



## **Economic Consequences of Proposed California Budget Cuts**

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California, like many other states faces a severe fiscal crisis. In order to balance the budget, Governor Schwarzenegger has proposed \$16.7 billion in state spending reductions for Fiscal Year 2009-2010 and \$17.6 in reduced spending for FY 2009-2010. The remainder of the deficit would be made up by a combination of borrowing and fee increases. These cuts would result in an additional \$6.8 billion in lost federal funding in FY 2009-2010 and \$8.9 billion in 2010-2011, for a total reduced spending by the State of \$23.56 billion in FY 09-10 and \$26.56 billion in FY 10-11.

These reductions in spending can be expected to reduce employment in the state by 607,000 by the end of FY 10-11, a 3.67 percent decline. Approximately 73 percent of these results are driven by three major programs: In Home Supportive Services, Medi-Cal/Healthy Families and Cal-Works. Each of these programs brings in significant federal matching funds. The proposed cuts to IHSS alone account for 60 percent of the total job loss.

The employment reductions include direct effects, jobs that are directly eliminated by the state, indirect effects from the reduction in demand from suppliers, and induced effects from reduced spending in the overall economy.

If the state were to close the budget gap through a combination of \$7.5 billion in cuts, \$7.5 billion in new revenue, and the remainder from lowering the reserves by and garnering additional federal support and the three major programs were left intact, we estimate an employment reduction of 219,000 jobs, or 1.32 percent. Such an approach would lead to nearly 390,000 fewer jobs lost than an all cuts approach.

Under the Governor's proposed budget, 1.9 million people would lose health care coverage from public programs. The increase in unemployment can be expected to add an additional 280,000 adults and 110,000 children as workers lose health care coverage for themselves and their family members, bringing the total reduction in health benefits to 2.3 million. Demand for the programs

has been rising due to increased unemployment. The cuts can be expected to result in greater demand on safety net providers and emergency room services. These costs will translate into higher health care premiums. The wider economic impacts include increased bankruptcy due to medical debt.

An increase in unemployment of this scope is particularly worrisome due the interaction with the financial crisis. A sharp increase in unemployment can be expected to increase foreclosure rates in the states. California is among the hardest hit states in the nation in home foreclosures. This would in turn reduce the value of mortgage backed securities at a time when the banks are beginning to stabilize. There is also a strong connection between medical debt and home foreclosures.

The proposed cuts to education would have a long term detrimental effect on the California economy. The state has been a driver in the knowledge based economy. The presence of a robust public higher education system was an important element in the states leadership in information technology and biotech for example. Further weakening K-12 education would both reduce the economic opportunities for a generation of children; it would also make the state less attractive to high skilled workers.

The actual savings from the proposed cuts may be smaller than projected. Workers losing their jobs

### Methodology

The impact of the proposed spending reduction on real GDP for all programs with the exception of In Home Supportive Services was estimated using the multipliers provided by the Counsel of Economic Advisors for the American Recovery and Re-investment Act. The CEA estimates quarterly multipliers for government spending and tax cuts. We assumed that for FY 09-10 all reductions would begin in the second quarter. Each element in the Governor's budget proposal was classified as a spending cut, a fee or loan. Borrowing from local governments was classified as a spending cut. No value was assigned to borrowing from tax payers through increased payroll deductions. The CEA multipliers are conservative estimates. For example, the CEA multiplier for government spending progresses to 1.57 after 8 quarters. The U.S. Bureau of Economic Analysis puts the multiplier for state government spending in California at 2.17. Using the time-lag approach also reduces the impact in the first-two years. The larger employment effects would be felt in subsequent years.

To translate from declines in GDP to declines in employment, we followed the methodology from the CEA and assumed that a 1 percent decline in GDP is equivalent to a 0.75% decline in employment.

For IHSS workers, we estimate the direct impact by taking the current total number of IHSS workers of 376,000 and subtracting the projected workforce for the remaining clients following the cuts. The Department of Finance estimates that 36,000 clients would continue to qualify for care, with average monthly hours of 176.5. Assuming the average consumers has 1.25 providers, this gives us 46,000 remaining providers, for a direct reduction in employment of 330,000.

For the induced effect of a cut to IHSS we use a multiplier of 1.44 percent, from Beacon Economics estimates of the multiplier impact for the program. As with our other multipliers, we assume that these impacts take place over time, and that the full effect would not be felt in the first two-years.

The estimates for the health care reductions are derived from the Kaiser Commission on Medicaid and the Uninsured analysis of the impact of increased unemployment on health care coverage. Applying their rates to California and adjusting for California's lower share of workers with employer sponsored insurance; we find that each 1 percent increase in unemployment results in 129,600 more uninsured adults and 67,700 more children covered through public health programs. If the public programs are eliminated, we estimate an equal number of children becoming uninsured.

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