

California seeks massive loan from US Treasury to deal with financial crisis

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8 October 2008

In a letter sent to Treasury Secretary Henry Paulson last Thursday, California governor Arnold Schwarzenegger told the federal government that if the \$700 billion bailout of Wall Street failed to unblock the country's credit markets, California would be forced to ask the US Treasury for a financial rescue package. He suggested the federal government might purchase \$7 billion worth of state bonds that Sacramento has thus far been unable to sell on the market.

A recent article in the *Los Angeles Times* quoted Matt David, Schwarzenegger's communications director as saying, "California faces the potential of a perfect storm created by the financial crisis' effect on liquidity, lower-than-anticipated revenues currently coming into the state, and our late budget." Another administration official was even more blunt, saying that, "the window is shut, and if it stays shut, we are in deep trouble."

If the Treasury agrees, this would be the largest such loan given since 1975, when the US Government provided New York City with \$2.3 billion to stave off bankruptcy. As of October 7, the White House indicated that it was still considering Schwarzenegger's request.

In the letter sent to Paulson, the California governor indicated his support for the Wall Street bailout plan, adding his voice to those layers of the political establishment attempting to convince the ordinary population that the Treasury plan was in their interests. "The federal rescue package is not a bailout of Wall Street tycoons--it is a lifeboat for millions of Americans whose life savings, businesses, retirement plans, and jobs are at stake."

With the fate of the Wall Street bailout plan unclear at the time that Schwarzenegger made his request for financial aid, the governor indicated that he would use his influence to deliver a victory to the Bush

Administration by attempting to cajole the California congressional delegation into voting in favor of the bailout package.

The governor's letter followed on the heels of an announcement by the State Treasurer, Bill Lockyer, who said that without a sudden influx of funds, by the end of October the state's coffers would be dry, making it impossible to pay teachers' salaries, finance law enforcement, and continue bankrolling a significant portion of the public infrastructure and other state-supported services. One of the upcoming payments likely to be missed is a \$3 billion outlay to over 1,000 school districts across the state.

According to the *Los Angeles Times*, State Controller John Chiang, who is to issue official revenue numbers in a few days, said the news "will be bad." Chiang cited soaring unemployment and the evaporation of wealth caused by the stock market's drop as critical factors squeezing revenue.

Chiang called on California lawmakers to immediately return to Sacramento to address the crisis. Similarly, California Assembly Speaker Karen Bass said that an emergency legislative session may be needed. She is meeting Wednesday with Schwarzenegger to decide whether to call the Legislature into action.

California, like other states, typically relies on private sector financing during the autumn and winter months to fund state services until mid-spring when tax receipts are collected. The state secures short-term loans from large banks by issuing so-called Revenue Anticipation Notes or RANs.

Goldman Sachs and Bank of America have already been slated to manage the note sale during the week of October 13. However, state officials, doubting the willingness of large banks to purchase \$7 billion in

notes at one time, have proposed selling the notes in fragments over an extended period, meaning that the state would still not be able to meet its October 29 deadline, even if credit markets become unfrozen as a result government actions.

State officials have thus proposed raiding state retirement funds if the RANs cannot be issued in a timely and sufficient manner or if the proposed federal monies cannot be secured.

Democratic state senator Dean Florez, for example, proposed using the California Public Employee's Retirement System, (CalPERS), the largest pension fund in the US, to purchase the debt. Lockyer has proposed taking funds from both CalPERS and the California State Teachers' Retirement System. Effectively, this would mean that teachers and other public employees will pay their own salaries out of money they had previously saved up for retirement.

While it is true that both funds already finance state and local government operations by selling letters of credit to state bond issuers, the current economic climate raises questions as to whether or not the bonds will be repaid at maturity.

Despite the measures being proposed, it is still highly probable that the state will not meet its October 29 deadline and many state operations will simply cease to function. If the state continues to be unable to raise money on the market, as increasingly appears likely, California will then most likely formalize its appeal to the federal government to provide the necessary funding.

The letter to Paulson was delivered less than two weeks after Schwarzenegger signed into effect the 2008-2009 fiscal year budget. This new budget, which was passed with the support of the Democratic Party, was enacted 85 days after the start of the fiscal year. It consisted of a large-scale rollback in services for the state's most vulnerable residents, coupled with tax reductions for large corporations and the wealthy.

These measures were presented as the only reasonable solution to California's ongoing multi-billion dollar deficit, which has worsened over the course of the past year as the result of sharp decline in home values and the foreclosure crisis.

The enacted budget included a \$2.9 billion cut in education spending, a \$950 million reduction in public transit services, a 10 percent cut in state Medi-Cal

benefits, and the elimination of cost of living adjustments for Supplemental Security Income payments to the elderly and disabled. Schwarzenegger's vetoed of a tax rebate program for low-income elderly home renters and a \$500 million grant to fund HIV/AIDS research. These cuts along with others equaled a total reduction in state spending of \$7.1 billion.

In return for a two year suspension of certain tax credits, big businesses will receive an estimated \$1.2 billion each year through the refunding of taxes from previous profitable years and the transferring of tax credits among their respective corporate divisions, which will have the effect of decreasing the companies' total tax liability.

The budget continues a process of redistribution, in the interests of the rich, that has been going on in California for well over a decade. As Schwarzenegger's appeal for a federal bailout makes clear, this situation has made it impossible for the state to fund not only an array of drastically-reduced social programs, but the basic educational, health, and other services that ordinary people rely upon every day.

While Secretary Paulson has not yet spoken publicly about the initial proposal, House Finance Committee Chairman Barney Frank made his feelings known, saying that he opposed a loan to California as it could lead to other states asking for federal money. One day later, however, the congressman's home state of Massachusetts requested funds from the Federal Government to deal with a financial crisis of its own, indicating that California has now become only the first state of many.



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