

CALIFORNIA BUDGET PROJECT

Uncharted Waters:

Navigating the Social and Economic Context of the
Governor's 2009-10 Proposed Budget

1107 9th Street,
Suite 310
Sacramento,
California 95814
(916) 444-0500
www.cbp.org
cbp@cbp.org

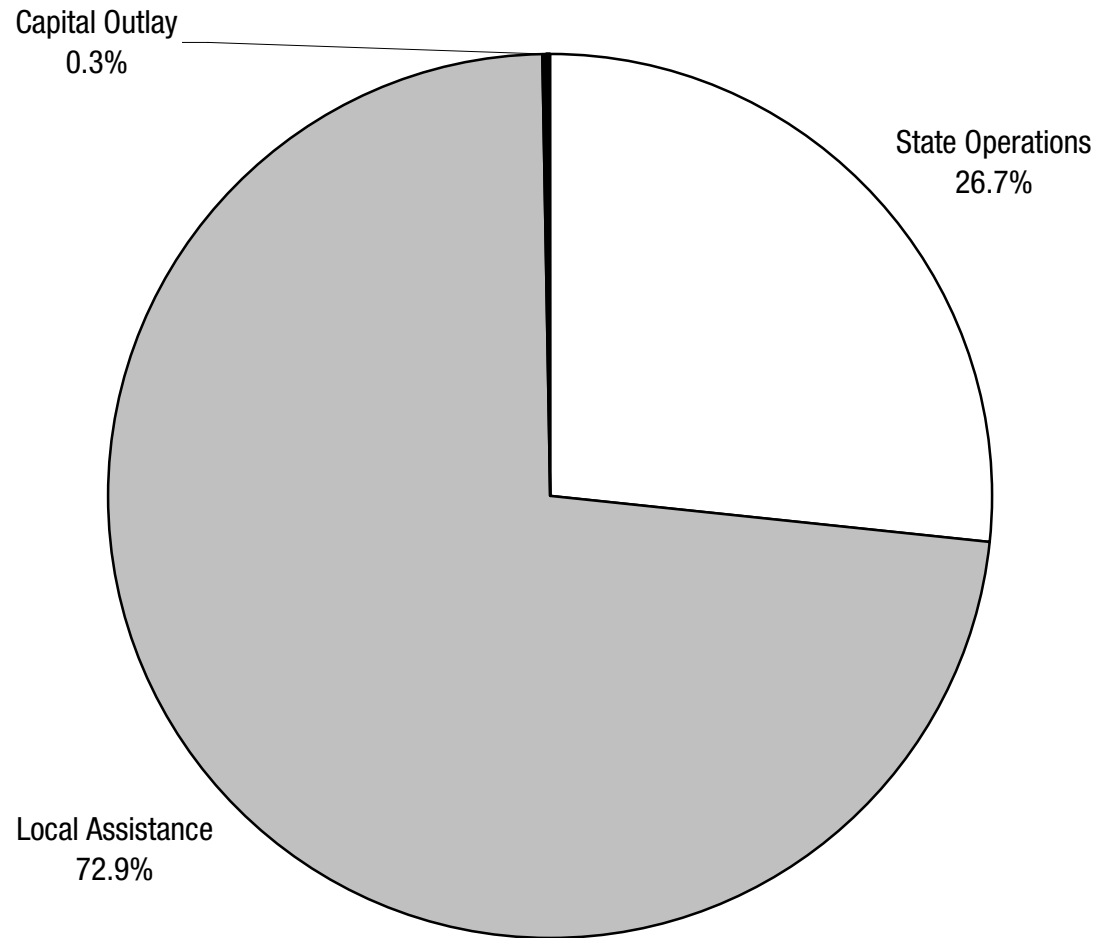
A PRESENTATION BY
THE CALIFORNIA BUDGET PROJECT
January 2009

Why Do Budgets Matter?

- Nearly three-quarters of every dollar spent through the state's General Fund flows to individuals, health providers, schools, and local governments.
- The decisions made in this year's budget debate affect the daily lives of all Californians – from the quality of our public schools to the roads we drive on and the air we breathe.
- Many of the decisions made as part of budget deliberations – such as changes in tax policies, the “base” for the state's school funding guarantee, and decisions to place constitutional limits on the budget and budget process – will affect Californians for decades into the future.

Most State Dollars Go to Local Communities and Individuals

2009-10 Proposed General Fund Spending



Note: Excludes unclassified spending.
Source: Department of Finance

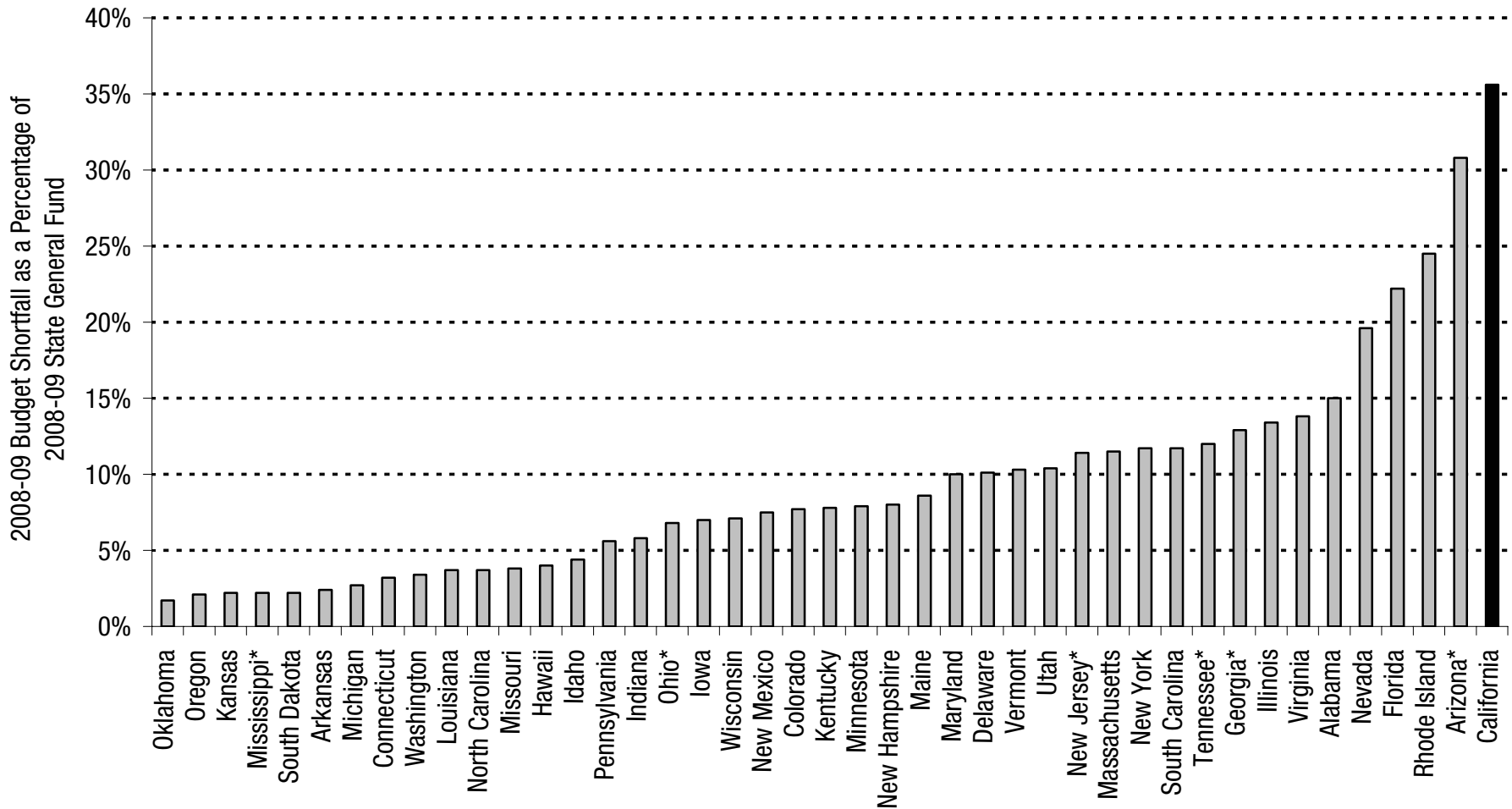
The Bottom Line

- California faces a \$40 billion budget shortfall in the remainder of 2008-09 and the 2009-10 fiscal years. Moreover, the Legislative Analyst projects that the state will face shortfalls in excess of \$20 billion per year through 2013-14.
- The shortfall results from a deterioration of current and budget year revenue collections due to a slowing economy; modestly higher-than-anticipated current year spending; and a structural imbalance between the cost of programs and services and the revenues raised by the state's tax system.
- The Governor proposes \$41.7 billion in "solutions" to close the gap and end 2009-10 with a \$2.2 billion reserve.

How Big Is a \$40 Billion Budget Gap?

- To close the projected \$15 billion gap in the remainder of 2008-09 and the \$25 billion gap projected for 2009-10 solely through spending cuts is equivalent to:
 - Eliminating General Fund support for schools, community colleges, resources, and environmental protection programs for the remainder of 2008-09 beginning March 1st; and
 - Eliminating General Fund support for corrections, CSU, UC, CalGrants, IHSS, CalWORKs, and SSI/SSP for all of 2009-10.

California's Budget Gap Is the Largest Among the 43 States With 2008-09 Budget Shortfalls



* Reflects the lowest estimated 2008-09 budget shortfall.

Note: Includes shortfalls identified both prior to and after adoption of states' 2008-09 budgets.

Source: Center for Budget Policy and Priorities

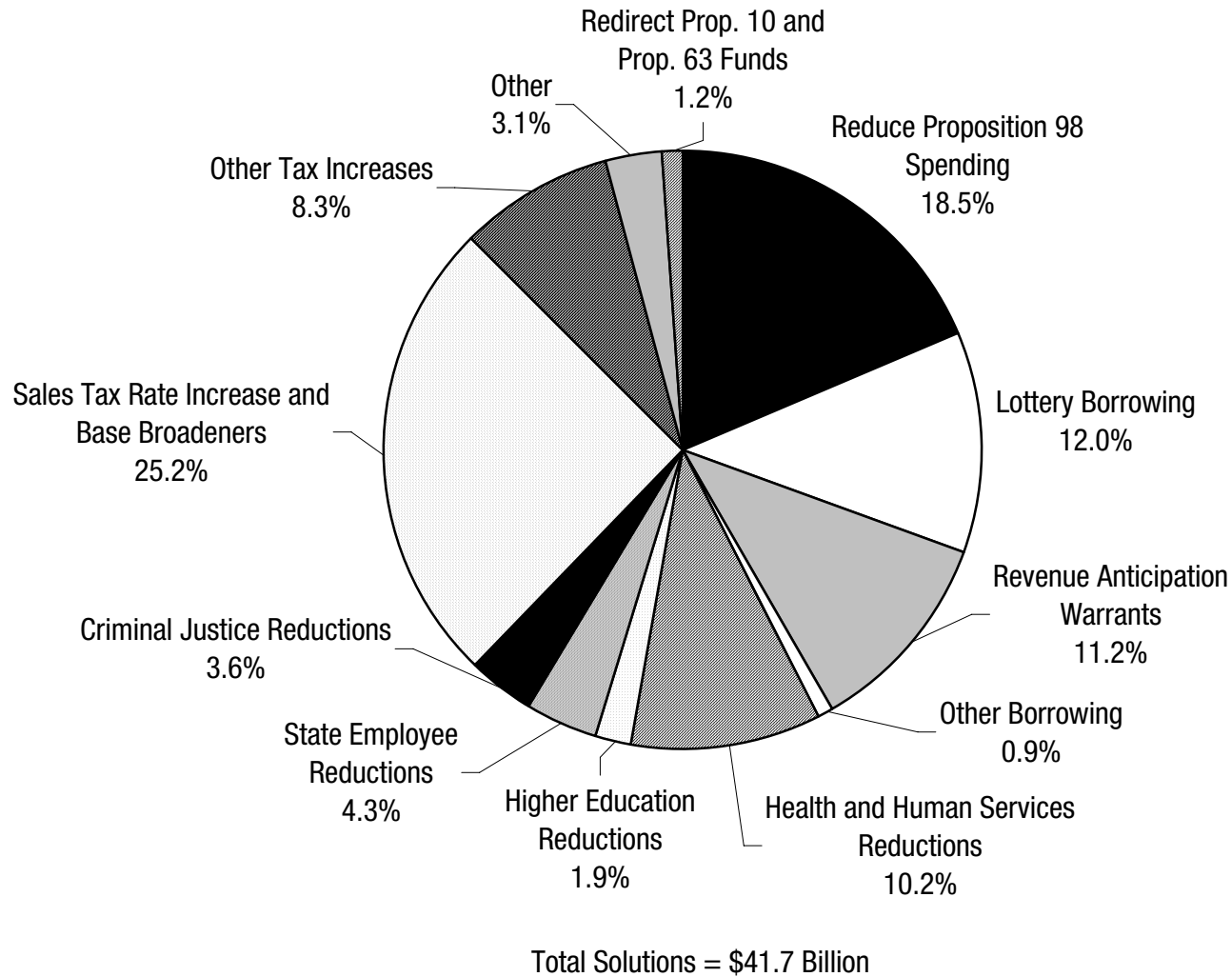
The Big Picture

- The 2008-09 budget crisis was bigger, different, and more challenging than any that California has faced before. The current crisis is even bigger, is more different, and is even more challenging than that of 2008-09 due to the impact of the recession and the state's cash flow problems.
- California's budget problems have been exacerbated by “solutions” to prior crises that impose future costs, earmark revenues, and otherwise limit options for balancing the budget.

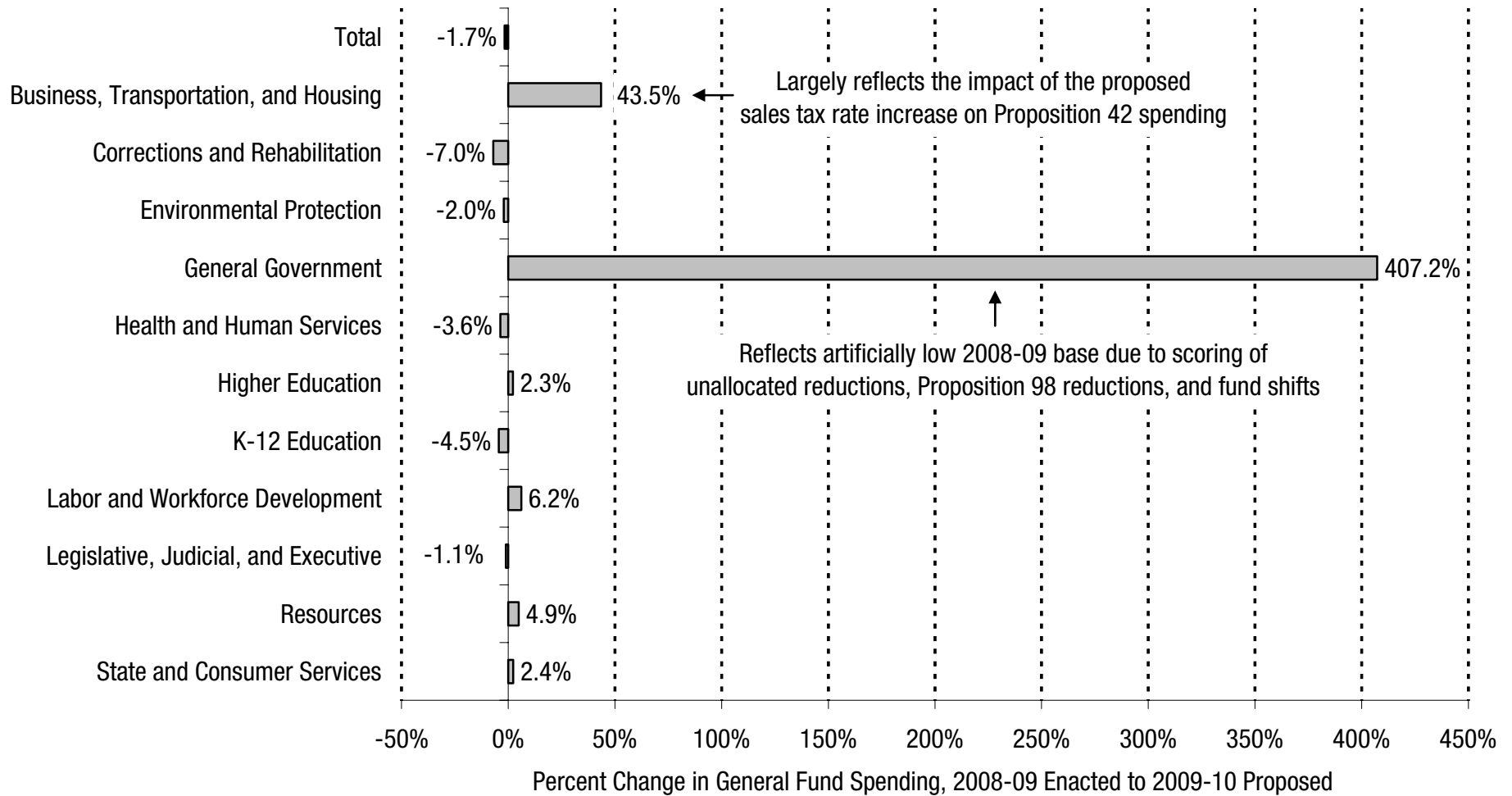
How Does the Governor Balance the Budget?

- The Governor proposes to close the state's budget gap by:
 - Cutting General Fund spending by \$17.5 billion;
 - Raising revenues by \$14.2 billion, primarily through a temporary 1.5 cent increase in the state's sales tax rate;
 - Borrowing \$4.7 billion using relatively short-term Revenue Anticipation Warrants;
 - Borrowing \$5.0 billion that would be repaid out of future lottery proceeds; and
 - \$358 million of other borrowing.

How Does the Governor Propose To Balance the Budget?



