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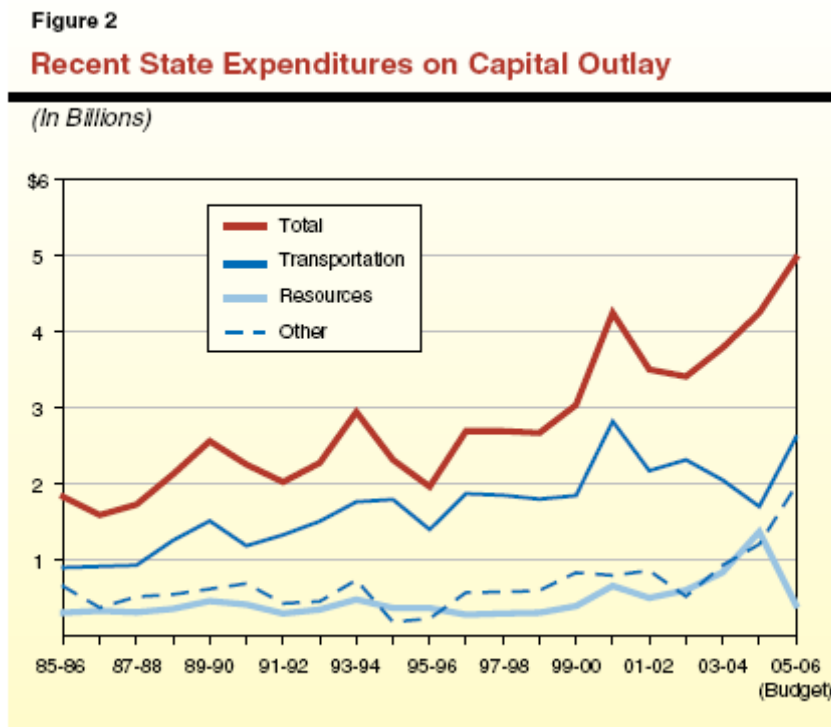
January 5, 2006

The State's Infrastructure and the Use of Bonds: New by Legislative Analyst

OK, hot off the press! The Legislative Analyst has just issued an up-to-date summary of California's infrastructure problems, and how bonds play in the mix. Our last *California Budget Report*, e-mailed on Tuesday, included some information on bonding, but it was a couple of years out of date. Now you have the new picture. [The State's Infrastructure and the Use of Bonds](#)

This 16-page report is full of very interesting stuff. Here are some of the highlights:

- Actual dollar state spending on capital improvement has increased in the last 15 years. Here is the LAO summary chart:

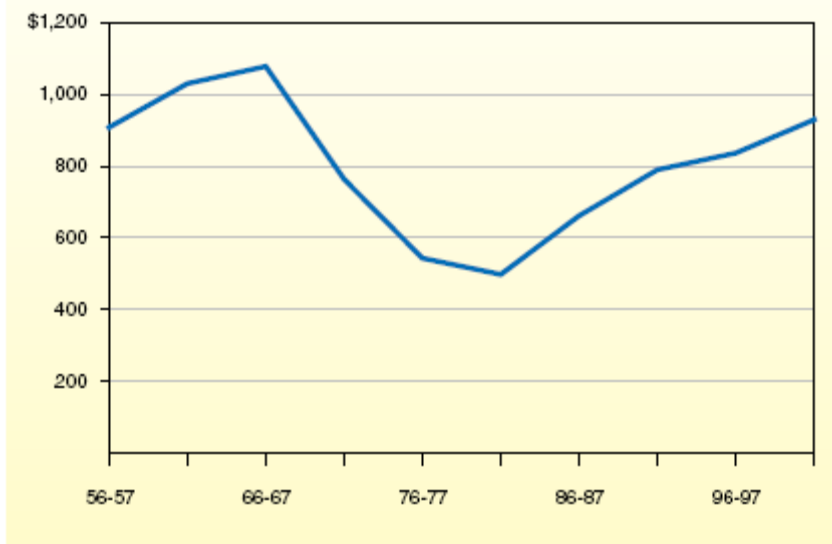


- The historic state spending on capital outlay (both state and local) has remained more level than we thought. The LAO provided an interesting chart showing the real, per-capita, spending from 1956-57 to today. That ought to be long enough for anyone to consider it a trend! Yes, there was a big drop in capital expenditures, starting in the mid-1960s, but the increase in spending began in the early 1980s, and has continued to this date. Here's the chart:

Figure 3

Real Per-Capita California State and Local Capital Outlay Expenditures

(In Today's Dollars)

