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Legislative analyst sees state finances as 'truly awful'

By Kevin Yamamura

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California will face massive budget shortfalls through at least 2014 without immediate action by lawmakers and Gov. Arnold Schwarzenegger, the Legislature's nonpartisan budget analyst said Tuesday.

In the midst of high unemployment, shaky consumer confidence and plummeting investments, the state needs a slew of tax increases and spending cuts to resolve a \$27.8 billion problem over the next 20 months, Legislative Analyst Mac Taylor said. Those budgetary actions also would help narrow annual deficits of about \$22 billion in subsequent years.

While California faced a larger budget gap in 2002-03 under then-Gov. Gray Davis, Taylor said the longer projected duration of the state's current budget problems is more daunting.

"The numbers are just truly awful," Taylor said. "It may be as dire a situation as I've seen in my time in the office. And as a result, we are recommending to our bosses it is just imperative that they act quickly and aggressively to address this problem."

Taylor's shortfall estimate of \$27.8 billion is greater than the \$24.2 billion figure the governor cited last week. But the legislative analyst said the governor's proposal, with its extensive cuts and tax increases, is reasonable and ambitious.

He also disputed claims that the budget gap can be bridged by cuts or taxes alone. He noted his office until now has proposed ways to balance the budget without new tax increases, but said that is now impossible.

"I think the magnitude of the problem has now reached such a level that we're not clear on how you could possibly do it on one side or the other," Taylor said.

He acknowledged concerns raised by Republicans that taxes would hurt an already struggling economy, though he suggested the state's greatest concern should be finding a permanent solution to its budget problems.

"Because the state's economy totals more than \$1.7 trillion in economic activity each year ... spending reductions or tax increases totaling between \$20 billion and \$30 billion would have a relatively small impact on the overall economy," he wrote.

Assembly Republican leader Mike Villines said he thought it was a "pretty good blueprint" and that he agreed on spending cuts embraced by the Legislative Analyst's Office report. But he disputed whether the tax proposals would bring in as much money as projected, suggesting that taxes instead hurt revenues.

"I think he makes some assumptions on taxes that certain revenues will come in that data has shown doesn't typically happen," Villines said.

The four legislative leaders, along with Senate President Pro Tem-elect Darrell Steinberg, met with Schwarzenegger for more than two hours Tuesday.

Republicans have voiced strong opposition to the governor's plan to raise the state sales tax 1.5 cents and impose new taxes on services from golf to appliance repair. But Senate Republican Leader Dave Cogdill seemed to relax that view, albeit slightly, after Tuesday's meeting. "Our goal is certainly to find a way to do it without raising taxes if we can do that, certainly," he said.

Steinberg and Cogdill expressed cautious optimism, and all of the leaders plan to resume talks Thursday.

"Everyone has been steeled by the LAO report today," Steinberg said. "The gravity of the problem here in California is very, very serious."

Assembly Speaker Karen Bass said Tuesday that the state's problems are so dramatic that California needs federal stimulus money. Taylor said there is a "good chance" such relief could come, though he warned it might only be \$2 billion to \$3 billion.

Even under an assumption that the economy will rebound in late 2009, the state would face annual deficits of roughly \$22 billion for four years starting in 2010-11, Taylor said.

If the governor's proposal takes effect, the state would still face deficits between \$9 billion and \$11 billion beginning in 2011-12, largely because the temporary three-year sales tax hike would have ended in 2011.

The LAO report suggested changes to the governor's plan. While Schwarzenegger proposed a \$2.5 billion mid-year cut in education spending, the legislative analyst said the reduction should be just \$1 billion because school districts already have locked in yearlong decisions on staff and class size. The report suggested eliminating school cost-of-living adjustments while suspending professional development fees and raising community college fees.

The report also recommended that the Legislature consider a 1-cent sales tax hike rather than a 1.5-cent increase, which it said would give California the highest average U.S. sales tax rate at 9.5 percent.

It also suggested increasing the state's vehicle license fee from its current 0.65 percent rate to 1 percent, the same rate used for other property.

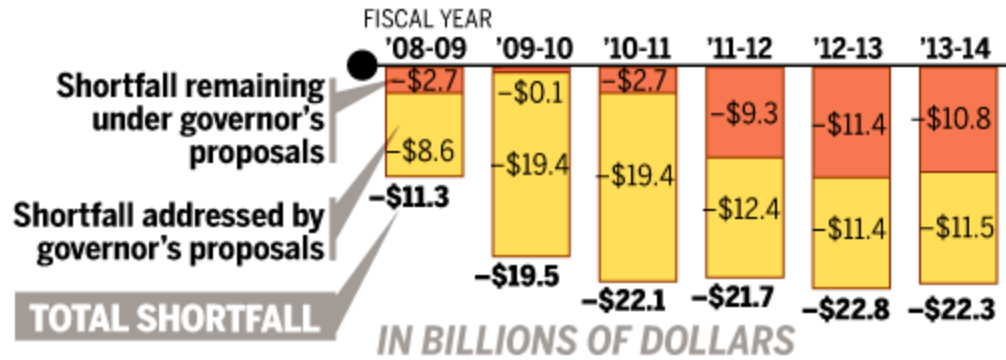
And Taylor warned about imposing taxes on services without serious consideration about which ones to tax. He said that would break new ground, and the idea warrants more extensive deliberation.



Legislative Analyst Mac Taylor said Tuesday the governor's plan for spending cuts and tax hikes is reasonable for dealing with the state's \$27.8 billion shortfall.

TAKING AIM AT THE GAP

The governor's latest budget proposals would lower the state's budget deficit through 2011, but shortfalls would increase when proposed sales tax hikes expired.



Source: Legislative Analyst's Office

NAM NGUYEN nnguyen@sacbee.com