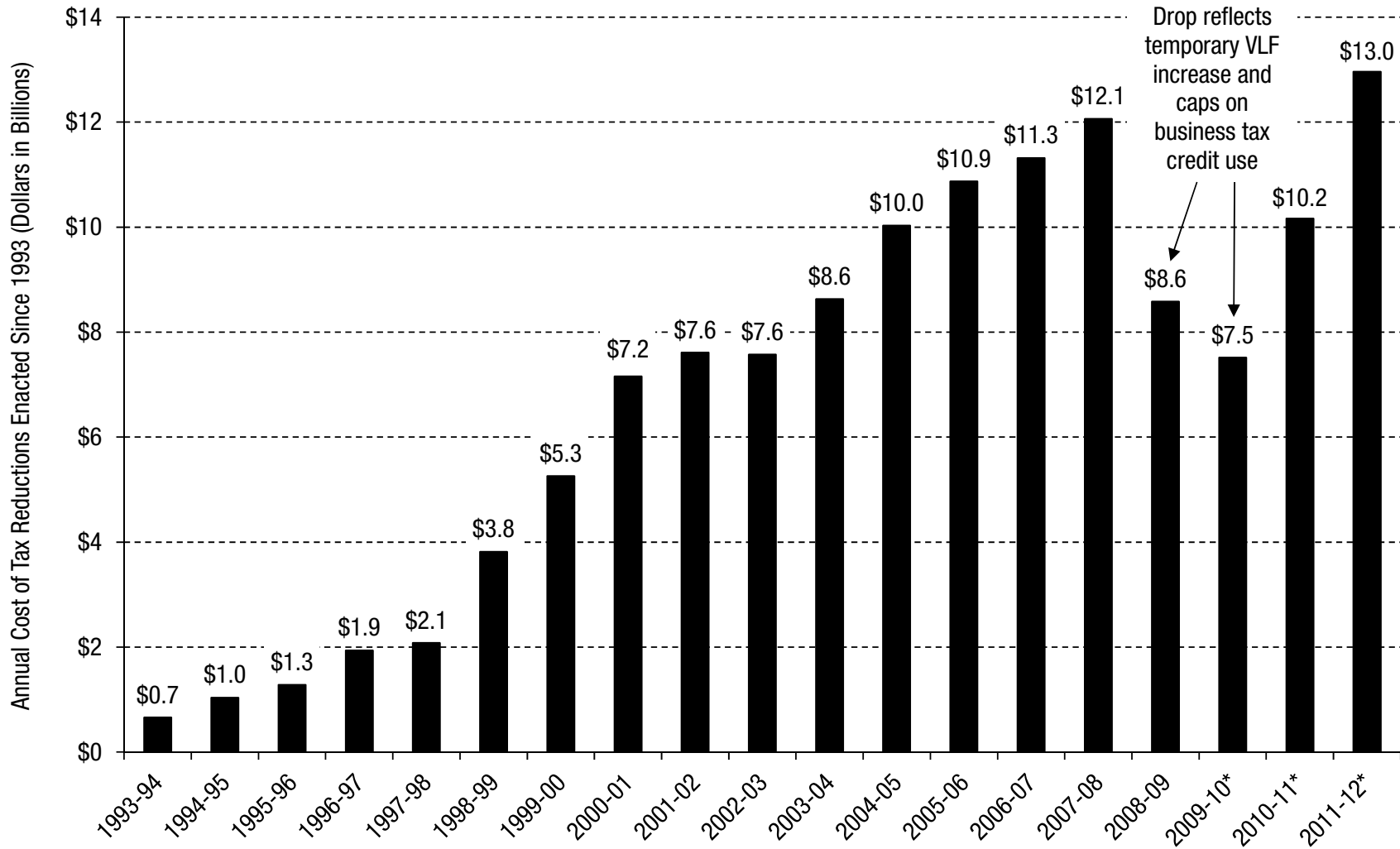


General Fund Revenues Are Forecast To Decrease by \$3.5 Billion in 2011-12

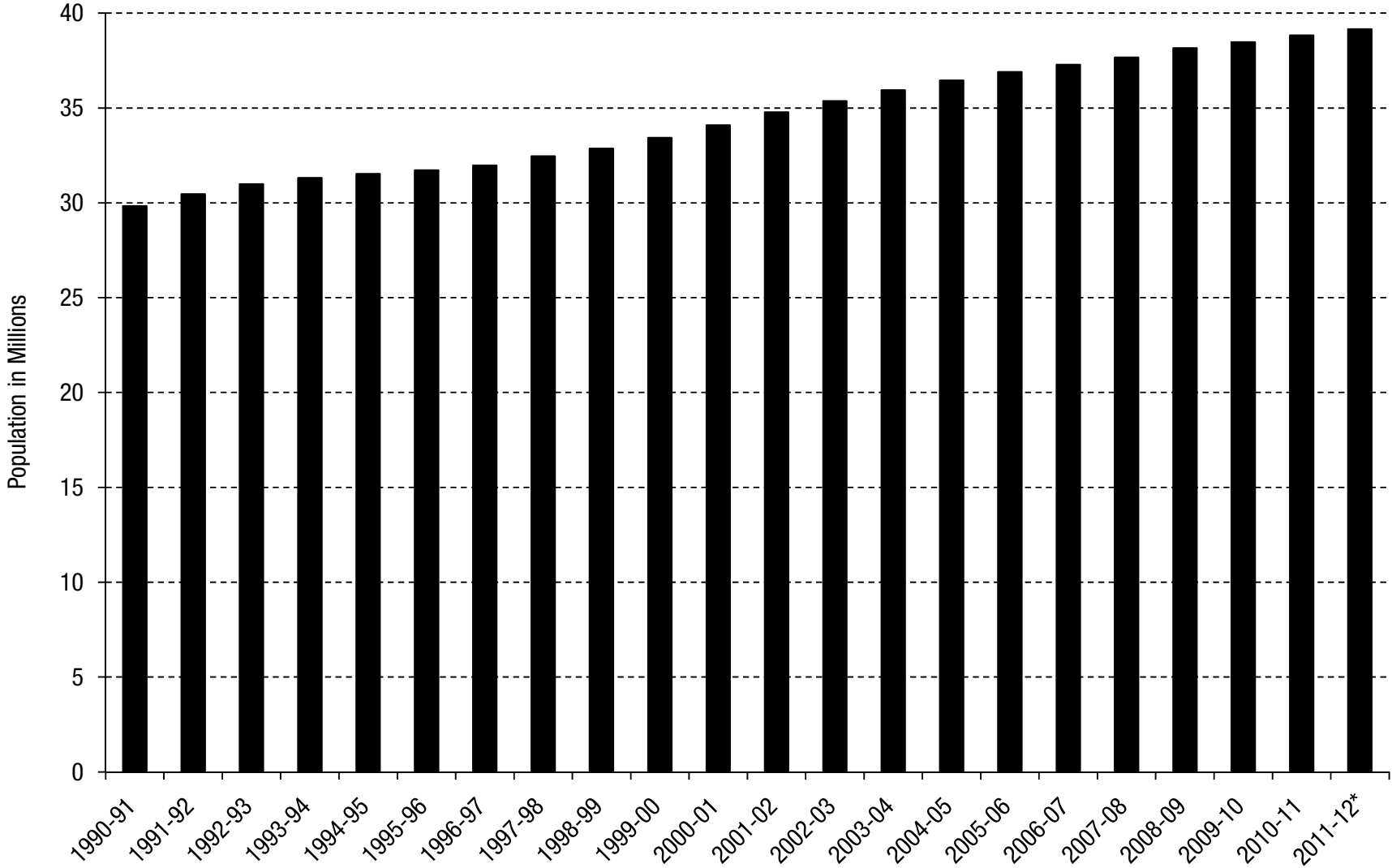


Source: Department of Finance

Tax Cuts Enacted Since 1993 Will Cost an Estimated \$13.0 Billion in 2011-12

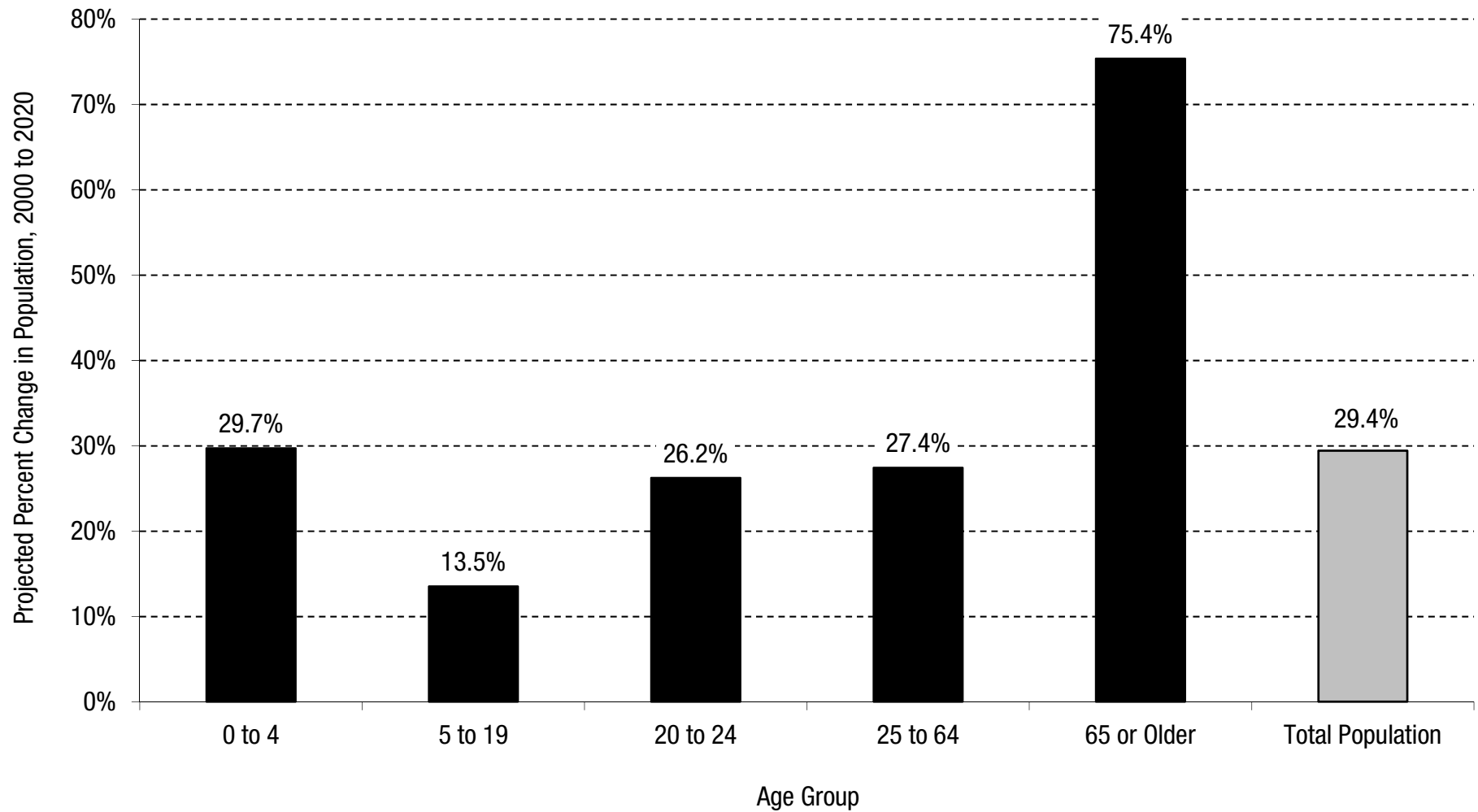


California's Population Continues To Rise

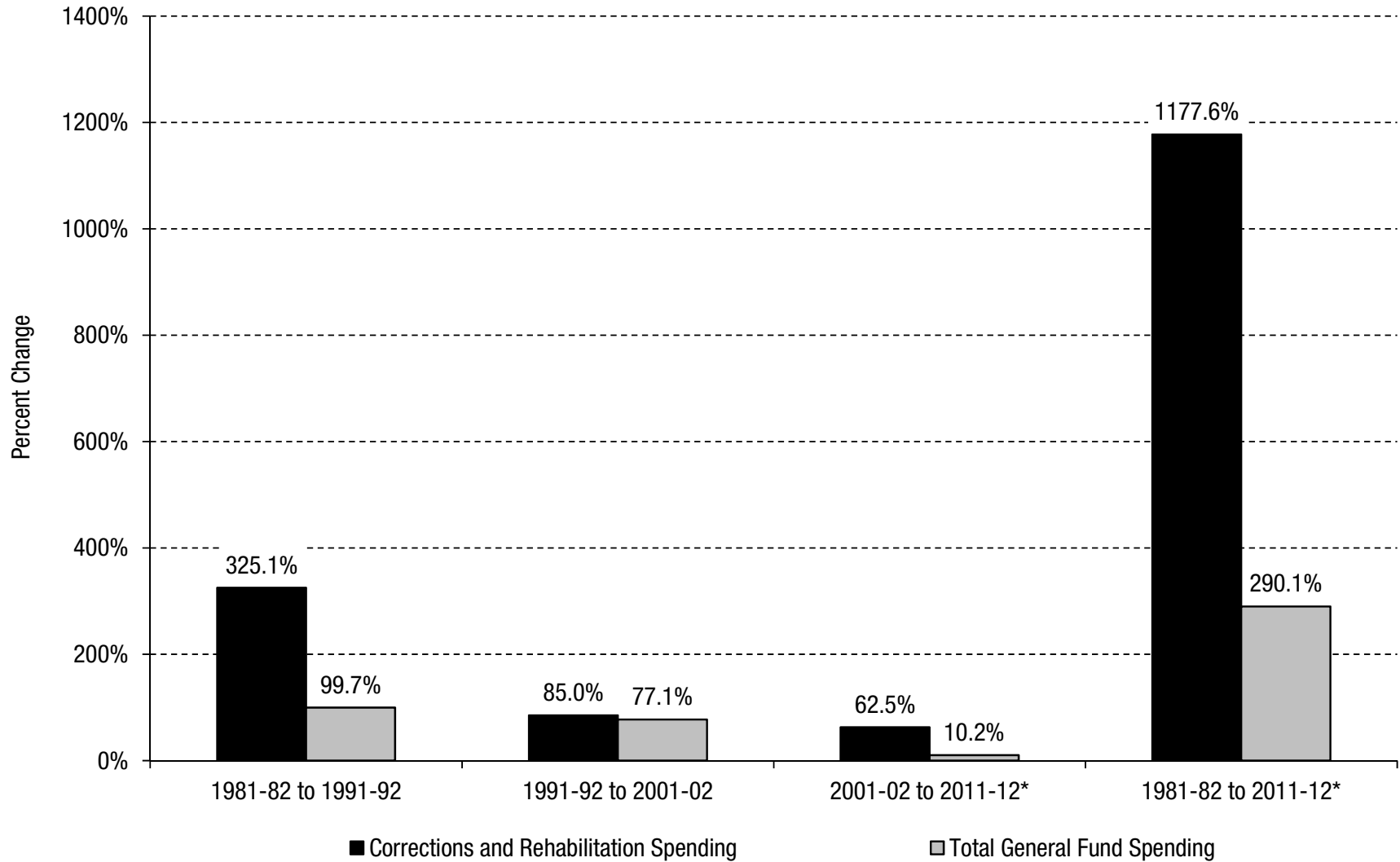


* 2011-12 projected.
Source: Department of Finance

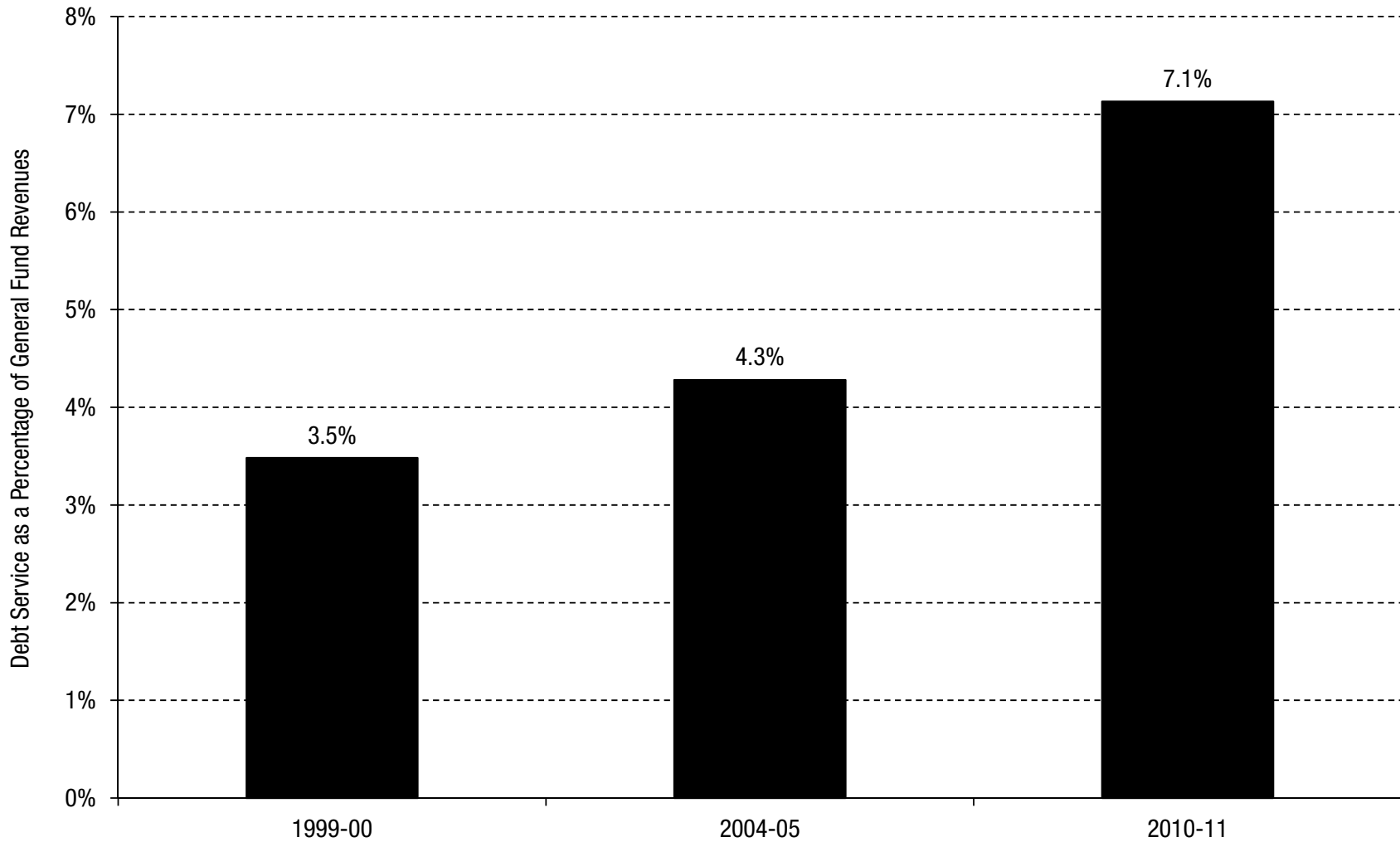
Californians Age 65 or Older Are Projected To Be the Fastest-Growing Age Group Between 2000 and 2020



Corrections Spending Has Grown at More Than Four Times the Rate of General Fund Spending as a Whole

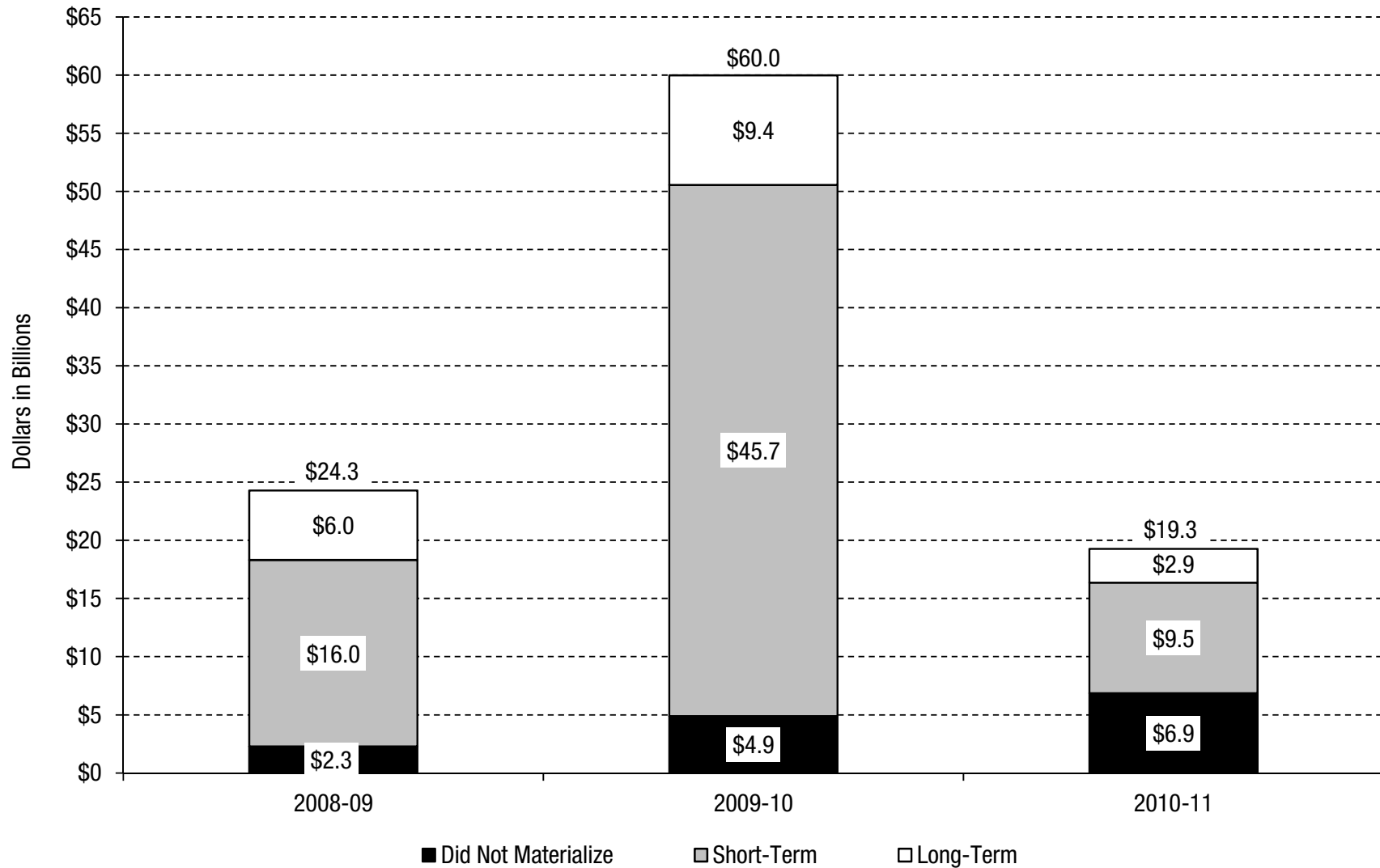


Debt Service as a Share of State Revenues Has More Than Doubled Since 1999-00



Note: Excludes debt service for Economic Recovery Bonds, Enterprise Fund Self-Liquidating Bonds, and General Obligation Commercial Paper.
