California Budget Update

Assemblymember Joan Buchanan

15th Assembly District

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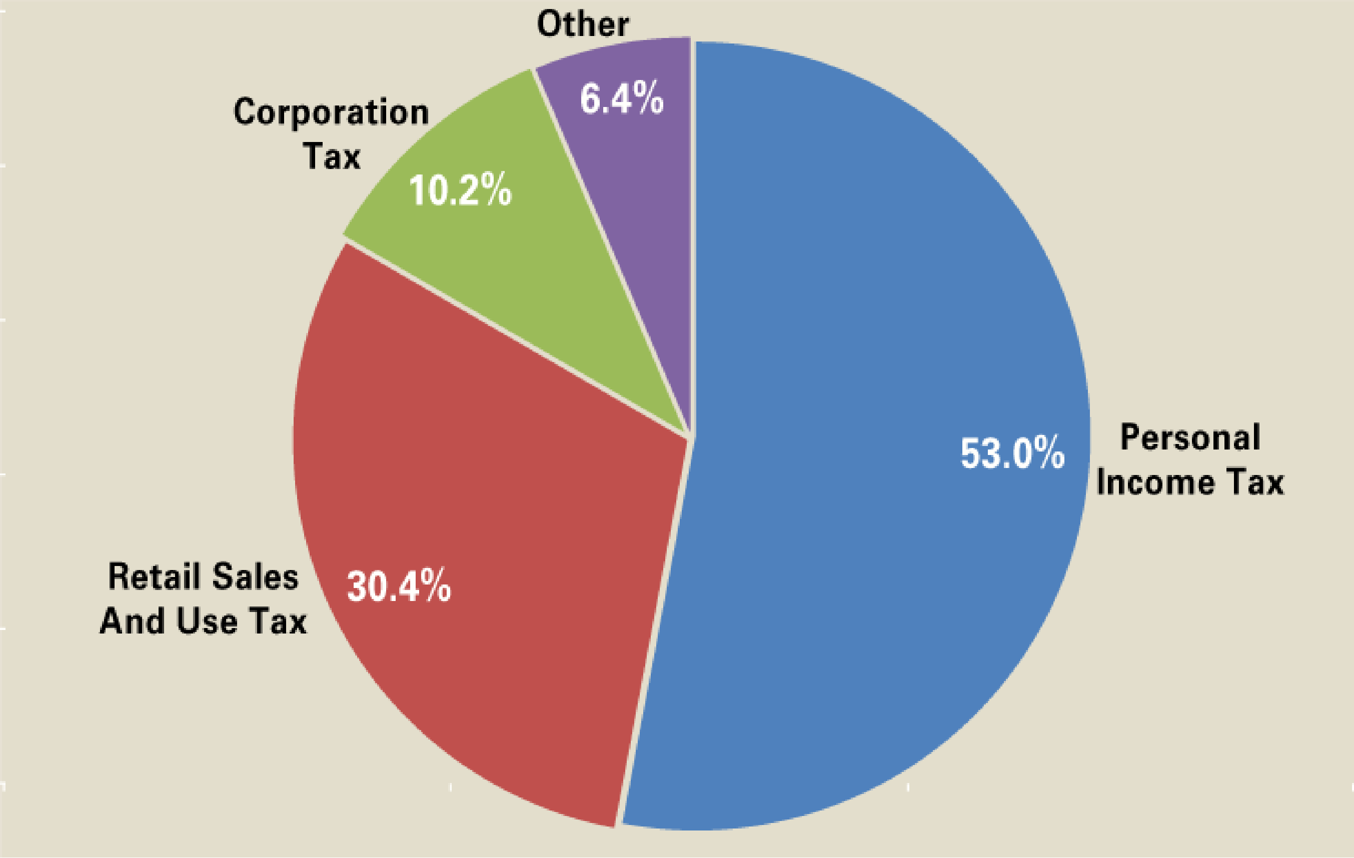
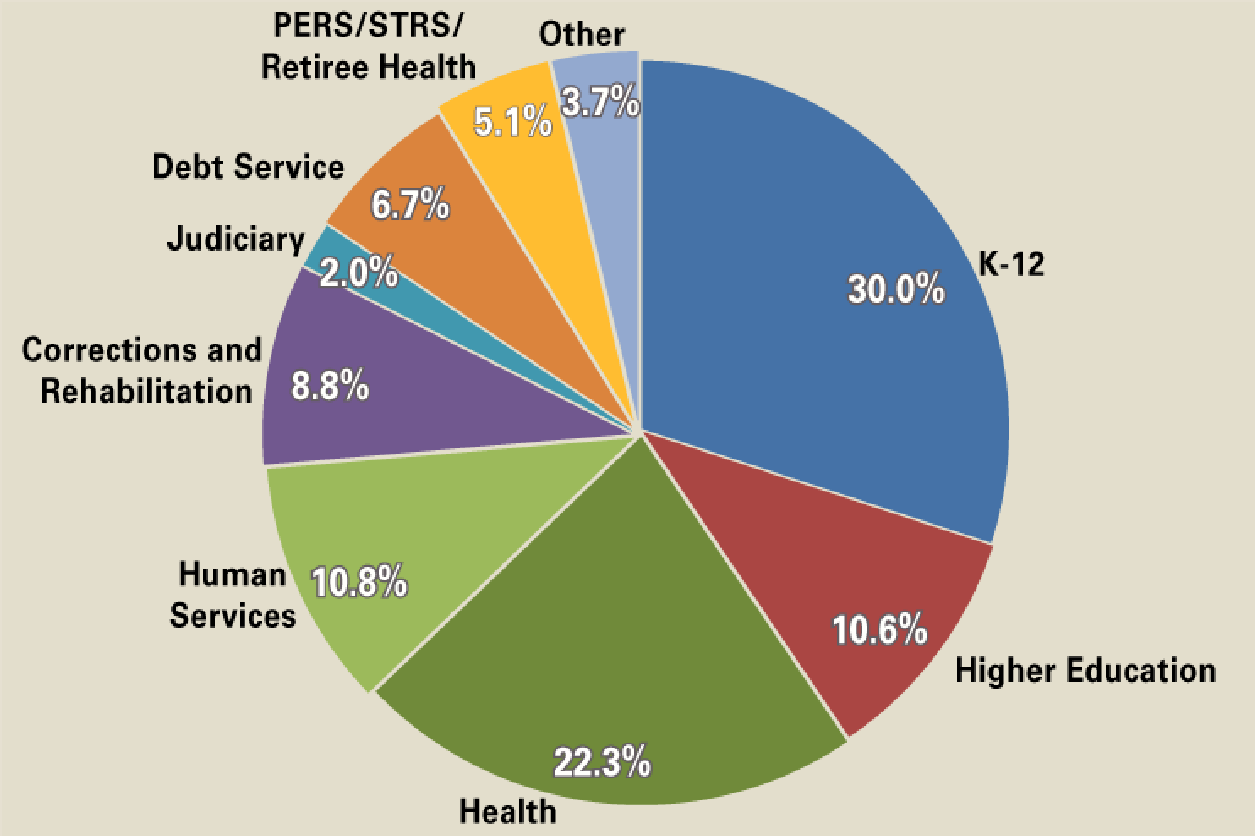
CA General Fund Revenues



