

The lowdown behind California budget-speak



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On May 14, Governor Schwarzenegger presented his May Revise budget proposal at a media conference. TV and radio accounts were largely confined to a few soundbites that pointed to a major budget crisis but provided little detail. Newspaper accounts were more thorough, sometimes containing charts and graphs derived from the May Revise documents. But even someone in the declining ranks of newspaper readership who was diligently trying to follow the story would likely be foiled by California budget-speak and opaque accounting practices. So what is the story and is there a path to resolution? And what does it mean for UC?

Of course, the basic fact is that the budget outlook remains grim. Close to home, even the modest partial restoration of the University of California budget item proposed by the governor was rejected by State Senate President Darrell Steinberg. Steinberg pointed to threatened social services as a clear-cut higher priority than restoring past funding cuts to higher education. While both the governor's proposal and the legislative reaction can be viewed as the opening of a prolonged negotiation, it is quite clear that the University will need to prepare a Plan B for next year's budget. It cannot count on even the modest state support the governor proposed.

Moreover, sharp differences between the governor and the key legislators suggest a prolonged summer stalemate with no budget in place. For the University, that development is especially unfortunate since it will occur at a time when the Regents are scheduled to be considering proposals affecting the long-term future of UC. They will have to make key decisions in the face of uncertainty about state policy. And the dynamics of an election year will add to the uncertain fiscal climate.

We could easily see a repeat of the budget impasse of summer 2008. That impasse did not conclude until mid-September, also with an Election Day looming. The result was passage of an unsustainable budget that all participants knew would have to be reopened in midyear.

In the present budget crisis, and even before issuing his May Revise, the governor had been speaking of a \$19-\$20 billion "deficit" that needed to be fixed. It had been alternatively been described as a gap, a shortfall, or just a hole. But exactly what does the number mean? California budget-speak unfortunately tends to be fuzzy about time periods and concepts. It mixes past debt with current developments and future projections. Borrowing and the equivalents of borrowing are sometimes treated as revenue. Mysterious negative expenditures appear in official documents. And descriptive words used in the media and by state officials — such as "hole" — are not found in accounting textbooks. These longstanding semantic practices are unhelpful in understanding the budget or in resolving the crisis.

So let me pull a few numbers from those released in the context of the May Revise that may be useful. Revenues — mainly taxes — are actually projected to be up in 2010-11 (which begins on July 1) compared to the soon-to-end current year (2009-10). The rise reflects a combination of the California economy bottoming out and of the temporary tax increases that were enacted in February 2009. In grossly rounded terms, the governor projects that revenues in 2010-11 will be something like \$90 billion. And he offers a workload projection of expenditures (what would happen if current fiscal policy is unchanged) of around \$100 billion.

In common parlance, you might say that with revenues short of expenditures by \$10 billion, the governor is projecting a deficit of \$10 billion for the coming year. Now \$10 billion is a big challenge, but it is roughly half of the \$19 to \$20 billion deficit-gap-shortfall-hole we are said to have. So what is the other part? The remainder is best thought of as an accumulation of past sins from prior years, i.e., debt that has accumulated in the state's general fund in the years before 2010-11 including during the current year. Debt accumulates when there is an ongoing excess of expenditures over receipts.

There are really two problems facing the state that have been wrapped into that widely-cited \$19-\$20 billion figure. Lumping them together amplifies the crisis. The state now faces a *financing problem* — how to deal with the resulting accumulated debt and over what time period to pay it off. And it faces an *imbalance problem* of inflows and outflows that would otherwise occur in 2010-11. Saying that we must fix the entire \$19-\$20 billion deficit-shortfall-gap-hole by July 1 - or even just within 2010-11 — tends to make the overall fiscal challenge intractable and invites a prolonged stalemate. It is important to separate the two challenges.

The combined financing/imbalance challenge is analogous to the budget crisis and stalemate California experienced in the summer of 2003. That crisis led to the recall of Gray Davis and his replacement by Arnold Schwarzenegger. Ultimately, Schwarzenegger resolved the Davis crisis by treating the financing problem and the imbalance problem separately. The debt repayment period was extended beyond the fiscal year. California issued “Economic Recovery Bonds” to deal with the financing problem, in effect allowing the resolution of the financing problem to occur beyond 2003-04.

We can wring our hands about what has been called in the past “kicking the can down the road,” i.e., extending the financing period. We can point to the dysfunctional processes that led to the financing problem and to the better decisions that could have been made when the state's economy was booming. And we can hope that Washington will provide some assistance, at least with regard to the financing problem. But in the end here we are right now.

Unless the two problems I have outlined are separated, the anger and frustration that were evident on both sides when the May Revise was presented will continue. Fingers will point and names will be called. The necessary negotiating process between the governor and the legislature will be hindered and delayed. Furthermore, Washington will not provide assistance unless there is a coherent proposal from the state.

At present, the fiscal challenge has been presented in the most intractable format possible because the dual problems — financing and imbalance — have not been separated. That failure to unravel the fiscal challenge is bad for California and bad for the University of California.