Source: State Treasurer's Office

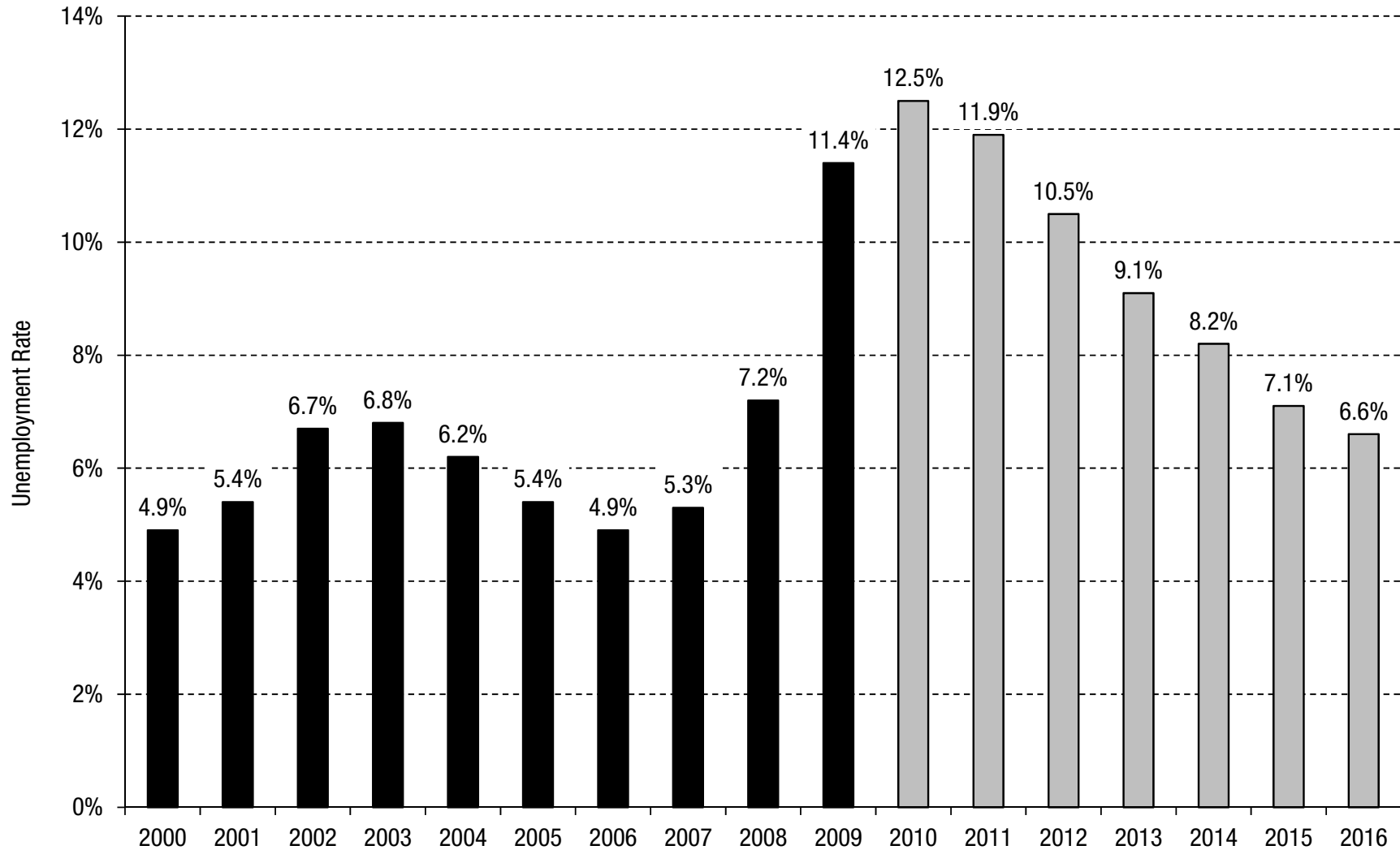
The Majority of Budget "Solutions" in Recent Years Were Temporary or Did Not Materialize



California's Economy Remains Weak

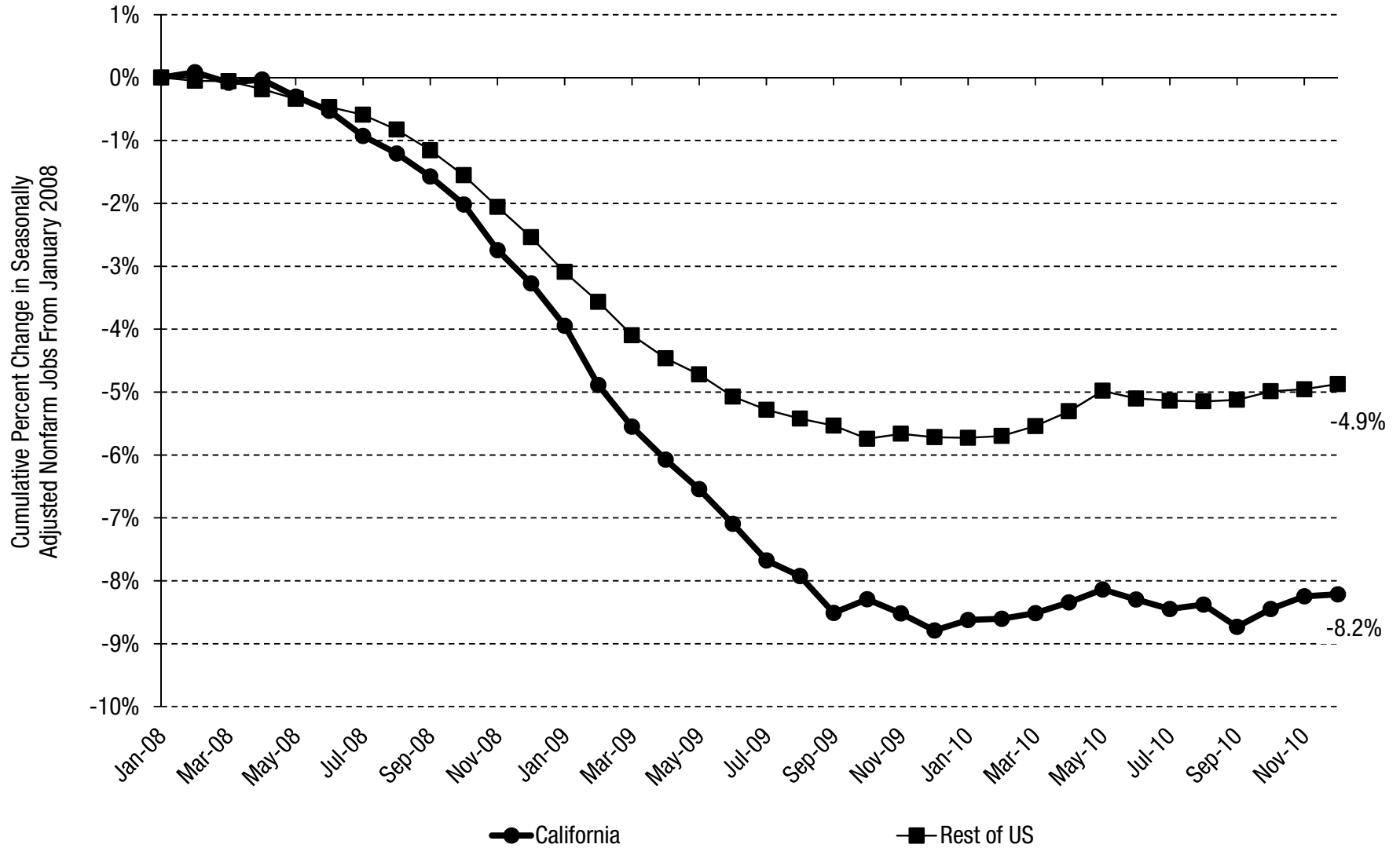
- Most experts anticipate that the economy will grow too slowly during the first few years of recovery to substantially reduce unemployment. California's unemployment rate is projected to drop by just 0.6 percentage points from an estimated 12.5 percent in 2010 to 11.9 percent in 2011, and then remain high – at 10.5 percent – in 2012.
- The income of the typical California household declined in 2009 – the most recent year for which data are available – and the poverty rate increased. Economists anticipate similar trends occurred in 2010.
- The weak labor market places additional demands on families *and* on public budgets.

