The fiscal crisis in the states and its impact on advancing open society priorities

What We Know About the State Fiscal Crisis

- Virtually every state is experiencing a large budget shortfall. In 2012, states project shortfalls totaling $125 billion.
- For 2009, 2010 and 2011 combined, state budget shortfalls totaled $430 billion.
- The main cause of these deficits is a sharp drop in tax receipts as a result of the recession.
- Even if the economic recovery continues, state budget shortfalls will last at least through 2013 because of the lag in revenue recovering.
- The state budget shortfalls in 2009-2011 have already been closed with spending cuts, withdrawals from reserves, revenue increases, and federal stimulus money. Looking forward, states will not be able to rely on these measures to offset shortfalls. Reserve funds have dwindled and federal stimulus money will not be available.
- Despite rising need, at least 46 states have cut services to respond to budget shortfalls. Steep cuts in healthcare, services for the elderly and disabled, education, and state workforces most severely impact marginalized and underrepresented populations.

Snapshot of U.S. Programs' Current Work

While U.S. Programs has not yet developed grants specifically targeted to respond to the state fiscal crisis, a number of U.S. Programs' grantees are currently conducting research, public education and advocacy on the state fiscal crisis. These include:

- **Think tanks on fiscal issues connected to state-based policy advocacy.** U.S. Programs is one of the largest funders of the Center on Budget and Policy Priorities, which generates ideas, research, and analysis on state fiscal policy. The Center is also the hub of the State Fiscal Analysis Initiative, a network of 31 groups (some of which we support directly in coordination with a funders' collaborative) that generate ideas to drive policy advocacy on state budget cuts, tax increases, and budget prioritization so that low-income people aren't victimized by the budget crisis. Another grantee is the Economic Policy Institute, which coordinates a complementary national network of state-based think tanks, the EARN network, that focuses more on economic justice and workers' rights. A grant to United for a Fair Economy and its network of state-based organizations, the Tax Fairness Organizing Collaborative, helps connect these ideas to community organizing and education. UFE is a leader in efforts to preserve the estate tax, and the collaborative engages people at the local level in a range of fiscal advocacy by making state budget policy relevant to their needs and interests. The Roosevelt Institute, which is a leader in generating ideas on fiscal matters, including state budget issues, is also a key grantee.
- **Transparency, equity, and accountability in state and local distribution of federal stimulus funding.** When federal stimulus funds began flowing to states in 2009, U.S. Programs had equipped state and national organizations to ensure that the money would be distributed transparently and equitably. Some of this work

continues and may provide models for how U.S. Programs can have an impact on the state fiscal crisis. National grantees, including the Center for Social Inclusion and PolicyLink, provided tools and guidance to make sure the stimulus helped those who are most in need. Grantee New America Media launched a "Stimulus Package News Beat" to give ethnic media original content related to the stimulus. Through the fall of 2011, U.S. Programs is funding eight state-based alliances that bring together think tanks, communications entities, and grassroots organizations to ensure equity and transparency in the distribution of stimulus money. These alliances have successfully spotlighted how the money was allocated and worked to secure changes so that the money benefits those most in need. These alliances are now turning their focus to addressing state fiscal battles.

- **Public education efforts to change hearts and minds about state spending.** Among a range of work advancing public education on these issues, U.S. Programs supports the Public Works project of Demos, which helps state-based organizations talk to the public about government and the importance of publicly funded services and programs. While the national-level dialogue remains unhelpful, Public Works has helped shift the debate in states and communities and led to concrete successes in raising revenue for public services that voters recognize as essential community needs. U.S. Programs also supports journalism, particularly at the state level, that is providing detailed analysis and accountability on state budget matters.
- **Opportunistic work to use the state fiscal crisis to advance key priority issues.** Particularly around criminal justice and drug policy reform, grantees are using the state fiscal crisis to advance U.S. Programs' goals. For example, grantees derailed and scaled back construction of large new jails in both Baltimore and New Orleans by successfully arguing that scarce public funds could be better used.

Questions to Frame the Board's Discussion

1. As a foundation, what primary goals are we hoping to advance in this area? Is our focus to support fiscal policy reform, to demonstrate that government can be effective, to ensure that the public has adequate data about the crisis and is engaged in how their states address it, or to promote policies that address the needs of low-income communities?

2. Should we focus on protecting progressive policies under attack in large states through supporting a time-limited campaign? How could our work on the state fiscal crisis be connected to our efforts to build long-term capacity in certain states?

3. What mix of strategies will be most effective in helping us reach our goals?

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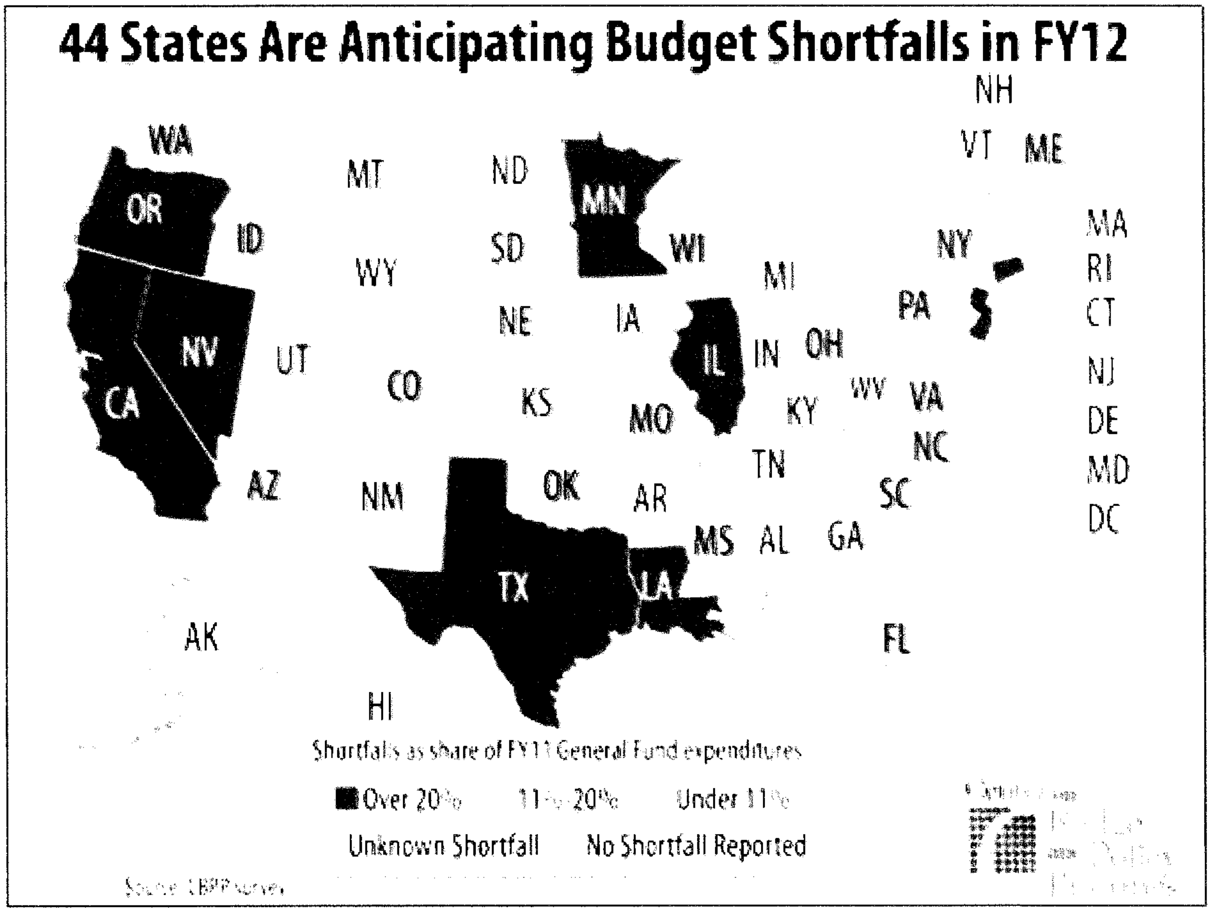

The worst recession since the 1930s has opened up large budget shortfalls in nearly every state. Nationally, states are projecting shortfalls for the coming fiscal year (2012) totaling $125 billion.

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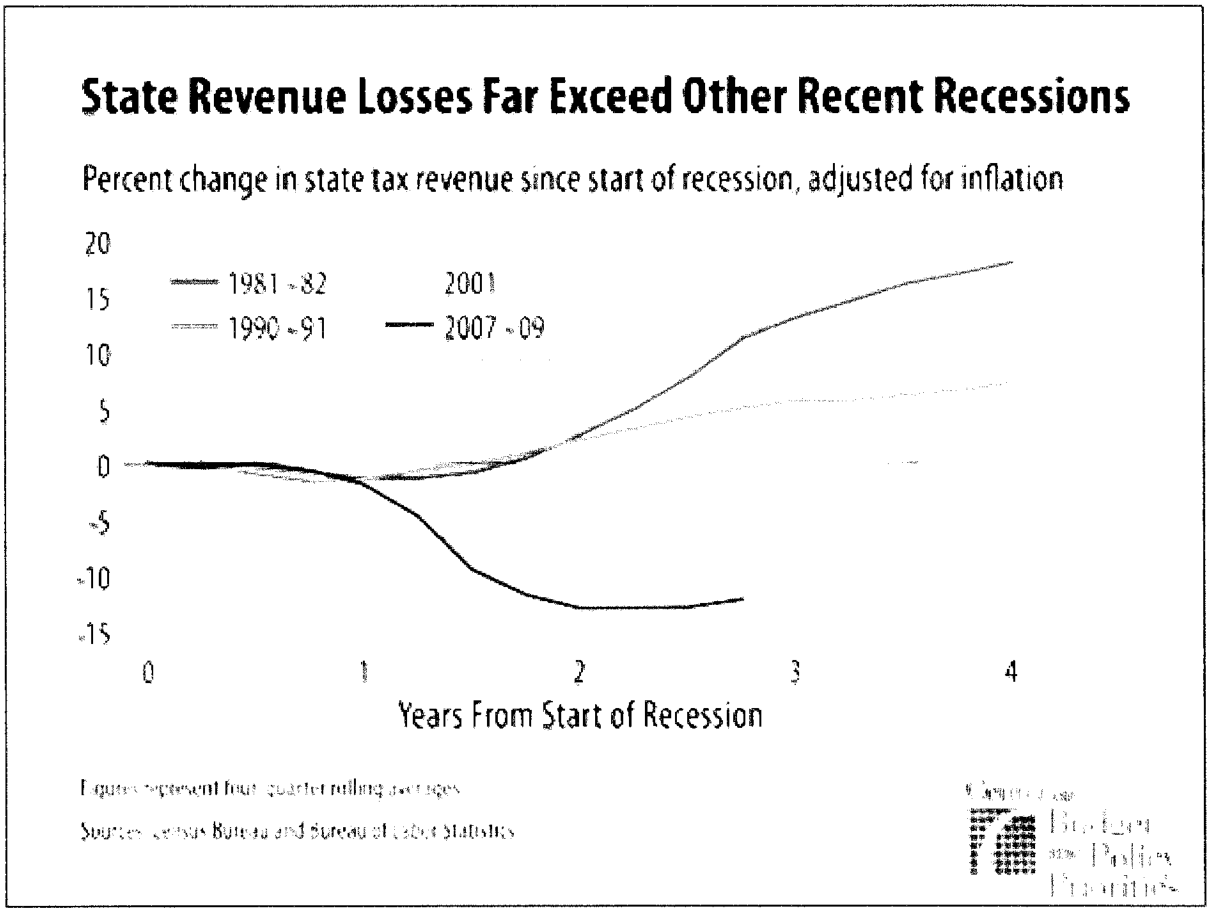

