
CALIFORNIA BUDGET REPORT

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*"...Feed the private sector,
starve the public sector...."*

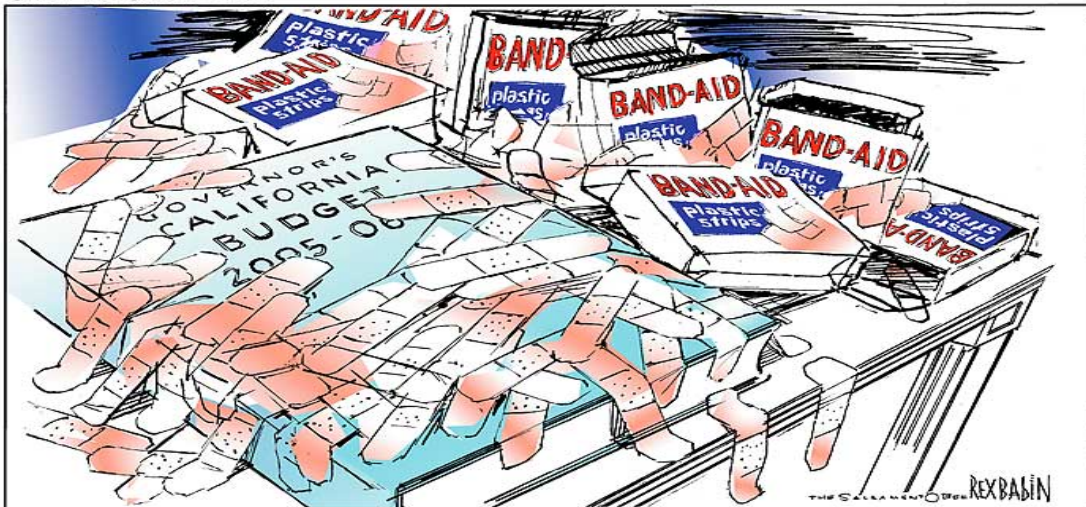
"We want to feed the private sector, and we want to starve the public sector," Governor Arnold Schwarzenegger told the *Sacramento Bee* Editorial Board, according to a *Bee* report January 16, 2005.

Was the Governor serious? Or was this another of his exuberant overstatements? According to reports, a number of conservative thinkers have advocated that the way to reduce the size of government is to cut taxes, eventually leading to smaller government. This attractive theory is that you can favor tax cuts and oppose new taxes without being forced to say where you would cut spending. Disingenuous to be sure, but politically attractive.

What surprised us is that the Governor would be so clear about it all. Which leads us to the Governor's proposed state budget

On the same day that the *Sacramento Bee* reported on the Governor's "feed a cold, starve a fever" comments, *Bee* editorial cartoonist Rex Babin published a terrific cartoon featuring the encyclopedia-sized 2005-2006 Governor's budget covered with Band-Aids and surrounded by empty Band-Aid boxes. It was a marvelous depiction of where we find ourselves today.

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Readers of the *California Budget Report* know that we strongly believe the budget mess facing the state is of our own making—not just evil interest groups, not just elected officials, but all of us. Collectively, the citizens of California, the elected leadership of the state—both Republicans and Democrats—and most of the media seem somehow satisfied with our state’s simultaneous support of the following inconsistent goals:

- No new taxes.
- Continued or increased state spending for favored programs, but no serious cuts.
- Mandatory formulas for state and local government spending for certain special programs.
- Voter approval of a continuing number of new bond issues for pet programs.
- Restrictions on the ability of elected officials to raise taxes.

Behind all of this is the narrow focus of almost every interest group in the state, and most of the citizens as well. “Does this budget increase help me? Does this budget cut hurt me?” After a while, it is hard to escape the conclusion that we no longer live in a society with common goals for any greater social purpose. Liberal or conservative, the refrain is the same, “I’ve got mine, to hell with the rest.”

The irony of our current situation is that some of the best and brightest among us see no problem with protecting their own turf, leaving to others the dirty job of making a budget balance. A comment from David Janssen, the very smart and creative chief administrative officer of Los Angeles County, reflects the state of public life in California. Reflecting on whether or not the Governor’s budget adhered to the terms of the 2004 “deal” with local governments, the *Los Angeles Times* (p. A 20, January 11, 2005) reported Janssen as saying the following:

“There are no gimmicks in this budget to try and take anything away from us. This is what we’ve said all along. ‘You need to address your expenditures.’ But it’s their issue to deal with, not ours.” (Emphasis added)

Ironic, isn’t it? Local government benefits from the provisions of Proposition 1A, the voter-approved measure that guarantees future state budgets can’t be balanced by reducing the funds that local governments get from the state. But here is local government turning a blind eye to the state’s fiscal crisis. Is there any concern that the state will run out of funds to give to local governments? Is there any concern that other possibly more important social priorities might be slighted by this protection of local governments?

