State budget: Revenues fall -- projected deficit soars

By Judy Lin - Bee Capitol Bureau
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Just weeks after lawmakers enacted a state budget amid partisan turmoil, finance officials say revenues are slipping below projections, making it likely that next year's problem will be worse than expected.

Based on major tax receipts collected in the first two months of the new fiscal year, California could face a $8.6 billion operating deficit or more in 2008-09 if the state's economy and soft housing market continue at the current pace. That would be 40 percent higher than the $6.1 billion gap officials anticipated in August.

"It's fair to say the revenue situation is not going to be as good as we had hoped," Finance Director Mike Genest said in a recent interview. "It's likely the $6.1 billion (projected operating deficit) will be higher."

What's more, several of the assumptions that went into the current $102 billion spending plan -- such as a $1 billion sale of EdFund -- are considered shaky. A Department of Finance memo listed several "threats" to the budget, including the sale of the state's student loan guarantor, which it acknowledges "could slip" beyond this fiscal year.

The sale of EdFund is among over a dozen issues and lawsuits that could easily wipe out the state's $4.1 billion reserve projected when the budget was approved. Already, the state has had to dip into the reserve to repay $500 million for a court judgment over a supplemental fund for 63,000 retired schoolteachers.

"It's going to be a much more challenging situation than they anticipated -- and they had anticipated the challenge," said Stephen Levy, director of the Center for Continuing Study of the California Economy in Palo Alto.

State departments have been told to propose no new spending next year unless they cut a like amount from an existing program.

In the fiscal year that closed June 30, the state fell $821 million below what it had anticipated to collect from its three major taxes -- personal income, sales, and corporate -- than it had projected just six weeks earlier.

The trend appears to be continuing. During July and August, the state fell $308 million below forecast in those three taxes.

If receipts continue to fall below what the state anticipated for the rest of the year, California could come up $2.5 billion below what was projected based on averaging the tax receipts from the last five months available.

"I'm not going to tell you that you would be wrong," Genest said of the projection. However, the Finance Department won't be announcing new projections until January, when the governor releases his new budget proposal.

Assemblyman John Laird, who chairs the Assembly Budget Committee, said projections in the last three budget years have been worse than reality.
"You always have to be a little nervous, but it's too early to tell," Laird said.

He said the state has always had one-time payments, including capital gains windfalls or leftover money from the previous cycle. Still, the Democrat from Santa Cruz said he would like to address "swings in revenues."

"This is an argument for major reform that would end the volatility we have now," Laird said. "We need to do that or we will be doing strange things at every swing of the economy."

Levy, whose private research group assesses demographic trends in California, said the state should anticipate less revenue given the state's economic forecast.

For one, job growth in California is barely half of the 1.5 percent the state had projected.

And, Levy added, the soft housing market continues to have a ripple effect on the state treasury.

While property tax goes directly to local governments, the money is counted against the state's share of school funding under a complex formula set by Proposition 98. If property taxes local government generates declines, the state shoulders a bigger burden to fund K-14 schools.

Property taxes aren't expected to be as robust this year, particularly in places like Sacramento, as homes stop appreciating and sales weaken. Forecasters recently predicted the housing market won't begin to recover until 2009, and a recession could quickly delay that recovery by more than a year.

There's even a possibility that homeowners in the Central Valley -- where home prices have dropped -- will seek reassessments on their homes in an effort to pay less property tax.

"If a house down the block just sold for $100,000 less than yours, you'd want a reassessment," Levy said.

All this means Schwarzenegger and lawmakers will likely face more budget cuts.

"It's going to be much harder next year," Levy said.