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# **CALIFORNIA BUDGET REPORT**

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## **The Bond Deal: Will They or Won't They?**

*“First you say you do, and then you don't.  
Then you say you will, and then you won't.  
You're undecided now, so what are you gonna do?”*

*Undecided, 1939, Lyrics by Sid Robbins, Music by Charles Shavers*

Any attentive California citizen would have to be puzzled as to whether the Governor and state legislators will agree on a bond package for the June election—or even the November ballot. Reading the public statements of Governor Schwarzenegger and legislative leaders, particularly Senate Democratic President Pro Tempore Don Perata and Assembly Speaker Fabian Nunez, would instill confusion in anyone. Thankfully, most California citizens aren't all that attentive and it's left to those of us in Sacramento to collect rumors.

And the latest rumors are that no one knows exactly what will happen, given that there are so many moving parts, and no one knows when anything will or won't happen, but there is still a chance that something may happen, maybe Friday, maybe by an extended deadline of March 13.

For weeks, all parties have been saying that they liked the idea of “investing” in California by authorizing a big wad of new bonds in 2006. The Governor, in Washington, DC for a meeting of the National Governor's Conference, told Tim Russert on *Meet the Press* that authorizing bonds was “investing,” not spending! Then he announced that the need for flood control was much greater than he first thought, the federal government was not willing to put up much money this year, and the voters approve \$6 billion worth of flood control funds in 2006.

The most interesting thing the Governor did was declare a State of Emergency for the Sacramento and Delta levees. [See the Governor's February 24, 2006 press release](#)

No one is yet sure if this means the Governor intends to suspend state contracting laws in order to promptly start levee repairs, nor is it clear that he will circumvent the state planning and environmental processes. This move does show that the Governor intends to rely on his own ability to move if the Legislature fails to act, a posture we've seen in the past.

President Pro Tempore Perata and Speaker Nunez were quoted as saying the total amount of bonds proposed by the Governor was too big, that the state could not afford it. To some political types, that may sound strange coming from Democrats. Then both Democratic leaders stated that the subjects covered by the Governor's bond package were too limited, that bonds were needed to help hospitals, maybe affordable housing and the environment too. That sounded more like it. And behind the scenes the feeding frenzy ensued.

Republican legislative leaders Dick Ackerman and Kevin McCarthy touted a "pay as you go" bond plan that was more of a plan to transfer money from existing programs to pay bond borrowing costs, a tough—probably impossible—budget move to do, but it allowed them to argue "no new taxes" and keep the Republican faithful.

So here we go again. More spending, no cuts, no tax increases. Apparently, the assumption is that we will "grow our way out of this problem."

### **Some things we heard about a possible bond deal this week**

1. Rumors are that there will be a bond deal for the June ballot, and that there won't. Lobbyists for transportation and education bonds are predicting that something will be done for the June ballot. Water folks hear that the water supply elements are off the table, but that flood control is still in. Habitat issues may also be in.
2. Estimated size of any bond deal range from \$40 billion to \$50 billion. In that case, you may see \$15 billion to \$20 billion for transportation, \$10 billion to \$15 billion for schools and \$5 billion or so for flood control. Maybe a little bit for environmental issues and affordable housing.
3. Lobbyists for the environment, hospitals and health care, and affordable housing are either proceeding with their own ballot measures to increase spending (e.g., environmentalists and hospitals) or just waiting to see what happens.
4. Most insiders are predicting that the Governor will have to drop his plan to raise bond funds for courts and local jails and state prisons. There seems to be little legislative support for this level of spending, and recent polls by the Field Institute and the Public Policy Institute of California show that voters are also skeptical.
5. Democrats are trying to force the Governor to delay implementation of his voter-approved after-school measure.
6. The Governor and politicians of all political parties are running as fast as they can away from any plan to impose fees or surcharges on water to fund water or flood control bonds.
7. Although the criticism is muted at this point, a lot of politicians from Southern California and the coastal North are suspicious of statewide bonds to fix Sacramento and Delta levees. Some insiders predict we are headed to another North vs. South battle over

money and turf—like the rehab of the San Francisco Bay Bridge. Expect the potential for regional differences to increase if the amount of money devoted to flood control increases.

