

# The Hardest Part of Politics: The California Budget

*The California Agenda*

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Californians are right to be concerned with the broken state budget system. In the last several years it has produced record deficits, unbalanced budgets and out of control spending.

This is unacceptable and on a broader basis symptomatic of a much deeper problem in Sacramento.

The State's political and governmental system is broken and in desperate need of a complete overhaul. Californians are aware of this fact as reflected in a recent Public Policy Institute of California (PPIC) survey in which "only 29 percent (of the respondents) say they can trust the government to do what is right just about always or most of the time."<sup>1</sup>

While it is healthy for citizens to be skeptical of their government the system to function properly must engender a much higher level of trust in its politicians than is now present.

How did we come to this point?

Many factors have combined to produce an environment in which the status quo is no longer acceptable.

Today, we have a state legislature that is constantly gridlocked and in many respects dysfunctional. The result has been more and more use of the initiative process as a means of resolving major public policy issues. Governing by initiative has rightly been termed "a blunt instrument" that bypasses the legislative process in which proposed laws are subjected to comprehensive scrutiny by a variety of interested parties. When a law is enacted through this process it may also be changed in the same way if flaws are detected or circumstances change. A law enacted through the initiative process may only be changed by a subsequent initiative.

It is imperative for the legislative process to be functional. But currently in Sacramento we are witnessing the almost total inability or unwillingness of political leaders – elected officials and constituency group leaders – to agree on problems and set priorities.

The factors contributing to this situation are a severe term limit law, a redistricting system that has produced safe seats for incumbent lawmakers and the tremendously increased power and influence of organizations representing public employees.

The outcome is a Capitol as one observer put it that is possessed by:

"a lethal combination of ideological imperatives, special interest pressures and single purpose budgetary laws"<sup>2</sup>

The state's term limit law effected a complete turnover of the legislature in ten years. While it may have been a worthy objective to be sure that legislators not make a career in Sacramento, as so often seems the case in America, we have gone from one end of the spectrum to the other.

Inexperienced legislators dealing with the complex problems of California is not equitable for anyone. It is especially severe to limit service to a specific number of years in each house (Senate, 8 years; Assembly: 6 years) and then ban for life anyone who has served the 14 years.

In this system Members once elected immediately focus on the next office they plan to seek with arguably much less time devoted to solving the state's problems.

When combined with a system of safe districts the outcome is very little main-stream voter accountability. Elections are decided in the Primary when fewer voters come to the polls. In November 2004 there were 153 Congressional, State Senate and Assembly Districts up for election. Not one changed parties. The same incumbents won and in open seats a person of the same party of the former incumbent won.

The lack of political will to take on tough problems that arises from this situation is not serving California's citizens.

This can best be illustrated by the immense public debt that politicians have built up in the last five years.

In 2003 the state was spending about 3 percent of its general funds to pay for its debt. PPIC in a recent report entitled, "California 2025" estimates that by 2007-08 the state will be spending about 7 percent on its debt.

In the 2005-06 fiscal year (that began on July 1) 3 percent of general funds is approximately \$2.6 billion dollars. Small percentage increases amount to big dollars that are not available to spend on education, transportation, higher education or natural resources.

Another example of the state's dysfunctional government was the energy crisis. The failure of the executive and legislative branches to take decisive action at the time has cost and will continue to cost Californian's billions of dollars. It need not have been. Actions to stop the skyrocketing wholesale prices were available but were not taken.

In another recent PPIC survey it was revealed that this massive failure to perform has resulted in an electorate where 64 percent of likely voters want to make long term budget and government reform decisions with only 32 percent wanting the Legislature and Governor to make these decisions. In the same survey, however, only 11 percent of Californians could correctly identify the largest category of state spending (education) and the largest revenue source (personal income tax).

I would argue that this conclusion of voters results not from their natural desire to make these decisions but from their frustration and the earlier cited profound distrust of their state government.

So what might a total overhaul of state government look like? In his January State of the State speech the Governor declared 2005 as "The Year of Reform" and outlined objectives in four areas:

1. Budget
2. Redistricting
3. Public Pensions
4. Education

While it is clear these are worthy issues today I will deal only with Budget and Redistricting.

