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California's Ongoing State Budget Crisis

Family Time, Cliffs, and Train Wrecks

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By Daniel J.B. Mitchell
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"I look forward to other opportunities that will allow me to spend more time with my family."

Tim Gage on being replaced as State Finance Director[1]

"I have never been so frightened about California's future as I am now. The ingredients seem to be here to take the state right over the cliff."

Democratic State Senator John Vasconcellos[2]

"Without bipartisan cooperation, we are headed for a fiscal train wreck."

Republican Assemblyman Keith Richman[3]

- California's long-term budgetary problems, related to demographic and other trends, have been well documented since at least the mid-1990s. However, the budget crisis of the early 2000s was linked to the downturn in the business cycle and the stock market. The State spent cyclical peak and windfall revenues as if they were permanent. Deficits were thus inevitable as these revenues declined.

- The focus of discussions on remedies to avert future crises has been on the Legislature and the constitutional institutions surrounding it. But the public so far has not shown enthusiasm for relaxing constraints such as term limits. An alternative approach would be to give the Governor greater budgetary authority. The 2003 recall movement against the Governor suggests that the public already regards the Governor as the key budgetary official. Yet under current constitutional arrangements, the Governor's role is largely limited to proposing a budget and signing one after the Legislature acts.

- The presentation of budgetary information by the Governor and the Department of Finance remains opaque. The widely-cited State budget "shortfall" – which reached $38 billion by the spring of 2003 – is not the State deficit nor is it a managerially useful number. Transparency in budgetary reporting is essential to analysis, decision-making, and public understanding.

- Variations in State tax revenue will remain a problem in the future, absent a substantial "rainy day" fund. Those variations related to financial markets might also be addressed by the State with modern financial instruments aimed at reducing risk.

Since the economic downturn of the early 2000s, Californians have become increasingly aware of a state budget crisis.[4] The crisis refers partly to the condition of the "General Fund," the largest portion of the state budget. This Fund went into deficit at the peak of the business cycle, leading to the inevitable subsequent problems as the economy softened. But the process of enacting a budget is also part of the crisis. Finally, there are "structural" problems surrounding the General Fund, i.e., problems that are likely to cause difficulties in the future absent institutional changes in process and allocation.

The most immediate problem is that expenditures of the General Fund have recently exceeded revenues by a significant margin. As Chart 1 shows, since the end of World War II, the General Fund has sometimes been in surplus and sometimes in deficit.[5] Deficits have tended to be associated with periods of recession, which cause reduced tax inflows. However, the magnitude of the current deficit – adjusted to remove distortions due to the expenditure and reimbursement of the General Fund related to the 2001 electricity fiasco – is unprecedented in postwar history.[6]

There are numerous funds within the state and related to state activities apart from the General Fund. Probably the best known relate to transportation and are financed through fuel taxes. But there are numerous others that are far more obscure and which were created for special purposes. Few residents of California will be aware of the Vocational Nurse Examiners Fund, the Licensed Midwifery Fund, or the Permanent Amusement Ride Safety Inspection Fund, unless they have some special involvement with these activities. Counting virtually everything including pension payments and federal-state programs such as unemployment insurance, over $200 billion in spending can be identified. However, much of such spending beyond the General Fund is earmarked for specific purposes and/or depends on a revenue stream that cannot be directly diverted to the General Fund.

On a cash basis, disbursements from the General Fund amounted to $78.7 billion in the fiscal year ending June 30, 2003. Chart 2 provides a broad categorical view of the distribution of General Fund expenditure. Over the six-year period shown, K-12 and community colleges accounted for 44% of general fund expenditures. This proportion is largely the result of voter initiatives and is thus formula driven. Expenditures for health and human services (HHS) are the next largest category with the rest of higher education (UC and CSU) and corrections (prisons) as the other major expenditure categories.

General Fund revenue comes mainly from taxation. During budget crises, however, various "transfers" are employed to draw on other funds including a reserve fund discussed below. Such transfers are mainly one-shot remedies whereas taxes provide an ongoing flow. Chart 3 shows that the General Fund is heavily dependent on the Personal Income Tax, which accounts for over half of its revenue stream. The state sales tax and corporate profits tax account for the bulk of the remaining revenue. Most of these sources, it will be noted later, are sensitive to the business cycle. In addition, the Personal Income Tax is sensitive to the stock market due to its capital gains component.

Direct Democracy in California

"I'm mad as hell and I'm not going to take this anymore!"

Fictional TV Newscaster Howard Beale
in the 1976 film "Network"

California was a hotbed of progressive reform in the early 20th century. Angered by perceived corruption in state and local politics – often centered on the influence of the Southern Pacific Railroad – the voters elected Governor Hiram Johnson in 1910. Under Johnson, the state adopted the initiative, referendum, and recall, as well as Workers' Compensation Insurance and women's suffrage. At the heart of the progressive movement were two beliefs. Politicians and political parties were seen as corrupt. But the same voters who elected those politicians and who belonged to those parties were seen as a corrective force through "direct democracy."[7] Dressed up in modern economics terminology, the progressives were positing a "principal/agent" problem. The "agents" (elected officials) were seen as following their own interests rather than those of their "principals" (voters). Note that this interpretation depends further on the idea that a clear-cut voter interest can be defined.

The early 20th century progressives must be viewed as part of the more general fascination of that era with "science" and rationalization of organizations. Science had recently brought about such wonders as the telephone, automobile, and electric light. Why not apply the scientific method to business and government? In the business sector, "scientific management" meant use of time and motion studies and industrial engineering to determine the one right way for workers to accomplish a task. Management schools would train businessmen in the proper methods of administration. Government should also be run on a professional basis with trained urban planners and city managers. Politicians were not professionals and therefore needed to be checked through ballot initiatives and - if necessary – recalls if they did not conduct official business properly. But here problems arise. Exactly what is the one right way to run the government? And why would voters be more likely than elected officials to know the one right way? Voters – after all – are not trained professionals.

Over the years, California has retained its progressive reforms and the contradictions that go with them. Various initiatives have passed limiting property taxes and the ability of government to raise taxes. Other initiatives have earmarked expenditures by formula. Proposition 13, enacted in 1978, was a reaction to rising property assessments and property taxes during that inflationary period. Large increases in property taxes accompanied by large budget surpluses in the state's General Fund (see Chart 1), sparked a taxpayers' revolt which then spread to other states. The rollback in property taxes substantially reduced revenues going to local governments especially school districts.

As Chart 4 illustrates, prior to Prop 13, about 74-75% of the General Fund went toward "local assistance," i.e., funding of programs administered at the local government level. To bail out the localities after Prop 13 limited their property tax revenues, such State-supplied funding jumped to over 80%. However, two severe recessions in the early 1980s led to a state budget crisis and the bailout share fell. By the mid-1980s concern over declining achievement in elementary and secondary education was rising and eventually led to Prop 98 (1988), which earmarks a share of the General Fund for K-14.[8] Still, by the early 2000s, the share of the General Fund going to all forms of local assistance was back to pre-Prop 13 levels. Although K-14 may be more protected as a result of Prop 98, the result is that other forms of local assistance are more vulnerable to revenue declines. And K-14 has become more dependent on Sacramento for support and direction.

Another outgrowth of California-style direct democracy in the late 20th century is the imposition of term limits on members of the state assembly and senate. At one time, powerful Legislative leaders made careers in the Legislature. Sacramento lore is filled with colorful stories of Assembly leaders Jess Unruh in the 1960s and Willie Brown in the 1980s and 1990s. Tales are told of deals drafted on a napkin in Frank Fats Chinese Restaurant near the state capitol building. Entrenched legislators wielded considerable power but also developed considerable knowledge of state institutions such as the budget. The electorate, however, was not enchanted by such history and knowledge and imposed term limits in 1990 (Prop 140). The result was a more amateur – but more diverse – Legislature and greater (relative) power in the hands of the Governor.[9] When offered a chance modestly to relax term limits in 2002 (Prop 45), voters rejected the option by a 58% to 42% margin.[10]

Budget 101

"The State can't print money, so there will have to be some kind of long-term balance."

David Hitchcock, Standard & Poors[11]

"They can print money, We can't. That's the difference."

Steven Maviglio, spokesperson for Gov. Davis, on why the federal government can run large deficits but not California.[12]

"Dear Mr. President, I read that you are working on giving up to $30 billion in cash and loans to Turkey in order to use that country as a staging area for a war on Iraq. Given the state of the economy and the state's budget deficit, I am sure California would be willing to consider serving as a staging area, too, if we can get the same terms as Turkey…"

State Senate Majority Leader John Burton[13]

"In the end I think the banks and bond dealers will force things to happen. They'll finance the state, and they'll want to get paid back."

Former Governor Jerry Brown[14]

Various misconceptions float around California's fiscal situation. The first has to do with the size of the state. California is the largest state in the union. It is roughly 50% larger than the next largest state. Boosters often point out that if California were a country, its Gross Domestic Product would make it the 5th, 6th, or 7th largest country in the world, depending on the year chosen and the exchange rate. When it comes to the budget, the implication seems to be that California is too big to fail.

The fact is, however, that if California were a large country, it could do what the federal government does. It could run large continuing deficits. The federal government finances its deficits with bonds that are promises to pay dollars in the future. Since the federal government ultimately can create dollars, it can honor these future commitments. For that reason, federal securities are top rated by security rating services such as Moody's, Standard & Poors, and Fitch. California cannot create dollars, although its bonds are also promises to pay dollars in the future. Therefore, as it increases its debt, its securities are viewed as more risky. Large continuing deficits, particularly if they occur in the context of legislative paralysis, will result in a higher and higher interest rate to compensate lenders for greater risk of default. Eventually, such deficits can lead to a refusal to lend at all.

As an example, Moody's investor service began raising its ratings of California General Obligation bonds in the prosperous 1990s from a trough rating of A1 in July 1994 to a peak of Aa2 in September 2000. By February 2003, after the Governor's budget proposal for 2003-04 appeared dead on arrival, Moody's rating had deteriorated to A2, the lowest of any state. Warnings of further possible downgrades were issued in early July 2003, as the state began the 2003-04 fiscal year without any budget in place.

A second and related misconception is that California should actively try to stimulate its economy through tax cuts and/or expenditure increases during business downturns. It is true that such actions have a stimulatory effect, other things equal. And it is also true that the federal government has justified such policies at the national level as economic stimulus. However, the ability of California to conduct that type of "Keynesian" macroeconomic policy is decidedly limited. As noted above, there are limits to deficits for the State level that do not apply at the federal level. In addition, as Chart 5 shows, the California business cycle is tightly linked to the U.S. business cycle. The ups and downs of California employment levels are largely reflections of the ups and downs of employment in the other 49 states. This linkage occurs because the large amount of trade and investment flows between California and the rest of the U.S. That means that a good part of any stimulus California might achieve is dissipated as it spills over to other states.

Structural Problems – Part I

"California has yet to confront the structural elements in its budget gaps or compensate for the loss of about 25% of the yield from its personal income tax."

Fitch rating service[15]

"We can't grow our way out of this."

Legislative Analyst Elizabeth Hill[16]

Will a revival of the California economy eliminate the State's ongoing deficit? Unfortunately, a back-of-the-envelope calculation suggests that the answer is "no." A major factor in the surge in state revenue in the late 1990s was the stock market bubble, especially in technology stocks. Capital gains revenue to the state resulted from two sources. The use of stock options as a form of employee compensation by the high-tech firms and dot.coms that were particularly concentrated in California raised taxable incomes of recipients as they cashed in their options. In addition, the general rise in stock values experienced by the average investor also produced taxable capital gains.

It is estimated that roughly an "extra" $12 billion of bubble-related tax revenue flowed into State coffers during the peak fiscal year 2000-01. Total revenues to the General Fund that year were about $78 billion, according to the State's cash statement. So absent the extra $12 billion, revenues would have been $66 billion. The Legislative Analyst assumes that normal growth in revenue is about 6% per year in nominal dollars. Had the economy continued along at its peak pace (but without the bubble), revenues in 2002-03 would have been $74 billion.

By that time, and already reflecting cutbacks of various types, disbursements were $79 billion, a deficit of $5 billion, the equivalent of almost 7% of ongoing revenue. Moreover, the business cycle peak had occurred with national unemployment at around 4%, a level the Federal Reserve considered unsustainably low. The Fed had been raising interest rates at the peak to slow the economy down. Thus, non-bubble revenue at a level of activity the Fed was prepared to allow would probably have been below $73.7 billion assumed in the calculation and, therefore, the deficit would have been larger than $5 billion. Indeed, the Legislative Analyst sees an ongoing "structural" deficit – one that will not be corrected by economic recovery – of about $7 billion. Under less optimistic assumptions, the Governor's "May Revise" budget proposal of May 2003 projected a deficit two years hence (for 2004-05) of $7.9 billion.

These budget problems are not a surprise in a longer-term prospective. A Rand report published in the mid-1990s forecast General Fund revenue into the early 2000s. Not surprisingly, the revenues projected for the late 1990s during the stock market bubble were underestimated. But by 2002-03, the Rand revenue projections are about right. And the expenditure trends, related in the report to education, corrections, etc., were straining resources.[17]

The word "structural" does not inherently mean intractable. A structural deficit of $7 billion is less than 1% of California's Gross State Product. As Chart 6 shows, General Fund spending at the peak of the business cycle was about 7% of state personal income. That level was high by past standards but roughly comparable to the immediately post-Prop 13 bailout years of the late 1970s and early 1980s. A 7% level is not more than California can "afford." What matters is what decision makers in the state want to "afford" and who those decision makers are.

As an example, at the peak of World War II, the U.S. devoted more than 40% of its entire GDP just to the military effort. Production of many consumer goods ceased. Food and other products were rationed. The nation "afforded" a huge expenditure because ultimately the public was willing to tolerate the cost. For California, the question is whether its public is willing to pay taxes to maintain any given level of expenditure. The answer to that question is political more than it is economic. Decision makers in California are a mix of elected officials – constrained by various constitutional arrangements – and the electorate.

What Does the Electorate Want?

"Difficult times force us to examine our priorities and make difficult choices."

Governor Gray Davis[18]

"They tried to tiptoe through the summer (of 2002) ignoring the bad news. The choice was made by all (officials) concerned to sweep everything under the rug beginning in June."

Ted Gibson, former economist, Department of Finance[19]

The public has been increasingly aware of the state's budget problems since 2001. But by large majorities, when asked by the Public Policy Institute of California about possible spending cuts in K-12, higher education, or health and human services, respondents oppose them.[20] Cuts in prison spending are supported. However, prisons are, as noted earlier, only about 7% of the budget. And although there are ways to reduce prison expenditures, the costs of prisons are driven heavily by the number of prisoners.

Generally, the public supports tough-on-crime legislation, such as "three strikes." California voters have, however, expressed a willingness to consider alternatives to prison for illicit drug use, as under Prop 36 (2000).[21] When asked about the possibility of releasing some prisoners to save money – something certain other states undertook for budgetary reasons – Governor Davis declared *"I don't favor letting prisoners out earlier."*[22] Overall, on the spending side, the public seems unenthusiastic about most cutbacks that political leaders might consider.

What about on the tax side? As Chart 8 shows, only slight plurality would be willing to add a higher top bracket to the personal income tax (a bracket which would not apply to most voters).[23] A slight majority opposes a half-cent increase in the state sales tax. There is even more opposition to an increase in the Vehicle License Fee. Only an increase in the "sin tax" on cigarettes receives broad support. That is, the public is not keen on spending cuts and is unenthusiastic about increases in those taxes that bring in substantial state revenue.

Although the poll did not ask about "tax expenditures" that might be reduced, a look at the major ones suggests that there would not be much support for cutting back on the key ones. Tax expenditures represent revenue lost because of an exception in the tax code for certain kinds of income or activities. As Chart 9 shows, major tax expenditures include such items as the deduction for homeowner mortgage interest payments, the deduction for charitable contributions, and the exemption from taxation of Social Security benefits and of employer contributions to health insurance and pensions. These provisions in the tax code have historically been popular at both the federal and state levels.

Given resistance to cuts in expenditures and increases in taxes, the only option left is borrowing. In the spring of 2003, the Governor and the Democrats in the Legislature supported a proposal to borrow $10.7 billion to "cover" past deficits as part of their proposals for the 2003-04 budget. To pay off the bond issue that would be needed, they proposed adding a half-cent to the state sales tax. The proposal raised some interesting legal issues since the state constitution requires a vote of the people for issuance of long-term bonds. As Chart 10 shows, 50% of adults were willing to support borrowing plus the sales tax increase.[24] There was slightly more support for deficit financing without a tax increase, essentially the Republican proposal.

