



Arnold opens door to tax hike

Governor's budget would borrow from lottery to cut deficit

By Harrison Sheppard, Staff Writer

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DOCUMENT: [Gov. Schwarzenegger's May Revised Budget](#)

Faced with a faltering economy and a worsening budget deficit, California Gov. Arnold Schwarzenegger, for the first time in his five-year tenure, opened the door Wednesday to a potential tax increase in his proposed 2008-09 budget.

Schwarzenegger said he will ask lawmakers and voters to authorize the state to borrow up to \$15 billion against future state lottery earnings over three years - but if that fails on the November ballot it would trigger an automatic 1 percent increase in the statewide sales tax for at least three years.

The proposal contrasts with promises Schwarzenegger has made from the beginning of his term to refuse to raise taxes, while also ending borrowing for normal government

operations.

"The (deficit) problem we face today is still \$17.2 billion, so our crisis is real and it is very serious," Schwarzenegger said at a press conference in Sacramento.

In unveiling his revised budget, the governor also backed off several of the more controversial cuts he had proposed in January and now said he will no longer seek to close 48 state parks and release thousands of prisoners early to try to save money.

Instead, he is planning for steeper cuts in health and human services. He will also cut education by about \$4.3 billion - although that's less than he had previously proposed - while still maintaining the minimum funding guaranteed under Proposition 98.

His proposed budget calls for \$144.3 billion in overall state spending next fiscal year, including \$104 billion in the general fund.

That is a slight increase from the current year, but because of growing costs and expanding needs for state services, it is considered a cut in overall service.

But Schwarzenegger is likely to have a difficult time getting the two-thirds support he needs to get his proposal through the state Legislature.

Democrats assailed the spending cuts, while Republicans attacked the possible tax increase and borrowing. A wide range of interest groups

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and local government officials were also unhappy.

"This is a budget beneath a governor of this great state," said Senate President Pro Tempore Don Perata, D-Oakland. "It's telling our citizens: This is it. Our best years are behind us."

"Under this plan, schools will lay off teachers and increase class sizes, and we will abandon children and the elderly. It's shameful."

Sen. George Runner, R-Lancaster, chairman of the Republican Senate Caucus, said the lottery/tax increase plan is unlikely to get a single Republican vote.

"It's outrageous," Runner said. "Both parts of the concept are bad."

He said the state has already tried to borrow its way out of the deficit when Schwarzenegger first took office and persuaded voters to approve billions in economic recovery bonds.

At the time, he promised that the state wouldn't have to borrow any more after those bonds.

"He just applied for a new credit card," Runner said. "It's called the state lottery."

Schwarzenegger Finance Director Mike Genest said that technically the lottery plan is not a form of borrowing. Instead, he called it "selling a future stream of revenue in exchange for a cash payment today."

The move is expected to generate about \$15 billion over three years, which would be put into the state's rainy-day reserve fund.

Some Democrats, however, were at least glad to see the governor has finally dropped his absolute opposition to using taxes to climb out of the state budget hole.

Assemblyman Mike Feuer, D-West Hollywood, a member of the budget committee, said that recognition by the governor is the first step toward crafting a more "balanced" approach to the budget.

The state's projected budget deficit of \$17 billion reflects a sharp increase from five months earlier. It also represents an inability by Schwarzenegger to live up to another one of his top campaign promises in the 2003 recall - getting the state budget under control.

Five months ago, the deficit was projected at \$14.5 billion over an 18-month period, but cost-cutting measures taken by the Legislature in February chopped that figure in half. But the state housing sector continued to worsen and the deficit ballooned again.

A wide range of groups and local government officials expressed concerns about the governor's proposed cuts.

"The governor's public-school budget cuts amount to educational malpractice in the devastating impact they will have on our kids," said Los Angeles Unified school board President

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Monica Garcia.

A spokesman for Mayor Antonio Villaraigosa said the mayor was reviewing the proposal.

"We ... hope that some creative compromises can be made in order to honor the state's obligation to improve schools, public safety and transportation," said Gil Duran.

The governor's sales-tax increase might also threaten plans by the Los Angeles County Metropolitan Transportation Authority to place a half-percent sales-tax hike on the county ballot in November.

