Introduction

The Governor's Budget proposes to close California's structural budget deficit and provide a strong and stable foundation to meet future needs. This year's spending plan relies on real solutions, most of them ongoing, and proposes a vast and historic realignment of government services.

The state is slowly emerging from the Great Recession, the longest and deepest recession since World War II. More than 1 million jobs were lost in California and the unemployment rate rose to 12.6 percent—the third highest in the nation. Personal income dropped by 2.4 percent, the first decline since 1938. General Fund revenues fell much more, dropping 24 percent from the height of revenues in 2007-08 to the bottom in 2009-10.

Although California has begun to recover, the Budget projects that it will be years before the more than 1 million lost jobs will be recovered. See Figure INT-01. Baseline revenues will not return to the 2007-08 level until 2013-14 and, even then, projected revenues will be insufficient to pay for program services that the state has committed to provide.

In recent years, California has made some difficult choices to close the budget gaps. Taxes were raised temporarily, the Proposition 98 Guarantee was reduced from a high of \$56.6 billion to \$49.1 billion, resulting in a \$7.5 billion decline, programs were eliminated, and spending cuts were adopted. In total, \$103.6 billion in budgetary actions were adopted between 2008 and 2010. But most budgetary actions, about 85 percent of them in 2010-11, were temporary or failed because of court challenges or faulty assumptions.

