In what has become a somber November tradition, the nonpartisan Legislative Analyst's Office projected Wednesday that California must close a $25.4 billion shortfall next year, twice as large as legislative leaders predicted.

California faces another major budget problem because tax rates are slated to drop, the federal government will provide less relief and state leaders enacted a flimsy fiscal plan last month, the analyst's office found. The economy is recovering, but not fast enough to overcome the state's budgetary obstacles.

The latest projections suggest a difficult road ahead for Gov.-elect Jerry Brown, who will likely spend much of the next four years wrestling with budget problems. The LAO report forecasts annual budget deficits of about $20 billion through 2015-16 without permanent changes.

The new deficit is larger than last year's $19 billion gap, which took legislators and Gov. Arnold Schwarzenegger until Oct. 8 to resolve, the latest budget enactment date in state history.

"I think it's going to be much, much more difficult than last year," said Legislative Analyst Mac Taylor, pointing out that many past solutions are no longer available. Legislative leaders had predicted a deficit of at least $12 billion.

The bulk of the new deficit – $19.3 billion – would occur in the 2011-12 fiscal year starting in July. But an additional $6.1 billion is due to what the LAO judged to be false assumptions in the October budget.

That $86.6 billion general fund budget assumed the state would receive $5.4 billion in new federal aid, a figure considered wildly optimistic even when the governor signed the budget plan. The legislative analyst believes the state will receive only about $1.9 billion of that money.

The analyst said other areas are too optimistic. He believes the state won't save $780 million in prison health care reductions, nor will it save $185 million by reducing the inmate population. By passing Proposition 22, which protects local government funds, voters saddled the budget with another $800 million problem.

The latest analysis assumes that nearly one-third of the $19 billion in solutions state leaders enacted in October will fall short.
"Clearly, they adopted some solutions that I think they knew – and most people knew – were risky," Taylor said. "I don't think people are shocked that we are going to end the year with a deficit. I think people may be surprised a little bit about the magnitude of the total number … ."

Schwarzenegger leaves office in January, handing the budget reins to Brown.

"The governor-elect is acutely aware of the challenges our state faces and met with Department of Finance officials last week to start work on a budget that will require a great deal of sacrifice," said Brown spokesman Evan Westrup.

State leaders knew big problems were on the horizon for the 2011-12 budget year. In February 2009, the Legislature and Schwarzenegger approved temporary tax hikes on income, vehicles and sales that will end in 2011. Those taxes provide $8.3 billion that will not be available for the next budget.

The state also will lose about $4.5 billion in federal aid. Beyond that, the state has faced an ongoing $5 billion to $6 billion gap between what it spends and what it receives.

The $25.4 billion deficit projection already assumes that K-12 schools and community colleges will receive the constitutional minimum in the next fiscal year, $2 billion less than this year. Schools are certain to clamor for more money, especially since they will lose federal funds that expire.

Education cuts have been a significant part of bridging past budget deficits. But given the circumstances, Taylor said there is virtually no more room to cut schools.

In the past two years, state leaders have relied significantly on federal stimulus help to plug the budget. That money is now running out, while Republicans, who took control of the House in November, are unlikely to approve further aid to states.

Taylor also noted that the state faces significant federal restrictions in how much it can cut the state's Medi-Cal programs.

Senate Republican leader Bob Dutton of Rancho Cucamonga asked Schwarzenegger to call a special mid-year budget session to tackle the problem in December, before Brown takes office.

"Delaying action only makes the problem more difficult to solve," he wrote to the outgoing governor. "As you know, it is imperative that we take immediate action to comprehensively fix the state's budget problem."

Senate President Pro Tem Darrell Steinberg used the LAO announcement to call for an overhaul of state government that makes cities and counties more responsible for funding services they provide.

"The LAO forecast is sobering, but we have been through worse," Steinberg said. "It's time to shake things up."
Democrats won some flexibility at the November ballot in Proposition 25, which allows them to pass a spending plan on a majority vote. Yet they still need a two-thirds supermajority to approve taxes. Voters also put two new restrictions on the Legislature's budgeting powers: state leaders cannot take funds from local government accounts, nor can they pass fees or certain tax maneuvers on a majority vote.

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