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Dan Walters: Recession holds key to budget

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Whether the latest incarnation of the deficit-plagued state budget hangs together and whether the state faces another fiscal meltdown next year are largely dependent on something completely out of politicians' hands – whether the state's recession-battered economy perks up.

Gov. Arnold Schwarzenegger assumes the recession will hit bottom late this year with a slow recovery next year. "This is a very uncertain period," Mike Genest, Schwarzenegger's budget chief, said in Fresno last week.

"We think an economic recovery starts in the fourth quarter. If not, we'll be back in a budget crisis."

This recession is not only unusually deep, but unusually wide.

When the housing industry meltdown, centered in California, transmogrified into a full-blown global banking crisis, it affected every segment of the economy, unlike past recessions.

Thus, California has not only seen unemployment skyrocket to levels not seen since the Great Depression – 11.6 percent most recently – but there's been a massive loss of consumer confidence, which has clobbered retail sales. New car sales, for instance, are half of what they were just a few years ago.

"The recovery ... depends on the strength and speed of the federal stimulus package and the pace of worldwide economic recovery," said Steve Levy of the Center for the Continuing Study of the California Economy. "There are no indications that private sector activity will turn up soon in the absence of aggressive stimulus efforts or worldwide growth."

Christopher Thornberg of Beacon Economics noted that income taxpayers will be carrying over stock market losses to offset any income gains, and retail sales will be re-benchmarked downward as wary consumers – loaded with debt – divert income, when possible, into debt repayment and savings. Ominously, 10 percent of California's home mortgages are delinquent or worse.

Even were the recession to bottom out statistically in a few months, employment and consumer spending, economists agree, are destined to remain stalled for at least another year. And that probably will mean continuing budget woes for state and local governments, especially the former, whose revenues come primarily from income and sales taxes.

The state Department of Finance is projecting an initial deficit of \$7 billion to \$8 billion for the 2010-11 fiscal year that begins in 11 months. Even as it continues to struggle with the current year's budget, the department soon will begin drafting its 2010-11 version for the governor to unveil in January.

That estimate, however, is based on its somewhat rosy economic outlook, coupled with an assumption that the current fiscal year will end next June without a big deficit, such as the \$3.4 billion shortfall from 2008-09 that bled into 2009-10.

"It seems awful optimistic to me," said Thornberg, adding a "back-of-the-envelope" guess that the 2010-11 problem will be more like \$15 billion to \$20 billion, given ongoing economic woes.

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