Figure INT-01

Full Recovery of Jobs Lost During Recession, Not Until 2016

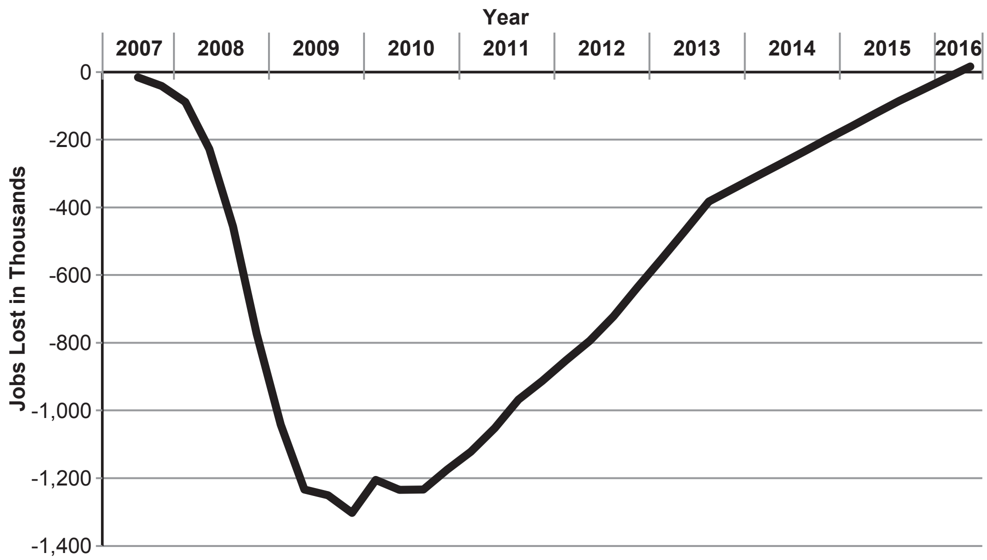


Figure INT-02

California Relied Mostly on Short-Term Solutions

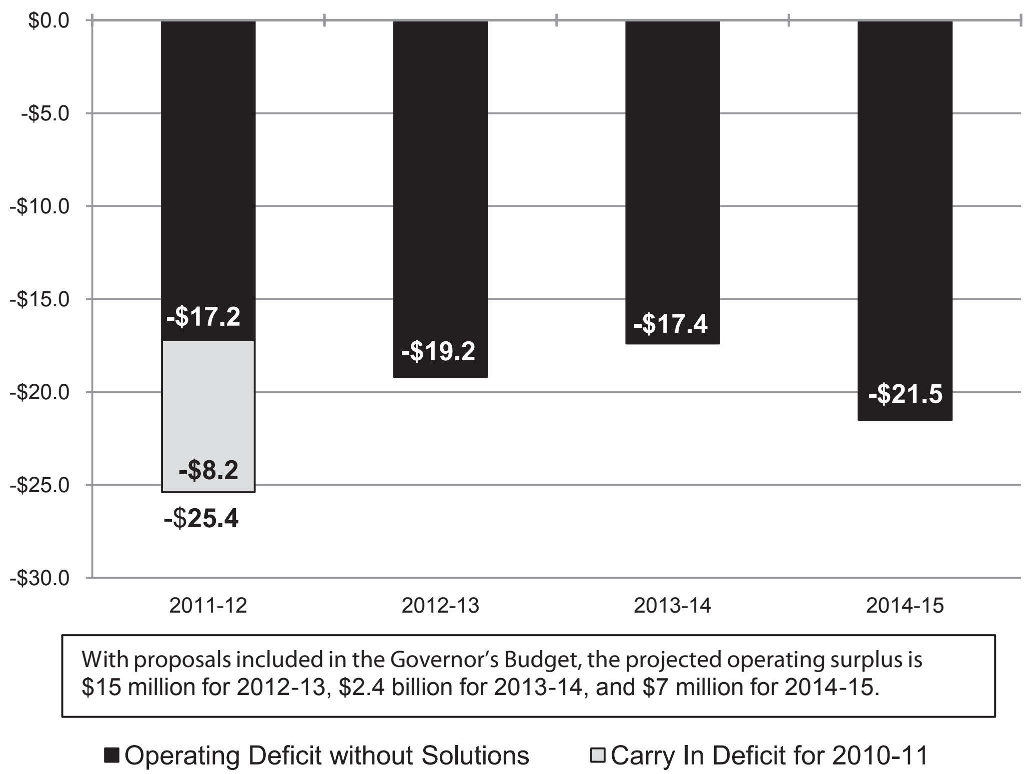
	Solutions (In Billions)	Short-Term / Did Not Materialize as a Percent of Total
2008-09	$24.3	75%
2009-10	60.0	84%
2010-11	19.3	85%

See Figure INT-02 for a summary of recent budget actions.

Although the economic downturn has been the chief contributor to today's budget gap, California entered the recession with an existing structural budget deficit, meaning that revenues did not cover costs. This structural deficit continued, in part, because of an overreliance on temporary remedies and savings proposals that did not materialize. Some actions adopted over the last decade, such as the Economic Recovery Bonds, have made the problem worse, adding $2.9 billion to the projected budget gap in 2011-12.

Without corrective action, as illustrated in Figure INT-03, the structural deficit will persist and grow to between $17.2 billion and $21.5 billion per year through 2014-15. The Governor's Budget proposes to close this structural gap in a manner that is both balanced and sustainable. Specifically, it proposes significant reforms to state and local programs, substantial reductions to state operations, and spending cuts across

Figure INT-03
Operating Deficits without Corrective Actions
Dollars in Billions



all service areas. The Budget also maintains existing tax rates in effect for another five years, subject to voter approval.

The Governor's proposal reflects the difficult choices that will be necessary to balance California's budget this year and into the future. Without decisive action, the state's severe budget problems will persist, threatening economic recovery, job growth, public education and the quality of life in California. But the adoption of this budget will position the state to lead the country as it slowly recovers from the Great Recession.

Defining the Budget Gap

California is projected to face a budget gap of $25.4 billion in 2011-12. This gap is made up of a current-year shortfall of $8.2 billion and a budget-year shortfall of $17.2 billion. With a reasonable reserve of $1 billion, $26.4 billion in cuts, taxes and other budget solutions are needed to close the budget gap.

