

## **When Luck Runs Out: Leadership – Present and Past - and the California State Budget\***

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*“If you put yourself in a vulnerable situation, you have to expect your luck is going to run out. Now the luck seems to have run out.”<sup>1</sup>*

In earlier issues of *California Policy Options*, we have traced the precarious fiscal situation of California from the days in which the Davis administration was proclaiming a nonexistent budget “surplus” through summer 2007 when Governor Schwarzenegger signed a budget said (incorrectly) to have a zero deficit. As has been repeatedly pointed out by the Legislative Analyst and others, California has an underlying “structural” deficit – a deficit that is sometimes hidden by revenue surges but tends chronically to reappear.

The causes of the structural deficit in California are varied. Common villains cited are the two-thirds requirement to pass a budget, the two-thirds requirement to raise taxes (imposed by Prop 13 of 1978), term limits, and gerrymandered legislative districts. Also cited are ballot propositions that establish formulas for various forms of state spending, most notably Prop 98 of 1988 which earmarks roughly 40% of the general fund for K-14 education.

All of these factors have played a role, producing a short-term fiscal focus and an inability of the governor and legislature to confront problems absent a severe crisis. However, as we will show later in this chapter, even in the supposed heyday of governmental flexibility and compromise – and when the two-thirds tax requirements and ballot-box budgeting constraints such as Prop 98 were not present - the legislature and governor had difficulty confronting a looming crisis. In the late 1970s, when the state budget was in surplus and the looming crisis was political – specifically, the growing taxpayer revolt that focused on property taxes – the powers-that-were came up with too little too late.

This chapter starts with the recent crisis and then looks at the earlier one that led to the passage of Prop 13. The lesson for governors from both crises is clear. Given the difficult political institutions of California, gubernatorial objects must be limited and focused on top priorities. Lack of focus produces lack of results, or unintended results.

### **Aftershocks**

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\* This chapter covers budget and other developments through early October 2008. Subsequent events are not reflected.

*“It was a fiscal shock that set in motion a complex system of reactions and counter-reactions...”*

George F. Break  
UC-Berkeley Economist<sup>2</sup>

Prop 13 had far more profound effects than just the cutting and limiting of property taxes. As noted, it created the two-third rule for imposing new taxes. But perhaps more significant were the political aftershocks. Shortly, after Prop 13, voters endorsed Prop 4 – sold as the son of 13 - which placed a limit on state spending linked to a formula. When Prop 4 led to a refund to taxpayers of an overage in state revenues in the late 1980s, the educational establishment successfully pushed for the above-mentioned Prop 98 which – with a subsequent Prop 111 – largely gutted Prop 4.<sup>3</sup>

Other interests have since sought to earmark some of the state budget for their favored programs. In 2002, for example, then-citizen Arnold Schwarzenegger successfully pushed for an earmark for after-school activities (Prop 49) as part of a pre-campaign strategy for a possible run for governor.<sup>4</sup> Also in 2002, transportation advocates earmarked sales tax revenue collected on gasoline sales (as opposed to the traditional source: gas tax revenue) for roads and other transportation projects under Prop 42. Of course, not all efforts at earmarking have been successful. In February 2008, the state’s community colleges – dissatisfied with their share of the Prop 98 earmark – unsuccessfully supported Prop 92 which would have given greater budgetary advantage to the community colleges.<sup>5</sup>

Although California has had direct democracy – initiative, referendum, recall – since the Progressive movement took control of the state government in the form of Governor Hiram Johnson in 1911 – the level of direct ballot activism has varied. In the 30 years before Prop 13 was passed, the state averaged substantially fewer than 2 initiatives on the ballot per year. Post-13, the rate has been closer to 5.<sup>6</sup>

Moreover, direct democracy tends to tilt more to causes favored by the political right than the left. As noted in last year’s *California Policy Options*, although the right and left are roughly balanced in terms of what makes it on to the ballot, issues favored on the right (bans on affirmative action, tougher criminal sentencing, etc.) have a greater electoral success rate than those of the left, e.g., universal health insurance plans.<sup>7</sup> An industry has grown up consisting of organizations that develop ballot propositions (and raise dues and contributions in doing so), petition signature gathering firms, and, of course, campaign consultants and managers.

In this chapter, we first look at the California budget crisis of 2008. We then turn to the era of Prop 13’s passage for some surprising parallels. As it turns out, shortsightedness and groupthink are not the recent developments in Sacramento that many pundits believe them to be. More importantly, there are strong parallels between current-Governor Schwarzenegger and his budget problem of 2008 and then-Governor Jerry Brown and his Prop 13 problem 30 years before. Both men are (were) media magnets. Both like (liked)

to identify with Big Issues. But these characteristics competed with a need for a tight focus on priority legislative and policy outcomes.

### **Roots of the 2008 Crisis**

*“I will go as far as saying that anyone, any candidate (for President) that writes a \$14.5 billion check to the State of California, I would endorse. It’s as simple as that. Anyone, Democrat or Republican alike.”*

Governor Arnold Schwarzenegger<sup>8</sup>

The roots of the current state budget crisis are by now well known. Even in the mid-1990s, there were warnings that California faced a “structural” budget problem owing to the nature of its revenue base and the dynamics of state demographics.<sup>9</sup> This potential problem was, however, masked in the late 1990s by the dot-com boom, which generated substantial revenue for the state in the form of tax receipts from capital gains as the stock market rose. The legislature largely spent the new revenue so that when the stock market bubble burst – and the windfall disappeared – state spending had ratcheted up to a level that could not be sustained without the bubble-related tax receipts.

As a result, spending suddenly and substantially exceeded revenues and the reserves that had been accumulated were quickly dissipated. Although then-Governor Gray Davis had a reputation as a micro-manager, he had little luck in controlling the overall size of the budget when revenues rose.<sup>10</sup> And trimming spending back to the level of incoming revenue on the downside was even more of a challenge for Davis.

The budget crisis under Davis worsened and the incumbent governor was recalled by voters in October 2003, replaced by Arnold Schwarzenegger. The new governor took over a plan from Davis to borrow sufficient funds to refinance state debt and actually enlarged the amount that could be borrowed beyond what Davis had proposed. But he also fulfilled a campaign promise to cut the so-called “car tax” which exacerbated both the immediate and the structural problem.<sup>11</sup>

Governor Schwarzenegger used two ballot propositions, Props 57 and 58, to deal with legal issues raised by the stillborn Davis borrowing plan.<sup>12</sup> The two propositions were sold to voters as a way of “cutting up the credit card” – something that in fact did not happen. However, a new financial bubble – this one in home prices as shown on Chart 1 – stimulated the state economy. Although the prime revenue effect of the new bubble was felt in property taxes, a local rather than state revenue source, the general prosperity was reflected in sales and income taxes. At the same time, the stock market recovered sufficiently to produce capital gains-related revenue for the state along with capital-gains receipts linked to real estate.

Combined with a tax amnesty program in 2004-05 which brought in a transitory windfall, the state budget went into temporary surplus.<sup>13</sup> But by 2007, the structural deficit again began to show itself, as can be seen on Chart 2. After a protracted delay, the 2007-08 budget was signed in late August 2007 (almost two months late) with great ceremony.

Although the participants were willing to pretend the budget was in some sense balanced, it was – or should have been – apparent to all that a) it wasn't – the economic deterioration due to the mortgage crisis was already well underway - and b) the fiscal problem in the following year would be worse. Why, then, did California return to essentially the same budget crisis in 2008 that had sparked the recall of 2003? Why wasn't the problem fixed in the interim?

## **Unfocus**

Tom Brokaw to Governor Schwarzenegger on TV's *Meet the Press*: “When you ran for governor in 2003, you ran as a fiscal conservative who would change the system... If you were the CEO of a public company, the board would probably say, ‘It’s time to go.’”

Schwarzenegger to Brokaw: “Are you always this positive?”<sup>14</sup>

With the benefit of hindsight, a theme emerges as a partial answer to the question of why the fiscal crisis returned. The initial “fix” of the budget in the period immediately after Governor Schwarzenegger took office was carried out cooperatively with the legislature and governor and resulted in the above-mentioned Props 57 and 58 which the voters endorsed. But in order to obtain breathing room to deal with the immediate budget crisis, the new governor made various “compacts” with different interests. While one of these – the compact with UC and CSU – had no real effect (and was quickly scrapped when budget problems re-emerged), others were more significant.

In particular, in a deal with the California Teachers Association (CTA), the influential teachers union, the Governor obtained an immediate cut of \$2 billion education spending under Prop 98, the 1988 initiative described above that applies formulas to determine state funding of K-14. It appears that the Governor did not understand the full nature of his deal and its interaction with the Prop 98 formulas.<sup>15</sup> Exactly how that misunderstanding occurred has never been clear.

One possibility is that in the heat of the emergency, the governor's inexperienced new staff advisors did not comprehend the agreement's implications. However, the governor had the benefit of some experienced staffers who had worked for former Governor Pete Wilson, Davis' predecessor, along with veteran civil servants in the Department of Finance. More likely, it appears that the governor, accustomed to a Hollywood deal-making style of “let my people meet with your people” to hammer out important details, simply agreed to something unilaterally that could not be undone subsequently by more-informed advisors.

In any event, when Governor Schwarzenegger later reneged on the K-14/Prop 98 deal, CTA reacted with outrage. In the world of collective bargaining in which CTA operates – and in politics much more so than in Hollywood – trust in deal making is sacrosanct. Once it is violated, trust cannot be easily restored. The result of the controversy was that 2005 became the governor's politically disastrous “Year of Reform.”

The governor's focus drifted quickly from longer-range budget solutions to a hodge-podge of four initiatives, two of which were aimed at neutering CTA. Only one of the four was aimed at trying to fix the structural budget problem. (Another initiative dealt with redistricting.) The public was unable to see the connection between an unfocused campaign for the four initiatives and a budget problem which in any case supposedly had been fixed by throwing away the credit card.

Ultimately, the four initiatives were handily defeated after a particularly clumsy campaign on their behalf as we have described elsewhere.<sup>16</sup> And with his popularity with voters at a low level and the November 2006 gubernatorial election on the horizon, the budget was dropped as an issue. Instead, the Governor made 2006 into the year of infrastructure, albeit infrastructure to be financed by borrowing. While borrowing for capital projects is not uncommon, financing such projects by general fund obligations rather than the earmarked gas tax or by user fees of some type was not the norm in California.<sup>17</sup> Nonetheless, the notion of improved infrastructure at no immediate cost was popular and the voters endorsed over \$40 billion in infrastructure bonds – and re-elected the governor for a second term. But by now 2 years of no budget fix had elapsed.

Health care became the focus of 2007 after the November 2006 election. The governor endorsed a near-universal health insurance plan in January. But having dropped the idea into the legislature, the governor did not produce an actual bill containing the proposal. A long hiatus ensued before a plan that was essentially a press release became a serious bill. During that period, there was much national and international attention paid to the governor's various "green" initiatives on global warming which even led to a speech at the UN. Meanwhile, the health plan became increasingly enmeshed in state budget problems, which by then were becoming apparent. As we have described elsewhere, the plan emerged successfully – although in modified form – from the state assembly in late 2007, but was abruptly killed in the state senate in January 2008.<sup>18</sup>

In short, 2004 was a year in which the preoccupation was a short-term budget fix to resolve the fiscal legacy left by the Davis administration. The year 2005 was an unfocused year of (failed) reform in which the possibility of a long-term budgetary reform was lost. To address his drop in popularity, 2006 became the governor's year of (largely debt-financed) infrastructure with budget reform off the table. By 2007, the structural budgetary problems were returning but were held at bay by the effort on health insurance, a major plan that was left to compete with greenhouse gas proposals, hydrogen highways, and the like – and ultimately produced no health program. Officially, 2008 was supposed to focus on education reform, but by the time the year began, the budget loomed over everything else.

### **The Legislative Role**

*"... (If spending can go up... and most of us can't discern any difference, can we blame voters for being hesitant to put even more tax money in the hands of the state?"*

John G. Matsusaka

While the discussion so far has centered on the governor, the legislature is inevitably a partner or adversary in any major policy proposal. As many commentators have noted, the legislature has become particularly polarized. There was a time when, for example, Assembly speakers – notably including Willie Brown – could be elected by a mix of both Democratic and Republican legislators.<sup>20</sup> But such times are no more. Moreover, in many ways, Republican Governor Schwarzenegger has had more difficulty obtaining budgetary and other cooperation from his GOP colleagues in the legislature than from the Democrats. Shouldn't the legislature receive its share of the blame for the difficulty California has had in addressing its fiscal dilemma?

Although in the abstract the legislature can be blamed, in reality the legislature consists of 80 assembly members and 40 senate members, not a single individual with state-wide perspectives or responsibilities. Anyone elected governor has to deal with that reality - which means that at best a tight focus on one or two priority issues is needed. That tight focus was lacking in the budget crisis of 2003-04 and beyond. As we will show later, even in the less-polarized 1970s, there was a similar lack of focus by then-Governor Jerry Brown on the looming political crisis of Prop 13. Polarization is certainly part of the later story – but apparently not all of it. Focus – or lack thereof – is a bigger part.

As the lead-in quote to this section suggests, most voters do not see a close link between state spending and their personal welfare. It is important to note that a substantial portion of the state's general fund goes into transfers that provide services to those less likely to vote – or even not eligible to vote (if they are non-citizens) - than to higher-income persons – particularly in Republican districts. Depending on what function is counted, about one fifth to one fourth of state spending in 2007-08 went to “welfare” type income-support programs and related in-kind health and other services.<sup>21</sup> Moreover, although the funds come from the state, these transfers programs are largely administered by local jurisdictions, particularly counties. So to the average person, and certainly to the median voter who is not a recipient of transfers, a substantial part of the state budget seems to disappear into a black hole.

The legislature in its current gerrymandered arrangement reflects this tension. Representatives from jurisdictions where such transfers are important to their constituents push for their enlargement. Those from other jurisdictions push against demands for tax increases which they see as providing no special benefits for their constituents and supporters. As will be noted below, these divisions are not recent developments but reflect tensions that were certainly in evidence in the 1970s when Prop 13 passed. Indeed, the taxpayer revolt of the 1970s in California (and nationally) followed a period of enhanced welfare and anti-poverty programs, combined with racial tensions surrounding desegregation, busing, and affirmative action.

### **The Drama of 2008 Begins**

*“We never fixed the problem. It’s been Scotch Tape and glue and staples and just praying we will never have to face the reality that the state government is on a path that is not sustainable.”*

Christopher Thornberg  
Beacon Economics<sup>22</sup>

By late fall 2007, it was no longer possible even to pretend that the 2007-08 budget was in any sense balanced. The sub-prime mortgage crisis was well underway – and had been underway when that budget was signed in late August 2007. Rising gasoline prices were also cutting into consumer spending. A weakening economy meant weakening state tax revenues. The governor ordered state departments to come up with plans for 10% budget cuts. Plans for cuts are not the same, however, as actual implementation. Republicans pressed the governor to order a “fiscal emergency” pursuant to Prop 58. In principle, such a declaration would have prevented legislative consideration of anything other than the budget. But beyond that, a declaration would not in itself have produced a solution – and no emergency was imposed until January.

