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Tax hikes could delay recovery

By Chris Rizo
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SACRAMENTO – Lawmakers are counting on a combination of tax increases and selling general obligation bonds to balance the state budget, but leading economists warn that approach could backfire, actually delaying California's economic recovery.

The Golden State's economy will recover gradually, likely at the same rate at which it dipped over the last 18 months, said Tom Lieser, a senior economist with the UCLA Anderson School Forecast, cautioning legislators not to count on a dramatic, short-term economic rebound to overcome this year's historically low revenue stream.

While tax increases could in fact slow the state's economic recovery, legislators are required to eliminate a potential deficit, Lieser conceded Monday, alluding to the state's \$23.6 billion shortfall a cash shortage equal to one-third of the state's current year general fund budget.

"There is no easy way out of this," he said, revealing statistics that show this year's first quarter experienced even further economic slowing. The good news, however, is that the state economy will likely rebound by mid-2003, albeit not at the same levels which characterized the Bull Markets of the 1990s, he said.

"But until the (San Francisco) Bay Area economy levels off, the state economy will not improve," Lieser explained, pointing to a steep downturn of the dot-com sector over the last couple years that has spurred massive layoffs and subsequent double-digit unemployment rates in the Silicon Valley.

Finding optimism in rising sales of semi-conductors, which are used to manufacture electronics components, Lieser said by 2003 technology-based sectors will rebound and be a further boost to California's economy.

In the meantime, however, lawmakers are left to grapple with one of the steepest declines of state revenues in more than half a century.

To make up for lagging tax receipts and faltering capital gains returns, the governor's 2002-03 budget plan, which is currently in the hands of the Joint Budget Conference Committee, proposes, among other things: a two-year suspension of the state's net loss carry-over tax break, which allows businesses to carry 60 percent of their losses for up to a decade, and use them to reduce their tax liability in subsequent profitable years.

"The energy crisis has done enough to deter new businesses from coming to California, and keep old ones from staying here. Suspending the (net loss carry-over) is just not a good signal to be sending businesses right now," said Peter Navarro, professor of economics at UC Irvine.

Also a part of the governor's budget proposal: increasing the cigarette tax by 50 cents to \$1.37 a pack, as well as a rollback the popular vehicle licensing fee rebate, which could more than double registration fees for motorists.

"Nobody would mind less cigarettes out there from the (increased) cigarette tax; but, picking on businesses, which is a populist response, usually winds up shooting you in the



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foot," Navarro said.

Davis' budget also partly balances on assumptions: economic recovery by next year, reimbursements from the federal government for homeland security costs, as well as the successful sale of bonds to repay the treasury for billions in electricity purchases made by the state last year.

Davis is also proposing borrowing \$4.5 billion against the state's future tobacco settlement funds in the form of bonds, which could be difficult given that many of the 49 other states and various municipalities most of which have higher credit ratings than California are also looking to bond financing to bridge their budget shortfalls.

California's poor, AA credit rating could also make it more expensive for the state to refinance its outstanding debt because investors typically demand higher dividends to hold lower-rated securities.

"As for selling bonds: the good news is interest rates are low. The bad news, it mortgages our future," Navarro said.

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