
CALIFORNIA BUDGET REPORT

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HERE WE ARE AGAIN: BUDGETS, POLITICS, POLITICIANS, VOTERS AND UNREALISTIC EXPECTATIONS

We all survived the November elections and are ready to move into 2007 with optimism for the future, right?

Some of you say, “No, we are not optimistic.” OK, we dismiss political candidates on the losing end of the November election. We also dismiss those who feel that the voters were tricked into supporting, or not supporting, wonderful ballot measures and candidates. That leaves the rest of us. Our hunch is that California voters, as they have for some years now, are just unwilling to make hard choices. We know voters like the idea of no taxes and lots more spending by government. We suspect they also know the good times cannot continue. The war in Iraq won't end any time soon, the state's budget problems look likely to continue for many years to come, and the hope of moderate, cooperative good government in Washington and Sacramento seems unrealistic.

We are gearing up for the 2007 legislative cycle and wanted to give you our take on the pending session, the budget and state politics in general.

Low voter turnout

For all of the national and state commotion over candidates, the war in Iraq and our almost-endless number of ballot measure, the voters of California were underwhelmed. The Public Policy Institute of California indicated that the official turnout was 46.3 percent of registered voters—which PPIC notes is the lowest in a Gubernatorial election in California history. For the short summary of their findings, take a look at http://www.ppic.org/content/pubs/jtf/JTF_Nov2006ElectionJTF.pdf There may be slight adjustments of the totals since absentee and provisional ballots are still being counted.

Political moderation, or just indifference?

The 8,976 political pundits, bloggers and members of the chattering class have already opined on what the November election really means. Our take is that a combination of unhappiness with the war in Iraq and a general sense that Washington is “all screwed up,” combined to end Republican domination in Congress. The relatively narrow margin of Democratic control in the House of

Representatives and the one-vote control in the U.S. Senate make it clear that the voters were not giving a blanket endorsement to all things Democratic.

Was there also a strong trend to moderation in politics? Well, maybe yes and maybe no. Independents were the key to this election nationally, and they traditionally seem to be horrified with the normal political yelling that dominates modern American politics. Is that a trend? We just do not know. Later in this report, we give you the fast summary of the new California Legislature and also speculate about what role moderates have to play in 2007.

Warning signs on the 2007-08 budget

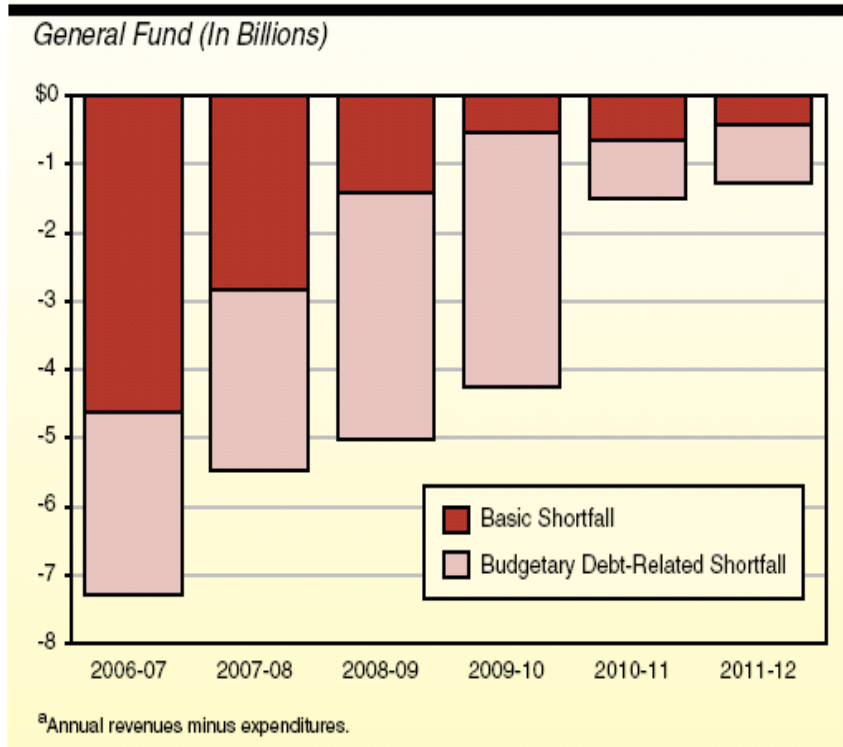
The hard news today is that California's Legislative Analyst issued its annual Fiscal Outlook, giving us a preview of next year's budget situation. To the surprise of no one, California has a continuing budget shortfall.

