

# **GOVERNMENT BY (HOT) CHECKS AND (IM)BALANCES:**

**CALIFORNIA'S STATE BUDGET  
FROM THE MAY 2009 VOTER REJECTION  
TO THE OCTOBER 2010 BUDGET DEAL**

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This chapter was completed in late October 2010  
and contains information only up to that date.

"We don't have to worry about going off the cliff; we're already there."

—state senator Bob Dutton  
vice chair of the Senate Budget Committee<sup>1</sup>

"...California has defied its prophets of doom before, recreating and renewing itself...I hope it does so again — for the country's sake as well as California's. But I have my doubts."

—John B. Judis, senior editor for *The New Republic*<sup>2</sup>

In prior editions of *California Policy Options*, as well as other publications, I have traced the travails of the California budget during the first decade of the 21st century. That period was noteworthy because of the 2003 recall election and the replacement of incumbent Governor Gray Davis by Arnold Schwarzenegger. In the 2010 edition of *California Policy Options*, I noted the contrasting personalities of those two governors and the paradoxical fact that despite the contrasts, both personality types led to a similar result.

Davis, the micro-manager, tended to be overextended to the point that warnings of crisis (in his case, electricity deregulation and budget) were ignored until events overwhelmed him. Schwarzenegger, who as governor loved championing "big picture" causes but was unconcerned about details, also missed warning signs. (In his case, the signs were the darkening budget outlook and its implications for his universal state health care proposal until it was too late.) As it turns out, too much micro-management and too much macro-management lead to unfortunate consequences.

In chapters in earlier *California Policy Options* editions, I also drew lessons from gubernatorial administrations that predated the Davis-Schwarzenegger era. Surprisingly, the governor most like Schwarzenegger in his appetite for both "big picture" identification and celebrity attention was Jerry Brown, first elected in 1978 and a renewed candidate for governor in 2010. Brown missed the growing momentum behind Proposition 13. In fact, he inadvertently contributed



to that momentum by building a huge state reserve at a time that property taxes were zipping upward. As a result, Brown ended his second term leaving a major fiscal crisis to his successor, George Deukmejian. In turn, Deukmejian—reelected in 1986 on a record of turning around state finances—left a major fiscal crisis at the end of two terms to his successor, Pete Wilson.

The fact that California's budget has had its ups and downs despite varying gubernatorial leadership styles and varying political institutions has led some observers to view the state's budgetary problems as simply a reflection of the national business cycle. After all, other states' fiscal problems have also corresponded to the business cycle. But across these states there are different institutions and political personalities.

In that view, California's famed dysfunction is just a matter of the state's size and prominence. It is no more dysfunctional than lower profile states; it is just noticed more. But while the national business cycle is obviously a key element in the fiscal problems of all state and local governments, California sported the lowest bond rating among the states in 2010. Only California handed out registered warrants (IOUs) rather than pay all its bills in 2009. While the business cycle poses similar challenges to all states, there is differentiation when it comes to the ability to make needed decisions to cope with those challenges. Some of California's inability to make necessary decisions on the budget quickly comes from institutional arrangements in the state. But in the background is the painful reality that California has yet to internalize the transition after 1990 from a state economy that had been given a federal push during three hot wars and the Cold War.

## UNDERLYING CAUSES

*"I don't think we have enough time to tell you the amount of things I didn't know, because there is no school for governors."*

—Governor Arnold Schwarzenegger asked in 2010 about what he knew about governing when elected in the 2003 recall <sup>3</sup>

*"Whenever we have a problem, everyone makes a big drama — 'Oh, my God, it's the end. California is over.' It's all bogus."*

—Governor Arnold Schwarzenegger <sup>4</sup>

In last year's budget chapter in *California Policy Options* I argued that there is indeed an underlying cause of California's fiscal dysfunction but that it goes beyond the business cycle. Most importantly, California's economic growth has two important inflection points. California underwent a notable growth acceleration after 1940 and a major deceleration in 1990s. The first date (1940) corresponds to the military expansion sparked by World War II and then continued by the Cold War (along with the Korean and Vietnam hot wars).

Military-related expenditures fueled state growth which in turn contributed to ongoing tax revenues that could be used for infrastructure construction (roads, water projects) as well as schools and higher education facilities. But rapid population growth eventually sparked environmental sensitivities and resistance to density pressures, a formula for rising property values. The resulting escalation of property taxes gave rise to Prop 13 and the accompanying tax revolt in 1978.

The second inflection point (1990) marked the end of the Cold War. It left California's with a more normal growth trend relative to the rest of the U.S. But California had a legacy of expectations for public services built on the earlier super-normal growth path. At the same time, the

tax revolt had limited the public's willingness to divert income to pay for such services.

Despite being a center of the dot-com boom of the late 1990s and then the housing/mortgage boom of the 2000s, California—even at the peaks of those booms—never get back to its old growth path. And the mismatch of expectations for services based on super-normal growth and tax receipts based on normal growth has led to repeated crises. During boom periods, the added tax receipts tend to be sucked into ongoing programs rather than put aside for “rainy days.” During slumps, what fiscal experts term the state's “structural” deficit quickly turns into a crisis. The most recent such crisis began to develop in fiscal year 2006-07.

Because other states have experienced budgetary problems in the latest economic slump, and because each state has different institutions, some observers have argued that the usual suspects in California—ballot-box budgeting, term limits, the two-thirds vote rules for passing budgets and taxes, Proposition 13 of 1978, dependence on the volatile state income tax, gerrymandered districts, etc.—are not the culprits. That is a mistake. What matters in California is the above-mentioned post-Cold War inflection *combined with* the usual suspects.

All states will experience negative budgetary consequences of a general downturn. But what is important is their ability—in the face of a downturn—to make decisions and rapid adjustments. States do not have the federal government's seeming ability to run large deficits over prolonged periods without consequences. Different states may have different institutions that either aid or impede such decisions and adjustments. California has developed a system that impedes.

California combines its structural deficit problem with a sequence of unintended consequences. Its direct democracy has become self-reinforcing. Governors

may decry ballot-box budgeting. But as candidates they can (and do) benefit by endorsing ballot initiatives.<sup>5</sup> Arnold Schwarzenegger himself began his political career in 2002 by promoting Prop 49, earmarking a portion of the General Fund by formula to after-school activities.<sup>6</sup> Governors—including Schwarzenegger—are tempted to take budgetary issues to the people directly when they become frustrated with the legislature.

Prop 13's political effects in many respects were more important than its cut in property taxes. It gave rise to an industry of ballot initiative pushers. In its wake, voters passed the so-called Gann Limit as part of the taxpayer revolt. Gann triggered tax rebates in the late 1980s. That development led the California Teachers Association and the education establishment successfully to enact Prop 98 in 1988 and a subsequent initiative which by complex formulas gutted Gann and channeled roughly 40% of the General Fund to K-14 education.<sup>7</sup>

Direct democracy was adopted by Californians in 1911 as an alternative form of lawmaking. It is inherently a process that weakens the authority of the legislature. Indeed, it was enacted precisely because early 20th century reformers viewed the state legislature as corrupt. The problem is that a weakened legislature, particularly one constrained by formulas and rules, is a slow deliberator. Frustration over legislative inaction leads to further voter weakening of the legislature, notably the adoption of term limits in 1990. But a legislature composed of amateurs and members focused on their next political office is not effective in dealing with crises. The result is more public frustration with the legislature.

Gubernatorial candidates will naturally promise to fix the problems of the state but their proposed fixes often require legislative action. A weak legislature thus leads to weak governors and more public disappointment and frustration with their chief executive. Governors can't always deliver what they promise—particularly

if they promise too much. Moreover, any realistic fixes necessarily involve unpleasant trade-offs.

For example, do you want to have a less volatile tax base for California? Then you must shift from heavy reliance on income and corporate taxes toward the less-volatile sales tax in some form. But if you do, you will make the tax system more regressive. You can try to disguise that impact. That approach was taken by the Commission on the 21st Century Economy appointed by the governor and legislature tried to do, by proposing to substitute a variant of a European-style value-added tax.<sup>8</sup> But such a tax, in the end, is a complicated sales tax. Not surprisingly, the Commission's recommendation is now buried in the state archives.

Reports that came out after the Commission's recommendations suggested that the proposal of a value-added variant was a pet project of the Commission chair.<sup>9</sup> In keeping with California's progressive tradition, the Commission was chaired by someone who did not hold elective office. As a result, the Commission's final document was a political nonstarter; it was dead on arrival. But even a more practical set of recommendations would have involved unpleasant trade-offs.

## RECAP: THE BUDGET STORY IN THE SCHWARZENEGGER ERA

*"California, it has long been claimed, is where the future happens first. But is that still true? If it is, God help America."*

—columnist and Princeton professor Paul Krugman<sup>10</sup>

*"People have been declaring this place on the brink of extinction for decades."*

—San Francisco mayor Gavin Newsom, comment on California when he was a candidate for governor<sup>11</sup>

Governor Schwarzenegger's priorities after he was first elected in 2003 shifted on an annual basis. Immediately after the 2003 recall and into 2004, the focus was on the state budget crisis left by predecessor Gray Davis. By that time, the California economy and budget situation was improving. However, a large short-term debt had accumulated under Davis which had to be rolled over regularly and at high interest rates.

Essentially, Governor Schwarzenegger adopted the plan that Davis had been proposing of refinancing the short-term debt on a long-term basis. Under the state constitution, borrowing long-term requires a popular vote. Moreover, such borrowing is not supposed to take place to finance ongoing state operations; rather, it was reserved for one-time infrastructure-type projects.

Davis had proposed a legally-questionable process to skirt these constitutional requirements but this avoidance would probably have undermined the plan in practice. It was hard to see how a long-term refinancing bond could be successfully floated, given the legal cloud. Who would buy a bond whose issuance might be ruled

illegal by a subsequent court decision? In such an event, the bond might be worthless, even if the state had the ability to make the contracted payments.

Schwarzenegger, taking advantage of his post-recall popularity, proposed two voter propositions aimed at approving the borrowing and amending the constitution to allow a one-time exception to the rule about ongoing operations. Sold as a bipartisan and unique fix—after which the state would “throw away the credit card”—his propositions 57 and 58 were approved in 2004. With the Davis budget debt legacy out of the way, Schwarzenegger could focus on other matters.

In 2005, Governor Schwarzenegger promoted a series of initiatives in a special election he called as part of what was dubbed the “Year of Reform.” Of four initiatives that ended up on the ballot, two seemed aimed at public-sector workers and unions, especially teachers. Only one dealt with the budget. A third proposed a process for neutral redistricting.

The four propositions of 2005 never seemed to be a coherent package. Indeed, the process of drafting them suggested that the governor just wanted to enact “reforms,” regardless of specific content. The upshot was that vast amounts were spent—especially on TV ads—pushing the pro and con sides in a special election—with the con side raising substantial monies.<sup>12</sup> Ultimately, all four initiatives were soundly defeated. At the same time, the governor’s popularity tanked. The public preferred the image of the cooperative governor working with the legislature to deal with the Davis debt legacy to the combative governor seeking to circumvent the legislature with diverse ballot propositions.

Faced with the 2006 gubernatorial election year, Governor Schwarzenegger switched from reform to infrastructure, albeit infrastructure to be financed by borrowing. The idea of reducing traffic congestion at no (immediate) cost carried the day and roughly \$40 billion

in bonds were authorized. The governor apologized to voters in his January 2006 State of the State address for the controversy he had created over his 2005 reform initiatives. There had been a “message received” from the voters, he proclaimed, and henceforth he would work with the legislature to solve California’s problems. With the economy improving and the appeal of new infrastructure, Schwarzenegger won reelection handily over Democrat Phil Angelides, the state treasurer.

In 2007, the governor’s centerpiece became a state universal health care plan, modeled loosely after a plan previously adopted in Massachusetts (and which became the general model for the Obama plan of 2009-10). However, having tossed the general idea of a state health plan to the legislature, the governor became involved in other environmental issues, even to the point of addressing the U.N. The health care plan did not take serious legislative form, i.e., a bill endorsed by the governor, until late 2007.

By that time, the state budget situation was deteriorating and the economy was weakening. In fact, the Legislative Analyst’s Office put the start of the Great Recession in California in the third quarter of 2007, somewhat ahead of the official dating of the slump for the U.S. as a whole.<sup>13</sup> The plan passed in the state Assembly but, despite a celebration following its lower-house passage, the governor’s health agenda was derailed in the Senate in early 2008 over budget concerns. From then on, the budget became the overwhelming issue in California.

A stalemate of (then) record duration left the state without a budget from July 1, 2008 until late September. At that point, a budget was passed but one widely known to be unsustainable. The result was a required mid-course redo of the 2008-09 budget in February 2009, combined with a new budget for the 2009-10 fiscal year.

Budgets and tax increases in California required a two-thirds vote in legislature and the Democrats had a majority—but not two-thirds in both houses.<sup>14</sup>

Eventually a deal was struck with a few Republicans thus allowing temporary increases in income, sales, and car taxes.<sup>15</sup> The Republican leaders in both houses were soon deposed by their GOP colleagues for making this accommodation.

In addition, a major recall effort was unsuccessfully mounted against an accommodating Republican assemblyman from southern California. Despite the formal failure of the recall, he chose not to run for reelection.<sup>16</sup> The only accommodating Republican who gained anything was state senator Abel Maldonado. He was nominated by the governor to fill a vacancy in the lieutenant governor position and—after a considerable delay and political manipulation—was eventually confirmed.<sup>17</sup>

Part of the February 2009 budget-revision deal involved putting a series of propositions on the ballot in a special election held in May. These ballot measures would allow voters to extend the newly-enacted tax increases beyond their scheduled sunset dates. And, if passed, the ballot propositions would divert otherwise earmarked revenues from mental health and early childhood services into the state's general fund. Borrowing against the state lottery would also have been authorized.

Voters rejected all of the substantive propositions in May 2009. Only one proposition—a meaningless slap at the legislature designed to attract support to the others—was enacted. At the same time, the revenue picture for the state continued to deteriorate due to the financial and housing bust/mortgage crisis that had begun to unfold in 2008.

Finally, 2010 was a gubernatorial election year as well as an election year for other state and legislative offices. Governor Schwarzenegger had become a lame duck, reducing what leverage he had in enacting a budget for 2010-11. Candidates began to emerge for the June 2010 primary in both parties.

Only one—Republican gubernatorial candidate Tom Campbell, a former budget director under Schwarzenegger—was willing to talk about a tax increase (the gasoline tax in his case). But Campbell eventually dropped out of the primary race for governor and shifted to the US Senate primary contest (and lost).<sup>18</sup> Attorney General and former governor Jerry Brown did not officially become a Democratic candidate until late in the game. But he suggested—as an unofficial candidate—that he was against tax increases.

More specifically, he indicated he would not propose tax increases *but* allowed that voters might enact them through ballot propositions. That stance suggested that—if elected—he might be planning to take budget-related issues directly to the electorate. Mostly, however, Brown was silent and just let the campaign contributions flow in. Since it became more and more likely that he would be running in the general election against a self-funded billionaire, Meg Whitman, Brown did not want to say anything that would put him at a further disadvantage.

San Francisco Mayor Gavin Newsom, who became a gubernatorial candidate but later shifted to the lieutenant governor race, was not specific about what he would do about the budget. Mainly he hoped that his mayoral record in San Francisco (which included kicking off the gay marriage agenda by marrying couples in City Hall despite state law—and a sense that he was Internet/high-tech savvy) would bring him the nomination. And he succeeded in obtaining the Lieutenant Governor nomination in the June 2010 Democratic primary to run against Maldonado.

Los Angeles mayor Antonio Villaraigosa was reported to be considering running for governor but decided against a run as his city's own budget situation deteriorated. Republican businesswoman Meg Whitman and insurance commissioner Steve Poizner—the surviving GOP candidates in the primary after

Campbell departed—focused initially on cutting state government employment. But much of what the state does is pass money to local governments so that large savings could not come from trimming that part of the state bureaucracy supported by the General Fund. Later, both Republicans came out with more detailed plans, neither of which involved tax increases. And much of their primary contest revolved around social issues such as immigration and gun rights.

As the victor in the Republican primary, Whitman softened her stance on immigration—provoking anger on the right. She was berated by Los Angeles AM radio hosts “John and Ken” for a seeming betrayal of the primary voters. But by that time, she was the candidate. The immigration issue resurfaced a few weeks before the general election when a former illegal immigrant housekeeper filed a claim against Whitman. Ostensibly, the claim involved a little over \$6,000 in back pay. However, the main element of “housekeepergate” involved the longtime employment of the woman involved and a subsequent seemingly unfeeling firing.<sup>19</sup>

Whitman continued to spend generously on her campaign demonstrating a willingness to spend that suggested a ballot-box strategy for her program if she won. That is, since her positions on the budget and other matters would likely not win the favor of a majority in the legislature, she could finance an initiative campaign. While that possibility evoked memories of Governor Schwarzenegger’s failed “Year of Reform” campaign in 2005, presumably she could outspend opponents in such a contest.

## RECAP: THE NUMBERS

*“We have been put through a stress test right now, and we have failed.”*

—Governor Arnold Schwarzenegger on  
The Tonight Show with Jay Leno<sup>20</sup>

*“Californians deserve a better system of governance, and this one is a failure... There has to be a better way...”*

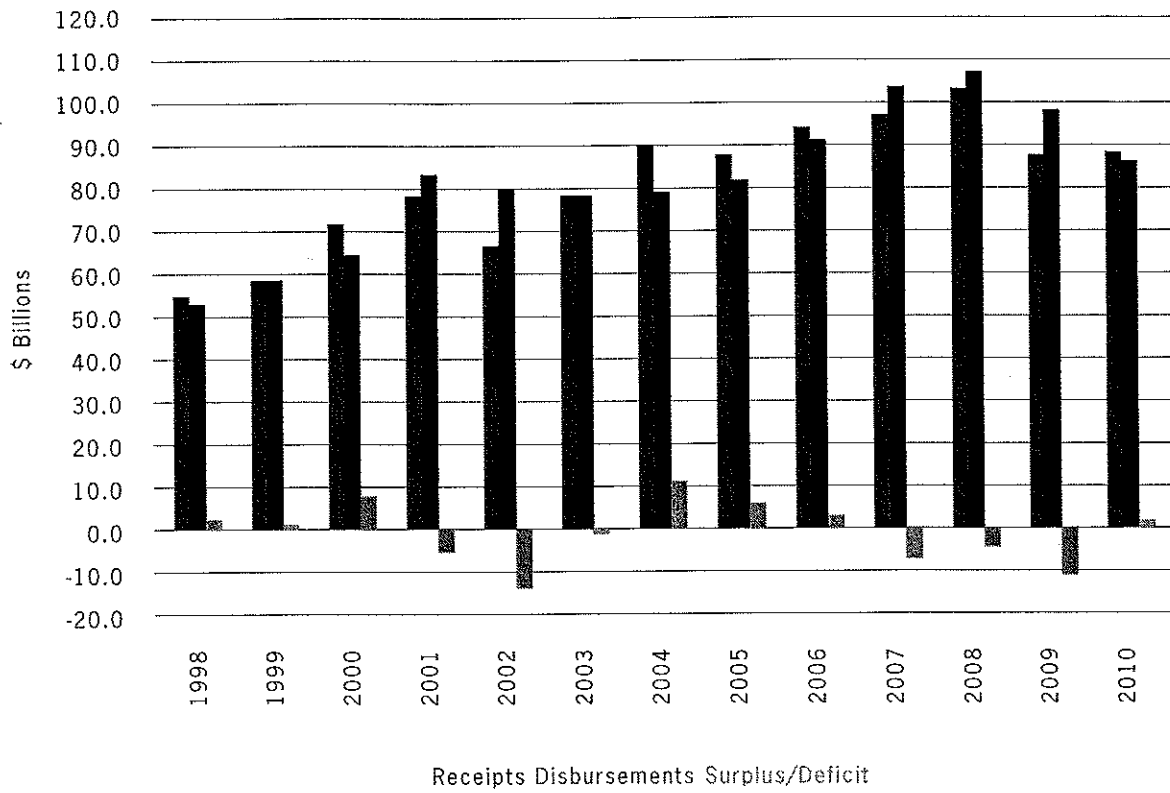
—Jim Wunderland, president of the Bay Area Council  
calling for a Constitutional Convention<sup>21</sup>

**Charts 1, 2, and 3** summarize the inflows and outflows to the General Fund from the late 1990s through the fiscal year ended June 30, 2010. Cash flow reports, available from the state controller, reflect the after-the-fact outcomes of budgets as opposed to budget projections and forecasts made when budgets were proposed or enacted. However, like budget documents, the cash flow reports tend to treat borrowing as revenue and saving as expenditure. **Chart 1** shows the officially reported receipts and disbursements. **Chart 2** makes a crude adjustment by removing transfers in and out of funds outside the General Fund. Such transfers often reflect borrowing and saving. **Chart 3** directly compares surpluses and deficits on the official and adjusted basis.

