INTRODUCTION

Even under the best of circumstances, California’s budget is often not in place by the start of the fiscal year on July 1. This year the state came within a day of the record for tardiness, with Governor Davis not signing the budget act until September 5. The pages that follow will describe the constitutional, partisan, economic, and fiscal aspects of the context within which this year’s epic battle was fought as well as the outcome of the struggle. An attempt will be made to explain why the process was especially drawn out this year, and to explore the question of transparency (or the lack of same) in the budget process.

THE CONSTITUTIONAL ENVIRONMENT: GUBERNATORIAL POWER AND LEGAL CONSTRAINT  (For additional information, see Krolak, 1994, chs. 46 and Davis, 2002b, A1)

References to the California state budget usually exclude revenue transfers from the federal government. Not counting this source (which a year ago was projected to add $44.6 billion to the total for FY 2001-02), state expenditures for the budget as adopted for FY 2002-03 came to $98.9 billion. Major portions of this money are not subject to direct annual control by either the legislature or the governor. For the FY 2002-03 budget, $2.8 billion was from the sale of bonds, and another $19.4 billion was from “special funds” earmarked for specific purposes (the largest of which are for transportation). On March 5 voters approved a constitutional amendment that will make permanent a statutory requirement, due to go into effect in FY 2003-04 and which had been due to expire after FY 2007-08, that money from sales taxes on gasoline be used for transportation purposes. Projections are that, in FY 2008-09, this will remove about $1.4 billion in revenue from the general fund. (B. Jones, 2002, 15)

Even much of the “general fund” (which accounted for $76.7 billion) is subject to restriction. The most important is a constitutional mandate that a little over 40% of the general fund must be spent on K-12 and community college education. However pitched and bitter budget battles become, it is only relatively restricted terrain that is being contested.

Since 1922 the state has employed an executive budget, which the governor is required to submit to the legislature each year. The Department of Finance, analogous to the federal Office of Management and Budget, assists the governor in the preparation of the budget. Its head, the Director of Finance, reports to and serves at the pleasure of the governor. As proposed, the Governor’s Budget must be balanced. (Note, however, that this does not necessarily mean that the state will actually end the fiscal year without a deficit.)
The “Governor’s Budget” is introduced in the legislature in January. The Office of the Legislative Analyst, which was created in 1941 as the Legislative Auditor (Blair and Flournoy, 1967, 52) and later served as a model for the Congressional Budget Office, assists the legislature in dealing with the budget. The Legislative Analyst prepares a report on the budget that is submitted to the legislature through the Joint Legislative Budget Committee. As the deadline for approval of the budget nears, the governor submits a “May Revise” to take into account changing economic and political circumstances.

The legislature is supposed to pass the budget (a single measure, unlike the 13 separate appropriations bills passed annually at the federal level) by June 15, giving the governor the remainder of the month to approve it. In relatively placid years the deadlines may be met, or nearly so. In difficult times, struggles over the budget may extend well into the summer. The record was set in 1992, when Governor Pete Wilson finally signed the budget into law on September 6 (California Assembly, n.d.).

As in most states, the governor possesses the item veto – the power to “blue pencil” a line item in the budget by reducing or eliminating it. In California it takes a two-thirds vote of the total membership (not just those present and voting) of the senate and the assembly to override a veto, and so overrides of any veto, including item vetoes, are extremely rare. The legislature must also pass, and the governor sign, any “trailer bills” necessary to bring state law into conformity with the budget just approved.

