CALIFORNIA BUDGET PROJECT

WHY THIS YEAR IS DIFFERENT

by Jean Ross

California's projected $16 billion shortfall is smaller in both percentage and dollar terms than those of recent years. The $34.6 billion gap in 2003-04 was larger by both measures and the deficits of the early 1990s were larger measured as a share of state spending. However, many longtime budget watchers, me included, believe that bridging this year's budget gap will prove to be the toughest challenge we've seen to date.

Why do many of us believe this year's budget battles will prove so tough? The roots lie in what makes this budget crisis different from those of recent years. First, California has faced budget shortfalls continuously since 2001. The duration of the state's fiscal crisis means that all of the easy solutions, such as borrowing unspent reserves, deferring maintenance, and eliminating non-essential programs and services were used up long ago. The state has borrowed and belt-tightened to the point where the debt service on amounts borrowed to close previous years' budget deficits will add about $2.5 billion to the 2008-09 budget, rising to more than $4 billion in 2009-10, and deferred expenditures have left many public systems – from bridges to schools to foster care – near a breaking point.

The roots of this year's crisis are also different and potentially more severe in terms of their impact on the California economy and the state's families. The budget crisis at the beginning of this decade was largely caused by a sharp drop in income tax collections attributable to stock options and capital gains that occurred when the dot.com boom turned into the dot.com bust. The significance of this is two-fold. First, while the drop in investment-related income was substantial, it overwhelmingly affected the wealthiest Californians. Secondly, it affected revenues that flowed into the state's coffers, with school and local government budgets largely left untouched.

In contrast, the downturn that precipitated this year's budget crisis is driven primarily by the turmoil in the housing market. The impact of the mortgage meltdown is much more widespread, ranging from families struggling to make their mortgage payments to workers who make their living in housing-related sectors of the economy. As the economy weakens, a rising number of families are in danger of losing jobs and homes. The mortgage meltdown's impact on public budgets and services is also more broadly based. The downturn in the housing market has depressed local property tax collections – affecting schools and, through the Proposition 98 guarantee, the state as well as county and city budgets. It also has affected sales tax collections – which are shared by the state, counties, and cities – as fewer home sales translate into fewer appliance purchases and families divert a larger share of their incomes toward their mortgage payment, leaving less for other types of consumer spending.

1107 9th Street, Suite 310
Sacramento, California 95814
P: (916) 444-0500
F: (916) 444-0172
cbp@cbp.org
www.cbp.org

The final differences between this year's budget crisis and those of prior years have to do with the options available to lawmakers as they seek to craft a spending plan. Over time lawmakers have cut taxes – tax cuts enacted since 1993 will cost the state $12 billion in lost revenues in the current year – and voters have "locked in" an increasing share of the budget – often with the help of the current Governor and/or the Legislature.

The largest of these tax cuts – the reduction in Vehicle License Fees (VLF), also known as the car tax – will cost the state $6.1 billion in 2008-09. How much is $6.1 billion? Enough to buy out all of the Governor's proposed cuts to state parks, environmental programs, welfare-to-work programs, higher education (including community colleges), *and* K-12 education. That's right. The revenues raised by restoring the VLF to where it was a decade ago would be sufficient to avert nearly two-thirds of the cuts proposed by the Governor, including all of the cuts to Proposition 98-supported programs. Reversing these tax cuts will be difficult because lawmakers can reduce taxes with a majority vote, but a two-thirds vote of each house of the Legislature is required to increase a tax.

Budget lock-ins also make it more difficult for the Legislature to balance the budget. Many of the new lock-ins are much more restrictive than those that have been on the books for a longer time, including Proposition 98. New lock-ins include $1.5 billion in transportation spending mandated by Proposition 42 and "locked in" by Proposition 1A of 2006; $547 million in after-school spending mandated by Proposition 49 of 2002; $1.5 billion in debt service costs for the deficit-financing bonds authorized by Proposition 57 of 2004; and $4.0 billion in debt service on voter-approved bonds, including the $42.7 billion of bonds approved by the voters in 2006. None of these new obligations came with additional revenues, meaning that in a time of scarcity, other programs and services lacking similar protections are left on the chopping block to pay the bills.

For all of these reasons, and many more, I'll add my name to the list of budget watchers who believe that this year's budget fight will be the toughest yet. It will also be the most important for all of us who believe that adequate investment in public services is essential to California's future.

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