The main cause of states' budget shortfalls is the steep drop in tax receipts. State revenues typically weaken during recessions, as the incomes of residents and businesses decline and so they pay less in income, sales, and other taxes. But the revenue loss during this recession is much worse than the loss in recent recessions.

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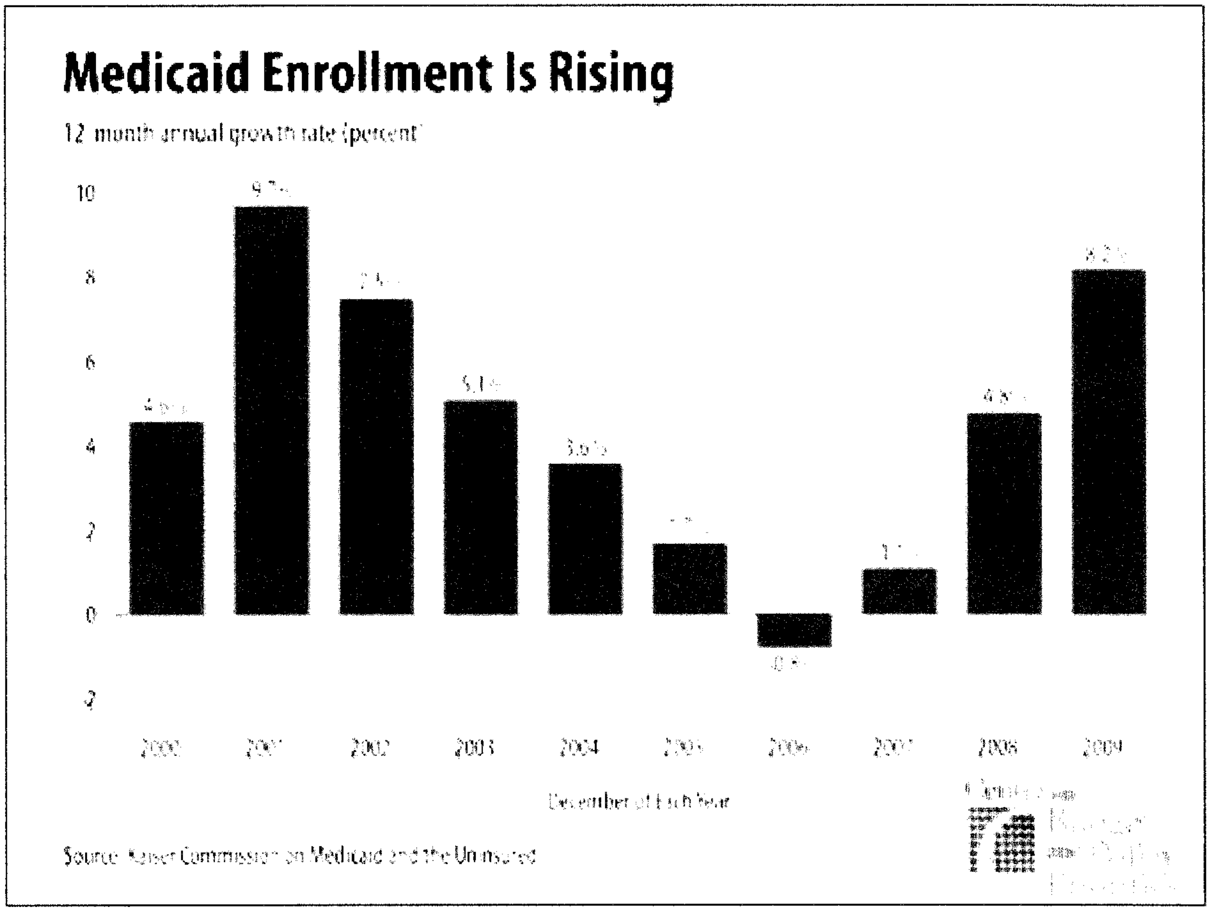

The recession is also squeezing state budgets by increasing residents' need for public services. For example, many people who have lost jobs or income because of the recession have become eligible for publicly funded health coverage through Medicaid. That adds to state costs.

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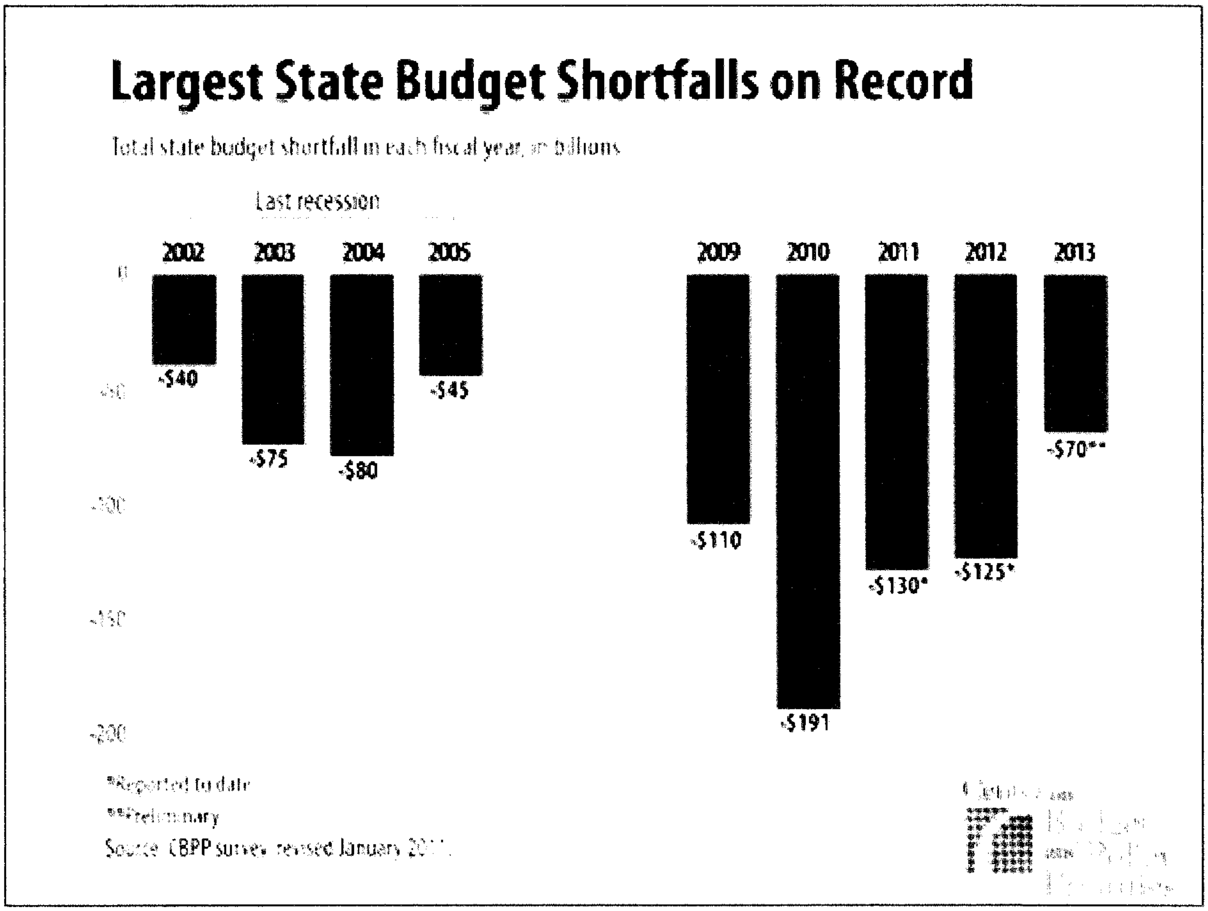

The combination of shrinking revenues and rising costs has produced budget shortfalls that far exceed those in the last recession. These shortfalls are expected to continue through fiscal year 2013, despite recent signs that the recession may be ending, because revenues generally don't recover from a downturn until well after the economy begins growing again.