THE PARTISAN ENVIRONMENT: DEMOCRATIC PARTY DOMINANCE

Traditionally, the “big five” (the governor, the speaker and minority leaders of the assembly, and the president pro tem and minority leaders of the senate) has dominated negotiations over the budget. Even when the governor’s party controls the legislature, leaders of the minority party have had seats at the table because of a constitutional requirement that the budget be approved by two-thirds vote of the total membership of each chamber. Only two other states require a supermajority for passage of the budget. As in California, a two-thirds majority is required in Rhode Island, while Arkansas demands a three-fourths vote. (Council of State Governments, 2000, 260)

In 1994, Pete Wilson cruised to a near landslide victory in his bid for reelection as governor, and Republicans were successful in four of the other six partisan races for statewide office. In legislative elections, Republicans, for the first time since 1968 won a majority of the elections for the assembly and, while remaining in the minority, gained ground in the senate as well. (In any given election year contests are held for all assembly seats and half of those in the senate.) Many observers saw these gains as confirmation of earlier speculation (Fay and Lawson, 1992) that California might be on its way to a Republican realignment.
Instead, the GOP proved unable to capitalize on its success, and instead it began a steady downward slide that continued through the 2000 elections. That year, Democratic presidential candidate Al Gore outpolled his Republican opponent by a 12-percentage point margin, the biggest for a Democrat since 1964. Democrats currently hold every statewide elective office except for secretary of state, and they are only four seats short of a two-thirds majority in the assembly and only one seat short in the senate. Figure 1 shows the Republican share from the 1991-92 legislature through the present of two-party seats (i.e., excluding vacancies, independents, and the one minor party legislator to hold office during this period) in each chamber of the state legislature.

Figure 1: Representation in the California Legislature

![Graph showing representation in the California Legislature](image)

While still technically able to block passage of the budget, the Republican legislative caucuses and their leaders had been able to play only a very limited role in budget negotiations during the first three years of the Davis Administration (1999-2001). With a few substantive concessions to the opposition party, Democrats succeeded in gaining the votes needed to pass a budget by including pet projects for the districts of a handful of GOP members.

The absence of a strong opposition party has not meant that the budget process has been a smooth one. Davis has frequently been at odds with his fellow Democrats in the legislature. Part of his difficulties has been stylistic, based on the governor’s sometimes-imperial manner. Early in his term he remarked of the legislature, “their job is to implement my vision (Gunnison, 1999).” Another part of the difficulty has been disappointment on the part of liberal Democrats over what they have regarded as Davis’s excessive caution in budgetary and other
matters. In particular, there is little love lost between Davis and John Burton, the fiery leader (President Pro Tem) of the senate.

THE ECONOMIC ENVIRONMENT

At one time, California ranked as one of the wealthiest states in the nation. Gradually, and for a variety of reasons, per capita income in the state has, compared to that of the nation as a whole, drifted down to the point where California’s average income has come very close to that of the country generally. At the same time, income polarization is greater in California, which has disproportionate numbers of both millionaires and people living below poverty.

Over the past decade, California has been on an economic roller coaster. In the early 1990s the combined effects of a national recession and the sharp decline of the defense industry hit the state hard in the post-Cold War years. Late in the decade, the state’s economy rebounded sharply, especially as the Silicon Valley came to epitomize the “dot com” boom. Still more recently, the state’s economy has suffered. California shared in the nationwide recession that began early in 2001 and that was exacerbated by the impact of the terrorist attacks of September 11. The state’s economy was also hit by a severe energy crisis that led to rolling blackouts and efforts by states with more abundant and cheaper energy supplies to lure away business. In Silicon Valley, the dot com boom was followed by the “dot bomb” bust.

THE FISCAL ENVIRONMENT: RAPID GROWTH IN RECENT YEARS

Until about twenty-five years ago, California was a high tax state compared to most others. All this changed dramatically with the passage of Proposition 13 (the Jarvis-Gann Initiative) in June 1978. This measure sharply lowered local property taxes. Much of the resulting revenue shortfall was made up by a bailout from the state. The long-term effect of Proposition 13 was to reduce overall levels of government revenue to close to the national average. In the year following passage of Proposition 13, California dropped from 4th to 24th among states in total tax revenues of state and local governments as a proportion of personal income (Wilson, 1998, A30). In FY 1998-99, the most recent year for which comparisons are available, California’s state and local own-source revenue was about 3% higher than the national average as a proportion of personal income (U.S. Census Bureau, 2001, 1,6).