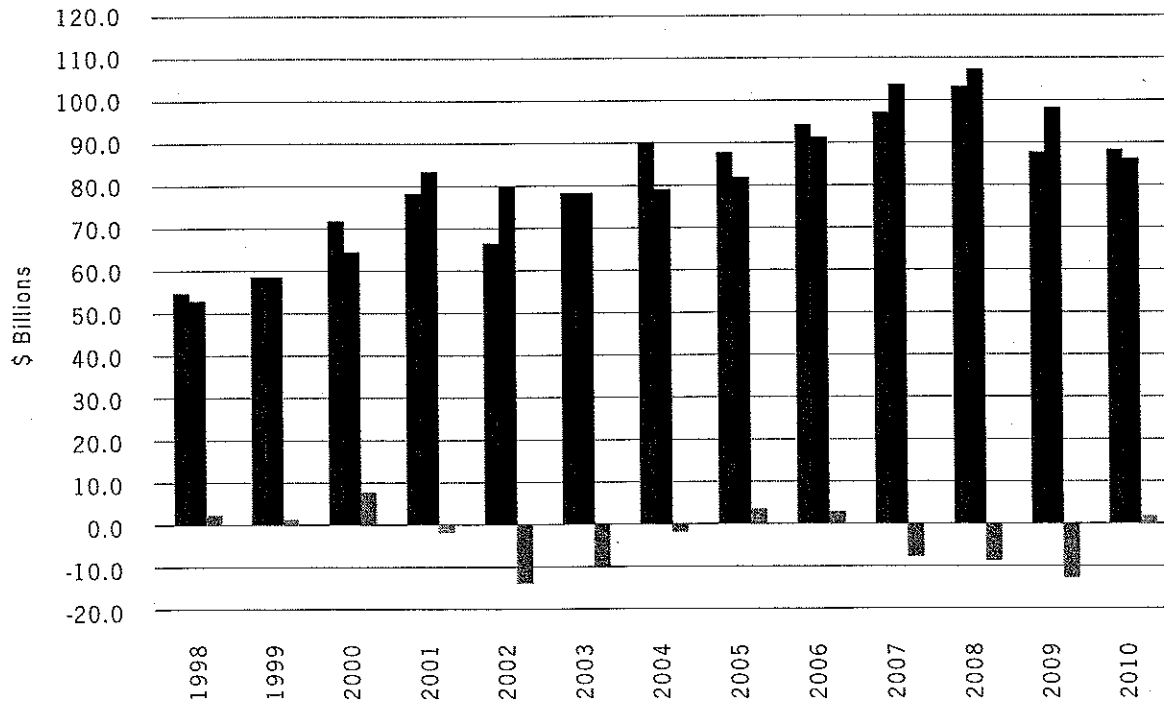
The official numbers are especially clouded by the electricity crisis of the early 2000s which led the state to buy electricity for its bankrupt and semi-bankrupt private utilities. Initially, the General Fund bore the expense but it was ultimately reimbursed by a bond issue (paid for by utility consumers). The adjusted figures show the deficit at the peak of the business cycle during fiscal year 2000-01. They also show the budgetary recovery that was underway at the time of the 2003 recall. The worsening budget situation that was developing in 2006-07 is also apparent.



**Chart 1. California General Fund: Official Cash Flows Fiscal Years Ending June 30**

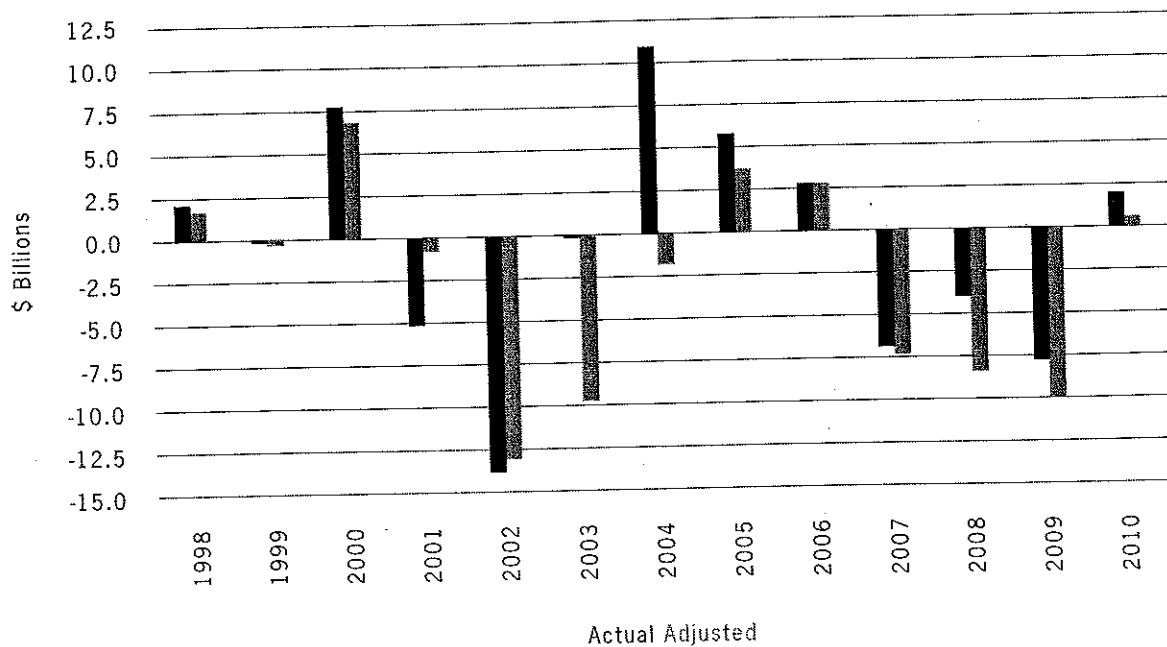


**Chart 2. California General Fund: Adjusted Cash Flows Fiscal Years Ending June 30**



Source of Charts: June monthly cash statements of the California State Controller.

**Chart 3. California General Fund Official vs. Adjusted Surplus or Deficit: Fiscal Years Ending June 30**



Source: June monthly cash statements of the California State Controller.

A combination of spending cuts and temporary tax increases, as well as a variety of one-time borrowings and diversions from other funds, improved the fiscal condition of the General Fund in 2009-10. However, the tendency of "workload" expenditures to rise and the playing out of one-time solutions created difficult challenge for 2010-11. Moreover, the voter rejection of the revenue generating elements in the special election of May 2009 made it unlikely that the electorate would come to the rescue with more taxes in 2010-11.

As **Tables 1** and **2** show, Governor Schwarzenegger's popularity ratings have risen and fallen with the budget situation. Indeed, the governor he most resembles in that regard is his predecessor Gray Davis, who he replaced in the 2003 recall. Both Davis and Schwarzenegger started with highly favorable ratings and ended as unpopular. The main difference is that

Schwarzenegger had a notable dip during his ill-fated "Year of Reform" in 2005. Davis' favorable ratings followed an inverted U pattern.

By late November 2009, Governor Schwarzenegger was booed when he appeared at Hollywood Park racetrack to honor a winning horse. The irony was that Schwarzenegger remained popular in 49 of the 50 states, California being the exception. He remained a sought-after national TV guest. In late April 2010 on *The Tonight Show with Jay Leno*, the governor said that "without a doubt" he would like to run for president were it not for his constitutional ineligibility due to foreign birth.<sup>22</sup> Governor Schwarzenegger also used the Leno show to announce his above-mentioned nomination of Abel Maldonado for lieutenant governor. These TV appearances suggest Schwarzenegger's continued national popularity outside California.

**Table 1. Trend of Arnold Schwarzenegger's overall job performance as governor (among registered voters)**

	Approve	Disapprove	No opinion
September 2010	23%	68	9
July 2010	22%	70	8
March 2010	23%	71	6
January 2010	27%	64	9
October 2009	27%	65	8
Late-April 2009	33%	55	12
March 2009	38%	54	8
September 2008	38%	52	10
July 2008	40%	46	14
May 2008	41%	48	11
December 2007	60%	31	9
October 2007	56%	32	12
August 2007	57%	31	12
March 2007	60%	29	11
September 2006	48%	37	15
July 2006	49%	40	11
May 2006	41%	46	13
April 2006	39%	47	14
February 2006	40%	49	11
October 2005	37%	56	7
August 2005	36%	52	12
June 2005	37%	53	10
February 2005	55%	35	10
September 2004	65%	22	13
August 2004	65%	22	13
May 2004	65%	23	12
February 2004	56%	26	18
January 2004	52%	27	21

**Party registration (Sept. 2010)**

Democrats	21%	71	8
Republicans	23%	65	12
Non-partisans/others	26%	67	7

Source: California Field Poll, <http://field.com/fieldpollonline/subscribers/Ris2357.pdf>

**Table 2. Comparing Governor Schwarzenegger's lowest and highest approval ratings with his six immediate predecessors**

	Approve	Disapprove	No opinion
<b>Schwarzenegger (R)</b>			
Lowest – March 2010	23%	71	6
Highest – September and August 2004	65%	22	13
<b>Davis (D)</b>			
Lowest – August 2003	22%	70	8
Highest – February 2000	62%	20	18
<b>Wilson (R)</b>			
Lowest – September 1992	33%	63	4
Highest – February 1991	52%	27	21
<b>Deukmejian (R)</b>			
Lowest – August 1990	53%	45	2
Highest – August 1985	73%	24	3
<b>J. Brown (D)</b>			
Lowest – April 1980	38%	61	1
Highest – March 1976	69%	25	6
<b>Reagan (R)</b>			
Lowest – August 1971	46%	52	2
Highest – February 1969	60%	33	7
<b>P. Brown (D)</b>			
Lowest – October 1961	35%	50	15
Highest – June 1959	51%	22	27

For measures conducted prior to 1994, original surveys used a five-point response scale which was converted to the current two-point approve/disapprove scale for comparative purposes. (D) denotes Democrat. (R) denotes Republican

Note: Governor Schwarzenegger's rating fluctuated in the 22-23% range during the period March – September 2010. See Table 1.

Source: California Field Poll, <http://field.com/fieldpollonline/subscribers/Ris2333.pdf>

Bond ratings, of course, are not directly reflective of political popularity but do reflect fiscal conditions. California had low ratings when Davis was recalled in the midst of the budget crisis, experienced a ratings rebound as the budget picture improved, and ended the period shown on **Table 3** roughly with ratings where they were at the recall. By the time voters rejected the substantive budget-related propositions in May 2009, California had the lowest bond ratings of any state.

**Table 3. Ratings of California General Obligation Bonds**

Fitch	Date	Rating
	April 2010	A*
	July 2009	BBB
	June 2009	A-
	March 2009	A
	June 2006	A+
	July 2005	A
	September 2004	A-
	December 2003	BBB
	December 2002	A

Moody's	Date	Rating
	April 2010	A1*
	July 2009	Baa1
	March 2009	A2
	May 2006	A1
	July 2005	A2
	May 2004	A3
	December 2003	Baa1
	August 2003	A3

Standard & Poors	Date	Rating
	January 2010	A-
	February 2009	A
	May 2006	A+
	August 2004	A
	July 2003	BBB

Source: California State Treasurer, <http://www.treasurer.ca.gov/ratings/history.asp>

Below, I pick up the budget story from the May 2009 voter rejection through the eventual adoption of a budget—after a record delay—in October 2010.

## AFTERMATH OF THE MAY 2009 ELECTION: VIEW FROM D.C.

*"Obviously the situation in California is serious. There are crises of different proportions in different states and California is obviously at the front of the list."*

—David Axelrod, senior advisor to President Obama <sup>23</sup>

*"...Washington will probably have to intervene sooner or later. There can be no American recovery if California collapses."*

—commentator and Schwarzenegger biographer  
Joe Mathews <sup>24</sup>

In the initial days after the May 2009 rejection/ election, the governor took the position that the electorate (or at least the 28.4% of registered voters who participated)—by turning down the tax extensions and budgetary diversions simply wanted sharp cuts in spending. Various drastic proposals were made such as cutting the length of the school year, cutting children's healthcare, phasing out Cal Grants (for college students), essentially ending state "welfare" (CalWorks), and cuts in prison funding (despite federal court mandates to do the opposite). To the extent that Governor Schwarzenegger was willing to consider new revenue sources, they tended to be controversial, e.g., new offshore oil drilling—a sensitive environmental issue—in exchange for oil lease payments. (Later, after a major off-shore oil spill in the Gulf of Mexico, he dropped that proposal.)

An interesting question, given the unpalatable nature of Governor Schwarzenegger's proposals, was whether he was really trying to draw in federal aid rather than make such cuts. Overall, his reported savings—if all proposals were enacted—would have saved \$3.1 billion in the soon-to-end 2008-09 fiscal year, \$20.8 billion in 2009-10, and \$18.6 billion in 2010-11, relative to a "workload" projection.<sup>25</sup> The cuts in "welfare" type programs such as Medi-Cal would actually cost the state—but not the state *budget*—more in federal matches than they saved.

Some of the proposed solutions involved diverting funds from local governments, leading to outcries from those sources. Apart from the diversions, cuts of the magnitude the governor proposed were sure not to be approved by the legislature. But the cuts did call national attention to the plight of California's budget.

There may well have been a calculation that rather than see sick children cast into the streets in California, the Obama administration would be forced to come to the rescue. After all, in late March 2009, President Obama had made a speech announcing a federal guarantee of repairs on cars purchased from the bailed-out GM and Chrysler corporations. "Your warranty will be safe," he said, "because starting today the United States will stand behind your warranty."<sup>26</sup> Might the President not do the same for holders of California state and local municipal bonds, if not for sick children? Indeed, if there were a problem in the municipal bond market in California, there could be spillover effects to other state and local bonds around the country.<sup>27</sup>

In a normal budget year, the governor provides an initial budget proposal in early January and follows it with the "May revise" proposal, so named because it comes in mid-May. The May revise is an update based on later economic projections and on political developments. However, 2009 was not a normal year.

For one thing, the 2009 May revise was dribbled out in pieces and was itself revised before and after the special election. In addition, a budget ostensibly through June 2010 had been adopted in February, albeit one that was partly linked to the rejected ballot propositions. So there was already a budget technically in place on July 1, 2009. Given the legislature's unusual action in February, the May revise was thus a proposed *modification* of an already-enacted 2009-10 budget rather than a proposal for a wholly *new* one.

The process of a May revise to an enacted budget raised an interesting legal question. To the extent that the legislature adopted the May revise or some other budget revision for 2009-10, it would be amending a budget in place. Normally, the governor has line-item veto powers over a *newly-enacted* budget. In this case, however, would those powers apply to a modification of an *existing* budget?

Initial litigation on that point favored the governor and, much later, a state Supreme Court decision approved the line-item vetoes he eventually made in the amended budget. It is noteworthy that former Governor Gray Davis, who Schwarzenegger replaced in the 2003 recall, supported the governor in this matter. "Neutering a governor during a fiscal crisis is irresponsible," Davis declared in a practical—but not necessarily legally grounded—opinion.<sup>28</sup> But whether a governor had the ability to impose line-item vetoes to a budget modification was not clear going into the episode.

Because of the budgetary and political turmoil in California, the idea of some kind of federal assistance to the state was raised periodically by state leaders. But the notion of a federal guarantee of California borrowing was reportedly dashed after a meeting with U.S. Treasury Secretary Timothy Geithner. Top Obama administration officials seemingly were hoping that the California problem would be resolved without federal help. They seemed to possess the talent of skilled waiters who know how to appear not to see a concerned diner who is signaling for attention.

Nonetheless, the feds were already indirectly involved in California finances; the state was constrained in what it could cut because of its receipt of federal stimulus funding. That funding came with restrictions on trying to support existing programs with federal monies. Stimulus funding was intended to *add* to economic activity, not to pay for programs *already* in place. Thus, the resulting federal "maintenance of effort" rules added another layer to the state budget dilemma.

California was trying to save money by furloughing state workers, a process that resulted in a variety of legal challenges from various public-sector unions. *De facto* pay cuts via furloughs could save some money and—after a brief flurry of lower-level federal attention—seemed not to be subject to federal maintenance of effort or similar rules.<sup>29</sup> However, a mix of conflicting court decisions and appeals made whatever savings emerged from furloughs yet another element of budgetary uncertainty. (The California Supreme Court ultimately let the furloughs stand but made it difficult for future governors to impose them without legislative concurrence.)

Opponents in the legislature charged that worker furloughs at the Franchise Tax Board were hindering tax collections and would cut the budgetary saving forecast by the governor by a third.<sup>30</sup> And concerns were raised about the longer-term effects. It appeared state workers on forced furloughs were taking less straight vacation time, thus accumulating a larger-than-normal "bank" of vacation hours.<sup>31</sup>

Also raising the level of uncertainty was an ongoing conflict between California and the federal courts regarding state prison overcrowding and resultant inadequate health services to prisoners. Litigation was pushing the state toward mechanisms to reduce its prison population. In the short run, that would mean either prisoner releases—with more strain on the parole system—or finding somewhere else to put prisoners.

One option—as noted—was keeping more prisoners in county jails. But that approach would add to the budget strain at the local level. Still another option was an early release of prisoners. More than a fourth of the prison population was potentially involved. Given the political ramifications of such a massive release, the issue was appealed to the U.S. Supreme Court which agreed to consider it in its fall 2010 term.

## REMEDIES: LONG TERM

*"...(T)he people wanted to send Sacramento a message... Do your job. Don't come to us with these complex issues. Live within your means. Get rid of the waste and inefficiencies. And don't raise taxes."*

—Governor Arnold Schwarzenegger, Budget message after May 2009 election<sup>32</sup>

*"There was one and only one on overarching message from the overwhelming majority of voters who DIDN'T EVEN BOTHER TO SHOW UP: Work it out yourselves and stop bothering us."*

—Commentators Jerry Roberts and Phil Trounstein<sup>33</sup>

Despite the governor's stance, various tax proposals were made, e.g., a cigarette tax. However, obtaining a two-thirds vote in the legislature—particularly after the May 2009 election—was never a practical alternative. Of course, tax increases could be approved through the initiative process and various initiative proposals to raise taxes were filed. Ultimately, one proposition that would suspend certain business tax breaks scheduled to go into effect in 2011 (part of the February 2009 budget deal) made it on to the November 2010 ballot (Prop 24).

However, as a practical matter, putting an initiative on the ballot requires extensive signature gathering. The cost of employing professional signature gathering

firms runs \$1–\$2 million and that sum just puts the matter before the voters; it doesn't enact anything. Still more money, lots more money, is required to mount an election campaign to pass an initiative about which there is any controversy. Public-sector unions could in principle come up with the required funds, but they would be reluctant to throw away money on initiatives likely to be rejected by voters. The only new tax initiative that made it on to the November 2010 ballot was an \$18 car fee to aid state parks (Prop 21).<sup>34</sup>

The ongoing budget crisis—particularly after the May 2009 election—seemed to create momentum for discussion of long-term reforms, even if there was stalemate over what to do about a state projected to run short of cash over the summer. Most ambitious was the idea of a state constitutional convention. There had not been such a convention since 1879. A convention could change just about anything in the constitution. And since an unspecified “anything” contains something that might appeal to anyone, the idea had significant support. It appealed particularly to a group of Bay Area/Silicon Valley types who seemed willing to sponsor the necessary initiatives to create the so-called “con-con.”

Their efforts in framing these initiatives were aimed to try to constrain what “anything” might entail and particularly to avoid wedge issues such as abortion. The fear was that one hot-button issue in a proposed new constitution could sink the entire package. Ultimately, after initiatives to create the con-con went into circulation, there were second thoughts by backers about where the process might lead. Initially, there were charges that signature-gathering firms were deliberately sabotaging the effort through “dirty tricks.”<sup>35</sup> But lack of financial support ultimately led to the abandonment of the effort. Even so, as long as there was budget gridlock in Sacramento, the con-con approach had a certain attraction, although the nickname “con-con” was not exactly good public relations.

Less grand than a full constitutional convention were particular reforms that could be accomplished by ballot proposition. One idea was to pass a constitutional amendment that would prevent future ballot initiatives from going into effect unless they included revenues to cover their costs. Another was to lower one or both of the two-thirds vote requirements (on budget and tax increases).

A more comprehensive initiative to change both requirements to a simple majority pushed by a UC-Berkeley professor had no money for signature gathering behind it and ultimately failed. It did serve to put to rest the idea that volunteer effort at signature gathering, i.e., one without the resources to pay a signature-gathering firm, would be sufficient to put a controversial fiscal item on the ballot. On the other hand, an initiative effort focused only on the budget two-thirds rule had wider backing and was put before voters in the November 2010 general election.

Still another reform the post-May 2009 budget problem resurrected was a longstanding proposal to modify Prop 13 and adopt a “split roll” assessment for commercial property. Under this approach (which has several variants), commercial property would effectively be taxed higher and under a different system than residential. The assessor of San Francisco launched a campaign for that option shortly after the May 2009 election.

Since the property tax is local, adding property tax revenue through a split roll would not directly affect the state's general fund. But it would provide a source of revenue to local governments that were being raided by the state in various ways to deal with its problems. So indirectly, it would offset what the state was doing to the locals. However, as of this writing, a serious campaign for some form of split-roll has yet to be mounted.

