When Gov. Arnold Schwarzenegger finally signed a record-late budget in September, it was evident to anyone with a brain that it was bound to collapse.

Although loaded with gimmicks of dubious validity, its main deficiency was assuming revenues based on an outdated, relatively rosy economic forecast that was self-evidently invalid, given the state's continued economic deterioration.

Very soon, the state was acknowledging that revenues were falling short as it sought investors for billions of dollars in short-term notes, pegging the shortfall at $3 billion for the year.

Even that number, however, evidently low-balled the precarious fiscal situation, because buried in the loan documents was a list of potential problems adding up to $5.5 billion. And now, Schwarzenegger et al. are acknowledging that the state has an immense budget hole, perhaps $10 billion or more.

Were they being duplicitous – consciously minimizing the problem to obtain lenders for the cash-flow loans they desperately needed – or merely dumb? If it's the former, they'd never admit it. It's bad form – and legally perilous – to mislead lenders.

It's even possible that underwriters of the "revenue anticipation notes" knew the shortfall number was bogus but accepted it because the state was willing to pay them hundreds of millions of dollars in extra interest earnings.

So officials are adopting what one might call a limited-hangout posture – that when they made their initial deficit estimate a month or so ago, they based it on straight-line projections of revenue shortfalls to date, but that a more sophisticated analysis of the revenue data after $5 billion in notes had been sold tripled the projected gap.

That's their story, anyway, and they're sticking to it. Regardless, the new deficit numbers will make it very difficult, perhaps impossible, for the state to peddle the remaining $2 billion in notes unless Schwarzenegger and the Legislature enact an emergency budget fix, presumably sharp cuts in spending and/or new revenues.
The Legislature will return to the Capitol this week for a lame-duck session. The governor has signaled that he wants hefty reductions in major spending areas, including education and health and welfare services, and will renew his plea for some kind of temporary tax increase, most likely a sales tax boost. The goal appears to be to cover half of the new deficit with spending cuts and half with revenues.

Whether he can win enough legislative votes for such a package is very uncertain, given the two-thirds vote requirement and seeming Republican intransigence on taxes. But the GOP may lose quite a few legislative seats on Tuesday, which could affect the gestalt.

Underlying everything is a sneaking hunch that the bad news may get worse as the economy continues to deteriorate and that even a $10 billion deficit could grow to $15 billion or beyond – not to mention what the 2009-10 fiscal year will bring.