State Budget 2010-11

The 2010 Budget Act

The 2010 Budget Act marks the third year in a row that the Governor and the Legislature have been compelled to take unprecedented steps to bring the state Budget into balance in the midst of the ongoing effects of the worst recession that California has faced since the Great Depression. After having to close a $24.3 billion budget gap in 2008 and a gap of $60 billion in 2009, the 2010 Budget Act closes a budget gap of $19.3 billion—an extraordinary three-year period in the state's fiscal history totaling budget solutions of $103.6 billion. The 2010 Budget Act holds General Fund spending essentially flat compared to the prior year—$86.6 billion in 2010-11 compared to $86.3 billion in 2009-10. This level of General Fund spending is substantially lower than the level of spending in 2004-05, adjusted for inflation and population growth. It is also lower than the level that would have been allowed had a spending cap been in place since 1999.

The Budget Act closes an estimated budget gap of $19.3 billion by a combination of expenditure reductions, federal funds, and other solutions. Figure INT-01 displays the solutions by category. In order to create a prudent reserve for economic uncertainties, the Governor has exercised his line-item veto authority to reduce General Fund spending by an additional $963 million, raising the reserve level from $375 million to $1.3 billion. These vetoes reflect the Governor's continued determination to build a reserve and

Figure INT-01
Enacted Budget Solutions
(Dollars in Millions)

	Solutions	
Expenditure Reductions	$8,387.9	43.6%
Federal Funds	5,403.2	28.0%
Other Solutions	5,483.2	28.4%
	$19,274.3	100.0%

reduce spending to the greatest extent possible, given constitutional, statutory, and court-ordered spending requirements. In addition, the budget agreement meets the Governor's requirements to link budget reform and pension reform as a long-term component of the state's current-year budget resolution.

Budget and Pension Reform

Beyond the necessity of closing this year's budget gap, the Governor made clear that long-term reforms to the state's budgeting and pension systems were essential to the state's long-term fiscal health and stability, and were necessary components of any budget agreement.

In response, the Legislature approved a measure to place a budget reform constitutional amendment before the people at the March 2012 election. In addition, the Legislature approved a measure to roll back unsustainable pension benefits for newly hired state employees.

Budget Reform

California's chronic budget crises have been driven by growing state spending commitments funded by temporary spikes in revenues. Once revenues return to their normal trend – or drop precipitously, as has been the case in this recession – the higher spending base cannot be sustained, and dramatic cuts to programs and/or tax increases have been required.

To help avoid these types of boom-and-bust budget cycles in the future, a constitutional amendment will be placed before voters to substantially strengthen the state's Rainy Day Fund, with more stringent deposit requirements in good budget years that will provide a greater cushion for bad budget years. The amendment's key changes to the Rainy Day Fund are outlined below.

Rainy Day Fund *Deposits*

- 3 percent of current year revenues are required to be deposited in the Rainy Day Fund every September.
  - The requirement to deposit funds can still be waived by the Governor until 2013-14.
  - The requirement to deposit funds cannot be waived after 2012-13, except:
    - When a withdrawal would be allowed, or
    - To the extent the deposit would bring the balance to over 10 percent of General Fund revenues in the year of the transfer.
  - Half of the deposited funds stay in the Rainy Day Fund and half goes into a subaccount to pay down Economic Recovery Bond Debt until a total of $5 billion has been deposited or the bonds are retired.

Unanticipated Revenues

- Unanticipated Revenues are defined as the amounts over 20-year regression (trend) of revenues after accounting for temporary tax changes.
- Unanticipated Revenues will:
  - Fund new Proposition 98 obligations created by the revenue over the trend, and
  - Fund current services budget (previous budget adjusted for population and inflation).
- Unanticipated Revenues will then be deposited into the Rainy Day Fund until the balance in the Fund equals to 10 percent of General Fund revenues.
- When the Rainy Day Fund is full then Unanticipated Revenues may be used for one time purposes.
  - Paying off budget debts shall have priority over other one-time purposes. This would include repaying Proposition 1A loans, Proposition 42 suspensions, Economic Recovery Bonds, and unfunded prior year Proposition 98 obligations.

- After all budget debts are paid, other payments for other-one time purposes such as: additional transfers to the Rainy Day Fund, infrastructure, other debt reduction, tax rebates or one-time reductions, and funding liabilities for non-pension benefits for annuitants.