## WHAT DO WE DO NOW?

*"The Big Five is not a perfect process. But it's a lot better than hanging 120 legislators out to dry while they get beat up by interest groups."*

—Dan Schnur, director, USC Unruh Institute of Politics<sup>36</sup>

*"What we need to do is just basically cut off all the funding and just let them have a taste of what it is like when the state comes to a shutdown—grinding halt."*

—Governor Arnold Schwarzenegger<sup>37</sup>

The immediate problem of the budget after the May 2009 special election could not be addressed with long-term reforms, particularly those that had to be vetted by voters. To some extent, discussion of long-term reforms was a diversion from what needed to be done quickly before the state exhausted its cash reserves, as it was projected to do over the summer. Indeed, after the May 2009 special election and voter rejection, "long term" soon became anything that couldn't be done in the next few weeks.

Normally, in the period after a May revise, the traditional approach was to gather a meeting of the "Big Five"—the governor and the four legislative leaders from both houses—to cut a deal, rather than rely on the full legislature. Such a process had been used since the 1980s, but in the tense atmosphere after May 2009, complaints were made that it wasn't "transparent." By 2009, transparency had been elevated by the earlier financial crisis into a Biblical virtue. (The mortgage-related securities that were seen as a major component of the 2008 financial crisis were said to be non-transparent.)

Of course, the strength of the Big Five process was precisely that it took place in the proverbial smoke-

filled room of opaque deal-making (although in the contemporary version, even the cigar-smoking Schwarzenegger couldn't light up inside the Capitol building). Budget negotiations, especially in the political arena, are bound to involve trade-offs and compromises that will upset various interest groups. True transparency of the process can lead to its failure.

However, there has to be enough overlapping interest to come to an agreement, even in a non-transparent process. Democrats were pushing for tax increases—despite the May 2009 vote. The governor and legislative Republicans were pushing a cuts-only approach. And there was some hope on both sides—despite what the Feds were saying—for a Washington bailout.

But the bailout did not come and there was no overlap among the two sides. Attempts at humor failed in the resulting tension. Senate president Darrell Steinberg sent the governor a basket of mushrooms after the governor called Senate budget proposals "hallucinatory." The governor sent Steinberg a sculpture of bull testicles with a note that he would need them to make budget decisions—which Steinberg returned and for which he received an apology.<sup>38</sup>

Meanwhile, economic pressures and budgetary constraints were having ripple effects. The City of Oakland publicly considered bankruptcy in June 2009 (although it did not go there). Educational and student loans to state teachers and nurses were not being repaid on schedule, threatening the solvency of the special fund that provides them. The governor backed off a proposal to cut payments to families of police and firefighters killed in the line of duty. He also (temporarily, as it turned out) backed off a proposal to sell state assets to raise cash, citing the poor commercial real estate market.

But the ripple effects persisted. Los Angeles County's short-term notes suffered a ratings downgrade. The University of California announced it would be



reducing enrollment for the coming year due to the budget squeeze. University of California (UC) faculty sent a letter to the Regents criticizing them for inaction in the face of a budget crisis. In response to such developments, the legislature cut its own budget and imposed furloughs on its staff.

The atmosphere of crisis pitted Democratic state administrative elected officials against Democrats in the legislature. Treasurer Bill Lockyer urged that an adequate state reserve be maintained to making borrowing—the task of the state treasurer—easier. Along with controller John Chiang, he warned that the state would run out of cash by late July and have to issue IOUs—known as registered warrants—to suppliers and others unless the legislature enacted a modified budget.

To conserve cash, the state cancelled various existing contracts with outside businesses and delayed payments to others. State superintendent Jack O'Connell criticized a legislative plan—pushed by Democrats and opposed by Republicans—to suspend the high school exit exam, ostensibly to provide relief for budget-constrained school districts. One fiscally-conservative state assemblyman, who was at odds with his Democratic colleagues over the budget, left the party and became an independent.

In late June 2009, the assembly passed three bills aimed at conserving cash by delaying payments to schools and local governments. Dealing with the budget in pieces and using borrowing to bring the budget back into some version of "balance" over a multiyear period seemed to be the Democrats' favored approach. But their approach was not clearly articulated—at least in public. Nonetheless, one of former Governor Davis' finance directors advocated that strategy explicitly.<sup>39</sup> However, Governor Schwarzenegger vowed to veto any temporary measures.

In any event, Republicans in the Senate ultimately blocked the Democrats' approach. And a more general legislative stalemate hindered any other deal-making. Courts continued to intervene regarding mandates for prison spending and by halting a wage cut for home care aides. Pet ideas kept being floated, some of which would have only long-term effects (e.g., pension reform) and some of which were questionable even as short-term measures (e.g., selling the state workers' compensation system to private buyers).

The governor threatened an increase in furlough days for state workers hoping it would give him leverage with Democrats anxious to avoid negative outcomes for public sector unions and employees. What he could not do, as he tried and failed to do in the budget stalemate a year earlier, was to cut state workers to the minimum wage. The minimum wage rule applied only to situations in which the state entered the new fiscal year with no budget in place. This time there *was* a budget in place for 2009–10—the one enacted in February 2009—albeit one that was unsustainable.

As the end of fiscal 2008–09 approached, Democrats came up with an elaborate approach that would raise taxes but avoid the two-thirds rule. It involved cutting the gasoline tax and raising taxes on cigarettes and oil production by an equivalent amount. The rationale for a simple majority was that there was no net tax increase. However, the lost gasoline tax revenue would be replaced by a gasoline fee, since raising user fees does not require a two-thirds vote. This elaborate, and potentially legally-challengeable approach, was met by an assurance from the governor that he would veto the package. So, in the end, passing the package was a device for legislative Democrats to shift the blame for the budget crisis and impending IOUs to the governor.

## NO DEAL

*"It's abundantly clear that just because you change governors, you don't change the financial condition of the state."*

—former Governor Gray Davis <sup>40</sup>

*"The problem is, no one wants to say what (any) program increase is really going to cost, or how much money (any) tax cut will cost today, tomorrow and years down the line."*

—former Assembly speaker Willie Brown <sup>41</sup>

Although unlike prior years in which stalemate resulted in no budget on July 1, this time the significance of July 1 was that the controller indicated he would start issuing IOUs (registered warrants) to save cash if no new budget deal had been enacted by that date. IOUs had not been issued by the state since 1992, during then-Governor Pete Wilson's budget crisis.<sup>42</sup> When there was no budget on July 1 this time, some banks indicated they would accept the 2009 edition of IOUs from existing customers at face value, at least for a limited time. Other banks did not. Most of those banks that did had discontinued the practice by mid-July.

Those individuals and businesses that held, or had to hold, the IOUs could not redeem them from the state until October. Although the IOUs paid interest at 3.75% per annum (tax-free)—a high rate for a short-term investment at the time—not all recipients, particularly those whose banks would not accept them at face value, were mollified. Controller John Chiang's Web site deflected objections with the suggestion that those recipients with complaints could "contact the governor or (their) local representative in the Senate and Assembly."<sup>43</sup> The impact of the issuance of IOUs was softened by an announcement about a week after the program began that they could be used to pay state income and corporate taxes.<sup>44</sup>

At the same time that IOUs were being announced, Governor Schwarzenegger boosted state worker

furlough days from two to three. Complaints regarding that decision wound up in court, ultimately producing a mix of verdicts until they reached the state Supreme Court, some endorsing and some rejecting the policy depending on the employee group and court involved. In some cases, the furloughs affected workers not supported by the general fund.<sup>45</sup> That gubernatorial decision seemed to be partly symbolic and partly a way to push public worker unions to pressure legislative Democrats. (As noted earlier, the state Supreme Court eventually upheld the governor's furloughs.)

The governor also attacked "fraud and waste" in state government.<sup>46</sup> In a TV commercial, he asked viewers to "stand for California" and support him in the budget battle.<sup>47</sup> Much of the public rhetoric focused on Prop 98's guarantee of funding for schools and the appropriation for, and administration of, a program to provide home care aides (In-Home Supportive Services or IHSS).<sup>48</sup> These areas of contention were forerunners of the budget negotiations that would take place a year later as the fiscal crisis lingered.

With no resolution in sight, California experienced a downgrade of its bond ratings. Parallels were drawn with the federal assistance provided to New York City during its financial crisis in the mid-1970s in exchange for external fiscal controls.<sup>49</sup> However, the Obama administration continued to be intent on averting its eyes from the California spectacle. The closest scrutiny from Washington came in the form of a ruling by the SEC that the registered warrants were securities subject to federal law in order to head off some fly-by-night trading schemes that began to arise.

The fiscal crisis opened the door to tactics and responses outside the legislature. Marijuana growers and distributors saw a chance to legitimize their trade by offering to have their product taxed as part of a legalization. Eventually, the offer evolved into an initiative placed on the November 2010 ballot (Prop 19). The American Cancer Society pushed for an added

tax on tobacco. Wacky initiatives were submitted; it only costs \$200 to file a proposition. One, for example, would have required drug testing of members of the legislature.

The California State University system (CSU) announced it would consider a significant tuition increase and announced there would be closed enrollment in the following spring semester. UC developed its own furlough plan, since it was not subject to the governor's authority. Public transit operators began to consider a ballot initiative that would protect their earmarked state funding from being raided to deal with the General Fund's problems. An initiative to that effect also ended up on the November 2010 ballot (Prop 22). Meanwhile, the state asked its private vendors if they would voluntarily cut their prices—even though these prices were already contracted.

Adding to the budgetary distress were court decisions arising from challenges to prior spending cuts. For example, the state's earlier Medi-Cal cuts were ruled violations of federal laws because the low reimbursements to providers did not offer quality health care to patients. As noted earlier, another court ruling rescinded a wage cut to state-supported home care aides.

However, the courts were also seen as a possible forum to deal with the legislative stalemate. Former UCLA chancellor Charles Young filed a suit challenging the feature of Proposition 13 of 1978 which added a two-thirds vote requirement for tax increases. The suit argued that the added supermajority requirement was a "revision" of the constitution, not just an amendment, and thus could not be enacted by initiative. (The original suit was rejected but was later re-filed. At this writing, it is still pending.)

Various proposals of the governor ran into strong opposition. These included suspension of Prop 98,

the minimum guarantee for K-14 funding, and the proposed partial sale of the state's Workers' Comp fund (formally known as the State Compensation Insurance Fund). A suspension of Prop 98 was strongly opposed by the California Teachers Association and other education-related groups. And the governing board of the Workers' Comp fund—which covers mainly smaller employers and about a fifth of the market—opposed its sale.

Both the Service Employees International Union (SEIU) and the California Correctional Police Officers Association (prison guards) threatened—but did not carry out—strike actions over contract disputes with the state. Although voters in May had rejected diverting funding from early childhood programs to the General Fund, the First 5 California Families Commission—which administers the earmarked monies—offered some assistance to the state. Its objective was to head off loss of child access to the state's Healthy Families program. (Healthy Families is part of a federal-state program providing health insurance to children of the working poor.) Meanwhile, the governor ordered a "garage sale" of state vehicles (some of which he personally autographed to increase their value) and other miscellaneous state property.

Budget strains were evident inside affected organizations. A community college president in San Francisco floated the idea of offering "naming rights" to sponsors of particular courses. After a controversy developed, the idea was dropped. Some department chairs at UC-San Diego suggested that budget cuts should be concentrated at less-prestigious campuses such as Merced and Riverside. At CSU, the faculty union approved a furlough plan but voted "no confidence" in the CSU system's chancellor.

## DEAL

*"I always distinguish between the best possible solution and the best solution possible. This is the best solution possible."*

—Rick Simpson, Policy advisor to Assembly Democrats<sup>50</sup>

*"The governor and the legislative leaders are implicitly telling us that flawed as it may be, the budget is the best they can do. The most damning aspect of this tiresome situation is that the best budget our political system can produce is deceptive and fundamentally dishonest. It should tell us that we have a much bigger problem than an unbalanced budget."*

—Columnist Dan Walters<sup>51</sup>

By late July, the outlines of a revised budget deal began to emerge as the result of on-and-off negotiations at the "Big 5" level followed by an all-night session at the legislature. Along the way, frictions arose over such issues as possible early prison releases and there were threats of lawsuits over possible raids on local government revenues. The solution to the former was to cut the prison budget without using the words "early release." At some later date, someone—but not the legislature—would specify later how the prison cuts would be made. In the latter case, eventually deals were concluded with local government representatives.

Various cuts in K-14 and higher education were made along with reductions in social programs and a furlough day was added for state workers (to three per month).<sup>52</sup> The latter recognized in a budgetary sense the furloughs already ordered by the governor—and ultimately provided a rationale for the state Supreme Court to okay the furloughs. Borrowing from local government funds was part of the deal. Various assumptions were made about things that in fact did not happen, such as partial privatizing of the state's workers' comp fund and offshore drilling licensing (the latter killed by the BP deep drilling fiasco in the Gulf of Mexico a year later).<sup>53</sup>

Some components addressed cash flow within the fiscal year by accelerating tax withholding. Normally, extra money received within a year in withholding is essentially borrowed against the following year. However, in this case, the new schedule would repeat indefinitely, thus providing a one-year windfall that would not be repaid in the future.

In the same spirit, the final state payroll at the end of June 2010 was moved to the beginning of July, thus taking one-twelfth of the payroll out of the 2009–10 budget. This one-time "saving" could only be maintained if—from that point on—the June 30 payroll was paid on July 1 of all successive years. Some budget cuts were partly "backfilled" through use of federal stimulus funding (which would not be available in future years). In short, the budget deal was partly composed by cobbling together a variety of one-time arrangements.

The governor and legislative leaders touted what they termed solutions to a "\$60 billion budget gap" for 2009–10 over the period February through July 2009 when the revisions were signed on July 28. That approach to framing the problem can be viewed as part of the longer-term budget dilemma. In round numbers, the budget at its peak was about \$100 billion per annum. Thus, the announcement that a "gap" of \$60 billion had been filled might lead one to think that there was somehow a budget of only \$40 billion left. Any such cut, of course, would have been impossible to achieve. The \$60 billion number in reality was a mix of years, of actual and projected flows of spending and receipts, and of stocks and flows.

Even apart from the confusing accounting methodology, elements of the July budget deal left significant loose ends. As noted earlier, although the governor vetoed well over \$400 million in expenditures, it was unclear at the time that he could veto line items in a budget revision as opposed to a complete budget.<sup>54</sup> (The state Supreme Court eventually approved the vetoes; a significant factor in its verdict was that the legislature had gone along

implicitly by adjusting the budget to reflect the payroll savings.) A cut in the prison budget, despite federal court supervision and despite no specification of a prisoner release program, was another area of uncertainty. Local redevelopment agencies—whose funds were to be borrowed—litigated the constitutionality of such borrowing (and eventually lost).

Finally, there was the underlying economy whose outlook in the summer of 2009 was more uncertain than usual. The official estimate when the budget revision was passed of revenue that would be received in 2009-10 was approximately \$95 billion. In fact, actual receipts came in at well under \$90 billion, despite the February 2009 increases in income, sales, and car tax rates.<sup>55</sup>

## AFTERMATH

*"Because the legislature failed to send him a balanced budget... the Governor was forced to make these difficult cuts. While Democrats are focused on a protracted battle to dig the state back into deficit, the Governor will continue to focus on moving our state forward..."*

—Gubernatorial spokesperson Aaron McLearn, responding to lawsuit against the governor's line-item vetoes<sup>56</sup>

*"We elected a governor, not an emperor."*

—Senate President Darrell Steinberg<sup>57</sup>

Indeed, it did not take long for complications to occur. As noted earlier, although the budget deal cut the prison budget, it did not explicitly specify releasing prisoners as a cost-saving device. In early August 2009, however, a federal court ordered California to reduce its prison population by over 40,000 (out of about 150,000). The governor's target for reduction was 27,000. State attorney general Jerry Brown, still at that time an unannounced candidate for governor in 2010, promised to appeal; at this writing the case is before the U.S. Supreme Court. Highlighting the issue was a riot at a state prison in Chino in early August, leading to a debate over whether overcrowding was a cause

and whether the riot proved that prisoner releases should be avoided.

The controversy, discussed earlier, over the validity of the line-item vetoes remained a political sore spot, apart from the legalities. It was claimed by legislative Democrats that they had a deal with the governor as part of the Big 5 negotiations that there would be no such vetoes. But the governor claimed that the understanding of no vetoes was undermined by subsequent legislative actions that cut into projected revenue. The budget thus remained an area of friction between legislative leaders and the governor. Public pensions and retiree healthcare benefits, notably CalPERS, CalSTRS, and UCRS, also became issues of controversy after the budget deal. Such plans became notably underfunded in the wake of the 2008 financial crisis, thus requiring increased contributions. At one point during the 2005 "Year of Reform," the governor had been pushing for an initiative on the pension issue but because of poor drafting, he pulled his support and the issue was not placed on the ballot.

During the 2010 gubernatorial campaign, GOP candidate Meg Whitman, even before the primary, apparently decided that having a pension initiative on the November ballot would attract union members and Democrats to vote in opposition. From her campaign's perspective, that outcome would not have been advisable. Proponents of such an initiative complained that "certain people" who "didn't want this on the ballot with them" refused to support their initiative.<sup>58</sup> However, the issue continued to rise and fall in media attention after the July budget deal. And in the atmosphere of cutbacks and furloughs, the availability of such pensions seemed to produce an increase in early retirements in the public sector.

There was disagreement about side deals that had been made as part of the budget agreement in July, leading to a feud between Senate President Darrell Steinberg and the Senate minority leader Dennis

Hollingsworth. The governor was reportedly somewhere in the middle trying to mediate between the two in a Big 5 session in the fall of 2009. Assembly majority leader Alberto Torrico accused the governor of “extortion” and Hollingsworth of sending the equivalent of “ransom notes.”<sup>59</sup>

The governor was booed when he made what he thought would be a courtesy visit to a Democratic meeting at a San Francisco hotel at the invitation of former assembly speaker Willie Brown. This episode, complete with YouTube videos of the occurrence, was clearly an embarrassment to Brown, who termed the behavior “totally inappropriate.”<sup>60</sup> One legislator who made rude remarks at the event was rewarded later with a veto message of a bill he authored with the first letter of each line in the message spelling out an obscenity.<sup>61</sup>

There was also friction between the governor (this time in accord with legislative Republicans) and Democratic leaders over the placement of a major water bond issue before voters. The conflict was mainly over provisions of such a bond measure. Schwarzenegger threatened to veto all bills until some agreement was reached. As it turned out, after placing the bond on the November 2010 ballot, the governor and legislature agreed in the summer of 2010 to postpone it to 2012; given the poor economy at the time and general public disenchantment with Sacramento, the bond’s chances for passage looked grim.<sup>62</sup>

When the issue of whether such a threat by the governor was legal came to Attorney General Jerry Brown, he declined to opine with the reminder that “compromise in the rough-and-tumble legislative process is not achieved by doilies and tea.”<sup>63</sup> Meanwhile, Local 1000 of SEIU and the Schwarzenegger administration feuded over whether Columbus Day was a paid holiday for state workers, since the legislature had never ratified the union’s contract deleting it.<sup>64</sup> (A later court decision involving another state government union upheld the

elimination of the Columbus Day holiday in February 2010.) Representatives of K-12 schools threatened a lawsuit claiming that state funding of public education did not meet California’s constitutional requirements.<sup>65</sup>

However, for members of the public who were not government employees, who were not enrolled in a public higher education institution, and who were not dependent on social programs, consciousness of the budget problem was episodic. Those Californians who frequented state parks might have experienced reduced hours.<sup>66</sup> But even some of the potentially high-profile cuts in social programs, such as pushing children off the Healthy Families program, never quite happened.<sup>67</sup> Cuts in other programs—that attracted less public attention—such as screenings of low-income women for breast cancer, did occur. Courts were subject to periodic closures as was the Department of Motor Vehicles (DMV). The latter may have been an attempt to engage public attention. A significant portion of DMV costs are paid through various motor vehicle fees, not out of the general fund budget.

At the local level, fees and traffic fines rose as local governments sought revenue. But by mid-August, the state controller announced that IOUs would no longer be necessary after early September, in part due to a loan from JPMorgan Chase. Still, despite the loan and the end of the IOUs, the Treasurer had difficulty selling state bonds in October 2009 and had to reduce the size of a planned offering.

In spite of a general sense of state government dysfunction, there was not much impact on the life of a typical voter. That feature of the budget crisis undoubtedly was a factor in the failure of advocates of grand reforms to carry public opinion. Thus, for example, the excitement about having a new state constitutional convention (con-con) was largely confined to a limited circle of policy wonks and good government advocates. As noted earlier, proponents of the con-con never raised enough money to put

the enabling initiatives on the ballot. Poll data had suggested that voters by a slim majority favored the idea of such a convention but also that they had no particular consensus on what specific reforms the convention might address.<sup>68</sup>

There was likely a gap between voter perceptions and policy wonk perceptions more generally. In policy circles, there is a view that California's direct democracy system of ballot initiatives has become a major factor in state dysfunction. But voters like the system, even though they complain about complex ballots and being asked to do the legislature's work. Perhaps symbolic of this gap were the comments of California historian Kevin Starr when he spoke in honor of Governor Hiram Johnson whose progressive agenda created the state's direct democracy in the early 20th century. "He got California ready for the 20th century," said Starr.<sup>69</sup> Pointedly, he did not extend his remarks about readiness into the 21st century.

