
CALIFORNIA BUDGET REPORT

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THE "STATE OF THE STATE" SPARKS THE ANNUAL BUDGET FIGHT

BALLOT BATTLES SEEM INEVITABLE

Political gossips and Sacramento insiders watched Governor Schwarzenegger's State of the State Address last night with great interest. We have attached to this CBR a copy of the actual address, so you can check to see if your local media got it right.

Next Monday, January 10, the Governor will release details of his proposed 2005-2006 state budget. We will know much more about the details of the new Schwarzenegger "vision" as articulated last night when that document appears online. This year, there will not be a book or CD-Rom version of the budget; it will be available only online through the Department of Finance website at <http://www.dof.ca.gov/>.

Here is our fast summary of the speech and its major details:

- The tone was upbeat, his manner was charming as usual and the words were aggressive.
- The Governor called a Special Session of the Legislature. Below is the precise wording of that call. All bills introduced in that special session must fit these subject matter descriptions. The full document can be found at the following link:
http://www.governor.ca.gov/state/govsite/gov_htmlprint.jsp?BV_SessionID=@@@@1678759399.1105030086@@@@&BV_EngineID=ccccaddhmjdjjgcfnegckmdffidfof.0&sFilePath=%2fgovsite%2fproclamation%2f20050105_SpecialSession.html&sTitle=Special++++Session&sCatTitle=Proclamation&sSubCat=null&iOID=60463:

1. To consider and act upon a Constitutional amendment to be placed before the voters and related legislation to reform the State's budget process so that government will be better able to keep spending within the amount of available revenues and thereby avoid budget deficits, and to require reductions in state expenditures when they exceed State revenues; and

2. To consider and act upon a Constitutional amendment to be placed before the voters and related legislation to reform the pension systems for future government employees from one that provides retirees a defined retirement benefit, to one that requires the state to pay a defined or fixed contribution each year into employee pension accounts; and

3. To consider and act upon a Constitutional amendment to be placed before the voters and related legislation to reform education by basing employment decisions concerning school teachers and administrators, including their compensation, on their successful performance not their longevity of service and to require more fiscal transparency and accountability on the part of local school districts; and

4. To consider and act upon a Constitutional amendment to be placed before the voters and related legislation that will reform the process of drawing California's legislative, congressional and Board of Equalization districts in order to ensure that the process of apportioning legislative, congressional and Board of Equalization districts is fair and equitable and free of undue political or partisan influences.

Please note that the call of the Special Session was probably written to prevent or discourage legislators from introducing bills to increase taxes, although as a legal matter we suspect Legislative Counsel might opine that tax increases fall within the call.

We cannot at this point determine how serious the Governor is about each of these major parts of the Special Session. For example, does he care more about reapportionment than merit pay for teachers? Is state employee “pension reform” more or less important than changes in the budget process? We don’t know at this point and we doubt that the Governor and his staff know either.

- We nominate for the most potentially contentious part of the Governor’s plan the following statements in his address (page. 2):

“... in the special session, I will submit to you legislation that cuts expenditures across the board when they grow above revenues.

We must take back responsibility for the budget. We must have a new approach that overrides the formulas, overrides the special interests and overrides the forces that have turned some of you from legislators into clerks”. (Emphasis added)

In case you miss the implications of this remark, it suggests that the Governor is proposing to amend the Constitution to repeal or revise Proposition 98, the 1988 ballot measure that gives K-12 and the community colleges a guaranteed first crack at the General Fund, and guarantees automatic spending increases too! Take it from us, this will be nuclear warfare.

Private discussions with knowledgeable Schwarzenegger staff suggest that the Governor is thinking about modifications of Proposition 98, not direct repeal. We suspect there is continuing argument within the Administration on this subject and the precise details may not be released any time soon. The *San Jose Mercury News* indicated today that the plan also includes steps to prohibit borrowing from Special Funds, like transportation money, but not this next year. If true, this would be another example of adopting a principal in the future, and ignoring it in the present.

- The *Sacramento Bee* reported today that the Governor would not include in his January budget repayment of the \$2.2 billion in education money that was borrowed last year. That decision, of course, helps bridge the budget shortfall of \$8 billion, and was an idea suggested by the Legislative Analyst. This action is, of course, another example of delaying the pain of making tough budget decisions—not a solution to the structural gap between spending and revenues.
- The Governor did not hint at any specific program cuts that would appear in his budget, nor did he give the health care community any hint as to what might come out on the long-awaited, much-discussed Medi-Cal redesign. An hour before the speech, the Department of Health Services issued an invitation to its Medi-Cal redesign e-mail list to attend a briefing on the redesign proposal. The rumor in the Capitol is that the Administration has not yet resolved with the federal government the hospital funding issues, which threaten to deep-six the Administration’s effort to move the aged, blind and disabled into managed care plans. Unless the federal government can provide the state some flexibility, use of managed care could cost the state’s hospitals more than \$1 billion.
- California Performance Review (CPR), that much-discussed “blowing up the boxes” of state government that the Governor promised was mostly honored by omission in the speech. Other than announcing a pending major restructuring of the Department of Corrections and California Youth Authority, the Governor said, “More changes will follow in the months ahead”. Sounds like no action to us.
- The State of the State speech suggests the Governor is intentionally picking a fight with legislative Democrats and wants to go to the ballot later this year. There appears to be little hope of a compromise between the warring factions in Sacramento, particularly over the items in Special Session, and ultimately only the voters can make substantial changes in the state Constitution. We assume that much of the early budget action this year will be posturing by legislative Democrats, Republicans and the Governor. In the meantime, various interests groups will immediately start to circulate elements of the Governor’s plan—and Democratic ideas as well—that might appear on a 2005 Special Election ballot.
- Some suggest that the Governor is threatening ballot fights as a way to force Democrats to compromise. Maybe, but we think it more likely that once the forces start to qualify ballot measures, there is little chance of any compromise. Which means another tense, ugly political year.

In some sense, the expressed will of the voters has put California in its current fiscal mess. Voters have enthusiastically limited new taxes and forced reductions in old taxes, while simultaneously mandating that spending continue at a high level for many social programs. The Governor seems to embrace just such inconsistent views with his “deal” last year with local governments. He also proposes to more directly restrict spending in the future, which voters may like in the abstract, but not in detail. What will happen? Only time can tell.

We’ll stay in touch.

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