California's Annual Jobless Rate Is Projected To Remain Above 10 Percent Through 2012

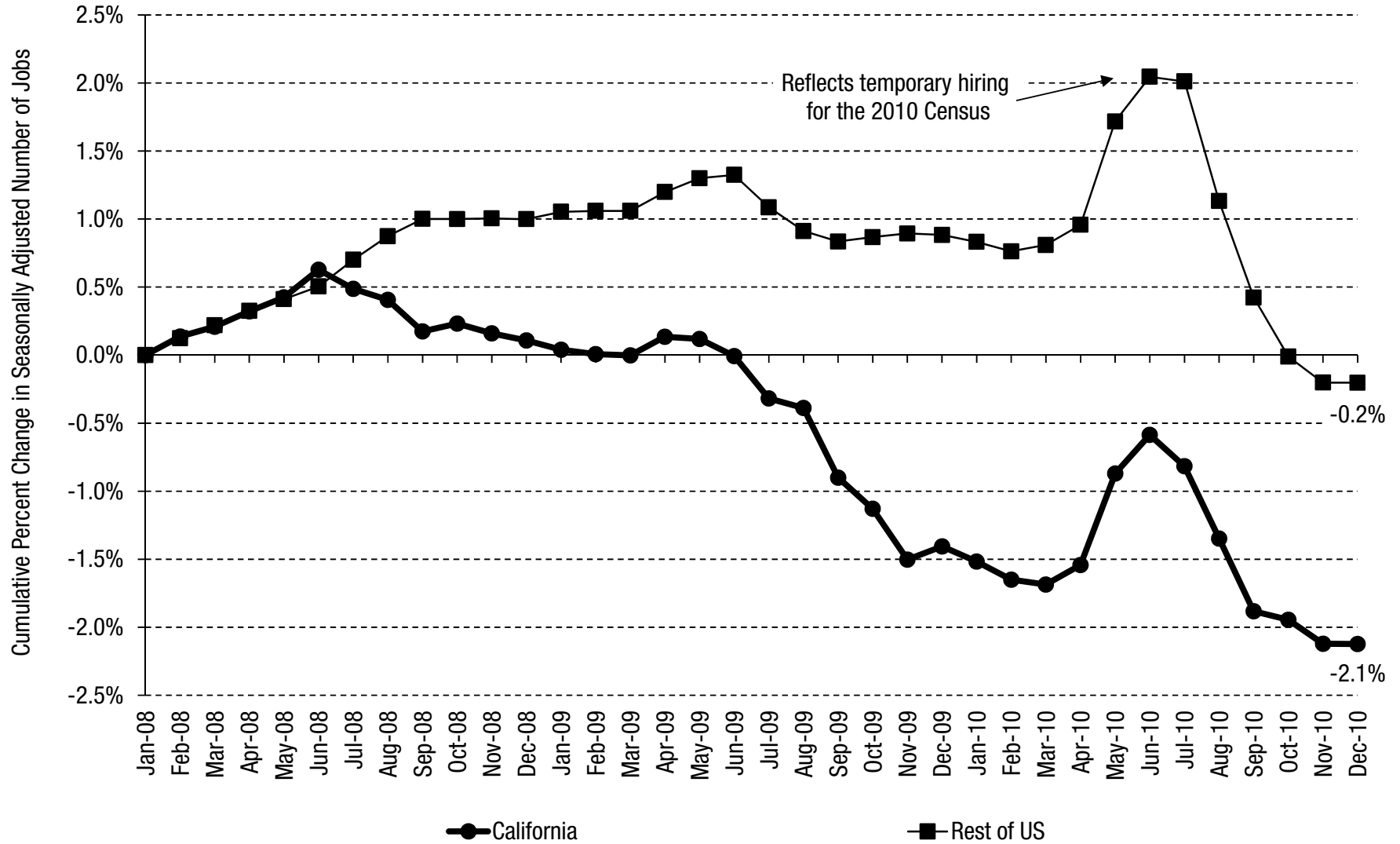


Note: 2010 is estimated, 2011 through 2016 are projected.
Source: Legislative Analyst's Office and US Bureau of Labor Statistics

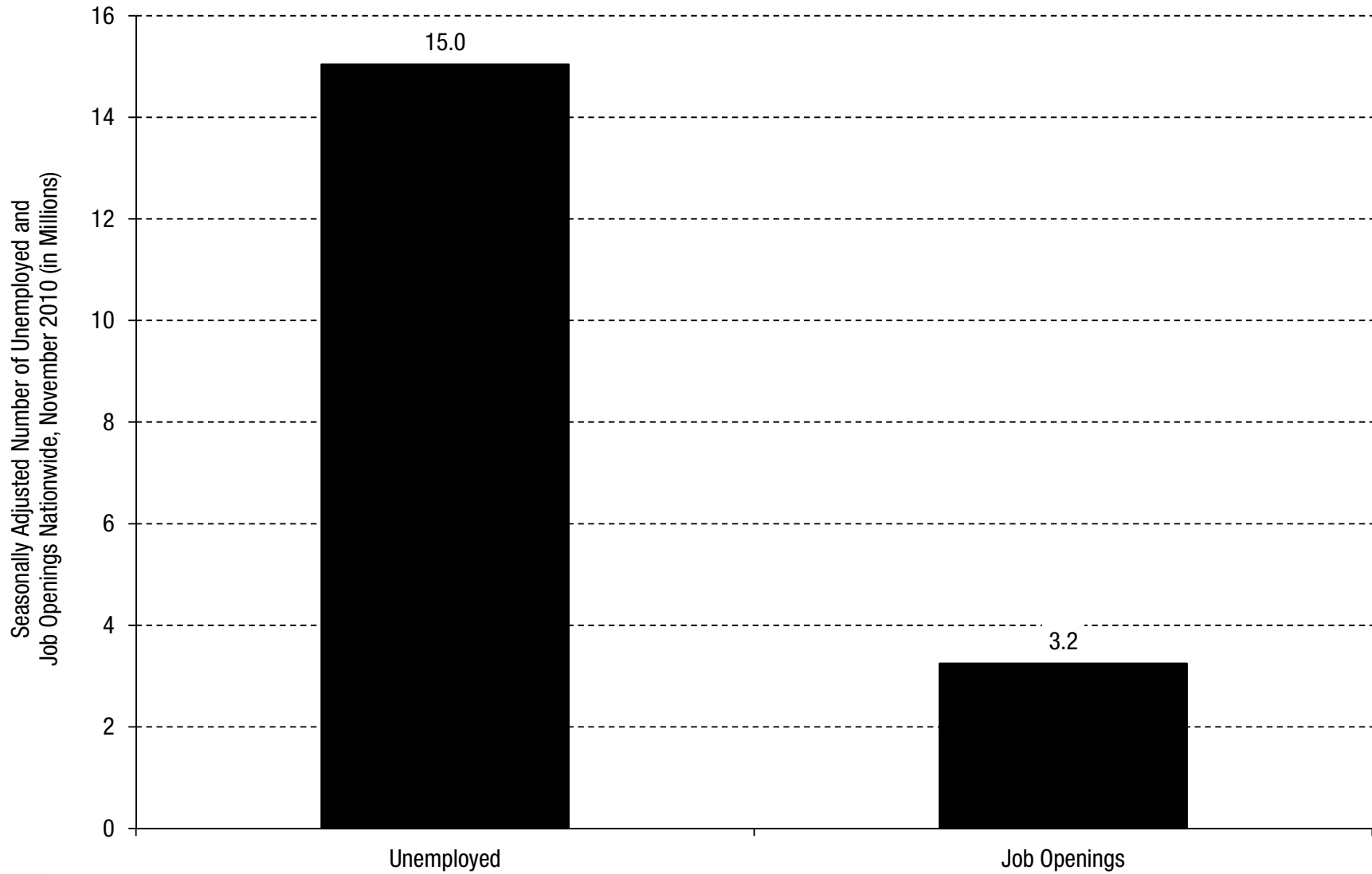
Job Losses Were Steeper in California Than in the Rest of the US During the Recession



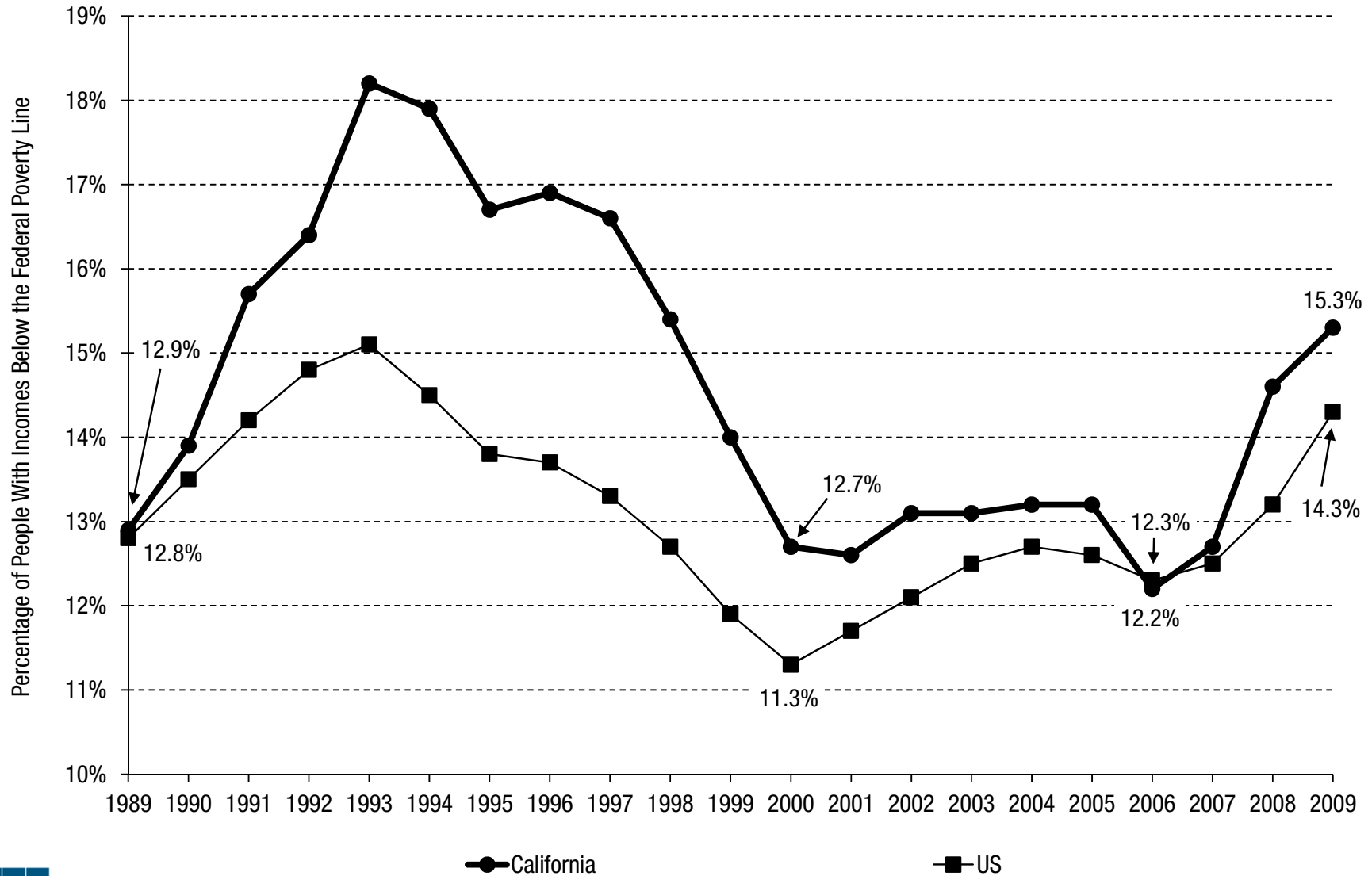
Public Sector Jobs Declined in California During the Recession



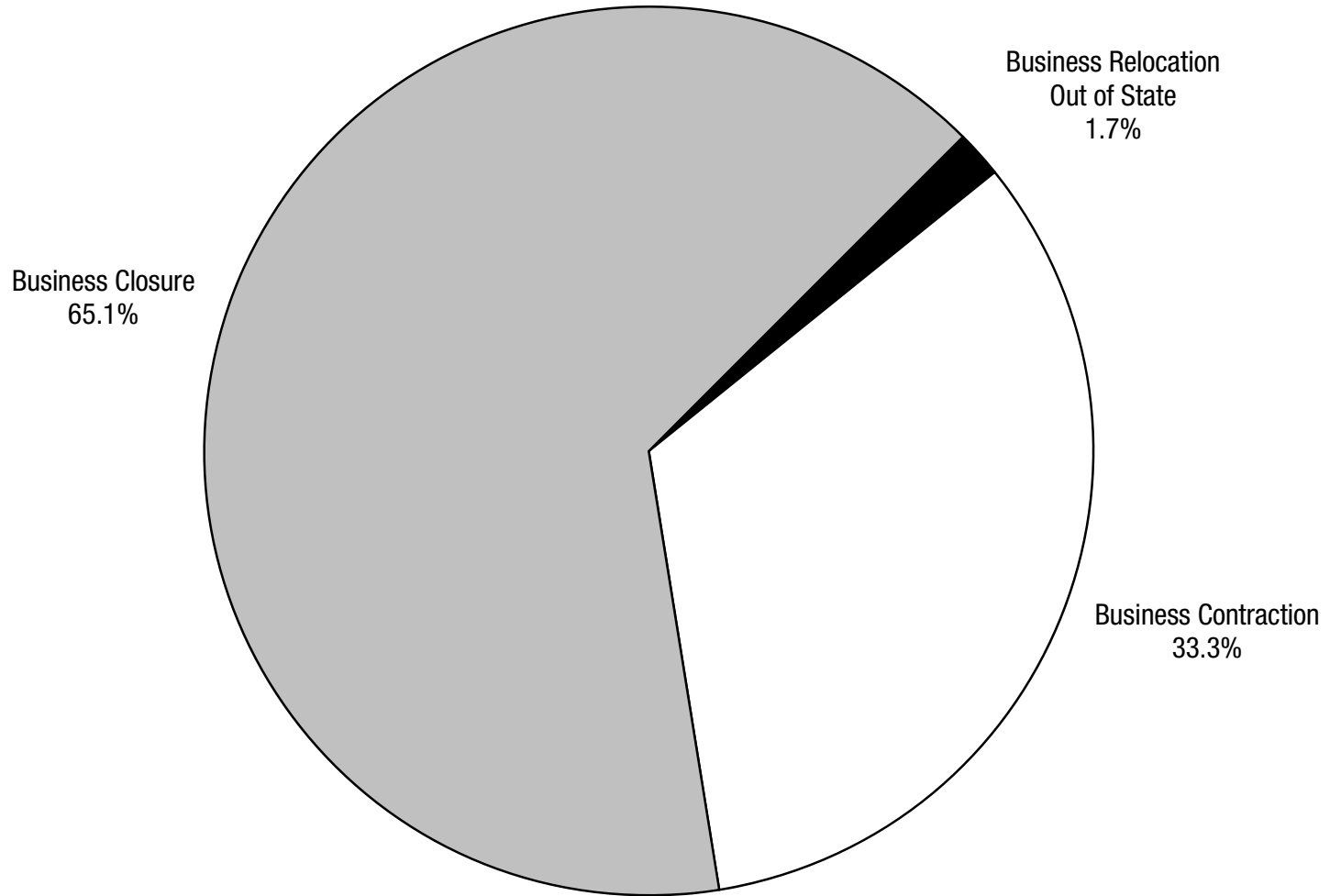
Unemployed Workers Outnumber Available Jobs by Five to One



California's Poverty Rate Increased Significantly Between 2006 and 2009



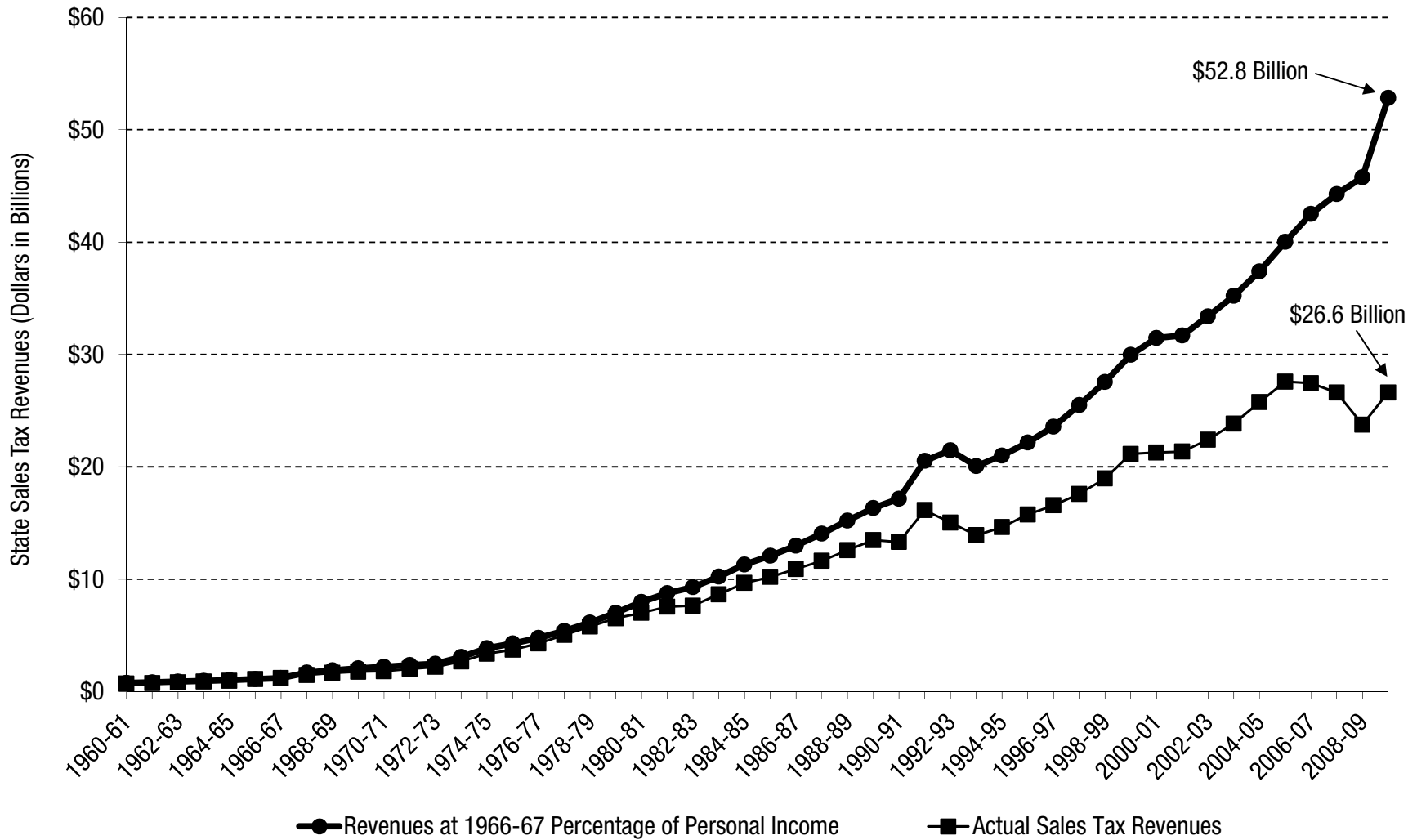
Business Relocation Made Up a Small Share of California's Job Loss Between 1992 and 2006



