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Editorial: Crisis demands action on several fronts

Legislators must put differences aside to bridge fiscal chasm

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One of the great fallacies of California's deepening budget disaster is that "spending is out of control."

You hear this mantra from anti-tax groups, conservative pundits and Republican legislators. Until recently, it was a sound bite that Gov. Arnold Schwarzenegger repeated widely.

But if you examine the chart above, based on numbers from the nonpartisan Legislative Analyst's Office, you'll see that per-capita spending in California hasn't risen this decade, adjusted for inflation.

Sure, overall spending in the general fund has risen – from about \$58 billion in fiscal year 1999 to \$103 billion last year. But during that same time, California's population has added 5.3 million people, and the cost of living – housing, food, fuel, etc. – has also increased.

As a result, real per-capita spending in California is now at \$2,690 per person – the same as it was in 1999. Not only that, but real per-person expenditures are expected to drop sharply – the question is how sharply – as lawmakers slash programs to close a \$11.3 billion shortfall in the current fiscal year.

Now that the LAO figures have set the record straight, lawmakers of both parties should honestly debate the bottom line.

In other words, what level of state spending is needed, in the midst of an epic revenue decline, to adequately run the state's public schools, operate its universities, protect public safety and provide a safety net for the poor, the elderly and the disabled?

Once they've come up with a spending plan that meets federal mandates, court orders and some semblance of humanity, they can discuss ways to adequately finance it in the least damaging way to the state's economy.

GOP's no-tax pledge

Currently, such discussions are strangled by the no-tax pledges signed by Republican lawmakers, whose votes are needed for a budget. Republicans insist that tax hikes will delay recovery of the economy, and on that score, they are right. As Legislative Analyst Mac Taylor acknowledged last week, any form of tax increase will have a negative impact.

The trouble is, Republicans refuse to recognize the flip side of Taylor's argument – that cuts in state expenditures will also hurt the economy. That's why the legislative analyst recommended a mix of spending reductions and revenue increases to close a gap that could grow ever larger. "The foremost concern must remain a permanent fix to the state's budget ills," Taylor said in his report.

Do Republican legislators have a cuts-only way to close an \$11.3 billion shortfall? And could they publicly float such a plan without angering parents, teachers, cops and other interest groups that might work to throw GOP lawmakers out of office?

We doubt it. Republicans couldn't produce such a plan earlier this year when faced with a smaller shortfall, and they can't produce one now. Aside from raising taxes, their only alternative is gimmicks – more borrowing or raiding of funds, such as those controlled by local governments.

Democrats pander to labor

For their part, Democrats are stubbornly opposed to any cuts in the state work force, which does little to bring their GOP counterparts to the table. Where Schwarzenegger hopes to save \$263 million this year and \$451 million next year by requiring one-day-a-month furloughs for state workers, leading Democrats are claiming that furloughs should be done only through the collective bargaining process.

That's bunk. In this type of emergency, lawmakers and the governor have the authority to enact furloughs, and they need to do it immediately to realize savings in the current fiscal year. Failure to do so could prompt the governor to consider layoffs of state employees. Intransigence by Democrats will also make it harder for Republicans to give on tax hikes, leading the Golden State closer to the brink.

Threat of insolvency

As we noted in an editorial Tuesday, the threat of insolvency is real. California needs to sell \$2 billion in revenue anticipation notes by February to maintain its cash flow. To sell these notes, it needs to adopt a midyear budget that gives creditors some confidence their loans will be repaid.

Without that confidence, California will run out of money and will be unable to sell bonds for all kinds of infrastructure – including projects that generate jobs.

To prevent this crisis from becoming a catastrophe, lawmakers need to take these actions:

A balanced tax hike

Schwarzenegger has proposed a temporary 1.5 cent sales tax increase to close much of the budget gap. Yet as the legislative analyst has noted, such a hike would give California an average sales tax rate (state and local) of 9.5 percent – the highest in the country. Consumers would likely reduce their spending or make more purchases outside of the state.

As an alternative, the legislative analyst suggests a smaller sales tax hike and a temporary 5 percent surcharge in personal income taxes. Such a hike would add to the volatility of state revenues, but it would only be temporary. It also would be less regressive and have less impact on consumer spending than a sales tax increase.

Schwarzenegger has also proposed an oil severance tax, a broadening of the sales tax to include some services, and higher alcohol taxes. To his credit, he says he's also willing to discuss other options – including restoring the vehicle license fee, a revenue source that could blunt potential cuts to public safety or other local priorities.

