



## Why this budget crisis is different than any before

According to the California Budget Project, California's projected \$16 billion shortfall for 2008 is smaller in both percentage and dollars than deficits of recent years. However, this year's budget gap will likely prove to be the toughest challenge we've seen to date. Here's why:

- California has faced budget shortfalls continuously since 2001. The duration of the state's fiscal crisis means that all of the easy solutions, such as borrowing unspent reserves, deferring maintenance, and eliminating nonessential programs and services, were used up long ago.
- The state has borrowed and belt-tightened to the point where the debt service on amounts borrowed to close previous years' budget deficits will add about \$2.5 billion to the 2008-09 budget, rising to more than \$4 billion in 2009-10, and deferred expenditures have left many public systems — from bridges to schools to foster care — near a breaking point.
- The budget crisis at the beginning of this decade was largely caused by a sharp drop in income tax collections that occurred when the dot-com boom turned into the dot-com bust. The significance of this is twofold. First, while the drop in investment-related income was substantial, it overwhelmingly affected the wealthiest Californians. Second, revenues flowed into the state's coffers, with school and local government budgets largely left untouched.
- California's economy has weakened substantially in the past six months. The unemployment rate has increased, reaching its highest level in more than three years. Sales tax collections have declined, the inflation rate has risen 20 percent in the last seven years, and the housing boom has disappeared.
- The mortgage meltdown's impact on public budgets and services is more broadly based than that of the dot-com bust. The downturn in the housing market has depressed local property tax collections — affecting school districts and the state, as well as local cities and counties. It has also affected sales tax collections, as fewer home sales translate into fewer appliance purchases, and families divert a larger share of their incomes toward their mortgage payment, leaving less for other types of consumer spending.
- California's tax system contributes to the budget gap. Over the last several years, lawmakers have cut taxes and voters have "locked in" an increasing share of the state budget for specific programs. Tax cuts enacted since 1993 will cost the state \$12 billion in lost revenues in the current year alone. The largest tax cut — the reduction of the Vehicle License Fee — will cost the state \$6.1 billion in 2008-09. This is more than enough to buy out all of the governor's proposed cuts to public schools, colleges, state parks, and programs for the poor. In addition, corporate income taxes as a share of the state's budget have declined. If corporations paid the same share of their profits in corporate taxes in 2005 as they did in 1981, corporate tax collections would be \$7.3 billion higher.