Overall, 56% of poll respondents said they know at least "some" about how "state and local governments spend and raise money." Only 15%, however, said they knew "a lot." And in an unrelated poll on the gubernatorial recall effort taken at around the same time, a slim majority said that they would back a recall of the Governor.[25] But when told the election might cost $25 million to conduct, the idea of a recall was defeated. Either some voters have their recall preferences finely balanced or – since $25 million is mere rounding error on the state budget – the distinction between "million" and "billion" is unclear to them.

Is voter confusion simply a matter of apathy or ignorance? It is not realistic to expect the electorate to spend their leisure hours poring through official budget documents. An important element of leadership whether by incumbents or candidates seeking office, is to educate the electorate. During the summer of 2002, the state went without a budget for over two months. When a budget was finally enacted, State Senate President John Burton declared that *"it's a get-out-alive budget. The problems next year, no matter what happens, will be severe."* [26] So the public was informed that a fiscal dilemma remained after the 2002-03 budget was passed. But neither gubernatorial candidate in 2002 devoted much effort to explaining the dilemma or what might be done about it in the future.

Structural Problems – Part II

"Governor Davis also announced that he will not sign a budget that does not include structural reform to prevent changes in the economy from significantly buffeting California's budget."

Press release for the Governor's January 2003 budget proposal[27]

The usual meaning of a "structural" problem in the budget context, as noted earlier, means an ongoing deficit that will not be eliminated by a strong economy. However, in the California budget crisis of the early 2000s, "structural" also came to be associated with the volatility of tax revenue. Essentially, as capital gains revenue poured in, the Legislature moved to spend it or provide tax reductions. Since there was great uncertainty about the ongoing nature of this revenue stream, i.e., when or how long it would continue, a more prudent option would have been to put the windfall into a reserve "rainy day" fund for use in future Hard Times.

Chart 11 shows that all of the major taxes varied substantially during 1998-99 through 2002-03. The personal income tax – which contains the capital gains – stands out as volatile. But so does the corporate profits tax. However, the personal income tax represents a much larger share of General Fund revenue than the other taxes. As Chart 12 illustrates, once the various taxes are weighted by their shares of total revenue, the variation in the personal income taxes dwarfs the others.

Whether volatility of taxes should be deemed a structural problem is uncertain, since the option of saving through a rainy day fund is available to deal with such variations. Using the structural terminology is inherently a matter of political assumptions in this case. Volatility is a problem if it is assumed that the Legislature will inherently dissipate windfalls when they occur rather than save them. On the assumption that volatility is a political-structural problem, some remedies will be discussed in a later section. It is noteworthy, however, that despite the statement of Governor Davis quoted above, a reform that would reduce volatility was not included in the January 2003 budget proposal. Nor was such a reform proposed in the May revision of the Governor's budget proposal.

The Basic Budget Process

"I'm not asking a lot. I'm just asking for what the state Constitution requires: a budget that is actually balanced."

Senator Tom McClintock (R-Thousand Oaks)[28]

"It has been very tough forecasting the unknowable, which is the stock market and what would arise out of the stock market."

Brad Williams, Senior Economist at the
Legislative Analyst's Office[29]

Budgeting is effectively a form of planning within a constrained environment. Although many public policies fall largely outside of budgeting, most have some budget implications. Thus, the budget – both on the expenditure side and on the revenue side – is really the most important expression of public policy enacted through the Legislative process.

Although it is widely thought that California's constitution requires a balanced budget – as the quote above by Senator McClintock suggests - that is not really the case. The Governor is required to produce a budget in January for the fiscal year beginning the following July 1. That budget is supposed to explain where the funds for the proposed expenditures will be obtained. But the constitutional requirement does not prevent the Governor from proposing to spend more than the state is taking in by – for example – drawing down existing reserves to supplement tax revenue. Nothing in the constitution requires the Legislature to enact a budget that is balanced. And even if a budget that is balanced by some definition is passed, unexpected shortfalls in revenue or greater than anticipated expenditures may produce a deficit budget after the fact.

Nothing in the constitution requires the Legislature to make mid-course corrections when economic events produce an unplanned deficit. There is nothing in the constitutional requirements that would compel the Governor or the Legislature to consider contingencies, i.e., what budgetary changes might be made in mid-stream if economic assumptions underlying the budget increasingly appear to be inaccurate. As noted earlier, if there is any force for fiscal discipline in the budgeting process, it comes from the bond market and Wall Street.

Although in theory the Legislature could simply go along with the Governor's January proposal (or quickly enact an alternative), in practice it does not do so. In May, the Governor submits a modified budget proposal known as the "May Revise." The new proposal reflects more up-to-date information upon which to base revenue and expenditure estimates. But it also incorporates changes designed to make passage more likely based on the debates that have gone on in the Legislature since January. In 2003, for example, the Governor's May Revise for 2003-04 was substantially different from the January version largely because of resistance to the January proposal. It relied more heavily on borrowing and less on expenditure cutbacks.

The Governor's budget proposals are put together by the state Department of Finance. Once submitted to the Legislature, the proposals are reviewed by the Legislative Analyst. It is important to emphasize that in both cases, a significant component of budget design and analysis is forecasting. Even when a budget is finally enacted, its projected revenues and expenditures will inevitably prove to be inaccurate to some degree. Chart 13 shows that revenues and transfers contained in the Budget Act after the fact differ from the *ex poste* totals. Errors of 10% or more have occurred. Over the period shown, the Budget Act error has averaged 4.5% in absolute value.

During the middle of the fiscal year, another estimate is made. Since by then there are data available on tax collections for part of the year, it would be expected that errors would be smaller. But even so, Mid-Year errors of over 5% have occurred and the mean absolute error for the period shown is 3.0%. And on occasion, Mid-Year errors have exceeded the earlier Budget Act errors. Generally, the more notable underestimates of revenue have occurred during business upturns and the more notable overestimates have occurred during downturns.

Expenditures are less sensitive to economic conditions and, therefore, forecast errors are smaller, as Chart 14 shows. The mean Budget Act expenditure error is 1.6% and the Mid-Year error is 1.4%. The gap between revenues and transfers and expenditures – the surplus or deficit – is shown on Chart 15. Since the gap could be zero or a very small number, the denominator for Chart 15 is total revenue and transfers rather than the actual surplus or deficit. During the economic slump of the early 1990s, there was repeated over-optimism about the fiscal situation. Conversely, during the expansion of the late 1990s, the forecasts proved to be on the pessimistic side. [30]

Since the Budget Act's estimates are never exact, the Legislature is voting on a forecast that it knows will not turn out precisely as written. The constitution requires a two-thirds vote in both the Assembly and Senate to pass a budget. There are 80 seats in the Assembly and 40 in the Senate. Thus, to pass, a budget must receive at least 54 votes in the lower house and 27 in the upper house. In principle, the Legislature is supposed to act by June 15 and the budget is to be in place, i.e., signed by the Governor, on July 1. However, the latter date is more critical. If no budget is enacted by July, the new fiscal year begins in a legal limbo.

Vendors to the state may go unpaid after July 1 if no budget is in place. Under a state Supreme Court decision of spring 2003, most state employees could be paid absent a budget, but only at the minimum wage. Some state employees under this decision, however, could receive full pay if they worked overtime. And some employees who are not paid on an hourly basis – typically managers and professionals - could receive no pay at all.[31] Only after a budget was passed would those state employees who were unpaid or underpaid receive back payments.

Clearly, the longer the time elapsed without a budget, therefore, the more disruptive is the impact. Some private contractors may cease work and penalties to the state may accrue due to the non-payment. In addition, in the context of a budget crisis, the spectacle of a state than cannot pass a budget on time contributes to an investor perception of risk in state securities. Thus, the potential for downgrades of state bonds and higher interest costs is increased.

Once a budget is enacted, the Governor signs it and has the option of exercising a line-item veto. That is, the Governor can eliminate or reduce particular categories of expenditure without vetoing the entire package. Officially, therefore, the constitutional role of the Governor is to start the budget process and end it. But there is also a political leadership role.

The Governor and the "Shortfall"

"He's the captain of the ship. He's got to lay out a course."

Senate Majority Leader John Burton on the Governor's role.[32]

"The remaining time before the (November 2002) election offers an opportune moment for the gubernatorial candidates to share their plans for dealing with the state budget. Voters have a right to know."

UCLA Professors Werner Z. Hirsch and Daniel J.B. Mitchell[33]

"Like any CEO in a recession, I have to make difficult choices. I am making them."

Governor Gray Davis[34]

"Gross mismanagement of California Finances by overspending taxpayers' money, threatening public safety by cutting funds to local governments, failing to account for the exorbitant cost of the energy fiasco, and failing in general to deal with the state's major problems until they get to the crisis stage."

Official grounds for recall stated in
the 2003 gubernatorial recall petition

The Governor proposes a budget but cannot enact one. Most of the action is in the Legislature with its crucial two-thirds requirement. The Governor can propose a budget at the beginning of the process and influence the process through the May Revise. Although the Governor cannot raise taxes, the line-item veto does allow some after-the-fact expenditure reductions. Such reductions need not be based solely on fiscal prudence. The Governor can eliminate or reduce expenditures on programs for any reason. As Chart 16 shows, all recent governors have used the line-item veto. Relative to the overall size of the budget, Republicans have been more likely to make big cuts using the veto than Democrats.

Since the 2003 recall movement petition was premised on gubernatorial fiscal actions or inaction, the issue of the Governor's accountability for budget outcomes is clearly on the table. During the summer of 2002 – when the state budget was almost two months overdue – Democrats complained that the Governor was aloof from the Legislative battle. *"The Governor has to step up,"* said Democratic Senator Don Perata.[35] Republicans charged that there would be what Assembly Minority Leader Dave Cox termed a *"November surprise,"* i.e., a disclosure of a more dire fiscal situation after the election that Davis was widely projected at the time to win.[36]

The fact is that *neither* gubernatorial candidate chose to educate the public about California's fiscal condition. It simply was not a central issue in the 2002 campaign. Yet with the Legislature still debating a budget in July and August that should have been passed in June, there clearly was a problem. Whether a more effective Republican candidate might have gotten more traction from the budgetary issue is open to speculation. The ability to communicate complex problems in understandable ways - and to convince people that your solutions are best - is an obvious political asset for a candidate or an elected official.

While the 2002 Republican gubernatorial candidate, William Simon, can be faulted for an inability to make the budget a key issue in the campaign, Governor Davis – upon re-election - was confronted with Republican gains in the Assembly and Senate. These gains would inevitably make obtaining a two-thirds vote for the next budget more difficult. There would be more pressure for expenditure cuts without tax increases from the Republican side. And with California's fiscal situation growing more difficult, the Governor could anticipate more resistance from his own party to spending cuts.

Despite these difficulties, which were apparent by late 2002 (and which materialized in 2003), the Governor did not move forcefully to enlist public support that might have pushed the Legislature toward his position or toward some form of compromise. When columnist George Skelton wrote in June 2003 that the Governor needed "*to take his (budgetary) case to California's civic leaders, to places like L.A.'s Town Hall, San Francisco's Commonwealth Club, Chico's Rotary,"* Davis responded that Skelton had *"a 1950s version of how this is done"* and that Skelton was *"assuming that Town Hall has something to do with votes in Sacramento."* [37] While one could debate which public forums were most appropriate – perhaps there was a better place than Chico's Rotary - the idea of a Governor seeking external support for his program is not an outmoded notion from the 1950s. On the other hand, whether failing to enlist such support is a sufficient reason for recall is a political judgment in the context of California's direct democracy.

There is a related issue of the way in which the budget problem is framed, an issue of "transparency" and "user-friendliness" discussed in prior editions of *California Policy Options*.[38] The Governor is constitutionally required to present a budget proposal. In reality, the technical work on the budget is done by the Department of Finance with the Governor providing overall policy direction. Both the January budget proposal and the May Revise are anxiously awaited by the Legislature and the media. Through the media, the information is conveyed to the public.

True, much budgetary information is available on the Department of Finance website. But it is unrealistic to expect the average citizen to interpret technical budgetary documents. Even the media rely largely on press releases and accompanying summary charts and tables. Unfortunately, the way in which the budget is summarized in these press releases and documents is not helpful in understanding the state's fiscal situation.

There is an important distinction between bookkeeping and managerial accounting that seems to have escaped those in charge of presenting budgetary information. Bookkeeping is simply recording transactions to keep track of funds and to make sure they are properly handled. Managerial accounting is arraying the resulting data and projecting those data in ways that facilitate analysis and decision-making. California needs to move toward a managerial approach.

For example, in January 2003, the problem was summarized by the Governor and the Department of Finance as a $34.6 (or a rounded $35) billion "shortfall." The estimate was raised to $38.2 (or $38) billion at the time of the May Revise, also described as a "shortfall." If a newspaper reporter had gone on the Department of Finance website to consult the online glossary of budgetary terminology, however, he or she would not find the word "shortfall."

In fact, as Chart 17 shows, in the one-month periods following the presentations of the January and May Revise budgets, these "shortfall" figures were widely cited in the media as "the" problem for California. Yet readers of these citations will be hard pressed to find any definition of what the summary number means. The media sometimes used the term "shortfall," sometimes "gap," sometimes "hole," and sometimes "deficit" to describe the figure.

There is an unfortunate tendency to confuse the so-called "shortfall" with "deficit." And most people think of deficit as the term is applied to the federal government budget. Very simply, a deficit in common parlance is a situation in which expenditures exceed revenues in a budget year. And a surplus is the opposite: a situation in which revenues exceed expenditures. That deficit and "shortfall" are often confounded by knowledgeable people is easily illustrated by three examples appearing in the *Los Angeles Times*. A *Times* editorial referred to the "shortfall" in August 2002 as a deficit. In a January 2003 op ed piece, State Librarian Kevin Starr, the author of an acclaimed multi-volume history of the State, referred to the "shortfall" as a deficit. So, too, did economist and commentator Peter Navarro in another op ed piece that month.[39] And there are numerous other examples of this confusion.

The "shortfall" concept is not "phony," but it is rather elastic in practice. The key problem is that it has little if any managerial significance. Knowing what the "shortfall" number is does not help in resolving California's fiscal problems. In principle, the "shortfall" is an amalgam of a stock and two flows, one a forecast and the other a hypothetical projection. Since stocks have no time dimension, but flows do, the shortfall concept has no meaningful time element. This time problem can be seen in the descriptions that often appeared in the *Los Angeles Times*. When the January 2003 budget proposal was announced, the *Times* tended to describe it as a shortfall over 18 months, i.e., 6 months to make the decision and 12 months of the actual budget. After a month went by, it was described as a shortfall over 17 months, then 16, 15, etc. Presumably, if the Legislature never enacted a budget, the shortfall would somehow vanish on June 30, 2004 as the time dimension reached zero!

The stock element in the "shortfall" comes from a concept known as the "reserve." It is, effectively, the difference between all revenues and all expenditures that have ever entered the General Fund. It might be thought of, therefore, as a kind of bank account the State possesses at the beginning of a budgetary period, presumably accumulated since the state was created in the middle of the 19th century. The bank account can be positive or negative (overdrawn). Since a stock exists at a moment in time, it has no time dimension.

Because the "reserve" – as used in budget presentations – is estimated on an accrual rather than cash basis, what is counted in the reserve is sometimes elastic. For example, in the May Revise of 2003, the Governor attributed to the reserve that would exist on the following July 1, $10.7 billion from a deficit-financing bond that was not proposed to be floated until well into the 2003-04 fiscal year. That is, by merely attributing this proposed bond issue to the prior year, the reserve was boosted by $10.7 billion. Surely, such flexibility in accounting standards does not contribute to the resolution of California's budgetary problems.

To calculate the "shortfall" for the budget proposal of January 2003, the Department of Finance took its estimate of the reserve as of July 1, 2002 and added to it the projected deficit that would occur in the then-current 2002-03 fiscal year, assuming that any proposed mid-year cuts that were not yet enacted would be adopted. That sum produced an estimate of what the reserve would be on July 1, 2003, the start of the new fiscal year (assuming the mid-year cuts). And to that was added the deficit that hypothetically would occur in 2003-04 if the state did not change its fiscal policy. The Governor then proposed to close this shortfall with various policy changes which brought the magic number to $23.6 billion.