8. The two Democratic candidates for Governor, Phil Angelides and Steve Westly, are trying to figure out if they want a bond package at all. Both appear to support increased infrastructure funding, but Angelides in particular has been highly critical of the Governor's plan to use state General Funds for bond borrowing costs. It appears Democratic legislative leaders are not developing their bond strategy based on the campaign considerations of either potential nominee.
9. It is not at all clear whether or how the selection of a new Assembly Republican leader will impact the negotiations. But it has long been unlikely that the lower-house caucus will get its demands met on labor concessions, CEQA and pay-as-you-go financing.
10. On the far out fringes of political calculation is gubernatorial candidate-in-waiting Antonio Villaraigosa. You didn't know he was running? He isn't this year, but insiders predict a run in 2010, right after his re-election as mayor of Los Angeles in 2009. That brings us around to the interesting interplay between the future of the Mayor of Los Angeles and his friends: Does the Mayor want to see a big bond issue, either in June or November? Does the Mayor want to see Schwarzenegger re-elected so that he can run in 2010 in an open primary? Of course, regarding any bond measure, Los Angeles must get its "fair share," which means a big cut of the action.

We only mention this to suggest that the political calculations of the Los Angeles Democratic legislative delegation may be shaped as much by the plans of Villaraigosa in 2010 as by anything else.

All this discussion of bonds has left work on the budget to simmer at a low heat. Assuming some kind of deal for the June ballot, we expect some increasing attention to be focused on the next budget. Our very smart Legislative Analyst, Elizabeth Hill, has reminded everyone that the Governor's budget proposal spends a lot more money than is raised by taxes. Even with the economy growing and new revenue projected, the Governor's proposed budget would spend at least \$5 billion more than the state is receiving! And that figure will grow in the years to come since much of the revenue growth is occurring as a result of highly volatile taxes like capital gains.

Does anyone care? No. Spending is fun. Cutting programs and raising taxes are not fun. Borrowing money today is a convenient way to avoid pain, particularly in an election year.

### **And speaking of pain avoidance . . .**

Our nomination for the most ignored, but very important public policy problem in California is the cost of health for retired public employees. Once again, the Legislative Analyst has put together a very impressive analysis of a serious problem. For full details, look at [\*Retiree Health Care: A Growing Cost for Government\*](#), issued a couple of weeks ago.

Our informed readers might say that this is no big news. After all, federal, state and local governments have spent years adopting new benefit programs and lowering taxes, and a university full of pundits has opined that the world is coming to an end. But nothing has happened.

Here are some highlights from the report, and one reason you can expect the competition for an increasingly tight public purse to increase.

- New federal accounting standards, called GASB 45 in government-speak, take effect shortly. Read the LAO's report for a full explanation in English, but suffice to say that California, along with every other level of government, is required to provide an actuarial analysis of the funded and unfunded amount of the healthcare debt for public employees.
- State employee healthcare costs, unlike state employee pensions, are pay as you go. The LAO estimates that almost 100 percent of state healthcare costs are "unfunded." Contrast this with "only" 20 percent unfunded state employee pension costs!
- Although this is something of a jump into the dark, **the LAO estimates that the unfunded liability of the State of California for retired employee healthcare costs is between \$40 billion and \$70 billion!!!!**
- Local government's unfunded healthcare debt is on top of this amount.

Being forced to publicly announce the unfunded liability has serious implications for the state's credit rating and will clearly affect other important programs. If, for example, the state is required to put aside funds to help pay for future retired employee obligations, that is money coming out of the state General Fund and almost every Special Fund we can think about. *That means less money for existing programs.*

We mention this only because there has to be some end to the popular illusion that we can all live on credit cards that will never come due. At some point the pressure to maintain existing programs and create new ones, countered by the failure to ever increase taxes or cut other spending, means this comfortable illusion is bound to get smacked upside the head by reality. There's the bug and there's the windshield.

Will the responsible folks wake up at this point? As we know, certainly not before.....

*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](mailto:phil@isenberg-oharen.com) or Maureen at [maureen@isenberg-oharen.com](mailto:maureen@isenberg-oharen.com)*