Former Governor Davis was charitable about his successor when asked about the renewed fiscal crisis. *“Nobody has repealed the business cycle,”* Davis said in late 2007.<sup>23</sup> While true, the same business cycle that was now cutting into revenue had provided revenue growth in the prior period during which the fiscal situation had improved but no basic reforms were enacted. Senate President Don Perata, however, was less charitable about one senate member – Republican Jeff Denham of Merced – who was expected to be a swing vote in passing the 2007-08 budget but refused to provide it. Perata initiated a recall against Denham for the June 2008 election – a campaign he aborted shortly before the actual election.<sup>24</sup> And just as the governor’s health insurance plan ultimately fell victim to budgetary concerns, so, too, did his effort to put a water bond on the February 2008 ballot.

The governor began to move back to his 2005 Year of Reform concerns. In early December 2007, he announced support for a new ballot initiative on redistricting, somewhat similar to one of his four initiatives in 2005.<sup>25</sup> Word began to be leaked about across-the-board cuts. Such proposals immediately invited two criticisms.

At the level of general public policy, across-the-board solutions suggested no selection of priorities. And at the practical level, not all expenditures, e.g., debt service, can be cut – so others must be cut still more than the average. The governor also suggested early prisoner releases to reduce prison spending – something legislative Republicans immediately rejected. There was also advance warning of a proposed fire fighting “fee” to be added to property insurance, in part a recognition of the costs of dealing with various forest fires in fall 2007.<sup>26</sup> And in an echo of 2005, and the controversy over the deal with CTA suspending Prop 98, hints arrived just before the budget proposal was formally introduced that another such suspension would be part of the plan.<sup>27</sup>

On the Democratic side, State Treasurer Bill Lockyer – a possible future gubernatorial candidate – called for long-term solutions and suggested immediate remedies such as

broadening the sales tax to cover “certain” services, ending general fund support for transportation (which had traditionally been financed by earmarked separate funds, and other remedies.<sup>28</sup> A California Field Poll released in late December 2007 showed that 43% of registered voters thought that the state’s budget problems could be resolved without new taxes while 48% thought that taxes would have to be raised. Thus, there was a high degree of voter ambiguity on the subject of taxes. Unlike the era of the taxpayer revolt of the late 1970s and early 1980s when about 4 in 10 voters thought California’s state and local taxes were too high, about 3 in 10 thought that way in late 2007.<sup>29</sup>

### **The January 2008 Proposal**

*“I will not raise taxes on the people of California because they pay enough taxes.”*

Governor Arnold Schwarzenegger<sup>30</sup>

*“It’s not real... (The governor) knows and we know that there is no way the Democrats... are going to suspend Prop. 98 and then cut \$4 billion from schools... Nor are they going to cut a similar amount from Health and Human Services... So if it’s not real, what is the real plan? He may not know at this point.”*

Dan Weintraub  
Sacramento Bee columnist<sup>31</sup>

The idea that the budget was not “real” could actually be applied to most January budget proposals by California governors. California’s constitution mandates that the governor submit a budget in early January. But the submission, nowadays accompanied by beautiful graphics and online videos, simply starts a slow-motion conversation. Since the new budget year does not begin until July 1, what normally occurs is some initial reaction, detailed analysis by the Legislative Analyst, less detailed summaries in the press, and then some hearings. Serious business really does not begin until the governor submits the “May revise,” a budget proposal in mid-May that reflects updated information on the state of the economy and incoming revenue, as well as a reflection of what appears to be acceptable or not from the earlier legislative reaction.

Much of what had been leaked earlier was included in the January 2008 budget proposal. There were various short-term cuts for the current 2007-08 year and some delays in payouts until the next year designed to avoid a cash shortage at the end of June 2008.<sup>32</sup> Some of the cuts proposed for 2008-09 would have led to revenue losses from matching federal funds which would have been reduced.

A total of over \$10 billion in cuts was proposed – the “across-the-board” total – although in fact some programs were exempted and others, therefore, cut more. Much of the cutting would have occurred in education, Medi-CAL (the state’s Medicaid program for welfare recipients and certain others), and cuts to various “welfare” programs including those for low-income seniors and disabled persons. There were proposals to close some state parks and release state prisoners early. Shortly after the budget proposal was made public, the Fitch rating service put California bonds – already tied with post-Hurricane

Katrina Louisiana for the lowest state ranking – on a “negative watch.” Since part of the January budget proposal involved the sale of \$3.3 billion in economic recovery bonds left over from the 2004 voter authorization, Fitch’s announcement was not helpful.<sup>33</sup>

Legislative Democrats seemed to assume that the governor’s budget was meant to signal that without new taxes the consequences of what Assembly Speaker Fabian Núñez termed a “cuts only budget” would be so drastic that (somehow) new tax revenue would be found. Subsequently, Núñez began to argue for a 50-50 split between cuts and added tax revenue.<sup>34</sup> And Republicans also took the proposal as simply an attention getter. Assembly Republican leader Mike Villines termed it “*only the first of many steps.*”<sup>35</sup>

The governor may also have had another motive in introducing a drastic cuts-only budget, however. He also – as hinted earlier – began to push for a ballot proposition, a variant of his failed initiative of 2005 – that would reserve a rainy day fund in good times to finance deficits in bad times. This idea, complete with impressive PowerPoint charts, seemed to become the centerpiece of the governor’s budget strategy for a time.

The charts were meant to show that had the proposed proposition been in effect for an extended period, the 2008 budget crisis would not exist. But there were two problems. First, since there had been no such proposition in effect, passing it in 2008 would do nothing to meet the looming budget crisis. Second, even if a rainy day fund were created in 2008, there would need to be economic sunshine to accumulate the fund, something forecasters were definitely not predicting for the near term.

In any event, there was no time to complete the petition process in time for the February 2008 presidential primary ballot. There was only a little time left to place it on the June 2008 state primary ballot. And even for the November 2008 presidential election (well into the 2008-09 fiscal year), the clock was running. Ultimately, despite the rainy day charts and the various presentations by the governor around the state, there was no petition for such an amendment, not even one aimed at November. Yet the governor continued to talk about the idea into the summer of 2008.<sup>36</sup> If the purpose of the January proposal was to create a political climate for popular enactment of a sustainable budget solution in 2008, it didn’t happen.

As will be noted below, a rainy day fund initiative will be on the ballot in 2009 as a result of the 2008-09 budget deal. The governor did kick off a drive for a redistricting initiative and necessary petition, an initiative which eventually landed on the November 2008 ballot as Proposition 11. Surprisingly, he did not propose a constitutional reform allowing midyear budget cuts in emergencies – a power that would have an immediate impact, unlike redistricting or a rainy day fund. Ultimately, he did get constrained midyear power to cut in the eventual budget deal for 2008-09, but not as a constitutional matter.

The budget crisis may have had some political effects on the February 2008 primary. On the ballot were four referendums to repeal certain state Indian gambling compacts. The repealing referendums were financed by a union trying to organize casino workers and

certain non-Indian gambling interests. However, the governor – who had signed the compacts – argued that the revenues the compacts would bring would help the budget situation and voters rejected repeal.<sup>37</sup> On the other hand, an initiative - pushed by Assembly Speaker Núñez that would have modified term limits and kept him and others in the legislature in office - failed despite gubernatorial support. The electorate may have felt that the initiative would reward those who were responsible for the renewed fiscal crisis.

Voters joined the governor in rejecting a proposition that would have earmarked an increased share of the general fund for community colleges on the grounds that a fiscal crisis was no time to allocate more spending by formula. And in the end, the legislature enacted what was billed as \$1 billion in mid-year spending cuts for the current 2007-08 fiscal year, although some of these were cosmetic. One item *not* enacted for 2007-08 was eliminating a minor tax benefit for out-of-state yacht buyers, dubbed by Democrats the “sloophole.” Because a two thirds vote was not available from legislative Republicans at the time, the sloophole remained in the law until finally removed in the 2008-09 budget deal.

### **The Budget Nun Intervenes**

*“Now may I remind you, you see though I’m a Republican, I’m a big believer when we have a financial crisis like this, we should all chip in. And this is why I totally agree with the Legislative Analyst’s Office when she says that we should look at tax loopholes. We should look at those seriously.”*

Governor Arnold Schwarzenegger<sup>38</sup>

*“I’m not for the recommendations she made, necessarily.”*

Governor Arnold Schwarzenegger<sup>39</sup>

In an unusual move in February 2008, the state’s Legislative Analyst, Elizabeth Hill, sometimes dubbed the “budget nun,” went beyond the usual comment and critique that normally followed a gubernatorial budget proposal. Generally, the Legislative Analyst’s Office puts out a commentary and interpretation of the proposed budget, with some general references to alternatives. Given the crisis – and perhaps also because she was soon to retire – Hill departed from that format and instead presented an alternative budget. At the most general level, the LAO alternative was a mixture of less severe cuts than the governor proposed and revenue enhancement by reducing tax loopholes of various types. However, as did the governor, Hill relied in addition on the sale of the remaining Economic Recovery Bonds.

By the time the LAO report was made public, economic conditions had worsened. Table 1, based on the LAO analysis, compares the governor’s January budget proposal with Hill’s proposal released in February – both relying on LAO’s economic projections. The figures on the table related to flows – revenues and expenditures – have been adjusted to exclude borrowing under the Economic Recovery Bonds. Although widely praised for

providing an alternative, there are problems with both budgets. The governor's budget was projected to produce a surplus in 2008-09, even under LAO assumptions. But, as noted, there were strong reasons at the time to doubt that the cuts proposed, with almost no revenue "enhancements," would be acceptable by the Democratic majority in the legislature.

The LAO's mix of revenue enhancements was expected to provide essentially a balanced budget in 2008-09 as opposed to the governor's ostensible surplus. However, the LAO argued that in later years, the surplus would revert to deficit and remain a deficit (albeit a declining one) through 2012-13. LAO provided a chart, not a table, showing the out-year deficits. In analyzing its own alternative, LAO asserted that – taking account of the reserve – the budget would essentially average a balance through 2012-13, although precariously so. But it provided no numbers or charts to back these assertions. Moreover, the issue of political feasibility remained, whether the proposal was the LAO's or the governor's.

If it were true that the Democrats would not accept cuts of the magnitude the governor proposed, it was also true that closing loopholes might not obtain the two-thirds vote needed from legislative Republicans. As can be seen from the quotes at the start of this section, the governor first seemed to support the LAO alternative, but then backed away from the specifics. The only specific loophole closing both he and the LAO supported was the above-mentioned "sloophole" for yachts.<sup>40</sup>

### **The May Revise**

*"All we have to do is lock ourselves in a room for three days and not go outside – and not be allowed to go to the bathroom. And then we'll be getting upset because it starts smelling in the room a little bit. And all of a sudden we will come to an agreement."*

Governor Arnold Schwarzenegger<sup>41</sup>

*"Raise taxes. That clear enough? Raise taxes."*

Senate President Don Perata when asked  
how the Democrats would balance the budget<sup>42</sup>

*"The governor does not believe that raising taxes is the solution for our chronic budget problems."*

Aaron McLearn  
Spokesperson for the governor<sup>43</sup>

Much of the period up to the May revise was spent reiterating positions on the budget or taking symbolic or minor actions. State hiring was frozen – but not quite. Certain higher management salaries were frozen. Bills in the state senate that involved more than \$50,000 in spending were suspended – with exceptions.

Externally, however, various interest groups were trying to head off budget cuts. Particularly notable in this regard was K-12 education, which aired various radio ads warning of the impact of a budget squeeze. Health providers aired a TV ad to the same effect. College students demonstrated against higher tuition. While the theme of these efforts was essentially “just say no,” the California Chamber of Commerce indicated that temporary tax increases might be acceptable if they were part of a grand package of reforms.<sup>44</sup>

Republicans in the legislature hinted that they would be seeking a variety of non-budget reforms of labor and environmental regulation in exchange for any two-thirds vote on the budget.<sup>45</sup> Incoming Assembly Speaker Karen Bass proposed establishing a commission to study the state’s tax base. And the idea of privatizing or “securitizing” (borrowing against) the state lottery – an idea that was originally rejected as a funding mechanism for the governor’s ill-fated 2007 universal health plan – was revived.<sup>46</sup> Efforts were also underway to sell the state’s EdFund, which guarantees student loans, although that idea was later shelved.

As in the case of the January budget, the May revise was proceeded with hints about what it would – and would not – contain. For example, word was put out that early release of state prisoners would not be in the new proposal, nor would closing state parks (but park entrance fees would be raised). Larger deficits were hinted. Some sort of ballot proposition would be suggested that would authorize borrowing against the lottery but trigger a sales tax increase if not approved. (It was never clear how a ballot proposition could trigger a tax increase by failing.) On the other hand, selling the EdFund – the prospects for which turned out not to be bright – was to be “postponed.” Prop 98’s guarantee for K-14 would be met. Some kind of user fee would be tacked on to property insurance for fire fighting. But unlike the earlier proposal, the fee would be risk-adjusted.

When actually released, the May revise and related proposals contained these elements and also assumed a more pessimistic revenue scenario as a result of a further softening of economic conditions. At about the time the May revise was released, a study by the California Research Bureau projected a disproportionate share of mortgage foreclosures would occur in the state because California had originated relatively more sub-prime loans than the U.S. average.<sup>47</sup> Given the deteriorating fiscal situation, it might have been expected that the governor and legislative leaders would have been undertaking early discussions to resolve the budget issue. But in a revealing interview, the governor said that he had to “negotiate with myself” to produce the May revise, since he had not been negotiating with legislative leaders since January.<sup>48</sup>

Even with the mid-year cuts, the May revise put the 2007-08 deficit (excluding the Economic Recovery Bonds borrowing) at over \$6 billion. A new feature in the May revise was a plan to securitize the lottery which was supposed to bring in over \$5 billion in 2008-09. Excluding that borrowing – although the governor’s office was at pains somehow to differentiate the plan from borrowing – there would be a deficit in 2008-09 of about \$4 billion, as shown on Table 2.

There was considerable skepticism in the LAO report on analyzing the May revise that the lottery plan would bring in as much as proposed. Indeed, shortly after the May revise was released, lottery officials lowered the projection of likely revenue for the year.<sup>49</sup> The LAO proposed a more modest lottery plan in place of the governor's suggestion and referred back to its alternate budget presented in February.

