



Schwarzenegger budget carries huge risk, analyst says

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Gov. Arnold Schwarzenegger's January budget relies on risky borrowing assumptions, and state leaders must act immediately to avert a "colossal" financial disaster, according to a report issued Thursday by the nonpartisan Legislative Analyst's Office.

Legislative Analyst Mac Taylor said Schwarzenegger's \$40 billion deficit estimate is realistic and the governor put forth a "good faith" effort in his proposal. But Taylor said his plan contains numerous contingencies, such as voter approvals and surviving legal challenges, that could make resolving the budget even more difficult if they do not pan out. The state already faces the likelihood of running out of cash in February, which would require issuing IOUs to state vendors and elected officials, as well as delay tax refunds.

Taylor said the problem is best described as "colossal" - for now.

"In our November report we used words like dire and bleak and awful, and since that time the problem has gotten a lot worse," Taylor said. "So we're kind of running out of adjectives."

Taylor emphasized that Schwarzenegger's budget relies heavily on borrowing to survive the fiscal crisis. The governor depends upon \$6.3 billion in short-term loans so the state can have enough cash to pay its bills and approximately \$5 billion in longer-term notes to solve its budgetary problem in 2009-10. He expects the state to issue \$7 billion in public works bonds. And he relies upon receiving \$5 billion upfront in exchange for giving investors lottery profits in future years, a plan that voters would need to approve.

"There is major uncertainty about the state's ability to access the capital markets for anywhere close to this volume of financing for the next 18 months," the report notes.

Taylor said the governor's reliance on roughly \$5 billion in cash borrowing to plug a budget deficit -- rather than a cash hole -- may be unconstitutional. A 2004 voter-approved measure, Proposition 58, prohibited borrowing for budgetary purposes. Schwarzenegger's proposal would have the state seek a \$5 billion loan this summer with

the anticipation that California would pay it off by 2011 and without an immediate explanation for how to do so.

"We think there are serious legal problems with this proposal," Taylor said. "Proposition 58 that the voters passed a few years back does allow a (loan) to be issued, but we don't think it allows it to be issued to address a portion of your deficit. So that's problematic, to say the least."

Because the governor's budget relies on a lottery plan and various fund shifts that must be approved by voters, the LAO report recommended that the Legislature work immediately to schedule an election earlier than June, which was seen as a possible date for a special election this year. Should voters kill the lottery proposal, an earlier election would give the Legislature more time to make up \$5 billion in anticipated lottery revenues.

The LAO also suggested that the Legislature could use an earlier election to place tax increases on the ballot rather than try to pass a controversial majority-vote plan that faces legal challenges.