California finances plummet less than three months after budget passage

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California finance officials have announced that the state has a current budget deficit of $1.1 billion. News of the shortfall comes less than 10 weeks after a balanced budget deal was reached by Republican Governor Arnold Schwarzenegger and the State Legislature.

An October report released by State Controller John Chiang announced that the latest budget deficit was mainly due to a large drop in third quarter income tax collection; revenues were 11 percent lower than initially projected.

The California Department of Finance is also expecting a deficit of $7.4 billion at the start of fiscal year 2010-2011, which begins next July. This could climb to as high as $20 billion by the start of fiscal year 2011-2012.

Loss of tax revenue due to the economic crisis and widespread unemployment and wage reductions is not the only component of the budget deficit. The state's fiscal health is also largely dependent upon the willingness of outside investors to purchase its municipal bonds and other securities.

As recently as last summer, the state's credit rating was lowered by all three of the largest agencies, Fitch, Moody's and Standard & Poor's, to the lowest in the nation. The state effectively became insolvent at that time and was reduced to handing out IOU's instead of actual cash payments to vendors, tax refund recipients and others.

The state's credit rating was restored only after austerity measures—the gutting of billions from public education and social programs—were passed last July to the satisfaction of the rating agencies and municipal bond investors.

This October, however, the state attempted a bond sale in which it only sold approximately $400 million of the $4.1 billion it had initially offered. Despite the fact that the state's bonds typically outperform the average stock return on the benchmark S&P 500, investors demanded much higher returns. This means that the state will likely be able to sell less than the initial $4.1 billion, forcing further cuts to social programs.

In another recent development, on October 31, the state began withholding an additional 10 percent in state income taxes from workers' paychecks. The state has promised to refund the additional withheld amounts once California residents file their 2010 tax returns.

This measure, which was a little-publicized provision of last July's budget deal, is expected to give the state up to $1.7 billion in additional revenue. The 10 percent income tax increase is part of several regressive tax increases recently passed by the legislature which included an earlier 0.25 percent rise in the state income tax, a one percent increase in state sales tax and a doubling of the vehicle license fee.

The most recent $1.1 billion deficit and those that will follow it ensure that further cuts to social services and public infrastructure will be in the offing. In a statement accompanying his deficit announcement, Chiang said, "I urge lawmakers and the governor to prepare for more difficult decisions ahead," while state treasurer Bill Lockyer called the state's budget a "train wreck" and added that "it's going to get worse."

Approval ratings for both the governor and the state legislature are now at abysmal lows due to the state's endless financial difficulties. A poll released in early October by the Field Institute recorded a 27 percent approval rating for the governor while the Legislature garnered an approval rating of only 13 percent.

Sacramento's widespread unpopularity among the population will not, however, force the political

establishment to reverse course. As the state's fiscal crisis deepens, the vicious austerity measures passed last July will prove to have only been a prelude to further cuts. State Democrats and Republicans, like their counterparts at the national level, are united in making the working class pay for the financial crisis.