JOHN CHIANG
California State Controller

December 22, 2008

The Honorable Arnold Schwarzenegger
Governor of California
State Capitol Building
Sacramento, CA 95814

The Honorable Darrell Steinberg
President pro Tem
California State Senate
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Karen Bass
Speaker of the Assembly
State Capitol, Room 219
Sacramento, CA 95814

The Honorable Dave Cogdill
Senate Republican Leader
State Capitol, Room 305
Sacramento, CA 95814

The Honorable Michael Villines
Assembly Republican Leader
State Capitol, Room 3104
Sacramento, CA 95814

Dear Governor Schwarzenegger and Legislative Leaders:

I am writing to underscore the stark reality that, if current projections hold true, the State is less than seventy days from running out of cash. Worse, my office's analyses indicate there will be no shelter from the storm as the State's cash position will remain negative throughout the remainder of the fiscal year.

As I indicated during the recent Joint Legislative Budget Session, the failure of the Governor and the Legislature to quickly arrive at an agreement to responsibly address the State's $41 billion budget crisis would begin a cascading series of regrettable actions necessary to conserve the State's dwindling cash reserves. However, these cash-preserving options no doubt will have the unintended effect of deepening and prolonging the recession

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that has already crippled our State's economy. The first of those actions were made last week:

- The Pooled Money Investment Board was forced to shut off the flow of $3.8 billion in loans to approximately 2,000 critical infrastructure projects. That action is expected to cost the state 200,000 private sector jobs and the loss of $12.5 billion to our economy.
- Last Friday, the Governor ordered mass layoffs and unpaid furloughs starting in February for nearly 250,000 state public servants, including nursing home inspectors, peace officers, and auditors charged with identifying fraud, waste, and abuse.

Unless adequate budget and cash solutions are fashioned in the next several weeks, the list of casualties will only multiply in the weeks and months ahead.

Specifically, my office will be forced to pursue the deferral of potentially billions of dollars in payments and/or the issuance of individual registered warrants, commonly referred to as IOUs. In order to ensure that the State can meet its Constitutionally-required obligation to schools and debt service, the Capitol's budget paralysis may leave me no choice but to, in full or in part, withhold payments or to issue IOUs to other individuals and entities entitled to state payments. Given the current financial instability of the banking industry, it is highly unlikely that the banks, if they accept the IOUs at all, will be able to do so for any sustained period of time. Consequently, the recipients of the registered warrants may have no apparent options but to hold them until redemption.

While I hope that reasonable minds and a shared desire to responsibly steer the State away from the worst fiscal crisis since the Great Depression will produce the necessary solutions in the days ahead, I must continue to make preparations for the impending cash crunch. These plans will be outlined for you shortly after the formal release of the Governor's January spending plan.

I also have directed my staff to immediately accelerate the efforts necessary to issue a Revenue Anticipation Warrant (RAW), a rarely-used and extremely costly form of external borrowing. However, given the strained condition of the financial markets, the lack of market liquidity and the current condition of the State's finances, this type of financing may not be possible. A high risk of failure exists even assuming the imposition of high fees and that the Legislature adopts triggered spending reductions and/or tax increases that likely would be necessary to ensure that money is available to allow us to repay a RAW at maturity.

The State's dire cash position not only jeopardizes and places at risk our ability to meet our financial obligations in a timely manner, it threatens our ability to respond to natural disasters and protect our communities from crime. I cannot stress enough the crisis we are

facing. Without action by the Legislature and the Governor, we literally are weeks away from a meltdown of State government that threatens the delivery of critical public services our citizens deserve and expect.

Sincerely,

Original signed by:

JOHN CHIANG
California State Controller

Cc: Members of the State Legislature
Bill Lockyer, California State Treasurer
Mike Genest, Director, Department of Finance
Mac Taylor, Legislative Analyst