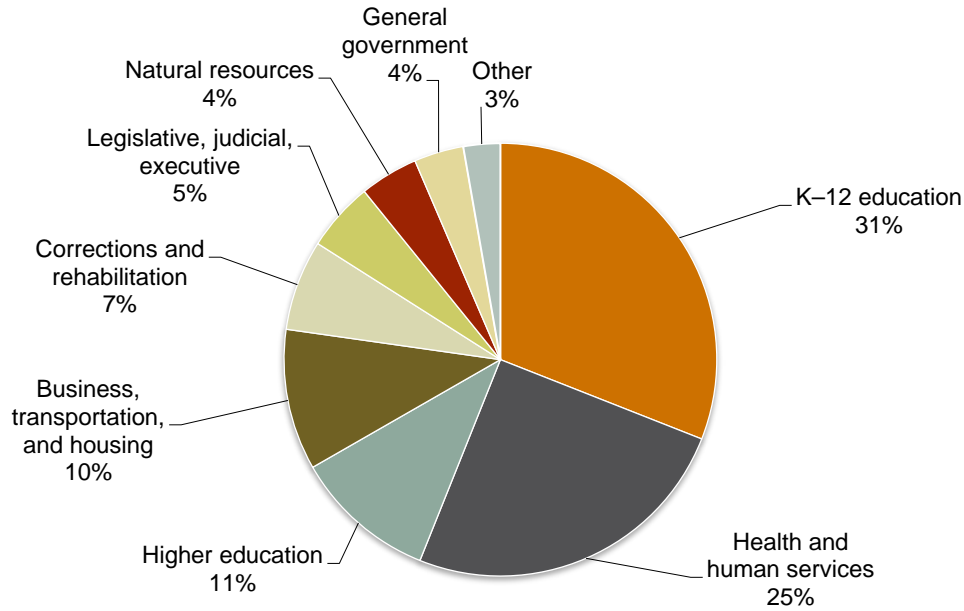


- **CALIFORNIA'S STATE GOVERNMENT IS A ROUGHLY \$120 BILLION ENTERPRISE.**
 The governor's proposed budget for 2010–11 calls for \$119 billion in state spending. The state budget is organized into funds, the largest of which and the one over which lawmakers have the most discretion is the General Fund (\$83 billion). The remainder of state spending comes from special funds dedicated to specific purposes. The largest functional category of state expenditures (more than 30% of the total) is K–12 education, followed by health and human services (25%); higher education (11%); business, transportation, and housing (10%); and corrections (7%).
- **THE STATE'S REVENUES DECLINED SHARPLY DURING THE NATIONAL RECESSION.**
 The General Fund relies on personal income tax, sales tax, and corporate taxes for more than 90% of its revenues—sources very sensitive to fluctuations in the economy. Revenue collections in 2008–09 came in 20% below forecasts due to job losses, declining consumption, and weakness in the housing market. From the onset of the recession in December 2007 through the third quarter of 2009, real per capita revenues declined by more than 10% in California, compared to 4.4% in the nation as a whole.
- **DESPITE AN IMPROVING ECONOMY, THE STATE WILL CONTINUE TO GRAPPLE WITH MAJOR BUDGET SHORTFALLS.**
 The governor's budget projected that California would end the current fiscal year with a nearly \$7 billion deficit and a cumulative deficit of \$19 billion by the end of 2010–11. The Legislative Analyst's Office has pegged the total budget shortfall at closer to \$21 billion and has warned that adverse court rulings and other risks could push this figure even higher. In March, the legislature agreed to, and the governor signed, \$1.4 billion in budget solutions, thus reducing the earlier deficit projections by the governor and LAO by that amount.
- **THERE ARE NO EASY ANSWERS.**
 The governor has proposed closing California's budget gap through a combination of spending cuts (in health and human services, education, employee compensation, and corrections), obtaining federal funds (for health care, special education, and corrections), and shifting monies from special funds (created for such purposes as early childhood development and mental health care). If federal dollars do not materialize, \$7 billion in additional tax measures and program cuts would be triggered.
- **CALIFORNIA'S CASH MANAGEMENT IS EXTREMELY CHALLENGING.**
 Last year, a record number of states (42) were compelled to close mid-year budget gaps through spending cuts and/or by finding additional sources of revenue. California served as the most extreme example, in 2008–09 suspending infrastructure projects, furloughing state employees, and issuing IOUs for only the second time since the Great Depression. All three major credit rating agencies have downgraded California's general obligation debt since July 2009. California's credit rating is the lowest of all 50 states.
- **MORE CHALLENGES LIE ON THE HORIZON.**
 The LAO estimates that annual budget gaps on the order of \$20 billion will continue through 2014–15 as temporary tax increases expire, federal stimulus funds dissipate, and the state begins repaying budget-related borrowing. California's ratio of debt service to revenues will climb to 9% in 2013–14 due to declining revenues and major infrastructure bonds approved by the voters in 2006 and 2008. In addition, the state faces at least \$100 billion in unfunded pension liabilities and rapidly escalating costs for Medicaid and unfunded retiree health benefits.