The governor flirted with endorsing a reversion to a part-time legislature in late August "as one of the many ideas he's taking a look at," according to a spokesperson.<sup>70</sup> A year later, 2010 Republican gubernatorial candidate Meg Whitman seemed to pick up that message; she also made statements about a part-time legislature as well as California's proneness to too many ballot measures.<sup>71</sup> Governor Schwarzenegger pushed for K-12 reforms to increase California's chances in competition with other states for "Race to the Top" funds from the U.S. Department of Education. Ultimately, with union resistance as an important factor, California did not obtain those funds. (A second application involving a subset of school systems was filed but was unsuccessful.) At the higher education level, the budget crunch led to tuition increases and efforts to recruit more out-of-state students who would pay higher tuition than Californians.<sup>72</sup>

To the extent there was structural reform on the ballot as the result of California's fiscal distress, it came in

the form of Prop 14 in June 2010, a byproduct of the February 2009 budget deal.<sup>73</sup> Prop 14 created an open (nonpartisan) primary system for legislative positions on the argument that more "centrist" candidates would emerge. It ultimately was passed by the voters despite opposition from the political parties. Whether a court challenge will eventually be filed by either of the two major parties is not known at this writing; gubernatorial candidate Brown expressed some positive views on Prop 14 which might inhibit Democratic participation in such a suit. But minor parties—who might well be excluded from the general election under Prop 14—did sue.<sup>74</sup>

## FALL 2009: THE PAUSE THAT DISTRESSES

*"As a candidate, if you even peep about a tax, you're dead."*  
—attorney general (and unofficial gubernatorial candidate) Jerry Brown in late October 2009<sup>75</sup>

*"I'm absolutely convinced that lowering tax rates will produce an increase in tax revenues."*  
—insurance commissioner (and gubernatorial candidate) Steve Poizner<sup>76</sup>

The fall of 2009 was a period of pause while Californians awaited a renewed budget problem to be revealed in the governor's January presentation. But doing nothing in that interval did not improve the fiscal situation. Given the fact that taxes had been raised in the February 2009 deal, that voters had rejected an extension of those taxes, that Republican legislators who went along with the February deal had been punished politically, and that the two-thirds vote requirement for tax increases remained in effect, it seemed unlikely that new state taxes would be on offer for the 2010-11 budget. At the local level, due to a negative inflation factor, property taxes were due to *fall* very slightly after a state Board of Equalization calculation.

Moreover, there was unfinished business from the 2009-10 budget. Over twenty legal cases against the governor's imposition of furloughs on state workers were awaiting court action. Exactly how these would play out was unclear at the time. But to the extent furloughs might have been voided (which ultimately did not happen), the state budget could have suffer from awards of back pay.

Tuition at state public universities was seen as likely to rise in the wake of the 2009-10 budget. But, a report by the Legislative Analyst on the 50th anniversary of the state's Master Plan for Higher Education noted that state policy no longer provided guidance as to the split between student and state in providing educational finance.<sup>77</sup> Analysis of political forces in California suggested that institutional pressures could be expected to reduce the share of higher education in the overall budget, a process that could lead to *de facto* privatization.<sup>78</sup> Yet a Public Policy Institute of California (PPIC) poll indicated that over two-thirds of Californians opposed raising student tuition to support public higher education. Over half opposed raising taxes for that purpose.<sup>79</sup> Despite this sentiment, an earlier PPIC report indicated that California's workforce would need more college graduates in the future.<sup>80</sup>

More generally, at about the same time eight out of ten Californians in a *Los Angeles Times*/USC poll thought that the state was headed in the wrong direction. And over half saw the decline as long-term.<sup>81</sup> In such a pessimistic atmosphere, it was not surprising that public views about state issues such as higher education finance were often incoherent. Surprise or not, such incoherence added to the difficulty of crafting budgets.

Perhaps sensing that there could only be more fiscal distress ahead, the governor's finance director Mike Genest let it be known that he would resign by the end of 2009. "*It feels like a good time for me to step back from the day-to-day fray of things,*" he said in an

understatement.<sup>82</sup> In an interview, he indicated he had researched options for a state bankruptcy and found no legal procedures for a state to do so. "*I literally looked... to see if there was a way for states to return to territory status,*" Genest said.<sup>83</sup> Presumably, he found no options for such a return to the past. However, after resigning, he reportedly planned to go scuba diving in a former U.S. territory, the Philippines, just as the governor and the new finance director were unveiling the new budget.<sup>84</sup>

In the political sphere, San Francisco mayor Gavin Newsom officially bowed out of the governor's race on the Democratic side in late October 2009, despite an endorsement by former President Bill Clinton. He instead began to campaign for the Democratic nomination for lieutenant governor, an office whose lack of power he had earlier derided. That move left only Jerry Brown in the Democratic race, albeit unofficially at that point, with periodic rumors—that never proved true—that other candidates from his party might yet declare themselves.<sup>85</sup>

Also among things that didn't happen was a "split roll" initiative filed by the California Teachers Association (CTA). As noted earlier, under a split roll, Prop 13 would be modified to allow higher taxation of commercial property compared with residential. CTA did file two such initiatives in November 2009, but never gathered the signatures to put the issue on the ballot. Similarly, a group pushing for reduced public pension debt filed two initiatives in November, but never obtained the needed signatures.<sup>86</sup>

Among things that did happen was a *de facto* interest-free loan to the state created by increased income tax withholding. The legislature could accelerate tax withholding—as opposed to raising tax rates—by a simple majority. Although workers could in theory ask employers to reduce their withholding levels, human inertia meant that most did not do so. The impact of the new withholding rates became particularly important



during the summer of 2010. Added cash flows to the state helped staved off the issuance of IOUs that had occurred in the previous summer. However, the enhanced cash flows were somewhat offset by increases in unpaid tax liabilities, a reflection of the soft economy.

Generally, the state was hungry for cash. Its borrowing from funds outside the general fund suggested a literal nickel-and-dime approach. In particular, the state fund for recycling bottles and cans—based on deposits paid by purchasers of beverages—became sufficiently depleted by its loan to the general fund that recyclers sued the state in November 2009. Absent cash in the fund, recycling firms were not being paid for their services. After negative publicity, the governor promised in January to pay off the loan that was hobbling the fund. But complaints about unpaid bills owed to recyclers continued.<sup>87</sup>

The cash squeeze produced a short-term mentality. With the 2010 *Census of Population* looming, states could anticipate federal funding benefits by having the fullest possible count of residents. However, California allocated only a token amount for its effort to urge residents to cooperate with the census. The full-count issue was especially pressing for California because of its large immigrant (including illegal immigrant) population—which might prefer to avoid official contacts. But the benefits from a full count would be felt over the coming decade, not immediately, and so were not a high priority.

California's short-term mentality was also reflected in the development of a plan to sell state office buildings and lease them back. In effect, such arrangements are equivalent to borrowing. Cash is received up front—as in a bond sale. But then a stream of revenue over time is paid out—also as in a bond—in the form of future rents to the new owner. Eventually, a balloon payment at the end occurs when the state must either renew the lease or build or buy a new building.

While analogous to borrowing, such assets sales tend to be a very expensive method of obtaining immediate cash, although they avoid constitutional constraints on borrowing. The governor promised to “guarantee” not to sell if the prices were not right but it seemed unlikely that he could avoid de facto borrowing at what were implicitly high rates of interest.<sup>88</sup> In December 2009, a real estate broker was selected to prepare the sales.<sup>89</sup>

A plan to sell the state's EdFund—which provides loans to students—ultimately ran into a roadblock. The federal government, which is involved in the program, ordered a halt to the process in late July 2010. Concerned about poor administration, the U.S. Department of Education later assigned an out-of-state management firm to operate the EdFund.<sup>90</sup>

Both CSU and UC raised fees substantially in November 2009, despite vocal (and in some cases physical) student protests. Partly in response, a joint committee of the legislature was set up to review the 1960 Master Plan for Higher Education. The *Huffington Post* ran a mock article in late December indicating that UC-Berkeley had decided to eliminate students altogether and wait for the economy to recover.<sup>91</sup> In contrast to the rise in tuition, in December salaries of legislators and various elected state officials went down. The pay cut came after attorney general (and still-unofficial gubernatorial candidate) Jerry Brown ruled that such reductions—as determined by an independent tribunal—were legal.

In other legal affairs, a federal court confirmed its earlier order of a reduction (not exactly the same as a “release”) of California's prison population by about 40,000 over two years due to overcrowding.<sup>92</sup> The order came at about the same time Congress was cutting back on the aid California receives from the federal for holding illegal aliens convicted of crimes. With the focus on prisons, not surprisingly various exposés appeared in the media about excessive overtime, costly use of temps, and other expensive practices in California's prison administration.

Although Republican legislative leaders who had approved the February 2009 budget deal had been punished, one Republican—Abel Maldonado—was rewarded. Maldonado's needed vote to pass that deal produced both changes in the deal itself and the placing of a proposition—which passed—on the June 2010 ballot to create a non-partisan primary system. As noted earlier, Governor Schwarzenegger, a proponent of what was termed "post-partisan" politics, nominated Maldonado in late November 2009 to the vacant lieutenant governorship position, making the announcement on the *The Tonight Show with Jay Leno*.<sup>93</sup> The nomination led to complex on-and-off political manipulations but Maldonado was eventually confirmed by the legislature in late April 2010. As the incumbent in the June 2010 primary, he won the Republican nomination for Lieutenant Governor to oppose Democrat Gavin Newsom in November.

As calendar 2009 came to an end, Governor Schwarzenegger wrote to U.S. House of Representatives speaker Nancy Pelosi asking for more aid to California for health care programs and avoidance of costly mandates.<sup>94</sup> At the time, Congress was still considering the President's plan for universal health care. The letter was mild in tone, but it set the stage for a much more stinging complaint by the governor early in 2010 regarding the matter. Meanwhile, as is the custom as the time for a new budget message (for 2010-11) approached, leaks of information appeared in the media. To no one's shock, the main message was that there would be more cuts proposed for the coming fiscal year.

## THE NEXT ROUND: THE 2010-2011 FISCAL YEAR BATTLE BEGINS

*"Federal funds have to be part of our budget solution because the federal government is part of our budget problem... And now Congress is about to pile billions more onto California with the new health care bill... Health care reform... has become a trough of bribes, deals and loopholes... You've heard of the bridge to nowhere. Well this is health care to nowhere."*

—Governor Arnold Schwarzenegger,  
January 2010 State of the State speech<sup>95</sup>

*"I love the way that Arnold is so optimistic. But now, he's got to knock heads together."*

—Attorney General (and unofficial Democratic gubernatorial candidate) Jerry Brown commenting on governor's State of the State speech<sup>96</sup>

*"Governor Schwarzenegger's remarks were a sober reminder that we have a government we can no longer afford and we have serious challenges to overcome."*

—Meg Whitman, Republican gubernatorial candidate,  
commenting on governor's  
2010 State of the State speech<sup>97</sup>

Under the California constitution, the governor delivers a State of the State message and a proposed budget for the next fiscal year in early January. Since the State of the State comes first, it often provides a preview of the more detailed budget proposal. It has become a practice for the governor also to deliver a May revise budget message, based on new economic projections and political developments, in mid-May. Then the legislature enacts a budget, in principle before the start of the new fiscal year in July, but more often late. The new fiscal year (2010-11) was to set a record for delay in enactment.

**Table 4: January and May Revise Budget Proposal:  
2010 (\$ Billions)**

	2009-10 As of Jan. 2010 Proposal	2010-11 As Proposed by Governor Jan. 2010	2010-11 Workload Budget as of Jan. 2010
Revenue & Transfers	\$88.1	\$89.3	\$90.3
Expenditures	\$86.1	\$82.9	\$102.6
Surplus/Deficit	+\$2.0	+\$6.4	-\$12.3
Reserve at End of Year	-\$5.4	+\$1.0	-\$18.0

	2009-10 As of May Revise Proposal	2010-11 As Proposed by Governor May Revise	2010-11 Workload Budget as of May Revise
Revenue & Transfers	\$86.5	\$91.5	\$89.3
Expenditures	\$86.5	\$83.4	\$99.5
Surplus/Deficit	\$0.0	+\$8.0	-\$10.2
Reserve at End of Year	-\$6.8	+\$1.2	-\$17.9

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

Source: California Department of Finance, January and May Revise budget summaries.

As described earlier, there was a departure from the standard scenario in February 2009, when the legislature enacted both modifications to the ongoing fiscal year (2008-09) and a new 2009-10 budget. But apart from record delay, calendar 2010 initially followed the standard script. Before describing the 2010 process, it is useful to look ahead at the data behind the January 2010 and the 2010 May revise, found on **Table 4**.

The first thing to note is that by January 2010, the projections for the 2009-10 fiscal year—by then half way over—were for rough balance. Indeed, a nominal surplus is shown. Even after the May revise, the balance estimate was retained. Of course, the 2009-10 budget was filled with one-time fixes—such as moving the end-of-June payroll to the beginning of July (the next fiscal year); “smoke and mirrors” is the term of art. Nonetheless, it is noteworthy that with the gimmicks in place, at least the state did not technically accrue additional debt during 2009-10 when the books were closed. The rough balance of Table 4 accords generally

with the cash flow data summarized earlier on Charts 1-3. Put another way, at least it can be said that the smoke and mirrors succeeded in creating an illusion of fiscal adjustment—it could have been worse.

If there was an approximate bookkeeping balance in 2009-10, what were the challenges for 2010-11? There were two basic problems. First, on a “workload” basis, the budget would run a significant deficit in the 2010-11 year. Hence, just to have another year of rough balance, either more revenue or less expenditure or some combination of both would be needed. In January 2010, as Table 4 indicates, the governor estimated that about \$12 billion in solutions would be needed for such balance. This estimate was revised downward to about \$10 billion at the time of the subsequent May revise. Given that magnitude, it was not surprising that the governor hoped to pressure Washington for a significant portion of the solution.

However, the governor also wanted to pay off the negative balance in the general fund by the end of the 2010-11 fiscal year. He could argue that the California constitution, partly after his Props 57 and 58 of 2004, required that the entire problem (balance plus debt repayment) had to occur by June 30, 2011. Indeed, he wanted more: to end the 2010-11 fiscal year with a positive balance of about \$1 billion—or at least be on track to do so when his term as governor ended in January 2011.

Despite the governor’s desire, the options for extending the deadline for a complete fix beyond that June 2011 date were limited. But they were not completely absent, particularly if more smoke and mirrors could be applied. Creative minds are always available to provide some leeway. In addition, the governor wanted to achieve the fix without new taxes. Given those gubernatorial goals, along with the two-thirds votes needed for budget enactment and for tax increases, and given the still-soggy state of the California economy, a budget collision—with a stalemate after July 1, 2010—was assured.

Adding to the assurance of a major political tangle surrounding the budget was the fact that 2010 was an election year. For Governor Schwarzenegger, who was soon to be termed out, it meant a last chance for a legacy. His 2005 "Year of Reform" had been a bust. But he did obtain one of his 2005 reforms, in a rewritten format, in 2008, i.e., legislative redistricting to be done outside the legislature. As it turned out, however, he would have to defend even that victory in November 2010 against an initiative (Prop 27) to undo the 2008 proposition.

The governor's environmental record was also to be put on the line in November 2010 with an initiative to suspend AB32 (Prop 23), California's greenhouse gas law. And even sooner, there was to be an initiative for a non-partisan primary system on the ballot in June 2010, an idea the "post-partisan" governor supported. These ballot items made for odd alliances. Republicans favored the 2008 redistricting initiative. But party leaders in both the Republican and Democratic establishments generally disliked the non-partisan primary. Democrats opposed suspension of AB32 but Republicans supported it.

As an odd couple, there was former Democratic assembly speaker Willie Brown and Governor Schwarzenegger. Brown had nice things to say about the governor's legacy efforts to roll back certain provisions of public pensions.<sup>98</sup> He even had some nice words about the dead-on-arrival report of the commission on revising the tax system discussed earlier, a report to which Schwarzenegger continued to point as a needed roadmap for reform. On the other hand, Brown indicated that if he were still speaker, he would have passed the governor's May revise proposals, not because he favored them, but because it would have forced the governor to confess to believing in less draconian measures. The governor, he believed, could not have signed his own budget.

Both UC and CSU had pushed up their tuitions—at least the sticker prices—substantially. Student demonstrations in November 2009 protesting the hike at the UC Regents meeting that month had garnered substantial media attention. It was reported in early January that the governor did "not want his legacy to include a dismantling (of) the world's most acclaimed public university system."<sup>99</sup> The governor, it might be noted, is an *ex officio* Regent.

As already partly enumerated, not only were the governorship and other statewide offices up for grabs in November 2010, but there would be controversial items on the ballot. While some potential ballot items might have direct budget implications, there were also considerations of what ballot items might attract particular groups of voters to the polls. For example, when an initiative legalizing marijuana made it on to the November ballot, some observers argued that the issue would attract younger voters to the polls. Some opinion polling for Jerry Brown suggested he was more favorably viewed by younger voters than older. In turn, if he were more likely to win, that prospect might have some effect on legislative Democrats, depending on how they felt the budget battle was affecting the election.

Candidates that were in office could have some impact on the budget, which was inherently an element tied to their campaigns. Insurance commissioner Steve Poizner, a GOP primary candidate in the gubernatorial race, succeeded in tying up Governor Schwarzenegger's plan to sell the state-operated Workers' Compensation fund with a lawsuit. He argued that selling the fund might raise premiums to employers. But that move blocked the planned sale that was supposed to raise \$1 billion for the 2009-10 budget.

The 2010 State of the State address started with an elaborate story involving the governor's pet pot-bellied pig and a pony and how they worked as a team to steal his dog's food. Although the metaphor was somewhat obscure, the tale seemed to be a call

**Table 5: California and U.S. Unemployment Rates:**

	California	U.S.
<b>Year 2006</b>	4.9%	4.6%
<b>Year 2007</b>	5.3	4.6
<b>Year 2008</b>	7.2	5.8
<b>Jan. 2009</b> State of the State & Budget Messages	9.7	7.7
<b>Feb. 2009</b> Midyear Revision of 2008-09 Budget & 2009-10 Budget	10.2	8.2
<b>May 2009</b> Voters reject Budget-related Propositions	11.3	9.4
<b>July 2009</b> 2009-10 budget Revised & Passed	11.8	9.4
<b>Jan. 2010</b> State of the State & Budget Messages	12.5	9.7
<b>June 2010</b> 2009-10 Budget Ends With No New Budget Enacted	12.3	9.5

Note: Monthly data are seasonally adjusted.

Source: Employment Development Department, <http://www.labormarketinfo.edd.ca.gov/?pageid=164>

for the two parties in the legislature to work as a team to make painful budget cuts. However, midway through the speech, the governor declared that the "first priority" for 2010 was "jobs, jobs, jobs." As can be seen from **Table 5**, which shows state and U.S. unemployment rates, such a statement was hardly a surprise. Nonetheless, taken by themselves, budget cuts tend to reduce jobs directly if public-sector layoffs occur and have a demand-reducing effect indirectly.

As the table indicates, the California unemployment rate began to rise relative to the U.S. as early as 2007. The state's economy had become heavily dependent on housing, on rising home prices, and on shaky mortgages. So when the bubble began to burst, the impact was disproportionately felt in California. By the time of the January 2009 budget proposal

and the budget adoption the following month, state unemployment was already in the 10% range. When voters rejected the budget-related propositions in May 2009 and when the legislature revised the 2009-10 budget, unemployment was over 11%. And by the time of the January 2010 State of the State and budget message, California unemployment was over 12%. And it remained over 12% through the summer of 2010 and Election Day.<sup>100</sup>

But while it was easy, and politically understandable, to proclaim that the priority was jobs, actually doing much about the jobs problem in the short term was another matter. California does not have a monetary policy since there is no California currency and no California central bank. California's scope for mimicking the federal government's fiscal stimulus at the state level was very limited by constraints on the deficits a state could run. And as noted, making painful budget cuts was likely to worsen the local economic picture.

The main latitude that California might have, at least in minimizing the cuts, would have to come—if it were to come—from the federal government. But so far California's efforts to attract federal attention to its budget problems had not been especially successful. Hence, Governor Schwarzenegger complained that the feds should be providing more aid to California. His complaint about the then-pending federal health care bill—reflected in the quote above—could be viewed in that context.

After a meeting with President Obama in February 2010, the governor took a more conciliatory stance saying the Republican demand that a completely new health bill should be enacted was "bogus talk."<sup>101</sup> And once the Obama bill passed, the governor cooperated with its initial subsidy of a state program to cover individual with pre-existing health conditions that had made them otherwise uninsurable. The governor termed the state legislation to implement the federal program a "win-win

opportunity.”<sup>102</sup> By October 2010, he was predicting Obama would win re-election in 2012.<sup>103</sup>

Education is often viewed in the jobs context, not as a short-term remedy, but as a way of preparing students for the job market of the future. Hence, there was discussion in the governor’s speech about training and education. Included was promise of a proposed constitutional amendment—never in fact put on the ballot—that would preclude California from spending more prisons than on higher education.