Deep spending cuts

Given that the state could face revenue shortfalls for five years or more, there's no way of avoiding further cuts to state programs, including some that are helping Californians cope with the economic downturn.

Schwarzenegger has proposed \$4.5 billion in reductions in this special session, on top of cuts already made. Many of the cuts would come from education, which consumes most of the state's general fund spending.

In his report, the legislative analyst recommended several ways for lawmakers to enact cuts with the least possible disruption of schools already in session. They include elimination of some "categorical programs" – counseling and teacher professional development – that aren't as vital as instruction.

Revamping for the long term

The governor and lawmakers have created a commission to examine California's tax structure and revamp it for the modern economy. Introducing taxes to service industries, and reducing them for basic goods, are steps that are long overdue. If structured properly, such revisions could smooth out overall tax revenues that now fluctuate wildly.

Incoming Senate leader Darrell Steinberg is also planning a review of all state government spending, to weed out inefficiencies and outdated programs.

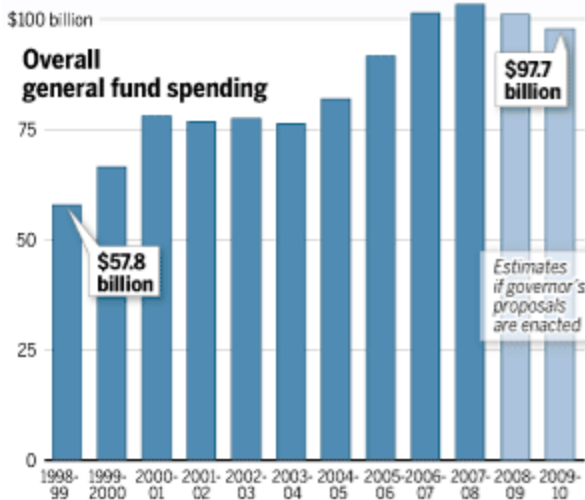
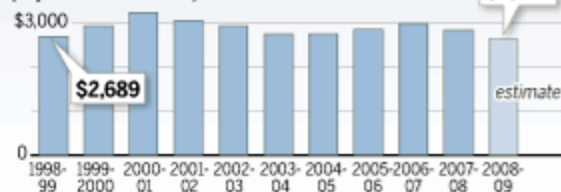
If lawmakers can take real steps to smooth out revenues and better focus the state's limited dollars, California could well be sipping lemonade in five years, after several sour and bitter years. But to get there, much work is ahead, with little time on the clock.

Why California faces a crushing shortfall of revenues

Spending

Republicans often say that government spending in California is "out of control." But adjusted for inflation and population growth, per capita spending has actually remained virtually flat the past decade, and has declined in recent years.

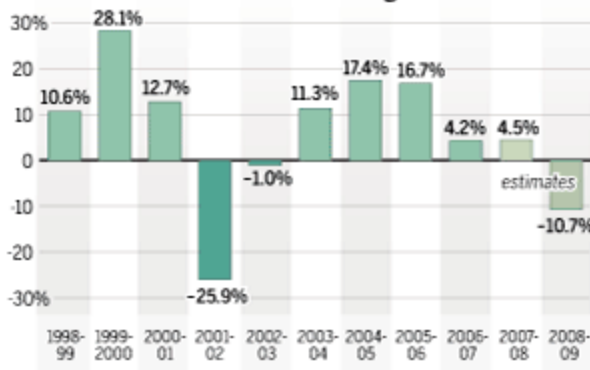
Per capita general fund spending (adjusted for inflation)



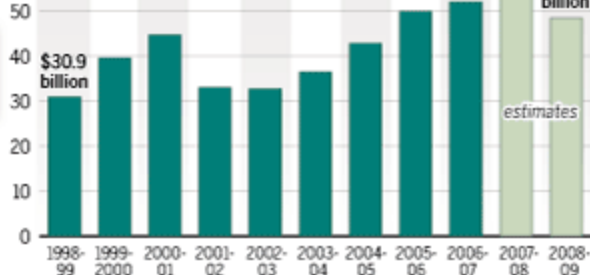
Revenues

Personal income taxes account for slightly more than half of California's general fund revenue. But those tax revenues gyrate wildly. Why? One big reason is the capital gains that Californians earn on investments. With the decline of the stock market, those revenues have dropped sharply.

Personal income tax revenue change



Personal income tax revenues



Shortfalls

The state faces at least an \$11.3 billion shortfall in the current fiscal year. Without action by lawmakers, those shortfalls are expected to grow to more than \$20 billion in coming years.

Projected shortfalls if no legislative action is taken