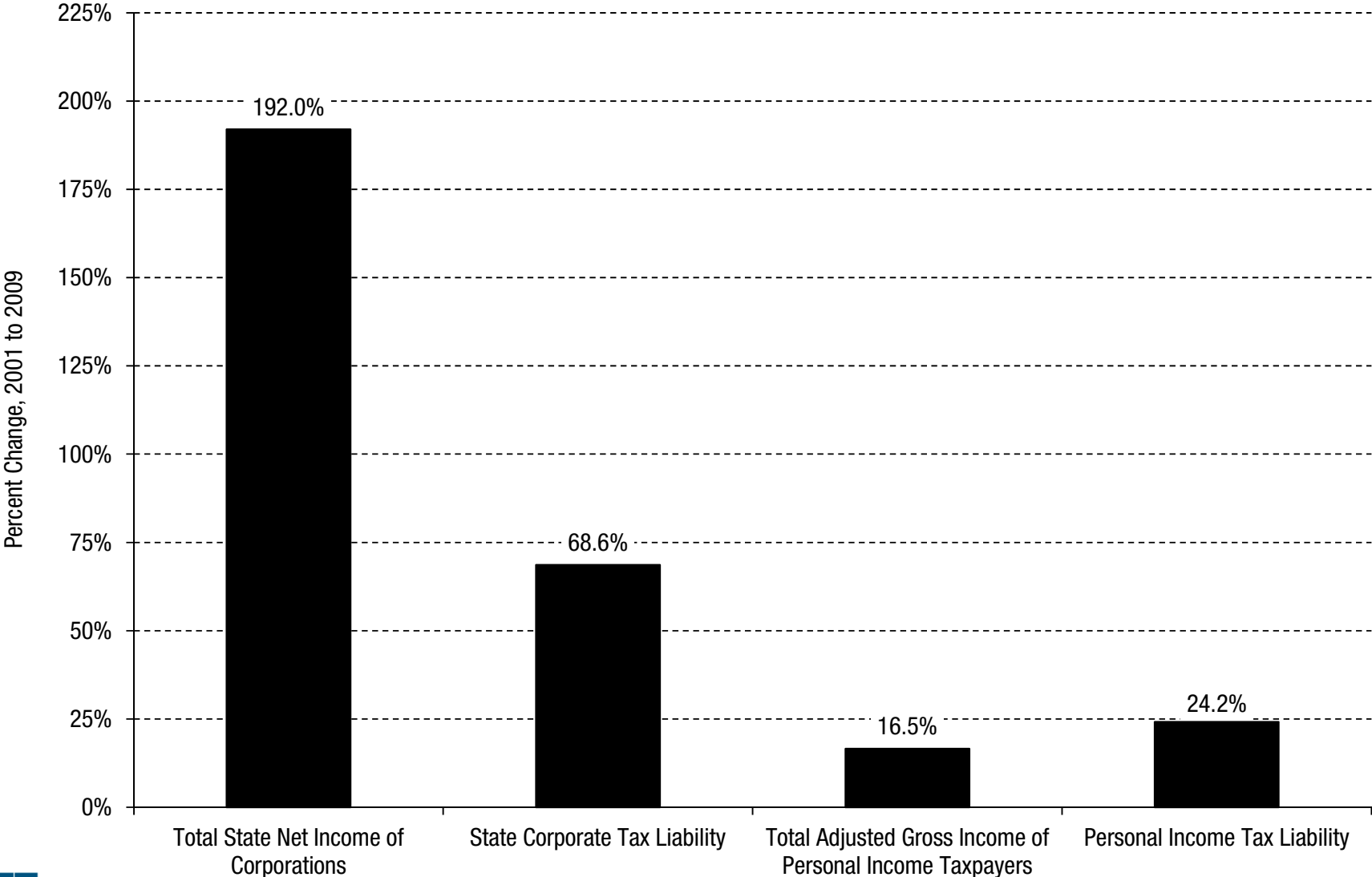
California's Tax System Is Part of the Problem

- Taxable sales have declined as a share of economic activity due to the rise of the service sector and untaxed sales.
- Corporate income tax collections have declined as a share of profits.
- The state's estate tax was eliminated as part of the Bush tax cuts early in the last decade and was not restored as part of the recent federal tax changes.
- Low- and middle-income families pay the largest share of their incomes in state and local taxes. Stagnating incomes at the bottom and middle of the income distribution have reduced growth in consumption-based revenues.
- State and local tax collections have declined as a share of the state's economy due to the trends listed above and legislated tax cuts.

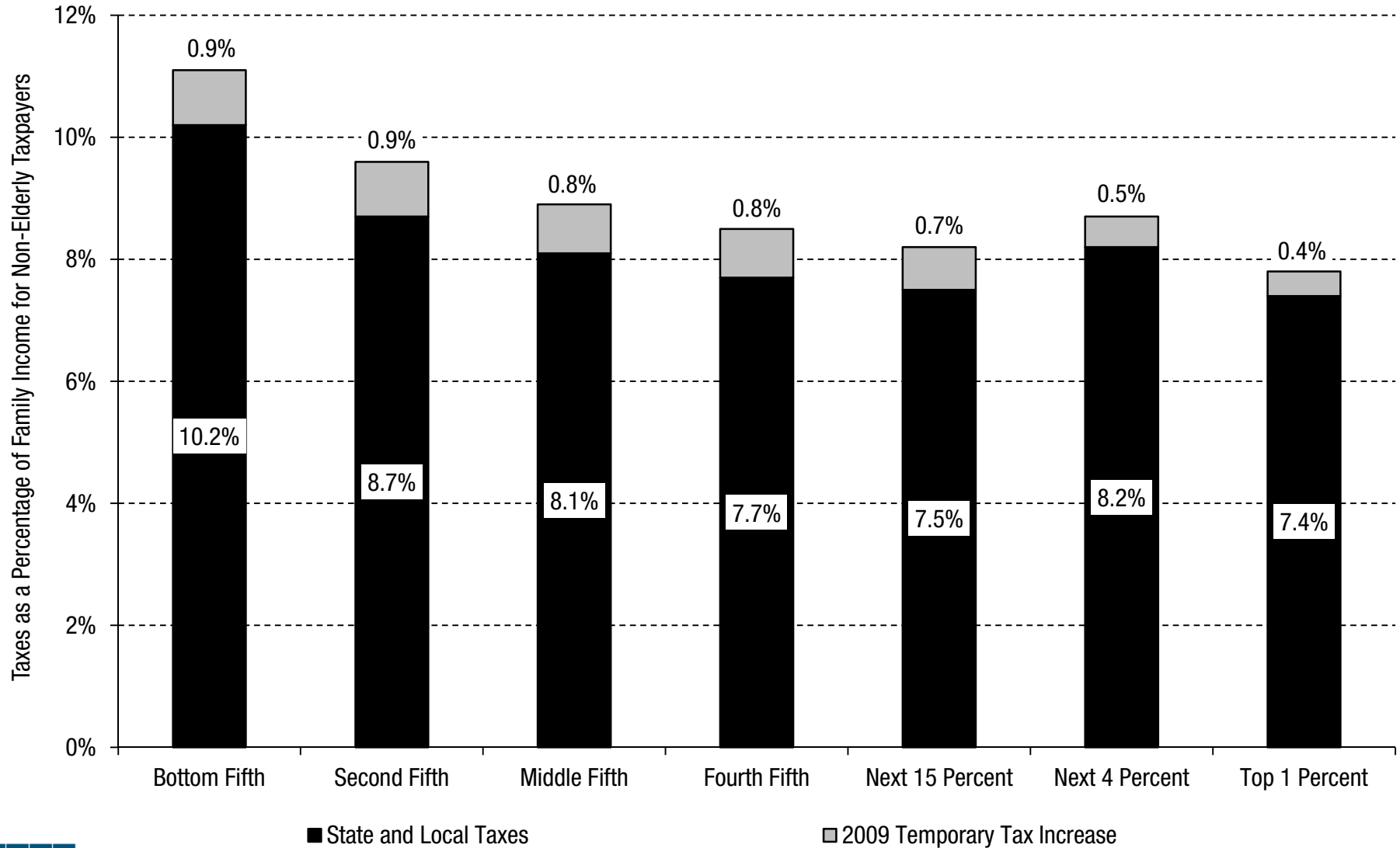
State Sales Tax Revenues Would Be \$26 Billion Higher if Taxable Sales Had Remained at 1966-67 Levels as a Share of the Economy



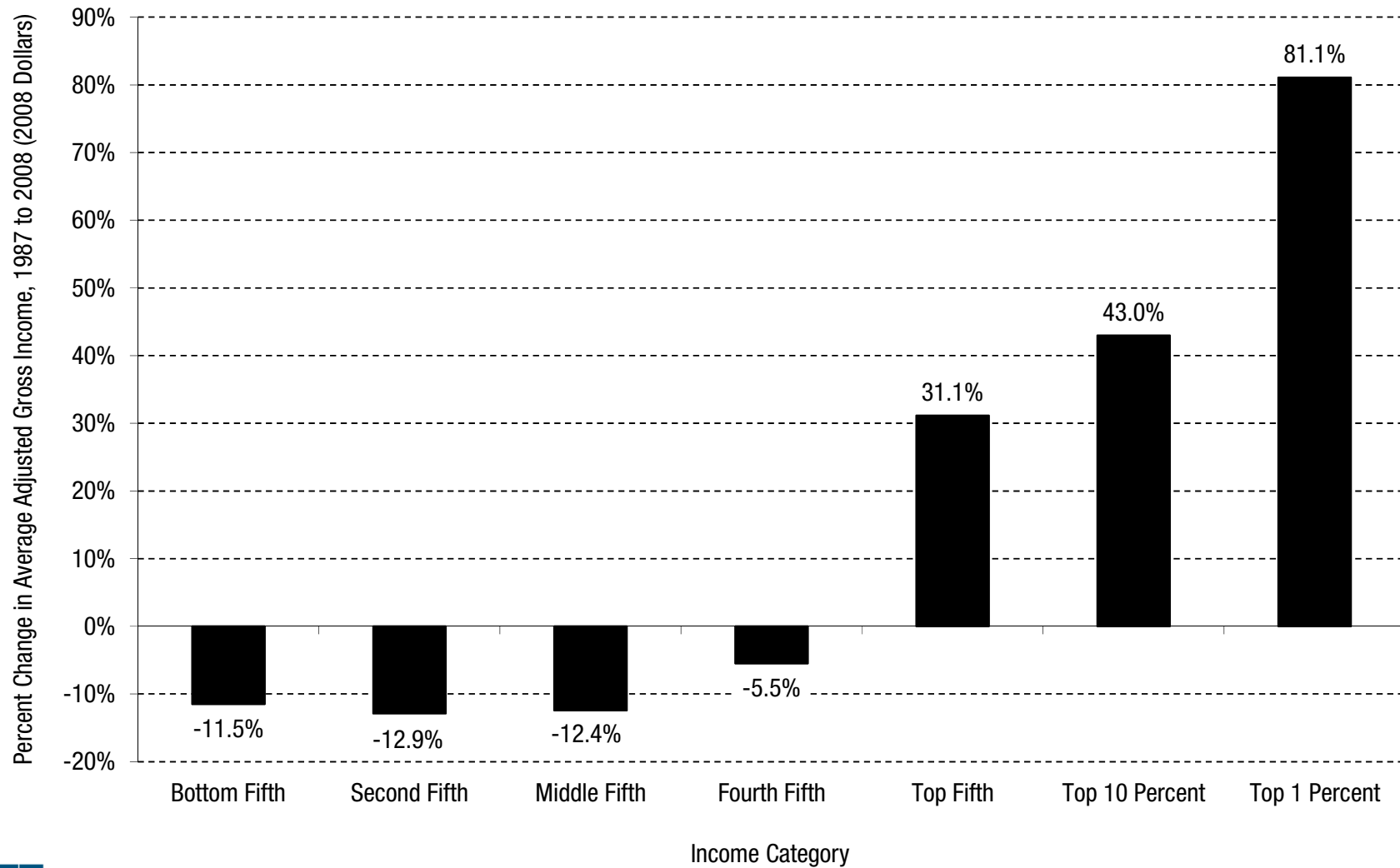
Recent Growth in Corporate Profits Has Outpaced Growth in Corporate Tax Payments



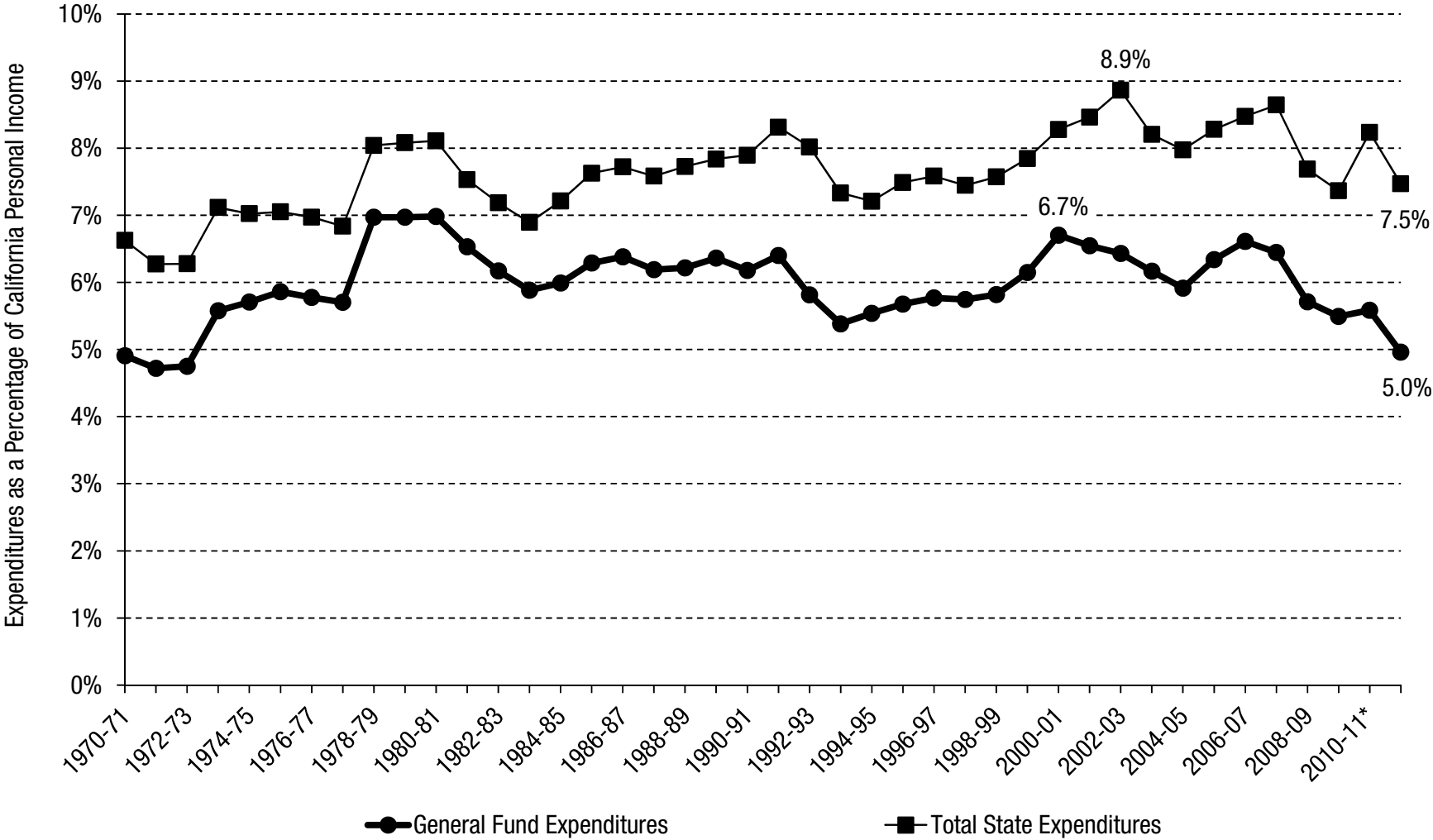
The Lowest-Income Families Pay the Largest Share of Their Income in State and Local Taxes