The governor reported that almost 11% of the general fund was going to prisons and only 7.5% to higher ed. It appeared he was referring only to UC and CSU since with the community colleges, the state was spending *less* on prisons (10.1%) than on higher education (13%) in 2009-10.<sup>104</sup> Nonetheless, despite the data inaccuracies, the amendment proposal brought the requisite thanks from higher education officials, although the actual budget proposal was to eliminate enrollment growth funding for UC and CSU. (No comments on the idea were made by prison authorities.)

In the end, the proposal seemed to be part of an effort by the governor to develop support for the use of private prisons to save money. The Legislative Analyst’s Office (LAO) criticized the proposal. In their view, it was yet another potential piece of ballot-box budgeting that would “unwisely” hamper decision-making.<sup>105</sup>

The actual budget message called for \$6.9 billion in federal aid to California. If the full amount was not forthcoming, the governor then proposed (threatened?) drastic cuts such as ending the home health care aide program (In-Home Supportive Services or IHSS) and ending welfare-to-work (CalWorks). In part, the proposal seemed to be yet another attempt to attract the attention and assistance of the Obama administration, which had honed its skill at distancing itself from California’s fiscal problems during its first year in office. The Legislative Analyst termed the chance of getting the full \$6.9 billion “almost non-

existent.”<sup>106</sup> Initially, the White House resisted a meeting between the President and governor, but a “private” session was eventually arranged for February.

Whatever the odds of more federal aid, the state’s two Democratic U.S. senators complained about the governor’s remarks. The governor’s speech seemed to imply they were not doing enough in bringing federal dollars to California in a year in which Senator Barbara Boxer would be up for re-election. According to Senator Dianne Feinstein, “California’s budget crisis was created in Sacramento, not Washington.”<sup>107</sup> But the governor rejected the push-back. “I think we have made enough noise, even though they are complaining, even though the congressional delegation, you know, now feels guilty. The truth always hurts.”<sup>108</sup>

There would be no new taxes under the governor’s plan, but over \$300 million was supposed to come from installing traffic enforcement cameras and fining offending motorists. A “fee” on property insurance to go to state fire-fighting efforts was proposed. State employees would see an end to furloughs but instead would have a 5% pay cut and an increase in pension contributions by 5%—a net cut of 10%. K-12 would receive about the same nominal funding per student as in 2009-10, a real cut if educational operating costs rose. Some local transportation money was to be diverted to the general fund, triggering an outcry from transit operators. The diversion in part involved the previously-discussed proposed substitution of a gasoline fee for the sales tax on gasoline—since the gas sale tax is normally earmarked for transportation.

## PAUSE II

*"If I had hesitated in my career every time I made a move because it was too hard, I would still be yodeling in Austria."*

—Governor Arnold Schwarzenegger <sup>109</sup>

*"...Schwarzenegger continues to serve—with impossibly good humor—as punching bag and scapegoat for 38 million people who simply refuse to recognize that they can't have something for nothing, and that they themselves are the cause of their systemic troubles."*

—Commentator and Schwarzenegger biographer  
Joe Mathews <sup>110</sup>

The governor clearly viewed the budget situation in January as requiring prompt attention. He declared a fiscal emergency and called a special legislative session on the budget. However, unlike the previous summer, there was no pressing cash crisis at that moment and no immediate danger of IOUs. Indeed, the state was the beneficiary—at least temporarily—of \$50 million in uncashed IOUs from the prior summer that payees had evidently lost or forgotten.

State controller John Chiang warned in late January that a cash crunch might reappear early in the summer of 2010. However, in early February, the Assembly Budget Committee rejected the governor's request to give him authority to defer payments from the state during cash shortages. As it turned out, sufficient revenue came in—particularly during June—thanks to the early withholding schedule that the state had adopted to delay the threat of such a crunch.

Financial markets—which might have been a source of pressure on the state through the bond market—turned out not to be a constraint. The Federal Reserve was holding short-term interest rates on riskless securities close to zero. Investors seemed willing—now that the economy was at least bottoming out—to buy California securities despite the low bond ratings of the state. Thus,

concerns that California would be unable to borrow if it didn't enact a budget that seemed "balanced" by some definition turned out to be unwarranted, at least through the summer of 2010. Demand was sufficiently high for California bonds in March that an offering was increased from \$2 billion to \$2.5 billion.

The result of a lack of pressure on the legislature in the January-June period was little movement on the budget. At one point, legislative Democrats enacted a gas tax/gas sales tax diversion, related to—but not the same as—the diversion proposed in the governor's January budget. The Democratic version did not contain a net reduction in gasoline taxation the governor had desired and he promptly vetoed the bill in mid-March.

Democratic state treasurer Bill Lockyer supported the veto, saying his Party's version of the diversion plan did not do much to reduce the deficit and was legally questionable.<sup>111</sup> Common wisdom after the governor had made his January budget proposal was that the fiscal situation—combined with the 2010 political year—would lead to a prolonged summer stalemate. Virtually no one thought there would be a budget in place on July 1.

Common wisdom proved correct. At best during the remainder of fiscal 2009-10, there was a nostalgic reminder for when a difficult budget deal had been reached in the past. The John F. Kennedy library awarded "Profiles in Courage Awards" to the four legislative participants who came to an accord in the February 2009 budget deal. The award celebrated the participants for "standing up to the extraordinary constituent and party pressure" the deal provoked.<sup>112</sup>

But there were ironies in that award. That deal was a re-do of an earlier September 2008 deal that all participants had to know was unsustainable. Both GOP legislative leaders who went along with the February agreement lost their leadership positions as a result. And the February deal itself came unglued, partly due

to voter rejection of propositions that were part of the accord. It, too, then had to be redone.

Pressures to make some budgetary progress were not totally absent, however. The U.S. Supreme Court declined initially to reverse a lower court ruling that California undertake a major prison population reduction. Governor Schwarzenegger mused at one point about housing illegal immigrant prisoners in Mexico so save money. But the idea was quickly dismissed by his staff as “just something the governor thought was interesting.”<sup>113</sup>

Later, the Schwarzenegger administration came out with a more thought-out plan to have UC oversee prisoner medical care, a plan that was said to save money. But given the risks entailed for UC, the Regents sent the plan to a committee for study. Regent chair Russell Gould indicated that the Regents would “have to spend a great deal of time” pondering the idea.<sup>114</sup> By mid-June, the U.S. Supreme Court had also decided to ponder the prisoner issue; the court now accepted an appeal by the state of the lower court order mandating a reduction in the state prison population.

State treasurer Bill Lockyer warned that lack of budgetary action would could it difficult to sell state bonds and thus hamper implementation of job-creating public works. As noted earlier, however, the fact that financial markets seemed willing to absorb California paper, despite these misgivings, undoubtedly weakened the force of the warning. More seriously, the possibility resurfaced that state workers would be paid only the federal minimum wage if there were no budget on July 1.

The minimum wage issue had arisen in 2008, during the budget stalemate that year, but was fended off with litigation. No one was actually paid at the minimum during that episode. However, when that round of litigation concluded, state controller John Chiang, who had resisted cutting pay in 2008, essentially had lost on

all but one legal point. That one point—later to prove crucial—was that the state’s antiquated computers might be unable to accommodate the pay change, or be able to do so in a manner that would comply with federal labor law.

There were also political diversions during the first half of 2010 in the form of the June primary that would determine the final candidates for the November 2010 elections. As time passed, more and more TV political advertising appeared. The ads initially were heavily the product of self-funding by Meg Whitman, the billionaire former CEO of eBay who was running in the Republican gubernatorial primary.

In the contest for U.S. Senate, the action was also on the GOP side since it was clear that the Democratic incumbent, Barbara Boxer, would be re-nominated. As might be expected, there was less focus on California’s budgetary issues in the Senate race than in the gubernatorial contest. But at one point, Republican primary candidate (and eventual nominee) Carly Fiorina criticized rival Tom Campbell for his one-time role as Governor Schwarzenegger’s director of finance, notably in the so-called “Demon Sheep” YouTube video that went viral.<sup>115</sup> The ad showed a sheep with glowing devilish eyes, presumably standing for Campbell—the wolf in sheep’s clothing.

Fiorina also created a stir by seeming to say a state bankruptcy was “a possibility” that “should always be considered.”<sup>116</sup> It was quickly pointed out that there is no legal mechanism for a state bankruptcy. Yet, oddly enough, Democrat Jerry Brown—who might have capitalized on Fiorina’s statement—himself used the B word in public in March.<sup>117</sup>

Two corporations—PG&E, the Bay Area utility, and Mercury Insurance—financed expensive campaigns for propositions on the June ballot related to their industries (Props 16 and 17). Both of those initiatives were eventually rejected by voters. And as part of the



February 2009 budget compromise, the legislature was reluctantly forced to put on the June 2010 ballot a proposition that would create “open” primaries (Prop 14). Proponents believed that such non-partisan primaries would yield more centrist candidates—perhaps avoiding budget stalemates. Both major parties—as well as third parties—opposed the concept. But in June the proposition passed.

As noted above, because of the lack of an active primary race for governor on the Democratic side, much of the advertising and debating came from the GOP. Insurance commissioner Steve Poizner, who eventually became the main opponent to Meg Whitman in the primary, had in 2004 supported lowering the supermajority requirement for educational parcel taxes from two-thirds to 55%. He moved to the right in the primary, so that all talk on the GOP side focused on promising no tax increases. Indeed, candidate Steve Poizner proposed a 10% cut in income, sales, and profits taxes. Whitman offered “targeted” tax cuts for business and elimination of state taxation of capital gains. Of course, governors cannot by themselves cut taxes without the support of the legislature or, alternatively, by initiative.

Democrat Brown did not offer tax cuts. But he pledged no tax increases although in a more qualified way. He would not propose a tax increase. But if voters approved one—something that could happen via initiative or through a proposition put on the ballot by the legislature—that was another matter. Brown’s stance on no new taxes unless voters approved them became part of his campaign message in the general election.

Despite the lack of effective opposition to Jerry Brown on the Democratic side, his fiscal record in his previous terms as governor ultimately became part of the campaign. Brown had run for President several times; in 1992, he had supported the so-called “flat tax,” an idea with some similarity to the value-added type of tax that the now-defunct Commission on the

21st Century Economy had proposed for California. A Brown campaign spokesperson was vague on whether he now supported such a tax for the state.<sup>118</sup>

In California, the state income tax is progressive. Indeed, the state’s heavy reliance on higher income recipients is the source of proposals to flatten the tax system, or rely more on the sales tax or a value-added tax. Since incomes at the top are volatile, so—too—are related state revenues. But although the income tax is progressive, there are many other regressive elements in state and local taxation, especially the sales tax. It is possible for California to rely heavily on higher income individuals for revenue *and* have a net regressive tax system at the same time. But fixing regressivity by adding more progressivity adds to volatility. And fixing volatility adds to regressivity.

That is the economic dilemma surrounding the flat tax. But there is also a political dilemma. Support by Brown for a flat tax in 2010 would have tied him to Governor Schwarzenegger. But Brown wanted Whitman tied to the governor, who was originally elected as a non-politician in the 2003 recall. According to Brown, who became a formal candidate in early March, “some people say... we need to go out and find an outsider who knows virtually nothing about state government. Well we tried that and it doesn’t work.”<sup>119</sup>

Both GOP candidates—Whitman and Poizner—by that time were distancing themselves from Schwarzenegger. But Whitman especially was emphasizing her business background and her lack of previous connection to state politics.<sup>120</sup> (Indeed, major gaps in her voting record as a private citizen had become campaign issues.) Brown pursued the theme of Whitman as another Schwarzenegger in a TV ad aired in October 2010 showing clips of the two using the same words. The mantra that “we don’t have a revenue problem; we have a spending problem” was common to both. The issue of an outsider coming to Sacramento to shake up the dysfunctional budgetary process did

tend to tie Meg Whitman to Schwarzenegger. Yet Steve Poizner, even though he was already in political office, emphasized his business/outsider past. Brown, on the other hand, questioned the idea of sweeping changes as the naïve view of outsiders. "Fundamental change of oneself, one's body, one's spirit or in the body politic is a mistake... (I)ncremental change consistently worked on is the way forward," he said. <sup>121</sup>

While political drama was occurring for statewide executive offices, there was little budget action—even incremental—in the legislature which seemed preoccupied with other matters. The Assembly, for example, passed a resolution against cursing in public. But there was more activity in the streets. An early March student-faculty demonstration against the earlier tuition hikes at UC-Berkeley led to vandalism and some arrests. There were also related arrests at the state capitol. Other groups also demonstrated from time to time.

Although there was not much action within the legislature on the budget, Legislative Analyst Mac Taylor began to turn out reports on various aspects of the governor's January proposals. With regard to natural resources, environment, and related infrastructure, the LAO expressed various concerns about how proposed water bond revenues would be managed. (The water bond had not been postponed to 2012 at that point.) He also noted that what the governor called a "fee" for fire fighting was in reality a tax, thus requiring a two-thirds vote. It would also indirectly trigger more spending on K-14 education pursuant to Prop 98. <sup>122</sup>

With regard to transportation, the LAO viewed Caltrans as overstaffed in some areas. It questioned the legality of the governor's push for public-private partnerships due to the use of federal funding for that purpose. And the LAO urged more legislative oversight of the High Speed Rail Authority, which would be receiving federal stimulus monies. <sup>123</sup>

According to the LAO, the legislature should restore state funding to UC and CSU to the 2007-08 level, a level less than the governor's proposal. Community college tuition should be raised. Cal Grants to qualifying low-income students should not be cut. <sup>124</sup>

At the K-14 level, although the governor's budget nominally complied with Prop 98, there were questions about whether such compliance was actually possible and about the legal interpretations surrounding Prop 98. The LAO suggested an explicit suspension of Prop 98 or some other adjustments to insure legal compliance. <sup>125</sup> Relief for local school districts from mandated programs so that they could allocate state-provided funds more flexibly was also recommended. <sup>126</sup>

For health and social services, in some respects the LAO mirrored complaints by the governor about federal and court constraints on state budgetary options. On one hand, the state should seek more flexibility. But on the other the reality for California was heavy dependence on federal funding and regulation. <sup>127</sup>

These reviews by the LAO received media attention but exactly what impact they had on the legislature is unclear. And the media were already more enmeshed in the political campaigning—particularly by the time Brown officially declared—than concerned with the intricacies of a budget that wasn't going anywhere.

Absent progress towards a budget, public attention focused on symptoms of the budget dilemma. Oddities in the results of the furloughs ordered by the governor were detected, including the situation of workers who received furlough-related pay reductions, but who were unable or not allowed to take the time off. Their furloughs in effect became "banked" for future use which could lead to *de facto* paid leaves in the future.

As noted, those who did take furlough time off tended to take less formal vacation time, thus growing their bank of unused vacation which would eventually have

to be paid. The main furlough problem, however, was the uncertain legality of the program; the governor was winning some lawsuits on the issue and losing others. An eventual verdict by the California Supreme Court of illegality could trigger back pay, although it was clear that such a decision would not be forthcoming with finality during fiscal 2009-10.<sup>128</sup> (And when it came during 2010-11, the furloughs were upheld.)

There were other oddities and consequences developing, apart from those associated with furloughs. Depletion of cash available to provide bridge loans for public construction led to delays in such projects, a perverse result during an economic slump. Voter-approved bonds have to be floated on an orderly schedule. Absent such bridge loans, projects could not begin until there was actual bond money on hand.

UC-Berkeley indicated it would take more out-of-state students who pay higher tuition than in-state residents for budgetary reasons. UC-Davis dropped certain team sports. At the community college level, for-profit Kaplan University advertised to students that it could offer courses that were becoming unavailable at the public institutions. Yet polling data suggest that almost nine out of ten California parents want their children to attain at least a college degree.<sup>129</sup> And employers were expressing concern about the impact of a deteriorating K-12 and higher education system on the state's workforce.<sup>130</sup>

Delays in college acceptance were also developing; both UC (except UCLA and UC-Merced) and CSU began using wait-lists for students since the budget that would be provided to higher education was uncertain. For stray pets, however, delays were shortened. A state-mandated requirement that stray animals in local pounds be kept alive for an extended period went unfunded, leading to shorter times to euthanasia.

Despite the symptoms of fiscal distress, there was a tendency in the legislature to wait until the May revise

before even considering major budget issues for 2010-11. The economy had at least bottomed out and the Legislative Analyst issued an interim report pointing to the somewhat improved economic outlook. It was more tempting to look at the bright side of that report and neglect its warning of a long-term structural deficit that had to be addressed.<sup>131</sup> However, in the period immediately after the Analyst's report, the legislature did pass some mid-year deficit cuts, mainly through a diversion of transit funds to the general fund. These cuts were combined with some tax breaks for green businesses and first-time homebuyers. Transit operators, while not happy with the diversion, basically agreed to it as better than other proposals on the table.

The problem was that every plus for the budget seemed to be accompanied by a minus. A court decision allowed the state to divert funds from local redevelopment agencies. But the governor dropped his plan for funding from offshore drilling after the BP oil spill in the Gulf of Mexico. By that time, poll data showed strong public opposition in California to such drilling.<sup>132</sup> April tax collections were below estimates made in the January budget proposal. New federal funding was secured but also less than what had been estimated (or perhaps "demanded" would be a better term) by the governor in January.

## REVISE AND DISSENT

*"I now have no choice but to stand here today and to call for the elimination of some very important programs. If we had reform in place we would not be facing the 'Sophie's Choice.' (E)very time we talk about reform, the lawmakers don't have any interest to really do those reforms. The special interests shout that we're balancing the budget on the backs of the poor and at the same time they push the lawmakers to drain the budget when we have spikes in revenues and then scream for tax increases when we fall short on revenues."*

—Governor Arnold Schwarzenegger<sup>133</sup>

*"I am disappointed that the Governor has chosen to surrender. That he sees California as unfixable and that he proposes a budget that kills the economy and harms so many. It is a non-starter. If God forbid this budget became a reality, California would be the only state in the union to not have a safety net for children. Leadership is not about blaming others. It's about finding solutions to tough problems to preserve the state and its people."*

—Senate president Darrell Steinberg <sup>134</sup>

*"What I said to the governor in just a hallway exchange was, 'You better be glad I'm not here, because I'd have my members send you the document you sent to us, which is not implementable.' It's clearly designed for refinement. You give him his original document, and he'll jump off the bridge."*

—former Assembly speaker Willie Brown <sup>135</sup>

Amidst the rhetoric surrounding the May revise proposal, the basic issue—as noted previously—was obscured. The governor proposed a plan that would, given his estimates, lead to a positive reserve of about \$1 billion at the end of fiscal year 2010-11. But the reserve at the end of 2009-10, the year that was soon to conclude, was estimated to be roughly -\$8 billion if nothing further were done for that year. So the governor wanted the end-of-year reserve to rise by a net \$9 billion. ( $-\$8 + \$9 = +\$1$ )

However, the workload budget for 2010-11—what would happen if nothing further were done—was in deficit by about \$10 billion. What the governor wanted was a fix totaling around \$19 billion. By his calculation, that would have resolved all current *and past* budgetary sins by the end of fiscal 2010-11. More specifically, what the governor was proposing was about a \$1 billion reduction in the 2009-10 budget and cuts of \$10 billion in the 2010-11 budget just to bring it into balance (income = outflow), and still more cuts in 2010-11 of about \$8 billion to correct the remaining past sins.

When the issue is posed as above, distinguishing present from past and stocks from flows, the question

can be looked at differently from the way it was presented by the governor. Specifically, the issue becomes how much past sin was it necessary to correct *within* 2010-11. For the governor, not correcting all of it was irresponsible or at least a legacy that he did not want to leave to the next governor. But that was not necessarily the way legislative Democrats saw it. What the governor viewed as "kicking the can down the road" (not ending with a positive reserve of \$1 billion) was seen by them as a multiyear approach (essentially borrowing internally and externally during 2010-11 as part the budgetary solution).

To keep the 2010-11 budget in balance and correct past sins would require either a substantial gain in revenue or substantial cuts. The governor had taken a stance on no new taxes so the emphasis was on cuts. But as in January it may have been that by proposing drastic cuts, he was still hoping to pry more aid from Washington.

Perhaps the threat of major cutbacks in social welfare programs such as Medi-Cal, home service aides, and CalWorks was designed to shock Washington into providing more support. If that was the goal, however, the added funds were not produced. But, as might be expected, the proposed cuts triggered strong resistance from legislative Democrats.