However, absent the lottery borrowing in either plan, LAO documents suggested that revenues would be about the same under the two – even though the LAO plan included loophole closings. The LAO plan included more Prop 98 K-14 funding than the governor's proposal. But exactly what total expenditures would be, or what the end-of-year reserve would be under the LAO plan was not indicated. LAO continued to assert that its plan would produce an average balance over the period ending in 2012-13. But, as in February, no detailed charts or data were provided.

The sad fact was that while LAO had alternative approaches, and probably a more realistic projection of what revenue stream might be obtained from the lottery, there was no plan - absent significant spending cuts or revenue additions - which could balance the budget in a meaningful sense. And there had been no serious negotiation involving the legislative leaders and the governor on finding a solution. Not surprisingly, California Field Poll approval ratings among voters of both the governor and legislature began to drop.<sup>50</sup> A state commission that sets salaries of legislators and state elected officials toyed with the idea of cutting their pay, but ended up freezing it, partly because of legal barriers to an across-the-board cut.<sup>51</sup>

### **The Summer Stalemate Begins**

*"We have open doors and everything is on the table. I don't want to go and say to anything, 'No,'"*

Governor Arnold Schwarzenegger<sup>52</sup>

*"There's not enough money to fund next year. We're proposing raising taxes... This is not a morality play. This is life."*

Senate President Don Perata<sup>53</sup>

*"We're having a difficult time getting our (Democratic) counterparts to really change their original premise on the budget which is, 'We need taxes.'"*

Mike Villines  
Republican Assembly leader<sup>54</sup>

There are two constitutional dates that matter for the state budget. Technically, the legislature is supposed to pass a budget by June 15. However, a more important date is July 1, the start of the fiscal year. If there is no budget, the state controller will not pay certain bills. Over the years, however, the bills that will not be paid have been narrowed by court decisions.

Absent a budget, the state does not pay what it owes to local governments including school districts. But such local entities are able to go for a time without the payments, knowing that their funds will eventually arrive. However, without a budget, the local entities cannot be sure what their total revenue from the state will be.

Vendors of services to the state are also not paid, but many can borrow against the state's IOUs. Unlike local government entities, which cannot be sure of what the eventual budget will provide, the vendors will eventually be paid whatever the state's contractual obligation to them may be. Most welfare payments and state employee payments are made, although higher managerial and professional workers may not be paid. The bottom line, however, is that the average citizen does not feel any immediate emergency. If he or she goes to the DMV to renew a driver's license, the service there continues.

So life after June 30, 2008 continued despite the absence of a budget. And there was little action in the legislature to resolve the Democratic-Republican divide. *"It's almost like there is no emergency there,"* complained the governor in mid-July.<sup>55</sup> And, in a sense, since life was continuing, there wasn't. The senate and assembly considered budget bills but these did not have support of the Republican minorities. A court-appointed monitor continued to threaten to impose an added revenue drain on the state to support prison health care. The governor and U.S. Senator Diane Feinstein together endorsed new borrowing for state water projects. Various wildfires continued to add to state costs for fire fighting.

A meeting of the legislative leaders finally occurred on July 17, but no agreement was reached and there was even a difference in views of the participants about what transpired. The governor reported the Democrats were planning to borrow from local governments, transportation, and other funds outside the general fund – which he termed *"not a good idea."*<sup>56</sup> Democrats then denied any such intent.<sup>57</sup>

Technically, it was true that the Democrats' plan was to raise taxes, not to borrow. But if Republicans did not go along with a tax increase, and if Democrats resisted spending cuts, the only safety valve would be borrowing from somewhere. And it seemed unlikely a lottery plan – whatever it might turn out to be - could completely fill the gap between revenues and spending.

### **Creating Urgency**

*"Today I am exercising my executive authority to avoid a full-blown crisis... I have a responsibility to make sure our state has enough money to pay its bills."*

Governor Arnold Schwarzenegger  
on signing an executive order to layoff certain workers  
and cut others' pay to the federal minimum wage<sup>58</sup>

*"Please walk a week in a state worker's shoes before you sign this executive order and imagine yourself and your family surviving on \$262 per week."*

Lieutenant Governor John Garamendi  
in a letter to the governor<sup>59</sup>

*“...(B)ecause it is based on faulty legal and factual premises, I will not comply with the Order.”*

State Controller John Chiang<sup>60</sup>

With the state projected to enter a cash crunch at some point, it appeared that both sides in the legislature were engaged in a chicken race to see who would concede before the emergency reached public consciousness. In response, the governor – citing a court decision from an earlier budget crisis – leaked word that he planned to order that many state workers be paid only the federal minimum wage until a budget was in place. (They would then be paid back the difference between their regular salaries and the minimum wage.) However, California controller John Chiang – whose office issues the targeted state paychecks – said he would not comply with such an order and that there would sufficient cash on hand to meet payrolls through September.<sup>61</sup>

Nonetheless, the governor issued the minimum wage order - which also provided for layoffs of selected temps, recalled retirees, and part-timers and elimination of most overtime - on July 31, 2008. The original estimate put the number of layoffs at around 20,000 but that figure was cut roughly in half after the governor spared various workers deemed to be in critical functions. A formal order was sent to Chiang demanding that the wage cut be implemented but Chiang indicated that the outmoded state computer system would require months of work to do the job – which in any case he had no intention of doing.

It was humorously noted that since the layoffs included recalled retirees – the only people who might remember how to work with the old computer programs couldn’t be employed to undertake the task.<sup>62</sup> In any event, despite the litigation, no court challenge could be heard before September which guaranteed that regular pay rates would prevail through August. And there never was a minimum wage pay cut since a final budget deal was reached in mid-September.

Because of the ability to borrow from state funds outside the general fund, even negative reserves in the general fund do not mean that the state is literally out of cash. It is difficult to determine from available figures exactly when a cash crisis could have been expected at the point of the Schwarzenegger challenge. The controller issues monthly statements on the state’s cash position. Included is an estimate of “available borrowable resources.” From these are subtracted any internal borrowing and short-term borrowing to produce an estimate of “unused borrowable resources.”

In the budget crisis of the early 2000s, after accounting for borrowing via Revenue Anticipation Warrants (RAWs), unused borrowable resources were down to around \$10 billion at the end of June 2003. At the end of June 2008, the controller’s estimate was a comparable \$12.8 billion. Estimates of the drop in resources from the summer of the

year before (when there was also no budget), suggested that if \$10 billion was in fact something of a danger range, the state was likely to fall below that level during the summer. However, there have been summers when the figure fell well below \$10 billion. And at least the controller's end-of-July estimates held the unused borrowable resources total at around \$10 billion and \$9.6 billion at the end of August. It was thus unclear from publicly-available data when a cash crunch might arise.<sup>63</sup>

However, the state often runs out of cash within a fiscal year because tax inflows and spending outflows don't match and so borrows using short-term Revenue Anticipation Notes (RANs). It did so, for example, during 2007-08, borrowing \$7 billion in the fall. The governor's January 2008 budget proposal assumed that \$9 billion in RANs would be borrowed in September with a budget in place. So the state was expected to run out of cash (and borrow) in the fall, with or without a budget. The difference is that without a budget, the state must issue RAWs (Revenue Anticipation Warrants) rather than RANs and likely pay a higher interest rate reflecting Wall Street's appraisal of a disorderly fiscal house. Put another way, the minimum wage/layoff action – although couched in terms of cash flow – was in fact a way of pressuring the legislature.

### **What Did He Say?**

*“The fact that the governor now has said we cannot balance this budget, we cannot get through the next three or four years, without at least a temporary tax I think is a step in the right direction... I'm glad he stepped up to this, but let's be clear, he doesn't have any support in his own party yet for this... (Legislative Republicans) have got to come up with proposals, and they have not done it.”*

Senate President Don Perata<sup>64</sup>

*“Senator Perata's statement regarding the lack of Republican solutions is patently incorrect. We have been bringing ideas to the table since first learning of the fiscal crisis.”*

Senate minority leader Dave Cogdill<sup>65</sup>

*“We are not discussing what is being negotiated in the Big 5.”*

Unidentified spokesperson for the governor<sup>66</sup>

*“This year we have heard Republicans and Democrats in the Legislature talk about our budget system, but the time for talk is over – it is time for everyone to compromise and get this done.”*

Governor Arnold Schwarzenegger  
after proposing his “August revise” budget<sup>67</sup>

In early August, word was leaked that Governor Schwarzenegger was willing to consider a 1-cent increase in the state sales tax (from 6.25 cents to 7.25 cents) to last three or four years. The quid pro quo would be a legislative agreement for reforms involving earmarking funds for (another) rainy day fund and a spending cap. Presumably, such an

exchange would involve putting these provisions on the ballot as constitutional amendments. Democrats welcomed the idea of a tax increase, but not of the sales tax. They preferred raising the upper bracket of the personal income tax and were leery of constitutional spending caps. Republicans criticized the tax idea. *“I cannot envision any Republican legislature supporting such a proposal,”* said Senate minority leader Dave Cogdill.<sup>68</sup>

However, in the third week of August, the governor took the unusual step of unveiling an August revise proposal. A key element was indeed the temporary 1-cent sales tax increase (estimated to pull in an additional \$4 billion in 2008-09) and continuing through the summer of 2011. To attract Republican votes, the proposed increase would be followed by a 1.25 cent decrease in September 2011, thus producing an eventual net decrease in the sales tax of a quarter cent. Various loans would be made from funds outside the general fund and other changes in tax treatment would be adopted.

The supporting documentation of the August revise was less complete than the May revise or the January budget proposals. But as Table 2 shows, it probably would have raised tax revenues on the order of \$6 billion, leaving an operating deficit of something like \$2 billion. That gap was to be made up through the above-mentioned borrowing of other state funds and by running down the reserve (which essentially existed only because of the earlier flotation of the unused Economic Recovery Bonds). Of course, the revenue figures depended in prior projections of state economic performance, which was anything but healthy.

### **Deal or No Deal**

*“It’s time to get this budget done. It’s been way too long.”*

Senate Republican lead Dave Cogdill<sup>69</sup>

*“It’s really no more than another get-out-of-town budget that will, more than likely, begin falling apart as soon as it’s signed.”*

Sacramento Bee columnist Dan Walters<sup>70</sup>

*“I’m not proud of this budget – it just kicks the can down the road.”*

Senate President Don Perata<sup>71</sup>

*“I don’t see much of a signing ceremony because there’s nothing to celebrate.”*

Governor Arnold Schwarzenegger<sup>72</sup>

While it might have seemed that the governor’s “August revise” proposal would have created a new dynamic and created a basis for a compromise budget, the stalemate continued. The California Taxpayers Association (CalTax) – a business-oriented group – supported the plan, albeit reluctantly. But Republicans would not accept a tax increase,

even temporary and even followed by an eventual tax cut. And CalTax was denounced by the Howard Jarvis Taxpayers Association as “the mouthpiece for corporate California” whose original sin was opposition to Prop 13 in 1978.<sup>73</sup> In any event, the resulting plan that ultimately came up for a vote – and did not receive the needed two thirds – was a version of the governor’s plan without the deferred sales tax cut. Governor Schwarzenegger confessed to a German magazine that he had little influence with Republican legislators. *“I have almost no contact with them – none. Because they’re just so out there,”* he said.<sup>74</sup>

Since the governor could not deliver any Republican votes, the stalemate continued until the Democrats essentially gave up and produced a bill Republicans indicated they could endorse. As initially framed, a key element was raising income tax withholding, but not tax rates – basically an interest free short-term loan to the state by taxpayers. The governor then called a dramatic press conference saying he would veto the compromise deal because its rainy day fund features were not sufficiently stringent. He indicated that he expected that since the budget was passed with a two-thirds vote – the same proportion needed to override a veto – his veto would also be overridden. But it turned out to be more complicated.

An increase in income tax withholding seemed likely to be very unpopular as it became evident that it was an interest-free loan. The smokescreen involved might well have proved more unpopular than an overt tax increase. And it was not clear that Republicans who supported the deal initially would want to override a gubernatorial veto. Moreover, the withholding part of the budget appeared in a separate bill which required only a majority vote – since it was technically not a tax increase. It appeared that contrary to the governor’s expressed expectation, an override of his threatened veto was not going to be easy. As a result, the legislature modified the deal to include tighter rainy day fund provisions and passed it on September 19, 2008.

The budget was signed on September 23, 2008 after the governor vetoed about half a billion dollars in expenditures. Once a budget was officially in place, various state bills that had gone unprocessed by the state controller could be paid. And state employees – who never actually had their paychecks cut to the minimum wage – could nonetheless participate in a charity event with the opportunity to drop Finance Director Mike Genest into a dunk tank.<sup>75</sup>

As Table 2 shows, the final figures for revenue and expenditure looked more or less unchanged from the August revise estimates (and contained a deficit). But since there was no hike in the sales tax in the final deal, as there had been in August, additional revenue sources had to be developed. Some of the added revenue came from technical changes in corporate taxes including “accelerated” payments (which subtract revenue from the future) and accrual changes (which accelerate bookkeeping – but not cash).

However, the economic outlook for the state on which the revenue numbers were based was becoming more uncertain as the country (and global economy) faced a major financial crisis just as the budget was being signed. There were concerns, as credit

markets froze, over whether the state might run out of cash and be unable to float Revenue Anticipation Notes – which had been planned for the fall - to cover its expenses. Based on the old economic estimates, the General Fund was to end with a reserve of \$1.7 billion at the end of June 2009 – which would exist only because of the floating of the remaining Economic Recovery Bonds during 2007-08. Given the economic uncertainty surrounding the financial crisis, there were considerable downside risks built into the new budget.

### **Aftermath and Afterthoughts**

*“Governor Arnold Schwarzenegger today signed the 2008-09 state budget, concluding a very difficult budget year and delivering a real win for California with a proposal to achieve meaningful budget reform”*

Office of the Governor Press Release<sup>76</sup>

*“...(B)y common consent, everyone pretends that outdated numbers are still valid – in effect punting the problem into the next year. Or as they say in Silicon Valley, garbage in, garbage out.”*

Columnist Dan Walters  
*Sacramento Bee*<sup>77</sup>

In the aftermath of the final budget deal, there were frustrated calls for revising key institutional features of California’s political decision making. These ranged from calling a constitutional convention, a complex process, to specific changes such as relaxing the two thirds vote requirement (something voters rejected in 2004) or term limits (something the voters rejected in 2008). And there were proposals to penalize legislators if budgets were not passed on time in the future.<sup>78</sup>

The California Correctional Peace Officers Association – a union representing state prison guards – began the process of recalling the governor, apparently to pressure the governor in collective negotiations and as part of the union’s own internecine politics. However, elements of the California Republican Party toyed with the idea of supporting the recall due to the governor’s proposal of a tax increase in his August revise. While “barely” opposing a recall, the conservative *Orange County Register* denounced Schwarzenegger as “Gov. Weather Vane” for – in its view – “abandoning principles.”<sup>79</sup>

As for the governor’s victory in winning modifications of the budget, there are surely doubts that can be raised. He had already put redistricting on the November 2008 (Proposition 11) as a long-term reform. Yet in terms of priorities on the budget, it was an odd choice – given the money needed to obtain signatures and run a campaign for an initiative. Redistricting cannot take place before the 2010 Census results become available and any impact it might have would affect budgets after the governor left office. So redistricting surely had no foreseeable effect on the immediate 2008 budget crisis when the decision was made to push it.