State Spending Would Fall Under the Governor's Budget Proposals



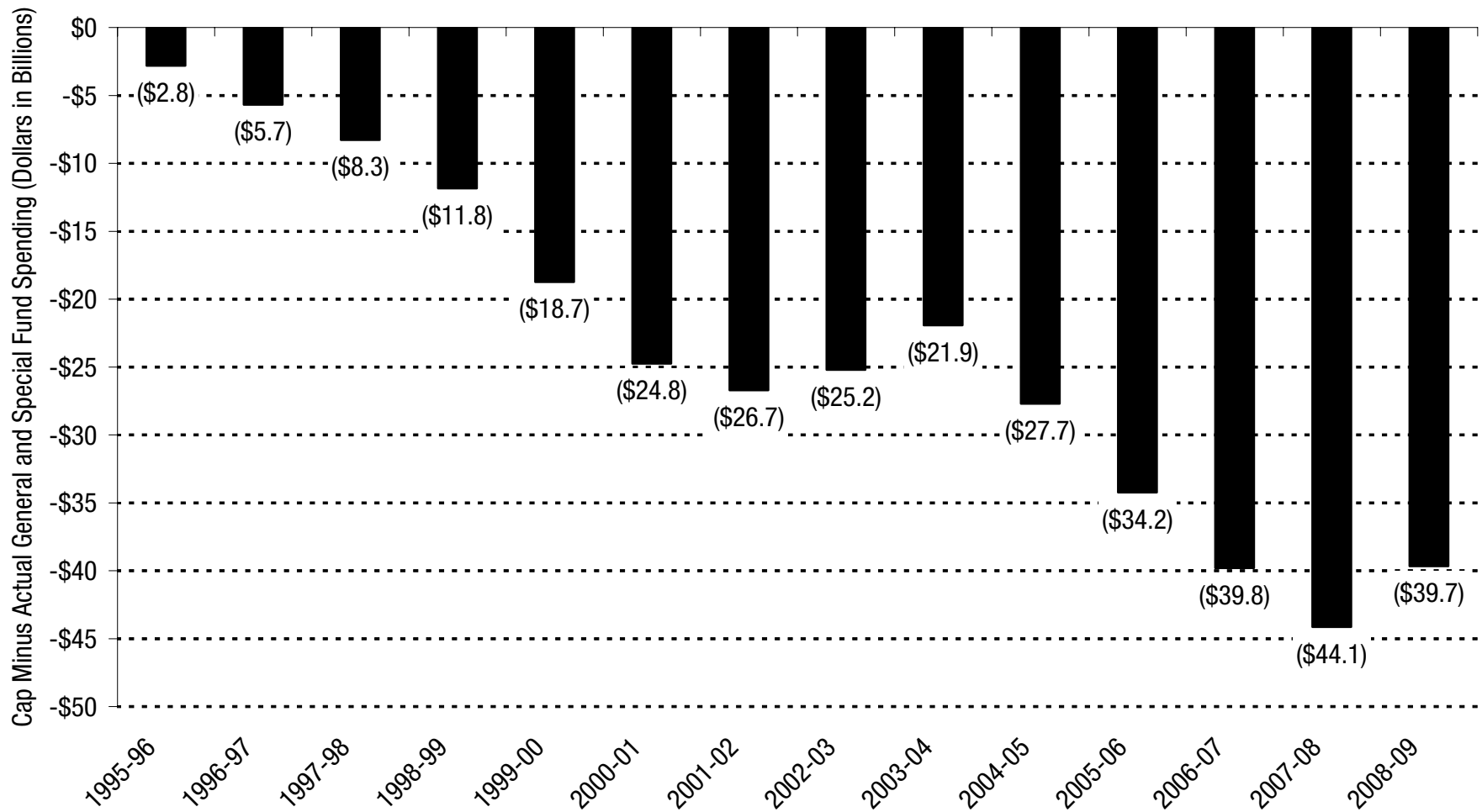
Note: General Government expenditures do not include offset for proposed lottery bond proceeds.
 Source: Department of Finance

What Are the Sticking Points?

- Since the Governor's special session call in November, ongoing negotiations between Legislative leaders and the Governor have focused on:
 - How much of the budget gap should be closed by taxes and how much by spending reductions? Should the state and can the state fill part of the gap through borrowing? What taxes? What cuts?
 - What “off budget” items – such as changes to environmental, labor, and state contracting laws – should be considered as part of a budget deal?
 - Republican lawmakers' call for the Legislature to place a “hard” spending cap on the ballot.

How Much Would the State Have To Cut To Live Within a Hard Spending Cap?

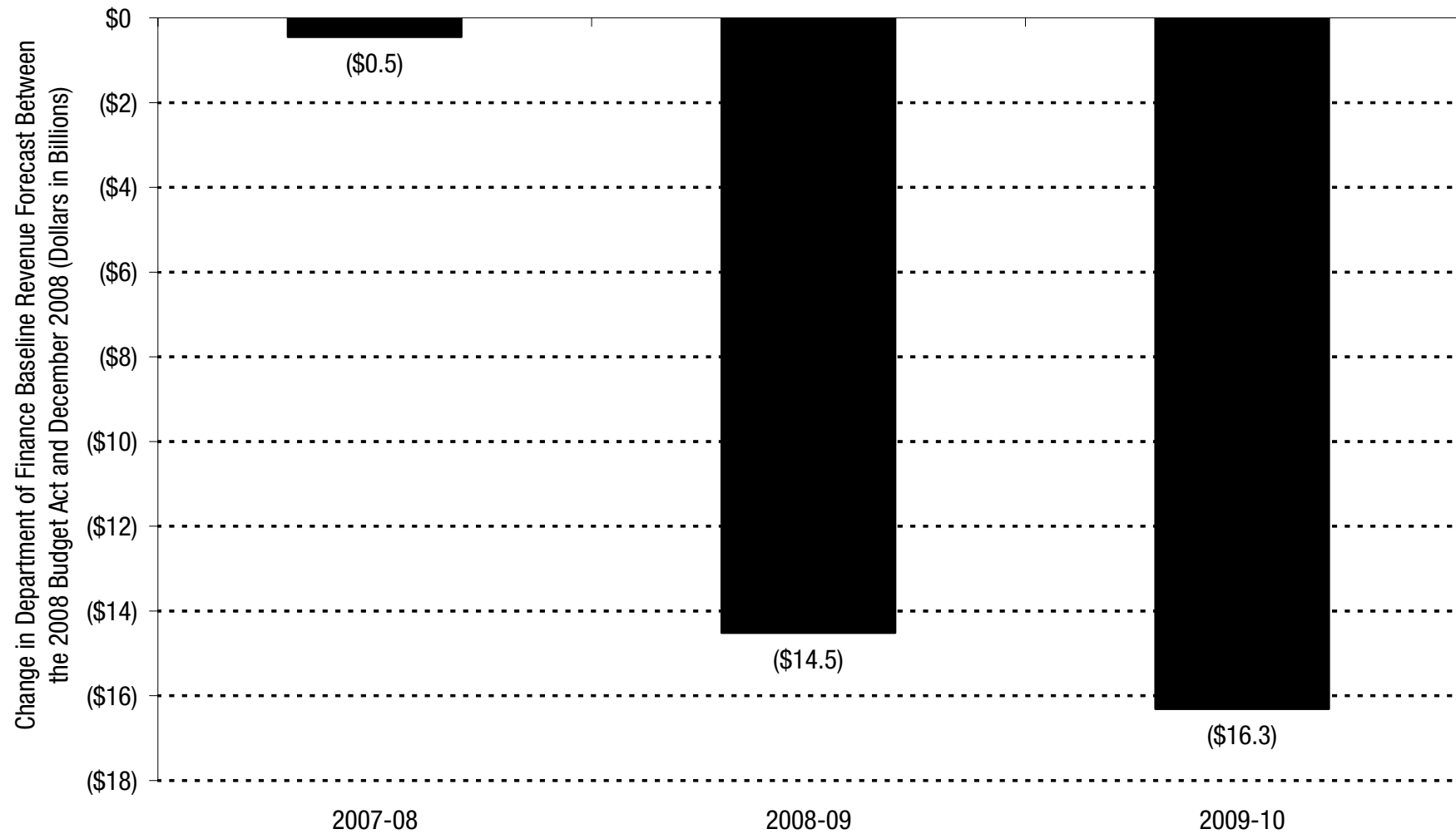
Assumes Implementation Beginning in 1995-96



How Did Things Get So Bad So Fast?

- Revenue forecasts for 2007-08, 2008-09, and 2009-10 have been downgraded by a total of \$31.3 billion since the 2008-09 Budget was signed into law in September.
- Spending is modestly higher than anticipated due to lower-than-expected local property tax collections, which boosts the state's costs for education; firefighting costs; and caseload-driven increases in health and human services programs due to the downturn in the economy.
- California faces an ongoing imbalance between revenues and expenditures that is exacerbated by the state's past reliance on one-time "solutions" to balance the budget and by debt service costs attributable to deficit-related borrowing.

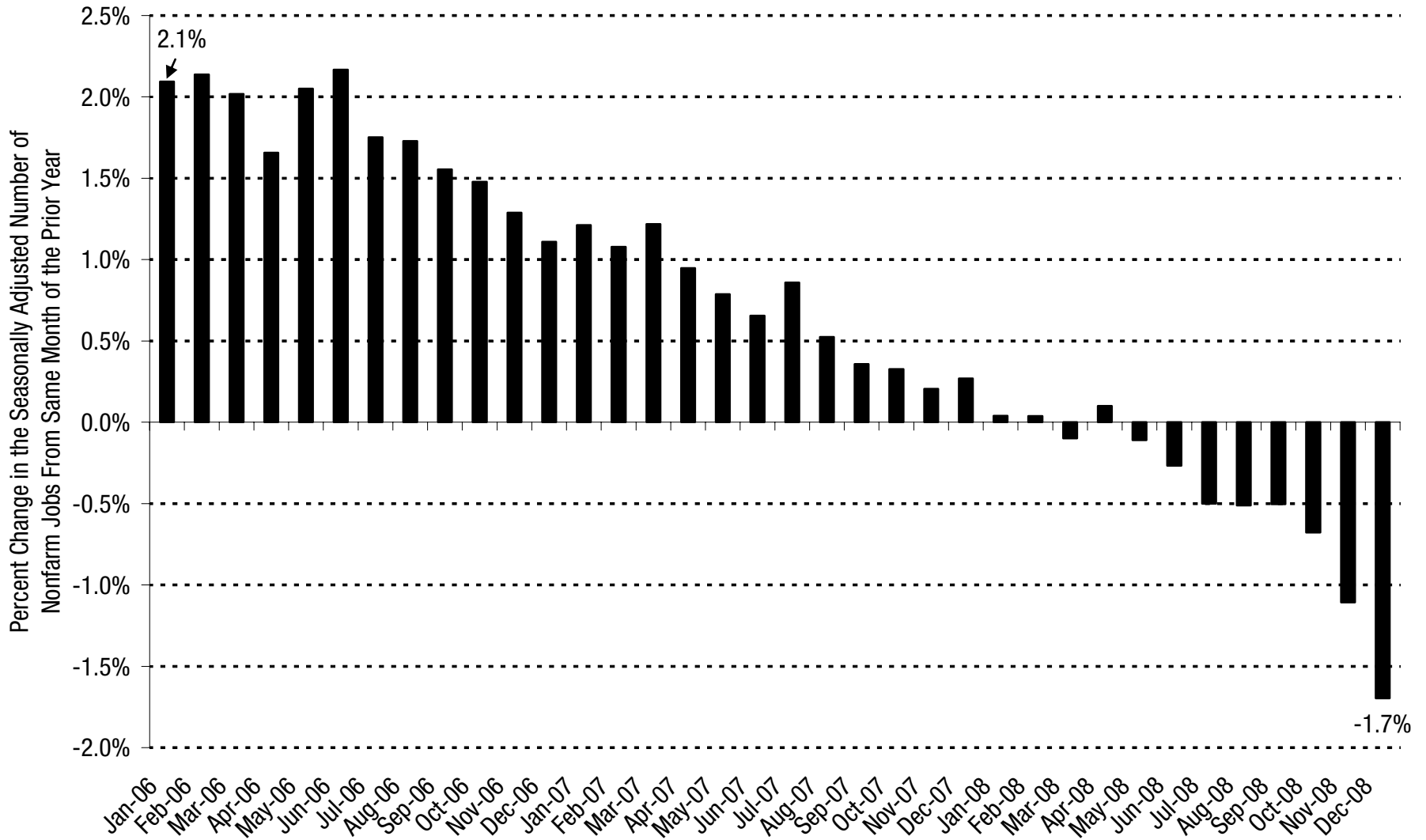
Anticipated Revenues Are Down by \$31 Billion Since September



The Economy Has Weakened Substantially

- Both the state and the nation are in what many economists expect to be the deepest recession in the post-World War II era. The recession, which began in late 2007, has led to substantial job losses, a sharp rise in unemployment, and a drop in consumer spending.
 - California’s job losses have accelerated in recent months. Approximately 60 percent of the 257,400 jobs lost in 2008 were lost during the last three months of the year.
 - California’s unemployment rate hit 9.3 percent in December 2008, up from 5.9 percent in December 2007, and new unemployment claims spiked by 66.3 percent during this period.
 - National personal consumption spending dropped by 3.8 percent in the third quarter of 2008 – the largest decline since 1980.
 - California’s median home price plunged from a peak of \$484,000 in the spring of 2007 to \$249,000 in December 2008.

California's Job Losses Accelerated in Late 2008



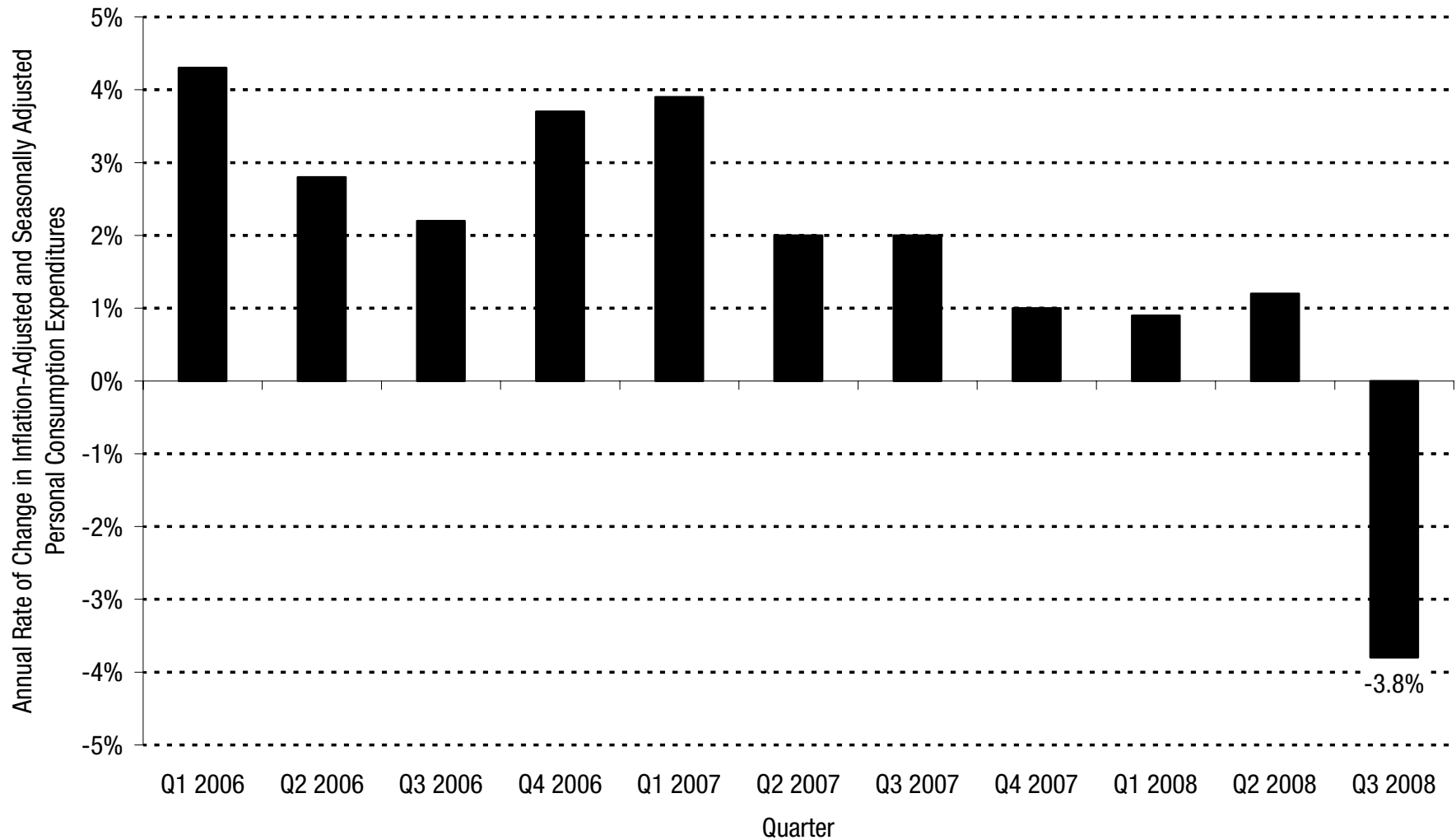
Source: Employment Development Department

New Unemployment Insurance Claims Have Spiked Over the Past Year

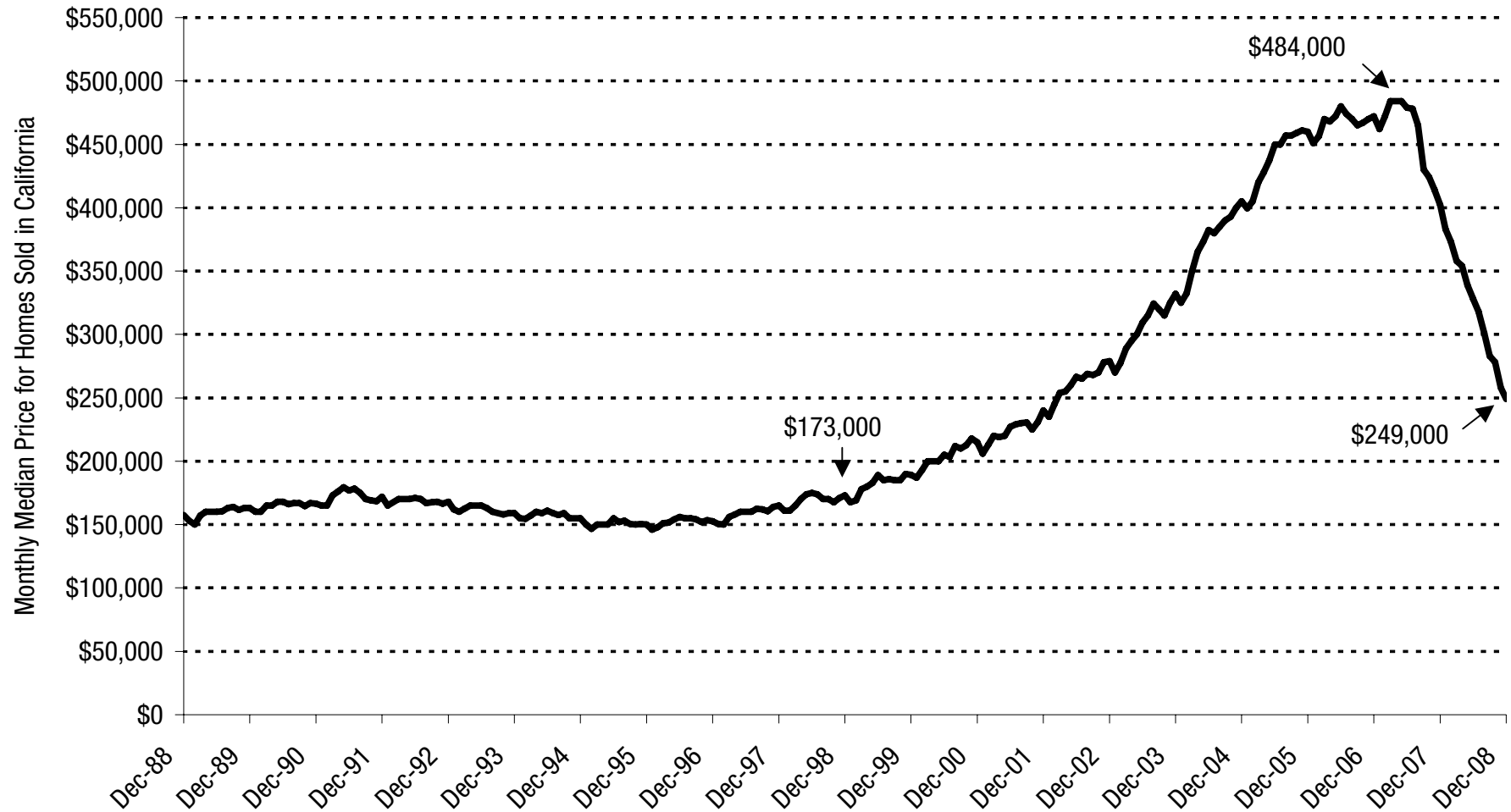


Source: US Employment and Training Administration

Personal Consumption Spending Fell in the Third Quarter of 2008 by the Largest Percentage Since 1980



