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Joint Assembly and Senate “Convention” Hears Grim Budget News

In what was termed an unprecedented meeting of the Assembly and the Senate, a panel of four fiscal experts made sobering presentations about the condition of the State Budget and the impending cash crisis. This "convention" heard testimony from Mike Genest, the Director of the Department of Finance (DOF); Mac Taylor, the Legislative Analyst (LAO); John Chiang, the State Controller; and Bill Lockyer, the State Treasurer. All four painted a very grim picture of the state's fiscal situation, laying much of the blame on the condition of the national and international economies, but also acknowledging that prior decisions on the State Budget have taken away many options to deal with the current crisis.

Both the Taylor and the Genest reiterated many of the points they had made during School Services' webcast on December 3, 2008. Taylor testified that the LAO's estimate of the two-year Budget shortfall was $28 billion and, if no corrective action is taken, the state would face operating shortfalls of $22 billion annually. He acknowledged that the Governor's proposals to deal with the current-year shortfall had merit-the estimates were reasonable, the solutions were balanced, and the proposals were ongoing for at least several years.

Taylor emphasized that this is a particularly dire situation because of the delayed enactment of the current-year Budget, the large operating shortfalls; very slow economy, which is not expected to pick up until 2010; and the fact that many solutions have been exhausted or are off of the table. Taylor also warned that, even if all of the Governor's proposals were adopted, Budget shortfalls would reemerge in 2011-12 as the sales tax increase expires and the proceeds from the Lottery securitization run dry.

Genest stressed the importance of acting immediately, pointing out that $2 billion of the $9.2 billion in proposed Budget solutions have already been lost because the Legislature did not act during the November 2008 special session. Genest indicated that, if no action is taken until June 1, 2009, the Governor's proposed solutions would generate less than $3 billion.

Turning to the cash shortfall, Genest warned that failure to act now could result in a negative $2.4 billion cash balance at the end of March 2009 and that, for the first month of the new fiscal year-July 2009-expenditures would exceed the available cash by $7.6 billion. This estimate assumes that the state will have exhausted all available internal borrowable resources. Genest stressed that the private credit markets would likely be unavailable to California if legislators have not passed measures to reduce 2008-09 spending and or increase revenues. Genest pointed out that a payment of $5.1 billion would normally be made to schools in July and that payment and many others would be at great risk. He indicated that the cash flow schedule for July "points directly at schools" to suffer a cut in the payment.

Chiang continued the grim message on the state's cash outlook. He warned that failure to act in a timely fashion would be "catastrophic," threatening public services, the state's safety net programs, and public safety. He indicated that, while he seeks to maintain a $2.5 billion cash cushion from month to month, there will be no cash available in March 2009. Under normal circumstances, the state would seek a short term loan -a revenue anticipation warrant (RAW)-from the capital markets; however, because of the global financial crisis, the markets may not be available this year. Moreover, revenues to the many special funds that are usually a source of internal borrowing will likely fall short for the same reasons that the General Fund is suffering, thus compounding the cash problem.

If the state runs out of cash, the Controller acknowledged as an option the issuance of registered warrants, otherwise known as IOUs. He indicated that California has issued registered warrants only once since the Great Depression and that resorting to this means of payment would create a multitude of problems as the year unfolds. Holders of a registered warrant would have first call on state revenues in subsequent months in order to be repaid, but this priority would threaten constitutionally required payments that normally rest at the top of the queue, such as payment to schools and debt service. Chiang indicated that resorting to registered warrants would probably trigger a multitude of lawsuits against the state.

Finally, Lockyer testified to the deteriorating condition of the state's Pooled Money Investment Account (PMIA), the source of funds for infrastructure projects before bonds are sold. He indicated that, because of the currently frozen credit markets, the state has not been successful in selling infrastructure bonds that replenish the PMIA. As a result, hundreds of infrastructure projects will come to a halt. This in turn deprives the state of an effective source of economic stimulus, which is especially important during a time of economic contraction. As an example, Lockyer indicated that $3.1 billion in school construction projects will lose funding, which has a multiplier effect of $12.5 billion affecting 200,000 private sector jobs.

As a matter of perspective, Lockyer indicated that the current downturn is significantly more challenging than the three he experienced as a legislator over his 25-year career in the Assembly and Senate.

The joint convention concluded with a number of questions from Assembly Members and Senators. While the specific answers might vary from expert to expert, the general message was unambiguous-California faces a massive budget crisis and that doing nothing is not an option. Immediate and major actions must be taken.

-Robert Miyashiro

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