Even as a long-term reform – the interaction of redistricting and the two-thirds vote requirement could conceivably make budget passage more difficult. The theory of redistricting is that less gerrymandered districts would produce more centrist candidates who would be more willing to compromise on budgets once elected. But it could also increase representation of a larger minority, essentially more Republicans, who would make a two-thirds vote less attainable.<sup>80</sup> California’s Democratic Party, and allied groups such as organized labor, viewed the governor’s redistricting plan as a Republican power grab.

The governor did win a ballot measure for a tightened “rainy day fund” (reserve in the General Fund) as a consequence of his veto threat. His target was to have an eventual reserve of 12.5% that could not be readily raided before it was accumulated or needed. But there are a number of problems with the focus on the rainy day idea. First, rainy day funds have to be accumulated when the budgetary sun is shining, which it assuredly was not in 2008 and was not likely to be in the near term. So the rainy day fund did not address the immediate budget crisis of 2008. Second, it is very difficult – whatever clever language is used – to prevent a *de facto* raid on a rainy day fund (or on other funds outside the General Fund) if the legislature is determined to do it. Third, a constitutionally required rainy day fund augmentation requires a vote of the people. The legislature agreed to put such a measure on the ballot some time in 2009, perhaps March or June, but someone would have to mount (and finance) a campaign to win voter approval.

Fourth, recent history regarding the rainy day fund concept is not particularly promising. Although there was not constitutional requirement to do so, the dot-com and stock market bubble of the late 1990s gave Governor Gray Davis a General Fund reserve of about 12% just as his budget outlook began to sour. Essentially, the legislature blew through the reserve quickly and plunged into crisis. The lesson seems to be that an ample rainy day fund of the magnitude Governor Schwarzenegger wanted (and which Gray Davis had), gives the state about a year to come up with more fundamental solutions than just spending the reserve. If it doesn’t find such solutions, the crisis is simply delayed a year.

The governor *did* obtain one concession relevant to the immediate 2008 crisis. One of the trailer bills that accompanied the budget deal provided him with authority to make midyear budget cuts in the 2008-09 budget – although hemmed in by various constraints on what could be cut and by how much. In principle, the authority extended beyond the 2008-09 budget year. But since this component of the deal was an ordinary bill – not a constitutional provision – the authority could be stripped away in future budgets. Thus, while the most pressing priority for dealing with the current budget crisis – as well as future ones – might have involved authority to make midyear cuts, the governor instead focused on redistricting in 2008, a reform with no immediate impact and uncertain long-run consequences.

We will have to await the verdict of history on Governor Schwarzenegger’s approach to the state budget. However, history does provide some lessons on what happens when a governor has a diffused agenda and remains aloof from a developing problem. These

lessons come in the form of Governor Jerry Brown and the passage of Prop 13 in 1978. We turn now to that episode for those lessons, noting also that Prop 13 led to fundamental changes in state and local fiscal affairs in California.

### **Prop 13's Genesis**

*“Nothing in life is so rigid that there aren't developments. That's true in politics. That's true in theology. That's true in personal relations. And for those small minds that slavishly adhere to foolish consistency, their irrelevance is their best reward.”*

Governor Jerry Brown  
explaining why he had turned from  
opponent to supporter of Prop 13<sup>81</sup>

In essence, Proposition 13 – on the ballot in June 1978 - was a simple initiative aimed at a simple problem. Rising home prices were causing local property tax bills to escalate. Prop 13 rolled back the assessment value to 1975-76 for existing properties or to 1% of the subsequent sales price, whichever was higher. It limited the tax rate on the assessment to 1%. (It had been the equivalent of anywhere from 1.5% to over 3% of assessed value, depending on jurisdiction, averaging 2.7%). Prop 13 allowed only a 2% increase for inflation in the assessment each year until the property was sold.<sup>82</sup> At that point, the assessment would be at the new market price - whatever it was. Prop 13 also required a two-thirds vote for new state taxes or tax increases and a two-thirds vote of the electorate for local taxes.

Local property tax revenue was cut by an estimated \$7 billion under Prop 13 (from a total of \$12.4 billion). The state initially provided a backfill to the localities of \$4.2 billion out of the \$7 billion (with over half the bailout going to school districts).<sup>83</sup> It was able to provide the large bailout because as shown on Table 3, the state had been running surpluses and had accumulated a significant reserve. The state would have continued with a larger surplus in 1978-79 after Prop 13 was enacted. However, given the ballot initiative and the resulting bailout, the result – as the table indicates - was a state deficit of about \$1 billion.<sup>84</sup> An initial legal challenge to Prop 13 on various technical issues failed when the state Supreme Court rejected the claims.

Current polling suggests the continuing popularity of Prop 13.<sup>85</sup> Not surprisingly, the further back in time homeowners purchased their house, the more familiar they are with Prop 13's details. But even recent homeowners indicate they would vote for Prop 13 if it were on the ballot now. Proposals to modify Prop 13 thus meet with suspicion and disapproval. The only change that might be acceptable – taxing commercial property at a different rate than residential – could conceivably win approval if it were pitched as taxing residential property at a lower rate than commercial as opposed to taxing commercial rate at a higher rate than residential.

Even that “split roll” approach – a proposal which pre-dates Prop 13 - would be problematic as a ballot measure since opponents would surely frame it as tinkering with

Prop 13 more generally. Certainly, Governor Schwarzenegger would not propose or endorse any such tinkering. In a notable incident during the 2003 recall of Gray Davis, candidate Schwarzenegger's advisor, Omaha-based financier Warren Buffett, made an off-hand criticism of Prop 13 to the *Wall Street Journal* and created a political brouhaha. Schwarzenegger managed to skirt the damage by quipping "*I told Warren if he mentions Prop. 13 one more time, he has to do 500 sit-ups.*"<sup>86</sup>

### **The Impact**

*"I'm sure Arnold was mortified when he read (Buffett's comments)."*

Frank Schubert  
Republican consultant

*"Warren's right. It's an unequal system. But all the polling indicators I've seen show the appetite for changing the system is very low."*

Bruce Cain  
Director, Institute of Governmental Studies at UC Berkeley<sup>87</sup>

*"...(If the current budget problem is a lack of revenue – which it isn't, of course, but let's pretend – then we still can't blame Prop 13 for today's budget imbalance. Why? Because about 5 years ago, the inflation adjusted, per capita property tax collections in California began to surpass Pre-Prop 13 levels."*

John Coupal  
President, Howard Jarvis Taxpayers Association  
in January 2008<sup>88</sup>

As the quotes above suggest, the effects of Prop 13 are still debated. And, as will be noted below, the statistical component of the third quote does not square with the report on which it appears to be based. At the time it was passed, there was much debate about the impact it would have. But Prop 13 had one predicted effect. Since local governments, especially schools, were heavily dependent on property taxes, cutting the tax shifted the burden to the state, which – for a time – was able to prevent sharp cutbacks. However, when the state's economy (and tax revenue) turned down in the early 1980s, the state retreated temporarily from its role of subsidizing the local authorities.

Since Prop 13 allowed user fees to go up – but restricted general tax increases – localities (mainly cities) which could charge such fees became more dependent on them. Through zoning decisions leverage, they also could push land developers to undertake infrastructure responsibilities previously assigned to government.<sup>89</sup> But school districts which provide a free service and are not involved in zoning policy had little opportunity to charge such fees or shift such costs. So schools became especially tied to state finance and eventually pushed for a ballot-box guarantee of funding.

A less predictable effect was to make local authorities more dependent on their portion of the sales tax and the so-called "fiscalization of land use." That is, local zoning decisions

tended to tilt toward developments such as retail and auto malls that generate sales tax and away from other uses such as manufacturing or residential. Finally, there was the political effect mentioned earlier of stimulating increased interest in using direct democracy to enact laws and constitutional amendments on budgetary matters and other issues. As noted, the pace of placing initiatives on the ballot increased after the success of Prop 13.

As the third lead-in quote to this section illustrates, it has sometimes been asserted incorrectly that property tax revenues, adjusted for inflation and population growth, eventually rose back to where they were prior to Prop 13. Note that since property tax assessments under Prop 13 have become a rolling weighted average of current sales (and therefore market prices) and earlier market prices (plus the 2%/annum adjustment), sufficient real estate inflation could bring about such a situation eventually. But the rate of property inflation – although rapid in some periods – was not fast enough overall to produce a catch-up over the entire period studied.

The combination of inflation and population growth since the passage of Prop 13 has been roughly 6% per annum. Even with the run-up in home prices in the early 2000s - before the bubble burst - the inflation only affected the assessed values of those properties that were sold. And, of course, the home price inflation then turned into dramatic deflation. A study by the California Taxpayers Association suggests that property tax revenues rose in nominal terms a bit over 8% per annum since Prop 13 came into effect. The roughly 2% per annum rise over population growth plus inflation is gradually raising the property tax take adjusted for those two factors. But even over the three decades since Prop 13 was passed, that relative growth would be unlikely to have made up for the inflation+population drop in revenue caused by Prop 13.<sup>90</sup>

In any event, the study that appears to be the basis of the quote - which the Howard Jarvis Taxpayers Association (HJTA) had commissioned - did not in fact say that adjusted property tax revenues had caught up.<sup>91</sup> It said instead that *total* state revenue adjusted for inflation and population growth was above pre-13 levels. In fact, that event had occurred long before 2002-03 (the final date of the study). On the other hand, county adjusted total revenue – although higher at the end of the period than the beginning – had followed a U-shaped path. City adjusted total revenue also had a U-shaped path, but recovered earlier than county revenue. School district adjusted revenue was essentially flat in the 1980s but then rose above pre-13 levels after the enactment of Prop 98.

The property tax is a local tax, not a state tax, so – as noted - the impact on the state was not as a tax recipient but as a subsidizer of the local authorities. Not surprisingly, the HJTA study showed that local property taxes, adjusted for inflation and population growth, had declined: a 60% drop for counties and 50% for cities. The report did not give a comparable property tax figure for school districts but the number had to be in the ballpark of the county and city figures. (School districts are located within counties and their boundaries often encompass whole cities.)

Also not surprisingly, transfers to dependent localities from the state – adjusted for inflation and population growth – were up substantially: a 78% increase for counties. City data showed a big shift to fee income. School district data were again limited but – as noted - the ability of the districts to charge user fees is small. Federal subsidies were up but only a fraction of the increase in total school revenue. So it appears that the state became the schools’ main patron.

What cannot be known is the degree to which Prop 13 altered the *total* of state and local revenue and spending in California. Since, as the HJTA study suggests, state and local budgets, adjusted for inflation and population growth, rose, it is clear that Prop 13 – even with its two-thirds vote requirement on taxes – was not an absolute cap. Part of the reason is that there was a two-thirds requirement to pass a state budget in effect long before Prop 13 came along – so the Prop 13 requirement was an incremental constraint, not something totally new. Moreover, Prop 13 does not stop the state from spending revenue windfalls that arise within its existing tax rates.

### **The Story of Prop 13**

*“I think Proposition 13 will be defeated and I will and I will do anything I can to see that happens.”*

Governor Jerry Brown  
before Prop 13 passed<sup>92</sup>

*“Limiting the public sector is the message of Proposition 13.”*

Governor Jerry Brown  
after Prop 13 passed<sup>93</sup>

Various authors have traced the history of Prop 13 from both a journalistic and academic perspective.<sup>94</sup> And not all agree with Governor Brown’s quote above that the public was anxious to limit the size of the public sector.<sup>95</sup> Another interpretation is that people wanted services to continue but also want to have both predictability in the tax burden and less of a tax burden. However, the meaning of “services” can vary across individuals. Police and fire enjoy popularity as desired services. “Welfare” spending (transfers to lower-income persons) is less favored.

The basic story of Prop 13 is well known. There were anti-property tax movements which ebbed and flowed as far back as the 1950s. But these were often led by disparate gadflies, sometimes advocating tactics such as “tax strikes” (which could have endangered the properties of any homeowners who took part or at least subjected them to late tax penalties). When the calls for property tax relief would become particularly vociferous, the state would enact various types of tax rebates and the fever would decline.

Moreover, property tax relief was not a simple left-right issue. Politicians on both sides of the spectrum would take up the cause. For example, when she first ran for a seat on the San Francisco Board of Supervisors in 1969, Diane Feinstein made property taxes an issue in the campaign. Voters, she said, should take their tax bills to the polls (whatever

exactly that meant).<sup>96</sup> Only after Prop 13 passed, was the taxpayer revolt cast as an issue of the right.

County tax assessors had a good deal of discretion in making assessments. Since they were elected, not appointed, assessors were likely to be sensitive to homeowner complaints (where the votes were). In some ways, they could act as a circuit breaker, cushioning the impact of jumps in real estate values (by undervaluing property). The result was a tilt of assessments away from private residences and toward commercial property. However, with discretion came opportunities for corruption. Thus, public policy shifted toward ensuring honest assessments. One of the inadvertent consequences of this reform was a shift in the property tax burden away from business and toward homeowners as assessments came closer to actual market values.

When home prices escalated and assessments rose in the 1960s and 1970s, anger tended to be focused on the county assessors who delivered the bad news to property owners. In Los Angeles County, Philip Watson was elected assessor on a platform of doing away with on-site investigators (“snoops”) who would visit properties to evaluate them. Instead, he relied on developing computerized methods based on comparable sales and known house characteristics such as square feet. Even so, Watson had a political problem as the target for homeowner anger as assessments rose. At one point, he was charged with corruption in assessing a particular commercial property (and then acquitted in a high-profile trial).

Watson sponsored ballot initiatives – essentially prototypes of Prop 13 - in the 1960s and 1970s, which would have cut property taxes. He thus deflected voter anger from himself and refocused it on the system instead. But he was scapegoated by some members of the LA County Board of Supervisors for his anti-tax activism. Ultimately, Watson was forced to resign in 1977, just as the pressures that led to Prop 13 began to rise.<sup>97</sup>

In essence, a perfect storm developed, in part because in California tax assessors had a reputation for what one study termed a “high level of professionalism and expertise” in calculating market values.<sup>98</sup> Just before Prop 13 was enacted, the ratio of property taxes to personal income was about 40% above the national average; only Massachusetts (which passed its own Prop 13-type initiative two years after Prop 13) had a higher ratio.<sup>99</sup> As Chart 1 indicates, home prices were rapidly escalating.