The tax hike would generate about \$700 million per year for local transportation projects. Metro's board is expected to ask county supervisors next month to place the measure on the ballot.

Metro CEO Roger Snoble on Wednesday had no immediate reaction to Schwarzenegger's proposal to raise sales taxes.

"Obviously, we would have some competition," said Metro spokesman Marc Littman.

Jack Kyser, chief economist at the Los Angeles County Economic Development Corp., said that with the weak economy, rising prices for food and oil, and a possible Metro tax hike, the public will not react well to the governor's tax proposal.

"I think consumers will be hostile to any possible tax increase," Kyser said. "Consumers are going to be very skeptical, because they're under

extreme financial pressure."

Student and faculty groups were glad that the governor's proposal included a smaller cut to the California State University system than proposed in January - about \$288 million instead of the earlier \$386 million.

Still, the California Faculty Association urged the governor and legislators to restore the full amount.

"California cannot afford to balance the state budget on the backs of students, their families, and the businesses that rely on the CSU for an educated work force," said CFA President Lillian Taiz.

Staff Writers Troy Anderson, Rick Orlov, Sue Doyle and Connie Llanos contributed to this report.

The Mercury News

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Schwarzenegger budget calls for expanding lottery, cutting programs

By Mike Zapler
Mercury News Sacramento Bureau

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Audio

- [Governor's press conference on revised budget \(24 minutes\)](#)

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SACRAMENTO - Anxious to avoid deep cuts in education spending, Gov. Arnold Schwarzenegger today on Wednesday proposed dramatically expanding the state lottery and slashing programs for the poor and disabled instead, to help close a budget gap now pegged at \$17.2 billion.

Schwarzenegger hopes to win voter support in November for a deal to obtain \$15 billion from Wall Street firms, to be repaid from what the governor expects will be greater lottery profits over as long as 32 years. The governor proposes increasing both the number of gambling games, and the amount they will pay out, to increase the lottery profits as a way of enticing the firms to provide the \$15 billion.

If voters rejected were to reject the plan, a 1-cent sales-tax increase would automatically kick in.

The possibility of a tax increase is a marked shift for Schwarzenegger, who in the past has proclaimed his opposition to tax increases.

The governor said his plan is designed to limit cuts to education and get the state back on sound financial footing. But it was met immediately by bipartisan resistance in the Legislature, which would have to approve both the social-service cuts and the lottery referendum idea with a two-thirds vote.

Schwarzenegger said he had little choice.

"I know this is going to be very difficult and very painful," the governor said, referring to the health and social-service cuts. "But the bottom line is we can't afford to spend money we don't have." He called the lottery an "underperforming asset" that needed to be "modernized," with a goal of doubling its current annual profit of \$1.2 billion. The proposal calls for schools to continue to receive the first \$1.2 billion in profit from the lottery, with the Wall Street firms collecting from profits beyond that amount.

The proposal allowed the governor to avoid calling explicitly for a tax increase, although Republicans said they oppose even the possibility of raising taxes. And while Schwarzenegger promised voters four years ago that he wouldn't ask to borrow money again to balance the state budget, the lottery deal would be tantamount to a loan, even though Schwarzenegger insisted on not calling it that - his staff is using the term "securitization."

The governor intends for one-third of the \$15 billion to go toward the deficit in the fiscal year starting in July. The rest would be used to create a "rainy day" fund to shield the state against future downturns - a top priority of his. The money would be paid back, with interest, over a period up to 32 years.

If voters reject the proposal, a temporary, 1-percentage-point increase in the state sales tax would go into effect, lasting until state finances

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improved and the budget was balanced. The sales-tax increase would be reversed if tax revenues rebound and the state turned a surplus, and it would sunset by the end of fiscal 2010-11 at the latest.

The governor also dropped two other unpopular proposals from his January budget proposal: closing 48 state parks, and releasing about 22,000 inmates from prison before their terms expire. Instead, he suggested raising fees by \$1 or \$2 at several popular parks.

Other services did not fare nearly as well. Health care advocates said the governor's cuts would deny coverage to hundreds of thousands more people and reduce access to care for many more.