Locals believe that the state steals “their” money and that only local government is efficient or responsible. That may well be true. But if someone as smart as David Janssen believes that it is the state that must cut spending for something, but continue to guarantee that local government gets its share of the pot, we have some serious thinking to do.

How did this all happen? How did California become a place where every interest can fight hard to protect its money, enshrine its funding in statute or in the Constitution, and not care about the consequences? We pause at this point for a short history lesson.

The California Constitution of 1849: Constrained From the Start

California's first Constitution was passed in 1849 and some decisions made then still echo today. Most historians focus on California's Bill of Rights (Article I), which survives today and is comparable to the federal Bill of Rights. Others note the amusing provisions that prohibited the state Legislature from granting divorces or allowing anyone to exercise "the privileges of banking or creating paper to circulate as money." Lotteries, dueling and slavery were outlawed. The right to vote was given to white male citizens of the United States and residents of Mexico who chose to become U.S. citizens. If the Legislature could work up its courage and get a two-thirds vote, it could grant the vote to "Indians or the descendants of Indians, in such special cases as such proportion of the legislative body may deem just and proper." Federal law solved that problem by the mid-1950s.

But for this story, it is worth noting that our first Constitution set us on the path of limited taxation and spending, and simultaneously mandated spending for good purposes. Here are the prime examples:

- Article VIII said that approving any public debt in excess of \$300,000 requires a direct vote of the people! This provision is still alive (Article XVI, Section 1). It takes no degree in history to know that, since 1849, this provision has been honored more in the breach than the observance. It is, however, worth noting that litigation challenging parts of Governor Schwarzenegger's 2004 deficit reduction plan still argue about the applicability of this provision.
- Article IX established the office of Superintendent of Public Instruction, told the Legislature to establish "a system of common schools" to be open at least three months a year, and set up the University of California. The provision on common schools, which education know-it-alls tell us mandated education only through the sixth grade, continues to be in our current Constitution (Article IX, Section 5), but the schools now have to be open six months a year! Our original Constitution did at least provide that proceeds of federal school land grants, assets left by those who died without a will, and a few other lesser sources would remain a "perpetual fund...inviolably appropriated to the support of common schools throughout the State."
- Article X required a two-thirds vote of the Legislature to propose any amendment to the Constitution, which is still part of our law. No easy changes allowed here.
- Article XI, Section 13, said all taxation "shall be equal and uniform" and provided a system of property taxation that mostly survives to this day. You can find the current version in Article XIII, amended heavily by the famous Proposition 13 of 1978.
- We leave you to puzzle Article XI, Section 16, which stated, "No perpetuities shall be allowed, except for eleemosynary purposes." For the right answer, talk to a law student taking courses on future interests in real property.

California's Constitution of 1879: Anti-Chinese, Anti-Corporate, Anti-Politician

California has had only two Constitutional conventions. The last one was in 1879. We still operate under that document, as amended over the past 120 years. The process of constitutional amendment has been accelerated by voter approval of the initiative process in 1911.

Kevin Starr, California's pre-eminent historian, briefly summarized the situation facing the state when the second constitutional convention convened:

“A convention met at Sacramento to draft a reformed state constitution, which the voters ratified on 17 May 1879. From start to finish, north and south, the 1870s had been an unmitigated disaster of drought, crop failure, urban rioting, squatter wars, harassment and murder of the Chinese, cynical manipulation of politics by the railroads, depression, price fixing, bank failure, and stock swindles.”

Americans and the California Dream: 1850-1915, Kevin Starr, Oxford University Press, New York, NY, p. 150.

Heavily influenced by the Workingmen's party, based in San Francisco, the Constitutional Convention became known by its actions to punish immigrants from China, attack private corporate power.....and to limit the ability of politicians to act. Most notably, the votes approved the following:

- Limits on the power of railroads by creating an elected railroad commission (the predecessor of the current Public Utilities Commission), which was given power to approve railroad rates. Voters also prohibited discrimination in rates by railroads (Article XII, Sections 20—22).
- An article forbidding the Legislature from using public money to “benefit...any corporation”... refunding money paid into the State treasury . . . or granting any “special or exclusive right, privilege, or immunity” to any corporation, association or individual (Article IV, Section 25, Nineteenth).
- An expanded mandate to have “common schools” and a mandate for some forms of high schools, evening schools, and technical schools. The time common schools were to be open was extended to six months. (Article IX, Sections 5-6).
- Constitutional status to the University of California, which was declared a “public trust.” This designation led to the current constitutional provision granting budgetary sovereignty to UC (see the old and new constitution, Article IX, Section 9). The practical consequence of this is that the Legislature and Governor may give or deny money to UC, but cannot legally tell the University how to spend it. Much time in intervening years has been spent by all the parties working out accommodations on when disputes arise.
- A provision denying local governments the right to grant tax relief (Article XI, Section 10), presumably to deny the railroads and other business interests a tax advantage. The

Legislature was denied the right to impose a tax on local governments, although the state could authorize the locals to impose their own tax.