Typically, homes were re-assessed on a three-year cycle so assessments would jump with three-years’ worth of house price inflation in one dollop. Disparate anti-property tax groups began to unite. Notably, two rivals in the movement – Howard Jarvis and Paul Gann – made sufficient peace with one another to co-sponsor Prop 13. And other influences that pushed property tax relief to the fore are often cited.

An earlier court decision in the *Serrano* case required the state to approximately equalize per pupil spending across school districts.<sup>100</sup> In effect, *Serrano* disconnected local property taxes from revenue going to local schools. Homeowners who might once have seen property taxes as a kind of user fee for schools, no longer had reason to do so.

While the influence of *Serrano* on the anti-tax movement is still debated, the rapid escalation of property tax assessments was also not linked to a visible upgrading of non-school local services. A homeowner's property tax might double. But streets were not twice as clean, potholes were not filled twice as fast, and police and fire departments did not respond in half the time to emergency calls.

Certainly, the school issue clearly had some influence. Particularly in LA's San Fernando Valley, the combination of *Serrano* and of court-ordered busing to end *de facto* segregation did not create a sense that schools were improving. In various ways, the anti-busing forces and the anti-property tax forces tended to fuse.<sup>101</sup> Both saw their route to salvation as the use of the ballot initiative. (An anti-busing initiative - Prop 1 of 1979 - and related litigation, ultimately brought the LA busing program to a halt.) Similarly, anti-growth movements were also developing as issues of congestion and density pitted the older development-political alliance against middle-class homeowners.<sup>102</sup> (Anti-growth forces eventually enacted Proposition U, placed on the LA City ballot in 1986.)

When Ronald Reagan was governor, he opposed the Watson approach because he feared – as a conservative – that shifting the financing of schools to the state and away from the local property tax would weaken local control. And the governor and legislature – as noted earlier – would periodically provide tax relief to homeowners in response to the initiatives and similar pressures. But as Prop 13 loomed as a possible ballot initiative and then became an actual ballot proposition, Governor Jerry Brown and the legislature seemed to dawdle. And Reagan – no longer governor but by then an active candidate for president – reportedly signed the Prop 13 petition. Prop 13 had become the centerpiece of an umbrella movement and an alliance of various forces in the taxpayer revolt.

Prop 13 was opposed by most – not all - local officials, public sector unions, and many in the legislature – not surprisingly. But it was also opposed by big businesses even though, as worded, the proposition would give more dollars back to business property than to homeowners if enacted. Chamber of Commerce types feared that ultimately cutting a local source of revenue would shift the tax burden more toward private business. On the other hand, many small businesses – Jarvis represented apartment-house owners, often mom and pop operators – found the proposition appealing.<sup>103</sup>

While some observers have found the opposition to Prop 13 of big business paradoxical, the fact is that as with any major policy change, there are often consequences which interest groups don't understand or fail to forecast accurately. For example, real estate agents were enthusiastic supporters of Prop 13, distributing petitions and the like. But Prop 13 contained incentives for people to stay in their existing houses, not trade houses. And other things equal, less churning of houses is a Bad Thing if you are a realtor dependent on sales commissions.

Similarly, it is doubtful that Jarvis and his apartment house owner/backers could have predicted that Prop 13 would spawn rent controls. Renters had been promised that landlords would somehow share the windfall of lower taxes in the form of lower rents.

Indeed, Prop 13 co-author Howard Jarvis had hinted at an agreement by apartment landlords to lower rents if the initiative passed.<sup>104</sup> But Prop 13 had no immediate effect on either apartment demand or apartment supply – so such rent reductions did not occur and angry tenants clamored for controls in response. Special interests do not always know for sure what their interests are.

In the end, despite the late arrival of an alternate ballot proposition placed there by the legislature and a rather ineffective campaign for the alternative and against Prop 13, Prop 13 won by a 2-to-1 margin. The alternative, Proposition 8, lost with 47% of the vote. As a result, Howard Jarvis – who was far more colorful and visible than the soft-spoken Paul Gann – became a folk hero (and even landed a comic part in the movie *Airplane*). His book – a kind of memoir and manifesto – was widely read.<sup>105</sup>

Jerry Brown – who opposed Prop 13 before it was passed - announced afterwards that he would make Prop 13 work as the will of the people. And he had the means, at least temporarily, to do so by bailing out the localities, given what state treasurer Jess Unruh called the “obscene” state reserve that had been accumulated.<sup>106</sup> Jarvis seemed to endorse both Brown and his Republican opponent, Attorney General Evelle Younger, in the fall gubernatorial election. (Younger had in fact given mild support to Prop 13 when it was on the June ballot.) Brown went on in November 1978 to win re-election to a second term as governor as a convert to the virtues of Prop 13. And, of course, Ronald Reagan won his first term as President in 1980, in part due to the spread of the taxpayer revolt from California to other parts of the country.

The Prop 13 episode has significant parallels to the budget crisis of 2008. In both cases, there were plenty of advance warnings of a coming crisis – Prop 13 in 1978 as a political crisis; the 2008 budget impasse as a fiscal crisis. Arguably, the legislature and governor had more potential ability to deal with the 1978 political crisis than the 2008 fiscal imbroglio. In the former case, the state was running a large budget surplus and had accumulated a reserve that could have been used for aggressive and pre-emptive property tax relief.<sup>107</sup>

Indeed, it was that surplus and reserve that allowed the state (partly) to bail out local governments when Prop 13 came into effect – at least until the recessionary climate of the early 1980s interacted with the bailout to cause a fiscal crisis for the state at the end of Governor Brown’s second term. If such a transfer of resources was possible *after* Prop 13 was adopted, it surely was possible *before*. What prevented action being taken preemptively at the state level? The actions (or lack thereof) of the governors in both the Prop 13 political crisis and the 2008 budget crisis had much to do with these two events.

## Two Governors

*“Maybe by avoiding doing things you accomplish quite a lot.”*

Governor Jerry Brown<sup>108</sup>

*“Flip-flopping is getting a bad rap, because I think it is great.”*

Governor Arnold Schwarzenegger<sup>109</sup>

Initially, other than the fact that both have been governor of California, Jerry Brown and Arnold Schwarzenegger could not appear to be more different. Brown was raised immersed in state politics in the household of Pat Brown who was state attorney general and then governor (1959-67). Son Jerry first intended to be a Jesuit priest, but then changed his mind and went into politics, initially as an elected member of the Los Angeles Community College Board, then as California secretary of state, and eventually as governor. Schwarzenegger, in contrast, was an immigrant weight lifter who became a celebrity movie star/action hero. When Schwarzenegger ran in the 2003 recall, he promised voters “action, action, action.” In contrast, Jerry Brown focused on lowered expectations and more meditation.

But there are some parallels, both in style and interest. Both governors enjoyed being recipients of publicity and media attention. Both characterized themselves as not being ordinary politicians. Both liked to cross traditional ideological lines. Both liked to identify with Big Issues, notably environmental. Both seemed aloof from nitty-gritty details of policy. Both liked to talk with a wide variety of people. Both were capable of taking actions that surprised their own staffs and both enjoyed having an eclectic mix of staff members. Both fitted the stereotypes about California as a place where unusual and amusing things happen, stereotypes which are popular outside the state and attracted national attention as a result. Both have proved capable of quickly reversing policy when the political need arose.

These characteristics work well in personal campaigns for elective office. They work less well in dealing with legislators who often *are* ordinary politicians with ordinary constituencies to please. They work less well in rounding up support for policies that are controversial and are opposed by major interest groups or in obtaining support for unpleasant actions in the face of fiscal distress or other difficult situations. On the other hand, the ability to reverse course, permits a political rebound when needed.

Thus, after Governor Schwarzenegger’s “Year of Reform” ballot initiatives were all defeated in November 2005 and his popularity sank dramatically, he proclaimed “message received” in his January State of the State address and went on to win re-election in November 2006. Similarly, when Jerry Brown found himself on the wrong side of Prop 13 after it passed in June 1978, he quickly became a dedicated Prop 13 supporter, wooing Howard Jarvis personally, and winning re-election in November of that year by a wider margin than his victory four years earlier.

Over time, what the issues are – and what will prove popular – changes. Jerry Brown made a point in his early career of not being just a copy of his dad and in fact in many ways was the anti-Pat. He took pride in running a budget surplus and holding spending below revenue. He took a hard line on student demonstrators. And, although opposed to

the death penalty, Jerry Brown identified more with a tough-on-crime approach than with an emphasis on rehabilitation.

Pat Brown – although he now has attained retrospective gubernatorial sainthood for his freeways, waterworks, and university campuses – left office after defeat by Ronald Reagan blamed for student demonstrators, the Watts Riot, and a major budget crisis that he left to his successor to fix. Jerry clearly did not want to be identified with those images. Operating with such New Age themes as “small is beautiful” and “era of limits,” Jerry generally opposed more freeways and similar infrastructure – with the exception of a fancied California state space program that never materialized.<sup>110</sup>

Schwarzenegger, ironically, invoked the now-sanctified senior Brown as the model great builder in pushing for Pat Brown-type infrastructure in 2006. The contrast between Jerry Brown’s modest choice of a Plymouth as his state car and Schwarzenegger’s predilection for Hummers simply reflects changing times. (And as public anxiety over rising gasoline prices came to the fore, the Hummers seemed to disappear from view.) Jerry Brown was interested in beaming solar energy from space. Arnold Schwarzenegger focuses on the “hydrogen highway.”

Now that New Age symbols and rebellion against tradition are no longer the novelties and the political assets they once were, Brown as mayor of Oakland returned to the conventional. As he prepared to return to statewide politics in the early 2000s (a successful run for Attorney General in 2006), he disconnected from a longtime Zen guru/advisor – who had made himself an embarrassment. And he married his longtime girlfriend.<sup>111</sup> Similarly, after the 2005 Year of Reform fiasco, Schwarzenegger dropped the Hollywood-style photo ops that had become counterproductive. He instead turned to professional press conferences and talks to civic groups to push his agenda, often in a suit and tie.

### **1977-78: What Happened?**

*“Whenever I tell an audience local government will come to a halt, all I see is smiling faces.”*

Assemblyman Paul Priolo  
Republican minority leader<sup>112</sup>

*“This may be the time they waited too God-damned long to act.”*

San Diego Mayor Pete Wilson<sup>113</sup>

The fiscal year that ended in June 1978 – with the passage of Prop 13 – turned out to be a crucial period in California’s budgetary history. Members of the legislature were certainly aware of pressures for property tax relief. A bill was in the hopper at the beginning of the fiscal year providing property tax postponements for seniors (until the property was sold) and other features. And there were policies considered that would allow taxpayers to defer property tax increases above a given percentage. Some

Democrats were willing to consider caps on spending – state and/or local – an idea that had been unsuccessfully pursued via initiative by then-Governor Reagan in 1973.<sup>114</sup> Debate also centered about a demand from the business community to abolish a tax on commercial inventories, as part of some more general tax relief.

Complicating the task, however, was court-ordered legislative compliance with *Serrano*, which one way or the other seemed to imply losses to wealthy school districts to finance gains for poorer ones. Wealthier districts naturally resisted such reallocation. One spokesperson for such a district said that when residents of his district understand the implications of the redistribution, “*it’s going to drive them right out of their skulls.*”<sup>115</sup> The combination of school finance and dealing with state-supported local tax relief proved difficult from the start. Finally, Governor Brown was adamant that whatever the legislature did on those two fronts, no general tax increase could be included or should result from legislative action.

But although some state officials were concerned about property taxes, Sacramento began the fiscal year without a sense that something dramatic would come about in less than twelve months. Governor Brown, in August 1977, visited a NASA center in the Bay Area as part of “Space Day” and pushed for research into satellites. In attendance at Space Day were notables of the day such as astronomer Carl Sagan, oceanographer Jacques Cousteau, and LSD enthusiast Timothy Leary.<sup>116</sup> “*The public is really fascinated by space,*” the governor observed, citing the success of the recently-released *Star Wars* movie.<sup>117</sup> Nonetheless, back on Planet Earth, new residents of California coming from out of state were being shocked by the price of new homes, what one termed the “*great California real estate freak-out phenomenon.*”<sup>118</sup>

Meanwhile, Howard Jarvis and Paul Gann, despite their differences, had begun circulating petitions on July 6 to put what would become Prop 13 on the state ballot. By late September, with no definitive response from the legislature, the two were projecting enough signatures to qualify for the June 1978 ballot. One activist attributed the success of the petition to “*the Legislature refusing to do anything about the tax mess.*”<sup>119</sup> Indeed, the governor and the legislature could not agree on a plan for property tax relief when the first half of the 1977-78 session ended in September.

With the legislature out of session, there was little action on the property tax issue as the calendar year came to an end. As is standard practice, word began to be leaked by the administration about the content of the governor’s forthcoming January budget proposal. In late December 1977, various legislators and the press were invited to a special briefing - former astronaut Rusty Schweickart was in attendance - on a communications satellite in which California would have a share and for which the budget would provide.<sup>120</sup> On property taxes, Governor Brown’s executive secretary Gray Davis said the governor would favor a bill that included a limit on local governments’ ability to raise property tax rates.

Once the legislative session resumed, Governor Brown argued that there would have to be a choice between property tax relief and income tax relief. California’s income tax

was highly progressive and inflation was pushing taxpayers into higher tax brackets. One remedy would be to index the brackets to inflation. But since there were calls for both income tax indexation and some version of property tax relief, the legislature would have to pick which one it wanted. *“The two ideas are incompatible,”* said Brown in mid-January.<sup>121</sup>

In the background of the debate was the 1978 gubernatorial race, already in progress. Attorney-General Evelle Younger, who would eventually emerge from the June primary as the Republican nominee for governor, favored tax relief. Nonetheless, when he formally announced his candidacy, Younger’s initial program was along the lines of past legislative efforts at tax relief when initiatives threatened, rather than Prop 13 which by that time was definitely on the June ballot.<sup>122</sup> At a later point, he criticized the initiative as *“poorly drafted”* but said he might vote for Prop 13 as *“the lesser of two evils,”* the other evil being a bill then pending in the legislature.<sup>123</sup> In short, Younger’s support of Prop 13 was limited at best.