His plan would cut hundreds of millions of dollars used to supplement the salary of in-home support-services workers who care for the elderly; eliminate a welfare program and reduce health care services for immigrants; deny federal cost-of-living increases to a welfare program that helps the elderly, blind and disabled; and make a parent in a family of three earning \$11,000 ineligible for Medi-Cal, the health care program for the poor and disabled.

Those reductions would be over and above more than \$4 billion in cuts to health and human services that Schwarzenegger proposed in his January budget. "Governor Declares War on the Poor," read the headline of a news release by the Western Center on Law and Poverty.

Santa Clara County officials said a hasty review of the budget proposal Wednesday indicated it could raise by \$70 million the county deficit, which already was projected at more than \$170 million.

"There's only so much you can keep cutting from

the poor," said Patricia Gardner, executive director of the Silicon Valley Council of Nonprofits.

And consumer advocate Anthony Wright of the group Health Access called the governor's plan "a massive step backward" for the state's already tattered health care system.

Education advocates, on the other hand, were cautiously heartened that the governor sought to reverse some of the cuts to schools he had called for earlier this year. His revised budget would provide a small funding boost and avoid suspending Proposition 98, which guarantees a minimum level of funding for schools each year.

"This is definitely a step in the right direction," said Terry Anderson of School Services, a Sacramento consulting firm that lobbies on behalf of school districts.

While the California Teachers Association continued boisterous rallies Wednesday to warn that 18,000 teachers could lose their jobs, only a handful of tenured teachers in Santa Clara County had received notice by today's deadline under state law.

The fate of the governor's plan rest in the hands of the state Legislature, where the proposal faces a tough audience. Democrats blasted the cuts to health and human services and called the lottery plan a "gimmick," while Republicans criticized the sales-tax increase, even as a last resort.

"Democrats are not going to accept this budget," predicted Sen. Denise Moreno Ducheny, D-Chula Vista, who chairs the budget committee. She called the spending plan "dishonest and irresponsible" and said, "It does use gimmicks, it does overborrow, it is much more of the same."

Republicans said they would consider the lottery

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proposal, but not if it was it's linked to a sales-tax trigger.

"The lottery is underperforming, and it could be part of the solution," said Senate Republican Leader Dave Cogdill, R-Fresno. "But we're not interested in raising taxes."

The current state sales tax is 7.25 percent. But counties can levy an additional tax, so the overall rate ranges from 7.25 percent to 8.75 percent depending on the county. In Santa Clara County, residents currently pay 8.25 percent; a 1-cent increase would raise that rate to 9.25 percent. Finance officials now peg the deficit for fiscal 2008-09 at \$15.2 billion. But Schwarzenegger wants to create a reserve of about \$2 billion, bringing the total gap to \$17.2 billion. The total general fund for fiscal 2008-09 is estimated at \$101.8 billion.

Mercury News Staff Writers Dana Hull, Sharon Noguchi, Karen de Sá and Edwin Garcia and Bay Area News Group Staff Writer Steven Harmon contributed to this report. Contact Mike Zapler at mzapler@mercurynews.com or (916) 441-4603.



Wednesday, May 14, 2008

Governor proposes revised budget to cover deficit

Among solutions is plan to borrow against the lottery or raise sales tax.

BY BRIAN JOSEPH

The Orange County Register

SACRAMENTO -- Breathe easy, California.

Five months after proposing a scorched-earth budget that would have released prisoners, closed parks and cut education, Gov. Arnold Schwarzenegger made an about-face Wednesday, dismissing all of those plans for a less invasive -- and more unconventional, solution to the state's financial woes.

Schwarzenegger's new plan centers on \$9 billion in cuts as well as securitizing the state lottery to bridge a deficit now estimated at \$17.2 billion for the 2008-09 fiscal year.

The governor's lottery plan projects that the state can secure in essence a \$5 billion advance on proceeds to cover the state's operating expenses. The plan hinges, however, on voter approval, so the governor is also proposing that if it's rejected the state increase the sales tax by 1 cent.

"As the deficit grew these past few months, I knew we could not solve this crisis by cuts alone," the governor said in a statement. "We had to get creative and find new revenues without raising taxes."

The idea was immediately panned as unrealistic and unwise budgeting.

"I don't think that's a good policy," said former Senate Republican Leader Dick Ackerman, of Irvine, adding that a smarter approach would be to pay down the state's debt.