For the full report, go to http://www.lao.ca.gov/2006/fiscal_outlook/fiscal_outlook_06.pdf
However, here are some interesting points:

1. Our current year 2006-07 budget surplus is \$3.1 billion. That is \$1 billion higher than the LAO estimate of the final budget.
2. Projected expenditures in excess of revenue for 2007-08 remains at \$5.5 billion. That trend is likely to continue, as illustrated by this chart from the LAO's report (p. 3):

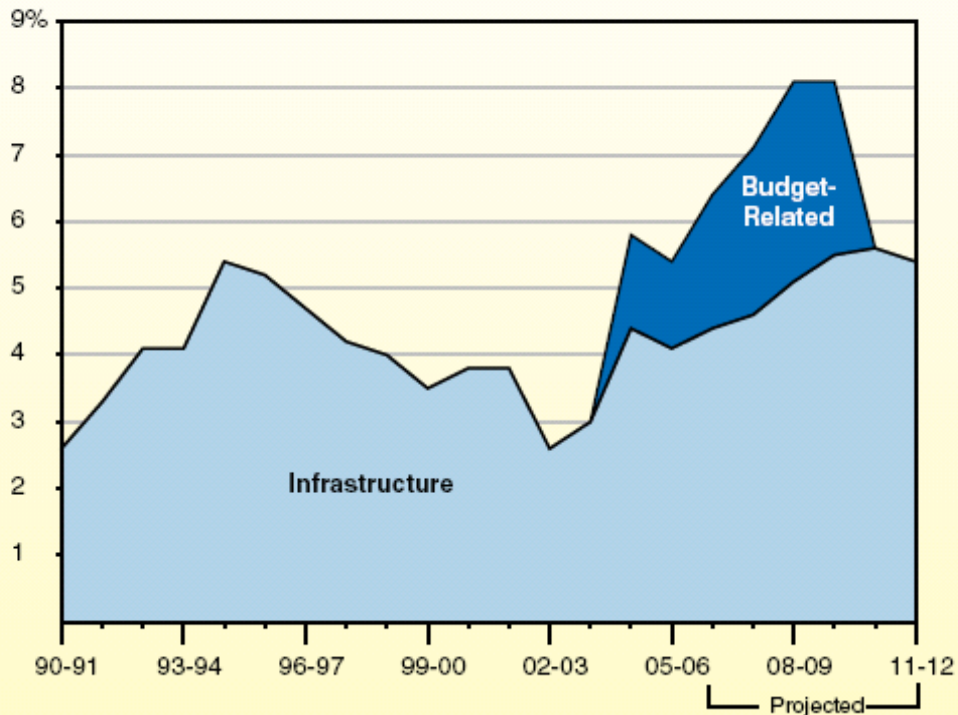
Figure 3

Large Operating Shortfalls Projected Through 2009-10^a



3. Yes, assumptions about the cost of all this new borrowing is factored into these figures, but the LAO estimates that borrowing costs alone will cost the state General Fund “\$3.8 billion in 2005-06, \$4.2 billion in 2006-07, and \$4.6 billion in 2007-08. Thereafter, it is projected to grow at an annual pace of almost 11 percent annually.” (p. 47). A good way to understand the debt-service ratio is this chart (p. 48):

Figure 8
Projected Debt-Service Ratio



4. Most important: all these figures are based on the assumption that the Governor and Legislature will not approve any new programs, will not have to pay for new lawsuits, and will not cut taxes or take any additional steps to put pressure on the General Fund! Many of you expect the Governor to announce a major plan to cover some or all of the uninsured in California. Have any idea about how he plans on paying for it? Want to bet the Legislature is going to reject a plan because it spends money we do not have?

Here at the *California Budget Report*, we’re betting the Governor does announce a big health plan in his State of the State address. We also bet that neither he, nor the Legislature will worry very much about paying for it. If you believe we are wrong...well, you probably also believe that George Bush is the most popular President in modern American history.

The 2007 legislative lay of the land

As we write this issue of the *California Budget Report*, only one Senate race remains to be decided. That is the 34th Senate District in Orange County, which was previously occupied by Democrat Joe

Dunn. Assemblywoman Lynn Daucher (R) is 147 votes ahead of Supervisor and former Assemblyman Lou Correa (D). According to the Orange County Registrar's office, a few hundred absentee ballots remain, but 6,000 provisional ballots are also uncounted. In the last few days, Correa has been edging much closer to Daucher and the last count we saw had Correa 147 votes behind. A final count should be ready by Thanksgiving, but maybe a re-count will occur too. Stay tuned for further reports.

Now that we have that out of the way, here is what we know or suspect:

- In the Assembly, there were 48 Democrats and 32 Republicans before the election. The same split continues in 2007.
 - ✓ 33 of the members are new, comprising 41 percent of the total membership of the Assembly.
 - ✓ Three of the new members are moving over from the Senate or have prior legislative experience: Richard Alarcon, Chuck Calderon and Nell Soto.
 - ✓ Most conventional wisdom reports that the new Assembly will be more liberal than the old one. We think it is too early to tell.