However, other Republican candidates for the nomination were not so reticent about backing Prop 13. Former LA Police Chief Ed Davis proclaimed that he had *“perceived the angry mood of Californians who are not going to be denied their taxation revolution. I gladly join that revolution.”* Another candidate, Assemblyman John Briggs of Fullerton, also was an enthusiastic Prop 13 supporter.<sup>124</sup> And there were supporters of the initiative developing even in the local governments that would lose property tax revenue if it passed. LA City Controller Ira Reiner, for example, endorsed Prop 13 as *“an understandable reaction to government excess.”*<sup>125</sup>

By late February, the legislature was still dicker over the terms of a property tax relief program. Real estate agents were opposing a plan that would partly finance relief by a new tax on house sales. Their opposition was delaying a final plan. Assembly Speaker Leo McCarthy fretted that *“if we don’t get a bill passed in the next few weeks, there really won’t be time to mount an intelligent alternative to the Jarvis initiative.”* But the governor remained silent on Prop 13, saying he was waiting to see what would emerge from the legislature.<sup>126</sup>

It is important to note that Prop 13 was not a sure thing as of early spring 1978. Polling results suggested that among those aware of the initiative, roughly a third favored it, a third opposed it, and a third were undecided.<sup>127</sup> By early March, the legislature finally did put an alternative Prop 8 on the ballot which provided more modest property tax relief than 13 and was more in the spirit of past legislative endeavors in that area. Governor Brown signed it saying *“This is real property tax relief – not a gimmick.”*<sup>128</sup>

Although Prop 13 was still not a sure thing, by late April it was at least a possibility. Yet, former Legislative Analyst A. Alan Post observed that as far as he could tell, there was no contingency planning going on concerning how to deal with it if it passed. *“Nothing is happening,”* lamented Post, who – after Prop 13 did pass – was named to head a commission on how to deal with it.<sup>129</sup> However, by mid-May, word leaked out that the Brown administration had begun contingency planning. The governor reportedly told

local officials who were warning of dire consequences if Prop 13 passed that *“The thing is, I don’t think people believe you when you’re saying all that.”*<sup>130</sup>

Information also began to come from other sources. Word began to leak in Los Angeles of large increases to be announced in property assessments.<sup>131</sup> And there were reports that the state surplus would be larger than originally projected.<sup>132</sup> But despite these leaks, polling suggested Prop 13 was still a toss up, even a few weeks prior to Election Day.<sup>133</sup> However, the initiative received a final fillip when the LA County tax assessor released the actual new assessments shortly before the election and Prop 13 passed with 65% of the vote. Prop 8, the legislative alternative, in contrast, lost with 47% of the vote.

### **Immediate Aftermath**

*“Governor Brown just discovered 13 after he knew the people were going to vote very heavily for it. By the day after election, he had clutched it to his bosom to the extent that you thought maybe he wrote it.”*

Former Governor Ronald Reagan

*“A Brown-Jarvis alliance would have seemed bizarre less than a month ago, but that is no longer the case. Politics takes strange turns.”*

Columnist David S. Broder<sup>134</sup>

Almost immediately after Prop 13 passed, Governor Brown addressed the legislature and said a new state budget plan – with no new taxes – would have been enacted in two or three weeks to bail out local governments. Prop 13’s co-sponsor Paul Gann commented afterwards that *“for a speech he didn’t have much time to prepare, what he said, I liked.”*<sup>135</sup> Hiring was frozen in the state and pay rates were frozen. President Carter declined a request from Governor Brown to return to the state the federal tax windfall that would result from the decline in (income tax-deductible) property taxes.<sup>136</sup>

Although the legislature did not send the governor a final budget bill by the start of the fiscal year, it had one on his desk by July 6. But that was breakneck speed – particularly in view of the magnitude of the post-Prop 13 task – compared with contemporary budget delays. Governor Brown signed the bill but vetoed pay increases and cost-of-living adjustments in various welfare programs. The new budget, said the governor, *“keeps faith with the voters’ mandate.”*<sup>137</sup>

Governor Brown took up the mantle of tax cutting and spending limitations – supporting a federal balanced budget amendment – and decisively won re-election in November 1978. Paul Gann went on to put Prop 4 on the 1979 ballot which placed an effective cap on government spending and which passed with 78.5% of the vote. By 1980, however, when Howard Jarvis put Prop 9 on the state ballot to cut the state income tax, voters in California had apparently tired of the anti-tax fervor and “Jarvis II” failed with only 39% support. Later in the 1980s, voters gutted the Prop 4 Gann limit by passing Prop 98 and then 111 which earmarked state spending for K-14. Gann and Jarvis never collaborated

after Prop 13 but each went on proposing initiatives. Jarvis died in 1986. Gann died in 1989 of complications related to AIDS.<sup>138</sup>

A. Alan Post's commission on dealing with the longer term fiscal implications of Prop 13 produced a more orderly blueprint for dealing with future bailouts than was possible with the hasty plan enacted for 1978-79. In a 1998 interview, however, Post complained that Governor Brown never focused on its recommendations. *"I wasn't getting much help from Jerry Brown or his director of finance, Dick Silberman,"* he said. *"We even had a tough time getting the report printed and distributed."*<sup>139</sup>

In any event, recession in the early 1980s depleted the state treasury and Brown's new-found popularity faded. He lost a bid for the U.S. Senate to Pete Wilson in 1982. Thereafter, he retired from politics until 1989 when he beat Steve Westly in a race to become chair of the California Democratic Party. From his current post as California's attorney general, Brown is rumored to be planning a run to return to the governorship in 2010. Post, now in his 90s, continues to be active in state affairs and in a second career as a painter.

### **Leadership and the Budget**

*"I can't help you with what you must soon face, except to say that the future is not set. You must be stronger than you imagine you can be."*

Kyle Reese  
Visitor from the future in  
Schwarzenegger's film *The Terminator*

California has had governors of varying personalities and leadership styles. All have had to deal with issues of state budgeting. But, depending on the economy and the political winds, fiscal affairs can be more or less challenging. It does appear, however, that when challenges arise, an ability to focus is a necessary – but not sufficient – condition to avoid having what started as a challenge become a crisis.

Of course, governors cannot enact budgets on their own. Legislative leadership is also important. But with term limits – a policy not in effect during the Prop 13 episode – strong leadership is now less likely to come from the legislature on fiscal affairs than it was in earlier times. Jerry Brown as governor let events overtake him when the property tax movement began to coalesce around Prop 13. In terms of winning re-election, he was successful. In terms of guiding the state's fiscal affairs in a troubled period, less so.

Arnold Schwarzenegger came to office in a recall, largely because of a state budget crisis. He clearly wanted to fix the problem. But after an initial short-term fix in 2004 – essentially borrowing to refinance the general fund – he mixed budget reform in 2005 with a variety of other issues and failed to enact any of them. Gubernatorial election year 2006 produced infrastructure plans – always popular – but again based heavily on seemingly-painless borrowing. Nonetheless, as with Brown's abrupt shift in direction in 1978, Schwarzenegger's shift in 2006 led to renewed popularity and re-election.

In 2007, the issue for Governor Schwarzenegger was to be universal health care. However, after an initial health proposal, gubernatorial attention wandered to other issues and by the time attention was refocused on health, the health plan proved to be a near miss: passed in the assembly, killed in a senate committee. And by the summer of 2008, the unresolved structural problem of the state budget had forced itself back as The Issue for California.

There is no guarantee that strong focused leadership could have repaired the state's underlying budgetary problem. Governor Schwarzenegger's favored reform for 2008, redistricting, seems only distantly connected to the budget and can't have an effect until after the 2010 Census. Moreover, the effect it might have could conceivably complicate attaining a two thirds vote on fiscal policy.

A bigger rainy day fund – the favored reform for 2009 - can't hurt. But history tells us that the legislature effectively blew out such a reserve in the early 2000s when the dot-com and stock market bubble burst. And accumulating a sizeable rainy day fund requires economic sunshine, something forecasters are not predicting for the near term.

An ability to make midyear cuts is helpful, absent other remedies, but to the extent such ability is not written into the constitution, it exists only with the will of the legislature. The governor did obtain (constrained) authority to cut as part of the 2008-09 budget deal. Whether he will continue to have such authority is a matter of legislative discretion.

Despite the unfavorable fiscal outlook, the future is not set. Strong and focused leadership from now on would help.

Table 1: Governor's January Budget Proposal and LAO Budget Proposal Under LAO Economic Assumptions (\$ Billions)

	2006-07	2007-08	2008-09	2009-10
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Governor				
Revenues	\$95.9	\$96.5	\$102.4	na
Expenditures	\$101.2	\$103.6	\$101.1	na
Surplus or Deficit	-\$5.3	-\$7.1	+\$1.2	-\$3.8
LAO				
Revenues	\$95.9	\$96.5	\$103.4	na
Expenditures	\$101.2	\$102.5	\$103.6	na
Surplus or Deficit	-\$5.3	-\$5.9	-\$0.2	na
LAO End-of-Year Reserve	\$5.0	\$2.4	\$2.2	na
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Note: Reserve includes proceeds of \$3.3 billion Economic Recovery Bond sale in 2007-08.

na = not available

Source: California Legislative Analyst's Office, "The 2008-09 Budget: Perspectives and Issues," especially pp. 9, 11, 88, available at [http://www.lao.ca.gov/analysis\\_2008/2008\\_pandi/pandi\\_08.pdf](http://www.lao.ca.gov/analysis_2008/2008_pandi/pandi_08.pdf)

Table 2: The Governor's May and August Revise Proposals and LAO May Alternative (\$ Billions)

	Governor - May		LAO - May	August	Final
	2007-08	2008-09	2008-09	2008-09	2008-09
Revenues	\$97.4	\$97.9	\$97.9	Approx. \$101	Approx. \$101
Expenditures	\$103.5	\$101.8	na	\$103.4	\$103.4
Surplus or Deficit	-\$6.1	-\$4.0	na	Approx. -\$2	Approx. -\$2

Note: Figures exclude borrowing under Economic Recovery Bonds in 2007-08 and lottery securitization in 2008-09. Also excluded are proposed loans from other funds in the August Revise and transfers in the final budget.

na = not available

Note: Revenue estimate from the August revise is the sum of revenues reported on p. 7 of the supporting document plus approximately \$6 billion of non-borrowed revenue (\$4 billion from the temporary sales tax increase plus other tax revenues including an amnesty which would technically be assigned to the prior fiscal year.

Source: California Legislative Analyst's Office, "Overview of the 2008-09 May Revision," May 19, 2008, especially p. 8, available at [http://www.lao.ca.gov/2008/bud/may\\_revise/may\\_revise\\_051908.pdf](http://www.lao.ca.gov/2008/bud/may_revise/may_revise_051908.pdf), and "LAO Alternative Budget: Revenue-Related and Revenue-Increasing Proposals," June 2, 2008, available at [http://www.lao.ca.gov/handouts/FO/2008/060208\\_SBFR\\_Hearing.pdf](http://www.lao.ca.gov/handouts/FO/2008/060208_SBFR_Hearing.pdf); California Department of Finance, "August 2008-09 Update: Proposed Compromise" available at [http://www.dof.ca.gov/budget/historical/2008-09/documents/August\\_Revision\\_R2-w.pdf](http://www.dof.ca.gov/budget/historical/2008-09/documents/August_Revision_R2-w.pdf).

Table 3: California General Fund, 1974-75 - 1978-79  
(\$ billions)

Year	Revenues & Transfers	Expenditure & Transfers	Surplus or Deficit	Reserve
1974-75	\$8.6	\$8.3	+\$0.3	\$0.7
1975-76	9.6	9.5	0.1	0.8
1976-77	11.4	10.5	0.9	1.8
1977-78	13.7	11.7	2.0	3.9
1978-79	15.2	16.3	-1.1	2.9

Note: Details may not add to totals due to rounding.

Source: California State Controller, *Annual Report of the State Controller*, various years.

Chart 1



Source: Annual median home price data 1971-78 from Marion S. Beaumont, “Proposition 13 Winners and Losers: Were First-Time Home Buyers Affected Adversely?” in Frederick D. Stocker, ed., *Proposition 13: A Ten-Year Retrospective* (Cambridge, MA: Lincoln Institute of Land Policy, 1991), p. 163; monthly home price data from UCLA Anderson Forecast converted to annual averages, 1979-2007, California Consumer Price Index (CPI-U) from California Department of Finance. All home price data originally credited to California Association of Realtors.

Chart 2



Source: California State Controller, June reports on General Fund Cash Receipts and Disbursements, available at <http://www.controller.ca.gov/ard/cash/index.shtml>.

## Footnotes

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<sup>1</sup> The author of this chapter quoted in Evan Halper, "Governor Teeters on the Edge of Deficit Abyss," *Los Angeles Times*, November 7, 2007.

<sup>2</sup> George F. Break, "Proposition 13's Tenth Birthday: Occasion for Celebration or Lament?" in Frederick D. Stocker, ed., *Proposition 13: A Ten-Year Retrospective* (Cambridge, MA: Lincoln Institute of Land Policy, 1991), p. 175.

<sup>3</sup> Daniel J.B. Mitchell, "From Jerry-Rigged to Petered Out: Lessons from the Deukmejian Era for Contemporary California State Budgeting," in Daniel J.B. Mitchell, ed., *California Policy Options 2008* (Los Angeles: School of Public Affairs, 2008), pp. 39-76, especially pp. 53-58.

<sup>4</sup> Joe Mathews, *The People's Machine: Arnold Schwarzenegger and the Rise of Blockbuster Democracy* (New York: Public Affairs, 2006), pp. 79-104.

<sup>5</sup> The California Teachers Association, a prime mover behind Prop 98, opposed Prop 92 as did the Regents of the University of California. Both groups expressed the concern that tying up more of the state budget was a Bad Thing. In the case of CTA, it had many more members in K-12 than in community colleges. But some unions – notably the California Federation of Teachers, a smaller group representing instructors at community colleges – supported Prop 92. Prop 92 received only 43% of the vote on Election Day.

<sup>6</sup> Data on initiatives per year comes from a database maintained by Hastings College at [http://library.uchastings.edu/library/Research%20Databases/CA%20Ballot%20Measures/ca\\_ballot\\_measures\\_main.htm#ballotinit](http://library.uchastings.edu/library/Research%20Databases/CA%20Ballot%20Measures/ca_ballot_measures_main.htm#ballotinit) and recent election reports from the California Secretary of State at [www.sos.ca.gov](http://www.sos.ca.gov).

<sup>7</sup> Daniel J.B. Mitchell, "Unions and Direct Democracy in California: A New Pattern Emerging?" in Daniel J.B. Mitchell, ed., *California Policy Options 2008* (Los Angeles: School of Public Affairs, 2008), pp. 197-221.

<sup>8</sup> Quoted in *Capital Alert* (on-line service of the *Sacramento Bee*), January 31, 2008.

<sup>9</sup> See Stephen Carroll, Eugene Bryton, C. Peter Rydell, and Michael A. Shires, *Projecting California's Fiscal Future* (Santa Monica, CA: Rand, 1995). A Legislative Analyst's report in 1996 also warned of future budget deficits. See California Legislative Analyst's Office, *California's Fiscal Outlook: The LAO's Economic and Budget Projections, 1996-97 through 1998-99* (Sacramento: LAO, 1996).