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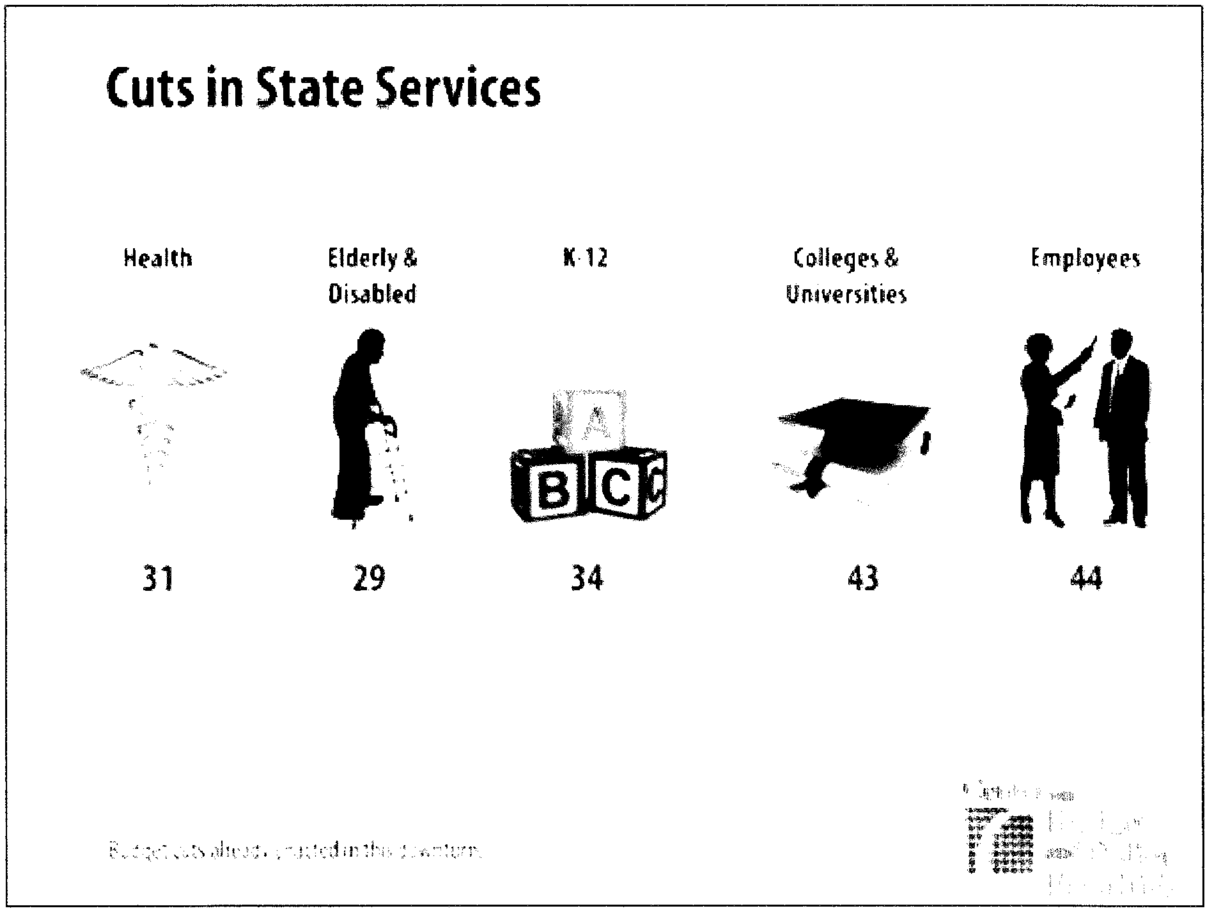

To help balance their budgets, at least 46 states plus the District of Columbia have cut public services, despite rising need. The cuts are affecting all major areas of state services, including health care, help for the elderly and disabled, and education. Also, 44 states have reduced their personnel costs through layoffs, unpaid leaves, hiring freezes, or similar actions.

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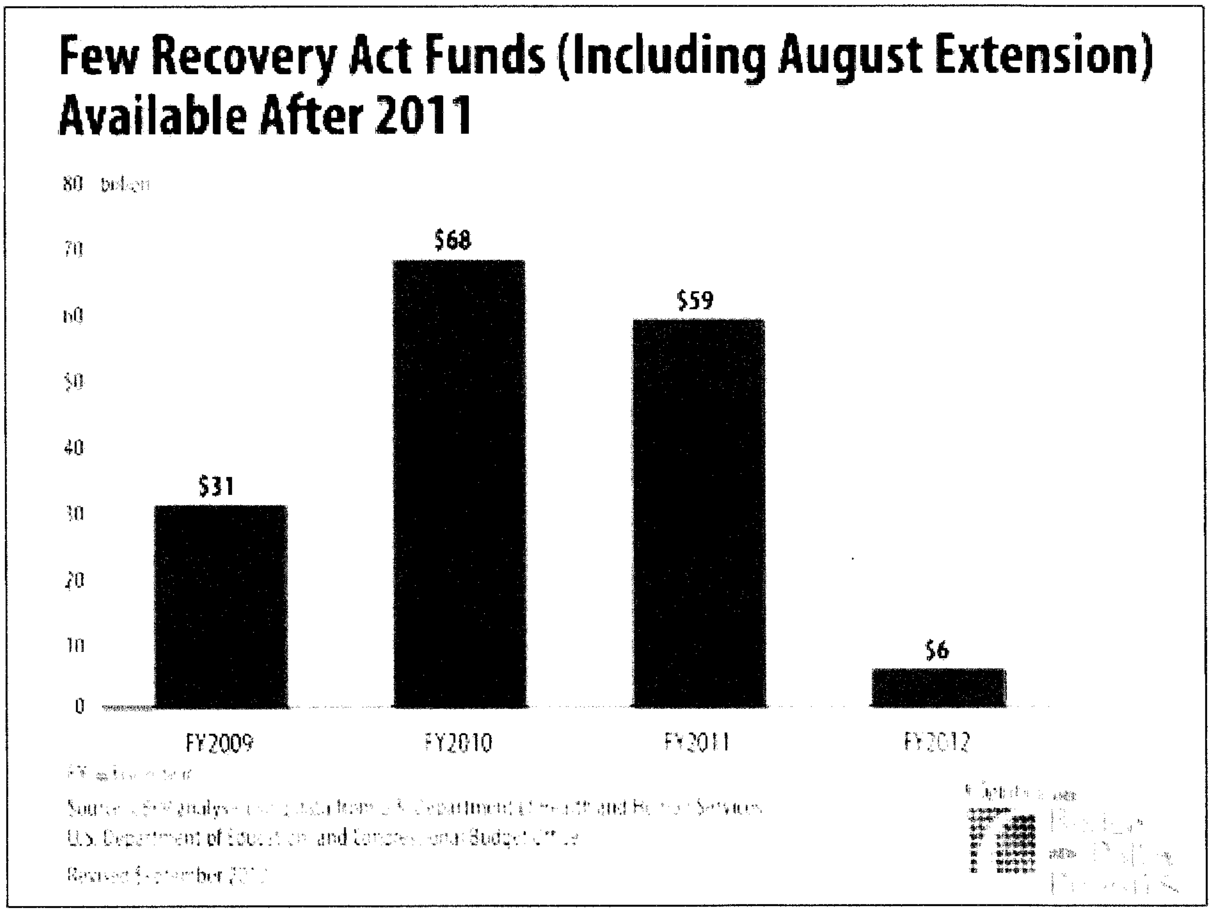

States would be imposing even larger budget cuts and tax increases if the federal government hadn't provided about $135 billion to $140 billion in fiscal relief through the Recovery Act, mostly in the form of increased Medicaid and education funding. The August jobs bill provided additional assistance of $26 billion. These measures have closed roughly 30 percent to 40 percent of state budget shortfalls so far. While federal aid has helped close state budget shortfalls and avert the loss of jobs, there is now a danger that the federal government could worsen the state fiscal situation (and the economy) by passing tax or spending policies that would increase shortfalls.

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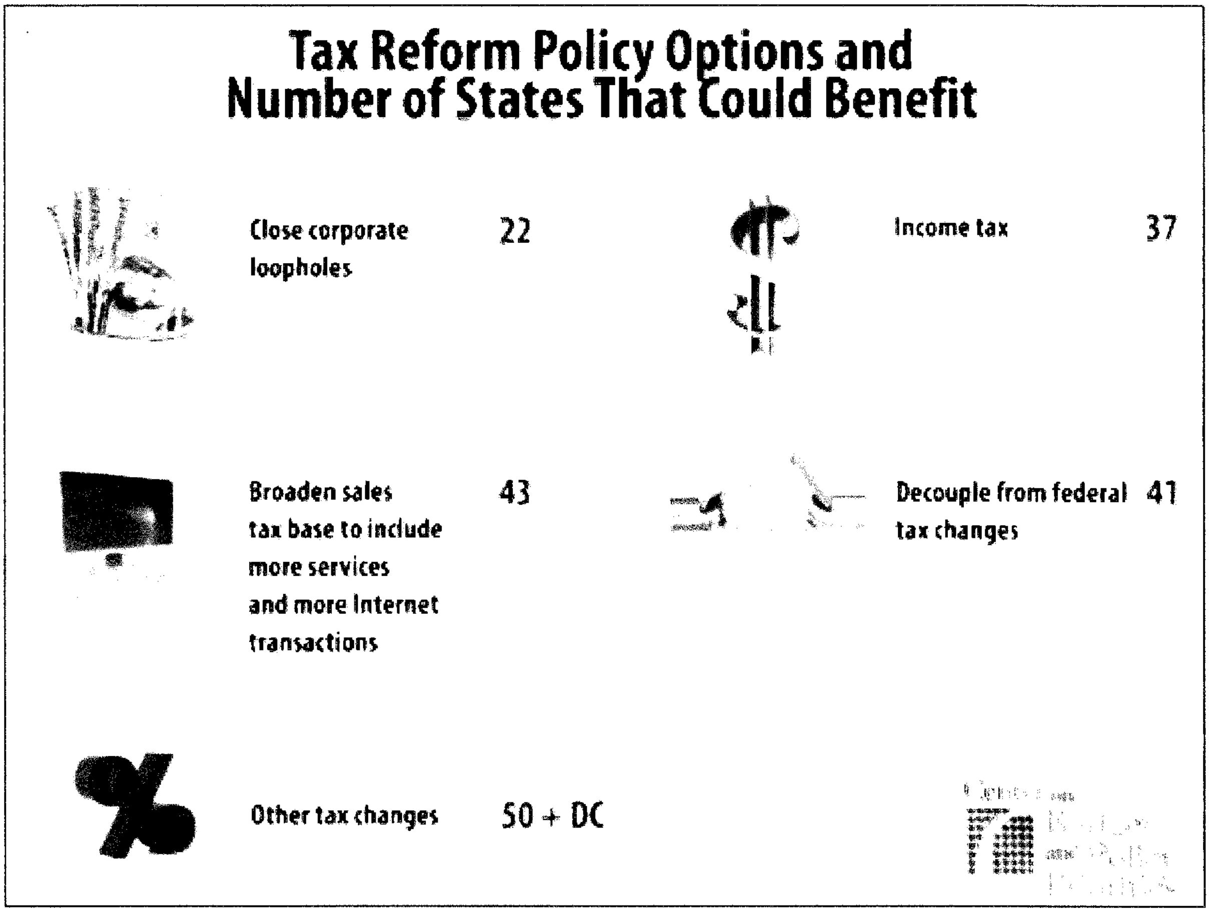