California's Median Home Price Has Plunged Since Peaking in Spring 2007



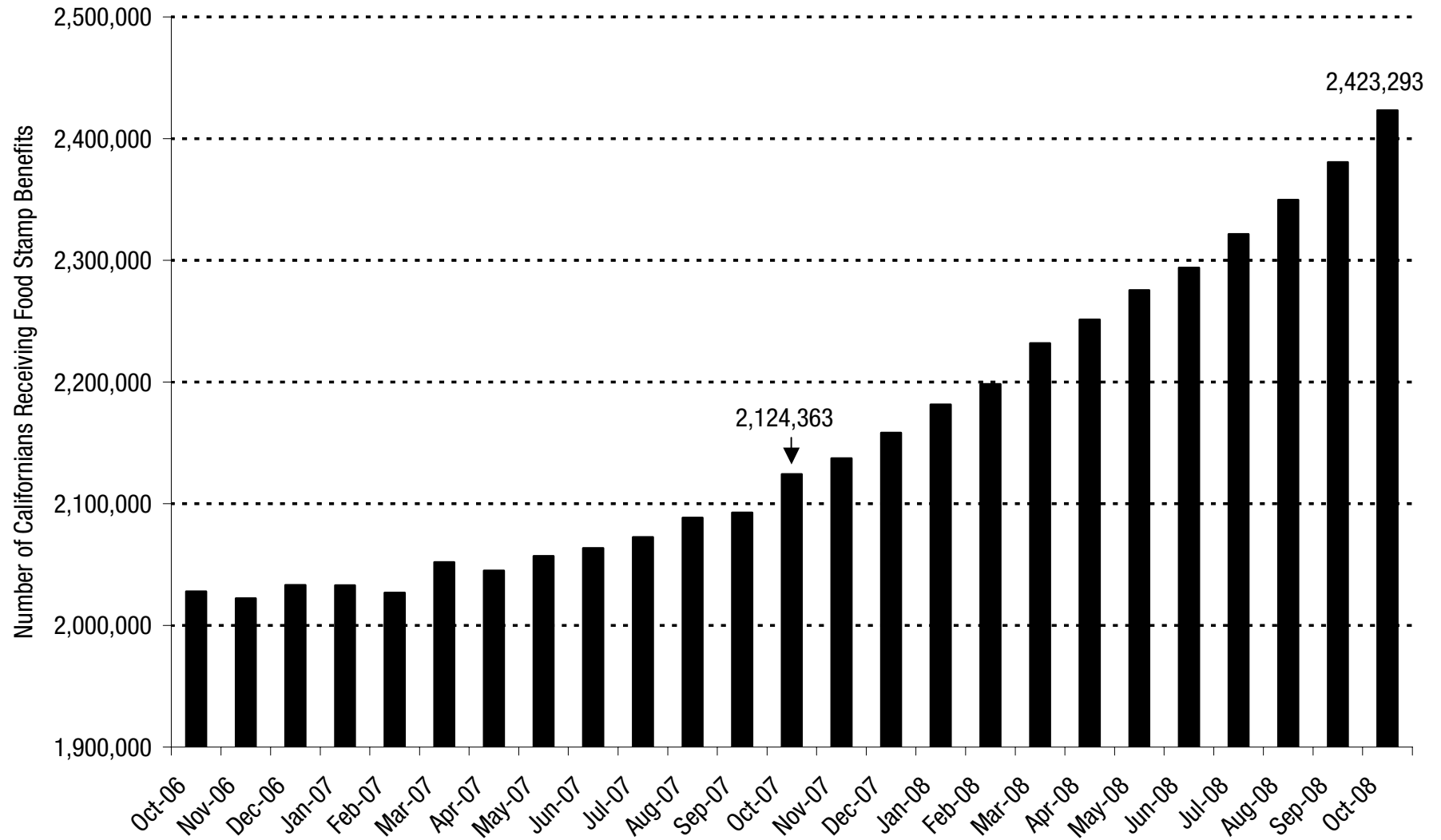
Note: Includes new and resale condominiums and single-family detached homes.

Source: MDA DataQuick

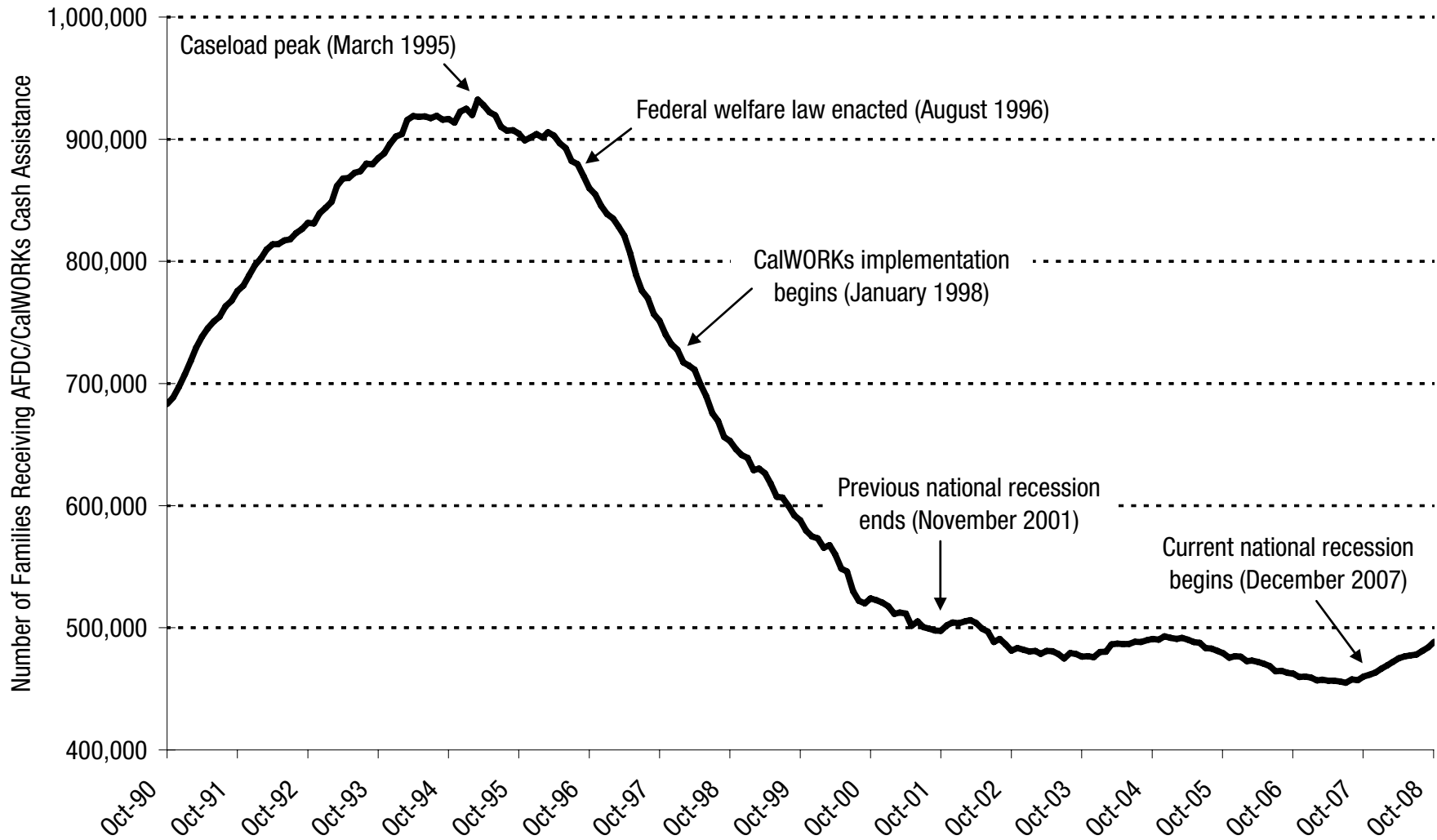
Demand for Services Rises as Economic Conditions Worsen

- Between September 2007 and September 2008:
 - The number of Californians receiving food stamp benefits increased by 13.8 percent (288,212) – nearly four times the increase during the prior 12 months (3.7 percent).
 - The number of children enrolled in the Healthy Families Program increased by 5.8 percent (48,544), following an 8.0 percent increase (62,242) during the prior 12 months.
 - The number of families receiving CalWORKs cash assistance increased by 5.9 percent (26,914), marking a reversal from the prior year's trend, when the September caseload declined by 1.3 percent (6,091).

The Number of Californians Receiving Food Stamp Benefits Has Risen Substantially



The Number of Families Receiving CalWORKs Cash Assistance Has Increased Since July 2007

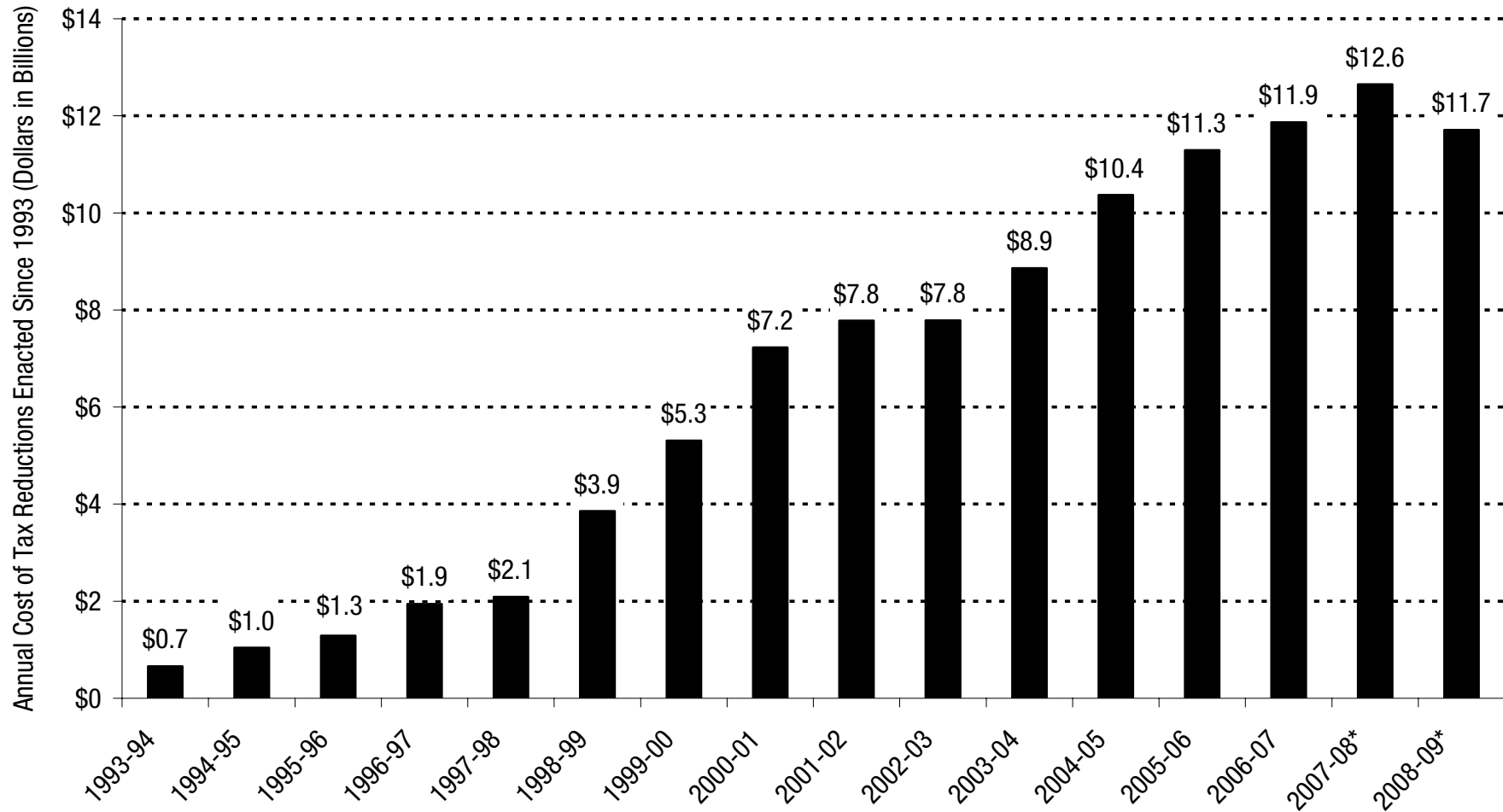


The Long-Term Roots of the Crisis

- Tax cuts enacted since 1993 cost the state nearly \$12 billion in 2008-09. The largest of these – the reduction in Vehicle License Fees – shows up in the budget as a spending increase, distorting the true balance between revenues and expenditures.
- Voter-approved bonds and earmarked spending limit policymakers' ability to balance the budget. The state's debt service costs as a percentage of spending have more than doubled since 2002-03.

Tax Cuts Enacted Since 1993 Will Cost \$11.7 Billion in 2008-09

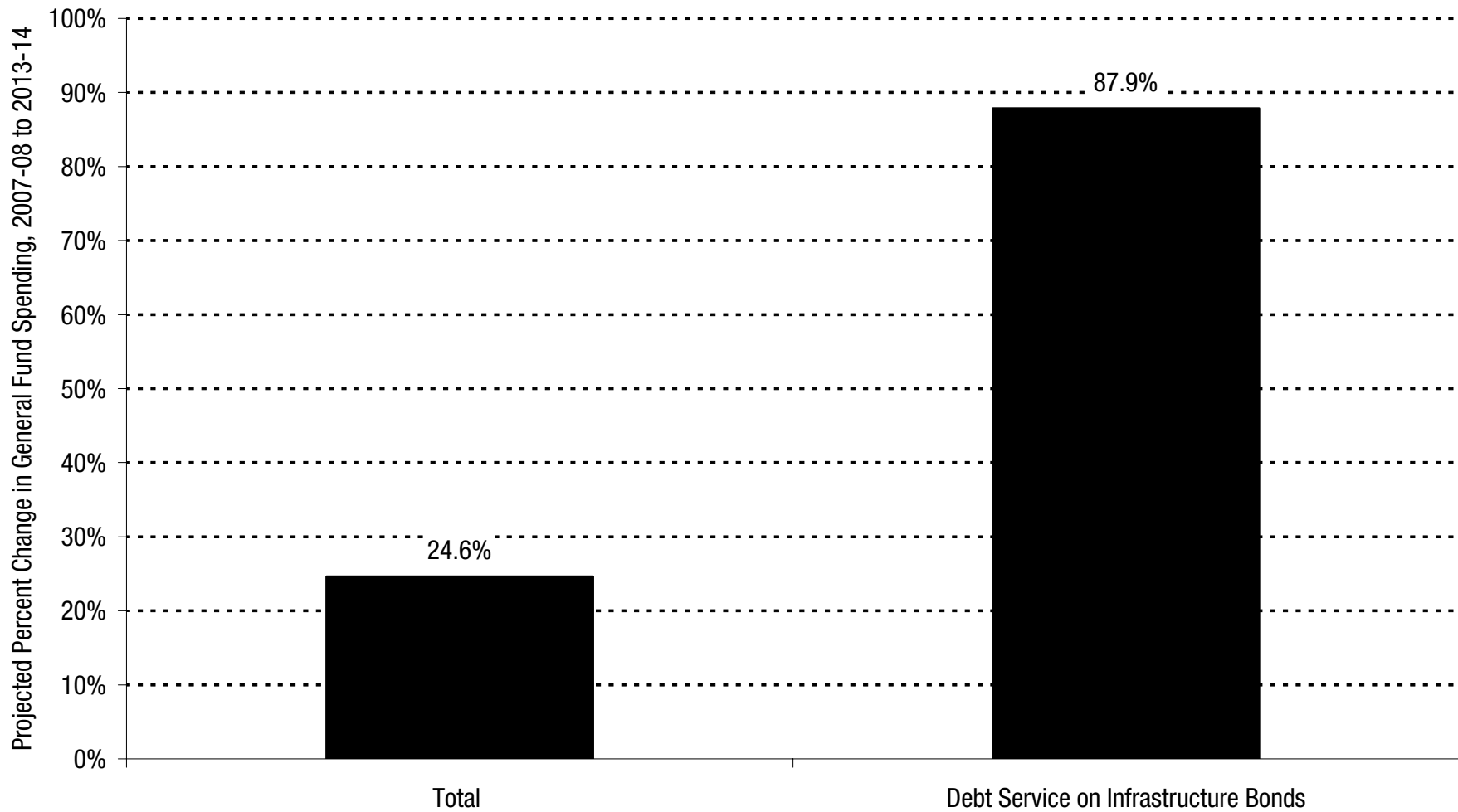
2008-09 Drop Reflects Suspension of Net Operating Loss Deductions



*2007-08 and 2008-09 estimated.

Source: Assembly Revenue and Taxation Committee, Board of Equalization, Department of Finance, Franchise Tax Board, and Legislative Analyst's Office

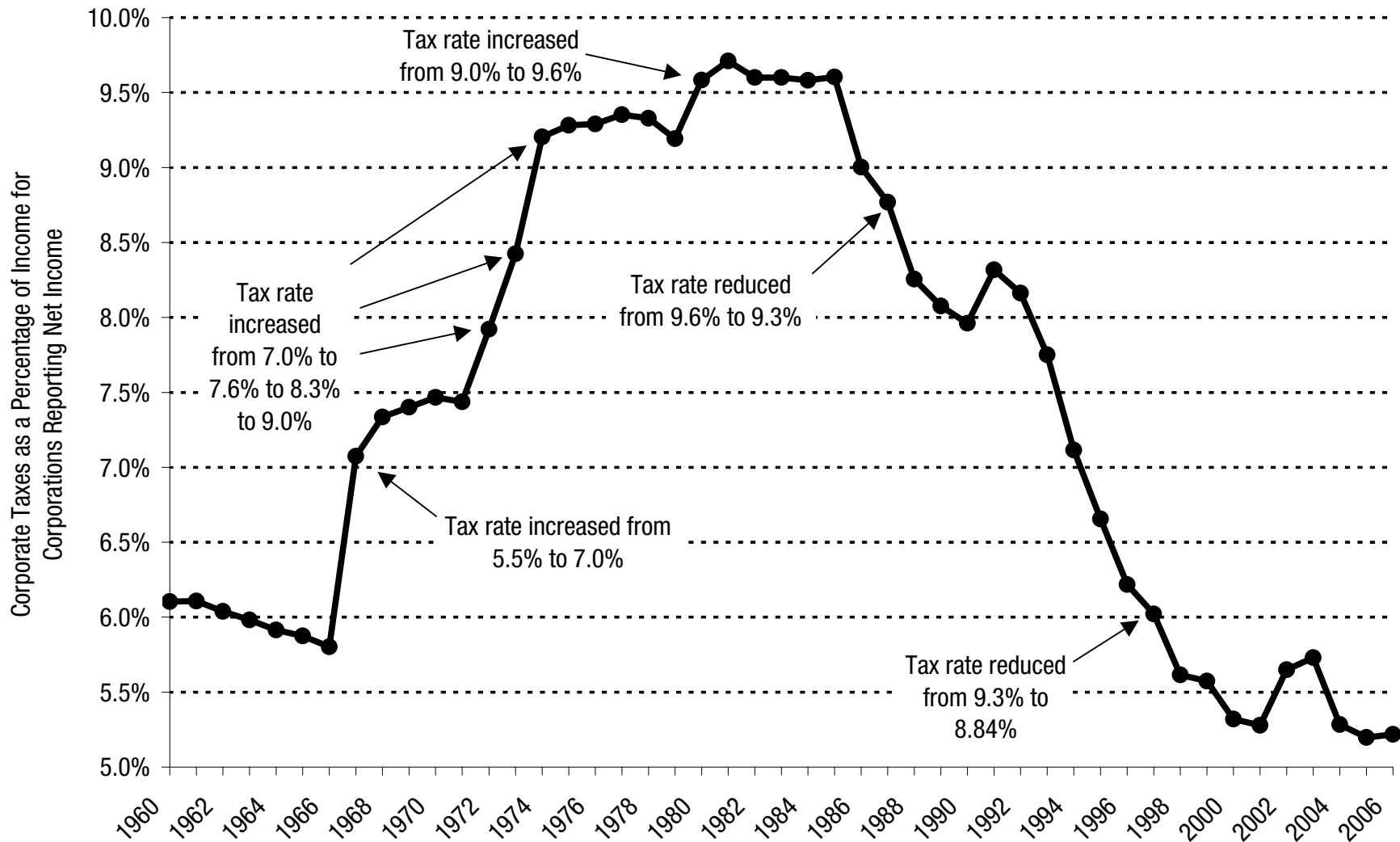
Infrastructure Debt Service Costs Expected To Rise at More Than Three Times the Rate of Overall Spending



California's Tax System Contributes to the Budget Gap

- Tax policies and economic trends contribute to the state's budget problems:
 - Corporate income taxes have declined over time as a share of General Fund revenues and as a share of corporate profits. If corporations had paid the same share of their profits in corporate taxes in 2006 as they did in 1981, corporate tax collections would have been \$8.4 billion higher.
 - The yield of the state's sales tax has declined over time, reflecting the shift in economic activity from goods to services and the rise of Internet and mail-order sales that escape taxation. If taxable purchases accounted for the same share of personal income in 2007-08 as they did in 1966-67, the state would have collected an additional \$16.4 billion in sales tax revenues.
 - The phase-out of the federal estate tax will cost the state over \$1.1 billion in 2009-10. Current law reinstates the tax in 2011; however, most experts believe that the state portion of the tax will not be restored.

