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SECTION: NEWS**LENGTH:** 948 words**HEADLINE:** State budget proposal released**BYLINE:** DAVID M. DRUCKER, Staff Writer**DATELINE:** SACRAMENTO**BODY:**

Gov. Arnold Schwarzenegger today will propose closing a gaping \$8.1 billion budget hole with a spending plan that he admittedly doesn't like and is sure to elicit howls from the Legislature's Democratic majority and the Capitol's spending lobby.

The Republican governor's proposal for the fiscal year beginning July 1 would not raise taxes. It would make a series of significant program cuts, raid special funds and rely on borrowing as the state grapples with its fifth budget deficit in a row.

"This is a budget that a broken system requires him to submit, and it's a budget that [shows] the need for reform," Schwarzenegger's press secretary Margita Thompson said.

Overall general-fund spending will increase 4.2 percent against a projected growth in state tax revenues of 6.8 percent, administration officials said. But the plan will be attacked, the governor conceded Wednesday in his State of the State speech, acknowledging that he dislikes it, too.

"I do not like this budget at all," Schwarzenegger said. "It does not solve our ongoing structural problem, because our deficit [in the following fiscal year] will be even worse."

The deficit could hit \$10 billion in 2006-07, according to state projections. The current year's budget calls for a total of \$105 billion in general and special-fund spending.

Schwarzenegger is banking on his sweeping package of government reforms to permanently cure the state's fiscal ills. In the meantime, he described his budget plan for 2005-06 as a temporary, one-year fix.

To get through the coming year, he proposes borrowing two years' worth of state gas-tax revenues - likely to total around \$2 billion - and limiting the growth of spending on public education. Similar to the deal Schwarzenegger made last year with local governments, his plan would outlaw state raids on transportation funds beginning in 2007.

Administration officials said the governor will recommend that the Democrat-led Legislature increase general-fund spending on public education by \$2.9 billion, which includes a \$2.5 billion increase in the amount of general-fund property-tax revenues that flow to K-12 schools.

Total spending on Proposition 98 - the formula that guarantees public education almost half of the entire

budget - is set to grow 7.1 percent, although school districts will be asked to absorb \$460 million in payments to the teachers pension system - an amount that could ultimately cost teachers the equivalent of 2 percent of their take-home pay.

"He would like to provide more for education," said H.D. Palmer, Schwarzenegger's chief budget spokesman. "But the alternative would have meant very deep reductions to health and human services, many of which affect children."

Various health care and welfare programs for the poor will see reductions, although overall health and human services spending will rise by an undisclosed percentage from the \$25.5 billion in general fund money allocated to them in the current year.

Democrats, saying their main goal is to ensure Schwarzenegger's budget does not harm the "middle class," are signaling they will not contest the governor's refusal to raise taxes. But they have made clear that they are likely to oppose any cuts they consider harmful to public schools and the poor, elderly and disabled.

Protecting the middle class is "the Democrats' mandate. ... those are the people we're here to represent," said state Senate President Pro Tem Don Perata, D-Oakland. "What about the poor, the infirm, disabled? That's the entry fee to becoming a Democrat."

If the Legislature and the governor agree on a handful of proposed constitutional amendments by the end of February, voters could have the opportunity to vote on Schwarzenegger's fiscal reforms in time to alter the shape of 2005-06 budget.

Even if the governor bypasses the Legislature and backs ballot initiatives, voters could approve his "spending control" proposal - a hard spending cap that would prevent the state from spending more than it takes in - in November. And, officials say, it could take immediate effect, producing a large impact in the 2005-06 fiscal year.

The spending control would outlaw intra-government borrowing - such as this year's proposal to borrow special gas-tax funds to fulfill general fund obligations - and preclude taking general-fund money allocated to public education under Proposition 98 to cover other expenditures.

Schwarzenegger's constitutional overhaul of the budget process also seeks to end lawmakers' penchant for passing budgets later than the June 30 constitutional deadline.

Should the budget run late, the governor will be required by law to call a special legislative session, with the state controller forced to lower payments across-the-board to programs and other obligations if a spending plan is not implemented within 30 days.

Even if the budget is passed on time, any plan in which spending was projected to outpace revenues would also require the governor to call a special session, in which legislators would have 45 days to close the projected gap before the controller was automatically forced to reduce funding for state programs.

Government finance experts say the proposed overhaul could fundamentally alter California's complex and contentious budget process.

"It's major," said Steve Frates, a senior fellow at the Rose Institute of State and Local Government at Claremont McKenna College. "It changes the political calculus around the budget process and will bring some discipline to the proceedings."

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