Even Republicans were reticent. GOP gubernatorial candidate Meg Whitman she wouldn't have called for the complete elimination of CalWorks, but rather would have reformed it. <sup>136</sup> Similar sentiments were expressed by Republican Senator Roy Ashburn who thought the governor was just being "provocative" in making the proposal. <sup>137</sup> The Legislative Analyst indicated that it would be better to squeeze more money out of education at all levels than completely to terminate CalWorks. Yet various educational groups had filed suit shortly after the May revise challenging state funding of K-12 education. Their claim was that the state was not meeting its constitutional requirements to provide free public education. <sup>138</sup>

An additional issue was that the governor tied his eventual signing of a budget to reforms that had limited immediate effect on the budget. That is, in his final year in office, he may have wanted to leave a legacy as a reformer. Some of the threat to the Schwarzenegger legacy was effectively on the ballot in November 2010, but not something the legislature could directly influence. He had succeeded through a ballot initiative in 2008 to take redistricting out of the hands of the legislature (after failing in 2005). However, Prop 27 was put on the November ballot by another initiative and it would reverse the 2008 proposition, sending redistricting back to the legislature.

Related to reforms in voting was Prop 14 on the June 2010 ballot creating a non-partisan primary system for the legislature. Proponents—who vastly outspent detractors of Prop 14—believed that such a primary system would lead to more centrist candidates and legislators, and so persuaded the voters. A legal challenge was soon mounted. Among the proponents of Prop 14 was Governor Schwarzenegger.

The governor had developed an international reputation as an environmentalist by supporting state reduction of greenhouse gas. But Prop 23 on the ballot would suspend key legislation—AB32—that would implement that reduction. Apart from ballot issues, the non-partisan primary that voters passed in June 2010—part of the budget deal of February 2009—was challenged in court. The governor was a supporter of the non-partisan approach, but there was nothing that budget negotiations could do to deal with these legal challenges to the Schwarzenegger legacy.

Another goal of Governor Schwarzenegger in the past was creating a “rainy day” fund to smooth out budget fluctuations. In 2004, as part of the budget workout of that era, Props 57 and 58 were passed by voters. A rainy-day fund of sorts was created. But in reality the general fund always has had a reserve and creating a second reserve essentially added little. Whether the

governor would insist on yet a third reserve—or a modification of the earlier rainy day fund—with some tighter formula as part of a budget deal was unclear.

However, the governor did express a clearer desire for pension reform. All three major state pension funds, CalPERS, CalSTRS, and UC, had become underfunded. As part of his abortive “Year of Reform” initiative package in 2005, the governor had originally included a pension-related proposition. But it was dropped and never appeared on the ballot because of technical language problems that seemed to target the widows of public safety officers. (And had it appeared on the ballot, it almost certainly would have been swept to defeat with the other 2005 initiatives the governor had pushed.)

## A PENSION DIGRESSION

*“Our pension crisis... will continue to grow and crowd out funding for programs and services Californians hold dear such as higher education, parks and environmental protection.”*

—Governor Arnold Schwarzenegger <sup>139</sup>

Public pension issues became more pressing by 2010, thank in part to the 2008 financial collapse which led to major declines in the stock market. These declines affected not only state public pension system but also local government pensions maintained by various jurisdictions. The issues of pension funding are complex. But a few elements are worth reviewing here.

Public pensions tend to be of the “defined-benefit” type. Defined-benefit plans provide a monthly pension on retirement that is based on a formula, typically involving age, length of service, and pay history. Good management of such pensions requires setting a formula that is not susceptible to gaming by employees; such gaming is known in the field as pension “spiking.” If the pay history covers only a

short period before retirement, and if that history is allowed to include such things as overtime pay, employees may be able to inflate their final earnings and thus qualify for a pension out of line with their true past earnings history. Some public pensions in California were susceptible to spiking.

Good management also involves the funding side. Employees are accruing pension promises annually as part of their pay packages for current services. If employers do not put aside adequate funds to provide for those promises at the time the promises are earned, then—in effect—services of public employees today are being charged to the future, a bad practice. Future taxpayers, who were not necessarily the recipients of those services, will be paying for the compensation of retired employees who worked earlier.

Pension experts have a concept—the “normal cost” of a defined-benefit pension—which can be thought of as the amount needed to be put aside today to pay for today’s promises when those promises eventually come due. Part of the calculation of the normal cost involves the expected rate of return of the pension fund’s investments. Since the future rate of return cannot be known with certainty until it occurs, it is possible for pension funds to become underfunded or overfunded even if good-faith estimates of the normal cost are put into the pension trust.

Good practice, however, is to keep contributing the normal cost to the fund, even during periods when pensions appear overfunded, since investments—particular stocks—can go up and down in value. California public pensions were given increased latitude to invest in stocks through a legislative ballot proposition in 1984. If underfunding becomes pronounced, good practice involves “amortizing”—paying off the gap in installments over a period of years. Thus, the contribution to the fund—usually a combination of employer and employee contributions—should be the normal cost plus any needed amortization.

Suffice it to say that public pensions in California were not always managed according to these good practice rules, although the degree of departure from the rules varied with the particular fund. The legal status of retiree and employee claims against public pension funds in California is pretty ironclad; once benefits have been earned, they cannot be taken away retroactively. Thus, pensions of already-retired employees cannot be cut. And the prior accruals of active employees are also protected.

However, public employers—including the state—can legally terminate pension plans, ending future (but not past) accruals. New hires can be given lesser benefits (or even no benefits). Active employees can be given lesser benefits *going forward* or, as just noted, even no further accrual of benefits.

Governor Schwarzenegger appeared to favor some version of such a “two-tier” approach, i.e., a degraded pension for new hires and for active employees going forward. Various options fall into the two-tier category. One version could be a new, but less generous, defined-benefit pension. Another—explicitly favored by GOP gubernatorial candidate Meg Whitman—would offer as a second tier a “defined-contribution” plan. Under such a plan, the employer simply puts a defined amount—say a fraction of the basic wage—into a tax-favored savings account for the employee. The employee is left to invest the money in various funds offered by the employer, e.g., a stock fund, a bond fund, etc.

Since the employer has not promised more than the current contribution, a defined-contribution plan—by definition—cannot be underfunded. However, what the plan would end up offering as a retirement income would depend partly on what rate of return the employee had achieved. He/she could take the cash accumulated upon retirement to a commercial insurance company and buy a monthly annuity that would pay a specified benefit for life. How much the accumulated cash would buy would depend on such factors as the

rate of interest at the time of retirement. In short, moving from defined benefit to defined contribution shifts a major risk from the employer to the employee.

Even if the state were to adopt some version of a two-tier pension system, it would still owe benefits under the old plans to retirees. And it would still owe active employees what they had accrued under the terms of the old plan up to the date that the lower-tier plan was substituted for the old one. Thus, the annual budgetary savings of going to the two-tier approach are limited.

Moreover, other things equal, two tier is a cut in pay for those affected. During a weak economy, that may not pose an immediate problem, since recruitment of new employees is limited and current employees are less likely than in good times to quit. But should prosperity return, cuts in pension benefits might have to be offset by other forms of pay. The bottom line is that pension reform would have only a limited effect on the 2010-11 budget and its savings in the future might be less than its proponents may think.

It was not clear what the governor would view as a sufficient step to count as a reform legacy in the pension area, although some general elements emerged. Following the May revise, he signed contracts with various state unions which raised employee contributions to their pensions and create a second tier for new hires. In a *Wall Street Journal* op ed, he suggested that more would be required for him to sign a budget. But some of what he seemed to want might require constitutional amendments which could not be on the ballot before the governor's term expired.<sup>140</sup>

Earlier, he had used strong language saying that needy recipients of state services were being "robbed blind" by public pensions.<sup>141</sup> Yet while this rhetoric was being uttered, a trial balloon was leaked from the governor's office suggesting that the state might in some way "borrow" from CalPERS.<sup>142</sup> Not surprisingly, that possibility was quickly abandoned.

Whatever the explanation, complaints about pension underfunding and proposals to borrow from the same pension plan did not go together.

In any case, in the union contracts that were signed, the lower-tier retained the defined-benefit format and did not affect future accruals of existing workers. The unions that made these deals may have felt it was best to sign with the current governor. The uncertain alternative was to await either Meg Whitman—known to favor a more drastic two-tier approach with the lower tier being defined contribution—or Jerry Brown who had a mercurial reputation. Whitman exempted only public safety workers from her defined-contribution approach—except for prison guards whose union endorsed Brown.

The pension question became both a political issue in the 2010 gubernatorial election campaign and an element of the eventual budget deal reached in October 2010 regarding the 2010-11 budget. Governor Schwarzenegger had—as noted—made some kind of pension reform a "legacy" issue and insisted that he would not sign a budget without such reform. An eventual deal between the administration and SEIU Local 1000 (a key state worker union), became what the Governor seemed willing to regard as sufficient. The deal included higher employee contributions to CalPERS and a defined-benefit plan lower tier plan for new hires.

After the budget was signed, the governor criticized certain Republican legislatures by name for not going along with the pension deal in his weekly radio address of October 15, 2010. The YouTube version of the address included photos of the errant legislators. The pension matter also entered the gubernatorial race through the "whore-gate" controversy. Candidate Jerry Brown called a representative of a police union trying to enlist support and left a voicemail message. He did not properly hang up the phone and the voicemail picked up subsequent talk among Brown and other aides.

One of the aides called Whitman a "whore" on the recording for accepting police union support in exchange for deviating from her plan for creating a lower tier defined-contribution pension for state workers. As indicated, she supported an exception, allowing defined benefits for police. Although the matter surfaced as an insult to women for which Brown apologized, he rather inarticulately made the allegation of exchanging police union support for retaining defined contribution at a TV debate. Perhaps more surprisingly, Governor Schwarzenegger criticized Whitman for just such a political exchange in a Twitter note.

In any case, the immediate budget crisis was leading to more pension underfunding, not less. CalPERS had proposed a large increase in employer contributions to the fund but postponed the request shortly after the May revise was presented. The UC Regents authorized a restarting of employer and employee contributions to the UC pension plan in April. But they were unable to obtain funding from the state so the employer share was deducted from other elements of the university budget.

Moreover, absent state funding, the UC restart was itself underfunded and below the Regents own policy toward pension funding. In September, they boosted contributions but, again, still to a level below their own policy. At this writing, the Regents planned to come up with a two-tier defined-benefits approach by the end of calendar 2010.

## SUMMERTIME AND THE BUDGET IS QUEASY

*"They always start late, therefore they always will be late."*  
—Governor Arnold Schwarzenegger <sup>143</sup>

*"The budget will not be written behind closed doors in 'Big Five' meetings."*  
—Assembly Speaker John Pérez, after being sworn in to the Speakership <sup>144</sup>

*"(Budget proposals) are the exact kind of things you can't discuss in public. That's what makes them evaporate. Once you get to resolution you can talk about it but not before. It's the greatest way that you undermine the ability to get to resolution."*  
—Assembly Speaker John Pérez, after two weeks into the 2010-11 fiscal year with no budget in place <sup>145</sup>

On July 1, 2010, as virtually all observers had long predicted, there was no budget in place. Nor was there much sign that a budget would be enacted any time soon. The governor mounted a deficit "clock" outside his office that purported to show the daily deficit accruing as each day with no budget passed. (In fact, since budgets can apply retroactively, and since receipts and expenditures are seasonal, it is not possible to attribute a precise number to a given day.) And despite claims that transparency required avoiding private discussions among the Big-5 (the governor and the four legislative leaders), there were on-again/off-again Big-5 meetings and consultations (that apparently produced no results).

Governor Schwarzenegger initially had the minimum wage threat available; state workers would be paid the federal minimum until a budget was enacted. (Then they would receive the total salary due.) Attempts by Democrats in the legislature to make the state payroll a "continuing appropriation"—which would have ended



the threat—were unsuccessful. But the arguments in court of state controller John Chiang soon thwarted that threat.

Chiang argued—as he had in 2008—that the state’s payroll computers couldn’t handle the cut to the minimum (and the subsequent reimbursement for lost pay after a budget was in place) within the legal bounds of federal labor law. A court refused to force Chiang to implement the cut, pending a full hearing on that issue. The refusal effectively pushed the minimum wage issue off the table through the end of the legislative session on August 31st and beyond.<sup>146</sup> However, some state labor unions did sign contracts with the governor which potentially would exempt them from the minimum wage—assuming the legislature approved the deals. So the minimum threat seemed to be more effective in collective bargaining than it was in the budget realm.

Once the court decision took away the minimum threat, the governor found a new bargaining chip. Furloughs were to end with the expired 2009-10 fiscal year. The governor announced new furloughs to be in force until a budget was enacted. By that time, various furlough-related legal cases had reached the state Supreme Court, although no final decision had been reached. Thus, the continued furloughs became a substitute lever for the governor.

Governor Schwarzenegger had a setback in court which prevented a resumption of furloughs in July but eventually his authority was at least temporarily restored while the issue went to the state Supreme Court. In various interviews, he insisted that with the budget must come various reforms—notably in the public pension area. And he threatened that if there were no reforms, the budget impasse might last until his term ended and a new governor took office.

Democrats pushed for a delay in various business tax breaks that were due to start on January 1, 2011

under the terms of the February 2009 budget deal. But that would require Republican votes which were not forthcoming. And in any event, a proposition on the November ballot (Prop 24) would repeal those breaks.

There was also a complicated scheme involving borrowing from the Beverage Recycling Fund and paying back the Fund with an oil severance tax. Their approach was supposed to avoid the two-thirds vote requirement but it was legally dubious. Indeed, Democratic gubernatorial candidate Jerry Brown—in his role as attorney general—said the plan was illegal. Given the uncertain legal issue, it was unlikely that buyers of bonds issued on the basis of the scheme could be found, if it were somehow enacted.

Another tax plan by the Democrats involved raising certain taxes that could be deducted from federal income taxes—mainly the state income tax—and providing partially offsetting tax cuts elsewhere. The argument was that the net effect, once the federal deductions were factored in, was that Californians would come out ahead. There was some dispute over the impact. The LAO found that not all tax brackets, particularly those covering folks in the middle-income range, would produce net benefits. That is, middle-income taxpayers would typically experience a net increase in taxes. In any event, the impact would vary from taxpayer to taxpayer.

It appeared that part of the debate was over whether to make the comparison with current taxes or with the taxes that would be paid once the February 2009-enacted temporary increases lapsed. Senate president Darrell Steinberg insisted that the current comparison was the relevant one to make, even though voters in May 2009 had rejected extending the February 2009 increases. In any event, coming out ahead when federal deductions are factored in does not void the two-thirds vote requirement. And Republicans seemed unlikely to provide the needed votes.

There was also discussion of pushing responsibility for some social welfare programs—"realignment" was the term used—from the state to the counties, although how the counties would fund the programs was unclear. Candidate Brown seemed to favor the idea, saying that at the state level government had become "constipated and overloaded with too many conflicting mandates."<sup>147</sup> Odd ideas surfaced from the legislature. For example, one bill was approved by the senate and sent to the assembly which would have allowed digital advertising on car license plates as a way of generating revenue.

Meanwhile, the June primary had brought the gubernatorial contest—and other statewide contests—effectively down to two candidate races, one Republican and one Democrat. Of interest for budgetary reasons was the Insurance Commissioner race on the GOP side. Former Assembly minority leader Mike Villines had lost his leadership position because he went along with the February 2009 budget compromise. He ran in the Republican primary for Insurance Commissioner against a virtual unknown who did little campaigning. Immediately after the June 2010 primary election, it appeared that the unknown candidate had narrowly won. Later, once all ballots including absentees were counted, Villines had eked out a narrow victory. Nonetheless, it was clear that Villines' near loss in the primary was due to compromising on the budget, a message Republicans in the legislature surely recognized.

Neither Jerry Brown nor Meg Whitman in the gubernatorial race had kind things to say about Governor Schwarzenegger. As a result, the governor withheld endorsing either candidate in the general election. Indeed, he pronounced GOP candidate Whitman's call to cut state employee jobs by 40,000 "bogus."<sup>148</sup> But he conceded when pressed in an interview that his eventual endorsement for a successor would be a Republican (and Whitman was the only Republican).<sup>149</sup> With Whitman continuing

to blame the budget situation on the legislature and governor collectively, Schwarzenegger remained silent as to any endorsement. At this writing, no endorsement had been made by the governor.

Initially, after the primary, Brown seemed to revert to his 1970s off-beat persona, making statements such as that "the fundamental quest is how do we touch our spirituality."<sup>150</sup> He emphasized incrementalism rather than specific grand plans for the budget or anything else, talking about an "agenda of humility," a phrase that harked back to the "small is beautiful" approach of his earlier governorship.<sup>151</sup> Whitman had issued a booklet before the primary with a general plan which Brown dismissed saying "She doesn't have a plan. She has a pamphlet, and most of it is pictures."<sup>152</sup> But later he began to issue more specific plans of his own.

Whitman continued to outspend Brown on campaign advertising, mainly TV and radio, by a large margin. She criticized both the legislature and the governor for not producing an on-time budget. Since Brown was dependent in large part on union support—financial and indirect—she tried direct appeals to unionized workers individually such as nurses. But to the extent that Brown allies were able to do so, they continued to raise her Wall Street connections and her sparse voting record as a private citizen. Also surfacing was an incident at eBay where Whitman apparently had an argument with an employee and shoved her, leading to a lawsuit and a significant monetary settlement with the employee.

There was not much direct critique in the anti-Whitman advertising about her particular budget priorities. Indeed, some of the critique she received was from the right—not through advertising but through talk radio. Arizona had passed a law aimed at preventing illegal immigration that had become controversial. Whitman was viewed by some on the right as insufficiently tough on illegals because she did not endorse similar approaches for California.

More generally, conservative Republican congressman and former state legislator Tom McClintock referred to a possible Whitman victory as "Arnold Schwarzenegger's third term," a description not meant to be a compliment.<sup>153</sup> (McClintock—as a state legislator—was known for voting against all enacted budgets.) He continued his critique after she won the Republican primary and did not endorse her. For the general public, however, the absence of a budget or even the cuts in the prior budget had little day-to-day effect. Only those particularly dependent on state services felt the effect. CSU, for example, raised summer 2010 tuition and then tuition for fall 2010.

From time to time, items would appear in the news media about particular programs being threatened—such as mammograms for poor women or Cal Grants for community college students—or about peculiar results occurring.<sup>154</sup> For example, in the past under the Williamson Act, a program existed to preserve agricultural land from development through state-funded property tax reductions to farmers. The program was administered by counties that would normally receive funding from the state. But the governor had used a line-item veto cutting the program to \$1,000 total. So the media reported that counties were receiving checks from the state for as little as one cent as their shares of the \$1,000 total.

The IOU threat was periodically raised by the controller and others. In a sense, IOUs were again issued during summer 2010. When there is no budget, suppliers to the state go unpaid and various public programs go unpaid. So the state saves cash by not paying bills on time and thus owes the funds both to private and public entities. Various health providers received a form of IOU in the late summer. But the state did not return to issuance of Registered Warrants during the summer and the controller indicated that the various other deferrals of payments would stave off issuing such warrants until at least October.<sup>155</sup>

In effect, the cost of not having a budget in place to the political actors was low. Academic research across states suggests that when these costs are low, the probability of late budgets rises.<sup>156</sup> California was a poster child for that premise in the summer of 2010. Even the fact that the legislative session technically ended on August 31 did not produce budget progress. Votes were taken on Democratic and Republican versions of the budget with both sides knowing that absent a two-thirds vote neither would pass.

The governor had announced that he would call a special session to deal with the budget beginning September 1, so all participants had every reason to think the budget would remain a live issue. As it turned out, he did not immediately call such a session. Instead, he held a press conference on September 1, much of which was focused on the pension issue. He insisted that even though there appeared to be no more Big-5 sessions going on, some kind of behind-the-scenes contacts were occurring and that really all sides were "very close" to a deal, held apart only by special interests and election politics.<sup>157</sup> But since no deal emerged, he took off on a scheduled trade mission to Asia. Big-5 meetings took place on his return—with a renewed promise that a deal was in the offing.

## PROPOSITIONING THE VOTERS

*"These two initiatives are Exhibits A and B as to why the initiative process needs to be reformed."*

—State Senate president Darrell Steinberg,  
referring to Props 22 and 26<sup>158</sup>

By mid-July, the propositions that would appear on the November 2010 ballot were assigned numbers and the ballot analyses and arguments were published. Some of the propositions had budgetary implications. As noted, a water bond was originally on the ballot

but was removed by the legislature, fearing that voters would not pass it in the midst of an economic slump. Prop 19 purported to legalize marijuana—not just “medical” marijuana—a flat collision with federal law. Part of the argument for Prop 19 was that legalized marijuana could be a source of tax revenue. One ad suggested there could be “billions” in revenue—a bit of a stretch, albeit no time period was mentioned. Prop 21 added a motor vehicle fee of \$18 per annum earmarked for state parks. The pro side added the enticement that California-registered cars would receive free admission to those parks. Prop 22 tightened prior constitutional language to prevent the state from raiding the treasuries of local governments and transit agencies. However, not all local governments were sold on the idea; counties that were heavily dependent on the state were concerned that tying the state’s fiscal hands would lead to less funding for them. Prop 24 was a repeal of the business tax breaks included in the February 2009 deal and slated to go into effect beginning in 2011.