The Share of Corporate Income Paid in Taxes Has Fallen by Nearly Half Since 1981



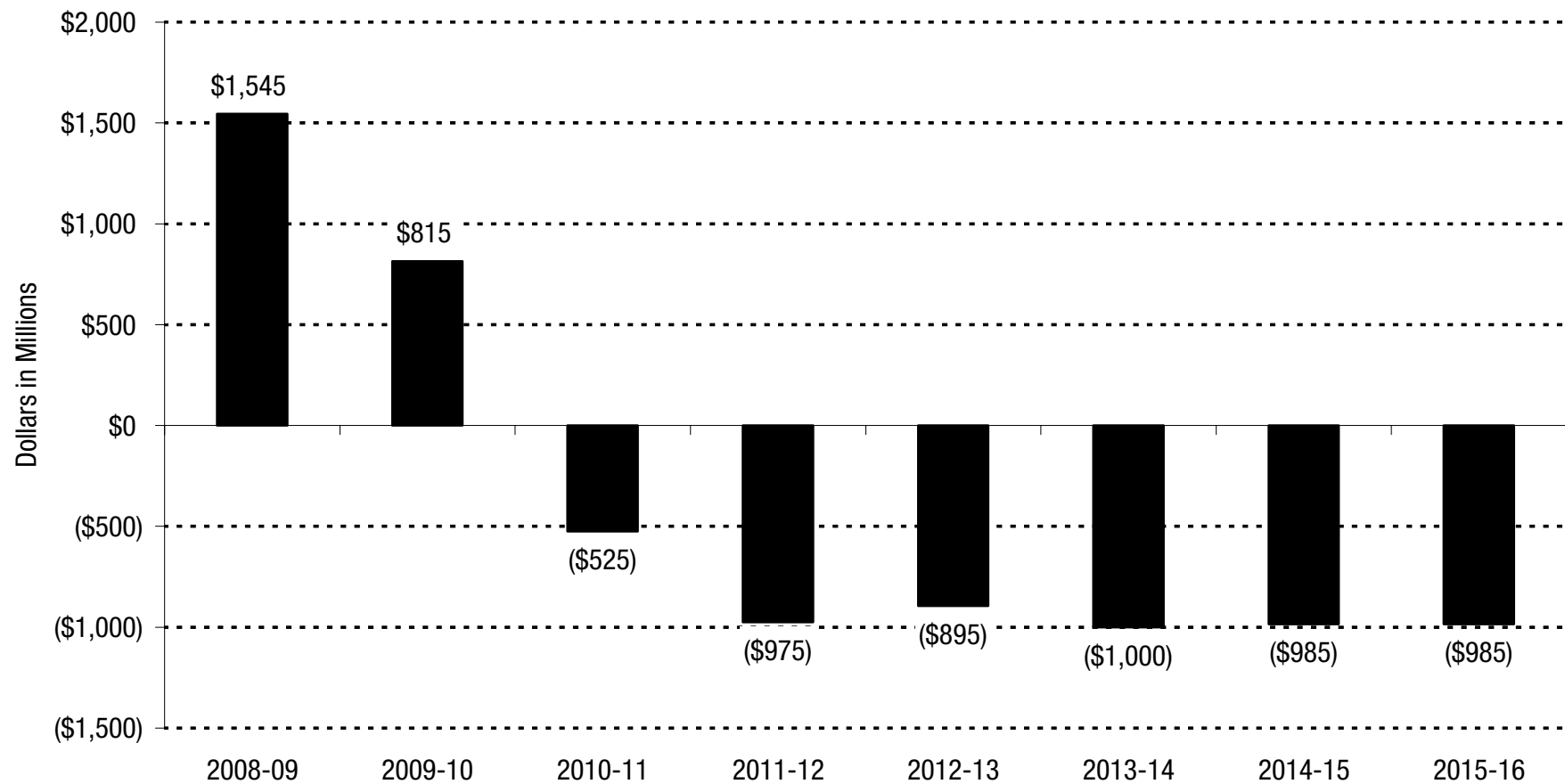
Source: Franchise Tax Board

The 2008-09 Budget Agreement Sets the Stage for Future Problems

- Provisions in the 2008-09 budget agreement will:
 - Reduce corporate tax revenues by more than \$3.0 billion over the next eight years, with a loss of approximately \$1 billion per year thereafter.
 - Increase state education costs by nearly \$1.0 billion per year if the proposal to sell bonds backed by lottery proceeds is successful.
 - Require the state to transfer more money each year into a budget reserve, and severely limit the use of the reserve, without providing funding for the increased transfer.

2008 Tax Deal Will Lose More Than \$3 Billion Over Eight Years

Losses Will Continue Permanently

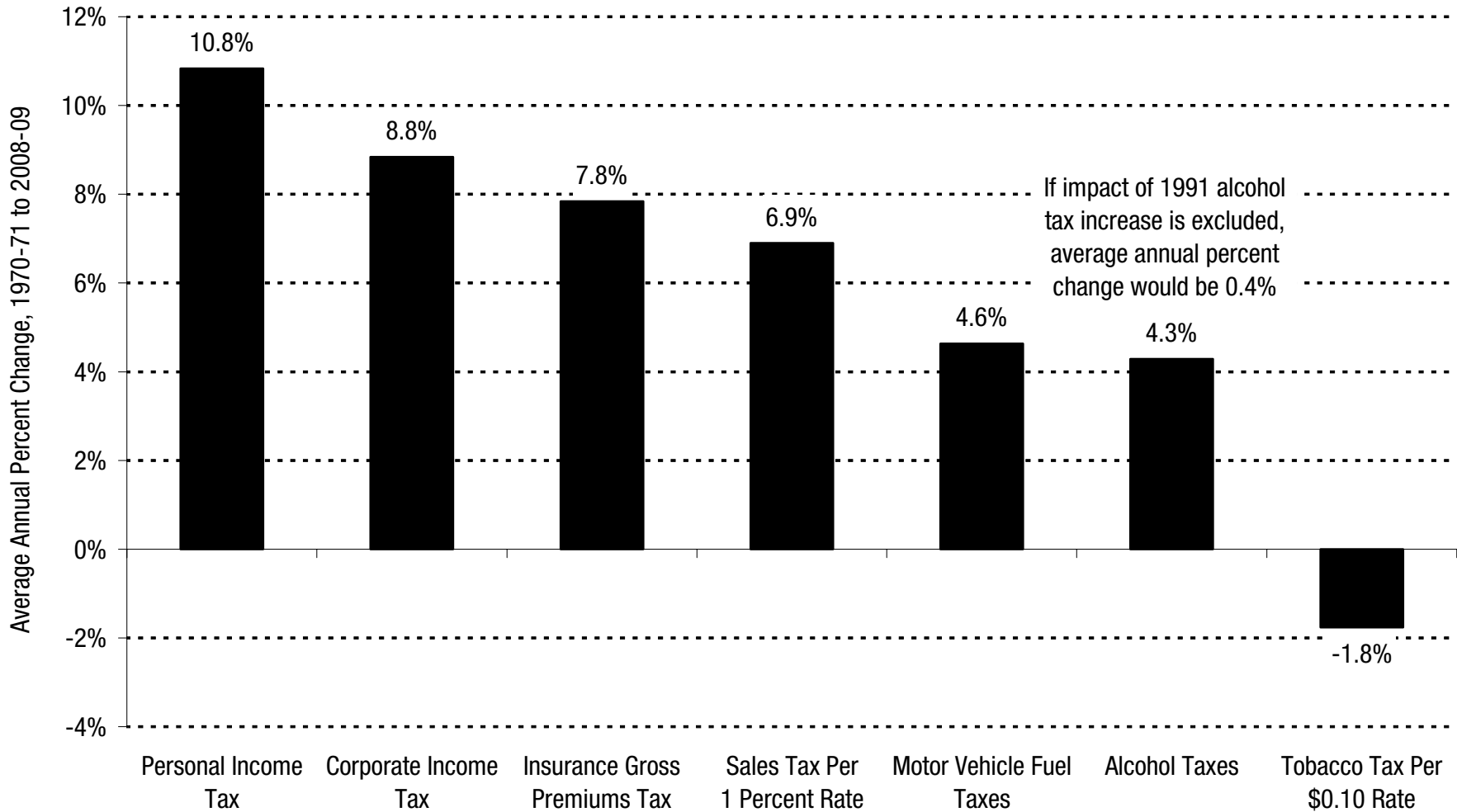


Net Cost of Net Operating Loss and Business Tax Credit Provisions in the 2008 Budget Agreement

What Are the Facts?

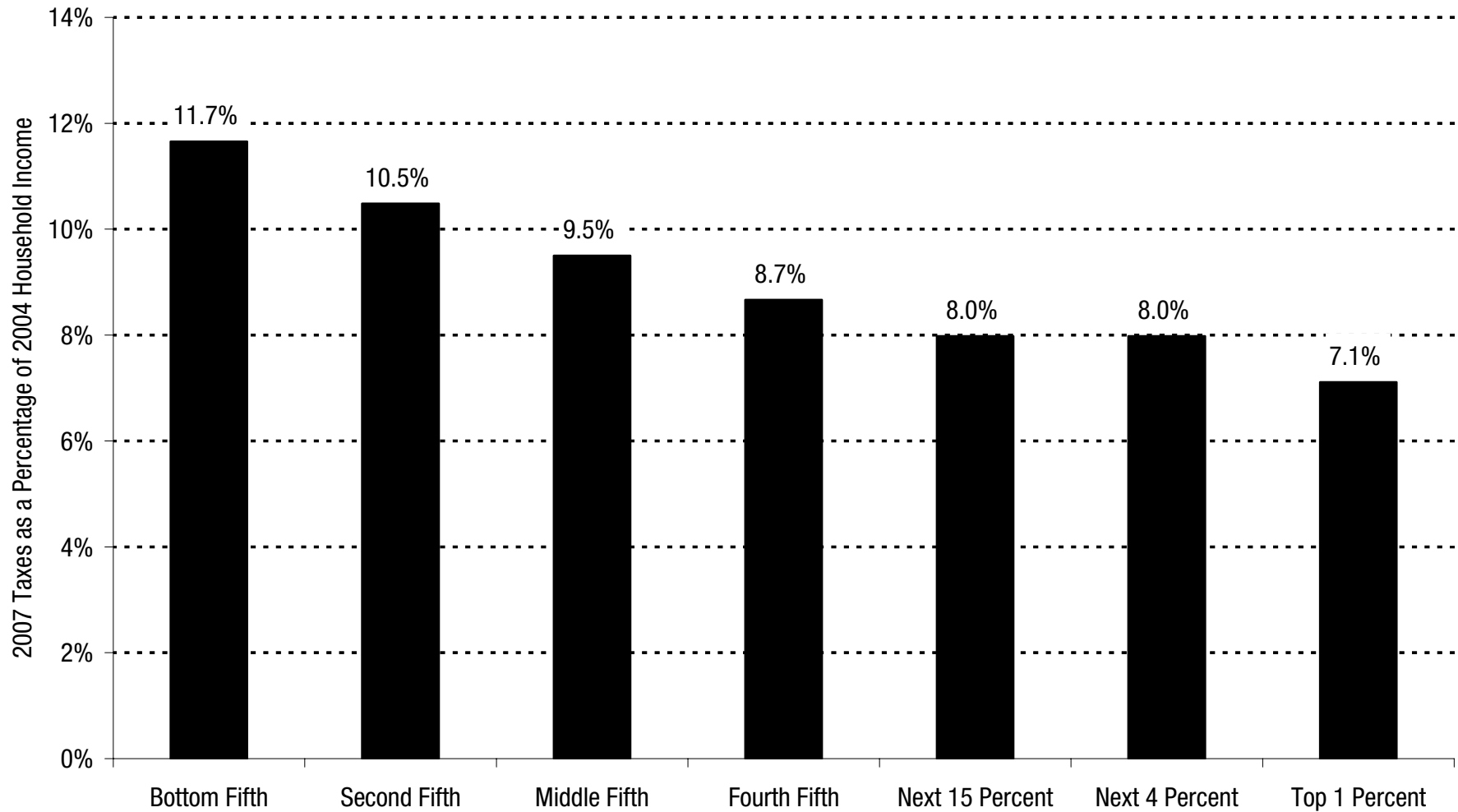
- California's budget problems are not due to a lack of growth in personal income tax revenues. In fact, the personal income tax posts the strongest growth of any of the state's major taxes.
- Low-income households pay the largest share of their income in state and local taxes. Low-income households pay a larger share of their income on sales and excise taxes, while high-income households benefit from the deductibility of state income taxes for federal tax purposes.
- California is a moderate tax state, when all state and local taxes and fees are taken into account.
- Spending has increased because California is growing, aging, and becoming more diverse, all of which have significant implications for the budget.

Personal Income Tax Posts the Highest Average Annual Growth Rate Over Time



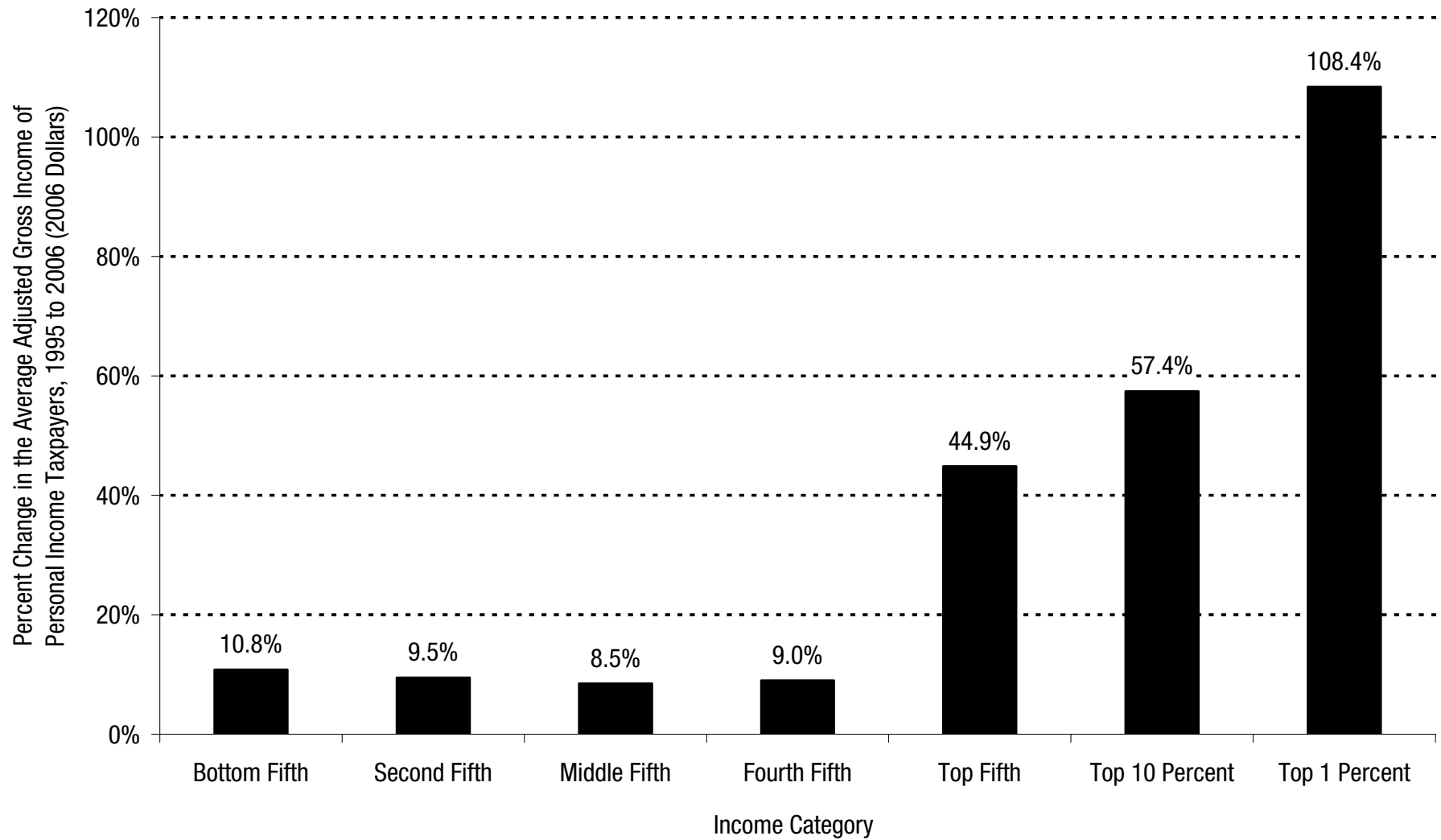
Note: 2008-09 revenues estimated.
Source: CBP analysis of Legislative Analyst's Office data

Lowest-Income Households Pay the Largest Share of Their Income in State and Local Taxes



Note: Includes offset for federal deductibility of state taxes.
Source: Institute on Taxation and Economic Policy

The Gains of High-Income Taxpayers Far Outpaced Those of Other Taxpayers, 1995 to 2006



How Does California Compare?