- In the Senate, the 25-Democrats-to-15-Republicans split continues if Lou Correa wins Joe Dunn's old seat, but if Daucher wins, the split is 24-16.
 - ✓ There are 12 new members in the Senate. All but one of them are moving over from the Assembly.
 - ✓ Only Senator-elect Alex Padilla has no prior legislative experience.
 - ✓ Insiders suggest that the Senate is slightly more moderate as a result of the November election. New members Ron Calderon, Gloria Negrete-McLeod, Alex Padilla and Leland Yee will bring a slight business bent to the Senate Democratic Caucus. Is this a sign of a new, moderate Senate Democratic Caucus? We doubt it goes that far, although the Senate is no longer the liberal fortress of the John Burton years.

- Democrats will retain Speaker Fabian Nunez in the Assembly, and President Pro Tem Don Perata in the Senate. Even if Daucher wins the 34th District race, Perata will remain in his post.

- Assembly Republicans removed previous Minority Leader George Plescia, replacing him with Mike Villines from the Central Valley. In part, this is fallout from the reported comment of Governor Schwarzenegger's Chief of Staff Susan Kennedy that Plescia "looked like a scared deer in the headlights," which was on the much-referenced tapes of private conversations between the two. That and disagreements within the caucus relating to Plescia's negotiation of the bond measures and other issues led to the change.

- Senate Republicans appear likely to keep Dick Ackerman as their Leader, but rumors abound that Senator Jim Battin would like to take that slot earlier rather than later.

- The most interesting thing to watch is how candidates to replace Nunez and Perata start to position themselves. We will not bore you with idle speculation and the list of rumored candidates, but for insiders this is the really important stuff. Forget the budget!

- The number of women in the Legislature was at 37 and will drop to either 34 or 35 depending on the outcome of the Daucher-Correa contest. That means either 28.3 percent or 29 percent of the legislative membership is women.
- There were 29 Latinos, and now there will be either 27 or 28, depending on the outcome of the SD 34 contest (22 or 23 percent).
- There were 9 Asian-American members and that number stays the same (7.5 percent).
- There were 6 African-Americans, and that number increases to 9 (7.5 percent).

National report on ballot measures --- and pending California ballot measures

Yes, dear readers, there are a whole slew of ballot measures just waiting for the 2008 June Primary ballot in California. Before we get to that horrifying prospect, however, we wanted to give you a place to review the results of the 204 (yes, 204) ballot measures presented to the voters of 37 American states this month. The Initiative & Referendum Institute did a first-rate summary of these and you can find the full report at [http://www.iandrinstitute.org/BW%202006-5%20\(Election%20results\).pdf](http://www.iandrinstitute.org/BW%202006-5%20(Election%20results).pdf)

We like the IRI study because they put these proposed ballot measures in context. Here are some key findings:

- ✓ 68 percent of all ballot propositions passed nationwide, but only 41 percent of all citizen initiatives (75 measures of the total 204). By the way, there were also four referendum measures and one measure put on the ballot by a state commission. The rest were legislative ballot measures.
- ✓ The most-frequent ballot measures dealt with eminent domain (9), same-sex marriage or the like (7) and increasing the minimum wage (6).
- ✓ Ballot bond measures passed in Arkansas, California, New Mexico, Pennsylvania and Rhode Island. California, however, by adopting a total of \$43 billion worth of bonds (add Proposition 84 to the Governor/Legislature package deal), approved far and away the largest total. **If we read this report correctly, it means that California alone accounts for 99 percent of all borrowing authorized by U.S. states this November!**

Here is a fast take (and some rumors) on what will be around the corner. Check the Secretary of State's web site for weekly updates: http://www.ss.ca.gov/elections/elections_j.htm#ag

- ✓ The much-delayed bond issue for High-Speed Rail in California has been scheduled for the 2008 June Primary election. The cost is \$12 billion, but expect this one to be continued one more time for issues considered more important by the Legislature.
- ✓ There are currently eight ballot measures in circulation.
 - Three of those deal with domestic partnership. Expect two of these measures to fail to meet the November deadline for signatures; the third has until January 2007 to make the cut.
 - One measure to guarantee funding for community colleges. Cynics call this a "mini-Proposition 98" for the colleges, but whatever you call it, it is more

mandated spending without any new revenue. Behind this measure is the endless fight of K-12 vs. the community colleges over a "fair share" of Proposition 98 revenue.

- Another measure proposes that child support payments should be tax-deductible, which would cause a loss of General Fund revenue –hundreds of millions, according to the LAO.
- Another ballot measure proposes to ban California from issuing driver licenses to illegal immigrants.
- Two measures tinker with the Legislature. One would substitute a housing allowance for legislative per diem; the other would create a single-house Legislature of "not less than 50 or more than 80" members!

There are also two ballot measures at the Attorney General's office waiting for title and summary. One would propose to adopt SB 840 (Kuehl), a universal health care plan vetoed by the Governor this year. The other deals with public agency accountability, but the actual text is not posted and we wanted to get this out to you today (that means we do not know what it proposes).

The California Budget Report is produced by Phil Isenberg and Maureen O'Haren of ISENBERG/O'HAREN. Questions, comments and requests to be added to the mailing list should be directed to Phil at phil@isenberg-oharen.com or Maureen at maureen@isenberg-oharen.com

www.isenberg-oharen.com