- A provision stating that no county, city, town, township, Board of Education or school district could “incur any indebtedness or liability in any manner, or for any purpose, or for any purpose, exceeding in any year the income and revenue provided for it for such year, without the assent of two thirds of the qualified electors...” Failure to comply voided the debt (Article XI, Section 18).
- Business interests today might faint reading Article XII, which imposed individual and personal liability on stockholders of corporate stock” . . . said the right of the state to take property by eminent domain shall never be construed to prevent taking of corporate property . . . placed hard limits on the rights of corporations to issue stock . . . declared railroads to be “common carriers” and subject to extensive regulation . . . said no railroad was allowed to grant free passes to public officials, a violation of which would lead to immediate forfeiture of office (still the law today) . . . no common carrier could conspire on prices with other common carriers, nor have discriminatory rates . . . the State Board of Equalization was created . . . income taxes on individuals and corporations were authorized, subject to legislative enactment . . . and for amusement, a poll tax of \$2 “on every male inhabitant of this State, over twenty-one and under sixty years of age, except paupers, idiots, insane personas, and Indians not taxed” was imposed, to be deposited in the state School Fund!
- The Legislature was directed to adopt a homestead law, protecting family land from foreclosure (Article XVII).
- Probably the most ugly expression of racism in the state’s history is found in Article XIX, titled “Chinese,” which prohibited any governmental body, state or local, and any corporation in the state from “employing directly or indirectly, in any capacity, any Chinese or Mongolian,” ordered the Legislature to “discourage their immigration by all the means within its power” and found “Asiatic coolieism” a form of “human slavery.”
- Just to give you an additional flavor of what the politics of 1879 were like, the Constitution gave mechanics and laborers a lien on their work (still an occasional hot issue in the Legislature) . . . declared an 8-hour work day . . . and said “No person shall, on account of sex, be disqualified from entering upon or pursuing any lawful business, vocation, or profession.” (Article XX, Sections 15, 17-18).

And We Have Been Doing Similar Things Ever Since...

California’s involvement with “direct democracy,”—the slogan that describes the process of voter-generated changes like the initiative, referendum and recall—began in 1911. These “reforms” were the hallmark of the Progressive Movement in California, led by then-Governor Hiram Johnson and placed in the Constitution that year. For a summary of all proposed initiative ballot measures and the history of their passage or defeat, see the interesting report *A History of California Initiatives* (2003), Secretary of State, http://www.ss.ca.gov/elections/init_history.pdf.

The purpose of this too-long historical discussion is to illustrate that the voters of California actually like deadlock and constrained government. After all, for more than 150 years, they have been

imposing rules that tie the hands of elected officials. The creation of the initiative, referendum and recall processes in 1911 only accelerated the pace of constitutional amendment, and has allowed momentary majorities to enshrine in law their personal preferences. What follows is a chart summarizing the past 30 or more years of the history of limits on state and local government in the areas of budget and finance.

FISCAL CONSTRAINTS ON CALIFORNIA GOVERNMENT

The following charts are shamelessly cribbed from various excellent publications by the Legislative Analyst, including *Cal Guide* (1995), *Cal Facts* 2000, 2002 and 2004, *Understanding Proposition 218* (December 1996). Some of the commentary is Phil's, particularly the discussion of measures on the November 2004 election ballot and pending ballot measures. All errors are ours, not the LAO's.