Prop 25—opposed by Governor Schwarzenegger—dropped the two-thirds vote requirement to pass a state budget to a simple majority. Opponents objected to the title which explicitly noted that the two-thirds vote requirement on taxes would not be touched. They raised issues related to whether Prop 25 might indirectly allow majority votes on taxes. However, an attempt to obtain a court-ordered title change failed. Going in the opposite direction, Prop 26 went in the opposite direction, adding a two-thirds vote requirement for increasing state fees. Proponents argued that a loose distinction between a fee and a tax had allowed the legislature to engage in *de facto* tax raising by majority vote.

While the implications (or outcomes) of these various propositions for future budgeting is not clear at this writing, their presence on the November ballot added to a climate of fiscal uncertainty. For that matter, the fact that 2010 was a gubernatorial election year was also a source of uncertainty. Fear of the unknown

**Table 6: Registered Voter Views of the California Economy, September 2010**

California voters Characterizing the Economy as “Bad Times”	93%
Voters Expecting the Economic Situation to Worsen or Stay the Same	66%
Voters Characterizing Unemployment in California as Very Serious	89%
Voters Expecting Job Situation to Worsen or Stay the Same	65%

Source: California Field Poll, <http://field.com/fieldpollonline/subscribers/Ris2360.pdf>

might conceivably have spurred budget negotiators to complete their business over the summer. But it did not appear to have that effect.<sup>159</sup>

The approach of Election Day, however, did seem to encourage a renewed attempt at deal-making which culminated in the budget accord—however shaky—described in the next section. Much depended on how one might think lack of a budget would affect votes for Prop 25—the measure to reduce the votes needed to pass a budget to a simple majority. Republicans may have concluded that a continuing budget stalemate would increase the odds that Prop 25 would pass. A simple majority rule would likely weaken minority party power to block a budget.

For both parties, as **Table 6** shows, voters were in a sour mood due to the California economy. Almost all registered voters in September 2010 thought that the condition of the state’s economy was bad and two thirds thought the situation would continue in the following year or even worsen. How this dark view would play out in the November election was unclear, but it was possible to paint scenarios in some legislative districts that would be unfortunate for one party or the other.

# THE FALL 2010 BUDGET DEAL

*"State legislators stalled on a new budget for a record 100 days... It didn't improve with age. The budget they enacted is a sick joke of phantom revenues and low-ball expenditures that will almost certainly fall apart in a few months."*

—Dan Walters, Sacramento Bee columnist <sup>160</sup>

*"...(A)s the economic recovery is expected to be slower than shallower than those of the past, the state will have a more difficult time growing its way out of the current negative balances."*

—Moody's Investors Service, commenting on the reserve in the general fund <sup>16</sup>

Although California's institutions have gradually adapted to delayed budgets—the government does not shut down when there is no budget in place—the costs do creep up. There were little annoyances— toilet paper in state park restrooms and outhouses was reportedly running out since suppliers weren't being paid. And there were bigger ones—\$3.9 billion in transportation project spending was delayed to the point where fall and winter weather conditions (mainly rain) would cause delays in spending—even if a budget were suddenly to be enacted. <sup>162</sup>

As such problems accumulated in late September, word began to leak out of the budget negotiations that some kind of deal was close. Then a "framework" for a deal was announced. And finally an actual deal was concluded and legislative leaders patched together enough votes to pass the accord.

While this process was unfolding, the two gubernatorial candidates were hinting at what they would do about the budget and related issues. Both Jerry Brown and Meg Whitman seemed likely to take some kind of budget-oriented propositions to the voters through ballot measures. Brown threw out a number of ideas such as using final-offer arbitration

**Table 7: Enacted 2010-11 Budget Compared to Earlier Workload Estimate (\$ billions)**

	2010-11 Workload Budget as of May 2010 Revise*	2010-11 Enacted Budget Oct. 2010 With Vetoes
Revenue & Transfers	\$89.3	\$94.2**
Expenditures	\$99.5	86.6
Surplus/Deficit	-\$10.2	+7.6
Reserve at End of Year	-\$17.9	+1.3

\*From Table 4.

\*\*\$1.4 billion of the increase relative to the workload estimate comes from adoption of a more optimistic forecast.

Source: Enacted budget estimates from Legislative Analyst's Office, Major Features of California's 2010-11 Budget, October 12, 2010. (This release first appeared without the governor's line-item vetoes and was revised after the vetoes were made.)

in the legislature to determine whether the budget would be the Democratic or Republican version. <sup>163</sup>

He also suggested so-called zero-based budgeting (all programs start from zero and must be annually justified to continue). <sup>164</sup>

**Table 7** compares the pension agreement of October 2010 with the workload projection issued by the governor as part of his May 2010 revise. "Agreement" may be too strong a term because after the governor line-item vetoed over \$900 million in spending, legislative Democrats suggested that he had not upheld their understanding. They vowed to restore at least some of the cuts, although such restoration would depend on cooperation of the governor who would take office in January 2011. One lawsuit challenging a particular veto of an expenditure of over \$100 million for child mental health was filed. At this writing, there could be yet other such suits challenging either vetoes or other budget elements in the future.

There were also reports and denials that whatever understanding with the governor about vetoes existed had been voided by legislative failures to pass certain bills the governor wanted. <sup>165</sup> Just as there was

political retribution after the February 2009 budget deal, so, too, was there a reoccurrence in October 2010. In the later case, a Democratic legislator who voted against the budget deal—Senator Leland Yee of San Francisco—had his name stripped from a bill and was later removed from a leadership position.

Ostensibly, through a combination of revenue enhancements and budget cuts, the 2010-11 budget was not only “balanced” but ostensibly runs a surplus of over \$7 billion, sufficient to end the fiscal year with a reserve of over \$1 billion. However, the budget numbers were shaky. Of the revenue increase shown relative to the May workload budget, \$1.4 billion was the result of a more optimistic forecast. About \$1.8 billion was in fact borrowing from outside the general fund and another \$0.9 billion represented enhanced estimates of asset sales (state office buildings). As noted earlier, borrowing and asset sales are not really “revenue” in a meaningful sense.<sup>166</sup> There were optimistic assumptions of \$4.1 billion in federal support, some of which might not arrive. On the other hand, there was a suspension of a business tax break that would otherwise have cost over \$1 billion.

There were real cuts—notably the line-item vetoes just mentioned—and a suspension of Prop 98 requirements for K-14 spending. Some cuts might not happen, however, such as a drop in prison medical care of \$800 million that appeared to fly in the face of court orders to the contrary.<sup>167</sup> Although a pension deal was part of the governor’s requirement for reaching a budget deal, there were no pension savings reported for 2010–11. His pension deal would have budgetary impacts only in the future. The future was clouded, however, by structural problems that included expiration of the temporary tax increases passed in February 2009. Indeed, there was a possibility that the new governor who took office in January 2011 would push for a reopening of elements of the budget for 2010–11 as part of the budget proposals that would have to be made for 2011-12.

## WHAT DO WE LEARN?

*“You can’t win everything.”*

—Governor Arnold Schwarzenegger, commenting on the budget deal and his legacy<sup>168</sup>

*“I’ll probably make some new mistakes. But I’m not making any old ones.”*

—2010 gubernatorial candidate Jerry Brown, on what he would do if elected<sup>169</sup>

Clearly, California was a state in dysfunction with regard to the budget and other matters of public policy. The usual suspects for this dysfunction are well known, although observers put different weights on the various elements. But they include institutional features such as ballot-box budgeting, supermajority requirements, gerrymandering, party polarization, and the amateurism brought about by term limits. Underlying the problem is an inability to make sufficiently rapid budget adjustments, as the economy fluctuates, to keep the budget reasonably balanced.

Budget problems were a key factor in the recall of Governor Gray Davis and his replacement by Arnold Schwarzenegger in 2003. Yet the new governor ended his period in office with a level of public disapproval comparable to Davis’ at the time of the recall. Perhaps voters expect more of their governors than is reasonable. But it is also true that as governor, Arnold Schwarzenegger, tended to have an expansive agenda and an impatience for detail.

His ability to focus on solving the underlying budgetary institutions that brought him into office was insufficient to bring about major change within his two terms. The Schwarzenegger budgetary legacy may hang on the fate of his favored nonpartisan primary (passed by the voters but in litigation) and redistricting outside the legislature (whose fate in the hands of voters in November 2010 is unknown

at this writing). Proposition 25—dropping the votes needed for a budget from two-thirds to a simple majority—might affect the decision time for budgetary enactment. But since Governor Schwarzenegger opposed it, it cannot be part of his legacy, even if passed. A new governor will take office in January 2011 and face an immediate legacy of a budget still in short-term and long-term distress.

**1** Quoted in "Not Sure He's Joking," *California's Capitol*, May 22, 2009. This chapter relies heavily on news sources such as the *Sacramento Bee* (including its *Capitol Alert*), the *Los Angeles Times*, the *San Francisco Chronicle*, and associated and independent news blogs. In general, only direct quotations are cited due to space limitations.

**2** John B. Judis, "End State: Is California Finished?" *The New Republic*, October 26, 2009.

**3** Quoted in Kevin Yamamura, "Schwarzenegger Wishes He Could Run for Third Term," *Sacramento Bee Capitol Alert*, April 26, 2010.

**4** Quoted in Michael Grunwald, "Despite Its Woes, California's Dream Still Lives," *Time*, October 23, 2009.

**5** Erik P. Bucy and Michael J. Ensley, "Issue Benefactors or Issue Victims? Ballot Initiative Influence on the Vote for California Governor, 1982-1998," *California Journal of Politics & Policy*, vol. 1, no. 2 (2009).

**6** Joe Mathews, *The People's Machine: Arnold Schwarzenegger and the Rise of Blockbuster Democracy* (Public Affairs, 2006), pp. 79-104.

**7** Despite the gutting, the state bumped up against the modified Cann limit at the peak of the dot-com boom. But no one knew it at the time and no tax rebates resulted.

**8** California, Commission on the 21<sup>st</sup> Century Economy, *Final Report*, September 2009. Available at [http://www.cotce.ca.gov/documents/reports/documents/Commission\\_on\\_the\\_21st\\_Century\\_Economy-Final\\_Report.pdf](http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf)

**9** "Swap Meet: Keeley Blows the Whistle on Parsky," *Calbuzz*, December 19, 2009.

**10** Paul Krugman, "State of Paralysis," *New York Times*, May 25, 2009.

**11** Quoted in Mark Leibovich, "Who Can Possibly Govern California?," *New York Times Magazine*, July 5, 2009.

**12** Although it is sometimes argued that campaign spending against ballot measures is more effective than supportive spending, that view appears to be incorrect. However, in this case, opponents were able to outspend the governor. See John M. de Figueiredo, Chang Ho Ji, and Thad Kousser, "Financing Direct Democracy: Revisiting the Research on Campaign Spending and Citizen Initiatives," working paper, June 8, 2010. Available at <http://ssrn.com/abstract=1672408>

**13** National Conference of State Legislatures, "State Budget Update: November 2009," p. 56. The official starting date of the recession for the U.S. as a whole, determined by the National Bureau of Economic Research, was at the tail end of 2007.

**14** At this writing, the electoral fate of a proposition on the ballot in November 2010 (Prop 25) that would lower the budget threshold from two-thirds to a simple majority is unknown. However, were it to pass, the two-thirds requirement on tax increases (under Prop 13 of 1978) would remain in place.

**15** The sales tax increase was 1 cent effective April 1, 2009 ending June 30, 2011. Prior to the increase, the total state sales tax was 5 cents. (Local governments add their own sales taxes to the state tax which can double the total.) Each of the seven tax brackets in the personal income tax was raised by 0.25 percentage points for the 2009 and 2010 tax years. The car tax (Vehicle License Fee) was raised from 0.65 to 1.15 percent on May 1, 2009 and lasting until June 30, 2011. The car tax is a local tax collected by the state. When it was lowered under Gray Davis, the state reimbursed the local governments for the revenue loss. Davis tried to raise the car tax but his increase was reversed by Governor Schwarzenegger immediately after he took office after the recall. Raising the car tax rate decreases the money the state must pay the local governments.

**16** Assemblyman Anthony Adams was targeted by the John and Ken radio show in Los Angeles. After signatures for the recall were turned in, there turned out to be an insufficient proportion of valid



signatures. There was some suggestion that the signature-gathering firm had acted improperly but the issue died without a public airing of what happened. Adams was apparently induced to go along with the budget by a special law for his district that benefited a local redevelopment district. As it turned out, the law was invalidated by a court decision during the summer of 2010. See Dan Walters, "Anthony Adams' Shift on Tax Vote Backfires," *Sacramento Bee*, August 2, 2010.

**17** The incumbent Lieutenant Governor, John Garamendi, resigned after being elected to Congress in November 2009. Democrats were concerned that putting Maldonado into the Lieutenant Governorship might give him an incumbent's advantage in the election of November 2010. On the other hand, they thought they had a reasonable chance of replacing him with a Democrat in the senate once his seat was vacated.

**18** Campbell in some respects was more ideologically pure than his two rivals for the Republican nomination for governor. In the early 1970s, he supported liberal Democrat George McGovern for president but subsequently became a self-described Reagan Republican. In contrast, Meg Whitman gave money to various Democrats including US Senator Barbara Boxer in late 2003. Steve Poizner was a Gore supporter in the presidential campaign of 2000. Source: "Republicans for Democrats," *Sacramento Bee*, October 25, 2009.

**19** Housekeeper-gate unfolded shortly before Jerry Brown and Meg Whitman were due to debate on Spanish TV, placing the issue before a Latino voter audience. Whitman and her husband claimed that they did not know their employee was illegal because she gave them phony documentation. It appeared, however, that the Social Security administration notified them of a mismatch between the name of the employee and the Social Security number she gave. After denying knowledge of the letter, and then hinting that the housekeeper might have intercepted it, a copy of the letter surfaced with the handwriting of Whitman's husband on it. A hearing on the actual wage claim was scheduled, but for after the November election. Housekeeper-gate raised a portfolio of unpleasant issues: possibly hypocrisy on the immigration issue, mistreatment of an employee, and lifestyle issues such as an improbably large house, and husband

with the unlikely name "Griff Harsh." Although not featured in the mainstream media, Internet reports of two Whitman overprivileged sons who behaved obnoxiously and possibly illegally were given added impetus by housekeeper-gate.

**20** Quoted in "Schwarzenegger to Leno: We'll Fix Budget," *San Diego Union-Tribune*, May 26, 2009.

**21** Quoted in a press release dated October 28, 2009 of Repair California, an organization associated with the Bay Area Council that pushed unsuccessfully for a state constitutional convention. The Bay Area Council is a business group which also includes some nonprofit organizations.

**22** Quoted in "Schwarzenegger for President? He Would If He Could," *Sacramento Bee*, April 29, 2010.

**23** Quoted in Peter Nicholas and Richard Simon, "Washington Declines to Help California, At Least for Now," *Los Angeles Times*, May 22, 2009.

**24** Joe Mathews, "Golden State Bailout," *Los Angeles Times*, May 22, 2009.

**25** The cuts appear in a table released by the governor's office entitled "All General Fund Solution Proposals for May Revision," May 29, 2009.

**26** Quoted in Neil Roland and Richard Truett, "U.S. Will Guarantee GM, Chrysler Warranties, Obama Says," *Automotive News*, March 31, 2009.

**27** It is difficult to find data on the total size of the muni bond market. A study of data in 2000 found the market to have about \$2 trillion in outstanding securities. See U.S. Securities and Exchange Commission, "Report on Transactions in Municipal Securities," July 1, 2004, p. 5.

**28** Quoted in Kevin Yamamura, "Davis Sides with Ex-GOP Governors, Others on Line-Item Veto," *Capitol Alert*, October 7, 2009.

- 29** At one point, proposed cuts in the pay of state-supported home care aides were challenged by the Obama administration as threatening federally mandated program requirements but that challenge was quickly dropped.
- 30** "Furloughs and Budget Cuts Disrupting State Tax Collections," *California's Capitol*, February 12, 2010.
- 31** Jon Ortiz and Phillip Reese, "Unused Vacation Time Could Wash Out State Furlough Savings," *Sacramento Bee*, March 11, 2010.
- 32** "Text of Gov. Schwarzenegger's Speech to the Legislature," *Sacramento Bee*, June 2, 2009.
- 33** Jerry Roberts and Phil Trounstine, "How May 19 Election is Just Like 'Rashomon,'" *Calbuzz.com*, June 3, 2009.
- 34** The proposition provided for free admission to California cars on which the surcharge was paid.
- 35** Joe Mathews, "Repair California Says There is a Blacklist," *Fox & Hounds*, February 4, 2010. Exactly why the signature firms would sabotage the process is unclear. There was some thought that perhaps they feared a constitutional convention would produce limits on their activities.
- 36** Quoted in Jim Miller, "Inland Lawmaker Targets Secrecy of Big Five Budget Talks with Governor," *Riverside Press-Enterprise*, June 7, 2009.
- 37** Quoted in Jerry Roberts and Phil Trounstine, "Friday Fishwrap: Sex, Gossip & Taxes," *Calbuzz.com*, June 12, 2009.
- 38** Patrick McGreevy and Eric Bailey, "Lawmaker Returns Joke Gift from Schwarzenegger," *Los Angeles Times*, June 18, 2009.
- 39** Tim Gage, "How to Deal with California's Budget Problem," *California Journal of Politics & Policy*, vol. 1, issue 2, 2009. (Online journal.)
- 40** Quoted in Jerry Roberts and Phil Trounstine, "Just In: Kennedy Whacks Davis, More on Gov Money," *Calbuzz.com*, July 2, 2009.
- 41** Willie Brown, "State Should Have Seen Budget Mess Coming," *San Francisco Chronicle*, July 19, 2009.
- 42** IOUs were about to be issued during the budget crisis of 1983 under Governor George Deukmejian. However, a bank loan was provided at the last moment and although the IOUs were technically issued, they were paid on demand as ordinary checks would have been.
- 43** Quoted in "Promises, Promises," *Sacramento Bee AM Alert*, July 2, 2009.
- 44** Presumably, those whose refunds were delayed did not owe such taxes, however.
- 45** The U.S. Department of Labor expressed concern about the impact of furloughs on the processing of unemployment benefits—a federal/state joint program outside the General Fund.
- 46** Arnold Schwarzenegger, "Gov. Arnold Schwarzenegger: Waste is Killing California," *Los Angeles Times* (op ed), July 3, 2009.
- 47** The commercial may be seen as part of <http://www.youtube.com/watch?v=UtOyw4Z-AG8> which also contains other commercials opposing the governor and other video from this period.
- 48** Cuts ultimately made in the IHSS program triggered lawsuits which the Obama administration supported in a brief filed in early March 2010. The cuts were placed on hold by the court and a final decision had not been made at this writing.
- 49** Henry S. Rowan, "A New York Solution for Bailing Out California," *Wall Street Journal*, July 8, 2009.
- 50** Quoted in George Skelton, "Budget's a Mess, But It's Our Mess," *Los Angeles Times*, July 23, 2009.

- 51** Dan Walters, "Another Tricky Budget Devised for California," *Sacramento Bee*, July 21, 2009.
- 52** The furlough impact was partly offset by a two-month holiday from health insurance premiums.
- 53** As part of the budget deal, a vote was taken in the legislature on oil drilling off Santa Barbara. The proposal failed and the Assembly removed the vote from the official record to avoid embarrassing members who voted for the bill. Despite this failure and historical revision, the oil drilling proposal remained alive in subsequent gubernatorial budget proposals until the Gulf disaster when the governor abandoned the idea. While he did not abandon the idea of privatizing the state workers' comp fund, small business groups were opposed, fearing resultant hikes in workers' comp premiums.
- 54** The Legislative Counsel provided an opinion to Assembly Speaker Karen Bass on August 5, 2009 indicating that the line-item veto could not be applied to a budget revision. However, this opinion was just that—an opinion. The Schwarzenegger administration produced counter-opinions and the matter was ultimately decided in court. Apart from the lawsuit against the vetoes filed by Senate President Steinberg, a second lawsuit was filed by private advocacy groups for the disabled that were affected by the vetoes.
- 55** Apart from the income tax rate increase, there was a small unforeseen increase due to Consumer Price Index deflation. Tax brackets are indexed to the CPI and when there is deflation, the brackets are lowered proportionally. The CPI fell 1.5% from June 2008 to June 2009, leading to such bracket lowering for the 2009 tax year.
- 56** Quoted in "Schwarzenegger Responds to Steinberg's Suit Over Line-Item Vetoes," *Capitol Alert*, August 7, 2009.
- 57** Quoted in Susan Ferriss, "Steinberg to Sue Governor Over Vetoes," *Sacramento Bee*, August 8, 2009.
- 58** Marcia Fritz, president of Californians for Fiscal Responsibility, quoted in Jon Ortiz, "Schwarzenegger, Whitman Back Away from Ballot Measure to Cut Pension Costs," *Sacramento Bee*, February 24, 2010.
- 59** Quoted in Anthony York, "Big 5 Meeting Dissolves in Rancor," *Capitol Weekly*, October 6, 2009.
- 60** Quoted in Carla Marinucci, "You Lie!—Bad Manners or Just Politics," *San Francisco Chronicle*, October 9, 2009.
- 61** The veto message read: *For some time now I have lamented the fact that major issues are overlooked while many unnecessary bills come to me for consideration. Water reform, prison reform, and health care are major issues my administration brings to the table but the legislature just kicks the can down the alley. Yet another year has come and gone without the major reforms Californians overwhelmingly deserve. In light of this, and after careful consideration, I believe it is unnecessary to sign this measure at this time. Sincerely, Arnold Schwarzenegger.* (A year later, apparently all was forgiven and the governor signed a bill by the same author with a more pleasant hidden message: You are welcome.)
- 62** The governor was instrumental in creating a "California Latino Water Coalition"—seen by some as an "Astroturf" group rather than a grass roots entity—to push his water agenda. The internal politics of the water bond are described in Steve Wiegand, "Water Package: Sealing the Deal," *Sacramento Bee*, November 29, 2009. Much of the public controversy at the time and after the deal was over the degree of "pork" in the bond agreement. Less prominent was the issue of additional general obligation debt to fund infrastructure, a practice that had apparently become ensconced after the 2006 infrastructure program the governor had sponsored.
- 63** The quote appears in the last line of a letter from Brown to State Senator Jeff Denham and Assembly majority leader Alberto Torrico dated October 9, 2009.
- 64** After Columbus Day passed, the union and administrative officials had predictably different versions of the degree to which workers stayed home.
- 65** The suit was filed later and is pending at this writing.
- 66** Despite the park cutbacks, Governor Schwarzenegger received an award—which sparked controversy given the cuts—from the National Park Trust on October 29, 2009.