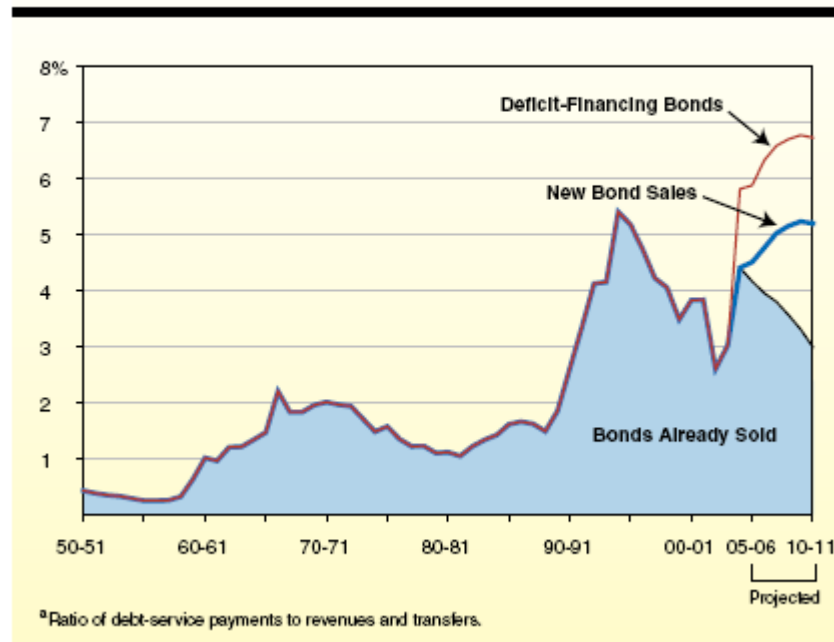


We leave it to the historians to argue about why the spending drop, and why the increase, but we bet that the post-World War II highways/water systems/university expansion had mostly run its course by the mid-1960s, and other spending began to be more important (both law enforcement and health and welfare). We also note that a large increase in spending in the mid-1980s included the gasoline tax increase approved by Governor George Deukmejian, and incorporated in Proposition 111 of 1990.

- The LAO estimates that the “need” for capital spending through 2011 will total about \$60-\$75 billion --- up considerably from the last estimate made in 2003, which showed a need of \$53 billion.
- Another interesting chart showed the General Fund Debt-Service Ratio, that mysterious ratio between annual revenues and the cost of debt --- which does, or does not, have something to do with whether Wall Street buys state bonds. Here is what the LAO shows for the last 15 years:

Figure 8

California's General Fund Debt-Service Ratio^a



When you look at this chart by itself, it appears sobering, maybe suggesting that the Governor's plan to have a bond package near or exceeding \$50 billion may not be financially wise. Well, we thought that might be the case until we read this report. At first blush, it sure looks like the LAO is suggesting that California increase its capital spending in a big way.

One high-ranking LAO reader told us in no uncertain way that the LAO infrastructure report should not be read as an open invitation for endless General Fund spending on bonds. No, the LAO is still insistent that the state has to find a way to pay for the bonds, including user fees, bonds supported by earmarked revenue or, if the General Fund is the source, *the state should actually budget for future bond payments!*

That makes sense to us, but it sure does not to most interest groups or politicians. There is still a vague feeling that bonds are "free money", where you get to spend what you want, but it has no cost. That's wrong, but a common attitude.

We would guess that the Governor's announcement on Tuesday that he is proposing a \$4 billion increase in spending on K-12 education, of which about \$1.7 billion is "repayment" for borrowed funds, is not reassuring. Remember that this repayment is coming from the state reserve and won't be available for other needs, like debt service. If you want to see the Governor's full proposal, look at his press release here [Governor Schwarzenegger Proposes \\$4 Billion Increase in K-12 Education](#)

Add to the K-12 repayment, another \$428 million to pay for start-up of the Governor's before-and after-school programs authorized by Proposition 49 (2002), and you start to understand that there is not going to be much control on some new state spending this year.

School advocates and Democratic legislators immediately responded that the amount was not enough and you can expect a healthy additional increase in school spending to occur this year.

Finally, we note that the Department of Finance December 2005 Financial Bulletin is showing a continuing growth in revenue. All this good economic news makes us nervous, but reminds us of that grand old song, adopted as the slogan of Franklin Delano Roosevelt's New Deal:

Happy Days Are Here Again

[Music and Lyrics by J. Yellen and M. Ager]

**So long sad times
Go long bad times
We are rid of you at last**

**Howdy gay times
Cloudy gray times
You are now a thing of the past**

**Happy days are here again
The skies above are clear again
So let's sing a song of cheer again
Happy days are here again**

**Altogether shout it now
There's no one
Who can doubt it now
So let's tell the world about it now
Happy days are here again**

**Your cares and troubles are gone
There'll be no more from now on
From now on ...**

**Happy days are here again
The skies above are clear again
So, Let's sing a song of cheer again**

**Happy times
Happy nights
Happy days
Are here again!**

The Governor delivers his State of the State speech this evening. We'll be following the event from inside his tent at the Capitol, pretending to be learning serious insider stuff, but actually trading gossip with others of the Capitol gang. More information to follow.

The California Budget Report is produced by Phil Isenberg and Maureen O'Haren of ISENBERG/O'HAREN. Questions, comments and requests to be added to the mailing list should be directed to Phil at phil@isenberg-oharen.com or Maureen at maureen@isenberg-oharen.com