Source: Legislative Analyst's Office

All three major sources of revenue are tied to the economy.

CA General Fund Expenditures



Source: Legislative Analyst's Office

Public Policy Institute of California polls show voters want the legislature to make tough decisions to balance the budget. When given choices, they want to cut prisons and debt but not education, health or human services.

How Does California Compare?

- 15th in taxes and fees compared to other states
- 47th in number of state employees per capita
- 45th in total number of state and local government employees per capita (including teachers)

How did we get here?

- It is important to remember that we didn’t get into this financial situation in just 1 year and we won’t be able to solve all the budget problems in 1 year without significant impacts to programs like education, public safety, health, and human services.

- The following example is intended to illustrate how past budget decisions have contributed to our current fiscal crisis.

Let’s assume we have $100B in revenue and $105B in expenses…

	Year 1	Year 2	Year 3	Year 4	Year 5 Recession
Revenue	$100				
Expenses	105				
Structural Deficit	5				
Borrowing	5				
Borrowing As % of Revenue	5%				

In Year 1 of this example, if we borrow to balance the budget, total borrowing is 5% of revenue.

Let's assume we have $100B in revenue and $105B in expenses…

	Year 1	Year 2	Year 3	Year 4	Year 5 Recession
Revenue	$100	$100	$100	$100	
Expenses	105	105	105	105	
Structural Deficit	5	5	5	5	
Borrowing	5	10	15	20	
Borrowing As % of Revenue	5%	10%	15%	20%	

By the time we get to year 4, if borrowing continues, the structural deficit still remains at $5 billion or 5% of revenue, but the total borrowing rises to $20 billion or 20% of revenue. This is because we must borrow $5 billion to cover the current year deficit and an additional $15 billion to repay the short-term borrowing from the previous years.

Let's assume we have $100B in revenue and $105B in expenses…

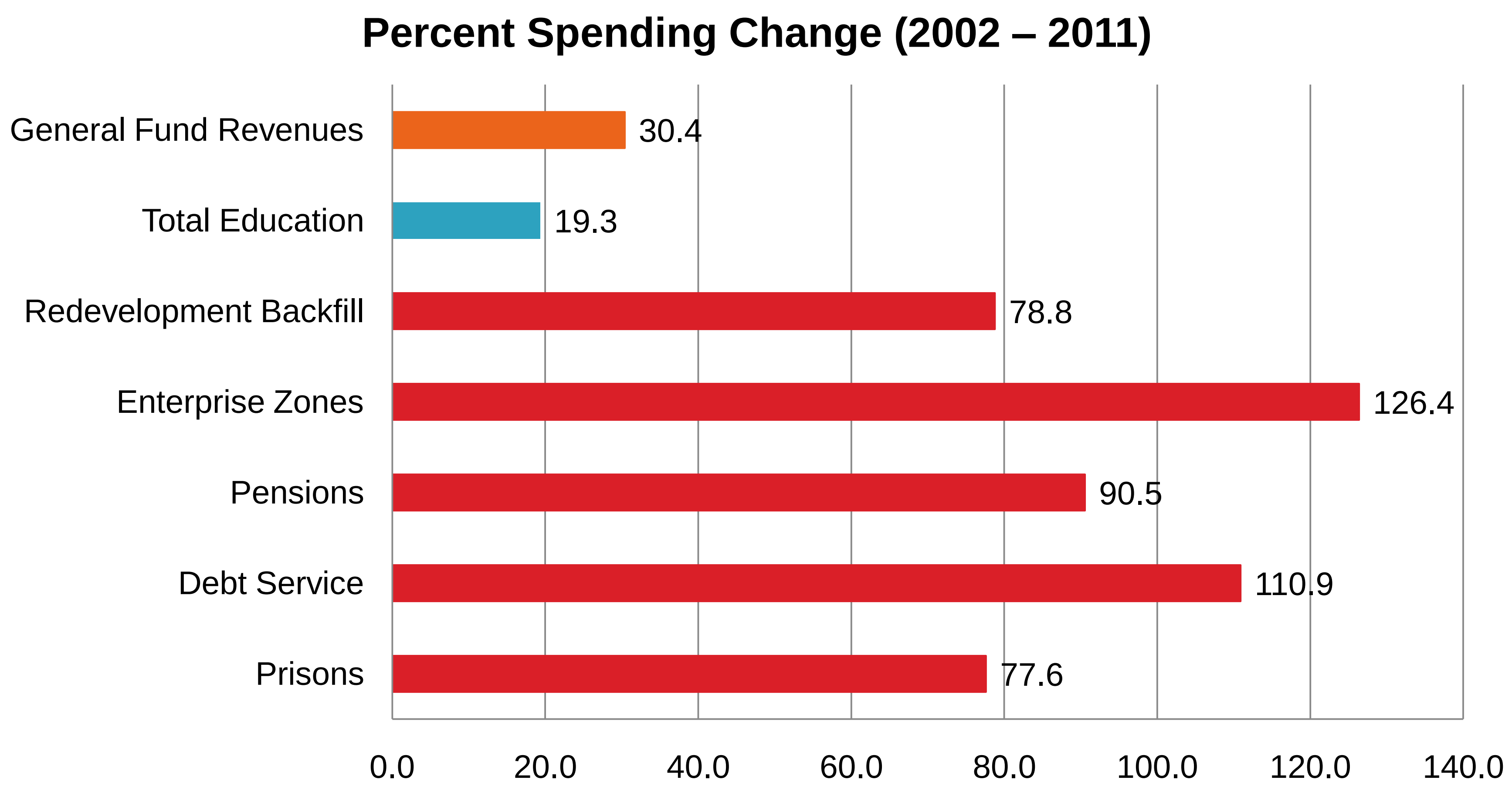
	Year 1	Year 2	Year 3	Year 4	Year 5 Recession
Revenue	$100	$100	$100	$100	$80
Expenses	105	105	105	105	105
Structural Deficit	5	5	5	5	25
Borrowing	5	10	15	20	45
Borrowing As % of Revenue	5%	10%	15%	20%	56%

If in Year 5 we experience a deep recession and revenue drops 20%, now we face a structural deficit of $25 billion in addition to $20 billion in short-term borrowing from the previous four years. The cumulative shortfall is $45 billion or 56% of revenue.

