Budget deadline looms for California

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Ten days before the statutory June 15 deadline for a budget agreement in the legislature, Wall Street banks reluctantly approved an $11 billion loan to the California state government. The loan would allow the state to limp through the summer without running out of cash. However, Wall Street credit agencies warned that the loan is contingent on legislative approval of Governor Gray Davis's May 15 budget revision.

Instead of downgrading the state's credit rating below investment grade, the rating agencies agreed to extend credit, provided the state pay $84 million up-front to a consortium of large banks. A bluntly worded caution from Moody's Investor's Service warned investors about uncertainties surrounding the state's 38 billion budget deficit.

On May 15, Davis released a revised budget plan in an attempt to reach consensus in a bitterly divided state legislature. The revision balanced the 2003 budget, which expires in June 30, with $10.7 billion in loans to be paid off over the next five years, ratcheting up future deficits. Davis's draft also proposes $8 billion in new taxes—on tobacco and motor vehicles, plus a very modest tax increase on high-income households in addition to a half-cent increase in the state's income taxes. Davis is seeking the same $24 billion in program cuts and financing he sought in an earlier budget proposal released in January of this year. Meanwhile, under current budget projections, the estimated budget deficit keeps growing and is now expected to reach $38.2 billion in the next 14 months.

Mounting imbalances between expenditures and revenue will become even more explosive when debt service charges are added to next year's budget. If the budget is approved, analysts foresee 2004-2005 fiscal year deficits reaching the $50 billion mark. The budget revision designed to bring the two sides together has been greeted with howls of derision by the Republican minority in the legislature.

The impact of the revised budget will be devastating. If, as expected, the legislature rejects the measure, the effects can be even worse—250,000 state workers' salaries will be slashed to the federal minimum wage of $5.15 an hour by July 1, the beginning of the new fiscal year, and mass layoffs will take place.

State Controller Steve Westly told reporters, "The state will run out of money and we will have exhausted our credit opportunities." With no access to funds, checks drawn on the state's general fund will not be honored due to insufficient funds. The state will become insolvent, and state services will begin to shut down, from public educational institutions, to medical care, transportation, social services and county services.

Proposition 13, a 25-year-old law that bars the state from raising property taxes, made state programs almost entirely dependent on income taxes that are increasingly volatile under conditions of rapidly increasing unemployment. The measure also imposed a two-thirds requirement on the legislature to approve a state budget, which this year means Davis needs the votes of six Republican legislators. The Republican legislators have formed a block to not approve any budget that raises taxes. Last week, Republican Senate leader Jim Bruelte issued a threat that he will personally work to defeat in the upcoming November elections any legislator who supports the Davis tax plan.

Thus, though both the Democrats and Republicans support the severe cuts contained in the original and revised budget proposals, many legislators consider that voting for the draft budget is tantamount to committing political suicide. Governor Davis's approval rating has sunk to 27 percent, the lowest in the state's history. It is widely believed that if the budget were put to a vote, Davis would stand alone. With the present deadlock in the legislature, the budget is unpassable.

In addition to the new loans, the City of Sacramento borrowed more than $1.8 billion from the state pension fund in May. Debt service on the loans will add millions to future deficits. Were the United States to continue drifting into a Japanese-style deflationary crisis, the real cost of servicing the debt would increase, requiring further slashing of education, health services and other social programs.

There have been calls from the legislature that the impasse is so unshakable that the courts and banks will have to step in and impose a solution, as they did in New York City in 1975. In a blow last week to the state's credibility, state-issued bonds that borrow against the state's tobacco settlement were reduced to junk status. This designation prevents pension funds from buying the bonds and significantly raises the interest rates that the state would need to pay as a condition for continuing to borrow.

The draft budget contains about $8 billion in new taxes, but it softens the 2 percent tax rise proposed in January on high-income earners, reducing it to 0.3 percent. It also reduces the original budget's tax on cigarettes. More than 60 percent of the $8 billion in revised taxes comes from an increase in vehicle taxes, estimated to raise registration fees by an average of $158 per motor vehicle. In the January budget, the vehicle registration fees—life and death for many county programs—were diverted to the state general fund.

Though Governor Davis's May draft is considered less draconian than his January proposal—restoring funds to high-profile programs—the revised budget poses a disaster to environmental and peripheral state programs. Monies diverted to the state's general fund include $4.7 million from the Dam Safety Program; $7.2 million from a variety of energy-related programs; $20 million from the California Teleconnect Fund Administrative Committee Fund; a reported 50 percent cut to the state's environmental protection agency (EPA) and a similar cut to the programs that alert the public to hazardous pollutants in the local environment. Also affected is an $88.1 million reduction to the state's Department of Housing, a shift of $9.7 million in housing rehabilitation funds to the general fund, together with $27.1 million from the Farm Worker Housing Grant.

It is significant that the only programs to receive large increases in salaries and construction are not the state's public schools and universities but the state's prison guards and sprawling prison system. This beneficence, however, is not extended to the prisoners themselves. Three hundred thirty professional educators are to be laid off, and the prison guards' union—a major donor to Davis—is campaigning to eliminate educational programs in the prisons altogether.