First, redistricting. As noted earlier, legislative districts in the state were constructed to be safe for the incumbents. This is a system in which legislators get to pick their voters rather than voters picking their legislators.

For many reasons, I believe it is time to remove the power to draw district lines from the legislature and place that authority and responsibility in a more neutral setting. While there is no perfect answer as to how this should be structured other states have used a variety of approaches from Commissions to “special masters” appointed by the State Supreme Court. Whatever the method chosen the objective is clear: draw districts that objectively represent natural communities and when possible do not divide cities and towns. While this process naturally will produce some relatively safe seats for both parties it also should result in more “competitive” districts where the election will take place in November and where each of the two candidates has an arguable chance to win.

Over time (and probably not much time if California retains its current term limit law) this should result in a legislature that is more accountable and more balanced with members of both parties that will work together to solve problems. This also might result in increased voter participation rates at a time when the number of citizens voting is declining.

I want to mention, briefly, one other electoral change that also could produce similar results. That change is a move to an “Open Primary” at the state level. Simply stated, this system would list all candidates for the office on the Primary ballot. Voters would be eligible to choose any one of the candidates. The top two vote getters in the Primary regardless of Party registration would “run off” in November. This essentially, is how we conduct all local elections today in California.

Together with the reforms already noted the state might once again have a legislature with the “political will” to take on and solve difficult issues. Hopefully, this also would result in fewer initiative measures being submitted to voters with a substantial saving in funds now devoted to qualifying proposals and mounting multi-million dollar campaigns for and against them.

Second, the California State Budget. In early July, the Governor and Legislature agreed on a budget for the 2005 – 06 fiscal year that exceeded \$116 billion dollars. Despite the tremendous changes that have occurred in the state in the last 40 years the process for considering the budget and its associated decisions has not changed. Numerous Commissions and advisory groups have been formed over the years to examine the budget process and many excellent recommendations have been made for needed change. In 1996 the California Constitution Revision Commission created by the Governor and Legislature issued an extensive set of recommendations regarding the structure of state government and the Budget process.

In relation to the Budget, the Commission noted that, “there is a lack of long term vision, a lack of performance measures to guide budget decisions and few constitutional standards for improving fiscal discipline” The Commission recommended adopting:

- “A long term strategic plan to guide the state
- A formal performance-based budgeting system
- A two-year budget
- A budget “rebalancing” process to meet changing conditions”<sup>3</sup>

More specific recommendations followed and ultimately were drafted in bill form and introduced in each house of the Legislature. Neither of the legislative constitutional amendments cleared the first committee to which they were referred.

California has a 19<sup>th</sup> century budget process completely unsuited for 21<sup>st</sup> century needs. Spending decisions are driven by immediate perceived needs with no long term goals or priorities established. There is a constant debate about raising taxes versus spending restraint. Truthfully, even if taxes were increased the demand for the additional funds would be far greater than the proceeds of the tax increase. In a state with 37 million residents and extensive public needs there will always be scarce resources. This is at the heart of the reason why California needs a fully functioning state government. It is the principal task of the Governor and legislature to equitably allocate these scarce resources. No one would argue that this is an easy task. But it is critical to all of our citizens and to future generations of Californians. Failure to responsibly execute these duties will and has had great immediate and longer term consequences.

A good example of the longer term consequences of this failure can be found in the state's infrastructure (or public works).

In 1960-61 13.5 percent of the state's general funds were allocated to infrastructure investments. In 2002-03 that percentage was down to 0.9 percent.

I would argue that the state's fiscal and budget problems of the last five years constituted a gross failure to properly execute these responsibilities and at a minimum demonstrated a complete lack of any fiscal discipline. The structural reasons for this stemmed principally from the numerous "ballot box budgeting measures" that have been enacted since 1978 and the absence of any meaningful constitutional framework that would have required some restraints and indeed, if in place, might have prevented the problem.

For any organization, private or governmental, the size of California to have a budget that is enacted about July 1 of each year and not reviewed until the next budget is enacted is beyond comprehension. Any private organization that pursued this course would quickly go out of business.

So how do we bring California's budget process into the 21<sup>st</sup> century? We must remedy the shortcomings of the existing process. The Constitution Revision Commission identified three areas that must be addressed:

1. There is no organizational way to develop and adopt a long term vision for the investment of public resources
2. The current process is organized and operated to protect the status quo and, as such, is insulated from change; and
3. Fiscal discipline is not one of the values that governs the budget process."