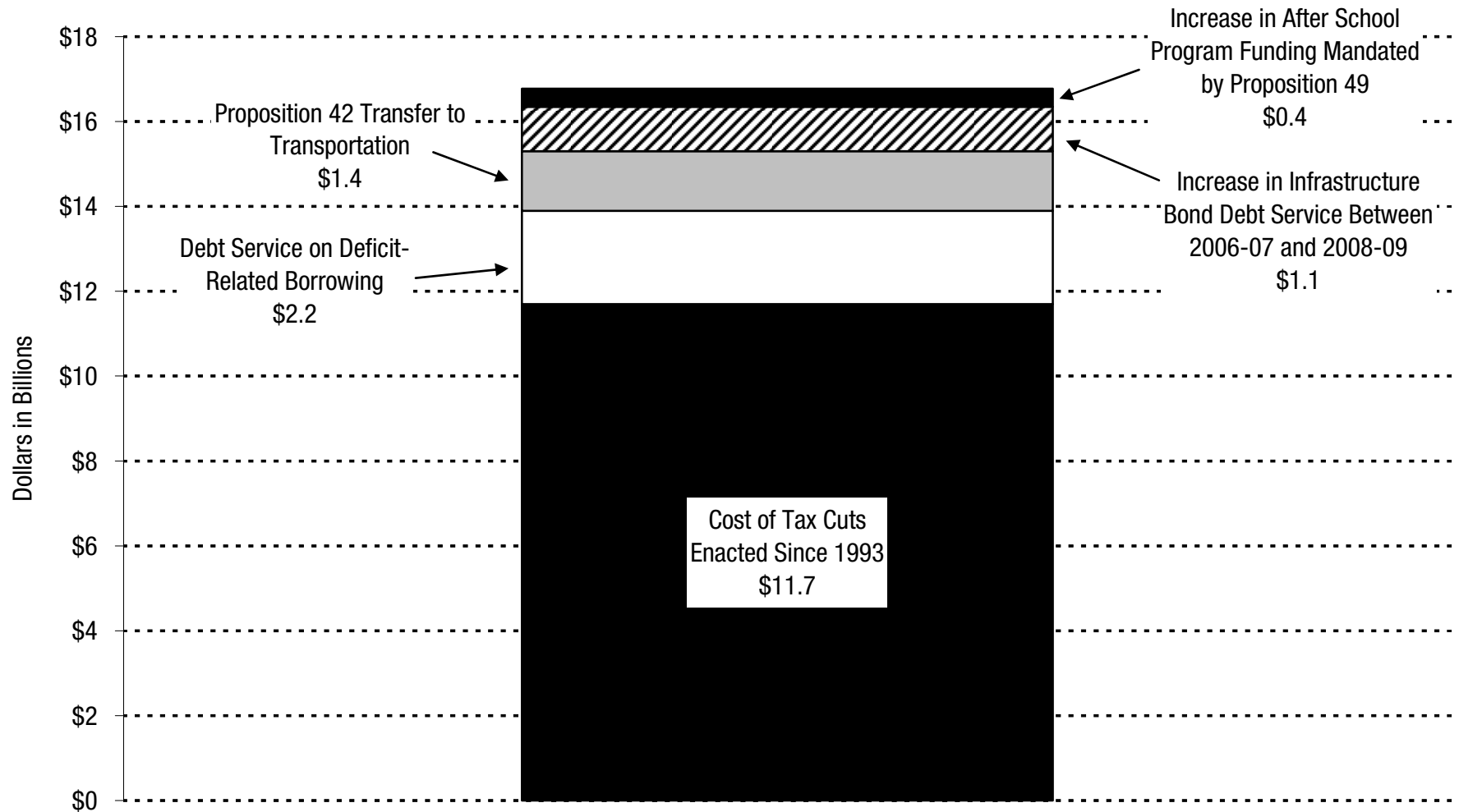
Revenues as a Percentage of Personal Income

| | California Rank | California | US |
|--|-----------------|------------|--------|
| Total State and Local Own Source (2005-06) | 17 | 16.96% | 16.29% |
| Total State and Local Taxes (2005-06) | 13 | 11.73% | 11.23% |
| State Taxes (2006-07) | 14 | 7.76% | 6.65% |
| Local Taxes (2005-06) | 32 | 3.76% | 4.52% |
| State and Local General Sales Taxes (2005-06) | 16 | 2.89% | 2.65% |
| State and Local Property Tax (2005-06) | 36 | 2.67% | 3.37% |
| State General Sales Tax (2006-07) | 23 | 2.21% | 2.10% |
| State Motor Fuels Taxes (2006-07) | 45 | 0.23% | 0.32% |
| State Tobacco Tax (2006-07) | 44 | 0.07% | 0.14% |
| State Alcoholic Beverage Sales Taxes (2006-07) | 39 | 0.02% | 0.05% |
| State Individual Income Tax (2006-07) | 4 | 3.61% | 2.36% |
| State Corporate Income Tax (2006-07) | 6 | 0.75% | 0.47% |

Source: US Bureau of Economic Analysis and US Census Bureau

An Alternative Way of Looking at the Deficit

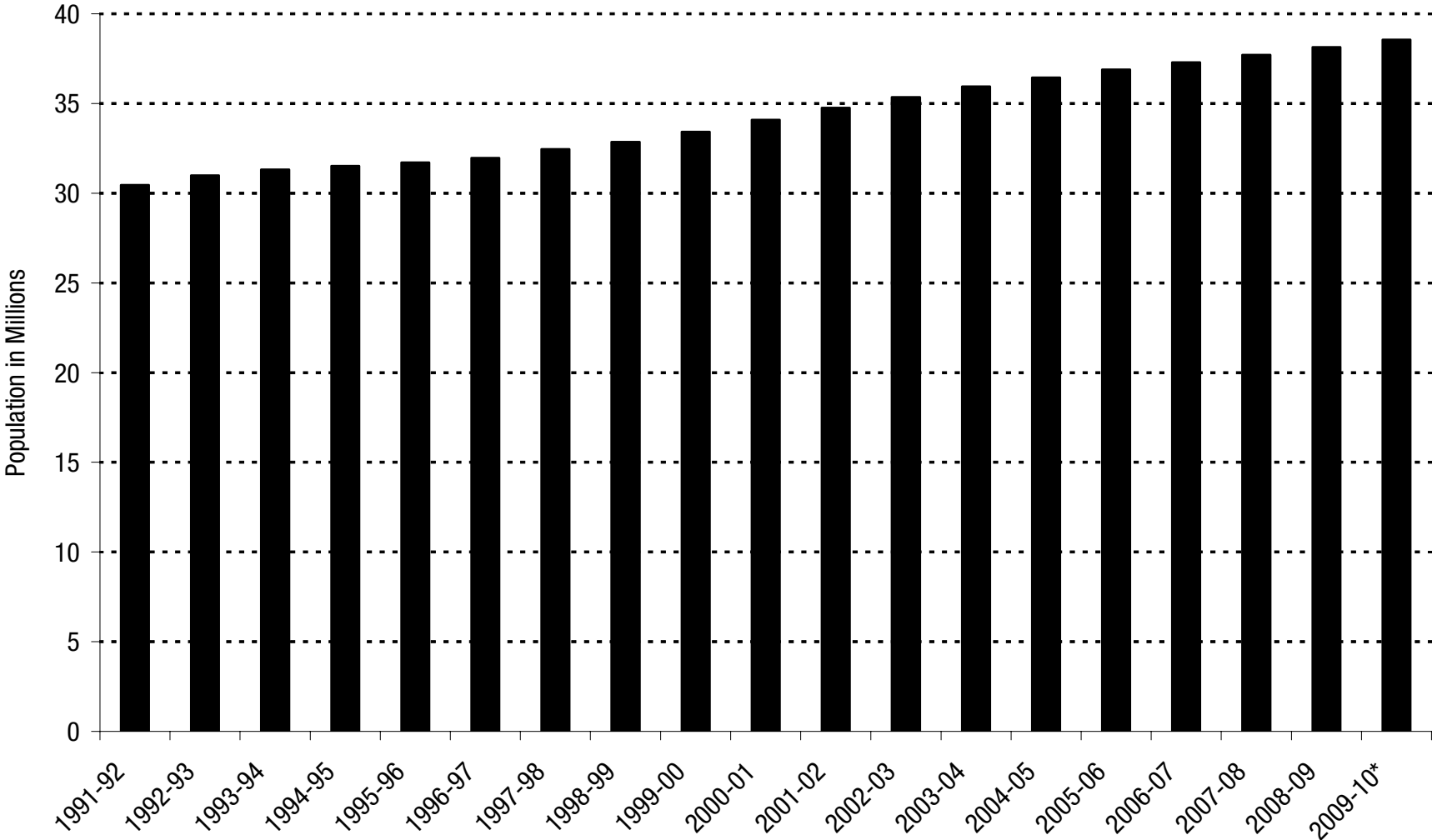
2008-09 Projected Deficit = \$14.8 Billion



Increased Spending Largely Reflects Demographic and Economic Trends

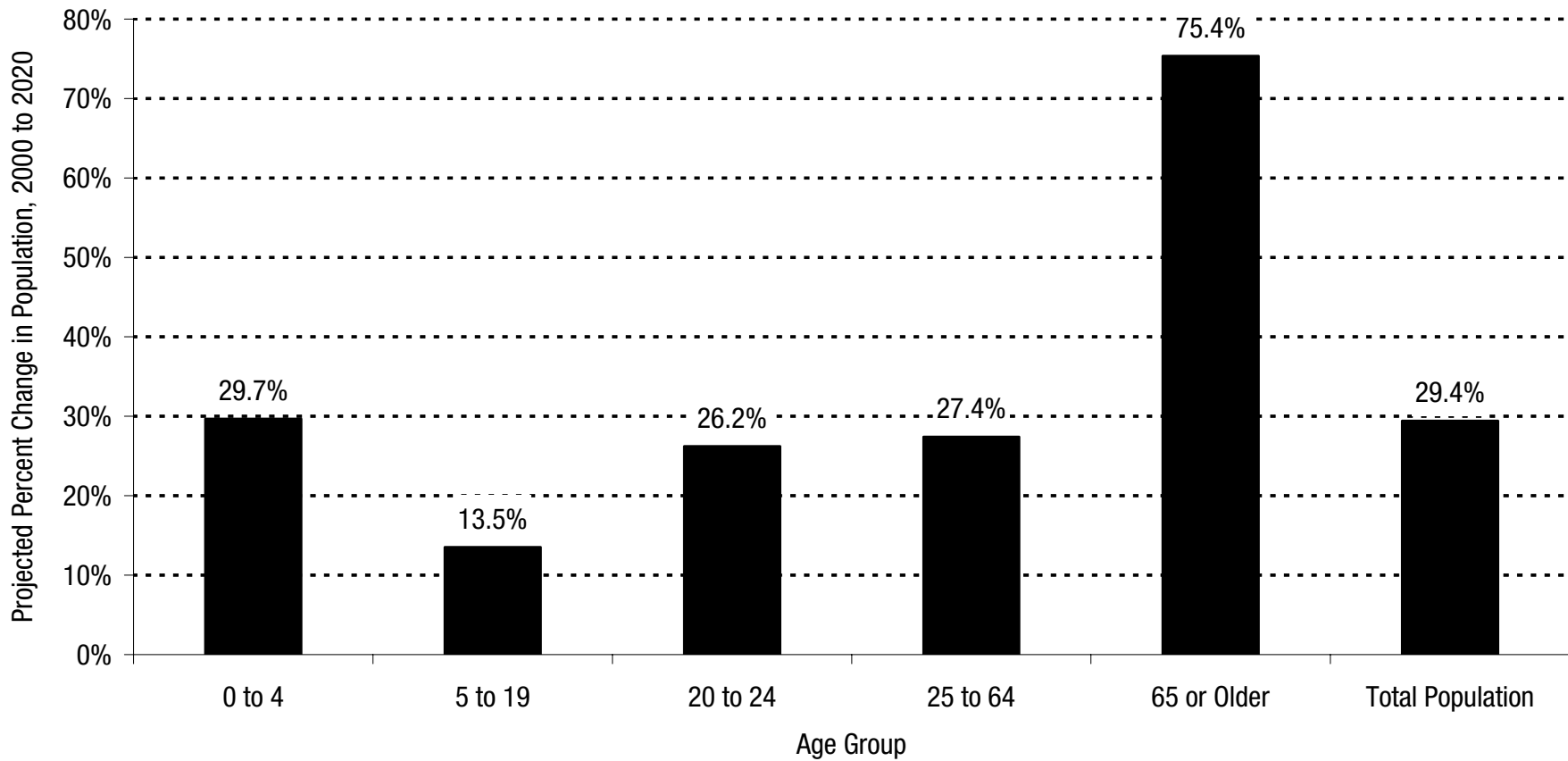
- Population growth and inflation push the cost of basic services higher:
 - California’s population grew by 435,905 between July 2007 and July 2008. Since 2000, the state’s population has increased by 4.1 million, an increase of 11.9 percent.
 - Seniors are the fastest-growing segment of the population, increasing demands on health- and age-dependent programs.
 - Inflation pushes the cost of goods and services purchased by the state higher. The Consumer Price Index – the most common measure of inflation – rose by 25.0 percent between 2000 and 2008.

California's Population Continues to Rise



*2009-10 projected.
Source: Department of Finance

Californians Age 65 or Older Are Projected To Be the Fastest Growing Age Group Between 2000 and 2020



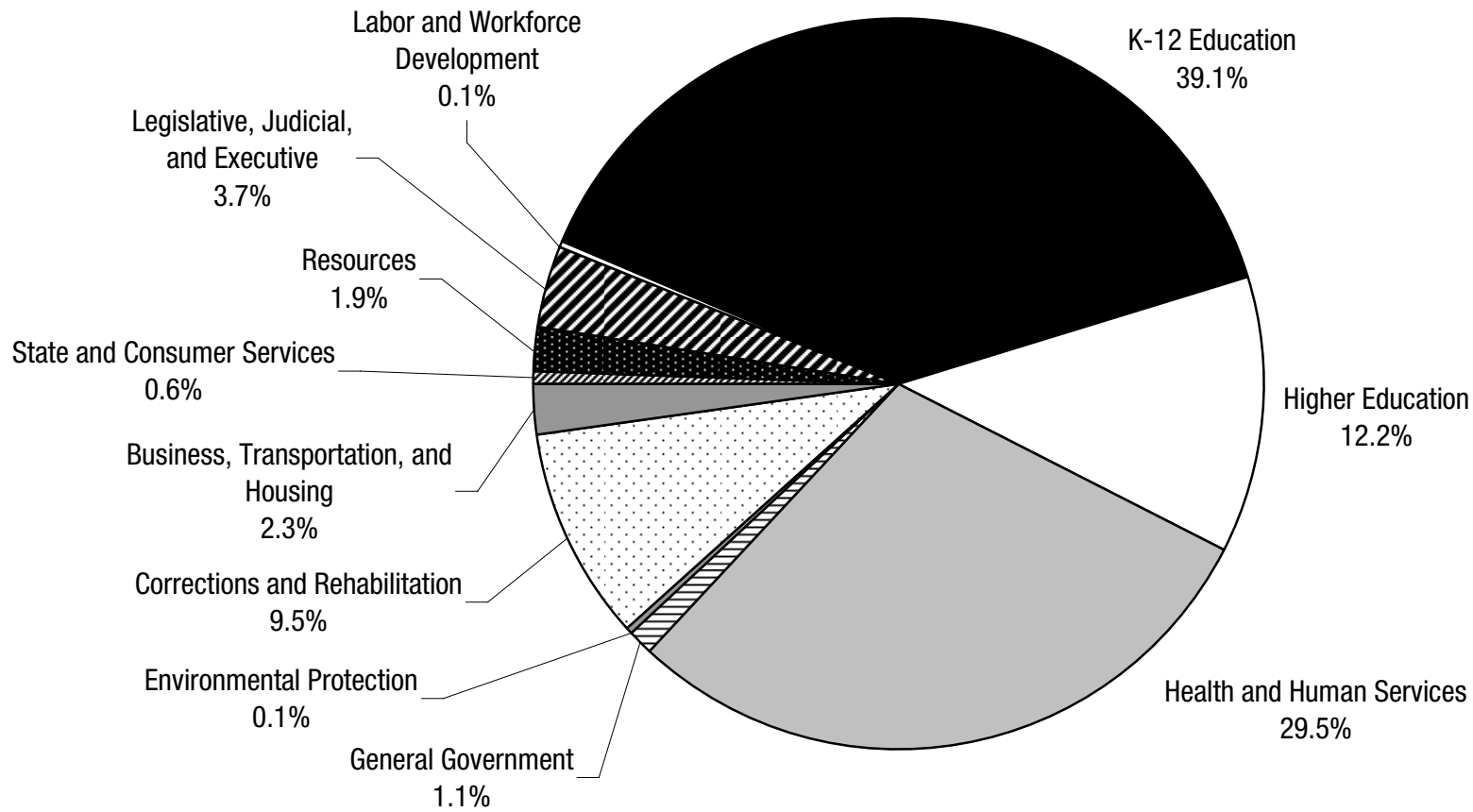
Source: Department of Finance

What Does the Increased Spending Pay For?

- Education for 323,857 students – the increase in K-12 enrollment between 2000 and 2008.
- Affordable health coverage for 542,813 children – the growth in Healthy Families enrollment between November 2000 and November 2008.
- Higher education for 36,679 students at the University of California, 65,654 students in the California State University system, and 43,142 community college students – the enrollment increase between 2000 and 2007.
- In-home care for 179,413 low-income seniors and people with disabilities – the increase in the In-Home Supportive Services Program caseload between 2000-01 and 2008-09.
- Adoptions of 39,119 children with special needs – the increase in the Adoption Assistance Program caseload between 2000-01 and 2008-09.

Education Accounts for the Largest Share of 2009-10 Spending

General Fund Spending by Agency



2009-10 Proposed General Fund Expenditures = \$101.7 Billion

Note: General Government expenditures do not include offset for proposed lottery bond proceeds.
Source: Department of Finance

How Does California's Spending Compare?

Spending as a Percentage of State Personal Income, 2007-08

| | California Rank | California | US |
|----------------------|-----------------|------------|--------|
| Total Expenditures | 22 | 15.06% | 13.78% |
| General Expenditures | 25 | 12.81% | 12.00% |
| Corrections | 4 | 0.52% | 0.39% |
| Education | 29 | 4.70% | 4.34% |
| Health | 8 | 0.74% | 0.49% |
| Highways | 46 | 0.59% | 0.87% |
| Hospitals | 23 | 0.40% | 0.41% |
| Natural Resources | 12 | 0.31% | 0.19% |
| Parks and Recreation | 37 | 0.03% | 0.05% |
| Police Protection | 36 | 0.09% | 0.11% |

Source: US Bureau of Economic Analysis and US Census Bureau

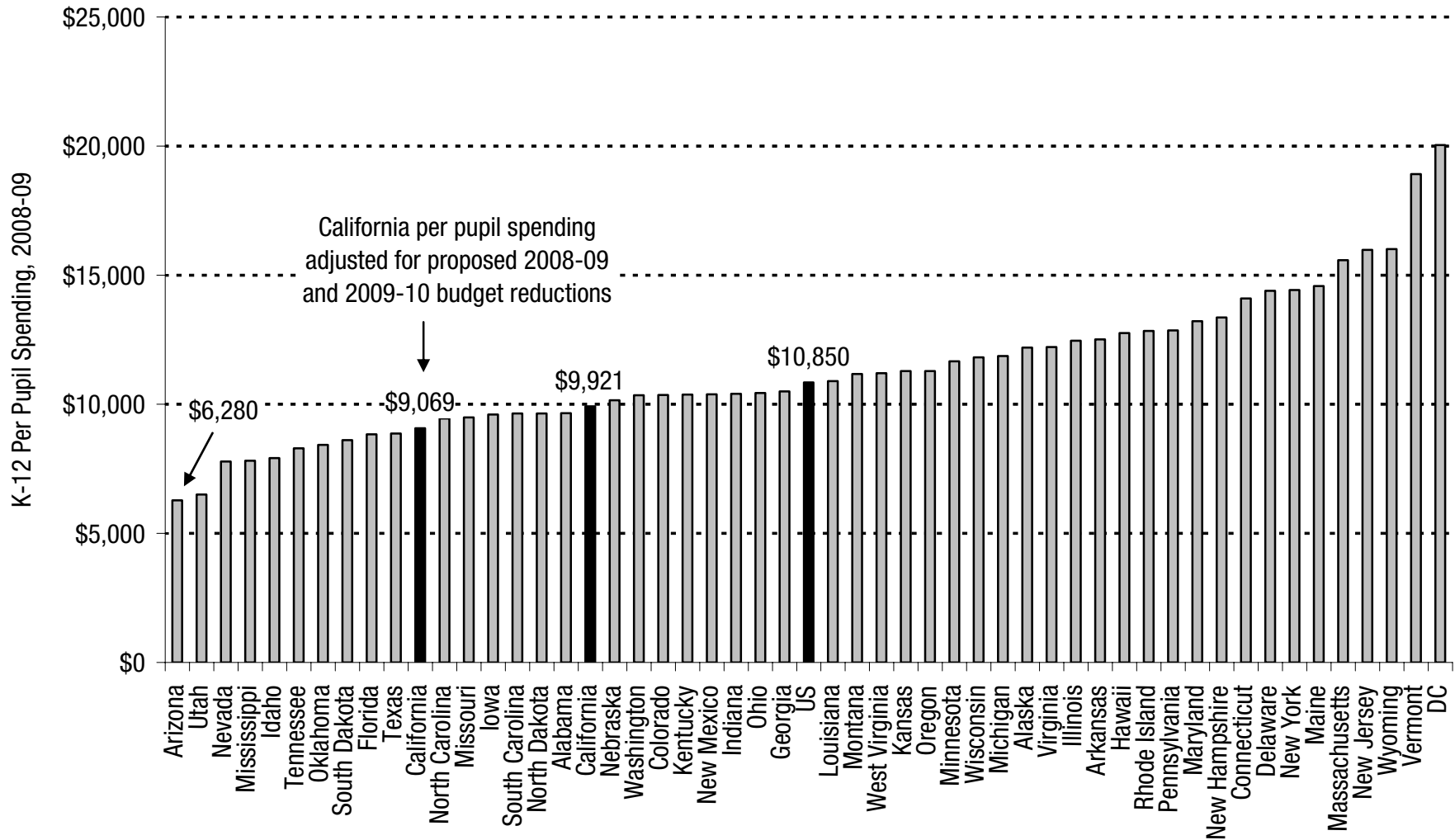
The Governor Proposes Deep Cuts To Public Education

- The Governor proposes to:
 - Reduce 2008-09 spending on K-14 education to the minimum level required, reflecting the Governor’s estimate that the 2008-09 Proposition 98 guarantee has fallen 11.4 percent (\$6.6 billion) below the level assumed in the 2008-09 Budget Act. Moreover, the Governor’s proposal reflects a 2009-10 Proposition 98 minimum guarantee that is 5.3 percent (\$3.1 billion) lower than that which would exist without reductions to 2008-09 Proposition 98 spending.
 - Eliminate COLAs for K-12 education programs, a cut of \$2.5 billion; reduce revenue limit funding by \$1.5 billion; and allow school districts to shorten the school year by five days, a cut of \$1.1 billion.
 - Replace \$891.6 million in state lottery funding with General Fund dollars that would be counted toward the Proposition 98 funding guarantee.
 - Provide schools districts with “complete and permanent flexibility with respect to the use of categorical funding.” The Governor’s proposal would allow schools to shift earmarked funds, such those for class size reduction and instructional materials, to a district’s General Fund.

