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SHORTFALL COULD HIT \$22 BILLION WITHOUT CUTS OR TAX HIKES, ANALYST'S REPORT SAYS

BYLINE: David M. Drucker, Sacramento Bureau

BODY:

SACRAMENTO - Gov. Arnold Schwarzenegger's revised 2004-05 budget could set the state on a course to run up sizable deficits in the future unless there are more spending cuts or tax hikes, a legislative analyst's report released Monday said.

Legislative Analyst Elizabeth Hill said the governor's plan would close a \$15 billion budget gap projected for next year and leave the budget balanced in 2005-06. But Hill said the plan could cause a combined \$22 billion shortfall in years 2006-07 through 2008-09.

"The May revision misses an opportunity to make further progress on addressing the state's long-term structural imbalance" of revenues and expenditures, said Hill, a nonpartisan analyst who has reviewed budgets for 26 years.

Released on the six-month anniversary of Schwarzenegger's inauguration, the report said the governor's revised \$102.8 billion budget is less effective at curing the state's long-term fiscal health than his original January proposal.

Schwarzenegger's aides were quick to defend the governor's plan, saying Hill's analysis did not take into account future budget-cutting efforts.

"The concept of a structural gap three to five years down the road assumes you make no changes other than what's in this budget - that you go on a policy vacation for three years," said H.D. Palmer, the governor's chief budget spokesman.

"That's not going to happen with this governor."

He said Schwarzenegger's effort to repair the state's finances - beginning with the passage of Propositions 57 and 58 - is progressing and a blueprint will be in place by 2006-07, to close the \$8 billion deficit projected for that year.

Plans to overhaul Medi-Cal, streamline government operations and other proposals would also be in place over the next 12 months to further reduce the shortfall Hill anticipates, Palmer said.

In her report, Hill also said she was nervous about the side-deals Schwarzenegger has cut with interest groups to save California billions of dollars immediately on the promise of future funding increases.

She recommended the Democrat-controlled Legislature reject or rethink a number of the Republican governor's proposals.

Hill said she was concerned about an unrealistic belief by many lawmakers that California can simply rely on a growing economy to generate more revenue to support state programs at their current spending levels. At some point, they must face the tough decision of either raising taxes permanently or making further cuts to public education and other such services.

Some economists who follow the state budget closely gave Schwarzenegger high marks for his revision, especially compared with the last few plans offered by former Gov. Gray Davis.

Steve Frates, a senior fellow at the Rose Institute of State and Local Government at Claremont McKenna College, praised Schwarzenegger for getting kindergarten through 12th grade and higher education officials, and local governments, to accept cuts now for moderate increases later. Frates also said the governor has assumed realistic growth rates for state revenues and the economy as a whole.

"The governor and his staff are playing it pretty straight - there's not the fiscal smoke and mirrors we've seen in the past couple of years," Frates said.

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