Chart I: Historic Summary of Constraints Imposed on California Governments

Year	Ballot	Statute	Description
1972		SB 90	Establishes property tax rate limits and allowed local agencies to seek reimbursement to state-mandated program costs.
1978	Prop 13		*Limits general property tax rate to 1 percent and limits increase in assessed value after property is bought or constructed. *Makes Legislature responsible for dividing property tax among local entities. *Requires two-third vote for Legislature to increase taxes. *Requires two-third voter approval for new local special taxes.
1978		SB 154	Authorized one-year "bail out" program to offset local property tax revenue losses under Proposition 13.
1979		AB 8	Established permanent "bail-out" program, consisting of "buy-outs" of county costs for health and welfare programs, shifts of property tax revenue from schools to cities, counties and special districts, and increased state assistance to school districts.
1979	Prop 4		*Generally limits spending of "proceeds of taxes" by the state and local entities to prior-year amount, adjusted for population growth and inflation (now per capita personal income growth.) *Requires state to reimburse local entities for some mandated costs.
1981		State Budget	State budget action reduced or eliminated several subventions previously earmarked for cities and counties in fiscal years 1981-82 through 1983-84.
1982	Prop 6		Prohibits state gift and inheritance taxes, except for "pickup" tax qualifying for federal tax credit.
1982	Prop 7		Requires indexing of state personal income tax brackets for inflation.
1982		AB 799	Transferred responsibility for providing health care for Medically Indigent Adults from state to counties.
1984	Prop 37		*Establishes state lottery and dedicates a portion of revenue to education. *Places prohibition of casino gambling in State Constitution.
1986	Prop 62		Requires approval of new local general taxes by two-thirds of the governing body and a majority of local voters.

1988	Prop 98		<p>*Establishes minimum state funding guarantees for K-12 schools and community colleges (they get a “first crack” at the state General Fund). In 1997-98, as the General Fund grows in total revenue, K-14 receives approximately 60 cents of every additional General Fund dollar.</p> <p>*Requires distribution to schools and community colleges of half of any state tax revenue in excess of appropriation limits (those set by Proposition 4).</p>
1988	Prop 99		<p>*Imposes 25 cent per pack surcharge on cigarettes and tobacco products.</p> <p>*Limits use of surtax revenue, primarily to augment health-related programs, anti-tobacco advertising, research, anti-tobacco education and environmental purposes. Note: the exact scope of this measure is still being litigated.</p>
1988		SB 612 and AB 1197	Establishes the Brown-Presley Trial Court Funding Act to provide increased state support for county-operated trial courts. Approximately \$300 million additional given to counties. Note: In 1991 the Legislature and Governor declared their intention to eventually assume the largest share of trial court costs.
1990	Prop 111		Amended Proposition 4 spending limit provisions to increase spending growth and to provide exemptions from the limit for certain types of spending. The Proposition basically increased gas taxes and spending on transportation but exempted this increase from the Proposition 98 set-aside for education.
1991		AB 758, AB 948, AB 1288	Implemented major program realignment, including transfers of mental health and other health programs to counties, changes in state/county cost sharing ratios, and increased Sales and Vehicle License Fee taxes to pay for the increase in county expenditures.
1992	Prop 162		Limits the Legislature’s authority over PERS and other public retirement systems, including their administrative costs and actuarial assumptions.
1992	Prop 163		Repealed “snack tax” and prohibits any future sales tax on food items, including candy, snacks and bottled water.
1992-1993		State Budget	Permanently transferred \$3.6 billion of annual local property tax revenues to schools from cities, counties and special districts. Transfers began during 1992-1994 and allowed reductions in state obligations for funding of school districts.
1996	Prop 218		<p>Directly affects taxes, assessment and fees for local governments.</p> <p>*All general taxes must be approved by majority vote of the people (local voters). This expands the Proposition 62 provision to include general law cities.</p> <p>*Elections for general taxes must be consolidated with a regularly scheduled election for members of the local governing board. In an emergency this may be waived by a unanimous vote of the local board.</p> <p>*Any tax imposed for a “special purpose” is a special tax and requires a two-thirds vote of the local voters. Prior to Proposition 218, money deposited in local General Fund was considered general taxes and only required a majority vote.</p> <p>*All assessments require majority vote of those charged. This may</p>

