

## Budget outlook grim thru 2012

By **John Howard** | 11/12/09 12:00 AM PST

California's budget, rarely pretty, is getting uglier. Personal income-tax collections are weak, courts are intervening, one-time fixes are exhausted, the economy is grim and grimmer, borrowing money is dicey, forced furloughs continue. The Capitol's partisan politics is more entrenched than ever, and in the background looms the 2010 gubernatorial election – in which the state's unraveling finances are likely to take center stage.

"Given what we projected back in the summer and given the other pressures, the gap we're going to have to close in the coming budget is likely to be in double digits," said Finance Department spokesman H.D. Palmer.

Even for a state accustomed to budget meltdowns, the new numbers are daunting.

"I don't see any bright spots. I keep looking for them. We used every trick we could find to balanced this year's budget," said Assemblywoman Noreen Evans, D-Santa Rosa, the chair of the Assembly Budget Committee. "This year we tried to fund every program at a minimum. I just don't know what options we are going to have next year."

Gov. Schwarzenegger says the state faces a \$5 billion to \$7 billion shortage before the end of the current fiscal year next June. That's a dramatic shift from the roughly \$500 million cushion that had been predicted in an \$85 billion General Fund that already had been cut by \$6 billion from the year before.

That means a new round of cuts is coming. "I think that there will be across-the-board cuts again. I mean, we are not going to go and pick and choose. I think that we always have to go and cut across the board," Schwarzenegger told reporters in San Jose. "So we just have to hang in there, tighten our belts and live within our means. That's the most important thing."

In August, the administration projected some \$22.4 billion in shortages through the middle of 2012, a figure that reflects a \$7.4 billion shortfall through the end of 2010-11 fiscal that ends 19 months from now and grows to \$15.5 billion the following year. That number did not include the governor's latest estimate.

The Legislature's nonpartisan fiscal adviser, the Legislative Analyst's Office, plans to release its own budget outlook report next week. It will reflect the most current numbers -- which may be even more severe than the administration's given that the economy has weakened since August.

Tax receipts are running below projections by more than \$850 million, although the latest numbers show they may be flattening out.

Absent action and assuming a flat or worsening economy, the state is looking at shortages of perhaps \$25 billion or more during the next 2 ½ years, but the number is a moving target because an array of taxes are phased out, and a number of tax breaks phase in.

The General Fund has already dropped nearly \$19 billion in two fiscal years – from \$103 billion in 2007-08, to \$85 billion in the current year.

One member of the Assembly budget and a veteran of city and county government, said long-term budgeting is a necessary first step.

"We've got to do a systematic approach and address the cost drivers of the budget. We ought to be budgeting for five years," said Assemblyman Jim Beall Jr., D-San Jose, a member of the Assembly Budget Committee.

"When the economy is bad, caseloads go up. I'm not sure lowering caseloads is feasible, because more and more people are applying for aid. Proposition 36 money (for drug rehabilitation) has been cut to the bone, from \$120 million to \$18 million, but alcohol and drug abuse are big drivers for prison costs. Rehabilitation has been ignored by the governor – he's vetoed it," Beall added.

Other factors are intensifying the crisis.

Temporary taxes will expire over time, leaving the state without money that it counted on last time to balance its books. Tax breaks for businesses, approved as part of the last budget to woo Republican votes, will kick in, further draining the treasury. Last time, lawmakers and the governor delayed a \$6.3 billion payment to schools, accelerated tax collections to get money quickly, tapped federal stimulus money and delayed payments to employees, among other items.

"The basic problem is that tax revenue goes away and the corporate loopholes take affect – all at the same time. This is self-inflicted. This has nothing to do with the economy," said Lenny Goldberg of the California Tax Reform Association, which opposes corporate tax breaks.

But to replace or revise those taxes, however dire the state's fiscal condition, is all but certain to spark political warfare, as minority Republicans block new taxes in a repeat of the round of crises and confrontations with the Democratic majority that dominated 2009.

Borrowing money also will be difficult. This week, the state borrowed \$1.9 billion, but was forced to pay a 4 percent tax-free yield to attract bond buyers, the Los Angeles Times reported. The borrowing is intended to repay local governments for a \$2 billion shift in property tax funds to the state, which need the money to balance its books.

Some items that brought in revenue will disappear. A boost in the personal income tax, which was expected to bring in \$5.8 billion, will expire by July 2011, and a .25 percent income tax increase, worth about \$3.7 billion, will go out of existence in December 2010. A ½ percent increase in the vehicle license fee to 1.15 percent of the depreciated value of the vehicle ends in the middle of 2011, reverting to its earlier level of .65 percent.

Federal stimulus money, some of which was used to replenish the state's General Fund, will dwindle in the upcoming budget.

A one-cent increase in the statewide sales tax, worth about \$4.4 billion to the state, ends, on June 30, 2011. A two-year borrowing from local governments – the locals called it a "raid," not a borrowing – brought in about \$2 billion, including \$1.7 billion one year and a projected \$350 million the next. But budget writers can't do the same thing again until that money is paid back, the under provisions of voter-approved Proposition 1A of 2004, which was intended to protect locals' funding.

Sacramento's penchant for tapping other funds, such as transportation money under Proposition 42 that was intended to relieve traffic congestion, also will be harder. That's because those borrowings are limited to twice a decade, and the state has used up its quota.

The state also has tapped money from local redevelopment funds, a move that thus far has drawn two lawsuits. Also in the courts: the administration's efforts to save \$80 million by cutting back In-Home Supportive Services. The state also delayed payments to schools and workers, including a \$6.3 billion payment to education, that will have to be resolved in the new budget. The decision to delay payments by one day and shift them to the new fiscal year changed the year that certain funds were given to them," O'Malley noted.

"It is very difficult to say where we have the ability to cut without very significant, very substantial program cuts," said Marianne O'Malley, a budget expert with the Legislative Analyst's Office.

There is a potential bright spot.

With the Dow climbing, there is a possibility of significant revenue from capital gains transactions. During the dot.com bubble of the late 1990s, tax revenue from capital gains – which are taxed like income -- fueled state unprecedented state spending.

One issue that may be at risk in the upcoming budget wrangle is the governor's legacy, which insiders believe is hooked to water projects to be financed by an \$11 billion bond measure scheduled to go before voters next year. But with the market uncertain, the chances of the bond's passage are problematic.

"His legacy? It's not about his legacy anymore, it's about helping the state survive. It's not about helping