



MEMORANDUM

Date: June 24, 2009
To: Governor Schwarzenegger
From: Mike Genest, Director
Subject: Cuts Necessary to Offset Proposition 1A Borrowing

Local government leaders have expressed opposition to borrowing from local governments pursuant to Proposition 1A of 2004 as part of the solution to our \$24.3 billion budget gap. Per your request, the Department of Finance (DOF) has identified options for additional cuts that can be made to offset the \$1.98 billion in Proposition 1A borrowing.

Our options at this point are quite limited. As difficult as the choices are, DOF proposes we fill the gap left from eliminating local government borrowing by:

- (a) Eliminating the state's contribution to employee health benefits, which would produce \$1 billion of savings in 2009-10; and
- (b) Eliminating the state's share of costs for the Child Welfare Services and Foster Care programs, which would save approximately \$890 million in General Fund dollars.

We must also consider that our revenue situation has not yet stabilized. Cash receipts from the end of May indicate that DOF's revenue projections were on track, showing a \$21.3 billion deficit. However, preliminary data for cash receipts in June indicate that a significant shortfall is developing. At this point, revenues for June are \$1.1 billion below projections.

This strongly suggests that the additional \$3 billion shortfall (leading to a total \$24.3 billion deficit) identified by the Legislative Analyst's Office (LAO) is likely to occur. It would be extreme negligence to adopt a budget that fails to address the entire revenue shortfall.

Today the Controller announced that without a complete plan to resolve the \$24.3 billion deficit, we will run out of cash and must start issuing Registered Warrants (IOU's) by July 2. This will result in IOUs being distributed for general fund payments to: local governments for social services, private contractors, state vendors, and income and corporate tax refunds, among other things.