As Figure INT-04 illustrates, various factors contribute to the projected deficit in 2011-12. First, the budget plan adopted in 2010-11 relied in part on unrealistic assumptions, including the receipt of billions of dollars in federal funds, and on spending cuts that were not achieved. These factors contributed $5.3 billion to the budget problem ($3.6 billion federal funds and $1.7 billion reductions).

Figure INT-04
Shortfall in 2011-12 Governor's Budget
(Dollars in Billions)

June 30, 2011, Reserve Projected as of 2010 Budget Act		$1.3
Workload Adjustments:		-26.7
Additional Federal Funds Assumed in 2010-11 Did Not Materialize	-3.6	
Erosions of Other Enacted Solutions in 2010-11	-1.7	
Revenue Decline in 2010-11	-3.1	
Proposition 22 impact in 2010-11 and 2011-12	-1.6	
Other Workload Adjustments	-2.1	
Sunset of Temporary Increases in Tax Rates and Other Revenue Changes in 2011-12	-7.2	
Federal Stimulus Funds Previously Approved by the Federal Government are Expiring	-4.0	
Other One-Time Value of Enacted Solutions in 2010-11	-3.4	
Rebuild Reserve		-1.0
Total Solutions Proposed		-$26.4

This year's revenues are $3.1 billion lower than were projected at the time of the 2010 Budget Act, in part due to the recently enacted federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The passage in November of Proposition 22, which prohibits the use of certain transportation funds to pay for debt service or to be loaned to the General Fund, created an additional budget shortfall of $1.6 billion. All other workload adjustments including population and caseload changes added $2.1 billion.

The sunset of temporary increases in tax rates amounts to a projected drop in revenues of over $7 billion from 2010-11 to 2011-12. Federal stimulus funds that temporarily reduced state spending will end in 2010-11, increasing General Fund costs by $4.0 billion. Finally, another $3.4 billion of solutions adopted in 2010-11 will expire at the end of the fiscal year.

Closing the Budget Gap

To restore local-government authority to make decisions that are best made closer to the people, make government more efficient, and protect core services, the Governor proposes a balanced approach to close the budget gap. As illustrated in Figure INT-05, the Budget includes $26.4 billion in spending cuts, revenues and other solutions to balance the budget this year and into the future, and to provide for a reserve.

Figure INT-05

Proposed Budget Solutions

(Dollars in Millions)

	2010-11	2011-12	Total	
Expenditure Reductions	$422	$12,075	$12,497	47%
Revenues	3,163	8,864	12,027	46%
Other	506	1,379	1,885	7%
Total	$4,091	$22,318	$26,409	100%

The Budget reduces spending by $12.5 billion. It includes substantial cuts to most major programs, such as $1.7 billion to Medi-Cal, $1.5 billion to California's welfare-to-work program, $1 billion to the University of California and California State University, $750 million to the Department of Developmental Services, and $580 million to state operations and employee compensation.

Recognizing that school funding has been disproportionately reduced since 2007-08, the Budget maintains Proposition 98 funding (state General Fund and local property tax) for K-12 programs at the same level in 2011-12 as is in effect in 2010-11. To maintain funding for schools, fund public safety services at the local level, and to balance the budget, this proposal maintains current tax rates for another five years. The Budget also proposes to uniformly apply the single sales factor income allocation rules to certain corporate taxpayers and to eliminate an ineffective tax expenditure program. These proposals will generate $12 billion.

While most of the budget solutions are ongoing, the Budget includes some one-time savings and borrowing. These include $1.8 billion in borrowing from special funds, $1.7 billion in property tax shifts, $1.0 billion from Proposition 10 reserve to fund children's programs, and $0.9 billion from Proposition 63 moneys to fund community mental health services. $8.2 billion of the budget gap is one-time in nature. Closing a portion of the gap with some one-time solutions is appropriate because a portion of the budget gap is one-time in nature.