The Governor Proposes Deep Cuts to Higher Education

- The Governor proposes to:
 - Cut funding below the levels specified by the Higher Education Compact, a \$209.9 million reduction for the University of California (UC), \$217.3 million reduction for California State University (CSU), and \$0.5 million reduction for the Hastings College of Law (HCL).
 - Make additional unallocated funding cuts to the UC (\$65.5 million), the CSU (\$66.3 million), and the HCL (\$0.4 million).
 - Eliminate the statutory COLA for California Community College programs, a reduction of \$332.9 million.
- The Governor assumes a 9.3 percent fee increase at UC, 10 percent at CSU, and 13 percent at HCL, which would generate a total of \$300.7 million. Unlike in past years when fees have increased, the Governor would not fully fund the CalGrant program to cover the cost of higher fees.

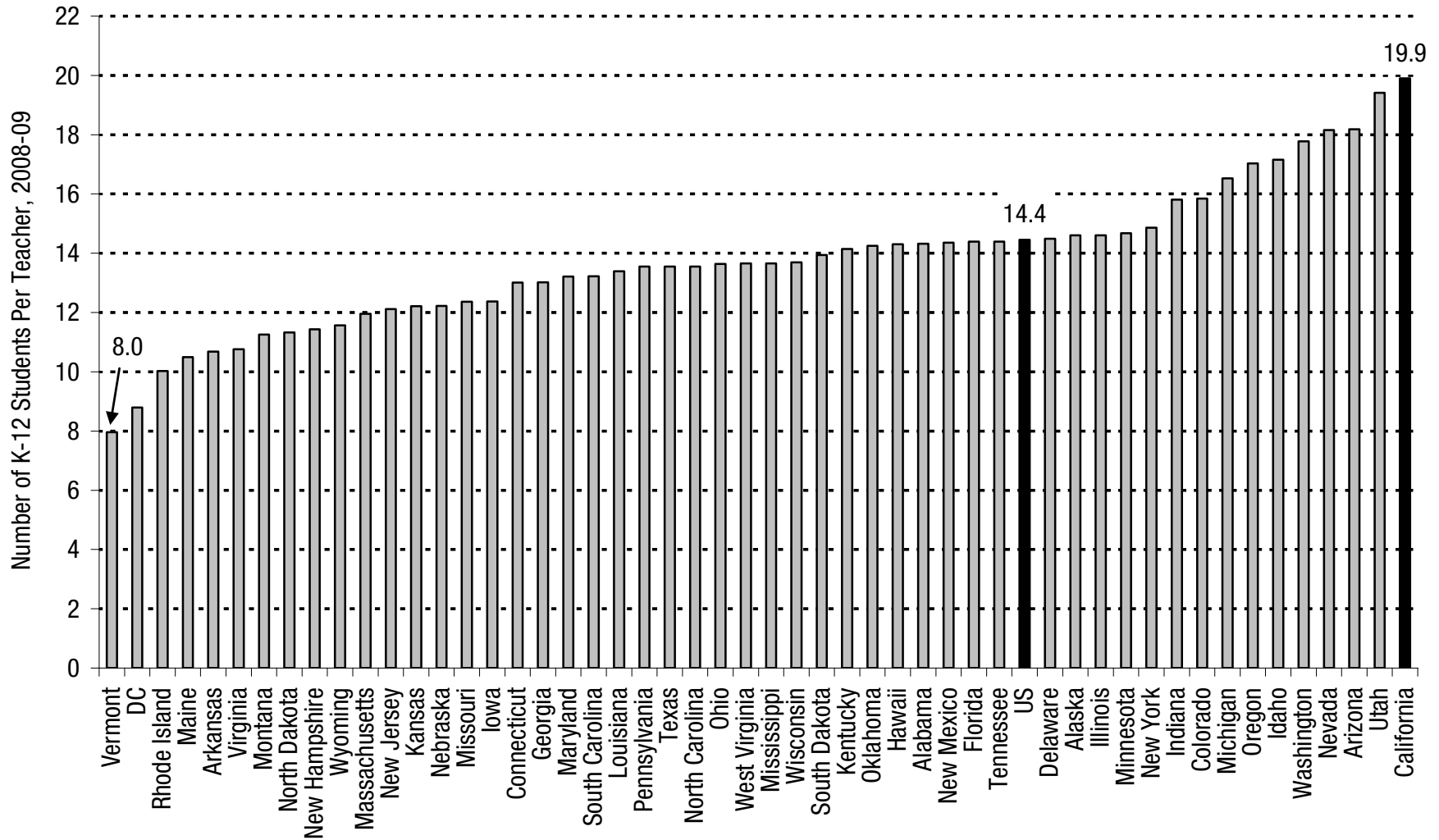
California Would Fall Further Behind Under Proposed Budget Reductions



Note: Data reflect estimates developed by state departments of education or the National Education Association.

Source: National Education Association and CBP analysis of Department of Finance data

California Has the Highest Number of K-12 Students Per Teacher



Note: Data reflect estimates developed by state departments of education or the National Education Association.

Source: National Education Association

How Do California's Schools Compare?

| | California Rank | California | US |
|--|-----------------|------------|----------|
| K-12 Per Pupil Spending (2008-09) | 35 | \$9,921 | \$10,850 |
| K-12 Spending as a Percentage of Personal Income (2007-08) | 36 | 3.86% | 4.10% |
| Number of K-12 Pupils Per Teacher (2008-09) | 51 | 19.9 | 14.4 |
| K-12 Per Pupil Spending, Adjusted for Regional Cost Differences (2005-06) | 47 | \$7,571 | \$9,963 |
| Percentage of K-12 Pupils in Districts with Adjusted Per Pupil Spending at or Above the US Average (2005-06) | 23 | 29.2% | 42.6% |
| Percentage of High School Students Who Graduate With a Diploma (2004-05) | 34 | 70.1% | 70.6% |

Source: Education Week, National Education Association, and US Bureau of Economic Analysis

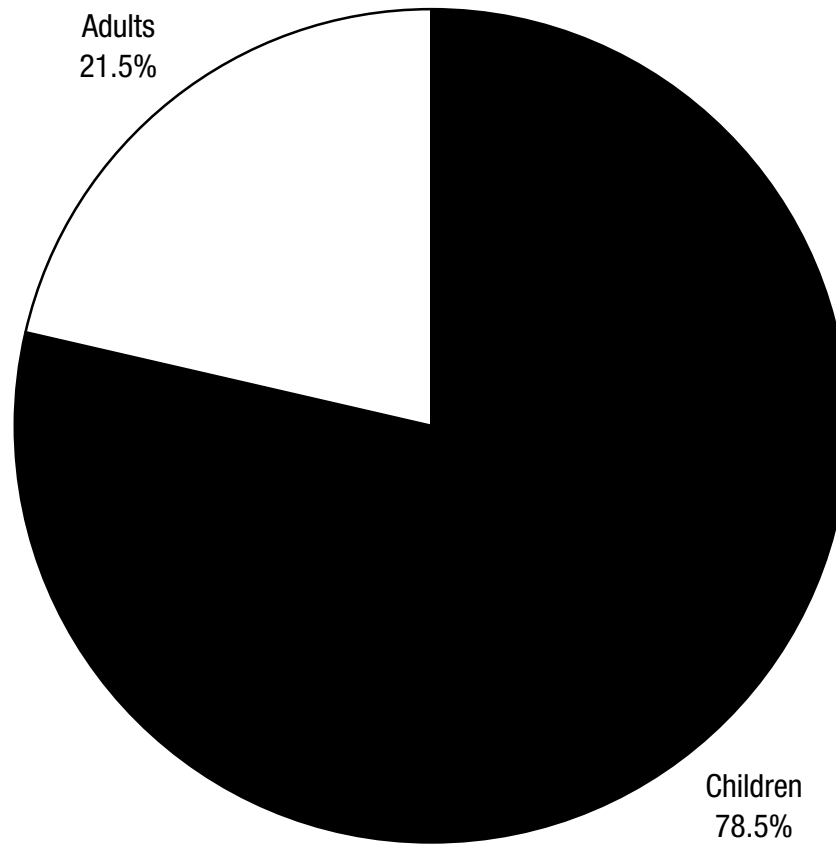
The Governor Proposes Cuts to Child Care Programs

- The Governor proposes to:
 - Increase the fees that families pay for child care assistance, for savings of \$14.4 million in 2009-10.
 - Reduce reimbursement rate limits in voucher-based programs, including the Alternative Payment Program, from the 85th percentile to the 75th percentile – based on the 2007 regional market rate survey – effective July 1, 2009, for savings of \$38.7 million in 2009-10.
 - Suspend the 5.02 percent 2009-10 COLA for child care and preschool programs overseen by the California Department of Education, for savings of \$79.5 million.
 - Permanently reduce annual funding for child care and development programs by \$55 million to reflect recurring unspent funds.

The Governor Proposes To Drop More Than 230,000 Low-Income Children From the CalWORKs Program

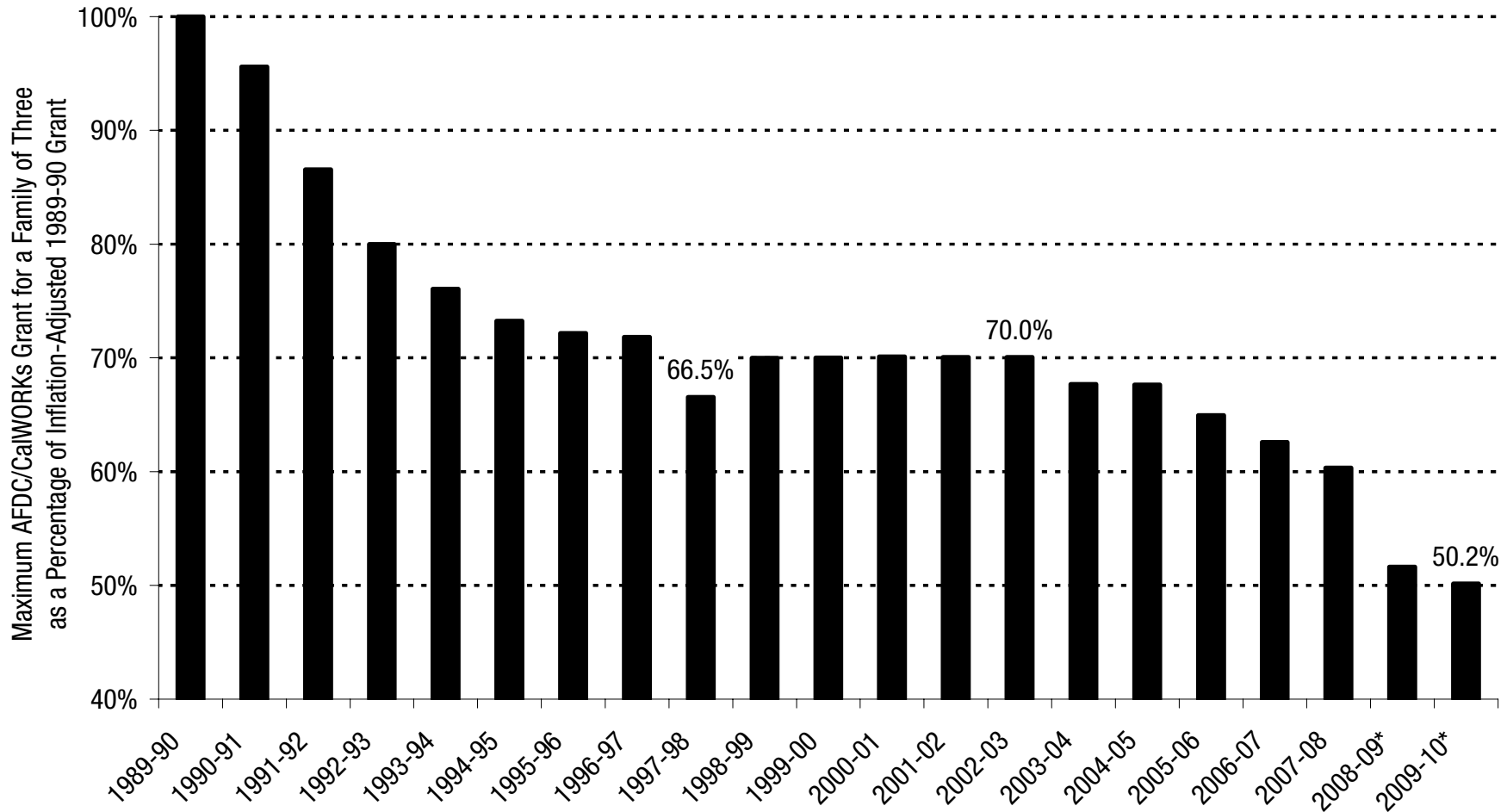
- The Governor proposes CalWORKs changes that would result in total savings of \$123.5 million in 2008-09 and \$776.0 million in 2009-10.
- The Governor's proposals would eliminate:
 - “Safety-net” cash assistance for 90,400 children after their parents have reached the state's 60-month time limit.
 - “Child-only” cash assistance after 60 months for 83,400 children whose parents are ineligible for CalWORKs.
 - Cash assistance for 30,400 children whose parents fail to attend a meeting with a county worker.
- In addition, the Governor proposes to:
 - Reduce the maximum grant by 10 percent – which would cause 30,200 children to lose cash assistance – and to suspend the July 2009 COLA for CalWORKs grants.

Nearly Four Out of Five CalWORKs Recipients Are Children



Number of Individuals Receiving CalWORKs Cash Assistance in October 2008 = 1.2 Million

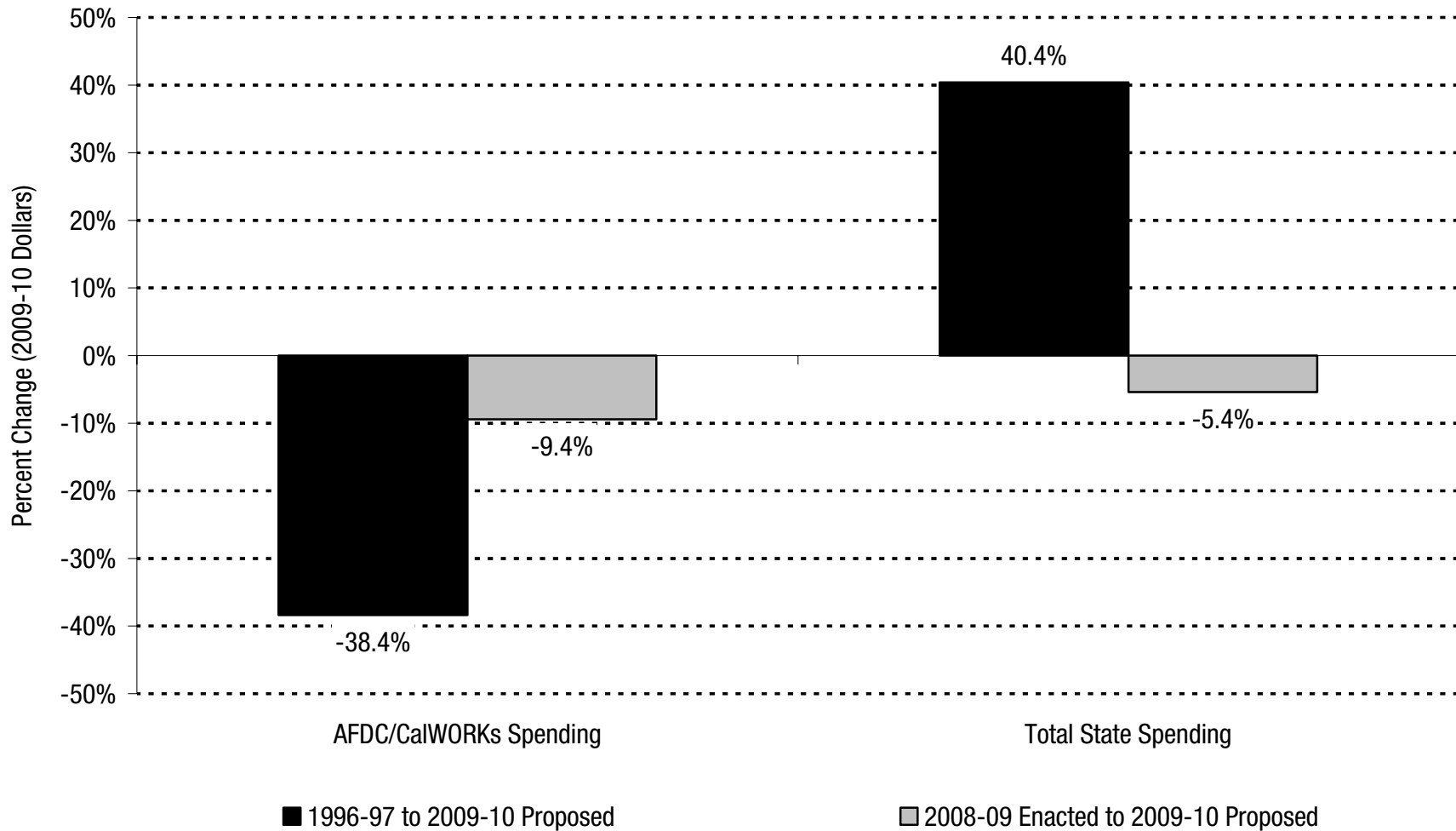
Purchasing Power of CalWORKs Grants Would Drop Further Under the Governor's Proposals



* Reflects the Governor's proposal to cut the maximum CalWORKs grant level by 10 percent beginning on May 1, 2009 and suspend the July 2009 cost-of-living adjustment for CalWORKs grants.

