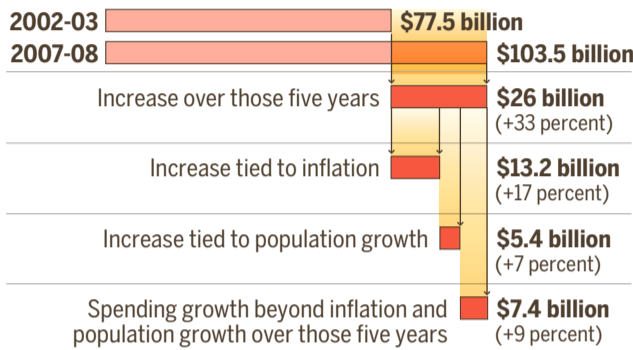


On the rocky road to the 2008-09 budget

Why does California seem to struggle with its budget every year? Is state spending really out of line, as Republicans suggest, or are Democrats right when they say we need more revenue? **Dan Walters** walks us through some key mileposts on the road to this year's state budget stalemate, and offers some key statistics to help you get to the bottom of the debate.



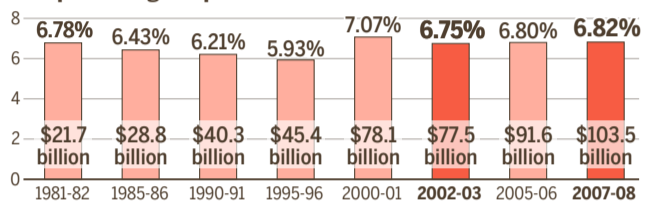
GENERAL FUND SPENDING



IS STATE SPENDING OUT OF CONTROL?

One way of measuring state spending is by looking at its relationship to the overall economy. In the last five years, general fund spending has increased from 6.75 percent of Californians' personal income to 6.82 percent.

Fiscal year general fund spending* as a percentage of personal income



*Not adjusted for inflation. Source: California Department of Finance

BIGGEST CONTRIBUTORS TO SPENDING GROWTH

PRISONS

Spending jumped nearly 75 percent, from \$5.8 billion a year to \$10.1 billion, thanks not only to an 11,000-inmate increase in prison populations but sharply higher salaries for guards and other prison workers.

VEHICLE LICENSE FEES

Gov. Arnold Schwarzenegger cut the car tax but promised to pay local governments who use the money from the state treasury anyway. State payments to local governments rose about \$3 billion over the period, to \$6.1 billion per year, as more cars hit the road and their value increased.

EDUCATION

The biggest dollar increase has been in state support of K-12 education, from \$28.8 billion in 2002-03 to \$42.1 billion in 2007-08, but \$6.1 billion of that increase was from shifting the method of reimbursing local governments for losses of vehicle license fee revenues. The real increase for schools was \$7.2 billion, or 25 percent. Inflation during the period was 17 percent, and school enrollment was relatively flat, so inflation-adjusted per-pupil spending by the state did rise by approximately 8 percent.

OTHER FACTORS

Spending on Medi-Cal also outstripped population growth and inflation due to increased health care costs. Increases in most other major state expenditures were in line with inflation and population growth.



30 YEARS OF BUDGET PROBLEM MILEPOSTS

MILE 1 PROP 13

1978: Before 1978, fashioning a state budget each year was a fairly routine task. But passage of Proposition 13 in June 1978, which slashed local property taxes, began a radical budgeting

makeover. General fund spending jumped as the state assumed greater responsibility for schools and local services.

MILE 2 GANN LIMIT

1979-1990: After Proposition 13 passed in 1978, its co-author, Paul Gann, sponsored a 1979 measure to limit government spending increases to inflation and population growth, with excess

revenues rebated to taxpayers. The measure limited state spending increases in the 1980s, and mandated one rebate, but was loosened in 1990 as part of deal between Republican Gov. George Deukmejian and Democratic legislators on a boost in gas taxes. The Gann Limit has never been a factor in the state budget since, but Republicans are now demanding that it be revived.

MILE 3 PROP 98

1988: The budget continued to balloon as the state assumed more burdens previously borne by property taxes. In 1988, a coalition led by

the California Teachers Association persuaded voters to pass Proposition 98, aimed at giving schools a guaranteed portion – 40 percent or more – of the state's revenues.

MILE 4 TAX HIKES

1991: The end of the Cold War and the rapid drop in military spending plunged the state into the worst recession in a half-century. General fund

spending was virtually frozen at about \$40 billion for several years as GOP Gov. Pete Wilson battled with Democrats and the CTA. They balanced the budget by raising income and sales taxes, cutting some state spending and forcing local governments to shoulder some of the impact. A temporary sales tax increase was later made permanent, with approval

of voters, to make up some of the losses to local governments.

MILE 5 TAX CUTS

1999-2000: A new economic surge, centered on the high-tech industry, flooded state coffers. Revenues – mostly income taxes – skyrocketed to

\$75.7 billion in 2000-01. Under Wilson and then-Democratic Gov. Gray Davis, spending also jumped sharply for schools and health care for the poor. Republicans demanded and got billions of dollars in corporate and individual tax cuts, including a two-thirds cut in property taxes that motorists paid on their cars, known as vehicle license fees or the car tax.

MILE 6 .COM BUST

2001: The surge of revenue from high-tech stock transactions was a one-time windfall. As the dot-com bubble burst, revenues dropped to \$62.7 billion in 2001-02,

leaving the state with a \$14 billion operating deficit that year. Thus

began a cycle of deficits that has plagued the state ever since. The gap narrowed somewhat middecade as the state's economy picked up again, but has worsened since the housing industry's meltdown.

MILE 7 CAR TAX

2003: As the state's deficit worsened, Davis reinstated the car tax to ease the impact on the general fund. The move added fuel to a drive to recall him. Actor

Arnold Schwarzenegger made restoring the tax break a cornerstone of his campaign, a promise he fulfilled in his first act as governor, even as he promised to end "crazy deficit spending."

MILE 8 BONDS & DEBT

2004: Schwarzenegger persuaded voters to approve \$15 billion in bonds to refinance short-term debt the state could not repay. Repaying those

bonds has become a multibillion-dollar bite on the general fund, worsening the deficit. His aides contend that the

repayments should not be counted as spending increases on his watch, since they covered deficits run up during the Davis years. Overall, however, general fund spending has outstripped population growth and inflation during Schwarzenegger's five years as governor. Gaps have been covered largely by borrowing, including raids on special funds, and accounting maneuvers, such as shifting liabilities to the next fiscal year.

MILE 9 BIG GAP

2008: Schwarzenegger has pegged the 2008-09 deficit at \$15.2 billion plus another \$2 billion he says the state needs as an emergency

reserve. He initially proposed borrowing against the state lottery's future profits, as well as making some spending cuts and accounting maneuvers to close the gap. Recently he has proposed a temporary one-cent increase in the state sales tax, which would raise about \$6 billion a year – about what the car tax cut costs the state.