How did we get here?

- While, the actual budget numbers are different, the previous example is a good illustration of past decisions that led to our current budget crisis.
  - 2003: Gov. Davis was recalled because we had a budget deficit. He wanted to increase the Vehicle License Fee (VLF) to close the gap.
  - 2004: Gov. Schwarzenegger rejected increasing the VLF to close the deficit. Instead, he asked voters to pass a $15 billion revenue bond to balance the budget, pay the debt, and tear up the credit card. Yet we continued to borrow year after year.
- This along with the deep recession, has resulted in a $26.6 billion budget deficit.

Major Budget Stressors



When some costs grow faster than revenues, funding for other programs must be redirected.

Major Budget Stressors

	2001-02	2010-11	$ Increase	% Increase
General Fund Revenues	$72.263	$94.230	$21.967	30.4%
K-12 and Higher Ed	37.903	45.234	7.331	19.3%
Prisons	4.998	8.879	3.881	77.6%
Debt Service	2.282	4.812	2.530	110.9%
Pensions	0.891	1.698	0.807	90.5%
Redevelopment Backfill	1.284	2.296	1.012	78.8%
Enterprise Zones	0.257	0.581	0.324	126.4%

Governor's January Budget Proposal

Starting Shortfall	**-$26.6 billion**
Expenditures Reductions	$12.5 billion
Revenue Solutions	$12.0 billion
Other Solutions	$3.2 billion
Total Solutions	**$27.7 billion**
Final Reserve	**$1.1 billion**

Governor's Proposed Expenditure Reductions

Health and Human Services (not including child care)	$6.0 billion*
Redevelopment Agencies	$1.7 billion
UC/CSU	$1.1 billion*
Transportation Prop 22 Weight Fee Fix	$1.0 billion*
Corrections	$1.0 billion*
State Salaries / State Operations	$0.7 billion*
Local Mandate Savings	$0.2 billion*
Energy Efficiency Programs	$0.2 billion*
Cal Grant Restrictions	$0.2 billion*
Courts	$0.2 billion*
Various Others (rounding)	$0.3 billion*
Total	**$12.5 billion**

*Already passed by the Legislature and signed by the Governor in March

Governor’s Proposed Revenue Solutions

5-year PIT surcharge extension (voter approval)	$3.3 billion*
5-year Dependent Exemption reduction extension (voter approval)	$2.0 billion*
5-year VLF extension (voter approval)	$1.4 billion*
5-year Sales Tax extension (voter approval)	$4.5 billion*
Mandatory Single Sales Factor	$1.4 billion*
Repeal Enterprise zones	$0.9 billion*
Various other revenue solutions	$0.5 billion*
Total	**$12.0 billion**
(Prop 98 impact of Revenue Solutions)	($2.0 billion)

