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## Politics



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### Boom and bust

California's fiscal fortunes peaked about May 2000, when Gov. Gray Davis revised his budget plan to take into account a stunning \$12.3 billion windfall in tax revenues.

### Bush toppling forest safeguards, critics say

WASHINGTON -- A decade ago, the northern spotted owl -- an elusive bird that inhabits the ancient forests of the Pacific Northwest -- flew into the national spotlight as the symbol of conflict between loggers and environmentalists over the future of public lands.

### The Buzz: Panel pinchers do their bit to cut the deficit

In the spirit of saving a few pennies here, a few thousand there, a small state commission announced recently that it will cut its own funding immediately.

### Payment for their days' toil

Thousands of Mexican workers who were brought to the United States in the 1940s to pick peaches, plow fields and toil on the railroads have been granted more time in their quest to recoup wages that they earned, but never received.

### Dan Walters: State has huge fiscal headache, which could get even worse

California now has, officialdom has finally acknowledged, a financial headache that not only has grown to immense proportions but could plague the state's politicians and taxpayers for many years.

## Boom and bust

### State's fiscal fortunes rose -- and have fallen -- with the stock market

By John Hill -- Bee Capitol Bureau  
*Published 2:15 a.m. PST Monday, December 30, 2002*

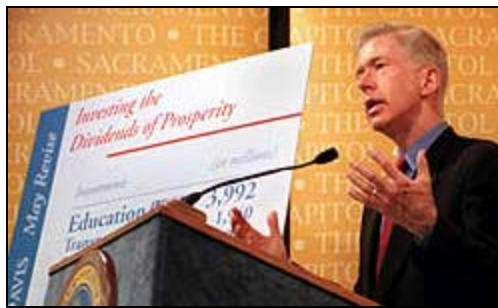
California's fiscal fortunes peaked about May 2000, when Gov. Gray Davis revised his budget plan to take into account a stunning \$12.3 billion windfall in tax revenues.

On the heels of two years of pleasant budget surprises, it seemed like the sunny days could last forever.

But Davis sounded a note of caution. The state shouldn't count on that money over the long haul, the governor warned.

"I intend to resist the siren song of permanent spending whether it comes from the left or the right," he said at a press conference. "And I will stand up to anyone who tries to convince the Legislature that they should spend most or all of this money in ongoing expenses."

Two and a half years later, it looks like the



Bulging state coffers allow Gov. Gray Davis to propose spending increases and tax cuts in May 2000.

Sacramento Bee file, 2000/Laura Chun



sirens -- sea nymphs in classical mythology whose songs lured mariners to destruction -- got their way.

Davis, in a much more somber press conference this month, announced the state faces a gap between spending and revenues of almost \$35 billion through June 2004. In a state prone to busts, it is the worst budget crisis yet, one almost certain to bring deep cuts to popular programs and tax increases.

The dramatic turnaround is a reflection of the state's growing dependence on a notoriously unpredictable source of revenue: the stock market. Davis and other budget-writers were well aware of its volatility. But almost no one predicted the prolonged skid in the financial markets and the lingering sluggishness of California's economy.

In the meantime, the pile of cash beckoned.

Democrats pushed for new spending in education and health care, Republicans for tax cuts. Even as they vilified each other, both parties, to some extent, got their way. And as the fiscal storm approached, they were reluctant to reverse course by making substantial cuts to the programs or restoring the taxes.

"Republicans and Democrats marched arm in arm," said Steve Peace, a former state senator just appointed by Davis to head the Department of Finance.

The result was two budgets in a row that failed to fully address the gap left by the sudden drop-off in tax revenue from stock options and capital gains. Then the bad economic news got worse.

"This current budget was a sham. There's no other way to describe it than as a pure sham," said Ted Gibson, who resigned as the chief economist for the governor's Department of Finance a year ago and is now a Sacramento financial consultant. "What we're seeing now is the accumulation of two deficit budgets piling up into the coming year. ... and there's just nowhere to hide anymore."

In 2000, doubters were hard to find.

"Nobody foresaw it," said Brad Williams, senior economist for the nonpartisan Legislative Analyst's Office, which advises the Legislature on the budget. "In fact, there was a lot in the media at the time about the Dow going to 20,000 or 30,000. ... It was an environment in which it was hard to say, 'I think the market's going to be off 30 or 40 or 50 percent.' "

In the late 1990s, the state treasury enjoyed an unprecedented infusion of money from stock options and capital gains. As stock prices soared in the high-tech boom, a huge number of Californians exercised options and realized capital gains on investments. Taxable income from those two sources shot up from less than \$50 billion in 1996 to \$200 billion in 2000. The revenue they generated also exploded, from \$4 billion to \$17.7 billion.