The Incomes of the Wealthiest Californians Have Increased Significantly Over the Past Two Decades, While Those of All Other Californians Have Declined

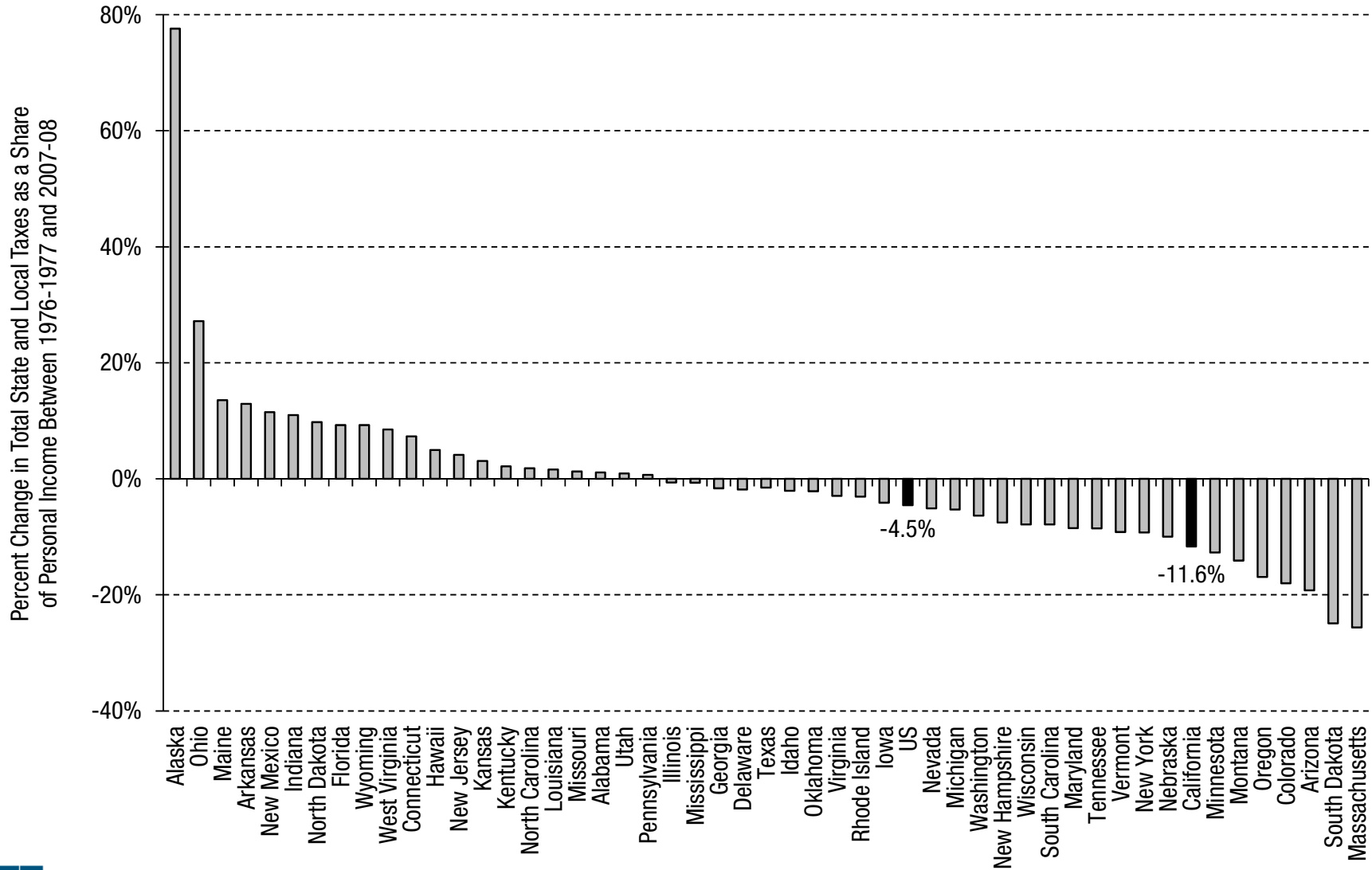


State Spending as a Share of the State's Economy Has Declined in Recent Years and Would Drop Further Under the Governor's Proposed 2011-12 Budget



* 2010-11 estimated and 2011-12 projected.
Source: CBP analysis of Department of Finance and US Bureau of Economic Analysis data

State and Local Taxes Have Declined Significantly in California Relative To Other States



How Does California Compare? Revenues as a Percentage of Personal Income

	California Rank	California	US
Total State and Local Own Source (2007-08)	12	16.91%	15.90%
Total State and Local Taxes (2007-08)	10	11.65%	10.88%
State Taxes (2008-09)	21	6.35%	5.85%
Local Taxes (2007-08)	19	4.30%	4.46%
State Individual Income Tax (2008-09)	9	2.79%	2.01%
State Corporate Income Tax (2008-09)	4	0.60%	0.33%
State and Local General Sales Taxes (2007-08)	22	2.57%	2.49%
State General Sales Tax (2008-09)	29	1.82%	1.87%
State and Local Property Tax (2007-08)	20	3.30%	3.35%
State Motor Fuels Taxes (2008-09)	45	0.20%	0.29%
State Tobacco Tax (2008-09)	46	0.06%	0.14%
State Alcoholic Beverage Sales Taxes (2008-09)	41	0.02%	0.04%

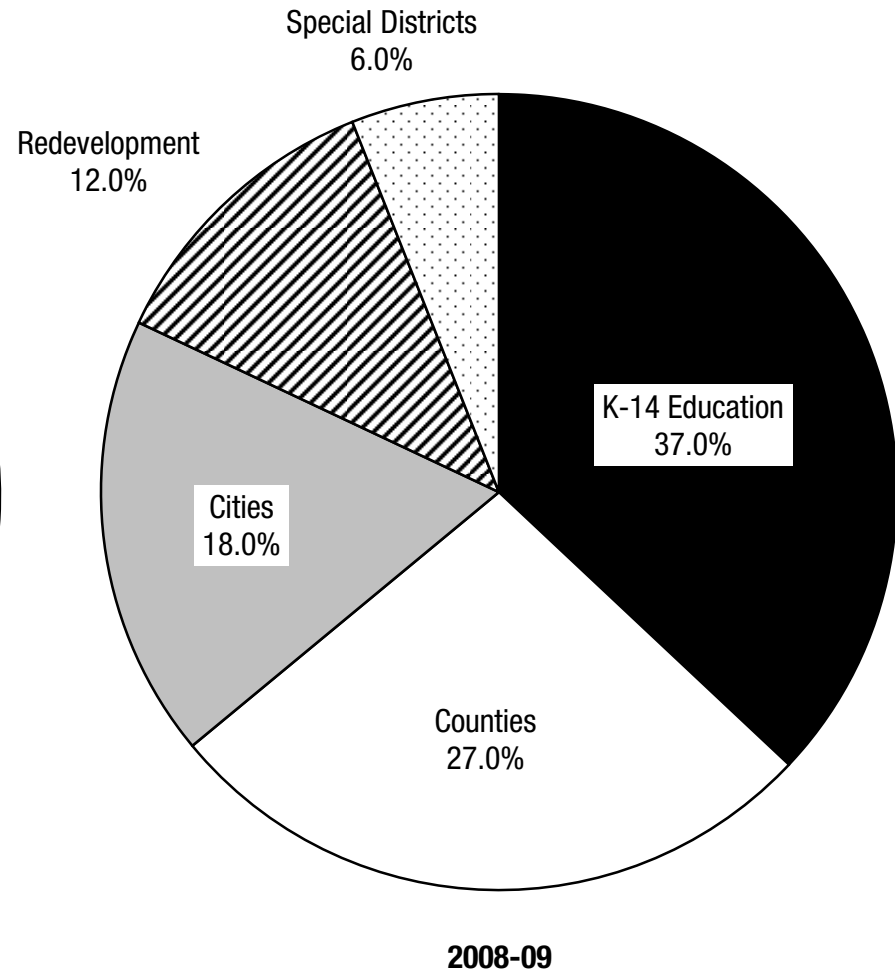
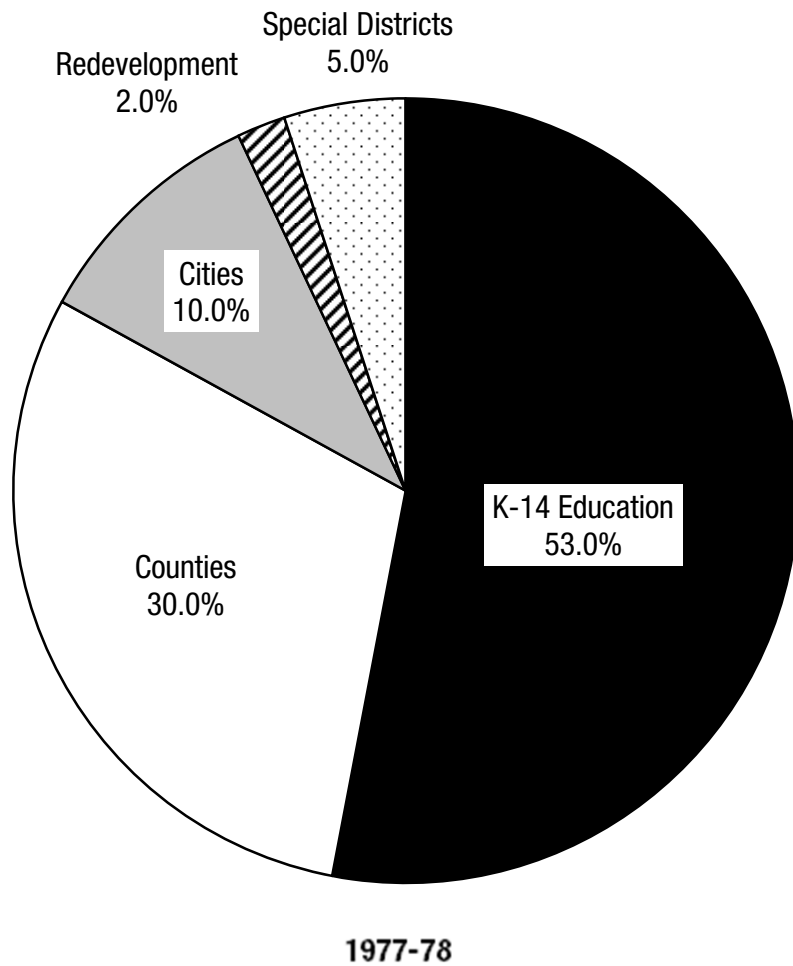
Realigning Responsibility

- The Governor proposes to shift responsibility for a set of criminal justice, mental health, human services, and other programs to counties along with a dedicated, but temporary, source of revenues.
- While there is broad conceptual support for shifting more responsibility to the local level, key questions remain:
 - Where will the money come from when the temporary tax extensions end?
 - Will growth in revenues match growth in program demands?
 - What is the appropriate balance between providing local flexibility and ensuring that statewide standards are met?

Eliminating State Subsidies for Local Economic Development

- The Governor proposes to end state support for two programs that subsidize local economic development activities by:
 - Eliminating redevelopment agencies and using \$5.2 billion in 2011-12 “tax increment” revenues to repay redevelopment agency debt (\$2.2 billion); provide pass-through payments to schools and local agencies (\$1.1 billion); offset state costs (\$1.7 billion); and make payments to local governments (\$210 million). In future years, property tax increment revenues would be allocated to schools and local governments and repay redevelopment agency debt.
 - Eliminating the state’s Enterprise Zone Program and related tax breaks for savings of \$924 million in 2010-11 and 2011-12 and more than \$600 million per year thereafter.

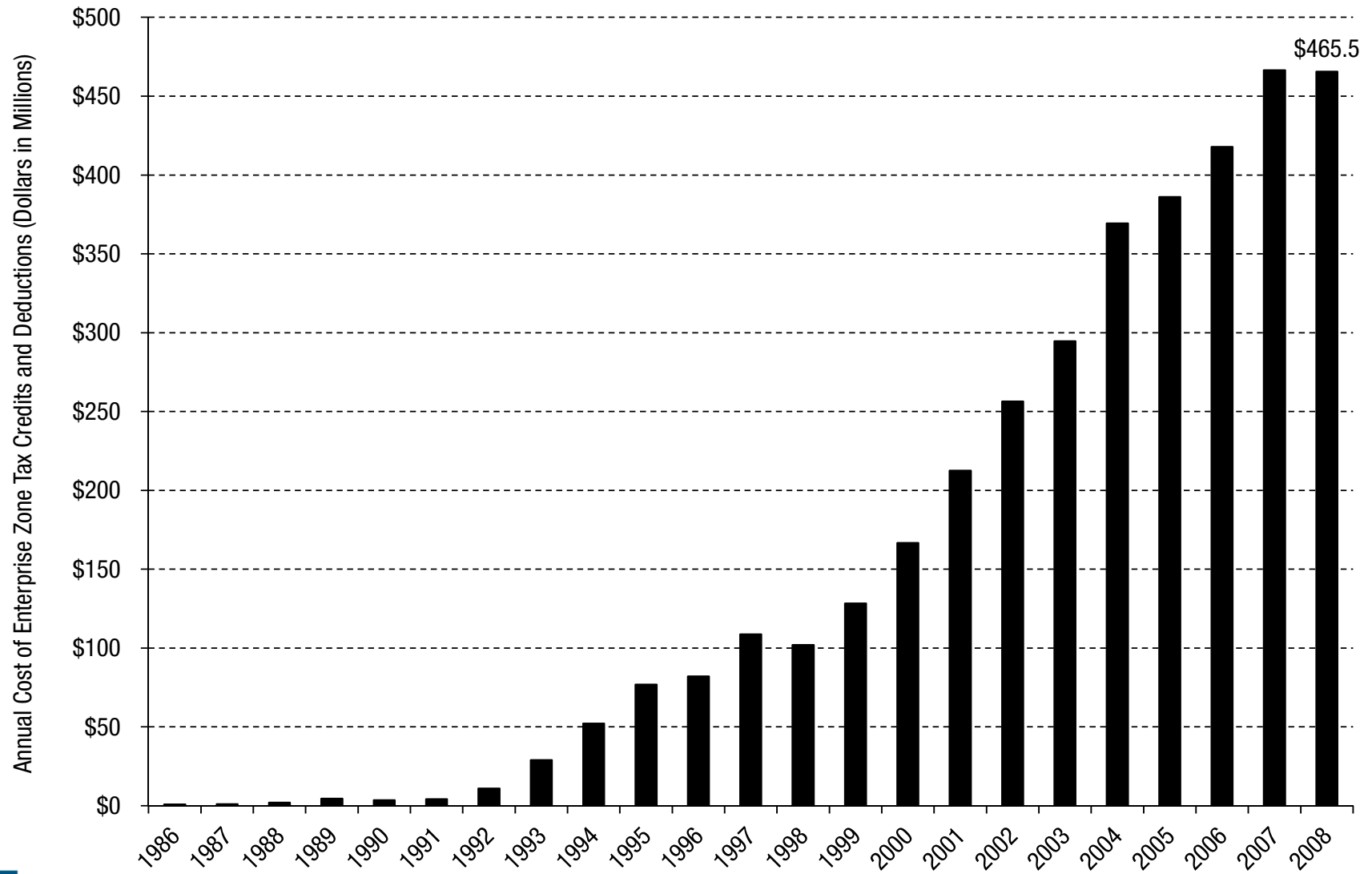
Redevelopment Agencies Received 12 Percent of Statewide Property Taxes in 2008-09, Compared to 2 Percent in 1977-78



What Does the Research Say About Redevelopment?