While Congress can help the states by providing more fiscal relief, states can also help themselves by adopting reforms that strengthen their tax bases. For example, few states have fully updated their sales taxes to reflect the shift of Americans' household spending from goods to services. Many states can also strengthen their corporate income taxes and personal income tax

Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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STATES CONTINUE TO FEEL RECESSION'S IMPACT

By Elizabeth McNichol, Phil Oliff, and Nicholas Johnson

As governors across the country prepare their budget proposals for the coming year, they continue to face a daunting fiscal challenge. The worst recession since the 1930s has caused the steepest decline in state tax receipts on record. State tax collections, adjusted for inflation, are now 12 percent below pre-recession levels,[1] while the need for state-funded services has not declined. As a result, even after making very deep spending cuts over the last several years, states continue to face large budget gaps.

To date some 44 states and the District of Columbia are projecting budget shortfalls for fiscal year 2012, which begins July 1, 2011 in most states. These come on top of the large shortfalls that states closed in fiscal years 2009 through 2011. States will continue to struggle to find the revenue needed to support critical public services for a number of years, threatening hundreds of thousands of jobs.

A survey of state fiscal conditions suggests that:

- **2012 is shaping up as states' most difficult budget year on record. Thus far some 45 states and the District of Columbia are projecting budget shortfalls totaling $125 billion for fiscal year 2012.** While states are anticipating significant shortfalls in the coming year, their options for addressing those shortfalls are dwindling. Federal assistance for states, which has been enormously helpful in allowing states to avert some of the most harmful potential budget cuts, will be largely gone by the end of fiscal year 2011, the current fiscal year. Nearly one-half of the nation's governors have now released their budget proposals for fiscal year 2012, and their proposals reflect this grim fiscal reality. A number of these proposals contain deep cuts to state services on top of the substantial cuts that states have already made since the start of the recession.

- **There are signs that state finances will start to stabilize after next year, but recovery will be slow.** The list of states that need to close mid-year budget gaps for the current year is far shorter than in the last two years. Thus far only 11 states and the District of Columbia have reported new shortfalls emerging in their 2011budgets. In fiscal year 2010, by contrast, some 45 states saw new shortfalls emerge after they enacted their budgets. This trend may indicate that

[1] As of the 3rd quarter of 2010. CBPP analysis of Rockefeller Institute, Census Bureau, and Bureau of Labor Statistics data.

Short-Term Cyclical Deficits Are Distinct from Longer-term Costs Facing the States

This report chronicles the short-term deficits states currently are facing, which will have to be closed as budgets are enacted for the upcoming fiscal year. These deficits are primarily caused by the continued slow economic growth and high unemployment that have depressed revenues, along with increase demand for services. Over the past three years, states and localities have used a combination of reserve funds and federal stimulus funds, along with budget cuts and tax increases, to close these recession-induced deficits. While these deficits have caused severe problems and states and localities are struggling to maintain needed services, this is a cyclical problem that ultimately will ease as the economy recovers.

As explained in another Center report, Misunderstandings Regarding State Debt, Pensions, and Retiree Health Costs Create Unnecessary Alarm cyclical deficits are distinct from the longer term issues related to bond indebtedness, pension obligations, and retiree health insurance. These latter issues — size of which often has been exaggerated in recent months — can be addressed over the next several decades. It is not appropriate to add these longer-term costs to projected operating deficits for the purpose of declaring that states are in a crisis too deep for them to handle.

state revenues are stabilizing and that state finances will begin to recover along with the broader economy.

- **Despite modest signs of improvement, states continue to face a long road to recovery.** Already, some 22 states are projecting shortfalls totaling $70 billion for FY 2013 (the year that begins 17 months from now). Once all states have prepared estimates, this total is likely to grow. Thus, significant state shortfalls are expected to persist into the future.

  The shortfalls that states are projecting for fiscal years 2012 and 2013 are in addition to the over $430 billion in shortfalls that states have already closed in fiscal years 2009, 2010, and 2011 combined.

State Budget Shortfalls in 2011, 2012, and 2013

States already have addressed extraordinarily large shortfalls as they developed and implemented spending plans for fiscal years 2009, 2010, and 2011. Shortfalls are the extent to which states' revenues, hit hard by the recession, fall short of the cost of providing services. Every state save Vermont has some sort of balanced-budget law. So the shortfalls for 2009 and 2010 and most of the shortfalls for 2011 — which totaled over $430 billion combined — have already been closed through a combination of spending cuts, withdrawals from reserves, revenue increases, and use of federal stimulus dollars. Similarly, the shortfalls projected for 2012 will be closed when states adopt their budgets.

FIGURE 1:
Largest State Budget Shortfalls On Record

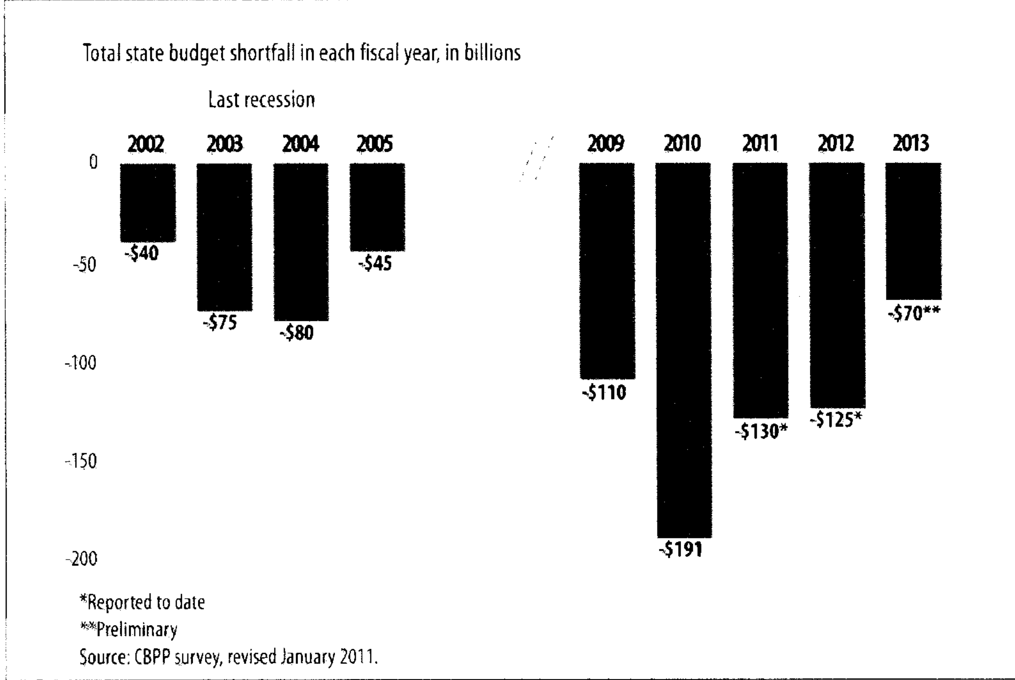
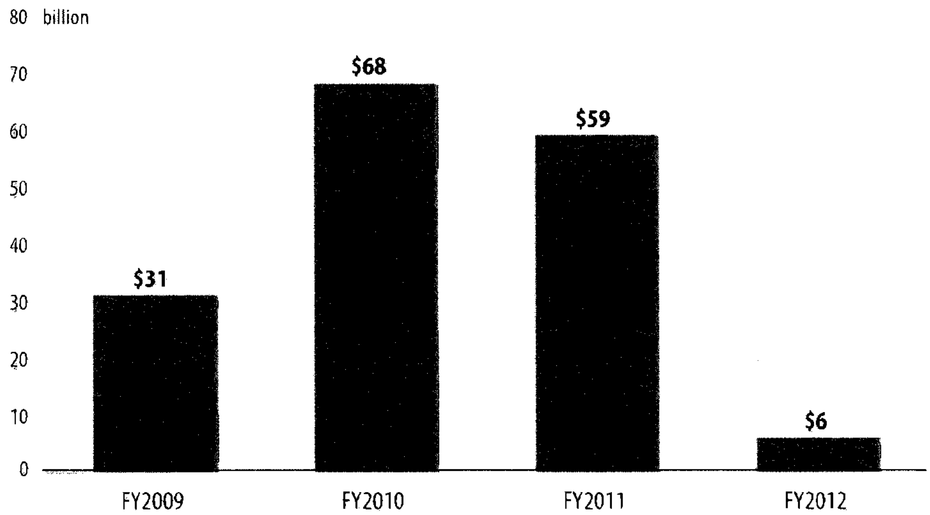


Figure 1 compares the size and duration of the shortfalls that occurred in the recession of the first part of this decade to shortfalls reported to date during the current recession. In the early 2000s, as in the early 1990s and early 1980s, state fiscal problems lasted for several years after the recession ended. The same will undoubtedly be the case this time, since the current recession is more severe — deeper and longer — than the last one, and state fiscal problems have proven to be worse and are likely to remain so.