By the time of the May Revise of 2003, with the shortfall then put at $38.2 billion, the borrowing described above was proposed as a way of closing the gap. But borrowing does not remove a deficiency. Borrowing is essentially what you do when you are spending more than your income and have run out of other assets to pay for it. The alternative is bankruptcy. Borrowing does not close a gap. It is (part of) the gap.

As Table 1 shows, the $38.2 billion shortfall-gap-hole has been evolving from $12.5 billion in the Governor's budgetary documents since the January 2002 budget proposals for the 2002-03 fiscal year. As this multi-year, stock-flow amalgam ballooned relative to the annual budget, there may have been a view in the Governor's office that the large magnitude would scare the Legislature into adopting the various gubernatorial proposals. After all, if the problem appears intractable - but the Governor is somehow offering a solution nonetheless - why not take it? If that is the strategy, there is only one program. It doesn't work, as the delays in budget passage demonstrate. The intractability of magnitudes such as $38.2 billion in the context of a budget in the neighborhood of $70 billion may well impede a solution.

Consider the position of a typical state assembly or senate representative. Suppose someone proposes a policy change that would save $1 billion a year but will cause some pain in your district. The policy change appears to be only 1/38th of the solution. Why should you vote for such a change since it causes pain and hardly contributes to a resolution? But if, alternatively, you are told that the *deficit* is more on the order of $10 billion (a figure closer to reality), a $1 billion saving begins to look like a serious alternative.

The problem of framing the budget has been dealt with in previous editions of *California Policy Options.*[40] In a later section on budget-related options for reform, some suggestions for more appropriate formatting will be offered. Suffice it to say at this point that current methodology has not contributed to solving California's ongoing fiscal crisis. Moreover, public suspicions that the truth is being hidden can only be fueled by obscure presentation of the budget. The Department of Finance seems wedded to current budgetary practices. But the Department reports to the Governor. It is therefore up to the Governor to determine if California will begin to produce user-friendly and transparent budgets.

The Legislature and the Budget

"Recognizing that the laws entrenched incumbents, voters … in the 1990s … approved term limits. In doing so, they transformed our public officials into teenagers. … With the gerrymandering of legislative districts, voters no longer choose their representatives; instead representatives choose their voters."

Benjamin Zycher, Senior Fellow at the
Pacific Research Institute[41]

"I cannot give up hope that a bipartisan compromise can be achieved. Is it difficult? Unquestionably. Is it doable? Absolutely."

Governor Gray Davis on the Legislature[42]

"Actually, Senator Burton and I agree on the budget. We both think it's the other party's fault we don't have one."

Senate Minority Leader Jim Brulte referring to the Majority Leader
and the lack of a budget deal despite the start of the 2003-04 fiscal year[43]

Has the Legislature become dysfunctional when budgets are considered? Chart 18 shows the number of days the state has gone without a budget for each fiscal year since the mid-1960s. The trend is troubling. Although on-time budgets cannot be said to have been the norm in any given time period shown, the really long delays are a phenomenon that began in the 1990s and continued into the 2000s. Various culprits have been named for this dysfunction.

Obviously, periods of economic softness are more likely to force hard decisions on the Legislature and thus produce delay. But in addition, term limits are often seen as creating amateur legislators who are not experienced in budget mechanics or, more generally, the art of compromise. Redistricting is seen as polarizing the Legislature between liberal majority Democrats and conservative minority Republicans, most of whom are in "safe" seats. When combined with the two-thirds rule for passing a budget, the results is that conservative Republicans can prevent enactment of a liberal budget but have only limited influence on the process of budget formation until the moment of decision arrives.

As noted earlier, California has little influence on its business cycle, which is largely a national phenomenon. So periods of economic slack are not within State control. But the other seeming culprits for Legislative dysfunction result from political and institutional decisions. If the various institutional changes that have been made by the electorate over the years are summed, it appears that voters want a weak Legislature but one made up of folks who agree with them. Given that choice, the Governor becomes the key official who receives the credit or blame for state developments.

One set of proposed solutions revolves around strengthening the Legislature's decision-making capabilities. These solutions tend to be the ones most widely discussed and favored by the State's elites. But the voters may well prefer putting more ultimate decision-making capacity in the hands of the Governor and then holding the Governor responsible for what transpires. These issues will be discussed further below.

The Legislative Analyst and the Budget

"She's got a lot of ideas that are good, which are the ones I agree with, and she's got some that are bad, which are the ones I disagree with…"

Senate Majority Leader John Burton
on Legislative Analyst Elizabeth Hill[44]

Part of California's longstanding progressive tradition is that while politicians are viewed with suspicion, neutral professionals who understand the key issues are valued. The Legislative Analyst position was created as the byproduct of a fight between then-Governor Culbert Olson and the so-called "Economy Bloc" in the Legislature in 1941. The analyst is seen as a neutral professional. With regard to the budgetary process, the Legislative Analyst's Office (LAO) provides an alternative view and a commentary on the Governor's January and May Revise budget proposals. This alternative view may depart from the Governor's proposals because of differences in underlying economic assumptions. But the LAO may also list different policies the Legislature might consider, usually framed as options in a pro-and-con framework.

Apart from the January budget proposal and the May Revise, the LAO analyzes the versions of the budget that are seriously considered in the Assembly and Senate. For 2003-04, however, a compromise proposal by Republican Assemblyman Keith Richman and Democratic Assemblyman Joe Canciamilla was not analyzed by LAO, despite the significant media attention given to it. There were also other Republican plans that were put to votes but not given public analysis by the LAO. While there may have been some uncertainty about the magnitudes and assumptions involved in these plans, it is unfortunate that at least some documentation concerning these proposals was not released by LAO.

One area which the LAO has not addressed is the formatting of the budget and the issue of user-friendliness and transparency discussed above. The LAO has so far taken the Governor's "shortfall" methodology and other oddities of state budget accounting as a given. While it is understandable that the LAO would start with the Governor's format – since it is contained in the budget proposals the Legislature receives in January and May – the LAO could present alternative formats as well as alternative projections and options. Such a move would likely push the Governor and the Department of Finance toward more transparency and consistency in their own documents. In short, the LAO needs to look at budget presentation and formatting as an issue in developing its analyses as well as the budget itself.

The Treasurer and the Controller

"It should come as no surprise that there are practical limits to the amount of additional long-term state bonds that prudently can be authorized before California puts its fiscal house in order. We are at those limits."

State Treasurer Phil Angelides[45]

"Without a budget, I will be forced to attempt to pursue additional borrowing at what are likely to be substantially higher interest rates… In that scenario, it is possible that investors will refuse to lend the State any more money."

State Controller Steve Westly[46]

Two elected state officials play an indirect role in state budgeting. The Treasurer floats securities needed to finance state programs. A need to issue debt arises from two sources. The state may simply run out of cash to pay its obligations and need to borrow. Such developments occur in part because the inflows to, and outflows from, the General Fund do not necessarily balance over short time periods. Tax receipts are not evenly spaced out over the twelve months of the year, for example. It is more likely, however, that cash needs will arise when the state is having difficulty balancing its budget. Beyond such short-term needs, the voters from time to time approve long-term borrowing for various state projects, typically involving capital improvements and infrastructure.

California's constitution on its face requires a vote of the electorate for debt issuance of the General Fund. However, courts have interpreted short-term borrowing as exempt from this requirement on the grounds that what is involved is simply smoothing over a mismatch of the timing of receipts and disbursements. As of June 1, 2003, the Treasurer reported $44 billion in outstanding debt obligations of the General Fund. Of this total, $12 billion was in soon-to-expire short-term Revenue Anticipation Notes (RANs). RANs are ostensibly issued because of timing mismatches *within* a fiscal year. As late as

November 2002, however, voters were still approving new long-term debt obligations for the General Fund (totaling $11.4 billion). Over $15 billion in such voter-approved debt was still unissued by June 1, 2003.

The Controller is the disbursement agent for state expenditures and the recorder of its revenue inflows. On a monthly and annual basis, the Controller prepares statements of cash flows and cash holdings of the State. When short-term borrowing is needed to cross from one fiscal year into the next – something that happens only during budget crises - the Controller (not the Treasurer) is the issuing agent due to an odd constitutional quirk. Such cross-year securities are known as Revenue Anticipation Warrants (RAWs). In June 2002, the Controller issued $7.5 billion in RAWs. Of that total, about $6.5 billion was due to a delay in a flotation of electricity bonds, i.e., about $1 billion would have been needed had the electricity bond been on time. In June 2003, it was found necessary to issue $11 billion in new RAWs. The difference over that 12-month period ($11-$1 billion) is an indication of a cash problem of about $10 billion.

Unlike the RAWs of 2002, the June 2003 batch had to be sold with "credit enhancements" from various investment banks. Essentially, the banks guaranteed that if the State could not repay the RAWs in June 2004, the banks would roll over the debt for the State. However, the interest rates on the rolled-over RAWs would jump at that point from 1.1% to 7% with rising penalties as time passed, a remarkable yield for a tax-free security.[47] As it was, the fees charged for credit enhancements and flotation of June 2003 RAWs came to about $86 million, a reminder that while Wall Street is the ultimate disciplinarian in state finances, the State's fiscal problems are also a source of profit until bankruptcy threatens.

Chart 19 shows the pattern of available "unused borrowable resources" available to the Controller to meet disbursement needs on a monthly basis during 2001-02 and 2002-2003. These are balances in various funds that can be drawn upon to handle outflows from the General Fund. During the earlier year, those resources never fell below $5 billion. In the later year, they dropped below $2 billion. Notable was the pattern in the summer of 2002. With the $7.5 billion in cash raised through the RAWs, the Controller started the 2002-03 year with over $10 billion. By September, this cushion had declined to about $3 billion. Absent a budget – the situation at the beginning of 2003-04 - state disbursements are reduced in the short term, since many state bills go unpaid. But ultimately there are penalties imposed on the State (greater expense) and other costly disruptions when vendors are paid later.

The situation as of the end of the 2002-03 fiscal year was in marked contrast to earlier periods, as shown on Chart 20. Resources available to the Controller relative to disbursements stood at roughly 14%, i.e., about 7 weeks worth of gross outflows, through 2000-01. Were it not for RAWs, the percentage would have dropped below 4% by the end of 2001-02 and turned negative by the end of 2002-03. Put simply, the state would have run out of cash to pay its bills.

Possible Remedies

*"*Discussion: *A method of confirming others in their errors."*

Ambrose Bierce in "*The Devil's Dictionary*"[48]

In this section, eight possible budget-related reforms are briefly considered. These are 1) relaxing the two-thirds rule for budget passage and for tax increases, 2) making the Governor's May Revise budget the default budget if the Legislature has not acted by July 1, 3) relaxing term limits, 4) requiring transparency in budget presentations, 5) mandating a "balanced" budget, 6) enactment of a contingent "Plan B" budget, 7) mandating some type of "rainy day" fund, and 8) use of financial instruments to offset variations in tax collection. Before such remedies can be considered, however, it is important to identify the problems to be addressed.

As noted above, there are "structural" budgetary issues that face the state. Demographic trends such as immigration and aging of the population tend to put more demands on public services. The degree to which the State chooses to respond to those demands is a political choice and that choice is not discussed here. Clearly, however, if the choice is to respond to those demands with increased services, enhanced revenue sources will need to be found. The kinds of options discussed in that regard are extending sales taxation to Internet purchases and using a "split roll" system of property tax to obtain more revenue from commercial property.[49] There are a variety of administrative and other issues that accompany such proposals but these are not covered here. Whatever the choice on the level and quality of services – in the near term or in the long term – the existence of a fiscal system that is prone to crisis will degrade delivery of those services. Thus, the focus below is on avoiding fiscal crises in the future.

The fiscal crisis of the early 2000s has three basic dimensions. One element is simply the delay in enacting the budget and the fact that the State frequently is forced to operate without a budget in place when the fiscal year begins. When that happens, vendor payments are delayed and services are potentially disrupted. Delayed decisions also potentially add costs to existing programs and can make later adjustment to tighter budgets more difficult. Two possible options are considered in this section which address the delay problem: changing the two-thirds rule regarding budget passage and tax increases and making the Governor's May Revise budget the default option.

There is no guarantee, of course, that a timely budget will be a "better" budget than one that emerges from a delayed process. As indicated before, whether a budget is better than some other budget is partly a political judgment about the desirability of various expenditures and about the behavioral and distributional consequences of the tax code. But another aspect of being "better" is maintaining fiscally responsibility. Excessive borrowing and deficit spending at the state level can lead to increased interest costs and onerous terms imposed by lenders. Taken to an extreme, it can lead to bankruptcy and disruption of services. Some options that might reduce the risk of fiscal irresponsibility are relaxation of term limits, the above-mentioned "Governor-default" option, transparency in budget presentation, and a mandated "balanced" budget.

Finally, structural variability in tax receipts (and, to a lesser degree, unanticipated expenditures) can complicate the budgetary process. Such variability is addressed by the Plan B, rainy day fund, and financial instrument options. All of the eight options – and their primary targets - are summarized on Table 2.

1) <u>The Two-Thirds Requirements</u>

"A two-thirds supermajority means that the vote of a legislator opposing a measure counts for twice as much as that of one voting yes. This has allowed a small minority to tie up the budget process for increasing periods."

Statement of the League of Women Voters of California supporting a proposed initiative cutting the budget vote needed to 55%[50]

"The solution to California's budget problems will not be found in Progressive policies like the two-thirds budget rule, where Democrats throw table scraps to Republicans who play along… Let Democrats pass a budget along a party line vote, and then hammer away at the irresponsibility with which they spend our money."

Tom Krannawitter, Vice President,
The Claremont Institute, advising California Republicans[51]

The two-thirds requirements for budget passage and tax increases clearly makes negotiations within the Legislature more difficult. In a sense, however, that is what it was intended to do. The original objective stemmed from the experience of the Great Depression when an amendment was adopted requiring a two-thirds vote if the General Funds increased by more than 5%. In 1962, the 5% element was removed. And in 1996, the bipartisan California Constitutional Revision Commission recommended that budgets be enacted by simple majorities. Most states - the Commission noted - do not require supermajority votes and some of those that do impose the requirement only under certain contingencies.

A public opinion poll on a proposal to lower the budget requirement from two thirds to 55% found 46% of adults (50% of Democrats) in favor and 43% opposed. Thus, producing a majority vote for the initiative might well require considerable effort on the part of proponents. A complication for such a campaign was the disclosure of an overheard July 2003 meeting - prominently reported in the press – in which some Assembly Democrats discussed the option of prolonging the budget stalemate to make the 55% initiative more attractive to the electorate. Allegations that the budget impasse of summer 2003 was artificial will undoubtedly be made by opponents of lowering the voting requirement.

In another context, however, the electorate was willing to relax a voting rule. Prop 39 (November 2000) cut local voting requirements to 55% from two thirds for school-related bonds and taxes. So relaxing the two-thirds vote rule at the Legislature might be feasible.[52] Prop 39 was passed by 53% of the voters. Note, however, that the voters who favored Prop 39 were relaxing a requirement on themselves, not on the Legislature.

In early summer 2003, the Nevada state legislature was unable to enact a budget under that state's supermajority requirement. A decision of the Nevada Supreme Court voided the two-thirds rule for that state on the grounds that the state constitutional imposed certain requirements for educational funding. The Court found that the supermajority rule led to a budget impasse that was thwarting the education mandate. As a result of the Nevada precedent, the California State Superintendent of Schools declared that he would file a similar suit in California. Nonetheless, it seems unlikely that the California Supreme Court would overturn a longstanding constitutional voting requirement.

2) <u>The May Revise as Default</u>

"...The voters clearly want a chief executive they can hold accountable. Under this (May-Revise) procedure the Governor would surely be accountable, with all the perils and rewards that accountability entails."

UCLA Professor Daniel J.B. Mitchell[53]

Changing legislative voting requirements would involve a constitutional amendment. Another possibility for constitutional change would be to put more decision-making authority in the hands of the Governor and leave the legislative rules as they are. A major premise of the 2003 recall effort against Governor Davis was that he was responsible for the budget crisis. Yet a Governor ultimately does not enact the budget; the Governor only makes a budget proposal. The constitution could, however, be revised to alter that situation and make the Governor truly accountable.

Specifically, if as of July 1 of any fiscal year, no budget had been enacted, the Governor’s “May revise” budget would become the state budget until such time as an alternative is enacted. There would then be no legal issues about whether the state could pay its bills, since a budget would be in place. Of course, this reform would substantially increase the power of the Governor. Members of the Legislature would know that if they dawdled, or if they proposed a budget the Governor would veto, the Governor’s own budget would become law. Some legislators might be tempted to remain intransigent in order to please a particular interest group. But others might see virtue in having an influence on the final product and pass a budget on time.