*All pending legislative action

Governor’s January Budget Proposal

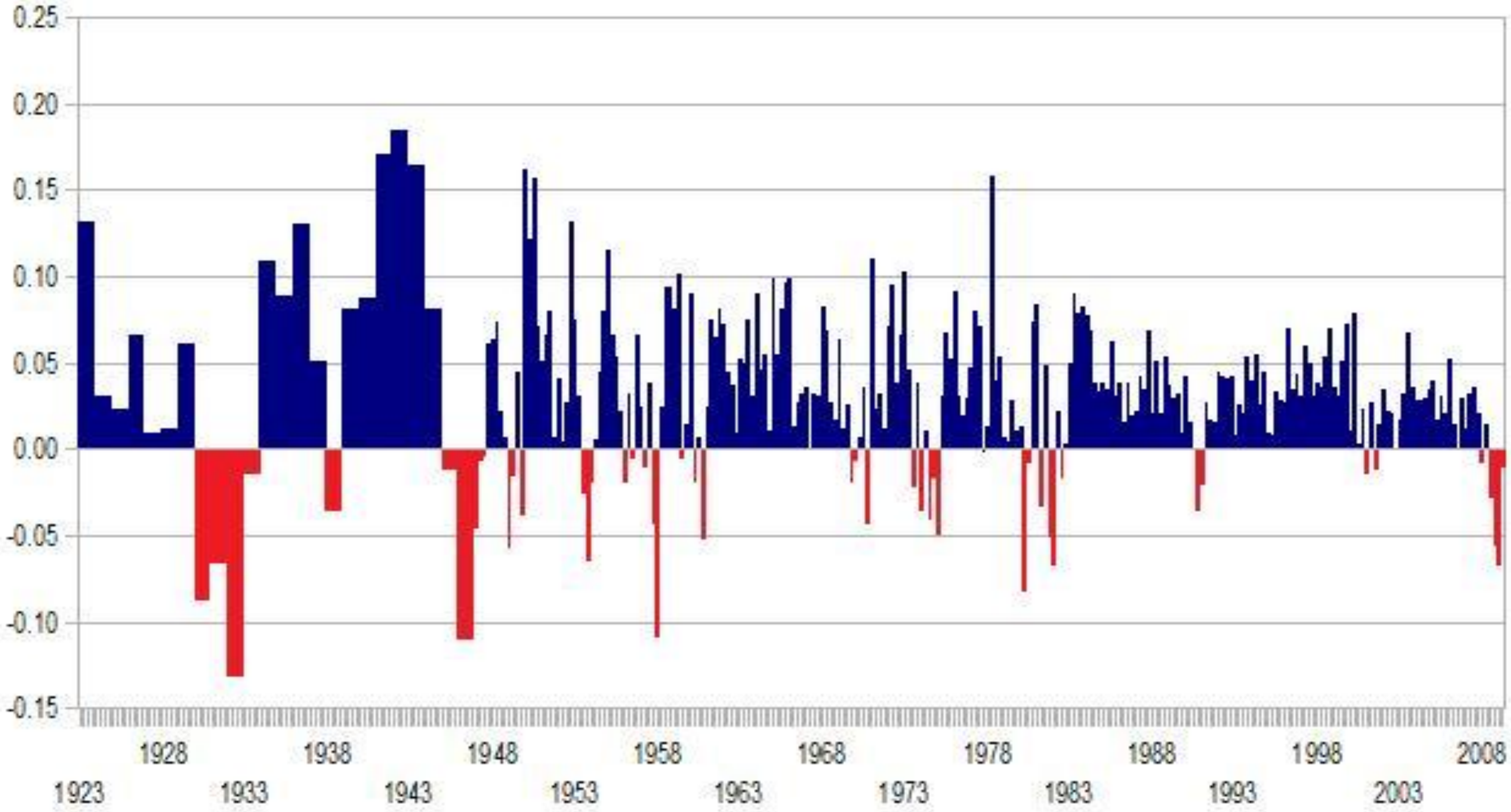
- I support the Governor’s proposal to close the budget deficit with a balanced approach of both expenditure reductions and an extension of temporary revenues.

- THIS RECESSION IS DEEPER THAN ANY WE HAVE EXPERIENCED IN OUR LIFETIMES.

What makes this recession different?

- What happens in a typical "V" shaped recession?
  - CAUSE: interest rates increase, eventually "choking off" demand.
  - RESPONSE: Federal Reserve Bank has tools to lower interest rates, increasing demand.
  - RESULT: Coming out of a recession, GDP usually increase at 7-8% accelerating the economic recovery.