**67** During 2006-07, 31% of California children under age 18 were covered by Medi-Cal. The figure was 72% for those in families under the federal poverty level. Source: California HealthCare Foundation, *California Health Care Almanac*, November 2009.

**68** California Field Poll of October 14, 2009 at <http://field.com/fieldpollonline/subscribers/RIs2316.pdf>.

**69** Quoted in "Modesto Native Lucas Among 13 Added to California Hall of Fame," *Modesto Bee*, December 3, 2009.

**70** The quote is from gubernatorial advisor Adam Mendelsohn and appears in Carla Marinucci, "Governor Looking at Part-Time Legislature," *San Francisco Chronicle*, August 20, 2009. California had a part-time legislature until reforms were enacted in the mid-1960s.

**71** John Myers, "Brown, Whitman Lukewarm on Reform," KQED Capital Notes, October 20, 2010; David Siders, "Whitman Willing to Take Pension Cutbacks to the Ballot Box," *Sacramento Bee*, September 21, 2010.

**72** UC president Mark Yudof pledged to raise financial aid money to offset the tuition increases for needy students. Students whose families had incomes below \$70,000 were also promised some protections from the increase.

**73** Prop 14 was put on the ballot by the legislature to get the vote of Republican state senator Abel Maldonado. Maldonado came from a "swing" district and thought such a reform would help politicians like him. He was later rewarded with an appointment as Lieutenant Governor by Governor Schwarzenegger.

**74** With all candidates running in a single primary, it is very unlikely that a minor party candidate would be among the top two candidates that would be on the ballot in the general election. Of course, minor party candidates could participate in the primary.

**75** Quoted in Martin Wisckol, "Jerry Brown Shows O.C. his Moderate, Populist Side," *Total Buzz Blog, Orange County Register*, October 30, 2009.

**76** Quoted in George Skelton, "Poizner Sticks to the Supply Side," *Los Angeles Times*, November 2, 2009.

**77** Legislative Analyst's Office, "The Master Plan at 50: Assessing California's Vision for Higher Education," November 12, 2009.

**78** Luciana Dar, "The Political Dynamics of Higher Education Spending," Graduate School of Education, UC-Riverside, August 2009, unpublished working paper.

**79** Public Policy Institute of California, "Californians & Higher Education," November 2009.

**80** Hans Johnson and Ria Sengupta, "Closing the Gap: Meeting California's Needs for College Graduates," Public Policy Institute of California, April 2009.

**81** "USC/Los Angeles Times Poll: California Statewide Survey Results," *Los Angeles Times*, November 6, 2009.

**82** Quoted in Shane Goldmacher, "Schwarzenegger's Budget Boss to Step Down," *Los Angeles Times*, November 3, 2009.

**83** Quoted in Sarah Murray, "State Finance Directors Warn of More Trouble Ahead," *California Weekly*, November 13, 2009.

**84** Dan Walters, "State Budget, Genest Both Underwater," Capitol Alert, *Sacramento Bee*, January 14, 2010.

**85** US Senate Dianne Feinstein was sometimes mentioned as a gubernatorial candidate, although she eventually excluded herself in February 2010.

**86** The group that filed the initiatives was the California Foundation for Fiscal Responsibility, a group sponsored by various taxpayer organizations and associated with such figures as John Moorlach, an Orange County Supervisor, Keith Richman, a former assemblyman from Northridge (now deceased), and Ted Costa of People's Advocate, the organization that kicked off the recall of Governor Gray Davis in 2003.

- 87** Dan Regan, "Going Green Puts Recyclers in the Red," *Capitol Weekly*, March 11, 2010. A report of the Legislative Analyst noted that loans from the Beverage Container Recycling Fund were squeezing the program. It suggested leaving major changes in the program until after the May revise. See Legislative Analyst's Office, *The 2010-11 Budget: Funding and Policy Options for the Beverage Container Recycling Program*, March 18, 2010.
- 88** Quoted in Judy Lin, "Schwarzenegger: No Fire Sales of Calif. Buildings," *San Jose Mercury News*, April 21, 2010.
- 89** Later, a complicated financial arrangement involving a public agency was proposed for such a sale. (Little was said about the arrangement in public. A legal notice of it appeared in the print edition of the *Los Angeles Times*, May 27, 2010, p. B8.) The scheme was described as a "lease lease-back" in which a public authority would sell bonds to lease—not buy—the buildings and then lease the property back to the state. In effect, it was a complicated borrowing plan. See Daniel Miller, "State Finding It Hard to Let Go," *Los Angeles Business Journal*, June 28, 2010. That plan was apparently discarded and at this writing buyers for the buildings have been announced but the deal had not been completed. The governor was reported to have removed appointees to various bodies that oversee state property, appointees who apparently were opposed to such sales. An attempt to sell the Orange County Fairgrounds fell through in March 2010 when bids were judged to be too low. However, the state made a deal in October 2010 to sell the property while opponents threatened to block the arrangement. On the problems entailed in selling assets and leasing them back, see Christopher Thornberg, "A Bad Deal: An Analysis of the Pending California State Official Building Sale/Leaseback Program," Beacon Economics, April 9, 2010. The SEIU—representing state workers who might be displaced by the sales—financed the report, but its conclusions were not disputed by fiscal experts. See Legislative Analyst's Office, *Evaluating the Sale-Leaseback Proposal: Should the State Sell Its Office Buildings?*, April 27, 2010. The LAO urged the legislature to find other alternatives.
- 90** At this writing, it appears the decision by federal authorities will be challenged in court.
- 91** Steven Clifford, "University of California at Berkeley to Eliminate All Students on Jan. 1," *Huffington Post*, December 18, 2009. The mock article also pointed out that by admitting no one, Berkeley would become the most selective university in the US News rankings.
- 92** The reduction could in theory be accomplished by admitting fewer prisoners into state prisons (presumably by keeping them in local jails) or sending more prisoners to out-of-state or private prisons. About 150,000 prisoners were kept in state facilities at the time of the order.
- 93** The position became vacant when Lieutenant Governor John Garamendi won a seat in Congress in a special election.
- 94** Office of the Governor, press release dated December 22, 2009.
- 95** "Transcript of Gov. Arnold Schwarzenegger Delivering State of the State Address," *Sacramento Bee*, January 6, 2010.
- 96** Quoted in Robert Cruickshank, "Jerry Brown is Trapped in 1978," *Calitics.com*, January 6, 2010.
- 97** Quoted in "What They're Saying About the State of the State," Political Blotter, *Sacramento Bee*, January 8, 2010.
- 98** Public sector union officials declined to attend or support Willie Brown's annual breakfast in October 2010 because of his pension stance. However, Governor Schwarzenegger did attend.
- 99** Kevin O'Leary, "California Deficit: Arnold Has to Make a 'Sophie's Choice,'" *Time*, January 9, 2010. Information in this article about the governor's legacy preference was attributed to his "aides."
- 100** Although not part of the General Fund, California unemployment insurance claims rose dramatically in the Grate Recession. As a result, the state's unemployment benefit fund showed a negative and worsening balance beginning in calendar 2009. In such situations, the federal government loans states sufficient funds to keep the program operating. And certain dispensations were given as part of the Obama stimulus plan. However, the state will eventually have to raise taxes on employers and pay interest on its debt to the federal government.

**101** "Start from Scratch on Health Care? 'Bogus Talk,'" Says Schwarzenegger, *Capitol Alert*, February 22, 2010.

**102** Quoted in Cathy Bussewitz, "Calif. Takes Steps to Cover Medically Uninsured," *San Jose Mercury-News*, June 27, 2010.

**103** "Arnold Schwarzenegger: Obama will win in 2012," *Politico*, October 5, 2012.

**104** Some information about the amendment was included in a press release of the Office of the Governor dated January 6, 2010. A formula, according to the release, would require that in 2014-15, 10% of "taxpayer money" would go to higher education and no more than 7% to prisons. Specific wording of the proposed amendment was not included.

**105** Legislative Analyst, *Prisons vs. Universities Proposal Would Unwisely Lock Up Budget Flexibility*, January 26, 2010.

**106** Quoted in Kevin Yamamura, "Don't Count on Windfall from U.S., California Legislative Analyst Says," *Sacramento Bee*, January 13, 2010.

**107** Quoted in Dan Walters, "Schwarzenegger Reverts to Fantasy with Budget Proposal," *Sacramento Bee*, January 10, 2010.

**108** Quoted in Michael Rothfield and Richard Simon, "Washington Fires Back at Schwarzenegger," *Los Angeles Times*, January 15, 2010.

**109** Quoted in Timothy Egan, "Arnold's Last Yodel," Opinionator Blog, *New York Times*, January 13, 2010.

**110** Joe Mathews, "The Crazy Glue Governor, and the Real Shame of California," online commentary, New America Foundation, January 25, 2010.

**111** Josh Richman, "Bill Lockyer: Arnold Right to Veto Gas-Tax Swap," Political Blotter, *Contra Costa Times*, March 17, 2010.

**112** Kevin Yamamura, "2009 Legislative Leaders Win JFK Profile in Courage Award," *Capitol Alert*, March 16, 2010.

**113** Spokesperson Aaron McLear quoted in Steven Harmon, "Governor Schwarzenegger Talking Through his Sombrero Again, Aide Says," *Contra Costa Times*, January 26, 2010.

**114** Quoted in Larry Gordon, "UC Regents Not Eager to Take on California's Prison Healthcare," *Los Angeles Times*, March 26, 2010.

**115** Campbell had originally been in the gubernatorial race but switched to the senate race when polls indicated he was not doing well against Meg Whitman and Steve Poizner.

**116** Duane W. Gang, "Fiorina: State Should Keep Bankruptcy as Option," *Riverside Press-Enterprise*, February 9, 2010.

**117** Andrew S. Ross, "Bottom Line," *San Francisco Chronicle*, March 11, 2010.

**118** Carla Marinucci, "Will Jerry Brown's 1992 Signature Issue, Flat Tax, Rise Again in 2010?," The Spin Cycle blog, *San Francisco Chronicle*, February 12, 2010. Spokesperson Steve Glazer said Brown had favored the flat tax at the federal level. But when asked if Brown was against the flat tax for the state, Glazer replied "He's not saying that."

**119** Quoted in press release from the Brown campaign dated March 2, 2010.

**120** Opponents to Whitman tended to cite her Wall Street rather than "business" ties. There were counter-attempts by Whitman and allies to try and link Brown to Wall Street in some way. It was claimed that while Brown was mayor of Oakland, the City made what turned out to be a disadvantageous interest rate swap with Goldman Sachs. Also raised were questions about Brown family ties—particularly Jerry Brown's father (and former governor) Pat Brown—as consultants to the Indonesian dictatorship in the 1970s. As noted in an earlier footnote, with regard to family, media reports appeared of loutish behavior by Whitman's sons in prep schools and university. Poizner's attempt to sell himself as an education reformer was somewhat undermined by a "This American Life" broadcast in late April 2010 that questioned the premise of a book he had written about his attempt to aid what he depicted as a gang-infested school. There were also questions about whether the book had been artificially boosted by campaign-related purchases aimed at making it a "best seller."

- 121** Quoted in Steve Harmon, "Brown, Holding Forth," Politics Blotter blog, *Contra Costa Times*, April 16, 2010.
- 122** Legislative Analyst's Office, *The 2010-11 Budget: Resources and Environmental Protection*, March 8, 2010.
- 123** Legislative Analyst's Office, *The 2010-11 Budget: Transportation*, March 2, 2010.
- 124** Legislative Analyst's Office, *The 2010-11 Budget: Higher Education*, February 25, 2010.
- 125** Legislative Analyst's Office, *The 2010-11 Budget: Proposition 98 and K-12 Education*, February 25, 2010.
- 126** Legislative Analyst's Office, *Year-One Survey: Update on School District Finance and Flexibility*, May 4, 2010.
- 127** Legislative Analyst's Office, *The 2010-11 Budget: Health & Social Services—A Restricted Environment*, March 2010; Legislative Analyst's Office, *The 2010-11 Budget: Health and Social Services Budget Primer*, March 2010
- 128** There was some evidence of a spike in retirements, perhaps a symptom of workers close to retirement age deciding that the climate of public employment was not favorable. See Jon Ortiz, "California State Worker Retirements Spike," *Sacramento Bee*, April 14, 2010.
- 129** See Public Policy Institute of California, *Californians & Education*, April 2010.
- 130** See Bay Area Council, *Recession and Recovery: An Economic Reset*, April 2010.
- 131** Memo from Legislative Analyst Mac Taylor to Legislative Budget Staff dated March 19, 2010 and entitled "March 2010 Fiscal Update."
- 132** Public Policy Institute of California, "Californian & the Environment," July 2010.
- 133** Press release from the governor's office, May 14, 2010.
- 134** Press release from Senator Steinberg's office, May 14, 2010.
- 135** Quoted in Patt Morrison, "Willie Brown: State's Man," *Los Angeles Times*, August 21, 2010.
- 136** Anthony York, "Whitman Says Schwarzenegger Welfare Cut Goes Too Far," Political Blog, *Los Angeles Times*, May 17, 2010. GOP candidate Steve Poizner also said a complete elimination of CalWorks went too far and noted the loss of federal matching dollars such an elimination would entail.
- 137** "Schwarzenegger Unveils Stark Budget Plan: Democrats Balk," *California's Capitol*, May 14, 2010.
- 138** *Robles-Wong v. California* was filed in Alameda Superior Court on May 20, 2010.
- 139** Press release from the governor's office, July 8, 2010.
- 140** Arnold Schwarzenegger, "Public Pensions and Our Fiscal Future," *Wall Street Journal*, August 27, 2010.
- 141** Quoted in John Myers, "Budget +55: 'Robbed Blind,'" *KQED Capitol Notes*, August 24, 2010.
- 142** The proposal as leaked was unclear. It reportedly involved borrowing against the saving from future pension reform. Borrowing from a pension fund would involve paying interest at a rate higher than the usual tax-exempt municipal bond. Such tax exemption is worthless to pension funds since they don't pay taxes and, hence, do not normally invest in tax-exempt bonds. The state would have to pay interest to CalPERS in any borrowing competitive with taxable securities carrying equivalent risk.
- 143** Quoted in John Myers, "Budget +26: Kinder, Gentler PR," *KQED Capitol Notes*, July 26, 2010.
- 144** Quoted in Anthony York, "Pérez Finds an Open Budget Process is Easier Said Than Done," Political blog, *Los Angeles Times*, July 15, 2010.

- 145** Quoted in Anthony York, "Pérez Finds an Open Budget Process is Easier Said Than Done," Political blog, *Los Angeles Times*, July 15, 2010.
- 146** There were some court decisions on matters relating to the minimum wage issue in late August but the technical and legal feasibility issue remained in abeyance.
- 147** Quoted in "Brown Says State Government Has Become 'Constipated,'" PolitiCal blog, *Los Angeles Times*, July 1, 2010.
- 148** Quoted in David Siders, "Schwarzenegger Jabs at Whitman," *Capitol Alert*, June 28, 2010.
- 149** Shane Goldmacher, "Schwarzenegger Says He Would Not Have Been Able to Win a Republican Primary," PolitiCal blog, *Los Angeles Times*, June 11, 2010.
- 150** Quoted in "Jerry Gets Cosmic, Meg Prez Fever Grows," *Calbuzz*, June 12, 2010.
- 151** Quoted in Peter Hecht, "Brown Vows 'Agenda of Humility' in Primary Night Victory Speech," *Capitol Alert*, June 8, 2010.
- 152** Quoted in Jack Chang, "Jerry Brown: Start Budget Process Before January," *Capitol Alert*, June 10, 2010.
- 153** Quoted in David Siders, "Tom McClintock Still 'Not Prepared to Endorse' Meg Whitman," *Capitol Alert*, August 6, 2010. In October, McClintock stated, "I agree with (Whitman) maybe 20 percent of the time. I agree with Jerry Brown about 20 percent of the time. I agree with the libertarians about 80 percent of the time. So I'm not making an endorsement..." Quoted in Brian Leubitz, "Tom McClintock Still Doesn't Like eMeg, Part 2," *Calitics*, October 19, 2010.
- 154** UC and CSU fronted the funds for students who otherwise would have received Cal Grants on time. But community college districts were not able to do so.
- 155** In mid-August, the controller suggested that IOUs would be issued in September but a later clarification pushed the date to October.
- 156** Carl E. Klarner, Justin H. Phillips, and Matt Muckler, "The Causes of Fiscal Stalemate," unpublished working paper date August 17, 2010, <http://ssrn.com/abstract=1660494>.
- 157** Quote from "Gov. Schwarzenegger Holds Press Conference to Discuss the Budget," posted September 1, 2010 at <http://www.gov.ca.gov/speech/15909/>.
- 158** Quoted in Shane Goldmacher, "2 California Propositions Could Undo Budget Patch," *Los Angeles Times*, August 4, 2010.
- 159** There is cross-state evidence that legislators that produce late budgets are penalized by voters. However, California's gerrymandered election districts that keep incumbents safe may mute this effect. See Asger Lau Andersen, David Dreyer Lassen, and Lasse Holbøll Westh Nielsen, "Fiscal Governance and Electoral Accountability: Evidence from Late Budgets," working paper, August 27, 2010, University of Copenhagen.
- 160** Dan Walters, "Legislators Add to Woes with San Diego Arena Deal," *Sacramento Bee*, October 20, 2010.
- 161** Moody's Investors Service, *California Budget Likely to Lead to Mid-Year Shortfall and Large Gaps in Future Years*, October 18, 2010.
- 162** George Skelton, "Privies Pinched Without Budget Deal," *Los Angeles Times*, September 23, 2010; Gary Richards, "Lack of Budget Means \$3.9 Billion in Transportation Funds on Hold," *San Jose Mercury News*, September 23, 2010.
- 163** Under final offer arbitration—sometimes called "baseball" arbitration because of its use in team vs. player salary disputes—an arbitrator must pick the proposal of one side or the other and cannot compromise or split the difference. "Brown Proposes Baseball Arbitration Budget Plan," *Calbuzz*, September 20, 2010.
- 164** Zero-based budgeting as an abstraction is appealing. But many programs are assumed to be ongoing—such as social welfare programs, schools, and higher education. They cannot as a practical matter start from zero each year. Jack Chang, "Jerry Brown Unveils Start-from-Scratch Budget Plan for California," *Sacramento Bee*, September 16, 2010.



**165** One bill would have authorized advertising on freeway electronic signs. Another would have allowed slant drilling for oil in certain areas (drilling from land to undersea deposits). Exactly what understanding there might have been is, of course, impossible to determine. See Anthony York, "Behind the Scenes: The Fight Over Freeway Advertising," *Capitol Weekly*, October 14, 2010.

**166** The official line was that since the buildings would be leased for twenty years by the state, all calculations of the cost should end there—which showed leasing and ownership would cost the same. The problem is that at the end of the period, the state has no office building. It must at that point either lease, buy, or build to obtain space.

**167** A medical parole bill was signed by the governor in September 2010 which covered incapacitated inmates. However, the annual saving projected for this bill was very small compared to the cut in prison spending in the budget.

**168** Quoted at the annual Willie Brown breakfast in David Siders, "Schwarzenegger Leaves Criticism of GOP Lawmakers Behind, Praises Compromise on Budget," *Capitol Alert*, October 19, 2010.

**169** Quoted in Jack Chang, "Jerry Brown Admits Past Errors, Vows Not to Repeat Them if Elected Again," *Sacramento Bee*, September 12, 2010.

The cover features a dark, textured background with a large, irregular circular cutout. Inside and around this cutout are several overlapping, semi-transparent geometric shapes in shades of gray, including triangles and curved forms. The text is printed in white, bold, sans-serif font, with each line of text underlined with a series of small vertical dashes.

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