In any event, a Governor would have substantial leverage in obtaining approval for his/her budget proposals, either through legislation or by default. And the “May revise” budget – or whatever budget was enacted - would likely tilt toward fiscal prudence. For example, the Governor's January 2003 initial budget proposal did not rely heavily on deficit finance. In contrast, his May Revise was structured around deficit financing since it had become evident by that time that the Legislature was unlikely to make sharp spending cuts.

3) <u>Relaxing Term Limits</u>

"Term limits have brought a breath of fresh air to California government. Before the introduction of term limits, entrenched incumbents, awash in campaign contributions from special interest lobbyists… clung to power. …But now, with California facing such enormous challenges, we need Proposition 45 to empower the people with the option of keeping their own representative."

Official ballot argument in favor of Proposition 45
of March 2002, which would have relaxed terms limits[54]

As noted earlier, legislative term limits came into play in 1990. And the major delays in budget passage beyond the fiscal year began to occur in the 1990s. Moreover, it could be argued that term limits make legislators less concerned about the long-term consequences of their actions. But although term limits are widely viewed by the state's elite as contributing to the budget problem, the voting public seems quite content with those limits. Note that the ballot initiative - Prop 45 - whose official argument is quoted above, used language praising term limits hoping to attract voter support to relax them. Under Prop 45, voters could have added another 4 years to the term limits of legislators by petition. But even that modest relaxation went down to crushing defeat, receiving only 42% of the vote. It seems unlikely that term limits will be relaxed any time soon.

4) <u>Transparency in Budget Presentation</u>

"California currently produces a wealth of budget information. Much of this information is extremely detailed and intimidating to the lay reader."

California Budget Project[55]

Making the budget transparent and user friendly is something that could be done without constitutional amendment. Indeed, it is difficult to imagine constitutional language that could effectively force a transparent presentation. But the Governor, the Department of Finance, and the Legislative Analyst could move toward transparency as a policy decision.

There are really only a few common-sense rules that should be followed in presenting the General Fund budget. Here are some basics:

- Revenue should consist of taxes, fees, and interest receipts.

- Transfers should be limited to grants from other levels of government (which will typically be the federal government) and transfers from other state funds that are truly unencumbered, i.e., that do not have to be repaid.

- Transfers that *do* have to be repaid are borrowings, not transfers. Borrowings do not close a budget deficit. They are what you have to do when you have run out of assets to finance a deficit.

- Tapping the General Fund reserve should not be confused with, or treated as, revenue.

- Expenditures are purchases of goods and services (including labor services) and grants to other levels of government (typically these will be local governments) that do not have to be repaid.

- Tax reductions are not expenditures unless they are grants to other levels of government to compensate for lost revenue. Except for such grants, tax reductions simply are lower revenue. General grants to compensate local governments for lost revenue are just expenditures and can be listed as bloc grants.

- The annual deficit or surplus should be clearly enumerated as revenue plus unencumbered transfers minus expenditures. Deficits or surpluses are flows. Budget language should never use such terminology to refer to stocks, such as the reserve. Generally, budget language should mimic federal practices in this regard.

- While all of these flows can legitimately be reported on an accrual basis (and therefore the reported reserve will be on an accrual basis), loose attribution of time periods should be avoided. Thus, for example, the proposed flotation of a bond issue in 2003-04 should not have been attributed to the prior year (as it was in official documents).

- Consistency in accounts from year to year is important. Thus, expenditures for electricity should not have been off the books in the year they occurred and then retroactively termed a negative transfer for that year in later periods (as they were in official documents).

- Differences between the annual cash statements issued by the Controller and accrual-based budget documents issued by the Department of Finance should be regularly reconciled and the results prominently published.

There will undoubtedly be objections to these basic rules because they do not accord with official state bookkeeping practices. But - again - it is important to recall the difference between bookkeeping and managerial accounting. The latter is an arraying of data to assist in analysis and decision-making. Budget presentation should not be driven by bookkeeping considerations.

Rules of transparency should apply to all reports related to budget developments. For example, the Department of Finance releases a monthly *Finance Bulletin* showing "actual" tax and other receipts vs. "forecast" receipts. However, the forecasts shown are not the forecasts made in the original budget, but rather a rolling forecast that includes known actual data for prior months. Thus, the July 2003 *Bulletin*, which summarized the entire 2002-03 fiscal year, reported that the actual receipts were within half of one percent of the forecast. But the forecast used in the *Bulletin* included actual data for all but two of the 12 months of the fiscal year. In contrast, the difference between the original budget forecast (from the May Revise of 2002) and the actual was quite large. Actual revenues for 2002-03 were in fact about $8 billion below the original forecast.

Of course, it is quite appropriate for the Department of Finance to modify its estimates of the year's receipts as actual data become available. But omitting the original forecast from the tables clouded public understanding of the degree to which State revenue had fallen. The test for public information should always be the same. Does the format in which budget-related information is released help or hinder analysis and understanding?

5) <u>Mandating a "Balanced" Budget</u>

"The Commission's objective is to prohibit spending in any fiscal period that will exceed the revenue that will be received. Adopting a balanced budget requirement will enhance the state's fiscal integrity and accountability and impeded carrying over deficits to the next fiscal period."

California Constitutional Revision Commission[56]

California's constitution mandates only that the Governor present a budget proposal in January under which expenditures are covered by available resources. But these resources could involve tapping whatever reserve the state has available. Nothing requires the Legislature actually to pass a budget balanced, even in that limited sense. And even if a budget were balanced on paper, if subsequent economic circumstances caused a deficit, there is nothing in the constitution requiring the Legislature to make a mid-course correction. The 1996 Constitutional Revision Commission recommended a balanced budget requirement, but none was enacted.

There are states that do have balanced budget requirements of various sorts. For example, in summer 2003, the Texas state comptroller used her constitutional authority to reject a budget the legislature had enacted on grounds it was not truly balanced. As a result, the Legislature had to make additional cuts to receive her blessing.

In principle, California could adopt such a system. And it could even include requirements for mid-course corrections. However, rather detailed language would have to be inserted into the constitution to ensure that the definition of "revenue" was tightly constrained. And if some official were given authority along the lines of the Texas comptroller, the constitution would have to designate who that would be. California does have a Legislative Analyst who is viewed as a neutral expert. However, putting such authority in the hands of the Analyst would inject that office into the political process. Designating some other official as the budgetary watchdog, such as the Treasurer or Controller, could invite strategic behavior. For example, the Texas comptroller was rumored to be considering a later campaign for Governor and a show of tight-fisted taxpayer protection could assist such ambitions.

6) <u>Having a "Plan B" Budget</u>

"When you come to a fork in the road, take it."

Yogi Berra[57]

Budget making is an uncertain activity. As noted earlier, budgets are essentially forecasts and forecasts will inevitably be inaccurate to some degree. It would be possible for the Legislature to consider and - perhaps actually to enact - contingent language that would trim the budget or raise taxes if revenues fell below expectations. It would not be necessary to amend the constitution to require such a process, although it could be mandated by constitutional amendment. The practice could simply be adopted. Note that not every step in the current budget process is constitutionally mandated. Some important steps, notably the provision by the Governor of the May Revise, is a practice, not a requirement.

It is not unusual for private economic forecasters to look beyond their expected projections and to consider a range of alternative scenarios. In contrast, the California budget is based on a single forecast. No development of a Plan B is part of the process. Considering alternatives in advance would seem to be a prudent measure for both the Governor and Legislature.

7) <u>A Rainy Day Fund</u>

"The Legislature shall establish a prudent state reserve fund in such amount as it shall deem reasonable and necessary."

California Constitution[58]

The State does have a "reserve" as part of the General Fund, which could be viewed as a rainy day fund. However, the constitution does not provide a specific target or formula for fund accumulation. Nothing, however, prevents the Legislature from pursuing a given target for the reserve, even if none is constitutionally required. The 1996 Constitutional Revision Commission recommended a mandated target of 3%. But as Chart 21 shows, the existing reserve was as high as 14% of expenditures in 1999-00, but rapidly tumbled into negative territory thereafter. Thus, a target as low as 3% seems inadequate, if there is to be either a mandated target or a target in practice.

Of course, the 3% proposal was made in the context of a recommended balanced budget mandate and so a larger reserve might have seemed unnecessary to the Commission. The experience of the early 2000s, however, suggests that absent a balanced budget, a rainy day fund target would need to be quite high, if it is to provide a real cushion. However, as will be noted below, there may be some other steps that can be taken to deal with revenue variability.

It might be noted that the Legislature has placed a proposed constitutional mandate on the ballot that is awaiting the voters. Assembly Constitutional Amendment 11 would set up an infrastructure fund financed on a pay-as-you-go basis rather than by borrowing. Under this proposed amendment, 1% of the General Fund would be diverted from the General Fund for infrastructure beginning in 2006-07 with the percentage growing later to 3%. The amendment provides for reduced diversions - down to zero - in cases where revenues grow slowly or decline. However, if the mandate passes, any diversion of General Fund revenue toward a rainy day fund would come on top of the diversion toward the infrastructure fund.

8) Use of Financial Instruments

"It will fluctuate."

Early 20th century financier Bernard Baruch when asked what the stock market would do in the future[59]

As Chart 22 illustrates, the stock market can be quite variable and, therefore, personal income taxation from capital gains can vary dramatically. Such fluctuations played a major role in the state budget crisis of the early 2000s. The stock market as a whole - as measured by such broad indexes as the S&P 500 - varied substantially from year to year. The NASDAQ index, which was heavily weighted toward dot.coms and technology firms, was even more affected by the inflation and bursting of the bubble. California was the home of many such firms and of employees in such firms who received stock options and grants as a form of compensation.

Predicting stock market variation is more difficult than general economic forecasting. And there are other variations in financial markets that have an influence on the state budget situation. For example, low interest rates make state borrowing cheaper. But interest rates are also subject to fluctuations and can make future borrowing costs difficult to anticipate.

Professional money managers, such as pension fund administrators, now have available a variety of financial instruments that can be used to hedge the risks inherent in stock and bond markets. One possibility that the state may want to explore is the degree to which such instruments might be employed to deal with financial risks that affect the budget. Of course, use of financial engineering to deal with fluctuations in asset markets would have a cost, just as any form of insurance involves a cost. Whether public opinion would accommodate a strategy under which the state paid to hedge risk is an open question. However, the use of modern financial technology is an area that should be examined.

Is There a Bright Side to the California Budget Crisis?

"The optimist thinks this is the best of all possible worlds. The pessimist fears it is true."

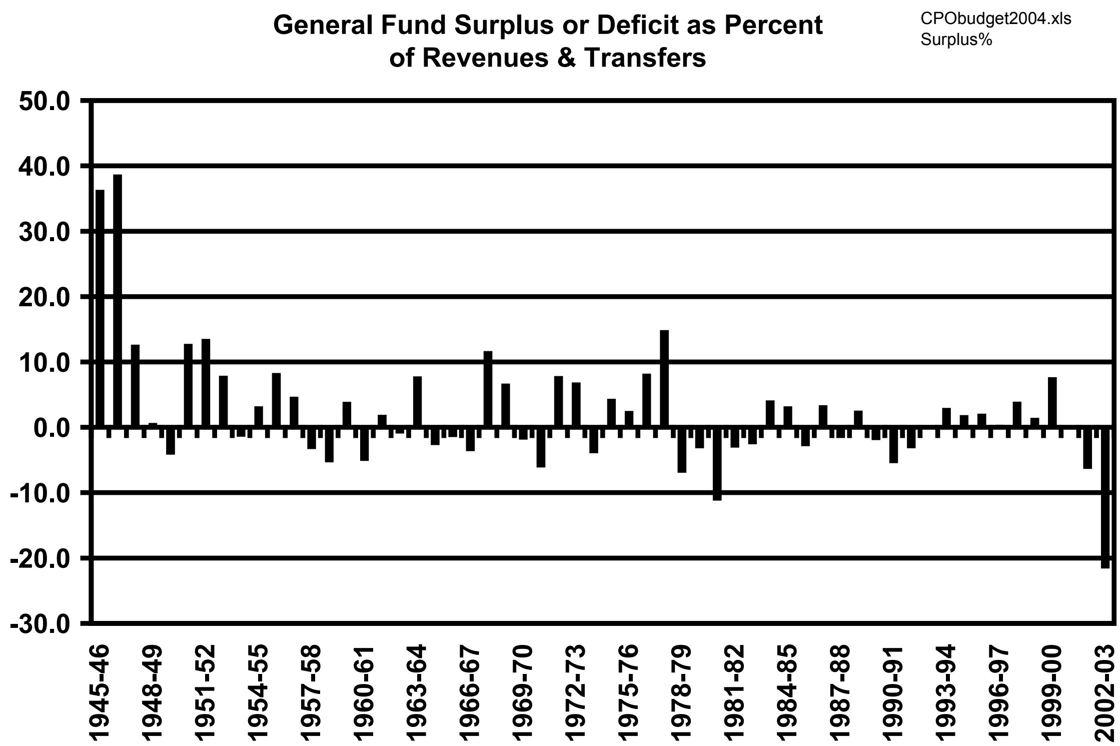
J. Robert Oppenheimer, Technical Director,
The Manhattan Project[60]

Although the California budget process seems broken and the State's fiscal situation seems grim, it is nonetheless true that crises tend to provoke reform. Above, eight possible alternatives for reform were listed. Some would require a constitutional amendment and would be difficult to enact. But not all would. Such options as budgetary transparency, targets for a rainy day fund, and use of modern financial instruments to cushion the budget, are available without constitutional modification. These are reforms that would help avert future crises.

What is clear is that California has had a budget crisis roughly once every decade since the 1970s. The current crisis will not be the last, although it will undoubtedly be long remembered because of its size and the political reaction it triggered. The crisis of the early 1990s led to the budgetary reform recommendations of the California Constitutional Revision Commission. But in the rush of prosperity in the latter half of that decade, the notion of reform was forgotten. Is it too much to hope that lessons will be better learned this time around?

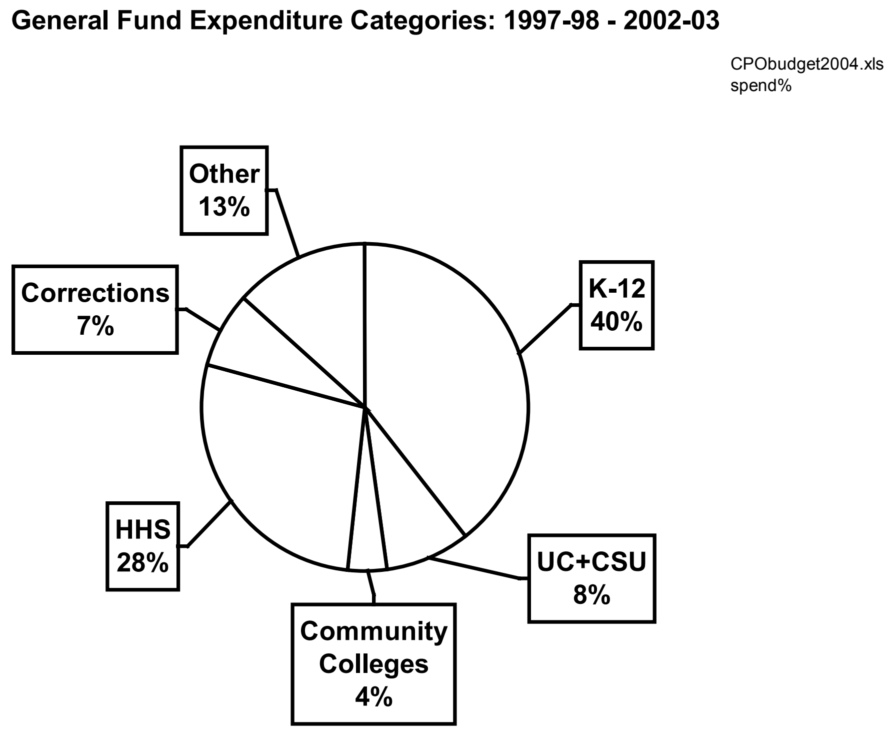
Interim Draft: 7/23/03. Please send comments to Daniel J.B. Mitchell, UCLA, at daniel.j.b.mitchell@anderson.ucla.edu.