National GDP Growth

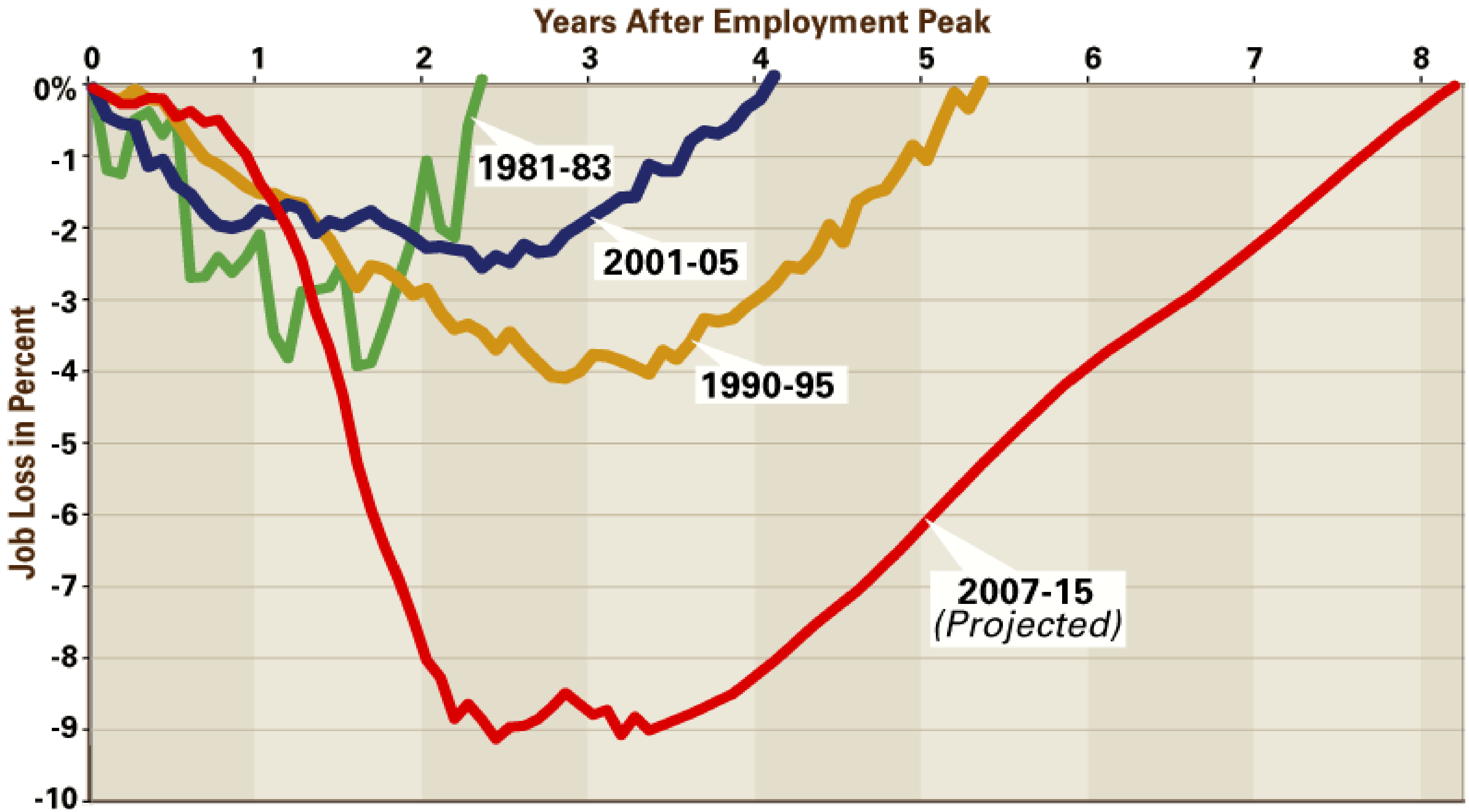


A typical "V" shaped recession occurs about every 3-4 years.

What makes this recession different?

- This is an “L” shaped recession.
- Causes of an “L” shaped recession
  1. The near collapse of the worldwide financial markets – access to credit remains limited.
  2. Bursting of the largest housing bubble in our lifetimes – unemployment in construction trades remains above 30%. Thus construction will not be able to lead the economy to recovery.
  3. Recession began while the FED Funds Rate was already at 1% – the FED has little room to adjust interest rates in order to increase demand.

