COMMENT

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Viewpoint

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Stabilizing California's Budget

Earlier this month, Gov. Arnold Schwarzenegger unveiled his 2008-09 budget, which takes difficult but necessary steps to stabilize the budget and address the problem that drives California's chronic deficits.

The governor's budget does not raise taxes, but it reduces funding for nearly every spending program by 10% for the next fiscal year. The cuts are likely to impact virtually everyone and, although extremely painful, they are necessary because the state budget is \$3.3 billion in the red this year. If nothing is done to prevent it, that deficit will increase to \$14.5 billion by the end of the next fiscal year.

Permanent Spending

When the governor took office in 2003, he inherited a financial crisis. The budget was fundamentally out of balance because the Legislature and previous administration had added permanent spending obligations during temporary stock market and dot-com booms. The governor is trying to stop this rollercoaster by proposing—for the third time—a budget stabilization act.

To understand why we need this change, consider the following. For the nine budget years from 1998-1999 to 2007-2008, California's tax revenues grew at an average annual growth rate of 5.8%, close to the growth in personal income over the same period of time. But look at the wild ride our annual revenue took to achieve that average:

Budget Year	Yearly % Change
2007-08	1.6%
2006-07	2.7%
2005-06	13.6%
2004-05	9.9%
2003-04	4.8%
2002-03	-1.1%
2001-02	1.1%
2000-01	-0.7%
1999-00	23%

Even though our average annual growth was 5.8%, each year's growth swung wildly, with some years up, some years down, and not a single year within 10% of the average.

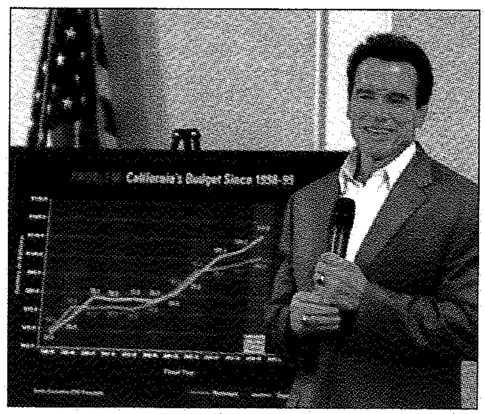
This up-and-down volatility results from the nature of California's tax system, which is highly dependent on very few taxpayers (10% of California's taxpayers provide more than 80% of our tax revenues) and a cyclical stock market and other investment gains.

With budget revenues growing on average at close to the same rate as our economy grew, our problem is not that we need more tax revenue but rather that we don't set aside some of that tax revenue in years of above-average growth in order to provide for years of below-average growth.

Rainy Day Money

The proposed budget stabilization act will do what every family, business and not-for-profit does when faced with such volatile revenues: set aside money in the above-average years to make sure there is enough money in below-average years. It's really that simple.

Also, California's infrastructure—roads, schools, courthouses, water supply—is ageing. So, even in a world of tight budgets, we



Schwarzenegger on budget stump: proposing budget stabilization act

must continue to rebuild our infrastructure because those capital expenditures provide huge dividends in the future in the forms of better quality of life and greater economic growth.

To make these new investments, the governor wants to leverage partnerships with the private sector through performance based infrastructure to deliver more value for government money and better service to constituents and government workers.

Growth Council

The governor also proposed the creation of a strategic growth council to coordinate state agency activity in order to make our infrastructure investment projects efficient and sustainable, with years of lasting benefits.

In addition, \$48.1 billion of new general obligation bonds were proposed to augment the existing funds for the strategic growth plan through 2016. This new funding would be put toward long-lived assets that produce years of benefits for our residents, such as K-12 and higher education, the court system and the expansion of the state's water supply and management systems.

It's unfair—and unnecessary—that Orange County schools, nursing homes and parks must worry about their fate every year because of volatile tax revenues. We need a system that accommodates that volatility by reserving money in strong years in order to provide more money in weaker years. And we must continue to make smart capital investments that improve quality of life and pay dividends in the future.

Crane is special adviser to the governor for jobs and economic growth.