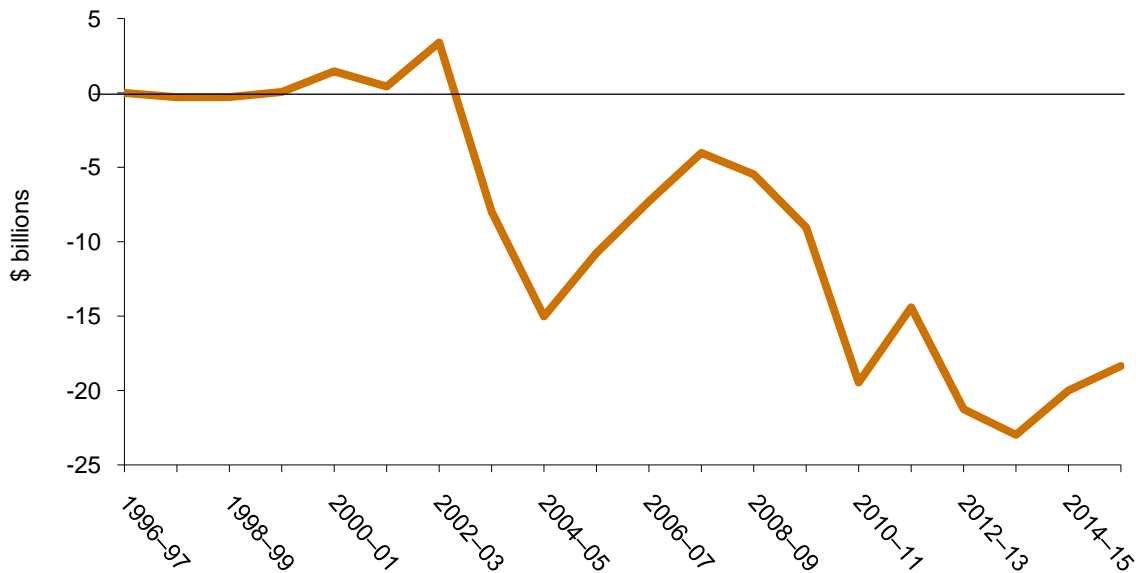
Total State Expenditures, FY 2010–11



Source: Governor's Budget, FY 2010–11.

Notes: Total expenditures include selected bond funds. "Other" includes Environmental Protection (\$1.47 billion), State Consumer Services (\$1.37 billion), and Labor and Workforce Development (\$0.44 billion).

Projected Operating Surpluses/Shortfalls at Beginning of Each Budget Cycle



Source: LAO Fiscal Outlook, various years.

Notes: Figure is based on LAO 12-month projections made in the November preceding each fiscal year, except for years after FY 2010–11, which are estimates from November 2009. The line in the figure represents the difference between current-law revenues and expenditures, excluding carry-in balances and budget-related borrowing.

Contact: Tracy Gordon



PPIC

PUBLIC POLICY
INSTITUTE OF CALIFORNIA

www.ppic.org