

Absent a budget fix, IOUs on the way

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Published Wednesday, Jun. 24, 2009

State controller John Chiang warned today that if legislators and Gov. Arnold Schwarzenegger fail to come up with a budget-balancing package in the next week, he would begin paying California's bills with IOUs on July 2.

The controller's warning came as legislators began what many on both sides of the aisle acknowledged was a rhetorical song-and-dance over closing a \$24 billion deficit that stretches over the fiscal year that ends Tuesday and the one that begins Wednesday.

In the state Senate, Republicans - joined by Democratic Senators Leland Yee of San Francisco and Lou Correa of Santa Ana - blocked a Democratic bill that contained \$11 billion in spending cuts, the first of a 20-bill package aimed at reducing the deficit, which includes a proposed reserve. The bill also failed in the Assembly, which like the Senate recessed until Thursday.

After the vote was announced, Senate President Darrell Steinberg dismissed the body and said it would meet again Thursday morning.

The Democratic plan contains new tax hikes and some accounting legerdemain along with the spending cuts. Republican lawmakers and the governor have said the Democratic plan is dead on arrival, and there were indications Democrats were ready to abandon the tax-hike portion of the plan, possibly in favor of "borrowing" \$1.9 billion from local governments.

While Democrats control majorities in both houses, the package requires a two-thirds approval so it could go into effect immediately. Even then, Schwarzenegger said he would not sign a plan with new taxes, fees and accounting gimmicks, even though he had initially proposed some of them.

"Next Wednesday we start a massively unbalanced spending plan and a cash shortfall not seen since the Great Depression," Chiang said in a news release. "The state's \$2.8 billion cash shortage in July grows to \$6.5 billion in September, and after that we see a double-digit freefall."

Resorting to IOUs -- whose technical name is registered warrants -- would mark only the second time since the 1930s that California has paid its bills that way. The last time was 1992.

Chiang and other state officials had said that the state would first probably resort to delaying payments to vendors, local governments and others of the state's creditors while a budget balancing deal was worked out so the state could borrow money from Wall Street for its cash flow problems.

Both borrowing for cash flow and delaying payments are commonplace. In fact, Chiang delayed payments in February for 30 days while legislators and the governor wrestled with a budget deficit.

But, Chiang said, the current cash shortfall was five times larger than the February hole. Since Gov. Schwarzenegger said last month he would not authorize a form of short-term borrowing through what are called revenue anticipation warrants, Chiang said IOUs were the only option.

A federal court ruled in 1996 that state employees couldn't be paid with IOUs. Others who receive them will draw interest on them, but banks and other financial institutions can refuse to accept them. Chiang said the IOUs would have a maturity date of Oct. 1.

Lawmakers began debate over a Democratic bill that would include some of the \$11 billion in cuts in every major area of state spending from schools to prisons.

Steinberg D-Sacramento, attempted to inject a note of civility into the rhetoric by saying he was proud of past efforts by legislators to solve the state's chronic budget problems.

"I know it's pretty easy sport to bash this institution and criticize it," Steinberg said. "(But) we take rightful pride in the fact that we have avoided economic catastrophe in this state ... we should take pride in that point."

But, Steinberg warned, Democrats would not follow Schwarzenegger's proposals to completely eliminate health insurance programs for children, services to the disabled, cuts in welfare-to-work and college tuition aid to needy students.

"We will not, we will not eliminate the Healthy Families program, we will not eliminate Calworks, we will not eliminate in-home care ... it's not going to happen. And if that is the price for earning or garnering your votes for a budget, respectfully, forget about it. It's not going to happen."

But Senate Republican leader Dennis Hollingsworth of Murrieta countered that the Democratic plan didn't cut deep enough and his caucus would not support taxes and accounting maneuvers in place of spending cuts.

"Today we are voting on an \$11 billion solution to a \$24 billion problem," he said. "This is not only partial and incomplete, but because it is those two things, it is not a solution ... we have eight days before the state's checks are no good and we have to issue IOUs ... we need to get serious and solve the problem."