Source: CBP analysis of Department of Finance and Department of Social Services data

Welfare Spending Has Declined by More Than One-Third Since 1996-97

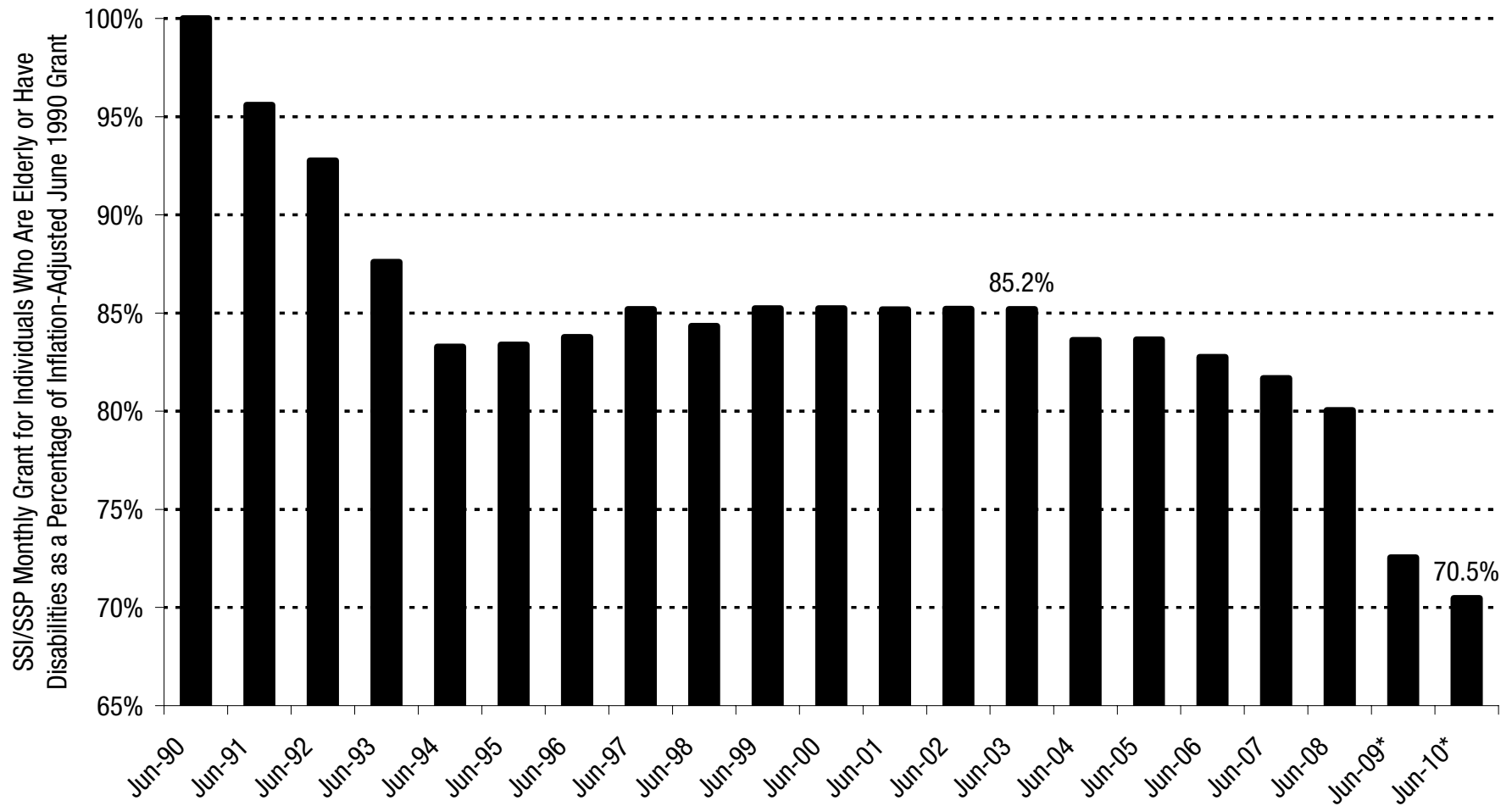


Note: AFDC/CalWORKs spending includes federal, state, and county funds. Total state spending includes federal and state funds.
 Source: Department of Finance and Department of Social Services

The Governor Proposes To Cut Grants for More Than 1 Million Low-Income Seniors and People With Disabilities

- The Governor proposes to:
 - Reduce SSI/SSP grants to the minimum level required by federal law, for savings of \$180.1 million in 2008-09 and \$1.117 billion in 2009-10. The SSI/SSP grant for individuals would drop from \$907 per month to \$830 per month (8.5 percent) effective May 1, 2009.
 - Suspend the June 2010 state COLA for SSI/SSP grants, for savings of \$27 million in 2009-10 and annual savings of \$323.9 million beginning in 2010-11.
 - Eliminate the Cash Assistance Program for Immigrants, which provides state-funded cash grants to legal immigrants who are not eligible for SSI/SSP grants due to their immigration status, for savings of \$20.0 million in 2008-09 and \$129.6 million in 2009-10.

Purchasing Power of SSI/SSP Grants Would Decline Further Under the Governor's Proposals



* Reflects the Governor's proposal to reduce SSI/SSP grants to the federally required minimum beginning on May 1, 2009 and to suspend the June 2010 state cost-of-living adjustment (COLA). Also reflects the Administration's assumption that the federal government will not provide an SSI COLA in January 2010.

Source: CBP analysis of Department of Finance and Department of Social Services data

The Governor Proposes Significant Cuts to the In-Home Supportive Services (IHSS) Program

- The Governor proposes three major changes to the IHSS Program that would result in total state savings of \$62.7 million in 2008-09 and \$384.2 million in 2009-10. The Governor proposes to:
 - Cap the state’s contribution toward the wages of IHSS workers at the minimum wage.
 - Eliminate a state subsidy for less-impaired IHSS recipients who must pay a share of the cost of the services they receive.
 - Eliminate domestic and related services – such as shopping for food, meal preparation, and housekeeping – for less-impaired IHSS recipients.

The Governor's Budget Proposals Would Cut Funding for Additional Health and Human Services Programs

- The Governor proposes to:
 - Eliminate the California Food Assistance Program (CFAP) effective July 1, 2009, for savings of \$37.8 million in 2009-10. CFAP provides state-funded food assistance to certain legal noncitizen adults who are ineligible for federal food stamp benefits solely due to their immigration status.
 - Cut funding for Regional Centers, which coordinate services for people with developmental disabilities, by \$334 million in 2009-10. This cut would be in addition to the Governor's proposal to reduce funding for Regional Center operations and services by 3 percent, for savings of \$24.6 million in 2008-09 and \$60.2 million in 2009-10.

Still Stretched Thin: Counties Failed To Receive Nearly \$1 Billion in 2008-09
 To Cover the Rising Cost of Operating Health and Human Services Programs
 Dollars in Millions

| | State Funds | Total State and Federal Funds |
|-------------------------------------|----------------|-------------------------------|
| Adoptions Program | \$16.8 | \$22.1 |
| Adult Protective Services Program | \$16.5 | \$20.9 |
| CalWORKs Program* | \$250.6 | \$250.6 |
| Child Welfare Services Program | \$206.9 | \$486.4 |
| Food Stamp Program | \$19.5 | \$49.0 |
| Foster Care Program | \$8.2 | \$12.5 |
| In-Home Supportive Services Program | \$24.8 | \$59.6 |
| Medi-Cal Program** | \$32.3 | \$64.6 |
| TOTAL | \$575.6 | \$965.7 |

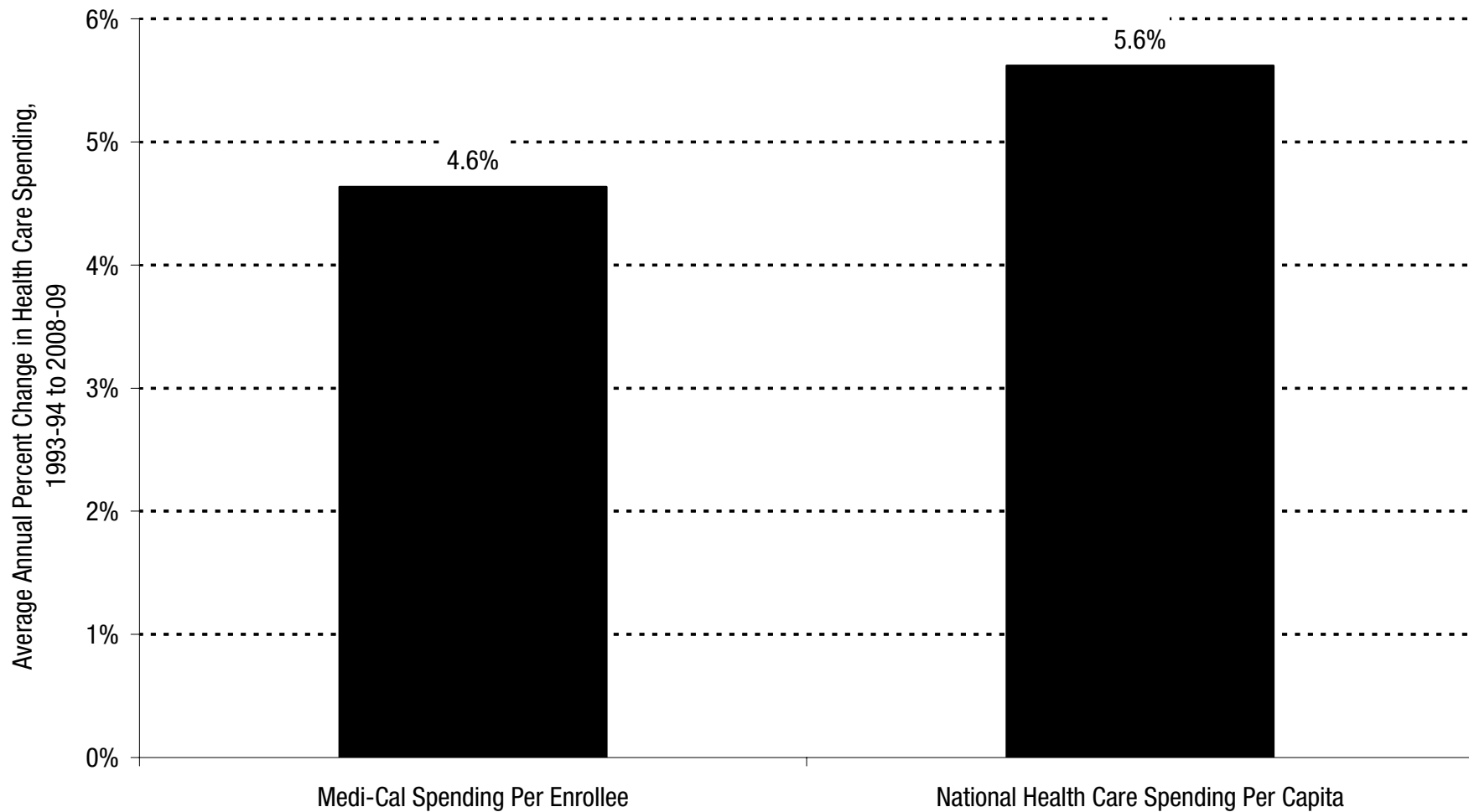
* State and federal funds are used interchangeably in the CalWORKs Program.

** Prior to 2008-09, the state had provided funding for counties' Medi-Cal operating-cost increases every year since 2003-04.
 Note: Except for the Medi-Cal Program, figures reflect amounts that counties would have received in 2008-09 if the state had consistently provided funding for counties' operating-cost increases every year since 2000-01.
 Source: County Welfare Directors Association of California and Department of Health Care Services

The Governor Proposes Significant Cuts to Medi-Cal

- The Governor proposes benefit and eligibility changes to the Medi-Cal Program that would result in total state savings of \$58.6 million in 2008-09 and \$618.9 million in 2009-10, along with a loss of federal Medicaid funds of a similar magnitude. The Governor proposes to:
 - Eliminate dental and other services for Medi-Cal recipients age 21 and older, except for pregnant women and nursing home residents.
 - Restrict Medi-Cal eligibility for low-income parents. This change would annually prevent 429,000 parents with incomes somewhat below the federal poverty line from qualifying for Medi-Cal starting in 2011-12.
 - Reduce the number of seniors and people with disabilities who qualify for Medi-Cal without a share of cost. This change would affect more than 73,000 low-income individuals.
 - Reduce Medi-Cal services provided to certain legal immigrants, and restrict access to Medi-Cal for unauthorized immigrants.

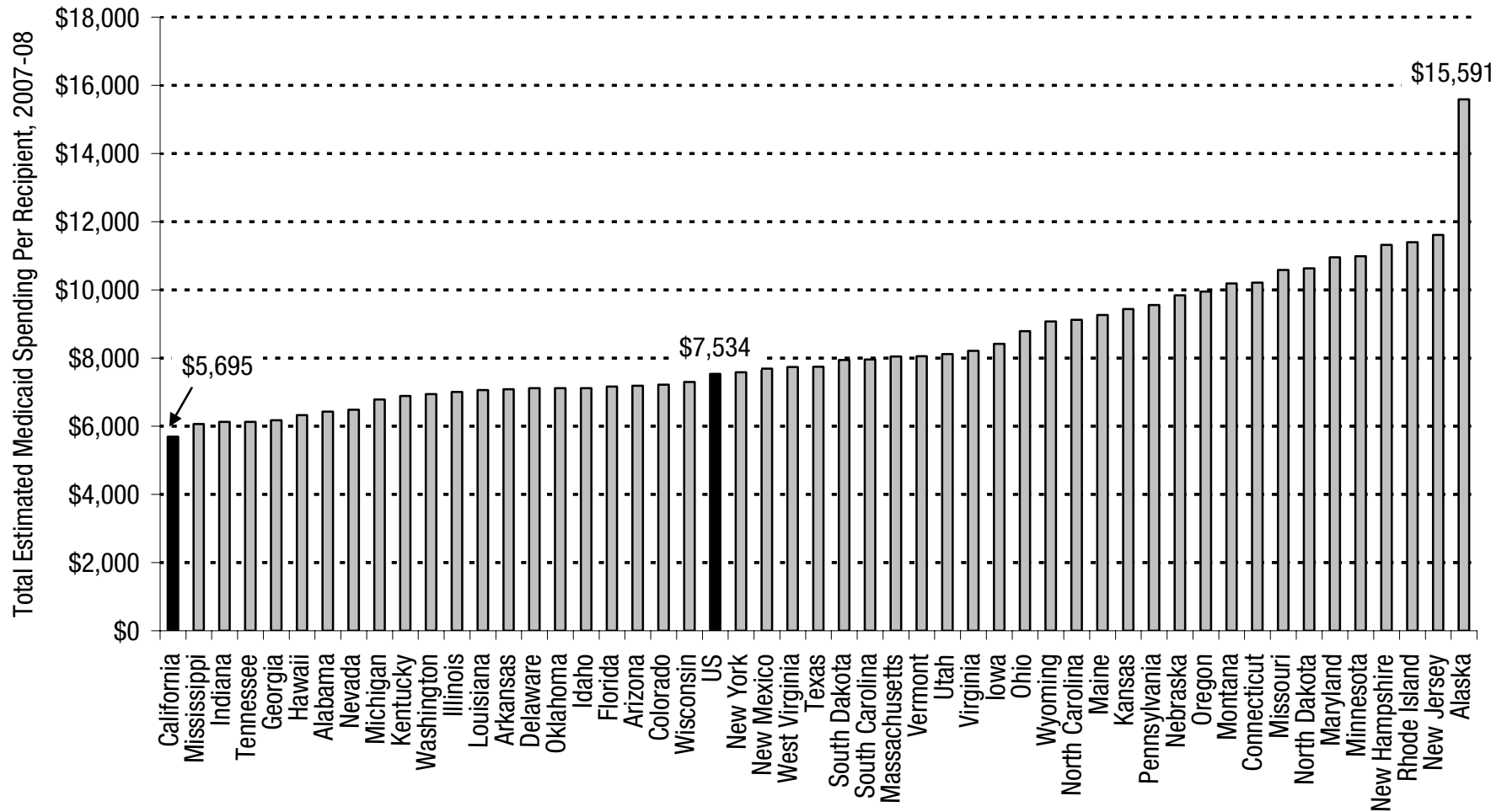
National Health Care Spending Has Increased More Rapidly Than Medi-Cal Spending Since the Mid-1990s



Note: 2008-09 spending is projected.

Source: Department of Health Care Services and US Centers for Medicare & Medicaid Services

California Spends Less Than Any Other State Per Medi-Cal Enrollee



Note: Number of recipients is for December 2007.

Source: Kaiser Family Foundation unpublished data and National Association of State Budget Officers

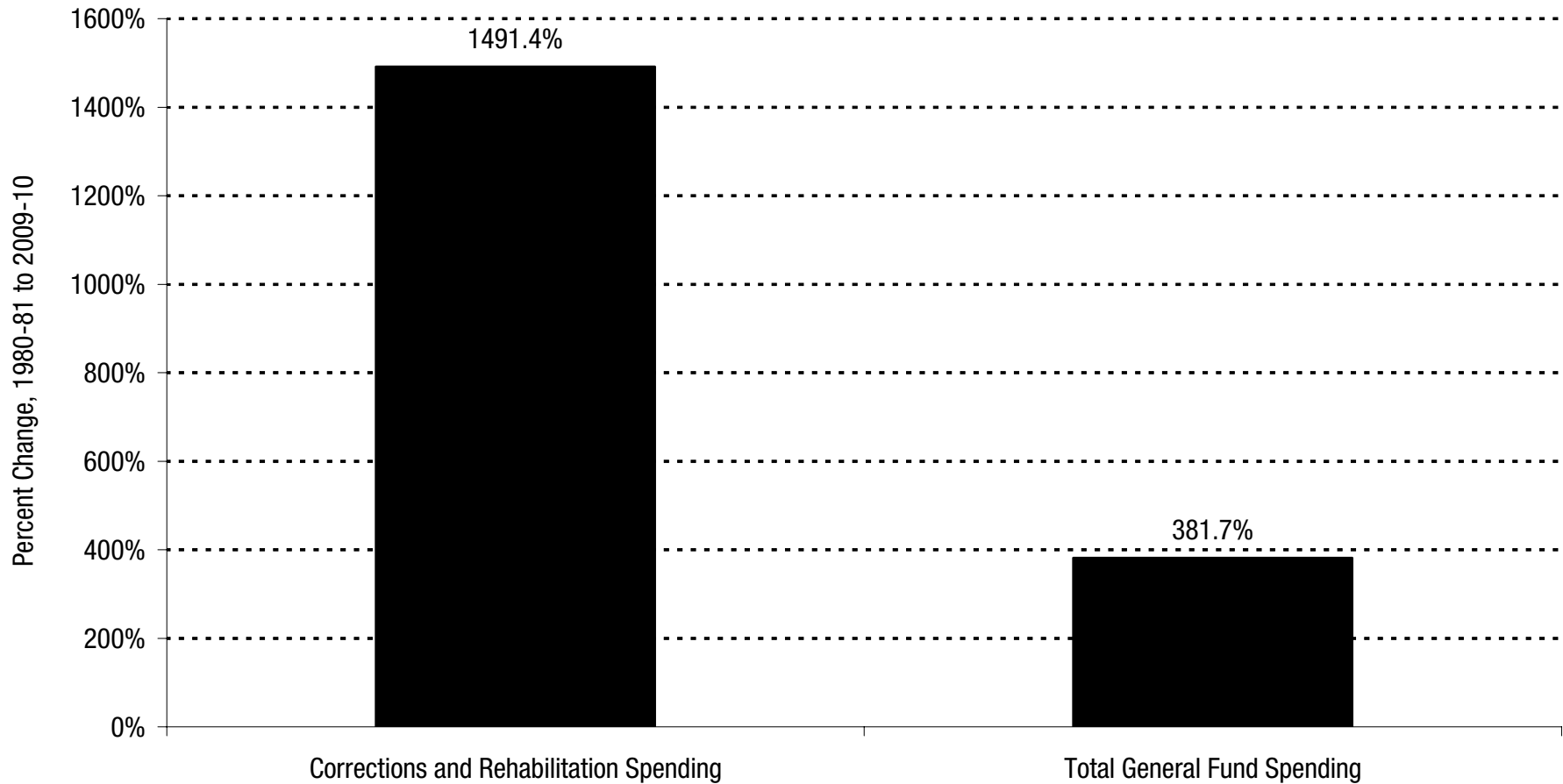
The Governor Proposes To Shift Funding From Programs Funded by Propositions 10 and 63

- The Governor proposes to:
 - Eliminate the First 5 California Commission and redirect all state funds and 50 percent of county First 5 funds to support children’s programs overseen by the Department of Social Services, for state General Fund savings of \$275 million in 2009-10. First 5 supports programs for young children using funds provided by a 50-cent-per-pack tax on cigarettes imposed by Proposition 10 of 1998.
 - Divert funds raised by Proposition 63 of 2004 – which was intended to provide additional funds to expand mental health services – to reduce the state’s costs for Mental Health Managed Care, for General Fund savings of \$226.7 million in 2009-10.
- Both of these proposals would require voter approval.