Despite this overall similarity, California’s finances differ in some significant ways from those of other states. As a consequence of Proposition 13, state and local governments derive less of their general revenue from property taxes. On the other hand, California relies more heavily on personal income taxes, and at 9.3% has one of the highest marginal rates in the country. As a result, the fiscal fortunes of the state are tied especially closely to those of its most prosperous residents (Weintraub, 2002; E. Hill, 2002a, 37ff.).
While combined levels of state and local government spending in California are fairly typical of what is found elsewhere, local governments do a larger proportion of the spending. In FY 1998-1999, the last year for which figures are available, local governments in California accounted for 65.1% of direct state and local expenditures, compared to 57.3% for the nation as a whole (U.S. Census Bureau, 2001, 1,6). It would be inaccurate, however, to describe California’s system as decentralized. In FY 1998-1999, net state transfers to local government accounted for 36.4% of all local government revenue in California. In all states, the figure was 29.5%. Proposition 13, in fact, helped centralize budgetary power by making local governments, especially counties and school districts, more dependent on Sacramento.

At the state level, the late 1990s produced a sharp rise in spending levels. Figure 2 shows, for fiscal years beginning with 1990-91, annual changes in personal income and in state expenditures (including general, special, and bond funds). (Numbers for FY 2001-02 are estimates.) In the early 1990s, expenditures declined relative to the economy despite increased tax rates as the recession cut into state revenues, and in FY 1993-94 fell even in absolute terms. From the mid-nineties through the turn of the century, the economy grew rapidly, but was outpaced by the rate of increase in the state budget. These patterns are partly a result of the state’s progressive income tax structure, but short term political factors have also played a role. Note especially the rate of growth in expenditures in the first two years of the Davis administration (FYs 1999-00 and 2000-01). During this period, expenditures grew from $75.3 billion to $96.4 billion, an increase of 28%. This rate of growth slowed to 7% in FY 2001-02 but still sharply outpaced the rate of growth in the state’s economy. (It should be noted, however, that the data in Figure 2 were produced before some mid-year cutbacks in the FY 2001-02 budget.)

Figure 2: The Budget and the Economy
Throughout the winter and spring of 2002, the news just kept getting worse, as readers of the state’s newspapers digested the following comments along with their breakfasts:

- January 9. “The $12-billion budget gap . . . is certain to dominate this election year (Barabak, 2002).”
- February 21. “The Legislature is looking at a shortfall of about $15 billion (J. Hill, 2002a).”
- April 14. “Preliminary estimates indicate that the state’s budget shortfall will be at least $17 billion (Frates, 2002).”
- April 23. “Anemic income tax receipts [will leave] a shortfall of $20 billion or more (J. Hill, 2002b).”
- May 15. “Governor Gray Davis detailed his plan for dealing with a $23.6 billion budget shortfall (J. Hill, 2002c).”

The “shortfall” referred to in these passages represents the difference between anticipated receipts and the expenditures that would be produced by a “baseline” budget containing no policy changes. The Office of the Legislative Analyst provided a breakdown of the final $23.6 estimate of the shortfall as follows: a roughly $6 billion deficit at the end of FY 2001-02, an anticipated gap of about $17 billion between receipts and expenditures in FY 2002-03, and a half-billion dollar reserve fund. According to the Legislative Analyst, the biggest cause of the shortfall was a decline in income tax revenues from capital gains brought about by declining prices in the equities markets (E. Hill, 2002b, 3).

THE BUDGET BATTLE

In the early years of his administration, Governor Davis rode the crest of a surging economy and borrowed a page from President Clinton’s playbook by successfully triangulating between conservative Republicans and a state legislature increasingly dominated by liberal Democrats. By the start of 2002, with an economy that had turned sluggish, this triangle looked more like a tight box for the Governor. In his State of the State address on January 8, Davis pledged that the budget he would submit “will not increase taxes.” (Davis, 2002a) His words were carefully parsed by observers, who noted that, while the budget Davis submitted did not include increased taxes, it did propose increases in various fees (Tamaki, 2002b). They also pointed out that, while pledging that he “will not increase taxes,” he did not say that he would stand in the way of a tax increase (Tamaki, 2002a; Morain, 2002a; Schnur, 2002; Skelton, 2002).