			<p>mean that general purpose spending (police, libraries, recreation, etc.) must be financed by taxes or other nonassessment revenue.</p> <p>*Fees not related to property do not require a public vote. However, property-related fees require a two-thirds vote of property owners (and renters) or the entire electorate in the affected area. Note: water, sewer and garbage collection exempted. Second note: being contested in court.</p>
1998	Prop 10		Puts \$.50 per pack charge on cigarettes and other tobacco products. Limits use to augment early childhood development programs.
2000	Prop 39		Allows 55% of local voters to approval local GO bonds for school facilities.
2002	Prop 42		Permanently transfers gasoline tax revenue from General Fund spending to transportation only. General Fund loss of \$1.4 billion in 2008-09, increasing thereafter.
2002	Prop 49		Requires \$455 million more be spent on before/after school programs. Money taken from General Fund, after Proposition 98 is funded. Proposed by Arnold Schwarzenegger.
March 2004	Prop 57		Governor Schwarzenegger's Economic Recovery Bond Act, the \$15 billion borrowing package to balance the state budget. The bond borrowing will be paid back in 9 to 14 years. A portion of existing taxes is dedicated to payment of the bond cost.
March 2004	Prop 58		Governor Schwarzenegger's Balanced Budget Act, requiring (a) adoption of a balanced General Fund budget (current law only requires Governor to propose one), (b) establishing a General Fund budget reserve (phased in until it reaches 3% of GF, in 2008-09), (c) prohibits future deficit bonds, (d) allows Governor to declare a mid-year budget emergency, call Legislature into session and if the Legislature does not act in 45 days, no other bills may be considered and Legislature must stay in session until legislation is passed.
Nov 2004	Prop 1A		Governor Schwarzenegger's deal with cities, counties and special districts. Takes \$1.3 billion in 2004-05 and 2005-06 from local governments (\$350 million each from cities, counties and special districts; \$250 from redevelopment agencies) and gives the money to schools (thus, reducing state contribution for schools). Measure prohibits state in the future from reducing local share of sales tax, optional local sales tax, plus permits a "take" of property taxes, VLF and other taxes, but only with approval from the locals.
Nov 2004	Prop 61		Authorizes \$750 million of general obligation bonds to finance development at Children's hospitals. Bond interest payments come from the General Fund.
Nov 2004	Prop 63		Voter initiative to impose a 1 percent surcharge on taxpayers with incomes of \$1 million or more to fund local mental health services.
Nov 2004	Prop 71		Voter initiative to authorize \$3 billion of general obligation bonds to finance stem cell research. All bond interest payments come from the General Fund.

As this document is being written, the Governor, both political parties, and a host of interest groups are proposing additional ballot measures, including more bonds, limits on spending, mandates to spend, and increased taxes for a variety of purposes. You can get a constantly updated list of all pending ballot measures from the Secretary of State's web page, found at http://www.ss.ca.gov/elections/elections_j.htm#2006Primary/.

There is a strong possibility that a special election will be called in late 2005 by the Governor and most, if not all, ballot measures that are pending will appear on that special election ballot. To date, a \$600 million bond proposal for library construction and a \$10 billion bond issue for high-speed rail are set to appear on the 2006 ballot. Ballot measures in circulation (see the web site indicated) include further limits on the ability of state or local governments to increase fees and other charges for services.

Chart II: Rules for voting on state and local taxation and bonds

It is damn hard to understand the array of ballot-imposed rules restricting state and local government. Imagine yourself on a city council or board of supervisors, or even in the state Legislature, trying to puzzle through the follow practical hurdles to raising revenue (taxes, fees or charges) that have been imposed in the last 30 years:

This chart is taken directly from *Cal Facts*, 2004, by the Legislative Analyst (page 16).

Approval Requirements for State and Local Revenues

State Level	Legislative Approval	Voter Approval
Taxes	Two-thirds	None
General obligation bonds	Two-thirds	Majority
Other debt ^a	Majority	None
Fees	Majority	None
Local Level	Governing Body Approval	Voter Approval
City or county "general" taxes (revenues used for unrestricted purposes)	Two-thirds (Majority for charter cities)	Majority
City or county "special" taxes (revenues used for specific purposes)	Majority	Two-thirds
All school or special district taxes	Majority	Two-thirds
City, county, and special district general obligation bonds	Majority	Two-thirds
K-14 district general obligation bonds	Two-thirds	55 percent
Other debts	Majority	None

Property assessments	Majority	Majority of property owners Votes weighted by assessment liability
Property—related fees	Majority	Two-thirds of voters or majority of property owners
Fees—all other	Majority	None

- a Includes revenue and lease-revenue bonds and certificates of participation.
- b Exceptions: The State Constitution (1) requires approval by two-thirds of voters if the district does not meet certain requirements, and (2) specifies that a majority of voters can approve bonds used for repairing or replacing unsafe public school buildings.
- c No vote required for gas, electric, water, sewer, refuse, or developer fees.

Why are we forcing you to read all of this? Well, there is no way to make sense of the current budget fight, and no way to decide how to change things for the better, unless we all understand how we got to the current mess we are in. We also have to decide whether this endless spiral of turf protection, limits and constraints (whether favored by liberals or conservatives) makes any sense at all. California faces the 21st century tightly bound by a series of spending mandates and prohibitions on taxation that make it unlikely any legislature or Governor—whether the Governor is Arnold Schwarzenegger or the Pope—would be able to satisfy the inherently conflicting views of our society.

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