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## Dan Walters: Proposal to raise California taxes falls way short

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The state's whopping budget deficit is obviously a huge political headache for Gov. Arnold Schwarzenegger and legislators, and it shows no signs of being resolved quickly. But it's also an object lesson in unintended consequences.

The centerpiece of Schwarzenegger's scheme to handle the \$15.2 billion deficit is borrowing \$18.4 billion against future state lottery profits and using \$5 billion of the loan to close about one-third of the gap. Another \$10 billion from the lottery loan would be held in reserve. The governor wants to place the lottery loan before voters on the November ballot with a standby 1-cent increase in the sales tax that could be triggered if voters reject the plan.

Polls, however, indicate that "securitizing" the lottery is a hard sell, so it may be a political chess move – a way for Schwarzenegger to indirectly impose a \$6 billion-per-year sales tax boost without leaving his fingerprints. But if the Legislature agreed and voters did, in fact, reject it – or opponents were to tie it up in court – the alternative sales tax may not be the fail-safe backstop the governor and his minions portray it as being.

Elizabeth Hill, the legislative budget analyst, points out that the sales tax could not be triggered until Jan. 1, halfway through the fiscal year, at the earliest, thus generating just \$3 billion, not the full \$5 billion that the lottery loan would provide. And it's possible that the tax would be delayed until next spring, cutting its yield even more, although administration officials say they could borrow against the revenue through "revenue anticipation warrants" to keep cash flowing.

Hill cited another wrinkle – and this is where the law of unintended consequences kicks in. Any tax increase triggers a recalculation of state aid to local schools under Proposition 98, the 1988 school finance measure. So roughly half of the \$3 billion from the sales tax would automatically go to schools as additional state aid, Hill says.

The net effect of the backup sales tax could be, therefore, minimal, leaving another huge hole to be filled. Arithmetically, it might take a 3-cent increase in the sales tax – a 50 percent increase in the state's share – to backfill the lottery loan for the 2008-09 fiscal year without borrowing against the tax. And with Republicans vowing to oppose even a 1-cent increase, prospects look very dim.

Hill has proposed a more modest lottery loan plan with a backup sales tax limited to one year that, viewed in historic terms, is quasi-radical change for her office, which has consistently advocated a pay-as-you-go policy, not borrowing.

That change underscores, perhaps, the depth of the current problem, but also highlights an unintended consequence of Proposition 98 – encouraging politicians to borrow rather than impose new taxes when facing deficits.

Since roughly half of new taxes must be channeled to the schools, regardless of their financial condition or other spending needs, any approach to deficit-closing that relies on taxes must be much larger – and therefore much more politically difficult – than it otherwise would be.

Schwarzenegger says the state has a \$15.2 billion deficit. It's about 15 percent of general fund spending. Closing it all with new taxes – unless Proposition 98 were to be suspended – would require \$25 billion to \$30 billion in new levies of some kind. It would be the equivalent of virtually doubling state sales taxes or increasing personal income taxes by about 50 percent.

California's voters, first by mandating two-thirds legislative votes on new taxes with Proposition 13 in 1978, and then guaranteeing schools a hefty share of current revenue and any new taxes with Proposition 98 in 1988, may have made it almost impossible to balance revenue and spending.

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