States' current fiscal conditions remain extremely weak even as the economy appears to be moving in the direction of recovery. Indeed, it appears increasingly likely that due to declining federal assistance, fiscal year 2012 will be more difficult than 2010 or 2011. In fiscal year 2011, states have approximately $59 billion in federal aid to assist in closing budget shortfalls that totaled some $130 billion. For 2012, states are already reporting shortfalls that total $125 billion with only $6 billion in federal Recovery Act dollars remaining available.[2] The shortfall amount for FY2012 is likely to grow higher. Figure 2 shows the federal Recovery Act dollars available to states each fiscal year.

[2] In general, the projected budget shortfalls reflect state fiscal conditions before shortfall-closing actions are taken. States are using a combination of actions to close the shortfalls including use of federal stimulus funds, budget cuts, tax increases, and reserves. (For FY2011, however, some states projected the size of the shortfall after use of federal stimulus funds. This would be reflected in the $130 billion in shortfalls reported to date for FY2011. The estimated total of $160 billion reflects the projected shortfall before the use of approximately $59 billion in federal stimulus funds.)

FIGURE 2:
Few Recovery Act Funds (Including August Extension) Available After 2011



FY = Fiscal Year

Source: CBPP analysis using data from U.S. Department of Health and Human Services, U.S. Department of Education, and Congressional Budget Office.

Revised September 2010.

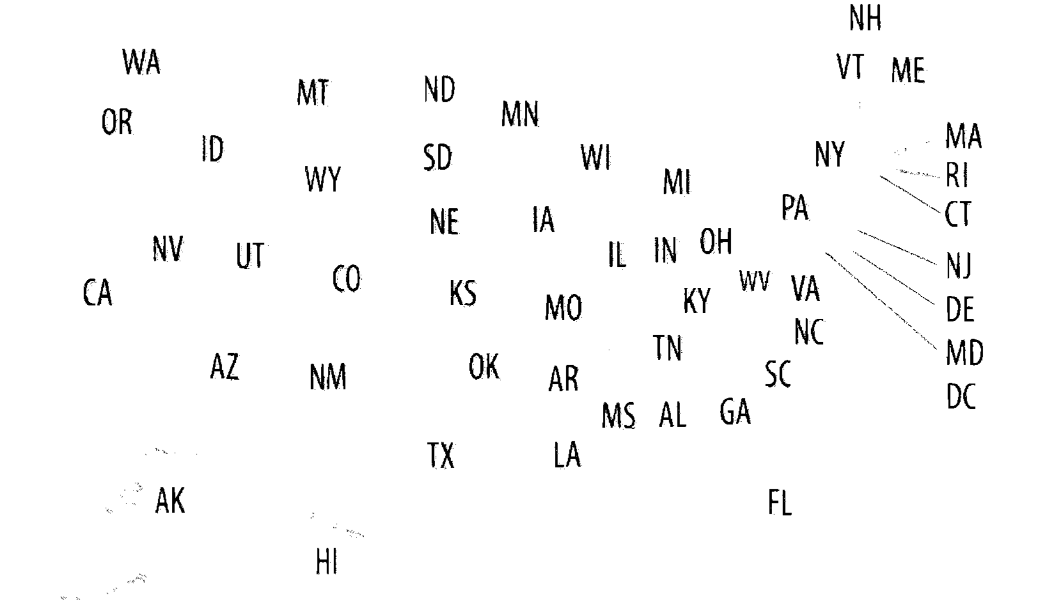
Unemployment remains above 9 percent, and many economists expect it to remain at high levels throughout 2011 and beyond. Continued sluggish job growth will keep state income tax receipts at low levels and increase demand for Medicaid and other essential services that states provide. High unemployment and economic uncertainty, combined with households' diminished wealth due to fallen property values, will continue to depress consumption; thus, sales tax receipts also will remain low. These factors suggest that state budget gaps will continue to be significantly larger than in the last recession, and last longer.

Estimates from the states, although incomplete, are consistent with this outlook. To date at least 45 states and the District of Columbia are projecting shortfalls for fiscal year 2012 totaling $125 billion. Table 1 lists the shortfalls that states anticipate for 2012. (Also see Figure 3.) These gaps are in addition to the new gaps that have opened up in eleven states plus the District of Columbia since fiscal year 2011 budgets were adopted. (Table 2 lists these states.)

Looking even further ahead at least 22 states are already projecting shortfalls totaling $70 billion for fiscal year 2013. (See Table 3.) It is reasonable to expect that this total will grow as more states prepare projections.

These future year shortfalls are in addition to the gaps that states have closed or continue to face in fiscal year 2011. Overall, 46 states have faced shortfalls in 2011 totaling $130 billion. (See Table 4.) This total includes the $7.4 billion in new gaps that have opened up in eleven states plus the

FIGURE 3:
Thus Far 45 States Are Anticipating Shortfalls in the Coming Year



Source: CBPP survey.

District of Columbia since fiscal year 2011 budgets were adopted. This may be an indication that the state revenue situation is stabilizing, as a much smaller number of states are expecting new mid-year gaps than at the same time last year. However, revenues, while increasing from the point reached at the depth of the recession, remain depressed at a level far short of the amount needed to pay fully for an ongoing level of services.

Of course, a faster-than-expected recovery could reduce the size of future shortfalls. But several factors could make it particularly difficult for states to recover from the current fiscal situation. Housing markets might be slow to fully recover; their decline already has depressed consumption and sales tax revenue as people refrain from buying furniture, appliances, construction materials, and the like. This also would depress property tax revenues, increasing the likelihood that local governments will look to states to help address the squeeze on local and education budgets. And as the employment situation continues to be weak, income tax revenues will continue to lag, and there will be further downward pressure on sales tax revenues as consumers are reluctant or unable to spend.

Some states have not been affected by the economic downturn, but the number is dwindling. Mineral-rich states — such as New Mexico, Alaska, and Montana — saw revenue growth in the beginning of the recession as a result of high oil prices. More recently, however, the decline in oil prices has affected revenues in these states. The economies of a handful of other states have so far been less affected by the national economic problems. Only one state, North Dakota, has not reported budget shortfalls in any of these years. Two other states — Alaska and Arkansas – faced

TABLE 1: STATES WITH PROJECTED FY2012 GAPS	FY12 Projected Shortfall	Shortfall as Percent of FY11 Budget
Arizona	$974 million	11.5%
California*	$25.4 billion	29.3%
Colorado	$988 million	13.8%
Connecticut	$3.7 billion	20.8%
District of Columbia	DK	na
Delaware	$208 million	6.3%
Florida	$3.6 billion	14.9%
Georgia	$1.7 billion	10.3%
Hawaii	$410 million	8.2%
Idaho	$300 million	12.6%
Illinois	$15.0 billion	44.9%
Indiana	$270 million	2.0%
Iowa	$294 million	5.6%
Kansas	$492 million	8.8%
Kentucky*	$780 million	9.1%
Louisiana	$1.7 billion	22.0%
Maine	$436 million	16.1%
Maryland	$1.6 billion	12.2%
Massachusetts	$1.8 billion	5.7%
Michigan	$1.8 billion	8.6%
Minnesota	$3.9 billion	24.5%
Mississippi	$634 million	14.1%
Missouri	$1.1 billion	14.4%
Montana	$80 million	4.3%
Nebraska	$314 million	9.2%
Nevada	$1.5 billion	45.2%
New Hampshire	DK	na
New Jersey	$10.5 billion	37.4%
New Mexico	$410 million	7.6%
New York	$9.0 billion	16.9%
North Carolina	$3.8 billion	20.0%
Ohio	$3.0 billion	11.0%
Oklahoma	$600 million	11.3%
Oregon*	$1.8 billion	25.0%
Pennsylvania	$4.5 billion	17.8%
Rhode Island	$290 million	9.9%
South Carolina	$877 million	17.4%
South Dakota	$127 million	10.9%
Tennessee	DK	Na
Texas	$13.4 billion	31.5%
Utah	$437 million	9.2%
Vermont	$150 million	13.9%
Virginia*	$2.3 billion	14.8%
Washington	$2.9 billion	18.5%
West Virginia	$155 million	4.1%
Wisconsin	$1.8 billion	12.8%
States Total	**$125.0 billion**	**19.9%**

Note: Kentucky and Virginia have two-year budgets. They closed their FY2012 shortfalls when they enacted their budgets for the FY2011-FY2012 biennium. California's shortfall includes an $8.2 billion shortfall carried forward from FY2011. Oregon's shortfall is one half of the state's total projected shortfall for the 2011-2013 biennium.

shortfalls in fiscal year 2010 but have not projected gaps for subsequent years. Montana is now projecting a shortfall for FY2012 after avoiding gaps for the earlier years of the state fiscal crisis.

The Consequences of Shortfalls

In states facing budget gaps, the consequences are severe in many cases — for residents as well as the economy. To date, budget difficulties have led at least 46 states to reduce services to their residents, including some of their most vulnerable families and individuals.[3] Over 30 states have raised taxes to at least some degree, in some cases quite significantly.

If revenue remains depressed at low levels, as is expected in many states, additional spending and service cuts are likely. Budget cuts often are more severe later in a state fiscal crisis, after largely depleted reserves are no longer an option for closing deficits.

TABLE 2: States With FY2011 Mid Year Gaps

	Mid-Year Shortfall Amount	Shortfall as Percent of FY11 Budget
Arizona	$531 million	6.3%
California*	See Note	
Colorado	$257 million	3.6%
Connecticut	$45 million	0.3%
Kansas	$60 million	1.1%
Louisiana*	$108 million	1.4%
New Mexico	$159 million	2.9%
New York	$315 million	0.6%
Oregon	$378 million	5.4%
Texas	$4.3 billion	10.1%
Washington	$1.1 billion	7.1%
District of Columbia	$175 million	2.8%
Total	**$7.4 billion**	**4.2%**

Note: **California** did not fully address the shortfall that it faced prior to adopting its FY2011 budget (listed in table 1). An $8.2 billion shortfall remains open for FY2011. **Louisiana** ended FY2010 with a shortfall that must be closed in FY2011.

