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## Dan Walters: Could California budget gap get wider?

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Gov. Arnold Schwarzenegger and state legislators are searching – so far, in vain – for a solution to the whopping budget deficit that can pass political muster inside and outside the Capitol.

Lurking in the shadows, however, is fear that California's troubled economy could become even worse than current forecasts indicate and thus add billions more dollars to the budget gap.

The sharp spike in unemployment to 6.8 percent reported last week, coupled with dark numbers on other economic indicators, intensifies that fear. But leading economists disagree on whether California is seeing a bottom to its economic woes, whose proximate cause is the residential real estate collapse, or the worst is yet to come.

UCLA's Anderson Forecast last week adopted a cautiously optimistic tone, with leading economist Jerry Nickelsburg concluding that, as the Anderson summary put it, "California's service sectors, the state's traditional economic engines of growth, are still sidestepping the turbulence in the financial, construction and real estate sectors, keeping California's employment growth positive."

Nickelsburg also noted that exports and agriculture, which recently had been somewhat stagnant, "are now providing enough additional positive data to also offset the sharp declines in home construction and real estate." But Anderson also "predicts a very weak economy throughout 2008."

UCLA's macro view is similar to that of Schwarzenegger's latest budget. But Nickelsburg's colleagues at UC Santa Barbara's Economic Forecast Project have a more sour take. Project director William Watkins and his staff unveiled a new forecast in Sacramento on Tuesday that sees California's recession lasting well into 2009, at least.

"Overall, California's economy looks pretty weak," the UC Santa Barbara survey declares. "Much of the state is losing jobs. The real estate market is in meltdown. Retail sales are collapsing. Tourism has been surprisingly weak. The public sector will decline. The state has no budget, and policy makers have no idea how to create one. We see little reason to be optimistic about California's economy."

Watkins noted that the state is seeing "almost zero" job growth even though the pool of job-seekers has expanded sharply, in part, he believes, because stressed-out families seek more income to offset rising housing, fuel and food costs.

The housing meltdown is having both direct negative impacts – fewer construction jobs, declining purchases of building materials, furniture, and so on – and indirect ones. Even Californians whose incomes have remained steady must face rising prices and, if they're homeowners, are seeing personal wealth in the form of home equity decline, so are cutting consumer purchases.

The economic malaise affects income, sales and property taxes – the latter because of construction slowdowns and declines in taxable values due to market declines – and thus exacerbates the budget deficit.

Roughly speaking, the state has a "structural deficit" – a semipermanent imbalance between income and outgo – of around \$8 billion a year. The economic downturn has doubled it. The official estimate is that the 2008-09 fiscal year budget has a \$15.2 billion gap to be closed. But if the economy continues to slide, it will grow larger.

So far, Democrats have proposed unspecified new taxes in varying amounts ranging up to \$11.5 billion, which Republicans flatly reject. Schwarzenegger proposes to borrow against the state lottery to cover about a third of the deficit and cut spending, tap special funds and use accounting gimmicks to cover the remainder without broad new taxes.

Whether middle ground can be found is still very problematic, and the possibility that it could get worse compounds the uncertainty.

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