Chart 1



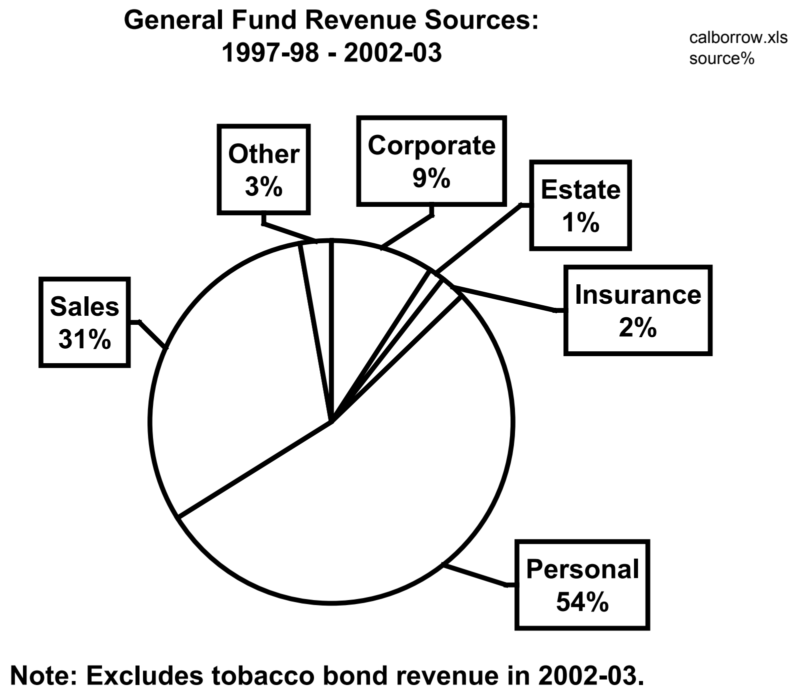
Source: California Department of Finance

Chart 2



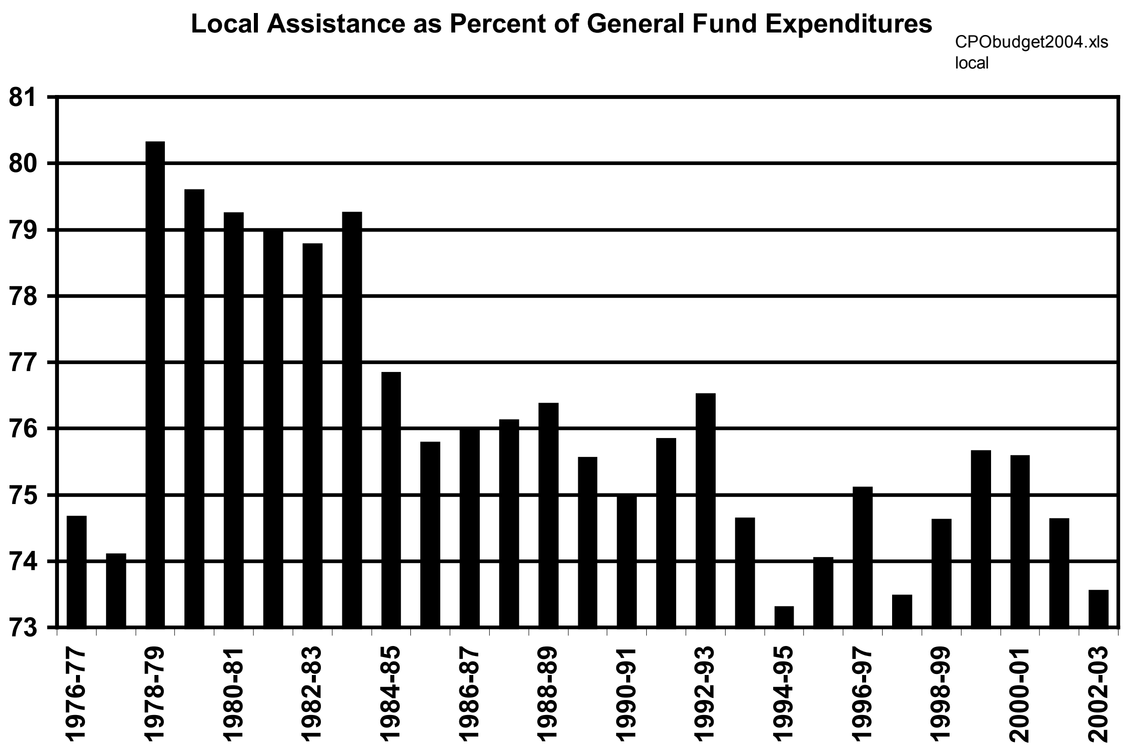
Source: California Department of Finance

Chart 3



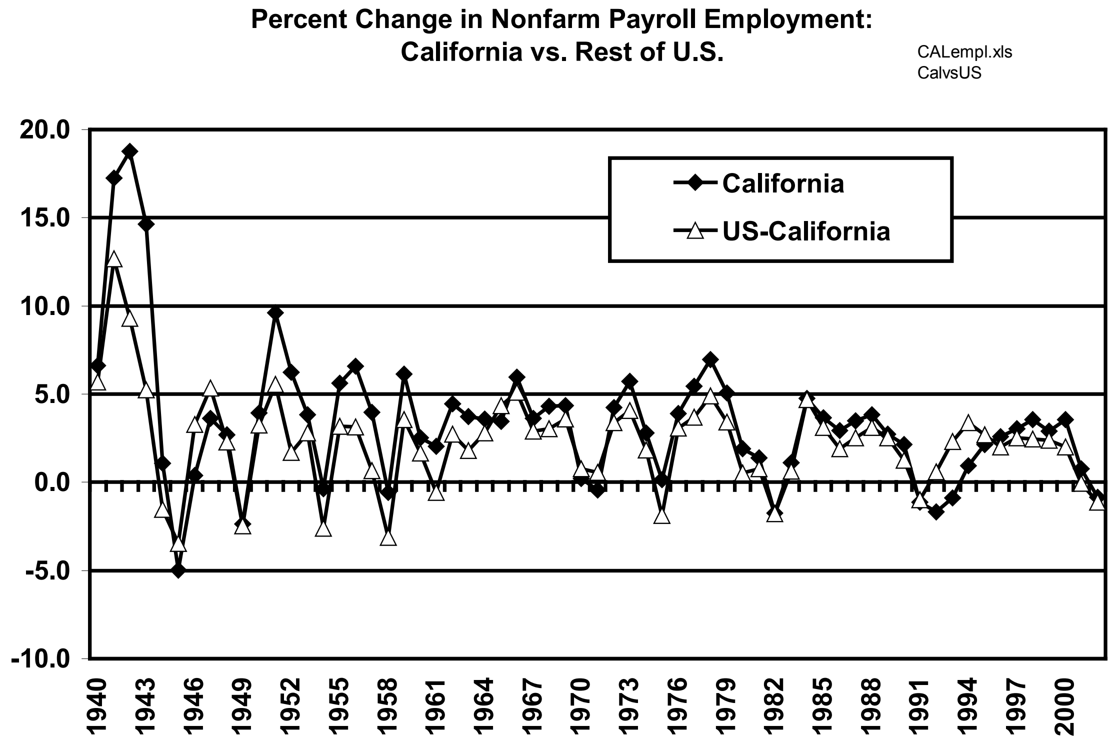
Source: California Department of Finance

Chart 4



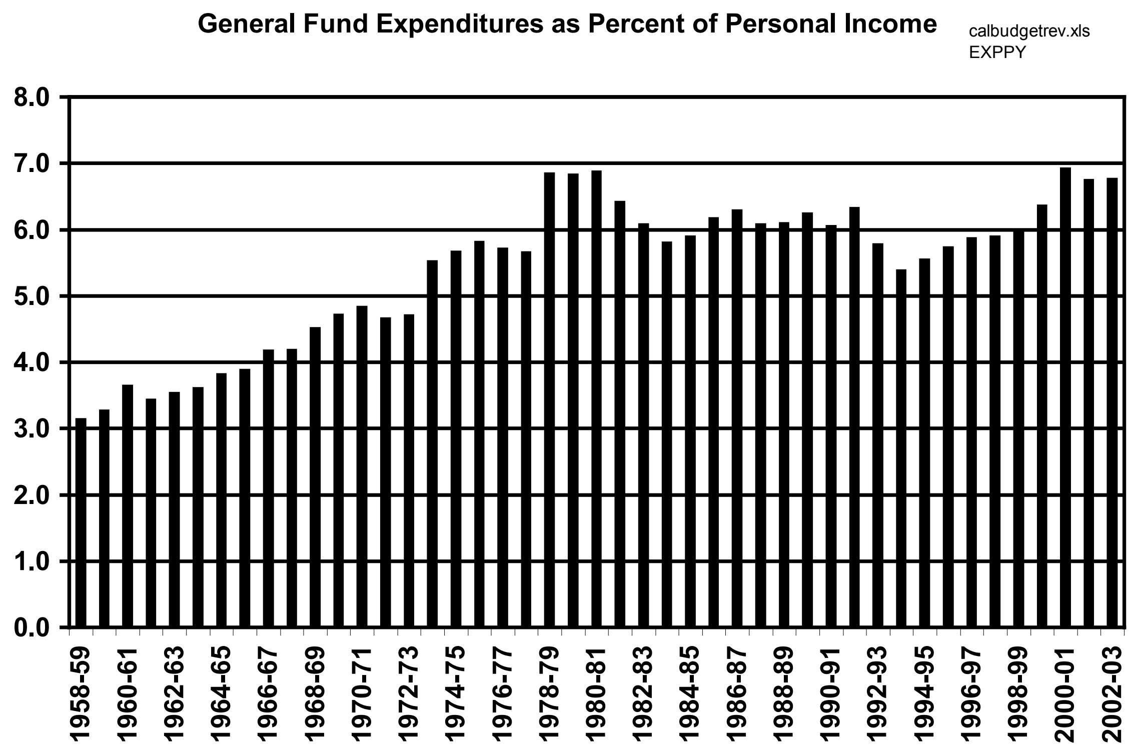
Source: California Department of Finance

Chart 5



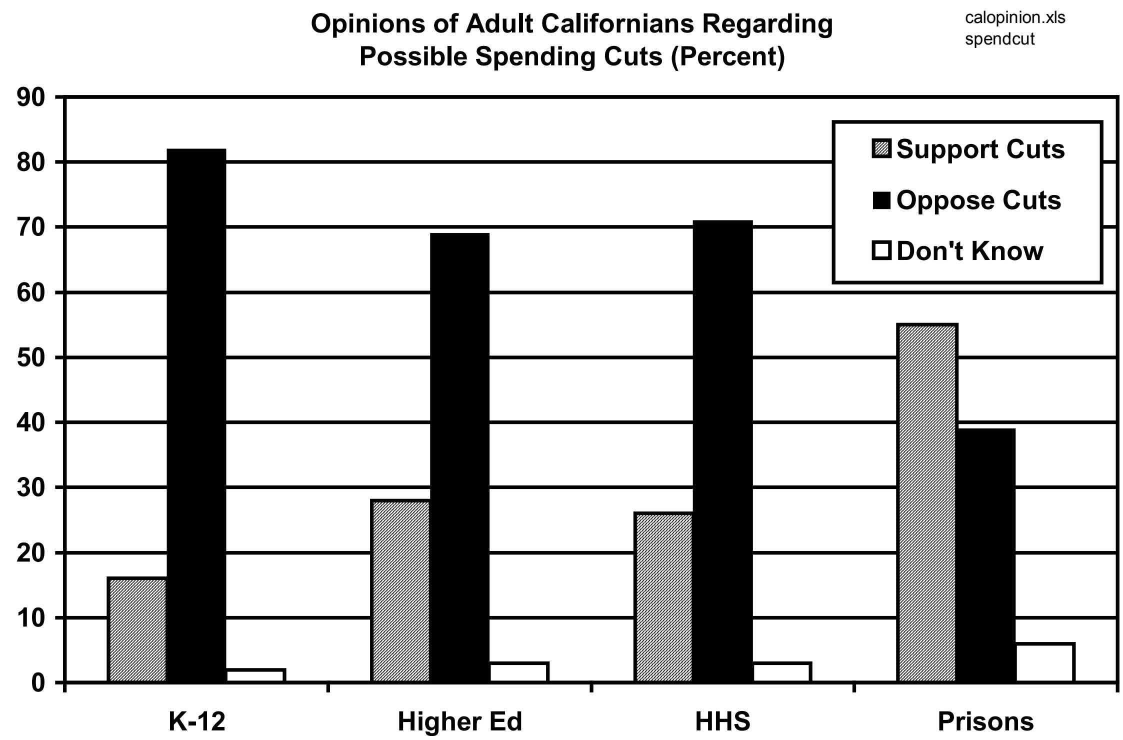
Source: U.S. Bureau of Labor Statistics

Chart 6



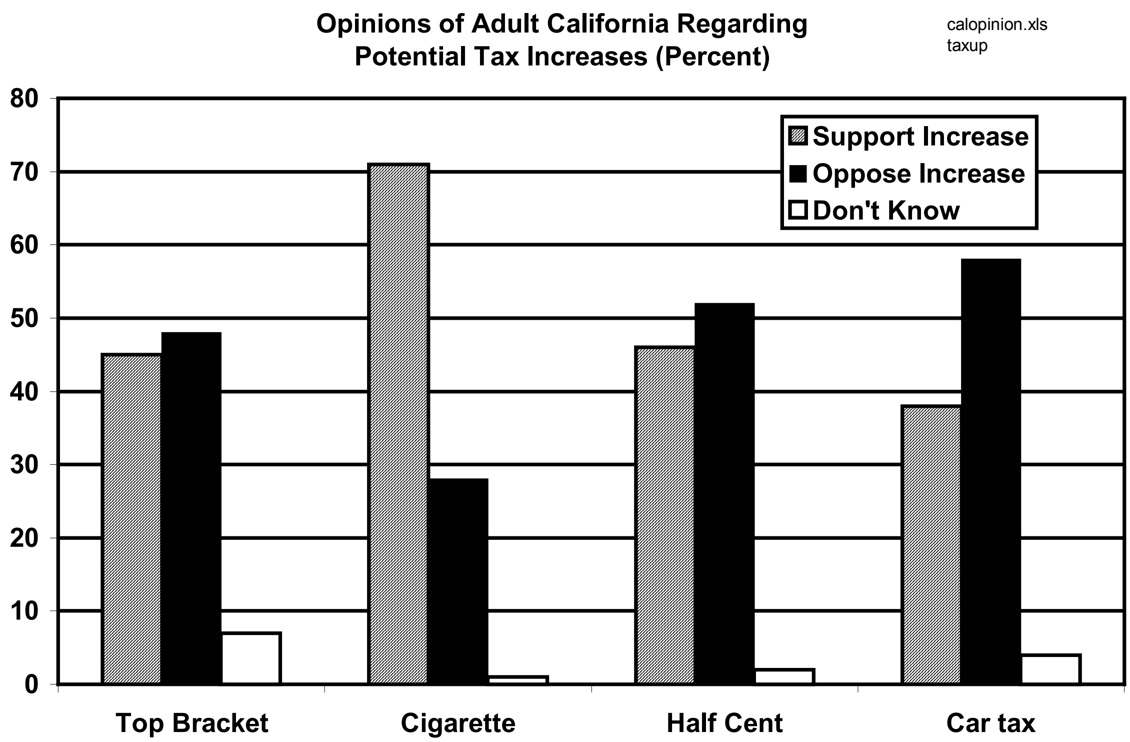
Source: California Department of Finance; U.S. Bureau of Economic Analysis