- The Public Policy Institute of California concluded that “the existing tax increment system is not an effective way to finance redevelopment. Few projects generate enough increase in assessed value to account for their share of these revenues.”
- The Legislative Analyst’s Office concluded that “there is no reliable evidence that redevelopment projects attract businesses to the state or increase overall economic development in California. The presence of a redevelopment area might shift development from one location to another, but does not significantly increase economic activity statewide.”

The Cost of Enterprise Zone Tax Credits and Deductions Has Skyrocketed



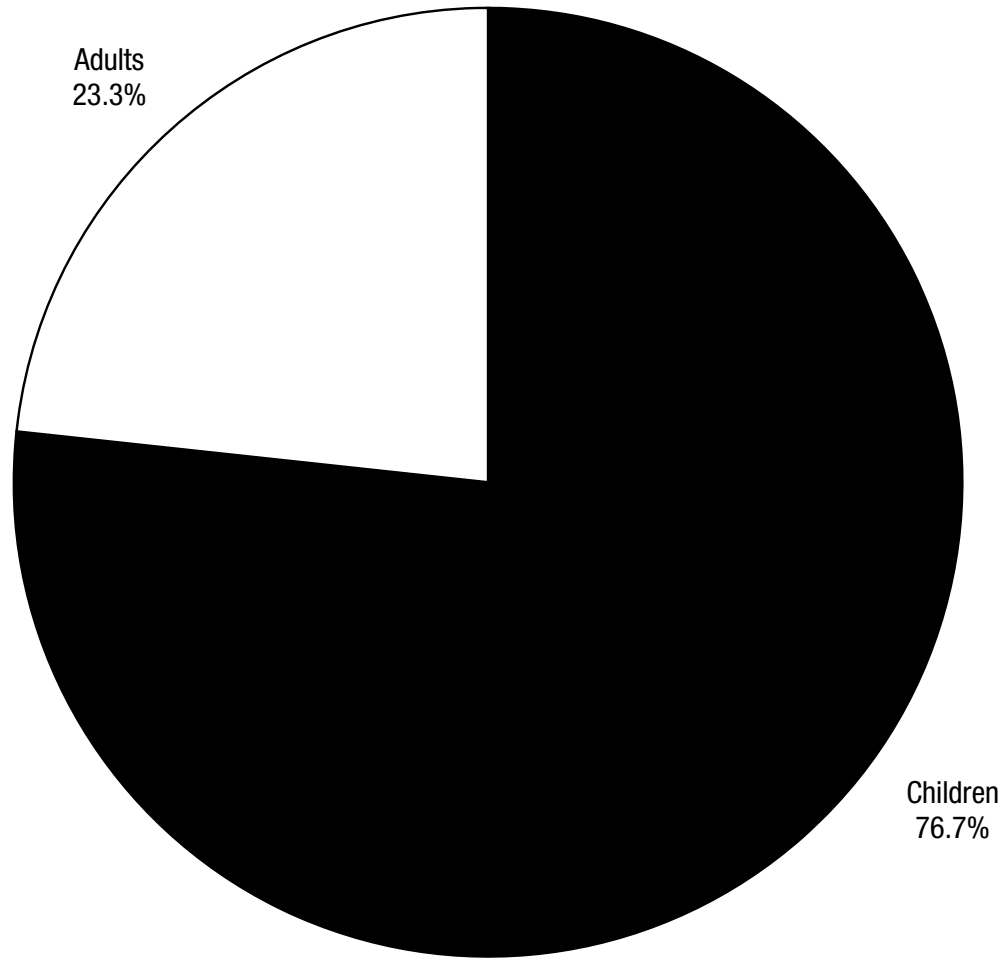
Research Finds That Enterprise Zones Fail To Create Jobs or Businesses

- The Public Policy Institute of California (PPIC) found that “California’s enterprise zone program – the state’s largest economic development program – has no statistically significant effect on employment.”
- The PPIC researchers concluded that “the absence of evidence of a beneficial effect of California’s enterprise zones on job and business creation clearly calls into question whether the state should continue to grant enterprise zone tax incentives. . . . For a cash-strapped state, it is too costly a program to simply continue with ‘business as usual’ without clearer evidence of the program’s benefits or a well-defined plan to make the program more effective.”

The Governor Proposes Substantial Cuts to CalWORKs

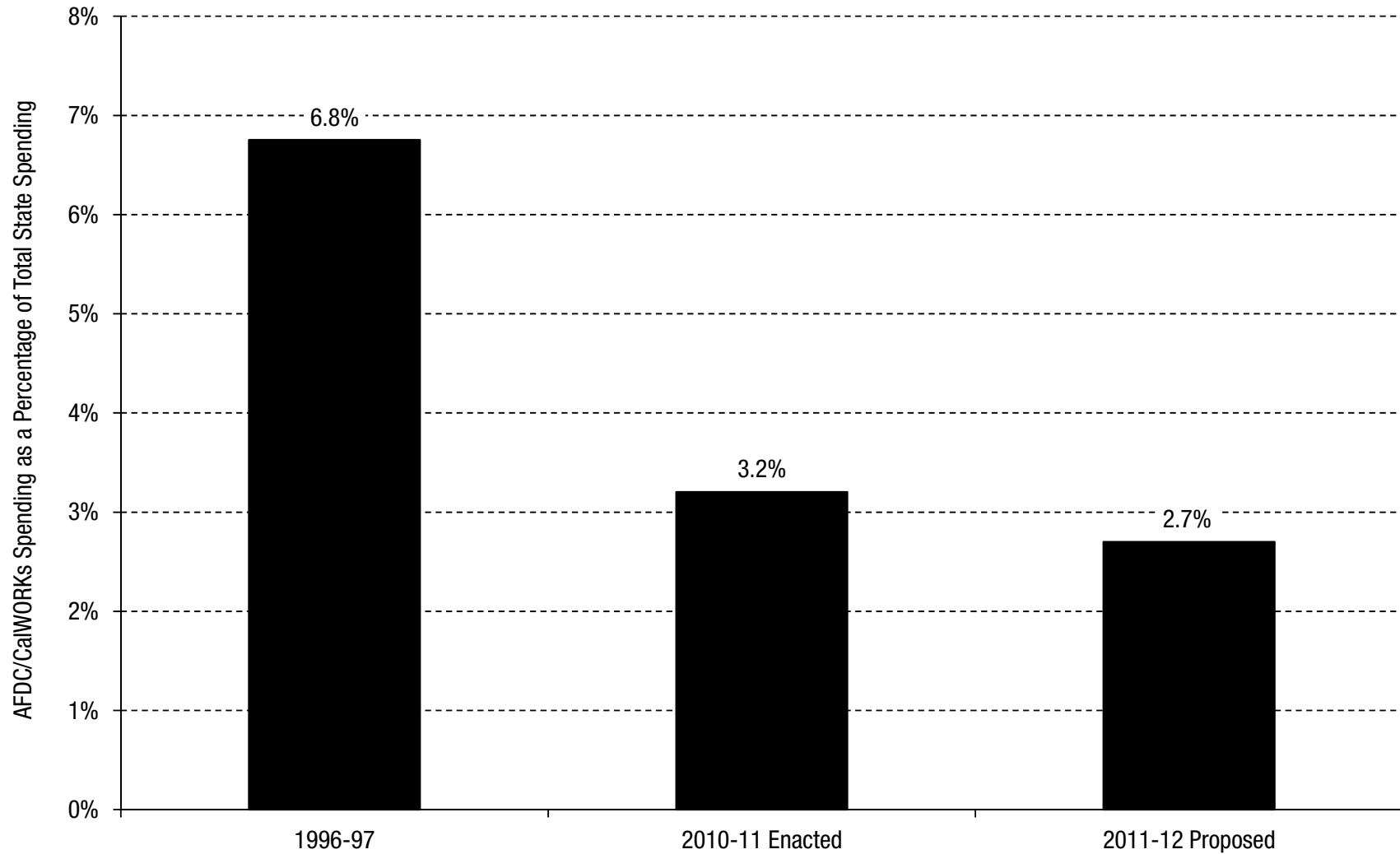
- The Governor proposes to:
 - Limit families to 48 months of cash assistance effective July 1, 2011 for savings of \$851.0 million in 2011-12. This cut would be applied retroactively. Approximately 115,000 families with 234,000 children would lose benefits. Some families could receive a child-only grant beyond 48 months.
 - Reduce grants by 13.0 percent effective June 1, 2011 for savings of \$14.3 million in 2010-11 and \$415.0 million in 2011-12.
 - Cut funding that counties use to provide services and child care by \$376.9 million in 2011-12.

More Than Three Out of Four CalWORKs Recipients Are Children

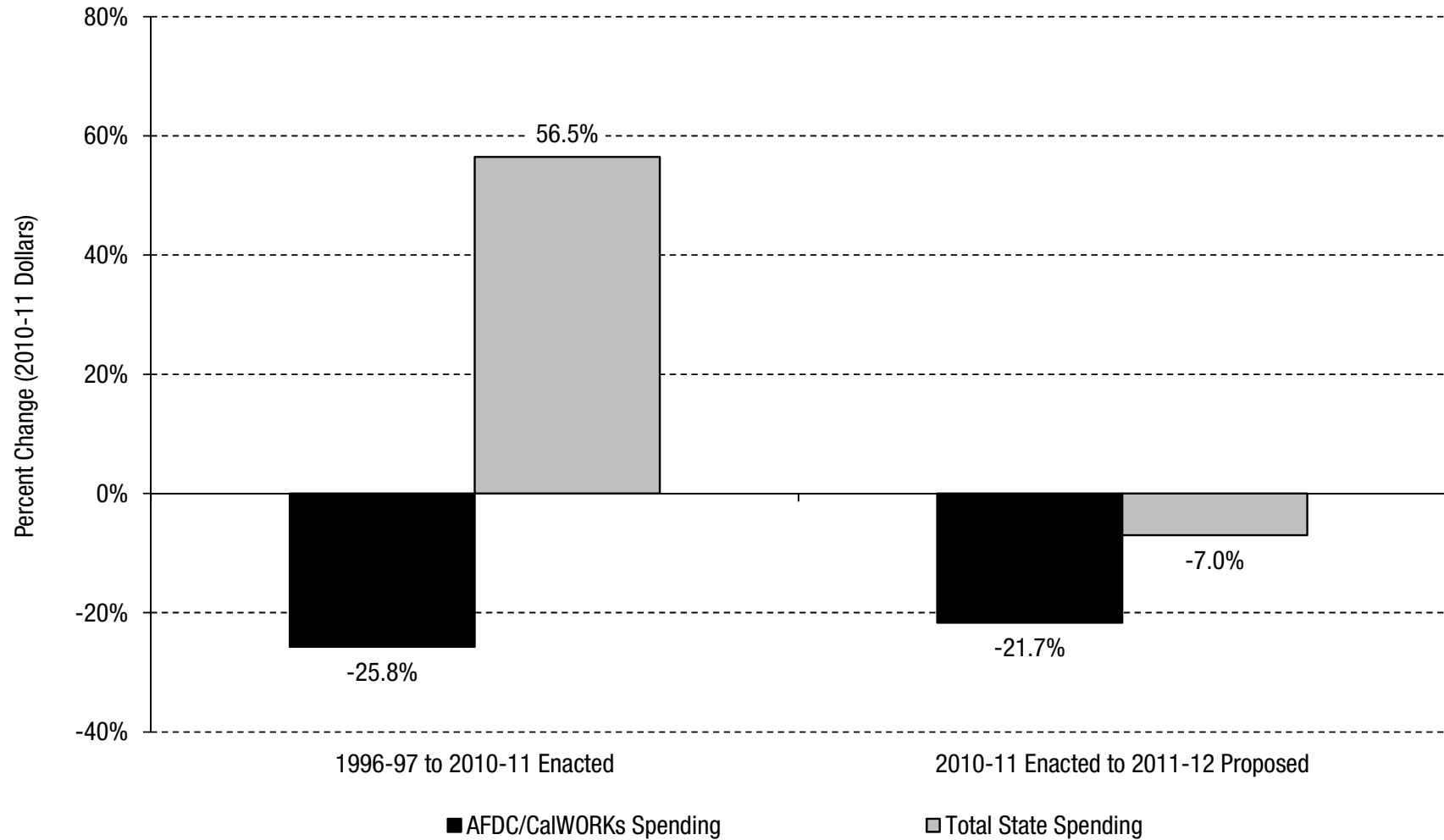


Number of Individuals Receiving CalWORKs Cash Assistance in September 2010 = 1.4 Million

Welfare Spending as a Share of Total Spending in California Has Dropped by More Than Half Since 1996-97



Welfare Spending Has Fallen by One-Quarter Since 1996-97 and Would Drop Further Under the Governor's Proposed 2011-12 Budget

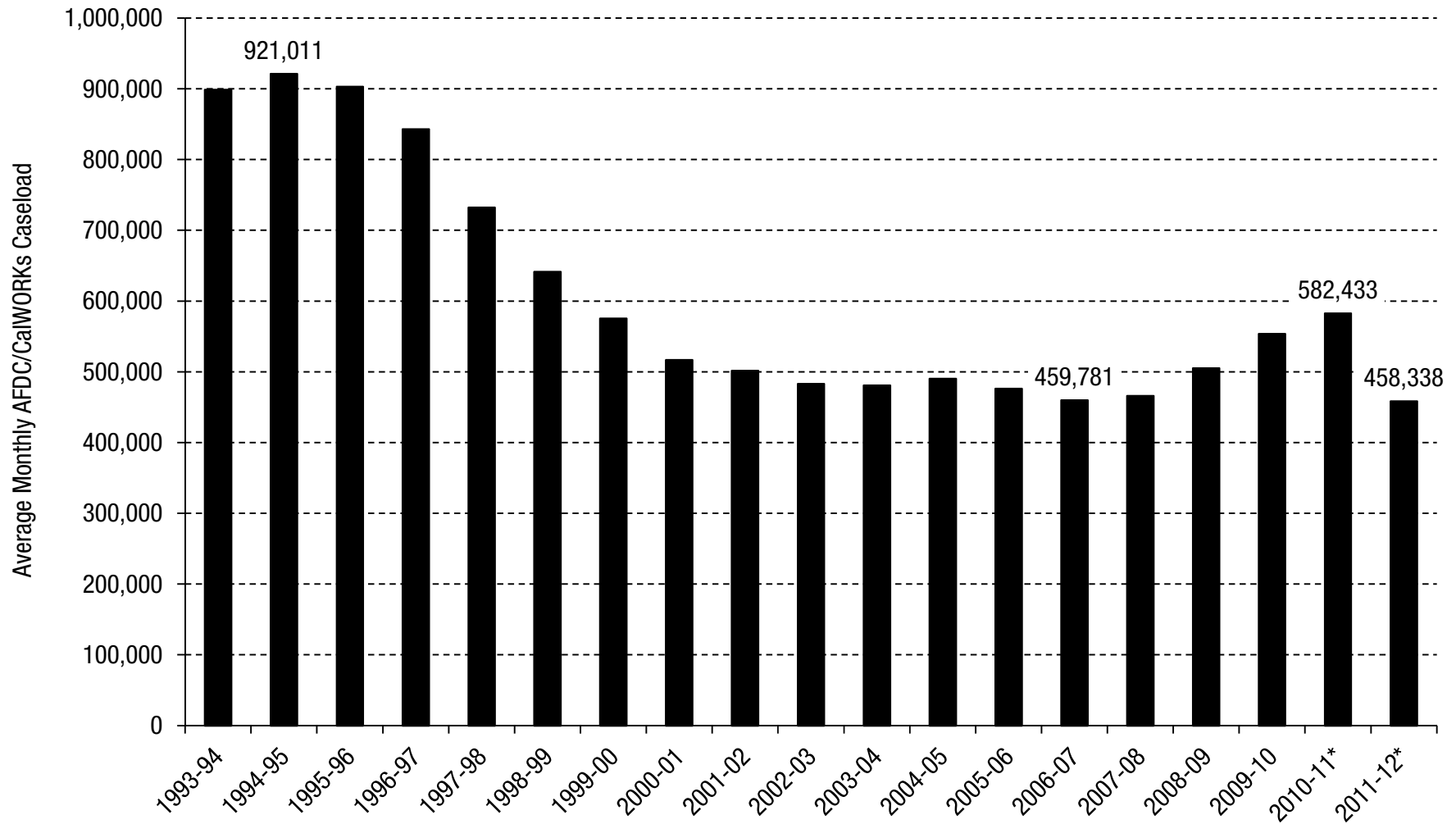


Note: AFDC/CalWORKs spending includes county, state, and federal funds.