The Governor Proposes to Significantly Reduce Corrections Spending

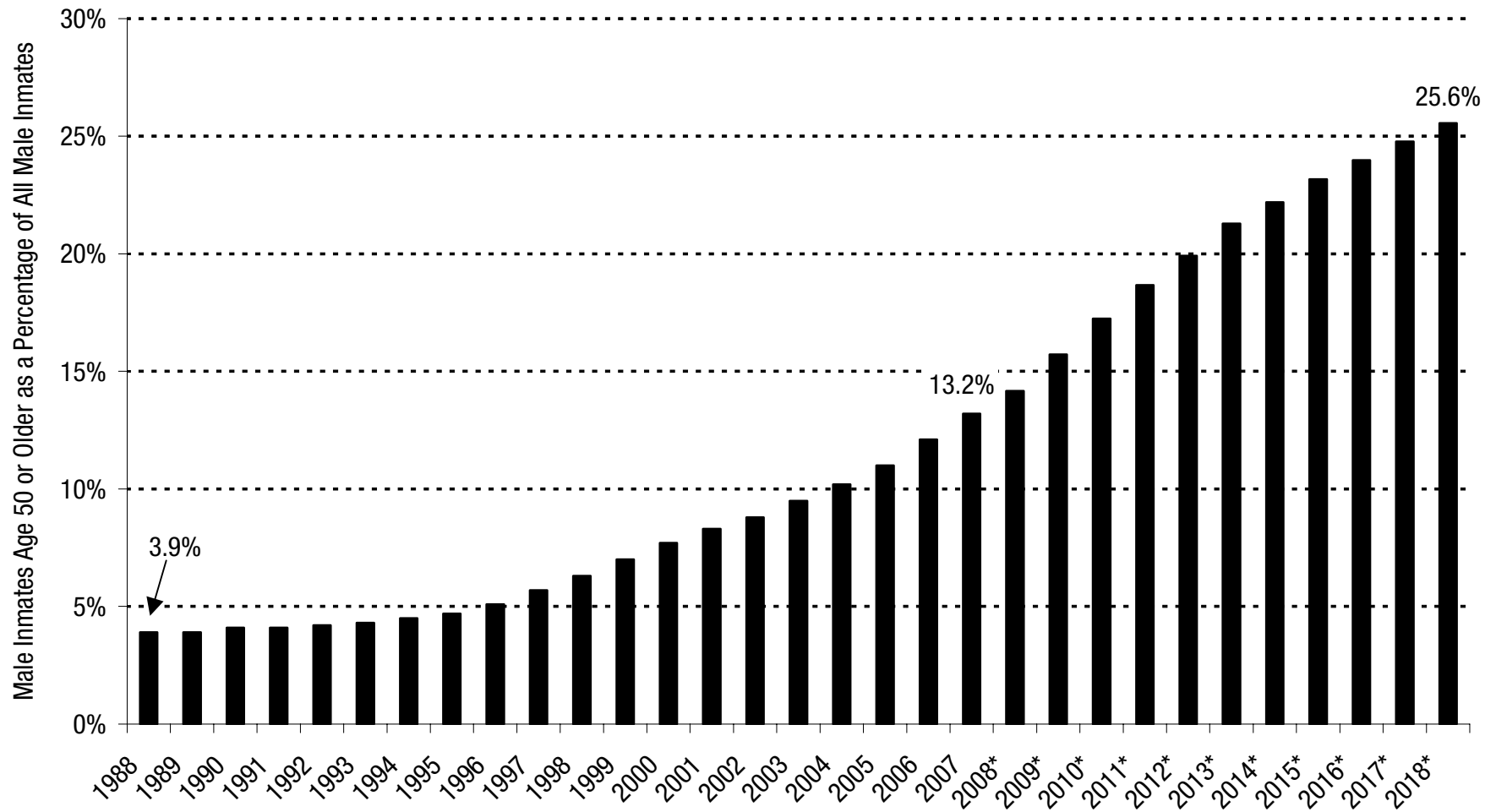
- The Governor's proposals would reduce corrections spending by \$841.9 million through a combination of policy changes and fund shifts, including:
 - Various parole and prison reforms, including eliminating parole for non-violent, non-serious offenders.
 - Cutting funding for the receiver overseeing medical services by 10 percent.
 - Shifting support for local juvenile probation and camps from the General Fund to Vehicle License Fee (VLF) revenues that currently support the Department of Motor Vehicles (DMV). The Governor would, in turn, increase vehicle registration fees by \$12 to replace VLF funds shifted from the DMV.
 - Shifting substance abuse treatment costs to a special fund supported by a proposed increase in alcoholic beverage taxes.

Corrections Spending Has Grown at Nearly Four Times the Rate of General Fund Spending as a Whole Since 1980-81



Note: 2009-10 spending proposed.
Source: Department of Finance

The Share of Male Inmates Age 50 or Older Is Projected To Continue Rising Sharply



* Projected.

Note: Data reflect only felons.

Source: Department of Corrections and Rehabilitation

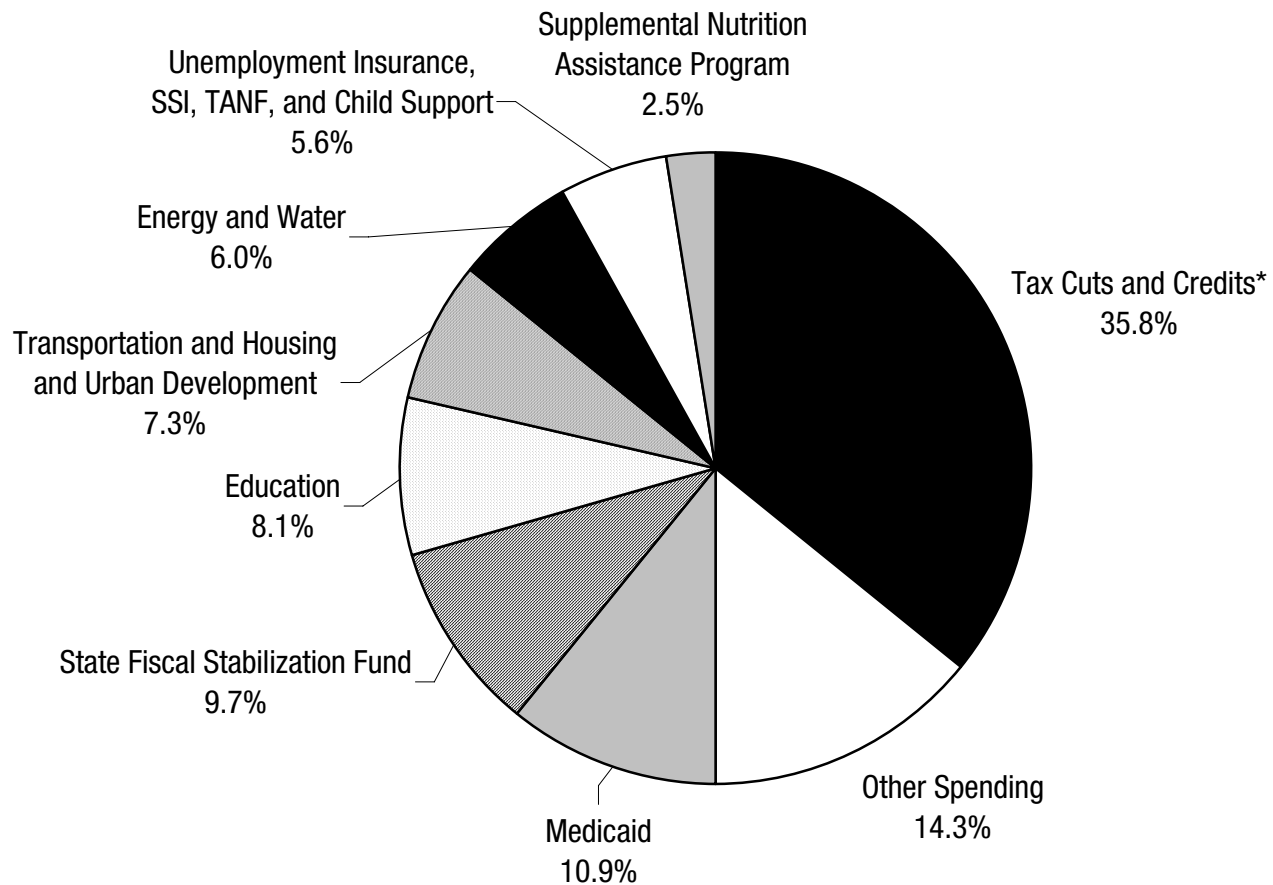
The Governor Would Reduce State Employees' Compensation and Benefits

- The Governor proposes to lay off an unspecified number of state employees, as well as reduce compensation costs by:
 - Requiring state employees to take two furlough days each month;
 - Eliminating two state holidays and “premium pay” for hours worked on the remaining state holidays; and
 - Changing the method for calculating overtime pay.
- The Governor has also proposed contracting directly with private insurance companies for state employees' health benefits, rather than purchasing through CalPERS.

California Will Receive Billions in New Federal Funding

- The President has proposed and Congress will soon act on a package of spending and tax measures to boost employment and the economy.
- California stands to gain more than \$30 billion under the House proposal, and similar amounts in the Senate package, in additional federal funds for Medi-Cal, education, food stamps, infrastructure, and other programs. California could receive roughly \$8 billion of the new federal dollars for Medi-Cal in 2008-09 and 2009-10. These funds would directly help policymakers address California's \$40 billion budget gap. The remainder would provide additional funds for specific programs, boost benefits to individuals, or support a range of capital investments.
- California could lose its share of new federal funds for Medi-Cal – roughly \$11 billion over three fiscal years – if the state adopts more restrictive Medi-Cal eligibility criteria and renewal procedures than those in place on July 1, 2008, and could lose other federal funds if education funding is cut below specified levels.

Allocation of 10-Year Spending in the Proposed House Economic Recovery Package



Total Expenditures in H.R. 1 as Introduced, 2009 to 2019 = \$815.9 Billion

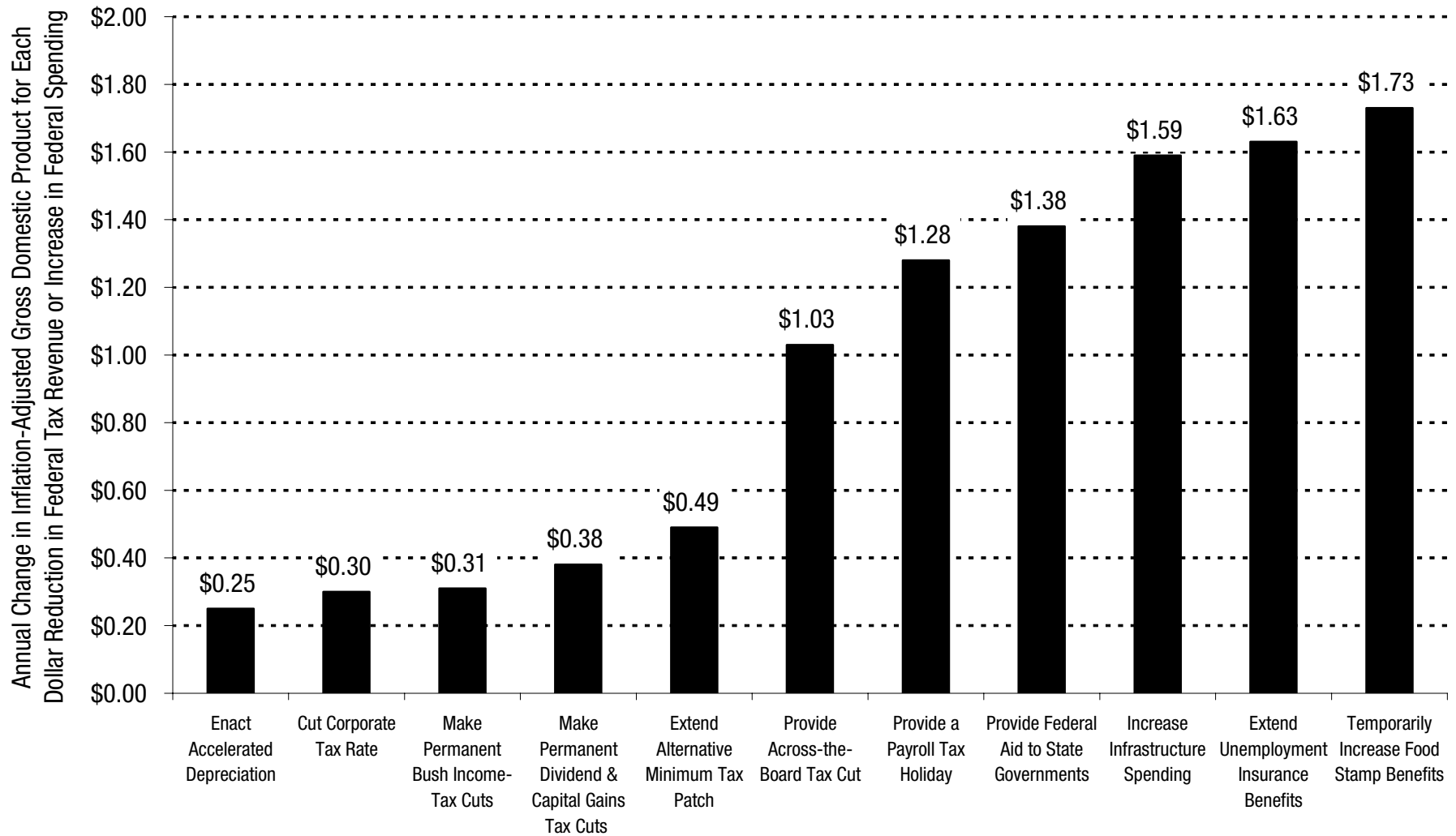
* Includes revenue impact of certain direct spending provisions.

Source: Congressional Budget Office

At the End of the Day

- There is no easy way out of the budget crisis. Bridging the budget gap will require a combination of carefully targeted tax increases and spending reductions.
- Funding from the federal economic recovery package will help bridge the gap, but difficult choices will remain.
- California is the only state in the nation to require more than a majority of its legislature to approve both a budget and any tax increase – a factor that severely affects efforts to reach agreement on a lasting solution to the budget crisis.

Federal Spending on Unemployment Insurance and Food Stamp Benefits Has the Biggest “Bang for the Buck”

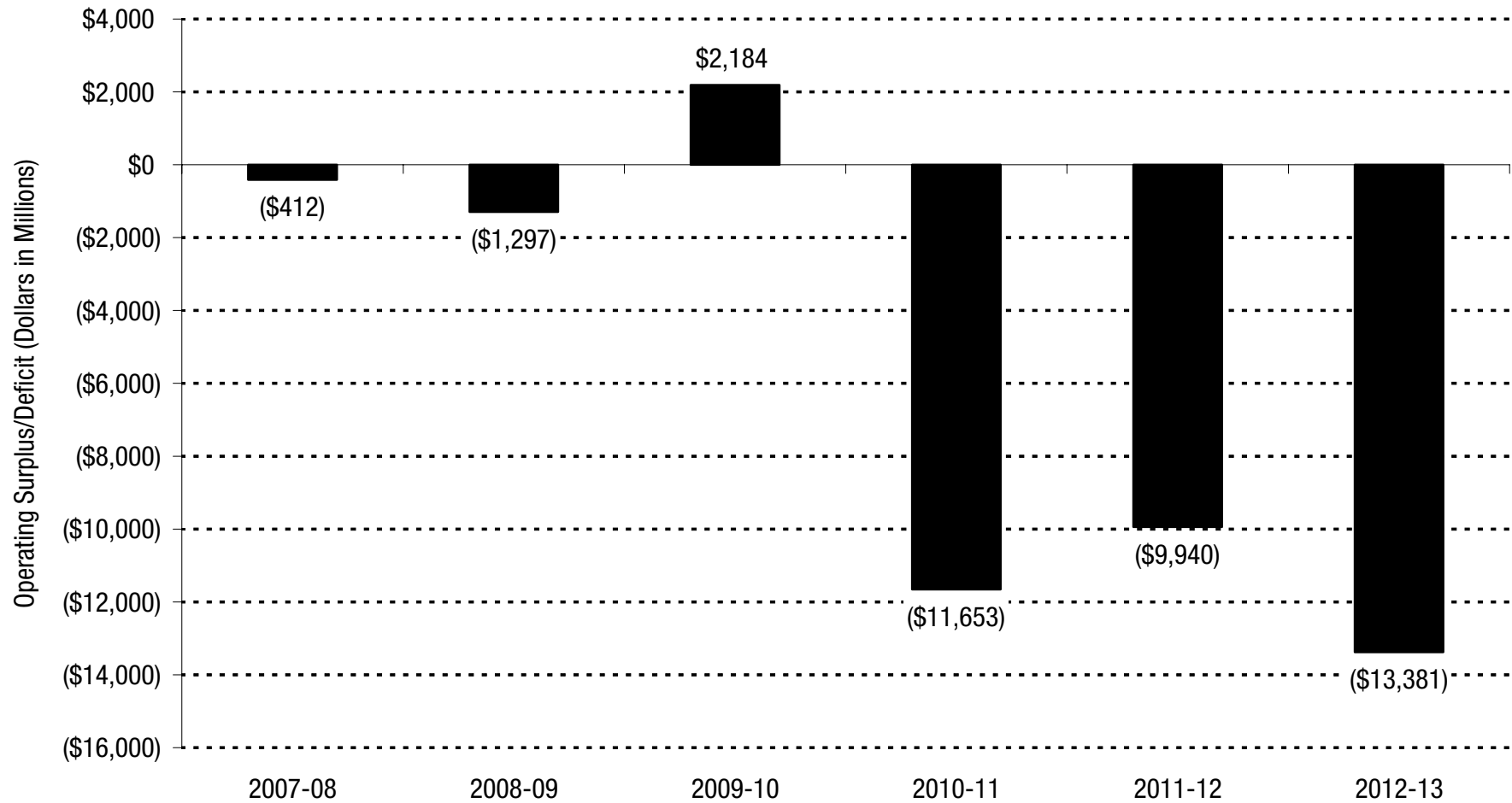


California Is the Only State To Require a Supermajority Vote To Pass Both a Budget and Any State Tax Increase



Note: Arkansas, Florida, and Michigan require a supermajority vote for certain taxes.
Source: National Conference of State Legislatures

Even With the Governor's Proposed Cuts and Tax Increases, Operating Deficits Would Resume in 2010-11



Note: Assumes that all of the Governor's proposed 2008-09 and 2009-10 revenue and expenditure changes are enacted.

Source: Department of Finance