Ackerman predicted that Republicans wouldn't support the lottery plan and would continue to push for a "cuts only budget." In addition to the lottery proposal and the \$9 billion in cuts, the governor's plan includes \$3 billion in what Ackerman termed "gimmick" financial moves.

"We'd like to eliminate all the gimmicks and do cuts only," Ackerman said.

Come back here for more later.

Wednesday, May 14, 2008

Schools face shortfall even after state funding boost

More coverage of the school finance crisis

[Irvine students go to Sacramento](#)
[Anaheim Union releases names of 98 who face layoff](#)
[Capistrano district wants layoff exception for 13 teachers](#)
[Arts education funding in limbo](#)
[Small classes sizes could be retained at three CUSD schools](#)

Gov. Arnold Schwarzenegger is proposing to meet minimum school funding levels next year, but state finance officials say schools will need \$4 billion more to cover costs.

By **SCOTT MARTINDALE** and **FERMIN LEAL**

The Orange County Register

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SACRAMENTO – Gov. Arnold Schwarzenegger on Wednesday revised his 2008-09 state budget proposal to uphold the minimum funding guarantee for public education mandated by Proposition 98, but schools continue to face about a \$4 billion shortfall.

That shortfall includes \$3 billion in unfunded cost-of-living increases and \$1 billion in other needed funds, state education officials said in a telephone news conference after the governor's announcement.

William Habermehl, Orange County's superintendent of public schools, said the governor's revised budget plan paints a brighter picture for local school districts, but the forecast remains cloudy.

"If district superintendents were to call me and ask if the governor's revised budget means they can rescind layoff notices, I would have to say no," Habermehl said. The revise "won't affect schools until the Legislature takes action. This could happen as late as November."

The governor in January proposed suspending Prop. 98, which guarantees a minimum level of funding based on the state revenue. At the time, the proposal was projected to shave \$4.8 billion from the money K-12 schools and community colleges were entitled to receive.

Now projections indicate Prop. 98 would be fully funded – with the state spending about \$193 million more than this year, according to the governor's Web site.

But local school districts facing big budget shortfalls say fully funding Prop. 98 does not change much given their needs.

"His definition of fully funding Prop. 98 and mine are different," said Superintendent Steve Fish of the Saddleback Valley Unified School District, which is looking to make \$19.3 million in cuts. "Quite frankly, my kids are still losing out on some very significant programs with zero COLA (cost-of-living adjustment)."

Meanwhile, on Wednesday, the University of California raised student fees 7 percent and California State University raised them and 10 percent for next year, to help make up some of the deficit.

While they were cautiously pleased that some of the previous budget cuts had been restored, university officials were still unhappy there's no money for enrollment growth or inflationary cost increases.

The president of the CSU faculty union, Lillian Tainz, said that California "cannot afford to balance the state budget on the backs of students and their families."

UC officials had also hoped for \$8 million for special projects such as improving the overworked student mental health system, considered a priority in the wake of the Virginia Tech massacre.

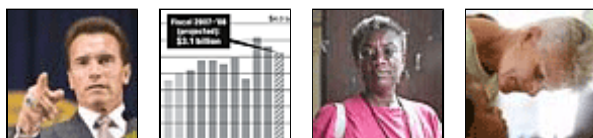
Staff Write Marla Fisher contributed to this report.

SFGate.com

Governor's big gamble with the budget

Matthew Yi, Cecilia Vega, Chronicle Staff Writers

Thursday, May 15, 2008

**(05-15) 04:00 PDT Sacramento - --**

Gov. Arnold Schwarzenegger's unusual proposal to borrow against future state lottery revenue to help erase the state's \$17.2 billion budget deficit drew sharp criticism Wednesday from Democratic lawmakers and financial experts who say the idea is risky and irresponsible.

Republican legislators bristled at the GOP governor's back-up plan if the lottery proposal fails - to temporarily raise the state sales tax by 1 cent.

But Schwarzenegger defended his strategy, saying that his earlier plan to balance the budget entirely with cuts in spending is no longer possible because of the state's weakening economy.

"Our crisis is real, and it is very serious," he said in unveiling a revised budget that contains \$101 billion in general fund spending.