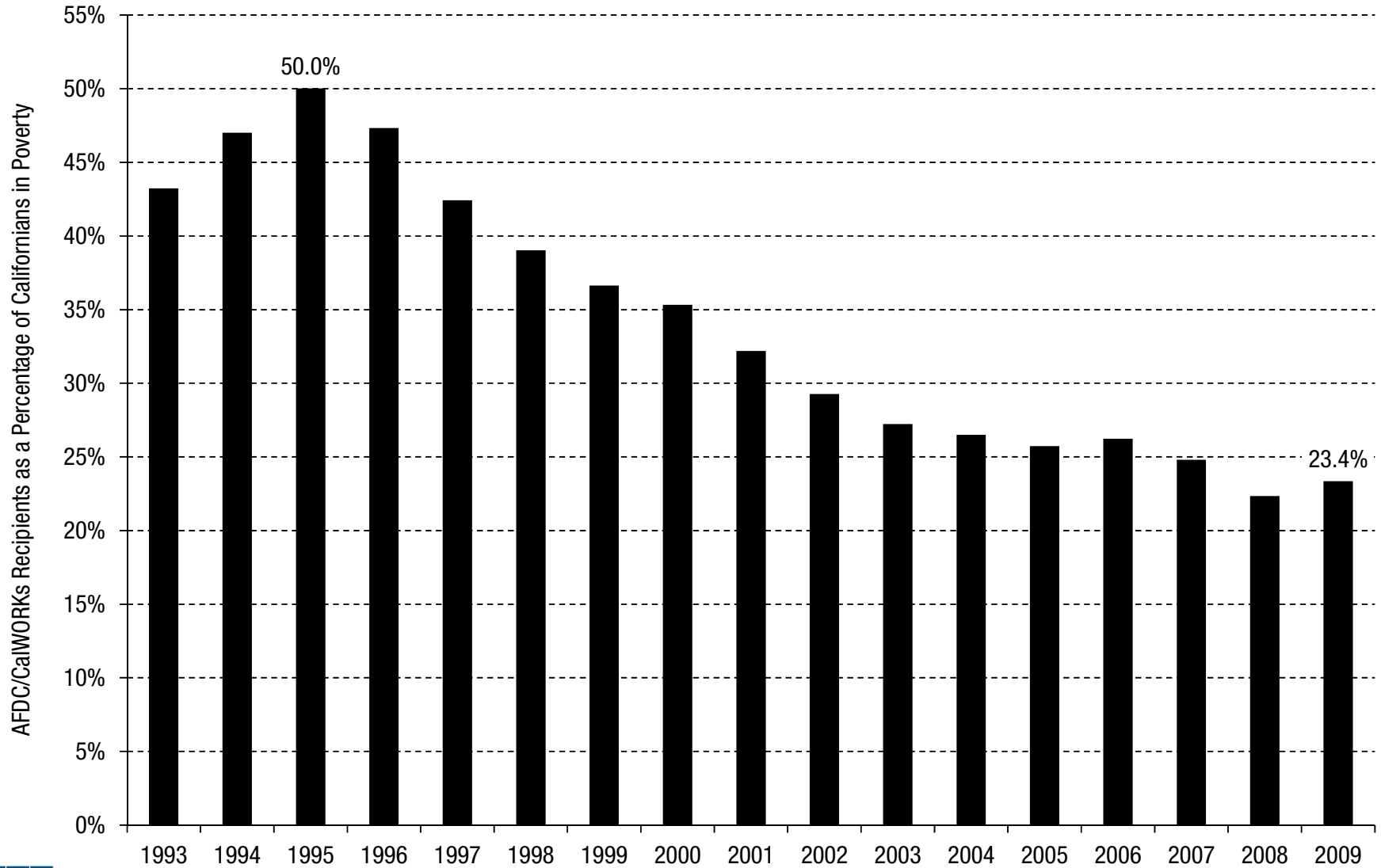
Total state spending includes state and federal funds.

Source: Department of Finance and Department of Social Services

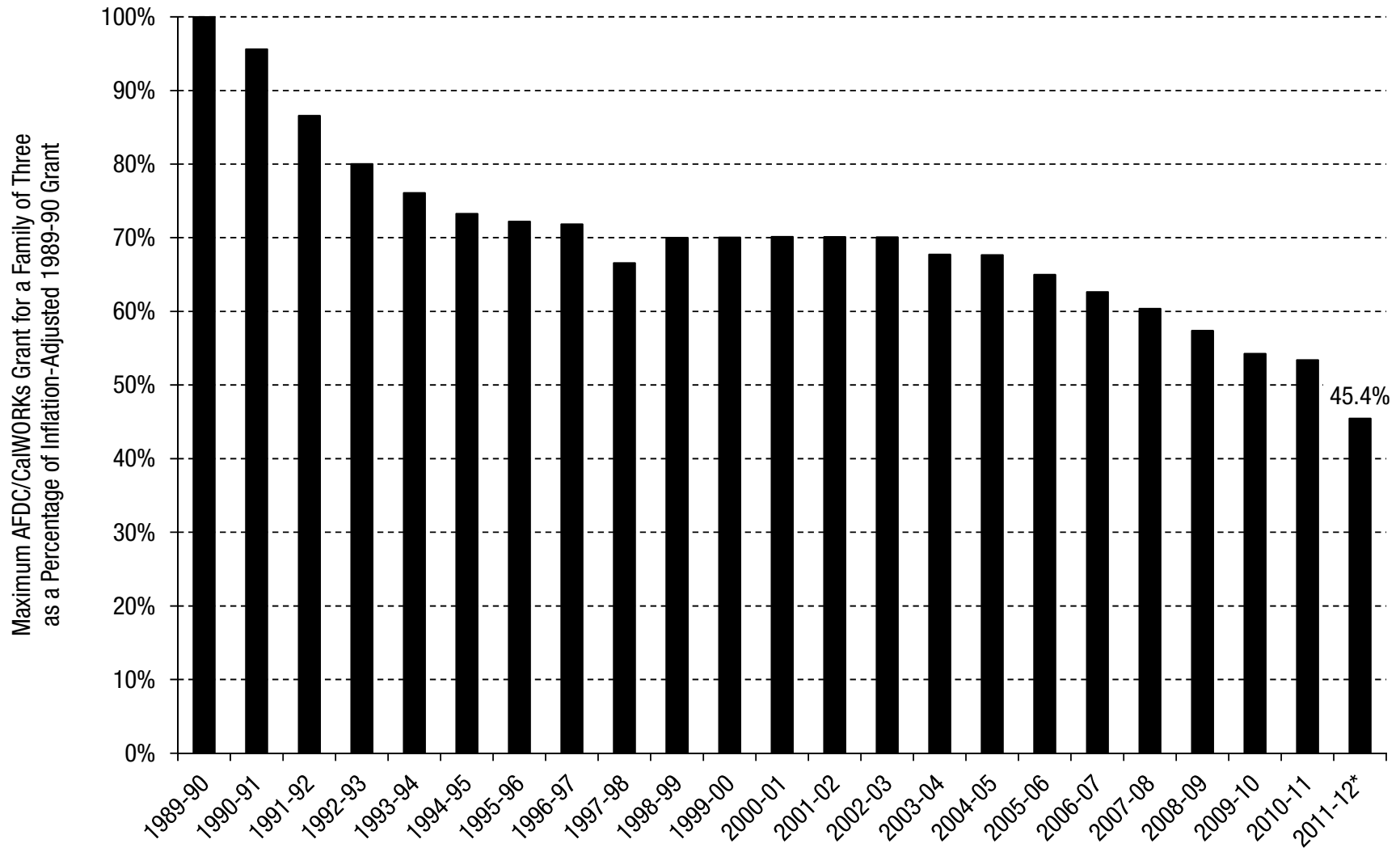
The Number of Families Receiving CalWORKs Cash Assistance Would Drop by Nearly 125,000 Under the Governor's Proposed 2011-12 Budget



Californians in Poverty Are Much Less Likely To Receive Cash Assistance Than in the Mid-1990s



Purchasing Power of CalWORKs Grants Would Drop Further Under the Governor's Proposed 2011-12 Budget

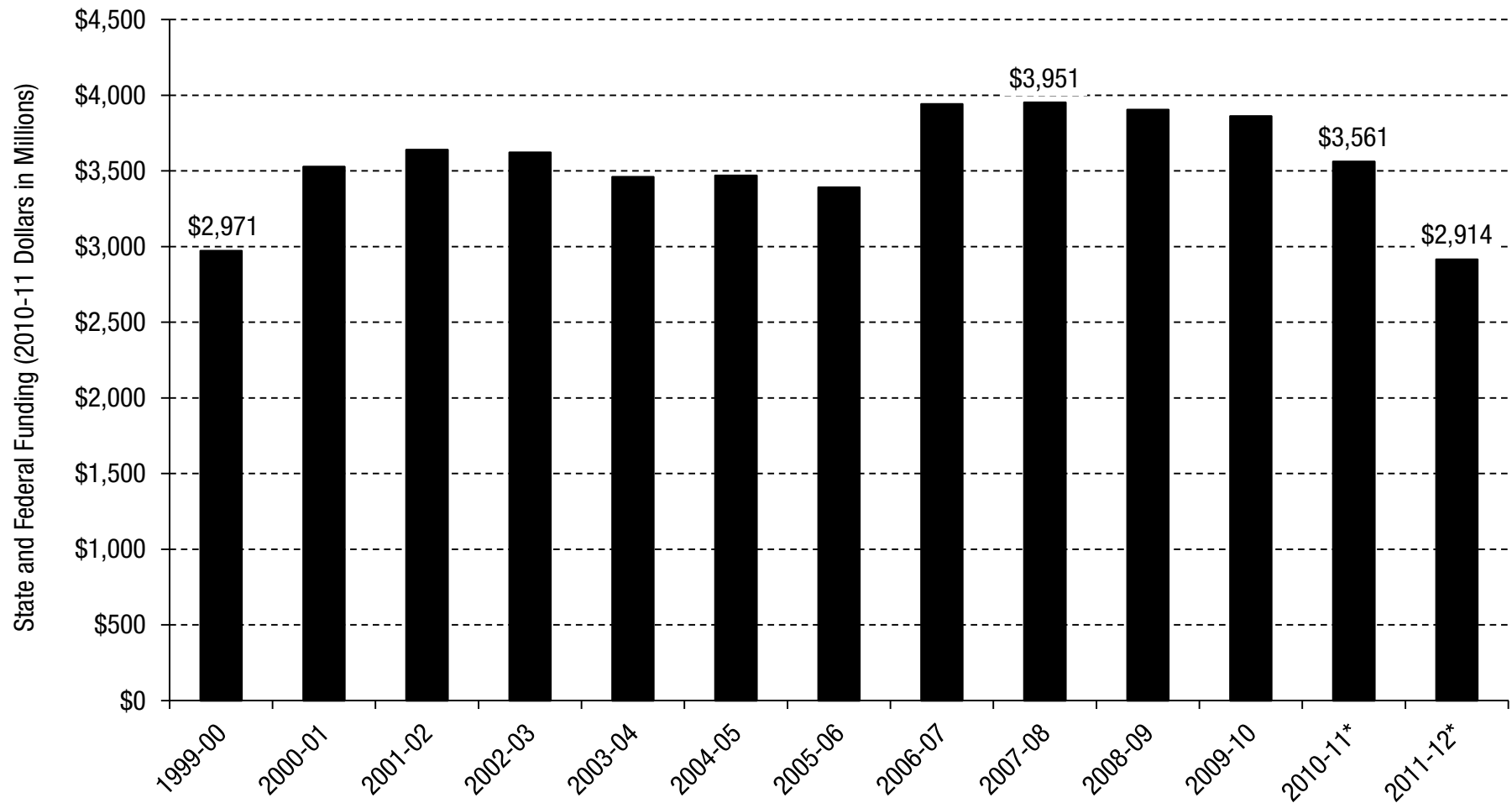


The Governor Proposes Cuts to Child Care Assistance

- The Governor proposes to:
 - Reduce the amount of funding for each child care slot by 35 percent for savings of \$577 million. This proposal assumes that costs would be shifted to families to make up for reduced state funding.
 - Reduce the income limit from 75 percent of the state median income (SMI) to 60 percent of the SMI for savings of \$79 million. The income limit for a family of three would decline from \$45,225 to \$36,180 per year – a 20.0 percent cut.
 - Eliminate child care assistance for 11- and 12-year-olds for savings of \$93 million. Approximately 14,000 children would lose child care.

Total Funding for Child Care and Development Programs Would Drop Significantly in 2011-12

Afterschool Funding Has Increased From \$67 Million in 1999-00 to a Projected \$687 Million in 2011-12, After Adjusting for Inflation



* 2010-11 estimated and 2011-12 proposed.

Source: California Department of Education, Department of Finance, Department of Housing and Community Development, Department of Social Services, and Legislative Analyst's Office

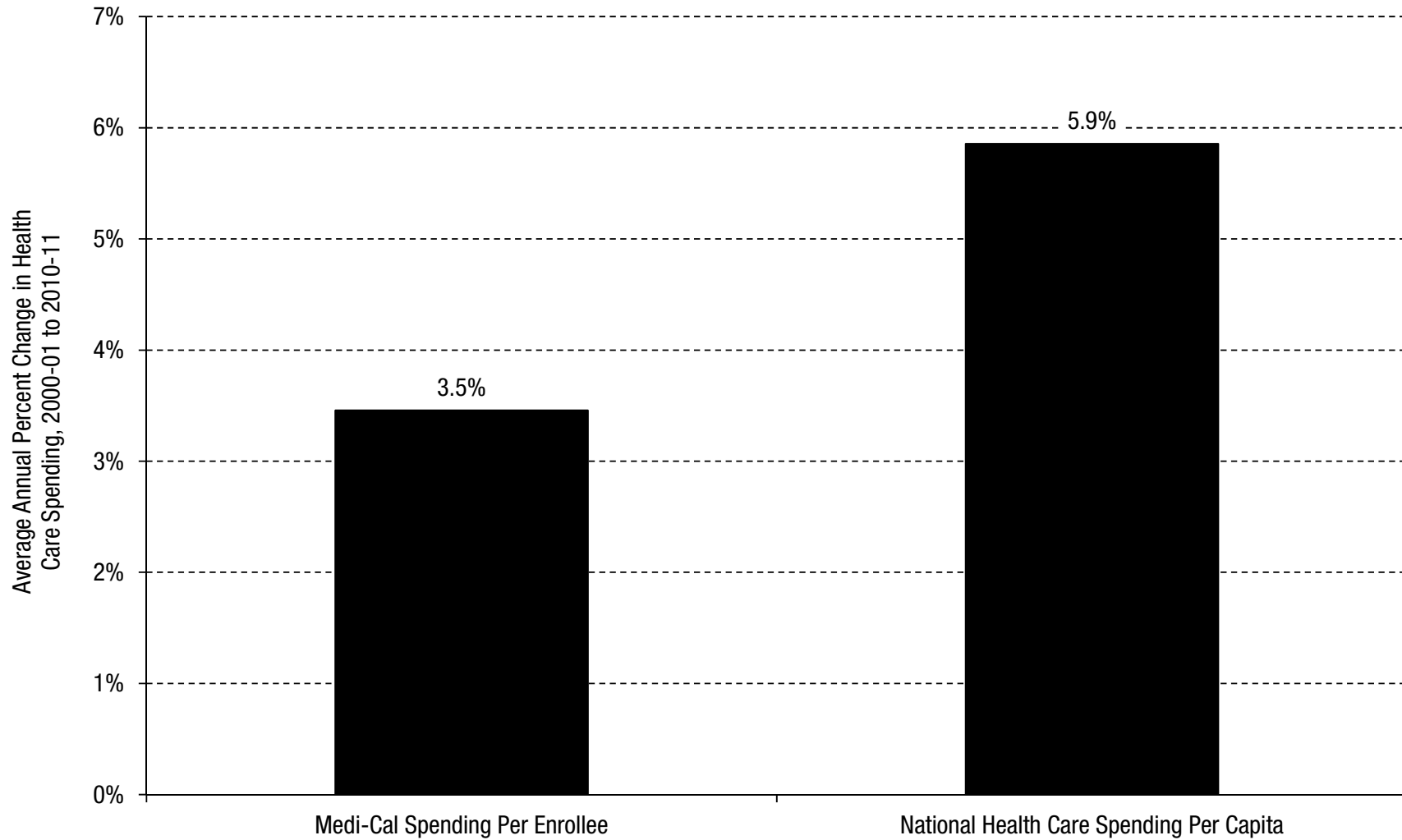
The Governor Proposes Substantial Cuts to IHSS

- The Governor proposes to:
 - Reduce all In-Home Supportive Services (IHSS) recipients' authorized hours by 8.4 percent for state savings of \$127.5 million in 2011-12.
 - Eliminate domestic and related services, including shopping and laundry, for recipients who live with others for state savings of \$236.6 million in 2011-12. This cut would affect 300,000 recipients.
 - Eliminate all services for recipients who lack a doctor's certification that IHSS is necessary to prevent out-of-home care for state savings of \$120.4 million in 2011-12. This cut would affect 43,000 recipients.