Chart 7



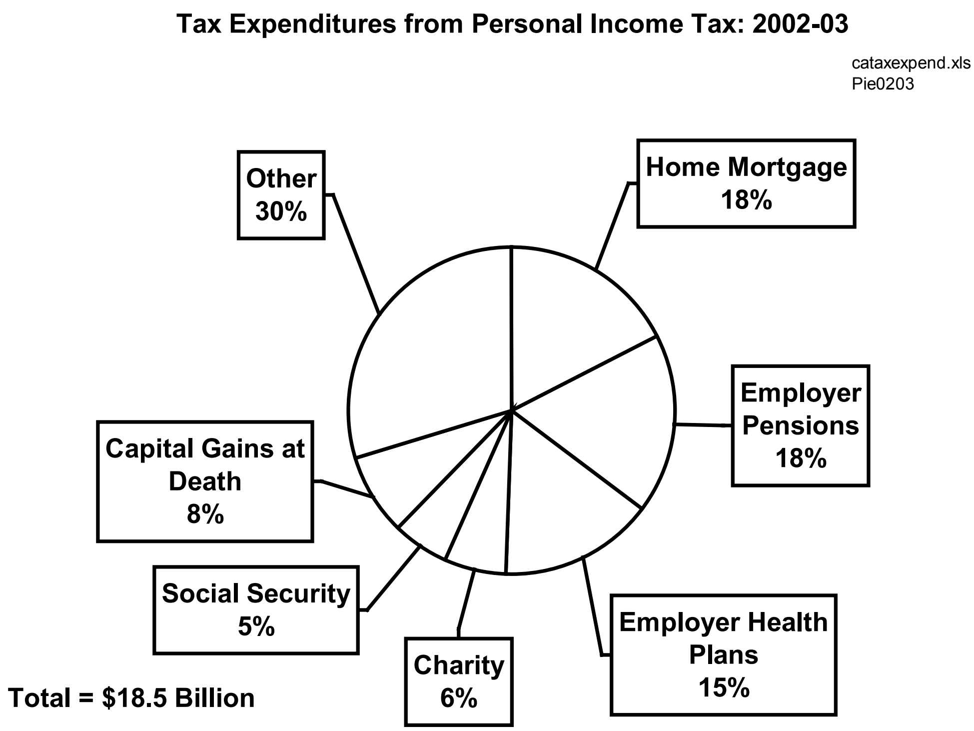
Source: Public Policy Institute of California

Chart 8



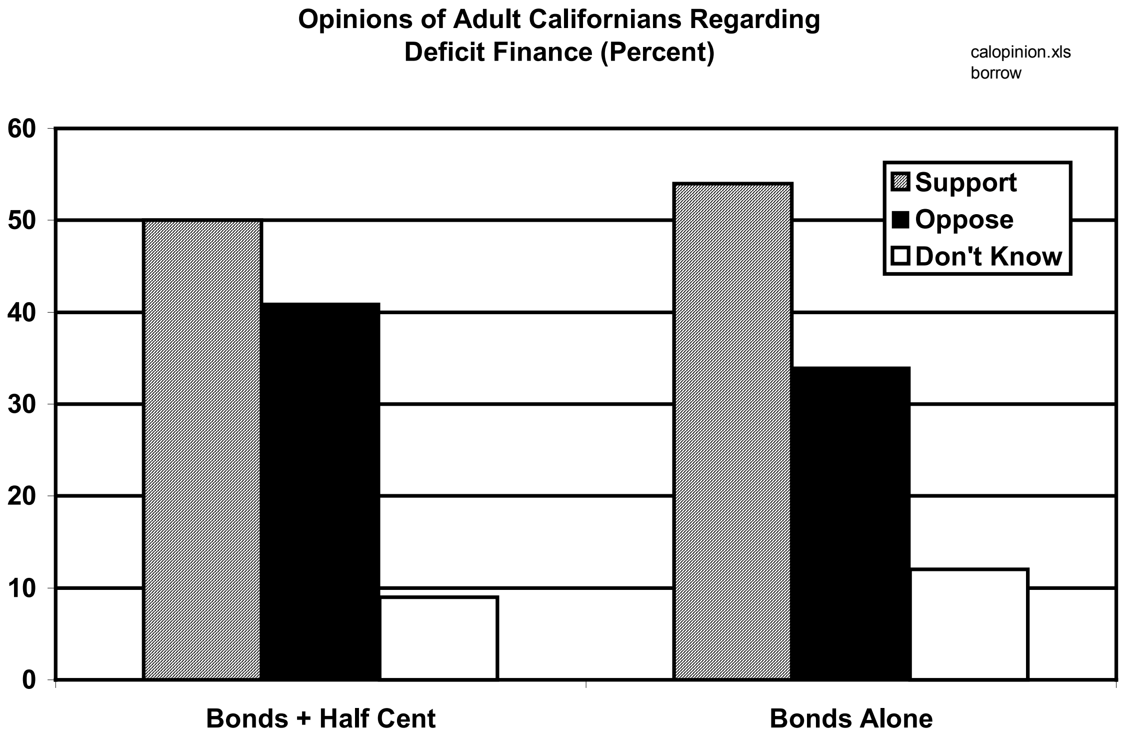
Source: Public Policy Institute of California

Chart 9



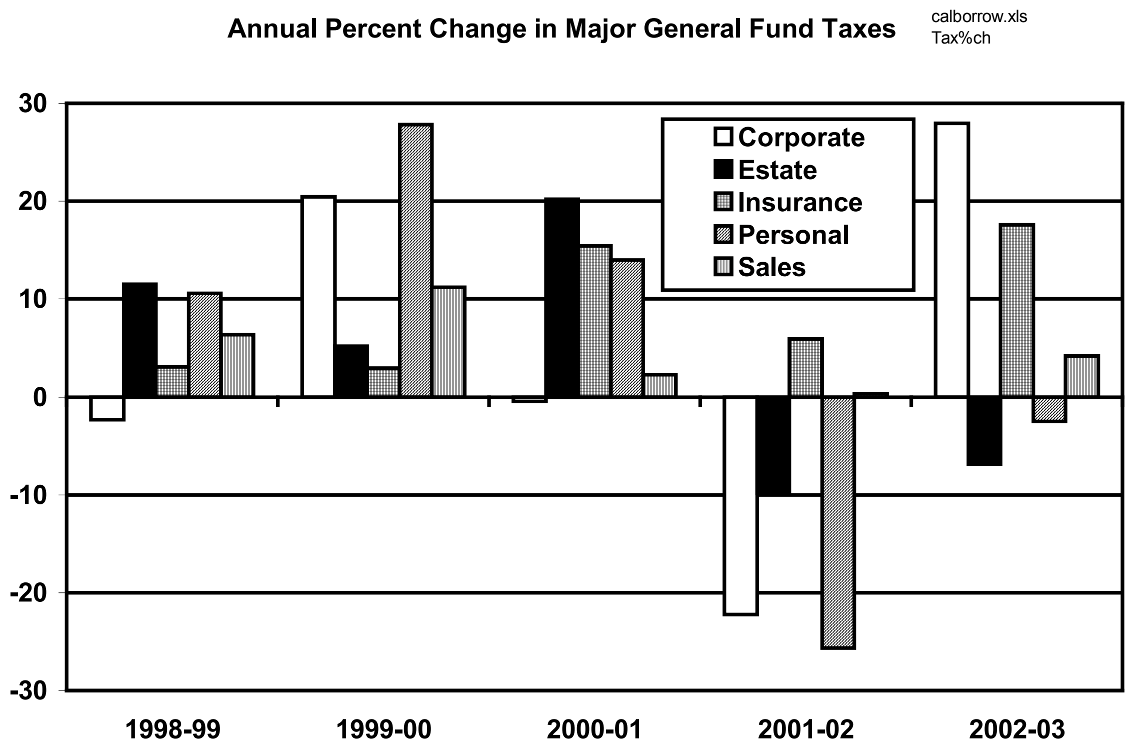
Source: California Department of Finance

Chart 10



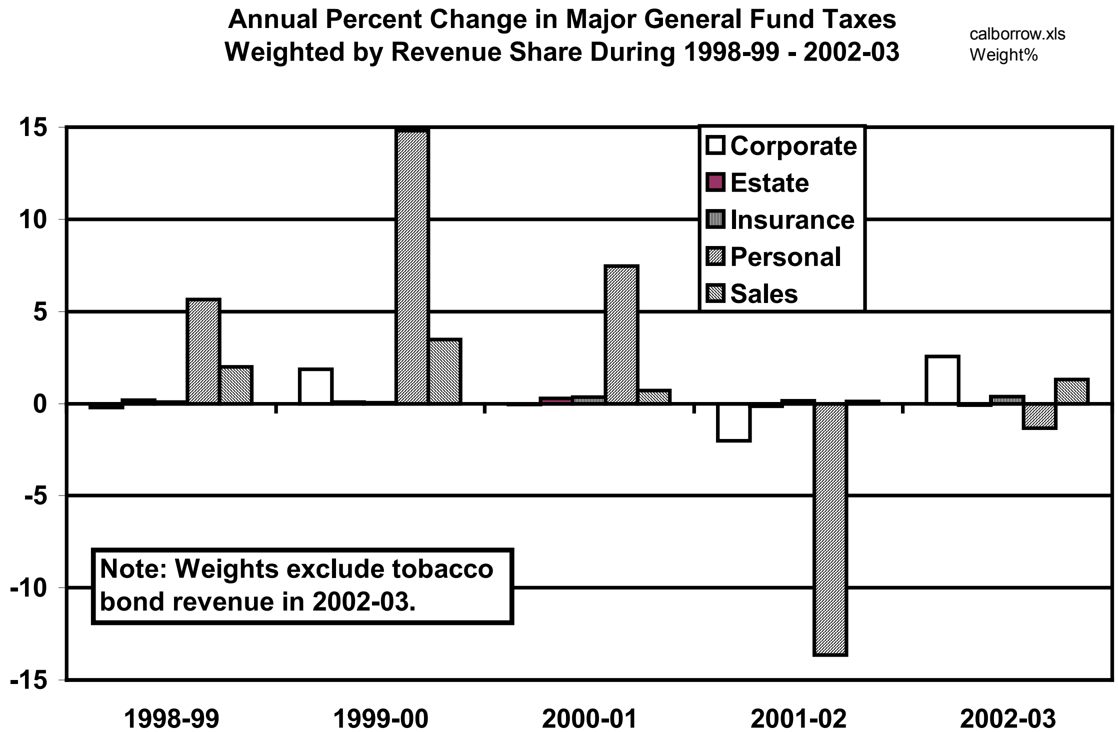
Source: Public Policy Institute of California

Chart 11



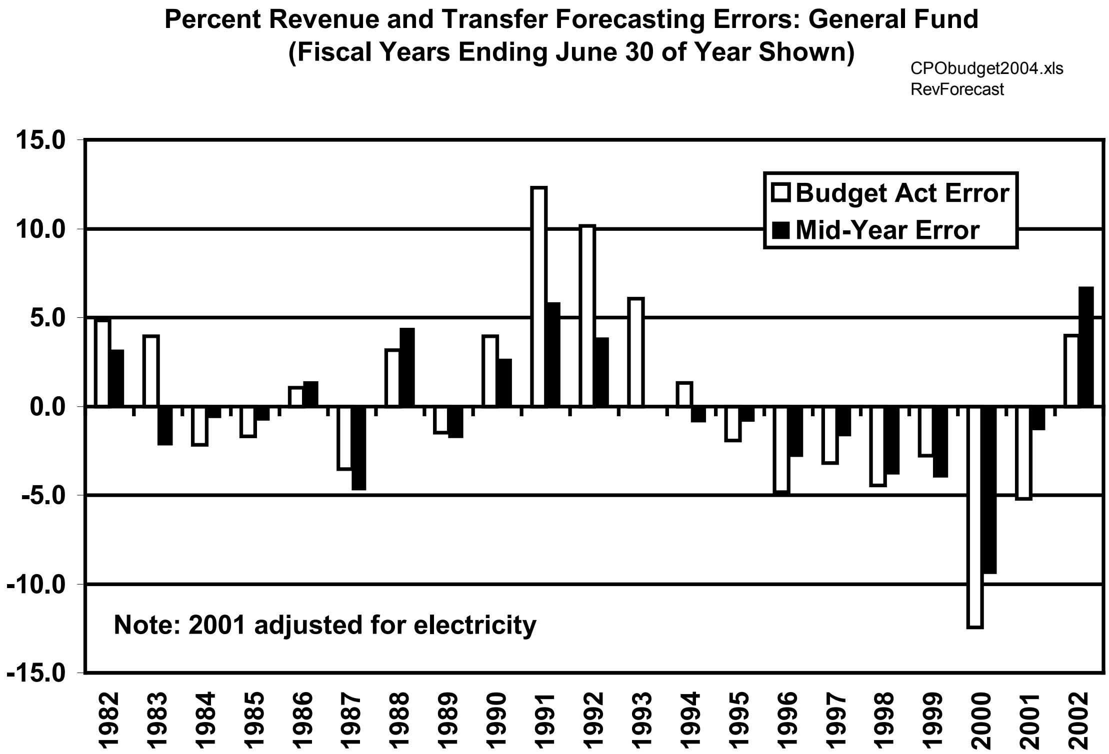
Source: California Department of Finance

Chart 12



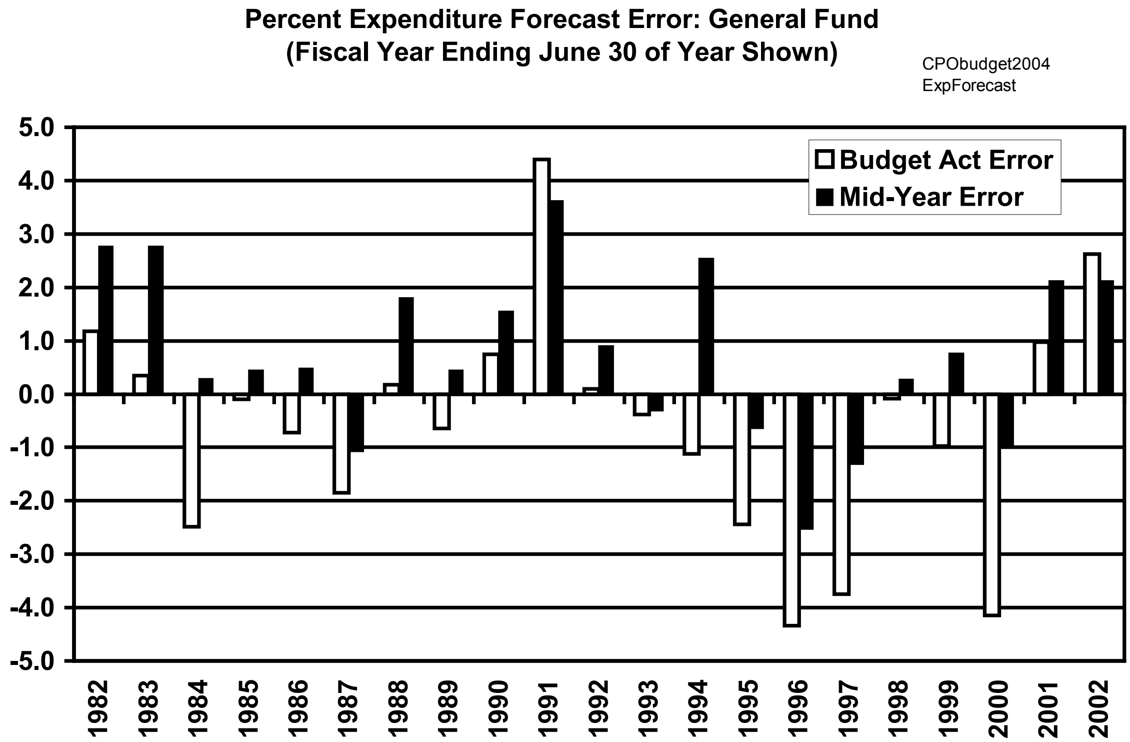
Source: California Department of Finance

