State leaders on Wednesday called for "an honest dialogue" about closing California's spending gap amid news that next year's budget will contain nearly a $10 billion deficit.

That figure is more than the state spent this year on the University of California and California State University systems combined.

In releasing her five-year fiscal outlook Wednesday, Legislative Analyst Elizabeth Hill said lawmakers face tough decisions for the fiscal year that begins July 1.

"All the easy solutions are gone," she said.

Hill, the state's top budget analyst, called for immediate cuts to "double up" savings for the current and upcoming fiscal years. She also offered solutions certain to meet political opposition, including raising taxes.

Her projections were worse than previously stated by the Schwarzenegger administration, which pegged the shortfall at $6 billion. Hill said the deficit has increased due to growing government expenses that have outpaced revenues in an economy weakened by the real estate slump.

In recent years, a strong economy and a surge in personal income taxes had brought extra cash to state coffers, helping to mask the imbalance. State spending is projected to increase 7 percent next year while revenue will grow only 4 percent.

Gone are days of double-digit growth in corporate earnings, Hill said. About the only good news, she said, is the state isn't heading into a recession.

Assemblyman Roger Niello, R-Fair Oaks, vice chairman of the Assembly Budget Committee, called the forecast a wake-up call for lawmakers.

"We cannot continue to put off the tough decisions required to get our fiscal house in order without facing serious consequences for our state," Niello said.

Senate President Pro Tem Don Perata, D-Oakland, said in a statement the governor and lawmakers should begin "an honest dialogue" that "must include exploring all options."

Hill echoed that sentiment: "We've always said spending and revenues should be on the table."
The Senate budget committee is expected to review the report later this month.

Gov. Arnold Schwarzenegger has focused his efforts on cutting costs. He recently ordered all departments to prepare spending plans that are 10 percent less than what they had anticipated.

In a statement, Schwarzenegger said, "I have not made any final decisions yet, but it's clear that the decisions that will be involved will be tough."

The state in August passed a $102 billion general fund spending plan that contained a $4 billion reserve. But lower tax and property revenues, a legal settlement to repay retired schoolteachers, a pay increase for prison guards and the unexpectedly high cost of fighting wildfires have already begun to erode that safety net.

Hill's forecast predicted the state will be $1.8 billion in the hole by next June. Absent change, the gap between revenues and expenses will increase by $8 billion in the 2008-09 fiscal year, bringing the total deficit to $9.8 billion.

Hill said the state's structural imbalance has been around for years – a challenge state leaders have failed to address.

"We've been facing a problem every year since 2001-02," Hill said. "And when you look out to 2012-13, we still do not have our expenditures and revenues in line."

The state has confronted bigger fiscal crises before. In 2003-04, lawmakers were facing gaps as big as $38 billion. The state resorted to borrowing, which Hill said is exacerbating the current problem because cash is going to debt payments.

All this will likely impact key services, such as schools, public transportation and social services.

The report suggested saving $250 million by suspending a cost-of-living increase scheduled to go into effect in June for the aged, blind and disabled poor receiving Supplemental Security Income/State Supplementary Program benefits.

Schwarzenegger also has the authority to delay $1.6 billion in debt payment, according to the report. The suggestion was made during the 2007-08 budget negotiations, but the governor opted against it.

In the current fiscal year, state revenues are $1.1 billion below forecast, according to the latest financial bulletin. Finance Department officials attributed the decline largely due to the weakened real estate market.

Besides a surge in foreclosures, the Finance Department reported that the median price of homes sold in September fell 10 percent from August – "the steepest one-month decline on record."

According to the legislative analyst's report, a drop in local property tax revenue will place an extra burden on the state general fund. Because property taxes help offset education expenses, the state will have to contribute $1 billion more to fund Proposition 98, the state law guaranteeing schools a minimum level of funding.
Other factors driving down revenue forecasts include a delayed sale of EdFund, the state's student loan guarantee program.

And instead of pulling in $1 billion, as the budget assumes, the analyst now assumes the state will receive just $500 million from the sale.

Palmer, the governor's spokesman, disagreed with that estimate.

"We still believe in the $1 billion figure," Palmer said.

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**Bigger budget problem**
A budget report released Wednesday forecasts a $9.8 billion deficit in the upcoming fiscal year.

<table>
<thead>
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<th><strong>2008-09 general fund</strong></th>
<th><strong>BILLIONS</strong></th>
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<tbody>
<tr>
<td>Balance from prior year</td>
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<tr>
<td>Revenues</td>
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<td>Expenditures</td>
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<td>Future spending commitments</td>
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<td><strong>Total needed:</strong></td>
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Forecast deficit **$9.8 billion**

Source: Legislative Analyst's Office Sacramento Bee

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**FACTORS IN THE SHORTFALL**

• California's housing slowdown

• Costs from the recent wildfires in Southern California

• Pay hike for prison guards

• Inability to sell EdFund this fiscal year

• Lower property tax revenues