The slowing economy has steadily increased the state's deficit for the coming fiscal year, from \$14.5 billion in January to \$16 billion a month later, when the governor and Legislature took emergency actions - borrowing money, delaying debt payments and slashing Medi-Cal reimbursements - to cut the deficit to \$8 billion.

Schwarzenegger now says the budget gap is at \$17.2 billion, which includes \$2 billion that he wants in reserves.

His latest plan is not without severe cuts. While he has abandoned some of his earlier controversial ideas, such as early release of 22,000 prisoners and closing 48 state parks, the new budget still contains cuts totaling \$11 billion.

Health and welfare programs were among the hardest hit. The governor has proposed cuts in health care for the poor, recent immigrants and disabled residents.

"I know this is going to be very difficult, and I know this is going to be very painful. This is why I had a hard time making those cuts," Schwarzenegger said. "But the absolute bottom line is that we cannot spend money that we do not have. Plain and simple."

But his budget is centered on borrowing money against future revenue from the state lottery, which voters approved in 1984 to help fund education.

While other states have enacted or considered leasing, selling or creating a quasi-public entity to operate their lotteries, this would be the first time that a state would sell bonds against future lottery revenue.

Schwarzenegger wants the state to sell up to \$15 billion in bonds over three years. The new debt would be repaid with interest using profits generated by the state lottery, said Mike Genest, director of Department of Finance.

In addition, lottery money spent on public education in the state would be capped at the current level of \$1.2 billion, even if lottery revenue increases.

The plan also would aim to make more state lottery revenue, which peaked at \$3.6 billion two years ago but fell to \$3.3 billion last year. Lottery officials estimate that revenue will fall to \$3.1 billion in the current fiscal year.

Schwarzenegger admitted the state lottery is underperforming and will have to be revamped to generate more revenue.

His aim is to put the lottery plan on the November ballot. But if voters reject the idea, the governor wants a temporary 1 percent increase in the sales tax, which would expire in 2011.

The governor's new spending proposal sets the stage for what will likely be a prolonged budget battle at the state Capitol. Senate President Pro Tem Don Perata, D-Oakland, said the governor's lottery proposal faces a major uphill battle.

"Getting it to the ballot would be hard enough," Perata said. "Passing it would be mission impossible."

Republican legislators argued they cannot support any increase in the sales tax.

"From the standpoint of Senate Republicans, the issue relating to the 1 percent sales tax is definitely dead on arrival," said Republican Senate leader Dave Cogdill of Modesto. "We believe that would be a further detriment to an already struggling economy and that makes no sense at all to us."

Assemblyman Roger Niello, R-Fair Oaks (Sacramento County), who is vice chairman of the Assembly Budget Committee, said Republicans would be open to considering Schwarzenegger's proposal to allow Wall Street to invest in the state lottery, but triggering a "tax increase on an autopilot basis is not an acceptable approach for us."

Sen. Denise Ducheny, D-San Diego, chairwoman of the Senate Budget and Fiscal Review Committee, called the governor's proposal dishonest and irresponsible.

"Just say, 'Maybe we need a 1-cent sales tax.' That's a legitimate proposal," she said. "If he wants to put that out there, put it out there and be clear about it."

But Schwarzenegger said he doesn't believe the sales tax increase will be needed. He said he is confident the lottery proposal would generate enough cash not only to ease the current budget crunch but also to allow the state to create a so-called rainy day fund to be used in future fiscal crises.

Larry Gerston, a political science professor at San Jose State University, said it's ironic that Schwarzenegger, whose fiscal mantra before becoming governor was to "cut up the credit card," is now resorting to borrowing more money.

"The question is, at what point do people decide we can't continue mortgaging our future with almost sleight-of-hand gimmickry when we have serious issues that need serious policies to resolve them?" he said.

Steve Levy, director of Center for Continuing Study of the California Economy in Palo Alto, said he is concerned that the governor's lottery plan would call for one-time funds to help fill the state's chronic shortage of operating revenue.

Levy also worried that the governor's proposal to revitalize the lottery would aim to increase gambling in California when the state's Indian casinos are undergoing major expansions.

"I just don't think there's an infinite amount of gambling monies," he said.

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