Spending cuts are problematic during an economic downturn because they reduce overall demand and can make the downturn deeper. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and nonprofit organizations that provide direct services, and cut benefit payments to individuals. In all of these circumstances, the companies and organizations that would have received government payments have less money to spend on salaries and supplies, and individuals who would have received salaries or benefits have less money for consumption. This directly removes demand from the economy.

Tax increases also remove demand from the economy by reducing the amount of money people have to spend — though to the extent these increases are on upper-income residents, that effect is minimized because much of the money comes from savings and so does not diminish economic activity. At the state level, a balanced approach to closing deficits — raising taxes along with enacting budget cuts — is needed to close state budget gaps in order to maintain important services while minimizing harmful effects on the economy.

Ultimately the actions needed to address state budget shortfalls place a considerable number of jobs at risk. The roughly $130 billion shortfall that states are facing for fiscal year 2012 after taking

[3] For more detailed information, see "An Update on State Budget Cuts," http://www.cbpp.org/cms/index.cfm?fa=view&id=1214

federal assistance into account equals about 0.85 percent of GDP. Assuming that economic activity declines by one dollar for every dollar that states cut spending or raise taxes, and based on a rule of thumb that a one percentage point loss of GDP costs the economy 1 million jobs, state shortfalls could cost the economy 850,000 jobs next year.

The Role of the Federal Government

Federal assistance is lessening the extent to which states need to take pro-cyclical actions that further harm the economy. The American Recovery and Reinvestment Act, enacted in February 2009, includes substantial assistance for states. The amount in ARRA to help states maintain current activities is about \$135 billion to \$140 billion over a roughly 2½-year period — or between 30 percent and 40 percent of projected state shortfalls for fiscal years 2009, 2010, and 2011. Most of this money is in the form of increased Medicaid funding and a "State Fiscal Stabilization Fund." (There are also other streams of funding in the economic recovery act flowing through states to local governments or individuals, but these will not address state budget shortfalls.) This money has reduced the extent of state spending cuts and state tax and fee increases.

TABLE 3: States with Projected FY2013 Gaps

	FY13 Projected Shortfall	Shortfall as Percent of FY11 Budget
Arizona	\$612 million	7.2%
California	\$19.2 billion	22.2%
Connecticut	\$3.6 billion	20.2%
Florida	DK	na
Hawaii	\$362 million	7.2%
Louisiana	\$1.6 billion	20.6%
Maine	\$368 million	13.6%
Maryland	\$1.9 billion	14.8%
Minnesota	\$2.0 billion	12.8%
Montana	\$227 million	12.2%
Nebraska	\$472 million	13.9%
Nevada	\$1.5 billion	45.2%
New Hampshire	DK	na
New York	\$14.6 billion	27.4%
Oregon*	\$1.8 billion	25.0%
Pennsylvania	\$2.5 billion	9.9%
Rhode Island	\$328 million	11.1%
South Carolina	\$1.2 billion	22.9%
Texas	\$13.4 billion	31.5%
Vermont	\$126 million	11.7%
Washington	\$2.9 billion	18.5%
Wisconsin	\$1.7 billion	12.1%
States Total	**\$70.4 billion**	**21.1%**

Oregon's shortfall is one half of the state's total projected shortfall for the 2011-2013 biennium.

In addition, H.R. 1586 — the August 2010 jobs bill — extended enhanced Medicaid funding for six months through June 2011 and added \$10 billion to the State Fiscal Stabilization Fund. But it still appears likely the federal assistance will end before state budget gaps have fully abated. The Medicaid funds are scheduled to expire in June 2011, the end of the 2011 fiscal year in most states.[4] States will have drawn down most of their State Fiscal Stabilization Fund allocations by then as well. So even though significant budget gaps will remain in 2012, there will be little federal money available to close them. States are likely to respond with spending cuts and tax increases even larger than those that have already been enacted.

[4] Most states operate on a July-June fiscal year; the exceptions are New York (April-May), Texas (September-August), and Alabama and Michigan (October-September).

One way to avoid this would be for the federal government to reduce state budget gaps — and hence avert some spending cuts and/or tax increases — by again extending the Medicaid funds over the period during which state fiscal conditions are expected to still be problematic, rather than cutting them off in June 2011.

Conversely, some actions of the federal government would deepen states' fiscal problems. Already, the provision included in the tax-cut agreement between president Obama and Republican leaders to allow full expensing of business investments could cost states more than $11 billion over two years in lost tax revenue due to the interaction of state and federal tax codes if states do not act to delink from it. Moreover, Congressional Republicans' proposal to cut non-security discretionary spending by 15 percent below funding levels budgeted for the current federal fiscal year would reduce federal support for services provided through state and local governments.[5] Such actions would worsen state budget problems and slow economic recovery.

[5] See James Horney, "House GOP Plan Cuts Non-Security Discretionary Programs 15 Percent Through End of Fiscal Year," at http://www.cbpp.org/files/2-4-11bud.pdf

TABLE 4:
Gaps States Have Faced in FY2011

	Gap Before Budget Adoption in States with Biennial 09-11 Budgets	Gap Before Budget Adoption in States With Annual Budgets/New Gap in Biennial States	Total FY11 Shortfall Closed When Budget Adopted*	Total Shortfall as Percent of FY11 Budget
Alabama	0	$586 million	$586 million	8.3%
Arizona	0	$3.1 billion	$3.1 billion	36.5%
California*	0	$17.9 billion	$17.9 billion*	20.7%
Colorado	0	$1.5 billion	$1.5 billion	21.5%
Connecticut	$4.4 billion	$700 million	$5.1 billion	28.8%
Delaware	0	$377 million	$377 million	11.4%
District of Columbia	0	$104 million	$104 million	1.7%
Florida	0	$4.7 billion	$4.7 billion	19.5%
Georgia	0	$4.2 billion	$4.2 billion	25.4%
Hawaii	0	$594 million	$594 million	11.8%
Idaho	0	$84 million	$84 million	3.5%
Illinois	0	$13.5 billion	$13.5 billion	40.4%
Indiana	0	$1.3 billion	$1.3 billion	9.4%
Iowa	0	$1.1 billion	$1.1 billion	20.3%
Kansas	0	$510 million	$510 million	9.1%
Kentucky	0	$780 million	$780 million	9.1%
Louisiana	0	$1.0 billion	$1.0 billion	12.9%
Maine	$765 million	$174 million	$940 million	34.7%
Maryland	0	$2.0 billion	$2.0 billion	15.3%
Massachusetts	0	$2.7 billion	$2.7 billion	8.6%
Michigan	0	$2.0 billion	$2.0 billion*	9.3%
Minnesota	$2.8 billion	$1.2 billion	$4.0 billion	25.0%
Mississippi	0	$716 million	$716 million	15.9%
Missouri	0	$730 million	$730 million	9.4%
Nebraska	$150 million	$179 million	$329 million	9.7%
Nevada	$1.3 billion	$504 million	$1.8 billion	54.5%
New Hampshire	$250 million	$115 million	$365 million	27.2%
New Jersey	0	$10.7 billion	$10.7 billion	38.2%
New Mexico	0	$333 million	$333 million	6.1%
New York	0	$8.5 billion	$8.5 billion*	15.9%
North Carolina	$4.4 billion	$1.4 billion	$5.8 billion	30.6%
Ohio	$2.5 billion	$463 million	$3.0 billion	11.0%
Oklahoma	0	$725 million	$725 million	13.7%
Oregon*	Yes	$577 million	See Table 4	See Table 4
Pennsylvania	0	$4.1 billion	$4.1 billion	16.2%
Rhode Island	0	$395 million	$395 million	13.4%
South Carolina	0	$1.3 billion	$1.3 billion	26.1%
South Dakota	0	$102 million	$102 million	8.8%
Tennessee	0	$1.0 billion	$1.0 billion	9.4%
Texas	$3.3 billion	$1.3 billion	$4.6 billion	10.8%
Utah	0	$700 million	$700 million	14.7%
Vermont	0	$338 million	$338 million	31.3%
Virginia	0	$1.3 billion	$1.3 billion	8.5%
Washington	$2.1 billion	1.4 billion	$3.5 billion	22.5%
West Virginia	0	$134 million	$134 million	3.6%
Wisconsin	$3.4 billion	0	$3.4 billion	23.9%
Wyoming	0	$147 million	$147 million	10.3%
States Total	**$25.3 billion**	**$97.3 billion**	**$122.6 billion**	**18.8%**

Note: **California** did not fully close the shortfall listed in this table. A $8.2 billion shortfall remains open for FY2011. **California**'s shortfall does not include $1.2 billion in proposed reserve replenishment. **Oregon** has a two-year budget. See Table 4 for additional gap information.

