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## Dan Walters: Politicians, economists in a dither

By Dan Walters - [dwalters@sacbee.com](mailto:dwalters@sacbee.com)

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California's once-soaring housing industry is in a nosedive and its economy is flattening, but does that mean we're fated for a recession that would worsen the state's budget crisis?

It's an important question, but one that the practitioners of the "dismal science" of economics are unable to answer with certainty.

This month, economists at the Economic Forecast Project, based at the University of California, Santa Barbara, declared that despite the slowdown, they don't see recession looming in the state.

"So far, at least, California has been remarkably resilient," said EFP's director, Bill Watkins, "even as it has borne a very disproportionate share of the United States housing crises."

Watkins cited the fact that only two of the state's major economic sectors, construction and non-durable manufacturing, had shown "significant weakness." Many sectors appear to be expanding, including traditional manufacturing of durable goods, even as factory jobs disappear.

"This creates something of a dilemma for policymakers and economic analysts," Watkins said. "Historically, the measure of economic growth has been job creation. However, the benefits of an economy are realized in consumption."

While Watkins sees the economic glass as being at least half full, a private economic analysis company, Beacon Economics, sees it emptying fast as the state slips into recession.

Beacon's Christopher Thornberg told an economic conference Thursday in San

Diego that California is already in recession and is pulling the rest of the nation down with it.

"My counsel to anyone would be ... (be) afraid, be very afraid ... for now," Thornberg said. "And then be ready to capitalize on the many opportunities that will begin to present themselves in 2009."

Local and state governments have a particularly large stake, and Thornberg warned that the housing downturn could hammer sales and property taxes upon which locals depend and that the state budget deficit, now pegged at \$14.5 billion for the next year and a half, "will grow worse ... because the state's sources of income are likely to shrink."

More economic prognostications are coming, including one from the Legislature's budget analyst on which many critical revenue and spending decisions will be based this year. But it's apparent from the competing views in the EFP and Beacon reports that Gov. Arnold Schwarzenegger and lawmakers will be compelled to make large decisions without any certainty on the underlying economic assumptions.

There has been an historic tendency for the state to underestimate the negative revenue impacts of an economic downturn, as well as the positive impacts of recovery – a syndrome that's been exacerbated by the state's ever-increasing reliance on volatile personal income taxes.

In other words, the current \$14.5 billion deficit estimate is more likely to expand than shrink as more data become available, especially state income tax returns that are due in April, even if the state isn't technically in recession.

We know from past experience that even a small dip in the economy can have a big impact on income tax revenues.

Compounding the crisis is a related but separate cash flow crunch. The state must repay short-term loans, called "revenue anticipation notes," in June and while it can make the payment, it would, under current circumstances, leave it unable to meet other obligations, especially aid to schools and local governments, in July and August.

The Schwarzenegger administration is telling locals the payments may be delayed for a couple of months, thus forcing them to seek emergency loans if they lack sufficient reserves to cover the shortfall and their own revenue problems.

It'll be quite a year.

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