Unemployment in Recent Prolonged Recessions



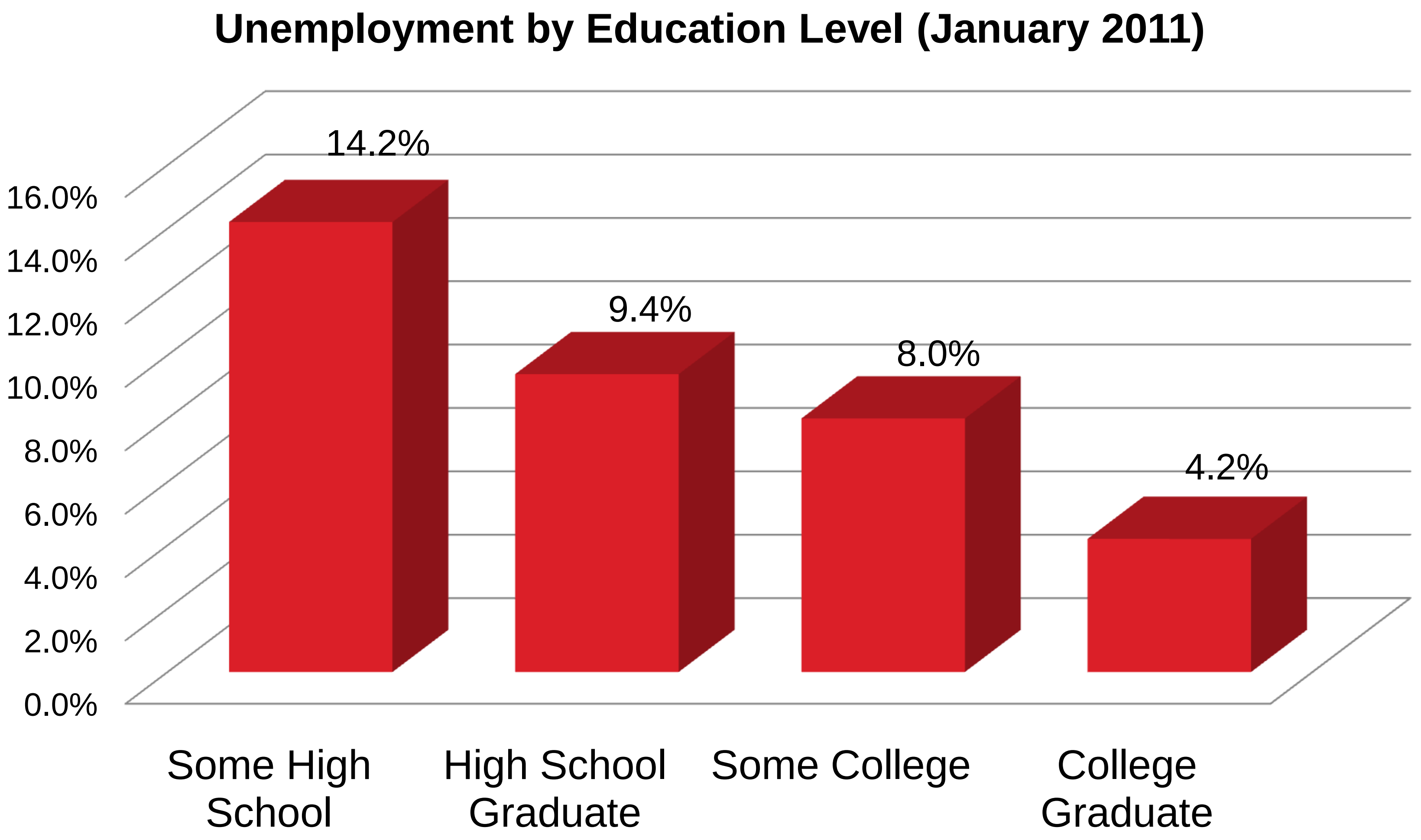
Source: Legislative Analyst's Office

The Legislative Analysts Office predicts employment will not recover until 2015. Some economists predict that it may take even longer.

Building a Bridge to Recovery

- The Governor's plan builds a bridge to recovery by making real cuts that will balance the budget and create stability in our state's finances.
- His budget also asks voters to extend temporary revenues to build a bridge to recovery.
- Additionally, extending the temporary revenues will help avoid devastating cuts to K-12 education, additional cuts to higher education, heath and human services, as well as public safety.
- Economists agree that additional cuts to education will have severe negative long-term impacts on California's economy.

Education is the Driver of the Economy



How do California's Schools Compare?

	California Rank	CA	US
K-12 Per Pupil Spending (10-11)	47	$8,908	$11,397
K-12 Spending as a Percentage of Personal Income (09-10)	47	3.5%	4.2%
Number of K-12 Students Per Teacher (10-11)	51	20.5	14.4
Number of K-12 Students Per Counselor (08-09)	51	813.9	457.0
Number of K-12 Students Per Librarian (08-09)	51	5455.2	915.6
Number of K-12 Students Per Administrator (08-09)	48	434.4	308.1
Percentage of High School Students Who Graduate with a Diploma (06-07)	42	62.7%	68.8%

Source: California Budget Project, National Education Association, National Center for Education Statistics

What do we want California to look like?

