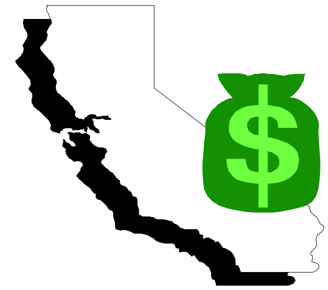
A YEAR LATER: HOW IS CALIFORNIA DOING?



One year ago, when Arnold Schwarzenegger was elected, he promised to fix the state’s budget mess. And, certainly there are positive signs.

The governor appears to be working hard to bring fiscal gains to our state. He has been to Washington, touting his ability to be the “Collectinator.” (Success, however, has been minimal.) He has promoted our products and services in Japan. And, Californians say that our state is headed in the right direction—the first time in five years we have said that.

What are the key indicators that show California’s economic climate improving?

Economists give Schwarzenegger credit for creating a better business climate—one not so frightening, as one economist stated. And, Wall Street’s view of the Golden State has improved which brings down the cost of borrowing money for our state.

However, California still has the lowest credit rating of any state in the country. Standard & Poors says the rating is due to “the need to bring spending and revenues into balance.” Californians passed two bond measures in the last election; we do not yet know the rate at which the bonds will be sold. The state debt has risen from $36.6 billion in November 2003 to $53.9 billion one year later.

Although eschewing most tax measures, voters in November agreed to a tax surcharge for those earning more than $1 million a year to pay for mental health services. The impact of this tax increase on the state budget is not known. Those who opposed the measure said that it would make some high-income earners leave the state, reducing the income tax revenue available for future budgets. Others counter that argument by looking to the early 1990s, when California had higher rates on the top income tax brackets and the number of millionaires increased.

The state's continued use of property tax funds intended for cities and counties to relieve its budgetary problems has been a sore point with local governments for more than a decade. The passage of Proposition 1A allows the state to take an additional $1.3 billion per year this fiscal year and next, but after that the state will be prevented from taking additional property taxes unless they are repaid with interest. This will certainly create additional pressure on the state’s budget.

How well are other indicators of the state’s economic climate doing? Unemployment is down. But, the prison population—a large drain on the state budget—is up.

School districts are in increasing trouble. In each of the past six years the number of California school districts not able to meet their budget has grown—from one to nine. Those with a qualified budget (districts that say they may not be able to meet their budget over the coming three years) have increased from 14 to 35. According to many, these numbers will go up this year, too. Also, fees for classes at all UC and CSU campuses have increased by at least 14 percent in the last year. Community college fees have gone up by 44 percent.

The Legislative Analyst has indicated that there is a structural deficit of about $8 billion a year within the state budget that must be fixed. She says it will worsen if lawmakers and the governor don’t deal with it this coming fiscal year.

Continuing to rely on one-time fixes, bonds and other borrowing mechanisms creates its own problems. It appears new taxes will need to be raised or further cuts to health, education, transportation, social programs, and other state programs will occur. But, the governor said that he will not raise taxes and has chosen Tom Campbell—a man with similar views—as his new Director of Finance.

The governor may have been right when he stated, “The people do not like to be taxed.” The November election results were mixed. Will further service and program cuts be the answer to our budget ills? Or, at what point will the people agree to more taxes for governmental services to meet citizen needs?