Rainy Day Fund *Withdrawals*

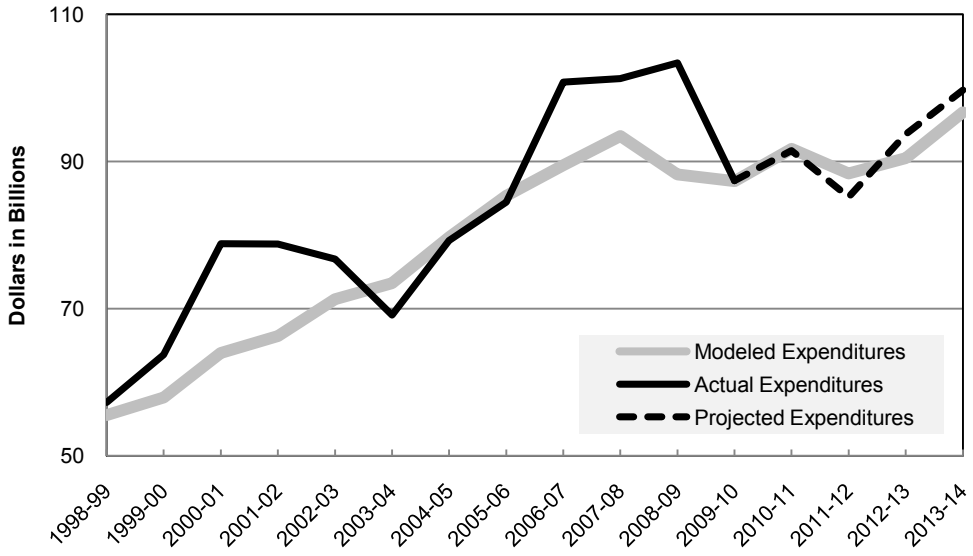
- Withdrawals from the Rainy Day Fund are permitted only when revenues are not sufficient to fund the current services budget. Withdrawal amounts are limited to the lesser of:
  - The amount that when added to available revenues would fund the current services budget.
  - Half of the balance when a withdrawal has not occurred in the previous year, or,
  - If withdrawals were made from the Rainy Day Fund in both of the previous two years, then the withdrawal amount is limited the amount that when added to available revenues would fund the current services budget.
- Withdrawals are permitted to fund the costs of responding to a declared emergency (e.g. natural disaster, civil disturbance, or war).
- Except in years when a transfer from the Rainy Day Fund to the General Fund is made, 1.5 percent of revenues is transferred from the Rainy Day Fund to an account, which must be used for reduction of debt and infrastructure spending.

Had these provisions been in place over the past decade, the state would have entered the recession with a $10 billion Rainy Day Fund, which would be helping to balance the Budget this year and next year as well. Expenditures would have grown at a much steadier pace, without the unsustainable highs that were fueled by the dot-com and housing bubble revenue. Thus, the cuts necessary to adjust to the recession would have been mitigated by: (a) the larger Rainy Day Fund and (b) starting from a significantly lower 2008-09 budget level, as illustrated in the Figure INT-02 below.

Pension Reform

In fiscal year 2010-11, the State of California's employee pension contributions to the California Public Employees' Retirement System (CalPERS) are estimated to be $3.8 billion ($2.1 billion General Fund). (The California State Teachers' Retirement System costs the state an additional $1.3 billion General Fund this year.) CalPERS has

Figure INT-02
Budget Reform Modeling - 10/1



a large unfunded liability that results in a significant impact on employer contributions in 2010-11 and beyond. A major contributor is the increase in pension benefits granted through SB 400 (Chapter 555, Statutes of 1999). SB 400 was enacted to retroactively and prospectively boost pension benefits for any employee (existing or to be hired) who retired on or after January 1, 2000.

Comprehensive pension reform achieved through collective bargaining and legislation includes a rollback of SB 400 benefit increases for new employees, increases employee contributions towards pensions, and ends pension spiking, which will save CalPERS up to $100 billion over the years and decades to come. It also adds disclosure requirements for CalPERS to increase pension funding transparency.

Specifically, pension reform does the following:

Retirement Formulas for New Employees — Rolls back retirement formulas used to calculate pension payments, which increases the retirement age to achieve full benefits for most new employees. Retirement formulas are generally described by the percentage multiplier at a specified age for the employees' number of years of service. Figure INT-03

below identifies the previous and new retirement benefits by retirement category for newly hired state employees.

Figure INT-03
Employee Retirement Formulas

Retirement Category	Current Retirement Formulas	New Retirement Formulas
Miscellaneous - First Tier	2% at Age 55 (2.5% at Age 63+)	2% at Age 60 (2.418% at Age 63+)
Miscellaneous - Second Tier	1.25% at Age 65+	1.25% at Age 65+
Industrial	2% at Age 55 (2.5% at Age 63+)	2% at Age 60 (2.418% at Age 63+)
State Safety	2.5% at Age 55+	2% at Age 55+
Peace Officer/Firefighter	3% at Age 50+[1]	2.5% at Age 55+
Firefighter BU8	3% at Age 50+[1]	3% at Age 55+
Patrol	3% at Age 50+[1]	3% at Age 55+

[1]SB 400 changed the formula to 3% at age 55, but 3% at age 50 was collectively bargained under the previous Administration.

Increased Pension Contributions — Permanently increases pension contributions for current and new employees ranging from 2 to 5 percent.

Pension Spiking — Prevents pension spiking by requiring pension benefits for future employees be calculated based on the highest consecutive three-year average salary, as opposed to the single highest year (for those groups still at the highest single year formula).

Transparency — Improves transparency of the state's pension liabilities and costs of servicing those liabilities. Specifically, it will require CalPERS, any time it adopts contribution rates, to submit a report to the Governor, Treasurer, and Legislature that in plain language describes: (1) the discount rate it uses to report pension liabilities and how those liabilities would be valued if a risk-free discount rate was used, (2) the investment return it assumes for projecting contributions and how those contributions would change if a lower investment return assumption was used, (3) the period over which it amortizes

unfunded liabilities and how contributions would change if unfunded liabilities were amortized over a period equal to the estimated average service periods of employees covered by the contributions, and (4) the market value of its assets and how that value differs from its chosen actuarial value for those assets. It will also require the Treasurer to evaluate and provide his or her opinion of the report to the Legislature.

Plan to Address Anticipated Cash Shortfall

In addition to the $19.3 billion in enacted budget solutions, the budget package includes additional cash measures to assist the Controller in managing cash immediately after budget enactment. While the state is proceeding expeditiously to obtain external cash financing consistent with standard practice, these additional tools will assist the state in managing the large sum of payments not made during the budget impasse that is due upon budget enactment. Specifically, the cash management legislation included as part of the budget package provides for a short-term payment deferral for pension contribution for schools and potential deferrals to schools and higher education to assist the state in meeting its priority payments. These deferrals are in addition to deferrals that can be made under Controller's authority.

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