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Budget Summit Seeks to Quantify California's Budget Problem

On December 8, 2010, Governor-elect Jerry Brown hosted a two-hour long Budget Summit for invited state and local elected officials to quantify the magnitude of California's Budget problem. Brown's message was that we need to have consensus on what the problem is before we can develop solutions. Brown turned to Ana Matosantos, who, as Brown announced on December 7, will continue as Director of the California Department of Finance (DOF) in his Administration, and to Legislative Analyst (LAO) Mac Taylor, to describe the magnitude of the deficit, the state's expenditures and revenues, and how California compares to other states on various metrics. Treasurer Bill Lockyer was asked by Brown to explain the state's borrowing, and Controller John Chiang was tasked with talking about cash. Following the formal presentation, state and local officials were given the opportunity to ask questions.

Scope of Budget Problem

The takeaway from today's Summit is that California's Budget problem is much worse than the Budget problems the state has experienced in the past decade. First, the 18-month Budget deficit could be as high as \$28.1 billion, \$2.7 billion worse than the LAO has projected, depending upon what Congress does with the federal estate tax.

The LAO said that revenues are in line with spending. The problem is that temporary solutions—such as \$8.3 billion in temporary taxes—are expiring, and California will have less to spend because the federal stimulus dollars will go away. The ongoing problem is about \$20 billion.

The LAO explained that California went into the recession in poor fiscal shape, with no reserves. The recession devastated revenues—we lost more than 25% of what the LAO projected in 2008. The revenue loss is partially attributable to personal income taxes that are not being paid by unemployed workers. California's 9% job loss during this recession is more than twice what California has experienced in any prior recession. The LAO is projecting it will take about eight years (from the beginning of the recession) before California's job total is back to where it was before the recession, although we are starting to grow modestly.

The presenters said that California has had three categories of Budget solutions in the last decade: temporary, one-time, and solutions that made the long-term deficit worse. For example, to achieve one-time monies, California accelerated its collection of revenues and shifted state employee payroll from June 30 to July 1. Solutions that made the long-term deficit worse included the sale of state office buildings, which is expected to occur this month.

Most of the discussion of cuts was at a macro level, with a broad discussion of the programs that have experienced cuts in recent years, but without quantifying the percentage cuts that other programs have taken. Matosantos did acknowledge that education has accounted for a substantial portion of the cuts. Proposition 98 funding for K-14 education has gone from \$56.7 billion in 2007-08 to a projected \$47.5 billion in 2011-12, a reduction in state funding of more than 10%, and a \$9 billion drop in base funding. Next year, there will be another reduction in Proposition 98, and no additional federal stimulus funds to cushion the reduction.

To further stress the importance of getting California's fiscal house in order, Ana Matosantos cited other threats to California's finances, including its \$100 billion to \$500 billion pension liability, its \$10.3 billion

unemployment insurance deficit, outstanding budgetary borrowing of \$15.3 billion, and the estimated \$3.5 billion cost for health care reform.

Borrowing

Treasurer Bill Lockyer presented a startling picture of the cost of the state's debt. Because the state's outstanding debt has increased dramatically since 2003, its debt service has grown from \$2.5 billion to almost \$6 billion per year. In fact, debt service is expected to peak in two years at more than 10% of the General Fund revenues. There is another \$54 billion in bonds that have been approved by voters or authorized by the Legislature that have not been sold. California has the worst credit rating of the 50 states, meaning that it pays 1.10% higher interest on its bonds than if those bonds were AAA rated. If all of the authorized bonds were issued, this higher interest cost would amount to an extra \$12 billion cost over the life of the bonds.

Cash

The state needs cash to pay its bills. In a bit of good news, Controller Chiang said that California is not expected to face a cash crisis in the current year. However, without a balanced, on time Budget, he said California's cash position could be a negative \$4.6 billion in September 2011. He said that we can't wait for an upturn in the economy, because economists are seeing protracted slow growth for California and double digit unemployment. California is increasing its borrowing; in July 2007 borrowing represented 12% of the General Fund, but borrowing is now 23.5% of the General Fund, and that does not include the deferrals or the economic recovery bonds. Moreover, California has been operating in the red for the last three years.

Conclusion

Brown concluded by suggesting that we don't point fingers regarding the current Budget problem, but that we join hands to get Californians together to get the state back on track. The task is monumental, as the data presented illustrates. Moreover, the politics won't be easy. Although the December 8 Summit was to have focused only on identifying the problem, some elected officials could not resist providing suggested solutions, which were of a partisan nature. However, Senate President pro Tem Darrell Steinberg (D-Sacramento) said it best in his introductory remarks. It comes down to answering the following question: What do we want in California and how do we pay for it? Governor-elect Brown provided no hints as to how he will address those questions in his January 10 Budget Proposal.

—Deborah Harmon

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