

CALIFORNIA'S STATE BUDGET: THE GOVERNOR'S MAY REVISION

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► California's current budget shortfall has been reduced since January.

By law, the governor must submit a revised budget proposal to the legislature in May that includes updated revenue and expenditure estimates, and the legislature has until June 15 to pass a budget bill. On May 16, Governor Brown proposed \$132.5 billion in state spending for 2011–12; this includes \$88.8 billion for the state's General Fund, an increase of 5% from January. The estimated 18-month budget gap narrowed from \$25.4 billion in January to \$9.6 billion in May (excluding the reserve), thanks mostly to \$11 billion in spending cuts enacted in March and \$6.6 billion in higher-than-anticipated revenues.

► The legislature has already closed much of the budget gap with spending cuts ...

In January, Governor Brown proposed closing the budget gap with equal parts spending cuts and revenue increases. In March, the legislature approved \$11 billion worth of spending cuts and other measures. An additional \$2.4 billion in gap-closing measures will take effect once the 2011–12 budget is enacted. The bulk of the spending cuts affect social and health programs (\$5.5 billion) such as CalWORKs and Medi-Cal (the state's welfare and health care programs, respectively) and higher education (\$1.2 billion). Also, 70 state parks are slated for closure (\$22 million).

► ... and the governor proposes to close the remainder mostly through revenue increases.

The legislature did not approve the governor's January proposal to place a five-year extension of the expiring tax increases on the ballot for a June special election. The governor is now asking the legislature to extend these increases for five years (four for the personal income tax), which would generate \$8.6 billion in 2011–12. A portion of these tax extensions would support the governor's realignment proposal to shift some state programs to local control, including a shift of nearly 40,000 inmates from state prison to local jails that the legislature approved in March. The governor wants voter approval for these tax extensions, but any vote would take place after the budget deadline.

► Education and economic development score gains; state boards and technology projects lose.

Under the rules of Proposition 98, higher-than-anticipated revenues will result in approximately \$3 billion more K–12 funding than the legislature approved in March. The governor proposes to use most of this funding to reduce deferred payments to schools rather than increase classroom funding. The May revision reforms and scales back enterprise zones, which were slated for elimination in January's proposal. It also expands a small-business hiring credit and temporarily reduces the sales and use tax for manufacturing equipment. At the same time, the governor proposes to eliminate or consolidate dozens of state boards, commissions, and departments, and to suspend—permanently, in some cases—data and technology projects in several program areas.

► The governor's proposal focuses on debt reduction.

The May budget proposal borrows less from state special funds and schools and community colleges than January's proposal. Furthermore, the governor proposes that revenue growth beyond what is necessary to meet current program obligations be dedicated to paying back the \$35 billion that the state owes bondholders, schools, special funds, and others—debt that was incurred to close previous budget gaps. In addition, the state has an estimated \$181 billion in unfunded pension and retiree health liabilities and \$81 billion in outstanding general obligation and lease revenue bonds for infrastructure and related long-term investments.



The budget gap: from \$25.4 billion in January to \$9.6 billion in May

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| January budget gap | \$25.4 billion |
| March legislative budget measures | -\$11.0 billion |
| Unanticipated revenue increases | -\$6.6 billion |
| Pending legislative measures | -\$2.4 billion |
| Restored Proposition 10 funding | +\$1.0 billion |
| Canceled sale of state buildings | +\$1.2 billion |
| Additional state spending | +\$2.0 billion |
| May budget gap, excluding reserve | \$9.6 billion |
| 2011–12 reserve | +\$1.2 billion |
| Remaining budget gap | \$10.8 billion |

Source: Governor’s Budget May Revision, Figure INT-02.

Note: In January, the governor proposed shifting \$1.0 billion from the Proposition 10 account, which supports early childhood development under the First 5 program, to the General Fund in order to support Medi-Cal services for children aged 5 years or younger. The state faces lawsuits challenging the legality of this fund shift. The May Revision restores funding back to Proposition 10.

Higher revenues would close most of the remaining \$10.8 billion gap

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| Remaining budget gap | \$10.8 billion |
| <i>Resolved through increased revenue</i> | |
| Sales tax extension | -\$4.5 billion |
| Reduction in dependent tax credit | -\$2.2 billion |
| Single sales factor business tax | -\$1.4 billion |
| Vehicle license fee | -\$1.3 billion |
| Personal income tax surcharge | -\$1.3 billion |
| Other revenue | -\$0.5 billion |
| Total | -\$11.2 billion |
| <i>Resolved through reduced spending</i> | |
| Elimination of redevelopment areas | -\$1.7 billion |
| Health-care reductions | -\$0.2 billion |
| State employee compensation reductions | -\$0.1 billion |
| Other reductions | -\$0.3 billion |
| Total | -\$2.2 billion |
| <i>Required/proposed additional spending</i> | |
| Proposition 98 guarantee | +\$1.9 billion |
| State debt reduction | +\$0.7 billion |
| Total | +\$2.6 billion |
| Balance | \$0 |

Sources: Governor’s Budget May Revision, Figure REV-02; Legislative Analyst’s Office “The 2011–12 Budget: Overview of the May Revision,” Figure 3.

Note: All solutions are totals for 2010–11 and 2011–12, except the personal income tax surcharge, which is for 2011–12 only. The governor estimates additional Proposition 98 guarantee costs of \$1.7 billion. The \$1.9 billion LAO estimate also includes additional funds from shifting mental health services for special education students from counties to school districts.

Sources: Governor’s Budget May Revision. Legislative Analyst’s Office.

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