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California Bets on Trump's Help With \$54 Billion Budget Gap.

- Once worst-rated state righted itself but it can't fill hole
- · Lawmakers say more federal aid is needed to prevent deep cuts

In 2009, President Barack Obama's administration rejected a plea by top state officials to bail out California, whose yawning fiscal hole at the time prompted its comparisons to debt-riddled Greece.

The state needed to solve its problems itself, the feds said. And California did: once the worst-rated state, it slashed spending, paid off debt, raised taxes and overhauled legislative rules to curb political dysfunction hobbling it. Also key: socking away some of its revenue gains from the nation's record economic expansion into a rainy day account with the hope of avoiding crippling cuts in the next downturn.

Indeed, in January, California, with its highest credit rating in two decades, was expecting continued growth in jobs and revenue and mulling expanding services and moving even more cash into its reserves. But then the pandemic struck. In just two months California lost more jobs than it did through the Great Recession and now faces a \$54 billion shortfall through fiscal 2021 — more than three times its record savings account.

The speed and severity of the coronavirus-induced economic downturn, exacerbated by recent civil unrest, has policy makers in Sacramento and statehouses across the country calling on the federal government for more aid. And as the Monday deadline for lawmakers to pass a balanced budget approaches, California's Democratic leaders are faced with counting on help from President Donald Trump, a Republican who routinely disparages their policies.

"Do you make structural cuts in the budget, or do you just hope that the federal government will recognize the need to fund state and local governments at a time when they're really bearing the brunt of the responsibility?" said Howard Cure, head of municipal research at Evercore Wealth Management. "How do you make cuts in the budget under those circumstances when there's really a need for help?"

California is contemplating a combination of raiding reserves, cutting services, internal borrowing and accounting gimmicks to balance its books. That's similar to other states, some of which have already acted. Missouri slashed education funds, while Illinois, at risk of being the first U.S. state to be cut to junk status, passed a budget dependent on loans from the Federal Reserve and another potential Congressional rescue package.

"It's a mix of acting now and being in wait-and-see mode," said Josh Goodman, senior officer with the Pew Charitable Trusts. "There's some real pain in the decisions that states are making."

Job Losses Are Shifting to States, Cities After Business Rebound

That was seen in the most recent labor data, which showed that in the past two months, states and

cities have cut more jobs than they did in the aftermath of the last recession. While the Trump administration is "unpredictable," Moody's Analytics expects it will ultimately approve a rescue package to assist state and local governments because of the consequences, said Sarah Crane, an economist at the company.

"It would have the potential to send us into a double-dip recession, if the money doesn't come through," Crane said. "We would think that the administration would try to hold on to their own jobs by doing what they can to preserve American jobs."

The deep financial hit has largely had little impact on the state's bonds, which have rebounded along with the rest of the market from the March selloff triggered by the pandemic. California debt due in 2032 is yielding about 1.3%, about 24 basis points more than top-rated debt. That spread, the main gauge of perceived risk, is down from as much as 108 basis points in March.

A Democrat-backed bill that would give states and cities more than \$1 trillion has stalled in Congress. California Governor Gavin Newsom said in May that money would reverse the need for around \$14 billion in cuts he's proposed for the year beginning July 1. Those include reducing pay for all state workers by 10% as well as less money for education and safety-net programs such as health care for low-income residents.

Last week, Democratic leaders of both legislative chambers said they've agreed on a budget framework that takes a different approach: it counts on federal aid and only triggers cuts in October if it doesn't materialize. Their plan, if Congress fails to act, relies on measures such as deferring payments and moving the June payroll date for state workers into the next fiscal year. They're negotiating with Newsom ahead of the Monday deadline.

Complicating the state's budget struggle is uncertainty from the pathogen: whether there will be a second outbreak; when a vaccine is developed; and if and how businesses will be transformed.

"It's really challenging to have this type of debate now when not only you're suffering so much from decline in revenue, but you just don't know or have any realistic idea when there's going to be a recovery," Cure said.

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By Romy Varghese

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