



GOVERNOR'S BUDGET

May Revision

2006-07

Introduction

California's economy continued to perform strongly into 2006, with the state's unemployment rate falling to 4.8 percent in January and March—a rate not seen in over five years—and the number of jobs in the economy is now more than 560,000 higher than in November 2003.

This economic strength, coupled with a surge in revenues tied to corporate tax, capital gains, and stock options, has resulted in an increase in projected state revenues when compared to the Governor's January Budget of \$4.8 billion in the current year and \$2.7 billion in the budget year, for a two-year increase of \$7.5 billion.

Given the volatility of California's revenues, it is imperative to view these gains with caution. Precise data on the components of the new revenue growth will not be available for several months. Therefore, fiscal prudence dictates that most of the current-year gain be viewed as one time in nature, which is why the budget-year revenue projection is significantly less than the current-year gain would seem to suggest. In light of this, the May Revision proposes a total reserve of \$2.2 billion, by far the largest May Revision reserve since the enactment of Proposition 13.

Governor Schwarzenegger recognizes that the state must continue to exercise fiscal discipline in the face of a persistent structural budget problem. Thus, the May Revision proposes an

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unprecedented \$3.2 billion to prepay future debts. This is an increase of \$1.6 billion over the amount of pre-payment and repayments proposed in the Governor’s Budget. Figure INT-01 details the pre-payments and repayments of debt proposed in the Governor’s Budget as revised.

Figure INT-01
**Debt Pre-Payments and Repayments Proposed
 in the Governor’s Budget as Revised**
 (Dollars in Millions)

Included in Governor’s Budget:		\$1,627
Proposition 42 Prepayment*	\$920	
Transfer to Budget Stabilization Account (to Retire ERBs)	460	
Special Fund Loans Repayment	149	
Repayment of Reimbursements to Local Governments for State Mandated Programs**	98	
Additional at May Revision:		\$1,572
Economic Recovery Bonds Pre-payment*	\$1,000	
Special Fund Loans Pre-payment*	198	
Proposition 98 Settle-Up Pre-payment*	150	
Flood Control Subventions Pre-payment*	100	
Pre-payment of Reimbursements to Local Governments for State Mandated Programs**	87	
GO Bonds Debt Pre-payment*	40	
Adjustment to Transfer to Budget Stabilization Account (to Retire ERBs)	12	
Adjustment to Repayment of Reimbursement to Local Governments for State Mandated Programs**	-15	
Total		\$3,199
Proposition 98 Settle-Up is reflected in prior year, not affecting 2006-07 Operating Deficit		-150
Amount Included in 2006-07 Operating Deficit		\$3,049

* Under existing law, not due until 2007-08 or later.

** Excludes school districts.

It is especially noteworthy that the May Revision proposes to pre-pay an additional \$1 billion in principal on Economic Recovery Bonds approved by voters in 2004. While the Governor’s Budget proposed to make the constitutionally required repayment of \$460 million, the May Revision proposes to go beyond the minimum requirement. This incremental amount demonstrates the seriousness of the Governor’s commitment to retire the “credit card debt” approved by the people as Proposition 57. With these pre-payments we now project that the

Economic Recovery Bonds will be fully repaid in 2008-09, one year earlier than we forecast in January.

While the large reserve and the massive commitment to pre-pay debt are reflective of caution and fiscal restraint, the Governor also recognizes the importance of fully funding education, protecting citizens from crime, strengthening our levees to prevent floods and to ensure the continuity of the state's water supply, and preparing the state to respond to public health emergencies and natural disasters.

The May Revision proposes a settlement of litigation related to the 2004-05 suspension of the Proposition 98 guarantee. It includes full funding for the guarantee, resulting in a \$3.1 billion increase in 2006-07. It also recognizes \$2.9 billion in payments for 2004-05 and 2005-06 and proposes a repayment plan that will have no effect on the General Fund until 2009-10. In order to provide resources for the initial years of the settlement repayment schedule, the May Revision proposes legislation to authorize the re-funding of the Golden State Tobacco Securitization Corporation's 2003A bonds. This re-funding involves a new structure for utilizing the tobacco settlement payments in a way that will generate additional proceeds of \$900 million for the state without jeopardizing payments to the existing bondholders.

The May Revision also proposes one-time funding of \$400 million to help local hospitals and public health agencies prepare for public health emergencies and natural disasters by providing funding for equipment, medicine, and other assistance in developing surge capacity to handle medical needs during future emergencies, including a potential influenza pandemic. Additionally, the recently enacted bond package includes a one-time \$500 million General Fund appropriation so that the state can immediately begin making levee repairs to protect against floods. Finally, the May Revision proposes \$142 million to invest in public safety augmentations.

In summary, the Governor is proposing a May Revision budget that is fiscally prudent, pays off debt and nevertheless fully funds education and provides urgently needed funding to protect the public.

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