Chart 13



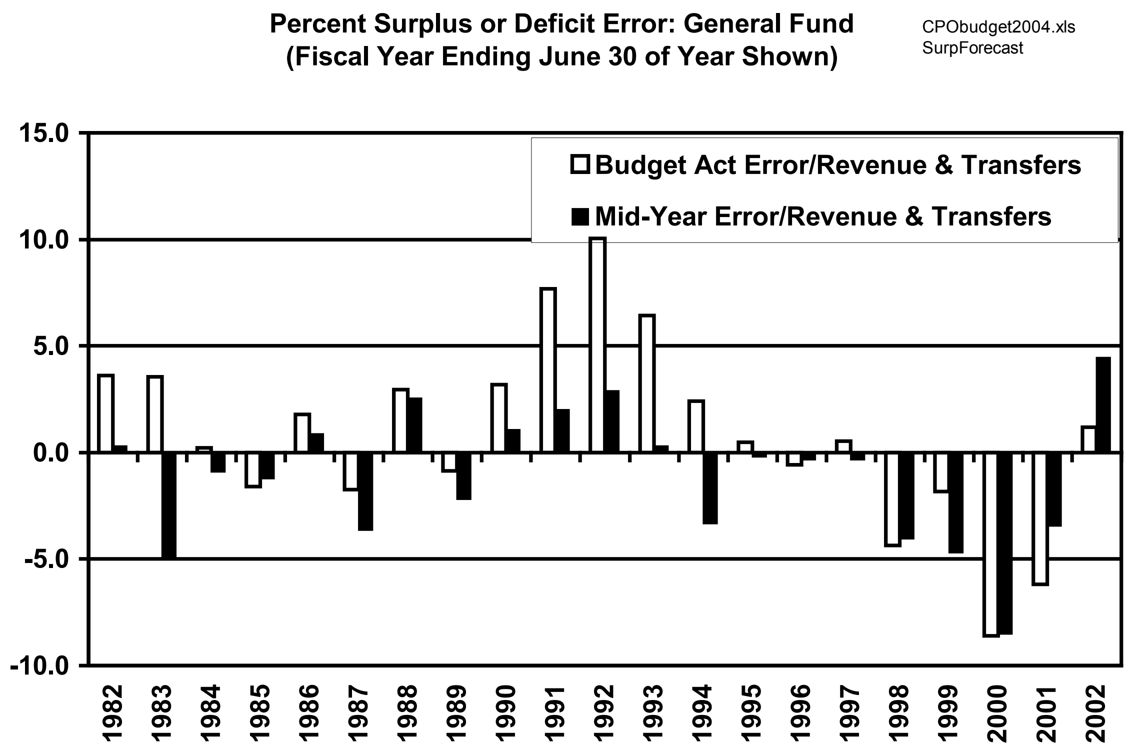
Source: California Department of Finance

Chart 14



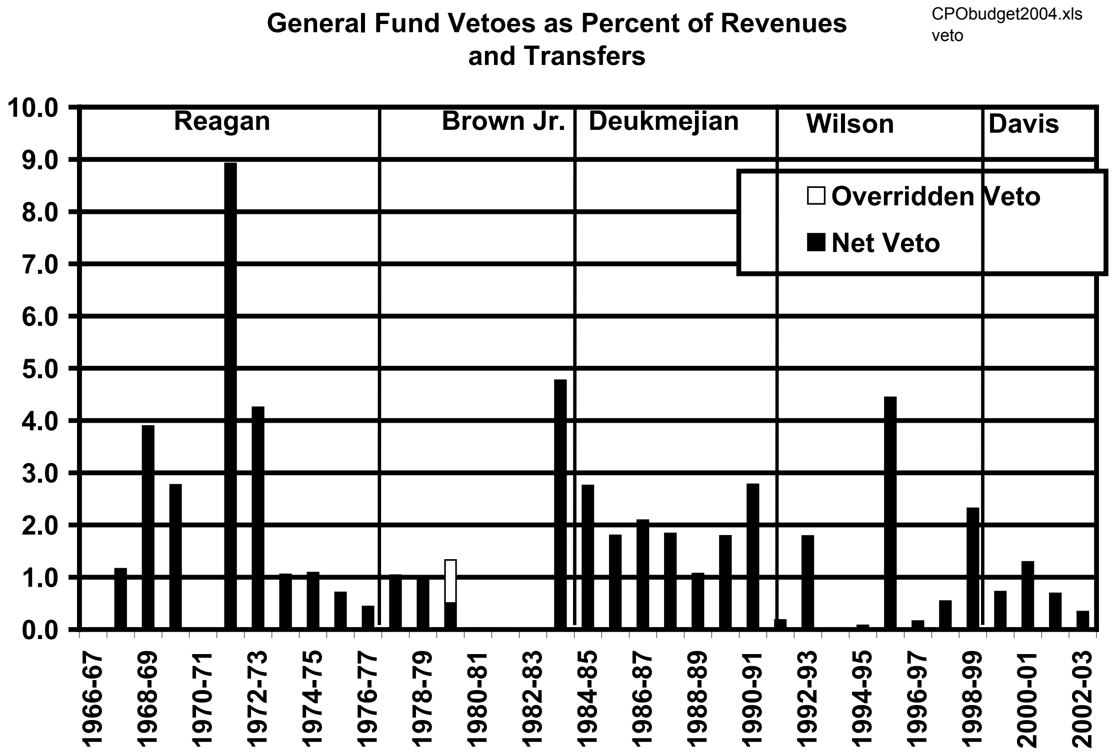
Source: California Department of Finance

Chart 15



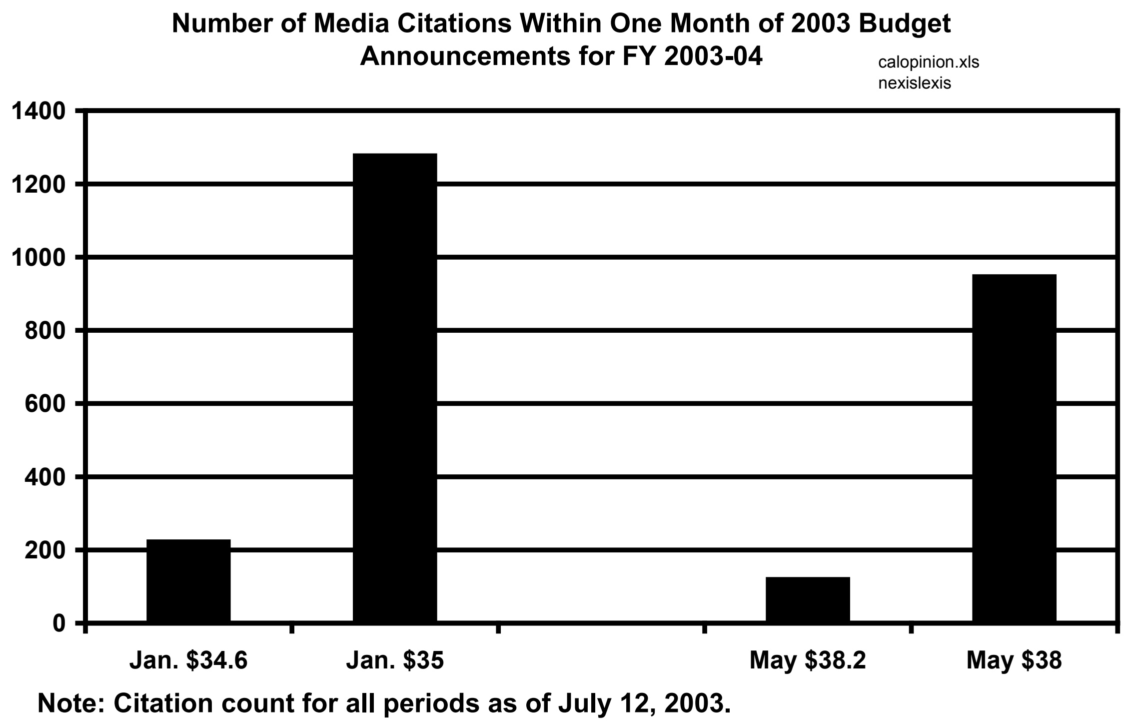
Source: California Department of Finance

Chart 16



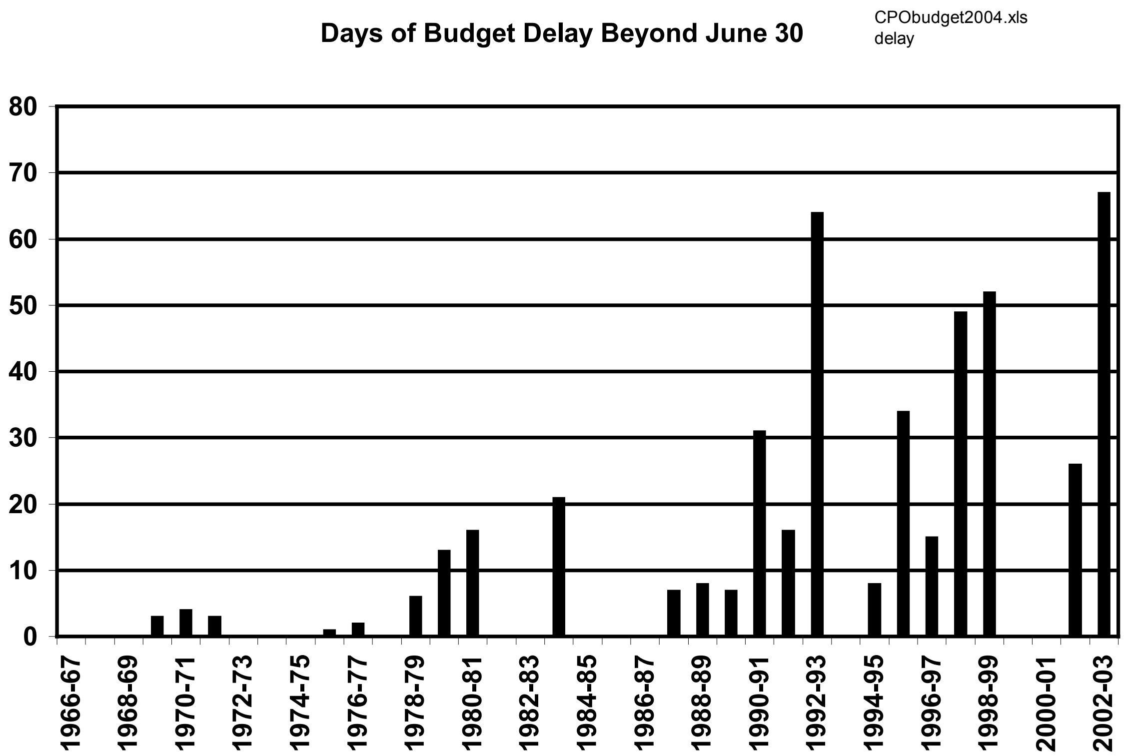
Source: California Department of Finance

Chart 17



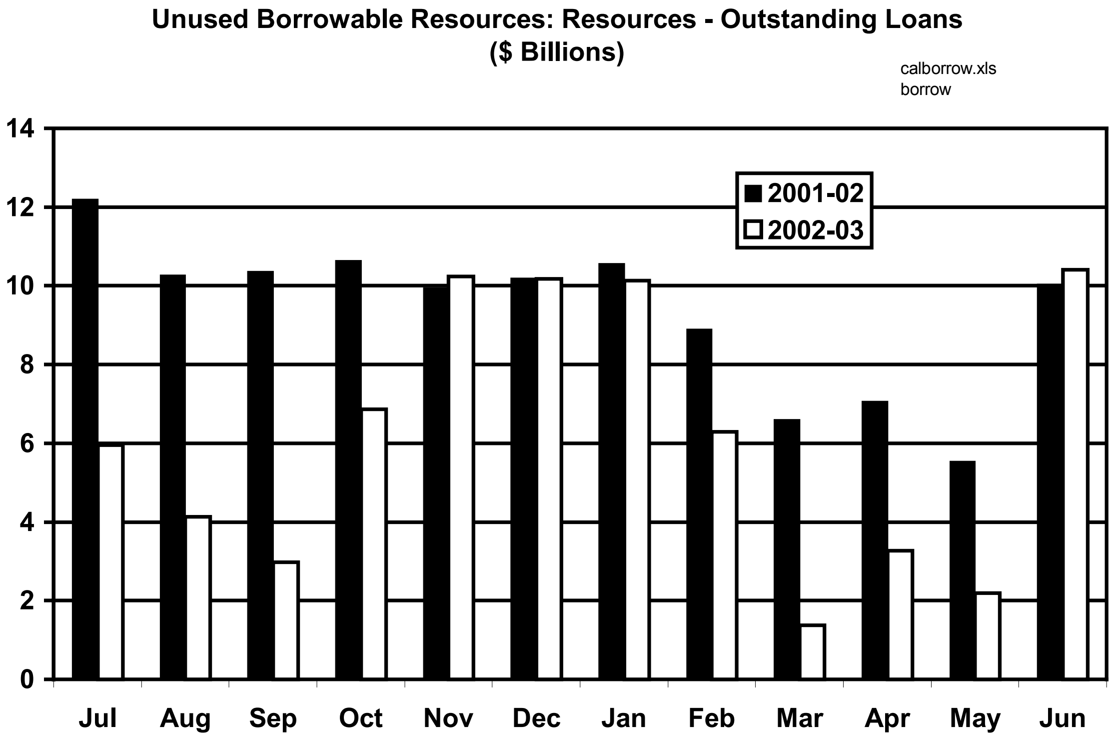
Source: Nexis-Lexis database.

Chart 18



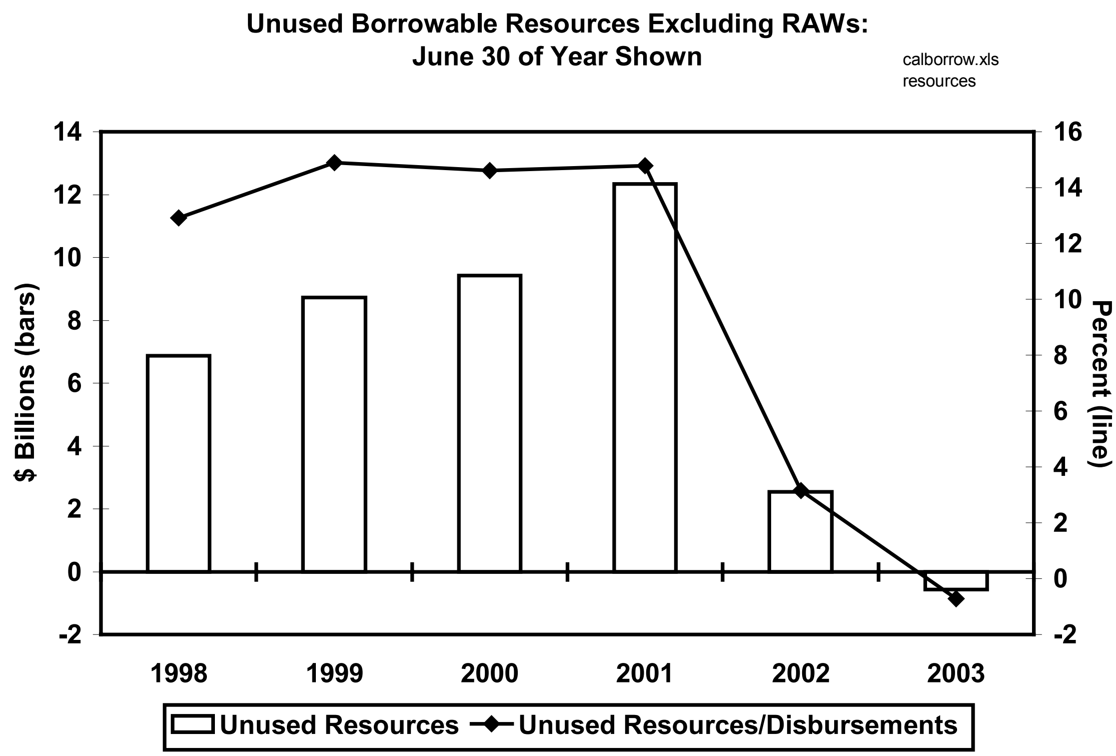
Source: California Department of Finance