At various times during the ensuing legislative struggle, Democrats proposed closing the budget gap through one or another form of major tax increase. Senate President Pro Tem John
Burton argued for raising the marginal income tax for individuals earning over $130,000 per year and couples earning more than $260,000. Another plan called for restoring cuts made in recent years in the motor vehicle registration tax. Still another would have raised state taxes on a pack of cigarettes from eighty cents a pack to three dollars, the highest rate in the country outside New York City. Republicans staunchly resisted all of these proposals, arguing for closing the gap entirely through spending cuts, though they were not specific as to where these cuts should be made.

On June 29, it appeared that the Democrats had achieved a breakthrough. Joined by a lone Republican defector, Maurice Johannessen, they were able to muster the minimum 27 votes needed to pass a budget in the Senate. They succeeded in wooing Johannessen in the usual fashion. A women’s prison in his district was spared the budget ax, support for a new home for military veterans in the district was agreed to, and the proposal to raise the marginal income tax rate was abandoned (Walters, 2002a). If Assembly Democrats could win over just four Republicans in like fashion, the battle would be over.

From there on, however, Republicans refused to follow the script of recent years. Senate Republicans summarily expelled Johannessen from the party caucus (Tamaki, 2002d). Throughout the summer, the Republican Caucus in the Assembly maintained strict party discipline. There was even speculation that the legislature might adjourn at the end of its regular session without a budget, leaving the issue hanging until a “lame duck” session could be convened after the November elections. Finally, on the last day of the regular session at the end of August, the parties reached a compromise agreement. With the tacit blessing of Republican leaders (J. Hill, 2002d), four Republicans joined with Democrats to pass the budget by the minimum vote required. The measure sent to Governor Davis included deeper cuts than the Democrats had wanted, while Republicans reluctantly agreed to some “revenue enhancements.” Long-term problems in the budget were put off for future legislatures to confront.

As finally signed into law, the budget (including the general fund, special funds, and bonds) totaled $98.9 billion, a drop of 2.4% from the previous year. In the general fund, the budget’s largest component, the sharpest reductions were for health programs, corrections, and the University of California. K-14 education and social services received modest general fund increases (E. Hill, 2002b, 7, 9).

A total of $7.5 billion, or about a third of the $23.6 billion budget gap discussed earlier, was made up through “program cost savings,” that is, various reductions in spending compared to a baseline budget. Another $2.9 billion was made up through “revenue increases,” the largest of which was produced by deferring $1.2 billion in allowable business deductions. Another $5.6 billion was obtained through increased borrowing (mostly against future revenues from litigation against tobacco companies to which California was a party). $4.8 was realized through shifting of funds, and $1.7 resulted from delays in education reimbursements to local governments. Finally, the budget assumed an increase of $1.1 billion in federal assistance (E. Hill, 2002b, 4ff.).
The budget agreement was greeted with sighs of relief, but little enthusiasm. Only one legislator (a termed-out Democratic Assemblyman) was present to witness the decidedly low-key ceremony at which Davis signed the budget into law (Morain and Jones, 2002).

There are probably several reasons why the process took so long this year. A general explanation is simply that it is harder to accept pain than prosperity, and thus harder to make budget decisions in bad times. An explanation more specific to 2002 is that the members of the “big five” had their own reasons for not playing their usual lead roles in negotiating an agreement (Cox, 2002; Keeley, 2002; Morain, 2002b; Tamaki, 2002c). Ever the cautious politician, Governor Davis tried to stay above the fray and as much as possible keep his fingerprints off the budget document. Republicans, on the other hand, reasoned that the longer they could postpone resolution of the crisis, the more they could embarrass the Democratic majority and governor.