To correct the absences and voids in the current process we need:

1. A "spending cap" that allows state spending to grow with the economy and that prevents the spending of one time "windfall" revenue from being spent on on-going programs. The Revision Commission expressed this as a, "need for fiscal integrity. The Commission's objective is to pro-

hibit spending in any fiscal period that will exceed the revenue that will be received.”<sup>5</sup>

2. A real “prudent reserve” and a priority on repayment of the staggering debt that has financed the gap between expenditures and revenue existing in the operating budget for the last five years. The current Administration has been supportive of each of these goals. Proposition 58 enacted in 2004 requires the enactment of a balanced budget and the establishment of a reserve. The initial payment into a reserve will begin at the end of September 2006.
3. A process for re-balancing the budget during the year so that the state will never again get so deeply in deficit that the problem cannot be remedied. This is a critical missing piece in the current process. Again, the Revision Commission called for this in 1996 and it remains absolutely necessary. The Governor currently is supportive of an initiative measure (The “California Live Within Our Means Act”) that has qualified for the November 8, 2005 ballot. That measure specifies an explicit procedure that is to be followed when the budget falls out of balance as early as three months into the fiscal year.
4. A method for dealing with the failure of the state to enact a budget by the start of the fiscal year (July 1)
5. A prohibition on borrowing from “special funds” to balance the general fund.
6. Modification of the K-12 school funding formula that meets the reasonable needs for public school funding but does not increasingly “crowd out” other unprotected general fund spending (for example: public higher education, health programs especially for children, resources etc).
7. Consideration of moving to a biennial budget to reflect the legislative cycle and to permit longer term setting of priorities and when necessary their modification.

### SUMMARY/CONCLUSION

Californians have made it clear that they believe the state’s political and budget system are badly broken and in need of systemic reform. They have made it clear that the “status quo” is not acceptable. But the forces that protect things as they are present a mighty barrier to accomplishing needed reform. What’s at stake is the future quality of life to be experienced by the young people who follow the current generation and the state’s economy. In many respects, today we are living off the legacy of the previous generation. That generation invested public resources wisely and brought us an excel-

lent quality of life.

I believe we have an obligation to do no less for our children.

The reforms outlined above ideally should be accomplished by the Governor and Legislature through negotiated agreements with (when necessary) submission to the voters. In the absence of agreement the initiative process seems the only resort.

The one constant that remains is that our state government must confront and eventually solve the problems facing California. To do any less would constitute a breach of trust to all of our citizens.

Thank you

## Jean Ross

### California Budget Project

It is fitting that we are gathered today under the auspices of the Pat Brown Institute of Public Affairs: Pat Brown governed during what is widely considered California's "golden era." An era when the state came together to build school, university, water, and highway systems that were the envy of the nation. These investments have sustained the state and supported the tremendous population and economic growth of the past 40 years.

I am the product of Pat Brown's dreams for California. I was educated in California's public schools, during the golden years prior to the passage of Proposition 13 in 1978, and I am a graduate of the University of California. The question now before us is whether my generation will leave a comparable legacy for the current and future generations of Californians.

California stands at a crossroads. In the upcoming weeks and months, California's voters will make decisions at the ballot box that will affect the size and role of government services in California, as well as the process of governance itself for decades into the future. The measures that will appear on the ballot reflect divergent views of how and who should determine the state's policy priorities and what role government should play in California's social and economic future.

There is agreement across the political spectrum that California faces considerable challenges. However, there is far less consensus over how to respond to these challenges. I would highlight the following:

- The demographic make up of the state's workforce is changing. Our research finds that in 2020, more than 70 percent of the state's prime age workforce - those between the ages of 25 and 54 - will be non-white and nearly half will be Latino. Historically low levels of educational attainment for Latinos will increase demands on the state's K-12 and higher education systems to boost graduation rates and ensure a steady supply of well-educated workers.
- Based on demographic trends, enrollment in higher education should outpace population growth through the end of the decade. Yet, due to budget reductions, enrollment at the University of California (UC) and the California State University (CSU) systems actually fell in 2004-05 - by 900 at UC and 7,600 at the CSU.
- The state has high standards for our public schools - the 2<sup>nd</sup> highest in reading and highest in math in the nation, according to one survey. Yet we have the 4<sup>th</sup> highest pupil to teacher ratio and Education Week magazine reports that California ranks 44<sup>th</sup> in per pupil spending, adjusted for regional costs of living, and 39<sup>th</sup> in respect to taxable resources spent on education. In 2002, just 0.6 percent of California's students were in districts with per pupil spending at or above the US average.