Chart 19



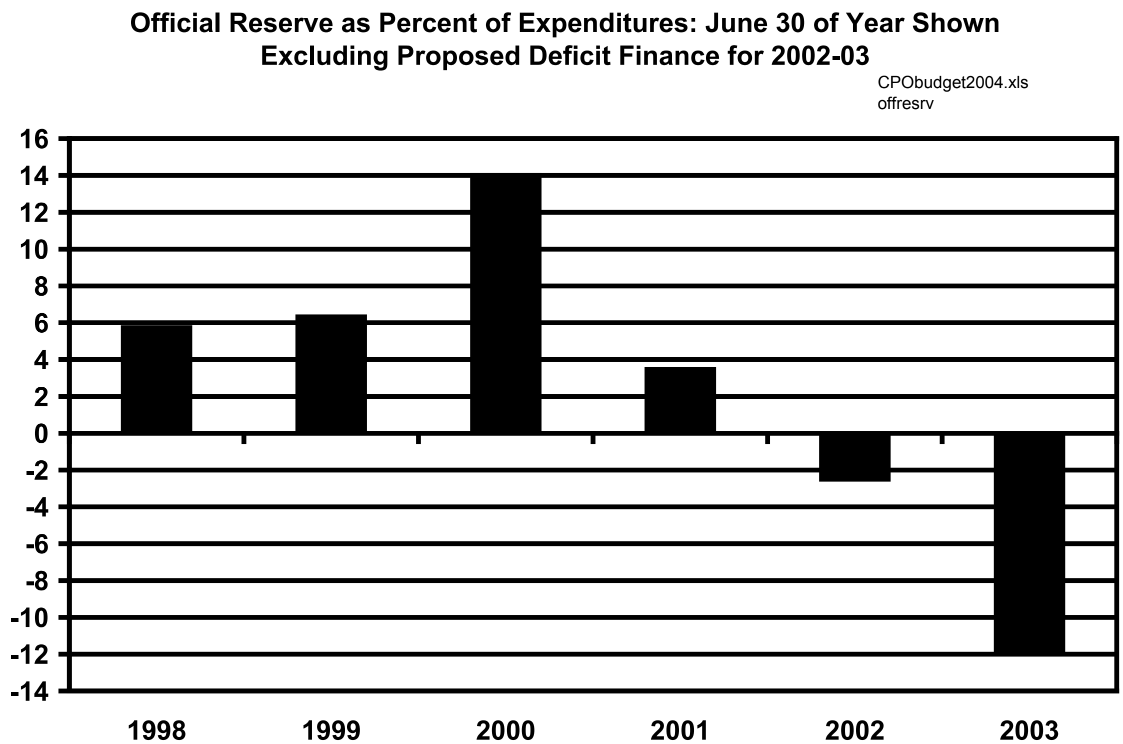
Source: California State Controller

Chart 20



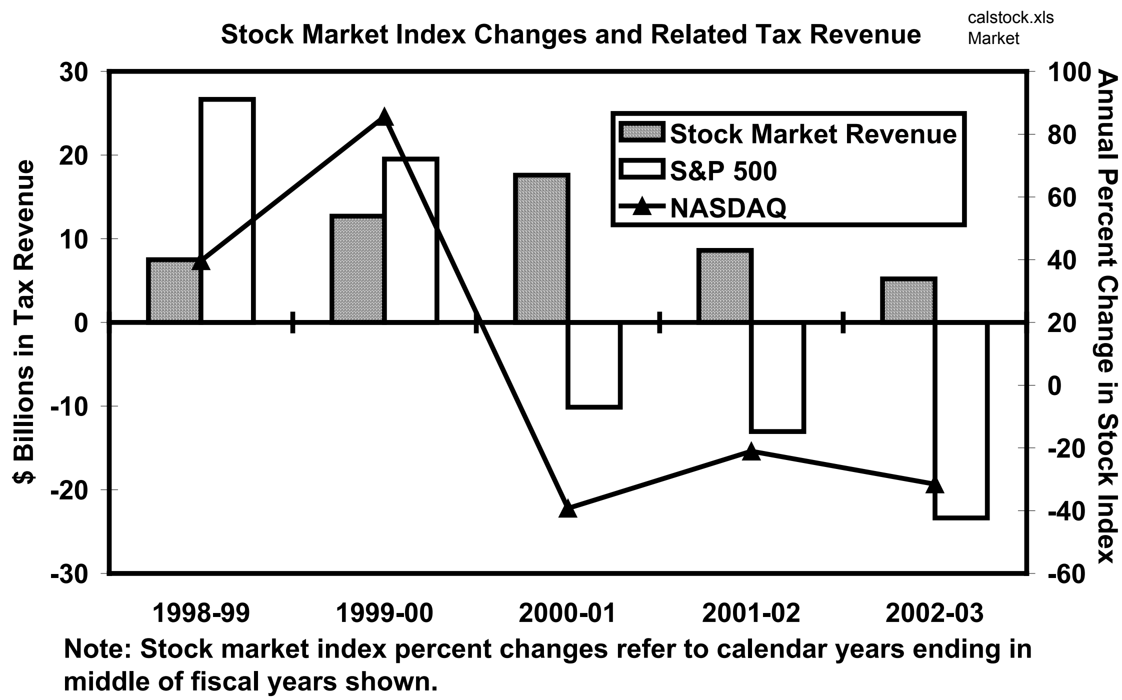
Source: California State Controller

Chart 21



Source: California Department of Finance

Chart 22



Source: Legislative Analyst's Office; economagic.com

Table 1: Evolution of the So-Called Shortfall-Gap-Hole
($ Billions)

Type of Measure	Estimated Reserve "in the bank" at Beginning of Current Year	What is Believed to be Happening in the Current Year*	What Could Happen Next Year**	Note: Reserve Expected to be "in the bank" at end of Next Year
	Stock	Annual Flow	Annual Flow	Stock
Proposals for 2002-03				
Jan. 2002 -$12.5 =	+2.8	-1.3	-14.0	+1.5
May Revise 2002 -$23.6 =	+3.0	-3.1	-23.5	+2.0
Proposals for 2003-04				
Jan. 2003 -$34.6 =	-3.5	-2.3	-28.8	+1.9
May Revise 2003 -$38.2 =	-2.0***	-7.3	-28.9	+1.9

*Assuming all proposed mid-year cuts and revenue and transfer enhancements were enacted.
**Assuming no change in policy from current year (with all proposed mid-year cuts and revenue enhancements for current year enacted).
***Counting $10.7 billion bond issue proposed to be floated in 2003-04 as if it were floated in 2002-03.

Source: California Department of Finance

Table 2: Eight Options for Fiscal Reform and the Primary Problem Addressed by Each

	Decision Delay	Fiscal Responsibility	Structural Variation
Relaxing the Two-thirds Rule for Budget Passage and Tax Increases	X		
Making Governor's May Revise Budget the Default Option	X	X	
Relaxing Term Limits	X	X	
Transparency in Budget Presentation		X	
Mandated "Balanced" Budget		X	
Plan B Budget			X
Rainy Day Fund			X
Use of Financial Instruments			X

Note: See text for discussion.

Footnotes

[1] Quoted in Governor's press release of December 18, 2002. Press releases by the Governor are available at www.governor.ca.gov.
[2] Quoted in Jenifer Warren, "Budget Intransigence Dismays an Old Pro," *Los Angeles Times*, June 20, 2003. Page numbers for newspaper articles cited in this chapter are generally not included since many articles were obtained from the Internet.
[3] Press release of June 17, 2003 for Richman and Democrat Joe Canciamilla who were trying to produce a bipartisan budget compromise.
[4] The earlier chapters are Werner Z. Hirsch and Daniel J.B. Mitchell, "Making California's State Budget More User-Friendly and Transparent: Further Thoughts" in Daniel J.B. Mitchell, ed., *California Policy Options 2003* (Los Angeles: UCLA School of Public Policy and Social Research, 2003), pp. 23-50; Werner Z. Hirsch and Daniel J.B. Mitchell, "Making California's State Budget More User-Friendly and Transparent" in Daniel J.B. Mitchell, ed., *California Policy Options 2002* (Los Angeles: UCLA School of Public Policy and Social Research, 2002), pp. 20-46. Earlier information can be found in Eileen A. Roush and Philip J. Romero, "Surrendering Sovereignty to Sacramento: State-Local Fiscal Relations During the 1990s" in Daniel J.B. Mitchell and Patricia Nomura, eds., *California Policy Options 2000* (Los Angeles: UCLA School of Public Policy and Social Research, 2000), pp. 24-44.
[5] Most of the data used in this chapter come from the California Department of Finance (budget data, budget proposals), the State Controller (cash statements), the Treasurer (bond information), and the Legislative Analyst's Office and are available on the web at, respectively, www.dof.ca.gov, www.sco.ca.gov, www.treasurer.ca.gov, and www.lao.ca.gov.
[6] California's arrangements for a de-regulated electricity market led to blackouts and the use of General Fund money to buy electricity on behalf of bankrupt and near-bankrupt utilities in 2001. About $6.5 billion in such purchases was involved. The state then floated a bond issue, based on an electricity surcharge on rate payers, to reimburse the General Fund. The flotation and reimbursement occurred in late 2002.
[7] For a history of early budget making in California, see Tom Laichas, "This Old House: Under the Floorboards with the California State Budget" in Daniel J.B. Mitchell, ed., *California Policy Options 2003* (Los Angeles: UCLA School of Public Policy and Social Research, 2003), pp. 51-62. See also Kevin Starr, "Reforming California" and "Progressivism and After" in his *Inventing the Dream: California Through the Progressive Era* (Oxford University Press, 1985), pp. 199-282.
[8] Prop 98 was modified by Prop 111 in 1990. The detailed formulas of Prop 98 and their implications for K-14 revenue are discussed in Paul M. Goldfinger and Bob Blattner, *Revenue and Limits: A Guide to School Finance in California, 2003 Edition* (Sacramento: School Services of California, 2003), chapter 2. In the late 1990s, the State funded K-14 above the minimum requirements. Under the Prop 98 rules, such extra funding adds to the minimum base for subsequent years.
[9] Governors are also term limited to two four-year terms. But except for Earl Warren in the 1940s and early 1950s, no governor had ever held office for more than two terms.
[10] Assembly representatives are limited to 6 years and senators to 8 years under Prop 140. Prop 45 would have allowed the electorate by petition to permit another 4 years for both offices.
[11] Quoted in Dan Morain, "Talk Turns to Which Taxes to Hike," *Los Angeles Times*, December 20, 2002.
[12] Quoted in Michael Finnegan, "Bush, Davis Take Two Tacks on Taxes," *Los Angeles Times*, January 12, 2003.
[13] Quoted in Patrick McGreevy, "Inside Politics," *Los Angeles Times*, March 10, 2003.
[14] Quoted in Bill Bradley, "The New Boss," *LA Weekly*, February 7-13, 2003.
[15] Fitch Ratings, "Public Finance: State of California," June 30, 2003. Available at www.fitchratings.com.
[16] Quoted in Evan Halper and Jeffrey L. Rabin, "Lawmakers Warned on State Budget," *Los Angeles Times*, May 20, 2003.
[17] The Rand report overestimated the trend in prisoners and related expenditures. See Stephen Carroll, Eugene Bryton, C. Peter Rydell, and Michael A. Shires, *Projecting California's Fiscal Future* (Santa Monica, CA: Rand, 1995). A Legislative Analyst's report in 1996 warned of future budget deficits based on underlying trends. However, the rapid rise in revenue staved off the problems foreseen. See Legislative Analyst's Office, *California's Fiscal Outlook: The LAO's Economic and Budget Projections, 1996-97 through 1998-99* (Sacramento: LAO, 1996).

[18] Quoted in Evan Halper and Gregg Jones, "Davis Calls for Steep Tax Hike," *Los Angeles Times*, May 14, 2003.
[19] Quoted in Jeffrey Rabin, "Budget Balanced on Faulty Figures," *Los Angeles Times*, February 23, 2003.
[20] See Public Policy Institute of California, *PPIC Statewide Survey, June 2003: Special Survey on the California State Budget* (San Francisco: PPIC, 2003). The survey was taken in late May and included about 2,000 respondents. Question details for Chart 7 can be found on pp. 21-25.
[21] Under Proposition 36 (2000), drug treatment rather than prison is preferred. Voters have also supported legalization of "medical marijuana" (Proposition 215; 1996), support that suggests greater drug tolerance than federal law currently permits.
[22] Quoted in Dan Morain and Jenifer Warren, "Battle Looms Over Prison Spending in State Budget," *Los Angeles Times*, January 22, 2003.
[23] See earlier citation for exact questions underlying Chart 8.
[24] See earlier citation for exact questions underlying Chart 10.
[25] See Michael Finnegan, "Slim Majority of Voters Backs Davis Recall," *Los Angeles Times*, July 4, 2003. Despite the fact that the recall was framed around gubernatorial budget failures, only 13% of those polled who favored recalling the Governor cited "budget stalemate" as a reason. The table containing the poll numbers appears in the print version on p. A24; it is not contained in the web version.
[26] Quoted in Dan Morain and Gregg Jones, "Budget Just Postpones State's Pain," *Los Angeles Times*, September 6, 2002.
[27] Press release dated January 10, 2003.
[28] Quoted in Evan Halper, "Yes, They Do Always Vote 'No' on Budget," *Los Angeles Times*, July 12, 2003.
[29] Quoted in Jeffrey L. Rabin, "California's Economists Frequently Are Wrong," *Los Angeles Times*, January 14, 2003.
[30] The mean absolute error for the surplus or deficit (using revenue and transfers as the denominator) was 3.3% for the Budget Act and 2.5% for the Mid-Year estimate.
[31] The decision, dated May 1, 2003, is generally cited as Howard Jarvis Taxpayers Association v. Steve Westly as Controller. The language of the decision refers to the federal Fair Labor Standards Act and therefore would seem to involve the federal minimum wage ($5.15/hour) rather than the higher state minimum wage ($6.75). The Controller, however, in references to the decision, cited the state minimum wage. See his press release and letter to legislators dated May 19, 2003.
[32] Quoted in Gregg Jones and Michael Finnegan, "Budget May Make or Break Davis," *Los Angeles Times*, January 6, 2003.
[33] Werner Z. Hirsch and Daniel J.B. Mitchell, "Review and Overhaul California's Tax System, *Los Angeles Times*, October 28, 2002 (Op Ed).
[34] Press release of January 10, 2003.
[35] Quoted in Dan Morain, "Governor Sits Out the Budget Standoff," *Los Angeles Times*, August 28, 2002.
[36] Quoted in Steve Geissinger, "Davis to Agencies: Brace for More Cuts," *Oakland Tribune*, August 8, 2002.
[37] George Skelton, "Surrogates Just Won't Do: In Budget Crisis, the State Needs Davis to Lead," *Los Angeles Times*, June 9, 2003; George Skelton, "This Angry Reader Has a Unique Perspective on Budget Crisis, *Los Angeles Times*, June 12, 2003.
[38] See earlier citation of prior budget chapters.
[39] "Deaf to Health Fund Crisis," *Los Angeles Times*, August 18, 2002 (editorial); Kevin Starr, "Time to Rethink Golden State," *Los Angeles Times*, January 12, 2003; Peter Navarro, "Braking Budget Roller Coaster," *Los Angeles Times*, January 16, 2003.
[40] See earlier citation of prior budget chapters.
[41] Benjamin Zycher, "State's Profligate Short-Timers," *Los Angeles Times*, June 9, 2003.
[42] Quoted in Gregg Jones and Nancy Vogel, "Davis Won't Sign Bill Linking Cuts to Auto Fee Hike," *Los Angeles Times*, February 5, 2003.
[43] Quoted in Peter Nicholas, "You Just Don't Understand," *Los Angeles Times*, July 19, 2003.
[44] Quoted in Evan Halper, Jeffrey Rabin, and Dan Morain, "Davis Budget Can Solve Crisis But Is Far From Perfect, Analyst Says," *Los Angeles Times*, February 20, 2003.
[45] Press release of May 20, 2003.
[46] Press release of May 19, 2003.

[47] Information drawn from “Forward Warrant Purchase Agreement Dated as of June 18, 2003” available on request from the California State Controller.
[48] Ambrose Bierce, *The Collected Writings of Ambrose Bierce* (New York: Citadel Press, 1946), p. 225.
[49] Under Proposition 13, residential and commercial properties are assessed in the same fashion. When property changes hands, the value is assessed at 1% of the purchase price. Thereafter, the assessed value can go up only 2% per year. It is argued that business property may not technically change hands due to corporate and other ownership practices as often as residential property. Under the split roll proposal, business property would be assessed more frequently under various alternative methodologies.
[50] Undated announcement at http://ca.lwv.org/lwvc/action/budget/b_accountability_act.html.
[51] Press release dated May 2, 2003.
[52] See the Public Policy Institute of California poll cited earlier.
[53] UCLA Anderson Graduate School of Management press release, June 17, 2003.
[54] Official ballot pamphlet for March 2002 election.
[55] California Budget Project, *Dollars and Democracy: An Advocate's Guide to the California State Budget Process* (Sacramento: CBP, 1999), p. 38.
[56] California Constitutional Revision Commission, *Final Report and Recommendations to the Governor and the Legislature* (1996), p. 41. Available on the web at http://www.library.ca.gov/CCRC/pdfs/finalrpt.pdf.
[57] Yogi Berra, *The Yogi Book* (New York: Workman Publishing, 1998), p. 48.
[58] Article 13B, section 5.5.
[59] Quoted in Brian Graney, "Taking Advantage of Market Fluctuations," *The Motley Fool*, March 23, 2001, http://www.fool.com/news/foth/2001/foth010323.htm.
[60] The quote is widely attributed to Oppenheimer. Variations have been attributed to others.

Interim Draft: 7/23/03. Please send comments to Daniel J.B. Mitchell, UCLA, at daniel.j.b.mitchell@anderson.ucla.edu.