<sup>10</sup> Davis' reputation as a micro-manager was emphasized in a lawsuit by one of his top officials – the former head of the Department of Motor Vehicles - claiming he was eligible for unemployment insurance after having been fired after the recall by incoming Governor Schwarzenegger. The lawsuit alleged that despite his high title, the official had no real authority and was thus an ordinary employee entitled to unemployment benefits. See John Hill, "A Juicy Benefits Battle," *Sacramento Bee*, November 18, 2007.

<sup>11</sup> The car tax is actually a property tax on motor vehicles that is collected by the state on behalf of local governments. Since it is really a local tax, when the tax was cut, the state reimbursed the local governments for the lost revenue. So reducing the car tax increases state spending on support for local governments. The car tax had been cut during the revenue boom of the late 1990s with a trigger that could raise it back to the old level if the state found itself in fiscal distress. Davis pulled the trigger during the period leading up to the recall and candidate Schwarzenegger promised to cut it back to the reduced level – which he did upon taking office.

<sup>12</sup> The state constitution requires that general obligation borrowing be approved by the voters and that such borrowing should be for specific projects, not general operating purposes. By amending the constitution to allow the borrowing, Governor Schwarzenegger short-circuited these requirements on a one-time basis. The original Davis plan did not involve going to the voters and relied on a questionable legal strategy that surely would have been challenged in court. A pending court challenge would likely have made Davis' proposed bonds impossible to sell, since an adverse ruling could void any investor claim on the state.

<sup>13</sup> Some of the amnesty money may have to be paid back in the future as tax litigation is completed. It appears that some taxpayers who were disputing tax liabilities paid the state under protest during the amnesty to avoid penalties if their cases ultimately resulted in a liability – even if they expected to win.

<sup>14</sup> Both quoted in Evan Halper, "Brokaw Needles Schwarzenegger on Spending, Economy," *Los Angeles Times*, June 30, 2008.

<sup>15</sup> Daniel Weintraub, *Party of One: Arnold Schwarzenegger and the Rise of the Independent Voter* (Sausalito, CA: PoliPoint Press, 2007), pp. 75-76.

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<sup>16</sup> See Daniel J.B. Mitchell. ““They Want to Destroy Me””: How California's Fiscal Crisis Became A War on "Big Government Unions." *WorkingUSA: The Journal of Labor and Society*, (March 2006), vol. 9, pp. 99-121.

<sup>17</sup> See Daniel J.B. Mitchell. “Something Different in the Air? The Collapse of the Schwarzenegger Health Plan in California.” *WorkingUSA: The Journal of Labor and Society*, (June 2008), vol. 11, pp. 199-218.

<sup>18</sup> See Daniel J.B. Mitchell. “Something Different in the Air? The Collapse of the Schwarzenegger Health Plan in California.” *WorkingUSA: The Journal of Labor and Society*, (June 2008), vol. 11, pp. 199-218.

<sup>19</sup> John G. Matsusaka, “Where Does It All Go?,” *Los Angeles Times*, July 17, 2008. In this op ed, Matsusaka cited a 40% increase in the state budget – although he focused on the overall state budget, not just the general fund.

<sup>20</sup> James Richardson, *Willie Brown: A Biography* (Berkeley: University of California Press, 1996), pp. 255-271; Willie Brown, *Basic Brown: My Life and Our Times* (New York: Simon & Schuster, 2008), pp. 146-156.

<sup>21</sup> If all state supported spending on health services, mental health services, development services, and social services is counted, the total of \$28.4 billion is about a fourth of general fund expenditures. Counting only state-supported but locally-delivered SSI/SSP/IHSS, CalWorks, and Medical Assistance brings the total down to \$21.5 billion or about a fifth of expenditures. Source: California State Controller, *Statement of General Fund Cash Receipts and Disbursements: June 2008*, p. A3. Available on line at <http://www.sco.ca.gov/ard/cash/0708/jun.pdf>.

<sup>22</sup> Quoted in Evan Halper, “Schwarzenegger Orders Plan for 10% Budget Cuts,” *Los Angeles Times*, November 6, 2007.

<sup>23</sup> Quoted in George Skelton, “The State’s Money Woes Will Trump Its Big Plans,” *Los Angeles Times*, November 15, 2007.

<sup>24</sup> Denham was in one of the few legislative districts that were regarded as marginal for the GOP. The recall option remained on the ballot although it was abandoned by Perata in early May after both sides mounted significant TV advertising campaigns and at one point Denham charged Perata with illegal use of state staffers for the recall. Various interpretations could be made of Perata’s action ranging from teaching a lesson to other recalcitrants (thereby conceivably easing enactment of the 2008-09 budget) to opening the possibility of adding a new Democratic senator to a mechanism to move campaign funds around to a favored campaign consultant. Dan Walters, “Denham Recall Drive Motivation Still Hazy,” *Sacramento Bee*, June 23, 2008. One interpretation of Denham’s refusal to provide the needed vote for the 2007-08 budget was that he was planning a run for Lieutenant Governor in 2010 and would need conservative support in the primary. Denham began proposing such steps as a constitutional amendment that would freeze legislative pay if a budget was not passed by the June 15 constitutional deadline. Such proposals had no chance of legislative enactment but could serve a purpose in a future Republican primary campaign.

<sup>25</sup> The defeated 2005 initiative would have put districting line drawing in the hands of retired judges and would have affected congressional as well as legislative districts (drawing opposition from congressional representatives in both parties). The new initiative would apply only to the legislature and would set up a panel of Republicans, Democrats, and independents or minor party representatives to do the redistricting and became Prop 11 on the November 2008 ballot.

<sup>26</sup> User “fees” are not subject to the two-thirds vote requirement as opposed to taxes. In this case, the insurance industry favored the fee as a way of limiting its fire liability. However, taxpayer groups charged that the fee was in reality a tax. And there was criticism of an across-the-board fee on all property insurance as opposed to a risk-based charge for those with property in high fire regions. See Marc Lifsher and Evan Halper, “Gov. Urges Insurance Assessment to Fund Firefighting,” *Los Angeles Times*, January 9, 2008.

<sup>27</sup> Judy Lin, “Governor: Slash School Aid,” *Sacramento Bee*, January 10, 2008.

<sup>28</sup> “Lockyer’s Holiday Message: No Tooth Fairy for the Budget,” *Capitol Alert*, December 14, 2007.

<sup>29</sup> California Field Poll, release #2257, December 28, 2007. (All California Field Polls are available at [www.field.com](http://www.field.com) by clicking on “archives.”)

<sup>30</sup> Quoted in Dan Walters, “Crisis May Lead to a Grand Deal,” *Sacramento Bee*, January 11, 2008.

<sup>31</sup> Dan Weintraub, “On Budgets and Leverage,” *Capitol Alert*, January 10, 2008.

<sup>32</sup> If the state borrows within a fiscal year using Revenue Anticipation Notes (RANs), the borrowing is handled by the Treasurer with little fanfare. If the borrowing crosses the fiscal year line, however, the state must issue Revenue Anticipation Warrants (RAWs) through the Controller. While there is little difference

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between the two in financial terms, use of such RAWs might be taken as a signal on Wall Street of particular fiscal distress, since they are rarely used or needed. Courts have long viewed such short-term instruments as essentially a cash management tool rather than the kind of long-term borrowing that requires voter approval.

<sup>33</sup> The sale took place in February 2008. Because the Economic Recovery Bonds were attached to a dedicated revenue stream, investors viewed them as more desirable than other California state general obligation bonds.

<sup>34</sup> See Dan Walters, "Two Buddies Part Ways Over Taxes," *Sacramento Bee*, February 13, 2008.

<sup>35</sup> These quotes and those of other state officials can be found in the "The Budget Reaction," *Capitol Alert*, January 10, 2008.

<sup>36</sup> Evan Halper, "Legislature Considers Raiding Voter-Approved Funds," *Los Angeles Times*, July 18, 2008.

<sup>37</sup> As it turned out, one of the tribes whose compact was at issue had not actually signed the agreement and seemed as of mid-June to be holding out for better terms. See James P. Sweeney, "Sycuan Withholds Gambling Pact OK," *San Diego Union-Tribune*, June 19, 2008.

<sup>38</sup> Quoted in Kevin Yamamura, "Governor Backs Off Tax Breaks," *Sacramento Bee*, February 29, 2008.

<sup>39</sup> Quoted in Kevin Yamamura, "Governor Backs Off Tax Breaks," *Sacramento Bee*, February 29, 2008.

<sup>40</sup> As noted earlier, the sloophole was eventually removed as part of the budget deal for 2008-09.

<sup>41</sup> Quoted in "Governor Suggests No Potty Breaks," *Capitol Alert*, March 10, 2008.

<sup>42</sup> Quoted in Evan Halper, "State Democrats Determined to Raise Taxes," *Los Angeles Times*, March 5, 2008.

<sup>43</sup> Quoted in Jim Sanders, California Assembly Kills Núñez Oil Tax Plan," *Sacramento Bee*, March 13, 2008.

<sup>44</sup> Loren Kaye, "State Tax Hike Talk Must Be Linked to Budget Reform," *Sacramento Bee*, April 22, 2008.

<sup>45</sup> Judy Lin, "GOP Senators Demand Changes in Business, Environmental Policies," *Sacramento Bee*, April 30, 2008.

<sup>46</sup> Judy Lin, "Lawmakers Take a New Look at Privatizing California Lottery," *Sacramento Bee*, April 22, 2008.

<sup>47</sup> Rani Isaac, "Foreclosures in California," California Research Bureau, CRB 08-006, May 2008. Available at <http://www.library.ca.gov/crb/08/08-006.pdf>.

<sup>48</sup> Kevin Yamamura, "Governor Says Ball is in Lawmakers' Court," *Sacramento Bee*, May 16, 2008.

<sup>49</sup> Judy Lin, "California Officials Expect Revenue to Drop 8 Percent," *Sacramento Bee*, May 21, 2008.

<sup>50</sup> California Field Poll, Release #2272, June 3, 2008.

<sup>51</sup> John Myers, "With Hands Tied, A Salary Freeze," *KQED Capitol Notes*, June 10, 2008. Postings available at <http://blogs.kqed.org/capitalnotes/>. Go to archives for past postings. The California Citizens Compensation Commission could have only cut pay of new members of the legislature (all of the assembly and half of the senate) because it cannot cut pay during terms of office. No other elected officials could be cut in 2008 since all were in the midst of terms of office.

<sup>52</sup> Quoted in Evan Halper, "State Republicans See Opportunity Amid Crisis," *Los Angeles Times*, June 16, 2008.

<sup>53</sup> Dan Walters, "Senate Dems Throw Down the Gauntlet," *Capitol Alert*, June 11, 2008.

<sup>54</sup> "Villines Says Lawmakers 'Not Making a Ton of Progress,'" *Capitol Alert*, June 30, 2008.

<sup>55</sup> Quoted in Kevin Yamamura and Judy Lin, "Schwarzenegger Blasts Budget Inaction," *Sacramento Bee*, July 16, 2008.

<sup>56</sup> Quoted in Evan Halper, "Legislature Considers Raiding Voter-Approved Funds," *Los Angeles Times*, July 18, 2008.

<sup>57</sup> "Perata Insists Democrats Don't Want to Borrow," *Capitol Alert*, July 18, 2008.

<sup>58</sup> Quoted in "Text of Governor's Executive Order," *Los Angeles Times*, posted on-line on July 31, 2008.

<sup>59</sup> "Garamendi: Could You Live on \$262 a week?," *Capitol Alert*, July 29, 2008. The federal minimum wage was \$6.55 per hour. Garamendi's figure of \$262 is the minimum wage times 40 hours.

<sup>60</sup> California State Controller, press release and attached letter dated July 31, 2008.

<sup>61</sup> Kevin Yamamura and Jon Ortiz, "Governor Set to Slash State Workers' Pay," *Sacramento Bee*, July 24, 2008.

<sup>62</sup> Certain critical workers were to be exempted from the minimum wage cut. About 180,000 workers were estimated to be subject to the cut and another 50,000 were excluded. Kevin Yamamura, "Schwarzenegger Formally Asks California Controller to Cut Pay," *Sacramento Bee*, August 6, 2008; Kevin Yamamura,

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“California State Computers Can’t Handle Pay Cut, Controller Says,” *Sacramento Bee*, August 5, 2008. Original estimates put the layoffs at 22,000, a figure that appeared in various news reports, e.g., Dan Walters, “Legal Picture Muddled in Game of Budget Chicken,” *Sacramento Bee*, July 29, 2008. An early tabulation appearing in an on-line database maintained by the Sacramento Bee found about 32,000 potential layoffs.

<sup>63</sup> Perhaps not surprisingly, an effort by the author to obtain more detail on the calculation of unused borrowable resources from the controller’s office was unsuccessful.

<sup>64</sup> Quoted in “‘At Loggerheads’, Perata Sees ‘No End in Sight,’” *Capitol Alert*, August 5, 2008.

<sup>65</sup> Quoted in “Cogdill: Perata is ‘Patently Incorrect,’” *Capitol Alert*, August 5, 2008.

<sup>66</sup> Quoted in John Howard, “Job Loss, Business Impacts Seen in Proposed Sales Tax Hike,” *Capitol Alert*, August 5, 2008.

<sup>67</sup> Arnold Schwarzenegger, “A Compromise Budget for All Californians,” op ed on the on-line *Fox & Hounds Daily*, August 21, 2008, available at <http://foxandhoundsdaily.com/print/1267>.

<sup>68</sup> Quoted in Jim Sanders, Schwarzenegger Proposes Sales Tax Increase,” *Sacramento Bee*, August 5, 2008.

<sup>69</sup> Quoted in Matthew Yi, “Governor and Lawmakers Agree on Spending Plan,” *Sacramento Bee*, September 19, 2008.

<sup>70</sup> Dan Walters, “Revised State Budget is Still a Sham,” *Sacramento Bee*, September 19, 2008.

<sup>71</sup> Quoted in Evan Halper and Jordan Rau, “Schwarzenegger, Top Legislators Reach a Budget Deal,” *Los Angeles Times*, September 19, 2008.

<sup>72</sup> Quoted in “AM Alert: What’s Next,” *Capitol Alert*, September 22, 2008.

<sup>73</sup> Jon Coupal, “CalTax Gets Rolled by the Governor,” *Taxpayer Update* (emailed newsletter), September 7, 2008.

<sup>74</sup> Quoted in “The Buzz: Schwarzenegger Has No Regrets About Missing Convention,” *Sacramento Bee*, September 9, 2008.

<sup>75</sup> “Put Mike Genest in the Dunk Tank,” *Capitol Alert*, September 24, 2008.

<sup>76</sup> Office of the Governor, press release of September 23, 2008.

