California prepares massive cuts in response to budget crisis and economic woes

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The growing economic crisis in the US and the collapse of the housing market is beginning to have major ramifications on state budgets throughout the country. Nowhere is the impact more acute than in California, where the state government, under the leadership of Governor Arnold Schwarzenegger, is preparing for massive spending cuts over the next year.

The current budget crisis in California is hitting the state only four years after it faced a massive budget deficit as a result of the collapse of the dot.com bubble. The economic problems revealed then were not resolved, but were covered over mainly by massive borrowing, buoyed by the housing market bubble, and combined with cuts in social programs.

California was the state with one of the sharpest rises in home prices in the country, and therefore the subsequent deflation is one of the most severe. It is home to five of the top ten cities in the nation with the highest foreclosure rates. The housing collapse has led to a considerable decline in consumer spending, particularly on so-called "big ticket items," such as cars and furniture, which are considerable sources of sales tax revenue.

There have also been major job cuts in the state, including in housing-related industries. As the prospect of a recession in the US looms, the situation in California—the most populous state in the country—appears increasingly bleak.

Other states have also been severely affected by the housing market collapse, with 24 states reporting that their tax revenue has declined. A recent article in the *Los Angeles Times* quoted Corina Eckle, an analyst for the National Conference of State Legislatures, as noting, "We're at the early stage of a problem that's going to get worse."

The economic situation in California—as described by state officials—has shifted sharply in the recent period. Schwarzenegger proclaimed as recently as last January, "We reduced the deficit over time and got our fiscal house in order." State finance officials reported a projected budget surplus of $4.1 billion merely four months ago for the fiscal year ending in June 2008.

California's financial outlook has quickly nosedived since. In November the state Legislative Analyst's Office (LAO) predicted a shortfall of nearly $2 billion at the end of the current fiscal year, expanding to $10 billion at the close of the next. Newer estimates put the projected total budget gap through June 2009 at over $14 billion.

The LAO's report predicts that a 4.6 percent increase in tax revenue will be offset by a 7 percent increase in expenditures. The state agency proposes addressing the deficit through increased tax rates, the reduction or elimination of cost-of-living adjustments—which typically increase state program benefits in conjunction with rises in the Consumer Price Index—and a general cut in social spending.

Schwarzenegger has also suggested that the state might grant an early release to 22,000 inmates to reduce the booming state prison budget. The state has a prison population of 173,000 people, an increase of 8 percent over the past four years.

The principal strategy of the Schwarzenegger government, however, is to place the burden of the state's fiscal problems on the backs of working people, already hard-hit by the state's economic problems. Schwarzenegger is planning to utilize powers granted by a recent amendment to the state constitution to declare a state of "fiscal emergency" on January 10. Under the terms of the amendment, the state legislature will then have 45 days to address the governor's proposed budget legislation or else not be allowed to adjourn or consider other bills.

It is not possible at this point to predict exactly which measures the legislature will enact, but it will doubtless involve cuts, numbering into the billions of dollars, in vital social services. The state's beleaguered educational system is the first on the chopping block, with the Legislative Analyst's Office announcing that $400 million can be cut from the current fiscal year's budget without impacting constitutionally guaranteed funding under Proposition 98.

Education spending accounts for roughly 43 percent of the General Fund Budget. There have already been sharp cuts in education over the past several years.

Other state officials believe that $400 million may not be enough and, showing contempt for the will of California voters, have proposed the suspension of Proposition 98 entirely. The governor himself is proposing a $1.4 billion reduction in the state's education budget for this year, based on new calculations of the state's revenues, which in part determine minimum education spending under Proposition 98.

Schwarzenegger is also proposing 10 percent across-the-board cuts in all government spending for the next fiscal year, beginning in July.

While Proposition 98 legislates funding for public K-12 schools and community colleges, other colleges and universities will suffer as well. The University of California and California State systems are still reeling from cuts and attendant tuition increases enacted during the budget crisis of 2003. California students were once able to attend these schools free of charge, prior to budget reforms initiated by the governorships of Republican Ronald Reagan and Democrat Jerry Brown in the 1970s.

