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# Deficit is clear, remedy is not

## Solutions raise new dilemmas

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It's a deceptively simple problem: Match how much money state government takes in with how much it spends.

But the devil, as the saying goes, is in the details. And if there's one thing California government abounds in, it's devilish details: more than 150 agencies and departments populated by more than 200,000 employees carrying out uncounted programs that serve more than 37 million people.

If you want to pay for all those programs, you have to raise more revenue than the state has now, or is likely to have. Conversely, if you don't want to raise revenue, you have to cut into or abolish many of those programs.

Simple, at least to define. To solve it, however, is a lot more complex.

Depending on whose numbers you use, California is facing a budget deficit of from \$24.2 billion to \$27.8 billion over the next 19 months.

To close the gap, legislators and Gov. Arnold Schwarzenegger are mulling over – and arguing about – a host of possible ways to increase revenue and cut spending.

Here, in nutshell form, are just some of the possibilities and their potential effects.

## CUTTING SPENDING

Schwarzenegger has proposed \$4.5 billion worth of spending cuts in the current budget. About \$3.8 billion of it is in these four areas:

### SCHOOLS

The governor wants to cut about \$2.2 billion from elementary and high schools (about 4.2 percent of their total budget) and about \$300 million from community colleges (5.2

percent of their budget). Schwarzenegger also proposes to relax some state regulations to give local districts more flexibility in making the cuts.

But school officials say it would be nearly impossible to make that deep a cut midway through the school year, because districts already have signed contracts, set staff levels and class size, and started programs.

The Legislative Analyst's Office recommends that the cuts be reduced to \$1 billion by rescinding a small cost-of-living increase for K-12, raising community college per-unit fees from \$20 to \$26, deferring some maintenance and delaying the purchase of some instructional materials.

## **SOCIAL SERVICES**

The governor proposes to cut state grants to the elderly, blind and disabled from \$870 a month to \$830 a month for individuals. He also would reduce grants and eligibility for welfare, and would restrict access to services for shut-ins. That would save \$783 million.

The legislative analyst recommends a less drastic package of about \$250 million in cuts.

## **STATE PAYROLL**

Rather than laying off state workers, Schwarzenegger wants to furlough workers one day a month and take away two of their 13 fixed holidays. That would amount to a 4.6 percent pay cut and save the state \$320 million.

The legislative analyst has no recommendation to counter Schwarzenegger's. But state workers have protested that it's unfair that they would be subject to any tax hikes that are approved and have their salaries cut.

## **LOCAL MASS TRANSIT**

The governor proposes cutting state assistance to local mass transit programs by \$230 million. The Legislative Analyst's Office suggests grabbing revenue not being used by the Department of Motor Vehicles (\$55 million) and redirecting some funds paid by Indian casinos for transportation purposes to the state's general fund (\$62.9 million).

Local transit officials point out that the budget already diverts \$1.7 billion from the state's Public Transportation Account to pay for other programs.

# **RAISING REVENUE**

## **INCREASE SALES TAX**

The governor has proposed raising the state's general sales tax rate of 7.25 percent to 8.75 percent for three years. (That doesn't include local governments' additions, which already bring the total to as much as 9.25 percent in some parts of the state.)

The boost would increase state revenue by an estimated \$10.9 billion over the next 18 months – and would add \$375 to the price of a \$25,000 car.

California has the highest base sales tax rate of any state, according to the Federation of Tax Administrators, and Californians spent \$1,039 per capita in 2005 on state and local sales taxes, according to the National Conference of State Legislatures. That's 13th among 50 states. The sales tax was last increased in 1991, by 1.25 percent.

Proponents of a sales tax hike contend it's the fastest way to raise a significant amount of money. Opponents point out it's a "regressive" tax that hurts poorer taxpayers more because the rate is the same for everyone, meaning it is a higher percentage of their income.

## **EXTEND SALES TAX**

While other states apply their sales taxes to as many as 160 services, California's sales tax applies almost exclusively to "tangible personal property" other than most food and prescription drugs.

Schwarzenegger has proposed extending the sales tax to a range of services and entertainment venues that include veterinary services, vehicle, furniture and appliance repair, and golf courses, sporting events and amusement parks.

The administration estimates that would add about \$1.5 billion to state coffers over the next year and a half.

The proposal not only would give the state more money now, but would soften the blow when the rate increase expired in three years by broadening the sales tax base.

But it also raises a question of fairness: Why golf but not bowling? Why amusement parks and not movies?

## **INCOME TAX SURCHARGE**

As alternatives to the governor's proposals, the nonpartisan Legislative Analyst's Office has suggested other options, including a 5 percent surcharge added to the final liability of income tax payers.

That would raise \$2.25 billion in revenue, and unlike sales taxes, the surcharge could be deducted on federal income tax returns. Since it's based on income, it would fall less on poorer Californians.

But it also could exacerbate the state's over-reliance on a very small percentage of taxpayers to foot a very large percentage of the income tax bill.

## **RAISE THE CAR TAX**

Virtually the first thing Schwarzenegger did when taking office in 2003 was to cut the vehicle license fee (the part of registration fees that's determined by the value of the vehicle) from 2 percent to 0.65 percent. That rolled back the average fee from \$223 to \$73.

The legislative analyst estimates that raising the rate to 1 percent would generate \$1.6 billion in the next fiscal year.

But Schwarzenegger has been leery about rolling back the first promise he kept as governor. Besides, because of a complicated deal worked out with local governments in 2004, the governor would need legislative or voter approval – or both – to restore the rate.

## **CLOSE LOOPHOLES**

In April, the Legislative Analyst's Office produced a list of \$2.7 billion worth of "tax expenditure programs" – a term for tax credits and exemptions – that lawmakers might consider eliminating. For example, reduce the \$294 credit for each dependent child on personal income tax forms to the \$94 that single taxpayers get.

Proponents argue it's unfair to give tax breaks to some, such as the elderly or people with children, without regard to whether they need it or not.

Legislators did close a small \$21 million loophole for buyers of boats, planes and recreational vehicles this year. But Republican legislators so far have balked at closing anything with a larger price tag, contending that cutting a tax break is tantamount to raising a tax.

## **RAID SPECIAL FUNDS**

Over the past 20 years, voters have approved ballot measures that require significant amounts of various tax revenue to be spent only on specific programs, or lock in minimum levels of state spending on specific programs.

These range from 1988's Proposition 98, which locked in about 40 percent of the state's general operating budget for schools, to Propositions 99 (1988) and 10 (1998), which

required nearly \$1 billion a year from cigarette taxes be spent on anti-tobacco education, health care for the poor and early childhood development programs.

Easing the requirements to spend the money only on specific categories would give legislators and the governor more wiggle room in producing a budget each year. But at least some of the changes would require voter approval, which means going back to the ballot at the special election the governor is expected to call for this spring.