California may run out of cash by August

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Published 12:46 am PDT Tuesday, May 6, 2008

California is facing a cash crisis this summer, putting pressure on elected officials to submit an on-time state budget or risk asking taxpayers to pay a premium on loans.

In the past, the state has been able to pay its bills despite projected deficits by borrowing money internally from some state special funds and by selling short-term notes on Wall Street.

But a lack of cash reserves this year combined with lagging revenues has led officials to predict that the state will run out of cash as early as August, giving lawmakers a smaller-than-expected window to strike a budget deal.

Without a budget in place, the state would have to borrow money from banks at higher interest rates than those they can secure with internal borrowing. Such a move also could negatively affect the state's credit rating, making future borrowing even more expensive.

"In essence, it's taking a subprime loan for the state, and it comes with greater costs," said state Controller John Chiang.

In separate interviews, Chiang and Treasurer Bill Lockyer, who respectively act as the state's chief financial officer and banker, said they are closely monitoring the situation and have been pressuring lawmakers and Gov. Arnold Schwarzenegger to quickly work out the budget shortfall, which the governor now estimates to be as much as $20 billion – or one-fifth of the general fund – for the new fiscal year.

Unlike last year, when the state started with a $10 billion reserve, finance officials say California begins planning for the 2008-09 fiscal year with far less cash on hand.

Chiang said state accounts continue to deteriorate as a result of housing and stock market losses. Those factors, coupled with continued growth in state spending, would trigger a cash shortage.

The Schwarzenegger administration confirmed the controller's concerns.

"If revenues drop further, the state may run out of cash sooner," said Schwarzenegger's finance spokesman, H.D. Palmer.

California's credit rating is already among the lowest of state governments. When the state took out an $11 billion loan from Wall Street during the 2003 budget crisis,
taxpayers wound up paying the loan with interest – plus an $84 million fee for the cost of borrowing from investment firms.

The Treasurer's Office estimated that a similar short-term loan today could easily cost taxpayers more than $100 million – enough to educate more than 8,300 students for a year.

"We really do need to have a budget developed as soon as possible – and hopefully a gimmick-free budget," Lockyer said.

State officials have already averted one cash crisis this year. The governor declared a fiscal emergency in January when it looked like the state would run low on cash in March.

Schwarzenegger and the Legislature approved about $7 billion worth of emergency measures, including the sale of pre-approved bonds for a quick cash injection.

Lockyer said the state doesn't have "easy things like that" in its arsenal anymore.

The Legislature has a June 15 constitutional deadline for approving a budget. But missing that deadline is nearly an annual rite.

The state went for two months without a budget last year, when Republican lawmakers demanded additional spending cuts and restrictions on environmental lawsuits. The stalemate resulted in delayed payments to vendors, contractors, health care providers and local governments.

If it happens again, the state could skip out on $5.5 billion in bills due in the first three months of the new fiscal year, according to the Treasurer's Office. The state could be required to pay that back with interest.

Most state workers, however, would still get their paychecks under prior labor rulings.

During the marathon budget standoff between former Gov. Pete Wilson and the Legislature in the early 1990s, tens of thousands of employees received IOUs for two months instead of paychecks.

Employee groups sued, resulting in a court decision heavily restricting the use of IOUs. State workers wound up receiving as many as seven days' worth of paid time off as compensation from being inconvenienced by the delay.

Wilson ultimately closed a $14 billion deficit with a blend of tax hikes and spending cuts.