TABLE 5: Total FY2010 Budget Gaps				
	FY2010 Before Budget Adoption	Additional FY2010 Mid-Year Gap	FY2010 Total	Total Gap as Percent of FY2010 General Fund
Alabama	$1.2 billion	$400 million	$1.6 billion	23.7%
Alaska	$1.3 billion	0	$1.3 billion	28.9%
Arizona	$3.2 billion	$1.9 billion	$5.1 billion	65.0%
Arkansas	$146 million	$247 million	$395 million	9.1%
California*	$45.5 billion	Yes*	$45.5 billion	52.8%
Colorado	$1.0 billion	$600 million	$1.6 billion	23.8%
Connecticut	$4.2 billion	$513 million	$4.7 billion	27.0%
Delaware	$557 million	0	$557 million	18.2%
District of Columbia	$650 million	$167 million	$817 million	13.0%
Florida	$5.9 billion	$147 million	$6.0 billion	28.5%
Georgia	$3.1 billion	$1.4 billion	$4.5 billion	28.8%
Hawaii	$682 million	$533 million	$1.2 billion	25.2%
Idaho	$411 million	$151 million	$562 million	22.4%
Illinois	$9.3 billion	$5.0 billion	$14.3 billion	43.7%
Indiana	$1.1 billion	$309 million	$1.4 billion	10.6%
Iowa	$779 million	$533 million	$1.3 billion	22.6%
Kansas	$1.4 billion	$459 million	$1.8 billion	33.9%
Kentucky	0	$1.2 billion	$1.2 billion	14.5%
Louisiana	$1.8 billion	$777 million	$2.5 billion	27.8%
Maine	$640 million	$209 million	$849 million	28.0%
Maryland	$1.9 billion	$936 million	$2.8 billion	20.3%
Massachusetts	$5.0 billion	$600 million	$5.6 billion	20.4%
Michigan	$2.8 billion	$454 million	$3.3 billion	15.8%
Minnesota	$3.2 billion	$209 million	$3.4 billion	22.7%
Mississippi	$480 million	$437 million	$917 million	19.3%
Missouri	$780 million	$931 million	$1.7 billion	22.7%
Nebraska	$150 million	$155 million	$305 million	9.2%
Nevada	$1.2 billion	$384 million	$1.5 billion	46.8%
New Hampshire	$250 million	$180 million	$430 million	28.6%
New Jersey	$8.8 billion	$2.2 billion	$11 billion	40.0%
New Mexico	$345 million	$650 million	$995 million	18.2%
New York	$17.9 billion	$3.2 billion	$21.0 billion	38.8%
North Carolina	$4.6 billion	$391 million	$5.0 billion	26.2%
Ohio	$3.3 billion	$296 million	$3.6 billion	13.9%
Oklahoma	$777 million	$864 million	$1.6 billion	28.4%
Oregon*	$4.2 billion	0	$4.2 billion	32.4%
Pennsylvania	$4.8 billion	$1.1 billion	$5.9 billion	23.6%
Rhode Island	$590 million	$400 million	$990 million	34.8%
South Carolina	$725 million	$439 million	$1.2 billion	21.5%
South Dakota	$32 million	15.8 million	$48 million	4.3%
Tennessee	$1.0 billion	$170 million	$1.2 billion	12.1%
Texas	$3.5 billion	0	$3.5 billion	10.7%
Utah	$721 million	$279 million	$1.0 billion	22.1%
Vermont	$278 million	$28 million	$306 million	28.3%
Virginia	$1.8 billion	$1.8 billion	$3.6 billion	24.1%
Washington*	$3.4 billion	$1.4 billion	$4.8 billion	23.2%
West Virginia	$184 million	$120 million	$304 million	8.2%
Wisconsin	$3.2 billion	0	$3.2 billion	23.7%
Wyoming	0	$32 million	$32 million	1.8%
Total	**$158.5 billion**	**$32.3 billion**	**$190.8 billion**	**29.0%**

Notes: * California's mid-year gap is included in the total shown for FY11 in Table 1. **Oregon** has a two-year budget. For Oregon, the size of the combined shortfall before budget adoption for FY10 and FY11 is shown here.

TABLE 6:
Total FY2009 Budget Gaps

	Gap Before Budget Was Adopted	Additional Mid-Year Gap	Total	Total Gap as Percent of FY2009 General Fund
Alabama		$1.1 billion	$1.1 billion	12.7%
Alaska		$360 million	$360 million	6.8%
Arizona[1]	$1.9 billion	$1.8 billion	$3.7 billion	36.8%
Arkansas	$107 million		$107 million	2.4%
California	$22.2 billion	$14.9 billion	$37.1 billion	36.7%
Colorado		$1.1 billion	$1.1 billion	14.2%
Connecticut	$150 million	$2.5 billion	$2.7 billion	15.5%
Delaware	$217 million	$226 million	$443 million	12.2%
District of Columbia	$96 million	$583 million	$679 million	10.8%
Florida	$3.4 billion	$2.3 billion	$5.7 billion	22.2%
Georgia[1]	$245 million	$2.2 billion	$2.4 billion	11.5%
Hawaii		$417 million	$417 million	7.3%
Idaho		$452 million	$452 million	15.3%
Illinois	$1.8 billion	$2.5 billion	$4.3 billion	15.1%
Indiana		$1.2 billion	$1.2 billion	9.1%
Iowa	$350 million	$134 million	$484 million	7.6%
Kansas		$186 million	$186 million	2.9%
Kentucky	$266 million	$456 million	$722 million	7.8%
Louisiana		$341 million	$341 million	3.7%
Maine	$124 million	$140 million	$265 million	8.6%
Maryland	$808 million	$691 million	$1.5 billion	10.0%
Massachusetts	$1.2 billion	$4.0 billion	$5.2 billion	18.5%
Michigan	$472 million	$1.5 billion	$2.0 billion	8.5%
Minnesota	$935 million	$654 million	$ 1.6 billion	9.2%
Mississippi[1]	$90 million	$363 million	$453 million	8.9%
Missouri		$542 million	$542 million	6.0%
Nevada	$898 million	$561 million	$1.6 billion	19.9%
New Hampshire	$200 million	$50 million	$250 million	8.0%
New Jersey[1]	$2.5 billion	$3.6 billion	$6.1 billion	18.8%
New Mexico		$454 million	$454 million	7.5%
New York	$4.9 billion	$2.5 billion	$7.4 billion	13.2%
North Carolina		$3.2 billion	$3.2 billion	14.9%
Ohio[1]	$733 million	$1.9 billion	$2.6 billion	9.4%
Oklahoma	$114 million		$114 million	1.7%
Oregon		$442 million	$442 million	6.6%
Pennsylvania		$3.2 billion	$3.2 billion	11.3%
Rhode Island	$430 million	$442 million	$872 million	26.6%
South Carolina	$250 million	$871 million	$1.1 billion	16.3%
South Dakota		$27 million	$27 million	2.2%
Tennessee[1]	$468 million	$1.0 billion	$1.5 billion	13.4%
Utah		$620 million	$620 million	10.4%
Vermont	$59 million	$82 million	$141 million	11.6%
Virginia	$1.2 billion	$1.1 billion	$2.3 billion	13.8%
Washington		$1.3 billion	$1.3 billion	8.5%
Wisconsin	$652 million	$1.0 billion	$1.7 billion	11.7%
Wyoming		$119 million	$119 million	6.8%
TOTAL	**$46.8 billion**	**$63.1 billion**	**$109.9 billion**	**15.2%**

[1] These states provided a range of estimates for their FY09 gaps; this table shows only the low end of the estimates. For more detail see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009*, available at http://www.cbpp.org/1-15-08sfp.htm

Note: In most cases these shortfalls have already been addressed.

TABLE 6: Source of Gap Estimates	
State	**Source**
Alabama	Governor's Office/ Arise Policy Project
Alaska	Legislative Fiscal Office/Legislative Finance Division Overview of proposed budget
Arizona	Joint Legislative Budget Committee, Financial Advisory Committee
Arkansas	Governor's proposed budget, Dept of Finance and Administration
California	Governor's budget, Legislative Analysts Office, Dept of Finance, Controller
Colorado	Colorado Fiscal Policy Institute/CO Legislative Council
Connecticut	CT Voices for Children analysis of Office of Fiscal Analysis data/ Comptroller/ Office of Policy and Management
Delaware	Governor's proposed budget
District of Columbia	Chief Financial Officer
Florida	Revenue Estimating Conference/Office of Economic and Demographic Research
Georgia	State budget, Georgia State University/ FY11: Georgia Budget and Policy Institute
Hawaii	Council on Revenues forecast/Governor's Office
Idaho	Legislative summary of adopted budget/Governor's budget office/Office of Legislative Services
Illinois	State budget/Voices for Illinois Children analysis
Indiana	State Budget Committee/Governor's Budget Proposal
Iowa	Fiscal Services Division/Revenue Estimating Conference
Kansas	State Budget and Legislative Research Department
Kentucky	Consensus Forecasting Group/Governor's office
Louisiana	Revenue Estimating Conference/Governor's budget/Louisiana Budget Project
Maine	Revenue Forecasting Committee/Office of Fiscal and Program Review/Bureau of Budget
Maryland	Department of Legislative Services/ State Board of Rev Estimates
Massachusetts	MA Budget & Policy Center
Michigan	Consensus Revenue Forecast, Senate Fiscal Agency
Minnesota	Management and Budget forecast
Missouri	Governor's budget office and Missouri Budget Project
Mississippi	Governor's office
Montana	Montana Budget & Policy Center analysis of Leg. Fiscal Div. Budget Outlook
Nebraska	Governor's office/Tax Rate Review Committee/General Funds Financial Status
Nevada	Division of Budget and Planning/Board of Examiners and Jan Economic Forum FY12 Agency Budget Requests/January Economic Forum
New Hampshire	Budget Director/Press reports of revenue shortfalls, court case/New Hampshire Fiscal Policy Institute
New Jersey	Governor's office/ FY12 Treasurer/Office of Legislative Services
New Mexico	Consensus Revenue Estimate/NM Voices for Children/Leg Finance Committee
New York	Division of Budget
North Carolina	North Carolina Fiscal Research Division/ FY12 NC Budget and Tax Center
Ohio	Office of Budget and Management/ FY12 Community Solutions
Oklahoma	State Tax Commission/OK Policy Institute/ FY12 Fiscal Services Division
Oregon	Jt. Committee on Ways & Means/September Revenue Forecast/ FY12 OR Reset Report/OR Center for Public Policy
Pennsylvania	Governor's office/ Budget Director/Pennsylvania Budget and Policy Center
Rhode Island	Governor's budget/FY12 Poverty Institute
South Carolina	State Budget and Control Board and revised revenue projections
South Dakota	Governor's proposed budget/South Dakota Budget and Policy Project
Tennessee	Press reports of State Funding Board meeting
Texas	Center on Public Policy Priorities analysis of Legislative Budget Board, Comptroller and HHS Commission data/News Accounts of Estimates from Texas Elected Officials
Utah	Governor's proposed budget, Legislative Fiscal Analyst, press reports/Voices for Utah Children
Vermont	State budget office /Public Assets Institute analysis of Joint Fiscal Office data
Virginia	House Appropriations/Governor's office
Washington	Governor's Budget/WA Budget and Policy Center/FY12 OFM Six Year Outlook/Economic and Revenue Forecast Council
West Virginia	Department of Revenue/Governor's budget/FY12 Budget Director (press)
Wisconsin	Legislative Fiscal Bureau/Wisconsin Budget Project
Wyoming	Consensus Revenue Estimating Group

For source information for the original shortfall estimates, see *29 States Faced Total Budget Shortfall of At Least $48 billion in 2009,* available at http://www.cbpp.org/1-15-08sfp.htm

Chronology

1930s-1970s

State governments expand rapidly and modernize their tax systems in response to economic and federal pressures.

