Capitol Lurches through Budget Crisis

By Anne Henderson, LWVC State and Local Finances Program Director

The new legislative session began in December 2008 with newly-elected legislators joining holdovers in plunging into a complicated political dance. The opening steps begin with addressing a huge shortfall in the current year's budget and segue into the question of how to resolve the entire picture of the state's budget through June 2010. Estimates of the deficit have grown to about $15 billion for the current fiscal year and $25 billion for 2009-10, a total of about $40 billion if corrective actions are not taken. Those numbers continue to rise as the economy deteriorates. As if that were not enough, two other elements, a special session on the economy and potential ballot measures presumably headed to a special election in 2009, have also been tossed into the mix.

New Session, Same Old Problem

Legislators had hardly been sworn in when the Governor declared a fiscal emergency and called a special session (http://gov.ca.gov/index.php?/press-release/11159/) to address the shortfall in the current year's budget. The Legislature had 45 days to resolve the problem. That session failed to reach an agreement, and the Governor then called another special session on December 19, thereby extending the deadline (http://gov.ca.gov/index.php?/press-release/11306/). The state is likely to have a cash flow crisis in February if the problem is not quickly addressed.

November Background. The special session the Governor called in the final days of the last legislature failed to deal with the problem. The Governor proposed roughly equal budget changes from both new revenues and additional spending cuts to close the gap. His new revenues included a 1.5 percent increase in the sales tax, taxing some services, a 9.9 percent oil severance tax, a five-cent per drink tax on alcoholic beverages, and a $12 per vehicle increase in vehicle registration fees. His cuts fell chiefly on health and human services, K-12 education and higher education.

In response, Democrats conceded that further painful cuts would have to be made, and they suggested a return to the old Vehicle License Fee (VLF) rate of 2 percent. That would produce about $5 to $6 billion per year but would take too long to implement to solve this year's shortfall, although if approved, short-term borrowing against those revenues might be possible. Democrats also proposed a one-year suspension of the inflation adjustment of personal income tax brackets, a move that would bring in another billion dollars or so. Republicans resisted new revenues and demanded more cuts, but did not specify where they would make enough cuts to cover the shortfall, and the November session ended in an impasse.

December Attempts. The Governor proposed changes to the budget that included a different set of cuts and new revenues, but they were not presented in a bill that could be voted on.

A joint session of both houses of the Legislature heard dire warnings from State Treasurer Bill Lockyer, Controller John Chiang and Finance Director Mike Genest that the state would not have enough money to pay its bills by the end of February unless significant changes were made before then. Lockyer also said the state had tried to borrow money to meet the cash flow problem and failed. Subsequently those three, who constitute the Pooled Money Investment Board, voted to cut off funds already committed for a number of highway, school and other infrastructure projects (http://www.sacbee.com/capitolandcalifornia/story/1481017.html).

Both parties went back to the drawing board. The Republicans produced a plan (http://www.cssrc.us/news.aspx?id=5256&AspxAutoDetectCookieSupport=1) that would make about $15 billion in cuts to education, health and social services, employee compensation including legislators' salaries, and other items. They also proposed adding to the revenue side by transferring money from some special funds and delaying loan repayments on past transfers. The transfers included as yet unspent funds from early childhood programs funded under Proposition 10 and from mental health programs funded under Proposition 63. Because those were voter-approved initiatives, such a change would have to go on an early ballot and be agreed to by the voters.

The Democrats then produced a creative $18 billion package of changes to the 2008-09 budget, including both spending cuts and $9.3 billion in new revenues that they passed on a majority vote. The new revenues included a 3/4 cent sales tax increase, an oil severance tax of 9.9 percent, a 2.5 percent surcharge on personal income taxes and a 3 percent withholding requirement on independent contractors. Those tax increases were balanced by repealing the existing excise and sales tax on gasoline, a reduction of 26 cents a gallon. The tax changes concerning gasoline were in turn more than offset by a fee on gasoline of 39 cents a gallon. Fees can be passed by a majority vote. Democrats argue that state law allows tax changes to be made by majority vote if they are "revenue neutral," that is, tax increases balanced by tax cuts. They have a Legislative Counsel opinion that they believe will uphold their complicated action, but it will clearly be challenged in court.
(http://democrats.assembly.ca.gov/templates/ademmain.aspx?articleid=762&zoneid=2 or http://democrats.sen.ca.gov/index.asp?Type=B_PR&SEC={2754CE93-A286-4BF3-BF44-53862B9EBE4C})

The Governor immediately rejected the Democrats' proposal. However, negotiations continue into the new year. In an unexpected move on the last day of 2008, the Governor's Department of Finance presented a package for 2008-09 and 2009-10 well ahead of the January 10 deadline for unveiling his proposed 2009-10 budget.

The Session on the Economy

On December 1 the Governor also called a special session to "implement an economic stimulus package to help retain and create jobs, keep Californians in their homes and fix the state's Unemployment Insurance Fund."

(http://gov.ca.gov/pdf/press/Special_Session_Proclamation_December_1,_2008.pdf) The Fund is almost broke and may be taken over by the federal government.

Some specifics of the plan immediately divided Republicans and Democrats. These included changing regulations on overtime pay, meal and rest periods and flexibility of work schedules in ways that are advocated by business and opposed by labor.

Republicans, including Governor Schwarzenegger, also want such things as more public-private partnerships on projects and more contracting out to business, and more flexibility on environmental regulations. They also seek more tax credits for business.

A New Commission

A new bipartisan Commission on the 21st Century Economy (http://www.gov.ca.gov/index.php?/press-release/11233/) has been created and charged with recommending changes to modernize California's "out of date revenue laws that contribute to our feast-or-famine state budget cycles." Of the commission's 12 members, six were appointed by the Governor and six by the legislative leadership. The commission is to report by April 15.

Previous commissions have covered this ground with little to show for it, but at least their reports may serve as a basis for beginning discussions. Commissioners are likely to take up the revenue changes proposed by the Governor in the previous special session, as well as the VLF and ideas suggested by the Legislative Analyst's Office (LAO), and these will become part of budget negotiations.

Ballot Measure Issues

Republicans also renewed their demand for a ballot measure that would require more money to be put in the reserve fund and make it much harder to access it. They also want tough spending caps that would make it difficult to increase spending even in better times.

Such a measure was part of the September budget deal (http://www.lao.ca.gov/laoapp/PubDetails.aspx?id=1892), and was supposed to go on the ballot in a special election to be called this year, along with the Governor's proposal to expand the state lottery in the expectation of raising more money for the state. The lottery proposal is intended to realize $5 billion in both the 2009-10 and 2010-11 budget years through the sale of bonds that would be repaid by the future lottery revenues. The measure would also provide that education would continue to receive as much as it now gets from the lottery, with future adjustments for school population and cost of living.

In the present credit environment it seems probable that those bonds would have to be guaranteed by the state's General Fund (GF) and pay a relatively high interest rate, if they could be sold at all. The LAO also says that while the bonds could help balance budgets for the next two years, after that they would cost the state about $1 billion annually.

When the budget was passed in September it was assumed that these measures would move to the ballot soon, probably in June 2009, but the Legislature has not actually set such an election. Republicans and the Governor will presumably press for it to be scheduled, but it is by no means clear that Democrats will see any advantage in moving either of those measures to an early ballot. These are not measures with much appeal to the public, which has probably had enough of elections for the time being. It would probably be a low turnout election, which usually means one with a fairly conservative base.

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