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States of Crisis for 46 Governments Facing Greek-Style Deficits

By Edward Robinson - Jun 25, 2010



Arnold Schwarzenegger, governor of California, speaks to the state assembly about his proposed budget in Sacramento, California. Photographer: Ken James/Bloomberg

Californians don't see much evidence that the worst economic contraction since the Great Depression is coming to an end.

Unemployment was 12.4 percent in May, 2.7 percentage points higher than the [national rate](#). Lawmakers gridlocked over how to close a \$19 billion [budget gap](#) are weighing the termination of the main welfare program for 1.3 million poor families or borrowing more than \$9 billion in the bond market. California, tied with Illinois for the lowest credit rating of any state, is diverting a rising portion of tax revenue to service debt, Bloomberg Markets magazine reports in its August issue.

Far from rebounding, the Golden State, with a \$1.8 trillion economy that's larger than Russia's, is sinking deeper into its financial funk. And it's not alone.

Even as the U.S. appears to be on the mend -- gross domestic product has climbed three straight quarters -- finances in Arizona, Illinois, New Jersey, New York and other states show few signs of improvement. Forty-six states face budget shortfalls that add up to \$112 billion for the fiscal year ending next June, according to the Center on Budget and Policy Priorities, a Washington research institution. State spending is 12 percent of U.S. GDP.

"States are going to have to cut back spending and raise taxes the same way Greece and Spain are," says [Dean Baker](#), co-director of the Center for Economic and Policy Research in Washington. "That runs counter to stimulating the economy and will put a big damper on the recovery in the latter half of this year."

Stimulus Dries Up

State budget woes are a worsening drag on growth as the federal government tries to wean the economy from two years of extraordinary support. By Jan. 1, funds from the \$787 billion federal stimulus bill will dry up. That money from Washington has helped cushion state budgets as tax revenue has plunged.

State leaders won't be able to ride out this cycle the way they have in the past. The budget holes are too large. For the first time since 1962, sales and income [tax revenue](#) fell for five straight quarters, through December 2009, according to the Nelson A. Rockefeller Institute of Government at the State University of New York at Albany.

Lawmakers need to overhaul tax policy, underfunded public pensions and entitlement spending programs such as Medicaid if they want to establish long-term plans that will foster growth, says former New Jersey Governor [Christine Todd Whitman](#).

If they fail to act, state fiscal positions will steadily erode and hurt the U.S. economy through 2060, according to a March 2010 report prepared for Congress by the U.S. Government Accountability Office.

'Major Surgery'

"States don't have a choice anymore," Whitman says. "These problems are going to require major surgery."

Reform may get short shrift as Republicans and Democrats intensify their age-old fight over taxes and spending in this election year. On May 20, New Jersey Governor [Chris Christie](#) vetoed a Democratic bill that would have raised income taxes for residents earning at least \$1 million a year to help close an \$11 billion deficit. Christie, a Republican, wants to cut spending for school districts and cap [property tax increases](#).

"At some point, the people's ability to pay runs out," Christie said in a speech in New York on May 25.

The widening deficits have led to some unorthodox moves. In California, the state grabbed \$1.7 billion in redevelopment money from local governments in May. Riverside County, a Los Angeles suburb where the housing bust has left unemployment at more than 15 percent, lost \$28 million that had been set aside to build fire stations, senior centers and other public works.

Jobs or Education

The projects would have created 3,000 jobs, says Tom Freeman, spokesman for the county's Economic Development Agency. The government needed the county cash for schools, says [Aaron McLear](#), spokesman for Governor [Arnold Schwarzenegger](#).

The episode demonstrates how the fiscal mess pits job creation against education in a zero-sum game, says [Robert Hertzberg](#), the Democratic speaker of the State Assembly from 2000 to 2002. California is locked in a rigid system in which legislators need a two-thirds majority to raise taxes and yet must comply with voter-approved initiatives that mandate prison construction and other spending.

There's little chance of any sweeping changes this year ahead of a gubernatorial race between Republican [Meg Whitman](#), former chief executive officer of EBay Inc., and Attorney General [Jerry Brown](#), a Democrat who was governor from 1975 to 1983.

'So Dysfunctional'

The winner will have to muster the political courage to take on core constituencies, whether anti-tax conservatives who support Whitman or labor unions that back Brown, says [Steve Westly](#), California's Democratic treasurer from 2003 to 2007.

The risk is that California ends up like [Greece](#), with no one trusting that it can get its financial house in order, says Westly, now a venture capitalist in Menlo Park. "It has to be a combination of cuts and revenue increases," he says.

Still, California isn't Greece. It's home to [Silicon Valley](#), Hollywood and a \$27 billion agriculture industry. "It's unbelievable," says [Bob Nichols](#), CEO of Windward Capital Management Co. in Los Angeles. "How do you screw up a place with the growth capability of California? It's so dysfunctional."

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