
CALIFORNIA BUDGET REPORT

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The May Revision Says the Two-Year Budget Problem is \$24.3 Billion!

The Solutions: Borrowing \$15 Billion, Using Future Lottery Revenues to Pay Off the Debt and Hoping Voters Approve the Deal in 2008

...Or They Trigger a 1 Percent Sales Tax Increase

Oh, boy, is this fun! The Governor has just issued his 2008-09 May Revision to the budget and did some pretty dramatic things. We recommend you not immediately get lost in the details, though you can read the full May Revision at the following web address:

<http://www.ebudget.ca.gov/pdf/Revised/BudgetSummary/FullBudgetSummary.pdf>.

Important as those details are, we urge you to pay attention to the major thrust of what the Governor is saying, which we think is the following:

- **The budget shortfall is bigger than expected.** The current-year-plus-budget-year shortfall is \$23 billion to \$24 billion. The Legislature has dealt with about \$7 billion of that amount (ignore that most of it is through borrowing and one-time gimmicks). That leaves \$17.2 billion left to be addressed! (By June 15, if you abide by the state Constitution.)
- **We should borrow \$15 billion to help us through this budget crisis.** To make sure Wall Street will loan us the money, the Governor proposes that the California Lottery revenue be pledged to pay off this borrowing. Note: California voters have to approve this transaction in 2008 to make it work.
- **The new borrowed money goes into the Revenue Stabilization Fund.** Essentially, this is another reserve fund for the state. The Governor thinks that \$5.1 billion of the new Revenue Stabilization Fund—or RSF—should help pay for the current year shortfall. The balance is held for the budget year, with a bunch of bells and whistles about how it can be accessed.

- **If the voters reject the lottery deal in 2008, a 1 percent sales tax increase goes into effect..** This is the first time the Governor has presented a fully developed, if not easy to understand, tax proposal. Republicans will not like this at all, and Democrats are still fussing about the lottery proposal. But it is clear that new taxes are on the table. The Governor likens this approach to the one used by former Governor George Deukmejian, who approved a sales tax trigger. The Governor does not explain how he will get legislative Republicans to vote for this sales tax trigger.
- **The new sales tax increase stays in effect until the RSF balance equals 15 percent of total General Fund revenue.** We do not have time in this *California Budget Report* to get into the details, but you can be sure that much attention will be paid to this approach.
- **Governor proposes to sweep state agencies and special funds for transfers or loans totaling a lot.** For details, look at page 22 (\$43 million), page 24 (State & Consumers Affairs miscellaneous sums/\$126.5 million), Special Fund loans (pages 28-29/\$288.7 million), Resources special funds (page 32/\$38.6 million), Health special funds (pages 52-53/\$40.3 million). There are many others included, but not enough time to detail them yet.
- **Use gas tax earmarked for mass transit to balance the budget.** Take a look a pages 26-27 to see how the spillover sales tax on gasoline is proposed to be used for K-12 home to school transportation, plus general fund support. This is nothing new; a very similar proposal was rejected last year. It is hard to imagine how the Legislature avoids doing something like this.
- **Suspend the guaranteed spending of the Higher Education Compact.** The HEC is something like a Proposition 98 guarantee of funding for higher education, although not a constitutional or statutory protection.
- **Impose more cuts on top of all this.** We are still trying to understand the full implications of the new cuts, and probably have to wait for the Legislative Analyst to tell us what this all means. More later. But one thing we've divined is that the cuts proposed in the January budget are still contained in the Governor's budget unless expressly adjusted in the May Revise documents.

Idle Observations:

- ✓ We cannot help but note the irony of borrowing \$15 billion in 2008, when the Governor's 2004 Deficit Reduction Bonds also authorized the same level of borrowing—while promising never to do it again!
- ✓ The Department of Corrections & Rehabilitation budget is being reduced by about \$115 million, but no one gets out of prison! The Governor dropped his early prisoner release notion (all legislators ducked the issue) and now assumes a lower level of prisoners. Ah, the perfect solution: no one gets blamed for the fact that fewer crooks are sentenced to prison.

- ✓ Curiously, the Governor did not take up the Legislative Analyst's proposal for criminal justice/prison/probation realignment. Maybe fighting with water and sewer districts is too much trouble. More likely, however, the Governor is waiting for the Legislature to propose the idea.
- ✓ Also absent was any attempt to divert voter-approved Proposition 10 money for early childhood development. Senate Republicans have a crusade against this program, but we guess that no one has found a way to get around a vote by the people to do it. The last effort made to repeal Proposition 10 lost in March 2000, when 72 percent of the voters said no.
- ✓ Health care programs are still getting cut significantly. Despite intense lobbying efforts by the California Medical Association and an entire coalition of providers large and small, the rate cuts as well as the proposed cuts to the optional Medi-Cal benefits, including adult dental, remain. Also, it appears that the proposal to cut rates in the Healthy Families Program remains intact as well. Rates to managed care plans, however, will be bolstered by \$169.8 million in order to continue to carry out the new rate methodology and ensure federal matching funds for the program. The 10 percent provider rate cut, however, will be factored into the rate development.
- ✓ Cuts to programs within the Office of AIDS also remain in the budget, except that the AIDS Drug Assistance Program will be funded at \$325.3 million, a 16 percent increase over the \$280 million proposed in January. The increase is apparently provided to fund drug costs for new eligibles.

Since the May Revise is being blasted by both sides—the Democrats claiming it is too gimmicky and the Republicans opposing the tax trigger—the Governor must be doing something right. Senator Perata said that the Governor could do a lot better. Treasurer Bill Lockyer, no newbie to budgets, had the following nuanced comment on the proposal:

“The Governor deserves credit for offering a plan that recognizes our state needs to deal effectively with both its revenues and its spending. Proposing a statewide tax increase, even if only temporary, takes guts for any California Republican these days. However, this budget still seems to assume that the state's structural deficit and legitimate spending needs will somehow take care of themselves in future years with a return to a steady increase in revenues. History shows that's not an assumption that makes for sound fiscal planning.”

So there you have it for today. We'll be reporting more in the days to come as more comes out. Stay tuned.

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