The boom drove up state revenues in other ways. Businesses -- especially dot-coms -- were burning through cash at an astounding rate; some of that money went to sales, business and income taxes.

At its peak, the bubble may have contributed as much as \$20 billion to the state treasury, Gibson said, although the exact figure may never be known. "I don't think any of us realized the extent to which the bubble was inflating revenues, or if we did, we thought it wouldn't collapse entirely," he said.

Davis was leery of the state's dependence on the financial markets, Gibson said. His budgets in the flush years included one-time expenditures that would not

### **Testing the waters**

WILLOWS -- There's no Sunset Strip, no Venice Beach and no bikinied Rollerbladers in this weathered Glenn County town.

### **Business tax breaks face state scrutiny**

Lenny Goldberg isn't happy about the state's gargantuan budget deficit, but there is one thing about California's depressed economy that makes the longtime tax-reform activist feel pretty good.

### **Candidates getting early start -- on '06**

Kevin Shelley has another week to wait before he's sworn in as California's secretary of state. But already, he's filed paperwork to run for re-election in 2006.

### **Condit's embark on libel suits' risky route**

WASHINGTON -- Libel lawsuits can become a two-edged sword, as Rep. Gary Condit and his wife, Carolyn, may discover.

### **New laws in 2003: Licensing crematory managers**

The body -- wrapped or clothed -- is placed in a closed container and then in a chamber known as a retort where temperatures reach 1,800 to 2,500 degrees.

have to be repeated year after year if the economy went sour.

Overall, about 40 percent of revenue growth beyond the 5 percent to 6 percent considered necessary to maintain state operations was proposed for one-time spending, said Tim Gage, Davis' finance director who will depart in January. But that meant 60 percent would be built into the budget to be sustained in the years to come.

Davis had campaigned in 1998 on a promise to improve schools, a cause that enjoyed bipartisan support. As the size of the windfall became apparent, he moved quickly to deliver. A few days before he released his revised budget in 2000, he announced that he would commit \$1.8 billion of new money to California schools to make up for years in which they got no cost-of-living increases. Most of the money went to raise teacher salaries.

Proposition 98, the 1988 initiative that guaranteed schools a certain amount each year according to a complex formula, had been treated in the early 1990s recession as a ceiling.

Under Davis, it started to look more like a floor. The governor and lawmakers consistently dedicated more than required.

But those "overappropriations" drove up the guarantee the following year, much like compounding interest. The cumulative impact over the past six budgets is a yearly guarantee \$10.5 billion higher than it would have been if schools had gotten the minimum, the Legislative Analyst's Office says.

"Overfunding Proposition 98 is a very dangerous thing to do," said Assemblyman John Campbell, R-Irvine, a member of the Assembly Budget Committee. "It can end up with schools absorbing a disproportionate share of the budget."

Education advocates are unapologetic. They say the money was well-spent, attracting and retaining teachers, making sure that students had textbooks focused on the state's new academic standards, testing students and bolstering low-performing schools.

That spending brought the state close to the national average, said Kevin Gordon, executive director of the California Association of School Business Officials. "The truth is, we're still behind," he said.

New spending was not confined to schools.

In the eight years after the end of the last fiscal crisis in the early 1990s, the state dedicated \$4 billion more in its annual budget to Medi-Cal, the health program for the poor and disabled. Another \$3 billion went to other health and social service programs, \$2.7 billion to higher education and \$2.2 billion to prisons, according to the Legislative Analyst's Office. State spending on child-care programs tripled to more than \$3 billion in the past seven years.

In other cases, the costs of existing programs shot up. In one program that serves elderly, blind and disabled people who can't live alone without help, the cost per person increased 62 percent, largely as the result of salary increases for the caregivers. The caseload, meanwhile, rose 50 percent.

The state also cut taxes, most notably a 67 percent reduction in the annual vehicle license fee, at a yearly cost to the budget of about \$4 billion, since the local governments must be paid that money regardless. In the the 1990s the state granted other kinds of tax relief, from a reduction in the bank and corporation tax to credits for teachers and businesses. By last year those tax

breaks added up to \$2.8 billion.

A year after the windfall, it was clear that the good times were drawing to a close. Stock options and capital gains were still strong, but the stock market decline and a slowing economy caused Davis to reduce his revenue estimate for the coming year by \$4.6 billion.

