When Gov. Arnold Schwarzenegger's budget office reported last week that revenue is running $1.2 billion below estimates for the current fiscal year, it added fuel to one of the Capitol's biggest guessing games: How large is the state budget deficit?

These are the numbers: In January, Schwarzenegger said the gap for the remaining six months of the 2007-08 fiscal year and all of the 2008-09 budget was $14.5 billion. The Legislature's budget analyst, Elizabeth Hill, citing revenue projections, jumped the number to $16 billion. The administration informally agreed with Hill's higher number, and the $1.2 billion shortfall revealed last week, budget experts agree, validated her $16 billion figure.

Because the state also had a potential cash flow problem, the governor and lawmakers quickly agreed to some midyear corrections to improve cash flow, including borrowing the last $3.3 billion from a 2004 deficit-financing bond issue, reducing some spending and postponing some payments. The effect of those changes, the Department of Finance calculates, is to reduce the deficit – whatever it may be – by $7 billion. So at the moment, the remaining gap is approximately $9 billion.

To put the $9 billion in perspective, it's about 9 percent of annual general fund spending and roughly what's spent each year on prisons or higher education. Covering it with new revenue would require raising sales taxes by about 1.5 cents per dollar of sales (31 percent), or income taxes by 16 percent.

The $9 billion figure, however, is very problematic. As the state's economy continues to slide into what every major economist says will be a recession and revenue continues to flatten, there's a widespread belief that the deficit will grow even larger. How much is very uncertain.

The Capitol has seethed with competing deficit-closing proposals, ranging from the across-the-board spending cuts that Schwarzenegger proposes but has semi-disavowed, to up-front increases in general taxes and closure of tax loopholes, which the governor has said he's willing to discuss. Hill's alternative budget proposes a combination of spending reductions and loophole closures.

There has been, however, almost no face-to-face engagement on how to deal with the deficit, even as the taxes-vs.-spending-cuts debate rages outside the Capitol in
demonstrations, ad campaigns and other forms of political persuasion by affected groups. One reason for the political stall is that no one really knows how big the problem could be.

As the Department of Finance revenue report was being released last Tuesday, Schwarzenegger was conducting one of his budget-related "town hall" meetings in Salinas. When asked about the deficit, replied that "we're talking here about $17.5, $18 billion of deficit."

Aides said later that Schwarzenegger misspoke and that at the moment, the $16 billion figure remains intact – reduced to about $9 billion by the midyear corrections – pending new calculations for the "May revise" of the budget.

It's entirely possible, however, that his gaffe was prescient, because no one would be surprised if the deficit grows by a couple of billion dollars. In fact, Capitol politicians would consider themselves lucky if it expanded by only that much. No one really knows how serious the looming recession will be, and the state's convoluted tax system is inordinately sensitive to even a mild economic downturn.

Two-thirds of the revenue shortfall so far this year has been in corporate income taxes, which may be a harbinger of worse times to come. Another ominous omen is Friday's news that the state's unemployment rate has spiked to 6.2 percent, third highest of any state.

California and its politicians are looking for a bottom, and haven't found it yet.