- According to the Kaiser Family Foundation, California has the 7<sup>th</sup> highest percentage of uninsured residents and ranked 39<sup>th</sup> in the share of the state's population with employment-based health coverage in 2002-03.
- California ranks 35<sup>th</sup> with respect to the share of the state's population living in poverty and 33<sup>rd</sup> with respect to the share of the state's children living in poverty. The state's large number of families who are working, but poor, places additional demands on publicly supported health and other safety net services, as well as our public schools.
- Reports by groups ranging from the Business Roundtable to the Public Policy Institute of California find that the state has unmet infrastructure needs that will require significant investment in order to ensure that the state can meet the demands of a growing population.

How policymakers respond to these challenges will have a tremendous impact on the ability of our economy to compete, the social and economic well-being of the state's families, and the future of California.

Frankly, I am deeply concerned about the future of our state and fear that California lacks the shared commitment to providing the next generation the opportunities enjoyed by my generation and that our failure to do so will leave the state ill-prepared to meet the challenges of the future.

The budget lies at the heart of my concerns. California faces red ink for as far as the eyes can see. The state faces a structural shortfall – a gap between the spending required under our current laws and policies and the revenues brought in by the state's tax system – of approximately \$5 billion through the end of the decade and, potentially, thereafter. The budget shortfall will seriously constrain the state's ability to respond to the significant the policies challenges that confront California.

California's fiscal difficulties have lingered longer than those of other states, in large part, because of the constitutional rules that govern taxing and spending in California. Specifically, California is one of just three states in the country to require a two-thirds or greater margin to pass a state budget under any circumstances. The other two – Rhode Island and Arkansas – are substantially smaller and less diverse than California. Moreover, California is one of just 11 states to require a supermajority vote of the Legislature to approve any state tax increase. When faced with fiscal crises of a magnitude similar to those of California - states across the country including "red" states such as Tennessee, Ohio, and Virginia - have raised taxes to help bring their budgets into balance.

The conventional wisdom – advanced by Governor Schwarzenegger and his allies – is that California has "a spending problem." The facts do not support this assertion:

- California ranks near the middle of the 50 states in state spending as a share of the state's economy. We ranked 24<sup>th</sup> in total spending and 26<sup>th</sup> in general purpose spending in 2001-02, the most recent year for which data are available.

- California ranked even lower, 32<sup>nd</sup> in 1999-00 (the most recent year for which data is available), in spending by local government. This results from Proposition 13's limits on local property taxes. Because of Proposition 13, a significantly smaller share of combined state and local revenues comes from property taxes – 25 percent – than in the nation as a whole, where the comparable figure is 31 percent. This disparity has implications for the volatility of our revenue system – property taxes are extremely stable – and for school finance. In most of the country, when state funding for schools is cut, local property taxes are increased to make up the shortfall. Proposition 13 prevents this from happening in California.
- Public opinion polling consistently shows that Californians want their government to do more, not less, and that they are particularly opposed to reductions in funding for education. The Governors budget proposals reflect that fact that there is little or no public support for cutting the state's way out of the problem. Neither the Governor's January nor May budget proposals were balanced. His May Revision to the 2005-06 budget spent \$2.5 billion more than anticipated revenues in 2004-05 and \$4.7 billion more than anticipated revenues in 2005-06.
- The other part of the story, which is not mentioned by the purveyors of the convention wisdom, is the impact of tax cuts on the state's budget problems. Between 1993 and 2004, the state enacted tax cuts that reduced 2004-05 revenues by \$9.3 billion. The reduction in Vehicle License Fee rates alone is responsible for three-quarters of the state's 2005-06 shortfall (\$4.5 billion).