<sup>77</sup> Dan Walters, “Rosy Fiscal Forecasts? Forget It,” *Sacramento Bee*, September 28, 2008.

<sup>78</sup> When there is no budget, legislators and their staffs are not paid. But they receive the back pay owed once the budget is signed. There were proposals simply to dock pay for each day of budget delay and not repay it once the budget was enacted.

<sup>79</sup> “No, But Just Barely, to Recalling Arnold,” *Orange County Register*, September 12, 2008.

<sup>80</sup> Doubts about redistricting were raised in Eric McGhee, *Redistricting and Legislative Partisanship* (San Francisco: Public Policy Institute of California, 2008).

<sup>81</sup> Quoted in Dan Walters, “Schwarzenegger Flip-Flops Like Jerry Brown,” *Sacramento Bee*, July 23, 2008.

<sup>82</sup> It is difficult to find exact statewide figures on pre-Prop 13 tax rates. The range estimates come from Valerie Raymond, *Surviving Proposition Thirteen: Fiscal Crisis in California Counties* (Berkeley, CA: UC-Berkeley Institute of Governmental Studies, 1988), p. 9. Note that the figures given in this source are provided on the basis of a 25% valuation of property – the ratio used prior to Prop 13. The figures have been divided by four to convert them to tax rates on full value. The average estimate comes from Roger L. Kemp, *Coping with Proposition 13: Strategies for Hard Times* (Malabar: FL: Robert E. Kreiger Publishing Co., 1988 [1980]), p. 151.

<sup>83</sup> Roger L. Kemp, *Coping with Proposition 13: Strategies for Hard Times* (Malabar: FL: Robert E. Kreiger Publishing Co., 1988 [1980]), pp. 93, 145, 171.

<sup>84</sup> It is unclear that – in the rush to deal with the fiscal crisis the localities faced in the short interval between the June election and the July 1 beginning of the new fiscal year – the legislature had good projections of what state revenues and expenditures apart from the bailout would be. Commentary from that period suggests more optimistic results than actually occurred. See Selma J. Mushkin, ed, *Proposition 13 and its Consequences for Public Management* (Cambridge, MA: Abt Books, 1979). See in particular the comments on p. 7 by Edward Hamilton. Hamilton projects a reserve at the end of the 1978-79 fiscal year of \$9 billion, absent the bailout of \$4.2 billion. That would suggest that with the bailout, the reserve should have been \$4.8 billion rather than the actual \$2.9 billion, as shown on Table 3.

<sup>85</sup> California Field Poll, “Proposition 13 Thirty Years After Its Passage,” June 2008. Available at: <http://field.com/fieldpollonline/subscribers/COI-08-June-Prop-13-Tax-Matters.pdf>.

<sup>86</sup> Quoted in Mark Lachter, “What’s the Harm in Talking About Prop 13?,” *San Diego Business Journal*, September 1, 2003.

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- <sup>87</sup> Both quoted in Mark Simon, "Buffett's Prop. 13 Comments Cause Stir," *San Francisco Chronicle*, August 16, 2003.
- <sup>88</sup> The Association sends out periodic email editorials. The statement appears in Jon Coupal, "One More Time: California's Budget Woes are Not Prop 13's Fault," January 7, 2008. Available at <http://www.hjta.org/commentaryV6-01>. As will be noted below, the statement is incorrect.
- <sup>89</sup> Jeffrey I. Chapman, *Proposition 13 and Land Use* (Lexington, MA: Lexington Books, 1981).
- <sup>90</sup> California Taxpayers' Association, "Cal-Tax 2008: Proposition 13 Revisited," June 2008, available online at <http://www.caltax.org/Proposition13.pdf>.
- <sup>91</sup> Center for Government Analysis, "An Analysis of Government Revenues in California Since the Enactment of Proposition 13," October 2005. Available from the Howard Jarvis Taxpayers Association at <http://www.hjta.org/content/pdf/CGA-HJTA-P13-Report.pdf>. No reply was received by the author to a request for information to the Center on the inflation deflator used was received.
- <sup>92</sup> Quoted in Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), p. 233.
- <sup>93</sup> Quoted in Steven F. Hayward, *The Age of Reagan: The Fall of the Old Liberal Order, 1964-1980* (Roseville, CA: Forum/Prima Publishing, 2001), p. 528.
- <sup>94</sup> This section relies heavily on Robert Kuttner, *Revolt of the Haves: Tax Rebellions and Hard Times* (New York: Simon and Schuster, 1980); and Clarence Y.H. Lo, *Small Property Versus Big Government: Social Origins of the Property Tax Revolt* (Berkeley: University of California Press, 1990). For a contemporary account, see also Robert B. Hawkins, Jr., "Traveling Through the Tax Barrier: What It Looks Like on the Other Side of Proposition 13," *Publius*, vol. 9 (Winter 1979), pp. 11-25. A jaundiced view from the late 1990s can be found in Peter Schrag, *Paradise Lost: California's Experience, America's Future* (New York: The New Press, 1998), pp. 129-187.
- <sup>95</sup> David O. Sears and Jack Citrin, *Tax Revolt: Something for Nothing in California* (Cambridge, MA: Harvard University Press, 1982).
- <sup>96</sup> Jerry Roberts, *Diane Feinstein: Never Let Them See You Cry* (New York: HarperCollinsWest, 1994), p. 74.
- <sup>97</sup> Watson claimed his battle with the supervisors led to heart problems and ultimately received a disability pension. However, when he suggested several years later that he might return to politics, the degree to which he was disabled was questioned by the supervisors and he retreated back to private life. See Jack Jones, "Ex-Assessor Philip E. Watson Dies at 62," *Los Angeles Times*, December 9, 1986.
- <sup>98</sup> Robert J. Dworak, *Taxpayers, Taxes and Government Spending: Perspectives on the Taxpayer Revolt* (New York: Praeger, 1980), p. 72.
- <sup>99</sup> Jack Citron, "Introduction: The Legacy of Proposition 13" in Terry Schwadron, ed., *California and the American Property Tax Revolt: Proposition 13 Five Years Later* (Berkeley, CA: University of California Press, 1984), p. 17.
- <sup>100</sup> The *Serrano* case was actually a sequence of three California Supreme Court cases: *Serrano v. Priest*, 5 Cal.3d 584 (1971) (*Serrano I*); *Serrano v. Priest*, 18 Cal.3d 728 (1976) (*Serrano II*); *Serrano v. Priest*, 20 Cal.3d 25 (1977) (*Serrano III*). The first case, however, established the principle that variations in property values between wealthy school districts and poor school districts should not result in substantially disparate school revenues. On the debate over the impact of the *Serrano* case, see William A. Fischel, "Did *Serrano* Cause Proposition 13?," *National Tax Journal*, vol. 42 (December 1989), pp. 465-473; Kirk Stark and Jonathan Zasloff, "Tiebout and Tax Revolts: Did *Serrano* Really Cause Proposition 13?," *UCLA Law Review*, vol. 50 (February 2003), pp. 811-814; William A. Fischel, "Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff's 'Tiebout and Tax Results: Did *Serrano* Really Cause Proposition 13?,'" working paper 03-13 (August 2003), Dartmouth College Economics Department.
- <sup>101</sup> A major figure in the anti-busing movement in the San Fernando Valley was Bobbi Fiedler. Like Jarvis, she was not a politician although she won first a seat on the LA school board and then in Congress as a result of her prominence in the movement.
- <sup>102</sup> Mike Davis, *City of Quartz: Excavating the Future in Los Angeles* (New York, Vintage Books, 1992 [1990]), pp. 153-219. Unlike the anti-busing and anti-property tax movements, leadership of the anti-growth movement was primarily political, particularly LA City Councilman Marvin Braude.
- <sup>103</sup> The fact that Jarvis represented apartment house owners was an issue in the campaign. Some observers have challenged the idea that the movement behind Prop 13 was really spontaneous and a grass-roots affair as a result. See Daniel A. Smith, "Howard Jarvis, Populist Entrepreneur: Reevaluating the Causes of

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Proposition 13,” *Social Science History*, vol. 23 (summer 1999), pp. 173-210. However, most political movements involve alliances.

<sup>104</sup> Bruce Keppel, “Edelman, Jarvis in Sharp Clash Over Prop. 13,” *Los Angeles Times*, March 15, 1978.

<sup>105</sup> Howard Jarvis (with Howard Pack), *I’m Mad as Hell: The Exclusive Story of the Tax Revolt and Its Leader* (New York: Times Books, 1979).

<sup>106</sup> Unruh’s term is quoted in Jackson K. Putnam, *Jess: The Political Career of Jesse Marvin Unruh* (Lanham, MD: University Press of America, 2005), p. 397.

<sup>107</sup> Note that rising property taxes – because they are deductible from income taxes – actually cut into state and federal income tax revenue. When property taxes were cut by Prop 13, the state and federal governments received a windfall gain (that partly offset the gain to property tax payers).

<sup>108</sup> Quoted in Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), p. 156.

<sup>109</sup> Quoted in Dan Walters, “Schwarzenegger Flip-Flops Like Jerry Brown,” *Sacramento Bee*, July 23, 2008.

<sup>110</sup> A state senate subcommittee killed the plan about a month before Prop 13 passed. Prop 13 then ended any prospect for reviving the plan. Larry Stammer, “Panel Shelves State Satellite,” *Los Angeles Times*, May 9, 1978.

<sup>111</sup> Jacques Barzaghi, a French Zen devotee with minor movie credits, became an advisor to Jerry Brown in the 1970s. When Brown was mayor of Oakland, however, Barzaghi was charged with sexual harassment of a female employee and the city ultimately paid \$50,000 to settle the case. A subsequent domestic dispute involving Barzaghi to which police were called led to his departure from the mayoral staff. Steven Rubenstein and Janine DeFao, “Barzaghi Leaves Jerry Brown’s Staff,” *San Francisco Chronicle*, July 20, 2004. In contrast to his unmarried relationship with pop star Linda Ronstadt while governor, Brown married Anne Gust in both a public ceremony conducted by Senator Diane Feinstein and a traditional Catholic ceremony later. Leah Garchik, “Oakland’s Royal Wedding: Nearly 600 Attend Jerry Brown’s Nuptials,” *San Francisco Chronicle*, June 19, 2005.

<sup>112</sup> Quoted in Robert Fairbanks, “Property-Tax Issue Awaits Legislators,” *Los Angeles Times*, January 2, 1978.

<sup>113</sup> Quoted in Kenneth Reich, “Wilson Taking Warmer View of Tax Initiative,” *Los Angeles Times*, January 6, 1978. Wilson was at the time a candidate for the Republican nomination for governor.

<sup>114</sup> Robert Fairbanks, “Lawmakers Agree on Tax Break for the Elderly,” *Los Angeles Times*, July 19, 1977; Daniel J.B. Mitchell, “Governor Reagan’s Ballot Box Budgeting: One That Got Away,” *Southern California Quarterly*, 89, 195-227; Ray Ripton, “Wrath Turns to Action on Tax Burden,” *Los Angeles Times*, August 21, 1977..

<sup>115</sup> Quoted in Scott Moore, “Schools Await Impact of New Financing Plan,” *Los Angeles Times*, July 24, 1977.

<sup>116</sup> Roger Rapoport, *California Dreaming: The Political Odyssey of Pat & Jerry Brown* (Berkeley, CA: Nolo Press, 1982), pp. 185-189.

<sup>117</sup> Quoted in David Johnson, “Brown Urges Energy, Space Spending,” *Los Angeles Times*, August 2, 1977.

<sup>118</sup> Quoted in Dick Turpin, “Plight of the Newcomer,” *Los Angeles Times*, August 7, 1977.

<sup>119</sup> Quoted in William McPhillips, “Tax Reform Failure Aids Initiative Drive,” *Los Angeles Times*, September 22, 1977.

<sup>120</sup> George Alexander, “Proposed State Use of Satellite Detailed,” *Los Angeles Times*, December 23, 1977.

<sup>121</sup> Quoted in Kenneth Reich, “Brown Sees 2 Ways to Ease Tax Load,” *Los Angeles Times*, January 15, 1978.

<sup>122</sup> Kenneth Reich, “Younger Enters Governor’s Race,” *Los Angeles Times*, February 2, 1978.

<sup>123</sup> Richard Bergholz, “Younger Raps Drafting of Jarvis, Behr Measures,” *Los Angeles Times*, March 30, 1978.

<sup>124</sup> Richard Bergholz, “Davis Says He Will Back Jarvis Initiative,” *Los Angeles Times*, March 9, 1978.

<sup>125</sup> Quoted in Erwin Baker, “City Council Urged to Oppose Jarvis Plan,” *Los Angeles Times*, April 18, 1978.

<sup>126</sup> Jerry Gillam, “Lobbying by Realtors Stalls Tax Relief Bill,” *Los Angeles Times*, February 23, 1978.

<sup>127</sup> Mervin V. Field, “Prop. 13 Margin of Support Dips in Survey,” *Los Angeles Times*, April 12, 1978.

<sup>128</sup> George Skelton and Jerry Gillam, “Legislature Passes Property Tax Relief,” *Los Angeles Times*, March 3, 1978.

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- <sup>129</sup> Ronald L. Soble, "Tax Plans Needed, Post Says," *Los Angeles Times*, April 21, 1978.
- <sup>130</sup> Quoted in Larry Stammer, "State Readying Spending Cuts in Case Prop. 13 Wins," *Los Angeles Times*, May 12, 1978.
- <sup>131</sup> Erwin Baker, "Total Assessed Property Value of L.A. Up 17.5%," *Los Angeles Times*, May 16, 1978.
- <sup>132</sup> Jerry Gillam, "Economic Boom Created Surplus, Fiscal Chief Says," *Los Angeles Times*, June 3, 1978.
- <sup>133</sup> "Results of Poll Please Official," *Los Angeles Times*, May 18, 1978.
- <sup>134</sup> Both the Reagan and Broder quotes appear in Robert Welkos, "Reagan's Advice to Jarvis: Stay Neutral," *Los Angeles Times*, June 30, 1978.
- <sup>135</sup> Quoted in George Skelton, "Brown Asks Aid for Local Governments," *Los Angeles Times*, June 9, 1978.
- <sup>136</sup> Jack Nelson, "Carter Won't Give the State Any Extra Revenue," *Los Angeles Times*, June 20, 1978.
- <sup>137</sup> George Skelton and George Frank, "Brown Vetoes Raises," *Los Angeles Times*, July 6, 2008.
- <sup>138</sup> Gann reportedly acquired the disease through a blood transfusion. State legislation dealing with transfusion safety now bears his name.
- <sup>139</sup> Quoted in Bob Schmidt, "A. Alan Post: The 'Real Tragedy' of the Property Tax Revolt," *Cal-Tax Digest*, March 1998. Available at <http://www.caltax.org/MEMBER/digest/Mar98/mar98-3.htm>.