CALIFORNIA

Higher tax revenue eases deficit

But budget analyst warns of need for long-term solution

- Lynda Gledhill, Chronicle Sacramento Bureau
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Sacramento -- A brisk increase in tax payments is expected to give the state $2.2 billion in unexpected revenue this year, but even with that windfall lawmakers must make difficult -- and lasting -- budget adjustments to avoid spiraling deficits years into the future, the state's nonpartisan budget analyst said Tuesday.

The new revenue comes largely from increased corporate capital gains, Elizabeth Hill said, and it bodes well for the state's fiscal outlook. Still, the gap between the state's spending and income remains large, and lawmakers have to find at least $4 billion in cuts or revenue increases to balance the budget next year and have manageable deficits in the future, she said.

"This is an opportunity for the Legislature to use healthy revenues and make the ongoing solutions of the magnitude outlined in the budget plan in order to well position the state in terms of getting its fiscal house in order, " said Hill, who advises lawmakers on fiscal matters and is widely respected for her nonpartisan views.

If lawmakers do not make significant cuts in the next budget, she warned, the state will be in for years more of deficits close to $10 billion starting in 2006-07 and continuing for at least two more years.

"The price of inaction is dramatic," she said.

Gov. Arnold Schwarzenegger proposed a general fund budget of $85.7 billion in January that does not raise taxes. The spending plan eliminates cost-of-living increases for the disabled, slashes welfare for families and withholds from K-12 education more than $1 billion it is owed this year.

The governor also relies on borrowing from transportation accounts and deficit bonds that voters approved last year to help close the budget gap.

Democratic lawmakers have made it clear they oppose many of the cuts proposed by Schwarzenegger.

"We're not going to balance this budget on the backs of the people who most depend on state services, such as the disabled," said Senate Budget Committee chair Wes Chesbro, D-Arcata (Humboldt County). But he acknowledged that lawmakers cannot simply spend the new revenue without worrying about the future.

Vince Sollitto, a spokesman for the governor, said the new numbers were encouraging and would be updated again when the governor presents his revised budget in May.

"We shouldn't think the added revenue removes the need for savings and reforms in the current budget," he cautioned.

Education officials have been attacking the governor for not giving schools money from the extra revenue that is coming in this year. If lawmakers decide to give schools that money, including a portion of the new revenue Hill outlined, that would provide less money to the state budget for other programs, or to help close the budget gap.

State Treasurer Phil Angelides, a likely candidate for governor in 2006, said the legislative analyst's report underscored that Schwarzenegger was breaking his campaign promise to "tear up the credit card" by relying on $3.5 billion in new borrowing to balance the budget for the fiscal year starting July 1.

"Sadly, the budget fails to meet the test of being balanced and being balanced in a way that protects the future of California," Angelides said.

He advocates closing the budget gap by closing corporate tax loopholes and increasing the state's personal income tax to the rate that was in effect when Republican Gov. Pete Wilson was in office. A bill by Assemblywoman Wilma Chan, D-Oakland, proposes doing that by taxing income earned over $277,132 at 11 percent and over $138,566 at 10 percent. The maximum tax rate now is 9.3 percent.

Hill criticized many of the governor's proposed long-term reforms, including an across-the-board spending cut and changes to how education and transportation are funded. The across-the-board cut would require the controller to automatically cut state spending if expenditures outpace revenues and lawmakers cannot agree on a budget solution. The automatic cuts could also take place twice more during the year.

"It is really important to look at the tools the Legislature and the governor have available to them to balance the budget," she said. "We're concerned that the budget reforms put forward make the problem worse rather than better. A number of the governor's proposals put more spending on auto- pilot."

Schwarzenegger has also proposed changing Proposition 98, which sets minimum funding for schools, so that lawmakers could no longer give schools less in difficult budget years. Hill said that idea would take away from lawmakers a key tool they have used in the past to balance the budget. Prop. 98 makes up about 45 percent of the state's general fund revenue.

Angelides attacked Schwarzenegger's automatic spending cut plan as a gimmick that would worsen California's budget problem.

But Sollitto said the primary purpose of the budget control proposal was to force lawmakers and the governor to work together.

"We want to stabilize the state's finances and force the government to live within its means," he said.