

California budget Q&A: How did we get here? Where are we going?

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Published Monday, Jun. 22, 2009

This is usually the time of year when state legislators begin sparring in earnest over the adoption of a new state budget for the fiscal year that begins July 1.

But this week they're scheduled instead to begin sparring in earnest – and doubtless at length – over plans to fix a cumulative \$24 billion hole in the budget they already approved last February for the coming fiscal year, and the current year ending June 30.

So much for working ahead of schedule.

The budget-balancing plan combines deep cuts, new taxes and some accounting sleight of hand, and almost certainly raises a few questions in the minds of interested citizens. Such as:

Who came up with this budget-balancing plan?

It was sort of a group effort. Gov. Arnold Schwarzenegger offered up his version last month, after state finance officials put together a new forecast of how much revenue the state could expect to collect in the coming fiscal year, and what bills it might incur.

Then a 10-member, two-house legislative committee (three Democrats and two Republicans from each house) took about a month to overhaul the governor's plan.

Since Democrats dominate both houses, they won any disputes, so it's safe to call the plan being voted on this week the Democratic legislative proposal.

But Democratic leaders took pains to point out last week that the committee accepted about 45 percent of Schwarzenegger's ideas in total, and about 93 percent in part.

What's proposed to get cut?

Just about every major area of state spending. Elementary and high schools were cut by \$4.5 billion (about half of which will be replaced by one-time federal stimulus money); community colleges by \$1 billion, and the University of California and California State University systems by about \$2 billion over two fiscal years.

The committee rejected plans by the governor to abolish several health and social service programs for poor, elderly and disabled people, but did make cuts in them, at depths that varied from medium to deep.

The prison system got whacked by \$1.2 billion, and the judicial branch by \$168 million, mostly from closing the courts one day a month. Altogether, about \$11.4 billion of the deficit is filled by spending cuts.

What about taxes and fees?

About \$2.5 billion worth is in there. The biggies would raise the state's cigarette tax from 87 cents a pack to \$2.27 (\$1.2 billion); impose a new 9.9 percent tax on oil produced in the state (\$830 million); a \$15-per-vehicle registration fee to fund state parks (\$145 million); a \$48 fee on home insurance policies to build up a pot of money for fighting wildfires (\$120 million), and a \$6-per-unit hike in community college fees (\$80 million.)

Schwarzenegger has vowed to veto all taxes and fees, even though the fire/insurance fee was originally his idea.

What else is in there?

There's \$2.1 billion worth of grabbing gas-tax money from local governments and mass transit programs; accelerated collections of personal and corporate income tax payments (\$610 million); a 10 percent higher income tax withholding rate, starting in January (\$1.7 billion), and about \$2.2 billion in changes in various business taxes.

Oh, and the state would save \$1.2 billion by paying employees on July 1, 2010, instead of June 30, 2010, thereby pushing the payroll expense into the following fiscal year.

Speaking of state workers, why aren't they taking a hit?

They already did. The governor exercised his executive authority last December and ordered unpaid two-day-a-month furloughs for state workers, tantamount to a 9.3 percent pay cut. He also eliminated 5,000 state jobs, although many of those jobs' occupants will find work elsewhere in the state bureaucracy.

Schwarzenegger proposed an additional 5 percent cut in state workers' pay, but Democrats on the legislative committees rejected the idea.

Why doesn't the state just do what most businesses do, and lay off a bunch of workers when revenues slip?

Mostly because the state doesn't – and couldn't – operate like a business. Unlike private businesses, most of the state's spending isn't spent on personnel costs.

The part of state spending that is most in trouble, the general operating fund, employs about 100,000 people. If you fired all of them and didn't replace them for two years, you still wouldn't cover the current deficit.

In fact, most of the general fund represents pass-through money that the state doles out to schools and local governments for various programs. And the state has no or very little say in the employment practices of cities, counties and schools.

How did we get into this mess?

All kinds of ingredients went into the stew. First and foremost, the bleak condition of the world economy. Also the state's overdependence on income taxes from the wealthiest Californians. Too much spending on programs and tax breaks and not enough saving in years that were replete with tax revenue. Generous pension plans locked in when times were good. Too much growth in state-financed programs, some triggered by automatic spending increases in law, without enough thought about how to pay for them down the road. The rollback of the vehicle license fee just as other state revenues began to slip. Lousy political leadership. Too much budgeting by ballot box.

Are other states in this mess?

Yup, although few of them are in it as deep as the Golden State. A recent study by the Rockefeller Institute of Government found that California's personal income tax revenue fell 33.8 percent in the first quarter of this year compared to 2008. Only three income-taxing states – Arizona, South Carolina and Michigan – suffered greater losses.

California's problems are exacerbated by several factors: its sheer size, the extraordinary diversity of its population, the costs of living – and most or all of the factors listed in the answer to the "how did we get into this mess?" question.

Can't we quit spending money on illegal immigrants?

The short answer is "nope."

For one thing, it's unclear how much the state actually spends on undocumented workers, vs. what they contribute in payroll taxes and to the overall economy.

For another, the federal courts have said (a) states cannot deny emergency medical care to anyone, and (b) illegal immigrant children are entitled to go to public schools.

So what happens next?

Democratic legislative leaders said last week they expect to put the plan up for a vote as early as Tuesday, via a package of nearly two dozen separate bills.

Most of the proposals can be approved by simple majority votes, which means Republican legislators are superfluous to the process. But the tax hikes will take two-thirds approval from

both houses, and GOP leaders have said emphatically that there will be no Republican votes for any of the proposed tax hikes.

Once the plan gets to the governor, he can veto part or all of it. What's more likely is that legislative leaders and Schwarzenegger will huddle privately to work out a compromise, maybe by the end of this week.

One of the big fights is likely to be over Schwarzenegger's insistence that the plan include a \$4.5 billion reserve. Democrats think the state can get by with a smaller rainy day fund.

What happens if they don't reach a deal?

State Controller John Chiang has warned that the state's piggy bank will be empty by the end of July.

State financial officials usually borrow money from private investors to smooth over cash-flow problems at the beginning of fiscal years.

But Chiang and state Treasurer Bill Lockyer have said that without a no-gimmicks balanced budget in place by June 30 at the latest, it will be exceedingly difficult and expensive to borrow enough money.

Without private-market loans, the other options are to delay payments to some of the state's creditors until more tax revenue comes in, or issue IOUs, formally called registered warrants. Warrants were last issued in 1992 – the only time since the Great Depression.

What are the odds that the governor and Legislature will be faced with another big budget deficit before the end of the year?

About the same as it being hot in Sacramento sometime this summer.

Why doesn't the state just declare bankruptcy and start from scratch?

No can do. Federal laws restrict access to bankruptcy to individuals, businesses and in some cases to local governments.

We're stuck with whatever lawmakers and the governor agree on.