1930
Mississippi enacts first modern general sales tax.

1933
President Franklin D. Roosevelt launches New Deal, rapidly turning federal government into the states' dominant fiscal partner as they receive large transfers for federally sponsored social and economic programs.

1940
State government spending has grown by more than 250 percent since 1927.

1965
President Lyndon B. Johnson signs into law Medicaid, the federal-state health insurance program for the needy and disabled.

1978
California voters approve Proposition 13, severely limiting state property tax rates and sparking nationwide anti-tax revolt that continues today.

1980s-1990s

States enter cycle of recession-driven busts — but mainly booms, as economic activity and stock market rallies fill their coffers.

1992
Colorado voters approve Taxpayer Bill of Rights, limiting increases in state spending.

1999
Throughout the 1990s, most states enact permanent tax cuts, lowering revenues by 8.2 percent.

2000s

State budgets are hit by collapse of dot-com and housing bubbles.

2002
With state revenues dropping, states defer maintenance and infrastructure spending.

2003
Most states cut funding for higher education and social services; 27 propose Medicaid reductions; Congress sends states $10 billion in extra Medicaid money and $10 billion for general funds. . . . By a 2-to-1 margin, Alabama voters reject a proposed $1.2 billion tax hike. . . . Electricity brownouts and a $38 billion shortfall prompt California voters to recall Gov. Gray Davis, select actor Arnold Schwarzenegger.

2004
Government Accounting Standards Board requires all states, beginning in 2007, to publish the cost of state workers' retirement health benefits over the next 20 years.

2005
San Diego Mayor Richard Murphy resigns in the face of a $1.4 billion pension shortfall. . . . Schwarzenegger presents a politics and budget "reform" package to voters, who reject all of it.

2007
No state ends the fiscal year with a budget deficit. . . . Foreclosure filings increase by 75 percent over the previous year — with the rate almost doubling in December, when the nation slips officially into recession.

2008
Vallejo, Calif., seeks bankruptcy protection, citing declines in sales taxes and home values. . . . State and local government jobs peak in August, with 55,000 cut over the following year.

2009
Feb 17: President Obama signs $787 billion stimulus package. Most of the money will be spent through states and localities, but only about $135 billion is available for states to balance their budgets. . . . May 19: California voters turn down ballot propositions that would have tweaked spending requirements from earlier ballot measures and raised taxes by $16 billion in exchange for a spending cap. . . . June 4: South Carolina Supreme Court orders Gov. Mark Sanford to apply for $700 million in federal stimulus funds. Like several other Republican governors, Sanford had balked at accepting federal dollars he felt would create future financial liabilities for the state. . . . July 1: As the fiscal year begins, every state but North Dakota and Montana has had to cut spending or raise taxes to grapple with budget shortfalls for fiscal 2010 that total $168 billion, or one-fourth of total state budgets. . . . July 2: Facing a $26.3 billion shortfall, California starts issuing IOUs to its vendors. . . . Sept. 4: Unemployment hits a 26-year high at 9.7 percent, with the U.S. economy having lost 7.4 million jobs since the recession began at the end of 2007. . . . Dec. 1: A government-streamlining commission will recommend ways to reduce the size of Michigan's government from 18 cabinet departments to no more than eight.

To: George Soros
From: Ann Beeson, Lenny Noisette
cc: Aryeh Neier, Bryan Stevenson
Re: Criminal Justice Reform Opportunities in California
Date: February 14, 2011

We provide this in memo in response to your inquiry about and interest in criminal justice reform opportunities in California. Information here is based on preliminary research and discussions with funder colleagues and grantees working in California. We look forward to your thoughts and would be happy to arrange a call with you (and our Board advisors if you wish) to discuss these proposals in more detail.

<u>The Climate for Reform</u>

The new leadership in California and the dire fiscal circumstances in the state have created the potential for meaningful reform of criminal justice policy. Governor Brown has already floated ideas for significant changes as part of his plan to address California's budget deficit (discussed more fully below). New Attorney General Kamala Harris, former district attorney of San Francisco, ran for office on a criminal justice reform platform and wants to play a leadership role on these issues.

The state is also facing continued pressure to reduce its prison population under the directive of a federal court order to address the unhealthy conditions caused by overcrowding, a ruling currently under U.S. Supreme Court review. The legislature is solidly democratic, and newly enacted rules provide that budget bills now only require a simple majority for passage as opposed to the previously required super majority of 2/3; the law still requires a 2/3 majority for laws to *raise* revenue, but the anticipated criminal justice-related legislation would *reduce* expenditures and are hence subject to the new rules.

<u>Specific Reforms in Progress or Under Consideration in California</u>

1. California Community Corrections Performance Incentive Act

Passed in 2009, the California Community Corrections Performance Incentive Act includes a provision for counties to receive a portion of General Fund savings based on their success in reducing the number of felony probationers going to prison because of violating their terms of probation or committing new crimes. The Act is scheduled to go into effect in July 2011, and activities related to local implementation are currently underway.

2. Governor Brown Proposals Under Consideration

Governor Brown has presented the broad strokes of a plan for realignment of the criminal justice system which would result in substantial reductions in incarceration and significant savings for the state. One change proposed by Brown would eliminate the state office of parole and place responsibility for parole supervision at the county level. Brown has also proposed realigning petty offenses – that is, keeping people convicted of low-level offenses at the county level rather than in state prison. A third Brown proposal would close the state Department of Juvenile Justice and its detention facilities and require that localities detain or supervise juveniles locally.

3. Sentencing Reform

Some advocates and funder colleagues believe that the political climate also presents opportunities for sentencing reform. In particular, in California all drug offenses except for marijuana are classified as felonies. While the most recent effort at broad drug sentencing reform, Proposition 5, was defeated in 2008, some believe that a more tailored reform could garner support. In addition, recent successful efforts to address the high rates of incarceration of women may suggest an opening for further reform to reduce this discrete population.

4. Modification of Three Strikes Law

California's penalties for multiple convictions are the harshest in the nation. Under its "Three Strikes" laws, an individual with a previous conviction for a violent offense can have the length of his sentence for a second felony automatically doubled, even if that second offense is a non-violent crime. Conviction of a third felony offense results in a mandatory sentence of 25 years to life imprisonment even if that offense is not considered serious or violent. Advocates opposing these provisions are developing a ballot initiative to put forward in 2012 which would repeal these provisions to require that enhanced sentencing be limited to multiple convictions of serious, violent felony offenses. While not yet public, this effort has the financial backing of David Mills, chair of the board of the NAACP Legal Defense Fund, and financial backer of the Mills Clinic at Stanford law School, which houses a Three Strikes Project.

<u>Potential OSF Investments in Support of Reform</u>

1. Strengthening Capacity of Key Reform Organizations

Any successful reform effort will require increased public education and community engagement activities by leading reform organizations. For example, while Governor Brown's proposals for realignment are a major positive step, they are not enough. Without sentencing reform, realignment runs the risk of simply moving the state's overcrowding and mass incarceration problems from the state level to the counties. Strengthening the capacity of California-based advocates to lead these reforms is essential to meaningful systemic change and reduction in incarceration.

The Fund for Non-Violence and the Rosenberg Foundation have partnered to increase support for three organizations working in coalition to push for reform, Ella Baker Center, Drug Policy Alliance and the ACLU of Northern California, and are eager to have additional partners in this effort. Discussions have recently begun about developing a multi-year campaign, possibly involving the above groups and the California Attorneys for Criminal Justice (CACJ), to fund a position in the state capitol, Sacramento, to enhance public education and policy work. CACJ, a membership organization, would with separate funds also potentially engage in a range of (c)(4) activities such as developing television and radio ads targeted at more conservative counties.

2. Development of Local Service Delivery Models

The Public Welfare Foundation and Rosenberg Foundation are interested in exploring work in a handful of counties to help with the development of best practices and innovative service delivery models to ensure the effective and successful implementation of the California Community Corrections Performance Incentive Act, and are looking for additional funding partners in this effort. Increasing the capacity of localities to provide services for former prisoners is also important to ensure that any sentencing reforms reducing incarceration levels are coupled with sufficient reentry services for those returning home.

Potential (c)(4) Funding

The Open Society Policy Center could explore the possibility of assisting with any number of potential 2012 ballot initiatives, including one related to repealing the Three Strikes Law, as well as a potential return of a marijuana legalization initiative. In addition, support for greater lobbying capacity in Sacramento is worth consideration.

Open Society Foundation Partners in California

The foundation has invested for a number of years in reform efforts in California, and has a number of strong organizational and philanthropic partners we could work with, some of which are mentioned in the sections above. Among our grantees working on criminal justice reform are California-based Ella Baker Center for Human Rights (executive director Jakada Imani participated in the criminal justice panel at the September 2010 board meeting); The W. Haywood Burns Institute; Critical Resistance; the Youth Justice Coalition; and the California State Conference of the NAACP. National grantee Drug Policy Alliance, and a number of ACLU chapters, particularly the Northern California office, are also actively involved in reform efforts. OSF's recent investments have supported activities aimed at reducing the detention and incarceration of juveniles; challenging the sentencing of children to life without the possibility of parole; removing barriers to and promoting opportunities for employment of formerly incarcerated individuals and others with criminal records; sentencing reform, particularly related to drug offenses; and reform of the death penalty.

There are a number of other foundations supporting criminal justice reform efforts in California, include national foundations like Ford and the Public Welfare Foundation, as well as some whose funding is largely focused on the state, such as the Rosenberg Foundation, Fund for Non-Violence, Akonadi Foundation and the Women's Foundation of California. We share grantees with many of these foundations, and have worked closely with some of them on discrete projects.