Adopting the Budget's long-term solutions is critical to eliminating the structural imbalance in the future. Based on the proposed budget, current law, and the latest forecast of the economy, revenue, and program costs, the operating surplus over the forecast period ranges from a low of $7 million to a high of $2.4 billion—a structurally balanced budget each year.

Recognizing the urgency of the state's fiscal problems, the Budget calls for an accelerated timeline to restore balance to the state's finances. It assumes that all necessary statutory changes to implement budget solutions will be adopted by the Legislature and signed by the Governor by March. This will allow the necessary ballot measures to be placed before the voters at a statewide special election to be called for June 2011. In addition, early enactment of budget proposals will lead to implementation sooner allowing greater savings to be achieved by the end of 2011-12. Likewise, the Administration expects that the legislative process will be inclusive and that a two-thirds vote will be obtained to quickly implement the statutory changes.

Transforming the State and Local Relationship

The budget proposes a major shift in the state-local relationship by reversing the trend of consolidating control and budget authority in Sacramento. When fully implemented, this proposal will restructure how and where more than $10 billion in a wide range of services are delivered.

This realignment will allow government at all levels to focus on their core functions and become more efficient, more effective and less expensive, by clarifying lines of program responsibility and reducing the duplication of services and administrative costs.

The first phase of this proposal will be a $5.9 billion transfer of programs from the state to the counties funded by maintaining the 1-percent sales tax and the 0.50-percent Vehicle License Fee that are currently set to expire in 2011.

Reducing Spending and Promoting Efficiency

The state must reexamine all aspects of its operations to be more efficient and effective. Reducing waste and redundancies will generate substantial savings, improve operations, and restore public confidence in government.

The Governor's Budget begins what will be an ongoing effort to make state government more effective and efficient. The Administration will increase efficiency and accountability by reducing costs, improving timeliness, and reducing overlapping responsibilities. The Governor has already taken steps to accomplish these goals. They include:

- Eliminating the Office of the Secretary of Education.
- Eliminating the Inspector General for the American Recovery and Reinvestment Act. The federal stimulus funds are nearing their completion, and the state already has a number of well-established oversight entities.
- Reducing the Governor's Office budget. The operations of the Governor's Office have been reduced by 25 percent. Additional current-year savings will be achieved by spending only $120,000 of the $770,000 appropriated for transition costs during 2010-11.

In addition, the Governor has directed agency secretaries and department directors, in consultation with the Department of Finance, to immediately review their operational costs and identify options to generate savings. As part of this effort, specific reorganization proposals will be developed to consolidate or eliminate departments, programs and functions. In addition, over time the realignment proposal will achieve major administrative savings when duplication is reduced and unnecessary administrative costs at the state level are eliminated.

Two areas of particular scrutiny will be the use of cell phones by state employees and the number of state vehicles. The state currently pays for about 96,000 cell phones, one for over 40 percent of all state employees. The Governor has set a statewide goal of reducing the number of cell phones by at least 50 percent. In addition, the Administration will reduce the number of vehicles the state maintains. There are approximately 13,600 light duty vehicles (cars, pickups, vans) in the state fleet, not including some 12,000 that are used for public safety. To reduce the number of vehicles in the state's fleet, the Administration will require each vehicle's purpose and necessity to be rejustified. Only vehicles necessary for critical state functions will be retained, and only when retaining such vehicles is cost effective.

Cash

The Governor's Budget projects the state will have sufficient cash to repay the entire $10 billion of Revenue Anticipation Notes (RANs) as scheduled in May and June 2011. Absent corrective action, the state will once again face substantial challenges in meeting all General Fund cash needs beginning in July 2011. Proposals to close the budget gap will reduce this cash problem. However, in addition to budget solutions, the state will need to obtain external financing early in the fiscal year. Further, it is highly likely that most, if not all, allowable payment deferrals in effect during the 2010-11 fiscal year will need to be continued in 2011-12 to align receipts and disbursements and to reduce the need for external borrowing.