

California's budget gap won't close for long

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By [Jim Christie](#) - Analysis

SACRAMENTO, California (Reuters) - Even if California Governor Arnold Schwarzenegger and top lawmakers quickly plug a \$26.3 billion deficit to balance the state's budget, the state's weak revenues signal that a new shortfall will emerge.

Schwarzenegger and lawmakers say they are near a deal to balance the budget, even though a hoped-for agreement did not emerge on Wednesday because of a part of his plan to suspend a law on school funding.

A balanced budget for the fiscal year that started July 1 would allow the state to resort to traditional borrowing, providing a steadier supply of cash at a better price than the unorthodox IOUs it has been forced to issue in order to conserve cash.

But a balanced budget is seen as fleeting because California's economy, which is reeling from high unemployment and the recession, will remain in the dumps for some time. Closing the current shortfall does not account for further deterioration in the economy -- and revenue -- that many economists expect.

"It will be horrible next year," said economist Steve Levy of the Center for the Continuing Study of the California Economy.

The UCLA Anderson Forecast unit last month said in a report that California's economy is in for a "continued rough ride for the balance of 2009 and is not going to see economic growth return until the end of the year." The unit also projected the state would suffer double-digit unemployment until 2011.

California's revenues from personal income tax collections, its main revenue source, are posting their worst decline since the Great Depression.

"By no stretch of the imagination is it done," said Christopher Thornberg, an economist at Beacon Economics in Los Angeles. "This isn't going away any time soon."

RETAIL SALES TAXES WEAK

Orange County Supervisor John Moorlach said retail sales tax collections also will be weak for some time as consumers rein in spending.

Moorlach said he sees that happening all across Orange County, in Southern California, home to the subprime mortgage industry whose loans helped fuel the housing boom earlier this decade.

Many of the industry's former employees are living on bare-bones budgets and their absence from shopping malls will add strain to both local and state finances, Moorlach said.

"Our social services offices have seen a lot of former mortgage brokers applying for food-stamps and welfare," he noted, adding that the number of individuals and businesses in his county seeking bankruptcy protection rose 62 percent in May from a year earlier and 5.4 percent from April.

"Let's just hope the bottom (of the recession) is getting closer and closer," Moorlach said.

WALL STREET CONCERNED

Wall Street credit rating agencies are likewise on edge over California's tumbling revenues.

Moody's Investors Service earlier this week cut its rating on about \$72 billion of the state's general obligation debt by two notches to Baa1, or three notches above speculative status, and said the rating may suffer further downgrades.

Without a solution to the budget gap, the risk to priority payments is increasing, Moody's said.

To conserve cash for top payments, state finance officials began on July 2 issuing IOUs, an emergency measure they have taken only once before since the Great Depression. Through Tuesday they had issued roughly 130,500 IOUs worth \$588 million, according to the state controller's office.

Standard & Poor's managing director Steven Zimmermann is eager to see details of any budget agreement for signs of how Sacramento will manage its finances in coming months.

Zimmermann said it will be essential that Schwarzenegger and lawmakers not flinch from cutting spending beyond the deep levels they are now contemplating and from raising revenues to keep the state's budget in balance if necessary.

"We hope the legislature would step up and with the governor make changes if they were necessary," he said, noting S&P rates the state's general obligation bonds at A and has them on its CreditWatch with negative implications.

(Editing by Leslie Adler)

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