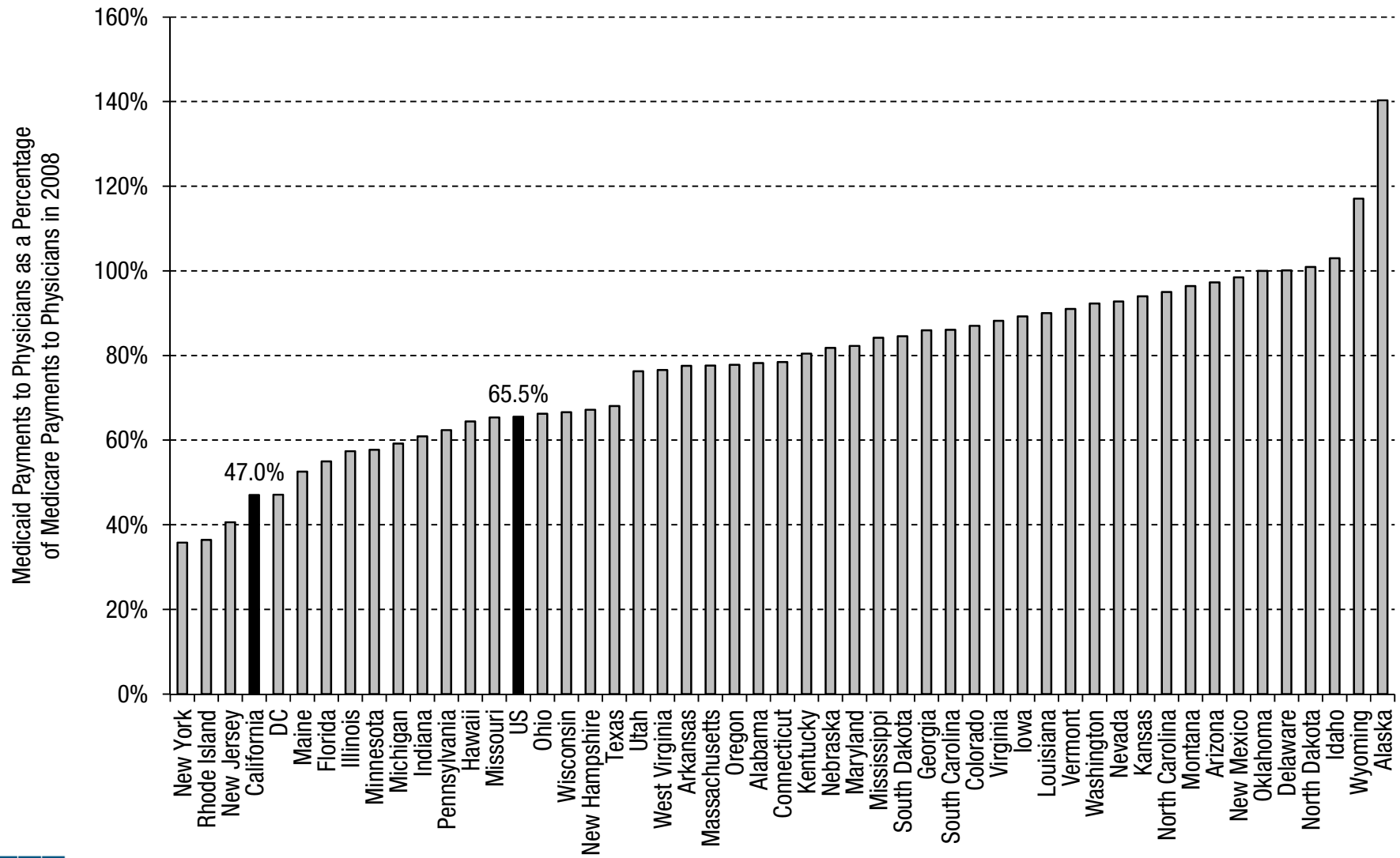
The Governor Proposes Significant Cuts to Medi-Cal

- The Governor proposes \$1.7 billion in reductions to Medi-Cal in 2010-11 and 2011-12 combined. Specifically, the Governor proposes to:
 - Limit doctor visits and prescriptions, place caps on medical supplies and durable medical equipment, and require copayments from Medi-Cal patients for state savings of \$774.5 million.
 - Eliminate Medi-Cal coverage for Adult Day Health Care services and certain over-the-counter medications for two-year savings of \$195.5 million.
 - Reduce payments to health providers who treat Medi-Cal patients, for two-year savings of \$745.4 million.

National Health Care Spending Has Increased More Rapidly Than Medi-Cal Spending During the Past Decade



Medi-Cal Payments to Primary Care Physicians Are Among the Lowest in the Nation



The Governor Proposes Cuts to Healthy Families

- The Governor proposes to:
 - Increase premiums for children in families with incomes at or above 150 percent of the federal poverty line, effective June 1, 2011, for state savings of \$1.9 million in 2010-11 and \$22.2 million in 2011-12.
 - Increase copayments for emergency room visits and hospital stays, effective October 1, 2011, for state savings of \$5.5 million in 2011-12.
 - Eliminate vision benefits, effective June 1, 2011, for state savings of \$0.9 million in 2010-11 and \$11.3 million in 2011-12.

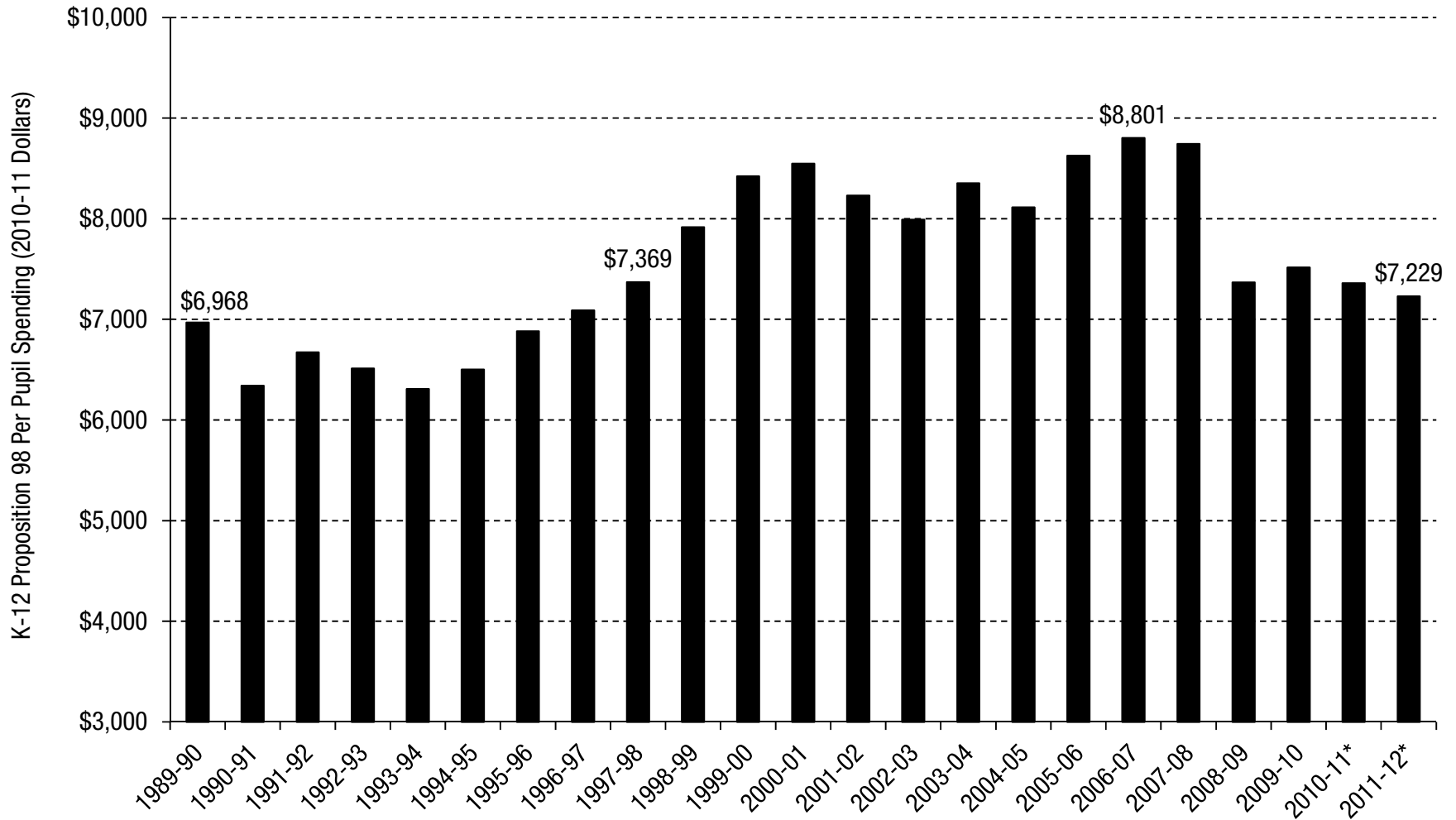
The Governor Proposes To Cut SSI/SSP Grants

- The Governor proposes to:
 - Reduce the maximum monthly SSI/SSP grant for individuals from \$845 to \$830 – the minimum allowed by federal law – effective June 1, 2011 for savings of \$15.1 million in 2010-11 and \$182.3 million in 2011-12. The grant for couples is already at the federal minimum and therefore cannot be cut further.

The Governor Proposes Flat Funding for K-12 Schools

- The Governor proposes to:
 - Provide a K-12 Proposition 98 funding level of \$43.8 billion in both 2010-11 and 2011-12. The proposed K-14 Proposition 98 spending level is \$2 billion above the minimum guarantee in the absence of additional revenues.
 - Defer \$2.1 billion in K-12 education spending from 2011-12 to 2012-13.
- As a result of past cuts, California's K-12 education spending now ranks 47th in the nation without adjusting for regional cost differences.

Schools Would Receive Slightly Less Per Student in 2011-12 Under the Governor's Proposal, After Adjusting for Inflation

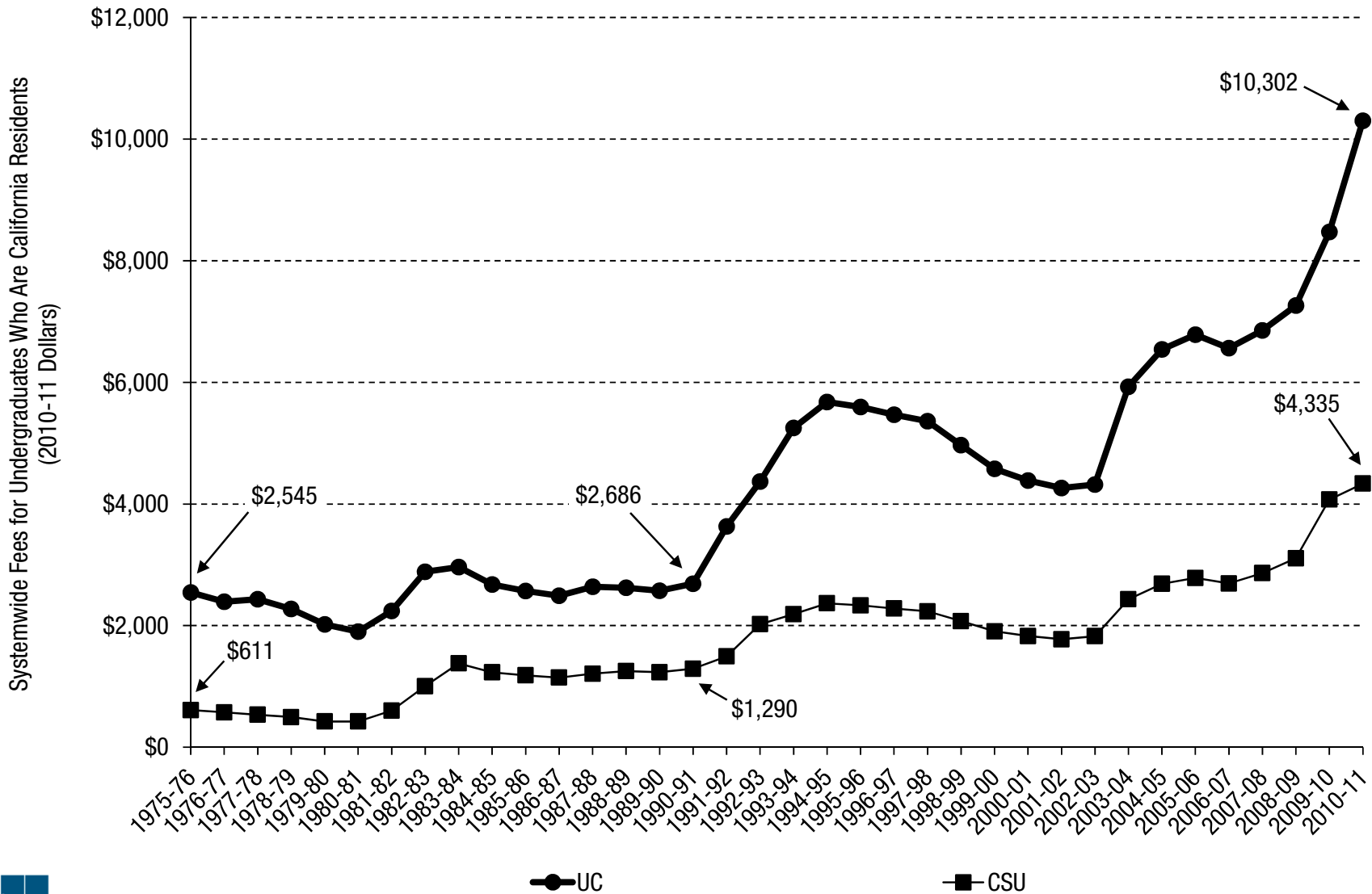


How Do California's Schools Compare?

	California Rank	California	US
K-12 Per Pupil Spending (2010-11)	47	\$8,908	\$11,397
K-12 Spending as a Percentage of Personal Income (2009-10)	47	3.5%	4.2%
Number of K-12 Students Per Teacher (2010-11)	51	20.5	14.4
K-12 Per Pupil Spending, Adjusted for Regional Cost Differences (2007-08)	43	\$8,852	\$11,223
Percentage of K-12 Students in Districts With Adjusted Per Pupil Spending at or Above the US Average (2007-08)	20	33.5%	40.6%
Percentage of High School Students Who Graduate With a Diploma (2006-07)	42	62.7%	68.8%

Source: Education Week, National Education Association, and US Bureau of Economic Analysis

Inflation-Adjusted UC and CSU Fees Have More Than Tripled Since 1990-91



The Governor Proposes Reductions to State Worker Salaries and Benefits

- The Governor proposes to:
 - Reduce the take-home pay of employees in six collective bargaining units with expired contracts by 10 percent for savings of \$308.4 million;
 - Reduce state employee and retiree health care costs; and
 - Reduce spending on state operations by \$200 million.
- The 2010-11 spending plan assumed \$1.5 billion in savings related to implementing new collective bargaining agreements reached with 15 bargaining units in 2010, capping the size of the state workforce to reduce personnel costs by 5 percent, and other administrative actions.

Preparing California for the Future

- California has always been the land of great promise and opportunity. This promise remains as true today as it was 62 years ago when Carey McWilliams wrote that:

“On the state capitol in Sacramento one can read the scroll “Bring Me Men to Match My Mountains!” This is California’s need today: for men and women who can match, in the scale of their imagination and the depth of their insight, the extraordinary diversity, power, and challenge which is implicit in this immense and fabulous province which sprawls along the Pacific like a tawny tiger.”