Finally, term limits, the demise of the blanket primary, and the recent redistricting of the legislature combined to reduce incentives for compromise on both sides of the aisle.

- Some Republican legislators facing term limits had little to gain by obtaining a few “pork barrel” projects for their constituencies. Those with future political ambitions might have been reluctant to incur the party’s wrath in exchange for such inducements, especially after the abject lesson the party made of Johannessen.

- In 1996, California adopted a blanket primary in which voters, regardless of party registration, could vote for any candidate for any office. Following the 2000 primary, however, the U.S. Supreme Court declared the blanket primary unconstitutional because it violated the parties’ freedom of association. Since then, legislation has been adopted allowing parties to permit independent (“decline to state”) voters to vote in their primaries. Both major parties now accept this practice. While it was in effect, the blanket primary seems to have made little difference in most races, but in a couple of Republican Assembly contests crossover voters did provide the margin of victory for moderate candidates facing more conservative opponents. Now that the party faithful will again dominate the primaries, candidates of neither party have much incentive to move toward the center to attract centrist voters.

- The redrawing of legislative districts in California following the 2000 census was a classic bipartisan gerrymander, leaving almost all seats safer for the incumbent. In the years ahead, many legislators may be more likely to face challenges from within their own party in the primary than effective opposition in the general
election. According to Republican political analyst Tony Quinn, one legislator explained his unwillingness to compromise by saying, “Look, I can’t afford to cross my primary voters; they demand that I hang tough (Quinn, 2002).” Democratic consultant Bill Carrick remarked that “If the only thing legislators represent is safe districts, there is no push to the middle. All they do is pander to their base (Chance, 2002).” This may have left Democrats even less willing to accept spending cuts and Republicans even more opposed to tax increases (Walters, 2002b).

LACK OF TRANSPARENCY: A MAGIC ACT, OR A CIRCUS?

Although the budget signed into law on September 5 on paper closed the gap between receipts and expenditures, commentators have remarked that this has been accomplished only with “blue smoke and mirrors.” Many were quick to point out that much of the closing of the budget gap was either short-term (such as borrowing money or deferring payments and deductions), or illusory (such as fund shifting or assuming additional help from Washington). Some were already predicting that the state will face another $20 billion deficit when Davis submits his FY 2003-04 budget in January (Morain and Jones, 2002).
All of this raises the question of budget transparency. Is the public being fooled by legerdemain on the part of Sacramento magicians? Undoubtedly some of this does take place. However:

- Legislative slight of hand is probably less prevalent in the highly visible budgetary process than in the passage of ordinary legislation. The annual battle over the budget is one of the few occasions when the media give the state legislature the level of scrutiny usually reserved for car chases and warehouse fires. On the other hand, the legislature passed over 1,200 bills in the final days of the 2002 session (G. Jones, 2002), some of them containing stealth provisions not likely to appear on the public radar screen.

- Passing an almost $100 billion budget is an inherently complicated process.

- As part of California’s Progressive Era legacy, the state constitution is riddled with provisions enacted by initiative that severely constrain taxing and spending decisions by elected officials.

- Because of the technical requirements imposed by a convoluted and fragmented budget process, much of what transpires is less a magic act than a circus that features a great deal of juggling and acrobatics.

A NOTE ON SOURCES

The Governor’s Budget and related documents are available in PDF format at the Department of Finance web site (http://www.dof.ca.gov). Critiques of the budget by the legislative analyst, also in PDF format, are available on the web site of the Office of the Legislative Analyst (http://www.lao.ca.gov). References to articles in the Sacramento Bee are to the final edition. References to articles in the Los Angeles Times are to the Orange County edition.

REFERENCES


Walters, Dan (2002b). “With Legislative Seats Guaranteed, Budget ‘Drills’ Make Little Sense.” Sacramento Bee. 11 August.