That turned out to be just the beginning. Stock options and capital gains income would drop a breathtaking two-thirds in one year. And the effects of the downturn spread. Taxable sales fell, primarily as the result of softness in business spending on items such as computers, telecommunications equipment and construction materials.

"The fundamental thing that hasn't happened is the recovery and resurgence of business capital investment," Gage said.

The extended decline has done more than wipe out the windfall, Gage said. It has sent revenues down to a point at which the annual growth since the end of former Gov. Pete Wilson's term now averages an anemic 2.5 percent. That's below the rate needed to sustain the natural growth of government operations, he said.

In May, as the estimate of the shortfall almost doubled to \$23.6 billion, Davis proposed a plan to bridge the growing gap. Much of the solution involved one-time fixes, shifts between accounts and other bookkeeping maneuvers. He also proposed an array of cuts to health care and social programs, such as eliminating dental care for adult Medi-Cal recipients and restricting eligibility for the government health care program. Advocates called the cuts draconian.

Over the next four months, lawmakers on both sides of the aisle blocked many of these steps. Assembly Republicans, meanwhile, refused to vote for a budget that included tax increases.

"Had we gone with the tax increases, they would have restored some more cuts," Campbell said. "There was no willingness by the Democrats to deal with the structural deficit last year."

On the last night of the legislative session, increases in the vehicle license fee and cigarette tax were dropped. That revenue was replaced in part by shifting even more school spending to the following year and unspecified cuts to state operations.

Davis' proposal in May might have cut as much as \$5 billion from the current budget gap. But it was largely undone. Some lawmakers from both parties criticized the governor, who was seeking re-election in November, for not battling harder for his plan.

And as it turned out, Davis' solution would not have been nearly enough.

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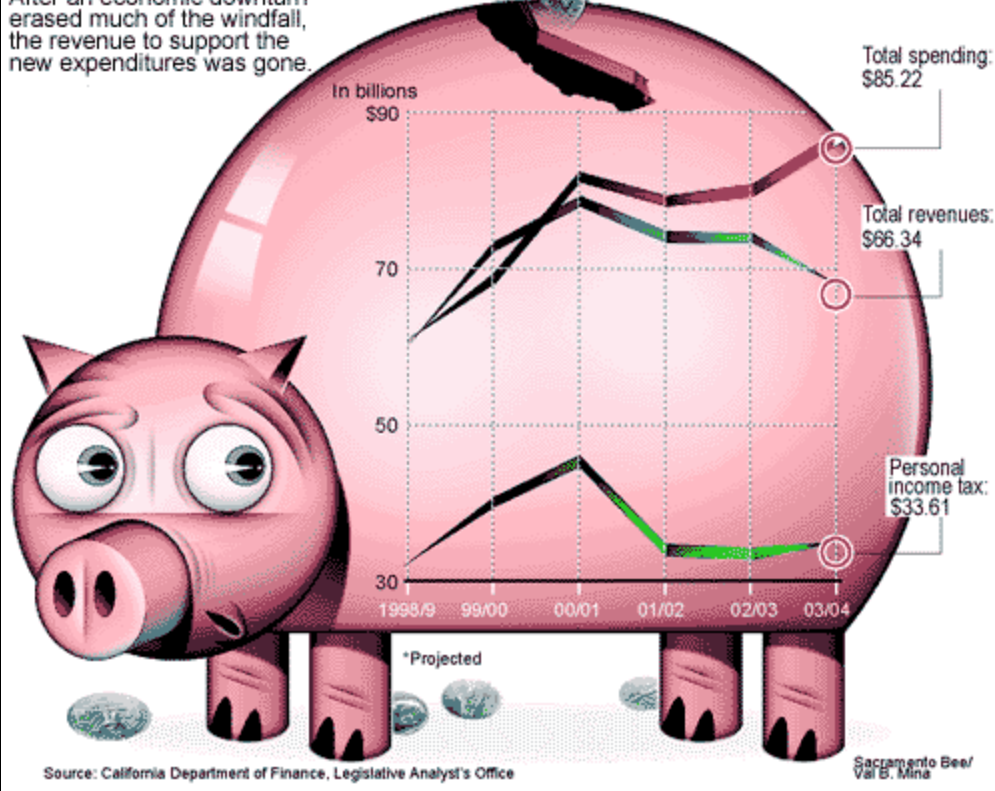
#### **About the Writer**

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## Budget gap

When the high-tech boom pushed state revenues up at the end of the 1990s, Gov. Gray Davis and the Legislature spent more on schools and health and welfare programs, as well as cutting taxes. After an economic downturn erased much of the windfall, the revenue to support the new expenditures was gone.



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