The state's budget problems are the focus of a costly special election, the outcome of which will be critical to the future of California. At the heart of the debate is Proposition 76, an initiative sponsored by Bill Hauck of the Business Roundtable and Allan Zaremberg of the California Chamber of Commerce.

Proposition 76 would:

- Give the governor sweeping power to reduce spending, potentially including the ability to override state laws. The governor could declare a fiscal emergency and cut spending even in years when the state is running a surplus.
- Reduce the long-term Proposition 98 school spending guarantee by nearly \$4 billion per year, equivalent to a reduction of slightly less than \$600 per student for K – 12 education at a time when California's public schools face the challenge of educating a rising number of low-income children and children who are more likely to come from families where English is not their first language.

- Allow the state to spend more than it brings in in revenues when the state heads into an economic downturn, but less than it brings in during a recovery.
- Cap spending from voter-approved taxes, such as Proposition 10's tobacco tax for early childhood programs.
- Cap spending supported by regulatory and user fees, including student fees paid by California State University students. Proposition 76 would prohibit the state from all of the revenues it receives from fees for their intended purposes in years when total state revenues exceed the new spending cap.
- Put more, not less, spending on "autopilot" by eliminating the legislature's ability to defer certain transportation spending in bad budget years and by eliminating a provision of the Proposition 98 guarantee that was designed to ease pressure on the budget during years when the state experiences a shortfall.

If Proposition 76 had been enacted last year, it would require spending to be cut \$7.7 billion below the level proposed by the Governor in his May Revision. If Proposition 76 had been in place during this year's budget negotiations, it would have required cuts of the magnitude of those proposed by the Governor, including \$3.6 billion in cuts to K – 14 education; deep cuts in cash assistance to poor families, seniors, and the disabled; plus an additional \$7.7 billion in spending reductions. At the same time, this measure would make it much more difficult for the Legislature to achieve the required level of reductions by "locking in" in an even greater share of state spending, prohibiting certain reductions to transportation funding and preventing internal borrowing from special funds.

Moreover, the measure has serious flaws that may be inadvertent, but which make little or no sense:

- Because of the interaction with Proposition 58, the measure approved last year in as part of a package that authorized the issuance of bonds to finance the state's budget deficit, if even one dollar were spent out of the state's Budget Stabilization Account (BSA), the Governor would gain the authority to make unilateral reductions in state spending. This interaction would last until the state allocates \$5 billion from the BSA toward early repayment of the deficit financing bonds.
- The cap would potentially apply to moneys the state borrows using the authority granted by voter-approved bonds in the years when the cap is in place. In fact, since Proposition 76 does not define what spending the new cap would cover, cap we really do not know what it would and would not apply to.

The fiscal noose facing California will become even tighter if another measure supported by the campaign committee associated with the Governor and the sponsors of the

LWOM Act succeeds in winning votes. That measure would require a two-thirds vote to approve any measure that increases user fees or the tax of even a single Californian. Currently bills that increase some taxes, but reduce others, can be approved by a majority vote so long as the net impact is a tax reduction.

The fight over Proposition 76, and other measures slated for the November ballot, including initiatives that would impose strict limits on public workers' unions' ability to use members' dues money for political activities, lengthen the period teachers must work before achieving permanent status, and a change the method for reapportioning legislative and congressional districts, are likely to create deep rifts between key players in the public life of California. Labor unions will view the limitations on their use of dues money as a major threat to their ability to represent the interests of their members. A broad array of advocates for education, children, poor families, and others will see Proposition 76 as a threat to the programs and services they value greatly. They will also view - correctly in my opinion - the shift of power to the Governor as a threat to their ability to have an effective voice in public policy debates.

My concerns for the future of the state where I was born and raised are rooted in the tenor of the current debate around the budget, budget process, and the fundamental issues of taxing, spending, and governance. I am generally an optimist, however, it has become increasingly difficult to maintain an up-beat attitude, and my short-term prognosis for California is decidedly gloomy. Whatever the outcome, the battle that will ensue during the upcoming months will drive a wedge between individuals and organizations whose cooperation and collaboration are essential to charting a future that addresses the challenges facing California.

Fortunately, Californians are resilient and the state retains tremendous wealth and diversity. These are our greatest assets, assets that, if used wisely, will build a future that honors Pat Brown's achievements and leaves a legacy for current and future Californians.

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