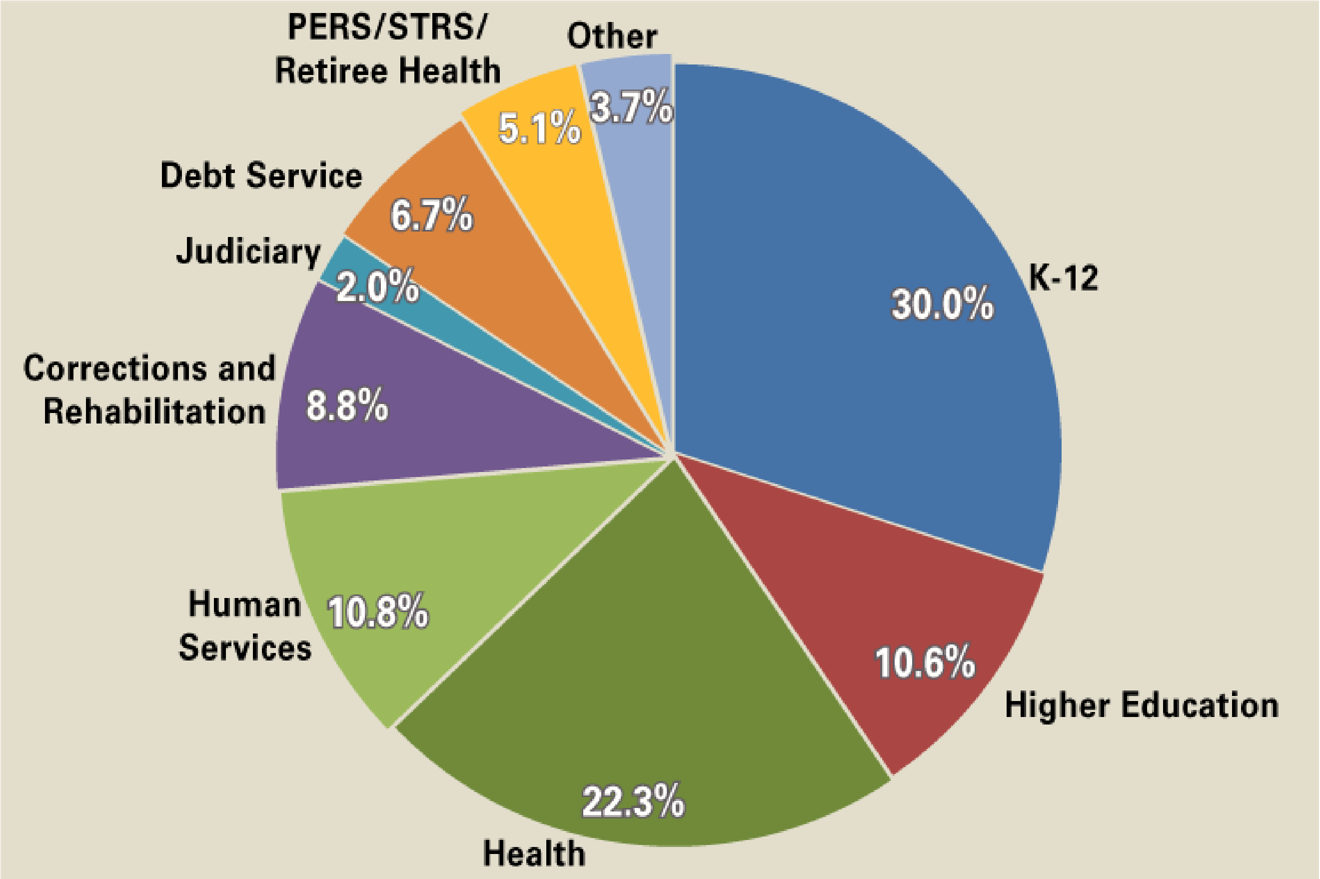
- The choice we face:

1. Do we build a bridge to recovery by taking a balanced approach to resolving our budget crisis?

OR

2. Do we cut an additional $14 billion from education, public safety, health, and human services?

What do we want California to look like?



The choice to extend temporary revenues or make deeper cuts will have a profound impact on the programs we value. What would you cut?... And what would California look like?