In additional to spending cuts, the state is also hoping to gain additional revenue through various privatization schemes, including $500 million through the planned sale of the state loan program EdFund and the leasing of the state's lottery system.

The EdFund program administers privately funded student loans under the Federal Family Education Loan Program, and currently manages a portfolio of $29 billion worth of outstanding loans, while the state lottery is mandated to provide 34 percent of its revenues to public education. These two measures in particular illustrate that state officials are more than eager to further abandon educational programs to the vicissitudes of the market.

The state is hoping to solve the present crisis through such massive spending reductions and privatization schemes in large part because the two primary solutions to the 2003 crisis—massive debt borrowing coupled with the continued expansion of the housing bubble—are no longer available and are themselves largely responsible for the current crisis.

The 2003 budget deficit was initially balanced through the approval of several billion dollars worth of state bonds. Of the approved $15 billion, the state has not yet repaid the $11.3 billion it actually borrowed, and under the terms of Proposition 58, passed by California voters in 2004, the state may not issue any future deficit bonds.

Of the $15 billion approved, however, the state may still borrow the remaining $3.7 billion as a last resort. Although this would satisfy, in part, constitutional requirements to balance the budget, it would inevitably exacerbate a future budget crisis and provide cover for more draconian spending cuts. According to the three largest credit rating agencies—Standard & Poor's, Fitch, and Moody's—the state's bonds already have the second worst rating in the nation.

In addition to cutting spending and selling public assets, state officials are proposing various increases in regressive fees and taxes. The state currently receives approximately 33 percent of tax revenue from sales and excise taxes and 52 percent from personal income taxes. The collapse of the housing market has impacted these two sources, prompting Sacramento officials to propose the creation of an Internet tax along with an increase in the Annual Car Registration Fee.

Tax increases are largely opposed by Republican lawmakers, who would rather balance the budget through massive spending cuts alone. State Democrats who support the increases will ultimately do nothing to close tax loopholes for large corporations and the rich, which, in and of themselves, would resolve the current shortfall. Both parties are instead united in forcing the state's working class and poor to pay for a crisis not of their making.

All of these austerity measures will arrive while the state's overall employment outlook remains quite bleak. According to California's Employment Development Department, (EDD), 1,020,700 people are currently unemployed, a net increase of 184,200 jobless between November 2006 and 2007. While the state itself realized a net gain of 24,000 jobs during this period, this was not commensurate with an overall labor force increase, which accounts for a rise in the unemployment rate from 4.6 percent to 5.6 percent.

State law requires companies to provide a minimum 60 days notice in advance of a mass layoff or plant closing. Nearly 700 of such Worker Adjustment and Retraining Notifications, or WARN notices, were made to the EDD between January 1 and November 30, 2007. This figure does not include force reductions involving temporary or contract workers, or employees working less than 20 hours per week, nor does it include businesses with fewer than 75 full- and part-time employees.

Many of the jobs lost were in the financial services sector, and, more specifically, the mortgage banking industry—that is, those areas most directly affected by the housing market collapse.

Of workers affected by the mass layoffs, 21 percent worked in mortgage banking and related financial services; 15 percent in the aerospace, hi-tech manufacturing and software industries; 14 percent in health care, pharmaceuticals and related industries; 9 percent in food services and agriculture; and 2 percent in the entertainment industry. All the aforementioned industries have long been considered the backbone of California's economy, the nation's largest, accounting for nearly 17 percent of US gross domestic product.

In addition to job losses, many adjustable rate mortgages are scheduled to reset in 2008, leading to a new rash of home foreclosures.

Governor Schwarzenegger is counting on, and will no doubt receive, the continued collaboration of the Democratic-controlled legislature in pursuing the needed cuts. In September, Democrats joined with Schwarzenegger in approving a budget that included hundreds of millions in cuts to social services. Both parties in the state of California, as in the country as a whole, are committed to a program that will deal with increasing financial distress through a sharp decrease in the standard of living of working people.